The Private Equity Review

Fourth Edition

Editor
Stephen L Ritchie

Law Business Research

The Private Equity Review

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EDITOR'S PREFACE

The fourth edition of *The Private Equity Review* comes on the heels of a solid but at times uneven 2014 for private equity. Deal activity and fundraising were strong in regions such as North America and Asia, but were flat to declining in Western Europe. Nevertheless, private equity continues to play an important role in global financial markets, not only in North America and Western Europe, where the industry was born, but also in developing and emerging markets in Asia, South America, the Middle East and Africa. As large global private equity powerhouses extend their reach into new markets, home-grown private equity firms, many of whose principals learned the business working for those industry leaders, have sprung up in many jurisdictions to compete using their local know-how.

As the industry continues to become more geographically diverse, private equity professionals need guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. This review has been prepared with this need in mind. It contains contributions from leading private equity practitioners in 26 different countries, with observations and advice on private equity deal-making and fundraising in their respective jurisdictions.

As private equity has grown, it has also faced increasing regulatory scrutiny throughout the world. Adding to this complexity, regulation of private equity is not uniform from country to country. As a result, the following chapters also include a brief discussion of these various regulatory regimes.

While no one can predict exactly how private equity will fare in 2015, it can confidently be said that it will continue to play an important role in the global economy. Private equity by its very nature continually seeks out new, profitable investment opportunities, so its further expansion into growing emerging markets is also inevitable. It remains to be seen how local markets and policymakers respond.

I want to thank everyone who contributed their time and labour to making this fourth edition of *The Private Equity Review* possible. Each of them is a leader in his or her respective market, so I appreciate that they have used their valuable and scarce time to share their expertise.

Stephen L Ritchie
Kirkland & Ellis LLP
Chicago, Illinois
March 2015

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MEXICO

Carlos del Rio, Eduardo González and Jorge Montaño[1]

I OVERVIEW

i Deal activity

The Mexican private equity industry continues to undergo significant growth. Since 2000, the number of general partners operating in Mexico has increased 15-fold, reaching 125 managers in 2014,[2] during which time the PE industry has raised over US$24.76 billion in committed capital. The industry has grown with both domestic and non-Mexican players.

Domestic fund managers initially operated more commonly in the context of 'family offices' given the legal restrictions preventing public pension funds from investing in private equity; however, due to a change in regulations in 2009, Mexican pension funds are now allowed to invest in publicly traded vehicles that are managed by a general partner and that serve as platforms to carry out private equity investments. This triggered a significant increase in the amount of money deployed into the industry (over US$6 billion has been deployed by institutional investors) and in the number of new Mexican private equity firms, such as EMX, Wamex, Discovery, Nexxus Capital and Vertex. It is still expected that new changes to the laws applicable to pension funds will be introduced in the near future permitting pension funds to invest directly in private equity funds (i.e., without requiring the listing of securities in public markets), which should provide further depth and growth to the PE market.

International managers have been continuously and increasingly investing in the Mexican market. Some firms, such as Advent, Southern Cross, Aueros Capital, Linzor and Evercore have actually established a physical Mexican presence, and other firms and

1 Carlos del Rio, Eduardo González and Jorge Montaño are partners at Creel, García-Cuéllar, Aiza y Enríquez, SC.

2 Mexican Association of Private Equity Funds (AMEXCAP).

funds have continued to make investments from their principal offices abroad. Given the market opportunities and relatively stable macroeconomic environment in Mexico, we expect the number of managers participating and establishing a formal presence in the Mexican private equity market to continue increasing.

The sector that has benefited the most from private equity funds has been the real estate industry, to which approximately 43 per cent of the committed capital has been allocated in the period between 2000 and 2014. Infrastructure-related funds have attracted approximately 15 per cent of the committed capital and other general growth and buyout funds 42 per cent of committed capital. Of committed capital, other than real estate and infrastructure, the sectors with most investments with the use of private equity funds were consumer goods, business services, financial services and manufacturing.

In our experience, funds that have more flexible investment strategies, allowing them to take on minority positions, to acquire convertible or other mezzanine-type securities, and which do require them to make control investments, have been most successful in Mexico. The legal framework in Mexico is developed enough to provide these sponsors with adequate protections that would be expected in any private equity transaction regarding corporate governance and their exit strategy. By having such a flexible investment strategy, the investment opportunities that are available increase significantly, particularly given that a significant majority of businesses deemed attractive for private equity investors are family-owned enterprises, many of which have been handed down for generations, and which – for different reasons – are not eager or not quite ready to give up control.

Exits by PE funds are through the traditional channels: strategic buyers, other PE funds, initial public offerings (IPOs) and buyouts by management or existing shareholders. According to AMEXCAP, there were 84 exits between 2000 and 2014, of which 41 per cent were transactions to a strategic buyer, 28 per cent were to existing shareholders through a recapitalisations or otherwise, 17 per cent were through IPO and 14 per cent were to another private equity sponsor. These statistics are representative of the Mexican marketplace and of the benefits that PE funds can bring to a company. The high percentage of strategic buyer transactions is a reflection of how PE funds can help make companies more attractive by increasing their revenues and profitability, as well as by instilling better corporate governance practices. It is not surprising that sales to management and existing shareholders is the second most common exit, given the desire of many family-owned business to remain as such. While IPO exits have been growing, that is an exit strategy that should be available more often as the capital markets in Mexico become deeper over time. Sponsor-to-sponsor transactions may increase as the venture capital market grows and the companies in which those investments are made become attractive to growth capital funds.

Between January and September 2014, there were 41 private equity transactions reported to AMEXCAP, of which 11 were in the real estate sector, 14 were growth capital in varied sectors such as consumer goods and technology, media and telecommunications, 12 were venture capital investments and four were investments in the infrastructure sector. Figures as of the end of 2014 are not yet available.

ii Operation of the market

Management incentive plans

Generally, management incentive plans, particularly stock incentive plans, remain quite novel in the Mexican market. Their introduction has currently been pushed to a significant extent by the participation of institutional money in Mexican companies. Traditional family-owned businesses have tended to stay away from granting their employees stock options or other equity-based compensation. There has been a clear distinction as to who the owners are and who the employees are, which is not to say that top executives are not often offered cash, performance-based bonuses. As private equity and other international participants have made investments in Mexico, the culture of aligning the interests of management with those of the shareholders has permeated into those businesses that have attracted such kind of capital.

Considering that institutional investors, such as private equity sponsors (even if domestic), follow international investment and corporate governance standards, the types of management incentive plans that are being implemented are similar to those that would be found in the United States or Europe, being mindful at all times of technical Mexican legal provisions that one must abide by. As such, and depending on the needs of the specific company and the negotiations with management, in the context of a private equity investment, it is common to structure stock option plans, stock grants and phantom stock plans to high-level officers.

Stock plans and stock grants are usually structured by adopting general principles of the plan at a shareholders' meeting of the relevant company, and they are implemented through a trust to which the shares that will be the subject matter of the grant or plan are conveyed. The shares remain at the bankruptcy-remote trust until the vesting of the grant or plan occurs, which is usually over a three- to five-year period, at which time the relevant shares are delivered to the employee in exchange for the pre-agreed upon consideration. It is also common that upon the occurrence of an IPO any unvested options or grants are accelerated so that the employee may monetise such grants or options in the open market. One does have to be careful when structuring these plans to avoid triggering adverse labour and tax consequences for the company and the beneficiaries of the plan.

Standard sale process

A private equity fund typically approaches the target portfolio company a few months or even a year prior to the time when an investment is agreed upon. It can take time to convince family-owned businesses that have been handed down from generation to generation that an investment by an institutional investor does not necessarily equate to relinquishing its company, and that it can mean increasing profitability and maximising results for all shareholders. Likewise, boutique and major investment banks are now more frequently procuring sale processes for their clients in Mexico, which means that the process is longer than if bilateral negotiations take place from the beginning. As there are more participants in the private equity industry, banks know that they can call upon a long roster of prospective investors.

Once the parties engage in exclusive negotiations, the deal can move quite quickly, although timing can depend greatly on a variety of factors, such as whether:

a the deal is in a regulated industry that requires prior governmental approval for the investment (e.g., the airline industry);
b the deal is of a size that requires antitrust approval;
c the transaction entails any pre-closing restructuring actions;
d there is a requirement for third-party consents, such as lender consents, to implement the transaction;
e the entire shareholder constituency is in favour of the transaction and whether they are required to act as a bloc;
f the target company can efficiently provide information for purposes of the business, accounting, tax and legal due diligence; and
g all parties in the transaction have engaged legal counsel that is familiar with these types of transactions.

II LEGAL FRAMEWORK

i Acquisition of control and minority interests

The full array of private equity transactions have been structured and completed in Mexico in recent years. Traditionally, most international private equity investors with a presence in Mexico tend to favour majority or control acquisitions, while local investors tend to be more flexible and open to acquiring minority stakes. Transactions involving convertible debt and hybrid instruments are less prevalent. Funds, and most specifically CKD funds (which are publicly offered in order to be able to receive funds from Mexican pension funds), are formed as Mexican trusts established with a Mexican trustee. In turn, the funds are managed by a fund manager, typically as an SA or SRL. Trusts are also commonly used to raise funds from other domestic investors (i.e., other than pension funds).

At the time investments are made, foreign funds are typically channelled through foreign pass-through entities established and domiciled in jurisdictions with which Mexico has entered into a treaty to avoid double taxation (e.g., the US, Canada, the Netherlands, Belgium and Spain). As far as investments are concerned, the preference is to have target companies incorporated as SAPIs, because the Securities Market Law (SML) exempts SAPIs from the application of certain restrictive provisions of the General Law of Commercial Companies (GLCC). This exemption allows shareholders to execute shareholders' agreements wherein they freely negotiate investment and governance arrangements otherwise prohibited or limited under the GLCC (e.g., voting restrictions, punitive dilution remedies, transfer restrictions, and liquidity and exit provisions).

Notwithstanding the foregoing, US investors often insist on having target companies incorporated as SRLs, which the US Internal Revenue Service considers eligible for pass-through treatment in the US. Nevertheless, sponsors need to take into consideration that the SAPI gives the sponsor (and its co-investors) greater certainty in terms of the enforcement of minority rights and transfer restrictions, and ultimately its exit strategy through an IPO or otherwise. SRLs cannot be listed on a stock market, hence precluding an IPO exit unless the SRL transforms into an SA.

Generally speaking, Mexico has followed the US and other foreign private equity markets in connection with the typical provisions found in purchase or subscription agreements of private equity transactions which include the execution of shareholders' agreements and the amendment of the target's by-laws to implement corporate governance and other private equity provisions. Private equity transactions in Mexico are subject to commercial law, as are fund managers in connection with their performance requirements (which are further explained below).

ii Purchase agreements

In connection with purchase agreements, sponsors need to focus on due diligence of the target companies and the existing controlling shareholders to address adequate risk allocation of past and existing liabilities. Among the typical provisions of particular concern to sponsors, the following should be considered when carrying out any investment.

Conditions to closing

Purchase agreements will generally include a provision of conditions for closing of the transaction, addressing, *inter alia*, specific actions that the sponsor requires the target to undertake prior to making the investment, mainly to address issues identified during the due diligence process, and if required, depending on the size of the transaction, the need to obtain the approval of Mexico's antitrust authority as well any other required third-party consents (e.g., foreign investment).

Material adverse effect (MAE) or material adverse change (MAC) conditions

When a private equity transaction involves financing, including in going-private transactions, one of the most controversial sections of the loan documents is the section relating to the conditions to drawdown, and specifically the MAE or MAC condition that directly affects the certainty of funds. It is hardly ever the case that the definition of MAE or MAC in the purchase agreements matches the definition in the loan documents, and therefore the 'gap' is generally a risk that the private equity investor is asked to assume. In the context of a cross-border deal, the definition of MAE or MAC becomes even more complex when negotiating political or national risk language within the agreement. Having said that, we see that sponsors are generally more comfortable with the legal and related risks involved in private equity transactions. Increasingly, investors focus on returns and less on country risk.

Post-closing recourse

Purchase price adjustments, holdbacks, carve-outs, cash-outs and escrow arrangements are all provisions commonly used in Mexican practice to adjust the purchase price and reassure the purchaser that it will be indemnified for any losses or purchase price adjustments or reassure the seller that sufficient funds to pay the purchase price exist. Sponsors doing business in Mexico commonly agree indemnification covenants that are usually guaranteed by escrow agreements with respect to a portion of the purchase price paid by the buyer.

Governing law

As far as governing law is concerned, foreign sponsors increasingly allow Mexican law to govern the purchase agreement as well as the shareholders' agreement. However, US sponsors often insist on New York law as the governing law of the transaction agreements (including the escrow agreement) and Mexican law for the shareholders' agreement since it is not advisable to have a shareholders' agreement and by-laws governed by different laws. In any case, when Mexican law is used, disputes are almost invariably submitted to commercial arbitration.

Financing issues

Funding of private equity investments is relatively straightforward. Most transactions are funded through direct capital contributions pursuant to capital increase resolutions adopted by the shareholders' meeting of the target company. Where investors require distributions on their investment on a 'current basis' and don't merely rely on annual dividends then, subject to applicable thin-capitalisation and transfer-pricing rules, some investments provide for a combination of direct capital contributions in exchange for shares or interest in the target company and shareholder loans.

Leveraged buyouts (LBOs)

With respect to LBOs in Mexico, the main consideration in structuring such transactions depends on the ability of the target companies to pay dividends and make distributions to its shareholders on a current basis to service acquisition loans. Hence, when structuring LBOs in Mexico, it is paramount to incur the acquisition financing at the level of the operating target companies, or to somehow restructure the debt after the closing so that the operating entities can actually service the debt without having to deal with the tax and other timing restrictions applicable to dividends under Mexican law. Also, in pricing acquisition financing, investors have to consider both applicable withholding taxes on interest payments made to foreign lenders (and the potential incremental cost they represent in terms of gross-up provisions), and fraudulent conveyance issues under the Mexican Insolvency Law that are mitigated through due diligence, representations, warranties and, ultimately, indemnities.

Termination or break-up fees

Finally, it should be noted by counsel that termination fees and break-up fees are not common in Mexico; however, the parties tend to agree on setting forth a right by either party to receive a reimbursement of expenses incurred upon termination by the other party in certain circumstances.

iii Shareholders' agreements (corporate governance)

Private equity transactions typically contemplate the establishment of specific governance rights for the applicable minority, such as the right to appoint a specific number of board members and members to applicable committees, the right to approve a negotiated list of 'major decisions' at the board or the shareholders' meeting, and the right to receive periodical financial information. In particular, as in many other jurisdictions, sponsors need to take into account the following.

Classes or series of shares

Shareholders' agreements include provisions dealing with specific rights of different classes or series of shares held by the private equity investor with respect to:

a pre-emptive rights to subscribe and pay capital increases;
b board, committee member and surveillance appointments;
c available exit strategies (i.e., registration rights in the Mexican Stock Exchange and the possibility of an offering outside of Mexico, including 144A/Reg S offerings, which are common together with piggyback rights);
d shareholder non-competes;
e dividend policy; and
f transfer restrictions (i.e., right of first offer, right of first refusal, lock-up periods, drag and tag-along rights).

Statutory minority rights

In addition to the rights mentioned in the preceding paragraph, certain statutory minority rights, which include the right to appoint board members based on a certain percentage of shares held (e.g., 10 per cent in the case of a SAPI or SAB and 25 per cent in case of a SA), and the need to obtain a supermajority vote in the case of certain decisions (e.g., admission of new partners to a SRL, the transfer of equity interests issued by a SRL or the approval of any amendments to the target's by-laws).

Access to information and records

When considering a minority interest investment in Mexican companies, private equity investors in closed corporations should note that the GLCC imposes very limited obligations on a company in terms of preparing and delivering financial and operating information to the shareholders. Therefore, investors need to specifically outline the nature of the information that the investment vehicle should produce and deliver, but also the process that must be followed by the parties in order to inspect books and records and to access the company's facilities and management, so as to ensure that it will have full access to the company's information.

Group deals

For club or group deals, the most important issue is how decisions are made within the investor group, which rights are conferred individually to each investor and which rights must be exercised by the group unanimously or by a specific majority of investors (e.g., drag-along rights, demand registration rights). In addition, special consideration must be made where investors require specific forms of reporting by the portfolio company (e.g., financial information pursuant to more than one set of accounting standards). Where the investors agree to act as a bloc relative to the other shareholders of the portfolio company, they may forego certain capital gains exemptions at the time of exit.

Publicly listed companies

Finally, any shareholders' agreements that relate to publicly listed companies and contain board appointment rights, veto rights, non-compete clauses, any agreements related to the sale, transfer or exercise of pre-emptive rights and any agreements that allow for the sale and purchase of shares, voting rights and the sale of shares in a public offering must

be notified to the company in order to allow the company to disclose such agreements to the investors through the stock exchanges on which its securities are being traded and to be made public in an annual report prepared by the company. Sponsors must take into account that shareholders' agreements:

a will be available for the public to review at the company's offices;

b will not be enforceable against the company and their breach will not affect the validity of the vote at shareholders' meetings; and

c will only be effective between the parties thereto until they have been disclosed to the public.

iv Other relevant matters

In addition to customary due diligence items that apply to all M&A transactions (whether stock or asset acquisitions), sponsors need to take special care with respect to the possible tax effects of the transaction, third-party consents and regulatory approvals required to consummate the transaction, including antitrust approval and foreign investment restrictions as well as other closing conditions. Below are some specific topics that need special attention.

The Foreign Investment Law

In general, under the Foreign Investment Law and its regulations, foreign investors may invest in both listed and unlisted Mexican companies, subject to a limited number of restrictions on investment in certain economic sectors that are, under the law, specifically reserved for Mexican nationals or the government. In a nutshell, up to 100 per cent foreign investment is accepted in companies and activities, except for the foreign ownership limitations in sectors that are specifically set forth in the law and for which different investment thresholds apply (e.g., 10 , 25 or up to 49 per cent). Thus, foreign sponsors need to take foreign investment laws and their regulations into account during the initial phase of any project in order to ascertain that the investment in any given sector is viable. Other than such specific limitations on foreign investment participation, the Foreign Investment Commission also needs to approve any proposed investment by foreigners in a company whose assets are worth in excess of the Mexican pesos equivalent of approximately US$200 million.

Certainty of closing

The most important issues as to the certainty of closing are related to the transaction's authorisation by the Mexican Antitrust Commission (which may be required if the transaction reaches any of the premerger filing monetary thresholds provided in the Mexican Competition Law) and other governmental authorisations that may be required for investments in foreign investment-restricted sectors or sectors subject to specific regulatory oversight (e.g., telecommunications, transportation, electricity, gas, oil and petrochemical sectors, and financial services). These issues are usually resolved by closing conditions and termination rights if such authorisations are not obtained within a certain period.

Additionally, closing is usually conditioned on obtaining the relevant corporate authorisations from both parties and the targets' shareholders' meeting (if required), to

obtain third-party consents required under material agreements for the target's business, and to the absence of a material adverse effect. The negotiation of the MAE or MAC definition is somewhat difficult, because of the allocation of risk it entails to the parties. If problems or contingencies were identified during the diligence process, corrective measures may sometimes need to be taken before closing the investment. Accordingly, provisions can be carefully drafted in the agreement to establish obligations to correct any problems so that, at the time of making the investment, such problems are solved or the correction measure is waived by the private equity investor. Special care should be taken when drafting such conditions in order for them to be valid and enforceable under Mexican law; for example, counsel should keep in mind that the fulfilment of or compliance with such conditions does not unilaterally depend on one of the parties, to avoid any risk of such condition being rendered null and void.

v Fiduciary duties and liabilities

Fiduciary duties of directors do apply in Mexico. Before the enactment of the Securities Markets Law (SML), fiduciary duties under Mexican law were vague. Following the model of fiduciary duties in the United States of America and other capital exporting countries, the SML imposes a duty of care and a duty of loyalty upon members of the board of directors and committees, the CEO, officers and even controlling parties (as the term is defined by the SML) of publicly listed companies. Shareholders of an SAPI may elect that the relevant corporate governance provisions (including those relating to fiduciary duties) of publicly listed companies apply to the SAPI; otherwise, the general corporate governance and responsibility framework of the GLCC would apply to the investment vehicle. Because fiduciary duties under the SML are voluntary, rarely adopted by sponsors in their investment vehicles and clearly described in the SML, we describe below in general terms the duties of the sole administrator or any member of the board of directors and officers of Mexican companies (jointly – 'directors') that apply under general commercial legal provisions (including the GLCC).

Fiduciary duties of directors under the GLCC

The directors of a company have the general duty to perform all functions prudently and with the care they would ordinarily exercise in their personal affairs. The appointment of a director is personal in nature, and may not, therefore, be vested or otherwise delegated by such director to any person. This duty is generally satisfied by attending all board meetings, and complying with the specific obligations imposed by statute or by the company's by-laws. Sponsors should bear in mind that the rights and obligations of a director derive from a personal appointment, and a director must personally exercise all rights and satisfy all obligations relating thereto.

A director who in any given matter has a conflict of interest with regards to the company must disclose the nature and scope of such conflict to other directors, and refrain from participating in any resolution or deliberation in connection therewith. Directors will be liable for damages and loss of profits caused to the company for breach of this obligation.

In the event of a bankruptcy proceeding, directors have a duty to the company to maintain the ordinary course of business and assist the individuals appointed by

the bankruptcy judge as may be required until they are released. A director could face potential civil and criminal liabilities if the bankruptcy judge determines that he or she has acted fraudulently to the detriment of the company, its shareholders or creditors and in the event of fraudulent conveyance.

Liabilities for breach of duty

Generally, directors may be found liable for civil and criminal liabilities, as follows.

Civil liability

A director is generally liable for damages and loss of profits caused by breach of duties as provided by law and the company's by-laws. As a general rule, actions for breach of duty may be initiated by a resolution adopted by the general shareholders' meeting of the company. Shareholders representing 33 per cent of the capital stock of an SA (20 per cent in the case of a SAPI) may, however, pursue a civil cause of action for breach of duty against directors when the claim includes the total amount of liabilities incurred by directors, and not only the amount corresponding to the personal interest of the plaintiffs; the plaintiffs voted against any resolution of the shareholders' meeting regarding the release of the director's liabilities; and any amounts received pursuant to the claim will accrue for the benefit of the company. In addition, individual shareholders or interested third parties are entitled to initiate general civil actions against a director for damages caused by illegal acts of the director, on the understanding that the damages sought shall be directly caused by such illegal actions.

Criminal liability

In addition to the criminal liabilities that could arise from accountable or fraudulent conveyance, as mentioned above, other criminal liabilities could arise to the extent a director knowingly and personally participates in fraudulent or otherwise criminally sanctioned activities.

Tax liability

Directors could be held jointly and severally liable with the company for the payment of taxes or other charges owed by the company to the Mexican tax authorities, in the event that during their term of office the company fails to register as a taxpayer; advise the tax authorities of a change of its tax address or when it vacates the premises of its tax address; and keep accounting records, or when the company hides or destroys such accounting records.

Joint liabilities

Directors are also exposed to joint and several liabilities with respect to the company, unless they express their objection on the matter of relevance at the time such matter is discussed and resolved, for:

a the actual existence of shareholders' contributions;
b the satisfaction of the requirements to distribute dividends;
c the existence and maintenance of the company's accounting, control, registry and information systems;

d the strict compliance with the resolutions of the shareholders' meetings;
e separating the amounts required for the statutory capital reserve (5 per cent a year until it reaches 20 per cent of the total capital stock) from the net profits account;
f damages caused to the company resulting from authorising the acquisition by the company of its own stock; and
g any actions taken after the company has been dissolved, or after a cause for dissolution has occurred.

Sponsors should bear in mind that the absence of a director appointed by them from any board meeting of the target company would not suffice to release him or her from these liabilities.

Moreover, directors are generally liable together with their predecessors for any irregularities in which the latter may have been implicated, if the current directors were aware of them and failed to so notify the company's statutory auditor.

Officers' duties

Officers of a Mexican company (i.e., those individuals employed by a company to handle its day-to-day operations) do not have specific duties or liabilities under the GLCC. However, as a general matter and under the Federal Labour Law, the officers (like any other employee) have a general duty of care and loyalty, and must avoid all conflicts of interest. In addition, those officers that are also attorneys-in-fact are obliged to exercise their authorities under the respective powers of attorney pursuant to the terms they were granted and always in furtherance of their purpose to the benefit of the company. Failure to comply with these general duties could result in civil and even criminal liability through an action brought by the company against the relevant officer.

III YEAR IN REVIEW

i Recent deal activity

2014 was a year with significant transaction volume in the private equity space. During the first three quarters of the year, there were 41 private equity transactions reported to AMEXCAP, of which 11 were in the real estate sector, 14 were growth capital in varied sectors such as consumer goods and technology, media and telecommunications, 12 were venture capital investments and four were investments in the infrastructure sector. Figures for the end of the year were not available at the time of writing. Funds that participated in such transactions included Nexxus Capital, IGS Group, Planigrupo, Wamex, MRP, EMX Capital, Latin Idea and Alta Ventures Capital.

Likewise, some of the notable exits between July 2013 and August 2014 include the following:

a the strategic sale by Mexico Retail Properties of its portfolio of commercial real estate assets to FIBRA Uno, a Mexican traditional REIT;
b the strategic sale by Finsa, Walton Street and AIG of its portfolio of industrial real estate assets to FIBRA Uno;
c the IPO of Volaris, a low-cost airline carrier, granting an exit for Discovery Americas;

d the strategic sale by Kimco Realty of its portfolio of industrial real estate assets to Terrafina, a Mexican traditional REIT;

e the strategic sale by SINCA Inbursa of its stake in Landsteiner Scientific, a Mexican pharmaceutical company, to Imagina tu Crecimiento investment fund; and

f the strategic sale by Newgrowth Fund of Punto Clave, a transactional services company, to Edenred.

ii Financing

Mexican corporate law does not impose restrictions on financial assistance, and thus a Mexican target company's ability to secure acquisition financing with its own assets makes financing alternatives relatively more available for PE transactions.

There is no recent particular trend between bank and mezzanine debt on Mexican PE transactions. As in other markets, the type of acquisition financing is decided upon several factors, including the target company's sector and its growth plans and needs. High yield is not yet a common source of financing for PE investments in Mexico, chiefly because investors are not yet willing to accept certain risks relating to the enforceability of Mexico's bankruptcy regime, which risks were highlighted in the relatively recent debt restructuring of Vitro, Mexico's biggest glass maker.

In those PE transactions that include bank debt and where a US sponsor is involved, Mexican banks are normally pressured to incorporate US terms in their loan documents, including MAC provisions that match the sponsor's right to withdraw from the potential acquisition and provisions that seek to limit the conditions to the financing as regards the conditions applicable to the closing of the acquisition. Due to the absence of financial assistance restrictions and Mexican banks' conservative approach to lending (which might change in the near future due to a recent financial reform), Mexican banks very rarely accept 'covenant-lite' loans, which thus turns the negotiation of the financing terms and conditions and the implementation of the relevant collateral packages into a substantial part of the legal work relating to the closing of a transaction.

III EXITS

i Fundraising

Even though, from a number of funds and total deal value perspective, Mexico is not yet comparable with other markets more popular for PE (e.g., Brazil), according to AMEXCAP, the annual rate of fundraising amounts to approximately US$1.52 billion, and during 2014 the number of general partners active in the market reached 125.

Before mid-2009, Mexican pension funds (AFORES) were not allowed to invest in private equity due to specific investment regime restrictions. It was only after that date that those restrictions were relaxed through the creation of a new type of equity linked-notes (CKDs), which are traded on the Mexican Stock Exchange. Today, this increased flexibility enables AFORES to invest directly in private equity for the first time and creates the opportunity for private equity funds to raise capital from AFORES through the issuance of CKDs.

ii Exits

As mentioned above, Mexico has seen the full spectrum of exit transactions for private equity investors. The type of exit depends on the prevailing economic cycle in Mexico and globally, as well as the industry and target company in question. There are many examples of exits through the capital markets as part of a global primary and secondary offering of shares, most often through a public offering in Mexico and a placement outside of Mexico pursuant to Regulation S and Rule 144A of the US Securities Act 1933. Likewise, there exist many and varied examples of private equity investors exiting through buyouts, in some cases by other shareholders, another sponsor and, more commonly, by a strategic buyer.

The vast majority of going-private transactions in recent years in the Mexican market have been made by the existing controlling shareholders rather than as a result of an acquisition by a third party, and have included all sorts of industries. A trend that we expect to continue (and possibly increase) is strategic M&A activity by local and foreign companies seeking alternatives within Mexico to increase their market share, which may prove to be another exit possibility for sponsors.

IV REGULATORY DEVELOPMENTS

Leaving aside fundraising activities related to local Mexican pension funds and other institutional investors through CKDs that are traded on the Mexican Stock Exchange, generally speaking, there is no particular regulatory body that has oversight authority in Mexico over private equity transactions or sponsors' activities.

Notwithstanding the foregoing, for some time now managers participating and establishing a formal presence in the Mexican private equity market have come into a market where the government, through its development banks (e.g., Bancomext), actively participates in the private equity sector. An example of such participation is the government's interest in Corporación Mexicana de Inversiones de Capital (a major Mexican fund-of-funds). Bancomext, as a matter of public policy, participates as a shareholder of the fund to incentivise higher returns and the growth of mid-cap companies in all sectors of the Mexican economy. The participation of this fund-of-funds has been an important driver for growth in the Mexican private equity landscape for experienced and first-time managers of sponsors.

As explained in previous sections – and in common with most jurisdictions – Mexico has certain sectors and activities that are regulated. When targets are involved in such sectors, sponsors will need account for governmental authorisations that may be required to close the investments in foreign investment-restricted sectors or sectors subject to specific regulatory oversight (e.g., telecommunications, transportation, electricity, gas, oil and petrochemical sectors, and financial services).

V OUTLOOK

Mexico's improving regulatory framework and sound economic outlook has made most economic analysts believe that the Mexican economy has entered into a period of steady expansion.

Further, Mexico's demographic trends show an economy less dependent on exports, a growing middle class and an increased consumerism (with more access to consumer credit), which suggests investment opportunities in sectors serving domestic consumption, such as financial services, health care, retail, education, lodging and agro-industry.

Mexico's stock exchange index has reached record highs, domestic equity and debt capital markets have been active, achieving greater depth, and the availability of credit to Mexican small and mid-cap businesses by local financial institutions is evident and showing consistent growth. In general, the business environment in Mexico has been welcoming during the past couple of decades and is still improving (relatively much better than any of the BRIC countries).

Mexican companies are predominantly small, and several industries remain extremely fragmented and are characterised by low regulation, which translates into consolidation opportunities, high growth potential and interesting prospects for private equity funds.

Investors are also paying close attention to the developments in the telecommunications and energy sectors due to recently enacted reforms.

The secondary legislation governing the telecoms reform, which was signed into law on 14 July 2014, is considered to be one of the remaining milestones in the President's economic agenda, and analysts believe it has the potential to significantly alter Mexico's media landscape, particularly through a strengthened regulatory framework that intends to control and prevent media monopolies.

The telecommunication reform closely follows OECD recommendations by aiming to raise competitiveness in the sector, opening it up to greater foreign investment by creating a more level playing field for new and smaller industry players. The fact that Mexico has a rapid growing middle class and one of the highest per-capita GDPs in Latin America creates an ideal scenario for potential foreign investors to participate in the national telecommunications market.

The entrance into the market of the second-largest US mobile phone carrier, AT&T, can be taken as the first sign that Mexican telecoms are on their way to becoming more competitive and filled with new opportunities.

In addition to the telecommunications reform, lawmakers are now turning toward legislation that will complete the government's most ambitious reform, the opening of Mexico's oil and gas industry to private investment after a 75-year state monopoly; this legislation is considered to be on a scale comparable with the North American Free Trade Agreement in terms of economic significance.

The energy reform seeks to open Mexico's lucrative oil and gas reserves to foreign investment for the first time in decades, and attract billions of dollars in new investment into the sector; however, these ambitious aims and all projects relating thereto are currently on hold as the world's oil prices continue to plummet.

Infrastructure continues to offer interesting investment opportunities. Most Latin American countries are in urgent need of the infrastructure that will support their growth, and Mexico is no exception. According to the Latin American Private Equity and Venture Capital Association, the amount spent on Latin American infrastructure is close to half the total funds private equity invested in the region last year.

The need for funding will be significant, and banks' need for collateral (due to regulatory reserve requirements) may force them to focus on brownfield projects rather than greenfield projects. Reduced interest rates, state and municipal governments close to their debt ceilings, and hundreds (if not thousands) of opportunities for investment in airports, roads, ports and rail make infrastructure investments in Mexico inviting for private equity firms.

Until recently the government was committed to increase government spending in infrastructure, however, the recent dramatic drop in oil prices – which is key for Mexico's government finances – has forced it to put a hold on such commitments.

Even though the Mexican PE market has grown at an accelerated pace during the past decade, when compared with other emerging markets, the PE market in Mexico remains relatively underdeveloped. Needless to say, PE penetration as a percentage of Mexico's GDP is below levels observed in most of the developing world; however, now more than ever, opportunities are becoming available, and Mexico has regained its attraction for private equity entities.

Appendix 1

ABOUT THE AUTHORS

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Carlos del Rio S specialises in a wide range of mergers and acquisition-related matters, including cross-border transactions, real estate investments, strategic joint ventures, mergers, spin-offs, divestitures and private equity transactions. Mr del Rio has actively represented various foreign companies and investors in the sale or acquisition of their interests and business assets in Mexico, and he also regularly handles corporate governance and other related work. In addition, Mr del Rio offers advice on all aspects of corporate and business law relating to the incorporation, operation and maintenance of Mexican businesses of domestic and foreign clients operating in various sectors and industries within Mexico, including by advising on, tailoring and negotiating a wide array of civil and commercial contracts. Mr del Rio is recommended in *Chambers Latin America 2013* in the 'Leaders in their Field' corporate/M&A section. He was nominated to the Latin American Corporate Counsel Association as being among the region's leading business lawyers for 2014, and is a member of the Association. *Latin Lawyer 2012* described Mr del Rio as impressing clients with his deal-oriented, problem-solving and knowledgeable approach. Mr del Rio has authored and co-authored several articles for publications with Chambers and Partners, Law Business Research and the IBA corporate and M&A law committees.

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Eduardo González I specialises in a wide range of mergers and acquisitions, private equity, corporate finance and corporate transactions, with particular emphasis on mergers and acquisitions, representation of funds, corporate restructurings, general corporate advisory work and joint ventures. He represents international and domestic clients on complex corporate and transactional matters, including representation of the world's top private

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Jorge Montaño specialises in mergers and acquisitions, private equity and capital markets transactions. Mr Montaño has actively represented domestic and international companies in cross-border transactions, including advising on the structuring and execution of joint ventures and private equity transactions. Representative clients, deals and matters include advising Equifax Inc, Tupy SA, Grupo ADO, Ecolab Inc, Quadgraphics and Grupo Modelo in their acquisitions, sales or divestitures of Mexican companies; and multiple private equity funds, such as Advent International, Southern Cross and Evercore Mexico Capital Partners carrying out investments in Mexico in varied sectors, including oil and gas services, retail, real estate, financial services and low-income housing. Mr Montaño also represents US and Mexican underwriters and Mexican issuers in equity capital market transactions, as well as in investment-grade and high-yield bond transactions. Mr Montaño obtained his law degree from Instituto Technologico Autonomo de México, a master's degree in law (LLM) from New York University School of Law, and an advanced professional certificate in law and business from NYU's Stern Business School. Mr Montaño collaborated in the publication of the International Financial Law Review's *The 2006 Guide to Mergers & Acquisitions*, 'SAPIs to Promote Private Equity in Mexico', and co-authored the overview of the *Practical Legal Guide to M&A in Mexico 2013* published by Chambers and Partners.

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