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Rating Action: Moody's places the third issuance of senior debentures issued by MGI -- Minas Gerais Participacoes on review for downgrade

Global Credit Research - 12 Aug 2015

Sao Paulo, August 12, 2015 -- Moody's America Latina has placed the Ba1 (sf) global rating and Aa2.br (sf) national scale rating of the third issuance of senior debentures backed by re-performing ICMS taxes issued by MGI- Minas Gerais Participacoes (MGI) on review for downgrade.

The senior debentures are backed by the right to receive 60% of collections resulting from monthly payments of renegotiated ICMS taxes (Imposto sobre Operações Relativas à Circulação de Mercadorias e Prestação Serviços de Transporte Interestadual e Intermunicipal e de Comunicação) originally owed to the State of Minas Gerais.

MGI is a public limited company almost wholly owned (99.8%) by the State of Minas Gerais (Ba1).

The rating action is driven by: (1) the downgrade of the rating of the State of Minas Gerais to Ba1 from Baa3; and (2) a review of the potential credit impact of the refinanced receivables.

Issuer: MGI - Minas Gerais Participações S.A. third issuance of debentures backed by re-performing ICMS taxes

-- Senior Debenture, Ba1 (sf) and Aa2.br (sf) ratings placed on review for downgrade; previously on Apr 29, 2014 confirmed at Ba1 (sf) and Aa2.br (sf)

RATINGS RATIONALE

The rating of the State of Minas Gerais was downgraded to Ba1 from Baa3 as a result of the ongoing deterioration of Brazil's economy and of the federal government´s fiscal position that have a direct impact on the operating environment of the State, as it relates to the downgrade of the Government of Brazil's government bond rating to Baa3 from Baa2, its senior unsecured debt rating to Baa3 from Baa2, and the senior unsecured shelf rating to (P)Baa3 from (P)Baa2. The rating agency also changed Brazil's foreign currency country ceilings as part of this rating action. The foreign currency bond ceiling went to Baa2 from Baa1, while the foreign currency deposit ceiling went to Baa3 from Baa2. The local currency country ceilings were not affected.

Although MGI is the sole obligor under the debentures and investors have no recourse to the State of Minas Gerais under the transaction, MGI and the State of Minas Gerais are closely related given the extent of the state's ownership of MGI and the portion of the transaction's subordinated debt it holds.

Through May 2015 an amount equivalent to 28.6% of the original pool balance related to receivables that became delinquent after the transaction closed has been refinanced. Moody's notes that under the transaction documents, refinanced receivables must be indemnified by the State of Minas Gerais. In contrast, MGI and the State of Minas Gerais have argued that such refinancings have no impact on noteholders, as the refinanced receivable started to perform again, generating cash flows. This argument is supported by the transaction's strong performance in recent months. Nonetheless, Moody's is requesting additional information on the refinanced receivables to determine the potential impact of such receivables on the future cash flows of the transaction.

Since the extraordinary amortization of the debentures in February 2014, the transaction has performed within expectations, with an average debt service coverage ratio (DSCR) of 2.18x from February 2014 to June 2015, above the minimum requirement of 1.8x. The asset coverage ratio as of June 2015 was 321%, higher than the 200% trigger level. The asset coverage ratio has stood between 310% and 364% since February 2014, in part supporting the issuer's contention that the refinanced receivables started to perform again with no impact on noteholders. However, Moody's notes that the asset coverage ratio incorporates receivables that are less than 90 days past due, including refinanced receivables, despite their delinquent history and uncertain credit quality.

Loss and Cash Flow Analysis:

Moody's updated cash flow projections indicate that collections will be sufficient to repay the debt principal and interest by the transaction's maturity in August 2017, as the DSCR will remain above 1.5x through that time.

However, the 1.8x DSCR trigger is expected to be breached, and in the event that this occurs, at current collection levels and applying the cash available in the cash collateral account, the transaction is expected to be repaid in five months.

Stress Scenarios:

In its analysis Moody's reduced the expected cash flows by 6% to reflect potential pressures in collections due to refinanced receivables.

Conclusion of the review:

During the review period, Moody's will evaluate the potential impact of the refinanced receivables on the transaction's cash flows, which could lead to a trigger breach and, if so, require support from the State of Minas Gerais.

FACTORS THAT WOULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATING :

Factors that would lead to a downgrade include a deterioration of the collateral performance; a determination that the refinanced receivables are negatively affecting the credit quality and cash flows from the pool; and a further downgrade of the rating of the State of Minas Gerais.

RATING METHODOLOGY

The principal methodology used in this rating was "Moody's Approach to Rating Future Receivables Transactions," published in June 2015. Please see the Credit Policy 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".

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

Moody's did not receive or take into account a third-party assessment on the due diligence performed regarding the underlying assets or financial instruments related to the monitoring of this transaction in the past six months.

Moody's describes its loss and cash flow analysis in the section "Ratings Rationale" of this press release.

Moody's quantitative analysis entails an evaluation of scenarios that stress factors contributing to sensitivity of ratings and take into account the likelihood of severe collateral losses or impaired cash flows.

Information sources used to prepare the rating are the following: parties involved in the rating and public information.

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The date of the last Credit Rating Action was 29 April 2014.

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