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DESARROLLADORA HOMEX
First Quarter 2006 Earnings Conference Call
April 27, 2006
10:00 am ET

Coordinator: Good morning and welcome to the Desarrollador Homex First Quarter 2006 Earnings conference call. At this time all participants are in a listen only mode. Later we will conduct a question and answer session and instructions will be given at that time.

I would now like to turn the conference over to your host Mister Carlos Moctezuma, head of Investor Relations at Homex. Sir you may begin.

C. Moctezuma: Good morning and welcome to the Homex First Quarter 2006 Results conference call. On the conference call are Gerardo de Nicolas, Homex's Chief Executive Officer and Mario Gonzalez, our Chief Financial Officer.

We will discuss some of the important events for the quarter as well provide a view of the key figures after which we will open the call for a question and answer session.

I would like to remind you that certain statements made during the course of this conference call about future events and financial results constitute forward looking statements that are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995.

Forward looking statements are subject to risks and uncertainties. The discussion of factors that may affect future results are contained in the filings with the Securities and Exchange Commission. We undertake no obligation to correct or update any forward looking statements whether as the result of new information, future events, or even changes in our expectations.

Now I would like to turn the call over to Gerardo de Nicolas.

G. de Nicolas: Good morning and thank you for joining us as we discuss results for the Homex first quarter 2006. Results which we reported following the market close yesterday came in very strong. Revenues were Ps. 2.3 billion for the quarter representing an increase of 71% from the comparable period in 2005.

Given the effect of the combination of Beta for the first quarter 2005 pro forma revenues will have shown an improvement of 21% reflecting double digit increases in both affordable entry-level and middle-income revenue.

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G. de Nicolas: EBITDA ended with a 22.6 margin and is 25% higher than the comparable pro forma EBITDA for the first quarter 2005 reflecting the improvements in our profitability.

Homex ended the quarter with a net debt of Ps. 2.1 billion, which represents a net debt to EBITDA ratio of 0.93 times. This ratio improved when compared to the previous quarter ended December 31, 2005 when the company reported a ratio of 1.0x.

Homex ended the quarter with positive free cash flow of approximately Ps. 181 million after land acquisition and before capital expenditures associated with the construction of our new corporate headquarters.

One year ago during our first quarter 2005 conference call we announced to you our intention to acquire Beta. Today the acquisition and integration has been very successful and has proven to be accretive to our shareholders.

As you know, Homex completed a transition of Beta onto our IT and operating platforms during December. Since then we have continued to focus on improvement and combined operating efficiencies and redeploying employees from overlapping functions. All of the personnel related changes were completed in March and we are continuing to focus on improvements in working capital.

Another area of continued improvement is management of building materials inventory. We see considerable room to drive the days of inventories held in the warehouses down. As we pointed out at the time of the merger Beta was operating with more than 35 days of materials in inventory compared to an average of just four days at Homex where we follow a just in time model.

At the end of the first quarter our team had built the number of days of inventory in the acquired materials centers down to 11 days. We hope to have this figure reduced to the four day historical Homex average by the end of 2006.

Accounts receivable were Ps. 5.2 billion at the end of this quarter. As a percentage of the last 12 months total revenues accounts receivable improved to 51% from the 68% reported at the end of the first quarter of 2005. Even when compared to the 55% reported at the end of 2005 this ratio shows a significant improvement. This reflects the company’s focus on stronger collection processes and the rapid integration of the Beta operations into the Homex collection driven operation.

Accounts receivable turnover reported as of March 31, 2006 using end of period information was 183 days. When utilizing 12-month average information the accounts receivable turnover was 176 days.

G. de Nicolas: With regard to inventory turnover days without land and utilizing 12 months average information the number is 65 days and using end of period information inventory turnover days without land was 92 days. Considering the land bank in the calculation and using end of period information our inventory turnover was 271 days.

On other occasions we have articulated our geographic diversification strategy to have a leading presence in the 30 most attractive housing markets in Mexico by year end 2008. This means that we will continue with our process of expanding our footprint, closing branches in small cities, opening more attractive ones, while increasing our market share in existing cities. With this in mind at quarter end we had communities underway in 26 different cities around the country, each with adequate land and sales prospects to support our growth. Four new phases of existing projects were initiated in the past quarter to drive deeper in these markets taking advantage of economies of scales in existing sales offices.

While it's still early in the year, we believe INFONAVIT will again exceed its target for this year of granting 435,000 mortgages. INFONAVIT is now capitalizing on the major technological improvements it has made in the past five years and on the strengthened and financial position.

Funded by its own collections, the contribution from the Mexican workers, and the market, INFONAVIT represents more than 45% of the mortgage backed securities markets in Mexico. We believe that the Mexican housing authorities are well positioned to continue supporting the Mexican housing industry regardless of the outcome of the Mexican presidential election.

Homex has been closely monitoring the availability of mortgages from INFONAVIT throughout the country. What we have seen is increased funding becoming available in the mid-sized markets, mostly from INFONAVIT but from other sources as well. This has served us well given the training that our sales force has been receiving in the different mortgage products so they can direct customers to the best available option.

The greatest amount of funding during this first quarter was available through INFONAVIT. As a result more than 72% of the Homex home sales were financed through mortgages form INFONAVIT and another 17% were through commercial banks and Sofoles and 10% from FOVISSTE.

Total sales volume on a pro forma basis grew more than 15% compared to the first quarter of 2005. A major contributor to this result was the volume growth in the higher margin middle-income homes, growing 19% from the same period in the prior year and increasing slightly its participation in the overall mix from 8% to 8.2%.

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G. de Nicolas: The various initiatives the company's undertaking to support the middle-income sales like a differentiated marketing image are expected to facilitate our continued improvement in this business line throughout the year. Affordable entry-level volume also contributed to our strong results growing 15% on a pro forma basis in this quarter.

As of March 31, 2006, Homex reported a land bank of 143,000 lots of which more than 113,000 are allocated to the affordable entry-level and close to 30,000 on the middle-income sales. The land bank is sufficient to support more than two years of anticipated sales. We believe that Homex's land bank is sufficient because all the land in our bank is suitable for homes and is located in cities where we are present already to initiate operations. In addition to this land bank the company maintains approximately 134,000 lots in optioned land representing an additional two years of anticipated sales.

This March we're moved in to our new corporate headquarters in Culiacan. The offices were constructed on time and within the Ps. 160 million budget. We believe that this investment is an important one for Homex both in terms of improving operations efficiency as well as continuing to embrace employee morale.

In conclusion, the housing market in Mexico continues to be a strong and we're working to assure that Homex takes full advantage of this trend mainly on INFONAVIT and on the middle-income market.

We will also continue with out efforts to support our main assets – our people. Here's our CFO Mario Gonzalez who will provide you with a very brief rundown of the financial results for the quarter and following his comments we will be glad to answer any questions you may have.

M. Gonzalez: Thank you Gerardo. Homex achieved strong results in the first quarter of 2006. Volume increased 75% to 8,570 homes sold in the quarter with 92% coming from the affordable entry segment. On a pro forma basis first quarter 2006 volumes increased 15% on a 5% higher average price for homes compared to the previous year.

Total revenues were Ps. 2.3 billion in first quarter 2006 representing an increase of 71% over Ps. 1.3 billion reported in first quarter '05. This was primarily driven by the growth in volumes. On a pro forma basis revenues rose 21% in the first quarter of '06 compared to the same period in the prior year, particularly driven by a 27% increase in middle-income revenues in the quarter.

Gross profit for the quarter increased 68% to Ps. 712 million and gross margins reached 31% in the first quarter of '06 compared to 32% in the same period for '05

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driven by the addition of Beta to the company's results. On a pro forma basis gross margins improved 40 basis points from the 30.8% reported in first quarter '05.

M. Gonzalez: SG&A was reduced as a percentage of revenues in the first quarter '06 reaching 9% compared to 9.2% as a percentage of revenues in the first quarter of '05 in spite of the Beta consolidation costs.

Operating income increased 68% to Ps. 507 million with operating margins of 22.2% in the first quarter '06. On a pro forma basis operating margins improved 80 basis points from 21.4% in the first quarter '05.

Net comprehensive cost of financing rose Ps. 174 million in the first quarter of '06 from Ps. 44 million in the same period last year, resulting from higher interest costs associated with higher debt levels and non-cash foreign exchange loss of Ps. 51 million compared to a gain of Ps. 2 million in the first quarter of '05.

These results reflect a net non-cash accounting charge of Ps. 51 million for the quarter, arising out of derivative hedge and underlying dollar denominated unsecured notes issued in September of 2005.

In this regard the year end audited results to be announced in connection with the annual shareholders' meeting will also reflect a net non-cash adjustment of approximately Ps. 61 million arising out of the same accounting principles.

Net income for the first quarter of '06 reached Ps. 233 million representing a 32% increase over the Ps. 176 million reported in the same period of last year. On a pro forma basis, net margin decreased slightly from 10.4% in the first quarter of '05 to 10.2% in the first quarter, resulting primarily from a non-cash charges in the net comprehensive financing costs reported in first quarter of '05.

Earnings per share reached Ps. 0.68 in the first quarter of this year versus Ps. 0.55 reported in the same period last year. In terms of ADS earnings per share in dollar terms reached approximately US$0.38 per ADS which compared favorably with the US$0.31 reported per ADS in the first quarter '05.

For the first quarter, EBITDA increased 70% to Ps. 515 million so EBITDA margins were 22.6%. On a pro forma basis, EBITDA rose 25% and EBITDA margins improved 70 basis points in the first quarter '06 from the 21.9% reported in the first quarter '05, evidencing a smooth and fast integration of Beta.

Homex had a cash position of Ps. 1.5 billion as of March 31, '06, which leads to a net debt of Ps. 1.9 billion as of March 31, '06.

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M. Gonzalez: Homex reports a net debt to EBITDA ratio of March 31, '06, of 0.93 times in line with the company's target ratio of less than 1.3x.

The company reported total debt to total capitalization at March 31, '06, of 0.32x and gross interest coverage of 4.4x.

Homex reported positive free cash flow after land purchases and before CAPEX during the first quarter of '06 of approximately Ps. 181 million.

In conclusion, we're pleased with the results accomplished in the first quarter 2006, particularly in the volume growth, margin expansion, and collection improvements. I will now turn the call back to the operator to open for questions.

Coordinator: Thank you sir. At this time we'll begin the question and answer session. And if you would like to ask a question please press star 1 on your touchtone phone. Our first question comes from Rafael Buerba from Banamex Asset Management.

R. Buerba: Good morning. My question is regarding cash flow. I don't know if you could tell us what was the cash flow that you registered during the quarter and if you're still expecting to reach breakeven for this year.

M. Gonzalez: Yes, the total cash flow, without considering the CAPEX of our new building, was Ps. 181 million reported this quarter. And it was, considering that investment, a net of Ps. 118 million, which is in line with our expectations of ending up with a free cash flow for the full year.

R. Buerba: With a positive free cash flow you said?

M. Gonzalez: Yes, certainly.

R. Buerba: Okay. Thank you.

Coordinator: Thank you sir. And once again as a reminder that's star 1 to ask a question. Sir we have a question coming in from Jorge Kuri from Morgan Stanley.

J. Kuri: Hi, good morning. My question is can you provide us details of how the average prices in the different segments you operate in changed year on year on a pro forma basis? Because I'm assuming that the ones in the press release are non-pro forma so it's a bit difficult to really understand them because it's a different mix. On a pro forma basis if I look at affordable entry, middle-income, and what would have been the changes in average prices? Thanks.

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M. Gonzalez: The average price that we reported first quarter of 2006 is Ps. 266,000. For the first quarter ’05, it was at that time without Beta, Ps. 263,000. So it was very close to what we have at this point in time. That was a reported price, both the affordable plus middle-income.

So prices in the last, I would say two, three quarters have not changed at all on average. In terms of breaking it up, affordable, which have been the, as you know has been a major segment of presence, have in a way shown from the first quarter Ps. 226,000 and this quarter we have reported Ps. 237,000. So a small increase of 1.7%.

So mainly most of the high volumes that we’re presenting, it is really most of the high revenue that we’re reporting, have come in from the good and high growth volumes that we have had.

J. Kuri: Okay. Thank you.

Coordinator: Thank you very much sir. Once again as a reminder that’s star 1 to ask a question. And we do have our next question coming in from Cecelia del Castillo from Citigroup.

C. del Castillo: Hello. Good morning. How are you? I have a couple of questions regarding the interest expense. What do you expect for the following quarters in terms of the, you know, in terms of the interest expense and also do you expect the interest rate to come down in the following quarters?

And the second question would be on the margins. In the pro forma basis or - well you reported an EBITDA margin of 22.6%, so I don’t know if you could talk a little bit about the seasonality that you expect during the following quarters to get to the 23%, 23.5% that you are targeting for the year.

M. Gonzalez: Okay Cecilia. The interest as you know we have a very good, actually for us a known cost in the long term because of the US$250 million unsecured loan that we have put for the next ten years. So this mainly would represent the major part of our interest costs. And we have a very small in short term. Total interest costs for this quarter were Ps. 100 million.

Moving o, it shouldn’t change that much because these known costs that we have, which will be major ones. If you compare to fourth quarter we have – we reported Ps. 113 million. I would expect that interest costs will range in those two levels for the coming quarters.

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Could you again spell out the margin question - the seasonality – if I understood it well, you were asking if we expect seasonality in the coming quarters in terms of volume and revenues – is that the question not for the second and third quarter?

C. del Castillo: No, I was thinking more on the what do you – what trends do you expect on the EBITDA margin in the following quarters to get to the 23.5. And now that you mentioned seasonality, I don't know if you can talk also a little bit about what you expect in terms on that side.

M. Gonzalez: Yeah, we feel very comfortable to get to the guidance number that we have published, which is 23.5%, starting from 23.5% to 24%. As you see, we have been moving constantly every quarter; improving as we speak. Our SG&A is under control at the 9% plus or minus level. So we're confident to get to that guidance as we continue bringing these types of excellent results to the market.

C. del Castillo: Okay. Thank you.

Coordinator: Thank you very much. We have our next question coming from Jamie Nicholson from Credit Suisse First Boston.

J. Nicholson: Hi, good morning. Just ,do you guys see any slowdown in mortgages out of INFONAVIT with elections coming up this summer? Any transitional issues that you expect might affect the pace of mortgages either over the summer or after elections?

G. de Nicolas: Thanks Jamie. What we have heard from the Presidential candidates and mainly from the two with more possibility of becoming the next president is that they want to improve what the actual administration has achieved in terms of housing in Mexico. Then we are expecting better chance and better opportunities in terms of mortgage availability and number of homes built in Mexico.

In terms of any slowdown or transitional issue, now we feel comfortable with the institutionalization of INFONAVIT. Now it's a more independent, transparent institution with better IT systems and procedures to make things easier for us in terms of collecting homes. And you can see that impact on our reduction in accounts receivables in this quarter, and that's an achievement that we can have because of INFONAVIT, it is improving and we are confident that this trend will continue with the next president, after December 1.

J. Nicholson: Okay. Thank you very much.

Coordinator: Thank you. We have our next question coming in from Everardo Camacho from GBM.

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E. Camacho: Hi gentlemen just one quick question. Could you give us a breakdown on how you're calculating your free cash flow for the quarter? You mentioned Ps. 181 million without the new building and Ps. 118 million if I heard correctly with the new building. So could you just give us a breakdown on how you're getting to these numbers?

M. Gonzalez: Yes, Everardo. We reported a total of Ps. 181 million free positive cash flow for the quarter, without considering CAPEX of the new building. And we as you know have wonderful corporate offices, that we think that will serve for continuing growth of the company as we move forward.

That had a cost of Ps. 160 million over a couple of quarters plus land at the third quarter, the land acquisition which was a little bit earlier. Before the quarter we included the final part of the cost of this new headquarter's office of Ps. 60 million.

So at the end we're reporting a net, out of this, positive free cash flow for the quarter affecting Ps. 118 million. And as you know our guidance is to expect positive free cash flow for the full year.

E. Camacho: Yes, I understand correctly what you're saying. But I'm just wondering could you give us a breakdown starting from the EBITDA on how you get to this Ps. 181 million free cash flow?

M. Gonzalez: Yes, in general terms working capital was a contributor in the calculation of free cash flow of Ps. 200 million plus. And then we had a land acquisition – as you know, this positive free cash flow reflects the purchase of land of nearly Ps. 450 million outside the major line items that we have. Of course the other part is coming from the positive results at the net income level that we have.

E. Camacho: Okay I'll guess I'll try to follow up later with you. Thank you very much.

Coordinator: Thank you sir. Once again as a reminder that's star 1 to ask a question. We have our next question coming in from Alex Adams from Maverick.

A. Adams: Hi guys. I'm just wondering if you could give me some sense of how I can calculate the foreign exchange gain or loss. I know it was something you hadn't previously reported and I guess you changed your accounting policy and it was, you know, somewhat significant, 10% that went to earnings or so. So I'm just wondering if you can give me a sense of either guidance or way to calculate it for the quarters going forward.

M. Gonzalez: Certainly. Remember this is a non-cash event, at all. We did record for the year-end from our audited results an immaterial – what is called a material adjustment in the

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foreign exchange line of a total of Ps. 41 million. This was for the end of the year. There's a small typo in there because the press release is showing Ps. 61 million. But it's Ps. 41 million.

Now moving in the first quarter by the way the total amount recorded was a net of, a non-cash event of Ps. 51 million. Now as we move forward the net foreign exchange gain per loss is through the term of the unsecured loan debt that we have on fixed terms for ten years plus – minus the mark-to-market results of our swap – hedge swap will even

So it may vary positively as we move with a peso devaluing in the foreign exchange line and it will move a bit negative every time that the peso revalues. These are as I mentioned non-cash events and at the end of the ten-year period, thanks to the fixed debt and the good hedge that we put in there, it will not have a cash effect.

A. Adams: Okay so did you guys used to report this? I mean how did you report this in '05? Was this just a charge to equity and didn't go through your income statement?

M. Gonzalez: Yes, that's the case.

A. Adams: Okay. And how come you decided to change the report? I mean it makes sense that the non-cash – I just – when I've seen other companies have, you know, foreign exchange gain and losses that basically net out over a ten year period they usually just charge it to equity rather than run it through the earnings

M. Gonzalez: Yeah it's a conservative view. It was recommended by our auditors.

A. Adams: Okay. But for ongoing business purposes I should probably just back that out and then come up with my own earnings number, right?

M. Gonzalez: Yes, that's the best thing to do because it's a non-cash event.

A. Adams: Okay. Thank you very much.

M. Gonzalez: Thank you.

Coordinator: Thank you. Once again that's star 1 to ask a question.

And sir at this time I show no further questions and would like to turn the call back over to you for closing remarks.

C. Moctezuma: Thank you. Well we'd like to thank everyone again for your time today and interest in the company and like to remind you a playback of this call will be available starting later today by dialing 402-220-9673 and the audio webcast will be also available on our IR website. You can also access to the corporate site at ww.homex.com.mx. And please free to contact with any other questions you may have.

Thank you once again and good day.

Coordinator: Thank you everybody for joining the conference call today. Have a good day. You may disconnect your lines at this time. Thank you.

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About Homex

Desarrolladora Homex, S.A. de C.V. is a leading, vertically-integrated home development company focused on affordable-entry level and middle-income housing in Mexico. It is one of the most geographically diverse home builders in the country. Homex has a leading position in the top four markets in the country and is the largest builder in Mexico, based on the number of homes sold and net income.

For additional corporate information please visit the Company's web site at: www.homex.com.mx