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

H1 2023
Earnings Conference Call Transcript

28 July 2023

Tabreed Participants:

Adel Salem Al Wahedi, Chief Financial Officer
Salik Malik, Vice President – Finance
Farida Talaat, Strategic Communications

Presentation

Farida Talaat

Good afternoon, everyone. On behalf of Tabreed's management team, I welcome you all and thank you for joining us for the H1 2023 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 number two 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 have with us Adel Salem Al Wahedi, Chief Financial Officer, as well as Salik Malik, vice president of finance. Adel will begin with the opening remarks and provide an overview for H1 2023 performance and key events. Following that, Salik will discuss the financial performance in more detail. Adel will then conclude the presentation and we'll open the lines for your questions. Thank you, and over to you, Adel.

Adel Salem Al Wahedi

Thank you, Farida, and everyone, for joining us today. I would like to provide an overview of Tabreed's first half of this year 2023 performance and key events. Tabreed recorded 9% growth in group revenue, which is primarily attributed to the robust performance of our core chilled water business, specifically our core business revenue grew by 8%. This growth was driven by various factors, including new connections in existing concessions, higher consumption volumes and positive impact of CPI.

Throughout the first half of this year, the company delivered a healthy and sustainable EBITDA of 590 million, with a margin of 55%. H1 of this year as well, net income for the one-off gains increased by 16% 280 million. Including the one-off gains of 107 million, our net income increased by 61% to 386 million. In India, Tabreed has established a strategic alliance with Tata Reality and Infrastructure Ltd, TRIL, for its first project in the country. Excluding India, we have successfully commissioned three new plants during the first half of the year, one in UAE and two in Saudi Arabia.

As part of the previously-communicated capacity expansion plan, Tabreed has been diligently working towards delivering the capacity guidance of 120,000 RT for the years 2023 and 2024. As part of it, we have now successfully delivered 34,000 RT of this planned capacity expansion. We are pleased to announce the publication of our third environmental, social and governance, ESG, report, available in our portal.

Moving to the next slide, please, Tabreed is the first and one of the world's largest publicly-listed district cooling companies, providing district cooling services across five countries, with a strong presence in the GCC and recently in India. Our operational portfolio comprises 89 plants collectively delivering close to 1.3 million RT of cooling. As we move forward, our growth strategy remains focused on exploring selective opportunities in the Egyptian market.

Across all aspects of our business, we remain dedicated to driving growth and optimising operational efficiency. This is a testament to the mindset of our management team and their pursuit of excellence. We continue to work diligently in all areas from business development to operations, to drive growth and improve operational efficiencies.

Moving to the next slide, which summarizes our connected capacity, in the current quarter we achieved a significant increase in our operational capacity, adding 20,000 RT. This expansion brings our overall connected capacity close to 1.3 million RT. Notably, the entirety of this new connected capacity in the second quarter is purely organic and arises from new plants and connections established within our existing concession areas, which includes 14,000 RT in Saudi Arabia, 6,000 RT in UAE, and 1,000 RT in Bahrain. For this quarter as well, we spent a total CAPEX close to AED 60 million, strategically directing this capital towards for expansion and construction of the new growth.

Moving to the next slide, please, looking ahead to the next two years, we maintain our guidance for the new capacity additions in 2023 and 2024, targeting a total of 120,000 RT. This is aligned with our previous guidance. Approximately 60% of this guided capacity expansion is expected to come from consolidated entities, with the remaining contribution coming from equity accounted entities. We are confident in our ability to achieve our stated guidance for the year 2022/23 period, as we have already made substantial progress by achieving 89,000 RT on last year's guidance.

Tabreed's consistent ability to steadily increase its connected capacity in the region is a reflection of our dynamic growth in key markets across the GCC. Furthermore, our expertise in utilization of the regional network allows us to capitalize on commercial opportunities as they arise.

Moving to the next slide, Tabreed operates a stable utility business model, engaging in long-term contracts with highly credit-worthy clients. As previously mentioned, the group's connected capacity is close to 1.3 million tons across the GCC with an average contract term spanning over 25 years. Approximately 80% of the group revenue are is derived from contracts with either fully government-owned or partially government-owned entities, underpinning our credit profile. Leveraging our utility business model and partnerships, Tabreed has experienced a consistent growth in revenues, showcasing strong annual growth rates of 15% since the year 2020.

Moving to the next slide, throughout the years, Tabreed's business has demonstrated consistently a growth trajectory in EBITDA, profits from operations and net income, which closely align with its top line performance. This upward trend has been supported by capacity charge components within our revenue model, effectively enhancing earnings predictability.
Over the past three years, during the same period, our EBITDA, Operating Profit and Net Income margins have remained stable, maintaining an average of 55%, 36% and 30% respectively. This stability underscores the sustainability and effective financial prudence that forms the core of our business practices. With confidence in our robust and resilient business model, we continue to expect to deliver these margin levels over the long term, further solidifying our position in the market.

Next slide. Tabreed has demonstrated resilience in cash flow from operations, enabling us to uphold our investment grade rating, with both reputable credit rating agencies Fitch and Moody's. Through the early settlement of one of our bank facilities, we successfully reduced our total debt by AED 650 million, resulting in a lower gearing ratio, from 52% to 49%. I will now hand over the presentation to Salik who will provide a detailed overview of the financial results for the first half of this year.

Salik Malik

Thank you, Adel, and good afternoon, everyone. Let me present the key highlights from our income statement for H1 2023 versus the same period last year. As mentioned by Adel, the total revenue delivered a robust growth of 9%, primarily driven by our performance in our core chilled water business segment, which recorded an impressive year-on-year growth of 8%. This growth is primarily organic, attributed to the addition of 55,000 tons, majorly through new connections during the last 12 months.

Our consumption volume has also experienced an increase of 5%, and we benefited from the positive impact from 2022 CPI at 4.8%. The rise in operating cost is in line with the corresponding increase in our consumption volume, ensuring efficient management of our expenses. During the first half of 2023, Tabreed delivered a healthy EBITDA of AED 590 million, demonstrating our ability to generate consistent earnings with a sustainable margin of 55%. Finance costs decreased compared to the previous year, due to the interest cost saving arising from our Q1 liability management exercises, as well as the fixed deposit income.

During the first half of this year, there were two significant events which had a positive impact on net income. One was the liability management. Tabreed’s board approved the early settlement of one of our loan facilities, along with the associated hedging instrument, resulted in reduced future finance costs and improvement in our gearing. This initiative led to an other income of almost 100 million, comprising a cash flow gain from unwinding the hedges and a re-classification of fair value of derivatives from OCI to P&L. After the writing off of unamortised transaction costs, the total net gains amounted to 78 million.

Additionally, during the same quarter of this year, PIF, the Saudi sovereign investment fund, became new shareholders in Saudi Tabreed. Consequently, the group holdings in Saudi Tabreed diluted from 31% to 22%, resulting in a one-off accounting gain of 49 million, based on the fair valuation of PIF transaction .

In summary, the net income for the first half of this year was 386 million, including a one-off gain of 107 million recorded during the same period. Net income before one-off adjustments amounted to 280 million, reflecting a notable increase of 15% compared to the same period last year.

Moving on to the next slide, this slide represents a summarised version of the balance sheet, as of end of June 2023, highlighting the key points. The decrease in trade receivables is attributed to the enhanced in our billing to cash conversion cycle, reflecting efficient working capital management. The increase in investment in associates reflects a fair value adjustment of our investment in Saudi Tabreed, and a share of in-year profit demonstrating our value creation in our investments to our shareholders.

Our net debt position has decreased to 5.4 billion as of June 2023. It also reflects the decline in the gross debt by 650 million from the liability management exercise done during this period.

And in addition, a healthy EBITDA generation during the last 12 months led to an improved leverage ratio of net debt to EBITDA of 4.4 times.

Our financial positions are prudently secured with two fixed rate DCM instruments, sukuk and bonds, and a 100% hedged corporate loan. This effectively shielded Tabreed from higher interest costs, which is a highlight of having an effective risk management policy at Tabreed.

As a reminder, we have two facilities maturing in 2025, one in H1, the other one in the second half of 2025. Our loan facility allows us penalty-free prepayment, providing us with greater flexibility to manage our cost of capital and refinancing risk. As mentioned earlier, during the second half of 2022, both Fitch and Moody's reaffirmed Tabreed's investment grade status, with Moody's at Baa3 and Fitch at BBB, also gave us an upgrade in the outlook to stable, a testament to our strong financial standing. The movement in equity and reserves from 31st December are due to the settlement of dividends, reflecting our commitment to value distribution to our shareholders.

Moving on to the next slide, the cash flow performance during the period has remained robust, strong cash from operations totalling 709 million, reflecting efficient collection process across all of our valued customers and reinforcing our strong financial position. Our cash from operations to EBITDA ratio for the first half of this year was 120%, again reflecting our effective and improved customer collections and prudent financial track record.

The net cash flow from investment activities in the first half reflects a strategic CAPEX allocation required for growth and maintenance, enabling us to strengthen and expand our operations. The financing activity primarily represents the settlement of bank facilities as part of the liability management programme and the payment of dividend for the year 2022.

Overall, the first half of the year recorded a robust cash flow from operations, resulting in a healthy closing cash balance of 1.2 billion, and a revolving credit of 590 million remains fully unutilised. This liquidity position, combined with our flexible capital structure does strongly position the group to fund any future growth opportunities easily.

Moving on to the next slide, the net operating cash flow pre-working capital remained at 590 million. This is, once again, a testament to our company's resilient business model and ability to consistently generate sustainable cash flow. Our dedication to disciplined investment is evident in our net cash flow post-investing activities for 2023, which has increased to 633 million, showcasing our strategic approach to acquisition and expansion.

As you will notice, we are well-positioned to invest in any new opportunities which meets our threshold of board mandated IRR whilst remaining competitive to our peers. With this, I conclude the financial highlights presentation. I will now hand back to Adel to take you through the rest of the proceedings. Over to you, Adel.

Adel Salem Al Wahedi
Thank you, Salik. I would like to provide a concise overview of Tabreed's commitment to environmental sustainability. Tabreed has set ambitious targets to reduce energy consumption and emissions. We are committed to achieving these goals by harnessing the innovative technology solution and implementing environmentally-friendly operating practices. They include utilizing treated sewage effluent, thermal energy storage, seawater , emission monitoring, hazardous waste management, and strict compliance with trade effluent regulations.

We take pride in reporting that our operations have resulted in saving approximately 2.3 billion kWh of energy consumption, which is equivalent to powering over 134,000 homes for an entire year, and preventing the annual release of more than 1.4 million tons of CO_2 emissions.

The carbon emissions prevented through our sustainable cooling services play a crucial role in supporting regional government's efforts to achieve their sustainability targets. Tabreed recently released its 2022 ESG report, which highlighted our commitment to invest in new technology and to enter into strategic partnerships which will enable us to meet our stakeholders' expectations.

Lastly, in line with the UAE government directive, Tabreed remains committed to its sustainability objectives as we continue to provide innovative district cooling solutions to the region and beyond. Tabreed has demonstrated its commitment to decarbonisation and net zero by signing the UAE Climate Responsible Companies pledge last March.

These initiatives underscore our unwavering dedication to environmental stewardship and our role as a responsible corporate citizen, aligning our efforts with the global sustainability objectives. I will now request the operator to open the lines for Q&A, please.

Questions & Answers

Operator
Thank you. If anyone would like to register a question, please use the written Q&A box online to register a written question. Our first question reads, could you please share with us an approximate geographical split of the remaining new capacity additions over 2023/24? Could you please also elaborate on timing of key milestones of the contract with Tata?

Salik Malik
Thank you for the question. With regard to the split of the new capacity guidance, the majority of this is going to come from our consolidated entities, mainly in UAE, and also it will be contributed from our Saudi business operations. So with that, I think I've answered the first part of the questions. With regards to your second part, on the timing of the key milestones of contract, yes, we have signed this contract and the plant is commissioned in July. That's the key milestone, and this is the 2,000 tons contracted capacity with the concession of 6,600.

Operator
Thank you. Our next question is from Mark Adeeb from CI Capital. And the questions read, what was the reason behind the annual drop in Gross Profit in absolute terms and GPM accordingly? The second question is do you expect margins to revert back in H2 2023 to normal levels? And the third question is can you give us some colour on margins related to regional expansion and expected revenue contribution?

Salik Malik

Thank you, Mark, for your questions. Let me split this into the three questions, one by one. The first question, regarding the drop in the Gross Profit Margin, there's no drop in the profit margin as such, I would like to reiterate that. The last year, we had a provision release due to the acquisition in 2021 of one of our assets, and we had built some accruals in 2021 which was excess and we had to reverse last year in 2022, first half. As a result, you would notice that we are having a drop in the first half of this year, but that is not a drop. That is what I would like to clarify here.

And your second part of the question, the margins, will it be back by the year-end, yes I would like to confirm that the margins are going to be back to the normalised business operations by the end of the year. And let me look into the third question. So, the regional expansions are going to be fully embedded in the results. As of now, in the first half of the year, the impact of Tabreed India's operations has not been embedded, it is going to be reflected in Q3. I hope this answers your questions, Mark.

Operator

Thank you. Our next question is from Shankar Puthanveetil from FIM Partners. And their question reads, can you please give more details on the AED 12 million other expense booked in the second quarter 2023?

Salik Malik

Thank you, Shankar, for your questions, appreciate it. With regards to the one-off, the reason that we have booked it, it is related to some of the development cost on new development that we were working on. We have prudently made those provisions but, again, as I said, it's a prudent provision that, against those development costs, we will be assessing it by the year end, and may reverse it as well. So it is a provision.

Operator

Thank you. Our next question reads, what is the target net debt to EBITDA? Will the maturities in 2024/2025 be rolled over?

Salik Malik

Thank you for the question. Regarding the net debt to EBITDA target, as we have mentioned previously as well, our aim is to maintain the investment grade status. Our board and the management are very clear on that, and it's a red line for us. So we will continue to maintain our investment grade status, and that is the target, pursued target, as well for the net debt to EBITDA.

And with regard to the rollover of the debt, just to let you know that there's nothing due in 2024. The bullet facilities that are due is in the first half of 2025, the first maturity. And we'll continue to assess the financial positions of our cash balances, as well as the growth opportunity. Accordingly, the management and the board will decide, and we will be making the investor community aware about the situation.

Operator

Thank you. We have no further questions, so I'd like to hand back to Farida for any closing remarks.

Farida Talaat
Thank you, everyone. And that concludes the H1 2023 earnings call. Until next time, thank you and goodbye.

Note: This transcript has been edited to improve readability

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