

# DIAMOND HILL

INVESTED IN THE LONG RUN

## Walmex: Investing in Long-Term Growth Amid Uncertainty

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Mexican President Claudia Sheinbaum's early months have seen a continuation of uncertainty about the Mexican economy's direction. Days before she took office, her predecessor, Andrés Manuel López Obrador (AMLO), oversaw yet another successful constitutional reform that transformed federal judges into elected officials, leading to questions about judicial independence and shaking business confidence.



President Sheinbaum and the ruling Morna party seem set to continue AMLO's reform agenda, which has rattled the Mexican economy. Additionally, sunseting social benefits from COVID stimulus while remittances from the US are coming under pressure has stoked fears about a consumer spending slowdown. Add uncertainty from the new US administration's tariff policies, and the outlook for Mexican consumers is less-than-encouraging.

Against that backdrop, Walmart de México, Mexico's largest retailer, has suffered share price volatility. Beyond these macro headwinds, Walmex has drawn scrutiny for its 2025 capital return program (dividends + buybacks), which is only up about 1% versus 2024, seemingly leaving a few wanting more, given the stock price is down quite a bit since last year.

However, management is also materially accelerating new store openings – 180 net new stores opened in 2024, the largest year-over-year store expansion in over a decade, and a pace management expects to continue and even accelerate. Some investors wonder why Walmex isn't leaning harder into buybacks when its stock looks undervalued.

Still, we believe Walmex's management team is prioritizing for the long term – choosing to deploy capital organically in ways that improve the company's competitive position and increase returns (ROIC) first but also reflect confidence in the team's view of intrinsic value, given the enhanced capital return program that now includes share repurchases – before a small buyback in 2023, the last time Walmex repurchased shares was in 2015. This may be a good time for investors to similarly adopt a long-term mindset with this retail powerhouse.

### A retail titan driving change in Mexico

With approximately MEX\$800 billion in sales in 2024, Walmex commands approximately 32.5% market share in Mexico's modern retail sales channel according to Euromonitor (as of 2023) – which is approximately 2.5x the size of its next closest competitor OxxO (dominant in small convenience formats) and approximately 4-5x the size of the next two: Soriana and Chedraui.

Scale is key in the fiercely competitive, commodity-like grocery business. Walmex has a unique position, leveraging its size to source products at lower costs and then passing savings on to customers. This isn't just a pricing tactic; it's a self-reinforcing moat. Lower prices attract more customers, boosting sales volume and strengthening Walmex's purchasing power.

This dynamic is particularly powerful in Mexico, where the retail market is still evolving. Over half of total retail sales in Mexico stem from informal sources like street vendors, open-air markets and small neighborhood shops. Unlike these informal competitors, Walmex offers the technological sophistication, consistent inventory, global brand partnerships, private-label options and purchasing, scale that it has spent decades refining. The shift from informal to formal retail is inevitable and Walmex is well-positioned to capture and sustain leadership.

## A consumer play for the long term

Headline concerns that may discourage some investors can make Walmex more appealing for those with the patience to think longer term. Here's why we see Walmex as a compelling opportunity:

- **Attractive valuation.** Walmex is currently valued at approximately 16x next 12-month earnings — an all-time low, on par with the 2008-2009 financial crisis levels. Compare Walmex's valuation to US peers such as Costco (over 47x) and parent company Walmart (32x) or local peer FEMSA (19x).
- **Sustainable growth.** We anticipate long-term revenue growth of 6%-8% over the long term, supported by healthy same-store sales growth, new store growth, continued e-commerce penetration, new business lines and steady market-share gains. The aggressive store expansion plans, perhaps met with skepticism by some, seem prudent considering the returns Walmex has historically earned on its new stores.
- **Industry-leading ROIC.** Walmex boasts industry-leading, low/mid-20% returns on invested capital. This is higher than even much-admired Costco, which earns 18%-20% — and remember that Walmex currently trades at approximately one-third of the price (16x P/E for Walmex vs 47x for Costco). We believe such returns reflect Walmex's durable competitive advantages, efficient operations and disciplined capital management.
- **Compelling TSR yield (total shareholder returns).** A 4% total shareholder return yield (3% dividend + 1% buyback) adds icing to the cake, offering stable income to investors while signaling management's confidence in Walmex's robust cash-flow generation.

Walmex's dominance isn't a coincidence; it's a product of scale and strategy. Walmex has a clear price and assortment advantage over Mexico's informal retail sector. The transition toward formal retail continues to accelerate, and Walmex is helping drive the change.

Walmex exemplifies a mindset that transcends market cycles, prioritizing long-term, higher-returning new store growth investments over near-term capital returns through this period of market volatility. The stock may be undervalued today, but management isn't losing sight of the much bigger value-creation opportunity over the long run.

As of 28 February 2025, Diamond Hill owned shares of Walmart de México SAB de CV.

**Return on invested capital (ROIC)** is a calculation used to determine how well a company allocates its capital to profitable projects or investments.

**Price-to-earnings (P/E)** ratio measures a company's share price relative to its earnings per share (EPS). The **NTM P/E** ratio is a variation of the standard P/E ratio (Price/Earnings) that uses projected earnings per share (EPS) for the next 12 months instead of historical EPS.

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