

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

November 25, 2016

Instrument	Amount	Rating Action
Issuer Rating	N/A	Revised to [SL]BBB- from [SL]BBB. Outlook of the rating is Negative.
Senior Unsecured Redeemable Debentures	LKR 3,000 Million	Revised to [SL]BBB- from [SL]BBB. Outlook of the rating is Negative.

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service has revised the Issuer rating for MTD Walkers PLC ("MTDWP"/"the Company") from [SL]BBB (pronounced S L triple B) with a Negative outlook to [SL]BBB- (pronounced S L triple B minus) with Negative outlook. ICRA Lanka has also revised the Issue Rating from [SL]BBB with a Negative outlook to [SL]BBB- with Negative 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, given the significant operational and financial linkages among them.

The revision in the rating and reaffirmation of the negative outlook takes into consideration the slowdown witnessed in the construction sector over the past year and its impact on the order booking and project execution status for the company during this period. Correspondingly, the financial performance of the Group for the FY16 and 3MFY17 was significantly weaker compared to ICRA Lanka's earlier expectations with the company reporting net losses and very high debt levels following the increase in the working capital requirements. ICRA Lanka notes that the slowdown during the past two years 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. However, after the reinstatement of the suspended mega construction contracts by the new government, tendering activity for the new government projects witnessed a significant growth and has resulted in an increased competitive scenario in the construction industry. Moreover, ICRA Lanka views the company's engagement in the construction of the large Central Express Way Phase -ii positively, along with other leading government funded development projects.

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 continued 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 rating continues 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 rating also takes into consideration the professional management team of the company supported by regular project tracking and implementation systems of the company.

The MTD Walkers Group operates mainly in six sectors i.e. Civil Engineering, Engineering Services, Power Generation, Marine Engineering, Trading and Real Estate. For FY16, Civil Engineering Sector contributed approx. 88% of the Group's revenue, while Power generation sector contributed approx. 4% and Engineering Services & Trading Sectors contributed approx. 4%, whilst the remaining 4% was 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 CS2 graded contractor, which is now the highest grade available, for Building Construction and Highway Construction by Institute for Construction Training and Development) operating in the Civil Engineering segment. CML- MTD accounted for approximately 75% of the Groups' revenues. 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 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 FY16 due to ongoing investigation on environmental pollution concerns raised by local stakeholders. 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.

During 3MFY17 the Group's profitability was adversely affected due to the slowdown in the government funded construction contracts over the past two years. During this period, the Group recorded a loss after tax of LKR 229 Mn, a 45% decline from the same period in FY16. Return on Capital Employed (ROCE) has declined to 2.6% in FY16 from approx. 18.8% during FY14.

Also, the working capital intensity (as characterized by net working capital / operating income) of the Group witnessed a significant increase during FY16 and 3MFY17 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. Moreover, the company has to finance around 65% of the construction value for certain Urban Development Authority's (UDA's) housing development projects. This has further contributed to the company's high working capital position. As a result, the Group level capital structure and debt protection indicators have further weakened from over the previous two years. Moreover, with interest and finance costs 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.

At the standalone level, post the debenture issue of LKR 3.0 Bn, gearing levels for the holding company in 3MFY17 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 plans 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. However, this would require a significant turnaround in the financial performance of the operating entities and hence remains a concern.

Company Profile

Walkers Group of Companies has been in operation in Sri Lanka for over 160 years with its origin in 1854 and has 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. The parentage of the company (with majority shareholding in the company being held by MTD Capital Berhad, a Malaysian conglomerate focused on infrastructure sector), provides managerial and financial support on a regular basis.

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.

During FY16, MTD Walkers Group reported a net loss of LKR 121.3 Mn on a total income of LKR 11,964.3 Mn compared to a net profit of LKR 1,107.2 Mn reported on a total income of LKR 14,025.1 Mn in the same period of FY16.

For the 3MFY17, MTD Walkers Group reported a net loss of LKR 229.4 Mn on a total income of LKR 2,170.4 Mn compared to a net loss of LKR 158.4 Mn reported on a total income of LKR 2,220.7 Mn in the same period of FY16.

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