



Report and Recommendation of the President to the Board of Directors

Project Number: 50138-001
September 2017

Proposed Loan Walkers Colombo Shipyard (Private) Limited Shipyard Rehabilitation and Infrastructure Project (Sri Lanka)

This is the version of the document approved by ADB's Board of Directors that excludes information that is subject to exceptions to disclosure set forth in ADB's Public Communications Policy 2011.

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 28 August 2017)

Currency unit	–	Sri Lanka rupee/s (SLRe/SLRs)
SLRe1.00	=	\$0.00654
\$1.00	=	SLRs153.00

ABBREVIATIONS

ADB	–	Asian Development Bank
CML	–	CML-MTD Construction Ltd.
EPC	–	engineering, procurement, and construction
LTA	–	lender's technical advisor
US	–	United States
WCS	–	Walkers Colombo Shipyard (Private) Limited
WSL	–	Walkers Shipyards Limited

NOTES

- (i) The fiscal year (FY) of Walkers Shipyards Limited ends on 31 March. "FY" before a calendar year denotes the year in which the fiscal year ends, e.g., FY2017 ends on 31 March 2017.
- (ii) In this report, "\$" refers to US dollars.

Vice-President	D. Gupta, Private Sector and Cofinancing Operations
Director General	M. Barrow, Private Sector Operations Department (PSOD)
Director	S. Chakraborty, Infrastructure Finance Division 1, PSOD
Team leader	M. Choudhary, Senior Investment Specialist, PSOD
Team members	G. Abel, Senior Transaction Support Specialist (Integrity), PSOD
	I. Aguilar, Social Development Officer (Safeguards), PSOD
	J. Gomez, Safeguards Officer (Environment), PSOD
	L. Johannes, Senior Results Management Specialist, PSOD
	M. Manabat, Senior Investment Officer, PSOD
	I. McDermid, Counsel, Office of the General Counsel
	R. Molligoda, Senior Officer, PSOD
	E. Ong, Associate Investment Officer, PSOD
	D. Urbaneja-Furelos, Investment Specialist, PSOD

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PROJECT AT A GLANCE

1. Basic Data		Project Number: 50138-001	
Project Name	Shipyards Rehabilitation and Infrastructure Project	Department /Division	PSOD/PSIF1
Country	Sri Lanka		
Borrower	Walkers Colombo Shipyards (Private) Limited		
2. Sector		ADB Financing (\$ million)	
✓ Transport	Water transport (non-urban)		4.00
		Total	4.00
3. Strategic Agenda		Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Medium
4. Drivers of Change		Gender Equity and Mainstreaming	
Partnerships (PAR)	Implementation	No gender elements (NGE)	✓
Private sector development (PSD)	Promotion of private sector investment		
5. Poverty and SDG Targeting		Location Impact	
Geographic Targeting	No	Nation-wide	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG9		
6. Nonsovereign Operation Risk Rating			
Obligor Name	Final Project Rating	Facility Risk Rating	
Walkers Colombo Shipyards (Private) Limited	NSO10	NSO10	
7. Safeguard Categorization			
Environment:	B	Involuntary Resettlement:	C
Indigenous Peoples:	C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		4.00	
Nonsovereign LIBOR Based Loan (Regular Loan): Ordinary capital resources		4.00	
B-Loans		0.00	
None		0.00	
Official Cofinancing^a		0.00	
None		0.00	
Others^b		9.90	
Total		13.90	

^a Concessional financing from external sources.

^b Derived by deducting ADB financing, B Loans and Official Cofinancing from Project Total Cost.

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan of up to \$4.0 million to Walkers Colombo Shipyard (Private) Limited (WCS) for the Shipyard Rehabilitation and Infrastructure Project in Sri Lanka.

II. THE PROJECT

A. Project Identification and Description

2. **Project identification.** Sri Lanka is an island nation with 1,340 kilometers of coastline. It is strategically located in the center of the Indian Ocean, near the main east–west international maritime trade route connecting the People’s Republic of China and East Asia to Europe, Africa, and the Middle East. More than 60,000 ships travel this route annually, carrying two-thirds of the world’s oil and half of all container shipments.¹ The Government of Sri Lanka’s 2008–2010 and 2010–2014 port development plans call for liberalization and strengthening of the rules and regulations to promote the country’s shipping and maritime businesses. A 7-year port development plan is being prepared and will be completed by 2020. By that time Sri Lanka is expected to handle 200 million tons in deadweight tonnage capacity and achieve \$1 billion in revenue from the port industry annually, which may require up to \$10 billion in incremental investment.² Significant investment in ports and shipping-related infrastructure has resulted in the growth of support industries, such as ship repair. However, the current capacity for ship repairs has not kept pace with the investment in port and shipping capacity. Colombo Dockyard PLC is the only operational shipyard in Sri Lanka that performs work of international quality with capacity, but it focuses primarily on building new ships.

3. MTD Walkers PLC, established in 1854, is one of Sri Lanka’s leading conglomerates with interests in engineering, construction, and infrastructure. *(Confidential information redacted under para. 97(v) of ADB’s Public Communications Policy)*. MTD Walkers’ ship repair business will be undertaken in the three locations through its wholly owned subsidiary Walkers Shipyards Limited (WSL), which is in the final stages of being incorporated to manage all of MTD Walkers’ maritime-related businesses.

(Confidential information redacted under para. 97(v) of ADB’s Public Communications Policy).

4. **Sponsor and borrower.** WSL will be the sponsor, while WCS will implement the project and be the borrower of the ADB loan. *(Confidential information redacted under para. 97(v) of ADB’s Public Communications Policy)*.

5. **Sponsor’s parent company.** Once established, WSL will be wholly owned by MTD Walkers, Sri Lanka’s 46th-largest company in terms of turnover (2015).¹ It has a track record in Sri Lanka in (i) civil, mechanical, and electrical engineering; (ii) pile construction; (iii) power generation; and (iv) real estate development services. MTD Walkers’ largest subsidiary, CML-MTD Construction Ltd. (CML), was involved in the construction of several ADB-funded projects in Sri Lanka.² MTD Walkers is publicly listed on the Colombo Stock Exchange with a market capitalization as of 28 August 2017 of SLRs5.5 billion. MTD Capital Bhd, an investment

¹ LMD The Voice of Business. LMD 100 (2014/15). <https://lmd.lk/lmd-100-201415/>.

² ADB. 1998. Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grant to the Democratic Socialist Republic of Sri Lanka for the Road Network Improvement Project. Manila; ADB. 2009. Completion Report: Road Network Improvement Project in Sri Lanka. Manila; and ADB. 2008. Major Change in Scope: Southern Transport Development Project in Sri Lanka. Manila.

holding company incorporated and domiciled in Malaysia, directly owns 90.8% of MTD Walkers; the remaining 9.2% is publicly held.

(Confidential information redacted under para. 97(v) of ADB's Public Communications Policy).

B. Development Impact, Outcome, and Outputs

6. **Impact.** The successful implementation of the project will help develop Sri Lanka into a competitive hub for maritime activities in South Asia. The proposed financing will help increase jobs in fisheries and related industries, and improve the socioeconomic status of the country's fishing community. Furthermore, improvements in fishing vessel repairs are expected to increase national fisheries production and benefit the nutritional status and food security of Sri Lanka's population.

7. **Outcome.** The outcome will be improved operations of the local marine industry. For the Colombo yard, the outcome indicators will be the number of small and medium-sized fishing vessels with access to ship repairs and the number of merchant vessels up to 70 meters long with access to ship repairs by 2020. During operations, the project is expected to provide at least 100 jobs by 2020.

8. **Outputs.** The outputs will be (i) small vessel repair capacity commissioned, (ii) local employment generated, and (iii) growth of the local economy supported. The output indicators will be the number of piers with shiplift and transfer system capacity commissioned in the Colombo yard by 2019. The project will ensure that environment and safeguards standards are well maintained and fully met. WCS's expansion will lead to direct jobs during construction.

C. Alignment with ADB Strategy and Operations

9. **Consistency with ADB strategy and country strategy.** The project is consistent with the Midterm Review of Strategy 2020, which includes a focus on private sector development and operations, as well as infrastructure development.⁸ ADB's support for the project is in line with its country partnership strategy for Sri Lanka, 2018–2022 and upholds two key aspects of the first pillar for ADB's focus areas: expanding the provision of growth-orientated infrastructure and logistics, particularly improving connectivity in the transport sector such as ports, and strengthening the infrastructure of the economic corridor, especially in the transport sector.⁹

10. **Consistency with sector strategy and relevant ADB operations.** The project is in line with ADB's Sustainable Transport Initiative, which recognizes regional cooperation and integration as an emerging need and challenge that should receive more ADB support.¹⁰ This is to be done by addressing constraints to trade growth, such as the indirect costs associated with unreliable transport times, border-crossing delays, and handling and storage costs that result from poor terminal infrastructure. The project is also in line with ADB's Operational Plan for Regional Cooperation and Integration, 2016–2020, which emphasizes the need to strengthen connectivity between economies by improving cross-border physical connectivity.¹¹

11. **Lessons from previous operations.** The proposed loan will be the first ADB nonsovereign infrastructure loan in Sri Lanka since 2000. In October 2014, ADB approved up to \$40 million for a senior loan in a related sector to Ocean Sparkle Limited (a company from India) for funding the acquisition of tugboats and platform service vessels to be deployed in India's and Sri Lanka's ports.¹² Lessons from similar projects include (i) the need for robust market

assessments and conservative revenue projections, (ii) the need for robust transaction structures that could absorb temporary disruptions in the market, and (iii) the importance of engaging sponsors with demonstrated technical and management capability to execute such projects.

D. Project Cost and Financing Plan

(Confidential information redacted under para. 97(v) of ADB's Public Communications Policy).

E. Implementation Arrangements

(Confidential information redacted under para. 97(v) of ADB's Public Communications Policy).

F. Projected Financial and Economic Performance

12. The project is financially viable because its expected financial internal rate of return is 9.7%, higher than the weighted average cost of capital of 9.0%. The project is economically sustainable as the economic internal rate of return is 12.1%, higher than the social discount rate of 9.0%.³ Sensitivity analysis shows the project is financially and economically viable under adverse scenarios.

III. THE PROPOSED ADB ASSISTANCE

A. The Assistance

13. ADB's proposed assistance is a direct loan of up to \$4.0 million to WCS from ADB's ordinary capital resources, with a tenor of 8 years, including a 1-year grace period. WSL, the sponsor, and MTD Walkers, the sponsor's parent company, will jointly guarantee the ADB loan.

B. Value Added by ADB Assistance

14. ADB's assistance to the project will add substantial value in the following ways:

- (i) ADB is filling a critical market gap by funding a project—the first to cater to smaller vessels—to serve Sri Lanka's shipping industry. Long-term dollar financing of the kind proposed to be provided by ADB is not readily available in Sri Lanka.
- (ii) ADB's participation will further strengthen the project's environmental and social standards, as well as improve corporate governance and transparency of Sri Lanka's ship repair industry.
- (iii) ADB's assistance, an essential source of financing for the project, will support the government's initiative to promote the country's shipping and maritime businesses by developing a high-quality service operation to sustain the growth and maintenance of key private sector infrastructure.

C. Risks

(Confidential information redacted under para. 97(v) of ADB's Public Communications Policy).

³ ADB. 2017. Guidelines for the Economic Analysis of Projects. Manila.

IV. POLICY COMPLIANCE

A. Safeguards and Social Dimensions

15. The project is classified as category B for environment, category C for involuntary resettlement, and category C for indigenous peoples in accordance with the ADB Safeguard Policy Statement (2009). The potential environmental and social impacts of the project have been identified, and effective measures to avoid, minimize, mitigate, and compensate for the adverse impacts are incorporated in the safeguard reports and plans. WCS's capacity and commitment to manage the project's social and environmental impacts are adequate. The shipyard is in a fisheries harbor and has a lease arrangement with the harbor authority. Project activities will be in areas earmarked within the premises of the harbor, free from any non-titleholders, and will have no involuntary resettlement or indigenous peoples impacts. Key issues include the management of dredging activities and disposal of dredged materials, mitigation of noise associated with activities during construction and operation, treatment of wastewater effluent, disposal of solid waste, and occupational health and safety management. An initial environmental examination, including an environmental management and monitoring plan, an audit of the existing facility, and a corrective action plan, has been prepared for the shipyard and will be disclosed on ADB's website upon receipt of Board approval.

16. The company will comply with national labor laws and, pursuant to ADB's Social Protection Strategy (2001), will comply with internationally recognized core labor standards.⁴ The borrower will report regularly to ADB on (i) their compliance with such laws and (ii) the measures taken to comply with the international standards. A project-specific grievance redress mechanism will be adopted, and information disclosure and consultations with affected people will be conducted in accordance with ADB requirements.⁵ The project is categorized as having no gender elements.

B. Anticorruption Policy

17. WCS (the borrower), WSL (the sponsor), and the sponsor's parent company were advised of ADB's policy of implementing best international practice relating to combating corruption, money laundering, and the financing of terrorism. ADB will ensure that the investment documentation includes appropriate provisions prohibiting corruption, money laundering, and the financing of terrorism, as well as remedies for ADB in the event of noncompliance.

C. Investment Limitations

18. The proposed loan is within the medium-term, country, industry, group, and single-project exposure limits for nonsovereign investments.

D. Assurances

19. Consistent with the Agreement Establishing the Asian Development Bank,²⁴ ⁶ADB will proceed with the proposed assistance upon establishing that the Government of Sri Lanka has

⁴ ADB. 2003. Social Protection. Manila (adopted in 2001).

⁵ Summary Poverty Reduction and Social Strategy; Safeguards and Social Dimensions Summary; and Findings of the Corporate Safeguards Audit: Environmental and Social Management System Arrangement (accessible from the list of linked documents in Appendix 2).

⁶ ADB. 1966. Agreement Establishing the Asian Development Bank. Manila.

no objection to the proposed assistance to WCS. ADB will enter into suitable finance documentation, in form and substance satisfactory to ADB, following approval of the proposed assistance by the Board of Directors.

V. RECOMMENDATION

20. I am satisfied that the proposed assistance would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of up to \$4,000,000 to Walkers Colombo Shipyard (Private) Limited from ADB's ordinary capital resources, for the Shipyard Rehabilitation and Infrastructure Project in Sri Lanka, with such terms and conditions as are substantially in accordance with those set forth in this report, and as may be reported to the Board.

Takehiko Nakao
President

4 September 2017

DESIGN AND MONITORING FRAMEWORK

Impacts the Project is Aligned with			
Sri Lanka developed as a competitive hub for maritime activities in South Asia (Government of Sri Lanka) ^a			
Employment opportunities in fisheries and related industries increased, and socioeconomic status of the fishing community improved (Government of Sri Lanka) ^b			
Nutritional status and food security of the population of Sri Lanka improved by increasing the national fisheries production (Government of Sri Lanka) ^b			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Outcome	By 2020		
Operations of local marine industry improved	<p>a. At least (Confidential information redacted under para. 97(v) of ADB's Public Communications Policy) ships repaired per year (2016 baseline: 0)</p> <p>b. At least (Confidential information redacted under para. 97(v) of ADB's Public Communications Policy) fishing vessels repaired per year (2016 baseline: 0)</p> <p>c. (Confidential information redacted under para. 97(v) of ADB's Public Communications Policy) jobs provided during operation (2016 baseline: 0)</p>	a–c. MTD Walkers annual monitoring report	Weaker demand than projected for small vessel repair
Outputs	By 2019		
1. Small vessel repair capacity commissioned	<p>1a. (Confidential information redacted under para. 97(v) of ADB's Public Communications Policy) piers with shiplift and transfer system capacity commissioned for the Colombo yard project (2016 baseline: 0)</p> <p>1b. (Confidential information redacted under para. 97(v) of ADB's Public Communications Policy) boat lift commissioned for the Colombo yard project (2016 baseline: 0)</p>	1–3. MTD Walkers annual monitoring report	Construction delays due to force majeure
2. Local employment generated	2a. (Confidential information redacted under para. 97(v) of ADB's Public Communications Policy) jobs provided during the construction phase (2016 baseline: 0)		Cost overruns
3. Growth of local economy supported	3. Domestic purchases during construction and early operation amounted to at least (Confidential information redacted under para. 97(v) of ADB's Public Communications Policy) (2016 baseline: 0)		

<p>Key Activities with Milestones</p> <p>Outputs 1-3. Small vessel capacity commissioned; Local employment generated; Growth of local economy supported</p>
<p>Inputs Senior</p> <p>Loan: ADB: \$4.0 million loan</p>
<p>Subordinated Loan: <i>(Confidential information redacted under para. 97(v) of ADB's Public Communications Policy).</i></p> <p>Equity: <i>(Confidential information redacted under para. 97(v) of ADB's Public Communications Policy).</i></p>
<p>Assumptions for Partner Financing</p> <p>Not Applicable</p>

ADB = Asian Development Bank, WCS = Walkers Colombo Shipyard.

^a Ministry of Ports and Shipping. About Us. <http://www.portmin.gov.lk/ministry-of-port-shipping/ABOUT-US>.

^b Ministry of Fisheries and Aquatic Resources Development. http://www.fisheries.gov.lk/content.php?cnid=abt_mnstry.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=50138-001-4>

1. Sector Overview
2. (Confidential information redacted under para. 97(v) of ADB's Public Communications Policy)
3. (Confidential information redacted under para. 97(v) of ADB's Public Communications Policy)
4. Contribution to the ADB Results Framework
5. (Confidential information redacted under para. 97(v) of ADB's Public Communications Policy)
6. (Confidential information redacted under para. 97(v) of ADB's Public Communications Policy)
7. Country Economic Indicators
8. Summary Poverty Reduction and Social Strategy
9. Safeguards and Social Dimensions Summary