Deep Dive: Why I’m Not Buying Corporativo Fragua ($FRAGUAB.MX)

Corporativo Fragua (FRAGUAB), the parent company of Farmacias Guadalajara, is cheap, growing, well-managed, and has a clean balance sheet – but ultimately, I decided to pass.

INTRINSIC GLOBAL CAPITAL

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Business Overview

Farmacias Guadalajara is not a pure-play pharmacy chain. In 1989, the company pioneered a hybrid format called “superfarmacia” that combines pharmacy services with convenience retail. The stores carry pharmaceuticals alongside groceries, household goods, personal care products, photo printing, baked goods, and financial services including bill payments and money transfers.

The company operates three in-house distribution centers (Guadalajara, Monterrey, and Hidalgo) and runs its own transport and logistics subsidiary. This vertical integration creates real cost advantages over smaller competitors and new entrants who would need to build equivalent infrastructure from scratch.

Fragua has also developed a private label business estimated at ~20-30% of sales, which helps offset limited pricing flexibility on branded pharmaceuticals and OTC products. The stores carry their own branded water, snacks, and everyday essentials.

Fragua trades at roughly ~10x trailing earnings. Revenue has compounded at ~14% annually from 2019-2025. The balance sheet carries net cash in a retail business with ~2,800 stores and ~44,000 employees. The founding Arroyo Chávez family controls the company and has run it with disciplined stewardship. There has been no follow-on equity offering since the 1997 IPO. Every store has been funded from operating cash flow.

The company opens ~120 new stores per year and has hit that target consistently for the past decade. Revenue grew from approximately MXN ~60 billion in 2019 to over MXN ~130 billion in 2025. The stock pays a roughly ~3% dividend and trades at a ~0.1-0.2 beta, making it pretty uncorrelated to global equity markets.

All of this looks compelling on a screener, but the thesis had a few sticking points I couldn’t quite get over.

Market, Customers, and Competitive Landscape

The underlying drivers of growth in the Mexican pharmacy market are structural: an aging population, elevated chronic disease rates (particularly diabetes and obesity), healthcare spending as a share of GDP that remains well below developed-market levels, and rapid growth in both the adjacent pharmacy-clinic model as well as the superfarmacia model, both of which Fragua is well positioned to take advantage of.

While I can find a few reasonable sources that place overall Mexican retail pharmacy market growth in the high-single-digit CAGR range through the end of the decade, sizing the superfarmacia market itself is a bit more tricky to do credibly. Minimally, we can say that the overall number of pharmacies in Mexico is ~65,000 and Fragua operates roughly ~2,800 of those. This position of ~4-5% of total Mexican pharmacy locations figure is somewhat misleading, as Fragua's superfarmacia stores generate significantly higher revenue per location than independent pharmacies, which comprise roughly ~75% of that overall figure, so their actual market share is likely notably higher. While I could probably directionally guess that figure, it doesn't meaningfully impact the core thesis-breakers, so I'll save us all some time on that one.

Fragua's Customers:

Fragua's customer base is broad and largely undifferentiated. The stores generally serve the Mexican middle class, primarily households purchasing a mix of prescription medications, OTC products, and everyday convenience items. The superfarmacia format is designed to capture a full basket on each visit rather than competing purely on pharmaceutical pricing.

The company does not publicly disclose same-store sales figures or customer metrics in meaningful detail, which limits visibility into the quality of the revenue base. What is observable from the outside is consistent: double digit YoY revenue growth in recent years, driven by a combination of new store openings and organic growth from the existing base.

There is no meaningful customer concentration risk. No single buyer represents a material share of revenue. The business is high-frequency, low-ticket, and habitual. Consumers visit because the store is close, the hours are convenient, and the assortment covers multiple errands in a single trip. That behavioral pattern is sticky, but it is driven by proximity and habit rather than brand loyalty or switching costs. If a competitor opens a more convenient location (or can somehow offer notably better pricing), the customer follows.

Competitor Overview:

Farmacias Similares is the largest chain by store count, with over ~8,000 locations operating on a low-cost franchise model. Similares sells exclusively generic drugs and targets lower-income consumers with a fundamentally different value proposition than Fragua. The two businesses overlap more on convenience retail than on pharmacy, but Similares captures a significant share of the prescription volume in price-sensitive segments.

Farmacias del Ahorro operates ~1,300-1,600 stores and is probably Fragua's closest direct competitor in terms of pricing, format, and geographic focus. The chain is privately held, which limits financial visibility, but from what I gather via industry chatter and customer experience reports, they compete aggressively on price and maintain a strong digital presence with home delivery and a popular loyalty program.

Farmacias YZA, owned by Grupo FEMSA through its FEMSA Health division, has over ~4,000 points of sale across Latin America under several brand names including YZA, Moderna, Cruz Verde, and SanaSana. YZA is the most relevant brand in Mexico. FEMSA's ownership gives YZA access to capital, logistics infrastructure, and strategic alignment with OXXO's convenience retail footprint, which has significant implications addressed separately below.

Farmacias Benavides operates a smaller ~1,300 store footprint with less than ~$1B of revenue. The company is owned by Sycamore Partners via the Boots Group, and may be a candidate for divestiture in the coming years as it was likely seen as a non-core asset in the 2025 take-private of the parent company. Given the tumultuous recent (and likely future) story, as well as geographic concentration, Farmacias Benavides isn't a notable competitive threat.

Farmacias San Pablo rounds out the major chains with approximately 100 locations, primarily in central Mexico. Very small – not a real peer competitor.

Beyond the pharmacy specialists, every major Mexican grocery retailer operates in-store pharmacies. Walmex, Chedraui, HEB, Soriana, and La Comer all compete for prescription and OTC spending, though pharmacy is a secondary category for these businesses rather than the core format.

The critical takeaway here is that no single competitor has a dominant market position – even if we assume a relatively generous (though unsourced) revenue figure for the large chain pharmacies vs the smaller independent pharmacies that comprise the remainder of the ~65,000 location count, the top five chains together likely account for less than ~50% of total retail pharmacy revenue, suggesting meaningful fragmentation even among the scaled players. This is a market where competitive advantage accrues through logistical execution, sustained customer satisfaction, and cost discipline rather than through structural barriers or consolidation.

Why I Passed

No Pricing Power

Pharmacy retail in Mexico is intensely competitive. Fragua faces numerous independent pharmacies, several major pharmacy groups, and a few national grocery retailers with in-store pharmacies, all competing for the same consumer.

In the competitive environment described in the previous section, Fragua cannot meaningfully raise prices above competitors, particularly in a system where drug pricing is partially regulated. Mid-single-digit operating margin is typical for pharmacy retail, but it provides little buffer if competitive intensity increases.

The natural counterargument is that Walmart doesn't have pricing power either, and it has been an extraordinary compounder, which is fair, but Walmart's compounding is underwritten by a cost advantage so large that competitors cannot profitably match it. The question for Fragua is whether it has a comparable structural cost advantage. The answer is: generally yes, but that advantage is under direct threat.

The OXXO Risk

This is the issue that kills the thesis for the risk-averse reader.

FEMSA owns the OXXO convenience store chain, which operates over ~21,000 locations in Mexico. That is roughly 8x Fragua's store count. OXXO has the highest foot traffic of any retail format in the country and is within walking distance of virtually every Mexican consumer. For any of you from Mexico or LATAM (or have spent any time at all in the region), you understand the extent of OXXO's footprint, as well as its impact on daily life.

FEMSA also owns Farmacias YZA and has been explicitly building a "proximity health" strategy. They do not need to convert all 21,000 OXXOs into pharmacies. They need to add pharmacy counters to a few thousand high-traffic locations, which they are already piloting.

Fragua's core competitive advantage is density and convenience: being the closest pharmacy when a consumer needs medication. That advantage erodes significantly the moment OXXO scales pharmacy services across its existing footprint. OXXO does not need to build distribution centers, negotiate real estate, or establish brand awareness. The infrastructure, capital, and customer relationship are already in place.

Fragua spent ~30 years building ~2,800 stores to achieve its current level of geographic density. FEMSA could replicate or exceed that pharmacy footprint in two to three years using stores it already owns and operates.

Because Fragua runs at mid-single-digit operating margins, even a modest traffic loss of ~10-15% to OXXO pharmacy locations could compress margins to levels where the store expansion model becomes uneconomic. The company has no pricing lever to pull in response. It would need to compete on cost, which means compressing thin margins further against a competitor with significantly greater scale.

I have no idea when (or even if) FEMSA pulls the trigger on a nationwide rollout, but the fact that a single competitor has the capability, the stated strategic intent, and an existing ~21,000-store base from which to execute is a risk I cannot dismiss at a ~4-7% operating margins.

Single-Country Concentration

Single-country concentration may be less of a concern for most of you on this one, but I was considering Fragua alongside my existing Mexican consumer exposure through Coca-Cola FEMSA (KOF).

KOF operates across Mexico, Brazil, Colombia, Guatemala, Costa Rica, Nicaragua, Panama, and other Latin American markets. If Mexico has a challenging year (peso devaluation, policy shock, consumer recession, whatever other man-made horror the macro world throws at us next), KOF's other LATAM operations provide diversification.

Fragua is 100% Mexico. All revenue is in pesos. All operations are subject to a single regulatory environment and a single political administration. A ~20% peso devaluation reduces the dollar value of the position by ~20% regardless of how the underlying business performs.

The stock's recent history illustrates this vulnerability. From October 2024 to April 2025, Fragua declined approximately ~45%, driven not by business deterioration but by broad investor concern about the Mexican economy. That type of drawdown is inherent with a single-country, single-currency exposure, and it can occur at any time for macro reasons entirely unrelated to the company's operational performance or strategic plan.

Adding Fragua alongside KOF concentrates my Mexican consumer exposure slightly more than I'm comfortable with, and it does so in a business with thinner margins and a more vulnerable competitive position than the position I already hold.

What Would Change My Mind

I do not think Fragua is a bad business – the management team is excellent, the track record is impressive, and the balance sheet is very strong for emerging market retail.

There are conditions under which I would revisit.

FEMSA credibly deprioritizes pharmacy: If FEMSA's disclosures indicate a pullback from the proximity health strategy, whether due to unfavorable unit economics or competing capital allocation priorities, the OXXO risk diminishes and Fragua's competitive position becomes more durable.

Valuation compresses further on macro weakness: If Fragua trades down to ~6-7x earnings in a broad (non-Mexico-specific) emerging market selloff, the net cash position starts to represent a meaningful percentage of market capitalization, and the downside becomes protected by hard assets regardless of the competitive environment.

I had no existing Mexican consumer exposure: If I did not already own KOF and wanted defensive, inflation-protected consumer staples exposure in a growing emerging market, Fragua would earn a spot on my watchlist on its own merits.

Conclusion

In this case, valuation is necessary but not sufficient to get fully comfortable in building a position. Fragua at ~10x earnings with a net cash balance sheet and a ~14% revenue CAGR is a genuinely attractive screen. But a 6.2% operating margin in FY2025 provides little cushion against competitive intensification, and the most powerful retailer in Mexico has both the infrastructure and the stated intent to compete directly in pharmacy.

In a concentrated portfolio, every position needs to survive a stress test against a specific, named competitive threat. Fragua does not survive the OXXO test at current margins. That is a narrow conclusion, not a broad one. Different portfolios, different risk tolerances, and different competitive assumptions could reasonably lead to a different answer. But for my current portfolio composition, the risk-reward does not clear the bar at this valuation.

Disclosure: I hold a position in Coca-Cola FEMSA (KOF), which is referenced in this article. This content is for informational and entertainment purposes only and does not constitute investment advice, a recommendation, or a solicitation to buy or sell any security. I am not a registered investment advisor, broker, or dealer. All opinions expressed are my own and reflect my personal investment research process. You should conduct your own due diligence and consult a qualified financial professional before making any investment decisions. Past performance is not indicative of future results.