

## National Central Cooling Co. - Tabreed

Equity Research Update

Sector – Utilities

### Strong FCF generation; but acquisitions missing

#### Cash utilization and UAE acquisitions to be focal points in 2024E

Tabreed should continue its strong FCF generation that progressively reduces significant downside risks due to the company's deleveraging profile (~99% of its debt portfolio hedged at <4%) and maintains its IG ratings thresholds. Further, the company's recurring revenues at healthy GP margins, strong cash position (9M-23: AED 1.43 Bn) and dividend payout potential which we expect to be comfortably around 70% in the absence of acquisitions of DC assets preserves its defensive fundamentals. We however retain our 'Neutral' rating on Tabreed as we believe that the company's organic capacity addition forecasts (~350k RT from existing concessions) look fully priced in at current market prices. For 2024E, we believe investors are likely to look at how Tabreed executes its cash utilization optionality between dividends and UAE acquisitions. Nevertheless, we remain optimistic on Tabreed's associates over the longer term, especially with PIF's investment in Saudi Tabreed, which should improve its ability to win DC and O&M utilities concession bids of Saudi's mega projects.

#### Core UAE capacity powers through with higher FCF

Acquisition of UAE DC assets remain elusive as developers maintain their strong liquidity on the back of strong cash-based transactions and price momentum, which pushes out any need for monetizing non-core assets in the near term. We continue to believe that the main catalyst for Tabreed's TAM realization and ROIC maximization will depend on how quickly these transactions come to the market and acquisitions are executed, apart from organic signings. For the company's organic growth, we raise capacity forecasts to 135k RT for 2023E/24E and retain 135k RT for 2024E/25E, as connected capacity picks up the shortfall of management guidance of 120k RT over 2021/22 (95k RT achieved). As a result, we fine tune Tabreed's group revenues that should reach AED 2.34 Bn in 2023E, and thereafter reach AED 2.53 Bn by 2025E, driven by organic capacity growth of 4.6% over 2022-25E. EBITDA margins should remain strong at ~55% over 2023E-25E, derived from higher non-cyclical capacity-linked revenues. EBITDA-FCF conversion rates would approach +70% by 2025E (AED 981 Bn) according to our forecasts, which should additionally help in generating additional cash pile for acquisitions.

#### Associates to witness capacity growth; DPO has potential to move higher

Tabreed's income from associates is set to increase income with: 1) Strategic partners such as PIF (30% stake) invested in Saudi Tabreed that allows focus on both district cooling and utilities concessions for large multi-use projects; 2) Saudi Tabreed securing the King Salman Park project with a total concession capacity of 60k RT and Phase 1 of 20k RT; 3) Deconsolidation of Tabreed Parks on 50% stake sale which is subsequently going to be recognized as an associate. Separately, Tabreed recognized a non-cash one-off deferred tax liability of AED 358.8 Mn for its 2020 acquisition of Downtown DCP based on IAS-12, as the UAE promulgated the corporate tax which required recognition via the income statement. Nevertheless, this was reversed in our recurring net income forecast for 2023E of KWD 683.7 Mn and should not impact Tabreed's DPO capacity. Although Tabreed mentioned its DPO guidance of 50%-60% and penchant for reinvestment growth while keeping its investment grade rating, we do believe that Tabreed should be able to achieve DPO of ~70% in the absence of acquisitions.

#### Valuation & Risks – Revised TP of AED 3.55 (Previous: AED 3.40)

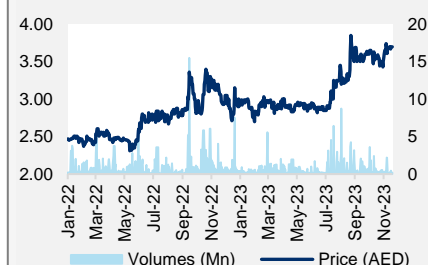
We revised our TP for Tabreed to AED 3.55/share based on a 70:30 blend between DCF and 2024E EV/EBITDA. **Key upside risks:** 1) Key DC assets acquisitions materialize in the UAE; 2) Faster international DC footprint growth. **Key downside risks:** 1) Lower RE market activity; 2) Delays in the ramp-up of Tabreed's connected capacity. 3) Lower consumption revenues due to lower occupancy rates.

Neutral

CMP 17-Nov-23: AED 3.70

Target Price (TP): AED 3.55

Upside/Downside: -4.0%



Price Perf.	1M	3M	12M
Absolute	3.1%	12.1%	20.9%
Relative	-3.4%	13.5%	1.8%

#### Stock Data

Bloomberg Ticker	TABREED UH		
Last Price (AED)	3.70		
MCap (AED Mn)	10,515		
MCap (USD Mn)	2,865		
EV (AED Mn)	15,269		
Stock Performance - YTD (%)	25.0%		
PE - 2023E (x)	15.4		
EV/EBITDA - 2023E (x)	11.7		
Dividend yield - 2023E (%)	4.2%		
52-Week Range (AED)	2.70/3.85		

Sources: Kamco Invest Research & Bloomberg

Tabreed Financials	2022	2023E	2024E
Revenue (AED Mn)	2,216	2,345	2,424
EBITDA (AED Mn)	1,232	1,306	1,339
EBITDA margin (%)	55.6%	55.7%	55.2%
EPS* (AED/share)	0.21	0.24	0.23
PE* (x)	0.21	0.24	0.23
EV/EBITDA (x)	14.0	15.4	16.1
Div Yield (%)	11.3	11.7	11.0

Source: Kamco Invest Research, Tabreed, \* from continuing operations

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## Valuation and Risks

### Target price raised to AED 3.55/share; retain 'Neutral' rating

Post 9M-23, we revise our TP for Tabreed to AED 3.55/share (Previous AED 3.40/share), based on a blend of DCF (70%), 2024E EV/EBITDA (30%), and our forecasts for connected organic capacity. Tabreed's share price rallied almost 25.0% YTD in 2023, and we retain our 'Neutral' rating on the company as we feel that revised organic capacity addition forecasts (~350k RT from existing concessions) look fully priced in at these levels. Our thesis for Tabreed going forward will focus on the company's use case for its cash (9M-2023: AED 1.43 Bn) and undrawn RCF of AED 590 Mn for acquisitions and/or dividends, given its strong deleveraging profile and recurring revenues at high GP margins.

Tabreed Fair Value	
DCF based value	3.47
EV/EBITDA - 2024E (11.5x)	3.75
<b>Blended price target</b>	<b>3.55</b>
Current market price (17 Nov 2023)	3.70
<b>Downside</b>	<b>-4.0%</b>

Sources: Kamco Invest Research

Our DCF model reflects the significant visibility of Tabreed's recurring revenues and cashflows, attained from having a majority of revenues locked-in, as per take-or-pay contracts over the next 10 years. Our model incorporates a revenue CAGR of 4.6% over 2022-2025E, driven by a similar growth in percentage terms for total connected capacity, from the 1.27 Mn RT connected in 2022 across the GCC. We expect EBITDA margins to remain strong at an average ~55% over 2023E-2025E, given the higher proportion of non-cyclical capacity linked revenues. We have assumed a terminal growth rate of 2.0%, revised our average WACC to 7.1% over our forecast period, and have adjusted our after-tax cashflows for the introduction of UAE's corporate income tax of 9% starting from 2024E. For the company's terminal value, the sustainable long-term growth rate adequately reflects the risks, competition in the market, and a return on new investment capital (RONIC) that is comparable to the terminal year WACC. For value from associates and JVs, we derive market values based on a target IRR of 10%. Book values of cash, debt and minorities are based on 9M-2023 financials.

Currently, Tabreed trades at a 2024E multiple of 11.0x, which we think is reasonably fair considering market conditions, and bearing in mind that the company trades at a reasonable discount to its larger industry counterpart – Emirates Central Cooling Systems Corporation PJSC (Empower - not rated by Kamco Invest Research) that trades at 13.2x based on consensus estimates. Moreover, barring any market-wide correction, we feel significant downside risk is protected due to the company's strong defensive profile. Even in the case of an economic slowdown or market-wide correction, declines in Tabreed's share price would make its dividend yields attractive, as the company's operating environment in terms of recurring revenues and hedged debt portfolio should remain largely unaffected.

### Risks to our rating & forecasts include:

#### Upside risks:

- Winning bids for key DC assets acquisitions materialize in the UAE
- Faster international DC footprint growth in India, KSA, Egypt and Kuwait
- Rising number of RE mixed-use projects being announced in the UAE and the GCC
- Higher pass-through of CPI for consumption revenues
- Quicker commercial mainstream adoption of geothermal cooling with ADNOC

#### Downside risks:

- Lower real estate project market activity, and new project cancellations in Tabreed's target markets

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- Delays in ramp-up of Tabreed's connected capacity towards ultimate capacity targets in existing projects
  - Lower consumption revenues for the Chilled Water segment due to lower occupancy rates and footfall from existing commercial real estate clients
  - FX risks for international operations that erode project IRRs

<b>Tabreed Financials</b>						
<b>Balance Sheet (AED Mn)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
<b>Assets</b>						
Cash and cash equivalents	1,313	1,197	1,773	1,749	2,224	2,791
Receivables	1,214	1,015	1,233	1,203	1,208	1,222
Other current assets	42	51	60	64	66	69
<b>Total current assets</b>	<b>2,569</b>	<b>2,263</b>	<b>3,066</b>	<b>3,015</b>	<b>3,497</b>	<b>4,081</b>
Net PPE including capital WIP	4,437	4,813	4,753	4,912	4,913	4,929
Other assets	6,306	7,758	7,632	7,289	7,025	6,753
<b>Total assets</b>	<b>13,313</b>	<b>14,833</b>	<b>15,451</b>	<b>15,217</b>	<b>15,436</b>	<b>15,764</b>
<b>Liabilities</b>						
Current Liabilities	662	859	819	791	818	855
Total debt	6,623	7,272	7,217	6,503	6,378	6,282
Other Liabilities	153	256	261	644	655	668
<b>Total liabilities</b>	<b>7,438</b>	<b>8,387</b>	<b>8,297</b>	<b>7,938</b>	<b>7,850</b>	<b>7,805</b>
<b>Shareholders' Equity</b>						
Share capital	2,716	2,776	2,845	2,845	2,845	2,845
Retained earnings	2,134	2,460	2,757	2,805	3,014	3,284
Minority Interest	710	700	679	712	746	779
Other Equity	315	510	872	915	981	1,050
<b>Total Equity</b>	<b>5,875</b>	<b>6,446</b>	<b>7,154</b>	<b>7,278</b>	<b>7,586</b>	<b>7,959</b>
<b>Total liabilities and equity</b>	<b>13,313</b>	<b>14,833</b>	<b>15,451</b>	<b>15,217</b>	<b>15,436</b>	<b>15,764</b>
<b>Income Statement (AED Mn)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
Revenue	1,741	1,955	2,216	2,345	2,424	2,534
Cost of goods sold	-683	-829	-875	-905	-941	-982
<b>Adjusted gross profit</b>	<b>1,058</b>	<b>1,126</b>	<b>1,341</b>	<b>1,440</b>	<b>1,483</b>	<b>1,551</b>
General and administrative expenses	-88	-93	-109	-134	-144	-157
<b>EBITDA</b>	<b>970</b>	<b>1,033</b>	<b>1,232</b>	<b>1,306</b>	<b>1,339</b>	<b>1,394</b>
Depreciation and amortization	-340	-410	-430	-464	-465	-466
<b>EBIT</b>	<b>630</b>	<b>623</b>	<b>802</b>	<b>843</b>	<b>874</b>	<b>928</b>
Finance costs	-222	-258	-289	-287	-285	-296
Interest/investment income	3	3	22	59	58	58
Other Income/Loss	130	166	99	209	104	106
<b>Net profit before income taxes</b>	<b>542</b>	<b>534</b>	<b>633</b>	<b>824</b>	<b>751</b>	<b>796</b>
Income taxes				-359	-64	-68
<b>Net profit after tax</b>	<b>542</b>	<b>534</b>	<b>633</b>	<b>465</b>	<b>687</b>	<b>728</b>
Discontinued operations & one-offs	32	77	0	252	0	0
<b>Net profit from continuing operations</b>	<b>573</b>	<b>611</b>	<b>633</b>	<b>717</b>	<b>687</b>	<b>728</b>
Minority interest	-23	-26	-33	-33	-33	-33
<b>Net profit attributable to parent</b>	<b>550</b>	<b>585</b>	<b>600</b>	<b>432</b>	<b>653</b>	<b>695</b>
<b>Net profit attributable to parent- continuing operations</b>	<b>518</b>	<b>508</b>	<b>600</b>	<b>684</b>	<b>653</b>	<b>695</b>
<b>EPS (AED)</b>	<b>0.19</b>	<b>0.21</b>	<b>0.21</b>	<b>0.15</b>	<b>0.23</b>	<b>0.24</b>
<b>EPS from continuing operations (AED)</b>	<b>0.18</b>	<b>0.18</b>	<b>0.21</b>	<b>0.24</b>	<b>0.23</b>	<b>0.24</b>
<b>Cash Flow (AED Mn)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
Net cash from operating activities	629	1,316	1,355	1,354	1,279	1,329
Net cash (used in) from investing activities	(2,595)	(977)	(214)	4	(43)	(45)
Net cash from (used in) financing activities	3,051	(455)	(565)	(1,103)	(762)	(718)
Change in cash and cash equivalents	1,086	(116)	576	255	475	567
FX and other adjustments	0	0	0	(279)		
<b>Cash at the end of the year</b>	<b>1,313</b>	<b>1,197</b>	<b>1,773</b>	<b>1,749</b>	<b>2,224</b>	<b>2,791</b>

Source: Kamco Invest Research and Tabreed

<b>Valuation &amp; Financial Ratios</b>						
<b>Ratios</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
<b>Leverage Ratios</b>						
Total Debt / Total Assets (x)	0.50	0.49	0.47	0.43	0.41	0.40
Total Debt / Equity (x)	1.13	1.13	1.01	0.89	0.84	0.79
Net Debt/Equity (x)	0.90	0.94	0.76	0.65	0.55	0.44
<b>Operating Efficiency &amp; Liquidity Ratios</b>						
Receivables Turnover Ratio (%)	2.3	2.5	2.8	2.7	2.8	2.9
Payables Turnover Ratio (%)	2.9	2.9	3.0	3.0	3.0	3.0
Cash conversion cycle	29.2	21.2	8.6	14.3	7.9	3.6
Total Assets Turnover Ratio (x)	0.13	0.14	0.15	0.15	0.16	0.16
Current Ratio (x)	3.88	2.63	3.75	3.81	4.28	4.77
<b>Margins &amp; Profitability Ratios</b>						
Adjusted Gross profit margin (%)	60.8%	57.6%	60.5%	61.4%	61.2%	61.2%
EBITDA margin (%)	55.7%	52.8%	55.6%	55.7%	55.2%	55.0%
EBIT margin (%)	36.2%	31.9%	36.2%	35.9%	36.0%	36.6%
Net profit margin (%)	29.8%	26.0%	27.1%	29.2%	27.0%	27.4%
Return on Assets (%)	4.1%	3.9%	3.9%	2.8%	4.2%	4.4%
Return on Equity (%)	9.4%	9.1%	8.4%	9.4%	8.6%	8.7%
ROIC (%)	6.2%	6.1%	6.2%	7.0%	6.7%	7.0%
<b>Per Share Data and Valuation Ratios</b>						
Enterprise Value (AED Mn)	12,393	13,170	13,940	15,269	14,669	14,007
Earnings Per Share (AED)*	0.18	0.18	0.21	0.24	0.23	0.24
Book Value Per Share (AED)	2.12	2.27	2.52	2.56	2.67	2.80
Dividend Per Share (AED)	0.06	0.06	0.13	0.16	0.15	0.16
PE (x)*	13.9	13.8	14.0	15.4	16.1	15.1
EV/EBITDA (x)	12.8	12.7	11.3	11.7	11.0	10.0
PB (x)	1.2	1.1	1.2	1.4	1.4	1.3
Dividend Yield (%)	2.3%	2.4%	4.6%	4.2%	4.0%	4.3%

Source: Kamco Invest Research and Tabreed, \* recurring EPS

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