



RATING ACTION COMMENTARY

Fitch Revises Finlombarda S.p.A.'s Outlook to Stable; Affirms IDR at 'BBB'

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Fitch Ratings - Milan - 09 Nov 2023: Fitch Ratings has revised the Outlook on Finlombarda S.p.A.'s (FL) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) to Stable from Negative and affirmed the IDRs at 'BBB'. A full list of rating actions is below.

The revision of the Outlook reflects upward revision of FL's Standalone Credit Profile (SCP) to 'bb' from 'bb-'. This offsets expectedly higher recourse to borrowing from market sources, which would lower FL's share of government-guaranteed debt below the 75%. Fitch continues to expect a growing role for FL amid high interest rates, due to stronger demand for loans and other financial services at concessionary terms to support small and medium enterprises (SMEs) in the Region of Lombardy.

KEY RATING DRIVERS

Status, Ownership and Control: 'Very Strong'

FL is a public-sector entity and in-house provider of developmental financial services for the region, supporting the local economy. Lombardy fully owns FL, appoints its board of directors, authorises its new borrowing and monitors FL's adherence to regional guidelines.

Under national legislation, local and regional governments' (LRG) companies are subject to bankruptcy. However, previous cases of liquidation, such as that of ASAM S.p.A., suggest FL would see an orderly transfer of liabilities and assets in case of default.

Support Track Record: 'Very Strong'

FL benefits from fee revenue from Lombardy, which is calibrated to ensure its minimum profitability. We would expect continued equity support to support FL's balance-sheet

expansion if needed, as we believe in-house providers of near-governmental functions may be exempt from EU state aid rules.

Our assessment considers also guarantees from Lombardy to facilitate borrowings from the European Investment Bank (EIB; AAA/Stable/F1+), which represents FL's major funding channel.

Socio-Political Implications of Default: 'Moderate'

FL's activity is of limited size, given its 12 bond investors and the EIB as main bank lender. FL has around 3,000 borrowers and while its lending activity could ultimately be carried out by other financial intermediaries that are largely present in Lombardy, reputational repercussions for the region would be more severe, because a default of FL would cast doubt on the region's ability to control its government-related entities (GRE).

Financial Implications of Default: 'Strong'

A default by FL would have a limited impact on Lombardy's borrowing capacity, given the presence of Cassa Depositi e Prestiti SpA (CDP; BBB/Stable/F2) as the lender of last resort for Italian LRGs.

Fitch believes FL can expect extraordinary support of nearly EUR0.5 billion (FL's expected debt in the medium term) from Lombardy to overcome unforeseeable financial market dislocations, which would not represent a major burden for the region. This could easily be channelled via advances on future grants or equity injections to avoid acceleration of the repayment of FL's outstanding debt, triggered by guarantees on EIB loans and cross-default clauses on loans and listed bonds.

Standalone Credit Profile

The revision of FL's SCP to 'bb' from 'bb-' reflects a proven record of prudent loan portfolio growth, while reducing concentrations and non-loan assets. It also reflects Fitch's expectation that the impaired loans ratio will remain below 4% in the medium term and the gross debt to tangible equity ratio will stay close to 2x. FL's SCP is assigned using Fitch's Non-Bank Financial Institutions Rating Criteria and is constrained by FL's small franchise and narrow, business model. The SCP is supported by low leverage (gross debt/tangible equity of 1.8x at end-2022) and below-average credit risk in its loan portfolio (impaired loans on average around 3% of gross loans).

Fitch expects FL's new lending to SMEs in Lombardy to be about EUR100 million in 2024 (gross loan portfolio estimated at EUR600 million at end-2023), despite a higher

demand for co-lending amid higher interest rates. This is because FL is close to its internal leverage target. Fitch expects profitability to remain weak in 2024, despite higher interest rates, due to FL's cost-plus and non-profit-maximising business model. Access to funding is underpinned by available credit lines from the EIB, but Fitch's assessment is constrained by a limited, albeit growing, record of accessing debt markets.

Derivation Summary

Fitch classifies FL as a GRE of Lombardy under its GRE Criteria and believes that the region would likely provide extraordinary support to FL to avoid its default, resulting in an overall support score of 35. Combined with our internal assessment of Lombardy and FL's 'bb' SCP, this leads to FL's 'BBB' IDR.

As per our GRE criteria, the single factor leading to rating equalisation with the sponsor no longer applies to FL, as the share of government-guaranteed debt in the entity's total debt is not expected to be at least 75% on a sustained basis.

Short-Term Ratings

As per Fitch's criteria, FL's Short-Term IDR is 'F2' as derived by our internal short-term assessment of Lombardy.

Debt Ratings

Fitch rates FL's senior unsecured debt (EUR500 million EMTN programme and EUR50 million 0.967% bond 22 December 2025) at 'BBB'.

KEY ASSUMPTIONS

Debt will rise to around EUR540 million by 2024, of which nearly half will have Lombardy's guarantee. We expect FL will contract a new EIB line of up to EUR250 million by 2024, which will be depleted by 2026. Drawdown on FL's EMTN programme and loans from other banks will be about EUR340 million at end-2023 and EUR300 million at end-2024. As in 2022, we expect the share of government-guaranteed debt to remain below 75% until end-2025, since borrowing from market sources will complement EIB loans more than in the past to support FL's loan portfolio growth. We expect FL's loan portfolio to reach nearly EUR700 million by 2024.

Liquidity and Debt Structure

In Fitch's view, FL's equity will stay largely aligned with past years at about EUR250 million, while its debt will increase to nearly EUR540 million by 2024 with most of the amortisation covered by cash liquid investments, expected to be around EUR100 million. A bullet bond is due in 2025, which we expect to be pre-funded as has occurred in past years.

Issuer Profile

FL has been Lombardy's in-house provider of development finance since 1971. This includes research and payment services commissioned by the region, management of the region's developmental funds, including EU funds, and acting as lender for regional enterprises and for local SMEs, promoting national and international development.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

A downward revision of Fitch's internal credit assessment of Lombardy could lead to a downgrade of FL's ratings.

Negative rating action could also stem from a deterioration in FL's SCP, if not offset by increased willingness of the regional government to provide extraordinary support. FL's SCP could be revised down on an inability to sustain its corporate and SME lending franchise in Lombardy or on materially higher impaired loans ratio and leverage. However, this is not Fitch's base case over the next 12 to 18 months.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upward revision of Fitch's internal credit assessment of Lombardy could lead to an upgrade of FL's ratings if there was also an increased willingness of the regional government to provide extraordinary support.

An upward revision of Fitch's internal credit assessment of Lombardy could also lead to an upgrade of FL's ratings if there was also an improvement in FL's SCP. A wider product offering and increased scale would be prerequisites for an upward revision of FL's SCP.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

FL's ratings are linked to Fitch's internal assessment of the Region of Lombardy.

References for Substantially Material Source Cited as Key Driver Rating

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
Finlombarda S.p.A.	LT IDR	BBB Rating Outlook Stable		BBB Rating Outlook Negative
	Affirmed			
	ST IDR	F2	Affirmed	F2
	LC LT IDR	BBB Rating Outlook Stable		BBB Rating Outlook Negative
	Affirmed			
senior unsecured	LT	BBB	Affirmed	BBB
senior unsecured	ST	F2	Affirmed	F2

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Government-Related Entities Rating Criteria \(pub. 30 Sep 2020\)](#)

[Non-Bank Financial Institutions Rating Criteria \(pub. 05 May 2023\) \(including rating assumption sensitivity\)](#)

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Finlombarda S.p.A.

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