

# Convergence & Differentiation

What is  
success in  
a connected  
world?\*

Interview transcripts of Xavier Garcia de Quevedo Topete,  
CEO of Minera Mexico and President & COO of SCC,  
Mexico



### Xavier Garcia de Quevedo Topete is CEO of Minera Mexico and President & COO of SCC

**PwC:** What is your level of confidence, the confidence of Southern Copper (SC), in doing business in the country? And of the mining industry in the markets where you operate?

**XGQ:** Our level of confidence is very high, since the commodities' environment has excellent perspectives, in spite of the possible recession of the US economy. We are seeing really strong markets like the Asian market, especially China, where the other day an economist said 6% growth would be like entering into a recession for them. These are very strong markets with high demand of raw materials; for us, copper is our core business. In the case of copper there is not a well-defined development of short-term supply: therefore, the prices will continue to be strong in the next three years, especially regarding non-ferrous minerals.

**PwC:** What do you think about business networks? What are your plans regarding business networks, partners, joint ventures, strategic alliances, etc?

**XGQ:** As SC, we do not have business networks but this doesn't mean we will not have strategic alliances or partners in the future. We have a very aggressive development programme based on our reserves. We are the second company in the world, after Codelco, with the highest copper reserves for many years now, which makes us very attractive. Our development strategy is not based on acquisitions, not for the time being. We think about growing based on our reserves, in the markets where we already operate. We have four large copper mines; two of them are in Peru and two in Mexico. The mines in Cananea (Mexico) and Toquepal (Peru) have important reserves, and we have lower development costs compared to an acquisition. We have already approved projects with quantified reserves, where we might look for strategic alliances or minority partners, who are also copper consumers with something positive to give, like financing or any kind of technical benefit.

**PwC:** Is there a difference between your market approach (in terms of business networks) and that of your multinational competitors, like Codelco or any other large mining company? Do they have a similar approach? Or they use joint ventures and strategic alliances more?

**XGQ:** What is currently happening in the industry in terms of joint ventures and strategic alliances is a consolidation process. Many large companies are currently looking for mergers and others want to develop their reserves. Our position is completely different; our reserves are at such a good level that for us it is easier to grow and duplicate our production capacity maybe in eight years using our own reserves. This is the best way to give a better ROI to investors.

**PwC:** The next subject is financial strength. There is a hypothesis about financial growth and emerging markets: some say they do not have access to capital. According to our survey, most emerging markets companies want to obtain financing through debts. Could you state your opinion on access to capital, not just for you, but the market in general? And how this combines with internal strength or with your own assets?

**XGQ:** I think SC is in a very good condition right now, based on our international experience in Asia years ago, where we went through a very difficult financial situation and we had to develop strategies to overcome it. We have practically shielded ourselves financially, and we basically have no debts. Our financing scheme is through bonds, and most of them are financed until 2035. Therefore, we are really strong and our cashflow is excellent thanks to the high prices of metals. However, answering your former question on strategic alliances or partners, we are planning our growth based on our own resources, maybe acquiring some new debt but without exceeding certain limits, so we are open to having partners, especially for the development of new projects.

**PwC:** Do you have any restriction on capital access?

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**XGQ:** We have no restrictions. Usually, our financing sources are foreign: US, Canadian and European banks with very competitive rates and no restrictions. We have achieved a good rating among debt raters, we currently have a 3B- rating and we are confident it will continue to improve. The company's performance has been excellent as I have already said, allowing us to have unprecedented returns and a very strong cashflow.

**PwC:** In 2002 and 2003 you faced a period of very restricted prices and you managed, in a really short period of time, to overcome this difficult situation. You had an important debt to finance several major projects. How did the market treat you regarding capital access? Since you were not in the situation you are now.

**XGQ:** To a certain extent, it was something to be expected, but the answer we got from the financial markets was not very good. We had never gone through such a difficult situation, which originated from our indebtedness with the "low prices" of some metals, and from certain credits that forced the company to carry out a difficult renegotiation that compromised our entire export account receivables portfolio, putting much more pressure to the organisation. First, we were able to overcome the situation because the company maintained a firm position on not selling important assets of the group to pay debts. We also managed to convince the foreign financial institutions to renegotiate the debt by giving them the widest guarantees possible if they gave us enough time to pay them back. Then, by the end of 2004, prices started to recover and we were able to prepay the debt and eliminate the guarantees we had given to our creditors and we got access to new credits with competitive conditions. Afterwards, there was the merger of South and Peru Copper Corporation with Minera Mexico, and we cancelled the commercial debt and issued long-term debt bonds.

**PwC:** What kind of answer would you have liked? There was a very difficult negotiation as you said, where you had to give some warranties, but what would you have liked? What do you recommend to those bankers and brokers who deal with emerging markets? What would you recommend to the financial community and to your counterparts who might be facing a similar situation?

**XGQ:** My recommendation to some financial institutions, not all of them, is to make a deeper analysis of the commodities industry, specifically of the mining industry, because we are a long-term industry, it is an industry of long-term risk capital. We have more than 100 years in the market; we have gone through all the market and low prices cycles. So my recommendation would be basically not to have a short-term vision, but a medium-term perspective, and most of all focus on the long range.

For CEOs, first of all I recommend a deep analysis of all the risks. In the commodities industry, when we undertake large projects, it is necessary to assess the debt acquired considering the lowest market prices possible, since it is an industry in which we cannot control them; they are fixed by supply and demand. If they are already in such a situation, I would recommend maintaining their position and trying to convince their creditors about their particular strengths and their future capacity to comply with the commitments acquired, even if they have to undergo a long and costly negotiation.

**PwC:** You mentioned the strength of your reserves and the low-cost operations of the group and you have given us an overview of what happened in 2002 and 2003. What can you tell us about your management team? What role did it play during this difficult time for SC?

**XGQ:** The management team was completely involved in the process; we put to the test their strength, their knowledge of the industry, but most of all their capacity to work as a team. This would not have been possible if we had not worked as a team everyday. Decisions were taken on a daily basis in order to overcome the difficulties. Back then, the company exported almost 50% of its production and our exports portfolio was guaranteed, and when the portfolio was compromised by contracts we were forced to decide how to continue our daily operations and production to keep our commitments with our clients and employees and at the same time continue the negotiations.

**PwC:** You have talked about the mining company, but Grupo Mexico is more than a mining company, and you were also in charge of the railway company (Ferromex), which implies a different competitive environment and a financial strength that has made it the number one railway company in the country. What can you tell us about that strength? It grew differently, as another financial structure, with a different perspective and not as a market leader. However, it became a leader. How did you achieve this goal in a completely different industry?

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**XGQ:** Ferromex was born as the result of a privatisation process, which is an example for Mexico, since it was a business managed by the government for many years and had a very negative image and reputation. The government realised it was a business with no future and launched the bidding process for national or foreign companies. Initially, they granted a concession for 50 years, which could be renewed for another 50 years. The market share of this cargo business had been decreasing significantly, since the largest share belonged to auto transportation sector. The practices of the business were obsolete and productivity levels were really low. However, thanks to the chance of making a new collective contract, it was possible to start this business with no liabilities and market prices had some controls, basically regulated by the cargo auto transportation market. The strategy of the group was to diversify, since we were a group 100% devoted to the mining industry, but we found in this business an opportunity that satisfied our diversification goals, not through synergies, because the railway business only moves 5% of the mining business in Mexico (95% is made up of other clients). The plan was to start the railway business with zero debts and it surprised us from the beginning because of its financial and operational results. We thought this business should be managed by experts in railways, not in mines, so we chose the best people with industry expertise and they chose their own teams. Also, we were lucky to have a good partner who helped us with the strategy and the modernisation process of the railway. Now we are really proud of the results! At first they didn't trust us; it was the longest railway in Mexico, but certainly not the most efficient one. Today, we can proudly say this is the best railway in the country with the highest financial and operational indicators.

**PwC:** I know you have an American partner, Union Pacific, in this business. What would be the main differences between the two companies regarding people and operating approaches?

**XGQ:** We are two companies with a very clear objective in mind: results. We both focus on having the lead position in the market, on modernising and using the latest technology. We are strong and determined in everything we do. Most of us are mining people, although some have different working experiences. For most of us, it was a very important learning experience, because in this business it is necessary to focus completely on customer service, improving delivery times and processes, preventing thefts and reducing the probabilities of railway accidents to a minimum. With our partner, who helped us retrain our people, we focused on defining the critical elements to succeed and creating them.

**PwC:** There are two main areas of interest here: the culture, which includes the elements that allowed you, as a Mexican company, to develop and operate in other countries like Chile, Peru and the US. In your opinion, what cultural elements have contributed to the success of the railway and the mining businesses? And which have been the most difficult to overcome?

**XGQ:** People and culture are essential for our business. The railway business succeeded because we had the chance to build the organisation. It is true we kept the best operators and technicians, but we didn't have a team for the commercial, controlling, management and human resources functions. Besides, there is a huge difference in the way we do business in the private sector and the way the government operates. All that part of the structure was new for us and it was really important to respect the culture of the people who worked for that industry. Railway and mining people are very different, so we gave them the necessary room and respected their culture. Like this we were able to change for the sake of the business and adopt a culture of productivity and efficiency. We didn't have systems, there was no ERP and we started with a very difficult system, even for well-established businesses, SAP. However, people accepted it pretty well and we obtained good results in the short-term, managing and controlling our business through better IT systems. As for Peru, we respect their culture as an Emerging Markets Perspectives – CEO Insights country and we identified some strengths we do not have in Mexico, which we promoted among our people to enhance their morale, and we applied those practices in Mexico. In Peru the company was American for many years and had a double structure (Americans and Peruvians). After the acquisition, many Americans decided to leave the company and we promoted Peruvian executives to higher positions. This generated a lot of confidence. If we analyse past and present results, we will see the increase in efficiency and productivity and financial results have been spectacular.

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**PwC:** Can you mention some of those positive elements you found in Peru?

**XGQ:** It is a more committed culture; people achieve higher efficiency and productivity indexes in some areas. What we Mexicans have transmitted to them is basically good teamwork and a reduced costs culture. We managed to reduce costs effectively, and this was a significant contribution to the positive results of SP during its first three years of operation.

**PwC:** Is there an analogy between Mexico and the US, for example?

**XGQ:** In the US, I had the opportunity to be the first President of Asarco, since Grupo Mexico used to be Asarco Mexicana. Mexican investors bought Asarco during the “Mexicanisation” in 1967, acquiring 51% of the shares. In the case of Asarco it was also very important to respect the culture and we struggled to reduce costs and increase efficiency. At the beginning, for example, we centralised all functions in Arizona and closed the office in New York, which didn’t generate any advantages for the mining business.

Back then, we faced an important challenge, to sell two non-mining divisions of Asarco to cover an important bridging loan of \$800m. Therefore, we sold a chemical products division and an aggregated products and cement division, concentrating only in the mining business. Due to the sale of those two divisions, it made no sense to stay in New York, so we put all executives in the same place, near the mining operations and we started to achieve very important results. The year we took control of the company, it had a deficit of more than \$150 in EBITDA, and during the first year of operations we overcame that situation along with the Americans, as a team.

**PwC:** How did you manage to work together?

**XGQ:** The main executives of Asarco had their golden parachute, so in a very short period we had to promote a lot of people, basically Americans, to occupy higher positions, and we also moved them to Arizona.

**PwC:** What can you tell us about corporate governance? Most companies in emerging markets began as family businesses. This can help accelerate decisions and, on the other hand, it can generate more organisational levels, higher or lower, to make other decisions. We would like to know your view on corporate management. How do expand and operate in an emerging market and does family-based culture contribute or not to corporate governance?

**XGQ:** Corporate governance is a transformation that has given us greater strength. Years ago, Grupo Mexico started as a family business with a centralised management and decision-making process. In both businesses, mining and railway, we have made important progress in corporate governance issues, and we have managed to balance the presence of a strong majority partner and minority shareholders. Nowadays, we have a very plural board with independent advisors and committees that work perfectly fine. The huge effort made by Mexico and Peru to comply with Sarbox has brought important benefits to the company. For example, we had to update our information controls to be able to comply with regulations and the NYSE.

**PwC:** Operationally speaking, for example, talking about management or the decision-making processes, how have they changed? Being part of an emerging market culture contributes to operational decisions, not just board decisions?

**XGQ:** Operationally, it has been very important to promote internally our vision, mission, standards and policies. We want to increase empowerment; we have a strategic plan for each of our businesses, and we act according to our objectives, projects and strategic actions, we want to communicate better at all levels.

**PwC:** What benefits did you obtain through this transformation?

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**XGQ:** One of the benefits is the higher level of confidence we give the markets and the shareholders. We have achieved important progress in IT systems, controls, management by results, risk management, and the formal operation of our Operations and Control Board Committees.

**PwC:** In areas such as supply chain, costs structure, innovation and research, is there any competitive advantage with these companies or how could they compare to similar companies in developed markets?

**XGQ:** As for competitive advantages in the mining sector, the reserves I mentioned before come to mind; a significant increase in productivity; many of our mines are very competitive in terms of costs; at least three of our four mines operate in the first quartile. Also, SC is geographically diversified, 50% of our copper production comes from Mexico and 50% from Peru, and we don't depend only on one metal like copper: we are also strong in the production of molybdenum zinc and silver.

**PwC:** Governments can help companies in four basic areas: regulations, infrastructure, business and human development. As a Mexican company, that has expanded beyond its borders, how do you think governments can help companies globalise, based on the four areas mentioned above?

**XGQ:** The goal is to achieve sustainable growth: for this it is indispensable to have the necessary juridical and job security, as well as the promotion of better infrastructure development by the government. However, in the mining sector, the industry always develops its own infrastructure, because mines are in remote places. We have to develop the mines, install the plants, and take care of all human and community issues; from building roads, providing power supply, water, housing, schools, and recreational activities. They are real development poles! Currently, the global industry is facing important challenges; maybe one of the most important ones is the lack of talent, human capital. In an industry like ours, there is not enough human capital; we compete at global level to get the best talent available. Therefore, companies have to develop strategies to attract, keep and develop human capital.

The second important issue is electric power. Today electric power is scarce and expensive, especially in emerging markets. In Latin America, in spite of its many undeveloped reserves, one of the most important challenges is the lack of electric power and water. The only option to obtain more water is to desalinate seawater, which implies more electric power consumption. Another important issue is the environment: the mining industry must comply with environmental regulations. New projects must foresee closing plans when reserves are depleted. Nowadays, the mining industry does not face financial or technological challenges.

**PwC:** How would you like the government to help you?

**XGQ:** On the most critical aspects of the business there is an important support for the mining industry. It is not an economic support because we have financial resources and the country has other important priorities. The government is accompanying us, but the responsibility of developing infrastructure or finding the proper talent relies on us.

**PwC:** As for electric power, is the government helping you in any way?

**XGQ:** We have received some support from the government, but basically, the industry takes care of everything. The government contributed with the reduction of the maximum fee, which has been affected by the increase of oil and coal prices. The government is expediting the self-supply of power to the mining industry, since it cannot solve the serious competitiveness problem we have in Mexico, so we are paying twice the price we pay in the mines of Arizona. The government is trying to provide more options for us to supply ourselves with the electric power we need. This is one of our main strategies for Mexico and Peru as well.

**PwC:** Are some governments providing more support than others?

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**XGQ:** Peru, Chile and Canada have very well-defined support policies for exploration activities, to find new reserves and to develop new projects. They have important formulae and incentives for exploration activities. Another difference is the cost of water, which is very competitive in comparison to Mexico. The mining industry pays the same prices than any other industry that uses the public supply, but the industry has to develop its own infrastructure, take care of all operative costs, and carry its own water.

**PwC:** Could you mention some differences between developed and emerging economies?

**XGQ:** Labour, for example. In Peru we have job security, we make collective contracts that last six years, annual salary increases are predetermined, and we only review them if inflation perspectives change in the country. In Mexico we have to review salaries every year and contracts every two years, and due to the winning streak of the industry we are forced to review new conditions every year due to the demands of one of the unions. In SC we have been trying to solve these issues and we have achieved some success. We allowed workers to choose their leaders and vote freely; nine out of 12 collective contracts are now operating with a different union, that is focused in productivity, efficiency and the well-being of the people and their families. The union democracy that has started to develop in the industry is going to be a positive factor.

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