Oman Cables Industry Co. SAOG

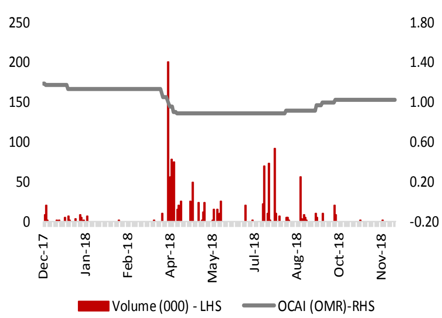
TP : OMR 1.092/share

Date: 02 Dec 2018

Recommendation	**HOLD**
Bloomberg Ticker	OCAI OM EQUITY
Current Market Price (OMR)	1.025
52wk High / Low (OMR)	1.19/0.88
12m Average Vol.	4,951
Mkt. Cap. (USD/OMR mn)	239/91.9
Shares Outstanding (mn)	89.7
Free Float (%)	36%
3m Avg Daily Turnover	971
6m Avg Daily Turnover	3,426
PE 2019e (x)	11.2
PBv 2019e (x)	0.9
Dividend Yield '18e (%)	4.0%

Price Performance:	
1 month (%)	0.00
3 month (%)	11.41
12 month (%)	-13.87

Price Volmue Chart



Source: Bloomberg

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- **Low leveraged company with ability to sustain dividends**
- **Limited growth at top level due to increased competition**
- **Flexible business model to reduce concentration risk**
- **Strong shareholders to provide opportunities for exploring new markets/clients.**

We rate the company as a **HOLD** considering the ability of the company to maintain dividends despite limited growth in business. This comes from relative stability of margins and strong fundamentals. The new **TP of OMR 1.092/share** implies an **upside of 6.5%** to the last closing price. At the current market price, the stock is trading at PE of 11.2x and P/B of 0.89x and offers ROaE of 8.12% on 2019 earnings and a dividend yield of 4% on 2018 earnings.

Export oriented business model amid strong shareholders

Oman Cables is working in a relatively stable industry and we do not see a drop in demand. However, considering the overall macroeconomic indicators in the region and moderately low oil prices, we believe that demand to be slower compared with historical levels. Thus, the ability to explore new market and utilizing the shareholders' clients' network shall open doors for better performance. Nevertheless, we conservatively expect revenue to see a CAGR of 3.1% over 2018e – 2022e and forecast EBITDA margin to stand at an average of 5.2% during the same period. Net profit margins are expected to average 3.2% during the forecast horizon.

Lower need for borrowing and large CAPEX to sustain dividends

With a low net debt to equity ratio of 2.2% and healthy retained earnings (50% of total assets), Oman Cables can easily sustain its dividends history. We expect dividend payout to be 50% for 2018 and to increase further to 55% over the forecast years resulting in an average dividend yield of 4% at current prices. Further, the company has completed majority of CAPEX requirement, which shall also support its ability to increase dividends in future.

Key Ratios	2017	2018e	2019e	2020e	2021e	2022e
GP Margin, %	7.7%	7.1%	7.4%	7.3%	7.2%	7.1%
EBIT Margin, %	3.5%	3.6%	3.8%	3.7%	3.6%	3.5%
PAT Margin, %	2.8%	2.9%	3.2%	3.1%	3.0%	2.9%
PE, x*	14.9	12.5	11.2	11.2	11.2	11.0
PB, x*	1.06	0.93	0.89	0.85	0.83	0.83
Div. Yield, %*	4.0%	4.0%	4.5%	4.9%	4.9%	5.0%
ROE, %	7.11%	7.53%	8.12%	7.76%	7.51%	7.49%

Source: Company Financials, U Capital

* From 2018 onwards are calculated on price as of 2/12/2018

The Company Business Updates

Demand in the key market segments to continue

The company's key target markets such as Utilities, Building and Construction Industries (Commercial), Oil, Gas and Petrochemicals, Industrial -Mining and Processing Plant, Transportation and Residential are progressing well in the region as well as locally. Globally Power sector, for instance, is expected to see investments of USD 260bn during 2018 – 22e, of which USD 152bn is expected for generating additional 117 GW of capacity while the rest is to be invested in transmission and distribution (T&D), according to Arab Petroleum Investments Corporation (APICORP)[1]. APICORP said that the GCC represents 47%, or 151GW, of current MENA power-generating capacity. Yet, around USD 90bn worth of investments is projected over the next five years as per the following table.

Required GCC investment during 2018 - 22 ($bn)

	Generation	T&D	Total
Bahrain	1.9	1.2	**3**
KSA	12.9	8.0	**21**
Kuwait	9.1	5.7	**15**
Oman	5.4	3.4	**9**
Qatar	5.4	3.4	**9**
UAE	20.5	12.7	**33**

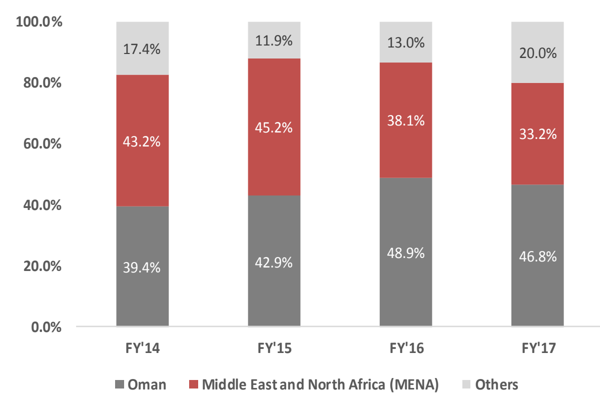
Source: APICORP

In Oman, the latest Oman Power and Water Procurement's (OPWP) 7-year statement covering 2017 – 2024 projects that under the "Peak Demand" scenario, the demand for electricity to post an annual growth of 5.7% for the Main Interconnected System and Dhofar Power System, 20.4% for Ad Duqm Power System and 8.5% for Musandam Governorate. Further, investments planned for 2018 related to Oil and Gas projects are USD 11bn[2] as Omanis focused on developing its gas sector.

Flexible business model with around 50% of revenue generated locally

In 2017, 46.8% of the group's revenue was generated locally. The company local market share is above 60%. Currently, three companies are working within the same industry. Further, outside Oman, the UAE forms 25% of total exports. Considering the drop in oil prices which results in reforms within the power sector and increasing costs, in addition to sluggishness in regional government spending, we expect thinner contribution from the region to the company revenue in favor of other regions.

Revenue geographical segmentation



Source: Company Financials, U Capital

[1] MENA power investment: reforms slowing demand growth

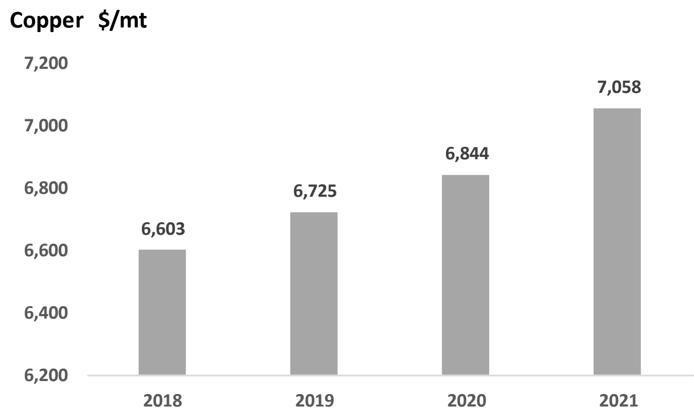
[2] Oman oil, gas investment set at over $11bn in 2018

OAPIL (subsidiary) is back on track

During 2017, OAPIL, which contributes roughly 18% to the group top level, has incurred loss due to the un-remunerative aluminum rod premiums and effect of disruption suffered due to force majeure declared by its main supplier of input aluminum (Sohar aluminum). Starting 2018, the issues at the main supplier were solved and the subsidiary saw stability in its business.

Copper prices are likely to increase as trade war jitters fade

On YTD basis, copper prices stand at USD 6,534 a tonne which is higher than 2017 average by 6%. However, the London Metal Exchange cash copper price in 2019 is seen averaging $6,725 a tonne according to the median forecasts provided by Bloomberg. This positive view is built on more encouraging Chinese macro numbers and hopes for trade war between States and China to be solved. In our view, the prices are not expected to see much improvement considering the mixed fundamental signals and geopolitical tensions globally. Traditionally, higher copper prices support the company's absolute revenue but not necessarily reflect on margins considering pressures on sales prices.



Source: Bloomberg consensus estimates

Challenges include

- **Increasing competition shrinks gross profit margin**

  Gross profit margin has fell from 11% in 2014 to 7.7% in 2017 mainly on lower selling prices due to competition. The company completely hedges its exposure to volatility in international copper price which forms roughly 60% of the top level, while the balance forms other physical materials in costs and the markup. We expect pressures to continue considering the moderate demand and increasing competition.

- **Slower government spending restricts demand growth**

  Oman and GCC market which constitute more than 70% of Oman Cables business are under the mercy of oil prices volatility. Despite better Brent price in 2018 with an average of USD 73.3/barrel on YTD versus an average of USD 51.3/barrel over 2015 – 2017, yet GCC tries to prioritize spending and clearing expensive sovereign debts.

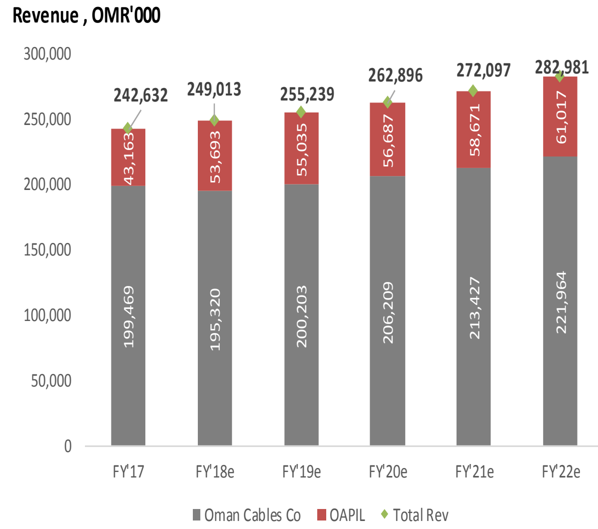
- **Reforms slowing demand growth**

  In order to mitigate the drop in oil prices, many GCC countries have removed critical subsidies within industrial sectors and impose taxes. This include increasing electricity tariffs, merging entities, liberalizing fuel prices and developing regulations. It is likely to slow demand growth in the medium term.

Key Arguments and Outlook

Competition and overall macros to restrict top level growth

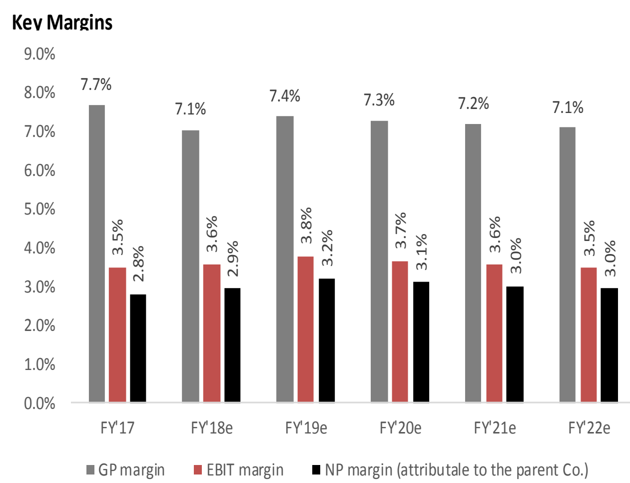
Despite our belief that the industry is doing good and demand is increasing which is driving volume sales, we see drop in realizations as a potential threat which limits the revenue growth. We expect total revenue of OMR 249mn for 2018 up by 2.6% YoY. Currently, we are conservative about macro improvement in the region and thus, we estimate revenue to post a CAGR of 3.1% during 2017 – 22. Oman market to remain the major target with 50% of the total revenue pie followed by the UAE with 20%. The reason behind this view is related to the Omani government commitment towards diversification and free zones promising future.



Source: Company Financials, U Capital

Moderate margins on inability to fully control realizations

Cost of sales to revenue ratio has went up from an average of 91% in 9M'17 to around 93% in 9M'18 despite hedging of the key raw materials, as pressures on realizations continue thus resulting in lower margins starting 2017 not to mention the troubles faced by the subsidiary in the same year. In our view, as majority of the costs, around 70%, is hedged, we do not see much change in current margins in medium term and expect operating profit at 3.6% in 2018, slightly higher than 2017 but notably below than 2014 – 2016 average of 8%. For the forecast years, i.e. 2018 – 2022, we estimate EBIT margin of 3.7%. Similar scenario applies to net profit margin as it is a low debt company and retained earnings is sufficient for any expansions without the need for borrowing.



Source: Company Financials, U Capital

Lower need for borrowing and large CAPEX to sustain dividends

Oman Cables is a low debt company with net debt to equity at 2.2% as at end of 9M'18. Further, notable retained earnings of OMR 69mn, is sufficient to cover any need for financing, payables or additional working capital. We think this is one of the strongest points about the company. We expect level of 50% for dividend payout to be sustained during the forecast period. At current prices, dividend yield stands at 4%.

SWOT Analysis

Strength	Weakness
➢ Low debt company. Organic growth ➢ Ability to maintain dividends. ➢ Stability of business. ➢ Low concentration risk.	➢ Unable to fully control sale price volatility. ➢ Limited growth in the medium term. ➢ Illiquid share considering the shareholding structure and daily market trades. (Top two holders controls 63.3% of the company).
Opportunities	**Threats**
➢ Free Zones such as Ad Duqm project to create demand ➢ Exploring new markets in Africa. ➢ Utilizing its main shareholder i.e. Draka Holding's client network.	➢ Fluctuations in commodity prices linked to raw materials. ➢ Lower government spending in utility and oil sectors. ➢ Increasing competition. ➢ Increase gas prices to Sohar Aluminium to result in higher costs for the subsidiary

Financial Statements

Income Statement, OMR'000	2017	2018e	2019e	2020e	2021e	2022e
Revenue	242,632	249,013	255,239	262,896	272,097	282,981
Cost of Sales	(223,983)	(231,443)	(236,351)	(243,704)	(252,506)	(262,889)
Gross profit	**18,650**	**17,570**	**18,888**	**19,191**	**19,591**	**20,092**
Other income	112	349	250	200	180	220
Admin Exp.	(6,147)	(5,467)	(5,360)	(5,521)	(5,714)	(5,943)
S & D Exp.	(3,930)	(3,366)	(3,829)	(3,943)	(4,081)	(4,245)
Dep	(194)	(172)	(255)	(263)	(272)	(283)
EBIT	**8,491**	**8,914**	**9,694**	**9,664**	**9,703**	**9,841**
Net Finance	(548)	(122)	(217)	(228)	(234)	(232)
Share of results of an associate	(279)	(247)	30	32	35	40
PBT	**7,664**	**8,546**	**9,507**	**9,469**	**9,505**	**9,650**
Tax	(1,799)	(1,341)	(1,426)	(1,420)	(1,426)	(1,447)
PAT	**5,865**	**7,205**	**8,081**	**8,048**	**8,079**	**8,202**
NCI	980	133	150	150	150	150
PAT to the parent	**6,845**	**7,338**	**8,231**	**8,198**	**8,229**	**8,352**

Balance Statement, OMR'000	2017	2018e	2019e	2020e	2021e	2022e
Property, plant and equipment	35,028	34,490	33,093	31,725	30,389	29,090
Available for sale investment	163	163	163	163	163	163
Held to maturity investments	1,000	1,000	1,000	1,000	1,000	1,000
Non Current Assets	**36,191**	**35,653**	**34,256**	**32,888**	**31,552**	**30,253**
Inventories	29,451	33,063	36,362	37,493	38,847	39,681
Trade and other receivables	65,451	65,530	56,720	55,935	56,184	57,751
Due from related parties	4,315	4,315	4,315	4,315	4,315	4,315
Cash and Bank balances	6,791	10,204	17,403	23,835	29,366	30,834
Current Assets	**106,008**	**113,111**	**114,799**	**121,578**	**128,712**	**132,582**
Total Assets	**142,199**	**148,764**	**149,055**	**154,466**	**160,264**	**162,835**
Share capital	8,970	8,970	8,970	8,970	8,970	8,970
Share Premium	978	978	978	978	978	978
Legal reserve	4,445	4,445	4,445	4,445	4,445	4,445
General reserve	12,961	12,961	12,961	12,961	12,961	12,961
Retained earnings	67,738	71,039	75,601	79,684	83,404	83,404
Cumulative Change In fair value	672	672	672	672	672	672
Equity holders of the parent	**95,763**	**99,064**	**103,626**	**107,709**	**111,429**	**111,429**
Non-controlling interests	4,294	4,251	4,447	4,622	4,782	4,782
Total Equity	**100,057**	**103,315**	**108,073**	**112,331**	**116,210**	**116,210**
Deferred tax	1,409	1,409	1,480	1,628	1,872	2,247
Employees' end of service benefits	1,428	1,570	1,797	2,141	2,650	3,406
Non Current Liability	**2,837**	**2,979**	**3,277**	**3,769**	**4,522**	**5,653**
Trade & other payables	29,403	32,145	26,261	27,078	28,056	29,210
Due to related parties	4	4	4	4	4	4
Bank Borrowings	8,324	8,747	9,740	9,774	9,935	10,175
Taxation	1,574	1,574	1,701	1,510	1,536	1,583
Current Liability	**39,305**	**42,470**	**37,705**	**38,366**	**39,531**	**40,972**
Total Liability	**42,142**	**45,449**	**40,983**	**42,135**	**44,053**	**46,625**
Total Equity and Liability	**142,199**	**148,764**	**149,055**	**154,466**	**160,264**	**162,835**

Cash Flow, OMR'000	2017	2018e	2019e	2020e	2021e	2022e
Cash flow from operations	7,720	6,398	8,133	8,819	8,235	8,131
Cash flow from financing	(10,728)	(3,523)	(2,331)	(3,755)	(4,039)	(7,962)
Cash flow from investing	3,198	538	1,397	1,368	1,336	1,299
Net Change	**190**	**3,413**	**7,200**	**6,432**	**5,531**	**1,468**
Cash at the begining	6,601	6,791	10,204	17,403	23,835	29,366
Cash at the end	**6,791**	**10,204**	**17,403**	**23,835**	**29,366**	**30,834**

Key Ratios	2017	2018e	2019e	2020e	2021e	2022e
Margins						
GP Margin, %	7.7%	7.1%	7.4%	7.3%	7.2%	7.1%
EBITDA Margin, %	5.1%	5.0%	5.3%	5.2%	5.1%	5.0%
EBIT Margin, %	3.5%	3.6%	3.8%	3.7%	3.6%	3.5%
PAT Margin, %	2.8%	2.9%	3.2%	3.1%	3.0%	3.0%
Multiples and Equity Valuation						
PE, x*	14.9	12.5	11.2	11.2	11.2	11.0
PB, x*	1.06	0.93	0.89	0.85	0.83	0.83
EV/EBITDA, x*	8.74	7.60	6.56	6.04	5.57	5.38
Div. Yield, %*	4.0%	4.0%	4.5%	4.9%	4.9%	5.0%
Return Ratios						
ROE, %	7.11%	7.53%	8.12%	7.76%	7.51%	7.50%
ROA, %	4.85%	5.04%	5.53%	5.40%	5.23%	5.17%
Liquidity ratio						
Quick ratio, x	1.95	1.88	2.08	2.19	2.27	2.27
Current ratio, x	2.70	2.66	3.04	3.17	3.26	3.24
Leverage ratio						
Debt/ Equity ratio, x	0.08	0.08	0.09	0.09	0.09	0.09

Source: Bloomberg, U Capital, The Company Financials

*From 2018 onwards are calculated on price as of 02/12/2018

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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