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

Q3 and Nine Months 2020
Earnings Conference Call Transcript

12 November 2020

Tabreed Participants:

Adel Salem Al Wahedi, Chief Financial Officer
Richard Rose, Senior Vice President – Finance
Souad Jamal AlSerkal, Vice President – Strategic Communications

Presentation

Operator

Ladies and gentlemen, welcome to Tabreed's Third Quarter 2020 Earnings Call. I hand over the call to your host, Ms. Souad Jamal Al Serkal, Vice President, Strategic Communications. Madam, please go ahead.

Souad Al Serkal

Hello again. My name is Souad Jamal Al Serkal, Vice President of Strategic Communications here at Tabreed. On behalf of Tabreed management team, I would like to welcome you all and thank you for joining us for the third quarter 2020 result conference call. Hope you're all keeping safe and healthy. Given that we are all working remotely, kindly excuse us for any technical issues on the 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 risk and uncertainties. Kindly refer to slide 2 of the presentation the detailed disclaimer. I would now request you to turn to slide 3 for today's agenda.

On today's call we have Mr. Adel Salem Al Wahedi, Chief Financial Officer, and Richard Rose, Senior Vice President of Finance. Adel will first provide an overview of the third quarter 2020 performance and key events. Following that, Richard will discuss the financial performance in more detail. Adel will then conclude the presentation, and we will open the line for questions. Thank you and over to you, Adel.

Adel Al Wahedi

Thank you, Souad, and thank you everyone for joining us today. I would like to begin by highlighting our nine months of current year 2020 performance. Chilled water business grew by 13.6%, and total revenue grew by 11.5%. During the same period, EBITDA growth was 20%, and as a result, our EBITDA margin expanded from 50% to 54% for the same period. Net profit during the nine months increased by 12.6%, and the margin remained flat at 29%.

On an organic basis, connected capacity addition during the nine months was 23,000RT. We remain positive about our outlook and confident of achieving our target, delivering 75,000RT of new capacity over 2020 and 2021.

In October 2020, we successfully raised $500 million with a seven-year 2.5% coupon bond issuance. The initial issue of $400 million was oversubscribed by almost five times, demonstrating strong investor confidence in Tabreed's solid credit fundamentals.

Despite the current global economic uncertainty, the seven-year bond was particularly well received by international investors, who accounted for 90% of the final geographical allocation, with 49% from Europe, 21% from Asia, and 20% from offshore US funds. The bond will be listed on the London Stock Exchange, alongside Tabreed existing 2025 Sukuk.

During the quarter, we also closed a syndication of $692 million loan successfully, which was pre-funded by HSBC Middle East.

Going to the next slide, please. Tabreed is contributing to the region's growth through efficient and environmentally friendly cooling, enabling sustainable development as our business grows. So that's our positive environmental footprint.

We currently operate 83 plants across the region, delivering about 1.35 million tons of cooling. Our operation saved over 2 billion kilowatt hours of energy consumption in 2019, enough to power over 117,000 homes for a year and equivalent to reducing over 1.2 million tons of CO2 emissions.

Moving to slide 7, this slide outlines our capacity growth strength across the region. At the beginning of 2020, we announced that we expected to add at least 75 kRT of new connected capacity by end of 2021. During nine months, we added more than 23,000RT of capacity across the region in addition to the Downtown DCP acquisition. Of this capacity, around 16,000RT were added to the consolidated level and 6,875RT is through joint ventures and associate entities. This is over and above the acquisition of Downtown district cooling assets from Emaar Group.

Tabreed continued to demonstrate its ability to deliver a steady increase in connected capacity in the region, driven by 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, please. 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 of future earnings and cash flow. We currently have 86% of our capacity contracted for at least next ten years.

Also, about 80% of our revenues are derived from fully government-owned or partly government-owned organisations, therefore limiting counterparty risk. Tabreed has a track record of delivering profitable growth. EBITDA has increased by 13% every year since 2017. Our acquisition of Downtown DCP cooling assets and the concession agreement with the Emaar Group is a significant step toward penetrating the largest district cooling market in the world.

I would like to reiterate that about the resilient business model of Tabreed, which is evident from our performance for the nine months of this year despite the prevailing turbulent times. Given the utility nature of our services, there is limited direct impact of COVID-19 on our business. I will now hand over to Richard to talk about our financial results in more detail.

Richard Rose

Thank you, Adel, and thank you everyone for joining us today. Looking at slide 10, let me start by highlighting the key points on the income statement for the first nine months of 2020. Total revenue grew 11.5% primarily driven by chilled water business. Chilled water revenue itself grew by 13.6% over the period.

The key factors driving that growth were the acquisition of Downtown DCP and new capacity additions, offset to some extent by an increase in finance lease amortisation as a result of a negative CPI and some lower consumption particularly in Q2 as a result of the COVID pandemic. Value chain business accounts for only 3% of consolidated revenue and less than 1% of EBITDA. EBITDA for the first nine months grew by 20.3%, and the margins for the period were 54% compared to 50% in the same period last year. This margin enhancement was primarily driven by a change in the consumption capacity mix of the business due to COVID.

Finance cost for the period was higher due to the new loan for the Downtown DCP acquisition, offset in part by lower LIBOR rate this year.

The share results and joint ventures were lower for two reasons. One was some relatively poor performance coming out of QatarCool, and also the results for 2019 were boosted by a one-off gain in a UAE joint venture.

Overall, net income increased by 12.6% with the same strong margin as the previous year. We will now look at the statement of financial position on the next slide. The acquisition and consolidation of Downtown DCP earlier this year has increased fixed assets, receivables, equity, debt, and other liabilities, so it's responsible for most of the major movement we see on the balance sheet.

Receivables are up. That's partly due to Downtown DCP consolidation, as I mentioned. It's also partly a seasonality factor. We normally see an increase in receivables compared to the year end in Q3 because our summer billings are the peak of our business. But there is also some slowdown in receivables from customers, which I will come on to again in a few moments.

Turning to the next slide, we will take a look at the cash flow statement. Cash flow generation during the period has remained resilient to the current difficult economic backdrop. Many of the customers are directly impacted by COVID, and we did see a drop in consumption during Q2 of the year, as I mentioned. However, this has recovered strongly in Q3, and as I think you all know, consumption doesn't drive the EBITDA and net income of the business. So it doesn't have a significant impact on bottom line.

The customers are continuing to pay their bills. However, overall, we have seen in a small increase in DSOs, but we do remain in a strong working capital position. Our cash flow-generating ability remains robust, driven by the essential nature of the services that we provide and by the long-term price certain contracts that we have. And this has enabled us to grow significantly so far in 2020.

Let me now turn to the next slide, which shows our debt portfolio in a bit more detail. We currently have AED 5.4 billion of net debt and a gearing ratio of 51%.

The acquisition of Downtown district cooling concession was financed earlier this year by AED 2.5 billion corporate facility with a tenure of five years and a hundred percent bullet structure. That facility does allow penalty-free prepayments, which will allow Tabreed to manage its financing risk over the life of the facility.

We do plan to repay the liabilities up to 2023 before the end of this year. Both Moody's and Fitch have reaffirmed their investment-grade rating, which is a testament to our strong financial position and resilient cash flows.

Coming on to the next slide, I will just say a little more about the bond issuance that we completed last month. We issued a $500 million conventional bond that's now listed on the London Stock Exchange, alongside the 2025 Sukuk. The bond has a tenure of seven years and a coupon of 2.5%. The bond is rated Baa3 by Moody's and BBB by Fitch both in line with Tabreed's corporate rating.

The issuance was heavily oversubscribed and, as Adel mentioned earlier, it attracted investors globally. And the final allocation saw 90% going to investors outside the MENA region. We plan to utilise those funds to acquire existing operational cooling assets in the UAE and to refinance a corporate debt facility, as I mentioned, which is due to mature in 2023. With that, I will hand back to Adel.

Adel Al Wahedi

Thank you, Richard. Before we open the line for Q&A, let me make a few closing comments. As a stable utility business model, Tabreed continues to deliver strong financial and operating performance driving profitability and stable margin.

Tabreed has a strong investor base and experienced management team. Solid corporate governance, and market leading transparency demonstrated by board composition of all 50% independent directors, including chairman. Tabreed has a flexible capital structure to fund future growth.

As we have mentioned before, we will look at opportunities within and beyond GCC and will provide you with updates as and when such opportunities materialise. We continue to work on various fronts from business development to operation to help drive growth and improve profitability. I will now request the operator to open line for Q&A.

Questions & Answers

Operator

Our first question today comes from Divye Arora from Daman Investments. Divye, your line is now open. Please go ahead.

Divye Arora

Hi, thank you very much for the call. Before we take this new bond into the account, what we see is that currently your net debt-to-EBITDA, it stands around close to five times. If we take into account the RCF, when we take into account the dividends that you got from the associate, it goes to around 4.7-4.8x.

So how are we saying that we are trying to analyse the fourth quarter of the EBITDA that you have disclosed. To understand now, you have already raised a bond of $500 million. This has been done to acquire more assets, plus you will be doing another $500 million more because you have an approval for $1 billion in total. When we take into account that, If there's $1 billion rate around, let's say, 10% return on investment in EBITDA terms, what we see is that potentially your net debt-to-EBITDA is going to get stretched toward six times in next six months to one year, assuming that you complete those acquisitions. Do you think that you will need to raise more equity or rather to cut the dividends for next one year, unless the EBITDA or the return on investment is much more higher than 10%?

Adel Salem Al Wahedi

Thank you for the question. First of all, regarding the bond issuance, although we took the approval from the shareholders for $1 billion, but it won't be exercised unless there is something on the ground and it will have the right return as an investment case for Tabreed. It is not a must. But if there is something, it will materialise.

The second thing that on many occasions, we were mentioning that the growth for Tabreed, it is the strategy for now but subject to maintaining the investment grade. Maintaining investment grade is something very important, and we will not turn away from this threshold. Whatever it takes that the shareholder to take a decision how to maintain that, definitely that they will take that call in the right in the time, in the right case.

Divye Arora

If you were to find an opportunity to invest that $1 billion. We have heard of a couple of opportunities in the market. Dubai airport has mentioned something yesterday. Manzel Hotel is also talking about it. I am not saying that you're going to go and acquire them.

But let's say, if the opportunities are available, and there might be because maybe a lot of developers, a lot of other companies are seeing the sea cooling plants as non-core asset in the current environment when there is stress on the cash flow. You might get some opportunities. If there are enough opportunities available to invest that $1 billion and based on the math that if you look at the return that could be generated from that $1 billion, it appears that you will breach those covenants.

For maintaining your investment-grade rating, you might need to maintain 4.5 to five times. But it looks like it's going to go higher than that. The question is that you have said that shareholder decision, but then ultimately is there any chatter around that? Will it be from the dividend side that you will rather take a call to not give any dividends this year? Next year?

Or the dividend policy is sustainable? It is committed that you have to pay 50% to 60% of the earnings every year, and then it might be a cash call on the shareholders in terms of right issue.

Richard Rose

Hi, Divye. It's Richard here. I think there's a lot of questions in there, so let me try and reiterate what Adel said, which was we went to our shareholders for an approval which would cover, we thought, for at least 12 months in terms of potential for growth. There is no obligation on us to raise a billion dollars. We currently have no plans to raise any further funds at this time.

As you say, we did the $500 million issuance in this quarter, which is actually slightly larger than we had intended to because the process went so well on the day that the demand and the coupon was low, and it allowed us to do some refinancing as well. We did the $500 million. But there is no obligation to do anything further, and there is no plan to do anything further.

When it comes to dividend policy, the headline dividend is to grow dividend in line with growth in the business, and everybody is focused on that. But the full dividend policy is to do that, bearing in mind and always taking into account the demands of the business for growth and working capital. Again, we don't have an obligation to continue the same payout ratio.

Nevertheless, giving value to our shareholders is a key function of what we do, and we'll have those discussions with the board at the end of the year, and a decision will be made by the board, which will then go to the shareholders at the AGM. And ultimately it is a decision for them at that time. There is really nothing I can say. We are not going to speculate on other growth opportunities, how we might fund them if we were successful to get them and what impact that could have on the broader business. That's all we're able to say at this time.

Divye Arora

Clear. Just to follow up on this, if you get stress on the net debt-to EBITDA, just taking an example. To maintain that investment grade rating, do you have some leeway for next one to two years so that by reducing the dividend when you add to the cash, if you don't pay out, the net debt-to-EBITDA automatically declines next one to two years toward five times?

Or let's say net debt-to-RCF declines for the next one to two years toward five times? I'm just taking example over here. How much leeway you have with those rating agencies? For one year? Is timeline within one year, over next two year you have to bring it back to the required level? To threshold level?

Adel Salem Al Wahedi

Hi, Divye. We cannot anticipate what is the response from the rating agencies. We cannot talk on their behalf, but you can see what the market practice. Case by case, they are providing six months or one year or 18 months or two years to a company. It could be the case, or it could be not.

We cannot really speculate about the response about that one. But we know that to maintain investment grade, it is important thing to the shareholder, and any decision related to that, definitely they will take that decision. We know that so many options. Corporate finance. Investment bank analysis to have it, and they will take it in the right time. But we cannot speculate anything now.

Operator

Our next question comes from Zeeshan Bagwan from Abu Dhabi Capital Management. Zeeshan, please go ahead.

Zeeshan Bagwan

Hello, thank you for taking my question. I had a question on the receivable collections that we have seen for the nine months of 2020. Could you give us some more colour excluding the acquisition that you have done? So on a stand-alone basis. How has collection improved. And where do you stand?

Richard Rose

Zeeshan, thank you for your question. As I said in the notes there, we have three things that are happening in receivables at the end of Q3 compared to the year end, which is the comparison you see on that slide. Number 1 is the acquisition of Downtown DCP. That's adding a balance to receivables.

Then we have the seasonality of our business, so our billings in the summer months are higher than they are just because consumption is much higher than they are in other times of the year. And then we have some small slippage in overall DSO for the customer base, so that is skewed. We have quite a significant element of our busines with a small number of customers, and if those small number of customers pay slightly slow, then that has a significant impact overall on the DSO. Our two largest customers are paying slightly slower, as at the end of Q3, but I can tell you both of those have paid significant amounts in Q4. So this isn't a problem which is getting bigger. It's just that there's been a bit of slippage, and it seems to be staying at a new level around about ten days slower than we were seeing this time last year.

Operator

There are no further questions in the conference call. I will now give back the floor to the company. Thank you.

Souad Al Serkal

Thank you very much and this concludes our third quarter earnings call. Tabreed looks forward to interacting with you at our earnings 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 us on this call and stay safe.

Note: This transcript has been edited to improve readability

For further information, please contact:

Bijay Sharma
Investor Relations
Email: Tabreed@churchgatepartners.com

Richard Rose
Senior Vice President, Finance
Tel: +971 2202 0400
Email: IR@tabreed.ae

Salik Malik
Head, Financial Planning & Analysis
Tel: +971 2202 0397
Email: smalik@tabreed.ae