

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

September 07, 2017

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

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

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

The revision in the ratings and reaffirmation of the negative outlook takes into consideration the deterioration of the debt metrics notwithstanding the recovery witnessed in the construction sector, the improved order book position & project execution status of the company. The financial performance of the Group for the FY17 and 3MFY18 has remained adverse with the company reporting net losses (excluding the extraordinary income gains from the revaluations of investment properties) and very high debt levels following the increase in the working capital requirements. ICRA Lanka notes that the deterioration of company's financial performance during the past two years was to a large extent driven by regulatory/industry uncertainty. However, since mid CY2016, 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 strong order book position and the engagement in the construction of the large Central Express Way Phase-2, and Rajasthan road construction project in India, positively, along with other leading government funded development projects.

The ratings could be revised further downwards, going forward, if the Group is unable to successfully execute new orders (which have been received recently) in line with the scale of its operations, resulting in negative profitability and fails 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 ratings from Negative to Stable.

The assigned 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 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 12MFY17, Civil Engineering Sector

contributed approx. 75% of the Group's revenue, while Engineering Services & Trading Sectors and Real-Estate Sectors contributed approx. 14% and 9% of the group turnover during this period whilst the remaining 2% was contributed by the Marine Engineering and the smaller companies in the Group. On a standalone basis, MTDWP does not 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 Construction Industry Development Authority) operating in the Civil Engineering segment; the group's civil engineering segment accounted for approximately 75% of the Groups' revenue. Some of the larger government projects that are currently being handled by CML-MTD are 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. 18% of the civil engineering segment's revenue in FY17. Northern Power Company (Private) Limited (NPC), which constitutes the only exposure of the group to the power generation segment, was non-operational in FY17 and 3MFY18 due to ongoing court proceedings on alleged environmental pollution charges that were leveled against the company. 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. The company has recently invested in real estate and marine engineering operations, and therefore, the performance of these operations are expected to improve in the medium to long term.

The Group's profitability has been adversely affected in the recent past due to cost over runs, variations/additional works and the high finance cost owing to increased working capital requirements. In 3MFY18, the Group recorded a loss after tax of LKR 606 Mn, from a loss of LKR 229 Mn in the same period in FY17.

Also, the working capital intensity (as characterized by net working capital / operating income) of the Group witnessed a significant increase during 12MFY17 and 3MFY18 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 65% on a deferred contractor financing model amounting to a total of approximately LKR 4.4Bn. Repayments from UDA will be within six months after completion of the respective projects and the same is expected during CY18. 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. The gearing level (without adjusting for the high working capital requirements under the UDA housing development projects) at the consolidated level of the group of companies in 3MFY17 has increased to 3.00(x) from 2.5(x) and 1.7(x) in FY17 and FY16 respectively. Moreover, with interest and finance costs likely to increase further 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 rating 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 1.10x (from 0.2x 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 parent 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, Real estate, Power Generation sectors, Marine Engineering and Trading. The key operating companies of the Group currently are CML-MTD Construction Limited, Walker Sons & Company Engineers (Private) Limited, Colombo Engineering Services (Private) Limited, Walkers CML Properties (Pvt) Ltd, Walkers Piling (Private) Limited, Walkers Equipment Limited and Northern Power Company (Private) Limited.

During 12MFY17, MTD Walkers Group reported a net loss of LKR 337.0 Mn (excluding the extraordinary gain from revaluation of investment properties) on a total income of LKR 13,704.3 Mn compared to a net loss of LKR 121.3 Mn reported on a total income of LKR 11,964 Mn in FY16.

For the 3MFY18, MTD Walkers Group reported a net loss of LKR 606 Mn on a total income of LKR 3,145.11 Mn compared to a net loss of LKR 229.4 Mn reported on a total income of LKR 2,170.4 Mn in the same period of FY17.

During 12MFY17, MTD Walkers PLC (at standalone) reported a net loss of LKR 403.3 Mn on a total income of LKR 166.8 Mn compared to a net loss of LKR 129 Mn reported on a total income of LKR 148.3 Mn in FY16.

For the 3MFY18, MTD Walkers PLC (at standalone) reported a net loss of LKR 155.0 Mn on a total income of LKR 53.7 Mn compared to a net loss of LKR 79.2 Mn reported on a total income of LKR 50.1 Mn in the same period of FY17.

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