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# Rating Action: Moody's downgrades Mills' ratings to B3/B2.br; negative outlook

**Global Credit Research - 05 Sep 2017**

Sao Paulo, September 05, 2017 -- Moody's América Latina ("Moody's") downgraded Mills Estruturas e Serviços de Engenharia S.A.'s ("Mills") corporate family ratings and senior unsecured ratings to B3 (global scale) and B2.br (national scale) from B2 (global scale) and Ba2.br (national scale). The outlook for the ratings remains negative.

Ratings downgraded:

-Corporate Family Rating ("CFR"): to B3 from B2 (global scale); to B2.br from Ba2.br (national scale)

-BRL 200.00 million 5-year senior unsecured debentures due 2019: to B3 from B2 (global scale); to B2.br from Ba2.br (national scale)

-BRL 109.06 million senior unsecured debentures due 2020: to B3 from B2 (global scale); to B2.br from Ba2.br (national scale)

The outlook for the ratings remains negative.

RATINGS RATIONALE

The downgrade reflects our expectations that Mills' operating performance will remain weak through at least 2018, which mirrors the fundamentals for the company's key heavy construction and homebuilding industries. Mills has been downsizing over the last few years, selling assets and keeping investment low to generate cash and meet debt obligations. While we acknowledge that the short cycle of Mills' investments provides the company flexibility to efficiently react to slowdowns by selling assets, this model is unsustainable if the downturn persists for a longer than anticipated period of time. In addition, despite the smaller size today, the company has a heavy cost structure that leads to negative operating margins, and depends on asset sales to generate cash, which increased its overall credit risk.

Mills' B3/B2.br ratings continue to incorporate its leading position in the Brazilian concrete formwork and access equipment sector backed by long-standing relationship with the major local construction companies and offering of innovative solutions and updated technology. The rating is also supported by Mills' flexible business model, prudent financial management, and current adequate liquidity that is sufficient to cover cash needs at least until the end of 2018.

On the other hand, the ratings are constrained by Mills' reduced size and still high exposure to the cyclical construction industry. The ratings also incorporate Mills' dependence on additional asset sales throughout 2018 to generate cash and fully service debt maturing from 2019 onwards. Finally, our expectations that conditions in the heavy construction and homebuilding industries will remain weak at least until the end of 2018 is an additional rating constraint.

Mills' operating performance has been deteriorating since 2014 along with fundamentals for the Brazilian construction industry. The company's revenues declined to BRL 298 million in the last twelve months ending June 2017 from BRL 832 million in 2013, and its efforts to reduce operating expenses only partially mitigated the negative impact of the lower revenue stream in the company's margins, and adjusted EBITDA margins shrank to 17% from 52% in the same period.

While we do not anticipate additional deterioration in Brazil's construction industry and in Mills' operating performance, we also do not expect a material recovery in the near term. Activity in the heavy construction industry will remain weak until the end of 2018 due to Brazil's government fiscal constraints and presidential elections, and new launches in the homebuilding industry will take time to recover based on still high inventories of finished units. Some relief may come from higher industrial activity in Brazil in 2018, which will increase demand for industrial equipment rental. Nevertheless, Mills' credit metrics will remain under stress, with weak EBITDA generation and high leverage metrics in 2017 and 2018.

In this context, we expect Mills' to continue pursuing asset sales and reducing absolute debt levels. The renegotiation of covenants applicable to the company's debentures in March 2017 and consequent assignment of a cash collateral corresponding to 50% of the debentures outstanding amount increased the predictability of debt payments until the end of 2018, but from 2019 onwards Mills will need to successfully sell assets and raise cash to amortize debt.

The negative outlook reflects our expectations that Mills' operating performance will remain weak in the next 12-18 months, leaving the company dependent on asset sales to generate cash and meet debt obligations.

The ratings could be further downgraded if conditions in the construction industry deteriorate further or if the company is not able to sell assets and generate positive free cash flow to fully service debt obligations from 2019 onwards.

The ratings could be upgraded if there are clear signs of sustained recovery in the construction industry and if Mills is successful in prudently managing dividends and investments, and consequently leverage, while maintaining a solid liquidity position. Quantitatively, the ratings could be upgraded if Mills' total adjusted debt to EBITDA remains below 5.5x (7.7x in LTM ending June 2017), EBITA to interest expense above 2.0x (-1.7x in LTM ending June 2017) and EBITA margin above 12.5% (-34% in the LTM ending June 2017) on a sustained basis.

Founded in 1952 and headquartered in Rio de Janeiro, Mills Estruturas e Serviços de Engenharia S.A. ("Mills") is a leading provider of concrete formwork and access equipment services to construction companies and rental of motorized access equipment in Brazil, having reported BRL 298 million (USD 92 million) in net revenues in the last twelve months ended June 2017.

The principal methodology used in these ratings was Business and Consumer Service Industry published in October 2016. Please see the Rating Methodologies page on www.moodys.com.br for a copy of this methodology.

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Carolina Chimenti
Analyst
Corporate Finance Group
Moody's America Latina Ltda.
Avenida Nacoes Unidas, 12.551
16th Floor, Room 1601

Sao Paulo, SP 04578-903
Brazil
JOURNALISTS: 800 891 2518
Client Service: 1 212 553 1653

Marianna Waltz, CFA
MD - Corporate Finance
Corporate Finance Group
JOURNALISTS: 800 891 2518
Client Service: 1 212 553 1653

Releasing Office:
Moody's America Latina Ltda.
Avenida Nacoes Unidas, 12.551
16th Floor, Room 1601
Sao Paulo, SP 04578-903
Brazil
JOURNALISTS: 800 891 2518
Client Service: 1 212 553 1653

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