

Notes to the unaudited interim condensed financial statements

1. Legal status and principal activities

Muscat City Desalination Company SAOG (the “Company”) is a public joint stock company registered in the Sultanate of Oman. The Company was incorporated on 19 January 2013. The Company’s principal activity is the sale of desalinated water. The Company commenced commercial production of potable water on 19 February 2016. The Company was listed on the Muscat Securities Market on 2 January 2018.

1.1 Key agreements

Water Purchase Agreement

On 11 February 2013 the Company signed a long term Water Purchase Agreement (WPA) with Oman Power and Water Procurement Company SAOC for the supply of 42 million imperial gallons of water per day. The agreement expires 20 years after the Scheduled Commercial Operation Date of 12 October 2014, subject to any extension period or early termination arising under the terms of the agreement.

Engineering, Procurement and Construction Contract

The Company entered into an agreement for the construction of a desalination plant with a capacity of 42 million imperial gallons of water per day with International Water Treatment LLC (“the EPC Contractor”) on a turnkey basis which was completed during 2016.

2 Basis of preparation and significant accounting policies

2.1 Basis of preparation

Statement of compliance

The interim condensed financial statements of the Muscat City Desalination Company SAOG are prepared in accordance with International Accounting Standard 34, Interim Financial Reporting. The accounting policies used in the preparation of the interim condensed financial statements are consistent with those used in the preparation of the annual financial statements for the year ended 31 December 2017.

The interim condensed financial statements do not contain all information and disclosures required for full financial statements prepared in accordance with International Financial Reporting Standards and should be read in conjunction with the Company’s annual financial statements as at 31 December 2017. In addition, results for the nine months period ended 30 September 2018 are not necessarily indicative of the results that may be expected for the financial year ending 31 December 2018.

This is the first set of the Company’s financial statements where IFRS 15 and IFRS 9 have been applied. Changes to significant accounting policies are described in Note 3.

3 Summary of change in significant accounting policies

Except as described below accounting policies applied in these interim financial statements are same as those applied in the Company’s financial statements as at and for the year ended 31 December 2017.

Notes to the unaudited interim condensed financial statements**3 Summary of change in significant accounting policies (continued)**

The changes in the accounting policies are also expected to be reflected in the Company's financial statements as at and for the year ended 31 December 2018.

The Company initially adopted IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments from 1 January 2018.

The effects of initially applying these standards do not have a material effect on the Company's financial statements. The newly effective accounting policies are as follows:

IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments that replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. IFRS 9 brings together all three aspects of the accounting for financial instruments project: classification and measurement, impairment and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Except for hedge accounting, retrospective application is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.

a) Classification and measurement

The Company does not expect a significant impact on its financial position or equity on applying the classification and measurement requirements of IFRS 9.

Trade receivables are held to collect contractual cash flows and are expected to give rise to cash flows representing solely payments of principal and interest. Thus, the Company expects that these will continue to be measured at amortised cost under IFRS 9.

b) Impairment

IFRS 9 requires the Company to record expected credit losses on all of its debt securities, loans and trade receivables, either on a 12-month or lifetime basis. The Company will apply the simplified approach and record lifetime expected losses on all trade receivables. The Company has determined that there will not be significant impairment losses to be booked after applying IFRS 9.

c) Hedge accounting

The Company is currently involved in cash flow hedging and hence IFRS 9 will have an impact on the financial statements of the Company. The hedge accounting model is designed to align with how entities undertake risk management activities when hedging financial and non-financial risk exposures. IFRS 9 requires the company to recognize the effective portion of the gain or loss on the hedging instrument OCI in the cash flow hedge reserve, while any ineffective portion is recognised immediately in the statement of profit or loss.

d) Other adjustments

In addition to the items described above, on adoption of IFRS 9, other items of the primary financial statements such as deferred taxes, assets held for sale and liabilities associated with them, investments in the associate and joint venture, will be adjusted as necessary. The exchange differences on translation of foreign operations will also be required to be adjusted.

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3 Summary of change in significant accounting policies *(continued)*

IFRS 15 Revenue from Contracts with Customers

In May 2014, IFRS 15 was issued which established a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 18 Revenue, IAS 11 Construction Contracts and the related interpretations when it becomes effective.

The core principle of IFRS 15 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the standard introduces a 5-step approach to revenue recognition:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation.

Under IFRS 15, an entity recognises when (or as) a performance obligation is satisfied, i.e. when control of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15.

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4 Property, plant and equipment

Cost	Civil and structural works RO'000s	Plant and machinery RO'000s	Pipelines RO'000s	Decommissioning asset RO'000s	Spares RO'000s	Furniture, fixtures & office equipment RO'000s	Motor vehicles RO'000s	Total RO'000s
1 January 2018	31,326	46,369	19,908	330	576	26	39	98,574
Additions	-	-	-	-	79	5	-	84
Adjustment	-	-	-	-	-	-	-	-
30 September 2018	31,326	46,369	19,908	330	655	31	39	98,658
Accumulated Depreciation								
1 January 2018	1,459	2,160	927	50	26	24	39	4,686
Charge for the period	587	869	374	6	12	1	-	1,849
30 September 2018	2,046	3,029	1,302	56	38	25	39	6,535
Carrying value 30 September 2018	29,280	43,340	18,606	274	617	6	-	92,123

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4 Property, plant and equipment (continued)

Cost	Civil and structural works RO'000s	Plant and machinery RO'000s	Pipelines RO'000s	Decommissioning asset RO'000s	Spares RO'000s	Furniture, fixtures & office equipment RO'000s	Motor vehicles RO'000s	Total RO'000s
1 January 2017	31,326	46,358	19,908	1,073	576	26	39	99,306
Additions	-	11	-	-	-	-	-	11
Adjustment	-	-	-	(743)	-	-	-	(743)
31 December 2017	31,326	46,369	19,908	330	576	26	39	98,574
Accumulated Depreciation								
1 January 2017	676	1,001	430	23	12	22	34	2,198
Charge for the year	783	1,159	498	27	14	2	5	2,488
31 December 2017	1,459	2,160	928	50	26	24	39	4,686
Carrying value								
31 December 2017	29,867	44,209	18,980	280	550	2	-	93,888

Notes to the unaudited interim condensed financial statements

4 Property, plant and equipment *(continued)*

The land on which the plant is constructed has been leased from the Government of the Sultanate of Oman (represented by the Ministry of Housing) for a period of 25 years from 11 February 2013. The lease term can be extended by an additional 25 years at the request of the Company. Lease rentals are paid at the rate of RO 15,045 per annum.

5 Trade and other receivables

	Unaudited 30 September 2018 RO'000s	Audited 31 December 2017 RO'000s
Trade receivables	1,194	1,243
Prepayments and other receivables	79	43
Deposits	2	3
	<u>1,275</u>	<u>1,289</u>

6 Cash and cash equivalents

	Unaudited 30 September 2018 RO'000s	Audited 31 December 2017 RO'000s
Cash at bank	1,203	1,203
Short term deposits	1,422	3,268
	<u>2,625</u>	<u>4,471</u>

The short term deposits are denominated in US Dollars and are with Sumitomo Mitsui Banking Corporation Limited in London with maturities of less than one month. These deposits yield interest at an insignificant rate.

7 Capital and reserves*(a) Share capital*

The authorised share capital comprises of 250,000,000 (2017: 250,000,000) ordinary shares of 100 baisa each and the issued share capital comprises 155,550,400 (2017: 15,555,040) fully paid up shares of 100 baisa each.

The Shareholders of the Company are:

	Unaudited 30 September 2018		Audited 31 December 2017	
	Number of shares	%	Number of shares	%
Summit Water Middle East Company	50,553,880	32.5	50,553,880	32.5
Malakoff Oman Desalination Company Limited	50,553,880	32.5	50,553,880	32.5
Others	54,442,640	35	54,442,640	35
	<u>155,550,400</u>	<u>100</u>	<u>155,550,400</u>	<u>100</u>

Notes to the unaudited interim condensed financial statements

7 Capital and reserves (continued)*(a) Share capital (continued)*

The two main shareholding companies are registered in Cayman Islands and British Virgin Islands respectively. None of the other ordinary shareholders owns 10% or more of the Company's paid-up share capital as at 30 September 2018.

(b) Legal reserve

Article 154 of the Commercial Companies Law of 1974 requires that 10% of a company's net profit be transferred to a non-distributable statutory reserve until the amount of the statutory reserve becomes equal to at least one-third of the Company's paid up share capital.

(c) Dividend

Shareholders at the Ordinary General Meeting ("OGM") held on 27 December 2017 authorised the Board of Directors to determine and distribute cash dividends to the Shareholders of the Company in February 2018 out of the retained earnings as per the audited financial statements for the period ended 30 September 2017, provided that the aggregate amount shall not exceed 3.2% of the paid up share capital of the Company (i.e., 3.2 Baizas per share).

In the board of directors meeting held on 8 February 2018, it was resolved to distribute cash dividend of Baizas 2.9268 per share, out of the retained earnings as per the audited financial statements for the financial period ended 30 September 2017 to the shareholders of the Company who are registered in the Company's shareholders' register with the Muscat Clearing & Depository Company SAOC as on 28 February 2018.

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 as per 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).

8 Term loans

	Unaudited 30 September 2018 RO'000s	Audited 31 December 2017 RO'000s
Term loans	64,605	67,044
Less: deferred finance charges	(1,176)	(1,232)
	63,429	65,812
Less: current portion of term loans	(3,096)	(3,024)
Non-current portion of term loans	60,333	62,788

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8 Term loans (continued)**Facilities**

On 25 July 2013, the Company entered into a long term financing agreement for loan facilities (“the term loans”) in the aggregate maximum amount of RO 81,451,616 (USD 211,837,752) with a consortium of international banks.

9 Derivative financial instruments

In accordance with the Common Terms Agreement, the Company is required to enter into interest rate hedging agreements to cap the Company’s exposure to fluctuating interest rates. This requirement covers the term loans.

The hedging arrangement obliges the Company to pay fixed interest at the rate of 2.86% per annum on a quarterly basis for the term loans. These cash flow hedges were assessed as highly effective as at 30 September 2018 (For the year ended 31 December 2017: highly effective).

The classification of the fair values of the derivative financial instruments based on the remaining period to maturity from the reporting date is as follows:

	Unaudited 30 September 2018 RO’000s	Audited 31 December 2017 RO’000s
Current portion	23	(93)
Non-current portion	453	(1,952)
Cumulative changes in fair value	476	(2,045)
<i>Cumulative changes in fair value are recognised as follows:</i>		
Cumulative changes in fair value	476	(2,045)
Related deferred tax liability/ asset	(71)	307
Cumulative changes in fair value, net of deferred tax	405	(1,738)

10 Provision for decommissioning obligation

The decommissioning cost represents the present value of management’s best estimate of the future cost to remove the facilities and restore the affected area at the Company’s leased site to its original condition. The estimate has been made on the basis of an independent report by a professional consultant, discounted at 4.60% to its present value, over the plant’s estimated useful life of 40 years.

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11 Shareholders' loans

	Unaudited 30 September 2018 RO'000s	Audited 31 December 2017 RO'000s
Summit Water Middle East Company	2,073	2,865
Malakoff Oman Desalination Company Limited	2,073	2,865
Sumitomo Corporation	2,129	2,129
Malakoff International Limited	2,129	2,129
Interest accrued	536	406
	8,940	10,394
Less: current portion of Shareholders' loans	-	(1,583)
	8,940	8,811

Facilities

The Shareholders' loans of RO 1,691,800 (USD 4,400,000) were provided in October 2015. Further Shareholders' loans of RO 4,037,250 (USD 10,500,000) were provided during the year ended 31 December 2016. Further, amount due to related parties (ultimate shareholders) of RO 4,257,842 (USD 11,073,711) were converted into shareholders' loan in July 2017.

In April 2018, the Shareholders' loans of RO 1,583,000 (USD 4,117,035) provided by Summit Water Middle East Company and Malakoff Oman Desalination Company Limited were repaid.

12 Shareholders' stand – by equity loans

	Unaudited 30 September 2018 RO'000s	Audited 31 December 2017 RO'000s
Summit Water Middle East Company	377	377
Malakoff Oman Desalination Company Limited	377	377
Cadagua Al Ghubrah UK Limited	-	83
	754	837

Facilities

The Shareholders' stand-by equity loans of RO 837,031 (USD 2,176,932) were provided in November 2015. In March 2018, the Shareholders' stand-by equity loans of RO 83,703 (USD 217,693) provided by Cadagua Al Ghubrah UK Limited were repaid.

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13 Accruals and other payables

	Unaudited 30 September 2018 RO'000s	Audited 31 December 2017 RO'000s
Accruals and other payables	<u>1,675</u>	<u>2,484</u>

14 Related party transactions

Related parties comprise the shareholders, directors, key management personnel and any business entities in which these parties have the ability to control or exercise significant influence. The Company maintains significant balances with these related parties which arise in the normal course of business. The terms and conditions of related party transactions are mutually agreed.

	Unaudited 30 September 2018 RO'000s	Unaudited 30 September 2017 RO'000s
Operation and maintenance cost to Muscat City Desalination	<u>2,949</u>	<u>2,678</u>
Net receipts under Shareholders loans	<u>-</u>	<u>4,258</u>
Interest expense on Shareholders' loans	<u>136</u>	<u>135</u>
Key management compensation	<u>144</u>	<u>115</u>
Director's sitting fee	<u>11</u>	<u>-</u>

15 Operating costs

	Unaudited 30 September 2018 RO'000s	Unaudited 30 September 2017 RO'000s
Operation and maintenance cost	2,914	2,656
Electricity charges	2,652	2,712
Depreciation	1,848	1,865
	<u>7,414</u>	<u>7,233</u>

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16 Administrative and general expenses

	Unaudited 30 September 2018 RO'000s	Unaudited 30 September 2017 RO'000s
Employee costs	192	251
Insurance	157	178
Legal and professional expenses	93	110
Depreciation	1	2
Others	149	117
	<u>592</u>	<u>658</u>

17 Finance costs (net)

	Unaudited 30 September 2018 RO'000s	Unaudited 30 September 2017 RO'000s
Interest expense on term loans and interest swaps	2,301	2,453
Interest expense on Shareholders' bridge loan	136	135
Amortisation of deferred finance cost	57	57
Interest income on term deposits	(11)	(49)
Other finance cost	46	87
	<u>2,529</u>	<u>2,683</u>

18 Income tax

The Company is liable to income tax at the rate of 15% (30 September 2017: 15%). No provision for income tax has been made for the period ended 30 September 2018 in view of the taxable losses for the period.

Deferred tax arises on account of tax losses and temporary differences between the tax base of assets and liabilities and their carrying values in the statement of financial position. No deferred tax asset on losses has been recognised as management does not consider it probable that sufficient taxable income may arise prior to their expiry to obtain the benefits therefrom.

19 Earnings per share

	Unaudited 30 September 2018	Unaudited 30 September 2017
Profit / (Loss) for the period (RO'000s)	<u>880</u>	<u>(539)</u>
Weighted average number of shares outstanding during the period	<u>155,550,400</u>	<u>155,550,400</u>
Earnings / (Loss) per share (basic and diluted)	<u>0.006</u>	<u>(0.003)</u>

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20 Lease commitments

The land which the plant occupies has been leased from the Government of the Sultanate of Oman (represented by the Ministry of Housing) for a period of 25 years from 11 February 2013. The lease term can be extended by an additional 25 years at the request of the Company. Lease rental is paid at the rate of RO 15,045 per annum.

21 Financial instruments

The Company's financial risk management objective and policies are consistent with those disclosed in the financial statements as at and for the year ended 31 December 2017.

22 Comparative figures

Certain comparative figures for corresponding period have been reclassified to conform to the presentation adopted in the current period.