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

First Half 2019
Earnings Conference Call Transcript

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Tabreed Participants:

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 Second Quarter 2019 Earnings Call. Today's speakers are Mr. Steve Ridlington, CFO; and Mr. Richard Rose, VP Finance. I hand over to your host, Ms. Souad Jamal AlSerkal. Madam, please go ahead.

Souad Jamal Al Serkal
On behalf of Tabreed management team, I welcome you all and thank you for joining us for the first half 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 two of the presentation for the detailed disclaimer.

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

On today's call, we have with us Steve Ridlington, CFO, and Richard Rose, VP of Finance. Steve will first provide an overview of the first half 2019 performance and key events. Following that, Richard will discuss the finance and financial performance in more detail. Steve will then conclude the presentation, and we will open the lines for your questions. Thank you, and over to you, Steve.

Stephen John Ridlington
Thank you, Souad, and good afternoon, everybody. Nice to talk to you again on the occasion of our first half results.

Let me begin with slide five, the performance highlights. Overall, first half 2019 revenues grew 3.3% year-on-year, led by 2.8% increase in chilled water revenues and 12.3% increase in value chain business revenues.

During the same period, EBITDA growth was 12.2%, and as a result, our EBITDA margins expanded from 50% in the first half of 2018 to 54% in the first half of 2019. IFRS 16 implementation had a favourable impact of 3% on EBITDA margins. Adjusted for that, the margin would have been 51% in the first half of 2019 compared to 50% in the first half of 2018. Richard will discuss the impact of IFRS 16 in more detail later.

Underlying net income increased by 11% compared to the first half of 2018, when last year's net income is adjusted for the profit on partial disposal of Saudi Tabreed. Excluding this adjustment, reported net income declined by 6%.

Total capacity additions during the first half of 2019 was 14,500 refrigerated tons, all attributable to consolidated entities. With our fifth plant in Oman becoming operational, our total number of plants across the GCC reached 75. We remain positive about our outlook, and I am confident of achieving our target of delivering 65,000 refrigerated tons of new capacity over 2019 and 2020.

Turning next to slide six, Tabreed at a glance. 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 our positive environmental footprint. We currently operate 75 plants across the region, delivering about 1.15 million refrigerated tons of cooling. Our operations saved around 2 billion kilowatt hours of energy consumption in 2018, enough to power 112,000 homes for a year and equivalent to reducing about 1 million tons of CO_2 emissions.

Moving on to slide seven. 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 779,000 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 12 plants outside of the UAE, providing 367,000 tons of cooling to customers.

During the quarter, we connected a new plant at the Mall of Muscat in Oman. This took our total number of plants to 75. Around two-thirds of our capacity is consolidated, while the rest is equity accounted as associates or joint ventures.

Moving on to slide eight. This slide outlines our capacity growth trends across the region. At the beginning of 2019, we announced that we expect to add at least 65,000 refrigerated tons of new connected capacity during 2019 and 2020.

During the second quarter of 2019, we added 11,500 tons of capacity at our consolidated entities in the UAE and Oman. This takes our total capacity addition in the first half of 2019 to 14,500 tons. As I mentioned before, we remain confident of achieving our guidance of 65,000 tons by the end of 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 successfully leveraging our regional network to take advantage of commercial opportunities as and when they arise.

Moving on to the next slide, slide nine, headline performance. This slide 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 on 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, limiting counterparty credit risk. Tabreed has a track record of delivering profitable growth. Net income and EBITDA have increased by 8% and 10% per year, respectively, since 2016.

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

Richard Rose

Thank you, Steve. Turning to slide 11. Let me start by highlighting the key points on our income statement for the first half of 2019.

Tabreed recorded overall revenue growth of 3.3% with chilled water revenue increasing by 2.8%. The main factors driving chilled water revenue growth were the CPI indexation on our capacity revenues, which added 1.4%; new capacity additions in the UAE accounted for 0.4%; and the acquisition and consolidation of S&T Cool in Q1 2018 made up the balance.

Revenues for our value chain businesses increased by 12% mainly driven by improving order book for our EPPI piping business.

IFRS 16 implementation resulted in reclassification of operating expenses in the first half of 2019 into depreciation of AED 14 million and finance costs of AED 8 million. Both depreciation and finance costs do not form part of the EBITDA, resulting in a 3% higher EBITDA margin in the first half of 2019. Adjusting for this, EBITDA margins would have been 51%, which is in line with last year. Other gains last year included the AED 32.6 million gain arising from the dilution of our stake in Saudi Tabreed.

The share of results from associates and joint ventures declined by AED 6 million in the first half of the year or 12.6%, mainly due to a 5 million reduction from Saudi Tabreed, reflecting the dilution of 5% of Tabreed’s share of the JV and also lower one-off development income.

Net income adjusted for one-time gains on the partial disposal of Saudi Tabreed in the first half of 2018 would have grown by 11%.

I will now turn to slide 12, the statement of financial position. Significant movements in the balance sheet as at the 30th of June 2019, compared to the end of 2018 were primarily due to the implementation of IFRS 16. This increased fixed assets, following the capitalisation of operating leased assets and also increased debt due to the recognition of operating lease liabilities.

Receivables in June normally show an increase compared to the year-end due to the higher consumption billings in the warmer months in the summer. We also had some short-term delays in collections. However, these were largely rectified in July, and compared to June 2018, receivables were down 2%.

Turning to the next slide. Slide 13 summarises the statement of cash flows, and it shows that Tabreed continues to generate strong cash flows, which are being utilised to invest in growth and provide dividend returns to our shareholders. Operating cash flow was strong at AED 349 million, an increase of 24% compared to the first half of 2018, reflecting a higher profitability and an improved working capital position. There was very little capital expenditure during the first half of the year.

Variance in debt service payments in the first half of 2019 were due to a higher drawdown from the revolving credit facility in the first half of 2018. Our cash-generating ability remains robust driven by the long-term price-certain contracts, which enable investment in future growth.

I'll now turn to the slide on debt portfolio, slide 14. This slide provides the usual background on Tabreed's debt portfolio as at the 30th of June 2019. Key points to note are: Tabreed has AED 3 billion of net debt and a gearing ratio of 41%. However, it is important to note that IFRS 16 has increased reported debt by AED 290 million and net debt-to-EBITDA by 0.3 times. Excluding the impact of this accounting treatment, IFRS 16, both net debt and net debt-to-EBITDA are lower than the previous 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.

That completes the detailed review of the first half 2019 results. I'll now pass back to Steve to conclude.

Stephen John Ridlington
Turning to slide 16, before we open the lines for Q&A, a few closing comments.

As a stable utility business model, Tabreed continues to deliver strong financial and operating performance with rising profitability, stable margins and robust cash flow. We have added 14,500 refrigerated tons at our consolidated entities during the first half of 2019, and 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 we will provide you with updates as and when such opportunities materialise. In line with this strategy, in the first quarter of 2019, we announced our entry into India, one of the biggest and fastest-growing markets.

Today, Tabreed is stronger than ever before. We have a strong 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.

With that, I'll hand you back to Souad. Thank you.

Souad Jamal Al Serkal
Thank you for joining us for our H1 2019 earnings call. We will now take any questions you may have.

Question and Answer Session

Operator
Our first question comes from Michel Said from CI Capital. Please go ahead

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Michel Said
I have a couple of questions. The first one is more on the business itself. I would like to understand what's the difference between a plant, let's say, cooling plant that will cost you, per RT, AED 5,000 and another that can cost up to AED 15,000? I understand that your guidance has been always to build a plant with an average price of AED 10,000 per RT. But looking to other plants in UAE and in the region, I have seen that prices have been ranging between AED 5-15,000. So, if you can help me just understand the difference in business model.

The second question would be regarding the CPI in Abu Dhabi and UAE. Recently, you've been going through deflation. So, I'd like to understand what will be the impact on the revenue per RT for 2020. If you will be adjusting on negative inflation. I understand that it's like 70% of the inflation that you adjust in the year after for revenue. But in case when it's negative, it's the same rule applies or there is a different rule?

Stephen John Ridlington
Thank you, Michel, for those good questions. First one on the CapEx cost per ton. You're right, historically, the range is quite large, as you say, from potentially AED 5,000 to 15,000 per tons. There are a number of reasons why we have a variation in cost. One very important reason is the size of the plant and the size of the network. The longer the network, the higher the cost. That's one of the primary reasons. And second, some of the plants need to be designed and built to a specification of the real estate developer, which can also increase the cost.

But I don't think we are looking at numbers over AED 15,000 going forward. Our cost to build has been coming down over time. It's currently in the range AED 7,000-10,000 a ton. I think that's the kind of figure that you should be using going forward. Certainly not figures up over AED 10,000 a ton. We're not building at that cost anymore. So, I think the guidance that you've been given is the guidance that you should run with.

In terms of the CPI impact on 2020, yes, you're right. There are indications of lower CPI growth than historically. If the number does turn out to be negative, we will clearly not be seeing growth in revenues in 2020. Exactly what the impact will be is something that we'll have to look at. Some of the contracts that we have are not clear on what the mechanism is, in particular, whether a deflation number would be passed on in terms of lower revenues. That's something we'd have to look at on a contract-by-contract basis. I think there's not much more we can say on that point at this point in time.

Michel Said
And if I may add a last question regarding IFRS 16. When modelling the finance lease receivables, my understanding is that IFRS 16 was more about operating leases, and what you saw in your presentation for the 1Q, how is that impacting, for the operating expenses being below the EBITDA. So now when it comes to finance lease receivables that we have seen that the financial lease income is going down as well. So, is this more a change of the maturity of the contract? Or it's more about the discount rate you are using? And if we'll be seeing more change every year, when you'll be working your finance lease numbers with the new updated CPI figure? I know it's a bit technical question, but just to understand the impact.

Richard Rose
There's quite a significant impact in the financials arising from the accounting under IFRS 16. There are changes to the finance leases and what should be included in the finance lease models under the previous accounting standard and what should be included in this standard, as well as the changes that you mentioned for operating leases.

However, I do not propose to go through the detail of IFRS 16 accounting on this call. We can take that off-line and discuss that in more detail if you'd like to do so. I think it's a bit too technical for this call.

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

Rakesh Tripathi
I had a few questions. The first one was regarding the CapEx, so far, in H1. So, you've had around close to 15,000 RT of capacity addition in the first half. The CapEx so far has been well below your full year guidance of around about AED 200 million. How do you see the CapEx turning out for the year?

The second one is, could you clarify a bit on the available RCF at this time, and what is the expiration date for the facility?

The last one is, looking at your Q2 revenues breakdown, the chilled water revenues have not shown growth in Q2 year-on-year. So, was this due to relatively lower consumption charges, assuming that the CPI adjustment would, of course, be built into these revenues as well?

Stephen John Ridlington
I'll answer 1 and 3, and I'll ask Richard to handle question two. So, first of all, question one on CapEx. I think we've guided within the 65,000 tons CapEx levels of around AED 100 million to AED 150 million per year, which has been broadly in line with previous years. So, I don't think we're seeing AED 200 million as a number for either 2019 or 2020 based on the 65,000

tons that we've announced. What I would also add is that quite a lot of the capacity additions in the first half of the year are connections to existing plants. There is one new plant but that was largely built before this year started, but as you know, new connections to existing plants have low CapEx, so a fairly low figure, for the first half, but within that overall AED 100 million to AED 150 million per year.

In terms of Q2 revenues, I think the primary driver there has been lower volumes than we experienced in the first half of 2018. Richard, do you want to take the question on the RCF?

Richard Rose
Yes, so just in terms of available capacity on the RCF. The RCF is an AED 590 million facility, which is available to us. So far, in the first half of the year, we've utilized AED 65 million of that. So, we still have in excess of AED 500 million available to us. And in terms of tenure, that's a five-year facility, that was put in place towards the end of last year.

Souad Jamal Al Serkal
That concludes our H1 2019 earning call. We look forward to interacting with you at our earning conference calls 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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