M&A IN MEXICO

Rafael Sámano is a managing partner and founder of Sámano Abogados. He graduated cum laude from Escuela Libre de Derecho in Mexico City (JD 1993), has masters degrees in public policy and administration from the School of Public and Private Affairs (SIPA) in Columbia University (CU) (MPA, 1996) and in international finance and banking (SIPA, CU, MIA 1997). He is a member of the International Bar Association, the US–Mexico Bar Association, the Mexican Bar Association and the Mexican Business Lawyers Association. Rafael has built Sámano Abogados into a 35-member leading corporate and regulated sectors law firm in Mexico. He is also a founding member of Besser Law Firm Alliance.

Rafael's key clients include leading industrial, technology, health and consumer services corporations. He has also served as advisor and counsel to multiple tech start-ups, and several local entrepreneurs and established businessmen.

Recent keynote deals and cases include:

- advising Grupo Veolia on its successful bid, in consortia with other local investors, in the bid to build and operate in Mexico City the first and largest Waste-to-Energy plant in Latin America, a US$3.1 billion, 34-year project (2017);
- advising Weex, a Mexico City-based mobile virtual network operator start-up, on its Series B equity round to incorporate ALLVP Venture Fund and Cinepolis into its shareholder base alongside Coca-Cola ventures (2017); and
- advising Grupo Vitalmex's controlling shareholders on its US$75 million dollar investment by Australis Partners (2018).

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GTDT: What trends are you seeing in overall activity levels for mergers and acquisitions in your jurisdiction during the past year or so?

Rafael Sámano: M&A activity in Mexico has enjoyed a good run in recent years, although levels in terms of principal investment and number of deals remain low when compared to Brazil, which continues to lead the region, and only slightly above Chile. Given the size of the Mexican economy, its industry diversification and recent regulatory changes, this is an indication of the unleashed potential of the M&A market. Some of the factors which have limited growth are:

- high levels of market concentration around a handful of companies in most sectors;
- controlling shareholders' resistance to institutionalisation, corporate governance and compliance policies within the organisations;
- an ineffective legal system and challenged Rule of Law; and
- low penetration of capital markets (equity mostly).

For both local and foreign investments, 2018 has been a transitional year as national presidential elections held public attention until Mr Lopez Obrador's (AMLO) overwhelming victory in early July, as did the uncertainty regarding the North American Free Trade Agreement and a potential trade meltdown with the United States (Mexico's main commercial partner) until the recent bilateral agreement was announced in late August. Many players and dealmakers took to the sidelines in a wait and see approach before committing to new transactions.

As these uncertainties are resolved, a new picture is emerging around the kind of leadership, policies and measure that the upcoming AMLO administration will enact. Also, alongside the nature and scope of the new trade deal with the United States we are observing increased interest in M&A activity. Left-behind deals and first player moves are brewing again in sectors such as oil and gas, real estate, consumer goods, technology, and industrial services.

GTDT: Which sectors have been particularly active or stagnant? What are the underlying reasons for these activity levels? What size are typical transactions?

RS: Particularly active sectors include oil and gas, real estate and consumer goods. A constitutional amendment and the corresponding new laws, regulatory entities and framework set the stage for the deregulation and opening of several sectors in oil and gas – such as storage, distribution and commercialisation of refined products and molecules. The popularity and acceptance of Mexican-style real estate investment trusts (Fibras) has allowed huge amounts of cash to be transferred to real estate projects and investment


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pools (mostly from pension funds and other institutional investors), and lately to energy deals as a new Fibra E version was successfully introduced into the market. Consumer goods have also been in a roll as aggregate spending in large urban centres outpaces GDP and disposable income edges forward as the Mexican consumer matures into a more sophisticated and demanding buyer.

Laggards include telecom and financial services. High concentration in these sectors, coupled with market saturation and margin pressure, have kept large deals out of scope (these factors led the two largest Mexican financial players – Banorte and Interacciones – to merge last year). Most new investments have been on emerging business models fostered by niche opportunities (telecom) or behind the expectations of the new Mexican Fintech Law and its upcoming regulations.

GTDT: What were the recent keynote deals? What made them so significant?

RS: One of the keynote deals in Mexico was the October 2017 merger between Banorte and Interacciones. This was a particularly relevant transaction because it involved the only two remaining local financial institutions, both owned by related families. The merged entity rose ranks to position itself second or third in most

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banking categories (assets, deposits, commercial lending), realising synergies and increasing its visibility vis-à-vis large sector leaders as Citibank (Banamex), BBVA Bancomer & Santander. The deal was welcomed by regulators and industry players alike, and built upon a renewed 'Mexican pride' widespread feeling.

Another very active sector in 2017 was renewables, where large wind power energy deals pointed to a successful and maturing market in Mexico. Blackstone sold its Ventika wind farm for over US$850 million, Quebecoise CDPQ and CKD Infraestructura Mexico (a local player) acquired a 1.7 gigawatt renewable energy facility from Enel Green Power, and Actis, a private equity fund, acquired the remaining 50 per cent of Energía Sierra Juárez, a developer and operator of wind farms. Together, these deals reflected an evolution of the Mexican electricity market and the positive effects of the energy reform enacted in the early years of the Peña administration, as greenfield developers successfully built wind farms and were able to transfer their operations to new market players participating in the emerging electric market.

GTDT: In your experience, what consideration do shareholders in a target tend to prefer? Are mergers and acquisitions in your jurisdiction primarily cash or share transactions? Are shareholders generally willing to accept shares issued by a foreign acquirer?

RS: Local shareholders in Mexico tend to favour cash considerations vis-à-vis share offerings, although it is common to see a mix in larger institutional deals. Private equity transactions are generally cash-based, where a large portion of the investment is committed to growth opportunities or balance sheet restructuring, while a lesser part could be directed to a secondary offering, with the original investors partially realising their stakes in the company. In larger institutional deals (structured infrastructure transactions, real estate) it is not uncommon to see local participants take equity stakes from a foreign acquirer, particularly when the shares offer good liquidity or cash equivalency options.

GTDT: How has the legal and regulatory landscape for mergers and acquisitions changed during the past few years in your jurisdiction?

RS: The legal landscape for M&A in Mexico is liberalised and friendly toward foreign investment, with some regulated areas where specific rules apply, not necessarily limiting the

amount or participation of the foreign player, but rather of procedural and administrative nature (compliance related). The Peña administration introduced relevant constitutional reforms through its 'Pact for Mexico', which gathered the three main political parties and yielded important results. Strategic sectors of the economy were liberalised and their administrative framework advanced. Far-reaching reforms were passed in the energy, telecom, labour and financial sectors. The tax code was also overhauled, a new public education system was introduced, and the electoral system suffered major changes. Finally, a much-needed and solicited anti-corruption and transparency reform was passed. A complex system was created to fight corruption, to grant courts more independence and to improve the chances of holding a broader scope of entities, public officers and now private players accountable. Several laws and regulations were modified and new ones created: the Administrative Court was granted constitutional status, a revamped Amparo Law with broader reach was introduced, a new criminal system was enacted, and the National Transparency and Information Access Institute (IFAI) was awarded new powers and authority.

Overall, the recent years have brought deep, structural changes to Mexico's legal and regulatory landscape. An important challenge going forward will be to uphold and foster the merits of the good reforms, and to tame the scaling back of some of the less successful ones, as eyed by the new AMLO Administration.

GTDT: Describe recent developments in the commercial landscape. Are buyers from outside your jurisdiction common?

RS: Deal-wise, until recently, most transactions were intra-regional, with most buyers coming from North America (the United States tops the list, followed by Canada, Mexico and some Latin countries like Colombia and Chile). However, since the Trump administration took office, we saw European and Asian investors targeting and entering the Mexican market, either through M&A deals (CCNOC, China–Mexico Fund, Anhui Jianghuai Auto) but also through direct investments (Huawei, Tata, Infosys, Wipro, Lupin and Claris, to name a few). This trend continues today and is expected to gain more traction going forward.

GTDT: Are shareholder activists part of the corporate scene? How have they influenced M&A?

RS: Shareholders activism is scant in Mexico. Low capital markets penetration, lack of an established investor culture and a vertical shareholder concentration in most local companies, has impaired a more active role on behalf of the common investor. However, institutional investors like pension funds, investment trusts and real estate trusts, are becoming more active in demanding basic corporate checks and balances from targets, such as corporate governance provisions, compliance structures and anti-corruption prevention measures.

Regarding private equity funds and institutional deals, it is common to find as part of the closing documents standard and even enhanced provisions in the subscription and shareholder's agreements governing the composition and authority of the Board of Directors and derived committees (audit, compensation and corporate practices, at least), supermajority requirements for key decisions, minority rights, exit rights, top management issues, internal control and compliance. Appropriate communication and understanding of these multiple topics is fundamental to successfully close any M&A deal. This is probably one of the most demanding challenges in the process, and a particular issue directly associated with the Mexican market.

GTDT: Take us through the typical stages of a transaction in your jurisdiction.

RS: M&A buy-side origination involving local companies in Mexico in middle market transactions (US$20 to US$100 million range) follows many different dynamics regarding first approach. I would divide most deals in this category into:

- strategic;
- joint ventures; and
- buyouts.

Regarding strategic investments in this middle market, first approach is not necessarily made through a qualified intermediary, but rather through a common contact to soften the initial conversation and to produce sufficient interest and trust to advance the process. Once a mutual interest and basic layout is set, professional advisors join in to provide methodology and order to the process, as per standard international protocols (non-disclosure agreement signing, basic due diligence, term sheet, enhanced due diligence and negotiation of definitive terms and conditions through closing documents). A key success point in this process rests in the ability of the buyer and its representatives to communicate effectively with the target and its controlling shareholders. First approach is a very sensitive step which could derail further talks should not handed appropriately.

Joint ventures follow a different path, as a common interest facilitates efforts to structure the deal upon the capacities of each participant. Associated challenges refer to the implementation of the usually complex commercial agreements, corporate vehicle and governance, indemnities,

THE INSIDE TRACK

What factors make mergers and acquisitions practice in your jurisdiction unique?

The business sector in Mexico is rather new when it comes to market dynamics. Prior to 1986, when Mexico joined the General Agreement on Tariffs and Trade, and the 1990s, when a broad privatisation policy was implemented and the North American Free Trade Agreement was signed, most economic sectors were dominated by public companies, which acted as sector monopolies, and the government had the authority to set prices and to control imports & exports. Hence, privatisation in many aspects created a vertically integrated system of few per sector, family-owned, dominant companies. Only in the last 20–25 years has an entrepreneurial, innovative and competitive business sector emerged, alongside an increased presence of foreign corporations, either directly or through joint ventures.

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

- Local knowledge of the market, its trends and business dynamics.
- Experience in dealing with local families, family offices and personal advisors (in addition to the usual suspects) to design the appropriate strategy to each case.
- Seasoned communication skills to convey the right messages at the right time.

M&A resembles more an art than a job. In Mexico, particularly, successful deals rely more on skill and technique, than on pre-established protocols and formats. Proper documentation is always a must, but it is the commoditised element of the transaction that is very important. The competitive edge goes to the integration of a dedicated team able to understand both the business and the personal elements of the deal. Combining a comprehensive strategy with the proper communication, backed by solid technical abilities, is the formula to deliver superior results.

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

We recently closed a US$75 million transaction in a leading local healthcare services company, where the controlling shareholders were interested in assessing a private equity transaction with an international fund or strategic partner to achieve multiple goals:

- foster institutionalisation and corporate governance towards a generational transition;
- diversify their holdings through a partial realisation of their equity investment;
- fund growth with new capital; and
- prepare and elevate the company going forward into capital and debt markets to generate liquidity events.

The diverse nature of the goals made it a complex transaction, where we had to coordinate, negotiate and accommodate several interests and objectives with various tax, corporate and regulatory implications. We successfully closed the deal in six months, working together with other law firms, tax advisors and investment bankers.

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responsibility and exit strategies. The establishment of a trust is very common, as all closing documents must provide the consortia the ability to monetise the structure to serve as an underlying asset for financing. Joint ventures are particularly identified in infrastructure and real estate deals.

Buyouts usually involve a prior ongoing commercial or business relationship, where the foreign investor wishes to augment its participation, whether to gain control or to buy out the local partner. Buyouts in Mexico are a good alternative for local families in generational transitions, as it allows for a controlled step-up exit plan. Less recurrent are management buyouts and leveraged buyouts, as they usually require the target to be either a public company or their shares to allow for liquidity or monetisation to support the deal.

GTDT: Are there any legal or commercial changes anticipated in the near future that will materially affect practice or activity in your jurisdiction?

RS: The main challenge for Mexico's economy and the investment community today resides in the uncertainties surrounding the position and actions that the new AMLO administration will take once in office in December 2018. The AMLO-led coalition, Morena, obtained a landslide victory unlike any other in the last 40 years in Mexico, winning the Presidency, the Senate, a qualified majority in Congress and most governorships and local congresses. This means that AMLO was granted pretty much a blank cheque to proceed as he sees fit. His coalition encompasses an unusual mix of leftist radicals, moderates, right wing representatives, controversial figures and a top business leader. How will all these various political forces and ideologies accommodate themselves going forward is anybody's guess. Given the scope of defeat of the traditional parties (PRI, PAN and PRD), de facto players like the media,

business and professional councils, the academia and civil society organisations now hold a key role as liaisons and communication envoys with the Morena leadership. A new political setting will ensue, and the results are, for the time being, mostly uncertain.

GTDT: What does the future hold? What activity levels do you expect for the next year? Which sectors will be the most active? Do you foresee any particular geopolitical or macroeconomic developments that will affect deal sizes and activity?

RS: The months following the early July presidential election have been in many respects uneventful, as the catastrophic warnings from various players proved unsubstantiated. The AMLO team has effectively taken over and is already calling the shots. The market has, unexpectedly, welcomed the election outcome, as the peso gained more than 5 per cent in the ensuing weeks and has since stabilised and maintained its value. While some of AMLO's choices for public office are questionable, the overall grade for his cabinet and main congressional positions is good. His speech has moderated, and it seems that the vociferous leftist radicals have been kept in check (art least for the time being). Some of the forthcoming legislative proposals have been well-received, especially the judicial reform, aimed at strengthening the independence of the Judiciary and the Rule of Law. On the international arena, the announcement of a trade agreement with the United States marked a major advance in the recomposing of the bilateral relationship with our main partner (albeit several important details were left out and are yet to be determined).

Overall, we have seen a noticeable increase in deal flow heading toward the end of the year and of the Peña administration. Transactions put on hold are being retaken, and new ones are being originated. Noticeable active sectors are energy, real estate and consumer goods. The liberalisation of the electric market and the oil middle stream segment are detonating several initiatives in power generation and supply, refined products storage and distribution, and gas transportation. As a defensive play, excess liquidity is being allocated in real estate, as Fibras' take off and lead the bulk of accessory deals. Regarding consumer goods, Walmart just announced the acquisition of three-year old delivery service company Cornershop for US$225 million to ramp up its online grocery services in Mexico and Chile. More tech related transactions are expected, as other players follow Walmart.

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