



# Management

## comments and analysis

### Management comments

2018 was a transformation year for Walmex and we made significant progress 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 continuous success and to deliver even stronger results.

Progress regarding our strategic priorities:

- We are making progress around delivering a seamless and more enjoyable shopping experience. Customers are liking the changes in our stores, and they're letting us and others know through improvements in the net promoter score in all the formats.
- We are proud with the continuous growth in 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 savings into our business while improving profitability. Our financial strength has served as a great competitive advantage, specially while we are going through this transformation.

### Disclosure of **nature of business**

Walmart de México y Centroamérica is one of the most important commercial chains in the region.

As of December 31, 2018, 3,249 units were in operation, throughout 6 countries (Costa Rica, Guatemala, Honduras, El Salvador, Mexico, and Nicaragua), including self-service stores, membership clubs, pharmacies and omnichannel sales.

Walmart shares have been traded in the Mexican Stock Exchange since 1977; the ticker symbol is **WALMEX**.

## Disclosure of management objectives and its **strategies for meeting those objectives**

The company's objective to double total sales in 10 years and to leverage operating expenses to reinvest in the business was set in 2015.

Sales growth will stem from:

- Same store sales
- Sales from new stores
- eCommerce

## Results of **operations and perspectives**

**Note:** Sales growth percentage in Central America is determined on a constant currency basis.

We are committed to driving sales. During the fourth quarter consolidated revenues increased 5.5%.

Mexico delivered total revenues for \$145.9 billion pesos, an increase of 6.0% over last year.

In Central America, total revenues totaled \$31.5 billion pesos, which represented 3.6% growth.

Walmex total revenues grew 7.6% in 2018: 8.1% in Mexico and 5.9% in Central America.

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.

It is worth noting that based on two-year stack same-store sales, Mexico grew 13%, while Central America 7%.





**Performance by format:**

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

The Central region posted the strongest growth, followed by the Southern and the Northern regions. The Metropolitan area had a lower, but solid growth given its penetration and competitive environment.

Sam’s Club delivered the highest growth. Actually, it has been the format with the highest same-store sales growth for three consecutive years. The team has succeeded in signing-up new members and retaining them. By offering compelling merchandise and prices, and innovating to better serve our members, we are leading the club sector, and we feel confident that we are on the right path.

Walmart also posted strong growth. It is amazing what the team is doing to deliver a seamless shopping experience. Besides a successful execution of our seasonal events, Walmart focus on price leadership and omnichannel integration is helping our customers to save time and money.

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

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

In Central America, despite a challenging environment, we were able to grow ahead of the market and invest in capabilities for future growth.

During this quarter we opened the largest and most modern fresh distribution center in Costa Rica, which will service more than 1,400 local fresh suppliers. We have a firm commitment to support national farmers and to double the volume of local sourcing.

We also opened a 409,029 square feet distribution center in Nicaragua, which is 3 times larger than the existing one and will allow us to better service our stores and reach more places where we do not have presence currently.

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

Sales growth in Nicaragua was challenged by the socio-political conflict in the country that are impacting economic conditions in general.

We are putting in place new commercial strategies such as price point programs, improving the price gap measuring methodology to reinforce our price leadership, and we continue to roll out the Centers of Excellence program in the five countries. As of December 2018, 50% of our stores were operating as Centers of Excellence.

The strategies that we are deploying in the region are starting to show results, but given the nature of the challenges that we are facing, we expect growth to resume at a slow pace.

For 5 consecutive years we have outperformed the self-service and club market according to ANTAD reports. In 2018 we surpassed the market by 350 basis points, the highest gap in 5 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 outpaced ANTAD.

We are working hard every day to improve our customer and member satisfaction, and customers are rewarding us with their loyalty.

### Performance by division:

From a merchandise perspective, we saw strong growth in all divisions, particularly in our core division of Food and Consumables.

During the second half of the year food inflation was much lower than 2017, impacting sales especially in Fresh departments, but we were able to drive volume to partially offset this impact.

We are excited with what we have accomplished so far across formats and divisions but we are not satisfied yet. All of us at Walmex continue to work really hard to become the most trusted omnichannel retailer in Mexico.





### New stores

The 2018 expansion program was the largest in the last 5 years, in terms of store openings.

We opened 134 new stores: 100 in Mexico and 34 in Central America. This compares to the 125 opened in 2017.

In 2018 new stores contributed 2.3% to total sales growth, in keeping with the information shared last year.

### Omnichannel

In eCommerce we are gaining traction and accelerating omnichannel growth.

The on-demand service allows us to leverage our most important assets: our stores, and it helps us build loyalty and increase shopping frequency. Last quarter we reinforced the on-demand assortment to offer more than 5,000 General Merchandise items on same-day delivery. As we have shared, our priority is to win in on-demand and our infrastructure enables us to lead this business.

The marketplace is also gaining traction. We ended the year with over 800 sellers, and during the *Buen Fin* event and December, the marketplace grew triple digit.

During the year, eCommerce sales grew 40% and GMV grew 47%; the General Merchandise division posted an even higher growth.

eCommerce now represents 1.4% of total Mexico sales and contributed 40 basis points to total sales growth.

### ESG

We have also made important progress in environmental, social and corporate governance related matters.

For third consecutive year, Walmart de México y Centroamérica was included in the FTSE4Good Emerging Index, which evaluates environmental, social and governance performance of its constituents.

In Walmex we value and encourage our associates diversity. Last year we were also included in the Bloomberg Gender Equality Index. Walmex is the only retail company in Mexico that has been included two years in a row.

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

#### Fourth quarter & full year results

We made certain accounting reclassifications that have no effect on EBITDA or EPS but impact gross profit and SG&A. Such reclassifications were included in 2017 figures for comparison purposes.

Besides a solid sales performance, in 2018 we were also able to improve profitability both in Mexico and Central America.

We are committed to maintain our operational discipline in order to reinvest strategically and position our business for the future.

#### MEXICO:

##### Fourth Quarter Results

During the fourth quarter total revenues grew 6.0%.

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 allowed 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 digit: 13.8% and 12.9% respectively.

Our already best in class EBITDA margin expanded by 70 basis points to 11.0%.

We were able to reduce our regular operating expenses by 8 basis points through the implementation of productivity initiatives.

Efficiencies in 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.





### *Full year results*

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%.

We are 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.

### **CENTRAL AMERICA:**

**Note:** Sales growth percentage in Central America is determined on a constant currency basis.

### *Fourth Quarter Results*

Total revenues increased 3.6%.

Gross profit margin reduced by 10 basis points as a result of strategic price 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 9.0% and EBITDA, 9.5%, which led to an EBITDA margin expansion of 50 basis points.

### *Full Year Results*

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%.

## CONSOLIDATED:

### *Fourth Quarter Results*

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 point expansion.

Net income increased a solid 11.2%.

### *Full Year Results*

During the year we invested \$17.9 billion pesos in high return projects. Our capital allocation is in line with our long-term strategy.

We are becoming more productive in our remodels and new store investments and thereby freeing capital to fund strategic investments. By doing this, we are trying to balance the short and long term.

Our disciplined expense management allowed us to reinvest in key initiatives such as prices, salaries, eCommerce and Digital, Logistics and new stores.

All in all, in 2018 we posted strong results while we progressed on our goal of becoming the leading omnichannel retailer in Mexico.

Consolidated revenues increased 7.6%.

Gross profit margin expanded by 10 basis points to 23.0%.

After reinvesting in the business, we achieved 20 basis points 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 10.0%.

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





## Financial position, liquidity and capital resources

Our financial strength gives 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 \$38.8 billion pesos, 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 \$60.5 billion.

After investing \$17.9 billion pesos in high return projects, we still returned \$25.6 billion pesos to our shareholders in the form of dividends.

We have an ongoing commitment to return excess cash to our shareholders.

On February 27th, 2019 we distributed the final installment of last year's dividend declaration of \$0.33 pesos per share.

On February 13th, 2019, the Walmex Board of Directors agreed to recommend a proposal to shareholders for an ordinary dividend of \$0.84 pesos per share and an extraordinary dividend of \$0.91 pesos per share. Total dividends add up to \$1.75 pesos per share.

Dividend yield would be approximately 3.6% based on the price of Walmex shares at the end of January, 2019.

We expect the annual shareholders' meeting to be held on March 21st, 2019 to vote on the proposal.

This year we are 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 three installments of \$0.28 pesos per share in April, August and November 2019.

Extraordinary dividend to be paid on three installments: the first one of \$0.35 pesos per share in April 2019, the second one of \$0.30 pesos per share in August 2019, and the last one of \$0.26 pesos per share in November 2019.