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

Q3 and Nine Month 2018
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's Third Quarter 2018 earnings call. I will now hand you over to Miss Souad.

Souad Al-Serkal
On behalf of Tabreed management team, I would like to welcome you all and thank you for joining us for the third quarter and nine months 2018 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, Steve, our CFO will first provide an overview of the third quarter 2018 performance and key events. Following that, Richard our VP of Finance will discuss the financial performance in more detail. Steve will then conclude the presentation and we will open the lines for your questions.

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

Stephen Ridlington
Thank you, Souad, and good afternoon everybody, nice to talk to you again this quarter. Let me begin on slide five by outlining the major highlights for the year so far.

Nine-month 2018 revenues grew 3.9% compared to the same period last year, led by a 4% increase in chilled water revenues. 2018 has seen a 9% increase in EBITDA and as a result, we saw EBITDA margins increasing from 44% last year to 46% in 2018. We connected 7,500 refrigerated tons of capacity in Q3, mostly at Saudi Tabreed's Jabal Omar development in the Holy City of Mecca. Total capacity additions this year have been 29,000 refrigerated tons. With our third plant at the West Bay in Qatar becoming fully operational, our total number of plants reached 73 across the GCC. We remain confident that we will deliver the announced 65,000 RTs of new capacity additions over 2018 and 2019.

Recently, Tabreed has successfully completed a comprehensive debt refinancing exercise, which will deliver a number of benefits including an increased average life of debt, lower cost over the medium-term, and more flexible debt terms. The key elements of this refinancing underpinned by newly acquired investment-grade ratings are the refinancing of almost all of our debt with a $500 million Sukuk and new unsecured bank facilities. Richard will talk more about the refinancing shortly.

Turning to slide six. As you know, 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 773,000 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 10 plants outside the UAE, providing 348,000 tons of cooling to customers.

During the quarter, we connected our third plant at West Bay in Qatar; this takes our total number of plants to 73. Around two-thirds of our capacity is consolidated while the rest is equity accounted as associates or joint ventures.

Moving to the next slide, this slide outlines our capacity growth trends across the region. At the beginning of 2018, we announced that we expected to add at least 65,000 RTs of new connected capacity during 2018 and 2019. During the third quarter of this year, we added over 7,500 RTs of capacity mostly through Saudi Tabreed. This takes our total capacity additions during the nine months of 2018 to 29,200 RTs. We remain confident of achieving our capacity guidance of 65,000 RTs by the end of 2019, as all of this capacity is already fully contracted.

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.

Turning to slide eight. 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 flows. 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 organisations and therefore limiting counterparty credit risk. Tabreed has a track record of delivering profitable growth.

In summary, over the last four years, total group connected capacity has grown by 6% per annum, total revenues have increased at the same rate driven by chilled water revenue growth of 7% per annum, net income and EBITDA have increased by 8% and 7% per annum per year respectively and EBITDA margins have consistently been approaching 50%.

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

Richard Rose
Thank you, Steve. Turning to slide 10, let me highlight a few key points on our results for the nine months so far of 2018.

Tabreed recorded overall revenue growth of 3.9% with chilled water revenue increasing by 4%. The main factors driving chilled water revenue growth were the acquisition of S&T, which added about 3%, new connections in Oman and Bahrain and the impact of CPI indexation on our capacity revenue. Revenues through our value chain businesses increased by 1.4%. The share of results from associates and JVs declined by AED 20 million or 22.3% on a year earlier, mainly reflecting three factors. Firstly, the impact of the new accounting standard, IFRS 15, which reduced the contribution from Qatar Cool by AED 11.5 million. Secondly, a AED 5 million reduction from Saudi Tabreed reflecting lower incomes and Tabreed's lower share of the JV. Finally, the impact of S&T moving from a JV treatment to a fully consolidated entity following acquisition.

Finance costs were higher due to higher EIBOR and also drawdown of our revolving credit facility to help fund the acquisition of S&T. Other income mainly reflects the one-off gain of AED 32.6 million on the dilution of our stake in Saudi Tabreed. Overall, net income in the first nine months of 2018 was AED 319 million, up 10% on the same period last year, and EBITDA was AED 506 million up 9%.

Improved gross margins due to operating cost efficiencies resulted in EBITDA margins increasing to 46% in the first nine months of 2018, up from 44% in the same period of 2017.

We now turn to slide 11 to look at the statement of financial position. Significant movements in the balance sheet as at 30th September 2018 compared to the end of 2017 were as follows.

Firstly, the increased in fixed assets mainly reflects additions of AED 400 million on consolidation of S&T after acquisition of the 50% stake from Aldar. The decrease in associates and joint ventures balance reflects dividends received, also the consolidation of S&T, the 5% dilution of our shareholding in Saudi Tabreed and the IFRS 15 adjustment for Qatar Cool. The increase in receivables reflects consolidation of S&T and also seasonality compared to December 2017. The receivables as at the 30th September 2018 were in line with those at 30th September 2017.

The reduction in equity and reserves is due to the 2017 dividend being paid and the effect of the implementation of IFRS 9 and IFRS 15. The decrease in debt is due to scheduled repayments. Gearing at the end of Q3 2018 was at 40%.

Turning to the next slide, we will look at the cash flow statement. Tabreed continues to generate strong cash flows which have been utilised to invest in growth and to provide dividend returns to our shareholders. Operating cash flow was strong at AED 532 million, an increase of 45% compared to last year, reflecting higher profitability, robust receivables collections and higher payable balances.

Investing activities primarily reflect the AED 252 million paid for the acquisition of S&T, offset by dividends received and proceeds from the dilution of our shareholding in Saudi Tabreed.

Financing outflows reflect the dividend and debt service payments offset by higher utilisation of the RCF to fund the S&T acquisition. Our cash generating ability remains robust driven by our long-term price-certain contracts.

I will now turn to slide 13, which outlines our current debt portfolio. This slide provides the usual background on Tabreed's debt portfolio as at September 2018. However, most of it has changed after the recent refinancing exercise, which I will elaborate on shortly.

Key points to note on this slide are that Tabreed has AED 3.1 billion of gross debt and a gearing ratio of approximately 40%. Net debt and net debt to EBITDA have declined since 2016 as debt has been repaid and EBITDA has grown. Return on capital employed and return on equity has also improved since 2016 due to strengthening of the balance sheet and higher profitability.

That completes the detailed review of results for the first nine months of 2018. On the next slide, I will discuss the recent debt refinancing in a bit more detail.

Slide 14 highlights the strategic rationale of the refinancing and presents the post-refinancing pro forma debt structure had this been completed on 30th September 2018.

Tabreed's improved operational and financial performance in recent years, coupled with our strong shareholder base has enabled us to implement a revised financing strategy. The key elements of the strategy are to:

- Establish Tabreed as an investment-grade company, which has been achieved with investment-grade ratings now published from Moody's and Fitch;
- Secondly to access debt capital markets in order to broaden our investor base and access longer-term debt; and
- Lastly to move away from secured debt structures to introduce simpler and more flexible terms.
- These features together deliver a capital structure in line with mature utility companies.

The main components of the refinancing are the issue of a $500 million seven-year Sukuk with a cost of 5.5%, a new $250 million five-year amortising term loan and AED 590 million five-year revolving credit facility. These have refinanced all our debt other than a AED 320 million of project and asset-based financing for Dubai Park, the Nation Tower development and Tabreed Oman. We have retained access to approximately AED 600 million of undrawn but committed long-term RCF to provide growth funding for the business going forward.

Overall, the results of the refinancing are an increase in debt tenure from 4.5 years to over six years and no change in the overall cost of debt in 2019, but given the rising interest rate environment, there are significant potential savings in later years.

We now have a stronger balance sheet which optimises Tabreed's ability to capitalise on future growth opportunities.

I will now hand the call back to Steve for closing remarks.

Stephen Ridlington
Thank you, Richard. Before we open the lines for questions and answers, let me just make a few closing comments around slide 16.

We continue to deliver strong financial and operating performance with rising profitability, stable margins, and robust cash flow. We have seen strong capacity additions in our equity accounted entities and we are confident of achieving our capacity guidance of adding 65,000 tons over 2018 and 2019.

A new Sukuk issue and refinancing delivers improved balance sheet efficiency, lower cost in the longer term and longer-term maturity. With investment-grade ratings and a successful Sukuk, Tabreed has accessed global debt capital markets. Tabreed has a flexible capital structure to fund future growth. We will look at opportunities within and beyond the GCC and will provide you with updates as an when such opportunities materialise.

Today, Tabreed is stronger than ever before. We have a strong shareholder base, 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. We remain optimistic about the future. Our core chilled water business provides stable and predictable revenues and profits, and we continue to seek growth opportunities across and beyond the GCC.

Question and Answer Session

Operator
Our first question comes from Ahmad Mahdy from Arab Bank Investment. Please go ahead.

Ahmad Mahdy
I just wanted to know if there is any dividend guidance for next year or for this year?

Stephen Ridlington
Dividends are decisions that are taken by the shareholders and our shareholder meeting (annual general meeting) is generally held in early March. I expect it to be the same next year. In terms of history of dividends, we have paid out approximately 50% of our earnings as dividends in each of the last three or four years and we announced a dividend policy at the beginning of this year which said that we will grow dividends in line with the business, which essentially means a relatively constant pay-out. That is a rather long way of saying you shouldn't expect to see too much change, but the number will obviously be a decision for the board and the shareholders next year.

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

Rakesh Tripathi
My first question is on the revenues, so you mentioned that around 3% of the revenues were contributed by the S&T acquisition. Can you talk about the like-for-like growth, how much was the organic growth in revenues year-on-year.

Richard Rose
As you said quite rightly, approximately 3% of the 4% increase in revenues is driven by the consolidation of S&T following that acquisition. It's almost by definition therefore that, excluding S&T, revenues were up about 1%. There were two factors there, the CPI increases that we applied this year were relatively low. CPI was less than 2% in the UAE last year and secondly the consumption was quite low in Q1, which doesn't really impact our net income, because there's no real margin on consumption revenues as it is pass through of our cost, but it can affect top line revenue.

Rakesh Tripathi
Yes, but traditionally Q1 and Q4 are the quarters where you see the consumption revenues being lower, so we should be expecting some slowdown in revenues in Q4 as well on account of the consumption revenues, right?

Richard Rose
That's correct. They're our lower quarters, yes. I'll just reiterate that impact on revenues really has no impact on the bottom line because of the nature of consumption revenues being a pass through of our costs.

Rakesh Tripathi
My next question is regarding your debt levels, would it be possible for you to discuss a bit on the extent of the amortisation payments that are scheduled for Q4 and typically on a yearly basis as well. I understand that the project finance facilities that were the existing loans and the new term loan that you have taken, these are both amortising in nature, right?

Stephen Ridlington
Let me start by just saying that one of the principal reasons for this refinancing was to free up cash to retain within the business. So, on the Sukuk there will be six-month coupon payments. The first coupon payment will be in April 2019. There is also no term debt repayments either by the end of this year. The first will be early next year and the term loan essentially have annual repayments of around AED 140 million per year over the five-year life. The Sukuk doesn't have any principal repayment until it matures, and then there will be smaller repayments associated with the project financing facilities, the AED 320 million facilities that we're retaining, but those are really quite small.

Rakesh Tripathi
Okay, so the rating agencies, I mean Moody's in particular, has put in thresholds on your interest coverage and retained cash flows to net debt, and they look for more of deleveraging or higher cash flow generation as perquisite for sustaining or even for improving the credit ratings and the credit profile. So, I just wanted to get your outlook on how you see your debt evolving from here on and what are your plans regarding the total level of debt and maintaining or improving your credit ratings, particularly Moody's.

Stephen Ridlington
We are newly rated as investment-grade by Moody's and Fitch and it's clearly our intention to maintain that investment-grade status. Regarding our gearing, amortisation of debt is going to be fairly minimal over the next five years, but we do expect EBITDA to grow as the business grows. So, in terms of net debt to EBITDA multiples in a steady state world it will decline, as it has done, over the last two or three years. . The business will naturally continue to de-lever unless we see a significant acquisition or significant call on capital for whatever reason, which will assist us in retaining that investment-grade status that we have.

Rakesh Tripathi
About the EBITDA growth, how do you see that growth coming over the near term? How much is organically from your operating margin improvements and growth in organic businesses, and how much do you see inorganic growth contributing to it? Basically, your outlook towards acquisitions.

Stephen Ridlington
We don't give guidance on movements in EBITDA or net income. The guidance that we give is in relation to capacity additions and then it is relatively straightforward to model how those capacity additions might flow through into revenue and net income. We've announced 65,000 tons of capacity additions. That's equivalent to about 3% growth over the next year or so. I think you can do your own calculations as to what that might mean for EBITDA.

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

Metehan Mete
I just wanted to ask you about two things. One of them is that in your income statement, I can see that for a pure utility company you have significantly high corporate expenses. I guess it's because of the high staffing in your HQ, which is unlike the other utility companies. Is there a plan to reduce it going forward so that you can become a more lean and efficient company, and then you can boost your return on equity to somewhere around the mid-teens? The second question is that if we see that the growth opportunities are slowing in the market, do you expect to go above the 50% dividend pay-out ratio that you did in 2017,

for example, as a utility company and like a generator of significant cash flows? I think you can afford something around 80% quite comfortably.

Stephen Ridlington
First of all, I don't agree with you that we're a high-cost organisation. I think we have added some small increase in headcount to the company to reflect a broader executive management team and also to bolster our business development and growth efforts. I don't think that you should lose sight of the fact that as far as we're concerned standing still is not really an option. We need to see this company moving forward. We need to see it expanding within the GCC. We'd also like to see some expansion outside the GCC, because that is what our strategy is really all about. It's about delivering solid performance in the existing business, but growing and adding to that, and of course as you do that you then begin to see corporate staff and other head office costs per RT declining. So, I don't think that we're overstaffed. I think we're fit for purpose and we're focusing our efforts very much on the things that matter to the business, such as growth and HSE.

In terms of dividend pay-out, that's really going to be a matter for the board and shareholders. We are not a company that expects to sit on cash for a long period of time. So, if we don't see growth materialising then I am sure that's a discussion at the board that the shareholders will want to have about what do we do about the level of dividends. However, our focus at the moment is very much on trying to grow the business more rapidly than we have seen in the last year or two.

Operator
Our next question comes from Angad Dugal, The National Investor. Please go ahead.

Angad Dugal
My question pertains to your capacity additions. Can we expect any more additions this year or is the bulk of it going to be next year?

Stephen Ridlington
We're almost halfway through the 65,000 tons we said we'd deliver over two years. I think we have said in the past that we expect a bit of it to be towards the back end. I am not expecting a strong quarter in Q4. We may see some additions, but I think the majority of it is going to be in 2019.

Angad Dugal
Sure and these capacity additions, are they through building new plants or acquisitions?

Stephen Ridlington
This is all contracted capacity for new plants and new connections to existing plants. We don't include any projections for acquisitions in these numbers. It's all numbers that have been fully contracted and sanctioned. If we do an acquisition, we will announce it at the right time and that will then be incremental capacity additions to what we've already announced.

Operator
Our next question comes from Divye Arora, Daman Investments. Please go ahead.

Divye Arora
Just one question on receivables, have you booked any provisions over the last nine months on the receivables? We have seen that you're exposed to the King Abdullah Financial District in Saudi, which is not very big in terms of your overall capacity, but are you seeing some sort of delay in terms of payments from there? In terms of capacity, you were adding around 65,000, but we have seen most of this increase has come from Qatar and Saudi, which are basically your associates where in Saudi especially you own 20% and in Qatar you own 44%, so the impact on the earnings will not be in line with the increase in capacity, or the capacity will also be coming over from the UAE going forward? Thank you.

Stephen Ridlington
We'll do these questions in reverse order. I will do the first two and then Richard will handle the receivables. You're absolutely right that most of the capacity additions are in Saudi and Qatar, and we have said consistently that of the 65,000 tons, we expect about half of it to be in the consolidated entity and half of it in the associates and joint venture line. So as most of what we have seen so far is in associates and joint ventures, you can expect most of what we do in 2019 to be at a consolidated level. That 50/50 split is still good for us. As you quite rightly say, not such a big impact on revenues this year, more so next year with consolidated capacity additions.

In terms of the King Abdullah Financial District, we are not exposed to that project as Saudi Tabreed is O&M operator for that project; we don't own the plant and we're not exposed to the credit risks or the receivables there. With that, I will hand over to Richard to talk about your first question on receivables.

Richard Rose
Looking at the cash flow you see that receivables collections have been very strong in the first nine months of this year and we haven't made any material provisions for receivables through the income statement in the year at all. What we have done is implemented IFRS 9 and IFRS 15, and in doing that we made some provisions which went to retained earnings at the beginning of the year, but there's been nothing material at all in current provisions during the course of the year and receivables collections have been very strong.

Souad Jamal AlSerkal

Thank you all. That concludes our Q3 2018 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, so have a great day and thank you once again for joining us.

Note: This transcript has been edited to improve readability

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