

# In good company

By Katie Llanos-Small

The 2013 M&E *LatinFinance* Brazil Stars Index has vastly outperformed the country's other sustainability indices over the past three years. The index, which picks and weights companies by the strength of their management practices, returned 42.62% in the three years to December 28, 2012 – outperforming the Ibovespa, the benchmark index of the São Paulo Stock Exchange, by 53.6%, and ISE, Brazil's main corporate sustainability index, by 19.31%.

The Brazil Stars Index comprises the 16 best-run Brazilian companies, weighted according to how sustainably they are run, in terms of management, performance and risks. The index takes into account several factors to weight components. It assesses how companies comply with regulatory standards and best practice on ethics and transparency. Financial performance is the second measure. Here, firms' financial histories – including revenues, return on equity and assets – are reviewed, and companies with upward trends get a higher grade.

The volatility of that data forms the third metric for the index. The standard deviation of revenue changes is subtracted from the overall score. Finally, the company's strategy is compared with the sector overall.

Market capitalization also contributes to the weightings. Ambev's weight in the index has gone up five-fold with its increase in market capitalization from 98.3 billion *reais* to 264.8 billion *reais* over the three-year reference period, for example.

Meanwhile, the index's exclusion of underperformer Petrobras has played an important role in its success.

The Brazilian oil firm has lost over a third of its value over the past three years – falling to 255 billion *reais* from 347 billion *reais*, according to M&E. The company failed to make it into the Brazil Stars Index because of its poor risk rating.

## Lending well

Of the 16 companies in the index, the three banks – Banco Bradesco, Bicbanco and Itaú – have the best management

## Strong management practices pay off: the M&E *LatinFinance* Brazil Stars Index outperforms the Ibovespa by 53.6%

practices of the 16 components. Itaú, in particular, stands out: it has improved its efficiency ratio by 9% since 2010, and has made progress on restructuring since merging with Unibanco in 2009.

Despite an increase in non-performing loans and a slowdown in SME lending, Bicbanco is ranked second for its management practices.

Vale, Embraer and Natura, meanwhile, are making the most of their community spending, according to M&E calculations of the correlation between trends in those expenses and net sales. Vale is also the biggest spender of the Brazil Stars on social programs – it spent 416 million *reais* on such initiatives in 2011.

Itaú and Bradesco are big community spenders as well, questions remain over the return on that investment. Itaú generates 177 *reais* per *real* spent on the community, suggesting it is overspending.

## Diversification ahead

The Brazil Stars Index is set to expand to include retail, construction, and healthcare firms in the coming years. As well as incorporating firms in sectors that investors are keen on, expanding the index is expected to allay any concerns over concentration risk.

Not that diversification is everything. Brazil Stars also outperformed Dow Jones's much larger Sustainability World Index by 38% over the three year to December 2012.

TAM and Redecard fell out of the index last year when they delisted. The year before, Banco do Brasil was replaced by BMFBovespa in the index. **LF**

