



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

Annual Report
2005

PALESTINE ELECTRIC COMPANY P.L.C
P.O.Box 1336 Gaza, Palestine
Tel.: +970 8 2823800
Fax: +970 8 2823297
E-mail: info@pec.ps
Website: www.pec.ps

PEC Financial Summary 2005

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Chairman's Statement:

Proud of the Success of Palestine Electric Company

At the start of our quest in establishing the first Palestinian power generating company, we faced many obstacles and challenges but our determination and trust in a vision of a better Palestine kept us going, and to everyone's surprise and joy we succeeded and surpassed all expectations.

Palestine Electric Company, through its performance during the past years, continues to prove to be a successful investment and a strong company, and I remain very confident of its success and long term growth prospects.

I am proud of the success of our Company which is attributed to the extraordinary efforts from the Executive Managing Director and the remarkable working team who made it possible for the company to surpass all the difficulties of this sensitive phase, and to maintain the success and good performance of our company. In the name of the Board of Directors, I would like to congratulate the Palestine Electric Company team for their performance and loyalty to the company and to our shareholders that have given us their trust. I have great confidence in the continual success of the company in the coming years through the constructive group effort of the PEC working team.

Wishful of a peaceful entity within our Palestine ....

Said Khoury
Chairman

Executive Managing Director's Statement

Our Strength Is A Powerful Team And Our Core Motivator Is To Maximise Our Shareholders' Value

As we believe that the first step to a peaceful environment is an independent strong economy, we try, through PEC holding and its input to the Palestinian Economy and Society, to achieve this goal by contributing to the development of the Palestinian infrastructure, promoting and encouraging the private sector's involvement in the Energy sector and creating job opportunities for the local population. Our interests lie in building the confidence of International investors in these high-risk investments and politically difficult environment in Palestine in order to allow the population of this region to benefit from development and prosperity.

We also believe in establishing a trustworthy and transparent relationship with our shareholders and the general public, in order to build the people's confidence and hope in a better future.

At Palestine Electric Company, we have celebrated success and achieved remarkable results year after year as we reached commercial operation at 140MW on March 15th, 2004, started trading in the Palestine Securities Exchange on May 10th, 2004, conducted the first distribution of dividends successfully during the year 2005, and the list of success goes on as we are a solid company with a vision for the future. Our strength is a powerful team and our core motivator is to maximise our shareholders' value.

Following our continuous success and role in the Palestinian economy, I would like to thank the Chairman of the Ministry of Energy and Natural Resources and the managers of the distribution company for their collaboration and positive support in addition to their compliance and execution of all agreements with the Palestine Electric Company in the aim to strengthen the trust in the Palestinian economy and investments.

I would like to thank our Chairman and Board Members for their continuous support, encouragement and faith in the PEC/GPGC team, and our shareholders for their continuous commitment and efforts that empower Palestine Electric Company.

Included in this booklet, my comments on the Company's financial results for the year 2005.

Walid Salman

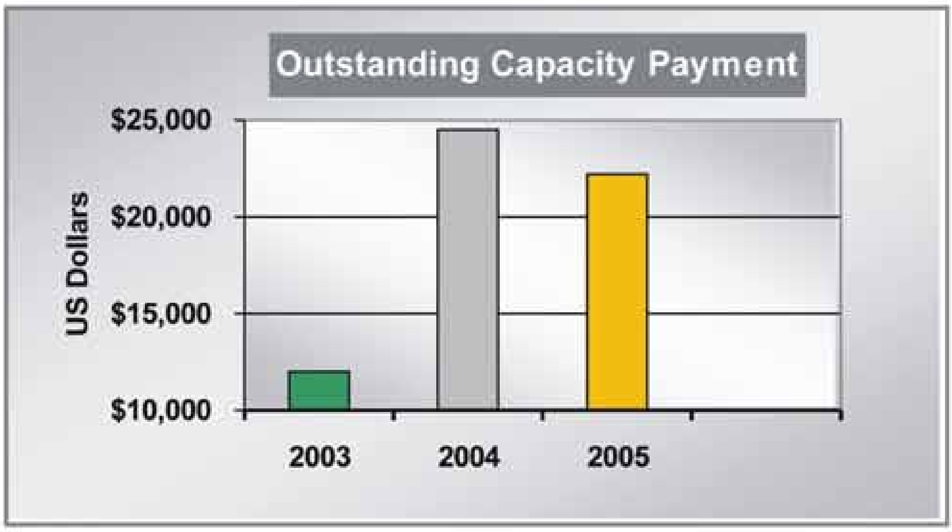
Executive Managing Director

Executive Managing Director's Comments on the Company Financial Results

Issues with the Palestinian National Authority (PNA)

Revenue Payment Progress

During the past year, Palestine has witnessed unstable economic and political conditions; however, in light of these circumstances, PNA has been honouring their outstanding capacity payment due to GPGC in line with the collection agreement between the two parties. As a result of these consistent payments since April 2005, the outstanding receivables from capacity payment have been reduced from $24.5 million to $22.2 million.



Discount

GPGC is aware of the long-term benefits of accelerating the construction of the transmission facilities and providing natural gas as the primary fuel; this lead to the realization of supporting PNA regarding this issue. Therefore, as a sign of good will, the Board of Directors agreed on the 25th August 2005 to offer PNA a discount of $4 million per year for a period of two years or until the construction of the transmission grid is completed and the gas has been delivered to the power plant, whichever is earliest. The discount has been put into effect since September 2005, whereby it is applied as a deduction from the outstanding receivables. Consequently, the company's Cash flow has not been affected; however, the profits will be affected directly as it is expensed in the Income Statement from the future billings.

Executive Managing Director's Comments on the Company Financial Results

Issues regarding Engineering, Procurement and Construction (EPC)

Settlement Agreement with Siemens / Alstom Power

On 29th September 2005, GPGC and Siemens signed a Settlement Agreement, which addressed all Outstanding Issues related to the EPC Contract. GPGC was focused on tackling specific issues, which are significant to ensure that all technical specifications & obligations were adhered to. GPGC managed to settle Alstom Power's Force Majeure claim of $48 million to a total of $16.85 million out of which $1.55 million was paid by GPGC on behalf of Alstom Power to the local subcontractors during 2003 & 2004; and $7.9 million was already settled by GPGC. During November 2005, GPGC had settled the final payment of $7.4 million of Force Majeure claim. In addition to the full settlement of the Force Majeure Claim, GPGC managed to finalize a list of technical outstanding issues which Alstom Power are obliged to complete satisfactorily within a specified period of time. Furthermore, all matters related to VAT claims, Security costs and Change Orders where settled. Overall, the Settlement Agreement resulted in a cost saving of around $2.3 million.

Issues with Arab Bank

Repayment of Principal & Interest

GPGC have been honoring the repayment of the debt service obligations to the Arab Bank. The company has been able to manage their cash flow and furnish their debt service Reserves account in line with all agreements.

Interest Impact

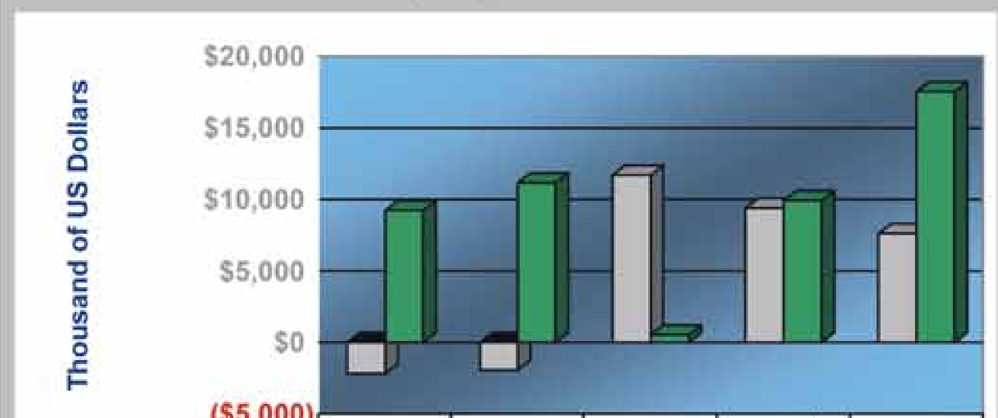
Due to the global trend, LIBOR rates have been fluctuating and have been increasing. In light of these uncontrollable external factors the company's performance will be affected. However, GPGC consistently explore ways to manage their cash flow and budget as their efforts will be directed to fixing their interest rate; thus minimize the risk accompanied with the fluctuations of the LIBOR rates.

Executive Managing Director's Comments on the Company Financial Results

Internal Company Issues

Financial Overview

In 2005, GPGC was able to maintain and achieve its expectation in relation to the company's profits. Again, the company had a reasonably good financial performance despite of the unstable political & economical conditions in Palestine. GPGC had managed to achieve a \$7.6 million in profits. However, profits had been reduced by 19% from 2004. This drop in profits can be directly traced to two main reasons: the discount amount offered to PNA and the increasing LIBOR rates (ie. Increase in borrowing costs).



	2001	2002	2003	2004*	2005
Net (Loss) / Profit	($2,179)	($1,916)	$11,687	$9,413	$7,639
Accummulated (Loss) /Profit	$9,259	$11,175	$512	$9,925	$17,528

* Declared & Paid Dividends of \$6 Million

Financial Expectations for 2006

In August 2005, GPGC offered a discount to PNA, as a sign of good will to assist PNA during the difficulties. Furthermore, the company is currently considering donating an amount of \$1.5 million to PNA, dedicated to complete the constructions of part of the transmission grid under certain conditions set forth by GPGC in which PNA has to comply with. Even though the company's profitability from normal operations is expected to remain consistent, as with previous years, the impact of these above two issues will be seen on the company's Net Income for 2006.

Executive Managing Director's Comments on the Company Financial Results

GPGC's financial performance for the year 2006 will be temporarily affected in the short-term by these strategic decisions made during the year, nonetheless, the long-term benefits of these decisions outweigh their drawbacks and their benefits are in compliance with the company's vision of long-term growth and maximising shareholders' value.

As a result of the discount offered and the donation under consideration, PNA will be able to complete strategic parts of their transmission grid and thus will be able to absorb more electricity dispatched from the Power Plant. This will lead to the benefit of improved efficiency. Furthermore, once Natural Gas reaches the Power Plant, PNA will benefit tremendously from the reduced fuel costs and thus will be able to improve their financial situation. This in turn will mean that PNA will be able to honor their commitments to GPGC in a much more relaxed manner while benefiting from the enhanced electricity availability to the public.

Budget Focus

Budget Focus 2005

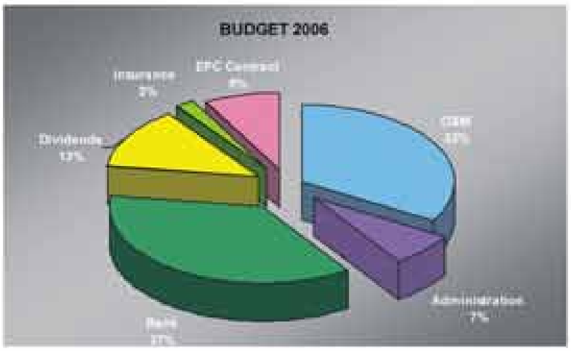
GPGC's professional financial outlook constantly aims to focus its efforts on the enhancement and improvement of its financial and commercial policies and procedures; hence striving to reduce costs, preserve a transparent image and increase the efficiency and productivity of its operations in each department. Accordingly, GPGC manage their budget by allocating it each year to achieve the goals set forth. In 2005, GPGC has managed to settle the Force Majeure claim due to Siemens while attaining a cost saving. In addition, GPGC's internal management had reduced costs of its operating expenses and management overhead cost by 4%.

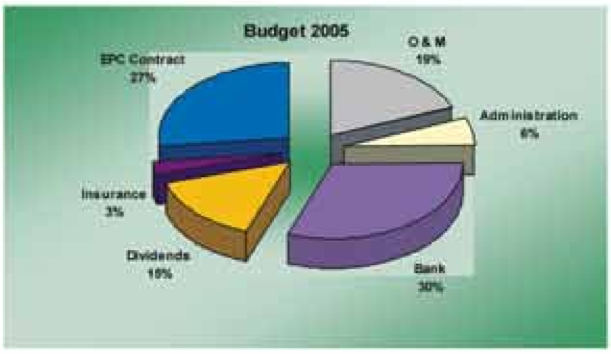
Budget Focus 2006

GPGC budget focus for 2006 is mainly targeted towards the Operations & Maintenance Department and the debt service obligation due to the Arab Bank under the Credit Agreement

Executive Managing Director's Comments on the Company Financial Results

whereby the rest of budget capacity has been allocated according to the necessity of other departments and issues as referred to in the charts below.





Part of GPGC's strategy for 2006 is to allocate a portion of its budget to carry out several high-qualified training programs that will have a positive impact in the development of its staff's skills and abilities. The training programs will vary from developing interpersonal skills such as leadership skills and communication skills to technical training. Furthermore, GPGC has allocated a budget to build the strategic inventory spare part of the Power Plant.

Dividend Policy

GPGC always has their shareholders in mind as the company's efforts are directed towards constantly enhancing its image in front of the shareholders thus maximizing their shareholders value. The company continuously searches for and seizes opportunities to grow and attain a higher level of success, as this will reflect positively to higher returns for their shareholders. During the year 2005, the company distributed dividends of $6 million and will attempt to maintain its dividend policy for the coming years. As the financial commitments and obligations dwindled, the intention of increasing the dividends will be part of the company's objectives.

Audited Financial Statements

PALESTINE ELECTRIC COMPANY
PUBLIC SHAREHOLDING COMPANY LIMITED

Consolidated Financial Statements
As of December 31, 2005
Together with Independent Auditors' Report

ERNST & YOUNG

■ RAMALLAH
P.O.Box 1373
Sixth Floor
Trust Bldg., Jerusalem St.
Ramallah - Palestine
Tel.: (02) 2401011
Fax: (02) 2402324

■ GAZA
P.O.Box 5315, Omar Al Mokhtar
Third Floor, Suite 307
Al Jala' Tower, Ahmad Abdel Aziz St.
Gaza - Palestine
Tel.: (08) 2821004
Fax: (08) 2828647

Independent Auditors' Report

To the Shareholders of
Palestine Electric Company
Public Shareholding Company Limited
Gaza - Palestine

We have audited the accompanying consolidated balance sheet of Palestine Electric Company "Public Shareholding Company Limited" (the Company) as of December 31, 2005 and the related consolidated statements of income, changes in shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. 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 plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Palestine Electric Company Public Shareholding Company Limited as of December 31, 2005 and its consolidated results of operations and 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 Authority is committed to compensate PEC for the amounts of the force majeure claims that was agreed upon by the Company and the power plant project's contractor. Further and as explained in note (26), the Palestinian Energy Authority is the sole customer of the Company. To the date of the issuance of this report, the Palestinian Energy Authority did not provide the Company with the letter of credit as required by the power purchase agreement.

for **Ernst & Young**
Saed Abdalla

Gaza - Palestine
March 8, 2006

Palestine Electric Company
Public Shareholding Company Limited

CONSOLIDATED BALANCE SHEET
As of December 31, 2005
(Currency: U.S. Dollar)

	Notes	2005	2004
Assets			
Current Assets			
Cash	5	12,667,889	9,669,117
Accounts receivable	6	18,537,076	23,685,853
Inventories	7	4,212,242	2,935,528
Other current assets	8	463,982	1,094,063
Total Current Assets		35,881,189	37,384,561
Other receivables from Palestinian National Authority	9	15,023,417	9,620,718
Prepayments and deferred expenses	10	2,664,030	3,135,521
Civil work projects in progress	11	-	778,779
Property, plant and equipment, net	12	121,709,895	126,805,372
Total Assets		175,278,531	177,724,951
Liabilities and Shareholders' Equity			
Current Liabilities			
Current portion of amount due to contractor	13	3,746,300	7,998,709
Current portion of long term loan	15	14,550,854	6,148,912
Other current liabilities	14	1,821,602	1,778,508
Total Current Liabilities		20,118,756	15,926,129
Amount due to contractors, long term portion	13	2,545,218	-
Long term loan	15	80,568,000	91,397,601
Provision for employees' indemnity	16	481,336	475,733
Total Liabilities		103,713,310	107,799,463
Shareholders' Equity			
Share capital		60,000,000	60,000,000
Statutory reserve	17	2,874,000	2,110,027
Retained earnings		8,691,221	7,815,461
Total Shareholders' Equity		71,565,221	69,925,488
Total Liabilities and Shareholders' Equity		175,278,531	177,724,951

The accompanying notes from 1 to 26 are an integral part of these financial statements.

Palestine Electric Company

Public Shareholding Company Limited

CONSOLIDATED STATEMENT OF INCOME

For the Year Ended December 31, 2005

(Currency: U.S. Dollar)

	Notes	2005	2004
Operating revenues			
Sales of electric capacity	6	28,716,672	27,750,107
Discount	6	(1,333,333)	-
		27,383,339	27,750,107
Operating expenses	18	(15,009,826)	(15,118,162)
		12,373,513	12,631,945
Other revenues (expenses)			
Interest income		1,025,364	659,319
Finance costs		(5,293,659)	(3,759,541)
Amortization	10	(329,824)	(329,824)
Foreign currency translation (loss) gain		(135,661)	211,031
Profit for the year		7,639,733	9,412,930
Earnings per share	19	0.127	0.157

The accompanying notes from 1 to 26 are an integral part of these financial statements.

Palestine Electric Company

Public Shareholding Company Limited

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
For the Year Ended December 31, 2005
(Currency: U.S. Dollar)

	Share Capital	Statutory Reserve	Retained Earnings	Total Shareholders' Equity
Balance at January 1, 2004	60,000,000	1,168,734	(656,176)	60,512,558
Profit for the year	-	-	9,412,930	9,412,930
Statuary reserve	-	941,293	(941,293)	-
Balance at December 31, 2004	60,000,000	2,110,027	7,815,461	69,925,488
Profit for the year	-	-	7,639,733	7,639,733
Statuary reserve	-	763,973	(763,973)	-
Dividends (Note 20)	-	-	(6,000,000)	(6,000,000)
Balance at December 31, 2005	60,000,000	2,874,000	8,691,221	71,565,221

The accompanying notes from 1 to 26 are an integral part of these financial statements.

Palestine Electric Company

Public Shareholding Company Limited

CONSOLIDATED STATEMENT OF CASH FLOWS

For the Year Ended December 31, 2005

(Currency: U.S. Dollar)

	2005	2004
Cash flows from operating activities		
Profit for the year	7,639,733	9,412,930
Adjustments:		
Provision for employees' end of service indemnity	150,314	220,554
Depreciation	7,054,473	6,539,999
Amortization	471,491	471,491
Finance costs	5,159,374	3,705,792
	20,475,385	20,350,766
Change in working capital:		
Increase (decrease) in accounts receivable	5,148,777	(11,674,119)
Increase (decrease) in other current assets	630,081	(682,765)
Increase in inventory	(1,276,714)	(322,224)
(Decrease) increase in other current liabilities	(517,015)	43,320
Employees indemnity paid	(144,711)	(70,198)
Net cash flows from operating activities	24,315,803	7,644,780
Cash flows from investing activities		
Power plant project	(1,069,705)	(6,037,603)
Civil work project in progress	(440,427)	(778,779)
Force majeure payments to contractor	(9,393,185)	(4,290,000)
Force majeure payment received from PEA	2,750,000	-
Purchase of property and equipment	(136,790)	(67,593)
Net cash used in investing activities	(8,290,107)	(11,173,975)
Cash flows from financing activities		
Proceeds from long term loan	-	12,396,000
Loan's repayment	(720,000)	-
Finance cost payments	(6,867,033)	(2,974,273)
Dividends paid	(5,409,491)	-
Cash repaid to shareholders	(30,400)	(65,040)
Net cash (used in) from financing activities	(13,026,924)	9,356,687
Net increase in cash	2,998,772	5,827,492
Cash, January 1	9,669,117	3,841,625
Cash, December 31	12,667,889	9,669,117

The accompanying notes from 1 to 26 are an integral part of these financial statements.

1. Company, Capital and Activities

Palestine Electric Company Public Shareholding Company Limited (PEC) 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 financial statements were authorized for issue by the board of directors on March 8, 2006.

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. On March 15, 2004 GPGC commenced the full commercial operations of the 140 MW combined cycle power plant, while partial operation commenced during 2003.

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 (ALSTOM), 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. ALSTOM completed its construction work under the EPC contract during 2004.

- The power purchasing agreement (PPA) signed with the Palestinian Energy Authority (PEA), (Note 6).
- 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 ALSTOM 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.
- During June 2004, the collection agreement was activated, according to which GPGC can collect its electricity billings due from PEA bank accounts from which all electricity collections from Gaza Electricity Distribution Company customers are deposited.

3. The Consolidated Financial Statements

The accompanying consolidated financial statements include the assets, liabilities and results of operations of PEC and GPGC. The financial statements of GPGC are consolidated on a line-by-line basis with PEC financial statements after eliminating all intercompany balances and transactions between PEC and GPGC.

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. Significant Accounting Policies

- **Basis of preparation**

  The consolidated financial statements have been prepared under the historical cost convention in accordance with International Financial Reporting Standards, as published by the International Accounting Standards Board. The accounting polices are consistent with those used in previous year.

- **Revenues recognition**

  Electric capacity revenues are recognized during the period in which electricity are generated according to the power purchase agreement with the PEA.

- **Expenses recognition**

  Expenses are recognized when incurred.

- **Cash**

  Cash consists of cash on hand, bank current balances and short-term deposits with an original maturity of three months or less.

- **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.

- **Inventories**

  Inventories are stated at cost using the weighted average method. Costs are those expenses incurred in bringing the inventory to its present location and condition.

- **Project in progress**

  Project in progress comprises all costs incurred to construct projects including the design, engineering and construction costs, environmental studies, finance costs, management expenses and project development costs. Completed and substantially completed parts of projects are capitalized and recorded as property, plant and equipment.

- **Finance costs**

  Finance costs directly attributable to the construction of the power plant project are capitalized and recorded as part of the power plant project in progress. Finance costs are expensed when construction of the project is completed.

- **Property, plant and equipment**

  Property, plant and equipment are stated at cost, and are depreciated over their estimated useful lives using the straight-line method 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.

- **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 PEC has an obligation arising from a past event, and the costs to settle the obligation are both probable and able to be reliably measured.

- **Earning per share**

  Earning per share is computed based on the weighted average of subscribed share capital during the year.

- **Foreign currencies**

  Transactions in currencies other than U.S. Dollar are translated into U.S. Dollar using the prevailing exchange rate in effect at the time of each transaction. Monetary assets and liabilities, which are denominated in other currencies, are translated to U.S. Dollar using exchange rates prevailing at the date of the balance sheet. Gains and losses arising from exchange differences are reflected in the statement of income.

5. Cash

	2005	2004
Cash on hand	2,627	7,076
Current accounts	9,410,236	4,091,687
Deposits at banks	3,124,746	5,409,674
Restricted cash for refund to shareholders	130,280	160,680
	12,667,889	9,669,117

Deposits at banks represent call deposits with an average annual interest rate of 2.6% during the year.

6. **Accounts Receivable**

During 1999, a power purchase agreement (PPA) was signed with the Palestinian Energy Authority (PEA), under which the PEA shall purchase all the electric capacity available from GPGC's power plant for a predetermined price. Further, PEA 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 is as follows:

	2005	2004
Accounts receivable from PEA, January 1	23,685,853	12,011,734
Sales of electric capacity	28,716,672	27,750,107
Discount *	(1,333,333)	-
Interest on PEA receivables, according to PPA	924,184	625,857
	51,993,376	40,387,698
Cash received from PEA	(33,456,300)	(16,701,845)
Accounts receivable from PEA, December 31	18,537,076	23,685,853

* On August 25, 2005, the board of directors decided to offer PEA 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. This amount represents the discount for the period from August 25, 2005 to December 31, 2005.

7. **Inventories**

	2005	2004
Goods in transit	487,029	-
Mechanical materials	2,410,699	1,908,094
Electrical materials	294,745	234,842
Instrumentation and control materials	760,239	587,106
Operation materials	244,228	193,745
Safety materials	11,690	8,807
Others	3,612	2,934
	4,212,242	2,935,528

8. **Other Current Assets**

	2005	2004
Prepaid insurance premium	224,949	244,294
Advances to suppliers	127,767	725,729
Others	111,266	124,040
	463,982	1,094,063

9. Other Receivables from Palestinian National Authority

	2005	2004
Receivables from PEA for force majeure claims*	14,173,185	7,530,000
Value added tax receivables **	850,232	2,090,718
	15,023,417	9,620,718

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

During 2001, GPGC and PEA reached an agreement whereby, PEA agreed to refund GPGC U.S. $ 2,500,000 that is payable to ALSTOM as part of the settlement of the force majeure claim raised by ALSTOM 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 ALSTOM.

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

Furthermore, GPGC agreed to pay ALSTOM a monthly amount of U.S. $ 250,000 starting January 2004 as a payment on account against the force majeure claim that GPGC agreed to be undisputed.

During September 2005, GPGC reached a settlement agreement with ALSTOM, according to which force majeure claims (including accrued interest) were settled for a total of U.S. $ 15.3 million of which U.S. $ 7.9 were already paid by GPGC and 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 ALSTOM.

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

	2005	2004
Balance, January 1	7,530,000	3,240,000
Force majeure payments made to ALSTOM's subcontractors	-	1,290,000
Force majeure payments made to ALSTOM	9,393,185	3,000,000
Received from PEA for force majeure claims	(2,750,000)	-
Balance, December 31	14,173,185	7,530,000

** The amount includes a claim of a Value Added Tax (VAT) receivable amounting to U.S. $ 845,044 that has not been received/processed by the VAT Department at the Ministry of Finance.

10. Prepayments and Deferred Expenses

	2005	2004
Prepaid land lease *	849,998	991,665
Deferred legal fees **	1,814,032	2,143,856
	2,664,030	3,135,521

* 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.

	2005	2004
Prepaid land lease, January 1	991,665	1,133,332
Lease expense for the year	(141,667)	(141,667)
Prepaid land lease, December 31	849,998	991,665

** 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.

	2005	2004
Deferred legal fees, January 1	2,143,856	2,473,680
Amortization for the year	(329,824)	(329,824)
Deferred legal fees, December 31	1,814,032	2,143,856

11. Civil Work Projects in Progress

Civil work project in progress consists of the costs incurred for the civil work construction. Cost of completed projects is transferred to property, plant and equipment. Movement during the year follows:

	Balance, January 1	Additions during the year	Balance, December 31
Extension of administration building	200,653	47,284	247,937
Conference building	152,102	24,809	176,911
Boundary wall	149,497	-	149,497
Warehouse	80,037	98,117	178,154
Other civil work	196,490	270,217	466,707
	778,779	440,427	1,219,206
Transferred to property, plant and equipment			(1,219,206)
			-

12. Property, Plant and Equipment

	Balance, January 1	Additions/ depreciation	Disposals	Balance, December 31
Cost:				
Power plant	139,060,444	603,000	-	139,663,444
Building	132,960	1,219,206	-	1,352,166
Motor vehicles	74,769	-	-	74,769
Computers and printers	87,060	47,943	-	135,003
Office equipment	71,102	34,323	-	105,425
Furniture and fixture	104,620	54,526	-	159,146
	139,530,955	1,958,998	-	141,489,953
Accumulated Depreciation:				
Power plant	12,492,391	6,953,023	-	19,445,414
Building	15,512	39,819	-	55,331
Motor vehicles	56,076	4,154	-	60,230
Computers and printers	35,922	21,787	-	57,709
Office equipment	52,101	19,876	-	71,977
Furniture and Fixture	73,581	15,816	-	89,397
	12,725,583	7,054,475	-	19,780,058
Net book value	126,805,372			121,709,895

Property, plant and equipment includes U.S. $ 149,576 and U.S. $ 139,460 of fully depreciated assets as of December 31, 2005 and 2004, respectively which are still in use.

13. Payable to the Power Plant Contractor

	2005	2004
Current portion of amount due to contractor	3,746,300	7,998,709
Amount due to contractor, long term portion	2,545,218	-

According to ALSTOM settlement, GPGC reached a final settlement under the EPC contract 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 January 7, 2008. According to the ALSTOM 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.

14. Other Current Liabilities

	2005	2004
Palestine Electric Company P.L.C (PEC Holding)	424,467	769,736
Consolidated Contractors Company	49,376	307,250
Dividends payable	590,510	-
Due to Shareholders	130,280	160,680
Accrued expenses	36,267	23,799
Payroll income tax	293,900	162,458
Provision for employees vacations	145,244	194,323
Others	151,558	160,262
	1,821,602	1,778,508

15. 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
Due	360,000	3,361,252	3,721,252
2006	8,352,000	2,477,602	10,829,602
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 2010	34,542,000	-	34,542,000
	89,280,000	5,838,854	95,118,854

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.
- 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 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 insure 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.

16. 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.

	2005	2004
Balance, January 1	475,733	325,377
Additions during the year	150,314	220,554
Payments during the year	(144,711)	(70,198)
Balance, December 31	481,336	475,733

17. Statutory Reserve

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

18. Operating Expenses

	2005	2004
Salaries and wages	3,003,882	3,111,067
Employees' end of service indemnity	150,314	220,554
Employees' insurance	98,002	104,010
Travel and transportation	330,445	583,222
Power plant insurance expense	1,004,335	1,239,237
Power plant operation and maintenance	2,410,923	2,379,844
Depreciation	7,054,473	6,539,999
Professional and consultancy expenses	239,635	241,257
Land lease	141,667	141,667
Telephone and fax	121,409	114,861
Legal fees	125,850	222,650
Registration fees	28,968	16,676
General assembly meeting expenses	50,491	33,670
Rent	17,853	15,406
Office supplies	59,173	43,236
Advertisements and publications	50,740	46,887
Miscellaneous	121,666	63,919
	15,009,826	15,118,162

19. Earnings Per Share

	2005	2004
Profit for the year	7,639,733	9,412,930
Weighted average number of shares during the year	60,000,000	60,000,000
Earnings per share	0.127	0.157

20. Dividends

PEC's general assembly in its meeting held on April 26, 2005, approved dividends distribution of U.S. $ 6,000,000, the equivalent of 10% of paid in capital.

21. 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 balance sheet are as follows:

	2005	2004
Cash at the Arab Bank	12,665,262	9,662,041
Arab Bank loan and accrued interest	95,118,854	97,546,513
Payable to PEC Holding	424,467	769,736
Payable to Consolidated Contractors Company	49,376	307,250

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

	2005	2004
Arab Bank loan interest expense	5,159,374	3,628,912
Compensation of key management personnel	729,750	773,502

In addition, as part of Arab Bank's consideration on the restatement and amendment agreement (Note 15), 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 CCC a counter guarantee for the value of 9.09% each, of the issued guarantee amount.

22. 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.

23. 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:

	2005	2004
Long term maintenance service agreement	19,969,095	21,650,457
Land lease agreement	2,646,000	2,646,000
	22,615,095	24,296,457

24. 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 other current assets. Financial liabilities consist of long term loan, accounts payable and other current liabilities.

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

25. 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.

26. Risk Management

Credit risk

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

Interest rate risk

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

	2005	2004
Deposits at banks	3,124,746	5,409,674
Long term loan	89,280,000	90,000,000

Liquidity risk

PEC limits its 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 balance sheet includes VAT receivable balance amounting to U.S. $ 850,232 that is denominated in New Israeli Shekel.