Grupo Argos

Track: Management Education and Teaching Cases

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Grupo Argos

Abstract

José Alberto Vélez, Chief Executive Officer at Grupo Argos, a leading business group in Colombia, met with his team in Medellín to analyze whether Grupo Argos' five subsidiaries, engaged in cement production, energy, coal mining, seaport management, and real estate development would adapt to the aggressive growth pattern he and his team had submitted in order for Grupo Argos to attain revenues of US$ 20 billion and a US$ 30 billion market capitalization by 2023.

José Alberto Vélez, Chief Executive Officer of Grupo Argos, a leading business group in Colombia, met with his team in Medellín on a rainy afternoon in October 2014. Together, they analyzed whether Grupo Argos' five subsidiaries (engaged in cement production, energy, coal mining, seaport management, and real estate development) would adapt to the aggressive growth pattern Vélez and his team had proposed to help Grupo Argos attain revenues of US$ 20 billion and a US$ 30 billion market capitalization by 2023.

Grupo Argos had launched a growth architecture to increase revenue and reduce portfolio uncertainty. It was aimed at expanding the group's core businesses to account for 80% of EBITDA by 2023. Also, it proposed trying scalable businesses in order to generate 15% of the firm's EBITDA and emerging businesses to account for 5% of EBITDA, in order to test the hypothesis without jeopardizing its portfolio.

Grupo Argos' Executive Committee wondered whether it was better to keep investments as they were or whether it should divest a few subsidiaries. They were concerned about their current investment portfolio failing to reach the goal set for 2023—namely, 50% of revenue from operations outside Colombia, 10% from new ventures and US$ 10 billion in revenues from the cement business.

Grupo Empresarial Antioqueño business and investment philosophy

According to Mr. Vélez:

In order to understand Grupo Argos, you must understand Grupo Empresarial Antioqueño's philosophy. Over time, this philosophy has given us a first-world corporate governance code and a clear focus for each group in its own field. We have promoted geographic expansion and diversification, and we have engaged in senior executive training with a balance between personal and professional life. We achieved good results in terms of managing these groups and their strategic business units.

In 1950 and 1960, a number of business groups, both from abroad and from other regions in Colombia, showed an interest in acquiring the largest companies in the northwestern Antioquia department in Colombia. This raised concern among business owners in the region, who disagreed with losing control over their companies. To deal with this scenario,

some Antioquia businesspeople founded what today is known as Grupo Empresarial Antioqueño (GEA), a group without legal status differentiated by its corporate culture and values and its members' shared vision.

Grupo Argos, Grupo Sura and Nutresa were three major GEA players. They formed a triangle to exchange shareholding percentages in order to maintain mutual control. For example, Grupo Argos had a 29% stake in Grupo Suramericana and a 10% stake in Grupo Nutresa. At the same time, Grupo Suramericana had a 36% stake in Grupo Argos and 35% in Grupo Nutresa. Grupo Nutresa, in turn, owned 13% of Grupo Suramericana and 10% of Grupo Argos. In addition, some subsidiaries had a percentage interest in the various groups. (See Exhibit 1 - Shareholding Triangle among Grupos Argos, Sura, and Nutresa.)

Each group specialized in a particular field. Grupo Sura focused on financial, insurance and social investment services, with significant involvement in strategic business units such as Bancolombia (a bank) (26%) and Suramericana (an insurance firm) (81%), among others. Nutresa specialized in the food industry, with seven business units dealing in cold cuts, biscuits, chocolate, coffee, ice cream, pastas and dehydrated juice powder. Following a number of changes, Grupo Argos focused on industries related to natural-resource mining and processing, concentrating mainly on infrastructure development. Grupos Argos carried this out through five strategic business units: Cementos Argos, Celsia (energy), Compas (seaports), Sator (coal) and Situm (real estate development).

Grupo Argos- Inception

Grupo Argos began in 1934 with the founding of Compañía de Cementos Argos S.A. At that time, the Arango family from Medellín invited 100 shareholders to invest in the project. Two years later, the company was producing the first bags of cement, as well as shareholder profits and dividends. After that and until 2003, Compañía de Cementos Argos helped consolidate the Colombian cement industry through eight companies[1] in which it had equity shares.

While companies initially offered their goods in different geographical regions, they began to compete in order to seek economies of scale. Each cement company had its own brand, president, board of directors and executive committee. Seeking greater operational efficiency and higher value for shareholders, José Alberto Vélez, a board member of Cementos del Caribe and, later, president of the combined company, proposed and led business consolidation. Merger advisors

1The eight companies were Cementos del Caribe, Cementos del Valle S.A., Cementos Paz del Río S.A., Cementos Rioclaro S.A., Compañía Colombiana de Clinker S.A. (COLCLINKER), Cales y Cementos de Toluviejo S.A. (TOLCEMENTO), Cementos El Cairo S.A. and Cementos del Nare S.A.

included JP Morgan, an investment bank that performed company valuation, and BNP Paribas, another investment bank that issued a fairness and justice opinion on the proposed terms of trade for shareholders.

In 2005, Cementos del Caribe, after absorbing the other companies, changed its name to Cementos Argos S.A. The merger resulted in operational savings and greater capacity and financial flexibility, providing access to capital markets both in Colombia and abroad. By then, the cement company had assets worth US$ 3.1billion and was able to produce 10.5 million tons of cement and 5.6 million cubic meters of concrete.[2] Company liabilities equaled US$ 517 million, and company equity was worth US$ 2.6 billion.

As a result of the merger, Compañía de Cementos Argos was renamed Inversiones Argos S.A., and then, in 2012, Grupo Argos. Grupo Argos retained a 70% stake in Cementos Argos S.A. and complemented its investment portfolio with holdings in the financial sector, through Bancolombia and Grupo de Inversiones Suramericana, and in the food sector, through Grupo Nutresa. By then, the parent company was totally dependent on the resources of its main subsidiary. According to Ricardo Sierra, VP for Grupo Argos Finance Unit:

Inversiones Argos S.A. was a holding company practically on paper, even though the two companies were listed on the Colombia Stock Exchange. All holding company members also belonged to Cementos Argos S. A, and the latter took most of our time. We focused on Inversiones Argos mainly when we had to develop consolidated financial statements and prepare information for meetings and assemblies.

By then, Inversiones Argos was a parent company specializing in cement production. Both José Alberto and his team felt that it was important to diversify portfolio risk, and to do so, they considered investing in other industries. They had noticed a cyclical pattern in the cement industry, with lower demand at certain times. After considering several industries, they determined that the production cycle of power generation countered low-demand periods in the cement industry cycle. Thus, they concluded that investing in that industry could bring stability to their investment portfolio.

Power generation was not new to the Inversiones Argos team. While dealing with Cementos Argos, they had established and managed power plants to supply power to cement factories. Looking for a means to enter this industry, in 2008, Inversiones Argos S.A. acquired a 19% stake in Colinversiones, a business group with an investment portfolio worth US$ 800 million. Investment in power generation accounted for 45% of Colinversiones' portfolio. By 2010, Inversiones Argos had acquired a controlling stake (50%) in this group, which later would be renamed Celsia. The decision to diversify the

2 Cuartas, F. 2005. **Nace la nueva Cementos Argos S.A.** Superintendencia financiera Grupo Argos.

group's portfolio was the beginning of Inversiones Argos' role as a parent company and of its independence from Cementos Argos in order to focus on two investment pillars: cement production and power generation.

As a part of its diversification in 2012, Inversiones Argos acquired a number of coal assets, power generation, seaport and real estate assets, which had split from Cementos Argos. Cementos Argos managed these assets as a cost center, but they were underutilized and confounded external analysts who omitted them when estimating company value. By disconnecting itself from non-cement assets, Cementos Argos would become a pure player in the cement industry, while Inversiones Argos would have the chance to participate in other industries. For those assets, plus other portfolio investments, they conducted a US$ 3.800 million transaction. Preferred shares to Cementos Argos shareholders were issued (0.31 preferred shares of Inversiones Argos for each common share of Cementos Argos).[3] Based on calculations made by international investment banks both boards of directors proposed this transaction.[4]

Inversiones Argos' specialists said that the assets purchased had great potential for the development and creation of value. These assets were characterized by relatively inelastic demand and for being difficult to replicate due to long-term contracts or concession terms. Also, they were capital-intensive but had low operating and maintenance costs, thus leading to high operating margins. They had stable cash flows and predictable returns and a low correlation with traditional assets such as stocks and bonds, which made them ideal for diversifying the firm's portfolio.[5]

After the new acquisitions, Inversiones Argos was renamed Grupo Argos in 2012. This offered shareholders a chance to benefit from growth and profitability in the seaport and real estate businesses, in which they could not invest directly on the Colombian stock market. In addition, it gave the group a chance to mitigate business risk and volatility as a result of the security offered by more mature businesses such as energy and cement production.[6] They demonstrated that they were making good decisions and that investors could trust them. For example, divesting non-cement assets had resulted in a 56% appreciation for Cementos Argos shares. (See Exhibit 2 - Cementos Argos Stock Valuation.)

Grupo Argos Structure

Grupo Argos had a seven-member board of directors. Five of the directors were independent members, in line with both Colombian law and Grupo Argos' Code of Good Corporate Governance. The board chairman was also an independent

3 Grupo Argos, 2011 Report and Financial Statements.
4 Grupo Argos, 2011 Report and Financial Statements.
5 Grupo Argos, 2011 Report and Financial Statements.
6 Grupo Argos, 2014. Corporate profile. Accessed December 2014. http://inversionistas.grupoargos.com/perfil-corporativo/quienes-somos

member. Grupo Argos' Code of Good Corporate Governance required at least 50% of directors to be independent members and all board members to have board experience. Also, it stated that no company employee could sit on the board and that the chairman had to be an independent member. Another requirement was for members to have professional expertise relevant to company activity. At least one member was required to be a corporate finance and/or internal control expert. All board members were required to have the basic skills to perform properly, including the ability to understand and question financial information and business proposals and the ability to work in an international environment. Grupo Argos' board was characterized by diversity in terms of both gender and specialties. As a parent company, Grupo Argos promoted its Code of Good Corporate Governance among all of its subsidiaries.

In addition to the board, Grupo Argos had three support committees composed of board members and company officials, providing information and analysis. (See Exhibit 3. Board of Directors and Support Committees.) However, a fourth group, the executive committee, answerable to the board, was in charge of developing and implementing corporate strategy. This committee consisted of the president and his assistant and the vice presidents of corporate affairs, corporate finance and management. Both the president and the vice presidents had been involved in multimillion transactions in Cementos Argos, including mergers and acquisitions as well as bond issues. Their extensive experience was recognized in the national business community, and it gave the parent company the ability to spread knowledge to the rest of the team and its affiliates. Including the VP teams, Grupo Argos had 83 people with 100% growth in 2013 (Exhibit 4 - Grupo Argos' Executive Committee).

As a parent company, Grupo Argos was actively involved in formulating strategy for its subsidiaries. At least two members of Grupo Argos' Executive Committee were board members on any subsidiary, a practice Grupo Argos used as a control mechanism with regard to its strategy implementation. However, Grupo Argos was not deeply involved with Cementos Argos and Celsia, as these subsidiaries were more mature. Rather, Grupo Argos made direct recommendations only upon request from their boards or management teams. On the other hand, in addition to helping develop Compas' strategy, Grupo Argos provided it with support in mergers and acquisitions. For these three subsidiaries, the criteria issued by the parent company were recommendations rather than directives, whereas in Sator and Situm, the executive committee of Grupo Argos served as the board of directors, was responsible for formulating strategies together with their management teams and issued guidelines for their management teams to implement. Also, Grupo Argos offered shared services to these two subsidiaries in terms of mergers and acquisitions, accounting, payroll, HR management, treasury, legal advice and technological support. (See Appendix 5 - Shared Services.)

According to Vice President of Corporate Affairs Camilo Abello:

Grupo Argos lacked a formal system of combined service centers, with basic functions adjusted to any type of industry allowing for shared services of information technology, management, payroll processes or legal advice. This was because that was not Grupo Argos' raison d'être. Had Grupo Argos engaged in that, it would have ended up diverting its attention from the Group itself, whereas its goal was to help subsidiaries focus, expand and then diversify risk.

Another way in which Grupo Argos supported subsidiaries and achieved common goals was through special panels. These included monthly meetings involving subsidiaries' managers and the parent company's president or a vice president. At each meeting, a manager stated the most relevant issues of subsidiary performance in terms of strategy, mergers and acquisitions, corporate affairs and sustainability. In addition to panels, Grupo Argos started an ethics and behavior committee in charge of creating and spreading common values and behaviors among all subsidiaries. These groups established guidelines that each subsidiary was expected to incorporate into its DNA. (See Exhibit 6 - Administrative Committees Responsible for Ensuring Common Goals.)

Ricardo Sierra, Corporate Finance Vice President at Grupo Argos, explained:

In addition to the structure the parent company built to support subsidiaries, the latter gained from the recognition Grupo Argos enjoyed in the country, with market capitalization equal to 2% of Colombia's GDP. This made Grupo Argos one of the first business firms that investors were seeking with ideas and proposals that could be transferred to subsidiaries. Besides, Grupo Argos' financial capacity provided access to several sources of funding, such as the capital market, bonds and shares issues, and loans from multilateral and financial institutions, among others. This allowed it to structure capital in the best possible way in any business endeavor.

Work environment and human resource development

María Clara Aristizábal, corporate strategy manager, said: "*Grupo Argos' work environment was unique in the country. In addition to providing all resources needed, top management cared for all team members' personal development. As a result, highly trained workers with mathematical and financial profiles preferred to work for Grupo Argos."*

Grupo Argos was rated 94%, very close to excellence, in the "Great Place to Work" work environment survey. Employees saw working for Grupo Argos or its subsidiaries as a great career opportunity. In 2013, more than 400,000 hours were invested in local and international training.[7] The parent company's HR team implemented a system that identified high-potential employees at both Grupo Argos and its subsidiaries and developed and mobilized them into key positions. They took into account workers' performance and capabilities, so that employees were moved into positions with increasing responsibility until they reached a point allowing for optimal performance. The system allowed for a succession plan and provided internal candidates for any need. Even though headquarters managed the system, staff members were mobilized only with the consent of the subsidiaries.

At the same time, Grupo Argos' performance appraisal system aimed to obtain results and took into account innovation, teamwork and leadership skills, all of which were part of the group's culture. Leaders and staff provided mutual feedback. By 2013, all executives at Grupo Argos had undergone evaluation, as had 60% of management staff and 59% of other employees, and Grupo Argos planned to transfer its evaluation system to its subsidiaries. Evaluation was already under way at Cementos Argos, Compas, Sator and Situm. Celsia, however, still lacked the system. (See Exhibit 7 - Percentage of Employees Undergoing Performance Assessment per Level.)

Grupo Argos offered higher than average compensation and benefits compared to similar business groups, although this was not true of the subsidiaries. In addition to its performance appraisal system, Grupo Argos' variable compensation system aimed to reward employees for achieving strategic objectives. Until 2013, this system covered 64% of employees and was intended to cover 96% by 2014.

Financial Information and Investment Portfolio Structure

By 2013, Grupo Argos' portfolio was worth, on average, US$ 8.2 billion. Cementos Argos, a subsidiary engaged in producing cement, concrete and aggregates, accounted for 35% of the portfolio, followed by Situm, a subsidiary in charge of real estate development (15%); Celsia (12%), responsible for energy production; Sator (2%), responsible for coal mining; and Compas (2%), responsible for seaport administration. The remainder accounted for Grupo Argos' financial investments (27%) and investment in the food sector (6%), through shareholding in Grupo Sura, Bancolombia and Nutresa. (See Exhibit 8 - Changes in Grupo Argos' Portfolio Composition.)

7 Grupo Argos, 2013. 2013 Combined Report.

In 2013, Grupo Argos had 791 million outstanding shares, with the value per share growing 0.6% per annum to US$ 10.4. However, in the first quarter of 2014, financial analysts valued Grupo Argos' investment portfolio at US$ 9.7 billion. According to them, Grupo Argos' discount rate was 2.8%, and its shares had the potential to reach US$ 11.96 per share. (See Exhibit 9 - Grupo Argos' Portfolio Valuation.)[8]

Thanks to investment, Grupo Argos' revenue grew 18% a year between 2009 and 2013, to US$ 4.08 billion in 2013. Operating profit was US$ 721 million; operating capital was US$ 6 billion; and weighted cost of capital was 9.8%. In addition, the Group's reported EBITDA amounted to US$ 1.02 billion, and its net income equaled US$ 157.8 million. Grupo Argos had assets worth US$ 14.6 billion, liabilities of US$ 4.4 billion and US$ 10.2 billion in equity. In 2013, 62% of revenue came from Cementos Argos, 30% from Celsia and the remaining 8% from other investments. In relation to EBITDA, Cementos Argos was responsible for 49%, Celsia 45% and other investments 6%. (See Exhibit 10 - Grupo Argos' Financial Information.)

Subsidiaries

Cementos Argos

Grupo Argos had a 60.4% share in Cementos Argos in 2013 and 60.7% until June 2014. Other investors consisted of mainly pension funds, plus a few others. Cementos Argos had been a major cement producer in Colombia since 1934. It was the fifth largest producer in Latin America and the Caribbean and the second largest producer in the Southern U.S. It had 13 cement plants, nine clinker grinding plants, 390 concrete plants and 20 seaports and terminals to exchange goods between its different sites. Forty-six percent of its cement was sold in Colombia, 30% in Central America and the Caribbean, 17% in the U.S., and the remaining 7% was exported to other countries. As for concrete, it sold 58% in the US, 36% in Colombia and 6% in Central America and the Caribbean. (See Exhibit 11- Cementos Argos Geographical Scope.)

Between 2009 and 2013, income grew 13.5% per annum, reaching $ 2.7 billion in 2013. This allowed for a Operatinf profit of US$ 311 million, EBITDA of US$ 523 million and net profits of US$ 98.3 million. The company's operating capital was US$ 3,369 million; its total assets amounted to US$ 6,223 million, liabilities to US$ 2.,150 million and equity to US$ 4,072 million. The firm's market capitalization equaled US$ 7 billion. (See Exhibit 12 - Cementos Argos Financial Information.)

8 Corredores Asociados. 2014. Grupo Argos, Coverage Update. Davivienda.

Cementos Argos had its own board, which included José Alberto Vélez and Camilo Abello, who were also members of Grupo Argos' Executive Committee. It also had an independent management team of eight vice presidents responsible for implementing competitive strategy, and more than 7,000 operations employees (See Exhibit 13 Cementos Argos Board and Management Team). Due to Cementos Argos' maturity, the parent company spent less time and energy on it. Gustavo Uribe, investor relations manager at Cementos Argos, commented:

Grupo Argos provided support with macroeconomic, financial and market analysis on the various regions where different subsidiaries operated. This information facilitated decision-making when competitive strategy was developed. Partners' experience in relation to taxes or mergers and acquisitions allowed them to properly advise less experienced subsidiaries. In addition, the parent company served as a link between subsidiaries. For example, Celsia was considering investing in Honduras, as Cementos Argos had identified a major energy shortage there.

Over the previous few years, global cement consumption had experienced a 4.3% annual growth rate.[9] In Latin America and the United States, the rate had been 3.8% and 4.2%, respectively. Thus, Grupo Argos' Executive Committee and Cementos Argos' board and management team remained optimistic about the industry's growth potential. They felt that demand for cement would continue as it had until then, especially in markets where demographics, urbanization and economic growth propelled a need for housing and infrastructure.

Cementos Argos aimed to meet needs in its markets. For example, in Colombia, where it had a 48% market share, the government's infrastructure plan included investing US$ 56 billion during the current administration, while the private sector was estimated to invest around US$ 12 billion per year. Grupo Argos had been awarded six road-building projects (856 km) and was expecting to be awarded three more projects for 380 km in total. Moreover, even though over the last five years, 145,000 housing units per year had been built, more than 500,000 families lacked a home, and more than one million existing houses needed improvement. According to projections, by 2020, over 60% of the population would be less than 35 years old, leading to an increased demand for residential building.

In relation to Central America and the Caribbean, the company was faced with high growth prospects, due mainly to the strategic link between its branches, which had enabled it to achieve a 53% market share in Honduras and 47% in Panama. In addition, it was the only cement producer in Haiti and Surinam. In the Honduran market, Cementos Argos had infrastructure projects worth US$ 1.6 billion. Also, there was a need for 30,000 housing units and a shortage of over 80,000

9 International Cement Review. 20013. Insights from the *Global Cement Report, 10th edition.*

units, in addition to the demand for non-residential construction. Furthermore, Panama continued to expand its Canal, as well as its subway system and highways, and was facing a housing shortage of 125,000 units. In the Caribbean, Haiti was under reconstruction, and the Dominican Republic was investing in infrastructure by expanding roads and the Santo Domingo subway. Other Caribbean islands were investing mainly in infrastructure and tourism projects.

In the United States, the company had consolidated mainly in the southern states,[10] where it was the second largest cement producer. This allowed it to integrate vertically and also become the second largest concrete producer across the country. Company analysts predicted 7.2% annual growth in cement consumption in the U.S., with a higher increase (8.2%) in the states in which the company operated. These states also showed a higher population growth rate (1.2%), when compared with the population growth rate in the country as a whole (0.8%).

Besides expanding the company in the regions in which it operated, Cementos Argos' management team was considering operating at other sites. After announcing a merger, Holcim and Lafarge (two major MNCs) needed to divest some of their assets in order to obtain permission from antitrust authorities. Cementos Argos saw an opportunity to acquire Holcim-Lafarge divested assets in Brazil and Canada. In Brazil, Holcim and Lafarge were about to divest three combined plants and two grinding stations with a total capacity of 3.6 million tons per year and also a ready-mix concrete plant.[11] Holcim would divest assets in Canada, including two cement plants in Toronto and Montreal able to produce 2.7 million tons per year, as well as 35 ready-mix concrete plants in Ontario and 15 in Quebec. In addition, it would divest 25 quarries providing raw materials for cement, sand and gravel.

Celsia

In 2008, Grupo Argos acquired a 19% stake in Colinversiones (renamed Celsia in 2012). Since its inception in 1919, Colinversiones had invested in tobacco (Coltabaco), paper (through a joint venture with Kimberly Clark), hospitality (Hoteles Medellín) and finance (Corporación de Ahorro y Vivienda). Between 2001 and 2007, Colinversiones conducted a series of divestitures resulting in a capital injection of nearly US$ 1 billion. Following that, and with advice from Colombian consultants and international banks such as Citi Group and BNP Paribas, Colinversiones focused on the energy industry. Through a series of mergers and acquisitions, it invested in the energy sector, with its portfolio going from 24% in 2007 to 54% in 2008.

10 Alabama, Arkansas, Georgia, Florida, Mississippi, North Carolina, South Carolina, Texas, and Virginia.

11 Lafarge. 2015. Holcim and Lafarge announce a project to sell assets to CRH for an enterprise value of EUR 6.5 Bn [CHF 6.8 Bn] in the context of their planned merger. http://www.lafarge.com-

According to Celsia's Corporate Affairs Vice President Rafael Olivella: *"Eighty percent of acquisitions took place between 2008 and 2009." However, Rafael believed that the major acquisition was Empresa de Energía del Pacífico S.A (EPS.A.), the fifth largest power generator in the country with a capacity of 1,068 MW. The acquisition was made through an open tender offer in which Celsia acquired 47% and Grupo Argos 12%.* According to Rafael, *"The influence of Grupo Argos has been key to Celsia, not only because of the capital contributed to control EPS.A., but also because they have been with us in various mergers and acquisitions, even being responsible for the negotiations in some cases. They have also made important recommendations, such as a bond issue to replace part of the debt*."

By 2014, Grupo Argos had 52.4% of Celsia shares, together with pension funds (27.6%), minority investors (16.1%) and foreign investors (3.9%). Celsia had specialized in power generation and distribution, with installed capacity able to generate 2,312 MW through 20 plants located in Colombia, two power plants in Panama (274 MW) and one in Costa Rica (49.5 MW). Power generation accounted for 68% of Celsia's revenue and was conducted by Celsia and EPS.A. The remaining 32% was the result of power distribution by EPS.A. and CETS.A., two subsidiaries in which Celsia had a controlling interest. (See Exhibit 14 - Celsia Corporate Structure).

Celsia had its own board of directors composed of seven members, including José Alberto Vélez and Ricardo Sierra from Grupo Argos' Executive Committee. The board established three internal committees: the audit and finance committee, the sustainability and corporate governance committee, and the human development committee. In addition, Celsia had a steering committee responsible for implementing competitive strategy. This was composed of the president, seven vice presidents, the corporate auditor and EPS.A.'s general manager. Celsia had 1,070 employees, including those in administrative positions and the operations staff.

For three years, company revenues had grown 10% a year to US$ 1.274 million in 2013. Celsia's Opereting profit at that time was US$ 383 million; EBITDA was US$ 462.5 million, and net profit was around US$ 200 million. This had been achieved with a working capital of US$ 2.069 million, total assets of US$ 3.919 million, liabilities of US$ 1.293 million and equity of $ 2,627 million. (See Exhibit 15 – Celsia Financial Information.) In addition, Celsia's market capitalization was US$ 2.350 million, thanks to stock appreciation since Grupo Argos had invested in Celsia. (See Exhibit 16 - Celsia Stock Appreciation.) However, Celsia's management team wanted to improve results, including business growth, operations optimization and strengthening the organization's capability.

The largest share of the Colombian market was held by EPM (22%), followed by Emgesa (20%), Isagen (15%), Celsia (12%), Gecelca (8%), AES Chivor (7%), and others (15%). In terms of distribution, the largest market share was held by Codensa (26%) and EPM (26%) followed by Electricaribe (22%), Emcali (7%), Celsia through EP S.A. (4 %) and others (15%). Celsia saw a great opportunity for growth since per capita power consumption (1,120 kWh) was below the average for Latin America and the Caribbean (2,243 kWh). Also, in the last six years, the demand for energy had grown 3% annually and was expected to increase to 4% annually for the next 15 years.

Celsia's board and steering committee decided to increase production capacity by 2021. So, they invested in five additional projects in Colombia to increase generation capacity by 447 MW and annual average power generation by 30%. In addition, in the medium term, Celsia intended to expand its international component to include renewable energy. However, it was aware of some risks that could adversely affect expectations, including changes in energy regulation, delays and cost overruns on building projects and natural phenomena related to climate change adversely affecting water availability.[12]

Situm

Cementos Argos had had experience in real estate development since 1999, when city growth in Barranquilla had come close to its cement plant site. Cementos Argos saw a golden opportunity, so it changed land use to develop 350 hectares. What made this project unusual was that internationally renowned architect Rafael Obregón gave advice and developed a design that resulted in a tenfold price increase per square meter.

After that, Cementos Argos established a real estate development team, which consolidated itself as Situm in 2012 after the absorption of non-cement assets by Grupo Argos. Situm engaged in horizontal development (road infrastructure, service networks and green fields, among others) to offer clients space for vertical development (buildings, residential areas, and shopping malls, among others.). In addition, Situm developed commercial property income projects.

Situm President Juan David Uribe said:

At the beginning, we asked banking organizations in United States, Mexico and Brazil to conduct meetings with their best real estate development clients in order to learn from best practices in the industry. In 2012, we established a group of people (39 from management and 25 from operations) to provide high-level real estate development to land owned by

12 Celsia, 2013. 2013 Combined Report.

Grupo Argos. Being under the Grupo Argos umbrella is advantageous because, despite the fact that we are a new company, we have their support, so investors and customers approach us with confidence.

Situm was a wholly-owned subsidiary of Grupo Argos. Unlike Cementos Argos' and Celsia's investors, those who were interested in Situm could access it only by investing in Grupo Argos since Situm was not listed on the Colombian Stock Exchange. Situm's operating profit in 2013 was US$ -2.9 million; operating capital was US$ 41.2 million; and weighted cost of capital was 9.7%. Revenue for 2012 was US$ 22.5 million, and EBITDA was US$ 5.1 million, while revenue in 2013 was US$ 34.0 million and EBITDA US$ 9.6 million. (See Exhibit 17 – Situm Financial Information). According to Grupo Argos' analysts, both land development and property income projects had return rates above 10%, making them very attractive. (See Exhibit 18 - Real Estate Development Projects Rate of Return.)

Situm competed in a high growth potential industry. Colombia's population (46 million people) was expected to reach 54 million by 2021. The country was facing a housing deficit (36%), and most of the population was under age 30, which pointed to a significant need for residential construction in the future. On the other hand, compared to other South American countries, Colombia had a low density of commercial buildings.[13] New brands kept entering the country, making investment in commercial property appealing.

By 2016, Situm planned to develop six property income projects worth US$ 208 million, and Grupo Argos owned land that was available to Situm. For instance, in Barranquilla, it had 1,200 hectares worth US$ 817 million. The master plan called for the development of 765 hectares with potential for housing construction, business development, services and light industry. It also had 1,300 hectares in Barú, with 22 km of coastline very close to Cartagena. The estimated value of this land was US$ 562 million, and it had potential for housing and resort development. In addition, Grupo Argos had 2,600 hectares in the rest of the country, worth US$ 126 million, with potential for tourism, housing, and services.

Sator

Since 1995, Carbones del Caribe had managed coal mines at different factories owned by Cementos Argos. Coal, by that time, was a strategic resource for Cementos Argos, and, thus, it included Carbones del Caribe as a cost center in the cement

13 Commercial building density: Peru 5.5 m^2/100; Colombia 7.2 m^2/100; Venezuela 12.4/100 m^2/100; Chile 19.2 m^2/100; Spain 32 m^2/100.

plant. However, in 2012, after Grupo Argos absorbed Cementos Argos' non-cement assets, it established Sator, a wholly-owned subsidiary of Grupo Argos with coal as its strategic resource. Sator had 873 million tons of resources to exploit and a reserve of 156 million.

Sator could offer its product either to Cementos Argos or to Celsia to produce thermal energy, provided that the transactions were made at market prices. This requirement was consistent with headquarters' policy for commercial transactions between subsidiaries.

Sator CEO Eduardo Bettin explained:

They were making a huge effort to be consistent with Grupo Argos' development model, which focused on making large capital investments in key sectors to process natural resources—e.g., turning limestone into cement, water into energy, beachfronts into seaports and land in real estate development. However, Sator exploited and sold coal, so it needed to find a way to not only mine coal but, rather, transform it into something else in order to be consistent with Grupo Argos' development model. So they saw it most reasonable to transform it into energy.

Sator conducted individual analyses for each mine, taking into account financial, administrative, operational and legal issues, and discovered that it had to divest some of its mines. Between 2012 and 2014, operating mining projects went from 12 to five, and the number of hectares under concession went from 109,100 to only 26,400. Even though the company had 815 workers in 2012, by the second half of 2014 that number had declined by 30% and, by year's end, it was expected to be 48%.

Sator's operating profit in 2013 was US$ -7.2 million, its operating capital US$ 7.6 million, and its weighted cost of capital 9.7%. Between 2011 and 2013, income declined at an annual rate of 1.0% reaching US$ 41.7 million by 2013. In that year, Sator posted a negative EBITDA of US$ 6.1 million and a loss equal to US$ 1.6 million. Over the last two years, however, loss surpassed US$ 20 million. The company had assets of US$ 81.0 million, liabilities of $ 69.9 million and equity of US$ 11.1 million. (See Exhibit 19 – Sator's Financial Results).

Analyses conducted by Grupo Argos' staff based on data from the Ministry of Energy and Mines showed great challenges and complexities in the coal business. The operating scheme Sator used to operate its mines contrasted with industry legality and formality. The industry was highly fragmented: only 0.7% of mining production units (MPUs) had more than 100 employees; 27% had between six and 100 employees; and the rest was composed of less than six employees.

An estimated 40% of the materials mined by MPUs came from unlicensed operations. To compound things, a number of irregularities with licensed MPUs existed. For instance, 37% of MPUs did not pay royalties to workers; 47% had no environmental management plan; 50% did not take safety, hygiene, and occupational health actions; and 82% did not properly handle dumping and had no forestry and water catchment projects.

However, Sator saw an excellent opportunity and believed it should be a leader in formalizing this industry. It sought change through good relationships with leading companies with intensive thermodynamic industrial processes, with the aim of encouraging them to be consistent and committed to their corporate responsibility policy statement. Also, it sought to differentiate its product so that price was not the key element in coal supply. Sator did so through attributes such as a guarantee of sustainability, reliable supply and timely deliveries or through transformation and addition of value.

Compas

Compas was founded in 2012 following a decision by Grupo Argos and Southern Port Holding, Inc. to establish a network of multipurpose public seaports under a 50/50 partnership agreement. (Southern Port Holding was founded by the Echavarría Obregón family and Grupo Ership of Spain.) Compas allowed Grupo Argos to rely on a major port management company with experience both in Colombia and abroad. Also, it enabled joint work between subsidiaries, such as Compas' administration of marketing and operations in the South Central Cement terminal in Houston, Texas, a seaport specializing in cement and owned by Cementos Argos. In 2014, they were able to mobilize 8.6 million tons per year through two port terminals in Cartagena, one in Buenaventura, one in Barranquilla, one in Tolú and two more in Panama and Houston, Texas (both in partnership with Cementos Argos), operating in both oceans.

Compas' board of directors was composed of five members, including Ricardo Sierra. In addition, Compas' management team was responsible for implementing competitive strategy. This team included the President, the Human Resource Manager, Counsel and the Commercial, Operations, New Business, Finance and Shared Services vice presidents. Compas had 380 operations employees. (See Exhibit 20 - Compas Organizational Structure.) In 2013, it mobilized 4.4 million tons, 4% more than the year before. Its revenue was US$ 55.1 million, and its EBITDA amounted to 14.3 million. However, it experienced a US$ 3.8 million loss. Compas had assets worth US$ 238.4 million, liabilities equal to US$ 93.9 million and equity equal to US$ 144.5 million. Compas' operating profit in 2013 was estimated to be US$ - 700.000, operating capital US$ 152.4 million, and weighted cost of capital 9.7%. (See Exhibit 21 – Compas' Financial Information).

Grupo Argos' analysts felt that this industry was promising. They said that they would benefit from free-trade agreements with the United States and the European Union, as well as from bilateral negotiations between Colombia and South Korea, Japan and the Pacific Alliance, among others. Also they based their claim on IMF projections indicating that over the next five years, imports volume in Colombia would grow 5% a year, while exports would grow at 6% per year. This would expand what had been happening over the last ten years, when seaborne exports increased from 76 to 129 million tonnes and imports went from 13 to 29 million tonnes.

Furthermore, Compas' management team felt that the company was positioning itself to capitalize on the momentum the sector was experiencing. Although there were some differences, mainly between the business culture of the counterpart and the culture Grupo Argos sought to establish among its subsidiaries, the combination of both resulted in financial strength, ability to implement, business knowledge and experience in business administration. These aspects gave Compas a growing platform, and Grupo Argos expected Compas to become the first Colombian group to offer foreign trade integrated logistics services by 2016, diversifying service so that customers could mobilize containers, coal, gas, fertilizer, grains and vehicles, among other cargo. In addition, they would operate a network able to mobilize 20 million tons of cargo by 2018.[14]

Conclusion

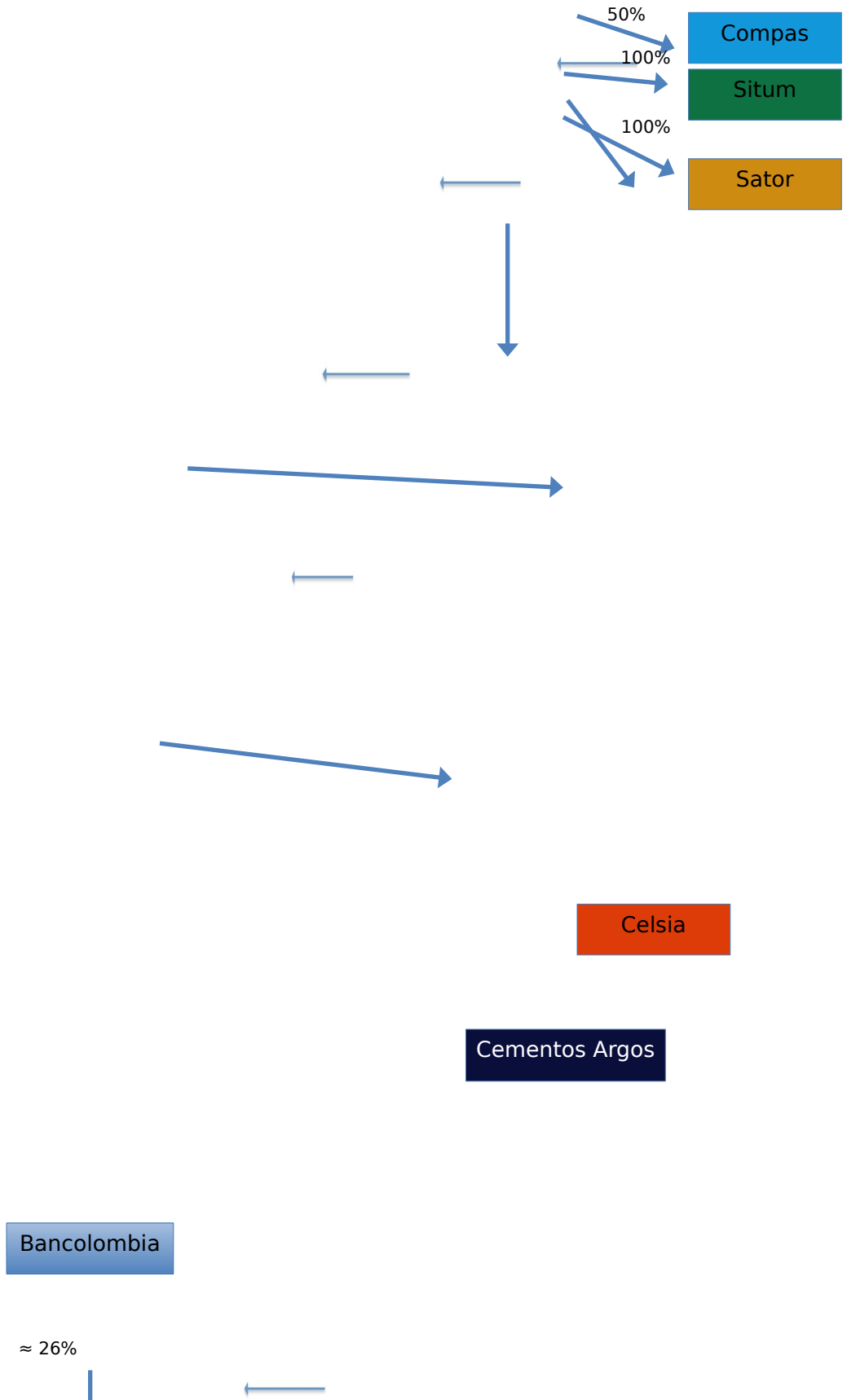
Late in the afternoon, after carefully analyzing the information on Grupo Argos and each of its subsidiaries, José Alberto and his team were preparing themselves to present the results of their analysis to the board. They had to decide whether the growth architecture raised in relation to EBITDA was appropriate and whether the subsidiaries could adapt to it. Also, they had to decide whether 50% of revenues could come from operations outside Colombia and whether new businesses could generate 10% of revenues. They had to present their conclusions about subsidiary performance in order to make a final decision regarding which subsidiaries would help achieve the Group's growth revenue target of US$ 20 billion by 2023.

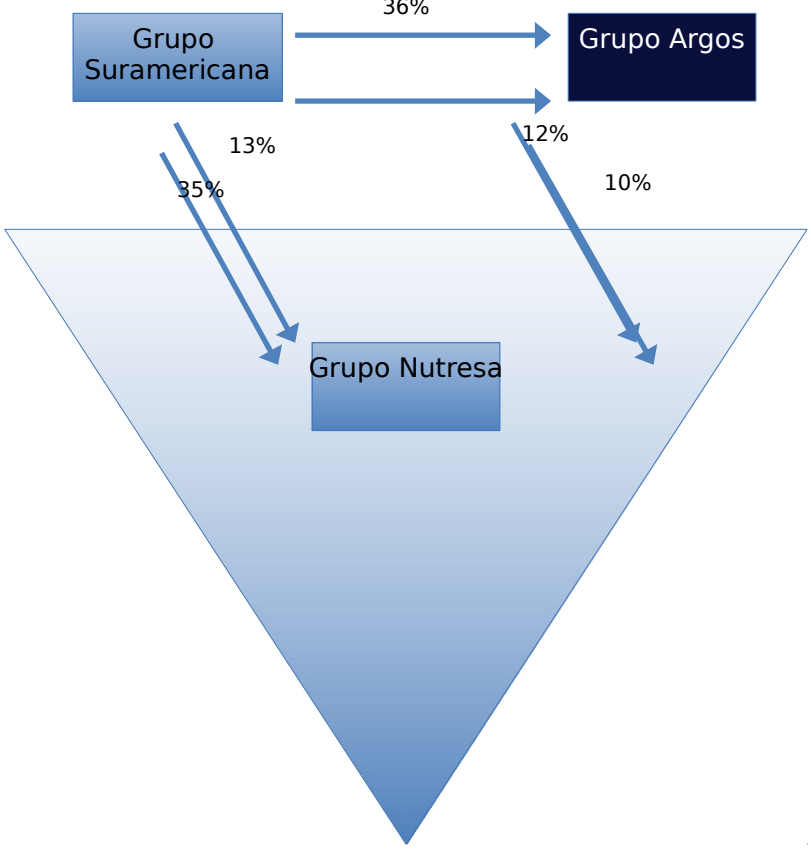
14 Compas. Quiénes somos. http://www.compas.com.co/es-co/quienessomos/contexto.aspx

Exhibit 1

Grupo Argos

Shareholding Triangle among Grupo Argos, Sura, and Nutresa and Grupo Argos' Shareholding in Subsidiaries, 2014


50%
Compas
100%
Situm
100%
Sator
Celsia
Cementos Argos
Bancolombia
≈ 26%


Grupo Suramericana
36%
Grupo Argos
13%
35%
12%
10%
Grupo Nutresa

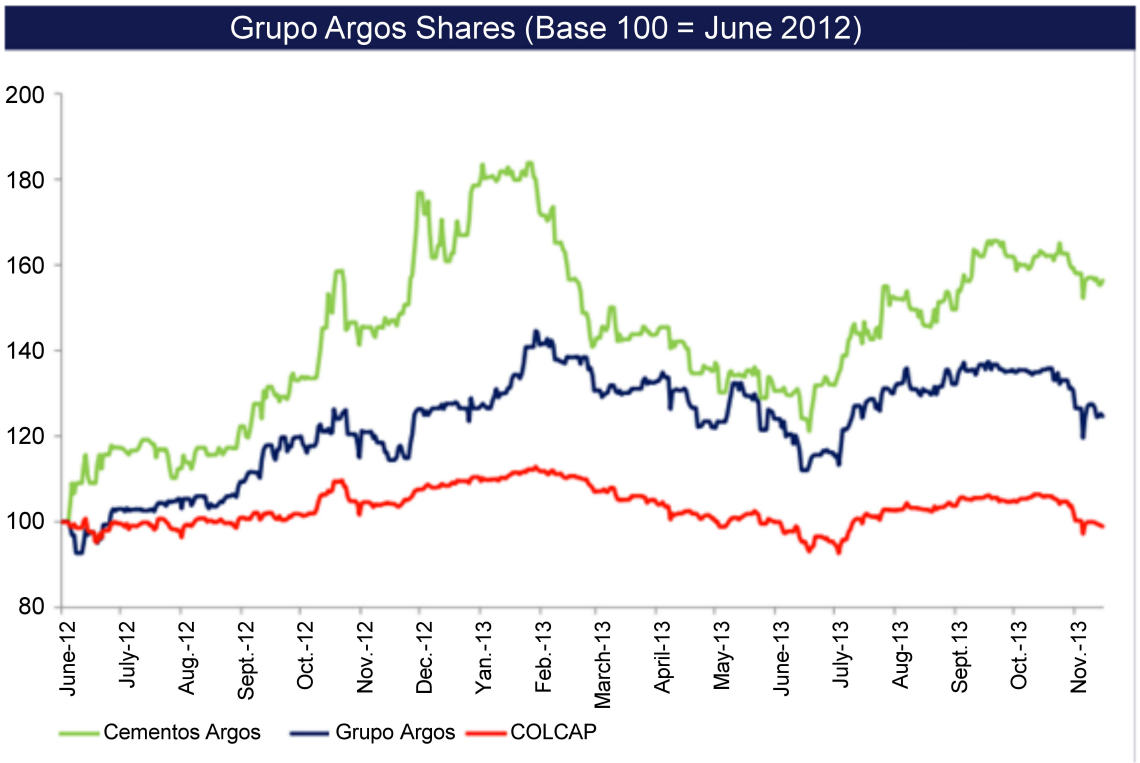
Source: Grupo Argos – 2013

Exhibit 2

Grupo Argos

Cementos Argos' and Grupo Argos' Stock Valuation at the Colombia Stock Exchange (June 2012 – November 2013.

Base: 100)

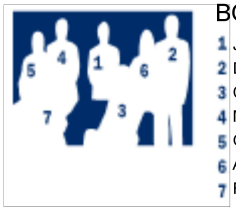


Source: Grupo Argos – 2013 Presentation to the Board.

Exhibit 3

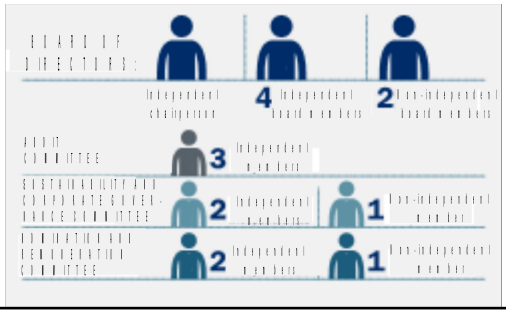
Grupo Argos

Grupo Argos' Board of Directors and Support Committees



BOARD MEMBERS:

1 Jorge Esteban Giraldo
2 David Bojanini
3 Carlos Enrique Pidrahita
4 Mario Scarpetta
5 Guillermo Heins
6 Ana Cristina Arango
7 Rosario Córdoba

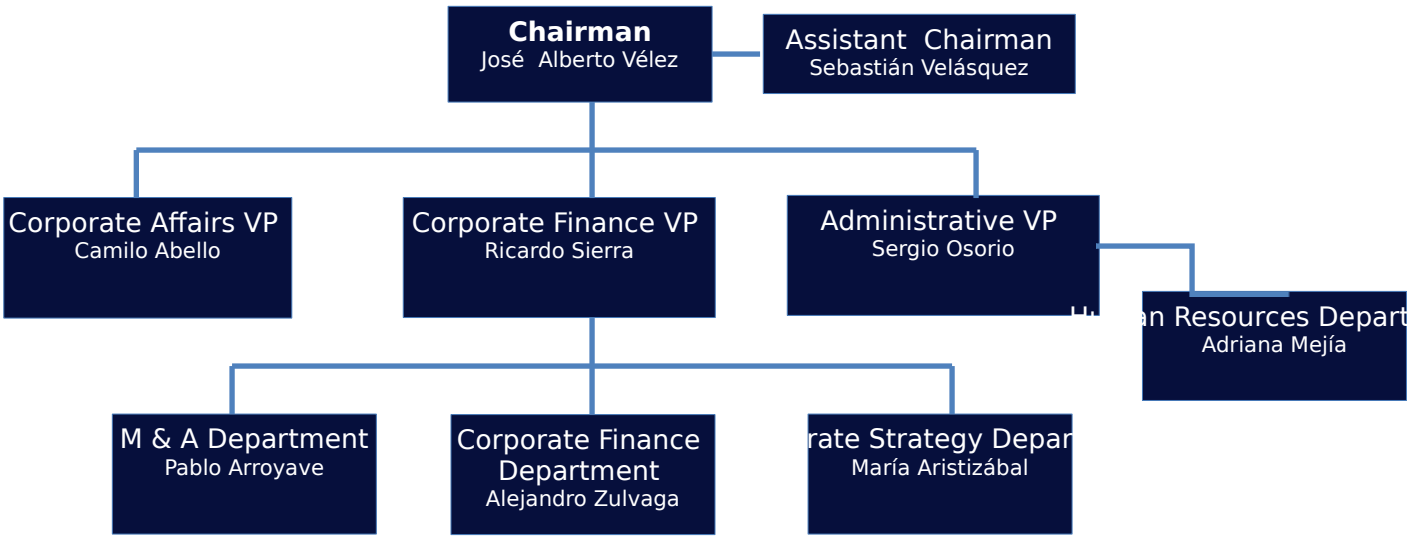


Source: Grupo Argos - 2013 Executive Report

Exhibit 4

Grupo Argos

Grupo Argos' Executive Committee



Source: Interview with María Clara Aristizábal, Grupo Argos' Corporate Strategy Manager

Exhibit 5

Grupo Argos

Grupo Argos & Subsidiaries - Shared Services

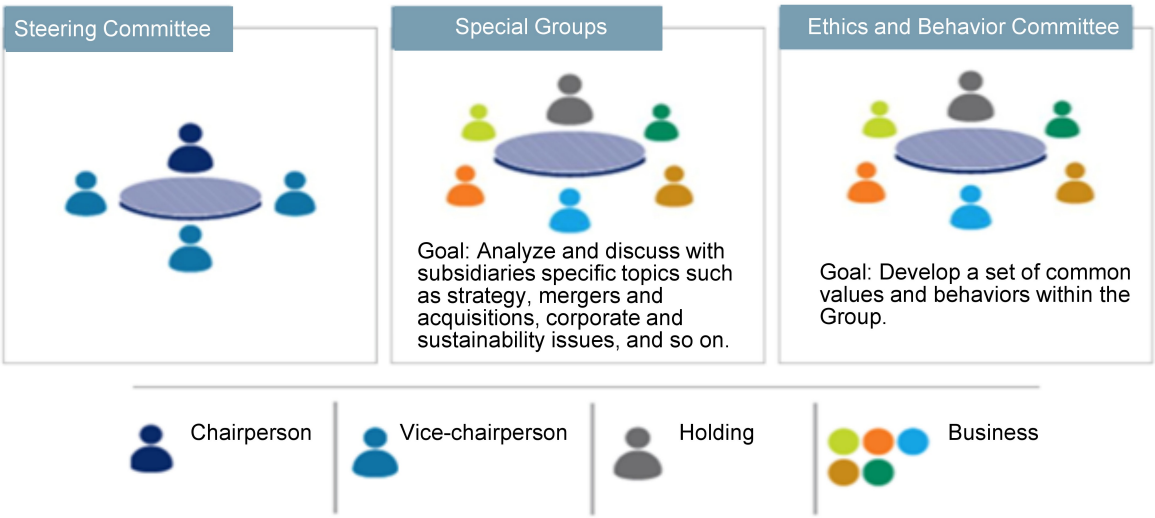
Subsidiary	Strategic Planning	Mergers & Acquisitions	Accounting and Payroll	H.R. Management	Treasury	Legal	Technology
Cementos Argos	†						
Celsia	†						
Compas	†	†					
Sator	†	†	†	†	†	†	†
Situm	†	†	†	†	†	†	†

Source: Interview with Sebastián Velásquez

Exhibit 6

Grupo Argos

Administrative Committees Responsible for Ensuring Common Goals



Source: Grupo Argos' Corporate Presentation.

Exhibit 7

Grupo Argos

Percentage of Employees Undergoing Performance Assessment per Level

	Executive level	**Management level**	**Other levels**
Company	**Percentage**		
Grupo Argos	100	62	59
Cementos Argos	100	99	49
Celsia	0	0	0
Others	67	44	0

Source: Grupo Argos- 2013 Annual Report

Exhibit 8

Grupo Argos

Changes in Grupo Argos' Portfolio Composition

Line Item	2009	2010	2011	2012	2013
	US$ million				
Portfolio value	5,686.0	6,765.5	5,874.2	9,154.0	8,231.6
	Percentage				
Cement	67%	61%	61%	33%	35%
Energy	18%	20%	24%	11%	12%
Real estate	NA	NA	NA	13%	15%
Coal	NA	NA	NA	2%	2%
Seaports	NA	NA	NA	2%	2%
Financial services	NA	NA	NA	33%	27%
Food	NA	NA	NA	6%	6%
Others*	15%	19%	15%	NA	NA

*In 2009, 2010 and 2011, this line item includes investment in financial services (Sura) and food (Nutresa).
Source: Grupo Argos' Annual Reports

Exhibit 9

Grupo Argos

Grupo Argos' Portfolio Valuation

Investments	Number of shares	US$ Million	Weight on portfolio	Share target price (US$)	Percent share
Cementos Argos	698,806,652	3,748.74	34.7%	5.4	61%
Grupo Suramericana	145,827,850	2,944.91	27.3%	20.2	38%
Celsia	376,704,1	1,241.37	11.5%	3.3	52%

	38				
Grupo Nutresa	45,243,781	672.65	6.2%	14.9	10%
EPS.A.	12,701,958	299.57	2.8%		12%
Bancolombia		174.24	1.6%	13.7	3%
Situm		1,510.86	14.0%		
Sator		117.51	1.1%		
Compas		81.74	0.8%		
Total Investments		**10,791.59**			
Net debt 1Q 2014		727.12			
VP Operating expenses		279.92			
Portfolio Value		**9,784.55**			
Historical discount since 2010		2.80%			
Target price		11.96			
Current price		10.89			
Potential		9.76%			

Source: Corredores Asociados, Davivienda. **Exhibit 10**

Grupo Argos

Grupo Argos' Financial Information

Line Item	**2009**	**2010**	**2011**	**2012**	**2013**
	US$ Millones				
Revenue	2,083	2,849	3,131	3,718	4,081
EBITDA	729	855	877	892	1,020
EBITDA Margin	35%	30%	28%	24%	25%
Operating profit	559	621	629	606	721
Net profit	420	205	83	191	158
Assets	8,432	12,800	13,741	14,916	14,666
Liabilities	2,452	3,864	4,916	5,092	4,404
Net worth	5,980	8,935	8,826	9,824	10,262

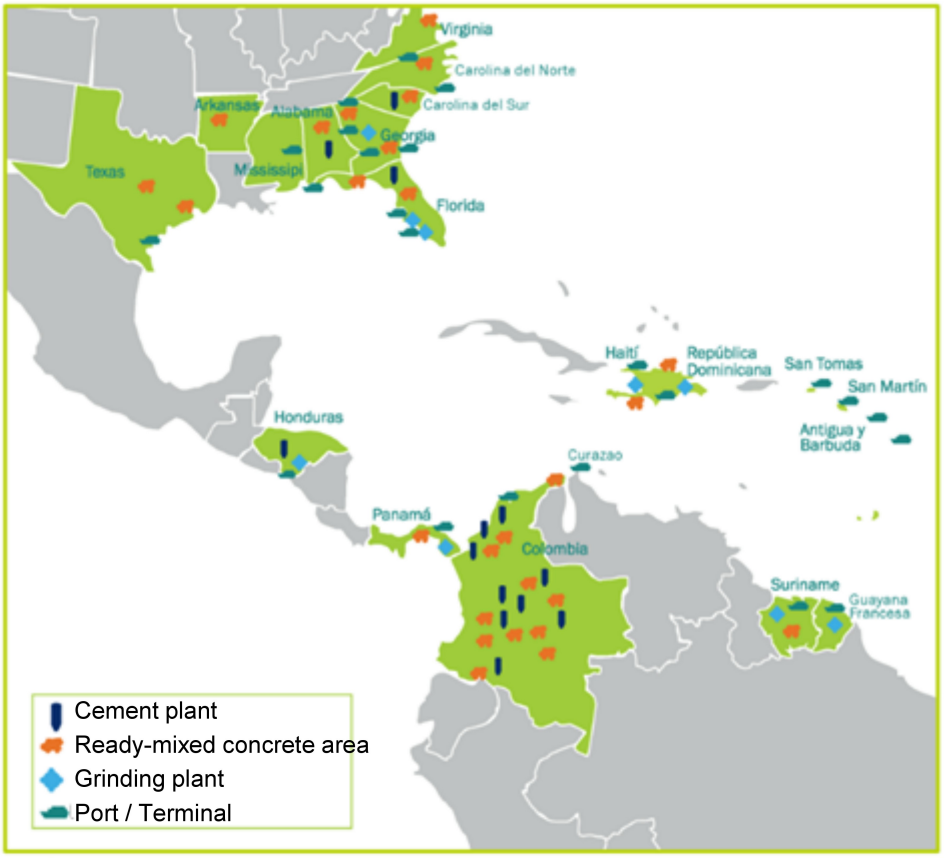
Operating capital	3,142	4,752	5,608	5,562	6,039
WACC	10.0%	9.1%	8.4%	9.5%	9.8%
Taxes	33.0%	33.0%	33.0%	34.0%	34.0%
Mkt Cap	5,695	6,763	5,878	9,302	8,359

Source: Grupo Argos' Annual Reports.

Exhibit 11

Grupo Argos

Cementos Argos Geographical Scope



Source: Cementos Argos 2013 Annual Report

Exhibit 12

Grupo Argos

Cementos Argos' Financial Information.

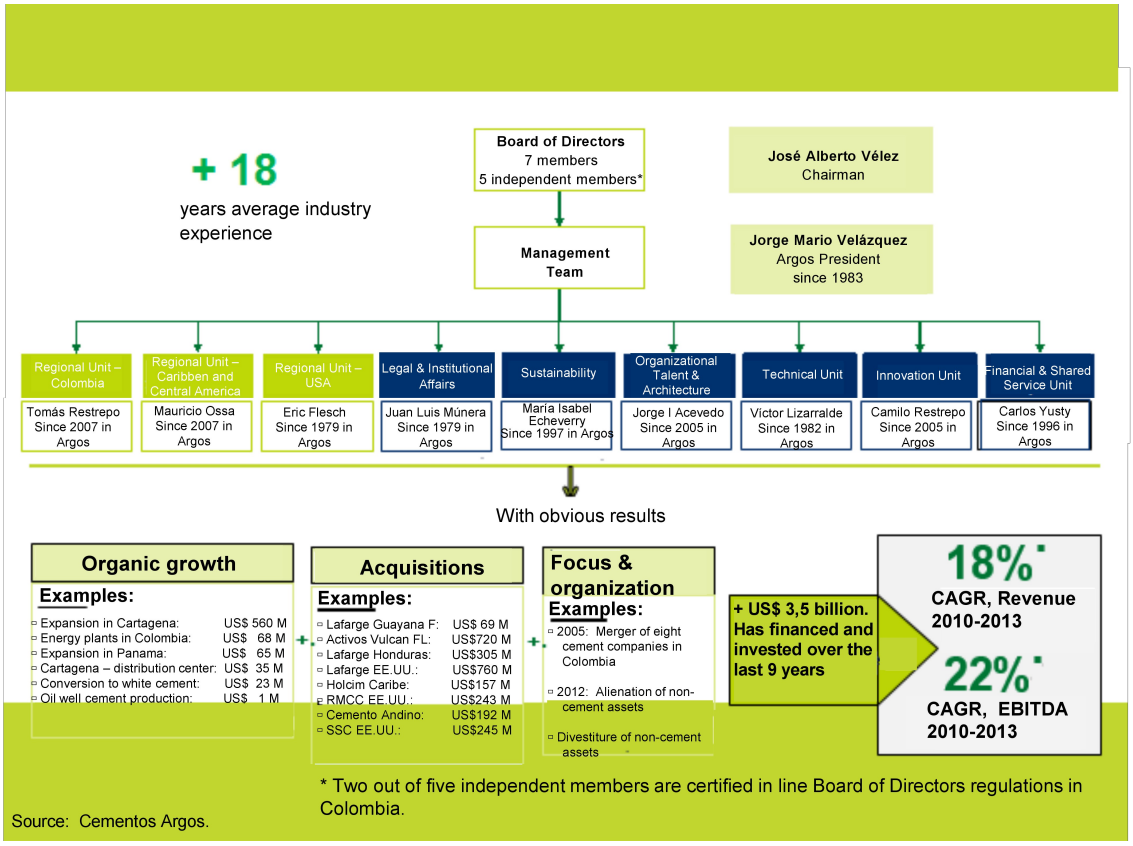
Line Item	2009	2010	2011	2012	2013
	US$ Millones				
Revenue	1,600	1,592	1,985	2,438	2,658
EBITDA	302	284	369	440	523
EBITDA Margin	18.9%	17.8%	18.6%	18.1%	19.7%
Operating profit	139	115	188	231	311
Net profit	97	152	200	216	98.3
Assets	6,815	8,155	9,081	5,714	6,223
Liabilities	2,258	2,221	2,750	2,488	2,150
Net worth	4,557	5,934	6,330	3,226	4,072
Operating capital	2,438	2,664	3,282	3,037	3,369
WACC	9.8%	8.7%	8.5%	8.7%	9.5%
Taxes	33.0%	33.0%	33.0%	34.0%	34.0%
Mkt Cap	5,749	6,902	6,764	6,455	7,330

Source: Grupo Argos & Subsidiaries - Annual Reports.

Exhibit 13

Grupo Argos

Cementos Argos' Board and Management Team

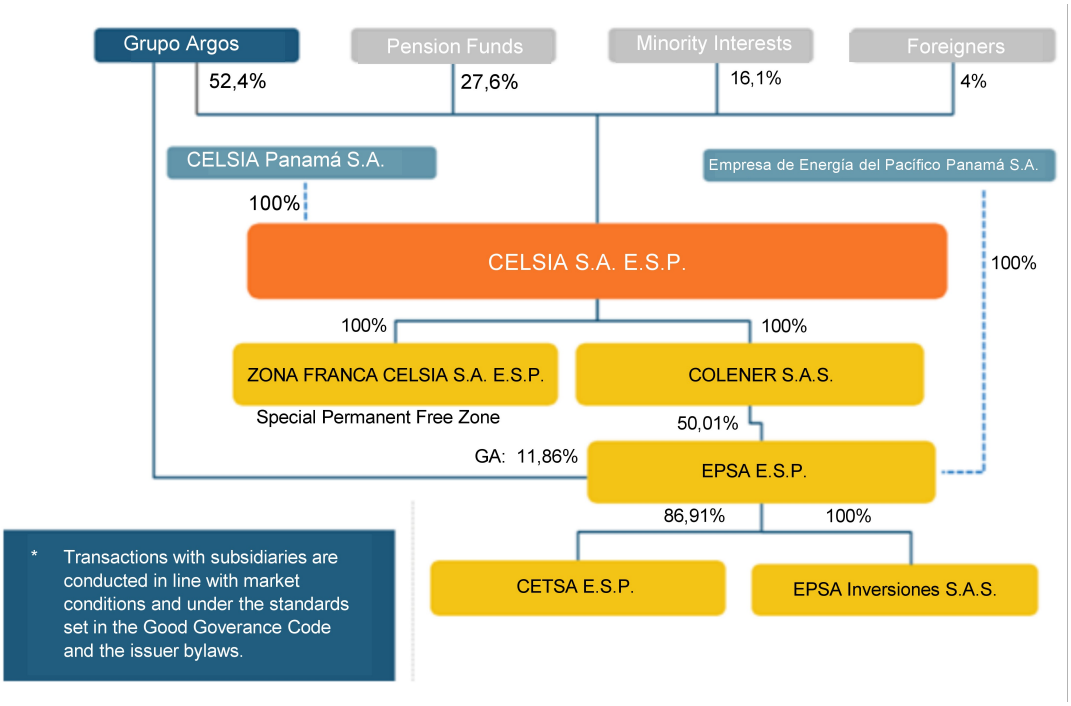


Source: Cementos Argos 2013 Report

Exhibit 14

Grupo Argos

Celsa – 2013 Corporate Structure



Source: Grupo Argos' Corporate Presentation

Exhibit 15

Grupo Argos

Celsia Financial Information

Line Item	2009	2010	2011	2012	2013
	US$ Millones				
Revenue	877	950	1,001	1,126	1,274
EBITDA	279	353	386	407	462
EBITDA Margin	31.8%	37.10 %	38.60 %	36.10 %	36.30 %
Operating	586	306	315	330	383

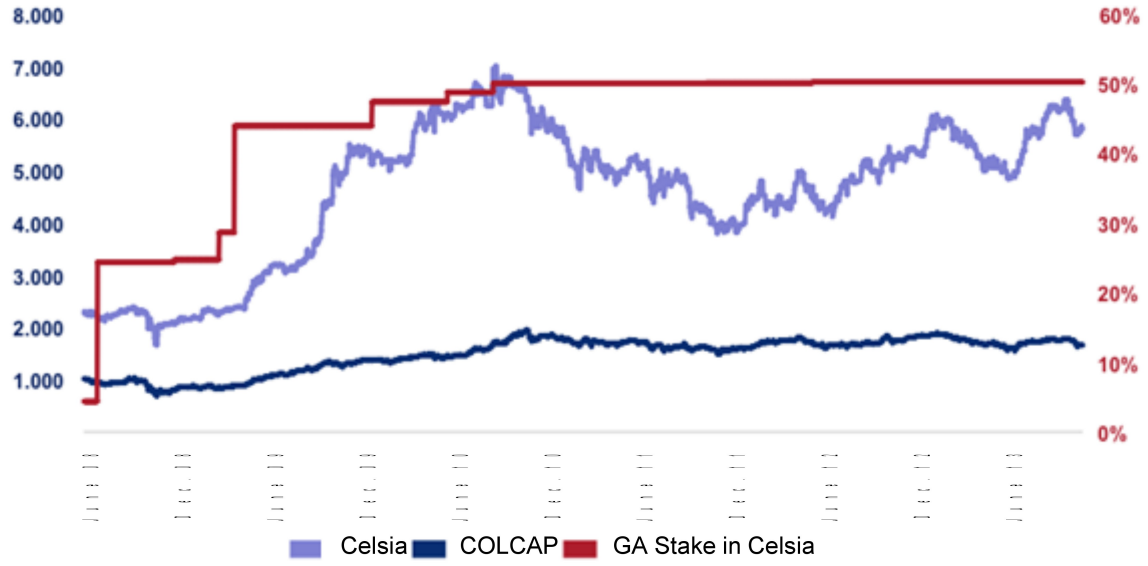
profit					
Net profit	492	136	83	128	200
Assrts	1,703	3,553	3,677	3,807	3,919
Liabilities	635	1,359	1,458	1,373	1,293
Net worth	1,068	2,193	2,220	2,434	2,627
Operating capital	1,238	1,968	1,991	2,116	2,069
WACC	8.3%	8.9%	8.6%	8.5%	8.3%
Taxes	33.0%	33.0%	33.0%	34.0%	34.0%
Mkt Cap	1,708	2,187	2,327	2,449	2,348

Source: Grupo Argos & Subsidiaries - Annual Reports.

Exhibit 16

Grupo Argos

Celsia Stock Performance Based on Argos Stake. Value in Colombian Pesos – COP. June 2008 -June 2013.



Source: Grupo Argos' Corporate Presentation

Exhibit 17

Grupo Argos

Situm Financial Information

Line Item	**2009**	**2010**	**2011**	**2012**	**2013**
	US$ Millons				
Revenue	20.9	35.3	39.7	22.5	34.0
EBITDA	9.3	19.0	23.8	5.1	9.6
EBITDA Margin	44%	54%	60%	23%	28%
Operating profit	-	0.5	5.6	0.3	-2.9

Net profit	ND	ND	ND	-0.5	-4.4
Assets	ND	ND	ND	ND	45.5
Liabilities	ND	ND	ND	ND	42.9
Net worth	ND	ND	ND	ND	2.6
Operating capital	2.9	1.6	1.2	18.3	41.2
WACC	10.5 %	9.2%	8.2%	9.8%	9.7%
Taxes	33%	33%	33%	34%	34%

Source: Grupo Argos & Subsidiaries - Annual Reports.

Exhibit 18

Grupo Argos

Real Estate Development Projects' Rate of Return

	Malls	**Offices**	**Industrial Properties**	**Development before taxes**
Project rate of return before taxes (1)	11-13%	11-13%	12-14%	NA
Investors' IRR (before taxes) (1)	12-14%	12-14%	14-16%	15%-25%
Market capitalization rate	8.60%	8.10%	8.50%	NA
EBITDA margin (2)	NA	NA	NA	16-20%

(1) Capital structure for real-estate income: 60% equity / 40% debt.
(2) Includes cost of land based on Colliers appraisals for split completed in May 2012.
Source: Grupo Argos. 2014 Corporate Presentation

Exhibit 19

Grupo Argos

Sator Financial Results

Line Item	2011	2012	2013
	US$ Millons		
Revenue	42.52	38.53	41.69
EBITDA	-0.72	-6.60	-6.13
EBITDA Margin	-1.7%	-17.1%	-14.7%
Operating profit	-2.12	-7.30	-7.23
Net profit	-23.82	-21.68	-1.63
Assets	ND	68.34	80.99
Liabilities	ND	52.62	69.87
Net worth	ND	15.71	11.12
Operating capital	27.80	32.12	7.58
WACC	8.2%	9.8%	9.7%
Taxes	33%	34%	34%

Source: Grupo Argos & Subsidiaries - Annual Reports.

Exhibit 20

Grupo Argos

Compas' Organizational Structure

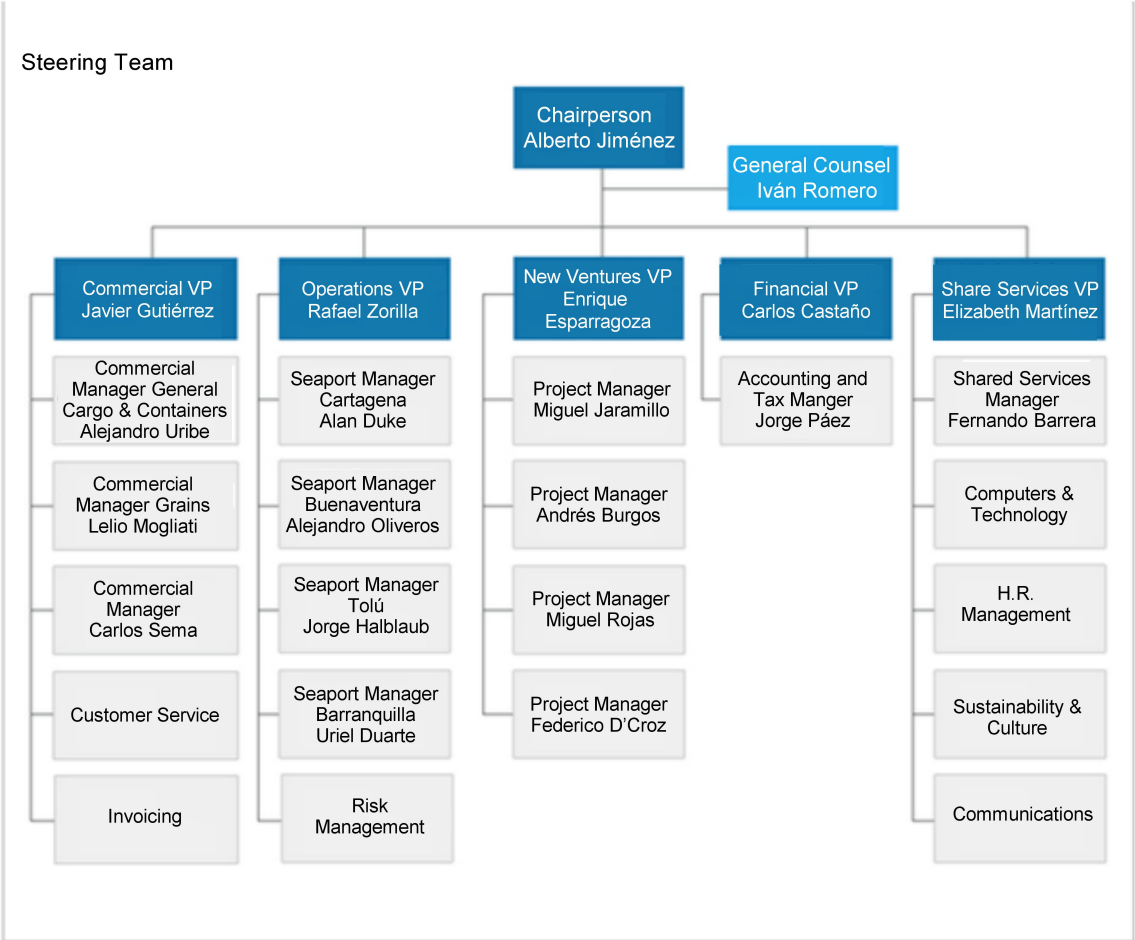


Exhibit 21

Grupo Argos

Compas' Financial Information

Line Item	**2012**	**2013**
	US$ millons	
Revenue	57.51	55.14
EBITDA	12.35	14.35
EBITDA Margin	21%	26%
Operating profit	2.42	-0.67
Net profit	2.04	-3.76
Assets	240.74	238.39
Liabilities	85.18	93.87
Net worth	155.56	144.52
Operating capital	153.25	152.36

WACC	9.8%	9.7%
Taxes	34%	34%

Source: Grupo Argos & Subsidiaries - Annual Reports.

Grupo Argos

Teaching Note

Summary

José Alberto Vélez, Chief Executive Officer at Grupo Argos, a leading business group in Colombia, met with his team in Medellín to analyze whether Grupo Argos' five subsidiaries, engaged in cement production, energy, coal mining, seaport management, and real estate development would adapt to the aggressive growth pattern he and his team had submitted in order for Grupo Argos to attain revenues of US$ 20 billion and a US$ 30 billion market capitalization by 2023. Grupo Argos' Executive Committee wondered whether it was better to keep investments as they were now or divest a few subsidiaries. They were concerned about their current investment portfolio failing to reach the goal set for 2023, namely, 50% of revenue from operations outside Colombia, 10% from new ventures and US$ 10 billion in revenues from the cement business.

By 2013, Grupo Argos' portfolio was worth, on average, US$ 8.2 billion. Cementos Argos, a subsidiary engaged in cement, concrete and aggregates production, accounted for most of the Group's portfolio (35%) followed by Situm, a subsidiary in charge of real estate development (15%); Celsia (12%), responsible for energy production; Sator (2%) responsible for coal mining and Compas (2%) responsible for seaport administration. The remainder accounted for Grupo Argos' investments in finance (27%) and food (6%), through shareholding in Grupo Sura, Bancolombia and Nutresa. Grupo Argos had 791 million outstanding shares of equity, with share value growing 0.6% per year to US$ 10.4.

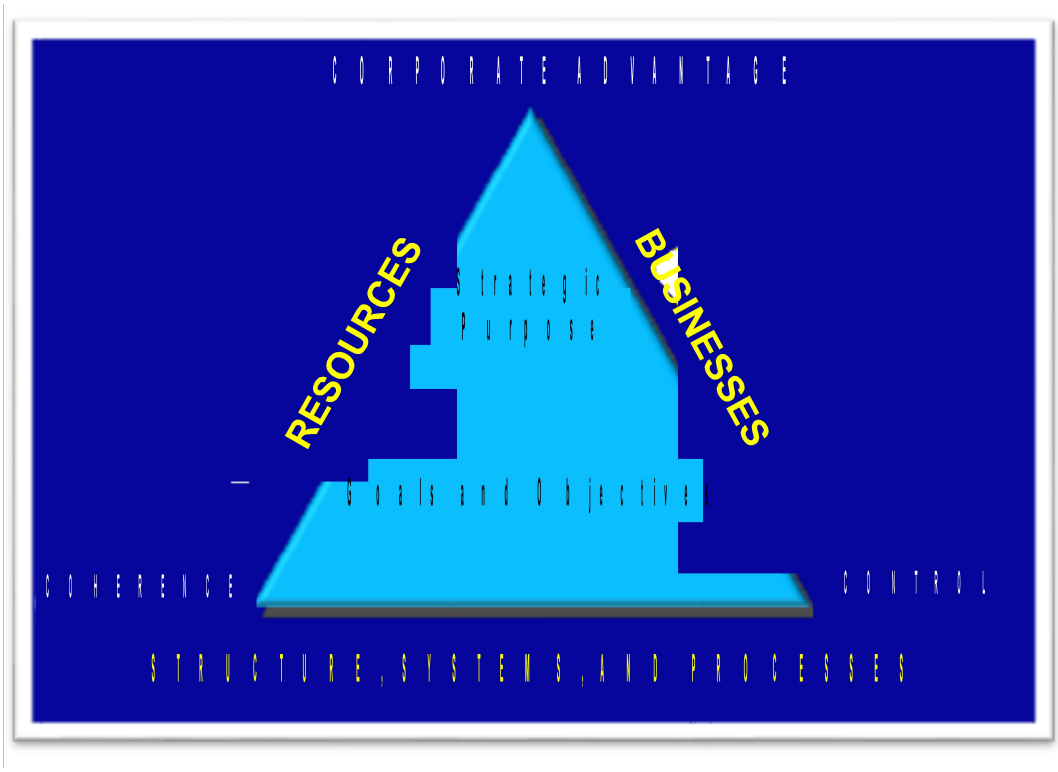
Grupo Argos managed to grow revenue 18% a year between 2009 and 2013 to US$ 4.08 billion in 2013. Its operating profit amounted to US$ 721 million, operating capital US$ 3,370 million, and weighted cost of capital amounted 9.8%. In addition, the Group's reported EBITDA amounted to US$ 1.02 billion and its net profit equaled US$ 157.8 million. Grupo Argos had assets worth US$ 14.6 billion, liabilities of US$ 4.4 billion and US$ 10.2 billion in equity. In that same year, 62% of revenue came from Cementos Argos, 30% from Celsia and the remaining 8% came from other investments. In relation to EBITDA, Cementos Argos was responsible for 49%, Celsia for 45% and other investments for 6%.

Use of Case Study

This case study was written to be used at Corporate Strategy courses of MBA or EMBA Programs (among other academic programs), with a focus on basic principles of corporate strategy, according to Collins and Montgomery conceptual framework.[15] It is based on the idea that corporate strategy relies on value creation by the parent company for its strategic business units (SBUs) and vice versa.

Figure 1. Corporate Strategy – Conceptual Framework

15 Collins J. y Montgomery D. 2004. Corporate Strategy: A Resource-Based Approach. Irwin Professional Publishing; 2nd edition.



Source: Collins and Montgomery 2004.

Teaching Objectives

- Understand the basic principle of corporate strategy
- Implement Collins and Montgomery (2004) conceptual framework in order to:
- Analyze corporate goals, objectives and future vision and their alignment to SBUS.
- Identify strategic resources, which are the basis for value creation for both the corporation and the SBUs.
- Determine if the SBUs are in an attractive or growth industry and if they possess a suitable competitive positioning, which together will create value to the corporation.
- Analyze how the organization controls and coordinates SBUs' and human resource activities (structure, systems and processes).
- Identify control mechanisms used by the parent company to ensure that the SBU's competitive strategy is aligned to corporate strategy.

Case Study Questions

1. Does Grupo Argos have a vision for the future, clear goals and objectives? Do you think it has the ability to achieve them with its current strategic business units?
2. Mention Grupo Argos' and subsidiaries' strategic resources.
3. Are the strategic business units (SBUs) competing in industries that can add value to the corporation? Are these consistent with Grupo Argos value proposition?
4. Describe Grupo Argos' structure.

5. What are the control mechanisms used by Grupo Argos to ensure that SBUs have a competitive strategy aligned with corporate strategy?
6. Are there synergies between Grupo Argos' SBUs?

Analysis

1. Does Grupo Argos have a vision for the future, clear goals and objectives? Do you think it has the ability to achieve them with its current strategic business units?

Grupo Argos has a clear vision for the future; in fact, it wants to be an experienced group in industries related to the **natural resource mining** and **processing,** focusing mainly on **infrastructure development.**

In addition, it has very clear goals for 2023:

A. Growing Group revenue to US$ 20 billion and market capitalization to US$ 30 billion.
B. Attaining US$ 10 billion in revenue at the cement business.
C. 50% of revenue coming from operations outside Colombia

a. Between 2009 and 2013 Grupo Argos' revenue grew 18% a year. By 2013 Group's revenue amounted to $ 4 billion, so a target of US $ 20 billion required a 17% growth rate per year. These figures could be calculated using CAGR and the information in Exhibit 10. Using this information students may infer the possibility of achieving the objectives, as the growth rate was achieved over the last four years.
b. An analysis of Cementos Argos showed its revenue had grown at a 10% rate in 2009-2013. However, the goal for this subsidiary was to attain revenues of $ 10 billion, implying a 15% annual growth. A brief description of the environment indicates economic growth in the various geographical areas where Cementos Argos operated, as well as population growth and housing needs, contributing to a need for cement. Thus, one could infer that the Group's revenue would increase at least at the same rate as cement consumption increased, i.e., 4.2% worldwide, 3.8% in Latin America and 4.2% in the United States. On the other hand, Cementos Argos was considering to acquire the cement assets available as a result of the Holcim-Lafarge merger in the Canadian and Brazilian markets. Even though the case study shows no indication of that transaction taking place, students may still infer that, in order to increase revenues, this subsidiary should invest in other markets, since deepening the markets where it was already operating might not be sufficient.
c. This objective could be achieved through Cementos Argos and Celsia, both with international presence, although Cementos Argos was the subsidiary with the most potential to achieve it. It had already established itself in Colombia with a significant market share (48%), so it could increase its share in other regions either by deepening operations in other Caribbean Basin countries or by adding more countries to its platform, either Mexico or countries from Central America. On the other hand, Celsia had a presence in Colombia, Costa Rica and Panama. However in Colombia its market share was

only 12% in relation to power generation and 4% in relation to distribution. So, before investing abroad it should consolidate itself in Colombia. Celsia was characterized by inorganic growth; as a result, it could consolidate itself in Colombia by merging or acquiring other companies. Alternatively, Situm still has enough room to develop in Colombia, and Compas is focusing on having a seaport with integrated services also in Colombia. On the contrary, Sator is reducing operations in the country, so it would not become international.

2. **Mention Grupo Argos' and subsidiaries' strategic resources.**

Strategic Resources.

Grupo Argos:

A. It is a member of Grupo Empresarial Antioqueño, with a corporate culture displaying first-world management practices and comprising other renowned business groups in Colombia and Latin America. All of this helps support Grupo Argos and strengthens its portfolio investment.
B. Reputation in Colombia as a solid business group that knows how to do things right. This can be shown by the increased share value of Cementos Argos and Celsia thanks to the influence of Grupo Argos. Subsidiaries benefit from being under the umbrella of Grupo Argos, as it is one of the first contacts made by investors.
C. Access to capital and funding sources allowing it to better structure debt.
D. Staff recognized in Colombia, as they had led large transactions mainly in the cement and energy industries. Experience, leadership and recognition. José Alberto Vélez, Ricardo Sierra, Camilo Abello and Sergio Osorio, all of them members of the Group's Executive Committee.
E. Grupo Argos staff. Grupo Argos has been assembling a team with a background in corporate and competitive strategy, corporate finance, mergers and acquisitions and in the legal field, allowing it to perform a quantitative and qualitative analysis in the decision-making process related to its investment portfolio. Furthermore, this team provides information allowing subsidiaries to make the best possible decisions. It retains human talent by offering adequate working conditions and payment above the average offered by similar groups.
F. Land bank for real estate development

Cementos Argos:

A. Over 70 years of experience in the cement industry.
B. Staff experienced in replicating the business model in other countries.
C. Brand recognition in Colombia, with a market share of around 50%.
D. Platform for cement production and distribution in the Caribbean Basin.
E. Cement and concrete plants in the markets where it competes.

Celsia:

A. Power generation plants in Colombia, Costa Rica, and Panama.

Situm:

A. Staff with experience in real estate development.
B. Availability to develop Grupo Argos land bank.

Compas:

A. Experience in seaport management.

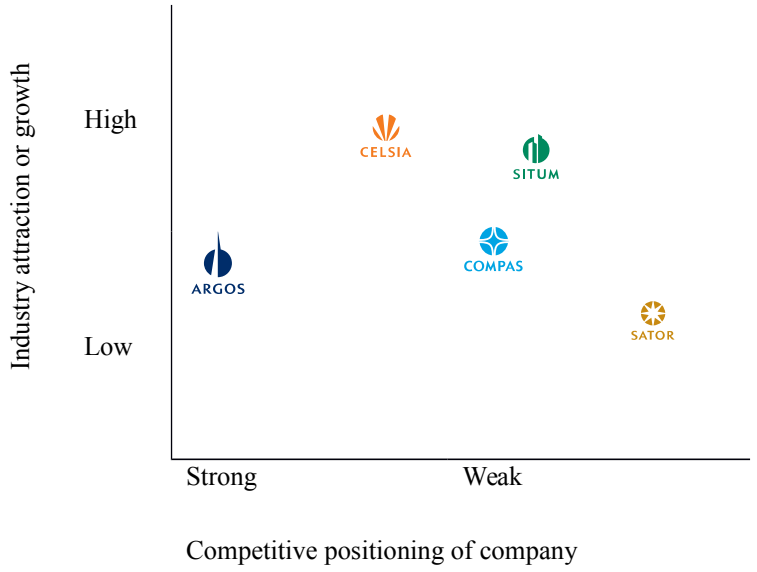
Sator:

A. Concessions to exploit coal mines.

3. Are the strategic business units (SBU) competing in industries that can add value to the corporation? Are these consistent with Grupo Argos value proposition?

To answer this question students can use Boston Consulting Group's conceptual framework[16], relating industry attraction to company positioning in the market.

Figure 2. Competitive positioning versus industry attraction



Cementos Argos is located in the lower left quadrant, corresponding to companies with relatively high market share in a low-growth industry, which can be highly profitable with low investment requirements. On the other hand Sator, in the

16 Collins J. y Montgomery D. 2004. Corporate Strategy: A Resource-Based Approach. Irwin Professional Publishing; 2nd. edition.

lower left quadrant, shows a competitive disadvantage due to the informality of its industry. There is little it can do to change this situation so a possible strategy would be disinvestment.

The upper right quadrant comprises companies in a growing or attractive industry, with low market share. These are not certain about their performance and so they require investment or capital flows to succeed. Here you can position Situm and Compas. However, Compas is located in an industry with potential to stabilize its relatively fast growth and therefore it is located at the edge of the right lower quadrant.

Finally, the upper left quadrant comprises companies competing in attractive industries with a high market share. Companies in this quadrant are characterized by capital requirements due to rapid industry growth and also to increase market share before industry growth declines. Here you can position Celsia, the fourth largest power generating company in the country, with a 12% market share. Celsia has the potential to increase its market share either by acquiring other companies or investing in new projects.

The case study indicates the kind of industries where Grupo Argos wants to compete. In order to create value for the Group's portfolio, those industries must have a number of characteristics including,

A. "Following a number of changes, Grupo Argos focused on industries related to **natural resource mining and processing**, and concentrated mainly on **infrastructure development".**
B. *Grupo Argos' development model, which focused on* ***making large capital investments in key sectors of the economy to process natural resources,*** *e.g., turning limestone into cement, water into energy, beachfronts into seaports and land in* ***real estate development.***
C. *"Grupo Argos should concentrate in helping subsidiaries* ***focus, expand and then diversify risk****." It feels a way for each subsidiary to diversify risk is by replicating the business model in different geographical areas.*

By taking into account the statements above, students may infer that the subsidiaries most aligned with these characteristics are Cementos Argos, Celsia, and Situm. All of them are in industries where there natural resources are processed, as stated by the parent company. Compas is less clear in relation to these features. Although it invests much capital to transform coastlines into seaports, it is more difficult to expand this business. In the medium term it will focus more on port management than in port development. Finally Sator is a subsidiary mining coal, a natural resource. However, it does not engage in processing. In addition, due to the informal nature of this industry it is difficult for Sator to be competitive, expand, and then diversify risk.

4. Describe Grupo Argos' structure

Grupo Argos consists of a seven-member board with three supporting committees, (1) Audit, (2) Sustainability and Corporate Governance, and (3) Appointments and Compensation. It also had a fourth team, the Executive Committee, responsible for developing and implementing corporate strategy. This committee consists of the president, his assistant and three vice presidents (Corporate Affairs, Finance, and Administration, which together with the subdivisions employ 83 people. Grupo Argos executive committee was made up of employees.

5. **What are the control mechanisms used by Grupo Argos to ensure that SBUs have a competitive strategy aligned with corporate strategy?**

A. According to Camilo Abello, Vice-president of Corporate Affairs, "Grupo Argos lacked a system of shared service centers, with basic functions adjusted to any given type of industry allowing for shared services of information technology, management, payroll processes or legal advice. This was because that was not Grupo Argos' raison d'être. Had Grupo Argos engaged in that it would have ended up diverting its attention from the Group itself, whereas its goal was to help subsidiaries focus, expand and then diversify risk."

B. This comment can lead students to infer that Grupo Argos does not intend to fully control subsidiaries. Rather, it wants for them to go through a number of stages and become independent. Take for instance Celsia. This is a company with a diversified portfolio that under the influence of Grupo Argos focused on the energy industry. Celsia is now expanding in Colombia and once it is consolidated in that country it can diversify its risk, increasing its geographical scope. According to the case study, Cementos Argos is now consolidated and it is diversifying risk by expanding its geographical scope. Celsia is underway and Compas, Situm, and Sator (the latter two are totally dependent on the parent company) are currently focused. However, they should consolidate to diversify risk.

C. Participation by members of Grupo Argos Executive Committee in the subsidiaries' boards.

D. Special groups consisting of monthly meetings of subsidiaries' managers and the parent company president or a vice president. At each session a manager spoke about the most relevant aspects of subsidiary performance on strategy, mergers and acquisitions, corporate affairs and sustainability.

E. The Ethics and Conduct Committee in charge of creating and conveying common values and behaviors among all subsidiaries.

6. **Are there synergies between Grupo Argos' SBUs?**

A. Grupo Argos receives information from all subsidiaries. It can process and distribute it whenever it thinks it valuable and helpful to subsidiaries. Moreover, its prestige facilitates negotiations with investors. Also, its ability to attain financial leverage helps subsidiaries better structure their debt.

B. Although not explicitly stated in the case study, students can infer synergies between Cementos Argos and Situm as a result of the industries where they operate. The more real estate development generated by Situm the more need for cement in the

market, with a logical benefit to Cementos Argos. In addition, Cementos Argos can inform Situm about performance of the construction and real estate industries in international markets, should Situm considers investing in those markets or as opportunities arise.

C. Students can infer synergies between Celsius and Cementos Argos. Celsia can provide cement plants with energy needed for production. As stated by the case, divesting non-cement assets increased the share price for Cementos Argos as it is now a pure player in the cement industry. The existence of Celsia prevents Cementos Argos from investing in non-cement assets and therefore it focuses on cement production. Notice that all transactions between subsidiaries take place at market prices as directed by the parent company. Thus, Celsia must provide energy at competitive prices.

D. In addition, based on the assumption that the cement industry is a cyclical one, Celsia covers value losses in the portfolio resulting from Cementos Argos when the cement industry undergoes difficulties.

E. Compas can serve as a platform to export coal and cement, thus benefiting Sator and Cementos Argos. Also, it can serve to import raw materials such as coal for the cement plants or to produce thermal energy for Celsia. Besides, the case study explicitly states that Compas provides management services to South Central Cement in Houston, owned by Cementos Argos, allowing the latter to concentrate on cement production.

F. Sator can supply coal for the cement production process or to produce thermal energy for Celsia. As mentioned above, transactions between subsidiaries take place at market price.

Financial and performance metrics

The case provides sufficient information for readers to carry out financial analysis using the Dupont tool and to find out EVA for each subsidiary.

Dupont: This tool is used to calculate return on equity (ROE), that is, how many profit dollars result from each dollar of equity. Dupont analyzes three variables: (1) profit from each dollar of sales (*sales margin*); (2) profit from each dollar of assets employed, (*asset turnover*), and (3) amount of equity used to finance assets (*financial leverage*). Sales margin indicates profit in dollars earned from each dollar of sales. The asset turnover ratio indicates company asset management to maintain sales, and leverage points to equity used to finance assets.[17]

$$ROE = \frac{net\ profit}{equity} = \frac{net\ profit}{sales}\ X\ \frac{sales}{assets}\ X\ \frac{assets}{equity}$$

Table 1. Grupo Argos – Dupont Calculations

Dupont	**2009**	**2010**	**2011**	**2012**	**2013**
	US$ million				

17 Robert H. 2004. Análisis para la dirección financiera. 7th. ed. Madrid, McGraw-Hill interamericana.

a. Revenue	2,083	2,849	3,131	3,718	4,081
b. Net profit	420	205	83	191	158
c. Assets	8,432	12,800	13,741	14,916	14,666
d. Liabilities	2,452	3,864	4,916	5,092	4,404
e. Equity	5,980	8,935	8,826	9,824	10,262
	Ratios				
(1) Sales margin (b/a)	20%	7%	3%	5%	4%
(2) Asset turnover (a/c)	25%	22%	23%	25%	28%
(3) Financial leverage (c/e)	1.41	1.43	1.56	1.52	1.43
ROE= 1 X 2 X 3	7.0%	2.3%	0.9%	1.9%	1.5%

Table 2. Cementos Argos – Dupont Calculations

Dupont	**2009**	**2010**	**2011**	**2012**	**2013**
	US$ million				
a. Revenue	1,600	1,592	1,985	2,438	2,658
b. Net profit	97	152	200	216	98
c. Assets	6,815	8,155	9,081	5,714	6,223
d. Liabilities	2,258	2,221	2,750	2,488	2,150
e. Equity	4,557	5,934	6,330	3,226	4,072
(1) Sales margin (b/a)	6%	10%	10%	9%	4%
(2) Asset turnover (a/c)	23%	20%	22%	43%	43%
(3) Financial leverage (c/e)	1.50	1.37	1.43	1.77	1.53
ROE= 1 X 2 X 3	2.1%	2.6%	3.2%	6.7%	2.4%

Table 3. Celsia – Dupont Calculations

Dupont	**2009**	**2010**	**2011**	**2012**	**2013**
	US$ million				
a. Revenue	877	950	1,001	1,126	1,274
b. Net profit	492	136	83	128	200
c. Assets	1,703	3,553	3,677	3,807	3,919
d. Liabilities	635	1,359	1,458	1,373	1,293
e. Equity	1,068	2,193	2,220	2,434	2,627
	Ratios				
(1) Sales margin (b/a)	56%	14%	8%	11%	16%
(2) Asset turnover (a/c)	52%	27%	27%	30%	32%
(3) Financial leverage (c/e)	1.59	1.62	1.66	1.56	1.49
ROE= 1 X 2 X 3	46.1%	6.2%	3.7%	5.3%	7.6%

Note: Celsia's net profit in 2009 includes revenue from assets sale.

Table 4. Compas – Dupont Calculations

Dupont	2012	2013
	US$ million	
a. Revenue	57.51	55.14
b. Net profit	12.35	14.35
c. Assets	240.74	238.39
d. Liabilities	85.18	93.87
e. Equity	155.56	144.52
	Ratios	
(1) Sales margin (b/a)	0.21	0.26
(2) Asset turnover (a/c)	0.24	0.23
(3) Financial leverage (c/e)	1.55	1.65
ROE= 1 X 2 X 3	7.9%	9.9%

Table 5. Situm – Dupont Calculations

Dupont					
a. Revenue	20.9	35.3	39.7	22.5	34.0
b. Net profit	NA	NA	NA	-0.5	-4.4
c. Assets	NA	NA	NA	NA	45.5
d. Liabilities	NA	NA	NA	NA	42.9
e. Equity	NA	NA	NA	NA	2.6
(1) Sales margin (b/a)	NA	NA	NA	-0.02	-0.13
(2) Asset turnover (a/c)	NA	NA	NA	NA	0.75
(3) Financial leverage (c/e)	NA	NA	NA	NA	17.75
ROE= 1 X 2 X 3	NA	NA	NA	NA	-171.60%

Table 6. Sator – Dupont Calculations

	2011	**2012**	**2013**
Dupont			
a. Revenue	**42.52**	**38.53**	**41.69**
b. Net profit	**-23.82**	**-21.68**	**-1.63**
c. Assets	**NA**	**68.34**	**80.99**
d. Liabilities	**NA**	**52.62**	**69.87**
e. Equity	**NA**	**15.71**	**11.12**
(1) Sales margin (b/a)	**-0.56**	**-0.56**	**-0.04**
(2) Asset turnover (a/c)	**NA**	**0.56**	**0.51**
(3) Financial leverage (c/e)	**NA**	**4.35**	**7.28**

ROE= 1 X 2 X 3	**NA**	**-138.0%**	**-14.6%**

Economic Value Added (EVA)

EVA is a methodology assuming that business success is directly related to the generation of economic value. The latter is estimated by subtracting from operating profit the financial cost of owning the assets used to produce those profits. This technique removes subjectivity from accounting.[18]

$$EVA = NOPAT - (capital\,employed * wacc)$$

Where NOPAT (Net Operating Profits After Taxes) equals operating profit after taxes and WACC equals the weighted cost of capital. Capital employed equals the sum of working capital (excluding cash) plus fixed assets used to generate operating profits.

Table 1. Grupo Argos – EVA Calculations

	2009	**2010**	**2011**	**2012**	**2013**
	US$ million				
(A) Operations profit	559	621	629	606	721
(B) Tax	33%	33%	33%	34%	34%
(C) NOPAT= 1*(1-2)	374	416	422	400	476
(D) Operating capital	3,142	4,752	5,608	5,562	6,039
(E) WACC	10%	9%	8%	9%	10%
EVA= C-(D*E)	61.21	-14.29	-47.57	-127.77	-117.30

Table 2. Cementos Argos – EVA Calculations

	2009	**2010**	**2011**	**2012**	**2013**
	US$ million				
(A) Operations profit	139	115	188	231	311
(B) Tax	33%	33%	33%	34%	34%
(C) NOPAT= A*(1-B)	93	77	126	152	205
(D) Operating capital	2,438	2,664	3,282	3,037	3,369
(E) WACC	9.8%	8.7%	8.5%	8.7%	9.5%
EVA= C-(D*E)	-144.77	-155.78	-152.24	-112.61	-115.95

Table 3. Celsia – EVA Calculations

18 ACUÑA, G. sf. Valor Económico Añadido. Departamento de Finanzas de la Facultad de Ciencias Económicas de la Universidad Nacional de Colombia

	2009	2010	2011	2012	2013
	US$ million				
(A) Operations profit	585.7	306.4	314.9	329.8	383.1
(B) Tax	33%	33%	33%	34%	34%
(C) NOPAT= A*(1-B)	392.4	205.3	211.0	217.6	252.8
(D) Operating capital	1,237.6	1,968.4	1,991.2	2,115.9	2,069.3
(E) WACC	8.3%	8.9%	8.6%	8.5%	8.3%
EVA= C-(D*E)	290.3	30.7	40.6	37.7	82.1

Table 4. Compas – EVA Calculations

	2012	2013
	US$ million	
(A) Operations profit	2.42	-0.67
(B) Tax	34%	34%
(C) NOPAT= A*(1-B)	1.6	-0.70
(D) Operating capital	153.3	152.4
(E) WACC	9.8%	9.7%
EVA= C-(D*E)	-13.5	-15.5

Table 5. Situm – EVA Calculations

	2009	2010	2011	2012	2013
	US$ million				
(A) Operations profit	**-**	**0.5**	**5.6**	**0.3**	**-2.9**
(B) Tax	**33%**	**33%**	**33%**	**34%**	**34%**
(C) NOPAT= A*(1-B)	**-**	**0.5**	**5.6**	**0.3**	**-2.9**
(D) Operating capital	**2.9**	**1.6**	**1.2**	**18.3**	**41.2**
(E) WACC	**10.5%**	**9.2%**	**8.2%**	**9.8%**	**9.7%**
EVA= C-(D*E)	**-0.3**	**0.4**	**5.5**	**-1.5**	**-6.9**

Table 6. Sator – EVA Calculations

	2011	2012	2013
	US$ million		
(A) Operations profit	-2.12	-7.30	-7.23
(B) Tax	33%	34%	34%
(C) NOPAT= A*(1-B)	-2.12	-7.30	-7.23
(D) Operating capital	27.8	32.1	7.6
(E) WACC	8.2%	9.8%	9.7%
EVA= C-(D*E)	-4.4	-10.5	-8.0

Note that one of the reasons behind Grupo Argos portfolio diversification and investment in power generation was that earnings from the power industry compensated Grupo Argos loss from cement production and vice versa. According to José

Alberto Vélez and his team, the cement industry was cyclical. Thus, students may infer that this assumption is being fulfilled and that Celsia is now covering Cementos Argos loss in order not to destabilize the portfolio.

Revenue and EBITDA

Students can compare individual subsidiaries' revenue and EBITDA amounts against those of Grupo Argos as a whole. This will show the parent company still depends on Cementos Argos and Celsia. Also, it will indicate that, in spite of receiving less revenue from Celsia, it contributes more EBITDA to the parent company. In other words, Celsia operations are more efficient in creating value than operations at Cementos Argos.

Table 1. Grupo Argos and Subsidiaries Revenue and EBITDA.

REVENUE	**2009**	**2010**	**2011**	**2012**	**2013**
Grupo Argos	100%	100%	100%	100%	100%
Cementos Argos	87%	57%	65%	63%	62%
Celsia	42%	33%	32%	30%	31%
Situm	1%	1%	1%	1%	1%
Sator	0%	0%	1%	1%	1%
Compas	0%	0%	0%	2%	1%
EBITDA					
Grupo Argos	100%	100%	100%	100%	100%
Cementos Argos	48%	34%	43%	47%	49%
Celsia	39%	41%	44%	45%	45%
Situm	1%	2%	3%	1%	1%
Sator	0%	0%	0%	-1%	-1%
Compas	0%	0%	0%	1%	1%