MAY 2016

SPECIAL REPORT: PRIVATE EQUITY IN MEXICO

EMPEA

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Private Equity in Mexico

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WE ARE GRATEFUL FOR THE GENEROUS SUPPORT WE RECEIVED FROM EMPEA MEMBERS AND INDUSTRY PARTICIPANTS IN PRODUCING THIS PUBLICATION.

In particular, we would like to thank the numerous fund managers active in Mexico that donated their time and provided valuable data sets to help inform our analysis. We'd also like to thank the institutional investors, funds of funds, law firms and placement agents that shared their insights with us.

We would especially like to thank the following firms for providing key thought leadership, as well as the financial support necessary for this syndicated report:

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A LETTER FROM EMPEA CONSULTING SERVICES

Dear Reader,

EMPEA Consulting Services is pleased to present this *Special Report: Private Equity in Mexico,* EMPEA's second dedicated research coverage of the market since 2012.

Descending through the haze on final approach to Benito Juárez International Airport, travelers to Mexico City are treated to a panorama of one of the world's largest conurbations—the verdant polygon of the Bosque de Chapultepec gives way to the skyscrapers lining Paseo de la Reforma and the ochre-toned roofs that stretch over and around the mountains at the horizon. Beneath lies a city teeming with energy and commercial activity—surely, one thinks, there must be opportunity for investors.

Yet with the headline stories of corruption, kidnappings and cartel violence emanating from the country in recent years, it is little surprise that global investors have had reservations about deploying capital into the market. These are real challenges that investors must navigate cleanly; but they're also only one part of Mexico's story. One has been more likely to hear about the murder rate in Ciudad Juárez than mobile app developers in Mexico City, meth manufacturers in Michoacán than auto parts manufacturers in Monterrey and *autodefensas* in Guerrero than entrepreneurs in Guadalajara. One must dig deeper to get a more holistic view of Mexico's reality.

Economically, Mexico has exhibited atypical stability for an emerging market, delivering an average of 2.5% real GDP growth since 2012. Yet this figure belies a vibrancy and dynamism taking place at the local level—where in many states and cities growth is a multiple of GDP.

Long overshadowed by its Lusophone peer, Mexico is coming into its own as a market demonstrating political stability and a commitment to opening up new sectors of the economy to competition and investment. Moreover, reforms around pensions systems and securities regulations are unlocking local pools of capital to invest in private equity; and government support for incubators, accelerators and early-stage investors is catalyzing a steady flow of potential investable companies in the years to come. The industry appears to be primed for growth, with political, economic and societal tailwinds supporting its development.

We would like to thank our report sponsors—Fondo de Fondos, Alta Growth Capital, PineBridge Investments, Southern Cross Group and TC Latin America Partners—for providing us with the support needed to undertake this research effort, as well as the numerous firms active in Mexico that took time to share their views on the market. We'd also like to thank AMEXCAP (the Asociación Mexicana de Capital Privado) for being an industry partner.

As private equity remains an opaque asset class, we encourage readers to review our data methodology on page 40.

We hope that you enjoy this publication, and that it provides a fresh perspective on a richly diverse economy. We welcome your comments at consulting@empea.net.

Best wishes,

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AN INTRODUCTION TO PRIVATE EQUITY IN MEXICO

For decades, Mexico remained under the radar as private equity investors with an interest in Latin America poured their money into Brazil. Headline risk around corruption and the war on drugs, a relatively small pool of fund managers, and the high concentration of large, family-owned businesses potentially restricting deal flow were among the many factors that had deterred greater investment. However, the tide appears to be turning—particularly with the entrance of the local pension funds (or Afores), which in 2009 were given the freedom to invest 10% of their assets into private equity under new regulations. Since this time, fund sizes for the more established general partners in the region have grown, while the total number of private equity and venture capital funds operating in the market has multiplied. In the eight years leading to 2016, Mexico-dedicated funds had raised nearly US$8.7 billion, with an additional portion of the US$12.7 billion raised by regional funds earmarked for the market (see Exhibit 1).

Perhaps the most important driver, however, in pushing the asset class forward has been the Mexican government. It has demonstrated a deep appreciation for how private equity can help develop the economy, lead to job creation and instill best practices throughout local businesses, which puts the country well ahead of the curve in relation to a number of its emerging market peers. While the road is not always a straight one, the government, along with the local industry, has been focused on making continuous improvements to the legal and regulatory framework in favor of private equity, one small step at a time.

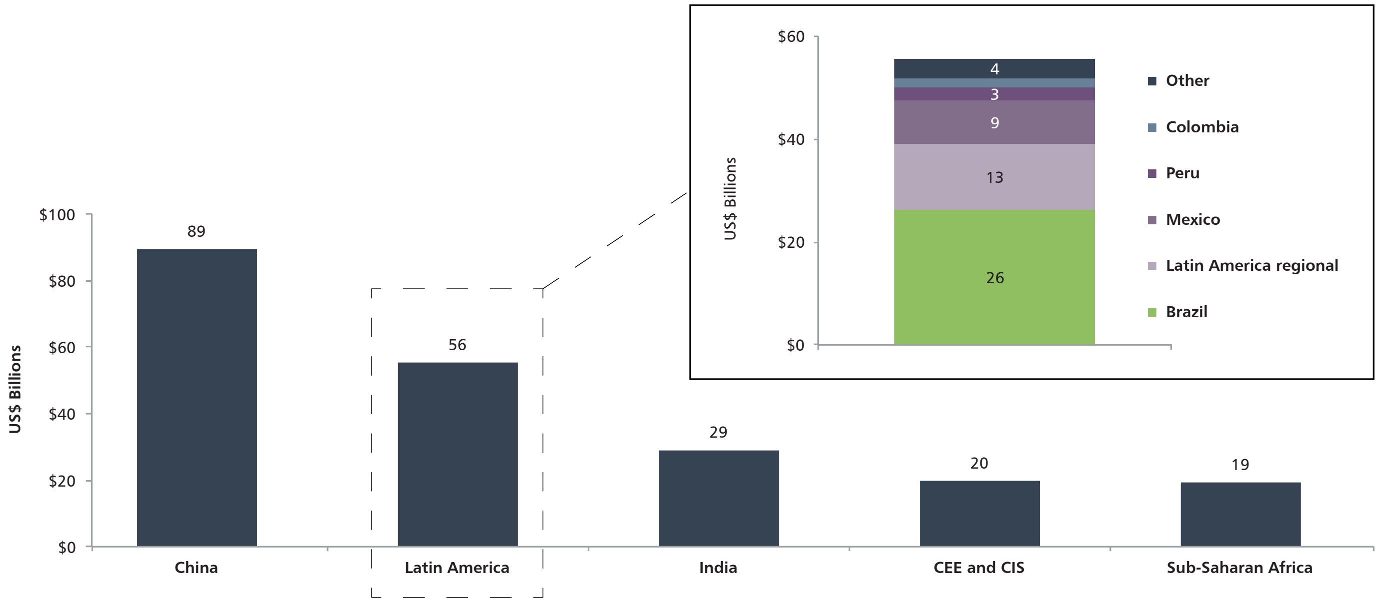
A ROCKY ROAD

The earliest private equity fund managers, the majority of which were large buyout firms based in the United States, began to flock to Latin America during the 1990s. On the back of their success with the asset class at home, many of these firms' institutional investors were flush with cash and saw the fact that many emerging markets were increasingly opening up their economies as a means to generate high returns and diversify their portfolios. By the end of 1999, over 100 private equity funds were deploying capital in Latin America.[1] Mexico—as well as a number of other countries across the region—saw substantial volumes of capital flow into the market.

Unfortunately, a bust quickly followed the boom, and by the early 2000s, many of these pioneers had not survived. In 2002, the former Texas-based buyout firm Hicks, Muse, Tate & First, Inc. and GE Private Equity, an investment arm of General Electric Co., both shut down their Mexico City offices, representing just two examples of firms on the retreat. The reasons were multifold: a growing realization that the model that had worked so well in a developed market context was not a plug-and-play that could be applied to Latin America, coupled with broader regional macroeconomic woes—including the aftermath of the 1994 Tequila Crisis—resulted in overall poor performance.

"These early investors were not very happy because their results never materialized," recalls Joaquín Ávila, Co-founder of EMX Capital. "What followed was a drying out of equity, and it took quite some time before people and money started to return to this industry. With the next wave, we started humble and small, but the opening of the local pension funds has really moved the needle."

Exhibit 1: Cumulative Private Capital Fundraising for Select Emerging Markets, 2008-2015 (US$B)



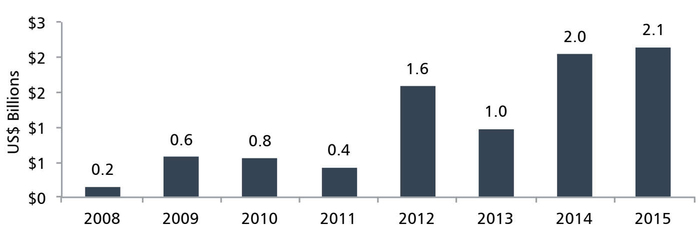
Source: EMPEA. Data as of 31 December 2015.

1. For more information on the history of private equity in emerging markets, see Roger Leeds, *Private Equity Investing in Emerging Markets.* New York: Palgrave Macmillan, 2015.

Homegrown firms—many of which were supported by local development bank-backed investor Fondo de Fondos (see *Sidebar: Building a Local Industry*)—began investing in the market in the late 2000s in an effort to prove the concept, while a number of international firms moved in, this time with a much greater emphasis placed on recruiting and building local teams. Once the Afores were given the green light to invest in private equity (as well as real estate and infrastructure) through an innovative, publicly listed instrument called a *certificado de capital de desarollo* or CKD, the tide began to turn. From a modest fundraising total of US$152 million raised in 2008, Mexico-dedicated private capital vehicles raised US$2.1 billion in 2015 (see Exhibit 2), representing a compound annual growth rate of 46% and overtaking Brazil for the first time since EMPEA began tracking fundraising statistics.

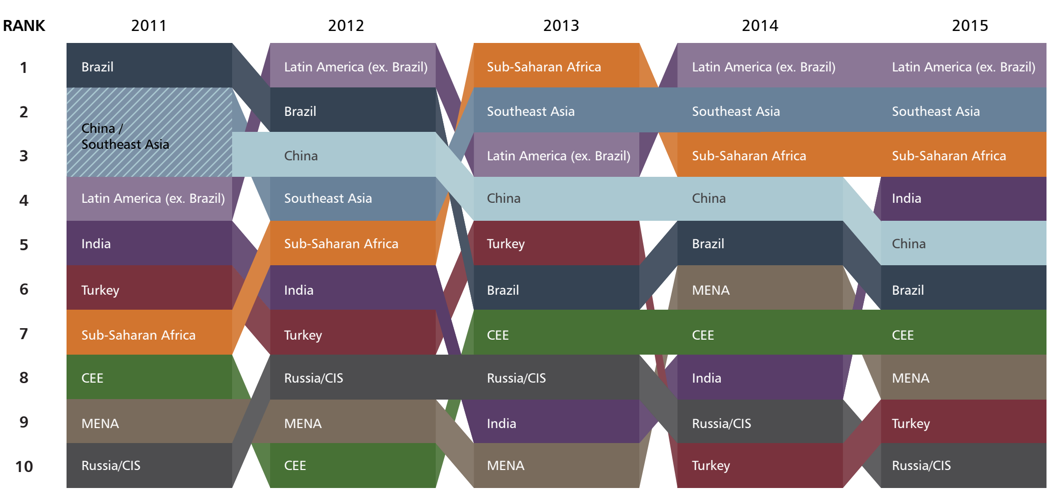
Alejandro Rodriguez, Director in the Private Funds Group of PineBridge Investments, notes, "When we started looking at the region back in 2008, there were about 30 managers investing in all of Mexico, and this includes regional funds that were doing investments in the country. Today, we have more than 70. We've seen the power that local capital has had on other markets, and this is now happening in Mexico—the involvement of the Afores has been a huge inflection point for the industry."

Exhibit 2: Mexico Private Capital Fundraising, 2008-2015 (US$B)



Source: EMPEA. Data as of 31 December 2015.

Exhibit 3: LP Views on the Attractiveness of Emerging Markets for GP Investment



Source: EMPEA's 2015 *Global Limited Partners Survey*.
Note: China and Southeast Asia tied for second place in 2011 Survey. Southeast Asia was classified as "Other Emerging Asia" in 2011 and 2012. LPs ranked markets based on a view over the following 12 months.

THE CASE FOR PRIVATE EQUITY IN MEXICO

Alongside the rise in local investor participation, the global limited partner community has recently begun to take increased notice of the Mexican market. EMPEA's 2015 *Global Limited Partners Survey* reveals that Latin America excluding Brazil, of which Mexico represents the largest market, has been ranked as the leading market for general partner investment for the last two years in a row (see Exhibit 3). A number of macro and micro factors are responsible for this uptick in interest.

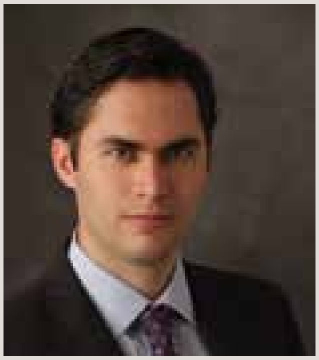
On the macro front, Mexico, which put in place a number of reforms in response to the financial crises of the 1990s, has demonstrated remarkable stability—if not stellar growth. Johannes Goderbauer, Senior Investment Manager at DEG, shares, "The story of Mexico—and this has been my mantra for years—is that there is no big story, and I mean that as a positive. Following the financial crisis, three significant sources of funding disappeared to a large extent, with remittances down, oil prices tanking and the swine flu causing tourism to drop. Any one of those factors could have led to a major disaster but yet there wasn't an economic crisis in the country."

From a micro perspective, a number of Mexico's fund managers have now had the benefit of going through a few fund cycles, while new entrants continue to crop up and are focusing on a variety of strategies, increasingly including venture capital. Deal flow is reportedly opening up as family-controlled companies pass down through generations and as business owners increasingly understand the benefits of a private equity partner. "Things are going in the right direction," notes EMX Capital's Ávila. "Competition is maturing now across a number of industries. As this competition gets tougher, more and more people understand that the opportunity to not only bring in money, but smart money and people who can help you professionalize and improve your speed of growth, is valuable." In addition, the options for exit are slowly beginning to expand beyond strategic sales to include a growing secondary market as well as public offerings.

The recent growth in Mexico's private equity industry—albeit starting from a low base—has been extraordinary. The following pages will provide greater color on both the macro and micro drivers that have propelled—and in some cases impeded—this progress.

WHERE DOES MEXICO FIT WITHIN A GLOBAL EMERGING MARKET ALLOCATION?

BY ALEJANDRO RODRIGUEZ, DIRECTOR, PRIVATE FUNDS GROUP, PINEBRIDGE INVESTMENTS



Global investors are always thinking about how to best build a global emerging market portfolio. The recommendations we give our clients are usually based on their current exposure, since they may already have an allocation to a local market that they naturally know better. However, if we were looking at a clean slate and building an emerging markets fund of funds portfolio from scratch today, then typically Latin America would represent about 25-30% of those portfolios, with the remainder being focused primarily on Asia and Africa.

In Latin America, middle-market growth equity via primary and secondary investments in Mexico, Brazil and the Andean Region are showing attractive opportunities. On the primary side, many investors are overweighting Mexico relative to the size of its economy—I would expect that Mexico, Brazil and the Andean region each represent roughly a third of many regional allocations. On the secondary side, most of the opportunities we've seen and will continue to see are primarily in Brazil due to the amount of capital that has been invested in that market over the last five years.

The reason that Mexico is very attractive and worthy of overweight vis-à-vis the rest of Latin America is because Mexico has the right regulations, the right managers and the right framework to do private investments, yet we see low private equity penetration relative to GDP. Mexico has both a good macro and good micro story. On the macro side, the country has stability that has been built up over the last 20 years and is implementing important reforms, for instance in telecom and energy. Mexico also has a growing middle class and several sectors—for instance, financial services, education, consumer staples and health care—that are positioned to benefit from rising consumption. Infrastructure and related industries are also a rich source of opportunity in Mexico. We believe that while finding the right private equity opportunities is much more about the micro, it's crucial to get the macro right as well.

On the micro side, when you look at the opportunity set in Mexico, the need for capital is extremely high, as is the need for the fund managers' expertise to help small- and mid-size businesses get through the challenges they face as they grow and evolve from a family-owned business to one that is institutionally managed with the right corporate governance. In Mexico, there is an opportunity for the private markets to take advantage of dislocations in the market, whether in terms of a void in capital available to certain sized companies, sectors or geographic areas. That's the great thing about the private markets—you can be flexible and more patient since you have longer-term capital.

Long-term investors have to make an effort to not get into the trap of trying to time a cycle. We started investing in Mexico in 2010, at a time when people were not so keen on the market. It was not until around 2013—when some of the reforms started to come to fruition—that more people started looking at Mexico more closely, particularly as Brazil became relatively less attractive. We also made the decision to set up an office in Mexico City in 2012, around the time we closed our development capital certificate (CKD), to cover all of our Latin American investments, which was different from a number of our peers. We believed in the depth of the market and felt that an evolution was about to take place. In particular, we expected the involvement of the Afores in private markets to be a huge inflection point, as we have seen in other markets.

Of course, one aspect that will be crucial for this momentum to continue is to see more realizations from Mexico's fund managers. People have been willing to invest, and to take a long-term view on the market, but we need to see a greater number of exits to prove them right. That's always a challenge; you don't see as many exits in Mexico as you do in other markets, which is a factor in allocating capital to the region. Fortunately, more exits are expected to come from mergers and acquisitions as well as strategic acquirers in the next few years.

Although many investors have already allocated capital to the region for some time, is it too late to invest there now? I don't think so. It is still a very good time to keep investing, or even start investing, in long-term projected opportunities in Mexico and Latin America.

Mexico's Macroeconomic Environment—A Bright Spot in Latin America

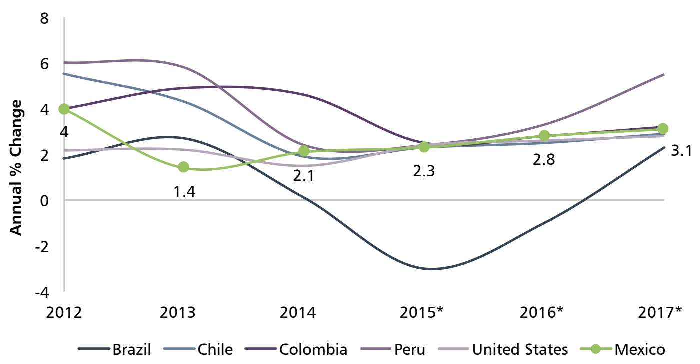
Rising U.S. interest rates, depreciating emerging market currencies and persistent low oil prices have created a tumultuous environment for private equity investors across the globe. Despite these strong headwinds, Mexico has shown remarkable resilience, largely due to the government's continuous push for reforms, which have created a sound economic base and enabled the country to manage external macroeconomic threats. The country's slow but steady growth, driven by internal consumption and a diverse range of exports, as well as a number of initiatives under President Enrique Peña Nieto's administration—including privatization of the energy sector and the implementation of antitrust laws—are contributing to a positive macroeconomic outlook for Mexico.

SLOW AND STEADY WINS THE RACE

Over the last three years, Mexico's GDP has been steadily growing, and is projected to continue to grow modestly (see Exhibit 4). Due in part to its close correlation with U.S. growth rates, Mexico's GDP has largely avoided the higher levels of volatility seen in many other Latin American countries. Scott McDonough, Managing Director of Alta Growth Capital, touts the country's stability, "When we were raising our first fund, one could summarize the entire emerging markets story with the BRICs. However, Mexico is now becoming more of a standalone story, in part because of the attention it is getting from a macro standpoint. It is growing—not as much as people would like, particularly the Mexicans—but relative to the rest of the world, it looks pretty good. A 2.5% growth rate is nothing to sneeze at these days."

Despite a slowdown in inflation-adjusted consumption growth rates over the last few years, consumption has risen 11% between 2011 and 2014.[2] The sectors that witnessed the greatest gains in spending in 2015 included health care, clothing and accessories, and hardware (see Exhibit 5). Alta Growth Capital's McDonough remarks, "The trend that we like in Mexico is that of its young, emerging middle class coupled with increased consumerism—and this trend hasn't changed since we launched our first fund. With a stable economy, people are able to spend more and improve their standard of living." Eduardo Cortina, Director at The Abraaj Group agrees that this is a positive trend. "When you look at the country's GDP per capita and drill down to analyze different derivatives such as the growing middle class, credit expansion and the demographic dividend, you'll see that there is a lot of economic power coming online in Mexico. This ultimately translates into a very compelling investment opportunity for investors in consumer-facing sectors and companies."

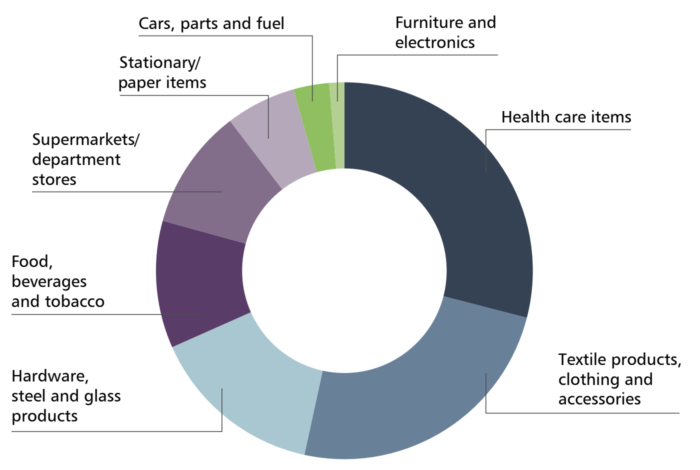
Exhibit 4: Mexico's Steady GDP Growth Is Closely Tied to the United States



Source: IMF World Economic Outlook October 2015. Accessed 21 March 2016.
*Estimated.

Exhibit 5: Health Care Products and Clothing Drove Consumer Growth in 2015

Breakdown of total consumer growth by sector in 2015



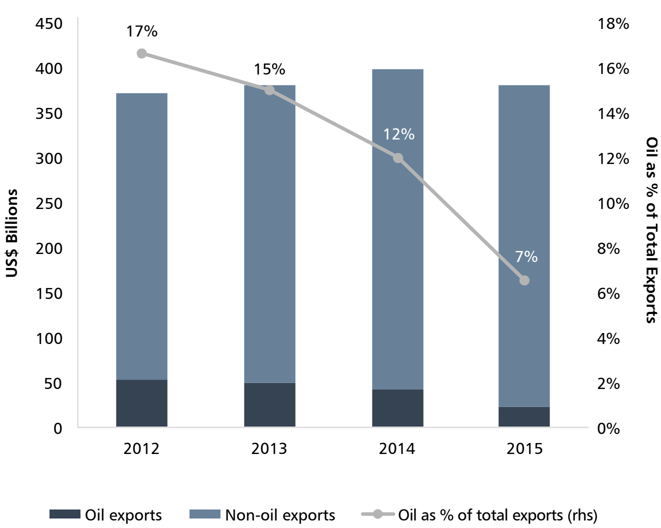
Source: INEGI. Accessed 22 March 2016.

2. World Bank, 2016.

In addition to the increase in spending associated with its nearly 129 million citizens,[3] Mexico also benefits from international consumers by being one of the most globalized countries in the world. Ten free trade agreements connect Mexico to 45 countries, while the country is party to 32 reciprocal investment promotion protection agreements and nine partial trade agreements.[4] "Mexico is one of the countries with the most number of signed treaties for export and trade in the world—it really is an open economy and incredibly competitive," points out The Abraaj Group's Cortina. "Local companies have benefited from a stable macroeconomic environment, which has allowed them to expand through most of the states in the country. Once these companies expand regionally, they are competing on an even playing field against large multinational companies."

Mexico ranks 13th globally in exports,[5] and is diversified in terms of the products that it sends abroad. Oil constituted only 7% of exports as of 2015; in 2012, prior to the fall in oil prices, it represented 17% (see Exhibit 6). This diversification away from commodities has contributed significantly to the stability of Mexico in comparison to the broader region. Although PEMEX, the state-owned petroleum company, accounted for approximately 11% of government revenue in 2014,[6] total revenue remained relatively stable despite the drop in oil prices (which resulted in losses of US$10 billion in the third quarter of 2015 for PEMEX),[7] due to tax reforms that increased tax intake.[8] Taxes are estimated to have risen from 10.5% of GDP to 13% between 2014 and 2015.[9]

Exhibit 6: The Majority of Mexico's Exports Are Unrelated to Oil
Oil versus non-oil exports (US$B, % of Total)



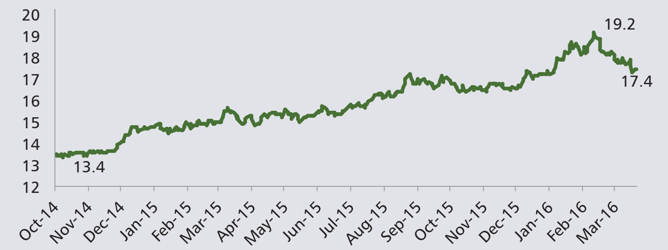
Source: Banco de México, Balanza Comercial de Mercancias de México. Accessed 21 March 2016.

3. United Nations, estimate as of April 2016.
4. Pro Mexico Trade and Investment, 2016. See: http://www.promexico.gob.mx/en/mx/tratados-comerciales.
5. World Integrated Trade Solution, 2014.
6. IMF Article IV, 2015.
7. Adam Williams and Andrea Navarro, "Pemex Reports Biggest Loss Ever as Oil Market Rout Cuts Deeper," Bloomberg, 28 October 2015.
8. IMF Article IV, 2015.
9. Ibid.

Spotlight: The Depreciating Peso

For private equity investors, both local and international, one of the greatest challenges has been the depreciation of the Mexican peso. Since early 2014, the peso has lost approximately 30% of its value against the U.S. dollar.

The Rising USD/MXN Exchange Rate



Source: IMF. Accessed 21 March 2016.

Banco de México has taken an active role in attempting to smooth over the depreciation using market operations. At the same time, low oil prices reduced the foreign earnings of PEMEX to a fraction of 2014 levels. These two factors combined have caused a significant depletion of Mexico's foreign reserve assets, which, as of 2015, had just reached the lower end of the IMF's suggested adequacy range.

However, the central bank sent a strong signal to speculators on 17 February 2016 when it conducted a surprise rate hike that stimulated a quick appreciation of the peso. According to Agustín Carstens, Governor of the central bank of Mexico, "This is not the beginning of a cycle of interest rate hikes…it was a way of showing our protest, our clear rejection of those levels." As of the time this report went to press, the peso had been appreciating steadily against the U.S. dollar.

INDUSTRY VIEWS ON REGIONAL INTEGRATION

"When we took a deep dive and evaluated investments that we've made globally to see what worked well and where things could have improved, we discovered some common themes and success stories. In the case of Latin America, we found it was easier to sell a Latin American platform rather than a single-country company. In Mexico, we are seeing increasing integration within the Pacific Alliance in terms of trade, cross-border transactions and human mobility. There is a cultural affinity amongst these countries that is translating into positive business outcomes—Colombian companies are entering Mexico, Peruvian companies are going to Chile, Chilean companies are going everywhere, and Mexican companies are expanding regionally as well. And if you collectively look at the size of this group of economies, you'll find that it is bigger than Brazil."

–Eduardo Cortina, Director, The Abraaj Group

"We are a Mexico-based fund and we invest in Mexico-based companies, but all of our investments, except one, operate either regionally or globally. We like this strategy because it gives us growth opportunities and diversified income, and it capitalizes on the strength of the management teams here in Mexico. As an example, our e-commerce company Linio is headquartered in Mexico and was incubated by the German group Rocket. But if you believe in e-commerce in Mexico, you also believe in it for the rest of the region. Today, we are the number one operator in e-commerce in Colombia, Peru and Ecuador, and number three in Chile. We also have an operation in Argentina that's going to start growing faster now that the economy's opening up. It's a perfect example of, 'Great, it works in Mexico but why limit yourself to Mexico?' It's a model that is scalable and repeatable as long as you have the right team to execute on it."

–Alex Rossi, Managing Partner, LIV Capital

"It is a challenge for some regional companies to grow in Mexico because of the adaptations that you have to do to a given product. Products are not as standardized as they are in the United States—what you get in California is the same thing that you get on the East Coast. We are not at that stage. In Mexico, if you go to the Southeast, the culture, the food and the products are very different from what you get in the North. But this is changing rapidly. And one way for this to change is with private equity investing in those regional companies and helping them to grow nationally. For us, the way to grow is through a significant acquisition, and partnering with someone with some significant presence."

–Roberto Terrazas, Managing Director & Chief Investor Relations Officer, Nexxus Capital

(Continued from page 9)

> "When you look at the country's GDP per capita and drill down to analyze different derivatives such as the growing middle class, credit expansion and the demographic dividend, you'll see that there is a lot of economic power coming online in Mexico."
> –Eduardo Cortina, *The Abraaj Group*

The United States is by a large margin the principal trading partner of Mexico, accounting for 82% of Mexico's non-oil exports and 42% of its oil exports.[10] In particular, the automobile industry has become a key sector for Mexico, comprising 40% of exports in January 2016, the value of which has nearly doubled since 2010.[11]

In October 2015, the Mexican government signed the Trans-Pacific Partnership (TPP) agreement. Whether this will result in new investment opportunities and greater export potential for private equity firms, or simply increased competition, remains unknown. One investor explains that private equity players in Mexico are well positioned to help family-owned businesses take advantage of these agreements as they are very familiar with developing partnerships and participating in mergers and acquisitions. Nonetheless, the challenge of moving businesses north to the United States or to other developed trading partner counties remains great. "There are clearly going to be more opportunities for Mexican companies with the right management and the right resources to grow outside of Mexico," notes Roberto Terrazas, Managing Director and Chief Investor Relations Officer of Nexxus Capital. "However, it will be a challenge; the success rate of companies moving to the United States has been quite low. You have to be well prepared and you have to be fit before entering that market—it's going into the first league."

LONG AWAITED GOVERNMENT REFORMS

Pacto por México, the suite of reforms proposed and partially implemented by President Enrique Peña Nieto beginning in 2012, has been groundbreaking. These reforms tackle inefficiencies in an enormous breadth of topics including taxation, education, transparency, energy sector ownership and free competition, and have sent a clear signal to investors that the government is sincere in its efforts to promote growth.

Private equity participants, as well as the broader investment community, have been closely following the comprehensive energy reforms signed into law by Peña Nieto in August 2014, and which opened the energy sector to private investment.[12] Unfortunately, five months later, in January 2015, oil prices dropped below US$50 per barrel, making many of the newly privatized oilfields less enticing to investors than they had been before the price movement. However, many local firms won tenders for onshore oil fields in the first three rounds of bidding, and this year, ten deep-water sites have been announced for future auction.[13] One stakeholder explains that although there has been a "gloomy sentiment" around the energy sector privatization in Mexico due to low oil prices, it is always good to remember that "one should invest when no one is interested because eventually the prices will recover."

In speaking with industry players, it is clear that many are optimistic that the impact of reforms will be long lasting. PineBridge Investments' Rodriguez claims, "Compared to other emerging markets both in and outside of the region, the reforms that Mexico has been able to implement in the last three years have been very important and translate to an attractive opportunity from a mid- to long-term perspective. It is going to take a lot of patience especially given what has happened to commodity prices over the last few years; however, the reforms are powerful because they are intended to be here for decades, not for one or two years."

One long-term drag on the Mexican economy has been the presence of monopolies and the lack of competitive markets, holding back both consumers and entrepreneurs. An OECD study estimated that prices in Mexico have been approximately 40% higher than they could have been if markets were more competitive.[14] This finding encouraged the government to implement a new Federal Antitrust Law. Passed in April 2014, this law bolstered institutional capacity to implement antitrust policy by giving more power to the Federal Competition Commission (COFECE), expanded the list of antitrust behaviors to be sanctioned, and clarified how the law should be applied. Industry participants expect these reforms to alter the economic landscape in Mexico. In particular, mid-cap companies will likely be the biggest winners from the reforms since they may now have a better chance of capturing larger market shares.[15] Finally, the overlapping financial reforms could increase competition in the banking sector and thus lower interest rates available to households and small- to mid-sized companies.

Mexico's resilience in a tough global macroeconomic environment, combined with the promise that structural reform entails, has rekindled investor interest in the market. Private equity investors are well suited to identify the companies that can best capitalize on Mexico's progress—but is this story resonating with global investors?

10. Banco de México, January 2016.
11. Banco de México, January 2016 and February 2015.
12. Brookings, 2014. See: http://www.brookings.edu/research/articles/2014/08/14-mexico-energy-law-negroponte.
13. Forbes, 2016, and Wall Street Journal, 2015. See: http://www.forbes.com/sites/christopherhelman/2016/02/22/mexican-president-promises-success-of-historic-oil-reforms/#75cbf5723dfc and http://www.wsj.com/articles/mexico-auctions-onshore-oil-fields-amid-low-prices-1450199493.
14. OECD. "Mexico Better Policies for Inclusive Development," September 2012. See: http://www.oecd.org/about/secretary-general/2012%2009_Mexico_Brochure_EN.pdf.
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TAKING STOCK OF MEXICO'S PRIVATE EQUITY INDUSTRY—THE LOCAL ASSOCIATION VIEW

BY MARÍA ARIZA, CEO OF AMEXCAP

Over the past ten years, the private equity industry in Mexico has grown significantly. In 2006 there were 32 GPs; today there are over 155 operating across a diverse pool of sectors and strategies. Accumulated capital commitments—for private equity, venture capital, real estate, infrastructure and energy—have more than doubled in the last five years from US$17.4 billion in 2010 to US$38 billion in 2015.

According to AMEXCAP data, private equity funds active in Mexico invest in business services, financial services and consumer goods, as these are the most targeted sectors. To no surprise, large international funds like Actis, BlackRock, Blackstone, First Reserve, and Partners Group, among others, have recently arrived to Mexico. Some important transactions that took place in 2015 included the acquisition of GE Lending, GE's equipment lending and leasing platform, by Linzor Capital Partners, the investment in real estate developer and operator ZKC by Nexxus Capital, and the participation in entertainment center operator Grupo Diniz and satellite telecommunications business Elara Communications by Northgate Capital, among others.

We've seen 22% annual growth in the overall private equity industry, highlighting the participation and support of important stakeholders and the appetite that Mexico represents today for these types of investments.

A number of developments are likely to contribute to the industry's continued growth:

- The recent announcement made by Mexico's President to promote economic development through **the creation of "FIBRA E" and "CerPIs."** These new investment vehicles were designed to attract top national and global asset managers, as well as local and international institutional investors, by featuring transparency of information to adequately align incentives with managers, co-investors and investors.

  –"FIBRA E" will allow public and private investors to monetize assets in the energy and infrastructure sectors with predictable and stable cash flows under a fiscal regime that reduces tax levels, and thus allows for higher distributions.

  –"CerPIs" or "Fiduciary Investment Project Securitization Certificates" will provide flexibility to attract top quality managers to develop projects and enterprises in a GP-LP private equity-like framework, with the highest corporate governance standards.

- **Domestic pension funds** have played a determinant role in the growth of the private equity industry, as the "development equity certificates" (CKDs) have come a long way. The total amount issued by CKDs as of December 2015 was approximately MXN$191.3 billion distributed among 52 CKDs. 2015 was also the year with the greatest amount and number of CKDs issued (16 total) for a record MXN$83.7 billion, more than the previous four years combined.

- **The government has played an important role** in supporting the industry. Mexican development banks, including NAFIN, FOCIR, Banobras and Bancomext, as well as other institutional investors have invested through the fund of funds investment vehicle "CMIC," in addition to another 67 funds. They have also co-invested with 12 funds. And INADEM (The National Entrepreneur Institute) has been very important for the seed capital market, creating more than 25 new seed capital funds and participating as a co-investor with other stakeholders.

- **The opening of the energy sector** to the private sector is particularly promising in order to boost growth, as it is expected to increase oil and gas production, and provide Mexican manufacturers with cheaper energy inputs. Cheaper power will attract manufacturing and promote industry competitiveness. Electricity currently costs about 30-35% more in Mexico than in the United States.

- There are many compelling features to the Mexican economy but **export businesses are the country's economic engine**, with 87% of its exports going to the United States. Mexico is the leading exporter of high-tech advanced manufacturing, accounting for 35% of the region's total trade,[1] sixth aerospace supplier to the United States, with over 270 aerospace companies, eighth vehicle producer worldwide and fifth largest auto parts supplier worldwide,[2] to name a few. In 2013, Mexican exports reached 31.5% of GDP, versus 12.5% for Brazil, 24.4% for China, and 24.7% for India.[2]

Looking forward, we expect Mexico's private equity industry to continue to flourish. 2016 will most likely be an important year, with at least 12 new CKDs in the pipeline targeting over US$2.7 billion. We should also expect the first issuances of "CerPIs" and "FIBRA Es," and we should continue to see large investments in the infrastructure and energy sectors.

1. Data from ProMéxico.
2. Data from 31 December 2013. Source: Institute Brasileiro de Geografia e Estatística, Instituto Nacional de Estadística Geografía e Informática, Central Statistical Organization, India, China National Bureau of Statistics, Haver Analytics.

A Closer Look at Mexico's Fundraising Environment

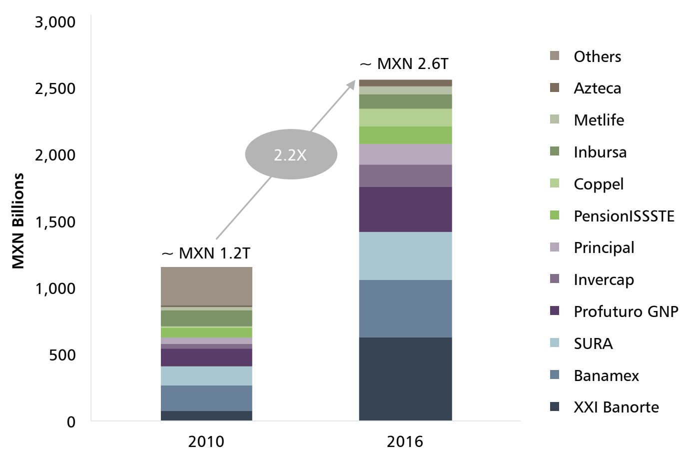
Given the size of Mexico's economy, fundraising for country-dedicated private equity funds had been underwhelming for years—constituting less than 5% of all capital flowing to Latin America-focused vehicles between 2006 and 2008. Eclipsed by fund managers focused on Brazil and the Andean region, as well as pan-regional fund managers operating at scale, Mexico-dedicated managers were toiling away in the shadows, and had a tough row to hoe indeed (see Exhibit 7).

All of that changed in 2009, when the Mexican government revealed regulations permitting the country's Afores (or retirement fund administrators) to invest in private equity through publicly listed trusts called *certificados de capital de desarollo* (CKDs)—a process that would accelerate the development of Mexico's private equity ecosystem.[16] While macroeconomic and political challenges have beset a number of countries in Latin America—most notably Brazil—contributing in part to depressed overall fundraising figures for the region, Mexico has come into its own, with fundraising for Mexico-dedicated vehicles growing from US$574 million in 2009 to US$2.1 billion in 2015.

THE AFORES' CATALYTIC EFFECT

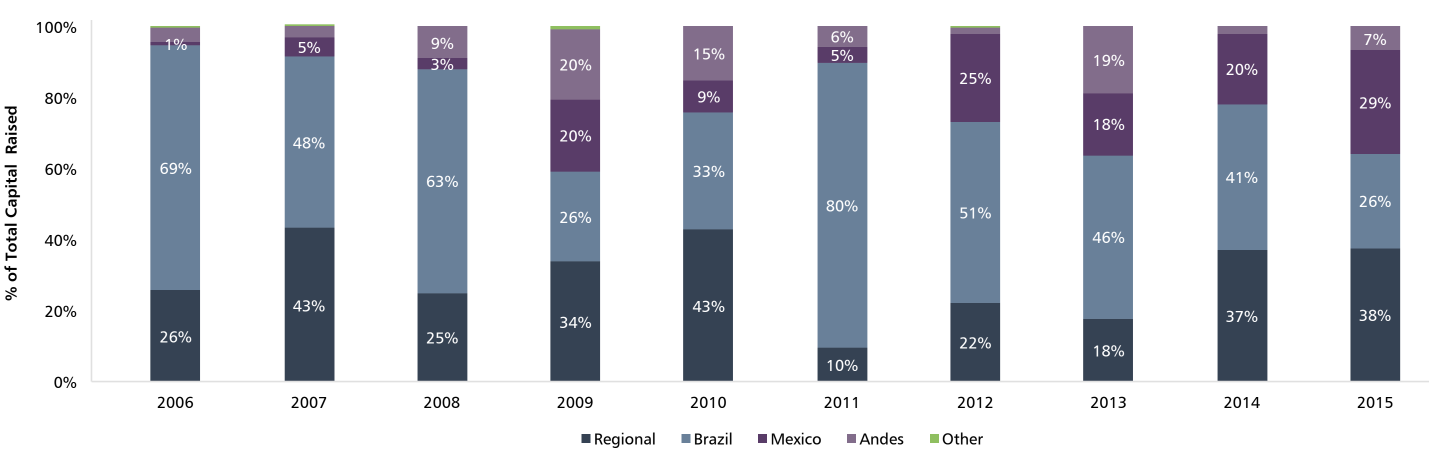
As in many emerging market countries that have embraced pension and retirement system reforms, local pools of savings in Mexico have been growing at a torrid pace. To illustrate, the assets administered by Mexico's Afores more than doubled between January 2010 and January 2016, growing from MXN1.2 trillion (US$88 billion) to MXN2.6 trillion (US$142 billion; see Exhibit 8),[17] representing a compound annual growth rate of 16.7%—more than five times faster than average GDP growth over the same period.

Exhibit 8: Growth in Afores' Assets under Administration



Source: CONSAR. Accessed March 2016.
Note: Data for each year are as of January.

Exhibit 7: Mexican Private Capital Fundraising in a Latin American Context (% of Total Capital Raised)



Source: EMPEA. Data as of 31 December 2015.

16. For more on the origins and development of Mexico's retirement system and CKDs, see EMPEA's 2011 report, *Local Pension Capital in Latin America*.
17. Note that pesos were converted to US$ using the spot rate as of 31 January for each year.

On the one hand, these growing pools of local savings are a stable source of long-term capital to finance indigenous growth and investment. On the other, these rapidly growing asset bases pressure retirement fund managers to diversify their portfolios, fueling demand for new products. The CKDs enabled asset and fund managers to issue securities on the Bolsa Mexicana, which could be invested in a variety of real estate and infrastructure projects, as well as private equity investments—asset classes that, heretofore, lay beyond the reach of the Afores.

As with any process of reform, the initial CKDs were not without complication. From the institutional investor perspective, the structure of the CKD mandated a pre-funded commitment, so 100% of the committed capital was required at the time of the CKD's issuance. This created a relatively inefficient deployment of capital and a deeper J-curve.

Meanwhile, private equity firms marketing a CKD endured an arduous listing process that could last in excess of 18 months. Moreover, governance and disclosure requirements created knock-on effects in terms of limiting GPs' ability to attract international LPs and source deal flow. For example, granting Afores' representatives authority over investment decisions violated the traditional LP-GP structure (off-putting to a number of international LPs), and some entrepreneurs questioned the merits of partnering with private equity firms if doing so required publicly disclosing financials. According to Mauricio Basila, Partner at Basila Abogados, "The market in Mexico can be very concentrated, and it can become an issue to disclose information to the competition. In most cases when a fund invests, the company is a family-owned business and it can be damaged by the fact that the competition will know everything. Private equity is supposed to be private."

In 2012, regulators modified the structure of CKDs to be more in line with international standards, enabling capital calls akin to a traditional LP-GP structure, with the proviso that 20% of the total committed capital be pre-funded. Following the election of President Peña Nieto, the Mexican government unveiled new investment instruments, including *certificados bursátiles fiduciarios de proyectos de inversión* (CerPIs), *certificados bursátiles fiduciarios inmobiliarios* (FIBRAs; similar to REITs in the United States) and *certificados bursátiles fiduciaries de inversion en energía e infraestructura* (FIBRA E), all of which offered greater convergence with international best practices, and in the case of the latter, favorable tax incentives (see Exhibit 9, as well as *The Regulatory Perspective* on page 21). Basila explains, "The securities regulator, the Comisión Nacional Bancaria y de Valores (CNBV), issued new regulations creating the CerPI because they wanted to attract global investment managers, and they recognized that they wouldn't be able to do so without an instrument closer to the traditional limited partnership. With the CerPI, they eliminated the technical committee's influence over investment decisions and these instruments are placed through a restricted offering to qualified investors with more than MXN100 million, which in turn mitigates issues around public disclosure of private company financials."

The Mexican government's efforts to catalyze local savings toward long-term investment are having their intended effect: CKDs have fueled the growth in private equity fundraising in Mexico, constituting 76% of the total capital raised for the market since 2009 according to EMPEA statistics (see Exhibit 10). "Clearly the participation of the Afores has been a game changer because two things are happening," claims Nexxus Capital's Terrazas. "One is that first-time funds are now able to raise capital and operate in the market—this is a once-in-a-lifetime opportunity to build a track record and deliver. The second is that firms like ours have been able to demonstrate traction with local investors, and then raise additional capital from international LPs that right-sizes us for our strategy. In the past, a number of LPs, such as insurance companies and funds of funds, were not able to invest with us because we weren't operating at sufficient scale to meet their thresholds."

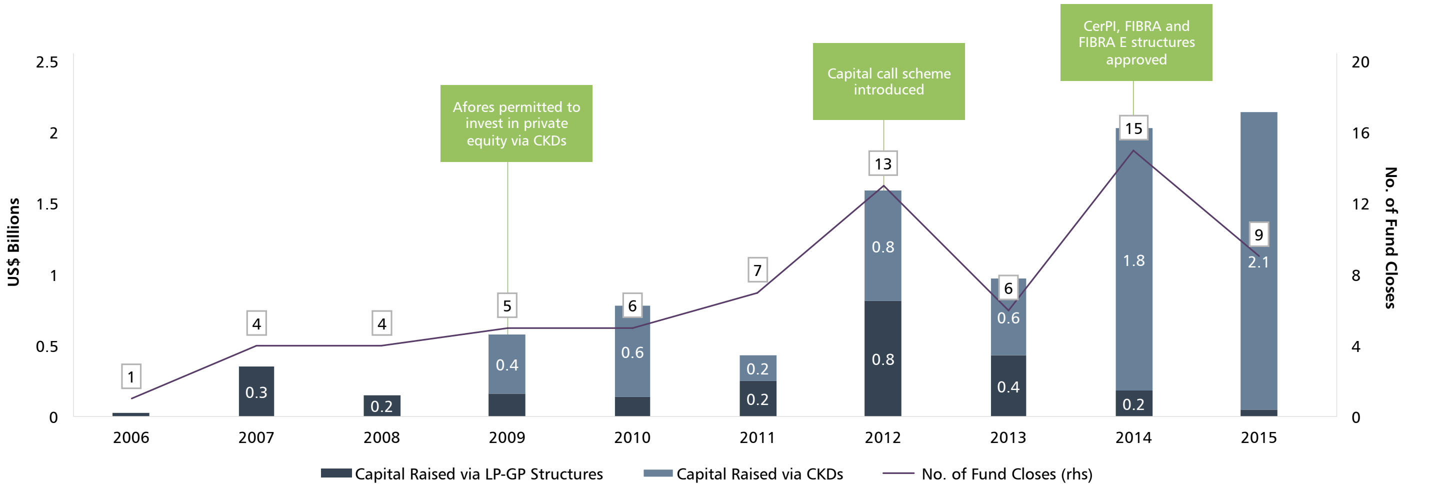
Alex Rossi, Managing Partner of LIV Capital shares these sentiments. Reflecting on his firm's experience, Rossi recalls, "It took us a while to raise our first CKD, but investing and operating with the Afores has been a very constructive and positive experience—so much so, in fact, that when we went out to raise our fourth fund, we felt we should secure the CKD first before moving to the LP structure. The involvement of the Afores has been one of the best things that has happened for private equity in Mexico because it has broadened the market and given us all the chance to scale our funds." Moreover, the reforms are attracting a number of global fund managers to participate in Mexico's privatization and private markets opportunity set. For example, in November 2015, KKR reportedly approached the Bolsa Mexicana with a request to issue a US$500 million CKD.

Exhibit 9: Overview of Local Currency Investment Vehicles

Vehicle	Description	Notable firms that have issued vehicle
CKD	Publicly listed trusts that can be used to finance investments in real estate, infrastructure and private equity. Since 2012, the instrument has enabled capital call schemes (with the provision that the first 20% of capital commitments must be pre-funded). In a CKD, minority shareholders and investors with representatives on the technical committee can have influence over investment decisions.	The Abraaj Group, Acon, Atlas Discovery, Axis Capital Management, Credit Suisse, EMX Capital, LIV Capital, Nexxus Capital, Northgate, Promecap, Riverstone, WAMEX
CerPI	Certificates marketed to qualified institutional investors under a restricted public offering. The proceeds can be used to finance investments in a wide range of sectors. Unlike the CKD, the technical committee of a CerPI does not serve as an investment committee, but rather an advisory committee. Moreover, minority shareholder right thresholds are set at 25%.	
FIBRA	A trust that can be used to invest in real estate assets. Similar to real estate investment trusts (REITs) in the United States.	Banco Actinver, Fibra Uno, Macquarie
FIBRA E	A trust focused on energy and infrastructure assets that offers tax advantages at the fund and company level.	

Sources: Interviews with industry experts; Bolsa Mexicana de Valores.

Exhibit 10: Mexico Private Capital Fundraising (US$B, No. of Fund Closes)



Source: EMPEA. Data as of 31 December 2015.
Note: Includes interim and final closes for each year.

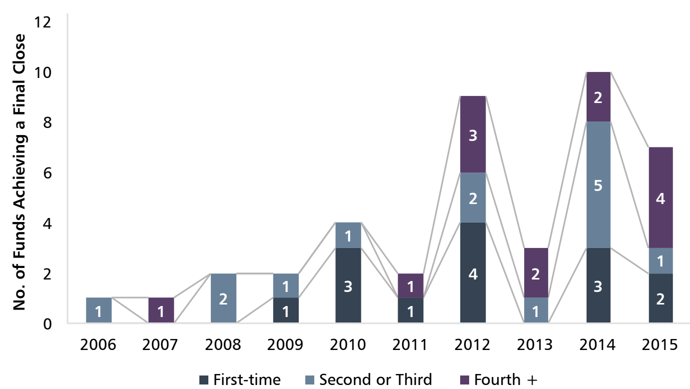
A DEEPENING MARKET

Beyond the surge in capital flowing to Mexico-dedicated fund managers, one of the more promising dynamics is the distribution of funds able to close on capital commitments. In stark contrast to a number of emerging markets, in which capital is concentrating in fewer, larger funds, Mexico displays a burgeoning ecosystem where more funds are being raised. For example, five first-time fund managers achieved closes over the last two years, while six GPs managing their second or third funds—such as Alta Growth Capital and Discovery Americas—were able to do so (see Exhibit 11). GPs are demonstrating an ability to scale up their own operations, raising incrementally larger funds, and thus providing a more stratified opportunity set. In effect, the pyramid of private capital providers is being built out.

More broadly, the asset class is deepening by fund strategy. In 2008, three strategies closed on capital—buyout, growth equity and venture capital. Following the onset of Mexico's reforms, however, funds targeting infrastructure and real assets, as well as private credit opportunities, have gained traction (see Exhibit 12).

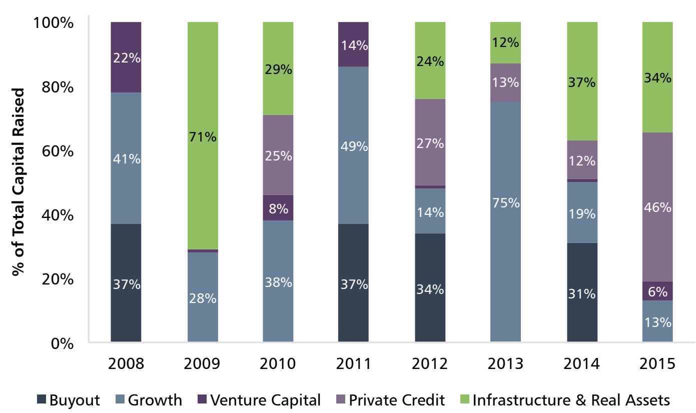
While the strategy hasn't attracted very much institutional third-party capital to date (approximately US$329 million since 2008), venture capital is undergoing a profound transformation in Mexico. In addition to the arrival of 500 Startups in 2012, the Mexican government created a National Institute of Entrepreneurship (*Instituto Nacional del Emprendador*, or INADEM) in 2013 to drive startup activity and business formation. Beyond its direct financing of entrepreneurs and SMEs, INADEM has backed approximately 20 seed-stage venture funds in an effort to assist Mexican entrepreneurs' ability to scale. When married with the growth in Mexico's incubator and accelerator landscape, the entrepreneurial environment may very well contribute to more robust, investor-friendly deal flow for the country's more experienced fund managers, many of which operate in the growth and buyout segments.

Exhibit 11: Mexico Funds Achieving Final Closes by Fund Series, 2006-2015



Source: EMPEA. Data as of 31 December 2015.
Note: Includes final closes for each year. Under EMPEA's methodology, spin-outs are categorized as first-time funds.

Exhibit 12: Mexico Private Capital Fundraising by Fund Strategy, 2008-2015 (% of Total Capital Raised)



Source: EMPEA. Data as of 31 December 2015.
Note: Includes interim and final closes for each year.

An Evolving LP Base

As with many emerging markets, development finance institutions (DFIs) have been critical supporters of the industry since its earliest days in Mexico. Thirteen DFIs have disclosed commitments to Mexico-dedicated funds. These include the international organizations CAF, DEG, FMO, IDB Group, IFC and OPIC, as well as local development banks such as Bancomext and Nacional Financiera. Local capital, in the form of the Afores, has also become a critical source of funding for the industry since 2009, and is expected to grow in the years to come.

Funds of funds, including Fondo de Fondos, PineBridge Investments and 57 Stars have been active participants in the market, with Fondo de Fondos having committed capital to more than 80 funds, and PineBridge having raised a CKD to invest in local opportunities.

Following the participation of local capital, a broader set of international institutional LPs have been committing to fund managers in the market, including insurance companies, endowments such as the University of North Carolina at Chapel Hill, and a number of foundations including the John D. and Catherine T. MacArthur Foundation, the Rockefeller Foundation and the W.K. Kellogg Foundation.

Beyond institutional capital, the involvement of the Afores in private equity has also spurred greater participation from Mexico's family offices. One local fund manager explains, "There had been a monopoly of capital concentrated in the family offices. They did their own form of private equity and were willing to invest for a long horizon—decades, in fact. While we had trouble in the past trying to raise money from family offices, today they are more open because they see an opportunity to invest alongside us. Engagement with the Afores and the move toward more professionalized investors has helped open them up."

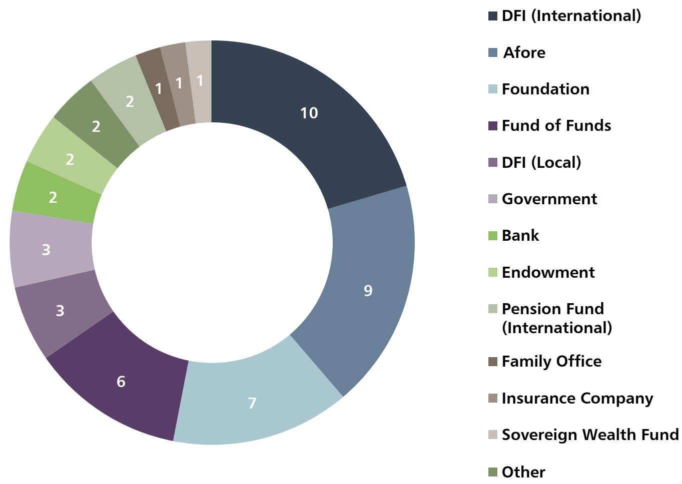
The steady expansion of LPs committing to Mexico-dedicated funds suggests that the structural foundations are coming into place for the market to find its footing as a destination for institutional capital.

(Continued from page 15)

Within private credit, Promecap Capital de Desarrollo has been the most active GP employing a special situations strategy, while Adobe Capital and Northgate Capital have raised mezzanine-dedicated vehicles, and Credit Suisse has raised two diversified private credit funds. In infrastructure and real assets, large global firms such as Macquarie, Riverstone Holdings and The Rohatyn Group (as part of a joint venture with BK Partners), have issued CKDs to raise local capital for investment in Mexico, while BlackRock acquired Mexican infrastructure firm I Cuadrada in late 2015.

The ecosystem for entrepreneurial finance is deepening in Mexico, with more managers employing a broader array of strategies, and existing managers demonstrating an ability to scale alongside the country's businesses. The government's reforms are unlocking capital for productive, long-term investment in the Mexican economy—including in new, deregulated sectors—and they are stimulating entrepreneurship. The pickings for an institutional investor are certainly richer than they were five years ago. The foundation is set for broadly diversified private capital activity across the capital stack—the challenge for GPs is sourcing quality deal flow.

Exhibit 13: LPs with Disclosed Commitments to Mexico-dedicated Funds, by Type of Investor



Sources: EMPEA, Preqin. Accessed March 2016.

Exhibit 14: Sampling of Largest Mexico-dedicated Funds

Fund Manager(s)	Fund Name (Vintage Year)	Fund Type	Currency	Capital Raised to Date (US$m)
BlackRock	I Cuadrada Infrastructure Fund II (2014)	Infrastructure	MXN	756
Credit Suisse Emerging Markets Credit Opportunities (EMCO)	Credit Suisse Mexico Credit Opportunities Trust II (2015)	Diversified Private Credit	MXN	751
Riverstone Holdings	RIVERCK 15 (2015)	Real Assets	MXN	733
Credit Suisse Emerging Markets Credit Opportunities (EMCO)	Credit Suisse Mexico Credit Opportunities Trust (2012)	Diversified Private Credit	USD	550
Nexxus Capital	Nexxus Capital VI (2013)	Growth	USD	550

Source: EMPEA. Data as of 31 December 2015.

Exhibit 15: Sampling of LPs with Disclosed Past Commitments to Mexico-dedicated Funds (by LP Type)

Afores	Endowments and Foundations	DFIs / Multilateral Organizations	Others
Afore Banamex	University of North Carolina at Chapel Hill	Bancomext	57 Stars
Afore Coppel	University of Texas Investment Management Company	Banobras	California Public Employees' Retirement System
Afore Inbursa	John S. & James L. Knight Foundation	Nacional Financiera (Nafinsa)	Conacyt
HSBC Afore	KL Felicitas Foundation	CDC Group	Focir
ING Afore	Omidyar Network	Corporacion Andina de Fomento (CAF)	Fondo de Fondos
InverCap Afore	Rockefeller Foundation	DEG	Gray Ghost Microfinance Fund
MetLife Afore	Soros Economic Development Fund (SEDF)	Export Development Canada	Instituto Nacional del Emprendedor
PensionISSSTE	W.K. Kellogg Foundation	Inter-American Investment Corporation (IIC)	Japan Bank for International Cooperation (JBIC)
Profuturo GNP Afore		International Finance Corporation (IFC)	JPMorgan Chase
		Multilateral Investment Fund (MIF)	Los Angeles Fire and Police Pension System
		Netherlands Development Finance Company (FMO)	Massachusetts Mutual Life Insurance Company
		Overseas Private Investment Corporation (OPIC)	New Mexico State Investment Council
			Northgate Capital
			Okabena Advisors
			PineBridge Investments
			Promotora Social México
			Rockefeller and Co
			Sarona Asset Management

Sources: EMPEA, Preqin. Accessed March 2016.

Spotlight: LP Perspectives on Mexico

EMPEA interviewed a number of institutional investors and placement agents in the course of conducting research for this report in order to glean a better understanding of LP sentiment toward private equity in Mexico. Below are some of the key takeaways on the opportunities and obstacles they see regarding the asset class.

THE ENDOWMENT PERSPECTIVE

"The limited depth of GPs in Mexico is a challenge. Given the structure of the local business community, deals tend to take longer to complete, minority transactions face significant counterparty risk, and a control strategy is tough to execute. All that said, we are generally bullish on Mexico."

–Endowment Representative

"We looked at Mexico extensively for a number of years, and decided to walk away from it for a number of reasons. We've been frustrated by the economy's inability to achieve its potential, and we've struggled to understand exactly why—maybe it has to do with political corruption, incompetence, or market structure. In addition, as Mexico has gone through a radical evolution over the past five years in terms of opening up the market to domestic investors, we fundamentally believe that there is a misalignment between the risk-return appetite of those investors and ours. It's a long-term problem for us if their return expectations are much lower than what we would want when allocating capital to a market like Mexico."

–Endowment Representative

THE PLACEMENT AGENT PERSPECTIVE

"Mexico is a market that I am very fond of. The regulators are excellent, and the government's financial policies are actually very robust in terms of creating the proper regulation, the proper visibility, and the proper reporting. Mexico is one of the only countries I know of where minority investing is structured and regulated. In addition, the entry of institutional capital into alternatives is also well-monitored and structured through special vehicles in an innovative way. The private equity market in terms of a number of professionals isn't that deep, although the experiences that the large pan-regional funds have had have been quite good. The region's generally going through a little bit of a downturn at the moment, but I think over the long term the country has very good prospects."

–Mounir Guen
CEO of MVision Private Equity Advisors

THE DFI PERSPECTIVE

"You are not going to get the high growth rates in Mexico that you saw in Brazil, but Mexico is also less of a developing country. Think about the guy selling tacos on the street corner in Mexico—he has a cellular phone. The same guy in Brazil does not, so you have a larger market for such items. It may not have that high growth, but I would argue that Mexico is a less risky, much more stable play on a macro level than most of Latin America."

–Johannes Goderbauer, *Senior Investment Manager, DEG*

THE LOCAL PENSION FUND PERSPECTIVE

"Mexico has great opportunities and we have learned a lot in the past eight years. We thought that private equity would grow at a faster pace but there appears to be more deal flow and capital absorption capacity in real estate and infrastructure, meaning we can increase an allocation quickly if desired. We also need more pension funds to participate in private equity vehicles but this will likely happen when returns go up."

–Afore Representative

THE PRIVATE FUNDS PERSPECTIVE

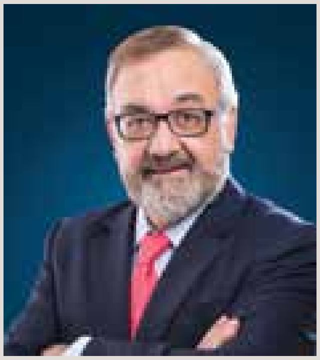
"We believe the [Mexican] market is very attractive—we see the right regulations, the right managers and the right framework to do private investments, yet we see low private equity penetration relative to GDP. On the macro side, the country has stability that has been built up over the last 20 years and is implementing important reforms. On the micro side, when you look at the opportunity set in Mexico, the need for capital is extremely high as is the need for the fund managers' expertise to help small- and mid-sized businesses get through the challenges they face as they grow and evolve from a family-owned business to one that is institutionally managed with the right corporate governance."

–Alejandro Rodriguez
Director, Private Funds Group, PineBridge Investments

(for more detail see *Sidebar: Where Does Mexico Fit Within a Global Emerging Market Allocation?*)

BUILDING A LOCAL INDUSTRY—THE ROLE OF FONDO DE FONDOS IN MEXICO'S PRIVATE EQUITY ECOSYSTEM

BY FELIPE VILÁ GONZÁLEZ, DIRECTOR GENERAL, FONDO DE FONDOS



When the first Latin America-focused private equity fund managers began looking to invest in Mexico in the mid-1990s, they found that they could only raise local capital from the four government-owned development banks (Nacional Financiera, Focir, Banobras and Bancomext). Shortly afterward, when Mexicans started to form country-focused private equity funds and also came to these same sources for funding, the Ministry of Finance realized that this could be an opportunity to start fostering direct investment into fast-growing Mexican businesses. As a result, they decided to create Fondo de Fondos in 2006 as a tool to foster investment into private equity, to be supported by the four development banks that had already invested into this asset class. These banks would transfer their prior commitments to the new entity as well as provide additional funding. This was the beginning of our company.

We had several mandates: (1) to manage the existing investments and commitments; (2) to start looking for new investment opportunities across private equity, real estate and infrastructure; (3) to support the development of the ecosystem through designing and promoting legal frameworks; (4) to conduct domestic and international promotional activities for the industry; and, (5) to establish best practices. This last mandate was vitally important—we knew that we had to prove that we embraced best practices and could deliver returns on a risk-adjusted basis in order to raise third-party capital to invest in this industry. Of course, it was difficult to look for best practices as we were the only institutional investors in Mexico at that time. Therefore, we interviewed limited partners from abroad—primarily from the United States—to learn from them. We spent two years meeting funds of funds, gatekeepers, pension funds and university endowments in an effort to understand their due diligence and investment processes.

Upon reflection, it was a wise decision to begin understanding best practices when we did because since that time, the Mexican private equity industry has rapidly grown. If we had only had resources from our four development banks, we could have become a marginal player. Fortunately, that has not been the case. We have successfully been able to raise money from third-party investors—big international investors as well as Mexican ones. Our next step is to raise capital from high net-worth Mexican individuals and family offices to invest in our recently launched venture capital fund of funds.

Since our formation, we have been extremely active. In addition to managing our legacy portfolio, in 2009 we launched Mexico I as a fund of funds with capital commitments of US$275 million, most of which has already been invested into 22 funds. In 2011, we believed that Mexico might be ready to develop a venture capital ecosystem and decided to launch Mexico Ventures I with US$80 million to focus on innovation and technology. To manage this fund of funds, we partnered with a New Mexico-based fund manager called Sun Mountain Capital to help us find U.S.-based fund managers that could invest in Mexico, to introduce Mexican companies to U.S.-based fund managers, and to convince Mexican entrepreneurs to search for capital within the U.S. venture capital fund managers. To date, we have invested in six Mexican fund managers and five U.S. fund managers who are actively coming to Mexico in search of technology-oriented companies. In 2012, we launched Mexico II with over US$400 million in commitments that will go into approximately 20 funds, and through which we will look to do some co-investments. Last year we established an energy-focused fund of funds as well as one targeting mezzanine, while this year we launched Mexico Ventures II to continue channeling investments into early-stage companies.

We are almost ten years old as a company, and are proud to say that we have been able to support the growth of the industry. During the life of this company, we have invested in 437 Mexican companies through 560 capital injections. We have rapidly increased the amount of capital committed and invested in the market through our ability to raise additional resources. Of the US$107 million that we invested last year, 45% came from third parties. We have been able to calculate that for each dollar we invest from our shareholders, the total amount invested into the economy is 30x. This multiplier effect has been a big reason for why we've seen the percentage of our participation within our funds decrease over time. When we were incorporated, we represented 18% of the total fundraising commitments of our fund managers. Today, we account for 7%, on average, of the capital raised by Mexican and pan-regional fund managers.

The Mexican industry is growing fast and there are plenty of investment opportunities. Right now, one of our top priorities is to recruit well-established general partners, who may not have been actively looking at Mexico, to come and invest in the country for the first time. We are ready to invest in these firms and to support them by providing introductions to companies, other private equity firms and government officials. Like all LPs, we are a passive investor but whenever a fund manager asks us for help, we do what we can to facilitate their life in Mexico. We are well positioned to do this, and believe it is important in our effort to continue catalyzing this industry.

The Legal & Regulatory View

THE LEGAL PERSPECTIVE

AN INTERVIEW WITH MAURICIO BASILA, PARTNER, BASILA ABOGADOS, S.C.

What are some of the most important legal developments impacting private equity that have taken place over the last few years?

An important development took place during the 2014 financial reform with the acknowledgment, finally, in the securities law of the existence of the *certificados de capital de desarrollo* or CKDs. Prior to this, the CKD was just a commercial name that the stock exchange came up with. The only problem, however, is that it included in the law a requirement—aimed at the pension funds—that the CKDs should only invest in Mexico. Instruments should not be restricted in terms of where they can invest but this rule comes from the investment regime of the Afores. As such, there is a component of nationalism.

The pension system in Mexico used to be a defined benefit system. When it changed to a defined contribution system, this changed the social rights completely. We didn't have a revolution as a result, but the regulations have been tough in terms of where the Afores can invest. The rules were very conservative in the beginning but have been slowly opening up over time with the recognition that it's not good to be too financially concentrated. Yet some requirements remain, including the requirement that the Afores can only invest in publicly offered, listed securities and that they can only invest in Mexico—with a few exceptions, for instance, through ETFs. They can also now have mandates with global asset managers for global investments, but only for listed securities.

The market continues to evolve. It's amazing; it never stops—the regulations, the framework, the participants, the funds, the investors, etc. I always say that what we see today is not going to be the same thing that we will see tomorrow. Of course, there's always something missing. There's always something that can be improved in terms of the legal framework. I always ask our clients to be patient, because I know we will get there.

What are the prospects for a greater number of companies to list their shares of the Mexican exchange, including small and mid-size firms?

There is no large capital requirement to be listed in Mexico, but there are a number of mid-size companies that would do well to list their companies. However, most of them are family-owned businesses. They don't have the culture nor the interest to become a public company. This task is generally performed by the private equity firms. After they invest in a company, and increase its value, the second generation of the family becomes interested because they know that at some point they are going to have to exit the company. History proves that it doesn't work well to try to keep the family in the business.

Even though perhaps the best exit for a fund is the public market, until recently Mexico had a structural problem preventing this from happening more frequently. However, we now have two layers of funds, which was not true in 2009 when we only had private equity funds. Today there are more venture capital funds than private equity funds, which is perfect because it then forms a pyramid. These venture capital firms will provide the opportunities for the private equity funds, and then the private equity funds will eventually list on the Bolsa Mexicana. So we finally have the right structure.

Things started to fall into place in 2005 when we included what is called the SAPI (*sociedad anónima promotora de la inversion*) in the securities market law. This is a regular company, but it can enter into shareholder agreements, and can have drag-along and tag-along rights, which is customary for private equity investments globally. Until then, the legal framework of companies lacked this in Mexico, and so even if you had those agreements in your documents, they were not going to be valid in a court of law. This issue prevented many private equity firms during the 1980s, 1990s and the early 2000s from investing in Mexican companies. And some that did had very bad experiences.

The SAPI was the first step of the ladder. Then in 2009 when the local pension funds began participating in private equity, we had a multiplier effect with international investors coming in who now felt more comfortable putting money into a parallel fund. Now the fund managers are able to raise a lot more money from both local and international investors. They will eventually invest in companies, and these companies will eventually list. But the private equity firms are the ones who must provoke a company to go public; they need that push.

I believe that a number of things are aligning now to allow this market to grow and be home to more listed companies. This isn't the result of some policy or market engineering, but rather is a consequence of the fact that things are working well and that there is a market capable of absorbing assets at any given point in time—whether it is an angel investor, a venture capitalist, a private equity firm or the public market. You must have all these structures working together and I think that is now happening, slowly but surely.

THE REGULATORY PERSPECTIVE

AN INTERVIEW WITH EDUARDO FLORES HERRERA, VICE PRESIDENT FOR MARKET SUPERVISION, COMISIÓN NACIONAL BANCARIA Y DE VALORES (CNBV)

How has the regulatory environment evolved over the last decade with regard to private equity in Mexico?

Private equity itself is not regulated in Mexico; it falls under common mercantile and civil regulation. However, starting in 2009, when the famous CKDs were created to allow asset managers to channel the resources of the pension funds (or Afores) into projects, we became involved. The Afores have a legal restriction that they can only invest in publicly offered securities, either in Mexico or abroad, so the CKDs, by being listed, created a way for pension funds to invest in private equity. Those private equity funds that are publicly traded in Mexico (even though it sounds like an oxymoron) are supervised by us.

The structure has been evolving. In the beginning, it was very complex to issue a CKD, with each issuance taking approximately a year and a half to complete. However, the Afores have gotten to know the product better, and we have pushed through a lot of changes to make issuances simpler, more expeditious, and less expensive. Even our teams are now better and more efficient in authorizing these sorts of vehicles. With the financial reforms in 2014, there were changes made to the law regarding corporate governance and investor rights related to the CKD. Even though CKDs are a trust, they have a corporate structure similar to that of a publicly listed company so they need to have independent directors, while some investment decisions need to be authorized by the technical committee and others need to be authorized by the shareholders themselves.

The CKDs have been successful and we believe they have been a good source of investment. However, we wanted to take the next step and start attracting larger asset managers worldwide. We did a study along with the Ministry of Finance to see what could be missing and realized that some of the CKD regulations were so complex and stringent that they affected the other vehicles of the fund managers. Globally, investors typically have more of a supervisory role, serving on a LP Advisory Committee for example, so we started to look into how we could create something similar so that more experienced fund managers would feel comfortable coming to Mexico to complement the experienced fund managers we have locally. We think there is room for everybody given the investment needs in Mexico.

At the end of last year, we created the CerPI, which was a more precise approach for bringing private equity funds to Mexico in which the Afores could invest. The idea behind the CerPI is that the manager has more flexibility, and the investment decisions are neither passed by the technical committee nor by the shareholders. As long as what you do falls within the approved policies, you do not need prior approval to make a purchase. However, we are very explicit about the rights the shareholders would have against the fund manager in the case of any wrongdoing. CONSAR[1] is currently in the process of issuing their regulations on how the Afores would invest in CerPIs, and there is a draft already in public consultation.

What are the prospects for private equity-backed companies to become public in Mexico?

There is still is a stigma in Mexico that the stock exchange is only for the really rich. I've heard the heads of companies say, "No, we don't have the size to become public. We only bill US$1 billion a year." We're trying to convince people that going public is not necessarily only about the need for cash; it allows you to reach new sources of financing, but it also gives you an objective valuation of your net worth.

We are making an effort to change this mindset and to ensure that the market becomes a real option for private equity exits. After three to five years, depending on your fund, you need to sell your investments. A few firms have been successful in taking a company public but we'd like to see more. Private equity is a good filter to get a company listed because if you have received private equity investment, you already have some sort of professionalization, corporate governance, etc.

We've enacted a lot of changes to allow companies to become public faster and at a reduced expense. In particular, we are focused on boosting the liquidity of smaller companies. We have passed reduced requirements for smaller companies of less than approximately US$80 million in capital. They can go public but don't need to have IFRS (International Financial Reporting Standards) until 2017. They can also disclose their information every six months rather than every quarter.

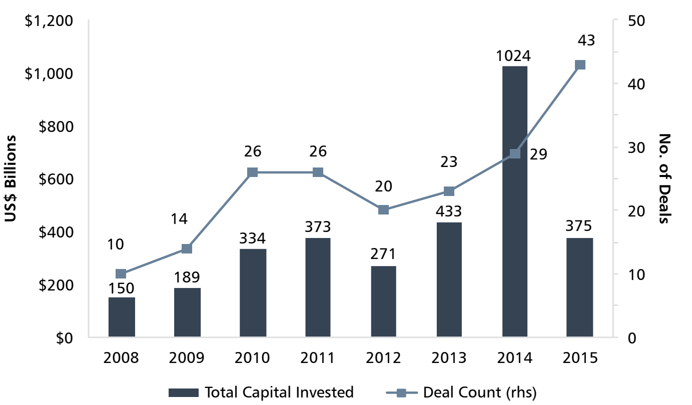
We are also optimistic that a second exchange focused on small- and mid-size companies will come to Mexico in the following months, and this has given us an opportunity to revisit all of our capital markets regulation so that any changes can be made in line with the entrance of the new exchange. In Mexico, we have some very old regulations—we had a crisis in the 1980s, we had a crisis in the 1990s, and therefore much of the mindset of our regulations is based on those experiences. We are taking a close look to see what we can do to make improvements. We're also very open to hearing outside perspectives on what else we can do.

1. Comisión Nacional del Sistema de Ahorro para el Retiro (CONSAR) is the regulator for Mexico's pension system.

A Closer Look at Mexico's Investment Environment

While undeniably starting from a low base, investment activity in Mexico has steadily accelerated over the last several years. The 43 deals that took place in 2015 represent a significant uptick from the 10 transactions recorded in 2008, as well as a 48% increase over the prior year (see Exhibit 16). While the US$375 million in disclosed capital deployed in the same year may seem like a drop in the bucket compared to US$1.6 billion invested in Brazil, it demonstrates that the market continued to absorb capital at a time when Latin America more broadly witnessed the largest percentage decline in disclosed capital invested across all emerging market regions, and when total investments by number remained flat.

Exhibit 16: Mexico Private Capital Investment by Year, 2008-2015 (US$B, No. of Deals)



Source: EMPEA. Data as of 31 December 2015.

Notwithstanding this growth, the total number of deals—141 over the last five years—that have taken place in the market remains relatively low, particularly given the size of Mexico's economy and the favorable investment reforms outlined earlier in this report. Indeed, a perceived lack of deal flow is a common criticism directed toward the Mexican private equity industry, and such views have carried influence with limited partners as they evaluate whether or not to seek exposure to the country.

IN SEARCH OF DEAL FLOW

When one LP was asked to elaborate on why their firm had chosen not to commit capital to any Mexican private equity funds to date, the individual proclaimed disbelief over the assertion that the opportunities to invest in good Mexican companies were plentiful. "It's hard to get exposure to high-quality companies given the amount of family money that is running around in Mexico. The reality is that there are 50 to 70 families that control the majority of the economy, and we felt that the good companies were simply being traded amongst these groups. It was only the bad companies that private equity firms were able to get their paws on."

Family-owned companies do dominate the Mexican economy. In a recent study, Mexico ranked ninth globally in terms of the number of companies within the top 500 largest family-owned businesses by revenues.[18] Of the 15 Mexican firms to make the list, America Movil (Carlos Slim and family), Fomento Económico Mexicano (the Garza and Sada families), CEMEX (the Zambrano family) and Grupo Bimbo (the Daniel Servitje Montull family) led the pack. Recent annual revenues for the group of Mexican leaders range from US$2.7 billion to US$61.6 billion and are generated from a wide range of industries.

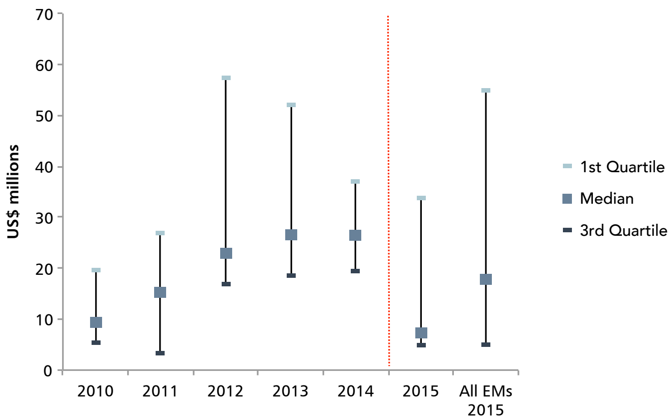
Some market participants acknowledge that sourcing quality deals is a challenge in Mexico. DEG's Goderbauer explains, "It is really complicated to find good companies that are willing to accept private equity money. There are many, many reasons for this—taxes, culture, the lack of exit opportunities through the public markets, etc." He continues, "Few firms want to invest in the small companies but the larger ones don't believe that they need private equity money. It's difficult to find something in between, and if you do, it's usually a family business. Many of these owners are rather happy having their personal expenses on the company balance sheet, and are perfectly content with an annual growth rate of 2-3%. Why would they want to change that?"

Other firms see this dynamic as an opportunity. "It's to our advantage to originate investments through our network within the families," notes one private equity participant. "You can better understand the deals and how to best approach them rather than just bringing money. If you show up with a value-added business plan, you will get their attention. The real difficulty is with businesses that are generating US$100 million to US$200 million in annual revenues or above. Many of the companies that we work with, which are below that threshold, face a challenge with the founder's dilemma and how to pass a company on. A fund like ours can come in and implement corporate governance, improve management, and help the company think about growth differently."

The relatively small size of deals that have taken place in Mexico suggests that many of the investment opportunities for private equity firms lie below this threshold. Since 2010, disclosed median deal sizes for Mexico have averaged only US$17.9 million compared to US$27 million in Latin America (see Exhibit 17).

18. Center for Family Business at the University of St. Gallen, Global Family Business Index. Accessed April 2016.

Exhibit 17: Mexico Private Equity Investment by Size, 2010-2015 (US$m)



Source: EMPEA. Data as of 31 December 2015.
Note: Excludes venture capital, real assets, infrastructure and private credit transactions.

The majority of private equity fund managers operating in the market agree that opportunities can be found, though it may require broadening one's scope. For instance, many of the firms that we interviewed in the course of researching this report remarked on the rich deal flow that exists outside of Mexico City (see *Spotlight: A Tale of Many Mexicos).* The Abraaj Group's Cortina elaborates on the market's potential. "If we have to search for two investments per year in a US$1.2 trillion economy consisting of 32 states and over 35 cities with more than 500,000 people, we'll probably find almost 4,000 companies with revenues above US$30 million. The investment opportunity out there is tremendous and there is a lot of space to invest."

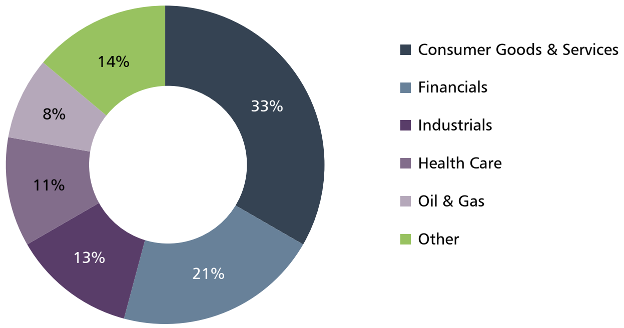
THE INTERNAL CONSUMPTION STORY

One of the primary arguments for investing in emerging markets these days is to tap into the growth of the emerging middle class consumer, and the investment thesis for Mexico is no exception. With the population growing, incomes rising and access to credit expanding, many private equity firms are seeking investments that will be able to profit off of the resultant change in consumer preferences. One local investor points out, "More people are now able to access Mexico's banking system. After they have solved their main needs—a house, a car, appliances, etc.—they start to look for other improvements to their lives."

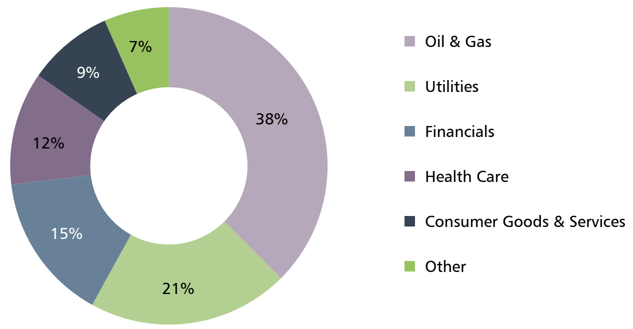
In 2014 and 2015 combined, fund managers invested in 24 companies focused on the consumer goods and services segment, representing 33% of all activity by number (see Exhibit 18). Local private equity firm LIV Capital was particularly active in terms of

Exhibit 18: Mexico Private Capital Investment by Sector

Sector Investment by No. of Deals, 2014-2015



Sector Investment by Capital Invested, 2014-2015



Source: EMPEA. Data as of 31 December 2015.

investing in consumer-oriented businesses, putting capital to work in B2C merchandising e-commerce platform Linio, digital animation studio Anima Estudios and online bus ticket booking engine Reserbus, among others, in 2015. Northgate Capital, a global fund of funds that is beginning to do direct investments in the Mexican market, is another example of a firm actively seeking to capitalize on favorable consumption trends, having acquired a 49% stake in entertainment center operator Grupo Diniz in July 2015. In early 2016, Nexxus Capital completed its acquisition of restaurant platform Inversionistas en Restaurantes de Carnes y Cortes (IRCC), consisting of brands La Mansión, Gino's, Casa Ávila, Champs Elysees and Bistrot Mosaico, through its Taco Holding vehicle.

McDonough of Alta Growth Capital shares an example of how a consumer-focused business can prosper. "A company that can offer a higher quality service at a competitive price can be very successful in Mexico," he claims. "We invested in a franchisee of Little Caesars Pizza in Monterrey through our second fund, and brought to the area a uniform product sold from clean stores at an attractive price point. Our stores sell more here than anywhere else in the world—even though it has been around in the United States for decades and has been entering other growth markets. Coming to a less competitive environment like Mexico with an attractive value proposition offers growth possibilities that are quite large. "

In terms of the total volume of disclosed capital invested, the oil and gas sector took the lead over the last two years, accounting for 38% of all dollars invested, or US$525 million. However, all of these dollars were concentrated in one large transaction—the investment in Sierra Oil & Gas by Riverstone Holdings, EnCap Investments and I Cuadrada (now owned by BlackRock), which took place in September 2014. The company was the winning bidder in the first oilfield auction since President Peña Nieto's signing of the energy reforms into law, allowing private drilling for the first time since 1938. Five other transactions—executed by both local and global private equity firms—took place in this segment, yet all were undisclosed in value.

As the Mexican government focuses on channeling greater funding into upstream opportunities, related opportunities are likely to transpire. PineBridge Investments' Rodriguez explains, "These large infrastructure and energy projects will have a huge spillover effect on companies that provide services like logistics, construction or transportation. The government is keen on making this environment viable for private investors from a fiscal and legal perspective." While a number of industry experts commented that such developments may be hindered by the recent fall in the price of oil, they remain optimistic from a medium- to long-term perspective.

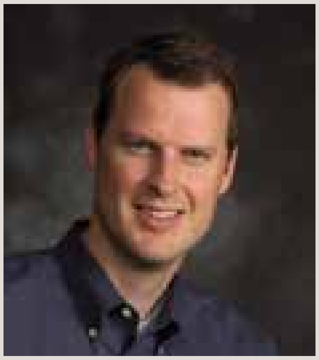
Exhibit 19: Sampling of Venture Capital Deals in Mexico, 2015

Fund Manager, Co-investors	Company Name	Primary Sector	Investment Date	Investment Amount (US$m)
ALLVP (Venture Partners Mexico)	Médica Santa Carmen	Health Care Equipment & Services	Apr-15	7
Seaya Ventures	ComparaGuru	General Retailers	Feb-15	4
ALLVP (Venture Partners Mexico)	Farmacias Personalizadas	Food & Drug Retailers	Mar-15	3
DILA Capital (with Capital Invent)	Aliada	General Retailers	May-15	0.8
ON Ventures (with Capital Invent)	Parkmovil	General Retailers	Aug-15	0.6
LIV Capital	Reserbus	Travel & Leisure	Sep-15	0.5
Rise Capital (with Capital Invent)	Gaia Design	Household Goods & Home Construction	Dec-15	N/A
Alta Ventures Mexico	Clip	Support Services	Dec-15	N/A
First Round Capital (with Felicis Ventures)	Bright	Alternative Energy	Aug-15	N/A
DILA Capital	EConduce	General Retailers	Jun-15	N/A

Source: EMPEA. Data as of 31 December 2015.

MAKING THE CASE FOR GROWTH EQUITY INVESTING IN MEXICO

BY SCOTT MCDONOUGH, MANAGING DIRECTOR, ALTA GROWTH CAPITAL



"Can you really make minority, growth equity investments work in emerging markets?" This question often comes up when we meet with limited partners who wonder how you can actually exert influence, or even successfully exit, if you don't have "control" of a company. Alta Growth Capital has been investing in Mexico since 2007 and the majority of our investments have been traditional growth equity with minority positions. Our experience shows that not only can growth equity work in Mexico, but that it provides distinct advantages that can lead to better returns than other strategies.

Like many things in life, there is an art and a science to growth equity investing. The science part is the need to adequately structure the transaction in a way that provides the investor with the necessary contractual tools to protect its position and exert influence over the operation and, importantly, the exit of a company. Prior to 2006, this was difficult to do in Mexico. However, several changes have since been made to Mexican corporate law to allow the contractual flexibility to include these protections.

While having the proper contractual structure is necessary, it is not sufficient. Generally, contracts are respected within the business community, but it can take time and expense to enforce things legally if it comes to that. For that reason, significant effort must be put into the art of growth equity. Deals must be structured to ensure an alignment of interest, and time must be invested in building strong relationships with your partners. Doing this helps to ensure that the majority shareholders will listen and be willing to work with you when challenges or opportunities arise. In addition, alignment helps create motivated partners who feel empowered to do things that will be beneficial for everyone involved. It really is a win-win situation.

One of our investments in our first fund was a healthcare deal in which our ownership was less than 20%. In spite of that, we were able to include several elements that gave us sufficient control and influence to make us comfortable, such as a variable valuation mechanism, board representation, several vetoes, and even a drag-along. In addition, much time was spent working with the founder to improve the operations of the company, evaluate strategic initiatives, and build a strong relationship. As a result, when the opportunity arose, the founder helped us to engineer a sale of our minority position to a financial buyer that more than doubled our money. The structure of the investment combined with our relationship with the founder made this happen.

A big advantage of being willing to do minority deals is that it opens up a much broader universe of opportunities. In a place like Mexico where capital is limited, particularly for lower middle market companies, there are many founders who are interested in raising capital to accelerate growth, but are not quite ready to sell outright. Another benefit of growth equity investments is that they tend to be lower risk. These companies are usually large enough to have some track record and a functioning business model, but small enough to still have significant growth ahead of them. In addition, the transactions themselves do not typically involve leverage as compared to buyouts. This helps with capital preservation.

Overall, the growth equity strategy is alive and well in Mexico. Developing the ability to implement this strategy in Mexico, as we have done at Alta Growth Capital, can increase significantly the number and quality of investment opportunities, and lead to very positive outcomes for limited partners.

MEXICO'S REAL ESTATE SECTOR: AN ATTRACTIVE INVESTMENT OPPORTUNITY

BY GREGORIO SCHNEIDER, MANAGING PARTNER & CHIEF INVESTMENT OFFICER, TC LATIN AMERICA PARTNERS

The real estate asset class in Mexico has evolved over the past decade and we have seen an increase in the number of institutional players in the market, fostering a more liquid investment environment. Furthermore, Mexican real estate markets now have a deeper connection with capital markets. Since FIBRAs (the Mexican equivalent of the U.S. REIT) started in 2011, ten FIBRAs have raised funds in the capital markets with a total market capitalization of US$14.3 billion. INFONAVIT and FOVISSSTE, Mexico's largest mortgage lending institutions, have also reached a new level of maturity, while commercial banks, most of them currently held by international firms, have aggressively increased their mortgage portfolios. In addition, we believe the asset class remains underpenetrated. Collectively, this offers an attractive risk / reward investment opportunity with downside protection supported by the value of land—a situation unique to real estate investment.

We currently believe that mixed-use projects are particularly appealing. As urban populations increase and traffic worsens, proximity to local services will be advantageous. We also believe the industrial and logistics sectors in Mexico will offer compelling investment opportunities, as exports of manufactured goods to the United States are expected to increase due to a decline in the Chinese economy and better terms of trade for non-oil exporting sectors given the low energy prices and a weak currency situation, which we expect to continue.

We see an opportunity in the residential segment notwithstanding the challenge of finding suitable land and developers with the adequate financial and operational structure to develop profitable projects. According to SOFTEC, a real estate consultant, and the Sociedad Hipotecaria Federal, there are close to ten million Mexican families living with inadequate housing or otherwise in a housing deficit condition. Despite government efforts, this deficit is currently growing at a pace of 750,000 additional homes annually, given insufficient new annual supply vis-à-vis incremental demand.

Finally, we continue to see opportunities in for-sale greenfield projects as there is less competition from institutional capital, which is focused on income-producing assets. For-sale greenfield investment also offers the ability to execute successful exit strategies by selling to a FIBRA, capitalizing on both situations. We estimate that the size of the investment opportunity for all greenfield development projects in Mexico ranges from US$3 billion to US$6 billion annually, based on construction loans granted in 2014 of approximately US$18 billion. The investment opportunity for greenfield development in Mexico could reach up to US$25 billion across all real estate sectors (i.e., residential, industrial and commercial) if we include debt in addition to equity investments.

Mexico mirrors the United States in the late 1940s in terms of size, population and education levels. As stated by SOFTEC, most countries that reach Mexico's current level of GDP per capita double their income in 20 years, as evidenced by Austria, Belgium and South Korea, among others, which, like Mexico, expanded their economies based on manufactured exports and witnessed the rise of a robust middle class. Going forward, we expect a convergence to the state of affairs in the United States, with specialized players and new, more sophisticated instruments arising. Mortgage securitization (RMBS and CMBS) is yet to become a reality and, if well managed, will bring additional liquidity to the real estate sector.

The key factors that will drive continued growth of real estate in Mexico include the underinvestment in this segment, the broad housing deficit, demographic pressures, expansion of the middle class, increased liquidity in the markets and recent reforms to the energy and telecommunications sectors, which are expected to boost the growth of the economy. The country's real estate sector is still underdeveloped relative to developed economies, with mortgages outstanding close to 10% of GDP (versus 50-80% in developed markets). The aforementioned conditions make Mexico an attractive market and one of the most compelling environments for investment available today.

(Continued from page 24)

THE EXECUTION CHALLENGE

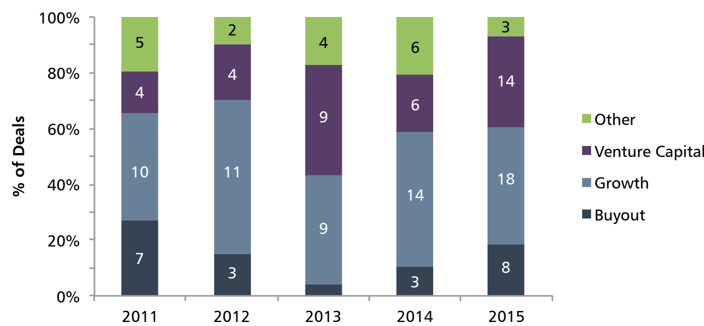
Private equity investors in Mexico often face an uphill battle to execute deals. The strong family business culture and a general lack of awareness regarding private equity, as previously discussed, can make for a tough sell. In addition, taxes can play a leading role in bulldozing a negotiation process. One industry participant states, "Half of the deals that we've lost have been due to taxes. We reach an agreement but then the business owners want you to send a check to Switzerland. Some have never paid taxes, and many don't want to."

Competition is also heating up, putting increased pressure on the industry. "We've lost more deals historically to family offices than to anyone else," confides one private equity investor. "For obvious reasons, they can deploy capital cheaper than we can, and they can hold an investment for a longer time period. They can also be very aggressive. However, the broader community is beginning to realize that a venture capital or private equity fund can add a lot of value, which was not necessarily the case ten years ago."

In addition to the family offices, private equity firms are not only competing for deals against their local peers, but also from regional and international players who, on average, have accounted for 33% of all transactions since 2011. César Pérez Barnés, Partner at Southern Cross Group, observes, "Private equity in Mexico is not for just anyone. There are new firms coming into the market every day and deal sourcing becomes key. Having a long-standing presence and the right strategy gives you an edge. There is a higher chance for a newcomer to do a minority deal, but control deals, where the whole of the value creation is in your hands, is still the terrain of a handful of firms."

Exhibit 20: Growth Remains Primary Investment Strategy but Venture Capital Increasing in Prominance

Mexico private capital investment by strategy (percentage distribution by no. of deals), 2011-2015



Source: EMPEA. Data as of 31 December 2015.
Other includes mezzanine and debt deals.

Accordingly, growth equity investments have been the dominant play over the last five years, representing 42% of all transactions by number in 2015 (see Exhibit 20). Buyouts have continued to represent a small portion of overall activity (19% in 2015), while venture capital has been gradually expanding in the market over time, in line with an uptick in fundraising. Many private equity participants believe a burgeoning venture capital ecosystem will be a positive for the industry overall as companies are created and nurtured to a higher level of development that may result in them being targets for growth- and buyout-focused investors. Alta Growth Capital's McDonough notes, "There was hardly any venture capital back when we first got started but that has changed a lot. The growth in venture is helping to raise awareness with more entrepreneurs, and it is actually improving deal flow, particularly in the lower to middle-market segment."

Exhibit 21: Sampling of Largest Disclosed Deals in Mexico, 2014-2016

Fund Manager, Co-investors	Company Name	Primary Sector	Investment Type	Investment Date	Investment Amount (US$m)
Riverstone Holdings, BlackRock, EnCap Investments	Sierra Oil & Gas	Oil & Gas Producers	Growth	Sep-14	525
Actis	Zuma Energía	Electricity	Growth	Sep-14	250
Nexxus Capital	Portafolio Inmobiliario Estrella	Real Estate Investment & Services	Growth	Nov-15	61
Advent International	Grupo Financiero Mifel	Banks	Growth	Jun-15	52
Southern Cross Group	Grupo Expansión	Media	Buyout	Jun-14	47
Mexico Infrastructure Partners	COVIMSA	Construction & Materials	Mezzanine	Feb-16	40
Northgate Capital	Elara Comunicaciones	Mobile Telecommunications	Buyout	Aug-15	38
Macquarie Infrastructure and Real Assets (MIRA)	Santiago HydroGen	Electricity	Growth	Jan-14	37
EMX Capital	Farmapiel	Pharmaceuticals & Biotechnology	Growth	Jun-14	28
Northgate Capital	Health Digital Systems (HDS)	Software & Computer Services	Growth	Mar-14	25
Alta Growth Capital	Pequeño Caesarmex	Travel & Leisure	Growth	Mar-14	18

Source: EMPEA. Data as of 4 April 2016.

> “More people are now able to access Mexico’s banking system. After they have solved their main needs—a house, a car, appliances, etc.—they start to look for other improvements to their lives.” –Local Fund Manager

Mexico’s reputation as a market where it is tough to build a pipeline and successfully execute transactions may be well deserved. However, the pool of fund managers operating in the market today is doing deals in ever increasing numbers and steadily building a track record. Change, however, will be most catalytic with a shift in the mindset of the investees. According to Gabriel Mizrahi, Director at Northgate Capital, “Mexico still needs to evolve as a country and as a business community. Our culture needs to change so that people are more open and willing to bring a value-adding partner to the table. Sometimes when you approach local companies, they still see you as a source of capital…and only capital. They are trying to maximize a valuation but you have to try to convince them that once you are part of the company, you can grow it and make it more profitable by thinking long term and in creating value together.”

As more private equity funds make deals, and as more investees have a positive experience with the asset class, success stories will spread across the broader market, and gradually the burden of explaining private equity will decrease over time. However, it is imperative that these investments perform well—that exits take place and are done in a way that benefits all the parties involved.

Spotlight: A Tale of Many Mexicos

Built on the ruins of the ancient Aztec capital Tenochtitlan, Mexico City is home base for the majority of Mexico's local fund managers, as well as the bulk of the companies in which they invest (representing over 60% of all disclosed transactions in 2015). However, conversations with private equity participants indicate that the asset class is beginning to expand to all corners of the country as GPs seek the exceptional growth rates and fresh deal flow that exist outside of the main hub. Below are several industry views on investing across Mexico.

"In Mexico you have to travel. Even though a big portion of the opportunities that exist are in Mexico City, most are known by the majority of the players in the industry and they come with an investment banker, making them the typical transaction that you don't want to do. If you travel around and go to Monterrey, Guadalajara, Bajio or the Southeast, you'll find plenty of opportunities that are under the radar, particularly in the range on which we focus: transactions of US$50 million to US$300 million in annual revenues. Our challenge is that they are often totally clueless about what private equity is, so you have to explain the pros and cons. The time that it takes to close these transactions is often much longer but in the majority of cases, they ended up being the better transactions."

–**Roberto Terrazas,** Managing Director & Chief Investor Relations Officer, Nexxus Capital

"The top three cities—Mexico City, Monterrey and Guadalajara—are big, populous and growing fairly fast. But once we go into other cities, we actually start to see much higher growth rates; growth that is at least twice as fast in comparison to the country's top line GDP. Diving deeper, within those cities there are industries or economic regions that are doing especially well. We go to these cities, organize events, and meet with the main business owners. You wouldn't believe the amount of companies out there; it is just not institutionalized yet. This nuanced approach is how we find companies that are growing four to five times faster than national GDP."

–**Eduardo Cortina,** Director, The Abraaj Group

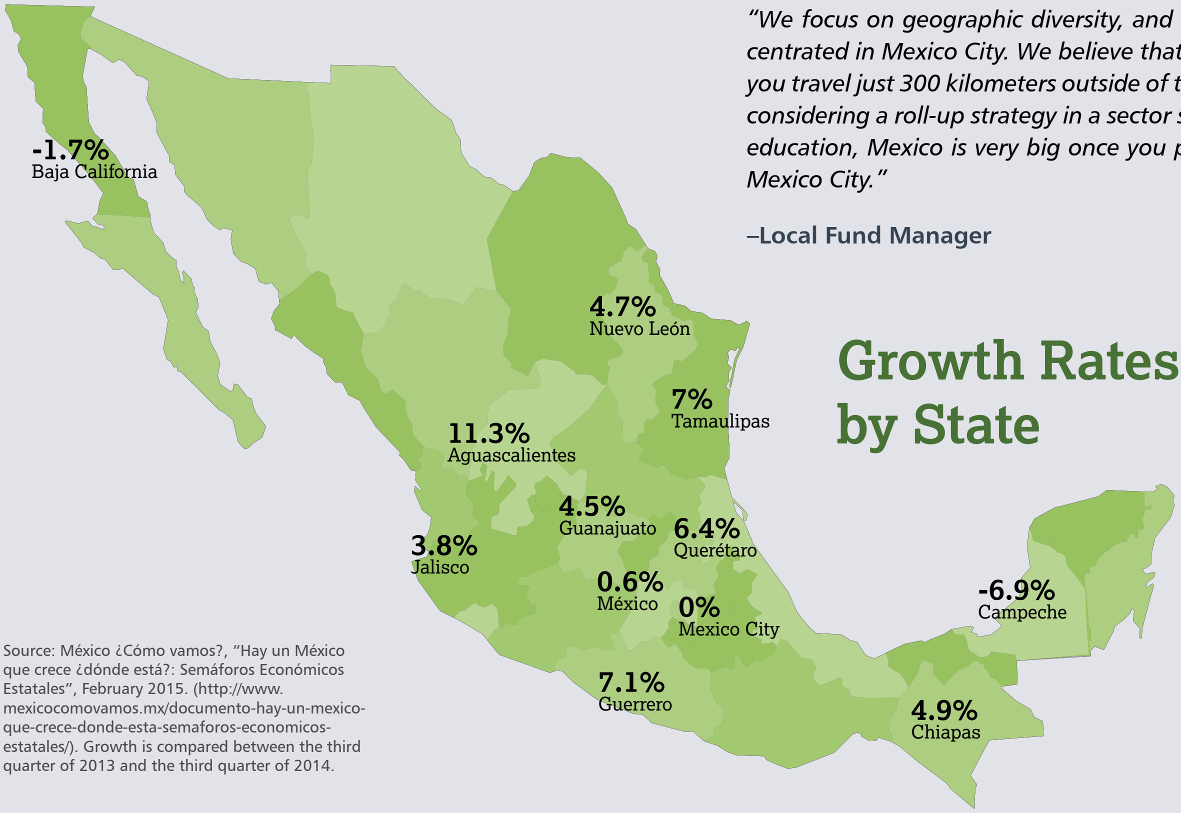
"One of my favorite investments is a retail company in a state called Colima, which you probably haven't heard of. There are a lot of opportunities in the provinces outside of Mexico City, and I think that's where the fund managers need to go in order to find transactions. The problem obviously is that those companies are very often much less sophisticated. You have to explain the benefits of private equity, and you have to start with the basics. I don't know how many GPs are willing and able to do that, particularly because there is also a huge cultural disconnect between Mexico City and places like Angangueo or Oaxaca."

-**Johannes Goderbauer,** Senior Investment Manager, DEG

"We focus on geographic diversity, and our portfolio is not concentrated in Mexico City. We believe that there is a lot of depth if you travel just 300 kilometers outside of the capital. When you are considering a roll-up strategy in a sector such as transportation or education, Mexico is very big once you pick your head up above Mexico City."

–**Local Fund Manager**

Growth Rates by State



Source: México ¿Cómo vamos?, "Hay un México que crece ¿dónde está?: Semáforos Económicos Estatales", February 2015. (http://www.mexicocomovamos.mx/documento-hay-un-mexico-que-crece-donde-esta-semaforos-economicos-estatales/). Growth is compared between the third quarter of 2013 and the third quarter of 2014.

Case Study: **Liquid Capital**

The case of The Abraaj Group's investment in Liquid Capital illustrates how a Mexican business can benefit from the value creation initiatives a private equity firm brings to the table in addition to its capital—and the knock-on effects to an economy that can result. In Liquid Capital, Abraaj saw an opportunity to invest in a high-growth company while supplying a critical part of the broader business infrastructure. Additionally, Liquid Capital's leasing operation addressed a major bottleneck in Mexico's business ecosystem: the scarcity of bank financing, especially for SMEs. By leasing their office equipment, Mexican entrepreneurs could preserve and extend their precious capital.

The Company

Liquid Capital
FINANCIANDO EL ÉXITO

Essentials

Company: Liquid Capital (Docuformas S.A.P.I. de C.V.) (www.liquidcapital.mx)

Sector: Diversified financial services

Business focus: Providers of lease financing

GP: The Abraaj Group, a private equity investor in growth markets with approximately US$9.5 billion in assets under management (www.abraaj.com)

Date of Investment: January 2008

Liquid Capital's Story

In 1996, Xerox decided to transfer its Mexican print equipment distribution business to independent operators. Adam Wiaktor, an executive of the company at the time, decided to step in and acquire the franchise himself, thus creating Liquid Capital (previously named Docuformas).

One of the individuals involved early in the history of Liquid Capital approached members of Abraaj's team for funding in 2007. By January 2008, Abraaj had agreed to invest. The investment rationale was compelling: the Mexico City-based company was a market leader with a record of rising profits and strong cash flow. Through its strategic alliances with Hewlett-Packard and Xerox, it obtained machines at a substantial discount to their selling price. In addition, the management team was dedicated to continued growth through new product lines, such as medical and optical equipment leasing, funded by the additional capital supplied by Abraaj.

The years leading to 2012, however, did not entirely conform to the script, as the global financial crisis threatened the company's lines of credit. Although Abraaj's investment team managed to arrange additional financing for the company, the chaos of the crisis resulted in a year of lost growth. During 2012, however, the new product lines and an emphasis on franchised leasing operations put the company on a renewed growth path.

Today Liquid Capital is the second largest independent leasing company in Mexico. The company has two operating units—Liquid Capital and Liquid Capital Franchises—and a subsidiary named ARG, a leasing company acquired in December 2014:

- Liquid Capital: engages in sales of office equipment and related software, supplies, parts, service and technical support.
- Liquid Capital Franchises: offers factoring and leasing facilities for various clients.
- ARG: provides fleet management services to medium sized companies.

Since the acquisition of ARG, Liquid Capital has focused on capturing commercial and operational synergies, and increasing top line revenue through organic growth by opening new franchises, increasing contract values and exploring new sectors.

The Role Played by Private Equity

Concentrating on governance and risk, Abraaj worked closely with the management team to develop a viable business plan that included a diversification strategy to focus on new business lines. Abraaj helped strengthen the company's governance processes, including the establishment of a well-functioning Board, and a risk framework that enhanced accounting and reporting standards; for instance, by adopting IFRS in place of Mexican GAAP. Furthermore, risk analytics and the credit approval processes were strengthened using stronger customer data analytics. Abraaj also introduced the company to the *Balanced Scorecard* and *Strategy Map* to identify the company's strengths, weaknesses, opportunities and threats, while improving communication amongst co-workers and departments.

Moreover, Abraaj provided crucial support for the company during the global financial crisis. Lending to financial companies in Mexico was severely restricted, and when available, it was at uneconomic interest rates.

The Abraaj team accepted the challenge of helping Liquid Capital maintain old credit lines and opening new ones. In January 2009, Abraaj convinced Mexico's National Development Bank (Nacional Financiera) to guarantee 30% of the company's debt.

By 2012, Abraaj and management were successful in shifting from leasing office equipment, a market that was shrinking, to providing other types of financial services for SMEs. Most significantly, the company purchased a master franchise for Mexico from Canada's Liquid Capital, resulting in the firm's name change and through which the company can sell franchises to entrepreneurs interested in establishing receivables for factoring and leasing services.

Among other achievements, during Abraaj's investment period, the company has revitalized its employee training through an association with a local university, totaling 8,874 man-hours with approximately US$183,000 invested in training in 2015 alone.

Exit Trends & Performance

Positive top-line trends, such as increased fundraising totals and climbing deal counts in Mexico, as well as conversations with both local and international stakeholders, make it clear that fund managers and investors believe that there is good money to be made in Mexico. In EMPEA's 2015 *Global Limited Partners Survey*, 48% of respondents indicated that they expect returns greater than 16% for Latin America ex. Brazil funds, compared to 41% who expect similar returns for funds focused on Brazil. While the growth of Mexico's private equity environment in recent years offers many reasons for optimism, LPs are likely not basing their future returns expectations on past results.

The publicly available data on historical performance in Mexico remains relatively limited. Investment advisory firm Cambridge Associates analyzed the returns from Mexican companies that received private equity funding between 1992 and 2013, and found that these investments delivered a median gross IRR of -0.2%, with an upper quartile breakpoint gross IRR of 13.5%. In comparison, investments in Brazil over the same timespan generated a median gross IRR of -2.67%, but a top quartile breakpoint of 18.1%. Across all of Latin America, companies receiving investment from 1992 to 2013 returned a median gross IRR of 2.6% and a top quartile breakpoint gross IRR of 19.8%.

Cambridge Associates' data suggest that private equity investments in Mexico during the previous two decades underperformed relative to the broader region, and lacked the larger success stories found in Brazil, Latin America's largest market. However, DEG's Goderbauer contends, "I would argue that Mexico is a less risky, much more stable play on a macro level than most of Latin America. It comes down to a question of risk-adjusted returns. If your downside is less dramatic, you technically should be more than happy to accept a lower return as a result."

A closer look at the market's performance data demonstrate the progressive development of the asset class in Mexico over time, exemplified by the history of Fondo de Fondos, the first institutional investor in the region (see *Sidebar: Building a Local Industry*). An analysis of their portfolio reveals a consistent improvement in returns over time. According to Fondo de Fondos, the firm's earliest investments in funds with vintages between 1996 and 2001 (which are fully realized) generated a net IRR of 8.4%, followed by its next round of investments in funds with vintages between 2002 and 2006 (which are almost fully realized) returning an improved net IRR of 10.7%. The firm is confident about its most recent batch of commitments made between 2007 and 2011, which has already begun to return capital and is estimated to be tracking an IRR of nearly 15% net of fees but before discounting carried interest.

Speaking to the improvement of its returns over time, Director General of Fondo de Fondos Felipe Vilá González explains, "Having invested in private equity in Mexico since the beginning, we faced an ill-developed ecosystem and have had to go through a learning curve, as did all of our fund managers who were either first-time fund managers focused on Mexico or international fund managers investing in Mexico for the first time. We all had to learn our way. Given our collective inexperience, the returns from the early vintages were surprisingly good, and they have continued to improve ever since." This improved performance over time, coupled with Mexico's stability and strong growth lends some credence to investors' optimism over future return expectations.

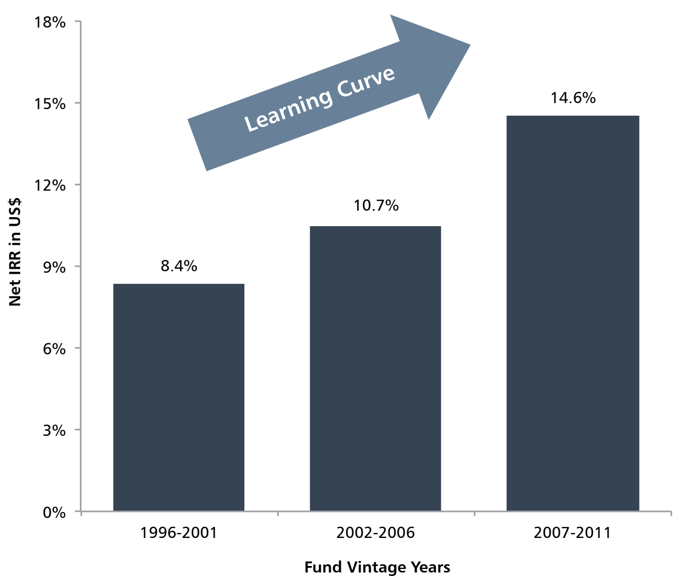
Exhibit 22: Gross Portfolio Level Returns for Mexico-based Companies, as of 30 September 2015

		Gross IRR (%)		
Companies in Mexico Receiving Initial Investment in:	Pooled Gross IRR (%)	Upper Quartile (%)	Median	Lower Quartile (%)
1992-2013	5.96	13.53	-0.22	-41.76

		Total Value to Paid-in Multiple		
Companies in Mexico Receiving Initial Investment in:	Pooled Gross TVPI	Upper Quartile	Median	Lower Quartile
1992-2013	1.36	1.78	0.99	0.10

Source: Cambridge Associates Private Investments database, as of 30 September 2015.
Note: Total number of companies included in the analysis is 88.

Exhibit 23: Fondo de Fondos' Investment Returns, 1996-2011



Source: Fondo de Fondos. Data as of 16 February 2016.
Note: IRR is denominated in US$. There are six funds included in the 1996-2001 vintages, eight funds included in the 2002-2006 vintages and 22 funds in the 2007-2011 vintages. IRR from 1996-2001 vintages is fully realized and net of fees and carry; from 2002-2006 vintages is almost fully realized and net of fees and carry; and, from 2007-2011 vintages is estimated and net of fees but before discounting carried interest.

THE PROMISE OF A LOCAL IPO MARKET IN MEXICO

BY CÉSAR PÉREZ BARNÉS, PARTNER, SOUTHERN CROSS GROUP

In January 2016, one of our portfolio companies, Mexican homebuilder Javer, raised MXN1.8 billion (US$101 million) through an initial public offering on the Mexican Stock Exchange. Six years ago, Southern Cross and two co-investors (Evercore and Arzentia) had acquired 60% of the company. At the time, Javer was the fifth largest company in Mexico's housing industry.

The homebuilding industry experienced challenging times following the global financial crisis, as most players focused on growth irrespective of capital structure adequacy, which resulted in the three largest homebuilders entering Concurso Mercantil (a Chapter 11 equivalent process). In that complex environment, Javer concentrated on a few key elements that helped the company excel operationally: 1) professional management and institutional governance; 2) product diversification in a limited number of large geographic markets; 3) strong focus on operational efficiency, particularly working capital management; and, 4) long-term financing at the corporate level to enhance operational flexibility. As a result, while the market shrunk by 50%, Javer thrived, generating positive free cash flow and becoming the undisputed number one homebuilder in Mexico.

This success story was recognized by investors that participated in the IPO, particularly given the uncertainties surrounding emerging markets in 2015 and 2016. The other key factor of Javer's IPO is that the investor base is overwhelmingly local, anchored by the Afores (Mexico's pension funds) who have demonstrated their capability and willingness to underwrite deals, given their large and growing amounts of assets under management and their top-notch analyst teams. Southern Cross believes that the local market has become deep enough to be a viable alternative for private equity funds looking to either exit a company or to raise additional capital.

However, it is important to keep in mind that going public entails a significant effort by the company. In the case of Javer, that effort was somewhat reduced by the fact that it was already SEC compliant given that it had previously issued a long-term bond in the United States and that the company's Board of Directors complied with the requirements of a public company, including well-respected independent members. But many other private firms are less prepared and need to make the necessary changes to institutionalize the decision-making processes and the governance of the company.

Marcos Mulcahy (l) and César Pérez Barnés (r) of Southern Cross Group at Javer's IPO

(Continued from page 31)

AN EXPANDING ARRAY OF EXIT OPTIONS

Strategic sales have proven to be the most viable exit channel in Mexico, accounting for over half of all exits in Mexico recorded by EMPEA during the past two years. However, many fund managers are optimistic that secondary sales and listings on the public market could become more common in the coming years, as the local private equity industry and the infrastructure surrounding it continues to develop.

Strategic Sales

Mexico is a market well suited for exits via strategic sales for many reasons. Perhaps the most obvious reason is its geographic and economic proximity to the United States. Mexico is the United States' third largest trading partner, accounting for US$295 billion in imports and US$236 billion in exports in 2015, and makes up an increasing amount of the manufacturing capacity of U.S.-based companies, most notably the American auto industry.[19] Undoubtedly, Mexico's economy is tied to that of its northern neighbor, and companies looking to cash in by catering to the world's largest economy could find Mexico an attractive place to set up shop.

> "Having invested in private equity in Mexico since the beginning, we faced an ill-developed ecosystem and have had to go through a learning curve, as did all of our fund managers who were either first-time fund managers focused on Mexico or international fund managers investing in Mexico for the first time. We all had to learn our way. Given our collective inexperience, the returns from the early vintages were surprisingly good, and they have continued to improve ever since."
>
> –Felipe Vilá González, *Fondo de Fondos*

19. U.S. Department of Commerce, Census Bureau, Economic Indicators Division. "Top U.S. Trade Partners: Ranked by 2015 U.S. Total Export Value for Goods." See: http://www.trade.gov/mas/ian/build/groups/public/@tg_ian/documents/webcontent/tg_ian_003364.pdf

International companies are also attracted to Mexico because of its appealing demographics and consistent economic growth. However, international firms sometimes find Mexico difficult to penetrate on their own. Private equity can therefore play a vital—and potentially profitable—role by acquiring and consolidating the smaller, often family-owned companies that make up much of Mexico's economy. As PineBridge Investments' Rodriguez explains, "Some managers are putting together consolidation plays of small businesses in fragmented markets and really making them a plug-and-play for an international firm that perhaps could see the attractiveness of the Mexican market for their specific sector. They can't come and do all that work and buy a small company in Monterrey for US$5 million and then another one in Guadalajara. Some fund managers are doing that work so that an international player can come in and gain access to the market."

Private equity then serves as a valuable tool for these international companies to filter, consolidate and professionalize potential acquisitions in Mexico. As EMX Capital's Ávila puts it, "It gives foreign companies a tremendous amount of relief to come to Mexico after a good private equity firm has done its job. We have the proper documentation and compliance in place, so they know what they're buying."

Global firms, however, are not the only ones buying private equity-backed companies in Mexico. A number of industry participants interviewed during the course of researching this publication commented on the growing prevalence of domestic companies in Mexico becoming potential buyers. One example of a strong homegrown company is Mexico's own Grupo Bimbo, which has transformed from a small domestic operation into the largest baked goods company in the world, acquiring both Mexican and international companies along the way. As Mexico continues to develop its own international juggernauts, strategic acquisitions from private equity fund managers could be a primary source of fuel for these companies' growth. Fund managers in Mexico stand to benefit from the continued development of strong companies headquartered closer to home.

IPOs

Exits via public offerings have played a smaller role in most firms' exit strategies in Mexico. While there were six initial public offerings on Mexico's Bolsa Mexicana de Valores (BMV) in 2015, none of them were backed by a private equity investor. However, Southern Cross Group raised MXN1.8 billion (US$101 million) for its home construction supply company Javer through an IPO on the BMV in January 2016, suggesting that a local IPO market for companies seeking an issuance of under US$250 million is emerging (see *Sidebar: The Promise of a Local IPO Market in Mexico*).

Nexxus Capital is an example of a firm in Mexico that has listed multiple companies on the BMV, having completed four IPOs since 2008. The firm most recently listed a company in 2014, raising MXN750 million (US$57 million) for its portfolio company Grupo Hotelero Santa Fe in a primary offering. Nexxus Capital's Terrazas explains his firm's strategy regarding IPOs as not necessarily being an exit on day one. "In all cases, we have maintained a significant portion of our ownership in the company, even after the IPO. We see it as another round of financing in order to continue giving value to the company."

Exhibit 24: Sampling of Recent Notable Exits and IPOs in Mexico

Company Name	Fund Manager(s)	Primary Sector	Year(s) of Investment	Capital Invested (US$m)	Transaction Date	Exit and Return Detail
Javer	Southern Cross Group	Household Goods & Home Construction	2009	73	Jan-16	IPO on BMV raised MXN1.8B (US$101m)
Diagnósticos de México, Diamex (Olab)	Nexxus Capital	Health Care Equipment & Services	2009	N/A	Sep-15	Full divestment from OLAB; further transaction details undisclosed
SinDelantal.Mx	Seaya Ventures	General Retailers	2013	3	Feb-15	Strategic sale to United Kingdom-based takeout ordering service Just Eat
Analistas de Recursos Globales (ARG)	Alta Growth Capital	Industrial Transportation	2010	N/A	Dec-14	Strategic sale to Docuformas, Mexican franchisee of financial leasing company Liquid Capital*
Grupo Hotelero Santa Fe	Nexxus Capital	Travel & Leisure	2010	29	Sep-14	IPO on BMV raised MXN750m (US$57m); no disposal of shares
Grupo RedIT	Cartesian Capital Group, LIV Capital, The Abraaj Group	Software & Computer Services	2007, 2009, 2013	N/A	Jul-14	Strategic sale to undisclosed buyer
Volaris	Discovery Americas	Aviation & Aerospace	2010	9	Sep-13	IPO on BMV and NYSE (via ADRs) raised US$350m; no share disposal disclosed
Hoteles City Express	WAMEX Private Equity Management	Hospitality & Leisure	2010	10	Jun-13	IPO on BMV raised US$200m; no share disposal disclosed

Source: EMPEA. Data as of 4 April 2016.
*For more information on Docuformas, see *Case Study: Liquid Capital* on page 32.

While a handful of firms have had success listing companies in Mexico, a number of fund managers cite a lack of liquidity on the BMV as a key deterrent to issuing IPOs in the country. One industry stakeholder remarks, "Liquidity is a concern in Mexico. If your company won't trade at least US$1 million a day, it is not worth the effort to list because there will be price pressure." Regulators in Mexico recognize this liquidity issue, and are actively trying to combat it. Eduardo Flores Herrera of the CNBV explains, "Even very large companies that have been listed for a long time in Mexico are often highly illiquid because the family owns 95% of the float. We've been talking a lot with all of these companies and some have been willing to let go of some of their shares, which has led to a better result for them. This has particularly been the case for companies with good financials. It's better to be the owner of 70% of something that is worth US$5 billion than to be 90% owners of something worth US$2 billion."

In order to further promote IPOs in Mexico, many in the industry have also proposed an intermediate exchange structured for smaller companies and with lower listing requirements (see *Sidebar: The Regulatory Perspective*). Basila Abogados' Basila agrees, "You need an intermediate market because there are companies that have received private equity investment that are ready for an exit, but they are not of a scale to issue an IPO. Listing these companies in an intermediate market, where qualified institutional investors can acquire the shares and eventually take the company to the next level, offers a way to realize the value that is there." While many firms seem to be cautiously optimistic regarding a potential SME exchange in Mexico, others worry that the liquidity problems present on the existing market will only be magnified on a smaller scale.

Secondaries

Secondary sales to other financial investors have historically been uncommon in Mexico, but many fund managers in the country are confident that they are becoming a more viable exit channel as Mexico's private equity industry attracts global players such as KKR and BlackRock. Mizrahi of Northgate Capital explains the role that these larger funds could play in Mexico's exit environment, noting that, "Since we are investing in smaller or medium-size companies with high growth potential, after four or six years, these companies may still have a lot of room to grow. Therefore, these businesses could be attractive for other, larger private equity funds."

While strategic sales will likely continue to be the most common exit method in Mexico, the recent development of Mexico's private equity industry, including greater international interest in the country as well as proactive regulation, has broadened the methods by which fund managers in Mexico can exit their investments. Private equity in Mexico may be stuck in a classic "chicken and egg" scenario, in that fund managers need to demonstrate a strong track record to raise new funds, but funds must be raised and capital then invested before exits can be completed. In order for private equity in Mexico to truly flourish, fund managers must prove with their current crop of portfolio companies that exits in Mexico are both viable and profitable.

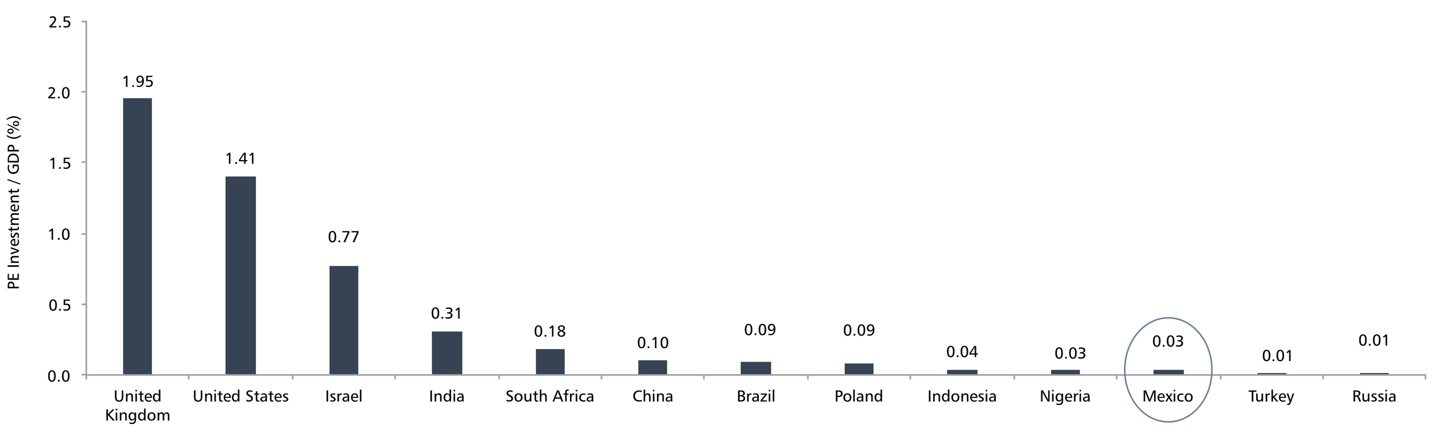
Conclusion

As one industry veteran points out, "The amount of private equity capital in Mexico is incredibly low for a country with so many needs." We would tend to agree. The total value of private equity investment in 2015 accounted for only 0.03% of Mexico's GDP, in comparison to nearly 2% in the United Kingdom and 1.4% in the United States (see Exhibit 25). Mexico also lags a number of its emerging market peers; for instance, measuring only one-third the rate of Brazil and one-tenth the rate of India.

The challenging investment climate, one dominated by local families, is certainly a contributing factor. There is an old Mexican business saying: *padre noble, hijo rico, nieto pobre* (father noble, son rich, grandson poor). Whether by helping a company improve its internal operations, raise additional financing, or take advantage of Mexico's numerous trade agreements to expand operations, private equity firms are willing and able to help domestic companies ensure they do not go broke by the third generation. A tighter embrace between private equity firms and family-controlled businesses could result in greater openness and transparency regarding the local business environment, as well as promote stronger job creation and more inclusive economic growth.

Northgate Capital's Mizrahi observes, "We will continue to have some ups and downs but, in general, Mexico is committed to growing this industry because the benefits of private equity have been proven in nearly every other place in the world. As a developing country, we still have many challenges in terms of poverty, corruption, education, health systems, etc. But this also gives us in the business community a lot of opportunities. It's a two-fold situation where we are trying to take advantage of those opportunities as well as hopefully contribute to the longer term growth of the economy and expansion of the middle class."

Exhibit 25: Sampling of Global Private Equity Penetration, 2015



Source: EMPEA EM PE investment data as of Q4 2015. IMF GDP data as of December 2015. PE data for the U.S., U.K. and Israel from Pitchbook as of Q4 2015.
Note: Includes private equity, private credit, private infrastructure and real assets.

As highlighted throughout the previous pages, Mexico's government has indeed demonstrated its commitment to supporting the local private equity industry. That being said, the to-do list is a long one. Industry participants with whom we spoke during the course of our research for this report raised a number of reforms that are still needed in order to push the industry forward, including improvements to the tax system; a continued easing of the burden on fund managers looking to issue CKDs and / or CerPIs (inclusive of the associated costs); clarity regarding potential tax contingencies on outsourced labor; a reconsideration of the calculation on pension fund caps, which currently include both invested and committed capital; and, of course, allowing the Afores to invest internationally and directly through private vehicles.

It is undeniable that Mexico is moving in the right direction, and what makes this introspective market special is the recognition of its imperfections. As more capital is committed to funds and as more companies receive investment, Mexico's fund managers will have greater opportunities to add value, and ultimately demonstrate success stories and realizations. The untapped potential in Mexico is palpable, and it will be up to the industry to actualize it. Fortunately, Mexico's private equity stakeholders are cognizant of all the work that remains to be done, and they have the confidence to move it forward.

"Mexico is committed to growing this industry because the benefits of private equity have been proven in nearly every other place in the world. As a developing country, we still have many challenges in terms of poverty, corruption, education, health systems, etc. But this also gives us in the business community a lot of opportunities. It's a two-fold situation where we are trying to take advantage of those opportunities as well as hopefully contribute to the longer term growth of the economy and expansion of the middle class."

–Gabriel Mizrahi, *Northgate Capital*

SAMPLING OF FIRMS INVESTING IN MEXICO

Fund Manager	Funds (Final Close Year, Amount Raised)	Firm Type	Website
57 Stars	57 Stars Global Opportunity Fund 4 (Fundraising), 57 Stars Latin America Opportunity Fund (2013, US$40m), 57 Stars Global Opportunity Fund 3 (2014), 57 Stars Global Opportunity Fund 2 (2009), 57 Stars Global Opportunity Fund 1 (2007)	Fund of Funds	57stars.net
500 Startups	500 Luchadores (Fundraising, US$3m)	Venture Capital	500.co
ACON Investments	ACON Latin America Opportunities Fund IV (2014, US$515m), ACON CKD (2014, US$153m), ACON Latin America Opportunities Fund III (2009, US$173m)	Multi-strategy	aconinvestments.com
Actis	Actis Energy 3 (2013, US$1.15B)	Multi-strategy	act.is
Adobe Capital	Adobe Social Mezzanine Fund I (2014, US$20m)	Mezzanine	adobecapital.org
Advent International	Latin American Private Equity Fund VI (2014, US$2.1B), Latin American Private Equity Fund V (2010, US$1.65B), Latin American Private Equity Fund IV (2007, US$1.3B), Latin American Private Equity Fund III (2005, US$375m)	Buyout, Growth	adventinternational.com
ALLVP (Venture Partners Mexico)	Venture Innovation Fund II (Fundraising, US$36m), Seed Innovation Trust I (2014, US$6m)	Venture Capital	venturepartners.vc
Alta Growth Capital	Alta Growth Capital Mexico Fund II (2014, US$152m), Alta Growth Capital Mexico Fund (2009, US$75m)	Growth	agcmexico.com
Alta Ventures Mexico	Alta Ventures Mexico Fund I (2012, US$70m)	Venture Capital	altaventures.com
Axis Capital Management	AXIS2CK14 (2014, US$478m), AXISCK12 (2012, US$509m)	Buyout	axiscapital.com.mx
BlackRock	I Cuadrada Infrastructure Fund II (2014, US$756m), I Cuadrada Infrastructure Fund (2010, US$222m)	Infrastructure	blackrock.com
Capital Group Private Markets	Capital International Private Equity Fund VI (2011, US$3B)	Growth, Buyout	thecapitalgroup.com/pe
Capital Indigo	Fund Indigo 1 (2014, US$60m)	Multi-strategy	capitalindigo.com
Conduit Capital Partners	Latin Power III (2006, US$392m)	Buyout, Infrastructure	conduitcap.com
Corporacion Actinver	Actinver Private Equity Fund I (Fundraising, US$62m)	Growth	actinver.com
Corporación Mexicana de Inversiones de Capital (Fondo de Fondos)	Mexico Ventures II Fund of Funds (Fundraising), Mexico Ventures SME Mezzanine Fund I (Fundraising), Mexico Energy Fund of Funds (2015, US$405m), Mexico Ventures I Annex Fund (2013), Fund of Funds Mexico II, (2012, US$400m), Mexico Ventures I (2011, US$80m), Fund of Funds Mexico I (2009, US$275m)	Fund of Funds	fondodefondos.com.mx
Creation Investments Capital Management	Creation Investments Social Ventures Fund II (2013, US$75m), Creation Investments Social Ventures Fund I (2010, US$32m)	Buyout, Growth, Venture Capital	creationinvestments.com
Credit Suisse Emerging Markets Credit Opportunities (EMCO)	Credit Suisse Mexico Credit Opportunities Trust II (2015, US$751m), Credit Suisse Mexico Credit Opportunities Trust (2013, US$550m)	Direct Lending, Special Situations	credit-suisse.com
Darby Private Equity	Darby-ProBanco Fund II (US$75m)	Growth, Mezzanine, Infrastructure	darbyoverseas.com
DILA Capital	DILA Capital II (Fundraising, US$9m)	Venture Capital	dilacapital.com
Discovery Americas	Discovery Americas III (2014, US$159m), Discovery Americas II Canada (2010, US$40m), Discovery Americas II (2009, US$90m)	Growth	discoveryamericas.com
EMX Capital	EMX Capital Partners I (USD) (2012, US$68m), EMX Capital Partners I (CKD) (2011, US$126m), Carlyle Mexico Partners (2007, US$134m)	Buyout	emxcapital.com
Evercore Mexico Capital Partners	Evercore Mexico Capital Partners III (2013, US$201m), Evercore Mexico Capital Partners II (2008, US$125m)	Growth	evercore.com.mx
GBM Infraestructura	GBM Mexico Infrastructure Fund (2012, US$380m)	Infrastructure	gbminfraestructura.com
Goldman Sachs Merchant Banking Division (MBD)	GS Infrastructure Partners II (2010, US$3.1B)	Multi-strategy	goldmansachs.com

Fund Manager	Funds (Final Close Year, Amount Raised)	Firm Type	Website
Graycliff Partners	Graycliff Latin America Fund I (2009, US$100m)	Buyout, Growth, Mezzanine	graycliffpartners.com
IFC Asset Management Company (AMC)	IFC African, Latin American and Caribbean Fund (IFC ALAC Fund) (2010, US$1B)	Growth, Infrastructure, Fund of Funds	ifcamc.org
IGNIA Partners	IGNIA Fund II CKD (2015, US$89m), IGNIA Fund I (2010, US$102m)	Venture Capital	ignia.com.mx
HarbourVest	HarbourVest Global 2015 Fund (Fundraising), HarbourVest Global 2014 Fund	Fund of Funds	hvpe.com
Kandeo	Kandeo II (Fundraising, US$229m), Kandeo I Colombia (2011, US$126m)	Growth	kandeofund.com
Latin American Partners (LAP)	Central American Mezzanine Infrastructure Fund II (Fundraising, US$10m), Central American Mezzanine Infrastructure Fund (2009, US$150m)	Mezzanine, Infrastructure	latinamericanpartners.com
Linzor Capital Partners	Linzor Capital Partners II (2011, US$465m)	Buyout, Growth	linzorcapital.com
LIV Capital	LIVE Fund I (2014, US$7m), Latin Idea Mexico Venture Capital Fund III (2012, US$56m), Latin Idea Mexico Venture Capital Fund III (CKD) (2012, US$46m), Latin Idea Mexico Venture Capital Fund II (2006, US$20m)	Growth, Venture Capital	livcapital.mx
Macquarie Infrastructure and Real Assets (MIRA)	Macquarie Mexican Infrastructure Fund (MMIF) (2012, US$405m)	Infrastructure, Real Assets, Real Estate	mirafunds.com
Mexico Infrastructure Partners	Promotion of Energy and Infrastructure in Mexico (EXI) (US$150m)	Growth	mexicoinfra.com
Newgrowth Fund	Newgrowth Fund (2012, US$15m)	Growth	newgrowthfund.com
Nexxus Capital	Nexxus Capital VI (2013, US$550m), Nexxus Capital IV & V (2011, US$315m), Nexxus Capital III (2008, US$146m)	Growth	nexxuscapital.com
Northgate Capital	Northgate Capital Mezzanine CKD (2015, US$236m), Northgate Capital Mexico PE Fund I (2012, US$249m)	Growth, Mezzanine, Fund of Funds	northgate.com
ON Ventures	ON Ventures Mexico I (2015, US$7m)	Venture Capital	onventures.mx
Pantheon	Pantheon Emerging Markets Fund (Ex-Asia) (2014, US$140m)	Fund of Funds	pantheon.com
PC Capital	Mexico Development Fund I (Fundraising, US$28m)	Growth, Venture Capital	pc-capital.com
PineBridge Investments	PineBridge Mexico CKD I (2012, US$209m)	Fund of Funds	pinebridge.com
Promecap Capital de Desarrollo	Fideicomiso Promecap Capital de Desarrollo II (2014, US$240m), Fideicomiso Promecap Capital de Desarrollo (2010, US$198m)	Special Situations	N/A
Riverstone Holdings	RIVERCK 15 (2015, US$733m)	Buyout, Growth	riverstonellc.com
Southern Cross Group	Southern Cross Latin America Private Equity V (Fundraising, US$455m), Southern Cross Latin America Private Equity IV (2010, US$1.681B), Southern Cross Latin America Private Equity III (2007, US$751m)	Buyout	southerncrossgroup.com
TC Latin America Partners	Terranum Capital Latin America Real Estate Fund I (2013, US$235m)	Real Estate	tclatam.com
The Abraaj Group	Abraaj Latin America Fund II (Fundraising), Abraaj CKD (2015, US$191m)	Buyout, Growth, Real Estate	abraaj.com
The Rohatyn Group	Balam Fund I (JV w/ BK Partners) (Fundraising, US$156m)	Multi-strategy	rohatyngroup.com
WAMEX Private Equity	Multinational Industrial Fund II (2012, US$160m)	Growth	wamex.mx

Source: EMPEA.

EMPEA METHODOLOGY

This report provides an overview of trends in fundraising and investment among private capital fund managers active in Mexico. Unless stated otherwise, the data and statistics presented here are drawn from EMPEA's database of funds and transactions, FundLink, and are based on information obtained from press releases and trade publications, as well as from communications with industry participants and regional and country-focused venture capital associations. Fundraising, investment and exit amounts in EMPEA reports have been confirmed wherever possible directly by fund managers. EMPEA updates historical data on a quarterly basis as new data from fund managers and other sources is compiled in FundLink. Any discrepancies between the aggregate statistics published by EMPEA and the constituent data on individual funds and transactions included in tables and raw data files can be attributed to confidential information that has been omitted from public reporting.

EMPEA's reporting covers activity by *long-term*, *fixed-life, private, direct* investment funds, backed by institutional investors, across the following three asset classes: private equity, private infrastructure and real assets, and private credit—collectively "private funds" or "private capital". EMPEA data and statistics exclude activity from real estate funds, funds of funds, secondaries funds, traditional investment holding companies, corporate strategic investors, government-owned or managed entities and captive investment vehicles, as well as funds investing primarily in publicly-traded equity or debt securities.

Reported fundraising totals reflect only official closes (interim and / or final) as reported in primary and secondary sources or directly by fund managers. Capital commitments accruing prior to or between official closes are not included in reporting.

EMPEA classifies investments into one of three asset classes—private equity, private infrastructure and real assets, or private credit—and into one of the following deal types: buyout, growth, venture capital, PIPE, mezzanine or debt. Venture capital includes seed, early-stage and late-stage investments. When determining how an investment should be classified, EMPEA takes into account the typical investment strategy of the fund manager(s) involved, the type of security acquired, the reported round number or type of transaction, the development stage of the company at the time of investment, the company's business model and the type of product or service that the company provides.

Secondary investments (both traditional and direct) are excluded from reporting. In addition, wherever possible, bank (acquisition) financing and co-investment from excluded entities are also excluded from reported investment values, both to ensure continuity across regions and to provide a more accurate picture of the scale and pace of capital deployment by the funds that are the primary focus of EMPEA's research.

The statistics in this report are based on the "market" approach. Fundraising activity is categorized based on the countries, sub-regions or regions in which fund managers intend to invest, while investment activity is categorized based on the country headquarters of investee companies. For companies registered in offshore financial centers or developed markets, but operating exclusively or predominately in emerging markets, investment activity is categorized based on the geographic footprint of the operations of investee companies. In the case of global or multi-regional funds, only those funds investing primarily in emerging markets are included in fundraising totals. Country-dedicated fundraising data and statistics reflect only those funds with a single-country strategy or mandate. Target allocations to individual markets within a broader global or regional fund are not attributed to single-country fundraising totals.

EMPEA's fund and company sector classifications are based on the Industry Classification Benchmark (ICB), which is owned by FTSE International Limited (FTSE). FTSE® is a trademark of the London Stock Exchange Group companies and is used by FTSE under license. FTSE does not accept any liability to any person for any loss or damage arising out of any error or omission in the ICB.

ABBREVIATIONS COMMONLY USED IN THIS REPORT:

EM – Emerging markets

PE – Private equity

VC – Venture capital

GP – General partner (fund manager)

LP – Limited partner (fund investor)

In some exhibits, percentage labels may not sum to 100% due to rounding. In all tables in which it appears, "N/A" denotes a confidential or otherwise undisclosed value.