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Corporate M&A 2023

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Mexico: Trends and Developments
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Trends and Developments

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Nader Hayaux & Goebel (NHG) is a market-leading law firm 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, government procurement, antitrust and compliance. NHG consists of 16 partners, three of counsels and more than 35 associates who together make up 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.

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A Review of 2022

As in previous years, 2022 cannot be explained without taking a quick look at 2021, a year which started very slowly to show signs of recovery after the 2020 lockdown as a consequence of the COVID-19 pandemic. This recovery was a significant achievement and it crystallised during 2022, although not without major hurdles, constant risks and new challenges.

The economic slowdown hit essential industries including the export, retail, manufacturing, food, restaurant, hospitality, real estate, services and entertainment sectors, among many others. Compared to 2020, 2021 showed a dramatic increase in M&A-related activity, with new markets re-opening and an attempt to bolster economic growth. Mexico continued to show again prudent fiscal discipline, a strong manufacturing base and a positive trade balance.

While 2022 reaffirmed the return of economic growth in multiple sectors, it also evidenced the consequences of what had happened in the prior two years. The disruption caused in economic chains increased inflation exponentially and prompted central banks across the world to increase interest rates to cut down inflation risks. The foregoing, coupled with geopolitical events, including the war in Ukraine, and the enormous loss of buying power of the middle class, raised flags that had not been considered, including the risk of "stagflation", entailing negligible economic growth, low consumption, a rise in unemployment and continued high levels of inflation. Mexico itself reached levels of 8% in inflation and 10% in Central Bank interest rates. And yet, despite these and many other challenges, vast and valuable opportunities in the M&A market arose.

Mexico continues to experience turbulence in the economic, political and legal arenas. GDP growth in 2022 was not substantial and while foreign investment numbers were solid, many additional opportunities were lost or delayed due to uncertainty regarding public or government policies. The year 2022 also saw strong debates on electoral, judicial and security issues. Nevertheless, the Mexican economy benefited from the strong recovery of the USA, supported by manufacturing exports, remittances and a strong currency.

Then again, the injection of millions of dollars into the economy during 2020 and 2021, among other factors mentioned above, brought along the always serious problem of inflation and, with it, measures to tighten lending and slow down the economy in an environment where recovery has not yet been achieved. The latest problem: the risk of a large and long recession towards the end of this year. Most likely, it may not result in a very deep economic slowdown, but the hike in interest rates has to hurt, as is currently the case in the bond market.

Given the margin between the interest rates in the United States and Mexico and the inflow of dollars into Mexico as a result of export activities, the Mexican peso is likely to remain strong and, although a number of hiccups are expected, 2023 appears to be fertile ground for multiple M&A transactions and a high level of activity. Some of the more interesting areas are dealt with below.

The new features of the United States-Mexico-Canada Agreement (USMCA), which include changes to dispute resolution mechanisms, minimum wage increases and new "country of origin" rules for automakers, are facing scrutiny as multiple challenges are addressed in specialised panels, including in the automotive, energy and electricity sectors. The outcome of such disputes will shape the strength of the USMCA and the enforceability of cross-border trade arrangements.

Looking Ahead at 2023

M&A will be significant and productive in 2023. Not without risks, sectors such as hospitality, automotive, manufacturing, e-commerce, tech, logistics, industrial real estate, financial, telecoms, renewables and infrastructure will likely benefit from a stronger market, stable economic conditions and new investments. M&A activity in the form of asset sales, stock purchases, strategic acquisitions, joint ventures and divestitures of business divisions will continue, and potentially increase. Mexico must remain attractive for investment from foreign participants, and greater certainty with regard to the rule of law, respect for institutions and the enforceability of projects and investments is key to this endeavour.

Investments through private equity have been steady for a number of years and will continue to be steady. Although it is facing adverse market conditions, acquisition financing remains strong, as does structured finance-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 opportunistic mergers, spin-offs, workouts and corporate reorganisations and restructurings.

Nearshoring

One of the features that the recent crisis created is the concept of "nearshoring". It results from the disruption of manufacturing and distribution chains, the higher costs in those areas, the shutdown in China and the desire to secure production and a vast proportion of goods for consumption within one regional area supported by economic and trade treaties. The best example is the relationship between the United States and Mexico, but nearshoring is also applicable in other regions that, directly or indirectly, benefit from open markets, trade agreements and regional access to other markets, including Europe and South America.

Nearshoring has actually existed for many years. The introduction of the North American Free Trade Agreement prompted the expansion of manufacturing facilities in Mexico, particularly in the northern region, to assemble products and import them back to the United States and Canada. China competed for many years with this structure but given the circumstances mentioned above, Mexico has emerged as a better place for nearshoring.

The new push of the nearshoring wave has the potential to increase investment in Mexico enormously in multiple areas, including manufacture, exports, tech, hospitality, logistics, industry and services.

Exports

Mexican exports have increased by close to 25% from last year, currently totalling almost USD50 billion per month. Approximately 60% of such exports relate to the automotive industry, which has, once again, seen exponential growth. Particularly in the case of Mexico and the United States, the synergies and complementation created on both sides of the border for many years now is impressive, extending to multiple manufacturing and distribution sectors.

Neighbouring countries' nearshoring needs represent fuel for exports. Solid legal structures, including through joint ventures, produce the confidence to invest in, and develop, new production facilities. The establishment of new businesses in a variety of sectors is planned for 2023, including major car manufacturing units.

Fintech

Fintech-related activities have grown dramatically in Latin America, with Brazil and Mexico representing 80% of such increase. Mexico has seen the development of new unicorns, which started off as brilliant ideas, were then funded by private and venture capital, and are now in a consolidation process.

In addition, other 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 and IT service providers, through joint ventures, associations, combinations, collaboration agreements, mergers and services agreements.

Among others, the need to operate remotely has created the need to afford individuals and companies the tools that permit them to carry out their work through electronic devices and digital means. The definitive arrival of artificial intelligence will create unthinkable challenges, many of which will be met by new fintech-related companies, prompting new M&A activity in different sectors.

Hospitality

During 2022, Mexico's tourism sector made a strong recovery. Although it has security-related issues, Mexico has continued to be a destination of choice for foreigners in a number of regions. The economy has benefited in all sectors related to tourism, including restaurants, entertainment and cultural experiences.

New and very ambitious resort and hotel destinations are being developed, particularly in the Yucatán peninsula and the Baja California region. Such projects entail a complex structure of local and foreign investment, secured and structured financing, acquisition and elaborated joint ventures. The hospitality sector in general is likely to continue to grow in 2023.

Logistics

As mentioned before, Mexico is a strategic manufacturing, logistical and distribution centre. This year is expected to see the consolidation of many businesses in such sectors and the creation of even more opportunities for new players. Industry-related real estate projects survived the pandemic in good health and are now required to meet new increasing needs in a local and global market that requires more products, as quickly as possible and at a lower cost. It is unthinkable for growth and consumer discretionary businesses to avoid the need for more efficient and well-established logistical facilities and, with them, the need for equity investments and financing facilities.

Services and others

E-commerce, banking, financial, advisory and tourism-related services are just a few examples of areas of continued economic growth. Also, 2022 saw examples of M&A transactions in sectors ranging from aviation to retail and financial institutions. It is likely that 2023 will bring new and far more complex investments, consolidations and combinations involving institutional investors, private equity funds, venture capital funds and entrepreneurs, including in the financial, technological and telecoms industries, with new and complex equity and financing structures available to them.

In line with global endeavours, Mexico has taken a lead in green and sustainable projects, including in real estate and infrastructure projects, as well as in financing alternatives. New regulations have to be considered in order to face environmental and climate change risks. There has also been an increase in the issuance of green and sustainable bonds, driven by US and European banks.

State projects

A final word on government procurement and M&A activities stemming out of it. The Mexican federal government has continued to focus on its landmark projects, particularly the oil refinery in Dos Bocas, Tabasco and the Mayan Train in the Yucatán Peninsula. Few additional significant new projects or programmes have been launched to foster economic growth and employment and stimulate local and foreign private investment.

The Transoceanic Corridor in the Isthmus of Tehuantepec (a rail and road corridor between the Gulf of Mexico and the Pacific) continues to face challenges. The potential growth that such project could bring is unimaginable; connecting the north and south of Mexico and the Pacific and Atlantic oceans, creating a unique logistics and distribution corridor and developing new business and economic activities.

The impasse on private investment in the oil and gas and electricity sectors will continue, given the support of Mexico's current administration for Pemex and the Federal Electricity Commission (*Comisión Federal de Electricidad*, or CFE). A change of policy, particularly given electricity needs, could vitalise alternatives in the generation and supply of electricity. Mexico is far from reaching its potential in terms of renewables, since Mexico is the sixth-largest country in the world in terms of its capacity to produce renewable energy. Its natural conditions make it a very attractive destination to deploy investments in this area. A fresh policy in the renewables sector could unleash a huge economic in-flow and the creation or development of hundreds of businesses.

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