الشركة الفلسطينية للكهرباء م.ع.م
PALESTINE ELECTRIC COMPANY P.L.C

Annual Report
2006

PALESTINE ELECTRIC COMPANY P.L.C
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PEC Annual Report 2006

Contents:

Chairman's Statement

We are proud to announce that Palestine Electric Company is back in power to light up Gaza city again

It has already been three years since Palestine Electric Company started commercial operation, got listed in the Palestine Securities Exchange and started trading, and gained the respect and trust of its shareholders in this magnificent project. One cannot help but stand in front of this successful project in complete admiration and respect, applauding the efforts of the Executive Managing Director and the working team.

The long and difficult path that the company crossed up to today only made it stronger and allowed it to gain the ultimate trust and loyalty of our shareholders, whom I thank for their support and confidence in us.

We will never forget the day the power plant's 6 transformers were bombed and completely destroyed on 28 June 2006. Upon which it was thought that this strike will render us useless…

Today, on April 2007, at our fourth General Assembly Meeting, we are proud to announce that Palestine Electric Company is back in power since October, to light up Gaza city again after a record breaking repair time that did not exceed four months.

I remain confident of this company's success and long term growth prospects under the management and efforts of a superb team.

Said Khoury

Chairman

Executive Managing Director's Statement

We will transcend all expectations in 2007 and the years to come

Our company's strength and sustainability was put to the test in 2006 when the power plant's 6 transformers were bombed and destroyed and all operations were forced to shut down.

As unfortunate as this incident is, we came out of it stronger and more confident than ever that our company is here to stay, armed with a highly capable and effective working team and supported by our Chairman and Board Members, and encouraged and trusted by our shareholders that empower Palestine Electric Company.

I believe that 2007 will open new doors for Palestine Electric Company as we embark on a difficult yet promising vision of enhancing and expanding our operations in Palestine.

During 2006, we have proved that we are here to stay, and with our continuous efforts and success we will transcend all expectations in 2007 and the years to come.

I would like to thank all parties that helped our company get back in power in a record breaking time, starting with the Palestinian Government and President Abu Mazen for his support, our company Chairman Mr. Said Khoury whose efforts towards this exceptional project are what keeps us going, and the Palestinian Energy and Natural Resources Authority for their cooperation all throughout.

I would also like to thank our Board members for their support and encouragement, and our shareholders for their continuous trust and faith in Palestine Electric Company.

Included in this booklet are my comments on the Company's financial results for the year 2006.

Walid Salman

Executive Managing Director

Executive Managing Director's Comments on the Financial Statements Results for 2006

Summary of the Financial Results and Expectations

Financial overview:

In 2006, GPGC faced several challenges that threatened the operation of the power plant and the company's financial situation.

On 28th June 2006, the Israeli Armed Air Forces deliberately bombed the Gaza Power Plant by launching eight missiles precisely targeting the six transformers of the power plant. As a result of this strike, all transformers were severely damaged.

Initial internal and external assessments where reported in which the estimated costs and time for repair of the damages where excessive and in turn were expected to severely impact the financial situation of the company. However, the Palestinian Energy and Natural Resources Authority (PENRA) took on the initiative of communicating with the Egyptian Authorities over the supply of the required replacement transformers at their own cost in order to alleviate the pains of their fellow Palestinian peoples. As of 28th October 2006, 7 transformers (4 step up 11/66 KV transformers and 3 step down 66/11 KV transformers) were installed and commissioned allowing GPGC to dispatch 60-70 MW. PENRA has confirmed that the remaining transformers (5 in total) will be procured and installed by June 2007.

As a result of PENRA's support, GPGC's financial situation was not impacted and thus, the company was able to maintain and achieve its profit expectation and had a reasonably good financial performance despite of the unstable political and economical situation in Palestine.

GPGC has managed to achieve a $7.403 million in profits. This shows a 2.64% change in profits from the year 2005 and this change is attributable to various issues but mainly to the changes in the market interest rates.

Financial results as of 2006:

All amounts in US $ ('000)	2001	2002	2003	2004	2005	2006
Net (Loss) / Profit	- 2,179	- 1,916	11,687	9,413	7,604	7,403
Accumulated (Loss) / Profit	- 9,259	- 11,175	512	9,925	17,529	24,932
Paid-in Share Capital	60,000					
Dividends Payout	0	0	0	- 6,000	- 6,000	
Net Shareholders Equity	50,741	48,825	60,512	69,925	71,529	78,932
Earning Per Share	- 0.036	- 0.032	0.195	0.157	0.127	0.123

Financial Expectations for 2007:
One of the key concerns for GPGC during 2007 is the ability of PENRA to settle its monthly payments along with the settlement of the outstanding receivables due to GPGC. As mentioned, various international support exists and PENRA has indicated its intent to settle the outstanding amounts as soon as possible.

Furthermore, GPGC is currently negotiating with its creditors on improving the deposit interest rates in order to achieve more competitive rates.

Payment Summary from the Palestinian National Authority (PNA)

As part of the international support towards the Palestinian crisis, the League of Arab States and the European Commission have contributed on behalf of PENRA to the settlement of part of the outstanding payments due to GPGC.

A total amount of $28.64 million was received by GPGC on account of the outstanding payments due from PENRA.

Development Issues

GPGC continuously remains to investigate with PENRA the possibilities of obtaining natural gas as source of fuel for the power plant. However, due to the overall political situation, this issue remains to be settled.

Budget Focus

Budget 2006:

GPGC always ensures that its efforts constantly focus on the enhancement and improvement of its financial and commercial policies and procedures; hence striving to reduce costs, preserve a transparent image and increase the efficiency and productivity of its operations in each department Accordingly, GPGC manage their budget by allocating it each year to achieve the goals set forth. In 2006, as a result of the Israeli air strike on the power plant, GPGC immediately took on contingency actions in order to minimize the financial impact on the company. Various administration and personnel policies where introduced which protected both the interests of the company and its employees. As a result, the company was able to honour all of its obligations despite the difficulties.

Budget Focus 2007:

GPGC budget focus for 2007 is mainly targeted towards the maintenance of the power plant and the honouring of its debt service obligations. This year is expected to be a challenging financial year for GPGC as we work towards meeting our obligations towards our creditors.

Dividend Policy

GPGC has celebrated success and achieved remarkable results year after year. We are a solid company with a powerful team and a vision for the future. In our goal to maximize our shareholders value, GPGC has distributed dividends at the rate of 10% on its equity in 2005 and 2006 to its shareholders and, as the company further establishes itself and grows, the intention of increasing the dividends will be part of the company's objective.

Audited Financial Statements

Palestine Electric Company
Public Shareholding Company Limited

Consolidated Financial Statements
December 31, 2006

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Independent Auditors' Report to the Shareholders of
Palestine Electric Company - Public Shareholding Company Limited

We have audited the accompanying financial statements of Palestine Electric Company "Public Shareholding Company Limited" (the Company), which comprise the consolidated balance sheet as at December 31, 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Board of Directors is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

ERNST & YOUNG

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of Palestine Electric Company - Public Shareholding Company Limited as of December 31, 2006, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Without qualifying our opinion, as explained in note (9) to the accompanying financial statements, the Palestinian Energy and Natural Resources Authority (PENRA) is committed to compensate the Company for the amounts of the force majeure claims that were agreed upon by the Company and the power plant contractor. Further, as explained in note (27) to the accompanying financial statements, PENRA is the sole customer of the Company. To the date of the issuance of this report, PENRA did not provide the Company with the letter of credit as required by the power purchase agreement.

Ernst + Young

Gaza, Palestine
April 2, 2007

Palestine Electric Company
Public Shareholding Company Limited

CONSOLIDATED BALANCE SHEET
As at December 31, 2006

	Notes	2006 U.S. $	2005 U.S. $
ASSETS			
Non-current assets			
Property, plant and equipment	5	111,152,324	121,709,895
Intangible asset	6	2,235,584	-
Prepayments and deferred expenses	7	2,192,539	2,664,030
		115,580,447	124,373,925
Current assets			
Materials and inventories	8	5,331,674	4,212,242
Accounts receivable	9	32,626,675	32,710,261
Other current assets	10	2,927,612	1,314,214
Cash and cash equivalents	11	11,829,216	12,667,889
		52,715,177	50,904,606
TOTAL ASSETS		168,295,624	175,278,531
EQUITY AND LIABILITIES			
Equity			
Issued capital	1	60,000,000	60,000,000
Statutory reserve	12	3,614,381	2,874,000
Retained earnings		9,354,648	8,691,221
Total equity		72,969,029	71,565,221
Non-current liabilities			
Long term loan	13	68,148,000	80,568,000
Provision for employees' indemnity	14	807,756	481,336
Amount due to contractor, long term portion	15	-	2,545,218
		68,955,756	83,594,554
Current liabilities			
Current portion of long term loan and accrued interest	13	20,623,537	14,550,854
Current portion of amount due to contractor	15	3,783,315	3,746,300
Other current liabilities	16	1,963,987	1,821,602
		26,370,839	20,118,756
Total liabilities		95,326,595	103,713,310
TOTAL EQUITY AND LIABILITIES		168,295,624	175,278,531

The attached notes 1 to 27 form part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT
Year ended December 31, 2006

	Notes	2006 U.S. $	2005 U.S. $
Revenues			
Sales of electric capacity	9	29,214,432	28,716,672
Interest on PENRA receivables	9	725,524	924,184
Discount	9	(1,386,772)	(1,333,333)
		28,553,184	28,307,523
Operating expenses	18	13,633,113	15,009,826
Operating profit		14,920,071	13,297,697
Finance costs		(7,227,502)	(5,293,659)
Income from PENRA assistance	17	3,401,976	-
Loss from disposal of property, plant and equipment	5	(3,747,770)	-
Amortization	7	(329,824)	(329,824)
Other income (expenses)	19	386,857	(34,481)
Profit for the year		7,403,808	7,639,733
Basic and diluted earnings per share	20	0.123	0.127

The attached notes 1 to 27 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
Year Ended December 31, 2006

	Issued Capital U.S. $	Statutory Reserve U.S. $	Retained Earnings U.S. $	Total Equity U.S. $
Balance at January 1, 2006	60,000,000	2,874,000	8,691,221	71,565,221
Profit for the year	-	-	7,403,808	7,403,808
Total income and expense for the year	-	-	7,403,808	7,403,808
Transfer to statutory reserve	-	740,381	(740,381)	-
Dividends (Note 21)	-	-	(6,000,000)	(6,000,000)
Balance at December 31, 2006	60,000,000	3,614,381	9,354,648	72,969,029
Balance at January 1, 2005	60,000,000	2,110,027	7,815,461	69,925,488
Profit for the year	-	-	7,639,733	7,639,733
Total income and expense for the year	-	-	7,639,733	7,639,733
Transfer to statuary reserve	-	763,973	(763,973)	-
Dividends	-	-	(6,000,000)	(6,000,000)
Balance at December 31, 2005	60,000,000	2,874,000	8,691,221	71,565,221

CONSOLIDATED CASH FLOW STATEMENT
Year Ended December 31, 2006

	2006	2005
	U.S. $	U.S. $
Operating activities		
Profit for the year	7,403,808	7,639,733
Adjustments:		
Provision for employees' end of service indemnity	335,623	150,314
Depreciation	7,030,285	7,054,475
Amortization	503,891	471,491
Finance costs	7,227,502	5,159,374
Income from PENRA assistance	(3,401,976)	-
Loss from disposal of property, plant and equipment	3,747,770	-
	22,846,903	20,475,387
Working capital adjustments:		
Accounts receivable	(2,916,414)	5,148,777
Other current assets	(629,406)	630,081
Material and Inventory	(1,119,432)	(1,276,714)
Due to Power Plant Contractor	(2,508,203)	-
Other current liabilities	(322,080)	(517,015)
Employees indemnity paid	(9,203)	(144,711)
Net cash flows from operating activities	15,342,165	24,315,805
Investing activities		
Power plant project	-	(1,069,705)
Civil work project in progress	-	(440,427)
Force majeure payments to contractor	-	(9,393,185)
Force majeure payment received from PENRA	3,000,000	2,750,000
Purchase of property, plant and equipment	(220,484)	(136,792)
Net cash flows from (used in) investing activities	2,779,516	(8,290,109)
Financing activities		
Loan's repayment	(4,536,000)	(720,000)
Finance cost payments	(8,888,819)	(6,867,033)
Dividends paid	(5,514,485)	(5,409,491)
Cash repaid to shareholders	(21,050)	(30,400)
Net cash flows used in financing activities	(18,960,354)	(13,026,924)
Net (Decrease) increase in cash and cash equivalents	(838,673)	2,998,772
Cash and cash equivalents at January 1	12,667,889	9,669,117
Cash and cash equivalents at December 31	11,829,216	12,667,889

The attached notes 1 to 27 form part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006

1. Activities

Palestine Electric Company Public Shareholding Company Limited (PEC/the Company) located in Gaza – Palestine was established and registered in Gaza on December 14, 1999, under registration number 563200971, in accordance with the Companies' Law of 1929, with an authorized share capital of 60 million shares of 1 United States Dollar par value each.

The main objectives of PEC are to establish electricity generating plants in the territories of the Palestinian National Authority (PNA) and to carry out all the operations necessary for the production and generation of electricity through its 99.99% owned subsidiary; Gaza Power Generating Private Limited Company (GPGC).

The consolidated financial statements were authorized for issue by the board of directors on April 2, 2007.

2. The Power Plant Project

GPGC has an exclusive right from PNA to provide capacity and generate electricity in Gaza for 20 years following commercial operation with the opportunity to continue for up to two additional consecutive five-year periods.

For the purpose of establishing and operating the power plant project, PEC and GPGC have entered into the following main agreements:

- The land lease agreement of 147,279 square meters was executed with the PNA on November 25, 1999, for a period of 30 years effective from the commencement of the commercial operations of the power plant. The lease may be extended for an additional 10 years period. According to the lease agreement, the power plant and any other improvements on the leased land shall constitute personal property and not be part of the land. If the power plant and other improvements remain on the land following 166 days of the termination of the lease, they will become the property of the PNA.
- The engineering, procurement and construction contract (EPC Contract) with ALSTOM Power Sweden AB, later changed to SIEMENS, (Power Plant Contractor) was signed to engineer, supply, construct, test and commission a 140 MW combined cycle power plant in Gaza for U.S. $ 100,500,000, in addition to change orders of U.S. $ 1,406,014. The Contractor completed its construction work under the EPC Contract during 2004.
- The power purchasing agreement (PPA) was signed with the Palestinian Energy Authority, which later changed the entity's name to Palestinian Energy and Natural Resources Authority (PENRA), (Note 9).

- The implementation agreement under which the PNA agrees to reimburse GPGC for all costs incurred associated with the construction or improvement of roads and ports necessary for offloading the equipment required for the construction of the power plant.
- The PPA and the implementation agreements provide GPGC with an exclusive right for 20 years (with the opportunity to continue for up to two additional consecutive five-year periods) to provide capacity and generate electricity in Gaza for sale to entities owned or controlled by the PNA.
- The long term maintenance service agreement (LTSA) under which SIEMENS shall provide the technical services and spare parts necessary for the power plant gas and steam turbines. The agreement amount is Swedish Krona 179,000,000 (U.S. $ 27,052,352). The agreement expires either 10 years after completion of the project under the EPC contract or on the satisfactory completion of the major inspection of the project turbines, whichever is earlier.
- The collection agreement according to which GPGC can collect its electricity billings due from PENRA bank accounts in which all electricity collections from Gaza Electricity Distribution Company customers are deposited.

3. Basis of Consolidation

The consolidated financial statements comprise the financial statements of PEC and its subsidiary GPGC as at December 31, 2006. The financial statements of the subsidiary are prepared for the same reporting year as the Company, using consistent accounting policies.

All intra-company balances, transactions, income and expenses and profits and losses resulting from intra-company transactions that are recognized in assets, are eliminated in full. A subsidiary is fully consolidated from the date of acquisition, being the date on which the Company obtains control, and continues to be consolidated until the date that such control ceases.

GPGC was established and registered in Gaza as of June 30, 1999 as a private shareholding limited liability company, with an authorized share capital of 6,000,000 shares with U.S. $ 10 par value each, of which 5,999,800 shares are owned by PEC.

4. Summary of Significant Accounting Policies

Basis of preparation

The consolidated financial statements of the Company and its subsidiary have been prepared in accordance with International Financial Reporting Standards.

The consolidated financial statements have been presented in U.S. Dollar.

The consolidated financial statements have been prepared under the historical cost convention.

Changes in accounting policies

The accounting policies for the Company and its subsidiary are consistent with those used in the previous year.

IASB Standards and Interpretations issued but not adopted

The following IASB Standards have been issued but are not yet mandatory, and have not yet been adopted by the Company:

Amendments to IAS 1 - Capital Disclosures

Amendments to IAS 1 "Presentation of Financial Statements" were issued by the IASB as "Capital Disclosures" in August 2005. They are required to be applied for periods beginning on or after January 1, 2007. When effective, these amendments will require disclosure of information enabling evaluation of the Company’s objectives, policies and processes for managing capital.

IFRS 7 Financial Instruments: Disclosures

IFRS 7 "Financial Instruments: Disclosures" was issued by the IASB in August 2005, becoming effective for periods beginning on or after January 1, 2007. The new standard will require additional disclosure of the significance of financial instruments for the Company’s financial position and performance and information about exposure to risks arising from financial instruments.

IFRS 8 Operating Segments

IFRS 8 "Operating Segments" was issued by the IASB in November 2006, becoming effective for periods commencing on or after January 1, 2009. The new standard may require changes in the way the Company discloses information about its operating segments.

IFRIC Interpretations

During 2006 IFRIC issued the following interpretations which will be effective on January 1, 2007:

IFRIC Interpretation 8 Scope of IFRS 2
IFRIC Interpretation 9 Reassessment of Embedded Derivatives
IFRIC Interpretation 11 IFRS 2 - Group and Treasury Share Transactions

Management does not expect that these interpretations will have a significant impact on the Company's consolidated financial statements when implemented in 2007.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment in value.

Depreciation is calculated on a straight line basis over the estimated useful lives of the assets at the following annual rates:

	%
Power plant	5
Building	5
Motor vehicles	20
Computers and printers	25
Office equipment	25
Furniture and fixture	20

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount, being the higher of their fair value less costs to sell and their value in use.

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately is capitalized and the carrying amount of the component that is replaced is written off. Other subsequent expenditure is capitalized only when it increases future economic benefits of the related item of property, plant and equipment. All other expenditures are recognized in the consolidated income statement as the expense is incurred.

Intangible assets

Intangible assets acquired by way of government grant and assistance are measured at fair value. Following initial recognition, intangible assets are carried net of any accumulated amortization and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be either finite or indefinite.
Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life is reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in the income statement in the expense category consistent with the function of the intangible asset.

Right to use PENRA's transformers

Right to use PENRA transformers is amortized using the straight-line method over a period of the remaining useful life of the Power Plant being 17.5 years. Amortization expense is recognized in the consolidated income statement.

Impairment and uncollectibility of financial assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, any impairment loss is recognized in the consolidated income statement. Impairment is determined as follows:

- For assets carried at fair value, impairment is the difference between cost and fair value, less any impairment loss previously recognized in the consolidated statement of income;
- For assets carried at cost, impairment is the difference between carrying value and the present value of future cash flows discounted at the current market rate of return for a similar financial asset;
- For assets carried at amortized cost, impairment is the difference between carrying amount and the present value of future cash flows discounted at the original effective interest rate

Materials and inventories

Materials and inventories are stated at the lower of cost or net realizable value using the weighted average method. Costs are those amounts incurred in bringing each item of materials and inventories to its present location and condition.

Accounts receivable

Accounts receivable are stated at original invoice amount less a provision for any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when there is no possibility of recovery.

Cash and cash equivalents

For the purpose of the Statement of Cash Flows, cash and cash equivalents consist of cash in hand, bank balances, and short-term deposits with an original maturity of three months or less.

Accounts payable and accruals

Liabilities are recognized for amounts to be paid in the future for goods or services received, whether billed by the supplier or not.

Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Provision for employees' indemnity

Provision for employees' end of service benefits is calculated in accordance with the labor law prevailing in Palestine, and the Company's internal policies, based on one-month indemnity for each year of employment.

Revenue recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured.

Electrical capacity revenues

Electric capacity revenues are recognized during the period in which electricity is available according to the power purchase agreement with PENRA.

Interest revenues

Interest revenue is recognized as interest accrues using the effective interest method that is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset.

Income from government grants and assistance

Government grants and assistance are recognized where there is a reasonable assurance that the grant will be received and all attaching conditions will be complied with.

A government grant and assistance in the form of a transfer of a non-monetary asset, which is intended for use of the entity, is recognized at the fair value of that asset. Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable willing seller in an arm's length transactions.

A government grant and assistance that becomes receivable as compensation for expenses or losses incurred for the purpose of giving immediate financial support to the entity with no future related costs shall be recognized as income of the period in which it become available.

Expense recognition

Expenses are recognized when incurred according to the accrual basis of accounting.

Finance costs
Finance costs are recognized as an expense when incurred.

Judgments and estimation uncertainty
The preparation of the consolidated financial statements in conformity with IFRS requires the use of accounting estimates and assumptions. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The Company's management continually evaluates its estimates, assumptions and judgments based on available information and experience. As the use of estimates is inherent in financial reporting, actual results could differ from these estimates. The areas involving a higher degree of judgment or complexity are described below:

Useful lives of tangible and intangible assets
The Company's management reassesses the useful lives of tangible and intangible assets, and are adjusted if applicable, at each financial year end. The Company's management believes that the estimates and assumptions used are reasonable.

Foreign currency
Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange ruling at the balance sheet date. All differences are taken to the consolidated income statement.

Earnings per share
Basic earnings per share is calculated by dividing profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share amounts are calculated by dividing the profit attributable to ordinary equity holders of the parent (after adjusted for income or expenses associated with the dilutive potential shares) by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

5. Property, Plant and Equipment

	Power plant	Building	Motor vehicles	Computers and printers	Office equipment	Furniture and fixture	Total
	U.S. $	U.S. $	U.S. $	U.S. $	U.S. $	U.S. $	U.S. $
Cost							
At January 1, 2006	139,663,444	1,352,166	74,769	135,003	105,425	159,146	141,489,953
Additions	-	112,738	-	71,563	11,800	24,383	220,484
Disposal *	4,222,839	-	-	-	-	-	4,222,839
At December 31, 2006	135,440,605	1,464,904	74,769	206,566	117,225	183,529	137,487,598
Accumulated Depreciation							
At January 1, 2006	19,445,414	55,331	60,230	57,709	71,977	89,397	19,780,058
Depreciation	6,877,593	63,177	4,154	38,927	22,026	24,408	7,030,285
Disposal *	475,069	-	-	-	-	-	475,069
At December 31, 2006	25,847,938	118,508	64,384	96,636	94,003	113,805	26,335,274
Net carrying amount							
At December 31, 2006	109,592,667	1,346,396	10,385	109,930	23,222	69,724	111,152,324
At December 31, 2005	120,218,030	1,296,835	14,539	77,294	33,448	69,749	121,709,895

Property, plant and equipment includes U.S. $ 178,823 and U.S. $ 149,576 of fully depreciated assets as of December 31, 2006 and 2005, respectively, which are still used in the Company's operations.

* Disposal represents costs of transformers destroyed and removed from service due the Israeli air strike during June 2006, amounting to U.S. 4,222,839 and related accumulated depreciation of U.S. $ 475,069.

6. Intangible Asset

Intangible asset represents the Company's right to use PENRA's installed step-up transformers which is recognized at the fair value of 4 step-up transformers made available by PENRA on October 1, 2006 for use by GPGC as part of the agreement made on September 2, 2006 (Note 17). Intangible asset is amortized over the remaining useful life of the Power Plant being 17.5 years starting October 1, 2006.

	2006	2005
	U.S. $	U.S. $
Balance, October 1	2,267,984	-
Amortization	(32,400)	-
Balance, December 31	2,235,584	-

7. Prepayments and Deferred Expenses

	2006	2005
	U.S. $	U.S. $
Prepaid land lease *	708,331	849,998
Deferred legal fees **	1,484,208	1,814,032
	2,192,539	2,664,030

* Under the land lease agreement (Note 2), GPGC paid U.S. $ 1,700,000 for the first 12 years of the lease period. After which the lease payments are fixed at U.S. $ 147,000 annually for the remaining 18 years.

	2006	2005
	U.S. $	U.S. $
Prepaid land lease, January 1	849,998	991,665
Lease expense for the year	(141,667)	(141,667)
Prepaid land lease, December 31	708,331	849,998

** This item represents the legal fees paid in relation to the long term financing facilities loan. The fees are amortized over the loan original term of 11 years starting July 1, 2000.

	2006	2005
	U.S. $	U.S. $
Deferred legal fees, January 1	1,814,032	2,143,856
Amortization for the year	(329,824)	(329,824)
Deferred legal fees, December 31	1,484,208	1,814,032

8. Materials and Inventories

	2006	2005
	U.S. $	U.S. $
Goods in transit	50,233	487,029
Mechanical materials	3,818,761	2,410,699
Electrical materials	467,849	294,745
Instrumentation and control materials	859,299	760,239
Operation materials	133,576	244,228
Others	1,956	15,302
	5,331,674	4,212,242

9. Accounts Receivable

	2006	2005
	U.S. $	U.S. $
Accounts receivable from sale of capacity to PENRA *	21,453,490	18,537,076
Receivables from force majeure claims **	11,173,185	14,173,185
	32,626,675	32,710,261

* During 1999, a power purchase agreement (PPA) was signed with the Palestinian Energy Authority, under which PENRA shall purchase all the electric capacity available from GPGC's power plant for a predetermined price. Further, PENRA shall, at all times, supply and deliver all the fuel required to generate the power needed, in addition to the fuel required for commissioning, testing and start-up of the power plant at no cost to GPGC.

The duration of this agreement is 20 years effective from the date the power plant project starts its commercial operations. Commercial operation started on March 15, 2004. Movement of accounts receivable from sale of capacity is as follows:

	2006	2005
	U.S. $	U.S. $
Accounts receivable from PENRA, January 1	18,537,076	23,685,853
Sales of electric capacity	29,214,432	28,716,672
Discount	(1,386,772)	(1,333,333)
Interest on PENRA receivables, according to PPA	725,524	924,184
	47,090,260	51,993,376
Payment of capacity invoices from PENRA	(25,636,770)	(33,456,300)
Accounts receivable from PENRA, December 31	21,453,490	18,537,076

On August 25, 2005, the board of directors decided to offer PENRA a one time discount amount of U.S. $ 4 million per year for a period of two years or until the time at which the construction of the electric transmission grid in Gaza is completed and the gas has been delivered to the power plant, whichever is the earliest. Further, on June 30, 2006, the board of directors resolved to discontinue giving this discount to PENRA and therefore the Company ceased to discount its invoices effective June 2006.

** During October 2001, the Power Plant Contractor notified GPGC that a force majeure event had occurred as a result of the political situation in Palestine, and raised a force majeure claim. Total force majeure originally claimed and submitted by the Power Plant Contractors to GPGC reached U.S. $ 48.3 million.

During 2001, GPGC and PENRA reached an agreement whereby, PENRA agreed to refund GPGC U.S. $ 2,500,000 that is payable to the Power Plant Contractor as part of the settlement of the force majeure claim raised by the Power Plant Contractor against GPGC. The amount is payable to GPGC in two equal annual installments within two years following the commercial operation of the power plant and upon the presentation of a proof that such payments were made by GPGC to the Power Plant Contractor.

Further, on July 18, 2003, PENRA issued a letter committing itself to compensate GPGC with the full amounts of force majeure claims that will be agreed upon by the Power Plant Contractor and GPGC up to the date of completing the construction of the power plant.

During September 2005, GPGC reached a settlement agreement with the Power Plant Contractor, according to which force majeure claims (including accrued interest) were settled for a total of U.S. $ 15.3 of which U.S. $ 7.9 was paid prior to the date of the settlement and the remaining U.S. $ 7.4 million was settled by GPGC during November 2005 by making a final payment towards the settlement of all force majeure claims. In addition, during 2003 and 2004, GPGC paid a total amount of U.S. $ 1.55 million as a settlement of force majeure claim to subcontractors on behalf of the Power Plant Contractor.

The movement on the receivables from PENRA relating to force majeure claims during the year was as follows:

	2006	2005
	U.S. $	U.S. $
Balance, January 1	14,173,185	7,530,000
Force majeure payments made to the Power Plant Contractor	-	9,393,185
Received from PENRA for force majeure claims	(3,000,000)	(2,750,000)
Balance, December 31	11,173,185	14,173,185

10. Other Current Assets

	2006	2005
	U.S. $	U.S. $
Due from PENRA *	1,133,992	-
Value added tax receivables **	1,258,048	850,232
Palestine Electric Company P.L.C (PEC Holding)	93,467	-
Prepaid insurance premium	183,369	224,949
Advances to suppliers	222,016	127,767
Others	36,720	111,266
	2,927,612	1,314,214

* The amount represents the fair value of the two remaining transformers that PENRA is committed to supply and install (Note 17).

** The amount includes a claim of a Value Added Tax (VAT) receivable amounting to U.S. $ 1,144,125 that has not been received/processed by the VAT Department at the Ministry of Finance.

11. Cash and Cash Equivalents

	2006	2005
	U.S. $	U.S. $
Cash on hand	6,340	2,627
Current accounts	11,713,646	9,410,236
Deposits at banks	-	3,124,746
Restricted cash for refund to shareholders	109,230	130,280
	11,829,216	12,667,889

Current accounts at banks earn interest at an average annual rate of 1.25% and 1.13% as of December 31, 2006 and 2005, respectively.

12. Statutory Reserve

The amount represents cumulative transfers of 10% of profits to statutory reserve in accordance with the Companies' Law.

13. Long Term Loan

On June 26, 2000, GPGC signed an agreement with the Arab Bank P.L.C. for a long term loan of U.S. $ 90,000,000, with an interest rate of LIBOR plus 2.75% repayable in 22 semi-annual installments starting December 31, 2001.

On November 16, 2003, GPGC signed a restatement and amendment agreement with the Arab Bank relating to the long term loan facility of U.S. $ 90,000,000 and a working capital facility of U.S. $ 3,000,000. According to this agreement, the Arab Bank and GPGC agreed that the long term loan will be repaid by 19 semi-annual installments the first of which starts on December 31, 2004 and the last installment due on December 31, 2013. These installments are based on predetermined percentage of the loan amount. Further, the interest rate on the long term loan was reduced to LIBOR plus 2.25%.

In addition, the accrued interest during construction has been rescheduled to be paid after the completion of the construction of the power plant starting March 31, 2004 by 12 quarterly equal installments. Loan and accrued interest are payable as follows:

	Loan	Accrued interest	Total loan & accrued interest
	U.S. $	U.S. $	U.S. $
Due	4,176,000	4,027,537	8,203,537
2007	12,420,000	-	12,420,000
2008	10,008,000	-	10,008,000
2009	11,592,000	-	11,592,000
2010	12,006,000	-	12,006,000
Thereafter	34,542,000	-	34,542,000
	84,744,000	4,027,537	88,771,537

As a collateral for the loan, the Arab Bank has a security pledge over all GPGC assets and all of GPGC shares owned by PEC. PEC's shares traded on the Palestinian Securities Exchange are not part of this security pledge.

Following are the main financial covenants of the loan agreement:

– PEC and GPGC shall not declare, pay or make any distribution of dividends or any other distributions, whether cash or inkind, if a default has occurred or would occur as a result of such distribution and other than from moneys standing to the credit of the distribution account in accordance with the loan agreement. PEC has obtained a consent from the Arab Bank to distribute dividends for 2006 and 2005.

– GPGC shall not, without the Arab Bank consent, transfer any amount from its bank accounts to the distribution account except in accordance with the clauses of the loan agreement and only subject to the following conditions:
    - The debt service coverage ratio is greater than 1.15 : 1, and the projected debt service coverage ratio is greater than 1.15 : 1.
    - No default or potential default has occurred or would occur as a result of such transfer.
    - The construction of the power plant is completed.

– GPGC shall not without the Arab Bank's consent purchase, cancel, reduce or redeem any of its share capital, or issue any of its share or loan capital other than permitted shares, or alter any right attaching to its issued shares nor create any new class of shares.

– GPGC shall maintain its corporate existence and shall not amalgamate, merge or consolidate with or into any other person or become the subject of any reconstruction, or apply for its winding-up or dissolution or for any other insolvency proceedings.

– GPGC shall not, incur without the prior consent of the Arab Bank, any capital expenditures other than the power plant cost and any operating costs, construction costs, major maintenance costs in excess of the agreed upon amounts.

– GPGC shall not acquire, or agree to acquire, any asset other than assets required in the ordinary course of the constructing, managing, maintenance and repair of the power plant.

– GPGC shall not incur any indebtedness except indebtedness previously approved by the Arab Bank and unsecured indebtedness not in excess of U.S. $ 500,000 at any time.

– GPGC shall not, without the consent of the Arab Bank acquire any securities or any interest in any party, or enter into any joint venture, partnership or other business association.

– GPGC shall ensure that its payment obligations under the loan agreement shall at all times rank in all respects in priority to all its other indebtedness.

– GPGC shall not create or permit to subsist any encumbrances on or over any of its assets except as permitted by the loan agreement.

14. Provision for Employees' Indemnity

Provision for employees' end of service indemnity is calculated in accordance with the labor law prevailing in Palestine, based on one month indemnity for each year of employment.

	2006	2005
	U.S. $	U.S. $
Balance, January 1	481,336	475,733
Additions	335,623	150,314
Payments	(9,203)	(144,711)
Balance, December 31	807,756	481,336

15. Payable to the Power Plant Contractor

	2006	2005
	U.S. $	U.S. $
Current portion	3,783,315	3,746,300
Long term portion	-	2,545,218
	3,783,315	6,291,518

During 2005, GPGC reached a final settlement agreement with the Power Plant Contractor, under the EPC Contract according to which GPGC was to pay U.S. $ 6,295,218. According to the agreement, GPGC shall have the right to pay the settlement amount in accordance with an agreed upon schedule of payments according to which GPGC is obligated to pay in the amount in 25 monthly installments amounting to U.S. $ 250,000 each starting November 7, 2005 in addition to a final installment of U.S. $ 45,218 due on December 7, 2007. According to the settlement, these payments are subject to interest rate of 5.75% on late payment and GPGC has the right to prepay or accelerate the payment against the payment schedule referred to above.

16. Other Current Liabilities

	2006	2005
	U.S. $	U.S. $
Dividends payable	1,076,024	590,509
Palestine Electric Company P.L.C (PEC Holding)	-	424,468
Consolidated Contractors Company	93,325	49,376
United Engineering Services S.A.	46,837	-
Payroll income tax	438,857	293,900
Due to shareholders	109,230	130,280
Accrued expenses	14,010	36,267
Provision for employees vacations	92,248	145,244
Others	93,456	151,558
	1,963,987	1,821,602

17. Income from PENRA Assistance

In an agreement, following the destruction of GPGC's transformers by the Israeli air strike, the PENRA and GPGC agreed that the PENRA would rectify all damages within the power plant and to restore the power supply from the power plant. Accordingly, PENRA agreed to purchase and install 6 step-up transformers to replace GPGC's destroyed transformers. According to the agreement, these transformers will be owned by PENRA and GPGC will have the right to use such transformers and will be responsible for their operation and maintenance. As of the date of the financial statements, only 4 transformers were installed at the Power Plant and the remaining 2 transformers are to be supplied and installed during 2007 by PENRA.

	U.S. $
Fair value of 4 step-up transformers installed (Note 6)	2,267,984
Fair value of 2 step-up transformers to be installed (Note 10)	1,133,992
Fair value of all 6-step up transformers	3,401,976

18. Operating Expenses

	2006	2005
	U.S. $	U.S. $
Salaries and wages	2,745,271	3,003,882
Employees' end of service indemnity	335,623	150,314
Employees' insurance	92,454	98,002
Service fees	1,010,837	-
Travel and transportation	420,402	330,445
Power plant insurance expense	796,711	1,004,335
Power plant operation and maintenance	346,817	2,410,923
Depreciation	7,030,285	7,054,475
Amortization of intangible asset	32,400	-
Professional and consultancy expenses	154,707	239,633
Land lease	141,667	141,667
Telephone and fax	119,894	121,409
Legal fees	51,894	125,850
Registration fees	27,110	28,968
General assembly meeting expenses	46,655	50,491
Rent	17,503	17,853
Office supplies	27,591	59,173
Advertisements and publications	66,128	50,740
Security services	125,500	67,500
Miscellaneous	43,664	54,166
	13,633,113	15,009,826

19. Others Income (Expenses)

	2006	2005
	U.S. $	U.S. $
Interest income	190,251	101,180
Foreign currency exchange	126,352	(135,661)
Others	70,254	-
	386,857	(34,481)

20. Basic and Diluted Earnings Per Share

	2006	2005
	U.S. $	U.S. $
Profit for the year	7,403,808	7,639,733
Weighted average of subscribed share capital during the year	60,000,000	60,000,000
Basic and diluted earnings per share	0.123	0.127

21. Dividends

PEC's general assembly in its meeting held on April 30, 2006, approved dividends distribution of U.S. $ 6,000,000, the equivalent of 10% of paid in capital.

22. Related Party Transactions

Related parties represent associated companies, major shareholders, directors and key management personnel of PEC and GPGC, and companies of which they are principal owners. Pricing policies and terms of these transactions are approved by PEC and GPGC management.

Balances with related parties included in the consolidated balance sheet are as follows:

	2006	2005
	U.S. $	U.S. $
Cash at the Arab Bank	11,822,876	12,665,262
Arab Bank loan and accrued interest	88,771,537	95,118,854
Payable to PEC Holding	-	424,468
Payable to United Engineering Services S.A.	46,837	-
Payable to Consolidated Contractors Company	93,325	49,376
Receivable from PEC Holding	93,467	-

The consolidated income statement includes the following transactions with related parties:

	2006	2005
	U.S. $	U.S. $
Arab Bank finance cost	7,227,502	5,293,659
Service fees charged by United Engineering Services	1,010,837	-
Consulting and service fee charged by Consolidated Contractors Company	228,000	67,500
Compensation of key management personnel	565,182	729,750

In addition, as part of Arab Bank's consideration on the restatement and amendment agreement (Note 13), Consolidated Contractors Group S.A.L. (Holding Company) issued a guarantee in the amount of U.S. $ 22 million in favor of the Arab Bank. The value of the guarantee is automatically reduced by the same amount of the principal payment of the long term loan. During 2004, the Arab Palestinian Investment Company Ltd. (APIC) and Palestine and Development and Investment Company (PADICO) submitted to Consolidated Contractors Group S.A.L a counter guarantee for the value of 9.09% each, of the issued guarantee amount.

23. Income Tax

According to the Implementation Agreement, the PNA has agreed to exempt GPGC and its shareholders (with respect to dividends and earnings receivable from GPGC), for the term of the agreement of 20 years including any extensions thereof, from all Palestinian taxes.

24. Contractual Commitments

The contractual commitment represents the difference between the contract gross amount and the executed portion of the contract at the financial statements date. As at the financial statements date, GPGC has the following contractual commitments:

	2006	2005
	U.S. $	U.S. $
Long term maintenance service agreement	18,730,998	19,969,095
Land lease agreement	2,646,000	2,646,000
	21,376,998	22,615,095

25. Fair Values of Financial Instruments

Financial instruments comprise of financial assets and financial liabilities. Financial assets consist of cash and bank balances, accounts receivable and some other current assets. Financial liabilities consist of long term loan, accounts payable and some other current liabilities.

The fair value of financial instruments, are not materially different from their carrying values.

26. Concentration of Risk in Geographic Area

PEC and GPGC are carrying out all of their activities in Palestine. The political and economical situation in the area increases the risk of carrying out business and could adversely affect PEC and GPGC performance.

27. Risk Management

Credit risk

GPGC is obliged to make available all of its generating capacity to PENRA regardless of the extent to which PENRA can absorb that capacity. Currently, all GPGC electric capacity revenue is generated from one customer, PENRA. To the date of these financial statements, PENRA has not provided GPGC with the letter of credit of U.S. $ 20,000,000 as required by the Power Purchase Agreement.

Interest rate risk

PEC and GPGC are exposed to interest rate risk on the following interest bearing assets and liabilities.

	2006	2005
	U.S. $	U.S. $
Deposits and current account at banks	11,713,646	12,534,982
Long term loan	84,744,000	89,280,000

Liquidity risk

PEC and GPGC limit their liquidity risk by ensuring bank facilities are available and by maintaining adequate cash balances to meet its current obligations and to finance its operating activities.

Currency risk

PEC maintains its major liabilities and assets in one currency, which is the U.S. $. In addition, its revenues are collected in U.S. $ and most of its expenses are paid in U.S. $, except for the expenses paid under the long term maintenance agreement, that is denominated in Swedish Krona. In addition, the consolidated balance sheet includes VAT receivable balance amounting to U.S. $ 1,258,048 that is denominated in New Israeli Shekel.