

Oman Cables – Underleveraged balance sheet, Neutral on valuations...

Closing Price: RO 1.570

Recommendation: Neutral

Fair Value: RO 1.545

Sector Outlook remain Cautious for 2017/18: During 2011-16, the demand for power cables segment has revealed stable growth driven by Industrialization, urbanization, thrust on development and diversification projects along with increase in population. However, with the reduction in overall spending by the regional governments during last 12-18 months on back of low oil prices, has resulted in lower off take of cable products during 2017E. We believe from our recent interactions with the management, the margins of new orders secured recently are lower as compared to the previous ones. We maintain our cautious outlook for 2017/18 for the cables industry in the GCC region.

Order backlog declined amid lower Govt spending: As per the management, historically the company has been maintaining three months of order back log. However, the average order book cycle has reduced since 2016. The impact of the downturn in the GCC economies have started reflecting and the company believes there is less visibility seen with regards to improving demand for the cables over the short term. To counteract this, the company has concentrated on specialty cables which will partially mitigate fall in revenues going forward.

Copper price volatility to impact customer buying: The copper prices revealed volatile trend during in Jan-Aug 2017 (YTD) and has touched a high of \$6,600/t recently. The volatility in the copper prices is expected to see the impact of changing customer buying pattern, reflecting in lower sales of the cables manufacturing companies including Oman Cables. In addition, there has been an increased competition from the regional players which implies pressure on the operating margins. Overall, we believe 2017 to remain challenging for the MENA cable manufacturers. We see the commencement of new Investment program (Government and Private) would reinstate cables demand during 2018.

New Electricity tariffs and increase in taxes to impact: With the introduction of new dynamic electricity tariffs for commercial customers starting 2017 by the Oman Government, the charges are set to double in 2017 thereby impacting the gross profit of the company. During 2016 the Electricity and water charges of the group company stood at RO 825K. The details of utility expenses are not disclosed in H1 2017 results. An increase in the income tax rate from 12% to 15% to further weigh on the company performance during 2017.

Subsidiary - OAPIL performance remains dragger: Oman Cables subsidiary Oman Aluminium processing Industries (OAPIL) witnessed significant earnings decline during H1 2017 amid lower demand and drop in margins and this trend is likely to continue rest of 2017. Added recently, Oman Cables has disclosed that the operations of OAPIL have impacted negatively due to disruption in supply of liquid metal to OAPIL from Sohar Aluminium. However, the company is taking alternative steps to obtain the raw material. We do see the performance of OAPIL to drag the group profitability over the short term.

Underleveraged Balance sheet provides comfort for higher dividends, Neutral on Valuations: At current levels, the stock trades at a PE (2017E) of 11.7X and PE (2018E) of 11.0X and provides a dividend yield 4.4%. Post weak H1 2017 results, we have revised lower our 2017E and 2018E earnings and downgrade the stock to '**Neutral**' rating with revised **fair value of RO 1.545 (PE and DCF methodology)**. On the other hand, we see the balance sheet of the company remaining strong with lower level of debt (related to working capital requirements) and provides a case for increasing the dividend payout ratios to c. 70% levels from the current levels of 50%. Assuming 70% dividend payout, the dividend yield increases to 6.1% levels (2017E). Key investment risks include prolonged weakness in the economic environment, increase in working capital cycle and delay in finding alternative arrangement of raw material procurement for its subsidiary.



Financial Highlights - H1 2017

Revenue declines despite surge in raw material prices: During H1 2017, Oman Cables (Parent) reported total revenue of RO 103.730 million, which dropped up by 4.1% YoY. We believe the drop in the revenue was on the back of fall in volumes offtake despite a surge in the raw material prices. For H1 2017, LME copper prices averaged around \$5,755 per tonne as against \$4,707 per tonne in H1 2016, an increase of 22.2% YoY.

The revenue contribution from its subsidiary witnessed a surge of 36.8% on YoY basis for H12017 due to higher aluminium prices. For H1 2017 the LME aluminium prices averaged around \$1,878 per tonne as against \$1,543 per tonne in H1 2016. The group company during H1 2017 posted revenue of RO 125.264 million a marginal rise of 1.1% YoY. This was in line with our estimates.

Gross margins decline on increase in cost of sales: The total expenditure of the parent company declined by 1.1% YoY to RO 92.573 million. The company witnessed further decline in the gross profit which we believe is on the back of higher cost of sales owing to increased operating expenses. The parent company reported a gross profit (GP) of RO 11.157 million which is a decline of 23.7% YoY. The gross profit margins narrowed by 280 bps YoY to 10.8% levels.

At the Group level, the company reported a Gross Profit of RO 11.909 million for H1 2017, a considerable drop of 28.1% YoY. GP margins stood at 9.5% levels as against 13.4% in H1 2016.

Earnings falls amid stiff competition: For H1 2017 the Company's (Parent) reported earnings of RO 5.877 million a decline of 39.8% YoY more in line with decline in revenues. The fall in revenue due to lower offtake coupled with higher cost of sales and an increasing competition from the local and regional cable manufacturers had weighed on the net earnings. The net profit margins of the parent company stood at 5.7% levels in H1 17 as against 9.0% in H1 16.

The Group Company (before minority) reported a net profit of RO 5.544 million a decline of 42.9% YoY. While the Net Profit (after minority) of the group company stood at RO 5.708 million. For H1 2017, the group's net margins stood at 4.6% as against 7.6% in H1 2016.

Subsidiary performance continues to remain bleak: The Company's subsidiary Oman Aluminium Processing Industries (OAPIL) performance continued to disappoint. The company posted a net loss of RO 333k during H1 17 as compared to H1 16 earnings of RO 48k. As per the company, lower demand and drop in margins had weighed on the earnings considerably had a negative impact.

Fall in bank borrowings a positive: There has been a considerable decline in the bank borrowings of the company during H1 2017. There were no long term borrowings and the short-term borrowings (linked to working capital requirements) fell to RO 20.576 million from RO 32.580 million in H1 2016 which remain positive.

Oman Cables (Group) - Income Statement Trend (Quarterly)

Find below the table with the quarterly earnings trend (since Q1 2015) of the company

Period Ended	Q1 15	2Q 15	Q3 15	4Q 15	Q1 16	2Q 16	Q3 16	4Q 16	Q1 17	Q2 17
Avg LME Copper (\$/t)	5,837	6,046	5,267	4,890	4,678	4,736	4,778	5,278	5,838	5,668
QoQ (%)	-12.0%	3.6%	-12.9%	-7.2%	-4.3%	1.2%	0.9%	10.5%	10.6%	-2.9%
Revenue	73,137	72,290	65,219	72,824	61,532	62,412	48,882	55,813	68,082	57,182
QoQ (%)	-7.0%	-1.2%	-9.8%	11.7%	-15.5%	1.4%	-21.7%	14.2%	22.0%	-16.0%
Total Expenditure	64,027	63,310	57,844	63,134	53,161	54,216	43,987	48,677	61,440	51,915
QoQ (%)	-7.6%	-1.1%	-8.6%	9.1%	-15.8%	2.0%	-18.9%	10.7%	26.2%	-15.5%
Gross Profit	9,110	8,980	7,375	9,691	8,371	8,196	4,895	7,136	6,642	5,267
GPM (%)	12.5%	12.4%	11.3%	13.3%	13.6%	13.1%	10.0%	12.8%	9.8%	9.2%
QoQ (%)	-2.2%	-1.4%	-9.0%	31.4%	-13.6%	-2.1%	-23.7%	45.8%	-6.9%	-20.7%
Admin & Gen Expenses	2,745	2,647	2,667	2,721	2,720	2,589	2,087	2,984	2,544	2,370
QoQ (%)	-9.7%	-3.6%	0.8%	2.0%	0.0%	-4.8%	-19.4%	43.0%	-14.7%	-6.8%
EBITDA	6,365	6,333	4,708	6,970	5,651	5,607	2,808	4,152	4,098	2,897
EBITDA Margin (%)	8.7%	8.8%	7.2%	9.6%	9.2%	9.0%	5.7%	7.4%	6.0%	5.1%
QoQ (%)	1.5%	-0.5%	-25.7%	48.1%	-18.9%	-0.8%	-49.9%	47.9%	-1.3%	-29.3%
Profit attributable to the Parent Co	4,777	4,782	3,492	5,456	4,660	4,735	2,461	3,398	3,256	2,452
PAT Margin (%)	6.5%	6.6%	5.4%	7.5%	7.6%	7.6%	5.0%	6.1%	4.8%	4.3%
QoQ (%)	-2.0%	0.1%	-27.0%	56.2%	-14.6%	1.6%	-48.0%	38.1%	-4.2%	-24.7%

Source: MSM; GBCM Research

Q2 2017 Performance

Revenue falls on seasonality: Despite higher copper prices the revenue of the parent company for Q2 2017 declined by 17.4% YoY and 20.0% QoQ to RO 46.097 million. This we believe is on the back of summer and Ramadan impact. However, the subsidiary's revenue jumped (due to low base) to RO 11.085 million an increase of 68.0% YoY and 6.1% QoQ. **The group company reported a revenue of RO 57.182 million for Q2 2017, a modest decline of 8.4% YoY and 16.0% QoQ. This is one of the lowest revenue figures for the group company over the last ten quarters.**

Margin falls as demand slows and competition intensifies: Slowing demand for the power cable products in the region due to ongoing economic downturn along with increasing competition from the local and regional players have resulted in lower margins for Oman cables. The parent reported a gross profit of RO 4.959 million a significant decline of 34.4% YoY and 20.0% QoQ during Q2 2017. The GP Margins of the parent company too narrowed to 10.8% in Q2 2017 as against 13.5% in Q2 2016. While the group posted a Gross profit of RO 5.267 million a considerable decline of 35.7% YoY and 20.7% QoQ. **Group company GP margin contracted by 390 bps to 9.2% on YoY basis.**

Lowest quarterly earnings since 2015: Seasonality impact coupled with slowing demand and high competition in turn weighed on the overall performance of the company which lead to lowest quarterly during Q2 2017. The parent company reported Net income of RO 2.577 million a significant decline of 45.4% YoY and 21.9% QoQ. While the subsidiary reported a loss of RO 239k as against a profit of RO 32k in Q2 2016. The group company reported a Net profit (Profit attributable to the Parent Co) of RO 2.452 million a significant decline of 48.2% YoY and 24.7% QoQ. The NP margins of the parent stood at 5.6% in Q2 2017 as against 8.5% in Q2 2016 while **the group's net profit margin declined to 4.3% in Q2 2017 as against 7.6% in Q2 2016.**

Oman Cables- Relative valuations

Find below the valuation details of key regional comparable for your reference.

Company Name	Country	Mkt Cap (USD Mn)	P/E (x)	P/B (x)	ROA (%)	ROE (%)	EV/EBITDA T12M (x)	Div. Yield (%)
Oman Cables Industry **	Oman	365.8	11.4	1.3	7.9	11.7	7.8	5.4
Gulf Cable & Electrical	Kuwait	352.6	12.5	0.8	5.0	6.8	19.1	3.9
Electrical Industries Co	Saudi Arabia	247.4	18.0	1.5	4.3	8.2	10.2	4.4
Saudi Cable Co	Saudi Arabia	116.5	NA	1.7	NA	NA	NA	NA
El Swedy Electric Co	Egypt	1,158.6	5.0	1.8	16.8	44.0	4.4	5.4
Average- MENA			11.7	1.4	8.5	17.7	10.4	4.8

Source: Bloomberg, GBCM Research, ** 2017E GBCM Estimates

Oman Cables trades at PE (2017E) of 11.4X, which is in line with the MENA Industry average PE (TTM) of 11.7X and the company has been trading at similar PE levels (11x) during the last three years. To arrive at our fair value of the company using PE method, we have assumed 11X on 2017E earnings.

The valuations of Gulf Cables Kuwait trades similar to Oman Cables, while the Saudi Companies are trading at higher valuations (on low earnings). Saudi Cables is undergoing restructuring and has reported losses. On the other hand, El Sewedy (Egypt) is trading at PE (TTM) of 5X, mainly on stronger numbers during last 12 months backed by higher turnkey projects, inventory at lower costs and positive forex impact.

On a EV/ EBITDA basis, Oman Cables trades at 8X, which is lower as compared to regional average of 10.4X. Despite challenging economic environment in the region, the performance of Oman Cables remains relatively resilient during the last ten quarters.

Oman Cables (Group): Income Statement Highlights

In RO 000's	2013	2014	2015	2016	2017E	2018E
Revenue	306,058	303,145	283,470	228,639	242,679	253,218
Cost of Sales	271,666	266,204	244,914	196,622	213,935	223,617
Gross Profit	34,391	36,941	38,556	32,017	28,744	29,601
EBITDA	24,708	26,797	28,240	22,106	19,336	20,230
Depreciation	3,281	3,488	3,640	3,659	3,739	3,818
EBIT	21,427	23,309	24,600	18,447	15,597	16,411
Finance Cost	973	1,351	784	597	450	450
PBT	20,492	21,973	23,817	17,880	15,147	15,961
Tax	2,096	2,095	2,475	2,102	2,272	2,394
PAT	16,886	17,718	18,507	15,254	12,315	12,990

Source: Company; GBCM Research Estimates

Oman Cables (Group): Balance Sheet Highlights

In RO 000's	2013	2014E	2015	2016	2017E	2018E
Fixed assets	38,622	38,056	38,783	37,592	35,603	33,534
Stock	56,077	44,629	37,809	28,684	37,233	38,850
Debtors and prepayments	66,804	71,843	72,146	65,346	69,812	72,844
Cash and cash equivalents	1,275	2,100	2,485	6,601	7,017	11,955
Current assets	126,351	120,071	114,089	100,806	118,051	128,505
Total assets	166,980	160,127	153,544	140,195	155,475	163,886
Share capital	8,970	8,970	8,970	8,970	8,970	8,970
Share Premium	978	978	978	978	978	978
Statutory Reserve	3,569	4,010	4,445	4,445	4,445	4,445
General Reserve	5,958	7,638	9,453	10,992	12,224	13,523
Retained Earnings	48,672	56,376	64,559	70,200	75,127	80,323
Shareholders' Equity	72,461	83,498	92,738	102,000	108,400	115,501
Long Term Borrowings	4,875	3,250	1,625	0	0	0
Short Term Borrowings	58,015	43,033	34,763	11,242	16,625	16,625
Creditors and accruals	26,964	25,608	19,043	22,259	26,376	27,569
Other Liabilities	2,281	2,175	2,709	2,167	2,158	2,274
Total liabilities	166,980	160,127	153,544	140,195	155,475	163,886

Source: Company; GBCM Research Estimates

Oman Cables (Group): Ratios

Key Ratios	2013	2014	2015	2016	2017E	2018E
Margins (%)						
GPM (%)	11.2%	12.2%	13.6%	14.0%	11.8%	11.7%
EBITDA Margins (%)	8.1%	8.8%	10.0%	9.7%	8.0%	8.0%
NPM (%)	5.5%	5.8%	6.5%	6.7%	5.1%	5.1%
Per Share Ratio (In RO)						
EPS	0.188	0.198	0.206	0.170	0.137	0.145
Book Value	0.808	0.931	1.034	1.137	1.208	1.288
Dividend Per Share	0.088	0.090	0.090	0.085	0.069	0.072
Valuation Multiples (X)						
PE	8.3	7.9	7.6	9.2	11.4	10.8
PBV	1.9	1.7	1.5	1.4	1.3	1.2
Dividend Yield (%)	5.6%	5.7%	5.7%	5.4%	4.4%	4.6%
Profitability Ratio(%)						
RoAE (%)	25.2%	22.7%	21.0%	15.7%	11.7%	11.6%
RoE	23.3%	21.2%	20.0%	15.0%	11.4%	11.2%
RoAA (%)	10.8%	10.8%	11.8%	10.4%	8.3%	8.1%
RoA	10.1%	11.1%	12.1%	10.9%	7.9%	7.9%
Leverage Ratios (X)						
Net Debt to Equity	0.9	0.5	0.4	0.0	0.1	0.0
Total Debt to Equity	0.9	0.6	0.4	0.1	0.2	0.1
Current Ratio	0.7	0.6	0.5	0.4	0.4	0.4
Working Capital Ratios (in days)						
Debtors turnover	80	87	93	104	105	105
Creditors turnover	36	35	28	41	45	45
Inventory turnover	75	61	56	53	64	63
Cash Cycle	119	113	121	116	124	123

Source: Company; GBCM Research Estimates



Stock Rating Methodology:

Buy - Upside more than 20%

Accumulate - Upside between 10% and 20%

Neutral - Upside or downside less than 10%

Reduce - Downside between 10% and 20%

Sell - Downside more than 20%

Not Rated - Stocks not in regular research coverage

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