

TECOM Group PJSC

High occupancy and rental rates drove profitability

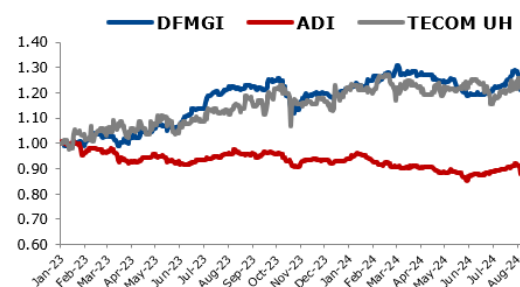
Current Price
AED 2.85

Target Price
AED 3.15

Upside/Downside (%)
+11%

Rating
ACCUMULATE

- TECOM's client base grew 11% YOY to more than 11,000 in 1H24, with the addition of more than 1,000 new customers.
- TECOM experienced a strong occupancy of 92% across the Industrial and Commercial leasing segment in 1H24.
- TECOM's recurring free cash flow reached AED 362 Mn in 2Q24, due to lower capex spending and improved collections.
- Tecom's Group plan worth AED 1.7 Bn includes the acquisition of three land plots, two buildings, and two industrial city land plots coupled with three development projects that are expected to be completed by 2027, all three will contribute AED 190 Mn to the revenue at full occupancy. The investment will be funded through internal accruals.
- The board approved an interim dividend of AED 400 Mn for 1H24.



2Q24 Net Profit higher than our estimate

TECOM Group PJSC (TECOM/the Company) net profit increased 35.4% YOY to AED 311 Mn in 2Q24, which is higher than our estimate of AED 248 Mn. The increase in net profit is primarily attributable to healthy revenue growth and lower net finance cost, partially offset by a rise in direct cost, higher operating expenses, and tax expenses.

P&L Highlights

TECOM's revenue increased by 9.1% YOY to AED 584 Mn in 2Q24, led by new customers, solid occupancy levels, rental rates, and a healthy retention rate coupled with strong demand across all segments. Commercial Leasing segment revenue increased 4.5% YOY to AED 290 Mn in 2Q24, primarily due to new leases, rise in rental rates, and higher occupancy. Similarly, the Industrial Leasing segment revenue grew 8.7% YOY to AED 86 Mn in 2Q24, owing to increased leasing across warehouses and workers accommodation which pushed the occupancy rates higher. Furthermore, revenue from land leasing climbed 9.8% YOY to AED 137 Mn in 2Q24, owing to higher revenues from Dubai Internet City and Dubai International Academic City, primarily from new leases, healthy retention, and higher rental rates. Services income increased 31.7% YOY to AED 71 Mn in 2Q24, mainly due to high AXS sales and increasing demand for co-working spaces. However, direct costs increased 3.1% YOY to AED 191 Mn in 2Q24. As a result, the Company's gross profit rose 12.3% YOY to AED 393 Mn in 2Q24. TECOM's G&A expenses increased substantially 59.7% YOY to AED 51 Mn in 2Q24, while selling and marketing expenses increased 59.5% YOY to AED 11 Mn. Furthermore, other income grew 36.5% YOY to AED 23 Mn in 2Q24 and other expenses recorded a sharp rise from AED 22 Mn in 2Q23 to AED 39 Mn in 2Q24. Resultantly, operating profit increased 7.9% YOY to AED 354 Mn in 2Q24. Moreover, Commercial leasing segment EBITDA grew 8% YOY to AED 202 Mn in 2Q24, while the Industrial leasing segment EBITDA fell 5%

Stock Information

Market Cap (AED, mn)	14,250.00
Shares Outstanding	5,000.00
52 Week High	2.95
52 Week Low	2.40
3M Avg. daily value (AED)	1,564,004

2Q24 Result Review (AED, mn)

Total Assets	15,265
Total Liabilities	8,730
Total Equity	6,535
EBITDA	457
Net Profit	311

Financial Ratios

Dividend Yield (12m)	5.61
Dividend Pay-out (%)	74.19
Price-Earnings Ratio(x)	11.77
Price-to-Book Ratio (x)	2.18
Book Value (AED)	1.31
Return-on Equity (%)	18.71

Stock Performance

5 Days	2.89%
1 Months	4.78%
3 Months	4.01%
6 Months	-0.35%
1 Year	11.33%
Month to Date (MTD%)	4.01%
Quarter to Date (QTD%)	9.62%
Year to Date (YTD%)	3.64%

YOY to AED 55 Mn. Similarly, Service segment EBITDA improved by 23% YOY to AED 55 Mn in 2Q24. Besides, EBITDA from Land Leasing grew 6% YOY to AED 141 Mn in 2Q24. The company's overall EBITDA increased by 7.2% YOY to AED 457 Mn, with an EBITDA margin of 78.2% in 2Q24 compared to 79.6% in 2Q23. TECOM's finance income increased 45.1% YOY to AED 19 Mn in 2Q24, while finance cost fell 49.6% YOY to AED 56 Mn in 2Q24 attributed to efficient refinancing comprising of lower borrowing and transaction costs. The Company recorded income tax expense of AED 6 Mn in 2Q24.

Balance Sheet Highlights

TECOM's borrowings increased 6.0% YOY and 5.8% QOQ to AED 4.6 Bn in 2Q24, including AED 3.0 Bn in committed undrawn floating rate bank borrowing. The Company's funds from operations rose by 33.9% YOY to AED 427 Mn in 2Q24, supported by healthy collections. Furthermore, TECOM's recurring free cash flow grew 42.5% to AED 362 Mn in 2Q24 due to lower capex investment and improved collections. The Company incurred AED 66 Mn in maintenance capex and AED 6 Mn in growth expenditure during 2Q24.

Target Price and Rating

We revised our rating on TECOM from BUY to ACCUMULATE with an unchanged target price of AED 3.15. The Company's share price rose 5.2% since our previous rating. Strong demand and increasing rental rates across commercial as well as residential properties are driving TECOM's performance. Dubai is emerging as a global business hub as Companies across the globe set up their production units and offices in the emirate due to supportive government policies. Thus, the group expects the demand for office spaces to grow in the upcoming period due to limited supply and a rising number of businesses. Moreover, strong growth in property prices, high rental rates, and occupancy rates led to a healthy appreciation in TECOM's portfolio. TECOM's customer base increased 11% YOY to more than 11,000 in 1H24, with addition of more than 1,000 new customers. On the other hand, TECOM Investment FZ LLC, a TECOM Group subsidiary, will buy two Grade A office buildings in the Dubai Internet City for a consideration of AED 420 Mn. Besides, TECOM also plans to acquire 73 plots across Dubai Industrial City spanning 13.9 Mn square feet for a consideration of AED 410 Mn. The acquisitions are expected to positively benefit the Group's financial performance and strengthen its commercial asset portfolio. In addition, TECOM also announced phase 2 of Dubai Design District which will consist of 6 Grade A commercial buildings with a GLA of 503,076 square feet. Furthermore, TECOM inaugurated the first permanent Middle East campus of L'ÉCOLE, School of Jewelry Arts at Dubai Design District (d3) and expanded its customer base across Dubai Industrial city. The conclusion of the investment plan worth AED 1.7 Bn includes the acquisition of three land plots, two buildings, and two industrial city land plots coupled with three development projects that are expected to be completed by 2027, all three will contribute AED 190 Mn to the revenue at full occupancy. The investment will be funded through internal accruals. The strong core operations of the group resulted in a robust recurring free cash flow of AED 362 Mn in 2Q24. The board approved an interim cash dividend of AED 400 Mn for 1H24. Thus, considering the abovementioned factors, we revised to ACCUMULATE rating on the stock.

TECOM - Relative valuation

(at CMP)	2019	2020	2021	2022	2023	2024F
PE	22.49	24.61	18.94	14.85	13.22	11.93
PB	0.87	0.98	0.73	0.71	0.92	0.93
EV/EBITDA	15.16	15.74	12.75	11.64	11.41	10.38
Dividend yield	10.3%	4.6%	13.0%	12.1%	5.6%	5.6%

FABS Estimates & Co Data

TECOM – P&L

AED mn	2Q23	1Q24	2Q24	2Q24F	Var.	YOY Ch	QOQ Ch	2023	2024F	Change
Sales	535	564	584	574	1.7%	9.1%	3.5%	2,169	2,325	7.2%
Direct cost	-185	-185	-191	-191	0.0%	3.1%	3.0%	-760	-771	1.4%
Gross profit	350	379	393	383	2.5%	12.3%	3.7%	1,409	1,555	10.3%
G&A expenses	-32	-45	-51	-43	19.3%	59.7%	15.2%	-154	-161	4.2%
Marketing & selling exp.	-7	-9	-11	-10	9.5%	59.5%	21.8%	-43	-43	0.8%
Other income	17	13	23	12	92.6%	36.5%	75.7%	47	47	-1.1%
Other expenses	0	-4	0	-4	NM	NM	NM	0	-16	NM
Operating profit	328	335	354	338	4.6%	7.9%	5.7%	1,259	1,381	9.7%
Depr. & Amort	98	104	103	110	-6.3%	5.1%	-1.4%	395	427	8.3%
EBITDA	426	439	457	448	1.9%	7.2%	4.0%	1,654	1,808	9.4%
Finance income	13	19	19	20	-5.0%	45.1%	-1.2%	82	80	-2.0%
Finance cost	-111	-50	-56	-101	-44.4%	-49.6%	13.2%	-262	-219	-16.6%
Profit before zakat	229	304	316	258	22.6%	38.0%	4.0%	1,078	1,242	15.2%
Income Tax	0	-12	-6	-10	-41.0%	NM	-49.5%	0	-47	NM
Net Profit	229	293	311	248	25.2%	35.4%	6.1%	1,078	1,195	10.8%

FABS estimate & Co Data

TECOM - Margins

	2Q23	1Q24	2Q24	YOY Ch	QOQ Ch	2023	2024F	Change
Gross margin	65.4%	67.1%	67.3%	190	15	64.9%	66.9%	190
EBITDA margin	79.6%	77.8%	78.2%	-135	38	76.2%	77.8%	154
Operating margin	61.3%	59.3%	60.6%	-68	125	58.0%	59.4%	135
Net profit margin	42.9%	51.9%	53.2%	1,033	133	49.7%	51.4%	168

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	2.94	70.0%	2.06
Dividend Discount Method (RV)	2.59	15.0%	0.39
Price/ FFO	4.66	15.0%	0.70
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 8.6%. It is arrived after using the cost of equity of 9.5% and after-tax cost of debt of 6.5% with a debt-to-equity ratio of 38.3%. The cost of equity is calculated by using a 10-year government bond yield of 5.4%, beta of 1.00 and equity risk premium of 4.1%. 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 6.5%. Also, it assumed a terminal growth rate of 2.0%.

Sum of PV (AED, Mn)	4,926
Terminal value (AED, Mn)	13,917
FV to Common shareholders (AED, Mn)	14,716
No. of share (Mn)	5,000
Current Market Price (AED)	2.85
Fair Value per share (AED)	2.94

DCF Method

(All Figures in AED Mn)	FY 2024E	FY 2025E	FY 2026E	FY 2027E	FY 2028E
NOPAT	1,334	1,304	1,350	1,420	1,475
D&A	427	440	451	455	461
(-) Capex	-493	-333	-279	-480	-637
Change in working capital	-131	38	7	6	6
Free Cash Flow to Firm (FCFF)	423	1,449	1,529	1,402	1,304
Discounting Factor	0.97	0.89	0.82	0.76	0.70
Discounted FCFF	411	1,293	1,256	1,060	907

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 9.5%

Sum of PV (AED, Mn)	3,786
Terminal value (AED, Mn)	9,180
FV to Common shareholders (AED, Mn)	12,965
No. of share (Mn)	5,000
Current Market Price (AED)	2.85
Fair Value per share (AED)	2.59

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	0.97	0.88	0.81	0.74	0.67
Present Value of dividend	774	795	807	737	673

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) Current	PE (x) ¹ Current	Price/FFO (x)
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

Research Rating Methodology:

Rating	Upside/Downside potential
BUY	Higher than +15%
ACCUMULATE	Between +10% to +15%
HOLD	Lower than +10% to -5%
REDUCE	Between -5% to -15%
SELL	Lower than -15%

FAB Securities Contacts:

Research Analyst

Ahmad Banihani +971-2-6161629 ahmad.banihani@Bankfab.com

Sales & Execution

Abu Dhabi Head Office

Trading Desk +971-2-6161700/1 Online Trading Link
 +971-2-6161777

Institutional Desk +971-4-4245765

DISCLAIMER

This report has been prepared by FAB Securities (FABS), which is authorised by the UAE Securities and Commodities Authority, licensing registration number 604002, and is a member of the Abu Dhabi Securities Exchange and Dubai Financial Market. The information, opinions and materials contained in this report are provided for information purposes only and are not to be used, construed, or considered as an offer or the solicitation of an offer or recommendation to sell or to buy or to subscribe for any investment security or other financial instrument. The information, opinions and material in this report have been obtained and derived from publicly available information and other sources considered reliable without being independently verified for their accuracy or completeness. FABS gives no representation or warranty, express or implied, as to the accuracy and completeness of information and opinions expressed in this report. Opinions expressed are current as of the original publication date appearing on the report only and the information, including the opinions contained herein, are subject to change without notice. FABS is under no obligation to update this report. The investments referred to in this report might not be suitable for all recipients. Recipients should not base their investment decisions on this report and should make their own investigations, and obtain independent advice, as appropriate. Any loss or other consequences arising from the uses of material contained in this report shall be the sole and exclusive responsibility of the recipient and FABS accepts no liability for any such loss or consequence. The value of any investment could fall as well as rise and the investor may receive less than the original amount invested. Some investments mentioned in this report might not be liquid investments, which could be difficult to realise in cash. Some investments discussed in this report could be characterised by high level of volatility, which might result in loss. FABS owns the intellectual property rights and any other material contained in this report. No part of this report may be reproduced, utilised or modified in any form either in whole or in part or by any electronic, mechanical or other means, now known or hereafter invented, including photocopying and recording, or stored in any retrieval system without the prior consent of FABS in writing. While utmost care has been taken to ensure that the information provided is accurate and correct, neither FABS, nor its employees shall, in any way, be responsible for the contents. By accepting this document, the recipient agrees he/she has read the above disclaimer and to be bound by the foregoing limitations/restrictions.