

# MEXICO'S INVESTMENT LANDSCAPE AMID COVID-19 CRISIS

MAY 2020



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## OUR COMMITMENT

The approach / methodology expressed herein is based on our most up-to-date understanding of your situation and latest thinking of how to address your requirements.

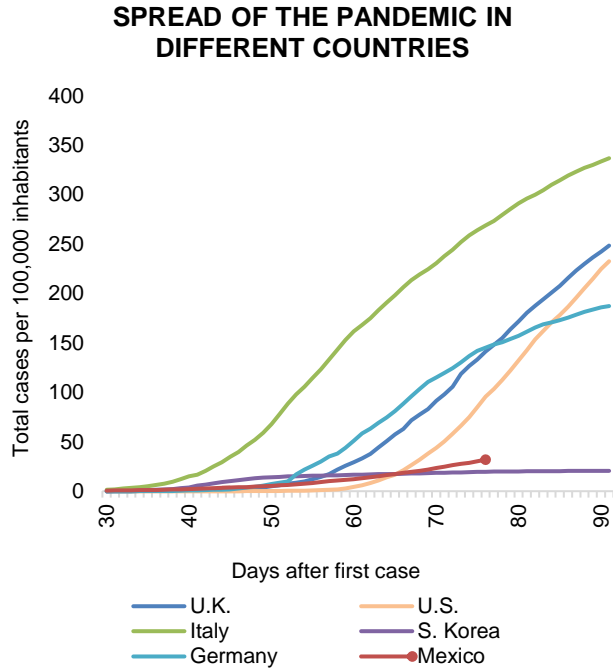
During our engagements we have found the need to occasionally pivot our approach as client requirements change or data discovery drives this shift.

Our commitment is to provide deep data-driven insights and findings to solve our client's challenges and deliver quality recommendations and support in accordance with your requirements.

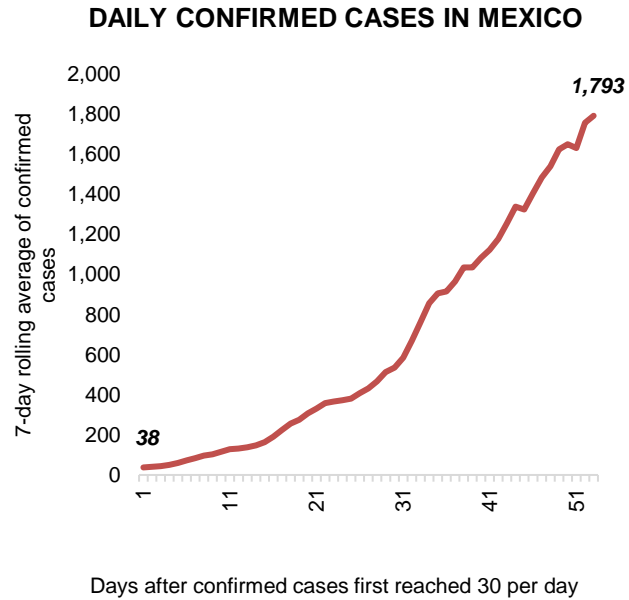
<b>COVID-19 AT A GLANCE</b>	<ul style="list-style-type: none"><li>▪ The number of cases around the world is still growing, while <b>Mexico remains in its early stages of the outbreak, it is poised to become a major hub of contagion</b> due to substandard key medical indicators</li><li>▪ <b>There are five phases to a pandemic – these will bring a series of cycles with many peaks and troughs</b> but with a diminishing case growth per day if the mitigation policies are implemented efficiently and on time</li></ul>	
<b>SUPPRESSION POLICIES</b>	<ul style="list-style-type: none"><li>▪ Seeing as cases increase exponentially, <b>countries have implemented decisive actions, like social distancing and contact tracing programs, to “flatten the curve”</b> and diminish the strain on the healthcare system and economy</li><li>▪ <b>Uncertainty is the enemy of every investor</b> and, therefore, <b>understanding the different possible scenarios of economic recovery is crucial</b> in order to better prepare for the future and improve decision-making</li></ul>	
<b>ECONOMIC IMPACTS IN MEXICO</b>	<ul style="list-style-type: none"><li>▪ <b>Mexico’s GDP will experience a drop in the current year</b>, according to all major financial institutions, and the peso has also seen a depreciation of 23% with regards to the USD since the end of February.</li><li>▪ By assessing the pandemic impact on each industry and their potential to recover through digitalization, <b>we can identify which ones may represent investment opportunities in the short- and long-term</b></li></ul>	
<b>PLANNING AND MANAGING UNCERTAINTY</b>	<ul style="list-style-type: none"><li>▪ Even though <b>this crisis has hit countries and companies in an unexpected way</b>, it does not mean that they will not recover from this situation, and, <b>if managed properly, even come out stronger than before</b></li><li>▪ <b>Taking advantage of a downturn must begin with a realistic assessment</b> of a company’s strategic and financial positions – these then create different strategic initiatives that will allow them to grow</li></ul>	

# 01. COVID-19 AT A GLANCE: STAGES AND MATURITY OF THE VIRUS

The number of cases around the world has hit over 4 million and is still growing, while Mexico remains in its early stages of the outbreak, it is poised to become a major hub of contagion due to substandard key medical indicators



Mexico is still in the early days of contagion and is yet to see the toughest part of the increase. If adequate government policy is not successfully implemented the effects can be disastrous.



Even though Mexico has not seen the same pattern of growth as other countries, it is starting to show exponential growth in the number of cases. This can be underestimated due to lack of testing.

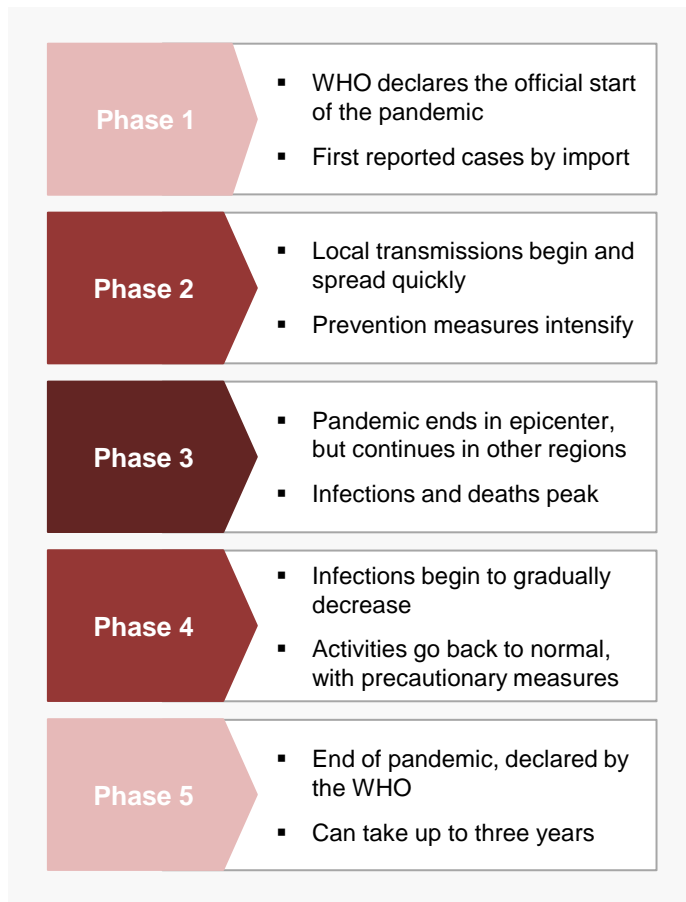
### KEY HEALTH INDICATORS

INDICATOR	OECD	MEXICO
Case fatality rate of COVID-19	5.35%	10.03%
Total COVID-19 tests per 1,000 people	33.33	0.89
Total hospital bed, per 1,000 inhabitants (2018)	4.7	1.4
Life expectancy at birth (2018)	81 years	75 years
Total doctors per 1,000 inhabitants (2018)	3.5	2.4

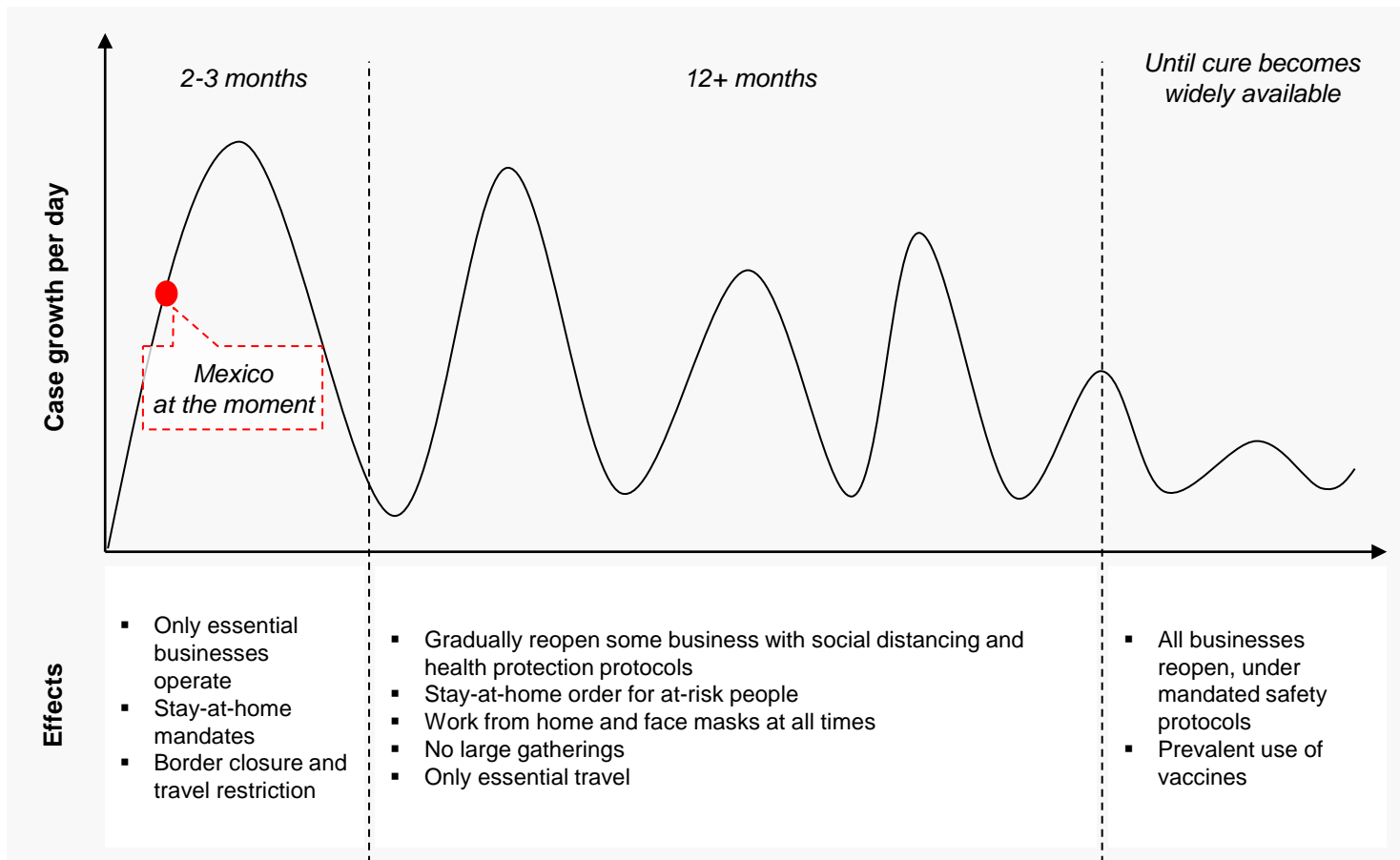
# The Phases and Cycles of the Pandemic

There are five phases to a pandemic – these will bring a series of cycles with many peaks and troughs but with a diminishing case growth per day if the mitigation policies are implemented efficiently and on time

## WORLDWIDE PHASES OF A PANDEMIC



## CASE GROWTH PER DAY CYCLE AND ITS RESPECTIVE ECONOMIC/SOCIAL IMPLICATIONS



# 02. SUPPRESSION POLICIES: SHAPING THE NEXT PHASES OF COVID-19

# Damage Mitigation Actions

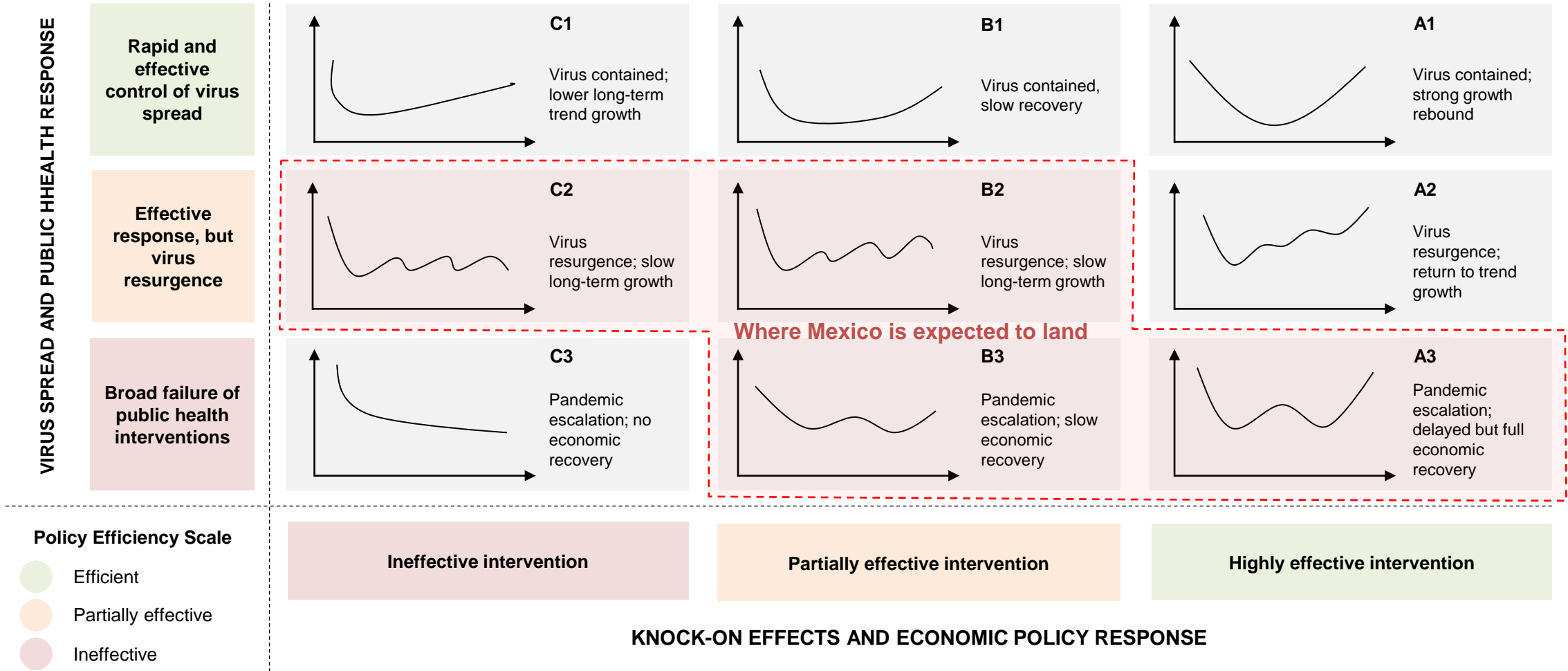
Seeing as cases increase exponentially, countries have implemented decisive actions, like social distancing and contact tracing programs, to “flatten the curve” and diminish the strain on the healthcare system and economy

INITIATIVES	EXAMPLES	DESCRIPTION	BENCHMARK	MEXICO
<p><b>Surveillance of pandemic</b></p>	Testing	Testing and tracking are the window onto the pandemic and how it is spreading. Without testing and tracking there is no way of understanding the pandemic	<ul style="list-style-type: none"> <li>▪ <b>South Korea's</b> government has tested more than 600,000 people by April 28, over 23,000 tests per day</li> <li>▪ <b>South Korea</b> has introduced “drive-through testing” and “phone booth testing”</li> </ul>	<ul style="list-style-type: none"> <li>▪ Mexico currently does 0.89 tests per 1,000 people, the lowest among all the OECD countries</li> <li>▪ No tracking system implemented yet</li> </ul>
	Tracking			
<p><b>Economic policies and incentives</b></p>	Lowering and differing taxes	Fiscal and economic stimulus packages are placed in order to attempt to soften the effects of the coronavirus pandemic.	<ul style="list-style-type: none"> <li>▪ <b>Japan</b> has passed the largest fiscal stimulus package that amounts to about 21.1% of its GDP</li> <li>▪ <b>The US</b> has lowered the federal funds rate from 1.5% -1.75% to 0.0% - 0.25%</li> <li>▪ <b>Hong Kong</b> has given \$1,200 cash to all adult permanent residents</li> </ul>	<ul style="list-style-type: none"> <li>▪ Banxico has lowered the interest rate by 125 basis points in the last three months, and approved MXN 750 billion in liquidity measures</li> <li>▪ Support SMEs with one million loans of MXN 25,000 each</li> <li>▪ Total government stimulus package amounts to 0.7% of GDP, lowest of G20</li> </ul>
	Loans to SMEs			
	Lowering the interest rate			
<p><b>Healthcare programs and initiatives</b></p>	Infrastructure	Effectiveness in creating programs and initiatives to respond to the pandemic and support the health system to withstand the crisis	<ul style="list-style-type: none"> <li>▪ <b>Italy</b> has invested \$3.2B EUR in the national health service, recruiting more than 20,000 health workers, as well as purchasing and producing medical equipment</li> </ul>	<ul style="list-style-type: none"> <li>▪ Added a total of 8,396 hospital beds</li> <li>▪ Deal with private hospitals to take in more than 12,500 patients</li> </ul>
	Workers			
<p><b>Social measures</b></p>	Social distancing measures (travel bans)	COVID-19 spreads mainly among people who are in close contact for a prolonged period. Limiting contact is the only proven method to slowing the spread.	<ul style="list-style-type: none"> <li>▪ <b>EU</b> restricts non-essential travel on March 17</li> <li>▪ <b>Chile</b> has implemented curfews and some areas are in full lockdown</li> </ul>	<ul style="list-style-type: none"> <li>▪ Cancelled all school and public events since March 16</li> <li>▪ No travel ban as of today (May 14)</li> <li>▪ Suspension of non-essential businesses on March 30</li> </ul>
	Closing non-essential businesses			






# Possible Economic Impact Scenarios

Uncertainty is the enemy of every investor and, therefore, understanding the different possible scenarios of economic recovery is crucial in order to better prepare for the future and improve decision-making



# Mitigation and Game Changers

There are three categories of therapeutics that could speed up eradication or at least lessen the burden of severe disease and mortality. Timing and scale of these products can alter the course of contagion and economic impact

PRODUCT TYPE	DESCRIPTION	CURRENT SITUATION
 <p><b>DIAGNOSTICS</b></p>	<ul style="list-style-type: none"> <li>▪ Diagnostics are helpful to identify the positive cases in order to treat patients and manage the spread</li> <li>▪ Without testing there is no way of understanding the pandemic and its effect</li> </ul>	<ul style="list-style-type: none"> <li>▪ <b>There are more than 240 regulatory authorized diagnostic tests, of which:</b> <ul style="list-style-type: none"> <li>▪ 67 are FDA-Emergency authorized</li> <li>▪ 143 are approved to sell in Europe</li> <li>▪ 1 is a laboratory developed test (LDT)</li> <li>▪ 26 are LDT-EUA (Emergency Use Authorization)</li> </ul> </li> </ul>
 <p><b>TREATMENT</b></p>	<ul style="list-style-type: none"> <li>▪ Antivirals target the virus in people who already have an infection. They either prevent the virus from replicating, or block it from infecting cells</li> <li>▪ Usually approved before a vaccine</li> <li>▪ Preferably administered before the virus causes significant damage</li> </ul>	<ul style="list-style-type: none"> <li>▪ <b>The 96 treatments that have assets in human clinical trials or patients, all have different goals, which are:</b> <ul style="list-style-type: none"> <li>▪ Treat symptoms (28)</li> <li>▪ Anti-inflammatory (37)</li> <li>▪ Anti-viral growth (29)</li> <li>▪ Prevention (2)</li> </ul> </li> </ul>
 <p><b>VACCINES</b></p>	<ul style="list-style-type: none"> <li>▪ A vaccine is designed to protect people before they're exposed to a virus. A vaccine basically trains the immune system to recognize and attack the virus when it encounters it</li> <li>▪ According to the director of the National Institute of Allergy, Dr. Anthony Fauci, a vaccine won't be available for widespread use for at least another 12 to 18 months</li> </ul>	<ul style="list-style-type: none"> <li>▪ <b>There are more than 100 preclinical vaccine candidates, but only 14 vaccines that have assets in human clinical trials:</b> <ul style="list-style-type: none"> <li>▪ Phase I (Safety, side effects/dose) – 8</li> <li>▪ Phase II (Effectiveness/safety) – 2</li> <li>▪ Phase III (Confirm effectiveness) – 3</li> <li>▪ Phase IV (Risk-benefit/best-use) – 1</li> </ul> </li> </ul>
<p><b>IMPLICATION ON DEVELOPMENT AND RECOVERY</b></p>	<p><b><i>Any development in these mitigation products can drastically change the course of the pandemic and, therefore, change the economic damage and recovery scenarios</i></b></p>	

# 03. COVID-19 ECONOMIC IMPACTS IN MEXICO

# Mexico Macroeconomic Outlook

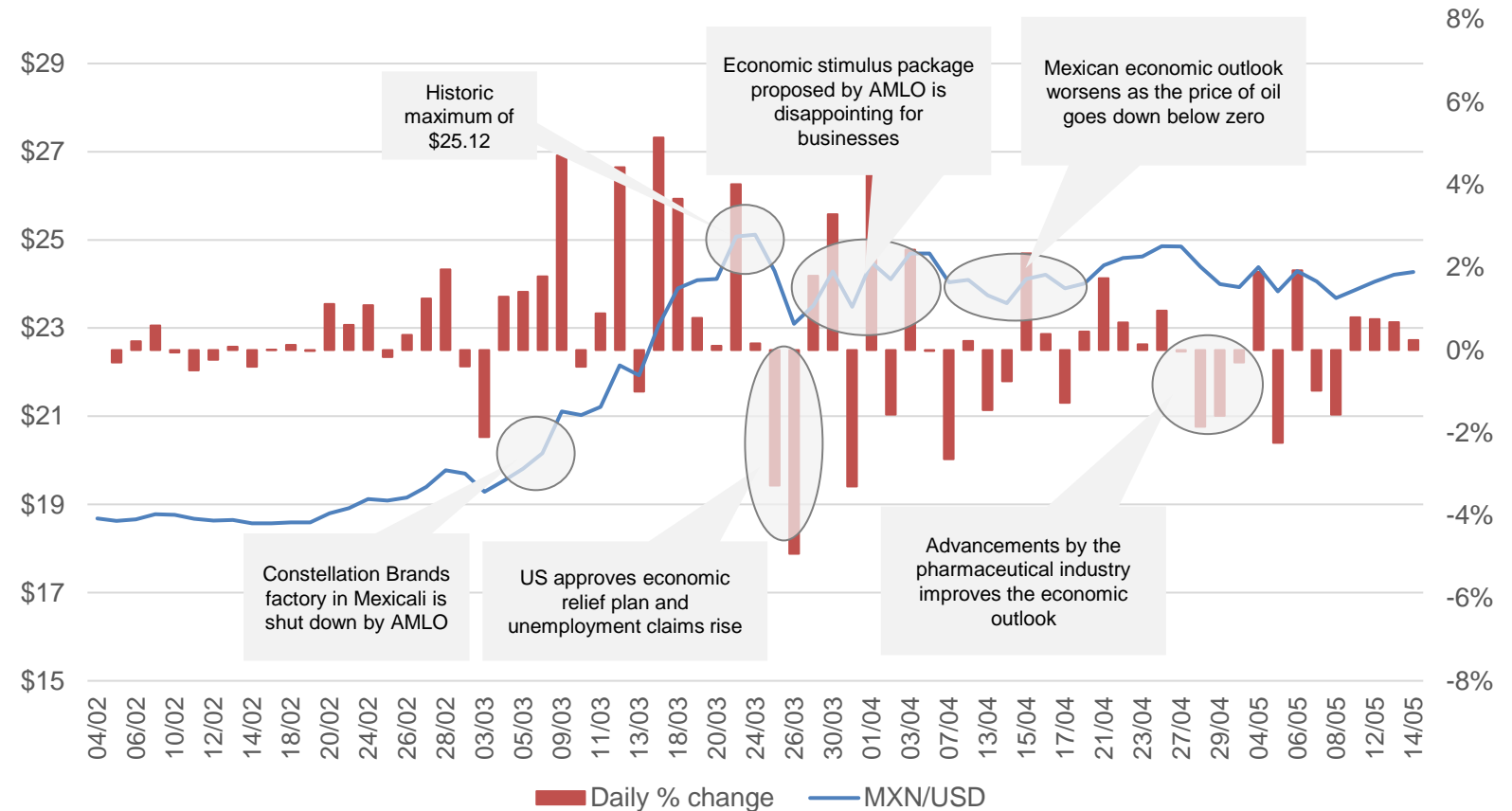


Mexico's GDP will experience a -6.4% to -9.0% drop in the current year, according to all major financial institutions and the peso has also seen a depreciation of 23% with regards to the USD since the end of February.

## MEXICO GDP FORECAST

Institution	2020 Growth
Citibanamex	-9.0%
Scotiabank	-8.4%
BANORTE	-7.8%
J.P.Morgan	-7.5%
BBVA	-7.0%
Bancomer	-6.6%
Santander	-6.4%

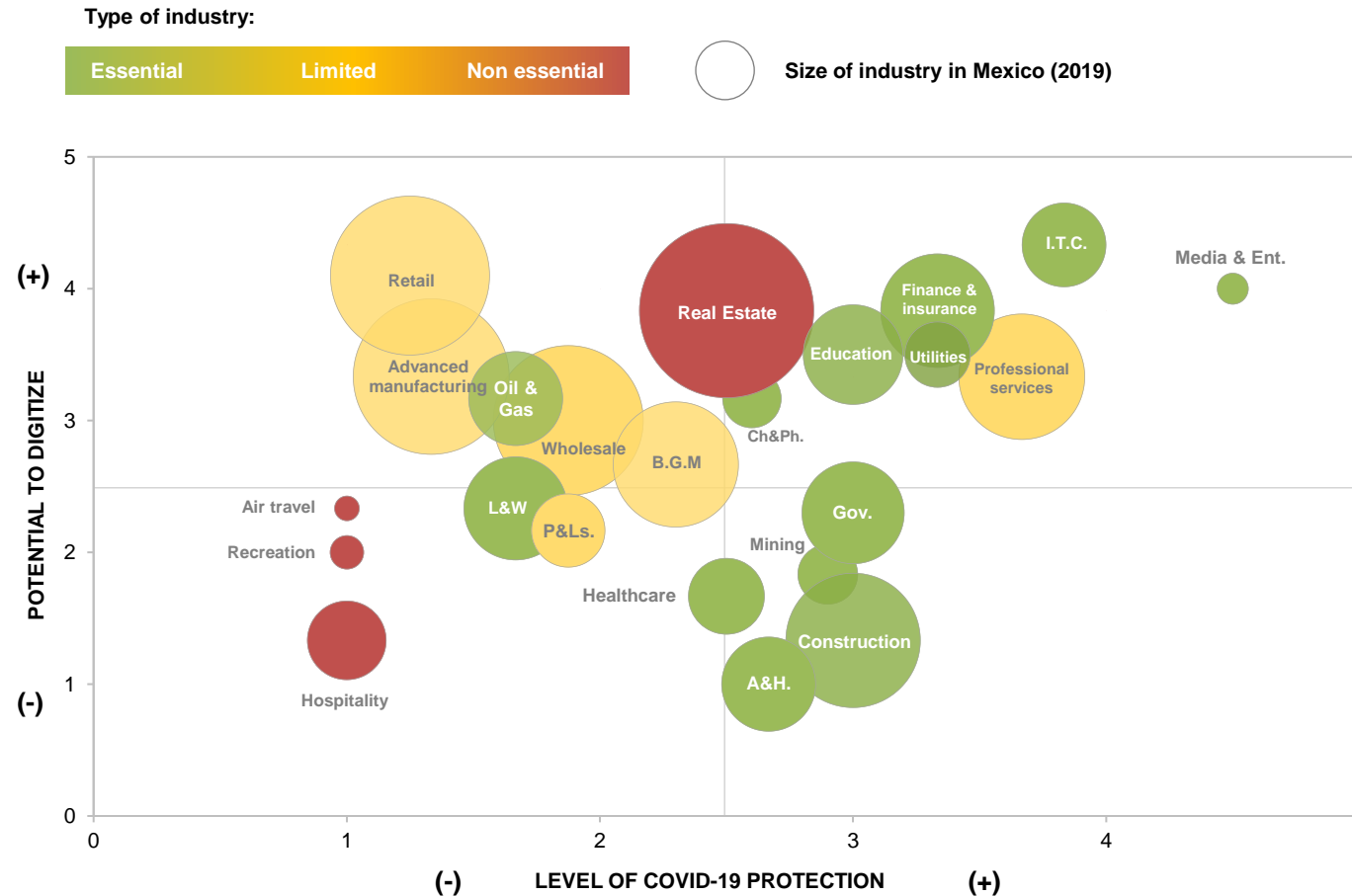
## MXN/USD IN THE PAST 2 MONTHS



# 04. SECTOR SPECIFIC IMPACTS IN MEXICO

# COVID-19 impacts by industry

By assessing the pandemic impact on each industry and their potential to recover through digitalization, we can identify which ones may represent investment opportunities in the short- and long-term

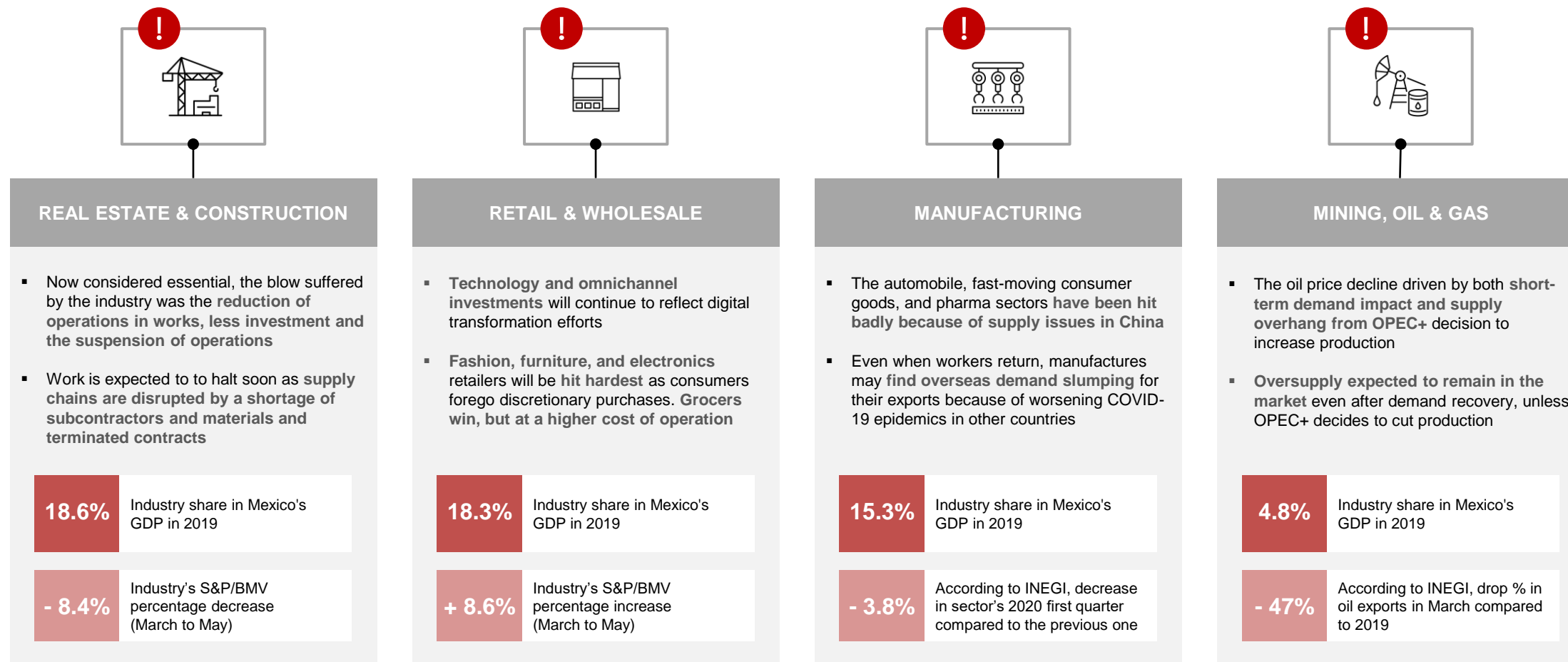


## ASSESSED FACTORS:

- LEVEL OF COVID-19 PROTECTION:** Evaluates the degree to which COVID-19 may affect the performance and continuity of the Mexican sectors
  - Disruptions in supply chain: Analysis of the status of supply chains (strained, disrupted, or shut down)
  - Operational risk: Mexico's dependence on face to face labor to operate the sector
  - Shifts in demand: Estimated variation in the distribution of disposable income per capita for each sector in Mexico
- POTENTIAL TO DIGITIZE:** Analyzes the extent to which sectors could recover from the pandemic using digital transformation technologies
  - Operational work: The degree to which digital tools ramp up productivity on operational or core activities
  - Business processes: Evaluates the level of software adoption to manage back-office activities
  - Transactions: The ease of adopting e-commerce platforms

# Mexico's most highly impacted industries

Focusing on the most important industries for the national economy, we can foresee possible risks and new opportunities as the sectors mitigate risk and prepare for the next phase of recovery



# 05. ANALYSIS SPOTLIGHT:

## ITC & REAL ESTATE



Telecom, cloud computing and some IT services will be some of the sectors that will maintain and exceed projected growth due to the rapid adoption of digital technologies and home office policies in the country

## TECHNOLOGY AS A KEY FOR BUSINESS RESILIENCE

- +300%**

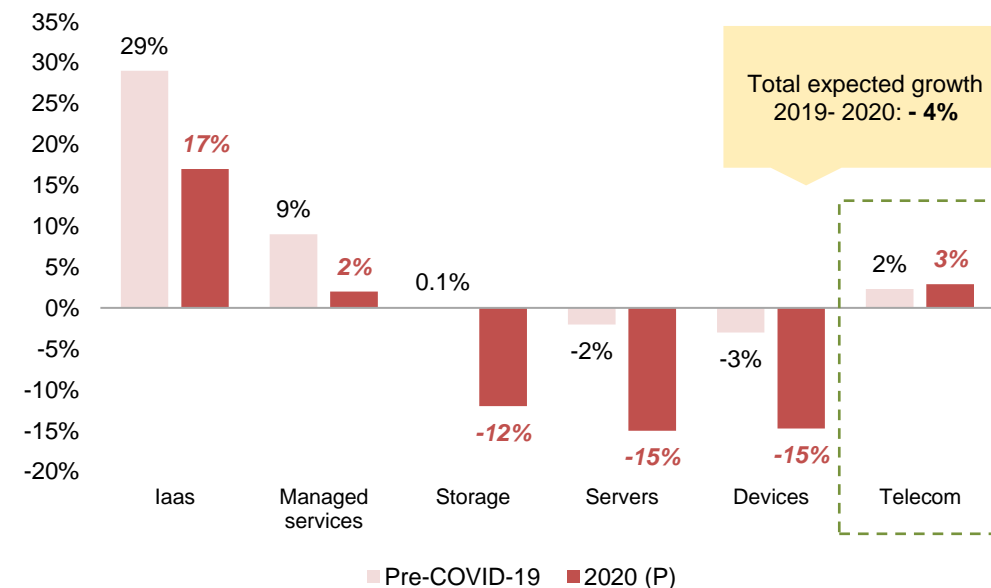
  - Increase use of Microsoft enterprise/productivity applications (teams, planner, e-mail, among others), from February to March 2020 worldwide
- 60%**

  - According to PWC, percentage of businesses in Mexico that are preparing for a definite digitalization of processes as of 2020 – only 20% of Mexico business were prepared for remote working in 2019
- 79%**

  - According to PWC, Expected percentage of business that will have implemented home office policies by the end of 2020 in Mexico
- 36%**

  - According to PWC, percentage of business in Mexico that are currently (2020) spending in data analytics solutions for procurement and demand planning to optimize decision making

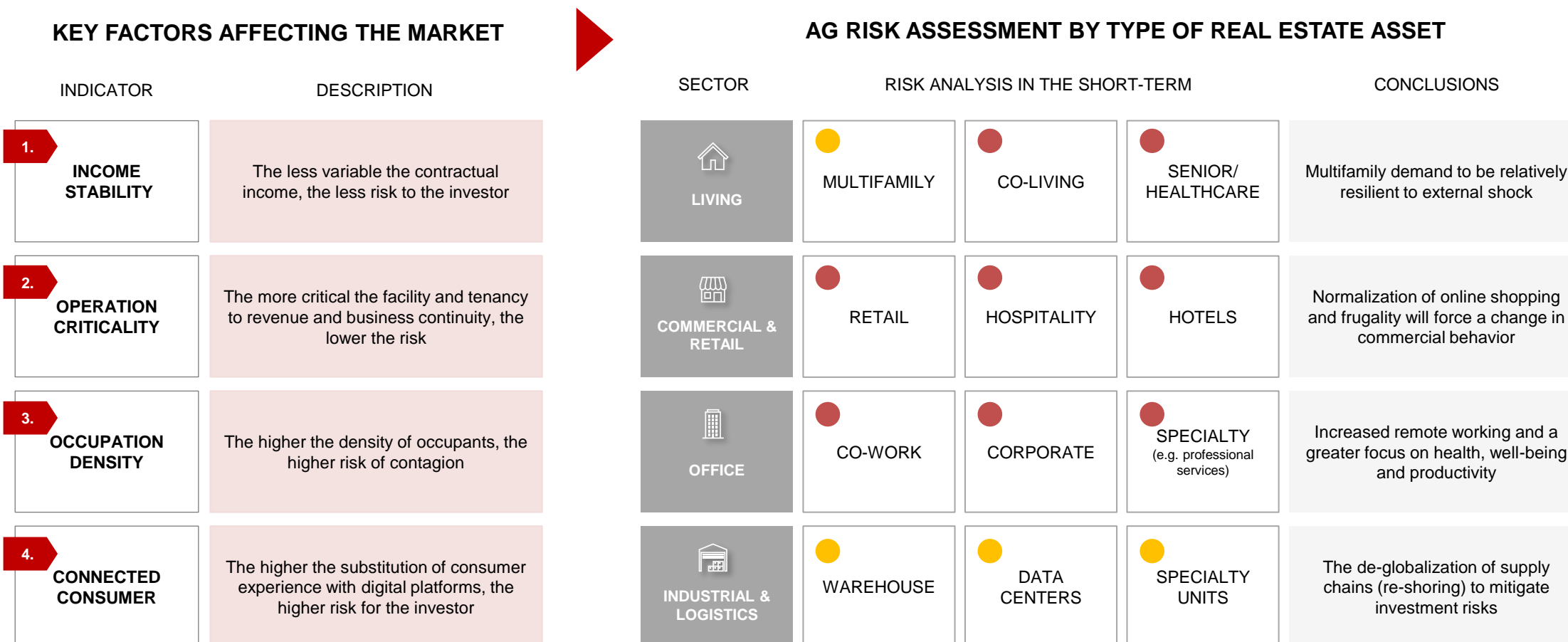
## ITC PROJECTED GROWTH IN MEXICO (2020)



- According to IDC, the most affected sectors are those related to **on-premise equipment such as PCs and servers**
- Sectors that will maintain growth are **telecommunications, cloud computing and some IT services** (remote support, security and cloud, and virtualization, communication and collaboration solutions)
- A rapid ITC recovery of **6.6% is expected by 2021**

# Analysis spotlight – Real Estate

Even though real estate investments had generated steady cash flow and returns with a low risk in the past, this reality has changed, and real estate players will need to apply more due diligence to mitigate possible risks



# 06. PLANNING AND MANAGING

## COVID-19 UNCERTAINTY

# Opportunities Amidst the Crisis

Even though this crisis has hit countries and companies in an unexpected way, it does not mean that they will not recover from this situation, and, if managed properly, even come out stronger than before

## POTENTIAL BENEFITS OF INVESTING DURING A DOWNTURN

01.

- Providing liquidity to markets in shock can be a win-win opportunity. This cash can save a company from going bankrupt and enable it to come back stronger than before.

02.

- It is easier to sell high when you have bought low. Easier said than done, but it is a fact that public-market comparables are lower than they have been in several years.

03.

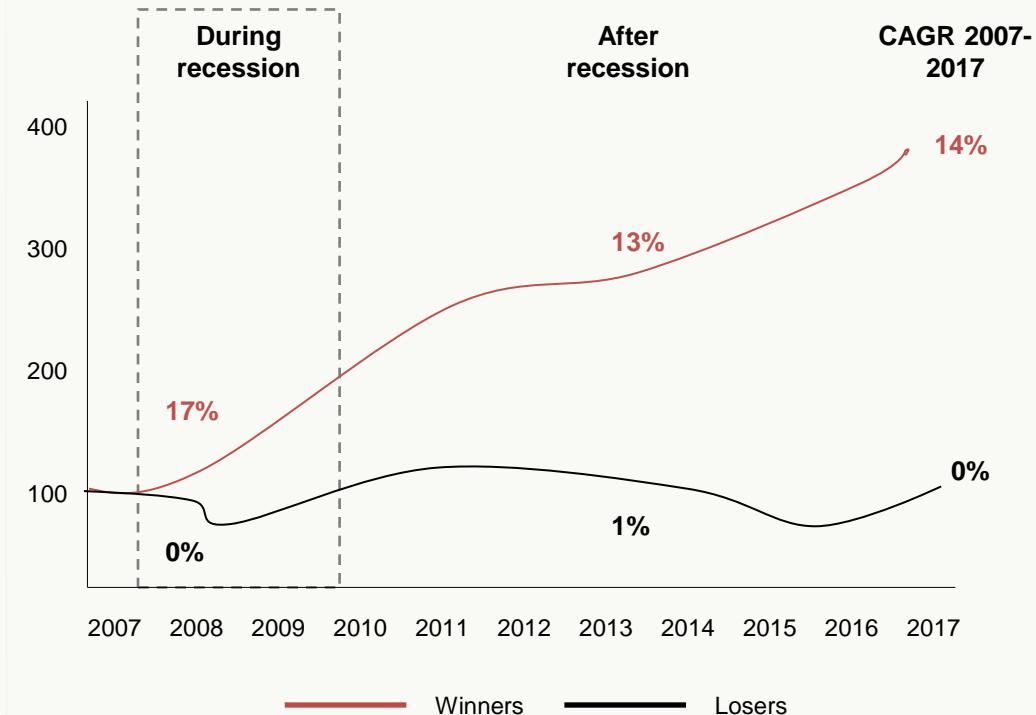
- Experience with the 2008-09 recession demonstrates that companies that look beyond the recession and accelerate profitability in the downturn end up with higher returns than those who don't

04.

- It is important to keep deploying capital despite the current tumult and uncertainty. A McKinsey analysis of 500 PE firms confirms that those which maintained their capital-deployment rate tended to outperform those that didn't.

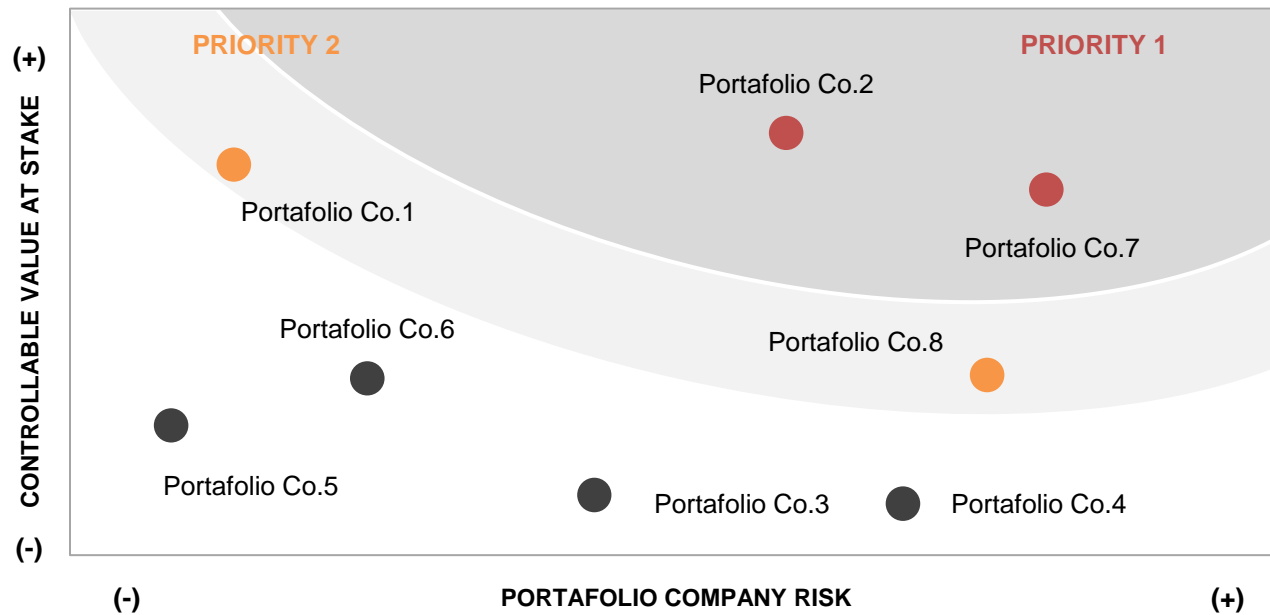
## Companies that accelerated profitability during and after the recession came out as winners

Growth in nominal EBIT (indexed 2007 = 100)



Prioritizing investments by evaluating risk and controllable value, enables the creation of an effective response strategy in order to approach to the challenges and risks faced by portfolio companies

## PRIORITIZING CURRENT PORTFOLIO COMPANIES



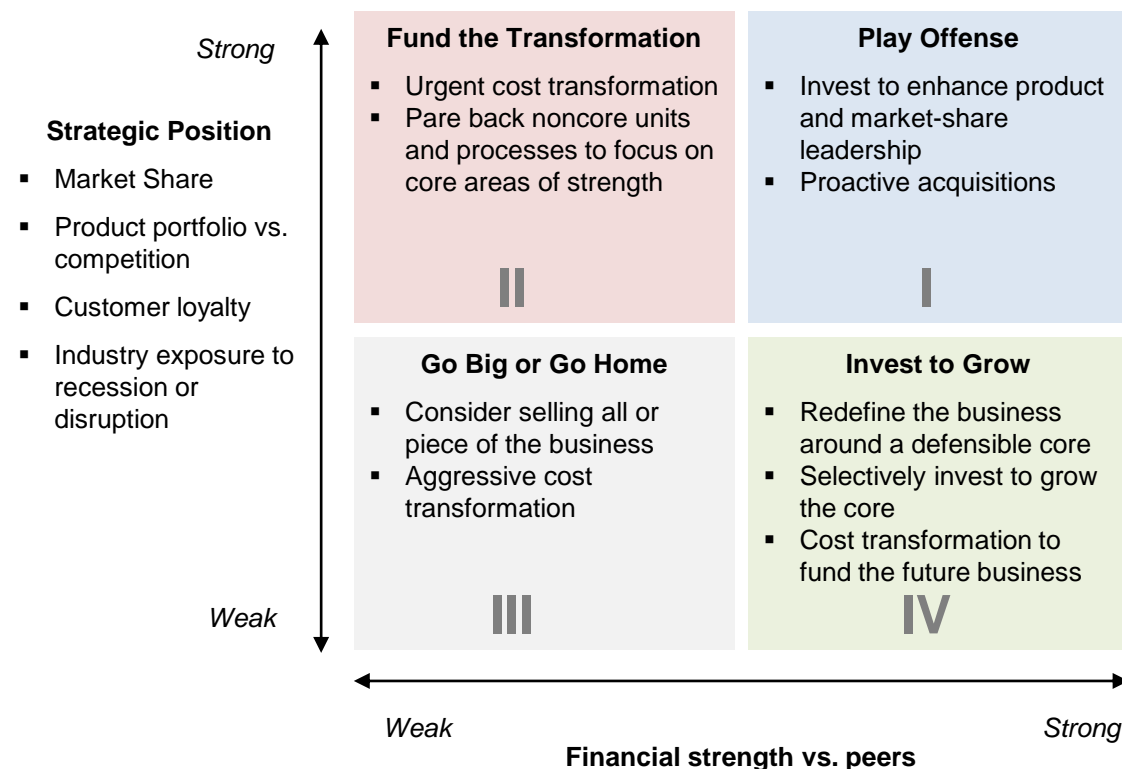
- **PRIORITY 1:** large, at risk portfolio companies with issues that can be addressed
- **PRIORITY 2:** lower-risk portfolio companies with issues that can be addressed

## KEY FACTORS:

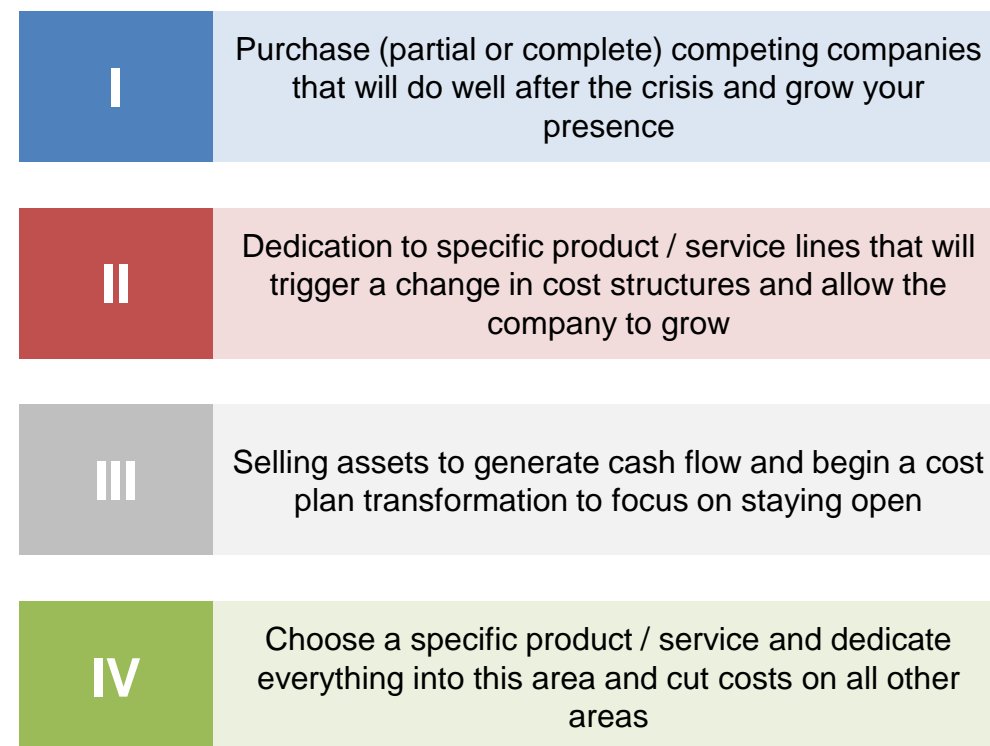
- **FACTORS FOR CONTROLLABLE VALUE AT STAKE:**
  - Ability to impact: Can the fund help mitigate the risks?
  - Share of fund: What percentage of assets under management does the portfolio company represent?
  
- **FACTORS FOR PORTAFOLIO COMPANY RISK:**
  - Individual company assessment:
    - Demand reduction exposure
    - Supply chain and operations exposure
    - Labor and talent risks
    - Financial strength

Taking advantage of a downturn must begin with a realistic assessment of a company's strategic and financial positions – these then create different strategic initiatives for investors to improve their current portfolio

## ASSESS CURRENT POSITION AND DEFINE STRATEGY



## WHAT DEPLOYING THESE STRATEGIES CAN MEAN



# Investment Assessment Criteria

Now more than ever, thorough due diligence and evaluation processes will be key to selecting winning opportunities. These include looking at qualitative factors and not just the economics of the company

## KEY ELEMENTS TO ASSESS IN AN INVESTMENT OPPORTUNITY

### 1. INDUSTRY AND MARKET

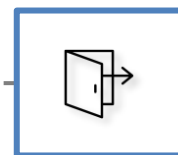
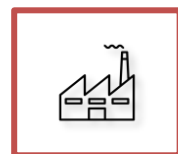
- Opportunities of total addressable market
- CAGR
- Expected market share
- Level of competition in the market
- Potential to recover after COVID-19

### 2. BUSINESS MODEL & ECONOMICS

- Clear business model and revenue strategy to thrive in the recovery
- Financial projections and level of traction
- Time to positive cash flow, break-even and revenue generation

### 3. PRODUCT OR SERVICE

- Status of MVP (minimum viable product)
- Clear customer profile and pain points
- Uniqueness of product
- Breadth and depth of intellectual property
- Easiness to sell through e-commerce channels



### 4. MANAGEMENT TEAM

- Level of direct experience within the industry
- Fulfillment of leadership functions (executive, financial, sales and marketing, and operations)
- Clear vision and mission
- Ability to weather and adapt to uncertainty

### 5. THE DEAL CHARACTERISTICS

- Investor's structure
- Shareholder makeup
- Potential IRR for investors
- Venture's follow-up on financing requirements

### 6. THE EXIT STRATEGY

- Clear exit strategy
- Time to liquidate through M&A or IPO
- Readiness to be sold

# Key Questions for Investment Opportunities

Due diligence will require new skills to understand the short- and long-term impacts to industries and companies, as well as how firms can add value and mitigate risk, in order to take advantage of investment opportunities

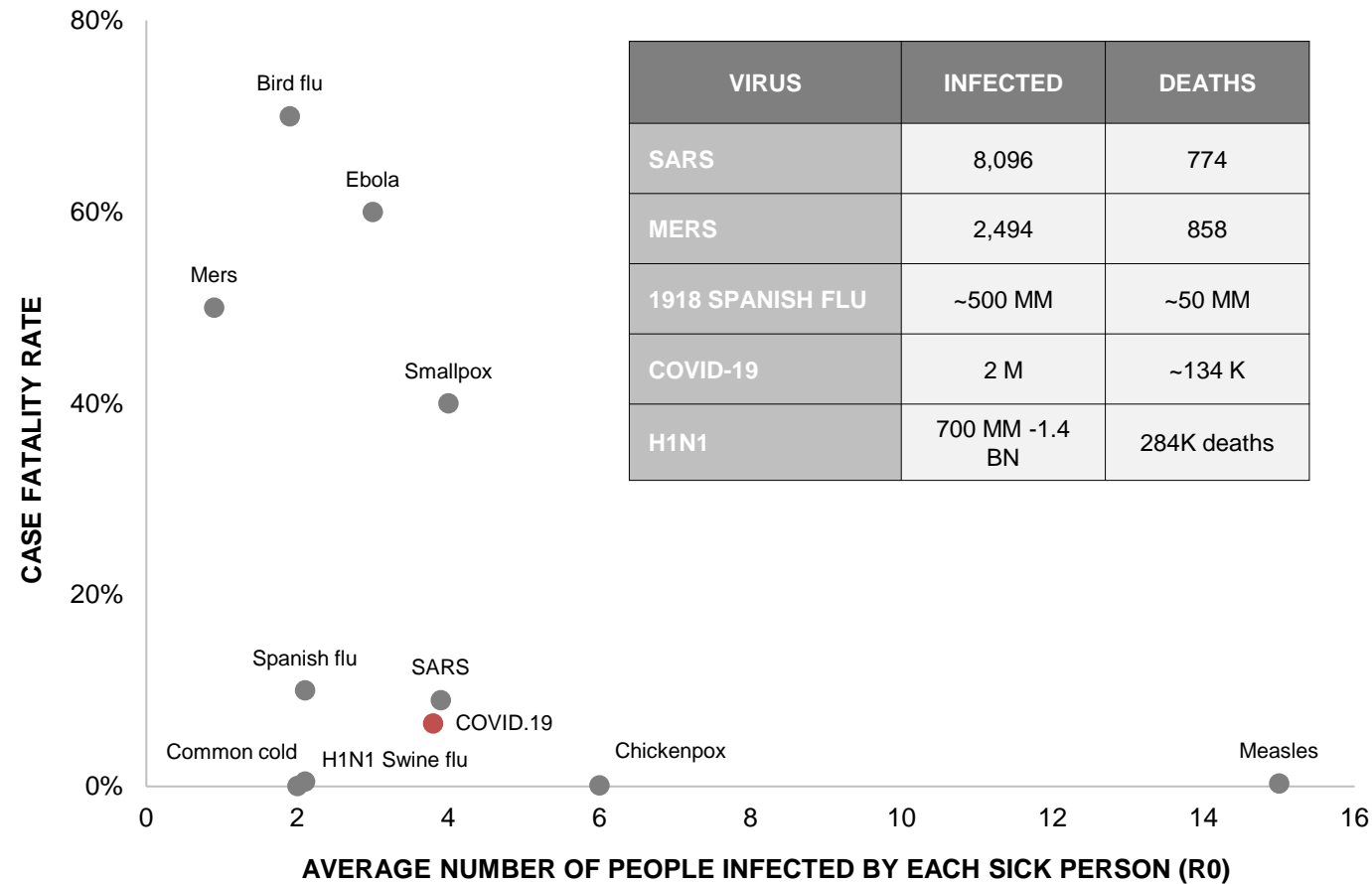
KEY QUESTIONS	RATIONALE
<ul style="list-style-type: none"><li>What will happen to industry demand after the crisis?</li></ul>	<p>After a period of artificially suppressed demand for goods and services, many industries are likely to bounce back when the immediate crisis passes, and the economy can find its footing. But the shape of the demand profile will vary from industry to industry and may be different than it was before the crisis.</p>
<ul style="list-style-type: none"><li>Is the problem COVID-19 or something else? (case by case basis)</li></ul>	<p>Healthy companies that had forged a strong market position will be in a much better position to recover and thrive when the crisis abates than companies that already had issues holding it back.</p>
<ul style="list-style-type: none"><li>How well-poised is the company to win as its industry emerges from the crisis?</li></ul>	<p>The key is to emerge from the crisis aligned with any structural changes in customer behaviors.</p>
<ul style="list-style-type: none"><li>What are the risks from near-term disruption?</li></ul>	<p>Any investment during this highly turbulent and uncertain period must account for scenarios that assess disruption risk and the company's ability to withstand it. Due diligence should assume the worst and identify specific, practical action plans.</p>
<ul style="list-style-type: none"><li>Does this investment line up with the firm's differentiated capabilities and repeatable value-creation model?</li></ul>	<p>A distressed investment may look like a bargain. But, are you confident your firm knows how to mitigate the risk by pulling the right levers to retool the company?</p>
<ul style="list-style-type: none"><li>Are we capable of conducting effective investments under high-risk / distressed environments?</li></ul>	<p>With many companies in troubled situations, decision-making will take place faster and with less data. Also, investors need to be able to know how to track bankruptcy risk and what to do (and do quickly) if things head south.</p>





# COVID-19 vs other disease outbreaks

COVID-19 is currently more deadly than the flu, but information about transmission and mortality continues to evolve



## COVID-19 FACTS:

- R-naught (R0) represents the number of cases an infected person will cause:
  - Initial estimates suggested COVID-19 R0 is between **2 and 3** (with edge of range estimates closer to 1.4 and 3.6), which means each person infects **2-3 others**; R0 for the seasonal flu is around **1.34**
- The global case fatality rate for confirmed COVID-19 cases is currently **6.53%**
- We expect case fatality rates to fluctuate as testing expands identifying more cases and as existing cases are resolved
- While the median incubation period is **5.5 days**, symptoms have been documented to occur over a longer time frame; **14 days should capture 99% of all cases**
- Ideally, asymptomatic individuals should be tested during quarantine to ensure they have not been infected

# Industry grouping



CATEGORY	INEGI	2019 SIZE <sup>1</sup>
Informational technology and communications	517 - Telecomunicaciones	\$476,915.77
	518 - Procesamiento electrónico de información, hospedaje y otros servicios relacionados	\$2,549.47
	519 - Otros servicios de información	\$1,029.86
Media & Entertainment	511 - Edición de periódicos, revistas, libros, software y otros materiales, y edición de estas publicaciones integrada con la impresión	\$17,775.10
	512 - Industria fílmica y del video, e industria del sonido	\$26,690.98
	515 - Radio y televisión	\$23,053.99
Professional Services	54 - Servicios profesionales, científicos y técnicos	\$367,796.91
	56 - Servicios de apoyo a los negocios y manejo de residuos y desechos, y servicios de remediación	\$705,724.44
Finance and insurance	52 - Servicios financieros y de seguros	\$880,071.17
Wholesale trade	43 - Comercio al por mayor	\$1,526,562.34
Corporate	55 - Corporativos	\$104,603.47
Advanced manufacturing	326 - Industria del plástico y del hule	\$78,489.47
	324 - Fabricación de productos derivados del petróleo y del carbón	\$39,572.50
	327 - Fabricación de productos a base de minerales no metálicos	\$71,274.15
	331 - Industrias metálicas básicas	\$182,395.33
	332 - Fabricación de productos metálicos	\$94,748.66
	333 - Fabricación de maquinaria y equipo	\$128,657.56
	334 - Fabricación de equipo de computación, comunicación, medición y de otros equipos, componentes y accesorios electrónicos	\$261,119.65
	335 - Fabricación de accesorios, aparatos eléctricos y equipo de generación de energía eléctrica	\$89,694.77
	336 - Fabricación de equipo de transporte	\$601,718.30
	337 - Fabricación de muebles, colchones y persianas	\$31,057.84
	339 - Otras industrias manufactureras	\$67,460.33

CATEGORY	INEGI	2019 SIZE <sup>1</sup>
Oil & gas	211 - Extracción de petróleo y gas	\$602,032.08
Utilities	221 - Generación, transmisión y distribución de energía eléctrica	\$233,113.68
	222 - Suministro de agua y suministro de gas por ductos al consumidor final	\$61,338.27
Chemicals & Pharmaceuticals	325 - Industria química	\$234,874.64
Basic goods manufacturing	311 - Industria alimentaria	\$680,843.53
	312 - Industria de las bebidas y del tabaco	\$174,853.18
	313 - Fabricación de insumos textiles y acabado de textiles	\$25,088.52
	314 - Fabricación de productos textiles, excepto prendas de vestir	\$13,277.49
	315 - Fabricación de prendas de vestir	\$57,157.53
	316 - Curtido y acabado de cuero y piel, y fabricación de productos de cuero, piel y materiales sucedáneos	\$22,230.33
	321 - Industria de la madera	\$25,385.51
	322 - Industria del papel	\$51,592.60
	323 - Impresión e industrias conexas	\$17,653.96
	Mining	212 - Minería de minerales metálicos y no metálicos, excepto petróleo y gas
213 - Servicios relacionados con la minería		\$70,804.32
Real Estate	53 - Servicios inmobiliarios y de alquiler de bienes muebles e intangibles	\$2,062,407.35
Air transportation	481 - Transporte aéreo	\$42,819.00
Other transportation	482 - Transporte por ferrocarril	\$22,411.12
	483 - Transporte por agua	\$12,046.14
Passenger transportation	485 - Transporte terrestre de pasajeros, excepto por ferrocarril	\$379,926.02
Logistics & Warehousing	484 - Autotransporte de carga	\$625,580.01
	486-488 - Transporte por ductos. Transporte turístico. Servicios relacionados con el transporte	\$88,600.14
	493 - Servicios de almacenamiento	\$13,791.09
Mail	491-492 - Servicios postales. Servicios de mensajería y paquetería	\$26,277.44
Education	61 - Servicios educativos	\$677,692.06
Retail	46 - Comercio al por menor	\$1,720,068.08
Recreation	71 - Servicios de esparcimiento culturales y deportivos, y otros servicios recreativos	\$79,228.61
Personal & local services	81 - Otros servicios excepto actividades gubernamentales	\$369,745.60
Government	93 - Actividades legislativas, gubernamentales, de impartición de justicia y de organismos internacionales y extraterritoriales	\$708,492.75
Healthcare	62 - Servicios de salud y de asistencia social	\$394,401.45
Hospitality	72 - Servicios de alojamiento temporal y de preparación de alimentos y bebidas	\$424,042.41
Construction	23 - Construcción	\$1,229,596.57
Agriculture & Hunting	11 - Agricultura, cría y explotación de animales, aprovechamiento forestal, pesca y caza	\$604,061.11