

Past Political Scandal Brazil's Banco Rural Is Reevaluated by Fitch

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Fitch Ratings has removed from Rating Watch Negative and affirmed the long and short-term national ratings of Brazilian bank Banco Rural S.A. (Rural) of 'BB-(bra)' and 'B(bra)', respectively. At the same time, Fitch placed the long-term rating on Negative Outlook. The Support rating of '5' was affirmed.

These rating actions reflect Fitch's opinion that, despite its difficulties, Rural has taken some measures necessary to continue to honor its short-term commitments, demonstrating a capacity to generate liquidity in an acceptable manner.

Although the bank's liquidity continues to be under pressure, the composition and tenor of its liabilities indicate that the maturity period of its assets, together with the contingencies it is exploring, are expected to enable the bank to continue to honor its commitments.

Fitch understands that the alternative sources of funding that are being structured by the bank are fundamental for it to rebuild its operations, principally with respect to a return to sustainable operating earnings that can support its long-term viability, and it continues to track their implementation closely.

Rural's balance sheet for the second half of 2005 reflects a marked deterioration in asset quality, a reduction in equity to reserve for this deterioration, an increase in intangible assets relative to its capital base, tight liquidity, and the strong erosion of the bank's image.

These can be attributed to the fact that Rural's name was linked to a kickback scheme involving the Brazilian ruling party and member of Congress who were paid monthly to vote in favor of the government's proposals in the legislature. The political crisis beginning in June 2005, compromised the bank's earnings generation and funding capacity.

Fitch, however, focuses its credit risk assessment on a long-term horizon, reflecting the agency's expectations regarding the bank's development in the future. Despite the large volume of loans considered impaired (for Fitch, loans classified 'D-H' in accordance with Brazilian Central Bank prudential regulations), Rural presents reserves equivalent to 85% of these, a higher percentage than the majority of banks its size.

The Negative Outlook reflects Fitch's opinion that Rural continues to be vulnerable to abrupt changes in its operational performance and that the bank faces an arduous task to resume operating in a suitable manner, with recurring operational profitability.

Despite the deterioration in the bank's ratios, Fitch understands that Rural's executives, aware of the severity of the present crisis and its effects on the bank, are continuing to implement various measures to adjust the bank's operations to the loss of funding. The bank's new strategy is clear and objective regarding the need to adjust its operations and structure to its smaller size.

Nevertheless, Fitch also considers that Rural still faces a series of challenges - reflected in its current ratings - mainly relative to its cash flow, and the success of its planning depends, above all, on its success in convincing investors to return to placing funds in the bank.

Founded in 1948, Banco Rural is a multiple bank controlled by five members of the Rabello family (who holds 84.7% of the common shares), with a tradition in lending to small and medium-sized companies. Headquartered in Minas Gerais, it has 39 service points (29 branches) in Brazil (115 in June 2004) and two facilities overseas (7 in June 2004).

Fitch's National Ratings provide a relative measure of credit worthiness for rated entities in countries where the sovereign's foreign and local currency ratings are below 'AAA'.

National ratings are not internationally comparable since the best relative risk within a country is rated 'AAA' and other credits are rated only relative to this risk. They are signified by the addition of an identifier, for the country concerned, such as 'AAA (bra)' for national ratings in Brazil.

Fitch Ratings - www.fitchratings.com