MOODY'S INVESTORS SERVICE

Credit Opinion: Finlombarda SpA

Global Credit Research - 17 Jul 2012

Italy

Ratings

Category	Moody's Rating
Outlook	Negative
Issuer Rating	Baa2

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Key Indicators

Finlombarda SpA

	2006	2007	2008	2009	2010
Total assets (EUR million)	197	224	205	215	218
Managed funds (EUR million) [1]	590	1,442	972	1,102	1,131
Surplus (deficit) of the year / intermediation margin (%)	23.3	26.9	22.4	21.7	18.9
Gearing (%) [2]	0.0	0.0	0.0	0.0	0.0
Liabilities / total assets (%)	3.6	13.0	3.0	4.2	3.5
Current assets / current liabilities (x)	30.4	7.8	38.5	26.0	31.7
Return on equity (%) [3]	2.1	2.9	2.2	2.2	1.7

[1] Third-parties' funds managed by FL off-balance sheet. [2] Financial liabilities / equity (%). [3] Surplus (deficit) for the year / equity (%).

Opinion

SUMMARY RATING RATIONALE

The Baa2 issuer rating of Finlombarda SpA (FL) reflects its close operational links with the Italian Region of Lombardy (Baa1 negative), which exercises strong oversight of the company. Furthermore, the rating reflects FL's strong capitalisation, debt-free status, its robust financials and prudent management approach. However, the rating also takes into account the risks associated with FL's corporate status and public-policy mandate. Moreover, FL's business plan entails a moderate increase in the company's risk exposure and financial leverage going forward.

On 16 July 2012, Moody's downgraded by two notches the rating of Finlombarda, following the downgrade of Lombardy's rating to Baa1 from A2.

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, including strong capitalisation

- The company is currently debt free

- Risk-averse management approach

Credit Challenges

Credit challenges for FL include:

- Anticipated 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 oversight

Rating Outlook

The negative rating outlook mirrors the outlook on Lombardy's rating.

What Could Change the Rating - Up

A rating upgrade is regarded as unlikely, given the negative rating outlook. Stabilisation or upgrade of Finlombarda's rating will reflect stabilization or upgrade of Lombardy's ratings.

What Could Change the Rating - Down

A downgrade of Lombardy's rating would lead to a downgrade of Finlombarda's rating.

Issuer Profile

Headquartered in Milan, FL is a joint-stock company fully-owned by the 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 the management of regional/EU funds, and to provide consultancy services primarily to the region.

Recent Developments

The recent downgrade of Italy's government ratings prompted the downgrade of all Italian sub-sovereign ratings, including the Region of Lombardy. The two-notches downgrade of the regional financial arm Finlombarda SpA reflects Moody's assessment of the degree of subordination to its sole shareholder.

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 the region of Lombardy in the event that the entity face acute liquidity stress.

Baseline Credit Assessment

Finlombarda's BCA of 10 (equivalent to Baa3) on a scale of 1-21 where 1 represents the lowest credit risk, reflects the following factors:

Institutional Framework

FL was established in 1971 as a joint-stock company outside the regional budget to provide in-house services exclusively for the Region of Lombardy. Its ownership structure, public-policy mandate and governance reflect its strong operational links with the regional government. Lombardy exercises regular oversight of the company, although FL does not receive operating subsidies from the region nor does it enjoy 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. The regional decree n. 530 in September 2010 further tightened the oversight and control exerted by Lombardy on its 17 owned companies, including Finlombarda.

Its statute and regional legislation lay out 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, including private finance initiatives (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. It is also authorised to access new borrowing, even for lending purposes.

Financial Performance

FL enjoys robust financial fundamentals, which largely reflect Lombardy's financial and strategic commitment to sustain the company's operations. Revenue streams - arising from its interest margin on equity investments and net commissions from the management of regional funds and consultancy activities - are generated alongside a lean expenditure structure, which reflects the nature of its consultancy services and headcount of only 100.

Although it is not oriented towards profit maximisation, FL has traditionally recorded buoyant surpluses, which have been re-invested and/or set aside in a fund for general 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 2011, FL managed EUR641 million in regional funds, as well as around EUR194 million in its own resources (mostly comprising equity).

FL's operating income has also benefited from advisory-service commissions; consultancy activities have recently been expanded to include payments to suppliers of Lombardy's healthcare system, with an expected total volume of payments of total EUR11 billion in the period 2007-2011, and the management of certain regional taxes, including primarily the car registration tax worth approximately EUR1 billion. The latter is expected to represent a major activity going forward. The Erario Integrato Regionale (ERIR) project will boost FL's consultancy revenue, which is expected to contribute up to 50% to the intermediation margin in the coming years (vs. the average 20% in 2006-2010). On the healthcare front, we note that FL has been effective in managing current payments to suppliers. FL's intermediation, combined with Lombardy's regular cash flows should enable it to reduce days of sales outstanding to 60 days, a record low in Italy.

According to original forecasts, surpluses are expected to shrink to around 7% in 2012-13 (from the 23% average in 2006-10), in accordance with a projected increase in administrative costs, annual provisions to reserves and the effects of the low rates on the interest margin in 2010 and 2011. 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 good performance of the company's equity investments.

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. Moreover, there are only limited risks arising from its ordinary operations and ancillary activities. In fact, its participations in local businesses, credits and guarantees absorb a negligible proportion of the company's budget. Whilst shares in local businesses may reduce overtime, the provision of credits to local businesses or FL's contribution to credit enhancement programmes across Lombardy are anticipated to increase slightly going forward. The majority-owned 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

At year-end 2011, the company was debt free and strongly capitalised. To date, FL has adequately addressed market, liquidity and operational risks. The firm's liquidity management is conservative and risk averse. FL's portfolio of EUR190 million as at September 2011 was composed primarily of liquid or semi-liquid investments, including deposits in bank accounts (83%), floating-rate bonds issued by large Italian banks (3%), funds (9%) and other low-risk financial instruments (5%). Compared with the past few years, the company has increased the diversification of its pool of depository banks, which now comprise 14 financial institutions. The composition of its equity investments and the company's overall financial strategies reflect a very conservative and risk-averse management approach.

Its large capital endowment, the good performance of its equity investments and little fixed costs enabled FL to endure volatile market conditions and maintain a strong financial profile over time. Moreover, FL's equity has represented a source of untapped reserves for the company to actively manage to date. FL's business plan is based on the company's equity (with EUR100 million cash resources made available) to favour bank financing of investments carried out by local businesses. The largest project in this regard (Made in Lombardy) is currently in its initial phase and FL expects disbursements to increase in 2012-13. 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 EUR33 million regional guarantee.

Furthermore, the company will soon open a EUR200 million credit line in order to on-lend to regional manufacturers for working capital needs. The use of this credit line will foster an increase in FL's debt stock to approximately EUR50 million by year-end 2012 and to EUR150 million by 2013. This is not expected to substantially alter FL's credit profile or its financial metrics, as 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 reflect a high degree of operational integration with the regional government. As an in-house company, FL has a "mono-line" business relationship with Region of Lombardy, which has thus far represented a credit positive for FL. Management quality is considered adequate to fulfil the statutory responsibilities. Senior management has consolidated experience in the banking sector and academia, whilst the middle-management team brings significant experience in consultancy and finance industries. Notwithstanding FL's role public-policy mandate, its staff are not civil servants. Prudent operating and financial strategies have been accompanied by a culture of transparency and accountability.

Extraordinary Support Considerations

Moody's assigns a high likelihood of extraordinary support from Region of Lombardy, reflecting primarily FL's institutional framework, which is regulated by and integrated within 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 National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".mx" for Mexico. For further information on Moody's approach to national scale ratings, please refer to Moody's Rating Methodology published in March 2011 entitled "Mapping Moody's National Scale Ratings to Global Scale Ratings".

The Moody's Global Scale rating for issuers and issues 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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