Management Discussion and Analysis Report 2019

General Overview

The construction and contracting business are among those sectors expected to receive highest impact of current downturn due the economic implications of COVID-19 pandemic and drop in oil & gas prices. As one of the mitigations taken by the government, the country's 2020 budget has been reduced by 10% affecting expenditure in infrastructure and some development projects.

In addition, the oil and gas industry considered several mitigations to reduce expenditure in new projects and development of oil fields. This has been elevated by the planned OPEC plus oil production cuts as attempt to restore oil prices.

The cash-flow strains with the government treasury have affected severely payments of dues to Engineering and Contracting business such as Galfar, adding burden to these businesses to bridge the cash flow deficit with expensive short-term borrowing. Within the current economic situation it is essential to improve cash-flow and payment of dues to contractors to sustain in the short term.

Galfar performance overview in 2019

Galfar Engineering and Contracting SAOG maintained its position as a flagship of Oman construction and contracting business with operations across the Sultanate. 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 2019 has resulted in negative contribution to the equity and increase in accumulated losses due to significant amount of provision for impairment of receivables.

During the year, the Company has completed the divestment process of Indian operations and received part of the money from the buyer.

In spite of the difficult economic conditions as explained above, the Company managed to generate a positive cash flow during the year under review. The Company was successful in collecting certain long pending receivables from its clients. This has facilitated to reduce its bank borrowing. However there are significant amount of overdue receivables to be collected especially from Government entities.

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Asset turnover ratio for the year is also very much improved in comparison to previous periods.

During the year Company, including its subsidiaries, has recorded turnover of RO 248.8m (2018: RO 289.1m) with loss after tax of RO 6.3m (2018: Profit RO 0.08 m).

The parent company's turnover for the year 2019 was RO 231.4m (2018: RO 272.3m) and reported loss after tax of RO 21.4m (2018: Profit RO 5.7m).

The performance of the subsidiaries is as follows:

Galfar Aspire Readymix LLC, which produces ready mix concrete, recorded a turnover of RO 19.8 m (2018: RO 17.9 m) with loss after tax RO 0.5 m (2018: RO 1.6 m).

Aspire Projects and Services LLC which is a specialized engineering and services company had a turnover of RO 7.7 m (2018: RO 7.7 m) with profit after tax RO 0.4 m (2018: RO 0.6 m).

Al Khalij Heavy Equipment & Engineering LLC which specializes in hiring out of equipment recorded a turnover of RO 1.7 m (2018: RO 1.8 m) and incurred a profit RO 0.01 m (2018: Loss RO 0.02 m).

Galfar Training Institute LLC which specializes in the field of training Omanis in various trades recorded a turnover of RO 0.4 m (2018: RO 0.7 m) and incurred a loss of RO 0.06 m (2018: 0.05 m).

During the year under review the Company has received new orders worth RO 229 Million. This has contributed to increase the value of orders on hand as on 31 December 2019 to RO 401 million.

Business Scenario

The business scenario demands a transformation for achieving operational excellence.

Transformation initiatives started in 2016 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 were sold.

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 organization structure in order to achieve cost effective cost effective efficient operations.

Quality, Health, Safety and Environment

Galfar consistently maintains a competitive edge through its management systems certified for compliance with ISO 29001:2010 (Petroleum & Petrochemical Sector Standard), ISO 9001:2015 (Quality), OHSAS 18001:2007 (Health & Safety) and ISO 14001:2015 (Environment) standards.

Despite exposure to high level of activities and challenges, our performance continues to be encouraging; we have worked 70 million man hours and have driven 71 million kilometers collectively during the year 2019. The Lost Time Injury Frequency recorded during the year is 0.17 (lower than the set limit of 0.28). The Road Traffic Accident Frequency of the company for the period is also lower than the limit set for the year (1.53 against 2.0).

Over the course of 2019, we have maintained international best practices on our projects and incorporated new initiatives successfully to reduce defective work and reduction of incidents:

- A new HSE Induction video has resulted in customer accolades and better HSE output
- 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 technical on-site activities
- Quarterly CEO Award for the 'Best Near Miss Reporter'.

Galfar senior management is a key component of high levels of success. They imbibe and live by the company's values, policies and procedures and demonstrate effective leadership by inspiring staff and the workforce towards higher levels of performance.

Our focus throughout the year has been to support SMEs and Local Community Contractors.

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.

As part of improving Omanization, 350 Omani staff were recruited in 2019. This includes 13 senior and middle management staff, 37 staff in various Omanized categories (by replacing expatriates) and 300 trainees. With the help of the National Training Fund, the newly recruited trainees are being given training to perform their roles effectively.

Galfar outlook for 2020

For 2020 the Government development budget is 1300 Mln RO. Continuous development in roads and ports, water and power and sewage treatment infrastructure is expected.

Oil and Gas

There are several Projects in this sector and we expect tenders in the range of RO. 350 Million to be released during the year 2020 by all major oil Companies. These will range from upstream maintenance and service contracts to downstream process related projects. Some of these Projects are in the Oil and Gas concession areas while others will be in and around Duqm. The Projects envisaged will also include large diameter cross-country pipelines.

In the coming years, new opportunities in engineering and construction are expected from BP and ENI, who have signed an Exploration and Production sharing agreement with the Ministry of Oil and Gas 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.

Roads & Bridges

With several noteworthy iconic projects, Galfar continues to be a Contractor of choice for the Roads sector in Oman. During the year 2019 Galfar was primarily engaged in finishing the ongoing projects. Our wait for some of the Projects scheduled for last year will end soon, and we are in full preparedness to proceed with their execution.

Civil and Marine

The Civil and Marine Unit of Galfar continues to deliver its commitments thorough 2020. Both the Hospital and the Duqm Fishery Port are well underway towards completion. We expect to be awarded a few projects in 2020.

Utilities and Services

With the award of the Sultan Qaboos University Maintenance works our Utilities and Services unit has secured its future in the O&M Sector. While the competition is cut-throat we will strive to maintain the high standards we have brought to this sector and continue to maintain our position as a "prime choice" O&M contractor.

Further, with substantial tenders announced in the power transmission and distribution we believe the Unit can grow in the utilities sector with prominence.

Opportunities in the water management sector will continue to grow with increased transmission and distribution networks being installed in the Sultanate.

Risks

Risks remain an integral part of the construction business in the region. The construction sector faces the risk of higher cost of capital and increasingly difficult access to working capital in the future.

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 2020. Another major threat is the economic implication of the ongoing Covid-19 pandemics which poses risks of uncertain proportion to the business.

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 is actively involved in risk management and impact of events on project progress is reviewed weekly with the Management Leadership Team.

Our gratitude and commitment

Galfar take this opportunity to thank the customers, shareholders, suppliers, bankers, business partners/associates, financial institutions and the Government of Sultanate of Oman for their consistent support and encouragement to the Company.

On behalf of Galfar, I convey my sincere appreciation to all employees of the Company and its subsidiaries and associates for their hard work and commitment. Their dedication and competence has ensured that the Company continues to be a significant and leading player in the contracting industry.

Tribute to late His Majesty Sultan Qaboos bin Said bin Taimour, for his visionary leadership and wise guidance, which placed Oman firmly on the path to peace, prosperity and sustainable development over the past five decades. We pledge to full loyalty to His Majesty Sultan Haitham bin Tarik and his government in their endeavors to build even further on this outstanding legacy in the years to come.

Hamoud Rashid Al Tobi
Chief Executive Officer