

Management Discussion and Analysis Report 2016

Omani market context in 2016

The engineering and construction market continued to be influenced by lower global oil price. There was significant work available in the upstream oil and gas sector as well as in the downstream refining and petrochemical industries. Work in these areas is at an all-time high. Government infrastructure project award has slowed down apart from the essential water and electrical infrastructure. No significant road projects have been awarded. Non-government sector building development is very active.

For existing government projects, non-payment of due amounts started in mid-2016 and is continuing till date. This is significantly affecting our financial resources.

Galfar performance overview in 2016

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 324.0 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 on time and in strict compliance with safety and quality standards.

The Company, including its subsidiaries, has recorded for the year 2016 turnover of RO 340.9 m (2015: OMR 345.2 m) with loss after tax of RO 10.8 m (2015: RO 28.9 m). The parent company's turnover for the year 2016 was RO 324.0 m (2015: RO 326.0 m) and incurred a loss after tax RO 11.7 m (2015: RO 28.5 m). The loss was as a result of impairment of receivables RO .6.8 m (2015: RO 31.9 m), and Impairment of investment RO 6.1 m (2015: nil).

This provision for impairment of receivables and investment are in line with International Financial Reporting Standards (IFRS) requirements and the Company's accounting policies. These provisions are made without prejudice to the company's right to recover these dues through amicable settlement or arbitration proceedings.

In 2016 16 major projects were closed out. This includes major civil works for upstream oil and gas and Duqm refinery site preparation.

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 RO 23.5 m (2015: 14.3 m) with profit after tax RO 0.8 m (2015: RO 0.7 m). Galfar Aspire Readymix LLC, which produces ready mix concrete, recorded a turnover of RO 20.7 m (2015: RO 20.0 m) with profit after tax RO 0.7 m (2015: RO 1.0 m). Aspire Projects and Services LLC which is a specialized engineering and services company had a turnover of RO 4.7 m (2015: RO 3.3 m) with profit after tax RO 0.4 m (2015: RO 0.3 m). Al Khalij Heavy Equipment & Engineering LLC which specializes in hiring out of equipment recorded a turnover of RO 1.7 m (2015: RO 1.8 m) and incurred a loss RO 0.02 m (2015: RO 0.1 m). Galfar Training Institute LLC which specializes in the field of training Omanis in various trades recorded a turnover of RO 0.5 m (2015: RO 0.3 m) and incurred loss RO 0.4 m (2015: 0.3 m).

The 2016 transformation programme was multi-faceted and focussed on: organizational transformation, liquidity management and assets optimization, overhead cost reductions, productivity improvement and lean on-site execution, and supply chain management optimization. The newly introduced construction methods have enhanced the operational performance in all areas of the business.

Human Resources and Omanization

Galfar is committed to develop its resource and maintaining its Omanization targets. Our total salary bill remains a high risk to profitability which can only be offset by enhanced people and productivity output. To that effect daily performance monitoring and enhancement has been introduced. 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 82.2 million man-hours and has driven 102.4 million kilometres collectively during year 2016, in projects across the country. Our Lost Time Injury Frequency (LTIF) was at 0.41.

The Company has recorded several achievements in terms of man-hours worked without Lost Time Injury in projects / units. The most significant one being 41 million man-hours in Off-plot Delivery Contract with PDO.

This demonstrates our commitment to protect our employees & other stakeholders from injuries & ill health, prevent damages to assets and minimize impact on the environment during the course of our business.

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.

Galfar outlook for 2017

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 650.1 m (2015: RO 641.7 m).

The main threat for 2017 is the delayed payment for projects which has led to unpaid certified receivables of OMR 58.6 million as at 31 December 2016 and which further increased since the beginning of 2017. This situation will lead to reduced activity levels in those areas and part demobilisation to make expenditure match income. Work in oil and gas upstream and downstream will go ahead as per contract.

Management of our borrowings has now become extremely critical until such time that the receivables backlog is resolved.

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

Galfar Aspire Readymix now has 7 operational areas. Efforts are being made to ensure that the turnover is maintained as in the previous year despite tough market conditions.

Aspire Projects and Services LLC will continue focusing on providing specialized facilities management and engineering services.

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.

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 more than 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