

## **Management Discussion and Analysis Report 2018**

### **Overview of Oman Economy**

Economic growth is set to be modest over the medium term, with GDP expected to increase by 2.5 per cent in 2019 and to be 2.9 per cent by in 2020.

The Oman economy across the last year has demonstrated contraction of developmental spend to meet the budget and backlog.

Oman's 2019 budget contains new measures that would durably stop or reverse the fiscal deficit in an environment of moderate oil prices. The 2019 budget aims to allocate sufficient funds to strategic infrastructure project as well as maintain infrastructure and continue to push for economic diversification by enhancing participation of private sector.

The focus is to improve the investment climate, promote public private partnership and offer support to SMEs.

The engineering and construction market continued to face a backlog in due payments, due to which it has become very difficult to manage working capital for smooth delivery of projects. There are serious fiscal constraints in the sector influenced by lower global oil price. All contractors are carrying this burden in their projects, which is having a significant impact on their ability to maintain business, let alone grow business.

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 will be at an all-time high in 2019 and the near future. 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.

New opportunities in engineering and construction are expected from BP and Eni, who have signed a heads of agreement (HoA) with the Ministry of Oil and Gas of the Sultanate of Oman to work jointly towards a significant new exploration opportunity in Oman. The same is expected from the signing of an interim agreement by the Ministry of Oil and Gas with Shell and Total for the development of integrated gas projects in Oman.

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 infrastructure to the country.

### **Galfar performance overview in 2018**

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 one of the largest employers 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 Group's performance during the year 2018 has resulted in positive contribution to the equity and reduction in accumulated losses. The majority of accumulated losses are from Indian operations.

Post Balance Sheet date the parent company has entered into a preliminary agreement with M/s PMA International LLC to sell all its investments in India. The company is expected to complete the process in the coming months. This deal will facilitate the company to concentrate on its core business in Oman and enhance value addition to the shareholders and stakeholders.

During the year Company, including its subsidiaries, has recorded turnover of RO 289.1 m (2017-Restated: OMR 293.1 m) with profit after tax of RO 2.2 m (2017-Restated: Loss RO 6.5 m).

The parent company's turnover for the year 2018 was RO 272.36 m (2017: RO277.73 m) and reported profit after tax RO 5.7 m (2017: Loss RO 3.7 m).

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 153 Million. The major orders received are tabled below. The backlog as per end Feb 2019 is 380 million RO.

S.No.	Unit	Client / Project Details	RO Millions
1	U&S	SSDC - Operation & Maintenance of Salalah Waste Water System & Treated Effluent Network	13
2	O&G	Daleel - Provision of Construction Services for Daleel On-Plot Areas (Service Contract)	30
3	O&G	Petrofac - Salalah LPG Project – Subcontract for CMEI Works Package-1	16
4	O&G	BP - Phase II Gas Gathering	36

5	O&G	Petrofac - EPC of Buildings-Process and Non-Process - PKG 1 & 3	19
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The performance of the subsidiaries are as follows:

Galfar Engineering & Contracting India Pvt. Ltd., and its subsidiaries which is engaged in EPC / BOOT contracts in India, recorded a turnover of RO 8.9 m (2017-Restated: 33.7m) incurred loss of RO 6.1 m (2017-Restated: Loss RO 2.6 m).

Galfar Aspire Readymix LLC, which produces ready mix concrete, recorded a turnover of RO 17.9 m (2017: RO 19.5 m) with profit after tax RO 0.5 m (2017: RO 0.5 m).

Aspire Projects and Services LLC which is a specialized engineering and services company had a turnover of RO 7.7 m (2017: RO 7.3 m) with profit after tax RO 0.6 m (2017: RO 0.6 m).

Al Khalij Heavy Equipment & Engineering LLC which specializes in hiring out of equipment recorded a turnover of RO 1.8 m (2017-Restated: RO 1.7 m) and incurred a loss RO 0.01 m (2017-Restated: Loss RO 0.1 m).

Galfar Training Institute LLC which specializes in the field of training Omanis in various trades recorded a turnover of RO 0.7 m (2017: RO 1.2 m) and incurred a loss of RO 0.05 m (2017: loss of 0.02 m).

### **Business Scenario**

It is expected that the current development budget will reduce the award of new projects in certain infrastructure segments, like roads. Continuous development in water and power and sewage treatment infrastructure is expected

Transformation initiatives:

Galfar initiated 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 operational cost reduction and efficient use of resources for achieving profitable growth in the competitive business environment. The emphasis is on better contract and project management and lean operations. The endeavour is to lower cost by maintaining quality and managing complexity. The transformation programme initiated in 2016, will continue and includes organizational transformation, liquidity management and assets optimization, overhead cost reductions, productivity improvement and lean 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 is focused on value creation and enhancing return through monetization. As such all Indian operations are being sold and our investment in an associate company is being studied for sale.

**3. Emphasize on Improving Working capital level**

The Company will continue to focus on reducing the working capital level by emphasis on 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 Xpedeon, an enterprise resource model, which integrates project management.

**5. Organizational Restructure**

The company is also regularly amending the organisation structure in order to achieve cost effective cost effective efficient operations.

**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 equipment 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**

Galfar leads the industry with high levels of Quality and Safety output and consistently maintain a competitive edge through our management systems certified for compliance with ISO 29001:2010 (Petroleum & Petrochemical Sector Standard), ISO 9001:2008 (Quality), OHSAS 18001:2007 (Health & Safety) and ISO 14001:2004 (Environment) standards.

Despite exposure to a high level of activities and challenges our performance continues to be encouraging; we have worked 67 millionman hours and have driven 76 million kilometers collectively during year 2018. Our Lost Time Injury Frequency recorded during the year is 0.18 (lower than the set limit of 0.28). Road Traffic Accident Frequency of the company for the period is also lower than the limit set for the year (1.92 against 2.0).

We have also achieved a new milestone of 163 days and 29 million man hours worked by the Company without any LTI surpassing a previous record of 89 days and 15 million man hours (during 2015). Over the course of 2018, in order to enhance our overall performance, several QHSE enhancements were introduced with a view to reduce defective work and reduction of incidents:

- Activity-specific HSE animation video – direct impact on improvement of safe works

- VWI (Visual Work Instructions) – improvement of workmanship through visual aides
- 4M – ‘Lean Methods’ – revitalization of methods, procedures and tools to enhance productivity
- Pre-activity workshops – significant reduction of re-work through engaging workers responsible for their activities
- Incentivize ‘Don’t Dismiss a Near-Miss’ - Monthly and Quarterly awards of identification of unsafe works, hazards and near misses

Company management visits are practiced on a routine basis - ‘GEMBA Walk’ Program, which aims to highlight good practices as well as improvements. This practice has seen worker engagement with the upper management and therefore the opportunity to raise concerns leading to overall improvement of workers’ morale.

### **Galfar outlook for 2019**

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 380 m (2017: RO 483 m). Currently projects in East Africa and Kuwait are being studied as potential new areas of work.

The Company has taken strategic initiative to expand its operation in MENA region. It has registered a wholly owned subsidiary at Kuwait to execute projects in Infra and Oil and Gas sector.

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 selected clients in the region, which 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 2018 has successfully completed and handed over the BEW Phase - 3 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 two major road projects in 2019. 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 2019 we will be working in full capacity on a major hospital and Duqm fishery port.

### **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 will participate.

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

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 is the delay in receipt of payment for major projects which has led to significant unpaid certified receivables which further increased since the beginning of 2019. This situation will lead to reduced activity levels in those areas and part demobilization 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, minimize threats / surprises and maximize opportunities.

### **Our gratitude and commitment**

Galfar salutes His Majesty Sultan Qaboos, who, in the morethan 48 years of his 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.



**Hans Erlings**  
**Chief Executive Officer**