

LATIN LAWYER REFERENCE MERGERS AND ACQUISITIONS 2020

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# Mexico

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## **1 Has the level of M&A activity slowed, increased or remained flat in 2019 as compared to 2018, and what are conditions like today? In general terms, what level of activity is foreseen for 2020? What are the factors influencing the level of M&A activity – Economic? Political? Commodity prices? Weakness in currency? Stock market performance? Liquidity? Rule of law? Other?**

The level of M&A activity in Mexico during 2019 remained the same as 2018 considering the number of reported and/or disclosed transactions, even considering the controversial political conditions arising from the change of the controlling party that took office during December 2018.

Considering the overall amounts of the reported and/or disclosed transactions, the variation is of approximately minus 23.8 per cent, as mentioned in the recently issued 2019 Annual Report prepared by Rión Mergers and Acquisitions (the Rión Report).

The slight variation on the amounts of the transactions has been influenced by a number of factors, especially during the first semester of 2019: (i) the positive macroeconomic environment; (ii) the certainty caused by the successful negotiations of the USMCA that modified a number of matters vis-à-vis NAFTA; and (iii) the boost of the US economy (the largest partner to the Mexican economy).

Notwithstanding the foregoing, some sectors in the Mexican economy have been slightly adversely affected due to the political uncertainty during the first months of the year and the polemical governmental policies, such as infrastructure, government procurement and energy (mostly oil and gas and power) industries.

In addition to the above, the capital markets industry saw a mixed performance during 2019, while debt issuances had a slight growth; the equity issuances suffered a heavy decrease.

## **2 Which industries do you expect will see the most M&A activity in 2020?**

We foresee that the stabilisation of the new administration and the ratification of the USMCA might dissipate the uncertainty and consequently infrastructure projects could reboot some projects.

We expect that fintech (with all the recently passed regulations), real estate, heavy industry, tourism and manufacturing will experience an increasing activity.

Unless a major change in the governmental policies is passed, we do not expect to see a significant growth on the energy (mostly oil and gas and power) industry. Despite the above, the wholesale electricity market remains active and market participants have been actively looking for other options to develop renewable energy projects by selling energy to the market or through power purchase agreements with other market participants other than the Federal Electricity Commission.

As in 2019, we also foresee that during 2020 a large number of M&A transactions will have an important financing component. The reasons of this are: (i) the low interest rates that currently prevail in the Mexican finance industry (both, banking and non-banking sources); (ii) the strong economy in the US (the largest export market for Mexican players) that could derive in surplus of the liquidity together with the appetite to compete with Mexican financing sources; (iii) the trade “war” between the US and China this year, which is a very good opportunity for Mexican entities to compete with Chinese manufacturers to satisfy the demand from the US market; and (iv) the potential rise of the capital markets (particularly equity) in Mexico.

## **3 What types of deals do you expect to see?**

We expect that, as seen throughout 2019, during 2020 international investors will most likely look for joint ventures with local entities or takeovers of Mexican players.

In addition, we expect a number of mergers or acquisitions between commercial competitors among Mexican participants.

As seen in recent years, we also expect to see a number of minority investments from large investors (institutional investors, private funds, hedge funds and pension funds) in new businesses.

**4 Discuss the level of M&A activity you have seen over 2019 and expect to see in 2020 of:**  
**(i) pure domestic deals;**  
**(ii) deals in your jurisdiction involving a domestic target and foreign acquirer from Latin America, or a foreign acquirer from outside Latin America; and**  
**(iii) deals involving a domestic acquirer and foreign target in Latin America or a foreign target outside Latin America.**

Based on the reported transactions per the Rión Report, the number of pure domestic deals rose approximately by 3 per cent, which matches our perception for confidential transactions, while the acquisition of Mexican target companies by foreign entities rose by almost 6 per cent. M&A transactions where Mexican entities acquired foreign targets dropped by around 6 per cent.

The countries hosting entities with the highest participation of M&A transactions are: the United States (by far the largest), Canada, Germany, France, Japan and Belgium.

**5 What is the level of private equity activity? Are domestic or international funds involved? What kinds of deals are they doing?**

According to the Rión Report, during 2019, a significant change has occurred as compared to 2018. While the number of deals decreased by almost 50 per cent, the overall amount of capital invested suffered a major raise by more than 113 per cent. This percentage sets a new yearly record of growth as compared to the previous one (the former record was 2017).

According to the most recent numbers disclosed by the Asociación Mexicana de Capital Privado (Mexican Association on Private Equity), domestic and international funds investing in Mexico are usually (close to 90 per cent of their portfolio) seeding and funding early stages of development of their targets in Mexico.

Funds (private and public) definitely boosted the M&A activity in the country during 2019, remaining unaffected by the Mexican political uncertainty during the first months of the year.

**6 Is acquisition financing available for deals? Where is financing coming from? How much concern do you have that an increase in interest rates or risk of a recession will limit the availability of financing?**

Yes, financing is generally available for all players within the Mexican market and for almost all of the industries.

As every other year, we have seen highly leveraged transactions, and others less leveraged. A number of factors have impacted the equity/debt ratio in the reported transactions, being the most important: (i) industry; (ii) target of the M&A; and (iii) type of acquirer.

During 2019, as compared to 2018, the financing coming from international lenders and banks has remained flat. While financing arising from domestic sources (ie, Mexican governmental agencies) and capital markets has dropped by almost 11 per cent; capital markets financing (either via public or private placements) has raised around 3 per cent.

We think that the currency exchange stability has favoured the volume of the M&A activity as a whole (both, transactions and financings), as almost half of the financing transactions during 2019 were valued and performed in US dollars.

For more than three years, during which almost no volatility has occurred (depreciation of the Mexican peso against the US dollar of just 1.8 per cent), has incentivised the growth of leveraged transactions without fear of investors to acquire debt in foreign currency.

During the 4Q 2019 and the first month of 2020, we have seen a significant decrease in the interest rates of the Mexican financing sources, which we anticipate might boost M&A activity in Mexico.

In addition to the foregoing, we expect that funds will be players of utmost importance in the financing market during 2020.

**7 How open is your country to investments and acquisitions by foreign buyers? Is there a level playing field when foreign and domestic bidders compete to buy the same domestic target company?**

Mexico has for long time been a destination that welcomes investments and acquisitions of foreign participants in mostly all of the industries (save for a selective list of activities that are restricted by law from foreign investment).

During the past 10 years, the number of reported transactions completed by foreign investors and local groups are somehow equalised and there are no legal or market blockers that might produce an unlevel playing field for foreign bidders.

A significant fact in how tempting it is for foreign players to either acquire Mexican entities or to invest (directly or indirectly) into them is that 2019 has shown a growth of more than 18 per cent on the overall number for these types of transactions, as compared to 2018.

## **8 Are corruption and compliance concerns affecting M&A activity? Are there industries where this is a particular issue?**

Given that the new administration has been very vocal against corruption, there are a number of actions pending to implement the National Anti-corruption System.

Mostly, these anti-corruption measures have affected a number of transactions regarding government procurement and joint ventures with governmental bodies. We have noticed certain reluctance from clients to enter into transactions in which targets (mostly foreign) are exposed to government contracts.

## **9 How big a part of M&A activity is the restructuring of financially troubled companies? Have you seen more of this in 2019 as compared with 2018? What are the prospects for 2020?**

In spite that we have not seen a substantial growth in the restructuring of financially troubled companies during 2019, as compared to 2018, the market has shown that a number of companies might be seeking for financial restructuring (either by the way of equity, getting cheaper debt or by the way of a workout) during 2020. The reason for this is that the Mexican economy suffered a mild slowdown during 2019, which is likely to affect many companies from different industries.

In addition to this, the Mexican market is likely to have a significant amount of financings maturing throughout the year, which were obtained by entities between 2013 and 2016, with maturities starting in 2020.

## **10 Does your country's bankruptcy law permit the reorganisation of the debtor as a going concern, and the acquisition of the entity out of bankruptcy? Are you seeing much activity in this area?**

Yes, the Mexican reorganisation law (Ley de Concursos Mercantiles) provides for the possibility of debtor to go through a reorganisation process, and the possibility to have new investors or even to sell the entity subject to the reorganisation or bankruptcy proceeding at any time of the process prior to the bankruptcy liquidation of the assets to pay creditors.

Reorganisation processes that began during 2019, increased slightly vis-à-vis those that started during 2018, and we believe that for 2020, reorganisation activity will depend on whether interest rates will decrease or not, on the growth on the GDP as well as on the legislative and regulatory developments that the new administration might be passing (ie, taxes, labour, infrastructure, etc).

Given that the interest rates have been lowering during the last months of 2019 and the first of 2020, it might be the case that more Mexican companies could file for restructuring proceedings to have a better position to negotiate with creditors and to obtain cheaper and more favourable financing conditions.

## **11 Has there been any increase in public company M&A?**

No, M&A in public companies has remained somehow flat in 2019 as compared to 2018. In most of the cases, during 2019 public companies have been acquiring new entities or businesses.

Despite the above, according to the Rión Report and the reported transactions in the Mexican stock exchanges (Mexican Stock Exchange) and Institutional Stock Exchange), subsidiaries to public companies have shown an intense M&A activity for new areas of their core business. Subsidiaries to telecom and mining public companies have been the most active M&A sectors.

## **12 How well protected are minority shareholders in public companies? What recent developments have there been as relates to independent directors, special committees, independent advisers, fairness opinions?**

The rights granted to minority shareholders under the Stock Market Law are:

- Right to appoint and revoke one member of the Board of Directors, with every 10 per cent of stake, even for stock without voting rights.
- Right to appoint a statutory auditor, with 10 per cent of stake, even for stock without voting rights.

- Right to request the chairman of the Board of Directors to call a to a Shareholders' General Meeting at any time with respect to the matters on which they are entitled to vote, with 10 per cent of stake:
- Right to file a claim for civil liability against the directors for the benefit of the company, with 15 per cent of stake. Right to challenge in court, resolutions passed by the shareholders' meeting, with 20 per cent of stake.

During 2019, there were no changes regarding independent directors, special committees, independent advisers or fairness opinions.

### **13 Has there been any increase in shareholder activism and hostile takeovers? Are international hedge funds active in your market? What defences are target companies permitted to adopt?**

Considering the reported transactions and based on the Rión Report, during 2019 shareholders' increase of stake has risen by almost 21 per cent as compared to 2018. We are not aware of any hostile takeovers during 2019.

Hedge funds (both, local and international) as well as institutional investors are quite active in the Mexican market, particularly as stakeholders to public companies and long term investments.

Given the large volume of capital they manage, Mexican pension funds, also called AFORES (Administradoras de Fondos para el Retiro), are the most important investors in the Mexican market.

### **14 Have directors, management and controlling shareholders changed how they conduct themselves in M&A deals? What kind of fiduciary duties do directors, management and controlling shareholders have under the laws of your jurisdiction? From your experience, are directors, management and controlling shareholders more diligent today in their review of M&A transactions and other matters?**

In general, we have not observed changes as to how directors, management and controlling shareholders conduct themselves in M&A deals.

The Stock Market Law provides managers of public companies with two fiduciary duties that must be followed – duty of diligence and the duty of loyalty.

The directors shall at all time perform their duties in the best interest of the public company and its affiliates and subsidiaries. The members of the board of directors shall fail to exercise the duty of diligence and thus, be liable whenever damage is caused to the company's assets or to their affiliates and subsidiaries.

The duty of loyalty should be followed by the directors as they must keep confidentiality on the information and matters that they have knowledge of and will be held liable for the breaches in which they incur. Whenever directors fail to exercise the duty of loyalty, they will be responsible for the benefits obtained and damages caused to the company, among others.

Directors and managers are increasingly trying to obtain the best possible support (financial, legal accounting, etc) prior to closing M&A transactions, as well as opinions from independent advisers on the viability of the M&A.

In recent years, we have seen a slight increase in the claims against managers claiming breaches of their fiduciary duties in Mexico. In almost all the cases, the outcomes of such litigations are not public, since unrevealed settlements are usually reached between the parties.

### **15 Should directors, management and controlling shareholders be more concerned today about negative publicity, shareholder criticism, regulatory pressure, shareholder lawsuits and liability from potential litigation?**

As in every other jurisdiction, reputational exposure due to the media and the increasing pressure of regulators (mostly through audits), directors and managers should be more careful as to how to deal with publicity.

Hiring insurances for managerial and decision-taking positions against litigation has been an increasing practice during the past three years for managers and directors of public companies and of private but institutionalised entities.

### **16 Are there major differences in how domestic and cross-border deals are being conducted? For instance, does the type of purchase agreement used in your jurisdiction differ significantly from the international style of agreement? If so, which type is being used more often?**

Generally, domestic and cross-border deals involving Mexican participants are conducted in similar ways.

Purchase agreements are often times following the international style of such agreements adjusted to the Mexican legal regime.

## **17 Have there been changes in the process for how M&A transactions are conducted in your jurisdiction?**

Processes to conduct M&A transactions in Mexico have not changed significantly during recent years.

## **18 How level is the playing field for domestic and international bidders?**

The playing field is level in our opinion. Foreign bidders are usually very concerned with compliance breach (ie, money laundry and corruption), corporate governance and corruption findings.

It is understandable that domestic investors are often more tolerant to certain risks or contingencies due to their deeper knowledge of Mexican market. We see that international buyers are usually fearful and more uncertain on labour risks, governmental actions and law enforcement.

## **19 For international buyers and investors looking at deals in your jurisdiction, what are the three most important pieces of advice you have and what are the three most important pitfalls that should be avoided?**

The most important advice for international buyers and investors that are interested in deals in Mexico would be:

- conduct deep financial and legal due diligence;
- certainty on the perfection of securities and governmental approval requirements; and
- adequate choice of law as to ensure enforceability and foreclosure.

As to the pitfalls that should be avoided by international buyers and investors that are having transactions in Mexico:

- material tax, labour and social security contingencies. Outsourcing and employer substitution schemes should be carefully evaluated;
- environmental liabilities; and
- carve-outs and/or caps on representations or indemnities.

Whenever bidders were to be competitors, they should be very careful during the due diligence process to avoid any breach of antitrust regulations forbidding pricing disclosures.

Given the already passed, as well as the expected upcoming regulatory changes mainly to the tax and labour regulations, we consider that the analysis of the above-mentioned items might change for deals that will be taking place during 2020 and onwards.

## **20 Have there been any significant regulatory developments affecting M&A – your country's securities exchange commission, antitrust regulators, tax authorities, Central Bank, other regulators that review deals etc?**

During the second half of 2019, the Mexican lawmakers have passed significant amendments to labour laws and tax regulations. On the labour side, changes in the outsourcing contracting and labour unions' rights were passed. As to tax regulations, a significant amount of rules aiming to strengthen the collection of taxes was approved, as well as the scope of authorities of the tax regulators.

The Mexican Antitrust Commission has been quite active in different markets, including energy, transportation, agro-foods, finance, health, digital platforms and government procurement as it relates to potential collusion among bidders. For this reason, the Commission has indicated the need to improve the legal framework to avoid the abuse of loopholes. It has suggested increasing transparency, providing new price determination methods prior to public bids, and creating unified regulations instead of several local regimes, among other measures.

In recent months, the Mexican Antitrust Commission has also passed a number of relevant resolutions that include significant penalties to participants (local and foreign) of many industries (retail, real estate, airlines, banks, credit score provider, etc).

On the infrastructure side, the federal government has announced four major infrastructure projects, including: (i) an alternate airport in the Santa Lucía military base 30 miles north of the current airport; (ii) an oil refinery in Dos Bocas, Tabasco; (iii) the Mayan Train, which is intended to traverse the Yucatán Peninsula and to be a major connection within the south region of

the country; and (iv) the Transoceanic Corridor in the Isthmus of Tehuantepec, intended to provide transportation and industrial infrastructure as an alternative to the Panama channel. Subject to further actions to be taken by the new administration, we expect that these projects may bring an important amount of transactions (by the way of government procurement, financing, joint ventures, etc).

As to the financial sector, the fin-tech industry is quickly developing in Mexico. The competent authorities have gradually published enabling regulations of the fin-tech industry and now there is a clearer scenario as to how this sector is expected to operate. The regulations include provisions applicable to the operation of financial technology institutions, the use of crypto currencies, electronic payment funds institutions, crowdfunding and other compliance and anti-money laundering provisions. As in 2019, it is reasonable to expect that the number of fin-tech transactions could grow at a significant pace.

Finally, the Mexican Congress is expected to work on the completion and adoption of the Basel IV regulations as to the international banking standards regarding supervision, reporting, clearing of transactions, among others.



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Héctor Arangua L specialises in capital markets, structured finance, mergers, acquisitions and private equity.

*Chambers Latin America, IFLR1000, The Legal 500* and *Latin Lawyer 250* recognise him as a leading lawyer and for his outstanding expertise. *Chambers Latin America* ranks him as a leading individual for capital markets and has described him as ‘one of the hardest-working lawyers in the market, who always goes the extra mile to ensure that everything is perfect’, as ‘incredibly technical and methodical, as well as having great business sense and a hands-on attitude’, and as ‘seriously skilled when it comes to negotiating’.

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 capital development certificates.

His structured finance practice is focused on providing advice to lenders on structuring complex bankruptcy-remote payment structures.

He regularly advises on M&A transactions and has also developed expertise in the venture capital and private equity sector, in which he has continuously advised on fund formation and on investment and divestment 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 Instituto Tecnológico Autónomo de México.



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Miguel A González J 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 from the Universidad Panamericana, from which he also holds a graduate degree in commercial and corporate law, with honors, and he obtained his LLM in finance from the Institute for Law and Finance of the Goethe University Frankfurt am Main; he is a candidate for an MBA at the Instituto Tecnológico y de Estudios Superiores de Monterrey.



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NHG is the only Mexican law firm with an office in London, with a strong focus on developing and pursuing business opportunities among Mexico, the UK and other European countries. The firm also enjoys excellent working relationships with law firms in all major cities around the world

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