Management Discussion and Analysis Report 2015

GCC and Omani market context in 2015

Economic growth in the GCC region slowed down in 2015 driven by the sharp drop in oil prices. Price per barrel halved over the past 18 months and wiped out estimated OMR 140 bn of export earnings. This situation required Governments to increasingly focus on diversifying revenues, selectively reduce public spending and utilizing their reserves. The region continued to expand through fiscal deficits.

Oman Budget 2015 was aimed towards driving and sustaining growth and economic diversification. Despite the decline in oil prices and its potential adverse effect on the macro-economic environment, the country showed healthy GDP growth. According to IMF, GDP growth increased from 2.9% in 2014 to an estimated 4.4% in 2015. The Omani non-oil sector played a significant role in achieving this growth; rapid infrastructural developments paired with continued economic diversifications are among the key contributing factors.

The GCC (and in the Sultanate) construction market has remained robust, driven partially by long-term mega projects. The Omani government remained instrumental in driving the construction sector thanks to its continued focus on economic diversification and its leading role in various development plans and initiatives. However competition intensified and the market became increasingly challenging putting pressure on local and regional construction players, impacting industry profitability and liquidity.

Galfar performance overview in 2015

Galfar Engineering and Contracting SAOG maintained its position as one of the leading contracting companies in Oman with operations across the Sultanate and India, with a turnover of OMR 326 m. Galfar remains the largest employer of Omani nationals in the Private Sector.

Galfar's objectives are always aligned with the policies of the Sultanate, with its core objective to satisfy its stakeholders and clients through committed efforts to deliver projects in time and in strict compliance with safety and quality standards.

The Company, including its subsidiaries, has recorded for the year 2015 turnover of OMR 345 m (2014: OMR 373 m) with after tax loss of OMR 29 m (2014: profit OMR 0.2 m). The parent company's turnover for the year 2015 is OMR 326 m (2014: OMR 354 m) and incurred a loss after tax is OMR 29 m (2014: profit OMR 1.2 m). The loss was the result of a provision of OMR 32 million.

This provision is for impairment of receivables and stock and is in line with International Financial Reporting Standards (IFRS) requirements and the Company's accounting policies. Out of the total provision amount, the major portion is a provision for the Muscat Expressway project and Central Corridor project. The provision was made in line with the offer made by Muscat Municipality. Galfar had received offers from Muscat Municipality together with draft supplemental agreements. The Board, after careful consideration, did not accept the client's proposal and decided to pursue recovery of the amount due to the company through the proper mechanism. These provisions are made without prejudice to the company's right to recover these dues through amicable settlement or arbitration proceedings.

Galfar recognizes the urgent need to significantly improve its operational and financial performance. In the second half of 2015, a detailed analysis on the market outlook and Galfar's current performance and capabilities were conducted and measures are now being taken to enhance performance (see section Galfar outlook and operational focus for 2016).

In 2015 a significant number of jobs have been completed. Amongst them are:

Ras al Hadd airport and phase 1 of Salalah airport

Five road projects

Hallaniyat port and road network

Nizwa water distribution network and four high end building projects

Four electrical grid stations

Galfar has five subsidiaries and three associates in operations. The performance of the subsidiaries is as follows: Galfar Engineering & Contracting India Pvt. Ltd., which is engaged in BOOT contracts in India, recorded a turnover of OMR 14 mln (2014: 16 mln) with profit after tax OMR 0.7

mln (2014: OMR 0.1 mln). Galfar Aspire Readymix LLC, which produces ready mix concrete, recorded a turnover of OMR 20 mln (2014: OMR 17 mln) with profit after tax OMR 1 mln (2014: OMR 1.1 mln). Aspire Projects and Services LLC which is a specialized engineering and services company had a turnover of OMR 3.3 mln (2014: OMR 3 mln) with profit after tax OMR 0.3 mln (2014: OMR 0.2 mln). Al Khalij Heavy Equipment & Engineering LLC which specializes in hiring out of equipment recorded a turnover of OMR 1.8 mln (2014: OMR 1.8 mln) with profit after tax OMR 0.1 mln (2014: OMR 0.1 mln). Galfar Training Institute LLC which specializes in the field of training Omanis in various trades recorded a turnover of OMR 0.3 mln (2014: OMR 0.9 mln) and incurred loss OMR 0.3 mln (2014: 0.1 mln).

Human Resources and Omanization

Galfar is committed to develop its resource and maintaining its Omanization targets. Omanization policies in the company are critical and directed towards development, performance and steady growth. Galfar aims to accomplish employee development through transparent and harmonious HR policies, and maintain a motivating work environment and retain talent. Our goal is to be seen as the employer of choice.

Quality, Health, Safety and Environment

The Company continues to maintain its certification to ISO 9001 (Quality), OHSAS 18001 (Health & Safety), ISO 14001 (Environment) standards and ISO 29001 (Petroleum & Petrochemical Sector specific standard).

The Company has worked 84.5 million man-hours and has driven 110.8 million kilometres collectively during year 2015, in projects across the country. In spite of exposure to such enormous amount of activities, Lost Time Injury Frequency (LTIF) of 0.17 recorded during the year is the lowest annual LTIF ever achieved by the company and is amongst the best in the industry.

The Company has also recorded several achievements in terms of man-hours worked without Lost Time Injury in projects / units. The significant ones are 50 million hours of Oil & Gas projects and 16 million man hours of Civil & Marine Infrastructure Unit.

The Management Review Committee chaired by the CEO with the participation of all Unit Heads is reviewing the HSEMS and QMS performance on a regular basis and initiating actions for continual improvement.

Oman economic outlook for 2016

Real GDP is forecasted to increase by 2.0% in 2016 (compared to 3.2% in 2015) due to lower oil revenues, austerity measures and lower regional trade. Oman’s 2016 budget proposes reduced oil price subsidies and increased corporate income taxes, with total budgeted expenditure for 2016 dropping to OMR 11.9 bln (11% lower than estimated actual spending in 2015). Public development spending is set to decrease by 18%, with non-core projects postponed.

The Budget indicates that the Government is going ahead with the essential projects planned, in line with the strategic objectives, amongst others of becoming a regional logistics hub by 2020. If oil prices remain low for a prolonged period of time, it is expected that some investment plans will be delayed or cancelled, and that the government will further rely on external borrowings and tap into international debt markets.

Galfar outlook and operational focus for 2016

Building on its strong market position and its reputation for delivering high-quality construction projects across various sectors, Galfar has a confirmed healthy order book of around OMR 665 million as of today. Revenues for 2016 are expected to be at par or above 2015 levels despite an increasingly challenging market environment.

Several projects are seen to be in the pipeline and Galfar stands a good chance at winning some of them during the year 2016. The outlook to win additional projects is particularly promising in the oil and gas sector.

Operating profits in 2016 should see a healthy recovery. 2015 was adversely affected by a number of loss making projects, the majority of which have been completed last year.

During 2016 a holistic transformation program will be executed driving enhanced financial and operational performance. In this context, Roland Berger, a leading global strategy consultancy with a strong track record in operational, organizational and financial company transformation, has been appointed in December 2015.

Key building blocks of this program include organizational transformation and enhanced talent management, enhanced liquidity management and assets optimization, overhead cost reductions, productivity improvement and lean on-site execution, supply chain management optimization, and information technology transformation.

Beyond the core business, the outlook of subsidiaries is overall positive.

For example, Galfar Aspire Readymix LLC counts today ten batching plants at seven different locations compared to only one batching plant in 2011. In 2016, the company is expecting to increase production to 900,000m^3 (+4.7%). Aspire Projects and Services LLC will continue focusing on providing specialized facilities management and engineering services.

The Indian operations of Galfar have a positive long-term outlook with significant value creation potential. In the very short-term funding is required.

Risks

Risks remain an integral part of the construction business in the region.

The construction sector, and Galfar in particular, face the risk of higher cost of capital and increasingly difficult access to capital in the future. A deteriorating macro-economic environment might result in banks tightening their lending. This could affect the company's funding and might have broader repercussions on the country as a whole.

Galfar has a strong confirmed order book paired with a positive business development pipeline. However, an increasingly difficult macroeconomic context could cause clients to slow down or even stop ongoing projects and delay award of new projects.

A major risk is the delay of collecting outstanding payments. Construction companies have large concentrations of receivables and continue to deal with outstanding payments that are increasingly hard to collect.

Additionally, there lies a risk of delay in completion of jobs due to various external reasons like the long process to obtain government approvals, changes of scope and approval for variation orders. These factors are outside Galfar's control and can have significant negative impact on profitability.

The profitable delivery of projects relies on the right talent. Higher salaries in other countries in the Arabian Peninsula are driving away expatriate workforce and pose a risk to Galfar operations. At the same time, the construction sector is struggling in attracting qualified Omani nationals.

Our gratitude and commitment

Galfar salutes His Majesty Sultan Qaboos, who in the 46 years of his commendable rule has transformed Oman into a powerful modern economy in the region. Galfar shall endeavour to reach even higher standards of project delivery through continuous improvement in processes and wishes to lead by action in Omanization as a true Omani enterprise.

Hans Erlings
Chief Executive Officer