

National Central Cooling Co. - Tabreed

Equity Research Update

Sector – Utilities

Valuation gap closes amid smaller-ticket signings

TP achieved. Organic growth now priced in - downgrade to 'Neutral'

Tabreed's share price rallied almost 30% YTD in 2022, and growth based on our revised organic capacity addition forecasts (~250k RT from existing concessions) looks fully priced in at these levels. We therefore downgrade the stock to 'Neutral' based on full valuation and seek better entry points in future. The next triggers for a re-rating in our view are, the acquisition of key DC assets to be offloaded by RE developers in the UAE, and international growth from markets such as India, Egypt, Kuwait, and Saudi Arabia. We believe that Tabreed has adequate dry powder in terms of cash balances and undrawn RCF facilities to actively pursue these opportunities, while remaining flexible enough to keep their investment grade (IG) ratings. Nevertheless, investors are more likely to focus on dividend commentary and the company's ability to raise DPO to 65%-70% in the near term in the absence of the acquisitions and international growth.

Potential acquisitions from the UAE & international growth take center stage

Divestments of non-core DC assets from UAE based RE developers will remain Tabreed's strongest potential growth driver, and catalyst for lifting medium term growth from here on. RE developers are likely to continue exiting non-core assets such as DC assets to fund their expansion plans in a rising interest rate environment, in our view. Nevertheless, with fewer number of brownfield acquisition opportunities remaining in UAE, Tabreed's international aspirations to achieve footprint growth also become crucial in our view. The company highlighted that they are looking to deploy USD 400 Mn over the next 3-5 years in India, targeting 100k RT of capacity, through their 75% JV participation with IFC (25%). Further, growth beyond the recently bagged concession agreements from Egypt (Egyptians for Healthcare Services -30k RT, D5M mall -7.5k RT), and opportunities in Kuwait are being pursued by the company. Moreover, FX risks for opportunities from Egypt and India are likely to be reflected in higher IRR considerations (10%-12% assumed for its UAE assets). In terms of forecasts, we expect Tabreed's group revenues to reach AED 2.11 Bn in 2022E, and thereafter reach AED 2.33 Bn by 2024E, driven by organic capacity growth of 6.2% over 2021-24E. We continue to see strong EBITDA margins of around 55%-56% over 2022-24E, derived from higher proportion of non-cyclical capacity-linked revenues.

Debt exposure hedged, and flexibility remains a boon

We believe that Tabreed has the flexibility to pursue inorganic growth, even in a rising interest rate environment, given its strong deleveraging profile supported by operating cashflows. Margins above reference rates for company's respective debt exposures remain hedged with all-in cost of debt<4%, and as majority of the loans (+99%) remain on a fixed rate basis. Further, future DC asset acquisitions and the recent consolidation of equity accounted capacities are unlikely to impact Tabreed's investment grade (IG) rating, as they are readily EBITDA generative, despite being partially debt funded. As a result, Fitch Ratings expects FFO net leverage to average 4.2x over 2022E-25E reaching 3.7x by 2025E, comfortably below the IG rating sensitivities at 'BBB' of 4.5x. Moreover, a cash balance of AED 1.33 Bn (H1-2022) and undrawn committed facilities of AED 590 Mn should encourage Tabreed to be active in bids for UAE and regional DC acquisitions. Delays in acquisition bids coming to the market should improve deleveraging metrics in the meantime, as the company focuses on smaller-ticket regional signings.

Valuation & Risks – Revised TP of AED 3.25 (Previous: AED 3.00)

We revise our DCF based TP for Tabreed to AED 3.25/share, as we gain more visibility on organic capacity development. We also include concessions from Al Mouj Muscat (+30k RT), and the two new agreements in Egypt (total: 37.5k RT) in our valuation. **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.

Neutral

CMP 07-Nov-22: AED 3.20
Target Price (TP): AED 3.25
Upside/Downside: +1.5%


| Price Perf. | 1M | 3M | 12M |
|-------------|-------|-------|-------|
| Absolute | 13.5% | 16.8% | 18.0% |
| Relative | 13.3% | 14.9% | 8.9% |

Stock Data

| | |
|-----------------------------|------------|
| Bloomberg Ticker | TABREED UH |
| Last Price (AED) | 3.20 |
| MCap (AED Mn) | 9,094 |
| MCap (USD Mn) | 2,478 |
| EV (AED Mn) | 15,183 |
| Stock Performance - YTD (%) | 29.7% |
| PE - 2022E (x) | 16.1 |
| EV/EBITDA - 2022E (x) | 13.1 |
| Dividend yield - 2022E (%) | 3.4% |
| 52-Week Range (AED) | 2.31/3.40 |

Sources: Kamco Invest Research & Bloomberg

| Tabreed Financials | 2021 | 2022E | 2023E |
|--------------------|-------|-------|-------|
| Revenue (AED Mn) | 1,955 | 2,105 | 2,211 |
| EBITDA (AED Mn) | 1,033 | 1,157 | 1,238 |
| EBITDA margin (%) | 52.8% | 55.0% | 56.0% |
| EPS* (AED/share) | 0.18 | 0.20 | 0.22 |
| PE* (x) | 13.8 | 16.1 | 14.5 |
| EV/EBITDA (x) | 12.7 | 13.1 | 11.8 |
| Div Yield (%) | 2.4% | 3.4% | 3.8% |

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

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Valuation and Risks

Target price raised to AED 3.25/share; downgrade to 'Neutral' on valuation

Tabreed's share price rallied almost 30% YTD in 2022 and achieved our previous TP of AED 3.00/share. We updated and rolled over our forecasts since our previous update '[Tabreed Research Update - Pentant remains for bolt-on acquisitions](#)'. We revise our DCF based TP for Tabreed to AED 3.25/share, as we gain more visibility on the ~250k RT of remaining capacity to be connected from ultimate capacity targets in existing district cooling concessions. Further we include: 1) The exclusive perpetual cooling concession agreement with Al Mouj Muscat for +30k RT of district cooling (19k RT connected and operational); 2) concession agreement of 30k RT signed with Egyptians for Healthcare Services (EHCS), and the partnership agreement to provide 7.5k RTs of district cooling for D5M mall in Egypt, in our valuation. We downgrade Tabreed to 'Neutral' on full valuation at current price levels, providing limited upside for investors. We seek better entry points in future and look for the next triggers in the form of the acquisition of key DC assets yet to be offloaded RE developers in the UAE, and international growth from markets such as India, Egypt, Kuwait, and Saudi Arabia.

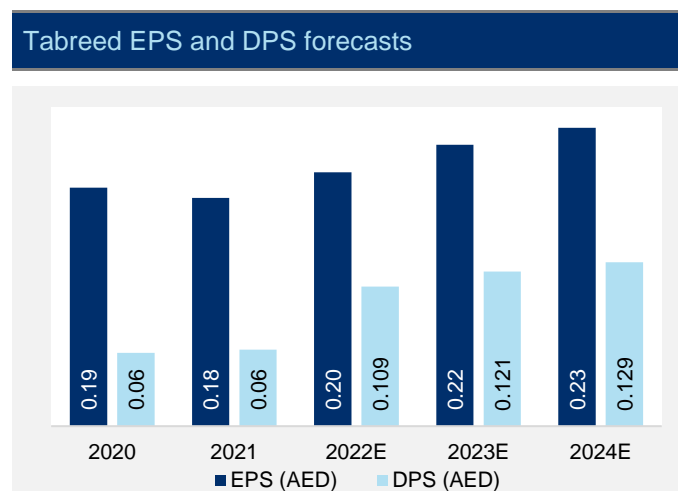
| Tabreed Fair Value | |
|------------------------------------|------|
| DCF based value | 3.25 |
| Current market price (07 Nov 2022) | 3.20 |
| Upside | 1.5% |

Sources: Kamco Invest Research

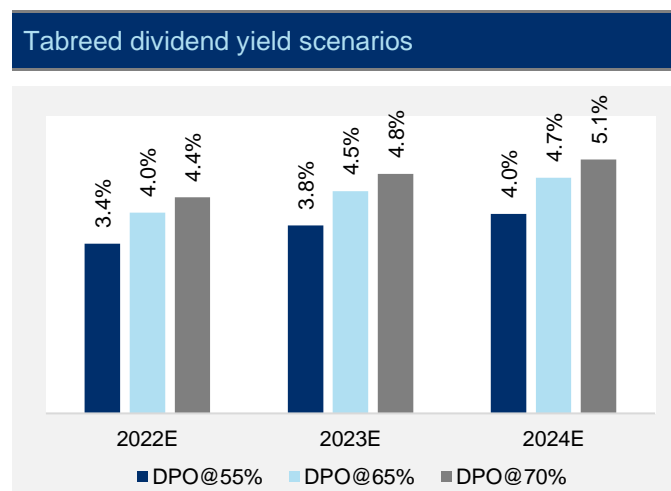
Our DCF model reflects the significant visibility of Tabreed's recurring revenues and cashflows, attained from having a majority of revenues locked-in, as per take-or-pay contracts over the next 10 years. Our model incorporates a revenue CAGR of +6% over 2021-2024E, driven by a similar growth in percentage terms for total connected capacity, from the 1.21 Mn RT connected in 2021 across the GCC. We expect EBITDA margins to remain strong at an average of 55%-56% over 2021E-2023E, given the higher proportion of non-cyclical capacity linked revenues. We have assumed a terminal growth rate of 2.0% and revised our average WACC to 7.3% over our forecast period. Our revised WACC incorporates the higher risk premiums warranted by the market in a rising interest rate environment. 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 H1-2022 financials.

DPO guidance becomes focus in the absence of future acquisitions

Revenue growth and stable margins should drive recurring EPS to grow at 9.3% CAGR over 2021-24E in our view. We expect Tabreed to achieve a dividend payout ratio (DPO) of 55% over 2022E-24E.



Source: Kamco Invest Research, Bloomberg



Source: Bloomberg, Kamco Invest Research

Investors are more likely to focus on dividend commentary in the near term and the company's ability to raise DPO to 65%-70% if there are delays or an absence of acquisitions and international growth. We look for dividend guidance for 2022E and 2023E in such a scenario, as yield expectations of investors have increased with rising risk premiums.

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, 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

Downside risks:

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

Tabreed Financials

| Balance Sheet (AED Mn) | 2019 | 2020 | 2021 | 2022E | 2023E | 2024E |
|---|--------------|---------------|---------------|---------------|---------------|---------------|
| Assets | | | | | | |
| Cash and cash equivalents | 227 | 1,313 | 1,197 | 1,222 | 1,688 | 2,266 |
| Receivables | 901 | 1,214 | 1,015 | 1,287 | 1,335 | 1,388 |
| Other current assets | 35 | 42 | 51 | 55 | 57 | 61 |
| Total current assets | 1,163 | 2,569 | 2,263 | 2,564 | 3,081 | 3,715 |
| Net PPE including capital WIP | 3,940 | 4,437 | 4,813 | 5,040 | 5,079 | 5,081 |
| Other assets | 3,800 | 6,306 | 7,758 | 7,354 | 7,188 | 7,018 |
| Total assets | 8,904 | 13,313 | 14,833 | 14,958 | 15,348 | 15,814 |
| Liabilities | | | | | | |
| Current Liabilities | 815 | 662 | 859 | 747 | 774 | 815 |
| Total debt | 2,947 | 6,623 | 7,272 | 7,311 | 7,256 | 7,252 |
| Other Liabilities | 127 | 153 | 256 | 226 | 241 | 258 |
| Total liabilities | 3,888 | 7,438 | 8,387 | 8,285 | 8,272 | 8,326 |
| Shareholders' Equity | | | | | | |
| Share capital | 2,716 | 2,716 | 2,776 | 2,716 | 2,716 | 2,716 |
| Retained earnings | 1,923 | 2,134 | 2,460 | 2,860 | 3,175 | 3,495 |
| Minority Interest | 71 | 710 | 700 | 726 | 751 | 777 |
| Other Equity | 306 | 315 | 510 | 372 | 435 | 501 |
| Total Equity | 5,016 | 5,875 | 6,446 | 6,673 | 7,077 | 7,488 |
| Total liabilities and equity | 8,904 | 13,313 | 14,833 | 14,958 | 15,348 | 15,814 |
| Income Statement (AED Mn) | 2019 | 2020 | 2021 | 2022E | 2023E | 2024E |
| Revenue | 1,520 | 1,741 | 1,955 | 2,105 | 2,211 | 2,330 |
| Cost of goods sold | -613 | -683 | -829 | -853 | -876 | -922 |
| Adjusted gross profit | 907 | 1,058 | 1,126 | 1,252 | 1,335 | 1,408 |
| General and administrative expenses | -143 | -88 | -93 | -95 | -98 | -100 |
| EBITDA | 763 | 970 | 1,033 | 1,157 | 1,238 | 1,308 |
| Depreciation and amortization | -231 | -340 | -410 | -448 | -463 | -481 |
| EBIT | 532 | 630 | 623 | 709 | 774 | 826 |
| Finance costs | -181 | -222 | -258 | -301 | -317 | -334 |
| Interest/investment income | 3 | 3 | 3 | 8 | 12 | 12 |
| Other Income/Loss | 91 | 130 | 166 | 175 | 183 | 185 |
| Net profit - continuing operations | 445 | 542 | 534 | 591 | 652 | 690 |
| Discontinued operations | 36 | 32 | 77 | 0 | 0 | 0 |
| Net profit | 481 | 573 | 611 | 591 | 652 | 690 |
| Minority interest | -8 | -23 | -26 | -26 | -26 | -26 |
| Net profit attributable to parent | 472 | 550 | 585 | 566 | 627 | 664 |
| Net profit attributable to parent- continuing operations | 437 | 518 | 508 | 566 | 627 | 664 |
| EPS (AED) | 0.17 | 0.20 | 0.21 | 0.20 | 0.22 | 0.23 |
| EPS from continuing operations (AED) | 0.16 | 0.19 | 0.18 | 0.20 | 0.22 | 0.23 |
| Cash Flow (AED Mn) | 2019 | 2020 | 2021 | 2022E | 2023E | 2024E |
| Net cash from operating activities | 782 | 629 | 1,316 | 1,066 | 1,214 | 1,293 |
| Net cash (used in) from investing activities | (184) | (2,595) | (977) | (415) | (127) | (99) |
| Net cash from (used in) financing activities | (620) | 3,051 | (455) | (626) | (620) | (616) |
| Change in cash and cash equivalents | (22) | 1,086 | (116) | 25 | 466 | 578 |
| FX and other adjustments | 0 | 0 | 0 | | | |
| Cash at the end of the year | 227 | 1,313 | 1,197 | 1,222 | 1,688 | 2,266 |

Source : Kamco Invest Research and Tabreed

| Valuation & Financial Ratios | | | | | | |
|--|-------|-------|-------|-------|-------|-------|
| Ratios | 2019 | 2020 | 2021 | 2022E | 2023E | 2024E |
| Leverage Ratios | | | | | | |
| Total Debt / Total Assets (x) | 0.33 | 0.50 | 0.49 | 0.49 | 0.47 | 0.46 |
| Total Debt / Equity (x) | 0.59 | 1.13 | 1.13 | 1.10 | 1.03 | 0.97 |
| Net Debt/Equity (x) | 0.54 | 0.90 | 0.94 | 0.91 | 0.79 | 0.67 |
| Operating Efficiency & Liquidity Ratios | | | | | | |
| Receivables Turnover Ratio (%) | 2.6 | 2.3 | 2.5 | 2.3 | 2.3 | 2.3 |
| Payables Turnover Ratio (%) | 2.4 | 2.9 | 2.9 | 2.8 | 2.9 | 2.9 |
| Cash conversion cycle | -10.1 | 29.2 | 21.2 | 30.4 | 32.6 | 32.3 |
| Total Assets Turnover Ratio (x) | 0.17 | 0.16 | 0.14 | 0.14 | 0.15 | 0.15 |
| Current Ratio (x) | 1.43 | 3.88 | 2.63 | 3.43 | 3.98 | 4.56 |
| Margins & Profitability Ratios | | | | | | |
| Adjusted Gross profit margin (%) | 59.6% | 60.8% | 57.6% | 59.5% | 60.4% | 60.4% |
| EBITDA margin (%) | 50.2% | 55.7% | 52.8% | 55.0% | 56.0% | 56.1% |
| EBIT margin (%) | 35.0% | 36.2% | 31.9% | 33.7% | 35.0% | 35.5% |
| Net profit margin (%) | 28.7% | 29.8% | 26.0% | 26.9% | 28.3% | 28.5% |
| Return on Assets (%) | 5.3% | 4.1% | 3.9% | 3.8% | 4.1% | 4.2% |
| Return on Equity (%) | 9.4% | 9.4% | 9.1% | 8.5% | 8.9% | 8.9% |
| ROIC (%) | 8.2% | 6.2% | 6.1% | 6.2% | 6.6% | 6.8% |
| Per Share Data and Valuation Ratios | | | | | | |
| Earnings Per Share (AED) | 0.16 | 0.19 | 0.18 | 0.20 | 0.22 | 0.23 |
| Book Value Per Share (AED) | 1.85 | 2.12 | 2.27 | 2.35 | 2.49 | 2.63 |
| Dividend Per Share (AED) | 0.11 | 0.06 | 0.06 | 0.11 | 0.12 | 0.13 |
| PE (x) | 11.4 | 13.5 | 13.8 | 16.1 | 14.5 | 13.7 |
| EV/EBITDA (x) | 10.3 | 12.8 | 12.7 | 13.1 | 11.8 | 10.8 |
| PB (x) | 1.0 | 1.2 | 1.1 | 1.4 | 1.3 | 1.2 |
| Dividend Yield (%) | 5.7% | 2.3% | 2.4% | 3.4% | 3.8% | 4.0% |

Source : Kamco Invest Research and Tabreed

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