

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.

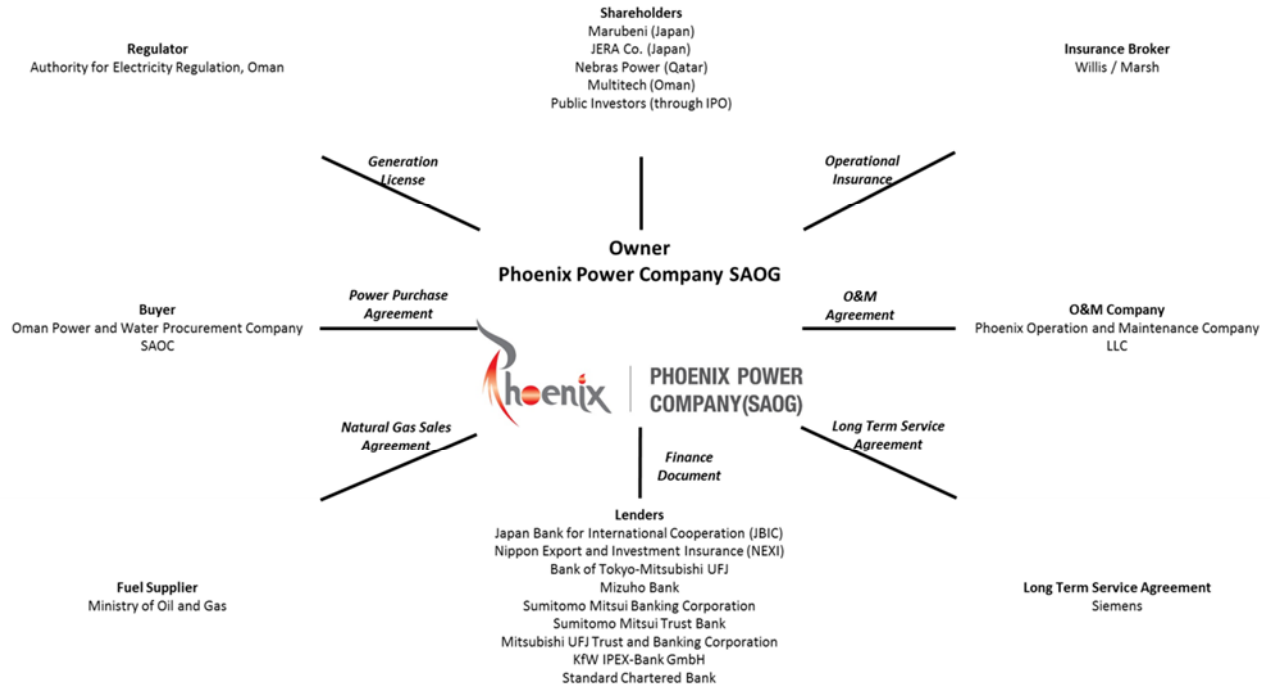
OPWP is the single buyer of power and water for all IPP / IWPP / IWP projects within Oman. OPWP is responsible for ensuring that there is sufficient electricity and water production capacity available at the lowest cost to meet growing demands in Oman. OPWP undertakes long-term generation planning and 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.

OPWP intends 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.

Risk Management

The Company has a well established contractual framework which mitigates commercial risk as shown below:



Risk Management Process

The Company has a comprehensive risk management framework in place aimed at identifying principal risks that threaten achievement of business objectives and enables assessment of their significance to be understood. Mitigating controls to manage identified risks to an acceptable level are then put in place.

All new and emerging risks are reviewed as well as any changes to existing risk levels. The risks are reviewed every quarter and reported to the Board of Directors.

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 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.

EPC Contract Claim

PPC has previously withheld or been paid liquidated damages by the EPC Contractor, Daewoo under the EPC Contract in relation to delays in achieving the Scheduled Plant Completion Date and Daewoo has contested PPCs entitlement to the liquidated damages (the “Final Power Dispute”).

On 31 May 2017, PPC and the EPC Contractor agreed to settle the Final Power Dispute with an outcome which resulted in a cash payment to the Contractor of RO 4.5 million.

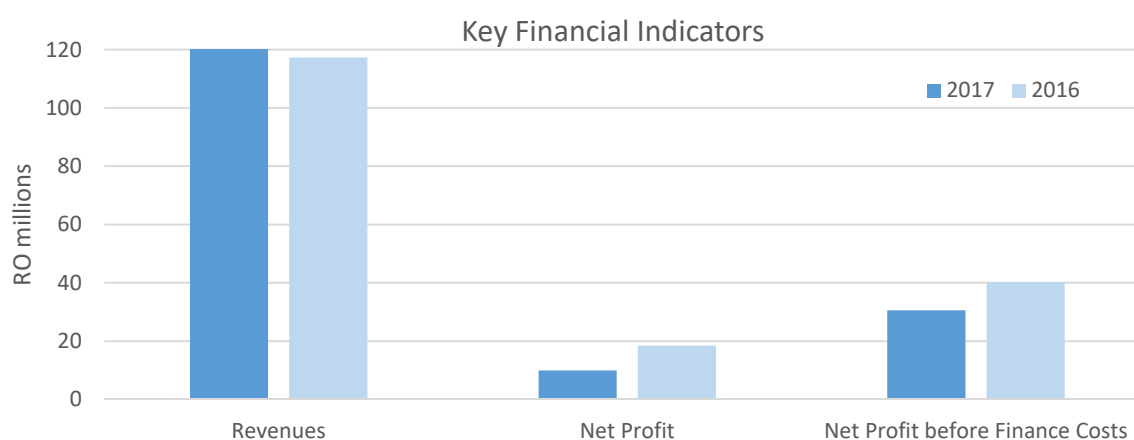
Discussion on Operational and Financial Performance

Operating Highlights

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

Financial Highlights

All figures in RO Millions		2017	2016
Revenues	1	128.40	117.30
Net Profit	2	9.98	18.46
Net Profit before Finance Costs	3	30.61	40.18
Total Assets	4	598.36	623.92
Capital (Paid-up)	5	146.26	146.26
Shareholders' Fund (Net Assets)	6	165.34	153.28
Term Loans [^]	7	364.44	388.93
Weighted average number of shares	8	1,462.60	1,462.60
Actual number of shares outstanding	9	1,462.60	1,462.60
Ordinary Dividends	10	11.55	8.78



Key Financial indicators		2017	2016
Net Profit margin	2/1	7.77%	15.74%
Return on Capital (Paid-up)	2/5	6.82%	12.62%
Return on Capital Employed	3/(6+7)	5.78%	7.41%
Debt Equity ratio	7 : 6	68.8 : 31.2	71.7 : 28.3
Net assets per share (Baizas)	6/8	113.05	104.80
Basic earnings per share (Baizas)	2/8	6.82	12.62
Dividends per share (Baizas)	10/9	7.90	6.00

[^]Excluding unamortised transaction cost

Analysis of Profit and Loss

Revenues of RO 128.40 million in 2017 were higher when compared to RO 117.30 million in 2016 mainly due to higher commercial availability and increased dispatch (pass-through) of the plant. The Net Profit of RO 9.98 million in 2017 is lower than the RO 18.46 million in 2016 mainly due to the recognition of liquidated damages and the impact by the amendment to the corporate income tax law in the Sultanate of Oman by virtue of Royal Decree 9/2017 issued on 19 February 2017 and published in the Official Gazette on 26 February 2017. Liquidated damages were

retained by the Company, under the terms of the EPC Contract, as a consequence of delays to the commercial operation date of the plant. Liquidated damages of RO 5.35 million have been recognized in 2017 compared with RO 10.12 million recognized in 2016. The impact which have been recognized in 2017 by the change of tax law on the deferred tax liability for the prior years is RO 5.19 million.

Analysis of Balance Sheet

Total Assets of the Company stood at RO 598.36 million as at 31 December 2017 as compared to RO 623.92 million in 2016. This was mainly due to a full year's depreciation being charged for the year.

The cash and cash equivalents stand at RO 14.13 million as at 31 December 2017 as compared to RO 22.49 million at the same date in 2016.

The Shareholders' Funds (Net Assets) at RO 165.34 million as at 31 December 2017 were higher when compared to RO 153.28 million at the same date in 2016 **due to profit for the year being offset by the dividend distribution in line with the net profit for the year.**

Hedging Reserve (net of Deferred Tax) reducing Equity by RO 23.01 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 364.44 million as a result of scheduled repayments in accordance with financing agreements.

The Company continues to make adequate provision for asset retirement obligations 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 2017 was RO 9.07 million (translating to 6.2 Baizas per share paid in July 2017 and January 2018) and paid out of the audited retained earnings for the year ended 31 December 2016.

Dispute with EPC Contractor

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Omanisation

Omanisation levels across the business approximate to 67%. 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 2018.

The settlement of the Final Power Claim with the EPC Contractor will have an impact on future dividends.

Internal Control Systems

The Board of Directors and management of the Company believes in the importance of the internal control system and PPC has a comprehensive system of internal controls in place, comprising:

- A well defined governance structure.
- Clearly defined delegated levels of authority.
- Documented key business processes.
- Plans and annual budgets which will deliver the Company strategy supported by regular reporting of these plans and budgets to the Board of Directors.

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. An internal audit plan was developed for 2017 and implemented with recommendations being provided to the Audit Committee who meet once per quarter. No significant failings or weaknesses have been identified in PPCs system of internal controls in the year ended 31 December 2017.

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