

# THE MEXICO PRIVATE EQUITY MARKET

## Introduction

For the past several years investors' attention – and capital – has been focused squarely on Brazil, Russia, India, and China (the “BRIC” markets) in the context of emerging markets private equity. At the time of the original Goldman Sachs BRIC report, fund managers active in Mexico protested the exclusion of Mexico as one of the top emerging private equity markets. Since then, the Mexican market has continued to develop, providing opportunities to obtain superior risk-adjusted returns for investors with the foresight to invest today in private equity in Mexico. This report provides an overview of StepStone's view on the private equity market in Mexico.

## A Rocky Past

In the 1990's, some renowned U.S. and European private equity firms raised funds to invest in Latin America that were poor performers. The main reasons for this sub-par performance was the lack of local presence in the markets to provide in-country expertise and networks, coupled with fiscal collapses and currency crises in large economies such as Mexico in 1994, Brazil in 1999 and Argentina in 2001. In addition, U.S. private equity funds largely exported the U.S. and Europe models to Latin America without careful analysis of the local environment, particularly with respect to portfolio company exits.

The last decade of economic and political stability and the continued improvement of the macro-economic outlook in Mexico, as detailed below, has resulted in substantial improvements in the investment environment in Mexico. Mexico's key economic indicators compare very favorably to the BRIC countries as set forth in [Table 1](#). In addition, the competitive environment in Mexico is relatively benign. There are less than twenty private equity funds investing in small and middle market companies in Mexico, compared to more than fifty such funds in each of India and China and hundreds of such funds in the United States and Europe.

The first wave of private equity funds that entered Mexico in the early to mid-1990's could be characterized as middle to large buyout funds with little or no local country presence. Later in the decade, a second wave of funds focused on venture investing (mostly based in the U.S.) emerged, looking to “seize” the opportunity of an internet dot.com craze that was spreading to Mexico and the rest

of Latin America. With very few exceptions, both of these initial investment strategies resulted in poor risk-adjusted returns.

The timing of these initial ventures was heavily influenced by three separate economic episodes (two occurring in Latin America and one in the U.S.) that negatively affected the overall private equity market in the region. The first episode was the Mexican peso crisis of 1994, which was accompanied by a severe international capital flight from Mexico. The second was the combination of Brazil's devaluation of the *real* in early 1999 and the Argentine peso devaluation of late 2001 (accompanied by capital flight from the region). The third was the dot.com “bubble burst” in the U.S. in the early 2000's.

## The Third Wave of Mexico Funds

Whereas the first two waves in the Mexican private equity industry were driven by middle to large buyout funds without significant local presence and opportunistic venture funds, the third wave of fund management in Mexico has been driven by sophisticated and experienced local fund managers seizing opportunities in the growing Mexican middle market. Our meetings with these fund managers have demonstrated that they recognize, and have corrected for, the mistakes of the early 1990's.

On one end of the spectrum are fund managers with an established track record of investing in Mexico, including Advent International, Darby Overseas, and Nexxus Capital, which all are raising or investing their third or fourth funds. In addition, many new funds are being formed by talented and experienced managers who were trained by the foreign funds that operated in Mexico or were brought in by investors to salvage value in troubled portfolios.

The local presence of private equity managers provides the platform for improved analysis of regulatory, political, family succession, and reputational risks. Such presence also provides better knowledge of the structures that work locally. For example, trusts that hold the shares of the key shareholders are used in Mexico in order to provide for self-execution of various agreements that would normally be codified in a shareholders' agreement in the U.S.

Mexico offers a large number of high quality companies that have solid underlying assets with significant potential

for improved performance and growth. A large majority of these businesses are family owned and often require outside investment despite the strong assets and solid fundamentals. Family succession, liquidity issues or performance problems are some of the reasons why these companies may require outside investment. Some companies can benefit from more professional management, refined strategic focus, alignment of management interests, changes in capital structure, better operational and financial strategies, and the know-how and capital to become regional or global players. There is a rich target for investment and the current crop of private equity funds focused on investment in Mexico is poised to exploit those opportunities and provide superior returns to the leaders willing to invest in the market before the crowds.

## Fundraising

A defining moment in Mexican private equity took place in 2006, when the four principal government development banks in Mexico (NAFIN, BANCOMEXT, BANOBRAS, and FOCIR) formally established a fund of funds to consolidate the private equity investment activities of the Mexican government. That fund, the *Corporación Mexicana de Inversiones de Capital S.A. de C.V. (Fondo de Fondos)*, currently oversees approximately \$500 million and is expected to finish committing the \$250 million of capital available for investment (the other half of the *Fondo de Fondos* consisted of contributions of LP commitments by the shareholders) in the first quarter of 2008. While these development banks had invested separately in local private equity funds in the past, the new *Fondo de Fondos* represents the first collaborative plan by these entities to invest in and promote the local private equity industry.

This event, combined with the increasing sophistication of the local General Partners, has increased the availability of local Limited Partner capital and has prompted a surge in the number of funds raising money in the market over the last two years. Funds targeting the small and middle Mexican market are focusing on either private equity or real estate strategies and are characterized by exclusively local management or very strong local presence. Funds targeting the Mexican venture sector still have a very insignificant presence relative to such a large economy. Overall, the amount of Limited Partner dollars available or with an interest in the Mexican market has increased but

the market remains underserved by private equity measures.

Private equity capital raised in Latin America has grown from a record low of \$800 million in 2004 to \$2.8 billion in 2006. We predict that the \$5 billion fundraising record set in 1998 will be exceeded in 2007. In contrast, in just the first half of 2007 private equity funds have raised \$15.8 billion to invest in Asia, and China alone accounted for \$5.6 billion of that amount. While we believe the opportunity in Asia is very attractive, these numbers demonstrate that there is less competition among funds in Latin America and, in particular, in Mexico, as funds targeting investment in Brazil account for roughly 80% of the capital raised during the first half of 2007 (final 2007 data should be published in March 2008).

The fund market in Mexico can be divided into funds with a regional strategy to invest in various Latin American countries and funds focused only on the Mexican market. [Appendix 1](#) contains a list of all private equity funds that are based in Mexico or have significant investments in Mexico.

Among the most established funds with a regional strategy and strong presence in Mexico are Advent International and Southern Cross Group. Boston-headquartered Advent has long had a Mexico-based team, and the firm held a final closing early in 2007 on approximately \$1.3 billion for its fourth Latin America fund, a sharp increase from its previous fund size of \$300 million. Even with the significant size increase, the fund was still substantially oversubscribed. Southern Cross, which is an active investor in the Southern Cone and is now expanding its Mexico activities, is seeking \$500 million of capital commitments. Both of these funds take a buyout approach to investing and prefer control investments. In contrast, the funds focused only on Mexico generally do not seek control investments and tend to make investments in smaller companies than the ones sought by Advent or Southern Cross.

While the pan-Latin American funds provide the benefit of geographic diversification, we believe that investors should not focus solely on such funds. The opportunity provided by the funds targeted exclusively at Mexico's small and middle market is compelling given the macro-economic situation in Mexico and the dedicated local resources necessary for tapping that opportunity.

Today, Mexico offers investors the opportunity to realize superior risk-adjusted returns given the lack of competition among capital providers and the various other factors outlined in this report. In addition, relationships can be forged now with the top performing managers of tomorrow given the opportunity to identify future leaders from a very limited pool. These relationships will be very valuable in future cycles when access may be very limited, as has already been demonstrated by Advent's recent fundraise.

## Why Mexico? Why Now?

### ✓ Global Integration

The economic convergence of Mexico into North America brought about by more than a decade of free trade (NAFTA and 11 other Free Trade Agreements with 25 countries) has positioned private equity investments in Mexico as an opportunity to achieve attractive risk-adjusted returns. Mexico currently has the most free trade

agreements of any country in the world making it an attractive platform for companies seeking to export goods.

### ✓ Sustained Macroeconomic Stability

For the first time in its modern history, Mexico is undergoing an extended period – over a decade – of macroeconomic stability. Below, [Table 1](#) presents some of Mexico's key economic indicators and how these rank against the BRIC markets: Brazil, Russia, India, and China.

While Mexico's population and land area are smaller than those of the BRICs, it outperforms most of these larger markets according to several macroeconomic indicators and, overall, ranks second to China according to [Table 1](#).

Mexico's Gross National Income per capita ranks first among BRIC countries, indicating strong purchasing power which should translate into stronger consumer spending. Increased consumer spending generated by growing disposable income will provide opportunities for

**Table 1: Mexico and the BRICs: Market Comparison**

Criteria	Brazil	Rank <sup>(a)</sup>	Russia	Rank <sup>(a)</sup>	India	Rank <sup>(a)</sup>	China	Rank <sup>(a)</sup>	Mexico	Rank <sup>(a)</sup>
<b>Market Size &amp; Population<sup>(a)</sup></b>										
Life Expectancy at Birth (total years)	71.2	3	65.5	4	63.5	5	71.8	2	75.4	1
Population (millions)	186.8	3	141.4	4	1129.9	2	1321.9	1	108.7	5
Surface Area (sq km in millions)	8.5	3	17.1	1	3.3	4	9.6	2	2.0	5
<b>Average Market Rating</b>		<b>3.00</b>		<b>3.00</b>		<b>3.67</b>		<b>1.67</b>		<b>3.67</b>
<b>Economic Indicators<sup>(a)</sup></b>										
GNI per Capita (Atlas method)	\$4,730	3	\$5,780	2	\$820	4	\$2,010	5	\$7,870	1
GDP (\$ in billions)	\$1,100	2	\$987	3	\$906	4	\$2,700	1	\$839	5
GDP Growth Rate (annual %)	3.7%	5	6.7%	3	9.4%	2	11.1%	1	4.8%	4
Trade as % of GDP	21.2%	5	47.5%	3	32.5%	4	66.0%	1	61.8%	2
Workers' remittances and compensation of employees, received (\$ in billions)	3.5	4	3.3	5	25.7	1	22.5	3	24.7	2
Time Required to Start a New Business (days)	152.0	5	28.0	2	35.0	3	35.0	3	27.0	1
<b>Average Economic Rating</b>		<b>4.00</b>		<b>3.00</b>		<b>3.00</b>		<b>2.33</b>		<b>2.50</b>
<b>Debt Indicators<sup>(b)</sup></b>										
External Debt (Government)	176.5	2	287.4	4	132.1	1	305.6	5	178.3	3
External Debt as % of GDP (Government)	16.0%	3	29.1%	5	14.6%	2	11.3%	1	21.2%	4
Public Debt as % of GDP	50.0%	4	8.0%	1	52.8%	5	22.1%	3	20.7%	2
<b>Average Debt Rating</b>		<b>3.00</b>		<b>3.33</b>		<b>2.67</b>		<b>3.00</b>		<b>3.00</b>
<b>Technology<sup>(a)</sup></b>										
Internet Users (per 1,000 people) <sup>(2)</sup>	195	1	152	3	55	5	85	4	180	2
High Tech Exports % of manufactured exports	12.8% <sup>(2)</sup>	3	8.1% <sup>(2)</sup>	4	5.0% <sup>(3)</sup>	5	30.6% <sup>(2)</sup>	1	19.6% <sup>(2)</sup>	2
<b>Average Technology Rating</b>		<b>2.00</b>		<b>3.50</b>		<b>5.00</b>		<b>2.50</b>		<b>2.00</b>
<b>OVERALL AVERAGE</b>	<b>FOURTH</b>	<b>3.29</b>	<b>THIRD</b>	<b>3.14</b>	<b>FIFTH</b>	<b>3.36</b>	<b>FIRST</b>	<b>2.36</b>	<b>SECOND</b>	<b>2.79</b>

Sources: (a) World Bank Group; (b) CIA World Factbook

(1) Ranked from highest (1) to lowest (5)

(2) 2005 figure shown; 2006 data not available

(3) 2000 figure shown; 2005 and 2006 data not available

growth of enterprises in Mexico.

For more than a decade now, the Mexican government has promulgated sound monetary and fiscal policies that have brought about improved economic conditions across the country. Some of these policies and results have included:

- **Improving Fiscal Environment:** Mexico has benefited from its balanced budget, growing fiscal revenues, reduced debt, and better distribution of resources to states and municipalities in recent years.
- **Sound Monetary Policy:** Effective management of supply and demand for pesos has helped lower inflation from 8.9% in 2000 to 4.0% in the last twelve months. The currency has shown stability throughout this period.
- **Strengthening Capital Inflows:** The volume of capital inflows to Mexico continues to increase, driven by (i) foreign investment attracted by macro-economic stability and (ii) the surge in remittances from abroad which have almost doubled from \$13.3 billion in 2003 to \$24.2 billion in 2006.
- **Increasing Domestic Savings Levels:** The *Afores*, Mexico's private pension funds established by law in the 1990's, have created a domestic long term savings pool (estimated at \$71 billion as of the end of June 2007 or 8.5% of GDP) that may provide resources to finance long-term projects. Domestic savings by the general population have increased from 6.8% of GDP in 2000 to 8.7% of GDP in 2006.
- **Exports:** Mexico's exports are much less commodity based than other countries in Latin America. Mexico's exports are more manufacturing and value-added products. By comparison, while 19% of Mexico's exports are commodities, Brazil's is 52%, Argentina 61%, Chile 75%, Colombia 57%, and Venezuela 90%. Mexico has not benefited as much from the recent commodities boom, but it is much better positioned in the event of a downturn in the commodities cycle. This bodes well for continued stability.

Overall, the openness of the Mexican economy, combined with its successful management by the government authorities, has provided solid footing for the three major international credit agencies to give Mexico investment grade status. Economic experts have expressed optimism

about the sustainability of Mexico's economic growth into the future, particularly amongst newly industrialized nations (e.g. Goldman Sachs' N-11 reports).

## ✓ Favorable Demographic Trends

Mexico has the most Spanish speakers in the world with a population of more than 100 million. The population is also very young with 50% under 25 years of age. With 800,000 young Mexicans entering the job market each year, there is a high level of new household formation fueling demand for housing and related products and services. Over 90% of children ages 6 to 14 have access to schooling, providing a skilled workforce for growing domestic and foreign enterprises, and generating demand for post-secondary education.

## ✓ Growing Middle Class

Mexico's middle class consists of more than 30 million people. Middle class families with annual income of \$8,500 are expected to increase from 30% in 2000 to 51% 2010. At the same time, banks and other financial institutions have increased the availability of consumer credit (i.e. credit cards). Consumer lending has increased from 0.7% of GDP in 2000 to 3.5% of GDP in 2006, a 31% CAGR during this period. Short-term interest rates have also been declining to historical lows since 1995, although they are still high vis-à-vis international standards.

The increase in consumer lending coupled with lower interest rates provides additional access to capital for discretionary spending by the middle class in higher value products such as automobiles and home appliances. Spending in tourism related industries and entertainment should also increase given this dynamic. As evidence of our assessment with respect to the growth of consumer spending we note that consumption per capita has grown at an annual rate of 11.4% over the last 10 years. Retail sales have grown at an average of 5% in dollar terms for the period 2000-2005.

## ✓ Hispanic Growth in the U.S.

The U.S. Hispanic market exhibits the same favorable characteristics for private equity investing as the Mexican market. According to the U.S. Census Bureau, the Hispanic population is the largest minority group in the U.S., having doubled since 1990 to more than 42 million

people. This group will continue to grow at a rate three times faster than the general non-Hispanic population and has become the fourth largest Spanish-speaking population in the world. The Mexican-American population is approximately 25 million (or 60%) of Hispanics living in the U.S.

U.S. Hispanic consumer buying power is driven by its young population with an average age of 26 years compared to 37 years for non-Hispanics. Hispanic buying power is expected to reach \$1 trillion this year and is growing at 7.7% per annum or three times faster than the national rate. Also important to this growth is the 1,951 mile U.S./Mexico border, which is one of the busiest borders in the world. Since the Mexican-American community is by far the largest block of Hispanics living in the U.S., there will be many opportunities for Mexican companies to serve the consumption patterns of the Hispanic community in the U.S. as well as other U.S. markets where Mexican products and services are desired.

### ✓ **Stability Despite Potential US Downturn**

As discussed above, Mexico's economic stability has been achieved through disciplined fiscal and monetary policies over the past decade. With single digit inflation since 2000, Mexico is undergoing the longest period of economic stability since the 1960's. Still, a critical question to ask is: what would be the effect of a U.S. economic downturn on the Mexican economy?

One of the most important consequences that this consolidation of macroeconomic stability has brought to Mexico is the resurgence of the domestic market as the main engine for economic growth. Between 1995 and 2000, Mexico's main growth engine was the export sector. This was due, in large part, to the 1994-95 peso devaluation crisis which brought about a sharp contraction in employment and real wages accompanied by several years of severe debt overhang problems due to ever-rising interest rates. In 2002, however, the economy began a gradual period of recovery sustained by a moderate, but continuous recovery in real wages and a fast expansion of consumer credit that began in 2000. Also, since 2003, stability has led to a boom in the housing market as long-term fixed rate mortgages became available to lower and middle income families for the first time since 1974. Mexico's domestic market has become the

main driver of economic growth and job creation and now accounts for 67% of Mexico's GDP.

All of these factors are reasons to feel cautiously optimistic that the impact of a potential U.S. downturn in the Mexican economy will not be as hard felt as it could have been in the mid-1990s, early 2000s period.

## PRIVATE EQUITY OPPORTUNITY

Table 2 provides an overview of the number of companies in Mexico. The small and medium market segment represents approximately 151,000 companies or 98% of the market. The less than 1,000 companies with more than \$130 million in sales represent approximately 2% of companies in Mexico.

**Table 2: Estimate of Company Market in Mexico**

(\$ in Millions)

<u>Size</u>	<u># of Companies</u>	<u># of Employees</u>	<u>Sales / Co.</u>
Large	976	> 1,000	> \$130.0
Medium	16,663	100 - 1,000	\$4.0 - \$130.0
Small	134,227	11 - 100	\$0.2 - \$4.0
	<u>151,866</u>		

Source: INEGI

Referring again to Table 1, the time required to establish a company in Mexico is typically 27 days, less than that of any of the BRIC markets, particularly Brazil, where it typically takes around 152 days to start a business. This factor is likely to have encouraged the growth of local entrepreneurs and contributed to the large universe of potential investments for private equity funds in Mexico.

### Increased Private Equity Investment

The overall market has seen a large uptick in activity over the last three or four years, with deal volume estimated at over \$500 million during the first half of 2007. A key driver of deal flow stems from the preponderance of small and medium-sized enterprises ("SMEs") and family-owned businesses, many of which face succession issues or capital-induced growth constraints. At the large end of the fund market (those with capital of \$300 million and above), there has been evidence of a trend towards larger buyouts. Examples include Advent International's investments in Milano, a \$200 million buyout of Mexico's largest discount clothing retailer from private equity

investor Newbridge Latin America, and in Corporativo Javer's housing business subsidiaries, which is expected to exceed \$500 million in transaction value. In 2006, Morgan Stanley and Southern Cross invested an undisclosed amount in MMCinemas, the second largest theater chain in Mexico. These larger transactions have been prompted by an increased availability of leverage brought about by the favorable macro fundamentals discussed above: GDP growth, stable currency, low inflation, low interest rates.

Established middle-market companies in Mexico have historically had a difficult time in financing working capital and growth and the market has been under-penetrated by banks, which tend to be very conservative. Commercial credit is still expensive in Mexico (it experienced negative growth for a decade following the 1994 currency crisis until the beginning of 2005 when it started turning positive). Many high-quality, established companies are in need of growth capital to keep up with the demand from the consumer market. The majority of these companies are still financing growth with costly and inefficient forms of financing, such as suppliers. Driven by the growing consumption patterns evident in the Mexican economy, many of these same companies are now poised for sustained growth and will be more open to alternative forms of financing, such as private equity investments, to finance such growth.

## Transaction Value

Similar to the U.S. small and middle market, personal relationships are critical for deal sourcing and completing transactions. Since many companies are family owned, factors such as the prior personal relationship of the seller with the buyer can influence critical aspects of the transaction, including the value of the transaction. As a result of the lack of competition among capital providers the sales process is less efficient and generally does not include auctions. This also keeps transaction values in check in the less efficient small and middle market space. Private equity managers' personal networks and their ability to work with the dynamics of family-owned businesses are critical to the success of the funds focused in the small and middle markets in Mexico. Funds that are able to purchase companies in the inefficient small and middle market and sell them in the more efficient market of larger companies will benefit from multiple arbitrage; meaning companies can be grown and sold to a wider

audience that includes large regional and global private equity funds and multi-national companies.

## Active Exit Environment

Several high profile exits through IPOs and trade sales over the last couple of years provide reassurance that the exit venues for Mexican private equity investments have not only opened, but also continue to improve. There is also a growing M&A market with active participation from strategic buyers, including private equity funds. M&A deals greater than \$5 million increased from 35 in 2005 to 50 in 2006, a 43% increase. Total value of these deals increased from \$6.5 billion in 2005 to \$8.3 billion in 2006, a 28% increase. In 2006, there were 8 deals valued at over \$300 million.

In addition, the availability of credit for established large private equity funds provides the environment for LBO transactions. Middle market funds should be the primary beneficiaries of this trend as they capitalize on buying small and middle market enterprises and growing them to the next level, where a sale to a larger private equity fund or strategic buyer becomes a possibility.

## Industry Sector Opportunities

Every industry sector, other than oil exploration and certain energy sectors for which private investments are prohibited, are prime candidates for private equity investments. We expect the following sectors to be particularly attractive for private equity investors over the next five to ten years:

### ✓ Consumer Products, Food and Beverages, Media & Entertainment, and Education

Opportunities in these particular industries will arise from the combination of the country's growing demographics and economics: as discussed earlier, 50% of population is under 25 years of age and middle class families will grow from 30% of the population in 2000 to 51% by 2010. Commercial credit is still expensive in Mexico and experienced negative growth for a decade until 2005. Many high quality companies are in need of growth capital to keep up with the demand of the consumer market.

### ✓ Telecom and Technology

Even though Mexico has been taking steps to enhance its telecommunications infrastructure in order to improve communication and IT services, the country's IT spending is still lagging behind. In October 2005, the Ministry of Communication and Transportation (SCT) published the technology convergence law that allows media companies to offer services to telecoms and vice versa. Other interesting general market statistics: the stock of personal computers in 2005 was equivalent to 11/100 people and 1/100 for broadband; TV penetration reaches 63% of population (this audience generates 92% of total household income); TV advertisement represents around 50% of total media expenditures.

### ✓ Housing

This sector has experienced average annual growth of 5.6% over the last five years. Housing growth is driven by the fact that Mexico is a young country, and the population in the age group 25-50 will demand 900,000 new homes per year for the foreseeable future.

On top of this, government estimates show that the current housing deficit stands at approximately 4 million units. Also, due to the opening of the credit markets via lower interest rates, mortgages have grown at an average annual rate of 40% in the last five years (20 and 30 year mortgage annual interest rates have come down from 25% at the beginning of this decade to under 15%). Even with those dramatic growth numbers, mortgages in Mexico still represent a small proportion of GDP.

In terms of market risks, unlike the U.S., Mexico has not experienced the unprecedented growth of subprime lending that the U.S. has experienced over the last five years. This is mainly because of the lack of mortgage refinancing mechanisms in Mexico. Loans tend to be made using fixed rates (as opposed to ARMs) and only the major banking institutions in Mexico offer mortgages (as opposed to the U.S. where there is an established market of subprime lending institutions). These banking institutions in Mexico find themselves in very solid financial positions with mortgages being only one of the many products they offer to diversify their portfolios.

### ✓ Infrastructure

The last decade has seen improvements in Mexico's infrastructure network, especially improved access to water and sanitation, electricity, and telecommunications.

However, Mexico still lags behind in infrastructure investment with a decline from 7% of GDP in 1988 to 3% of GDP today (in comparison, highly competitive countries are typically investing 10% of their GDP in infrastructure projects). Since his electoral campaign in 2006, current President Felipe Calderon has proposed that his six-year term will be 'the sexenio of infrastructure' and recently launched a national *Infrastructure Master Plan* to boost investment in infrastructure to 8% of GDP (this could reach \$60 billion per year). In order to attain this ambitious goal, the Calderon Administration will attempt to use more Public-Private Partnerships (PPP) to boost private investment in Mexico's major infrastructure projects. PPPs that are currently being used or are being implemented include: long term productive infrastructure projects known as PIDIREGAS (Proyectos de Inversión Diferida En El Registro del Gasto), Concessions (mainly in water and transport projects), public investment funds that stimulate additional private investment (known as FINFRAs), long term service and supply contracts, and a new investment scheme created in 2004 known as Projects for the Provision of Services (PPS). There will be significant opportunities for both Mexican and foreign companies in all areas of modern infrastructure design, financing, and construction in industries such as: *transportation* (i.e. airports, federal highways, secondary roads, railroads), *electricity* (basic generation, transmission, distribution), *health* (hospital facilities), *environmental* (wastewater treatment plants), and *education* (public and private schools and universities).

### ✓ Healthcare

Opportunities in this sector will likely arise from infrastructure needs and lack of access to the public health system. Mexico's healthcare infrastructure is old and insufficient compared to other OECD countries; total spending in 2005 was 6.4% of GDP vs. 9.0% on average in OECD countries. It is estimated that 59% of the Mexican population does not have access to the national public health system. Lack of public investment in the national healthcare system has been substituted by investments by the private sector (during the period of 2000-2005, private outpatients grew at annual rate of 8.2% vs. public outpatients which grew at just 3.7%). Growth will be driven by access to capital and long-term concessions of public health care services. Finally, the pharmaceutical market in Mexico is set for expansion driven by increased generics production and exports.



## ✓ Financial Services

Banking services in Mexico have been growing but show ample opportunities for growth. New financial services companies are stepping in to address market niches that are being overlooked by large financial institutions. In the past 12 months, 13 new bank licenses have been granted. Since 2004, total commercial lending has grown 16.9% in real terms. However, in 2006 total commercial lending represented 4.9% of GDP vs. 26.5% of GDP in 1994. Lack of financing on the commercial side and the continued high cost of capital represent ample growth opportunities for private equity firms.

## ✓ Manufacturing

Mexico's manufacturing sector has grown at a 2.6% CAGR for the last 25 years. It grew 4.6% in 2006. Manufactured exports are growing 2.5 times faster than GDP since 2004. Mexico's exports are much less commodity based than other countries in Latin America. Mexico's exports are more manufacturing and value-added products. By comparison, 19% of Mexico's exports are commodities, 52% in Brazil, 61% in Argentina, 75% in Chile, 57% in Colombia, and 90% in Venezuela. Mexico has not benefited as much from the recent commodities boom, but it is much better positioned in the event of a downturn in the commodities cycle. This bodes well for continued stability. Mexico is graduating from being a supplier of cheap manufacturing labor to becoming more closely integrated in the production and distribution systems of U.S. and other international industries. GE, GM, Honeywell and Delphi have created large R&D centers in Mexico. Overall, exports under NAFTA are concentrated in high valued manufactured goods. In terms of private equity investment opportunities, there is a lack of working and growth capital for many well-managed and high quality manufacturers.

## ✓ Tourism

Mexico is the eighth most popular destination in the world among tourists and the most popular tourist destination in Latin America with 3 times as many visitors as Brazil. It also ranks 11<sup>th</sup> in the world in terms of revenue earned from tourism, and its receipts of international tourist

expenditures are the highest in Latin America. Driven by rising real incomes and lower-cost domestic air travel, internal tourism by Mexicans is on the rise, with around 80% of total tourism consumption coming from Mexicans in 2004. There will be considerable private equity opportunities for investing in service companies that address the industry's needs, such as hotel management and transportation.

## Cross-border Opportunities

There will continue to be opportunities arising from the relationship between Mexico and its NAFTA partners, especially between Mexico and the U.S. due to: (i) growing consumer demand on the Mexican side, propelled by the growth of Mexico's middle class, and (ii) the explosive growth of the U.S. Hispanic market. As discussed earlier, since the Mexican-American community is by far the largest block of Hispanics, there will be many opportunities for Mexican companies to serve the consumption patterns of the U.S. Hispanic community as well as other U.S. markets where Mexican products and services are desired.

## HOW TO INVEST IN MEXICO

The private equity market in Mexico continues to evolve rapidly, both on a macro scale, as well as at the individual general partner level. While StepStone believes the opportunities in Mexico's market are vast, we also firmly believe that a prudent approach to accessing the market must incorporate careful due diligence and access to local industry networks.

Please contact us if you wish to explore opportunities for investment in private equity partnerships specialized in Mexico or Latin America. StepStone has unparalleled relationships in Mexico which give us the ability to provide strategic advice regarding the development of a Mexico investment strategy and thorough due-diligence with respect to specific investment opportunities. We would be happy to discuss in detail the specific opportunities currently available in the market.

*Sources: StepStone Research, World Bank Group, CIA World Factbook, Inter-American Development Bank, Organization of American States, Mexican Government agencies, Asesoría y Estrategia Económica, Venture Equity Latin America, Emerging Markets Private Equity Association, Latin Finance, The Economist, San Diego Union Tribune, Private Equity International.*

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Founded in 2007, StepStone Group LLC offers customized private equity investment management and advisory services to institutional clients using industry leading analytics and research capabilities, with a focus on providing highly responsive and collaborative client service. StepStone Group was founded on the principle that the primary asset of the firm is its diverse team of professionals. The firm takes extreme care to develop and safeguard this asset to ensure greater value creation for clients. For more information about the firm, its philosophy, and services please visit [www.StepStoneLLC.com](http://www.StepStoneLLC.com).

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## Appendix 1: Mexico's Venture, Private Equity, and Real Estate Funds

Fund	Strategy	Fundraising Target / Last Fund Size (\$ in US millions)	Investment Size (\$ in US millions)
<b>Currently Fundraising</b>			
1 Alsis Funds	Private Equity: Securitization	n/a	\$20-300
2 Alta Growth Fund	Private Equity: SME's/Growth	\$150	\$10-20
3 Aureos Latin America Fund	Private Equity: SME's/Growth (Latin America Regional)	\$300	\$10-30
4 Capital i-2	Real Estate	\$45	n/a
5 Darby Mexico Infrastructure Fund	Private Equity: Infrastructure	\$200	\$15-25
6 Discovery Americas I	Private Equity: Middle market growth equity	\$125-\$150	\$10-20
7 Evercore Mexico Capital Partners II	Private Equity: SME's	\$125	\$10-30
8 Insignia Capital	Private Equity: SME's	\$100	\$3-12
9 Latin Idea Ventures	Venture (Growth/Late stage)	\$30	\$3-5
10 La Salle Investment Management	Real Estate	\$500	n/a
11 Mexico Opportunity Fund	Private Equity: Expansion	\$100	\$2-5
12 Nexxus Capital Private Equity Fund III	Private Equity: Middle market growth equity	\$300	\$15-25
<b>Not Currently Fundraising (Local Private Equity Team, Mexico-only Focus)</b>			
1 BBVA Proyectos Empresariales	Private Equity: Growth	\$190	\$10-25
2 Carlyle	Private Equity: Buyout	\$134	\$20-50
3 Fausto Garcia & Asociados/Fondo Sinaloa	Private Equity: Growth	\$16	\$1-2
4 Fondo Guanajuato	Private Equity: Growth	\$8	<\$1
5 Fondo para la PYME Auxiliar del Sector Turismo	Private Equity: Growth, Tourism Related	\$22	\$1-2
6 Industrial Global Solutions / MREI	Real Estate	\$100	\$1-10
7 Monterrey Capital Partners	Private Equity: Growth/Buyout	\$100	\$10-20
8 Nafta Fund/SAI Consultores	Private Equity: SME's (Mexico and US)	\$100	>\$2.5
9 Wamex/Multinational Industrial Fund	Private Equity: Growth	\$72	\$5-10
<b>Not Currently Fundraising (Local Private Equity Team)</b>			
1 Advent International	Private Equity: Buyout (Latin America Regional)	\$1,300	\$15-50
2 AIG	Private Equity: Buyout (Global)	\$450	\$25-50
3 Discovery/Protego	Private Equity: Middle market growth equity	\$70	\$10-30
4 Emerging Markets Partnership (EMP) Global	Private Equity: Buyout (Latin America Regional)	\$1,000	\$30-70
5 Fondelec Latin America Clean Energy Services Fund	Private Equity: Energy Related SME (Latin America Regional)	\$32	\$4-8
6 GP Invertementos	Private Equity: Growth/Buyout (Latin America Regional)	\$1,300	\$50-100
7 O'Connor Capital Partners	Real Estate (North America Regional)	\$500	\$10-15
8 Paladin Realty Partners	Real Estate (Latin America Regional)	\$200	n/a
9 Southern Cross	Private Equity: Buyout (Latin America Regional)	\$217	\$50-75
<b>Not Currently Fundraising (Foreign Private Equity Team)</b>			
1 Bravo Equity Partners	Private Equity: Buyout (US and Mexico)	\$50	\$5-20
2 Brysam Global Partners	Private Equity: Buyout (Global)	\$1,000	\$50-250
3 Capital Group	Private Equity: Buyout (Global)	\$618	\$10-\$50
4 Conduit Capital Partners	Private Equity: Energy Related (Latin America Regional)	\$393	\$30-45
5 CVC International	Private Equity: Growth/Buyout (Global)	\$1,600	\$5-15
6 JP Morgan Partners	Private Equity: Growth/Buyout (Global) - Exiting Market	\$740	\$5-10
7 Latin America Enterprise Fund	Private Equity: Buyout (Latin America Regional)	\$175	n/a
8 Morgan Stanley	Private Equity & Real Estate (Global)	n/a	\$15-30

Source: StepStone Group, Amexcap

StepStone is also in contact with other groups that are organizing fund-raising efforts at this time.