Rating Action: Moody's assigns definitive ratings to the senior debentures backed by re-performing ICMS Taxes issued by MGI - Minas Gerais Participações S.A.

Global Credit Research - 26 Nov 2012

BRL 316 million of senior debentures rated

Sao Paulo, November 26, 2012 -- Moody's America Latina (Moody's) assigned definitive ratings of Ba1 (sf) (Global Scale, Local Currency) and Aa2.br (sf) (Brazilian National Scale) to the senior debentures issued by MGI - Minas Gerais Participações S.A., a securitization backed by a pool of re-performing ICMS taxes owed by obligors to the State of Minas Gerais.

Issuer: MGI - Minas Gerais Participações S.A.

Senior Debentures - Ba1 (sf) (Global Scale, Local Currency) & Aa2.br (sf) (Brazilian National Scale)

RATINGS RATIONALE

The definitive ratings of Ba1 (sf) / Aa2.br (sf) are assigned to the 3rd Issuance of Senior Debentures Backed by Re-performing ICMS Taxes and issued by MGI - Minas Gerais Participações S.A. (MGI or the Issuer). The senior debentures are issued in a single series and are not convertible into stock.

MGI is a public limited company controlled by the State of Minas Gerais (or State of MG) which holds a direct participation of 99.8% in MGI as of March 31, 2012. The issuer rating of Estado de MG is Ba1 in the global scale. MGI is not rated by Moody's.

The ratings of Ba1 (sf) / Aa2.br (sf) assigned to the senior debentures are based mainly on the cash flows resulting from the credit rights that back the debentures. In addition, the ratings reflect the financial strength of the State of MG to make the indemnification payments as described below.

The senior debentures are guaranteed, via fiduciary assignment, by the right to receive 60% of collections resulting from payments of renegotiated taxes in the form of monthly installments (credit rights). The credit rights consist only of renegotiated ICMS taxes (Imposto sobre Operações Relativas à Circulação de Mercadorias e Prestação Serviços de Transporte Interestadual e Intermunicipal e de Comunicação) owed by obligors to the State of MG and that have been renegotiated, with recognition of the ensuing debt by obligors.

The transaction contemplates an amortizing, static portfolio, with a one-time sale of credit rights by the State of MG to the Issuer at their outstanding par value. Under the sale agreement (contrato de cessão onerosa) entered into between the State of MG and the Issuer, the State of MG is required to make the Issuer whole via indemnification payments for damages resulting from any future renegotiation of credit rights sold to MGI.

The transaction does not contain eligibility criteria; instead, the entire outstanding amount of re-performing ICMS taxes of the State of MG owed by companies (net of Excluded Cash Flows, as defined below) is sold to MGI to back the debt issuance. For modeling assumptions, Moody's assumed (i) the total issuance of senior debentures capped at BRL 316 million and (ii) a minimum of BRL 1,772 million of credit rights, whereby BRL 1,108 million of credit rights in respect to installments due prior to scheduled maturity of senior debentures on month 60.

As of September 28, 2012, according to data available on the fiduciary agent's website (Oliveira Trust) submitted by the SEF/MG (Secretaria da Fazenda de Minas Gerais), the portfolio backing the debentures amounted to BRL 1,713 million, whereby BRL 1,080 million are in respect to installments due prior to month 60. The senior debentures amounted for approximately BRL 318 million as of Sep 28. The total amount issued was BRL 316 million.

The senior debentures have a maturity of 60 months (August 30, 2017). Interest payments are made during first 6 months followed by a monthly scheduled payment of interest and principal starting on March 30, 2013. The interest, accrued daily, is equivalent to the Brazilian interbank deposit rate (DI) plus a fixed coupon of 3.25% per annum defined in a book building process subject to a cap of 5.0% p.a.. The debentures were offered via public distribution (CVM Instruction 400). The subordinated debentures were fully retained by the State of MG.

The transaction contains triggers, that when breached, give rise to an early evaluation event. Upon the occurrence of an early evaluation event, investors may vote to place the transaction in early liquidation and use all cash collected to pay down the senior debentures with no cash released to the sponsor before full amortization of senior debentures. The 2 performance triggers are:

• Asset Coverage Ratio (ACR) of at least 200%, defined as the ratio of performing ICMS Taxes over outstanding debt; to be calculated by the fiduciary agent on a monthly basis. A trigger of the Asset Coverage Ratio (ACR) will be considered an evaluation event on any verification date.

• Debt Service Coverage Ratio (DSCR) of at least 1.8, defined as the ratio of monthly collections over the monthly principal and interest payments on the senior debentures, to be calculated by the fiduciary agent on a monthly basis. The trigger is considered to be breached if it is not complied with for 2 consecutive verification dates or 3 alternate verification dates in a 12-month period.

As of September 28, 2012, as reported by the fiduciary agent, the Asset Coverage Ratio ("Índice de Garantia Real") was at 353.3% (or 70.5% overcollateralization) and the Debt Service Coverage Ratio ("Índice de Cobertura") was at 17.38.

To rate the transaction, Moody's has analyzed origination and performance data of the renegotiated ICMS tax programs of overdue taxes owed to the State of Minas Gerais. The data was reviewed and compiled by KPMG Auditores Independentes (KPMG).The analysis covers the period starting in October 2004 and ending in January 2012. The analysis is separated in static quarterly vintages of origination. Performance data of each vintage is provided on a monthly basis.

Interest rate risk and asset/liability mismatches:

According to information received from the arrangers, the credit rights are referenced to SELIC whereas the senior debentures have their interest rate referenced to the CDI (interbank deposit) rate. As the CDI closely tracks the SELIC, interest rate risk in the transaction is minimal.

Commingling risk is limited as:

• The obligors make installment payments in one of the financial institutions responsible for receipt of payments.

• The cash flows received from the credit rights are deposited in a linked master account, in the name of Secretaria de Estado de Fazenda de Minas Gerais, whereby movements of cash are exclusively made by Itaú Unibanco S.A. in its role as Master Servicer (Banco Centralizador) in the transaction.

• The Master Servicer (Itaú Unibanco) monitors and segregates cash flows belonging to the Municipalities of the State of MG, to FUNDEB, including legal expenses, whereby such segregated cash flows represent 40% of the cash flows received from the credit rights (Excluded Cash Flows), and which also have been deposited in the Master Account, to be subsequently remitted to an account of the State of Minas Gerais. The cash flows resulting from the credit rights, net of Excluded Cash Flows, are automatically transferred by the Master Servicer to the Receipt Account, in the name of the Issuer; the Master Servicer with authorization of the Fiduciary Agent is the only party able to transfer funds in this account. Such cash flows should be automatically transferred the following business day from the Receipt Account to the Master Account.

Among the main transaction risks and concerns are:

• Transaction is dependent on the State of Minas Gerais to provide transaction parties (Fiduciary Agent, Master Servicer) with timely and precise asset information such as (i) the occurrence of any tax renegotiations with borrowers, (ii) data necessary for the calculation of indemnification payments following the actual tax renegotiation with borrowers, (iii) information allowing transaction parties for correct calculation of transaction triggers, including the ACR and DSCR triggers. As a mitigant Moody's notes that Itaú Unibanco as master servicer will be continuously reviewing the cash flows of the transactions partially mitigating the reliance on the State of MG as sole information provider on the performance of underlying assets. Moody's also notes that the final transaction rating is no higher than the rating of the State of MG.

• Potential creation of new tax renegotiation programs: Moody's review of KPMG data suggests that in the immediate months following the past two tax renegotiation programs, the bulk of obligors in previous programs opted to further renegotiate the loans one more time. For example, 6 months subsequent to the renegotiation program launched in Dec/07, a 80% fall in outstanding loan balance was observed. Similar statistic was found for the program launched in May/10.

As a mitigant Moody's notes that any potential new tax renegotiation program leading to actual renegotiations would trigger mandatory indemnification payment from the State of MG to compensate MGI and/or debenture investors for damages.

In assigning the Ba1 (sf) / Aa2.br (sf) ratings to the senior debentures of the transaction, Moody's considered the principal source of credit enhancement -- initial overcollateralization of 71% and minimum ongoing overcollateralization of 50% (or 200% Asset Coverage Ratio) -- in a stressed scenario with view of historical performance of the assets.

Moody's considered a stressed cash flow derived from the:

• Scheduled future cash flows of target portfolio (contractual scheduled amortization assuming zero losses) as presented in underlying KPMG report;

• Stressed mortality curve, which reflects expected worst case portfolio losses of the target portfolio and incorporating the effect of seasoning. Moody's assumes that any arrears of installments of renegotiated and re-performing ICMS taxes above 3 months trigger exclusion from the program (contract mortality) hence producing a loss of the cash flows derived from the contract.

The resulting cash flows were applied to a cash flow model to determine probability of loss and expected loss to the senior debentures. The cash flow model also assumed a worst case scenario of deal triggers not triggering an early liquidation scenario following investor's inability to reach a majority vote in a investor's meeting.

Separately, Moody's evaluated the potential effect of new tax renegotiation programs on mortality. That is, Moody's evaluated to what extent a new renegotiation program would additionally drive portfolio mortality as obligors renegotiate and adhere to new programs.

Moody's assumes that the entire pool will renegotiate under such a scenario. To determine the effect of loss to inventors, Moody's reviewed the definition of the make whole provisions and repurchase option from the State of MG, as well as the global scale rating of the State of MG to determine its capacity to fulfill its contractual obligations.

Sensitivity and Break-Even Analysis

In order to calculate a break-even analysis, Moody's has further stressed the conservative base case assumptions, applying a stress factor in the form of a haircut on projected base case cash flows. The stress factor was increased up to the point where the senior debenture would start to suffer a loss. Given the significant credit enhancement derived from the transaction entering into early liquidation, whereby all stressed asset cash flows are used to service the senior debenture first, this break-even analysis was repeated for the various months in which the early liquidation event would come into effect.

For example, if the transaction never enters into early liquidation, cash flows could withstand an additional 28% decline over Moody's base case cash flows. Similarly, the base case cash flows could decline by 54%, without losses to investors, assuming that the transaction enters into early liquidation the month after closing.

Moody's notes that the stressed base case cash flows are conservatively sized as these have been derived by observing performance of the worst case historical vintages.

Concentration risk

The concentration risk in the transaction is mitigated by the coverage levels. Should largest 30 obligors that together represent circa 35% of total assets default simultaneously the month after closing, break-even analysis indicates that the transaction could continue to pay its scheduled payments if investors place the transaction into early liquidation in any month prior to month 40.

Further details of Moody's analysis of the deal can be found in the Pre Sale Report to be published in Moody's website, www.moodys.com.

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

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 positive impact on the rating.

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