MERGERS, SALES OR DILUTION: MEXICAN MAYOR ENTERPRISES FACING THE 1995 FINANCIAL CRISIS

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1. Introduction.

Several large Mexican economic groups were taken by surprise by the peso's devaluation in December, 1994 when they had high debt levels both, in pesos and dollars. Local banks had also taken important positions in foreign currency, increasing their short-term debt mainly with foreign brokers.

The abrupt peso's devaluation interrupted the economic expectations created by the recently created NAFTA, the stabilization reached by rate interests and inflation. The 100% nominal devaluation perpetrated in a few days, as well as local interest rates increase during the following months were elements that determined large enterprises and financial groups, created during the nineties, to change.

Suddenly, Mexico faced the closing of international financial markets. This was precipitated by : 1) reserves inexistence; 2) high short-term indebtment in the hands of foreign investors (Cetes, Tesobonos, Deposit Titles, etc); 3) foreign investors virtual loss within local stock markets; 4) conflicts at the core of the american government that impeded to act with the readiness required to stop the speculative wave.

The enterprises payment capacity deteriorated fast and this placed them in over-indebtedness conditions. The domestic currency financial contraction and the re-financing stoppage within voluntary capital markets, conducted to several of these enterprises to the verge of payments stoppage. In other cases, they were in an open disadvantage to restructurate their liabilities and some others are in an open stoppage.

Voluntary refinancing stoppage that capital markets were realizing with large enterprises foreign liabilities and with domestic banks, the rates of interest increase over such liabilities that were present during 1994, and the enterprises and banks balances disadjustments provoked by the same devaluation, obliged to assume significant exchange loss.

The aim of this paper is to point out the Mexican large enterprises over-indebtment level, the diversity of their characteristics, and the different strategies adopted to find an exit. Some domestic enterprises have even fallen into payment stoppage, some have had to dissolve their holders participation to exchange debt for stock, some others are going through a large restructuration process, and some others have reached new refinancing at the international capital markets.

2. The Largest Enterprises Over-indebtment.

During the first semester of 1996, the 132 most important enterprises total liabilities quoting at the stock exchange reached 53 billion dollars. Foreign debt balance increased to 36.2 billion dollars, 42% of it is short-term debt. This group liabilities stipulated in domestic currency increased to 17.2 billion dollars. The twelve most indebted enterprises absorb 53.4 % . They are: Cemex, Vitro, Telmex, Sidek-Situr, Alfa, Televisa, GCarso, AHMSA, ICA, Visa, La Moderna y Femsa. (Excelsior, August, 19th).

As for larger enterprises, 68% of their debt is stipulated in foreign currency, whereas only 25% of their sales are performed abroad. That is why, the exchange modifications produce, more sharply for some of enterprises, unsustainable passive positions. At the beginning of 1996, their total liabilities represented 89% of their share capital, when in 1992 they represented 69% (Mexican Stock Exchange data).

Among the enterprises with liabilities higher levels are Cemex (4.7 billion dollars), Sidek-Situr (3.9), Telmex (3.2), Vitro (2.8), Alfa (2.5) GCarso (2.0), Televisa (2.0) Ahmsa (1.7), Visa (1.5), ICA (1.5), Femsa (1.3), La Moderna (1.2). There are a lot more Mexican enterprises that have allocated stock at international markets, such as Synkro, Posadas, Tribasa, GMD, Bufete Industrial, etc. During the last months some of them have found funds to refinance at the international market. Although with very high over-rates, they have allocated new issues (500 base points or more).

Despite the recent assets revaluation and the debt's restructuration process, at the beginning of 1996 (first semester) there are several enterprises that belong to the most important group that quote in the stock market that have a total liabilities- assets relation (leverage relation) higher than 60%. Among others, the most important are Vitro (62), Televisa (60), Sidek (86), Ahmsa (61), Situr (89), La Moderna (64), GMD (66), TMM (63), San Luis (80), Dina (75), CMA (1.45), Simec (63), Aeromex (74), Posadas (66), GSyR (1.14), Realtur (75), Bufete (65), Ceramic (72).

Nevertheless, it is difficult for domestic and foreign creditors to stablish objective evaluation parameters of the most indebted group's solvency, to the extent that there are problems within assets valuation and revaluation criteria. Therefore it can be considered that the leverage relation, in some cases, can be even higher.

It is estimated that interests to be paid according to their foreign debt represented about 6% of their total sales in 1995 to which it is added 10% in accrued interest for domestic debt, which sums up to 16% of total net sales assigned to interest payments for their total liabilities, when in 1992 such amount was 10.7%. Besides, in 1995 they faced 41% of their short-term foreign currency liabilities refinancing.

So, their market's refinancing processes have been present under higher over rate schedules, while other enterprises have had to restructurate. The establishment of the enterprises payment capacity has been difficult according to the amounts contracted in foreign currency, to the extent that many enterprises do not have enough foreign currency cash flow to cover maturities. New exchange rate movements can even weaken the enterprises passive position, reducing their action margins on the side of domestic financial authorities, due to the limited international reserves availability of the country.

To face maturities, the largest enterprises have started several restructuration programs that have led them to: personnel cut off, selling part of their assets, to capitalize part of their debt, and to issue subordinated obligations.

Sidek-Situr, owing total liabilities for 3.9 billion dollars, has been one of the most difficult cases, to the extent that it is under stoppage since February, 1995 in a commercial paper issue for 19.5 million dollars at the international markets, and in February, 1966 it again didn't pay Eurobons for 20 million dollars. The negotiation process with domestic banks took a year to reach the signature of an agreement memorandum. Nevertheless, negotiations with other foreign creditors have not come to an end. These negotiations may lead to the stock's package dissolution or to new capitals injection.

Tribasa, a group mostly involved in highways construction with a total liabilities debt for 840 million dollars, has also faced strong obstacles to restructurate liabilities. During negotiations the group has exchanged debt for stock, and it has issued debt to be converted into stock, but the point is to find out if it dilutes the main proprietors stocks value. To be able to obtain this, it is being considered if some assets and part of the debt can be transferred to a fiduciary fund supported by the government.

Vitro, the third national glass producer, which has total liabilities for 2.8 billion dollars, is selling Anchor Glass, his subsidiary in the United States recently acquired in 1989, estimated in 410 million dollars. Anchor Glass debt amounts 580 million dollars. Nevertheless, such subsidiary represented for the group 33% of its sales in 1995. (Excelsior, August, 16, 1996). Besides, this company is also restructuring administratively and is selling other assets that are not generating enough cash flows to face liabilities. Also, Serfin's capitalization requirements where Vitro participated with stock amounting to 20%, pushed to the dissolution of a part of the assets participation to an amount of 11.46%.

La Moderna (1.2 billion dollars debt) is going through a different situation. In 1994 it sought to do new business in the perishable agricultural products and seeds packing. To be able to finance purchases at the end of 1994, this enterprise obtained a bridge loan from several Mexican and foreign banks for 345 million dollars and with devaluation it delayed its debt's refinancing. In November, 1995 it received a non-guaranteed syndicated credit (the first a private enterprise receives since 1982) for 139 million dollars, and in January, 1996 it allocated 125 million dollars at the euromarket to 3 years to refinance its short-term debt. 45% of its sales are performed in dollars and it owns subsidiaries abroad. Its income in 1995 amounted 1,210 million dollars. During the third trimester in 1996, it will conclude US DNA Plant Technology Co.'s acquisition, a leader enterprise in biotechnology, and it will also buy an important stock amount in Royal van Namen, a Dutch agricultural products exporter, which will allow it to access to the fruits and vegetables European market. (Euromoney, from El Financiero, July, 16, 1996).

Liabilities restructuration has been very difficult for several enterprises due to the great creditors dispersion both, national and foreign, and due to the urgency to stop the banking crisis. So that it was created the Unidad Coordinadora para el Acuerdo Bancario Empresarial (UCABE) that has been working to establish agreements among enterprises and creditors, including the restructuring understanding letters to negotiate debts. All this to prevent payment stoppage and bankruptcies. Nevertheless, middle size and small enterprises have not been able to prevent bankruptcy.

3. Commercial Banks Over Indebtedness.

Besides the voluntary refinancing suspension at the international market immediately after December's devaluation, local banks also faced liquidity problems at the market and in their own foreign indebtment level.

Mexican banks foreign debt was estimated, in December, 1995, in 30 billion dollars, from which 16 billion dollars are short-term debt. Such foreign currency liabilities represent almost 24% of the banks total assets, or 40% of the current total portfolio.

The Mexican financial crisis includes not only over-indebtedness, mainly foreign indebtedness, of large enterprises and domestic banks, as it happened during the last debt crisis in 1982, but it is also present in the domestic currency over-indebtedness of middle size and small enterprises and consumers.

During 1993 and 1994 when the economic activity lost its dynamism, a growing number of bank clients, middle and small enterprises and consumers fell into insolvency and required debt's refinancing and interests capitalization. During the first semester of 1994, the banks over-due loans reached 10% of the total portfolio. Such portfolio was the preoccupation of financial authorities just before the financial crisis burst and several programs were devised to reach the restructuration of some insoluble liabilities. These were very limited to the extent that neither the economy could recuperate nor interest rates lower substantially. At the end of 1995, the Mexican banks over-due loan reached 20% of their total portfolio and 8.6% of GDP.

Under interest rates conditions and the banks margins that prevailed during the first months of 1996, it is estimated that commercial banks loans will yield during this year interests equal to 17% of GDP in 1996.

To this amount it adds interest payments for the federal government domestic debt, which is estimated to be 140 billion pesos, which at the average rate should pay at least about 50 billion pesos in 1996, which means 2.3% of GDP this year.

It is estimated that for 1996 the foreign debt will yield interests amounting 14 billion dollars which represent 5.5% of GDP estimated for the current year.

To sum up, it can be estimated that considering foreign debt interests to be paid during 1996 (5.5%), the total banking credit portfolio interests (17%) and domestic public debt interests (2.3%), the interests amount to be paid represent 24.8% of GDP. This interest payments amount points out the existence of an unbearable financial burden for the Mexican economy. In the face of domestic currency over-indebtedness and of the banks over-due loans fast growth, financial authorities measures have been aimed at trying to stabilize bank balances and to capitalize them, as well as to support large enterprises to avoid payments stoppage. This has jeopardized government resources above 240 billion pesos (30 billion dollars) up to now. Nevertheless, in spite of the fact that financial rescue for large enterprises and banks has been very high, it has not been enough to contribute to several middle, small and micro enterprises or consumers solvency recuperation.

High interest rates and the last months deep recession put most enterprises in an over-indebtedness position. That is, their financing costs have exceeded their profits generation, which makes them transfer to their creditors even part of their own patrimony. This also provokes the extension of the economic recession effects and unemployment, and enterprises and homes bankruptcy.

While active interest rates are above growth and the economy's productivity, interests paid are enough to transfer to creditors (either national or foreign) not only yields but also part of their own patrimony.

4. Enterprises Restructuration.

In spite of high foreign investment flows at money and capital markets in Mexico during 1990-1993, gross fixed investment was stacked, domestic savings rates diminished, enterprises, the government, banks and consumers fell into over-indebtedness, while the same foreign debts increased.

In the case of banks, over-indebtedness has implied to establish a capital strengthening program and a portfolio purchase charged to public resources. By December, 1996, the rescue package was estimated in 240 billion pesos, which represents more than 10% of GDP for 1996, or 60% of the public budget estimated for 1997.

Besides, new banks purchasing and sales operations have continued to be held, and one of the dominant signs of these operations has been foreign capitals participation. Bank Bilbao Vizcaya bought Mercantil-Probursa, Banca Cremi and Banco Union, which made it to be in a few months the fourth most important bank in the country. Central Hispanoamericano and Comercial Portugues participate in Bital; Bank of Nueva Escocia participate in Inverlat; and Bank of Montreal participate in Bancomer. Other operations can be expected soon, but the tendency of the process is to modify quickly positions within the largest bank markets in the country. Banks acquired or merged recently are having greater weight within the payment system in all the financing system.

To be able to operate under financing liberalization conditions, domestic banks must not only have funds in domestic currency, but also in foreign currency. Their over-indebtedness process derives mainly from the fact that they haven't been able to penetrate the american market as it was thought to be possible when NAFTA was agreed. That is why they rapidly widened their interbanking credit lines with american banks, to the extent that exchange stability allowed them to contract credit in dollars to interests lower to the current ones within the Mexican market, and to loan in pesos with high rates that prevailed during those years. That is why also Mexican banks accumulated foreign debt, mainly short-term debt that came to be higher than 40 billion dollars at the crisis burst. When devaluation precipitated such dollar-credit funding operations completely unbalanced banking balances in pesos obliging to an accelerated brokers capitalization. It can be stated that for local banks to operate it is required constant and growing foreign currency flows, which eventually conducts to a fast association (under different modalities) with foreign institutions.

Industrial and services enterprises and large corporations have also have to sell their assets or part of their capital, as in the case of soft drinks, beer and food industries. The tourism sector has restructured radically, some having serious over-due loan problems, such as Sidek-Situr. Several assets changes have been performed within the radio, television and telephone companies, where corporations such as Televisa and Carso have participated. Large enterprises leverage -taken as the relation total liabilities between share capital- grew a lot during 1991-94, going from 49 to 83 per cent. That is why the liabilities re-negotiation and assets transference to cover debt is a file to which important corporations such as Sidek, Marti, Synkro, Zapata and Canada have appealed to. Among firms that changed proprietors are Compañia Mexicana de Aviacion y Aerovias (AeroMexico). Presently these two firms keep several operative and financial links and both have had to renegotiate their debt.

Conditions under which financial markets operated during the last years, which implied high domestic interest rates as a mechanism to attract foreign capitals, were enough for the largest enterprises to seek foreign resources. Nevertheless, their capacity to generate foreign currency is not enough to face foreign maturities, and in some cases it is not even enough to pay interests. So the enterprises recent debt issues have seen the grades given by specialized agencies to diminish and only in cases where such issues have guaranty funds from the International Financing Corporation have reached grades above the ones obtained from sovereign issues.

In June, 1996, Moody's reduced the grade given to Cementos Mexicanos and Telmex long-term debt. The firm argued that in spite of diversification outside Mexico, operations realized in the country where the enterprises were located represented about half of cash flows, which constitutes a problem that affects the firm's solvency. All this made Cemex to carry out its debt's refinancing plan at the international markets and it could be expected that it will even require to exchange debt for stock.

Another important corporation with allocations at the american market is Vitro, which, to face its debt, which resulted from the Anchor Glass leverage purchasing, should have to be sold within the following months accumulating loss, therefore restructuring also its activities in Mexico.

There are several examples, the fact is that to operate from Mexico without guaranteeing high sales within foreign markets generates the firms great vulnerability. But, to perform from foreign markets is not necessarily an instrument to achieve exports capacity growth of the Mexican economy. Investment withdrawal could give way to some firms, but increasing manufacturing exports is not the way to achieve investment processes financing in the country, which is so necessary due to competence terms associated to the Mexican economy opening level.

While structural conditions where trade balance operate keep a need for foreign capital flows, firms that operate within high demand contraction and high financing costs, above earnings expectations, will not reach consolidation to operate profitably and competitively within the market.

Within this macroeconomic framework it is difficult to decrease over-indebtedness levels. That is why assets sales will multiply as a mechanism for the firms to face debt problems. With these transactions assets are being sold to prices awfully lower than in the previous months, specially in dollars, which reflects a debt deflation process. Among other cases, -as of banks- over- indebtedness faces public resources, with the debt's problem unsolved. Under such circumstances, long-term self-sustained growth is not possible, which does not prevent, at least temporarily, financial earnings to multiply, as well as it does not prevent mergers, necessary purchases and assets transference to increase.

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