



RATING ACTION COMMENTARY

Fitch Affirms Finlombarda at 'BBB-'; Outlook Stable

Fri 26 Nov, 2021 - 11:25 AM ET

Fitch Ratings - Milan - 26 Nov 2021: Fitch Ratings has affirmed Finlombarda S.p.A.'s (FL) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'BBB-' with Stable Outlooks and Short-Term Foreign-Currency IDR at 'F3'. Fitch has also affirmed Finlombarda's senior unsecured debt at 'BBB-'.

The affirmation reflects Fitch's view that the share of FL's debt guaranteed by the region of Lombardy will remain around 75% over the medium term, which triggers the rating equalisation, overriding the assessment of government-related entity (GRE) support factors. Fitch expects a growing role for FL in the aftermath of the pandemic, with stronger demand for loans and other financial services at favourable concessionary terms, in order to continue supporting small and medium industrial enterprises (SMEs) in the region of Lombardy.

KEY RATING DRIVERS

Status, Ownership and Control: 'Very Strong'

Fitch believes this rating factor very strongly supports the likelihood of the region of Lombardy taking over FL's liabilities if necessary to prevent its default, as it carries out near-governmental functions. FL's limited-liability nature exclude the automatic transfers of liabilities to the region in case of default, but Fitch would expect FL's liabilities to be transferred to Lombardy due to their proximity.

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; and through recurring checks monitors FL's adherence with regional guidelines.

The national legislation on local and regional governments' companies subjects in-house providers to bankruptcy. However, past cases of liquidation, such as ASAM (WD), suggest there would be an orderly transfer of liabilities and assets to the region in case of FL's default. The same legislation includes early-warning indicators of deteriorating credit quality, such as abnormal growth of non-performing loans, to prompt government support.

Support Track Record: 'Very Strong'

Fitch views the support record of the public sector and expectations of support as 'Very Strong', contributing to the alignment of FL's rating with our internal assessment of the region of Lombardy.

The assessment reflects ongoing fee revenue from Lombardy, which is calibrated to ensure minimum profitability for FL. Financial viability is encouraged by requirements and controls from the regulator - Bank of Italy - to which Finlombarda is subject as a financial intermediary.

There is also a record of support in the form of equity increases in 2013-2014 and we believe there would be additional ones to support FL's balance-sheet expansion, if needed. National legislation tends to allow for equity injections for loss-making GREs when part of a recovery plan and Fitch believes in-house providers may have further leeway if they carry out near-governmental functions, as EU state aid rules may not apply.

Our assessment of the strength of linkage with the region considers also the guarantees from Lombardy in order to allow FL to borrow from the European Investment Bank (EIB; AAA/Stable). Loans with the EIB have represented at least 70% of FL's loans and bonds, averaging 77% over the past five years.

Socio-Political Implications of Default: 'Moderate'

Fitch views that socio-political implications of FL's default moderately contribute to the alignment of its rating with the internal assessment of the region of Lombardy.

FL's activity is of limited size considering around a dozen bond investors, the EIB as a main bank lender, and around 3,000 borrowers. Fitch considers that FL's lending activity could

ultimately be carried out by other intermediaries, but the pandemic makes FL's replacement in case of its default less likely, given the increased relevance of FL's credit services to channel resources and support local SMEs.

Financial Implications of Default: 'Strong'

Fitch assesses this factor as strongly contributing to the alignment of FL's IDR with our internal assessment of Lombardy. The assessment weights the perception of FL as a quasi-proxy funding agency against Fitch's expectations that FL's default would have a limited impact on Lombardy's borrowing capacity, as the region could borrow from Cassa Depositi and Prestiti (CDP; BBB-/Stable), the lender of last resort for Italian local and regional governments, regardless of FL's default.

Fitch deems extraordinary support of up EUR0.5 billion (FL's expected debt in the medium term) to help FL overcome unforeseeable dislocations on the financial markets and remain current on its debt repayments would not represent a major burden for Lombardy's government. This could easily be channelled via advances on future grants or equity injections to avoid acceleration of the repayment of FL's entire outstanding debt, triggered by guarantees on EIB loans and cross-default clauses on loans and listed bonds.

Standalone Credit Profile

Fitch has assessed FL's Standalone Credit Profile (SCP) at 'bb-' on the basis of its Non-Bank Financial Institutions Rating Criteria. FL's SCP is constrained by its nominal franchise and narrow business model. The SCP also reflects FL's non-profit-maximising business, owing to its policy mandate to support regional SMEs by co-lending with other banks and disbursing EIB funds. The SCP is supported by low leverage (0.6x at end-2020) and the lower-risk lending portfolio (impaired loans around 3% of gross loans). We already factor in a planned increase in leverage (debt/equity) close to but below 2x.

FL significantly broadened its lending operations following the management change in 2019. It increased the product offer with corporate finance solutions (e.g. basket bond, leveraged & acquisition, pool financing, turnaround financing) and strengthened its internal resources with extra staff in the underwriting and monitoring functions. Fitch expects the increased lending to SMEs, regional companies and other entities to reach EUR500 million by 2023 from nearly EUR300 million in 2020. Asset quality should remain sound in the medium term, due to FL's exposure to generally financially sound corporates and SMEs in Lombardy.

Fitch considers the guarantee on EIB loans as peculiar to the developmental functions and enabling funding at concessionary terms that would otherwise unlikely be available on the market.

Derivation Summary

FL is a GRE whose ratings reflect links to the Region of Lombardy and expectations of the latter providing extraordinary support to prevent its default. The equalisation of the IDR with Fitch's internal assessment of Lombardy stems from the latter's guarantee of around 80% of FL's liabilities over the past five years, with expectations that this will average 75% over the medium term. This factor overrides the valuation of the GRE support factors.

FL's overall support score of 35 and its 'bb-' SCP, not more than three notches away from our internal credit assessment of Lombardy, also result in a rating equalisation with the region's internal assessment, while FL's SCP represents a rating driver.

Short-Term Ratings

As per Fitch's criteria, FL's 'F3' short-term rating stems from its Long-Term IDR.

National Ratings

N/A

Debt Ratings

Fitch rates FL's senior unsecured debt (EUR500 million EMTN programme and EUR50 million 1.53% bond 22 September 2022) at 'BBB-'.

KEY ASSUMPTIONS

Debt will continue to be largely assisted by Lombardy's guarantees. Fitch assumes that draw-down on FL's EMTN programme over the medium term will be double the outstanding EUR50 million due for repayment in September 2022. This will still be well below the EUR500 million of allowed draw-down under the EMTN programme, which FL recently updated and increased to EUR500 million from EUR200 million.

Liquidity and Debt Structure

Fitch expects FL to develop its intermediary activity, leading to balance sheet growth of around 75%, reaching about EUR750 million by 2023, driven by loans and bond investment in SMEs. "Credito adesso evolution" is the main loan scheme. This is syndicated to SMEs in

cooperation with banks (50%) while its 50% share is backed by EIB funding and Lombardy subsidises the interest rate.

In Fitch's view, equity will hover around EUR250 million, and business growth will be funded by recourse to market and EIB loans at concessionary rates assisted by the regional guarantee. Debt will be around EUR500 million by 2023 and debt repayments will be largely covered by liquidity and liquid investments of at least EUR100 million until 2023.

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% together with a weakening of FL's SCP to more than three notches away from our internal credit assessment of Lombardy, while the overall support score remained unchanged at 35.

Downward revision of Finlombarda's SCP could stem from inability to grow its corporate and SME lending franchise in Lombardy or from materially higher impaired loans ratio and leverage.

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 the share of guaranteed debt would still around 75%.

A wider product offering and increased scale would be prerequisites for any 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 Stable	BBB- Rating Outlook Stable
	Affirmed		
	ST IDR	F3 Affirmed	F3

LC LT IDR	BBB- Rating Outlook Stable	BBB- Rating Outlook Stable
Affirmed		

senior unsecured

LT	BBB-	Affirmed
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BBB-

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APPLICABLE CRITERIA

[Non-Bank Financial Institutions Rating Criteria \(pub. 28 Feb 2020\) \(including rating assumption sensitivity\)](#)

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

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Finlombarda S.p.A.

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