



Mergers & Acquisitions

2017

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Editors:

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Mexico

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Overview

The main laws regulating mergers and acquisitions and in general, all type of business combinations in Mexico, are: the Commerce Code, which generally regulates all commercial acts and transactions; the Federal Civil Code, regulating relationships between individuals and private or public companies; the Corporations Law, regulating company structuring and mergers; the Bankruptcy Law, regulating corporate restructuring; and the Law of Negotiable Instruments and Credit Transactions, which provides the legal framework for the possession and transfer of shares and other negotiable instruments. All of these laws have a nationwide scope of application in their Federal character.

There are also other complementary laws that may apply depending on the nature of the transaction, the entities involved, and their corporate purpose and nationality, such as the Securities Market Law, the Federal Antitrust Law, the Federal Labor Law, the Foreign Investment Law and their respective regulations and rules.

Transaction agreements in Mexico may be governed by a foreign law, as is common in global acquisition transactions, while it is also common for them to be governed by Mexican federal or the state laws of the location of the acquired assets. The Commerce Code and the Federal Civil Code are the main laws governing these type of transactions; however, local laws from the states of Nuevo Leon (with Monterrey as capital city), Jalisco (with Guadalajara as capital city) and Mexico City are considered to be the most sophisticated local jurisdictions, and are regularly used to govern transactions – although other new geographical areas, such as El Bajío and Baja California, are emerging as new industrial and commercial poles where mergers and acquisitions activity is also taking form.

Financial institutions, private lenders, funds, bank syndicates and the stock market greatly support fund access for these transactions. Transactions among private companies are commonly governed only by the interests of the parties; while by contrast, transactions involving public companies (companies with shares registered at the Mexican Stock Exchange) are subject to some restrictions overseen by the National Banking and Securities Commission.

There are certain specific industries that are subject to additional restrictions and regulations. Among the most restricted industries are transport, oil & gas exploration (although recently deregulated, as we discuss further in this document), trade, telecommunications and banking. Although less restricted, some other activities and sectors are subject to special regulations when there are foreigners involved, such as insurance, explosives, newspapers, air transport services, border administration services and others.

Additionally, there are special programmes designed to encourage investors and new development in specific industries. The manufacturing and development sectors are among

those incentivised, in addition to industries benefiting from various international treaties approved by the Mexican government. Most importantly, the recent energy reforms set in motion a major agreement shift, which is now allowing foreign and Mexican private companies to work in activities that in the past could only be undertaken by the Mexican government-controlled Petroleos Mexicanos (Pemex).

The steady economic growth of the country in recent years has caused an increase in mergers and acquisitions activity. New growth areas across the country offering infrastructure and skilled human capital, and the looming presence of a private equity funds market, are attracting foreign capital into different investment areas such as the energy, mining and technology fields.

Significant deals and highlights

In 2016, the Mexican M&A (mergers & acquisitions) market registered a 9% decrease in value, despite a 2% increase in the number of transactions compared to 2015. In number of transactions, the leading sectors were Real Estate (25), Financial (20) and Retail & Distribution (18). Q4 was the most important quarter in M&A activity with 91 transactions, such as OTPP and CPPIB's acquisition of 49% of Autopista Arco Norte at a US\$ 935.96m value range.

We highlight the following as the most significant M&A transactions that occurred in Mexico during the year 2016 by size and scope:

- (a) The private equity fund KKR acquired from Pemex for US\$ 1.2bn, through a sale-and-leaseback structure, some of its infrastructure assets, with a concurrent lease back to Pemex for a 15-year period; the acquisition included pipelines, a system of subsea cables, two non-drilling platforms and a facility for gas compression.
- (b) Acquisition of the totality of the shares of the Mexican clothing retail chain Suburbia by the Mexican department store Liverpool for an amount of approximately US\$ 1bn. Suburbia was a Mexican subsidiary of U.S.-based retailer Wal-Mart Stores Inc. This acquisition involved intellectual property rights for the Suburbia trademark and other related trademarks such as Weekend and Non Stop, as well as 119 stores and lease agreements with Wal-Mart and other related third parties.
- (c) Acquisition of the Ventika I and Ventika II wind farm facilities located in the Mexican state of Nuevo Leon, the largest operating wind farm in Mexico, by IEnova, the Mexican subsidiary of Semptra Energy, for an approximate amount of US\$ 900m.
- (d) Acquisition of 49% of the Mexico City toll highway "Autopista Arco Norte" by OTPP and CPPIB for an approximate amount of US\$ 936m.
- (e) Acquisition of U.S.-based Pittsburgh Glass Works (PGW) by the Mexican glass manufacturer Vitro for an approximate amount of US\$ 310m. Additionally, Vitro announced that it will acquire seven manufacturing plants and two satellite plants in the U.S., and an investigation centre and four glass processing plants in Canada.
- (f) Acquisition of the totality of the shares of Spanish industrial bakery Panrico by the Mexican bread maker Bimbo for an amount of approximately €190m (around US\$ 209m).
- (g) Acquisition of 90% of the shares of the European automotive company ACE by the Mexico-based conglomerate Grupo Industrial Saltillo or GIS for an amount of approximately US\$ 80m.
- (h) Acquisition by Mexican retailer Soriana of 96.31% of the shares of its competitor, Mexican retailer Controladora Comercial Mexicana, for approximately US\$ 1.6bn, and

which grew Soriana’s facilities to 143 stores, in addition to other assets and includes the use of trademarks and technology platforms.

- (i) Acquisition of Vonpar, one of the largest private bottlers in Brazil, by the Mexican multinational beverage company, Coca-Cola FEMSA, or KOF in a deal valued at approximately US\$ 1.1bn.
- (j) Acquisition of Cerámica San Lorenzo, which markets and manufactures ceramic floors and coatings, by Mexican Grupo Lamosa for approximately US\$ 230m.

Key developments

During 2016 the Corporation Law, one of the key laws that govern mergers and acquisitions in Mexico, was amended to include the Simplified Stock Corporation (*Sociedad por Acciones Simplificada*, or “**SAS**”) as a new type of corporation, being the first single-member corporation in Mexico allowing one or more individuals, Mexican or foreign, to incorporate a company in an easier and more efficient manner. Although the scope of operation is certainly limited for the SAS, this amendment to the Corporation Law represents a big step towards the simplification and practicality of doing business in Mexico. To summarise the main features of the SAS, we can mention the following:

- (a) It can be incorporated by one or more shareholders, who should be only individuals, with a simple process of incorporation, since it can be done electronically.
- (b) The total annual revenues of a SAS cannot exceed MXN \$5,000,000 (approximately US\$ 250,000).
- (c) It has no limitations on foreign investment.
- (d) Its shareholders can incorporate the company electronically without the need of a notary public, expressing their consent through the standard form of bylaws available in the electronic incorporation system at the Ministry of Economy’s website.

Other significant law applicable to mergers and acquisitions in Mexico which was recently created is the new **Insurance and Bonding Law**. It came into force since April 2015; however, certain relevant aspects were not effective until the year 2016. This Insurance and Bonding Law reinforces Mexico’s position in the bonding sector, which has a steady growing market, even prior to the implementation of this new law. To summarise the main features of the Insurance and Bonding Law, we can mention the following:

- (a) Implementation of the insurance bond (*seguro de caución*), which blends the legal structure of both the insurance and certain bonding products in an innovative way.
- (b) Modifications to the way of determining the capital requirement of insurance companies, which has traditionally been based on average parameters.
- (c) Creation of a proper framework of self-regulatory bodies for the development of the industry, renewing the framework for the liquidation and dissolution of insurance and bonding companies.
- (d) It creates also the framework necessary to permit insurance companies to carry out mechanisms that will enable them to transfer insurance portfolios to vehicles offering securities to the investing public.
- (e) It provides for information disclosure requirements with respect to information and risk management.
- (f) It envisages strengthening the insurance companies’ corporate governance.

Along with the reforms in the Oil & Gas and Electricity sectors which derived in the

new Federal Hydrocarbons Law and the Electricity Industry Law and all their applicable regulations during the year 2014, some amendments to the **Foreign Investment Law** also became effective on August 12, 2014, related to the exploration and production of hydrocarbons, the planning and control of the national power grid and the transmission and distribution of electric power, which will remain strategic activities to the Mexican state, but the private sector would be open to participate in them in certain cases and subject to certain conditions. Also, some amendments were made to enable:

- (a) The free participation of foreign investment in: (i) gasoline and liquefied petroleum, gas marketing and the supply of fuel; (ii) the use of vessels operating in inland and coastal waters, and on the high seas that offer support services for the exploration and exploitation of hydrocarbons; and (iii) the construction of pipelines for the transportation of oil and its derivatives, and in oil and gas drilling wells.
- (b) Petrochemical manufacturing is no longer a strategic activity of the Mexican state.
- (c) Starting January 1, 2017, the Energy Regulatory Commission (CRE) is analysing and granting permits for the sale of gasoline and diesel to the public, and Pemex may not limit the supply of these products only to those who have franchise agreements with Pemex.

Competition was encouraged since the Reform in Telecommunication was approved back in 2013 with the publication of the new **Federal Law of Telecommunications and Broadcasting**. Such reform eliminates, among others, the 49% limit on direct foreign investment in the telecommunications sector, and it forced market-controlling America Movil to open its infrastructure. Since then, many new players have arrived in this sector and acquisitions have been recorded; such as AT&T acquiring Isuacell and Nextel, and Grupo Televisa acquiring Television Internacional (TVI) in year 2016. The main purposes of this new law are as follows:

- (a) To regulate the use of radio spectrum, public telecommunications networks, orbital resources, satellite communication, public telecommunication services provision and the process of free competition in these sectors.
- (b) To strengthen the rights related to freedom of speech and access to information.
- (c) To adopt measures in order to encourage competition in open and pay television, radio, mobile and fixed telephony, data and telecommunications services in general.
- (d) To create conditions to increase substantially the telecommunication infrastructure and the obligation to make its use more efficient, which has a direct impact on the lowering of prices and increase of service quality.

Industry sector focus

- (a) **Energy industry.** Since the energy reform in year 2014, the Mexican energy market and the power sector have opened up to foreign and private opportunities and this is expected to reverse declining Mexican oil productivity. The most important events of year 2016 in the energy sector were: the bid process for significant farm-out agreements with Pemex (the first in its kind in Mexico); the success of the different bidding rounds for different and significant E&P packages; the access granted to third parties for the sale of fuels, triggering with such access the free import of gasoline and diesel during 2017; and the determination of prices according to market conditions starting in 2018. During 2016, the energy sector contributed with an important participation in M&As; a figure of around US\$ 6bn in value of transactions represents an increase of 343%

compared to 2015. Given the high value of the transactions, this sector was one of the main players of the year.

- (b) **Power industry.** Together with the energy industry, the power sector is aiming to be one of the most active business sectors in Mexico in the following years. Since the reforms began back in 2014, the main beneficiaries have been the manufacturers and major industrial conglomerates, major consumers and investment entities participating in electricity generation. The open market in electricity is reacting, bringing international competitors to develop power plants including clean energy fields, bringing technology in such area into the country. Companies such as IEnova, the Mexican subsidiary of Sempra Energy, which acquired the Ventika I and Ventika II wind farm facilities, have been part of the M&A development in this sector.
- (c) **Aerospace industry.** The aerospace industry in Mexico involves all those companies providing manufacturing, maintenance, repair, engineering, design and related services for commercial and military aircraft. Mexico consolidated its position in the sector as a global leader, having a competitive operating environment and strong trade links. It is reported that aerospace investment inflows represent 47% of total foreign direct investment in Mexico. For example, the Canadian company Bombardier in 2016 began outsourcing part of the work on its Q400 aircraft in Mexico, and the French company SAFRAN is planning to invest US\$ 75m in a factory in Mexico for the production of its Leap engine in 2017.
- (d) **Automotive and components industry.** Mexico is also an attractive location for the manufacturing of automobiles and components, offering competitive labour costs and a strategic location for business, having several of the most significant worldwide brands investing in large plants or expanding its current ones. This industry sector contributes approximately 35% to Mexico's GDP. During 2016, Mexico sold a record of 1.6 million units, Nissan Motor Co. being the leading player with a 25% market share, followed by General Motors with a 19% market share, Volkswagen with a 15% market share, Toyota with a 6.5% market share and Kia and Hyundai with a 6% market share, according to the Mexican Automobile Distributors Association. In recent months, this industry has been the most sensitive to any potential trade barriers, which could ultimately result in being imposed by the U.S. for cars imported to such country from Mexico. While it is too early and impossible to determine the effects, if any, of any such potential barrier or increased tariffs, the uncertainty generated has resulted in a number of companies in this sector delaying projects or further investments. This is a key sector of the Mexican economy, which should be closely monitored for future investment and growth opportunities in the country.
- (e) **Construction industry.** Since 2014 the construction industry has left behind its declining phase and begun accumulating months of consecutive growth, mainly driven by private investment, such as derived from M&As. This continuing growth is a consequence of the structural reforms executed by the Mexican government, including the energy sector reform, which allows foreign and local private companies to participate in the oil and gas related products market, and hence, the construction of pipelines, power plants and airports have increased since then. Also the housing construction sector increased in 2016 due to lower interest rates on mortgage loans.
- (f) **Telecommunications industry.** At the end of year 2016, the telecommunication sector registered annual growth of 2.1%. During year 2016, the telecommunications sector reported new operators, M&A transactions between competitors, launching and

incorporation of value-added services, and a significant decrease in the services' prices compared to year 2015. Although the TV market is now widely open for almost anyone who wants to go into the business in Mexico, the constant growth of the over-the-top (OTT) content industry (video and other media transmitted via the internet without an operator of multiple cable or direct-broadcast satellite television systems), makes it the main competitor. OTT content will also generate a new race in the media market and consequently an increase in M&A activity in this sector which has been a constant subject of debate regarding antitrust regulations, given the predominance of the main competitors in the different areas of this industry.

The year ahead

For 2017, the Mexican M&A market seems in some ways to be uncertain, due to uncertainty derived from any potential modifications to the trade policies in the U.S. Considering that Mexico's exports to the USA account for approximately 80% of its total exports, such dependency could have a significant impact on the Mexican economy. However, the improvement of the macroeconomics of Mexico, the recent reforms in strategic sectors like energy, telecommunications and the automotive industry, and any political or implementation stalling of any such Mexican-adverse potential policies by the U.S., could bring M&A activity and competitiveness back on track in 2017.

Although Mexico's manufacturing sector may suffer during the uncertain period while any potential new trade policies are being negotiated by Mexico and the U.S., making it difficult to maintain the investment and growth levels registered in the past four years, other sectors such as telecommunications, technology and other outsourcing services may continue their growth. Another attractive M&A activity could come from Mexico's banking sector, considering the effect that the recent rate increase announced by the FED could have.

Even though the economic forecast for Mexico for this year may be additionally challenged by any potential changes in commercial and trade policies in the U.S., with an expected gross domestic product that will expand by only 1.7%, the Mexican currency's loss in value may generate a perfect climate for M&A activity, as the country may be seen as a good opportunity to invest. We anticipate that the application of the structural reforms, which finally will take a more substantial form in the year 2017, the current situation of the country, and the internal activity that seems to continue its normal growth, will be reflected in mergers and acquisitions in a diversity of sectors such as real estate, energy, financial and retail.

There is no doubt that 2017 will be a challenging year for Mexico and its M&A activity, but any potential changes in commercial and trade policies in the U.S. have also brought increased awareness from local and foreign investors of the new opportunities that a major change in the relationship between Mexico and the U.S. could create.



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