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Jail-Building Triggers Rebound in Homex Bonds: Mexico Credit

2012-05-15 19:28:24.800 GMT

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May 25 (Bloomberg) -- Desarrolladora Homex SAB, the worst-performing major Mexican homebuilder in the bond market last year, is beating peers in 2012 after its expansion into prison building helped spark a 60 percent surge in profit.

Yields on Homex's dollar bonds due in 2019 have tumbled 69 basis points, or 0.69 percentage point, this year to 9.39 percent, according to data compiled by Bloomberg. Yields on similar-maturity debt from Corp. Geo SAB, Mexico's largest homebuilder after Homex, fell 37 basis points in the same period to 9.31 percent. Borrowing costs for Latin American companies that share Homex's rating have dropped 44 basis points this year to 7.08 percent, Credit Suisse Group AG data show.

Homex, based in Culiacan, Mexico, is taking advantage of government demand for prison construction at a time when an increase in subsidized mortgages has buoyed homebuilding in Latin America's second-biggest economy. The company said May 2 that penitentiaries accounted for 37 percent of total revenue in the first quarter and that it has completed about a third of the prison projects it expects to finish and deliver to the federal government this year.

"It's a great business line for them," Raymond Zucaro, who helps manage about \$230 million of emerging-market corporate debt, including Homex bonds, at SW Asset Management LLC, said in a telephone interview from New York. "If I look at the metrics and the return on the capital, it's a no-brainer."

Homex's bonds yield 637 basis points more than Mexican government debt due in 2020, compared with 692 at the end of last year, according to data compiled by Bloomberg. It is rated BB- by Fitch Ratings, three levels below investment grade and four steps below Mexico. Yields on the company's bonds rose 276 basis points last year to 10.08 percent.

Profit Jumps

The company said earnings before interest, taxes, depreciation and amortization -- a measure of profit known as Ebitda -- jumped to 1.34 billion pesos (\$95.9 million) in the first quarter from 839 million pesos a year earlier, according to its May 2 report. Geo's Ebitda climbed 12 percent in the period. Urbi Desarrollos Urbanos SAB, Mexico's third-largest homebuilder by sales, said Ebitda rose 11 percent in the first quarter.

Homex "had better results, and there's been more interest in the bonds" as a result of the prison projects, Guillermo Rodriguez, who helps manage \$5.5 billion of debt at Corp. Actinver SAB, said in telephone interview from Mexico City.

"It's helped them."

Press officials from Homex didn't respond to phone calls seeking comment. Geo spokesman Alejandro Haiducovich declined to comment. Antonio Jorge, an investment relations official with Urbi, declined to comment.

Cash Drain

Mexico is seeking to reduce overcrowding in the nation's prisons. The country's 429 federal and state prisons have 223,521 inmates, or 22 percent more than the designed capacity of 183,188, according to a 2011 report from the Secretary of Public Security.

Charles de Quinsonas, an analyst at Spread Research, said that while the prison business is boosting Homex's profitability, it's also draining cash. Cash flow was negative 892 million pesos as of March 31 because the prison projects under construction are registered as accounts receivable. The homebuilding business alone generated positive cash flow of 865 million pesos.

"In the medium to long term, the penitentiaries might well generate significant cash flows, but in the short term it's clearly a negative for the credit," de Quinsonas said in a telephone interview from Lyon, France.

The extra yield investors demand to own Mexican government dollar bonds instead of U.S. Treasuries narrowed three basis points to 234, according to JPMorgan Chase & Co.

Default Swaps

The cost to protect Mexican debt against non-payment for five years increased three basis points to 149 basis points yesterday, according to data compiled by Bloomberg. Credit- default swaps pay the buyer face value in exchange for the underlying securities or cash equivalent if the issuer fails to comply with debt agreements.

Yields on Mexican interbank rate futures contracts due in December, known as TIIE, were little changed at 4.76 percent yesterday.

The peso fell 0.2 percent to 14.0153 per U.S. dollar.

Homex predicts sales will climb as much as 61 percent in 2012, according to forecasts included in the company's first- quarter report. Its profit margin will rise to as high as 27 percent, about five percentage points higher than it would have been without the jails.

"The country needs to build more prisons," Alejandro Hernandez, who helps manage about \$1.3 billion of assets at Grupo Financiero Interacciones SA, said in a telephone interview in Mexico City. "It's a great business because the money comes from the federal government."

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