

WALMEX

Quarterly Report

October 29, 2019

Gross margin gains offset expense pressures

- Walmex delivered 3Q19 results that topped our expectations in terms of profitability, as an improvement at the gross level offset pressure on expenses. We expect a positive response to the report
- Sales rose 4.9% yoy to MXN 155.0 billion, underpinned by a 3.1% increase in SSS. EBITDA rose 18.6% to MXN 17.7 billion (+3.9% vs. BNTe) while the margin expanded 130bps (+40bps excluding IFRS16)
- We are introducing our PT2020 of MXN 65.00, which implies a 2020E FV/EBITDA multiple of 15.0x, similar to the current level and historical averages. We reiterate our BUY rating on the stock

Ongoing improvements in profitability. Walmex delivered a good 3Q19 report that topped our expectations in terms of profitability. Sales were up 4.9% yoy to MXN 155.0 billion, driven by a 3.1% increase in consolidated SSS and 2.1% sales floor expansion. The gross margin was a positive surprise, rising 30bps to 23.6%, as relatively better commercial conditions and less aggressive retailing in Mexico offset price investments in Central America. EBITDA grew 18.6% yoy to MXN 17.7 billion (+3.9% vs. BNTe) and the margin rose 130bps to 11.4%. Although IFRS16 explains most of this performance, on an accounting changes-adjusted basis, EBITDA grew 8.9% yoy and the margin 40bps, despite expense pressure from higher electricity rates and more spending on advertising related to the summer season. Finally, net profit rose 6.6% to MXN 9.2 billion (+4.7% vs. BNTe), underpinned by a lower effective tax rate, which offset a 264% higher CFC.

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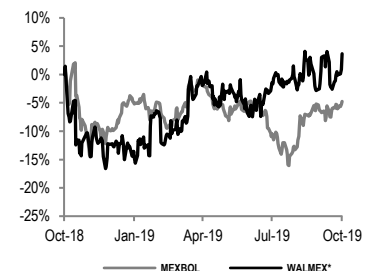
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BUY

Current Price	MXN\$57.13
PT 2020	MXN\$65.00
Dividend	0.54
Dividend Yield (%)	0.9%
Upside Potential	13.8%
Max – Min LTM (MXN\$)	59.87 – 45.90
Market Cap (US\$m)	52,206.9
Shares Outstanding (m)	17,461.4
Float	30%
Daily Turnover (MXN\$m)	962.8
Valuation metrics TTM	
FV/EBITDA	14.9x
P/E	26.0x

Relative performance to MEXBOL LTM



Financial Statements

MXN, million	2017	2018	2019E	2020E
Revenues	573,265	616,910	648,825	697,030
Operating Income	43,838	49,190	55,078	60,263
EBITDA	55,482	61,747	72,121	78,607
EBITDA Margin	9.7%	10.0%	11.1%	11.3%
Net Income	39,865	36,753	38,883	41,300
Net Margin	7.0%	6.0%	6.0%	5.9%
Total Assets	295,256	306,529	345,301	383,415
Cash	35,596	38,830	18,429	28,070
Total Liabilities	135,722	141,615	183,888	212,167
Debt	15,053	15,465	55,497	55,497
Common Equity	159,534	164,914	161,413	171,248

Source: Banorte with data from MSE

Valuation and financial metrics

	2017	2018	2019E	2020E
FV/EBITDA	17.6x	15.8x	14.3x	13.0x
P/E	25.0x	27.1x	25.7x	24.2x
P/Book	6.3x	6.0x	6.2x	5.8x
ROE	24.4%	22.7%	23.8%	24.8%
ROA	13.5%	12.0%	11.3%	10.8%
EBITDA/ Interest expen	6.9x	6.9x	6.9x	6.9x
Net Debt/EBITDA	-0.4x	-0.4x	0.5x	0.3x
Debt/Equity	0.1x	0.1x	0.3x	0.3x

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Document for distribution among public

WALMEX – Results 3Q19

MXN, million

Concept	3Q18	3Q19	Chg %	3Q19e	Diff% vs Estim.
Revenue	147,768	155,019	4.9%	154,961	0.0%
Operating Income	11,811	13,384	13.3%	12,769	4.8%
Ebitda	14,903	17,676	18.6%	17,012	3.9%
Net Income	8,682	9,251	6.6%	8,835	4.7%
Margins					
Operating Margin	8.0%	8.6%	0.6pp	8.2%	0.4pp
Ebitda Margin	10.1%	11.4%	1.3pp	11.0%	0.4pp
Net Margin	5.9%	6.0%	0.1pp	5.7%	0.3pp
EPS	\$0.50	\$0.53	6.6%	\$0.51	4.7%

Income Statement (Million pesos)

Year	2018	2019	2019	Change	Change
Quarter	3	2	3	% yoy	% qoq
Net Revenue	147,768	154,350	155,019	4.9%	0.4%
Cost of goods sold	113,355	119,440	118,492	4.5%	-0.8%
Gross profit	34,412	34,910	36,527	6.1%	4.6%
General expenses	22,618	22,952	23,257	2.8%	1.3%
Operating Income	11,811	12,080	13,384	13.3%	10.8%
Operating Margin	8.0%	7.8%	8.6%	0.6pp	0.8pp
Depreciation	3,092	4,195	4,293	38.8%	2.3%
EBITDA	14,903	16,276	17,676	18.6%	8.6%
EBITDA Margin	10.1%	10.5%	11.4%	1.3pp	0.9pp
Interes income (expense) net	(366)	(1,074)	(1,333)	264.1%	24.1%
Interest expense				N.A.	N.A.
Interest income	334	326	280	-16.3%	-14.3%
Other income (expenses)	(459)	(1,458)	(1,491)	225.0%	2.2%
Exchange Income (loss)	(242)	57	(122)	-49.5%	N.A.
Unconsolidated subsidiaries				N.A.	N.A.
Income before taxes	11,445	11,006	12,051	5.3%	9.5%
Income taxes	2,763	2,254	2,800	1.3%	24.2%
Discontinued operations					
Consolidated Net Income	8,682	8,751	9,251	6.6%	5.7%
Minorities				N.A.	N.A.
Net Income	8,682	8,751	9,251	6.6%	5.7%
Net margin	5.9%	5.7%	6.0%	0.1pp	0.3pp
EPS	0.497	0.501	0.530	6.6%	5.7%

Balance Sheet (Million pesos)

Total Current Assets	104,341	99,600	100,822	-3.4%	1.2%
Cash & Short Term Investments	33,061	26,603	20,555	-37.8%	-22.7%
Long Term Assets	187,780	226,571	234,015	24.6%	3.3%
Property, Plant & Equipment (Net)	134,976	126,259	130,379	-3.4%	3.3%
Intangible Assets (Net)	1,882	1,845	1,864	-1.0%	1.0%
Total Assets	292,122	326,171	334,837	14.6%	2.7%
Current Liabilities	109,824	115,913	110,961	1.0%	-4.3%
Short Term Debt	318	2,984	3,031	>500%	1.6%
Accounts Payable	106,736	108,808	101,749	-4.7%	-6.5%
Long Term Liabilities	29,558	61,445	63,781	115.8%	3.8%
Long Term Debt	15,166	49,841	52,466	245.9%	5.3%
Total Liabilities	139,382	177,358	174,743	25.4%	-1.5%
Common Stock	152,740	148,813	160,094	4.8%	7.6%
Noncontrolling Interest				N.A.	N.A.
Total Equity	152,740	148,813	160,094	4.8%	7.6%
Liabilities & Equity	292,122	326,171	334,837	14.6%	2.7%
Net Debt	(17,577)	26,222	34,941	N.A.	33.3%

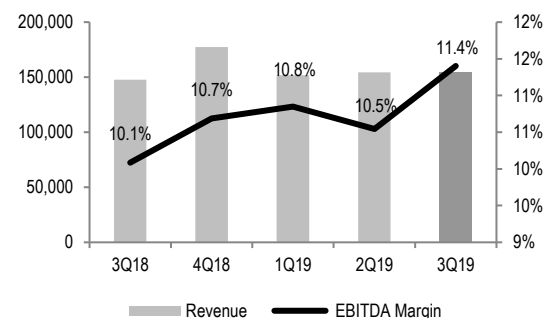
Cash Flow (Million pesos)

Cash Flow from Operating Activities	13,870.7	13,521.0	12,347.8
Cash Flow from Investing Activities	(4,581.3)	(3,490.8)	(6,384.9)
Cash Flow from Financing Activities	(5,393.5)	(12,928.5)	(12,062.9)
FX Effect on Cash Flow	(1,091.1)	(10.0)	52.0
Change in Cash Balance	2,804.7	(2,908.3)	(6,048.0)

Source: Banorte, MSE.

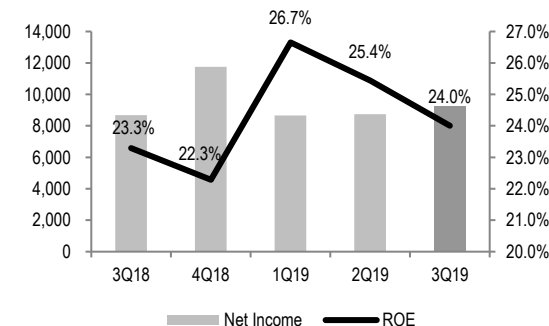
Revenue & EBITDA Margin

MXN, million



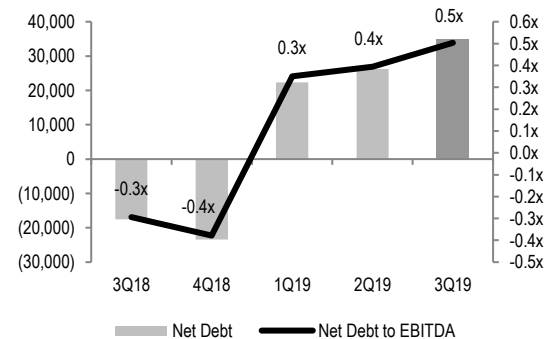
Net Income & ROE

MXN, million



Net Debt & Net debt to EBITDA ratio

MXN, million



Mexico's SSS surpassed ANTAD's by 60bps. Walmart de México y Centro América reported 3Q19 revenues of MXN 155.0 billion, increasing 4.9% on the year-ago quarter. This performance was mostly driven by a 3.1% increase in consolidated SSS as well as 2.1% sales floor growth following the opening of 145 new stores over the last 12 months. In Mexico, consolidated sales rose 5.2% on a 3.8% rebound in SSS, while 103 new store openings drove PV by 1.8%, which would explain the additional 140 bps. In Central America, peso-denominated sales rose 3.7%, driven by a positive exchange rate conversion effect of 1.1%, while in local currency SSS growth was 2.6% due to a 0.2% decrease in SSS and a 4.3% increase in the sales floor as a result of 29 store openings. While performance across regions was positive, this time the highest growth occurred in the north and south followed by the center and the metropolitan area, while by format, Sam's was out in front again thanks to its value for members focus. The Walmart format was not far behind thanks to its focus on an improved purchasing experience, special displays, and a successful execution of the back-to-school season not to mention the summer campaign "Rebajas para todos," while at Superama, the focus was on perishables and results were underpinned by the "Días de verano" campaign; the "Morralla" campaign was the main driver of Bodega. Finally, by category, food and consumables displayed the highest growth –even surpassing SSS– followed by general merchandise, which was slightly weaker, while apparel and footwear recorded a SSS decrease owing to operating difficulties derived from imports at the beginning of the year.

Gross margin rose 0.3%. Walmex positively surprised by reporting a 30bps expansion in the 3Q19 gross margin to 23.6%, as better negotiations with suppliers (explained by cost reduction initiatives) and less aggressive retailing in Mexico, drove the local indicator by 0.3 pp to 23.3%, thus offsetting price investments in Central America (-10 bps to 24.6%). We view the company's performance in Mexico as remarkable, especially in view of fierce retail sector competition associated with the summer season, so better handling of markdowns is undoubtedly a positive. Thus, gross profit rose 6.1% to MXN 36.5 billion.

Despite some expense pressure, the EBITDA margin rose 130 bps and 40 bps excluding the IFRS16 effect. Although Walmex faced expense pressures (+5.2% yoy excluding the effect of accounting changes, which is above the rate of revenue growth) owing to higher electricity rates and greater investment in advertising campaigns during the summer season in Mexico, which compensated for higher expense leverage in Central America, they were offset by gross profit. Thus, the adjusted EBITDA margin rose 40 bps and EBITDA 8.9% yoy. However, including the effect of IFRS16 accounting changes, Walmex reported a 2.85 yoy increase in expenses and yoy EBITDA growth totaling MXN 17.7 billion (+3.9% vs. BNTE) with a resulting 130 bps improvement in profitability to 11.4%.

Net profit rose 6.6%. Despite operating growth (+13.3%), the adoption of IFRS16 considerably increased WALMEX's financial expense, which resulted in the CFC rising 264.1%. As a result, net profit rose 6.6% yoy to MXN 9.2 billion (+4.7% vs. BNTe), partially driven by a lower effective tax rate (23.2% vs 24.1% previously).

Slightly higher debt. As a result of a qoq decrease of MXN 6.0 billion in cash and a qoq increase of MXN 2.7 billion in debt with cost, leverage rose slightly to 0.5x ND/EBITDA from 0.4x in 2Q19. Even so, it is important to note that Walmex continues to boast a very solid financial structure and that the yoy increase is mainly due to the effect of lease liabilities following the adoption of IFRS16.

Decrease in valuation parameters following the report. After factoring in 3Q19 results, WALMEX's multiples cheapened. FV/EBITDA decreased to 14.9x from 15.4x previously, while P/E decreased to 26.3x from 26.0x, which is positive.

2020 Estimates

According to our valuation model, Walmex's total revenues should grow 7.4% yoy to MXN 697.0 billion due to SSS growth of 5.3%, while new store openings –which we expect to speed up with sales floor growth of 2.6% and 184 openings (105 in Mexico and 37 in CA) – should contribute 210 bps to performance. It should be pointed out that in the case of the Central American operations, expected exchange rate depreciation (MXN 21.30) should underpin results due to a favorable forex conversion effect. Meanwhile, we expect SSS growth along with strict expense control to translate into higher operating leverage, resulting in a 20 bps expansion of the EBITDA margin to a double-digit number (11.3%e). Thus, EBITDA should grow 9.0% yoy to MXN 78.6 billion. We forecast net profit growth of 6.2% yoy to MXN 41.300 billion, as a higher effective tax rate (24.8%e vs. 22.7%e previously) should put pressure on net profit. Finally, CapEx should amount to MXN 24.0 billion (+1.7% yoy) reflecting a higher pace of openings as well as aggressive investments related to the company's omnichannel strategy.

Introducing our PT2020 of MXN 65.00 while reiterating our BUY rating.

In order to determine Walmex's theoretical value, we used a relative valuation methodology. After including 3Q19 results in our valuation, the share is trading at 14.9x LTM FV/EBITDA (a slight decrease on 15.4x prior to the report). Assuming a 2020E FV/EBITDA multiple of 15.0x, similar to historical averages, we reached a 2020E PT of MXN 65.00. While implied valuation may seem on the conservative side in view of the [pick-up in economic growth](#) and [lower interest rates](#) our economists are projecting for 2020, the size of the rerating will depend on how prevailing global and local risks play out. Nevertheless, our PT suggests attractive upside potential (13.8%), and we therefore reiterate our BUY rating.

Certification of Analysts.

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer, Francisco José Flores Serrano, Luis Leopoldo López Salinas, Jorge Antonio Izquierdo Lobato and Leslie Thalia Orozco Vélez, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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HOLD	<i>When the share expected performance is similar to the MEXBOL estimated performance.</i>
SELL	<i>When the share expected performance is lower than the MEXBOL estimated performance.</i>

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History of PT and Ratings

Stock	Date	Rating	PT
WALMEX	October 23, 2019	BUY	MXN\$65.00
WALMEX	May 28, 2019	BUY	MXN\$60.00
WALMEX	January 8, 2018	BUY	MXN\$58.00
WALMEX	July 25, 2018	HOLD	MXN\$59.00

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