International Conference Call
Mills - Estruturas e Serviços de Engenharia
2nd Quarter 2015 Earnings Results
August 4, 2016

Operator: Good morning ladies and gentlemen. Welcome to Mills' 2Q 16 earnings conference call. At this time all participants are in listen-only mode and after Mills' remarks are over there will be a question-and-answer session. At a time further instructions will be provided.

Should any participant need assistance during this conference call please press star zero to reach the operator.

I would like to remind you that this conference call is being recorded and simultaneously translated into English. Questions can be asked also by participants connected from abroad.

This recording will be available at the company's website at www.mills.com.br/ir. This conference call is being broadcast simultaneously over the web and can also be accessed through the company's website at www.mills.com.br/ir.

Before proceeding let me mention that possible statements that might be made during this conference call relative to the company's business perspectives and projections are based on expectations on forecasts and expectations of Mills' management relative to the future of the company. Such expectations are subject to microeconomic conditions, market risks and other factors.

Today we have here with us Mr. Sergio Kariya, CEO of the company; Mr. Gustavo Zeno, Administrative, Financial and Investor Relations Officer and Ms. Camila Conrado, Investor Relations Coordinator.

I now turn the conference call over to Mr. Sergio Kariya, CEO of the company.

Mr. Sergio Kariya: Good morning ladies and gentlemen. Thank you very much for joining us at this conference call to discuss Mills' results in 2Q 16. In this quarter we continued to face a challenging top line result as we had anticipated and reported in 1QTY.

Before presenting our results I would like to mention that the company has a number of initiatives in place which aim at maintaining cash generation, reducing delinquency focusing primarily on reversing our allowance for doubtful debt - ADD.

Another measure under way we are having a more rational number of branches and equipment to adjust to a new market reality. This initiative will allow us to reduce costs and increase our profitability.

We are developing… We are working with a specialized consulting firm to map, redesign and perfect our processes and consequently to improve our productivity and operations.

And also in equipment maintenance this is a project that we are calling internally MAPA and that will contribute to increase our operating efficiency.

In the maintenance front our focus is to improve productivity with a direct impact on labor costs on the consumption of maintenance inputs with an impact on materials expenses and on the quality of our equipment maintenance, thus leading to greater safety and customer satisfaction. With that we expect a reduction in maintenance costs more specifically.

Coupled with that we have the implementation of management rituals aiming to standardize our routine follow-up of company indicators starting at the operational level all the way up to the CEO seeking to improve our bottom line through better management of qualitative and financial results.

While in 2015 actions taken were more geared towards a reduction of SG&A expenses in 2016 our biggest efforts are focused on Cogs, mainly on costs related to maintenance and storage, on the revenue stream diversification and a better location of capital invested through a reduction of our PP&E.

We also identify new initiatives to enter the non-construction segment with our rental units machines to use them in recurring industrial maintenance services, which are less subject to economic cycles.

With the foreign exchange appreciation there is a shrinking window of opportunity for us to sell our equipment in the international market, which leads us to put even more effort in making these opportunities viable and fast.

Our visibility regarding market recovery remains slow; but we believe in the company's fundamentals and its financial health and soundness.

To present the results of 2Q 16 I now turn the floor to our Administrative, Financial and Investor Relations Officer Gustavo Zeno.

Mr. Gustavo Zeno: Good morning everyone. Let us begin with the company's financial performance shown on slide three. As expected our net revenue declined by 19% compared to the previous quarter. The rental business unit continues to have the biggest share in our net revenue, 52%, with have the construction accounting for 31% and real estate accounting for 17% of our total net revenue.

The main reason explaining this reduced revenue was the sales of semi-new equipment, which were 81% lower than in the previous quarter and this was due to the accounting of a significant revenue coming from sales of semi-new machines in the rental business unit in 1Q and so this is a nonrecurring event.

Costs and expenses totaled 91.7 million BRL in 2Q 16, down 9% compared to 1Q due to lower selling costs as a result of a lower sales volume in the period. The percentage share of job execution and warehouse storage costs was 31% in the quarter versus 23% in the prior quarter.

As mentioned by Sergio Kariya the company has been seeking to increase productivity in the equipment maintenance and moving processes. As a result in the midterm we can expect a lower share of direct costs/net revenue.

SG&A expenses increased by 6% in the quarter and the ADD reduction partially offset the increase of other SG&A expenses. We will explain the main variations in this line later on in the call.

Ebitda and net earnings were negatively impacted by a lower utilization rate and market prices. Ebitda margin was 13% and our net loss was 20.9 million BRL.

In this quarter we recognized a provision for the future loss of goods available for sale, which negatively impacted the company's result by 1.4 million BRL. This provision refers to the sale of 98 machines remaining from the equipment sale agreement amounting to €8 million, a contract signed in August of 2015 and this was due to foreign exchange depreciation.

According to CPC 16 inventories should be reduced to their net realizable value. The sale value of every machine contracted in euros converted by the exchange rate at the end of the quarter minus inventory value including expected expenses related to maintenance and freight generated a material negative variation in this quarter, and thus there was need to account for this provision.

Nonrecurring items totaled 3.9 million BRL in the quarter of which 2.5 million referred to expenses related to the closing of branches and 1.4 million stemming from liabilities of the industrial services business unit sold in 2013. In this quarter we demobilized the Manaus, Cuiabá and Goiânia branches of the construction business unit.

We are at a final stage of assessment to unify the São Paulo construction branches in another location. If the São Paulo… If the Osasco branch is relocated investments will be necessary to make adjustments to the branch in this new location.

Excluding results and provision of sales of semi-new equipment and the nonrecurring items the Ebitda margin would have been 23.3% in the period.

Please go to slide four now. On slide four we can see the rental revenue… That the rental revenue was 5% lower due to a lower rented volume in both business units with a negative impact of 5 million BRL in the period.

We continue to see a reduction in our utilization rate which in the quarter was 42.7% in construction, which corresponds approximately 48,000 tons; and it was 57% in the rental business unit with approximately 3,400 machines. Average utilization rate LTM shows a downward trend in both business units.

Our results reflected the effect of a downward market cycle: lower demand, pressure on prices and consequently lower margins. In this scenario we are working hard to minimize damage to our profitability. In the construction sector projects are generally being executed at a slow pace and there are no big projects in the short term pipeline.

According to news published in the media auctions, infrastructure auctions should only be expected after a final verdict on Pres. Dilma Roussef impeachment. Despite the government's will to release invitations to bid as quickly as possible, the concessions program will remain under consideration for a longer period of time.

Please go to slide five. Here we show our Ebitda performance, which was 13 million BRL in 2Q down from 29 million in 1Q 16. It was 13.7 million more specifically. Excluding the effect of the… and provision of sales of semi-new equipment and the nonrecurring items Ebitda would have been 18.5 million in 2Q against the 22.7 million BRL in 1Q.

The biggest impact on the Ebitda was the increase in SG&A expenses net of ADD, provision of sales and nonrecurring items with an impact of 3.5 million BRL from one quarter to the next as we can see on this slide.

In this quarter we were impacted by an increase in expenses related to third-party services primarily due to the consulting plan which is assisting the company in reviewing its operating and billing processes and with nonrecurring expenses.

Another reason which impacted SG&A even more than Cogs was the increase in personnel expenses due to the provision and payment of collective bargaining agreements in the branches of Rio de Janeiro, Brasília, Camaçari and Recife. The next big impact of the collective bargaining agreement will be in September in the São Paulo branch.

On slide six we can see the performance of our allowance for doubtful debt - ADD which reached 6% of our net revenue in 2Q down from 7% in the prior quarter. Breaking down by business unit the biggest quarterly ADD variation was in the heavy construction unit which had a positive net effect of 2.2 million BRL in 2Q, around 7.8% of net revenue.

In real estate ADD was 5.8% of net revenue while in the rental business unit the share was 5% of net revenue. We predict that ADD will remain at this level in the coming quarters. I would like to emphasize that we have intensified our strategies to reduce delinquency.

Please go to slide seven talking about cash flow. Adjusted operating cash flow before interest paid and before investments in rental goods reached 50 million BRL in the quarter with a total of 130.8 million BRL YTD, which represents the company's ability to generate cash. The variation comparing both quarters was impacted primarily by a decline in the revenue from sales of new and semi new equipment. Net of this revenue the decline would have been 16% comparing 1Q and 2Q.

Talking about our investments we invested 1.4 million BRL in the period of which 1 million in equipment rental for the construction business unit.

We will now speak specifically about the construction business unit starting on slide nine please. He we see the consolidated results for the construction business unit which posted a net revenue that was 5.1% lower than in the prior quarter. The biggest factor explaining this decline was the revenue from semi-new equipment which was partially offset by an increase in income from technical assistance and indemnities.

The increase in technical assistance income was a one-time event and was also due to the new profile of contracts that we are currently serving to fill the gap and offset the lack of large projects. This increase in technical assistance income in the construction segment resulted in an increase of third-party costs, since we often times have to outsource workers to set up and take down equipment.

ROIC was negative by 11.5% LTM ending in June 2016. Net of 30.9 billion BRL in impairment recognized in 4Q 15 the ROIC would have been -8.2%. As we reduced our assets primarily in real estate segment invested capital and consequently ROIC will be positively impacted.

Please go to slide 10 where we see rental revenue breakdown for heavy construction, which accounted for 65% of the total construction revenue. By origin of resources private sector projects accounted for 47% of the revenue; the publicly-funded projects 35%; and public-private partnerships - PPPs 18%. With the government intent to have more participation from the private sector in new infrastructure projects we envision an increase in the share of private investment.

As for the real estate business the residential market represented 53% of the revenue and commercial market accounted for 28%.

Please go to slide 11. Here we list the main projects in which Mills is participating: in the Southeast the highlights go to Olympics related projects such as the Deodoro Arena, the

Olympic Park and Transbrasil in Rio de Janeiro. We also have urban mobility contracts in São Paulo and the expansion of the Confins airport in Minas Gerais.

In the Midwest and the South of Brazil we are working on the new Guaíba bridge in Rio Grande do Sul State, in the São Manuel hydro power plant in Mato Grosso State and in the Papuda Penitentiary in the Federal District.

We continue with low visibility regarding the recovery of this segment.

Let us now review the rental business unit on slide 13. The 29% decline in net revenue was due primarily to a lower sales volume of semi-new equipment. Of the €8 million agreement last year to sell 307 semi-new pieces of equipment - this was announced in 3Q 15 - 20.6 million BRL have been recognized, of which 2.3 million BRL in this quarter.

With the BRL appreciation we are revisiting the commercial strategy of this agreement and thus we will reduced the number of machines being sold. If the sales do occur they will be opportunistic and aiming at profitability as opposed to strengthening our cash.

Since we believe in the aerial work platform market we seek to reduce our plates of telehandlers, which have lower profitability and higher maintenance costs. In this quarter we sold some telehandlers below book value given their physical condition.

With a decline in revenue and increase in SG&A expenses the Ebitda margin was down to 27.7%. Excluding the result and provision of sales of semi-new equipment the Ebitda margin in the period would be 33.1%.

We will now address the company's indebtedness on slide 14… On slide 15. We ended the quarter with a cash position as we see on this slide resulting in a net debt of 181 million BRL. We ended the quarter with a net debt position of 181 million BRL compared to 207.5 million in the end of 1Q. Our cash position in the end of this quarter was 356.8 million.

Most of our debt is tagged to CDI with no real collateral, it is a clean indebtedness. Again this shows the financial soundness of the company.

Please go to slide 16. We have our net debt position of 181 million, I am stressing that... This quarter of 2016 our indebtedness indicators are at a comfortable level. We ended this 2Q with a net debt/Ebitda ratio net of nonrecurring items of 1.5x. LTM Ebitda/financial income ratio was 2.5x in the same period, also net of nonrecurring items. So we feel quite comfortable in that regard.

Given the great uncertainty regarding the extent and duration of the current low activity cycle of the construction industry in Brazil we remain cautious reducing expenses and above all preserving our cash. Even in an adverse scenario the company does not envision a liquidity risk and is able to fulfill its operating and financial obligations.

Finally on slide 18 we present historical data since 2010. We can conclude that the challenging scenario negatively impacted our revenues and margins. We still expect a deteriorating market; but we remain confident that we will come out of this crisis stronger and better structured.

I would like to thank all of you for joining us and we remain available to answer your questions. Again thank you very much for joining us in this conference call. Our investor relations team remains available for further clarifications if necessary.

Q&A Session

Operator: Ladies and gentlemen we will now begin our question-and-answer session. If you have a question please press star one now. If at any time you would like to remove yourself from the questioning queue please press star two.

Our first question comes from Sami Karlik with Votorantim Bank.

Mr. Sami Karlik: Good morning. Considering that there is uncertainty regarding new projects given all of the political issues and perhaps new projects will come only next year and considering your backlog today and the cycle of every project the trend of the rental revenue in the construction segment, do you see a stabilizing trend for the coming quarters or do you think that we can expect another decline? This is my first question.

Mr. Kariya: hello Sami this is Kariya speaking. We continue to see a lot of pressure on volumes and prices in all three segments. As a consequence we see a drop in the company's top line in terms of rental revenue.

Mr. Karlik: okay thank you. My second question is considering the cyclic nature of your business particularly in construction I would like to know looking at the long-term what are the main measures that you are adopting now to try to reduce the cyclicality, which I think is inherent to the business?

And I would like to understand the ROIC, the return level. Obviously this metric is quite distorted given the volumes; but in the long-term in your business plan how do you see the ROIC of the two main segments?

Mr. Kariya: well Sami there are some things that I will not be able to disclose to you because they are strategic to the company; however I can say that we are sparing no effort to try to get more predictability in the company's cash flow. This means that the company's efforts in the long-term will be to seek alternatives in the company's top line in markets which are less exposed to these cycles.

One example is rental, we have said that before. In a short period of time the commercial team is making efforts to try to seek revenues in the non-construction market, in other words trying to rent equipment in the industrial market; in cleaning; maintenance; areas which are not related to civil construction and I think this is one example of what we are seeking to do in the long-term.

Now the other efforts we are starting now I cannot disclose to you for strategic reasons.

Mr. Gustavo Zeno: Let me mention one point about construction - this is Gustavo speaking - the company right now is considering ways to rationalize our inventory and consequently the number of branches.

What is the reason behind that? We want to understand which pieces of equipment in the mid to long-term will give us interesting ROIC for Mills.

And if the equipment does not deliver a minimum level that we expect we can consider selling this equipment, thus reducing our PP&E and in a consolidated basis having a return on investment.

Mr. Karlik: thank you Zeno thank you Kariya.

Operator: I would like to remind you that if you want to pose a question please press star one. As a reminder if you would like to pose a question please press star one now.

Our next question comes from Mr. Samuel Alves with BTG Pactual.

Mr. Renato Mimica: Good morning this is Renato Mimica. Thank you for taking my question. Could you please elaborate a little more about your strategy to sell assets looking forward? Because you had announced a plan in the past and how far are you in the plan? What can we expect for the next quarters or years?

And still on this topic and talking about sales efforts internationally how is this going and also efforts to internalize Mills' business?

Mr. Kariya: good morning Mimica. Let me try to break down my answer in two parts: the sale of assets in real estate and in the rental. Let me begin with rental. As we announced in this conference call and also the previous of our effort to sell rental assets have been reduced because the pressure in terms of cash generation of the company was reduced with the capital increase; and since we understand that rental assets, aerial work platforms and telehandlers are strategic our sales appetite is now reduced.

As we mentioned in the conference call we are trying to sell the assets in a continuous way, ongoing way; but the focus is no longer in cash generation, in cash flow generation; the focus now is on the business cycle trying to get returns and margins.

Now real estate is different. For real estate we still have quite a relevant surplus of equipment and so we continue with our sales strategy and looking at the international market.

Now today given the foreign exchange with the BRL appreciation we became a little less competitive in the global marketplace - but still we continue to increase our offer in pipeline both in Latin America and in the African market and the emerging markets.

So this is the focus in terms of the internationalization effort: we are focusing on African and Latin America markets to sell our real estate products.

Mr. Mimica: thank you very much Kariya.

Operator: our next question comes from Mr. Rodrigo Fonseca with Vertra Capital.

Mr. Rodrigo Fonseca: Good morning everyone. I have two questions and the first is about the 8-million agreement of semi-new equipment from the rental. Was this a delay? Are we going to see more effect in the coming quarters? Was it a matter of acceptance? What kind of uncertainties exist with this sale?

And my second question I would like you to comment on the consulting firm.

Mr. Kariya: this is Kariya Rodrigo, good morning. Well the project that we call Europa Project, the €8 million package, the fact is our contract was expected to end in February 2016. That was the initial agreement. However on our client's side there were some delays. We had announced in 4Q 15 that there would be an extension; however this is extending a little more.

So what are we doing? We are getting in touch with the client trying to see how we can adjust the contract. Looking at the current financial soundness there is some pressure from the client because they want to make some adjustments, they want us to reduce our values a little bit.

So we are rediscussing the commercial strategy of this contract. So it is possible that we will not complete 100% of the sale. I do know if this answers your question Rodrigo?

Mr. Fonseca: yes perfect this is essentially what I wanted to understand.

Mr. Kariya: as for the hiring of Fernanda our strategy in a low-cycle period as we are now seeing in the company we still must pay attention to our people. The fact that we are hiring somebody for the personnel department is exactly because of that because we need to look at our people internally; we need to take better care of our people; we need to maintain our team always motivated, which is the biggest challenge in Brazil at this point.

And we need to couple that with management. We are working strongly with a consulting firm on our management model, management rituals more specifically. We are trying to tag results to people assessing the performance of our team, with a program to develop our team. So we have to start looking now at our people in the company in the long-term, to look at our human resources. So this is basically our strategy in hiring this personnel department director.

Operator: our next question comes from Mr. Renato Hallgren with Banco do Brasil.

Mr. Renato Hallgren: Good morning. My question has to do with the sale of assets and you answered Mimica's question about that. So a follow-up question now: with the BRL appreciation the sale of assets became less attractive internationally; but for the domestic market are you considering the domestic market or does not it make any sense to sell this equipment internally because the market does not exist or because it is a company's strategy not to sell assets to the competition? Thank you.

Mr. Kariya: Renato I think that there is a little of both. Obviously when we look at the competition our sales appetite has reduced. The market is oversupplied.

And when we talk about the end-user at this moment the high cost of capital… it makes more sense for end-users who were interested in buying to have this equipment for the long-term.

So that pushes the sale of assets in the domestic market. Now obviously there is always a case here and there where the client wants to buy and we end up selling; but this is margin on our revenue. We tend to rent.

This is in terms of selling in the domestic market.

Mr. Hallgren: Okay thank you very much.

Operator: ladies and gentlemen as a reminder if you want to ask a question please press star one.

This concludes today's question-and-answer session. I would like to invite Mr. Sergio Kariya to proceed with his closing statements. Please go ahead sir.

Mr. Kariya: Ladies and gentlemen we would like to thank you for participating in this conference call to discuss Mills' earnings results for 2Q 16. The company's IR team remains available to answer any further questions you might have or to provide further clarifications, thank you.

Operator: That does conclude Mills conference call for today. Thank you very much for your participation, have a good day and thank you for using Chorus Call.