FitchRatings

RATING ACTION COMMENTARY

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

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Fitch Ratings - Milan - 18 Nov 2022: Fitch Ratings has revised Finlombarda S.p.A.'s (FL) Outlook to Negative from Stable, while affirming its Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'BBB'. A full list of rating actions is detailed below.

The Negative Outlook reflects our view that sustained and higher-than-previously anticipated recourse to borrowing from market sources could lower FL's share of government-guaranteed debt below the 75% threshold for rating equalisation with the Region of Lombardy's. Fitch expects a growing role for FL amid rising 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 borrowings and monitors FL's adherence to regional guidelines.

Under national legislation, local and regional governments' companies are subject to bankruptcy. However, past 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 minimum profitability for the former. 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 exempted from EU state aid rules.

Our assessment considers also guarantees from Lombardy to facilitate borrowings from the European Investment Bank (EIB; AAA/Stable), which represents the predominant funding for FL.

Socio-Political Implications of Default: 'Moderate'

FL's activity is of limited size, given its dozen bond investors and the EIB as main bank lender. FL has around 3,000 borrowers and while FL's lending activity could ultimately be carried out by other intermediaries, the pandemic has increased the relevance of FL's credit services for local SMEs, making a replacement in a default less likely.

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 and Prestiti SpA (CDP; BBB/Stable) as the lender of last resort for Italian local and regional governments (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

FL's 'bb-' SCP, which is based on our Non-Bank Financial Institutions Rating Criteria, is constrained by its small nominal franchise and narrow business model. The SCP also reflects FL's non-profit-maximising business and is supported by low leverage (gross debt/tangible equity of 1.9x at end-2021) and below-average credit risk in its loan portfolio (impaired loans on average around 3% of gross loans).

Fitch expects lending to SMEs, regional companies and other entities to slow in 2023, after FL's material portfolio growth in the past two years (gross loan portfolio estimated at EUR500 million at end-2022). This is because FL is close to its internal leverage target. Asset quality should remain sound in the medium term despite the challenging macroeconomic environment, due to FL's exposure to generally financially sound corporates and SMEs in Lombardy.

Derivation Summary

Fitch classifies FL as a GRE of Lombardy under its GRE Criteria and believes that the region would provide extraordinary support to Finlombarda to avoid its default. Its IDRs move in tandem with Fitch's internal assessment of Lombardy due to a substantial share of government-guaranteed debt in the entity's total debt that allow for the rating equalisation to the sponsor's, while overriding the assessment of other GRE support factors that gives an overall support score of 35.

FL's overall support score of 35 by itself would result in a single-notch differential with our internal assessment of Lombardy, given its 'bb-' SCP which, at more than three notches away from our internal credit assessment of the region, currently is not a rating driver.

Short-Term Ratings

As per Fitch's criteria, FL's Short-Term IDR at 'F2' is in line with 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 nearly EUR600 million by 2024, largely assisted by Lombardy's guarantees. Drawdown on FL's EMTN programme (EUR500 million) and loans from other banks will be around EUR200 million at end-2022 and EUR160 million at end-2023. We expect the share of government-guaranteed debt to fall below 70% in 2022 and 2023 before recovering to 75% in 2024-2026.

Liquidity and Debt Structure

In Fitch's view, FL's equity will be around EUR250 million-EUR260 million, while its debt will rise to EUR550 million-EUR600 million in 2024 with most of its amortisation covered by cash liquid investments on average of around EUR200 million in 2023-2024. A bullet bond is due in 2025, which we expect to be pre-funded in 2024.

Issuer Profile

FL is Lombardy's development entity. It lends to SMEs primarily on the back of EIB lending and provides consultancy services to the region for the disbursement of EU funds to SMEs and payment of invoices from Lombardy's healthcare suppliers.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

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

Negative rating action could also stem from a decrease in the share of regional guaranteed debt below 75% on a sustained basis, unless it is offset by an upward revision of the overall support score triggered by a stronger incentive for Lombardy to provide support.

FL's SCP could be revised lower 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:

Its Outlook may be revised to Stable if the share of regional guaranteed debt would remain around 75% with limited volatility or following an upward revision of FL's SCP.

An upward revision of Fitch's internal credit assessment of Lombardy could lead to an upgrade of FL's ratings, if the share of guaranteed debt remains around 75% with limited volatility over the medium term.

A wider product offering and increased scale would be prerequisites for an upward revision of FL's SCP.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

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

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

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 Negative	Affirmed	BBB Rating Outlook Stable
	ST IDR	F2	Affirmed	F2

	LC LT IDR BBB Rating Outlook Negative Affirmed	BBB Rating Outlook Stable
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)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 01 Sep 2021) (including rating assumption sensitivity)

Non-Bank Financial Institutions Rating Criteria (pub. 31 Jan 2022) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Finlombarda S.p.A.	EU Issued, UK Endorsed

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