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Railroad Merger Falls Through After Mexican Stockholders Nix Deal

by LADB Staff

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An ambitious plan to merge two US and Mexican rail companies into a single binational unit unraveled after shareholders of the Mexican partner in the venture, giant transportation company Transportes Maritimos Mexicanos (TMM), turned down the deal in a vote in mid-August. The US partner, railroad company Kansas City Southern Industries (KCS), had been prepared to form a large binational rail company after reaching an agreement with TMM officials in April of this year to acquire a large share of the company's rail subsidiary Transportacion Ferroviara Mexicana (TFM) for US$200 million. KCS, which already owned a small percentage of TFM, was proposing to merge its US and Mexican operations into a company called NAFTA Rail (see SourceMex, 2003-04-30).

In documents filed with Mexico's stock exchange, (Bolsa Mexicana de Valores, BMV), TMM said 99% of stockholders voted to oppose the transaction. The company said stockholders rejected the deal for a variety of reasons, including concerns that TMM might lose out on a huge tax refund that the company is trying to obtain from the Mexican government.

A Mexican tax appeals court (Tribunal Federal de Justicia Fiscal y Administrativa) recently upheld TMM's lawsuit against the government for improper collection of value-added tax (impuesto al valor agregado, IVA) in 1996. The refund could surpass the equivalent of US$1 billion if interest is included.

President Vicente Fox's administration, however, has announced its intention to appeal the decision. Deputy transportation secretary Aaron Dychter said the government is in no hurry to file an appeal. "The Finance Secretariat will have sufficient time to study legal options to counter the decision," said Dychter.

Timing of tax refund may have triggered decision

The timing of a possible refund complicated the TFM-KCS transaction because the appeals process could delay the refund for as long as a year. This delay could have had a bearing on whether TMM received an additional payment from KCS. Under the terms of the deal, TMM would receive an extra payment of US$175 million from KCS if it won the tax case from the US before the US company acquired the government's share in the Mexican railroad. If TMM received a favorable ruling after the sale had gone through, there would be no additional payment from KCS.

Rumors circulated that KCS executives had approached the government about acquiring its remaining 20% share in TFM without consulting TFM. Some analysts said this may have led TMM chief executive officer Jose Serrano, the company's largest stockholder, to turn from one of the largest proponents of the deal to a leading opponent. "It is a bit ironic that in the space of three to four months Serrano has gone from being the big proponent of this to shooting it down," James

A TMM spokesperson denied that the IVA refund was the main force behind the decision of stockholders to turn down the deal. "Stockholders are free to make their own decisions," said company spokesperson Marco Provencio. "From the company's point of view, this decision simply concludes the intention to sell and frees up TMM to seek financing alternatives more in tune with its interests." The documents filed with the BMV indicated that stockholders also voted down the transaction because of concern that KCS would absorb the parent company, not just NAFTA Rail.

Another factor cited in the report was that US debt-rating company Standard & Poor's recently downgraded KCS debt. To formalize the vote of the stockholders, TMM officials filed a notice in mid-August with the government's foreign-investment agency (Comision Nacional de Inversiones Extranjeras, CNIE) that the deal with KCS had been canceled. The CNIE must be notified anytime a Mexican company sells more than 49% of its shares to a foreign interest.

US company threatens legal action
KCS officials initially had little comment on the cancellation other than to issue a statement threatening legal action. Later, in a letter to TMM's legal counsel Kenneth Ostrow, KCS officials said the company had no intention of abandoning its pursuit of TFM despite the TMM vote.

KCS attorney John Marvin said the sales agreement acknowledged that the transaction would come up for vote by TMM stockholders, but that the outcome of the vote was not "one of the obligations" listed by TMM as a prerequisite for conclusion of the sale. Because of this, said Marvin, KCS views the purchase agreement as "valid and effective." (Sources: Reuters, Associated Press, 08/18/03; CNI en Linea, El Sol de Mexico, 08/19/03; The Dallas Morning News, CNI en Linea, 08/20/03; Notimex, 08/18/03, 08/22/03, 08/25/03, 08/26/03; La Jornada, 08/19/03, 08/27/03; El Universal, 08/19/03, 08/20/03, 08/25/03, 08/27/03; Milenio Diario, El Financiero, 08/19/03, 08/25/03, 08/27/03; La Cronica de Hoy, 08/19/03, 08/26/03, 08/27/03; Reforma, 08/19/03, 08/20/03, 08/22/03, 08/25-27/03)