MOODY'S
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Credit Opinion: Finlombarda SpA

Global Credit Research - 18 Oct 2010

Italy

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Aa2

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Key Indicators

Finlombarda SpA

	2005	2006	2007	2008	2009
Total assets (EUR million)	60.7	196.6	203.2	205.5	215.4
Managed funds (EUR million)	338.1	363.7	416.0	659.5	692.5
Surplus (deficit) of the year / intermediation margin (%)	23.7	23.3	26.9	22.4	21.7
Gearing (%) [1]	0.0	0.1	0.0	0.1	0.3
Liabilities / total assets (%)	8.8	3.6	4.0	3.0	4.2
Current assets / current liabilities (x)	13.0	30.4	27.7	39.2	27.6
Return on equity (%) [2]	5.7	2.1	2.9	2.2	2.2

[1] Financial liabilities / equity (%). [2] Surplus (deficit) for the year / equity (%).

Opinion

SUMMARY RATING RATIONALE

The Aa2 issuer ratings of Finlombarda SpA (FL) reflect its close ties with its unique shareholder, the Italian Region of Lombardy (Aa1, stable), as well as its robust financials and prudent management approach. However, the rating also takes into account the risks associated with FL's corporate status and the dependence of its activities on their strategic role for Lombardy. Whilst FL is currently debt-free and strongly capitalised, the expansion of its activities is expected to lead to a moderate increase in the company's risk exposure and financial leverage.

Credit Strengths

Credit strengths for FL include:

- Close operational links with the region, as reflected in its ownership structure, public-policy mandate and governance

- Sound financial profile

- The company is currently debt-free and strongly capitalised

- Risk-averse management approach

Credit Challenges

Credit challenges for FL include:

- Projected increase in the company's risk exposure and debt burden

- Risks associated with its corporate status and its arm's-length nature, although this is mitigated by the region's interest in the company's operations

Rating Outlook

The rating outlook is stable.

What Could Change the Rating - Up

Although unlikely, an upgrade in the Region of Lombardy's rating may prompt an upgrade of FL's rating.

What Could Change the Rating - Down

FL's rating is sensitive to future movements in Lombardy's credit quality, and its government ownership, role and support constitute fundamental rating drivers. Although highly unlikely, a downsizing of the company's role within the regional government's institutions may negatively affect its credit quality, as could a material deterioration in its financial fundamentals and higher than expected increase in its risk exposure.

Issuer Profile

Headquartered in Lombardy's capital, Milan, FL is a joint-stock company fully-owned by the Italian Region of Lombardy and acts as its financial arm. Its mission is to help promote the development of the regional economy, either directly or through management of regional/EU funds, and to provide consultancy services primarily to the region.

DETAILED RATING CONSIDERATIONS

The ratings assigned to FL reflect the application of Moody's Joint Default Analysis (JDA) rating methodology for government related issuers (GRIs). In accordance with this methodology, Moody's first establishes the baseline credit assessment (BCA) for the entity and then considers the likelihood of support coming from the regional government to avoid an imminent default by FL, should this extreme event ever occur.

Institutional Framework

Established in 1971 as a joint-stock company outside the regional budget, FL's ownership structure, public-policy mandate and governance clearly point to a strong operational link with the regional government. FL provides in-house services exclusively for the Region of Lombardy. The region's interest in the company's operations is reflected in its regular oversight, although FL neither receives operating subsidies from the region nor enjoys special legal status. As a registered financial intermediary, pursuant to Art.107 of the Italian Banking Act, FL is subject to the Bank of Italy's supervision and reporting requirements.

Its statute and the regional legislation define the company's strategic role in promoting economic development initiatives in the regional territory through: (i) the acquisition of shares - typically minority shares - in local enterprises, lending activity and provision of guarantees; (ii) the promotion of public-private partnerships; and (iii) the management of dedicated regional and EU funds. FL also provides consultancy services to the region for specific initiatives, including PFIs. FL derives financial means for its publicly led mission from active interests on its equity investments and commissions for consultancy services and management of EU/regional funds; the firm is also authorised to access new borrowing, even for lending purposes.

Financial Performance

Although FL is not oriented towards profit maximisation, it enjoys robust financial fundamentals, which largely reflect Lombardy's financial and strategic commitment to sustain FL's operations. Revenue streams - arising from its interest margin on equity investments and net commissions for the management of regional funds and consultancy activities - have combined with a lean expenditure structure, thereby allowing FL to record buoyant surpluses, which have always been re-invested and/or set aside into a risk fund. Furthermore, FL has a low risk profile due to the nature of its functions and we do not highlight significant in- and off-balance sheet financial risks.

Operating income (represented by the intermediation margin) has traditionally benefited from sizeable equity and a large pool of regional resources managed off-balance sheet. As of June 2010, FL managed EUR 725 million in regional funds, as well as about EUR 196 million in its own resources - mostly comprising equity. FL's operating income has also benefited from advisory-service commissions; consultancy activities have recently expanded to include healthcare and the management of certain regional taxes. The latter is expected to represent a major activity going forward: the related project Erario Integrato Regionale (ERIR) will boost consultancy revenue, which is expected to contribute approximately 30% to the intermediation margin by 2011 (vs. the current 20%).

Although the intermediation margin is set to grow going forward, surpluses are expected to shrink significantly to around 5%-7% in 2010-12 (from the 24% average in 2005-09), in accordance with a projected increase in administrative costs and annual provisions to reserves. However, Moody's expects FL's financial fundamentals and performance to remain sound, supported by the stability in the pool of managed funds and the company's equity investments.

We do not highlight significant risks arising from ordinary operations, as well as from ancillary activities. In fact, the participation in local businesses, credits and guarantees absorb a negligible proportion of the company's budget. The asset management company Finlombarda Gestioni SGR SpA has posted modest surpluses thus far, which have been reinvested or earmarked to cover losses recorded during its start-up phase.

Debt and Liquidity

The company is currently debt-free and strongly capitalised. To date, the company has adequately addressed key risks, including market, liquidity and operational risks. The firm's liquidity management is conservative and risk-averse. FL's portfolio is composed primarily of liquid or semi-liquid investments; FL's own resources are mostly deposited in bank accounts (60%) and floating-rate bonds issued by large Italian banks (20%), with the remainder invested in funds (14%) and other low-risk financial instruments (6%). Compared to the past few years, the company has increased the diversification of depository banks' pool.

FL's equity has represented a source of untapped reserves for the company to actively manage to date. According to FL's plans to use its capital to promote development projects sponsored by the region, the implementation of its biggest project "Made in Lombardy" entails the use of a large proportion of the company's own resources (EUR 100 million), essentially bank account deposits, for lending purposes to small and medium enterprises. This project is currently in its starting phase, and we expect disbursements to increase in 2011-12. However, Moody's does not expect that the higher exposure to credit risk going forward will translate into a material deterioration of FL's risk profile, especially given the

EUR 33 million regional guarantee.

Furthermore, the company is planning to activate financial leverage through the opening of a EUR 200 million credit line and its use for on-lending to regional manufacturers. The use of this credit line will foster an increase in FL's debt stock to approximately EUR 16 million by year-end 2011 and to EUR 78 million by 2012. The activation of its financial leverage is not expected to alter FL's credit profile; we understand that any new borrowing will receive implicit approval from the region and will have a limited impact on the company's finances.

Governance and Management

FL's management structure and governance clearly point to a high degree of operational integration with the regional government. The operational link with Lombardy - which has traditionally supported FL's credit quality - is evolving towards closer coordination and oversight, including tighter reporting requirements with regard to planning activity and organisational matters. Prudent operating and financial strategies have been accompanied by a culture of transparency and accountability. Management quality is considered adequate to fulfill the statutory responsibilities.

Extraordinary Support Considerations

Moody's assigns a high likelihood of extraordinary support from Region of Lombardy, reflecting primarily FL's institutional framework, which regulates its arm's-length nature and integration into the regional administration. FL performs its publicly-led mission under a mandate from and the direction of the regional government.

Moody's also assigns a very high default dependence between FL and the regional government, reflecting their close operational and financial links. In addition, FL generates revenues in Lombardy's territory, and is therefore exposed to business cycle fluctuations that might also influence the region's fiscal situation and debt servicing capacity.

ABOUT MOODY'S SUB-SOVEREIGN RATINGS

National and Global Scale Ratings

Moody's assigns national scale ratings in certain local capital markets in which investors have found the global rating scale provides inadequate differentiation among credits or is inconsistent with a rating scale already in common use in the country. Moody's National Scale Ratings are opinions of the relative creditworthiness of issuers and issues within a particular country. While loss expectation will be an important differentiating factor in the ultimate rating assignment, it should be noted that loss expectation associated with National Scale Ratings can be expected to be significantly higher than apparently similar rating levels on Moody's global scale. Moody's National Scale Ratings rank issuers and issues in order of relative creditworthiness: higher ratings are associated with lower expected credit loss.

National Scale Ratings can be understood as a relative ranking of creditworthiness (including relevant external support) within a particular country. National Scale Ratings are not designed to be compared among countries; rather, they address relative credit risk within a given country. Use of National Scale Ratings by investors is only appropriate within that portion of a portfolio that is exposed to a given country's local market, taking into consideration the various risks implied by that country's foreign and local currency ratings. The Moody's Global Scale rating for issuers and issues in local currency allows investors to compare the issuer's/issue's creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

Country Ceilings for Foreign Currency Obligations

Moody's assigns a ceiling for foreign-currency bonds and notes to every country (or separate monetary area) in which there are rated obligors. The ceiling generally indicates the highest rating that can be assigned to a foreign-currency denominated security issued by an entity subject to the monetary sovereignty of that country or area. In most cases, the ceiling will be equivalent to the rating that is (or would be) assigned to foreign-currency denominated bonds of the government. Ratings that pierce the country ceiling may be permitted, however, in cases where foreign-currency denominated securities benefiting from special characteristics are judged to give them a lower risk of default than is indicated by the ceiling. Such characteristics may be intrinsic to the issuer and/or related to Moody's view regarding the government's likely policy actions during a foreign currency crisis.

Baseline Credit Assessment

Moody's baseline credit assessment incorporates the Government Related Issuer's (GRI) intrinsic credit strength and accounts for all aspects of the entity's existing (or anticipated) activities, including benefits (such as regular subsidies or credit extension) and/or detriments associated with the government relationship. In effect, the baseline credit assessment reflects the likelihood that a GRI would require extraordinary support.

Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a Government Related Issuer (GRI) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0 - 30%), moderate (31 - 50%), strong (51 -70%), high (71 - 90%) and very high (91 - 100%).

Default Dependence

Default dependence reflects the likelihood that the credit profiles of two obligors may be imperfectly correlated. Such imperfect correlation, if present, has important diversifying effects which can change the joint-default outcome. Intuitively, if two obligors' default risks are imperfectly correlated, the risk that they would simultaneously default is smaller than the risk of either defaulting on its own.

In the application of joint-default analysis to GRIs, default dependence reflects the tendency of the GRI and the supporting government to be jointly susceptible to adverse circumstances leading to defaults. Since the capacity of the government to provide extraordinary support and prevent a default by a GRI is conditional on the solvency of both entities, the more highly dependent -- or correlated -- the two obligors' credit profiles, the lower the benefits achieved from joint support. In most cases GRIs demonstrate moderate to very high degrees of default dependence with their supporting governments, which reflects the existence of institutional linkages and shared exposure to economic conditions that draw credit profiles together.

Default dependence is described as either low (30%), moderate (50%), high (70%) and very high (90%).

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