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MARCH 6-9, 2024 | ORLANDO, FL

PRODUCED BY PMA  MetaStrategy

Nearshoring in Mexico: Opportunities and Challenges

March 8, 2024



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About Plante Moran





About Plante Moran

Plante Moran is among the nation's largest certified public accounting and business advisory firms.

We provide clients with audit, tax, business consulting, and wealth management services.

Whether you have a single, specific need or require comprehensive services on a worldwide scale, we have the knowledge, experience, and resources to meet your goals.

Our professionals specialize by industry. This means our clients benefit from the expertise and advice of teams that know their specific challenges and how to combat them. We bring the full resources of the firm to every client.

1924 year founded

3,500+ total staff

360+ partners

1,300+ number of CPAs

20 offices in United States

4 global offices



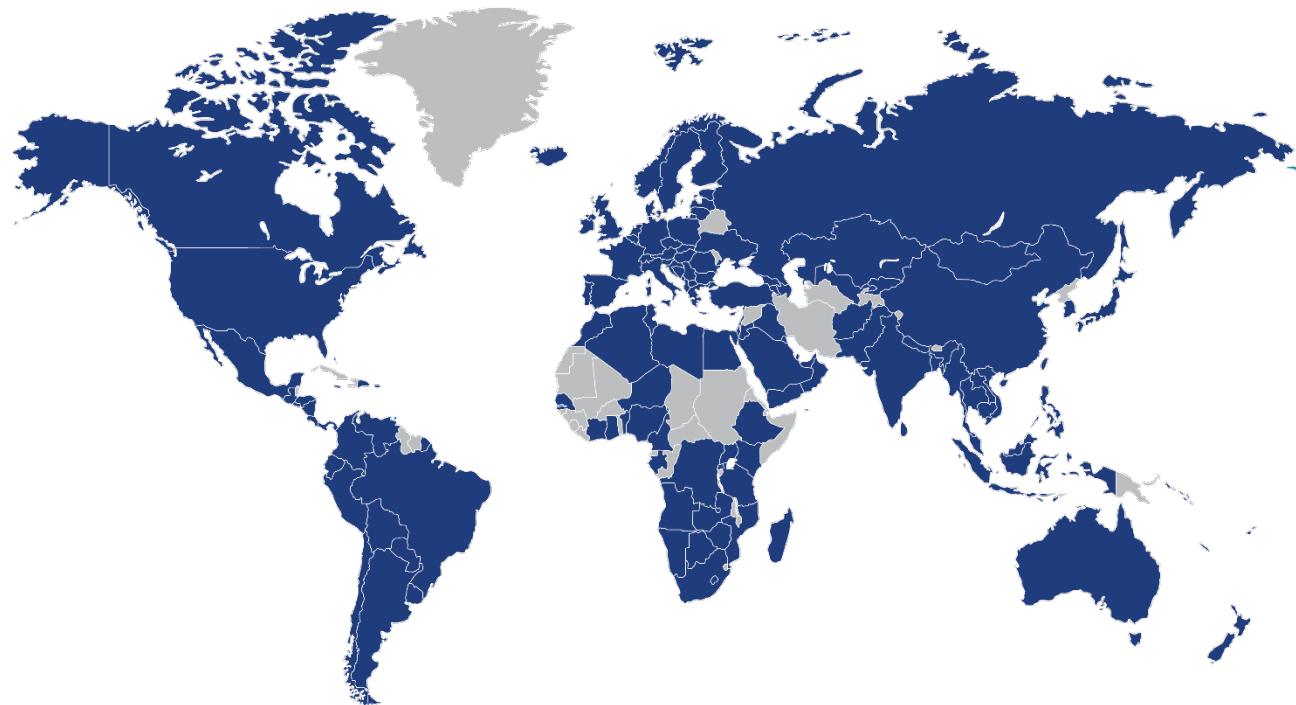
International services

Our clients do business on a global scale, and so do we.
We serve clients located in more than 100 countries.

We assemble engagement teams who deliver the ideal blend of expertise for each client, with a focus on their specific local, regional, national, and international service needs. When you want a future-focused partner, we're just a phone call away.

With professionals based in key markets around the world* (as shown on the map), we provide counsel and local expertise to our clients where they need it most.

*As a member of Praxity AISBL, the world's largest alliance of independent accounting and consulting firms.





Firm capabilities



Audit

- Financial statement audit
- Employee benefit plan audit
- International audit
- SEC surprise audit
- Single audit



Tax

- Federal tax
- State & local tax
- International tax
- Personal tax
- Mergers & acquisitions tax
- Tax controversy services
- Tax credits, incentives,
& deductions
- Transfer pricing



Consulting

- Commercial real estate advisors*
- Cost & margin intelligence
- Cybersecurity
- Data analytics
- Employee benefits consulting
- ERP consulting
- Finance & accounting solution
- Forensic accounting
- Group benefits & brokerage services
- International services & global expansion
- Investment banking*
- Real estate investment advisory
- Restructuring & transformation
- Risk management
- Senior living development consulting*
- Strategy
- Supply chain & operations
- Talent & organizational development
- Technology consulting
- Transaction advisory services
- Valuation services



Wealth Management

- Personal wealth management*
- Business transition services
- Estate planning
- Family office services
- Financial planning
- Insurance
- Investment advisory
- Personal tax planning
- Trust

* These services are provided by Plante Moran affiliates: Plante Moran Financial Advisors, P&M Corporate Finance, Plante Moran Cresa, and Plante Moran Real Estate Investment Advisors



About the speaker

Alejandro Rodriguez

Partner – Global Services

As a partner in the Global Services practice, Alejandro specializes in assisting clients to explore, establish, begin, and operate businesses in Mexico, Latin America, and any other country in the world. Since he opened Plante Moran's Monterrey, Mexico office, he has continued to build relationships with colleagues, clients, and business leaders in all of the international locations (Shanghai, China; Mumbai, India; and Tokyo, Japan) as well as many other countries that are of interest to foreign investors.

He primarily advises manufacturing and distribution companies of various sizes, from small and medium-sized enterprises working on their first international project to multinational corporations with global operations.

His experience includes advising clients on the development and validation of business cases, site selection, negotiation of government incentives, incorporation and structuring of legal entities, operational audits, customs matters for export and import, supply chain consulting, and operational assistance for startup and building cultural links.



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Nearshoring



Nearshoring background

Background

- Nearshoring is the process of moving production and supply chains closer to their main destination market.
- It's also the opposite of offshoring, a trend that was extremely popular over the last couple of decades.

What triggered the current nearshoring wave?

- The trade friction between the United States and China that began in 2018 and that eventually became a trade war.
- At the height of the trade war, the United States and China imposed tariffs on each other's products, tariffs that, for the most part, remain in place today.



What has fueled nearshoring?

What has fueled nearshoring to North America?

- The 25% tariffs the U.S. government imposed on Chinese goods
- The COVID-19 pandemic and the impact it had on the global economy
- The entry-into-force of USMCA
- Recent supply chain disruptions like the microchip shortage
- Volatile and increased shipping costs between Asia and North America
- The shortage of shipping containers and the congestion at the ports
- The geopolitical conflict between Ukraine and Russia
- The provisions for Mexico and the language of the U.S. Inflation Reduction Act



The impact of nearshoring

- Mexico is in an extremely unique position and **has captured the attention of foreign investors.**
- October 2023 marked a historic peak in U.S. imports from Mexico, reaching an unprecedented amount of \$42 billion USD, the highest monthly figure ever recorded.
- **Chinese companies**, in particular, have **started to establish manufacturing operations** in Mexico.
- To ensure the avoidance of the U.S. imposed tariffs on Chinese goods, many **companies are developing very complex tariff-engineering analyses.**
- Manufacturing foreign direct investment (FDI) **is expected to grow exponentially** as a result of nearshoring initiatives.
- These new investments in Mexico will generate opportunities for companies not currently operating in Mexico and for companies that already have a Mexican presence.



Mexico Country Profile





Mexico quick facts

- 12th largest economy in the world
- 2nd largest economy in Latin America
- 10th largest country in the world by population – 130 million
- 23rd place in the International Intellectual Property Index
- Main manufacturing industries in Mexico are:
 - Automotive
 - Electronics
 - Home Appliance
 - Aerospace
 - Food and beverage



Major economic indicators

- **Gross domestic product (GDP):** Mexico is the **12th largest economy in the world**, with a GDP of \$1.8 trillion (in 2023).
- **Inflation:** Mexico's inflation closed in 2023 with a rate of **4.23%**, which is well below the 8% we saw in 2022. But still above the central bank's target range of 3% (+/-1 percentage point).
- The annual **unemployment rate** in Mexico has averaged **between 5 and 3%** in the last decade. Peaking to almost its highest level during the pandemic.
- **Exchange rate:** MXP/USD exchange rate saw a record minimum during 2023 of **\$16.69 MXN**. During the previous five years, the exchange rate averaged between \$19.00 and \$21 MXN.



Trade

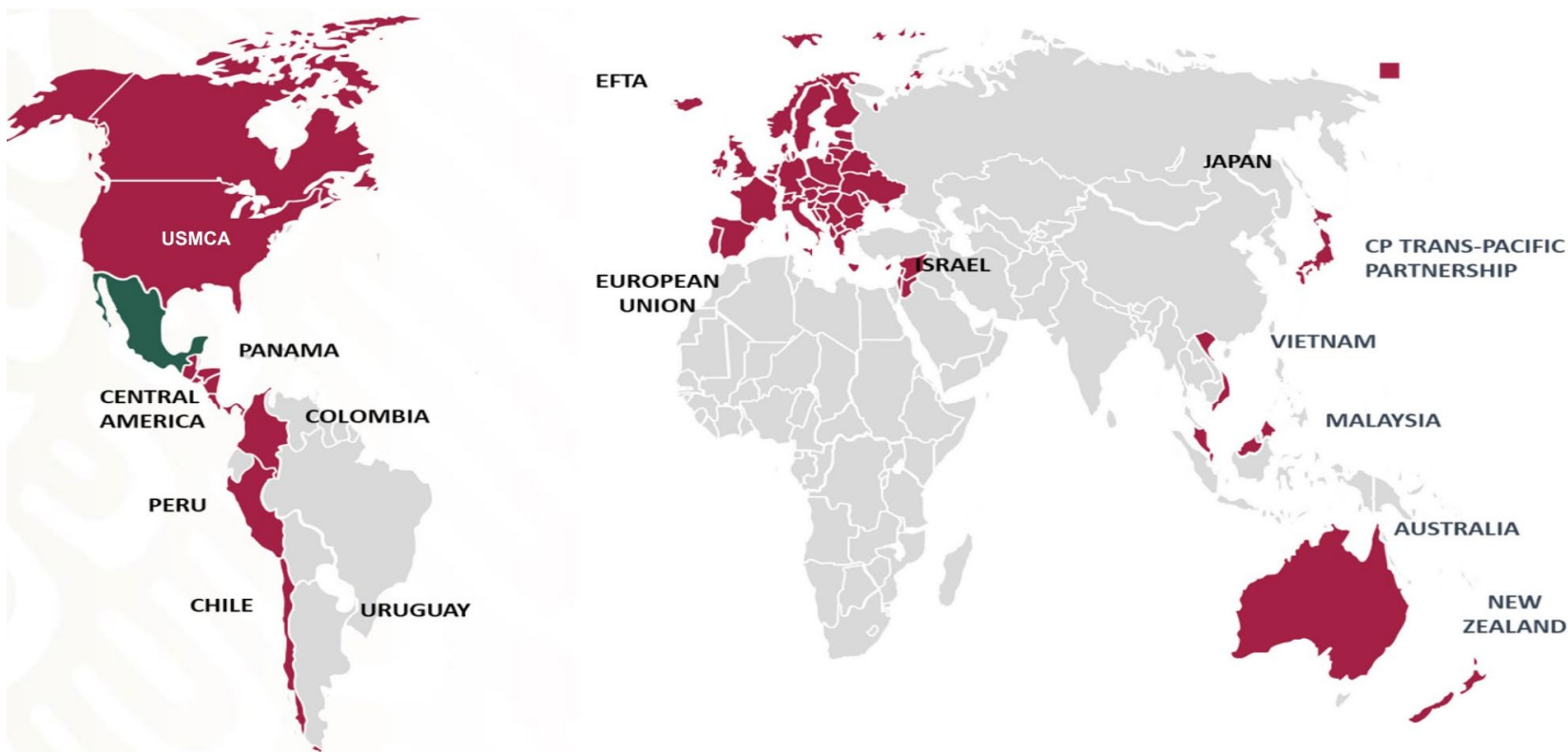
- **Trade:** Mexico's economy is heavily dependent on exports. The country is particularly reliant on trade with the United States, which is Mexico's top trading partner. Mexico's trade balance for 2023 was \$152B.
 - **2023 exports (\$475B):** Mexico's top exports are cars; motor vehicle parts & accessories; computers; delivery trucks; and crude petroleum. Exporting mostly to the United States, Canada, China, and Germany.
 - **2023 imports (\$323B):** Mexico's top imports are refined petroleum; motor vehicle parts & accessories; office machine parts; integrated circuits; and petroleum gas. Importing mostly from the United States, China, South Korea, Germany, and Japan.





Trade agreements

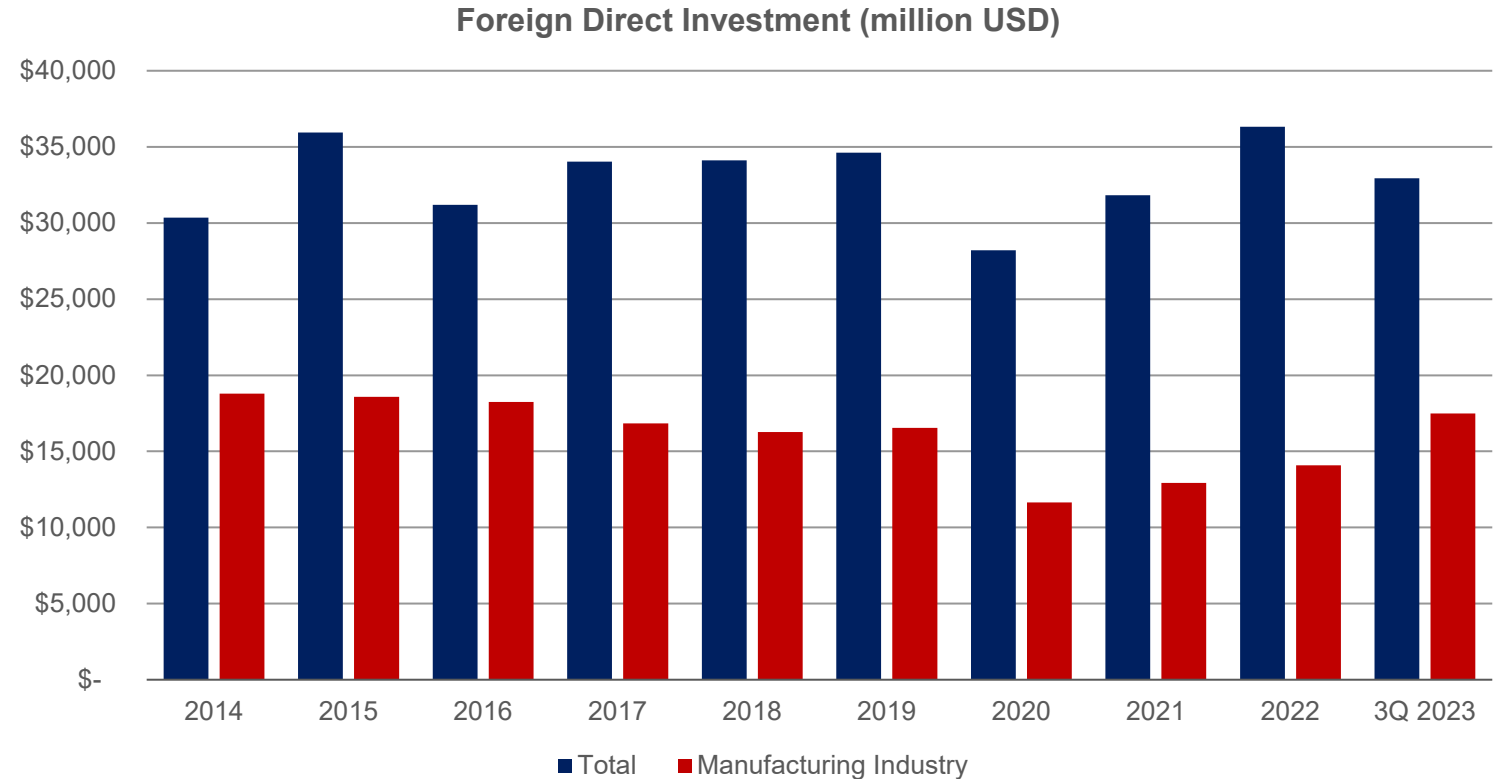
- Mexico has 14 Free Trade Agreements (FTAs) with 50 countries – including USMCA and with the European Union, the European Free Trade Area, Japan, Israel, ten countries in LATAM, and the 11-country Comprehensive and Progressive Agreement for Trans-Pacific (CPTPP).





Foreign direct investment in Mexico

- The U.S., Spain, Germany, Argentina, and Japan were the top 5 investors in Mexico in 2023
- CDMX, Nuevo Leon, Sonora, and Chihuahua were the states with the highest investments received
- FDI for 2024 is forecasted to be approximately \$40 billion USD





Industrial real estate lease rates

- The national average asking price for industrial shell buildings is \$0.55 USD per SQFT per month.
- These prices are increasing nationwide but even more so in northern industrial cities.
- The price is influenced by the active demand for industrial space and increasing construction prices.

Market	USD/SQFT/Month
Mexico (CDMX & Edo. Mex)	\$0.71
Toluca	\$0.58
Monterrey	\$0.60
Tijuana	\$0.76
Cd Juarez	\$0.61
Chihuahua	\$0.60
Queretaro	\$0.50
Matamoros	\$0.49
Reynosa	\$0.56
Guanajuato	\$0.46
San Luis Potosi	\$0.44
Saltillo	\$0.54
Guadalajara	\$0.52
Puebla y Tlaxcala	\$0.42



Salary & wage estimates

	Monterrey		Saltillo		San Luis Potosi	
	Annual USD Loaded		Annual USD Loaded		Annual USD Loaded	
Position	LOW	HIGH	LOW	HIGH	LOW	HIGH
Plant Manager	\$ 97,000.00	\$116,000.00	\$ 92,000.00	\$110,000.00	\$ 87,000.00	\$104,000.00
Quality Manager	\$ 77,000.00	\$ 97,000.00	\$ 73,000.00	\$ 92,000.00	\$ 70,000.00	\$ 87,000.00
HR Manager	\$ 58,000.00	\$ 77,000.00	\$ 55,000.00	\$ 73,000.00	\$ 52,000.00	\$ 70,000.00
Quality Engineer	\$ 58,000.00	\$ 77,000.00	\$ 55,000.00	\$ 73,000.00	\$ 52,000.00	\$ 70,000.00
Quality Technician	\$ 24,000.00	\$ 44,000.00	\$ 23,000.00	\$ 41,000.00	\$ 22,000.00	\$ 39,000.00
Automation Technician	\$ 24,000.00	\$ 44,000.00	\$ 23,000.00	\$ 41,000.00	\$ 22,000.00	\$ 39,000.00
Manufacturing Engineer	\$ 39,000.00	\$ 58,000.00	\$ 37,000.00	\$ 55,000.00	\$ 35,000.00	\$ 52,000.00
Material Handler	\$ 15,000.00	\$ 34,000.00	\$ 14,000.00	\$ 32,000.00	\$ 13,000.00	\$ 30,000.00
	Hourly USD Loaded		Hourly USD Loaded		Hourly USD Loaded	
Position	LOW	HIGH	LOW	HIGH	LOW	HIGH
Skilled Operator	\$ 4.20	\$ 6.70	\$ 4.00	\$ 6.40	\$ 3.80	\$ 6.00

*Fully loaded (in USD)
 **Benefits and social load of 45%
 ***MXN/USD exchange rate \$18



Utilities

Average utility rates in Mexico

- **Water**
 - \$4.73 - \$741 MXN/m³/month
 - \$0.26 - \$41.16 USD/m³/month
- **Electricity**
 - \$2.27 - \$2.71 MXN/kWh
 - \$0.12 - \$0.15 USD/kWh
- **Natural Gas**
 - \$42.72 - \$90.70 MXN/GJ
 - \$2.37 - \$5.32 USD/MMBtu

*MXN/USD exchange rate \$18
1 GJ = 0.947 MMBtu



Political snapshot

- Andres Manuel Lopez Obrador (AMLO) was elected as Mexico's president in the July 2018 election — his third attempt — with more than 50% of the popular vote and took office on Dec. 1, 2018.
- AMLO has focused on reducing corruption, promoting social programs for the poor, and addressing economic inequality.
- AMLO has also taken a nationalist stance on issues such as energy policy and trade, prioritizing the interests of Mexico over those of foreign companies or investors.
- AMLO faced criticism for handling the COVID-19 pandemic, which many Mexicans considered slow and ineffective.
- AMLO has also sought to maintain good relations with the United States, Mexico's largest trading partner, while advocating for greater sovereignty and self-determination for Mexico on the global stage.
- Mexico will hold presidential election on June 2, 2024 with the newly elected president taking office on October 1, 2024 from current President Andrés Manuel López Obrador (AMLO).



USMCA



USMCA: Overview

Background

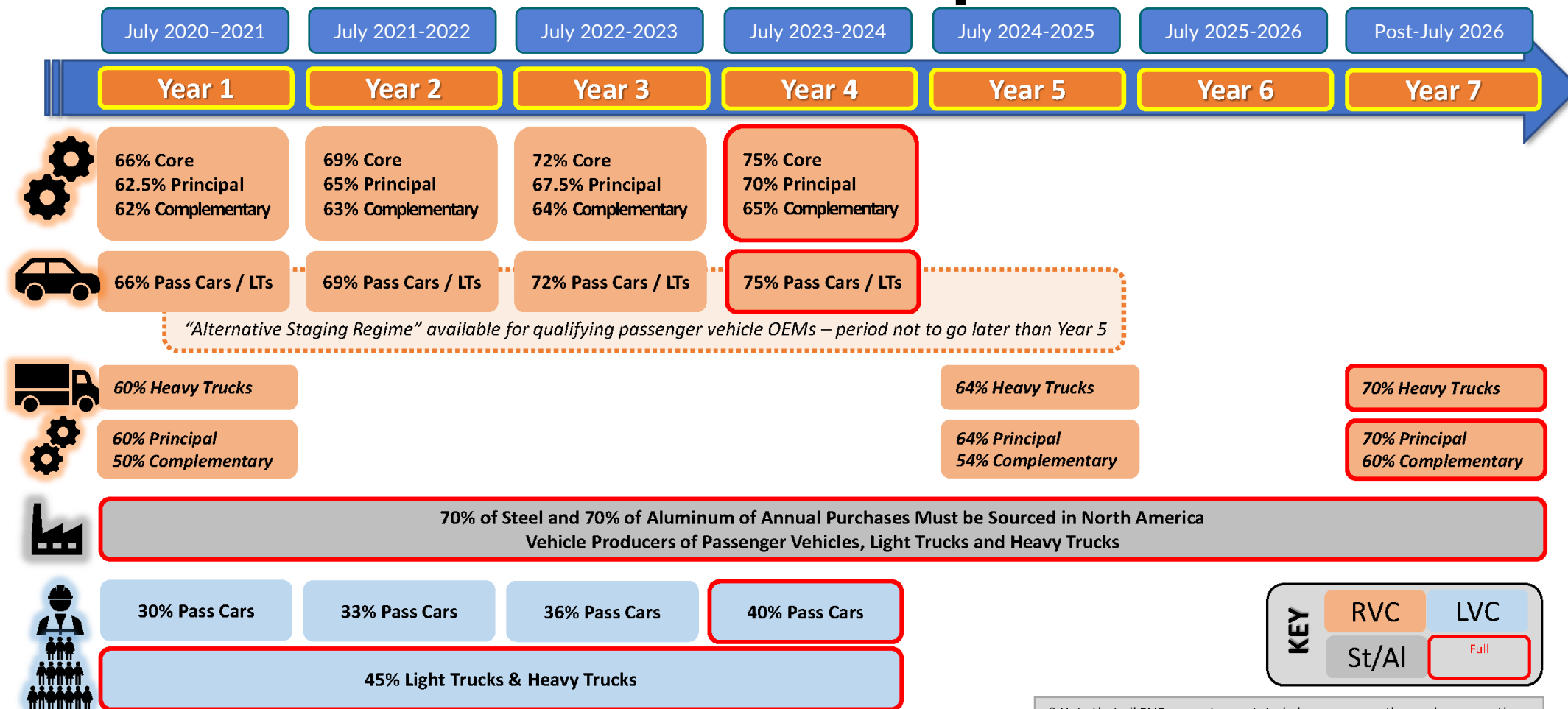
- USMCA replaced NAFTA and entered into force on July 1, 2020
- Centered on bringing back jobs from Asia to North America and rebalancing trade
- Sunset clause is 16 years – will be in place at least through July 2036
- Provides certainty to North American and outside investors
- Helps North America compete globally as a region vs. other regions

NAFTA vs. USMCA: What are the main differences?

- Compliance
- Increased regional content
- Documentation



USMCA: Automotive ROO phase-in timeline



USMCA Reference for Members (updated May 2020)



* Note that all RVC percentages stated above assumes the producer uses the net cost method. If transaction value is used, the RVC percentages are higher.



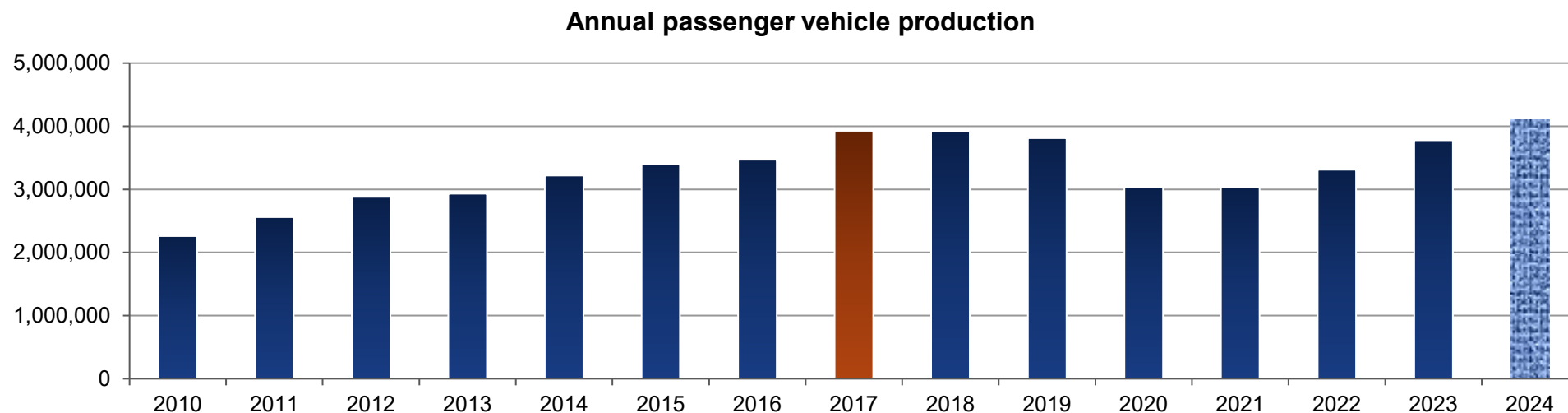
Automotive Industry





Automotive industry in Mexico

- Auto industry represents **3.5%** of the country's GDP and **20%+** of the manufacturing GDP.
- Employs more than **960,000** people, of which **100,000** are directly related to OEMs, and the remaining **860,000** are from automotive suppliers.
- Mexico is the **7th** largest passenger vehicle manufacturer in the world, producing **3 million** vehicles per year.
- Close to **90%** vehicles produced in Mexico are exported, and **75%** are exported to the United States.
- Mexico's passenger vehicle production hit historic high in 2017 with **3.9 million** vehicles produced.
- Mexico produced **3.78 million** cars and light trucks in 2023, a 14% increase over the previous year
 - Full-year auto exports rose 15% to 3.3 million units, and domestic new-car sales increased 24% to 1.36 million units.



*The data for 2024 is a forecast provided by the Mexican Association of the Automotive Industry.



Mexico OEM map





Tesla Gigafactory Mexico

- Tesla's plans to build its next Gigafactory in Mexico were announced during Tesla Investor Day on March 1, 2023.
- The plant will be located outside Monterrey, Mexico, and at full capacity, will employ more than 5,000 people.
- Tesla's investment will be more than \$5 billion for a 645-acre factory or more than 28 million SQF, which will make it "the biggest electric vehicle plant in the world."
- The latest report to investors informed that the plans for Mexico are still moving forward but at a slower pace than previously anticipated.





BYD plans for an EV plant in Mexico

- BYD has initiated feasibility studies for a Mexican assembly plant and is currently negotiating with officials over terms, including the factory's location.
- This facility was initially thought to target exports to the U.S. BYD has already clarified their initial objective is to serve the Mexican and Brazilian markets.
- While BYD's sales are concentrated in China, it aims to expand globally and is building new plants overseas in addition to boosting Chinese exports.



AUTOMOBILES

Tesla rival BYD weighs EV plant in Mexico

Chinese automaker's regional chief reveals plans with eye on U.S. market



BYD surpassed Tesla in global electric vehicle sales in the fourth quarter last year. © Reuters

TOMOHIRO ICHIHARA, Nikkei staff writer
February 14, 2024 02:34 JST

MEXICO CITY -- Top Chinese electric vehicle maker BYD is considering setting up a plant in Mexico, the head of the company's local subsidiary has told Nikkei, as the automaker seeks to establish an export hub to the U.S.



Strengths, challenges and best practices





Mexico's major strengths

- **Location:** Mexico's unique geographical location is strategic to serve North, Central, and South America, Europe, and Asia.
- **Trade agreements:** Mexico has trade agreements with 50 countries, more than any other country in the world.
- **Competitive labor rates:** On average, Mexico's manufacturing labor rates are lower than those in China.
- **Young and skilled workforce:** Mexico's median age is 29, and 57% of its population is 34 or younger.
- **Logistics:** Mexico has good and reliable transportation and logistics networks, which allow for easy and efficient movement of goods.
- **Business environment:** Mexico has made significant improvements in its business environment over the past decade thanks to a series of reforms and initiatives.



Mexico's major challenges

- **Labor:** Companies are experiencing higher-than-normal turnover in some of Mexico's industrial regions due to increased investment.
- **Real estate:** As new investments continue to arrive in Mexico, the availability of land and industrial buildings will decrease, and cost and lease rates will increase.
- **Utilities:** Energy is more expensive in Mexico, and large consumers must ensure enough power is available at their desired locations.
- **Security:** Some cities and regions — mainly on the U.S.-Mexico border, are experiencing higher levels of drug-related crime and violence.
- **Political:** New and evolving laws and government policies can be challenging for companies unfamiliar with Mexico.
- **Exchange rate:** the “super” peso has recently appreciated versus the USD, leading to a 17% increase in some of the costs for foreign-invested companies operating in Mexico



Mexico best practices

- **Salaries & wages:** Carry out constant benchmarking on salaries/wages and benefits within your area and city to ensure that you are competitive in the market.
- **Culture:** Ensure you have a strong company culture that makes your employees feel welcomed, heard, and supported.
- **Real estate:** Review your existing lease agreements to confirm that there are no unexpected or unanticipated changes in lease periods and/or costs.
- **Energy:** Make sure that the area where you operate has the necessary and reliable electrical infrastructure for current needs and in anticipation of future growth.
- **Relationships:** Build strong relationships with local suppliers, businesses, associations, and chambers to be aware of new business opportunities.
- **Diversify:** Take advantage of Mexico's diverse and growing industry ecosystem, including automotive, home appliances, aerospace, construction, food & beverages, among others.



Recent approved and proposed reforms





Recent approved reforms

Ultimate beneficial owner (UBO):

- Similar to what has recently been implemented in the U.S., companies in Mexico need to compile and prepare documentation regarding their UBO
- In Mexico, this information does not have to be submitted. It just has to be prepared in case the government requires it.

Collective bargaining agreements:

- Obligation to legitimize collective bargaining agreements to ensure that workers are aware of their collective bargaining agreement and are represented by their union(s).
- Non-legitimized collective bargaining agreements will cease to have legal effect, and the union or unions that obtain the minimum required representation of the company's employees (30%) may force the company to enter into a new collective bargaining agreement.



Recent approved reforms

Outsourcing / Subcontracting:

- Subcontracting structures, including insourcing and outsourcing, are mostly prohibited.
- Work labeled as specialized can still be outsourced, provided that several requirements are met.

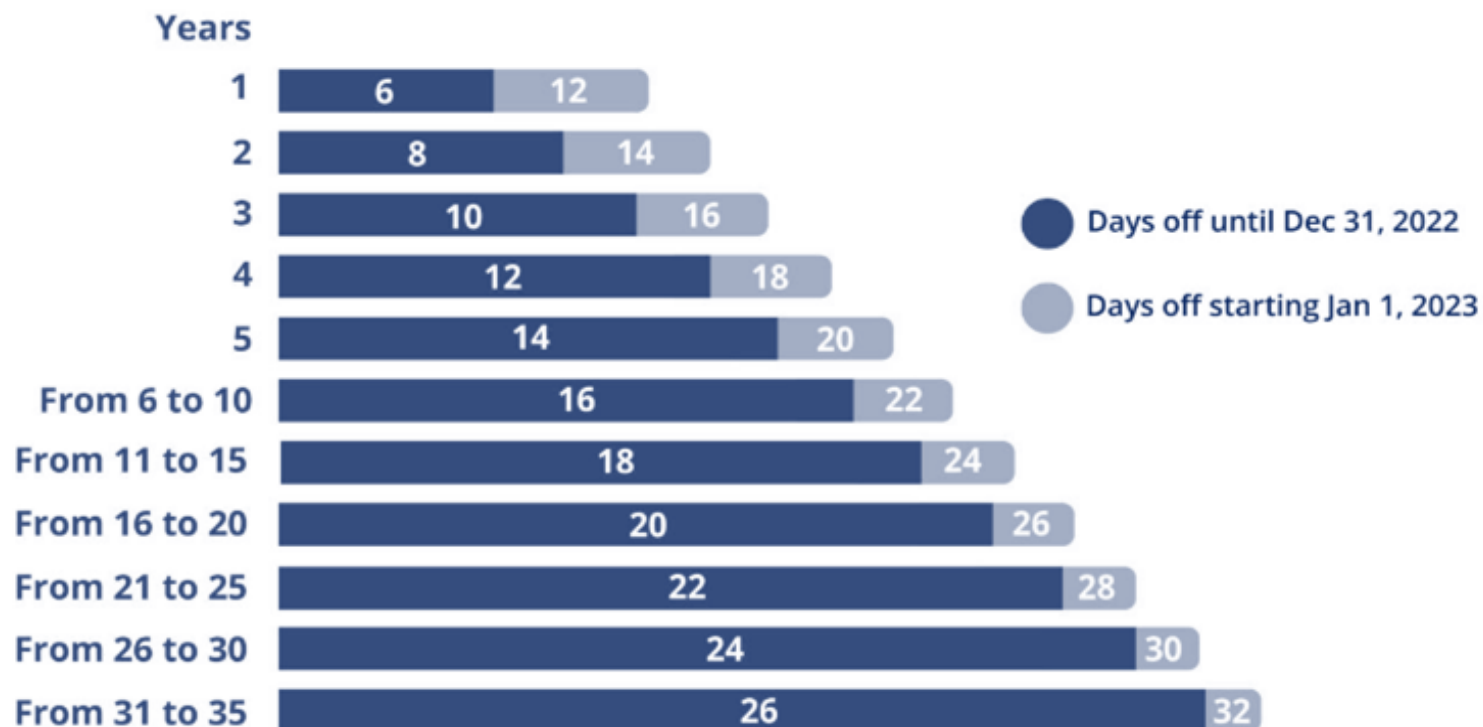
Employee-profit sharing (“PTU”):

- Mexican entities are required to pay a minimum of 10% of profits in employee profit-sharing each year.
- As a result of a recent Mexican labor reform PTU is limited to the greater of two proposed methods: three months of the employee’s salary, or the average profit-sharing paid over the last three years.



Recent approved reforms

Increase in paid vacations:



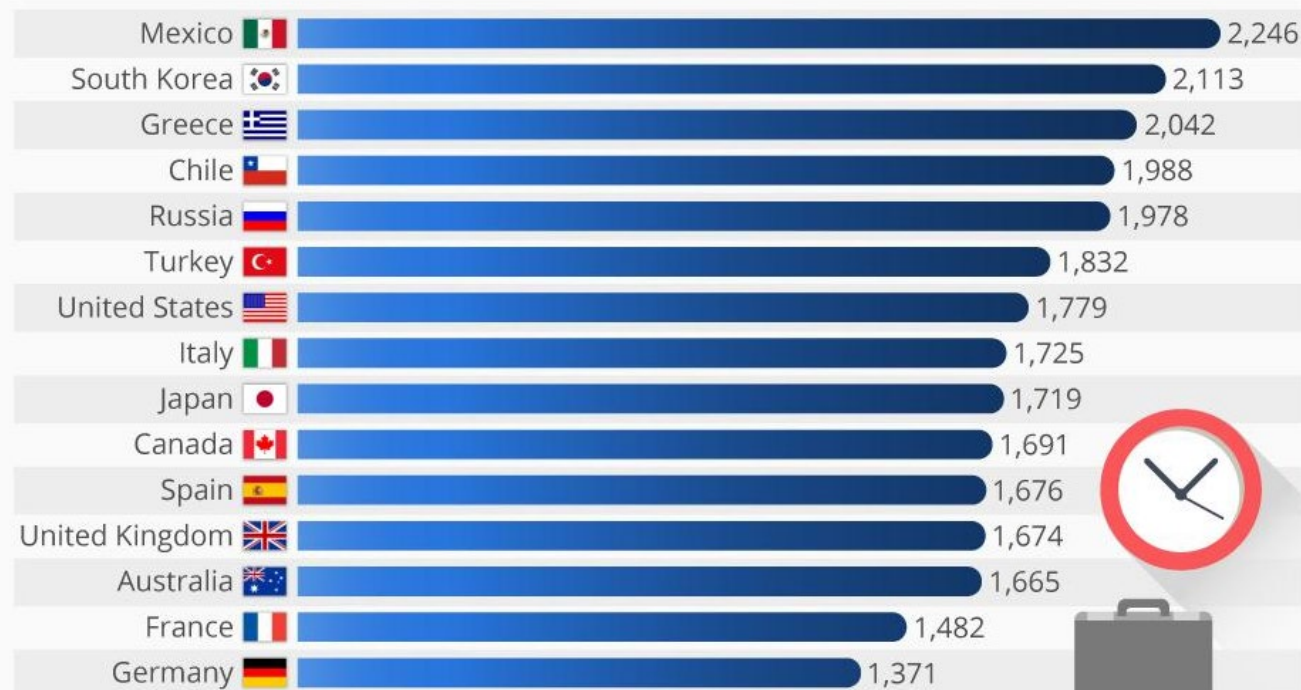


Proposed reforms

Weekly work hours:

- The Federal Labor Law establishes a working week in Mexico of 48 hours spread over six days with a day of rest.
- In 2023, an amendment to the Labor Law was proposed to reduce the work week from 48 to 40 hours.
- The bill is pending approval, but conversations are set to resume in 2024.

Average annual hours worked per worker in 2015 (selected countries)





Proposed reforms

Christmas bonus (*Aguinaldo*):

- A proposal has been submitted to increase the Christmas bonus (Aguinaldo) from 15 days per year worked to 30 days per year worked.
- This proposal is still being discussed and has not yet been fully approved by the Mexican legislative bodies.



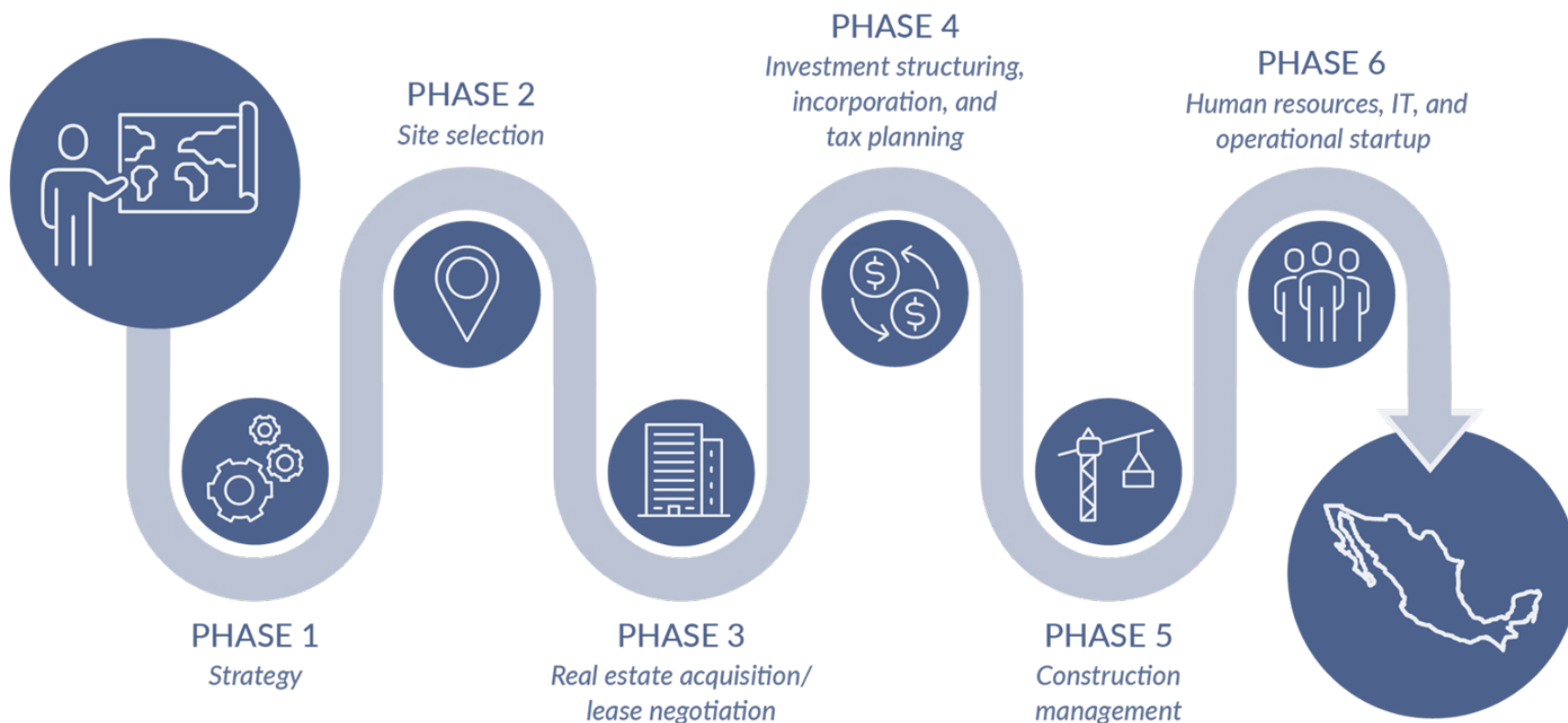
Mexico expansion: methodology and approach





Mexico expansion: Our proven roadmap

Over the last 25 years, we have supported hundreds of companies to establish operations in Mexico. As a result, we've developed a proven roadmap:





Mexico expansion: Approach & methodology



Phase 1: Strategy

- Whiteboard strategy session
- Business case development & validation
- Financial modeling



Phase 2: Site selection

- Labor analysis
- Logistical analysis
- Guided site visits
- Government incentives negotiations



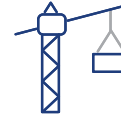
Phase 3: Real estate acquisition/lease negotiation

- Real estate representation
- Land purchase/lease negotiations
- Permit & licensing support



Phase 4: Investment structuring, incorporation, & tax planning

- Investment structuring & tax planning
- Legal entity structuring & incorporation
- Foreign trade licenses filing



Phase 5: Construction management

- Construction firm selection process
- Environmental permits & license filing
- Construction management & supervision



Phase 6: Human resources, IT, & operational startup

- Top talent recruitment support
- Tax compliance, bookkeeping, & payroll
- Equipment move & installation
- Vendor selection & procurement





Thank You!
¡Gracias!



Q&A Session

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