

MANAGEMENT DISCUSSION AND ANALYSIS REPORT

Description of the Company and Business

Muscat City Desalination Company S.A.O.G. (hereinafter referred to as **MCDC** or the **Company**) was incorporated as an S.A.O.C. with the commercial registration number 1163374 for an unlimited duration on 19 January 2013. At an EGM held on 27 October 2016, it was resolved to transform the Company into an S.A.O.G. The legal and commercial name is now Muscat City Desalination Company S.A.O.G. and its registered office is located at Building No: 310, Street No: 3605, Complex No: 236, 18 November Street, North Al Ghubrah, Muscat, Sultanate of Oman.

The Company underwent an Initial Public Offering (**IPO**) exercise in late 2017 and was subsequently listed on the Muscat Securities Market (**MSM**) on 2 January 2018.

The Company's core business activity is to develop, own and operate the Al Ghubrah Independent Water Plant, a Sea Water Reverse Osmosis (**SWRO**) desalination plant, with a contracted capacity of 191,000 cubic meter per day (42 Million Imperial Gallons per Day), located in North Ghubrah, Muscat Governorate, Sultanate of Oman (**Plant**). The Plant has been in commercial operations since 19 February 2016.

The Company generates its revenues from the sale of desalinated water pursuant to a Water Purchase Agreement (**WPA**) with the Oman Power and Water Procurement Company (**OPWP**). The desalinated water from the Plant is fully contracted to OPWP to meet the growing water demand of the Interconnected Zone (Northern Region of Oman) during the term of the WPA. The contracted water capacity of the Plant represents approximately 20% of the operating capacity in the Interconnected Zone in accordance with OPWP's 7 year statement (2018-2024).

The potable water is delivered to the Public Authority for Water (**PAW**) reservoirs located adjacent to the Plant.

Electricity is supplied to the Plant by Muscat Electricity Distribution Company (**MEDC**) pursuant to an Electricity Supply Agreement (**ESA**). The Company as System User, has entered into the Electricity Connection Agreement (**ECA**) with Oman Electricity Transmission Company (**OETC**) to secure connection to the Transmission System over the contracted WPA period.

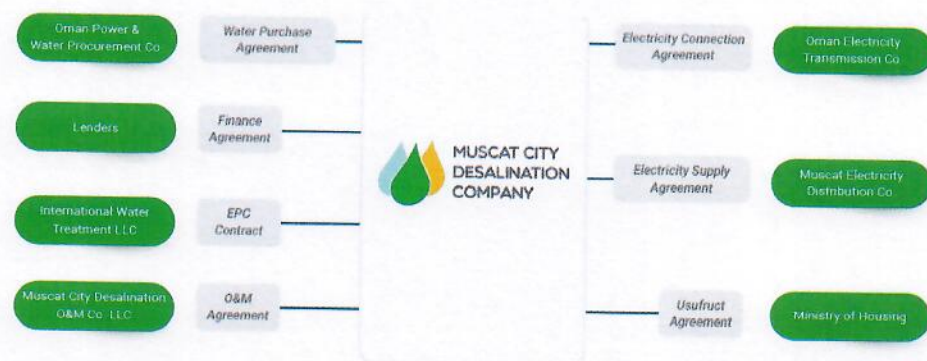
Competitive Strengths

The Company's competitive strengths include the following:

- One of the largest operating SWRO desalination plant at a single location in Oman.
- Well-established contractual framework with long term WPA, ensuring cash flow protection against adverse events such as buyer risk events and force majeure.
- Stable and predictable cash flows, resilient to potential shocks in electricity prices and water demand during the term of the WPA.
- Proven, long-term and reliable SWRO desalination technology.
- Experienced Project Founders with an established track record being able to transfer skills and know-how.
- Fully operational Plant operated by experienced and skilled personnel complying fully with the highest levels of Omanisation requirements.

Contractual Framework

MCDC's contractual framework is as shown below.



Water Purchase Agreement

The WPA was executed between the Company and OPWP on 11 February 2013. The WPA details the commercial terms agreed between the Company and OPWP and sets out standard representations and warranties that the Company is required to provide.

The WPA sets out a number of obligations of the Company throughout the tenure of the agreement. Among other things, the Company must, acting as a reasonable and prudent operator, operate and maintain the Plant in such manner so as to ensure that the Plant is capable of operating and maintaining water production on a continuous and reliable basis.

Under the WPA, the Company is also obliged to exclusively sell water output to OPWP and in return, receives from OPWP, payment for Water Capacity Charges and Water Output Charges. The Water Capacity Charges are designed to cover fixed costs such as debt service, return on capital, tax payments as well as fixed costs to operate and maintain the Plant (such as manpower, spare parts, maintenance and insurance). The Water Output Charges compensates the Company for variable operation and maintenance costs (such as chemicals, SWRO membranes, cartridge filters, consumables, spare parts) and the electricity charges for the water output delivered.

Electricity charges are calculated on the contracted specific power consumption of the Plant.

The Water Capacity Charges are also adjusted for scheduled unavailability, forced outages, derating of the Plant and also to take into consideration inflation and exchange rate movements. The Water Output Charges are adjusted for changes in exchange rate, US Producer Price Index (US PPI) and the Omani CPI.

The WPA also outlines various buyer risk events and the relief that the Company will receive should certain specified events occur that will hinder the Company from performing its obligations under the WPA. If a relevant buyer risk event is established in accordance with the terms set out in the WPA, the Company will not be liable for any failure to perform or any delay in its performance and will continue to be entitled to be paid capacity charges during the relevant period in accordance with the terms of the WPA. In the event that it is determined that a material adverse change has occurred and such material adverse change was caused by a buyer risk event or events which constitute a material adverse change, OPWP shall propose a mechanism to the Company in order to adjust the Water Capacity Charges and/or the Water Output Charges, as appropriate, or reimburse the Company by an agreed reimbursement mechanism.

The WPA also provides for relief to the Company if various force majeure events hinder the Company from performing its obligations under the WPA. If it can be established that a force majeure event has occurred, or will occur, and that it could not have been mitigated by the Company, acting as a reasonable and prudent operator, the Company will be relieved from liability for any failure to perform its obligations under the WPA for the duration of the force majeure event and the term of the WPA will be extended by the period for which the force majeure event hindered the Company from performing its obligations. Furthermore, the Company shall be entitled to continued receipt of capacity charges to the extent of its availability during the force majeure period.

Subject to certain force majeure, buyer risk events and termination provisions contained therein, the term of the WPA which commenced on 11 February 2013 shall expire on 11 October 2034.

Electricity Supply Agreement (ESA)

The ESA was entered into between MEDC and the Company on 11 February 2013 for the supply of electricity up to a maximum of 40MVA in accordance with the Permitted Tariffs in the ESA for operating the Plant. Both MEDC and the Company have the right to terminate the ESA by giving at least thirty days prior written notice to the other party.

Electricity Connection Agreement (ECA)

The ECA was entered into between the Company and OETC, a wholly owned Government company established in 2003, on 11 February 2013. The ECA sets out the terms and conditions for the connection to the Transmission System. It establishes a framework to provide for, amongst others:

- i. the payment by the Company to OETC of the connection fee; and
- ii. enforcement of the Grid Code between OETC and the Company.

The ECA became effective from the date of its execution and shall remain in force for an initial period of 25 years (**Initial Term**) and will continue in force beyond the expiry of the Initial Term unless and until either party terminates the ECA on six months prior notice to the other, provided that no such notice, shall take effect before the expiry of the Initial Term.

Usufruct Agreements (UAS)

The UAS were executed between The Ministry of Housing (**MoH**) and the Company on 11 February 2013. The UAS relates to the site on which the Plant is located (**Site**). It has a term of 25 years from the date of ratification of the UAS by the Government, subject to a further extension of 25 years at the option of the Company. The Company is under the obligation to only use the Site for the stated purpose as described in the UAS.

In accordance with the UAS, MoH has provided the Site to the Company free and clear of any right adverse to the usufruct right so granted including, but not limited to, any third party claim that may be made relating to the Site. MoH also ensures that the Company has undisturbed enjoyment of the Site throughout the term of the UAS.

Operations and Maintenance Agreement (O&M Agreement)

The O&M Agreement was entered into between the Company and Muscat City Desalination Operations and Maintenance Company LLC (herein referred to as **MCDOMC** or the **Operator**) on 27 November 2013. It provides for the provision of O&M services by the Operator. The O&M Agreement requires the Operator to operate and maintain the Plant until 11 October 2034, being 20 years after the Scheduled Commercial Operations Date (SCOD) of 11 October 2014.

The terms of the O&M Agreement may be modified to reflect any extension of the term of the WPA as may be determined between the Company and OPWP in accordance with the terms of the WPA. The O&M Agreement was amended on 21 October 2017 to revise the water capacity O&M charge due to the non-requirement of the second pass Reverse Osmosis sub-system of the Plant and to provide clarity on the sharing of the savings on the electricity consumption charges with the Operator.

Under the O&M Agreement, the Operator is responsible, amongst others, for:

- operating the Plant during the operation period in accordance with the scheduling requirements and the dispatch instructions issued to the Company by OPWP from time to time;
- maintaining the Plant to ensure that the Plant operates at the requisite capacity;
- recruiting, employing and training sufficient staff to operate and maintain the Plant;
- programming and carrying out such performance tests as may be required by the Company or OPWP from time to time and any additional performance tests as the Company or OPWP may propose in accordance with the testing procedures and restrictions under the WPA;
- performing all operation and maintenance works and procure all resources and materials to comply with the Omanisation Plan specified in the O&M Agreement;
- satisfying all of the Company's operation and maintenance related obligations under the Project Agreements;
- affording all reasonable assistance and co-operation in relation to the performance of the Company's obligations under the Project Agreements; and
- not undertaking any action or failing to take any action which would cause the Company to be in breach of any of its obligations under the Project Agreements.

The fees payable under the O&M Agreement consist of fixed and variable components.

EPC Contract

The EPC Contract was executed between the Company and International Water Treatment Company (IWT) on 10 April 2013. It established the terms upon which IWT was to design, engineer, manufacture, supply, procure, transport, erect, construct, install, test and commission the Plant and to warrant such works and remedy any defects or non-compliances therein.

In consideration of these works, the Company was to pay IWT the contract price in accordance with the milestone payment schedule.

The EPC Contract sets out the obligations of IWT. Amongst others, IWT was to ensure that the works and materials used in the construction were free from charges or liens and defects in title, design or workmanship and that the works would meet all environmental requirements and all applicable laws. IWT was obliged to attain Taking Over of the Plant on or before the Time for Completion, matching the Scheduled Commercial Operations Date (SCOD). The EPC Contract contains provisions for warranties as well as punch list items of the Works (as defined under the EPC Contract) noted by the Company as requiring rectification by IWT within twenty-four months from Taking Over date. The Taking Over date was 19 February 2016.

If the Contractor repairs, replace or renews all or any part of the Plant or works, then the Defects Liability Period shall apply to the part of the Plant or the Works so repaired, replaced or renewed until

the expiration of 24 months from the date of such repair, replacement or renewal, provided that the defects liability period shall not be greater than 48 months from Taking Over Date. As a result, IWT is responsible for carrying out at its cost all works of redesign, repair, reconstruction, rectification, renewal and replacement for the purpose of making good of Defects (as defined under the EPC Contract) or damage to the Plant or any part of the Works which may appear as a result of a Defect and for which IWT is responsible pursuant to the terms of the EPC Contract.

Risk Management

MCDC affirms its commitment towards ensuring and maintaining a sound internal control system which encompasses good governance, risk management and control processes. In light of this, the Company confirms that there is a proper risk management assurance process in place to identify, evaluate and manage significant risks impacting the Company's achievement of its objectives. The Company also acknowledges the presence of a sound system of internal control in safeguarding shareholders' investments, the Company's assets and other stakeholders' interests as well as ensuring compliance with applicable laws and regulations.

MCDC's risk management objectives are:

- Creating the right awareness and understanding of risk at all levels of the organisation.
- Instilling a culture of risk management and risk ownership as everyone's responsibility.
- Identifying risks and managing them well within the risk appetite of the organisation.
- Embedding risk management in the way the business is run.
- Developing a common risk language.
- Complying with appropriate risk management practises in terms of corporate governance guidelines.

Financial Arrangement

The Company has entered into financing agreements with a consortium of international banks, for an aggregate amount of OMR 81.25 million (US\$211.30 million). Senior debts are hedged in compliance with the requirement of the financing agreements via interest rate swap agreements. This further improves the predictability of cashflows of the Company.

Operation and Maintenance

The Plant is operated and maintained during the term of the WPA by the Operator, through the O&M Agreement with the Company. The Operator is primarily responsible for the Plant's availability and efficiency, meeting dispatch instructions, operational cost control and most importantly, the Health, Safety & Environment (HSE) compliance. The Operator is also responsible for ensuring adequate spare parts are available and that its employees are properly qualified and trained.

The maintenance of the Plant was undertaken in accordance with the Original Equipment Manufacturer (OEM) recommendations and in accordance with the O&M manuals. The maintenance schedule is maintained in the Computerized Maintenance Management System (CMMS).

The defects in the Plant, other than normal wear and tear, are being rectified by the EPC Contractor as the plant is under its extended defects liability period. A total of 133 warranty items have been raised out of which 112 items have been closed, and remaining warranty items are still ongoing.

Corporate Governance

The Board of Directors and Management of the Company are committed in ensuring that the highest standards of corporate governance are practiced in the Company and the Operator, as a fundamental part of its responsibilities in managing the businesses and affairs, protecting and enhancing stakeholders' values as well as financial performance while promoting the highest standards of integrity, transparency and accountability. Both the Company and its Operator abide by the governing laws and regulations and observes the applicable guidelines, rules and directives issued by the relevant regulatory authorities.

Discussion on Operational Highlights and Financial Performance

Health, Safety and Environment (HSE)

The HSE Policy commits the Company and the Operator in creating a safe, secure and healthy working environment and the elimination of all work-related incidents and injuries. The Company and its Operator have HSE policies in place to conduct all operations in a manner that protects the HSE of employees, sub-contractors and the public while complying with all applicable legal and other requirements.

All employees and contractors are required to perform their work in accordance with the implemented HSE policy, which is carried out through the following practices:

- communicating the HSE policy to all interested parties;
- providing the necessary resources to prevent ill health and injury of all working personal and to minimize pollution and environmental impact associated with activities;
- ensuring employees and contractors are provided with adequate training and supervision for the safe performance of the work;
- making all employees and contractors responsible and accountable for health, safety and environment in their daily work activities;
- establishing, maintaining, rehearsing and reviewing with concerned groups all emergency response plans to prevent injury and accidental environmental impact while minimising any damage to company property and the community; and
- seeking continual improvement in HSE performance through periodic monitoring and reviewing of policy, objective and targets.

During the year there were neither Lost Time Incidents (**LTI**) nor environmental incidents. As at 31 December 2018, the Company achieved 1037 days without an LTI since its Commercial Operations Date (**COD**) on 19 February 2016. The total man-hour is 69,848 hours.

The Operator had, in April 2017, been awarded ISO 14001:2004 Environmental Management System and OHSAS 18001:2007 Occupational Health and Safety Management System certification. In September 2018 the ISO 14001:2004 had been successfully migrated to ISO 14001:2015.

Capacity

The capacity of the plant is defined by the total capacity of water (m³/day or MIGD) which can be delivered by the plant into the PAEW water transmission system.

The contracted capacity of the Al Ghubrah Independent Water Plant under the WPA is 42 MIGD applicable from April 2018 to March 2019, following the Annual Performance Tests conducted in March 2018 which demonstrated that the plant met the contractual requirements under the WPA.

Plant Availability & Output

The reliability of the Plant is a measure of its availability to deliver the declared capacity in accordance with the WPA. For the financial year 2018, the Company achieved availability of 96% after scheduled and forced outages.

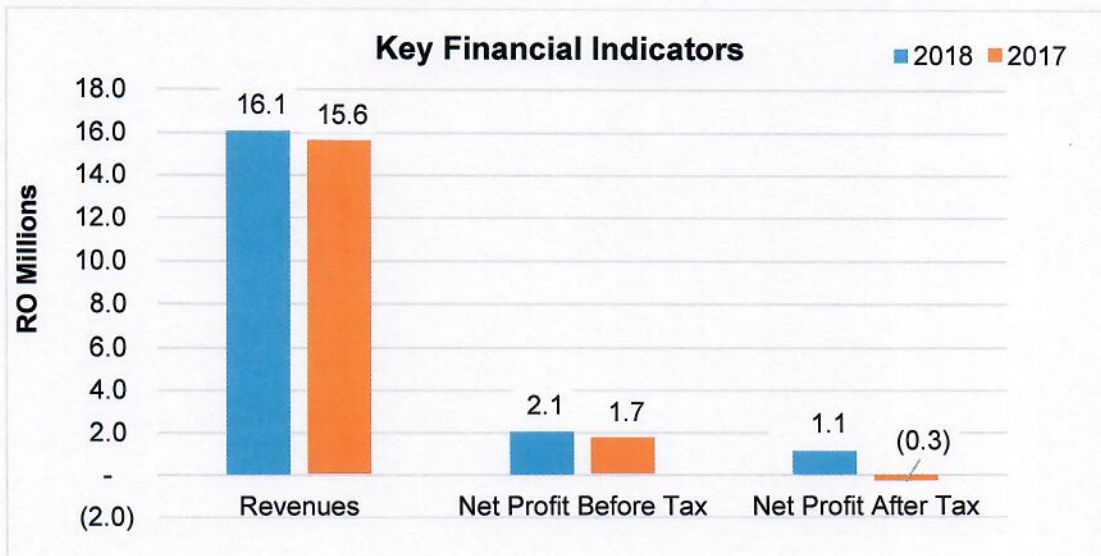
This year, the Plant had experienced additional events of algae bloom aggregating to almost 40 days of algae bloom compared with 21 days in 2017 and 6 days in 2016. Nonetheless, the impact of the algae bloom on the operations and availability of the plant, was mitigated with the incorporation of the Dissolved Air Flotation (DAF) system adopted at the plant. Technical support was also provided to the Operator by the founding shareholders, Malakoff Corporation Berhad (**Malakoff**) of Malaysia and Sumitomo Corporation (**Sumitomo**) of Japan, based on their experiences around the world.

During FY2018, the Plant produced a total of 59,929,864 m³/day of potable water with a utilization factor averaging 86% of total plant capacity or 88% of scheduled available capacity. Plant production is determined by the daily dispatch instruction issued by PAEW.

Financial Highlights

All figures in RO million		2018	2017
Revenues	1	16.1	15.6
Net Profit	2	1.1	(0.3)
Net Profit before Finance Costs	3	4.5	3.3
Total Assets	4	94.9	100.0
Capital (Paid-up)	5	15.6	15.6
Shareholder's Fund (Net Assets)	6	16.8	16.0
Term Loan (*1)	7	63.8	67.0
Weighted average number of shares	8	155,550,400	155,550,400
Actual number of shares outstanding	9	155,550,400	155,550,400
Ordinary dividends	10	1.45	-

(*) Excluding unamortized transaction costs



<u>Key Financial Indicators</u>		<u>2018</u>	<u>2017</u>
Net Profit Margin	= 2/1	6.83%	-1.92%
Return on Capital (Paid-up)	= 2/5	7.05%	-1.92%
Return on Capital Employed	= 3/(6+7)	5.58%	3.98%
Debt Equity Ratio	= 7 : 6	79 : 21	81 : 19
Net assets per share (RO)	= 6/8	0.108	0.103
Basic Earnings Per Share (RO)	= 2/8	0.007	(0.002)
Dividend per share (Baiza)	= 10/9	9.3234	-

Analysis of Profit and Loss

The Company managed to generate a healthy operating revenue of OMR16.1 million in FY2018, 3.21% higher than the OMR15.6 million in FY2017. This increase is mainly due to the higher available capacity and water production.

The profit before tax for FY2018 was OMR2.1 million, higher compared to OMR1.7 million in FY2017. The net profit after tax, is also higher in FY2018 OMR 1.1 million compared with a loss of OMR0.3 million in FY2017.

Analysis of Balance Sheet

Total assets of the Company stood at OMR94.9 million as at 31 December 2018 compared with OMR100.0 million in FY2017. This drop was mainly due to a full year depreciation charge and the reduction of the cash and cash equivalents, used to pay for the dividends and repayment of shareholders' loans.

The cash and cash equivalents as at 31 December 2018 is OMR1.8 million compared with OMR4.5 million as at 31 December 2017.

The shareholders' funds as at 31 December 2018 is OMR16.8 million compared with OMR16.0 million as at 31 December 2017. Hedging Reserve (net of deferred tax) increased equity by OMR 1.1 million, reflecting the fair value of the 2 interest rate swaps as at the balance sheet date. This however, does not impact the Company's capability to distribute dividends to its shareholders.

Term loans (including non-current and current balances) reduced to OMR63.8 million as a result of scheduled repayments made in accordance with finance agreements.

The Company continues to make adequate provision for asset retirement obligations to fulfil its legal responsibilities to remove the plant at the end of its useful life and restore the land to its original state, prior to handing over.

Dividend Distribution

At the Ordinary General Meeting held on 27 December 2017, the shareholders authorised the Board of Directors to determine and distribute cash dividends to the shareholders in February 2018 and the Board of Directors at its meeting on 8 February 2018 resolved to distribute cash dividend of Baizas 2.9268 per share to its shareholders who are registered in the Company's register as at 28 February 2018.

The Shareholders at the Annual General Meeting (AGM) held on 27 March 2018 authorised the Board of Directors to determine and distribute cash dividends to the Shareholders of the Company in November/December 2018 out of the retained earnings based on the audited financial statements for the period ended 30 September 2018, provided that the aggregate amount shall not exceed 6.4% of the paid up share capital of the Company (i.e., 6.4 Baizas per share).

The Board of Directors at its meeting held on 13 November 2018 approved the distribution of cash dividend of Baizas 6.3966 per share out of the retained earnings based on the audited financial statements for the financial period ended 30 September 2018 to the shareholders of the Company who are registered in the Company's shareholders' register with the Muscat Clearing & Depository Company S.A.O.C. as at 29 November 2018.

Employees, Training and Omanisation

MCDC and its Operator takes Omanisation as a responsibility to assist in the building of Omani expertise in the water desalination sector. Together, the Company and its Operator employs a total of 46 employees, of which 33 employees are Omani citizens.

Training is conducted frequently, with strong focus on HSE, operational improvements and personal development. The employees are encouraged to attend the continuous education programmes and seminars held from time to time to keep themselves abreast with the latest developments as well as to further enhance their competency and professionalism in discharging their duties.

The Project has achieved an overall Omanisation ratio of 71.7% as at 31 December 2018.

Internal control systems

The Board acknowledges that ensuring sound Internal Control Systems requires effective interaction among the Board, Management and its auditors. The Board, in ensuring effective discharge of its responsibilities, is assisted by the Board Committees, namely the Audit Committee and, Nomination and Remuneration Committee. Each committee has clearly defined terms of reference.

MCDC also has a comprehensive system of internal controls in place, comprising a well-defined governance structure, clearly outlined delegated levels of authority, annual budgets and plans to deliver the Company's strategy, supported by regular reporting of these plans and budgets to the Board of Directors.

Outlook

The Company will endeavor to ensure that it continues to take reasonable and prudent measures to improve its performance for FY2019, by improving the plant's reliability and availability, without compromising on HSE matters.