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

Q4 and Full Year 2017
Earnings Conference Call Transcript

31 January 2018

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

Presentation

Operator
Ladies and gentlemen, welcome to Tabreed's Full Year 2017 Financial Results Analyst conference call. I will now hand over to your host, Mr. Saket Somani from Tabreed. Sir, please go ahead.

Saket Somani
On behalf of Tabreed management team, I welcome you all and thank you for joining us for the full year 2017 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 will now request you to turn to slide three for today's agenda. Today's call will follow the usual pattern with Jasim, our CEO, providing a quick overview of the full year 2017 performance, and the key events. Following that, Steve, our CFO, will discuss the financial performance in more detail. Jasim will then conclude the presentation and we will open the line for your questions.

With that, I will now hand over to Jasim to begin today's presentation. Thank you and over to you Jasim.

Jasim Thabet
Thank you everyone for joining us today. I would like to begin by highlighting our full year 2017 performance and providing a snapshot of the recent events.

We are pleased to report another year of strong performance. Total revenue increased by 9% led by a 13% growth in chilled water revenues. Our net profit increased by 9% to reach AED 400 million. This performance was driven by 44,000 tons of new capacity additions in 2017, higher consumption volumes, and CPI indexation. We are committed to adding value to our shareholders and are pleased to recommend a dividend of 8 fils compared to a 6.5 fils paid for 2016. This is a 23% higher than the last year and reflects cash savings on the on the MCBs coupon payments. Going forward the board of directors has adopted a dividend distribution policy to grow dividends per share in line with the growth in the business.

Finally for this slide, I would like to outline our revised capacity guidance for the next two years; 2018 and 2019. Based on current signed contracts in hand, we expect to connect at least 65,000 tons of new capacity over 2018 and 2019.

Moving onto the next slide, this slide provides the usual overview of the company. Tabreed is contributing to the region's growth through efficient and environmentally friendly cooling, enabling sustainable development. As our business grows, so does out positive environmental footprint. We currently operate 72 plants across the region, delivering almost 1.1 million tons of cooling. Our operations saved 1.53 billion kilowatt hours of energy consumption in 2017, and that is enough power to power 51,000 homes for a year.

Moving onto the next slide on the regional presence. Tabreed is the only publicly traded district cooling company in the world. The UAE is our base of operations where we have a presence in six Emirates providing over 771,000 tons of cooling to our customers, through our 63 plants. In addition to the UAE, we work with key partners in four other GCC countries. We have a total of nine plants outside of the UAE providing over 321,000 tons of cooling to customers, and around 65% of our capacity is consolidated, while the rest is equity accounted, as associates and JVs.

Moving onto the next slide, this slide outlines our capacity growth trends across the region. At the beginning of 2017, we announced that we expected to add at least 60,000 tons of new connected capacity during 2017 and 2018. During the full year of 2017, we added 44,000 tons of capacity across the region. Of this capacity, 17,500 tons were added at a consolidated level and 26,500 tons through joint ventures and associates.

As I have already mentioned, based on recent and current signed contracts in hand, we expect to connect 65,000 tons of capacity over 2018 and 2019. Of this, we expect the split between consolidated level and equity account joint ventures to be circa 50:50. Tabreed continues to demonstrate its ability to deliver 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.

Moving to the next slide, this slide recaps a bit the evolution of our performance over the years. To summarise, Tabreed is a stable utility infrastructure business with long-term contracts with high profile customers. This provides us clear visibility of future earnings and cash flows. We currently have 95% of our capacity contracted for at least 10 years. Tabreed has a track record of delivering profitable growth. Our EBITDA and net income has grown at 7% and 6% annually since 2014. Our stable earnings enable the company to maintain an attractive dividend pay-out. In line with our commitment to provide sustainable shareholder return, we are pleased to propose a dividend of 8 fils which represents a 54% pay-out.

I will now hand over to Steve who will take us through the results in some more detail.

Steve Ridlington
Good afternoon everybody, nice to be here again. Let me start with slide 11 on the income statement, and I will just highlight some of the key developments and results for the year.

We registered 9% growth in both revenues and net profit, and our EBITDA grew by 8% in 2017. The revenue growth of 9% was led by a 13% increase in chilled water revenue, and that was driven by the following factors: new capacity additions has contributed 5%, the utility tariff increase in Abu Dhabi led to a further 6% increase, which we passed through to our customers, the 2016 published UAE CPI was 1.62%, which has already been passed onto the majority of the customers, as escalation of capacity charges, and finally, additional revenue from Oman and Bahrain contributed about 1%.

The reduction in order book at our pipe fabrication company was the main reason behind a 27% decline in revenue from value chain businesses. Though, I should add that that result did improve in the fourth quarter of 2017.

Associates and joint ventures are up 10%, mainly reflecting new connections in Qatar and Bahrain. Finally, our gross profit and EBITDA margin remain broadly unchanged at 45%.

Let's turn to the next slide to look at the statement of financial position. Our balance sheet is considerably simplified with the conversion of the mandatory convertible bonds into ordinary shares last year, and this accounts for the most significant changes to the balance sheet. The conversion resulted in a substantial increase in equity and a significant reduction in debt as the liability component of the bond was extinguished. The other significant movements were, first of all, an increase in receivables. This reflects timing delays in collections, but we have seen strong collections in January and most of the overdue amounts have now been collected. The second element, there is an increase in the cash balance of the company to AED 418 million. Gearing at 40% is in line, maybe slightly lower than global utilities.

In summary, Tabreed’s strong robust balance sheet positions us well for future growth opportunities.

Let me now turn to the cash flow statement on the next slide. 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. Cash flow from operations remain robust with over 550 million generated. We continue to invest in new cooling capacity and paid about AED 100 million for the acquisition of an ICT plant at the Nation Tower on the Corniche in Abu Dhabi. Other additions during the year include Meraas in the UAE, Remal Castle in Oman and expansion at the Yas Island plant.

Finally, just to note that the MCB coupon payments ceased in June 2017, resulting in a cash flow benefit to the company of AED 43 million in the second half of 2017.

In summary, our cash generating ability remains robust, driven by long-term price certain contracts, enabling investment in growth.

Let me now turn to our debt portfolio on the next slide. This is a slightly different version of what we normally show you, but I hope you will find it useful. We have over AED 3 billion of debt, and as I said, a gearing ratio of about 40%. Net debt and net debt to EBITDA have declined since 2015, as the two charts on the left side of the slide show you. This reflects repayment of debt, strong growth in EBITDA over the period.

In the bottom right hand corner, you see the debt maturity profile, which shows significant debt repayments due in 2021 and 2027, which are the main final maturity dates of our main corporate facilities. Our debt is largely AED based and floating rate, so we hedge a significant part of the debt into fixed rate through plain vanilla interest rate swaps. Our policy is to hedge between 50 and 75% of our debt, and the current hedge ratio is 57%. We expect to increase that ratio in the coming months.

Overall, we have a strong leverage profile and headroom available for funding future growth opportunities.

That completes the detailed review of our full year results. Let me now pass you back to Jasim.

Jasim Thabet
Thank you, Steve. Before we open the lines for Q&A, we have a few closing comments on this slide. We have been pleased to welcome Engie as a new major shareholder in the company. Tabreed has a strong shareholder base with Mubadala and Engie providing support to operations and growth. As a utility infrastructure company, Tabreed has a track record of delivering consistent results year-on-year. 2017 was another successful year for Tabreed with the net profit increasing by 9% to reach AED 400 million. We provided capacity addition guidance of 60,000 tons to be added over the next two years, and we delivered 44,000 tons in 2017. We have now updated that guidance to add 65,000 tons over 2018 and 2019. Tabreed now has a more flexible capital structure to fund growth beyond this. As we have mentioned before, we will look at opportunities beyond the GCC and I am pleased to say that we are actively evaluating opportunities in North Africa and India. These are still in early stages and we cannot be specific, but we will be providing further updates if and when such opportunities materialise.

That concludes the presentation now, and we can open the lines for Q&A.

Question and Answer Session

Operator
[Operator instructions]

Our first question comes from Sanyalak Manibandhu, FAB Securities. Please go ahead.

Sanyalak Manibandhu
I wanted to understand a bit more on your dividend policy, because it was a very big hike and I think it will probably be the biggest hike in this dividend season. I know you basically said that going forward it will be going up with profit growth, rather with operating performance and all of that. But then you also mentioned a 54% pay-out ratio. Are we to also read into that that 54% is a minimum and that going forward perhaps you can pay more than the 54% pay-out.

Jasim Thabet

With regards to the dividend question, there are two reasons for the 23% increase to 8 fils . First, it reflects the very strong performance for the company, with net income and cash generation abilities and strong EBITDA. Second it reflects the retirement of the mandatory convertible bonds, which resulted in additional savings in cash flow. So, we have the ability to increase our dividend.

And what do we expect going forward? Going forward, the board reviews dividend year-on-year, and we recommend to the shareholders a dividend in line with the company's performance, so as the company improves in performance, we would expect an increase to reflect such performance.

With regard to the specific 54% pay-out, is that the minimum? It is not set in stone as a minimum and it could be reviewed year-on-year.

Operator

Our next question comes from Asheeh Agarwal, Decimal Point Analytics. Sir, please go ahead.

Asheeh Agarwal

My question relates to the expansion plans. You said that you are going to add 65,000 tons in 2018/19, so you are already left with 16,000 tons of our earlier target of 60,000 tons. So, this 16,000, is it included in that 65 or is it excluding the existing target?

Steve Ridlington

It is including. What we do is we reset the clock at the beginning of each year, so anything that wasn't delivered in the second year of last year's target gets rolled into the new target. So, there is nothing to add to that. I would stress though that these are signed contracts, so we see this really as the minimum performance of the company going forward over the next two years, and we will obviously look to better that through further growth opportunities.

Asheeh Agarwal

Will it be possible for you to tell us exactly in which quarter how much capacity will be coming up?

Steve Ridlington

We don't give a quarterly profile. It is a little difficult to do that, because it does depend on when the associated real estate comes on, and that is always difficult to predict, as I am sure you're aware. So, we will obviously update you each quarter for what we have delivered, but we don't have a quarterly profile to share with you.

Asheeh Agarwal
Can you tell us what will be the CapEx for these expansions for 2018/19? Can you give us a number for that, and also a breakup between the maintenance CapEx and the expansion CapEx if possible?

Steve Ridlington
The second question first. Most of our maintenance CapEx actually gets expensed, because it's not that significant, so we don't have specifics of that. In terms of the total CapEx associated with those projects. What I would say is if you look at our CapEx trend over the last couple of years, it's been around AED 200 million a year and I think that will be more or less what we'd expect to see in general terms going forward over the next couple of years. Now, that of course excludes any new projects that we haven't got within our 65,000 RT capacity additions. Significant capacity additions above the 65,000 RT figure would adjust that number, but that annual number will be sufficient to deliver what we're talking about here.

Asheeh Agarwal
One more question. You said that the value chain business declined by 27%. Can you just repeat the reasons and I'd like to understand your outlook going forward the chain business?

Jasim Thabet
Yes, so in terms of our value chain business one of the businesses that we have is a pre-insulated manufacturing piping company and they're insulating pipes for district cooling networks. It's been a hard year for that specific business line, given the market conditions, but what I can say is it is still a bit positive. We're not injecting money into the company. It is operating as a standalone entity and we have seen improvements in the sales of the business in the fourth quarter. These companies, historically we had them as we were expanding and growing significantly, and now they're less significant to our core chilled water business.

Operator
Our next question comes from Riken Gopani, Bank Muscat. Please go ahead.

Riken Gopani
I wanted to understand a few things. One is on the revenue growth versus the gross profit growth, which is slightly lower than the revenue growth. Is it because consumption not necessarily leads to any improvement in the gross profit or is there any other particular factors impacting the gross margins for the company?

Steve Ridlington
You're basically spot on, yes. That does reflect a higher share of consumption revenue in the total, which does attract a lower profit margin, so that's the main factor within that.

Riken Gopani
So basically, what I'm trying to understand is that as and when there is any improvement in the overall utilisation, it should not be leading to any gross profit margin improvement in the future or is there some view that it can lead to improvement as well, or how should I approach that?

Steve Ridlington
Yes, well, certainly… if we're connecting new customers to existing plants, which is utilising spare capacity as you say, that is generally a higher margin business for us than building a new plant, because the costs of providing a service are not significant and of course the revenues per ton are very similar to other contracts, so generally you will see that effect, but what I would say and add to that is I wouldn't expect that to have a huge impact on the overall numbers, because we don't have a large amount of capacity to sell. It's significant and it's important to us, but it's not going to move the needle in terms of gross revenues that much.

Riken Gopani
The other question that I had was particularly on the working capital cycle. If I look at the receivables particularly, there has been a faster growth there compared to the revenues. If you could basically outline any particular takeaways on the receivables cycle or a reason why it has been extended during the current year.

Steve Ridlington
Well, first of all, no concerns, that's the first thing to say. The working capital level is higher, as you say, but it's timing and I think we've said on previous calls that we do have to work a little harder to collect our money. There are timing delays of payments, days and weeks rather than months and years I would stress, and indeed most of the increase in receivables that you saw compared to the end of last year were collected in January, so if we were to look at that number today, it would look lower. I would think about this as just the normal ups and downs of working capital and nothing beyond that. There is no systemic issue. We're providing an essential service to customers. It's critical, it's an operating cost for them, and they generally pay because they need the service.

Riken Gopani
One last thing I wanted to understand is from your presentation I understand that now there are two management positions where Engie also is there in the company plus at the board level. Now that they are in the company for some time, if you could highlight any particular strategy towards or anything either on cost efficiencies or new business opportunities that

can arise over the slightly medium-term, because of the engagement and the management roles that they play in the company?

Jasim Thabet
Like you mentioned, Engie joined us as a major shareholder, owning 40% of the company towards third quarter last year, and with that, there's certain board representation and they've filled two executive management slots. We are expecting that having a global energy leader such as Engie will lead to synergies and benefits to the company in terms of operational efficiencies and growth. I think Engie will open the door to opportunities to grow with Tabreed outside the GCC. So growth and synergies are potential upsides. In terms of timing, the new executive management have only been with us for a couple of months, so it's really hard to give you a number on that early in this stage.

Operator
Our next question comes from Metehan Mete, Waha Capital. Please go ahead.

Metehan Mete
My first question is on the… it sounds like you recently announced agreements with Masdar I think it was you were going to manage a cooling plant there, and in the new statement you talked about possibilities there to add up to 100,000 refrigerated tons of capacity. If there is such a possibility, will this be like, again, a managed cooling plant or will it be owned and operated by Tabreed in the future? Is it in any way captured into this 65,000 refrigerated tons addition forecast for 2018 and 2019? That's my first question. My second question is what's your outlook on the margins going forward? Do we expect any positive or negative surprises for 2018 with the addition of the VAT?

Jasim Thabet
As you rightly mentioned, we signed an O&M (operation and maintenance) agreement to provide services to the cooling plant providing cooling to the Masdar City in Abu Dhabi. That is a secondary business for Tabreed. It was a plant we did not build or own and Masdar has ambitious plans to grow the city, and with the growth of the city they would be acquiring additional infrastructure and an additional district cooling. So far, our 65,000 tons guidance does not include anything specifically for Masdar. But I think it's also important to mention that Masdar is a key energy player in the region and we work closely with Masdar and the Masdar's Institute of Science and Technology to look at new technologies and also R&D to see how we improve our efficiencies. Operating a plant for Masdar potentially could open doors to something much bigger with Masdar. On the margins, Steve?

Steve Ridlington
I think you had two questions, Metehan, one about EBITDA margins outlook and one about VAT. First of all, margin outlook, you've seen that we've been consistently around the 45-46% level for some time and I think we should expect that to continue. It may deviate up

and down depending on the mix of different types of revenue, a little bit from year-to-year, but overall we'd expect the level to be broadly stable, so I don't think you should expect any surprises in that. You won't see any surprises from VAT impacting margins either. We will be subject to VAT at a 5% VAT rate. We will charge 5% VAT to our customers on their invoices and we will pay 5% VAT to our suppliers when we pay them, and that will give rise to a net amount of VAT which will be paid over to the federal tax authorities. For us, it should be largely neutral and no impact on our margins.

Metehan Mete
Also, the 65,000 refrigerated ton additional plan, I guess most of them will be in associates and JVs rather than the consolidated business.

Jasim Thabet
No, the split for the 65,000 RTs over the next two years is 50/50, so 50% at a consolidated level and 50% at the JV and associate level.

Operator
Our next question comes from Imad Chukrallah, Al Mal capital partners. Please go ahead.

Question
This is Imad Chukrallah from Al Mal Capital Partners. I have two small questions. One is a bit related to the VAT that was just asked. How much do you expect average prices to go up by for your customers, like what you charge to your customers, given that a lot of it is linked to the CPI, which gets impacted by VAT across the region? Do you expect a much higher increase this year, the price increase that you will charge your customers irrespective of the pass-through VAT? That's the first question. The second one is we saw in the news the transaction of Emicool and DIC a couple of weeks back and I was just curious to get your view on it given that it seems it was conducted at around the 1.4 times book. Any view just on pricing and just if you were interested in that asset or not.

Jasim Thabet
I will start with the second question on the Emicool and DI. The Emicool transaction was something that was between two existing shareholders where UPI sold its 50% stake to DI and Tabreed has no part in that. In terms of valuations, that is a matter for DI and UP. Nevertheless, as a company we're always looking for opportunities to grow. Earlier in 2017 we acquired the Nation Towers cooling plant in Abu Dhabi and we continue to look for opportunities to grow. On the first question, our prices have gone up to reflect 5% VAT. The total capacity and consumption revenue has gone up 5%. With regards to CPI, the majority of our customers' capacity component will be increased in line with the CPI that is announced by the UAE.

Question
Sorry, so just to clarify, it's not that… so a customer who has a connected capacity right now, he would have an increase which is linked to CPI, which this year probably will be higher than previous years, given that CPI is going to be higher in general, and then on top of it there is that, that is not the case or it's only the increase and there's no VAT on top of the increase.

Jasim Thabet
So, a customer is going to pay a 5% increase for VAT on the total charges that Tabreed is invoicing, regardless of what CPI is. In addition, for the majority of our contracts, the capacity component escalates with the CPI.

Operator
[No further questions]

Saket Somani
Thank you for joining us for the full year earnings call. This concludes our 2017 earnings call. We will be attending multiple investor events during the rest of the year and we look forward to meeting you then. You can find further details on the last slide of the presentation and should you have any further questions, please don't hesitate to contact us. We have our contact details on the presentation. Have a great day and goodbye.

Note: This transcript has been edited to improve readability

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