

Deal-making in Mexico

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Agenda

- Mexico's Attractive Industries
- Buyers and Best Sources of Targets
- Deal Process and Financing Sources
- Role of Federal and Local Government Entities in the M&A Process
- Special Tax Issues
- Local GAAP Differences to IFRS
- Managing the Business After an Acquisition

Mexico's attractive industries

Mexico is open to worldwide commerce.

Macroeconomic stability

- Leading exporter in Latin America
- By 2050, Mexico will become the 8th largest economy in the world
- Ranked 11th in international foreign exchange reserves

International agreements

- Free Trade Agreements with 46 countries
- 32 mutual protection investment agreements with 33 countries
- 9 limited scope agreements

65% working age population

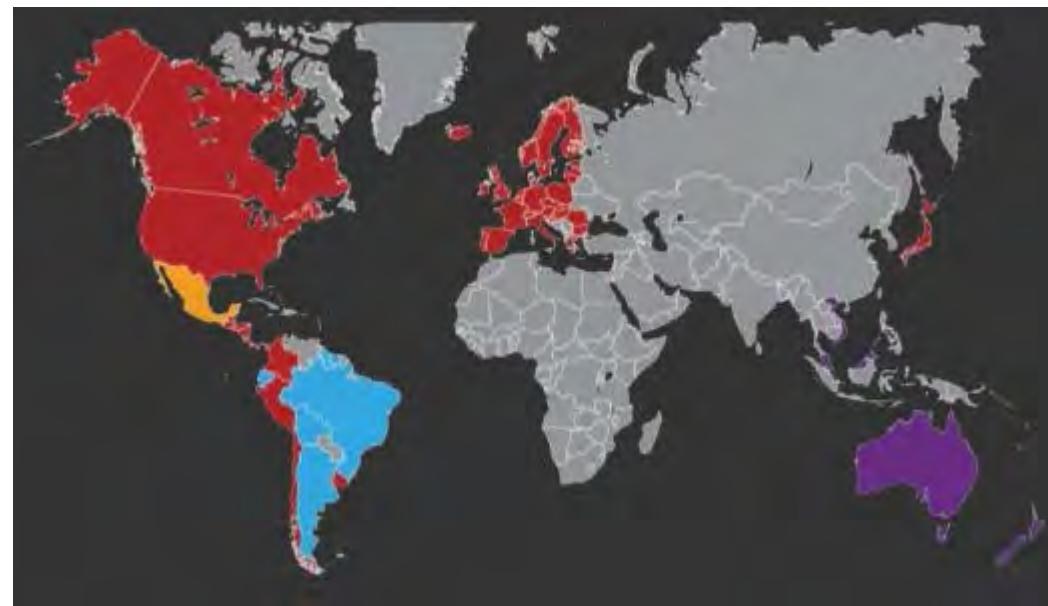
- Advantageous population structure
- Low wages
- Universal social security coverage

13 structural reforms in action

- Energy, telecom, anti-corruption, transparency, competitiveness, education, labor, and more

A country with great infrastructure

- 63 international airports
- 117 ports
- 16,740 miles of railroads
- 234,360 miles of roads



Sources: ProMéxico, Ministry of Economy

Mexico has a stable economy with a positive economic outlook.

	2015	2016	2017F	2018F	2019F	2020F
Inflation	2.1%	3.4%	5.7%	3.8%	3.6%	3.6%
GDP Growth	2.5%	2.3%	1.7%	2.1%	2.4%	2.7%
Exports/GDP	35.4%	38.1%				
10 year bonds	6.2%	7.3%	8.0%	8.2%	8.2%	
30 year bonds	6.9%	7.7%				
Exchange rate MXN/USD	17.25	20.62	20.15	20.01	19.75	
Exchange rate MXN/EUR	18.66	21.80	20.70			

Mexican GDP **US\$2,307 Trillion**
PPP (purchasing power parity) as
of 2016

12th largest economy in
the world

GDP per capita: **US\$18,900**
91st place in the world

Sources: Banco de México, INEGI, The World Factbook, and Fitch Ratings

Mexico has attractive industries for investing.



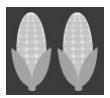
Tourism (8% of GDP):

- Annual growth in 2016 was 4.1%



Logistics and transportation (6% of GDP):

- Average annual growth for 2014-2016 was 3.52%



Agroindustry (US\$50 billion in value).

Worldwide rankings:

- 11th largest livestock producer
- 12th largest food producer
- 13th largest in agricultural crops
- 17th largest fishing and aquaculture



Automotive (3% of GDP):

- 7th largest car producer worldwide
- 18% of manufacturing GDP
- Average annual growth of 7% in the last decade



Metal/mechanical (2.3% of GDP):

- 14% of manufacturing GDP



Information technology (Market value in excess of US\$20.7 billion):

- Average annual growth 2002 – 2014 is 14%



Electronics (Export sales of more than US\$6.9 billion):

- Real annual growth rate for 2014-2020 is expected to be 4.2%



Aerospace (More than US\$6.3 billion in exports):

- Average annual growth of 20% in the last decade



Medical tourism:

- Revenues of US\$3.2 billion per year

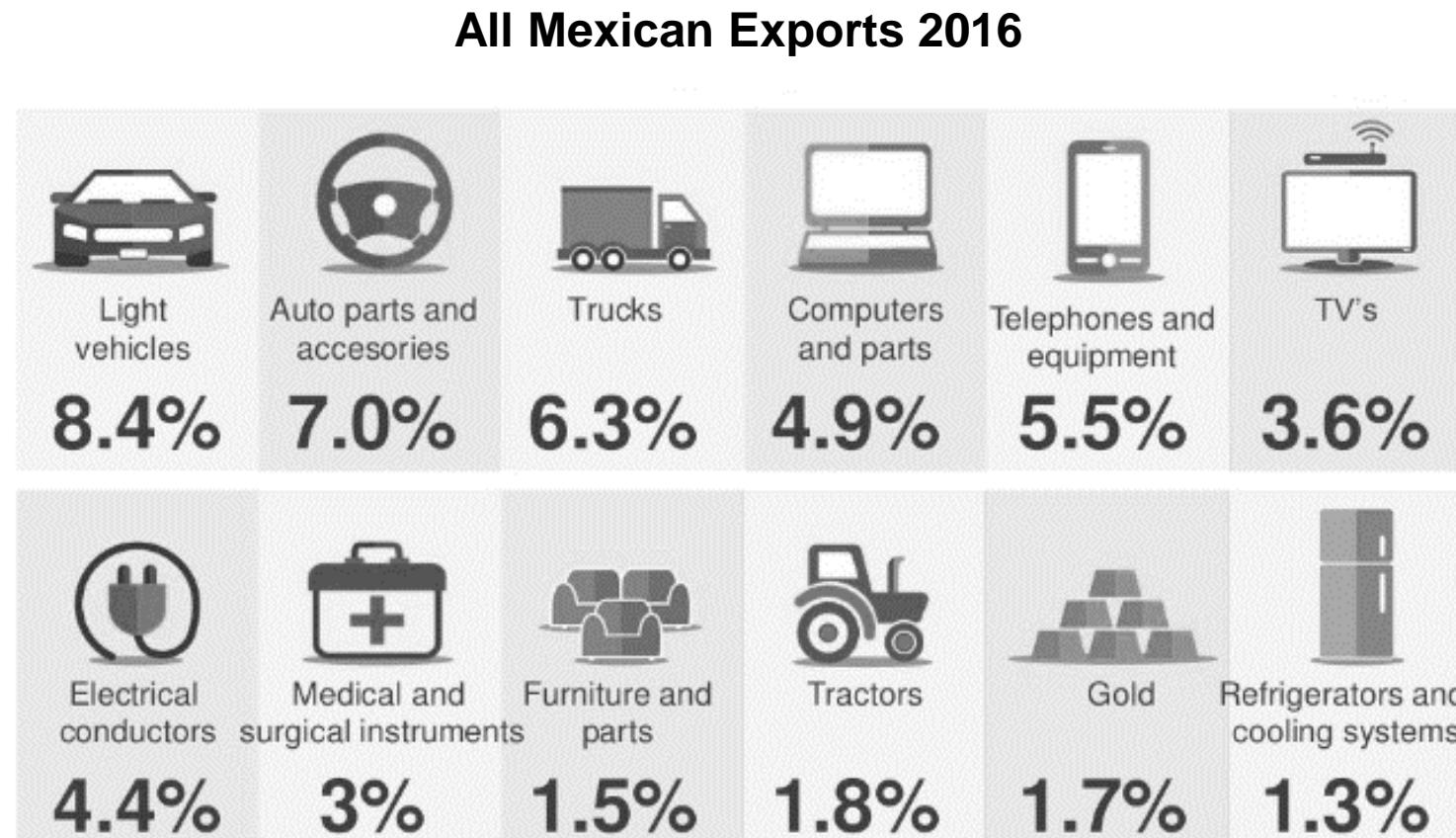


Energy:

- Average annual growth for 2005-2015 was 5.3%
- It is estimated that 37% of all energy will be renewable by 2040

Sources: ProMéxico, IEA, World Bank, Euromonitor, INADEM

Mexico is the leading exporter in Latin America.



Oil exports 5% 

Non-oil exports 95%

Mexico accounts for **34%** of all trade in Latin America.

2016

Sources: ProMéxico, INEGI

Many industries have experienced outstanding growth.

Leader in exports of the following crops:



More than 14 R&D global corporate centers including:

- Skyworks
- Nissan
- Mitsubishi Electric
- Intel design center
- Honeywell
- GE Aviation GEnx turbine
- Tenaris
- Ericsson
- 3M
- Bombardier
- Bosch

Aerospace cluster



Electronics cluster



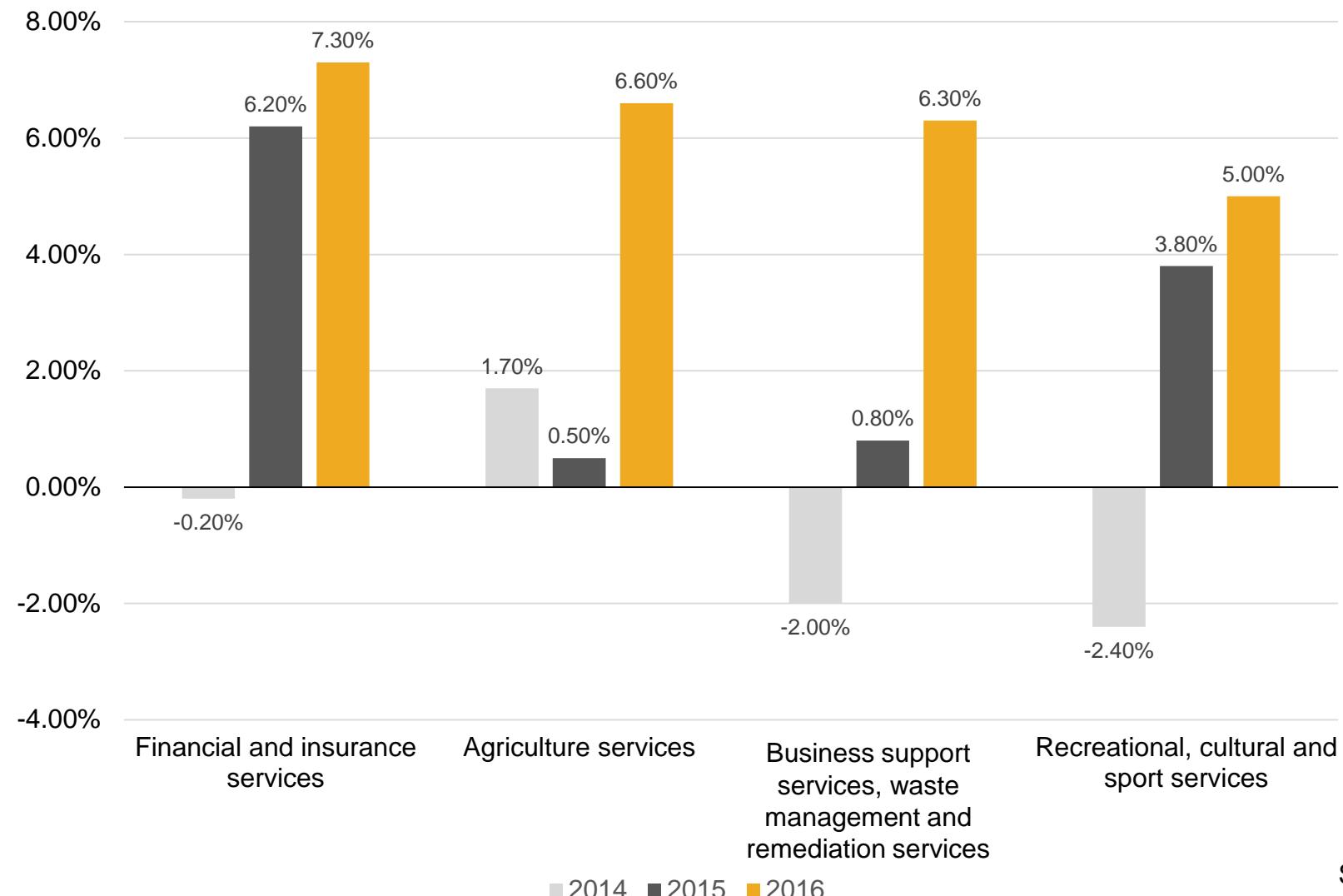
States with vehicle and auto parts production



Doing business in Mexico index.

	Rank 2017	Rank 2016	Change in Rank
Overall	47	45	-2
Getting Credit	5	5	0
Resolving Insolvency	30	29	-1
Enforcing Contracts	40	42	2
Protecting Minority Investors	53	51	-2
Trading Across Borders	61	60	-1
Dealing with Construction Permits	83	83	0
Starting a business	93	72	-21
Getting Electricity	98	84	-14
Registering Property	101	111	10
Paying Taxes	114	112	-2
Countries in Doing Business Index	190		

Which sectors grow faster in Mexico?



Some industries do not allow foreign investors to participate.

- Industries in which activities are reserved for the state
 1. Exploration and extraction of oil (the federal government can give a concession)
 2. Planning and control of the national electricity system
 3. Nuclear power generation
 4. Radioactive minerals
 5. Telegraphs
 6. Radiotelegraphy
 7. Postal service
 8. Control, supervision and monitoring of ports, airports and heliports
- Industries that permit only Mexican citizens
 1. Ground transportation (domestic) of passengers, tourism and cargo, not including courier and parcel services
 2. Development banking institutions

Some industries require a local partner.

Maximum foreign direct investment percentage for certain activities:

1. 10%: Corporate investment companies
2. 49%:
 - Manufacturing and marketing of explosives, firearms, cartridges, ammunition, and fireworks
 - Printing and publication of newspapers
 - Of special series shares ('T' shares) of companies holding agricultural, livestock or forestry land
 - Fishing in exclusive economic zones
 - Full port administration and port-handling services
 - Shipping companies engaged in the commercial operation of inland and coastal shipping vessels, with the exception of tourist cruises and the operation of dredges and naval vessels for the construction, maintenance, and port operations
 - Suppliers of fuels and lubricants for ships and aircraft and railway equipment
 - Broadcasting
 - Airlines, aero taxis, and specialized air transportation

A few industries do not require a local partner.

A favorable resolution of the National Foreign Investment Commission is required for foreign investment to participate in a percentage greater than 49% in the economic activities of companies mentioned below:

1. Port services to vessels that carry out certain inland navigation operations
2. Shipping companies engaged in operations between a Mexican port and an international port
3. Legal services

Mexico is looking to grow in the following industries:

According to the National Development Plan 2013-2018, these are strategic sectors to be developed.



Energy



Aerospace



Logistics



Information Technology



Textiles



Manufacturing



Electronics



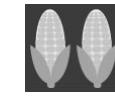
Chemical Industry



Construction



Tourism



Agroindustry



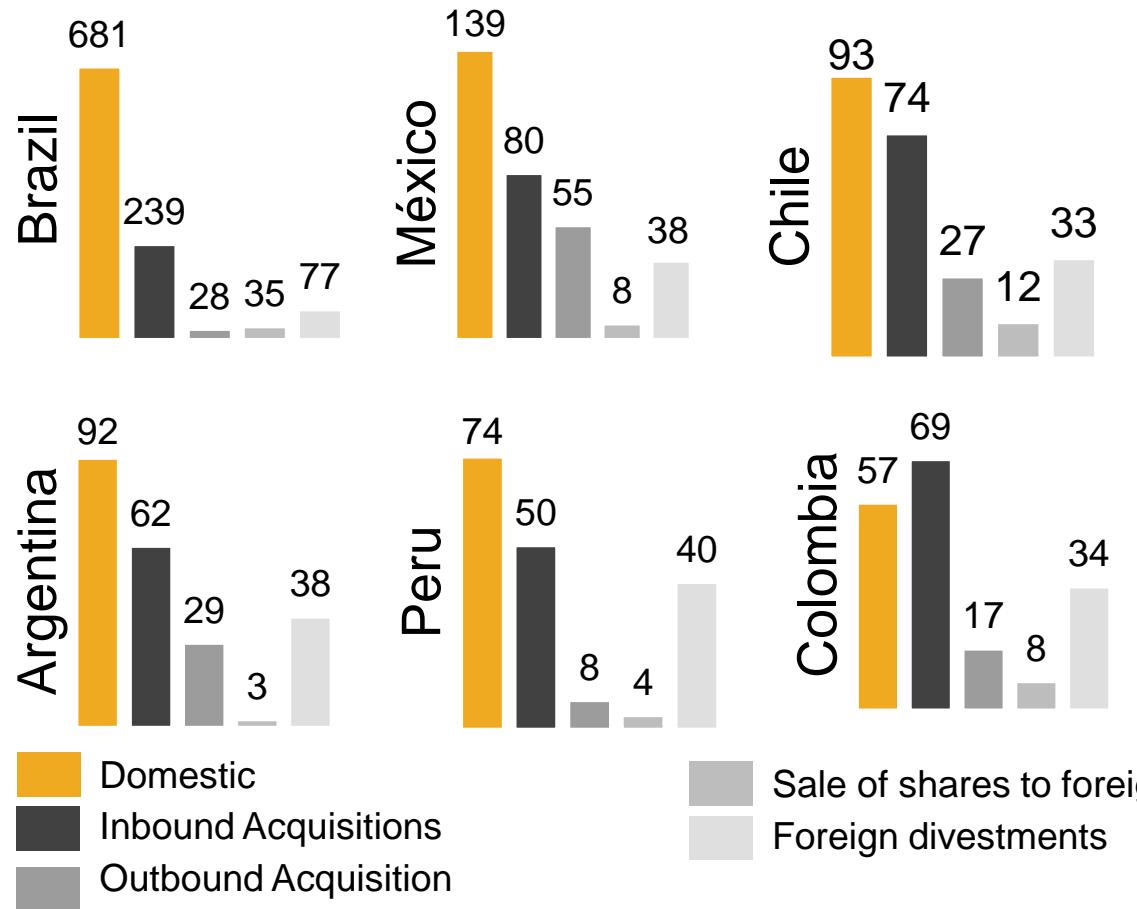
Medical Services and Equipment

Source: INADEM

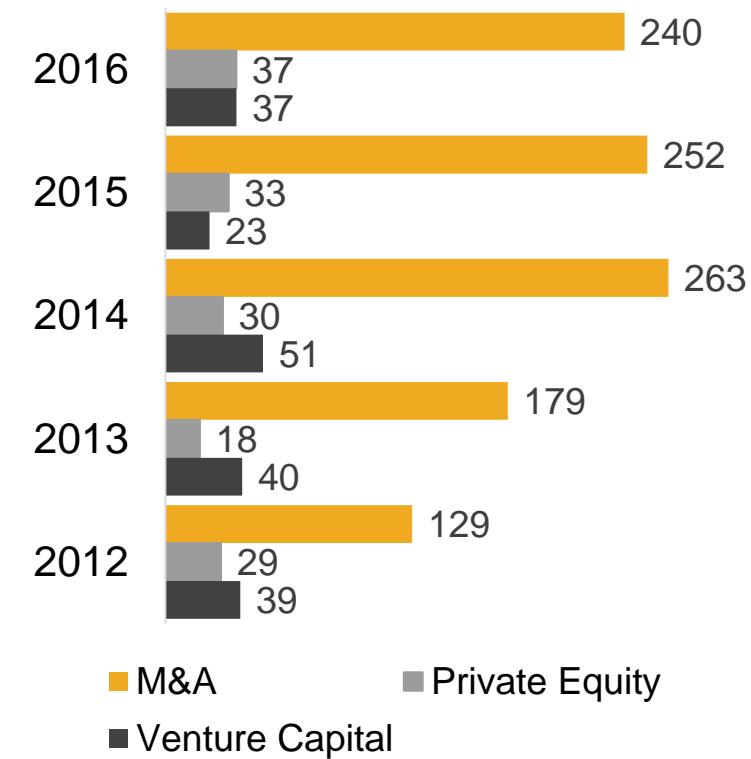
Buyers and best sources of targets

Most of the transactions in Mexico are domestic.

Number of M&A transactions in Latin America main countries 2016



Number of M&A transactions in Mexico per type of acquirer



Foreign investors are coming to Mexico to buy.

Figures in US\$ M

80 inbound acquisitions in 2016*



33 USA	\$4,083
2 Israel	\$2,300
9 Spain	\$1,480
7 Canada	\$1,060
3 Chile	\$1,104

2016	2017F	2018F
\$26,738	\$21,659	\$23,341

 -5.8%

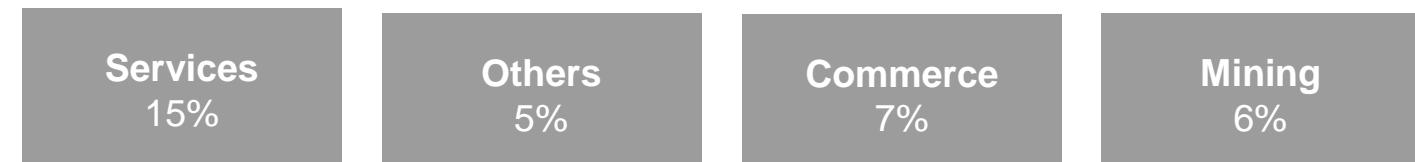
 -19%

 7.7%

Aggregated FDI 1999-2016 by country and sector **

Country	FDI
USA	\$213,534
Spain	\$57,120
Netherlands	\$52,484
Canada	\$27,476
Belgium	\$17,968

3,543 companies with foreign investors



* Includes public transactions only

** Includes public and private transactions

Sources: TTR and ProMéxico

Mexicans are going abroad to buy.

Figures in US\$ M

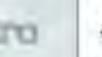
55 outbound acquisitions 2016*



 12 USA	\$1,527
 9 Spain	\$1,211
 8 Argentina	\$ 845
 7 Chile	\$2,024

During the first quarter of 2017, Mexican companies announced M&A investments in the USA alone worth US\$2.4 billion – an increase of 57 percent more than the total amount for all of 2016.

Transactions 1Q 2017

Buyer	Grupo México	VARIV Capital	Bio Pappel	Vitro	IGNIA Fund	Televisa	Arca Continental
Target	 Florida East Coast Railway	 MPOWER Financing	 Planta de papel	 Pittsburgh Glass Works	 Abra	 Acciones de Univision	 "Coca-Cola Southwest Beverages LLC
Seller	Fortress Investment Group	:	Nippon Paper	LKQ	-	Accionistas	AC Bebidas /Coca Cola Refreshments USA
Value	2,100	N.D.	200	310	N.D.	1,200	N.D.
SECTOR	Logistics	Financial	Pharma	Automotive	IT	Media	Beverages

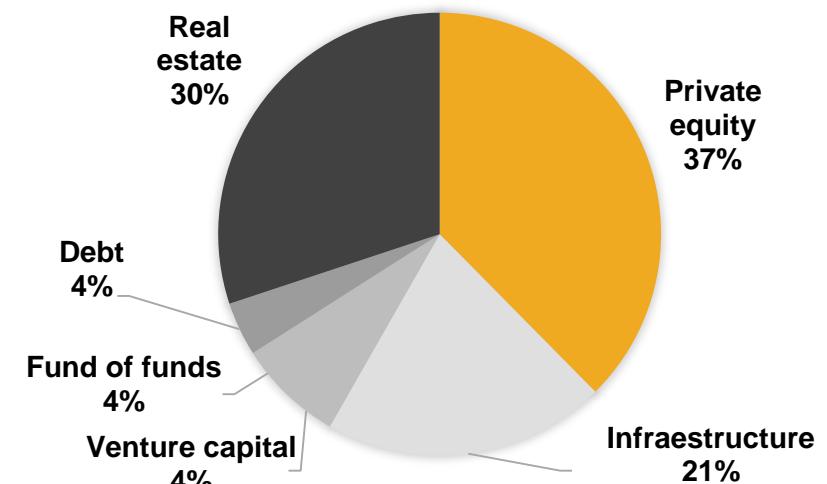
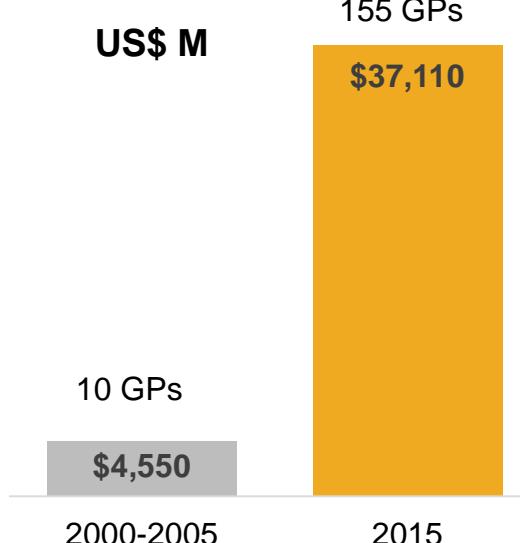
* Includes public transactions only

Private equity is growing in Mexico.



AMEXCAP represents more than 100 private equity companies, entrepreneurship capital and alternative investment funds that actively invest in Mexico. There are three main categories:

1. Seed capital
2. Growth, buyout, and mezzanine
3. Real estate and infrastructure



Member organizations:

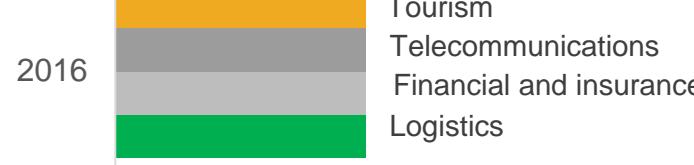
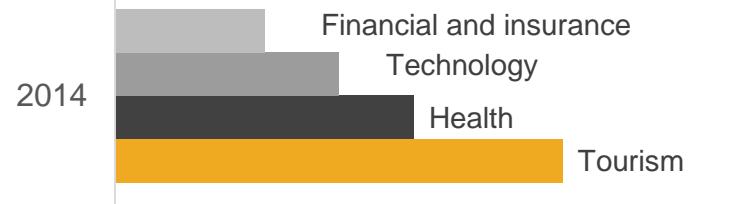
23 Real estate **28** Seed capital **38** Growth, buyout, mezzanine **11** Family offices **6** Institutional investors

Source: AMEXCAP

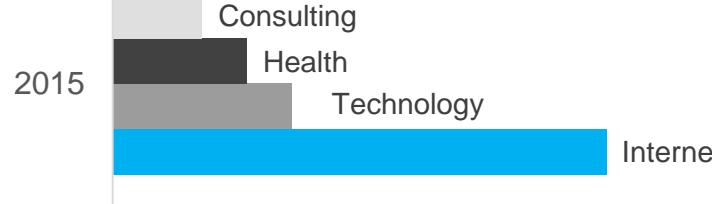
Private equity growth is helping industries improve and accelerate development.

Most Active Industry Sectors (based on number of transactions)

Private equity



Venture capital



FIBRAs (Mexican REITs)

- 10 FIBRAs in operation, accounted for 15% of real estate transactions
- 7% annual dividend yield (2Q 2016)
- By 2030, real estate market in Mexico could double in size

Getting credit is relatively easy, as many international banks operate in Mexico.

More than **70** Investment Banking Institutions



48 Commercial Banks



6 Development Banks



4 largest in Latin America

1. Credit Suisse
2. Deutsche Bank
3. Bank of America
4. Merrill Lynch

Mizuho Bank started operations as of **March, 2017**

Industrial and Commercial Bank of China started operations as of October, 2015

10 largest in Mexico

1. BBVA Bancomer
2. Banco Santander
3. Citibanamex
4. Banorte Ixe
5. HSBC
6. Scotiabank
7. Inbursa
8. Banco Interacciones
9. Banco del Bajío
10. Afirme

Nafinsa, a federal trust fund operates more than 30 different types of credits and warranties for all kind of companies. One of these programs is the:

Fund of Funds

- Created in 1996
- US\$700M of committed capital
- Investing in:
 - Private equity
 - Energy
 - Mezzanine debt
 - Venture capital

Many legal and accounting firms also operate in Mexico.

A lot of legal firms specialize in M&A



5 most important

1. Creel, García-Cuellar Aiza y Enriquez
2. Galicia Abogados
3. Gonzalez Calvillo Abogados
4. Basila Abogados
5. Robles Miaja Abogados

Accounting/Advisory Firms



7 most important in Mexico

1. Deloitte
2. PWC
3. EY
4. KPMG
5. Grant Thornton
6. Crowe Horwath
7. RSM

Financial Advisers

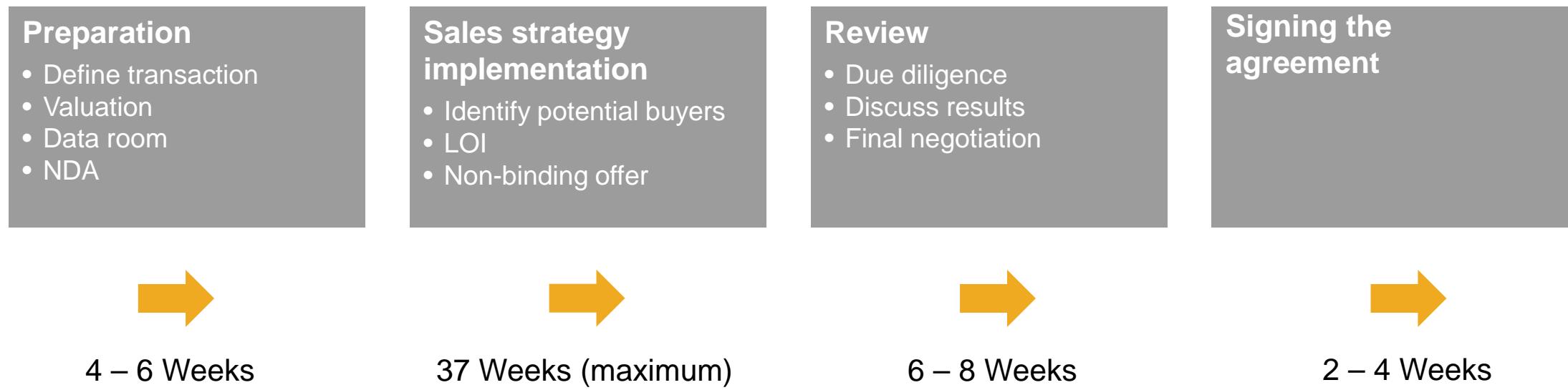


5 most important Q1 2017 by volume:

1. BBVA Bancomer
2. Barclays Bank
3. Morgan Stanley
4. Citigroup
5. Bank of America

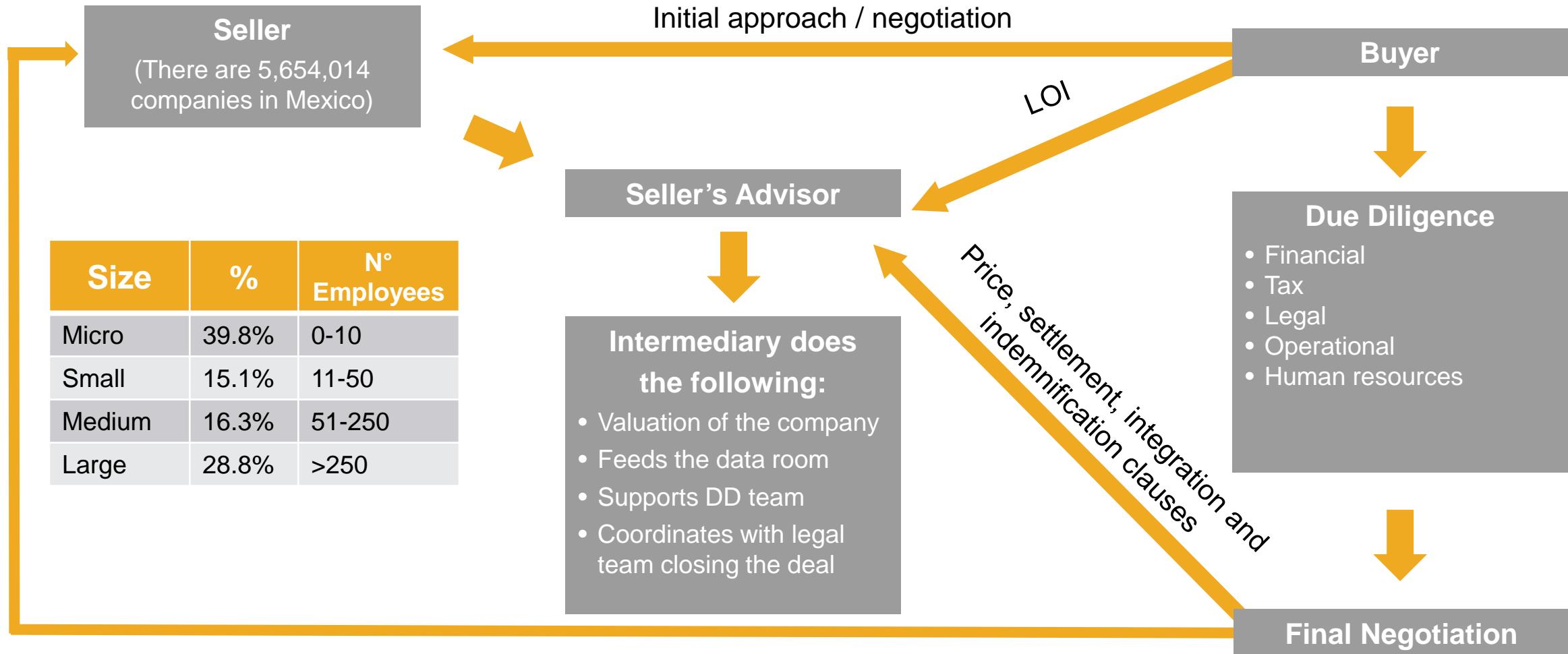
Deal process and financing sources

Timing is essential, but the time frame differs depending on the type and size of transaction.



The full process may take a year to be completed

How are potential sellers best approached? Through an adviser.



Federal laws govern M&A transactions.

In general, **Federal laws** govern commerce and commercial activities.

All matters dealing with commercial or business entities, banks, commercial transactions, negotiable documents, etc. are governed by **federal laws that will apply the same throughout the land.**

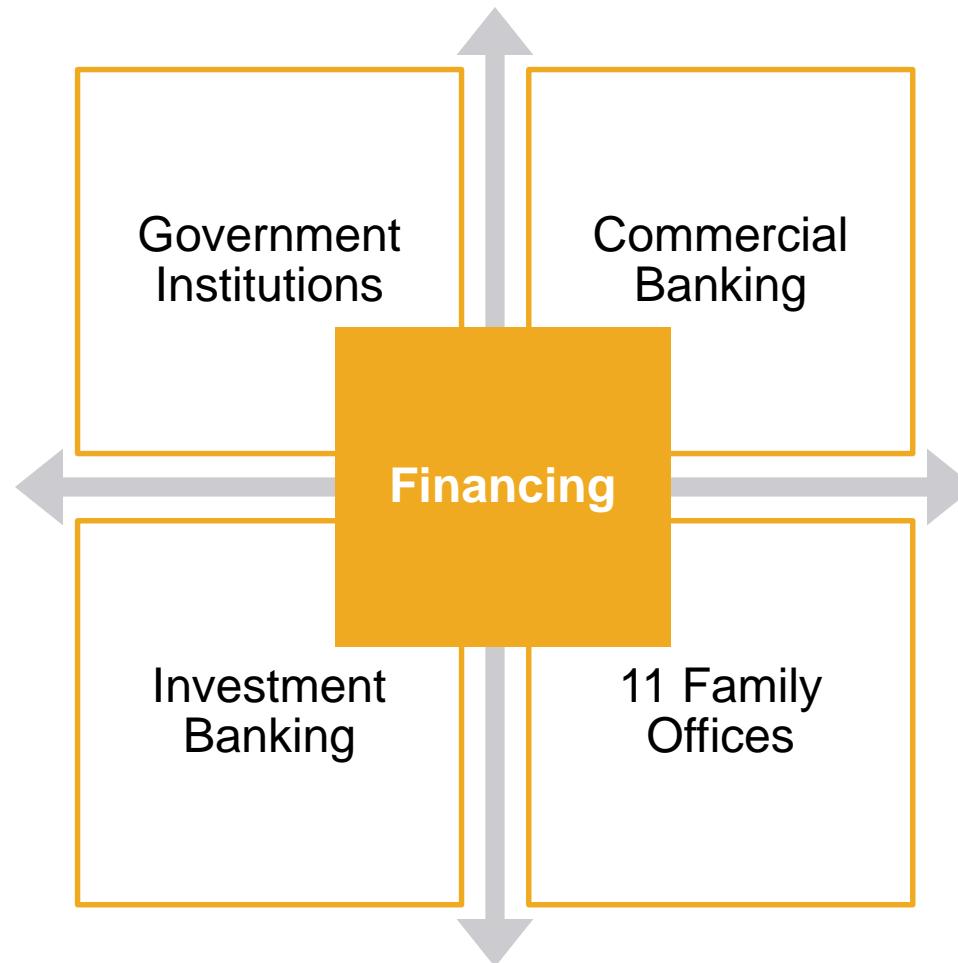
Mexican Laws and Regulations

- The Mexican Law of Business Corporations
- The Mexican Stock Market Law
- The Mexican Antitrust Law
- The Mexican Commerce Code
- The Federal Civil Code and relevant state civil codes (in this latter case when real property is involved)

All of these arrangements are commonly used in Mexican M&A deals.



Who provides financing to M&A transactions in the country?



The Mexican government provides support to domestic and international investors.

Domestic transactions and entrepreneurship:

- **INADEM (National Institute of the Entrepreneur):**
- Offers funds through different calls depending on the project type, size, and region
- **Nafinsa (Nacional Financiera):**
- Offers guarantees and provides credit to different segments of the population
- **Import Tax Refund to Exporters (Drawback):**
- Offers the possibility of paying back a duty previously paid on exporting excisable articles or on re-exporting foreign goods.

Foreign trade incentive programs:

- **Manufacturing, Maquila and Export Service Industry (IMMEX):** Temporary importation of goods.
- **Tax incentive programs**
- **Technological development and innovation programs (CONACYT)**
- **Sectorial Promotion Programs (PROSEC):** These programs are aimed at legal entities that produce certain goods, allowing them to import diverse goods for use in the development of specific products at preferential ad-valorem tariffs (general import tax), regardless of whether the goods to be produced are for export or the domestic market.

Source: ProMéxico,
Nafinsa, INADEM

Role of federal and local government entities in M&A process

Approvals are required related to competitiveness, health risks, and FDI.



Federal Economic Competition Commission

Founded in 2013, this government institution establishes conditions of effective competitiveness



Federal Commission for Protection Against Health Risks

Regulates the following:

- Medicines and health technology
- Toxic materials
- Food safety
- Basic sanitation
- Environmental risks
- Etc.



Secretariat of Economy

Regulates and keeps statistics on FDI

Depending on the kind of industry and the magnitude of the transaction, approvals may or may not be required. Industries such as energy, oil & gas, and transportation need additional approvals based on specific regulations.

Anti-bribery and anti-money laundering laws are enforced in Mexico.

SNA National Anticorruption System

Coordinates Federal, State and Municipal authorities to prevent, investigate, and enforce the anticorruption law

- 5 new secondary and 3 reformed laws enacted in the past few years
- On October 17, 2012 the Federal Law **“Federal Law for the Prevention and Identification of Operations with Resources of Illegal Origin”** was enacted. This law seeks to enforce the requirements of the Financial Action Task Force (FATF), improve interinstitutional coordination, gather useful information to make better quality investigations, and to pursue crimes with more efficiency
- With this new law, **more non-financial professional businesses** (lawyers, casinos, accountants, notaries, car dealers), **which are vulnerable against this type of crime, are included in the regulatory framework**. This regulation is different from the financial institution framework

Special tax issues

Taxes most important in an M&A transaction.

When doing M&A transactions in Mexico, taxes are frequently on the radar to ensure proper treatment

The following taxes are the most common required for a buyer to obtain solid knowledge by engaging advisers to support the acquirer in the process:

- Federal Corporate Income Tax
- Payroll Tax (social security, retirement and housing, and state payroll tax)
- Value Added Tax (VAT)

It is important to know that the corporate and individual income tax laws are applicable only at federal level as there are no state or municipal income taxes

Tax rates.

- 30% tax on income from outside Mexico
- 10% withholding on dividends; potential relief from double tax treaties
- Payments to foreign residents with Mexican source income
 - 4.9% to 35% withholding on gross income
 - Capital gains (on shares); election to net gain taxation
 - 40% payments to tax havens
- Income tax is the only corporate tax

**Mexico has signed 56 different
Avoidance of Double Tax Agreements**

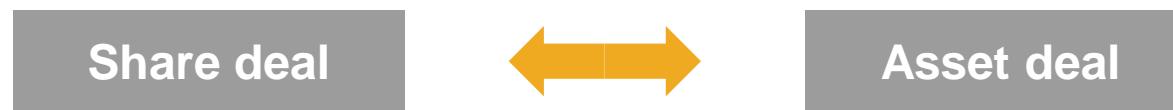
USA (>10% Ownership)	5%
USA (>80% Ownership)	0%
Canada (>10% Ownership)	5%
Netherlands	0%
UK	0%

Share versus asset deal.

The tax structures with possible impact on purchase price are to be considered individually depending on whether the transaction is done as a share deal or an asset deal

Share deal – If the seller sells the shares from a holding company, there will be tax on the capital gain. The tax can be paid as a direct withholding of the sale price or can be paid on the net gain

Asset deal – If the net assets are sold, the gain on all assets will be taxed at the seller level with a 30% corporate income tax (sale price less net tax value at moment of sale)



Value added tax.

VAT is 16% in all Mexican territories – the VAT rules are based on cash basis

In a share deal, in general, VAT is not a big issue in connection with the transaction because no VATs are involved in a share deal

In an asset deal, the investor has to pay 16% on top of the sale price and has the possibility to recover the VAT paid via a refund or offset it against other federal taxes

VAT is also important to consider as part of the due diligence examination of the target company to ensure that the company has properly applied the rules in its operations

In Mexico, there is a five-year statute of limitations

Employee taxation.

Employee taxation is an important issue to be knowledgeable about in connection with a transaction in Mexico

In Mexico, a large percentage of payroll taxes (social security, housing, and retirement) is mostly paid by the employer – about 95% of total

Corporations in Mexico are obliged to pay 10% profit sharing to employees. A large percentage of companies manage employees through external or specialized group labor corporations

Because of this system, the taxation of salary is high and it is a responsibility of the employer to correctly withhold employee taxes and required social security taxes

Tax incentives are available for investors.

- In Mexico, there are many tax incentives including accelerated depreciation of fixed assets and also for green energy projects
- Investment in the following areas results in a credit of up to 10% of corporate income tax paid
 - R&D and innovation
 - Cinematographic and theater
 - High-level athletics

Local GAAP differences to IFRS

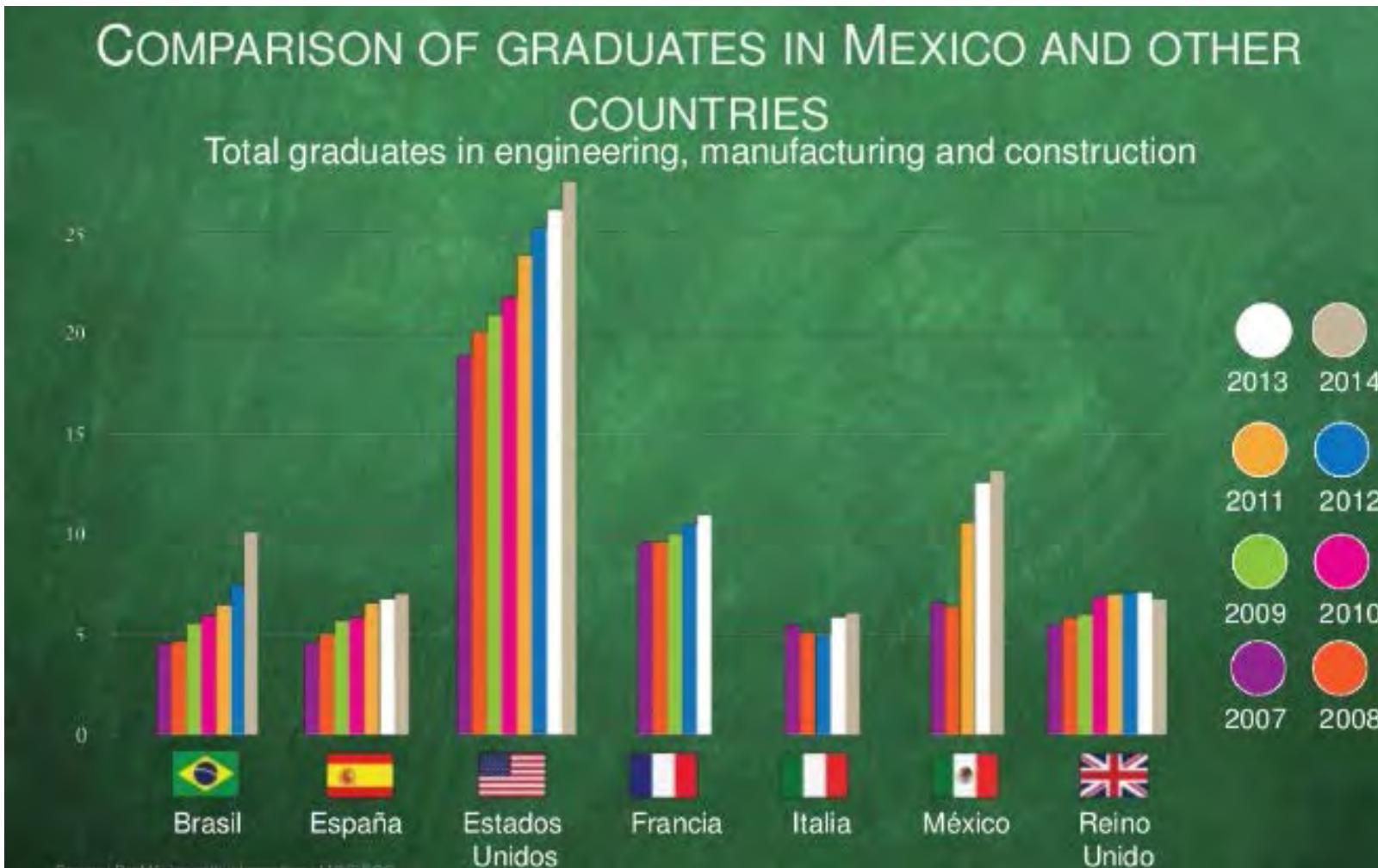
Mexican GAAP has converged with IFRS, other than a few exceptions.

Beginning in 2012, the Mexican Institute of Public Accountants (IMPC) made an effort to make NIF (Normas de Información Financiera, “Mexican GAAP”) converge in almost every way with IFRS. Still, some differences remain. For M&A purposes, the most relevant are:

IFRS	NIF
IAS 16 Property, Plant and Equipment IAS 38 Intangible Assets An entity shall choose either the cost model or the revaluation model for IAS 16 and IAS 38	C-6, C-8 The only choice is the cost model, revaluation is not allowed
IAS 13 Fair Value Measurement	B-17 Created in 2016. Shall be effective in 2018
IFRS 3 Business combinations The acquirer recognizes a contingent liability assumed in a business combination, even if it is not probable that an outflow of resources representing economic benefits will be required to settle the obligation	C-9 Such type of contingent liability recognition is not allowed

Managing the business after an acquisition

Is a local person required to be the lead director or general manager?
Can someone from Mexico fill this role?



For the PMI (post-merger integration) stage, a local person should be part of the management team. Investors will not have problems finding competent employees at all organizational levels

- The economically active population as of 3Q 2014 was 52.4 million.
- The current working age population (between 15 and 64 years) accounts for more than 65% of the total population; such level is expected to remain steady for two more decades.

There are unique culture issues that affect PMI.

Human Resources

7 mandatory holidays per year

10% employee profit sharing

Bilingual employees English - Spanish

2,682 Unions (2013) but no strikes in recent years

The Economy

NAFTA renegotiation creates uncertainty

Presidential election 2018

Anti-corruption system is working

Insecurity is localized in some specific regions of the country

Business

Negotiations can be made in a restaurant

No discrimination issues doing business in Mexico

Some BEPS requirements are mandatory as of 2017

Thank You

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