

Management Discussion and Analysis Report 2017

Overview of Oman Economy

Engineering and Contracting in Oman continues to be held back during the year under review due to lower oil prices and reduced availability of cash.

The Oman economy across the last year has demonstrated contraction of developmental spends due to relatively low oil prices.

The engineering and construction market continued to face a cash crunch which has become a very difficult to manage issue. All contractors are carrying this burden in their projects, which is having a significant impact on their ability to do business and grow.

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 expected to be at an all-time high in 2018. 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, delayed payment of due amounts started in mid-2016 and is continuing off and on till date. This is significantly affecting our financial resources. However, growth is expected to pick up over the medium term following modest increase in the oil price and boost in gas production and also from expected gains in the non-oil sector resulting from the government's economic diversification plan. The oil price remains a major uncertainty with US oil production becoming a dominant influencer.

Fiscal and current account deficits remain large, and with Oman increasingly resorting to external borrowing to finance its deficits, public debt is rising rapidly.

This economic and fiscal climate means that governments are becoming more reliant on the private sector to bring innovative finance schemes to the construction and asset management sectors.

The PPP, BOOT and BOT models are few of these innovations and it has significant potential in the Sultanate. PPPs have already been successfully implemented in the power and water sectors. Most of the regulations are already in place, and there is definitely a confidence in the government that this mechanism will work successfully to deliver much needed infrastructure to the country.

Galfar performance overview in 2017

Galfar Engineering and Contracting SAOG maintained its position as one of the leading contracting companies in Oman with operations across the Sultanate and India. 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 2017 turnover of RO 296.1 m (2016: OMR 340.9 m) with loss after tax of RO 5.8 m (2016: RO 10.8 m).

The parent company's turnover for the year 2017 was RO 277.7 m (2016: RO 324.0 m) and incurred a loss after tax RO 3.7 m (2016: RO 11.7 m).

The loss was as a result of impairment of receivables RO 4.9 m (2016: RO 6.8 m), and impairment of investment RO 0.3 m (2016: 6.1 m). 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.

Post Balance Sheet date the company has received two arbitration awards for Seeb vacuum network. This awards cover the income recognized in the Company's accounts.

In spite of the difficult economic conditions as explained above, the Company managed to generate a positive cash flow during the year under review.

During the year under review the Company has received new orders worth RO 106 Million. The major orders received are tabled below. The backlog as per end Feb 2018 is 483 mln RO.

S.No.	Unit	Client / Project Details	RO Millions
1	O&G	PDO - Off plot Mech. Contract -Qarn Alam	51
2	U&S	SSDS - Raysut WRP Upgrading	13
3	U&S	OECT- Birkat Al Mouz Grid Station	18
4	R&B	MOTC- BEW - 3 Package	26

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 20.2 m (2016: 23.5 m) with profit after tax RO 0.5 m (2016: RO 0.8 m).

Galfar Aspire Readymix LLC, which produces ready mix concrete, recorded a turnover of RO 19.5 m (2016: RO 20.7 m) with profit after tax RO 0.5 m (2016: RO 0.7 m).

Aspire Projects and Services LLC which is a specialized engineering and services company had a turnover of RO 7.2 m (2016: RO 4.7 m) with profit after tax RO 0.6 m (2016: RO 0.4 m).

Al Khalij Heavy Equipment & Engineering LLC which specializes in hiring out of equipment recorded a turnover of RO 1.7 m (2016: RO 1.7 m) and incurred a loss RO 0.1 m (2016: RO 0.02 m).

Galfar Training Institute LLC which specializes in the field of training Omanis in various trades recorded a turnover of RO 1.1 m (2016: RO 0.5 m) and incurred a loss of RO 0.02 m (2016: loss of 0.4 m).

Business Scenario

The performance in the current year will depend on pick up in government spending on development projects on infrastructure. The Company has identified the key thrust areas and strategies to focus on upcoming opportunities including PPP model.

Transformation initiatives:

Galfar has initiated many transformational initiatives to further strengthen its processes and systems to achieve operational excellence, it includes but not limited to the following.

- 1. Strengthening execution and operational efficiency**

The Company is focused on bringing about operational cost and efficiency for achieving profitable growth in the competitive business environment. The emphasis is on better contract and project management. The endeavour is to lower cost by maintaining quality and managing complexity. The transformation programme initiated in 2016 includes organizational transformation, liquidity management and assets optimization, overhead cost reductions, productivity improvement and lean on-site execution, supply chain management optimization and site skill-based training. The newly introduced construction methods have enhanced the operational performance in all areas of the business.

- 2. Value addition to business**

The Company started reviewing and looking for opportunities to divest some of the S&A companies in India and Kuwait. The company is focused on value creation and enhance return through monetization.

- 3. Emphasize on Improving Working capital level**

The Company will continue to focus on reducing the working capital level by emphasis in speedy collection, accelerating invoicing of work completed and reducing inventory level.

- 4. System implementation**

The company has identified system implementation as a key driver to enhance its competitiveness. Various initiatives are underway through implementation of a new enterprise resource model.

5. Organisational Restructure

The company is also continuously reviewing the requirement of the restructuring the organisation structure in order to achieve cost effective high productivity by reducing head count and optimization of resources.

Human Resources and Omanization

Galfar is committed to developing 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, 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 the competitive edge in Quality & HSE Management in the industry through our management systems certified for compliance with ISO 29001:2010 (Petroleum & Petrochemical Sector specific standard), ISO 9001:2008 (Quality), OHSAS 18001:2007 (Health & Safety) and ISO 14001:2004 (Environment) standards, in addition to our ASME - 'U' & 'S' and National Board - 'R' Stamp certifications and PDO approval in AVME list for fabrication of Pig Launchers & Receivers.

We have worked 74 million man hours and have driven 90 million kilometers collectively during year 2017. Despite exposure to an enormous amount of activities and challenges, our performance continues to be encouraging. Our Lost Time Injury Frequency recorded during the period is 0.21 (lower than the set limit of 0.35). Road Traffic Accident Frequency of the company for the period is also lower than the limit set for the year (2.28 against 2.5).

During the latter end of 2017, Galfar has introduced several new initiatives in QHSE in order to enhance the overall performance in terms of reducing defective work and achieving all activities safely without injuries. Some of these initiatives are:

- 'Getting right first time and every time' – a system to reduce cost of poor quality
- 'Don't dismiss a near-miss' – a behavioral based model to mitigate HSE risks
- 'Lean Methods' – revitalization of methods, procedures and tools to enhance productivity

In addition to the HSE Management Review Committee chaired by the CEO with the participation of all Unit Heads, the Company has initiated a Quality Review Committee to review on a monthly basis critical projects' compliance, cost of quality and optimum utilization of material, plant, tools and equipment.

Galfar outlook for 2018

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 483 m

(2016: RO 650 m). Currently projects in East Africa and Kuwait are being studied as potential new areas of work.

The company is committed to deliver and add value to shareholders and stakeholders through the restructured business units as outlined below.

Oil and Gas

Despite contraction of spends due to depressed oil prices, the Company is well placed to maintain a healthy order book and has potential opportunities in the areas of gas production and downstream projects. It has a strong customer connect with clients in the region, and it is expected to yield significant order wins and the outlook for the business is quite positive.

Roads & Bridges

Galfar has a reputation of delivering high quality roads and bridges across Oman, and in year 2017 has successfully completed and handed over the BEW Phase - I project. Taqa Mirbat road was opened in Dhofar area and in North Oman the Jabrin Ibri road was opened to the public.

The government is planning to award a few major major road projects in 2018. The government is also considering alternative financing for some projects, through privatization of these infrastructure projects and we are thus poised to take up new work as and when the projects materialize.

Civil and Marine

In 2018 we will be working in full capacity on a major hospital and Duqm fishery port. All other projects will be closed out in the period.

Utilities and Services

The government is actively pursuing plans to improve the water management services across the country in view of widespread expansion plans. This is giving rise to large business opportunity and the company is well positioned to exploit.

The areas of focus include in addition to maintenance, effluent / sewage treatment plants, emerging opportunities in waterways infrastructure, power transmission and distribution infrastructure.

The Company received an order from Salalah Sanitary Drainage Services Co. SAOC worth RO. 13 million in Jan'18 for Operation & Maintenance Of Salalah Waste Water System & Treated Effluent Supply Network for a further five years.

Galfar Aspire Readymix LLC 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 may have broader repercussions on the country as a whole.

The main threat for 2018 is the delay in receipt of payment for major projects which has led to unpaid certified receivables of OMR 61 million as at 31 December 2017 and which further increased since the beginning of 2018. 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.

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.

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 experienced Omani nationals.

To mitigate this the company has put in a comprehensive risk management structure and it is getting evolved across all the units. This will enable a systematic and structured approach of aligning the risk management initiative with our strategic and operational objectives, helping manage uncertainty more effectively, minimise threats / surprises and maximise opportunities.

Our gratitude and commitment

Galfar salutes His Majesty Sultan Qaboos, who, in the more than 47 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.

We acknowledge the contributions made by the team Galfar and thank our customers, vendors and other stakeholders who made delivery of our projects possible. Given our restructuring program and optimization of processes, we are determined to raise the bar and set new benchmarks in the industry.

A handwritten signature in black ink, appearing to read "Hans Erlings".

Hans Erlings
Chief Executive Officer