MOODY'S
INVESTORS SERVICE

Credit Opinion: Finlombarda SpA

Global Credit Research - 19 Feb 2014

Italy

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa2

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Key Indicators

Finlombarda SpA

	2008	2009	2010	2011	2012
Total assets (EUR million)	205	215	218	216	275
Managed funds (EUR million) [1]	972	1,102	1,131	1,194	1,373
Surplus (deficit) of the year / intermediation margin (%)	22.4	21.7	18.9	13.2	22.6
Gearing (%) [2]	0.0	0.0	0.0	0.0	24.0
Liabilities / total assets (%)	3.0	4.2	3.5	3.3	21.8
Current assets / current liabilities (x)	38.5	26.0	31.7	31.5	33.9
Return on equity (%) [3]	2.2	2.2	1.7	1.3	2.6

[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 stable), its unique shareholder, which exercises strong oversight of the company. Furthermore, the rating incorporates FL's strong capitalisation, its consistent and robust financial performances and prudent management approach. However, the rating also takes into account the increasing financial leverage and the risks associated with FL's corporate status and public-policy mandate. In particular, we note that FL's business plan entails a moderate increase in the company's risk exposure going forward.

On 18 February 2014, we changed the outlook on Finlombarda's rating to stable from negative. This action followed a similar action on the Baa1 rating of the Region of Lombardy, Finlombarda's sole shareholder, and reflects the close financial and operational linkages between the two.

Credit Strengths

Credit strengths for FL include:

- Close operational links with the region, as reflected in its ownership structure, public-policy mandate and strong governance mechanisms

- Robust financial performance and strong capitalisation

- Risk-averse management approach

Credit Challenges

Credit challenges for FL include:

- Rising debt burden over the next two years

- Expansion of funding contribution to small and medium size enterprises while containing risk exposure

Rating Outlook

The rating outlook is stable, in line with the outlook on the Region of Lombardy.

What Could Change the Rating - Up

An upgrade of the Region of Lombardy's rating would lead to an upgrade of Finlombarda's rating.

What Could Change the Rating - Down

A downgrade of the Region of Lombardy's rating would likely lead to a downgrade of Finlombarda's rating. In addition, a material shift in the risk profile of FL's core business activities might put downward pressure on the 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 mandate is to help promote the development of the regional economy -- either directly or through the management of regional/EU funds -- by providing financial support to SMEs and to entrepreneurial initiatives aimed at business innovation and development. As part of its core business, FL also provides consultancy services to the region. FL derives financial means from (1) active interests on its equity investments; and (2) commissions for consultancy services and management of EU/regional and its own funds. It is also authorised to access new borrowing, even for lending purposes.

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

Baseline Credit Assessment

FL's BCA of baa3 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 mechanisms reflect the strong operational links with the regional government. Lombardy exercises regular oversight of the company and appoints all of its the board members, 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 and related entities, including Finlombarda.

Its statute and regional legislation lay out the company's strategic role in promoting economic development initiatives in the regional territory through (1) the management of dedicated regional and EU funds; (2) lending activity, provision of guarantees and the acquisition of shares -- typically minority shares -- in local enterprises;

and (3) the promotion of public-private partnerships. FL also provides consultancy services to the region, including private finance initiatives (PFIs).

In 2013, Finlombarda merged with Cestec, a 100%-owned regional company, whose strategic mission was to promote competitiveness among SMEs located in Lombardy by fostering innovation-oriented and energy-saving entrepreneurial initiatives. Following the merge, FL has broadened its spectrum of activities, which now include smart energy and green economy projects, in line with the former strategic objectives originally set for Cestec.

Financial Performance

FL has traditionally reported robust financial results, reflecting Lombardy's strategic commitment to sustain the company's operations. Revenue streams have grown over time, albeit moderately, and were generated alongside a contained expenditure structure. The recent merge with Cestec will also lead to a more efficient expenditure structure, with a projected 8% reduction in functioning costs over the next two years.

Operating income is largely made (75%) of net commissions from consultancy services and management of funds, and of interest margin for the remainder. In the last few years, consultancy activities have become more important in generating operating income compared to commissions derived from the management of a large pool of regional funds. As of year-end 2012, FL managed EUR640 million in regional funds, as well as around EUR181 million in its own resources. FL's recurrent profits are re-invested and/or set aside in a fund for general risks, in line with the company's extremely prudent financial management and as it not oriented towards profit maximisation.

Net commissions from consultancy activities have been on an upward trend in the last five years, mainly driven (60%) by the project Erario Integrato Regionale (ERIR), which entails the management of certain regional taxes, including primarily the car registration tax. The second-largest area of consultancy activity is within the project Fondo Socio Sanitario, whereby FL acts as the payment agent to suppliers of Lombardy's healthcare system, with a total volume of payments of EUR15 billion between May 2007 and June 2012. Under this framework, FL's intermediation, combined with Lombardy's regular cash flows, successfully resulted in a reduction in days of sales outstanding to 60 days, a record low in Italy.

According to the company's business plan, FL projects an expansion in its consultancy activities leveraging its know-how and expertise as financial advisor to local governments in the regional territory. In particular, the company expects to get a further boost in revenues going forward primarily by (1) expanding the types of regional taxes under management, including collection activity; (2) acting as the main payment institution within the regional economic system; and (3) assisting healthcare units with the introduction of common accounting standards. On a longer-term horizon, the regional administration has recently discussed transitioning FL from a non-banking financial intermediary to public bank with the aim of providing financing to regional development and infrastructural projects. While this would represent a significant change in the company's mission and core activities - and subsequently in our assessment of FL's credit risk profile - we understand that this transition will take time to materialise.

FL displays a low risk profile associated with its ordinary operations and ancillary activities, as its participations in local businesses, credits and guarantees absorb a negligible proportion of the company's budget. We understand that FL's contribution to credit enhancement programmes will continue to expand going forward, following the launch in 2012 of the new project Credito Adesso to support net working capital needs of local enterprises in the manufacturing sector. This project benefits from a committed credit line from the European Investment Bank (EIB).

FL's large common capital, the good performance of its equity investments and little fixed costs enabled the company 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 date.

We do not see significant off-balance sheet financial risks.

Debt and Liquidity

At year-end 2012, FL's debt stock stood at EUR 51.7 million versus 2011 when the company was debt free. This new debt is the first tranche of the EUR 200 million credit line from the EIB and represents FL's contribution to the EUR 500 million on-lending programme Credito Adesso with other 43 banks. According to the company's forecasts, FL will entirely tap this credit facility by the end of 2014, which will prompt a material increase in its debt burden in just a two-year span. However, we do not expect this will substantially alter FL's credit profile in light of the company's commitment to (1) remain strongly capitalised; and (2) maintain a very low risk profile. FL loss on credits was close to zero as of 2012.

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 EUR181 million as at year-end 2012 was composed primarily of liquid or semi-liquid investments, including deposits in bank accounts (80%), and three-year to seven-year maturity bonds issued by large Italian banks (18%). Compared with the past few years, the company has increased the diversification of its pool of depository banks, which now comprise 21 financial institutions. The composition of its equity investments and the company's overall financial strategies reflect a very conservative and risk-averse management approach.

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 fulfill the statutory responsibilities. Senior management has consolidated experience in the banking sector, whilst the middle-management team brings significant experience in consultancy and finance industries. Notwithstanding FL's 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 October 2012 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.

Baseline Credit Assessment

Baseline credit assessments (BCAs) are opinions of entity's standalone intrinsic strength, absent any extraordinary support from a government. Contractual relationships and any expected ongoing annual subsidies from the government are incorporated in BCAs and, therefore, are considered intrinsic to an issuer's standalone financial strength.

BCAs are expressed on a lower-case alpha-numeric scale that corresponds to the alpha-numeric ratings of the global long-term rating scale.

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%).