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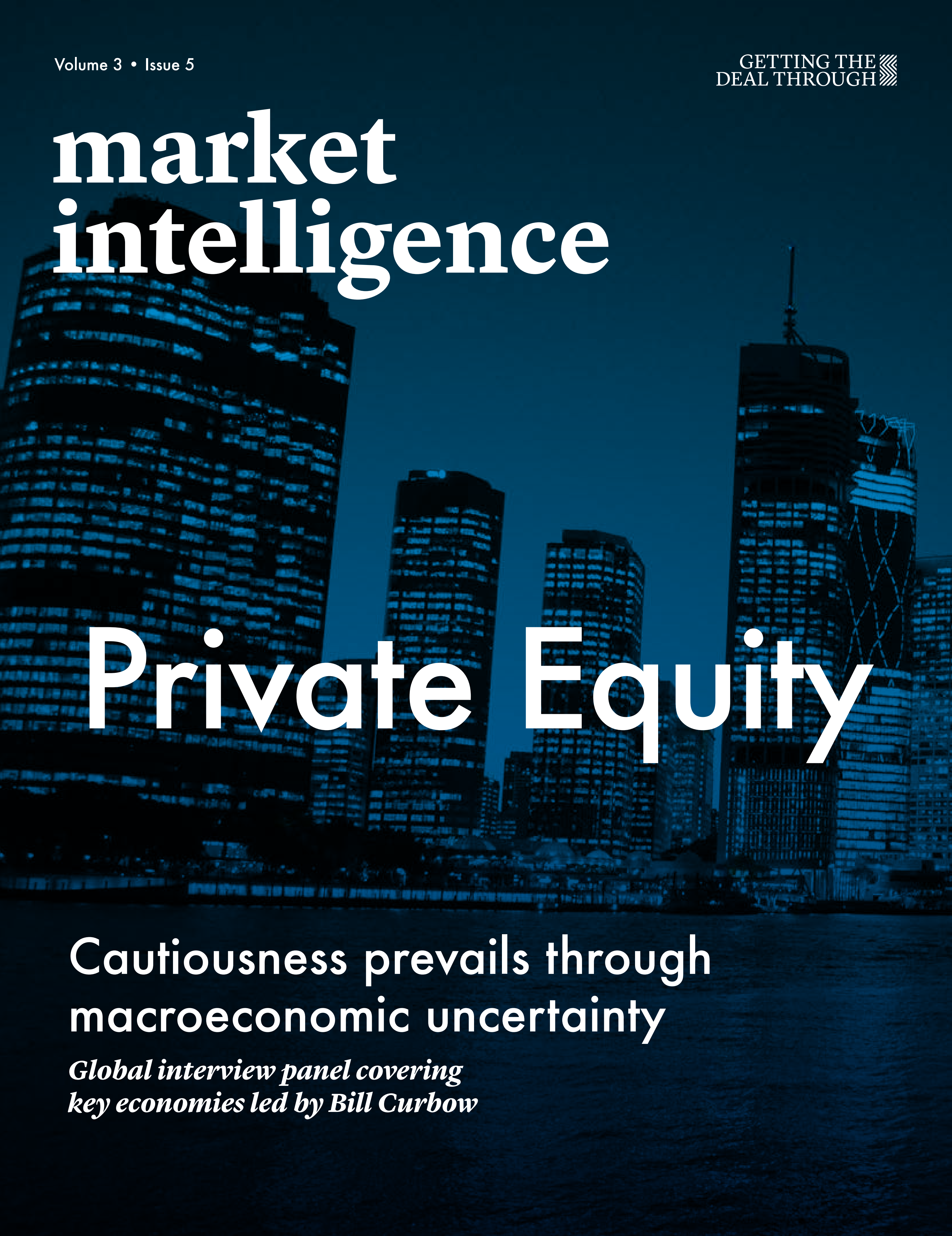
GETTING THE DEAL THROUGH

market intelligence



Private Equity

Cautiousness prevails through macroeconomic uncertainty

Global interview panel covering key economies led by Bill Curbow

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Europe • North America • Asia-Pacific • Latin America

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GETTING THE DEAL THROUGH

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Welcome to *GTDT: Market Intelligence*.

This is the third annual issue focusing on global private equity markets.

Getting the Deal Through invites leading practitioners to reflect on evolving legal and regulatory landscapes. Through engaging and analytical interviews, featuring a uniform set of questions to aid in jurisdictional comparison, *Market Intelligence* offers readers a highly accessible take on the crucial issues of the day and an opportunity to discover more about the people behind the most interesting cases and deals.

Market Intelligence is available in print and online at www.gettingthedealthrough.com/intelligence

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In this issue

Luis Burgueño

Andrés Nieto

PRIVATE EQUITY IN MEXICO

Luis Burgueño is a partner at Von Wobeser y Sierra SC with more than 18 years of experience advising global leading corporations that are part of the Dow Jones, S&P, DAX, Nikkei, Bolsa Mexicana de Valores, the Fortune 500 and Forbes 100. His practice covers banking and finance; corporate, structured and project finance; energy and natural resources; foreign investment; M&A; joint ventures; and securities and capital markets.

Luis has been involved in a number of matters related to transnational companies in Mexico, Latin America and the Caribbean.

Andrés Nieto is a partner at Von Wobeser y Sierra SC with more than 16 years' professional experience in Mexico, New York and Latin America. His clients appear in the Fortune 50 and Fortune 500, as well as the Dow Jones, S&P 500, DAX and the Nikkei.

Andrés has a multidisciplinary practice, with an emphasis on cross-border transactions, which includes experience in several of the principal transactions that have taken place in Mexico and the United States in the legal areas of banking and finance, securities, corporate and M&A, as well as in venture capital transactions, private equity, structured financing, project finance, mediation and arbitration.

What trends are you seeing in overall activity levels for private equity firm buyouts and investments in your country during the past year or so?

Luis Burgueño & Andrés Nieto: Even though oil prices have fallen, the benefits of the energy reform of 2013 have emerged in Mexico. For the past two years, the energy sector has assumed an important role in the country due to the opening for private investment. Apart from the energy sector, Fintech, health, telecommunications, real estate and consumer goods and services have also been trends for investors, both national and international, interested in entering the Mexican market. Private equity in Mexico is focused on investment in primarily small and medium-sized companies that are not traded in the stock market, with horizontal investments made over three to five years, during which time they seek to build the companies up to later sell their investment in the capital stock, and even doing so, in some cases, through a public stock offer in the securities market.

Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or joint ventures, also being considered?

LB & AN: With the opening of the energy sector to foreign and private investment, capital funds have expanded their investment asset classes to include the energy sector, in both direct majority acquisitions and minority-stake investments. Additionally, and as a result of the opening of such industries to foreign and private investment, both Petróleos Mexicanos (Pemex) and the Federal Electricity Commission, officially 'productive state enterprises', can now enter into alliances, associations or joint venture schemes with foreign investors to develop certain energy sector-related activities in the different downstream, midstream and upstream sectors, which will, in turn, play an important role in the market by allowing capital funds to participate in these types of transactions. Generating new ways to carry out transactions in Mexico will undoubtedly make the Mexican market more attractive to foreign investors.

What were the recent keynote deals? And what made them stand out?

LB & AN: During 2015, two deals stood out from the others. In one case, the fund Credit Suisse Mexico Credit Opportunities Trust II, managed by Credit Suisse Emerging Markets Credit Opportunities (EMCO), raised US$751 million. This fund was created regarding diversified private credit. In the other case, RIVERCK 15, managed by Riverstone Holdings, raised US$733. RIVERCK 15 was a fund created for real assets. These two correspond to the second and third of the largest Mexico-dedicated funds up to December 2015.

Overall, investments from 2000–2014 have been focused primarily on electronic commerce, telecommunications and financial services. However, as we mentioned before, two more sectors are now gaining more investments: health and consumer goods and services.

Does private equity M&A tend to be cross-border? What are some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal? Are those challenges evolving?

LB & AN: The greater part of private equity in Mexico comes from foreign investors and there is, therefore, a tendency to engage in cross-border transactions. Besides, Mexico's regulations generate interest in global investors and there are several industries that offer great opportunities for private equity. Private equity M&A in the country continues to grow also because of the exit options, which are expected to increase in the next few years.

For legal advisers in Mexico in the area of private equity, the main challenges are knowing and understanding the needs of all the practices involved in these kinds of transactions. In this regard, the legal advisers must know the practices and the legal structure of the private equity investors, as well as be familiar with the company culture in Mexico. As many Mexican enterprises are family businesses, they tend to be reluctant to surrender control of their companies. There are also various challenges to be overcome in an international transaction that can have implications in labour, tax, finance and other areas.

What are the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

LB & AN: Private equity in Mexico is increasing significantly as a result of several financial reforms that have taken place in recent years. The government´s developments have had a favourable impact in the market, promoting investment even in sectors that were exclusively for the state beforehand, such as the oil sector. Private investments have multiplied every year for the past decade. For the past two years, Mexico has been a leading market in Latin America for general partner investment. Mexico is still below expectations, but capital funds continue to grow within the Mexican market.

Regulation reforms are expected to continue with the private investment growth. Nevertheless, the structural reforms that have entered into force have already had consequences. The energy reform, for instance, has been closely followed by private equity participants due to the opportunities created by the opening of this sector.

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How has the legal and policy landscape changed during the past few years in your country?

LB & AN: Mexico made a series of significant reforms in telecommunications and energy that have created a more attractive environment for private equity; the opening up of oil and gas to private investment is a good example of this. The ending of the state monopoly in this sector with the 2013 energy reform and the new regulations issued have opened the sector to private investment, allowing Mexico to become an attractive market for private equity.

According to Luis Videgaray, Treasury and Public Credit Minister, a possible reform regarding Fintech is planned for the coming months. Mexico currently lacks a legal framework in this area (such is the case for crowdfunding, for example). Since Fintech is already important for private equity and the government is boosting national and international investments, a reform in this sector might further increase activity levels.

What are the attitudes to private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your country, and if so, how has it impacted private equity M&A?

LB & AN: An example of noteworthy resistance to private equity in Mexico has been the lack of competitive markets. According to an OECD study, prices in the country have been 40 per cent higher than if they had been in a competitive market. Consequently, Mexican authorities have worked on competitive regulations and have also sought in recent years to strengthen and promote the growth of private investment in sectors to which they did not previously have access. The government´s support for investments is giving Mexico an advantage compared with other emerging market peers. While this can be seen in both the opening up of the energy sector to private investment and the creation of public funds to encourage the development of small and medium-sized companies, one of the primary challenges facing private equity is the reluctance of the entrepreneurs and families heading many of the companies in Mexico to surrender control of their companies and to accept investment by capital funds as partners or shareholders. Still, private equity has been growing quickly in the past few years.

What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

LB & AN: The exit of an investor normally occurs through the following routes:

- the most common exit route is the transfer of the investor's investment to another company, generally a related company such as a competitor, supplier or client that finds strategic value in it;
- direct transfer to another capital fund;
- a public stock offer on the securities market; and
- the sale of the shares acquired by the investor to the other shareholders of the company.

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

The fact that publicly traded companies are typically controlled outside the stock market (ie, by a family or other closely held group) substantially limits public-to-private equity deals. Mexican firms are very reluctant to give away control or even provide transparency as a condition to accept private equity. Many Mexican firms and their owners and managers lack experience in M&A transactions (ie, M&A is not perceived as an integral part of a firm's growth strategy), so deals in Mexico can move very slowly in some instances, which private equity firms may find frustrating given the fast-paced nature of their typical transactions.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

Counsel should ideally have experience not only in private equity deals, but also in the industry where the target operates, or have experience in similar industries.

The firm should have experts in several areas of practice that are particular to Mexican law (labour, tax, environmental) and to the specific industry where the target operates (eg, energy, infrastructure, healthcare or telecommunications). Many boutique firms have very good transactional lawyers with experience in M&A and finance, but do not have real expertise in other areas of law that are critical to the success of the transaction.

The firm should have enough resources readily available to provide a timely response to private equity clients, for whom time is of the essence.

What is the most interesting or unusual matter you have recently worked on, and why?

Private equity firms are looking at Mexican targets as a base from which to develop their Latin American business and are interested in Mexican firms already doing business in other countries. This results in very interesting projects that involve not only Mexican operations, but also other countries in the region. We have participated in a couple of deals where we have had to lead due diligence efforts, transaction structuring and documentation involving not only Mexico, but also Brazil, Colombia and other jurisdictions. This has led us to develop closer working relationships with other firms in the region and has presented the challenge of having to identify and implement solutions that work not only in Mexico but in other countries as well.

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Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the past few years?

LB & AN: Sponsors that may add value with hands-on expertise and many other management skills are now preferred to pure capital investments. As the markets grow, the speed at which funds change hands is greatly accelerated and this requires that the managing parties are able to respond rapidly and efficiently.

Fundraising activities have been increasing since, in 2009, the government allowed retirement fund administrators to invest in private equity. According to EMPEA's special report on private equity in Mexico, fundraising for Mexico-dedicated vehicles has grown from US$574 million in 2009 to US$2.1 billion in 2015. Moreover, trust in alternative funding schemes has soared recently because of financial stability in increasing return rates. Financial growth and well-publicised successes, together with the latest amendments to the applicable law, have broadened the base for private equity operations. The range of opportunities for private equity has been expanded beyond the usual targets to incorporate a wide variety of projects. Consequently, the possibilities for aggressive expansion in the future seem very promising.

Talk us through a typical fundraising. What are the timelines, structures, and the key contractual points? What are the most significant legal issues specific to your country?

LB & AN: Companies looking to obtain funding to develop their business can do so primarily through: contributions of capital from their partners or shareholders; financing by the government; private equity; project finance; financing by banking institutions; and financing through the securities market. Each of these options requires the preparation and negotiation of different legal instruments that make it possible to carry out these types of transactions, and the time it takes depends on the complexity of each transaction.

How closely are private equity sponsors supervised in your country? Does this supervision impact the day-to-day business?

LB & AN: Generally speaking, there is no specific targeting of private equity sponsors. There are specific provisions in specific acts that require

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compliance, and tax issues must be addressed carefully because of the nature of these operations. Nonetheless, no specific treatment is granted to these players.

Compliance with the different legal provisions is very important. The financial players must be aware of the importance of having well-prepared legal counsel for the design and review of operations. From the point of view of supervision, the authorities do not intervene in the day-to-day business as long as there has been careful planning and design in the early stages of the project. In other schemes, as with publicly listed corporations, issuers of structured equity securities (CKDs) are subject to strict regulation relating to disclosure, directors' duties, corporate governance and minority rights.

What effects has the AIFMD had on fundraising in your jurisdiction?

LB & AN: The AIMFD has had a limited impact on normal operations in Mexico. Only those operations for European fund managers managing AIFs, AIFs established in Europe, and those who market units or shares in Europe, have been directly affected. Therefore, it has not affected all operations.

What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment changing?

LB & AN: Mexico grants benefits to trusts operating investment capital with a view to boosting investment (such as CKDs). For example, trust operation investment activities are not taxed until the revenues are allotted to private hands, and income tax is collected based on the receiver's status (respecting the personal tax status of the funders). These benefits have not only boosted investment, but also served to consolidate these practices in Mexico.

Nevertheless, the most challenging issues involve strict compliance with tax requirements, because to be eligible to receive these benefits all legal requirements must be met (pursuant to Mexican tax legislation). As evidence of the Mexican government's willingness to open the market to new alternative schemes, the tax authorities and other political actors decided to agree not to modify tax legislation. In a bold attempt to boost confidence in alternative investment structures and to foster the development of solid funding, therefore, the tax treatment of investment schemes has been frozen until November 2018.

Looking ahead, what can we expect? What will be the main themes in the next 12 months for both private equity M&A and fundraising?

LB & AN: One of the most attractive prospects in Mexico is the energy sector. Additionally, Fintech and telecommunications appear to be sectors to follow closely for investments, which will be encouraged by regulatory policies.

Other regulation reforms regarding competitive markets and anti-corruption will undoubtedly be an important step towards Mexico playing a significant role globally in terms of investment.

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