The Mergers & Acquisitions Review

Thirteenth Edition

Editor
Mark Zerdin

The Law Reviews

THE MERGERS & ACQUISITIONS REVIEW

THIRTEENTH EDITION

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Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34-35 Farringdon Street, London, EC4A 4HL, UK

www.TheLawReviews.co.uk

ISBN 978-1-83862-050-9

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

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PREFACE

2018 was the year of the mega-deal, with an unprecedented number of big-ticket mergers taking place across a range of jurisdictions and sectors. In the first six months of 2018, global deal value rose by 59 per cent compared to 2017, despite volumes falling by 12 per cent. Although there was a considerable drop off in activity in the second half of the year, 2018 nonetheless saw robust overall performance by market participants, with global activity in 2018 exceeding US$3 trillion for the fifth consecutive year.

The United States remained the most targeted and acquisitive region globally in 2018; however, the deal-making landscape in the US for the remainder of 2019 presents a mixed picture. On the one hand, tax reform, a more relaxed US regulatory climate and growing cash reserves present a favourable environment for investors. On the other, dealmakers are likely to be concerned by the trade dispute between the US and China – which is already threatening economic growth and, at the time of writing, shows no sign of abating – and the ongoing uncertainty regarding antitrust policies, which may lead to increased scrutiny of M&A deals.

In Europe, after a record-breaking start to the year, the prolonged uncertainty caused by stuttering Brexit negotiations and wider political tensions across the continent finally caught up with dealmakers in the second half of 2018. In line with a softening of the global economy, the value of European deals in H2 plummeted to its lowest level since 2013, and the volume of transatlantic deals between North America and Europe also fell by 29 per cent year-on-year.

One of the main disruptors to M&A activity over the past 12 months has been the rise in political intervention in cross-border deals. In particular, concerns over national security have led to the tightening of foreign investment regimes and antitrust regulations, coupled with more active enforcement by regulators. This growth in protectionism is likely to remain one of the main obstacles facing dealmakers in the near future.

Nevertheless, looking forwards into the remainder of 2019, there is certainly cause for optimism: private equity continues to enjoy record-breaking levels of dry powder, and developments in technology are driving both the sector itself and the facilitation of deals more broadly. Finally, and perhaps most importantly, the past 12 months have highlighted the resilience of companies and private equity firms in their navigation of global political uncertainty and economic shifts.

I would like to thank the contributors for their support in producing the 13th edition of *The Mergers & Acquisitions Review*. I hope the commentary in the following 47 chapters will provide a richer understanding of the shape of the global markets, and the challenges and opportunities facing market participants.

Mark Zerdin
Slaughter and May
London
July 2019

Chapter 30

MEXICO

Eduardo González and Jorge Montaño[1]

I OVERVIEW OF M&A ACTIVITY

Despite a weak start to 2019, the Mexican M&A market's performance has been relatively stable compared to previous years.

Certain assets have become more difficult to price due to concerns about the policy-making of the current administration, and therefore some transactions have been temporarily put on hold; however, other participants in the market continue to push forward with their transactions, in some cases as a preventive measure against Mexico's current political and economic environment. Transactions in the M&A space represent, for some family-owned businesses, a key avenue to monetise a life's or multiple generations' work that could otherwise face stagnant or limited growth if it were to rely solely on pure organic growth. This phenomenon, in turn, yields opportunities for investors or strategic buyers who have cash available.

A weakened yet relatively stable peso continues to provide attractive investment return opportunities in several industries including financial services, insurance, real estate, consumer products, health and pharma, manufacturing and industrial.

The number of transactions during 2018 was similar to that of recent previous years. The busiest sectors were technology, financial services and insurance, followed by real estate, industrial and consumer products. Another key industry that has seen continuous action is the infrastructure M&A space, both in social infrastructure such as hospitals and prisons, as well as traditional toll road, waste water treatment plants and renewable energy.

The private equity industry continues to be a key driver for M&A activity in Mexico, led by several established international and local firms, as well as family offices, which are steadily taking a more active role in investments, and thus are leaving behind their role as a silent partner in established funds and are moving in to acting as standalone funds themselves.

Data also provides evidence that the venture capital (VC) industry continues to grow at significant rates, and it is expected to continue doing so in the future. For example, Softbank announced in 2019 a US$5 billion fund dedicated to Latin American investments, and has begun to deploy such fund in companies such as Rappi and PayClip, which have significant operations in Mexico. Such announcement has sparked enthusiasm in the VC and entrepreneurship ecosystem, and is expected to attract other international VC funds to participate in transactions in Mexico

On the public exit front, although the initial public offerings market has historically lagged behind other emerging financial markets, there is still optimism that increasing exit

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

opportunities through the public offering of securities will be available to investors in the near future as the Mexican pension funds (AFORES) investment regime continue to become more sophisticated and diverse, thus freeing up capital to be allocated to public offerings. As described in more detail in Section VIII, the government has taken steps to incentivise initial public offerings in the coming years through tax incentives. It remains to be seen if these incentives will have the desired effect.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

Depending on the target's activities and the industry in which the target operates, any M&A transaction in Mexico will probably be subject to several statutes. For example, during the due diligence investigation of the target or during the structuring of the transaction, laws ranging from the broad mercantile, labour and employment, tax, environmental, insurance and anticorruption statutes to the more industry-specific ones such as those regulating, inter alia, financial services, fintech, cannabis, telecommunications, oil and gas, transportation and healthcare, will all provide guidelines and parameters within which all M&A transactions have to be structured.

In an effort to increase Mexico's attractiveness for investors, the federal government has consummated several changes to statutes that were perceived to be outdated during the past few years. Certain commercial statutes (e.g., the Mexican Commercial Companies Statute and the Mexican Securities Market Statute) have been amended to incentivise M&A activity by allowing parties to, inter alia, freely agree on customary governance and liquidity provisions required for investors (particularly of an institutional nature) to attain a higher level of certainty on governance and exit provisions. Through the liberalisation effort led by former President Peña Nieto's administration (2012 to 2018), the Mexican Foreign Investment Law has been subject to several amendments to decrease (or remove) foreign investment restrictions in, inter alia, the telecommunications and oil and gas industries.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

While the statutes relating to corporate and takeover law have remained relatively untouched, changes in respect of certain capital market products are sure to have a significant effect on the M&A landscape in Mexico.

By way of background, AFORES are still restricted regarding the investments that they are allowed to undertake in accordance with their investment regime, which is set forth by law. As of today, AFORES are not yet permitted to invest directly in privately held companies, but only in publicly listed companies and other publicly listed investment vehicles. However, amendments to such investment regime are currently being reviewed and discussed in Congress. If such amendments were to pass, AFORES will be able to invest directly in privately held companies, which will certainly broaden their investment opportunities and alternatives but would also put significant pressure on their analysis and risk management capabilities.

The current AFORE investment regime, spurred some years ago the creation of publicly traded vehicles that are managed by a general partner and that serve as platforms to carry out investments in various sectors (CKDs), including the private equity, infrastructure, renewable energy and real estate sectors. The existence of the CKD market in Mexico has caused M&A transactions in various fields and sectors to take off, as pension funds put their cash to work through fund managers in acquisitions and similar investments.

There are four similar products worth discussing that complement the CKD market in Mexico. The first is the creation of real estate investment trusts (FIBRAs), a vehicle that invests in or acquires a real estate asset portfolio and is created through the issuance of a public offering and ultimately listed on the Mexican Stock Exchange. The Mexican real estate market has historically been quite active. However, since the creation of FIBRAs, M&A activity in the real estate sector has increased significantly given that the creation of a FIBRA typically entails the bundling or acquisition of real estate assets that will become part of the FIBRA. The sponsors that manage FIBRAs have additional firepower from the amounts raised in a public offering or in follow-on offerings to acquire additional assets for a FIBRA's portfolio, and FIBRAs present a great take-out opportunity for real estate developers and other stakeholders of real properties.

The second product created the equivalent of a master limited partnership, the FIBRA E, which is an investment vehicle for energy and infrastructure projects and is listed on the Mexican Stock Exchange. One key feature is the tax benefits provided to investors in a FIBRA E, as the investment vehicle and the portfolio companies through which investments are held in the infrastructure and energy assets are deemed transparent from a tax perspective. Despite current volatility in capital markets generally, there is a robust pipeline of FIBRA E projects for the future. It is uncertain how many of the FIBRA E projects will effectively materialise. While a strong impact on M&A activity is not evident yet, there is an expectation that transactions in the energy and infrastructure space will continue to increase.

The third product is the special purpose acquisition company (SPAC), which is an investment vehicle listed on the Mexican Stock Exchange that obtains funds from the public offering through which it is created to invest and acquire a company, which may or may not be identified at the time of the public offering. Essentially, it provides a sponsor with sufficient funds to conduct an M&A transaction within the 24 months following its creation. Recent SPAC offerings, such as the one made by Promecap, indicate a acceptance of these types of investment vehicles in the Mexican market, but only time will tell if that acceptance continues. Recent tax incentives described further below also seek to foster the creation of SPAC and M&A transactions related thereto. To the extent that more SPACs are issued in the market, they should certainly result in a positive effect on the M&A market in Mexico.

The fourth product is the CERPI, which is a derivative of the CKD, but with two key differences: the first is a management and governance structure that more closely resembles a traditional private equity fund, in which limited partners are expected to have a very limited role in management and governance; the second, and the one that has really triggered a spur in the use of this product, is that up to 90 per cent of the proceeds raised in a CERPI may be deployed outside Mexico. This has led many international fund managers to seek to fundraise in Mexico, as they can use it now as a regional platform to invest not only in Mexico but outside of Mexico as well. This development is certainly expected to raise the level of M&A activity as these funds begin to deploy the funds they raise.

Another important recent legal development, was the enactment of the Fintech Law and its regulations, which have provided a legal framework for companies operating crowdfunding, wallet and crypto businesses. The Fintech Law has attracted a lot of attention and focus on technology-based solutions for the financial system, and will eventually lead to M&A activity as those participants begin to consolidate.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

As noted in previous sections, the participation of international and global companies in the Mexican market continues to be attractive. The level of cross-border transactions remains significant, and the long-term view of many global institutional investors continues to drive their desire to invest in Mexico and benefit from current opportunities in the market.

It is important to note that the United States continues to be the country that represents the most foreign investment activity in Mexico. Other principal countries carrying out substantial foreign direct investment in Mexico are Canada and Spain.

Given the manufacturing infrastructure and capabilities that Mexico has developed through the years, the steadily growing middle class and the increase in consumerism, certain sectors continue to be ripe for foreign investment, as has been evidenced through recent M&A transactions, and these are expected to continue to attract foreign investment. It is expected that foreign investment will continue to drive a significant portion of the large and complex M&A transactions in Mexico.

In September 2018, Mexico, the United States and Canada announced an agreement to modernise the North American Free Trade Agreement (NAFTA), which will be known as the United States–Mexico–Canada Agreement (USMCA). The new agreement includes significant revisions to the agreement signed in 1994. Regarding foreign investment, USMCA largely replicates the protections provided under the 1994 NAFTA that are typically afforded by bilateral investment treaties such as:

a a minimum standard of treatment, which includes fair and equitable treatment and full protection and security;

b national treatment;

c most-favoured nation treatment; and

d transfers and protections in the case of direct or indirect expropriations.

Under USMCA, such protections may be claimed only by American and Mexican companies working in the oil and gas, energy, telecommunications, transportation and infrastructure sectors, provided that they hold a government contract or carry out activities related to one of these sectors. Neither Canadian companies with investments in Mexico or in the United States, nor Mexican or American companies with investments in Canada, shall have access to arbitration under USMCA. Companies that do not participate in any of the above-mentioned sectors will only be able to submit to arbitration violations involving national treatment or most-favoured nation treatment, which require the government's implementation of a measure intended to discriminate against a company by reason of its nationality, and violations involving a direct expropriation. Any other treaty violations must be submitted before the national courts. USMCA provides a specific chapter for financial services, which also sets forth an investment arbitration mechanism that is limited to the above-mentioned narrower scope of protections. USMCA significantly limits the protection offered to foreign investment by making claims involving violations of fair and equitable treatment and indirect expropriation not subject to investment arbitration. In the absence of such protections, investors will not be able to resort to arbitration to defend against government harassment, abrupt regulatory measures or the unjustified termination of any agreement or permit.

The USMCA has yet to be ratified by the US Congress, Canada's Parliament and Mexico's Congress. However, the Mexican Senate, which is controlled by Lopez Obrador's political party, is expected to ratify the USMCA soon.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

As noted in the Section I, Mexican M&A performed strongly throughout 2018. There is a trend of consolidation and a high volume of activity in certain sectors, such as the technology, pharmaceutical industry, real estate, food and beverage, distribution and retail.

M&A activity in the real estate sector is driven in large part by FIBRAs, as discussed in Section III. Transactions mainly involve the acquisition of real estate portfolios. The acquisition story driven by FIBRAs has not slowed since then.

The infrastructure (e.g., toll roads) and soft infrastructure (e.g., government-concessioned hospitals, schools and prisons) space continues to attract international institutional investors, such as the Canadian pension funds.

The pharmaceutical industry remains fragmented and filled with attractive targets ripe for consolidation or participation by international participants.

In the aerospace and automotive sectors, we continue to see significant M&A activity, mostly on the basis of cross-border transactions effected by global players but also in respect of which Mexican operations will still have a significant role.

The airline industry has also supported developments that have led and may continue to lead to M&A activity. Recent amendments allowing a greater participation (up to 49 per cent) of foreign investment led, for example, Delta Airlines to acquire a substantial additional stake in Aeromexico.

Finally, there has also been a trend for a higher volume of transactions in the VC and technology space, which still may not represent significant M&A volume at this stage but should have an impact in the short to medium term as these ventures mature and the marketplace becomes more sophisticated. Increased valuations for technology companies has spurred significant activity in the growth stage of these companies, and should lead to future M&A activity as well.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

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 M&A and private equity transactions. Mexican banks are actively participating in the market, and this has opened the door to other types of lenders, such as credit opportunities funds created by global institutions.

There is no particular trend regarding bank and mezzanine debt in Mexican M&A and private equity transactions. As in other markets, a decision about the type of acquisition financing is based upon several factors, including the target company's sector and its growth plans and needs.

In those M&A and private equity transactions that include bank debt, Mexican banks are normally pressed to incorporate US terms in their loan documents, including material adverse change (MAC) provisions that match the acquirer's right to withdraw from a potential acquisition and provisions that seek to limit the conditions of the financing as regards the conditions applicable to the closing of the acquisition. Owing to the absence of financial assistance restrictions and a conservative approach to lending, 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.

When an M&A or private equity transaction involves financing, including going-private transactions, one of the most controversial sections of loan documents is the one relating to the conditions for a drawdown, and specifically the material adverse effect (MAE) or MAC condition that directly affects the certainty of funds. It is hardly ever the case that the definition of a MAE or MAC in a purchase agreement matches the definition in the loan documents, and therefore the gap is generally a risk that the acquirer or investor is asked to assume. In the context of a cross-border deal, the definition of a MAE or MAC becomes even more complex when negotiating political or national risk language within an agreement, especially in light of Mexico's current political environment and Trump's discourse on US–Mexico relations. Having said that, we see that sponsors in private equity transactions are generally more comfortable with the legal and related risks involved. Increasingly, investors focus more on returns and less on country risk.

With respect to leveraged buyouts (LBOs), the main consideration in structuring such transactions depends on the ability of target companies to pay dividends and make distributions to their shareholders regularly 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. In addition, in pricing acquisition financing, investors have to consider both the 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.

VII EMPLOYMENT LAW

Employee subcontracting regimes are common in Mexico and, consequent to relatively recent amendments to tax and employment laws, thorough diligence is crucial for identifying existing liabilities to avoid or reduce any labour or tax contingencies.

A subcontracting regime exists whenever employees of an entity (i.e., a contractor) perform tasks or provide services to another entity (i.e., a client). In view of the foregoing, whenever there is a subcontracting regime in place, it is crucial to verify whether it complies with the following conditions set forth by the Mexican Federal Labour Law:

a it cannot cover all the activities or those activities, similar or alike as a whole, that are performed at the workplace;

b services to be rendered must be justified because of their specialised nature; and

c subcontracting may not involve similar or the same activities as those performed by the other employees in the contracting party.

Failure to comply with the specific conditions will not only result in joint and several liability between the contractor and the client, but also in the direct obligation for the client to be liable for the costs of employment and social security obligations, including profit sharing.

Earlier this year, the Senate approved an overhaul of the country's federal labour law. The changes include workers' right to vote through secret ballots on unions and their labour contracts, which normally does not occur in Mexico. The labour reform seeks to ensure that workers will finally be represented by their unions.

VIII TAX LAW

Transfer pricing reporting obligations contained in Mexican law have an impact on tax filings for pre-closing, post-closing and straddling periods, as the buyer and seller will have to agree on the terms and conditions under which these obligations will be complied with on behalf of the target. Compliance with these obligations is particularly sensitive as it provides information related to the organisation and operation of the group worldwide, which, needless to say, the seller will not be willing to share with the buyer; thus, strong confidentiality provisions would have to be negotiated as well.

The imminent approval by Mexico of the OECD's multilateral instrument will limit access to certain tax treaties to which Mexico is a party. This is particularly important in light of the structuring work that needs to be performed prior to any M&A transaction taking place, because any structuring analysis will need to address additional limitations.

There are also new obligations within the Mexican legislation related to the issuance of digital invoices that are now applicable for, inter alia, stock purchases and payments made to non-Mexican residents. The tax authorities continue to enhance all the regulations pertaining to the issuance of digital invoices, which now apply to certain transactions that were not considered to be affected in the past. Accordingly, stock purchase agreements have to provide some detail in this regard to define which tax documents will be issued by whom at closing, thus avoiding any discussions, as these rules are numerous and detailed.

Earlier this year, the Tax Administration Service published the rules for the application of tax incentives for corporate bonds and initial public offerings (Rules). The Rules are the result of an open dialogue between the Ministry of Finance and Public Credit, various financial industry associations, the licensed securities exchanges in Mexico and their legal advisers. The tax incentive for initial public offerings, in summary, allows for Mexican-resident individuals and non-Mexican tax residents to apply a rate of 10 per cent to capital gains derived from the sale of shares issued by Mexican-resident corporations in licensed securities exchanges in Mexico during 2019, 2020 and 2021, provided that certain requirements are complied with.[2] The tax incentive for bond offerings, in summary, allows Mexican tax-resident issuers of corporate debt outside of Mexico to apply a zero per cent withholding rate (as opposed to 4.9, 10 or even 35 per cent, in some cases) subject to compliance with certain requirements such as having the debt instruments listed in Mexico.

2 In such regard, the Rules clarify that the total equity value of the issuer shall not be greater than 25 billion pesos and shall be computed prior to the initial public offering (IPO); the tax incentive is also applicable when a sale is done through the exercise of over-allocation options (greenshoe) or follow-ons; the tax incentive will also be applicable to whomever sells shares to a SPAC or sells shares issued by a SPAC obtained as a result of an initial business combination; with respect to the exception provided for the divestment process of a private equity investment trust (FICAP), the exception shall also be applicable to non-residents; the 20 per cent minimum participation of the FICAP shall be computed prior to the IPO; and the participation of a FICAP shall be computed taking into account not only the shares acquired by the FICAP, but also those acquired by certain foreign legal arrangements that are related to the FICAP or its manager.

IX COMPETITION LAW

Enforcement by Mexico's antitrust agency has been particularly active in recent years. Several ongoing investigations and the imposition of substantial fines in many sectors of the economy indicate the agency's new more active and aggressive stance. On the antitrust clearance front, the outcome of many M&A transactions has become more difficult to predict, especially in borderline cases for which preemptive planning of an intelligent approach to the agencies has become more important. Similarly, pre-closing integration efforts now need to be conducted with more sensitivity to antitrust requirements.

X OUTLOOK

According to recent polls, President Andrés Manuel López Obrador, having held office for less than a year, continues to be popular and has substantial support. It is still early to estimate the President's effects on the economy, the business sector and particularly on inbound M&A.

The President has consistently attacked the energy reform enacted by Peña Nieto's administration, and while there continues to be no indication of a major shift in the applicable regulatory framework, there is no optimism regarding new projects in the oil, gas and power sector.

In general, Mexico's regulatory framework and macroeconomic outlook has made most economic analysts maintain their view that the Mexican economy continues to be experiencing a period of slow expansion.

After an election year and with USCMA discussions in the ratification stage of the respectiver chambers of Congress, the expectation was that a good portion of the uncertainty affecting the M&A market during 2018 would have subsided considerably. However, in addition to global economic uncertainty, Trump's constant tariff threats towards Mexico and the rating agencies' recent revisions of the outlook for Mexico and Pemex (Mexico's state-controlled oil company) have not helped address such uncertainty.

CKD listings are on hold: while there are close to 30 listing filings in process, no listing has been made during 2019. There is more than one reason for such impasse, but one of them is the uncertainty as to the AFORES new investment regime.

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

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Mr Montaño has been ranked in M&A and capital markets by many publications, including *Chambers Latin America*, *The Legal 500* and *Latin Lawyer 250*.

Mr Montaño collaborated in the publication of the *International Financial Law Review's Guide to Mergers & Acquisitions* and the article 'SAPIs to Promote Private Equity in Mexico' (both in 2006). He has also co-authored the overview of the *Practical Legal Guide to M&A in Mexico 2013* published by Chambers and Partners and the Mexico chapter in *The Private Equity Review* (2014, 2015 and 2016 editions) published by Law Business Research.

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ISBN 978-1-83862-050-9