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

Q3 2021
Earnings Conference Call Transcript

14 November 2021

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 Q3 2021 Earnings Call. I now have the pleasure of handing over the call to your host, Ms. Souad Jamal Al Serkal, Vice President of Strategic Communications. Madam, please go ahead.

Souad Jamal Al Serkal

Thank you so much. As-salaam 'alykum, everyone, and hello. My name is Souad Jamal AlSerkel, the 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 2021 Q3 Results Conference Call.

Hope you're all keeping safe and healthy and well. 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 like to request you to turn to Slide 3 for today's agenda.

On today's call we have with us Mr. Adel Salem Al Wahedi, Chief Finance Officer, and Richard Rose, SVP of Finance. Adel will begin with the opening remarks and provide an overview of the Q3 2021 performance and key events. Following that, Richard will discuss the financial performance in more detail. Adel will then conclude the presentation. We will open the lines for your questions.

Thank you and over to you, Adel.

Adel Salem Al Wahedi

Thank you, Souad, and thank you everyone for joining us today. I would like to highlight our nine-months 2021 performance. Total revenue grew by 16.4% led by chilled water business growth of 15.9% and value chain business growth of 33.4%. During the same period, EBITDA growth was 14.6%, resulting in an EBITDA margin of 53% for the period. Net profit during the nine months of this year increased by 4.8% as to AED 388 million. During the nine months of this year, we added capacity of over 29,000 RT. We are confident of delivering the 75,000 RTs for 2020/2021 and delivering the 120,000 RTs of the new capacity over 2021 and '22.

During the quarter, we acquired the balance 50% stake in the exclusive 80,000 RT district cooling scheme supplying Al Maryah Island in Abu Dhabi. We expect the transaction to close and reflected in the financial strong Q4 of this year. We also divested our 44% stake in Qatar Cool to UDC. In October, Tabreed was honoured to receive the Sheikh Khalifa Excellence Award and also be awarded System of the Year by the International District Energy Association for outstanding operational excellence of district energy systems.

Moving on 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 does our positive environmental footprint. We are one of the largest district cooling providers in the region and currently operate 84 plants across GCC, delivering over 1.2 million tonnes of cooling.

Our operations saved over 1.88 billion kWh of energy consumption in the first nine months of this year alone, enough to power over 107,000 homes for a year and equivalent to removing over 1.12 million tonnes of CO2 emissions.

Moving on to the next slide. This slide outlines our capacity growth trends across the region. Last year, we have guided a capacity of 75,000 RTs for 2020 and 2021. We have delivered over 69,000 RTs since 2020, and we remain confident of achieving the target by the end of the year.

At the beginning of '21, we announced that we expected to add 120,000 RTs of new connected capacity by the end of '22. Of this, we expect around 80% to be contributed by consolidated entities and balance 20% from equity accounted entities. Tabreed continues to demonstrate its ability to deliver a steady increase in connected capacity in the region 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 the evolution of our performance of recent 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 almost 90% of our capacity contracted for at least the next ten years. About 80% of our customers have some level of government ownership, therefore limiting counterparty risk. Furthermore, the long-term nature of our contracts provides future revenue visibility. The current connected capacity is over 1.2 million RT, which has grown at an average of 10% since 2018.

The cold chilled water business has been growing at an average of 11% since 2018 and has been the primary driver of the group revenue. Tabreed has a track record of delivering profitable growth. EBITDA has increased at an average of 15% per annum since 2018. I will now hand over to Richard to talk about our financial results in more detail.

Richard Rose

Thank you, Adel. And thank you to everyone for joining us today. Let me start by highlighting the key points on our income statement for the nine months of 2021 so far.

Tabreed revenue grew by 16.4%, driven by robust performance of chilled water and value chain businesses. The chilled water business recorded growth of 15.9% during the period. Key factors driving this were the recent acquisitions which contributed around 14% to the growth, with new connections and increases in consumption volumes and overall improvement in operational efficiencies, partly offset by negative CPI, explaining the balance.

EBITDA for the first nine months of 2021 grew by 14.6% to AED 776 million. EBITDA margins for the period were 53%, marginally lower than last year. The growth in EBITDA was primarily driven by consolidation of Downtown DCP, Masdar and the Saadiyat Island DC assets. The margin impact was primarily due to higher costs on account of recent consolidation of acquisitions and due to the consumption capacity mix.

Higher finance costs reflect the two new facilities we raised last year for funding the acquisitions. And other gains in the previous mainly represent the gain that we took on contract amendment with an existing client. The net profit for the period increased by 4.8% compared to last year.

We'll now look at the Statement of Financial Position. The increased in fixed assets and intangibles represent additions due to the acquisition of Saadiyat Island DC assets. Receivables are in line with the year-end, while seasonality and new acquisitions would normally drive an increase. This reflects significant improvement in collections during the year-to-date compared to last year. The increase in other liabilities mainly represents seasonality and acquisition of the Saadiyat entities.

Turning to the next slide, we'll take a look at the Cash Flow Statement. Now, cash flow generation during the period has improved considerably in comparison to the same period last year. Strong cash flow from operations of AED 907 million reflects significantly higher collections from major customers.

Capex outflows relate to the acquisition of the Saadiyat Island DC assets which also includes the inflow from divestment of Qatar Cool. Closing cash balances are up over 800 million over last year. Tabreed retains strong liquidity with closing cash balances at the end of the period at over AED 1.1 billion, and our revolving credit facility remaining unutilised.

Let me now turn to the slide on the Debt Portfolio. This slide provides the usual background on Tabreed's debt portfolio as at September 2021. Tabreed has AED 5.5 billion of net debt, down from AED 6.1 billion at June 2020. This is primarily driven by strong cash generation and improved collections in year-to-date 2021.

The net-debt-to-EBITDA ratio improved to 5.18 times in September 2021 compared to 5.7 times at June '20. We expect this to further improve as the full EBITDA contribution from recent acquisitions is reflected in our financials. Both Moody's and Fitch have reaffirmed their investment grade ratings following our recent acquisitions. That completes the detailed review of our results for the first nine months of 2021. I'll now pass back to Adel for closing comments.

Adel Salem Al Wahedi

Thank you, Richard. In March 2021, Tabreed published its first ESG report, and it is available on our website under the Sustainability section. I would encourage you all to go through our media report. Tabreed is highly sustainable at the core, delivering significant power efficiencies compared to other cooling alternatives. Sustainability is the core of Tabreed's operations. This is reflected in the company's commitment to energy efficiency and to the environment and to the sustainable socioeconomic development of the region.

Moving to the next slide. Tabreed has set its own targets to support energy consumption reduction and emission prevention through innovative technology solutions and environmentally friendly practices. Various environment-friendly initiatives are part of Tabreed's operation, such as use of treated sewage effluent, emission monitoring, thermal energy storage, use of seawater, management of hazardous waste, and compliance with framework of the regulations of trade effluents.

All the above initiatives have saved over 1.88 billion kWh of energy consumption in the first nine months of this year alone, enough to power over 107,000 homes for a year, and equivalent to reducing over 1.12 million tonnes of CO_2 emissions.

Next slide. As a stable utilities business model, Tabreed continues to deliver strong financial and operating performance, both raising stability and margins. Tabreed has solid corporate governance and market-leading transparency demonstrated by our Non-Executive Board composition with an independent chairman.

We are part of DFM's UAE ESG Index, aimed to measure ESG best practices followed by UAE listed companies. Tabreed has a flexible capital structure to fund future growth. As we have mentioned before, we will look at opportunities within and beyond the DCC and will provide you with updates as and when such opportunities materialise.

We continue to work on various fronts, from business development to operations, to help drive growth, improve profitability and improve sustainability. I will now request the operator to open lines for Q&A.

Questions & Answers

Operator

Thank you. If you would like to ask a question today, please remember to press star, followed by the number one on your telephone keypads today. If you change your mind at any time, please press star two to remove the question. The first question we have on the phone line comes from Thomas Mathew of Kamco Invest. So, Thomas, please go ahead when you're ready.

Thomas Matthew

Hi. Thanks for taking my questions. Hello, Adel. Hello, Richard. Very good afternoon to all of you. I have three questions. The first one is regarding consumption revenues. For the next six months, starting Q3 2021, should we assume an increase in consumption revenues contribution within Chilled Water revenues? I'm guessing the steady state run rate was about 40% contribution. With the expo coming in for the next six months, is it a fair game to assume a slightly higher contribution from consumption revenues? That's one.

And the second one is on Saudi. I just wanted some sort of guidance about how Tabreed is seeing the Saudi market now for acquisitions. It's been a relatively quiet 12 months from that side. I'm just wondering if the reason for no particular M&A activity, is it because the IRRs are below the preferred range, which you've always outlined to be 10%, 12%, or are developers not looking or willing to offload the district cooling units just yet?

And the third question is a more strategic question on the M&A side. Would it be fair to assume that growth is really the priority, and the risks of an investment grade downgrade can be managed with the support from shareholders? Thanks for taking my questions.

Richard Rose

Hi, Thomas. This is Richard. Thanks very much for those questions. In terms of the consumption and expo, I think we're seeing this year a higher consumption capacity mix than we had last year. But I think last year was impacted by COVID, to some extent, certainly, in some of our customers.

In terms of the expo, I think we all know Dubai's pretty busy, the hotels are pretty full, but I don't think that that's going to move the needle too much in our numbers. So I wouldn't factor in any expo uplift. We're not cooling the expo facilities itself, so it would be secondary if we did see anything. But I wouldn't think it's going to be too much. Just turning to Adel for other questions.

Adel Salem Al Wahedi
About Saudi market, Thomas, Saudi market is potential market. This is maybe like other markets. We noticed a slowdown to their plans during the pandemic. But now it is picking up. It is still a big market potentially, so through Saudi Tabreed, we would like to pursue all that growth.
And it will be, I believe, a mix between acquisitions and greenfield. Maybe greenfield, it will more grow. So many plans that they have of development all around the kingdom. So it is still a potential, and it is one of our focused countries and markets.
About the third question, Thomas, definitely we are a rated company, and we will maintain our the investment grade status. But still this will not stop us towards our growth plan so that always we will balance between the growth and maintaining the investment grade. And it's also that growth definitely it will be to study the options how to fund it. For every case, we will select the right option and the right decision. So the shareholders, they are very supportive about this growth as well as maintaining investment grade.

Thomas Matthew
Sure, thanks for that.

Operator
Thank you. We now have the next question from Yawar Saeed from International Securities. So please go ahead. I have opened your line.

Yawar Saeed
Thank you. Thank you for the call. My question is on the margins. The third margins have fallen significantly. They declined sharply, and they're at multi-year low now. And can you point us to the exact line item which has impacted the margins, and is it because of some one-offs, or can we expect this trend, going forward, too?

Richard Rose
Thanks very much for the question, Yawar. Yes, I think we're seeing two things happening in Q3 on the margins. One is, as I said just now, consumption is higher. And as you'll be aware, the margin is much higher on capacity than we have on consumption. Consumption is fundamentally pass through of our costs. So if the mix of consumption capacity changes, that can have an impact, and we are seeing a little bit higher consumption compared to last year in Q3.

But the other key element of this, I think, is just some catch-up in costs following the acquisition of Saadiyat in Q2. I don't think we captured everything in Q2, so there's a bit of one-off extra cost in Q3, just to catch up there. So, in summary, I think you should not see this as a recurring, ongoing trend, but more of a one-off.

Yawar Saeed

So you mentioned about the one-off factor, plus there is some catching up. And the costs which you are mentioning, they are not recurring, right? So the consumption part, I understand that can normalise, but the costs, is it okay if you expect them to be one-offs and they will not recur?

Richard Rose

Yes, that's right. It's just higher costs in Q3 as we just make sure that we've caught up to date with everything, following that acquisition. But, no, we wouldn't expect that to recur within the quarter. So things should normalise back to normal levels, going forward.

Yawar Saeed

Thank you.

Operator

Thank you for the questions, Yawar. We now have another question on the line from Vikram Viswanathan of NBK Capital. So, Vikram, please go ahead.

Vikram Viswanathan

Yes, thank you. Thank you, Richard, for the presentation. My question is on the acquisitions, going forward. Given that your net-debt-EBITDA ratio is quite high, you'll have to acquire companies which are already profitable and which are already EBITDA-generating for you to keep the ratio at the same level.

So my question is, does this prevent you from… In the sense, are there enough opportunities in the market where companies are already profitable for you to acquire and integrate while maintaining the net-debt-EBITDA at current levels?

Richard Rose

Yes, thanks, Vikram. It's a good question. I think there are still opportunities in the market for us. I think we've seen a consolidation in the district cooling market in the last two years which is an exceptional period when you compare it to history. We anticipate that will continue for a little longer in the UAE, and then, hopefully and potentially, spread to other countries in the GCC. That's what we'd like to see. I think there are opportunities out there which will allow us to add continued value to the income statement and to meet the return criteria that we have.

Vikram Viswanathan

Okay. Just in terms of size and magnitude, are these opportunities as big as what you've done in the past? I think you acquired a couple of assets which are quite large. I remember one was that of Emaar, and then one was of Aldar. There may be opportunities in the market, going forward, but is the magnitude as big as you've seen in the past?

Richard Rose

As I say, and there's been a couple of other transactions as well in the market which were in that same ballpark figure that you've mentioned for those two, yes, I think we do see further transactions which are of a very significant size compared to historical district cooling transactions. But I don't think that's going to last forever. I think if you look five years hence, you'll see a more normal transaction size, single-plant asset acquisitions rather than multi-plant asset acquisitions. That's my guess for the future.

Vikram Viswanathan

Okay. A question on Saudi, from our interaction with banks there, it seems like the projects are starting to happen, banks are starting to see some financing starting to come about. Do you see any immediate opportunities there in terms of putting up DC plants? We've heard that the Red Sea project is already up and running. We also understand that there was a financing which was done for the utilities section of the Red Sea plan, Red Sea project. Are you seeing any immediate opportunities which can be executed in Saudi?

Richard Rose

Hi, yes, it's a very good question. I think what we're seeing in Saudi on these big megaprojects which make news all the time is multi-utility tenders. So we're not in a position as an organisation to bid solely for district cooling on these projects. The way that they're tendering out utilities, district cooling is part of that bigger tender. So that requires us to partner with power, water, sewage, and, in some cases, even data companies as well, if we're going to participate in these tenders.

And for that reason, I think it's unlikely that we're going to see the same kind of structure that we've seen with other greenfield projects that we've done historically. But it's very early days yet, and we're not in a position to give any details at this stage.

Vikram Viswanathan

All right, perfect. Thank you.

Operator

Thank you. We now have another question on the line from Jai Andrew Lawrence of Al Mal Capital. So, Jai, your line is open.

Jai Andrew Lawrence

Hi, Richard, Adel. Thanks for the call. Always a pleasure speaking. Just in terms of the capacity guidance that's been set out over the next two years, are we still sticking to that timeline? And, if it's possible, could you maybe tell us what we could expect for Q4 and then going into next year in terms of capacity guidance? That's my first question.

Richard Rose

Hi, Jai. Thanks very much for the question. I think what we normally do is we give overlapping two-year capacity guidance. You'll see from 2020 and 2021 that we've almost achieved the guidance that we gave back at the beginning of 2020. I think historically we've got a very good record of delivering the guidance that we've given in the past.

So far, year-to-date for the 2021/2022 guidance, we've delivered almost 30,000 tonnes of that, which is, I appreciate, only 25% of the guidance that we gave for those two years, but we're not yet full way through the first year. I think we indicated at the time that we saw a higher proportion of that guidance coming in 2022 than 2021, and that made mathematical sense if you look at the two-year guidance overlaps.

We're not giving out forecast numbers for Q4. I think what I'd say is that 120,000 looks a little more challenging, but we still have 15 months to go, and we are confident we'll get at least very close to that number.

Jai Andrew Lawrence

Sure. And just one question on the one-offs. From my understanding, based on what you said, it's partly to do with the fact that the blend was more towards consumption versus capacity, but also one-offs as a result of the Saadiyat acquisition or the acquisitions that happened that hampered the cost structure. Could you maybe just dive into some examples of those costs?

Richard Rose

These are pretty much operational costs and some transaction costs associated with the acquisition. I'm sure you'll be aware that when you acquire another business nowadays, you cannot capitalise the transaction costs associated with that. You have to expense them. So those are legal costs and advisory costs and so on. So there are some of those costs.

But, in addition to that, what I was trying to give some indication of is that we had some catch-up on normal operational costs from Q2 to Q3, so some costs that we didn't capture in Q2 that we're now capturing in Q3, just to bring us back up to speed. So it's a combination of those two things, really.

Jai Andrew Lawrence

Sure. Got you. Thank you.

Operator

Thank you, Jai. We now have the next question from Soha Saniour from Arqaam Capital. Soha, please go ahead when you're ready.

Soha Saniour

Thanks a lot for the call. So back to the one-off costs that led to pressure on margins for Q3, would you be able to quantify that, please?

Richard Rose

I don't have those numbers in front of me at this point in time. We can follow up and give you that detail later.

Soha Saniour

Sure. And another question is regarding the income. Because even if you factor out the sale of Qatar Cool or Qatar Cool's income in Q3, still the income is down significantly. So what's the reason behind that?

Richard Rose

Yes, it's a good question, Soha. I think what we've seen in the associates and JV is some underperformance from Saudi Tabreed. It's driven by a cash flow hedge that they have which has become ineffective in their books, and therefore we've had to mark-to-market that to market. And that's resulted in low returns from Saudi Tabreed which has affected that category.

Soha Saniour

But it is unsustainable. It should be back to normal next quarter.

Adel Salem Al Wahedi

Yes.

Soha Saniour

Thank you

Operator

Thank you. As we have no further questions, I would like to hand it back to Souad Jamal AlSerkal for some closing remarks.

Souad Jamal Al Serkal

And that concludes our Q3 2021 Earnings Call. Tabreed looks forward to interacting with you at future earnings conference calls and investor conferences. Should you have any further questions, please do not hesitate to contact us. This is Souad Jamal AlSerkal, the Vice-President of Strategic Communications at Tabreed wish you a great day once again, and thank you for joining the call.

Operator

Ladies and gentlemen, thank you for joining today's call. You may now disconnect.

Note: This transcript has been edited to improve readability

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