

Company In-Depth

31 August 2007 | 11 pages

Urbi Desarrollos Urbanos SA de CV (URBI.MX)

On Track to Meet Its 2007-2011 Plan; Upgrading to Buy

 Rating change

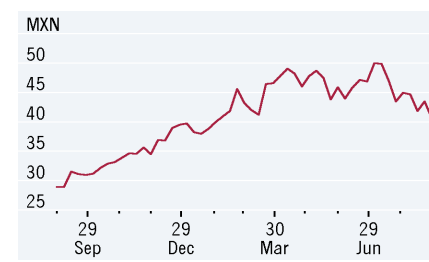
 Target price change

 Estimate change

- Now It Is a Buy** — We upgrade Urbi to Buy from Hold previously, as valuation now looks attractive and we believe that Urbi's long-term planning deserves a premium. Our target price remains unchanged at P\$52 per share, which translates into an ETR of 25.9% as the company does not pay dividends.
- Encouraging Urbi Analyst Update** — During yesterday's event, Urbi gave several presentations on their long-term strategies and planning. Management's achievements thus far lead us to believe the company will meet its goals to double net profit between 2006 and 2011 in real terms, and to continue to be number one in terms of margins.
- Our Estimates Remain Unchanged** — We believe our projections are in line with Urbi's planning. For the period 2007-2011, we foresee a 17.9%, 17.8% and 23.4% CAGR in terms of revenues, EBITDA and net income respectively vs. Urbi's projections of 18.6%, 18.3% and 20.2% for each heading.
- Urbi's Premium Will Remain** — We continue to believe that Urbi's long-term planning capacity based on its technology platform (UrbiNet) as well as its top level management will enable the company to maintain a valuation premium of approx. 16% to the sector EV/EBITDA multiple, similar to the average premium observed since Urbi went public.

Buy/Medium Risk	1M
<i>from Hold/Medium Risk</i>	
Price (31 Aug 07)	P\$41.30
Target price	P\$52.00
Expected share price return	25.9%
Expected dividend yield	0.0%
Expected total return	25.9%
Market Cap	P\$36,995M US\$3,339M

Price Performance (RIC: URBI.MX, BB: URBI* MM)



See Appendix A-1 for Analyst Certification and important disclosures.

Estimates	2006A	2007E	2008E	2009E	Q107A	Q207A	Q307E	Q407E
Sales (P\$ M)	10,056	12,607	15,465	19,210	2,220	3,177	3,356	3,854
EBITDA adj (P\$ M)	2,701	3,363	4,028	5,062	596	856	926	984
EBITDA margin adj (%)	26.9	26.7	26.0	26.3	26.8	27.0	27.6	25.5
Net income (P\$ M)	1,392	1,883	2,421	3,157	307	465	530	582
EPS (P\$)	1.55	2.10	2.70	3.52	0.34	0.52	0.59	0.65

Valuation					Ratios	2006A	2007E
EV/EBITDA adj	14.0	11.4	9.4	7.1	ROE adj(%)	18.5	20.3
PE	26.6	19.6	15.3	11.7	ROIC adj (%)	16.1	16.4
FCF (%)	0.0	-2.1	6.4	6.4	Total debt capital	29.8	25.8

Source: Citigroup Investment Research.

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Fiscal year end 31-Dec	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	31.9	26.6	19.6	15.3	11.7
EV/EBITDA adjusted (x)	17.5	14.0	11.4	9.4	7.1
P/BV (x)	5.5	4.5	3.6	2.9	2.3
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (P\$)					
EPS adjusted	1.29	1.55	2.10	2.70	3.52
EPS reported	1.29	1.55	2.10	2.70	3.52
BVPS	7.52	9.27	11.49	14.37	18.13
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (P\$M)					
Net sales	8,193	10,056	12,607	15,465	19,210
Operating expenses	-6,186	-7,614	-9,571	-11,705	-14,474
EBIT	2,007	2,442	3,036	3,760	4,736
Net interest expense	-298	-268	-501	-435	-376
Non-operating/exceptionals	-10	-82	91	38	25
Pre-tax profit	1,699	2,092	2,627	3,363	4,385
Tax	-540	-700	-744	-942	-1,228
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	1,159	1,392	1,883	2,421	3,157
Adjusted earnings	1,159	1,392	1,883	2,421	3,157
Adjusted EBITDA	2,143	2,701	3,363	4,028	5,062
Growth Rates (%)					
Sales	24.6	22.7	25.4	22.7	24.2
EBIT adjusted	31.7	21.7	24.3	23.8	26.0
EBITDA adjusted	30.1	26.0	24.5	19.8	25.7
EPS adjusted	4.5	20.1	35.3	28.6	30.4
Cash Flow (P\$M)					
Operating cash flow	669	527	-491	2,737	2,810
Depreciation/amortization	136	259	326	267	325
Net working capital	-1,002	-1,689	-3,339	-705	-1,531
Investing cash flow	-190	-539	-301	-356	-432
Capital expenditure	-190	-539	-301	-356	-432
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	244	482	126	188	131
Borrowings	306	574	306	362	328
Dividends paid	0	0	0	0	0
Change in cash	722	471	-666	2,569	2,509
Balance Sheet (P\$M)					
Total assets	12,385	17,813	20,294	25,068	30,579
Cash & cash equivalent	1,816	2,361	1,775	4,402	7,050
Accounts receivable	3,278	3,955	4,756	5,542	6,777
Net fixed assets	372	516	526	631	759
Total liabilities	5,653	9,508	10,005	12,198	14,340
Accounts payable	1,064	1,585	1,931	2,747	3,401
Total Debt	2,256	3,534	3,587	4,215	4,849
Shareholders' funds	6,732	8,305	10,289	12,870	16,239
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	26.2	26.9	26.7	26.0	26.3
ROE adjusted	19.0	18.5	20.3	20.9	21.7
ROIC adjusted	16.9	16.1	16.4	17.3	19.4
Net debt to equity	6.5	14.1	17.6	-1.4	-13.6
Total debt to capital	25.1	29.8	25.8	24.7	23.0

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Upgrading to Buy on Attractive Valuation and Good Long-Term Overview

We raised our rating for Urbi to **Buy/Medium Risk** from Hold/Medium Risk while our target price for the company remains unchanged at P\$52 per share. This target price translates into an expected total return of 25.9%, as the company does not pay dividends.

The factors behind this upgrade are:

1. Attractive valuation after the recent adjustment on its share price.
2. Urbi's long-term planning and our confidence in its management capacity, which should enable it to meet its growth and profitability prospects for the next 5 years and onwards.

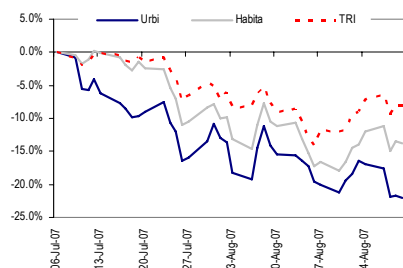
Attractive Valuation

After reaching its high last 6 July, Urbi's share price has had a sharp decline of -22.1%, this adjustment is much higher than the Habita Index's -13.7% and the TRI's drop of -8.0%.

Additionally, after trading at a 12.9x forward EV/EBITDA multiple in June, 2007, Urbi currently trades at a 10.5x multiple, which in our view is attractive for this company.

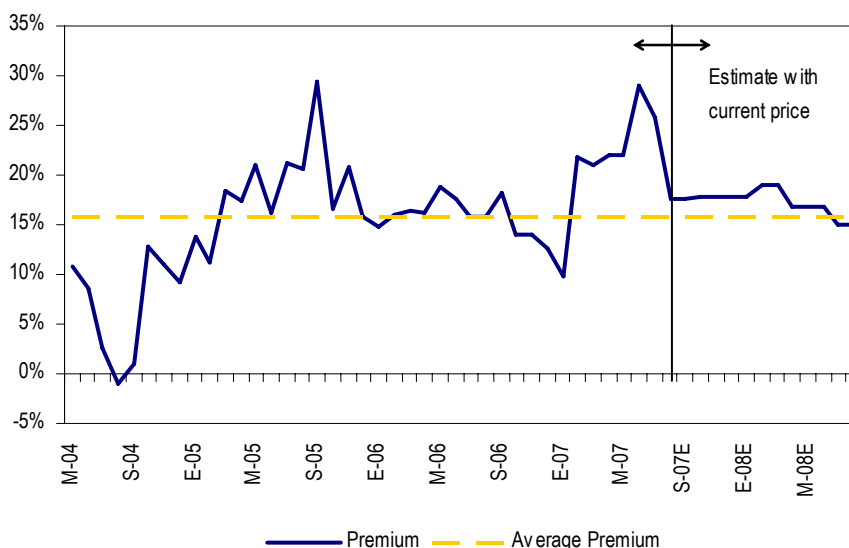
Figure 2 below shows the trend in Urbi's forward EV/EBITDA vs. the homebuilding sector. While the current premium is slightly above its historical average, we can observe that, given Urbi's more aggressive growth rates, it should continue to decline, making its valuation even more attractive.

Figure 1. URBI.MX vs. the Habita Index and TRI (6th July to 30th August, 2007)



Source: Mexican Stock Exchange

Figure 2. Trend in Urbi's Projected EV/EBITDA Multiple Premium/Discount vs. the Sector



Source: Company Reports and CIR Estimates

Urbi's Long-Term Planning and Our Confidence on Its Management

Yesterday we met Urbi's management at its Analyst Update event, in which we learned more about their last 12-months achievements in terms of its 3 strategies outlined last year to meet its growth and profitability targets: 1) the development of mortgage products for higher-priced homes and to increase its market share; 2) the expansion through joint ventures (strategic business units) in order to roll out the business in new regions; and 3) the offering of complementary products to its clients.

In general, we believe that the presentations were encouraging and make us believe that Urbi is on track to meet its medium and long-term goals.

Long-Term Planning

Urbi believes that the Mexican Housing Industry is still in an early stage and that there are at least 20 years of sustainable growth ahead for the sector.

As a result, the company is taking steps to predict the growth direction of the cities that are expected to have more population density in order to start to prospect land in the surrounding areas.

In terms of its planning and development, Urbi has very well established arrangements for up to 5 years.

Furthermore, with respect to the strategic inputs for operation such as human resources, urbanized land, mortgages, working capital, construction materials and labor force, their plans are in place for the next two years.

Under these premises, our certainty on Urbi's capacity to manage its expected growth has increased, as we believe that they have a solid base in terms of its human resources and its infrastructure (UrbiNet).

Macro Projects

Additionally, during this event we had the chance to talk to Carlos Gutierrez, Head of the National Housing Commission (CONAVI), as well as to Urbi's management with respect to our fears regarding Macro Projects. They gave us more light on this theme, as they agreed that the development of these kinds of communities, in which around 1 million people are expected to live, involve a shared effort in terms of investment from both, the public and the private sector. Urbi also made clear that when they talk about Macro Projects, they are not the only private company involved in each of them, and that they work closely with other specialists from different sectors, such as the industrial, commercial and services. They also mentioned that their working capital requirement does not increase as a result of Macro Projects as their development plans are organized in different phases and as they have the access to optioned land.

Financing Schemes

Another subject of special interest for us mentioned at the Urbi Analyst Update event was the one related to the financing of its growth plans and its new products. Selene Avalos, Urbi's CFO, said that from 2008 onwards, they will use an out of balance sheet SPV for an amount of P\$2 billion to finance its "Alternative Urbi" scheme (rent with an option to buy), as a result their accounts receivable cycle should return to a range of 140 - 150 days.

Also, she said that on the 3Q07 they will restructure the term of their debt to a maturity of between 3 to 5 years, as nowadays of the approx. P\$3.2 billion, P\$1 billion is short-term debt. To do this, they will make use of corporate bonds; as of today the CNBV (Mexican regulator) has authorized Urbi the issuance of up to P\$3 billion in corporate bonds.

Urbi Desarrollos Urbanos SA de CV

Company description

Urbi is one of the leaders in the housing sector in Mexico. During its twenty-five years of operations Urbi has developed more than 178,000 homes and has always conducted its business with a strong emphasis on financial performance, which makes it one of the most profitable companies in the sector. Urbi's business model is supported by UrbiNet, its IT platform.

Investment thesis

We rate Urbi Buy / Medium Risk (1M) with a 12-month target price of P\$52 per share. The company does not pay dividends.

Our rating takes the following considerations into account:

1) Sustained and profitable growth. We project that Urbi will manage to sustain above average growth and that technological systems combined with a very capable management will contribute to sustainable high margins and profitability levels.

2) Experienced Management. Like other homebuilders, Urbi's management knows the business well and is very experienced. In our view, what distinguishes it from the others is its ability to effectively transmit its ideas and strategies to the market, which has inspired a lot of confidence in it; needless to say, many investors view it as the best management team of the Mexican housing sector.

3) Valuation premium. We project that Urbi will continue to trade at a premium to the sector average due to its well-structured medium and long-term growth plans and ability to effectively communicate them to investors.

Valuation

We have set a 12-month target price of P\$52 per share. To determine it we used a FCFE method, the result of which is congruent with the price we obtained from an EV/EBITDA valuation.

- Free Cash Flow To Equity. We completed a FCFE exercise using our 2008-2012 projections, a discount rate of 12.4% and a perpetuity of 2.5% and obtained a 12-month target price of P\$51.8 per share. Our discount rate was based on the following assumptions: a Beta of 0.98, an risk-free rate of 6.9% and an equity risk premium of 5.6%. We now use the risk-free and equity risk premium estimates in Mexico calculated in Citi's Fair Value Cost of Equity model published by Geoffrey Dennis, Citi's Head of Latin America Equity Research.

- EV/EBITDA multiple. We view an EV/EBITDA multiple of 9.0x as reasonable for the sector in view of expectations of strong sustained growth. Over the last 12 months the sector EV/EBITDA multiple has revalued from 7.6x in June 2006 to 10x in July 2007.

Furthermore, since Urbi went public, in terms of the forward EV/EBITDA multiple it has traded at a premium to the sector which has averaged 16% (since May 2004 to date).

Given good growth prospects for Urbi in 2007-2012, consistent results and a professional management team, we believe this premium will tend move towards its historical average level. Based on this premise, we chose to value Urbi with an EV/EBITDA multiple of 10.4x, which is equal to a 16% premium to the sector target multiple. Using that multiple and our 2Q09 EBITDA and net debt projections, we arrived at a 12-month target price of P\$51.7 per share.

Risks

We rate Urbi Medium Risk share taking into account its fairly high daily trading volume and market cap. Moreover, we expect Urbi will show sustained growth and to maintain its sound financial position.

The specific risks that may prevent the shares from reaching our target price include:

1. Risks inherent to the sector such as:

- Temporal distortions in the housing market, such as an oversupply or a delay in regional operations.
- Delays in obtaining permits and licenses as well as with collections.

- Small or poorly capitalized developers suffering liquidity problems or even bankruptcy.

2. A downturn in the Mexican economy and an increase in unemployment levels could affect demand for housing loans. However, an upturn in the economy and decrease in unemployment levels could benefit the company and cause the shares to exceed our target price.

3. Given that Urbi is concentrated in northern Mexico, changes in the regional economy due to an economic downturn in the United States, could prevent our growth projections from being met

4. An increase in interest rates on mortgage loans granted by banks and Sofoles (non-bank banks) could stem demand for higher priced housing.

5. A change in the tax treatment of inventories could negatively affect cash generation and results.

6. Expectations of a more complicated financial structure could magnify the impact on the company of an unfavorable macroeconomic scenario.

If the impact on the company from any of these factors proves to be greater than we anticipate, the stock will likely have difficulty reaching our target price.

Appendix A-1

Analyst Certification

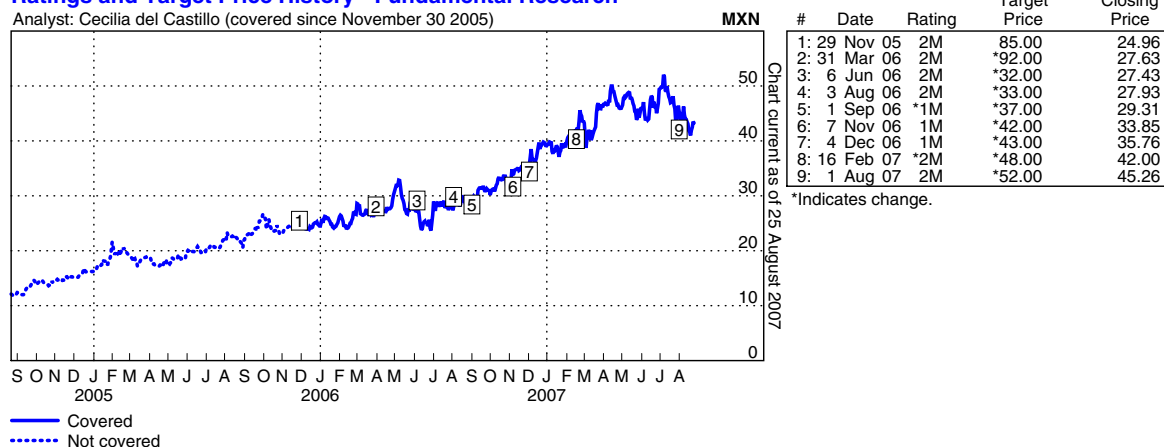
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Urbi Desarrollos Urbanos, SA de CV (URBI.MX)

Ratings and Target Price History - Fundamental Research

Analyst: Cecilia del Castillo (covered since November 30 2005)



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