www.pwc.com/it

The Italian NPL market

A new beginning?

March 2013

Foreword & Content

Foreword

In 2012 the market saw a successful deal closure of two important auction processes started in 2011 and a completion of some consumer credit NPL portfolio disposals.

On investor side, in 2012 several "new names" appeared on the Italian NPL market and some deals were closed thanks to these newcomers.

Looking ahead, we favourably record that at 2012 YE Italian banks have posted important loss provisions on their NPL books highlighting the deleverage is becoming a priority. Though, the political uncertainties of the Country as well as the limited availability of fresh finance for the RE market will certainly impact the pace of the deleverage of the NPL stock.

Only time will tell if we can speak about a "new beginning". For the time being we hope you appreciate the overview of the NPL market provided in this document and we wish there might be opportunities in advising you as a seller or buyer.

Kind Regards

Fedele Pascuzzi
Partner
fedele.pascuzzi@it.pwc.com

Antonella Pagano
Partner
antonella.pagano@it.pwc.com

Laura Gasparini
Senior Manager
laura.gasparini@it.pwc.com

Content

1 Italian macroeconomic scenario and real estate market overview

The recent political elections increases the execution risk of structural reforms introduced by the Monti's Government. However, Italy still offers attractive opportunities to investors based on some of its key economic strengths and a relatively stable RE market

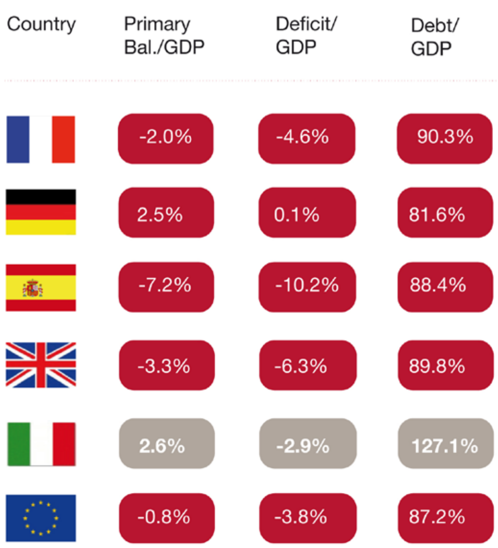
The Monti Government passed several reforms (austerity package "Save Italy", growth measures "Grow Italy") aiming at restoring economic growth and financial stability. The recent elections led to political uncertainties, which increase the risk of a timely execution of the reforms.

Despite a positive primary balance , the Italian macroeconomic environment remains challenging due to the high level of public debt (127% of the GDP) and to the prolonged contraction of the economic activity (six consecutive quarters of negative GDP growth, including -2.4% yoy in Q4-12).

Against this unfavourable backdrop, Italy still offers attractive investment opportunities based on these fundamentals:

- a relatively stable RE market. The Italian market has been less affected than most of other European countries by the 2008-2009 turmoil. The forecasts for the RE market in 2013 point to a slightly positive trend in turnover but still a sluggish environment in terms of prices;
- low private debt. Italy has one of the lowest private sector debt within the advanced economies. Combining private & public debt, Italy would score well within the European context - close to Germany and better than France;
- high financial wealth. Households' net financial assets (net of liabilities) as rate of disposable income in Italy stands at 2.4x versus an average of ~1.9x for Europe[1].

Chart 1 - European Countries' peers analysis



Source: PwC analysis on European Economic Forecast, February 2013

Table 1 - Real Estate turnover (value of the exchanged assets) and % change

Country	2012F Volumes	% Change YoY 2008	2009	2010	2011	2012F	Trend 2014
Italy	113,300	-2.6	-10.0	3.3	-0.4	-2.0	▶
France	135,300	-1.3	-18.7	0.9	3.0	-4.9	▶
Germany	167,100	-0.6	-9.6	2.7	2.9	4.4	▲
UK	112,400	-2.0	-11.3	1.4	2.9	-2.9	▲
Spain	74,000	-7.9	-17.6	-5.9	1.1	-4.0	▶
Avg EU 5	602,100	-2.5	-13.3	1.0	2.1	-1.3	▶

Source: PwC analysis on European Outlook 2013 – Scenari Immobiliari

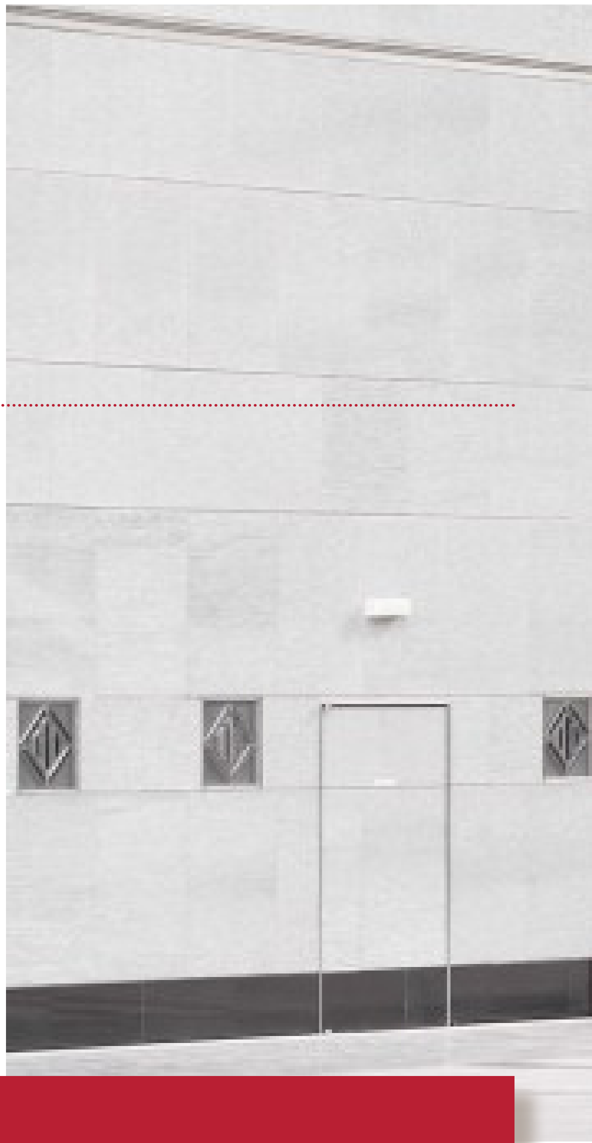
Table 2 - Real Estate price change

Country		% Change YoY 2008	2009	2010	2011	2012F	2013F	Trend 2014
Italy	Residential	1.0	-5.9	-3.2	-1.1	-2.2	-1.3	▲
	Offices	2.0	-2.9	-1.0	-1.0	-1.6	-0.5	▶
	Industrial	0.0	-7.0	-3.2	-2.2	-2.3	-1.6	▼
	Commercial	2.0	1.0	1.0	1.0	0.1	0.3	▶

Source: PwC analysis on European Outlook 2013 – Scenari Immobiliari

1 Source: Global Finance. Data refers to 2011 YE

2 Overview of the Italian banking system and loan distribution



Italian banks have a pure commercial banking business model: on average, loans to customers represent ~70% of banks' interest-earning-assets compared to 44% on average for European banks. Customer loans represent the bulk of Italian banks' assets (over 65% of total) and the funding structure is largely reliant on direct funding (over 60% of total liabilities).

Italian banks have a pure commercial banking business model, with strong focus on loans to customers (~€1.9 trn in 2012, 77% to Corporate and Households clients)

According to Bank of Italy /ABI data, as of 2012 Italian banks loans to customers totalled €1.9 trn, of which 77% to Households and Corporate and 23% to Public Administrations and Financial Institutions.

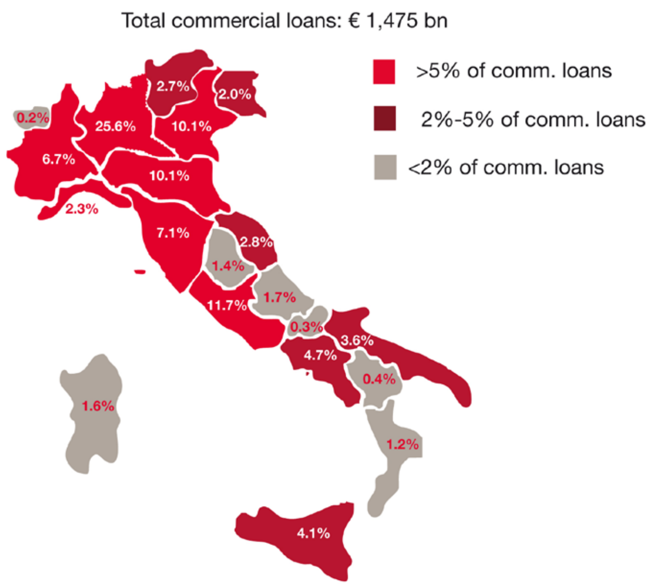
Focusing on the commercial loan book (Households and Corporate), 71.2% of it is concentrated in 6 regions mainly located in the north of Italy.

In terms of borrower type, the commercial loan book is composed mainly of Corporate loans (65%) and the remainder (35%) by loans to Households.

Italy is a country of small enterprises: out of ~4.4 mln of corporate entities, 95% have less than 10 employees.

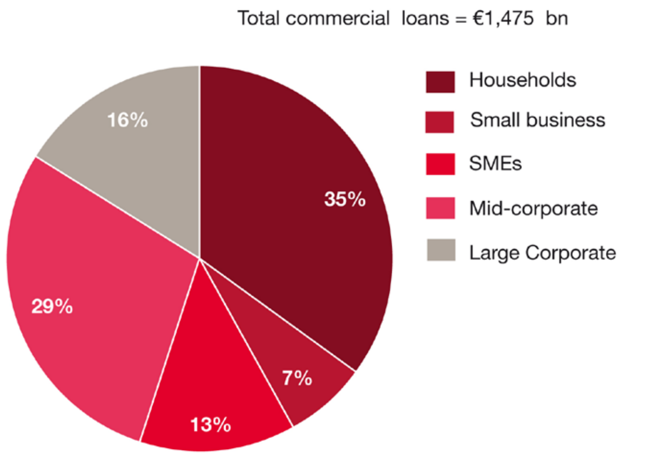
Even though SMEs and Small Business (20% of commercial loans) represent a higher risk profile than Middle and Large Corporate businesses, Italian banks can rely more extensively on personal guarantees provided by entrepreneurs or their family members. As a result, personal guarantees represent an additional ~19% of Italian banks' gross loans.

Chart 2 - Distribution of the commercial loan book by customer location (%)



Source: PwC analysis on Bank of Italy, "Bollettino Statistico", January 2013

Chart 3 - Breakdown of commercial loan book by type of borrower (%)



Source: PwC analysis on Bank of Italy, September 2012

Small business	small family businesses
SMEs	customers with up to €1 mln loan and less than €5mln turnover
Mid corporate	customers with up to €25 mln loan and less than €100mln turnover
Large corporate	customers with loans greater than €25 mln

3 Banks' challenges and asset quality deterioration issue

Italian banks are less profitable than their European peers due to significant structural and economic challenges. Within this context, the management of doubtful loans is a key priority

Italian banks face structural challenges (a highly pro-cyclical business model, a fragmented banking system) and economic headwinds (economic recession, prolonged low interest rates environment, asset quality deterioration, sovereign risk crisis) which adversely impact banks' profitability.

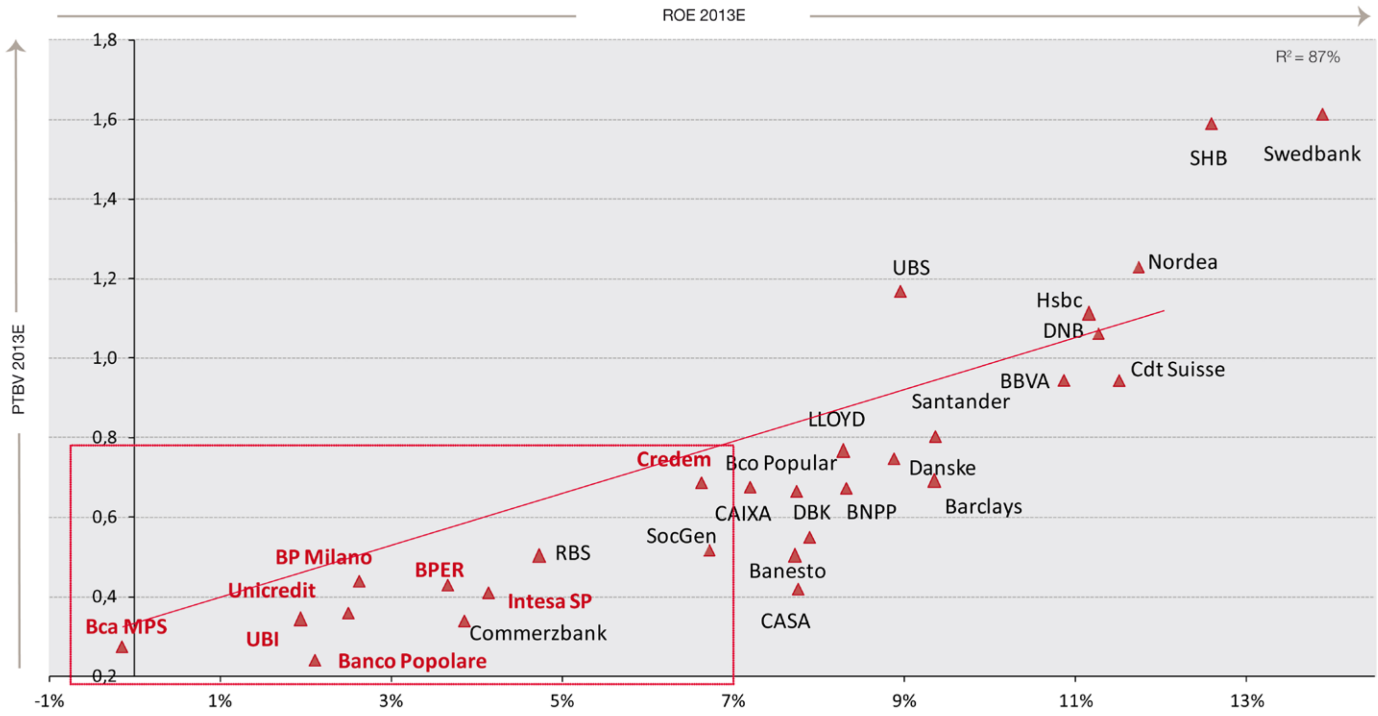
As of 9M-12, the ROTE (Return on Tangible Equity) of the top listed Italian banks fell below 5% on average, well below the relevant cost of equity (>10-12%).

The profitability outlook for 2013 remains challenging due to muted economic growth prospects and recent political uncertainties, which add to the gloom as concerns about the sovereign debt crisis are back.

Italian banks' share price reflects their lacklustre profitability prospects, with valuation standing at the bottom of the European range. At the same time, the equity market seems also to suggest that banks' asset quality profile is a key share price driver, with the banks showing relatively better asset quality ratios trading at higher multiples (see Chart 5).

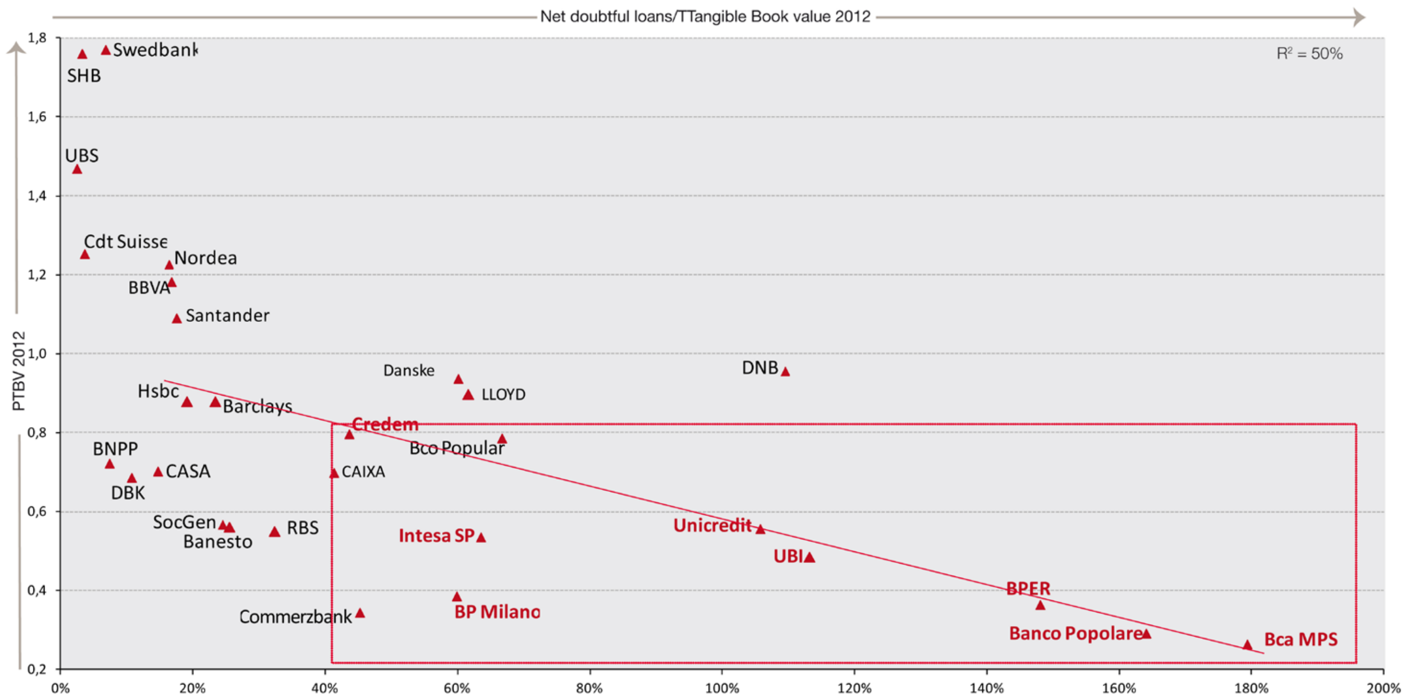
In such context, a strategic approach to doubtful loans management in our view is a key option for banks in order to restore market confidence and ultimately enhance shareholders' value.

Chart 4 - Italian banks market multiples compared to major European Banks



Source: Bloomberg, brokers' estimates as of March 2013

Chart 5 - Italian banks market multiples compared to major European Banks



Source: PwC analysis on 2012 Y/E data except for Italian banks which data refer to Q3 -2012 B/S and Bloomberg brokers' estimates as of March 2013

4 Size and features of the Italian NPL market

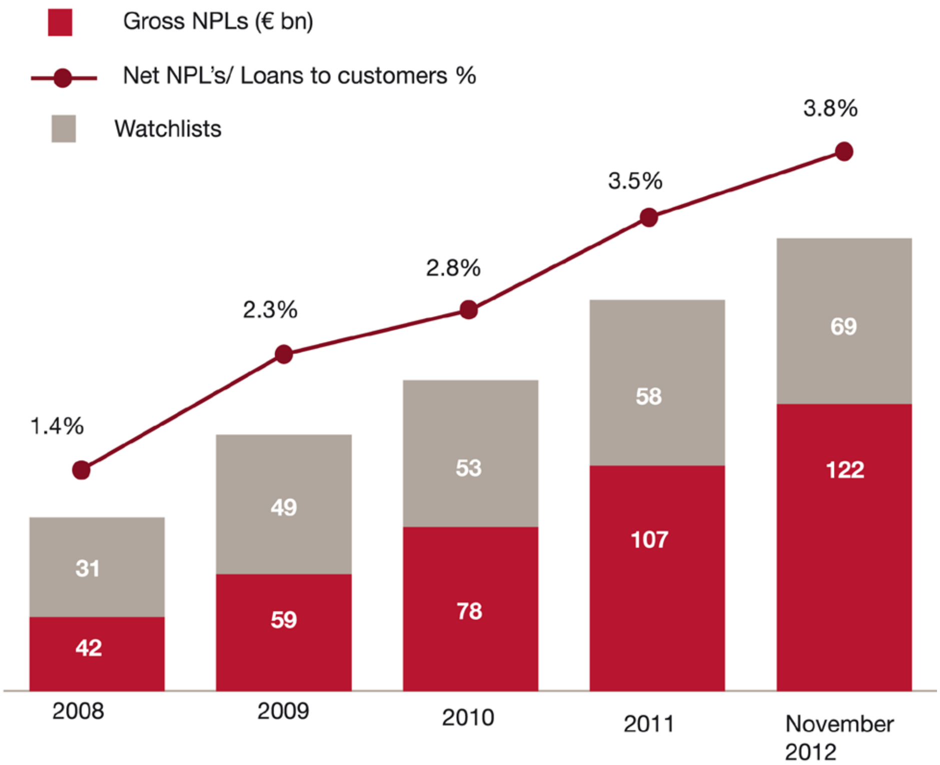
Since 2008, the stock of gross NPLs[1] increased significantly (CAGR 30.6%) reaching €122bn in November 2012. Watchlist loans also have been on the rise reaching €69 bn in 2012 from €31 bn in 2008. As a result, Italian banks asset quality ratios have deteriorated markedly since the onset of the crisis, with the net NPL ratio reaching 3.8% in Nov 2012. The asset quality is deteriorating for all asset classes, especially for the Consumer Credit Business whose gross NPL ratio reached 8% compared to 6.4%, 6.2% and 1.7% respectively of Leasing, Banking and Factoring business (data at YE 2011).

At Q3-12 top 10 Italian Banking Groups show a net NPL ratio standing (on average) at 3.4%, while the average NPL Coverage Ratio sets a low at 50.8%. Though, in the last few months the Bank of Italy has conduced a supervision on the top Italian Banking Groups with the focus on asset quality. Based on the initial evidence, this inspection led to a material increase in loan loss provisions in 2012 YE results.

In November 2012, the gross NPL stock reached 122 bn with a record high net NPL ratio of 3.8%.
Despite a Q3-2012 peer analysis on top banks highlighted a low NPL Coverage Ratio (50.8%), the Q4-2012 announced results for top banks show a significant increase in loss provisions

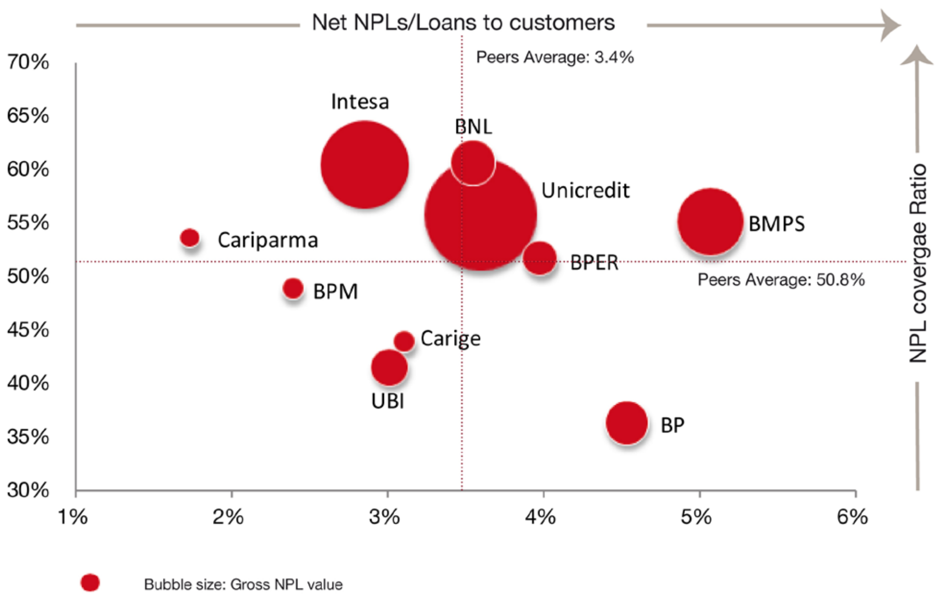
1 In this publication NPL stands for "sofferenze bancarie" and do not include watchlist, past due and restructured loans

Chart 6 - Trend of gross NPL stock, gross Watchlist stock and net NPL ratio in Italy



Source: PwC analysis on ABI and Bank of Italy Data –as per ABI Monthly Outlook, February 2013

Chart 7 - Top 10 Banking Group's NPL peer analysis (2011 versus 2011)



Source: PwC analysis on September 30, 2012 B/S, with the exception of Cariparma and BNL which data refer to June 30 2012

The NPL servicing market in Italy is a mature market even if the increase in NPL stock is leading to some changes. Moreover, main Non Captive Special Servicer have peculiarities to be factored in when choosing among them as partners for transactions

5 The NPL servicing market

In Italy the NPL servicing market can be considered a mature market where major Special Servicers (managing both secured and unsecured loans) have a long experience in this market.

Though, the significant increase of NPLs is creating new opportunities not only for them but also for Collection Agencies focused on the small ticket recovery management who leverage on their competences in managing consumer credit or insured receivables for acquiring mandates for the management of unsecured banks loans (up to €50 K). Some of them in fact have established some co-operation agreement for the management of unsecured loans with Special Servicers and/or international investors.

In the Special Servicers landscape some of them are captive servicers (Unicredit Credit Management Bank, SGC Banco Popolare and BCC Gestione Crediti) while others are independent.

Table 3 - Main NPL Non Captive Special Servicers

Company	Turnover ranking (€ mln)[1]	AUM (GBV € bn)[2]	# of employees[2]	Rating
Italfondiario	1st (51.5)	34.2	599	S&P: Strong Fitch: RSS1-/CSS1-
Guber	2nd (25.7)	2.8	155	S&P: n.a. Fitch: RSS2/CSS2
Prelios	3rd (11.0)	7.7	120	S&P: Above Average Fitch: RSS2/CSS2
Archon	4th (10.5)	2.1	106	S&P: Strong Fitch: RSS2+/CSS2+
FBS	5th (5.2)	3.6	95	S&P: Above Average Fitch: RSS2 IT/CSS2 IT
Jupiter	6th (3.9)	3.1	80	S&P: n.a. Fitch: n.a.
CAF	7th (3.9)	2.3	85	S&P: n.a Fitch: n.a.
NPL	8th (0.6)	0.8	25	S&P: n.a. Fitch: n.a.

1 Annual Report data at YE 2011 (except Jupiter for which data have been annualized)
2 Company management data at YE 2012 (except Jupiter at 8 March 2013)

Source: PwC analysis on Annual Report and company management data

Focus on Non Captive Special Servicers

According to company management data provided[3] to PwC, almost all Non Captive Special Servicers service the entire Italian territory and all of them manage a mix of secured and unsecured assets. However each servicer have peculiarities in terms of size of loans managed and business model in use so that despite the average number of secured loans managed by Asset Manager of the panel is around 219 positions, the min and max diverge significantly (38 – 400).

Chart 8 - Geographical breakdown (in %)

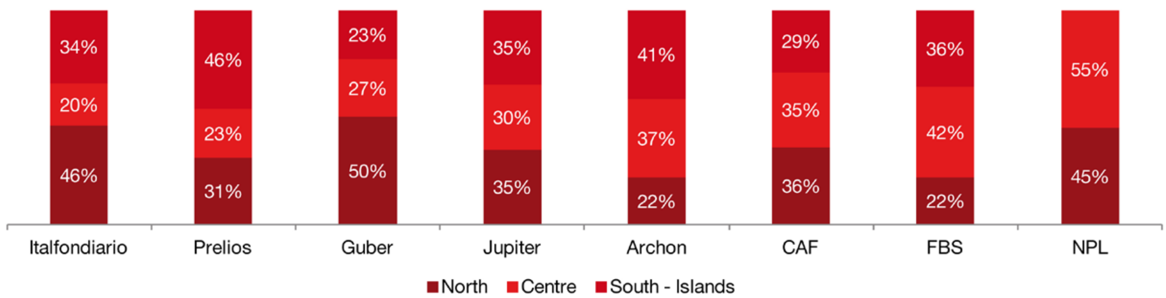


Chart 9 - Type of loans managed by GBV (in %)

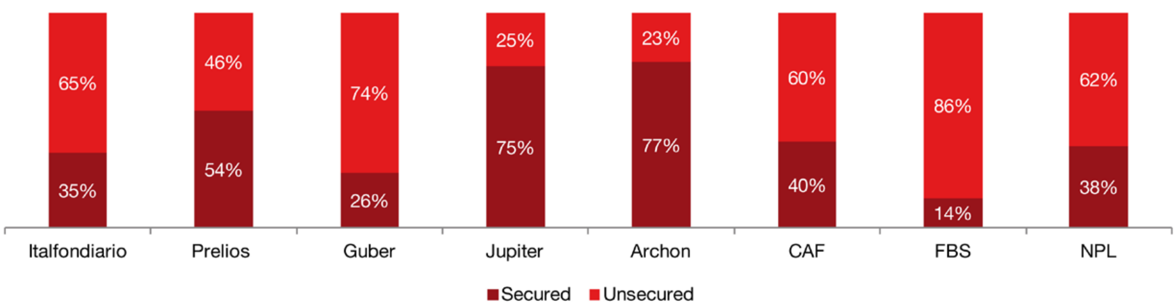
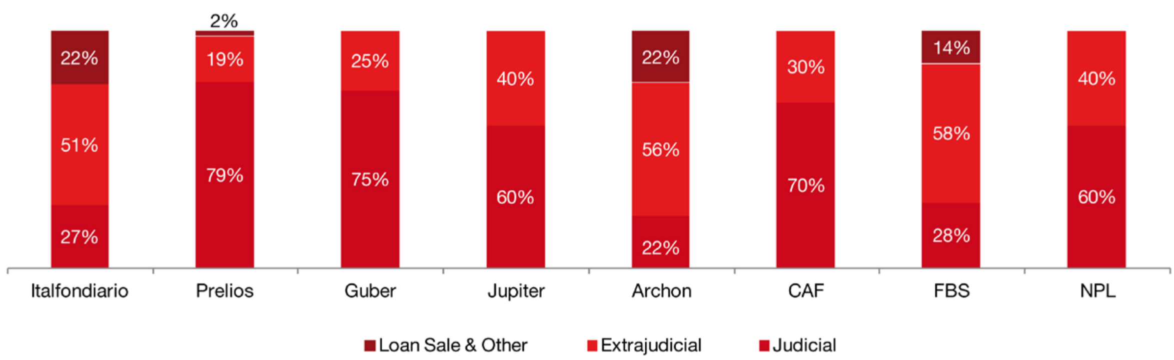


Chart 10 - Type of secured loans resolution (in %)



Source: PwC analysis on company management data

3 Source: Company management data at YE 2012 (except Jupiter at 8 March 2013)

6 Market recent activity and outlook

2012 activity and trends

In Q1-12 two competitive bid processes launched in 2011 by Intesa San Paolo and Banca delle Marche on their mixed NPL portfolios (secured & unsecured, retail & corporate) have been successfully closed. Both transactions were closed for a sensible smaller size compared to the original portfolio for which the auctions were launched, showing the need for tailoring the portfolio in order to meet investors' expectations.

The fast increase in the NPL stock for the consumer credit sector also pushed some major players to launch structured disposal processes on their NPL portfolios, while in the past this sector was only used to routine small size disposal processes. Two international groups in Q1 and Société Générale group (Fiditalia) in Q4 set the trend attracting both local players and international investors. According to rumors, other consumer credit players started the disposal processes but have not yet closed them.

Together with portfolios, also servicing platforms have been interested by some movements. In 2012, Prelios changed ownership and a disposal process (still on going) of one of the top 10 Collection Agencies launched a disposal process for its platform.

On the investors side, we counted several "new names" approaching the Italian NPL market with some of them turning out as bid winners.

2013 outlook

Based on initial evidence on 2012 YE results for top Banking Groups, it appears that recent inspections (focused on NPLs) of the Bank of Italy led to a material increase in loan loss provisions.

This should certainly help in the direction of closing the bid – ask gap. Though, the closure of transactions is certainly affected by the political stability of the Country as well as by the desirable measures driving the re-opening of the Real Estate lending.

The banking system itself - in the meantime – is exploring the possibility to find "in house" tailored solutions, such as a multi-originators platform, where different banks sell their NPLs to create the platform managed by one or more Special Servicers.

In 2013 the outlook depends significantly on the three above mentioned factors, i.e. provision level across portfolios of banks, political stability and RE lending. Despite the fact that we cannot assess the combined effect of these factors (i.e. the speed of the deleverage process), we expect the following processes to be in focus in 2013:

1. the continuance of consumer credit assets sale;
2. some big / medium size banks' disposing of mixed portfolios (especially unsecured assets);
3. potential acquisitions of Special Servicers / Collection Agencies by international investors, given the appetite of some international investors towards servicing platforms.

Table 4 - Main NPL portfolio transactions in 2012

Quarter	Seller	GBV (€mln)	Asset type	Buyer
Q4	Fiditalia	1,500	Consumer Credit	Multiple buyers: Anacap and Confidential
Q2	Banca Marche	127	Mixed S/U [1]	Christofferson, Robb & Company
Q1	Intesa San Paolo	1,640	Mixed S/U [1]	Confidential
Q1	Banca Marche	305	Mainly unsecured loans	FBS
Q1	Confidential	638	Consumer Credit	Banca IFIS
Q1	Confidential	498	Consumer Credit	Banca IFIS

[1] Mixed S/U: secured mortgage loans and unsecured loans, both retail and corporate

Source: PwC analysis on public available information

Portfolio Advisory Group

PricewaterhouseCoopers Advisory SpA
Via Monte Rosa 91
20149 Milano
Tel +39 02 80646.1

© 2013 PwC. All rights reserved.

"PricewaterhouseCoopers" and "PwC" refer to the network of member firms of PricewaterhouseCoopers International Limited (PwCIL). Each member firm is a separate legal entity and does not act as agent of PwCIL or any other member firm. PwCIL does not provide any services to clients. PwCIL is not responsible or liable for the acts or omissions of any of its member firms nor can it control the exercise of their professional judgment or bind them in any way. No member firm is responsible or liable for the acts or omissions of any other member firm nor can it control the exercise of another member firm's professional judgment or bind another member firm or PwCIL in any way.