

# Management Discussion and Analysis Report

## Industry Overview

On 1 August 2004, the Sector Law was issued with the objective of regulating the management and privatization of the electricity and water sector. The Sector Law is applicable to all the companies and establishments operating in the sector of electricity and water, including Phoenix Power.

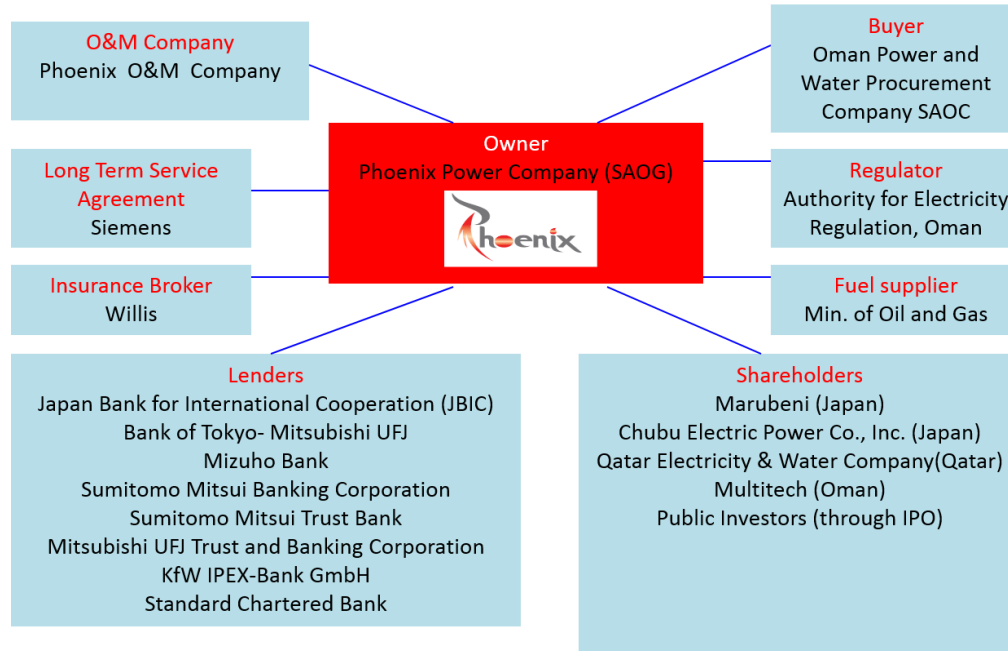
Following the implementation of the Sector Law, each of the functions of electricity generation, transmission, distribution and supply is subject to regulation. A “Single buyer” market structure has been adopted (with OPWP as the central buyer) and a system of non-discriminatory access to license transmission and distribution systems established. To follow their objectives, a single procurement company, OPWP has been established as well as a holding company, EHC. AER is established pursuant to the Sector Law, and is competent to regulate the electricity and related water sector. AER is an administratively and financially independent entity.

OPWP is the single buyer of power and water for all IPP / IWPP projects within Oman. OPWP is responsible for ensuring that there is sufficient electricity and water production capacity available at the lowest cost to meet growing demands in Oman. OPWP undertakes long-term generation planning and publishes an annual seven-year statement, which identifies new IPP/IWPP projects to be competitively tendered and developed by private sector entities, in order to meet the future power generation and water desalination requirements of Oman. Article 74 of the Sector Law specifies the functions and duties of OPWP, including but not limited to:

- Securing production capacity and output to meet demand for electricity in the MIS and Salalah System, in coordination with RAECO;
- Securing production capacity and output to meet demand for desalinated water in Oman;
- Meeting requirements for new electricity and desalinated water capacity in Oman, with new projects to be designed, constructed, financed, owned and operated by local and foreign investors; and
- The purchase, procurement, and management of production capacity and output, ancillary services and all goods and other services on the basis of economic purchase.

In January 2014, OPWP announced its intention to introduce new power and water procurement arrangements for the MIS. Whilst OPWP will retain its role as the Single Buyer for electricity, its proposals include the introduction of a “Spot Market” and more flexible processes for awarding new or extending existing PPAs.

## The Business Model



## Power Purchase Agreement (PPA)

Phoenix Power has entered into the PPA with OPWP who is the sole purchaser for a 15 year period until 31 March 2029. Under the PPA, Phoenix Power is obliged to exclusively sell electrical energy output to OPWP and in return, receive from OPWP capacity charges, electrical energy charges and fuel charges. Capacity charges are designed to cover fixed costs (including debt service and return on capital); electrical energy charges are designed to cover variable operating costs of generation (excluding fuel costs). The fuel charge is the amount payable to compensate Phoenix Power for the total fuel demand required for the production of electrical energy to be delivered in accordance with the terms of the PPA.

The PPA is resilient to changes in gas prices and power demand.

## Natural Gas Sales Agreement (NGSA)

The NGSA was entered into between MoG and Phoenix Power. It establishes the terms upon which Phoenix Power purchases natural gas as feedstock for the Plant from the MoG. The NGSA term is linked to the PPA term and, therefore expires on 31 March 2029. The NGSA term will automatically be extended to reflect any extensions to the term of the PPA.

In accordance with the NGSA, natural gas will be supplied up to the gas delivery point of the Plant. Phoenix Power has no obligation to pay the MoG for any natural gas delivered and accepted until Phoenix Power has received the amount of the PPA payment from OPWP.

## Financial Arrangement

The Company has entered into financing agreements with a consortium of international banks and an export credit agencies, for an aggregate amount of approximately RO 459 million. The Company senior debt is hedged in compliance with the requirement of the financing agreements through entering into interest rate swap agreements which further improves the predictability of cash-flows available to shareholders.

### Operation and Maintenance

The technical risk is considered low as the Plant uses proven technology from renowned international suppliers. POMCo is the operator and maintainer of the Plant through the O&M Agreement with the Company. In addition, the maintenance of the gas turbines, which is a specialized activity, has been contracted on a long-term basis to the original equipment manufacturer, Siemens, whose capabilities in this area are among the best globally.

### Discussion on Operational and Financial Performance

#### Operating Highlights

Please refer to Section “Operations Highlights” for the operational performance of the Company.

#### Financial Highlights

All figures in RO Millions		2015	2014
Revenues	1	101.87	2.27
Net Profit	2	28.77	11.31
Net Profit before Finance Costs	3	51.83	12.56
Total Assets	4	636.25	654.82
Capital (Paid-up)	5	146.26	146.26
Shareholders' Fund (Net Assets)	6	137.20	118.13
Term Loans <sup>^</sup>	7	412.97	435.94
Weighted average number of shares*	8	1,462.60	1,098.2
Actual number of shares outstanding*	9	1,462.60	1,462.60
Ordinary Dividends	10	6.59	Nil

Key Financial indicators		2015	2014
Net Profit margin	2/1	28.24%	498.24%
Return on Capital (Paid-up)	2/5	19.67%	7.73%
Return on Capital Employed	3/(6+7)	9.42%	2.27%
Debt Equity ratio	7 : 6	75.1 : 24.9	78.7 : 21.3
Net assets per share (Baizas)	6/8	93.8	107.6
Basic earnings per share (Baizas)	2/8	19.67	10.30
Dividends per share (Baizas)	10/9	4.51	Nil

*^Excluding unamortised transaction cost*

*\* Nominal value per share in 2014 was RO 1 but for comparison purposes 100 Baiza per share is assumed*

### **Analysis of Profit and Loss**

2015 is the first full year of operation as the Company entered Commercial Operation on 11 December 2014 and therefore only saw 22 days of operation during the year. Accordingly, a meaningful comparison cannot be made between 2015 and 2014 profit & loss. A brief analysis is provided in the ensuing paragraph.

Revenues of RO 101.87 million in 2015 were higher when compared to RO 2.27 million in 2014. The Net Profit of RO 28.77 million in 2015 is higher than the RO 11.30 million in 2014 mainly due to the fact that in 2014 only 22 days of revenue associated with the commercial operation was achievable. In addition, liquidated damages of RO 23.51 million were recognized in 2015 compared with RO 22.30 million being recognized in 2014 under the EPC Contract.

### **Analysis of Balance Sheet**

Total Assets of the Company stood at RO 636.25 million as on December 31, 2015 as compared to RO 654.82 million in 2014. This was mainly due to a full year's depreciation being charged for the year.

The cash and cash equivalents stand at RO 20.57 million as at December 31, 2015 as compared to RO 14.74 million at the same date in 2014.

The Shareholders' Funds (Net Assets) at RO 137.20 million as of December 31, 2015 were lower when compared to RO 118.13 million at the same date in 2014 due to dividend distribution in line with the net profit for the year.

Hedging Reserve (net of Deferred Tax) reducing Equity by RO 43.32 million reflects the fair value of the seven interest rate swaps and three currency swaps as at the balance sheet date and does not impact the Company's capability to distribute dividends to the shareholders.

Term Loans (including non-current and current balances) reduced to RO 412.97 million as a result of scheduled repayments in accordance with financing agreements.

The Company continues to make adequate provision for asset retirement obligation to enable it to fulfil its legal obligation to remove the plant at the end of its useful life and restore the land.

### **Dividend Distribution**

The Company follows a balanced dividend pay-out policy, subject to debt repayments, working capital and operational expenditure obligations. The Company's dividend distribution in 2015 was RO 2.49 million (translating to 1.7 Baizas per share) and paid out of the audited retained earnings for the year ended 31 December 2014.

### **Dispute with EPC Contractor**

Phoenix Power has withheld or been paid a total of US\$ 179.7 million of LDs by the EPC Contractor under the EPC Contract in relation to delays in achieving the Early Power

Completion Date (“EPCD”) beyond the Scheduled Early Power Completion Date (US\$ 29.5 million) and in achieving the COD beyond the Scheduled COD (US\$ 150.2 million).

Phoenix Power’s entitlement to LDs is contested by the EPC Contractor, who has so far submitted:

a claim for recovery of all the LDs in respect of the delay in achievement of the EPCD, as well as associated increased costs and other relief (the Early Power Claim); and

a claim for recovery of LDs in respect of the delay in achievement of the COD, as well as associated increased costs and other relief (the Final Power Claim),

in each case because, the EPC Contractor alleges, the relevant delays were the responsibility of Phoenix Power.

During 2015,

(i) Early Power Claim

The Early Power Claim has been settled with the EPC Contractor.

(ii) Final Power Claim

According to the EPC Contractor, the Final Power Claim relates to events concerning the Omani electricity grid which, if the EPC Contractor is correct, may be the responsibility of OPWP under the PPA. The EPC Contractor has, therefore, exercised its right under the EPC Contract requiring Phoenix Power to make a claim against OPWP under the PPA equivalent to the Final Power Claim. Discussions in relation to the Final Power Claim are on-going.

## **Omanisation**

The Ministry of Manpower has issued a Ministerial Decision No 248/2014 (the “MD”), published in the Official Gazette on 14th September 2014, and effective on the day following its publication, by means of which the Ministry has determined the Omanization percentage to be achieved in private sector enterprises operating in the electricity and water sectors.

Endeavours to achieve the Omanization requirements are ongoing and based on an holistic human resources approach which includes attracting the necessary talent, developing that talent through training and expertise transfer, consideration of a balanced approach to remuneration and reward as well as creating a positive working environment and culture.

## **Outlook**

All reasonable and prudent measures will be taken by the Management of the Company to ensure high standards of health, safety, environmental compliance reliability and availability are maintained over 2016.

Discussion and analysis of the EPC Contractor Claim in relation to Final Power will continue.

### **Internal Control System**

The Board of Directors and management of the Company believes in the importance of the internal control system. Since before conversion to an SAOG, and in recognition of the need to continually focus on controls, the company has appointed a full-time internal auditor in December 2013. An internal audit plan was developed for 2015 and implemented with recommendations being provided to the Audit Committee who meet once per quarter.

The management of the Company is fully committed to implementing the agreed recommendations arising in the internal audit reports.