Analysis

October 2007

Oman Power and Water Procurement Co. S.A.O.C.

Sultanate Of Oman

Table of Contents:

Analyst Contacts:

Dubai International Financial Centre 971.4.365 0283

Philipp Lotter
Vice President –Senior Credit Officer

Raffaele Semonella
Senior Associate

London 44.20.7772.5454

Helen Francis
Vice President –Senior Credit Officer

Stuart Lawton
Team Managing Director

Corporate Profile

The single buyer and seller of electricity and related water in Oman, thus underpinned by very low-risk regulated activities and full government ownership

Oman Power and Water Procurement Co. S.A.O.C. (OPWP), rated A2 with a stable outlook, undertakes fully regulated electricity and related water procurement services within the Sultanate of Oman. Established in 2003, it has the exclusive right[1] to act as the sole buyer of electricity and related water from licensed production facilities, and as the sole seller of electricity and related water to licensed electricity suppliers and water authorities. OPWP's primary focus is its duty to ensure sufficient capacity and output is available to meet the requirements of licensed electricity suppliers and to maximize the co-production of electricity generation and desalination water production where economical to do so. OPWP also liaises with water authorities with respect to the requirements for related desalinated water capacity in Oman over a 7-year time horizon. If new capacity is needed, the OPWP initiates fair and transparent competitions open to international investors to contract for the country's electricity and related water capacity requirements.

OPWP is a joint stock company (JSC), owned 0.01% by the Ministry of Finance of Oman and 99.9% by Electricity Holding Company SAOC, which is itself wholly-owned by the Ministry of Finance. Electricity Holding Company acts as the government vehicle that presently owns all government-owned constituents of the Omani electricity and related water sector (generation / desalination, transmission, distribution, supply and procurement), through which the government may ultimately execute its privatisation programme. It also provides financial accounting services and funding to government-owned companies in the sector. OPWP is one of two companies in the sector that – by law – cannot be privatised and will remain wholly-owned by the government.

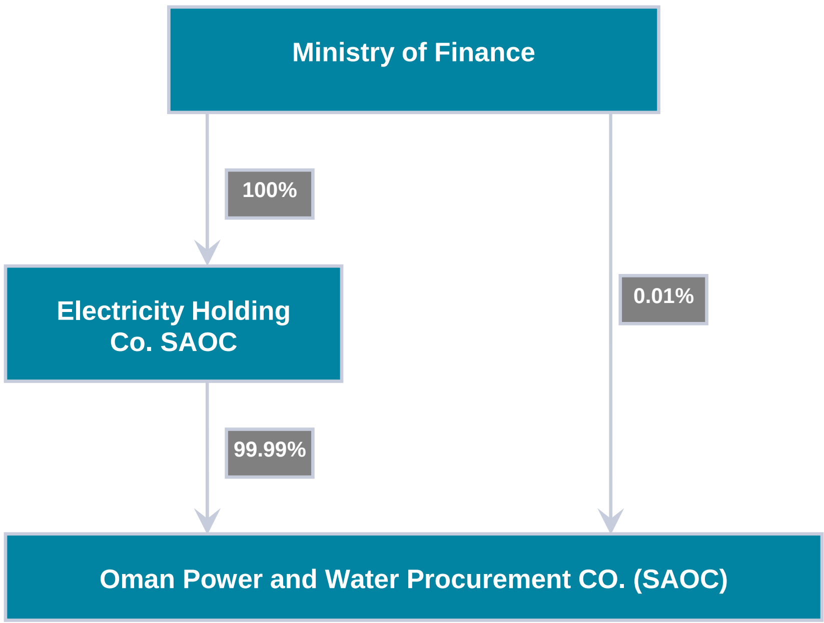
[1] Subject to certain limited exceptions

This Credit Analysis provides an in-depth discussion of credit rating(s) for Oman Power and Water Procurement Co. S.A.O.C. and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website. Click here to link.

Oman Power and Water Procurement Co. S.A.O.C.

Moody's views OPWP's business profile as very low risk, given the tight regulatory limitations on its business activities, its clearly defined mandate and the full pass-through of market risk that it provides under normal circumstances. The company does not undertake any production activities, but acts merely as a bulk purchaser and seller of electricity and desalinated water. Its regulatory framework and the stability thereof constitute the main emphasis of its credit risk assessment. Given its 100% ownership by the government of Oman and the statutory restriction on its privatisation, Moody's views OPWP as a government-related issuer (GRI).

Figure 1: Oman Power and Water Procurement Co. (SAOC) Ownership Structure



Key Rating Considerations

OPWP's rating are underpinned by its low-risk agency-like function

> …it is permissible for any Person to purchase shares in any…(successor companies)… except the Oman Power and Water Procurement Company which shall continue to be wholly-owned by the Government.
>
> **Royal Decree 78/2004, Part I, Article (14)**

Moody's assessment of the regulatory framework under which OPWP operates supports the company's low-risk business profile. At the same time, much of the company's credit risk profile hinges on the stability of the regulatory regime, in particular the continuity of its right to pass through procurement costs (thus eliminating market risk exposure) and the regulator's acceptance of its costs as reasonable and consistent with efficient operation and economic purchase. Although the regulatory framework has only been established in recent years, Moody's ratings thus assume that no regulatory changes will be made that could fundamentally alter OPWP's business risk profile to the detriment of creditors. In particular, Moody's cautions that any attempt by the government to phase out the still substantial state subsidies to the distribution companies by utilising OPWP to absorb some of the costs would harm the company's credit profile. This is neither planned nor anticipated.

As an entity that is ultimately 100% owned by the government, and given the strategic role it plays in the country's energy sector, the company's ratings not only incorporate its fundamental credit factors as expressed in its baseline credit assessment, but also the assumption of high government support, in the event of such a requirement. In Moody's view, the government of Oman would lend direct or indirect financial support to OPWP in all circumstances, and indeed is required by law to do so. Whilst this would normally provide uplift to the company's ratings, this is not the case for OPWP, as its baseline credit assessment is already at the A2 level of the Omani sovereign rating.

The Sector Law ultimately makes the government a funder of last-resort for any licensed company wholly-owned by the government operating in the electricity and related water sector

According to the Law for the Regulation and Privatisation of the Electricity and Related Water Sector, the Government of Oman will not sell its stake in OPWP, although it is fully committed to pursuing its privatisation policy in the wider sector. The stability of state ownership therefore further supports Moody's high government support assumption, as does the legal commitment by the Ministry of Finance to secure availability of *"adequate finance"* to successor entities to enable them to undertake statutory activities *"as long as the companies are wholly-owned by the government"*[2]. Furthermore, the government exercises strong influence over the company's corporate governance, as the Board of Directors is elected by the Ministry of Finance after the approval of the Council of Ministers.

The rating also factors a high degree of dependence between OPWP and the Omani government, given the high shared economic risk between the two entities, and the fact that OPWP is entirely reliant on domestic revenues.

The government of Oman has fully restructured its power sector, putting in place a framework for privatisation whilst retaining control over the procurement process through OPWP

In 2004, the government of Oman approved the "Law for the Regulation and Privatisation of the Electricity and Related Water Sector". The Law was promulgated by the Royal Decree 78/2004 and created a new regulatory framework aimed at achieving the progressive privatisation of the electricity and related water sector in Oman. This included the transfer of all relevant assets and liabilities previously held by the Ministry of Housing, Electricity and Water to ten successor entities under the government-owned Electricity Holding Company.

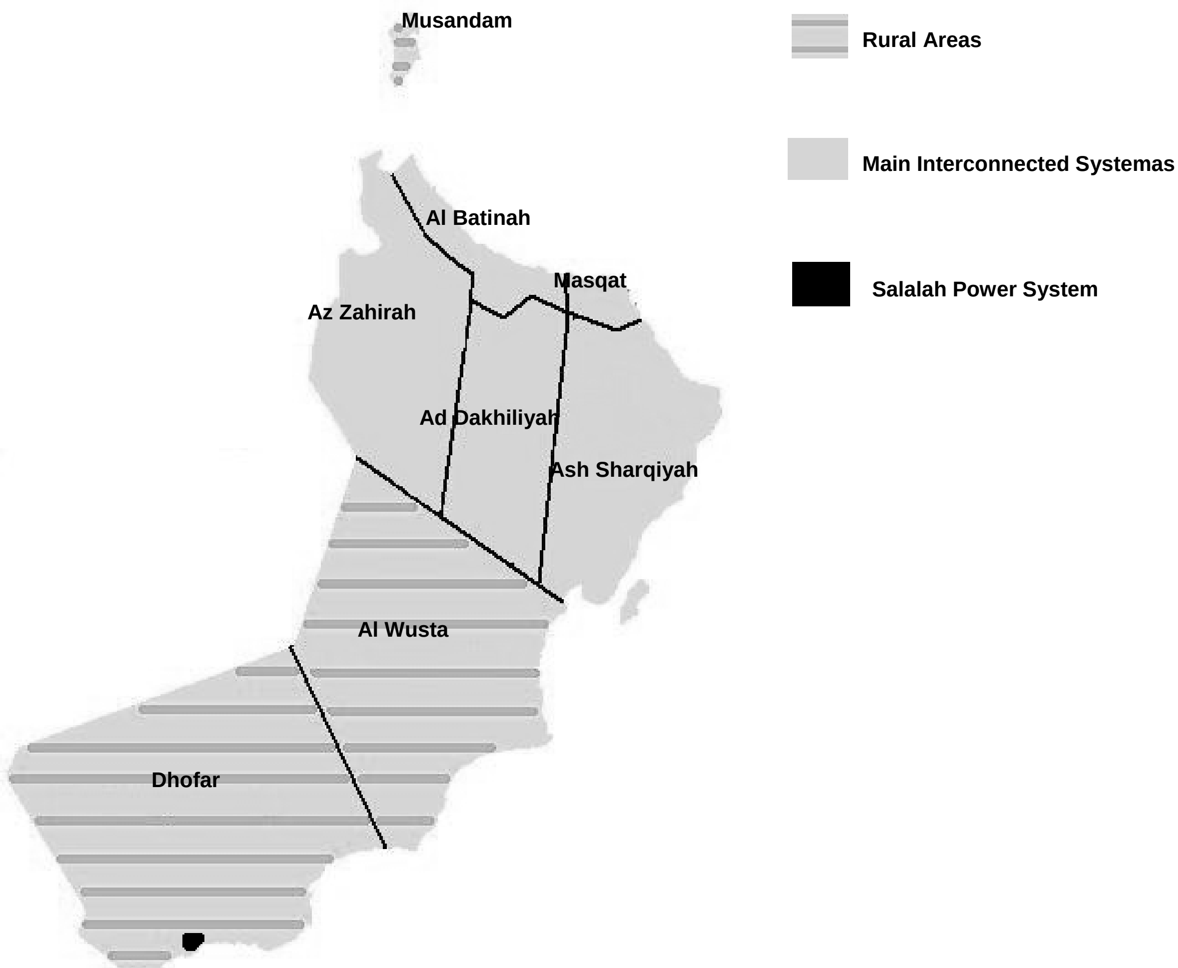
The Omani electricity and related water sector consists of three distinct geographic areas. Full legal unbundling of the transmission networks was implemented in the more densely populated northern part of Oman. This is known as the Main Interconnected System (MIS) and covers around 90% of the country's power demand. Conversely, the vertically integrated Rural Areas Electricity Company (RAEC) is responsible for supply in remote Rural Areas. The Dhofar Power Company (DPC) is a vertically integrated entity responsible for supply in the Salalah area of the Dhofar Governorate. Consequently, the vast majority of Oman's power supply today has organised generation, transmission, and distribution and supply activities in separate legal entities. The regional segmentation is shown in Figure 2.

In 2001, DPC was awarded a 20 year contract from the Omani government to build, operate and transfer (BOOT) a 240 MW new gas turbine station in Salalah in the far south of the country. The company is responsible for generation, transmission, distribution and supply of electricity for the area with over 48,000 customers.

[2] Royal Decree 78/2004, Part III, Article (67).

Oman Power and Water Procurement Co. S.A.O.C.

Figure 2: Oman's Electricity System: Geographic Distribution



The Main Interconnected System (MIS) represents approximately 90% of Oman's power market and has been fully unbundled

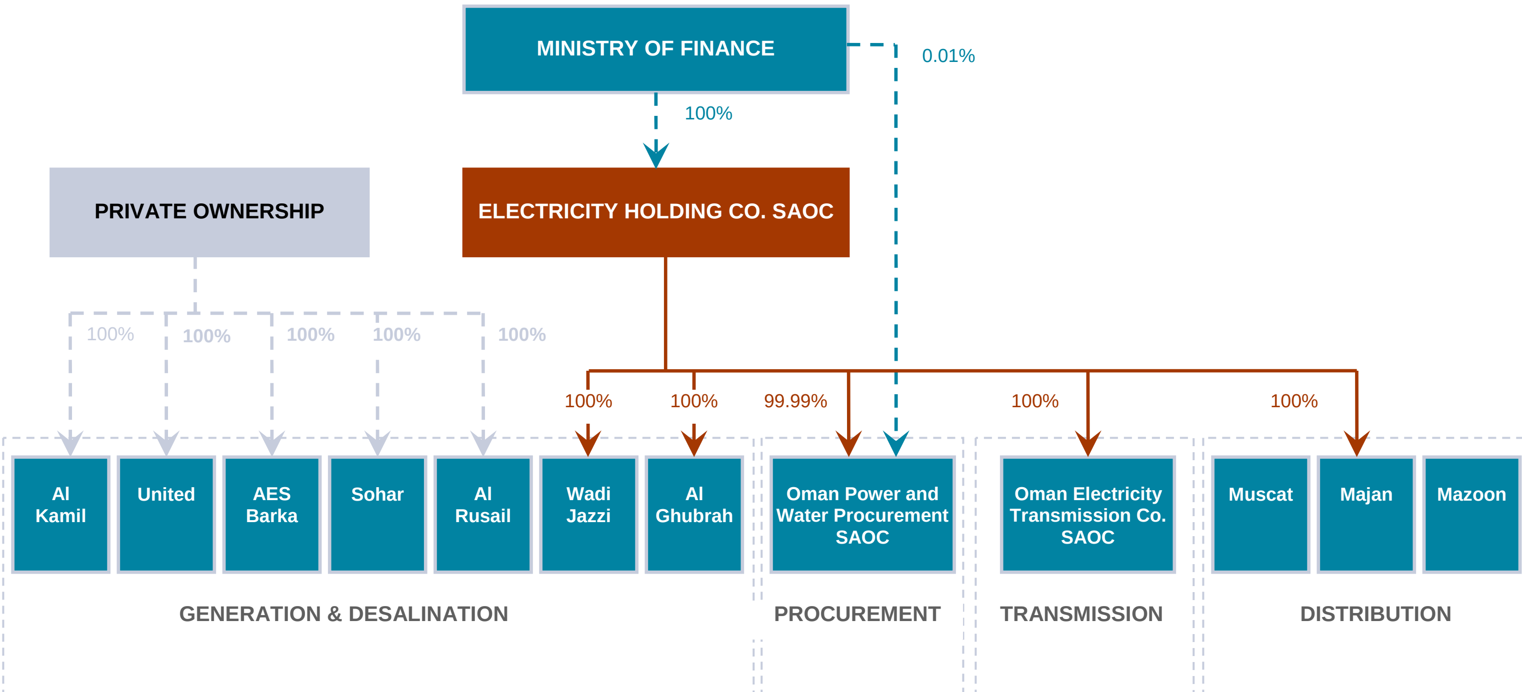
The MIS represents around 90% of the total electricity market in Oman. It comprises twelve licensed entities, most of them wholly-owned by the Ministry of Finance through Electricity Holding Company:

- Oman Electricity Transmission Company SAOC (OETC); an independent transmission company, which owns, finances and operates the transmission network.
- Seven licensed generators and water desalination companies, some of which are privately owned.
- Three companies licensed to undertake distribution and supply activities.
- Oman Power and Water Procurement Company.

Oman Power and Water Procurement Co. S.A.O.C.

The structure of the MIS is shown in Figure 3 below.

Figure 3: Main Interconnected System: Ownership Structure



Regulation of the electricity and related water sector in Oman is entrusted to the Authority for Electricity Regulation, Oman (the Authority). Its primary responsibilities include safeguarding the interests of consumers, reviewing electricity tariffs, promoting competition and facilitating the privatisation of the electricity and related water sector in Oman. The Authority is independent from the government and constitutes a well-respected body, whose independence is fully endorsed by the government. Moody's regards the Omani regulatory regime as one of the most advanced in the Gulf region.

The licensed transmission and distribution companies are presently wholly-owned by the government, although the government has allowed private ownership of some generation companies. The Ministry of Finance is planning to dispose of its shares in generation, transmission and distribution companies whilst OPWP, according to the Sector Law, will remain under state control indefinitely. This statutory provision affords significant support to OPWP's ratings, as it effectively eliminates any privatisation risk and cements OPWP's mandate as the government-owned vehicle for providing new capacity and output.

OPWP's activities are limited to its regulatory obligations

OPWP's activities are restricted to a number of core functions:

- (i) Procurement of electricity and related water capacity and output.
- (ii) Bulk supply of electricity to licensed suppliers and desalinated water to water authorities.
- (iii) Government counterparty responsibilities of the Salalah Concession Agreement.

OPWP purchases electricity and desalinated water according to Power Purchase Agreements (PPAs) and Power and Water Purchase Agreements (PWPAs). As outlined in the Sector Law, generators and desalinators must sell their entire output to OPWP. Therefore the generation market can be viewed as a monopsony, where a single buyer (OPWP) faces many sellers (generators and desalinators).

OPWP benefits from a well defined regulatory framework with a clear attribution of responsibility

OPWP sells electricity to licensed suppliers, and water to water authorities, according to bulk supply tariffs determined annually by OPWP and approved by the Authority. OPWP calculates bulk supply tariffs following the principles set forth in its licence: In any relevant year the actual tariff revenue cannot exceed the maximum allowed revenue. The maximum allowed revenue is determined following a typical cost-plus scheme and is defined as follows:

Maximum allowed revenue = Costs of power and water procurement (including CPI-adjusted allowed costs) + Licence Fees +- Last Year's Adjustments

The cost of power and water procurement includes a Notified Value which was fixed by the Authority in 2005 and is corrected each year for inflation. This provides OPWP with an incentive to improve efficiency as any outperformance of the Authority's cost assumptions can be kept by the company. In 2007, this Notified Value was in the region of OR 2.69 million.

The regulatory regime in Oman provides OPWP with a relatively high predictability of revenues and costs. Moody's also takes comfort from the fact that OPWP's revenues are determined according to a well defined recovery scheme and the Authority allows the company to recover purchase and procurement costs through regulated bulk supply tariffs, provided the company performs its statutory obligations efficiently and in accordance with the economic purchase condition of its licence. In other words, the amounts paid by OPWP to generators and desalinators for electricity and water is at all times matched to the amounts charged to licensed suppliers and water authorities at the other end.

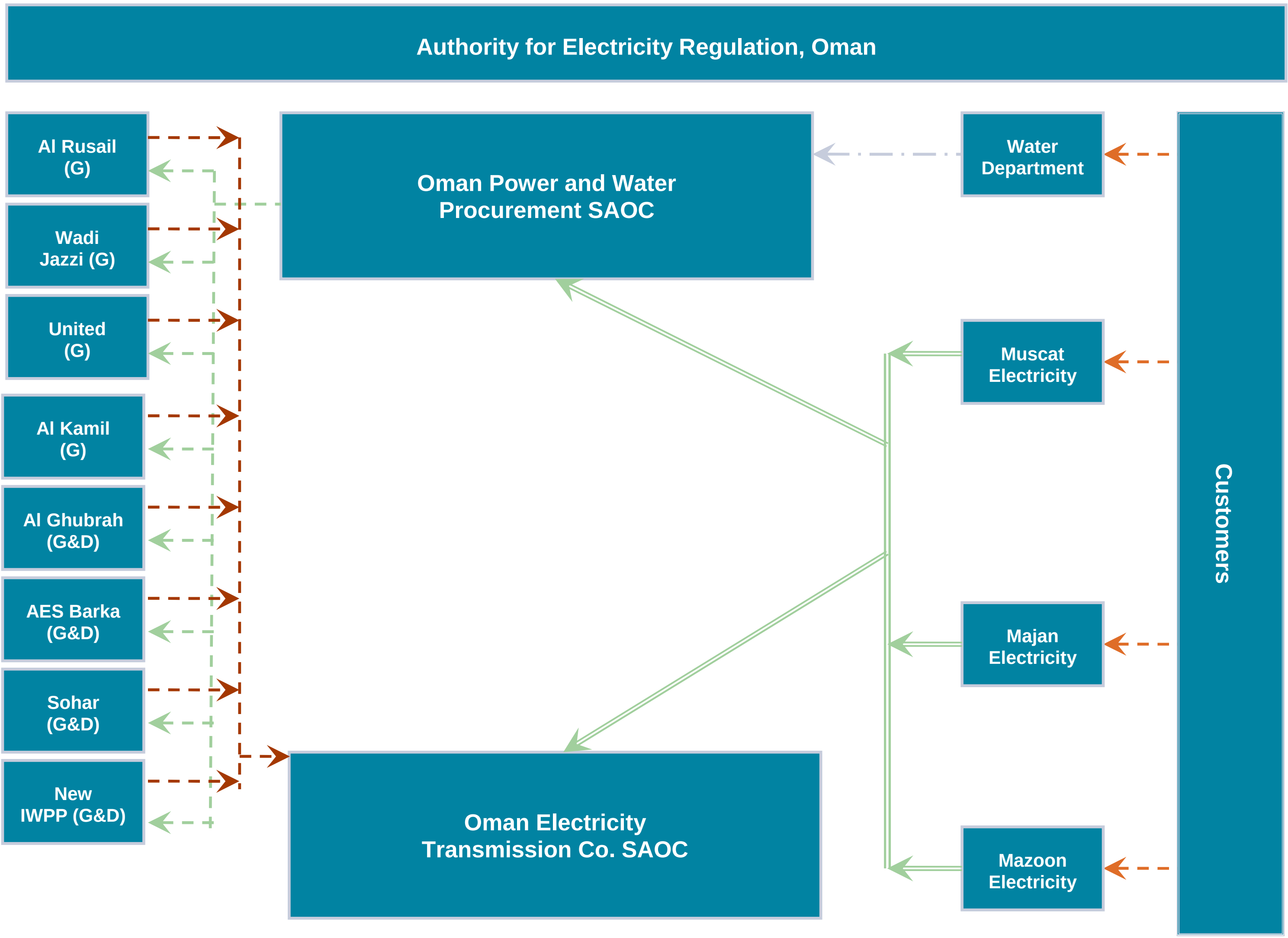
This eliminates any market risk and thus plays an important role in determining the company's sound credit profile. At the same time, Moody's cautions that OPWP may require occasional liquidity to bridge short term timing delays between power purchases and re-sales. OPWP relies principally on Electricity Holding Company or, ultimately, the Ministry of Finance to bridge any such shortfalls. Ratings are also based on the assumption that OPWP will always be able to fully recover all costs of procurement, without leaving the company exposed to longer term recovery shortfalls.

OPWP's secondary responsibilities include acting as government counter-party to the Salalah Concession Agreement

In addition to its primary responsibilities, OPWP monitors Dhofar Power Company's compliance with the objectives set in the Salalah Concession Agreement and facilitates the payment of the monthly allowances to which the company is entitled. The Ministry of Finance funds the monthly allowances and compensates OPWP for the administrative costs of its Salalah Business activities.

Oman Power and Water Procurement Co. S.A.O.C.

Figure 4: Main Interconnected System: Business Structure



PWP pays generators for Electricity, Water and Ancillary services
Generators pay OETC for transmission services
Licensed suppliers pay: (1) OETC for connection to transmission lines and use of system; (2) PWP for bulk purchase of electricity.
Water departments pay for bulk purchases of desalinated water.
Customers pay for electricity and water received.

G&D *Generator and Desalinator*
G *Generator*

Oman Power and Water Procurement Co. S.A.O.C.

The track Record of the Regulatory Regime is Relatively Short

The new framework of electricity regulation in Oman has a short track record and is significantly different to the 'ministerial self-regulation' it has replaced. Whilst Moody's believes that the low business risk associated with OPWP's statutory activities is supportive of the A2 credit rating, a rating sensitivity going forward will be the long term reliability and consistency of the new Omani electricity regulatory regime.

We believe that the Omani government will continue to implement its privatisation programme within the sector. However, such privatisations are likely to be credit neutral for OPWP, as long as they will not alter the company's status and mandate. In particular, it remains to be seen how the government will phase out its subsidies to licensed suppliers once these are privatised, given that these entities are the final off-takers of OPWP's bulk supply. As long as these entities are wholly-owned by the government, counterparty risk is minimal given the government's ultimate obligation to support these entities. Whilst not anticipated, any transfer of liabilities to OPWP, e.g. using it as a government vehicle to absorb and potentially fund losses within the system, would weigh negatively on its credit profile. Equally, any failure or significant delay on behalf of the government to pay the subsidies could also have adverse implications on the sector. Moody's regards the risks of both events as remote.

Consumer tariffs remain heavily subsidised by the state, although the government's long term intentions are to phase these out over time

Permitted Tariff revenues are not cost reflective and generally lower than the economic cost of supply. In 2006, Mazoon, Majan and Muscat, the three licensed suppliers operating in the MIS, received some RO 88 million in subsidies from the Ministry of Finance, as permitted tariffs covered only 62% of electricity supply costs (equal to 25.2 baizas/kwh in 2006).

Electricity demand in Oman is growing rapidly, which poses significant challenges on the system to keep pace with supply

OPWP is responsible for ensuring that requirements for new capacity and output are met in accordance with the generating security planning standard of the OPWP licence. If it is determined that additional generation and desalination capacity is needed, OPWP has to conduct *"fair and transparent"* competitions open to local and foreign investors. Overall electricity and desalinated water consumption in Oman is expected to surge over the next few years, mainly driven by strong economic development, increasing population and new industrial and tourism developments. Oman's electricity peak demand in the MIS is expected to grow by 9% annually through 2013. The demand of desalinated water is projected to grow from 151 million cubic metres in 2007 to 221 million cubic metres in 2013.

Given the significant increase in capacity needs over the next few years, the company faces a challenging task in accurately forecasting and contracting for supply requirements going forward. In particular, the license states that OPWP could face a revocation of its license, if it is deemed to have breached its duty to forecast electricity demand and contract for sufficient capacity to comply with the generating security planning standard. Whilst such license revocation would constitute a significant risk for the ratings, Moody's regards such an event is very remote, as it would require negligence which is unlikely given OPWP's expertise and its specialised mandate.

Oman Power and Water Procurement Co. S.A.O.C.

Financial Risk Assessment

OPWP relies on Electricity Holding Company for its accounting and financial activities

Electricity Holding Company provides general accounting support to OPWP including recording of general ledger, accounts payable and receivable, payments and receipts, based on transactions executed, authorized and approved by OPWP. Electricity Holding Company also provides services for cash management and treasury, payroll, management reports, and financial statements to OPWP.

OPWP's financial profile is sound, managing large inflows and outflows of cash, but with no long term financing requirements

Moody's recognises that OPWP's financial profile is very strong with a highly predictable revenue stream. The company makes significant payments to licensed production facilities as sole offtaker of power and related water and receives significant payments from licensed suppliers and water authorities when its commitments are sold on. OPWP is able to make a profit, if it is able to outperform the Authority's assumptions on costs and thus operate more efficiently. Conversely, it may make a small loss, if it is less efficient or receives penalties from the Authority.

As outlined earlier, bulk supply tariffs are set according to a typical cost-plus scheme in order to allow actual revenues for the year to equal maximum allowed revenues. In case of over-recovery (actual revenue higher than maximum allowed revenue) or under-recovery (actual revenue lower than maximum allowed revenue), the difference is compensated the following year through a correction factor determined by the difference between actual and allowed revenues from the previous year.

Figure 5: OPWP Financial and Ratio Summary (in OR millions unless stated otherwise)

	2005	2006
Revenues	137	200
Electricity bulk supply	97	140
Water bulk supply	31	44
Net Funding from MoF	7	12
Recharge for intercom. Transmission	2	4
Operating Costs	135	197
Electricity capacity output purchase costs	98	145
Water capacity output purchase costs	31	43
Funding for Dhofar Power Co.	6	9
Gross Profit	2	3
Funds from Operations	2	1
Total Debt	7	1
Total Cash	N.M.	14.5
EBIT Margin (%)	0.7%	0.03%
FFO / Debt (%)	21.6%	67.8%
Debt to Capitalisation	41.5%	13.8%

Liquidity needs are mainly covered by Electricity Holding Company or, ultimately, the Ministry of Finance

OPWP's heavily restricted business model does not require it to raise any long term debt. However, short term liquidity gaps may occur when cash outflows to the generators temporarily exceed cash inflows from licensed suppliers and water authorities. Such liquidity is normally provided by Electricity Holding Company, which holds overdraft facilities with a large domestic bank, and can attribute excess liquidity from other companies within the sector to those with liquidity needs. The Ministry of Finance also has the ultimate obligation to provide financial support to any licensed company in the power and water sector that is wholly-owned by the government and would provide immediate liquidity on demand, if required.

Financial statements comply with International Accounting Standards

OPWP reports under IFRS and has two years of financial accounts that are audited by Deloitte & Touche Middle East. The auditors have qualified OPWP's non-compliance with IFRIC 4, which determines whether an arrangement contains a lease, according to which its power purchase commitments would qualify as finance leases. Moody's is satisfied that this provision, if applied, would be inconsistent with OPWP's regulatory regime, as it would require OPWP to recognise the fixed assets in relation to the generation and transmission facilities at fair value on its balance sheet. Accordingly, Moody's recognises the regulatory reality over the accounting necessity.

Drivers of Rating Change

OPWP ratings are underpinned by the regulatory and legal framework within which it operates

As long as OPWP's activities remain limited to its licensed activities, and continue to achieve full pass-through of procurement costs between licensed production facilities and licensed suppliers and water authorities under normal circumstances (assuming efficient operation and economic purchase), its ratings are likely to move in sync with Oman's sovereign ratings. We also expect OPWP to remain wholly government owned and thus its vehicle for securing new electricity and related water capacity, thereby benefiting from the statutory provision of financial support from the government. Ratings also assume that OPWP will not be raising any debt, other than for short term liquidity purposes. In particular, ratings assume that OPWP will not absorb or otherwise finance any of the licensed suppliers' liabilities that may result from the reduction of government subsidies to the sector. Given their continued reliance on the government for subsidies, Moody's ratings anticipate the continued timely payment of these subsidies for as long as required, thus mitigating any counterparty risk for OPWP.

Oman Power and Water Procurement Co. S.A.O.C.

Appendix: Key Regulatory Provisions

Electricity Sector Law

1. Functions and duties listed in Article (22) to (39).
2. Article (67), privatization law…the ministry of finance shall secure the availability of adequate finance to enable ….(successor entities)…to undertake the activity assigned to them pursuant to this law whether such finance is from the Ministry of Finance or from any other source, provided the Ministry of finance approves such finance, all being AS LONG AS THE COMPANIES ARE WHOLLY-OWNED BY THE GOVERNMENT.
3. Article (68) Each of the companies stipulated in Article 66 of this law shall have a board of directors constituted by a decision of the ministry of finance after the approval of the council of ministers.
4. Article (14) Subject to the stipulations of article 7 of this law it is permissible for any person to purchase shares in any of the companies stipulated in article 66 (successor companies) of this law and other companies operating in the electricity and/or related water sector EXCEPT THE OMAN POWER AND WATER PROCUREMENT COMPANY WHICH SHALL CONTINUE TO BE WHOLLY OWNED BY THE GOVERNMENT.

OPWP Licence

5. Part 2, condition 15: The licensee (OPWP) shall procure that no separate business shall give any direct or indirect cross-subsidy to, nor receive any direct or indirect cross-subsidy from, another separate business or any other business of the licensee or the business of any affiliate.
6. Part 1, Licence term: this licence shall come into force on 1 May 2005 and, unless terminated in accordance with the provisions of condition….., shall continue in full force and effect until determined by not less than 10 years notice in writing given by the Authority to the licensee, such notice not to be served earlier than the 25th anniversary of 1 May 2005.
7. Part 2, condition 25: The licensee shall not: a) transfer its interests in, under or to this licence, (nor any part thereof) without the prior written consent of the Authority; or b) create or agree to create any security or effect a disposal of or relinquish control over any relevant asset (any asset which is necessary to enable the licensee to undertake its licensee activities in accordance with the provisions of the sector law and the licence and shall include PPAs, PWPAs and contracts for ancillary services). or any liability or create or agree to create or extinguish or agree to extinguish any interest it uses in connection with the licensed activities other than the prior written consent of the authority.
8. Part 2 condition 26 The Authority may at any time revoke this licence by not less than 30 days prior notice in writing to the licensee: If the licensee ceases to undertake the licensed activities for a period exceeding 90 days or **fails to any material extent to perform any of its licence duties.** Licensee has been adjudicated insolvent. Licensee suffers a change in control without the authority prior written approval.

Bulk Supply Agreement Terms

9. If the buyer (licensed supplier or water authority) fails to pay on the due date any amount due and owing by way of the bulk supply tariff, the buyer shall pay any such amount together with interest……..
10. OPWP shall have no liability to the buyer, whether for breach of statutory duty, tort (including negligence), breach of this agreement or otherwise in any manner whatsoever and to the extent that OPWP may be liable to any third party in respect of failure to supply any person in relation to any matters referred to in this clause, the buyer shall indemnify OPWP and keep OPWP so indemnified.
11. Except as provided in clause 8) (of this agreement) the buyer shall have no liability to OPWP, whether for breach of statutory duty, tort (including negligence), breach of this agreement or otherwise in any manner whatsoever.
12. Nothing in this clause shall limit the Buyer's obligation to pay the bulk supply tariff…..

Oman Power and Water Procurement Co. S.A.O.C.

Moody's Related Research

Analysis

- Emaar Properties PJSC, July 2007 (103740)
- Qatar Real Estate Investment Company, July 2007 (103653)
- DP World, June 2007 (102891)
- Saad Trading, Contracting and Financial Services Company Limited Partnership, May 2007 (102659)
- DIFC Investments LLC (DIFCI), May 2007 (103068)
- National Industries Group Holding NIG, April 2007 (102600)
- Dubai Holding Commercial Operations Group LLC, January 2007 (101668)
- Abu Dhabi National Energy Company, October 2006 (100108)
- Qatar Petroleum, April 2006 (97144)

Special Comment:

- Understanding Moody's Approach to Unsecured Corporate Sukuk, August 2007 (103919)
- Arabian Gulf Corporate Bond Market, March 2007 (102520)
- Family-Owned Corporates in the GCC, April 2007 (102897)
- Government Related Issuers in the Middle East Tend to Have Higher Levels of Support Than in other Regions, March 2007 (102334)
- Shari'ah and Sukuk: A Moody's Primer, May 2006 (SF74488)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Related Websites

Oman Power and Water Procurement SAOC Web Site**: www.omanpwp.co.om/**

Authority for Electricity Regulation, Oman: **www.aer-oman.org**

MOODY'S has provided links or references to third party World Wide Websites or URLs ("Links or References") solely for your convenience in locating related information and services. The websites reached through these Links or References have not necessarily been reviewed by MOODY'S, and are maintained by a third party over which MOODY'S exercises no control. Accordingly, MOODY'S expressly disclaims any responsibility or liability for the content, the accuracy of the information, and/or quality of products or services provided by or advertised on any third party web site accessed via a Link or Reference. Moreover, a Link or Reference does not imply an endorsement of any third party, any website, or the products or services provided by any third party.

Oman Power and Water Procurement Co. S.A.O.C.

Authors	Production Specialist
Philipp Lotter, Raffaele Semonella	Nita Desai

Moody's Investors Service