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## MedioCredito Centrale SpA

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# MedioCredito Centrale SpA

<b>SACP</b>	<b>bb</b>		+	<b>Support</b>	<b>+2</b>	+	<b>Additional Factors</b>	<b>0</b>
<b>Anchor</b>	<b>bbb-</b>			<b>ALAC Support</b>	<b>0</b>		<b>Issuer Credit Rating</b>  <b>BBB-/Negative/A-3</b>	
<b>Business Position</b>	Moderate	-1		<b>GRE Support</b>	<b>+2</b>			
<b>Capital and Earnings</b>	Strong	+1		<b>Group Support</b>	<b>0</b>			
<b>Risk Position</b>	Moderate	-1		<b>Sovereign Support</b>	<b>0</b>			
<b>Funding</b>	Below Average	-1						
<b>Liquidity</b>	Adequate							

## Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> <li>• Support from the Italian government</li> <li>• Strong capitalization</li> <li>• Sole manager of the public fund to support small and midsize enterprises (SMEs)</li> </ul>	<ul style="list-style-type: none"> <li>• Contained franchise compared with that of domestic banks</li> <li>• Reliance on relatively unstable sources of funding</li> <li>• Highly concentrated portfolio</li> </ul>

## Outlook: Negative

S&P Global Ratings' negative outlook on MedioCredito Centrale's (MCC) reflects that on the Italian sovereign, MCC's main shareholder, and our view that the potential acquisition of Banca Popolare di Bari could have negative repercussions for MCC's stand-alone creditworthiness.

We could lower the ratings on MCC by one or two notches over the next 12 months if the acquisition of Banca Popolare di Bari eventually materializes and we concluded that integration was likely to erode the bank's capitalization or that the bank's risk profile had deteriorated. Furthermore, if we were to lower the rating on the Italian sovereign, we would take a similar action on MCC.

Alternatively, we could revise our outlook on MCC to stable following a similar action on Italy, providing that the uncertainties about the execution of the potential Banca Popolare di Bari acquisition had abated.

## Rationale

The ratings on MCC remain underpinned by the company's strict interconnection with the Italian government, and, consequently, by our view that the latter would intervene to provide MCC with a certain extent of extraordinary support if needed. This is reflected in the issuer credit rating by a two-notch uplift from MCC's stand-alone credit profile (SACP).

The government's announcement as of December 2019 that it intends to inject up to €900 million into MCC to strengthen the bank's mission to support Italian enterprises, confirms our view of the connection between the two issuers. Although this capital injection represents a massive enhancement compared with MCC's current equity base of €270 million, we understand MCC may use the funds to participate in troubled institution Banca Popolare di Bari (not rated). Therefore, we will have to assess whether it would be sufficient to cushion the possible negative effect of integration on MCC's financial profile.

In our view, it is too early to determine how the announcement will affect MCC's creditworthiness. Therefore, our rating reflects our expectation that MCC's capitalization will remain stronger than that of most Italian commercial banks, with its projected S&P Global Ratings adjusted risk-adjusted capital (RAC) ratio likely to remain above 10% by year-end 2021.

The rating also reflects our view that MCC's direct lending business remains uncertain, representing a risk for revenue stability. Compared with traditional commercial banks, we anticipate MCC will continue to depend more on less sticky funding sources. In particular, customer deposits represented about 50% of the funding base as of June 2019, compared with over 90% for most Italian banks.

### **Anchor: 'bbb-' for banks operating in Italy.**

Our bank criteria uses our Banking Industry Country Risk Analysis (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating (ICR). Our anchor for a bank operating in Italy is 'bbb-'.

We believe Italian banks continue to face higher economic risk than most peers, despite the improvement made in the past three years. The overall gross stock of nonperforming exposures (NPEs) fell to €165 billion as of June 2019, or about 11% of customer loans, compared with €340 billion in 2015, mainly thanks to disposals. We expect the NPEs will fall below 10% of customer loans by 2020. While this represents material progress, the large legacy stock would represent a tail-risk if the Italian economy were to further deteriorate. Moreover, the substantial amount of time needed for creditors in Italy to recover collateral and settle lawsuits--due to the less effective insolvency and foreclosure procedures and judicial system--is likely to remain an obstacle to a more material reduction of the stock than we envisage.

Industry risks for Italian banks are also higher than for banks in peer countries, in our opinion. Many banks' access to wholesale funding market is likely to remain exposed to period of volatility amid uncertainties about the sovereign policy and economic prospects. We acknowledge that the abundant liquidity provided to Italian banks by the European Central Bank (ECB) over the years, and the banking sector's very low external position--just 5% excluding

ECB funding—have so far largely cushioned the effect of period of constrained or more expensive access to capital markets. Structural problems, such as high cost bases and fragmentation, paired with still-very-low interest rates, will continue to constrain the banks' profitability, in our opinion.

Supportive factors for the Italian banking system are Italy's traditional focus on retail and commercial lending, and our view that its regulatory standards are aligned with international best practices mainly thanks to the ECB directly supervising more than 80% of the banking sector.

**Table 1**

<b>MedioCredito Centrale SpA--Key Figures</b>					
	<b>--Year ended Dec. 31--</b>				
<b>(Mil. €)</b>	<b>2019*</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
Adjusted assets	2,454.0	2,348.5	2,608.5	2,724.1	2,552.8
Customer loans (gross)	1,562.0	1,519.8	1,659.6	1,770.2	1,584.2
Adjusted common equity	276.3	268.5	257.2	398.0	397.7
Operating revenues	41.1	89.4	96.3	96.3	101.9
Noninterest expenses	22.0	40.5	45.4	45.4	45.2
Core earnings	8.6	18.5	26.8	28.6	33.2

\*Data as of June 30.

### **Business position: Small public bank, with focus on Southern Italian economies**

We think that MCC will continue to direct its activities to promoting investments in economically depressed Southern Italy in 2020-2021, in line with its mission and business plan. Our expectations reflect the strict interconnection we see with the government, as well as the strong strategic alignment with its owner, Invitalia.

We believe that MCC, to pursue the group's strategic objectives, will continue focusing on the promotion of lending-facilitating tools--chiefly, the public "Fondo di Garanzia". The total number of requests from January-August 2019 reached about 90,000, compared with 60,000 over the 12 months ended December 2011. We expect this number to continue rising, supporting the bank's operating revenues. As of June 2019, fees stemming from this activity were €27 million.

In parallel with the management of these funds, the bank will continue to exercise its direct lending business. We note the gradual rebalancing toward a prevailing proportion of loans to SMEs based in the south, therefore favoring increased portfolio granularity. We understand that 55% of customer loans were toward corporations based in these areas as of June 2019. Nevertheless, we expect the bank's gross customer loans portfolio dynamics to be driven by the progressive run-off of its retail portfolio.

**Table 2**

<b>MedioCredito Centrale SpA--Business Position</b>					
	<b>--Year ended Dec. 31--</b>				
<b>(%)</b>	<b>2019*</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
Loan market share in country of domicile	0.1	0.1	0.1	0.1	0.1
Total revenues from business line (currency in millions)	41.1	91.4	96.3	97.2	101.9
Commercial banking/total revenues from business line	100.0	100.0	100.0	100.0	100.0

**Table 2**

MedioCredito Centrale SpA--Business Position (cont.)					
(%)	--Year ended Dec. 31--				
	2019*	2018	2017	2016	2015
Commercial and retail banking/total revenues from business line	100.0	100.0	100.0	100.0	100.0
Return on average common equity	5.7	7.8	6.0	6.9	7.6

\*Data as of June 30.

### Capital and earnings: Robust capitalization, backed by positive internal capital generation

We anticipate that MCC's capitalization will remain strong in 2020-2021. Specifically, without factoring in the impact of potential acquisition of Banca Popolare di Bari, we predict that MCC's RAC ratio will range from 13.5%-14.0% at year-end 2021, compared to 11.6% as of December 2018, supported by a sound capital generation capacity. In particular, we expect MCC to generate €60 million-€65 million cumulative profit over 2019-2021, and we do not envisage any dividend payment to Invitalia until 2021.

We forecast MCC's revenues will range from €80 million-€85 million per year from 2019-2021, sustained by the proceeds mainly coming from the management of the Fondo di Garanzia and other lending-facilitating tools. We anticipate that this low-capital-absorbing business will continue to materially contribute to revenue stability, generating approximately 50% of the revenue base. Furthermore, we believe that the bank will continue to benefit from a lighter-than-system-average cost base, reporting a stable cost-to-income ratio of about 50%, compared with 65% at the system level. This stems from the absence of a network of branches. Finally, we believe credit losses will continue to constrain MCC's profitability, with average cost-of-risk of 95-100 basis points (bps) between 2020 and 2021, slightly higher than the Italian system average for the same period (80 bps).

**Table 3**

MedioCredito Centrale SpA--Capital And Earnings					
(%)	--Year ended Dec. 31--				
	2019*	2018	2017	2016	2015
Tier 1 capital ratio	22.2	19.6	16.2	25.4	28.4
S&P Global Ratings' RAC ratio before diversification	N/A	11.6	N/A	13.2	N/A
S&P Global Ratings' RAC ratio after diversification	N/A	8.7	N/A	9.8	N/A
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	32.6	35.7	38.8	43.3	46.8
Fee income/operating revenues	65.8	62.8	53.8	51.5	43.2
Market-sensitive income/operating revenues	0.0	1.0	5.4	4.5	9.3
Noninterest expenses/operating revenues	53.6	45.3	47.2	47.1	44.3
Provision operating income/average assets	1.6	2.0	1.9	1.9	2.3
Core earnings/average managed assets	0.7	0.7	1.0	1.1	1.4

\*Data as of June 30. N/A--Not applicable.

Table 4

MedioCredito Centrale SpA--Risk-Adjusted Capital Framework Data					
(Mil. €)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
<b>Credit risk</b>					
Government and central banks	839.9	0.4	0.1	333.0	39.6
Of which regional governments and local authorities	2.1	0.4	20.0	1.0	47.6
Institutions and CCPs	92.8	24.1	25.9	44.1	47.5
Corporate	893.6	799.1	89.4	1,187.0	132.8
Retail	387.9	136.9	35.3	233.1	60.1
Of which mortgage	385.0	134.7	35.0	229.6	59.6
Securitization§	0.0	0.0	0.0	0.0	0.0
Other assets†	79.6	70.2	88.2	155.6	195.5
Total credit risk	2,293.8	1,030.7	44.9	1,952.8	85.1
<b>Credit valuation adjustment</b>					
Total credit valuation adjustment	--	5.4	--	0.0	--
<b>Market risk</b>					
Equity in the banking book	20.2	20.2	100.0	176.1	871.3
Trading book market risk	--	0.0	--	0.0	--
Total market risk	--	20.2	--	176.1	--
<b>Operational risk</b>					
Total operational risk	--	172.3	--	180.6	--
	<b>Exposure</b>	<b>Basel III RWA</b>	<b>Average Basel II RW (%)</b>	<b>S&amp;P Global Ratings RWA</b>	<b>% of S&amp;P Global Ratings RWA</b>
<b>Diversification adjustments</b>					
RWA before diversification	--	1,228.7	--	2,309.5	100.0
Total Diversification/ Concentration Adjustments	--	--	--	763.7	33.1
RWA after diversification	--	1,228.7	--	3,073.2	133.1
		<b>Tier 1 capital</b>	<b>Tier 1 ratio (%)</b>	<b>Total adjusted capital</b>	<b>S&amp;P Global Ratings RAC ratio (%)</b>
<b>Capital ratio</b>					
Capital ratio before adjustments		242.9	19.8	268.5	11.6
Capital ratio after adjustments‡		242.9	19.6	268.5	8.7

\*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions.

‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of 'Dec. 31 2018', S&P Global Ratings.

### Risk position: Highly sensitive to single-name defaults

We see MCC's comparatively low NPE ratio--standing at 9.0% versus 11.0% at the system level in June 2019--as potentially underestimating the real risk embedded in the bank's relatively unseasoned portfolio. This is reflected in the relatively quick asset quality deterioration experienced by the bank, which saw its NPE ratio increase materially in just

a few years (0.94% at end-2013).

In addition, with the top-20 performing exposures estimated at about 1.2x MCC's total adjusted capital (TAC) as of June 2019, the bank's single-name concentration will remain one of the major risks in terms of asset quality, in our view. This is because it might expose the bank to potentially significant inflows of nonperforming assets (NPEs) and credit losses. Although we expect the bank to progressively increase the granularity of its customer loans portfolio by lending to SMEs based in Italy's south, we believe that this process will take some time.

**Table 5**

MedioCredito Centrale SpA--Risk Position					
	--Year ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Growth in customer loans	5.5	(8.4)	(6.2)	11.7	15.9
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	33.1	N/A	35.3	N/A
Total managed assets/adjusted common equity (x)	8.9	8.8	10.2	6.8	6.4
New loan loss provisions/average customer loans	1.0	1.7	1.0	0.8	0.8
Gross nonperforming assets/customer loans + other real estate owned	9.0	8.9	7.9	4.5	2.7
Loan loss reserves/gross nonperforming assets	67.9	65.7	49.2	58.1	77.8

\*Data as of June 30. N/A--Not applicable.

### **Funding and liquidity: Potential risk stemming from reliance on unstable funding sources**

We see MCC as constrained by its reliance on sources of funding with relatively short maturities, especially in a context where Italian banks at times face constraints on their access to capital markets, due to uncertainties regarding the sovereign, government policy, and economic prospects. This could lead to an increased cost-of-financing and a maturity mismatch between the bank's funding mix and its customer loans portfolio, with an average maturity of more than four years.

We estimate that the weight of short-term interbank funding on the overall funding mix as of June 2019 was approximately 25%. The remaining part of the bank's funding structure is based on other sources of nonstable funding, including corporate deposits. Our stable funding ratio was about 95% as of June 2019, slightly below the average value reported by domestic banks (above 100%).

We positively consider the recent issuance of a €300-million senior unsecured social bond (due October 2024). In our view, it signals the management willingness to extend the average maturity of the funding sources, besides providing further diversification.

However, we believe that the bank's liquidity still adequately covers its short-term wholesale funding. Our ratio of broad liquid assets/short-term wholesale funding--excluding TLTRO II--was about 1x as of June 2019. In addition, we believe that Invitalia will remain supportive and provide its subsidiary with medium term financing if needed.

**Table 6**

MedioCredito Centrale SpA--Funding And Liquidity					
	--Year ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Core deposits/funding base	53.5	40.1	27.2	27.8	19.5
Customer loans (net)/customer deposits	133.0	179.7	282.8	284.7	395.8
Long-term funding ratio	62.3	59.2	57.1	54.0	49.5
Stable funding ratio	95.6	90.7	81.0	79.5	75.9
Short-term wholesale funding/funding base	42.7	46.2	48.1	54.9	61.2
Broad liquid assets/short-term wholesale funding (x)	1.0	0.9	0.9	0.7	0.7
Net broad liquid assets/short-term customer deposits	(4.3)	(20.5)	(24.6)	(183.2)	(428.3)
Short-term wholesale funding/total wholesale funding	91.9	77.1	66.1	76.0	76.1
Narrow liquid assets/3-month wholesale funding (x)	2.5	1.5	N/A	4,150.2	4,201.9

\*Data as of June 30. N/A--Not applicable.

### High likelihood of extraordinary government support

In accordance with our criteria for government-related entities, we base our view of a high likelihood of extraordinary government support on MCC's:

- Important role for the government. MCC is a profit-seeking bank whose activity--supporting southern Italy's economic recovery--fits well with its owner's public mandate; and
- Very strong link with the Italian government. The government now fully owns MCC through Invitalia.

Furthermore, we do not envisage any privatization of bank in the medium term. As a result, we believe that the Italian government will exercise stable control on the bank's business plan through Invitalia. Finally, we believe that a failure of MCC could directly damage the government's reputation.

### Additional rating factors: None

No additional factors affect the ratings.

## Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009



## Related Research

- MedioCredito Centrale Affirmed On Uncertainties Regarding Capital Injection For Banca Popolare di Bari; Outlook Negative, Dec. 20, 2019
- Banking Industry Country Risk Assessment: Italy; Dec. 19, 2019

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

## Ratings Detail (As Of February 4, 2020)\*

### MedioCredito Centrale SpA

Issuer Credit Rating BBB-/Negative/A-3  
 Senior Unsecured BBB-

### Issuer Credit Ratings History

30-Oct-2018 BBB-/Negative/A-3  
 31-Oct-2017 BBB-/Stable/A-3  
 15-Feb-2017 BB/Watch Dev/B  
 30-Jul-2015 BB/Negative/B

### Sovereign Rating

Italy BBB/Negative/A-2

### Related Entities

#### Poste Italiane Group

Issuer Credit Rating BBB/Negative/A-2  
 Senior Unsecured BBB  
 Short-Term Debt A-2

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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