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# Rating Action: Moody's Downgrades Mills' global scale ratings to B2, outlook Negative

**Global Credit Research - 23 Mar 2016**

Sao Paulo, March 23, 2016 -- Moody's América Latina ("Moody's") downgraded Mills Estruturas e Serviços de Engenharia S.A.'s ("Mills") global scale ratings to B2 from B1. At the same time its national scale ratings were downgraded to Ba2.br from Baa3.br. The outlook for the ratings remains negative.

Ratings downgraded:

Issuer: Mills Estruturas e Serviços de Engenharia S.A.

-Corporate Family Rating ("CFR"): to B2 from B1 (global scale); to Ba2.br from Baa3.br (national scale)

-BRL 270.00 million senior unsecured debentures due 2016: to B2 from B1 (global scale); to Ba2.br from Baa3.br (national scale)

-BRL 160.94 million senior unsecured debentures due 2017: to B2 from B1 (global scale) to Ba2.br from Baa3.br (national scale)

-BRL 200.00 million 5-year senior unsecured debentures due 2019: to B2 from B1 (global scale); to Ba2.br from Baa3.br (national scale)

-BRL 109.06 million senior unsecured debentures due 2020: to B2 from B1 (global scale) to Ba2.br from Baa3.br (national scale)

The outlook for all ratings remains negative.

RATINGS RATIONALE

The downgrade in Mills' ratings and negative outlook reflect the worse than expected impact on the company's operating performance as a consequence of its exposure to the Brazilian heavy construction and Homebuilding industries, and the likelihood that the negative scenario will persist for an uncertain period of time. More specifically, the action accounts for the further deterioration in the heavy construction sector fundamentals on the back of corruption scandals and macroeconomic uncertainties in Brazil. It also reflects the persistent slowdown in the homebuilding industry due to the challenging macroeconomic environment that will continue to put negative pressure on launches, construction rhythm, and sales speed. Moody's has a negative outlook for the Brazilian homebuilding industry as well as for the rated heavy construction companies.

Mills' B2 CFR incorporates its leading position in the Brazilian concrete formwork and tubular structures sector backed by its longstanding relationship with the major local construction companies engaged in complex infrastructure, commercial, industrial and residential projects, supported by the offering of innovative solutions and updated technology. With the divestiture of its industrial services division in 2013, Mills has increased its focus in the core, higher-margin, businesses that includes construction (infrastructure and homebuilding) and equipment rental. Recent equity offering that improved the company's liquidity is also reflected in the ratings.

The rating is also supported by Mills' flexibility and ability to reduce CAPEX and sell assets in periods of lower capacity utilization, prudent financial management, moderate dividend payout policy, and currently adequate liquidity that will help the company navigate the down cycle in its target industries. Mills is run by professional executives with long experience in the industry, which potentially reduces the company's execution risk, and has a good level of disclosure.

Mills' small and decreasing size relative to global peers, and its high dependence on the cyclical construction industry are constraining factors to the rating. Notwithstanding, the short cycle of its investments provides flexibility to efficiently react to potential slowdowns in the construction industry selling assets to adequate the company's size to weaker demand periods, but unsustainable if the downturn persists for a long period of time.

During the LTM ended December 2015, Mills' net revenues declined by 27.5% YoY, reflecting its 49%

concentration in heavy construction and real estate divisions, while the remaining 51% where generated by its rental division -- which is 57% exposed to construction, as of 4Q15 - evidencing a high dependence on these segments. We anticipate that Mills' exposure to the construction sector will remain high over the medium term. Also, Mills' operations are geographically concentrated in Brazil where it generates all of its revenues and cash flows, evidencing the narrow geographic focus and consequently its vulnerability to the vagaries of a single country.

Following COGS and SG&A reduction of about 8.4% and 12.4% respectively in 2015 compared to 2014, Mills reduced its capex levels to BRL 28.2 million in 2015, an 85.8% decrease from 2014 levels. Mills does not foresee any capex directed to expansion in 2016, given the high idle capacity of its business units. At such lower levels, CAPEX can be easily funded with internal cash generation as the company's cash flow from operations ("CFO") was BRL 200 million for the last twelve months ended in December 2015, somewhat reducing the pressure on the company's liquidity. Cash position increased to BRL 232 million in the end of December 2015 from BRL 193 million in the end of September 2015, reflecting the positive free cash flow ("FCF") generation of BRL 162 million in 2015, as a result of the lower CAPEX required during a stiff slowdown in the company's activities and no dividend payout. Cash position was also reinforced by the sale of assets in the order of BRL 53.9 million during 2015, of which 54% were semi-new equipments and by BRL 18.6 million received in July 2015 from the sale of the Industrial Services business unit in July 2013. In a recent equity offering the company raised about BRL 113 million in additional liquidity, and the proceeds will further reinforce its cash position. Mills' cash on balance sheet (pro-forma for the equity issuance) is sufficient to cover 100% of its debt amortizations in 2016, 2017 and part of 2018. Historically, Mills has enjoyed good relationship with large banks and had regular access to bank lines and the capital markets. We view all measures taken by the company to preserve liquidity as positive, but unsustainable if the downturn persists for a long period of time.

The negative outlook considers further negative impact on the company's future operating performance given its exposure to the heavy construction industry and the slowdown in the homebuilding industry, another important source of the company's revenues. Neither are showing signs of recovery.

The ratings outlook could be stabilized if there are clear signs of recovery in the construction segment while Mills is successful in prudently managing dividends and CAPEX investments, and consequently leverage based on its long term target of Net Debt to EBITDA of 1.0x while maintaining solid liquidity position during the downturn scenario. Mills is expected to maintain its leadership position, ensure healthy operating margins and debt protection metrics even during the down cycle.

The ratings could suffer further downward pressure if the effects from the economic downturn are larger than anticipated combined with no clear signs of recovery in the construction industry, or if the company is not able to generate positive FCF during down cycle or to sell assets in order to raise cash and properly adjust its asset size to the existing demand. Quantitatively, a downgrade could occur if FCF turns negative or if total adjusted debt to EBITDA is sustained above 5.5 times. Further downgrade pressure may arise in case Mills cannot sustain its lead market position across key lines of business. Also, a significant increase in the level of secured debt could cause a downgrade of the rated unsecured debentures.

Founded in 1952, Mills Estruturas e Serviços de Engenharia S.A., headquartered in Rio de Janeiro, is a leading provider of concrete formwork and tubular structures services to construction companies, industrial services and rental of motorized access equipment in Brazil, having reported BRL 576 million (USD 176 million) in net revenues in the last twelve months ended December 31, 2015.

POTENTIAL MAPPING RECALIBRATION FROM GLOBAL SCALE TO NATIONAL SCALE RATINGS

With the recent downgrade of the government of Brazil on the global rating scale and other issuers whose risk profiles are affected by related credit considerations, the distribution of national scale ratings (NSRs) among issuers in Brazil has become compressed, particularly at the Aa2.br level. As a result, the current mapping of global scale ratings to national scale ratings may no longer be adequately serving one of its intended purposes, which is to provide greater credit differentiation among issuers in Brazil than is possible on the global rating scale. However, if Moody's NSR methodology is revised as proposed in the Request for Comment (RFC) entitled "Mapping National Scale Ratings from Global Scale Ratings" published on January 20, the resulting new Brazilian scale would likely imply that many Brazil global scale ratings would be remapped to higher ratings on the national scale.

While the RFC included a new proposed national scale map for Brazil, given the aforementioned ratings changes, the new map design for Brazil will likely differ from the specific map proposal included in the RFC. In addition to the proposed Brazilian map, the RFC comprised a proposed update to our methodology for mapping national scale ratings from global scale ratings, including guidelines for the design of new national scale maps and changes to existing maps, as well as proposed new national scale maps for each of the other countries in which we currently offer NSRs. The comment period for this RFC closed on February 22.

The principal methodology used in these ratings was Business and Consumer Service Industry published in December 2014. Please see the Ratings Methodologies page on www.moodys.com.br for a copy of this methodology.

Moody's National Scale Credit Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale credit ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".za" for South Africa. For further information on Moody's approach to national scale credit ratings, please refer to Moody's Credit rating Methodology published in June 2014 entitled "Mapping Moody's National Scale Ratings to Global Scale Ratings".

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