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

Q3 2017 Earnings Conference Call Transcript

8 November 2017

<u>Tabreed Participants:</u>
Stephen Ridlington, Chief Financial Officer
Saket Somani, Investor Relations

Presentation

Operator
Ladies and gentlemen, welcome to Tabreed's Third Quarter 2017 Financial Results Conference Call. Today's speaker will be Steve Ridlington, CFO. I now hand over to your host, please go ahead.

Saket Somani
This is Saket Somani from Tabreed. On behalf of Tabreed's management team, I welcome you all and thank you for joining us for the Q3 results conference call.

Before we begin our presentation, I would like to remind you that some of the statements made in today's conference call may be forward looking in nature and may involve risks and uncertainties. Kindly refer to slide 2 of the presentation for the detailed disclaimer.

I would now request you to turn to slide three for today's agenda. On today's call, we will first provide an overview of nine months 2017 results and performance, and some key business developments, followed by a detailed performance discussion. We will then open the line for your questions. With that, I would now like to hand over the conference to Steve Ridlington, our CFO, to begin today's presentation. Thank you and over to you, Steve.

Steve Ridlington
Good afternoon everybody, thank you for joining us on this call today. Turning to slide four, I will begin by highlighting our year-to-date Q3 2017 performance and provide a snapshot of recent events.

First, in the first nine months of 2017, we reported strong performance with 14% increase in chilled water revenues and 8% increase in net profit. This was driven by over 100,000 tons of consolidated capacity addition since the middle of last year, higher consumption volumes, and pass through of utility tariff increases in Abu Dhabi. Going forward, we expect robust growth in both top and bottom lines on the back of continued good performance from our chilled water business segment.

Turning to other events, in October, Tabreed's stock was certified Sharia compliant and is included in the list of Sharia compliant companies on the DFM exchange. This will potentially broaden the shareholder base and therefore improve liquidity.

As you are aware, Mubadala converted all of the MCBs into equity shares, and simultaneously, ENGIE, the multinational leader acquired a 40% stake of Tabreed. Mubadala retained a 42% interest and continues to be our largest shareholder.

We also expanded our top management team with two new additions, a chief operating officer, and a chief development officer. Both joined Tabreed from ENGIE and will bring significant industry experience as we progress to the next phase of growth.

You may also have seen our new website with the new investor relations section. I hope you find this useful, and please provide us with any feedback and suggestions for improvement.

Moving onto the next slide - Tabreed at a Glance. This slide provides our usual overview of the company, and I won't dwell on it for long. Tabreed is contributing to the region's growth through efficient and environmentally-friendly cooling solutions enabling sustainable development. As our business grows, so does our positive environmental footprint. We currently operate 72 plants across the region delivering almost 1.1 million refrigerated tons of cooling. Our operations saved 1.4 billion kilowatt hours of energy consumption in 2016, enough to power 48,000 homes for a year.

Turning next to slide six. Again this is the usual slide we include on our regional operations. Tabreed is the only publicly traded district cooling company in the world. UAE is our base of operations where we have a presence in six Emirates providing over 770,000 tons of cooling to our customers through 63 plants. In addition to the UAE, we work with key strategic partners in four other GCC countries. We have a total of nine plants outside of the UAE, providing over 316,000 refrigerated tons of cooling to customers. Around 65% of our capacity is consolidated, while the rest is equity accounted as associates or joint ventures.

Turning to slide seven, this is a new slide in which we have just pulled out a little bit more detail on connected capacity for the company. At the beginning of this year, we announced that we expected to add at least 60,000 refrigerated tons of new connected capacity by the end of 2018. During the first nine months of 2017, we have added 38,000 tons across the region, and this chart demonstrates where that has been delivered; within the consolidated capacity, UAE, Bahrain and Oman, and then the equity accounted ventures in the UAE, Qatar, and Kingdom of Saudi Arabia. Of this capacity addition, 17,000 tons was added at the consolidated level and 21,000 through joint ventures and associates. We expect most of the remaining 22,000 tons making up the 60,000 tons of capacity additions to be delivered through joint ventures and associate companies. So we expect that not much of the remaining 22,000 RT will be consolidated capacity additions.

Tabreed has demonstrated its ability to deliver a steady increase in connected capacity in the region, driven by the 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. The 60,000-ton target of capacity additions represents capacity that is already fully contracted, and as such, we see this as a minimum target. We are very confident of achieving at least this figure by the end of 2018.

Turning next to headline performance on slide eight, this, again, is a usual slide that recaps the evolution of our performance in recent years. Just to summarise, Tabreed is a stable utility and infrastructure business, with long-term contracts with high profile customers. This provides us clear visibility of future earnings and cash flows. We currently have 95% of our capacity contracted for at least the next 10 years. Tabreed has a track record of delivering profitable growth. Our EBITDA and net income has grown at 4 and 6% annually respectively since 2014. Our stable earnings enable the company to maintain an attractive dividend pay-out. Our dividend has been rising over recent years with 2016 payout being around 50% of earnings.

Let me now go to the next section of the presentation and talk about the financial results in a little bit more detail.

Slide 10, the income statement compares the nine months of 2017 with the similar period for 2016, and throughout this part of the presentation, I will focus on those numbers. Overall, revenue growth has been 9% driven by the strong chilled water business. The 14% increase in chilled water revenue is driven by four key things: First, new capacity additions, which have contributed 7% or approximately half of that increase in chilled water revenue. Secondly, utility tariff increases in Abu Dhabi led to a further 5% increase as the tariff was passed through to customers. Third, 2016 published UAE CPI was 1.62%, which has already been passed onto a majority of the customers, as escalation on capacity charges. Finally, additional revenue from Oman and Bahrain contributed about 1% of that 14%.

Turning to the other businesses, a reduction in order books at our pipe fabrication company was the main reason behind the 38% decline in revenue from value chain businesses.

Associates and joint ventures were up 14%, mainly reflecting new connections in Qatar. Overall, net income increased by 8%, though margins were slightly compressed because of the higher share of lower margin consumption revenue in the total.

I am just going to take a minute here to talk about Q3-on-Q3 results, because I think that warrants a little bit attention in the call today.

A comparison of Q3 2017 against Q3 2016 shows a decline in total net income and also a very small decline in chilled water gross profits. The primary driver behind the decline in net income is our value chain businesses, spread across two or three of these businesses. Trading conditions have been difficult in 2017, though overall, these businesses continue to be profitable. There was also, as I said, a very small decline in chilled water gross profits. This mainly reflects a one-off gain of approximately AED 5 million relating to a one-time settlement of O&M fees paid to Tabreed by one of our UAE joint ventures. So that 5 million increased 2016 Q3 and therefore made the comparison with Q3 2017 slightly down. Overall, however, nine month results which are a more reliable indicator of undergoing performance shows strong growth on a year over year basis, and we expect that trend to continue.

Turning to slide 11, the financial position, our balance sheet remains strong with the recent highlights being, first of all, timing delays and seasonal impacts led to an increase in receivables at the end of 2017, compared to the end of December 2016. However, we have seen strong collections in October 2017, correcting those timing delays. And just a word on seasonality, Q3 is our peak consumption quarter, as it is the hottest quarter of the year and, hence, we have higher receivables in that quarter. Of the total increase in receivables compared to December last year, almost half is due to this seasonal impact. Overall, the receivable position having taken into account the collections in October remain strong.

Movements on the liability side of the balance sheet are dominated by the conversion of the MCBs into ordinary shares in August. The conversion substantially increased equity and reduced debt on the extinguished liability component of the bond. Gearing at 41% remains in line with global utilities. We will discuss the debt portfolio in the subsequent slide. We ended the nine months with approaching AED 400 million of cash on the balance sheet. In summary, Tabreed's strong robust balance sheet positions us well for future growth opportunities.

Let me now talk to the next slide on the cash flow statement. I am pleased to report that Tabreed continues to generate strong cash flows, which are being utilised to invest in growth opportunities and provide dividend returns to our shareholders. In the first nine months of 2017, operating cash flow was 12% higher than the same period a year earlier, reflecting robust profit from operations. We continue to invest in new cooling capacity, paying approximately AED 100 million to acquire the Nation's Tower plant from ICT, this is on the Corniche in Abu Dhabi. In summary, our cash generating ability remains robust driven by long-term price certain contracts, enabling investment in growth.

Let me now turn to developments with our debt portfolio. Slide 13 shows the usual background on Tabreed's debt portfolio. Key points to note are, first, Tabreed has over AED 3 billion of debt, which equates to a gearing ratio of 41%, as I have already mentioned, in line with global utility benchmarks. Second, the debt is largely floating rate, but we have recently increased our hedge ratio to further de-risk against interest rate increases. Currently, 73% our total debt is hedged into fixed rates. We have a strong leverage profile and headroom available to fund future growth opportunities. This completes the detailed review of the nine-month results.

So, turning to slide 15 just to conclude before the Q&A, a few of the usual closing comments. 2017 has been a good year and we have made good progress in the first nine months of the year, both in terms of revenue and profits. We provided capacity addition guidance as 60,000 tons to be added over the next two years and delivered 38,000 tons in the first nine months of 2017. Tabreed has a flexible capital structure to fund the future growth. The conversion of mandatory convertible bonds will save us over AED 160 million in future coupon payments and we have been pleased to welcome ENGIE as a new major shareholder. Tabreed has a stronger shareholder base with Mubadala and ENGIE providing support to operations and growth. Further, the recent Sharia compliant status for our shares could potentially enhance liquidity and the shareholder base.

That concludes the presentation for today. Thank you for joining us and we will now take any questions.

Question and Answer Session

Operator
[Operator instructions]

Our first question is from Metehan Mete from Waha Capital. Please go ahead.

Metehan Mete
I just wanted to ask you about the third quarter results details. When you adjust for that 5 million, approximately 5 million settlement gain in the third quarter 2016, I see the gross profits growth year-on-year still at 2%, while the capacity gain over the nine months year-to-date was around 3.5%. I was expecting something like 5% growth in the gross profits year-on-year and it came slightly weaker. Just could you please comment on that? The second question is that I see that you have reduced the SG&A expenses year-on-year around 9%. Are these sustainable going forward, or do you plan to make more cost reductions? My third question is that JVs and associates net income contribution is also around 10% lower year-on-year. What is the reason for that? Thank you.

Steve Ridlington
First of all on the Q3 versus Q3, there are one or two other things going on within those results, and in particular, the profile of capacity additions when you compare is somewhat different. The main factor is, as I said, that O&M fee that we received, but there are one or other small things going on. The underlying performance I think remains very good, and I think you will continue to see that coming through as our results progress through the year.

Regarding G&A, I wasn't quite sure, I didn't quite get the question that you asked there. Was it about the rate of growth…?

Metehan Mete
I see that you have reduced the SG&A expenses slightly year-on-year compared to the third quarter. Do you plan to make more cost reductions or is there a cost reduction scheme that is going on?

Steve Ridlington
That SG&A figure includes a lot of things besides cost. I don't think you should see that as a cost reduction initiative *per se.* Clearly, it is very important to us that we keep our costs under control, but there are other things that go inside that figure, which are not related to staff and G&A costs, which move up and down a little bit, so that is not an indication of cost reduction going forward.

In terms of associates and joint ventures, as we have said many times before, there is an element of lumpiness in the profile with some of our associates and, therefore, they do vary quarter to quarter a little bit. I think it is much better to look at the overall trend in these, looking at year-on-year, nine-month-on-nine-month, full year-on-full year increases, so I am not seeing any particular trend in that figure that you're quoting there.

Metehan Mete
Yes, but generally, like the two concerns that I had and that's why I wanted to ask you those concerns right now, where I just want to make sure if there are any rate reductions done by

the clients or any… are there any other cost increases that cannot be passed onto the end customers? I just wanted to get an idea on that.

Steve Ridlington
Certainly, I can confirm that there have not been any chilled water tariff reductions. . Utility price increases in Abu Dhabi have been fully passed through to our customers in line with the contracts. We've had CPI increases which again have been passed through. What we're talking about here are one-off items that are influencing the profile of the results, but underlying, as I said earlier, the trend is positive. There are no cost pressures that are influencing these results and there's certainly no inability to pass through costs or tariff adjustments going on. It is all about one-off items, which you will see smooth themselves out and level out as we move forward from here.

Metehan Mete
Yes and I guess there are also not any rate reductions imposed on you by the clients, because your client base is very concentrated, so like 50% Government clients and they don't have any… they haven't had any influence on the results, I guess.

Steve Ridlington
All I can do really is to repeat, Metehan, that there has been no tariff reduction.

Operator
We have a question from Sanyalak Manibandhu from NBAD securities.

Sanyalak Manibandhu
I have one or two questions. The first one is about ICT. The question really is what do you think the addressable market or the addressable total is in terms of acquiring things like ICT in terms of a consolidation in the Abu Dhabi district cooling market? There is also the question on the addressable market in Dubai. I think we're seeing that one of the partners in Emicool is buying out the other partner. Does that mean that it's much more difficult for you to mop up district cooling companies that are a lot smaller in Dubai than in Abu Dhabi? The third question is you mentioned that you have appointed a COO and a CDO that came from ENGIE. When do you think we'll be able to see the benefits from the ENGIE acquisition of 40% in Tabreed? Would it be a matter of quarters or will it be a matter of years until we see the benefit of that? Thank you.

Steve Ridlington
Some very good questions. First of all, the addressable market in Abu Dhabi. This is difficult to estimate but what I can tell you is that we have a n approximate 75% market share in Abu Dhabi. There are other competitors here, but they are generally quite small, and we talk to many of them. As we have said on these calls in the past, we are very open to acquiring

other district cooling companies, regardless of their size, as long as it makes economic sense. You'd have to say that the addressable market in Abu Dhabi is smaller than that in Dubai. I think that's pretty clear.

In terms of Dubai, even if it is a bigger addressable market, it is also dominated by a small number of fairly large players. I have no idea whether one partner is buying out another partner in Emicool. That is a question you'd have to put to the shareholders of that company, but changes like that do not really change our view of those markets. It's a market that we're very keen to grow in, both organically and, if possible, inorganically, but it's a bit more difficult, because they are bigger players, they have potentially bigger aspirations. If opportunities arise, we'll have a look at them and we'll take the steps that we need to take to grow our market share, which we would be very keen to do.

In terms of the time period over which we expect to see results from the COO and the CDO that we've hired, I think that's a very difficult question. The two gentlemen concerned have only just started with us. They're starting to get their feet under the desks. We're really looking forward to working with them and seeing what they can bring, but I think it will be difficult to predict now what benefits will arise and when they will be seen. So let's give them some time to get into the company and I'm sure this is something we'll talk about again in the future.

Operator
We have a question from Alia Elmehelmy from CI Capital.

Alia Elmehelmy
I guess my main question is just regarding the gross margin you reported in Q3, because they did lower even year-on-year, so acknowledging the fact that Q3 is a seasonably high quarter for consumption revenue. I just want to understand, obviously, as you mentioned, there have been increases in utility prices, but this is the new norm, because that would shape margins, I guess, even going forward, right?

Steve Ridlington
Yes, it's a very good point and very perceptive, Alia. The mix of consumption and capacity revenue is the biggest driver of margins, as you appreciate, and within that, there are two things that can change the mix. One is seasonal factors, which you pointed out already, so in the middle of the year and Q3 particularly, we have a bigger share of consumption revenue in the total and so since consumption margins are lower than capacity, that brings the overall margin down a little bit. Of course, there are utility prices, which in Abu Dhabi you would say would tend to be increasing over time rather than reducing. I'm not sure about Dubai where the tariffs are much higher. So I think you can see that there is a bit of a seasonal element and then maybe also a trend, so how that trend will play out is all about when utility prices increase in Abu Dhabi and, of course, that's not something that we can sit here and predict.

Alia Elmehelmy
Okay, because, I mean, it was something that was on my mind because Q3, this quarter, was the first one post the tariff increases. I think I was expecting the blended margin to be a bit higher, so I wanted to check if there is actually nothing that's changed in terms of your capacity charges or new capacity that you've consolidated.

Steve Ridlington
Absolutely no change to capacity charges, as I mentioned earlier to Metehan. The utility price increase was effective 1st January this year, not just the third quarter, but as you said, it was a fairly big increase. The previous increase a couple of years ago was one fil and this was four, so it was a bigger impact and that's why I think you're seeing that little bit of margin squeeze as a result. But I just want to confirm again, this is nothing to do with underlying performance of the business, costs or capacity tariffs.

Operator
We have a question from Sharif Farha from Amwal Capital Partners.

Sharif Farha
I have a question on the value chain business. As you said, it was much weaker versus nine months 2016 last year, so if you could just elaborate on what happened there.

Steve Ridlington
Yes, I mean, we have two primary value chain businesses. We have a pipe fabrication company, which provides the piping for the networks, chilled water networks, and we have a consultancy company and, as the market generally has been a little weaker in recent times, both of those companies have suffered with reduced orders and work, so this has really been a phenomenon I think over the last 9-12 months. I think there are signs that maybe this is bottoming out, but I obviously can't confirm that, but it's looking like things might be getting a little better.

Sharif Farha
Just one quick question, sorry, on that. Do you disclose the net income contribution of the business? Is it breaking even? Has it turned loss-making?

Steve Ridlington
As I mentioned earlier, the businesses have broadly broken even so far this year and there are signs that the business environment is beginning to improve.

Sharif Farha
I was just wondering, do you give a gross margin breakdown of that business maybe this year versus last year, gross profit or net profit, just to get an idea…?

Steve Ridlington
Yes, we can do that. I probably won't do it on the phone here. It’s probably not a good use of time, but we will get in touch with you offline and we can provide that.

Operator
We have a question from Dyvie Aurora from ADS Securities.

Dyvie Aurora
Hi, just a question on the consumption side. As you said, the utility prices went up in Abu Dhabi significantly in the first quarter on 1 January, so just to check, as you have passed it onto the consumers already, as you’ve said, but have the consumers been cautious in terms of consumption? On a like-for-like basis, do you see people trying to take a cut on the consumption just to save on money?

Steve Ridlington
No, we haven't seen that actually, no. Consumption volumes are at or above the levels of last year overall, so that’s not something we've seen.

Dyvie Aurora
Okay and you have also disclosed regarding when ENGIE comes in, so you will try to go out of the region, so any plans on that or anything you're studying right now?

Steve Ridlington
I think I just mentioned… I think we need to give ourselves a little bit of time. I appreciate you're keen to know and so are we, but I think it’s a little bit early, so there are no current plans that we have or can talk about at this point in time, but I assure you as soon as we've got something to say in these areas, we surely will.

Operator
Our next question comes from Mohamed Tarek.

Mohamed Tarek
Rather an immaterial figure, but what is “other” gains and losses?

Steve Ridlington
Sorry, I don’t have those details in front of me. It’s a relatively small number and we can take it offline and then we can help you with that.

Mohamed Tarek
One other question if I may. Knowing the current and global environment with increased global warming, I have been informed by professionals in the industry that the temperatures this year around July and August in Abu Dhabi in particular exceeded 50 degrees centigrade, and most competitors, what they told us was they have logistics company here, which is cooled by compressors, and what they said was that the compressors were working overtime and they tend to then break down. In your industry, is there a capacity limitation in terms of how much heat the equipment can take before there is a breakdown of any kind, i.e. with the increased consumption?

Steve Ridlington
Well, we obviously… I think the short answer to your question is no, so we design with the current temperatures in the region in mind. We generally have excess capacity that we build in, which allows us to run a little bit harder in the summer months when we need to. So far we haven't seen those issues and we don’t expect to.

Operator
We have a question from Metehan Meta from Waha Capital.

Metehan Mete
I just wanted to ask a follow-up question on the Qatar issue. I know that you have received a dividend so far for 2017, but have you been notified of any problems receiving the future dividends, given the FX issues in the Qatar for the following periods? Thank you.

Steve Ridlington
As you rightly said, and as we've said before, we receive a dividend once a year and that we received earlier this year in the first quarter. We wouldn’t typically be expecting another dividend until the same time next year, so that’s several months away. It’s something that we’ll address in the circumstance at the time, so there's not really very much to say at this point. In terms of the venture itself, again as we've said before, it is a standalone company and the business continues to perform well.

Operator
We have no further questions. Dear speakers, back to you for the conclusion.

This concludes today’s conference call. Thank you all for your participation.

Note: This transcript has been edited to improve readability

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