



## ***SMN Power Holding SAOG*** ***Under Transformation***

***Offer Price: RO 3.520***

***Outlook: Subscribe***



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GULF BAADER CAPITAL MARKETS S.A.O.C.

## SMN Power Holding - Steady Cash flow, Dividend play

### Outlook: *Subscribe*

**IPO Rating: Average**

- Utilities play providing fixed returns
- Best portfolio fit for low risk appetite investors
- Fair value factoring for higher dividend payouts

### **Issue for low risk appetite investors ...**

September 26, 2011

As a combined entity of two project companies, the SMN Power Holding SAOG (*under transformation*) owns the largest power generation capacities in Sultanate of Oman. Key promoters of the company include Kahrabel (*fully owned subsidiary of International Power*), Mubadala Power Holding Co and the National Trading Co.

**Power demand to remain intact:** As per the latest seven year projections (2011-17) of OPWP, the average electricity demand in Main Interconnected System (MIS) is estimated to grow from 1,924 MW in 2010 to 3,464 MW in 2017, reporting a CAGR of about 8.8%. Key drivers for demand include the estimated economic growth, investment in various tourism projects along with the development of various industrial hubs in Sohar, Sur and Duqm.

**Steady cash flow generation:** As per the PPA, the revenue of the company is fixed through the Power and water Purchase agreement (PWPA) with the single off taker, Oman Power and Water Procurement Co (OPWP). Owing to this, we believe that the company has a strong revenue visibility providing stable and reliable cash flow generation over the project period, which provides comfort to the investors.

**Strong shareholder support:** The presence of robust shareholder strength for SMN Power Holding in the form of International Power-GDF Suez, parent of Kahrabel, which is one of the leaders in global independent power generation with 72,360 MW (gross) 42,225 MW (net) in operations across the world. Added, Kahrabel / International Power are the largest private power and water producers in Oman.

### **Outlook - Steady cash flow, Dividend Play...**

Overall the stable industry performance along with the steady cash flow generation in the Utilities sector makes the issue an attractive dividend play. We rate the SMN Power Holding IPO as an average issue in our rating sale with the fair value factoring for higher dividend payouts. Based on our Valuation methodologies (*Dividend Discount Model*), **we have arrived at our fair value of RO 3.877 for SMN Power.**

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We recommend the low risk appetite investors to subscribe for the issue with the medium to long term horizon. **We also believe that the issue would be a best fit for long only funds and institutions. We expect the issue to see limited upside on listing, however considering the dividend yield we recommend to subscribe for the issue.**

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Offer Details ...

Table 1: Term Sheet

Issue Details	Key Terms
Name of the Company	SMN Power Holding SAOG (under transformation). The company is the holding company of the two power projects.
Authorized Capital	RO 70.00 million
Nominal Value	RO 1.000
Issued and Paid Capital (Pre & Post IPO)	RO 19.964 million
Number of Shares Offered for subscription	35% (6.987 million shares) of the Company's total share capital as per the obligations stipulated.
<b>Purpose of the IPO</b>	<b>Comply with the listing obligations stipulated in PFA</b> Requires 35% available for public subscription
Allocation	<ul style="list-style-type: none"> <li>Open to Omani and Non - Omani Investors</li> <li>Total foreign ownership following listing shall not exceed 70% of the paid up share capital.</li> <li>All GCC nationals are treated as Omani nationals in respect of ownership of and trading in shares.</li> </ul>
Proposed Allocation	<p><b>Category I - Retail Investors</b> 60% of the Offer (4.192 million shares), for individuals and juristic persons applying for a maximum of 5,000 Shares.</p> <p><b>Category II - Institutional Investors</b> 40% of the Offer (2.795 million Shares), for individuals and juristic persons applying for more than 5,100 Shares.</p> <p>Any under subscription in any Category shall be carried over to the other Category</p>
<b>Offer Price for each Share</b>	<b>RO 3.520 - Offer price of RO 3.500 plus 20 Baizas towards Issue Expenses</b>

Source: IPO Prospectus, GBCM Research

**Term Sheet details contd...**

<b>Issue Details</b>	<b>Key Terms</b>
<b>Total Offer Size</b>	<b>RO 24.595 million</b>
Minimum Limit for the Subscription	Category I: 100 Shares and in multiples of 100 thereafter  Category II: 5,100 Shares and in multiples of 100 thereafter
Maximum Limit for the Subscription	Allotment would be on a proportionate basis Category I: 5,000 Shares  Category II: 10% of the total Offer size representing 698,725 shares
Offer Opening Date	Allotment would be on a proportionate basis 11 September 2011
<b>Offer Closing Date</b>	<b>10 October 2011</b>
Approval of CM with regards to allotment	22 October 2011
<b>Listing of Shares in MSM</b>	<b>25 October 2011</b>
Selling Shareholders	<ul style="list-style-type: none"> <li>• Kahrabel FZE (47.5% of the offer shares)</li> <li>• Mubadala Power Holding (47.5% of the offer)</li> <li>• National Trading Co (5% of the offer)</li> </ul>
Subscription Banks	Bank Muscat National Bank of Oman Oman Arab Bank

Source: IPO Prospectus, GBCM Research



### Share Holding Pattern - Pre IPO

S.No	Shareholder	% Holding
1	Kahrabel FZE	47.50%
2	Mubadala Power Holding	36.63%
3	MDC Industry Holding	10.88%
4	National Trading Co	5.00%

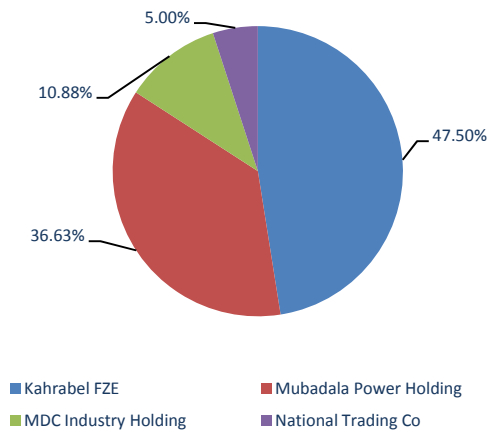
Source: IPO Prospectus, GBCM Research

### Share Holding Pattern - Post IPO

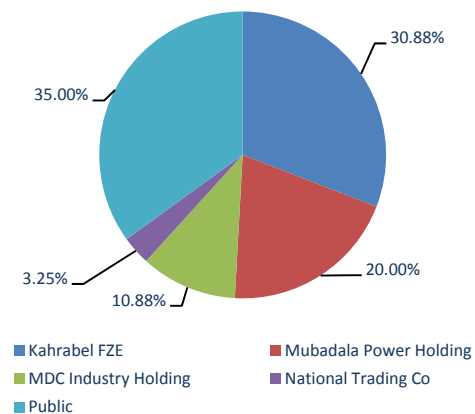
S.No	Shareholder	% Holding
1	Kahrabel FZE	30.88%
2	Mubadala Power Holding	20.00%
3	MDC Industry Holding	10.88%
4	National Trading Co	3.25%
5	<b>Public</b>	<b>35.00%</b>

Source: IPO Prospectus, GBCM Research

Graph 1: Pre IPO Shareholding



Graph 2: Post IPO Shareholding



Source: Prospectus, GBCM Research

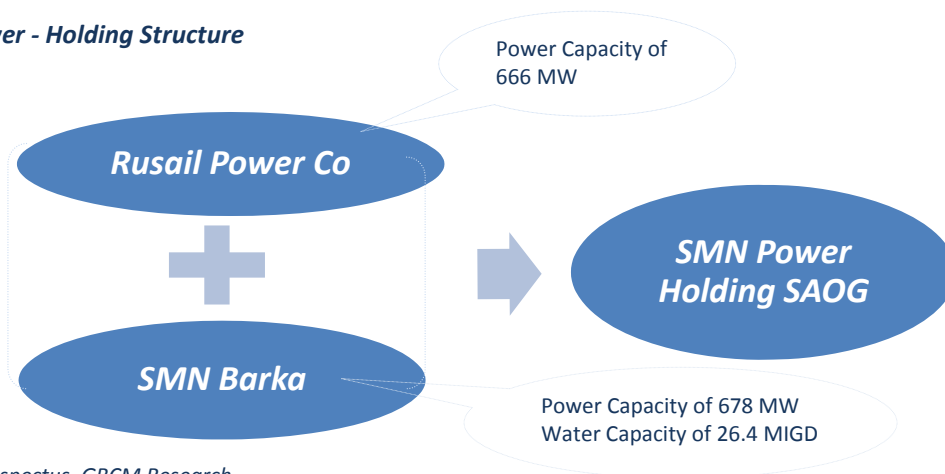


### Background of the company...

SMN Power Holding SAOG (*under transformation*) is the holding company which owns two major power projects in Oman namely Rusail Power Company (RPC) and SMN Barka Power Company (SMNBPC). As a combined entity, the SMN Power owns the largest power generation capacities in Sultanate currently. Key initial promoters of the power projects include Kahrabel (*fully owned subsidiary of International Power*), Mubadala Power Holding Co and the National Trading Co. As part of a privatization plan in 2006, the company had purchased the assets of RPC unit from the Government of Oman (EHC and Ministry of Finance), which is relatively an old one. On the contrary, SMN Barka is a newly built unit which had commenced operations in Nov 2009.

Both the projects have been formed under the Build, Own and Operate (BOO) scheme. As per Oman Power and Water Procurement Co (OPWP) statistics, the overall installed power capacity of the two power companies combined forms about 35% of the total capacity of the country's Main Interconnected System (MIS). The company also represents about 33% of the total generated power in Oman for 2010, forming the biggest one. As per the prospectus, for 2010 the new plant SMN Barka operated at an average availability of power of about 92.07% and the plant load factor (PLF) was at 37.5%. While for the RPC Plant, the average availability was at 90.8% and the PLF was 59.3%.

### SMN Power - Holding Structure



Source: Prospectus, GBCM Research

### Purpose of the offer

The holding company plans to go for the IPO to comply with the specified obligations under the project founders' agreement (PFA) which requires 35% of the shareholding available for public subscription.

### Proceeds of the offer

The IPO represents a pure offer for sale with the shares offered do not represent any issuance of new shares by the company. The total proceeds of the offer which includes the premium would be going only to the selling shareholders. Thereby, the proceeds from the IPO would not have an impact on the financials.

## Economic Outlook...

### Oman Economic Growth remains stable

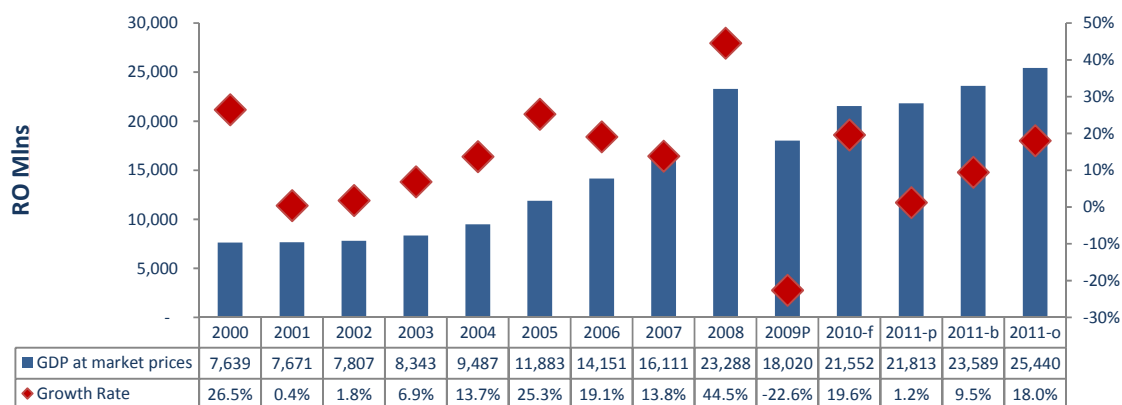
The continuance of robust Government spending towards the development of Infrastructure has led to incremental allocation of funds to key sectors especially the Utilities projects, which would be the drivers for economic growth. The stability in Oman's economy over the previous years has led to higher private sector investments in various critical sectors like Oil & Gas, Banking, diversified industries and the Power and water arena. Added, the prevailing higher oil prices along with the Government efforts taken towards the new job creation would in turn keep up the steady GDP growth momentum continuing over the coming years.

The thrust on the development of diversified income especially the non-oil contribution to GDP has led to huge project investments in Industrial hubs; Oil & Gas related industries and also the investment in tourism sector. We have also seen the Government's commitment towards the development of local human development by incremental allocations to health, education and other personal sectors, which we believe would be critical in the longer term. Oman's Eighth five year plan too targets continuance of stable economic growth thereby achieving the long term objectives of Oman Vision 2020 strategy (1996-2020).

### Thrust remains of Project spend

Eighth Five Year plan is anticipated to give local economy the right stimulus by offering development oriented growth to continue over the coming years. The sustainable levels of fiscal spending and the clear focus on new job creation is anticipated to bring in long term benefits towards achieving stability in growth. The presence of favorable demographics and the continuance of Infrastructure spend is believed to attract foreign investments in wide variety of industries moving ahead. Economic Diversification efforts and the creation of workforce are expected to lead in consumption lead growth moving forward. With the consensus oil price estimates of above USD 90 per barrel in FY2011E, we believe that the project investments undertaken by Government to go on a stronger pace of growth.

### Oman Nominal GDP Growth Trend



Source: MoNE, GBCM Research Estimates



## Oman Power Sector - An Introduction

Overall Demand for electricity in Oman has been growing at about 6-7% per annum in recent years, fuelled by robust industrial activity and steady economic growth. As per the OPWP, around 2,100 to 3,000 MW of additional power generation resources to be added to Main Integrated System (MIS) by 2015E. Overall annual Power consumption is estimated to increase by about 8% every year till 2020, which shows the stable industry nature. Government has planned an aggravated programme to cater to the growing demand for Power sector.

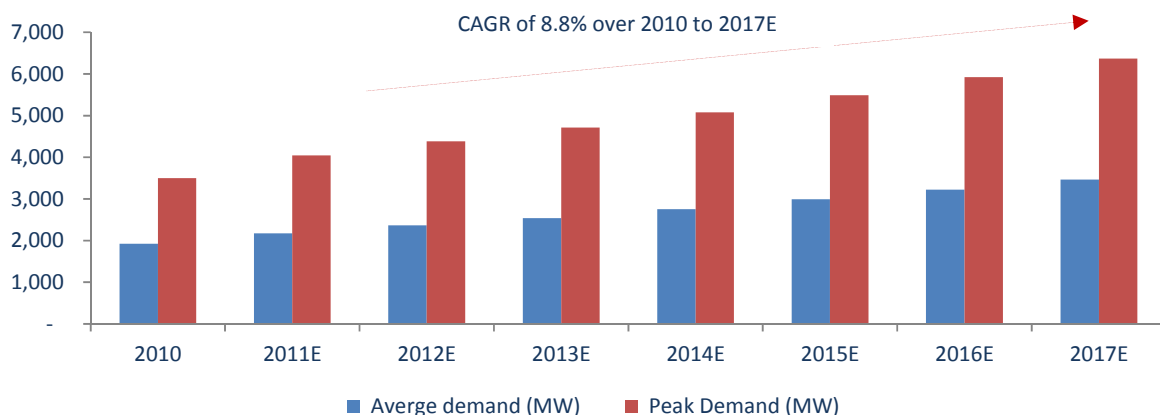
Oman is also the first country in the region to have a concept of private power thereby providing host of new opportunities for private sector players towards Sector development. This led to the entry of global majors like AES, International Power and Suez Energy (*largest investor in Oman Power Sector*). The first publicly owned power plant in Oman to be transferred to the private sector was the Al Rusail facility (*this is part of SMN Power Holding*) sold to Suez and Mubadala Development worth c. \$550 million in 2006.

### Power Demand growth remains steady

The Main Interconnected System (MIS) covers major portion of Sultanate comprising of several power generation facilities including SMN Power Barka and Rusail Power. Currently there are nine power generation companies, three distribution units, one transmission company and a rural firm covering remote areas. Over the last ten years, the overall electricity demand in MIS has grown by 7-9% annually. During 2010, the demand has increased by 7% YoY.

With the continuing investment towards the development of diversified economic growth, we believe that the demand for power would grow at a stable pace going forward. According to OPWP data, the overall power demand in the MIS grew at a CAGR of 9% over 2005 to 2010 which is mainly on the back of stronger economic growth, increasing population and the development of new industrial and tourism projects.

### MIS - Electricity Demand Projections



Source: OPWP, GBCM Research

### Average Demand to grow by 8.8% CAGR over 2010-2017E

As per the latest seven year projections (2011-17) of OPWP, the average electricity demand in MIS is estimated to grow from 1,924 MW in 2010 to 3,464 MW in 2017, reporting a CAGR of about 8.8%. Key drivers for demand include the estimated economic growth, investment in various tourism related projects along with the development of various industrial hubs in Sohar, Sur and Duqm. The upcoming two new IPPs (Sohar II and Barka III) are scheduled to be commissioned in phases during 2012 and 2013. This would add 495 MW in 2012 and 250 MW in 2013 with the total addition of 1,490 MW. On the other hand, the new Sur IPP (installed capacity of 1,500 to 1,200 MW) is expected to be operational by end 2013. Government has also initiated studies towards the investment in Solar Power generation, which could be beneficial in longer run.

	2011	2012	2013	2014	2015	2016	2017
<b>Current Contracted Capacity (MW)</b>							
Ghubrah	475	475	325	235	235	235	235
Rusail	687	687	687	687	687	687	687
Wadi Al Jizzi	325	245	245	245	157	157	157
Manah	273	273	273	273	273	273	273
Al Kamil	297	297	282	282	282	282	-
Barka 1	450	450	435	435	435	435	435
Sohar 1	590	590	590	590	590	590	590
Barka 2	710	710	679	679	678	678	678
Sohar 2	-	495	745	742	740	739	738
Barka 3	-	495	745	742	740	739	738
<b>Total</b>	<b>3,807</b>	<b>4,717</b>	<b>5,006</b>	<b>4,910</b>	<b>4,817</b>	<b>4,815</b>	<b>4,531</b>

Source: OPWP, GBCM Research

### Demand for desalinated Water continues to grow

According to OPWP statistics, the overall demand for potable and industrial water in the MIS is expected to grow from about 163 million m<sup>3</sup>/ annum in 2010 to 278 million m<sup>3</sup>/ annum in 2017, reporting a CAGR of 8%. The growth in demand is on back of the assumptions of incremental population, steady economic growth and also the change in policy towards lowering the reliance of ground water resources moving ahead. SMN Power Barka comes under the Barka Zone where the demand is estimated to grow by 8% CAGR over 2010-17E. The Barka Zone is located between Sohar Zone and Ghubrah Zone allowing PAEW to transfer within the zones.

Figures in 000 m <sup>3</sup> / day	2010	2011E	2012E	2013E	2014E	2015E	2016E	2017E	CAGR (2010-17E)
<b>Peak Water Demand</b>									
Ghubrah Zone	258	270	284	299	314	330	330	330	3.6%
Barka Zone	177	197	219	243	269	299	303	307	8.2%
Sohar Zone	83	101	121	122	139	168	174	214	14.5%
Sur Zone	40	45	52	59	67	76	77	79	10.2%
Ad Duqm Zone	1	3	6	12	14	16	18	21	54.5%
<b>Total All- Zones</b>	<b>559</b>	<b>616</b>	<b>682</b>	<b>735</b>	<b>803</b>	<b>889</b>	<b>902</b>	<b>951</b>	<b>7.9%</b>

Source: OPWP, GBCM Research

## Investment Rationale

### Leadership position in Oman

Currently, SMN Power Holding is the largest power company in terms of installed electricity capacity and generated output in Oman. Overall installed capacity of the holding company stands at about 1,343 MW, comprising of SMN Barka with the capacity of 678 MW and Rusail Power with a capacity of 665 MW, forming c. 35% of Oman's total installed electricity MIS capacity. While the 120,000 m<sup>3</sup>/day water capacity of SMN Barka forms about 20% of the water demand in the Main Supply Zone. The presence of higher capacity is believed to provide economies of scale in the longer run, which we believe would a positive one.

As of now, both the project companies of SMN Power Holding operate under higher efficiency, which is critical for the steady revenue growth. With regards to SMN Barka, the reliability factor stands at 98.8% and the availability for power is at 92.7% levels (end 2010), while the water reliability and availability is about 90.3% and 84.3% respectively. In the case of Rusail Power, the reliability is at 97.7% and availability is at 90.8% (end 2010).

### Robust shareholder support

The presence of strong shareholder strength for SMN Power Holding in the form of International Power-GDF Suez, parent of Kahrabel, which is one of the leaders in global independent power generation with 72,360 MW (gross) 42,225 MW (net) in operations across the world. Added, Kahrabel / International Power are the largest private power and water producers in Oman with the equity participation in Sohar IWPP, Al Rusail, Barka 2 IWPP, Al Kamil, Al Suwaidi (under construction) and Al Batinah (under construction). SMN also has the backup of Mubadala, the regional leader in the Power sector and the Omani establishment National Trading Co.

Kahrabel is expected to maintain about 22.75% of equity in each of the project companies until Nov 2013 which come under the PFA. The major shareholders have developed a wider knowledge of the sector through the implementation of various independent power and water plants across the globe, which we believe would give the holding company expertise in the effective implementation and efficient operation of both the plants.

### Major Plant Capacities in MIS

Plant Owner	Plant Status	Plant Type	Capacity	Developer	Contract Expiry
Rusail Power	Operational	OCGT Natural gas fired	666 MW	Kahrabel	2022
United Power	Operational	OCGT Natural gas fired	280 MW	SEI (Divested to MENA IF)	2020
Al Kamil Power	Operational	OCGT Natural gas fired	285 MW	Inter. Power	2017
ACWA Power	Operational	CCGT Natural gas fired	427 MW/ 20 MIGD	AES (Divested to ACWA)	2018
Sohar Power	Operational	CCGT Natural gas fired	585 MW/ 33 MIGD	Kahrabel	2022
SMN Barka Power	Operational	CCGT Natural gas fired	678 MW/ 26.4 MIGD	Kahrabel	2024
Al Batinah Power	Construction	CCGT Natural gas fired	744 MW	Kahrabel	2028
Al Suwadi Power	Construction	CCGT Natural gas fired	744 MW	Kahrabel	2028

Source: OPWP, IPO Prospectus, GBCM Research



### ***Revenue visibility remains strong***

As per the PPA, the revenue of the company is fixed through the Power and water Purchase agreement (PWPA) with the single off taker, OPWP. In terms of operating costs, the fuel (natural gas) is the major one which is chargeable to OPWP on an actual usage basis. We believe that the other costs especially the operations and maintenance charges, general and admin costs, depreciation, finance and tax rate remain mostly predetermined for the project companies. Owing to this, we believe that the company has a strong revenue visibility providing stable and reliable cash flow generation over the project period, which provides comfort to the investors.

Overall output of the installed capacities of the project companies would be contracted through a single long term PWPA each. The agreement on the off take gives low risk to price and volume with the revenue directly linked to the availability of the plant with the tariffs being fixed during PPA. The same would be valid till the expiry of the PWPA period for Rusail Power which is at March 2022 and for SMN Barka the same is at November 2024. We also believe that the total electricity and desalinated water demand is anticipated to grow on a stable phase over the coming years driven by economic growth, development of new industrial and tourism projects.

### ***Secured operational and maintenance costs***

The project companies (RPC and SMNPBC) has secured long term operation and maintenance contract towards the generation of electricity and production of water for supply to OPWP from Suez Tractebel Operations and Maintenance LLC (STOMO). This would ensure efficient management of spare parts, tools, materials and consumables required for the operation and maintenance (O&M) of the project companies. STOMO is required to operate and maintain the SMN Barka Plant until 31<sup>st</sup> Mar 2024, while the agreement to operate and maintain the RPC Plant is till 31<sup>st</sup> Mar 2022. We believe the presence of secured O&M agreement gives comfort to the investors towards the efficient running of the plant operations, which is critical in the long run of power plant. Added, this is expected to lower the operational risk of the projects in the form of any unexpected increase in operating and maintenance costs.

### ***Committed Gas supply agreements***

Both the project companies of SMN Power Holding use natural gas as the primary fuel to both of the plants. The companies get a committed supply of gas (*subsidized price at USD 1.5 per MMBTU*) over the period of the PWPA based on the longer term contracts (*Natural gas sales agreement - NGSA*) entered by both the companies with the Ministry of Oil and Gas of Oman. However, the companies used to have a strategic back up of fuel oil inventory to cover up to three days of operations in emergency. Added, as per the PWPA the project companies does not carry the fuel price risk with the incremental fuel costs being passed on to the OPWP till the PWPA period, which would keep the operational costs in controllable limits.



***Hedging mechanism to protect against changes in interest rates***

The project companies (*RPC and SMN Barka*) has its interest rate set based on 6 months LIBOR (*London Interbank offer rate*) and the interest rate volatility is hedged by interest rate swaps as per the hedging policy of the company. As part of its interest hedging, both the project companies have hedged at 95% levels currently (*increased from 80% to 95% levels in March 2009*) until March 2013, which also fulfils the facilities agreements.

As far as RPC is concerned, the project company has entered into an interest rate swap agreement in Nov 2008 increasing the hedged amount to 95% from 80% for four years till Mar 2013 at a fixed rate of 3.30% per annum. While SMNBPC has also entered into new hedging agreement increasing the amount hedged from 80% to 95% of the term loan for the period until Mar 2013 at a fixed rate of 3.36% per annum. This would in turn improve the stability in cash flows to shareholders in the form of dividends. On back of this, we believe the dividend outflow to the shareholders would not have major impact due to financial costs till Mar 2013.

## ***Risks and Concerns...***

### ***EPC related Claims***

During late last year, SMN Barka has reached an agreement with its EPC partner, Doosan towards the delay liquidated claims for failure to achieve the scheduled Early Power and Commercial Operation Dates. Both of them have reached an agreement (in principle) for final settlement with the basis that Doosan would pay to SMN Barka about USD 27 million in respect of delay liquidated damages under the EPC contract and has agreed to relinquish all costs claims to an extent of USD 38 million. As of now quoting prospectus, SMN Barka is also assisting Doosan's towards obtaining additional monetary relief from OPWP. The management of the company believes this claim not to have any negative financial impact going forward.

### ***OPWP related Claims***

As a result of delays in achieving the Commercial Operations dates of the Barka II Project, SMN Barka faces a claim by the OPWP under the PWPA. OPWP claims liquidated damages to an extent of USD 19.3 million. Although the company believes that OPWP may not waive the integrality of claims with respect to liquidated damages, they are optimistic that additional relief from OPWP may be obtained. Nevertheless, the company is also confident that it will be made whole for the full amount because any amount at which a final settlement shall be reached with OPWP should be recovered by the SMN Barka through a back to back claim against Doosan. The same would have a neutral impact on SMN Power financials.

### ***Ministry of Oil and Gas related Claims***

SMN Barka also has a claim arising under the SMN Barka NGSA which is towards the failure to meet the scheduled first gas delivery date which resulted in a delay to the Project of about 61 days. The total claim amounts to USD 8.47 million, as well as related costs of about USD 6.82 million. SMN Barka is confident that the same would be made completely for the full amount of the claims because any amount which cannot be recovered from MOG should correspond to the delay by Doosan.

### ***RPC - relatively old plant***

One of the project companies of SMN Power Holding is Rusail Power which we believe is relatively an old plant with the gas turbines installed in four phases between 1984 and 2000. This facility was bought by the company in 2006 as part of Government privatization process. Added, the company has spent significant initial expenditure towards increasing the performance of the plant. In 2010, RPC has performed a technical study to assess the life span of three transformers in RPC and has made provisions to an extent of RO 1.34 million, over the remaining period of PPA period, from 2010 to March 2022. We believe that any further expenses towards the RPC could impact the cash flow of the project company moving forward.



### **Concerns on Post PPA valuation**

#### **Unlocking Value beyond PPA**

The operating cash flows of the project company have been estimated with the certainty for the PPA period which is Nov 2024 for SMN Barka and Mar 2022 for RPC. The projections for post PWPA period cash flows have been provided by IPA, an independent consultant (*Source: Prospectus*). Further quoting the prospectus, the estimated cash flows post PWPA involve assumptions including demand for power and water, available capacities, alternative sources, tariffs, availability of gas, pricing of gas, off-take arrangements etc (18 different scenarios). The offer has been valued based on the assumptions and estimates for cash flows given by the independent consultant. As per the prospectus, the projections have been incorporated for the expected capex and dividend distributions. We perceive the concern of the post PPA valuation in terms of various dynamic market factors prevailing during that period, which might impact the project value unlocking beyond PPA period.

#### **Valuation - post PPA**

As per IPA + Water Economics report, there would be a significant value from the Plants post PWPA period either by extending the off-take agreements under the single buyer approach or by operating in liberalized markets for power and desalinated water. As per the prospectus quoting the independent advisors, the base case average annual EBITDA projected by IPA for RPC from the expiry of the PPA period to 2039 is RO 11.8 million and for SMN Barka from the expiry of the PWPA period to 2045 is RO 39.8 million. We believe that the concern remains in the form of several altering issues during the post PWPA period in the form of availability of Gas, pricing of Gas for the project beyond PPA, inflationary scenarios, adverse refurbishment costs etc, which could impact the valuations of the company.

## ***Valuations and Recommendation...***

### ***Dividend Discount Model***

As of now, the project companies have not distributed any dividends since the completion under the financing agreements, which were achieved on Aug 2011. As per the company, the first interim dividend is estimated to be paid by end of Nov 2011, representing a dividend per share of RO 0.193. The second dividend of RO 0.250 baiza (*expected to be announced in Mar 2012*) would be paid for the 2011E retaining earnings based on the cash flow position at the end of Mar 2012. Post this, the company expects to pay the dividends twice in a year, once for the period ended September and once for the period ended March.

With the presence of relative stability in cash flow generation (*dividend outflow*) and the prevailing off-take agreement with the single buyer, we believe that the projections of the cash dividend can be the apt one for the valuations. We have used the Dividend discount model (DDM) for our valuation based on two different scenarios with the base scenario considering the dividends similar to the one estimated in the prospectus. On the other hand, we have arrived at a probable scenario where we have reduced our dividend payout to about 90% levels beyond 2012E (*Please find the detailed valuation sheet in the next two pages*).

### ***Cash Sweep facility might impact dividends***

As per the facilities agreement, the project company RPC would have its cash sweep prepayment of starting from the 30 Sep 2016 until 31 Mar 2022 (end of term loan). For the SMN Barka, cash sweep prepayment of the Loan will apply starting from the 30 Sep 2018 until the end of the term of the Loan - 31 Mar 2024. However, if the project companies are able to refinance the loan before the commencement of the cash sweep, the dividend distribution to the investors would be possible subject to free cash availability.

## Dividend Discount Model (DDM) Valuation Methodology

### Base Case Scenario

- Assumed the dividend payout to remain at the same levels which is mentioned in the prospectus

DDM Model - Base Case	FY2011E*	FY2012E*	FY2013E*	FY2014E*	FY2015E*
Net Profit-RO 000's	3,775	6,245	7,256	7,637	8,518
Payout (%)	234.3%	121.5%	104.6%	99.3%	89.1%
<b>DPS-RO</b>	0.443	0.380	0.380	0.380	0.380
Div Yield on Offer Price	12.6%	10.8%	10.8%	10.8%	10.8%
Expected Dividends (RO 000's)	8,844	7,586	7,586	7,586	7,586
NPV of Expected Dividends	8,399	6,523	5,907	5,348	4,843
<b>Assumptions</b>					
Cost of Equity	10.4%				
Terminal Growth Rate	0.00%				
NPV (Terminal Value)-RO 000's	46,386				
<b>Fair value per share (RO)</b>	<b>3.877</b>				
Offer Price (RO)	3.520				
<b>Upside (%)</b>	<b>10.1%</b>				

Source: GBCM Research Estimates; \* Considered the March dividends as the previous year payment

\* Dividend for March is expected to be paid from previous year retaining earnings based on cash flow position at the end of first quarter

In the base case scenario of our DDM valuation model, we have assumed a dividend payout to remain at the same levels mentioned in the IPO prospectus from 2012E to 2015E. On this, **we have arrived at a fair value of RO 3.877**. We have assumed Cost of Equity of about 10.4% levels and also estimated zero terminal growth. In our valuation model, we have used the BETA of 0.68 (Source: Bloomberg) taken based on the comparable listed player ACWA Power Barka.

Sensitivity Analysis (Fair Value Ranges between RO 3.692 to RO 3.945)						
Cost of Equity						
Terminal Growth	10.0%	10.3%	10.4%	11.0%	11.5%	12.0%
0.0%	4.038	3.945	3.877	3.692	3.541	3.403
0.5%	4.168	4.067	3.994	3.794	3.633	3.485
1.0%	4.312	4.203	4.123	3.907	3.733	3.575
1.5%	4.474	4.354	4.267	4.032	3.844	3.674
Sensitivity Analysis (% Change from Offer Price)						
Cost of Equity						
Terminal Growth	10.0%	10.3%	10.4%	11.0%	11.5%	12.0%
0.0%	14.7%	12.1%	10.1%	4.9%	0.6%	-3.3%
0.5%	18.4%	15.5%	13.5%	7.8%	3.2%	-1.0%
1.0%	22.5%	19.4%	17.1%	11.0%	6.1%	1.6%
1.5%	27.1%	23.7%	21.2%	14.5%	9.2%	4.4%

Source: GBCM Research Estimates

### Probable Scenario

- We have assumed the dividend payout to remain at about 90% levels starting 2012E till 2015E, which is lower as compared to the company projections given in the prospectus.

DDM Model – Probable Scenario	FY2011E*	FY2012E*	FY2013E*	FY2014E*	FY2015E*
Net Profit-RO 000's	3,775	6,245	7,256	7,637	8,518
Payout (%)	234.3%	90.0%	90.0%	90.0%	90.0%
<b>DPS-RO</b>	<b>0.443</b>	<b>0.282</b>	<b>0.327</b>	<b>0.344</b>	<b>0.384</b>
Div Yield on Offer Price	12.6%	8.0%	9.3%	9.8%	10.9%
Expected Dividends (RO 000's)	8,844	5,621	6,530	6,873	7,666
NPV of Expected Dividends	8,399	4,833	5,084	4,846	4,894
<b>Assumptions</b>					
Cost of Equity	10.4%				
Terminal Growth Rate	0.00%				
NPV (Terminal Value)-RO 000's	46,874				
<b>Fair value per share (RO)</b>	<b>3.753</b>				
Offer Price (RO)	3.520				
<b>Upside (%)</b>	<b>6.6%</b>				

Source: GBCM Research Estimates; \* Considered the March dividends as the previous year payment

\* Dividend for March is expected to be paid from previous year retaining earnings based on cash flow position at the end of first quarter

In our probable case scenario of DDM valuation model, we have assumed a dividend payout of 90% from 2012E to 2015E. On this, **we have arrived at a fair value of RO 3.753**. We have assumed cost of equity of 10.4% and a terminal growth rate of zero. In our valuation model, we have used the BETA of 0.68 (Source: Bloomberg) taken based on the comparable listed player ACWA Power Barka.

### Sensitivity Analysis (Fair Value Ranges between RO 3.567 to RO 3.821)

Cost of Equity						
Terminal Growth	10.0%	10.3%	10.4%	11.0%	11.5%	12.0%
0.0%	3.914	3.821	3.753	3.567	3.417	3.279
0.5%	4.045	3.945	3.871	3.671	3.509	3.362
1.0%	4.191	4.081	4.002	3.785	3.611	3.453
1.5%	4.354	4.234	4.147	3.911	3.723	3.553
Sensitivity Analysis (% Change from Offer Price)						
Cost of Equity						
Terminal Growth	10.0%	10.3%	10.4%	11.0%	11.5%	12.0%
0.0%	11.2%	8.5%	6.6%	1.3%	-2.9%	-6.9%
0.5%	14.9%	12.1%	10.0%	4.3%	-0.3%	-4.5%
1.0%	19.1%	16.0%	13.7%	7.5%	2.6%	-1.9%
1.5%	23.7%	20.3%	17.8%	11.1%	5.8%	0.9%

Source: GBCM Research Estimates

### Company Comparable Valuations

Company	P/E		P/BV		Cash Dividend		Dividend Payout		Dividend Yield	
	FY10	FY11E	FY10	FY11E	FY10	FY11E	FY10	FY11E	FY10	FY11E
SMN Power Holding*	-	18.6	-	2.1	-	0.443	-	234.3%	-	12.6%
AES Barka	5.3	5.3	1.4	1.3	0.095	0.125	73.5%	95.8%	6.9%	9.1%
Al Kamil Power	6.3	6.1	0.9	0.9	0.080	0.160	31.1%	60.4%	4.9%	9.9%
United Power	7.7	8.2	0.6	0.6	0.200	0.120	151.6%	96.6%	19.6%	11.8%
Sohar Power	10.0	9.5	1.5	1.5	0.160	0.160	97.5%	93.1%	9.7%	9.7%

Source: Company Reports, GBCM Research Estimates; Closing price updated as of 25-Sep-2011

\* For SMN Power - Considered the March dividends as the previous year payment; \* Dividend for March is expected to be paid from previous year retaining earnings based on cash flow position at the end of first quarter

\* SMN Power - FY2011 Earnings includes one off expenses forming about RO 0.124 / share; Normalized EPS for 2011E works out to be RO 0.313, On the basis, the company trades at PE of 11.2X, which is still expensive to the comparables.

- On a PE (FY11E EPS) and PBV (FY11E BV) basis, the SMN Power Holding IPO issue looks pretty expensive as compared to the listed peer group. The total profit of the company is estimated to remain lower for 2011E and 2012E on the back of one off anticipated expenses (*Non-recurring items per share stands at about RO 0.124 bz*). EPS is estimated to normalize beyond 2012. The existing listed comparable players clearly remain cheaper at the current trading levels.
- Estimated average Oman Utilities sector dividend yield for 2011E works out to be about 10% levels as compared to the estimated dividend yield of 12.6% for SMN Power Holding Co. We believe that the issue commands a premium owing to the presence of higher dividends post IPO period.
- Dividend Payout ratio of SMN Power Holding remains higher during the initial years with the company paying out from its previous year retained earnings. The risk remains in the form of any unexpected costs in the due claims and the higher maintenance costs / unscheduled outages which could lead to decline in earnings moving forward, thereby impacting the dividend payout to the new shareholders.



### ***Outlook - Steady cash flow, Dividend Play...***

Overall the stable industry performance along with the steady cash flow generation in the Utilities sector makes the issue an attractive dividend play. We rate the SMN Power Holding IPO as an average issue in our rating sale with the fair value factoring for higher dividend payouts. Based on our Valuation methodologies (*Dividend Discount Model - Base scenario*), **we have arrived at our fair value of RO 3.877 for SMN Power.**

We recommend the low risk appetite investors to subscribe for the issue with the medium to long term horizon. ***We also believe that the issue would be a best fit for long only funds and institutions. We expect the issue to see limited upside on listing, however considering the dividend yield we recommend to subscribe for the issue.***

On a relative valuation basis, the existing listed comparable players remain cheaper than SMN Power. However, we may not be able to accumulate these counters in the market because of the illiquid nature in the secondary market. Hence we recommend the investors looking at a dividend yield story may capitalize through subscribing for the issue. ***We also feel that the stock might find support with the higher dividend yield protecting the downside from the offer price.***



### Income Statement Highlights

Figures in RO 000s	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
<b>Revenue - Group</b>	<b>24,969</b>	<b>30,814</b>	<b>36,310</b>	<b>78,322</b>	<b>79,342</b>	<b>83,026</b>	<b>85,335</b>	<b>87,700</b>	<b>90,201</b>
Operating costs	(21,869)	(25,764)	(29,868)	(49,525)	(52,531)	(54,314)	(56,572)	(59,041)	(61,847)
Gross profit	3,100	5,050	6,442	28,797	26,811	28,712	28,763	28,659	28,354
G&A expenses	(686)	(580)	(547)	(1,142)	(8,257)	(8,278)	(8,295)	(8,313)	(8,333)
<b>Operating Profit (EBIT)</b>	<b>2,414</b>	<b>4,095</b>	<b>4,886</b>	<b>19,771</b>	<b>18,554</b>	<b>20,434</b>	<b>20,468</b>	<b>20,346</b>	<b>20,021</b>
Finance charges	(3,286)	(4,256)	(8,341)	(15,511)	(13,594)	(13,044)	(12,190)	(11,633)	(10,303)
Profit (loss) before tax and extra. items	(872)	(161)	(3,455)	4,260	4,960	7,390	8,278	8,713	9,718
Profit (loss) before tax	(819)	139	15,865	4,197	4,960	7,390	8,278	8,713	9,718
<b>Net profit (loss)</b>	<b>(921)</b>	<b>(31)</b>	<b>13,741</b>	<b>1,189</b>	<b>3,775</b>	<b>6,245</b>	<b>7,256</b>	<b>7,637</b>	<b>8,518</b>

Source: Company Prospectus, GBCM Research

### Cash Flow Highlights

Figures in RO 000s	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Cash from operations	8,225	(6,663)	42,342	22,640	17,560	33,422	32,088	32,209	32,140
Provision for re. costs	4,740	-	-	-	-	-	-	-	-
Finance charges paid	(3,133)	(3,978)	(7,074)	(15,244)	-	-	-	-	-
Income tax paid	(147)	(65)	(148)	(159)	(206)	(131)	(139)	(134)	(133)
Other incomes	-	300	5	-	-	-	-	-	-
<b>Net cash from operations</b>	<b>9,685</b>	<b>(10,406)</b>	<b>35,125</b>	<b>7,237</b>	<b>17,663</b>	<b>33,503</b>	<b>31,973</b>	<b>32,080</b>	<b>32,004</b>
<b>Net cash from investing</b>	<b>(145,650)</b>	<b>(68,903)</b>	<b>(46,737)</b>	<b>3,989</b>	<b>335</b>	<b>(263)</b>	<b>(388)</b>	<b>(308)</b>	<b>(31)</b>
Repayment of term loans					(11,282)	(11,966)	(12,591)	(13,119)	(13,566)
Interest paid					(13,742)	(12,737)	(12,000)	(11,516)	(10,083)
Proposed dividends					(3,845)	(8,784)	(7,586)	(7,586)	(7,586)
Shareholder loans					-	(9,957)	-	-	-
<b>Net cash from financing</b>	<b>138,599</b>	<b>77,863</b>	<b>16,961</b>	<b>11,825</b>	<b>(28,413)</b>	<b>(43,444)</b>	<b>(32,177)</b>	<b>(32,221)</b>	<b>(31,235)</b>
<b>Net change in cash</b>	<b>2,634</b>	<b>(1,446)</b>	<b>5,349</b>	<b>23,051</b>	<b>(10,415)</b>	<b>(10,204)</b>	<b>(592)</b>	<b>(449)</b>	<b>738</b>
Cash at the beginning	-	2,634	1,188	6,537	29,588	19,173	8,969	8,377	7,928
<b>Cash at the end of the year</b>	<b>2,634</b>	<b>1,188</b>	<b>6,537</b>	<b>29,588</b>	<b>19,173</b>	<b>8,969</b>	<b>8,377</b>	<b>7,928</b>	<b>8,666</b>

Source: Company Prospectus, GBCM Research

### Balance Sheet Highlights

Figures in RO 000s	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Finance lease receivables	48,243	46,290	43,134	40,305	40,357	37,333	34,088	30,636	26,957
Property, plant and equip	114,934	186,910	231,448	223,523	215,514	207,500	199,479	191,450	183,411
Deferred tax asset	92	4,657	-	-	-	-	-	-	-
Others	-	1,406	1,551	1,445	1,084	975	865	756	646
Investment in JV	-	-	-	-	250	250	250	250	250
Goodwill	15,889	15,739	15,739	15,739	15,739	15,739	15,739	15,739	15,739
<b>Total non-current assets</b>	<b>179,158</b>	<b>255,002</b>	<b>291,872</b>	<b>281,012</b>	<b>272,944</b>	<b>261,797</b>	<b>250,421</b>	<b>238,831</b>	<b>227,003</b>
Inventories	2,673	2,660	2,794	2,689	2,689	2,689	2,689	2,689	2,689
Trade and other receivables	934	8,522	42,320	40,243	42,604	7,508	8,009	8,425	8,583
Finance lease receivables	3,778	4,120	6,389	5,249	-	-	-	-	-
Cash and bank	2,634	1,262	6,537	29,588	19,172	8,969	8,376	7,928	8,665
<b>Total current assets</b>	<b>10,019</b>	<b>16,564</b>	<b>58,040</b>	<b>77,769</b>	<b>64,465</b>	<b>19,167</b>	<b>19,073</b>	<b>19,042</b>	<b>19,938</b>
<b>Total assets</b>	<b>189,177</b>	<b>271,566</b>	<b>349,912</b>	<b>358,781</b>	<b>337,409</b>	<b>280,964</b>	<b>269,494</b>	<b>257,873</b>	<b>246,941</b>
<b>Equity and reserves</b>									
Share capital	500	500	500	500	19,964	19,964	19,964	19,964	19,964
Legal reserve	-	-	-	-	543	1,168	1,893	2,657	3,509
Retained earnings	(921)	(952)	12,622	13,811	13,668	10,504	9,448	8,735	8,816
<b>Shareholders' funds</b>	<b>(421)</b>	<b>(452)</b>	<b>13,289</b>	<b>14,478</b>	<b>34,175</b>	<b>31,636</b>	<b>31,305</b>	<b>31,356</b>	<b>32,289</b>
Hedging deficit	(3,322)	(37,742)	(17,189)	(23,827)	(23,827)	(23,827)	(23,827)	(23,827)	(23,827)
<b>Total equity</b>	<b>(3,743)</b>	<b>(38,194)</b>	<b>(3,900)</b>	<b>(9,349)</b>	<b>10,348</b>	<b>7,809</b>	<b>7,478</b>	<b>7,529</b>	<b>8,462</b>
<b>Liabilities</b>									
Long term loan	173,489	246,032	228,701	240,117	240,578	229,055	216,885	204,163	190,969
Shareholder loans	-	-	-	-	9,957	-	-	-	-
Hedging Instruments	3,679	42,667	19,412	27,080	27,080	27,080	27,080	27,080	27,080
<b>Total non-current liabilities</b>	<b>179,137</b>	<b>292,306</b>	<b>252,158</b>	<b>273,338</b>	<b>285,593</b>	<b>265,494</b>	<b>254,394</b>	<b>242,795</b>	<b>230,849</b>
Cur. portion long term loan	-	5,247	40,080	11,282	-	-	-	-	-
Trade and other payables	13,783	12,207	61,574	53,788	41,468	7,661	7,622	7,549	7,630
Shareholders' sub. loan	-	-	-	29,722	-	-	-	-	-
<b>Total current liabilities</b>	<b>13,783</b>	<b>17,454</b>	<b>101,654</b>	<b>94,792</b>	<b>41,468</b>	<b>7,661</b>	<b>7,622</b>	<b>7,549</b>	<b>7,630</b>
<b>Total liabilities</b>	<b>192,920</b>	<b>309,760</b>	<b>353,812</b>	<b>368,130</b>	<b>327,061</b>	<b>273,155</b>	<b>262,016</b>	<b>250,344</b>	<b>238,479</b>
<b>Total equity and liabilities</b>	<b>189,177</b>	<b>271,566</b>	<b>349,912</b>	<b>358,781</b>	<b>337,409</b>	<b>280,964</b>	<b>269,494</b>	<b>257,873</b>	<b>246,941</b>

Source: Company Prospectus, GBCM Research

### Ratio Analysis

Key ratios	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
<b>Profitability ratios</b>									
Gross Profit Margin	12.4%	16.4%	17.7%	36.8%	33.8%	34.6%	33.7%	32.7%	31.4%
EBIT Margin	9.7%	13.3%	13.5%	25.2%	23.4%	24.6%	24.0%	23.2%	22.2%
PBT Margin	-3.5%	-0.5%	-9.5%	5.4%	6.3%	8.9%	9.7%	9.9%	10.8%
Net Profit Margin	-3.7%	-0.1%	37.8%	1.5%	4.8%	7.5%	8.5%	8.7%	9.4%
Return on Equity	218.8%	6.9%	103.4%	8.2%	11.0%	19.7%	23.2%	24.4%	26.4%
Return on Assets	-0.5%	0.0%	3.9%	0.3%	1.1%	2.2%	2.7%	3.0%	3.4%
<b>Per Share Ratio</b>									
EPS	(1.842)	(0.062)	27.482	2.378	0.189	0.313	0.363	0.383	0.427
Book Value per share	(0.842)	(0.904)	26.578	28.956	1.712	1.585	1.568	1.571	1.617
Dividend per share	-	-	-	-	0.443	0.380	0.380	0.380	0.380
<b>Investment ratios **</b>									
Price/Earnings	(1.91)	(56.77)	0.13	1.48	18.62	11.25	9.68	9.20	8.25
Price/Book value	(4.18)	(3.89)	0.13	0.12	2.06	2.22	2.24	2.24	2.18
Dividend yield (%)	-	-	-	-	12.6%	10.8%	10.8%	10.8%	10.8%
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%	234.3%	121.5%	104.6%	99.3%	89.1%
<b>Activity &amp; Efficiency ratios</b>									
Asset turnover	0.13	0.11	0.10	0.22	0.24	0.30	0.32	0.34	0.37
Inventory turnover ratio	9.34	11.58	13.00	29.13	29.51	30.88	31.73	32.61	33.54
Days of Inventory	44.61	37.68	34.14	19.82	18.68	18.07	17.35	16.62	15.87
Days Receivables	13.65	100.95	425.41	187.54	195.99	33.01	34.26	35.06	34.73
Days Payables	230.04	172.94	752.46	396.42	288.13	51.48	49.18	46.67	45.03
Cash Conversion cycle	(171.78)	(34.31)	(292.90)	(189.06)	(73.45)	(0.41)	2.43	5.02	5.57
<b>Liquidity ratio</b>									
Quick ratio	0.53	0.80	0.54	0.79	1.49	2.15	2.15	2.17	2.26
Current ratio	0.73	0.95	0.57	0.82	1.55	2.50	2.50	2.52	2.61
<b>Leverage ratio</b>									
Debt/ Equity ratio	(412.1)	(555.9)	20.2	17.4	7.0	7.2	6.9	6.5	5.9

Source: Company Prospectus, GBCM Research Estimates; Calculated on Offer price of RO 3.520



### Stock Rating Methodology:

**Buy** - Upside more than 20%

**Accumulate** - Upside between 10% and 20%

**Neutral** - Upside or downside less than 10%

**Reduce** - Downside between 10% and 20%

**Sell** - Downside more than 20%

**Not Rated** - Stocks not in regular research coverage

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