Trends and Developments

Contributed by:
Michell Nader S. and Julián J Garza C.
Nader Hayaux & Goebel ***see p.26***

Introduction

What lessons, experiences, projects and changes did 2021 leave behind? And what to expect for the current year in terms of economic growth, business plans and personal development?

To understand 2021 it is essential to remember what 2020 brought. While such a statement may seem obvious, it may not be as self-evident that 2022, for different reasons and in different industries, may resemble – from a business and economic perspective – 2020.

Certainly, Mexico is fortunately in a much better condition to face the challenges of COVID-19; but the disruption that the pandemic caused, coupled with a number of political and socio-economic events, are likely to bring about the return of the types of challenges faced in 2020. This situation is explained by some economic theories as a W-shaped recovery. A recession followed by an economic recovery and then turning down into another recession. Will such recession happen in 2022, 2023 or even at all? Most probably it will happen at some point and in some fashion. The main drivers (all connected to each other) are (i) inflation that is not under control (and actually getting worse at the start of 2022), (ii) oil and energy prices rising, (iii) the consequent fall in demand for consumer products, (iv) geopolitical events, and (v) the enormous loss of buying power of the middle class, which keeps the economy revolving.

In fact, both Mexico and the wider world may face one of the worst economic scenarios: stagflation, which entails negligible economic growth, a rise in unemployment and higher levels of inflation. And yet, experience has shown that economies always eventually recover from such circumstances, which recovery will no doubt create valuable opportunities in the M&A market. 2021 showed us that lesson once again.

The slowdown in the economy in 2020 was dramatic. The manufacturing, export, retail, food, restaurant, hospitality, real estate and entertainment sectors, among many others, were severely impacted. The long-term repercussions of 2020 will remain for years to come.

A Year in Review

In 2021, M&A related activity was impressive, considering the circumstances of the prior year. Although outcomes were impossible to predict, Mexican M&A witnessed an extraordinary degree of activity, with new markets being opened and developed and new trends being established.

Positive signs were present in Mexico, such as fiscal discipline, a strong manufacturing base, a positive balance of trade, access to the United States–Mexico–Canada Agreement (USMCA) and other factors which make Mexico the number one trading partner of the USA.

Aside from the pandemic, Mexico continued to experience major public shifts in its economic, political, social and legal landscape over the last year. After a historical decrease in GDP of 8.5% in 2020, Mexico managed to achieve 5% GDP growth. This expansion benefitted from the strong recovery of the USA and low interest rates, supported by manufacturing exports, remittances and increase in private consumption.

As a result, Mexico continues to be immersed in the legacy of corporate finance transactions left behind by the crisis, while at the same time, new deals and industries are reshaping the economy for good; eg, tech, telecoms, logistics, e-commerce and digital banking and finance.

State projects

The Mexican federal government continued to focus on its main objectives: reducing government spending, promoting social programmes and attempting to stimulate state-owned energy and electricity agencies. No significant programme was launched to foster economic growth and employment, procure consumer acquisition power, develop feasible infrastructure projects or provide specific stimulus for local and foreign private investment.

The federal government has remained focused on its landmark infrastructure projects:

- the alternate airport in the Santa Lucía military base;
- the oil refinery in Dos Bocas, Tabasco; and
- the Mayan Train in the Yucatán Peninsula.

Unfortunately, the Transoceanic Corridor in the Isthmus of Tehuantepec (a rail and road corridor between the Gulf of Mexico and the Pacific) seems not to be moving forward as a priority.

Key economic sectors

A strong rebound was also seen in 2021 in economic sectors such as tourism and manufacturing. The other key area is finance: new and far more complex investments, mergers, acquisitions, consolidations and combinations involving institutional investors, private equity funds, venture capital funds and entrepreneurs, particularly in the financial industry, including, banking institutions, fintech players, Sofoms and Sofipos (Mexican corporate forms providing loans and credit), and a vast array of other financial entities, as well as technological and telecoms companies, logistics and e-commerce.

As expected, fintech start-ups are being acquired by larger companies, or are expanding their presence in Mexico by entering into a variety of different arrangements with financial service providers (eg, collaboration agreements, mergers, services agreements). Joint ventures, associations or combinations of fintech companies with Mexican financial intermediaries, as well as with telecom and IT companies are a consolidated reality.

Other sectors that showed interesting developments include agribusiness, industrial real estate, ESG, insurance, hospitality and information technology.

USMCA

Mexico, the USA and Canada commenced significant work under the USMCA, which is expected to provide for, among other matters

- enhanced IP protections for copyrights, pharmaceutical drugs and no duties on music and e-books;
- changes to dispute resolution mechanisms;

- an increase in minimum wages and other protections for workers;
- new “country of origin” rules for automakers; and
- new rules applicable to agribusiness.

The implementation of the matters mentioned above is facing crucial challenges, particularly, in the automotive and labour sectors. Also, as explained below, the proposed restrictions to the Mexican energy and electricity sectors are already creating controversies under the USMCA and in other jurisdictions.

ESG and competition concerns

Mexico's move, in line with the global shift, to green and sustainable finance and ESG principles has begun, with regulatory changes applicable to certain entities, requiring them to make an ESG analysis of their investments. Mexico's Central Bank is keen to enact regulation for financial institutions that takes into account environmental and climate change risks. There has also been an increase in the issuance of green and sustainable bonds driven by European and US banks.

To address the pandemic, the Federal Economic Competition Commission (COFECE) has issued a policy establishing a set of criteria to allow certain types of temporary co-operation agreements between competitors or non-competitors, for the purposes of maintaining or increasing supply, satisfying demand, protecting supply chains, avoiding shortages or hoarding of goods. A focus has been placed by the regulator on energy, telecoms, finance, and medical markets in order to promote competition to support the recovery of the Mexican economy.

What Lies Ahead

Private equity (in a variety of forms) has maintained, and even increased, its presence and growth in the Mexican market. The main sectors that are subject to meaningful acquisitions, joint ventures, mergers or combinations in 2022, include banking, finance, pharmaceuticals, information technology, agribusiness and real estate.

Energy sector reconfiguration

As mentioned above, the impasse over private investment in the oil and gas and electricity sectors will continue. In the oil and gas sector, the Mexican Congress amended the hydrocarbons law to strengthen Pemex by imposing additional requirements on private parties wishing to obtain permits in the sector. Also, in 2021, the Mexican Congress approved amendments to the electricity law, which mainly sought to change the criteria and the form of dispatch of electricity to favour the Federal Electricity Commission (*Comisión Federal de Electricidad*, or CFE).

With the reconfiguration of the energy sector, Mexico could see an increase in distributed generation and isolated supply projects to address the electricity needs of industrial and commercial off-takers. However, there is a pending initiative before the Mexican Congress that attempts to further restrict the investment and participation of private parties in the electricity sector. If such initiative were passed, significant controversies could arise and the sector would face major sales, divestitures and changes of control, among other issues.

Key growth areas for M&A in 2022

Growth in Mexico and abroad during 2022 will likely not be meaningful; however, M&A activity will continue to expand in all of the sectors mentioned above and may also extend to exports and manufacturing, entertainment, residential, commercial and office real estate, hospitals and pharmaceuticals.

Traditional financing as well as structured finance transactions continue to be available to fund projects, private equity investments and financial institutions, including through private securitisations, asset-backed lending and issuance of bonds, both in Mexico and abroad.

Other factors (which may not necessarily be positive) may also bring about mergers, spin-offs, workouts and corporate reorganisations and restructurings. Such is the case in the energy sector. This could have a negative effect on a vast number of companies which may need to undergo corporate restructuring or workouts to comply with new regulations and obligations.

Competition and regulatory issues to watch for

Antitrust will remain a key factor to watch in M&A activity. COFECE continues to pursue investigations, including in the telecoms, real estate and banking industries. It has also been active in different markets, including energy, transportation, agro-foods, finance, health, digital platforms and government procurement.

The programme launched during 2020 by the National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*) to provide regulatory relief to Mexican banks in order to permit them to extend or modify the credit facilities of borrowers in financial distress worked only as a palliative for some borrowers, which have not yet been able to improve their financial condition. Sectors including entertainment, restaurants, construction, development, infrastructure and aviation are already in the process of restructuring their financial and commercial arrangements.

Conclusion

A productive M&A environment can be expected in Mexico in 2022. Crisis brings business opportunities and economic recoveries do as well. A variety of sectors may benefit from joint ventures and strategic alliances with new partners, both foreign and local. There is also significant potential for sales or divestitures of assets or business divisions, including for publicly traded companies and regulated entities, in the agricultural, infrastructure, real estate, telecoms, and banking and financial sectors.

Nader Hayaux & Goebel (NHG) is a market leader in mergers and acquisitions, banking and finance, fintech, securities and capital markets, structured finance, telecoms, tax, insurance and reinsurance, project finance, real estate, energy and infrastructure, restructurings and workouts, real estate, government procurement, antitrust and compliance. NHG is formed of 18 partners and more than 35 associates and represents one of the largest groups of corporate finance experts in the Mexican market. NHG is the only Mexican law firm with an office in London, with a strong focus on developing and pursuing business opportunities between Mexico, the UK and other European countries. The firm also enjoys excellent working relationships with law firms in all major cities around the world.

AUTHORS

Michell Nader S. is a partner at Nader Hayaux & Goebel who specialises in structured and project finance, capital markets, restructuring and M&A. He advises clients on complex structured finance and securitisations; has been involved in the development of the APP regime; and has spearheaded ground-breaking financial structures in the real estate sector, including the largest ever real estate financing in Mexico, the creation of the first Mexican land bank and the IPO of two FIBRAs. He has represented bank syndicates in some of the largest debt restructurings in Mexico and has particular expertise in US-Mexico cross-border cases. He advised the US Department of the Treasury on the USD20 billion emergency financial package provided to the Mexican government.

Julián J Garza C. is a partner at Nader Hayaux & Goebel who specialises in banking and finance, M&A, capital markets, telecoms and structured and project finance. He has advised on some of the largest structured finance and capital markets transactions in Mexico, representing both sponsors and financial intermediaries. His mergers and acquisitions practice extends to a variety of industries, including real estate, telecoms, financial intermediaries and infrastructure facilities, as well as advising on foreign investment acquisitions and joint venture transactions. Julián has strong international experience; he regularly advises US and other international clients on their local operations or investments in the Mexican market. He worked in the Chicago office of Mayer Brown.

Nader Hayaux & Goebel

Paseo de los Tamarindos
No. 400-B, Piso 7
Bosques de las Lomas
05120 CDMX
Mexico

Tel: +52 55 4170 3000
Email: info@nhg.com.mx
Web: www.nhg.com.mx