

Mexico Fundraising Chapter in The Private Equity Review 2021

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written by Nader, Hayaux & Goebel | March 2, 2021

The Law Reviews: 10th Edition - By Partners Hans P Goebel, Héctor Arangua, Adalberto Valadez and Associate Miguel A González

OUTLOOK

The private equity industry in Mexico has been re-energised in recent years by government reforms and policies, a stable macroeconomic situation, stable population growth rate, an increase in real income and an active entrepreneurial ecosystem.

Mexico has successfully completed USMCA (which superseded NAFTA) negotiations with the United States and Canada and has gone through a smooth, peaceful and democratic power transition following the presidential election that took place in July 2018, providing

certainty to investors. However, Mexico's intention of being prepared for any scenario is clear from its aim to increase trade with Argentina and the Pacific Alliance (Colombia, Peru and Chile), as well as with the European Union and Asian countries, and from the government's

continued efforts over the past few years in the infrastructure and energy sectors.

While the forecasts are moderate, we expect contract and investment opportunities to be abundant as government policies support a shift towards a larger role for a combined private and public investment in the Mexican infrastructure industry and in the still-booming energy

industries. Opportunities will also be presented by the continuing rise of the fintech industry and by the implementation of the governmental programme for the economic reactivation during 2021 and onwards. The outlook for the Mexican PE industry is, therefore, positive, with local funds becoming more global and deploying

capital, and investments by foreign funds increasing throughout the energy sector.

We predict that the regime governing publicly issued PE funds will continue to be improved, and that the regulations regarding investment restrictions applicable to Mexican pension funds will necessarily evolve towards alignment with the types of regimes seen in other, more evolved countries, allowing the pension funds to conduct private transactions and investments in funds or projects directly (rather than only through publicly issued securities such as CKDs, FIBRAs, FIBRA Es and CERPIs).

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Over the past 19 years, Mexico's private equity (PE) industry has raised over US\$58 billion in capital commitments to PE investments, according to the Mexican Private Equity Association (AMEXCAP). Mexico's strong industrial and manufacturing sectors, along with recent reforms to policies and regulations, have had a positive impact on the PE industry, resulting in double-digit annual growth for the industry. Real estate and venture capital (VC) also had double-digit increases in the same period, of 16 per cent and 12 per cent, respectively. Currently, the number of active fund managers is over 180, with fund managers, or general partners (GPs), active across a range of sectors, and representing a sevenfold growth since the beginnings

of the industry in the early 2000s.

In recent years, the Mexican government has been an important participant in and supporter of the PE industry, investing in more than 72 funds⁷ through institutional investors such as NAFIN (the national development bank), the Capitalization and Investment Fund for the Rural Sector, Bancomext and Banobras, and through investment vehicle Corporación Mexicana de Inversiones de Capital, SA de CV, or Fund of Funds, which has invested more than US\$885 million in more than 84 funds and co-invested in 17 deals.⁸ In addition, the National Institute of Entrepreneurship helped the Mexican VC industry and seed capital ecosystem by investing or co-investing in 41 funds from 2013 to 2016. For 2016, the VC support grew to 100 million Mexican pesos, targeting one fund with an approach to the Asia-Pacific alliance countries, which is now finishing its fundraising period. Finally, domestic pension funds (AFOREs) have played a determinant role in the growth of the PE industry, having allocated more than US\$20.4 billion through 106 capital development certificates (CKDs) and investment project certificates (CERPIs) since 2008. This amount may increase by a further US\$5 billion, given the CKDs that are in the pipeline. Mexico is seen as one of the most favourable emerging markets to invest in, and is considered top in Latin America

according to various limited partner (LP) surveys, such as those conducted by the Association for Private Capital Investment in Latin America in 2014 and 2015, and by the Emerging Markets Private Equity Association in 2015, 2016 and 2017.⁹

Mexico returned to the World Economic Forum's (WEF) list of the top 10 countries to invest in globally, by rising four positions to number nine, sitting alongside the United States, China, Germany, India, the United Kingdom, Brazil, France, Australia and Japan. The Mexican economy is being reshaped, and in spite of an adverse economic environment, allows dynamism of its international trade, and the structure of its debts minimises the impact of external factors making it a healthy option for investing. The WEF ranks Mexico in 46th place, out of 140 countries, in the 2018 edition of the competitiveness index, which shows that the country has microeconomic and acroeconomic institutions with strong foundations. Mexico is placed as the second-largest economy in Latin America (with an estimated GDP of US\$1.222 trillion) and it is considered to have economic stability that has allowed to remain stable despite various difficulties. The Mexican economy has grown at an

average annual rate of 2.5 percent for the past 10 years, mainly because of the implementation of new regulations to improve development, sensible monetary and fiscal policies, ordered management of public finances led by the Bank of Mexico, and a gradual improvement in the country's external environment, despite a zero per cent growth being estimated for 2019. The World Bank suggests Mexico might be the world's seventh-largest economy by 2050 - a positive outlook that will only serve to attract direct foreign investment.

The PE industry and the VC sector in Mexico continue to grow and mature. The internationalisation of both funding sources and investment by domestic GPs suggests that Mexico is playing an increasingly influential role in financial and economic growth at both the regional and global levels. Within VC alone, Mexico has witnessed the number of GPs triple in the past seven years. The policies being implemented in Mexico, particularly the opening-up to competition of the energy and telecommunications sectors, and labour market reforms, have been welcome steps to attract investment and raise employment and, potentially, growth.¹³ This is evidenced by the extent to which infrastructure and energy funds have also increased significantly, reaching 30 funds in 2016 - a clear effect of the energy reform allowing private investments in the energy sector, including oil and gas, electric power generation and renewable energy. As at October 2017, an estimated US\$25 billion in cash reserves were available for investment by PE funds investing in Mexico.¹⁴

Likewise, accumulated capital commitments from 2018 to September 2019 increased by 1.7 per cent. These capital commitments were mainly concentrated on seed and early stage VC funds.¹⁵ As at September 2019, three new Mexican funds had been formed, bringing the number of funds operating in Mexico to 126, of which 60 per cent are now investing or managing their investments, while almost one-third are still at the fundraising stage.¹⁶

In general, information about PE funds is not publicly available during the fundraising stage unless the funds are public funds raised in the securities market, such as CKDs, CERPIs or Mexican real estate trusts (FIBRAs).

The Mexican fundraising market has been in an upward trend since 2014. In the

past, the most attractive sector has been real estate, but recently the VC sector has clearly been rising. Mexican PE funds are active, growing and covering a large spectrum of industries (business and financial services, consumer goods, healthcare, technology, oil and gas, etc.). VC funds mainly invest in consumer services, fintech and technology; real estate funds mainly target the industrial (mostly automotive, aerospace and pharmaceutical), commercial, tourism and housing sectors; and the infrastructure and energy funds are currently concentrated in the oil and gas sector. In March 2018, the Law Regulating Financial Technology Institutions (the Fintech Law) was enacted, providing for regulation of, among other things, electronic payments, cryptocurrency transactions and crowdfunding mechanisms. According to Fintech Radar Mexico, conducted by Finnovista in May 2019, Mexico is very close to reaching the 400 fintech start-up mark, and, in 2019, it regained leadership as the largest fintech ecosystem in Latin America, in part because of a strong presence of entrepreneurship and e-commerce.¹⁷ The Mexican fintech industry has shown an annual growth rate of 29 per cent, with the creation of 98 new start-ups, with the dominating sectors being loans, payments and remittances.¹⁸ Reports from recent years have highlighted the high growth rates of fintech in Latin America, such as LAVCA's 2017 Trend Watch: Latin American Venture Capital, which concluded that the fintech sector represents 25 per cent of the venture investments in information technology in the region. According to a survey conducted by Finnovista in collaboration with Endeavor, Mexican fintech companies have a monthly gross transaction value of 39 billion Mexican pesos, with an average of 8.7 million Mexican pesos being billed per fintech start-up per year. These results emphasise the importance and the possibilities of fundraising and VC investment in the development of the fintech ecosystem in Mexico. As the fintech industry represents a massive potential growth area in Mexico, the government has passed legislation that seeks to ensure financial stability and provide a defence against money laundering and corruption.

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The private equity industry in Mexico has been re-energised in recent years by government reforms and policies, a stable macroeconomic situation, stable population growth rate, an increase in real income and an active entrepreneurial ecosystem. Mexico has successfully completed USMCA (which is expected to

supersede NAFTA) negotiations with the United States and Canada and has gone through a smooth, peaceful and democratic power transition following the presidential election that took place in July 2018, providing certainty to investors. However, Mexico's intention of being prepared for any scenario is clear from its aim to increase trade with Argentina and the Pacific Alliance (Colombia, Peru and Chile), as well as with the European Union and Asian countries, and from the government's continued efforts over the past few years in the infrastructure and energy sectors.

While the forecasts are moderately strong, we expect contract and investment opportunities to be abundant as government policies support a shift towards a larger role for private investment in the Mexican infrastructure industry and in the still-booming energy industries. Opportunities will also be presented by the continuing rise of the fintech industry. The outlook for the Mexican PE industry is, therefore, positive, with local funds becoming more global and deploying capital, and investments by foreign funds increasing throughout the energy sector. If conditions remain the same and the growth rate remains at the levels we have been seeing, the PE industry should, according to AMEXCAP, reach US\$80 billion by the end of 2020. We predict that the regime governing publicly issued PE funds will continue to be improved, and that the regulations regarding investment restrictions applicable to Mexican pension funds will necessarily evolve towards alignment with the types of regimes seen in other, more evolved countries, allowing the pension funds to conduct private transactions and investments in funds or projects directly (rather than only through publicly issued securities such as CKDs, FIBRAs, FIBRA Es and CERPIs).

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