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Rating Action: Moody's confirms Ba1 (sf)/Aa2.br (sf) on MGI-Minas Gerais Participações' senior debentures

Global Credit Research - 29 Apr 2014

Third issuance of senior debentures

Sao Paulo, April 29, 2014 -- Moody's America Latina has confirmed the Ba1 (sf) (Global Scale) and Aa2.br (sf) (National Scale) ratings on the third issuance of senior debentures backed by re-performing ICMS taxes issued by MGI - Minas Gerais Participações (not rated). This action concludes the review Moody's initiated on 21 January 2014, when it placed the ratings under review for downgrade.

The senior debentures are backed by the right to receive 60% of collections 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 (Baa3, Global scale).

RATINGS RATIONALE

The ratings confirmation is based on (1) the sufficiency of cash flows to repay the debt, (2) the resolution of reporting inconsistencies, and (3) the State of Minas Gerais' ownership of MGI and Moody's opinion that the state would be proactive in taking the necessary measures to shore up this transaction' performance in the event of stress.

Moody's analyzed the transaction to determine whether cash flows will be sufficient to repay the debt after the extraordinary amortization of BRL31.6 million that took place on 26 February 2014, when investors accepted a principal prepayment of 10% of the original issuance amount. The debt service coverage ratio (DSCR) trigger, set at a conservative level of 1.80x, had been breached in June, when it declined to 1.68x; in September, when it declined to 1.67x; and again in November 2013, when it declined to 1.75x. The repeated trigger breach led to an evaluation event and a bondholder meeting at which investors agreed to waive the June and September DSCR breaches, but not the November 2013 DSCR breach. The extraordinary amortization eased the pressure on the DSCR by reducing the monthly principal and interest payments due. As a result of this action, as of February 2014, the DSCR was 2.01x, adequately above the 1.8x trigger.

According to Moody's adjusted cash flow projections (based on actual collections since the transaction's inception), the cash flows from the expected collections from the monthly payments of the ICMS taxes will be sufficient to repay the rated debt, although eventually at a level below the DSCR trigger. Moody's expects that upon the transaction's maturity, the DSCR will be around 1.5x, still sufficient for full repayment of principal and interest on the debenture.

In addition, MGI has resolved its reporting inconsistencies, whereby receivables due after the transaction's maturity had increased (which would be inconsistent with the static pool nature of this transaction), while the company's reports indicated a decline in the amount of delinquent receivables, without a corresponding increase in collections. As of February 2014, the State of Minas Gerais had refinanced receivables constituting 9.4% of the original pool balance and related to securitized receivables that had become delinquent after the transaction closed. MGI and the State of Minas Gerais argue that, because (1) these loans have started to perform again as expected and are generating cash and (2) the balance of receivables due before the debentures' legal maturity has not changed, the refinancing has not negatively affected the noteholders.

As a result, the composition of receivables for the remaining life of the debenture has changed and a higher amount of receivables is now due after the transaction's maturity date; delinquent receivables have declined as well. However, the State of Minas Gerais could continue to refinance additional receivables so that the amount of receivables due before the legal final maturity date could decrease and as such, the cash flow might not be sufficient to repay the debentures. After the refinancings to date, the expected cash flows to be received before the legal final maturity date have not decreased compared to cash flows expected at the transaction's closing, because of higher interest and penalties charged, as well as additional tax receivables that have been added to the refinanced receivables. The asset coverage ratio, which includes the refinanced receivables due before legal final maturity, was 358% as of February 2014, well above the 200% trigger.

Moody's will continue to monitor the refinancing taking place in the pool and the subsequent performance of these receivables.

Finally, although MGI is the sole obligor under the debentures and investors have no recourse against the State of Minas Gerais in the transaction, there is a close relationship between MGI and the State of Minas Gerais, given the extent (1) of the state's ownership of MGI and (2) of the portion it holds of the transaction's subordinated debt. Moody´s expects that the state will continue to pro-actively take the necessary measures to support the transaction's performance, through MGI´s governing bodies or as otherwise needed.

The principal methodology used in this rating was "Moody's Approach to Rating Future Receivables Transactions" published in May 2013. Please see the Credit Policy page on www.moodys.com.br for a copy of this methodology.

Although the underlying assets were existing at closing, the approach used to monitor the transaction cash flows, follows the future receivables methodology.

Factors that would lead to an upgrade or downgrade of the rating:

Factors that would lead to a downgrade would be a further deterioration of the collateral performance and a decline in the quality and consistency of the performance information provided.

Factors that would lead to an upgrade would be a significant improvement in collateral performance.

Moody's National Scale 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 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 ".mx" for México. For further information on Moody's approach to national scale ratings, please refer to Moody's Rating Methodology published in October 2012 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 received and took into account a third-party assessment on the due diligence performed regarding the underlying assets or financial instruments in this transaction and the assessment had a neutral impact on the rating.

In rating this transaction, Moody's used a cash flow model to model cash flow stress scenarios to determine the extent to which investors would receive timely payments of interest and principal in the stress scenarios, given the transaction structure and collateral composition.

As the section on loss and cash flow analysis describes, 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. Moody's weights the impact on the rated instruments based on its assumptions of the likelihood of the events in such scenarios occurring.

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

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The rating has been disclosed to the rated entity prior to public dissemination.

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The date of the last Credit Rating Action was 21/01/2014.

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