

Betting on Sustainability

by Staff Reporters

Brazilian companies that rank high in sustainability can outperform the Bovespa despite the costs involved, according to Management & Excellence (M&E). Indeed the message is that sustainability pays both for the company and the investors who buy the stock.

With this issue, *LatinFinance* in conjunction with M&E is launching its new “M&E LatinFinance Sustainability Index (Brazil).” The reason for creating the index is based on the belief that companies that excel in sustainability can compete in the marketplace and deliver superior price performance for equity investors.

Sustainability encompasses a whole range of areas including innovation, employee training, community relations, risk management, ethics programs, investor roadshows and R&D.

All these areas can have a positive impact on the company. For instance, improving community relations may help sales, while employee training helps with productivity and innovation. “It is like a blood test. It examines what is going on. If the measurements are healthy, the company is going to be healthy,” says William Cox, managing director at M&E.

Investments in these areas can be expensive and arguably companies that stress sustainability could be less competitive given the costs involved.

“Some of these big companies are spending in the order of \$200 million to \$300 million per year on such projects and if you want to include all the environmentally relevant modernizations the amount would be higher,” says Cox.

But despite such costs, the index and M&E’s analysis proves sustainability pays not only for the company but investors as well. Going back to December 2009, the M&E LatinFinance Sustainability Index (Brazil) has consistently outperformed the Bovespa. Indeed the index beat the Ibovespa by over 20% during the summer months and the performance gap between the two has grown.

Investing in sustainability can be costly, but companies that do tend to outperform the index. The new M&E LatinFinance Sustainability Index (Brazil) proves the point.

“We have been doing return on sustainability calculations for these projects and we found that free cash flow generation from these projects helps drive sales and revenues. In terms of reducing costs, and [things like] better motivated employees these returns are higher,” says Cox.

The index uses M&E’s analysis and criteria to rate and weight the most sustainable companies listed on the Brazil’s Bovespa

index and tracks the equity price of the companies that have been awarded the most superior ratings and scores.

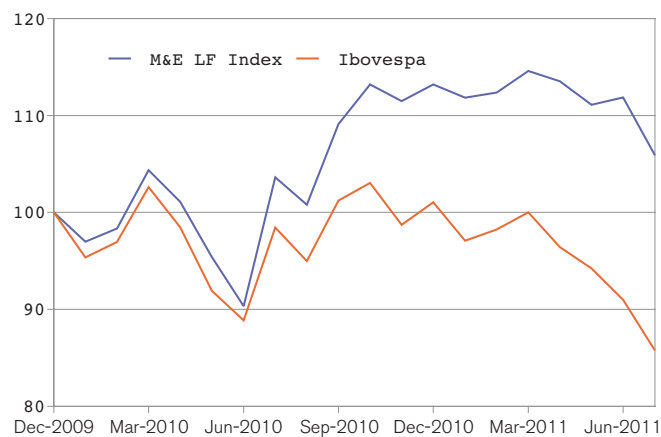
The 2011 lineup includes 18 companies. These are split into two groups, a full index member group, comprising seven companies, and another associate index member group made up of 11. Full members have to pass rigorous screening criteria,

while associate members must excel in one or two areas such as compliance and show promise of fulfilling other criteria in the future.

“We have refined the method and have sought to find the magical connection between sustainability, financial performance and finally equity performance,” Cox adds. “We know that companies that have done well in scoring and ratings really had the best equity price development.”

The index does not set any thresholds in regard to free float, volume traded or market capitalization, meaning that smaller

Performance of M&E LF Index vs Ibovespa
Companies investing in sustainability see superior price gains



Source: Management & Excellence SA

Brazil sustainability index

mid-cap companies can also qualify if they pass muster.

Full index members currently include companies of various sizes such as mid-size bank Bicbanco, as well as banking powerhouses such as Bradesco and Itaú, all of which received M&E's top rating of AAA+.

Other full members are utility Cemig, aircraft manufacturer Embraer, cosmetics company Natura and pulp and paper concern Fibra, which has long been seen as an improving credit story.

Associate members also include a variety of names, ranging from brewer Ambev, to petrochemical concern Braskem, to BR Foods, to airline TAM to payment processor Redecard. Indeed the variety of sectors represented is somewhat intentional.

The index aims to avoid excessive volatility by having a broad representation of companies from the country's main sectors. If a segment is over-represented, the company with the highest sustainability performance will be favored.

Companies can also be placed on a Watch List. This is the case with Brazilian mining giant Vale, which is an associate member

M&E LatinFinance Sustainability Stars (Brazil)

Most heavily weighted index components (%)	2010	2011
Vale	33.1	33.73
Itaú	23.99	22.29
Banco Bradesco	15.73	15.3

Best Performers (Index points)	2010 YTD	2011 YTD (7/29/2011)
	Braskem (115.8%)	Ultrapar (30.81%)
	Ambev (46.9%)	Redecard (29.61%)
	Natura (31.48%)	Tim Part. (23.25)

Source: Management & Excellence SA

Top Scoring Companies

Average total M&E sustainability score	81.1
Range consolidated (total) M&E sustainability scores	66-92.21
Best (highest) consolidated (total) sustainability score	Itaú
Best (highest) sustainability performance score	Bicbanco
Best (lowest) sustainability risk	Bicbanco
Best (highest) sustainability compliance score	Bradesco
Best (highest) Management Strength Score	Itaú

Source: Management & Excellence SA

now under critical review for the 2012 component selection. Reasons for going on the Watch List are many, including weak sustainability scores, missing data, or involvement in controversial activities.

M&E will heavily weight companies that can demonstrate quantitative evidence for consistently maintaining strong sustainability performance, accounting for everything from strong financials to investments in training and R&D. On this occasion these include companies like lenders Bradesco and Itaú.

Full members must be in good standing with the São Paulo Stock Exchange, and achieve at least a BBB minus sustainability rating from M&E, or an unaudited total score of more or equal to 0.75, among other criteria.

The index will be tabulated every month, and later on a weekly basis. The index members will be selected and re-balanced every year, with next rebalancing to be announced in December. *LatinFinance* will also post the index on its website, so that readers can more easily monitor the performance of these stocks. **LF**

M&E/LF Index's Comparative Performance Against Brazilian Indices

	M&E/LF Index	Ibovespa	Difference (M&E,Ibov)	Bovespa ISE	Difference (M&E,ISE)
Cumulative performance since inception (12/31/2009-7/29/2011)	5.89%	-14.24%	20.13%	0.61%	5.28%
Cumulative performance 2010	13.19%	1.04%	12.15%	5.84%	7.35%
Cumulative performance 2011 YTD	-5.31%	-11.64%	6.33%	-4.26%	-1.05%
Volatility in Cum. performance (% , monthly tabulation)	7.53%	4.62%	2.91%	5.22%	2.32%
Volatility YTD (% , monthly tabulation)	2.77%	4.88%	-2.11%	3.29%	-0.52%
Total sustainability adjusted market cap 2010 (BRL)	707.13	-	-	-	-
Total sustainability adjusted market cap 2011 (BRL)	800.41	-	-	-	-

Source: Management & Excellence SA