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# Oman Power and Water Procurement Co. SAOC

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# Oman Power and Water Procurement Co. SAOC

## Major Rating Factors

| Corporate Credit Rating |
|---|
| A/Stable/-- |

**Strengths:**
- Monopoly bulk buyer and seller of electricity and associated desalinated water in Oman
- Wholly owned by the Sultanate of Oman
- Fully regulated low-risk agency function with no direct operations
- No external long-term funding requirements

**Weaknesses:**
- Low margin activity
- Increased counterparty risk as distribution companies are privatized

## Rationale

The 'A' rating on regulated procurement and supply company Oman Power and Water Procurement Co. SAOC (OPWP) is based on an equalization with the long-term rating on the Sultanate of Oman (A/Stable/A-1). The equalization reflects Standard & Poor's Ratings Services' opinion that there is an "almost certain" likelihood that the government would provide timely and sufficient extraordinary in the event of financial distress.

In accordance with our criteria for government-related entities (GREs), our rating approach is based on our view of OPWP's:

- "Integral" link with the Omani government, given the company's public policy status and 100% state ownership through the Ministry of Finance and the Electricity Holding Co. SAOC (EHC). We view OPWP as a policy-based arm of the government, undertaking an agency role in the electricity and water sector, one that could not be readily undertaken by a private sector entity. OPWP must remain wholly owned by the government indefinitely, under Article (14) of the Law for the Regulation and Privatization of the Electricity and Related Water Sector (Sector Law). OPWP's obligations are not explicitly guaranteed, but under Article (67) of the Sector Law, the Ministry of Finance must provide adequate finance to enable OPWP to undertake its operations.
- "Critical" policy-based role as sole bulk buyer and supplier of electricity and desalinated water in Oman. Without OPWP as intermediary, generators and suppliers would need to interact directly, which is currently against public policy as it would entail material risks. OPWP also performs the critical role of forecasting demand and supply of electricity and related water in Oman.

It also reflects OPWP's unique and strategically important role as the sole bulk buyer and seller of electricity and related desalinated water in Oman.

These strengths are modestly offset by OPWP's inherently low profitability, and a potential increase in counterparty risks as Oman's distribution companies are privatized.

**Key business and profitability developments**

OPWP's revenues are fully regulated by Oman's Authority for Electricity Regulation, under a transparent cost-recovery tariff that allows full pass-through of procurement costs under normal circumstances. The authority is required to give OPWP at least 10 years' notice if it wishes to terminate the company's license.

OPWP publishes financial statements once a year. Given its public policy role, profitability is not a core objective for the company. In the year ending Dec. 31, 2008, OPWP reported revenues of Omani rial (OMR) 239 million, which mainly comprised regulated bulk supply tariffs from customers in electricity and desalinated water. These revenues were closely offset by capacity and output costs, and administrative expenses, to result in a net profit of OMR1.1 million.

**Key cash flow and capital-structure developments**

OPWP's credit protection measures are strong. The company has a short-term balance sheet that is dominated by accounts payable and receivable, reflecting procurement costs from generators and desalinators, and receivables from electricity suppliers and water departments. OPWP itself has no production facilities and is in fact prohibited under the terms of its license from engaging in the generation of electricity and/or the desalination of water. OPWP requires no external long-term debt financing, which results in strong credit ratios, although conventional credit measures are not really applicable to a company with OPWP's profile.

**Liquidity**

OPWP has an adequate liquidity position, in our view. The company incurs no capital expenditure and has no long-term debt; demand on its liquidity arises mainly from timing differences between payments to generators and desalinators and receipts from electricity suppliers and water suppliers. OPWP also has a seasonal pattern of cash flows as tariffs increase significantly in the summer months. These working capital needs are usually covered by existing cash balances and short-term funding from EHC, but OPWP also has access to an OMR7 million overdraft facility from EHC, which it uses sparingly. The facility expires in June 2010 and needs to be renewed annually.

## Outlook

The stable outlook factors in our view of the continued strong implicit and explicit support from the Sultanate of Oman. It also takes into account our belief that the tariff regime will remain supportive and that OPWP will not engage in any nonregulated activities without approval from the Authority for Electricity Regulation.

A change in rating or outlook on OPWP would likely result from a change in the rating or outlook on the Sultanate of Oman. Similarly, any change in the relationship between OPWP and the sovereign or in OPWP's singular policy-based mandate could have negative rating implications.

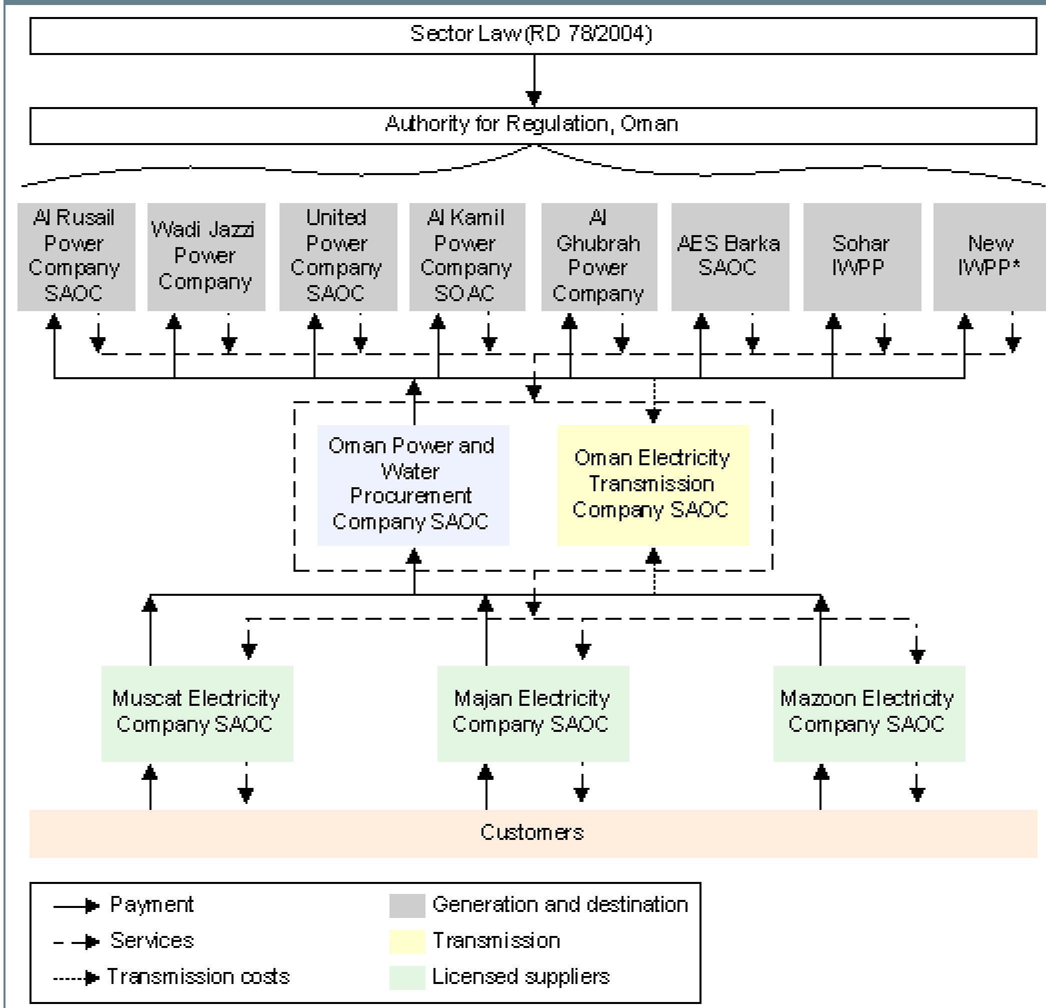
## Business Description

OPWP was established as a joint stock company in 2003 with the purpose of being the sole bulk buyer and seller of electricity and related desalinated water in the Sultanate of Oman. Wholly owned by the government, the company acts as the interface between generators and suppliers. It performs this role by buying bulk electricity and desalinated water under power purchase agreements (PPAs) and power and water purchase agreements, and selling to distributors/suppliers under bulk supply agreements. OPWP has no production facilities of its own, and it employed just 47 people at the end of 2008.

An additional function of OPWP is to provide the government with accurate forecasts of electricity and desalinated water demand in Oman and to ensure capacity is sufficient to meet this demand at the lowest possible cost. If OPWP forecasts a shortfall, as it does from 2010 due to the growth in population, industry, and tourism, it is required to arrange open and fair competition to attract local and overseas investors to build new capacity.

The electricity and related water sector in Oman is divided into three geographic zones. The Main Interconnected System (MIS), which covers about 90% of the country's power demand, has been fully and legally unbundled (see chart). Vertically integrated companies--the Rural Areas Electricity Co. and the Dhofar Power Co. (DPC)--cover the rural and the Salalah areas, respectively. OPWP's role as bulk buyer and supplier applies to the MIS, while its planning responsibility applies to all zones.

**Main Interconnected System: Sector Structure**




*New IWPP will soon be replaced by SMN Barca SAOC.
Source: Oman Power and Water Procurement Co. SOAC

## Rating Methodology

The rating on OPWP is equalized with that on the Sultanate of Oman in accordance with our criteria for GREs, where we view the likelihood of extraordinary government support as "almost certain." This is based on an "integral" link with the Omani government and a "critical" role.

We consider OPWP to be a policy-based arm of the government because it performs the unique and critically important role as the sole bulk buyer and seller of electricity and related water in Oman, and is responsible for planning the country's capacity needs.

OPWP is wholly owned by the government of the Sultanate of Oman. The ownership is 0.01% direct through the Ministry of Finance, and 99.99% indirect through EHC, which holds all of the government's interests in the electricity sector.

The company's functions and duties are governed by the Law for the Regulation and Privatization of the Electricity and Related Water Sector (Sector Law), which was issued by Royal Decree 78/2004. The Sector Law's aim is to separate and unbundle the government's assets in the electricity and related water sector into functional corporate entities, with a view to eventual privatization. However, although seven of the nine generation and desalination companies are now privately owned and the transmission and distribution companies are expected to be privatized over time, the Sector Law requires OPWP to remain 100% government owned, reflecting its singular and strategically important mandate.

The government does not explicitly guarantee OPWP's obligations, but Standard & Poor's considers ongoing shareholder support to be very strong based on the following factors:

- A requirement under the Sector Law for OPWP to remain wholly owned by the government indefinitely;
- OPWP's critical, policy-based role as the sole bulk buyer and supplier of electricity and desalinated water in Oman;
- A legal requirement by the Ministry of Finance under Article (67) of the Sector Law to provide "adequate finance" to successor entities that remain wholly owned by the government;
- Close governance oversight by OPWP's Board of Directors, appointed by EHC and the Ministry of Finance, and;
- The provision of accounting services and liquidity facilities by EHC.

## Business Risk Profile: Excellent, Supported By Unique Role, Protective Ownership And Regulatory Framework

The major supports for OPWP's strong business risk profile are:

- Its monopoly position within the electricity and related water sector in Oman: As long as OPWP retains its exclusive right to procure and sell bulk electricity and related water in Oman, the company will face no direct competition.
- The fully regulated nature of its revenues: OPWP's revenues are fully regulated by the Authority for Regulation, which was established by Royal Decree in 2004. The Authority prohibits OPWP from engaging in any non-regulated activities without its approval and operates independently from the government. It regulates OPWP's revenues through a transparent cost-recovery system that allows full pass-through of procurement costs

under normal circumstances. OPWP's maximum allowed revenue (MAR) equals the costs of power and water procurement (including Consumer Price Index-adjusted allowed costs) plus license fees and plus or minus the previous year's adjustments. The MAR's main component is a bulk supply tariff that OPWP sets and the regulator approves each year. The authority must give OPWP at least 10 years' notice to terminate its license, and although the license can be revoked, the conditions that would trigger this would essentially require negligence or fraud by OPWP.

- Its low-risk agency function with lack of direct operations: OPWP does not have generation or supply activities of its own and is not allocated a capital plan. It performs an agency-type function focused on the management of power and water contracts, while treasury and accounting are outsourced to EHC. The lack of direct electricity or related water operations reduces OPWP's overall business risk. OPWP's role is limited to planning and forecasting future requirements for electricity generation and water desalination, to procure capacity in a timely manner, and to promote efficiency in the electricity and related water sectors.

These supports are partially offset by:

- Sector privatization: The Government's aim in setting up OPWP was to separate and unbundle the government's assets in the electricity and related water sectors into functional corporate entities, with a view to eventual privatization. Most of the generation companies have already been privatized, and while we believe that the distribution companies will be privatized over time, OPWP is required by law to remain government-owned. One risk of privatization is that counterparty risks for OPWP could increase, but given that potential private sector entities would be licensed by the regulator, and would partly rely on a government subsidy, we would expect counterparty risk for OPWP to be low.
- Reduction of subsidies: Currently, the government pays about 30%-40% of the amount that the distribution companies charge OPWP, in the form of a subsidy, in order to protect the end consumer from the full costs of production. The government aims to gradually implement cost-reflective tariffs by reducing the subsidies over time, to be consistent with privatization and to force efficiencies in the system. We understand that the risk of additional payment will be borne fully by the distribution companies, and not by OPWP. If OPWP were to absorb any of the reduction in subsidy, this would be a negative rating factor, however, we consider it unlikely that the government would expect this to occur, given OPWP's limited financial capacity.
- Unpredictable market growth in Oman: OPWP risks fines from the regulator--the Authority for Electricity Regulation (AER)--if it fails to adequately plan for projected demand. If OPWP secures too much capacity for Oman's needs, the regulator would allow the associated costs to be passed through as long as the capacity had previously been approved under a seven-year plan. OPWP has revised its forecasts for 2009-2015 downward in light of a softer economy, but it still expects demand to grow at 8.5% per year, with a capacity shortage of as much as 500MW forecasted by 2011. The company has a number of projects in the pipeline that should address this, although there are concerns over market conditions for project financing, which have already caused delays on at least one project. OPWP is working with the AER on contingency plans in the event that the planned projects are not completed on time, such as new short-term PPAs with industrial companies and interconnection agreements with neighboring Gulf states. The electricity supply companies are also pursuing demand-side management initiatives in cooperation with the regulator.

## Financial Risk Profile: Intermediate, With No Long-Term Debt Requirement

The main strengths of the OPWP's intermediate financial risk profile are:

- No long-term debt: OPWP has a predominantly short-term balance sheet comprising mainly accounts payable and receivable, reflecting procurement costs from generators and desalinators, and receivables from electricity suppliers and water departments. OPWP itself has no production facilities, and incurs no capital expenditures. As such, it has no requirement for long-term external financing. Conventional credit metrics are therefore strong.
- Adequate liquidity: OPWP's government ownership and Article 51 of the Sector Law effectively ensure that OPWP will have sufficient liquidity to finance its functions at all times. Sources of liquidity have recently been centralized at EHC, which provides funding to all its subsidiaries in the electricity sector. It has an OMR20 million committed line in place, which is allocated to subsidiaries when required.

These strengths are moderated by:

- Weak profitability: Despite its monopoly position, OPWP's net income is low relative to turnover, reflecting the fully regulated nature of its revenues. OPWP is allowed a margin on its purchase costs above its estimated direct costs. This, therefore, allows OPWP "normal profit" if its cost performance is exactly in line with expectations. Any outperformance (in the form of lower direct costs) would allow OPWP to earn additional profit, while unanticipated increases in direct costs would reduce profit. Nevertheless, these amounts are low and do not provide the company with a significant unrestricted cash buffer.

- Reliance on shareholders for funding: OPWP's funding requirements are currently provided entirely by its shareholder EHC. While undiversified funding sources could constitute a risk, in the case of OPWP this is mitigated by the government ownership of EHC and the provisions in the Sector Law. We also note that OPWP previously obtained funding from the commercial banking sector on relatively favorable terms, and we consider this to be possible in the future, if required.

## Financial Statistics/Adjustments

OPWP reports under International Financial Reporting Standards. The company's accounts are audited by Deloitte & Touche (M.E.) and have 'Emphasis of matter' in the Auditor's report: OPWP has not adopted IFRIC 4, "Determining whether an arrangement contains a lease." Application of IFRIC 4 would require OPWP to recognize certain long-term PPAs as finance leases, which would bring the associated fixed assets onto its balance sheet and would create implied depreciation and interest charges. OPWP believes that this would be inconsistent with certain provisions in the license issued by the Authority for Electricity Regulation and other provisions of the Sector Law.

Standard & Poor's recognizes that even if the PPAs were brought onto OPWP's balance sheet, a zero-risk weighting would be assigned to the present value of future capacity payments, since PPA costs are fully recoverable under the regulated bulk supply tariff.

We make no material adjustments to OPWP's accounts, reflecting the company's limited scope and agency-type function (see table 1).

**Table 1**

| Reconciliation Of Oman Power and Water Procurement Co. SAOC Reported Amounts With Standard & Poor's Adjusted Amounts* | | |
|---|---|---|
| **(Mil. OMR)** | **--Fiscal year ended Dec. 31, 2008--** | |
| **Oman Power and Water Procurement Co. SAOC reported amounts** | | |
| | **Operating income (after D&A)** | **Cash flow from operations** |
| Reported | 1.0 | (7.3) |
| **Standard & Poor's adjustments** | | |
| Reclassification of nonoperating income (expenses) | 0.2 | -- |
| Reclassification of working-capital cash flow changes | -- | 9.8 |
| Total adjustments | 0.2 | 9.8 |
| **Standard & Poor's adjusted amounts** | | |
| | **EBIT** | **Funds from operations** |
| Adjusted | 1.2 | 2.5 |

*Oman Power and Water Procurement Co. SAOC reported amounts shown are taken from the company's financial statements but might include adjustments made by data providers or reclassifications made by Standard & Poor's analysts. Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts. OMR--Omani rial.

**Table 2**

| Oman Power and Water Procurement Co. SAOC Financial Summary* | | | | |
|---|---|---|---|---|
| | **--Fiscal year ended Dec. 31--** | | | |
| **(Mil. OMR)** | **2008** | **2007** | **2006** | **2005** |
| Rating history | A/Stable/-- | NR | NR | NR |
| Revenues | 238.6 | 214.0 | 200.5 | 137.4 |
| Net income from continuing operations | 1.1 | 1.3 | 0.5 | 0.9 |
| Funds from operations (FFO) | 2.5 | 2.9 | 1.3 | 1.8 |
| Capital expenditures (capex) | 0.2 | 0.0 | 0.0 | 0.1 |
| Cash and short-term investments | 1.7 | 6.2 | 14.5 | 0.0 |
| Debt | 0.0 | 0.0 | 1.4 | 7.5 |
| Preferred stock | 0.0 | 0.0 | 0.0 | 0.0 |
| Equity | 11.2 | 11.1 | 10.2 | 10.5 |
| Debt and equity | 11.2 | 11.1 | 11.6 | 18.0 |
| **Adjusted ratios** | | | | |
| EBIT interest coverage (x) | 72.2 | 114.4 | 1.9 | 140.6 |
| FFO interest coverage (x) | 147.6 | 220.8 | 3.2 | 254.3 |
| FFO/debt (%) | N.M. | N.M. | 91.5 | 23.8 |
| Discretionary cash flow/debt (%) | N.M. | N.M. | 1,554.5 | (106.7) |
| Net cash flow/capex (%) | 807.1 | 35,725.0 | 4,542.9 | 2,061.6 |
| Debt/debt and equity (%) | 0.0 | 0.0 | 12.0 | 41.5 |
| Return on common equity (%) | 9.6 | 12.2 | 4.3 | 8.2 |
| Common dividend payout ratio (unadjusted) (%) | 100.0 | 78.0 | 89.8 | 90.0 |

*Fully adjusted. OMR--Omani rial. NR--Not rated. N.M.--Not meaningful.

| **Ratings Detail** (As Of September 18, 2009)* | |
|---|---|
| **Oman Power and Water Procurement Co. SAOC** | |
| Corporate Credit Rating | A/Stable/-- |
| **Corporate Credit Ratings History** | |
| 07-May-2008 | A/Stable/-- |
| **Business Risk Profile** | Excellent |
| **Financial Risk Profile** | Intermediate |
| **Debt Maturities** | |
| None | |
| **Related Entities** | |
| **Oman (Sultanate of)** | |
| Issuer Credit Rating | A/Stable/A-1 |
| Senior Unsecured (2 Issues) | A |
| Short-Term Debt (1 Issue) | A-1 |

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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