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

First Quarter 2019
Earnings Conference Call Transcript

2 May 2019

Tabreed Participants:

Bader Al Lamki, Chief Executive Officer
Stephen Ridlington, Chief Financial Officer
Richard Rose, Vice President – Finance
Souad Jamal AlSerkal, Vice President – Corporate Communications

Presentation

Operator
Ladies and gentlemen, welcome to Tabreed First Quarter 2019 Earnings Conference Call.

I will now hand you over to Ms Souad Jamal Al Serkal. Please go ahead.

Souad Jamal Al Serkal
Hello, and welcome. On behalf of Tabreed Management Team, I would like to welcome you all and thank you for joining us for the first quarter 2019 results conference call.

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

I would now request you to turn to slide three for today's agenda.

On today's call we have with us, Bader Al Lamki – our new CEO, Steve – our CFO and Richard – VP, Finance.

Steve will first provide an overview of the first quarter 2019 performance and key events. Following that, Richard will discuss the financial performance in more detail. Steve will then conclude the presentation, and we will open the lines for your questions.

Before we begin the presentation, I would like to hand over to Bader for a few opening remarks. Thank you, and over to you Bader.

Bader Al Lamki
Thank you, Souad. Thank you, everyone for joining us today. This is the first time I am speaking to you all. As you are aware, I have joined Tabreed as the CEO recently. Prior to joining Tabreed, I spent more than 20 years in the energy sector, transitioning from working with the National Oil Company, ADNOC, to my most recent job with Masdar, where I led their renewable energy portfolio and supported Masdar to grow that portfolio to nearly four gigawatts across the globe and across 25 countries.

Let me start by saying I am very proud and excited to be taking this new position and it is certainly an exciting challenge and I look forward to contributing to growing this business. I am joining a high-performing company that has posted consistently strong results in recent years. These results for the first quarter represent a continuation of that trend, and soon we will hear the details from Steve and his team.

Together with the rest of the management team and all the staff at Tabreed, I look forward to driving shareholders' value through growth in our core GCC markets and selectively pursuing opportunities outside the GCC.

I look forward to interacting with you all in the near future. I would now like to hand over to Steve to walk us through the first quarter financial results.

Stephen Ridlington
Thank you, Bader, and thank you, everybody, for joining us today, and welcome to the first quarter results call.

As always, we will begin with the highlights for the first quarter on slide five. The key points are revenues for first quarter grew by 8.1% year-on-year and that was led by a 6.7% increase in chilled water revenues and a 31% increase in value chain business revenues.

During the same period, EBITDA growth was 14.5%, and as a result, our EBITDA margins expanded from 54% in the first quarter of 2018 to 57% in the first quarter of 2019. Net income growth during Q1 was 2.9%, with lower joint venture and associate results in part offsetting growth in chilled water.

Connected capacity additions during the first quarter were 3,000 RTs all attributable to consolidated entities. Despite the limited capacity additions in the first quarter, we remain confident of achieving our target of delivering 65,000 tons of new capacity over 2019 and 2020.

As you are aware, during the first quarter, we signed our first concession agreement in India to provide 20,000 tons of cooling capacity at the new Andhra Pradesh capital city, Amaravati. This is a significant step for Tabreed to penetrate one of the world's biggest and fastest-growing markets. We will, of course, keep you posted on all the developments with our first India project.

Turning to slide six, Tabreed at a glance, which 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 our positive environmental footprint. We currently operate 74 plants across the region, delivering over 1.1 million refrigerated tons of cooling. Our operations saved around 2 billion kilowatt hours of energy consumption in 2019, enough to power 112,000 homes for a year and equivalent to reducing about a million tons of CO_2 emissions.

Moving on to the next slide. Tabreed is the only public traded and regional district cooling company in the world. The UAE is our base of operations where we have a presence in six Emirates providing 776,000 tons of cooling to our customers through 63 plants. In addition to the UAE, we work with key strategic partners in four other GCC countries. We have a total of 11 plants outside of the UAE, providing over 358,000 tons of cooling to customers. Around two-thirds of our capacity is consolidated while the rest is equity accounted in associates and joint ventures.

Moving on, slide eight shows the usual summary of connected capacity. This shows the capacity growth trends across the region. At the beginning of 2019, we announced that we expected to add at least 65,000 tons of new connected capacity during 2019 and 2020. During the first quarter of 2019, we added 3,000 refrigerated tons, all in our consolidated entities in the UAE. We expect the majority of capacity additions this year to occur during the second half of 2019, so the second quarter of 2019 may also show limited capacity additions. However, we remain confident of achieving our guidance of 65,000 tons by 2020.

Tabreed continues to demonstrate its ability to deliver a steady increase in connected capacity in the region driven by the growth in our key markets across the GCC and by successfully leveraging our regional network to take advantage of commercial opportunities as and when they present themselves.

Moving on to the slide 9, headline performance. This recaps 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 flow.

We currently have 90% of our capacity contracted for at least the next 10 years. About 70% of our revenues are derived from fully Government-owned and partly Government-owned organizations, thereby limiting counterparty risks.

Tabreed has a track record of delivering profitable growth. Net income and EBITDA have increased by 8% and 11% per year, respectively, since 2016. Our first concession agreement in India is a significant step towards penetrating one of the world's biggest and fastest growing markets.

I will now hand over to Richard to talk about our financial results in more detail.

Richard Rose
Thank you, Steve. Let me start by highlighting the key points on our income statement for Q1 in 2019.

Tabreed recorded overall revenue growth of 8.1% with chilled water revenue increasing by 6.7%. The main factors driving chilled water revenue growth were the acquisition and consolidation of S&T in Q1 2018, which accounted for 4% of the growth. and CPI indexation on our capacity revenues which added about 2%. Revenues for the value chain businesses increased by 31%.

Tabreed's share of results from associates and JVs declined by 6 million or 28.7% on prior year mainly due to a number of factors. First, a AED 2 million reduction from Saudi Tabreed, reflecting 5% dilution of Tabreed’s share of the entity and lower one-off development income. Second, the impact of IFRS 16 reduced the contribution from Qatar Cool by AED 1 million, and third, the impact of S&T moving from JV treatment to full consolidation, also impacted by about AED 1 million.
The increase in finance cost was due to the implementation of IFRS 16, which I will discuss in more detail shortly. EBITDA margins were higher due to the implementation of IFRS 16 which, again, I will discuss further on a forthcoming slide.

The next slide shows the statement of financial position. Significant movements in fixed assets, equity and reserves and debt at the 31st March were largely due to IFRS 16. Other highlights were the receivables, which decreased compared to December 2018, reflecting better cash collection and compared to March 2018, outstanding receivables were down 2%. The movement in other liabilities was due to the dividend payable, which was subsequently paid on 2nd April 2019.

Turning to the next slide, we will now take a look at the statement of cash flow. Tabreed continues to generate strong cash flows, which have been utilised to invest in growth and provide dividend returns to our shareholders. Operating cash flow was strong at AED 238 million, an increase of 39% compared to Q1 2018 reflecting higher profitability and an improved working capital position. There was very little capital expenditure during Q1 2019.

Total debt service payments in Q1 2019 were similar to the same period last year. Our cash generating ability remains robust, driven by long-term price-certain contracts continuing to enable investment and growth.

Let me now turn to the slide on the impact of IFRS 16 adoption on Tabreed’s financials. As you're aware, the new accounting standard on leases, IFRS 16, was effective from January 2019 and is applicable to both operating as well as finance leases. Let me take a moment to highlight the key points on how this new standard impacts our results for Q1 2019.

Operating lease assets were previously not capitalised, and lease payments by Tabreed were recorded as part of operating expenses. IFRS 16 now requires these right-of-use assets to be capitalised along with the corresponding lease liability. This results in an increase in fixed assets of AED 223 million and an increase in lease liabilities of AED 308 million.

Within the income statement, lease payments were replaced with depreciation and finance charges relating to the lease liability. There is no change in the cash outflow for the group, however. For Tabreed, this results in a reclassification of operating expenses of AED 11.8 million into depreciation of AED 6.9 million and finance costs of AED 4.2 million.

It is important to note that this reclassification of expenses increased reported EBITDA as lease payments were above the EBITDA line but depreciation and finance costs are below. This change has increased the Q1 2019 EBITDA margin by 3%. Excluding the impact of IFRS 16, our EBITDA margin for Q1 2019 would have been in line with Q1 2018.

For finance leases, IFRS 16 requires the inclusion of contractual CPI, which increases the finance lease receivable and has a minimal impact on the income statement.

We will now look at the debt portfolio on the next slide. This slide provides the usual background of Tabreed’s debt portfolio as of March 2019.

Key points to note are that Tabreed has AED 3 billion of gross debt and a gearing ratio of 41%. However, it is important to note that IFRS 16 has increased reported debt by AED 300 million and net debt to EBITDA by 0.4 times. Excluding the impact of IFRS 16, both net debt and net debt to EBITDA are lower than the prior year.

Following the refinancing of our corporate debt with a seven-year Sukuk and new corporate loans, we have relatively light scheduled repayments until 2025, when the Sukuk becomes due. Net debt and net debt to EBITDA have declined since 2016, as debt has been repaid and EBITDA has grown. Our return on capital employed and return on equity has also improved since 2016 due to rising profitability.

That completes the detailed review of the Q1 2019 results, and I will now pass back to Steve to conclude.

Stephen Ridlington

Thank you, Richard. Before we open the lines for Q&A, let me make a few closing comments.

As a stable utility business model, Tabreed continues to develop strong financial and operating performance with rising profitability, stable margins, and robust cash flows. While we've had a slow start to the year, we are confident of achieving our capacity guidance targets for 2019 and 2020.

Tabreed has a flexible capital structure to fund future growth. As we have mentioned before, we will look at opportunities within and beyond the GCC and will provide you with updates as and when such opportunities materialise. In line with this strategy, we announced our entry into India, one of the biggest and fastest growing markets.

Today, Tabreed is stronger than ever before. We have a stronger shareholder base and a management team with significant industry experience. We are working on various fronts, from business development to operations, to help drive growth and improve profitability.

Souad Jamal Al Serkal
Thank you for joining us for our Q1 2019 earnings call. We will now take any questions you may have.

Question and Answer Session

Operator
We have a question from Michel Said from CI Capital. Please go ahead.

Michel Said
I have a couple of questions. The first one regarding the revenues. The 8% growth we witnessed in Q1 2019, I want to understand how much out of 8% is due to the increase in CPI? And what should we expect going forward as the S&T acquisition has been completed

in Q1 2018? I understand that part of the 8% is S&T, but going forward, this should be normalised, so what will be the additional capacity we'll be expecting? If I understand well, we are waiting for an addition 20,000-25,000 tons of RTs until the end of 2019, so how should this be reflect on the growth on the top line for the next three quarters?

My next question will be regarding the EBITDA. Can you just give us more light on impact of the IFRS 16 when it comes to the EBITDA level? That is all from my side.

Richard Rose
Thanks for the question. With regards to the revenue, 2% of the increase in revenue is due to CPI indexation, and 4% is the increase in revenues due to the impact of consolidation of S&T Cool. The guidance that we gave of 65,000 RTs is over the next two years.. WWe've added 3,000 RTs in Q1. We see most of the new capacity additions this year happening in the second half of the year rather than the first 2 quarters. However we are confident significant we will deliver the 65,000 over the two years as we've guided.

With regard to the EBITDA, the impact of IFRS 16 is as you see in the financials. So EBITDA would be in line with the same quarter of last year if we didn't have the impact of IFRS 16, so it's causing about a 3% increase in EBITDA margins.

Michel Said
So just to understand, so you'll be having the same EBITDA margin when comparing to 1Q '18. However, you'll be still having like 12% increase on EBITDA on absolute terms?

Richard Rose
Yes, that's about right, so the margin will basically look the same as Q1 2018 but obviously an increase at the absolute level of EBITDA, as you suggested.

Michel Said
Yes. Okay, perfect, so the 65,000, it's not equally spread over 2019 and 2020, and we could have less than 20,000 RTs coming in 2019?

Stephen Ridlington
We cannot give you a profile for the 65,000 tons in terms of quarterly and annual figures. That's very difficult to do, because the specific timing is hard to predict so we commit to 65,000 over the two years. We are also saying that of the capacity to be delivered this year, more will be in the second half of the year.

Operator
Our next question comes from Vishal Baghwan from Abu Dhabi Capital. Please go ahead.

Vishal Baghwan

I had a question on the receivables. Given that we have seen AED 19 million worth of reduction in receivables, could you give us some colour in terms of which are the key accounts from where we saw better collection, and what kind of trends do we expect for the remainder of 2019?

Stephen Ridlington

Well, I think the first thing to say about 2019 first quarter is that we've had pretty strong collections across the board, and that's really been a feature for some time now. We don't give details of specific customers. What I can tell you is that for one of our largest customers, there was a timing delay in collections in the first quarter of 2018 that didn't reoccur in 2019. It was all paid in accordance with contracts, so it was just one customer for which that year-on-year comparison makes that look a little better. We can't predict the rest of the year, but what I can tell you is that it's a key focus area for us to collect money from our customers and I think the result that you've seen in the last year or two demonstrate the strong collections record, so we'll work to make sure that continues.

Operator

Our next question comes from Rakesh Tripathi from Franklin Templeton. Please go ahead.

Rakesh Tripathi

I had a question around the new project that you've announced in India, so what is the kind of the CapEx that can be expected for this project, and what's the time line that we are looking at over which this is likely to be done, and when would this capacity come on board?

Stephen Ridlington

We signed a concession for 20,000 tons of cooling with the capital city, Amaravati. We announced at the time that the first stage of the project is for 5,000 tons, which is due to come online in 2021, so it's outside our capacity guidance. We're going to be building a plant for 5,000 tons and a network for 20,000. The capital cost of that is yet to be finalized, but it will be in line with the guidance that we usually give for CapEx per ton. So if you use the figures that we quote, which are in the range of AED 7,000 to AED 10,000 a ton, you can get a reasonable understanding of what the cost will be. As I say, the project is in early stages, with preparatory work ongoing and we're on track. However we haven't yet finalized all of the details so we can't share more information at this point in time.

Rakesh Tripathi

Okay and I'm assuming the kind of payments that you received, that's also in the finalisation process. I mean, I understand you can't give numbers naturally, but will it be more in line with the general per RT amount that you make on other typical projects?

Stephen Ridlington
If you're talking about the payments meaning revenues we're going to receive from the customer, yes, it's exactly the same kind of contract structure we have with our GCC customers in terms of capacity payments and consumption payments.

Operator
Our next question comes from Ambereen Jiwani from Ajeej Capital. Please go ahead.

Ambereen Jiwani
I'd like to know what the plans are given there's a new CEO now, and if you could share any information on how… what would be the strategy to take the company forward, and if there's any change in strategy that we should be hoping for?

Stephen Ridlington
There's no change in strategy. I think our strategy has been very clear for some time now. We're very focused on our district cooling business. We know the markets that we want to operate in. We're active in five markets today through a series of wholly owned and joint venture companies, so you can expect us to continue to focus on the five GCC markets we're in today. At the time of the ENGIE acquisition of shares in Tabreed, we announced that we would look beyond the GCC, but on a very selective basis. We said we would look at Egypt. We are looking at Egypt and continue to look at Egypt. We're active in India as you already know, and that is definitely a business we want to build going forward, and we will add potentially other markets in the region if we see the right type of opportunities. But the right type of opportunities means the type of opportunities that we're doing here in our existing markets, so focus on district cooling, ownership of plants, long-term offtake contracts. Exactly the same structure that you see today and with an increasing focus on growth. I think I would say that, that we want to grow the company more rapidly, and we're all working hard towards that, and as Bader said in his introductory remarks, it's going to continue to be a key focus.

Ambereen Jiwani
Sure, so the growth will be confined to district cooling and you guys are not looking to get into other areas in the same energy space?

Stephen Ridlington
We do operate in other areas of cooling. We're quite active in secondary side management of buildings, so we will potentially look at expanding more in those areas, but district cooling will continue to be the main focus. they

Operator
We have a question from Yawar Saeed from SHUAA capital. Please go ahead.

Yawar Saeed
I just want to know about the negative balances in other comprehensive income of 2, 3, and AED 7 million, which were like AED 12 million and AED 8 million positive the same quarter last year, which has led to a significant drop in total comprehensive income from AED 100 to 70 million. Can you shed some light on it?

Stephen Ridlington
The reason for the change in other comprehensive income is because Tabreed had a number of interest rate swap hedges last year some of which were unwinded after Sukuk issuance. In Q1 2019, the hedges are currently negative (i.e. swap rates higher than EIBOR forward curve) resulting in MTM losses in OCI. Interest rate swaps are initiated to fix our exposure to floating rates and reduce income statement volatility. In some cases, where we have project financing, they are a requirement of that financing. Following the sukuk issuance, all IR swaps held in relation to the refinanced debt were unwound in 2018. Currently we have no IR swaps in place at the Tabreed holdco level, but there are swaps in place in subsidiaries which are project financed and in some of our Associates and JV's.

The movements on the mark to market are shown in OCI for all these IR swaps. These movements have no impact on the Income Statement or cashflow. For the subsidiaries, the opposite entry impacts Liabilities in the balance sheet. For Associate & JV's the opposite entry impacts our investments on the balance sheet. Going forward, if EIBOR falls further then the impact would be shown in OCI, as you suggest. However, this would continue to have no impact on the Income Statement or cashflow.

As the debt is paid down over time, the value of the swap will decline and the OCI impact will become smaller and smaller. For any given IR Swap held to maturity, the cumulative impact in Equity and the Balance Sheet will be nil, over the life of the instrument.

Operator
We have a follow-up question from Vishal Baghwan from Abu Dhabi Capital Group. Please go ahead.

Vishal Baghwan
I have two questions. Firstly, what are the contracts that are coming up for renewal in the next two years for 2019 and '20, and do you see any risk in terms of pricing of these contracts?
The second question, I basically wanted to understand the trends and your views on how do you see the consumption volume growth and occupancy of your existing plants portfolio? Do you see an improvement that is happening for these plants?

Stephen Ridlington
First of all, there aren't any contracts maturing over the next two years - we have nothing that's maturing over 2019 and 2020. I think we've included in our corporate presentations on the website, a profile of contract maturities, and essentially over 90% of what we have today we will still have in 10 years' time, so there's a high degree of stickiness. OI should add that one of our key objectives is to make sure that we extend contracts well before they mature, so that even that 10% decline in contracted capacity we see in the next 10 years does not happen.

In terms of consumption volumes, they're running overall a little bit above last year, so we're not seeing any major shift in consumption volumes so far this year. The weather was a little cooler in February/March, but that had a pretty insignificant effect. It's also worth remembering that our business is relatively immune to consumption volumes, because over 85% of our EBITDA margin comes from our capacity charges.

Souad Jamal Al Serkal
This concludes our Q1 2019 earnings call. Tabreed looks forward to interacting with you at our earnings conference call and investor conferences. Should you have any further questions, please do not hesitate to contact us. Have a great day and thank you once again for joining this call.

Note: This transcript has been edited to improve readability

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