



# ARA

GBM

Outperformer | PT: P\$11.8

## Change in Estimates:

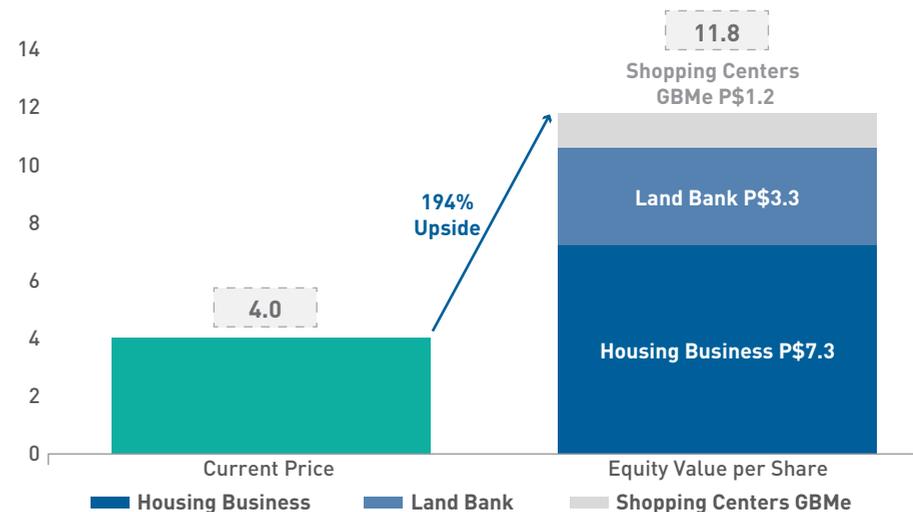
Our thesis on ARA remains unchanged, as we have long asserted that the home builder is one of the deepest value plays in Mexico. The company still boasts the qualities that make it a top investment idea in Mexico and with a high margin of safety. Trading at a 0.4x P/BV, ARA is one of the most discounted stocks in the Mexican market, which seems to be unjustified when considering the company's solid balance sheet, sizable net cash position, and track record of eight consecutive years with positive free cash flow generation. That said, **we are reiterating our Market Outperformer rating on the stock while introducing our 2022 price target of P\$11.8 per share.**

**All scenarios lead to a high upside.** We revisited our previous assessment where we try to understand what the market is discounting on the name. Conclusions are clear: the discount has somewhat widened since our last update, which means an even deeper unjustified valuation for ARA. The company is trading at a hefty discount to its work-in-progress inventory and land bank, which holds some beachfront gems that seem to be overlooked by investors.

**Stronger housing dynamics.** ARA has been swift in capitalizing on a shift in the housing dynamics in Mexico, where properties in the middle income to residential range have gained more relevance in the market thanks to a compressed demand in the affordable segment explained by the pandemic-driven downturn in the country's economy. Moreover, ARA's fire power and substantial land bank in privileged locations leave it in an enviable position to reap the benefits of an undersupplied housing market.

**Change in estimates:** All things considered, we are slightly revising upward our top-line estimates for the company to incorporate the current inflationary environment, in which ARA has managed to pass through price increments above inflation and delivered a cash flow generation that beat our expectations.

## Breakdown of ARA's Equity Value per Share



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## ARA, AN OVERWHELMING VALUE OPPORTUNITY

**We are reaffirming our thoughts on ARA's solid value proposition.** One year after the worst wave of the pandemic, ARA's valuation remains unscathed. Although the company's operations are still pressured and sales have not reached pre-pandemic levels, ARA remains the most resilient Housing player thanks to its hefty cash flow generation and the incredible way in which the company has weathered several crises. That said, we are slightly upward adjusting our expectations for the company's performance, as it has excelled in raffling high inflationary environment and managed to post solid results.

### Change in estimates

ARA has been slowly catching up to its pre-pandemic levels but its topline is still pressured since housing dynamics shifted and have not allowed for a full catch-up on units sold given a higher focus on mid and residential-income properties. That said, we are downward revising the expected units sold for 2022 from 7.1k to 6.6k (~10k were sold during 2019). Nevertheless, we are improving our view on the topline because the company has managed to pass through inflation and increase by more than 15% its prices across all its segments while incorporating more conservative profitability levels. Although we are increasing our free cash flow (FCF) expectations, we are still taking a conservative stance since we incorporate a cash tax rate of 30%, which is significantly above the company's historical levels.

	2022		
	Pre	Post	Var.
<b>—MXN Million</b>			
Revenues	6,635	6,919	4.3%
YOY %	4.0%	8.5%	
Op. Profit	846	753	-10.9%
Op. Mg.	12.7%	10.9%	-1.9 pp.
EBITDA	1,059	1,000	-5.6%
YOY %	10.1%	3.9%	
EBITDA Mg.	16.0%	14.5%	-1.5 pp.
Net Profit	716	632	-11.9%
YOY %	24.6%	9.8%	
Net Mg.	10.8%	9.1%	-1.7 pp.
<b>Cash Flow Statement</b>			
<b>— MXN Million</b>			
(+) EBITDA	1,059	1,000	-5.6%
(=) Op. FCF	386	585	51.6%
(-) Investments	27	87	225.6%
(=) FCF	359	498	38.6%
Dividend	-333	-290	-12.9%

### Our Valuation

High upside potential. Every time we revisit our numbers, our thesis on ARA is reaffirmed and our valuation approach remains untouched. It's clear the company's value lies on its balance sheet, which grants high upside opportunities even on a conservative approach. To value the company, we account its balance sheet and adjust its unconsolidated shopping centers. **These lead us to introduce our 2022 price target of P\$11.8 and Market Outperformer rating on the name.**

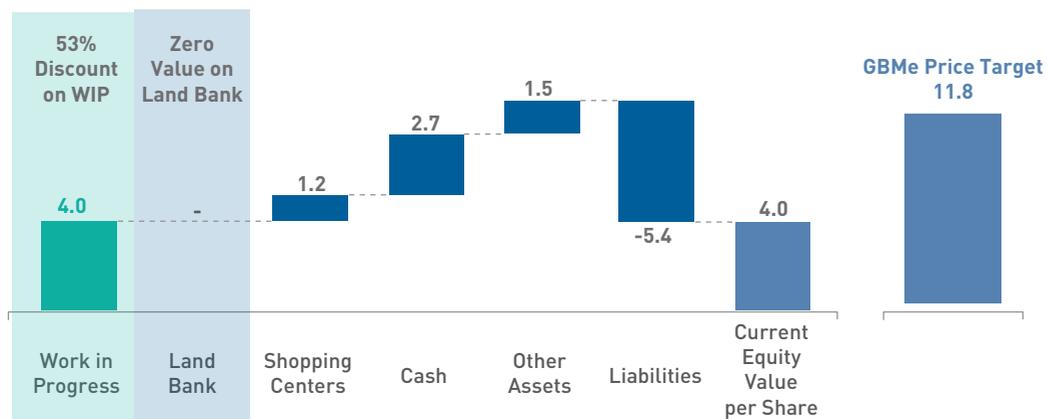
	GBMe Price Target
<b>Assets</b>	<b>21,655</b>
Work in Progres	10,657
Land Bank	4,201
<i>Implicit P\$ per sq. mt.</i>	<i>P\$135 / US\$6.6</i>
Shopping Centers	1,500
Cash	3,391
Other Assets	1,906
<b>(-) Liabilities</b>	<b>6,817</b>
<b>(=) Implicit Equity Value</b>	<b>14,838</b>
Equity Per Share	11.8
<i>Upside</i>	<i>194%</i>

# A DEEP VALUE OPPORTUNITY IN ALL SCENARIOS

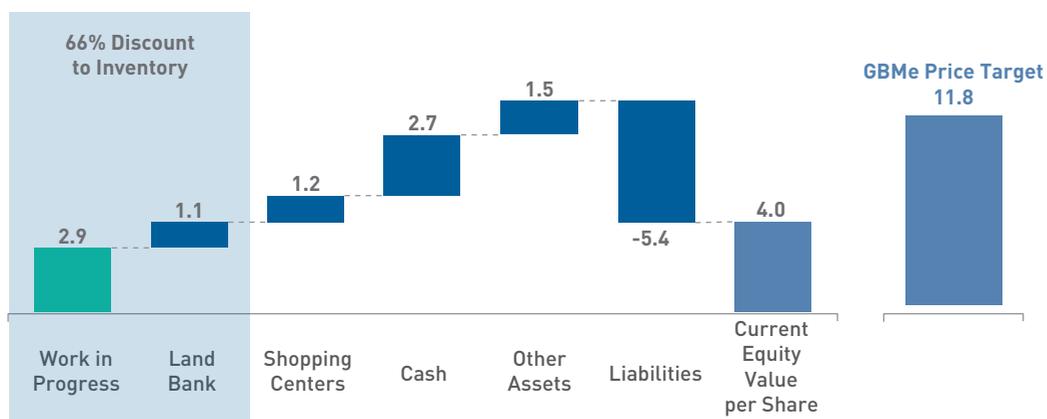
## Unreasonable discounts on valuations

Trading at an unjustifiable 0.4x P/BV, ARA offers one of the deepest value opportunities in Mexico. To put it into context, we ran different scenarios to see what that multiple would mean for the company. At current valuations, the market is granting zero value to the company's land bank and a 53% discount to its Work in Progress inventory or a 66% discount to its whole inventory. For us, these discounts are completely unfounded since the company poses one of the most resilient balance sheets, with a net cash position, attractive profitability and 8 years of FCF generation in a row.

### Equity Value of ARA at a 53% discount on WIP and zero value on land bank



### Equity Value of ARA at a 66% discount to inventory



## All roads lead to Rome

We have personally visited the majority of ARA's land bank throughout the years and done some research on key projects in order to understand its possible upside (given that it is accounted at acquisition cost). After these visits, we found some plots that could be worth 10x their book value, especially for beachfront properties. That said, we incorporated several scenarios to understand ARA's value potential for long-term investors as it presents itself as one of the best land bank investment options in Mexico.

**GBMe Price Target:** Accounting for the company's Book Value (at acquisition cost); **Bank Valuation:** Implicit valuation from banks when land is given as collateral; **Mid-Range:** Mid-way between the Bank's valuation and GBMe's sites visit; **GBMe Sites Visit:** Accounting for the possible value of beachfront properties and other analyzed land plots on site visits.

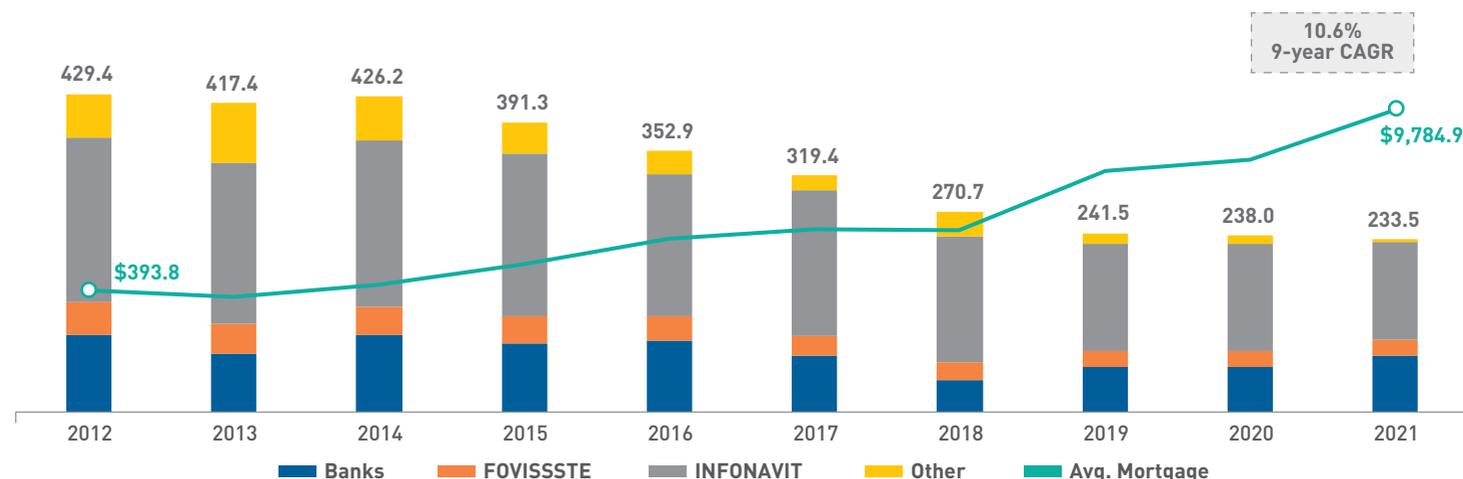
	GBMe Price Target	Bank Valuation Land Bank @1.9x BV	Mid-Range Land Bank @2.8x BV	GBMe Sites Visit Land Bank @3.6x BV
<b>Assets</b>	<b>21,655</b>	<b>25,435</b>	<b>29,006</b>	<b>32,577</b>
Work in Progress	10,657	10,657	10,657	10,657
Land Bank	4,201	7,982	11,552	15,123
<i>Implicit price per sq. mt.</i>	<i>P\$135 / US\$6.8</i>	<i>P\$257 / US\$12.8</i>	<i>P\$371 / US\$18.6</i>	<i>P\$486 / US\$24.3</i>
Shopping Centers	1,500	1,500	1,500	1,500
Cash	3,391	3,391	3,391	3,391
Other Assets	1,906	1,906	1,906	1,906
(-) Liabilities	6,817	6,817	6,817	6,817
(=) Implicit Equity Value	14,838	18,618	22,189	25,760
<b>Equity Per Share</b>	<b>11.8</b>	<b>14.8</b>	<b>17.6</b>	<b>20.4</b>
<i>Upside</i>	<i>194%</i>	<i>270%</i>	<i>341%</i>	<i>412%</i>

## REVISITING THE HOUSING INDUSTRY IN MEXICO

**New opportunities are emerging in the housing market.** The housing crisis, caused by some homebuilders that overproduced units disregarding their quality, led to a tainted image of the sector, and, as consequence, of ARA, even though it is one of the companies with the best practices. It also holds a solid balance sheet, a diversified land bank, and a constant FCF generation. Taking the good position of the company into account, we have seen that the market has changed in the last ten years and an opportunity has arisen as the growth of the Mexican housing market is accelerating, and ARA is ready to seize it.

**Market trends have changed.** The recent history of Mexican housing sector is highlighted by the housing crisis of 2012-2014, which resulted in the demise of the country's main players at the time. However, the market, as well as housing trends, has changed. Since 2012, overall mortgages given by ONAVIs (National Housing Agencies) have decreased, particularly from governmental bodies such as INFONAVIT and FOVISSSTE. When looking at 2021, bank mortgages, which mostly serve to fund the acquisition of mid-to-high-income properties, increased by 7.8pp. its market share vs. 2019, seemingly explained by the economic downturn and the new INFONAVIT rules, which slew down the demand from the affordable segments. These dynamics reflected on ARA's performance, but the company was quick on capitalizing from it as its sales mix slightly shifted towards higher income properties, allowing it to pass through high price increments and deliver the highest profitability levels in the last 5 years.

**Mortgages granted by National Housing Agencies (ONAVIS) vs. Average Mortgage (Thousands)**



Based on data from SNIIV.

ONAVI	Mortgages (Thousands)			Amount (MXN Billion)			Avg. Mortgage (MXN Thousand)		
	2021	YOY vs. 2019	9-year CAGR	2021	YOY vs. 2019	9-year CAGR	2021	YOY vs. 2019	9-year CAGR
Banks (CNBV)	76.36	26.8%	-3.4%	146.8	40.8%	6.6%	1922.2	11.0%	10.3%
FOVISSSTE	20.75	-8.2%	-7.9%	16.3	-3.1%	-3.9%	783.3	5.6%	4.4%
INFONAVIT	132.36	-7.9%	-5.6%	64.3	-1.0%	1.8%	485.7	7.4%	7.9%
Other	4.02	-73.2%	-25.8%	1.1	-50.9%	-38.6%	283.5	83.5%	-17.2%
<b>Total</b>	<b>233.49</b>	<b>-3.3%</b>	<b>-6.5%</b>	<b>228.5</b>	<b>21.3%</b>	<b>3.4%</b>	<b>978.5</b>	<b>25.5%</b>	<b>10.6%</b>

Based on data from SNIIV.

## AN UNDERSUPPLIED MARKET

**The house production dropped after the housing crisis.** The construction of new developments decelerated considerably, as the government imposed stricter requirements to obtain subsidies for affordable housing, to prevent the sale of uninhabitable houses. This created difficulties for buyers to obtain mortgages and overall slew down the replacement cycle of housing units.

However, this also turned into the positive absorption of available inventory, leading to an undersupplied market, which presented an opportunity for developers, particularly those who own land bank, since it provided a competitive edge that rose as the economic activities picked up.

### Total Housing Inventory through the years

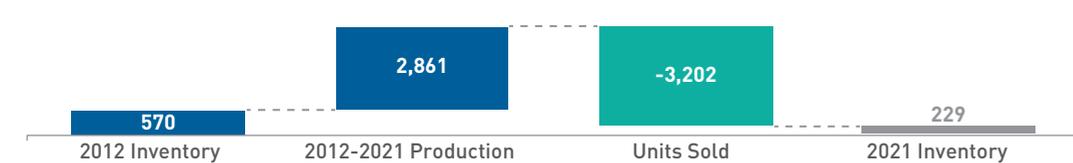
-In thousand units



Based on data from SNIIV.

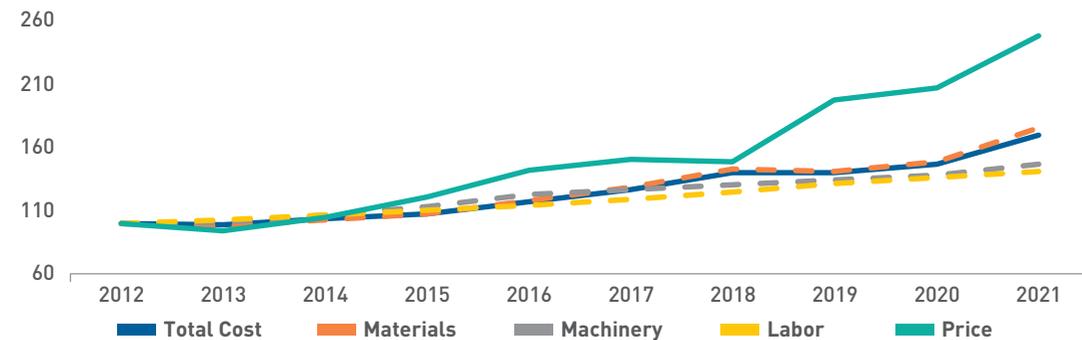
### Inventory Variation 2012 vs. 2021

-In thousand units



Based on data from SNIIV.

### Growth in Housing Costs and Prices (2012 index=100)

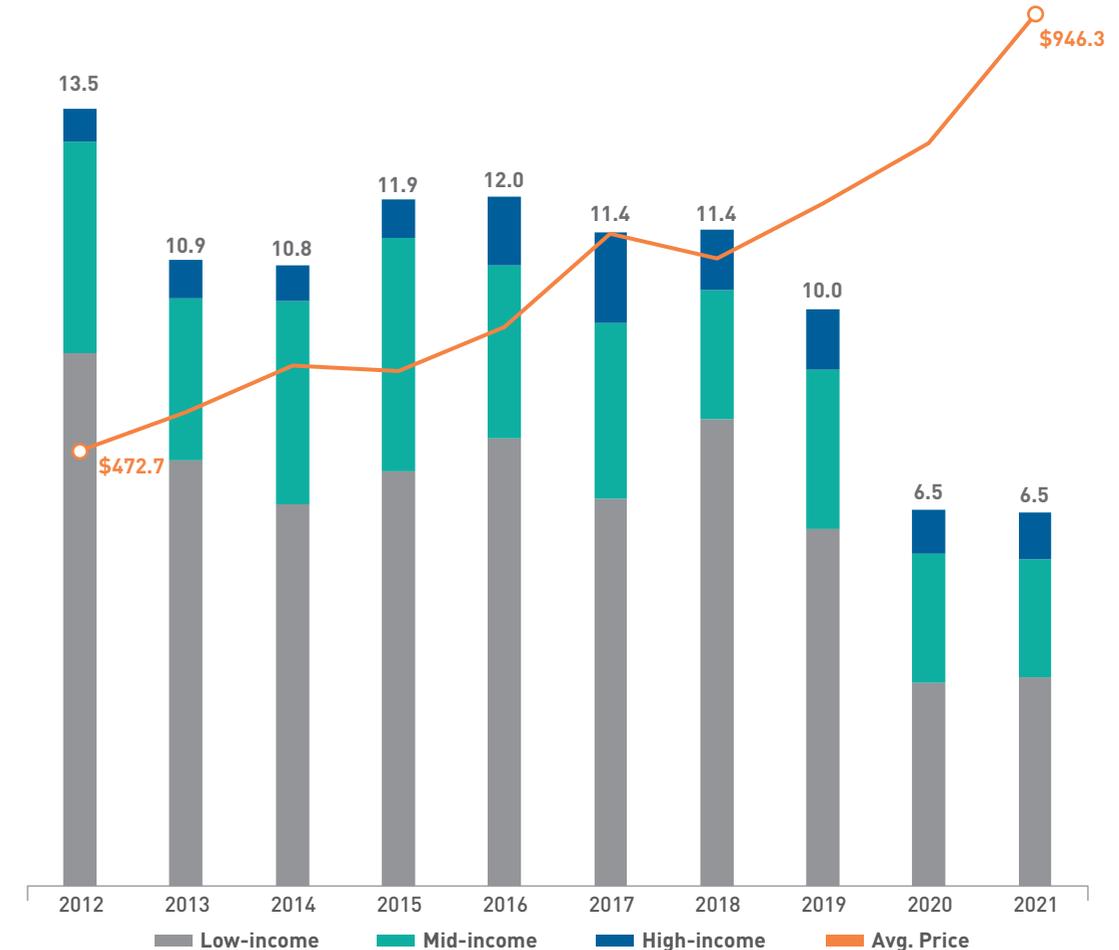


Based on data from SNIIV and INEGI.

**Strong pricing dynamics.** On the other hand, the inflationary pressures, caused by increased global demand in the construction sector and pandemic-related supply chain disruptions, led to raising construction costs. Overall, the sector has been able to passthrough such increments. Yet, ARA has excelled, managing to increase its prices in 2021 by 27.7% YOY vs. 2019, 6.5 pp. above construction inflation.

### ARA: Houses Sold & Average Price

-Thousand Units; MXN Thousand



Based on data from the company's reports.

## FINANCIAL ESTIMATES

Stock Information			
Last Price	P\$4.0	Stock Returns	
No. Shares ('000s)	1,261	1M	2.0%
Mkt Cap (MXN Million)	\$5,045	3M	-5.3%
6M ADVT (MXN Million)	\$2.0	6M	-7.3%
Net Debt Incl. IFRS 16 (MXN Million)	-\$1,342	1 Yr	-15.8%
Float	52.2%	3 Yrs	-20.2%
Max 52w	P\$5.7	5 Yrs	-34.2%
Min 52w	P\$3.9		

Valuation Ratios (Majority Figures)						
	2019	2020	2021	2022e	2023e	2024e
EV/EBITDA	4.4x	6.3x	3.8x	3.6x	3.4x	3.1x
P/E	7.5x	12.5x	8.8x	8.0x	7.3x	6.8x
P/S	0.7x	0.9x	0.8x	0.7x	0.7x	0.7x
P/BV	0.4x	0.4x	0.4x	0.3x	0.3x	0.3x
Net Debt/EBITDA	-0.3x	-1.4x	-1.4x	-1.4x	-1.3x	-1.3x
ROE	13.1%	11.3%	12.5%	14.1%	15.9%	15.9%
Op. FCF Yield before Working Capital	16.1%	9.0%	16.7%	13.1%	14.1%	15.2%
Op. FCF Yield	6.7%	13.4%	18.9%	11.6%	11.1%	12.1%
FCF Yield	6.4%	13.2%	16.9%	9.9%	8.9%	10.1%
Dividend Yield (%)	6.9%	0.0%	4.0%	5.7%	6.3%	6.9%

GBM Financial Estimates						
—MXN Million	2019	2020	2021	2022e	2023e	2024e
Revenues	7,678	5,460	6,377	6,919	7,305	7,691
YOY %	-6.5%	-28.9%	16.8%	8.5%	5.6%	5.3%
Op. Profit	809	467	691	753	822	879
Op. Mg.	10.5%	8.5%	10.8%	10.9%	11.3%	11.4%
EBITDA	1,069	658	962	1,000	1,076	1,153
YOY %	-10.1%	-38.5%	46.3%	3.9%	7.6%	7.2%
EBITDA Mg.	13.9%	12.0%	15.1%	14.5%	14.7%	15.0%
Net Profit	675	403	575	632	694	739
YOY %	-17.3%	-40.3%	42.6%	9.8%	9.8%	6.5%
Net Profit Mg.	8.8%	7.4%	9.0%	9.1%	9.5%	9.6%

Cash Flow Statement						
—MXN Million	2019	2020	2021	2022e	2023e	2024e
(+) EBITDA	1,069	658	962	1,000	1,076	1,153
(-) Working Capital	472	-224	-114	75	149	155
(-) Cash Interest	241	176	77	67	65	65
(-) Cash Taxes	17	28	45	273	301	322
(=)Op. FCF	340	678	955	585	560	612
(-) Investments	17	14	103	87	109	102
(=) FCF	323	664	852	498	451	510
Dividend	-350	0	-200	-290	-316	-347
Net Debt	-297	-890	-1,342	-1,428	-1,432	-1,444

# STOCK PRICE PERFORMANCE VS. ANALYST ESTIMATES



**15/06/21 | 11.7 Market Outperformer**  
**08/11/21 | 11.7 Market Outperformer**  
**29/03/22 | 11.8 Market Outperformer**

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