Voltamp Energy SAOG

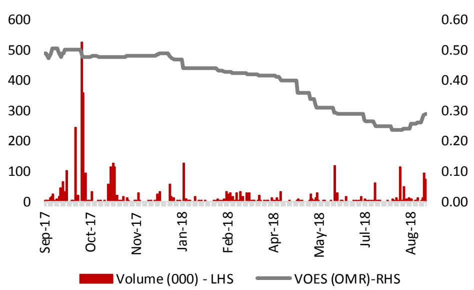
TP : OMR 0.352/share

Date: 13 Sep 2018

Recommendation	**Accumulate**
Bloomberg Ticker	VOES OM Equity
Current Market Price (OMR)	0.297
52wk High / Low (OMR)	0.51/0.225
12m Average Vol. (000)	15
Mkt. Cap. (USD/OMR mn)	63/24.2
Shares Outstanding (mn)	81.4
Free Float (%)	37%
20D Avg Daily Turnover	6,557
3m Avg Daily Turnover	3,480
PE 2018e (x)	20.6
PBv 2018e (x)	1.0
Dividend Yield '18e (%)	3.4%

Price Performance:	
1 month (%)	23.75
3 month (%)	2.41
12 month (%)	-38.57

Price Volmue Chart



Source: Bloomberg

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- **GCC contracts to support earnings and reduce concentration risk**
- **Margins remain under pressure on lower realization and higher cost of sales**
- **Demand for Voltamp to remain intact because of the nature of the business, the company operates in.**

We reduce our target price from OMR 0.516/share to **OMR 0.352/share** in view of challenges faced by the company. However, we assign **Accumulate** rating considering the significant drop in the stock price. The new TP implies an upside of 18.6% to the last closing price. At the current market price, the stock is trading at PE of 20.6x and P/B of 1x and offers ROaE of 5.1% estimates and a dividend yield of 3.4% on 2018 earnings.

Export segment to mitigate the tough domestic environment

Voltamp Energy has recently faced reduction in its operating margins mainly on its inability to pass increasing higher cost of raw materials (not copper which is fully hedged) to end consumers. Couple of reason in our view are behind this including but not limited to:

- Tougher competition which pressurized realizations.
- 60 – 70% of the used raw materials (mainly steel) is not hedged resulting in difficulty of forecasting the volatility of commodity prices during the long term fixed contracts.

We believe the current scenario will witness improvements in the coming period as export business (mainly from Qatar) and other GCC countries is expected to provide better terms of pricing and diversify the income sources. We also estimate better cost control and initiative of marketing high yield products along with obtaining key regulatory approvals in new export markets.

Revenue to grow at a CAGR of 5.6% during 2018-22

We expect revenue to see a CAGR of 5.6% over 2018e – 2022e and forecast EBITDA margin to stand at an average of 7.3% during the same period. Net profit margins are expected to average 4% during the forecasted horizon. Although we expect lower cash dividends for 2018 considering the 1H'18 performance, yet, we likely see continuity of bonus shares in view of converting the share premium to share capital. Moreover, we expect better cash dividends over the medium to long term period. The stock in our view is undervalued taking into consideration the notable drop in the stock price and expected recovery of margins.

Key Ratios	2017	2018e	2019e	2020e	2021e	2022e
Gross Margin	18.5%	13.9%	14.5%	15.1%	15.7%	16.3%
Operating Margin	9.0%	4.1%	4.9%	5.7%	6.5%	7.3%
Net Profit Margin	7.0%	2.5%	3.4%	3.9%	4.6%	5.3%
Debt / Equity (x)	0.43	0.50	0.47	0.50	0.50	0.50
P/E Ratio (x)*	13.2	20.6	11.7	10.9	9.5	7.9
P/BV Ratio (x)*	1.7	1.0	1.0	1.0	0.9	0.9
ROE	13.6%	5.1%	8.7%	8.9%	9.9%	11.7%
ROA	7.3%	2.7%	4.5%	4.6%	5.2%	6.1%
EV/EBITDA (x)	10.2	10.1	6.7	6.4	5.9	5.2

Source: Company Financials, U Capital

* P/E and P/Bv from 2018 onwards is calculated on price of 12/9/2018

The Company Business Updates

- **Local demand for electricity to remain at good growth level.**

According to the latest Oman Power and Water Procurement's (OPWP) 7-year statement which covers 2017 – 2024, the expected demand for electricity in Oman under "Peak Demand" scenario projects 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. Demand to touch 10,072 MW by 2024 compared with actual of 6,776 MW in 2017.

Electricity Demand Projections, Mw	2017	2018	2019	2020	2021	2022	2023	2024	CAGR
Main Interconnected System (MIS)	6,116	6,520	7,000	7,430	7,830	8,300	8,670	9,010	**5.7%**
Dhofar Power System (DPS)	550	570	600	680	710	740	790	810	**5.7%**
Ad Duqm Power System	30	30	40	50	70	80	90	110	**20.4%**
Musandam Power System	80	87	95	101	119	126	133	142	**8.5%**
Total	**6,776**	**7,207**	**7,735**	**8,261**	**8,729**	**9,246**	**9,683**	**10,072**	**5.8%**

Source: OPWP

The existing generation capacity stands at 9,624 MW which is expected to touch its highest level in 2019 at 11,200 MW before going down to around 8,259 by 2024 MW due to a number of contract expirations as per the current agreements which can be extended for some companies. However, despite any scenario, we believe the need for more power generation plants is required at long term level which will support the demand for Voltamp Power transformers.

- **Upcoming Transmission Projects to support distribution transformers products line**

Oman Electricity Transmission Company (OETC), which owns and operates the main electricity transmission network, said in its latest Five-Year Annual Transmission Capability Statement (2018 – 2022) that a total of 55 transmission projects are planned during the above mentioned period.

- **Long term ties with sound clients to protect business from seasonality**

In 2017, Voltamp Power LLC, signed a framework agreement with PDO of which the latter will give priority in purchase of Voltamp Power LLC products in its future project requirements for a period of five years. This is critical acknowledging the key investments of the PDO on yearly basis. According to the company Fact File[1], the company 2017 CAPEX stood at significant number of USD 5.8bn. Further, MEED stated that Petroleum Development Oman (PDO) is planning to invest more than USD 20bn in exploration and production activities by 2021[2].

[1] PDO Fact File 2017
[2] MEED about PDO Investments

- **Qatari Contract to stabilize the income and mitigate domestic competition**

  Voltamp Energy SAOG through its subsidiary (Voltamp Oman Transformer Company SAOC) has signed two contracts for the supply of electric transformers to the Qatar General Electricity and Water Corporation (KAHRAMAA) for a value of OMR 34mn. The transformers will be supplied during 2018 and 2019. We conservatively taken into account the 1H'18 performance, assuming full benefit of this deal to be felt starting 2019 onwards. The expected EPS implying a net profit margin of 2% is 8 Bz. We see more business to come from Qatar as the market offers promising investment opportunities. According to recent studies, Qatar switchgear market value was over USD 548mn in 2017 and is projected to surpass USD 1bn by 2025, backed by investments in infrastructure for the preparation of FIFA World Cup 2022 coupled with increasing power consumption. Moreover, Qatar National Vision, 2030 will play as key driver to keep high investments in development of airports, metros, etc., as well as in power transmission industry.

- **Challenges Include:**
  - **Increasing local competition**

    Voltamp Energy Co. business is distributed among three major categories i.e. 1) Switchgears (20%), 2) Distribution Transformers (40%) and 3) Power Transformers (40%). The company is a dominant and only key player in Oman when it comes to the power transformers segment. However, both distribution transformers and switchgears segments of which Voltamp gets recently the majority of its business is facing increasing completion either from the higher number of new entrants or outsiders. The company current market share is between 40% to 50%.
  - **Drop in demand of company's high yielding products**

    As per the BOD report and the management guidance, there are pressures on demand when it comes to high yield products in each major segment mainly due to lower government spending in utilities sector.
  - **Slowness in getting regulatory approvals from GCC government bodies to some of the company new products**
  - **Volatility in commodities prices creates ambiguity when it comes to long term contracts**

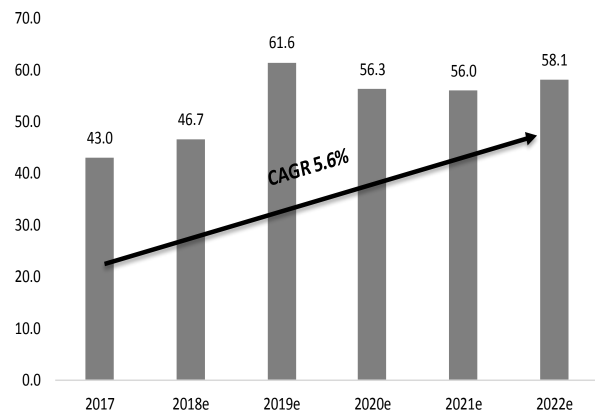
    Many of the company contracts are fixed on the long term one. Although, copper is fully hedged, yet it does not wave away the risk involved in volatility of prices as it only represents 20% of the products raw materials. The balance 80% is mainly Steel and other materials which are not hedged thus leaving the cost risk to be carried by the company.
  - **Bidding at almost no profit basis takes away many tenders from the company**

    Tendering process involves many local and regional players. Many of them bid on very low profit margin basis just for the sake of getting the tender.

Key Arguments and Outlook

GCC contracts to support top level

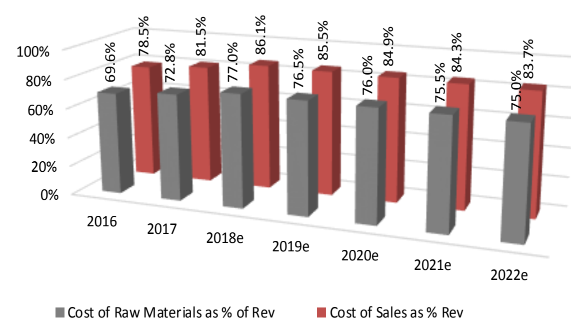
Revenue OMR mn



Source: Company Financials, U Capital

We do not see notable growth of business at domestic market over the short to medium term considering the rationality of spending by the government and increasing competition. Thus we revise our earlier estimates from an annual growth of 5% to 3% on local front. The needed support will come from regional contracts, yet volatility of such source to impact the top level. Over last six quarters, the contribution of export revenue went massively up from 3% in 1Q'17 to over 30% in 2Q'18. We expect 40% to come from export business in the next five years. Overall, we estimate a CAGR of 5.6% during 2018e – 2022e and revenue to increase from OMR 43mn in 2017 to OMR 58.1mn by 2022e.

Inability to pass the on the cost to end consumers, to affect the margins.



Source: Company Financials, U Capital

Cost of sales to revenue ratio has went up from an average of 78% in 1H'17 to above 85% starting 3Q'17 mainly on combination of higher raw materials costs (other than copper which is fully hedged) and the inability to pass such impact to clients as contracts are fixed over long period of time for many products and lower realizations. Copper forms about 25 – 30% of the end product leaving a good chance for volatility to erase profits besides the already low biddings in order to get the deals.

In order to mitigate this scenario the company has decided to look for other markets where it can get better pricing. We do not see much improvements in operating margins in the short to medium term, but expect gradual improvements when GCC contracts come into effect. We expect operating profit margin to average of 5.7% over 2018e – 2022e compared with 10.5% for 2015 – 2017. At net profit level, we estimate an amount of OMR 1.17mn for 2018e down by 61% on yearly basis which is impacted by lower realizations and higher cost of sales. Net profit margin is expected at 2.5% but to improve annually by about 0.3% in view of export contracts.

In absence of major CAPEX, stable earnings to sustain dividends

We assume CAPEX to be 1% of the total revenue over 2018e – 2022e as the company has not disclosed any major investments on the way. We believe one of the company advantage is the possibility of upgradation with minimal investments. We expect lower cash dividends for 2018 at OMR 0.010/share before improving profits because of better utilizations on the GCC contracts.

SWOT Analysis

Strength	Weakness
➢ The sole manufacturer of the Power Transformers in Oman ➢ Proximity to Sohar Industrial Port (Voltamp Power LLC). Thus, quicker connectivity to regional markets and lower delivery costs. ➢ Complete package of services. Voltamp is the only company in the Sultanate with capability of repairing transformers across all ratings and voltage class of up to 400kV ➢ Wide range of products	➢ Unable to control selling prices due to notable stake of non-hedged raw material in production cost. ➢ Heavy concentration in local markets. ➢ Delay in getting regulatory approvals in new markets ➢ Difficulty of controlling the volatility in commodities prices during long fixed contract.
Opportunities	**Threats**
➢ Duqum Refinery project to create demand ➢ Setting up of several of new industrial companies in free zones which creates demand for the company products.	➢ Fluctuations in commodities linked raw materials. ➢ Rising cost of manpower ➢ Lower government spending in utility and oil sectors. ➢ Increasing competition.

Financial Statements

IS, OMR	2017	2018e	2019e	2020e	2021e	2022e
Revenue	43,047,185	46,662,421	61,560,294	56,319,904	55,964,700	58,123,111
Cost of sales	(35,103,630)	(40,160,885)	(52,613,656)	(47,796,939)	(47,159,701)	(48,629,788)
Gross profit	**7,943,555**	**6,501,536**	**8,946,638**	**8,522,965**	**8,804,999**	**9,493,324**
Other income	334,245	233,312	369,362	394,239	447,718	523,108
SG&A	(4,411,858)	(4,836,806)	(6,319,489)	(5,725,215)	(5,633,142)	(5,792,275)
Operating Profit	**3,865,942**	**1,898,042**	**2,996,511**	**3,191,989**	**3,619,575**	**4,224,157**
(Loss)/gain on investments	(576)	6,332	7,599	8,549	9,233	9,694
Finance income	22,920	12,940	11,826	10,824	9,921	9,109
Finance cost	(540,211)	(539,371)	(577,593)	(606,917)	(641,712)	(650,531)
PBT	**3,348,075**	**1,377,944**	**2,438,343**	**2,604,444**	**2,997,017**	**3,592,430**
Taxation	(321,498)	(206,692)	(365,751)	(390,667)	(449,553)	(538,865)
PAT	**3,026,577**	**1,171,253**	**2,072,592**	**2,213,777**	**2,547,465**	**3,053,566**

BS, OMR	2017	2018e	2019e	2020e	2021e	2022e
Property, plant and equipment	9,194,902	8,774,940	8,467,139	8,072,899	7,625,182	7,160,197
Intangible assets	1,026,009	1,026,009	1,026,009	1,026,009	1,026,009	1,026,009
AFS	2,345,346	2,110,811	1,899,730	1,709,757	1,538,782	1,384,903
Deferred tax assets	168,851	215,123	261,395	307,667	353,939	400,211
Non Current Assets	**12,735,108**	**12,126,884**	**11,654,273**	**11,116,333**	**10,543,911**	**9,971,320**
Inventories	11,196,235	11,474,539	15,032,473	13,656,268	13,474,200	13,894,225
Trade and other receivables	19,350,014	17,947,085	18,654,634	19,420,656	21,118,755	21,933,250
Amounts due from related parties	31,622	31,622	31,622	31,622	31,622	31,622
Deposit with finance companies	360,000	360,000	360,000	360,000	360,000	360,000
Cash and bank balances	198,437	1,852,028	2,005,938	4,333,393	4,137,138	4,426,937
Current Assets	**31,136,308**	**31,665,273**	**36,084,667**	**37,801,940**	**39,121,715**	**40,646,034**
Total Assets	**43,871,416**	**43,792,157**	**47,738,940**	**48,918,273**	**49,665,626**	**50,617,354**
Share Capital	7,078,500	8,140,275	8,140,275	8,140,275	8,140,275	8,140,275
Share Premium	4,207,845	3,146,070	3,146,070	3,146,070	3,146,070	3,146,070
Share based payments	1,366,588	1,622,543	1,878,498	2,134,453	2,390,408	2,646,363
Available for sale reserve	-421,952	-421,952	-421,952	-421,952	-421,952	-421,952
legal reserve	2,724,020	2,611,157	2,498,293	2,385,430	2,272,566	2,159,703
Retained Earnings	8,132,048	8,052,259	9,199,421	9,932,601	10,361,206	10,564,811
Total Equity	**23,087,049**	**23,150,352**	**24,440,605**	**25,316,877**	**25,888,573**	**26,235,270**
Long term loans	2,060,366	2,266,403	2,493,043	2,742,347	3,016,582	3,318,240
Deferred government grant	2,134	0	0	0	0	0
End of service benefits	573,203	653,451	744,935	849,225	968,117	1,103,653
Non Current Liabilities	**2,635,703**	**2,919,854**	**3,237,977**	**3,591,573**	**3,984,699**	**4,421,893**
Trade and other payables	10,179,101	8,366,851	10,961,178	9,957,696	9,824,938	10,131,206
Bank borrowings	6,823,686	8,166,899	7,797,658	8,625,954	8,404,126	8,114,865
Amounts due to related parties	21,594	55,000	55,000	55,000	55,000	55,000
Current portion of term loans	1,124,283	1,133,201	1,246,521	1,371,174	1,508,291	1,659,120
Current Liabilities	**18,148,664**	**17,721,951**	**20,060,358**	**20,009,823**	**19,792,354**	**19,960,191**
Total Liabilities	**20,784,367**	**20,641,805**	**23,298,336**	**23,601,396**	**23,777,053**	**24,382,085**
Total Equity + Liability	**43,871,416**	**43,792,157**	**47,738,940**	**48,918,273**	**49,665,626**	**50,617,354**

Source: Company Financials, U Capital

CF, OMR	2017	2018e	2019e	2020e	2021e	2022e
Cash flow from Operations	43,544	517,034	401,435	1,820,477	898,676	2,125,314
Cash flow from Investing	1,239,255	654,496	518,883	584,212	618,693	618,863
Cash flow from Financing	-1,748,868	482,060	-766,407	-77,235	-1,713,625	-2,454,378
Net Cash at End	198,437	1,852,028	2,005,938	4,333,393	4,137,138	4,426,937

Key Ratios	2017	2018e	2019e	2020e	2021e	2022e
Gross Margin	18.5%	13.9%	14.5%	15.1%	15.7%	16.3%
Operating Margin	9.0%	4.1%	4.9%	5.7%	6.5%	7.3%
PBT Margin	7.8%	3.0%	4.0%	4.6%	5.4%	6.2%
Net Profit Margin	7.0%	2.5%	3.4%	3.9%	4.6%	5.3%
Debt / Equity (x)	0.43	0.50	0.47	0.50	0.50	0.50
EPS, OMR	0.043	0.014	0.025	0.027	0.031	0.038
CMP (OMR)	0.564	0.297	0.297	0.297	0.297	0.297
P/E Ratio (x)	13.2	20.6	11.7	10.9	9.5	7.9
P/BV Ratio (x)	1.7	1.04	0.99	0.95	0.93	0.92
Dividend Yield	2.7%	3.4%	5.1%	6.7%	8.4%	8.4%
ROE	13.6%	5.1%	8.7%	8.9%	9.9%	11.7%
ROA	7.3%	2.7%	4.5%	4.6%	5.2%	6.1%
EV/EBITDA (x)	10.2	10.1	6.7	6.4	5.9	5.2

Source: Company Financials, U Capital

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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