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Research Update:

Italian Mediobanca 'BBB/A-2' Ratings Affirmed On Sovereign Rating Action And Stabilizing Industry Risk; Outlook Negative

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Overview

- On June 6, 2014, we affirmed our 'BBB/A-2' long- and short-term unsolicited sovereign credit ratings on the Republic of Italy.
- We now identify a stable trend for the Italian banking sector's industry risk, as we believe its systemwide funding is unlikely to deteriorate further.
- We believe that Mediobanca SpA is successfully implementing its previously announced capital-enhancing actions, thereby reducing the potential downside risk to its capital position.
- We are therefore affirming our 'BBB/A-2' long- and short-term ratings on Mediobanca.
- The outlook on the long-term rating remains negative, reflecting that on our long-term unsolicited sovereign rating on Italy.

Rating Action

On June 17, 2014, Standard & Poor's Ratings Services affirmed its 'BBB/A-2' long- and short-term counterparty credit ratings on Italy-based Mediobanca SpA. The outlook remains negative.

Rationale

The affirmation follows our June 6, 2014, affirmation of our 'BBB/A-2' long- and short-term unsolicited sovereign credit ratings on the Republic of Italy (see "Ratings On Italy Affirmed At 'BBB/A-2'; Outlook Remains Negative").

The affirmation also reflects our view the downside risks for the ratings on Mediobanca have diminished, as we now see a stable trend for the Italian banking sector's industry risk assessment. We also believe Mediobanca is less exposed than most of its peers to a potentially weaker-than-anticipated economic recovery in Italy. This is because it has what we view as a sound capital position and it is more geographically diversified than its peers.

Mediobanca, however, remains exposed to the potential deterioration of Italy's sovereign creditworthiness, our view on which is reflected in our negative outlook on our unsolicited long-term sovereign rating on Italy.

We believe that Mediobanca is successfully implementing the actions included in its business plan. The plan aims to reduce its exposure to market risk through its equity stakes portfolio, improve the stability of its revenue base, and increase its business diversification. The bank has taken advantage of improved market conditions to accelerate the disposal of some of its largest equity stakes: Out of a total targeted €1.6 billion disposal by June 2016, the bank has already sold a total of €800 million, with total gross gains exceeding €200 million. We note that Mediobanca remains committed to completing the remaining disposals over the coming 12-18 months. We consider this target to be achievable in light of the current market environment.

Mediobanca's bottom-line performance in the past three quarters has been sound and outperformed expectations. It has mainly benefitted from sizable capital gains booked on equity disposals. However, we believe that an improving economy, the bank's increasing efforts to preserve its margins (which include the use of liquidity to reduce its reliance on costlier sources of funding), and more favorable market conditions should somewhat benefit the bank's operating revenue stream in 2014 and 2015. Moreover, we also consider that the bank's loan-loss provisioning needs will likely gradually decrease. We estimate that our risk-adjusted capital (RAC) ratio for Mediobanca is currently between 7.5% - 8.0%. We believe the bank can organically sustain this level and further strengthen it to 8.0% - 9.0% by 2015, considering its announced equity stake disposal.

We note that Mediobanca has been able to preserve what we view as a sound asset quality throughout the economic downturn. Its coverage level and nonperforming loan ratios compare very favourably with those of its Italian peers. Even if the bank is using part of its liquidity cushions to reduce its reliance on costlier sources of funding, we expect that its financing needs will remain modest over the next couple of years and that it will continue to adequately manage its funding and liquidity position.

Outlook

The negative outlook on Mediobanca reflects the possibility that we could lower our ratings on the bank if we were to lower our unsolicited sovereign credit ratings on Italy. We believe that, under our criteria, Mediobanca would not qualify to be rated higher than our unsolicited long-term sovereign rating on Italy. We seldom rate financial institutions above the foreign currency rating on the country where they are based, as we see a strong connection between banks' creditworthiness and that of their country of domicile. Italy is Mediobanca's country of domicile and its main market. It accounts for about 75% of the bank's total loans, and we therefore believe that Mediobanca would be severely affected by the same economic factors that could cause sovereign stress in Italy, despite its geographic diversification.

We anticipate that a potential increase in our view of the economic risks faced by Italian banks may not necessarily lead to a downgrade of Mediobanca. That said, we could lower our ratings on Mediobanca if we were to anticipate that it could not sustain its RAC ratio above 7% over the next two years, most likely due to a combination of increased economic risk, persistently high market risk exposure through equity stakes, and a materially lower-than-anticipated capital generation.

A review of the outlook to stable would be possible if we were to revise our outlook on our unsolicited long-term sovereign rating on Italy to stable.

Ratings Score Snapshot

Issuer Credit Rating	BBB/Negative/A-2
SACP	bbb
Anchor	bbb-
Business Position	Adequate (0)
Capital And Earnings	Adequate (0)
Risk Position	Strong (+1)
Funding	Average (0)
Liquidity	Adequate
Support	(0)
GRE Support	(0)
Group Support	(0)
Sovereign Support	(0)

Related Criteria And Research

Related criteria

- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related research

- Ratings On Italy Affirmed At 'BBB/A-2'; Outlook Remains Negative, June 6, 2014
- S&P Publishes Latest Banking Industry Country Risk Assessment On Italy, June 17, 2014
- Banking Industry Country Risk Assessment: Italy, June 17, 2014

Ratings List

Ratings Affirmed

Mediobanca SpA	
Counterparty Credit Rating	BBB/Negative/A-2
Certificate Of Deposit	
Foreign Currency	BBB
Local Currency	BBB/A-2
Senior Unsecured	BBBp
Senior Unsecured	BBB
Subordinated	BBB-
Mediobanca International (Luxembourg) S.A.	
Senior Unsecured	BBB
Certificate Of Deposit	A-2
Commercial Paper	A-2

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