

Peak Complexity?

Warren Buffett often counsels investors to avoid complexity: “I don’t try to jump over seven-foot hurdles. I look for one-foot hurdles that I can step over.” Here’s an argument that Mexico’s Femsa might be worth the extra effort.

As companies go, Mexico’s Fomento Económico Mexicano, known as Femsa, has a lot going for it. Its main business, Oxxo, is arguably the best convenience-store chain in the world, with operating margins well above those of global peers such as Circle K parent Alimentation Couche Tard and 7-Eleven parent Seven & I Holdings. Already with more than 20,000 stores in Mexico, the company says it can double that number through greater penetration in still mom-and-pop dominated areas of the country, and continues to expand throughout Latin America, with the biggest opportunity in Brazil. Its fast-growing loyalty program, Premia, has 15 million members and is driving more repeat business and higher average tickets. It owns 47% of Latin American bottler Coca-Cola Femsa and 15% of Dutch-based brewer Heineken.

As stocks go, however, Femsa’s has been a bust, having lost a cumulative 19% in U.S. dollars over the last ten years. Much of this is the market – the iShares MSCI Mexico ETF is down 18% over the same period – but Richard Cook of Cook & Bynum Capital Management attributes it also to all the irons the company has in the fire. “You could say it’s kind of at peak complexity right now,” he says. “Markets don’t like that – too much work.”

Femsa also runs pharmacies and gas stations in Mexico. It has spent more than \$2 billion to roll up distributors of so-called jan/san (for janitorial and sanitary) supplies in the U.S. In 2019 it bought more than 10% of U.S. restaurant-supply company Jetro Restaurant Depot. This past July it made its first foray into Europe, agreeing to buy for nearly \$1.2

billion Swiss-based Valora, which operates small retail kiosks at train stations and other highly-trafficked sites. On the announcement, Femsa’s market value fell by more than the price it’s paying for the profitable Valora.

While this latest deal is “the one we like the least,” says Cook, he says the company is generally disciplined about the prices it pays and has a strong long-term record of capital allocation. He thinks the distractions have caused the market to lose sight

INVESTMENT SNAPSHOT

Fomento Económico Mexicano (NYSE ADR: FMX)

Business: Holding company with primary operations in Latin American convenience stores, pharmacies and gas stations.

Share Information (@9/29/22):

Price	61.30
52-Week Range	58.73 – 87.97
Dividend Yield	2.3%
Market Cap	\$13.45 billion

Financials (TTM):

Revenue	MXN 610.00 billion
Operating Profit Margin	8.9%
Net Profit Margin	4.9%

Valuation Metrics

(@9/29/2022):

	FMX	S&P 500
P/E (TTM)	15.5	18.1
Forward P/E (Est.)	14.4	16.4

Largest Institutional Owners

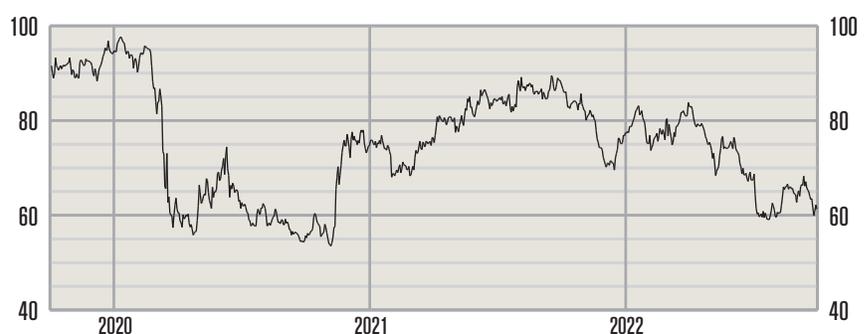
(@6/30/22 or latest filing):

Company	% Owned
Cascade Inv	7.8%
BlackRock	4.8%
Harding Loevner	3.0%

Short Interest (as of 9/15/22):

Shares Short/Float	1.3%
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FMX PRICE HISTORY



THE BOTTOM LINE

The company’s many irons in the fire obscure the importance and strength of its convenience-store business, says Richard Cook. As its value is better reflected, he believes the company’s shares can generate over his time horizon a nearly 15% annual return.

Sources: Company reports, other publicly available information

of the strength of the core Oxxo business. After backing out the market values of the stakes in Coca-Cola Femsa and Heineken as well as the prices paid for the U.S. supply businesses, he estimates the market today values Femsa's retail operations at around 9x forward estimated EV/EBIT, or at a 10x P/E. As recently as 2019, this

same EV/EBIT multiple for Femsa's retail business was 21x. Walmart's Mexican subsidiary Wal-Mart de Mexico today trades at 19x. Based on his valuation work, he believes Femsa's shares from here could generate a nearly 15% annual return.

Cook notes as well that the company under new CEO Daniel Rodriguez is quite

sensitive to the investor malaise around the stock and that "everything is on the table" to address it. His first suggestion: "We're most in favor of them just using free cash flow to buy in a lot of stock. If your stock is cheap, that's a wonderful way to deploy capital." ^{vii}

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Please visit cookandbynum.com to learn more. For questions or inquiries please contact Hollie Garner, hollie@cookandbynum.com