INDUSTRIAL GATE

Benefits of Nearshoring for Industrial Companies

A COMPREHENSIVE ANALYSIS

October 2023

NEARSHORING | AN INTRODUCTION

We are all familiar with the term offshoring – one of the pillars of globalization. Over the last fifty years, the world witnessed an integration of geographically distant economies and the movement of operational processes overseas to reduce the cost of production and services. On the back of this trend, China transformed itself into a global manufacturing hub. However, recent events such as the US-China trade war that started in 2018 and the COVID-19-induced supply chain crisis have reversed the globalization momentum, resulting in the birth of a competing phenomenon called de-globalization. Nearshoring is a business strategy in which companies outsource their processes, manufacturing, or services to countries that are geographically close to their home country and/or target market. It involves transferring operations to nearby countries or regions, often within the same continent or time zone, rather than outsourcing to more distant locations. Examples of nearshoring include German companies moving operations to Poland, Spanish companies moving operations to Morocco, and American companies moving operations to Mexico. Nearshoring is expected to gain momentum in the coming years due to its important benefits – cost efficiency, supply chain resilience, quality control, and cultural compatibility – all of which allow companies to optimize operations and maintain a competitive edge in the global market.

BENEFITS OF NEARSHORING

Nearshoring, like offshoring, allows companies to access cheaper supply chains and labor markets. However, nearshoring offers a number of distinct advantages over offshoring:

Proximity and Time Zone Advantage

- Being in the same or similar time zones allows for real-time collaboration, faster decision-making, and quicker response times.
- Proximity reduces transportation time and cost.

Supply Chain Resilience

- When companies reduce their reliance on distant and potentially vulnerable supply chains, it is far easier to adapt to changing market conditions, mitigate risks, and ensure the continuity of operations.

Reduced Environ-mental Impact

- Shorter supply chains result in lower energy consumption and environmental impact.

Additional Benefits

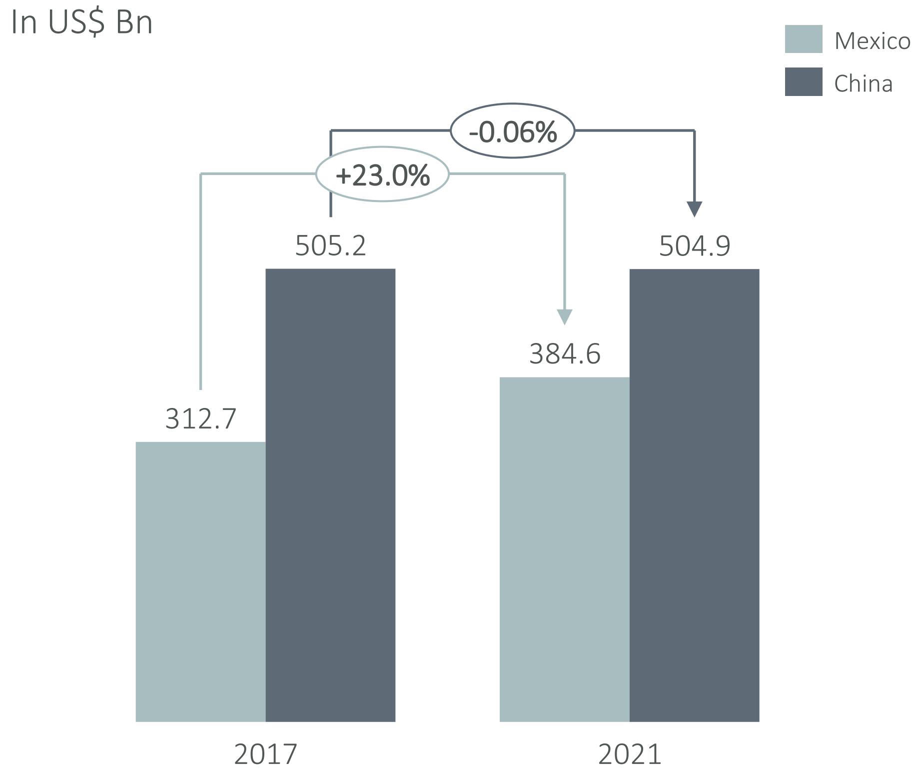
- Better quality control and IP protection.
- More cultural compatibility within the supply chain.
- Increased access to government support and incentives.

MEXICO'S NEARSHORING OPPORTUNITY

Mexico's strategic location along the US border, excellent connectivity, and openness to trade make it a key beneficiary of the nearshoring phenomenon. The US-Mexico-Canada free trade agreement (USMCA) supports mutually beneficial trade between the three economies. Recent geopolitical tensions have reduced trade between the US and China, with Mexico benefiting greatly. In 2017, Chinese exports to the US were valued at US$505 Bn, 62% greater than Mexico's US$313 Bn. However, by 2021, the gap was reduced by more than half, as the value of Mexico's exports to the US grew to US$385 Bn and China´s remained essentially flat.

Total Exports to the US-Mexico vs China

In US$ Bn



Source: USITC and Barclays Research

The Mexican nearshoring trend is gaining powerful momentum. At the North American Summit in early 2023, the partners agreed to relocate 25% of their Asian imports to North America, which would add 2% growth to Mexico's GDP. Analysts predict that trade between US$60 Bn and US$150 Bn in the next decade could flow into Mexico as part of nearshoring efforts. Last year US$30 Bn in investments were allocated to strategic sectors in Mexico such as manufacturing and advanced packaging, batteries, electric vehicles, logistics, and medical supplies. Of particular significance to Mexico are those industries where non-material costs, such as labor, transport, and tariff are relatively low, and provide a counterweight to the higher materials costs.

Economic and noneconomic factors that determine feasibility of regionalization[1]

High / *Low* Contribution to feasibility — High regionalization potential — Regionalization Potential

Industry[2]	North American demand, 2021 $ Billion[3]	Economic drivers	Non-economic drivers	North American imports / gross output[4], 2021, %
Medical devices	329			24
Semiconductors and electrical components	204			50
Computers and electronics	221			131
Pharmaceuticals	421			56
Automotive	964			20
Electrical equipment	259			73
Machinery and equipment	541			42
Chemicals	569			23
Mobile/communication equipment	196			165
Aerospace	142			16
Furniture	128			36
Food and beverage	1,254			8
Apparel	143			411
Textiles	69			62
Rubber and plastic	368			29
Transportation equipment[5]	91			11

Note: Excludes industries dealing with natural resources: agriculture, metals, glass and cement, mining, paper, petroleum, and wood.
[1] Feasibility of regionalization is the sum of two (1-4) scales representing economic and noneconomic factors.
[2] Resource-intensive industries are not included: agriculture, mining, utilities, forestry and paper, and oil and gas.
[3] Calculated as gross output plus imports minus exports.
[4] Includes production for the domestic market and imports from North America.
[5] Includes ships, locomotives, railways, bicycles, etc.
[6]Source: HIS Markit

THE IMPACT

Nearshoring is a golden opportunity for Mexico to revitalize its industrial platform, modernize its infrastructure, grow its skilled labor force, create well-paid jobs, and significantly boost its economy.

And while there is still debate on whether the world is experiencing permanent 'de-globalization' or just a pause in globalization, there is no doubt that just as offshoring had an important impact on the world's economic model, the impact of its reversion will also be important, particularly on Mexico's industrial real estate space.

Catalysing Nearshoring: TC Latin America Partners has established Industrial Gate, an integrated investment and development platform with a strategic focus on Mexico's industrial real estate sector.

TC Latin America Partners is an institutional fund manager specializing in the real estate sector across Latin America and the United States. The Firm has had a presence in Mexico since 2013 and has invested in the industrial real estate sector since 2016. In Mexico, Industrial Gate's primary focus lies in the acquisition and development of Class A industrial assets, catering to multinational companies that are progressively relocating their operations to the country to foster cross-border commercial activity with the United States.

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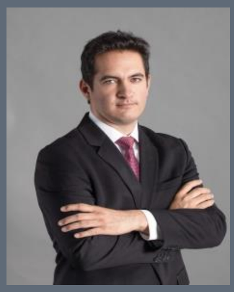

Mr. Baez serves as the Director of TC Latin America Partners for the office in Mexico and is responsible for the investment division at Industrial Gate. With an extensive background spanning over 15 years in the real estate sector, his expertise lies primarily in the origination, underwriting, and asset management of diverse asset types encompassing industrial, commercial, residential, and mixed-use real estate projects.

Prior to joining the Firm in 2015, Mr. Baez honed his skills as a relationship and financial manager at Grupo Frisa, a renowned industrial and commercial real estate developer in Mexico, where he worked for 8 years and closed over US$450 million in transactions.

Antonio holds an M.B.A. from Universidad del Valle de Mexico and a Bachelor in Finance (B.F) from *Escuela Bancaria y Comercial* in Mexico City.

[7] *Statista.com Mexico e-commerce projections*