The Italian NPL market

Increasing expectations

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Foreword

In 2013 several public and rumoured transactions occurred, almost exclusively in the NPL consumer credit space.

On the investor side, the market has been scouted by several investors which played their role in the executed transactions.

With a 2014 ECB Comprehensive Assessment in mind, most of major banks increased their provisioning levels for 2013 YE, with Unicredit leading the group with an increase of the NPL coverage ratio of 5.7% yoy.

We expect the ECB Comprehensive Assessment will lead to a further increase in provisioning levels in 2014 that together with investors' appetite and market liquidity should lead to a substantial increase in deal flows in the coming years.

Kind Regards,

Fedele Pascuzzi
fedele.pascuzzi@it.pwc.com

Antonella Pagano
antonella.pagano@it.pwc.com

Laura Gasparini
laura.gasparini@it.pwc.com

Content

01

Key Message: In an achieved context of stability, political focus shifted to the Country development and growth.
While waiting for measuring the ability of Mr Renzi in implementing the Country needed structural reforms, 2014 and 2015 GDP expectations are positive even if they remain at relative low levels.
In the RE market, the CRE sector shows signs of revitalization and the overall property's turnover is expected to strengthen 2013 initial positive trend

The Italian macroeconomic scenario and the real estate market overview

In a context where the Country's spread has sharply decreased in the last 2 years, the latest Italian governments (Mr Letta and Mr Renzi's ones) shifted their focus from granting economic stability to concerns regarding the Country growth and development. While waiting for the announced Renzi Government's structural reforms, the IMF GDP projections for 2014 and 2015, after 2 years of recession, are positive even if still at relative low levels.

Next few years would be crucial for the Country. The need for structural reforms cannot be further postponed. In fact, despite positive and slightly increasing primary balance, the Italian macroeconomic environment is strongly affected by the high public debt (nearly 134% and 132% of the GDP in 2014 and 2015) and by a steadily negative deficit (2.6% and 2.2% in 2014 and 2015).

Table 1: GDP growth (% change)

	% Change YoY				
Country	2011	2012	2013	2014	2015F
Italy	0.37	-2.37	-1.47	0.52	1.20

Source: PwC analysis on IMF data as of April 2014

Table 2: European Countries' peers analysis

		2013	2014	2015
Italy	Primary Balance	2.3%	2.7%	3.1%
	Deficit	-3.0%	-2.6%	-2.2%
	Debt	132.7%	133.7%	132.4%
France	Primary Balance	-1.8%	-1.6%	-1.4%
	Deficit	-4.2%	-4.0%	-3.9%
	Debt	93.4%	95.0%	95.0%
Germany	Primary Balance	2.2%	2.1%	2.1%
	Deficit	-0.1%	0.0%	0.0%
	Debt	79.6%	77.3%	74.5%
UK	Primary Balance	-3.3%	-2.3%	-1.4%
	Deficit	-6.3%	-5.2%	-4.2%
	Debt	91.4%	93.4%	94.5%
Spain	Primary Balance	-3.7%	-2.2%	-2.8%
	Deficit	-7.2%	-5.8%	-6.5%
	Debt	94.3%	98.9%	103.3%
EU	Primary Balance	-0.6%	0.2%	0.2%
	Deficit	-3.5%	-2.7%	-2.7%
	Debt	89.4%	89.7%	89.5%

Source: PwC analysis on European Economic Forecast, Winter 2013

[1] Debt of total economy is the sum of private and public debt

With reference to the Real Estate landscape, there are signs for a gradual recovery of the market after the outbreak of the global financial crisis in 2008 and the following debt crisis in 2011, with international players starting to invest mainly in the CRE sector.
During 2013, some investors, mainly Middle-Eastern, have acquired country's commercial properties, such as:

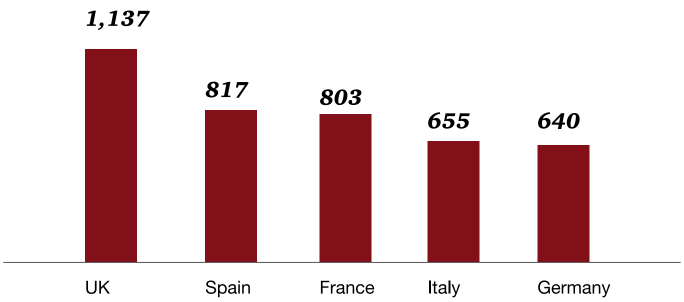
- *Hotels, e.g. the luxury hotel Eden in Rome sold for €105 mln to a sultan of Brunei, the prestigious Florence-based Four Seasons acquired by the Emir of Qatar for €150 mln*

- *Malls, e.g. Goldman Sachs, through a Morgan Stanley's RE fund, acquired 15-strong Italian Auchan shopping centres and a retail park for €650 mln*

- *Office buildings, e.g. Qatar's sovereign wealth fund bought 40% of the Milan's Porta Nuova from Hines Italia and the US private equity group Blackstone closed the acquisition of office properties in Milan owned by RCS, publisher of Corriere della Sera for €120 mln.*

Overall, timid signs of improvement in property's turnover have been observed in 2013 in Italy as well as in other European countries, and forecasts suggest that this initial recovery is expected to further strengthen in the coming years.

Chart 1: Debt of total economy per country (% GDP)[1]



Source: PwC analysis on OECD.Stat data, which refer to YE-2012

Table 3: Real Estate turnover and % change

		% Change YoY						
Country	**2013F Volumes**	**2009**	**2010**	**2011**	**2012**	**2013F**	**2014F**	**Trend 2015**
Italy	**113.500**	-10.0	3.3	-0.4	-2.0	0.6	1.0	↑
France	**138.600**	-18.7	0.9	3.0	-4.9	-0.4	0.8	↑
Germany	**194.000**	-9.6	2.7	2.9	4.4	3.0	3.6	↑
UK	**117.800**	-11.3	1.4	2.9	-2.0	1.1	2.0	↑
Spain	**75.500**	-17.6	-5.9	1.1	-4.0	-0.5	0.2	→
Avg EU 5	**639.400**	-13.3	1.0	2.1	-1.3	1.0	1.7	↑

Table 4: Real Estate price % change

		% Change YoY						
Country		**2009**	**2010**	**2011**	**2012**	**2013F**	**2014F**	**Trend 2015**
Italy	**Residential**	1.0	-5.9	-3.2	-1.1	-1.8	0.2	↑
	Offices	2.0	-2.9	-1.0	-1.0	-2.0	1.2	→
	Industrial	0.0	-7.0	3.2	-2.2	2.5	-1.5	↓
	Commercial	2.0	1.0	1.0	1.0	0.2	0.7	→

Source: PwC analysis on European Outlook 2014 – Scenari Immobiliari

02

Key Message: Banks lending to Households and Corporate at 2013 YE added up to €1.4 trn, decreasing by 4% yoy. The Commercial Loan Book is mainly concentrated in the North of Italy (60%) with a great exposure in the Construction and Real Estate sector (31%) as well as in the Manufacturing industry (23%) and Trade & Transportation sector (22%).

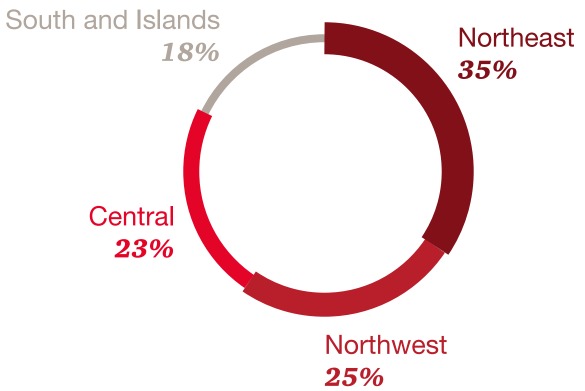
Overview of the Italian banking system

Italian banks have a commercial business model. According to Bank of Italy data[1], as of December 2013 Italian bank loans added up to €1.85 trn, of which 27.5% to Households, 49.1% to Corporate and the remaining 23.5% to Public Administrations and Financial Institutions.
Focusing on the Commercial Loan Book (Households and Corporate), €1.4 trn at 2013 YE, the overall lent amount decreased over the last year (-4.0% yoy).

This decrease is certainly linked to the declining trend observed for banks overall deposits (resident customer deposits and bank bonds). The overall deposits, in fact, decreased by 1.9% yoy, falling to €1.7 trn in Dec 2013. Behind this drop there is certainly the negative change in bonds stock (-9.8% yoy), which more than offsets the positive growth in short-term deposits (+1.9%)[2].
In terms of geographical distribution, the majority (60%) of the Commercial Loan Book is concentrated in Northern Italy.

About 1/3 of the Commercial Loan Book is allocated to the Constructions and Real Estate sector (31%), followed by the Manufacturing industry (23%) and Trade & Transportation sector (22%).

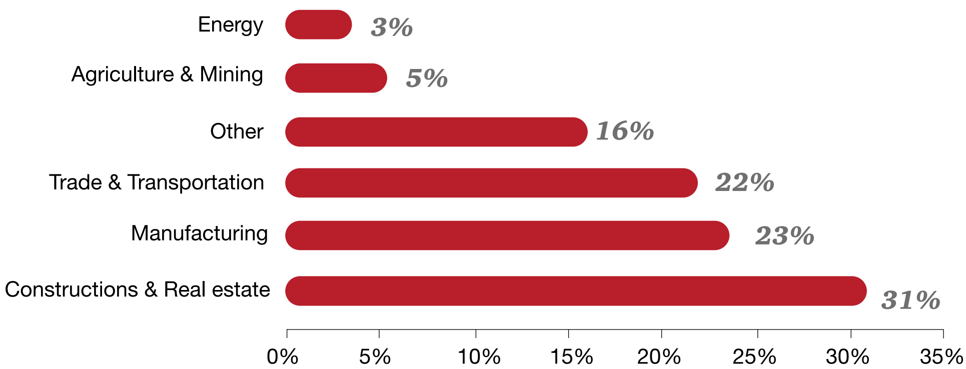
Chart 2: Distribution of the Commercial Loan Book by location



Source: PwC analysis on Bank of Italy, "Bollettino Statistico", data refer to YE-2013

Small and medium-sized enterprises (SMEs) are a key feature of the Italian economic landscape, accounting for about 80% of total employment and 68% of business value added.
Out of the SMEs, the micro enterprises with less than 10 employees account for 95% of the 4.4 mln corporate in Italy[3].

Chart 3: Breakdown of Commercial Loan Book by type of economic activity



Source: PwC analysis on Bank of Italy, "Bollettino Statistico" data refer to YE-2013

[1] Bank of Italy, Bollettino Statistico, I-2014, data refer to YE-2013
[2] ABI monthly outlook, March 2014
[3] Istat Publication, November 2013

03

__Key Message:__ According to our peers analysis, the relatively higher weight of impaired assets of Italian banks seems to be reflected in their share prices. We think that this will change in the next few years following the ECB Comprehensive Assessment exercise which will drive Italian banks to recapitalize and to review their loan book provisions.

Banks' asset quality deterioration issue

Following several years of economic crisis, the overall asset quality of Italian banks suffered with the total Impaired Loans reaching €283 bn, 17.8% of total customer loans. Since 2008, the impaired assets grew, on average, at a pace of +27% annually.

According to Bank of Italy current classification rules the Impaired Loans category does not correspond to the Italian NPL definition; Impaired Loans include the following sub-categories:

- *"Sofferenze" or "NPL",*
- *"Incagli" or "Watchlist",*
- *"Ristrutturati" of "Restructured Loans"*
- *"Scaduti" or "Past Due by more than 90 days".*

We expect that these sub-categories will soon disappear following the implementation of the recent[1] EBA definition of forbearance and non-performing exposures and following the Single Supervisory Mechanism implementation.

In fact, among the overall ECB Comprehensive Assessment currently undergoing in the Euro Area, one of the aims of the assessment is to improve transparency, i.e. enhancing the quality of information available concerning the condition of banks, especially with respect to their assets portfolio. In doing that, a common assets segmentation (the one provided by EBA) is utilized and is expected to be taken as reference for the future.

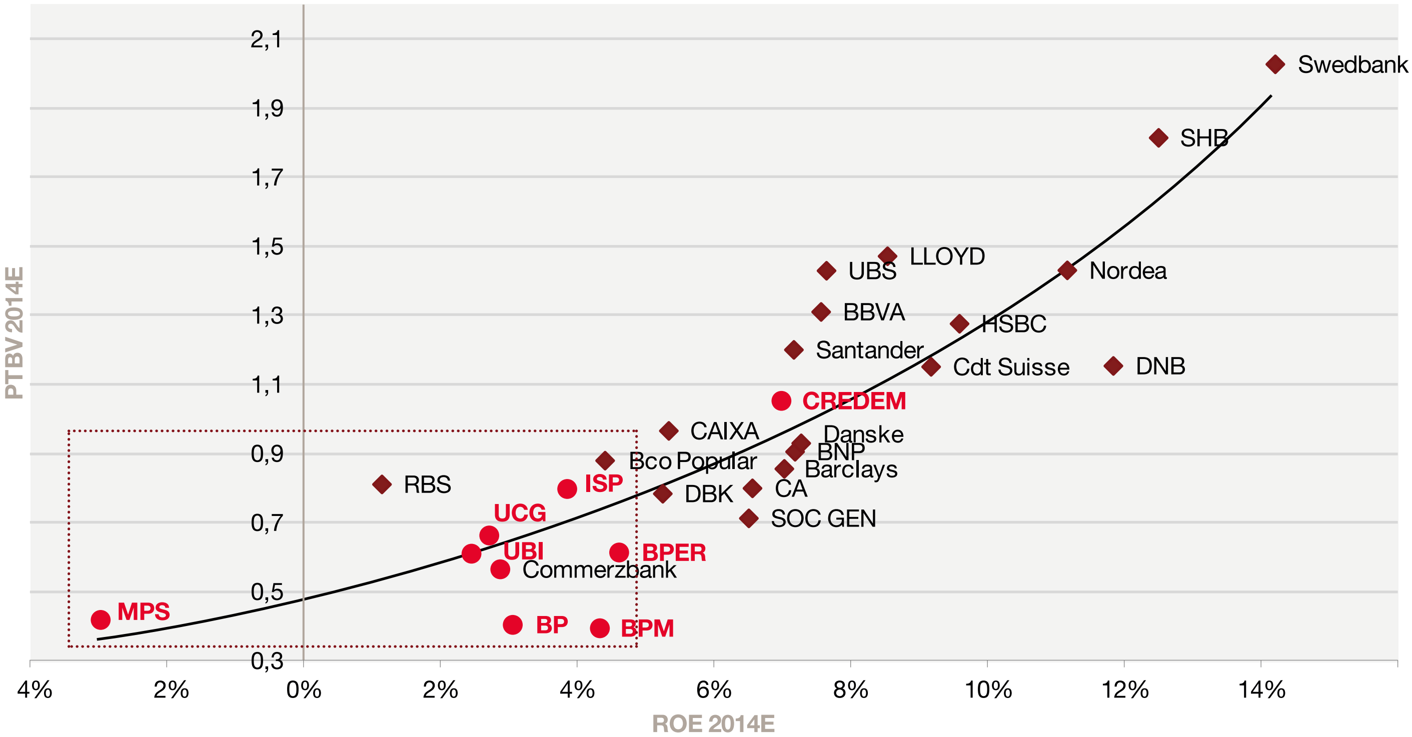
Comparing with the European peers', the relatively higher weight of impaired assets of Italian banks seems to be reflected on their share prices. Market values of Italian banks are on average lower than European competitors, with price to book values reflecting a lower expected profitability and a higher ratio between the Impaired Loans and the tangible book value.
(See Chart 4 and 5).

As for the asset quality component, this is expected to change in the next few years, driven by the ECB Comprehensive Assessment undergoing for Top 15 Italian banks. We expect in fact that the review of the credit files ("Asset Quality Review") will have a positive impact on banks' provisioning levels with a further increase in 2014 P&L.

Anticipating the ECB Comprehensive Assessment results (which will be disclosed in Q4 2014), 5 of the 15 Top Italian banks have recently announced capital increases for an aggregate amount of €7bn. Among them, Monte dei Paschi di Siena, Banco Popolare, Banca Popolare di Milano, Carige and Banca Popolare di Vicenza.
The expected positive effect on share price deriving from impaired assets disposal represents an incentive for the banks deleverage process.

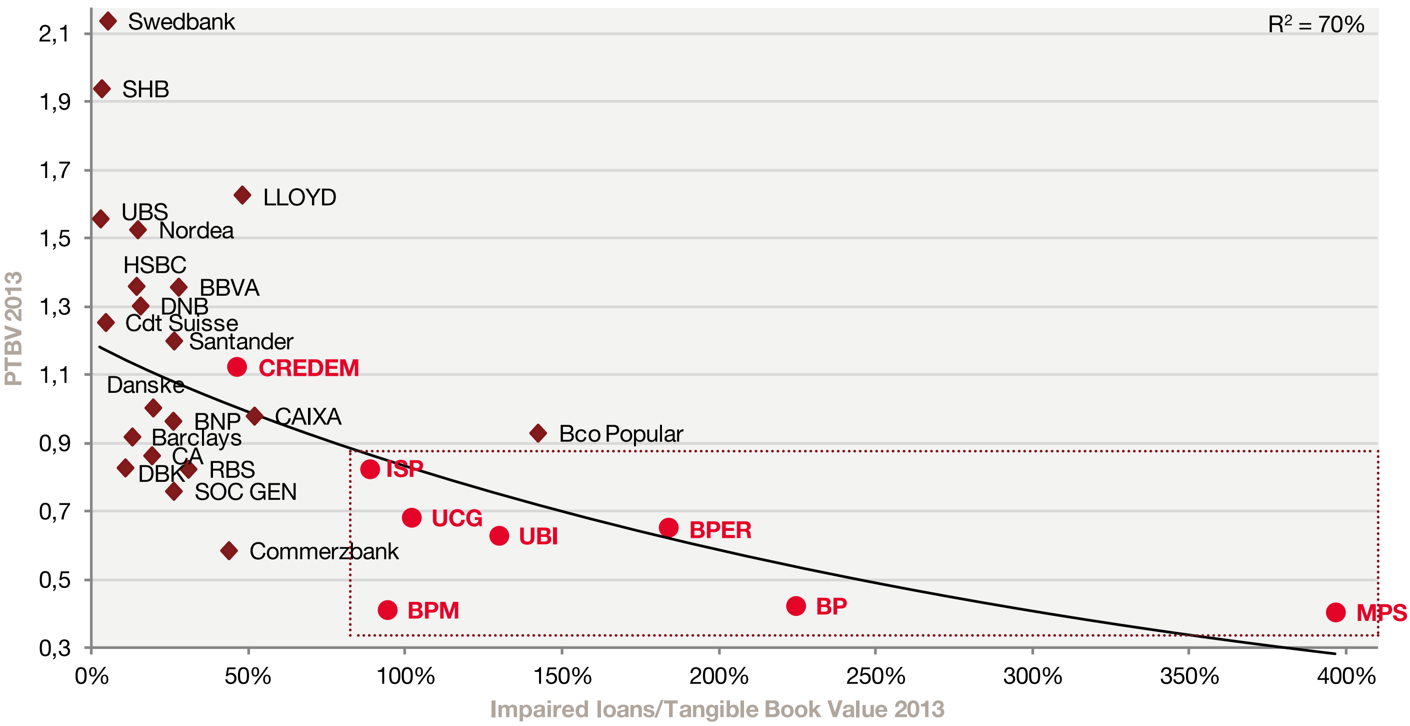
[1] According to the EBA definition, loans past due by more than 90 days should be considered non-performing exposures, with only few exception. For details, please refer to EBA FINAL draft Implementing Technical Standards - On Supervisory reporting on forbearance and non-performing exposures under article 99(4) of Regulation (EU) No 575/2013 – October 2013

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



Source: market price as of 27/02/2014; TBV 2014E based on the last available B/S data adjusted for dividends and expected earnings for 2014 based on Bloomberg estimates; ROE over expected net earnings for 2014 based on Bloomberg estimates

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



Source: market price as of 31/12/2013; last available B/S data for Impaired Loans and for TBV 2013E (adjusted for expected net earnings based on Bloomberg consensus, when end-period data are not available)

04

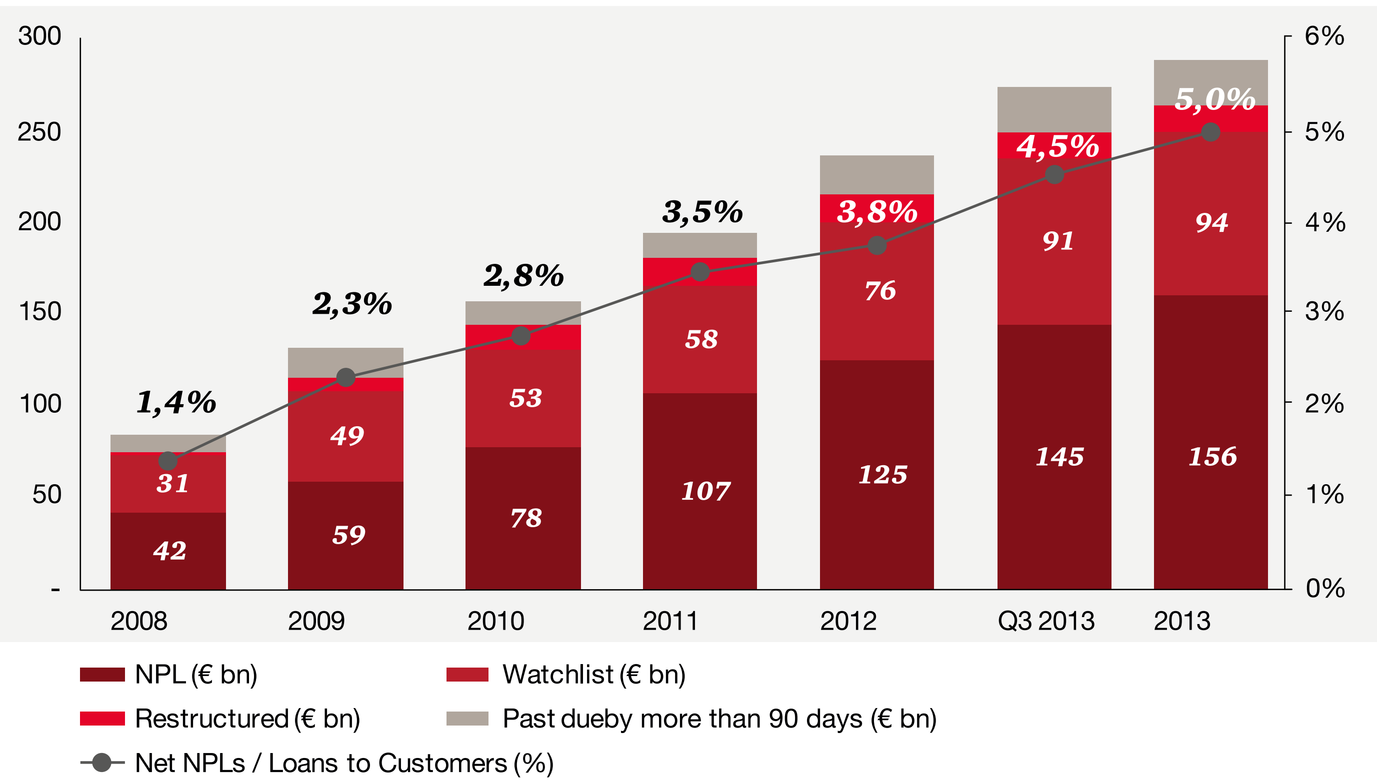
Key message: In December 2013, the gross NPL stock reached the record high level of €156 bn with a net NPL Ratio of 5.0%. The YE-2013 analysis on Top 10 Italian banks showed a significant increase in the last quarter of the NPL coverage ratio, now set at 54.7%. We think that the undergoing ECB Comprehensive Assessment will drive both the NPL and the Impaired Loans coverage ratios to further increases in 2014, accelerating the deleverage process.

Size and features of the Italian NPL market

As highlighted in the previous section, the Impaired Loans have progressively grown over the last 5 years (27% annually), with most of the increase attributable to the growth in NPL, i.e. "Sofferenze". The NPL, in fact, increased by almost 4 times in the last 5 years reaching its record high at €156 bn in December 2013, driving the gross NPL ratio to 9.8% and the net NPL ratio to 5.0%.

Focusing on Top 10 Italian banks, 2013 year end provision level evidences the effort made in preparation of 2014 ECB Comprehensive Assessment: the Coverage ratio increases, in fact, from 51.8% in Q3 2013 to 54.7% in Q4. In addition, the net NPL ratio is significantly lower compared to the overall Italian banking system (3.9% vs 5.0%).

Chart 6:Trend of Impaired Loans, NPL and net NPL ratio in Italy

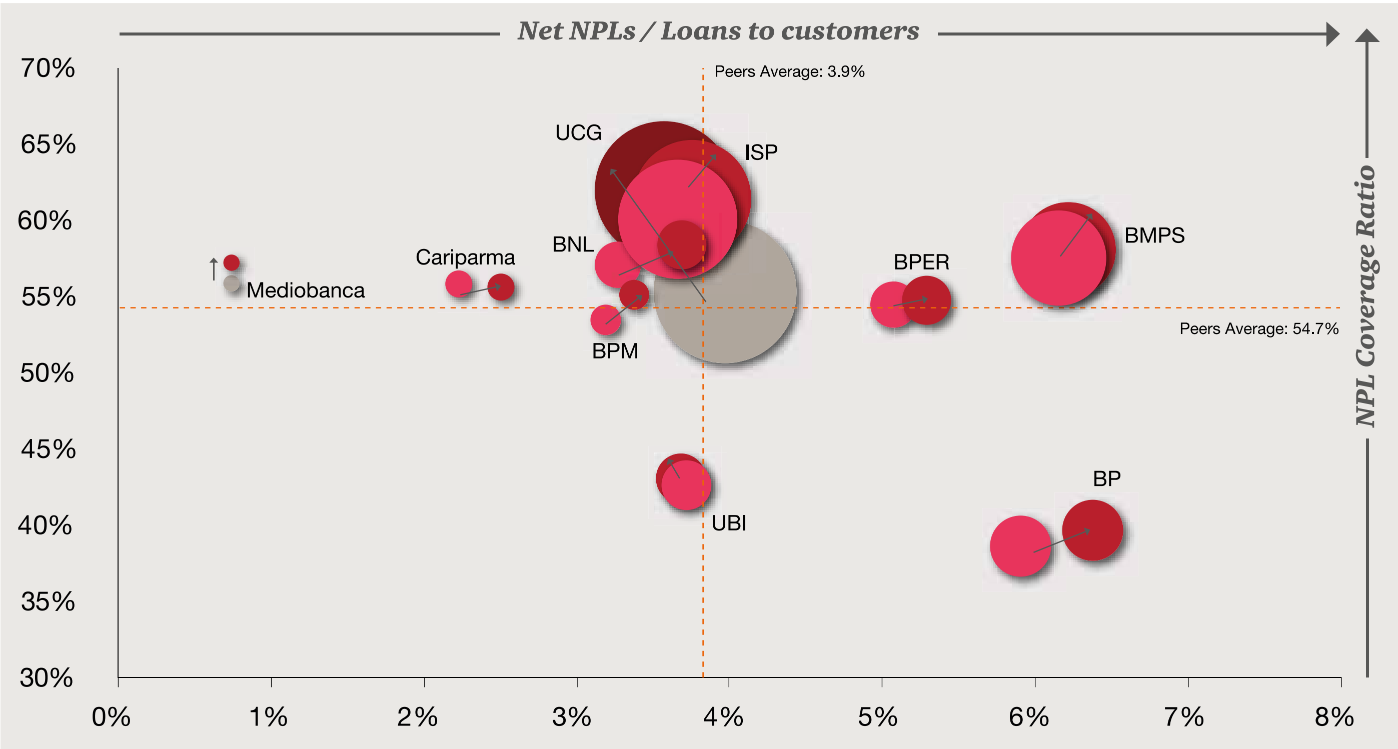


Source: PwC analysis on ABI Monthly Outlook and "Bollettino Statistico" of Bank of Italy, data refer to YE-2013.

Furthermore, we think that the implementation of the new EBA definition of non-performing exposures (in Italy the equivalent of Impaired Loans concept), is likely to drive the increase of the Impaired Loans coverage ratios.

We expect in the short term the deployment of a dual track, with Top 15 Italian banks under the Single Supervisory Mechanism ("SSM") pushed to comply with European standards immediately and the remaining banks under the Bank of Italy supervision aiming to the same objective in a relatively longer timeframe.

Chart 7: Top 10 Banks' movements – Q3 2013 vs YE 2013



Source: PwC analysis on companies' Q3-2013 and YE-2013 Results

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

05

__Key Message:__ We believe that the NPL servicing market will face strong opportunities for growth in the next coming years, deriving both from the expected deleverage process driven by the ECB Comprehensive Assessment undergoing for 15 Top banks and Italian banks need to outsource / partnership with specialized servicing players

The NPL servicing market

The NPL Special Servicing Market: strategic drivers for change

In the Italian special servicing space we distinguish few captive players - Unicredit Credit Management Bank and BCC Gestione Crediti - and several extra-captive players, where we focus our attention.

We envisage a boost in asset under management of independent servicer over the next 2/3 years resulting from servicing portfolios acquired by international investors and from the outsourcing activity and potential partnerships with Italian Banks.

In fact, following the significant increase in the NPL stock, banks workout departments are burdened and understaffed.
Outsourcing / partnership with one or more specialized servicers would allow to decrease the workload as well as to improve collection performance and operational KPI.

Moreover, Italian banks are under pressure for increasing profitability, which reverts to a great focus on cost income ratio and cost cutting initiatives.

The option of outsourcing/partnership would certainly help on transforming a fixed cost in a variable cost.

Table 5: Main NPL Non-Captive Special Servicers

Company	Turnover (€mln) 2013[1]	YoY	AUM (GBV €bn) 2013[1]	YoY	# of employees 2013[1]	YoY	Rating
Italfondario	46.9	-1.0%	36.1	5.0%	579	-3.0%	S&P: Strong Fitch: RSS1-/CSS1-
Guber	29.5	14%	4.5	60%	185	19%	S&P: n.a. Fitch: RSS2/CSS2/ABSS2
Cerved C.M.[2]	25.3	78%	9.7	213%	160	100%	S&P: n.a. Fitch: n.a.
Prelios	14.7	N/A	7.7	N/A	120	N/A	S&P: Above Average Fitch: RSS2/CSS2
FBS	13.5	30%	5.6	54%	112	18%	S&P: Above Average Fitch: RSS2 IT/CSS2 IT
NPL	11.6	51%	1.0	16%	21	-16%	S&P: n.a. Fitch: n.a.
Archon	10.0	-5.0%	1.8	-12%	48	-55%	S&P: n.a Fitch: n.a.
CAF	4.8	22%	4.0	74%	150	76%	S&P: Average Positive Fitch: n.a.

Source: [1] Management data as of YE-2013 (except for Prelios, whose data refer to YE-2012)
[2] Cerved C.M.: Cerved Credit Management

Focus on Extra-Captive Special Servicers

As of today, according to company management data provided to PwC, almost all Extra Captive Players 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 (generalist vs specialized, by asset class, ticket size,..).

Chart 8: Borrowers Geographical breakdown (Mix in %)

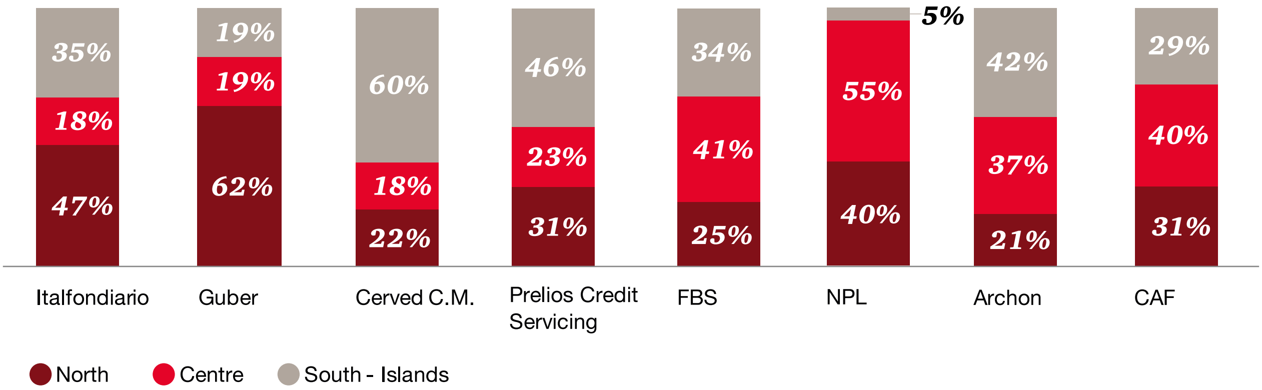


Chart 9: Type of loans managed by GBV (Mix in %)

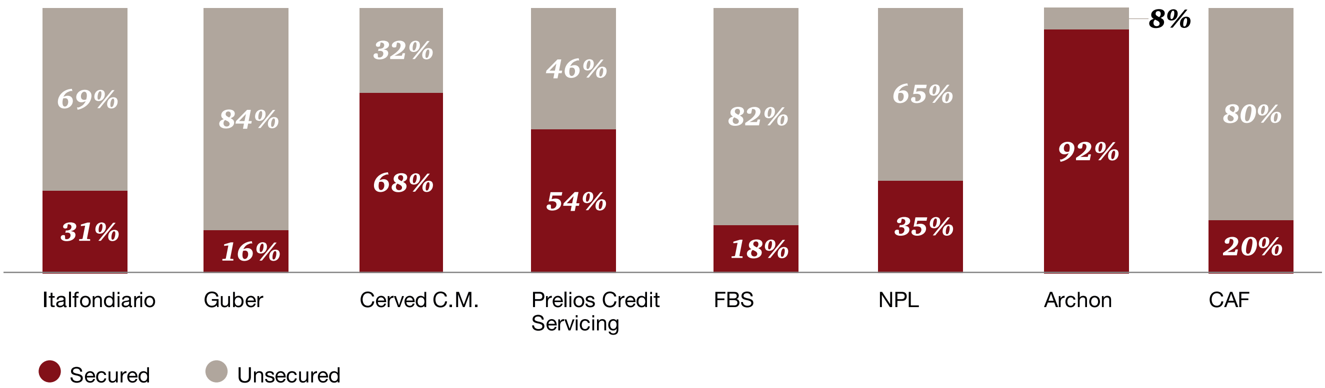
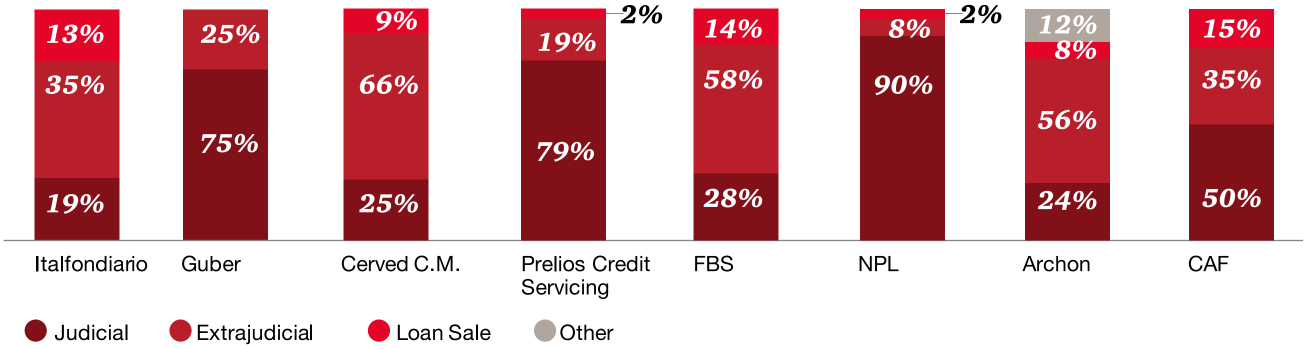


Chart 10: Type of Loan Resolution - Secured (Mix in %)



Source: PwC analysis on company management data as of YE-2013 (except for Prelios, whose data refer to YE-2012

06

Market recent activity and outlook

Recent activity and trends

In 2013 investors focused on unsecured loans: according to our observatory, 8 portfolio transactions closed over the last 15 months, for total asset face value of c. €4 bn (we list below only the publicly disclosed ones). In terms of underlying assets, most of the sold portfolios were consumer credit loans.

Payroll salary receivables ("CQS") attracted the investors' community attention. The sector, in fact, is currently undergoing some changes in the structure of funding of the business. This might represent an opportunity for players interested both in investing in existing stocks/platforms and in funding the new business at different levels of the capital structure. In 2013, Anacap stepped in acquiring a CQS portfolio from MPS Consum.it.

In terms of platforms, Cerved Credit Management acquired Delta Group's consumer credit servicing platform (Tarida), significantly enlarging their servicing capabilities.

Several international investors are approaching our country with the strategy of replicating investment models experienced in other countries, such as the combination of platform and portfolios experienced in Spain.

Table 6: Main public portfolio transactions in 2013 - 14

Quarter	Seller	GBV (€mln)	Asset Type	Buyer
Q1-2014	Creval	36	NPL - Mixed S/U[1]	Ares Management
Q1-2014	Unicredit	700	NPL - Mixed S/U[1]	Anacap
Q4-2013	MPS Consum.it	551	PL - Consumer	Anacap
Q4-2013	Unicredi	1,000	NPL - Consumer	Cerberus
Q4-2013	BCC	150	NPL - Mixed S/U[1]	Confidential

Source: PwC analysis on public available information

Unicredit, with the creation of a non core division with €87bn under management, some €1,7bn NPL sold in a few months, almost 10% increase in provisioning on NPL in Q42013 and a competitive auction process ongoing on its captive NPL servicing platform appears as a trend setter.

Looking ahead, we believe the undergoing ECB Comprehensive Assessment will facilitate the deleverage process: major Italian banks increased their provisioning levels at 2013 year end and we expect this trend to continue as a result of the undergoing on-site review of a significant number of credit files by the ECB inspectors .

Some banks are also carrying out capital increase programs, and this is attracting international investors willing to play a role in the Italian financial system.

In addition, the AQR process is leading to an improvement in data quality and transparency: this will benefit portfolio disposal processes, where the availability of a comprehensive and accurate data set is a crucial aspect for investment decisions.

We believe that structured deals combining portfolio and servicing platforms, with long term future flow servicing contracts, might represent a winning move for banks. In fact it creates value offsetting potential price gap on portfolios and reducing the bank fixed cost structure thanks to the employee transfer to the buyer.

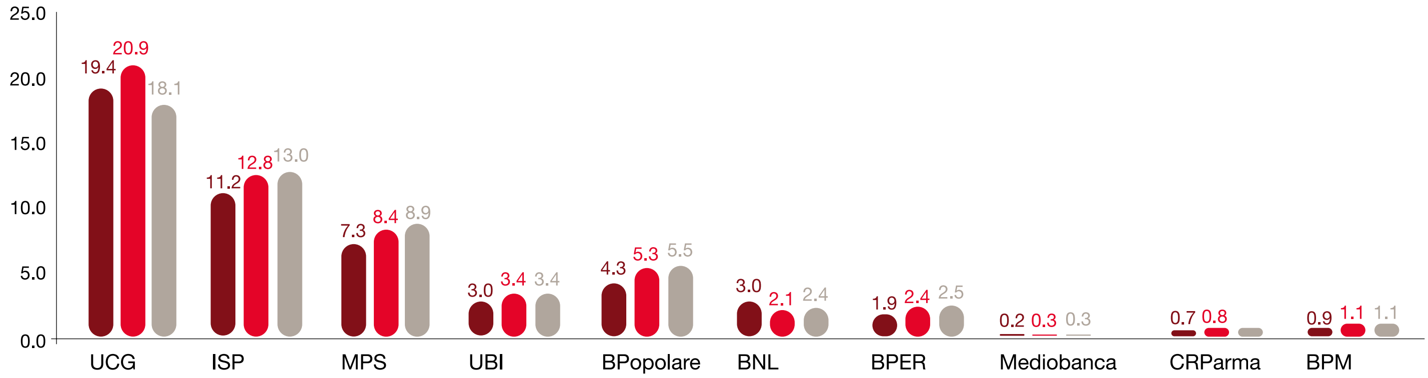
The considerable size of €283 bn impaired loans, the increasing liquidity available in the market and the regained political stability is attracting major international investors.

The deleverage process just started and is expected to deploy over the next 3 to 5 years.

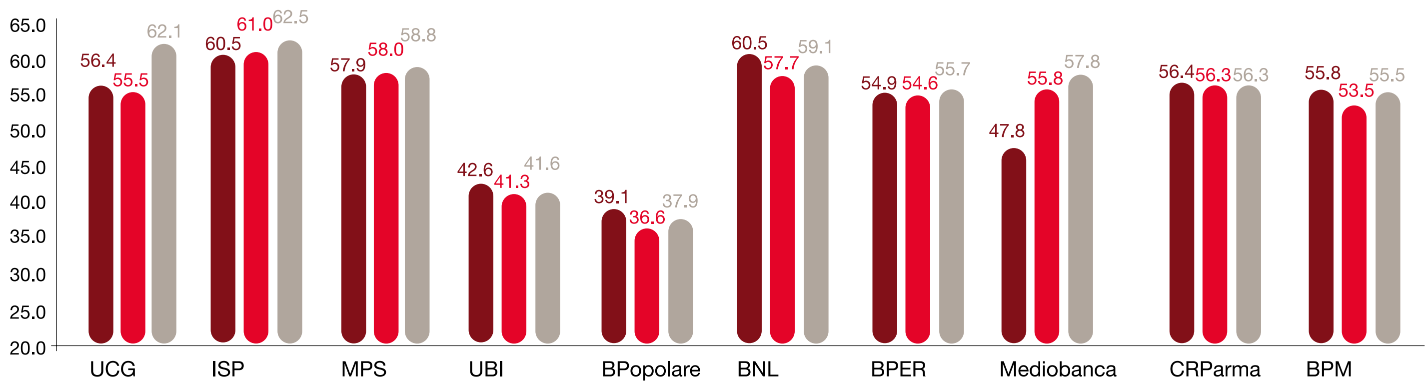
[1]Mixed S/U: secured mortgage loans and unsecured loans, both retail and corporate

Appendix - Top 10 Banks peer analysis (1|4)

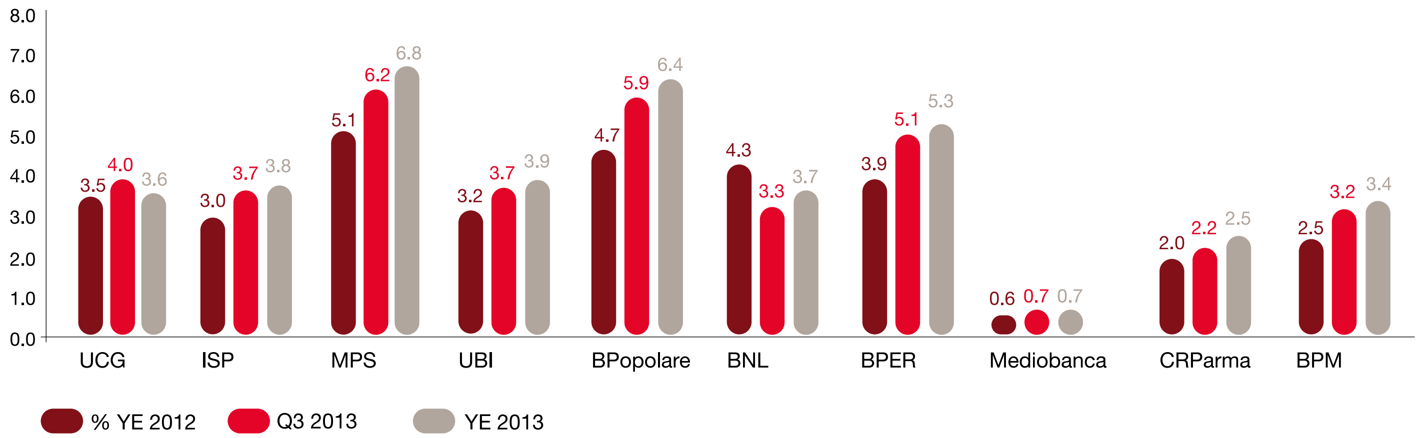
Net NPLs (€ bn)



NPL Coverage ratio (%) | NPL provisions / Gross NPLs



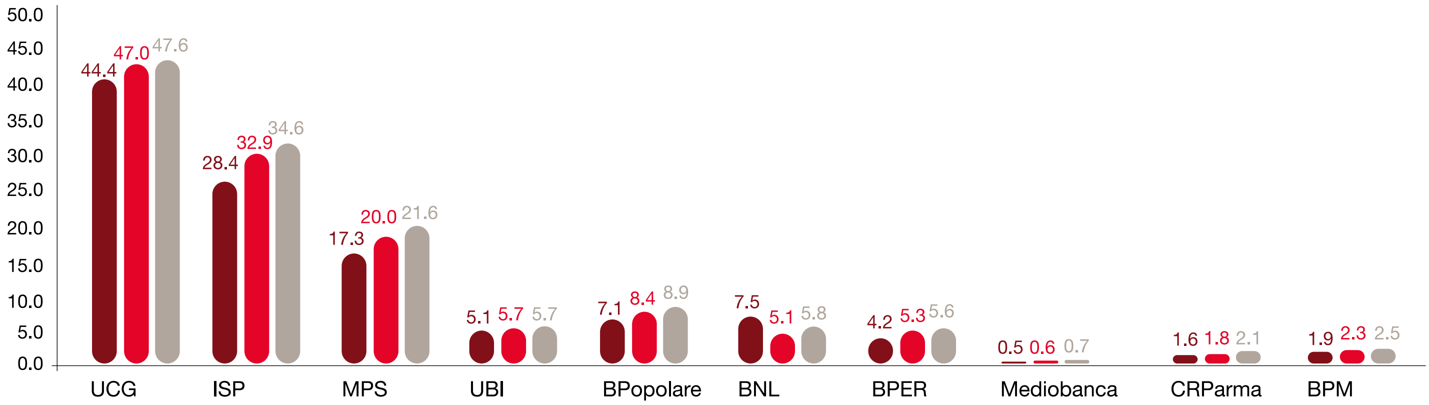
Net NPL ratio (%) | Net NPLs / Net Loans to Consumers



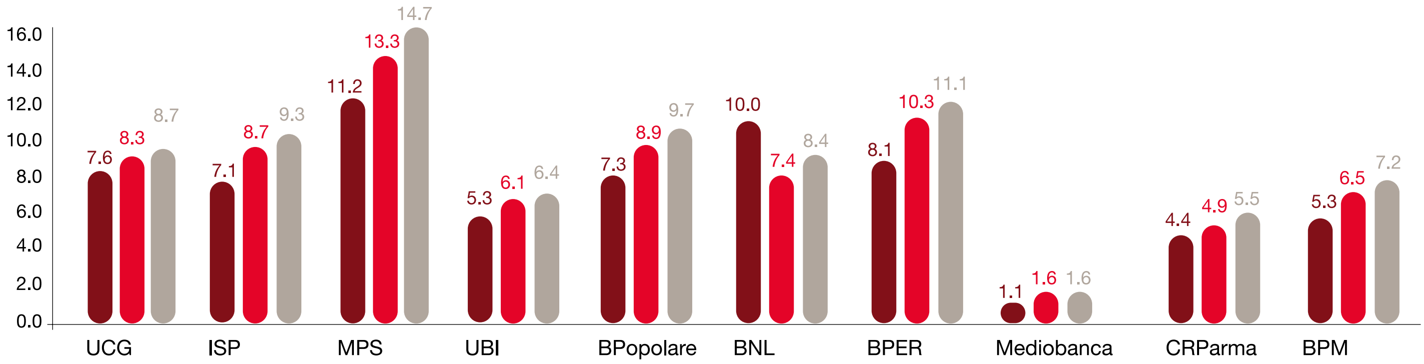
Source: PwC analysis on companies' FY-2013, Q3-2013 and YE-2013 Results. Data do not include "radiati"

Appendix - Top 10 Banks peer analysis (2|4)

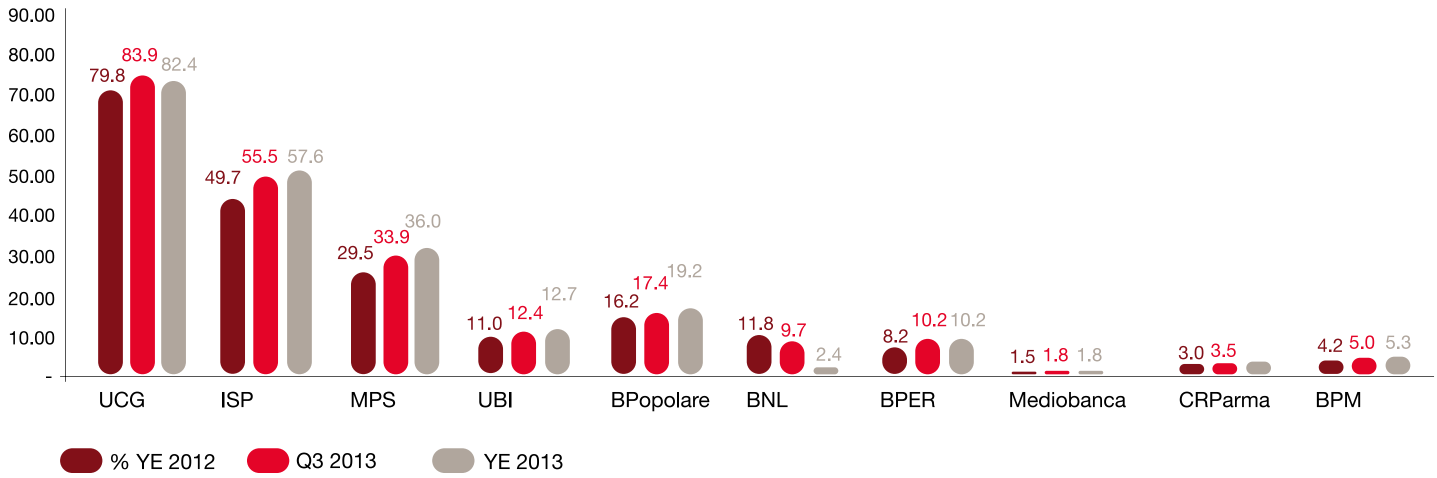
Gross NPLs (€ bn)



Gross NPL ratio (%) | Gross NPLs / Gross Loans to Consumers



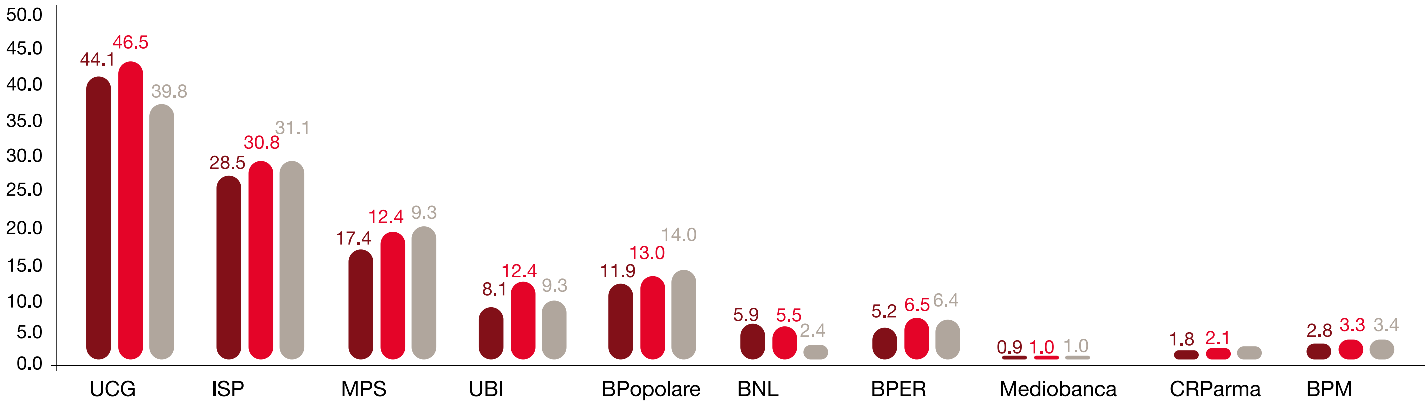
Gross Impaired Loans (€ bn)



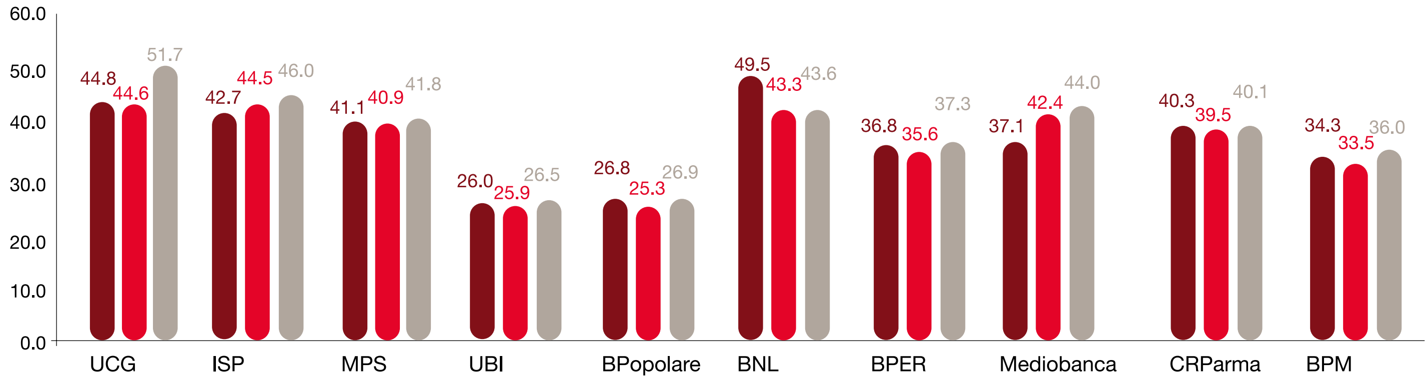
Source: PwC analysis on companies' FY-2013, Q3-2013 and YE-2013 Results. Data do not include "radiati"

Appendix - Top 10 Banks peer analysis (3|4)

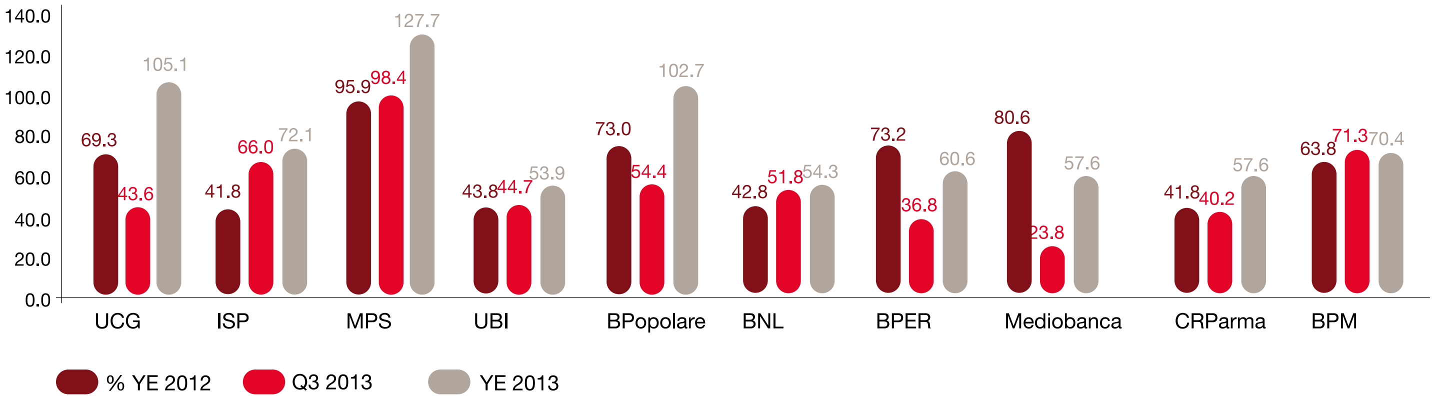
Net Impaired Loans (€ bn)



Impaired Loans Coverage ratio (%) | Total impaired provisions / Total impaired loans



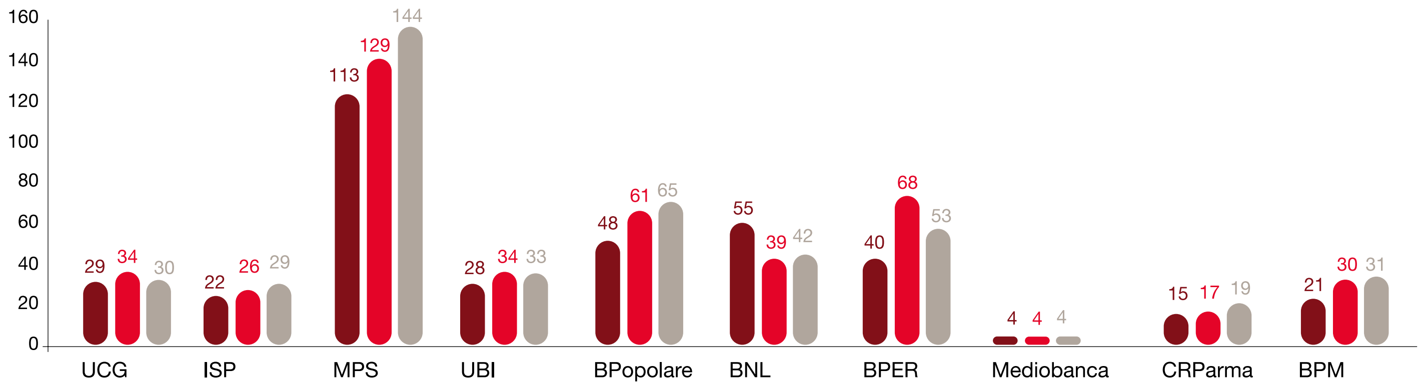
Yearly loan loss provision / Net interest margin (%)



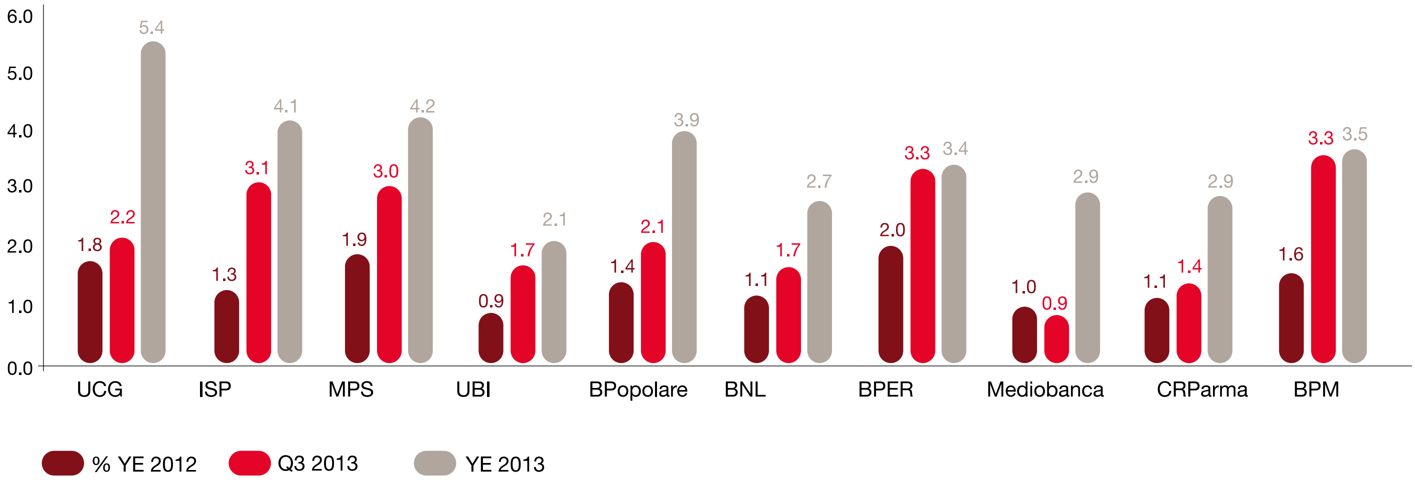
Source: PwC analysis on companies' FY-2013, Q3-2013 and YE-2013 Results. Data do not include "radiati"

Appendix - Top 10 Banks peer analysis (4|4)

Net NPL / Equity (%)



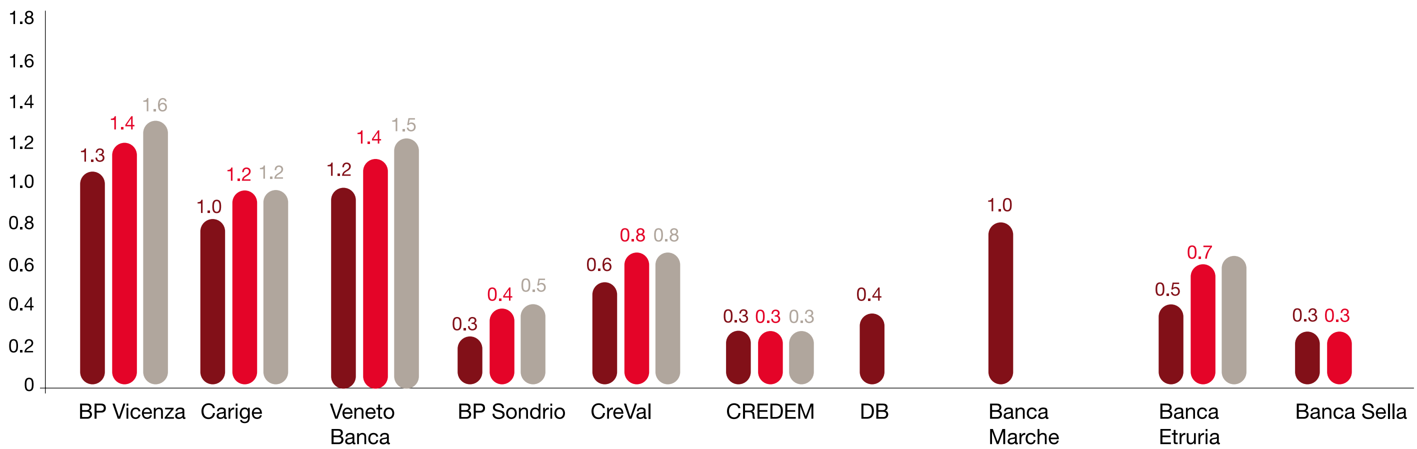
Writedowns/ Loans to consumers (%)



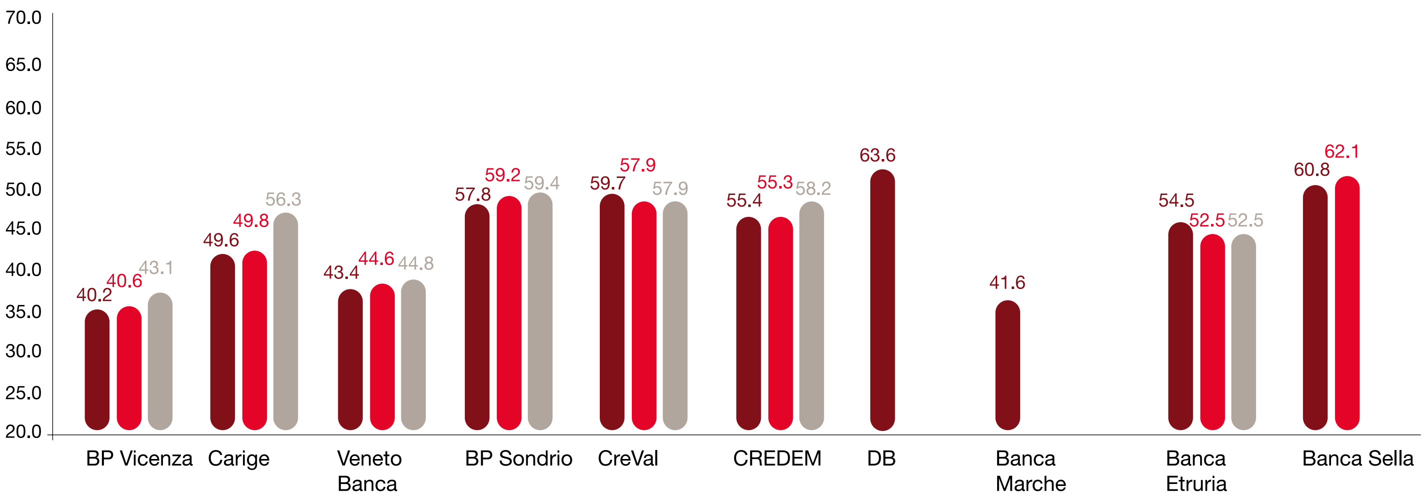
Source: PwC analysis on companies' FY-2013, Q3-2013 and YE-2013 Results. Data do not include "radiati"

Appendix - Other Top 20 Banks peer analysis (1|4)

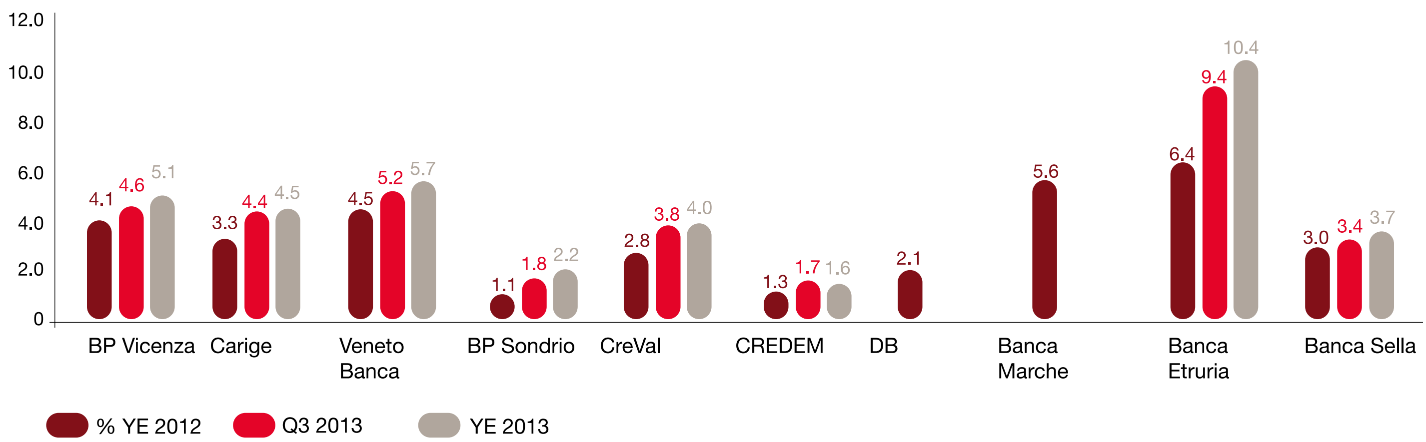
Net NPLs (€ bn)



NPL Coverage ratio (%) | NPL provisions / Gross NPLs



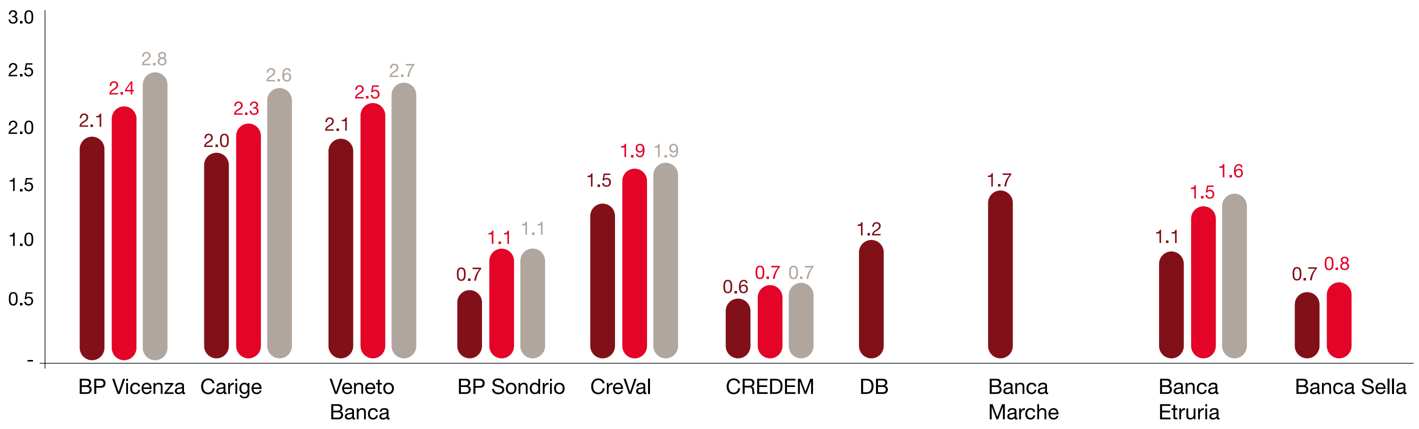
Net NPL ratio (%) | Net NPLs / Net Loans to Consumers



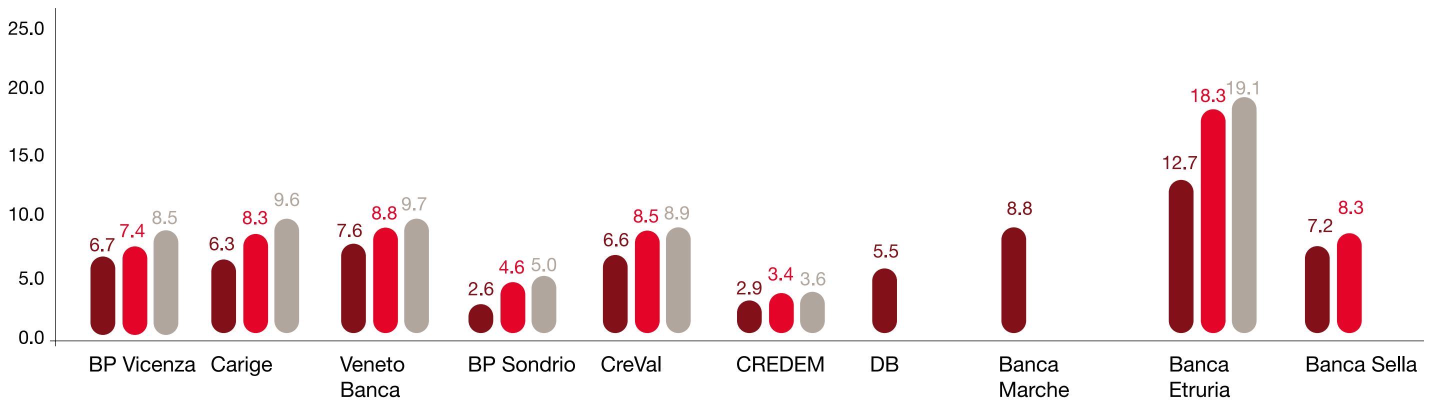
Source: PwC analysis on companies' FY-2013, Q3-2013 and YE-2013 Results, except for Deutsche Bank, Banca Marche and Banca Sella for which not all data were availabe.Data do not include "radiati"

Appendix - Other Top 20 Banks peer analysis (2|4)

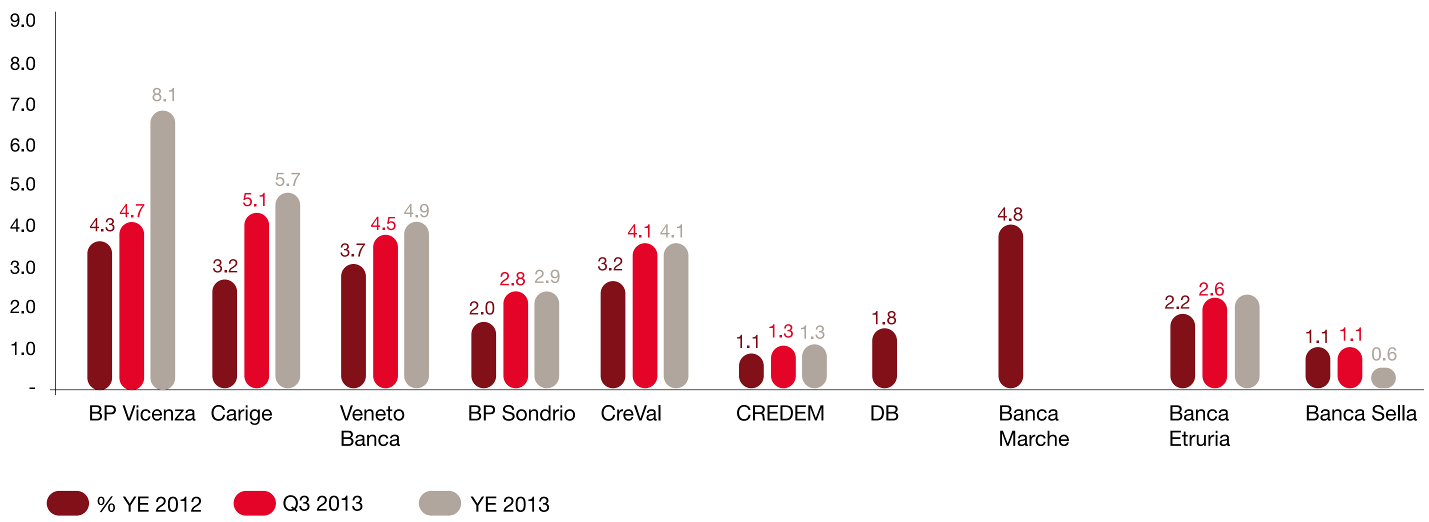
Gross NPLs (€bn)



Gross NPL ratio (%) | Gross NPLs / Gross Loans to Consumers



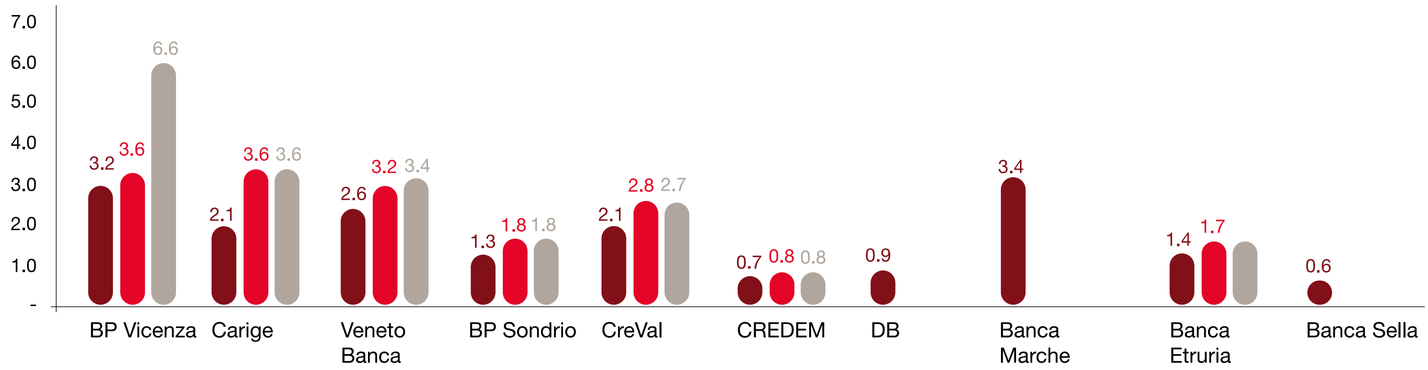
Gross Impaired Loans (€ bn)



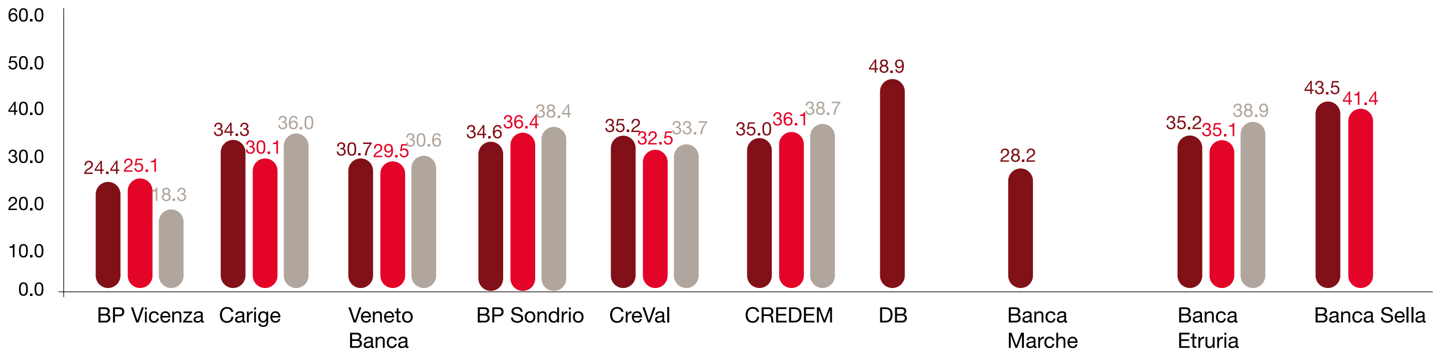
Source: PwC analysis on companies' FY-2013, Q3-2013 and YE-2013 Results, except for Deutsche Bank, Banca Marche and Banca Sella for which not all data were availabe.Data do not include "radiati"

Appendix - Other Top 20 Banks peer analysis (3|4)

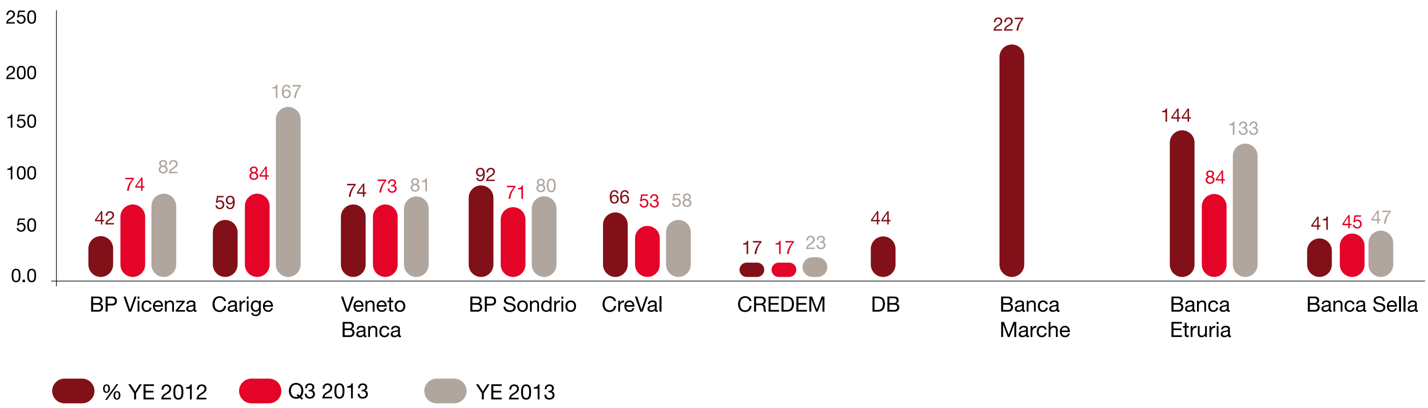
Net Impaired Loans (€ bn)



Impaired Loans Coverage ratio (%) | Total impaired provisions / Total impaired loans



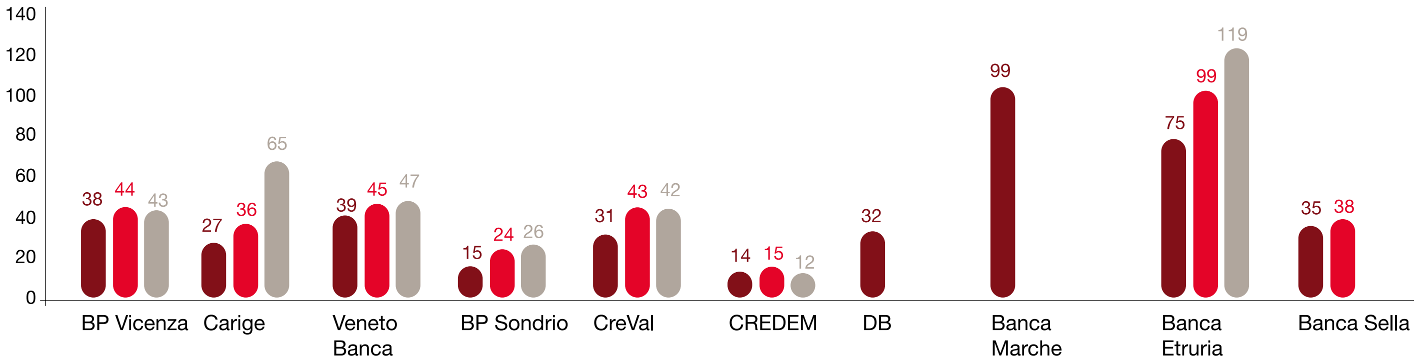
Yearly loan loss provision / Net interest margin (%)



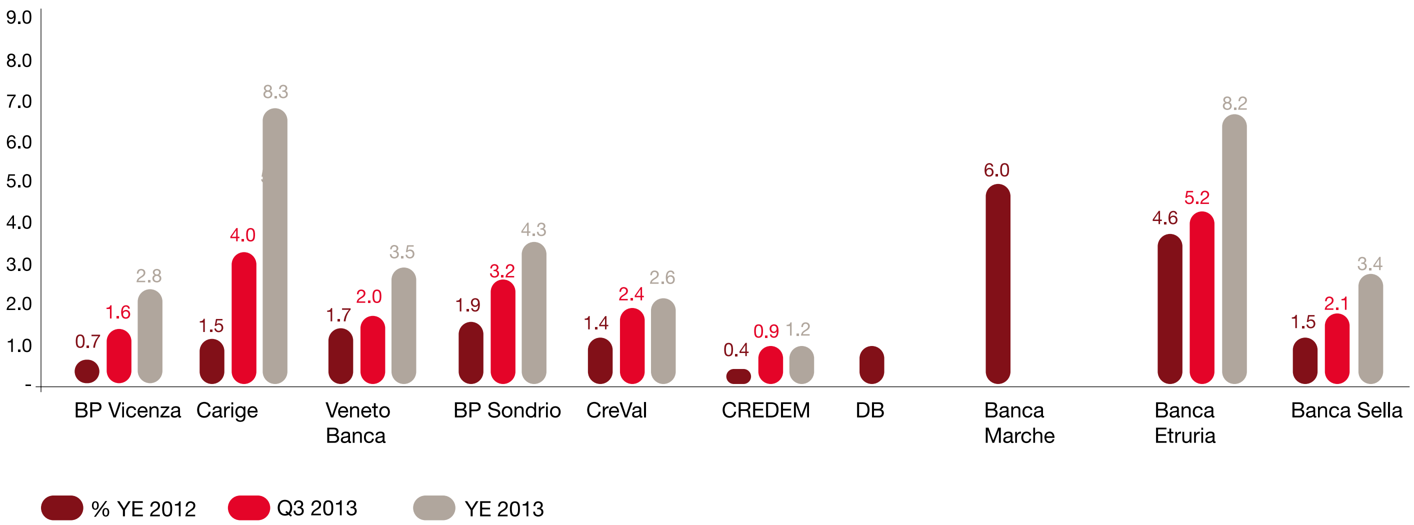
Source: PwC analysis on companies' FY-2013, Q3-2013 and YE-2013 Results, except for Deutsche Bank, Banca Marche and Banca Sella for which not all data were availabe.Data do not include "radiati"

Appendix - Other Top 20 Banks peer analysis (4|4)

Net NPL / Equity (%)



Writedowns/ Loans to consumers (%)



Source: PwC analysis on companies' FY-2013, Q3-2013 and YE-2013 Results, except for Deutsche Bank, Banca Marche and Banca Sella for which not all data were availabe.Data do not include "radiati"

Portfolio Advisory Group

PricewaterhouseCoopers Advisory SpA
Via Monte Rosa, 91
20149 Milano
Tel. 02 80646.1