Cassa Depositi e Prestiti S.p.A. (CDP) Issuer Rating Report

A- STABLE OUTLOOK

Scope Ratings has assigned an Issuer Rating of A- and senior unsecured debt ratings of A-, to Cassa Depositi e Prestiti S.p.A. (CDP), all with Stable Outlook.

For the full list of ratings see the **Ratings** section at the end of this report.

Highlights

The ratings reflect CDP's unique business model as the Italian National Promotional Institution (NPI) and its strong fundamentals, which are notable compared to other financial institutions in the country.

The ratings also reflect the very strong implicit and explicit links with the Italian sovereign in terms of assets and liabilities. Reflecting its mission as the Italian National Promotional Institution, CDP's exposure to Italian public finance (governmental and local) is material.

The implicit expected support from the Italian state is embedded in the analysis of CDP's business model, rather than through a separate assignment of support notches.

Rating drivers (summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:
1. A unique business model with inherently low risk
2. Strong financial fundamentals, largely reflecting CDP's business model
3. A majority of assets ultimately reflect Italian sovereign risk
4. The Italian government explicitly or implicitly guarantees CDP's liabilities
5. High-quality equity stakes portfolio provides a reliable flow of dividends

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Bloomberg: SCOP

Rating-change drivers

A material change in the Republic of Italy's credit fundamentals. We currently rate Italy at A- with Stable Outlook. The rating reflects Italy's large and diversified economy, relatively strong budgetary position, and well-progressing structural reforms. Italy also benefits from a favourable debt structure and a sustainable pension system. However, these strengths are balanced by significant challenges such as high public debt, growth below potential, residual fragilities in the banking sector and political uncertainties.

A change in our assessment of Italy's credit standing would likely affect CDP's ratings.

A material decrease in the level of expected support from the Republic of Italy coupled with a shift in balance sheet towards riskier activities. The issuer rating benefits from the high likelihood of governmental support, including on CDP's non-guaranteed liabilities. Evidence that such support may not be forthcoming would negatively affect the rating. This would especially be the case should CDP's activities contextually move away from its historical, low-risk profile and into riskier segments.

Rating drivers (details)

A unique business model with inherently low risk

CDP SpA is Italy's NPI, with the mission to support and promote Italy's economic development.

While its historical role had focused on channeling postal savings towards public infrastructure as well as Italian government and public administration finances, more recently CDP's scope of activities has broadened.

The 2016-2020 business plan includes investments in four main areas: public sector and infrastructure, corporates, export finance and real estate. CDP SpA is also the parent company of the CDP group.

CDP maintains a separate system of organisational accounting for activities of general interest (the separate account), which can be funded by postal savings, and residual activities (the ordinary account), which cannot be funded by postal savings. At the end of 2016, the separate account was EUR 348bn out of EUR 358bn in total assets.

CDP is owned and controlled by the Italian Ministry of Economy and Finance (83%); banking foundations (16%) are minority partners.

Due to its mission, and the patience of its shareholders, CDP can take a long-term approach to its investments, often filling a void left by market actors with a narrower focus on short-term profitability. Postal savings are a stable and inexpensive source of funding, providing CDP with a key competitive advantage in its markets.

On the other hand, CDP's governance structure protects it from excessive political interference. CDP can only invest in projects deemed economically and financially sustainable and therefore cannot bail out unviable businesses.

While CDP's own statute and reinforced governance rights for the banking foundations are important for managing the potential conflicts of interest with the Italian government, we believe the main protection against state interference is CDP's classification as a market unit for Eurostat purposes: as long as its products and services are offered at market conditions, CDP's is not considered part of the government sector and its debt is not consolidated into Italian government debt, leaving public-debt statistics unaffected, including on the ESA framework (European accounting). Likewise, the Italian treasury's guarantee on postal savings does not enter government-debt statistics for Maastricht purposes, unless called upon.

Similar to other development institutions[1], CDP is classified as an "Other Monetary Financial Institution" by the ECB. It is therefore subject to a reserve requirement, but not to CRD4/CRR. In Italy, CDP is supervised by a parliamentary committee and the Court of Auditors (Corte dei Conti). Since 2004, CDP is subject to "informative supervision" by the Bank of Italy, but no regulation specific to CDP has been issued.

CDP's business model makes it unique in the Italian context. Compared to banks, its asset exposures tend to be better quality (in large part aligned to Italian sovereign risk), and its main funding sources – postal savings and bonds – compete directly with bank deposits. Comparisons to other European NPIs are more warranted; yet each of these institutions have their own peculiarities.

Strong financial fundamentals, largely reflecting CDP's business model

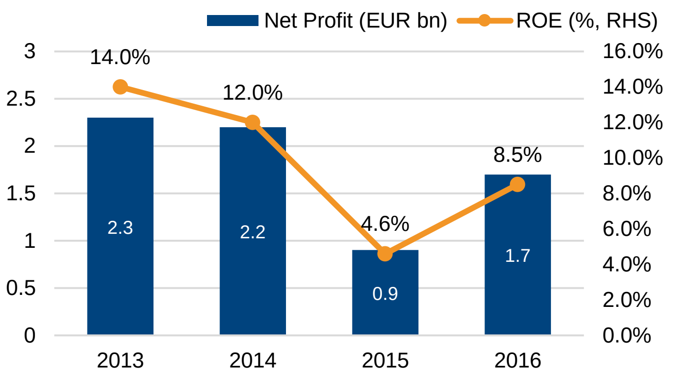
CDP's financial fundamentals are strong despite the adverse impact from the low interest rates (in normal times, we would consider this to be its main comparative advantage, i.e. access to stable and cheap captive postal savings). Despite the erosion of net interest income in recent years, CDP SpA reported an 8.5% ROE in 2016, which outperforms not only most Italian banks but also many in Europe.

The 2016 rebound in profitability was driven mainly by a jump in net interest income, from EUR 0.9bn to EUR 2.4bn. This was attributed especially to:

- A re-negotiation of the treasury account's remuneration to align it with market remuneration of government debt with similar effective maturity.[2]
- Managerial actions aimed at better asset and liability management, resulting in a higher markdown on interest bearing liabilities.

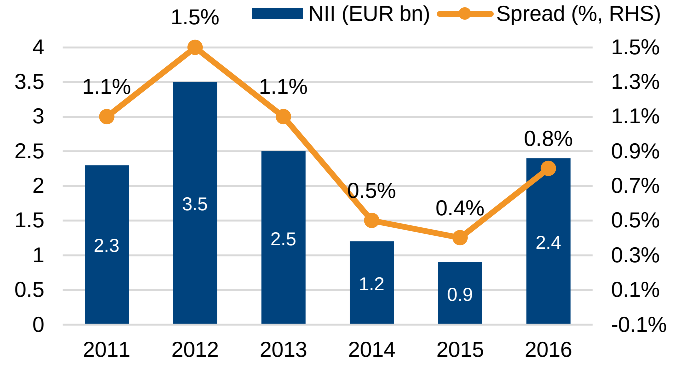
[1] KfW, ICO and CDC are subject to ECB reserve requirements but not to CRD4/CRR.
[2] The treasury account's rate of remuneration is based on weighted average of Italian 10 years treasury bonds and 6 months treasury bills (with 80% and 20% weights respectively)

Figure 1: Net income and ROE



Source: CDP, Scope Ratings

Figure 2: Net interest Income and spread

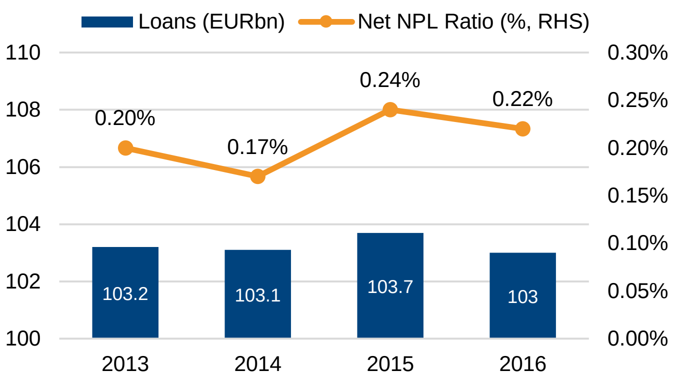


Source: CDP, Scope Ratings

CDP's unique features explain the profitability gap to other Italian financial institutions. Aside from the privileged access to postal savings (for which Poste receives a commission) and the profitable treasury account, we highlight CDP's entirely different cost of risk compared to those of Italian commercial banks. This is driven by a much lower level of non-performing loans and is related directly to the peculiarity of CDP's asset risk. Indeed, a large portion of CDP's balance sheet reflects Italy's low sovereign risk, with the remaining loan book skewed towards low-risk counterparties like public administrations and banks (see Figure 6).

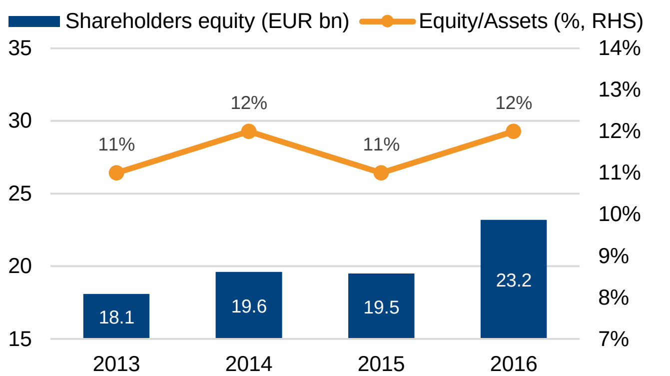
With respect to capital, it is important to stress that CDP is not formally subject to CRD4/CRR requirements, but to informational supervision by the Bank of Italy. Therefore, CDP is not required to disclose regulatory capital ratios. On a positive note, however, accounting equity has been increasing in line with assets and is stable at c. 12% of total assets (net of cash).

Figure 3: NPL ratio



Source: CDP, Scope Ratings

Figure 4: Equity/assets



Source: CDP, Scope Ratings

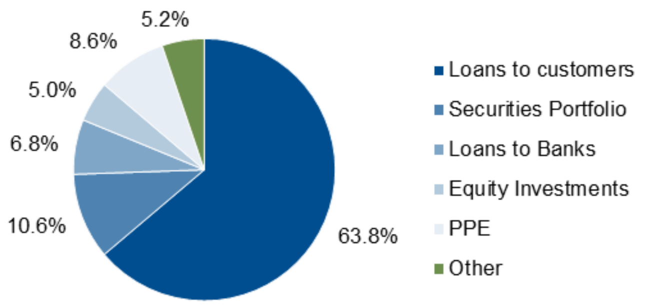
A majority of CDP Group's assets ultimately reflect Italian sovereign risk

CDP's assets are inherently low risk, a feature that may not be immediately evident when comparing its statutory balance sheet with those of other retail banks (see Figure 5). Loans to customers account for almost two-thirds of total assets, the securities portfolio for 11%, and the remainder are loans to banks, physical assets[3] and equity investments. On closer inspection the security portfolio, which mainly comprises Held to maturity and Available for sale assets, is composed almost entirely of government bonds, primarily fixed-rate and inflation-linked. These bonds form part of CDP group's liquidity reserves and partly hedge the profitability of its postal savings against falling interest rates. Government-related loan exposures account for 92% of loans to customers, which include EUR 148bn in a treasury account with the central state, EUR 46bn in other government loans, and EUR 48bn in loans to government agencies (essentially Italian regions and other public administrations).

[3] CDP group has c. EUR 35bn in PPE. The vast majority of these pertains to the electrical and gas network assets of Terna and Snam, subsidiaries of the group.

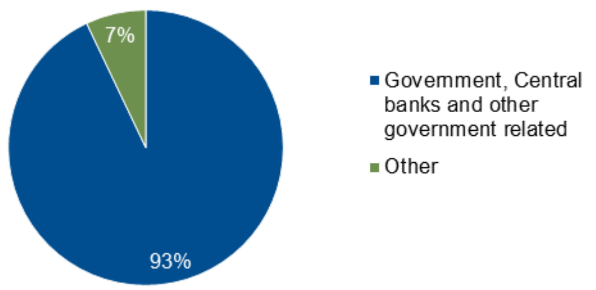
In other words, at least 70% of the total consolidated balance sheet of the CDP group reflects government-related risk (i.e. essentially Italian sovereign risk).

Figure 5: CDP's consolidated total assets, overview



Source: CDP, Scope Ratings

Figure 6: CDP's securities portfolio, detail

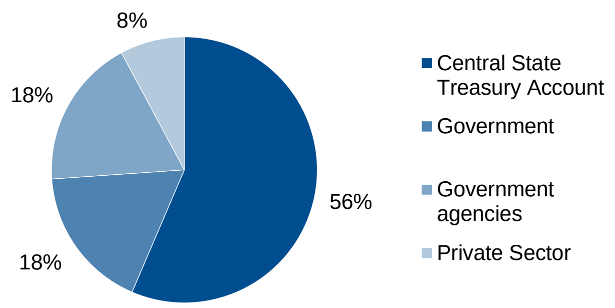


Source: CDP, Scope Ratings

Direct loans to the private sector (c. EUR 21bn) include lending to financial and non-financial corporations, with a tilt towards large corporations operating in highly regulated sectors.

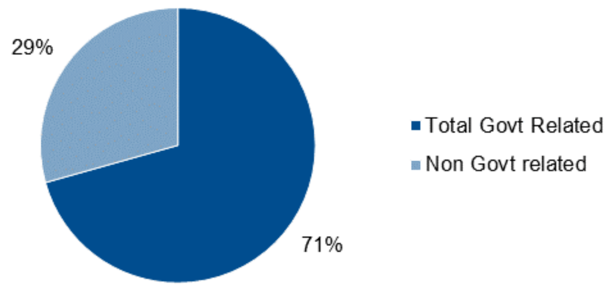
Loans to banks, which also include a non-immaterial central bank exposure (EUR 8bn in reserve requirement), are granted primarily to Italian financial institutions and linked to on-lending schemes (SME fund, Capital Goods Fund, etc.), which support SMEs and assist the reconstruction of areas stricken by natural disasters (Abruzzo, Emilia). These schemes only entail liquidity provisions, while the credit risk related to SMEs ultimately rests on the banks. CDP's credit risk is therefore limited to the banking counterparties, which we consider relatively safe given the strong credit profile of banks' senior obligations within the new post-crisis regulatory framework.

Figure 7: CDP group's Loans to customers, detail



Source: CDP, Scope Ratings

Figure 8: Total consolidated asset split



Source: CDP, Scope Ratings
Note: Government related exposures include State treasury account, loans to government and government agencies, Central bank reserves and Government and central bank securities

The Italian government explicitly or implicitly guarantees CDP's liabilities

CDP's main source of funding consists of postal savings in the form of passbooks or bonds. These liabilities are guaranteed explicitly by the Italian state, issued by CDP, and distributed via the Poste Italiane S.p.A. network against a fee. Despite being legally sight liabilities, this source of funding has been very stable.

In recent years, CDP has started to diversify funding away from postal passbooks and bonds.

Aside from postal passbooks and bonds, CDP SpA issues bonds in the wholesale market. Outstanding bonds include:

- EUR 1.5bn (2015) in a privately placed bond (bought by Poste Italiane), explicitly guaranteed by the state
- EUR 1.5bn (2015) in a retail bond

- the EMTN programme (launched in 2005, EUR 13bn maximum), including both private and public placements; currently c. EUR 8bn bonds are outstanding
- EUR 0.9bn (H1 2017) in commercial paper programme for up to EUR 3bn, launched in 2014
- Debt issuance programme (DIP), launched in 2015 for up to EUR 10bn. As of H1 2017, issuances have comprised EUR 2.3bn.

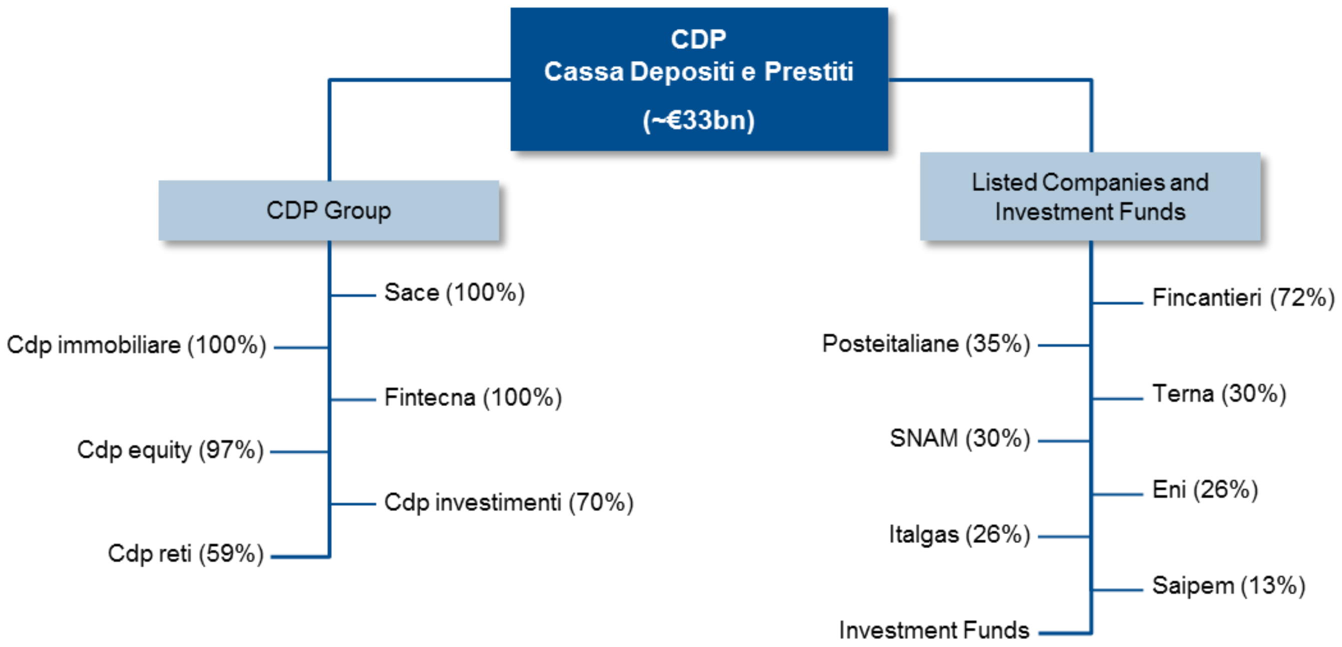
The bonds under the EMTN and DIP programmes are not guaranteed explicitly by the state, but rely on CDP's own credit strength; however, these bonds legally rank pari passu with postal bonds and passbooks. Therefore the bonds would only absorb losses in a scenario in which CDP became insolvent, pro-rata with the postal savings (in practice, postal-savings investors would be made whole by the Italian state, which would then have regress rights on CDP, pari passu with other senior creditors). We deem this scenario to be extremely unlikely: CDP is systemically important for the Italian economy, public administration finances and treasury liquidity management. Given this we believe the government would provide equity injections if needed and as long as the country has the financial means to do so.

Another important source of funding is the Operazioni di Tesoreria (OPTES), short-term deposits by the Italian government. Through these operations, the Bank of Italy manages the treasury's liquidity account on behalf of the Ministry of Economy and Finance. Required or excess liquidity is collected or assigned via a daily auction. The balance of OPTES liabilities at year-end 2016 stood at EUR 33bn: the daily average of these transactions has been increasing, from EUR 14bn in 2012 to EUR 50.3bn in 2015, in line with the treasury's excess liquidity.

High-quality equity stakes portfolio provides a reliable flow of dividends – a key revenue source in the current interest rate environment.

CDP's modalities of intervention are not limited to providing credit. The group can hold stakes in companies, as long as these are in the national interest. Figure 9 offers an overview of CDP's main equity investments.

Figure 9: CDP Group structure and equity stakes (2016)



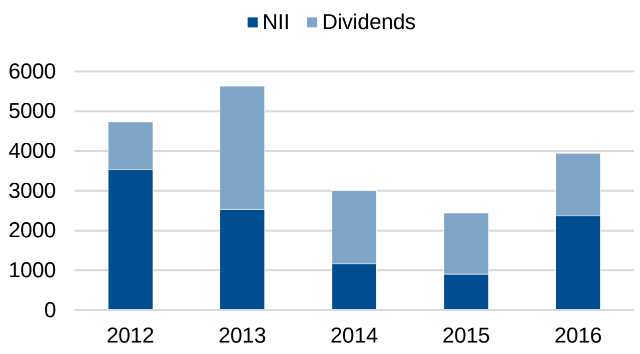
Source: CDP

CDP's equity investments can be grouped in four types of intervention:

1. **Asset preservation.** CDP is a long-term shareholder in Italian corporations deemed strategically important, such as ENI, Poste Italiane and Fincantieri, among others.
2. **Private-sector promotion**. Through a number of funds, often in partnership with other investors, CDP acts as a catalyst to promote entrepreneurship and to stimulate underdeveloped markets.
3. **International development.** Through the fully owned SACE/SIMEST group, CDP supports the international expansion of Italian companies.
4. **Asset enhancement.** A number of dedicated investment funds support public administrations to valorize and dispose of real estate portfolios. A dedicated fund to support tourism promotes the separation between real estate and hotel business management.

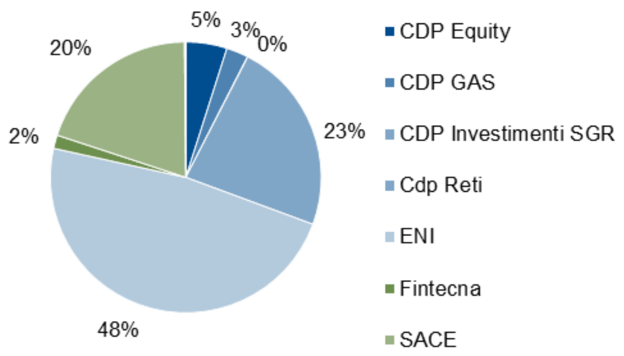
While relatively limited in terms of total assets, these companies represent an important source of revenue for CDP. In recent years, CDP's revenues have been under pressure from the very low interest rate environment. As a funding source, postal savings are stable, inexpensive, and not very price-sensitive. However, as market rates have been declining, the margins on these products have been shrinking, putting pressure on CDP's profitability. In 2016 trends on net interest income partly reversed, as a result of the re-negotiation of the treasury account's remuneration as well as managerial actions aimed at improving the ALM management of the NPI. During that year the participated companies contributed over EUR 1.5bn in dividends to CDP, following a relatively stable path over the past few years, with the bulk coming from ENI. It is worth noting that, until interest rates recover, CDP's revenues will remain dependent on dividends, particularly the one from ENI.

Figure 10: NII vs dividends



Note: 2013 includes exceptional dividend from SACE and Fintecna Source: SNL, Scope Ratings

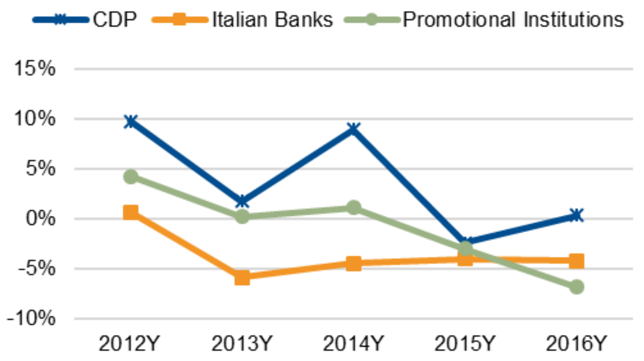
Figure 11: Dividend income sources for CDP SpA, 2016



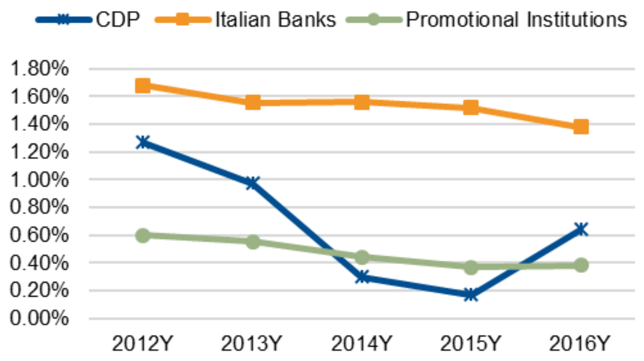
Source: CDP, Scope Ratings

Appendix A: Peer comparison

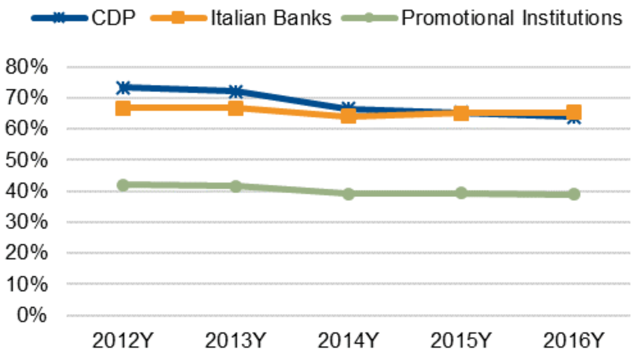
Net loan growth (%)



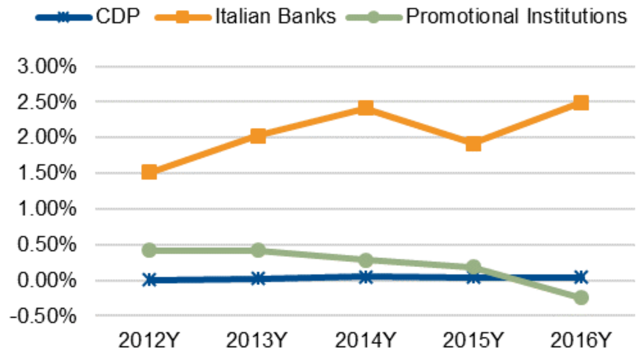
Net interest margin (%)



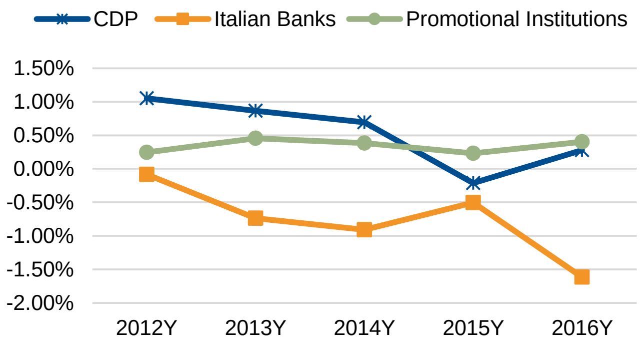
Net loans/assets (%)



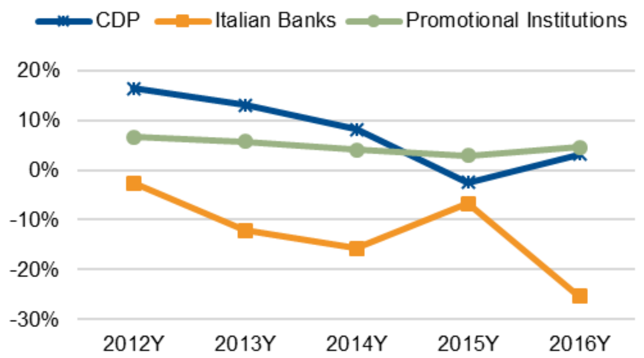
Loan-loss provision charges/net loans (%)



ROAA (%)



ROAE (%)



Source: SNL, Scope Ratings
Note: CDP data refers to group consolidated financials.

*Promotional Institutions: CDP Group, CDC, KfW, ICO, BNG Bank, EIB, NRW Bank, Landeskreditbank

**Italian Banks: Unicredit, Intesa MPS, Banco BPM, UBI, Carige, BPER, BP Sondrio, BP Vicenza, Veneto Banca

Appendix B1: Income statement – CDP S.p.A.

Cassa Depositi e Prestiti Spa (unconsolidated)	2012Y	2013Y	2014Y	2015Y	2016Y
Income statement summary (EUR m)					
Net interest income	3,522	2,539	1,161	905	2,369
Net commission income (expense)	-1,612	-1,583	-1,591	-1,553	-1,484
Dividends and similar revenues	1,207	3,089	1,847	1,538	1,571
Net gain (loss) on trading activities	156	76	13	70	6
Net gain (loss) on hedging activities	-10	-15	-44	5	1
Gains (losses) on disposals or repurchase	390	16	340	400	25
Gross income	**3,653**	**4,122**	**1,726**	**1,364**	**2,486**
Net impairment adjustments	-23	-45	-131	-96	-457
Financial income (expense), net	3,630	4,077	1,595	1,269	2,029
Administrative expenses	-103	-120	-128	-131	-136
Net provisions	-2	0	-2	-18	-1
Net adjustments of property, plant and equipment	-5	-5	-5	-5	-5
Net adjustments of intangible assets	-2	-2	-2	-2	-2
Other operating income (costs)	4	5	4	-18	4
Operating costs	**-110**	**-123**	**-133**	**-174**	**-141**
Gains (losses) on equity investments	147	-1,009	938	-209	-270
Gains (losses) on disposal of investments	0	0	0	0	0
Income (loss) before tax from continuing operations	**3,667**	**2,945**	**2,400**	**885**	**1,618**
Income tax for the year on continuing operations	-815	-597	-230	8	44
Income (loss) for the year	**2,853**	**2,349**	**2,170**	**893**	**1,663**

Source: SNL, Scope Ratings

Appendix B2: Balance sheet – CDP S.p.A.

Cassa Depositi e Prestiti Spa (unconsolidated)	2012Y	2013Y	2014Y	2015Y	2016Y
Balance sheet summary (m)					
Assets					
Cash and cash equivalents	0	0	0	0	0
Financial assets held for trading	640	473	299	201	208
Financial assets available for sale	4,975	4,939	6,908	7,579	9,596
Financial assets held to maturity	16,731	18,327	21,339	24,577	32,269
Loans to banks	13,178	14,851	26,508	25,208	23,965
Loans to customers	238,306	242,136	263,887	257,105	258,643
Hedging derivatives	372	325	684	789	733
Equity investments	30,268	31,769	29,038	28,138	30,897
Property, plant and equipment	207	218	232	253	273
Intangible assets	7	6	6	5	9
Tax assets	508	1,234	914	810	973
Other assets	239	407	392	234	146
Total assets	**305,431**	**314,685**	**350,205**	**344,899**	**357,710**
Liabilities					
Due to banks	34,055	24,009	13,291	14,337	14,487
Due to customers	242,303	261,520	302,765	294,844	305,799
Securities issued	6,672	6,907	9,990	14,382	12,032
Financial liabilities held for trading	477	445	290	170	183
Hedging derivatives	2,576	1,449	2,306	535	832
Adjustment of financial liabilities hedged generically (+/-)	56	52	48	43	38
Tax liabilities	916	669	394	142	211
Other liabilities	1,528	1,480	1,548	946	877
Staff severance pay	1	1	1	1	1
Provisions	12	15	19	39	43
Total Liabilities	**288,596**	**296,547**	**330,651**	**325,438**	**334,503**
Valuation reserves	965	975	1,073	940	947
Reserves	9,517	11,371	12,867	14,185	14,225
Share premium reserve	0	0	0	0	2,379
Share capital	3,500	3,500	3,500	3,500	4,051
Treasury shares (-)	0	-57	-57	-57	-57
Net income for period (+/-)	2,853	2,349	2,170	893	1,663
Total liabilities and equity	**305,431**	**314,685**	**350,205**	**344,899**	**357,710**

Source: SNL, Scope Ratings

Appendix C: Selected financial information – CDP Group

	2012Y	2013Y	2014Y	2015Y	2016Y
Balance sheet summary (EUR m)					
Assets					
Cash and interbank assets	17,364	18,017	28,533	28,141	27,218
Total securities	29,466	29,982	32,577	35,342	44,686
of which, derivatives	1,861	1,479	1,868	1,847	1,399
Net loans to customers	241,541	245,794	267,428	261,044	261,957
Other assets	40,541	46,675	73,142	74,344	76,565
Total assets	**328,912**	**340,467**	**401,680**	**398,871**	**410,425**
Liabilities					
Interbank liabilities	36,450	27,875	21,809	23,523	25,692
Senior debt	13,218	13,568	26,915	30,086	28,108
Derivatives	3,279	2,139	3,086	1,286	1,297
Deposits from customers	241,710	258,783	296,257	291,800	302,190
Subordinated debt	0	0	0	0	0
Other liabilities	13,199	14,603	18,457	17,622	17,459
Total liabilities	**307,857**	**316,967**	**366,523**	**364,317**	**374,746**
Ordinary equity	18,186	19,295	21,371	20,199	22,528
Equity hybrids	0	0	0	0	0
Minority interests	2,870	4,205	13,786	14,354	13,151
Total liabilities and equity	**328,912**	**340,467**	**401,680**	**398,871**	**410,425**
Core tier 1/ common equity tier 1 capital	NA	NA	NA	NA	NA
Income statement summary (EUR m)					
Net interest income	3,449	2,841	925	551	2,106
Net fee & commission income	-1,603	-1,548	-1,633	-1,576	-1,463
Net trading income	188	318	556	1,239	25
Other income	3,420	7,394	11,239	7,657	9,859
Operating income	**5,454**	**9,005**	**11,087**	**7,871**	**10,528**
Operating expense	1,010	4,818	7,753	8,052	8,115
Pre-provision income	4,444	4,186	3,334	-181	2,413
Credit and other financial impairments	23	56	166	116	479
Other impairments	0	3	0	53	40
Non-recurring items	0	0	0	0	0
Pre-tax profit	**4,421**	**4,127**	**3,168**	**-350**	**1,895**
Discontinued operations	0	0	162	7	0
Other after-tax Items	0	0	0	0	0
Income tax expense	1,187	1,228	671	515	766
Net profit attributable to minority interests	308	398	1,501	1,389	975
Net profit attributable to parent	**2,927**	**2,501**	**1,158**	**-2,246**	**153**

Source: SNL, Scope Ratings

Note: CDP group consolidated financials include the revenue and cost evolution of CDP's group subsidiaries, which can be volatile, reflecting amongst other factors, energy and commodity prices.

Appendix D: Ratios – CDP Group

	2012Y	2013Y	2014Y	2015Y	2016Y
Funding and liquidity					
Loans/deposits (%)	99.9%	95.0%	90.3%	89.5%	86.7%
Liquidity coverage ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Loans/assets (%)	73.4%	72.2%	66.6%	65.4%	63.8%
Impaired & delinquent loans/loans (%)	0.0%	0.0%	0.1%	0.1%	0.0%
Loan-loss reserves/impaired loans (%)	466.6%	421.8%	328.6%	354.5%	550.9%
Net loan growth (%)	9.8%	1.8%	9.0%	-2.4%	0.3%
Impaired loans/tangible equity & reserves (%)	0.2%	0.3%	0.3%	0.3%	0.3%
Asset growth (%)	14.5%	3.5%	9.4%	-0.7%	2.9%
Earnings and profitability					
Net interest margin (%)	1.3%	1.0%	0.3%	0.2%	0.6%
Net interest income/RWAs (%)	NA	NA	NA	NA	NA
Net interest income/revenues (%)	63.2%	31.5%	8.3%	7.0%	20.0%
Fees & commissions/revenues (%)	-29.4%	-17.2%	-14.7%	-20.0%	-13.9%
Cost/income ratio (%)	18.5%	53.5%	69.9%	102.3%	77.1%
Operating expenses/RWAs (%)	NA	NA	NA	NA	NA
Pre-provision income/RWAs (%)	NA	NA	NA	NA	NA
Loan-loss provision charges/pre-provision income (%)	0.5%	1.3%	5.0%	NA	19.8%
Loan-loss provision charges/net loans (%)	0.0%	0.0%	0.1%	0.0%	0.0%
Pre-tax profit/RWAs (%)	NA	NA	NA	NA	NA
Return on average assets (%)	1.1%	0.9%	0.7%	-0.2%	0.3%
Return on average RWAs (%)	NA	NA	NA	NA	NA
Return on average equity (%)	16.4%	13.0%	8.1%	-2.5%	3.2%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	NA	NA	NA	NA	NA
Common equity tier 1 ratio (%, transitional)	NA	NA	NA	NA	NA
Tier 1 capital ratio (%, transitional)	NA	NA	NA	NA	NA
Total capital ratio (%, transitional)	NA	NA	NA	NA	NA
Tier 1 leverage ratio (%)	NA	NA	NA	NA	NA
Asset risk intensity (RWAs/total assets, %)	NA	NA	NA	NA	NA
Market indicators					
Price/book (x)	NA	NA	NA	NA	NA
Price/tangible book (x)	NA	NA	NA	NA	NA
Dividend payout ratio (%)	NA	NA	NA	NA	NA

Source: SNL, Scope Ratings

Note: CDP group consolidated financials include the revenue and cost evolution of CDP's group subsidiaries, which can be volatile, reflecting amongst other factors, energy and commodity prices.

Ratings *	
Issuer Rating	**A-**
Outlook	Stable
Senior unsecured debt rating	A-

* The ratings are not applicable to debt issued by unguaranteed subsidiaries of the rated parent.

Methodology

The methodology used for this rating(s) and/or rating outlook(s) (Bank Rating Methodology - May 2017) is available on www.scoperatings.com.

Historical default rates of Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's definition of default as well as definitions of rating notations can be found in Scope's public credit rating methodologies on www.scoperatings.com.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months.

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The rating analysis has been prepared by Marco Troiano, Executive Director. Responsible for approving the rating: Sam Theodore, Managing Director

The rating was first assigned by Scope on 24.10.2017. / The rating was last updated on 24.10.2017.

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The rated entity and/or its agents participated in the rating process.

The following substantially material sources of information were used to prepare the credit rating: public domain, the rated entity, the rated entities' agents, third parties and Scope internal sources.

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