

Rating Action: Moody's rates Banco Rural E+ financial strength rating

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Sao Paulo, July 15, 2010 -- Moody's Investors Service has assigned a bank financial strength rating (BFSR) of E+ to Banco Rural S.A. (Rural). Moody's also assigned global local- and foreign-currency deposit ratings of B1 and Not Prime, long- and short-term, respectively; and Brazilian national scale deposit ratings of Baa2.br and BR-3, long- and short-term, respectively. All ratings have a stable outlook.

Moody's said the E+ financial strength rating derives from a banking franchise that is under transition following a lengthy operational restructuring initiated in 2006 that has resulted in substantial downsizing of the bank's balance sheet and infrastructure. Rural's financial metrics, therefore, largely reflect its condition as a start-up operation, as indicated by still volatile profitability, tight capitalization, and by asset quality indicators that are yet to be tested in light of the fast loan growth reported in 2009. Moreover, both loans and deposits have a high degree of concentration that may expose the bank's balance sheet to sudden shifts in confidence.

The rating agency noted that Rural's main business focus is commercial lending to small- and medium-sized companies, a segment that has long been its core competency. Lending to SMEs, however, only regained force by mid 2009, the growth more than doubling the bank's loan book from 2008 levels, while capital was quickly consumed. To ease funding and capital constraints, the bank has also been engaged in the payroll lending business. Accounting for 37% of Rural's origination in 2009, these loans have been for the most part securitized to the bank's own investment fund.

Management is primarily focused on sourcing deposits from corporate clients, although it has also relied on deposits guaranteed by the deposit insurance fund (FGC) as a way of attracting institutional investors and increasing the duration of its funding base; these sources, however, tend to bear high costs and could affect the bank's margins.

Moody's views the profitability of the restructured operation as challenged by operating efficiency that is still poor, which reflects the large size of its network relative to the bank's size and scope. Since 2008, management has been taking actions to enhance the bank's corporate governance and risk management guidance; nevertheless, these structures and procedures have yet to be proven effective.

Another key challenge for Rural's ratings is a small capital base, which, paired with a limited financial flexibility, may constrain the expansion of credit operations. Moody's will monitor the bank's recurring revenues generation capacity and its asset quality, both vital for capital replenishment and sustainable growth.

The global local currency rating of B1 assigned to Rural incorporates the bank's baseline credit assessment of B1 and Moody's assessment that the bank would receive no support should a systemic stress occur because of its limited participation in the deposits market.

The principal methodologies used in rating Rural were "Bank Financial Strength Ratings: Global Methodology" and "Incorporation of Joint Default Analysis into Moody's Bank Ratings: A Refined Methodology", which can be found on www.moody.com in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Rating Methodologies sub-directory on Moody's website.

Banco Rural S.A. is headquartered in Belo Horizonte, Brazil. As of December 2009, the bank had total assets of approximately R\$3.44 billion (US\$1.98 billion) and equity of R\$387 million (US\$223 million).

The following ratings were assigned to Banco Rural S.A.:

Bank financial strength rating: E+, stable outlook

Long-term global local-currency deposit rating: B1, stable outlook

Short-term global local-currency deposit rating: Not Prime

Long-term foreign-currency deposit rating: B1, stable outlook

Short-term foreign-currency deposit rating: Not Prime

Long-term Brazilian national scale deposit ratings: Baa2.br, stable outlook

Short-term Brazilian national scale deposit ratings: BR-3

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