

## Fitch Assigns 'B+/BBB+(bra)' IDRs to Galvao Participacoes; Outlook Stable

Written by Australian Business

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SAO PAULO--([BUSINESS WIRE](#))--Fitch Ratings has assigned the following ratings to Galvao Participacoes S.A. (GALPAR) and its fully owned subsidiary Galvao Engenharia S.A. (GESA):

GALPAR:--Local and Foreign Currency Issuer Default Ratings (IDRs) 'B+';--Long-term national scale rating 'BBB+(bra)';--Long-term national scale rating 'BBB+(bra)' to the proposed third issuance of BRL300 million non-convertible secured debentures due 2020.

GESA:--Long-term national scale rating 'BBB+(bra)'.

The proceeds from the proposed debentures issuance will be used for amortization of company's first debenture issuance and for investments in subsidiaries.

The Rating Outlook for the corporate ratings is Stable.

GALPAR and GESA ratings reflect Galvao Group's high consolidated financial leverage, and GESA's relevant market position as the sixth largest Brazilian contractor, by gross revenue. Fitch considers that the group has the challenges to strengthen its still reduced operating cash generation, present a more robust liquidity position and lengthen its debt average maturity profile as a way to improve its financial profile. The increased operating cash generation will be crucial to mitigate the impact of its high investment needs over the coming years, mainly in the water/wastewater segment.

The group's business improved profitability and credit profile recorded since 2012 was incorporated into the ratings, which had been impacted by the weak operating results in the engineering and sanitation segments in 2011. CAB Ambiental S.A. (CAB), the group's water/wastewater arm, already presented positive EBITDA margins last year which are expected to gradually increase, given the strong fundamentals of this industry. The ratings also reflect GESA's robust backlog, its high client concentration, the volatility of the heavy construction sector and company's corporate governance practices still under development.

GALPAR and GESA's national scale ratings are the same, due to the strong financial and shareholding links between them. GESA is Galvao group's main operating company and has historically concentrated the bulk of its cash generation, besides guaranteeing a significant part of the group's debt.

### High Leverage Reduction Remains a Challenge

Galvao Group's financial profile has been pressured by its still reduced operating cash generation and debt increase in support of its growth strategy through diversification into new businesses. The group has recorded a significant increase in its financial leverage over recent years, with a total debt/EBITDA ratio of 9.2x and net debt/EBITDA of 5.7x in 2012, well above the 3.4x and 2.3x recorded in 2010, respectively. Fitch expects the net leverage ratio to reduce to around 5.0x by end 2013 and to stay between 4.0x and 5.0x until 2015.

The ratings also contemplate a moderate liquidity position. At end of first half of 2013, Galpar's total consolidated debt was BRL2 billion, while the total cash and marketable securities was BRL524 million and covered 67% of the short-term debt of BRL788 million. The likely disposal of assets linked to the energy sector is seen as positive, as this should reduce the leverage and strengthen the group's liquidity.

### Expectation of Continued Recovery of Operating Margins

GESA continues to be Galvao group's main operating and cash generating company. In the first half of 2013, GESA accounted for 91% of the group's consolidated revenue and for 90% of its consolidated EBITDA, besides guaranteeing 35% of the group's consolidated debt. The other subsidiaries are in start-up or pre-operating phase, therefore with a small contribution or even with a negative contribution for the consolidated results. The other subsidiaries are expected to generate relevant positive results within the next couple of years, mainly the water/wastewater segment companies.

The construction company showed operating margins more in line with its business

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sector over the last four semesters, after the impacts of work losses which weakened the margins in 2011. GESA has also been able to manage its working capital needs more efficiently. The company recorded BRL198 million EBITDA during the last 12 months (LTM) ended June 30, 2013, with a 5.9% margin, slightly above the 4.6% margin in 2011. On a consolidated basis, GALPAR's EBITDA was BRL108 million in the first half of 2013, which represented a 5.8% margin.

Fitch expects the consolidated EBITDA to reach more robust levels, mainly driven by the expected maturation of CAB's concession portfolio. During the LTM ended June 30, 2013, CAB's EBITDA margin, of 9.3%, was well below the average of private companies in the same sector. This company has shown a strong growth in net revenues which reached BRL444 million in the period, as a result of business expansion, and a BRL41 million EBITDA.

Fitch expects Galvao group's free cash flow (FCF) to remain negative until 2015 in view of annual capex of around BRL250 million. During the LTM ended June 30, 2013, the cash flow from operations (CFFO) was BRL187 million, well below the BRL370 million capex, which after dividends of BRL8 million, resulted in negative FCF of BRL191 million. A continued recovery of business profitability could mitigate pressures on FCF.

### Robust Backlog Ensures Growth

GESA is among the leading contractors in the country and has maintained a strong backlog. As of June 30, 2013, company's backlog was BRL6.6 billion, sufficient to cover 2.5 years of operations. GESA's robust backlog has assured net revenue growth, which reached BRL3.4 billion during the LTM ended June 30, 2013, against BRL3 billion in 2012 and BRL2.2 billion in 2011.

The company has been able to reduce its backlog concentration by capturing new contracts and clients. The still significant 36% concentration with Petrobras represents a substantial reduction as compared to the high 58% recorded one year before.

### Rating Sensitivities

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The ratings could be positively affected by a consistent strengthening of company's liquidity and leverage reduction on a consolidated basis, combined with improved operating performance. Negative rating actions could result from a reduction in company's liquidity position, weakening of its capital structure, increased leverage and weakening of operating margins. Any changes to GESA's ratings could directly impact GALPAR's ratings.

Additional information is available at '[www.fitchratings.com](http://www.fitchratings.com)'.

Applicable Criteria and Related Research:--'Corporate Rating Methodology' (August 2013);--'National Ratings Criteria' (January 2011).

Applicable Criteria and Related Research:Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage [http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=715139](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715139)  
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