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Latin America Strategy

Who has the Best Corporate Governance in Latin America?

We are introducing a new annual report in which we rate Latin American companies according to their corporate governance practices.

Bottom-Up Approach: We analyze corporate governance across companies in the region on a bottom-up basis. We contend that companies wanting to tap deeper pools of international investors must adopt a much-improved treatment of minority shareholders that goes beyond any country-specific minimum requirements.

We use a defined questionnaire that explores four aspects of corporate governance as well as the collective expert opinion of our sector analysts to arrive at specific company results. The four areas of analysis are:

1. Shareholder Treatment
2. Management's Independence
3. Information Disclosure
4. Dividend Policy

Presenting The Results: We present our results in three different ways: i) a ranking of companies according to the four different categories, as well as an overall ranking based on the sum of the scores; ii) a ranking of sectors based on the average scores obtained by companies in each sector; and iii) a ranking of top companies by sector.

Rewarding Strong Corporate Governance: Investors reward companies with superior corporate governance practices. On average, companies in the top quintile trade at premiums of 23.2% and 43.2% in terms of 2001E P/E and EV/EBITDA, respectively, vs those in the bottom quintile.

Table 1: Top Latin American Companies by Corporate Governance

| Overall Ranking | Shareholder Treatment | Management's Independence | Information Disclosure | Dividend Policy |
|--------------------|-----------------------|---------------------------|------------------------|------------------|
| 1. Banacci | 1. Banacci | 1. Banacci | 1. Aracruz | 22 companies |
| 2. CCU | 2. Central Puerto | 2. Itau | 1. Brasil Telecom | obtained the |
| 3. Walmex | 3. Soriana | 3. VCP | 1. CCU | highest possible |
| 4. CBD | 4. Walmex | 4. Banco Edwards | 1. Central Puerto | score in |
| 4. Itau | 5. Argos | 4. Banco Santiago | 1. Femsa | this category |
| 6. Tele Cel Sul Pa | 5. Telmex | 4. Cemex | 1. KOF | |
| 7. Iusacell | 7. ASUR | 4. Globo Cabo | 1. Sabesp | |
| 8. KOF | 8. Iusacell | 4. Perez Companc | 1. Tele Cel Sul Pa | |
| 9. Bancomer | 9. Grupo Contal | 4. Unibanco | 1. Tele Norte Leste | |
| 10. Central Puerto | 9. Light | 10. Bradesco | 1. TGS | |
| | | 10. Petrobras | | |
| | | 10. Televisa | | |

Source: Deutsche Banc Alex. Brown estimates

Renato Grandmont
(1) 212 469 5363
renato.grandmont@db.com

Valerie Fry
(1) 212 469 7804
valerie.fry@db.com

Charles Iragui
(1) 212 469 4578
charles.iragui@db.com

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Who Has the Best Corporate Governance in Latin America?

Weak corporate governance imposes risks for minority shareholders

Corporate governance is becoming a matter of increasing importance to minority shareholders following several cases of abuse of power by controlling shareholders worldwide. Although some of these abuses of power occurred due to weak regulatory and legislative environments or simply because of feeble supervision, the issue poses important risks for minority shareholders. Fortunately, several governments in Latin America have recognized some of these structural deficiencies and are now trying to correct them. Yet, companies' treatment of minority shareholders varies widely regardless of the regulatory, legislative or supervisory environment in which they operate.

Companies wanting international investors must adopt stellar treatment of minority shareholders that go beyond any country-specific minimum requirements

Thus, in this report we perform a bottom-up analysis of corporate governance across companies in the region, without paying too much attention to country-specific regulatory, legislative or supervisory differences. The point is that, as the nature of investment becomes global, companies that want to attract major international investors must not restrict themselves to the minimum guidelines of their specific country's regulatory, legislative and supervisory environment. Companies that want to tap deeper pools of international investors must differentiate themselves by adopting stellar treatment of minority shareholders that go beyond any country-specific minimum requirements. In order to attract international investors, companies and their management are not only required to be strong from a financial standpoint, but also to act with transparency and in the best interest of *all* of their shareholders; in other words, to exercise sound corporate governance practices.

Our bottom-up analysis is divided into four categories

In this report, we analyze 72 companies in the region in an attempt to determine which ones follow the best corporate governance principles on a bottom-up basis. In order to analyze corporate governance in Latin America, we have surveyed our sector analysts about the corporate governance practices of companies in their respective sectors. Our questionnaire was divided into four categories:

1. **Shareholders' Treatment** (score range: -14 to +50 points);
2. **Management's Independence** (score range: -1 to +25 points);
3. **Information Disclosure** (score range: -2 to +20 points); and
4. **Dividend Policy** (score range: -4 to +10 points).

Some questions are more important than others and were given more weight accordingly. The questionnaire used, together with the methodology for weighing the answers, is shown at the end of the report. We have analyzed company rankings for each of the four categories, as well as for overall corporate governance practices, which was compiled by adding the scores obtained in all four categories. We have also analyzed sector rankings according to average scores obtained by companies in each sector. Finally, we have come up with a ranking of the best companies in each sector.

It Pays To Be Good

Investors and analysts already reward strong corporate governance practices

As shown in Table 2, we have calculated the average statistics for companies in the top and bottom quintiles of the sample. It is evident from the data that investors are already differentiating companies in terms of their corporate governance practices. Companies in the top quintile are rewarded with higher valuation multiples. Our data show that, on average, companies in the top quintile trade at premiums of 23.2% and 43.2% in terms of 2001E P/E and EV/EBITDA, respectively, vs companies in the bottom quintile. Also note that companies in the top quintile are less dependent on debt financing than those in the bottom quintile.

Table 2: Investors Favor Better Corporate Governance, priced as of 24 April 2001

| (x) | P/E 2000A | P/E 2001E | P/BV | Net Debt/ Equity | P/CF 2001E | EV/EBITDA 2001E | Mkt Cap (US\$bn) |
|---|--------------|--------------|-------|---------------------|---------------|--------------------|---------------------|
| Top Quintile Companies | 19.9 | 16.1 | 2.2 | 30.6% | 11.0 | 7.5 | 3,776.8 |
| Bottom Quintile Companies | 11.2 | 13.1 | 1.2 | 47.0% | 10.7 | 5.2 | 4,209.9 |
| Premium/Discount Between Top & Bottom Quintiles | 77.3% | 23.2% | 88.2% | -1640bps | 3.2% | 43.2% | -10.3% |

Note: Simple average is used for calculating average quintile statistic
Source: Deutsche Banc Alex. Brown estimates

Company Ranking Results

The top ten Latin American companies in terms of corporate governance practices are companies that achieved the highest scores overall by adding the scores obtained in each of the four categories included in our survey. Issues include minority shareholders treatment (scores range from -14 to +50), management's independence (scores range from -1 to +25), information disclosure (scores range from -2 to +20) and dividend policy (scores range from -4 to +10). Our top list includes five Mexican, three Brazilian, one Chilean and one Argentine company. In terms of sectors, we find three banks (Banacci, Itau, and Bancomer), two beverage companies (CCU and KOF), two retailers (Walmex and CBD), two telecom companies (Tele Cel Sul and Iusacell) and one electric utility (Central Puerto).

The top company in the region is Banacci

The top company in the region according to its corporate governance practices is Banacci, followed by CCU and Walmex.

Shareholders' Treatment

Banacci has the best treatment of shareholders in the region

Under this category, we addressed questions related to the treatment of minority shareholders, based on both past experience and companies' track records. We also addressed issues such as different classes of shares (voting and non-voting), tag-along rights (especially when it comes to changes in control) and the existence of corporate by-laws that protect minorities. The top company in this category was Banacci, followed by Central Puerto and Soriana. Mexican companies clearly dominated this category, as eight out of the top ten companies were Mexican, while there was only one Brazilian company and one Argentine company. The Brazilian government is currently addressing some of these issues in an effort to improve corporate governance practices in the country (see our reports: *Brazil: Focusing on*



Corporate Governance, 5 March 2001, which deals with regulatory changes impacting pension funds' investments, or *Brazil: Securities Legislation Advances – Buy ON Shares*, 8 June 2000, which discusses legislative changes dealing with empowering the regulator/supervisor, and also the treatment of minority shareholders). In terms of sectors, Consumers dominated this category (Soriana, Walmex, Argos and Contal), followed by Telcos (Telmex and Iusacell) and Electric Utilities (Central Puerto and Light).

Management's Independence

Banacci ranked top in the region for management's independence

This section addresses management ability to act independently from the majority or controlling shareholder and its ability to act in the best interest of *all* shareholders rather than in favor of the majority or controlling shareholder. Issues in this category include the charge of a management fee, management salaries tied to the share price and management's overall capabilities. The top company in this category, according to the survey, is Banacci, followed by Itau and VCP. Brazilian companies dominate this list, with six out of the top twelve, followed by Mexico (three), Chile (two) and Argentina (one). In terms of sectors, this category is clearly dominated by banks, with six out of eleven banks in the survey among the top list.

Information Disclosure

Ten companies received top scores in this section

This section of the survey focuses on the amount and quality of information provided by companies to analysts and investors. According to our analysts, ten companies received top scores in this category. Brazilian companies dominate this category, with five out of the top ten companies. Meanwhile, there were two Mexican companies, one Chilean and two Argentine. In terms of sectors, the beverage and telecom sectors had a significant presence in this category, with three out of the top ten companies each.

Dividend Policy

Twenty-two companies obtained a perfect score in this category

In this category, we analyzed whether Latin American companies have a clear dividend policy, and to what extent they respect such a policy. Twenty-two companies obtained a perfect score in this category, among all sectors and countries. We conclude that Latin American companies are well behaved when it comes to establishing and maintaining a dividend policy, even if this were a reflection of a no-dividend policy.

Table 3: Top Latin American Companies by Corporate Governance

| Overall Ranking | Shareholder Treatment | Management's Independence | Information Disclosure | Dividend Policy |
|--------------------|-----------------------|---------------------------|------------------------|---------------------|
| 1. Banacci | 1. Banacci | 1. Banacci | 1. Aracruz | 1. Ambev |
| 2. CCU | 2. Central Puerto | 2. Itau | 1. Brasil Telecom | 1. Banacci |
| 3. Walmex | 3. Soriana | 3. VCP | 1. CCU | 1. Brasil Telecom |
| 4. CBD | 4. Walmex | 4. Banco Edwards | 1. Central Puerto | 1. CBD |
| 5. Itau | 5. Argos | 4. Banco Santiago | 1. Femsa | 1. CCU |
| 6. Tele Cel Sul Pa | 5. Telmex | 4. Cemex | 1. KOF | 1. Coelce |
| 7. Iusacell | 7. ASUR | 4. Globo Cabo | 1. Sabesp | 1. Embratel |
| 8. KOF | 8. Iusacell | 4. Perez Companc | 1. Tele Cel Sul Pa | 1. Femsa |
| 9. Bancomer | 9. Grupo Contal | 4. Unibanco | 1. Tele Norte Leste | 1. Grupo Modelo |
| 10. Central Puerto | 9. Light | 10. Bradesco | 1. TGS | 1. Itau |
| | | 10. Petrobras | | 1. KOF |
| | | 10. Televisa | | 1. Light |
| | | | | 1. Metrogas |
| | | | | 1. Metropolitana |
| | | | | 1. Panamco |
| | | | | 1. Pepsi-Gemex |
| | | | | 1. Tele Cel Sul Pa |
| | | | | 1. Tele Norte Leste |
| | | | | 1. Telemig Cel |
| | | | | 1. Telesp Cel |
| | | | | 1. TGS |
| | | | | 1. Walmex |

Note: companies with the same score were listed in alphabetical order

Source: Deutsche Banc Alex. Brown estimates

Average Rankings by Sector

The top sector according to our survey is Beverage/Foods

We have also analyzed sector rankings, according to average corporate governance practices by companies in each of the nine sectors that we follow. The top sector according to our survey is the Beverages/Food sector, followed by the Banks and Retail sectors.

Table 4: Average Corporate Governance Practices by Sector

| | Shareholder Treatment | Management's Independence | Information Disclosure | Dividend Policy | Overall Ranking |
|--------------------------------|-----------------------|---------------------------|------------------------|-----------------|-----------------|
| Beverages/Food (13) | 1 | 7 | 3 | 2 | 1 |
| Banks (11) | 6 | 1 | 1 | 5 | 2 |
| Retail (5) | 3 | 6 | 7 | 3 | 3 |
| Telcos (9) | 5 | 9 | 4 | 1 | 4 |
| Cement/Construction (5) | 2 | 4 | 8 | 6 | 5 |
| Oil & Gas (4) | 7 | 3 | 2 | 4 | 6 |
| Conglomerates/Pulp & Paper (9) | 4 | 8 | 5 | 8 | 7 |
| Electric/Water Utilities (13) | 8 | 5 | 6 | 7 | 8 |
| Media (3) | 9 | 2 | 9 | 9 | 9 |

Source: Deutsche Banc Alex. Brown estimates

Top Companies by Sector

Companies were evenly distributed among countries

We have selected the company with the best corporate governance practices in each of the nine sectors that we follow. Companies were evenly distributed among countries, with three Brazilian, three Mexican, one Chilean and two Argentine.

Table 5: Top Companies By Sector

| Company | Sector |
|-----------------|----------------------------|
| Banacci | Banks |
| CCU | Beverage |
| Cemex | Cement/Construction |
| Aracruz | Conglomerates/Pulp & Paper |
| Central Puerto | Electric/Water Utilities |
| Globo Cabo | Media |
| TGS | Oil & Gas |
| Walmex | Retail |
| Tele Cel Sul Pa | Telcos |

Source: Deutsche Banc Alex. Brown estimates

Corporate Governance Questionnaire

Below, we present the questionnaire used for ranking the companies. We differentiated the most important questions by assigning them a larger range of scores (from -5 to +5). Analysts used the following guidelines in answering the questions:

Table 6: Criteria For Determining Scores

| Scores | Criteria |
|--------|---|
| -5 | 1 Worst Case: Analyst totally disagrees since company clearly violates the criteria |
| -2.5 | 2 Partially Disagrees |
| 0 | 3 Indifferent |
| 2.5 | 4 Partially Agrees |
| 5 | 5 Best Case: Analyst totally agrees since company clearly respects the criteria |

Source: Deutsche Banc Alex. Brown Latin America Equity Strategy

Table 7: Corporate Governance Questionnaire

| | Scores |
|--|---------|
| Shareholders' Treatment (maximum points range from -14 to +50) | |
| 1. The company does <i>not</i> have any conflicts of interest with a major shareholder. | -5 to 5 |
| 2. The rights of minority shareholders have always been acknowledged and respected in the past. | -5 to 5 |
| 3. The major shareholder always keeps the interest of subsidiary minority shareholders in mind when dealing with subsidiary companies within the group. | -5 to 5 |
| 4. There are internal mechanisms in place (corporate by-laws) to acknowledge and respect the rights of minority shareholders. | 1 to 5 |
| 5. There are <i>no</i> different classes of shares with different rights. | 1 to 5 |
| 6. The most liquid shares are the voting shares. | -5 or 5 |
| 7. All voting shares have the same rights (ADR voting vs local share voting: sometimes ADR votes cannot be split and therefore are never counted). | 1 to 5 |
| 8. Minority shareholders can appoint Board of Directors members. | 1 to 5 |
| 9. There are provisions in the corporate by-laws for minority shareholders to receive the same price as controlling shareholders in case the company is sold (tag along rights). | 1 to 5 |
| 10. There are provisions in the corporate by-laws for determining what the minimum tender offer price should be in the event of share buy-backs. | 1 to 5 |
| Management's Independence (maximum points range from -1 to +25) | |
| 1. Management's compensation is tied to the share price. | 1 to 5 |
| 2. Controlling shareholders do <i>not</i> charge a management fee. | -5 or 5 |
| 3. Management does have the ability to act in favor of corporate interests, ie, it is not always subject to the major shareholder's interest. | 1 to 5 |
| 4. The Board of Directors is independent from the major controlling shareholder. | 1 to 5 |
| 5. How would you rank the company's management's capacity vs its industry peers? | 1 to 5 |
| Information Disclosure (maximum points range from -2 to +20) | |
| 1. The company provides sufficient information to make a meaningful analysis. | 1 to 5 |
| 2. The company provides US GAAP/IAS financial statements (or has concrete plans to switch to it). | 1 to 5 |
| 3. The company does <i>not</i> differentiate among investors when disclosing information (keep reg FD in mind). | -5 or 5 |
| 4. Management is very receptive to minority investors' inquiries. | 1 to 5 |
| Dividend Policy (maximum points range from -4 to +10) | |
| 1. The company has a clear dividend policy. | 1 to 5 |
| 2. The company always respects its dividend policy. | -5 to 5 |

Source: Deutsche Banc Alex. Brown Latin America Equity Strategy



Table 8: Companies in the Survey

| Company | DB Analyst Rec | Price US\$ 24/04/01 | Company | DB Analyst Rec | Price US\$ 24/04/01 |
|-----------------------|----------------|---------------------|-----------------------|----------------|---------------------|
| Alfa | Mkt Perform | 1.33 | Kimberly Clark Mexico | Buy | 2.59 |
| Ambev | Buy | 21.10 | KOF | Buy | 17.85 |
| America Movil | Mkt Perform | 16.45 | Light | Buy | 68.99 |
| Apasco | Mkt Perform | 5.13 | Maseca | Mkt Perform | 3.96 |
| Aracruz | Buy | 13.56 | Metrogas | Mkt Perform | 7.50 |
| Argos | Buy | 2.41 | Metropolitana | Buy | 26.93 |
| ASUR | Mkt Perform | 1.96 | Panamerican Beverages | Buy | 17.62 |
| Banacci | Strong Buy | 1.81 | Pepsi-Gemex | Buy | 5.43 |
| Banco Edwards | Strong Buy | 15.00 | Perez Companc Hold | Mkt Perform | 14.50 |
| Banco Hipotecario | Mkt Perform | 7.35 | Petrobras | Buy | 25.61 |
| Banco Santander Chile | Buy | 16.51 | Quilmes | Mkt Perform | 9.00 |
| Banco Santiago | Buy | 21.15 | Sabesp | Buy | 78.57 |
| Bancomer | Buy | 0.75 | Sanluis | Underperform | 1.25 |
| Bansud B | Mkt Perform | 0.95 | Soriana | Mkt Perform | 2.18 |
| Bimbo | Buy | 1.47 | Tele Celular Sul | Buy | 17.72 |
| Bradesco | Buy | 4.81 | Tele Norte Leste | Strong Buy | 14.96 |
| Brasil Telecom | Strong Buy | 39.70 | Telemig Celular | Buy | 35.95 |
| Carso | Buy | 2.39 | Telesp Celular | Mkt Perform | 14.71 |
| CBD | Buy | 26.97 | Televisa | Buy | 35.24 |
| CCU | Mkt Perform | 24.09 | Telmex | Buy | 33.97 |
| Celesc | Mkt Perform | 0.23 | TGS | Mkt Perform | 7.08 |
| Cemex | Strong Buy | 21.55 | TVAzteca | Buy | 7.32 |
| Cemig | Mkt Perform | 11.43 | Unibanco | Strong Buy | 20.48 |
| Central Costanera | Mkt Perform | 0.94 | Vitro | Underperform | 2.74 |
| Central Puerto | Mkt Perform | 1.20 | VCP | Mkt Perform | 12.45 |
| Chilectra | Mkt Perform | 3.25 | Walmex | Buy | 2.49 |
| Coelce | Buy | 2.91 | | | |
| Comerci | Mkt Perform | 14.95 | | | |
| Consorcio Ara | Buy | 1.42 | | | |
| Copel | Buy | 7.04 | | | |
| Corp. GEO | Buy | 0.87 | | | |
| DESC | Mkt Perform | 7.26 | | | |
| Elektra | Buy | 8.60 | | | |
| Eletrabras PN | Mkt Perform | 13.77 | | | |
| Embratel | Mkt Perform | 9.28 | | | |
| Endesa | Mkt Perform | 11.00 | | | |
| Enersis | Mkt Perform | 16.32 | | | |
| Femsa | Buy | 36.70 | | | |
| GF Galicia | Mkt Perform | 13.83 | | | |
| Gissa | Mkt Perform | 0.77 | | | |
| Globo Cabo | Mkt Perform | 5.05 | | | |
| Gruma | Mkt Perform | 3.10 | | | |
| Grupo Contal | Strong Buy | 1.30 | | | |
| Grupo Modelo | Mkt Perform | 2.69 | | | |
| Itaubanco | Buy | 71.07 | | | |
| Iusacell | Mkt Perform | 7.15 | | | |

Source: Deutsche Banc Alex. Brown estimates and company information

Additional Information Available upon Request

Disclosure Checklist

| Company | Disclosure | Company | Disclosure |
|-------------------------|-------------------|--------------------------|-------------------|
| Alfa | | Gigante | |
| Ambev | | Gissa | |
| America Móvil | O | Gruma | |
| Apasco | | Kimberly-Clark de México | |
| Argos | | Light ON | |
| Bimbo | | Maseca | |
| Bradesco | @,* | Metrogas | O |
| Brasil Telecom | O, & | Metropolitana PN | |
| Capex | O | Modelo | |
| Carso | | Panamco | O |
| CBD | & | Pepsi-Gemex | |
| CCU | | Perez Companc | O |
| Celesc PNB | | Petrobras | O, # |
| Cemex | *,O,#,%,& | Quilmes | |
| Cemig PN | O | Sabesp ON | % |
| Coca-Cola Femsa | O | Sanluis | |
| Coelce PNA | | Soriana | |
| Comercial Mexicana | | Tele Celular Sul | |
| Consortio ARA | | Telemar | O |
| Contal | | Telemig Celular | |
| Copel PNB | | Telesp Celular | O |
| Corporación GEO | | Televisa | |
| Desc | O | Telmex | O, & |
| Distribucion y Servicio | | TGS | O |
| Elektra | | TVAzteca | |
| Eletrobras PNB | O | Vitro | |
| Embratel | O | Vitro | O |
| Femsa | O | Walmart de Mexico | |

Source: Deutsche Banc Alex. Brown estimates and company information

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