

# GRANT'S

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## So bad, it's good

"It's the worst-performing region in the whole world," matter-of-factly observes John Haskell, who ought to know. He's the director of research at the Latin-American-focused Explorador Capital Management, which is down a cool 44.4% in the year to date. "Developed, emerging or frontier," says Haskell—"any regional group in the index—Latin America is the poorest performing region for 10 years in absolute terms."

Now in progress is a Cook's tour of markets from which, as Haskell advises our deputy editor, Evan Lorenz, money is fighting to get out, not in. Stalwart seekers of deep value (including collectors of free options on the next inflation) may read on. Momentum-minded readers can avert their eyes.

Since year-end 2009, the MSCI Emerging Latin America Index has generated a total return of negative 35% in U.S. dollars compared with the S&P 500's positive 247%, including reinvested dividends. But take a longer view—say, back to the start of 1988, when Bloomberg picks up the scent—and the same MSCI LatAm equity index has topped the S&P, in dollar terms and with reinvested dividends, by 11.9% versus 10.5% per annum, the past lamentable decade notwithstanding.

"I mean, this is just an absolute wash-out in Latin America," Haskell proceeds, "total capitulation. Relative to any other time in my career, even through the financial crisis of 2008, I'd say this is by far the most dislocated. One way to think of it is, every once in a while there's an exogenous shock to the system. And then every once in a while, there's an exogenous shock followed by an exogenous shock. And every once in a while, there's

a shock on the shock on the shock."

The successive bolts from the blue are these: the end of the Chinese-driven commodity super-cycle, the Saudi-led collapse in oil prices and the coronavirus. Since the bug bit, Latin American stocks, compared to their American counterparts, have dropped more and recovered less. Peak-to-trough, they plunged by 53.7% versus 33.9% for the S&P. And they are quoted today at 34.6% below their 2020 highs versus a shortfall from the peak of 7.5% for the S&P.

What the LatAm investors are fleeing is not only past performance but also current value. The \$150 million Explorador portfolio, invested in six main markets across a variety of industries in about 25 separate names, trades at 4.8 times estimated 2020 earnings and 20% below book value while earning a projected 16.6% on book equity, the fund advises its limited partners.

Plainly, the market expects little, and this, too, presents an opportunity: "Often in the global investing world, we have greater visibility and comfort in the short-term outlook and less clarity on a 5-to-10-year horizon. In today's investing environment in Latin America, it is the inverse. We have less visibility in the next 12–24 months, but more confidence in the value of the businesses we hold over the long run. Given the market's preference and bias for immediate earnings visibility, assets are extremely discounted."

As examples, Haskell proffers first a pair of Mexican REITs, or, as they're known locally, FIBRAs (short for Fideicomiso de Infraestructura y Bienes Raíces).

No. 1: Concentradora Fibra Hotelera Mexicana S.A. de C.V.

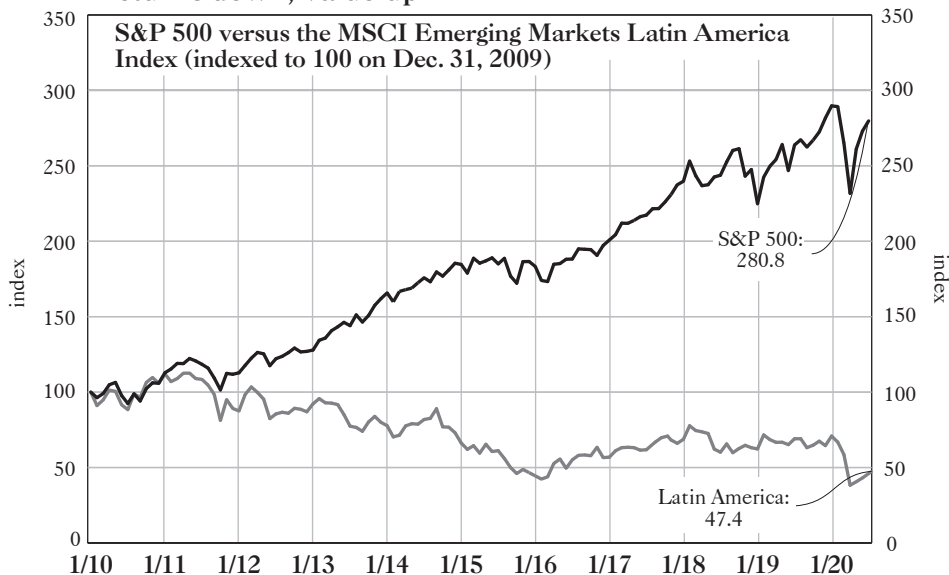
No. 2: Concentradora Fibra Danhos S.A. de C.V. (FIHO12 and DANHOS13 in Mexico).

Fibra Hotel owns what its name implies. Fibra Danhos holds a mix of high-end retail and office properties. Strong dividends, low leverage and attractive valuations constitute the sum and substance of the bull case.

*Grant's* laid out the bull case on Fibra Hotel, which operates 86 hotels with a total of 12,558 rooms, in the May 4, 2018 issue. Let us only say that we could have waited, the stock having subsequently lost 68% of its dollar value. Still and all, the investment-grade business is hardly distressed. True, on April 6 Fitch Ratings did downgrade Fibra Hotel to double-A-minus with a negative outlook from double-A, but, at last report on March 31, the ratio of debt to asset value on the Fibra Hotel balance sheet weighed in at 28%. And of that debt, only 17% matures between 2020 and 2022.

As the virus struck, Fibra Hotel shut 84 properties and moved to preserve liquidity by canceling the first-quarter dividend, deferring management fees and negotiating interest and principal payment grace periods through September. In consequence, the balance sheet shows cash on hand of 908.3 million pesos (\$40.4 million) against debt falling due in 2020 of 31 million pesos. On the April 23 earnings call, CEO Simón Galante estimated that, with no additional borrowing, the company could survive the shuttering of its every hotel for eight to 10 months. Perhaps not many other companies, North, South, East or West, could operate at zero revenue for three-quarters of a year, though that contingency now seems unlikely. Last week,

## Returns down, value up



source: The Bloomberg

management announced the reopening of 43 properties, fully half the portfolio.

Fibra Hotel trades at 28% of net asset value and is priced to yield 16% on estimated 2021 dividends. Of course, the virus-driven recession has its own secret timetable, and it may take longer than the bulls expect for the dividend checks to be cut and mailed. "In the meantime," says Haskell, "you own hard assets that are not undergoing financial distress. Ultimately, in the out years, the present year's income is really just a small portion of the total [net present value]. So, it's those kinds of dislocations that I think are very compelling on a bottom-up basis."

Fibra Danhos, REIT No. 2, owns marquee retail and office properties, primarily in Mexico City and Puebla. In the first quarter, shops and malls kicked in 50% of net operating income (NOI), followed by mixed-use centers (29%) and offices (20%). While social distancing is taking its accustomed toll on Mexican retailing, Danhos is financially prepared for the siege. As of March 31, the REIT showed a ratio of debt to total assets of 8.6% and, of that debt, most matures in 2026–27.

The word from Danhos management on the first-quarter call was that the company was offering "non-essential" retail tenants two months' worth of rent relief

(not rent deferral), spread between April and July. Nonetheless, Danhos, too, is taking steps to preserve liquidity by canceling its first-quarter dividend and deferring management fees.

For now, anyway, this tenant-friendly approach will weigh on earnings. "Relative to peers, Danhos will have the highest impact from Covid-19," analysts at Barclays Capital commented the other day. "Moreover, the company claims that it has reached an agreement with the vast majority of its tenants in the form of rent discounts. We estimate net operating income will decrease by 24% year-over-year in 2020. The biggest impact will be seen in the second quarter of 2020, yet we also expect some discounts in the second half. However, this effect will be temporary and only in the commercial segment of Danhos's portfolio."

Danhos changes hands at 59% of net asset value and is priced to yield 9.9% based on estimated 2021 dividend payments. "Their cap rate on 2020 earnings, even estimating the impacts on rents from temporary mall closures, is 10.8%," says Haskell. "Their cap rate on a trailing basis is about 15% on 2019 normalized NOI."

Inversiones La Construcción S.A. (ILC in Chile), Haskell's third example of "dislocated" equity pricing south of the border, is a financial-cum-med-

ical conglomerate. Assets encompass AFP Habitat (the country's second-largest pension manager), Confuturo (its fifth-largest life insurer), Consalud (tied for first place as Chile's largest health insurer), Redsalud (a hospital chain) and Banco Internacional (a commercial bank).

The market selloff slammed ILC's first-quarter results, ending in a net loss of 23.9 billion Chilean pesos (\$29.2 million) versus net income of CLP 35.5 billion in the first three months of 2019. A reduction of CLP 72 billion in reserves at the pension division and a CLP 29 billion equity loss in the life-insurance subsidiary's equity portfolio figured heavily in the loss. Excluding those items, the business remained profitable.

"Management has shown impressive capital discipline assembling a portfolio of generally high-barrier, regulated businesses," says Haskell. "These businesses benefit from the development of formal employment in Chile. This is a company that has increased book value around 10% from 2012 to 2019 and generates mid-teens ROEs."

After a 38% decline in dollar terms this year, ILC is valued at 8.8 times the 2020 estimate. "Shares now trade well below liquidation value of its parts," Haskell points out. "This more than reflects any regulatory concerns in Chile's privatized pension system and temporary earnings disruptions driven by Covid, particularly in the hospital network. The company has a solid debt profile and ample liquidity (CLP 67 billion of cash on hand and no more than CLP 30 billion per year in amortizations) and should yield above a 6.5% dividend this year."

While Interactive Brokers is prepared to transact in each Fibra (and Fibra Hotel is available on Schwab, too), ILC is apparently not so readily accessible to an American investor.

Apart from their merits as operating companies, Haskell extolls the Fibras as hedges against today's uniquely aggressive monetary and fiscal policies. "These inflation-protected assets," he says, "hard real-estate, hard brick-and-mortar assets essentially hold their value in real terms over the long run. I think they are very compelling opportunities."

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