

VI Mexico Advocacy Day
California-Mexico: Investment and Trade Opportunities
May 5, 2015

Thank you Mr. Chairman and members of the Senate select committee on California-Mexico Cooperation for inviting me to testify today and for supporting Mexico Advocacy Day. My partners and I at the Central Valley Fund are gratified and honored to be before you today to share our thoughts about "Investment Opportunities between California and Mexico."

The Central Valley Fund or CVF started in 2005 as a private equity investment fund based in Davis, CA with a satellite office in Fresno, CA. The fund's underlying core strategy has been to invest in small to middle market businesses in the California Central Valley, and also throughout the state of California. Our funds have managed \$175M in capital commitments from our investors, including the California Public Employee Retirement System (CalPERS) and other institutions and individuals with a commitment to California. In our current fund, CVF II, we have Mexico's largest institutional investor, Fondo de Fondos de Mexico, as a committed investor. We believe we were their first capital allocation to any U.S. based fund manager.

A valuable byproduct of our core investment strategy has been the rapidly growing trade relationship California enjoys with Mexico. As you may have heard from others, NAFTA trade has grown a solid 7 to 10% year-over-year. These ever increasing trade volumes, along with meaningful growth of tourism and direct investment, have been among the leading catalysts propelling both economies over the last 20 years.

My partners and I have incorporated this accelerating trade dynamic into CVF's investment strategy. We evaluate companies with, and have a heightened interest in, management teams that have not only executed successfully on growing their business plan in the U.S.A., but also their ability to capture the benefits of the U.S.-Mexico trade dynamic and/or serve the rapidly growing Mexican diaspora in California and throughout the U.S. Southwest.

The growing Hispanic population in the state of California is particularly pronounced in the San Joaquin Valley, where approximately 50% of the population is Hispanic and supports the state's world class agricultural industry. The Hispanic entrepreneurs around the state are concentrated, aside from Ag, in construction, hospitality, and retail businesses, collectively representing over 500,000 businesses. In the last ten years Hispanic entrepreneurs, particularly 2nd and 3rd generations, have launched businesses in manufacturing, distribution, and technology. The latter sectors have provided increasing opportunities for investors like CVF to deploy capital that capture these cross-border dynamics.

An example of one these opportunities is a Central Valley based fertilizer manufacturer where CVF invested. The company produces sustainable fertilizer products that provide healthy bio-degradable ingredients to improve crop yields while providing soil beds with increased nutrients. The company's products are particularly efficient with berry crops (i.e. - strawberries, blue berries, etc.). Management seized the opportunity to follow Central Valley farmers to Mexico, in order to provide their U.S. customers (i.e. - Safeway, Kroger, etc.) with year-round fresh fruit products and eliminate the seasonality associated with fresh fruit grown solely from April until October. The company built a distribution and mixing facility jointly with Mexican agronomists in Zamora, Michoacán in Mexico. This Mexican connection provided our Central Valley company year round sales and differentiated us from seasonal fertilizer operators in California.

Another example has been a Los Angeles based 3PL logistics provider that caters to the largest Mexican exporters of consumer products (i.e. - Bimbo, etc.) to store and distribute their products throughout the U.S. The company was founded by three Mexican nationals who came to the

U.S. with a vision to build a unique logistics business that catered to Mexican and Latin American exporters to the U.S. Currently the business employs over 200 employees, mostly Californians, and manages 1.5 million square feet of warehouse space across the country. The company has built a close working relationship with U.S. firms like Nike, Wrigley, etc. and continues to provide more added value services in logistics to Mexico's leading consumer brands throughout the country.

Scale and Scope

The key in any investment business is to measure the size of the addressable market and determine whether the marketplace will be open to collaborating with private capital providers like CVF. Investment funds look for interesting macro environments where companies are looking to attend to consumer needs and demands but also management teams willing to improve and scale their businesses.

The absolute size of the Mexican economy, roughly \$1.3 trillion dollars, and the California economy, exceeding \$2.2 trillion dollars, answer the question of scale. Combined, the region would rank as the 5th largest economy globally. The question of scale also addresses the number of businesses, advisors, and capital providers to insure there are numerous and diverse players to complete the investment ecosystem.

The matter related to scope refers to how diverse a particular economy or market may be to avoid any particular risk of concentration. An exaggerated example would be investing in Alaska where no matter what industry or business one invested into, one would be exposed to the volatility of commodity prices (oil, gas and minerals) because over 70% of the state's GDP depends on these extraction industries.

The advantage of the California-Mexico economies is the broad industry diversity. For example, if one makes an investment in the hospitality industry, it would be unlikely that a downturn in any particular industry could impact that investment, with the exception of broad macro trends nationally or even globally. The broad diversity of both economies would support the hospitality industry investment despite a downturn in commodity prices.

Opportunities for California entrepreneurs

The Mexican middle class has quadrupled the last 20 years amounting to over 60 million of its citizens and growing. The continual opening of the Mexican economy following significant regulatory reforms in key sectors like energy, transportation and telecommunications will continue to promote business friendliness. In the World Bank's recent 2014 rankings, Mexico ranks among countries like Israel and Spain regarding the "ease of doing business", a trend that is poised to continue.

Life has markedly improved for the average Mexican citizen. According to the UN's Human Development Index, which measures the average achievements in a country in three basic dimensions: a long and healthy life, access to knowledge and a decent standard of living, Mexico now ranks "High". The index was created to emphasize that people and their capabilities should be the ultimate criteria for assessing the development of a country, not economic growth alone. This further emphasizes a changing Mexican consumer seeking new technology, better education, higher quality food products, and, in general, better living standards.

The small and middle market entrepreneurs that understand this dynamic have been able to export or build local operations to cater to the Mexican market and serve as a springboard to Latin America.

Opportunities for Mexican entrepreneurs

The California consumer has integrated and adopted vast elements of Mexican culture into its cuisine, entertainment and traditions. The Hispanic populace in California of 14 million individuals provides a natural extension of the Mexican customer base, but also a springboard to the U.S. west coast market. The volume of California-Mexico trade has now reached \$25 billion dollars and represents California's most important trading relationship.

An example of the trade interdependence is clearly seen in the Ag industry. Mexican and California farmers cultivate close to 100,000 acres in Mexico, primarily to grow fresh fruit and vegetables to export to the U.S. when it is otherwise not possible due to the U.S. climate. These relationships contribute to the roughly \$3.2 billion in agricultural and livestock exports from Mexico to the California, or roughly 30 percent of Mexican Ag exports.

Conversely California's dairymen and cattlemen exported almost \$750M in dairy and various meat products in 2014, capitalizing on the state's unique position as the most productive agricultural producer among all U.S. states. These trends are expected to persist given the relative efficiencies of the California Ag operators and Mexico's relative advantage of its geography and weather year round.

Investment and Trade Opportunities are expected to endure

The economic research literature clearly states the benefits of improved cross-border investment and trade. Since the inception of the European Economic Community (EEC), that region has seen increased levels of cross border activities where each nation's relative economic strengths are captured. For example, German and French manufacturers dominate industrial equipment manufacturing while the United Kingdom is the continent's leader in financial services.

Personally I witnessed the incorporation of Spain and Portugal into the EEC in 1986. At the time of their entry into the EEC, the price adjusted per capita income of both countries was less than half the EEC average. Currently, almost 30 years later these income levels are 75-80% of the EEC's average.

The rate and pace of cross-border economic trade and investment in the new EEC has been motivated or arrested as a function of the transparency associated with business investment. This transparency is not only exhibited in terms of enforceable contracts and the rule of law, but also labor, environmental, tax and political framework that were fair and level for all. A well-known economist once commented about foreign direct investment, "Capital will be deployed and invested where it is wanted and well treated."

The role investment and trade plays is determined in great part by the incentives the polity provides entrepreneurs and the desired outcomes. For example, if Californian businesses see the Mexican economy as an opportunity to provide quality and well-priced products to Mexican residents and pre-empt other U.S. and foreign businesses, Mexico will see welfare improvements while California businesses see improved rents.

To the extent Mexican businesses capture the relative trade advantages related to its unique climate, lower labor costs, growing young populace, and untapped energy resources it will provide outsized rents to Mexican investment capital.

The promotion of these relative economic advantages becomes the key motivating factors in strengthening a healthy trade relationship.

Dangers of not capitalizing on the moment

The danger in not bridging and stimulating California-Mexico investment and trade would be higher relative prices and levels of unemployment in the region. The economic literature is also particularly clear about regions that live uncoordinated as autarkical economies are destined to underperform and limit the upward mobility of their respective populaces.

In closing, my partners and I are optimistic that there is a great deal of risk for both California and Mexico if we do not build a strong and closely knit business environment where leaders on both sides of the border work to develop the appropriate political framework to succeed. Despite the ever-present challenges, the region's future is bright, and promises to be a vibrant regional economy rivaling the world's best. We believe the best is yet ahead for Californians and Mexicans.

Thank you again for your time and thoughtful consideration of such an important matter for the state of California.