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Doing Business in Mexico
Automotive Industry

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Introduction

Eventhough during the last crisis the automotive industry was seriously affected, and as a result of the natural process of adaptation, many groups faced serious restructures and restricted budgets in the last two years, the automotive industry is back and holds it's place among the most emblematic and representative industries in the world economy.

The recovery does not mean that things will go back to how they were before. On the contrary, if the industry managed to make a comeback after the crisis, it was due to severe adjustments in different key aspects, such as the production capacity, restructuring the organization and mainly changing the focus of the business model of the large European, Asian and particularly North American automotive corporations.

In relation to the markets, the most significant change is evidently, the end of the hegemony of North American Automotive Industry, which was surpassed by Japan first and now by China, as the world's largest vehicle manufacturer in 2010, however, in 2011 North America Automotive Industry was the second largest vehicle manufacturer. Other changes can also be attributed to technological advances, which have made possible to improve the performance of internal combustion engines, introduce new lines of vehicles with electric or hybrid engines, and to the gradual trend of the large car manufacturers towards smaller size vehicles and designing unified construction platforms that allow for greater flexibility in producing different vehicle models at the same time and for a significant reduction in manufacturing and assembly costs.

But the most encouraging news for countries located below the Tropic of Cancer, is the new and most significant role that those emerging countries will take in the strategic world, either through local companies (China and India), or hand-in-hand with the large global automotive corporations, as in the case of Mexico, Brazil and other countries in Latin America.

Lead Partner of the
Automotive Industry
Luis Lozano

Automotive vocation

The recent evolution of the Mexican Automotive Industry (MAI), its rapid recovery from the effects of the crisis, its exports, the permanent flow of investments and the expansion of its production capacity are all more than sufficient arguments to prove that, like those of China, India, Korea and Brazil, the MAI is currently among the most dynamic and competitive in the world.

Worldwide, the MAI is in 8th place, with 2.68 million units produced in 2011 (see table 1.1), and in 8th place in exports, with a total of 2.14 million vehicles exported (see tables 1.2a and 1.2b).

Main car-producing countries in the world — Table 1.1

	2009		2010		2011	
1	China	22.35%	China	23.53%	China	22.99%
2	Japan	12.86%	Japan	12.40%	United States	10.80%
3	United States	9.29%	United States	10.00%	Japan	10.48%
4	Germany	8.44%	Germany	7.61%	Germany	7.87%
5	South Korea	5.69%	South Korea	5.50%	South Korea	5.81%
6	Brazil	5.16%	Brazil	4.70%	India	4.91%
7	India	4.28%	India	4.56%	Brazil	4.25%
8	Spain	3.52%	Spain	3.08%	Mexico	3.34%
9	France	3.32%	Mexico	3.02%	Spain	2.93%
10	Mexico	2.53%	France	2.87%	France	2.86%

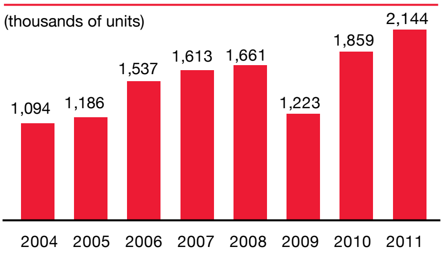
Countries maintained in top ten positions

Countries that have improved its position within the top ten

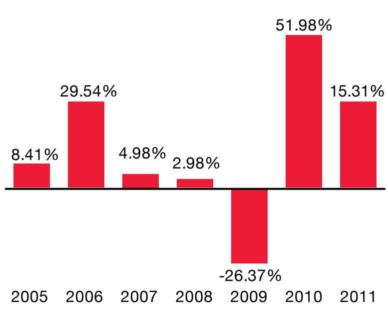
Countries that have decreased its position within the top ten

Source: OICA (Organisation Internationale des Constructeurs d'Automobiles)

Truck and car exports	Table 1.2a



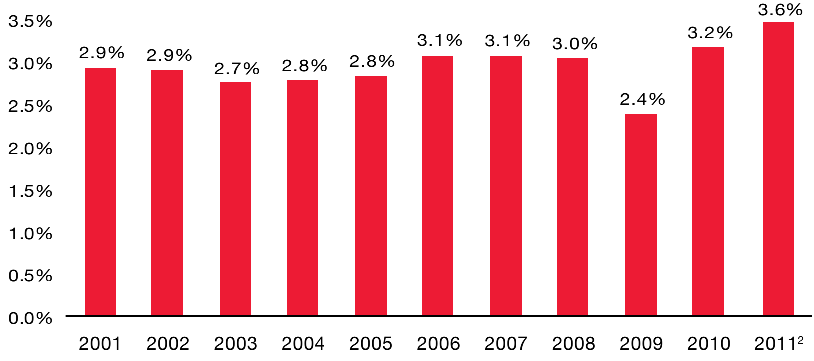
Truck and car exports	Table 1.2b



Source: Mexican Association of the Automotive Industry, (AMIA, AC. by its acronyms in Spanish) Monthly Bulletin (several years).

The importance of the MAI for the Mexican economy is beyond question. It accounts for 3.6% of the gross national product (GNP) and 20.3% of the GNP of the manufacturing industry (see tables 1.3a and 1.3b), aside is the principal generator of foreign currency (see table 1.4).

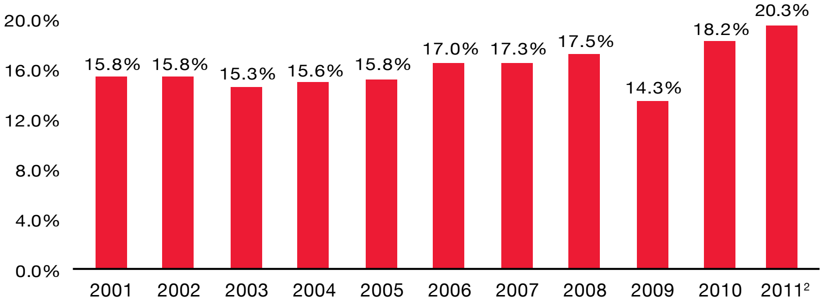
GNP Participation in manufacturing sub-sector of transport equipment [1]	Table 1.3a



Source: INEGI. Mexican National Accounts System.

[1]2003 prices.
[2]Third quarter.

Automotive industry participation in manufacturing industry GNP[1]	Table 1.3b

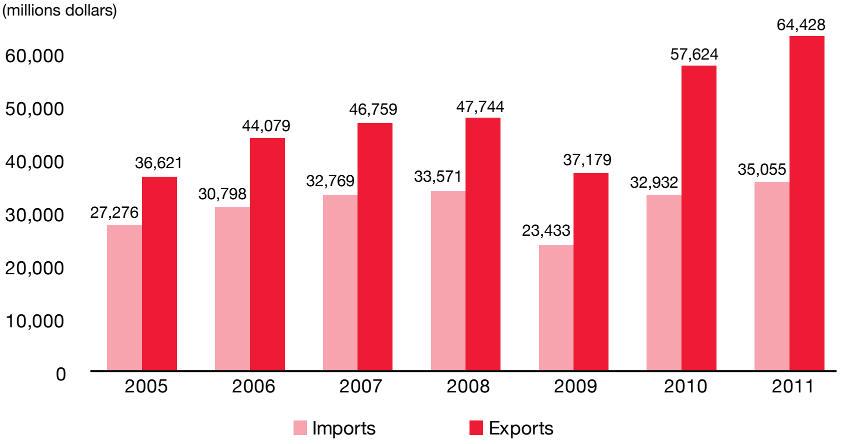


[1]2003 prices.
[2]Third quarter.

Source: INEGI. Mexican National Accounts System.

Total Automotive

Automotive industry imports and exports — Table 1.4



Source: Developed from data of the Working Group Foreign Trade Statistics, composed of the Bank of Mexico (Banxico), INEGI, the Tax Administration Service (SAT) and the Ministry of Economy (SE).

The MAI is also one of the country's largest employers, with more than 509,000 formal jobs (direct and indirect), a large percentage of which are for skilled workers, and is one of the production chains offering the best pay and training and professional development opportunities.

All that has contributed to improving general competitiveness in the regions in which it operates, thanks to the formation of clusters of suppliers and service providers, to the fact that it attracts highly qualified technical and professional personnel, to the spillover of technological capabilities applicable to other similar or related industries, such as the electricity, electronics and aerospace industries, and to the contagion and imitation of the good operating and administrative practices that spread out to local companies engaged in a wide variety of business endeavors in different sectors of the economy.

Beyond costs

Mexico's manufacturing vocation is solidly established, not only because of the low operating costs resulting from its geographical location, the salary levels and the advantages of the North American Free Trade Agreement (NAFTA), but also because of its long industrial tradition and the quality of the work done by skillful and ingenious people.

The foregoing can be said for all areas of the economy, but it particularly applies to the automotive and auto parts industry. Those branches, which comprise the second most important value chain in the country, are made up of dozens of intermediate and terminal manufacturing plants operating at the highest quality and productivity levels in the world, which have been awarded numerous prizes, including the prestigious Shingo Prize, which is the equivalent of the Nobel Prize for manufacturers.

Proven competitivity

How has the MAI sustained two digit growths in exports over the last ten years, reaching 2.14 million vehicles in 2011?

During the time it took us to research and prepare this report, we asked the presidents and general directors of some of those companies that same question, and the reply has been the same in all cases: "By offering consumers the best quality/price ratio."

For many years now, manufacturing quality has been the outstanding feature of vehicles manufactured in Mexico. They are exported to the most demanding markets in the world, such as the US, Germany and even Japan, where Mexican plants have been held up as examples of quality and commitment to constant improvement.

Among the most important factors for global automotive manufacturers when deciding on their investment strategies, location and geographical positioning, has been plant quality and Mexican labor.

As proof of the foregoing, over the last five years, the majority of the companies manufacturing automotive and commercial vehicles in Mexico and a significant number of companies producing automotive equipment, parts and components have made massive investments for the expansion of their production capacity and for outfitting, modernizing and automating their plants.

Promising future

Aside from Mexico's competitive advantage in terms of skilled labor, product quality and industrial processes, geographical positioning and preferential access to other markets as a result of a number of free-trade agreements, the MAI offers other advantages as well as an ample base of top-level local and multinational suppliers, spread out in 13 large specialized clusters in the North, Central and Bajio areas, including more than 20 public and private technological and design centers at which most automotive and commercial vehicle manufacturers have made headway in achieving value added processes and services.

With those competitive capacities and advantages, plus the processes for restructuring the automotive industry at the worldwide level, and the great opportunity offered by the development of the internal market, the MAI has a high potential for growth and for generating high-quality jobs. Furthermore, Mexico can improve its competitiveness as a platform for the production and exportation of light and commercial vehicles, as well as auto parts, advanced and technological components and value-added services.

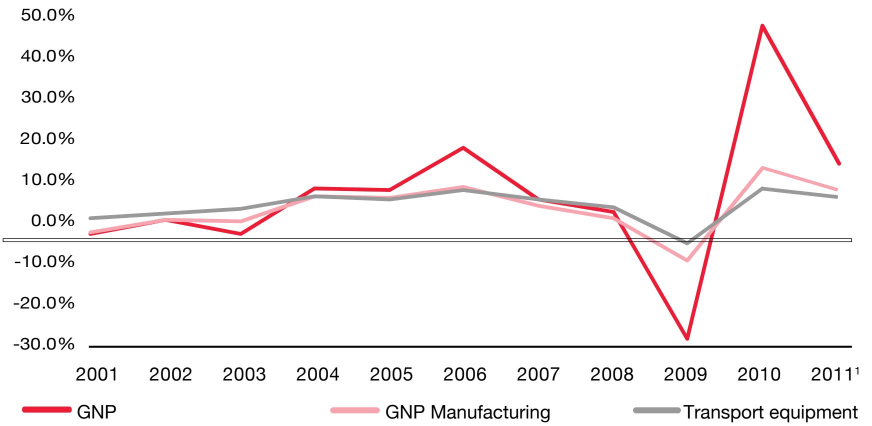
Contents

Outlook for the MAIT

Fenix industries

If the fall was spectacular, the rebound has been sensational… the fact is that the MAIT, which in 2009 suffered a drop of 26% in the GNP and a 28% in the total number of units produced, took merely one year to overcome the crisis, because at the close of 2010, it had recovered the losses and even generated a little more, the MAIT production for 2011 had an increase about 13.13% for a total operation of 2,557,550 units. In 2010, the GNP for the industry rose 40%, and the number of units manufactured rose 50% for a total of 2,260,774, 7.6% above the 2,101,361 units recorded in 2008, which up to that time was the highest production level ever in the history of the industry in Mexico. (See tables 1.5 and 1.6)

GNP growth by selected industries — Table 1.5

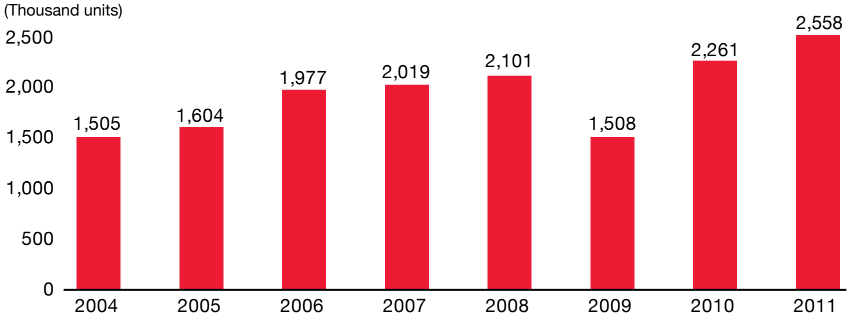


Source: INEGI. Mexican National Accounts System.

¹As of third quarter.

MAIT Production — Table 1.6

(Thousand units)

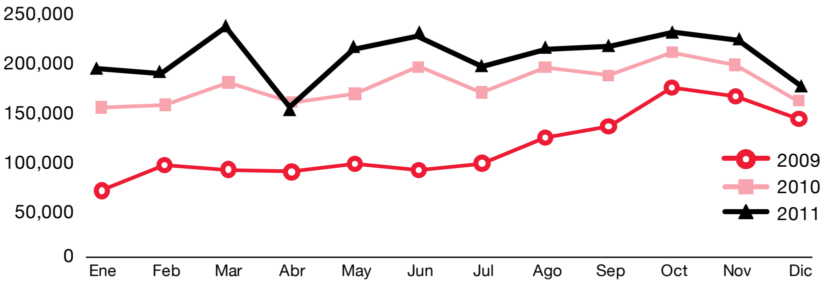


	2005	2006	2007	2008	2009	2010	2011
Growth %	6.55%	23.25%	2.17%	4.06%	-28.26%	49.97%	13.13%

Source: AMIA, AC. Monthly bulletin (several years).

But still more encouraging is the fact that the MAIT recovery continues apace at Formula One speed and performance in the last quarter of 2011 reported a 9% increase in overall vehicle production in contrast to the same quarter in 2010 (see table 1.7).

Monthly production of cars and commercial vehicles (units) — Table 1.7



Source: AMIA, A. C. Monthly bulletin (several years).

Recovery has been so fast, that this chain is now the principal driver behind the Mexican economy and accounted for one sixth of the 4.6% growth reported in the national GNP in the first quarter of this year.

Can it pull us all?

The automotive industry was the driving force behind the recovery, and now continues to lead the growth of the Mexican economy.

Even so, certain macro-analysts doubt its ability to sustain itself as the engine driving the economy over the medium and long term, since they believe that its capacity is limited by its dependence on the US demand for vehicles and components, and is therefore at serious risk of suffering a relapse in the event that the US dips into a slowdown or falls back into another recession process.

A question of focus

There is logic behind the argument, which reminds us that it is not yet time to start celebrating. However, a close look at recent performance and trends shows that the MAIT is going through a stage of restructuring and very significant changes in global business models and portfolios, which leads us to respond excitedly to the "reserved optimism" shown by the CEOs of the large Mexican automotive manufacturers.

The first factor behind that optimism has to do with the vocation and competitiveness of the Mexican automotive clusters within which many of the large global firms operate. It is precisely that competitiveness, which has made Mexico one of the most vigorous exportation platforms in the world, that led the "three great" US car manufacturers (and a few Asian and European as well) to assign Mexico a much larger role in their global and regional business strategies.

It is not a secret that over the last few years, the "three greats" have accelerated the relocation of US production plants to Mexico and invested copious amounts to build new plants and expand existing facilities; they have also chosen their Mexican operations as the most suitable manufacturing platform for the production and exportation of some of the new and most important product lines.

Export growth

The favorable expectations of the MAIT are bolstered by the fact that at the close of 2011, the exportation of light vehicles to the US and Canada were 6.7% over export sales recorded in 2010, while the increase in total vehicle sales in those markets was only 10.2% in the same period (see table 1.8a and 18.b).

Another more concrete fact is the 31.9% to 32.5% increase in market share vehicles of total vehicles imported into the US and Canada, and what is even more, the fact that those 0.60 percentage points were won over from the market share of Spain, France and Brazil, between others.

The growth of Mexican exports to the NAFTA markets was so significant, that it alone explains in 2011 the 45.8% growth in US and Canadian imports and the 7.2% increase in total sales of light vehicles recorded in those two countries (see table 1.8b).

Import and sales of light vehicles in US and Canadian markets				Table 1.8a
	2010	2011	Difference	
Country source of vehicles	(units)*	(units)*	(%)	(units)
Germany	569,426	634,394	11.4%	64,968
Japan	1,399,713	1,421,781	2.4%	33,020
Korea	561,626	527,380	-5.3%	-29,536
Mexico	**1,277,184**	**1,362,425**	**6.7%**	**85,241**
Others	216,096	248,713	15.1%	32,616
Total imports	4,024,045	4,194,693	4.4%	175,309
Vehicles manufactured in US and Canada	7,530,531	8,539,663	13.3%	1,004,529
Total market of US and Canada	11,554,576	12,734,356	10.2%	1,179,838

Source: Ward's Automotive Reports. * Cumulative figure from January to December

Import and sales of light vehicles in US and Canadian markets			Table 1.8b
	Participation % in total market of light vehicles		
Country source of vehicles	2010	2011	Δ[1]
Germany	4.9%	5.0%	5.5%
Japan	12.0%	11.2%	2.8%
Korea	4.8%	4.1%	-2.5%
Mexico	**11.1%**	**10.7%**	**7.2%**
Others	1.9%	2.0%	2.8%
Total imports	34.7%	32.9%	15.8%
Vehicles manufactured in US and Canada	65.3%	67.1%	84.2%
Total market of US and Canada	100.0%	100.0%	100.0%

	Participation % on light vehicle imports		
Country source of vehicles	2010	2011	Δ[2]
Germany	14.2%	15.1%	34.9%
Japan	34.6%	33.9%	17.7%
Korea	13.9%	12.6%	-15.9%
Mexico	**31.9%**	**32.5%**	**45.8%**
Others	5.4%	5.9%	17.5%
Total imports	100.0%	100.0%	100.0%

*Participation % from January to December periods each year
[1]Contribution to the growth of light vehicle sales in USA and Canadian markets"
[2]Contribution to the growth of light vehicle imports
Source: Ward's Automotive Reports.

The MAIT places its bets on diversification

The crisis provided a very hard lesson for car and commercial vehicle manufacturers and all the value chains, as it demonstrated the risks of concentrating investments in the US market.

After assessing the damage, most firms operating in Mexico have decided to diversify their markets. That change in strategy is now reflected in the composition of exports. From 2000 to 2008, only 15% of exports were sent to markets different that our northern neighbor, at the close of 2009, that percentage had risen to 28%; in 2010 it reached 31.3%, and according to the information published by the AMIA, A.C. at the close of 2011, the exportation of cars and light vehicles to other markets remained in two percentage points, to reach 36% (see table 1.9).

According to the same source, the regions that are gaining importance as markets for the exportation of Mexican vehicles are Latin America, Africa, Asia, and Europe, while Canada is in second place among countries receiving Mexican manufactured vehicles.

The strategy of seeking new markets is doubtless a step towards developing a sounder exportation profile and making Mexico less dependent on the demand cycles of our stronger trading partner. It should be pointed out that the strategy of Mexican car manufacturers is a diversification strategy rather but no replacement than a market-replacement strategy. According to the officers interviewed, there is no intention to neglect the North American markets, which will always be the most important. Instead, the diversification strategy stems from the wish to widen business horizons simultaneously mitigating the risks of exporting to a single destination. (See table 1.9)

National exports by destination region **Table 1.9**

	2010	2011	Difference		Participation % on exports		
	(units)	(units)	%	(units)	2010	2011	Δ[1]
US	1,277,184	1,362,425	6.67%	85,241	68.68%	63.55%	29.98%
Canada	142,800	159,440	11.65%	16,640	7.68%	7.44%	5.85%
Latin America	206,468	321,863	55.89%	115,395	11.10%	15.01%	40.58%
Africa	9,494	8,012	-15.61%	-1,482	0.51%	0.37%	-0.52%
Asia	29,050	25,538	-12.09%	-3,512	1.56%	1.19%	-1.24%
Europe	178,221	220,788	23.88%	42,567	9.58%	10.30%	14.97%
Others	16,300	45,813	181.06%	29,513	0.88%	2.14%	10.38%
Total	1,859,517	2,143,879	52.00%	284,362	100.00%	100.00%	100.00%

[1]Contribution to exports growth
Source: AMIA, A. C.

Those statistics and the changes in the aforementioned business models weaken the pessimist viewpoint, and although US demand will most likely slow down when the US authorities decide to deal aggressively with their complicated macroeconomic imbalances, it is also true that the MAIT has and will probably continue to hold a greater market share.

Furthermore, it is evident that the large US, European and Asian manufacturers operating in Mexico are not there only because of the NAFTA markets but are now aiming at markets in Latin America, Europe and Asia from the Mexican export platform. Therefore, when the US government decides to implement its "exit strategy", the MAIT will have a more diversified business portfolio.

Making things happen

The segments within the MAI are being called upon to play a much more relevant role in the positioning strategies of the large global firms. Proof of that is to be found in their investments, both present and scheduled, the incorporation of new product lines, the sustained growth of regional clusters and the number of suppliers, the greater sophistication and value of the Mexican component in cars, and the greater number of design, engineering and research and development centers in Mexico.

The description provided thus far is not intended to paint a rosy picture of guaranteed bonanza for the MAIT, but to point out its current and future potential over the medium and long-term, if all those involved (companies, workers, the government and consumers) manage to properly line up and balance their objectives and interests and make things happen.

Fighting bottlenecks

Actually, the greatest stumbling block faced by the MAIT is the weakness of internal markets, affected by the low average per capita income of the population and by a middle class that does not grow and is enmeshed in concern about the existing uncertainty and the effects of unemployment.

Other bottlenecks could be: the lack of financing, not only for the purchase of automotives, but also to lubricate performance along the entire value chain; taxes such as the new automotive tax (ISAN by its acronyms in Spanish) and the tax on vehicles (Tenencia by its meaning in Spanish), and the limitation on income tax and flat tax deduction of 100% of investments up to $175 thousand pesos; disloyal competition in the form of the disorderly importation of used cars; the lack of security and the resulting impact on the cost of insurance policies; and even the rise in the price of gasoline.

The government turns on the lights

Now that the crisis is over, the Mexican government is more receptive to the needs of the industry and is beginning to take steps to encourage its growth and competitiveness. The most significant step taken is the elimination of the Tenencia in 2012. Also, the House of Representatives' Special Commission for the Automotive Industry continues to work in a law for the Promotion of the Automotive Industry, which contemplates, among other things, the elimination of the ISAN and authorizes income tax and flat tax deduction of 100% of investments in new vehicles valued up to $400 thousand pesos.

Horsepower

In the race for global competitiveness, the MAI is at the ready, with engines running, and occupies a privileged and favorable position on the starting line. The machinery is good and competitive, and so are the drivers.

All that's missing is for the entire value chain, the three levels of government, the medium and higher education institutions and the research centers to be fully aware of its needs so that they can provide the industry with the special equipment needed to do an efficient job in the pits.

Nothing guarantees success… but the conditions are in place to achieve it, and if we take advantage of those conditions, there is every likelihood that in the future, the strength of the Mexican economy will no longer be measured in percentage points for growth, but other indicators will have to be used, such as the acceleration capacity of horsepower.

Structure, market power and competitiveness within the MAIT

The history of the MAIT began in 1925 with the installation of Ford's first assembly lines. General Motors arrived 10 years later, and in 1938 saw Automex (later Chrysler) started operations. In the 50s, the MAIT got a second wind with the entry of Volkswagen (1954), Nissan and Kenworth (1959). Third wind didn't come until the 80s, with the arrival of Honda (1985), followed by Scania (1992) and International (1996).

The MAIT evolved through a number of stages, some of which were marked by the need to adapt to the regulatory environment and to the growth and development strategies followed by the Mexican government, such as industrialization and growth models involving substitution of imports (1962-1980), the commercial opening and promotion of exports (1982-1993) followed by a more in-depth opening to commerce and foreign investment under the NAFTA regulatory umbrella, but also via the vigorous influx of globalization and the technological revolutions that have transformed and connected the world over the last two decades.

The MAIT has always been an important industry because of its capacity to generate well-paid jobs and the extent of its multiplying effect on the overall Mexican economy. However, its real takeoff, the rapid growth and increased sophistication that resulted in the current structure and size began with the negotiations leading up to the signature of the NAFTA and the growing influence of globalization trends within the world economy.

Over the last 25 years, Mexico has gone from a closed and not very competitive economy to one of the largest and most dynamic export platforms in the world, hand in hand with the automotive industry and the electric and electronic equipment industries, among others.

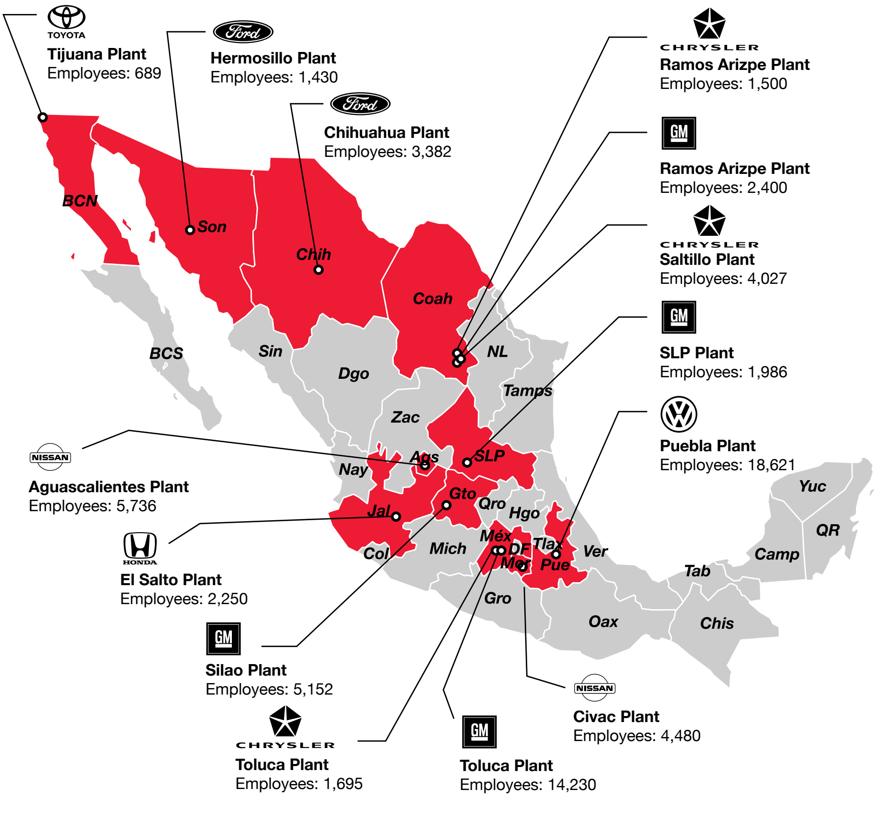
A competitive market

The MAIT markets in Mexico are quite open to international competition and there are no monopoly or oligopoly structures that can distort or exert significant influence on price setting processes for sales on those markets.

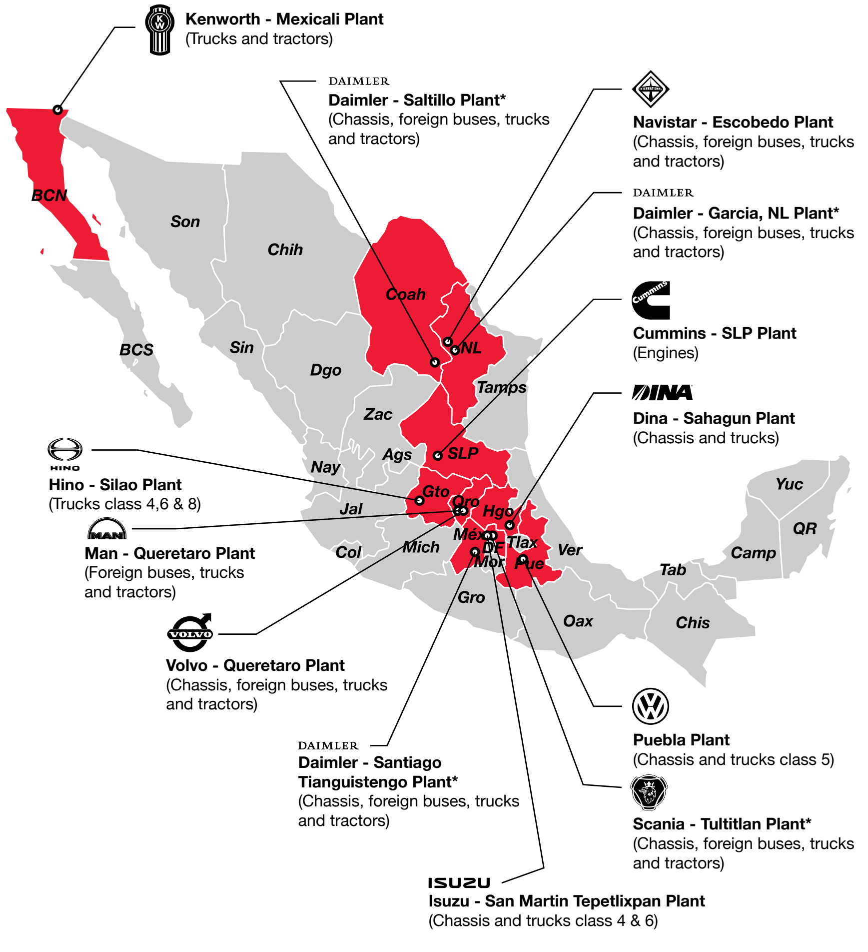
Eighteen of the world's most important light and heavy vehicle manufacturers have manufacturing and assembly plants in Mexico, which usually also handle foundry, production and stamping of body parts and engines. Most production centers are fully prepared to meet internal demand and export to the much sought-after North American markets. (See map of plants and heavy trucks)

Eight of those corporations compete principally in the automotive and light vehicle markets (vans, pick-ups and small buses), offering approximately 50 different models, while the remaining 10, with the exception of Volkswagen, produce mainly heavy trucks and tractor trucks. See map of plants and employees of light vehicles)

Geographical distribution of plants and employees of light vehicles



Geographical distribution of plants and heavy trucks



Intelligence and added value

For a number of years, most automotive corporations have been incorporating technologies and industrial operating models that are more and more sophisticated and efficient, as well as value added processes, which include: the design and development of technological solutions, equipment, specialized components and even some models of companies such as Ford, Nissan and Volkswagen which have been almost entirely designed in Mexico and are successfully positioned in the domestic and international markets.

The good economic, operating and strategic results reported for these value added and research and development activities have encouraged automotive companies to invest in the creation of more technological centers and in putting together large engineering groups in Mexico. (See map of technological centers)

This is of great importance, as it will allow the MAIT to complete the cycle of logistics, production, services, engineering and development required by the industry to exploit all its value-creating potential. The big challenge here will be developing the specialized human capital necessary to meet the growing demand of the industry.

Geographical Center of Engineering and Design

Who's who in the MAIT

The MAIT comprises the manufacturing plants of 18 large global corporations, but brands such as Audi, Mazda, Seat, Mitsubishi, Suzuki, Peugeot, Mercedes Benz, Subaru, Volvo, Acura, Fiat, Smart and Isuzu also compete.

Although the number of competitors is relatively large, the main roles are filled by Chrysler, Ford, General Motors, Nissan and Volkswagen. Together those companies account for 94% of overall production, 93% of exports and 76% of sales on the domestic market.

Although certain dynamism has been lost in the domestic market in the last few years, that does not mean that competition is more relaxed. On the contrary, competition is intense for consumer preference in all product segments and it is unusual for any given company to show clear leadership in more than two product and market segments.

Chrysler is in fifth place of the top five as concerning production (increase 8.76%, see table 1.11), exportation (increase 18.76%, see table 1.12) and sales on the domestic market (increase 3.20%, see table 1.13).

Ford, the grand old man of the industry in Mexico, continues to recover from the restructuring of recent years, and is coming back sharply focused on exports. Its exports have increased over the last six years from 106,027 to 449,925 units in 2011, making it the second-largest exporter in the sector. (See table 1.12)

General Motors is the largest manufacturer of light vehicles in Mexico, with overall production of 544,202 units at the close of 2011, and is also the largest exporter, placing 443,237 units in the US and Latin American markets in that year (see tables 1.11 and 1.12).

Nissan has led the internal market since 2009 with a sales volume of 162,234 units (see tables 1.13 and 1.13a). Aside from remaining in the lead position in domestic sales with 223,465 units in 2011, Nissan has managed to increase its market share from 22% of total domestic sales in 2009 to 25% in 2011.

On the other hand, Volkswagen maintains the Pole Position in the compact car segment, and in 2011 was in third place among manufacturers and exporters of automotives and light vehicles.

As it was to be expected, the best performance in terms of growth were shown by companies and brands recently joining or rejoining the market, such as Volvo, Renault, Mazda, Isuzu and Land Rover.

Total production of cars and trucks by company (units) **Table 1.11**

	2005	2006	2007	2008	2009	2010	2011[1]	Growth% 2010 -11"
Total	**1,603,759**	**1,976,645**	**2,019,447**	**2,101,361**	**1,507,527**	**2,260,776**	**2,557,550**	**13.13%**
General Motors	425,742	500,418	464,873	507,308	350,534	559,350	544,202	-2.71%
Nissan	349,179	398,618	489,254	440,629	353,018	506,492	607,087	19.86%
Volkswagen	300,386	347,020	409,566	449,096	319,743	434,685	510,041	17.34%
Ford	147,629	349,910	304,137	314,231	234,330	393,649	462,462	17.48%
Chrysler	343,748	313,387	283,960	280,147	157,082	257,319	279,869	8.76%
Honda	23,532	24,262	26,374	51,253	47,728	55,001	45,390	-17.47%
Toyota	0	33,209	32,249	49,879	42,696	54,278	49,596	-8.63%
Fiat	0	0	0	0	0	2	58,903	na
Renault	13,543	9,821	9,034	8,818	2,396	0	0	na

Source: AMIA, AC. Monthly bulletin (several years).

[1] As of December

Cars and trucks exports by company (units) **Table 1.12**

	2005	2006	2007	2008	2009	2010	2011[1]	Growth% 2009-10
Total	1,186,346	1,536,768	1,613,313	1,661,403	1,223,333	1,859,182	2,143,883	15.31%
General Motors	335,510	412,807	383,943	387,152	280,673	460,112	443,237	-3.67%
Ford	106,027	302,780	263,452	272,924	231,003	384,629	449,925	16.98%
Volkswagen	239,259	283,564	331,453	382,755	271,391	350,721	429,987	22.60%
Nissan	156,405	208,820	314,269	281,036	225,726	344,243	411,660	19.58%
Chrysler	334,323	303,441	272,109	253,601	135,011	224,078	266,117	18.76%
Toyota	0	10,111	32,249	49,879	42,696	54,278	49,549	-8.71%
Honda	14,499	15,107	15,755	34,037	36,829	41,121	36,429	-11.41%
Fiat	0	0	0	0	0	0	56,979	na
Renault	323	138	83	19	4	0	0	na

Source: AMIA, AC. Monthly bulletin (several years).

[1] As of December

Car and truck sales by company to dealers **Table 1.13**

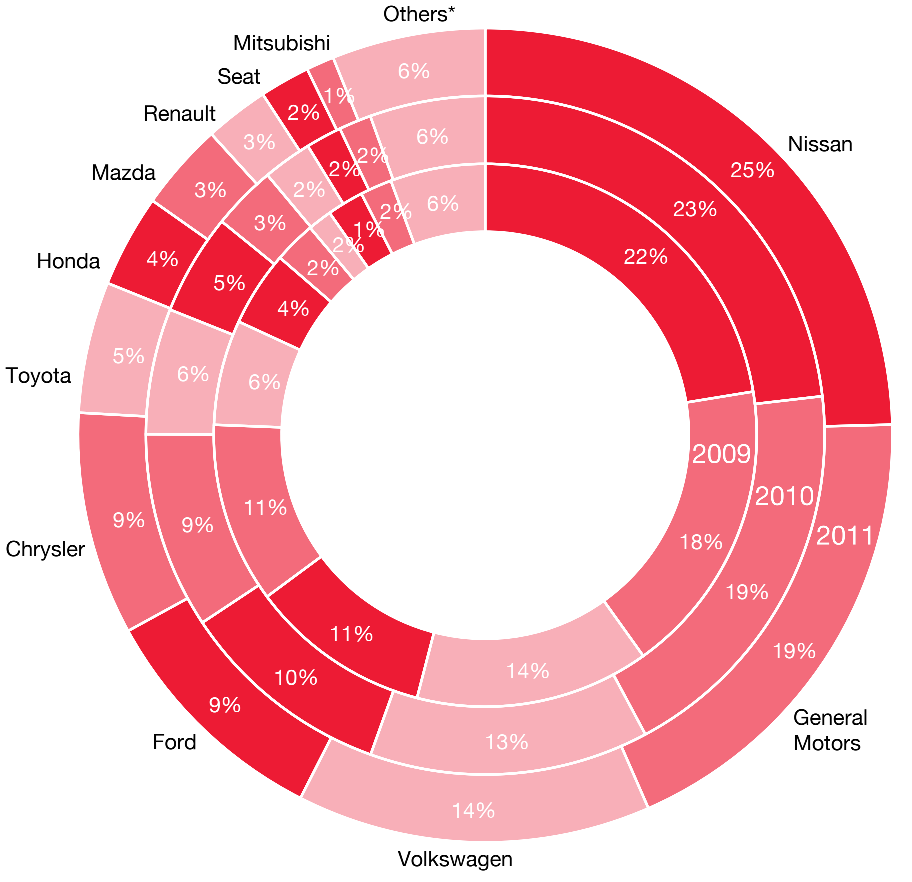
	2005	2006	2007	2008	2009	2010	2011	Growth% 2010-11
Total	1,125,971	1,157,356	1,074,342	1,019,153	723,423	834,024	909,026	8.99%
Nissan	236,869	238,024	209,404	208,490	162,234	193,170	223,465	15.68%
General Motors	243,920	242,935	223,100	213,447	127,930	158,600	171,397	8.07%
Volkswagen	145,145	136,388	126,394	117,785	100,819	110,993	127,795	15.14%
Ford	191,657	184,432	134,299	130,106	78,262	85,092	86,586	1.76%
Chrysler	122,555	130,864	125,050	113,666	77,775	78,061	80,557	3.20%
Toyota	38,174	58,244	75,736	61,186	45,268	49,945	47,388	-5.12%
Honda	38,237	48,839	55,913	52,292	32,377	40,154	33,442	-16.72%
Mazda	1,312	7,827	18,208	22,589	18,049	25,501	31,660	24.15%
Renault	23,433	20,175	17,772	14,884	10,414	19,486	23,108	18.59%
Seat	20,533	19,498	13,409	12,590	15,753	14,251	18,143	27.31%
Mitsubishi	15,373	16,992	16,841	17,380	13,645	12,876	10,080	-21.71%
Suzuki	867	4,381	6,130	8,109	6,732	8,120	9,791	20.58%
Audi	3,911	4,451	4,796	5,452	4,559	5,416	8,152	50.52%
Mercedes Benz	7,504	6,222	7,791	7,443	5,166	6,258	7,925	26.64%
BMW	6,580	6,897	7,836	6,859	5,431	5,534	6,995	26.40%
Peugeot	16,966	15,474	13,023	8,871	6,818	6,113	5,625	-7.98%
Mini	1,877	1,768	2,073	2,089	1,710	2,124	3,251	53.06%
Fiat	0	1,447	3,549	3,165	3,169	2,614	2,965	13.43%
Lincoln	4,378	5,384	4,953	4,288	1,777	2,723	1,964	-27.87%
Acura	1,139	1,715	1,852	2,106	1,846	1,960	1,829	-6.68%
Isuzu	0	0	226	768	964	1,340	1,671	24.70%
Smart	450	589	596	749	679	990	1,541	55.66%
Volvo	3,678	2,708	2,690	1,823	608	1,262	1,287	1.98%
Land Rover	592	729	1,005	727	331	446	638	43.05%
Subaru	0	393	752	1,146	525	503	563	11.93%
Infinity	n.d.	n.d.	n.d.	n.d.	n.d.	0	549	na
Porsche	475	676	740	859	465	413	546	32.20%
Alfa Romeo	n.d.	n.d.	n.d.	n.d.	n.d.	0	60	na
Jaguar	346	280	180	265	106	76	46	-39.47%
Bentley	0	24	24	19	11	3	7	133.33%

Source: AMIA, AC. Monthly bulletin (several years).

[1] As of December

Companies' participation % on sale of cars and trucks to dealers **Table 1.13b**

(units)



Source: AMIA, AC. Monthly bulletin (several years).
*Includes the following companies (2011): Suzuki (0.90%), Audi (0.90%), Mercedes Benz (0.87%), BMW (0.77%), Peugeot (0.62%), Mini (0.36%), Fiat (0.33%), Lincoln (0.22%), Acura (0.20%), Isuzu (0.18%), Smart (0.17%), Volvo (0.14%), Land Rover (0.07%), Subaru (0.06%), Infinity (0.06%), Porsche (0.06%), Alfa Romeo (0.007%), Jaguar (0.005%) and Bentley (0.0008%).

Weather forecasts

The short-term horizon for the MAIT looks promising. Obviously, the growth rate for production, exports and sales recorded in 2010 will not be seen again for many years. However, if the Mexican and international economies manage to keep up the current growth rate, it would not be very far-fetched to expect two-digit growth for this year, for both production volumes and value added, proof of that is the information of 2011 that we shared.

Furthermore, in the first quarter of 2011, the sale of new cars increased 16.2% in contrast to the same quarter in 2010. That marked improvement in sales could be the first sign of a rebirth in the internal market for cars and commercial vehicles.

Medium and long-term growth expectations for the MAIT are good, but slightly less optimistic, since they depend on the performance of the US economy (which in 2011 occupied the second place as an auto motor producer in the world) and on the administration of Barack Obama (or whoever is elected as US president in 2012) deciding to make the macroeconomic adjustments required by that country’s economy.

Other factors that could threaten the future performance of the MAIT have to do with internal matters, such as insecurity, poor control of used-car imports, and the results of the 2012 elections and its effects on the Mexican business climate.

In any case, the medium and long-term perspectives are good, and barring unexpected events, growth of the MAIT over the upcoming five years could easily be from 5% to 9%, always two or three points above growth of the overall Mexican GNP.

MAIT competitiveness

(Strengths, Opportunities, Weaknesses and Threats)

Strengths

- Installed capacity is ample and continues to grow as a result of the multiannual investment programs of the large multinational manufacturers operating in Mexico.
- There are 13 large clusters of suppliers and services for the terminal automotive industry, distributed through the central and northern portions of the country.
- Those clusters have a significant base of local and international suppliers with long experience in the manufacture of parts, components, original equipment and spare parts.
- Skilled labor at relatively lower cost.
- High-tech production lines with the flexibility necessary for simultaneous assembly of different models.
- World-class manufacturing systems operating with quality standards exceeding those of competitors in Latin America and in Asian countries such as China and India.
- A growing number of technological and engineering centers with the capacity to render value added service to the large manufacturers and auto parts suppliers.
- Exporting experience and the advantages of the commercial treaties signed with the US and Canada, the European Union, Japan and certain countries in Central and South America.
- The very advantageous geographic location favoring exports to North American markets, with considerable savings as concerns time and transportation costs.
- Development, production and distribution with a lower environmental impact.

Opportunities

- Diversify export destinations in order to reduce the dependence on North American markets.
- Improve quality and service costs of distributors and distribution channels.
- Control the entry of used cars.
- Issue an official standard regulating pollution levels in an effort to reduce the existing environmental impact and the entry of jalopies, which compete with the established industry.
- Detect new market niches throughout the sector value chain, from auto parts companies to automotive and transportation equipment insurers.
- Increase local and regional integration and value added percentages.
- Bring down or eliminate redundant operations.
- Search out improvements or benefits through strategic alliances or mergers.
- Improve or increase the availability of specialized engineers and professionals by means of programs that will attract more high-level students to the professional disciplines pertaining to the automotive industry.
- Do away with the ISAN and the Tenencia.
- Eradicate or significantly reduce all types of vehicle theft.

Weaknesses

- Their precarious financial position of certain manufacturers.
- Very large operating structures with significant direct costs.
- The rising weakness in the internal market over the last two years.
- The limited availability of domestic supplies of certain auto parts and specialized components.
- The limited availability of high-level specialized engineers coming out of public or private Mexican universities.
- Labor legislation out of step with current needs and with the new international trends and strategies used in managing human resources.

Threats

- The drop in the demand for cars and transportation equipment in the US.
- The persisting weakness in internal consumption.
- Protectionist trends and the indiscriminate use of non-tariff barriers in certain Latin American markets.
- Competition benefiting other nations in the form of subsidies and dumping practices.
- Insufficient effect of federal government promotion programs on car sales.
- The progressive and indiscriminate importation of used cars.
- Negative effects on consumer preferences resulting from the activities of organized crime.

Principal legislation applicable to the automotive industry

Legal Provisions

Foreign Investment

In Mexico, the legal framework that regulates investment by non-Mexican individuals or entities is the Foreign Investment Law (FIL), whose purpose is to establish and regulate the activities in which those individuals or entities are allowed to participate, assigning percentages, limits, restrictions or conditions for percentages of participation.

The FIL specifies activities reserved exclusively for the Mexican State, those reserved for Mexican entities and individuals and those in which foreign investment is unrestricted or is limited to certain percentages of participation.

In the case of certain restricted activities, the FIL considers exceptions, which are ultimately subject to a resolution issued by the regulating authority, that in this matter is the Ministry of Economy.

There are also cases in which foreign investment participation is limited, those limits cannot be exceeded directly, or through trusts, agreements, social or statutory agreements, corporate restructuring, or any other means that provides control or a participation that exceeds what is established in the FIL, except for the case of foreign investment in the capital stock of authorized Mexican companies or trusts.

According to the FIL, the companies should stipulate that foreign partners will be considered as Mexicans regarding their shares, partnership interests or rights acquired there under and regarding goods, rights, obligations, concessions, participations or interest of the holders, and therefore they agree not to appeal to the protection of their governments. Otherwise, they must add an exclusion clause clearly stating that the company will not allow foreign investment in its capital stock.

In the particular case of the automotive sector, until 1999, companies dedicated to manufacture and assembly of parts, equipment and accessories for this industry, could have a participation of 49% of foreign investment, however, from that year, the FIL was amended to allow 100% participation of foreign investment without the need to secure any kind of permit or favorable resolution from the Mexican authorities.

Nevertheless the increased openness to foreign investment in the sector, companies are required to report to the authorities their financial situation and the changes in their shareholding structure, their capital stock and their management (Board of Directors).

Investment in the Mexican Market

The automotive industry is one of the most important and productive value chains in the Mexican economy and although it has suffered the impact of the worldwide economic crisis over the last few years, since 2010 its recovery has been truly remarkable.

We, at PwC, realize that it is one of the industries with the greatest growth potential in our country, however, special attention should be paid to the following points and recommendations, to take full advantage of business opportunities offered by this sector and minimize the risks arising from the current regional and worldwide economic situation.

Following is a brief list of the principal means for investing in the Mexican market and we will attempt to respond the most frequently asked questions by investors interested in investing in the automotive industry.

Incorporating a new company

The most frequent way of investing in the Mexican market is incorporating a new company. In our experience, we have noticed that foreign investment in Mexico usually participates through a Stock Corporation (S.A.); or a Limited Liability Company (S. de R.L.[1]).

1 For its acronyms in Spanish

The principal differences between those two types of organizations are the following:

Stock Corporation (S.A.)	Limited Liability Company (S. de R.L. de C.V.)
The liability of the shareholders is limited to the payment of their shares.	The partners are only required to pay their contributions.
There must be a minimum of two shareholders. The maximum is unlimited. Shareholders may hold more than one share. Different series and shares may be created.	There must be a minimum of two partners. The maximum is 50. No partner may hold more than one partnership interest, unless different rights and obligations are specified.
Company management must be in the charge of a Sole Administrator or a Board of Directors. They may or may not be stockholders, and are temporary designated.	Company management must be in the charge of a manager or Board of Managers, who may be partners or third parties, temporary designated or for an undetermined period.
The supreme organ of the company is the Shareholders' Meeting. Shareholders' Meetings may be held at the company's domicile, and may be general or special. Resolutions must be based on the majority established in the bylaws or in the General Corporation and Partnership Law.	The supreme organ of the company is the Partners' Meeting. Meetings may be held at the company's domicile. Resolutions must be based on majority votes of partners representing at least 50% of the capital stock.

Common rules

- These companies may be of the Variable Capital type, and may increase or reduce their capital, as resolved at a Shareholders' or Partners' Meeting.

Considerations

- It is important to consider that the S. de R.L. de C.V. cannot quote on the stock exchange.
- If a S. de R.L. de C.V. looks forward to be positioned in the stock market, it may carry out a transformation to become an S.A. .
- Likewise, a S.A. may become an Investment Promotion Corporation, (S.A.P.I.[1])
- The legal framework for a S.A.P.I. is contained in the Stock Market Law (SML), which provides benefits and exceptions to the rules established for stock corporations in the General Corporation and Partnership Law (GCPL) with a view to attract risk capital investors.
- Some of the advantages of the S.A.P.I. regime are:
  1. The shareholders may stipulate in the bylaws restrictions for shares transfers; establish the basis for excluding shareholders or for allowing them to withdraw.
  2. S.A.P.I.s don't need to register or to be supervised by the National Banking and Securities Commission (NBSC).
  3. S.A.P.I. bylaws allow the issuance of several series of shares with different rights and obligations, in order to attract private and risk capital.
  4. The minority rights specified in the GCPL may be exercised with lower percentages.
  5. The option to apply better corporate governance practices.
- S.A.P.I.s may acquire their own shares, and are not subject to the prohibition established in the GCPL. They are not required to publish their financial statements.
- Their management is in charge of a Board of Directors. The company has two options: (a) to adopt the management regime of a S.A. or (b) to adopt the management regime of a Company Stock or (S.A.B.[1])
- S.A.P.I can operate under this regimen or transform to become a Stock Investment Promotion Corporation, (S.A.P.I.B.[1]).
- S.A.P.I.B.s are a transition in order to access to the Mexican Stock Market. Once a S.A.P.I. adopts the S.A.P.I.B. regime, it may list on the stock-market and adopt the S.A.B. regime within three years following the change.
- S.A.B.s are companies quoted on the stock market, and are therefore public to the business and investing community.
- S.A.B.s are subject to NBSC supervision.
- S.A.B.'s management is in charge of a Board of Directors and a General Director. They are also subject to corporate governance rules.

1 For its acronyms in Spanish

Mergers and acquisitions

Another way of investing is by means of a merger or acquisition of another company. This can be done by three principal mechanisms:

a. By purchasing the shares or partnership interest of an existing company.
b. By purchasing the assets of an existing company.
c. By merging two or more companies to create a new one, including the assets and liabilities of such companies.

Strategic alliances

A third option for investing in Mexico is to sign a contract with a company already established in Mexico. That way, a foreign individual or entity may use the infrastructure and/or rights previously acquired by its commercial allies.

Compliance with legislation

We should always take into account, that regardless of the way in which it is decided to invest, parties operating in this industry must comply with all applicable laws, before operations begin, and during business development. Primarily be taken into account, economic competition, environment, tax, labor and administrative rules, as well as obtaining licenses, permits and/or authorizations required for the proper operation.

Tax Obligations

Corporate taxpayers in Mexico are required to:

- File, no later than March of the following year, an annual tax return[1] showing the result or taxable profit for the period and the basis for Employees' Statutory Profit Sharing (PTU).
- File, no later than February, a number of informative returns reporting on specific points such as wages and salaries, taxes withholding, payments made to foreign residents, uncollectible accounts, donations made, tax withheld from third parties, etc.
- Prepare a statement of financial position and conduct an inventory count of stock at the year-end closing.

  In cases where income subject to income tax exceeds $34.8 million Mexican pesos and the value of its assets in the terms of the Income Tax Law (ITL) is above $69.6 million Mexican pesos or more than 300 of its personnel have rendered services in each of the months of the preceding period, its financial statements must be audited for tax purposes by an authorized public accountant.

  As part of the administrative facilities granted by the Mexican tax authorities, taxpayers may opt to provide certain information directly to the tax authorities rather than having their financial statements audited for tax purposes[2].
- An authorized public accountant must issue a report on compliance with Social Security and Workers Housing Fund obligations, when certain assumptions apply.
- Have an authorized public accountant report issued on compliance with local tax obligations, i.e. the average number of employees, the cadastral value of real property or bi-yearly water consumption.
- Have a transfer pricing study made to demonstrate that operations with local and foreign related parties were conducted at fair market value.
- Companies engaging in foreign trade must submit certain specific information to the Department of the Economy.

  Certain additional tax obligations must be complied with, depending on the operations conducted by each company. Those operations must therefore be analyzed separately.

1 Annual flat tax return also filed, and a report is issued on value added tax (VAT) for each of the months in the year.

2 However, the following advantages are lost if the tax report is not filed:
- Sequential review by tax authorities and early conclusion of in-house visits.
- Amended return resulting from the tax report (not included for the purpose of the limit).
- Spontaneous compliance (10 days).
- Reduction in the term for refunding favorable balances (from 40 to 25 days).
- Refund with a statement issued by the public accountant.
- The option to request certificates in the name of third parties; to microfilm or record the accounting on optic discs; to make monthly provisional or definitive payments; to request strip stamps or labels in advance.
- Releasing the Legal Representative from joint liability when that person is no longer a tax resident of Mexico (in liquidations).
- The authorization to use own equipment to record operations with the general public.

Income tax - IT

IT is payable in Mexico by parties resident in the country (on all income received in the period) and by parties resident abroad with a permanent establishment in Mexico or parties receiving income from a source of wealth located in Mexico.

In general terms, IT is calculated by applying the 30% rate to the tax result for the period[1].

The tax result is determined by subtracting authorized deductions (such as cost of sales, investments in fixed assets and financial costs and expenses) from taxable revenue for the period, then subtracting PTU paid. Unamortized tax losses[2] not amortized in preceding periods are subtracted from the tax profit, when applicable.

The Mexican tax system is very strict when compliance with obligations such as filing informative returns and issuing invoices is required in order to be entitled to apply authorized deductions. Special care should therefore be taken to ensure the tax compliance.

Additionally, as from January 1, 2011, digital tax documentation (particularly invoices) must be issued.

Certain advantages

The after-tax earnings account (CUFIN)

The ITL requires entities to keep a CUFIN to have the track of its profits on which tax has been paid. Dividends paid from that account are not subject to income tax.

The capital contributions account (CUCA)

Companies are required to keep an account called the CUCA to record capital contributions, which should not give rise to income tax when reduced, reimbursed or amortized.

It should be remembered that it is necessary to apply controls, keep records and ensure that there is documentation supporting the CUCA and the CUFIN, such as annual tax returns and tax reports, which must be kept throughout the lifetime of the company.

Tax losses

The ITL explains the treatment applicable to a company's tax losses, when, in the period, deductions declared exceed income. Those losses can be subtracted from tax profits in a ten year carry forward, until they are exhausted.

1 The applicable rate for 2013 will be 29%
2 It result when taxable income is less than the authorized deductions and PTU

Reduction of provisional tax payments

Taxpayers are required to make provisional income tax payments on account of annual income tax, based on a profit factor determined on tax figures for the preceding period. When that profit factor is considered to exceed the factor actually corresponding to those payments, the tax authorities can be requested to authorize a reduction in said payments as from the second half of the period.

Maquiladora industry

The maquiladora industry is born from the need to reduce operating costs of large transnational corporations, through cheap labor. In Mexico, the industry is a creative source of jobs, so the building on the premises of this industry has proliferated since the 60s. In fact, it started in 1965, and its history of international outsourcing (maquila process) through the so-called Border Industrialization Program, which aimed to solve the same problem of unemployment in the north border of our country, and reduce the flow of migrants to United States of America. Later analysis is presented regarding current foreign trade programs Mexican authorities which provide.

In relation to the above and to support companies in the maquiladora industry, many of which are involved in the automotive industry, were given a benefit with the income tax through the "Decree granting various benefits in Relation to Income Tax for Foreign Residents Related Companies Assembly" published on October 30, 2003, which exempts from corporate income tax substantially.

In general terms, the income tax of the payment exemption year will be obtained through the following calculation:

a) The fee is 6.9% of the total value of assets used in jobbing,
b) Multiplying the rate of 6.5% of total costs and expenses for the operation,
c) The taxable income which is greater under the preceding paragraphs, shall be deducted with an amount which results from applying the rate of 3% on the same basis as the preceding paragraphs,
d) To the reduced tax income under the preceding bullet, a corporate income tax rate (30% by 2011) will be applied and this is the amount to be exempted from income tax payment to the companies in the maquiladora industry.

There are several requirements that must be completed, especially in foreign trade, so we must be attentive to comply with them in due time and form.

The tax consolidation regime

An interesting item that can be used to streamline a company's tax burden and defer payment of income tax is the tax consolidation regime, the principal advantages of which are:

- Immediate application of the tax losses of the controlling and the controlled companies in the period in which they arise, against the tax profits of the other companies of the same group.
- Deferral, over a period of five years, of income tax on dividends not arising from the CUFIN, paid among the companies of the consolidating group.
- The figures of the controlled companies are immediately added to the CUFIN and the tax cost of the shares of the controlling company.
- Strengthening of the group, reflecting its importance in the country and in the eyes of the community in Mexico.

International treaties

Mexico has signed a number of international treaties for the avoidance of double taxation with numerous countries, including the following:

Argentina	Finland	Luxembourg	Spain
Australia	France	New Zealand	Sweden
Austria	Germany	Norway	Switzerland
Bahrain	Greece	Panama	The Czech Republic
Barbados	Iceland	Poland	The Netherlands
Belgium	India	Portugal	The UK
Brazil	Indonesia	Romania	The US
Canada	Ireland	Russia	Ukraine
Chile	Israel	Singapore	Uruguay
China	Italy	Slovakia	
Denmark	Japan	South Africa	
Ecuador	Lithuania	South Korea	

Tax incentives

Immediate deduction of new fixed assets

New fixed assets may be immediately deducted in the period in which the investment is made or the assets are first used, or in the following period.

For that purpose, the ITL establishes the deduction of investments in new fixed assets on the basis of an annual deduction rate, depends on the type of assets in question. This could represent a financial advantage, when goods are immediately deducted at a discount rate below the interest rate that would have to be paid on financing from third parties. In general terms, the discount rate specified in the ITL is 3%, and the percentage specified in the decree published on June 20, 2003 is 6%. Therefore, application would have to be analyzed.

It should be pointed out that certain requirements must be complied with in each particular case.

Additional to the above, on March 30, 2012 the tax authorities published a fiscal incentive which consists in decrease the taxable income determined in accordance with article 14 of the ITL with the amount of immediate deduction to be held in the year, in accordance with article 220 of the income tax law, for investment in new plant and equipment assets actually made.

Promotion of the national economical development (Promexico)

The Promexico fund was created by Presidential Decree on June of 2007, and focuses on contributing for the attraction of direct foreign investment, through the granting of support to projects that promote the national economical development.

The fund is operated through a trust fund which is operated by the National Bank of Foreign Commerce (BANCOMEXT) and is integrated by resources provided within the Federal Budget for the Ministry of Economy.

The fund supports Companies that provide within its business activities, the following:

a) Infrastructure
   (i) Physical (Civil engineer works and equipment).
   (ii) Technological (Installation of laboratories, design and test centers).
b) Buildings and constructions.
c) Equipment (purchase and installation of machinery and equipment).
d) Innovation and Technological Development (payment of royalties, licenses and intellectual property).
e) Technological transfer (expenses involved for the transfer of technology required for the development of the project).
f) Development of Human Capital (Training employees in Mexico and abroad).

Companies contracting special needs or blind persons
Employers may deduct IT withheld from employees with physical disabilities (which is refunded to them).

Incentive for employing persons 65 and over
The March 18, 2007 decree provides individuals and business entities subject to income tax with an incentive consisting of deducting (from taxable income) an additional 25% of salaries actually paid to any of the following persons:

I. Persons of 65 years old or over, or
II. Persons with motor incapacity requiring the permanent use of prosthesis, crutches or wheelchairs; mental incapacity; hearing incapacity or speech impediments with 80% or more of normal capacity; and blind persons.

Tax incentive for investments in Mexican motion picture production (FIDECINE)
Taxpayers may apply a tax credit of the amount contributed to investments in Mexican motion picture productions, against IT for the period.

That credit is not subject to IT, and may not exceed 10% of IT payable in the period immediately preceding that in which it is applied.

Investments in Mexican motion picture projects are considered to be only those made in Mexico, as well as the human, material and financial resources necessary for the project.

Tax incentive for investments in Mexican theater production
A tax incentive is provided to IT taxpayer equivalent to the amount contributed to investments in Mexican theater production projects; that incentive is applied to IT for the period and provisional payments for that same period.

That credit is not subject to IT and may not exceed 10% of the taxpayer's IT for the immediate preceding period.

Program for the Development of High-Technology Industries (Prodiat)
Prodiat rules were published on July 21, 2009. The objective is to promote the preservation and improvement of human capital developed by companies, as well as to provide temporary assistance for the transfer and adoption of technologies, based on market deficiencies in those industries.

Prodiat support consists of subsidies contemplated in the Federal Disbursement Budget, and are provided to beneficiaries under certain operating rules and other legal provisions based on objectivity, fairness and transparency criteria, as well as on the feasibility and social economic impact of the project.

Vehicle renovation program

The Prodiat provides this assistance for Type C Projects[1] which promote the expansion of the automotive market by means of vehicle renovation and the destruction of used vehicles. Amounts granted are determined on the basis of production levels of the beneficiary companies, which need to comply with certain requirements in order to be eligible.

New truck and bus tax incentive

Another tax incentive makes it possible to replace vehicles used to provide federal freight and passenger transportation service with new vehicles.

That incentive is applicable to authorized manufacturers, assemblers or distributors resident in Mexico that sell:

- Tractor-trailers
- Unit buses
- Buses

The tax incentive consists of a credit equivalent to the lowest of the price paid for used vehicles, 15% of the price of a new vehicle and the amount specified in the Decree; the ceiling is $161,000 Mexican pesos for fifth-wheel trucks, $103,000 Mexican pesos for three-axle minibuses, $69,000 Mexican pesos for two-axle minibuses and $138,000 Mexican pesos for full size-buses factory- outfitted with more than 30 seats.

The Decree establishes that the tax incentive determined may be credited against IT, against IT withheld from third parties, and against Value Added Tax (VAT) payable in provisional payments, definitive payments or in the annual return, as the case may be.

Other tax incentives

There are also other tax incentives, which include:

- Risk capital investments in Mexico
- Personal savings accounts and premiums on retirement insurance
- A tax incentive for bringing down provisional payments by the amount of paid PTU

1 Manufacturers of new light motor vehicles with current registration in the terms of article 3 of the Automobile Decree are known as “Type C Project Population Objective”

2010 tax amendments

Tax consolidation

A number of amendments to the tax consolidation regime were published in the December 7, 2009 Official Gazette requiring groups to determine IT deferred under consolidation, which is payable as from the sixth immediate preceding period (beginning in 2004); 25% of tax deferred up to 2004 is payable in June 2010, and the remainder is payable in the following periods, as shown below:

Portion of Payment

The tax period to which the deferred tax belongs	2010	2011	2012	2013	2014	2015	2016	2017
2004 and preceding years	25%	25%	20%	15%	15%			
2005		25%	25%	20%	15%	15%		
2006			25%	25%	20%	15%	15%	
2007				25%	25%	20%	15%	15%

When the controlling company fails to pay deferred tax in the allotted time, the tax authorities are empowered to determine omitted tax and the respective accessories.

Deferred tax can be calculated as per the mechanics specified for withdrawal or deconsolidation in the current ITL, or by means of an optional method. The mechanics elected must remain in place for a period of five years.

The registered public accountant auditing the financial statements of the controlling company must issue his opinion on the items involved and on determination of IT deferred under tax consolidation.

Said deferred IT includes items such as unamortized tax losses, dividends paid not arising from the CUFIN and differences between the consolidated CUFIN balance and the balances of the consolidating companies.

New rules have been issued in the miscellaneous tax resolution involving different points related to the determination of deferred IT, which prevent duplication of tax payment.

Flat Tax

A number of amendments and additions to the tax provisions went into effect on January 1, 2008. The most significant was the addition of flat tax and the annulment of asset tax (AT).

Flat tax is playable by individuals and business entities resident in Mexico as well as by parties resident abroad, with a permanent establishment in Mexico, on overall income received, regardless of the source.

Flat tax does not contemplate an exemption period. The law establishes that it is determined on the basis of cash flows, it does not recognize the benefits of the aforementioned tax incentives, and IT actually paid and the tax credits specified in the following paragraphs may be credited against it.

Unlike IT, flat tax payments do not generate CUFIN.

We would also like to mention the countries currently allowing flat tax paid, to be credited in Mexico[1] against IT for the period.

Australia	Finland	Japan	South Africa
Austria	France	Luxembourg	Korea
Barbados[2]	Germany	New Zealand	Spain
Belgium	Greece	Norway	Sweden
Brazil	Iceland[2]	Poland	Switzerland
Canada	India[2]	Portugal	The Czech Republic
Chile	Indonesia	Romania	The Netherlands
China	Ireland	Russia	The UK
Denmark	Israel	Singapore	The US[2]
Ecuador	Italy	Slovakia	

[2] Signed treaties not in force

1 Considered to be a tax on profits.

Relevant aspects

Flat tax is calculated as 17.5% of the taxable base arrived at by subtracting authorized deductions from income.

Income subject to the tax is the revenue arising from:

- The sale of goods
- The rendering of independent services
- The lease of goods

For flat tax purposes, the only deductions are for disbursements that are strictly indispensable for the described operations and those involving their management, as well as the production, sale and distribution of goods and services giving rise to income subject to flat tax.

Certain other items are not deductible from flat tax, such as wages, salaries and benefits, as well as Social Security dues, for which credits are granted at the flat tax rate. Lastly, there are no deductions or credits for interest or royalties paid to related parties.

Additional deduction of investments

There is an additional flat tax deduction for new investments acquired and paid from September 1 to December 31, 2007, applicable in 2008, 2009 and 2010, in three equal parts.

A portion of those investments paid beginning in 2008 is a flat tax deduction in that period.

Tax credits

The transitory provisions of the Flat Tax Law (FTL) and the Decree Granting IT and flat tax incentives published in the November 5, 2007 Official Gazette (the Decree) provide the following credits that can be applied against flat tax.

FTL

- Excess of deductions over income (only in 2009).
- Taxable wages and salaries, as well as Social Security dues.
- Investments acquired from 1998 to August 2007.

The November 5, 2007 Decree

- Inventory at December 31, 2007
- IT losses (resulting from the immediate deduction of fixed assets)
- Installment sales of goods
- Maquila Companies
- Operations conducted with the general public

In the case of the Decree, Inventory and Loss credits are applicable over 10 years, at 60% and 50%, respectively, of the base value applicable to same.

With respect to the maquiladoras, the incentive provided virtually extends the benefit that provides income tax reduction that for several years the ITL has established in order to promote the growth of this industry, recognizing its importance in the national economy.

There is no order of preference for the application of those credits, which means that companies should be on the alert for opportunities to apply them and avoid tax overpayments that cut into their finances.

A number of requirements must be complied with in order to apply those credits, and care should be taken to ensure that they are complied with, including restatement procedures.

Tax credit (for deductions exceeding income)

The FTL establishes that when authorized flat tax deductions exceed taxable income for the period, the taxpayer may apply a tax credit of the amount arrived at by applying the tax rate to the difference.

That tax credit may be credited against flat tax for the period and against provisional tax payments for the following 10 periods until the credit is exhausted.

Furthermore, when the taxpayer is entitled to take a flat tax credit in a particular period but fails to do so, the right to credit that tax in future periods is lost (up to the amount that could have been credited).

Other considerations

As a result of the annulment of the AT Law, rules have been established allowing for the recovery of the AT actually paid in the preceding 10 periods.

In periods in which a taxpayer generates IT, it may request an AT refund (limited to 10% of the lower of IT for the period and AT for 2005, 2006 or 2007).

That amount may be offset against flat tax, went flat tax exceeds IT for the period.

A number of flat tax provisions have been issued, such as Tax Incentives for the Economic Support Program, which makes it possible to defer IT, flat tax and Social Security dues, among others. Advantage should be taken of these incentives.

New vehicle tax (ISAN)

Individuals and business entities (other than the manufacturer, assembler, distributor and marketer) are required to pay ISAN on the sale of new vehicles and on their importation into Mexico.

The tax is calculated by applying rates corresponding to the price of the vehicle, including optional equipment, regular or luxury, with no discounts, reductions or rebates.

Certain rules apply to tax payment on imported vehicles, based on the type of vehicle and other factors. The payment is definitive, per tax period.

Additionally, the tax is not payable on permanently exported vehicles or on the sale of vehicles when the sale price (including optional equipment, regular or luxury) does not exceed $193,231.21 Mexican pesos. Furthermore, when the price is from $193,231.21 Mexican pesos to $244,759.53 Mexican pesos, there is a 50% exemption on tax payment.

Tenencia

The tax is calculated on the basis of the features of the vehicle, such as the model, brand name, year, version and price, using annually updated tables and percentages.

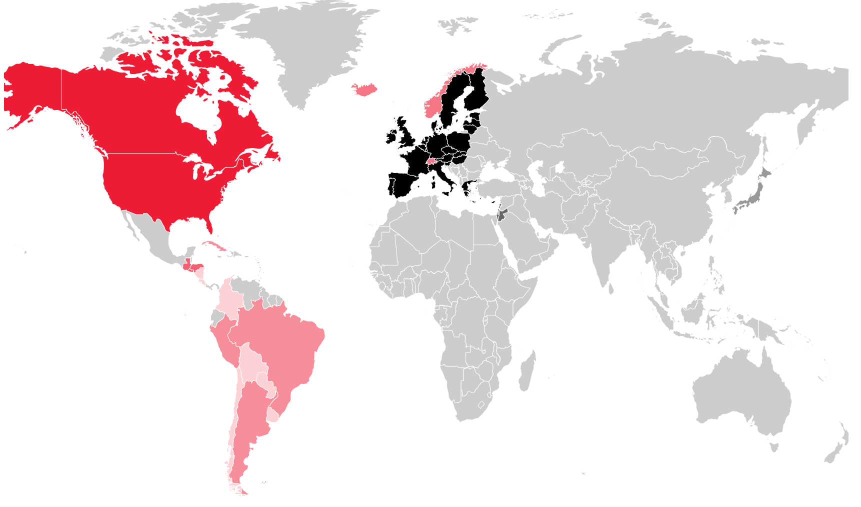
The tax is gradually reduced as the vehicle ages, and no tax is payable on vehicles 10 years or older.

As of 2012, this tax ceased to be a federal tax and it is now up to each state to impose it.

Foreign trade

Mexico has diverse programs to support the automotive industry, given the importance of this sector in the Mexican economy.

Notwithstanding the above, it is worth mentioning that Mexico has an extended treaty network such as Free Trade Agreements which allow to import goods under preferential duty rates. Nowadays this network includes 12 treaties with 49 different countries around the world.



European Union (EU)*

European Free Trade Association:
- Iceland
- Norway
- Switzerland
- Liechtenstein

North America:
- United States
- Canada

Triangle of North:
- Honduras
- El Salvador
- Guatemala

- Nicaragua
- Costa Rica
- G3: Colombia**
- Bolivia
- Chile
- Uruguay

6 ACEs Mercosur:***
- Argentina
- Brazil
- Peru
- Colombia

- Israel

- Japan

* Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, UK.

* As of January 1st of 2007, Bulgaria and Romania became a part of the EU

** As of November 19 of 2006, Venezuela is not longer a part of the TLC del G-3

*** Economic Complementary Agreements (ECA)

Temporary imports (IMMEX) previously known as Maquilas

The Ministry of Economy (SE) created The Decree to Promote Manufacturing, Maquila and Export Services Companies (IMMEX) published in November 2006. This Decree consolidates the Maquila and PITEX programs (the previous temporary import programs), nullifying the PITEX program. Entities exporting at least US$500,000 or 10 percent of their production may enter into a IMMEX program authorized by SE and rewarded with the following benefits:

1. Temporary (duty-free) imports (raw materials):
2. For up to 18 months for raw materials, supplies and packing materials used on the exported production.
3. Exemption from import duties:
   On fuels, lubricants, spare parts, and other consumables used in the production of exports.
4. The domestic sale of part of the production (with foreign content) covered under the program may be performed upon the payment of the suspended import duties over the foreign contents thereof.
5. VAT will be returned within 20 days if there is a credit balance.

The life of an IMMEX program is indefinite as long as the company complies with the provisions, including:

1. Generate a foreign trade operations annual report according to the program;
2. Keep an automated inventory record to control the merchandise imported and exported during the life of the program.
3. Export merchandise in 18 months, at the latest.

Zero rate of VAT is applicable to exports, even when they are physically exported by a third party, provided they remain under the temporary importation regime.

IMMEX includes the services authorized in the Maquila programs, as well as the additional services of repairing, cleaning, quality control testing, packing, painting, greasing activities and technological support services (software).

On December 24 2010, the IMMEX decree was amended re-defining the Maquila operation, including the following situations:

a. Raw materials are supplied by a foreign resident (with whom the Maquila has a maquila contract) are temporarily imported to be processed, transformed or repaired and returned abroad, in accordance with the Mexican Customs Law and the IMMEX decree, including virtual import-export customs declarations. For this purpose it would not be necessary to export scrap or waste.
b. The Maquila would also be permitted to have goods imported under the permanent regime and local purchases can be made, as long as such goods are consumed in production or are exported with the temporarily imported inventory under the IMMEX program.
c. Process, transformation or repair of goods would be required to be performed with temporarily imported Machinery & Equipment (M&E) and property of the foreign resident. For this purpose, at least 30% of the M&E used for Maquila operations must be property of the foreign resident and temporarily imported under the IMMEX. Such M&E cannot be previously owned by the Maquila or a Mexican related party.

M&E used in Maquila operations could be complemented with fixed assets that are property of the Maquila, or another Mexican unrelated party which provides those goods in a lease agreement.
Note that specific rules for determining the percentage of M&E would be applicable according to the specific rules of the tax authorities, which would be published.
The limits for M&E would not be applicable to companies that were operating under an IMMEX program as of December 31, 2009, if such companies have fulfilled all their tax obligations, especially those related to the transfer pricing safe harbors provided for by article 216-bis of ITL. If the authorization was in effect before 2010, there would be no specific limitations on percentages of M&E. However, many experts might consider that "some" M&E and inventory will need to be imported on a temporary basis and these temporary assets should be property of the foreign principal in order to be eligible for protection from the Permanent Establishment (PE) status and to be eligible for reduced income tax rates available to Maquilas.

d. Companies must fulfill all requirements established in articles 2 and 216bis of the ITL, and it is not considered a Maquila activity when goods transformed or repaired are sold in Mexico, unless such sale is documented with an export customs declaration (i.e. virtual exportations). Therefore, local sales would not ordinarily be deemed to be operations described in ITL articles 2 and 216-bis.

Companies with a high volume of exports, ALTEX

The High Volume Exporting Companies Registry (*Empresas Altamente Exportadoras*—ALTEX) is granted for entities exporting at least US$2 million annually or when its export sales represent at least 40 percent of gross sales.

As for non-tax benefits, ALTEX entities are provided with greater financial assistance, top priority in customs clearances and special promotional assistance in Mexico and overseas.

In addition, ALTEX entities are able to obtain value-added tax refunds within a 10 working day period, instead of the common 90 working day period.

Exporters may also be able to recover import duties through the drawback system when they export products in the same condition in which they were imported.

Although this program was suppressed in the last IMMEX Decree amendment, the previous registers are still valid, as long as the Companies fulfill their obligations.

Nowadays it is possible to benefit from the "ALTEX" benefits by enrolling into an IMMEX program.

Sectorial Relief Programs (SRP)

The SRP provides companies a preferential tariff rate to import goods intended for production, regardless of the country of origin, and charges preferential rates (foreign trade taxes from 0% to 5%) to export the resulting products.

The authorized sectors in which companies are able to charge preferential rates in the importation of goods are the following:

- Vehicle and auto-parts industry
- Electronic industry
- Capital goods industry
- Chemical industry
- Rubber and plastic manufacturing industry
- Steel industry
- Leather and fur industry

The program lifecycle is indefinite as long as the company complies with the law provisions, such as the production of other imported goods and the filing of an annual report.

Bonded Warehouse

Bonded Warehouse regime consists of introducing for a limited period of time, foreign, national or nationalized goods into authorized warehouses, with the purpose of being stored for safekeeping, exhibition, distribution, transformation or to be repaired, as long as such goods are strictly controlled.

The main benefits of said regime are as follows:

Neither import duties nor countervailing duties will be paid, except for those cases contemplated within the Free Trade Agreements Rules prevailing accordingly.

Non-tariff restrictions and regulations do not have to be complied with, except for those regarding animal and vegetable sanitation, public health, environmental and national security.

Duties and VAT will be triggered only if goods are extracted into domestic market, bonded via a definitive import.

Import duty drawback

Under import duty drawback, all exporters (including indirect exporter suppliers) are entitled to the refund of import duties paid up to one year before on imported merchandise integrated into exported goods or sold to other entities that physically transport the exported assets.

Conclusions

Road-signs

The Automotive Industry

This document contains the road-signs necessary to navigate safely through a sector opening up to world and national dynamics full of surprises. Throughout the different sections, by analyzing the figures and indicators provided, the reader will find areas of opportunity, as well as unforeseen situations.

As it can be seen throughout this document, the road-signs showing the way (expanding markets and speedily recovered competitiveness) are not unmovable; they sometimes shift in a positive manner and sometimes towards areas of uncertainty, such as the frequent changes in Mexican legislation. But those areas have to be dealt with and imply changes in strategy.

However, if the details contained herein are taken into account, the players in this industry will feel more confident in charting their way, with the aid of this PwC report, which has been designed to assist in planning future strategy. What is important to us is that this update will be instrumental in working out the best strategies for your company within the worldwide dynamics of the Mexican automotive industry.

The many changes in Mexican legislation and in the international regulations affected by it must be efficiently dealt with in order to mitigate contingencies and risks and provide practical and innovative solutions making it possible to streamline resources and avoid cutting into a company's financial capacity. Therefore, before setting out on the road to recovery, we recommend talking to the PwC automotive industry specialists and taking advantage of their expertise in dealing with all the challenges posed by globalization.

PwC offers overall support in designing, deciding or adjusting the best strategy for your company, as well as maximizing or transforming your business competitiveness.

We will be pleased to advise you in this regard.

Lead Partner of the Automotive Industry

Luis Lozano Soto

Luis Lozano is a Legal and Tax Services Partner, Lead Partner of the Automotive Industry at PwC Mexico.

He has 23 years of professional experience, advising local, multinational and international companies with their Mexican tax issues, requirements, reports, transactions, tax compliance and planning, primarily in the Automotive Industry, working in coordination with the global network of PwC.

He is a member of the Merger and Acquisitions and Innovation Committees and was member of the Tax Consolidation Committee in PwC; he is also a member of the American Chamber in Mexico as well the Mexican Institute of Public Accountants.

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