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

9M 2023
Earnings Conference Call Transcript
(Call conducted on 15 November 2023)

<u>Tabreed Participants:</u>

Adel Salem Al Wahedi, Chief Financial Officer
Salik Malik, Vice President – Finance
Yugesh Suneja, Head of Investor Relations

A video replay of the earnings conference call webcast is also accessible from the Investor Relations section of Tabreed's corporate website.

Presentation

Yugesh Suneja

Good afternoon, everyone. On behalf of Tabreed management, I am pleased to welcome you all to our earnings call for the first nine months of 2023. I am Yugesh Suneja, Head of Investor Relations at Tabreed. Before looking at the agenda for today's call, let me draw your attention to the disclaimer on this slide, which contains important information and cautionary advice on the use and limitations of historical data and forward-looking statements. Kindly refer to this slide for more details.

I am joined today by our Chief Financial Officer, Adel Al Wahedi and Salik Malik, Vice President of Finance. Adel will begin the presentation with key highlights and strategic progress during the first nine months of 2023, during which period Tabreed continued to deliver on its strategic priorities. Adel will then provide overview of financial performance and sustainability. Following that, Salik will discuss the nine months 2023 financial results in more detail. At the end of the call, Adel will conclude with an update on our guidance and outlook for the company. We will then open the lines for your questions. With that, I will hand it over to Adel.

Adel Salem Al Wahedi

Thank you, Yugesh. Good afternoon, everyone and thank you for joining us today.
Let me begin with the key highlights for the first nine months of 2023. Tabreed connected capacity reached 1.3 million RTs, increasing by 3% compared to December '22. The company started operating its first district cooling plant outside the GCC region, following acquisition from TATA Realty in India. We also started providing district cooling to another iconic development in the UAE, SeaWorld Abu Dhabi. Overall, UAE remains our largest and core market, accounting for 84% of connected capacity and remaining capacity coming from our regional presence in Saudi, Oman, Bahrain, and India.

Group revenue grew at a strong rate of 10% year on year in nine months of this year, driven by the robust performance of our core chilled water business, which contributed 97% of total revenue and increased by 10%. Our value chain business also supported growth and saw an increase of 16%. The growth was driven by various factors including new connections in existing concessions, new plants, higher consumption volumes and a positive CPI impact.

The company delivered a healthy and sustainable EBITDA of AED 914 million with a resilient margin of 50%. For the nine months of this year, reported net profit was AED 285 million, which included one-off non-cash items. Net profit adjusted for one-off items in both the periods and excluding the impact of deferred tax liability increased by 14% to AED 442 million, driven by stable EBITDA and lower net finance costs.

Let me shed some light on one-off items during the period, which significantly affect the underlying results of our operations and are mostly related to accounting treatment. In first half of this year, we have recognised fair value gains on unwinding of hedging instrument associated with an early repayment of one of our loan facilities and on the deemed disposal of Saudi Tabreed entity. In Q3 this year, we sold 50% stake in one of our subsidiaries, Tabreed Parks Investments, and recognised gain of AED 84 million.

During the third quarter, we also recognised deferred tax provision for AED 359 million. As per IAS 12 accounting standard, initial impact of deferred tax liability must be recognised with the introduction of UAE corporate tax law. This is related to intangible assets from our customer contracts based on the acquisitions of Downtown Dubai, Saadiyat and the step-up acquisition of Al Wajeez. This is a provision and not an actual tax liability, which will be released to P&L as we amortise intangible assets. And it will be fully reversed over the useful life of customer contracts.

It doesn't impact our EBITDA or our cash generation ability, which remains robust and resilient. We also do not see any impact of this non-cash item on the strength of our balance sheet and our investment grade credit rating. Our business model continues to provide strong visibility and predictable cash flows, which underpins our ability to grow the business.

In the first nine months, we added new connections of 41,000 RTs, and our overall connected capacity reached 1.3 million RTs by the end of the nine months of this year. Except for India, the new connected capacity in the nine months is purely organic and arises from four new plants, and connections within our existing concession areas. Of new connections, 24,000 RT came from UAE, 14,000 came from Saudi Arabi, 1,000 came from Bahrain, Oman, and India each. in the first nine months, we spend a total capital expenditure of around AED 132 million, strategically directing capital allocation towards expansion and construction of new plants.

Let me now talk about our value creation framework that allows us to deliver significant shareholder value. It is based on the three pillars of grow, optimise, and innovate. As shown, we aim to maintain the strong growth momentum of the past, ensuring that IRR on a new capacity exceeds our cost of capital, enabling us to add value for our shareholders as well as adequately compensate for upfront investment risk. We are also focusing on optimising our operations by leveraging on our integrated business model and having in-house O&M capability and centralised maintenance function. We have set targets to run our plants more efficiently.

Lastly, we are capitalising on innovative technologies such as big data and AI-driven tools to efficiently control and run our plants. We are also actively pursuing opportunities to use treated sewage effluent and seawater, renewable energy sources and the new nano materials to further extract efficiencies in our operations and contribute to sustainable development.

We have always managed our cash flows to maximise the returns to shareholders through a disciplined investment and future growth, optimise our capital structure and maintaining a stable and increasing dividend pay-out, whilst maintaining investment grade status. This financial discipline, coupled with our longstanding approach to integrating ESG, has led to sustainable value creation for our stakeholders over the years. Moving to the next slide.

On this slide, we show strategic progress achieved in the first nine months. We remain committed to delivering on our growth plans. As part of it, we have now successfully delivered 41,000 RTs of the planned capacity expansion. We started operations of four new plants that contributed 45% of the incremental capacity addition. Of these, three plants were green field and one plant in India came through brown field acquisition. The rest of the capacity addition was from new connections in our existing concession areas across UAE and GCC. As mentioned before, we incurred a Capex of AED 132 million in nine months, which is in line with our capital allocation strategy.

To secure our future growth, we also announced two new significant projects. First one was for a total district cooling concession capacity of 125,000 RT in India's Hyderabad Pharma City. Phase one will be 2,500 RT and it will be ramped up in line with the development and progress of the master plan. Expected Capex for phase one is around AED 36 million. The second project was King Salman Park in Saudi Arabia, this is for a total concession capacity of 60,000 RT, with phase one of 20,000 RT and estimated Capex of around AED 200 million.

We are also channelizing our efforts not only to grow capacity but also to enhance efficiencies in our operations and use of sustainable energy sources. We can now remotely monitor our plant equipment like chillers from head office and centralised team can take decisions to adjust various plant parameters such as water flow, temperature set point and turning equipment on/off as per customer load requirements. Our program to retrofit plant pumps with variable frequency drive is ongoing and we are increasing the number of plants under this program to reduce electricity consumption.

During the quarter, Tabreed also announced successful testing of geothermal wells in Masdar City, in partnership with ADNOC, to utilise underground heat to chill water. We are now currently working to operationalise this technology to partially meet the chilled water requirements of Masdar City.

Lastly, I would like to reiterate, Tabreed has a strong cash flow generation ability underpinned by long-term contracts. Free cash flow generation during the nine months of this year was AED 903 million. Strong cash generation allows us to optimally utilise our cash to invest in future growth, maintain a progressive dividend policy and reduce debt to strengthen our balance sheet.

I will now provide a summary of our financial performance before handing it over to Salik for a detailed discussion of the nine months' results. Leveraging on our strong operational track record, regional presence, and partnerships, Tabreed has experienced a robust growth in capacity and revenues, which have seen annual growth rate of 10% and 13% respectively between 2019 to 2022. This growth momentum was maintained during this year's nine-month period wherein the revenue increased by 10%. Tabreed's business is stable and predictable, like a utility business model. We have long-term contracts with highly creditworthy customers with an average contract term spanning 25 years on average. Approximately 80% of our group revenue is derived from contracts with either fully government owned or partially government owned entities, underpinning our robust credit profile.

Over the years, Tabreed's business has demonstrated a consistent growth trajectory in EBITDA, profit from operations and net income, which closely align with its top line performance. This upward trend has been supported by the capacity charge component in our revenue model which effectively provides earnings predictability, as well as increasing consumption demand. Between 2019 to 2022, our EBITDA, operating profit and net income margins have remained broadly stable driven by the sustained operating efficiencies, maintaining an average of 54%, 35% and 30% respectively. This stability underscores the attractiveness of Tabreed's business.

With confidence in our robust and resilient business model, we continue to expect to deliver these margin levels over the long term.

Tabreed has demonstrated consistent growth and cash flows from operations, which have grown at a higher rate than EBITDA due to efficient working capital management. Strong cash flow generation has enabled us to maintain our investment grade credit 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 in the first nine months of this year, resulting in a lower gearing ratio from 51% to 49%. Our net debt to EBITDA has also seen an improvement over the last few years due to a reduction in debt, higher EBITDA, and an increase in cash position. Our balance sheet remains strong and provides sufficient room to enhance shareholder returns through a combination of growth and a sustainable dividend policy. Moving to the new section.

This slide provides an overview of Tabreed's contribution to enable the sustainable use of energy and its environmentally positive operations. We are contributing to the region's growth through efficient and environmentally friendly cooling. As our business grows, so does Tabreed's positive environmental footprint. We are proud to report that Tabreed's operations have resulted in a saving of approximately 2.48 billion kilowatt hours of energy consumption, enough to power over 141,000 homes for a year and equivalent to the annual prevention of over 1.48 million tonnes of CO2 emissions. We are part of DFM's UAE ESG Index, aimed to measure ESG best practices followed by UAE listed companies.

Tabreed is a highly cash generating business, delivering significant power efficiencies compared to other cooling alternatives. We believe that the carbon emissions prevented through our sustainable cooling services are essential in enabling governments in the region to meet their sustainability targets for the future. As a result, Tabreed is committed to providing innovative district cooling solutions to the region and beyond.

Sustainability is at the core of Tabreed's long-term strategy, and we remain committed to integrating sustainability in our operations. Tabreed has set ambitious targets for reducing energy consumption and emissions. We will leverage innovative technology solutions and environmentally friendly operating practices, such as the use of treated sewage effluent, thermal energy storage, seawater, emissions monitoring, hazardous waste management and compliance with trade effluence regulations to achieve these targets. We are further committing to increase operational energy efficiency and water efficiency by 20% by investing in innovative solutions.

Lastly, in line with the UAE government's strategic goals, Tabreed remains committed to its sustainability objectives. Tabreed has demonstrated its commitment to decarbonisation and net zero by signing the UAE Climate Responsible Companies Pledge.

I will now hand over the presentation to Salik, our VP Finance, who will discuss in detail our financial results for the nine months of this year.

Salik Malik

Thank you, Adel. Hi, good afternoon, everyone. Let me start with the income statement highlights for the first nine months of this year versus the same period last year. Total revenue recorded a robust growth of 10% in the first nine months of this year versus the same period last year, primarily driven by the performance of our core chilled water business segment which also recorded an impressive year on year growth of 10%. This growth is organic and attributed to the addition of about 47,000 tons of new connections, connected during the last 12 months, majorly through new connections in existing concession areas. Our consumption volumes also experienced an increase of 9% year on year and we also benefitted from a positive CPI impact of 4.8%.

Gross profit for the same period increased by 3% year on year. The operating cost increase represents, in prior year there was a reversal of utility provisions after financial close of 2021 acquisitions, and a one-off increase in maintenance related to temporary chillers this year. Adjusting for this, operating cost increase was in line with the consumption volumes, underscoring efficient management of our cost.

During the first nine months of this year, Tabreed delivered a healthy EBITDA of 914 million and a margin of 50%, demonstrating our ability to generate a sustainable EBITDA margin between 50 to 55%. EBITDA is stable versus last year. Our general and administrative expenses increased modestly, reflecting prudent cost control measures and optimisation. EBITDA margins declined versus last year, mainly reflecting lower cost in 2022, as I mentioned earlier. Net finance cost reduced due to the lower interest costs after the repayment of some of our existing debt facilities and due to the higher fixed deposit income in a rising interest rate market.

Therefore, our profit from operations before deferred tax provision is at AED 605 million and a net profit before one-off gains and DTL provision is AED 442 million, which is an increase of 14% year on year compared to the same period last year driven by stable EBITDA and reduced net finance costs.

During Q3 this year, Tabreed divested a 50% stake in Tabreed Park Investments and as a result there was a gain of AED 84 million, which included the disposal of 50% interest and a fair value gain on 50% retained interest. Lastly, during Q3 2023 Tabreed also recognised a deferred tax provision of AED 359 million, which Adel explained in his opening remarks. This was due to an accounting treatment of intangible assets, based on our customer contracts. And we expect this to be fully reversed over the life of the customer contracts.

In summary, excluding the impact of all these one-off items explained above, and in addition to some prudent provisions in the first nine months, our normalised net profit amounted to AED 442 million, reflecting consistent growth in underlying operational and financial performance.

Moving onto the next slide. This slide presents the summary of the balance sheet as at the end of September 2023. The key highlights of the balance sheet movement during this year are:
Fixed assets movement represent the deconsolidation of Tabreed Parks assets, post 50% divestment of our stake and normal amortisation and depreciation recorded during the first

nine months of this year. Investments in associates and JV increased, which is mainly attributed to the fair value adjustment of our investment in Saudi Tabreed and the recognition of the remaining 50% stake of Tabreed Park Investments at fair value. Receivables and other Assets remained broadly stable as receivables increased due to seasonality impact, partially offset by improved collections. Others reflect MTM derivatives, which is lower with the early settlement of one of our project finance debts earlier this year and a forward curve impact of reduction in SOFR outlook.

The change in equity and reserves is mainly the reflection of 2022 dividends paid to shareholders earlier this year. There is an addition of deferred tax liability as previously mentioned. Our net debt position has decreased to AED 5.2 billion as of September 2023, on a strong cash generation during the same period and decline in gross debt by about AED 650 million from the liability management exercise done earlier this year.

Overall, our balance sheet continues to strengthen with an improved leverage ratio of net debt to EBITDA at 4.2 times and lowering of the gearing ratio to 49%. Our financial position remains prudent, with two fixed-rate DCM instruments - sukuk and bond and 100% hedged corporate loan. This effectively shields Tabreed from higher interest rates regimes, which demonstrates effective risk management policies at Tabreed. Moving forward we have these two facilities maturing in 2025, with one of them in the first half of that year and the other in the second half of 2025. Our loan facility allows us penalty-free prepayments, providing us with great flexibility to manage our cost of capital and refinancing risk. As mentioned earlier, both Moody's and Fitch reaffirmed Tabreed's investment grade credit ratings, with Moody's at Baa3 and Fitch at BBB, which is a testament to our strong financial standing. Moving on to the next slide.

Tabreed's business remains highly cash generative. This slide shows the sources and uses of cash in the first nine months of this year. Cash flow from operations, which is equal to EBITDA, amounted AED 914 million, highlighting the company's resilient business model and sustainable cash generation ability. This was further complemented by a positive working capital movement, indicating efficient management of collections and a strong credit profile of our customers. Our net operating cash flow to EBITDA ratio for nine months of this year stood at 105%, demonstrating prudent financial practices. Capital expenditure during the first nine months was around AED 132 million, which is in line with our strategic capital allocation, enabling us to expand our operations and maintain growth.

We divested a 50% stake in one of our subsidiaries, Tabreed Parks, and generated a net cash inflow of AED 68 million, allowing us to effectively recycle capital. All in all, we generated free cash flows of AED 903 million in the first nine months.

The financing activity primarily represents the cost of debt, net of interest income, the settlement of bank facilities as part of the liability management program and the payment of dividends to our shareholders. Overall, the first nine months of this year recorded robust cash flow generation, resulting in a healthy closing cash balance of AED 1.4 billion.

We are also in the process of renewing our revolving credit facility, which will further enhance our liquidity position to fund any major acquisition quickly. We are well-placed to capitalise on our strong financial position combined with a sold cash generation ability, to deploy cash towards funding growth initiatives, strengthening the balance sheet and returning cash to our shareholders. With this, I conclude the financial results presentation. Now, I will hand it back to Adel to take you through the rest of the presentation.

Adel Salem Al Wahedi

Thank you, Salik. Allow me to take you through our capacity guidance for the next two years. For the next two years, that is 2023-24, we maintain our guidance for new capacity addition of 120,000 RT. This is in line 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 have already made substantial progress by delivering 96,000 RTs since 2022, compared to our guidance of 120,000 RT. While there may be some spillovers from year end to beginning of the next year, we remain optimistic to close the year on a positive note.

Tabreed's ability to steadily increase its connected capacity reflects significant growth opportunities in the key markets across the GCC and Asia. These are driven by the demand for more energy efficient solutions from our customers, both government and private sector, and their combined efforts to reduce energy consumption. Furthermore, our expertise and diversified presence across the region allows us to capitalise on commercial opportunities as they materialise.

We are therefore excited by the prospects of our diversified presence across GCC and now in Asia through our entry in India. We are confident of delivering on our capacity guidance of 120,000 RT for the years 2023-24 and maintaining the positive momentum in the medium term. We will now open the floor for questions and answers.

Questions & Answers

Operator

Thank you. If you would like to ask a question, please click on the raise hand button to enter the question queue. Alternatively, you may type your question in the Q&A box. For those that are connected via the phones, please press * followed by the number one on your telephone keypad. And if you change your mind, please press star followed by two. When preparing to ask your question verbally please ensure your device is unmuted locally.

We have text questions from Thomas Matthew of Kamco Invest. The first one is, can you please explain how the accounting for the deferred tax liability of AED 359 million is amortised? And the second, can you talk a little bit about the landscape in terms of potential acquisition opportunities in the UAE in RTs?

Salik Malik

Thank you, Thomas, for your question. Regarding the deferred tax liability, UAE implemented the UAE corporate tax law on 16th January 2023. Any transaction related to the acquisition prior to that calls for the recording of deferred tax liability. And the deferred tax liability is recorded on the intangible assets and goodwill because the initial recognition exemption is not applicable. And the intangible assets are basically the future value of the customer contracts. And we had gone through various global accounting desks and concluded that as per IAS 12, this needs to be recorded and it must be recorded through the P&L, unlike the first-time adoption which goes into the retained earnings.

Regarding the amortisation, there is an annual amortisation of these intangible customer contracts. As we amortise them, 9% of that will be credited in the form of deferred tax credit. So, the net impact will be reflected in the tax that is payable to the FTA authorities.

I hope I answered your first part of the question. On the second part with regards to the landscape of the potential acquisitions in UAE, as you know our balance sheet position, we are well-placed to potentially tap into any acquisitions that may come up in our way. With AED 1.4 billion closing cash balance and an RCF facility of close to AED 600 million currently, we can turn around quickly for any financial close.

And regarding the landscape itself, there are a few opportunities that are still left in UAE that we are currently looking into and discussing with our potential customers. As and when this will materialize, we will be informing it through the DFM disclosure process.

Operator

Thank you. Our next question is from Rakesh Tripathi of Franklin Templeton, asking can you please elaborate on the lower EBITDA margin in Q3? Can you also confirm the size of the RCF and expiry date and whether it is committed? Can you also elaborate a bit on the tax liability?

Salik Malik

Thank you, Rakesh, for your question. Regarding the EBITDA margin being lower in Q3, as I explained previously, the acquisitions that we did in 2021, the financial close took place in 2022. As a result of that, there were some utility costs provisions we had reversed in 2022, and as a reflection of that you would notice the operating cost was lower in 2022 for the nine months and in Q3 2022 as well. So that's the main difference. Apart from that, during this year we had some one-off maintenance cost increases in the form of temporary chiller cost, which is one-off in nature, and it is not recurring. If you remove these one-off items, our EBITDA has grown almost 4% for this quarter of 2023.

Regarding your second question on the RCF, I would like to mention that it is a committed facility of AED 600 million from the combination of three banks.

Regarding the third point on tax liability, I already answered through the first question that was raised by Thomas. If you need any further clarification, please do let me know.

Operator

Thank you. Our next question is from Abdullah Hakimi of Hassana Investment Company, asking, could you please comment on the strategic direction behind the disinvestment of Tabreed Park Investments?

Adel Salem Al Wahedi

Yes, Hi Abdullah. The decision was strategically based, to open business opportunities and prospects between us and the owners of the development Dubai Parks - Meraas, which is now

Dubai Holding. Dubai Holding is a large group. And we are optimistic that it can open more business opportunities and prospects together. And that was the main reason for that. Thank you.

Operator
Thank you. We have a follow up question from Rakesh Tripathi of Franklin Templeton asking, can you please confirm the expiration date of the RCF?

Salik Malik
On the expiration date, it is under renewal because it is expiring in Q4. We have already got the commitment for the renewal from the three banks.

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

Yugesh Suneja
All right, if we have no further questions, then that concludes our nine months 2023 earnings call. If you have any follow up questions, please feel free to reach out to us or write to us on ir@tabreed.ae and we would be happy to answer the questions. Again, thank you everyone for joining this call and have a good day.

Note: This transcript has been edited to improve readability and for clarity.

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