

TECOM Group PJSC

Robust occupancy with a high retention rate and a rise in rental rates drove the top-line

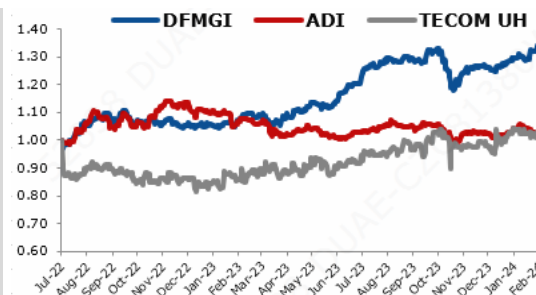
Current Price
AED 2.85

Target Price
AED 3.15

Upside/Downside (%)
+11%

Rating
ACCUMULATE

- TECOM added c. 1,500 new customers in 2023 resulting in a strong long-term and diverse customer base of more than 11,000.
- TECOM experienced a strong occupancy of 89% in 2023 across commercial and industrial portfolio with a retention rate of 91%.
- TECOM expanded in Dubai Science Park (DSP) and launched D/Quarters co-working solutions coupled with storage and logistics space of 200,000 square feet of GLA with a capex of AED 75 Mn.
- TECOM refinanced its existing AED 7.6 Bn loan facility at a lower rate resulting in lower finance cost.
- TECOM recorded a strong recurring free cash flow of AED 1.2 Bn in 2023 compared to AED 1.0 Bn in 2022.
- The board proposed a dividend of 8 fils per share for the second half of 2023 with a healthy dividend yield of 5.7%.



4Q23 Net Profit higher than our estimate

TECOM Group PJSC (TECOM/the Company) net profit increased significantly from AED 87 Mn in 4Q22 to AED 311 Mn in 4Q23 higher than our estimate of AED 149 Mn. The increase in net profit is mainly attributable to strong growth in revenue, a decline in direct cost and operating expenses coupled with an increase in finance income, and lower finance cost.

P&L Highlights

TECOM's recorded a strong growth in revenue of 17.4% YOY to AED 579 Mn in 4Q23 owing to solid occupancy across all segments, strong demand from existing customers and the addition of new customers. Commercial Leasing segment revenue rose 7.8% YOY to AED 291 Mn in 4Q23 owing to healthy occupancy driven by higher demand for quality workplaces due to limited supply and an increase in rental rates. Similarly, the industrial leasing business recorded a solid revenue growth of 13.6% YOY to AED 80 Mn in 4Q23, which is attributable to an increase in occupancy and a rise in leasing rates. Furthermore, revenue from Land Leasing increased significantly 35.1% YOY to AED 142 Mn in 4Q23 while Services revenue rose 37.3% YOY to AED 67 Mn. The growth in Services segment revenue is mainly driven by escalating demand for co-working spaces. On the other hand, direct cost declined 6.9% YOY to AED 204 Mn in 4Q23. Thus, the Company's gross profit increased 36.8% YOY to AED 375 Mn in 4Q23. TECOM's G&A expenses fell 40.6% YOY to AED 63 Mn in 4Q23 driven by enhanced operating efficiency. Selling and marketing expenses declined 2.6% YOY to AED 23 Mn in 4Q23. Furthermore, other income increased significantly from AED 2 Mn in 4Q22 to AED 28 Mn in 4Q23. As a result, operating profit more than doubled from AED 146 Mn in 4Q22 to AED 317 Mn in 4Q23. Commercial Leasing EBITDA increased 51.5% YOY to AED 194 Mn in 4Q23 while Industrial Leasing EBITDA

Stock Information

Market Cap (AED, Mn)	14,200.00
Share capital (Mn)	500,000
52 Week High	2.95
52 Week Low	2.23
3M Avg. daily value (AED)	2,472,371

4Q23 Result Review (AED, Mn)

Total Assets	14.814
Total Liabilities	8,485
Total Equity	6,329
EBITDA	419
Net Profit	311

Financial Ratios

Dividend Yield (12m)	4.23
Dividend Pay-out (%)	74.19
Price-Earnings Ratio(x)	12.78
Price-to-Book Ratio (x)	2.24
Book Value (AED)	1.27
Return-on Equity (%)	17.54

Stock Performance

5 Days	4.80%
1 Months	2.53%
3 Months	8.40%
6 Months	10.08%
1 Year	18.33%
Month to Date (MTD%)	5.58%
Quarter to Date (QTD%)	3.27%
Year to Date (YTD%)	3.27%

rose grew 48.1% YOY to AED 55 Mn in 4Q23. EBITDA from Land Leasing almost doubled to AED 130 Mn in 4Q23 compared to AED 65 Mn in 4Q22. In addition, Service Business EBITDA increased 38.6% YOY to AED 40 Mn in 4Q23. Thus, the Company's overall EBITDA rose 61.4% YOY to AED 419 Mn in 4Q23 with an EBITDA margin of 72.3% in 4Q23 compared to 52.6% in 4Q22. TECOM's finance income increased substantially from AED 9 Mn in 4Q22 to AED 41 Mn in 4Q23, while finance cost fell 31.1% YOY to AED 48 Mn due to refinancing of loan at lower interest rates.

Balance Sheet Highlights

TECOM's borrowings increased marginally by 0.2% to AED 4.4 Bn in 2023, with committed undrawn bank facilities of AED 3.2 Bn. The Company's funds from operations rose from AED 1.2 Bn in 2022 to AED 1.5 Bn in 2023, which is attributable to improvements in collections and better performance of income-generating assets. Furthermore, TECOM's recurring free cash flow grew 23.3% to AED 1.2 Bn in 2023 due to strong growth in core operations. The Company incurred a maintenance and growth capex of AED 258 Mn and AED 54 Mn in 2023 as compared to AED 234 Mn and AED 279 Mn in 2022, respectively.

Target Price and Rating

We maintain our ACCUMULATE rating on TECOM with a revised target price of AED 3.15. Solid occupancy levels across all segments, increased rental rates, and operating efficiency enhancements drove the Company's profitability during 4Q23. The strong performance of Dubai's real estate sector due to high demand with limited availability of office spaces resulted in high occupancy during the period. On the other hand, developments in transportation and e-commerce led to solid demand for warehousing spaces. TECOM added c. 1,500 new customers in 2023, resulting in a strong long-term and diverse customer base of more than 11,000 customers widely spread across different locations in Dubai, further boosting its top line. The Company expanded in Dubai Science Park (DSP) and launched D/Quarters co-working solutions coupled with storage and logistics space of 200,000 square feet of GLA with a capex of AED 75 Mn. The solid demand for warehouses and logistics spaces will further contribute to the Company's topline with the development in the DSP. The Company refinanced its existing AED 7.6 Bn loan facility at a lower rate which resulted in lower finance cost in 2H23 whereas the group can further use the AED 3.2 Bn undrawn revolving credit facility for its expansion plans. Furthermore, the strong core operations of the Company resulted in robust recurring free cash flow of AED 1.2 Bn in 2023 compared to AED 1.0 Bn in 2022 while the solid occupancy across its warehouses and commercial spaces affirms strong further cash flow visibility. The Board proposed a cash dividend of 8 fils per share for the 2H23 with a healthy dividend yield of 5.6%. Thus, considering the abovementioned factors, we maintain our ACCUMULATE rating on the stock.

TECOM Group - Relative valuation

(at CMP)	2022	2023	2024F
PE	14.8	13.2	15.9
PB	1.0	0.9	0.9
EV/EBITDA	14.2	11.4	11.1
Dividend yield	2.8%	5.6%	5.6%

FABS Estimates & Co Data

TECOM – P&L

AED Mn	4Q22	3Q23	4Q23	4Q23F	Var.	YOY Ch	QOQ Ch	2022	2023	Change
Sales	494	541	579	554	4.6%	17.4%	7.1%	1,973	2,169	9.9%
Direct cost	-219	-200	-204	-229	-10.7%	-6.9%	2.1%	-768	-760	-1.0%
Gross profit	274	341	375	326	15.3%	36.8%	10.1%	1,206	1,409	16.9%
G&A expenses	-107	-22	-63	-99	-35.9%	-40.6%	NM	-245	-154	-37.2%
Marketing & selling exp.	-23	-7	-23	-23	0.1%	-2.6%	NM	-42	-43	3.1%
Other income	2	0	28	6	NM	NM	NM	42	47	12.3%
Other expenses	0	0	0	0	NM	NM	NM	0	0	NM
Operating profit	146	313	317	210	51.4%	116.9%	1.6%	961	1,259	31.1%
Depr. & Amort	113	97	102	100	2.0%	-10.3%	4.5%	386	395	2.1%
EBITDA	260	410	419	309	35.5%	61.4%	2.3%	1,347	1,654	22.8%
Finance income	9	16	41	19	111.8%	NM	160.1%	77	82	5.7%
Finance cost	-69	-45	-48	-80	-40.5%	-31.1%	5.5%	-312	-262	-16.0%
Profit before zakat	87	283	311	149	NM	NM	9.8%	726	1,078	48.6%
Income Tax	0	0	0	0	NM	NM	NM	0	0	NM
Net Profit	87	283	311	149	NM	NM	9.8%	726	1,078	48.6%

FABS estimate & Co Data

TECOM - Margins

	4Q22	3Q23	4Q23	YOY Ch	QOQ Ch	2022	2023	Change
Gross margin	55.6%	63.0%	64.8%	919	174	61.1%	64.9%	386
EBITDA margin	52.6%	75.8%	72.3%	1,971	-343	68.2%	76.2%	798
Operating margin	29.7%	57.8%	54.8%	2,513	-298	48.7%	58.0%	936
Net profit margin	17.5%	52.3%	53.6%	3,609	130	36.8%	49.7%	1,294

FABS estimate & Co Data

Valuation:

We use Discounted Free Cash flow (DCF), Dividend Discount Method (DDM), and Price/Funds From Operations (FFO) method to value TECOM. We have assigned 70% weight to DCF, and 15% each to DDM and Price/FFO method.

Valuation Method	Target	Weight	Weighted Value
DCF Method	3.11	70.0%	2.18
Dividend Discount Method (RV)	2.74	15.0%	0.41
Price/ FFO	3.72	15.0%	0.56
Weighted Average Valuation (AED)			3.15
Current market price (AED)			2.85
Upside/Downside (%)			+11%

1) DCF Method:

TECOM is valued using free cash flow to the firm. We have discounted the cash flow using the weighted average cost of capital of 8.0%. It is arrived after using the cost of equity of 8.8% and after-tax cost of debt of 6.1% with a debt-to-equity ratio of 37.0%. The cost of equity is calculated by using a 10-year government bond yield of 5.2%, beta of 0.90 and equity risk premium of 4.0%. Government bond yield is calculated after adding Abu Dhabi 10-year spread over a 10-year US risk-free rate. The cost of debt is calculated using the cost of 6.7% after adjusting a tax rate arriving at after-tax cost of debt of 6.1%. Also, it assumed a terminal growth rate of 2.0%.

Sum of PV (AED, Mn)	5,106
Terminal value (AED, Mn)	14,397
FV to Common shareholders (AED, Mn)	15,561
No. of share (Mn)	5,000
Current Market Price (AED)	2.85
Fair Value per share (AED)	3.11

DCF Method

(All Figures in AED Mn)	FY 2024E	FY 2025E	FY 2026E	FY 2027E	FY 2028E
NOPAT	1,207	1,279	1,316	1,376	1,423
D&A	414	429	441	447	455
(-) Capex	-492	-334	-280	-481	-637
Change in working capital	-106	23	8	7	6
Free Cash Flow to Firm (FCFF)	923	1,397	1,486	1,351	1,247
Discounting Factor	0.93	0.86	0.80	0.74	0.68
Discounted FCFF	861	1,206	1,187	998	853

Source: FAB Securities

2) DDM Method:

TECOM dividend grew in line with its policy and pays regular dividend to its shareholders. Strong cash flow generation of the Company enables continuous dividend payments. Thus, we have valued TECOM using DDM method. The dividend is discounted at the cost of equity of 8.8%

Sum of PV (AED, Mn)	3,677
Terminal value (AED, Mn)	10,009
FV to Common shareholders (AED, Mn)	13,685
No. of share (Mn)	5,000
Current Market Price (AED)	2.85
Fair Value per share (AED)	2.74

DDM Method

(All Figures in AED Mn)	FY 2024E	FY 2025E	FY 2026E	FY 2027E	FY 2028E
Dividend paid -					
H1	400	400	500	500	500
H2	400	500	500	500	500
Total dividend	800	900	1,000	1,000	1,000
Discounting Factor	0.93	0.85	0.78	0.72	0.66
Present Value of dividend	741	767	784	721	663

Source: FAB Securities

3) Price/FFO:

We have used local peers to value TECOM and it is valued using the Price/FFO multiple. It is valued at Price/FFO multiple of 13.7x in line with peers.

Company	Market (USD Mn)	EV/EBITDA (x)	PE (x)	Price/FFO (x) ¹
		Current	Current	
Jadwa REIT Saudi Fund	648	23.2	74.4	16.2
Riyad REIT Fund	387	18.9	23.1	14.7
Al Rajhi REIT	650	17.0	28.6	18.3
Bonyan REIT	426	13.0	NA	12.0
Alahli REIT Fund 1	317	17.4	23.6	16.7
Derayah REIT	227	17.8	48.3	31.8
Mulkia Gulf Real Estate REIT	167	22.4	NM	19.8
Taleem REIT	151	16.2	16.6	16.4
Al Maather REIT Fund	149	15.8	NA	13.7
Average		18.0x	81.6x	17.7x
Median		17.4x	28.6x	16.4x
Max		18.9x	61.4x	18.3x
Min		16.2x	23.4x	14.7x

Source: FAB Securities, ¹Based on H12023 Results

