

# JAVER: Initiation of Coverage

## The Company's Focus on the Middle and Residential Segments Will Pay-Off With a High Growth in the Future

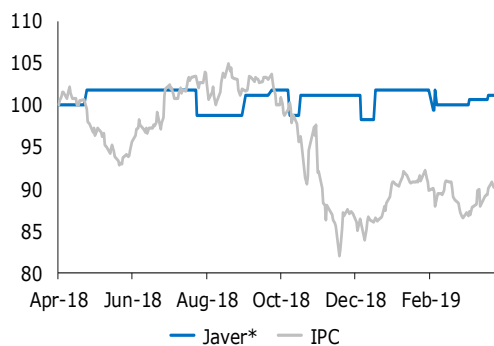
<b>HOLD</b>	
Target Price 2019E (MXN\$)	\$ 18.50
Current Price (MXN\$)	\$ 16.88
12M Max / Min (MXN\$)	\$ 15.91- 17.00
Expected Dividend (MXN\$)	\$ 0.00
Potential Return	9.6%
Market Cap. (MXN\$ Mn)	4,707
Enterprise Value (MXN\$ Mn)	6,394
Outstanding Shares (Mn)	278.8
Floating Shares	34.1%
ADTV (MXN\$ Mn)	\$ 0.04

We are initiating coverage on Servicios Corporativos JAVER, S.A.B. of C.V. ("JAVER")'s shares with a HOLD recommendation and a year-end target price of MXN\$18.50 per share. The potential return is 9.6% against the current market price. We are also initiating coverage on JAVER's Senior Notes due 2021 with a HOLD recommendation.

### Investment Thesis

**Solid fundamentals.** We believe that JAVER's fundamentals are solid due to its leading position in the housing sector and as the main provider of INFONAVIT loans, its flexible and efficient model that allows the company to adapt itself to demand and take advantage of market opportunities, its focus on maximizing positive free cash flow and ROIC, the continuous improvement of the working capital cycle, its low leverage, and its management team with a well-known track record of value creation.

**Slow start to the year offset by a strong performance in the residential segment.** We expect JAVER to present a decrease in units sold during the current year, but maintaining the same level of revenues and a slightly higher EBITDA, as a consequence of the macroeconomic weakness and the significant reduction in CONAVI's subsidies that was announced at the end of last year. In addition, the high



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## **JAVER:** Initiation of Coverage

investments in land reserves that the company will carry out during the first half of the year might pressure its working capital during such period. However, the improvement in the sales mix as a result of the company's focus on the middle and residential segment will boost its average price, helping to maintain the indicators.

**Favorable "sexenio" for the housing sector.** We believe that the National Housing Policy, which will likely be announced at the end of the current month, will be favorable for Mexican developers. Its objective will be to support the housing demand, reduce the existing deficit of approximately 9 million homes and, probably, offset the contraction in CONAVI's subsidies. In addition, we consider that the individuals who are in charge of the relevant housing organizations (INFONAVIT, FOVISSSTE, CONAVI) are very capable. On the other hand, we believe that the current subsidy scheme is unlikely to be modified.

**JAVER's growth will accelerate from 2020.** We expect JAVER's operating performance to improve during the next year, once the economy begins to grow at a higher rate and the company completes its investments in land reserves. We estimate that revenues, EBITDA and net income will grow at an average annual rate of 6%, 6% and 8%, respectively, in the 2020-2024 period. In addition, we expect the company to generate positive free cash flow and to gradually reduce its leverage. We believe that our projections might prove to be conservative since we are not including any benefits related to the new National Housing Policy in our model.

### **Valuation of the Shares**

JAVER shares are currently trading at an EV/EBITDA of 6.5x and a P/E of 12.8x, estimated for 2019. These multiples compare against the averages of 6.2x and 8.6x, respectively, of the Latin American housing developers, which justifies our neutral point of view.

We set our year-end MXN\$18.50 target price for JAVER shares through a discounted cash flow model which includes a 3.7% perpetuity growth rate and 10.0% WACC. The target forward multiples are 6.4x in terms of EV/EBITDA and 14.6x in terms of P/E.

**Senior Notes due in 2021**

Our HOLD recommendation on JAVER's Senior Notes 2021 is also due to our expectation that the company will enter a period of low operating growth and that the working capital could experience some pressure during the first half of the year as a result of significant investments in land reserves. However, we believe that any adjustment in the market price of these debt instruments should be considered as an investment opportunity for two reasons: i) they currently offer an attractive 9.66% yield to maturity in US Dollar terms, which compares favorably against the 7.72% average yield of Mexican non-investment grade corporate bonds denominated in dollars; and, ii) we believe that the trend of JAVER's credit ratings will be upwards the end of the current year. On the other hand, the company told us that it is currently analyzing refinancing alternatives for these instruments.

**Main risks**

The main risks that JAVER currently faces are: i) macroeconomic volatility; ii) adverse regulatory or fiscal changes; iii) changes in the availability of mortgage loans; iv) greater competition from other housing developers; v) changes in the administrative team; vi) low liquidity of the shares; and / or vii) refinancing of the Senior Notes due 2021.

## **JAVER: Initiation of Coverage**

### **THE HOUSING SECTOR IS A PRIORITY FOR THE CURRENT GOVERNMENT**

In our opinion, the housing sector is a priority for the incoming government since it contributed with 5.9% of GDP in 2017, according to information from CONAVI. In addition, it employed 2.9 million people. For this reason, we do not anticipate any adverse regulatory changes that could potentially affect the housing developers.

In fact, AMLO's campaign proposals included: i) an increase in the supply of housing; ii) higher financing and improved FOVISSSTE programs; iii) financing to non-employees; iv) strengthening of the housing program; v) investment in infrastructure for urban strengthening; vi) legal regulation and operation; and) regulation of the land market.

### **HIGH HOUSING DEFICIT IN MEXICO**

The Mexican housing market offers significant long-term growth potential given an estimated deficit of 9 million homes, according to INFONAVIT's and CONAVI's figures at the end of 2016.

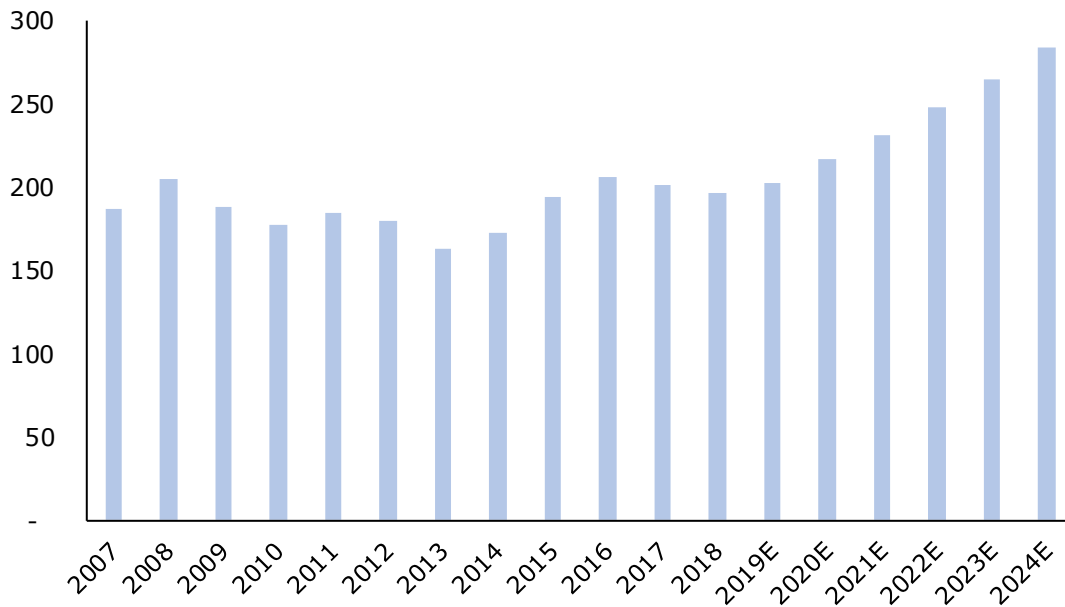
In 2017, we estimate that around 606 thousand new families were created. However, only 341 thousand of them had access to a mortgage. On the other hand, only 454 thousand homes were offered, increasing the deficit by 163 thousand homes.

In the future, we estimate that around 580 thousand houses will be needed annually until the year 2030, mainly due to the creation of new families given a population growth of approximately 1 million inhabitants per year. However, we project that only 56% of new homes, equivalent to 325 thousand per year, will have access to mortgage loans and that the remaining 44% will increase the housing deficit. In other words, it seems that such housing deficit will not reduce in the foreseeable future.

With respect to the supply of credit for new housing, it amounted to MXN\$196 billion in 2018, which represented a slight reduction compared to the MXN\$201 billion of the previous year. Within the 2018 amount, around MXN\$96 billion corresponded to commercial banking, which represented a 3.1% reduction. INFONAVIT placed nearly MXN\$82 billion, practically unchanged with respect to the previous year, and FOVISSSTE granted loans amounting to 18.1 billion, with an 8.3% contraction. For this year, we estimate that total mortgage credit will grow 3% to close to MXN\$203 billion, which will include a 9% increase in INFONAVIT, partially offset by a stable performance of the commercial banks and an additional 5% fall at FOVISSSTE. For the next few years, we expect total mortgage loans to increase at an average annual rate of at least 7%, given the low penetration with respect to GDP.

**JAVER:** Initiation of Coverage

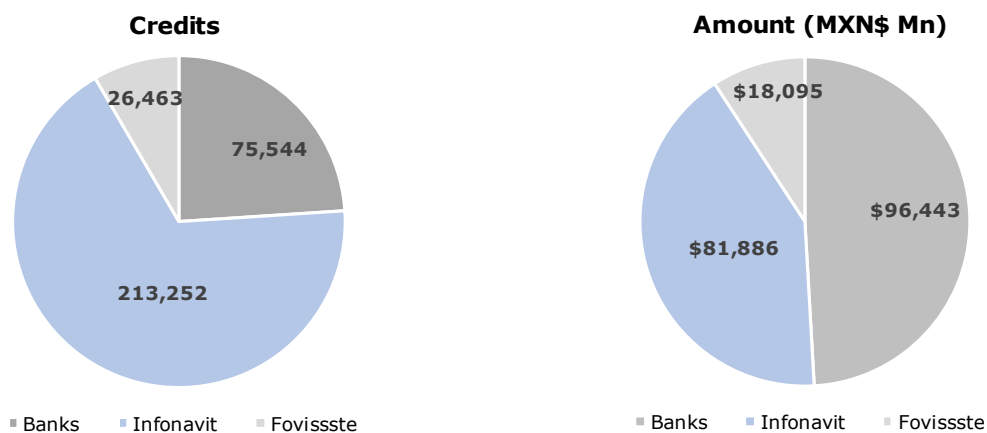
**Graph 1.- Total Housing Credit in Mexico (MXN Bn)**



Source: INFONAVIT, FOVISSSTE, Commercial Banks

INFONAVIT is the main driver of the low-income housing sector in Mexico, since it placed more than 213 thousand mortgages for new homes in 2018, with an average amount of MXN\$384 thousand per mortgage. FOVISSSTE placed 26,463 mortgages with an average amount of MXN\$684 thousand, while commercial banks placed 75,544 loans with an average amount of MXN\$1.28 million.

**Graph 2.- Breakdown of Housing Credit by Institution (2018)**



Source: INFONAVIT, FOVISSSTE, Commercial banks

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### **Macroeconomic Environment**

We believe that the macroeconomic environment has deteriorated recently due mainly to international financial volatility. Vector Casa de Bolsa's Macroeconomic Team expects GDP to grow 1.7% in 2019 and 2.3% in 2020. It also projects that the US dollar will close at MXN\$19.10 in 2019 and MXN\$19.00 in 2020. However, we believe that JAVER is highly defensive in such environment due to the significant housing deficit that currently exists in the country, as well as the company's flexible model, its excellent working capital management, its low leverage and its positive free cash flow generation.

### **LOWER SUBSIDIES BY CONAVI**

In 2006, the Federal Government launched a subsidy program for people who earned up to 2.6 minimum wages, which were granted by CONAVI. This program was modified in 2014 to increase the maximum salary to 5.0 minimum wages. In order for the land to qualify for a subsidy by the Federal Government, it must be located in urban areas U1, U2 or U3, as established by the Ministry of Agricultural, Territorial and Urban Development (SEDATU). 75% of the units to be built in JAVER's territorial reserves are located in the U1, U2 and U3 urban areas.

In 2018, the amount of subsidies provided by CONAVI was MXN\$6,829 million. The Economic Package for 2019 included a reduction to only MXN\$1,717 million, of which only MXN\$400 million is for new housing. We believe that this adjustment will continue to affect the demand for affordable housing built by the developers which are more focused in this segment, such as JAVER and CADU.

### **FAVORABLE "SEXENIO" FOR THE HOUSING SECTOR**

The new National Development Plan for the 2019-2024 period must be delivered to the Chamber of Deputies no later than April 30. It will include the new National Housing Policy that will be applied during this period, whose purpose is to support the demand for housing, reduce the existing deficit of approximately 9 million homes and, probably, compensate for the reduction in CONAVI's subsidies. We expect the new National Housing Policy to be implemented from next July. We believe that it will be favorable for the development companies. In addition, we consider that the individuals who are in charge of the relevant housing organizations (INFONAVIT, FOVISSSTE, CONAVI) are very capable.

We believe that the National Housing Policy could include certain new measures that will be applied through the INFONAVIT such as an additional support for low-income people for the acquisition of housing, the use of a benefit focused on reducing the payment of the principal in a more accelerated manner and/or an increase to the maximum amount of credits.

On the other hand, we believe that CONAVI's subsidy scheme has low chances of being modified after the sharp reduction that it suffered at the end of last year.

- **Support for low income INFONAVIT beneficiaries.** We talked with several participants of the housing sector and some mentioned that they expect the Federal Government to launch additional supports focused on low-income individuals. We

## **JAVER: Initiation of Coverage**

believe that this measure could reactivate the demand for social interest housing, which has been affected by the aforementioned reduction in CONAVI's subsidy scheme.

- **Benefit for the anticipated reduction of the principal.** According to an interview in certain media with Federico Sobrino, former member of INFONAVIT's Board, the institutions' beneficiaries who have an outstanding mortgage may use a benefit to pay the capital more quickly. We estimate that such benefit will represent around 5% of the workers' salary.
- **Possible increase in the maximum amount of mortgage credits.** Other participants in the sector told us that they expect INFONAVIT to increase the maximum amount of its mortgage loans to around MXN\$2.2 million, from the current level of MXN\$1.8 million. In our opinion, this measure could boost the demand for mortgage loans of all segments, not only the residential ones, which will most likely benefit most of the Mexican housing companies. However, this measure could face some opposition from commercial banks since these institutions might lose some market share to INFONAVIT in the mortgage segment.
- **Other possible measures.** According to Gonzalo Méndez, National President of CANADEVI, an extension of the maturity period and a reduction of the interest rate of INFONAVIT's mortgage loans have also been proposed. However, we note that some of these measures have been included in the "Shared Responsibility Program" that this Institute launched in early February. According to Federico Sobrino, the use of workers' retirement savings (we assume that the Afores's retirement sub-account) to purchase housing, which could reduce the payment period, has also been analyzed.

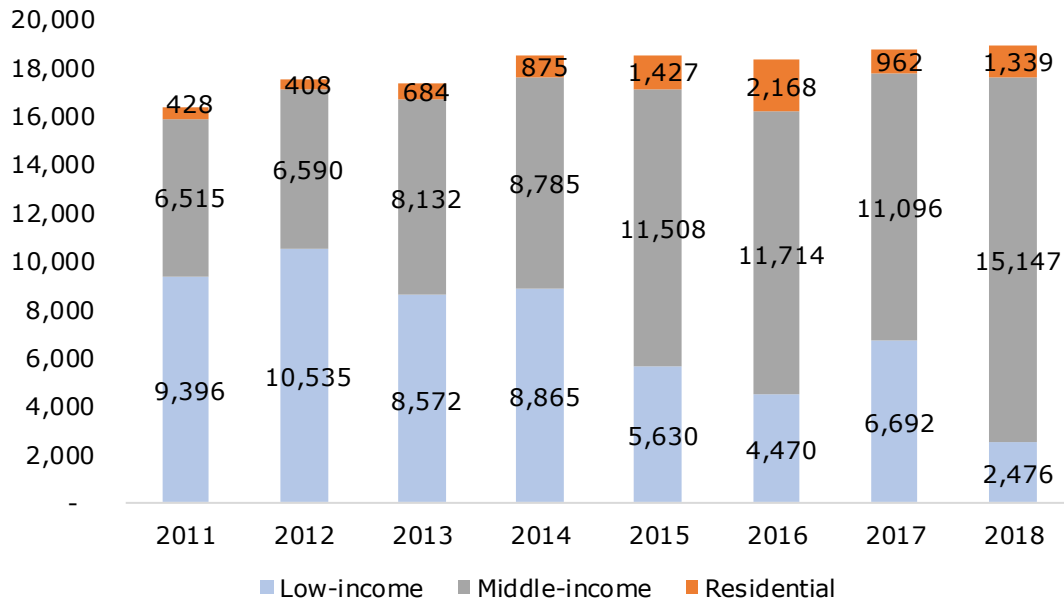
## **JAVER'S MAIN COMPETITIVE ADVANTAGES**

### **Flexible and Efficient Business Model**

This business model allows JAVER to adapt its product mix to the demand, and thus take advantage of market opportunities. For example, in 2013, the company sold a total of 17,388 homes, of which 8,572 were in the low-income segment, 8,132 in the middle-income one and 684 in the residential segment. In 2018, the company placed 18,962 units, of which 2,476 were in the social interest segment, 15,147 in medium interest and 1,339 in the residential segment.

## JAVER: Initiation of Coverage

**Graph 3.- Breakdown of Units Sold**

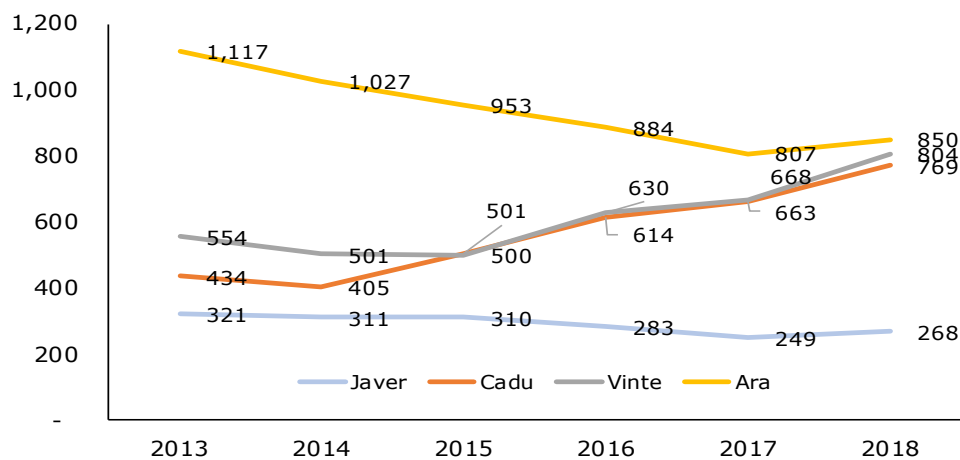


Source: JAVER

## Lowest Working Capital Cycle

JAVER has focused on the continuous improvement of its working capital cycle during the last few years. As a result, the company recorded the lowest capital cycle in the industry at the end of 4Q18.

**Graph 4.- Working Capital Cycle of Mexican Housing Developers (Days)**



Source: JAVER

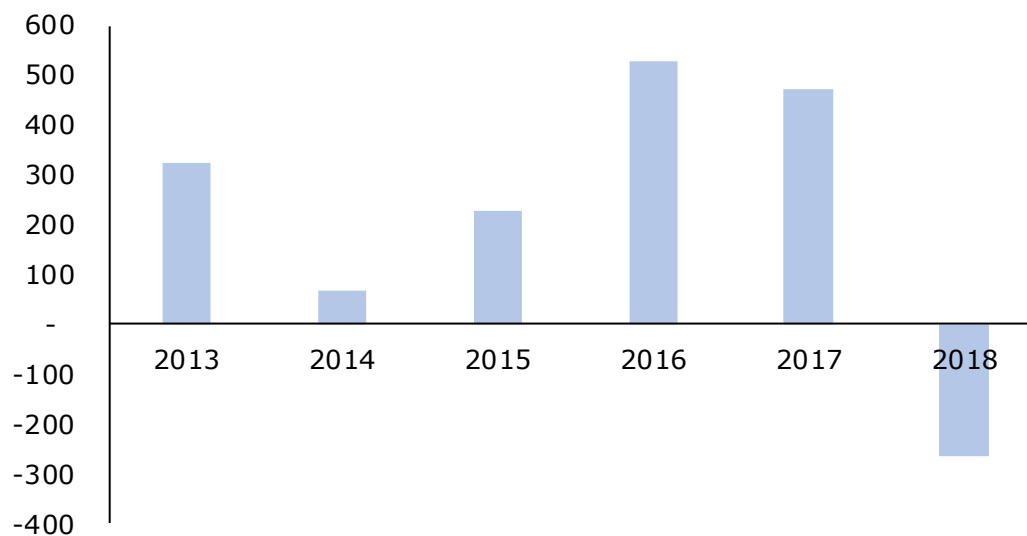


## JAVER: Initiation of Coverage

### Focus on Maximizing Free Cash Flow, ROIC and Returns for Shareholders

JAVER has generated positive free cash flow in each of the years comprised between 2012 and 2017, as can be seen in the following graph. In 2018, the company presented negative free cash flow due to sizable investments in land reserves, which we believe will persist at the beginning of the current year. However, we expect JAVER to start generating positive free cash flow again during the second half of the current year and during the following years.

**Graph 5.- Free Cash Flow (MXN\$ Million)**

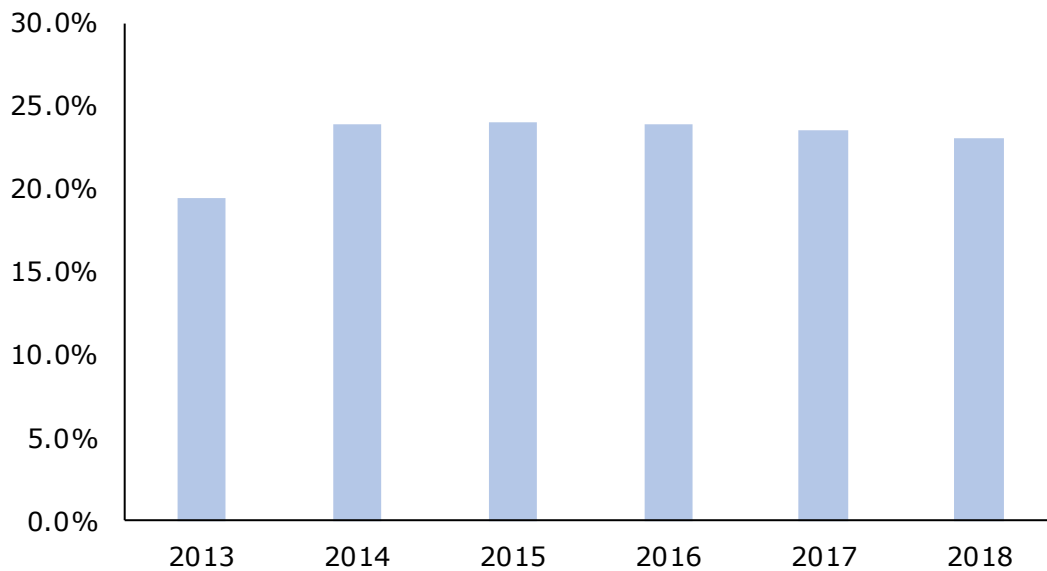


Source: JAVER

In addition, JAVER's ROIC (calculated as operating income of the last 12 months divided by total capital invested) has exceeded 20% since the beginning of 2014, as can be seen in the following graph. We believe that the company will continue registering a high ROIC during the following years.

## JAVER: Initiation of Coverage

**Graph 6.- Pre-Tax ROIC**



Source: JAVER

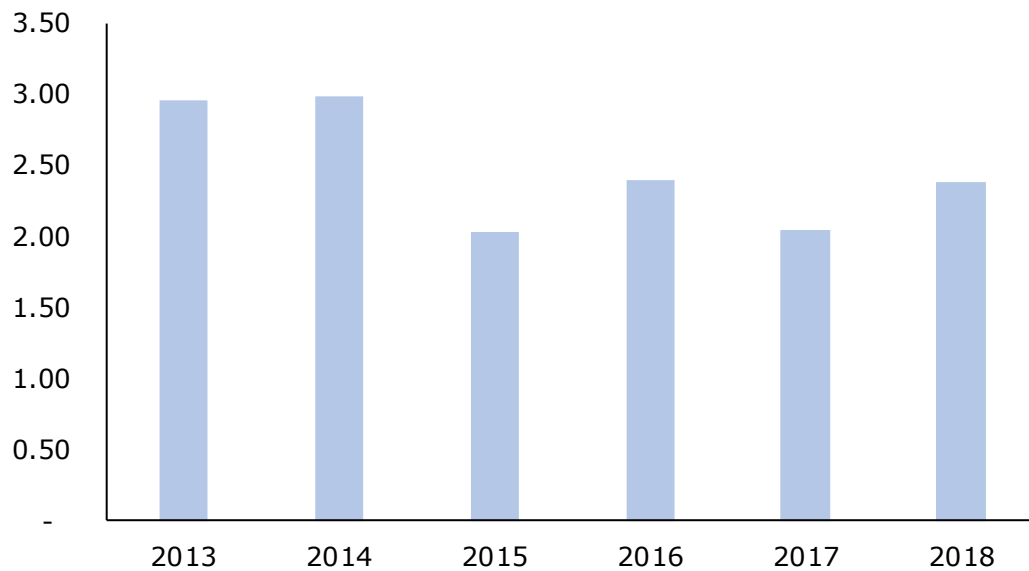
This strategy has allowed JAVER to pay dividends in the past. For example, in 2016, the company paid a MXN\$1.75 per share dividend for a total amount of MXN\$475 million. In 2017, it distributed a MXN\$0.2567 per share dividend, equivalent to a total amount of MXN\$71.5 million. However, in 2018, the company did not make any dividend payments. In a conservative way, we estimate that it will not distribute any amount during the next years.

### **Solid Financial Structure**

Historically, JAVER has focused on maintaining a low leverage. At the end of 2018, the company's net debt to EBITDA ratio was 2.4x, which we consider to be very solid. JAVER's long-term objective is to maintain its leverage below 2.5x.

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**Graph 7.- Net Debt / EBITDA Ratio (x)**



Source: JAVER

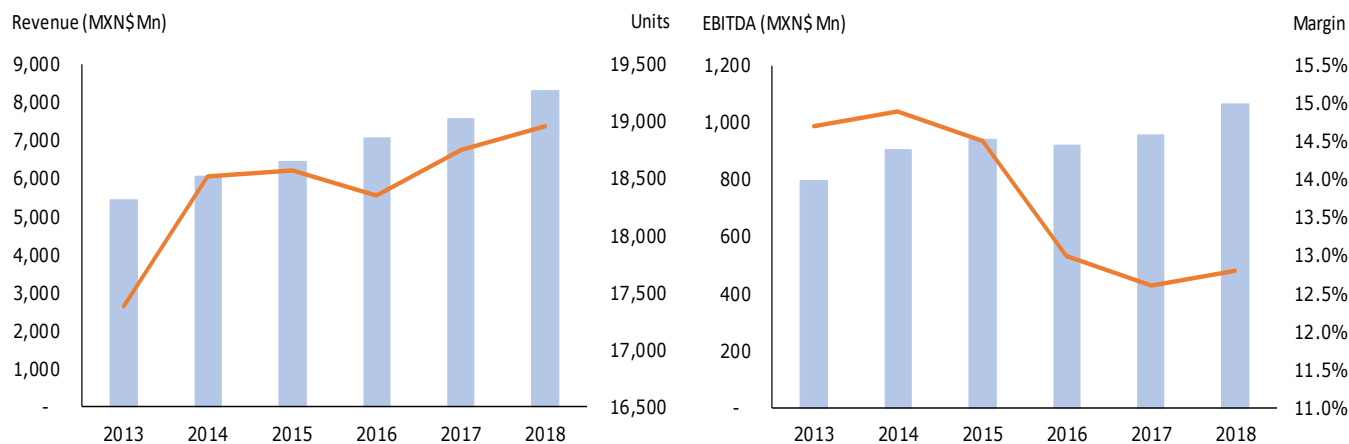
### **Management Team with a Solid Track Record**

The CEO, René Martínez Martínez, joined the company as COO in 2009 and was promoted to his current position in 2017. The CFO, Felipe Loera, joined in 2007 as Controller, receiving his current appointment in 2013. The COO, Juan Carlos Gallegos, has been working in the company since 1999 and has been in the current position since 2017.

JAVER's management team has a solid track record of creating shareholder value. Over the past few years, it has generated a continuous growth in revenues, units, and adjusted EBITDA.

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**Graph 8.- Revenues, Units, Adjusted EBITDA and Adjusted EBITDA Margin**



Source: JAVER

### **SLOW 2019, BUT FAVORABLE LONG-TERM OUTLOOK**

We expect JAVER to register slow results in 2019, mainly due to the macroeconomic weakness and the reduction in CONAVI's subsidies. In addition, the company will invest MXN\$700-800 million in the acquisition of land reserves, mainly during the first half of the year, which should put some pressure on its working capital during such period.

We anticipate that JAVER will sell 16,000 houses in 2019, down 16%. This will include a 49% reduction in the low-income segment and a 15% fall in the middle-income one, offset by a substantial 40% increase in residential housing. However, we expect the sales mix to improve, which will boost the average price by 18% to MXN\$515,000. As a result, revenues will decrease slightly to MXN\$8.244 million but its EBITDA to grow by 5.0% to MXN\$1.115 billion. The EBITDA margin will improve to 13.5% in 2019, higher than the 12.8% of the previous year.

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**Table 1.- JAVER'S Main Operating Indicators**

(MXN\$ Mn)	2018	2019E	2020E	2021E	2022E	2023E	2024E	2018	2019E	2020E	2021E	2022E	2023E	2024E
<b>Revenues</b>	<b>8,321</b>	<b>8,244</b>	<b>9,234</b>	<b>9,660</b>	<b>10,105</b>	<b>10,571</b>	<b>11,057</b>	<b>10.0%</b>	<b>-0.9%</b>	<b>12.0%</b>	4.6%	4.6%	4.6%	4.6%
Low-Income	691	369	390	412	435	459	485	-61.9%	-46.5%	5.6%	5.6%	5.6%	5.6%	5.6%
Middle-Income	5,898	5,223	5,865	6,131	6,409	6,700	7,004	35.0%	-11.5%	12.3%	4.5%	4.5%	4.5%	4.5%
Residential	1,698	2,631	2,955	3,089	3,229	3,376	3,529	31.6%	55.0%	12.3%	4.5%	4.5%	4.5%	4.5%
Commercial Lots	34	20	24	28	32	36	40	-62.4%	-41.1%	20.0%	16.7%	14.3%	12.5%	11.1%
<b>Units</b>	<b>18,962</b>	<b>15,970</b>	<b>17,246</b>	<b>17,431</b>	<b>17,618</b>	<b>17,808</b>	<b>18,000</b>	1.1%	-15.8%	8.0%	1.1%	1.1%	1.1%	1.1%
Low-Income	2,476	1,257	1,282	1,308	1,334	1,361	1,388	-63.0%	-49.2%	2.0%	2.0%	2.0%	2.0%	2.0%
Middle-Income	15,147	12,839	13,930	14,070	14,210	14,353	14,496	36.5%	-15.2%	8.5%	1.0%	1.0%	1.0%	1.0%
Residential	1,339	1,874	2,033	2,053	2,074	2,095	2,116	39.2%	39.9%	8.5%	1.0%	1.0%	1.0%	1.0%
<b>Average Price per Unit</b>	<b>437,037</b>	<b>514,962</b>	<b>534,069</b>	<b>552,586</b>	<b>571,744</b>	<b>591,565</b>	<b>612,071</b>	9.7%	17.8%	3.7%	3.5%	3.5%	3.5%	3.5%
Low-Income	279,006	293,950	304,238	314,886	325,907	337,314	349,120	3.0%	5.4%	3.5%	3.5%	3.5%	3.5%	3.5%
Middle-Income	389,409	406,802	421,040	435,776	451,028	466,814	483,153	-1.1%	4.5%	3.5%	3.5%	3.5%	3.5%	3.5%
Residential	1,268,038	1,404,326	1,453,477	1,504,349	1,557,001	1,611,496	1,667,899	-5.5%	10.7%	3.5%	3.5%	3.5%	3.5%	3.5%
<b>Revenues</b>	<b>8,321</b>	<b>8,244</b>	<b>9,234</b>	<b>9,660</b>	<b>10,105</b>	<b>10,571</b>	<b>11,057</b>	<b>10.0%</b>	<b>-0.9%</b>	<b>12.0%</b>	<b>4.6%</b>	<b>4.6%</b>	<b>4.6%</b>	<b>4.6%</b>
Cost of Sales	-6,173	-6,075	-6,804	-7,118	-7,447	-7,789	-8,148	10.3%	-1.6%	12.0%	4.6%	4.6%	4.6%	4.6%
Gross Profit	2,148	2,169	2,430	2,542	2,658	2,782	2,909	9.3%	1.0%	12.1%	4.6%	4.6%	4.6%	4.6%
Gross Margin	25.8%	26.3%	26.3%	26.3%	26.3%	26.3%	26.3%	-0.6%	1.9%	0.0%	0.0%	0.0%	0.0%	0.0%
Sales and Administrative Exp.	-1,201	-1,170	-1,303	-1,362	-1,420	-1,485	-1,550	11.6%	-2.6%	11.4%	4.5%	4.3%	4.6%	4.4%
Other Gains (Losses)	5	4	4	4	4	4	4	-641.9%	-21.1%	0.0%	0.0%	0.0%	0.0%	0.0%
Operating Profit	952	1,003	1,131	1,184	1,242	1,300	1,363	7.2%	5.3%	12.8%	4.7%	4.9%	4.7%	4.8%
Depreciation and Amortization	73	77	77	77	77	77	77	62.3%	4.8%	0.0%	0.0%	0.0%	0.0%	0.0%
Profit Sharing & Exec. Comp.														
<b>EBITDA</b>	<b>1,062</b>	<b>1,115</b>	<b>1,248</b>	<b>1,304</b>	<b>1,367</b>	<b>1,429</b>	<b>1,495</b>	<b>11.0%</b>	<b>5.0%</b>	<b>11.9%</b>	<b>4.5%</b>	<b>4.8%</b>	<b>4.6%</b>	<b>4.7%</b>
EBITDA Margin	12.8%	13.5%	13.5%	13.5%	13.5%	13.5%	13.5%							

Source: Miranda Global Research

We also expect the company to generate negative free flow during the first half of the year as a result of high investments in the acquisition of land reserves, which will be concentrated during this period. However, the free cash flow generation should improve during the second half of the year, with which the company will end up with a positive figure for the year.

In 2020, we expect a solid 8.5% unit growth in the middle-income and the residential segments. However, low-income units should only grow 2.0%. The average price should increase in line with inflation in all segments. This will boost the company's revenues by 12% to MXN\$9.234 billion. Despite this strong revenue growth, we are assuming that JAVER's EBITDA margin will remain stable at 13.5%, with which its EBITDA will also rise by 12%.

JAVER will continue to generate positive free cash flow in 2020. We believe that the company will use these resources to reduce its leverage, which should decline to 2.2x.

For the following years, we anticipate that JAVER's units will grow marginally and that prices will remain at least in line with inflation. This should generate a 5% annual average revenue increase. In our projections model, we are maintaining a stable EBITDA margin of 13.5%. We also assume that the company will continue to generate positive free cash flow and that it will use these resources to continue strengthening its balance sheet.

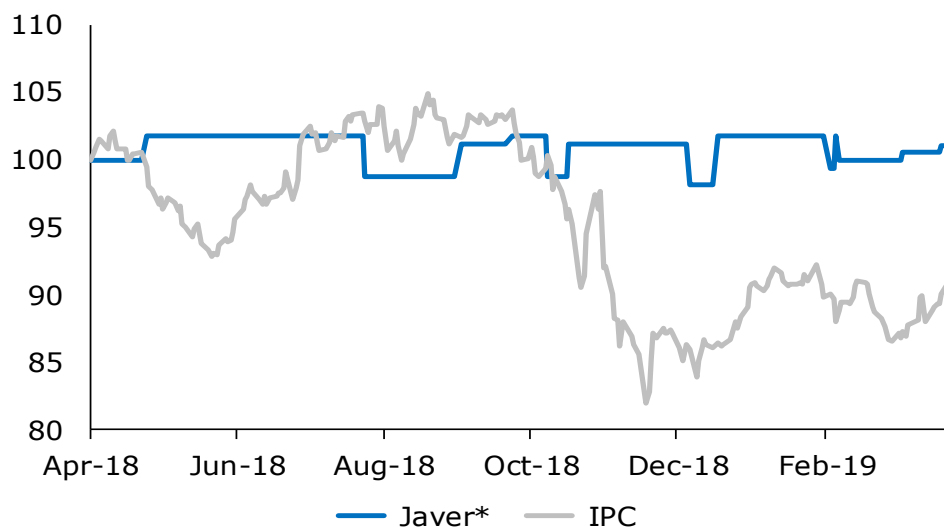
## JAVER: Initiation of Coverage

### VALUATION

#### Performance vs. IPC Index

JAVER's shares have outperformed the IPC Index by 654 bps during the last twelve months. We believe that they will perform in line with the IPC Index in the medium term due to the expectation of stable operating results in 2019, as well as the possibility that the company will generate negative free flow during the first half of the current year.

**Graph 9.- JAVER\* vs. IPC Index**



Source: Bloomberg

#### Valuation of Latin American Housing Developers

JAVER's shares currently trade at an EV/EBITDA of 6.5x and a P/E of 12.8x, in both cases estimated for 2019. These multiples compare against the averages of 6.2x and 8.6x, respectively, of Latin American developers, which justifies our neutral point of view.

## JAVER: Initiation of Coverage

**Table 2.- Valuation of Latin American Housing Developers**

Company	Price USD	Change (USD)		Mkt. Cap. (USD Mn)	EV/EBITDA		P/E		Δ EBITDA	
	08/04/19	5D	YTD		2019E	2020E	2019E	2020E	2018E	2019E
Javer *	\$ 0.89	0.0%	-0.7%	249	6.5x	6.0x	12.8x	13.3x	5%	12%
Ara *	\$ 0.27	2.2%	1.8%	354	4.8x	4.5x	7.5x	7.1x	12%	7%
Vinte *	\$ 1.48	-1.9%	-3.1%	281	8.6x	8.1x	10.2x	9.5x	7%	7%
Cadu A	\$ 0.75	-0.8%	-5.0%	257	6.2x	7.0x	6.2x	7.1x	4%	-11%
MRV Engenharia e Part	\$ 3.64	-1.1%	13.3%	1,615	6.3x	5.7x	7.8x	6.9x	19%	11%
Tenda	\$ 4.34	-2.4%	4.1%	453	4.7x	4.4x	7.3x	6.7x	17%	8%
<b>Average</b>				<b>3,209</b>	<b>6.2x</b>	<b>5.9x</b>	<b>8.6x</b>	<b>8.0x</b>	<b>11.1%</b>	<b>5.0%</b>

Source: Bloomberg, Miranda Global Research

### Discounted Cash Flow Model (DCF)

We set our year-end MXN\$18.50 target price through a discounted cash flow model which includes a 3.7% perpetuity growth rate in nominal terms and a 10.0% WACC. To calculate the WACC, we used a 9.5% cost of capital, a pre-tax cost of debt of 14.9% and a year-end debt to equity ratio of 57%.

**Table 3.- Discounted Cash Flow Model**

(Figures in Million Pesos)	2020E	2021E	2022E	2023E	2024E	Perp.
<b>OPERATING PROFIT</b>	<b>1,131</b>	<b>1,184</b>	<b>1,242</b>	<b>1,300</b>	<b>1,363</b>	<b>1,413</b>
Tax Rate	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%
Tax Shield	(339)	(355)	(373)	(390)	(409)	(424)
NOPLAT	792	829	869	910	954	989
Depreciation	77	77	77	77	77	79
Working Capital Changes	(449)	(192)	(204)	(375)	(401)	(416)
CAPEX	(24)	(28)	(32)	(36)	(40)	(41)
<b>FCFF</b>	<b>395</b>	<b>685</b>	<b>710</b>	<b>576</b>	<b>590</b>	<b>611</b>
<b>Perpetuity Growth Rate</b>						<b>3.7%</b>
PV of Explicit Period (2019 - 2023E)						2,217
Perpetuity Value						9,694
PV of Perpetuity Value						5,465
Enterprise Value						7,682
Net Debt						2,523
Market Value						5,159
<i>Outstanding Shares</i>						279
<b>Target Price</b>						<b>P\$ 18.50</b>
Current Market Price						<b>P\$ 16.88</b>
<b>Potential Return Incl. Dividends</b>						<b>9.6%</b>
Forward EV/EBITDA						6.4x
Forward P/E						14.6x
Average Cost of Debt						14.9%
LT Tax Rate						30.0%
After-Tax Cost of Debt						10.4%
Cost of Equity						9.5%
Market Risk Premium						6.0%
Risk-Free Rate						8.0%
Beta						0.25
% Total Debt						57%
% Capital						43%
<b>WACC</b>						<b>10.0%</b>

Source: Miranda Global Research

## JAVER: Initiation of Coverage

### Sensitivity Analysis

We carried out a sensitivity analysis of JAVER's target price based on different levels of EBITDA, Net Profit and target multiples. We are comfortable with our target price of MXN\$18.50 per share as it implies that JAVER's shares will trade at a forward EV/EBITDA of 6.4x and a projected P/E of 14.6x, which compare against the averages of the last five years of 6.3x and 11.7x, respectively.

**Table 4.- Sensitivity Analysis, EBITDA vs. EV/EBITDA**

	-10%	-5%	<i>Original</i>	+5%	+10%
<b>EBITDA 2020E</b>	<b>1,126</b>	<b>1,185</b>	<b>1,248</b>	<b>1,310</b>	<b>1,376</b>
<b>Target EV/EBITDA</b>					
4.9x	9.66	10.70	11.79	12.88	14.02
5.4x	11.68	12.82	14.03	15.23	16.49
5.9x	13.70	14.95	16.26	17.58	18.96
<b>6.4x</b>	<b>15.72</b>	<b>17.08</b>	<b>18.50</b>	<b>19.93</b>	<b>21.42</b>
6.9x	17.74	19.20	20.74	22.28	23.89
7.4x	19.76	21.33	22.98	24.63	26.36

Source: Miranda Global Research

**Table 5.- Sensitivity Analysis, Net Profit vs. P/E**

	-10%	-5%	<i>Original</i>	+5%	+10%
<b>Net Profit 2020E</b>	<b>318</b>	<b>335</b>	<b>353</b>	<b>370</b>	<b>389</b>
<b>Target P/E</b>					
11.6x	13.27	13.97	14.71	15.44	16.21
12.6x	14.41	15.17	15.97	16.77	17.61
13.6x	15.56	16.37	17.24	18.10	19.00
<b>14.6x</b>	<b>16.70</b>	<b>17.58</b>	<b>18.50</b>	<b>19.43</b>	<b>20.40</b>
15.6x	17.84	18.78	19.77	20.75	21.79
16.6x	18.98	19.98	21.03	22.08	23.19

Source: Miranda Global Research

### Senior Notes due 2021

The price of JAVER's Senior Notes 2021 has fluctuated between 106 and 97 since the beginning of 2015, as can be seen in the following graph. Their current price is 99.97, which translates into a yield to maturity of 9.66% in dollars. This yield compares favorably against the average 7.72% yield of Mexican non-investment grade corporate bonds denominated in dollars.

We are initiating coverage on the Senior Notes due in 2021 of JAVER with a HOLD recommendation due also to our expectation that the company will enter into a period of low



## **JAVER: Initiation of Coverage**

growth and that its working capital will likely experience some pressure due to the high investments in land reserve that the company will make during the first half of the current year.

However, we believe that any adjustment in the price of these debt instruments should be considered as a clear investment opportunity due to their attractive yield and our belief that the trend of JAVER's credit ratings will be upwards from the second half of the current year, once the company's growth and leverage improve, supported by a stronger macroeconomic performance and the announcement of the new National Housing Policy.

It is important to mention that JAVER has hedged the coupons of the Senior Notes 2021 until April 2020 as well as 100% of the principal. The company is currently analyzing different refinancing alternatives.

**Graph 10.- Price of JAVER's Senior Notes due 2021**



Source: Bloomberg

## JAVER: Initiation of Coverage

**Table 6.- Mexican High Yield Corporate Bonds (USD)**

	Precio		Monto		Currency	Coupon	Moody´s		S&P		Fitch	
	10/04/2019	Rend.	(Mill. de USD)				Rating	Outlook	Rating	Outlook	Rating	Outlook
Javer 9 7/8% due 2021	99.96	9.66	159.17		USD	9.8750	B1	Positive	B+	Negative	B+	Stable
Alphacredit 10.0% due 2022	96.23	11.17	300.00		USD	10.0000	B1	Negative	B+	Stable	n.a.	n.a.
Cemex 6 1/8% due 2025	104.03	4.45	750.00		USD	6.1250	n.a.	n.a.	BB	Stable	BB	Stable
Cemex 7 3/4% due 2026	109.18	4.69	1,000.00		USD	7.7500	n.a.	n.a.	BB	Stable	BB	Stable
Creal 7 1/4% due 2023	103.47	5.99	625.00		USD	7.2500	n.a.	n.a.	BB+	Negative	BB+	Stable
Creal 9 1/2% due 2026	107.38	7.85	400.00		USD	9.5000	n.a.	n.a.	BB+	Negative	BB+	Stable
Creal 9 1/8% Perp	97.50	9.96	230.00		USD	9.1250	n.a.	n.a.	B+	Negative	BB-	Stable
Docuformas 9 1/4% due 2022	97.18	10.19	150.00		USD	9.2500	n.a.	n.a.	BB-	Negative	BB-	Stable
Elmtia 5 1/2% due 2025	97.60	5.96	425.00		USD	5.5000	n.a.	Positive	BB *-	n.a.	BB+ *-	n.a.
Famsa 7 1/4% due 2020	96.42	10.55	140.00		USD	7.2500	n.a.	n.a.	B-	Negative	B-	Positive
Findep 8% due 2024	89.49	10.57	250.00		USD	8.0000	n.a.	n.a.	BB-	Negative	BB	Stable
GCCamm 5 1/4% due 2024	101.10	4.88	260.00		USD	5.2500	n.a.	n.a.	BB+	Stable	BB+	Stable
Ixegf 9 1/4% due 2020	107.90	3.73	120.00		USD	9.2500	n.a.	n.a.	BB+	n.a.	BB *-	n.a.
Kionet 7 1/2% due 2025	98.44	7.75	300.00		USD	7.5000	B1	Stable	BB-	Stable	n.a.	n.a.
Posada 7 7/8% due 2022	101.50	7.07	392.61		USD	7.8750	B2	Positive	B+	Stable	B	Stable
Tza 8 1/4% due 2024	97.62	8.75	400.00		USD	8.2500	n.a.	n.a.	n.a.	n.a.	B+	Stable
Unifin 7% due 2025	96.22	7.78	450.00		USD	7.0000	n.a.	n.a.	BB	Negative	BB	Stable
Unifin 7 1/4% due 2023	102.28	6.41	400.00		USD	7.2500	n.a.	n.a.	BB	Negative	BB	Stable
Unifin 8 7/8% Perp	90.50	11.14	250.00		USD	8.8750	n.a.	n.a.	B	Negative	B+	Stable
Vintev 9.83% due 2025	120.86	5.81	800.00		USD	9.8300	n.a.	n.a.	n.a.	Stable	n.a.	n.a.
<b>Average Yield</b>		<b>7.72</b>										

Source: Bloomberg

### COMPANY DESCRIPTION

With more than 45 years of experience in the sector, JAVER is Mexico's largest housing developer based on units sold and it is the leader in the granting of INFONAVIT loans. The company specializes in the construction of social interest, middle-income and residential housing. It has more than 60 developments in the states of Nuevo León, Jalisco, Estado de México, Querétaro, Aguascalientes, Quintana Róo and Tamaulipas. The markets served by JAVER represent more than 54% of the loans granted by INFONAVIT. The corporate offices are located in the City of Monterrey.

### Board of Directors / Corporate Governance

JAVER's Board includes eleven Directors, of which eight are proprietary and the remaining three are independent, thus complying with the Securities Market Law, which establishes that 25% of the Directors must be independent. We expect the next Annual Ordinary Shareholders Meeting to take place at the end of April, in which the current Directors are likely to be ratified in such positions.

## JAVER: Initiation of Coverage

**Table 7.- JAVER's Board of Directors**

Salomón Marcuschamer Stavchansky	Chairman	Victor Manuel Requejo Hernández	Independent
Marcos Alfredo Mulcahy Marcos	Propietary	Alfonso González Migoya	Independent
Sebastián Agustín Villa	Propietary	Alberto Rafael Gómez Eng	Independent
César Pérez Barbes	Propietary		
Alfredo Castellanos Heuer	Propietary		
Sebastián Odriozola Canales	Propietary		
Joe Ackerman Braun	Propietary		
Samuel Klein Marcuschamer	Propietary		

Source: 2018 Annual Ordinary Shareholders' Resolution

In addition to the Board of Directors, JAVER has an Audit and Corporate Practices Committee, which ensures compliance with existing regulations and a healthy supervision of the company's operations.

### Ownership Structure with Recognized Investors

JAVER's capital is represented by 278,540,411 common, free subscription and full voting shares. We consider that they have a low liquidity since the average daily traded value has been MXN\$41,633 during the last six months.

JAVER's ownership structure is well diversified since 26.81% of the shares are owned by some private equity funds of Southern Cross, 25.07% of the shares are owned by Proyectos del Noreste, a company controlled by Mr. Salomón Marcuschamer Stavchansky, 7.06% are from Glisco Partners, 5.65% are from Arzentia Capital, and 1.32% are from Real Estate Projects Developer Turin. This means that the floating shares represent 34.14% of outstanding shares.

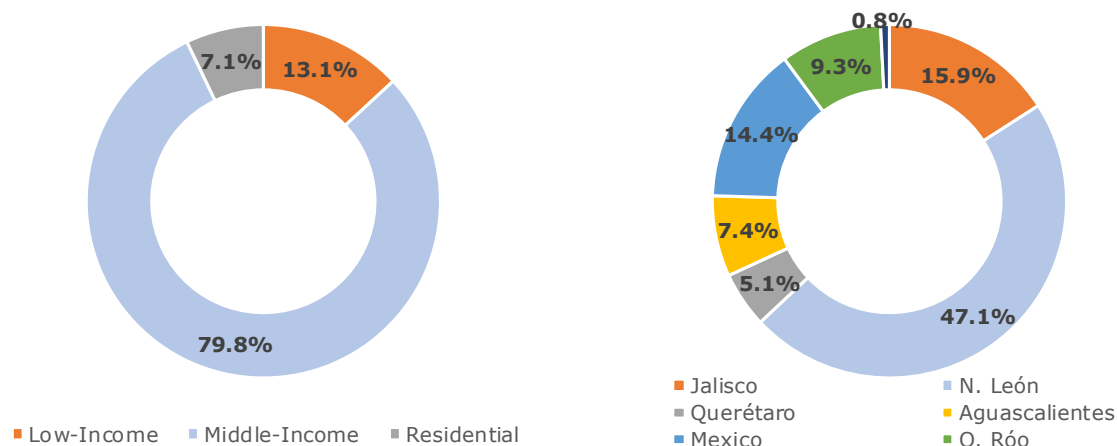
On December 21, 2012, all the controlling shareholders, except SMS Real Estate Group, transferred their shares to the Liquidity Trust, which serves as a mechanism to consolidate the vote of the shareholders and to govern certain restrictions on the transfer of shares owned by the Liquidity Trust. The Trustee of these shares votes in block.

### 4Q18 Results

JAVER sales decreased 12.7% YoY in 4Q18, reaching MXN\$2.032 billion. The main reason was a significant 55.4% YoY reduction in the low-income segment and 10.8% YoY fall in the middle-income one. On the positive side, sales of residential housing increased 14.1% YoY. Land revenues nearly tripled to MXN\$27 million, but they only represented 1.3% of total revenues.

## JAVER: Initiation of Coverage

**Graph 11.- Revenue Breakdown by Segment and Region (2018)**



Source: JAVER

Total units sold fell by 22.3% YoY to 4,340, which included a 55.5% YoY reduction in low-income and a 13.0% YoY decrease in the middle-income, which was partially mitigated by a 18.2% YoY increase in the residential segment. INFONAVIT + Cofinavit loans represented 92.3% of units sold in 4Q18, compared with 93.8% in 4Q17. However, the company experienced a 56.6% YoY reduction in subsidized units to only 500 due to the new government's policies. This type of units represented 11.5% of total units sold in 4Q18, compared to 20.6% in 4Q17. Vertical units accounted for 23.1% of total units, compared to 19.8% in 4Q17. Meanwhile, the average price improved 11.3% YoY to MXN\$462,000 due to a better sales mix.

The gross margin contracted 80 bp to 25.9% in 4Q18 as a result of lower volume. Sales and administrative expenses increased 11.3% YoY, mainly due to severance payments and debt refinancing expenses. This generated a 27.7% YoY EBITDA reduction in the current quarter. However, this indicator rose 11.0% on an accumulated basis in 2018.

In addition, the integral cost of financing was up 43.6% YoY to MXN\$183.0 million due to a combination of higher interests associated due to rising interest rates, lower interest income and higher foreign exchange losses. The quarterly net profit decreased 87.8% YoY to MXN\$17.6 million.

JAVER maintained a manageable leverage level with a net debt to EBITDA ratio of 2.38x at the end of 4Q18, from 1.80x in 3Q18 and 2.04x in 4Q17.

The company generated negative free cash flow of MXN\$256 million in 4Q18 due to an MXN\$1.0 billion investment in the acquisition of land reserves during the year (+ 34.2%). As a result, JAVER has sufficient reserves to build 88,455 units, of which 67% were purchased directly by the company and the remainder 33% through land trusts. 67% of these reserves

## JAVER: Initiation of Coverage

are for middle-interest housing, 25% for low-income and the remainder 8% for residential housing, which clearly shows the focus that the company will have during the coming years.

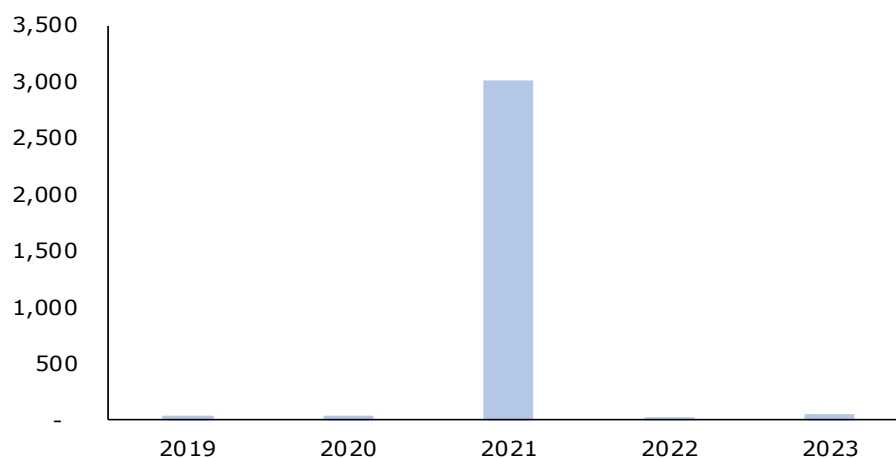
The company mentioned that in 2018 it opened 17 projects, of which 10 were located in the middle segment and 7 in the residential segment.

### Debt / Maturity Profile

At the end of 2018, JAVER registered a MXN\$3.269 billion gross debt. The total debt to EBITDA ratio was 2.9x and the net debt to EBITDA ratio was 2.4x. The debt consists mainly of Senior Notes due 2021 amounting to US\$158.5 million with a 9.875% coupon which increases to 15% including the hedges, a MXN\$107 million loan with Banco del Bajío at a TIIE + 3.5 percentage points rate and several leases amounting to MXN\$188 million. The average cost of debt was 14.9% at the end of 4Q18. In addition, JAVER has MXN\$581 million in available lines of credit, which can be used if the company is in compliance with the financial covenants of its Senior Notes.

The maturity profile is well structured since the company faces only MXN\$42 million in 2019 and MXN\$34 million in 2020. By 2021, JAVER will have to pay MXN\$3.006 billion corresponding to the Senior Notes 2021. The company told us that is currently analyzing refinancing alternatives for these instruments.

**Graph 12.- JAVER's Maturity Profile**



Source: JAVER

JAVER's credit ratings in a global scale are B + with a negative outlook from S&P, B + with a stable outlook from Fitch and from B1 with a positive outlook from Moody's. However, we expect these ratings to improve gradually by the end of the current year given the growth we anticipate for the coming years in terms of revenues, EBITDA, net income and free cash flow, as well as the possibility that the company will deleverage.

## **JAVER:** Initiation of Coverage

### **MAIN INVESTMENT RISKS**

**Macroeconomic volatility.** We believe that any macroeconomic slowdown, higher interest rates or depreciation of the exchange rate could have an unfavorable impact on housing demand in Mexico.

**Adverse regulatory changes.** However, we believe that the government's housing policies are unlikely to be modified in a negative way since the sector is a priority for the incoming government;

**Changes in the availability of mortgage loans** or in the administrative procedures of INFONAVIT, SHF, FOVISSSTE and the Mexican banking sector;

**Greater competition from other housing developers.** The entrance of other players into JAVER's regions could have a negative impact on prices and / or demand for houses built by the company.

**Changes in the management team.** We believe that a change in the main executives, mainly the CEO and / or the CFO, could have a negative effect on the price of JAVER's shares due to their extensive knowledge of the sector and solid track record of creating shareholder value.

**Low liquid shares.** JAVER's shares have a low liquidity since the average daily traded value has been MXN\$41,633 during the last six months. However, we believe that this situation will tend to improve in the medium term due to the company's favorable prospects and the low valuation of its shares.

**Refinancing of the Senior Notes 2021.** JAVER is currently analyzing refinancing alternatives for these instruments.

## JAVER: Initiation of Coverage

### FINANCIAL PROJECTIONS

INCOME STATEMENT	2017	2018	2019E	2020E	2021E	2022E	2023E	2024E	2018	2019E	2020E	2021E	2022E	2023E	2024E
Revenues	7,563	8,321	8,244	9,234	9,660	10,105	10,571	11,057	10%	-1%	12%	5%	5%	5%	5%
Cost of Sales	(5,598)	(6,173)	(6,075)	(6,804)	(7,118)	(7,447)	(7,789)	(8,148)	10%	-2%	12%	5%	5%	5%	5%
Gross Profit	1,965	2,148	2,169	2,430	2,542	2,658	2,782	2,909	9%	1%	12%	5%	5%	5%	5%
Gross Margin	26.0%	25.8%	26.3%	26.3%	26.3%	26.3%	26.3%	26.3%							
General Expenses	(1,076)	(1,201)	(1,170)	(1,303)	(1,362)	(1,420)	(1,485)	(1,550)	12%	-3%	11%	5%	4%	5%	4%
Other Gains (Losses)	(1)	5	4	4	4	4	4	4	-641%	-21%	0%	0%	0%	0%	0%
Operating Profit	888	952	1,003	1,131	1,184	1,242	1,300	1,363	7%	5%	13%	5%	5%	5%	5%
Operating Margin	11.7%	11.4%	12.2%	12.2%	12.3%	12.3%	12.3%	12.3%							
Depreciation and Amortization	(45)	(73)	(77)	(77)	(77)	(77)	(77)	(77)	62%	5%	0%	0%	0%	0%	0%
Profit Sharing and Exec. Comp.															
EBITDA	956	1,062	1,115	1,248	1,304	1,367	1,429	1,495	11%	5%	12%	5%	5%	5%	5%
EBITDA Margin	12.6%	12.8%	13.5%	13.5%	13.5%	13.5%	13.5%	13.5%							
Financial Gains	276	59	54	(70)	(53)	(61)	(23)	(20)	-78%	-10%	-231%	-24%	14%	-62%	-15%
Financial Cost	(409)	(571)	(531)	(557)	(543)	(543)	(558)	(558)	40%	-7%	5%	-3%	0%	3%	0%
Pre-Tax Profit	755	440	525	504	588	638	719	785	-42%	19%	-4%	17%	8%	13%	9%
Income Tax & Profit Sharing	(313)	(210)	(157)	(151)	(176)	(191)	(216)	(235)	-33%	-25%	-4%	17%	8%	13%	9%
Tax & Profit Sharing Rate	41.5%	47.6%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%							
Net Profit	442	231	367	353	412	447	503	549	-48%	59%	-4%	17%	8%	13%	9%
Outstanding Shares	278	279	279	279	279	279	279	279	0%	0%	0%	0%	0%	0%	0%
EPS	P\$ 1.59	P\$ 0.83	P\$ 1.32	P\$ 1.26	P\$ 1.48	P\$ 1.60	P\$ 1.81	P\$ 1.97	-48%	59%	-4%	17%	8%	13%	9%
<b>BALANCE SHEET</b>	<b>2017</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>
TOTAL ASSETS	7,385	8,365	9,313	10,197	10,664	11,305	12,075	12,782	13%	11%	9%	5%	6%	7%	6%
Current Assets	5,813	5,896	6,641	7,361	7,668	8,144	8,745	9,279	1%	13%	11%	4%	6%	7%	6%
Cash & Temp. Inv.	766	579	650	650	650	800	900	900	-24%	12%	0%	0%	23%	13%	0%
LT Assets	1,572	2,469	2,671	2,837	2,997	3,161	3,330	3,503	57%	8%	6%	6%	5%	5%	5%
P, P & E	220	307	251	198	150	105	64	28	40%	-18%	-21%	-25%	-30%	-39%	-57%
Intangible Assets	0	0	32	34	36	38	40	42	n.a.	n.a.	6%	6%	6%	5%	5%
Other LT Assets	1,157	1,444	1,644	1,844	2,044	2,244	2,444	2,644	25%	14%	12%	11%	10%	9%	8%
TOTAL LIABILITIES	5,569	6,363	6,943	7,485	7,549	7,753	8,029	8,197	14%	9%	8%	1%	3%	4%	2%
ST Liabilities	1,700	1,731	2,311	2,853	2,717	2,921	2,997	3,165	2%	34%	23%	-5%	8%	3%	6%
LT Liabilities	3,869	4,632	4,632	4,632	4,832	4,832	5,032	5,032	20%	0%	0%	4%	0%	4%	0%
TOTAL DEBT	2,998	3,269	3,173	3,444	3,394	3,475	3,625	3,659	9%	-3%	9%	-1%	2%	4%	1%
NET DEBT	2,233	2,690	2,523	2,794	2,744	2,675	2,725	2,759	20%	-6%	11%	-2%	-3%	2%	1%
TOTAL CAPITAL	1,816	2,002	2,370	2,713	3,115	3,553	4,046	4,586	10%	18%	14%	15%	14%	14%	13%
Stockholder's Equity	1,816	2,002	2,370	2,713	3,115	3,553	4,046	4,586	10%	18%	14%	15%	14%	14%	13%
<b>CASH FLOW STATEMENT</b>	<b>2017</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>
PRE-TAX PROFIT	442	231	525	504	588	638	719	785	-48%	128%	-4%	17%	8%	13%	9%
Inv. Related Activities	511	813	105	108	108	110	118	119	59%	-87%	2%	0%	2%	7%	2%
Pre-Tax Cash Flow	953	1,044	687	738	791	824	887	932	10%	-34%	7%	7%	4%	8%	5%
Working Capital Changes	(54)	(858)	2	(449)	(192)	(204)	(375)	(401)	n.a.	n.a.	n.a.	-57%	6%	84%	7%
Operating Cash flow	899	186	689	288	599	620	512	531	-79%	271%	-58%	108%	3%	-17%	4%
Investment Cash Flow	(21)	(9)	9	7	3	2	5	3	-57%	-196%	-21%	-58%	-45%	212%	-44%
Financing Cash Flow	(784)	(368)	(627)	(295)	(602)	(472)	(417)	(533)	-53%	70%	-53%	104%	-22%	-12%	28%
Net Incr. (Decr.) in Cash & Temp.	92	(187)	71	0	0	150	100	0	-303%	-138%	n.a.	n.a.	n.a.	-33%	n.a.
Beg. of Period Cash & Temp. Inv.	674	766	579	650	650	650	800	900	14%	-24%	12%	0%	0%	23%	13%
End of Period Cash & Temp. Inv.	766	579	650	650	650	800	900	900	-24%	12%	0%	0%	23%	13%	0%

Source: MGR