

## **ICRA Lanka revises the Issuer and Issue Ratings of MTD Walkers PLC to [SL]BBB (Negative) from [SL]BBB+ (Stable)**

May 31, 2016

<b>Instrument</b>	<b>Amount</b>	<b>Rating Action</b>
Issuer Rating	N/A	Revised to [SL]BBB with Negative outlook from [SL]BBB+ with Stable outlook
Senior Unsecured Redeemable Debentures	LKR 3,000 Million	Revised to [SL]BBB with Negative outlook from [SL]BBB+ with Stable outlook

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service has revised the Issuer rating to [SL]BBB (pronounced S L triple B) with a Negative outlook from [SL]BBB+ with Stable outlook for MTD Walkers PLC ("MTDWP" / "the Company"). ICRA Lanka has also revised the Issue Rating to [SL]BBB (pronounced S L triple B) with a Negative outlook from [SL]BBB+ with Stable outlook for the company's senior unsecured debenture programme of LKR 3,000 Mn.

ICRA Lanka has taken a consolidated view on MTD Walkers PLC and its subsidiaries as a whole, for the rating action, given the significant operational and financial linkages among them.

The revision in the ratings and outlook takes into consideration the weakness in the construction sector over the last eighteen months and its adverse impact on the order booking and projects execution status for the company during this period. Correspondingly, the financial performance of the Group for the 9MFY2016 was significantly weaker compared to ICRA Lanka's earlier expectations. ICRA Lanka notes that the slowdown in the construction sector was to a large extent driven by regulatory uncertainty owing to allegations of malpractices in tendering of government orders during the previous regime, which were opened up for investigation after the change in government in Jan 2015. As a result, new government projects witnessed a significant decline and resulted in increased competitive scenario in the construction industry. Further, receivables from ongoing government orders were stretched and adversely affected the liquidity position of the Group.

The rating could be revised downwards going forward, if the Group is unable to win & execute new orders in line with the scale of its operations & administrative overheads resulting in weak profitability at the net level for its consolidated operations. Further, the rating could also be revised downwards in case the Group is unable to demonstrate an improvement in its liquidity position through a recovery of its long pending receivables. Conversely, a meaningful improvement in the aforesaid factors could result in the revision of the outlook on the rating from Negative to Stable.

Nevertheless, the ratings continue to factor in the longstanding track record and established position of the MTD Walkers Group as a leading Engineering and Infrastructure Development Group in Sri Lanka. The ratings also take into consideration the professional management team of the company supported by regular project tracking and implementation systems; and the parentage of the company (with majority shareholding (90.78%) in the company being held by MTD Capital Berhad, a Malaysian conglomerate focused on infrastructure sector), providing managerial and financial support on a regular basis.

The MTD Walkers Group operates mainly in three sectors i.e. Civil Engineering, Engineering Services and Power Generation. For 9MFY2016, Civil Engineering sector contributed approx. 82% of the Group's revenue, while Power generation sector contributed approx. 5% and Engineering Services & Trading sectors contributed approx. 5%, whilst the remaining 8% being contributed by the real-estate sector, Marine Engineering and the smaller companies in the Group. On a standalone basis, MTDWP doesn't have any operating income and hence is reliant on subsidiary performance for cash flows. The largest subsidiary of

the Walkers Group is CML-MTD Construction Limited (CML-MTD, a C1 graded contractor by Institute for Construction Training and Development) operating in the Civil Engineering segment. CML- MTD accounted for approximately 75% of the Groups' revenue. Some of the larger projects that are currently being handled by CML-MTD are government projects issued by the RDA (Road Development Authority) and UDA (Urban Development Authority). Walkers Piling (Private) Limited under the Civil Engineering sector carries out the piling business of the Group and accounted for approx. 9% of the Group's revenue. Northern Power Company (Private) Limited (NPC), which constitutes the only exposure of the group to the power generation segment, was non-operational in FY 2015/16 due to ongoing investigation regarding environmental pollution concerns raised by local communities. NPC owns a thermal power plant in Jaffna and operated as an independent power producer with a Power Purchase Agreement (PPA) with the Ceylon Electricity Board (CEB) for a guaranteed production capacity of 27 MW for a period of ten years. With the plant remaining non-operational, NPC has been levying claims for fixed charges as per the PPA; however, the same is currently under dispute and is yet to be recognized by the CEB.

Over the past few years, the Group has been reporting steady revenue growth mainly due to the increase in the number of contracts in the construction industry following the end of the civil war. The Group reported a healthy financial performance during the FY2014 and FY2015 supported by a healthy order backlog of over Rs. 60,000 Mn of ongoing projects during this period coupled with the previous government's expediting policy towards Infrastructure Development and Construction. The operating margins have steadily improved since FY2011 following the management's efforts to restructure the organization and improve operational efficiencies. At the Group level, operating margins<sup>1</sup> have ranged between approx. 16%-20% levels during the past three financial years, while Group level Net Margins have ranged between 6-7% during the same period.

However during 9MFY2016 the Group's profitability was adversely affected due to the slowdown in the government funded construction contracts (as major construction contracts were halted pending investigation of alleged corruption charges against the previous government). During 9M FY16, the Group recorded a loss after tax of LKR 125 Mn, a 112% decline from the same period in FY2015. Return on Capital Employed (ROCE) has declined to 5.2% from approx. 18.8% during FY2014.

Also, the working capital intensity (as characterized by net working capital / operating income) of the Group witnessed a significant increase during FY2015 and 9MFY2016 on the back of a corresponding increase in the receivables position. The trade receivable days in relation to the execution of certain state funded construction contracts, have exceeded more than one year. As a result, the Group level capital structure and debt protection indicators weakened from over the last eighteen months. Further, the deterioration in the working capital and negative profitability during 9MFY2016 have adversely affected the cash flow position and the debt protection indicators of the company. Moreover, with interest and finance costs are likely to increase further and going forward, the debt protection indicators could further deteriorate. In ICRA Lanka's view, a meaningful reduction in the working capital intensity would be critical in improving the liquidity & financial flexibility of the company and would be a key credit sensitivity. ICRA Lanka would continue to monitor the company's performance on this front and may downgrade the rating further in case the situation does not show improvement in the near term.

At the standalone level, in the post debenture issue of Rs 3 Bn, gearing levels for the holding company has increased to 0.7x (from 0.1x before the Debenture Issue in FY15). As MTDWP is a non-operational investment holding company, its revenues are dependent on the fee income and dividend income received from its subsidiaries. Going forward, the management's plan to establish a project-wise fee based income structure, to be charged from the operational subsidiaries, which would eventually improve the standalone financial strength of MTDWP, and aid the company in meeting its debt service obligations.

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<sup>1</sup> Operating Margins - Operating Profit before Depreciation, Interest, Tax and Amortization (OPITDA) / Operating Income

## *Company Profile*

Walkers Group of Companies has been in operation in Sri Lanka for over 160 years with its origin in 1854 and had been a leading Construction and Engineering Group company in the country. Kapila Heavy Equipment PLC, which had been established as a public company in 1981 and listed on the Main Board of Colombo Stock Exchange in 1983, had subsequently acquired controlling interest of the Walkers Group. In April 2007, MTD Capital Bhd, a leading Malaysian based infrastructure development company, purchased a majority stake in Kapila Heavy Equipments PLC, the holding company of the Walkers Group of Companies. Kapila Heavy Equipments PLC was subsequently re-named as MTD Walkers PLC on 12th December 2007.

MTD Walkers PLC remains a non-operational investment holding company with subsidiaries operating across Civil Engineering, Engineering Services and Power Generation sectors. The key operating companies of the Group currently are CML-MTD Construction Limited, Northern Power Company (Private) Limited, Walker Sons & Company Engineers (Private) Limited, Colombo Engineering Services (Private) Limited and Walkers Piling (Private) Limited.

For the 9MFY2016, MTD Walkers Group reported a net loss of LKR 125 Mn on a total income of LKR 7,193 Mn compared to a net profit of LKR 988 Mn reported on a total income of LKR 11,021 Mn in the same period of FY2015.

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