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

Q1 2024
Earnings Conference Call Transcript
(Call conducted on 15 May 2024)

<u>Tabreed Participants:</u>

Adel Salem Al Wahedi, Chief Financial Officer
Salik Malik, Vice President – Finance
Yugesh Suneja, Head of Investor Relations

A video replay of the earnings conference call webcast is also accessible from the Investor Relations section of Tabreed's corporate website.

Presentation

Yugesh Suneja
Good afternoon, everyone. I am pleased to welcome you all to Tabreed's Earnings Call for the first quarter of 2024. I am Yugesh Suneja, Head of Investor Relations at Tabreed.

Very quickly, let me reiterate a few housekeeping points before we move on to the main presentation. Today's presentation may contain forward-looking statements. Kindly refer to the disclaimer on this slide for more details. It contains important information and cautionary advice on the interpretation and limitations of historical data and forward-looking statements. Today's call is recorded, and a transcript of the call, along with the presentation and other earnings material will be available on the IR section of Tabreed's website.

Moving on to the agenda for today's call. I am joined today by our Chief Financial Officer, Adel Al Wahedi, and Vice President of Finance, Salik Malik. Adel will begin the presentation with the key highlights of the quarter and an overview of sustainability at Tabreed. Following that, Salik will discuss the financial results in detail. Finally, Adel will provide an update on our guidance and outlook for the company. We will then open the lines for your questions. I will now hand it over to Adel to start the presentation.

Adel Salem Al Wahedi
Good afternoon, everyone. Thanks for joining us today.

In the first quarter of 2024, Tabreed demonstrated solid profit generation capability, remained focused on executing strategic growth initiatives, and continued to advance on its sustainability ambitions.

Financially, the revenue grew year over year, exceeding last year's strong performance. The growth in topline on a like-for-like basis is an increase of 6% after considering the deconsolidation of Tabreed Parks Investments and removing one-off CPI gains recorded last year. One of the key factors is an organic increase in consumption volumes, which has recorded an increase of 9%.

EBITDA margin improved to 58%, demonstrating a resilient business model. We continued our journey into prudent capital allocation measure, as a result reducing our debt level, which led to 32% savings in net finance costs and a healthier financial position.

These factors combined contributed to a 4% increase in net profit before UAE corporate tax and before the one-off gains, while net debt-to-EBITDA ratio improved to the level below 4.0x at the end of the first quarter of 2024.

Strategically, we witnessed an impressive 9% growth in consumption volumes, driven by higher cooling demand from our existing customers as well as through new connections in our concession areas.

During the last 12 months we have added new capacity of 26k RT in our core markets of UAE and GCC. But we are not stopping there. We continue to grow outside our core markets and expanded internationally into India and Egypt, adding 3k RT during the same period; thus, diversifying our geographical presence. To ensure continued growth, we have a large pipeline of new greenfield and brownfield projects, all carefully being vetted to deliver healthy returns for our shareholders.

On the **sustainability front**, we completed Phase 3 of the Tasheel program, which retrofitted our chillers with variable frequency drives. This brings more efficiency to our operations, as well as cost savings.

As a result of more sustainable district cooling produced by our operations, we significantly reduced energy consumption and carbon emissions, thereby translating into significant environmental benefits.

Overall, Tabreed delivered steady results in the first quarter and remains focused on profitable growth and environmental responsibility.

Let us dive deep into our operational performance and expansion updates.

As you know, our chilled water revenues consist of fixed capacity charges and variable consumption charges. The revenue mix in Q1 this year is fixed capacity charges made up 71%, which grew by 3% based on additions to connected capacity over the last 12 months and CPI indexation. Whilst variable consumption charges, typically lower in Q1 due to seasonality, recorded an increase of 9% over the previous year quarter and made up the remaining 29% of revenue in the first quarter.

This was partially offset by the deconsolidation of one of our assets in Q3 last year due to the 50% divestment of the Dubai Parks plant.

Our consumption volumes increased to 0.3 billion refrigerated tons hours, rising by 9% year over year. This growth is driven by both higher connected capacity and rising demand for cooling.

In terms of capacity, UAE remains our largest and core market, accounting for 83% of connected capacity. We also have a presence in Saudi Arabia, Oman, Bahrain, India, and Egypt.

Historically, our connected capacity has grown by 8% per year since 2019. Q1 2024 saw 1,700 refrigerated tons of new connections, mostly organic growth within the UAE. The addition of connected capacity in the first quarter is slightly behind our usual run rate recorded historically and is due to the phasing of new connections across different quarters, which is aligned to the timing of new developments coming on stream. I will provide more details on the capacity guidance later in the call.

The next slide highlights Tabreed's unique role in enabling sustainable development through our district cooling solutions. Cooling has become a critical part of our infrastructure requirements, especially given escalating climate challenges faced globally and particularly in the region.

In our ongoing battle against climate change, district cooling emerges as an effective tool in reducing carbon footprint and enhancing energy efficiency. By leveraging advanced technologies and innovative practices, we are not only meeting the immediate cooling needs, but are also contributing towards achieving broader sustainable goals.

In the last 12 months alone, Tabreed's operations resulted in energy savings of 2.54-billion-kilowatt hour, equivalent to powering over 143,000 homes for a year. Our operations also prevented an impressive 1.52 million tons of CO_2 emissions, equivalent to taking more than 330,000 cars off the road annually. This demonstrates the significant environmental benefit of our district cooling model. And as our business grows, so does Tabreed's contribution to reducing the environmental footprint with more and more savings in energy required to cool our planet.

Sustainability is at the core of Tabreed's long-term strategy, and we remain committed to integrating sustainability in our operations. Tabreed has demonstrated its commitment to decarbonization and net zero by signing the UAE Climate Responsible Companies Pledge. This pledge is more than a commitment – it is a public declaration of our dedication to achieving net zero and spearheading the transition towards a low-carbon economy.

A fundamental element of our roadmap to net zero emissions is the expansion of our digital capabilities. By leveraging big data and AI, we are enhancing the efficiency and resilience of our district cooling operations. The adoption of advanced technologies and clean energy sources plays a vital role in our strategy. The inclusion of geothermal and solar PV energy sources is a testament to our innovation and commitment to sustainability.

Our efforts to improve energy efficiency are ongoing and dynamic, indicated by the implementation of cutting-edge technologies, such as:

- partnership with HTMS to develop the Maxwell Fluid technology that promises efficiency improvements of 9 to 15 percent.
- installation of variable frequency drive motors across numerous plants that has significantly enhanced the energy efficiency of our chiller equipment.
- pioneering geothermal district cooling plants - first in the region - demonstrates our ambitious move towards using renewable energy. In collaboration with ADNOC, we are exploring more opportunities to integrate geothermal energy into our operations, reinforcing our commitment to sustainability.

Tabreed has also set ambitious targets to reduce water consumption and effectively manage waste across its operations. Tabreed has committed to pioneering initiatives that aim to cut down fresh-water consumption while optimizing our operational efficiency.

By leveraging treated sewage effluent in our cooling process, we can conserve fresh water that can serve communities and natural ecosystems instead. Similarly, our innovative approach by using seawater for cooling purposes underlines our commitment to finding sustainable solutions that reduce our reliance on freshwater resources.

Our dedication to sustainability extends beyond water conservation. Environmental stewardship involves the responsible management of all material, including those classified as hazardous. We continually review our processes to reduce the consumption of material, and where possible, we opt to recycle or reduce to minimize waste generation. We work alongside leading environmental service providers to ensure the safe management and disposal of hazardous materials, adhering strictly to the regulations governing trade effluent.

I will now hand over the presentation to Salik, who will discuss our Q1 2024 financial results in detail.

Salik Malik
Thank you, Adel, and good afternoon, everyone.

This slide provides the financial summary and overview for the first quarter 2024 across key areas. We will delve deeper into each aspect in the coming slides, but let's take a quick look at the Q1 2024 highlights.

- We delivered a healthy EBITDA of AED 272 million with a resilient 58% margin, demonstrating our operational efficiency.

- Net profit before taxes and one-off gains saw a 4% increase, reflecting a steady and sustainable growth in our financial metrics.

- Our commitment to financial prudence is evident from capital allocation and the continued improvement of our leverage ratios. Net debt to EBITDA stands at a healthy 3.97x at the end of Q1 2024.

- We have achieved exceptional cash generation capabilities, further solidifying our financial position and enabling us to deliver greater value to our shareholders.

During the annual general assembly meeting this year, Tabreed shareholders approved a cash dividend of 15.5 fils per share for the year 2023, compared to 13.5 fils the prior year. This underscores our commitment to increasing shareholder returns and generating attractive long-term value.

The next slide takes a closer look at the income statement and the key factors influencing its performance in the first quarter of this year.

Group revenue reached AED 468 million, primarily driven by our core chilled water business. While chilled water revenue saw an increase year-over-year, accounting adjustments due to finances lease receivables and deconsolidation of Tabreed Parks have masked the underlying organic growth.

- The first quarter of 2023 benefited from a one-time higher CPI gain with an indexation of 4.8%, while starting 2024, the CPI indexation was at 1.6%.
- Similarly, last year's first quarter numbers included revenue from Tabreed Parks Investments, which had been deconsolidated effective 14th August last year.

On a like-for-like basis, revenue growth is primarily organic, attributed to the gross addition of about 29,000 tons during the last 12 months, and the rise in consumption volumes by 9% compared to the same quarter last year.

Gross profit remained stable in the first quarter as operating costs increased proportionally with increase in the volume growth.

EBITDA reached AED 272 million, whilst maintaining a healthy margin of 58%. Deconsolidation of Tabreed Park Investments and higher costs impacted growth slightly. The expansion of our operations in both existing and new markets resulted in an increase in the staff costs, which should benefit us going forward as the new projects come on stream.

Looking at the net profit movement, the first quarter of 2023 net profit before one-off gains was AED 117 million, whereas net profit before UAE corporate tax for this year grew by 4% and was reported at AED 122 million. This performance is attributed to:

- prudent debt and cash flow management, including debt repayments and a partial Sukuk buyback, resulting in significant savings in finance costs.
- increased fixed deposit income due to a stronger cash balance.

With the introduction of corporate tax in 2024, the reported net profit for the first quarter of this year was 112 million.

The next slide summarizes Tabreed's balance sheet as of 31st March 2024. Key highlights and developments are:

- Changes in fixed assets and intangibles for the quarter reflect the normal depreciation and the amortization.
- Investment in Associates and JVs increased due to the first quarter profit earned.
- Improved collections and fair value movement in the derivatives led to a decrease in the receivables and other assets.
- Movement in equity and reserves primarily reflects the proposed 2023 shareholder dividends and the fair value changes in the derivatives.
- Payables and other liabilities increased due to the 2023 dividends, which were subsequently paid in April.
- Our net debt has decreased to AED 4.8 billion by March 2024. This is a result of strong cash generation and a reduction in gross debt through periodic repayments and a partial Sukuk buyback, representing the prudent capital allocation.

Overall, the leverage ratio, which is the net debt to EBITDA, has improved to a healthy 3.97x, demonstrating a robust balance sheet. Tabreed maintains a strong financial position with a strategic mix of financing instruments such as fixed rates Sukuk and bonds and a fully hedged corporate loan. This effectively shields us from interest rate fluctuation, showcasing our commitment to sound risk management. While two debt facilities are maturing in 2025, a recent US$ 201 million partial Sukuk buyback in April 2024 reduces our 2025 repayment obligation. Our loan facilities allow us for penalty-free prepayments, providing flexibility in managing cost of capital and refinancing risk.

The next slide talks about the highly cash-generative business. The slide shows the sources and uses of cash during the first quarter.

Our net operating cash flow, equivalent to EBITDA, amounted to AED 274 million. This demonstrates the strength and sustainability of our business model.

Negative working capital during the period reflects a reduction in payables after the increase in the prior year.

Receivable days continued to decline during the first quarter, indicating efficient collections and a strong customer credit profile.

The net operating cash flows to EBITDA ratio for the first quarter is at 90%, underscores our commitment to prudent financial practices.

Capital expenditure of AED 57 million during this quarter was incurred to fuel operational expansion and growth as we completed one new plant in Saadiyat Island, which became operational post the quarter end.

All in all, Tabreed delivered robust free cash flow of AED 187 million during the first quarter of 2024.

Financing activities primarily included debt service cost, interest income and debt settlements, and dividend payments to the minority shareholders from the subsidiary.

At the end of the first quarter of 2024, we reported a healthy cash balance of AED 1.6 billion. In addition, we have AED 600 million green revolving credit facility, which remains undrawn. This enhances our liquidity position and enables us to capitalize on growth opportunities, both organic and acquisitions, while maintaining balance sheet strength.

With a robust financial position and a proven ability to generate significant cash flow, Tabreed is well-placed to deliver sustainable value for all stakeholders.

With this, I conclude the summary of financial results presentation. Now I hand it back to Adel to take you through the rest of the proceedings.

Adel Salem Al Wahedi
Now I would like to provide an update on our cooling capacity and future growth plans.

We remain committed to our existing guidance of adding 120,000 RT of new capacity during the years 2023 and 2024 period. Approximately 60% of this growth is expected to come from consolidated entities, ensuring a direct contribution to revenue and EBITDA. We have already delivered 55,000 RTs in 2023 and Q1 of this year. While there had been a slow start this year, we expect the remaining capacity to be connected in 2024.

While we are executing planned projects and following the new business opportunities closely to achieve the guided target for 2023-2024, there could be some temporary timing differences. This difference mainly arises from small delays in the completion of the greenfield projects or development delays from the customer end, which could then temporarily push forward the new connection and capacity to the next quarter.

Beyond our current short-term guidance, we are targeting an annual growth rate of 3% to 5% in connected capacity over the next three years. This growth is fueled by existing development projects currently underway and the new project wins anticipated in 2024 for completion by 2026.

This strategic expansion plan positions Tabreed to capitalize on growing demand for sustainable district cooling solutions. We are confident in our ability to deliver consistent capacity growth and solidify our market leadership position.

On the next slide, we show key drivers for growth in the district cooling industry. Due to renewed focus on accelerating climate action and advancing sustainability goals, we see strong push for district cooling sector.

- Cooling typically accounts for 50% of electricity consumption or 70% of peak demand, especially in Tabreed's key markets, which exhibit a relatively hot climate. Energy demand for cooling is expected to increase at drastic pace, demanding huge investments in electricity systems.

- District cooling is 50% more energy efficient, more reliable, has longer asset life, and is more economical over a life cycle compared to conventional cooling, and thus offers a huge potential to save energy and avoid massive investments.

- Given its high efficiency, district cooling will be a critical enabler to meet strategic net zero emission targets announced by various governments in the region. Further efficiency improvements brought in by new technological developments, such as thermal energy storage, zero water consumption solution, renewables energy, etc. make district cooling a preferred choice for smart and sustainable developments.

- In most of our markets, economic growth is poised to outpace over the next five years compared to the last five years. Some of these markets, such as Saudi Arabia and India, hold a huge potential given relatively under-regulated DC markets and significant size of cooling demand. Governments remain focused to increase use of DC systems and integrate it with the master urban planning. We are excited to be present in these markets and play a leading role in this evolution.

Underpinned by a favorable market backdrop, let me now share with you Tabreed growth outlook.

In the heart of our growth strategy lies our local market, the United Arab Emirates. Our strategy here is twofold, focusing on organic growth and strategic mergers and acquisitions.

- We have secured opportunities to add additional capacity in our existing connection areas. For instance, our downtown DC assets have a total concession size of 235,000 RTs, with a current contracted capacity of approximately 185,000 RTs. Furthermore, areas such as Saadiyat, Al Maryah Island, Al Raha Beach, Yas Island, and Masdar City offer opportunities for expanding our capacity by about 300,000 RTs over the medium term.
- While we anticipate further opportunities for mergers and acquisitions in the UAE, the scale may not mirror our historical acquisitions. Nonetheless, these opportunities remain an integral part of our growth strategy.

Looking beyond the borders of UAE, Tabreed is poised to venture into new geographies, aiming to replicate our success on a global scale.

- We are actively assessing multiple opportunities in dynamic markets such as Saudi Arabia, India, and the wider Asian region. Our goal is to build greenfield plants or enter into new concessions, leveraging our expertise to meet the cooling needs of these flourishing markets.
- The international landscape offers suitable opportunities for growth through mergers and acquisitions. A prime example is Tabreed presence in Saudi Arabia, where Saudi Tabreed operates over 500,000 RTs for asset owners, highlighting potential avenues for acquiring assets and expanding our footprint.

In conclusion, the road ahead for Tabreed is paved with exciting opportunities and promising prospects. Our expertise in the industry positions us uniquely to seize these opportunities, ensuring value accretion for our shareholders and contributing to a sustainable future.

Before I conclude this presentation, let me summarize Tabreed's sustainable investment proposition. At the core of Tabreed's strategy to deliver long-term shareholder returns is a resilient business model designed for stability and sustainable growth.

Our utility-like tariff structure forms the backbone of this resilience. These attributes enable us to forge long-term contracts with our clients and afford us a high degree of future revenue, predictability, and visibility, crucial for steady growth and investor returns.

Looking ahead, Tabreed is positioned for significant growth. Our balance sheet's rapid deleveraging in recent years has left us well-placed to allocate capital towards growth initiatives.

Expanding our horizons, we actively leverage partnerships to venture into new markets and adopt cutting-edge technologies aimed at boosting operational efficiency.

Our disciplined approach towards investment has been a key driver of our success. By managing our cash flows, we have maximized shareholder returns through strategic growth investments, optimized capital structure, and increased dividends. This disciplined investment strategy is aligned with our commitment to sustainable growth and value creation.

In conclusion, our focus remains steadfast on pioneering solutions that are sustainable, efficient, and beneficial for all stakeholders. At Tabreed, we are more than just a cooling services provider. We are partners in progress towards a cooler, greener planet.

With this, I conclude my presentation. Thank you for your attention. We are happy to answer any questions you may have.

Questions & Answers

Operator

We will now move to the question-and-answer section. To ask a question, please press star 2 on your phone and wait to be prompted. If you're dialed in by web, you can type your question in the box provided or request to ask a voice question. We'll just wait a moment or two for the questions to come in.

We have text questions from **Metehan Mete from Waha Capital** – (1) What was the reason for the weakness in revenue growth as revenue was flat versus last year despite capacity growth? and (2) What is the equity IRR criteria for M&A?

Salik Malik

Thanks for your questions.

Regarding your first question on revenue being flat, I would like to reiterate that the revenue has not been flat. On a like-for-like basis, the fixed revenue has grown by 3% and the revenue from consumption volumes has also grown by 9% if I remove the one-off impact due to the CPI indexation of 4.8% last year versus 1.6% this year. Another reason is the deconsolidation impact as we divested 50% stake in Tabreed Parks Investment in Q3 last year. Due to the accounting treatment, we are now showing this asset based on equity method of accounting and not consolidating. These two factors have made the revenue appear flat.

With regards to the second question on the equity IRR criteria for M&A, as we had mentioned previously in various earnings calls, these returns are based on the regions where we operate. But typically, if I look in U.S. dollar terms, we usually make our decision based on IRR of high single digits or low double digits. When it comes to the equity IRR i.e. if you exclude the debt, it is higher than those high single-digit and the low double digits overall.

I hope I have answered your questions.

Operator

Thank you. Just a reminder, if you would like to ask a question, please press star 2 on your phone. You can also type in the text box provided if you're signed in online. We'll just wait another couple of moments to see if there are any other questions.

We have a question from Shadab Ashfaq from Al Ramz Capital. Your line is open. Please go ahead.

Shadab Ashfaq:

I have two questions. Firstly, on international expansion. Do you have any other projects in pipeline that you are targeting overseas, especially in India and Saudi Arabia? And my second question is about the new Dubai airport announcement. How will be the district cooling concession awarded for the new airport and will Tabreed also take part in this particular asset or concession? Thank you.

Adel Al Wahedi:

Thank you, Shadab. For the first question, the simple answer is yes. For the international markets, where we already operate now and the new markets where we are exploring, there are a few prospects that we are pursuing. And these efforts, and result of these discussions will be shared at the right time once it materializes.

On second question, Tabreed will pursue the prospect if it will be available to all operators or players in the market in an open tendering process and competitive bidding etc. Thank you.

Moderator:

Ok, thank you. So, our next question comes from Ildar from HSBC. Your line is open. Please go ahead.

Ildar Khaziev:

Thank you very much. Just a quick question about the overall growth trajectory over the next few years. There has been a wave of new real estate project announcements in the UAE. I just wonder whether there is a time lag between that and you guys being able to secure new contracts. I mean, what kind of time lag are we talking about here if that's the case? And do you expect this wave of new projects to impact your mid-term guidance? Thank you.

Salik Malik:

It is Salik here. The general timeline for a greenfield project, from the start of the work, is around 18 months before we commission the plant and start producing the chilled water supply to the customers. And generally, what we do in any district cooling is that we have an anchor load, and based on that anchor load we construct the plant and install the connected capacity. And then as the development ramps up and matures, we will add additional chillers to deploy our capital in a more prudent way and cost-effective way. When it comes to M&A, there are opportunities that we are pursuing. And at the right time, as Adel mentioned in his previous answer, we will be announcing it through the public platform. Thank you.

Moderator:

Okay, thank you. Just one final very quick reminder. If you'd like to ask a question, press star 2. We'll just give it maybe another 10 seconds or so to see if there's any other questions.

I'm not seeing any other questions, so perhaps I can hand it back to the Tabreed team for closing remarks. Yugesh, do you have any closing remarks, or shall we conclude here?

Yugesh Suneja:

Alright, if there are no further questions, this concludes our call. If you still have any follow up questions, please reach out to us or you can write an email to ir@tabreed.ae and we will be happy to answer your questions. Thank you everyone for your attention and time.

Note: This transcript has been edited to improve readability.

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