The Private Equity Review

Seventh Edition

Editor
Stephen L Ritchie

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Seventh Edition

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PREFACE

The seventh edition of *The Private Equity Review* follows a turbulent and at times nerve-wracking 2017. It was also a year in which private equity demonstrated its strength as an asset class in spite – perhaps because – of that turbulence. Deal activity and fundraising were strong in almost every major market despite fierce competition from public strategic buyers and strong returns in other asset classes, demonstrating private equity's ability to adapt quickly to changing conditions to find profitable investment opportunities. As a result, we expect private equity will continue to play an important role in global financial markets, not only in North America and Western Europe, but also in developing and emerging markets in Asia, South America, the Middle East and Africa. In addition, we expect the trend of incumbent private equity firms and new players expanding into new and less-established geographical markets to continue, although recent protectionist trends remain a risk factor.

While no one can predict how 2018 will unfold, one can confidently say that private equity will continue to play an important role in the global economy, and will likely seek to expand its reach and influence. It remains to be seen how local markets and policymakers respond.

Private equity professionals need – now more than ever – 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 27 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.

I want to thank everyone who contributed their time and labour to making this seventh 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 2018

Part I

Fundraising

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MEXICO

Hans P Goebel C, Héctor Arangua L, Adalberto Valadez and Lorenza Molina S[1]

I GENERAL OVERVIEW

Over the past 17 years, Mexico's private equity (PE) industry has raised over US$51.4 billion in capital commitments to PE investments according to the Mexican Private Equity Association (AMEXCAP).[2] Mexico's strong industrial and manufacturing sectors along with recent reforms to policies and regulations have had a positive impact on the PE industry, resulting in double-digit annual growth for the industry.[3] Capital commitments have increased, especially in the infrastructure and energy sector with a 19 per cent increase from 2015 to 2017. Real estate and venture capital (VC) also had a double digit increase in the same period of 16 per cent and 13 per cent respectively.[4] Currently, the number of active fund managers has reached over 177 active GPs across different sectors, growing sevenfold since the beginning of such industry in the early 2000s.

In 2015, Mexico surpassed Brazil becoming the most popular destination for countries dedicated to private equity vehicles in Latin America.[5] According to the Emerging Market Private Equity Association (EMPEA), Mexico dedicated private equity vehicles went from raising a modest US$152 million in 2008 to US$2.1 billion in 2015. While a decrease has been recorded over the past two years, Mexico is still placed second by capital deployed behind Brazil, and accounted for 22 per cent of investment in the region, according to the Latin American Private Equity and Venture Capital Association (LAVCA).

According to PRO México Trade and Investment, Mexico is one of the world's most globalised countries, with 10 free trade agreements spanning 45 countries, nine partial scope and economic complementation agreements within the framework of the Latin-American Integration Association (ALADI) and it is a member of the Trans-Pacific Partnership Agreement (TPP), and 32 reciprocal promotion and protection of investments agreements with 33 countries. Mexico's diversified export line is ranked 13th in the world and it is the seventh-largest car manufacturer in the world.[6] Mexico actively participates in multilateral and regional organisations and forums like the World Trade Organization (WTO), the Asia-Pacific Economic Cooperation (APEC), and the Organisation for Economic Cooperation and Development (OECD).

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1 Hans P Goebel C, Héctor Arangua L and Adalberto Valadez are partners, and Lorenza Molina S is an associate at Nader, Hayaux y Goebel, SC.

2 AMEXCAP, 'Inside Mexico's PE Market, November 2017'.

3 AMEXCAP, 'Overview of the Private Equity Industry in Mexico', June 2016.

4 Idem.

5 FINANCIER: www.financierworldwide.com.

6 PRO México: www.promexico.gob.mx/en/mx/tratados-comerciales-inversion.

In recent years the Mexican government has been an important player and a supporter of the PE industry, investing in more than 71 funds[7] through institutional investors such as Nacional Financiera, FOCIR (Fondo de Capitalización e Inversión del Sector Rural), Bancomext and BANOBRAS among others, and through the Fund of Funds (Fondo de Fondos) investment vehicle, the Mexican Corporation of Equity Investments (Corporación Mexicana de Inversiones de Capital or CMIC), which has invested more than US$885 million in more than 84 funds and co-invested in 17 deals.[8] In addition, the National Institute of Entrepreneurship (INADEM) has helped the Mexican venture capital industry (VC) and seed capital ecosystem, by investing or co-investing in 41 funds from 2013 to 2016. For 2016 the VC support changed to 100 million pesos targeting one fund with an approach to the Asia-Pacific alliance countries, which is now finishing its fundraising period. Finally, domestic pension funds (AFOREs) have played a determinant role in the growth of the PE industry, having allocated more than US$19.9 billion through 74 capital development certificates (CKDs) since 2009. This amount can further increase US$6.2 billion, with the CKDs that are on the pipeline. Mexico is seen as one of the most favourable emerging markets to invest in and top in LATAM according to different LPs surveys such as LAVCA 2014, 2015, and EMPEA 2015, 2016 and 2017.[9]

The Mexican economy performed better than expected during the first half of 2017 with an annual GDP growth at 2.3 per cent[10], it is placed as the second-largest economy in Latin America (with a GDP of US$1.14 trillion). Mexico has been considered to have economic stability, with conservative but still rising growth rates. The Mexican economy has been growing at an average rate of 2.5 per cent for the past 10 years, mainly due to the implementation of new regulations to improve development, sensible monetary and fiscal policies, ordered management of the public finance led by Banco de México (Banxico) and a gradual improvement in the country's external environment. The World Bank suggests Mexico might be the eighth-largest economy by 2050, which is a positive outlook to attract direct foreign investment.

The PE industry and VC sector in Mexico continues to grow and mature. The internationalisation of both funding sources and investment by domestic GPs suggests that Mexico is playing an increasingly influential role in financial and economic growth, at both the regional and global levels. Only within VC, Mexico has witnessed the number of GPs tripled in the past six years; infrastructure and energy funds have also increased significantly reaching 30 funds on 2016, a clear effect due to the energy reform that is allowing private investments on energy sectors, oil and gas, electric power generation and renewable energy. As of October 2017, an estimated US$25 billion of cash reserves were available for investment by PE funds investing in Mexico.[11]

In general, information about PE funds is not publicly available during the fundraising stage, unless such funds are public funds raised in the securities market, such as CKDs, investment project certificates (CERPIs) or Mexican real estate trusts (FIBRAs).

The Mexican fundraising market has been, since 2014, in an upward trend. In the past years the most attractive sector has been real estate, but recently the VC sector is clearly

7 AMEXCAP, 'Overview of the Private Equity Industry in Mexico', June 2016.

8 AMEXCAP, 'Inside Mexico's PE Market, November 2017'.

9 AMEXCAP, 'Inside Mexico's PE Market, November 2017'.

10 World Bank: http://www.worldbank.org/en/country/mexico/overview.

11 Idem.

rising. Mexican PE funds are active, growing and covering a larger spectrum of industries (business and financial services, consumer goods, healthcare, technology, oil and gas, etc.). VC funds mainly invest in consumer services and technology, real estate funds mainly target the industrial, commercial, tourism and housing sectors, and the infrastructure and energy funds are currently concentrated in the oil and gas sector. However, we must point out that an investment trend has been the growth of VC investment in fintech, totalling US$87 million for 2016 and US$63 million for 2017. Recent reports have highlighted the high growth rates of fintech in Latin America, such as the 2017 LAVCA Trend Watch, which concluded that the fintech sector represents 25 per cent of the venture investments in IT in the region. Moreover, according to Fintech Radar Mexico conducted by Finnovista in July 2017,[12] 238 Mexican fintech start-ups have been identified across 11 different segments, which represents a growth in the number of fintech start-ups of 50 per cent since August 2016; in less than a year 80 new fintech start-ups have been created, which positions Mexico as the largest fintech hub in Latin America, ahead of Brazil with 230 start-ups, due in part to a strong presence of entrepreneurship and e-commerce. Just in 2017, a total of US$62.9 million has been invested in 15 start-ups from the fintech industry, such as Abra, a mobile money start-up that uses the technology behind bitcoin; and Pangea Money Transfer, an app-based cash transfer service targeted at the US$25 billion Mexicans in the United States send home every year, all of them invested in by Monterrey-based Ignia. These results emphasise the importance and the possibilities of fundraising and VC investment in the development of the fintech ecosystem in Mexico. As the fintech industry represent a massive potential growth in Mexico, last year, the government proposed legislation that seeks to ensure financial stability a defence against money laundering. The legislation understands the need that a sector as dynamic as fintech needs a regulatory framework that allows authorities to mitigate risks and allow for growth in a competitive environment.

As mentioned above, the Mexican VC has grown significantly reaching US$1.64 billion in accumulated committed capital for the last 17 years.[13] Mexico's VC sector is now an attractive market in which to invest; Mexico's VC industry has 63 active Mexico-based fund managers, and 50 foreign GPs who performed at least one transaction in the last four years. In the same line, AMEXCAP registered 782 VC transactions for a total of US$834 million invested from 2010 to September 2017 and, on the liquidity side, noticed 37 exits. The industry saw record growth in 2016 with the largest number of transactions, representing US$209 million of capital invested.

In the last 17 years, foreign funds have only contributed with 10 per cent of the total accumulated capital commitments in the Mexican VC industry. However, as the number of foreign and domestic GPs increase, the activity of foreign funds is expected to increase in the Mexican VC industry.

The energy reform, which ended a 70-year chapter of restrictive laws in the oil and gas and electricity sectors, as well as the state monopoly on oil and gas production and in the electricity sector, has opened the investment and participation of private and foreign companies, including PE funds, in such industries. The Federal Electric Commission (CFE), in conjunction with the Ministry of Energy, has developed a strategy to increase gas transportation capacity through an expansion of the pipeline network in order to ensure gas

12 Finnovista: 'Fintech Radar Mexico (July, 2017)'.

13 AMEXCAP, 'Overview of the Venture Capital Industry in Mexico, October 2017'.

supply for power generation. The pipeline network is expected to increase from 11,126km in 2012 to 20,895km in 2019. As of March 2016, there are more than 20 CKDs that invest in the infrastructure and energy sectors that have risen over 80.5 billion pesos.[14]

This constitutional and statutory reform continues to restructure (some say creating) the Mexican energy industry, setting forth the framework for the participation of private investment not only in connection with hydrocarbons (including upstream, midstream and downstream activities) but also concerning the electricity industry. The implications for Mexico's PE industry are considerable, especially now that the attention has shifted to its implementation. PE funds are able to invest in the oil industry by investing in, or lending to, companies or consortiums of companies bidding in public tenders issued by the Ministry of Energy through the National Hydrocarbons Commission for the exploration and production of new oil fields. Considerable opportunities are starting to arise in any business relating to companies participating in midstream and downstream activities, such as petrochemicals and other transformations of hydrocarbons, and the transportation of oil and gasoline. According to AMEXCAP, Mexico's oil and gas value chain could require between US$300 and US$400 billion dollars in capital expenditure through to 2020, promoting a considerable inflow of outside capital and creating an estimated 2 million jobs by 2025.[15] The oil and gas sector is becoming a top sector, almost half of the transactions made, were made in this sector (almost US$6,000 million invested in the past years).

Furthermore, 2017 was a strong year in the power infrastructure sector, starting with the completion of the first two phases of the wind farm project 'Tres Mesas' carried out by the Spanish company Abengoa with a US$300 million investment, and forecasting that over the next three years the state of Tamaulipas will cover one-sixth of the US$6.6 billion dollars that can be awarded for the construction of eight renewable energy parks.[16] Private investment into Mexico's energy infrastructure industry will experience strong growth as the energy reform's measures continue to take hold; many other opportunities will also arise regarding electricity production projects (mainly combined-cycle gas plants and renewables) both for general and private consumption. In addition, Mexico is committed to honour its commitment to the Paris Climate Accord, after COP21 in Paris in 2015, Mexico introduced a major new clean energy policy, which includes a clean energy target: 25 per cent of electricity generation by 2018, 30 per cent by 2021, and 35 per cent by 2024, which means that by 2024, participants in the wholesale electricity market will need to satisfy 35 per cent of their demand through clean air certificates, thus the use of this mechanism will guarantee the demand for renewable energy.

The last four years have been very important for the infrastructure and energy sectors, raising 75 per cent of the total amount of capital since 2005, solely in 2017, three new funds raised a total of US$705.4 million,[17] which is a clear reflection that the reforms are working and Mexico's energy sector is on the right track. We have already seen a significant increase in investment into the power sector and the gas pipelines required to fuel the new thermal power plants tendered by CFE. International developers continue to arrive and the implementation of the reform continues to shift Mexico's energy sector into a positive

14 Idem.

15 Rosenfel E, 'Mexico to receive major economic jolt', CNBC.com, 2014.

16 El Financiero (May 11, 2017): http://www.elfinanciero.com.mx/monterrey/inauguran-parque-eolico-tres-mesas-en-llera.html.

17 AMEXCAP, 'Inside Mexico's PE Market, November 2017'.

direction; for example, Canadian energy firm TransCanada in joint venture with IENOVA and Infraestructura Marina del Golfo (IMG) were awarded a contract to construct and operate the US$2.1 billion Sur de Texas-Tuxpan natural gas pipeline (the Sur de Texas – Tuxpan (Marino) gas pipeline), which is now under construction and will transport natural gas from an underwater rout in the Gulf of Mexico, from the South of Texas to Tuxpan, Veracruz. The Sur de Texas-Tuxpan-Tula natural gas pipeline is supported by a 25-year transportation service agreement with Mexico's CFE, and will connect with the Cenagas pipeline system in Altamira and TransCanada's Tamazunchale and Tuxpan. The Sur de Texas-Tuxpan-Tula adds to TransCanada portfolio, which also includes a US$550 million contract to construct a 420km gas pipeline from Tula in Hidalgo State to Villa de Reyes in San Luis Potosi. The French energy company ENGIE is considering the investment of at least US$300 million to connect its Energia Mayakan natural gas pipeline, a 485-mile pipeline that transports natural gas from Ciudad Pemex in the state of Tabasco, to Valladolid in the state of Yucatan, to industrial and tourism users in the state of Quintana Roo.[18] BP expects to increase investment in everything from exploration to retail fuel sales, the British firm is already involved in three offshore projects, two in the Gulf of Mexico's deep waters and another in shallow waters. The company also launched Mexico's first foreign-branded gas station, with plans to open some 1,500 stations over five years. Tesoro Corporation (now Andeavor), has reached a definitive agreement with PEMEX for transportation services in Mexico. The agreement will enable Tesoro to supply transportation fuels and launch the ARCO brand in the Mexican states of Sonora and Baja California.[19] In addition to the construction of the aforementioned pipelines representing more than US$2 billion in investment, the private sector has begun to invest in storage, the largest initiative is Orizaba Energía's investment of US$115 million to build 2.7 million barrels of capacity in Tuxpan.

Industries are changing and Mexico's global competitiveness is increasing, reforms and governmental initiatives are modifying the structure of the economy to attract investments. The outlook is for Mexico to become a sophisticated design and manufacturing hub and not only a low-cost producer. A clear example is the state of Queretaro, which is growing into a new centre for the aerospace industry, with dozens of multinationals setting up shops in the state's industry zone making the most of generous subsidies offered by the government. At the centre of this growth is Queretaro Aerospace Cluster, whose clients include Safran, Airbus, Aernnova Aerospace México, Duqueine Group, Delta and Bombardier.[20] The aerospace industry has grown from 100 American and European producers in 2004 to more than 330 in 2017 as mentioned in the last Mexico's Aerospace Summit.

The Mexican PE market has grown considerably over the past 17 years. The above-mentioned reforms, their proper implementation and a solid economic foundation will likely foster the growth of Mexico's PE industry. Mexico is still viewed as one of the most attractive Latin American markets, not only because of its geographical position (sharing a border with the US), but also because of the number of trade agreements the country has in place, making preferential relations with 44 countries possible; a growing workforce;

18 El Economista (June 5, 2017): https://www.eleconomista.com.mx/estados/Engie-busca-expandir-en-Yucatan-gasoducto-Mayakan.

19 PEMEX: http://www.pemex.com/saladeprensa/boletines_nacionales/Paginas/2017-064-nacional.aspx.

20 PRO México: www.promexico.gob.mx/es/mx/queretaro.

and fiscal prudence.[21] We believe more firms will come to Mexico and benefit from such favourable conditions, and will continue to elevate PE fundraisings and to profit from the incentives arising from the newly structured legal frameworks, as seen during 2015 and 2016.

In connection with the foregoing, Mexico's government introduced in 2015 two new investment instruments that will be used to promote Mexico's economic development and in particular to boost the PE industry. In September 2015 the creation of 'FIBRA E' also known as the 'Mexican MLP' was announced. FIBRA E is an investment alternative in the form of an investment vehicle promoting long-term investment in Mexican qualified energy, electricity and infrastructure assets and the management thereof, to be traded in the Mexican Stock Exchange and offered locally and abroad. FIBRA E will allow private and public participants to monetise such assets under a tax regime that reduces levels of overall taxation and therefore opens the door for greater distributions. Certain amendments were made to the applicable regulations in April 2016, in order to make the instrument more appealing.

In December 2015, the investment project certificates or CERPIs were introduced. CERPIs will allow insurance companies, pension funds (Afores), and other (national or foreign) institutional investors to participate in equity projects in all productive sectors of the economy. This comes as a simplified version of the existing CKD providing for a larger scope of decision by the GPs and lower investment requirements for the investors. In January 2018, certain amendments were made to the applicable regulations, to allow Afores to acquire CERPIs issued to invest in portfolio companies outside of Mexico (as long as at least 10 per cent of the issuance amount is invested in Mexico), this particular amendment will make the instrument more appealing for issuers and Afores.

As to the reception by potential limited partners of PE funds in the pipeline, public Mexican funds such as CKDs, FIBRAs will likely be received favourably by Mexican institutional investors (mainly Mexican pension funds) if the projects are adequately structured and follow the standard market terms and economics of such funds. As to private Mexican funds, their success will likely depend on the recent success and market credibility of the sponsors or GPs of such funds. As for the newly introduced FIBRA E and CERPIS, they had their first issuances taking place at the end of 2016, reflecting the industry's appetite for financing new projects within the asset class. We might witness an increase of issuances of such instruments derived from the growth of the energy sector and the new amendments to the applicable regulations.

Depending on the structure used to implement a PE fund, the time frame for PE fundraisings may vary. As an example, if the creation of a public PE fund is carried out through the issuance of CKDs, FIBRA Es or CERPIs the time required to raise such fund may range between six to 12 months. For purposes of clarity, PE funds are generally structured as a CKD (and as of 2016, CERPIs) to allow them to raise commitments from the Mexican pension funds (Afores), which have very restrictive investment rules and can generally only invest in projects through these kinds of securities. Such funds are formed through Mexican trusts created to issue the CKDs or CERPIs to be placed and offered through a public offering on the Mexican Stock Exchange (BMV) and managed by fund managers (GPs) incorporated in Mexico. Most CKDs are issued to invest in portfolio companies in Mexico subject to the investment policies determined by the sponsor. At the time of writing, over 74 CKDs have been issued to try access a portion of the billions of dollars managed by the Afores that can be

21 'Private Equity in Mexico: Primed for significant growth', Antonio Martinez Leal and Pino del Sesto, Bain and Company.

invested in this type of security. There are 26 CKDs on the pipeline pending to be approved which would capture US$6.178 billion, nine CKDs per year is the annual average of CKDs that are listed per year since 2010.

The same timeline applies for Mexican FIBRAs that raise capital through the issuance of real estate certificates, which are generally publicly offered in the BMV but can also be offered in foreign markets. The funds raised by FIBRAs can only be invested in commercial real estate projects and developments (industrial, retail and hospitality), and are structured as Mexican trusts to which real estate assets are conveyed by the original owners who, in exchange, receive real estate certificates.

The timeline for privately placed PE funds structured through Mexican or foreign vehicles will vary depending on the market conditions.

Below are recent deals that were made publicly available.

In June 2017, Gava Capital held the issuance and placement of a CKD for a maximum amount of 2.1 billion pesos on the BMV. This CKD aims to invest in real estate in Mexico.[22]

In November 2017, Riverstone held the issuance and placement of a CKD for a maximum amount of 8 billion pesos on the BMV. This CKD aims to invest in renewable energy in Mexico. This is Riverstone's second CKD.[23]

In December 2017, Artha Capital held the issuance and placement of a CKD for a maximum amount of 12 billion pesos on the BMV. This CKD aims to invest in real estate in Mexico. This is Artha Capital's fifth CKD.[24]

The Abraaj Group partnered with Emerging America, a Mexican power project developer, to make a debut investment in Mexico's energy sector. The Abraaj Group, together with Emerging America, will build a 500MW natural gas-fired power generation platform in the state of Chihuahua, Mexico. Such platform will provide sustainable energy, reducing the cost of electricity for consumers. It will be one of the first platforms to enter into operation under the new legal and regulatory framework of the Mexican electricity sector, generating electricity efficiently and with low emissions compared to the country's fuel oil power plants.[25]

Caisse de dépôt et placement du Québec (CDPQ) and CKD Infraestructura México (CKD IM), a consortium of Mexican institutional investors, acquired 80 per cent of Enel Green Power's wind and solar assets in Mexico for US$1.35 billion. Enel Green Power, a global leader in renewable energy, will remain the operator and retain 20 per cent of the portfolio. Since the creation of their investment platform in 2015, CDPQ and CKD IM have invested in road and telecommunication infrastructure. With this transaction, they now add the renewable energy sector to their portfolio.[26]

ALLVP announces a follow-on investment in portfolio company, Weex, leading its latest round along with the pool of existing strategic co-investors, including Coca-Cola. The Company will use the funds to further expand its user base and become the largest mobile virtual network operator (MVNO) in Mexico, offering an innovative value proposition coupled with a unique marketing strategy.[27]

22 AMEXCAP: 'Transactional News'.

23 LAVCA: https://lavca.org/2017/11/27/riverstone-invest-renewable-energy-mexico/.

24 Nader, Hayaux y Goebel advised Artha Capital, acting as issuer, on this offering.

25 The Abraaj Group: https://www.abraaj.com/insights/news/press-releases/Abraaj-to-build-500MW-power-generation-platform-mexico.

26 CDPQ: https://www.cdpq.com/en/news/pressreleases/cdpq-and-ckd-im-acquire-mexican-wind-and-solar-assets-of-enel-green-power.

27 LAVCA: https://lavca.org/tags/mexico.

Actis, through its renewable energy platform Zuma Energía, obtained US$300 million in financing to complete two solar energy projects in Orejana and Santa María, which are located in the Mexican states of Sonora and Chihuahua, respectively.[28]

The Mexican venture capital firm IGNIA invested in the Mexico based start-up AirTm, a company that has created an easy, secure and low-cost way of moving money in local currency to an AirTm cloud-based US-dollar-denominated account (and vice versa). The company has a network of cashiers that connect more than 200 national banking systems and multiple e-money networks such as Paypal, Amazon, Neteller and Skrill.[29]

Mexico's government has committed US$4.1 million to three local agtech venture capital funds via its fund FOCIR. The funds are managed by local agtech VCs including Grupo Ercus, Innova Camp and Enture. The aim of the fund commitments is to support Mexico's agtech start-up ecosystem and give university researchers a clear pathway to commercialise their work. FOCIR runs seven internal private equity funds totalling more than US$500 million with more than 30 investments in rural projects.[30]

II LEGAL FRAMEWORK FOR FUNDRAISING

The Canadian limited partnership is one of the most popular legal forms to structure PE funds with Mexican limited partners investment, as they are considered transparent structures for tax purposes. In addition, other forms of vehicles used in Mexico include the PE investment trust and FICAPs, which is a Mexican trust that is not considered an entity under Mexican law, and which has a specific set of tax rules created to incentivise PE investments. To raise funds from investors, FICAPs issue certificates that can be either publicly placed through the BMV (the most recent CKDs are FICAPs) or privately issued. FICAPs are exempt from complying with certain management and tax payment obligations. The fundamental characteristic of the FICAPs is that the trust is subject to a transparent regime for tax purposes, and thus such regime allows the investors to directly recognise the income generated through the trust (dividends, capital gains and interest payments) as if they had obtained such income from investing directly in a Mexican target entity. Another form that is used by PE funds is the SAPI, which is mainly a Mexican corporation that provides great flexibility to structure different kinds of businesses (including PE funds), and also increases the protection offered to minority shareholders and provides exit strategies.

The key legal and negotiable terms of PE funds will depend on the vehicle chosen, but will be very similar to those in other jurisdictions (e.g., the term of the fund, investment policies, management of the fund and documentation of the relationship between the manager and the fund, fees, carried interest and exits for limited partners).

One of the key issues for a Mexican PE fund is its management. In connection with CKD funds, for example, the sponsor will normally act as the manager, and will carry out the business of instructing the trustee to make the required investments in eligible projects; however, pursuant to Mexican securities law, it would also require the approval of the limited partners for relevant investments or actions, which causes the limited partners of CKDs or FIBRAs to have an active role in the management of the fund. All CKDs and FIBRAs investments are subject to certain guidelines (including bondholder meeting approval).

28 Idem.

29 AMEXCAP: 'Transactional News'.

30 LAVCA: https://lavca.org/2017/09/05/mexico-government-invests-us4m-3-local-agtech-funds/.

Nevertheless, the structuring of CKDs has improved over time, and has evolved to the extent that CKDs are released from rules that previously prevented deals from taking place. In addition, we have noticed that management fees and carried-interest fees have changed over the past five years. The tendency has been for such fees to decrease (e.g., some CKDs had management fees amounting to around 2 per cent of the total amount invested during the investment period in 2009; currently, the management fees for 2017 transactions range between 1.5 and 1.75 per cent of the total amount invested during the 2016 investment period).

We have also noted that, rather than the usual passive limited partner role, certain institutional investors are seeking a more active role in traditional PE funds.

The SAPI is governed by federal law and, more specifically, by the Mexican Securities Market Law; all items not covered by the Mexican Securities Market Law are regulated by the General Law of Business Organisations. However, the SAPI is not subject to obligations applicable to public corporations or to the surveillance of the National Banking and Securities Commission. Therefore, no disclosure obligations must be met.

PE funds are reluctant to share information due to potential threats posed by competitors and other factors. However, if the PE fund is structured through a CKD, investors and fund managers must take into consideration that CKDs are publicly listed vehicles; as such, they are obliged to disclose certain information, and its issuers have the same disclosure obligations as other debt issuers according to Mexican regulations.

Disclosure obligations include the filing of quarterly and annual reports to the BMV that include updates and annual audited financial statements, as well as a duty to disclose any information necessary for investors to carry out investment decisions.

As explained above, depending on the structure of the PE investment, the method of investment solicitation at the fundraising stage may vary.

PE funds may raise capital by privately soliciting sophisticated investors in Mexico under the Mexican safe-harbour rule, which allows the private placement of securities to such investors. For public funds such as CKDs, CERPIs or FIBRA, solicitation is open to the general public (any kind of investor, person or entity, whether Mexican or foreign), although generally such funds target the investment of institutional investors such as the Afores, insurance companies and sophisticated investors who are private banking clients. Public funds such as CKDs, CERPIs and FIBRAs are also subject to certain solicitation and publicity guidelines applicable to all issuers on the BMV market.

GPs of PE funds formed as Canadian limited partnerships may be subject to certain Canadian regulations applicable to GPs.

Regarding Mexican vehicles, in structures such as SAPIs, the fiduciary duties of care and loyalty (such as conflicts of interest, disclosure and informational duties) shall be set forth contractually. Furthermore, the adoption of the Better Corporate Practices Guidelines issued by the Mexican Coordination Business Council is encouraged, and many funds have adopted such practices regarding corporate governance and fiduciary duties.

Regarding CKDs, CERPIs and FIBRAs, the manager of the fund is normally also the fund's sponsor and, in line with its responsibilities to carry out the fund's projects, it must comply with the resolutions and policies of the trust's technical committee; such committee will set up the terms and conditions of the manager's duties, and must reject any transactions that may involve a conflict of interest. Recently, it has become more common that managers of CKDs, CERPIs or FIBRAs are subject to the same fiduciary duties that the directors of Mexican public companies are subject to in accordance with Mexican securities law.

Regarding FIBRA E, it must be structured as a Mexican trust. The applicable tax rules provide that the trust must be formed following many of the requirements applicable to the FIBRAs with certain differences. The trust must have (1) up to 30 per cent of its book value represented by bonds of the federal government or shares of mutual funds who may invest only in fixed income securities, and (2) at least 70 per cent of its book value represented by investments in shares of Mexican companies. Such Mexican companies shall comply with the following: (1) the shareholders of the company (other than the trust itself) must be Mexican residents; this requirement does not exclude foreign investors in any manner, and they will be entitled to own shares of the underlying company through the trust or through a Mexican subsidiary, although depending on the amount of the investment, antitrust and foreign investment approvals may be required; (2) the corporate purpose of each company must be a Mexican-qualified energy, electricity and infrastructure asset-related activity, the management thereof or a combination of such activities, and at least 90 per cent of the annual taxable income of the FIBRA E should stem from qualified energy, electricity and infrastructure assets; and (3) the investments of the company must be in brownfield or qualified greenfield projects as only 25 per cent of the book value may be represented by new assets.

III REGULATORY DEVELOPMENTS

Except for publicly placed PE funds (such as the CKDs, FIBRAs, FIBRA E and CERPIs), there is no regulatory oversight of Mexican PE funds or their fundraising processes (other than the safe-harbour rule mentioned above).

CKDs, FIBRAs, FIBRA E and CERPIs are governed by federal securities law, and their main regulator is the Mexican Banking and Securities Commission or (CNBV). CKDs, FIBRA E, FIBRAs and CERPIs are supervised and regulated to ensure the proper operation of the financial system and to protect the interests of the general public. In consequence, issuers are subject to quarterly and annual reporting obligations, such as presentation of audited financial statements, and the registration of the fund requires the previous authorisation of the CNBV and the BMV.

Other forms of PE funds are not under any obligation or requirement to be registered in Mexico, and the sponsors or GPs do not have to be registered in any special registry in connection with their activities as fund managers.

Depending on the legal form of the PE fund, the tax rules can vary; thus, the specific tax regime applicable to the investors may also vary. Nonetheless, generally the vehicles chosen (including limited partnerships and FICAPs) are structured in a manner that allows them to be considered tax-transparent vehicles, which implies that the income realised is directly recognised by the investors.

In the case of foreign limited partnerships, a tax-transparency regime may be achieved to the extent that such partnerships are created in a country with which Mexico has a broad agreement for the exchange of information; that they do not have a legal personality of their own, separate from that of their members; and that they are tax transparent in their country of formation. If such requirements are met, the limited partnership will be treated as tax transparent for Mexican purposes, and thus the investors will be entitled to apply any benefits that may be included in any relevant double taxation treaty.

FICAPs, on the other hand, are also tax transparent, and are governed by a special set of tax rules that defines the withholding obligations applicable to the parties involved, as well as the moment at which the investors participating in FICAPs shall be liable to tax. More

specifically, according to such rules the investors shall be liable to Mexican tax upon receiving a distribution from the FICAP, and the tax regime actually applicable to each investor will be contingent on the nature and country of residence of such investors (e.g., institutional, foreign or local, tax-exempt or taxable).

To qualify as such, FICAPs are subject to certain requirements under Mexican tax provisions:

a FICAPs shall invest at least 80 per cent of the trust assets in stock issued by Mexican target entities (not publicly listed at the time of the investment) or granted as loans to such entities;

b the remaining percentage that is not invested in stock issued by Mexican target entities or granted as loans to such entities shall be invested in securities issued by the federal government or in Mexican debt mutual funds;

c the acquired stock shall be held for at least two years; and

d at least 80 per cent of the income realised by the FICAP should be distributed within two months following the end of the tax year. If the FICAP does not reach such thresholds, it will not be considered as such and thus will not benefit from the specific tax rules applicable to such vehicles.

Slight changes were made to the tax regime applicable to FICAPs for 2016; in particular, it should be highlighted that the limitation for the application of the FICAP regime for a maximum of 10 years has been repealed. In the case of FIBRAs, two additional requirements were included as part of the amendments made to the income tax legislation for 2014 (and which resulted in a new Income Tax Law): in the case of lease agreements where the consideration is established as a variable amount or based on a percentage, such type of income cannot exceed 5 per cent of the aggregate income of the FIBRA unless the rental payment is established as a fixed percentage of the sales of the lessee; and trusts operating as FIBRAs must be registered with the tax authorities. In addition, certain measures were included in the applicable securities rules to limit the ability of FIBRAs to incur debt. And more recently, the possibility has been established for the FIBRA trust to repurchase its own certificates, subject to several conditions.

As for the recently enacted FIBRA E, the main features of the tax regime that has been established may be summarised as follows:

a Both the underlying Mexican companies in which the trust invests and the trust itself shall be treated as tax transparent, and the certificate holders will directly recognise the tax result of the FIBRA E as computed by the trustee under the specific rules (no monthly or annual income tax payments are required at the trust or underlying company levels).

b In computing the tax result of the trust, the trustee shall consider the tax profits generated by the underlying companies (but not the tax losses, which may only be carried forward by the entity that generated them) and a deductible deferred expense, equal to the gain generated by the seller of the shares acquired by the FIBRA E trust as per below.

c The persons selling shares to a FIBRA E will be required to recognise the gain derived from the sale of the assets owned by the company whose shares were sold (instead of recognising a capital gain on the actual sale of shares).

d The trust will be required to distribute on a yearly basis at least an amount equal to 95 per cent of its annual tax result, using the proceeds distributed by the underlying companies.

e The aforementioned distributions will not be considered dividends for tax purposes and thus the 10 per cent dividend tax will not apply.

f Certain specific rules were enacted in order to allow the spin-off or otherwise segregate qualifying assets to special purpose vehicles in a tax-efficient manner, provided that at least a certain number of the shares in the resulting vehicle are subsequently sold to a FIBRA E within six months.

g Mexican-resident individuals and non-resident investors will be exempt from withholding tax on the sale of the certificates issued by the FIBRA E, provided that the sale takes place through an authorised exchange.

IV OUTLOOK

The private equity industry in Mexico has been re-energised in the past years by government reforms and policies, a stable macroeconomic situation, a stable population growth rate, real income increase and an active entrepreneurial ecosystem.

Mexico is currently facing the NAFTA negotiations with the United States as well as the presidential election in July 2018, which might bring uncertainty to investors. However, Mexico is preparing for any scenario, a clear example is the aim to increase trade with Argentina and the Pacific Alliance (Colombia, Peru and Chile), as well as the European Union and Asian countries, and the continued efforts made by the government in the past year in the infrastructure and energy sectors.

While the forecasts are moderately strong, we expect contract and investment opportunities to be abundant as government policies support a shift towards a larger role for private investment in the Mexican infrastructure and energy industries, as well as the rise of the fintech industry. There is a positive outlook for Mexican PE industry, local funds are becoming more global, deploying capital and investments of foreign funds are increasing all over the energy sector. If conditions remain the same and the growth rate remains at levels we have seen, the PE industry would reach US$80 billion by the end of 2020 according to AMEXCAP.

We predict that the regulations applicable to publicly issued PE funds will continue to be improved, and that the regulations regarding investment restrictions applicable to Mexican pension funds must necessarily evolve toward the type of regulation seen in other, more evolved countries in order to allow the pension funds to conduct private transactions and investments in funds or projects directly (and not only through publicly issued securities such as CKDs, FIBRAs, FIBRA E and CERPIs).

Appendix 1

ABOUT THE AUTHORS

HANS P GOEBEL C

Nader, Hayaux y Goebel, SC

Mr Goebel is a Mexican lawyer who specialises in mergers and acquisitions, private equity, capital markets, and banking and finance.

He is recognised as a leading lawyer by *Chambers Latin America*, *IFLR1000*, *Best Lawyers* and *PLC Which Lawyer?*, for his outstanding expertise. *Chambers Latin America* ranks him as a leading individual for capital markets, describing him as a 'tremendous negotiator', and also note that 'he is adept at managing client relationships, and is exceptional in his productivity: he provides multifaceted recommendations and solutions which are of great help to his clients'. Other recent editorial commentary in this publication includes feedback from clients who point out that Mr Goebel is 'a terrific lawyer who is always on top of everything and can resolve anything you ask of him', and they highlight 'he has a rare skill in being able to capture what is important and being truly practical in making it happen'.

Mr Goebel spent a year working in the Chicago office of international law firm Mayer Brown, having received his LLM (with honours) from the Northwestern University School of Law of Chicago. He graduated as an attorney from the Instituto Tecnológico Autónomo de México and has lectured in financial contracts at the Universidad Iberoamericana. He currently acts as independent director and board secretary of various financial institutions.

HÉCTOR ARANGUA L

Nader, Hayaux y Goebel, SC

Mr Arangua specialises in capital markets, structured finance, mergers and acquisitions, private equity, and energy.

He is recognised as a leading lawyer by *Chambers Latin America*, *IFLR1000*, *The Legal 500* and *LL250*, for his outstanding expertise. *Chambers Latin America* ranks him as a leading individual for capital markets, describing him as 'one of the hardest-working lawyers in the market, who always goes the extra mile to ensure that everything is perfect', and that 'he is incredibly technical and methodical, as well as having great business sense and a hands-on attitude'.

He is an expert in securities and regularly advises both private and public companies on issuances in the local market and abroad. He has also developed niche expertise in CKDs.

His structured finance practice is focused on providing advice to lenders on structuring complex bankruptcy-remote payment structures.

He has developed expertise in the oil and gas sector, in which he has continuously advised on capital markets, finance and M&A matters.

Mr Arangua has strong international experience. He is licensed to practise in New York and regularly advises US and other international clients on transactions in Mexico.

He obtained his LLM from the University of Michigan Law School, having graduated as a lawyer from the Instituto Tecnológico Autónomo de México.

ADALBERTO VALADEZ

Nader, Hayaux y Goebel, SC

Mr Valadez specialises in taxation matters, and he concentrates his practice on federal income tax and international tax, including cross-border M&A and joint ventures, inbound investments into Mexico, as well as structuring and implementation of collective investment vehicles (such as private equity funds) managed by Mexican and foreign sponsors.

He has solid experience in advising his clients on issuances in the local securities market, particularly in the case of development capital certificates and exchange traded funds.

As part of this practice he regularly advises multinational clients making investments in Mexico, or which have commercial relationships with companies in Mexico. He also spent six months working as a foreign associate in the Amsterdam, Luxembourg and Geneva offices of Loyens & Loeff.

He graduated with honours as an attorney from the Instituto Tecnológico Autónomo de México (ITAM).

LORENZA MOLINA S

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Mrs Molina specialises in capital markets, structured finance, mergers and acquisitions and private equity.

She has experience in advising public and private companies on issuances in the local market and abroad, as well as foreign companies, investment funds, banks and brokerage firms on matters primarily related to banking and securities law, capital markets, private equity investment structures and compliance and surveillance of the Mexican securities market.

She graduated with honours from Universidad Iberoamericana, attorney at law (2010) and received her LLM (with honours) from Northwestern University Pritzker School of Law (2014).

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