The Private Equity Review

Tenth Edition

Editor
Stephen L Ritchie

The Law Reviews

THE PRIVATE EQUITY REVIEW

TENTH EDITION

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Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34–35 Farringdon Street, London, EC4A 4HL, UK

www.TheLawReviews.co.uk

ISBN 978-1-83862-812-3

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

ALLEN & OVERY

ALTER LEGAL SL

BAHR

CUATRECASAS

FASKEN MARTINEAU DUMOULIN LLP

JINGTIAN & GONGCHENG

KIRKLAND & ELLIS

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PREFACE

The tenth edition of *The Private Equity Review* follows a turbulent year for dealmakers in 2020. Uncertainties created by the global covid-19 pandemic triggered a significant slowdown in deal activity in the first and second quarters. However, a combination of central bank interventions, fiscal stimulus, optimism about a vaccine and better virus management led to frenetic third and, especially, fourth quarters. The net result was that the number and value of global buyouts increased significantly over 2019's already robust activity, while there was a noticeable decline in private equity exits. The year 2020 also saw a flurry of IPO and merger and acquisition activity by special purpose acquisition corporations, or SPACs, some formed by private equity sponsors and others formed by other dealmakers. Fundraising activity was also strong, notwithstanding the pandemic, with aggregate capital of nearly US$1 trillion raised, as institutional investors remained extremely interested in private equity as an asset class because of its continued strong performance. As a result, private equity funds have record amounts – by one estimate, nearly US$1.5 trillion – of available capital, or dry powder. PE funds' dry powder (and the need to deploy it), together with competition from SPACs, sovereign wealth funds, family offices and pension funds, led to very competitive transactions being completed at increasing leverage levels and 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.

The year 2020 showed once again the resilience of the private equity market and the creativity of private equity dealmakers. Given PE funds' creativity and available capital, we are confident that private equity will continue to play an important role in the global economy, not only in North America and Western Europe, but also in developing and emerging markets in Asia, South America, the Middle East and Africa, and to further expand its reach and influence, even in the face of potential political, regulatory and economic challenges.

Private equity professionals need practical and informed guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. *The Private Equity 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 dealmaking 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 tenth 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
March 2021

Part I

Fundraising

Chapter 11

MEXICO

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

I GENERAL OVERVIEW

Over the past 20 years, Mexico's private equity (PE) industry has raised over US$60 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 11 per cent and 13.9 per cent, respectively.[4] Currently, the number of active fund managers is over 266, 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.

According to the Secretariat of Economy of Mexico, Mexico is one of the world's most globalised countries, with 13 free trade agreements spanning 50 countries; nine partial-scope and economic complementation agreements within the framework of the Latin-American Integration Association; 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 11th in the world and it is the sixth-largest car manufacturer in the world,[5] with the third-largest growth in exports within the automotive industry.[6] Mexico actively participates in multilateral and regional organisations and forums, such as the World Trade Organization, the Asia-Pacific Economic Cooperation, the Organisation for Economic Co-operation and Development and the CPTPP.

During 2020, all of the world's economies have been affected by the covid-19 pandemic and Mexico was no exception. The first case of covid-19 in Mexico was confirmed on 27 February 2020, and, because of its spread, a month later a nationwide shutdown of non-essential activities was ordered. Regardless of the effect of the pandemic, the Mexican government is optimistic as to the potential economic reactivation based on the fact that representatives of the private sector and the office of the President signed an agreement

1 Hans P Goebel C, Héctor Arangua L and Adalberto Valadez H are partners and Miguel Á González J is an associate at Nader, Hayaux y Goebel, SC.
2 AMEXCAP, 'Private Equity in Mexico 2019'.
3 ibid.
4 ibid.
5 World Population Review: https://worldpopulationreview.com/country-rankings/car-production-by-country.
6 World Trade Organization, World Trade Statistics Review, 2018.

seeking to promote 39 infrastructure projects with a value of 297 billion Mexican pesos, with the consequent projection of recovering the lost jobs because of covid-19 by April 2021.[7] In addition, the Mexican government has been very active so as to ensure a significant amount of vaccine doses, to be delivered as soon as available by the relevant developers. The commitment of the Mexican government is to achieve an economic growth of 3.7 per cent in 2021, as forecasted by the World Bank.[8] The forecasted growth will be strengthened by the economic strategy of the Mexican government that includes a consolidation of domestic consumption as a result of the implementation of social programmes and financial inclusion, an increase of private investment in infrastructure and strategic sectors, heavier public investment, and an increase in exports as a consequence of the reconfiguration of global value chains.[9]

In recent years, the Mexican government has been an important participant in, and supporter of, the PE industry, investing in more than 72 funds[10] 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.[11] 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$24.8 billion through 163 capital development certificates (CKDs) and investment project certificates (CERPIs) since 2008. This amount may increase by a further US$5.7 billion, given the CKDs that are in the pipeline.[12] 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 2020, and by the Emerging Markets Private Equity Association in 2020.

During 2019, 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.[13] 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 48th place, out of 140 countries, in the 2019 edition of the competitiveness index, which shows that the country has microeconomic and macroeconomic institutions

7 *Mexican Government* (5 October 2020): https://lopezobrador.org.mx/2020/10/05/136674/.

8 *El Financiero* (5 January 2021): www.elfinanciero.com.mx/economia/economia-de-mexico-crecera-3-7-en-2021-estima-el-banco-mundial.

9 *Mexican Government* (January 2021): www.proyectosmexico.gob.mx/por-que-invertir-en-mexico/economia-solida/crecimiento-economico/.

10 Secretaria General Iberoamericana and ProMéxico, 'Informe Global LATAM: México July 2018'.

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

12 414 Capital, 'Instrumentos Estructurados (CKDs y CERPIs): Actualización trimestral – 3T2020' (2020).

13 WEF (18 February 2019): https://es.weforum.org/agenda/2019/02/mexico-vuelve-al-top-mundial-de-los-10-paises-para-invertir/.

with strong foundations.[14] 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 the Mexican peso to remain stable despite various difficulties. 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.

Despite the uncertainty generated by the renegotiation over the past years of the United States–Mexico–Canada Agreement (USMCA), that superseded the North America Free Trade Agreement (NAFTA), it was finally signed on 30 November 2018; and the Protocol of Amendment to the USMCA, which, among other amendments, ensures that Mexican officials implement the promised labour reforms and adds changes in the agriculture sector, was agreed and signed on 10 December 2019. The USMCA finally came into effect on 1 July 2020. The USMCA, among other important changes, includes a specific chapter dedicated to boosting the growth of small and medium-sized businesses by implementing new measures such as incrementing the opportunities for commerce and investment through infrastructure development, promoting small and medium-sized businesses among minorities and start-ups, creating a committee dedicated to promoting the competitiveness and cooperation between these types of businesses and keeping entrepreneurs informed of updates and developments.[15] It also includes specialised chapters that regulate e-commerce, agriculture, labour and heavy industry (aerospace and automotive).

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 eight 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.[16] As at October 2017, an estimated US$25 billion in cash reserves were available for investment by PE funds investing in Mexico.[17]

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.[18] As at September 2019, three new Mexican funds had been formed, bringing the number of VC 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.[19]

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; as a matter of fact, 2019 was a record year in VC investments with a 60 per cent growth compared

14 *Entrepreneur* (28 January 2020): www.entrepreneur-com/article/345584.

15 *El Financiero* (19 December 2019): https://elfinanciero.com.mx/economia/tienes-una-pyme-estos-son-10-puntos-con-los-que-el-t-mec-quiere-darle-un-empujoncito-a-tu-negocio.

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

17 ibid.

18 AMEXCAP, 'Mexico: VC Overview 2019: Venture Capital Industry'.

19 ibid.

with 2018.[20] 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 March 2020, Mexico reached the 441 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.[21] The Mexican fintech industry has shown an average annual growth rate of 23 per cent, with the creation of 47 new start-ups, and the dominating sectors being loans, payments and remittances.[22] 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.[23] 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 that proved possible to regulate the sector without imposing regulation as heavy as it is for banks.[24]

As mentioned above, Mexican VC has grown significantly, reaching US$1.794 billion in accumulated committed capital over the past 11 years.[25] Mexico's VC sector is now an attractive market in which to invest, with 75 active Mexico-based fund managers and 19 foreign GPs that performed at least one transaction in the past five years. In the same vein, AMEXCAP registered over 1,233 VC transactions for a total of US$1.5 billion invested from 2009 to September 2019 and, on the liquidity side, noted five exits during 2019. The growth seen in 2016 remains the industry record, with the largest number of transactions; however, in terms of the capital invested, the first three quarters of 2019 established an industry record with US$330 million.

In the past 20 years, foreign funds have only contributed approximately 11.2 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.

20 AMEXCAP, 'Mexico: PE Overview 2019: Investments'.

21 Finnovista, *Fintech Radar Mexico* (May 2020).

22 ibid.

23 ibid.

24 S&P Global (7 March 2019): www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/50081755.

25 AMEXCAP, 'Mexico VC, October 2019'.

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 Electricity 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 2020, there were more than 30 CKDs investing in the infrastructure and energy sectors, which have raised over 140 billion Mexican pesos.[26]

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, which is the sector in which the government and the private sector invest the most. 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.

Furthermore, the past three years were strong in the power infrastructure sector, starting with the completion of the first three 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 593 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.[27] In addition, Mexico is party to the Paris Agreement on climate change. As of 2020, clean energy in Mexico accounted for more than 31 per cent of the total energy produced in the country.[28]

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,[29] 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 the 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, was awarded a contract to construct and operate the US$2.1 billion South Texas–Tuxpan–Tula natural gas pipeline, which is now supplying 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

26 414 Capital, 'Instrumentos Estructurados (CKDs y CERPIs): Actualización trimestral – 3T2020' (2020).

27 *El Financiero* (9 August 2018): www.elfinanciero.com.mx/nacional/reynosa-i-el-parque-eolico-mas-grande-de-mexico-sera-inaugurado-el-lunes.

28 *Forbes* (17 May 2020): www.forbes.com.mx/economia-mexico-energia-renovable-sener/.

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

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 users in the state of Quintana Roo.[30] 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.[31] 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 2020, more than 110 contracts have been awarded to 73 international firms or consortiums, from 20 different countries.[32] Regarding the infrastructure sector, Mexico's federal government has committed to the promotion of its development, as well as to maintaining and improving that which already exists, thereby encouraging: a balanced regional development, a sustainable urban development and the logistic integration of the country and an improvement in its interconnectivity. Furthermore, the World Bank and the Global Infrastructure Hub highlight Mexico's capacity to prepare, procure and manage public-private partnerships. Moreover, the 'Procuring Infrastructure Public-Private Partnerships Report 2018' issued by the World Bank places Mexico as one of most prepared countries in these matters, even when compared to Organisation for Economic Co-operation and Development members, and ranks Mexico above average.[33]

Additionally, during late 2019 the Mexican government announced the first project of the new Mexico City airport, which will be operating at the current Santa Lucía military airport. Through the National Infrastructure Plan that López Obrador, the Mexican President, revealed in November 2019, the Mexican government seeks to strengthen Mexico's economy The plan implies that his government, together with the business industry, will invest a total of 859 billion Mexican pesos in infrastructure projects over the next four years.[34] The plan provides for the investment in 147 major infrastructure projects, and the money will be allocated over the next four years. Among the 72 projects that started during 2020 are (1) the expansion of the port of Dos Bocas in Tabasco; (2) the expansion and renovation of 17 airports, mainly in the south and south-east of the country; (3) the construction of the

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

31 *Pemex* (18 July 2017): www.pemex.com/saladeprensa/boletines_nacionales/Paginas/2017-064-nacional.aspx.

32 Comisión Nacional de Hidrocarburos (December 2020): https://rondasmexico.gob.mx/esp/cifras-relevantes/.

33 *Mexican government* (January 2021): www.proyectosmexico.gob.mx/en/why_mexican_infrastructure/attractive-destination-for-investment-in-infrastructure/#tab-id-7.

34 *El País* (27 November 2019): https://elpais.com/economia/2019/11/26/actualidad/1574784256_745597.html.

Santa Lucía airport to serve Mexico City; and (4) the development of various roads in the Bajío region, as well as a second highway to the north of the capital. This plan is expected to positively affect the Mexican economy. During 2020, work on the Mayan Train project, that will connect a number of tourist sites around Mexico, began. Industries are changing and Mexico's global competitiveness is increasing as reforms and governmental initiatives modify the structure of the economy to attract investment. 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.[35] On the occasion of Mexico's Aerospace Summit 2019, it was announced that the aerospace industry has grown from 100 US and European producers in 2004 to more than 330 in 2019.[36] The numbers to be announced during Mexico's Aerospace Summit 2021 are expected to be higher.

The Mexican PE market has grown considerably over the past 20 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.[37] 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 the case during 2015 and 2018.

In connection with the foregoing, in 2015 Mexico's government introduced two new investment instruments to promote the country'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 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 on the Mexican Stock Exchange (BMV) 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 since their creation to make the instrument more appealing.

In December 2015, CERPIs were introduced. CERPIs 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 GPs and lower investment requirements for

35 www.niedersachsen-aviation.com/uploads/media/AEROCLUSTER_BROCHURE_web.pdf.

36 Mexico Aerospace Summit: www.mexicoaerospacesummit.com/.

37 Antonio Martinez Leal and Pino del Sesto, 'Private Equity in Mexico: Primed for significant growth', 16 May 2013, Bain and Company.

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 has made 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. Regarding 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 relatively 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 144 CKDs have been issued to try to 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 $65 billion Mexican pesos.[38] On average, 14 CKDs have been listed per year since 2010.

The same timeline applies for Mexican FIBRAs that raise capital through the issuance of real estate certificates, which are generally publicly offered on the BMV 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 that, 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:

a in October 2020, PC Capital acquired Financiera Finsol, to strengthen its position as the largest microfinancing company in Mexico;[39]

38 414 Capital, 'Instrumentos Estructurados (CKDs y CERPIs): Actualización trimestral – 4T2020' (2020).

39 AMEXCAP (14 October 2020): https://amexcap.com/2020/10/16/pc-capital-anuncia-la-adquisicion-de-cartera-y-ciertos-activos-de-operativos-de-finsol-por-parte-de-te-creemos-holding/.

b in November 2020, G2 Momentum Capital announced its investment in KOIBANX, a fintech company, which is expected to be valued US$2.3 billion by 2021;[40]

c in December 2020, PC Capital announced its investment in Medios Cattri and the acquisition of Lightbox OOH, strengthen the position for two advertising companies in the USA and Mexico;[41]

d in December 2020, Te Creemos Holding and Banco Forjadores reached an acquisition agreement; this operation is subject to the approval of several Mexican authorities;[42] and

e in December 2020, Plataform Capital announced its commitment to invest in Angel Ventures Pacific Alliance Fund II, which is targeted to invest in early stage tech companies.[43]

II LEGAL FRAMEWORK FOR FUNDRAISING

The Canadian limited partnership has been one of the most popular legal forms for structuring PE funds with Mexican LPs' investment as they are considered transparent for tax purposes; however, certain amendments to the Mexican tax laws restrict such transparency regimes, starting in 2021. 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 that 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 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

40 AMEXCAP (2 November 2020): https://amexcap.com/2020/11/03/koibanx-se-suma-al-portafolio-de-g2-momentum-capital/.

41 AMEXCAP (7 December 2020): https://amexcap.com/2020/12/08/pc-capital-anuncia-inversion-en-medios-cattri-y-la-adquisicion-simultanea-de-lightbox-ooh/.

42 AMEXCAP (8 December 2020): https://amexcap.com/2020/12/09/te-creemos-holding-y-banco-forjadores-llegan-a-acuerdo-de-compraventa/.

43 AMEXCAP (31 December 2020): https://amexcap.com/2021/01/04/platform-capital-commits-to-latin-america-based-venture-capital-fund-angel-ventures-pacific-alliance-fund-ii/.

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 CKD and FIBRA 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 range between 1.5 and 1.75 per cent of the total amount invested during the 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.

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 in Section II).

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, as noted above, the tax-transparency regime has been modified as of January 2021 and it is now available as a tax incentive that is expressly applicable to vehicles used to manage private equity investments in Mexican companies. Under these new rules, a foreign limited partnership may be treated as tax transparent in respect of interest income, dividends, capital gains and income from the lease of real estate properties 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; that they are tax transparent in their country of formation; and that the manager file a registration with the Mexican tax authorities disclosing the identity, nature and tax residency of the investors, who should be the beneficial owners of the income and shall be subject to taxation in respect thereof. If these requirements are met, the limited partnership will be treated as being tax transparent for Mexican purposes, and thus the investors should 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 was 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 that resulted in a new Income Tax Law): (1) 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 (2) 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 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; and

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 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).

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 a very good and innovative lawyer who offers strong capabilities in financing matters'. 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 Autonomous Technological Institute of Mexico and has lectured in financial contracts at the Ibero-American University. He 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 and private equity.

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 lawyer 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 Autonomous Technological Institute of Mexico.

ADALBERTO VALADEZ H

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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 is recognised as a leading lawyer and for his outstanding expertise by *Chambers Latin America*, *IFLR1000*, *Best Lawyers*, *The Legal 500* and *Latin Lawyer 250*. *Chambers Latin America* ranks him as a leading individual for tax and has described him as an 'exceptional adviser [who] enjoys solid capabilities assisting clients with tax advisory matters, particularly in the context of financial transactions', and mentions a client describing him as 'highly competent and knowledgeable; he understands the regulations and the problems clients face very well, and is very proactive in finding solutions', as having 'extraordinary willingness to work hard', and as knowing 'the financial sector very well, so it is a mix of expertise that leads us to work very well with him'.

He has solid experience in advising clients on issuances in the local securities market, particularly in the case of capital development 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 and he also previously worked as a foreign associate in the Amsterdam, Luxembourg and Geneva offices of Loyens & Loeff.

MIGUEL Á GONZÁLEZ J

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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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ISBN 978-1-83862-812-3