Moody's Investors Service

Credit Opinion: Finlombarda SpA

Global Credit Research - 31 Aug 2009

Italy

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Aa2

Contacts

Analyst	Phone
Francesco Soldi/Milan	39.02.9148.1100
Massimo Visconti/Milan	
Yves Lemay/London	44.20.7772.5454

Key Indicators

Finlombarda SpA

	2005	2006	2007	2008	2009F
Total assets (EUR million)	60.7	196.6	203.2	205.5	206.4
Managed funds (EUR million)	338.1	363.7	416.0	659.5	-
Surplus (deficit) of the year / intermediation margin (%)	23.7	23.3	26.9	22.4	3.4
Gearing (%) [1]	0.0	0.1	0.0	0.1	0.2
Liabilities / total assets (%)	8.8	3.6	4.0	3.0	3.1
Current assets / current liabilities (x)	13.0	30.4	27.7	39.2	36.6
Return on equity (%) [2]	5.7	2.1	2.9	2.2	0.3

[1] Financial liabilities / equity (%). [2] Surplus (deficit) for the year / equity (%).

Opinion

SUMMARY RATING RATIONALE

The Aa2 issuer ratings of Finlombarda SpA (FL) reflect its close operational link with the Italian Region of Lombardy - its unique shareholder - its robust financial fundamentals and prudent management, but also FL's corporate status and the dependence of its activities on their strategic role for Lombardy. The company is currently debt-free and strongly capitalised. The rating also takes into account the prospects for a moderate increase in the company's risk exposure due to the expansion of its activities, although these increases are expected to be gradual and prudently managed, within a stable institutional framework.

As a reflection of the application of Moody's Joint Default Analysis methodology for Government-Related Issuers, FL's rating is composed of two principal inputs: a baseline credit assessment (BCA) of 4 (on a scale of 1 to 21, where 1 represents the lowest credit risk); and a high likelihood of support from the Region of Lombardy (Aa1 stable outlook) to prevent a default in case of need. The high likelihood of support primarily reflects FL's institutional framework, which regulates its arm's-length nature and integration into the regional administration. FL performs its publicly-led mission under a mandate from and the direction of the regional government.

Credit Strengths

Credit strengths for FL include:

- Close operational integration into the regional government's institutions, as reflected in its ownership structure, public-policy mandate and governance

- Robust financial fundamentals, associated with a low risk exposure due to the nature of its activities

- The company is currently debt-free and strongly capitalised

- Prudent management approach, including risk-averse liquidity management

Credit Challenges

Credit challenges for FL include:

- The business plan entails an increase of the company's risk exposure

- Risks associated with its corporate status and its arm's-length nature, albeit mitigated by the region's interest in the company's operations

Rating Outlook

The rating outlook is stable.

What Could Change the Rating - Up

Although unlikely, an upgrade in the Region of Lombardy's rating may prompt an upgrade of FL's rating.

What Could Change the Rating - Down

FL's rating is sensitive to future movements in Lombardy's credit quality, and its government ownership, role and support constitute fundamental rating drivers. Although unlikely, a deterioration of the company's role to and operational integration with the region may negatively affect its credit quality, as could deteriorating financial fundamentals and higher than expected increase in its risks exposure.

Issuer Profile

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

DETAILED RATING CONSIDERATIONS

Institutional Framework

Established in 1971 as a joint-stock company outside the regional budget, FL's ownership structure, public-policy mandate and governance clearly point to a strong operational link with the regional government. FL provides in-house services exclusively for the Region of Lombardy and the region's interest in the company's operations is reflected in its regular oversight, although FL neither receives operating subsidies from the region nor enjoys special legal status. As a registered financial intermediary, pursuant to Art.107 of the Italian Banking Act, FL is subject to Bank of Italy's supervision and reporting requirements.

Its statute and the regional legislation define the company's strategic role in promoting economic development initiatives in the regional territory through: (i) acquisition of shares - typically minority shares - in local enterprises, lending activity and provision of guarantees; (ii) promotion of public-private partnerships; and (iii) management of dedicated regional and EU funds. FL also provides consultancy services to the region for specific initiatives, including 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; the firm is also authorised to access new borrowing, even for lending purposes.

Financial Position and Performance

Although FL is not oriented towards profit maximisation, it enjoys robust financial fundamentals and reports consistently positive results. Furthermore, 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.

FL's financials primarily benefited from the region's financial and strategic commitment. The operating income (represented by the intermediation margin) benefited from the substantial increase in equity, after the two capital injections from Lombardy in 2005-06, and the growth in the pool of regional resources managed off-balance sheet. As of June 2009, FL managed about EUR185 million in its own resources - mostly comprising equity - and EUR636 million in regional funds. FL's operating income has also benefited from consultancy service commissions. As a reflection of its strategic role to the region, FL's consultancy activities have recently expanded to include core regional responsibilities, such as healthcare and the management of regional taxes. In the context of a lean expenditure structure, growing revenue stream allowed the company to record buoyant operating surpluses, averaging 24% of its operating income in 2005-08. In the past ten years, profits have always been re-invested and/or set aside into a risk fund. Going forward, Moody's expects FL's financial fundamentals and performance to remain sound, supported by the projected stability in the pool of managed funds and the company's equity investments.

We do not highlight significant risks arising from ordinary operations and the participation in local businesses, credits and guarantees absorb a negligible proportion of the company's budget. Through its majority-owned investment management company, Finlombarda Gestioni SGR SpA, FL promotes private-equity and venture-capital investments in the region and Mediterranean basin. In the past three years, Finlombarda Gestioni generated modest surpluses, which have been re-invested or earmarked to cover losses recorded in its start-up phase.

Debt Profile and Liquidity

The company is currently debt-free and strongly capitalised. The firm's liquidity management is conservative and risk-averse. To date, the company has adequately addressed key risks, including market, liquidity and operational risks and recorded only modest losses from its liquidity investments over the course of 2008. FL's portfolio is composed primarily of liquid or semi-liquid investments; FL's own resources are mostly deposited in bank accounts (60%) and floating-rate bonds issued by large Italian banks (21%), with the remainder invested in funds (14%) and other low-risk financial instruments (5%). Compared to 2007, the company increased diversification of depository banks' family.

FL's equity has represented a source of untapped reserves for the company to actively manage to date. Going forward, FL plans to use its capital to promote development projects sponsored by the region. The implementation of the biggest project in the pipeline - Made in Lombardy - will entail the use of a large proportion of the company's own resources (EUR100 million), essentially bank account deposits, for lending purposes. However, Moody's does not expect that the higher exposure to credit risk will translate into a material deterioration of FL's risk profile, also in view of the regional guarantee. The company may eventually activate financial leverage in a limited measure to cofinance specific projects in the future. However, 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 Factors

FL's management structure and governance clearly point to a high degree of operational integration with the regional government, which is also evidenced by the regular oversight and coordination between the company's executives and the region's policymakers. Prudent operating and financial strategies have been accompanied by a culture of transparency and accountability. In Moody's view, continued prudent financial and risk management, combined with ongoing support from the regional government, will be core to supporting FL's sound financial fundamentals.

Extraordinary Support Considerations

High support primarily reflects FL's institutional framework, which regulates its arm's-length nature and integration into the regional administration. FL performs its publicly-led mission under a mandate from and the direction of the regional government. High default dependence between FL and the regional government primarily reflects 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 assigns national scale ratings in certain local capital markets in which investors have found the global rating scale provides inadequate differentiation among credits or is inconsistent with a rating scale already in common use in the country. Moody's National Scale Ratings are opinions of the relative creditworthiness of issuers and issues within a particular country. While loss expectation will be an important differentiating factor in the ultimate rating assignment, it should be noted that loss expectation associated with National Scale Ratings can be expected to be significantly higher than apparently similar rating levels on Moody's global scale. Moody's National Scale Ratings rank issuers and issues in order of relative creditworthiness: higher ratings are associated with lower expected credit loss.

National Scale Ratings can be understood as a relative ranking of creditworthiness (including relevant external support) within a particular country. National Scale Ratings are not designed to be compared among countries; rather, they address relative credit risk within a given country. Use of National Scale Ratings by investors is only appropriate within that portion of a portfolio that is exposed to a given country's local market, taking into consideration the various risks implied by that country's foreign and local currency ratings. The Moody's Global Scale rating for issuers and issues in local currency 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, for foreign-currency denominated securities benefiting from special characteristics that 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%), medium (31% - 70%) or high (71% - 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, the close economic links and/or close intergovernmental fiscal arrangements between a GRI and its associated government result in a medium to high degree of default dependence.

Default dependence is described as either low (0% - 30%), medium (31% - 70%) or high (71% - 100%).

Moody's Investors Service

Director and Shareholder Affiliation Policy."