Management Discussion and Analysis Report

The management of Al Kamil Power Company SAOG (AKPC) is pleased to present its report on the Company's performance, its future outlook, business structure and other matters of importance to shareholders.

Main Objects and Business

Al Kamil Power Company SAOG (AKPC) is contracted under a Power Purchase Agreement (PPA) to supply electricity into the North Oman Transmission Grid. AKPC owns a 285 MW electricity generating plant near Al Kamil in the Sharqiya region of Oman and is the first private sector power plant in this region.

The formation of AKPC as an independent power producer is part of the Government's on-going privatisation strategy. The Company operates within agreed project documentation with different Government agencies and the Oman Power and Water Procurement Company SAOC (OPWP), a closed joint stock company held by the Government of Oman.

The Government of Oman stands behind the financial obligations of OPWP. The PPA with OPWP and the Natural Gas Sales Agreement (NGSA) with the Ministry of Oil and Gas (MOG) are valid until 30 April 2017.

Under the PPA, OPWP commits to pay AKPC Capacity Charges and Energy Charges in return for AKPC making available the electrical generating capacity and selling the electrical energy produced. Oman Electricity Transmission Company SAOC (OETC) conveys its planned power off-take on a daily basis and the power is then generated and delivered to the grid according to these requirements. The project agreements provide both revenue and cost assurance to the Company and its investors. A major source of revenue for the Company is the Capacity Charge, which is payable for all times the plant is available, based on minimum availability levels as defined under the PPA. AKPC is safeguarded under the PPA against RO/US$ exchange rate movements and also against inflation. The actual level of power generation has no direct effect on the Company's net income.

Natural gas is received at the plant and burned in the gas turbines to produce power. It is supplied by pipeline from the Saih Rawl gas field, which also supplies gas to major industries in Sur. This energy drives the generator and electricity is produced. The electricity is then transformed up to 132 KV and supplied to the grid.

MOG is responsible for the supply of gas to the plant. In the case of non-availability of gas or gas not conforming to specifications, AKPC has to run the plant on fuel oil as required under the PPA and the NGSA. Under such circumstances, AKPC would be reimbursed by MOG for any additional costs arising as a consequence of running the plant on fuel oil and for any capacity shortfall that may arise as a consequence.

Al Kamil Construction & Services LLC (AKCS) is contracted to operate and maintain the power station. AKCS, a company whose major shareholder is International Power plc, the UK-based global power generation developer, has an Operation and Maintenance Agreement with AKPC for fifteen years. The operations and maintenance standards of the plant are based on international best practice, in accordance with International Power's policies and principles which in turn is derived from its experience in operating power generation plants worldwide.

The generating plant at the Al Kamil power station comprises three General Electric Frame 9171E gas turbines in open cycle configuration, together with related ancillary equipment

required for fully independent operation. These turbines are designed to run on both natural gas and distillate fuel oil.

The maintenance team of AKCS comprises mechanical, electrical, control and instrumentation engineers, including technicians trained to undertake day-to-day activities on the plant. The routine maintenance of the plant and related apparatus is carried out in accordance with recommendations from the Original Equipment Manufacturer and “Maximo” maintenance management software tools have been installed in this regard. Major inspections and overhauls are contracted to specialist organisations, for example General Electric (GE) via a Long Term Service Agreement (LTSA) subsisting until April 2017. The over speed test of the gas turbine is carried out annually as recommended by International Power plc.

Planned unit outages are arranged during the winter periods - according to the schedule agreed between AKPC and OETC - in order to maximise generation during summer months. GE’s scheduled combustion inspections (at 12,000 Factored Fire Hours), hot gas path inspections (at 24,000 Factored Fire Hours) and major inspections (at 48,000 Factored Fire Hours) are all conducted during these planned outages.

An engineering risk assessment was carried out on all plant equipment by International Power plc (IPR) during 2009. IPR assimilates its engineering experience gained from all its power plants and shares this information on potential new risks between the various plants.

The following major plant modification/improvement programmes were undertaken during the year to enhance the reliability and safety in the plant operations:

1. An infrared thermal survey was undertaken to identify electrical defects in the plant. No defects were found.
2. A chemical analysis of the transformer oil was routinely undertaken and values obtained were determined to be satisfactory.
3. The gas turbine external lube oil purification system was commissioned. This will additionally protect the turbines against the effect of impurities like varnish in the oil.

Some plant improvement programmes were initiated during the year 2009 in order to augment operational reliability and safety, as follows:

1. A Unit Auxiliary Transformer (UAT) for gas turbine GT1B was installed in February 2010. The other two GTs already have UATs. This will avoid a ‘black-out’ situation in the plant should the other two turbines suffer a simultaneous trip. Furthermore, the flexibility and the reliability of the plant dispatch and operation will significantly improve.
2. During the year 2009, the plant experienced a forced outage due to the malfunctioning of the electronic control panels of the gas Pressure Reduction Terminal (PRT). To ensure continued uninterrupted gas supply, it was decided to procure an improved protection and control system for the PRT. The installation and commissioning of the new system was completed in January 2010.

AKCS has been certified with ISO 9001 for excellent quality management, ISO 14001 for excellent environmental management, and OHSAS 18001-2007 for outstanding health and safety management. AKCS is also a recipient of the Gold Award for health and safety performance by ROSPA (the Royal Society for Prevention of Accidents in the UK). The Company and AKCS are both committed to achieving the best possible health, safety, environmental and quality performance standards. The management focus is to emphasise a health and safety culture in every aspect of its operations. The Company believes that all workplace accidents and injuries are avoidable. As such, it encourages safe behaviour and the right attitude in order to deliver zero accidents and zero incidents.

The health and safety training and awareness programmes conducted by AKCS during 2009 included:

Fresh Eye - A behaviour-based process that stimulates safety awareness in the work place. The programme coaches and mentors the employees at the work place to ensure that each person takes responsibility for his or her actions and assists in fostering this attitude among colleagues at the work place.
Take Five - A programme that involves personal hazard identification at the place where work is to be carried out.
Safety walk and audit - A programme that seeks continual health and safety improvements among the employees.
Toolbox talk - This is a communication and information sharing forum to discuss various aspects of the work with the ultimate aim to improve health and safety at the work place.
Emergency mock drill - A programme that tests the preparedness of employees to respond to all types of plant emergencies

Income and Expenditure

Operating revenues incorporate Capacity Charges and Energy Charges which are recovered on a monthly basis from OPWP. Revenues are indexed to the RO/US$ exchange rate and inflation.

Capacity Charges are payable for each hour during which the plant is available for generation. The Capacity Charge is the total of:

- an investment charge covering capital expenditure and all related costs of the project such as tax payments, debt service and return on capital;
- a fixed operation and maintenance charge covering fixed operation and maintenance and all related costs to the plant; and
- a new industry charge providing compensation for Sector Law costs.

Energy Charges are payable for the energy generated in response to despatch requests issued by OETC. The Energy Charges are the total of:

- variable operating costs of generation;
- fuel costs - based on an agreed heat rate of natural gas consumption to produce the electrical energy delivered at a specified efficiency; and
- start-up charge - payable to AKPC for the costs of fuel for any starts in excess of 100 per year for each gas turbine.

A significant operating cost of the power station is the fuel required to operate the gas turbines. AKPC is required to pay for the gas consumed for the generation of power in accordance with the NGSA. However, the fuel charge element of the PPA allows a full pass-through of the gas price to the extent that electricity is generated with the plant efficiency detailed in the PPA.

AKCS is paid a fixed and variable fee for the operation and maintenance of the station for the duration of the PPA. This fee covers fixed operational expenses including expert services and the maintenance of mandatory spares for the plant. The actual variable energy charge received from OPWP under the PPA based on the actual energy delivered is paid to AKCS as a variable fee.

Future Outlook, Investment Opportunities and Obstacles

1. During the period inspection of the gas turbines the General Electric proposed certain modification to gas turbines. The modification allows the gas turbines to increase the power generation of the gas turbines at base load. As a result, the plant is able to achieve a 14 MW increase in the power generation capacity of the plant.
   OPWP and the Company are in the process of finalising an amendment to the Power Purchase Agreement to make available to OPWP additional generating capacity of 14 MW for the summer months of 2010, 2011 and 2012. This will give a boost to the Company's future financial results for these years.
2. In the year 2007, as part of its Energy Conservation Programme on behalf of the Government of Oman, OPWP approached the Company to evaluate the conversion of the existing open cycle gas turbines (OCGT) to combined cycle operations thus increasing the power capacity and efficiency of our plant. Accordingly, a technical feasibility study was submitted by the company. OPWP is currently in the process of evolving a procedure for obtaining competitive bids from those power plants in Oman which have open cycle gas turbines. The Company is awaiting a response from OPWP in order to take this proposal to the next stage and to be able to prepare a commercial bid together with an EPC contractor
3. During the year the Company conducted a study with an aim to increase the power generation capacity of the gas turbines by employing inlet air cooling technologies such as evaporative coolers and chilling units. While both these processes would entail capital investment, no additional gas will be required for the additional power that would be generated.
   A technical and commercial feasibility study is underway that will also involve a review of the capacity of the gas turbine generators and step-up transformers to be able to take the additional load.
   OPWP has shown its willingness to purchase any additional power generation capacity arising from this exercise.
4. During the year the Company's financial results were negatively impacted as a result of the higher interest claimed by the Company's project lenders, who unilaterally invoked the 'Market Disruption Event' clause (MDE) of the loan agreement. The Company is unable to get assurances from the project lenders as to when they would end the invocation of the MDE clause of the loan agreement in the future roll-overs of the project loan. Future profits will continue to be adversely impacted if the project lenders persist with MDE claims.

Risks and Concerns

Loss of Availability due to Mechanical Breakdown

The principal risk to AKPC is the plant being unavailable due to mechanical breakdown. In order to mitigate this risk, AKPC ensures that AKCS operates and maintains the plant in line with AKPC policies, principles, directives and best practices in the industry.

Loss of Availability due to Accidental Damage

In accordance with industry best practice, AKPC ensures that adequate insurance policies are in place to protect the business against any loss of property and loss of income arising from accidental damage.

OPWP Payments

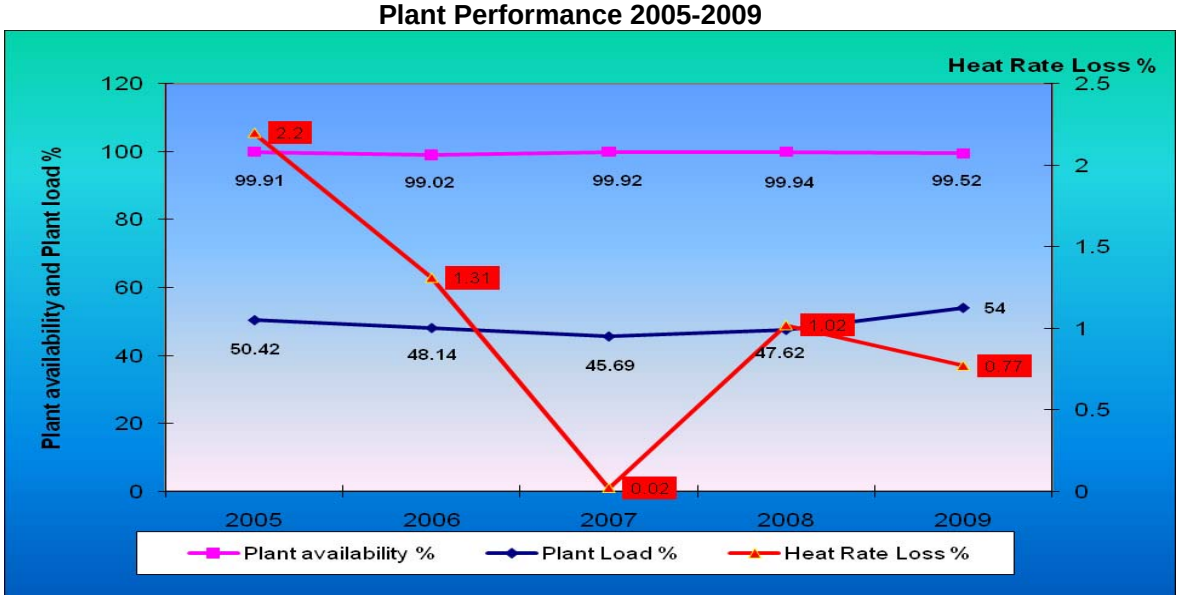
OPWP has settled in full all invoices within the agreed credit period.

Financial and Operational Performance

Plant Performance

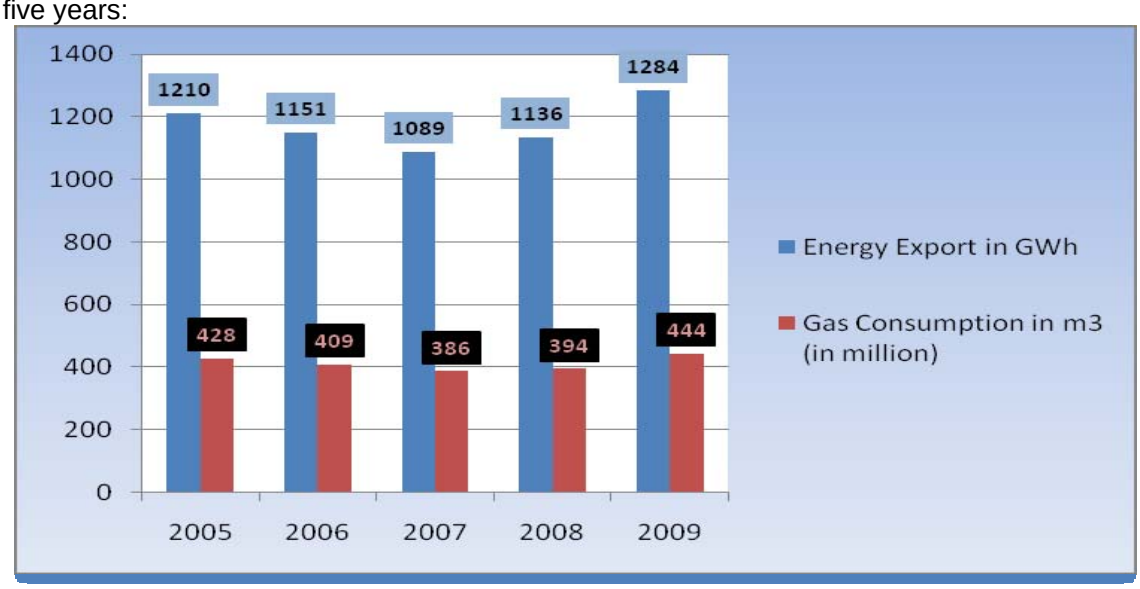
The plant operated extremely well throughout the year in compliance with OETC instructions with a commercial availability of 99.52%. The following chart demonstrates the performance of the Company over the last five years:

Plant Performance 2005-2009



The plant performance has been excellent over the last five years with the plant availability being consistently maintained. The plant has witnessed a steady improvement in plant load factor, with an average plant load factor for 2009 of 54%. Nevertheless, the plant continues to operate at a considerable unutilised capacity. During 2009, there has been a reduction in the heat rate loss due to an improvement in thermal efficiency. The plant generated 1,284 GWh of electricity, 13% higher than in 2008.

The following chart gives the power generated and gas consumed by the plant over the last five years:



Routine maintenance and performance tests were successfully carried out through the course of the year. A combustion inspection of one gas turbine was undertaken in March after it completed 36,000 Factored Fire Hours.

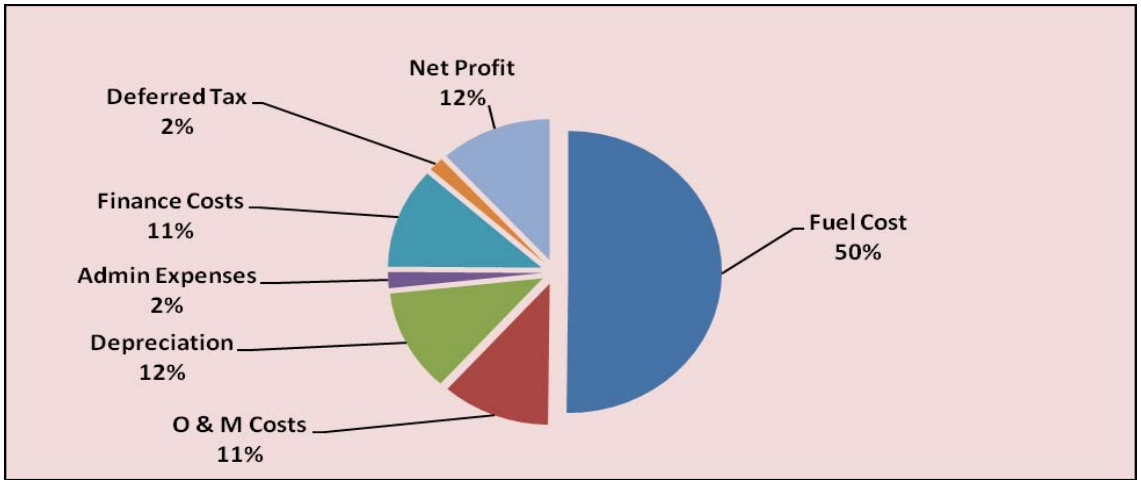
During the annual performance tests carried out in the presence of OPWP, the capacity of the power station on both natural gas and fuel oil was successfully demonstrated to be in accordance with the guaranteed capacity under the PPA for the current contract year. The plant fully complied with all the environmental guidelines issued by the Ministry of Environment and Climate affairs. Since its inception, there have been no Loss Time Accidents to any employees working for the power station.

Financial Performance

The financial performance indicators used by the Company address two key aspects of the business - its profitability and its cash generation.

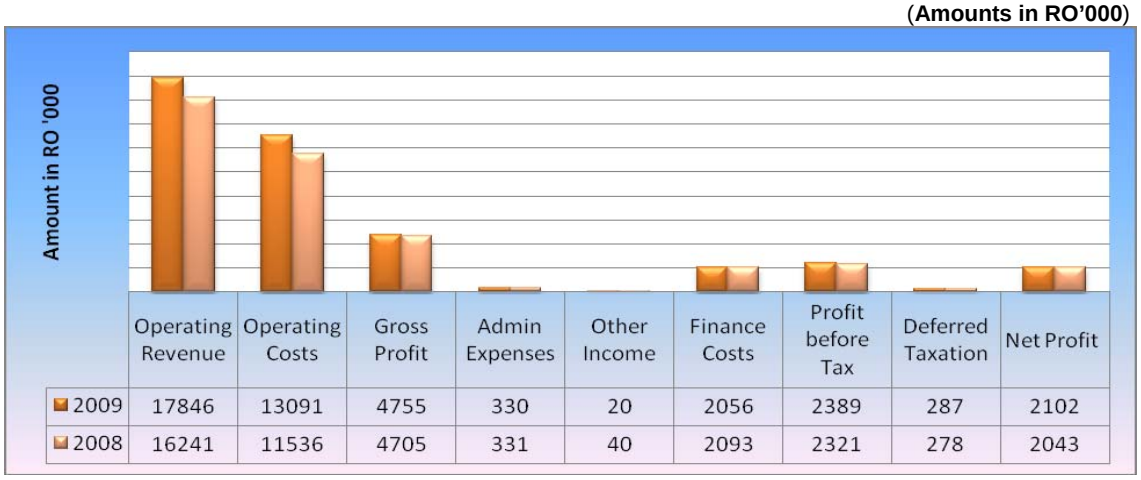
Power generation is a capital intensive business which necessitates the close monitoring of costs in order to achieve our targeted profits. The ultimate goal is to provide a fair return for our shareholders.

The following chart illustrates how the revenue earned during the year 2009 was spent:



Revenue and cost analysis for 2009 (as compared to 2008) are displayed in the following chart:

(**Amounts in RO'000**)



	Operating Revenue	Operating Costs	Gross Profit	Admin Expenses	Other Income	Finance Costs	Profit before Tax	Deferred Taxation	Net Profit
2009	17846	13091	4755	330	20	2056	2389	287	2102
2008	16241	11536	4705	331	40	2093	2321	278	2043

The following important factors contributed towards improving the financial performance of the Company during the year:

1. Inflation within the United States and in Oman increased the US Producers Price Index and Omani Consumer Price Index respectively. As the capacity and energy charge rates are linked to these indices, the charge rates increased leading to higher revenue. (However, as energy income is a pass-through income for the Company, any increase in the energy income has no impact on the net profit for the year).
2. The improvement in thermal efficiency reduced heat rate loss. The loss reduced from 1.02% in 2008 to 0.77% in 2009.
3. Close monitoring of general and administrative costs ensured they remained at the same level as in 2008.

It is important to note that the invocation by the project lenders of 'Market Disruption Event' clause (MDE) of the loan agreement negatively impacted the net profit of the Company. The additional interest as a result of MDE amounted to RO 0.239 million (US$ 0.621 million). If MDE had not been invoked by the lenders, the net profit of the Company would have been RO 2.341 million (US$ 6.087 million).

The summarised cash flow for the year 2009 (as compared to the year 2008) is given below:

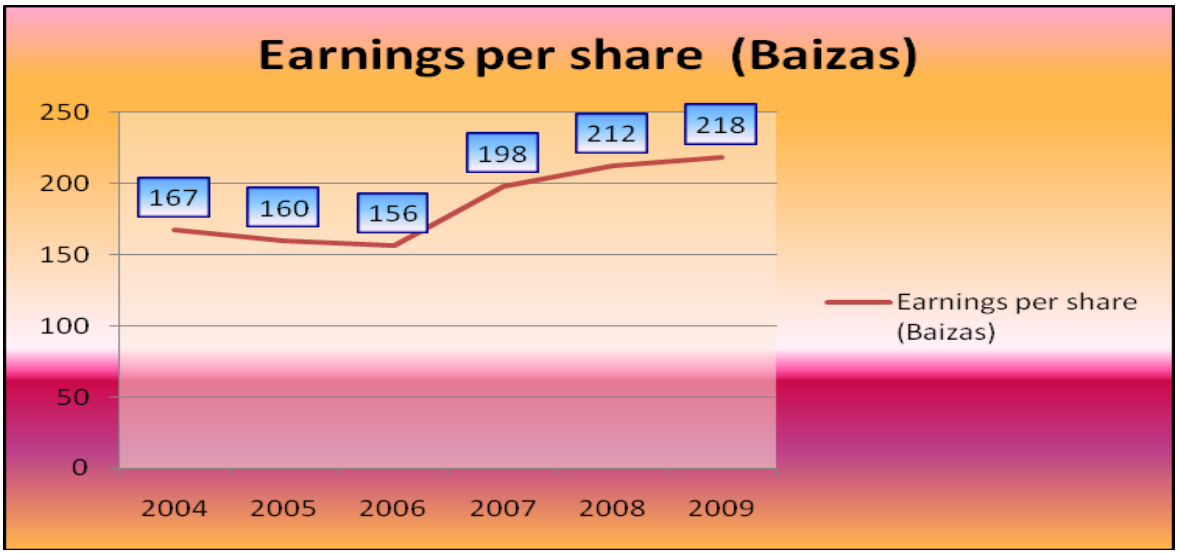
	2009 RO'000	2008 RO'000
Net cash from operating activities	3,849	3,931
Net investment in fixed assets (inclusive of capital maintenance)	(241)	(446)
Repayment of Project Loan	(2,324)	(2,150)
Repayment of BankMuscat subordinated loan	(225)	(225)
Dividend paid	(770)	(1,829)
Net increase in cash and cash equivalents	289	(719)
Cash and cash equivalents at the beginning of the year	1,309	2,028
Cash and cash equivalents at the end of the year	1,598	1,309

The Company is pleased to announce that it met all obligations under its bank covenants.

During the year the Company declared and disbursed a final dividend of 8% for 2008. The MDE related additional interest cost prevented the Company from declaring an interim dividend for the year 2009.

The Board of Directors have proposed a final dividend of 12% in respect of the financial year of 2009.

Finally, earnings per share (EPS) is a measure of the overall profitability of the Company. It is defined as the profit in Baizas attributable to each share in the company, based on the net profit for the year, after tax. The calculation for EPS is shown in Note 24 within the financial statements. The following chart highlights the value added to the shareholders' investment in the Company over the last six years:



The Company conducts no other business in the Sultanate of Oman or outside and has no subsidiaries.