



# Mexico: Catching the wave

Economic reform, strong demographics and investment-focused corporates mean that Mexico is a market on the move. But how should you deal in a country that also brings complexity?

Corbis/Ivan Vdovin

## Key insights

- ▶ The Mexican economy is set to become the largest Latin American economy within a decade, overtaking Brazil.
- ▶ This growth is partly down to Mexico's strong fundamentals, such as demographics and political reform.
- ▶ Mexico's consumer sector has seen more deals this year than any other industry in the country, in part thanks to developing consumer credit firing the sector's growth.
- ▶ The country has also garnered a reputation as being a key position in corporates' global supply chains.
- ▶ Mexico's multinationals are making big moves into developed markets, such as Europe and the US.

**B**razil might be a darling of investors, but Mexico may soon eclipse it. The country is on course to overtake Brazil and become the region's largest economy within a decade, according to research by investment bank Nomura.

"Mexico is now in the moment, as a result of macro and micro factors and industrial policies," says Roberto Cuarón, Partner, Valuation and Business Modelling, EY, Mexico. "Other countries haven't yet driven away the effects of the 2008 crisis."

A swelling middle class has made investors take note as Mexico integrates into the global supply chain. Mexico's statistics institute, INEGI, has shown that, from 2000 to 2010, the country's middle class grew by four percentage points to 39.2%.

The short-term outlook is also generally positive. Although the International Monetary Fund recently cut Mexico's growth forecast to 1.8% for this year, it expects growth to return to 3% in 2014 as ongoing structural reforms bear fruit. Additionally, capital market activity is thriving. Dealogic figures show that Mexico's equity capital market is having a record year – raising US\$10.4b in 2013.

## Economic reform

A big factor behind the investment drive is the progress of reforms, introduced by President Enrique Peña Nieto since he took office in December 2012. Key to this is Nieto's "Pact for Mexico", a signed accord that pushes cross-sector reforms that are designed to boost annual economic growth



### On the web

For more on entrepreneurship and growth in Mexico, read EY's *The power of three* at [www.capitalinsights.info/mexico](http://www.capitalinsights.info/mexico)

to 6% – a threefold increase on the average of 2% seen since 2000. The scale of the reforms encompasses labor, education, banking, tax, telecoms and energy. For example, this year, Congress has approved an overhaul of the country's telecom laws, opening up the sector to greater competition and to allow more FDI.

"Pact for Mexico" reforms are creating opportunities in sectors previously reserved for state monopolies. Investors had tended to bypass Mexico's hydrocarbon, mining, power and telecoms sectors, seeing them as the preserve of domestic firms. Since 1999, these sectors have accounted for only 9% of the FDI flowing into Mexico. By contrast, they account for 26% of FDI stock in Brazil, 35% in Argentina and 45% in Chile. The reforms are set to change the perception of investors and encourage entry into these sectors.

Although the reforms can provide a boost, experts note that solid foundations are the main drivers behind Mexico's recent wave of investor interest. "The reforms are very welcome, but we shouldn't lose sight of the fundamentals – the changing demographic and robust economic management – that will drive this country forward," says Nick O'Neill, head of fund manager Macquarie's Mexican Infrastructure Investment Fund. "And, if you overlay the reform program on top of this, you have a very compelling investment story."

The generally healthy macro indicators show that Mexico's economy is a good place to invest, says Tania Ortiz Mena, Vice President of Business Development at Mexican energy infrastructure company IEnova. The reforms are the icing on the cake. "We have a new administration that has proven that it can create a consensus with other politicians to pass substantial reforms. There is the expectation that this administration can achieve substantial change," she says.

Mexico's strategic location and growth potential means that companies will continue to acquire Mexican assets, notes Tony Del Pino, Partner at law firm Latham & Watkins, and Co-chair of its Latin America Practice. "Recent big deals have included Anheuser-Busch InBev acquiring Grupo Modelo for US\$20.1b in June. And the Swiss engineering company Foster Wheeler completed its first Mexican acquisition in April. This was a strategic move intended to grow their upstream capabilities, and their geographic engineering and construction footprint in Latin America," he says.

### Deal revival

Deal flow suggests that foreign firms have a strong appetite in Mexico. According to Mergermarket, Mexico saw 30 deals up to Q3 2013. This is the second-highest number in five years.

Mexico is receiving more attention than ever before from both strategic and institutional buyers, according to Del Pino. "Deal size has been on the rise, from the US\$20.1b

acquisition of Grupo Modelo to the US\$1.6b acquisition of Spanish banking group BBVA's pension fund business by Mexican bank Banorte. We're also seeing local companies take larger roles as buyers and investors, as well as more competition for private equity (PE) deals stemming from successful fund-raising by Mexico- and region-focused funds. As such, more deals are being carried out as auctions, which is unusual in Mexico."

The BBVA deal, completed in November 2012, is an example of a Mexican firm diversifying its revenue streams. "The rationale of the purchase of the asset management firm from BBVA was the synergies due to economies of scale in this business," says Fernando Solis Soberón, CEO of Long Term Investments at Banorte and Chairman of Afore XXI Banorte. "Additionally, it will also diversify the source of income for the financial group, given the increase in revenue from the commissions obtained from managing the compulsory retirement savings."

The consumer segment in Mexico – Latin America's second largest – has emerged as a more recent target for foreign investors. With nine deals so far this year, it has seen more activity than any other sector. The largest announced deal is US beverage company Constellation Brands' US\$2.9b acquisition of Compania Cervecera de Coahuila in February.

Outright buys aren't the only route to market. In the late autumn of 2012, for instance, global underwear retailer Triumph International acquired a majority stake in Mexican lingerie firm Vicky Form. Triumph

# 30

Number of inbound deals in Mexico in 2013 up to Q3 – the second-highest number for five years (Source: Mergermarket)

### Top three completed Mexican inbound deals, Oct 2012–13

Completion	Target	Buyer	Deal value
JUN 2013	Grupo Modelo	Anheuser-Busch InBev (Belgium)	US\$20.1b
JUN 2013	Compania Cervecera de Coahuila	Constellation Brands (US)	US\$2.9b
MAY 2013	ABA Seguros	ACE Limited (Switzerland)	US\$865m

Source: Mergermarket



## Mexico

Population  
116.2m (2013)

FDI  
US\$12.7b (2012)

GDP  
US\$1.2t (2012)

Source: CIA World Factbook;  
US Embassy in Mexico

wanted to enter the Mexican market, and saw the local leadership position of the Vicky Form brand as a platform for its own. For Vicky Form, the deal offers the chance to expand internationally. As Vicky Form's CEO José Zaga says: "With this JV, we gain access to some of the world's top commercial intimate apparel brands and the unique opportunity to expand the business model beyond Mexico. The partnership maintains its original plans of further developing Vicky Form in the Mexican markets and the region."

### Building growth

The manufacturing sector boasts pedigree as an FDI magnet. The Economic Commission for Latin America and the Caribbean notes that, in 2012, the sector was the strongest investment draw (absorbing 56% of the total). Among the main deals was Brazilian steelmaker Gerdau's US\$600m investment to build a new structural steel plant in October.

Alongside this, the automotive sector recorded a 75% jump in FDI, to US\$2.4b in 2012. Developed-market automakers have laid down roots as Mexican factories have established themselves in regional and global supply chains. For instance, last year, Audi announced plans to open a new plant in Mexico, which should begin producing cars in 2016.

A spokesperson for Audi told *Capital Insights* that: "Mexico is an ideal location, strategically offering a favorable sandwich position between North and South America."

The decision to locate in Mexico is aimed at safeguarding the automaker's competitive position on global markets, lowering its costs and increasing profit margins. And, it should provide a competitive advantage with consumers. As Mexico

is part of several free-trade agreements, it will be able to ship its cars duty free to the US, Latin America and Europe. If, instead, it had opted to build a production plant in the US, it would have had to contend with a tariff burden of 10%. The Mexican economy will profit by Audi's decision to set up its San José Chiapa, with the creation of about 3,800 new jobs. This will create a further 20,000 jobs for the periphery, the suppliers, logistics and service providers.

M&A activity in Mexico is in line with the long-term FDI trend. Pablo Coballasi, who heads corporate finance house PC Capital, says: "There's a correlation between international cross-border M&A and FDI. A lot of international investors are looking at the macro trends. The fundamentals have given them the confidence to come and expand by making current operations larger, or expanding within the market through M&A."

According to Olivier Hache, Managing Partner for EY's Transaction Advisory Services in Mexico and Central America, some of the deals are driven by Mexico's position in the global supply chain, particularly in the automotive industry.

"If you're an automaker, you might decide to have a supplier situated near your factory. If that's in Mexico, then the parts supplier

## Mexico's movers: looking beyond their borders



According to Banco de México, Mexican firms invested US\$25.6b outside the country in 2012, 111% more than in 2011. Brimming with confidence, these firms are now eyeing US and European

opportunities. For example, in April 2012, loan provider Grupo Elektra bought Advance America, the largest US payday lender, for US\$780m.

So what are Mexican firms looking at when acquiring abroad? "Once, it was only very large Mexican firms with the capacity for outbound acquisitions, but last year, Mexico exported more FDI than it received – the first time this has happened in five years," says Pablo Coballasi. "This reflects the greater availability of liquidity in local markets and the balance sheet strength of

Mexican corporates. Price is another factor. Asset prices in Europe and the US are cheap compared with previous years."

This has led to global market leaders with Mexican roots. "Cemex was a very large consolidator in the industry and has grown to have operations pretty much around the world," says Coballasi. "The same is true for other large corporates, such as América Móvil (AM). It set out to expand not just within Latin America, but also in Europe." In August, for instance, AM bid US\$9.6b for the 70% of Dutch telecom group KPN it doesn't already own.

# Viewpoint



**Peter Harbula** of prepaid services provider Edenred discusses the practicalities of investing in Mexico

has to be, too. This can sometimes be more about direct investment than pure M&A," says Hache.

The services sector has also sparked interest among corporates. This year, Swiss insurer ACE Group completed a deal for ABA Seguros, Mexico's fourth-largest auto insurance company, for US\$865m. Mexico's position as a bridge for the wider Latin American market was a key factor here. After the deal, Evan Greenberg, Chairman and Chief Executive Officer of ACE Limited, said that ABA Seguros' reputation and creativity was something "that can be leveraged across Mexico and the Latin America region."

## Overcoming the obstacles

M&A in Mexico still poses challenges, though. One is the lack of institutionalization within family-owned firms. "Mexican companies are used to running things in a 'family way' and are, therefore, not accustomed to bringing in new money or giving away a slice of their business," says Fernando de Ovando, Senior Partner at the Mexico office of international law firm Jones Day.

Such ownership can make them less transparent, posing a challenge to buyers seeking to make large investments and implement strategic changes. "Diligence and control issues are key questions. Partnering with excellent international and local advisors is a prerequisite," says Del Pino.

There has also been growth in PE funds that prefer to take on significant minority or controlling stakes while keeping local partners involved. PE investment in Mexico has grown rapidly in the last few years, with US\$14.9b in capital having been committed to PE investments since 2000. "That's a pretty sizeable pool of capital, and PE is going to become more and more important as family business owners get more educated about the benefits of having a PE partner," says Coballasi.

## How to ride the wave

For corporates looking to thrive in Mexico, here are three key factors to consider before investing:

**Get local know-how.** "Before you get into a deal, you need an advisor who knows the market and can help you not only with the general structure of the deal, but also the cultural aspects of doing a deal in Mexico," says de Ovando.

**Embed roots.** Investors need to be sure that key shareholders are involved early in the M&A process. "Once a deal is closed, you are going to need a local management team and local ownership to help guide you through the first years of the operation. It's key for the buyers to get to know the market with locals, so that they can become experts themselves as time passes," says de Ovando.

**Understand the system.** Deal-makers must keep a close eye on the specific set of factors unique to Mexico, such as foreign

The reason why Mexico is attractive to us is based on a number of trends, but one key trend is the growing formalization of the Mexican economy. The market has become more and more mature. Compared with previous years, more companies are declaring their full number of employees. As our services are meant for people on the official payroll, this is a robust medium-term growth driver.

Mexico is a strong market that offers sustainable growth opportunities, especially in light of its location and its close ties to the US, and helped by its membership of the North American Free Trade Agreement. There is good growth potential in the business-to-business services sector, the area in which our company is active. Services are growing very fast in Mexico.

We have been present in Mexico for 30 years. Investing in Mexico is, in a way, not so different to more developed economies: the financial and legal procedures are broadly similar, for instance. But there is a Latin American touch in the importance given to personal contacts, face-to-face meetings and establishing trust. Things agreed by handshake and verbal agreements are matters that are regarded with high importance.

Mexico is one of our top countries: our core products in the country are the food and meal vouchers, as well as the expense management solutions, for corporate fleets. The meal vouchers market is based on a regulation under which employers provide food and meal vouchers to their employees that exempt both of them from taxes. Mexico contributes largely to our organic growth.

*There is a Latin American touch in the importance given to personal contacts and establishing trust*

**Peter Harbula** is Corporate Finance Director at Edenred

ownership restrictions on certain industries. Tax and labor laws are also key. Roderick Branch, a partner at Latham & Watkins, says: "Tax matters, particularly the availability of applicable tax treaties, are key. Traditionally, labor laws have posed a particularly difficult set of challenges. Formal requirements inherent to Mexico's civil law system, such as notarization and public filings, need special attention that can affect structuring."

While challenges such as ownership restrictions and legal differences exist, for those prepared to persevere and set up in a rapidly growing, yet mature, economy, such obstacles are well worth overcoming. 🇲🇽

For further insight, please email [editor@capitalinsights.info](mailto:editor@capitalinsights.info)