Finlombarda S.p.A.

Full Rating Report

Ratings

Foreign Currency

Long-Term IDR	BBB
Short-Term IDR	F2

Local Currency

Long-Term IDR	BBB

Outlooks

Foreign-Currency Long-Term IDR	Stable
Local-Currency Long-Term IDR	Stable

Financial Data

Finlombarda S.p.A.

	31 Dec 15	31 Dec 14
Interest revenue (EURm)	10.5	10.5
Net operating income (EURm)	6.0	3.7
Loans (EURm)	73.8	96.1
Total debt (EURm)	157.5	109.9
Total assets (EURm)	451.8	386.2
Equity and reserves (EURm)	255.6	256.3
Interest rev. on loans/loans (%)	14.23	10.93
Net interest income/earning assets (%)	3.57	4.32
Impaired loans/total loans (%)	0	0
Liquid assets/total assets (%)	32.51	21.65
Loans/equity and reserves (%)	28.87	37.5

Related Research

Interpreting the Financial Ratios in International Public Finance Reports (July 2010)

2016 Outlook: Local And Regional Governments (December 2015)

Public Finance (EMEA) International - Rating Criteria Hierarchy (April 2013)

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Key Rating Drivers

Legal Status: Finlombarda S.p.A. (FL) is 100% owned by the Region of Lombardy and is the region's 'in-house provider' of financial services, while providing support to the regional economy (mainly SMEs), and to the region's developmental and social policies, either via direct lending or through the provision of regional/EU funds.

Integration: FL is progressively broadening its range of activities towards the banking sector, in its aim to become a "lender of last resort" for regional enterprises, and for local SMEs' national and international development. FL does not receive direct operating subsidies, but Fitch believes that there is some flexibility over certain revenues from the region, which can be adjusted, in case of need, to absorb income losses.

Control: FL's board of directors is appointed by the region, which also indirectly approves the company's financial statements and retains control over major strategic decisions. The company, however, is registered as a financial intermediary according to Italian banking law and subject to some prudential regulations from the Bank of Italy, including disclosure duties.

Strategic Importance: Fitch believes FL is key in implementing Lombardy's policy for economic development. To facilitate FL's core activity, the region has guaranteed a credit line of about EUR250m from the EIB. The limited size (1.5%) of FL's total financial debt relative to the regional budget means extraordinary support from Lombardy, in case of need, is likely.

Operations: Fitch expects loan activity to grow in the medium term towards EUR300m, despite a persistently low interest-rate environment. The limited diversification of the revenue structure with a low portion of fee-intensive activities, together with a moderate interest rate spread of about 300bps, should keep FL's profitability at around EUR3m-EUR5m in 2016- 2018 (EUR3m in 2015).

Deteriorating Credit Quality: FL's credit portfolio has deteriorated over the last couple of years but remains better than the national average. NPLs on its outstanding loans for its main loan products rose to 13% of gross loans at end-2015, from 4% at end-2013, while nationally impaired loans rose to 20% from 15% during the same period. Fitch does not expect FL's asset quality to deteriorate faster than the national average given the group's strengthened risk monitoring and the upcoming expected bank licence.

Debt Position: Debt increased to almost EUR160m at end-2015, from EUR110m at end-2014. Fitch expects FL to tap the capital markets for short- and long-term debt to diversify funding in terms of debt type and maturity. Total assets could therefore rise towards EUR1bn by 2018 under Fitch's base case scenario.

Rating Sensitivities

Creditworthiness: Changes in the region's creditworthiness would be reflected in FL's ratings. More formalised support from Lombardy, such as an explicit guarantee on all financial liabilities, could trigger an upgrade of FL's ratings.

Support: Conversely, a dilution of support or diminished integration with the region as indicated by, among other things, an increase in non-guaranteed financial debt towards 50% of total debt or a change in the statute or legislative framework weakening FL's link with the region, may result in a downgrade.

Rating History

Date	Long-Term Foreign IDR	Long-Term Local IDR
19 May 16	BBB	BBB

Profile and Overview

FL is a financial firm, publicly owned with 100% of its equity by the Region of Lombardy, acting as the region's 'in-house provider' for financial services.

Headquartered in Milan, its institutional mission and mandate is providing support to the regional economy (mainly SMEs), as well as developmental and social policies of Lombardy, either directly or through the management of regional/EU funds. The other major sources of funds are represented by the interest earned on its equity investments and commissions for consultancy services and management of funds (thereby including EU, regional and own funds). It is also authorised to tap the capital markets, even for lending purposes.

FL is the principal vehicle for regional intervention in the financial field, especially for those innovative instruments making recourse to private capital for the support of regional economic policies.

FL operates in four business areas, interacting with the Region of Lombardy as well as with local authorities, corporates, the European community and banks.

According to its statute and regional legislation, FL's main business areas are:

- Services to the Region of Lombardy;
- Management of dedicated regional and EU funds;
- Financial intermediation;
- Treasury.

As a registered financial intermediary, FL is subject to the Bank of Italy's supervision and reporting requirements. The company is expected to become a public bank in the foreseeable future, with the aim of providing financing to regional development and infrastructural projects.

Principal Rating Factors

Summary

	Legal status	Strategic importance	Control and oversight	Integration/ financial
Rating factors	Mid-range	Stronger	Stronger	Mid-range

Source: Fitch

Legal Status

Fitch considers the entity's legal link with the sponsor as Mid-Range and is therefore moderately supportive of its credit quality.

- Joint-stock company with not-for-profit mission

FL's main shareholder, the Region of Lombardy, is not expected to change in the medium term. FL is the principal vehicle for regional intervention in the financial field, especially for those innovative instruments making recourse to private capital for the support of regional economic policies. Headquartered in Milan, its institutional mission and mandate is to provide support to the regional economy (mainly SMEs), as well as developmental and social policies of Lombardy, either directly or through the management of regional/EU funds. Despite its joint-stock company status, Fitch acknowledges FL's not-for-profit mission, which strengthens its dependence on the region, supporting the top-down approach in assessing its ratings.

Related Criteria

International Local and Regional Governments Rating Criteria - Outside the United States (April 2016)

Rating of Public-Sector Entities – Outside the United States (February 2016)

Strategic Importance

Fitch considers the entity's strategic importance as Strong and is therefore highly supportive of its credit quality.

Since inception in 1971, FL's scope has been to develop the region's economy, promote competitiveness and new investments, and lend to SMEs, and therefore plays a key role in regional development strategy. To facilitate this process, the region issued a guarantee in September 2015 for 115% (or almost EUR280m) of the total amount of the loan facility agreed with the EIB.

Nevertheless, considering the limited size of the company compared to that of the sponsor, Fitch believes that there is a strong likelihood of prompt intervention through extraordinary support from Lombardy in case of need. In fact, FL's financial debt accounted for 0.7% (0.3% in 2013) of Lombardy's operating revenue, or roughly of EUR22.5bn in 2014. Should the issuer retrieve the full EUR300m amount agreed with the EIB, it would nevertheless account for less than 1.5% of Lombardy's budget.

Control and Oversight

Fitch considers that Control and Oversight is Strong and is therefore highly supportive of its credit quality.

- Lombardy as sole shareholder

Being wholly owned by the region, FL's board of directors is entirely appointed by its sponsor. Moreover, although FL's financial statements are not formally approved by the region, the control it exerts over FL's board ensures indirect approval, also complemented by the definition of the business strategy and scope of the policy design.

FL is registered as a financial intermediary according to Italian Law and therefore subject to some prudential regulations from the Bank of Italy, including disclosure duties; however, it does not yet have a full bank licence. Fitch expects the process to be completed in the foreseeable future.

Integration/Financial

Fitch considers the entity's integration into the general government sector as Mid-Range and is therefore moderately supportive of its credit quality.

- Progressive activity broadening

Within the regional territory where the company is mainly rooted, FL provides consultancy activities, including accounting, advisory on financial instruments, management of dedicated funds to foster regional companies to develop their international business, financial intermediation and treasury activities.

In 2013, FL merged with Cestec, which was fully owned by the region, widening its activities to include energy certification, renewable energy and new technologies. FL then sold the energy activities in 1Q15 to Infrastrutture Lombarde (an entity mainly centred on infrastructure and real estate management) and is in the process of selling its 100% stake in Finlombarda Gestioni SGR (a company focused on innovative financial instruments).

Now, FL is progressively focussing its activities on the banking sector and strives to be the "lender of last resort" for the region's enterprises. Fitch believes that the support from the region would materialise even if an equity increase became necessary, providing the company with adequate resources to support local SMEs' national and international development. FL does not receive operating subsidies, but Fitch understands that there is room for revenue manoeuvre to allow a balanced income statement, in case of need.

Overall Assessment

In view of the above factors, including the guarantee provided by the sponsor on the credit line stipulated with the EIB, Fitch has classified FL as a dependent public sector entity (PSE) under its rating of public-sector entities criteria. This is attributable to the entity's strategic importance as well as control and oversight and, to a lesser extent, legal status and integration. As a result, FL's ratings are credit linked to those of its sponsor and therefore would reflect any change in the region's creditworthiness.

Also, in Fitch's view, FL's small size in comparison with Lombardy's budget, means that the region would not face major hurdles in providing capital injections or liquidity if needed.

Operations

Financial Performance

- Stable interest spread expected

Main sources of revenue (interest income and net commissions) were stable at approximately EUR25m from last year. FL recorded EUR3m in net profit and it is expected to remain below EUR5m by 2018, mainly based on the interest income spread remaining at around 300bps in the medium term, underpinning its not-for-profit mission. Therefore, net profit expectations remain fairly dependent on a low interest-rate environment due to the limited diversification of the revenue structure with a subdued portion of fee-intensive activities.

In line with usual practice, Fitch expects that yearly financial results will continue to be used to support the gearing ratio (debt/equity) of the company, also in view of the forthcoming acquisition of the full banking licence and the subsequent increase in the risk profile of the business.

- Credit portfolio quality still strong despite deterioration

In line with the banking system reflecting the impact of the prolonged economic recession, the quality of FL's credit portfolio has deteriorated, although it still remains stronger than the national average. NPLs on the outstanding main products (namely Made in Lombardy and Credito Adesso) soared to 13% at end-2015 from 4% at end-2013; nationally, impaired loans rose to 20% from 15% in the same period.

Financial Performance: 2014-2018f (Selected Items)

Balance sheet (EURm)	2014	2015	2016f	2017f	2018f
Property, plant and equipment	0.2	0.2	1.0	1.0	1.0
Long term financial assets	173.7	189.8	200.0	220.0	240.0
Deposits with banks	28.6	39.9	40.0	44.0	44.0
Trade debtors	96.1	73.8	150.0	200.0	280.0
Short term financial assets	76.9	139.9	87.0	117.0	130.0
Total assets	**383.7**	**451.8**	**485.0**	**590.0**	**705.0**
Other current liabilities	11.5	31.3	35.0	40.0	45.0
Borrowings, bonds	109.9	157.5	185.0	280.0	390.0
Long term trade creditors	6.2	5.4	5.0	5.0	5.0
Pension and healthcare	1.1	1.6	2.0	2.0	2.0
Equity capital and reserves	254.3	255.6	257.0	262.0	262.0
Total liabilities and equity	**383.7**	**451.8**	**485.0**	**590.0**	**705.0**
Income statement (EURm)					
Interest proceeds	10.5	10.5	14.0	17.0	22.0
Interest expenses	-1.5	-1.2	-4.0	-6.0	-9.0
Interest margin	**9.0**	**9.4**	**10.0**	**11.0**	**13.0**
Net commissions	15.0	15.5	15.0	15.0	15.0
Operating costs	-21.0	-19.7	-20.5	-21.0	-22.0
Profit/loss from activities being sold	-0.1	-1.1	0.0	0.0	0.0
Taxes	-1.1	-1.5	-1.5	-1.7	-2.0
Net income	**2.6**	**3.0**	**3.5**	**3.9**	**4.6**

f: Fitch forecast
Source: Issuer and Fitch

- Net commission activities

FL's consulting and service-providing role for the region relates to a number of activities, including assisting the region in the implementation of strategic projects and managing the regional product portfolio of local SMEs, management to the Azienda Sviluppo Ambiente e Mobilità S.p.A. stake (A.S.A.M., BBB/stable), and healthcare system cash pooling system. These activities are a significant revenue source and Fitch believes that their total income will exceed EUR15m a year by end-2018. This specific role gives the asset/liabilities structure of a captive intermediary, therefore granting particular features to the ALM which are not common to commercial or investment banks. Also, FL's portfolio (when own funds are considered) is well diversified, as none of the top 10 positions exceeds 0.3% of the total loans. On the other hand, A.S.A.M. is the top borrower when the regional funds are taken into consideration, with 3.3% of the total regional funds.

Overall, Fitch expects FL to continue to post a small profit in the medium term driven by the typical sources of revenue as identified in interest income on financial instruments and commission from the region of Lombardy. Additional revenue may likely stem from higher interests on loans to SMEs.

- Scenario assumptions

In making our forecast, we have assumed the following:

- Total assets will grow by 15% in the period considered (whilst national GDP growth is expected to be limited to 1.5%), driven by growth in loans to customer (+60%) thanks to greater penetration of SME segment, namely through PPP and mini-bond;
- Held to maturity - HTM (+8%) and held for trading - HFT (+3%) will fill out the gap between loans to customers and total assets;
- Loans to customers' growth will be financed through new borrowing with the EIB (+15%);
- Shareholders' equity will remain unchanged and no dividends will be distributed, hence internally-generated funds will strengthen net equity;
- Growth in debt and a negligible increase in net equity will result in a deterioration of the gearing ratio (debt/equity), but still be manageable;
- Interest spread to remain below 200bps with net commission virtually unchanged;
- Overall corporate size to remain stable, although incorporating a different composition: new hires will be replacing those being dismissed when the two controlled entities (Infrastrutture Lombarde and the energy activity) are sold;
- Ebitda margin will remain stable at 20%, conducive to net profit remaining below EUR5m (this is also a way to minimise taxation).

- Deteriorating portfolio quality

In line with the banking system, the quality of the credit portfolio has deteriorated, as NPLs on the outstanding main products (Made in Lombardy and Credito Adesso) soared to 13% at end-2015 from 4% at end-2013. Fitch believes that, in the context of a full banking licence acquisition, the extraordinary support from the sole shareholder (Region of Lombardy) would materialise to maintain the strong current capitalisation as shown by 60% gearing ratio (which already doubled over the last few years, and is calculated as the ratio between the total financial debt and the equity). According to Fitch's calculations, in order to maintain the current gearing ratio at the current level, the company would need to receive an estimated capital injection of around EUR200m.

Debt, Liquidity and Contingent Liabilities

- Possible debt diversification in terms of classes and maturities

At end-2015, FL's outstanding long-term debt, entirely euro-denominated, grew to EUR160m from about EUR110m in 2014, as loans with the EIB continue to grow in accordance with the agreement signed by the Region of Lombardy, and assisted by its guarantees. Since 2012, the company has started to draw down the first two tranches of the EIB EUR200m 12-year loan (interest rate: EURIBOR6M + spread to be communicated by RCB when actual draw down is made).

Fitch expects FL to tap the capital markets for short- and long-term debt to diversify funding in terms of debt type and maturities. In case additional funding sources are needed to support the local economy, the company may finalise an EMTN programme, potentially accompanied by a commercial paper programme which, together with own resources, could collectively push total assets towards EUR1bn by 2018 under Fitch's base case scenario.

Debt Schedule: 2014-2018f (Selected Items)

Debt structure (EURm)	2014	2015	2016f	2017f	2018f
Debt source					
Bank	109.9	157.5	185.0	280.0	390.0
Capital market	0.0	0.0	0.0	0.0	0.0
Non-bank	0.0	0.0	0.0	0.0	0.0
Total financial debt	**109.9**	**157.5**	**185.0**	**280.0**	**390.0**
Total risk	**109.9**	**157.5**	**185.0**	**280.0**	**390.0**
Debt maturity					
Less than 1 year					
More than 1 year	109.9	157.5	185.0	280.0	390.0
Total debt	**109.9**	**157.5**	**185.0**	**280.0**	**390.0**
Cash & liquid deposits	0.0	0.0	0.0	0.0	0.0
Net debt/(cash)	**109.9**	**157.5**	**185.0**	**280.0**	**390.0**

f: Fitch forecast
Source: Issuer and Fitch

Appendix A

Finlombarda S.p.A.

(EURm)	2011	2012	2013	2014	2015
Profit and loss					
Interest revenue	3.5	6.6	9.1	10.5	10.5
Interest expenditure	0.0	-0.1	-0.8	-1.5	-1.2
Net interest income	3.5	6.5	8.3	9.0	9.3
Net fees and commissions	13.8	16.4	21.6	15.0	15.5
Other operating income	1.6	1.7	0.9	0.8	0.9
Personal expenses	-9.0	-10.8	-17.0	-14.1	-13.8
Other operating expenses	-4.1	-4.1	-7.6	-5.3	-4.4
Net gains and losses on securities and trading	-0.3	-1.6	-2.4	-1.7	-1.5
Net operating income/(loss)	5.5	8.1	3.8	3.7	6.0
Provisions	0.0	0.0	0.0	0.0	0.0
Operating profit (loss) after provisions	5.5	8.1	3.8	3.7	6.0
Other non-operating revenues/expenses	0.0	0.5	0.1	2.0	-1.6
Contributions from state budgets	-	-	-	-	-
Profit (loss) before tax	5.5	8.6	3.9	5.7	4.4
Taxation	-2.2	-3.1	-1.9	-1.1	-1.5
Net profit (loss)	3.3	5.5	2.0	4.6	2.9
Balance sheet					
Assets					
Cash and cash equivalents	0.0	0.0	0.0	0.0	0.0
Liquid securities	42.1	50.8	48.3	83.6	146.9
Deposits with banks	159.2	146.7	146.2	28.6	39.9
Loans	12.5	77.5	96.5	96.1	73.8
Other earning assets	-	-	-	-	-
Long-term investments	1.3	0.0	34.5	173.7	189.8
Fixed assets	0.1	0.1	0.4	0.2	0.2
Intangible	0.0	0.0	0.1	0.1	0.0
Other long-term assets	-	-	-	3.9	1.2
Total assets	215.2	275.1	326.0	386.2	451.8
Liabilities & equity					
Customer deposits	-	-	-	-	-
Deposits from banks	-	-	-	-	-
Short-term borrowing	-	-	-	-	-
Other short-term liabilities	4.3	5.7	9.3	11.5	31.3
Debt maturing after 1 year	0.1	51.7	68.1	109.9	157.5
Other long-term funding	-	-	-	-	-
Other provisions and reserves	1.2	1.1	2.2	1.3	2.0
Other long-term liabilities	1.1	1.6	5.3	7.2	5.4
Equity	170.3	170.3	201.0	211.0	211.0
Reserves	38.2	44.7	40.1	45.3	44.6
Total liabilities & equity	215.2	275.1	326.0	386.2	451.8
Memo					
Guarantees and other contingent liabilities	-	-	-	-	-

Source: Issuer and Fitch calculations

Appendix B

Finlombarda S.p.A.

	2011	2012	2013	2014	2015
Ratios					
Performance					
Interest revenue on loans/loans (%)	1.6	2.32	3.83	3.95	3.93
Interest expense/borrowings and deposits (%)	0	0.19	1.17	1.36	0.76
Net interest income/earning assets (%)	1.64	2.36	2.85	4.32	3.57
Net operating income/net interest income and other oper. revenue (%)	29.1	32.93	12.34	14.92	23.35
Net operating income/equity and reserves (%)	2.64	3.77	1.58	1.44	2.35
Net operating income/total assets (%)	2.56	2.94	1.17	0.96	1.33
Credit					
Growth of total assets (%)	-	27.83	18.5	18.47	16.99
Growth of loans (%)	-	520	24.52	-0.41	-23.2
Impaired loans/total loans (%)	-	-	-	-	-
Reserves for impaired loans/impaired loans (%)	-	-	-	-	-
Loan impairment charges/loans (%)	-	-	-	-	-
Liquidity and funding					
Long term debt/total equity and reserves (%)	0.05	24.05	28.25	42.88	61.62
Liquid assets/total assets (%)	19.56	18.47	14.82	21.65	32.51
Total deposits and debt/total assets (%)	0.05	18.79	20.89	28.46	34.86
Liquid assets/short term deposits and borrowing (%)	-	-	-	-	-
Capitalization					
Equity and reserves/total assets (%)	96.89	78.15	73.96	66.36	56.57
Net profit/total equity and reserves (%)	1.58	2.56	0.83	1.79	1.13
Loans/equity and reserves (%)	6	36.05	40.02	37.5	28.87
Regulatory capital adequacy ratio (%)	-	-	-	-	-

n.a.: Not available
Source: Issuer and Fitch calculations

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.