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WALMEX\*.MX - Q4 2018 Wal Mart de Mexico SAB de CV Earnings Call

EVENT DATE/TIME: FEBRUARY 13, 2019 / 9:30PM GMT



## CORPORATE PARTICIPANTS

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## PRESENTATION

### Operator

Good afternoon, ladies and gentlemen. Welcome to Walmart de México y Centroamérica's Fourth Quarter 2018 Earnings Conference Call.

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**Pilar de la Garza** - *Wal-Mart de México, S.A.B. de C.V. - Senior Director of IR*

Good afternoon. This is Pilar de Garza, Investor Relations Senior Director for Walmex. Thank you for joining us today to review the results for the fourth quarter 2018.

On today's call with me are Guilherme Loureiro, President and Chief Executive Officer for Walmart de México y Centroamérica; and Olga González, Chief Financial Officer. The date of this call is February 13, 2019. Today's call is being recorded and will remain available at [www.walmex.mx](http://www.walmex.mx).

Before we start, let me remind you that the content of this call is property of Wal-Mart de México S.A.B. de C.V., and is intended for the use of the company's shareholders and the investment community. It should not be reproduced in any way. This call may contain certain references concerning Wal-Mart de México S.A.B. de C.V.'s future performance that should be considered as good faith estimates made by the company. These references only reflect management's expectations and are based upon currently available data. Actual results are always subject to future events, risks and uncertainties, which could materially impact the company's actual performance.

Now I would like to turn it over to our CEO, Gui Loureiro.

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**Guilherme De Souza Macedo Loureiro** - *Wal-Mart de México, S.A.B. de C.V. - President, CEO & Director*

Thank you, Pilar, and good afternoon, everyone. Thanks for joining us today to review the fourth quarter and full year results.

2019 was a transformational year for Walmex, and I'm very pleased with the progress we made last year to meet the changing needs of our customers.

We are making strategic decisions that require us to change from the inside to position the company for continued success and to deliver even stronger results. I'm particularly excited about how we executed against our strategic priorities. While making progress around delivering a seamless and more enjoyable shopping experience, customers are liking the change in our stores, and they're letting us and others know through improvements in the Net Promoter Score and other formats.

I'm also pleased with the continued growth in the customer flow. We know that in order to deliver consistent results, we need to drive traffic to our stores. And last year, we were able to increase traffic by almost 2% in Mexico.

As a result of a disciplined and transformational management of expenses, we were able to reinvest sales into our business, while improving profitability. Our financial strength serves as a great competitive advantage, especially while we are going through this transformation.

Now let me start with sales performance. Please consider that when I talk about Central America, I'm referring to figures on a constant-currency basis.

We have committed to driving top line sales. In the fourth quarter, consolidated revenues increased 5.5%. Mexico delivered total revenue of MXN 145.9 billion, an increase of 6% over last year. In Central America, total revenue reached MXN 31.5 billion, which implied a 3.6% growth.

For the full year 2018, total revenues grew 7.6%, Mexico grew 8.1% and Central America, 5.9%. We are on track to reach our goal of doubling the size of the company in terms of sales by 2024.

Our performance was backed by consistent same-store sales growth. In Mexico, same-store sales grew 4.6% in the fourth quarter and 6.7% in the full year. In Central America, same-store sales remained almost flat during the quarter but grew 2.1% in the full year period. I would like to highlight that in the year, we achieved a double-digit 2-year stack growth for same-store sales in Mexico of 13% and 7% in Central America.

We drove quality, broad-based growth across all regions and formats in Mexico.

The Central region posted the strongest growth followed by the South and the North region. The Metro area had a lower but solid growth given its penetration and competitive landscapes.

Look at the performance by format. Sam's Club delivered the highest growth. Actually, it has been the format with the highest same-store sales growth for 3 consecutive years. The team has succeeded in acquiring new members and retaining them. By offering compelling merchandise as a value and innovation to better serve our members, we are leading the Club channel, and we feel confident about our path forward.

Walmart also posted strong growth. It's amazing what the chain is doing to deliver a seamless shopping experience. Besides the successful execution of our seasonal events, Walmart's focus on price has achieved an omni-channel integration. It's helping our customers to save time and money.

This year, we celebrated Bodega's 60th anniversary, with a solid sales performance and accelerated expansion. Each of one of the formats, Bodega, Mi Bodega and Bodegas Express delivered strong sales growth, backed by a healthy increase in traffic. In 2018, we opened 93 Bodega stores in Mexico, almost a 40% increase versus 2017.

Last but not least, Superama also had a good year. The team's focus on delivering the shopping experience that our customers desire, no matter how they choose to shop, has been key to enforcing performance leadership position in on-demand.

From a merchandise perspective, we saw a strong growth in all divisions, particularly in our core division of food and consumables. In the second half of the year, we experienced headwinds from lower food inflation that impacted sales, especially in the fresh department, but we're able to drive volume to partially offset this impact.

We're excited about what we have done in each one of the formats and divisions, but we aren't satisfied. All of us at Walmex continue to work really hard to become the most trusted omni-channel retailer in Mexico.

Now let's talk about Central America. Despite a challenging environment, we're able to grow ahead of the market and to invest in capabilities for future growth. During the quarter, we inaugurated the largest and most modern produce distribution center in Costa Rica. The new DC will service more than 1,400 local produce suppliers. We have a firm commitment to support national farmers and to double the volume of local poultry.

We also opened a 38,000 square meter distribution center in Nicaragua. The DC is 3x larger than the existing one, and it will allow us to give better service to existing stores as well as to expand with new whitespace for future growth opportunities.

In terms of sales performance in the year, Honduras and El Salvador were the countries with the highest same-store sales growth, while Costa Rican Guatemala delivered lower but positive growth.

Sales growth in Nicaragua was challenged by the social-political conflicts in the country that are affecting economic conditions in general. We are bringing new commercial strategies to some price point programs, improving the price gap methodology to reinforce our price leadership, and we are rolling out the Center of Excellence program in the 5 counts.



As of December 2018, 50% of our stores were operating as a Center of Excellence. The strategies that we have deployed in the region are starting to show results. And given the nature of the challenge that we are facing, we expect growth to resume at a slow pace.

Now let's talk about eCommerce. We are gaining traction in accelerating omni-channel growth. The on-demand service allows us to leverage our biggest assets, our stores. And it helps us build loyalty and increase shopping frequency.

Last quarter, we reinforced the on-demand assortment to over more than 5,000 general merchandise items on same-day delivery. As we shared with you, our priority is to win in on-demand, and our infrastructure positions us to lead this business.

The marketplace is also gaining traction. We ended the year with over 800 sellers. And during the (inaudible) event, in the month of December, the marketplace grew triple digit.

During the year, eCommerce sales grew 40% and GMV grew 47%. The general merchandise division posted even higher growth. eCommerce now represents 1.4% of total Mexico sales and contributed 40 basis points to total sales growth.

Moving to new stores. I'm proud to share with you that 2018 expansion program was the largest in the last 5 years in terms of store openings. We opened 134 new stores, 100 stores in Mexico and 34 in Central America. This compares to 125 stores last year. In 2018, new stores contributed 2.3% to total sales growth, which was in the guidance that we shared with you last year.

Now looking at the performance versus the market. We've been growing ahead of the self-service and clubs market measured by ANTAD for 4 consecutive years. In 2018, we surpassed the market by 350 basis points, the highest gap in 4 years.

Our strive for operational excellence, clear value proposition and committed associates are setting us apart from the competition. In 2018, all formats and divisions individually outpaced ANTAD. We are working hard every day to improve our customer and member satisfaction scores, and customers are rewarding us with their loyalty.

We have also made important progress in environmental, social and corporate governance-related matters. For 30 consecutive year, Wal-Mart de Mexico and Central America was included in the FTSE4Good Emerging Index, an index that evaluates environmental, social and governance performance of its constituents.

In Walmex, we value and encourage the diversity of our associates. Last year, we were also included in the Bloomberg Gender-Equality Index. Walmex is the only retail company that has made into the index for 2 years in a row.

As we go through this transformation, we are focusing on running up good business today. We are also very clear on how we should position it for the future.

I would like to thank all of our associates in Mexico and Central America for the progress we made as a company in 2018.

Sam Walton used to say that our people make the difference, and I share the same philosophy.

With that, I'll turn it over to Olga, who'll cover the financial results for the quarter.

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**Olga González Aponte** - Wal-Mart de México, S.A.B. de C.V. - CFO and Senior VP of Administration & Finance - Mexico & Central America

Thank you, Gui, and good afternoon, everyone. Besides a solid sales performance in 2018, we were also able to improve profitability in both Mexico and Central America. We are committed to maintain our operational discipline in order to invest strategically and position our business for the future.



I will start by covering results in Mexico. During the fourth quarter, total revenues grew 6%. Gross profit increased 30 basis points to 22.5%. Our merchants are doing a great job at conducting more efficient negotiations with our suppliers, which allows us to maintain our price leadership and to improve profitability.

As a result of a transformational SG&A management, we achieved 10 basis points of expense leverage by growing SG&A 4.8%, 120 basis points below total revenue growth.

Operating income and EBITDA grew double digits, 13.8% and 12.9%, respectively. Our already best-in-class EBITDA margin expanded by 70 basis points to 11%.

In the next chart, we can see SG&A performance in Mexico. We were able to reduce our regular operating expenses by 8 basis points through the implementation of productivity initiatives. Efficiencies and expenditures related to store remodeling and maintenance led to a 13 basis point reduction, and we invested 7 basis points in new stores and eCommerce.

Now let's move to Central America. Please consider that when I talk about Central America, I'm referring to figures on a constant-currency basis.

Total revenues increased 3.6%. Gross profit margins reduced by 10 basis points as a result of strategic pricing investments. The team has done an amazing job at managing expenses by operating with discipline and focusing on productivity.

SG&A grew 0.3%, resulting in 60 basis points of expense leverage.

Operating income grew 9% and EBITDA grew 9.5%, which led to an EBITDA margin expansion of 50 basis points.

We closed the year strong by delivering a robust fourth quarter. At a consolidated level, total revenues grew 5.5%. Gross profit increased 6.5% to a 22.8% margin. SG&A grew 3.8%, 170 basis points below total revenue growth. Operating income and EBITDA posted double-digit growth of 13.1% and 12.3%, respectively.

We reached a 10.7% consolidated EBITDA margin, which implied a 70 basis points expansion. Net income increased a solid 11.2%.

Now let's look at the results for the full year 2018. During the year, we invested MXN 70.9 billion in high-return projects. Our capital allocation is in line with the long-term strategy. We're becoming more productive in our remodels and new stores investments. And thereby, freeing capital to fund strategic investments.

By doing this, we're trying to balance the short and long term.

We will continue to invest in key initiatives such as prices, salaries, eCommerce and digital, logistics and new stores. In 2018, top line growth in Mexico was strong. Total revenues increased 8.1%, gross profit grew 8.6% and gross profit margin expanded by 10 basis points to 22.7%.

I am very pleased with our performance in terms of SG&A. We achieved 10 basis points of expense leverage as SG&A grew 7.2%, 90 basis points below total revenue growth.

As a result, operating income increased 12.8% and EBITDA, 11.6% to reach a 10.3% EBITDA margin.

Despite a challenging environment in Central America, we continue to grow ahead of the market and to improve profitability.

In the year, total revenues increased 5.9%. Gross profit expanded 10 basis points to 24.2% and SG&A grew 4.7%.

Operating income increased 9.4% and EBITDA margin expanded by 40 basis points to reach 8.9%.

Overall, in 2018, we posted strong results while we progress on our goal of becoming Mexico's leading omni-channel retailer. Consolidated revenues increased 7.6%, gross profit margin expanded by 10 basis points to 23%. After reinvesting in the business, we achieved 20 basis point of expense leverage and SG&A grew 6.5%.

Operating income grew 12.2% and EBITDA, 11.3%, to reach a double-digit consolidated EBITDA margin of 10%.

Income from continuing operations increased 13.5%, but net income was impacted due to the sale of Suburbia recorded in 2017.

Moving to the balance sheet. Our financial strength give us the ability to deliver short-term results while we build structural, competitive advantages to position the business for the long term.

We delivered strong free cash flow and closed the year with MXN 38.8 billion, 9.1% more than last year, driven by the strong cash generation from our operations and our increased focus in working capital. Our inventories and payables both increased 6.5%.

Operating cash flow increased 11.1% versus last year and reached MXN 60.5 billion. After investing MXN 17.9 billion in high-return projects, we still returned MXN 25.6 billion to our shareholders in the forms of dividend.

We have an ongoing commitment to return excess cash to our shareholders. On February 27, 2019, we will distribute the final installment of last year's dividend declaration of MXN 0.33 per share.

Today, the Walmex Board of Directors agreed to recommend a proposal to shareholders for an ordinary dividend of MXN 0.84 per share and an extraordinary dividend of MXN 0.91 per share.

Total dividend adds up to MXN 1.75 per share. Dividend yield will be approximately 3.6% based on yesterday's closing price of Walmex shares.

We expect the Annual Shareholders Meeting to be held on March 21, 2019, to vote on the proposal. This year, we're reducing the number of dividend payments to accelerate the distribution of cash to our shareholders. The proposed schedule for dividend payment is as follows. Ordinary dividend to be paid in 3 installments of MXN 0.28 per share in April, August and November 2019. Extraordinary dividend to be paid on 3 installments, the first one of MXN 0.33 per share on April 2019. The second one of MXN 0.30 per share on August 2019. And the last one of MXN 0.26 per share on November 2019.

In summary, I'm proud of the progress we have made on several fronts. And I am very excited about all the growth opportunities for Walmex going forward.

We have an incredible financial strength that provides flexibility and options. Please mark your calendars for our 15th Annual Analyst Meeting. We look forward to seeing many of you at the meeting. We will kick off with management presentations the morning of March 12 in Mexico City. Thank you very much for your interest in our company. As always, we will make ourselves available to receive your calls to answer any questions you might have.

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## Operator

With this, we conclude Walmart de México y Centroamérica's Fourth Quarter 2018 Earnings Conference Call. You may now disconnect.

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