Credit Analysis

Moody's International
Public Finance

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Finlombarda SpA

Italy

Table of Contents:

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Summary Rating Rationale

The issuer rating of Aa2 of Finlombarda SpA (FL) primarily reflects FL's close operational link with the Italian Region of Lombardy – its unique shareholder -, its robust financial fundamentals and prudent management. The rating also takes into account Moody's expectation of a moderate increase in the company's risk exposure, as well as its corporate status and the dependence of its activities on their strategic role for Lombardy. The company is currently debt-free and strongly capitalised.

FL acts as the financial arm of the Region of Lombardy. Its government ownership, role and support constitute fundamental rating drivers.

According to Moody's rating methodology for Government-Related Issuers (GRIs), FL's rating is composed of two principal inputs: a Baseline Credit Assessment of 4 on a scale of 1 to 21 (where 1 represents the lowest credit risk) and a high likelihood of extraordinary support from the Region of Lombardy (Aa1, stable). High support primarily reflects 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.

Rating Outlook

The stable rating outlook reflects Moody's expectations that the company will be able to run efficiently its ordinary operations and will prudently manage the expected increase in its risk exposure, within a stable institutional framework defining its strategic role to and operational integration with the region.

This Credit Analysis provides an in-depth discussion of credit rating(s) for Finlombarda SpA and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website. Click here to link.

Moody's Investors Service

Finlombarda SpA

Issuer Profile

A government-related financial company …

FL is a joint stock company fully-owned by the Italian Region of Lombardy and acts as its financial arm. It operates under a mandate from and the direction of the regional government, with its mission being to (i) help promote the development of the regional economy, and (ii) provide consultancy services, primarily to the region, for specific initiatives. To date, its major areas of activity have been:

- *Management of regional/EU funds* devoted to support small-to-medium sized enterprises in the regional territory. As of June 2008, FL managed €508 million regional and EU resources off-balance sheets (*gestione separata*).
- *Consultancy services*: FL has been active in providing technical assistance specific projects, including PFIs. More recently, FL's consultancy activities have expanded to include core regional responsibilities, including healthcare.
- *Promotion of innovative financial solutions* to attract private capital in the financing of publicly-sponsored development projects, through public-private partnerships. Through its majority-owned investment management company, Finlombarda Gestioni SGR SpA, FL also promotes private-equity and venture-capital investments in the region and Mediterranean basin.

Headquartered in Lombardy's capital, Milan, the company has about 60 staff. The company is currently debt-free and strongly capitalised. In the near future the company is expected to face higher risk exposure due to the expansion of its activities, although Moody's expects these increases to be gradual and prudently managed.

…supporting development initiatives sponsored by the Region of Lombardy

FL's ownership structure and governance practices reflect its integration into the region's institutions. Unlike many of its national peers[1] FL's business model is oriented towards promoting the participation of private capital in publicly-sponsored economic development initiatives rather than direct intervention. This is reflected in the negligible amount of participations in local businesses, credits and guarantees compared to budget volumes. This business model is tailored to the inherent characteristics of Lombardy's economic base, reflecting strong private-sector dynamism and attitude toward innovation; private-sector financial institutions play a pivotal role in supporting local enterprises.

The Region of Lombardy, which contributes nearly 21% to Italy's GDP and accounts for 16% of the national population, is the country's economic and financial hub. The region features an open and wealthy economy, with GDP per capita 28% above the national average and a low unemployment rate (3.4% in 2007 versus 6.1% for Italy).

Key Rating Considerations

Institutional Framework

A fully-owned joint stock company outside the regional budget

Established in 1971 as a joint stock company by a pool of banks[2] operating in the region, FL began shifting into a government-related entity when the Region of Lombardy acquired 30% of FL's shares in 1975. The turning point for FL, however, coincided with the region's acquisition of the control share (51%) in 1999. In 2004, the region acquired 100% ownership in FL and committed to providing the company with adequate

[1] The 17 regional financial companies and three development agencies currently operating in Italy pursue a common mission, albeit with different business models, ownership and governance structures. Different from other private-sector players – like merchant banks, holdings, investments trusts of funds – these government-owned financial entities do not pursue a profit maximisation target. The first regional financial company was established in 1967 by the Region of Friuli-Venezia Giulia (Friulia SpA). See Appendix 2 for a list of regional financial companies operating in Italy.

[2] Namely Cariplo, Mediocredito Lombardo, Banca Popolare di Milano, Banca Commerciale Italiana.

capital to pursue its mission. Whilst FL does not receive operating subsidies from the region to finance its operations, in 2005-06 the region provided FL with two capital injections totalling €160 million, increasing FL's capital to €170 million, entirely issued and paid. Moody's regards the region's 100% ownership of FL as an indication of its commitment to ensure the independence of the company from the interference of private shareholders, especially in light of FL's strategic role in managing public-sector resources.

Close integration into the regional government's institutions

Although FL is a private firm legally independent from the Region of Lombardy – since it does not enjoy special legal status –, FL's ownership structure, public-policy mandate and governance clearly point to a high degree of operational integration with the regional government. In compliance with Law n.248/2006 and the 2007 National Financial Bill, FL provides in-house services exclusively for the Region of Lombardy. Although Moody's sees the risk of dilution of the regional interest in the company's operations as remote to date, FL is exposed to risks associated with its corporate status and the instrumental nature of its activities. Moody's understands that FL's financial performance is ultimately affected by the regional government's strategy.

Its statute and the Regional Law n.30/2006[3] define the company's strategic role in promoting economic development initiatives in the regional territory through: (i) acquisition of shares – typically minority shares – in local enterprises, lending activity and provision of guarantees; (ii) promotion of public-private partnerships; and (iii) management of dedicated regional and EU funds. FL also provides consultancy services to the region and public-sector institutions for specific initiatives, including PFIs. About 30% of FL's operating income is derived from active interest on the company's equity investments, whilst 70% comes from fees and commissions for consultancy services and management of regional/EU resources.

As a registered financial intermediary, pursuant to Art.107 of the Italian Banking Act (Law 385/1993), FL is subject to Bank of Italy's supervision and reporting requirements. It is allowed to provide credits and issue guarantees, although these activities constitute a negligible portion of the firm's budget to date. Whilst FL could provide credits through lending in the near-term, the company reports that its status of registered financial intermediary does not represent a step to becoming a bank in the short-to-medium term; neither does it represent a fundamental prerequisite for managing third-party funds like regional funds.

Financial Position and Performance

Finlombarda SpA – Key indicators

(as of 31 December)	2005	2006	2007	2008F
Total assets (€ million)	60.7	196.6	203.2	207.2
Managed funds (€ million)	512.8	589.7	690.8	782.0
Surplus (deficit) of the year / intermediation margin (%)	23.7	23.3	26.9	17.1
Gearing (%) (1)	0.0	0.1	0.0	0.0
Liabilities / total assets (%)	8.8	3.6	4.0	3.7
Current assets / current liabilities (x)	11.6	29.3	26.7	29.2
Return on equity (%) (2)	5.7	2.1	2.9	2.3

Note: (1) Financial liabilities / equity. (2) Surplus (deficit) of the year / equity.

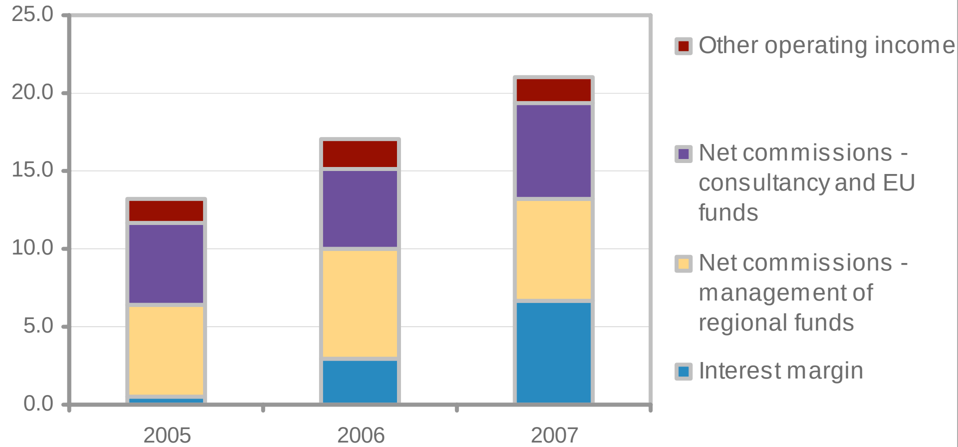
Robust financial fundamentals and positive performance…

Although FL does not pursue a profit maximisation objective, it enjoys robust financial fundamentals and reports positive results. Realised accounts for the past three years show that FL has been able to manage the expansion of its budget and consolidate positive financial performance, reflecting a growing revenue stream

[3] Pursuant to Regional Law n.30/2006, FL and other entities owned or controlled by the region are mandated to perform specific services on behalf of the region and under a regional directive, acting as operational arms of the region for the implementation of specific activities. The arm's-length nature of these entities is also reflected in the introduction of a centralistic governance model.

and lean expenditure structure. During 2005-07, the company recorded an average net surplus (after taxes) of €4.3 million, or 25% of its operating income (represented by the intermediation margin). In the past ten years, net results have always been re-invested and/or set aside into a risk fund; dividends have never been distributed to shareholders.

Figure 1 - Revenue Composition 2005-07 (€ million)



Source: Moody's elaboration from Finlombarda's income statement

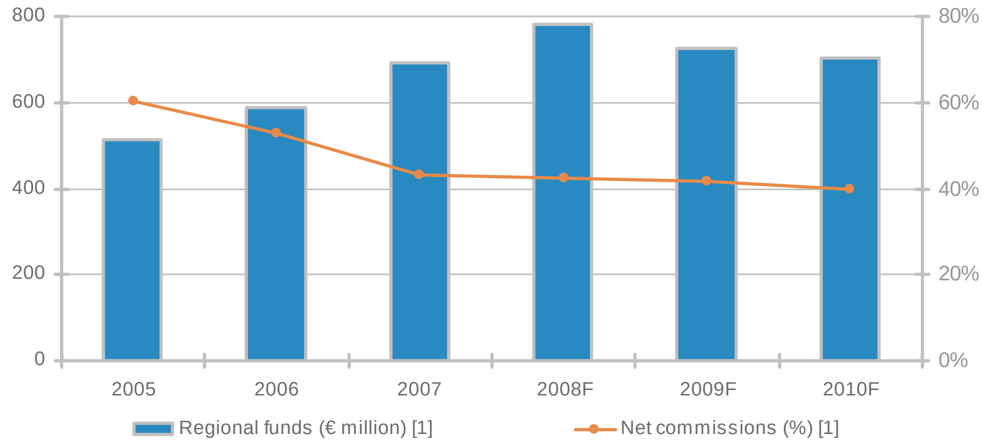
In the context of relatively stable fixed costs compared to budget volumes, FL's financials primarily benefited from the region's financial and strategic commitment. The growth in interest margin has been supported by the substantial increase in equity, after the two capital injections from the region in 2005-06. This combined with the progressive growth in the pool of regional and EU resources managed by FL off-balance sheets, helped sustain the growth of the intermediation margin (see Figure 1 above). As of June 2008, FL managed about €178 million in its own resources – mostly comprising equity – and €508 million in regional and EU funds. In particular, a large proportion of regional resources (78%) comprised liquid resources deposited in segregated bank accounts that cannot be accessed by FL for its own purposes. FL's remuneration for the management of regional resources is de-linked from the performance of its investments.

FL's operating income has also benefited from growing consultancy service commissions. In addition to technical assistance to the region – including the promotion and monitoring of project-financing initiatives (notably hospital PFI) – FL's consultancy activities have recently expanded to include core regional responsibilities. Since 2007, FL has acted as the central payment agent for specific categories of healthcare suppliers on behalf of the healthcare authorities (ASL) and hospitals (AO) in the region, out of a healthcare fund specifically set up by the region[4]. Moreover, FL has recently been involved in the analysis and management of some regional revenue items in preparation of the implementation of the fiscal federalism in Italy. The expansion of the company's activities reflects its functional role in the management of core regional responsibilities.

[4] In the start-up phase, this healthcare fund amounted to €1.6 billion. In compliance with recommendations of the Italian Court of Accounts, since 2008 the fund is alimented regularly by the region according to payment instructions; this explains the volatility during the course of the year of resources made available to FL for this purpose and deposited in bank accounts. FL retains commissions for the treasury service only and does not retain commission fees for the active management of such resources, which amounted to €207 million as of June 2008. This activity will, in turn, help set up conditions for smoother cash flow management in the regional healthcare system; a regular planning of cash flows is also expected to result in a reduction in interest payments on cash advances incurred by the healthcare entities with their treasurer banks.

Finlombarda SpA

Figure 2 - Finlombarda's Regional Funds



Source: Moody's elaboration from Finlombarda's Income statement
[1] Net fees and commissions for the management of regional and EU resources / intermediation margin (%).

Going forward, Moody's expects FL's financial fundamentals and performance to remain sound overall, supported by the continued strategic and financial commitment of the region, notwithstanding the expected reduction of the operating margin due in part to prudent budget estimates. Whilst the contribution of consultancy services to the intermediation margin is expected to gradually decrease, the future financial performance is expected to be supported by the projected stability in the pool of regional resources managed off-balance sheet and the company's equity investments (see Figure 2 above).

… associated with low risk exposure

Moody's does not highlight significant in- and off-balance sheet financial risks. FL has a low risk profile due to the nature of its functions. The participation in local businesses, credits and guarantees absorb a negligible proportion of the company's budget: as of YE2007, FL provided only €25,800 in credits and issued €32,500 in guarantees, out of total assets of €203 million. Furthermore, contractual agreements regulating the provision of services to the region, including intermediation activity for regional and EU funds, adequately protect the company from legal risks, including attachment of the company's assets. Reportedly, there are no legal actions pending against FL to date.

Through its majority-owned investment management company, Finlombarda Gestioni SGR SpA[5], FL promotes private-equity and venture-capital investments in the Lombardy's region and Mediterranean basin. The two private-equity funds (Next and Euromed)[6] managed by Finlombarda Gestioni employ regional resources and involve private capital in the financing of publicly-sponsored development initiatives. In the past three years, the investment management company generated modest surpluses, which have been re-invested or earmarked to cover losses recorded in its start-up phase. Aside from its participation in Finlombarda Gestioni, FL neither retains majority shares in independent companies nor is exposed to significant off-balance sheet financial risks.

5 Finlombarda Gestioni is a registered investment management company, pursuant to the Bank of Italy's deliberation n.139/2002. The company is 73.54% owned by FL, 25.7% by Milan's Chamber of Commerce and 0.75% by Consorzio Politecnico Innovazione. Pursuant to Art.36 of the Law n.58/1998 (Testo Unico della Finanza), the investment manager cannot use the funds' capital for own purposes and the funds' assets cannot be attached by creditors of the investment manager. FL consolidates the investment manager company into its accounts.

6 Next is the first public-private fund of hedge funds and coinvestment fund in Italy. It has a capital of €36.7 million (of which €2 million invested by FL, one-third covered by regional guarantee) and a settled maturity of 14 years. Investment targets are venture-capital hedge funds (FL plans to invest 50% of the fund's income indirectly in venture-capital hedge funds) and early-stage innovation and technology enterprises in the regional territory.
Euromed is a private-equity fund whose mission is to invest in joint ventures with Italian and European enterprises in the Mediterranean Partner Countries (as defined by the European Investment Bank). It has €50 million investment commitments (of which €1 million only has been invested in the start-up phase) and a maturity of eight years. To date, FL did not invest its own resources in the fund Euromed.

Debt and Liquidity

Sizeable capital cushion and risk-averse liquidity management

The company is currently debt-free and strongly capitalised. Moody's regards the firm's liquidity management as conservative and generally risk-averse (static liquidity management). To date, the company has adequately addressed key risks, including market, liquidity and operational. Since the firm has no exposure to currency risk, derivative instruments or structured products, its risk fund and equity reserve constitute a sizeable cushion to absorb the portfolio's risk profile.

FL's portfolio is primarily composed of liquid or semi-liquid investments, a factor that mitigates the effects of a rapid downturn of interest rates on the firm's investment portfolio. FL's own resources (€178 million, as of June 2008) are mostly deposited in bank accounts (59%) and floating-rate bonds issued by large Italian banks (22%), with the remainder invested in funds (14%) and other low-risk financial instruments (5%). Bonds and other financial instruments are registered at fair-value in the company's balance sheets. The company is committed to gradually increasing diversification of its own investments portfolio, which currently displays a certain degree of concentration in three bank counterparties[7]. During January-June 2008, average portfolio return outperformed the identified benchmark by 66 bps.

The business plan entails an increase of the company's risk exposure and, potentially, the activation of financial leverage

FL's equity has represented a source of untapped reserves for the company to actively manage to date. Going forward, FL plans to use its capital to promote development projects sponsored by the region. In fact, the company is expected to face a higher risk exposure, although Moody's expects any increase in the company's risk profile to be gradual and prudently managed, in terms of the financial burden on its budget. The company also projects to activate financial leverage for lending purposes in the medium term. The projected expansion of FL's activities will be accompanied by consolidation of ordinary activities, such as consultancy services and regional fund management.

The implementation of the biggest project in the pipeline – Made in Lombardy[8] – will entail the use of a consistent proportion of the company's own resources, mostly bank account deposits, for lending purposes. This project consists of a public-private portfolio totalling €400 million – comprising €100 million funds provided by FL and €300 million from the selected bank partner – to be used for financing development projects of regional SMEs. As a result, FL will be exposed to the credit risk of beneficiaries, typically manufacturing SMEs in the regional territory. However, Moody's does not expect that the higher exposure to credit risk will translate into a strong deterioration of FL's risk profile, also in view of the regional guarantee (€35 million). Tender documents regulate the revolving nature of the projects, as FL has an option to liquidate its investment after 24 months from the constitution of the portfolio – presumably in the second quarter of 2009 – and to replicate the project with another bank partner.

Prospects for new borrowing - namely in connection with an investment project in the water sector – are supported by FL's sound financials and the positive interest differential expected from lending. In addition, Moody's understands that any future decisions on the company's use of financial leverage to finance its activities will receive implicit approval from the region. However, timing for the implementation of the underlying project and details of FL's involvement are not yet defined.

[7] About 85% of the company's equity investments, mostly bank deposits and bonds, are with Banca Intesa (rated Aa3/stable/P-1), Banca Popolare di Milano (A1/stable/P-1), and BNL/BNP Paribas (Aa2/stable/P-1).

[8] See the tender document published in late July 2008, for a detailed description of the project Made in Lombardy.

Finlombarda SpA

Governance and Management Factors

FL's management structure and governance clearly point to a high degree of operational integration with the regional government, which is also evidenced by the regular oversight and coordination between the company's executives and the region's policymakers. The five members of FL's board of directors – who will remain in charge until December 2010 - are nominated by the regional government and major corporate strategies are approved by a joint committee (*Comitato di Indirizzo*) that includes the region's Financial Deputy.

Financial reporting is full and comprehensive and auditor reports do not contain serious qualifications. Prudent operating and financial strategies have been accompanied by a culture of transparency and accountability. Internal controls are supported by a recently established supervisory board and a code of business ethics. In Moody's view, continued prudent financial and risk management, combined with ongoing support from the regional government, will be core to supporting FL's credit fundamentals.

Finlombarda SpA

Company Annual Statistics

Finlombarda SpA

	31-Dec-05 Realised	31-Dec-06 Realised	31-Dec-07 Realised	31-Dec-08 Forecasts
BALANCE SHEET (€ 000's)				
Current assets	**52,106**	**186,741**	**192,652**	**194,157**
Cash and cash equivalents	3	3	5	6
Current financial assets	25,217	53,014	78,441	78,434
Credits vs. financial institutions (1)	26,886	133,724	114,207	115,718
Non-Ccrrent assets	**8,610**	**9,847**	**10,575**	**13,082**
Inventories	350	317	221	296
Other non-current assets	8,259	9,530	10,354	12,786
Total assets	**60,716**	**196,588**	**203,227**	**207,239**
Current liabilities	**4,506**	**6,375**	**7,218**	**6,642**
ST financial liabilities	3	99	24	51
Other current liabilities (1)	4,504	6,276	7,194	6,592
Non-current liabilities	**808**	**768**	**883**	**980**
MLT financial liabilities	0	0	0	0
Other creditors	808	768	883	980
Net assets	**5,314**	**7,143**	**8,102**	**7,622**
Equity	55,401	189,445	195,096	199,618
Total liabilities & equity	**60,716**	**196,588**	**203,197**	**207,239**
INCOME STATEMENT (€ 000's)				
Intermediation margin	**13,265**	**17,076**	**21,027**	**26,306**
Interest margin	558	2,950	6,627	8,963
Net fees and commissions	12,281	13,795	14,499	17,343
Management of regional funds	5,875	7,082	6,626	8,324
Consultancy & advisory	3,146	3,177	3,649	4,270
Management of EU funds	2,129	1,946	2,433	2,847
Other fees & commissions	1,131	1,590	1,791	1,902
Other operating income & rectification	427	330	(99)	0
Operating costs	**7,894**	**9,929**	**10,997**	**18,434**
Administrative expenses (excl. personnel)	4,540	4,742	5,473	10,832
Personnel expenditures	3,281	5,322	5,282	7,291
Other operating costs & rectification	3,354	5,187	5,524	7,601
Operating surplus (deficit)	**5,370**	**7,147**	**10,030**	**7,872**
Net Income from other activities	0	0	0	0
Surplus (deficit) before taxes and extraordinary Items	**5,370**	**7,147**	**10,030**	**7,872**
Taxes	2,193	3,088	4,249	3,362
Extraordinary items	0	0	0	0
Profit (loss) of participated companies (2)	(31)	(76)	(130)	(7)
Surplus (deficit) for the year	**3,147**	**3,983**	**5,652**	**4,503**

Finlombarda SpA

Finlombarda SpA

	31-Dec-06 Realised	31-Dec-07 Realised	31-Dec-08 Forecasts
CASH FLOW (€ 000's) (3)			
Cash flow from operations	**(129,820)**	**129**	**392**
Cash-flow from revenues stream	3,897	5,944	4,840
Liquidity gained (absorbed) by financial assets	(135,605)	(6,611)	17,185
Liquidity gained (absorbed) by financial liabilities	1,888	796	(21,634)
Cash flow from investment activities & other	**129,821**	**(129)**	**(421)**
Liquidity gained (absorbed) by investment activities	(179)	(129)	(441)
Capital increases	130,000	0	0
Dividends	0	0	20
Net cash flow	**1**	**1**	**(29)**

Notes:

(1] 2007 figures are net of €21 million giro account with the Region of Lombardy.

(2] Includes the investment management company Finlombarda Gestioni SGR SpA.

(3) Cash flow values are not available until 2005; the company adopted the IAS accounting standards in 2006.

Moody's Related Research

Credit Opinion:

- Italy, July 2008
- Cassa del Trentino SpA, May 2008

Analysis:

- Region of Lombardy, May 2008 (108954)

Special Comments:

- Rating Sub-Sovereign Government-Related Issuers in Americas and EMEA Region, June 2005 (93333)
- Rating Migration and Default Rates of Non-U.S. Sub-sovereign Debt Issuers 1983-2007, September 2008 (110252)
- Corporate Default and Recovery Rates, 1920-2007, February 2008 (107385)

Rating Methodology:

- The Application of Joint Default Analysis to Government Related Issuers, April 2005 (99025); Italian translation, June 2005 (100720)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Appendix 1 – Regional Financial Companies in Italy

Finlombarda SpA – National peers

Companies [1]	Region	Region's rating	Region's share	Activities (ordered by relevance)	Total assets (€ million, 2006) [3]	Net result (€ million, 2006)
FIRA SpA	Abruzzo	A2/sta	51%	Equity, advisory, regional/EU funds	487.8 (y2004)	n.a
Fincalabra SpA	Calabria	A1 RUR (neg)	80.6%	Equity, advisory, lending, regional/EU funds	n.a.	n.a
Friulia SpA	Friuli-VG	not rated	79.4%	Equity, lending, advisory, regional/EU funds	817.4	2.3
Filas SpA	Lazio	A2/sta	100% (2)	Regional/EU funds, lending , equity	124.3	0.2
Filse SpA	Liguria	Aa3/sta	53.6%	Regional/EU funds, advisory	261.9	0.1
Finlombarda SpA	Lombardy	Aa1/sta	100%	Advisory, regional/EU funds	196.6	3.8
SRGM ScpA	Marche	A1/sta	Consortium	Guarantees	20.5	0.1
Finmolise SpA	Molise	A3/sta	75.3%	Lending, leasing, factoring, equity	39.6	0.2
Finpiemonte SpA	Piedmont	Aa3/neg	62.2%	Regional/EU funds, equity, lending, guarantees	740.9	3.4
Finpuglia SpA	Puglia	A2/sta	95.2%	Advisory	9.8	(0.6)
SFIRS SpA	Sardinia	A1/sta	93.2%	Lending, advisory , regional/EU funds	209.7	1.0
Fidi Toscana SpA	Tuscany	Aa2/sta	39.4%	Guarantees, regional/EU funds, equity, advisory	456.1	2.4
Trentino Sviluppo	Trento AP	Aaa/sta	91.2%	Real estate, lending, advisory, equity,	141	0.1
Sviluppumbria SpA	Umbria	Aa3/sta	64.8%	Advisory, equity, regional/EU funds	n.a.	n.a
Finaosta SpA	Valle d'Aosta	not rated	77.6%	Lending, advisory	1532.5	6.7
Veneto Sviluppo SpA	Veneto	Aa2/sta	51%	Equity, lending, leasing, guarantees, regional/EU funds	76	2.6

Notes:

(1) The Regions of Basilicata, Campania, and Emilia Romagna promote economic development initiatives through development agencies instead of regional financial companies (SpA). The Region of Sicily manages its financial company in-house.

(2) Indirect participation though Sviluppo Lazio SpA (80.5% owned by the Region of Lazio).

(3) Excludes third-party funds managed off-balance sheets.

Finlombarda SpA

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