Factors Driving Opportunities for Private Equity Funds in Mexico

ILPA – Cimarron Investor Delegation to Latin America 2013

February 25, 2013

Introduction (1/2)

- First of all, welcome to Mexico, I truly believe our country has a lot to offer in terms of investment opportunities with attractive returns in the medium and long terms
- As I will show later, Mexico is experiencing a phase of macroeconomic stability, with economic growth, inflation, exports and fiscal deficits at relatively good levels
- Nevertheless, important structural reforms are necessary to further boost economic growth and development in our country. I will talk about this later on. First, I would like to make a few comments on the international economic landscape
- Even though there are considerable challenges ahead, I am optimistic, primarily because the US economy will most likely get out of the crisis strengthened and vastly restructured. At a slower pace, Europe will also leave the crisis behind considerably stronger than before
- Both regions will be stronger after the crisis mainly due to a deep economic restructure, as well as because of a structural change in their public finances, financial systems, manufacturing industries and labor markets
- In the US, companies, States and families already corrected their corresponding deficits, it is now the Federal Government's turn

Introduction (2/2)

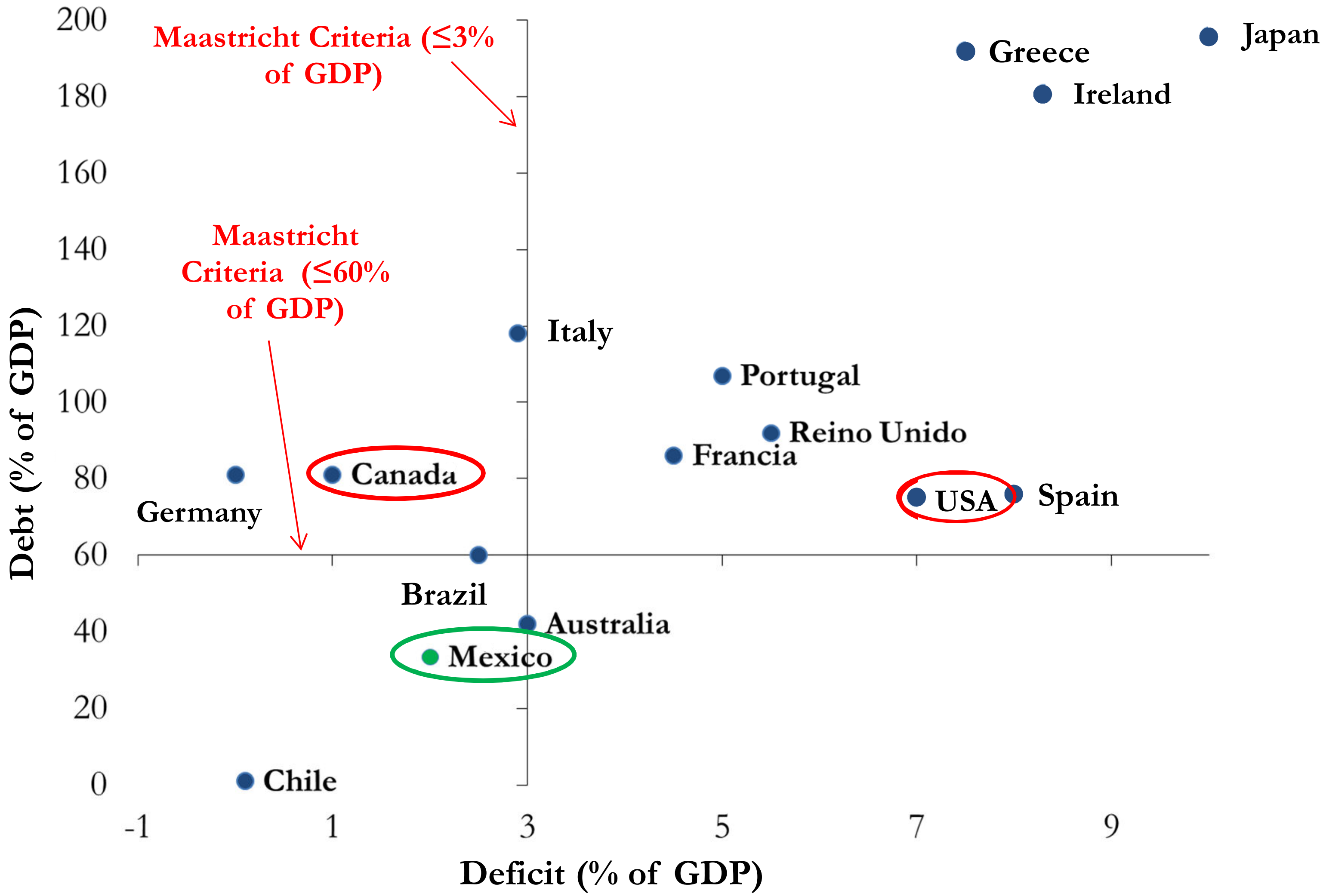
- Regarding the US, I have 6 reasons to be an optimist and one caution sign:

    1. The revival of the housing market after 5 years in crisis
    2. The technological revolution taking place in the production of energy in the US: shale gas and shale oil
    3. The new and improved financial system
    4. An efficient, competitive and innovative private sector with low debt
    5. The trust that, eventually, politicians will reach and agreement regarding the reduction of the fiscal deficit and the fiscal cliff
    6. The new free-trade agreements being negotiated

    - The caution sign is the slow recovery of employment

A. Mexico in the World

Debt and fiscal deficit in 2012 (as % of GDP)



Mexico is one of the few countries in a "favorable" situation in terms of debt and fiscal deficit

Source: Bloomberg, El País, Eurostat, SHCP

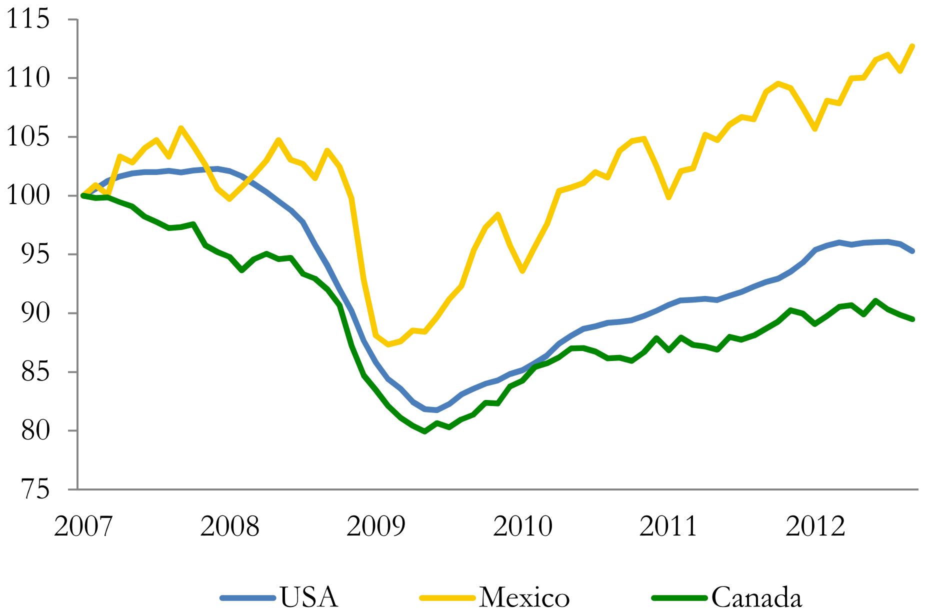
B. Macroeconomic Fundamentals

- Mexico has experienced a sustained growth above 3.5% for the third year in a row and, until recently, with a relatively controlled inflation
- For 2013 an inertial GDP growth rate of 3.5% is expected, as well as an inflation of 3.7%
- The expected inflation will continue to be relatively low in the coming years, with an expected average of 3.5% for the 2014-2017 period

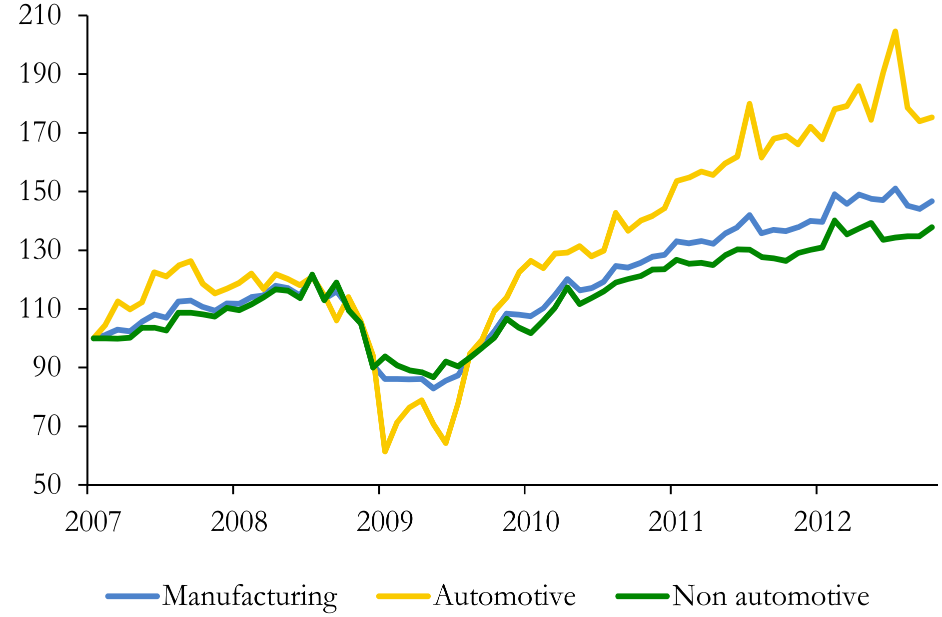
Source: Banxico, INEGI

Mexico's economic cycle: manufacturing production

Manufacturing production index (2007 = 100) [1]



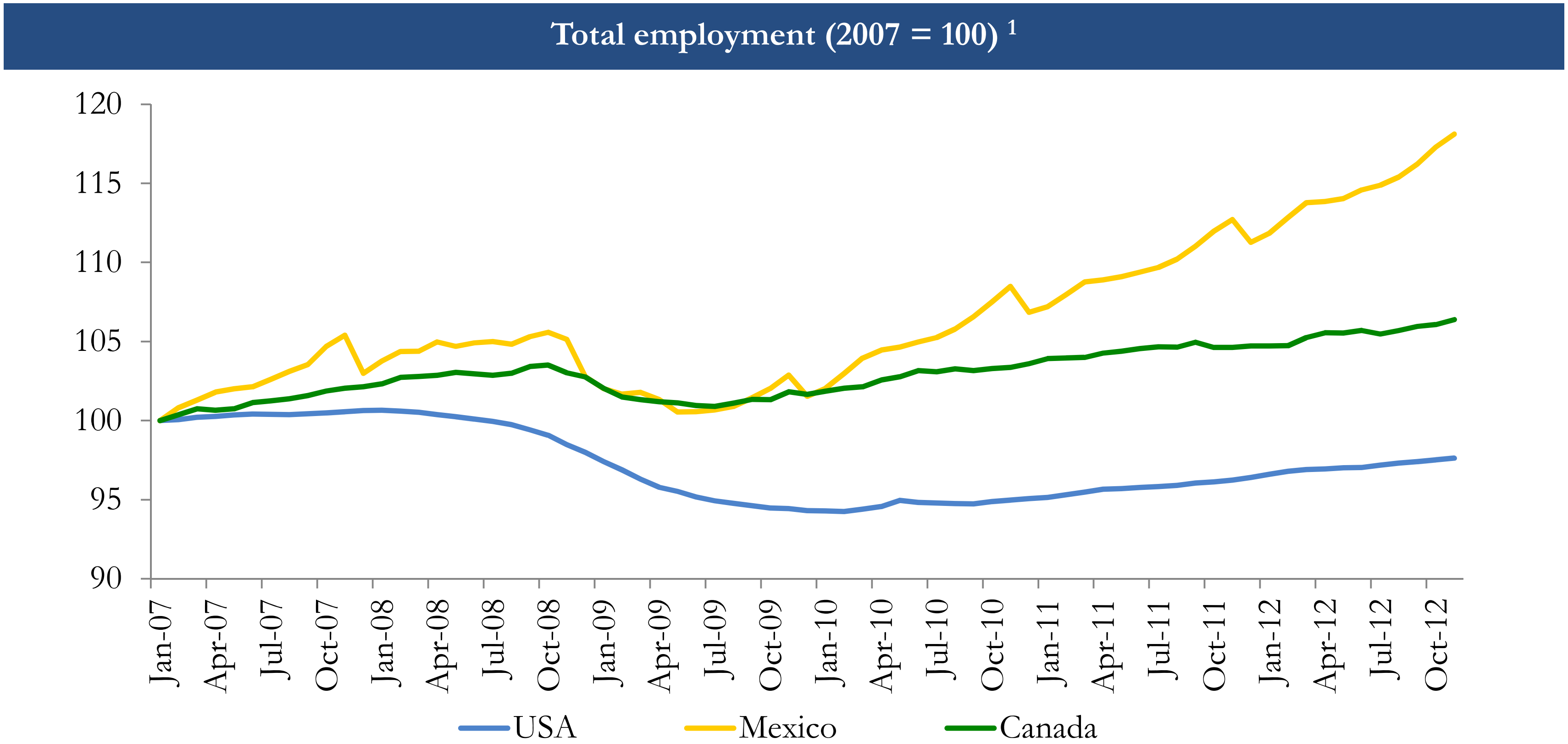
Mexican exports (2007 = 100) [2]



- Economic cycle: historically, manufacturing in Mexico follows closely the manufacturing sector in the US
  - Nevertheless, since 2009 the dynamism of Mexican manufacturing has been considerably greater
  - While manufacturing production has not fully recovered in the US, in Mexico it is considerably above its pre-crisis level and 29.8% above the lowest level reached during the crisis
- Mexican exports have not only recovered but show a positive trend
  - In 2012, Mexico became the fourth greatest car exporter in the world
  - Automotive exports have increased 204.4% since the lowest level they reached during the crisis

1) Source: BLS, Federal Reserve and INEGI
2) Source: INEGI

Mexico's economic cycle: employment

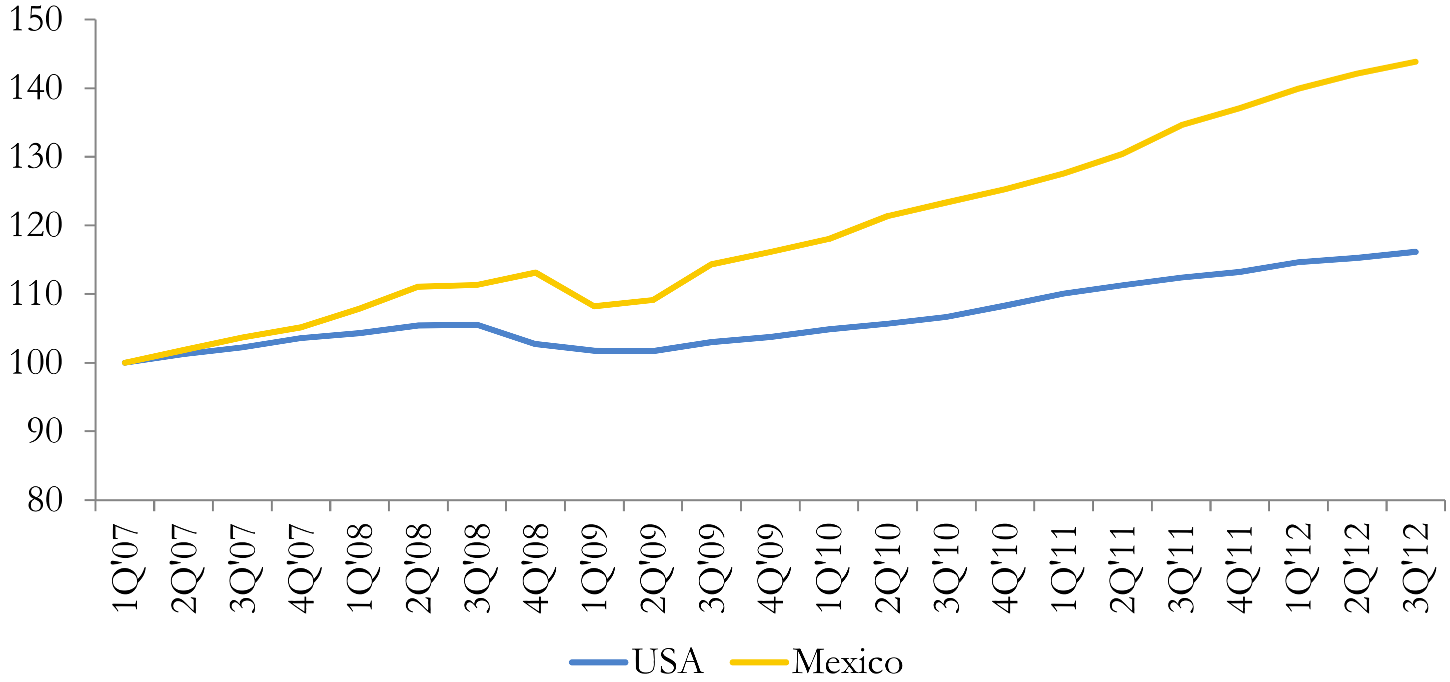


- Labor: already recovered its pre-crisis level. This is not the case for the US:
  - Jobs created in 2011: 612,000 in Mexico vs. 1.64 million in the US (with an economic relation of 1:10)
  - In 2012, the US created 1.8 million jobs while 710,000 were created in Mexico
  - Nevertheless, the average real wage in Mexico did not increase in 2012

1) Source: BLS, INEGI, STPS, IMSS

Mexico's economic cycle: private consumption

Private consumption (1Q 2007 = 100)[1]

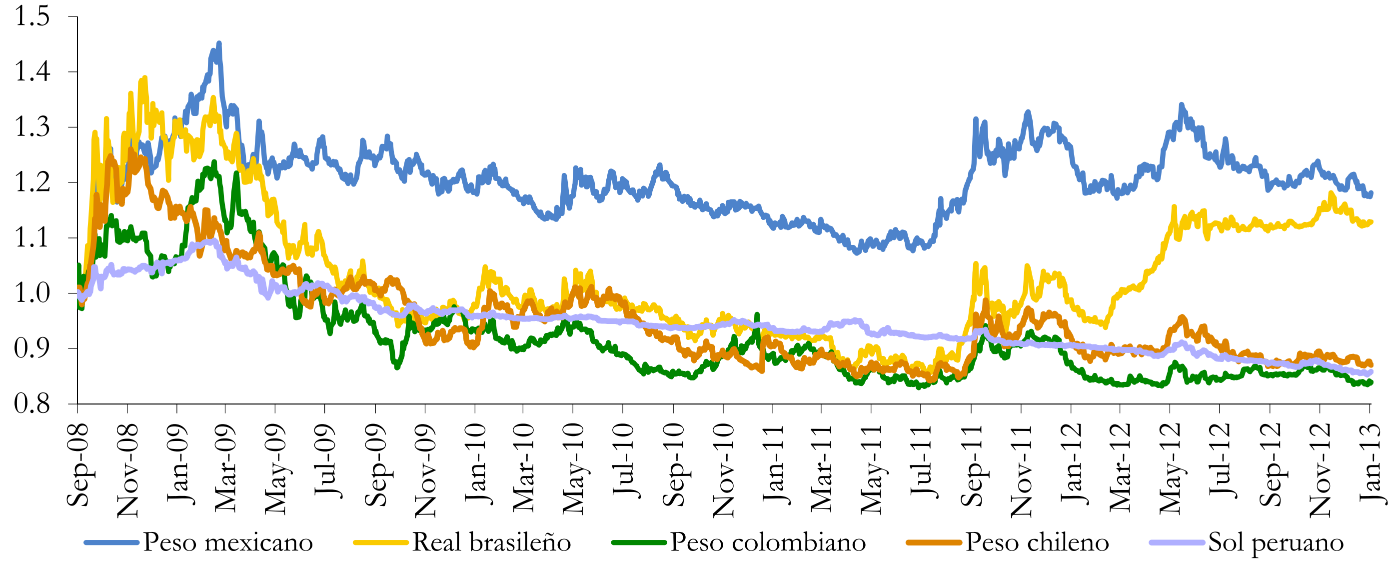


- From 2009 to date, private consumption expenditures in the US grew 14.2% while in Mexico it grew 32.9%
- The growth trend is considerably larger for Mexico's consumption than for that of the US

1) Source: BEA, INEGI

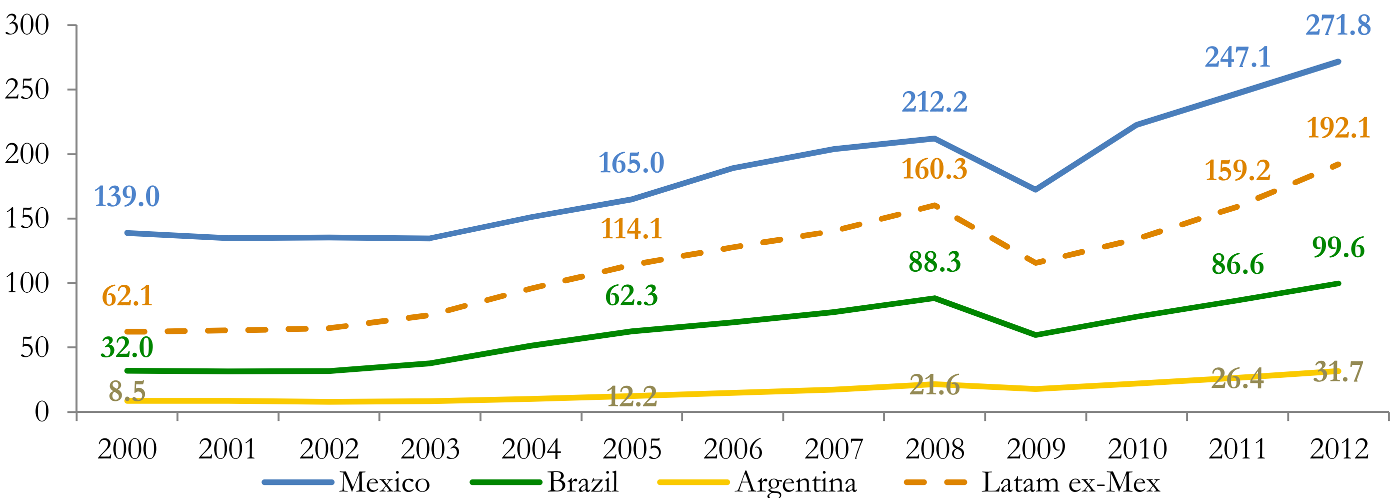
C. International Trade

Exchange rates (1.0 represents the level the currency had before the Lehman Brothers collapse)[1]



- The Mexican Peso strongly depreciated after the Lehman collapse and has remained depreciated, unlike most of the rest of the region's currencies

Manufacturing exports (US$ M)[2]



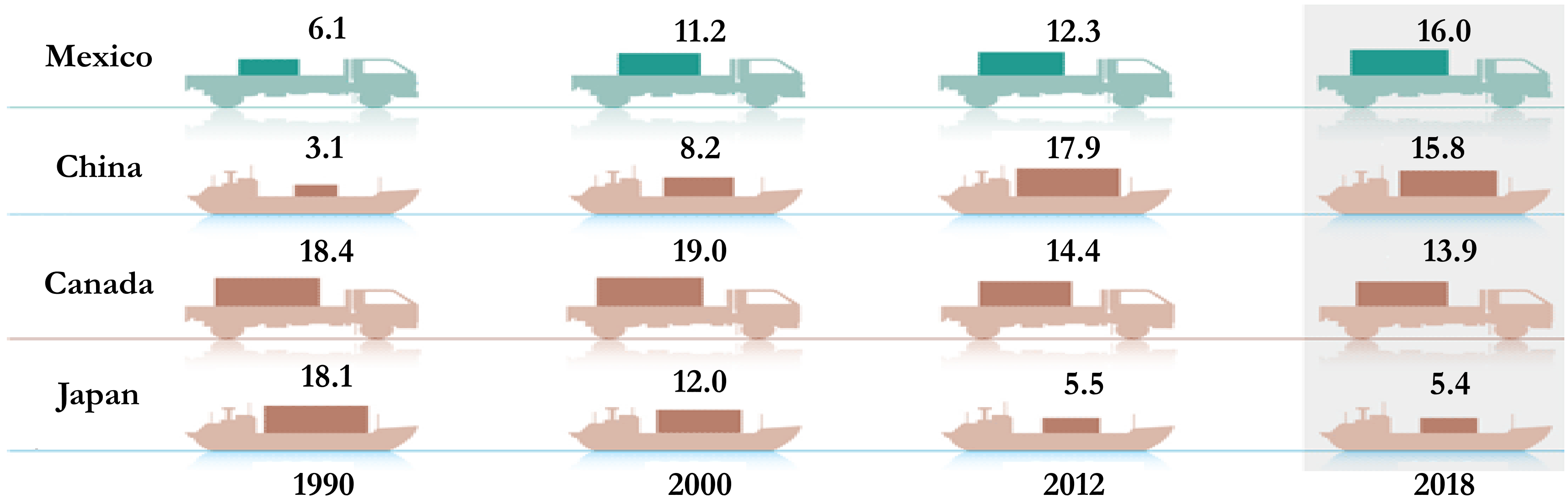
- The monetary and exchange rate policy in Mexico has boosted manufacturing exports: they have increased 157.6% since 2009 and are already ~31.7% above their pre-crisis level
- Currently, Mexico has more manufacturing exports than the rest of the Latam countries combined, and represent 2.73 times those of Brazil

In 2012, Mexico exported ~60% of the total manufacturing exports of Latin America

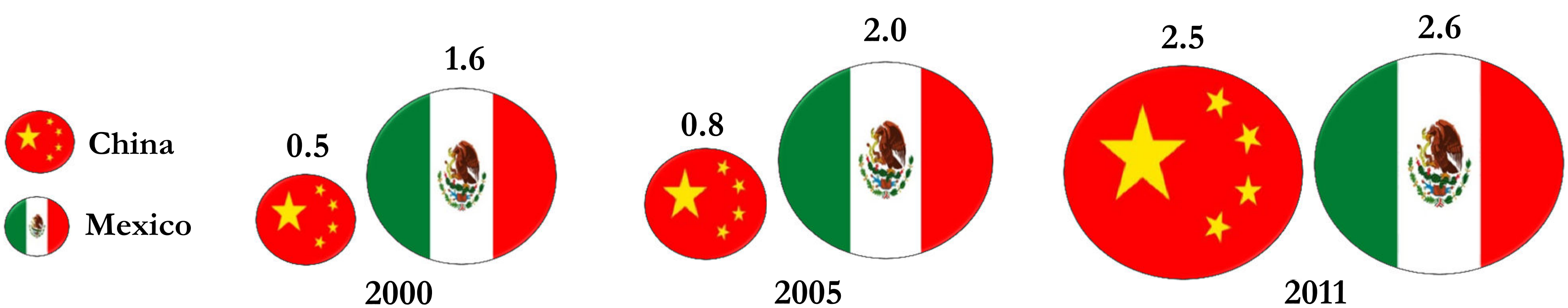
1) Source: Bloomberg
2) Source: ECLAC, Statistical Yearbook for Latin America and the Caribbean

Mexico's market share and converging costs between Mexico and China

US imports from selected countries (% del total)



Average manufacturing unit labor cost (USD per hour)

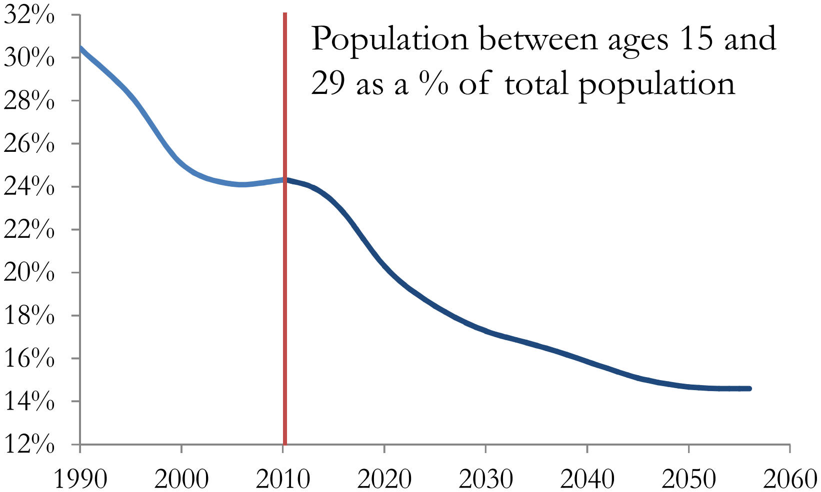


China is losing competitiveness because of: an increase in wages derived from its demographics, higher transportation costs and the appreciation of the Yuan

Source: Economist Intelligence Unit, US Department of Commerce.

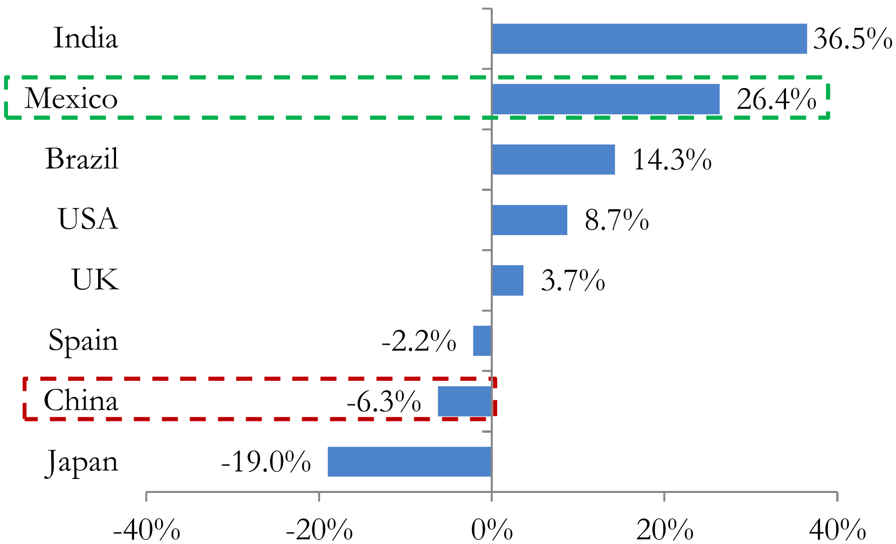
China's new demography

New workers for manufacturing



- In the last 30 years China's fertility rate has fallen from 2.6 to 1.6, and should reach 1.5 by 2020
- Fertility rates are even lower in the richest and most educated regions: the fertility rate in Shanghai is about 0.6
- Because of the "one-child policy" enforced since 1979, China will become old before becoming rich
- The immediate consequence is a reduced labor force – particularly for manufacturing – which will make salaries rise
- This means an end for China being "the factory of the world"

Working-age population (2010 – E2035, % change)



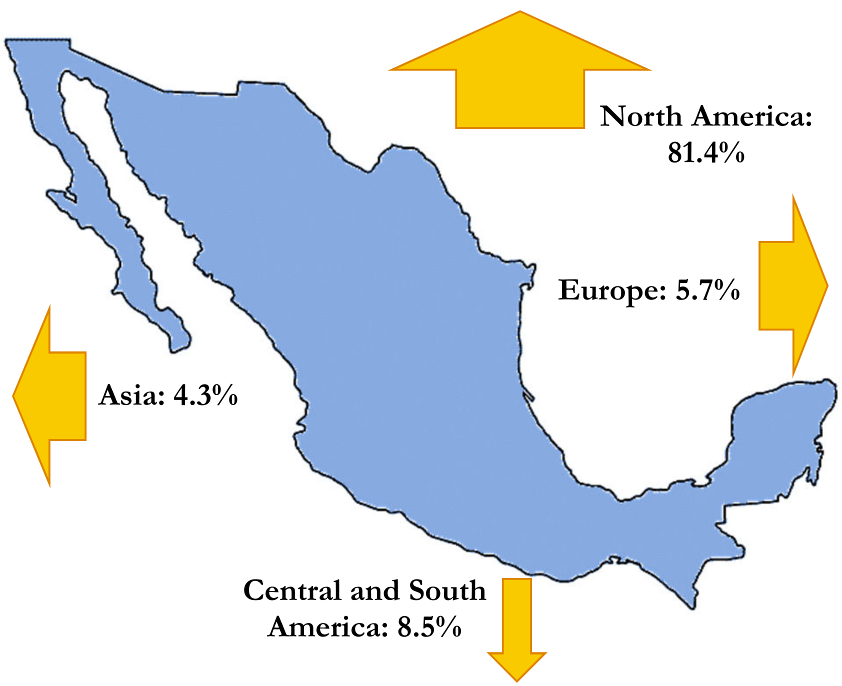
- Working-age population is the population aged 15 to 65 years old
- China's working-age population is expected to decrease by 6.3% in the next three decades:
  - A relatively large fall when compared to developed countries such as the UK (+3.7%) and the US (8.7%)
  - A sharp contrast with other emerging markets such as Mexico (+26.4%) and India (+36.5%)

Source: UN Population Division (2011) and the Economist Intelligence Unit

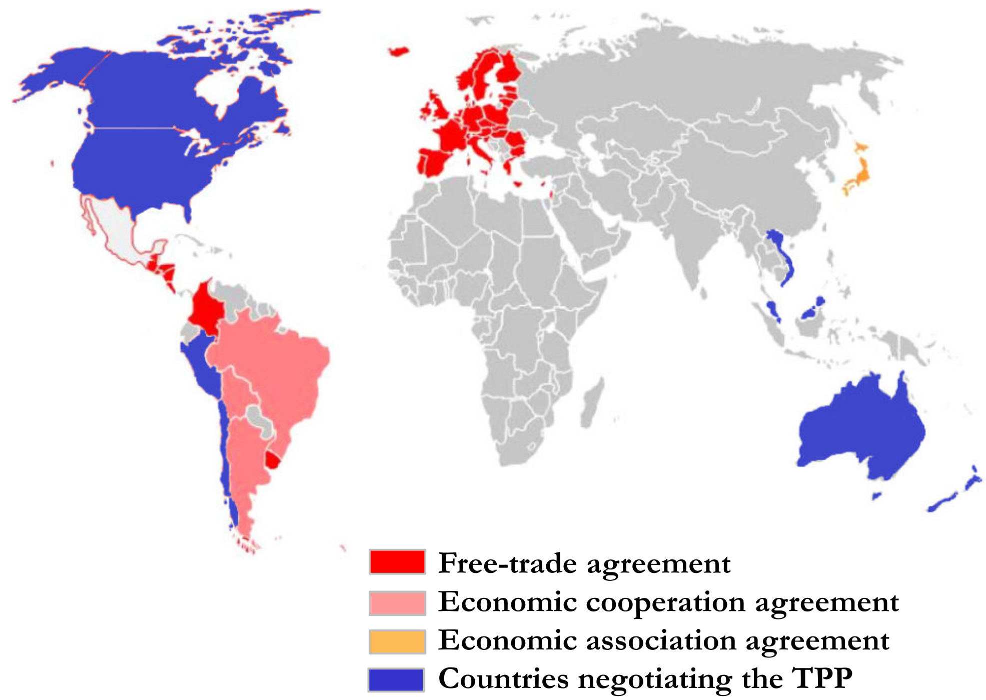
Mexico, one of the most open economies

- Even though Mexico has 42 free-trade agreements, 82% of Mexican exports go to NAFTA countries
- The sum of exports and imports as a percentage of GDP indicate an economy's openness: it is 18.5% for Brazil, 51.7% for Canada, 58.6% for Mexico and 21.6% for the US
- Currently, Mexico is trying to stay at the forefront in terms of free-trade agreements, closely following the US' negotiation of the Trans Pacific Partnership (TPP) and of the Transatlantic Trade and Investment Partnership with the European Union

Mexico's non-oil exports in 2011 [1]



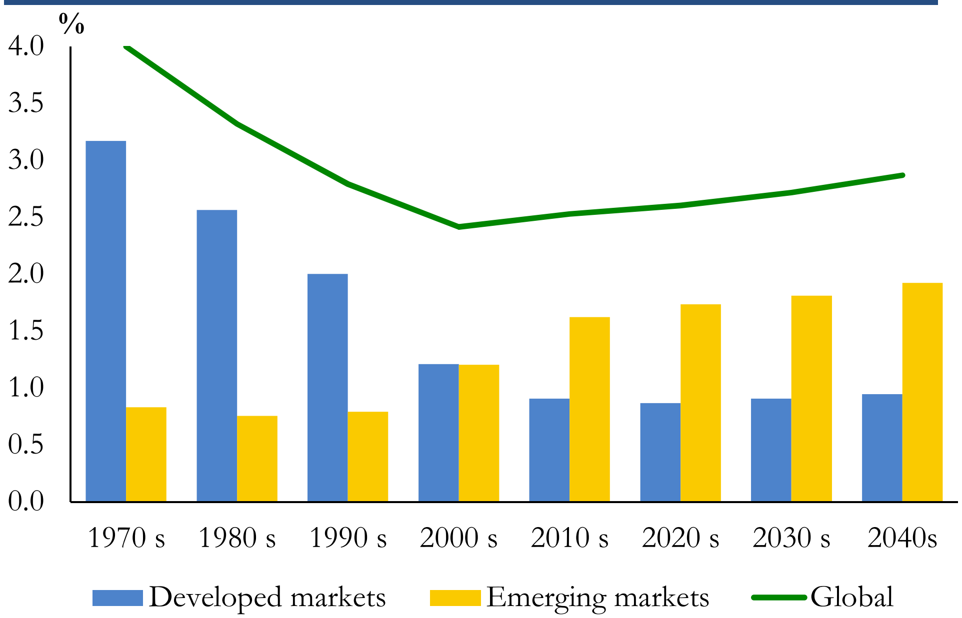
Mexico's commercial map[1]



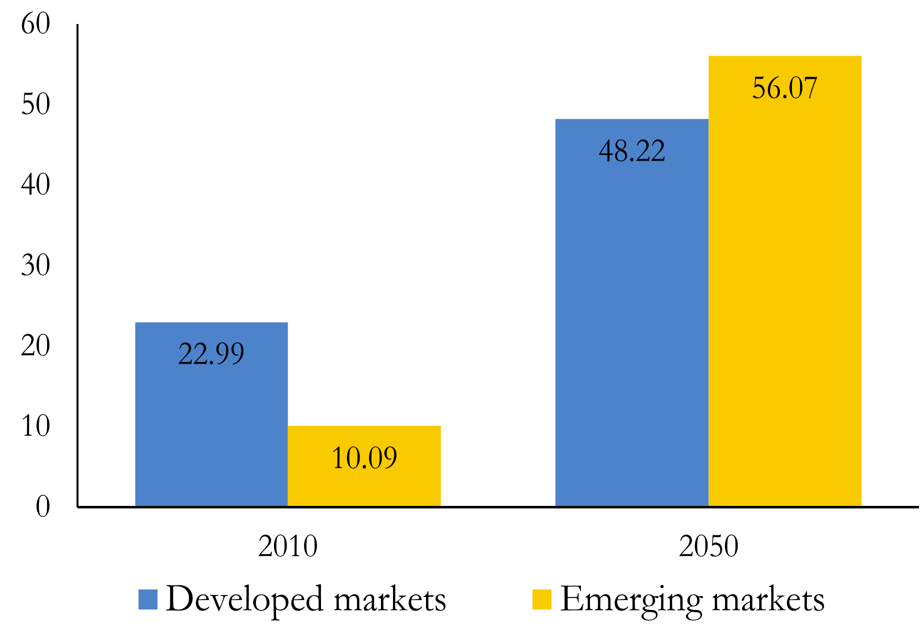
1) Source: INEGI, SE

Growth will come from emerging markets

Contribution to global growth (%)



Aggregate GDP (constant 2000 USD, trillions)

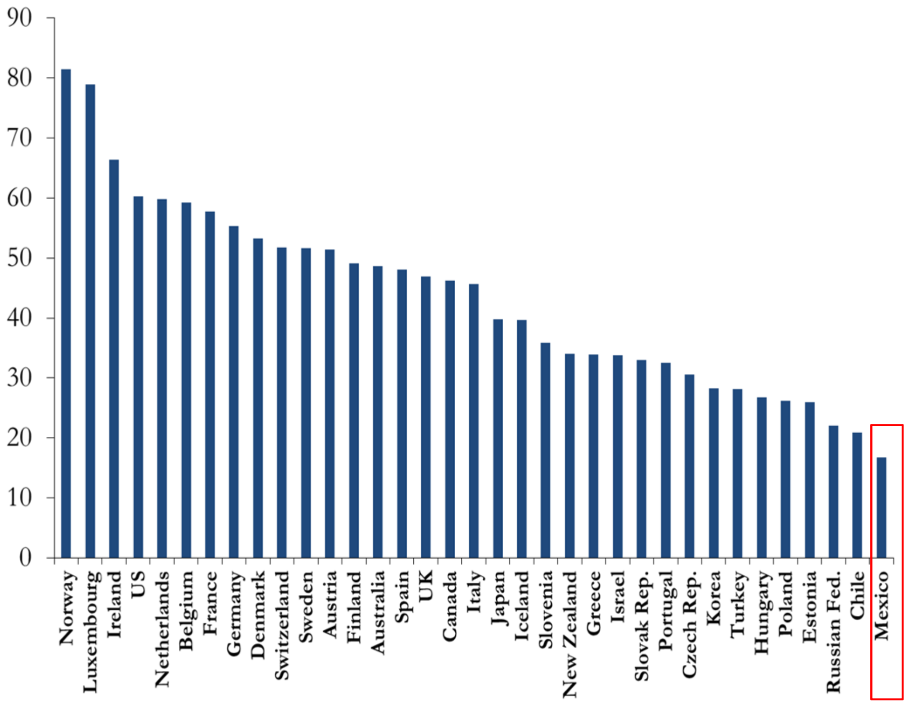


- In the next decades, two-thirds of global growth will come from current emerging markets
- Currently, the great majority of our foreign clients are developed countries; therefore, strengthening our commercial relationships with emerging economies presents a great window of opportunity for our future economic growth
- This change also represents an opportunity for Mexican businesses looking to export and foreign investment

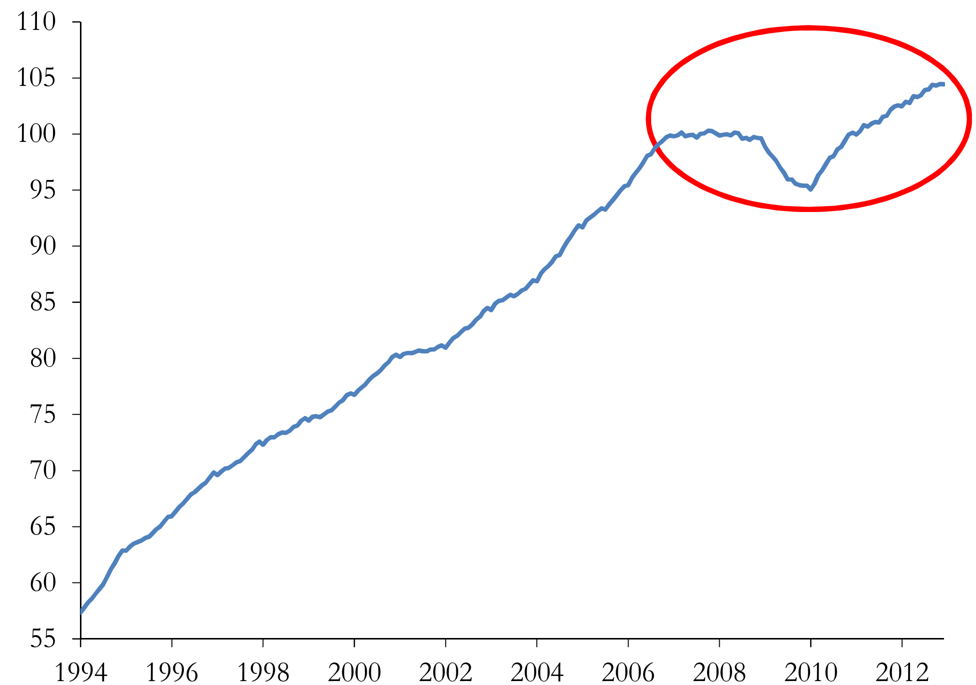
Source: IMF, World Bank

D. Mexico's Productivity

GDP per hour worked (2011, current USD)[1]



Manufacturing productivity in Mexico[2]



- In the last Global Competitiveness Report (World Economic Forum), Mexico shows one of the largest improvements in regional rankings, moving upwards 8 places
- The series of structural reforms that took place during the '80s and '90s resulted in increased growth of the manufacturing sector's productivity
- Nevertheless, in the last few years, manufacturing productivity has stagnated
- In order to end this stagnation in productivity, the adequate structural reforms have to be implemented

There is still room for improvement: structural reforms should boost productivity in the manufacturing sector

1) Source: OECD
2) Source: INEGI

E. Opportunities Going Forward

- Mexico requires its infrastructure to be further developed to reach the desired economic growth and development. This is particularly true since the country's current infrastructure is:
  - Obsolete in some sectors, such as railroads
  - Insufficient in other sectors, such as ports and airports
  - In need of legal changes required to modernize it in sectors such as telecom
- President Peña Nieto's government has already put structural reforms in the center of discussion
- It seems that the order of these structural reforms will be:
  - Education
  - Telecommunications
  - Energy
  - Fiscal
- The "Pact for Mexico" was signed by the leaders of the three main political parties. It contains 95 specific commitments, out of which two in particular stand out for our purposes:
  - Telecommunications backbone network (41)
  - Multiplying the exploration and production of hydrocarbons (56)

The structural reforms of 2013 could increase Mexico's economic growth by 2018 to 5%, turning the country into one of the most dynamic emerging markets in the world

Conclusions

International landscape

1. The US will have a 2.0% economic growth and it will generate around 150,000 new jobs per month, achieving a slight fall in its unemployment rate towards the end of this year
2. Europe will continue to restructure its economies
3. China had a successful political transition and should experiment stable economic growth. Its main issues are demography, public companies' productivity and its financial sector
4. Japan will probably continue in the chronic stagnation it has been in for the past 25 years

Mexico

1. 2013 will be a year of economic inertia for Mexico, growing at 3.5% with a similar inflation rate
2. This year's economic growth will be based on exports and the substitution of imports
3. Economic reforms are moving along, which will potentiate investment opportunities in specific sectors and economic growth across the whole economy
4. Investment opportunities exist in different sectors, even before reforms take place
5. In particular, investments in Private Equity seem like a great way to take advantage of the economic growth expected in the coming years in Mexico