THE PRIVATE EQUITY REVIEW

EIGHTH EDITION

Editor
Stephen L Ritchie

THE LAWREVIEWS

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CONTENTS

PREFACE

The eighth edition of *The Private Equity Review* follows an extremely active 2018. While the number of global private equity deals completed declined from 2017, the total value of such deals was the highest since 2007, and the third-highest of all time. Deal activity was weighted towards the upper end of the market, and included several large take-private transactions. Fundraising activity was also strong, as institutional investors remained extremely interested in private equity as an asset class because of its strong performance relative to public markets. As a result, private equity funds have significant amounts of available capital, leading to very competitive transactions being completed at increasing purchase price multiples. This has caused private equity firms to become even more creative as they seek opportunities in less competitive markets or in industries where they have unique expertise. Given all of this, we expect private equity will continue to play an important role in global financial markets, not only in North America and western Europe, but also in developing and emerging markets in Asia, South America, the Middle East and Africa. In addition, we expect the trend of incumbent private equity firms and new players expanding into new and less established geographical markets to continue.

While there are potential headwinds – including trade tensions, a slowing Chinese economy, Brexit and an eventual end to one of the longest-running recoveries in US history – on the horizon for 2019 and beyond, we are confident that private equity will continue to play an important role in the global economy, and is likely to further expand its reach and influence.

Private equity professionals need practical and informed guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. This review has been prepared with this need in mind. It contains contributions from leading private equity practitioners in 25 different countries, with observations and advice on private equity deal-making and fundraising in their respective jurisdictions.

As private equity has grown, it has also faced increasing regulatory scrutiny throughout the world. Adding to this complexity, regulation of private equity is not uniform from country to country. As a result, the following chapters also include a brief discussion of these various regulatory regimes.

I want to thank everyone who contributed their time and labour to making this eighth edition of *The Private Equity Review* possible. Each of these contributors is a leader in their respective markets, so I appreciate that they have used their valuable and scarce time to share their expertise.

Stephen L Ritchie
Kirkland & Ellis LLP
Chicago, Illinois
April 2019

Part I

FUNDRAISING

Chapter 14

MEXICO

Hans P Goebel C, Héctor Arangua L, Adalberto Valadez and Miguel A González J[1]

I GENERAL OVERVIEW

Over the past 18 years, Mexico's private equity (PE) industry has raised over US$56 billion in capital commitments to PE investments, according to the Mexican Private Equity Association (AMEXCAP).[2] 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.[3] Real estate and venture capital (VC) also had double-digit increases in the same period, of 16 per cent and 12 per cent respectively.[4] Currently, the number of active fund managers has reached 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 2015, Mexico outpaced Brazil to become the most popular destination country for private equity vehicles in Latin America.[5] According to the Emerging Market Private Equity Association (EMPEA), Mexican dedicated private equity vehicles went from raising a modest US$152 million in 2008 to US$2.1 billion in 2015. While a decrease has been recorded over the past two years, in terms of capital deployed, Mexico is still placed second, behind Brazil, and accounted for 22 per cent of investment in the region, according to the Latin American Private Equity and Venture Capital Association (LAVCA).

According to the Secretariat of Economy of Mexico, Mexico is one of the world's most globalised countries, with 12 free trade agreements spanning 46 countries; nine partial-scope and economic complementation agreements within the framework of the Latin-American Integration Association (ALADI); membership of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP); and 32 reciprocal promotion and protection-of-investments agreements, with 33 countries. Mexico's diversified export line is ranked 15th in the world and it is the seventh-largest car manufacturer in the world,[6] with the third-largest growth in exports within the automotive industry.[7] Mexico actively participates

1 Hans P Goebel C, Héctor Arangua L and Adalberto Valadez are partners, and Miguel A González J is an associate at Nader, Hayaux y Goebel, SC.
2 AMEXCAP, 'Mexico: VC Overview 2018: Venture Capital Industry'.
3 AMEXCAP, 'Overview of the Private Equity Industry in Mexico', June 2016.
4 Idem.
5 FINANCIER: www.financierworldwide.com.
6 Secretariat of Economy of Mexico.
7 World Trade Organization, World Trade Statistics Review, 2018.

in multilateral and regional organisations and forums, such as the World Trade Organization, the Asia-Pacific Economic Cooperation, the Organisation for Economic Cooperation and Development and the CPTPP.

In recent years, the Mexican government has been an important participant in and supporter of the PE industry, investing in more than 72 funds[8] 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.[9] In addition, the National Institute of Entrepreneurship has helped the Mexican venture capital (VC) industry and seed capital ecosystem, by investing or co-investing in 41 funds from 2013 to 2016. For 2016 the VC support changed 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.[10]

The Mexican economy performed better than expected during 2018, with annual gross domestic product (GDP) growth of 2.3 per cent,[11] despite the victory of leftist López Obrador in the presidential elections and the announcement of the cancellation of the construction of the New International Airport for Mexico City, currently the most important infrastructure project in Mexico. Notwithstanding the above, Mexico is placed as the second-largest economy in Latin America (with an estimated GDP of US$1.14 trillion). Mexico is considered to have economic stability, with conservative but still-rising growth rates. The Mexican economy has been growing at an average rate of 2.5 per cent 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. However, policy uncertainty and the continuing prospect of subdued investment are expected to keep growth at a moderate 2 per cent in 2019, despite the decrease in trade-related uncertainty following the announcement of the United States–Mexico–Canada Agreement signed on 30 November 2018.[12] The World Bank suggests Mexico might be the 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,

8 Secretaría General Iberoamericana and ProMéxico, 'Informe Global LATAM: México July 2018'.
9 AMEXCAP, 'Inside Mexico's PE Market: November 2017'.
10 414 Capital, 'Instrumentos Estructurados (CKDs y CERPIs): Actualización trimestral – 3T2018' (2018).
11 World Bank: http://www.worldbank.org/en/country/mexico/overview.
12 World Bank: http://pubdocs.worldbank.org/en/726341542818388766/Global-Economic-Prospects-Jan-2019-Latin-America-and-Caribbean-analysis.pdf.

at both the regional and global levels. Within VC alone, Mexico has witnessed the number of GPs triple in the past six 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 2017 to September 2018 increased 2.2 per cent (US$37 million); more than half of last year's fundraising activity took place in the closing quarter of the year. In addition, these capital commitments were mainly concentrated on the first VC funds.[15] As at September 2018, six new Mexican funds had been formed, bringing the number of funds operating in Mexico to 118, of which 63 per cent are specific to seed capital stages.[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, since 2014, been in an upward trend. In the past years 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 larger 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. The Mexican fintech industry has shown an annual growth rate of 40 per cent, with a particular increase in the retail, technologies, trading and capital markets sectors.[17] Recent reports 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. Moreover, according to 'Fintech Radar Mexico', conducted by Finnovista in August 2018,[18] 238 Mexican fintech start-ups have been identified across 11 different segments, which represents a growth in the number of fintech start-ups of 50 per cent since August 2016; in only a year more than 100 new fintech start-ups have been created, which positions Mexico as the second-largest fintech hub in Latin America, in part because of a strong presence of entrepreneurship and e-commerce. In 2017 alone, a total of US$62.9 million was invested in 15 start-ups from

13 International Monetary Fund, 'World Economic Outlook (WEO): Legacies, Clouds, Uncertainties (October 2014).

14 Ibid.

15 AMEXCAP, 'Mexico: VC Overview 2018: Venture Capital Industry'.

16 Ibid.

17 Finnovista, 'Fintech Radar Mexico' (August, 2018).

18 Ibid.

the fintech industry (such as Abra, a mobile money start-up that uses the technology behind bitcoin, and Pangea Money Transfer, an app-based cash transfer service targeted at the US$25 billion Mexicans in the United States send home every year) and all these start-ups were invested in by Monterrey-based Ignia. 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.

As mentioned above, Mexican VC has grown significantly, reaching US$1.71 billion in accumulated committed capital over the past 10 years.[19] Mexico's VC sector is now an attractive market in which to invest, with 63 active Mexico-based fund managers and 50 foreign GPs who performed at least one transaction in the past four years. In the same vein, AMEXCAP registered 973 VC transactions for a total of more than US$1 billion invested from 2009 to September 2018 and, on the liquidity side, noted 13 exits during 2018. The growth seen in 2016 remains the industry record, with the largest number of transactions and representing US$209 million of capital invested.

In the past 18 years, foreign funds have only contributed approximately 10 per cent of the total accumulated capital commitments in the Mexican VC industry. However, as the number of foreign and domestic GPs increases, the activity of foreign funds is expected to increase in the Mexican VC industry.

The energy reform, which ended a 70-year chapter of restrictive laws, and dismantled the state monopoly, in the oil and gas and electricity sectors, has opened up investment and the participation of private and foreign companies, including PE funds, in these industries. The Federal Electric Commission (CFE), in conjunction with the Ministry of Energy, has developed a strategy to increase gas transportation capacity through an expansion of the pipeline network to ensure gas supply for power generation. As at September 2018, there are more than 25 CKDs investing in the infrastructure and energy sectors, which have raised over 123 billion pesos.[20]

This constitutional and statutory reform continues to restructure the Mexican energy industry (some say creating it), setting out the framework for the participation of private investment not only in connection with hydrocarbons (including upstream, midstream and downstream activities) but also concerning the electricity industry. The implications for Mexico's PE industry are considerable, especially now that the attention has shifted to its implementation. PE funds are able to participate in the oil industry by investing in, or lending to, companies or consortiums of companies bidding in public tenders issued by the Ministry of Energy through the National Hydrocarbons Commission, for the exploration and production of new oil fields, and the Energy Regulatory Commission, in relation to other energy matters. Considerable numbers of opportunities are starting to arise in any business relating to companies participating in midstream and downstream activities, such as petrochemicals and other transformations of hydrocarbons, and in the transportation of oil and gasoline. According to AMEXCAP, Mexico's oil and gas value chain could require between US$300 billion and US$400 billion in capital expenditure through to 2020,

19 AMEXCAP, 'Overview of the Venture Capital Industry in Mexico, October 2017'.
20 Ibid.

promoting a significant inflow of outside capital and creating an estimated 2 million jobs by 2025.[21] The oil and gas sector is becoming a top sector: almost half the transactions made were in this sector (nearly US$6 billion invested in recent years).

Furthermore, 2018 was a strong year in the power infrastructure sector, starting with the completion of the first two phases of the Tres Mesas wind farm project carried out by the Spanish company Abengoa with a total investment of US$80 million and generating 148.5 megawatts; the inauguration of the wind farm Reynosa I, the biggest wind farm in Mexico and one of the biggest in Latin America, involving an investment of US$600 million; and seven more wind farms projects under construction.[22] Private investment into Mexico's energy infrastructure industry will experience strong growth as the energy reform's measures continue to take hold; many other opportunities will also arise regarding electricity production projects (mainly combined-cycle gas plants and renewables) for both general and private consumption. In addition, Mexico is committed to honour its commitment to the Paris Agreement on climate change. Following the 21st Conference of the Parties of the United Nations Framework Convention on Climate Change in Paris in 2015, at which the Agreement was adopted, Mexico introduced a major new clean energy policy that includes a clean energy target of 25 per cent of electricity generation by 2018, 30 per cent by 2021, and 35 per cent by 2024. This means that, by 2024, participants in the wholesale electricity market will have to satisfy 35 per cent of demand through clean energy certificates, the mechanism devised to guarantee the demand for renewable energy. As at 2018, clean energy in Mexico accounted for more than 24 per cent of the total energy produced in the country.[23]

Of the total amount of capital issued in Mexico since 2005, 75 per cent was raised between 2012 and 2017. In 2017 alone, three new funds raised a total of US$705.4 million,[24] which clearly reflects that the reforms are working and Mexico's energy sector is on the right track. We have already seen a significant increase in investment into the power sector and the gas pipelines required to fuel the new thermal power plants tendered by CFE. International developers continue to arrive and the implementation of the reform continues to shift Mexico's energy sector in a positive direction; for example, Canadian energy firm TransCanada in a joint venture with IENOVA and Infraestructura Marina del Golfo (IMG) was awarded a contract to construct and operate the US$2.1 billion South Texas–Tuxpan–Tula natural gas pipeline, which is now under construction and will transport natural gas from the south of Texas to Tuxpan, Veracruz, by an underwater route in the Gulf of Mexico. The South Texas–Tuxpan–Tula pipeline is supported by a 25-year transportation service agreement with Mexico's CFE, and will connect with the Cenagas pipeline system in Altamira, TransCanada's Tamazunchale pipeline and Tuxpan. The South Texas–Tuxpan–Tula pipeline adds to TransCanada's portfolio, which also includes a US$550 million contract to construct a 420km gas pipeline from Tula in Hidalgo State to Villa de Reyes in San Luis Potosi. The French energy company ENGIE has invested at least US$300 million to connect its Energía Mayakan natural gas pipeline (a 485-mile pipeline that transports natural gas from Ciudad Pemex in the state of Tabasco to Valladolid in the state of Yucatan) to industrial and tourism

21 Rosenfel E, 'Mexico to receive major economic jolt', CNBC.com, 2014.

22 El Financiero (8 August 2018): http://www.elfinanciero.com.mx/nacional/reynosa-i-el-parque-eolico-mas-grande-de-mexico-sera-inaugurado-el-lunes.

23 Ministry of Energy (2018) https://www.gob.mx/cms/uploads/attachment/file/418391/RAEL_Primer_Semestre_2018.pdf.

24 AMEXCAP, 'Inside Mexico's PE Market: November 2017'.

users in the state of Quintana Roo.[25] BP expects to increase investment in everything from exploration to retail fuel sales; the British firm is already involved in three offshore projects – two in the Gulf of Mexico's deep waters and another in shallow waters. The company also launched Mexico's first foreign-branded gas station, with plans to open some 1,500 stations over five years. Tesoro Corporation (now Marathon Petroleum Corporation) reached a definitive agreement with Pemex for transportation services in Mexico. The agreement enables Tesoro to supply transportation fuels and launch the ARCO brand in the Mexican states of Sonora and Baja California.[26] In addition to the construction of the aforementioned pipelines, representing more than US$2 billion in investment, the private sector has begun to invest in storage, with the largest initiative being Orizaba Energía's investment of US$115 million to build 2.7 million barrels of capacity in Tuxpan. As at 2018, more than 100 contracts have been awarded to 75 international firms or consortiums, from 20 countries, during the Round 1 bids.[27]

Industries are changing and Mexico's global competitiveness is increasing as reforms and governmental initiatives modify the structure of the economy to attract investments. The expectation is that Mexico will become a sophisticated design and manufacturing hub rather than remain merely a low-cost producer; a clear example of this is the state of Queretaro, which is growing as a new centre for the aerospace industry, with dozens of multinationals setting up shop in the state's industry zone and making the most of generous subsidies offered by the government. At the centre of this growth is the Queretaro aerospace cluster, which is host to Safran, Airbus, GE, Aernnova Aerospace México, Duqueine Group, Delta and Bombardier, among others.[28] On the occasion of Mexico's Aerospace Summit 2018, it was announced that the aerospace industry has grown from 100 American and European producers in 2004 to more than 340 in 2018.

The Mexican PE market has grown considerably over the past 18 years. The above-mentioned reforms, their proper implementation and a solid economic foundation are likely to foster further growth of the country's PE industry. Mexico is still viewed as one of the most attractive Latin American markets, not only because of its geographical position (sharing a border with the United States, and with access to both the Pacific and Atlantic Oceans), but also because of the number of trade agreements the country has in place, making possible preferential relations with 46 countries; it also offers the benefits of a growing workforce and fiscal prudence.[29] We believe more firms will come to Mexico and reap the rewards of these favourable conditions, thereby continuing to boost PE fundraisings while profiting from the incentives arising from the newly structured legal frameworks, as was seen to be case during 2015 and 2016.

In connection with the foregoing, Mexico's government introduced in 2015 two new investment instruments to promote Mexico's economic development and in particular to boost the PE industry. In September 2015, the creation of the first of these instruments, the FIBRA E (also known as the 'Mexican MLP'), was announced. The FIBRA E is an

25 ENGIE: https://www.engiemexico.com/#!EngieMexicoServicios/?seccion=transporte-gas-natural-ENGIE-mexico.

26 Pemex: http://www.pemex.com/saladeprensa/boletines_nacionales/Paginas/2017-064-nacional.aspx.

27 Comisión Nacional de Hidrocarburos (7 December 2018): https://rondasmexico.gob.mx/esp/cifras-relevantes/.

28 PRO México: www.promexico.gob.mx/es/mx/queretaro.

29 'Private Equity in Mexico: Primed for significant growth', Antonio Martinez Leal and Pino del Sesto, Bain and Company.

investment alternative in the form of an investment vehicle promoting long-term investment in Mexican qualified energy, electricity and infrastructure assets and the management thereof, to be traded in the Mexican Stock Exchange and offered locally and abroad. The FIBRA E allows private and public participants to monetise such assets under a tax regime that reduces levels of overall taxation and therefore opens the door for greater distributions. Various amendments have been made to the applicable regulations between 2015 and 2018 to make the instrument more appealing.

In December 2015, the investment project certificates or CERPIs were introduced. CERPIs will allow insurance companies, AFOREs, and other (national or foreign) institutional investors to participate in equity projects in all productive sectors of the economy. This comes as a simplified version of the existing CKD providing for a larger scope of decision by the GPs and lower investment requirements for the investors. In January 2018, certain amendments were made to the applicable regulations to allow AFOREs to acquire CERPIs that invest in portfolio companies outside Mexico (as long as at least 10 per cent of the issue amount is invested in Mexico); this particular amendment will make the instrument more appealing for issuers and AFOREs.

As to the reception by potential LPs of PE funds in the pipeline, public Mexican funds such as CKDs and FIBRAs have been favourably received by Mexican institutional investors (mainly Mexican pension funds) to the extent that the projects are adequately structured and follow the standard market terms and economics of such funds. As to private Mexican funds, their appeal is likely to depend on the recent success and market credibility of the sponsors or GPs of those funds. Reflecting the industry's appetite for financing new projects within the asset class, the first issuances of the recently introduced FIBRA E and CERPIS took place at the end of 2016. The growth of the energy sector and amendments to the applicable regulations might well result in an increase in the issuances of these instruments.

Depending on the structure used to implement a PE fund, the time frame for PE fundraisings may vary. As an example, if the creation of a public PE fund is carried out through the issuance of CKDs, FIBRA Es or CERPIs, the time required to raise the fund may range from six to 12 months. For clarity, PE funds are generally structured as a CKD (and, as of 2016, a CERPI) to allow them to raise commitments from the AFOREs, which have very restrictive investment rules and can generally only invest in projects through these kinds of securities. Such funds are formed through Mexican trusts created to issue the CKDs or CERPIs to be placed and offered through a public offering on the Mexican stock exchanges, and managed by GPs incorporated in Mexico. Most CKDs are issued to invest in portfolio companies in Mexico subject to the investment policies determined by the sponsor. At the time of writing, over 92 CKDs have been issued to try access a portion of the billions of dollars managed by the AFOREs that can be invested in this type of security. There are approximately 14 CKDs in the pipeline pending approval, which would capture around US$4 billion. On average, nine CKDs per year have been listed since 2010.

The same timeline applies for Mexican FIBRAs that raise capital through the issuance of real estate certificates, which are generally publicly offered in the BMV stock exchange but can also be offered in foreign markets. The funds raised by FIBRAs can only be invested in commercial real estate projects and developments (industrial, retail and hospitality), and are structured as Mexican trusts to which real estate assets are conveyed by the original owners who, in exchange, receive real estate certificates.

The timeline for privately placed PE funds structured through Mexican or foreign vehicles will vary depending on the market conditions.

As positive evidence of the market appetite, during July 2018, a new Mexican stock exchange, the Bolsa Institucional de Valores (BIVA), began operations. The BIVA seeks to increase the operations on the Mexican market as an alternative to the BMV by easing the requirements that the latter imposes for its listings.

Below are recent deals that were made publicly available.

In June 2018, IGS Group signed a purchase agreement for the portfolio of La Frontera, including 37 industrial warehouses, for a total of US$117 million. The transaction is still subject to approval by the antitrust authority, the Federal Economic Competition Commission.[30]

In June 2018, Delta held the issuance and placement of a CKD for a maximum amount of 4 billion pesos on the BMV. This CKD will invest in real estate and urban developments.

In September 2018, IDK capital announced a first closing for 1.05 billion pesos with private investors, this amount will help the fund to continue with its strategy of investing in infrastructure projects, including in water, transportation, health and civil infrastructure.[31]

In November 2018, ALLVP had the first closing of its US$100 million Fund III for US$73 million.[32]

In November 2018, O'Donnell Group held the issuance and placement of a CKD for a maximum of 2 billion pesos on the BMV. The fund will invest in industrial and urban real estate and in the development of industrial logistic infrastructure.[33]

In November 2018, Discovery Americas, through its vehicle DAIV, entered into an investment with one of the leading actors in the air cargo industry in Mexico, Mas Air, which is a cargo airline specialising in the transportation of freight.[34]

During 2018, IGNIA, Dalus Capital and Innocells led US$6.5 million investment in the online platform UnDosTres, a fintech digital payments platform that aims to provide secure financial services while reducing inefficiencies for consumers.[35]

II LEGAL FRAMEWORK FOR FUNDRAISING

The Canadian limited partnership is one of the most popular legal forms for structuring PE funds with Mexican LPs' investment, as they are considered transparent for tax purposes. Other vehicle structures used in Mexico include the PE investment trust and the FICAP, a Mexican trust that is not considered an entity under Mexican law and which has a specific set of tax rules created to incentivise PE investments. To raise funds from investors, FICAPs issue certificates that can be either publicly placed through the BMV and more recently through the BIVA (the most recent CKDs are FICAPs) or privately issued. FICAPs are exempt from complying with certain management and tax payment obligations. The fundamental characteristic of the FICAP is that the trust is subject to a transparent regime for tax purposes, and thus the regime allows the investors to directly recognise the income generated through

30 AMEXCAP: https://en.amexcap.com/content/grupo-igs-anuncia-la-firma-del-contrato-de-compra-del-portafolio-en-el-sector-industrial-denominado-frontera.

31 AMEXCAP: https://en.amexcap.com/content/idk-capital-fondo-mexicano-especializado-en-proyectos-de-infraestructura-anuncio-un-primer-cierre-por-mx-1-050-mdp-de-inversionistas-privados.

32 AMEXCAP: https://en.amexcap.com/content/all-in-latin-america-allvp-raises-a-fresh-100-m-fund.

33 LAVCA: https://lavca.org/2018/11/16/grupo-odonnell-registers-mxn2b-ckd-on-biva-en-espanol/.

34 LAVCA: https://lavca.org/2018/12/03/discovery-americas-invests-in-mexican-air-freight-servic e-company-mas-air/.

35 LAVCA: https://lavca.org/IGNIA+%26+Dalus+Capital+Lead+US%246.5m+Investment+in+Online+Payment+Platform+UnDosTres.

the trust (dividends, capital gains and interest payments) as if they had obtained the income from investing directly in a Mexican target entity. Another form that is used by PE funds is the SAPI, which is mainly a Mexican corporation that provides great flexibility to structure different kinds of businesses (including PE funds), and also increases the protection offered to minority shareholders and provides exit strategies.

The key legal and negotiable terms of PE funds will depend on the vehicle chosen, but will be very similar to those in other jurisdictions (e.g., the term of the fund, investment policies, management of the fund and documentation of the relationship between the manager and the fund, fees, carried interest and exits for limited partners).

One of the key issues for a Mexican PE fund is its management. In connection with CKD funds, for example, the sponsor will normally act as the manager, and will carry out the business of instructing the trustee to make the required investments in eligible projects; however, pursuant to Mexican securities law, it would also require the approval of the limited partners for relevant investments or actions, which causes the limited partners of CKDs or FIBRAs to have an active role in the management of the fund. All CKDs and FIBRAs investments are subject to certain guidelines (including bondholder meeting approval). Nevertheless, the structuring of CKDs has improved over time, and has evolved to the extent that CKDs are released from rules that previously prevented deals from taking place. In addition, we have noticed that management fees and carried-interest fees have changed over the past five years. The tendency has been for such fees to decrease (e.g., some CKDs had management fees amounting to around 2 per cent of the total amount invested during the investment period in 2009; currently, the management fees for 2017 transactions range between 1.5 and 1.75 per cent of the total amount invested during the 2016 investment period).

We have also noted that rather than the usual passive limited partner role certain institutional investors are seeking a more active role in traditional PE funds.

The SAPI is governed by federal law and, more specifically, by the Securities Market Law; all items not covered by the Securities Market Law are regulated by the General Law of Business Organisations. However, the SAPI is not subject to obligations applicable to public corporations nor to supervision by the National Banking and Securities Commission (CNBV) therefore no disclosure obligations have to be met.

PE funds are reluctant to share information because of potential threats posed by competitors and other factors. However, if the PE fund is structured through a CKD, investors and fund managers must take into consideration that CKDs are publicly listed vehicles; as such, they are obliged to disclose certain information, and their issuers have the same disclosure obligations as other debt issuers according to Mexican regulations.

Disclosure obligations include the filing of quarterly and annual reports to the BMV that include updates and annual audited financial statements, as well as a duty to disclose any information necessary for investors to carry out investment decisions.

As explained above, depending on the structure of the PE investment, the method of investment solicitation at the fundraising stage may vary.

PE funds may raise capital by privately soliciting sophisticated investors in Mexico under the Mexican safe-harbour rule, which allows the offering of securities to such investors in a private placement. For public funds, such as CKDs, CERPIs or FIBRAs, solicitation is open to the general public (any kind of investor, person or entity, whether Mexican or foreign), although generally such funds target investments by institutional investors such as the AFOREs, insurance companies and sophisticated investors who are private banking clients. Public funds such as CKDs, CERPIs and FIBRAs are also subject to certain solicitation and publicity guidelines applicable to all issuers on the stock market.

GPs of PE funds formed as Canadian limited partnerships may be subject to certain Canadian regulations applicable to GPs.

Regarding Mexican vehicles, in structures such as SAPIs, the fiduciary duties of care and loyalty (such as conflicts of interest, disclosure and informational duties) are established contractually. Furthermore, the adoption of the Best Corporate Practices Code issued by the Mexican Business Coordinating Council and the guidelines from the Mexican Institute for Competitiveness is encouraged, and many funds have adopted these practices regarding corporate governance and fiduciary duties.

Regarding CKDs, CERPIs and FIBRAs, the manager of the fund is normally also the fund's sponsor and, in line with its responsibilities to carry out the fund's projects, it must comply with the resolutions and policies of the trust's technical committee; the committee will set up the terms and conditions of the manager's duties, and must reject any transactions that may involve a conflict of interest. Recently, it has become more common that managers of CKDs, CERPIs or FIBRAs are subject to the same fiduciary duties as directors of Mexican public companies pursuant to the federal Securities Market Law.

The FIBRA E must be structured as a Mexican trust. The applicable tax rules provide that the trust must be formed following many of the requirements applicable to FIBRAs, but with certain differences: up to 30 per cent of the trust's book value must be in federal government bonds or shares of mutual funds that may invest only in fixed income securities; and investments in shares of Mexican companies must comprise at least 70 per cent of the trust's book value. Further, those Mexican companies must comply with the following: (1) the shareholders of the company (other than the trust itself) must be Mexican resident companies (this requirement does not exclude foreign investors in any manner, and they will be entitled to own shares of the underlying company through the trust or through a Mexican subsidiary, although depending on the amount of the investment, antitrust and foreign investment approvals may be required); (2) the corporate purpose of each company must be a Mexican-qualified energy, electricity and infrastructure asset-related activity, the management thereof, or a combination of these activities, and at least 90 per cent of the annual taxable income of the FIBRA E should stem from qualified energy, electricity and infrastructure assets; and (3) the investments of the company must be in brownfield or qualified greenfield projects, as new assets may represent only 25 per cent of the book value.

III REGULATORY DEVELOPMENTS

Except for publicly placed PE funds (such as CKDs, FIBRAs, FIBRA Es and CERPIs), there is no regulatory oversight of Mexican PE funds or their fundraising processes (other than the safe-harbour rule mentioned above).

CKDs, FIBRAs, FIBRA Es and CERPIs are governed by the federal Securities Market Law and its ancillary regulations, and their main regulator is the CNBV. CKDs, FIBRA Es, FIBRAs and CERPIs are supervised and regulated to ensure the proper operation of the financial system and to protect the interests of the general public. In consequence, issuers are subject to quarterly and annual reporting obligations, such as presentation of audited financial statements, and the registration of the fund requires the previous authorisation of the CNBV and the BMV.

Other forms of PE funds are not under any obligation or requirement to be registered in Mexico, and the sponsors or GPs do not have to be registered in any special registry in connection with their activities as fund managers.

Depending on the legal form of the PE fund, the tax rules can vary; thus, the specific tax regime applicable to the investors may also vary. Nonetheless, generally the vehicles chosen (including limited partnerships and FICAPs) are structured in a manner that allows them to be considered tax-transparent vehicles, which implies that the income realised is directly recognised by the investors.

In the case of foreign limited partnerships, a tax-transparency regime may be achieved to the extent that such partnerships are created in a country with which Mexico has a broad agreement for the exchange of information; that they do not have a legal personality of their own, separate from that of their members; and that they are tax transparent in their country of formation. If these requirements are met, the limited partnership will be treated as being tax-transparent for Mexican purposes, and thus the investors will be entitled to apply any benefits that may be included in any relevant double taxation treaty.

FICAPs, on the other hand, are also tax-transparent, and are governed by a special set of tax rules that defines the withholding obligations applicable to the parties involved, as well as the moment at which the investors participating in FICAPs shall be liable to tax. More specifically, according to the rules, the investors shall be liable to Mexican tax upon receiving a distribution from the FICAP, and the tax regime actually applicable to each investor will be contingent on the nature and country of residence of the investors (e.g., institutional, foreign or local, tax-exempt or taxable).

Certain requirements under Mexican tax provisions must be met to qualify as a FICAP:

a FICAPs shall invest at least 80 per cent of the trust assets in stock issued by Mexican target entities (not publicly listed at the time of the investment) or granted as loans to such entities;

b the remaining percentage that is not invested in stock issued by Mexican target entities or granted as loans to such entities shall be invested in securities issued by the federal government or in Mexican debt mutual funds;

c the acquired stock shall be held for at least two years; and

d at least 80 per cent of the income realised by the FICAP should be distributed within two months of the end of the tax year. If these thresholds are not reached, the trust will not qualify as a FICAP and thus will not benefit from the specific tax rules applicable to that vehicle.

Slight changes were made to the tax regime applicable to FICAPs in 2016; in particular, it should be highlighted that the limitation for the application of the FICAP regime for a maximum of 10 years has been repealed. In the case of FIBRAs, two additional requirements were included as part of the amendments made to the income tax legislation for 2014 (and which resulted in a new Income Tax Law): in the case of lease agreements where the consideration is established as a variable amount or based on a percentage, this type of income cannot exceed 5 per cent of the aggregate income of the FIBRA unless the rental payment is established as a fixed percentage of the sales of the lessee; and trusts operating as FIBRAs must be registered with the tax authorities. In addition, certain measures were included in the applicable securities rules to limit the ability of FIBRAs to incur debt. And more recently, the possibility has been established for the FIBRA trust to repurchase its own certificates, subject to several conditions.

As for the recently enacted FIBRA E, the main features of the tax regime that has been established may be summarised as follows:

a Both the underlying Mexican companies in which the trust invests and the trust itself shall be treated as tax transparent, and the certificate holders will directly recognise the tax result of the FIBRA E as computed by the trustee under the specific rules (no monthly or annual income tax payments are required at the trust or underlying company levels).

b In computing the tax result of the trust, the trustee shall consider the tax profits generated by the underlying companies (but not the tax losses, which may only be carried forward by the entity that generated them) and a deductible deferred expense, equal to the gain generated by the seller of the shares acquired by the FIBRA E trust as per below.

c The persons selling shares to a FIBRA E will be required to recognise the gain derived from the sale of the assets owned by the company whose shares were sold (instead of recognising a capital gain on the actual sale of shares).

d The trust will be required to distribute on a yearly basis at least an amount equal to 95 per cent of its annual tax result, using the proceeds distributed by the underlying companies.

e The aforementioned distributions will not be considered dividends for tax purposes and thus the 10 per cent dividend tax will not apply.

f Certain specific rules were enacted to allow the spin-off or otherwise segregate qualifying assets to special purpose vehicles in a tax-efficient manner, provided that at least a certain number of the shares in the resulting vehicle are subsequently sold to a FIBRA E within six months.

g Mexican-resident individuals and non-resident investors will be exempt from withholding tax on the sale of the certificates issued by the FIBRA E, provided that the sale takes place through an authorised exchange.

IV 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 the 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).

Appendix 1

ABOUT THE AUTHORS

HANS P GOEBEL C

Nader, Hayaux y Goebel, SC

Mr Goebel is a Mexican lawyer specialising in mergers and acquisitions, private equity, capital markets, and banking and finance.

He is recognised as a leading lawyer and for his outstanding expertise by *Chambers Latin America*, *IFLR1000*, *Best Lawyers* and *PLC Which lawyer? Chambers Latin America* ranks him as a leading individual for capital markets, describing him as a 'tremendous negotiator', and also notes that 'he is adept at managing client relationships, and is exceptional in his productivity: he provides multifaceted recommendations and solutions which are of great help to his clients'. Other recent editorial commentary in this publication includes feedback from clients who point out that Mr Goebel is 'a terrific lawyer who is always on top of everything and can resolve anything you ask of him', and they highlight his 'rare skill in being able to capture what is important, and being truly practical in making it happen'.

Mr Goebel spent a year working in the Chicago office of international law firm Mayer Brown, having received his LLM (with honours) from the Northwestern University Pritzker School of Law of Chicago. He graduated as an attorney from the the Autonomous Technological Institute of Mexico (ITAM) and has lectured in financial contracts at the Ibero-American University. He currently has acted as an independent director and board secretary for various financial and non-financial institutions.

HÉCTOR ARANGUA L

Nader, Hayaux y Goebel, SC

Mr Arangua specialises in capital markets, structured finance, mergers and acquisitions, private equity and energy.

He is recognised as a leading lawyer and for his outstanding expertise by *Chambers Latin America*, *IFLR1000*, *The Legal 500* and *Latin Lawyer 250*. *Chambers Latin America* ranks him as a leading individual for capital markets, describing him as 'one of the hardest-working lawyers in the market, who always goes the extra mile to ensure that everything is perfect', and as 'incredibly technical and methodical, as well as having great business sense and a hands-on attitude'.

He is an expert in securities and regularly advises both private and public companies on issuances in the local market and abroad. He has also developed niche expertise in CKDs.

His structured finance practice is focused on providing advice to lenders on structuring complex bankruptcy-remote payment structures. He has also developed expertise in the oil and gas sector, in which he has continuously advised on capital markets, finance and M&A matters.

Mr Arangua has strong international experience. He is licensed to practise in New York and regularly advises US and other international clients on transactions in Mexico.

He obtained his LLM from the University of Michigan Law School, having graduated as a lawyer from the Autonomous Technological Institute of Mexico (ITAM).

ADALBERTO VALADEZ

Nader, Hayaux y Goebel, SC

Mr Valadez specialises in taxation matters and concentrates his practice on federal income tax and international tax matters, including cross-border M&A and joint ventures, inbound investments into Mexico, and the structuring and implementation of collective investment vehicles (such as private equity funds) managed by Mexican and foreign sponsors.

He has solid experience in advising clients on issuances in the local securities market, particularly in the case of development capital certificates and exchange-traded funds. As part of this practice, he regularly advises multinational clients that are either making investments in Mexico or have commercial relationships with companies in Mexico.

Mr Valadez graduated with honours as an attorney from the Autonomous Technological Institute of Mexico (ITAM) and he also previously worked as a foreign associate in the Amsterdam, Luxembourg and Geneva offices of Loyens & Loeff.

MIGUEL A GONZÁLEZ J

Nader, Hayaux y Goebel, SC

Mr González specialises in banking and finance, structured finance, mergers and acquisitions and private equity.

He has experience in advising public and private companies on issuances in the local market and abroad, and in advising foreign companies, investment funds, banks and brokerage firms on matters primarily related to banking and securities law, capital markets, private equity investment structures, and compliance and supervision of the Mexican securities market.

Mr González graduated as an attorney-at-law (2009) from the Panamerican University, from which he also holds a graduate degree in commercial and corporate law, with honours (2010), and he obtained his LLM in finance from the Institute for Law and Finance of the Goethe University Frankfurt am Main (2013); he is a candidate for an MBA at the Monterrey Institute of Technology and Higher Education.

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