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

FY 2023
Earnings Conference Call Transcript
(Call conducted on 15 February 2024)

<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 the earnings call for the full year 2023. I am Yugesh Suneja, Head of Investor Relations at Tabreed. Before we start, let me talk about a few housekeeping points. Today's presentation may contain forward-looking statements. Kindly refer to the disclaimer on this slide for more details. It contains important information and cautionary advice on the interpretation and limitations of historical data and forward-looking statements. Today's call is recorded, and a transcript of the call along with the presentation and other earnings material will be available on the IR section of Tabreed's website.

Moving on to the agenda for today's call. I am joined today by our Chief Financial Officer, Adel Al Wahedi and Vice President of Finance, Salik Malik. Adel will begin the presentation with the key highlights and strategic progress for the full year 2023. Following that, Salik will discuss the financial performance for the full year 2023. At the end, Adel will provide an update on guidance and outlook for the company. We will then open the lines for your questions. I will now hand it over to Adel to start the presentation.

Adel Salem Al Wahedi

Good afternoon, everyone and thank you for joining us today. We will go to the first slide. This slide shows key achievements of 2023 under 3 main themes - financial, strategic and sustainability. And we are pleased to see positive results across three areas. Tabreed delivered strong financial results, demonstrating growth in revenues, which was driven by strong consumption volumes and an increase in connected load. Our normalized net profit grew 14% year-on-year and the company continued to see strong cash generation. This has put us in a solid financial position with a strong balance sheet at the end of 2023.

We are delivering on our strategic growth plans with expansion in the core markets of UAE and GCC while diversifying our presence internationally. We are now present in 6 countries, having started operations in India and Egypt during 2023. We have a strong pipeline of new opportunities that we are evaluating to maintain the growth momentum while ensuring new projects align with our disciplined approach to generate healthy returns for our shareholders.

Sustainability remains at the core of our operations. The year 2023 was a remarkable year with many new initiatives launched to advance our ambitions. We started the region's first geothermal district cooling plant in partnership with ADNOC and Masdar. After the successful operations of this plant, we will now explore more opportunities to tap into this renewable energy and provide efficient and sustainable cooling to our customers. We also signed an AED 600 million green revolving facility in line with our green financing framework. This will support to meet the growing demand for sustainable district cooling and invest in innovative technologies such as our pilot project of using nanofluids that further enhance the energy efficiency of district cooling.

Moving to the next slide. This slide shows key highlights of 2023 financial performance. Tabreed's connected capacity reached 1.304 million RTs, increasing by 3% compared to 2022. The company started operating its first district cooling plant outside the GCC region following its acquisition from Tata Reality in India. We also commenced operations of our plant in Egypt. Group revenue grew at a strong rate of 9% year-on-year, driven by the robust performance of our core Chilled Water business, which contributed 97% to total revenue. 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 1.2 billion, with a resilient margin of 50%. 2023 Net Profit Before Tax attributable to the parent came in at AED 751 million, a growth of 25% versus 2022. However, the reported net profit of AED 431 million was impacted by the recognition of one-off non-cash deferred tax liability. As mentioned before, adjusted for one-offs, normalized net profit saw robust growth of 14% year-on-year. The strength and sustainability of our operations are clearly evident in solid cash flow generation profile with free cash flows of AED 1.2 billion, increasing by 8% compared to 2022.

We also prudently managed our financial position. Following a proactive debt management exercise to reduce our debt, we saw leverage improving further with net debt to EBITDA at 4.1x at the end of 2023. The strength of our balance sheet, strong visibility and predictability of cash flows and positive outlook were reinforced by both rating agencies Moody's and Fitch, which maintained our investment grade credit rating with stable outlook following a recent review. Tabreed's Board of Directors recommended 15.5 fils cash dividend per share for 2023, an increase of 2 fils from 2022 level or 15% higher.

This shows their confidence in Tabreed's future growth outlook and ability to generate attractive returns for shareholders. Tabreed now offers a dividend yield of 4.7% which is quite attractive considering the future interest rate environment combined with Tabreed's resilient business model and potential growth upside.

Moving to the next slide. Let me now talk about operational performance and update you on our expansion plans. As you know, our chilled water revenues consist of fixed capacity charges and consumption charges. Fixed capacity charges contributed 56% of our chilled water revenues in 2023. The growth in fixed charges was driven by an increase in connected capacity and CPI increase.

The rest of the 44% of chilled water revenue came from consumption charges. Our consumption volumes increased to 2.6 billion RTH, growing by 8% year-on-year. This was driven by higher connected capacity as well as increasing demand for cooling in our core markets, which have a relatively hot climate. In terms of capacity, UAE remains our largest and core market, accounting for 83% of connected capacity, while the remaining capacity coming from our regional presence in Saudi, Oman, Bahrain, India, and Egypt.

Historically, our connected capacity has grown by 8% per annum since 2018. In 2023, we have added new connections of 53,000 RT, mostly organic growth from our existing concession areas. Of the new connections, 31 k RT came from the UAE, 14 k RT came from Saudi Arabia, 3 k RT from Bahrain, 1 k RT came from Oman. Beyond UAE and GCC, Egypt contributed 3 k RT and India 1 k RT. During the year, we continued to monitor our portfolio and disposed of 2 plants in Abu Dhabi. These plants were quite old and needed higher maintenance capex. Management took a prudent decision to sell these assets to streamline and optimize our portfolio returns. In addition, small load adjustments were carried out, leading to the net increase of 39,000 RT in connected capacity.

Moving to the next slide. On this slide, I will take you through the strategic progress achieved during 2023. We remain committed to delivering on our growth plans. We started operations of 6 new plants that contributed 40% of incremental capacity addition. Of these, 5 plants were Greenfield, and 1 Plant in India came through brownfield acquisition. The rest of the capacity addition was from new connections in our existing concession areas across UAE and GCC.

To secure our future growth, we also announced 2 new significant projects. First one was for a total District Cooling concession capacity of 125k RT in India's Hyderabad Pharma City. Phase1 will be of 2.5k RT, and it will be ramped up in line with the development of master community. The expected Capex for Phase 1 is about AED 36 million. Second project was King Salman Park in Saudi Arabia. This is for a total concession capacity of 60k RT with Phase 1 of 20k RT and estimated Capex of around AED 200 million.

We are also channelizing our efforts to enhance efficiency in our operations and use of sustainable energy sources. We recently concluded phase 3 of our extensive program to retrofit plant pumps with variable frequency drives. This is expected to drive savings in electricity consumption. During the last quarter of 2023, Tabreed also announced the successful commencement of the Geothermal district cooling plant in Masdar City in partnership with ADNOC. This plant utilizes underground heat to chill water and meet partial requirements for cooling Masdar City. We are now exploring other areas in the UAE that can utilize geothermal renewable energy and replace grid electricity. We have also completed a pilot project to use new innovative nanofluid technology in our chilled water pipes that helps to significantly increase the heat transfer efficiency of our network and thus save up to 15% energy.

In a nutshell, strong business fundamentals and visibility of future cash flows allow us to optimally invest in future growth, innovate to maintain industry-leading position and generate attractive returns for our shareholders.

Moving on the next slide. This slide provides an overview of Tabreed's contribution to enable the sustainable use of energy and the positive impact of its operations on the environment. 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 the saving of approximately 2.52 billion kWh of energy consumption in the year 2023, enough to power over 143 thousand homes for a year, and equivalent to the annual prevention of over 1.5 million tons of CO2 emissions. We are part of DFM's UAE ESG Index, aimed to measure ESG best practices followed by UAE listed companies. Tabreed delivers 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 investing in innovative district cooling solutions to meet growing demand in the region and beyond.

Next Slide. 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, use of seawater etc. 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 decarbonization and Net-Zero by signing the UAE Climate-Responsible Companies Pledge.

I will now hand over the presentation to Salik, who will discuss in detail our Financial Results for the year 2023.

Salik Malik
Thank you, Adel, and good afternoon, everyone. Let me start with an income statement summary for 2023.

Tabreed reported revenue of AED 2.4 billion in the year 2023, which was up 9% year-on-year.

Operating costs and general administrative costs recorded a similar increase on a normalized basis. We also saw a significant reduction in net finance costs, higher other income, and stronger growth in the share of income from JVs and associates.

As a result, profit before tax increased 24% year-on-year to AED 785 million and of which AED 751 million is attributable to the parent.

However, as we previously reported during Q3 2023 results, there was non-cash deferred tax liability recognized on account of UAE Corporate Tax implementation from 2024. This impacted our bottom-line and reported net profit was AED 431 million.

Moving on to the next slide. I will discuss the income statement in detail. Total revenue recorded a robust growth of 9.0% in 2023 versus 2022, primarily driven by the performance of our core Chilled Water business segment. This is attributed to the organic business growth through additional 53k RT during the last 12 months, majorly through new connections in existing concession areas.

It also includes four out of the six new plants commissioned during the year through consolidated entities.

Our consumption volumes also experienced an increase of 8% year-on-year, and we also benefitted from a positive CPI impact of 4.8%.

2022 Gross Profit increased by 4% YoY to AED 1.1 billion. On a normalized basis, increase in operating costs is in line with the increase in revenue. However, in 2022, there was a reversal of utility provisions and this year, there was one-off increase in maintenance cost related to temporary chillers. These factors resulted in reported operating costs to be higher than last year.

Tabreed delivered a healthy EBITDA of AED 1.2 billion, with a margin of 50%, demonstrating our ability to generate a sustainable EBITDA margin between 50 to 55%. 2023 EBITDA and EBITDA margin were in line with our historical averages. However, the lower margin in 2023 compared to the previous year is due to the one-offs in operating costs mentioned earlier and an increase of 16% year-on-year in General & Administrative expenses. The increase in G&A was due to the reversal in impairment provision that we recorded in Q4 of 2022 and then the additional charges in Q4 2023 related to consultancy and due diligence costs on some projects that we were pursuing. In addition, there was also an impact of divestment of 50% stake in Tabreed Parks and Investments in Q3, which reduced the contribution to EBITDA due to the deconsolidation.

These impacts were more than offset by a reduction in net finance costs by 24% year-on-year. This was on account of the lower interest cost after the pre-payment of some of our existing debt facilities, unwinding of positive interest rate swaps and the partial buyback of sukuk started in Q4 2023, as we prudently managed our debt and cash flows. And on top of these, we also had a higher fixed deposit income due to the better management of our idle cash in rising interest rate markets.

Other income more than doubled in 2023 driven by the one-off factors such as unwinding of interest rate swaps following the liability management exercise that we carried out, the fair valuation gains on investment with the introduction of PIF as strategic shareholder in Saudi Tabreed in Q1 2023 and lastly, the divestment of 50% stake in Tabreed Parks and Investments. These one-offs were partially offset by some provisions against the development costs. Therefore, Tabreed delivered an exceptional growth in profit before tax attributable to parent of 25% increase year-on-year. Reported net profit after tax is at AED 431 million, with the impact of the recognition of non-cash deferred tax liability.

Moving on to the next slide. This slide shows our normalized net profit to provide a like-for-like comparison of our financial performance. Net profit before one-off items and deferred tax is AED 603 million, an increase of 14% versus the normalized net profit for the year 2022. This growth was driven by stable operating profit and reduced net finance costs. In summary, Tabreed maintained a consistent growth in underlying operational and financial performance for the year 2023.

Moving on to the next slide. Here on this slide, we present the summary of the balance sheet as at the end of December 2023.

The key movements are - the fixed assets and the intangible asset movement is reflecting the deconsolidation of Tabreed Parks post our 50% divestment and a year-on-year movement in depreciation and amortization charges. The increase in associates and JVs is also mainly attributable to the reclassification of Tabreed Parks and Investments from fixed assets to an investment in associates and the fair value adjustment on our investment in Saudi Tabreed. The decline in receivables and other assets represents improved collections and the MTM movements in our interest rate swaps. Changes in equity and reserves mainly reflect the payment of 2022 dividends to our shareholders and the MTM changes on the fair value of derivatives.

Our net debt position has decreased to AED 4.9 billion as of the end of December 2023, on a strong cash generation during the period and a decline in gross debt by about AED 850 million from the debt management exercise that we conducted during the year 2023, mainly the settlement of early debt and the partial buyback of sukuk in Q4. Overall, our balance sheet continues to be strengthened, with an improved leverage ratio of net debt to EBITDA at 4.1x and improved gearing ratio at 48%.

Our financial position remains healthy with two fixed rate debt capital market instruments, sukuk and bond and 100% hedged corporate loan. This effectively shielded Tabreed from the higher interest rate costs, which demonstrated effective risk management policies being implemented at Tabreed.

Moving on to the next slide. Tabreed remains a highly cash-generative business, following the typical utility business-like model. Cash flow from operations, which is equivalent to EBITDA, amounted to AED 1.2 billion, highlighting the company's resilient business model and a sustainable cash flow generation ability. This was further complemented by a positive working capital movement, indicating effective and efficient management of collections and the strong credit profile of our customers.

Our net operating cash flow to EBITDA ratio for 2023 stood at 110%, demonstrating prudent financial practices. Capital expenditure during the year was AED 180 million, enabling us to expand operations and maintain growth. We divested 50% stake in one of our subsidiaries and the net cash inflows due to this was AED 68 million, allowing us to effectively recycle capital. All in all, we generated free cash flow of AED 1.2 billion in the year 2023.

The financing activity primarily represents the cost of debt, the settlement of bank facilities as part of the debt management program and the payment of dividend for the year 2022 in 2023.

Overall, 2023 recorded a robust cash flow generation, resulting in a healthy closing cash balance of AED 1.5 billion.

In addition, we signed the green revolving credit facility of AED 600 million, which provides us with enhanced liquidity to fund any major acquisition that may turnaround. We are well-placed to capitalize on our strong financial position, combined with our solid cash generation ability to deploy cash towards funding growth opportunities, strengthening the balance sheet and returning cash to our shareholders.

With this, I conclude the financial results presentation and hand it back to our CFO, Adel Al Wahedi, to take you through the rest of the proceedings.

Adel Salem Al Wahedi

Thank you, Salik. Let me provide an update on our Capacity guidance. For the 2022 to 2023 period, we provided a guidance of 120 k RT. We have delivered 109 k RT in this period, which marks an increase versus 96 k RT delivered in our previous two years guidance period. There was a slight shortfall against our guidance, but this was mostly related to equity-accounted entities. Consolidated entities, which directly contribute to revenue and EBITDA, represented 87% of new capacity over 2022-23 compared to expectations of 70%, and thus exceeded guidance by delivering 95 k RT.

For the next two years, that is 2023 and 2024, we maintain our guidance for new capacity addition of 120 k 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. As of the end of 2023, we have already made substantial progress by delivering 53 k RT in 2023, with the remaining capacity to be delivered in 2024. We are also introducing new capacity guidance for the next 3 years 2024-2026. We expect annual growth in connected capacity of 3% to 5%.

This is driven largely by new projects currently being developed and the award of new projects in 2024, which will be completed by 2026.

On the next slide, we show key drivers of growth in the district cooling industry. Due to the renewed focus on accelerating climate action and advancing sustainability goals, we see strong tailwinds for the district cooling sector. Cooling typically accounts for ~50% of electricity consumption (~70% at peak demand), especially in Tabreed's key markets (which exhibit relatively hot climate). Energy demand for cooling is expected to increase at a drastic pace, demanding huge investments in electricity systems.

District cooling is 50% more energy efficient, more reliable, has a longer asset life and is more economical over a lifecycle compared to conventional cooling and thus offers huge potential to save energy and avoid massive investments. Given its high efficiency, DC will be critical enabler to meet strategic Net Zero emissions targets announced by various governments in the region. Further efficiency improvements brought in by new technological developments such as Thermal Energy Storage, Zero Water consumption solutions, Renewables Energy etc. make district cooling a preferred choice for smart and sustainable developments.

Economic growth is expected to accelerate over the next five years compared to the last five years in most of our markets. Some of these markets such as Saudi Arabia and India hold huge potential given relatively underpenetrated DC markets and significant size of cooling demand. Governments remain focused to increase the use of DC systems and integrate it with master urban planning and we are excited to be present in these markets and play a leading role in this evolution.

Next slide. This slide provides an overview of our medium-term growth outlook. Tabreed's ability to steadily increase its connected capacity reflects significant growth opportunities in the key markets across the GCC and Asia.

Let me break down growth opportunities into two parts – locally in the UAE and in international markets. In UAE, we see growth largely driven by organic additions. We have already secured growth to add additional capacity in our existing concession areas. E.g., our Downtown DCP assets have a total concession size of 235k RT with a current contracted capacity of ~185k RT. Similarly, Saadiyat, Al Maryah Island, Al Raha Beach, Yas Island, Masdar etc. are all concession areas. All in all, we have about 300 k RT that can be added over the medium term.

We also see further M&A opportunities in the UAE, although the scale is not expected to be same as our historical acquisitions. M&A opportunities in the UAE are expected to be of a smaller scale to acquire standalone plants from captive asset owners or from developers.

In terms of new geographies in international markets, we are continuing to evaluate multiple opportunities in markets such as Saudi, India and wider Asia region to build greenfield plants or enter into new concessions.

Another prominent route to grow internationally is through M&A. For example, in Saudi Arabia, Saudi Tabreed operates >500 k RT for assets owners and this could be a potential pie to buy assets from owners.

All in all, our expertise and diversified presence allow us to capitalize on commercial opportunities as they materialize. 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 maintaining the positive momentum in the medium term and ensuring that the opportunities are value-accretive to our shareholders.

This concludes our presentation, and we will now open the floor for Questions and Answers.

Questions & Answers

Operator

As a reminder, if you would like to ask a question today, please use the raise hand button at the bottom of the screen or use the text Q&A box provided. We'll start with a text question that has been submitted by Rakesh from Franklin Templeton. The question is can you reconfirm the AED 200 million capex for King Salman Park project and if this is for phase one or the entire project? Also, can you confirm timelines for the Hyderabad Pharma City project and the King Salman Park project? Thank you.

Salik Malik

Hi, good afternoon. Thanks for your question. The AED 200 million capex for King Salman Park is for phase one, which is the 20 k RT out of 60 k RT concession capacity. Regarding the Hyderabad Pharma City, Tabreed was awarded preferred bidder, and we are currently waiting to sign the agreement with the master developer of the project. The project will be developed in phases. Phase one is for 2.5 k RT, which will be then ramped up to the 125 k RT of concession capacity. As of now, we have visibility on Phase one and we'll keep you informed of the development of different phases as we progress.

Operator

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

Yugesh Suneja
If there are no further questions, we will conclude the call. Please feel free to reach out to us at IR@tabreed.ae if you have any follow-up questions and we would be happy to answer them. Thank you, everyone, for joining in today and have a good day.

Note: This transcript has been edited to improve readability.

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