National Central Cooling Co. (PJSC)
(DFM: TABREED)

Q1 2020
Earnings Conference Call Transcript

7 May 2020

Tabreed Participants:

Adel Salem Al Wahedi, Chief Financial Officer
Richard Rose, Senior Vice President – Finance
Souad Jamal AlSerkal, Vice President – Strategic Communications

Presentation

Operator

Welcome to Tabreed First Quarter 2020 earnings call. I hand over to your host, Ms. Souad Jamal Al-Serkal, Vice President of Strategic Communications. Madame, please go ahead.

Souad Jamal Al-Serkal

Hello there, this is Souad Jamal Al-Serkal, Vice President of the Strategic Communications department at Tabreed. On behalf of Tabreed management team, I would like to welcome you all and thank you for joining us for the first quarter 2020 results conference call.

Hope you are all keeping safe and are healthy. Given we are all working remotely, kindly excuse us for any technical issues on the call.

Before we begin our presentation, I would like to remind you that some of the statements made in today's conference call many be forward-looking in nature and may involve risks and uncertainties. Kindly refer to slide two of the presentation for the detailed disclaimer.

I would now like to request you to turn to slide three of today's agenda. On today's call we have with us Adel Salem Al Wahedi – Chief Financial Officer and Richard Rose – Senior Vice President of Finance.

Adel will first provide an overview of the first quarter 2020 performance and key events. Following that, Richard will discuss the financial performance in more detail. Adel will then conclude the presentation, and we will open the lines for your questions.

Thank you, and over to you, Adel.

Adel Salem Al Wahedi

Thank you, Souad, and thank you everyone for joining us today. This is the first time I'm speaking to you all. As you are aware, I have joined Tabreed as the CFO recently. I started my career with Etisalat. For more than 13 years, I worked with them in UAE, Saudi Arabia, Sudan and Egypt. Then I moved to Abu Dhabi Ports, Petrofac Emirates and Arabtec. I have 22 years of experience in the fields of corporate finance, M&A, statutory accounting, budgeting, planning, costing and strategic decision making.

I look forward to interacting with you regularly. Now, let's move to our presentation.

Before I begin the discussion, in the quarterly performance I would like to say a few words on these unprecedented times and how Tabreed is positioned. As you are aware, this health calamity is resulting into significant economic crisis in the region and across the globe. However, given the utility nature of the services that we provide, there is limited direct impact of COVID-19 on our business.

We have invoked business continuity actions to ensure the safety and security of our staff, as well as uninterrupted customer service. All our plants are operational and we continue to provide cooling to our customers as we head into the warmer summer months. All of Tabreed's plants continue to operate and we continue to serve all our customers.

Now, moving to Q1 2020 performance. Despite COVID-19 scenario, our chilled water business continued a stable performance. However, revenue growth in Q1 2020 was impacted by 17% decline in our value chain businesses. During the same period, EBITDA growth was 5% and as a result, our EBITDA margins expanded from 57% in Q1 last year to 61% in Q1 this year.

On an organic basic, connected capacity addition during the quarter was close to 13,000 RTs. In April, we announced a transformational transaction for the company, where Tabreed acquired an 80% interest in Emaar's existing Downtown Dubai District Cooling assets for AED 2.5 billion. The transaction includes long-term concession agreement to exclusively provide up to 235,000 RTs of cooling to Dubai's most prestigious developments, including Burj Khalifa and The Dubai Mall. This transaction paves the way for a long-term relationship with one of the world's largest and most reputed real estate developers.

Moving to the next slide. Tabreed is contributing to the region's growth through efficient and environmental-friendly cooling, enabling sustainable development. As our business grows, so does our positive environmental footprint.

We currently operate through 83 plants across the region, delivering about 1.35 million RTs of cooling. Our operations saved over 2 billion kilowatt hours of energy consumption in 2019, enough to power over 117,000 homes for a year, and equivalent to reducing over 1.2 million tons of CO_2 emissions.

Slide seven will show the geographical footprint. Tabreed is the only publicly-traded and regional district cooling company in the world. The UAE is our base of operations where we have presence in six Emirates providing 946,000 tons of cooling to our customers through 70 plants. This is including the three plants of Downtown Dubai. This transformational acquisition significantly enhances our market positioning in Dubai, the largest DC market in the world.

In addition to UAE, we work with key strategic partners in four other GCC countries. We have a total of 13 plants outside UAE providing around 400,000 tons of cooling to customers. Around 70% of our capacity is consolidated while the rest is equity accounted and associates or JVs.

Moving to the next slide. The slide here outlines our capacity growth trends across the region. At the beginning of 2020, we announced that we expected to add at least 75,000 RTs of new connected capacity by end of 2021.

During Q1, we added 12,800 RTs of capacity across the region. Of this capacity, 5,900 RTs were added to the consolidated level and 6,900 RTs is through our JVs or associates. This is over and above the 150,000 RTs added on acquisition of Downtown Dubai District Cooling.

Given strong organic growth, we reiterate our confidence of adding the 75,000 RTs by end of 2021. Tabreed continues to demonstrate its ability to deliver a steady increase in connected capacity in the region, driven by growth in our key markets across the GCC, and by successfully leveraging our regional network to take advantage of commercial opportunities as and when they present themselves.

Next slide please. This slide recaps the evolution of our performance over the years. To summarize, Tabreed is a stable utility infrastructure business with long-term contracts with high profile customers. This provides us clear visibility of future earnings and cash flows. We currently have 90% of our capacity contracted for at least the next 10 years. About 80% of our revenues are derived from wholly Government owned or partially Government owned organizations, therefore, limiting counterparty risks. Tabreed has a track record of delivering profitable growth. We have increased the EBITDA by 8% per year since 2017. Our acquisition of Dubai Downtown District Cooling assets and the concession agreements with Emaar is a significant step to penetrating the largest district cooling market in the world.

Now, I will hand over to Richard to talk about our financial results in more detail. Richard.

Richard Rose

Thank you, Adel. Let me start by highlighting the key points on our income statement for Q1 2020. Chilled water revenue was in line with last year with gains arising on new capacities in the UAE and Bahrain, and higher consumption being offset by increases in finance lease amortization as a result of the negative CPI we experienced last year. In line with IFRS 16 requirements, finance lease amortization increases when CPI is negative and decreases when CPI is positive. These finance lease accounting entries are non-cash and do not change the customer billings or actual cash flows in any way. The impact of negative 2019 CPI pass-through on our 2020 revenues is around AED 1 million for the full year.

Decrease in total revenue was mainly due to the value chain businesses which declined by 17%. Value chain businesses account for 96% of our consolidated revenues and less than 1% of our EBITDA. They are non-core businesses, which continue to be profitable.

Gross margin improvement was primarily due to efficiency gains resulting in reduced operating costs.

We've also created a provision of AED 10 million for possible COVID-19 impact. As Adel highlighted, we have not been directly impacted by this pandemic, as all our customers continue to require cooling and all of our plants continue to operate as normal. It is too early for us to identify whether there will be any long-term impact on our financials.

Finance costs have been low due to low interest rates and principle repayments, and overall net income increased by 3% versus the same period last year.

We now look at the statement of financial position on the next slide. Significant movement in the balance sheet as of March 31st 2020 compared to the 2019 year-end were an increase in receivables due to timing differences in payments from some large customers, as well as seasonality compared to December 2019. This movement, however, is primarily attributable to a single large customer. We do have a strong relationship with this customer and we provide district cooling to them on an exclusive basis and there are no contractual disputes. Historically, they have always paid in full and we anticipate these receivables to normalize soon.

Movements in equity and other liabilities was due to dividend payables in 2019, which was subsequently paid on the 11th of April. An increase in corporate debt and cash balances primarily reflect AED 2.5 billion acquisition financing, which was drawn down in March and kept in escrow until the transaction closed in early April.

Turning to the next slide, we will now look at the statement of cash flow. Operating cash flow decreased compared to the first quarter of 2019, largely due to the higher receivables discussed on the previous slide. The capital expenditure incurred reflects new connections of our concession areas, at Raha Beach and Yas Island. Despite the short-term receivables build up, we believe our cash generating ability remains robust and we expect the situation to normalize very soon.

We will now turn to the normal review of our debt portfolio and return ratios. Tabreed has AED 2.9 billion of net debt with a gearing ratio of 40%. However, it is important to note that IFRS 16 has increased reported net debt by AED 285 million and net debt to last 12 months

EBITDA by 0.3 times. Excluding the impact of IFRS 16, both net debt and net debt to EBITDA are lower than the year earlier.

As you are aware, the acquisition of Dubai Downtown is 100% financed through a fully underwritten corporate facility of AED 2.5 billion, with a tenure of five years and a 100% bullet at maturity. However, the facility does allow penalty-free prepayments, which will allow Tabreed to manage refinancing risk over the life of that facility. Our intention is to refinance the term loans before the Sukuk repayment is due in 2025.

We are confident that our ability to generate strong cash flows will enable us to manage the leverage profile and bring it back in line with the guidance provided by the rating agencies within 18 months. Both Moody's and Fitch have reaffirmed our investment-grade ratings with stable outlook which is a testament to our strong financial position and cash flows.

Net debt and net debt to EBITDA have declined since 2017 as debt has been repaid and EBITDA has grown.

That completes the detailed review of our results for Q1 2020 and I will now pass back to Adel for closing comments.

Adel Salem Al Wahedi

Thank you, Richard. Before we open the lines for Q&A, let me make a few closing comments. As a stable utility business model, Tabreed continues to deliver strong financial and operating performance, with rising profitability and stable margins. We had a strong start to the year with strong organic growth and a very strategic transformational acquisition, as we mentioned earlier. Also, Tabreed has a flexible capital structure to fund future growth and, as we have mentioned before, we will look at opportunities within and beyond GCC and will provide you with updates as and when such opportunities materialize.

Today, Tabreed is stronger than ever before. We have a stronger shareholder base and a management team with significant industry experience. We are working on various fronts from business developments to operations to help drive growth and improve profitability.

Thank you, and I will now request the operator to open lines for Q&A.

Questions & Answers

Operator

Our first question comes from Matias Vammalle, BlueBay Asset Management. Please go ahead.

Matias Vammalle

Just two or three questions here. The first one is with regards to potential refinancing on the acquisition facility. I think you said that it does have prepayment penalties, but I just wanted to double-check that.

The second question would be, in light of what I think is attractive and competitive funding costs of that facility, however, whether you would be looking to refinance that in the market in the short to medium-term.

Lastly, given the increase in working capital from the receivables, whether the company currently has any committed credit facilities available and whether you would be considering drawing any such facilities given the increase in receivables. Thank you.

Richard Rose

The facility that we have for the acquisition in April does not have any prepayment penalties. We are able to prepay that over time as the entity Downtown DCP generates free cash flows and dividends going back up to corporate level, and that is our intention to do that.

I think your question on the funding costs and how that may drive our actions going forward is a very insightful question, and it is quite correct. It is a very tightly priced facility, especially given the current climate. However, I think we do have a clear refinancing risk in 2025 as you saw from the presentation, so we will have to manage that. I think a short-term move to the debt capital markets would seem to be unlikely, but a move at some time to refinance, whether that would be through debt market capital markets or another facility is going to be necessary. I think it will be more in the medium-term than the short.

I think your last question was on committed credit facility. We have an AED 590 million working capital facility. We routinely drawdown on that towards the end of Q1 and beginning of Q2 each year, and then normally by the end of Q2, beginning of Q3 we've repaid that in full and we're back in surplus. That is partially drawn at the moment, but I think we have around AED 250 million of that still available to us, which is not yet drawn down.

Matias Vammalle

I'm sorry, you said the total size of the facility is AED 500 million?

Richard Rose

AED 590 million.

Operator

Our next question comes from Belal Sabbah, Jadwa Investment. Please go ahead.

Belal Sabbah

First of all, if you could just take a couple of seconds and just explain how your revenues get impacted or don't get impacted by the situation of COVID. Do clients come and ask for some sort of waivers, etc.? Also, I think you mentioned something about receivables and how that's expected to normalize. Would you mind recapping that point please? Thank you.

Richard Rose

On COVID, I will reiterate, the direct impact on Tabreed is very limited. We have taken a number of actions, which have incurred a little bit of cost to ensure that we have business continuity and to ensure that COVID can't cause any kind of interruption in our business, but really those costs are not meaningful in any way.

In terms of the impact on revenues, we are passing through to our customers, the discounts which are being provided by the major utility companies in the region. So that will cause a small decline in revenue, but no decline in EBITDA or net income as a result of that. That's a simple pass through. If we're given a discount, then we will pass that through to the customers. Just finalizing COVID, beyond that, as I said, all of our customers continue to take our cooling services and all of our plants are continuing to operate. Therefore, given that, the vast majority of our EBITDA and net income is driven by capacity charges, they are still chargeable and we don’t expect any impact on the performance of the business as we sit here today, but it is very early days for us.

In terms of receivables, we have a single large customer who, historically, has been late with its payments at times, but they have always caught up and always paid us in full. The situation that we have on receivables, at the moment, is almost entirely due to that single large customer and we do expect them to pay us in full. I’ll reiterate again, that we have no contractual disputes with that customer and we are informed that all of our invoices are authorized for payment, so we do anticipate coming through in due course, and we don’t expect to have to incur any losses there at all.

Belal Sabbah

Just one thing, more of a general question, how are you guys seeing the pipeline of projects in the region now? I think the overall economy in the region, other than COVID, is also being impacted by low oil prices, etc. You guys did a fantastic job of securing the Emaar contract to secure some growth, but how is the overall market situation looking like now. Is there still a decent pipeline of projects that were maybe ongoing and they're soon looking for district cooling service providers, or has everything come to a halt and projects are being cancelled, etc.?

Richard Rose

We haven’t seen any projects cancelled. The majority of the growth that we've seen outside of the recent acquisitions over the last couple of years has come from our concession areas around our network. I think, at the moment, perhaps the most active of those concession areas is Raha Beach and Yas Island, which I mentioned and they continue to provide new capacity to us, at a relatively low level. The recent acquisition of Masdar is also a concession area, so over time that will provide further capacities as well.

Beyond that, I think that this climate, I think we've said over the last three or four years that this relatively depressed economic climate should create additional M&A opportunities for us over time, and it took time for that to materialize with the Downtown acquisition. I think there are other opportunities out there in the market and we don’t believe that Emaar is the only growth story in any way at all.

Operator

Our next question comes from Divye Arora, Daman Investments. Go ahead.

Divye Arora

I will just repeat the question regarding the COVID situation. If you look at your clients, 80% of them are Government or Government-linked entities. So there are guys like even Aldar and all over there, which have been impacted, whose businesses have been shut down. We can understand that capacity charge is a fixed charge and it is there to cover your investments, but on the consumption charge, have the customers approached you to discount on the consumption charge. When the facility was not operating, obviously, they were not using it, but now in the current environment when the malls are getting started again, is there any request for reducing the consumption charge or even the capacity charge, some of sort of a deferral to be made from the cash flow perspective.

Richard Rose

As I said, the discounts that are coming from the utility companies in the region, we are passing onto our customers, so that's the consumption discount that we have provided to our customers. We've seen a small reduction in consumption year to date or around 5%, that kind of area, which I think is reflecting the situation. Many large buildings being closed to the public, but we wouldn't anticipate that that carries on for the remainder of the year.

Then in terms of capacity discounts, if your customer is still taking the cooling, then the capacity charge is still payable. We haven't reached any agreement with any customers to defer or discounts in any way at all. Some discussions with customers, but nothing concrete at this stage.

Divye Arora

But any customer has approached you from that angle to provide a deferral or something, at least if not a waiver of the capacity charge for three months or six months?

Richard Rose

There have been some discussions with some customers, yes, but I'm not going to go into any details today. The position we have is very clear that the service is still being provided by Tabreed and therefore, we still need to be paid for that. We're still incurring the costs that we have to continue to provide that service. We can't cut our costs and continue to provide service, so we have to still be paid.

Divye Arora

In terms of the Emaar District Cooling acquisition, is this already closed, because the cash was still there on your balance sheet. Have you already paid for the acquisition?

Richard Rose

Yes, so the transaction closed on the 6th April, so we had drawn down the funds and put it in escrow as at 31st March and that's why you can see it in the Q1 financials. But the transaction is fully closed and we are now fully operating those plants on behalf of Downtown DCP.

Divye Arora

And the consolidation should begin from April 6th.

Richard Rose

Yes.

Divye Arora

The third question is linked to the revenues, so what we have seen is that on the chilled water side, the revenues have been flattish. You have mentioned something regarding, I think, some accounting charge or it was a non-cash charge over there. But I think as far as we remember, you have a CPI component and there is a delay of one year in passing on the CPI to the customers. Last year, I think, there was a deflation in the economy, so that would be having a negative impact on the revenues this year.

Richard Rose

I did mention that in the presentation. It's important to recognize not all of our contracts are the same. We're not a Government electricity company, so we have individual contracts with individual customers, and the escalation clauses within those contracts vary, so not all of the contracts will see the flow through of negative CPI into the tariff. The overall impact on this year's revenue will be about AED 1 million for the full year.

Operator

Our next question comes from Rakesh Tripathi, Franklin Templeton. Please go ahead.

Rakesh Tripathi

My questions are answered. Thank you very much.

Operator

Our next question comes from Soha Saniour from Arqaam Capital. Please go ahead.

Soha Saniour

I just wanted to ask about the growth of JV income on year-on-year basis. There is a part that is mainly due to one-off, as mentioned in the presentation, so I just wanted to see if you could quantify how much of the increase was due to one-off gains and how much was the normal growth.

Richard Rose

I don't know whether we could take it offline and maybe have a chat with Saket on that point. Is that possible? Thank you.

Operator

Thank you very much. There are no further questions in the conference call. I will now give back the floor to Ms. Souad. Thank you.

Souad Jamal Al Serkal

That concludes our first quarter earnings call. Tabreed looks forward to interacting with you at our earning conference calls and investor conferences. Should you have any further questions, please do not hesitate to contact us. Have a great day, and stay safe, and thank you once again for joining us on this call.

Note: This transcript has been edited to improve readability

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