



## Investment Update

# National Central Cooling Company

### Tabreed: Underweight Rating and Target Price at AED1.09

Rating	<b>Underweight</b>
Fair Value Estimate *	<b>AED1.09</b>
Upside (Downside) from latest market price	<b>(29.98%)</b>

\* Fair value estimate is for 12 months.

#### Market Data, Last trade as of 25 March 2013

ADX Code:	TABREED
Bloomberg Code:	TABREED:UH
Reuters Code:	TABR.DU
Sector	Contracting
Last Price (AED)	1.56
Daily Price Change (%)	-1.27
90d Average Daily Volume	14,395,394
52w High Price (AED)	1.79
52w Low Price (AED)	1.08
Shares Outstanding (mn)	657.05
Free Float Shares (mn)	470.18
Market Capitalization (AEDmn)	1,024.99

Interim Results			
(AEDmn)	4Q12	4Q11	% Δ
Revenues	286.69	272.57	5.18%
Costs	155.16	157.91	-1.75%
Gross Profit	131.54	114.66	14.72%
Operating PFT	116.33	85.95	35.34%
Net Profit	68.71	52.91	29.85%
OPFT Margin	40.58	31.53	9.04
EBITDA Margin	56.16	46.85	9.31
NPT Margin	23.97	19.41	4.55
(AEDmn)	Dec 2012	Dec 2011	% Δ
Assets	8,492.18	8,743.75	-2.88%
Liabilities	4,065.59	4,829.67	-15.82%
Equity	4,346.36	3,821.69	13.73%

#### Modest Revenue Growth and Cost-Savings Support 4Q12's 29% Profit Rise

In the last quarter, Tabreed recorded more than 29% YoY increase in attributable profits to AED68.71mn. Earnings improvement came after a moderate growth in topline but significant savings from lower operating costs. Revenues grew by 5.18% YoY to AED286.69mn, fueled by more customer connections as connected capacity jumped 2.55% YoY to 602K RT. Meanwhile, operating expenses dropped by 1.75% to AED155.16mn.

#### Net Margin Threatened by Higher Interest Expense Post December 2012

In 4Q12, Tabreed's margins showed healthy improvements: Gross Margin at 45.88% versus 42.82% in 3Q12, Operating Margin at 40.58% versus 34.98% in 3Q12, and Net Margin at 23.97% versus 22.35% in 3Q12. On the latter, there is an imminent threat via the start of paying cash coupons for the AED1.7bn mandatory convertible bonds and the AED1.4bn subordinated loan facility (undrawn portion). Both facilities will commence a 4% cash coupon payment from January 2013 until the maturity date (March 2019). Since the issuance of the facilities, Tabreed has had a payment-in-kind arrangement with the holders.

#### Dilution Risk Remains Present and Heightened by the Dividends to Bondholder

The biggest of Tabreed's inherent risks is the potential dilution, of which the minority shareholders will bear the burden (when it comes due). The potential dilution could change the mix of shareholders to 90:10, in favor of major shareholders and could bring down 2019F EPS by -80% and jack up forward PE. In our fair value calculation, we gave due consideration to the complex capital structure of Tabreed and its potential implications and came up with a median value of AED1.09 per share, a discount of about 30% to the current market price. Recently, Tabreed announced AED0.05 cash dividends per share to common shareholders as well as the bondholder, Mubadala. Though Mubadala is entitled to the same cash payment, it has opted to be paid by additional shares instead. This has heightened the dilution concerns as Mubadala is entitled to AED134mn worth of shares as it holds the equivalent of 2.7bn Tabreed shares (via MCBs maturing in 2019).

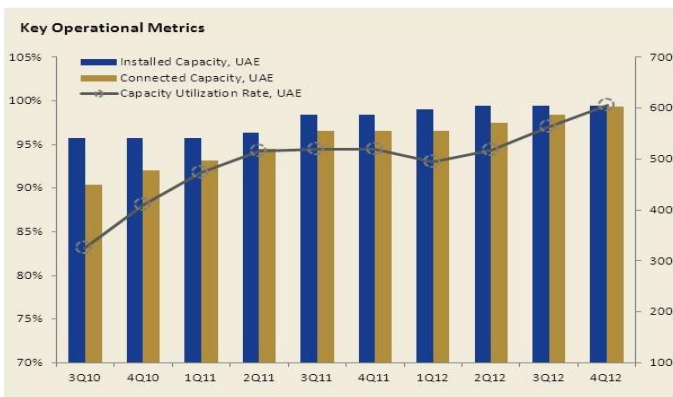
#### Basic Price Multiples Remain Attractive

These days, the drivers for Tabreed's price performance are dominated by business prospects and price multiples. As noted earlier, 4Q12 earnings growth was improving despite moderate revenue growth. Still, basic price multiples remain quite attractive. At the current market price, Tabreed's 2013 forward PE is at 4.41x, and PB is at 0.47x. Based on our fair value estimate, forward PE is at 3.09x, and PB at 0.33x (before dilutive effects).

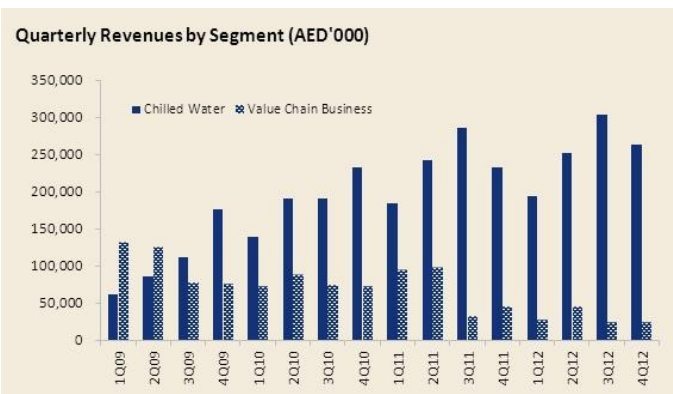
#### Key Financial and Valuation Metrics

	2012A	2013E	2014E	2015E
Revenues (AEDmn)	1,128.74	1,368.35	1,481.78	1,651.48
Net Attributable Profits (AEDmn)	236.35	232.21	287.32	360.92
Net Margin (%)	20.94	16.97	19.39	21.85
Return on Average Equity (%)	5.79	5.33	5.65	6.54
DE Ratio (x), <i>adjusted for convertible bonds</i>	2.85	2.42	2.09	1.80
EPS (AED)	0.36	0.35	0.44	0.55
BVPS (AED), <i>adjusted for convertible bonds</i>	3.03	3.29	3.77	4.37
Price/Earnings (x), based on market price	4.34	4.41	3.57	2.84
Price/ Book Value (x), based on market price	0.51	0.47	0.41	0.36
Diluted PE (x), based on market price	22.93	24.02	13.29	11.30
Diluted PB (x), based on market price	1.25	1.14	1.06	0.97

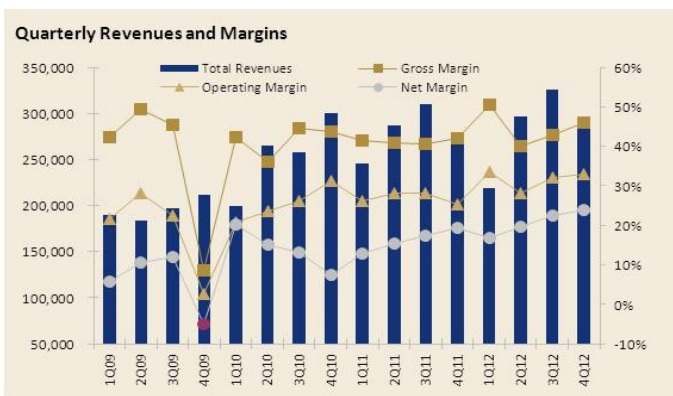
# 4Q12 Performance Review



\* While Tabreed's installed capacity in 4Q12 was unchanged (since 2Q12) at 605,325RT, connected capacity has been improving YoY and QoQ. At the end of the last quarter, connected capacity in the UAE has increased to 602,444RT, spread over 59 plants. Capacity utilization was last recorded at 99.52%. For the whole group (UAE + GCC), Tabreed's installed capacity was at 767,125RT across 65 plants. Connected capacity for the group was at 766,997RT. Capacity utilization for the UAE and for the group has been at record highs, and at almost full capacity, we expect that going forward, installed capacity increases will come from ongoing projects within the region (such as projects in Saudi).



\* Overall revenues (chilled water + value-chain business) rose 5.18% in 4Q12, better than the 9% drop in 4Q11 and also the same growth rate recorded in 3Q12. Chilled water revenues increased by 13.37% in 4Q12 to AED263.39mn while the value chain business declined by 42.10% to AED23.30mn. This has been consistent with Tabreed management's input that the contribution of the value-chain business has been significantly wound down with the completion of Tabreed's build-out program, and as of 4Q12 is already less than 10% of the overall business.



\* With the modest growth in revenues and double-digit growth in earnings, Tabreed saw continued across the board improvement in margins in 4Q12. For the chilled water business, which is the major revenue driver for Tabreed, GPM jumped to 48% in 4Q12, from 42.92% in 3Q12 and 43.73% in 4Q11. Tabreed has indicated that going forward, the chilled water business will be the focus. Meanwhile, expected growth in contribution from associated companies could partially offset the gap left by the value-chain services. In 4Q12, shares from associates reached AED24.72mn (57.50% up YoY). However, shares in joint ventures returned to losses at AED3.22mn.



\* With Tabreed having kept a tight lid on its operating expenses (dropped by 1.75% YoY and 16.87% QoQ), and operating income healthier, attributable net profits rose 29.85% YoY in the last quarter. As noted in our previous update (dated 10 December 2012), Tabreed's period of enjoying relatively low finance cost draws to a close as effective this year, the payment-in-kind component of its convertible notes will expire, and the notes will be charged fixed interest rates of 4% per annum, each.

Meanwhile, in the last 12 quarters and as the chart to the left suggests, 4Q earnings seasonally drop. This could be related to the seasonal cold (experienced mostly in the 4Q and even until 1Q), which then would imply that consumers required less air cooling, and thus actual consumption is not very strong for this period.

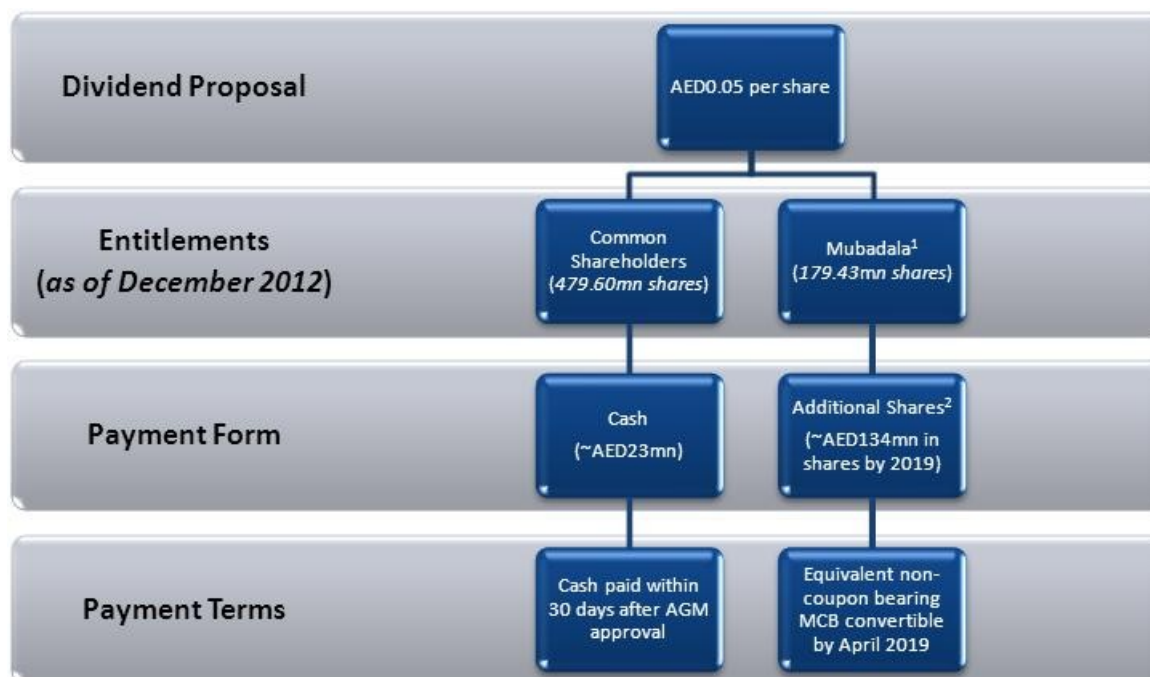
# Recent Developments

With two straight years of double-digit full-year profit growth and with a cash arsenal amounting to more than AED560mn (as of 31 December 2012), the Board of Directors of the company has recommended for the distribution of 5% cash dividends to its shareholders. The proposal will be up for approval when Tabreed holds its Annual General Meeting (AGM) on 09 April 2013.

Apart from the common shareholders of the firm who shall be entitled to the dividends (that is, all shareholders on record as of 21 April 2013, assuming that the AGM will reach a quorum on 09 April 2013), Mubadala Development Company, bondholders of Tabreed, is also entitled to the dividends. This automatic entitlement of the latter is part of the bondholder agreement as per the terms of the existing Mandatory Convertible Bonds issued to Mubadala in April 2011 and December 2012 (when the subordinated loan facility was rolled over as mandatory convertible bonds).

Mubadala is entitled to the dividend payment in cash, but has agreed to accept the payment in **new shares**. These shares will be issued to Mubadala in the form of non-coupon bearing mandatory convertible bonds, which can be converted into Tabreed shares by April 2019.

In simplistic terms, the proposed dividend distribution is depicted below:



Source: Tabreed, RAMZ

<sup>1</sup> As per Tabreed, Mubadala currently owns 97.60mn shares (~14.80%) and General Investments FZE, its wholly-owned subsidiary, owns about 81.85mn shares (~12.40%). Therefore, in total, Mubadala currently holds about 27.20% of Tabreed's common shares.

<sup>2</sup> Owing to the fact that Mubadala shall hold about 2.7bn shares when the MCB is converted by 2019.

The likely impact of the proposed dividends (which are decreased cash levels for the cash payment, and further share dilution by 2019 for the additional shares) has been adjusted accordingly in our financial model and consequently factored in our fair value estimation, the highlights of which are discussed in the next page. However, the dilution factor that the additional shares will have by 2019 cannot be determined as of yet. Upon checking with Tabreed, the conversion ratio for the additional shares will be based on a five-day average share price to be taken in May 2013.

# Recent Developments

Other recent developments on Tabreed include:

- In February 2013, Tabreed announced an additional investment into its Saudi Arabian affiliate, Saudi Tabreed, to develop an AED549mn district cooling project that will serve the Jabal Omar development in the Holy City of Mecca. The approved investment relates to the development and construction of the first two phases of the district cooling plant. Saudi Tabreed, which is 25% owned by Tabreed, is partnering with the Saudi-based Jabal Omar Development Company (JODC) to develop the 55,000RT project. The 20-year Build-Own-Operate-Transfer agreement will be completed by a special purpose vehicle named Central District Cooling Company (CDCC). CDCC is 60% owned by Saudi Tabreed and 40% owned by JODC. The first two phases of the district cooling project in the Jabal Omar development are expected to be completed in approximately 18 months, and currently have a contracted capacity of 35,900RT.
- In addition to the Jabal Omar development, Saudi Tabreed is also currently involved in two other major projects in Saudi Arabia. The company is in the final stages of completing the construction of a district cooling plant for ARAMCO that has a design capacity of 32,000RT on a Build-Own-Operate-Transfer contract for 23 years, and is also now completing the second phase of a district cooling plant in the King Abdullah Financial District (KAFD). Upon completion in 2013, the KAFD plants will have a total capacity of 100,000RT. Since the build-out program of Tabreed is now completed, the completion of these on-going projects are seen to increase the group's capacity accordingly.
- Early this month, Tabreed and the Abu Dhabi-based Masdar Institute of Science and Technology, an independent, research-driven, graduate-level university focused on advanced energy and sustainable technologies, are collaborating on a research and development (R&D) project that aims to enhance operational performance and reduce energy consumption in district cooling plants. The current research project – optimal chiller plant control, phase-I – aims to create a 'smart controller' capable of intelligently and independently managing district cooling plants to improve operational performance and decrease energy consumption, with minimal human interference. Under the terms of the collaboration, the two entities are developing a software module that can be integrated with the district cooling plants' control system to measure all external variables that impact the operational efficiencies of the plant, such as chilled water supply, return flow, outside temperature and humidity levels. The system will then automatically decide at what capacity major equipment such as chillers, water pumps and cooling towers need to operate at in order to meet customers' cooling requirements in the most economical and energy efficient way.

*Source: DFM Disclosures*

# Valuation

In this investment update, we retained the Discounted Free Cash Flow to Equity (DFCFE) Approach. We believe that the DFCFE Approach is the most appropriate and most stable for district energy providers such as Tabreed.

The result of our valuation gives Tabreed a fair value price range of AED0.97 per share to AED1.19 per share. Our median fair value estimate of AED1.09 per share represents 29.98% discount to its latest closing price of AED1.56 (as of 25 March 2013) at the Dubai Financial Market. Our median fair value estimate of AED1.09 per share represents a slight upward adjustment from our previous price target of AED1.02 per share. The change came after macroeconomic growth assumptions were updated to reflect the most recent consensus GDP forecasts, long-term inflation, as well as the outlook of the domestic property market.

## Discounted Cash Flow Approach (DCF)

Given the nature of its business contracts (long-term), we believe that valuing Tabreed's fair price through the DFCFE Approach is deemed appropriate. Our fair value estimate is supported by the following major assumptions:

<b>Perpetual Growth Rate</b>	<p>We provided a range of 0% to 5% to account for three scenarios which are: (1) down side (2) base and (3) up side.</p> <p>Our base case growth assumption of 3% is driven by our expectation that Tabreed will have a consistently healthy performance at par with the growth of the regional and domestic economy and along with the growing popularity of district cooling that adjusts to expected inflation.</p>
<b>Cost of Equity</b>	<p>Our Cost of Equity varies for each forecast period but averages at 15%. A different Cost of Equity for each forecast period is dictated by the debt-to-equity mix (which, in turn, changes due to the corresponding changes in the hybrid financing). The Capital Asset Pricing Model was used to arrive at our weighted Cost of Equity. A few salient points are:</p> <ul style="list-style-type: none"> <li>• Risk free rate was derived using US 30-year Treasury bond rate, adjusted for UAE risk.</li> <li>• Beta was levered to account for the financial risk. The Hamada equation was used to calculate the levered beta each forecast year.</li> <li>• An unlevered beta of 1 was adopted, while the DE ratio for valuation was adjusted to reclassify the equity component to debt, since it holds a fixed interest through 2019.</li> </ul>
<b>Free Cash Flow per Share</b>	<p>The valuation method was modified to use free cash flow to equity per share rather than the absolute value to account for the impact of the mandatory convertible bonds.</p>

### Summary Table: Discounted Cash Flow to Equity per Share

	2013 F	2014 F	2015 F	2016 F	2017 F	2018 F	2019 F	2020 F	2021 F	2022 F
Free Cash Flow to Equity (FCFE)	(0.09)	(0.03)	0.04	0.09	0.17	0.23	0.06	0.13	0.14	0.15
Discount Factor	0.87	0.75	0.66	0.60	0.55	0.51	0.56	0.61	0.58	0.55
Discounted FCFE	(0.08)	(0.02)	0.03	0.05	0.10	0.12	0.03	0.08	0.08	0.08
Terminal Value (TV)	0.76									
Perpetual Growth Rate (%)	3.00%									
Cost of Equity (%)	19.96%									
Present Value of FCFE	0.55									
Present Value of TV	0.08									
Value of Equity	<b>0.63</b>									
Book Value of Investments *	<b>0.46</b>									
<b>Combined Value of Equity</b>	<b>1.09</b>									

Number of Shares (mn) 657,047

\* A subjective liquidity discount rate of 20% was applied to the book value of investments as of 31 December 2012.

# Annex 01: Financial Summary

## TABREED: Income Statement

(AEDmn)	2012A	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2021F	2022F
Revenues	1,128.74	1,368.35	1,481.78	1,651.48	1,746.01	1,935.73	2,036.49	2,253.13	2,365.67	2,599.75	2,731.89
Operating Costs	628.14	752.59	807.57	891.80	934.11	1,025.94	1,069.16	1,177.26	1,230.15	1,351.87	1,420.58
Gross Profits	500.60	615.76	674.21	759.68	811.89	909.79	967.34	1,075.87	1,135.52	1,247.88	1,311.31
Share from Associates	57.59	55.77	61.35	67.48	74.23	81.65	89.82	98.80	108.68	119.55	131.50
Share from JVs	(3.58)	1.59	1.75	1.93	2.12	2.33	2.57	2.82	3.10	3.41	3.76
SG & A	144.34	177.89	197.08	217.99	232.22	257.45	270.85	299.67	314.63	345.77	363.34
Pre-Interest OP	410.27	495.23	540.23	611.09	656.02	736.33	788.86	877.83	932.67	1,025.08	1,083.22
Finance Costs	186.85	272.73	264.45	261.26	258.06	254.87	251.68	248.49	114.43	114.43	114.43
Interest Income	10.18	6.98	8.58	7.78	8.18	7.98	8.08	8.03	8.05	8.04	8.05
Provisions	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net Operating Profits	233.60	229.47	284.36	357.61	406.14	489.43	545.26	637.37	826.30	918.69	976.85
Other Income (Charges)	0.64	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net Profits	234.25	229.47	284.36	357.61	406.14	489.43	545.26	637.37	826.30	918.69	976.85
Non-Controlling Interest	(2.11)	(2.74)	(2.96)	(3.30)	(3.49)	(3.87)	(4.07)	(4.51)	(4.73)	(5.20)	(5.46)
Profit for Shareholder	236.35	232.21	287.32	360.92	409.63	493.30	549.34	641.87	831.03	923.89	982.31
EPS	0.36	0.35	0.44	0.55	0.62	0.75	0.84	0.18	0.23	0.26	0.27

## TABREED: Balance Sheets

(AEDmn)	2012A	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2021F	2022F
Cash & Equivalents	560.42	552.96	576.74	603.65	636.13	669.00	711.27	750.52	811.46	876.26	943.84
AR & Prepayments	558.27	718.85	749.77	784.75	826.97	869.71	924.65	975.67	1,054.90	1,139.14	1,226.99
PPE	4,939.10	5,160.99	5,382.94	5,634.11	5,937.19	6,244.05	6,638.51	7,004.81	7,573.65	8,178.44	8,809.18
Other Assets	2,434.40	2,783.25	2,902.95	3,038.40	3,201.84	3,367.32	3,580.05	3,777.59	4,084.36	4,410.51	4,750.66
<b>Total Assets</b>	<b>8,492.18</b>	<b>9,216.06</b>	<b>9,612.40</b>	<b>10,060.91</b>	<b>10,602.13</b>	<b>11,150.08</b>	<b>11,854.49</b>	<b>12,508.59</b>	<b>13,524.37</b>	<b>14,604.35</b>	<b>15,730.67</b>
AP & Accruals	608.52	551.04	551.04	551.04	551.04	551.04	551.04	551.04	551.04	551.04	551.04
ST Debts	278.44	278.44	278.44	278.44	278.44	278.44	278.44	278.44	278.44	278.44	278.44
Other Current Liabilities	73.87	73.87	73.87	73.87	73.87	73.87	73.87	73.87	73.87	73.87	73.87
<b>Total Current Liabilities</b>	<b>960.83</b>	<b>903.35</b>	<b>903.35</b>	<b>903.35</b>	<b>903.35</b>	<b>903.35</b>	<b>903.35</b>	<b>903.35</b>	<b>903.35</b>	<b>903.35</b>	<b>903.35</b>
AP & Accruals	29.66	29.49	28.70	27.91	27.12	26.32	25.53	25.53	25.53	25.53	25.53
LT Debts	3,057.56	2,901.81	2,823.93	2,746.06	2,668.18	2,590.30	2,512.43	2,512.43	2,512.43	2,512.43	2,512.43
Other NC Liabilities	17.55	17.69	17.22	16.74	16.27	15.79	15.32	15.32	15.32	15.32	15.32
<b>Total NC Liabilities</b>	<b>3,104.77</b>	<b>2,948.99</b>	<b>2,869.85</b>	<b>2,790.71</b>	<b>2,711.56</b>	<b>2,632.42</b>	<b>2,553.28</b>	<b>2,553.28</b>	<b>2,553.28</b>	<b>2,553.28</b>	<b>2,553.28</b>
<b>Total Liabilities</b>	<b>4,065.59</b>	<b>3,852.34</b>	<b>3,773.20</b>	<b>3,694.06</b>	<b>3,614.92</b>	<b>3,535.77</b>	<b>3,456.63</b>	<b>3,456.63</b>	<b>3,456.63</b>	<b>3,456.63</b>	<b>3,456.63</b>
Capital	657.05	657.05	657.05	657.05	657.05	657.05	657.05	3,596.31	3,596.31	3,596.31	3,596.31
Reserves & Others	1,205.96	1,259.21	1,295.91	1,336.06	1,385.23	1,385.12	1,448.91	1,531.51	1,623.39	1,721.07	1,822.96
MCB Component	2,353.14	2,809.41	2,887.28	2,965.16	3,043.03	3,120.91	3,198.79	0.00	0.00	0.00	0.00
Retained Earnings	130.21	557.81	918.73	1,328.36	1,821.67	2,371.00	3,012.88	3,843.91	4,767.80	5,750.11	6,774.54
<b>Share Holders Equity</b>	<b>4,346.36</b>	<b>5,283.48</b>	<b>5,758.97</b>	<b>6,286.62</b>	<b>6,906.98</b>	<b>7,534.07</b>	<b>8,317.62</b>	<b>8,971.73</b>	<b>9,987.50</b>	<b>11,067.49</b>	<b>12,193.81</b>
Minority Interest	80.23	80.23	80.23	80.23	80.23	80.23	80.23	80.23	80.23	80.23	80.23
<b>Total Liabilities and Equity</b>	<b>8,492.18</b>	<b>9,216.06</b>	<b>9,612.40</b>	<b>10,060.91</b>	<b>10,602.13</b>	<b>11,150.08</b>	<b>11,854.49</b>	<b>12,508.59</b>	<b>13,524.37</b>	<b>14,604.35</b>	<b>15,730.67</b>



22F, Sky Tower  
Al Reem Island  
Abu Dhabi

Phone: +971 2 6262626  
Fax: +971 2 6262444  
E-mail: research@alramz.ae

## Investment Ratings Guide

<b>Overweight</b>	The target price for the next 12 months is at least 10% above the current price.
<b>Neutral</b>	The target price in the next 12 months is between –10% and 10% of the current price.
<b>Underweight</b>	The target price for the next 12 months is at least 10% below the current price.
<b>Not Rated</b>	No investment rating has been assigned yet.

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