

Growth reimagined

Prospects in emerging markets
drive CEO confidence

*14th Annual Global
CEO Survey*

*Armando Garza Sada
Chairman of the Board
of Directors, Alfa, S.A.B.
de C.V., Mexico*

Interview Transcripts

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Alfa is a Mexican company incorporated in 1974. Its corporate offices are located in San Pedro Garza García, Nuevo León. Measured in terms of its income, Alfa is one of the largest diversified industrial companies in Mexico. It comprises four business groups: Alpek (petrochemicals), Nemak (high-tech aluminum auto parts), Sigma (refrigerated food) and Alestra (telecommunications). Alfa has manufacturing operations in Argentina, Austria, Brazil, Canada, China, Costa Rica, the Czech Republic, the Dominican Republic, El Salvador, Germany, Hungary, Mexico, Peru, Poland, Slovakia and the United States. Alfa markets its products in more than 70 countries around the world.

Armando Garza Sada has been the Chairman of the Board of Directors of Alfa since March 2010. However, he has worked with the Company since 1978, holding important executive positions, among the most important of which were Vice Chairman of the Board of Directors, Senior Vice President of Corporate Development, and President of the subsidiaries Versax, Sigma, Polioles and Selther. He is currently a member of the board of directors of FEMSA, Liverpool, FRISA, Lamosa, MVS and of the Instituto Tecnológico y de Estudios Superiores de Monterrey (ITESM). He is also a member of the board of Stanford University and of the Advisory Board of its business school. Armando Garza Sada has a major in Engineering from the Massachusetts Institute of Technology and a Master's degree from the Stanford Graduate School of Business.

Summary

- In recent years, our companies have been able to increase their market share, while our customers were doing so too. This has allowed us to grow.
- We serve our markets “from the bottom up”; that is, we try to discover or anticipate the needs of our customers in order to provide them with the best possible solutions.
- In Alpek we have interesting investment opportunities. We recently entered into a process of acquiring petrochemical plants from Eastman Chemical Co., which produce raw materials for polyester in all its applications.
- In Nemak, the expectation of accelerated growth of the automotive industry in Asia has driven us to develop our business in that region. We have top executives living in China, whose mission is to open spaces for our products and explore new alternatives in which we may benefit from our knowledge and experience.
- Our subsidiary Sigma is expanding internationally, both in the United States market, with a primary focus on the Hispanic segment, and in South America. We wish to adapt to these markets the business model we have implemented with great success in Mexico.

Alestra has found in the business niche of the Mexican market a significant growth opportunity through offering its customers a solid platform of value added telecommunications services.

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- Although we have always been significantly aware of our corporate social responsibility in Mexico, we have now expanded this concept to encompass our activities in other countries and regions. We have gotten involved with the needs and ambitions of our employees and of the communities surrounding our facilities, actively participating in the promotion of their well-being and quality of life.
- In Mexico, it is important to have a “country vision”, which is accepted by all or at least a vast majority of our population. This would allow us to recognise the areas that are really relevant so that we can advance in the correct direction.

Global environment

Indicators and trends

The virtuous circles of competitiveness

The economic crisis of 2008 brought very different challenges and opportunities for each of our businesses. The crisis was not so severe in food or in petrochemical products, since demand continued growing or at least did not fall. Neither was the crisis severe in the telecommunications services sector, which is in the forefront of the technological wave. Hence, our only business sector affected by the crisis was the one supplying the automotive industry.

In 2010, the first three businesses mentioned continued growing. The fourth sector experienced a strong recovery, as a result of the rebound of the automotive markets, which grew strongly although not achieving pre-crisis levels. The steps adopted by our subsidiary to cope with the difficult situation proved their worth and, with the increase in the demand, allowed it to generate record cash flow figures.

In the case of the economic regions, we have seen that the recovery of the North American and European markets has been slower than everyone would wish. Also, risks persist in the Euro Zone which could affect financial stability. On the other hand, the economic horizon looks clearer and more promising for the emerging nations of Asia and Latin America.

In any case, the good news is that our companies have been able to increase their market share, in tandem with our customers. This has allowed us to grow. In summary, the crisis has strengthened us, leaving us better prepared to continue steadily expanding.

Change of strategies

Living markets from the bottom up

Our business models are solid, as demonstrated during the global crisis we have undergone. We did not have to restructure these models or submit them to significant organisational reengineering, although we did take steps to protect our cash flow against the risk that the financial crisis could result in a generalised lack of liquidity. Thus we can state that the strategic changes made in the last few years, and those contemplated in the short or medium term, were not made in response to the crisis or its aftermath.

The only exception, as expected, was Nemark, in the automotive industry, where, in view of the problems faced by our customers from mid 2008 to the first quarter of 2009, we had to implement emergency measures and reduce our labor force.

At Alfa, we serve our markets “from the bottom up”; that is, we try to discover or anticipate, as precisely as possible, what the needs of our customers are, so as to provide the best solution. It is this

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“upwards” approach that has allowed us to increase our market share, whether through organic growth, acquisitions, joint ventures, or innovation and development of new and improved products.

Long-term planning pays off

As mentioned above, except for the automotive business, the crisis did not force us to make any significant changes. Thus, for example, in the petrochemical business, the market factors continued to be raw material prices and energy costs; as well as the manufacturing of products increasingly friendly to the environment. In the case of refrigerated foods, the inclination of the consumer towards healthier products or the search for specific nutritional content, trends that had already been present prior to the crisis. The same may be said for the telecommunications markets, where the key factor is found in the design of convergent connectivity solutions (voice, data and internet services), tailored to the specific needs of our current and potential customers.

Our strategic approach has been maintained within the framework of the mid- and long-term planning exercise, which is valid even for the big acquisitions we made this year, such as those of BAR-S in Sigma, and the petrochemical plants of Eastman Chemical Co., in Alpek. These acquisitions were not the result of a chance opportunity, but rather of the process of planning, resource management and negotiations over a long period of time.

Growth and geographic diversification

Markets on wheels

The automotive industry, of which we are suppliers, has faced a difficult situation recently. In addition to the financial crisis, the industry faced its own crisis, characterised by the oversupply of vehicles, a trend of rising fuel prices, technological advances, and changes in the preferences of consumers, who are increasingly sensitive to ecological and environmental sustainability problems.

We have a fairly clear picture of the new trends and of how the automotive industry markets will be in the short and medium term. We know that the most dynamic markets will be those of the emerging countries, mainly Asia, while the markets of Europe and the United States will grow at a considerably slower rate. We see that there is a clear trend toward manufacturing vehicles with more efficient engines, but without sacrificing power, as well as toward replacing large vehicles with lighter ones and with compact SUV's. We are ready to quickly take advantage of the business opportunities in the markets of the future, and those resulting from the transformation of the automobile to which I have referred.

Learning Mandarin...

In the near future, it is anticipated that the global automotive industry will come principally from the Asian continent. For that reason, we are closely observing those business is done in that region.

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For a few years now, we have been manufacturing and selling our products in China. Now, we are building a plant in India. Even though both efforts are still incipient, our commitment is strong: we have sent top-level executives to the region, with the mission of developing spaces for our products and exploring new alternatives through which we could leverage our knowledge and experience.

We see a great opportunity: a wide market, customers who have not yet consolidated their preferences, competitors with small-scale processes, with poor technological differentiation and high costs, etc., conditions that could be propitious for our acquiring an interesting part of the market and increasing our operations in Asia.

With a lot of protein...

In the food markets, we have interesting growth options, through strengthening our position in the Mexican market or expanding internationally.

For the Mexican market, Sigma's strategy consists of strengthening its leadership position and capturing a large share of the market through branding and creating new food alternatives for its customers and consumers. Internationally Sigma is aiming at the United States market, specially the Hispanic segment, as well as at the Central American, Caribbean and South American markets, where we will look to adapt our business model, which has been highly successful, to the circumstances in each case.

Good chemistry...

In the petrochemical markets interesting opportunities are also available. Such is the case of the acquisition, currently in process, of the Eastman plants that produce raw materials for polyester. Once this

transaction is closed, Alpek will redimension its capacities, becoming the company with the best technology in North America, which will place us in a good position to expand beyond this region, which has until now been our natural market.

And communicating.

In the case of Alestra, we offer value-added telecommunications services to the Mexican market, especially to the business sector. Our strategy is very focused: to provide the best connectivity and added value solutions, in order to benefit from the rapid growth of the sophisticated markets combining telecommunications with information systems.

Innovation and Development

Without I+D there is no paradise

Innovation has played an important role in the growth of our company. We may be the Mexican business group that destines the most resources to research and development. In fact, four years ago we institutionalised the innovative processes in our technological and research areas. By better orienting our efforts in this area, we have been able to develop new products and implement improvements in the productive processes which have resulted in greater efficiency.

It should be mentioned that in order to strengthen our R&D efforts, we have entered into collaboration agreements with universities in Mexico, the United States and Europe. We also have technological partners in some of our companies, who provide us with valuable support in this field.

In Sigma, our I+D activities have allowed us to launch new products into the market, with which we have gained market share and strengthened our brands. One of these products is Guten[®],

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a soy-based food which replaces meat products with considerable advantages from the nutrition point of view, since it has the same relative amount of proteins, with a lower fat content. Acceptance by the consumer has been favorable, since, in addition to the aforementioned advantages, this product is competitive in price.

Nemak's geographic scale and coverage allows it to invest in I+D projects of a multinational scope. We have two technological centers, located in García, Nuevo León, Mexico and Linz, Austria. For several years now, we have been developing projects for new products, new materials and technological improvements. To complement this, we also actively promote the development of new technologies jointly with our customers.

Production costs are the key competitive element in the petrochemical business. For that reason, our R&D efforts in Alpek have focused on searching for ways to increase efficiency. This includes reducing the specific investment per ton, increasing the yield from raw materials, reducing the consumption of energy and improving the environmental performance of the plants. Thus, we can say that Alpek operates with efficiency standards superior to the average in its industry and to many of its competitors.

Money and capital markets

Liquid markets

Alfa is a company that uses external financing to improve its return on capital. The debt markets have been willing to finance the investments of companies like ours that have solid balance sheets and good credit records. For example, in 2009, Alestra, Sigma and Petrotemex (a subsidiary of Alpek) issued bonds under Rule 144-A in the United States market.

The banks have also eased the conditions and costs of access to credit; therefore, they have become safe options for obtaining the financial resources that we have needed. Our good financial results have strengthened the confidence that institutions with which we have worked for many years have in us, as well as that of others with which, without having a very long relationship, we have encountered mutually beneficial business opportunities.

Labor markets and talent management

A well-proven model

Alfa has always achieved a harmonious relationship with its employees. This has resulted in low personnel turnover and in great employee loyalty to the company. The labor model is based on respect for the individual, as well as on investing in the employees so as to achieve their optimum development. This investment goes beyond training for their work position, extending to the assistance granted to the individual in order for him or her to grow as a person, which is made extensive to his or her immediate family.

Long-lasting relationships

In terms of executive remuneration, ALFA's formula is not different from that of other Mexican companies of a similar size. There is a fixed and a variable compensation, both in the short and the long term, which depend on reaching and exceeding pre-established goals.

Our capacity to attract, retain and manage executive talent does not depend on the compensation package, but rather on our ability to create a sense of belonging to an organization that offers a long-term relationship and a professional development opportunity, and that has a clear conception of itself, of what it wants to be, and of how to achieve it.

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In this sense, our commitment goes beyond the trends in most global corporations, where the people easily go from one company to another. On the contrary, at Alfa what we offer our executives is permanence and participation in a long-term business project, allowing them to grow professionally and economically without neglecting their family, social and human sides.

The development of internal talent is our base

Generally, in Alfa we hire our future executives when they graduate from university. The key is to evaluate the education they have received and select people with talent. Once they become part of the group, we train them and put them to work. After a reasonable period of time, they get the opportunity to occupy a position of greater responsibility and thus they climb the organisational ladder.

This strategy has yielded satisfactory results for many years, so that only on very rare occasions do we need to go out and look for talent outside our companies. Our management model may not be the most modern and sophisticated, but it has been one of the most solid pillars of our company. It also helps us understand why Alfa is an organisation where the principal stockholders and their families have a very long-term business vision. It also explains why our top-level staff and most of our senior executives have worked in the group for an average of more than 30 years.

Social responsibility

Historically, we have had a very clear vision of our commitment to Mexican society. In fact, we may state that we have been among the pioneers in our country in the field of corporate social responsibility. Now, we have expanded

outside of Mexico, so that our social responsibility has increased. We accept this circumstance and have gotten involved with the needs and aspirations of the communities where we operate. We are concerned with what happens beyond the limits of our plants.

Modern times demand that companies actively participate in society and that is what we are doing. We have a strong feeling of solidarity. Recently, in our home state of Nuevo León, Mexico, we have had significant security problems and a deterioration of the rule of law. We have also suffered natural disasters. The city, the state, the country and the world we live in demand that we dedicate part of our time to search for a way to solve these problems that affect us all.

Also, due to their greater capacity of organisation, management, handling and administration of resources, companies have a very significant role in supporting the society in its search for solutions to problems as complex and severe as those I have mentioned. An example of the benefits of collaboration between companies, government and society has been the rapid reconstruction of infrastructure in the state of Nuevo Leon, Mexico, which was seriously affected by hurricane "Alex". Private companies played a significant role in getting the federal funds for reconstruction to flow rapidly, by offering their help and participating as managers and guarantors of the transparent and correct administration of these funds.

Value metrics

At Alfa, we consider that the market value of the share and the return to the shareholders are the principal and least questionable indicators of the creation or destruction of value. On the other hand, we have recently been reflecting on who we are and who we want to be. It is clear that Alfa is a company with a

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shareholder base that has maintained its shareholding positions since the beginning and that they come from families that have shown an entrepreneurial spirit for more than 100 years. Our responsibility towards them is to ensure the continued profitable and sustainable growth of Alfa.

With that vision of our future development, we are developing new indicators that will help us to better measure our performance in organisation areas that are key to improving the productivity and competitiveness of our business units.

Public policies to improve the business environment

Constructing a country vision

On the subject of public policies to improve the Mexican environment, I believe our government should take the initiative to promote the construction of a “country vision” as widely shared and agreed as possible. A vision which shows us what we want to be, to be the starting point for all those involved: politicians, businessmen, intellectuals, and the civil society itself, to dialog and define what the country model is that we aspire to, a model that includes all of us, and in which we are all able to recognise ourselves. This would lay the bases for recognising the truly relevant aspects and eliminating those that are not; those that only distract us, preventing

us from focusing on formulating strategies to reach our objectives.

I believe this is one of the most urgent tasks we have to focus on. We cannot continue to lose time on issues that have already been overcome in developed, as well as some emerging, nations. Our government should decide to start searching for that “common denominator”, acting as a catalyst of that process, and above all bringing it to a happy conclusion. If this is done, there is no doubt that we would become a more productive, more prosperous and fairer society.

From reforms... to reforms

In Mexico there is a great debate over what are the structural reforms required by the country in order to trigger a new stage of sustained growth. There is no doubt that there are opportunities in the tax area, and in the energy and telecommunications sectors. But I am one of those who believe the first reform should be that of the government, since it is this that would allow us to have a live interaction process among all Mexicans, generating more productive political-legislative processes and creating the conditions to process and take everything else to a satisfactory conclusion.

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