Credit Opinion: Oman Power & Water Procur. Co. (S.A.O.C.)

Global Credit Research - 06 Feb 2013

Muscat, Oman

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	A1

Contacts

Analyst	Phone
Martin Kohlhase/DIFC - Dubai	971.42.37.9536
Rehan Akbar/DIFC - Dubai	
David G. Staples/DIFC - Dubai	

Opinion

Corporate Profile

Oman Power and Water Procurement Co. S.A.O.C. (OPWP) undertakes fully regulated water and electricity procurement services within the Sultanate of Oman. Established in 2003 and with headquarters in Muscat/Oman, OPWP has the exclusive right (subject to certain limited exceptions) to act as the sole buyer of electricity and related water from licensed production facilities, and is the sole seller of electricity and related water to the licensed electricity suppliers and water authorities. OPWP's primary focus is (i) to ensure that sufficient capacity and output are available to meet the requirements of licensed electricity suppliers and (ii) 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, OPWP initiates fair and transparent competitions open to international investors to contract for the country's electricity and related water capacity requirements.

OPWP's duties and functions are explicitly covered under `The Law for the Regulation and Privatisation of the Electricity and Related Water Sector' (Sector Law), which lays the foundation of the regulatory framework for the power and water sector in Oman. The Sector Law was promulgated by Royal Decree 78/2004 and amended by Royal Decree 59/2009. OPWP is a closed joint stock company registered under the Commercial Companies Law of Oman, owned 0.01% by the Ministry of Finance and 99.9% by Electricity Holding Company S.A.O.C., which is itself wholly-owned by the Ministry of Finance.

Rating Rationale

The rating of OPWP is based on Moody's assumption that OPWP (i) will continues to play a vital role in Oman's power and water sector while benefiting from the existing regulatory framework, (ii) will receive timely financial support from the government when required and as stipulated by law, and (iii) will remain wholly-owned by the government of Oman. OPWP's strictly regulated activities and clearly defined mandate creates a very low risk business profile which is enhanced by the stability of the regulatory framework. Given the legal and regulatory framework in combination with the government's exclusive ownership and low business risk profile, OPWP's baseline credit assessment (BCA) of a1 is on par with the credit risk assessment of the Government of Oman (A1/Stable).

DETAILED RATING CONSIDERATIONS

OPWP's rating incorporates its strategic role in Oman's growing power and water sector as well as its government agency-like function in certain activities such as future capacity planning. Furthermore, as an entity that is ultimately 100% owned by the government and is involved in an essential sector that provides economic and social stability, the rating assumes high government support. In Moody's view, the government of Oman would lend direct or indirect financial support to OPWP in all circumstances, and indeed is obliged by law to do so.

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 2004, Moody's rating assumes 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 substantial state subsidies to the licensed electricity suppliers by utilising OPWP to absorb some of the costs or increase counterparty risk would harm the company's credit profile.

OPWP's financial profile benefits from a highly predictable revenue stream offset by largely stable procurement costs. The company does not undertake any generation activity, but acts merely as a bulk purchaser and seller of electricity and desalinated water. OPWP makes significant payments to licensed production facilities as sole off-taker of electricity and related water and receives significant payments from licensed electricity suppliers and water authorities when its commitments are sold on. The company's gross profit is sufficient to cover operating expenses, while it is able to make a small profit if it can 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.

OPWP calculates bulk supply tariffs on the basis of a cost-plus formula, allowing for full pass-through of market risk under normal circumstances. Tariffs are determined annually by OPWP and approved by the Authority for Electricity Regulation (AER), Oman's independent regulatory authority. OPWP issues a preliminary invoice to licensed suppliers at the end of each month, with supplemental invoices for adjustments issued when practically feasible. Under normal circumstances, payments against invoices and adjustments are required to be made within 30 days of receipt.

At year-end 2011, OPWP was in compliance with its license requirements, including issuance of the 7-year statement from 2012 to 2018 on demand for electricity and desalinated water, and the power generation and desalination resources required to meet this demand; and issuance of the Bulk Supply Tariff for electricity and water for 2012.

Liquidity

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 power 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 electricity and related water sector that is wholly-owned by the government and would provide immediate liquidity on demand, if required.

Rating Outlook

The outlook of OPWP's rating is stable. As long as OPWP's activities remain limited predominantly to its regulatory obligations, and continue to achieve full pass-through of procurement costs under normal circumstances, its rating is likely to move in sync with Oman's sovereign rating. Changes in the regulatory framework and/or government policies may require a reassessment of the rating outlook.

What Could Change the Rating - Up

Moody's expects 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. Given the sector's continued reliance on the government for subsidies, Moody's rating anticipates the continued timely payment of these subsidies for as long as required, thus mitigating any counterparty risk for OPWP. All things being equal, OPWP's rating is expected to move in sync with Oman's sovereign ratings.

What Could Change the Rating - Down

OPWP's rating is derived from the strength of the sovereign, and a rating downgrade of the Sultanate of Oman could also lead to a downgrade of OPWP's rating. The rating assumes that OPWP will not be raising any debt, other than for short term liquidity purposes. Any changes in the regulatory framework or government policies that create financial stress on OPWP could lead to negative rating pressure. In particular, rating assumes 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. Market liberalisation measures, such as the privatisation of OPWP, would require a reassessment of the company's rating position and could place downward rating pressure.