Italy – 2020 Outlook

MEDIOBANCA SECURITIES

09 January 2020 | Country Update

Where there is Risk, there is Opportunity

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Global Macro: Risk for further steepening of yield curve tilted to the upside

The ECB highlights that whilst the Eurozone's incoming macro data remained weak, surveys pointed to signs of stabilisation adding that risks had become less pronounced. Developments on Brexit and the trade war have indeed taken a turn for the better in December. Our '20 base scenario for the Eurozone is that growth will remain sluggish, rates will remain low for a prolonged period of time, with no further cuts in the deposit rate, and that the US/Iran conflict is contained.

Italy: Stagnation, but no recession; '20 Budget provides little support to growth

Our central case is that subdued growth will continue also in '20, without entering a recession. Such assessment broadly coincides with that of the major institutions, which foresee modest growth to persist also in '20 with GDP growth expectations at +0.5%. That said, the most recent projections from international institutions are lower (+0.4%), something that may raise concerns on the assumptions included in the latest Budget, that we believe includes limited support to growth.

Banks: Tactical rotation still has legs; Preference for UCG & UBI

We argue that credit business margin compression may not intensify further and regulatory pressure can be dealt with organic capital generation, while we are seeing positive new regulatory signs. Meanwhile valuations are undemanding, with '21 P/E at 7.2x (only ISP is positioned at c10x), which stands below the normalised P/E since 2005, with discount peaking at c20% at UCG & c10%/15% at UBI/Credem. Banks offer deep valuation discounts vs Utilities/Insurers without compromising on dividend yields. We believe that asset gatherers (PST/Anima) should continue holding up well.

Utilities/Infra: Networks fully-priced; Energy deal is key; ASTM (Re-initiate with O) offers better risk/reward than ATL (Downgrade to N)

While regulated Utilities enjoy stable regulations and strong balance sheets should support dividends, we believe that trading at >30% premium on equity RAB, most of these stocks have already priced macro-related tailwinds. That said, we believe that the New Energy Deal opens a growth opportunity that should favour Enel (O). In the infra space, we resume coverage of ASTM with an Outperform rating and downgrade Atlantia to Neutral on a less attractive relative risk/reward profile.

Energy: Weaker crack spreads, Downgrade SRS; lower US rig count negative for TEN

We downgrade Saras to N (from O) due to a weaker than expected refining margin environment. We believe this could lead to more downgrades in FY20 consensus estimates. The ongoing decline in drilling activities across North America, and the political uncertainty in Argentina, continue to represent a drag for Tenaris (N).

TMT: Prefer Telecom Italia vs Towers/Media. Downgrade RWAY & MN

The mix of less competitive market dynamics for the mobile business, discussions over the set-up of a single fibre network & on-going potential catalysts (TI's CMD on 11 March) leads us to reiterate our preference for Telecom Italia vs Towers/Media. We move ratings on RWAY, MN & GEDI to N (from O) given limited upside on fundamentals.

Industrials: Selective approach; Too early for Auto re-rating (Downgrade Brembo to N); Cautious stance on Branded Goods

We prefer Prysmian (O) on offshore wind development & Leonardo (O) on persisting geo-political tensions. We downgrade Fincantieri to N (from O) on the back of enduring execution issues at Vard and slowing intake. We believe it is too early to call the Auto sector re-rating (downgrade Brembo to N from O) while Exor (O) should benefit from corporate action on underlying assets. We maintain a cautious stance on Branded Goods on demanding multiples (downgrade AEFFE to N).

We cut 2020/21 EPS by -7% for >25 cyclicals; Top picks: UCG/UBI, Poste/Anima, Enel, Telecom Italia, Prysmian/Leonardo/Exor

In this note, we cut our 2020/21 EPS by -7% for 25 cyclical stocks. This comes on top of the -6% cut in our estimates that we completed in 2019. This downwards earnings revision is mainly concentrated in the Oil, Branded Goods & Automotive sectors, with minor changes on banks. Our picks for '20 include exposure to Banks (UCG/UBI), Asset Gatherers (PST/ANIM), the Energy Deal (Enel) and some Industrials (TI/PRY/LDO/EXO).

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Sector Allocation / Stock Selection	
Most Preferred	**Least Preferred**
Banks (Unicredit, UBI)	Regulated Utilities (Terna, Snam, Italgas)
Asset Gatherers (Poste Italiane, Anima)	Insurance (UnipolSai, Cattolica)
New Energy Deal: Renewables (Enel)	Oil & Gas (Tenaris, Saras)
TMT (Telecom Italia)	Towers/Media (Rai Way / Mondadori / RCS)
Selected Industrials (Prysmian / Leonardo/ Exor)	Branded Goods (Ferrari, Ferragamo, Tods)

Rating Changes	
Atlantia	N (was O); TP: €22.1 (was: €25.4)
Brembo	N (was O); TP: €12 (unchanged)
ASTM	O (was Restricted); TP: €32.9
Rai Way	N (was O); TP: €7.02 (unchanged)
Fincantieri	N (was O); TP: €1.00 (was: €1.30)
Saras	N (was O); TP: €1.65 (was: €2.05)
Mondadori	N (was O); TP: €2.35 (unchanged)
GEDI	N (was O); TP: €0.46(was: €0.55)
AEFFE	N (was O); TP: €2.20 (was: €2.50)

PIR Selection
Autogrill, BFF, Interpump, Iren, ENAV, SeSa

Source: Mediobanca Securities

Contents

We thank Jacopo Vismara and Simone Galbusera for their contribution to this report

2020 OUTLOOK - EXECUTIVE SUMMARY

Global Macro – Policy Stances now appropriate; US growth expected to keep outpacing Europe

The IMF repeatedly cut its forecasts of global growth last year. In its latest World Economic Outlook in October, it foresees that growth in the US will outpace that of Europe meaningfully again in 2020 at 2.1% vs 1.4%. In fact, with the only exception of Japan, the US is the only advanced economy for which the institution upped its 2020 growth estimates in that update.

Monetary policy in 2019 was back to easing in both the US and Europe. The FED cut its Funds rate three times in 2019 and the ECB followed suit, with a deposit rate cut in September and a resumption of QE, pushing long-term rates in deeply negative territory and producing a further descent in short-term rates in Europe. The Eurozone yield curve flattened markedly in 2019, but recovered since September/October for more than a third of the initial fall.

Our general take from both central banks' December meetings, is that monetary policy is now appropriate. The tone of the Fed's December meeting statement was more upbeat and rid of references to uncertainties and the Fed's rate path does not foresee any move to rates in 2020. Furthermore, the ECB's December statement – the first under Mrs Lagarde's helm - kept to the same policy of statement and stance as in October.

Global Macro – On our base case, risk of further steepening in yield curve tilted to the upside

The ECB highlighted that whilst the Eurozone's incoming macro data remained weak, surveys pointed to signs of stabilisation, adding that risks albeit still tilted to the downside, had become less pronounced. In the US, market expectations for another rate cut have been pushed back to November this year. In Europe, probabilities of further cut to the deposit rate have fallen to virtually zero.

Barring very recent developments on the US/Iran front for which the outcome is hard to predict and highly uncertain, Brexit and the trade war - the key risks of last year to global macro - have indeed taken a turn for the better in the second week of December. In the UK Conservatives won the general elections with a notable majority, and the US administration reached an agreement on a phase-one trade deal with China.

Our base scenario for 2020 is that: (a) Eurozone growth will remain sluggish; (b) rates in the Eurozone will remain low, possibly for a prolonged period of time but the deposit rate won't be cut any further; (c) the USD will remain strong vs the Euro on better growth prospects in the US; (d) tensions between the US and Iran are to be contained and do not escalate into a full blown crisis. In those circumstances, we see risks of a further steepening of the yield curve (by the mean of an increase in the long part of the yield curve) tilted to the upside, were developments on trade and/or Brexit to turn out positive (although admittedly there are still plenty of challenges ahead).

Italy's Macro – Stagnation, but not recession

Macro data clearly show that global trade tensions are taking a heavy toll on Italy's economy. As a matter of fact, after the summer of 2018 Italy has been subject to a steady downward revision of GDP growth estimates (more marked than that of other European countries). Despite exiting technical recession in 2H18, GDP data remained stagnant throughout 2019.

GDP data in 3Q 2019 highlight the lack of growth (+0.3% y/y), below the +1.2% posted in the Eurozone, due to a mix of stagnant internal demand and weakening support from exports. Industrial production continued deteriorating sequentially, declining by -2.4% YoY in October 2019, following -1.5% on average in 3Q and -0.8% in 1H19. Consumer and manufacturing confidence, as well as economic sentiment are all deteriorating, after that PMIs already dropped close to relative lows from the relative high before the elections of 2018.

As all the major leading indicators (industrial production, consumer and business confidence) point to economic stagnation, our central case is that subdued growth will continue also in 2020, without entering a fully-fledged recession. Such assessment broadly coincides with that of the major institutions, which foresee modest growth to persist also in 2020 with growth GDP expectations for 2020 hovering over +0.5%. Moreover, the most recent projections from international institutions (pointing to +0.4% GDP growth) may raise concerns on the growth assumptions included in Italy's Government Draft Budgetary Plan.

The descent in Italy's 10-years sovereign yields (135bps vs c.240bps in Jun-19) can be attributed to a generalized fall in interest rates along the whole yield curve after the ECB comments on policy rates outlook and to an improved perception of Italy's country risk after the formation of the new Government. As we expect no further cuts in ECB policy rates, our central case is that sovereign yields will stay anchored at current levels (keeping the cost of new debt issuance at record lows), with possible uptick in the long maturities in the event of progress in trade talks.

Italy's 2020 Budget – Little support to growth

As the bulk of the resources employed in the Budget Law are needed to prevent further deterioration in internal consumption and investments, the Budget Law includes few expansionary measures (€5bn/€6bn) and we calculate that higher taxes/lower spending exceed fiscal expansionary measures by €3bn/€4bn. Also the largest expansionary measure (€3bn reduction in the fiscal wedge) accounts for only 0.5% of after tax personal income, not enough to change Italy's consumption in our view.

Our analysis on the fiscally expansionary measures in Italy's main trading partners shows that some support could only come from a reduction in Germany's fiscal surplus. However, additional spending worth 0.5% of Germany's GDP would translate into €16bn of additional GDP, from which the benefits for Italy's export could amount to few hundreds of millions of Euros, almost immaterial. Our analysis of the goods exported to other large trading partners (USA, Switzerland) indicate that 55% of the goods exported are unlikely to be involved in any fiscally expansionary measure. Hence, we conclude that a boost to Italy's export can only come from a generalised improvement in global trade.

We see few elements of conservatism in Italy's economic projections for two main reasons. On one hand, stricter rules on digital payments are to be enforced only from 2H20 onward and hence it is hard to see how this could provide a support to Italy's public finances in 2020. On the other hand, our analysis shows that the calculations underpinning the 2020 Budget Law projections look already based on record-low cost of debt (namely a 7-yrs BTP yield at 0.6%, the lowest level since the start of the summer 2019, already risen to 0.9% in the last auction dated November 2019).

Overall, being designed to prevent a further deterioration of internal consumption and investments – we believe Italy's 2020 Budget Law may face difficulties to deliver on GDP growth and hence risks look tilted to the downside on the +0.6% GDP growth expected by Italy's Government. In other words, with minimal self-help, Italy's economic outlook looks entirely tied to the global outlook.

Italy's Politics – Volatility is there to stay

A new government, led by PM Giuseppe Conte and supported by PD, Five Star, Renzi's Italia Viva and left-wing LeU, obtained a confidence vote in September 2019. Thanks to a constructive relationship with the EU, the new government has managed to negotiate with the EU more budget flexibility, something that has been seen as reassuring. At the same time, press continues to report on-going discussions within the coalition supporting the government (Renzi forming a new party, electoral & justice reforms, ESM, ArcelorMittal) and this could weaken the government's action, while current majority at the Upper House looks like thin.

Upcoming regional elections - with uncertain outcome in the Emilia Romagna Region - could increase volatility, while the time needed to implement the electoral reforms may eventually reduce risk of early elections. From an investment standpoint, we acknowledge the fact that volatility generated by Italy's political uncertainty is unlikely to fade away and see it as the main risk of our tactical rotation from utilities & insurance companies into banks.

Banks – The most credible candidate for further re-rating; Tactical rotation still has legs

We acknowledge that banks' earnings are not on an upward trajectory owing to negative rates and sluggish and unsupportive macro. We also reckon that regulation (Targeted Review of Internal Models (TRIM), EBA guidelines, EBA default definition, Basel IV at some point) will keep eroding banks' capital, preventing the accumulation of surplus capital.

However, the recent progress in trade talks and the clear outcome of the elections in the UK would point to easing global tensions felt last year, which – together with the recent comments from the FED and the ECB - would indicate that policy rates will not be cut further in the Euro Area. Moreover, the long part of the yield curve – which looks to have already stabilised on a higher level after the collapse suffered in August and early September – may also benefit from easing global tensions.

In other words, we argue that credit business margin compression may not intensify further and regulatory pressure can be dealt with by organic capital generation, while we are seeing positive signs on this front with article 104a of recently introduced regulation CRD V as the latest one of a longer string.

Meanwhile, valuations are undemanding, with Italian banks' 3-years looking forward PE (2021E) positioned at 7.2x (only ISP is positioned around 10x), which stands well below the normalised PE since 2005 (excluding crises periods from the normalisation), peaking at 20% at UCG and at c10%-15% at UBI and CREDEM. Similarly, to the EU banks sector, 3-years forward PEs are positioned well below those of crisis-free periods.

Sustainable projected profitability, no share count risk and undemanding valuations are at the heart of our tactical rotation into Banks from Utilities/Insurers. Banks offer investors the possibility of entering a sector trading at deep discount versus the historical normalised average without compromising on dividend yields (the average yield of UCG, UBI and CREDEM hovers over 5%, with UCG just below 7% including the buyback), as 4.5% average yield is positioned right in the middle of that of Utilities (just above 4%) and Insurers (c5.5%).

Insurance – Facing challenges due to low rates and top line pressure

The premium at which insurers trade versus banks looks stretched to us. Compared to the average normalised PEs since 2005, we calculate that banks' 3-years looking forward PEs are positioned around 10%-15% below that of insurers. Similarly, insurers' PEs are roughly aligned to the crisis-free levels, while banks trade at around 10% discount. We may accept insurers trading at some premium to banks, but 10%-15% looks too generous to us as ultra-low rates represent a challenging environment for both banks and insurers.

Rates are due to stay lower for a longer period, and this will lead insurers to find ways to offset this. Corporate bond exposure has generally gone up over the past 8 years, with BBB exposure increasing by 16p.p. (from 33% to 49% in 2018), outpacing the 10p.p. increase in the overall market. We also note that book value gearing for BB and below has doubled in the sector. As such, insurers already played out a search for yield via corporate bonds and BBB.

Equally, current 10-20bps dilution per annum in running income can be offset via a 0.1-0.2p.p. improvement in combined ratios, something not easy, given the solid starting point of most companies in our coverage.

From a top-line standpoint, Motor tariffs have declined since May this year (-0.7% on average). In addition, declining car registration does not bode well for the development of average premiums going forward. Non-Motor is the business all companies are focusing on, but the correlation to GDP dynamics makes us a bit sceptical about its growth.

As far as Life Insurance is concerned, 2019 has proved to be flat yoy so far, despite showing a very risk-off mix, with traditional products up 16% yoy and Unit Linked down 26% yoy. We, therefore, see increasing challenges ahead for insurers, which is why we remain cautious on this space. We rate all Italian insurers in our coverage (Generali, UnipolSai, Unipol, Cattolica Assicurazioni) with a NEUTRAL rating.

Asset Gatherers – Holding Up well

Within the financial space, we find asset gatherers enjoying hefty multiples, well ahead of those of banks and insurers. The sector already reflects in our view most of the positive factors listed below. However, unlike for insurers, suggesting a tactical rotation into banks from asset gatherers does not look appropriate to us as ultra-low rates and fading concerns on trade tensions will likely support inflows into AUM benefiting asset gatherers.

Net inflows have remained solid throughout 2019, with a pace of €200m inflows into asset management products per month confirmed by all financial advisors' networks. Though it is not easy to predict how flows will develop this year, a scenario of lower rates for longer is a positive for the asset management sector. Recruitment remains an important complementary part of the asset gathering business.

Most companies have carefully reduced such a component to a physiological level, with the exception of Azimut, for which it is above the historical average and close to its record high. As far as margins are concerned, we note that the repricing made by Banca Mediolanum and Azimut last year was completed, with no major consequences in terms of attrition. Cost control in the sector remains high, with Fineco standing out with a 37% C/I ratio (while Azimut and Banca Generali are both in the 50% region, and Mediolanum at 60% post-repricing).

Despite a strong performance throughout 2019, we still find interesting upside for Anima and Poste Italiane. In the first case, we see an attractive valuation (10x 2020E PE) coupling with a recovery in net inflows and the possibility to play the PIR theme both as a manager or an eligible investable stock in the Italian Mid-Cap index. As far as Poste Italiane is concerned, the development of its Motor TPL operations, and some new projects in the acquiring business are solid catalysts to keep attracting investors' interest.

We confirm our positive rating on Banca Generali too, while we rate NEUTRAL Azimut, Fineco and Banca Mediolanum.

Specialty Finance – Credit managers seek consolidation in a more mature market

Transactions of Italian NPLs touched a peak in 2018 at more than €100bn, boosted by GACS securitisations that allowed large and small banks to strongly deleverage their balance sheets. Going forward, even in presence of much lower traded volumes (c.€35-40bn p.a.), the market is expected to maintain a good liquidity, sustained by growing transactions on Unlikely-to-Pay (UtP) and an increasing component of secondary transactions.

With the bulk of the banks deleverage now behind them, large credit servicers are seeking consolidation in order to increase their competitive strength in the Italian more challenging market. While all major players have declared their intention to participate at this consolidation process, no deal has been closed so far showing how complex aggregations may be both in terms of governance and for the necessity to clearly define a long term servicing contract.

BFF (O; TP €6.5) is our favourite name in the specialty finance space as it couples an attractive risk profile with undemanding valuation. We are restricted on Cerved and Neutral on Banca Ifis.

Utilities – Networks fully priced; The New Energy Deal opens a Growth opportunity

The persistence of a low interest rate environment has favoured the outperformance of the utilities sector and its underlying multiple expansion as they have been seen as reliable bond-proxies. While we believe that the low interest rate environment is here to stay due to subdued growth and low inflation prospects, we think the tactical short-term trade of overweighting Banks over Insurers & Utilities is well-supported due to the currently significant valuation gap.

So, while the Italian regulated Utilities enjoy a stable regulatory framework at least until 2021 and their strong Balance sheets should support dividend policies, we believe that trading at premiums on equity RAB >30%, most of these stocks have already reflected those macro-related tailwinds and it is difficult to defend the value case.

That said, we believe that the energy transition & the development of the circular economy concept under the so-called European New Energy Deal opens the opportunity for a new wave of capex, which we identify in following three main blocks: (1) New renewable energies to substitute thermal-based technologies. Importantly, renewables are now highly competitive without subsidies; (2) an integrated energy network infrastructure that should ensure efficient consumption & security of supply; and (3) The strengthening of the Water distribution network and new waste management facilities to close the country's strong infrastructural gap. In this context, we favour Enel (O) and Iren (O).

Transport Infrastructures – Focus remains on regulation

Share prices of Italian transport infrastructure players rose, on average, ~25% in 2019 (vs. the 27% average for all European stocks), underperforming the market (+28%) but outperforming the Dow Jones Brookfield Europe Infrastructure index (+16%). While low interest rates were a tailwind for all, each company had its own specific drivers: Atlantia (+14%) traded mostly in line with the newsflow that was very volatile, ASTM (+59%) reduced the holding discount following the merger with SIAS, SIAS (+28%) was subject to a partial tender offer before being merged into ASTM, Enav (+27%) benefited from expectations of a favourable regulatory review and AdB (unchanged) reported strong fundamentals but remain subjects to unfavourable regulatory changes. Regulation was the dominant topic with strong interventions of ART in motorways and airports and the due regulatory review for Enav (positive) and Bologna Airport (negative).

At macro level, low interest rates and the new unconventional monetary measures announced by the ECB were on one hand certainly supportive, but on the other hand the proof of deteriorating growth prospects and weak inflation. As for traffic growth: i) motorways were weak (0.5% in 9M) due the economic slowdown; ii) airports remained healthy (4.0% in 11M) sustained once more by the low prices and new destinations offered by LCCs; iii) air navigation was again very strong (+6.6% in 11M) thanks to a best-in-class service quality. For 2020, we expect to see a deterioration of the operating leverage due to weak top line improvement with low traffic growth, downward pressure on tariffs and an increased focus on maintenance spending.

However, we believe that stocks' performance will be driven mostly by company-specific themes, in particular in motorways. We downgrade Atlantia to Neutral (TP €22.1) on the perception of a less attractive risk/reward profile that the stock offers and resume the coverage of ASTM with an Outperform rating (TP €32.9) as we find that the merger with SIAS strongly contributes to the creation of new international sector leader.

We confirm our positive stance on Enav as we think that the optimization of the capital structure may finally materialize and remain Neutral on Bologna Airport due to the limited upside the stock offers. With a totally different business model (concession catering) and North America representing 80% of its FY20 profits, Autogrill remains exposed to the expansionary phase of the US cycle.

Oil & Gas – Demand remains a concern, but lower US production should support outlook

Our view on oil prices remain unchanged, as we expect Brent to average US$65/bl in 2020. Concerns around a potential negative impact of the macro slow-down on oil demand are likely to exert some pressure on oil prices in the short-term. The ever-more important energy transition theme is also likely to exacerbate the already negative sentiment, adding new uncertainty on whether oil demand could continue to grow into the end of next decade.

However, when we look at 2020, we believe that the supply-side is likely to emerge as the key overriding factor determining the fate of oil prices. Across North America, a fast-declining US rig count could lead to lower than expected growth rates in US crude oil production, which could potentially turn negative by the end of 2020. This could provide a significant boost to the oil price outlook, leading to a much tighter oil supply/demand balance next year. Geopolitical factors could also represent a meaningful driver for oil prices in 2020, in light of the recently increased tensions in Middle East. However, as we expect a de-escalation between US and Iran, we also assume geopolitical risk premium to reduce during 2020.

Within this context, we favour Saipem (O), which should benefit from relatively stable oil prices, and a revival of offshore capex spending, which has been significantly depressed in recent years. We also believe that Saipem is well-place to capture the growth in the offshore renewables business, as wind farms are now approaching a size that allows them to compete with the economics of Oil&Gas projects once adjusted for execution risk. We also believe ENI (O) could benefit from stable oil prices, given its attractive production growth outlook. Its sector-leading efforts to reduce CO2 emission in the Upstream should make the group one of the favourite Energy companies for ESG investors.

Instead, we believe Tenaris (N) should continue to suffer from reduced investment plans in North America, which are likely to continue into 2020; and from the political uncertainty in Argentina. In addition, we believe consensus downgrades are likely for Saras (N), given the depressed outlook for refining margins. We believe this is mainly driven by weak demand in China, which comes with an increased supply following the start-up of two major downstream plants in the country.

TMT – Better Outlook for Mobile Business; Network sharing on-going; Advertising facing headwinds

We anticipate less challenging competitive dynamics in 2020 for mobile business. The ongoing increase in tariffs will bring good news for Tier1 operators, as a nice increase in mobile ARPU could come, and this could pave the way for an inflection point in the mobile service revenues trend. On the other hand, competition on fixed-line business is ongoing.

Discussions over the set-up of a single fibre network are ongoing: joint efforts in ultra BB deployment (public and private) could speed up the process (and save money), which would be good news for TI and Open Fiber, as well as for the country, in our view.

On the advertising side, a subdued growth in 2020 remains a key reason of concern, especially if the coming months will confirm weaker trends in global and Italian GDP, with particular focus on domestic consumptions. Hence we believe next year's trend for national advertising collection would not be that different, with sport events ('20 Olympic Games and Euro Cup) eventually providing some support.

The mix of less competitive market dynamics, potential catalysts (TI's CMD set for March 11 in Milan) leads us to reiterate our preference for the telecom sector (Telecom Italia) vs media and towers. We move rating on GEDI, MN and RWAY to N from O, to cash in our calls and given limited upside on fundamentals.

Industrials – Small relief from US-China tariff dispute but no miracles around the corner

After several months of reduction in a row, Global PMI started to show some early signs of stabilisation with Chinese indicator returning in expansionary territory. In the US manufacturing data remain positive, while Eurozone was the most affected by this global tariff dispute showing a marked contraction.

The recent agreement on a phase-one deal, between China and the US, may represent a relief for Industrial names finally unlocking some customers' capex decisions. Context in the consumer space, was less worrying to date and confidence data have been resilient both in EU and the US.

In this uncertain environment and ahead of a tough first part of 2020 for capital goods which suffers from a slowing demand coupled with destocking, we reiterate our preference for Prysmian (O) – a beneficiary of the European Energy Deal, Leonardo (O) – rising Geo-Political tensions in Middle-East may trigger incremental Defense spending and Piaggio (O) – positively impacted by the ongoing replacement cycle in EU. Among low-beta stocks, we remain cautious on Diasorin (N) and Campari (U), where current valuation does not give any upside.

Automobile – Too early for a sustainable re-rating

The Automotive sector's valuations look pretty attractive with next 3Y PE at 7.3x, or 6% below last 14 years normalized average, and we reckon that negative sales and production are progressively improving.

However, in our view other features may cap any re-rating in the short-term such as the introduction of new more stringent regulation in Europe and a delayed positive impact from the resolution of the trade war between US and China. Moreover, earnings consensus on 2020 is assuming a EPS increase of 15% for the car-makers, 21% for the components suppliers and 30% for the tyre makers, hardly achievable in our view.

Among our coverage, we have a positive stance on Exor, which might reduce its holding discount following corporate action of its underlying assets, and CNHI. About the latest, global Agricultural business is at a bottom in terms of tractors/combines sales and phase-one trade deal may lead to some relief with a potential rebound of volumes starting from 2H20E. On the other hand, we are more cautious on Brembo (downgraded to Neutral from Outperform following the strong stock performance) and Ferrari (fair valuation, strong 2019 price performance). About Pirelli, we have a cautious stance in light of both the low volumes/price visibility in Europe and the slow start of the winter tyre sales. That said, it's worth reminding that Feb. 11's CMD may represent a catalyst for the stock as a new restructuring activity may increase visibility on the FY20 targets.

Branded Goods – Macro Slowdown takes a toll on growth; M&A to support valuation

There are three themes that are likely to dominate the scene in 2020: (1) Hong Kong disruption and the impact that it might have on profitability; (2) The evolution of the trade tension between Europe and US; (3) Sector consolidation.

Hong Kong demand outlook (6-7% of the sector sales) has been negatively impacted by ongoing social protests since July, and with Chinese tourist flow plummeting retail sales have dropped substantially in the region. Besides Hong Kong, concerns related to trade war should continue to weight on the sector, although leather goods and most of RTW Made in Italy had not been targeted by tariffs so far.

Consensus numbers for 2019 and 2020 are still factoring-in a fairly supportive macro outlook in our view, despite downside risks to the global economy. This also reflects a 3Q reporting season that has been overall more supportive than initially anticipated on the top line.

The European Branded Goods sector trades at 28x 1Y forward, c.30% premium to the 10-year historical average. Within the sector, Italian players have historically traded at double-digit premium to the European sector, reflecting M&A potential, mono-brand strategy and potentially higher growth prospects.

In the space we have a relative preference for Brunello Cucinelli (N) as its business is highly sustainable and very predictable, which makes it a safe investment. We maintain a cautious view on Ferragamo (U), on its expensive valuation, despite some improvements on sales mix that over time might restore confidence in the margin recovery over time, and on Tod's (N) as the turnaround story is not gaining traction in this challenging environment.

Real Estate – Focus on Office Segment and prime locations

We believe that 2020 is likely to be characterised by continuing low interest rates coupled with a weak macro outlook for Italy. While low interest rates support the investment in real estate, subdued macro requires high selectivity in terms of locations and segments. This is due to sustain, in our view, the performance of the office segment with respect to the retail one, and of the largest cities (Milan and Rome) over secondary locations.

The slow improvement of the Italian residential sector is continuing. Transaction volume are growing at a low single digit rate, hold back by low bank financing availability due to tight credit standards. Price recovery remains limited to Milan and a handful of medium cities but is taking momentum. 0.2% price increase in 2019/2020 should be followed by 0.7% growth in 2021 and +1.1% in 2022.

In Real Estate we favor Coima Res (O) over IGD (N), reflecting the market preference for high quality segments/assets/locations.

Italy's Mid-caps trade at discount vs. Large-caps; Mind the PIR legislation

In 2019 the Italian Mid cap cluster experienced a positive re-rating, partly recovering the ground lost in 2018. This trend was not supported by PIR inflows. The Italian Mid-caps now trades at c15.5x 1YFWD earnings, at discount vs large caps and European Mid-caps, while 10% above their mid-cycle average.

The YTD re-rating was mainly the result of a multiple expansion, while earnings started to show some cracks. The recent worsening of global macro indicators, due to tariff tensions, triggered since June a further 6% cut on our EPS estimates for the Mid Cap cluster (ex-financials).

We believe that the recent change of the PIR regulation should be supportive for the whole index and favour companies showing sustainable DPS, above-average return on investment and free cash flow generation.

A PIR portfolio selection, to be held for the longer investment horizon of the scheme, should include, in our view, the following names: Autogrill, BFF Banking Group, Interpump, Iren, ENAV, SeSa.

We cut EPS for 2020/21 by -7% for >25 stocks, mainly Oil-Related, Auto & Branded Goods

We highlight that since January 2019, Mediobanca cut its 2019/20 EPS forecasts for the Italian Large caps by -6% on average. If we focus our analysis, excluding utilities and financials, we registered a remarkable -13% reduction due to the negative contribution from the Automotive (estimates down by -15%), Oil and Telecoms.

In this note and based on even more conservative assumptions, we are now cutting our 2020/21 EPS by a further 7% on 25 cyclical stocks. This downwards earnings revisions are concentrated in Oil, Branded Goods and Automotive sectors.

Finally, in this note we also downgrade our ratings from previous Outperform to Neutral for: Atlantia, Brembo, Rai Way, Fincantieri, Saras, Mondadori, Gedi & AEFFE.

List of Top picks for 2020: UCG/UBI, Poste/Anima, Enel, Telecom Italia, Prysmian, Leonardo & Exor

Our list of top picks for 2019 includes exposure to Banks (Unicredit/UBI), Asset Gatherers (Poste/Anima), the New Energy Deal (Enel) and some selected Industrial companies (Telecom Italia/Prysmian/Leonardo/Exor).

Mediobanca - 2020 Suggested Portfolio allocation

Sector Allocation / Stock Selection	
Most Preferred	**Least Preferred**
Banks	**Regulated Utilities**
(Unicredit, UBI)	(Terna, Snam, Italgas)
Asset Gatherers	**Insurance**
(Poste Italiane, Anima)	(UnipolSai, Cattolica)
New Energy Deal: Renewables	**Energy**
(Enel)	(Tenaris, Saras)
TMT	**Towers/Media**
(Telecom Italia)	(Rai Way / Mondadori / RCS)
Selected Industrials	**Branded Goods**
(Prysmian / Leonardo / Exor)	(Ferrari, Ferragamo, Tods)

Source: Mediobanca Securities

2020 OUTLOOK

GLOBAL MACRO – POLICY STANCES NOW APPROPRIATE, US ECONOMY EXPECTED TO KEEP OUTPACING EUROPE; ON BASE CASE RISK OF FURTHER STEEPING TILTED TO THE UPSIDE

The IMF repeatedly cut its forecasts of global growth last year. In its latest World Economic Outlook in October, it foresaw that growth in the US will outpace that of Europe meaningfully again in 2020 at 2.1% vs 1.4%. In fact, with the exception of Japan, the US is the only advanced economy for which the institution upped its 2020 growth estimates in that update.

Monetary policy in 2019 was back to easing in both the US and Europe. The FED cut its Funds rate three times in 2019 and the ECB followed suit, with a deposit rate cut in September and a resumption of QE, pushing long-term rates in deeply negative territory and producing a further descent in short-term rates in Europe. The Eurozone yield curve flattened markedly in 2019, but recovered since September/October for more than a third of the initial fall.

Our general take from both central banks' December meetings, is that that monetary policy is now appropriate. The tone of the Fed's December meeting statement was more upbeat and rid of references to uncertainties. The Fed's rate path does not foresee any move to rates in 2020. Mrs Christine Lagarde began her mandate as new President of the ECB in November at a time when Governing Council members showed growing signs of divide, particularly pertaining to the restart of QE.

The ECB's December statement - under her helm - kept to the same policy of statement and stance as in October, which reiterated those easing measures adopted in September by Mr. Mario Draghi. Mrs Christine Lagarde used her first meeting to stress though the need to avoid comparisons with her predecessors. She described herself as neither a dove nor a hawk, and wants to bring the best of the Governing Council, and for the use of instruments to be as consensual as possible.

As with the FED, the ECB's macro-economic projections were little changed in December vs September. Finally, at that meeting, the ECB highlighted that whilst the Eurozone's incoming macro data remained weak, surveys pointed to signs of stabilisation; and risks albeit still tilted to the downside, had become less pronounced.

In the US, market expectations for another rate cut have been pushed back to November this year. In Europe, probabilities of further cut to the deposit rate in Europe have fallen to virtually zero. Barring very recent developments on the US/Iran front for which the outcome is hard to predict and highly uncertain, the key risks of last year to global macro have indeed taken a turn for the better in the second week of December, with Conservatives winning a notable majority at the UK general elections, followed by the agreement of a phase-one trade deal between the US and China.

Our base scenario for 2020 is that: (a) Eurozone growth will remain sluggish; (b) rates in the Eurozone will remain low, possibly for a prolonged period of time but the deposit rate won't be cut any further; (c) the USD will remain strong vs. the Euro on better growth prospects in the US; (d) tensions between the US and Iran are to be contained and do not escalate into a full blown crisis. In those circumstances, we see risks of a further steepening of the yield curve (by the mean of an increase in the long part of the yield curve) tilted to the upside, were developments on trade and/or Brexit to turn out positive (although admittedly there are still plenty of challenges ahead).

US growth seen outpacing that of Europe in 2020, once again

The IMF' latest projections (World Economic Outlook October 2019) assume that growth in the US will outpace that of Europe meaningfully again in 2020 at 2.1% vs 1.4% (consensus looks currently positioned at 1.1%). In fact, bar Japan, the US is the only advanced economy for which the IMF upped its 2020 growth estimates in October 2019.

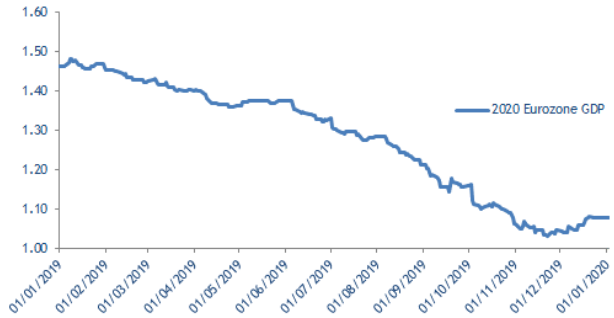
It raised US growth estimates by 20bps and cut that of the Euroarea by 20bps concurrently for the year. Although the policy rate differential between the two regions has narrowed since the FED rate cuts in July and October, we think the USD will remain well anchored in 2020, on the back of an expected stronger GDP growth in the US.

International Monetary Fund (IMF) – Overview of GDP Growth Projections (WEO October 2019)

%	2018A	2019	2020	Vs Jul-19 Projections (2020)
USA	**2.9**	**2.4**	**2.1**	**0.2**
Euroarea	**1.9**	**1.2**	**1.4**	**-0.2**
Italy	0.9	0.0	0.5	-0.3
EM and Developing Asia	6.4	5.9	6.0	-0.2
Latam & Caribbean	1.0	0.2	1.8	-0.5
Middle East Central Asia	1.9	0.9	2.9	-0.3
World	**3.6**	**3.0**	**3.4**	**-0.1**

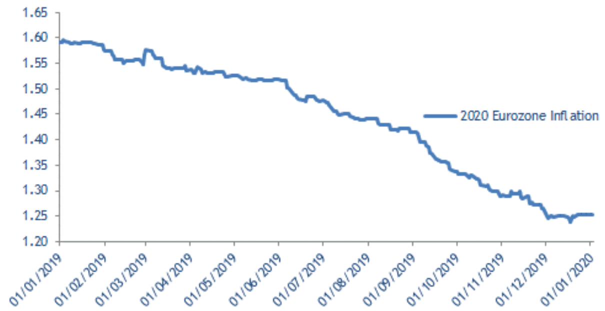
Source: IMF WEO (October 2019)

Eurozone consensus revisions of 2020 GDP (%)



Source: Mediobanca Securities, Factset

Eurozone consensus revisions of 2020 inflation (%)



Source: Mediobanca Securities, Factset

2019 was back to easing in US and Europe amidst global slowdown

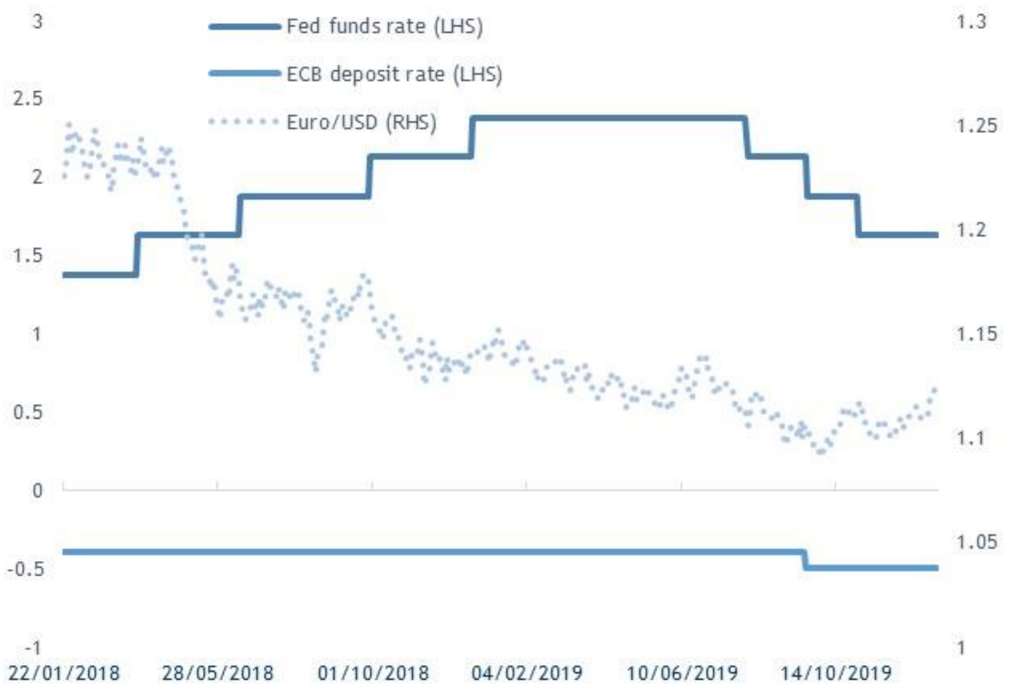
The IMF repeatedly cut is forecasts of global growth in 2019, and in its October update, it foresaw growth in that year of just 3%: its lowest since the financial crisis. It described a global synchronised slowdown amid rising trade tensions and geopolitical tensions, with the first contributing to the retreat in business confidence and investment and a marked slowdown in global trade. It also warned that risks remained titled to the downside.

In light of global growth deceleration, trade wars, and sluggish inflation in both Europe and US, 2019 saw a return to monetary easing. The FED cut rates three times in 2019 after four sets of hikes in 2018. The ECB lowered its deposit rate in September by 10bps (to -0.5%), and resumed asset purchases for €20bn per month – without a specific end date.

The Eurozone yield curve flattened in 2019, following suit with the US, for which the phenomenon started to take place in 2018, already.

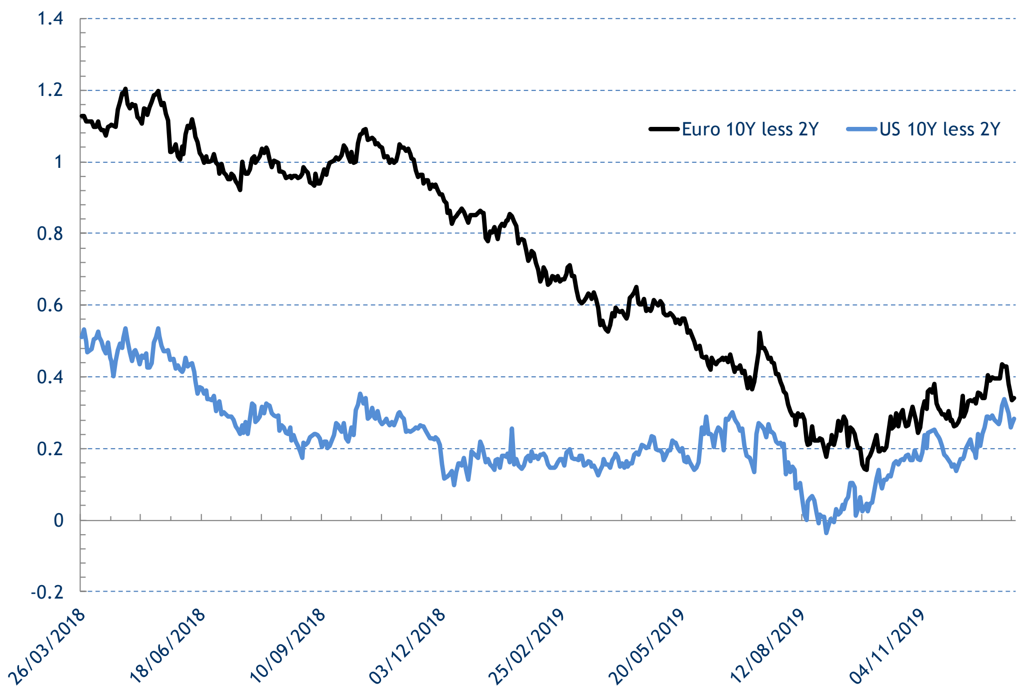
Mrs C. Lagarde took the helm of the ECB in November, and at her nomination in July, Eurozone bond yields declined on the news - the market had taken the view that she would follow the dovish policy of her predecessor. She arrived nonetheless at a time when Governing Council members were believed by the market to be showing growing signs of divide, particularly pertaining to the decision to restart QE in September last year. Mrs Lagarde used the first ECB meeting she chaired in December to stress the need to avoid comparisons with her predecessors. She described herself as neither a dove nor a hawk, and wants to bring the best of the Governing Council, and for the use of instruments to be as consensual as possible.

ECB deposit FED funds rates (%), and Euro/USD



Source: Mediobanca Securities, Factset

Europe and USA – Slope of the Yield Curve (Steepening since Oct-19), 2018-19



Source: Mediobanca Securities, Factset

Policy stances now look appropriate

Albeit having clearly flattened since January 2019, the Eurozone yield curve has recovered in steepness for more than a third of its 2019 decline since its post summer 2019 troughs. The US yield curve also steepened over the same period. We attribute this uptick to a combination factors. For the Eurozone, firstly, the news that ECB members were divided over the September policy changes may have suggested to the market that more loosening wasn't a given and, in our view, the speech from ECB Governor Mrs Christine Lagarde added arguments to such thesis. Secondly, the market perceived positive developments in regards to Brexit and trade tensions. C. Lagarde stated that she was not going to guess on the outcome of the phase-1 of trade deal, but that talks were progressing.

In the US, the FED policy statement of October dropped the pledge to 'act as appropriate to sustain expansion' something that was considered by the market a sign for further rate cuts ahead. In December, the FED explicitly wrote in its release that the committee judges the current stance of monetary policy appropriate, and it also deleted a previous reference to implications of global developments for the economic outlook – and so to uncertainties around the outlook.

The ECB's December meeting under the helm of Mrs Lagarde, signalled that whilst the Eurozone's incoming macro data remained weak, surveys pointed to signs of stabilisation; and risks albeit still tilted to the downside, had become less pronounced. As with the FED, the ECB's macro-economic projections were little changed in December vs September.

Barring very recent developments on the US/Iran front, the key risks of last year to global macro have indeed taken a turn for the better in the second week of December 2019. UK Prime Minister Boris Johnson won a decisive majority at the 2019 general elections on 12 December, with Tories obtaining 365 seats (56%). This was **the largest Conservatives majority since 1987**. Nonetheless, the negotiations on the future relationship with the EU is what's to come next and it won't be easy, with the next Brexit deadline on 31 December this year. After his victory, Mr Johnson sought to write into law that the UK would leave the EU on 31 December 2020, and won't extend the transition period, which did raise some concerns.

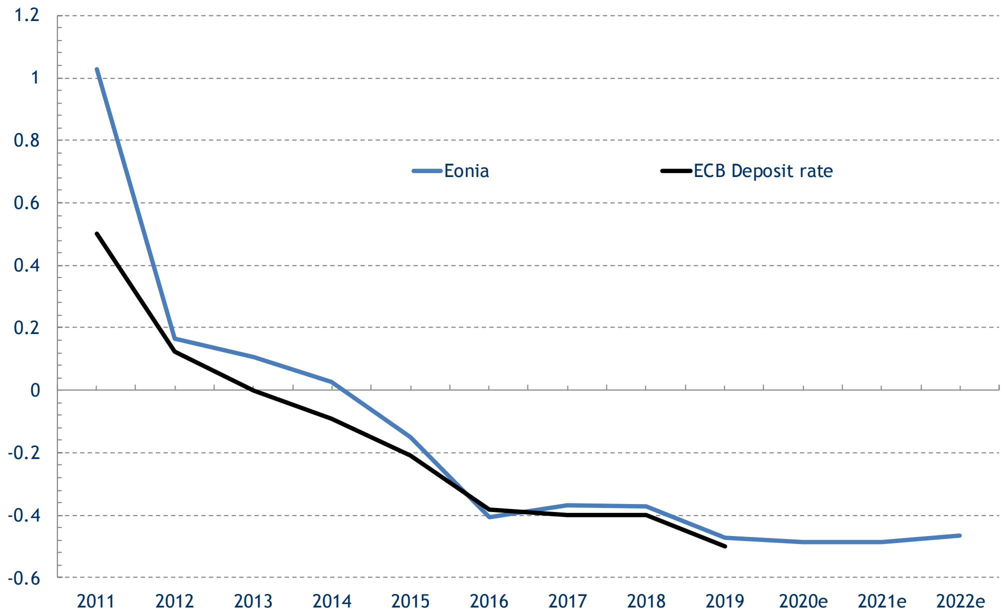
On 13 December, the **US and China announced progress on a trade agreement** – reaching the phase one agreement after a year and half trade war. This allowed the US and China from holding off from increasing tariffs on 15 December last year. President Trump suggested that China accepted to increase purchases of US agricultural, manufactured products and energy; and so, the US would cut by twofold the 15% tariff imposed in September on Chinese imports. On 18 December, it was announced that President Trump was impeached by the House. He is now to face trial at the Senate, which will have the final say on whether to convict him or not. It is widely expected that he will be acquitted since conviction will require backing by 67% of the chamber, and it is Republicans who control it.

On 3 January 2020, a US airstrike killed Iran's highest army commander Qasem Soleimani in Baghdad, which was seen by many political experts as a significant escalation in the Middle East. President Trump argued that the commander was planning immediate attacks on US personnel in the region. In turn, Iran vowed 'severe revenge' and announced it would no longer abide by the restrictions of the 2015 nuclear accord. Mr Trump threatened of a 'disproportionate' response in the event Iran attacked US assets or personnel. Oil prices rose by 4% post the airstrike, market participants fearing attacks on oil tankers in the Strait of Hormuz, as one of the possible retaliations by Iran. On 8 January in the early hours, Iran launched 22 missiles on two US military bases in Iraq. Following the attack, Iran argued that that it had concluded 'proportionate measures in self-defence' and that it does not 'seek escalation or war', but will defend itself. How the situation develops from here is hard to predict and evidently highly uncertain. But our base case is that implications of retaliations on both sides will act as a deterrent for this develop into a full blown crisis. In addition, with US presidential elections set to take place later this year, a period of stability would be preferable for Trump, in our view.

Market implied probabilities for another ECB deposit rate cut in 2020 gradually declined from c50% in October to nil in December. Meanwhile, in the US, the market prices another rate cut in November. The FED's signalling of a pause at its October meeting shifted out expectations of a rate cut from March to June this year initially, and the fact that macro-economic data in the country did not turn out as weak as some had feared shifted this out further. It should be highlighted that rate hikes in the

US were entirely dismissed by Chair Powell at both the October and December meetings, so long as there isn't a 'significant' and 'persistent' pickup in inflation'.

Eonia (%) – 1 day interbank interest rate for the Eurozone

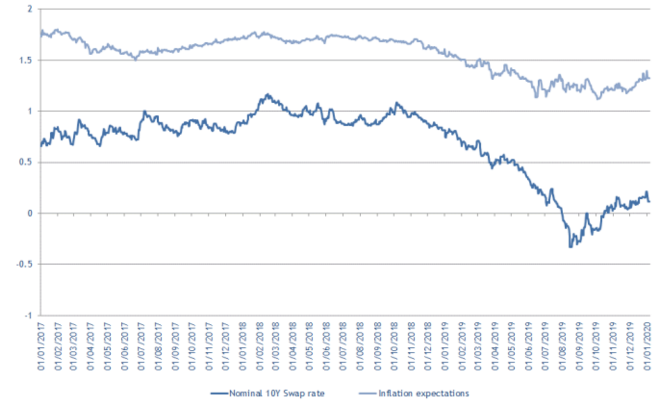


Source: Mediobanca Securities, Factset

Real rates in Europe at subdued levels still, despite uptick in September

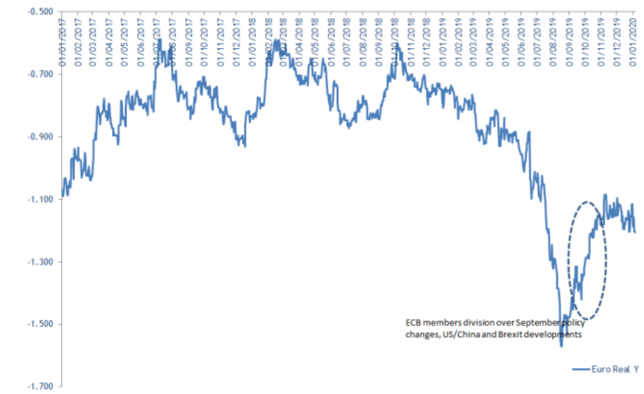
Eurozone 10Y real rates declined 40bps since the start of 2019 and although up since their post summer trough as just described, they remain at subdued levels.

Euro 10Y nominal swap rate and 5y5y inflation (%)



Source: Mediobanca Securities, Bloomberg

Eurozone real yields (nominal less 5y5y) (%)



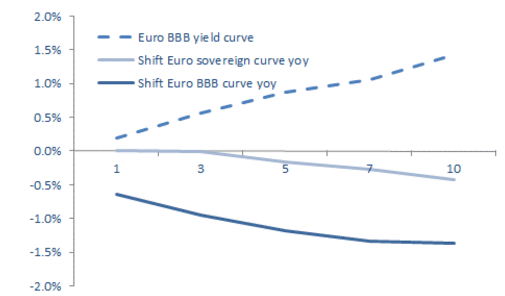
Source: Mediobanca Securities, Bloomberg

Material compression in Euro corporate credit spreads

Eurozone corporate credit spreads compressed materially in 2019. Indeed, in contrast to the euro sovereign curve which shifted down by an average of c20bps vs January 2019, the Euro BBB corporate yield curve saw a downward shift of >100bps, for a compression of 90bps. Most of it took place in H12019, so prior to the big ECB announcements in September.

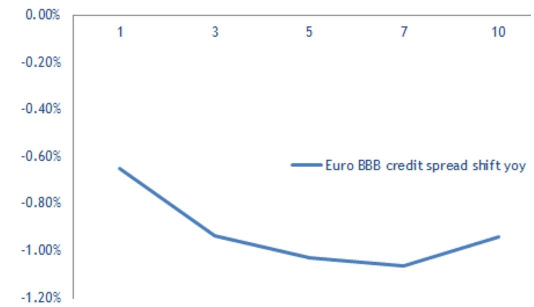
This is indeed material, since the ECB had estimated in the past that the total effect of the corporate asset purchase program was a lowering in investment grade credit spreads by 20bps only, between March 2016 and December 2017.

Yield curve shifts yoy: Euro BBB corporates and Euro sovereign curve (%, years)



Source: Mediobanca Securities, Factset

Shift in Euro BBB corporate credit spread vs January 2019 (%, years)



Source: Mediobanca Securities, Factset

ECB: Persistence of weak incoming data but signs of stabilization

On 12 December, the ECB effectively reiterated the measures announced in September and its October stance. This was Mrs C. Lagarde's first policy meeting, after taking the helm of the Bank in November. The main message from the first press conference of ECB President Lagarde was that the Eurozone's incoming macro data remained weak - although surveys showed some signs of stabilization. This justified the need for accommodative monetary policy over the medium term. ECB indicated that risks were still tilted to the downside, mainly related to geo-political factors and EM vulnerabilities, but had become less pronounced. ECB trimmed GDP forecasts for 2020 (-10bp), and increased CPI estimates for 2020 (+10bp) and decreased them for 2021 (-10bp).

- **Rates kept unchanged** - The interest rates on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility remained unchanged at 0.00%, 0.25% and -0.50% respectively.
- **Key interest rates to remain at current (or lower) levels until inflation comes back -** The inflation outlook should robustly converge to a level sufficiently close to, but below, 2% - and such convergence has been consistently reflected in underlying inflation dynamics- to change stance on key rates. The ECB did not include any specific end date.
- **Asset Purchase Program at €20bn/month** – As decided in September, the net purchases restarted under the ECB's asset purchase program (APP) at a monthly pace of €20bn from 1 November. The ECB expects them to run for as long as necessary to reinforce the impact of its accommodative policy and to end shortly before it starts raising the key policy rates.
- **Continue reinvesting principal payments -** The ECB intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case, for as long as necessary to maintain favourable liquidity conditions and an ample degree of accommodation.

Key messages from her press conference are the following:

- **Risks still tilted to downside but are less pronounced** – These are related to geopolitical factors, protectionism and EM vulnerabilities.
- **Weak growth although with some signs of stabilization: Eurozone's GDP growth was +0.2% QoQ in 3Q following +0.2% in 2Q -** The ongoing weakness of international trade and global uncertainties weighed on the manufacturing sector. At same time, survey information while weak, pointed to some stabilisation in the slowdown.
- **Mild increase in CPI in November -** CPI grew from +0.7% in October to +1% in November mainly due to services & food prices. There had been a mild increase in underlying inflation recently in line with previous guidance.
- **Slight revision in GDP forecast for 2020 –** GDP was here seen at: +1.2% in 2019, 1.1% in 2020, 1.4% in 2021 and 2022. Vs September, the outlook was revised down slightly for 2020 (-10bps).
- **Slight increase in CPI estimates for '20 and down for '21** – Headline Inflation forecasts: 1.2% in 2019, 1.1% in 2020, 1.4% in 2021, 1.6% in 2022. Vs September, forecasts were revised up slightly for 2020 (+10bps), and down slightly for 2021 (-10bps), mainly on the future path of energy prices.
- **M3 grew at +5.6% in Oct unchanged from September** – Growth of loans to non-fin +3.8% in Oct +3.6% in September. Loans to households continues to increase to +3.5% in October.
- **Structural policies need to be substantially stepped up to increase resilience** – This is a key message that Draghi used to push too.
- **Strategic review by January 2021 -** A strategic review was a bit overdue (last was in 2003). It needs to be comprehensive, and will 'turn each and every stone'. The plan is to get the review started in January, with completion before the end of 2020. Market participants say the focus here will probably include whether an inflation target of "below, but close to, 2%" is still relevant.

- **C. Lagarde says she is neither a dove or hawk -** She said she wants to be an 'owl' and the use of instruments will be as consensual as possible.
- **Finally, on the Green deal, Lagarde said she is very pleased to see the ambition of what was announced** - She Hopes that this ambition can be endorsed by all European institutions, and in compliance with the treaties. In the strategic review, they will take up climate change, and see how they can participate in that endeavour.

ECB – Eurozone's Macro-economic projections, December 2019

	2018	2019	2020	2021	2022
GDP					
Dec	1.90%	1.2%	1.1%	1.4%	1.4%
Sept		1.10%	1.20%	1.40%	
Dec vs Sep		*0.1%*	*-0.1%*	*0.0%*	
Inflation (headline)					
Dec	1.80%	1.2%	1.1%	1.4%	1.6%
Sept		1.20%	1.00%	1.50%	
Dec vs Sep		*0.0%*	*0.1%*	*-0.1%*	
Core Inflation (excluding changes in indirect taxes)					
Dec	1.0%	1.0%	1.3%	1.4%	1.6%
Sept		1.00%	1.20%	1.50%	
Dec vs Sep		*0.0%*	*0.1%*	*-0.1%*	

Source: ECB

FED: Cut rates three times in 2019, policy now in 'good place'

On 11 December, the FED kept rates unchanged at a range of 1.5-1.75%, after three cuts in 2019 – the last being in October. the decision was unanimous, after some dissents in the previous meetings. In summary, the tone of the Fed's December meeting statement was more upbeat, stating that monetary policy was appropriate and rid of references to uncertainties. The FED argued that the current stance of monetary policy was appropriate; its projections foresee no change to rates in 2020. Meanwhile, its growth and inflation forecasts were little changed vs September. It said that the rate cuts in 2019 helped keep the economy on track. For rates to move up, we would need a 'significant' and 'persistent' pick-up in inflation.

To note from the release:

- **The statement now says that the committee judges the current stance of monetary policy appropriate.** Something which had been voiced at the past press conference, but not written.
- **The statement also erased previous reference to those implications of global developments for the economic outlook.**
- **More generally, it reiterated that labour markets stay strong, and that economic activity has been rising at a moderate pace** but that fixed investments and exports remain weak. It also reiterated that both overall inflation and inflation ex food energy have been running below 2% on a 12m basis.

On projections: Projections were overall little changed vs September over the next two years. To note, core inflation in 2019 was brought down by 20bps to 1.6%, with no changes in outer years. No changes were made to GDP growth or headline inflation forecasts. As recap it foresees (i) GDP growth at: 2.2% in 2019, 2% in 2020 and 1.9% in 2021. (ii) Core inflation at 1.6% in 2019, 1.9% in 2020 and 2% in 2021. Headline estimates are the same as core in 2020/21, and seen at 1.5% in 2019. Regarding the Fed funds rate, the rate path is also unaltered: expecting no move in 2020 vs 2019, and still a hike in 2021.

To note from the conference:

- **Current stance will likely remain appropriate, as long as incoming information about the economy is broadly consistent with the outlook.**
- **Rate cuts helped keep the economy on track in 2019.** The Fed cut rates three times in 2019.
- **The relationship between resource utilisation/labour market and inflation has gotten weaker over the years.** There is the need to keep policy somewhat accommodative therefore.
- **For rates to move up, we would need a significant and persistent pick-up in inflation**
- **Trade: if a deal were to be enacted, it would be a positive for the economy**. Businesses they talk to have been saying all year that trade policies have been weighing on the outlook. Removal of uncertainty on this front would be a positive.

FED – US' macro-economic projections, December 2019

	2019	2020	2021
GDP			
Dec	2.2%	2.0%	1.9%
Sept	2.2%	2.0%	1.9%
Dec vs Sep	0.0%	0.0%	0.0%
Inflation			
Dec	1.5%	1.9%	2.0%
Sept	1.50%	1.90%	2.0%
Dec vs Sep	0.0%	0.0%	0.0%
Core Inflation			
Dec	1.6%	1.9%	2.0%
Sept	1.80%	1.90%	2.0%
Dec vs Sep	-0.2%	0.0%	0.0%
Federal funds rate			
Dec	1.6%	1.6%	1.9%
Sept	1.90%	1.90%	2.10%
Dec vs Sep	-0.3%	-0.3%	-0.2%
Number of rate hikes implied			
Dec	3	0	1
Sept		0	1
Dec vs Sep		0	0

Source: FED

ITALIAN MACRO – STAGNATION BUT NO RECESSION

Macro data shows that - since 2H18 – trade tensions are taking a heavy toll on Italy's economy. As a matter of fact, after the summer of 2018 Italy has been subject to a steady downward revision of GDP growth estimates (more marked than that of other European countries).

Despite exiting from technical recession in 2H18, GDP growth remained stagnant throughout 2019. GDP data in 3Q 2019 highlight the lack of growth (+0.3% y/y), below the +1.2% posted in the Eurozone, due to a mix of stagnant internal demand and weakening support from exports. Industrial production continued on its trend of sequential deterioration, declining by -2.4% YoY in October 2019, following -1.5% on average in 3Q and -0.8% in 1H19. Consumer and manufacturing confidence, as well as economic sentiment are all deteriorating, after that PMIs already dropped to relative lows from the relative high before the elections of 2018.

As all the major leading indicators (industrial production, consumer and business confidence) point to economic stagnation, our central case is that subdued growth will continue also in 2020, but without entering into a fully-fledged recession. Such assessment broadly coincides with that of the major institutions, which foresee modest growth to persist also in 2020 with growth GDP expectations for 2020 hovering over +0.5%. Moreover, the most recent projections from international institutions (pointing to +0.4% GDP growth) may raise concerns on the growth assumptions included in Italy's Government Draft Budgetary Plan.

The descent in Italy's 10-years sovereign yields (135bps vs c.240bps in Jun-19) can be attributed to a generalized fall in interest rates along the whole yield curve after the ECB comments on policy rates outlook and to an improved perception of Italy's country risk after the formation of the new Government. As we expect no further cuts in ECB policy rates, our central case is that sovereign yields will stay anchored at current levels (keeping the cost of new debt issuance at record lows), with possible uptick in the long maturities in the event of progress in trade talks.

GDP on a steady downward revision path in the past quarters

The deterioration of the global macro scenario has triggered a downward revision of the Italian GDP growth forecasts by the main institutions over the past months. Estimates on 2019 GDP growth settled in the 0.1% region, in line with the target unveiled by the Government in Sept-19 in the Draft Budget Law. The latest update from the EU Commission lowered Italy's GDP growth target to +0.4% in 2020 (from +0.7%), flagging no signs of meaningful recovery, with moderate rise in external demand and support to GDP from household spending possibly threatened by a deterioration in the labour market.

Italy – Main Changes in GDP Growth Projections, 2019-20

	Date	2019		2020		2021	
		New	Old	New	Old	New	Old
Bank of Italy	13-dec	0.2%	0.1%	0.5%	0.8%	0.9%	1.0%
Fitch	5-dec	0.2%	0.1%	0.4%	0.5%	0.6%	
ISTAT	4-dec	0.2%	0.3%	0.6%			
OECD	21-nov	0.2%	0.0%	0.4%	0.6%	0.5%	
European Commission	7-nov	0.1%	0.1%	0.4%	0.7%		
Confcommercio	21-oct	0.1%	0.3%	0.3%	0.5%		
IMF	15-oct	0.0%	0.1%	0.5%	0.8%		
Confindustria/ UPB	7-oct	0.0%	0.0%	0.4%	0.4%		
S&P	26-sep	0.1%	0.1%	0.4%	0.6%	0.6%	
Moody's	10-sep	0.2%	0.4%	0.5%	0.8%		
Average		**0.1%**	**0.2%**	**0.4%**	**0.6%**	**0.7%**	**1.0%**
Max		0.2%	0.4%	0.6%	0.8%	0.9%	1.0%
Min		0.0%	0.0%	0.3%	0.4%	0.5%	1.0%
Italy Draft Budget Law 2020	**30-Sep**	**0.1%**		**0.6%**		**1.0%**	
Italy Budget Law	19-Apr	0.2%		1.0%		1.1%	

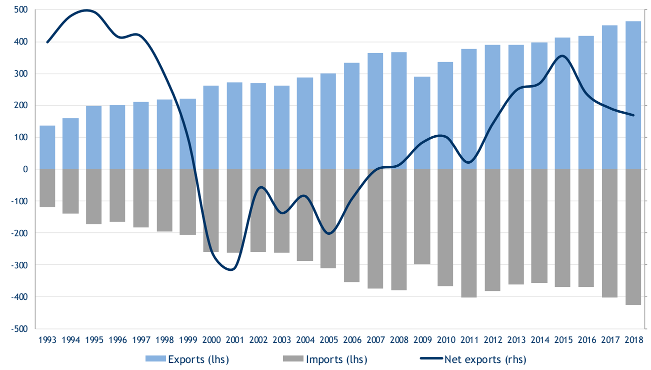
Source: Mediobanca Securities

The latest quarterly figure on the Italian GDP growth reported by the Italian Statistical Bureau (Istat) pointed to a +0.3% y/y (+0.1% q/q) growth in 3Q19, in line with 1H trends, and leading to a carry-over annual GDP growth for 2019 of +0.2%. Italy's GDP growth in 3Q19 remained softer than those reported by the other main European countries (+0.5% y/y in Germany, +1.3% y/y in France and +2.0% in Spain).

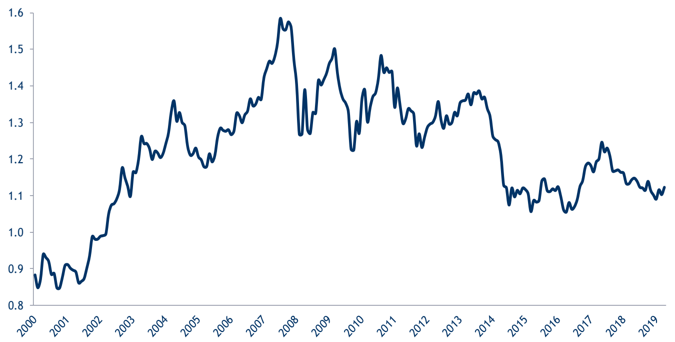
The modest q/q growth in Italy was supported by internal demand and inventories delta (+0.2% and +0.3%, respectively). Internal demand was driven by consumption (+0.4% households, +0.1% public administration), while investments were slightly down QoQ (-0.2%, mainly due to a negative trend in industrial and transport equipment). On the other hand, net exports were a drag in the quarter, down by-0.4% QoQ.

Despite the net balance between exports and imports deteriorated in 2018 due to imports growing faster, exports continue to play a key role in the Italian economy representing 29% of GDP in 2018 (up from 28% in 2017), also supported by the strengthening of other currencies such as the USD (+3.3%) vs. the Euro.

Italian exports and imports (€bn)



EUR/USD exchange rate



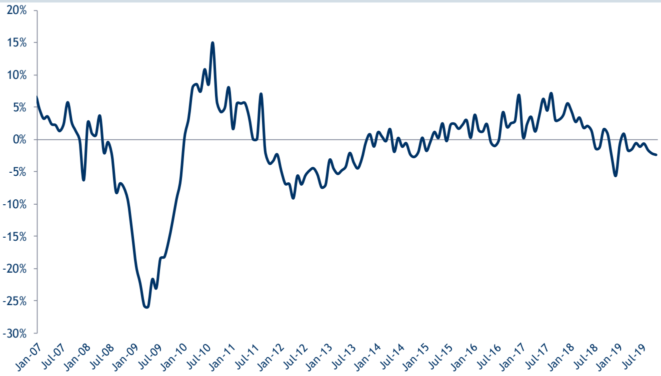
Source: Thomson Reuters Datastream

Other leading indicators point to a weakening economic outlook

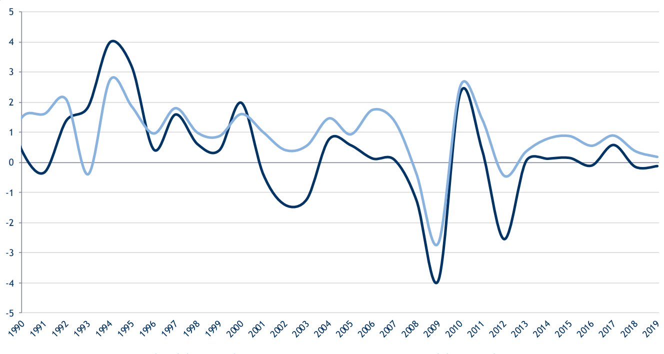
- **Declining industrial production** – Data on industrial production (-1.5% y/y the 3Q19 average) is below the 0.5% average of 2018 and showed further deterioration from 1H19 (-0.8% on average). In October, data showed further deterioration, with industrial production index declining by -2.4% YoY (-0.3% MoM), in line with consensus projection of -0.2% MoM (Reuters).

  Low productivity remains the Achilles' Heel of the Italian economy that in 1990-2019 has registered a small annual +0.3% average increase versus the +0.9% of the Eurozone. The reasons for what it seems structural low productivity seems related to lack of investments through the crisis, lack of structural reforms, and the small dimension of Italian enterprises.

Italian industrial production (y/y change, WDA)



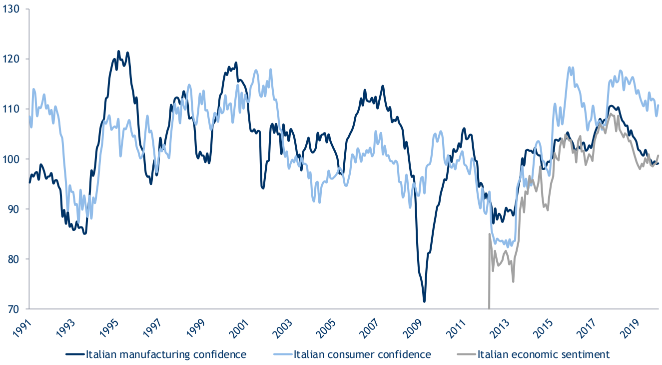
Italian and Eurozone labour productivity (y/y % change)



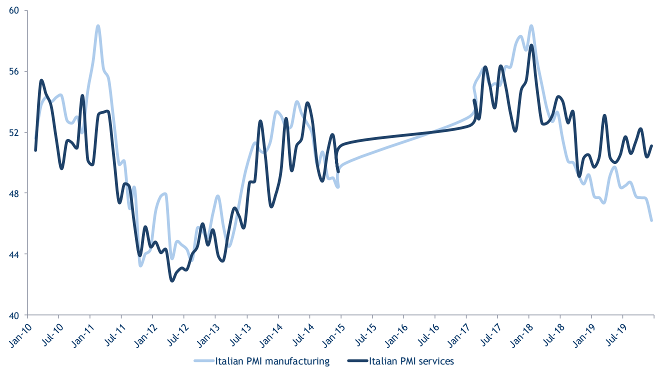
Source: Thomson Reuters Datastream

- **Deteriorating business and consumer confidence** - We find that the overall business environment in Italy is deteriorating with consumer confidence at 110.8 in December, after having touched 108.6 in November. Consumer confidence started to reflect signs of increasing uncertainty in 2019, after having moved fairly laterally throughout 2018 remaining close to the relative highs of 2015 (in the region of 118). Also, manufacturing confidence fell below 100 in August for the first time since 2014, and remained flat in the region of 99-100 since then. PMIs dropped significantly after reaching a relative high before the elections of 2018, with manufacturing PMI stood at 46.2 in December 2019 vs. 55.1 in Mar-18.

Italian business and consumer confidence indexes



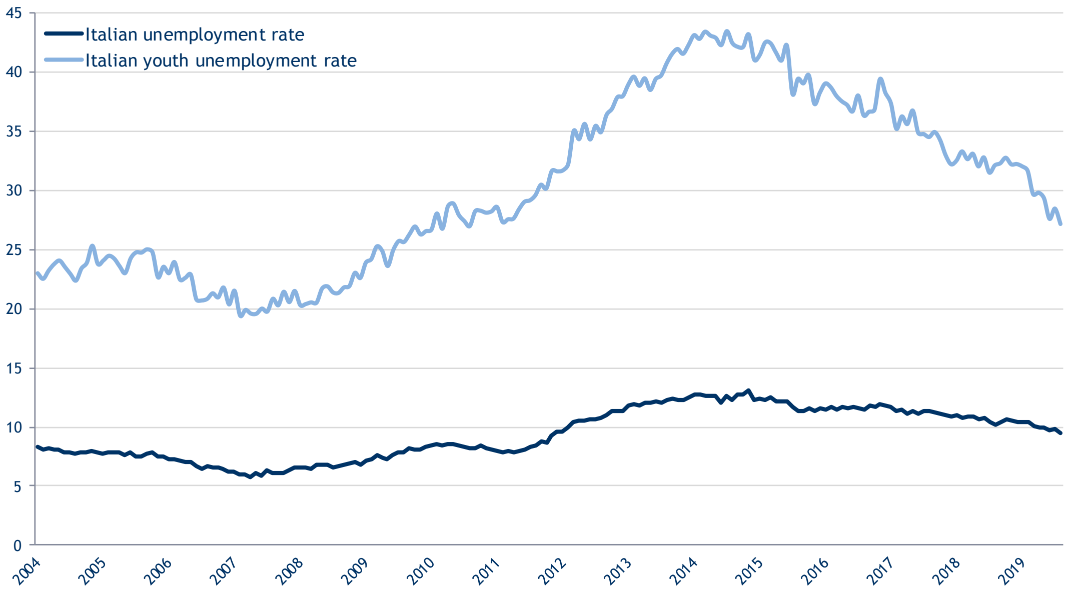
Italian manufacturing and service PMI



Source: Thomson Reuters Datastream

- **Unemployment declining, but slowly** – Unemployment at 9.7% in October 2019 confirms the decreasing trend since the peak of 13.1% at the end of 2014. However, structural issues (such as youth unemployment and differences between different areas of the country) remain largely unresolved.

Unemployment rate (%)



Source: ISTAT

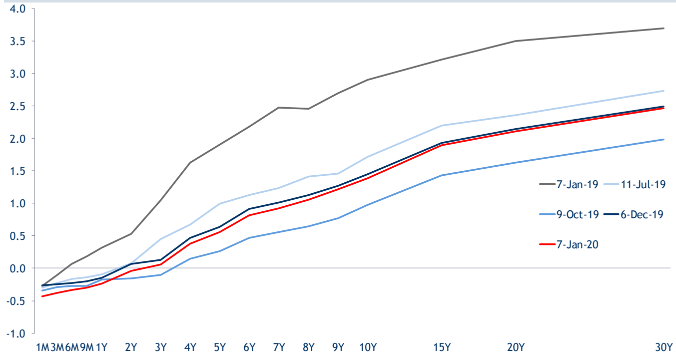
Curve flattening with drop in rates along the whole yield curve

The Italian sovereign yield curve today remains close to its lowest level of the last two years, on average 135bps[1] well below the level hit in early June 2018 when the market reaction to the new 5 Star-Lega government and its expansionary fiscal policies prompted a ballooning of sovereign 10-years yield from 1.8% to c3%. Since the peak reached in 4Q18 (3.7%, when the EC opened to a potential Excessive Debt Procedure), the yield on the 10-year maturity followed a downward path, collapsing below 1% in early September and bouncing back to current levels in October, also supported by the formation of the new PD-M5S Government.

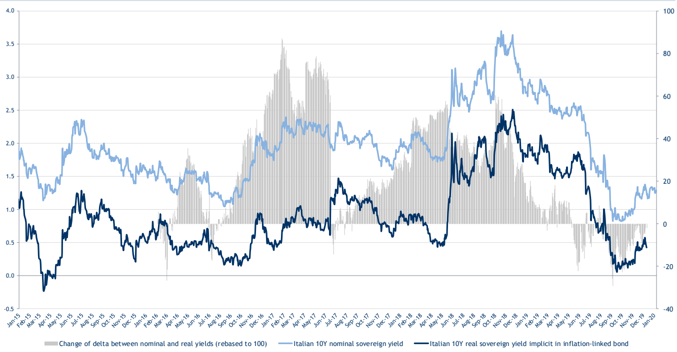
We also note a marked flattening of Italy's yield curve in the past year, with rates up to 2 years decreasing by 40bps while those beyond 2 years lower by c.150bps on average. In other words, we believe that the decline of the Italian sovereign yield has been supported by a generalised fall in the yield along the whole interest rate curve, partly attributable to progressively fading expectations in an increase in inflation. In example, we note a decline of ~20bps of the expected inflation implicit in the 10-year inflation-linked bonds, from 1.05% a year ago to the current 0.83%.

Interestingly, the spread between the 10-year and the 2-year maturity is now approaching the 130bps area, after having approached 100bps between September and October, but still below the 1.5%-2.5% range observed during 2018.

Italian nominal sovereign yield curve (%)

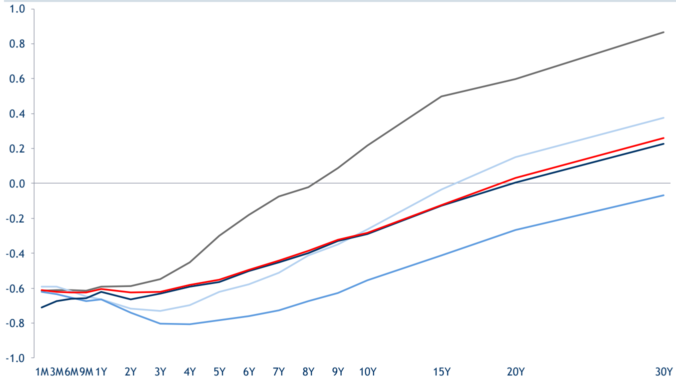


Italian 10Y nominal and real sovereign yield curves (%)

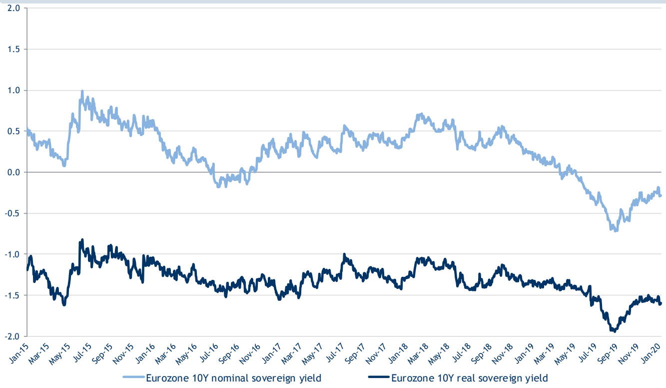


Source: Thomson Reuters Datastream

Eurozone nominal sovereign yield curve (%)



Eurozone nominal and real sovereign yield curves (%)



Source: Thomson Reuters Datastream

[1] Based on all maturities; the 10y sovereign yield is 166 below the relative peak of 7 June 2018

ITALY's '20 BUDGET LAW – LITTLE SUPPORT TO GROWTH

In the previous chapter we have shown that Italy's economic growth seen by the major international institutions is expected to remain subdued, anchored at +0.4% in 2020. We note that such growth is weaker than that embedded in Italy's 2020 Budget Law, seen at +0.6% in 2020. This chapter tries to answers to three main questions. First, assessing whether Italy's Budget Law contains measures that may support internal consumptions, accounting for c60% of Italy's GDP. Second, given Italy's reliance on exports, assessing the support possibly arising from fiscal expansionary policies in Italy's trading partners. Third, assessing whether the Budget Law contains elements of conservatism or not. Our analysis is largely based on information included in the Draft Budgetary Plan dated October 2019, as we understand that the final version of the Budget Law approved in late December should reflect only modest changes on the funding side.

Our analysis provides a clear answer to the first question: as the bulk of the resources employed in the Budget Law are needed to prevent a further deterioration in internal consumption and investments (through the sterilisation of the planned VAT increase in 2020 and Industry 4.0 incentives), we calculate that the Budget Law includes few expansionary measures (€5bn/€6bn) and that higher taxes/lower spending exceed fiscal expansionary measures by €3/4bn. Also the largest expansionary measure (€3bn reduction in the fiscal wedge) accounts for 0.5% of after tax personal income, not enough to change Italy's consumption. In other words, we do not see how the Budget Law could accelerate Italy's internal consumption.

Our analysis on the fiscally expansionary measures in Italy's main trading partners shows that some support could only come from a reduction in Germany's fiscal surplus. However, additional spending worth 0.5% of Germany's GDP would translate into €16bn of additional GDP, from which the benefits for Italy's export could amount to few hundreds of millions of Euros, almost immaterial. France and Spain do not plan any additional fiscal stimulus in 2020 and our analysis of the goods exported to other large trading partners (USA, Switzerland) indicate that 55% of the goods exported are unlikely to be involved in any fiscally expansionary measure. Hence, we conclude that a boost to Italy's export can come from a generalised improvement in global trade.

With regard to the third question, we do not see material elements of conservatism in Italy's economic projections for two main reasons. First, stricter rules on digital payments are to be enforced only from 2H20 onward and hence it is hard to see how this could provide a support to Italy's public finances in 2020. Secondly, and most importantly, our analysis shows that the calculations underpinning the 2020 Budget Law projections look already based on record-low cost of debt (namely a 7-yrs BTP yield at 0.6%, the lowest level since the start of the summer 2019, already risen to 0.9% in the last auction dated November 2019). In aggregate, being designed to prevent a further deterioration of internal consumption and investments – we believe Italy's 2020 Budget Law cannot foster GDP growth and hence risks look tilted to the downside on the +0.6% GDP growth expected by Italy's Government. In other words, with minimal self-help, Italy's economic outlook looks entirely tied to the global outlook.

2020 Budget Law in nutshell

Italy – Summary of macroeconomic assumptions included in the 2020 Draft Budgetary Plan

	2018	2019	2020	2021	2022
GDP growth	0.8%	0.1%	0.6%	1.0%	1.0%
Headline deficit	-2.2%	-2.2%	-2.2%	-1.8%	-1.4%
Primary Balance	1.5%	1.3%	1.1%	1.3%	1.6%
Structural deficit	-1.5%	-1.2%	-1.4%	-1.2%	-1.0%
Change in structural deficit	-0.1%	0.3%	-0.1%	0.2%	0.2%
Public debt	134.8%	135.7%	135.2%	133.4%	131.4%

Source: Mediobanca Securities on Draft Budgetary Plan

A defensive Budget Law providing little support to growth

The first step of our analysis is to assess whether the GDP growth prospects envisaged in Italy's Budget Law (which look more ambitious than those foreseen by the major international institutions) are somehow supported by measures included in the Budget Law itself which may foster growth in Italy after a more than one year of stagnation. This is of crucial relevance as internal consumption of firms and households account for around 60% of Italy's GDP (an incidence remained relatively stable over the past two decades).

The Budget Law is largely focused on preventing further deterioration…

On the funding side, the measures included in the Budget Law approved by the Italian Government could be divided in two main categories. First, the flexibility expected from the EU Commission, seen providing c.€16bn/€17bn. Second the "internal" sources of funding, worth overall c.€14bn (i.e. 45% of the total). The contribution to the Budget of the various measures can be summarised as follows:

- **Budget flexibility asked to EU -** c.€16bn/€17bn, equal to around 50% of funding needs for 2020;
- **Fight against tax evasion -** c.€3bn higher tax revenues, supported by a higher diffusion of digital payments;
- **Spending review -** c.€2bn from lower expenditures in Central Government;
- **Removal of environmental harmful subsidies -** c.€1bn of higher tax revenues from newly introduced taxes, among which the reduced introduction of a "plastic tax" from mid-2020;
- **Revision of taxes on gambling and of tax expenditures -** Italy expects to obtain c€1bn from higher taxation on gambling, while reducing (mildly) certain tax deductions;
- **Revision/postponement of taxation on self-employed workers** – Italy intends to postpone the payment of some taxes from 2019 to 2020 (c.€3bn) as – we understand – Italy has already covered such funding needs in 2019;
- **Postponement of fiscal deductibility of credit losses for banks** – By making credit losses not fiscally deductible in 2019, Italy aims at collecting €1.6bn from expanding banks' taxable income (based to the Draft Budget Law).

Italy: Summary of Funding Sources Included in 2020 Budget Law

€bn	2020
EU Budget Flexibility	c.16-17
Fight Against Tax Evasion	c.3.0-3.5
Other Income	c.3.5
Spending Review	c.2.0-2.5
Removal of Environmental Harmful Subsidies	c.1.0
Postponement Credit Losses Fiscal Deductibility	c.1.5
Revision of Taxation for Autonomous Workers	c.0.2
Tax on Gambling	c1.0
Revision of Tax Expenditures	c.0.2
Other Expenses	c.0.3

Source: MEF, Mediobanca Securities analysis and estimates

…with expansionary measures playing a modest role….

The measures incorporated in the Budget Law approved by the Italian government can be divided in two main categories, in our view. First, measures aimed at preventing a further deterioration in internal consumption, among which the most relevant one attains at the sterilisation of a widespread increase in VAT from January 2020 (so called safeguard clauses). Second, measures aiming at supporting internal consumption and investments. Below a recap of the main expenditures envisaged by the 2020 Budget Law:

- **Full sterilization of the VAT increase** – Italy plans to avoid entirely the VAT increase, which requires €23bn in 2020. For 2021, the government has currently foreseen a partial sterilization, worth c.€10bn (out of c.€29bn total safeguard clauses). This cannot be considered a measure supporting an economic expansion but only as a way to prevent further deterioration;
- **Confirmation of incentives related to *"Industry 4.0"*** for 2020, with increasing funds (approximately €2bn) to be devoted by 2022. Equally to the sterilization of the VAT, such measure only prevents a collapse in investments;
- **Cut in the fiscal wedge** – Such measure should increase the purchasing power of the Italian population for a total of c.€3bn in 2020, and increasing to €5bn in 2021-22. The cut in the fiscal wedge could be achieved through a lower tax burden for employees or through a lower cost per employee for firms by reducing pension costs and contributions;
- **Support to local and national investments** – Italy plans to inject around €1bn in 2020 and growing to c.€3bn in 2022), with the primary aim of promoting the diffusion of sustainability, circular economy, and maintenance of infrastructures;
- **Push to digital payments only from 2021 onward** - Incentives for businesses that promote electronic payments will kick-in in 2021, with measures estimated to be worth c.€3bn p.a. in both 2021 and 2022.

Italy: Summary of expenditures included in 2020 Budget Law

€bn	2020
Sterilisation of Safeguard Clauses	(23.0)
Fiscal Wedge Reduction	(3.0)
Support Industry 4.0	-
Incentives Industry 4.0	(0.1)
Cashback	-
Support for National Investments	(0.2)
Support for Local Investments	(0.5)
Family Policies	(0.6)
Support for PRM (Disabled People)	(0.1)
Healthcare	(0.2)
Eco Bonus	-
Other Local Initiatives	(0.3)
Non-Deferrable Expenses	(0.8)
Other Income	(0.1)
Other Expenses	(1.0)

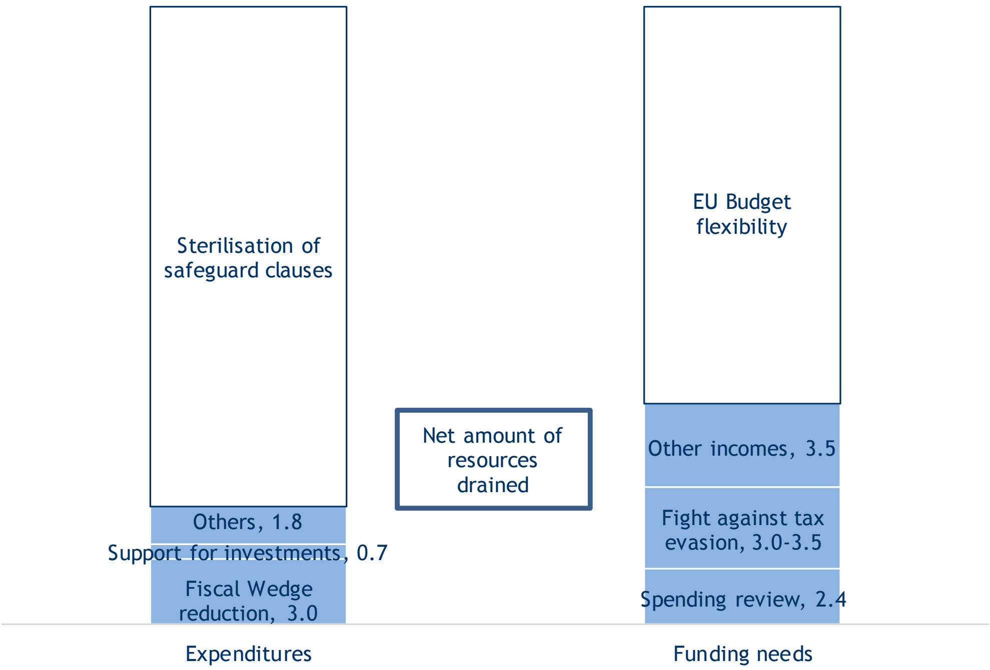
Source: MEF Draft Budgetary Plan, Mediobanca Securities analysis

…translates into a limited support to internal consumption

With the bulk of resources catalysed by the sterilisation of safeguard clauses (c.75% of 2020 budget expenditures), it is difficult to envisage that measures included in the Budget Law may trigger an inversion in internal consumption in 2020. As a matter of fact, we calculate that measures which may have an expansionary impact amount to around €5bn/€6bn, i.e. only 0.3% of GDP. The cut in the fiscal wedge alone accounts for 50% of the total estimated expansionary measures, but –even assuming this will be pursued entirely through lower taxes for employees – we calculate it would account for only 0.5% of after tax personal income (IRPEF). We hardly see how a 0.5% reduction in personal income taxes (in a best case scenario) can boost internal consumption.

On the other hand, given the limited room for leveraging on further deficit, and the weakening GDP growth, the government was forced to seek for contribution from additional tax revenues. Net of the flexibility asked to EU, we calculate in the Budget Law resources drained for funding needs should exceed the stimulus injected by expansionary measures by c.€3bn/€4bn, i.e. a net negative balance which could be estimated between 0.1%-0.2% of GDP.

Italy: Comparison between resources injected and drained by 2020 Budget Law (€, bn)



Source: Mediobanca Securities analysis and estimates

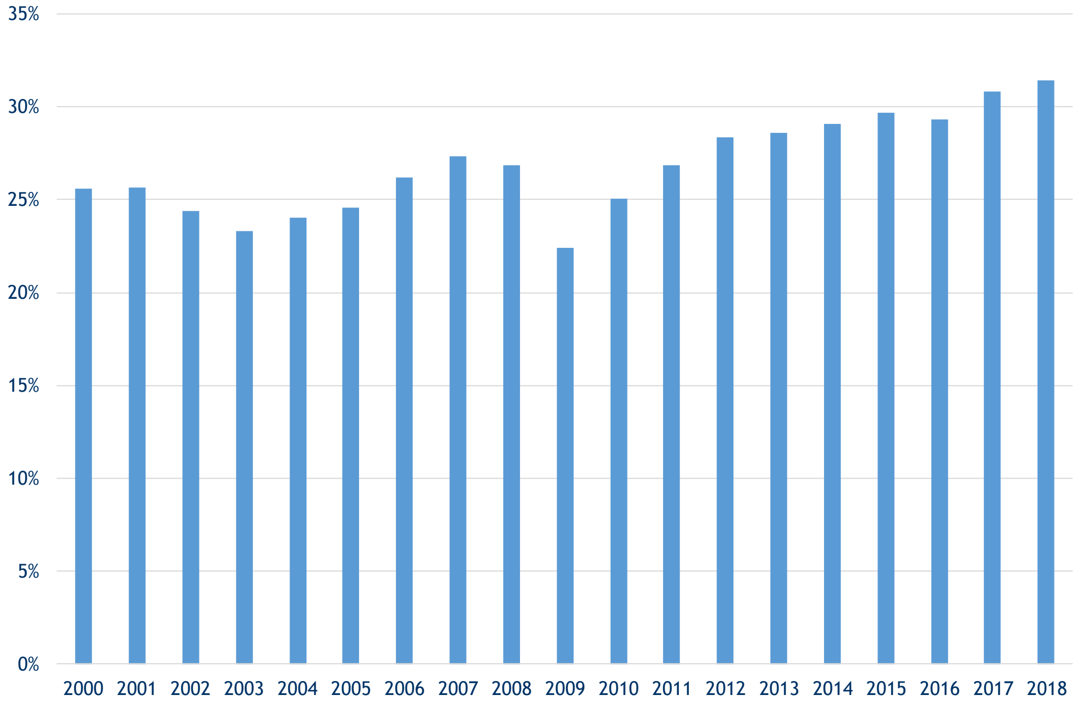
Just a little help from fiscal expansion from abroad

With little support to internal consumption, the acceleration in GDP growth foreseen by the Budget Law (+0.6% in 2020 vs +0.1% seen so far in 2019) look largely tied to exports and ultimately to the global economic outlook. Thus, we investigate who are Italy's main trading partners and try to assess whether the economic outlook of Italy's main trading partners justify some optimism (or not) on behalf of Italy's policymakers.

Export has compensated for Italy's chronic lack of investments

During last two decades, the weight of exports on the Italian economy has constantly risen over the past years to almost 32% of GDP from 22% in 2009. Such good performance can be attributed to the fact that internal consumption (firms, households and public entities) has been stagnant over the past decade, but we cannot neglect the good performance of Italy's exports over the past few years, when Italy managed to gain again 2.9% market share in the global exports versus 2.7% in 2012 (but still far from 3.3% in 2009).

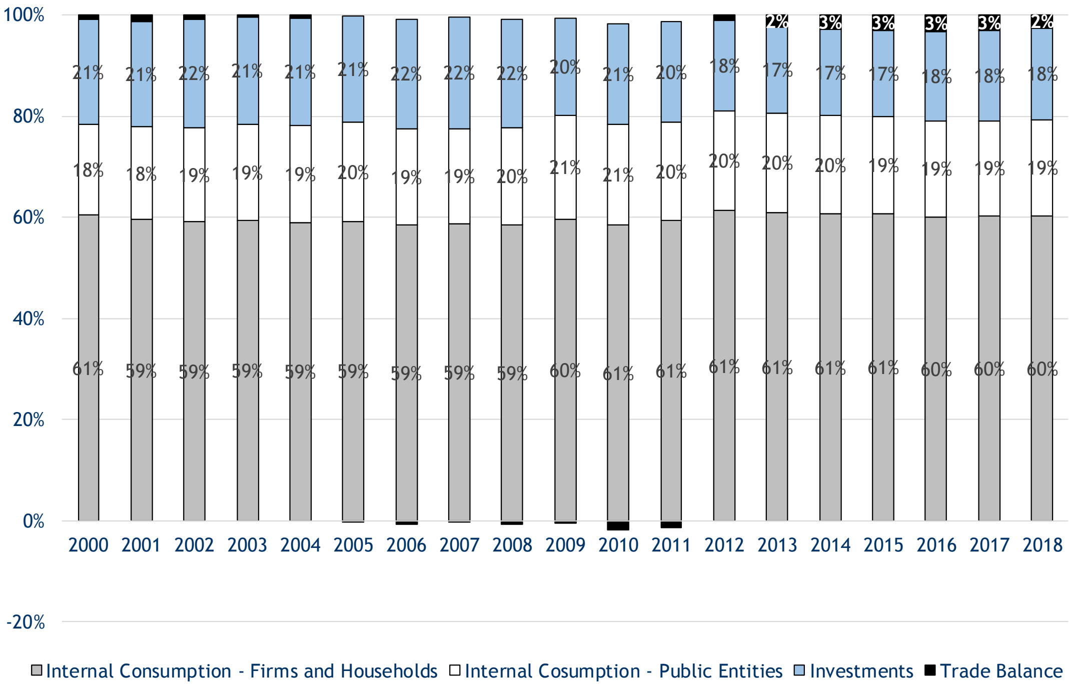
Italy – Weight of Nominal Exports on Nominal GPD (%), 2000-18



Source: ISTAT, Mediobanca Securities

Thanks to a rising export, Italy's improving trade balance compensated the chronic drop in investments of the past decade (falling to 18% of GDP in 2018 from the peak of 22% of GDP in 2007). In other words, despite very low investments in fixed capital (machineries, plants, land et cetera…), Italy's corporations managed to improve their exports so that we calculate the trade balance reverted in positive territory by average €49bn in 2014-18 versus a negative trade balance of €23bn in 2011 and by €29bn in 2010.

Italy – Breakdown of GDP by Main Components, 2000-18 (GDP at Market Prices)

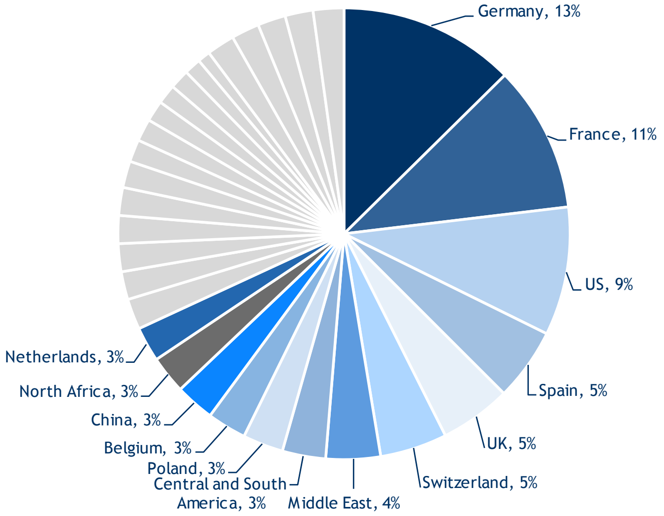


Source: ISTAT, Mediobanca Securities

Italy is highly reliant on exports to EU partners (Germany, France)…

Breaking down 2018 exports value by geography, we note that Italy's main trading partners are represented by Germany (13% of Italy's exports), followed by France (11%). Adding other largest European countries (Spain, UK, Poland, Netherlands, Belgium, Switzerland), we calculate that exports to Europe (as a geographical entity) account for more than 50% of Italy's exports. The US is largest player outside Europe and Italy's third largest partner, accounting for 9% of exports. Middle East accounts for 4% of Italy exports, while Latin America North Africa and China for only 3%.

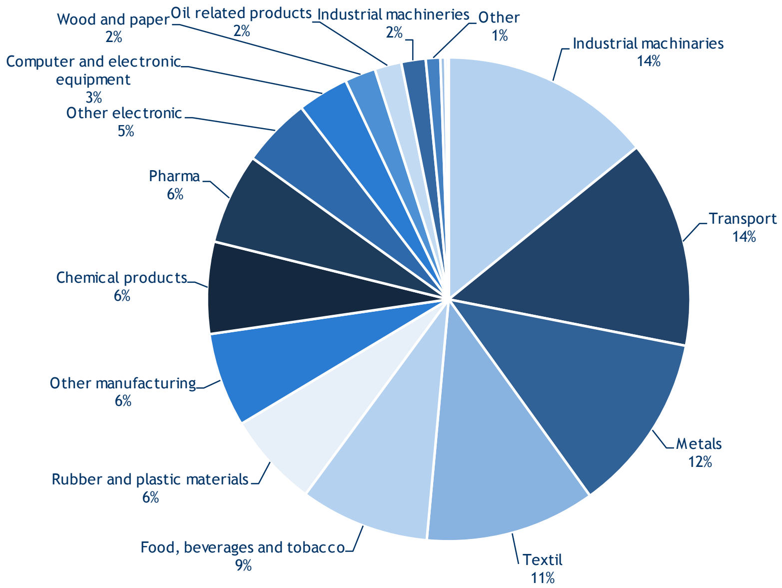
Italy - Main Trading Partners in Percent of Exports (2018)



Source: ISTAT

Focusing on the six largest trading partners (namely Germany, France, USA, Spain, UK and Switzerland), which jointly account for c.50% of Italy's exports value, we note that textile products, food-related and pharma account for more than 25% of Italy's export. We highlight the incidence of those products, as any fiscally expansionary measure carried-out in any of Italy's main trading partners is unlikely to affect such categories, which account for a good part of Italy's export.

Italy - Exports Value Towards Top 6 Trading Partners Broken-Down by Product Category (2018)



Source: ISTAT, Mediobanca Securities analysis

…but German fiscal stimulus looks too small to bring benefits to Italy's GDP

The former ECB Governor Mario Draghi clearly stated that Governments with fiscal space should act in an effective and timely manner with expansionary policies that may support the economy in the Euro Area. A fiscal boost (i.e. higher Government spending) in Italy's main trading partners could have a carry-over effect for Italy's GDP growth. Hence, we have analysed the published Draft Budgetary Plan (DBP) of largest European economies (Germany and France), which are also Italy's main trading partners. On the other hand, we do not consider the following countries in our analysis:

- **Spain** – Spain's plan has been prepared on a no-policy-change basis, in view of the caretaker nature of the government. Hence, we expect no additional fiscal expansion in Spain;
- **USA and Switzerland** – We do not account for any potential impact from an additional fiscal expansion in the USA and Switzerland (Italy's third and fourth largest trading partners) as the aggregate of textile products, food-related products, pharma, vehicles (including cars) and furniture account for almost 55% of Italy's export to those two countries. Such categories are unlikely to be involved in any fiscally expansionary measure. With regard to the USA, the recent past and the protectionist policy pursued by the US Administration would actually indicate a not immaterial downside risk on export to the USA;
- **UK** – The uncertainty surrounding Brexit make any hope of some kind of support to the Italian economy from an improved trade balance with the UK unrealistic.

Germany's Draft Budget Plan (DBP) takes into account the weak business cycle, which sees GDP growth at 0.5% in 2019 and 1.5% in 2020. Despite the economic slowdown and the resulting lower tax revenues, neither the draft 2020 federal budget nor the financial plan to 2023 envisage a net new borrowing, as Germany expects its structural budget surplus (in place since 2012) to continue also in the foreseeable future. In other words, Germany's debt is expected to keep shrinking.

The strong country's current account surplus can be attributed to the fact that far more German products and services are sold overseas than imported to Europe's largest economy.

Germany's 2020 DBP envisages a reduction of the country structural surplus from 1.25% in 2019 to 0.5% in 2020, largely attributable to the measures included in the Climate Action Programme 2030. As reported in the document, a priority has been placed on transport infrastructures, funding for the construction of housing, measures aimed at reaching the climate targets for 2030 and to education and research spending. However, we also note some resistance in some German political parties to a large increase in spending in absence of a marked uptick in unemployment.

Based on Germany's Draft Budget Plan, we calculate that reducing the structural surplus by 0.50% in 2020 would free up c.€16bn of additional Government spending, i.e. €16bn of additional GDP. Based on Germany's statistical Bureau (Statistische Bundesamt), we infer that import accounted for 40% of Germany's GDP in 2018.

Assuming that the additional GDP growth will not alter the current break-down of German GDP constituents, we may infer that – out of €16bn additional GDP growth – some €7bn may be imported. Knowing the value of Italian exports to Germany (approximately €55bn out of €1.36trn of German import, i.e. 4%) we derive that Italy's export to Germany may increase by few hundreds of millions of Euros on the back of additional €16bn fiscal expansion.

Germany – Draft Budget Plan Macroeconomic Assumptions, 2018-20

	2018	2018	2019	2020
	€bn	%	%	%
Headline Surplus (Deficit)/GDP		1.9	1.25	0.75
Structural Surplus (Deficit)/GDP		1.5	1.25	0.50
Debt/GDP ratio %		61.9	59.8	57.8
Real GDP growth	3,222	1.5	0.5	1.5
Unemployment Rate		3.2	2.9	2.7

Source: Germany Draft Budget Law, EU Commission, Mediobanca Securities

The French Government plans to keep its structural deficit at 2.2% this year and in 2020, but its headline deficit is set to fall from 3.1% in 2019 to 2.2%, reflecting some one-off changes in the tax system. Indeed, exceeding the 3% threshold set by EU rules will be temporary and exceptional due to the conversion of the Competitiveness and Employment Tax Credit (CICE) into a reduction in employer contributions. France's 2020 Draft Budget Plan clearly says that enables the Government to maintain its goal of fiscal loosening, i.e. it is not designed to expand further the public deficit.

France – Draft Budget Plan Macroeconomic Assumptions, 2018-20

	2018	2018	2019	2020
	€bn	%	%	%
Headline Surplus (Deficit)/GDP		-2.5	-3.1	-2.2
Structural Surplus (Deficit)/GDP		-2.3	-2.2	-2.2
Debt/GDP ratio		98.8	98.4	98.7
Real GDP growth		1.7	1.4	1.3

Source: France Draft Budget Law, EU Commission, Mediobanca Securities

Key France's policy measures focus on large cuts in taxes and social security contributions. Following its announcement in 2018, the Government stuck to its commitment to lower the corporate tax rate in 2020 to 31% (-2% decrease) for companies with revenues of more than €250m and to 28% for those below that threshold. The target of reaching a 25% tax rate in 2022 was upheld. Furthermore, they went ahead with lowering income taxes for households for an equivalent of €5bn, a promise of President Macron following the 'grand debat' in response to the yellow vest crisis. Needless to say, €5bn in lower taxes do not look like a large boost for France's internal consumption, from which Italy may indirectly benefit.

We see little margin of safety in 2020 Budget Law

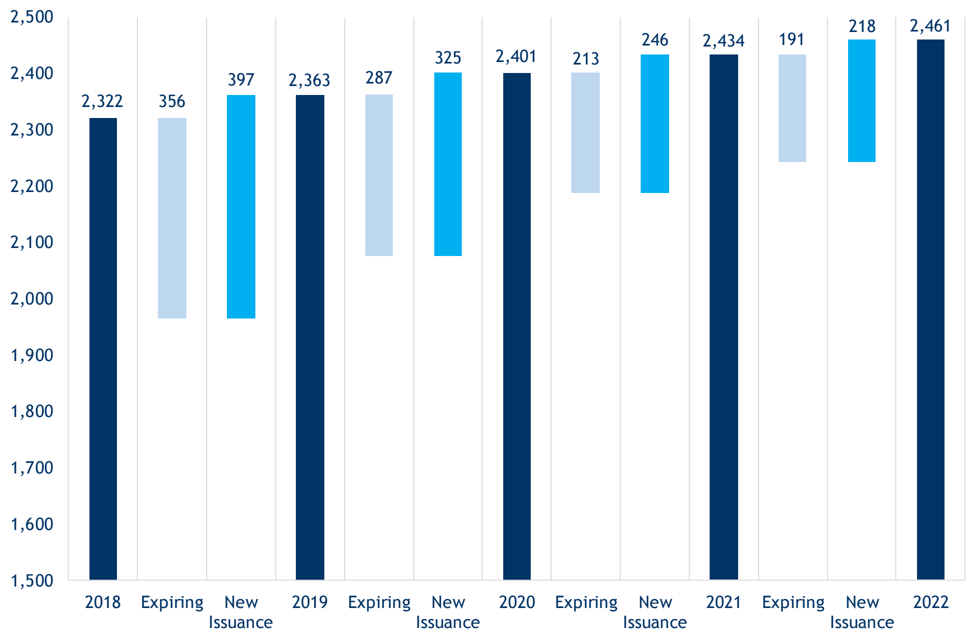
In the letter responding to the EU Commissioners (in which the EU Commissioners Valdis Dombrovskis and Pierre Moscovici asked for more clarity on how Italy intends to comply with the debt reduction trajectory), Italy highlighted that the Budget Law contains some elements of conservatism. More in detail, the Budget Law includes no impact from tax revenues that may accrue from a wider use of cashless transactions and Italy believes that fiscal consolidation and structural reforms may lead to a further decline in sovereign spreads, granting lower funding cost and an improvement in structural balance.

As tighter rules on the use of digital payments will start only in 2H20, we regard as reasonable not to consider possible higher tax revenues from digital payments as an element of cautiousness embedded in the Budget Law.

Hence, we focus our analysis on assessing whether the Budget Law is based on a prudent cost of funding and – in case – assessing whether this could go down further allowing some room for manoeuvre. We make the following assumptions:

- **We estimate Italy's Budget Law foresees debt to grow by around €40bn in 2020** - In 2020 Italy's Budget Law foresees a GDP growth of +1% in 2019 and +2% in 2020, bringing Italy's' GDP (at current prices) to €1.82trn in 2020. Italy's Budget Law foresee the Debt/GDP Ratio increasing by 1 percentage point in 2019 (to 132.5%) and then a gradual deleverage bringing the Debt/GDP Ratio to 132% in 2020 and to 128.4% in 2022. Knowing the nominal GDP and the Debt/GDP Ratio, we can calculate that Italy's Debt should hover over €2.4trn in 2020. The decline in the Debt/GDP Ratio mainly stems from growing nominal GDP growth, as – based on the Budget Law assumptions – we calculate the debt should keep growing by around €40bn in 2020;
- **We estimate Italy should issue around €325bn of debt in 2020** – Italy's Minister of Finance discloses €287bn of debt coming to maturity in 2020, which needs to be refinanced. Adding the expected increase in Italy's debt in 2020 (approximately €40bn), we calculate Italy's debt issuance should amount to around €325bn in 2020;

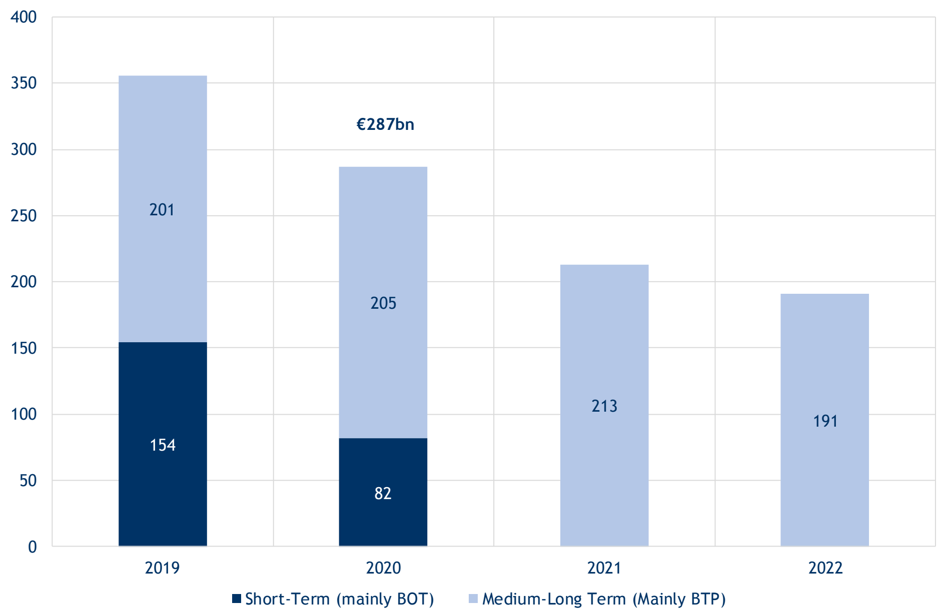
Italy – Estimated Amount of Debt to be Issued Each Year, 2019-22 (€bn)



Source: MEF, Mediobanca Securities analysis

Looking at maturity of the maturing debt, Italy's Government has to refinance c.€200bn of "long-term" debt per annum (mostly BTPs) and c.€230bn of short-term notes (BOT). Below, we show the amount of also to be financed. These are spreaded over the next two years.

Italy - Breakdown of Expiring Debt by Maturity (€bn), 2019-22



Source: MEF

- **We estimate €5bn/€6bn of lower interest expenses embedded in Italy's Budget Law** - In its latest budgetary plan, the Italian Government forecasts interest expenses to drop to 3.3% of GDP in 2020 from 3.7% in 2018. Knowing the trajectory of nominal GDP, we calculate that interest expenses should fall to €60bn in 2020. We estimate the marginal lower cost of funding embedded in the current Budget Law by comparing the interest expenses of today's Budget Law with those included in the previous revised Budget Law (dated April 2019). This compares to previous projections (DEF published on April 2019), which estimated interest expenses at 3.6% of GDP in 2019-2020. As a result, we estimate Italy's Government embeds the saving of c.€5.5bn interest expenses from a more benign rates environment and from lower Italian sovereign spreads.

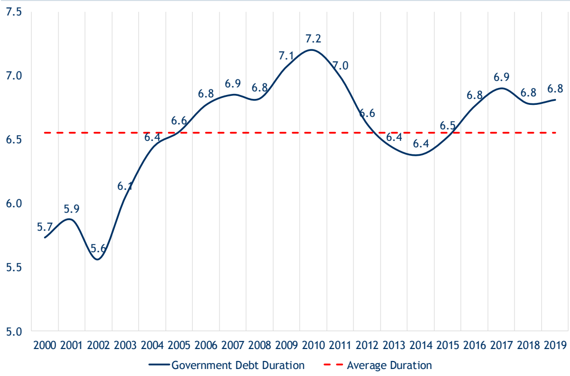
Italy – Estimated Lower Interest Expenses Embedded in 2020 Budget Law for the Year 2020

	2018	2019	2020	2021	2022
			NADEF ASSUMPTION (OCTOBER 2019)		
Interest Expenses - % GDP	3.7%	3.4%	3.3%	3.1%	2.9%
Interest Expenses - €bn	**65**	**61**	**60**	**58**	**56**
			DEF ASSUMPTION (APRIL 2019)		
Interest Expenses - % GDP	3.7%	3.6%	3.6%	3.7%	3.8%
Interest Expenses - €bn	**65**	**64**	**66**	**69**	**73**
Estimated Savings From Lower Interest Expenses - €bn	**0.0**	**3.6**	**5.5**	**11.2**	**17.2**

Source: MEF, Mediobanca Securities analysis

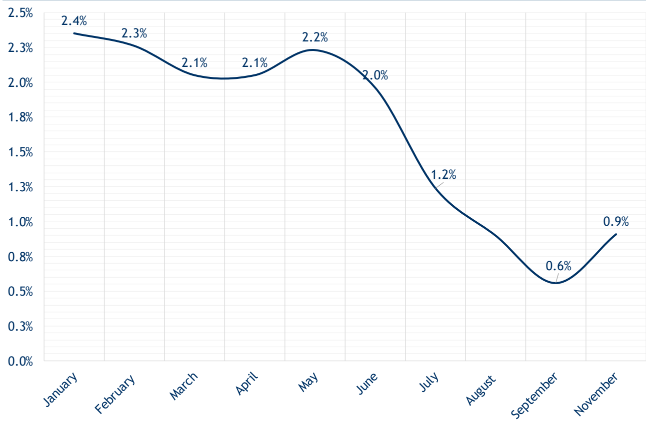
- **We estimate the average cost of Italy's debt has reduced by 170bps since the start of 2019** - Considering that Italy's debt has an average duration of c.7Y - which has been fairly stable over the past ten years, we compare the average cost on the latest issuances of 7-year BTP (dated September 2019) with the average cost of the issuances at the start of 2019, under the reasonable assumption that calculations underpinning the previous Budget Law (dated April 2019) were based on the cost of issuing 7-year BTP at that date A8averagging 2.2% in January-March 2019). We calculate that the cost of issuing 7-year BPT dropped by 170bps since the previous Budget Law (April 2019).

Italy – Average Government Debt Maturity, 2000-19



Source: MEF, Mediobanca Securities

Italy – Progression in Newly Issued 7-Yrs BTP Yield; 2019



Source: MEF, Mediobanca Securities

- **Our calculation indicate that Italy's Budget Law embeds 0.6% cost for debt issuance** - Given that Italy has to issue €325bn of debt in 2020 (€287bn refinancing and c€38bn new issuances), applying 170bps difference in funding cost versus the previous Budget Law throws-off €5.5bn lower funding cost, consistent with the savings estimates by the Government in the Budget Law. Thus, we infer that the Budget Law already incorporates the yields seen in September 2019, i.e. the lows of the past debt issuance. As an indirect proof, Italy issued a 7-year BTP on 12/13 September 2019 at 0.56% yield. In those days, Italy's 10-yeats BTP yield hit 0.84%, basically the record lows since the start of the summer.

Italy – Estimated Savings from Lower Interest Expenses Embedded in the 2020 Budget Law

	January-March 2019	September 2019	Saving
New Issuance in 2020 (€bn)	325	325	
7-Years BTP yield (%)	2.2%	0.6%	1.7%
Estimated cost of interest of the new funding (€bn)	**7.2**	**1.8**	**5.4**

Source: Mediobanca Securities analysis

- **The last issuance 7-Years BTP would indicate additional €1bn of deficit due to higher cost debt issuance** – MEF reported that the latest available issuance of 7-Years BTP (dated at 13/11/2019) has been finalised at 0.91% yield, which is equivalent to 30bps of additional cost of debt issuance compared to September data. This would imply an estimated cost of new funding of €2.9bn, which is equivalent to around €1bn of additional deficit (or 0.1% of 2020 GDP).

ITALIAN POLITICS – VOLATILITY IS THERE TO STAY; GOVERNMENT'S ACTION MAY BE WEAKENED BY ON-GOING DISCUSSIONS

A new government, led by PM Giuseppe Conte and supported by PD, Five Star, Renzi's Italia Viva and left-wing LeU, obtained a confidence vote in September 2019. Thanks to a constructive relationship with the EU, the new government has managed to negotiate with EU more budget flexibility.

At the same time, press continues to report on-going discussions within the coalition supporting the government (Renzi forming a new party, electoral & justice reforms, ESM, ArcelorMittal) and this could weaken the government's action, while current majority at the Upper House looks like thin.

Upcoming regional elections - with uncertain outcome in the Emilia Romagna Region - could increase uncertainty, while the time needed to implement the electoral reforms may eventually reduce risk of early elections.

From an investment standpoint, we acknowledge the fact that volatility generated by Italy's political uncertainty is unlikely to fade away and see it as the main risk of our tactical rotation call (Banks versus Utilities/Insurers).

New Government managed to get more EU Budget flexibility

After a troubled summer, on 10 September the Italian government – led by PM Giuseppe Conte and supported by PD, Five Star Movement, Renzi's Italia Viva and left wing L&U – obtained a confidence vote at the Upper House with 169 votes in favour and 113 votes against. Thanks to a constructive relationship with the EU, the new government has managed to negotiate with EU more budget flexibility.

According to the latest update provided by the parliament, the Government can count on 162 votes at the Upper House (with the majority threshold at 161 seats) and 343 at the Lower House (with the majority threshold at 316 seats).

Updated distribution of parliamentary seats

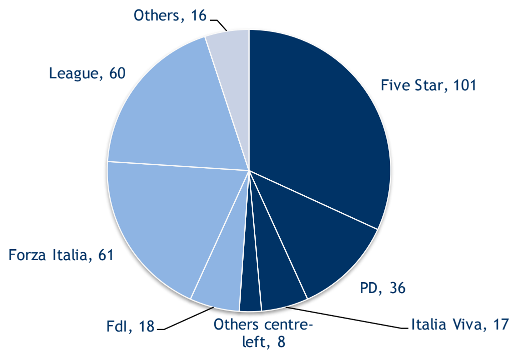
Upper House		Lower House	
Italia Viva	17	Italia Viva	29
Five Star	101	Five Star	214
PD	36	PD	88
Autonomie	8	LeU	12
Pro-government coalition	**162**	**Pro-government coalition**	**343**
Other	16	Other	9
League	60	League	125
Forza Italia	61	Forza Italia	97
Fratelli d'Italia	18	Fratelli d'Italia	35

Source: Mediobanca Securities, Senato.it, Camera.it

However, after less than a week, daily news flow started to become less supportive. Details are:

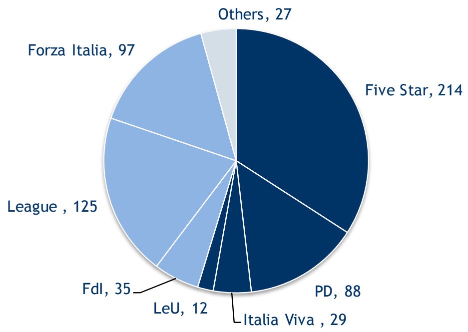
- **The support of smaller parties is crucial for the survival of the Government** - On 16 September the former PM Matteo Renzi announced his intention to leave PD and to form a new political party, **Italia Viva** (17 representatives at the Upper House, 28 at the Lower House). Mr Renzi confirmed the intention to support the existing government, but Italia Viva immediately tried to impose its own political agenda, openly criticising some of proposals to be included in the budget law. In an interview on La7 television on 5 December, Matteo Renzi said he gives “50% chance the parliament will not be dissolved, until last week it was 95%”; we flag at the Upper House the support of Italia Viva is crucial for the Government. On 19 December, *la Repubblica* published an article suggesting 10 senators may leave Five Star to form an independent group in the Upper house;

Italy - Upper House, updated distribution of seats



Source: Mediobanca Securities, Senato.it

Italy - Lower House, updated distribution of seats



Source: Mediobanca Securities, Camera.it

- **Polls would indicate that the reduced number of seats could favour the Centre-right coalition** - On 8 October, the Lower House approved the reform to cut 345 parliamentary seats, with 553 votes in favour and 14 votes against: the reform envisages a reduction in the number of seats at the Lower House from 630 to 400, and from 315 to 200 at the Upper House. A referendum to confirm the reform may be called between 15 April and 15 June 2020 (being a constitutional referendum, no quorum is required), with the cut potentially being effective starting from Autumn 2020. Furthermore, this reform (pushed by Five Star) may go along with an electoral reform (which is a key priority for PD) with the ruling coalition now expected to start discussions on this front. The time needed to finalize and implement these reforms may reduce the risk of having elections in place anytime soon (press flagging MPs could also be tempted to anticipate new elections in order to vote before the reform is eventually approved reducing the number of seats). On 21 November, the Court of Cassation greenlighted the proposed referendum made by the League and aimed at changing the electoral law aimed with **strong vocation for the majority system** (introducing the individual constituency). Early in 2020, the Constitutional Court will have to decide on whether the referendum is admissible. If that happens, a referendum could come in the second quarter of 2020. When looking at recent polls, it seems fair to argue such a reform could favour the centre-right coalition;
- Frictions between the two main parties of the ruling coalition on other specific the government has also to solve the ILVA issue: ArcelorMittal acquired the steel-producing plant, but recently announced the intention to close the plant. On 5 December press reported a draft proposal aimed at cutting 4,700 jobs by 2023.The Government is also debating over the option to offer a legal shield related to past administration’s environmental mistakes, with PD in favour and Five Star against such a measure;
- On 5 December press also flagged ongoing frictions between Five Star and PD on the **justice reform**, with PD not willing to accept ultimatum on the need to approve the new scheme proposed by Five Star;
- Finally, we flag Italian government will attempt to get a vote in parliament to decide on the reform of the **European Stability Mechanism (ESM)**. The Eurozone plan was to get political agreement signed by 19 December, but given the ongoing discussions within the Italian government coalition, with Five Star opposing signing off and PD supporting the plan, the deadline was postponed;
- On 7 January press reported that **Five Star is likely to eject few MPs from the group**, adding they would be welcome by the League party. Also, Italian daily la Repubblica published an

interview with former Minister of Education Fioramonti, criticizing the lack of debate inside Five Star. The article adds he may launch a new party, Eco, centred in ecology;

- On January 20, a Senate commission will have to vote, ahead of a vote by the full Upper House, on the **possible prosecution of Matteo Salvini** for refusing to allow a migrant rescue ship to dock in Sicily in July when he was Minister of the Interior. In a statement of defense, Mr Salvini said he was applying the Government policy.

Upcoming regional elections to fuel uncertainty

Finally, we flag on 26 January we will have local elections in Emilia Romagna and Calabria. Having Five Star rejected the option to go for an alliance with PD, the outcome on such elections remains highly uncertain. Latest polls are flagging a good advantage for the centre-right in Calabria, even if the recent appointment of a well-known entrepreneur as candidate form the centre-left may eventually reduce the gap.

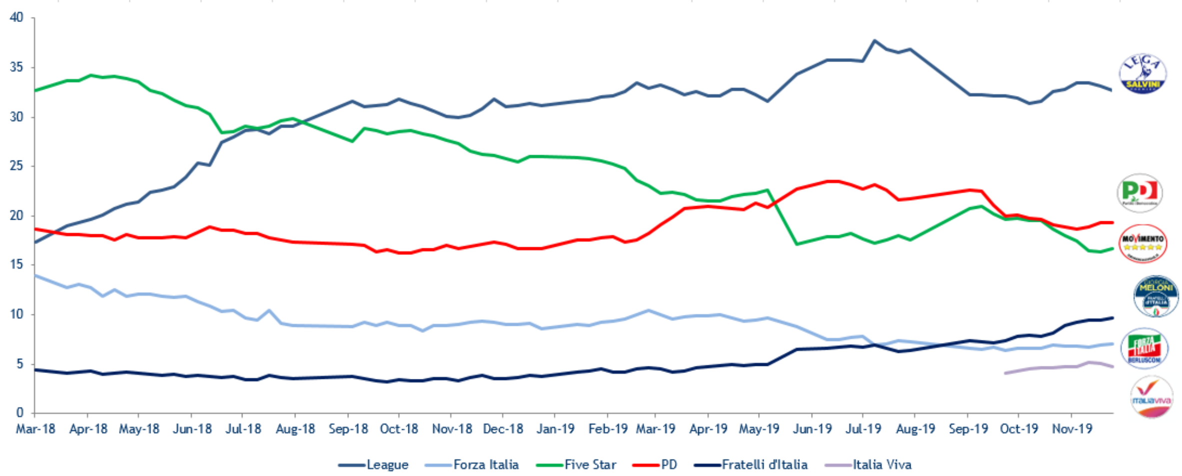
The local election to be monitored is the one of Emilia Romagna, being the region extremely important from an economic perspective (representing c. 10% of domestic GDP) and *representing an historically fortress for the centre-left*. Latest polls are suggesting a neck-and-neck situation, with Stefano Bonaccini (centre-left) at 50.5% and Lucia Borgonzoni (centre-right) at 47.5% (*Tecnè*, 28 November). Still Five Star have to appoint their candidate, and this could eventually change the picture.

During 2020, elections will happen also in Campania, Tuscany, Veneto, Liguria, Puglia and Marche (dates not yet disclosed, probably between May and June).

Latest polls confirming Centre-right remains strong

Since the latest National Elections held in March, the League and Fratelli d'Italia have gained ground, as indicated by the evolution of voting intentions, rising above 30% according to latest data. Its position has strengthened mainly at the expense of Forza Italia party and the Five Star. The chart below shows the evolution of voting intentions for main parties since the last national elections, based on data collected by *YouTrend*.

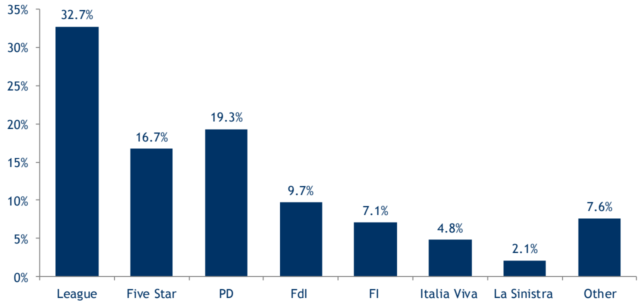
Italy – Evolution of voting intentions throughout 2018 (%)



Source: Mediobanca Securities on Istituto Ixè (as of November 28)

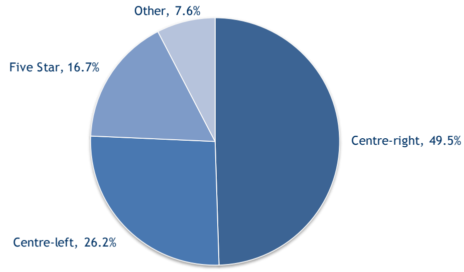
Looking at coalitions, latest available data show a strengthening of the Centre-right coalition, which nears 50% of the voting intentions. Such a share would theoretically ensure a sufficient majority, in case new elections are held in the near future, with the existing system.

Italy – Voting intentions for single parties



Source: Mediobanca Securities on YouTrend (as of Nov. 28)

Italy – Voting intentions for coalitions



Source: Mediobanca Securities on YouTrend (as of Nov. 28)

TACTICAL ROTATION INTO BANKS HAS STILL ROOM TO GO

The aim of this chapter is to identify opportunities of tactical sector rotation at the start of 2020 by comparing the relative valuations across different sectors. Our analysis is based on 3-years looking-forward PEs (admittedly a simplistic measure, but suitable for all sectors) for the main European sectoral indexes, starting from the assumption that price movement in Italian stocks should mirror that of European peers. Such assumption is reasonable with the possible exception of peculiar stock specific cases. In example, EU Telecom sector multiples do not look attractive, but we acknowledge TI trades at wide discount to its EU peers.

Our analysis shows that the EU market (STOXX600) trades at PE materially above (c20%) the normalised average of the past 15 years and in line or above crisis-free periods. Hence, candidates to benefit from rotation should be searched among sectors where such premium is absent or less evident. Banks and Automotive emerge as candidates, as both trade at discount to their long-term average PE (1% and 8% respectively), below PEs of crisis-free periods and just above the average of the past two years (affected by falling rates, trade tensions). On the other hand, such rotation should affect negatively Utilities and Insurance, as the PE of both trade well above their historical average (c20% and c10% respectively). Utilities PE is also positioned above that of crisis-periods when Utilities' defensiveness should have peaked. Insurance PE is aligned to crisis-free periods, despite ultra-low rates represent a tough scenario.

Although we acknowledge that easing trade tensions may trigger an outperformance of the Automotive sector owing to its undemanding valuation, we reckon headwinds (GDP weakness, restrictive rules on CO2 emissions and possible fines) may make any re-rating as short-lived.

The conclusion of our analysis is that the tactical trade of being overweight Banks over Utilities/Insurers still has steam, quantified in 5%-10% relative re-rating potential at EU sector level, translating into 8%-12% for Italian banks owing to higher betas versus EU peers. Relative to other sectors, Banks' PE multiples look undemanding considering – as we explain in the macro sections – that subdued macro is already plugged in our and, we believe, consensus projections, rates are unlikely to be cut further in Europe (easing credit margin pressure) and regulatory tightening should have come to an end (improving the visibility of capital ratios). Finally, switching into Banks should not come at the expenses of dividend yields, as banks' ones are aligned to those of Utilities and Insurers.

Banks (together with oil, telecoms) the clear long-term underperformers…

The table below shows the weight of the main sectors in Italy's FTSE MIB index, which shows the overwhelming weight of Financials (35%, two-thirds of which related to banks) and of Utilities.

Italy FTSE MIB – Breakdown of Weight by Sector (Alphabetical Order)

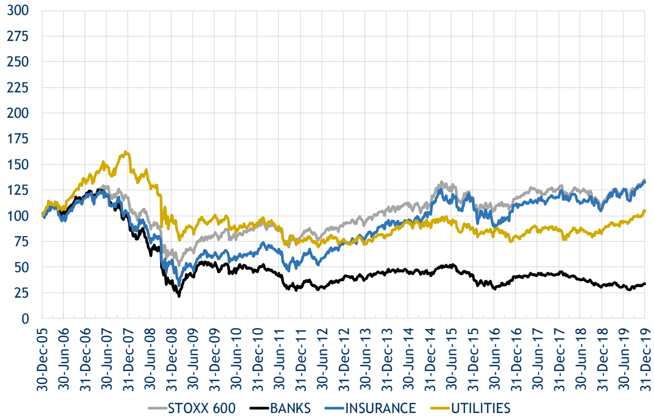
Sector	Weight
Automobiles and Components	c10%
Banks	c23%
Diversified Financials	c3%
Energy	c12%
Industrials	c9%
Insurers	c9%
Utilities	c22%

Source:Bloomberg, Mediobanca Securities analysis

The chart below shows the share price performances since the end of 2005 of the EU wide stock market and of the major sector indexes. Unsurprisingly, Banks are the standout underperformers, down some 65% over the period, followed by the Oil (c-20%) and Telecom sector (c-10%). Utilities are around flat, insurers are up around 35%, in line with the market.

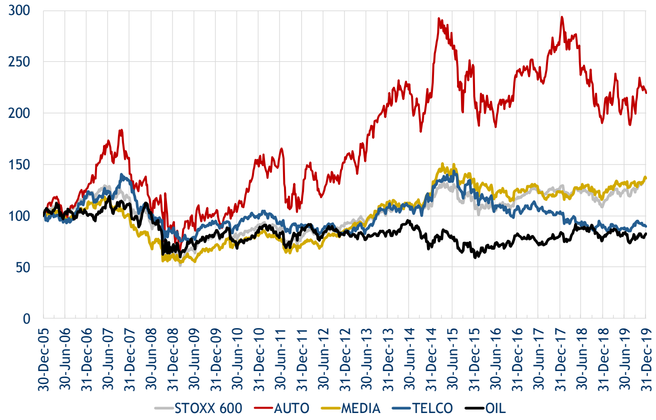
MEDIOBANCA SECURITIES

Europe - Price performance of European Market, Banks, Insurance and Utilities Since 2005



Source: Mediobanca Securities, Thomson Reuters

Price performance of European Market, Auto, Media, Telecom and Oil Since 2005



Source: Mediobanca Securities, Thomson Reuters.

…and in 2019…

Since the beginning of the year 2019, we note the wide market is up around 20% and we also note that Insurance mildly outperformed, Utilities mildly unperformed while –once again - Banks oil and Telecom have been the laggards. With regard to banks, such severe underperformance can be largely attributed to a collapse in rates (either on the short or on the long-part of the yield curve, fuelling concerns on what could be the level of a sustainable profitability with ultra-low or deeply negative rates) following the reinstatement of quantitative easing measured by the ECB with an indefinite term and due to regulatory pressure. Telecom’s underperformance can be attributed to ongoing competitive market dynamics and EU’s stance still far from being supportive in terms of sector consolidation. With regard to the oil sector, the underperformance of the Oil-Majors can be attributed to the weaker commodities environment (starting with falling gas prices), while oil-services have been impacted by muted capex plans from Oil-majors especially across North America (mostly falling rig-counts).

Europe – Year-to-Date Performance of Main Sector Indexes Relative to STOO 600 (prices as at 3 Jan-20)

	STOXX 600	BANKS	INSURANCE	UTILITIES	AUTO	MEDIA	TELECOM	OIL
Since Start of 2019 (Absolute)	+24%	+10%	+25%	+26%	+15%	+17%	+1%	+4%
Since Start of 2019 (Relative)	n.m.	**-15%**	1%	1%	-9%	-7%	**-23%**	**-20%**

Source: Mediobanca Securities, Thomson Reuters

…till recently, when banks underperformance came to a sudden halt

The table below illustrates the performance of the major sectors in the European market over the past three months, showing that – among underperforming sectors – banks re-rating produced around 5% outperformance in three months, largely concentrated in the month of October and December 2019. On the other hand, the two other laggards (Telecom and Oil) continued underperforming the wide EU market.

Europe – Last Three Months Performance of Main Indexes Relative to STOXX 600 (prices as at 3 Jan-20)

	STOXX 600	BANKS	INSURANCE	UTILITIES	AUTO	MEDIA	TELECOM	OIL
Last 3 Months Absolute	+10%	+16%	+11%	+6%	+10%	+6%	+-1%	+7%
Y-t-D Relative to STOXX 600	n.m.	**+6%**	+1%	-4%	+0%	-4%	**-11%**	**-3%**

Source: Mediobanca Securities, Thomson Reuters

Owing to their higher betas, some of the Italian banks rallied markedly, up to around +30% at UCG and BPER, outperforming the banks index and the wide European market (STOXX600) since the lows hit in mid-August or early September 2019.

Selected Italian Banks – Performance versus the Lows of the Past Three Months (Prices as at 6 Jan-20)

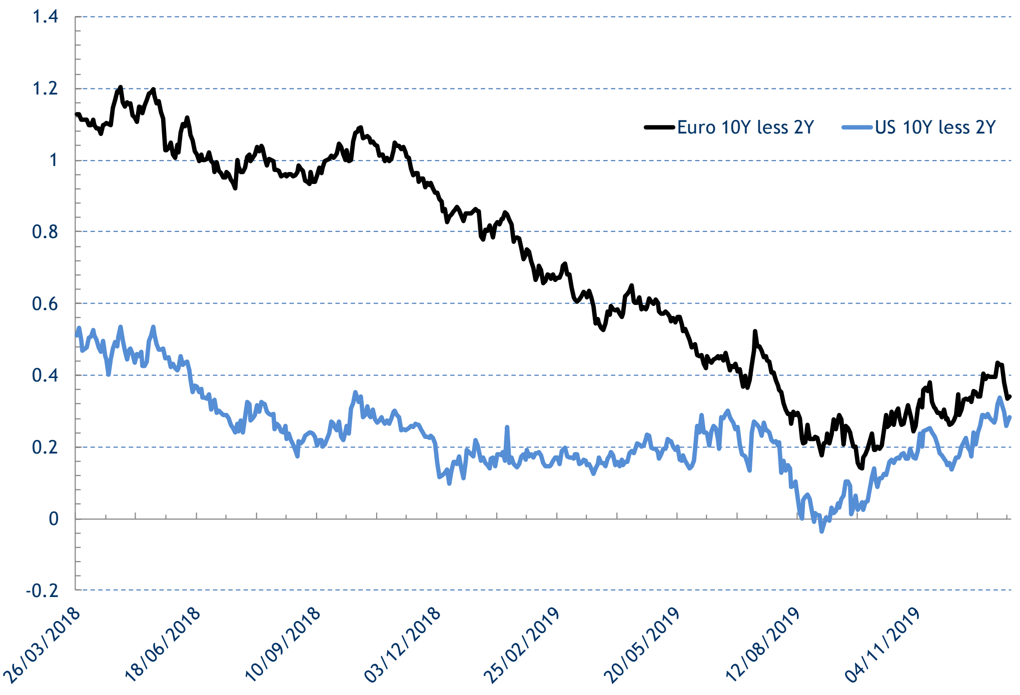
	UCG	ISP	UBI	MPS	BAMI	BPER	CREDEM	BPSO	CREVAL	SX7P	STOXX
vs Min Last 3 Months	+31%	+12%	+15%	+2%	+9%	+32%	+6%	+26%	+20%	+16%	+10%
Last 1-Month	+4%	+1%	-3%	-1%	0%	+3%	-2%	+0%	+3%	+4%	+2%

Source:Thomson Reuters, Mediobanca Securities analysis

In our view, the main reason behind such marked rally in banks (and especially in Italian banks) can be found in the inversion of the yield curve since the end of August 2019. Albeit well in the negative territory, real rates in Europe have risen since their lows post summer 2019 troughs and the yield curve steepened. This can be explained by several factors in our opinion:

- Easing on the trade dispute China-US with a phase-one deal potentially signed in the short-term according to President Trump. This agreement would lead to the cancellation of new tariffs and a reduction of existing ones;
- Second, not unanimous decision among ECB members over the last policy changes (especially the reinstatement of QE) may have suggested to the market that further loosening of monetary policy is not on the table. The first speech of the new ECB Governor (C. Lagarde) who stated that macro risks remain tilted to the downside but less pronounced and hence heading toward stabilization;
- Third, in October the UK and EU agreed on the Withdrawal Agreement and the Commons approved the second reading of the bill implementing the agreement into law, fuelling hopes of no Hard-Brexit scenario. UK elections on 12th December 2019 gave the Conservatives a large majority.

Europe and USA – Slope of the Yield Curve (Steepening since Oct-19), 2018-19



Source: Mediobanca Securities, Factset

In search for possible rotation between sectors: our approach

The aim of our analysis is to assess whether the sector rotation we have seen over the past months (namely banks outperforming the wide EU market) can continue and to spot further possible rotation among different sectors. Below we explain how we proceed:

- Our analysis is based on the assumptions that – in general terms – the price movements in Italian stocks have to mirror those of European peers, aside from peculiar or stock specific cases. In other words, we use EU sector performance and multiples to spot possible opportunity for sector rotations;
- Our analysis is mostly based on sector PE multiples on a European basis. Although being a simplistic metric, PE multiples can be used for most of the sectors under scrutiny. EV/EBITDA could not be used for financial stocks while P/Book to RoE is largely used for stocks where most of the assets are valued at fair value and heavily regulated (i.e. financial stocks) but it is not suitable for most of the "industrial" sectors;
- We mostly use 3-years forward PEs, as looking at consensus earnings in a three-years period should largely eliminate distortions related to one-offs in consensus projections. In example 1-year forward PE (2019E in current consensus projections) is certainly affected by one-offs already reported in 9M19 or possibly already disclosed for 4Q19. Although at a lower extent, 2-years forward PE (2020E in current consensus projections) could still be affected by one-offs already announced for the following year;
- We look at absolute PE multiples to assess where the various sectors trade versus the past, but we also look at the relative valuation of each sector versus the wide EU market (i.e. whether sectors' PE are positioned at premium/discount versus the past).

We look at relative valuations and PE multiples in four different periods:

- We look at current relative valuations and PE over a long period of time (namely 15 years) to assess whether current multiples and valuations largely differ from the historical averages. In this context we adjust the historical 3-years forward PE for the three major market collapses occurred over the past fifteen years, namely the financial crisis (mid-July 2007 to Jun-2009), the sovereign crisis (May-11 to July-12) and the market sell-off related to the trade-war (2H 2018). Although uneasy, current macro projections do not envisage a recession (also in Italy) and cannot be compared to the extreme consequences priced-in during the above mentioned crises. We use the crises-adjusted PE and relative premium/discount as the main tool to assess whether sectors trade above or below their "normalised" sector average;
- We look at current relative valuations and PE multiples and relative valuations in what could be defined as "benign periods", namely pre-crises and (2005-to mid-07), pre-trade war (2016-1H18) and reflation (1H16 to 2017). Comparison of current multiples and valuation with those of the above mentioned periods provide an idea of whether multiples can be judged as toppish;
- We look at PE multiples and relative valuations during the above mentioned crises as this provides an indication of whether sectors at trading at multiples met only in extreme conditions;
- We look at relative valuations and PE over a short period of time (namely 2018-19) to capture the multiples and the valuations at which the marked valued the different sectors in periods of progressively declining interest rates. This is particularly relevant for banks and insurers, as those sectors are supposed to suffer the most from a persisting low level of rates.

Banks/Automotive versus Utilities/insurance the candidates for rotation

Below we show the outcome of our analysis, which is clearly shown in the two tables below.

- **The wide EU market trades at PE multiples above the normalised historical ones and not far from that of crises-free periods** - In general terms, the whole EU wide market is trading at PE multiples higher than the past, or around 20% higher than the normalised one of the past 15 years. Moreover, our analysis shows that the wide EU market trades at multiples not far away from those what we defined as "benign periods" (pre-crisis, pre Trade-war and reflation). This means that sector rotation opportunities should be searched in sectors whose PE multiples trade slightly below the historical average or not far from the historical average;
- **Banks (and Automotive) only trade at discount versus the historical normalised average** – Our analysis shows that Banks and Automotive current PE multiples are positioned in line or below their historical average (1% and 8% below respectively).
- **Banks (and Oil) trade at large discount to crisis-free periods** – We note that banks trade at around 10% discount to crisis-free periods, while the wide EU market trades at premium to the respective PE of crisis-free periods. The Oil sector and the Telecom sector shows a similar discount to that of banks versus pre-trade war multiples (in the 10% region);
- **Utilities, Insurance and Telecom do trade at fairly large premium to their normalised historical average** – Our analysis shows that Utilities (20%) and Insurers (10%) sectors trade at premium versus their historical average. While Telecom sector is largely affected by large caps (such as VOD) trading at PE multiples and hence it may not be representative of the Italian peculiarities in the sector, it is a bit hard for us to justify the premium of Insurance and Utilities (especially for the former, which should be affected by the current low level of rates);
- **Utilities and Insurance trade at premium also to crisis-free periods** - Our analysis shows that Utilities trade at c10% premium to crisis-free levels. Intuitively this may be acceptable as the market may pay a premium for the earnings and DPS visibility offered by Utilities in periods of macro deterioration. However, we also note that Utilities' PE is positioned above that of crisis level when the premium for Utilities should have reached its peaks. With regard to insurers, it is hard to justify the premium at which the sector trades versus crisis-free periods considering the current level of rates. Unlike banks, insurance trade at the same PE multiple of the reflation-period when the market was expecting an increase in policy rates;

European Market – 3-Yrs Forward PE in Different Time Periods by Sector, 2005-2020 (Last as at 6 Jan-20)

		EUROPE	AUTO	OIL	MEDIA	TELCO	UTILS	BANKS	INSURERS
AVG 2005-19 (Normalised ex Crises)		**11.9X**	**7.7X**	**10.2X**	**13.6X**	**12.6X**	**12.4X**	**9.1X**	**9.4X**
AVG Pre-Crisis (2005 to Jul-07)	Crisis-free Periods	11.7X	8.5X	11.1X	13.2X	11.3X	13.2X	9.8X	10.0X
Pre- Trade War (2016 to 1H18)		13.2X	7.4X	12.2X	14.9X	14.3X	13.1X	9.6X	10.0X
Reflation Exp. (Jul-16 to Dec-17)		13.5X	7.4X	12.4X	14.9X	14.3X	13.1X	10.0X	10.2X
AVG Fin. Crisis (Jul-07 to Jun-09)	Crisis Periods	9.3X	7.1X	8.5X	10.0X	10.1X	12.0X	7.1X	6.8X
AVG Sov Crisis (May-11 to Jul-12)		8.6X	5.6X	7.1X	9.6X	9.1X	9.1X	6.0X	6.9X
AVG Trade War Crisis (4Q18)		11.8X	5.8X	10.1X	14.1X	12.6X	12.4X	7.9X	9.2X
Trade War Crisis Lows		11.1X	5.4X	9.1X	13.4X	11.9X	11.9X	7.3X	8.6X
AVG 2018-19		12.7X	6.6X	11.0X	14.3X	12.7X	13.1X	8.5X	9.7X
LAST		**14.1X**	**7.1X**	**11.2X**	**15.1X**	**13.3X**	**14.7X**	**9.0X**	**10.5X**

Source: Factset, Mediobanca Securities analysis

EU Market – Premium/ Discount of Current 3-Yrs Forward PE vs. Different Time Periods by Sector, 2005-2020

ABSOLUTE		EUROPE	AUTO	OIL	MEDIA	TELCO	UTILS	BANKS	INSURERS
LAST vs. AVG 2005 - 19 Normalised		19%	-8%	9%	11%	5%	19%	-1%	11%
LAST vs. Pre-Crisis	Crisis-free Periods	20%	-16%	1%	14%	18%	12%	-8%	5%
LAST vs. Pre-Trade War		6%	-3%	-9%	1%	-7%	12%	-6%	5%
LAST vs. Reflation		4%	-4%	-10%	1%	-7%	12%	-10%	3%
LAST vs. Fin. Crisis	Crises Periods	52%	0%	32%	51%	31%	23%	27%	54%
LAST vs. Sov. Crisis		63%	28%	57%	57%	46%	61%	49%	51%
LAST vs. Trade War Crisis		19%	23%	11%	7%	5%	19%	14%	14%
LAST vs. Trade War Lows		27%	33%	23%	12%	11%	24%	24%	22%
LAST vs AVG 2018-19		11%	8%	2%	6%	4%	12%	6%	8%

Source: Factset, Mediobanca Securities analysis

EU Market – Premium/ Discount of Current 3-Yrs Forward PE in Different Time Periods by Sector, 2005-2020

	EUROPE	AUTO	OIL	MEDIA	TELECOM	UTILITIES	BANKS	INSURERS
LAST vs. 2005-19 Norm.	Expensive	Cheap	Expensive	Expensive	Expensive	Expensive	Cheap	Expensive
LAST vs. Pre-Crisis	Above Peaks	Normal	Around Peaks	Above Peaks	Above Peaks	Above Peaks	Normal	Around Peaks
LAST vs. Pre-Trade War	Above Peaks	Around Peaks	Normal	Around Peaks	Normal	Above Peaks	Normal	Around Peaks
LAST vs. Reflation	Around Peaks	Around Peaks	Normal	Around Peaks	Normal	Above Peaks	Normal	Around Peaks
LAST vs. Fin. Crisis	Normal	Around Troughs	Normal	Normal	Normal	Normal	Normal	Normal
LAST vs. Sov. Crisis	Normal	Normal	Normal	Normal	Normal	Normal	Normal	Normal
LAST vs. Trade War	Normal	Normal	Normal	Normal	Around Troughs	Normal	Normal	Normal
LAST vs. Trade War Lows	Normal	Normal	Normal	Normal	Normal	Normal	Normal	Normal
LAST vs AVG 2018-19	Expensive	Expensive	Normal	Expensive	Normal	Expensive	Expensive	Expensive

Source: Factset, Mediobanca Securities analysis

The analysis of sector PE multiples indicates Banks (and possibly also the Automotive sector) as possible candidates for re-rating at the expenses of Utilities and Insurers. However, such analysis should be completed by comparing the premium/discount versus the wide European market at which each sector trades today versus the premium/discount of the past. Our analysis replicates the previous one, with the exception of comparing the premium/discount versus crises periods as markets dislocation make the outcome inconclusive. In example, we calculate that the PE discount at which Banks trade today versus the wide EU market (36%) is 14 percentage points wider than 23% average normalised discount in the period 2005-19 excluding crisis periods. In other words, banks trade at much wider discount than the historical average.

The second step of the analysis confirms the outcome: the discount at which banks and automotive sector trade versus the wide EU market is today larger than their respective historical average, which is not the case for Utilities and Insurers. In other words, we identify bank and automotive sectors as possible candidates for a sector rotation at the expenses of Utilities and Insurance.

EU Market – Premium/ Discount of Current 3-Yrs Forward PE by Sector in Different Time Periods, 2005-19

	AUTO	OIL	MEDIA	TELECOM	UTILITIES	BANKS	INSURERS
LAST vs AVG 2005-19 Norm.	Wider Discount	Wider Discount	Smaller Prem.	Wider Discount	In Line	Wider Discount	In Line
LAST vs. AVG 2018-19	In Line	Wider Discount	Smaller Prem.	In Line	In Line	In Line	In Line
LAST vs. AVG 2019	In Line	In Line	Smaller Prem.	In Line	In Line	In Line	In Line

Source: Factset, Mediobanca Securities analysis

Too early for a sustainable re-rating of the automotive sector…

We reckon that the Automotive sector's valuations look pretty attractive with next 3Y PE at 7.3x, or 6% below last 14 years normalized average and 14% below the pre-crisis level and we reckon that negative sales are progressively improving. However, we note other features may cap re-rating.

- **Trade war "phase-one" resolution recently announced may have a delayed effect on the cycle, while a positive impact of the easing trade tension may be already priced in for the Automotive sector** – 3-Yrs forward PE set at 7.7x is already aligned to the pre-trade war level of 7.4x. This may reflect the fact that the positive outcome of the tariff war between China and the USA may be already factored-in by the market and hence such event could likely trigger only a minor sector re-rating. Indeed, Auto index is already up 15% year-to-date despite a general downgrade revision of consensus estimates (-21% Car-makers, -21% Components, -28% Tyres) over the past twelve months. However, potential tariffs applied by the US to European cars sold in NAFTA can't be ruled out and represent another risk.
- **Visibility remaining pretty limited on the potential growth of China's market in 2020 (25% of global volumes)** - Despite the pretty poor 2019 reference market trend, with global car production expected down 6% and car sales -4%, we do not expect any major improvement in 2020 and visibility remains pretty poor. China (25% of global volumes) is set to report a drop of production in the range of 8% in 2019 after factoring a 4% reduction in 4Q19 and we do not expect any material improvement in 2020 in absence of public incentives.
- **Newly introduced rules and weak GDP growth cast shadows on Europe's volumes growth in 2020 (>20% of global volumes)** – In our view, new restrictions on CO2 emissions across Europe (lowering endothermic engines and pushing hybrid/BEV solutions) may limit the visibility and increase the uncertainty for the consumers who could postpone the investment decision in a new vehicle also in light of the lack of infrastructure.
- **Car-makers impacted by the new European regulation** – 2020 estimates are still assuming a 15% increase in the consensus EPS vs 2019 estimates for the carmakers (+21% for Components suppliers) which looks quite demanding in light of the introduction of the new CO2 regulation in Europe starting from the next year. Considering that European car volumes sold are around 20m units per year, assuming an average CO2 emission for the market in the range of 100g/Km, i.e. exceeding by 5g the targets set by the regulator, this would imply a penalty for the sector of around €10bn.

…but tactical rotation into Banks has legs (seen it in the 5%-10% region)

We try to quantify the banks' re-rating potential versus the wide market. Since, the uptick in rates post summer, European Banks and Insurance outperformed the market by 6% and 1% respectively while Utilities underperformed by 4%, but we think banks offer scope for further outperformance vs the market, as - in absence of a recrudescence in trade tensions and faltering hopes of no Hard-Brexit scenario - - we believe that rates will not be cut further in the Euro Area.

- **Looking at past long-term historical average would indicate large room for banks' re-rating (probably overstated)** - The next charts illustrate the evolution of 3yr forward consensus PE premiums / (discounts) of Banks, Insurance and Utilities indices vs the wider market. Over a 10y period, Banks trade below their 1 standard deviation PE discount to the market and Insurance broadly at one standard deviation below. Utilities on the other hand trade a bit above its historical average premium to the market. In other words, such analysis confirms that banks trade far away from their long-term historical average and hence could have an enormous re-rating potential.

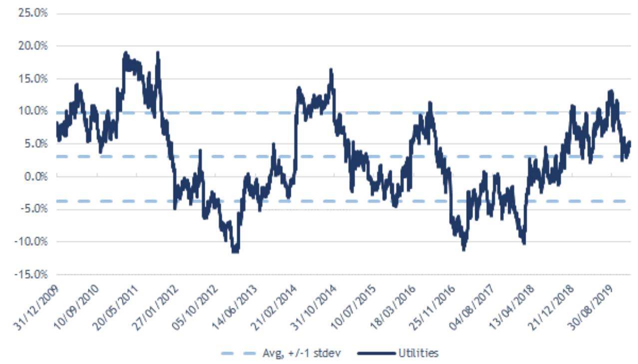
EU Banks - 3-Years Forward Consensus PE Discount to Market, 2009-19

Source: Mediobanca Securities, Factset consensus

EU Insurance - 3-Years Forward Consensus PE Discount to Market, 2009-19

Source: Mediobanca Securities, Factset consensus

EU Utilities - 3-Years Forward Consensus PE Discount to Market, 2009-19



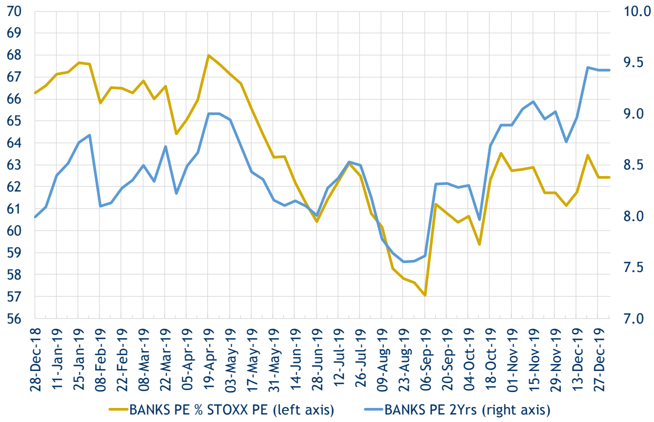
Source: Mediobanca Securities, Factset consensus

- **Narrowing the analysis to 2019 downsizes the relative re-rating potential to 5%/10%** – Investors may argue that looking at the discount to the PE averages of the past fifteen years for those sectors may not make much sense, as ultra-low or deeply negative rates (not just real rates, but actual negative rates) mark unprecedented conditions. Admittedly, ultra-low rates are very challenging conditions for banks (biting into revenue generation, only mitigated by a lower cost of funding).

  Such conditions are not ideal for insurers too, but P&C operations are much less sensitive to rates and insurers have room for manoeuvre the P&C pricing. On the other hand, ultra-low rates may be beneficial for utilities as those reduce the cost of debt to be replaced.

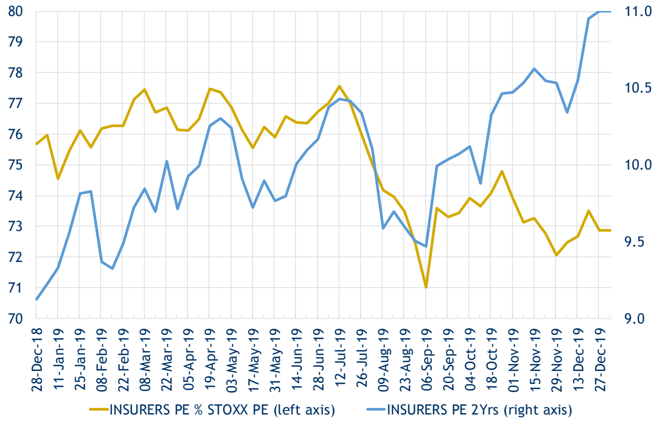
As the belief of the majority of market participants is that the current ultra-low rates may persist for a long time, we believe that the potential re-rating emerging from analysing the discount at which banks trade versus their long-term historical average needs a confirmation under today's conditions. Hence, we shorten the period of our analysis to 2019 only and we also look at 2-years forward PEs to avoid incorporating estimates with admittedly lower visibility. We see the PE of Utilities and Insurers largely above the levels seen in 2019. On the other hand, banks trade at just highest PE seen in 2019 (but not above) following the mild steepening of the yield curves in Oct-19.

EU BANKS - PE Relative to STOXX 600 PE and 2-Yrs Forward PE, 2019



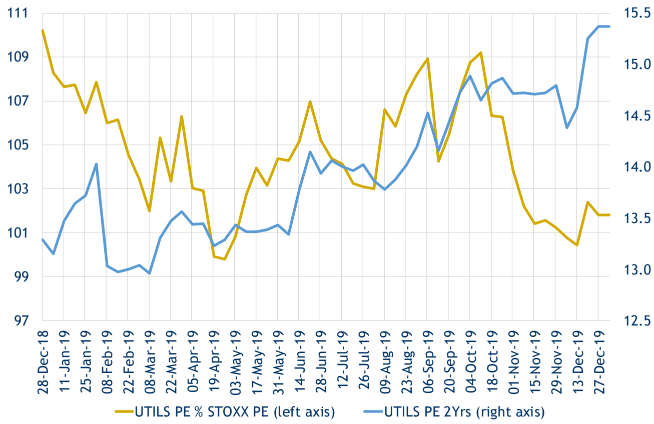
Source: Thomson Reuters, Mediobanca Securities analysis

EU Insurers - PE Relative to STOXX 600 PE and 2-Yrs Forward PE, 2019



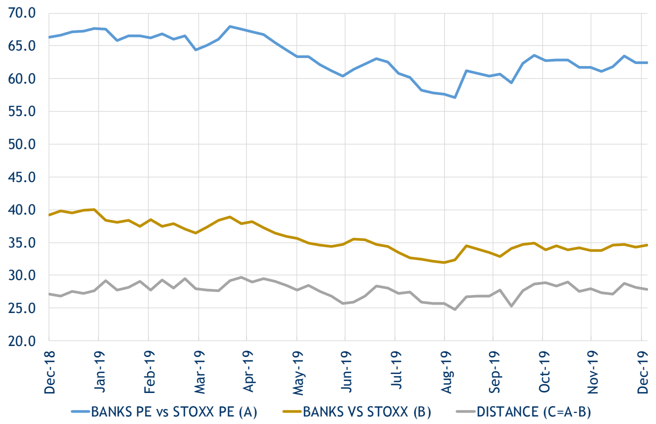
Source: Thomson Reuters, Mediobanca Securities analysis

EU Utilities - PE Relative to STOXX 600 PE and 2-Yrs Forward PE, 2019



Source: Thomson Reuters, Mediobanca Securities analysis

EU BANKS - Current versus Maximum Re-rating of EU Banks versus STOXX 600, 2019



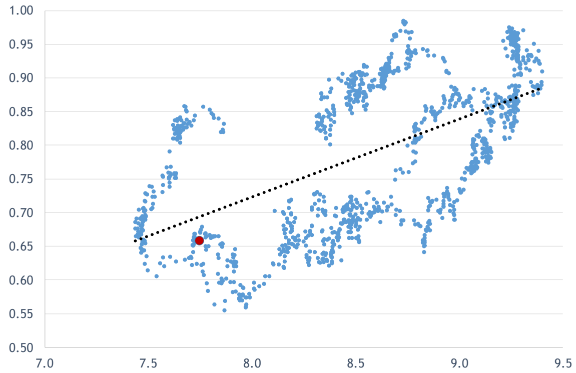
Source: Thomson Reuters, Mediobanca Securities analysis

The grey line in the chart above indirectly measures the re-rating, by calculating the distance between the ratio of the indexes and the ratio between PEs. In other words, if the ratio between PEs (banks versus STOXX600) grows more than the ratio between indexes (i.e. market capitalisation), it means the underlying earnings are not moving and hence re-rating. The grey line shows that the further re-rating potential of banks versus is capped to around 5%, i.e. the distance today at just below 28 versus a peak of 30 in 2019 (i.e. 5% re-rating potential). Finally, we note that EU Banks' PE today account for 62% of the market PE versus a peak of 68%, meaning a maximum 10% re-rating potential in current challenging conditions.

MEDIOBANCA SECURITIES

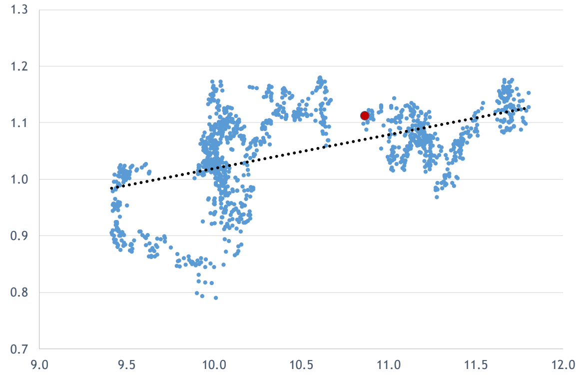
- **ROE/Price to Book analysis confirms re-rating potential in the 5%-10% region -** Looking at the relationship between ROE and Price to Book over the past five years (a period of progressive rates decline and toughening regulation with the introduction of stringent rules on capital (Basel IV), liquidity (NSFR, LCR) and bail-in (MREL)), banks look trading a bit below the regression line, Insurance a tad above and Utilities well above. If we assumed banks' valuation to position again along the regression line, we calculate c5% re-rating potential for banks (keeping RoE unaltered, P/Book multiple should move to 0.69X from current 0.66X) versus around 5% de-rating potential for insurers (keeping RoE unaltered, P/Book multiple should move to 1.05X from current 1.12X) and around 7% de-rating potential for Utilities (keeping RoE unaltered, P/Book multiple should move to 1.4X from current 1.5X). Summing up banks re-rating potential with the average derating potential for Insurers and Utilities, we would end-up in some 10% average relative outperformance of banks vs. Insurers (7%) and Utilities (12%).

EU Banks – Current 3-Yrs Forward P/Book vs RoE (red dot versus Historical 5 Yrs Average



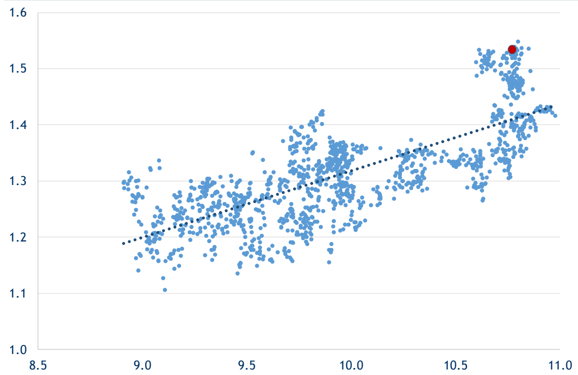
Source: Mediobanca Securities, Factset consensus.

EU Insurance – Current 3-Yrs Forward P/Book vs RoE (red dot) versus Historical 5 Yrs Average



Source: Mediobanca Securities, Factset consensus.

EU Utilities – Current 3-Yrs Forward P/Book vs RoE (red dot) versus Historical 5 Yrs Average



Source: Mediobanca Securities, Factset consensus.

…or 8%-12% re-rating potential for Italian banks owing higher Betas

We calculated that in absence of a material change in the macroeconomic scenario, EU banks (SX7P) may re-rate by around 5%-10% versus the wide market (STOXX 600, SXXP). However, we should also consider that – in such event - Italian banks should react more than the wide EU banks sector owing to a higher Beta and much more depressed valuations (all hovering over 0.5X TE or below with the exclusion of ISP and CREDEM).

Selected Italian Banks – RWA Beta versus SX7P, Last Two Years

	UCG	ISP	UBI	MPS	BAMI	BPER	CREDEM	BPSO	CREVAL
Raw Beta - Daily	1.4X	1.1X	1.3X	1.1X	1.4X	1.1X	0.85	0.9X	1.1X

Source: Bloomberg

We also note that dividend yields look supportive of a possible rotation as banks yields are not lower that the average of Utilities and Insurers. As we are suggesting a tactical rotation between banks and Utilities/Insurers in a period of time very close to the dividend season, the message of reducing the weight on Utilities and Insurers in favour of banks would be very hard to be conveyed if banks' yields were dramatically lower than those of Utilities and Insurers (investor would not likely reduce exposures to Utilities and Insurers if they had to exchange fairly high yields with low yields few months ahead of the DPS payments). Luckily enough, this does not seem to be the case, as a sample of banks composed of UCG/UBI/CREDEM would offer a weighted average yield of 5%, with all Italian banks sample (excluding MPS) at 4.5%, not far from the average of insurers (around 5.5%) and for Utilities (just above 4%).

MEDIOBANCA SECURITIES

PIR REGULATION TO REVIVE ALLOCATION ON SMEs

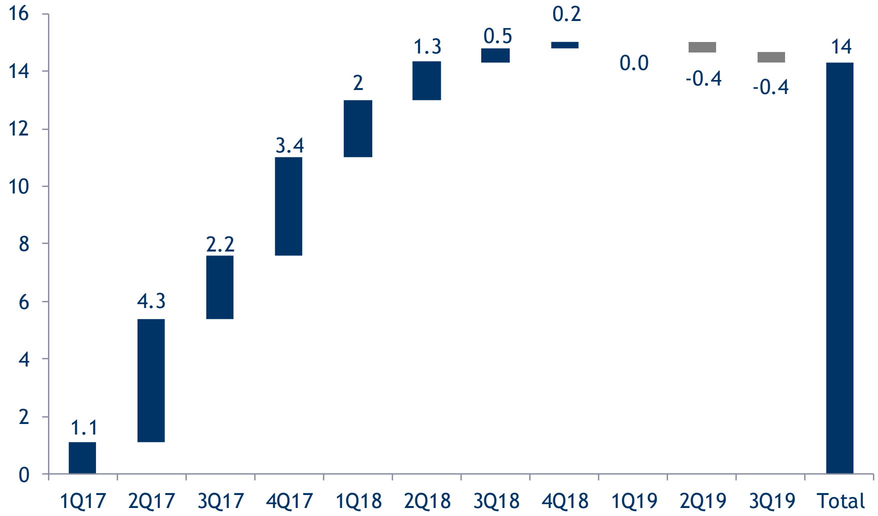
Italian mid-caps are now trading at c.15.5x 1FWD P/E, as multiples re-rated after the change in PIR regulation. Such a level is still below the peak reached at the end of 2017 in the region of 18x (helped by the first PIR introduction) and c.30% above the bottom levels observed in 2009 and 2012. In our view, the introduction of PIR rules (similar to the initial ones) may generate an immediate boost to traded values and trigger a rapid price expansion bringing the Italian Mid & Small cap cluster back to the historical average premium vs. Italian Large caps (currently at -5%).

During the first PIR wave in 2017, equity allocation by investors followed mainly a bottom-up approach, mixing short-term analysis of companies' fundamentals with a longer-term one focusing on companies showing sustainable DPS, above-average return on investment and free cash flow generation. M&A opportunities are another long-term aspect that drove PIR selection. Based on the new PIR regulation, we have no reason to change above mentioned allocation criteria.

Our core PIR selections includes the following names: Autogrill, BFF, Interpump, Iren, ENAV and SeSa. We also highlight that a wider PIR portfolio allocation, to be held for the longer investment horizon of the scheme, partially falling outside our one-year recommendation horizon (nine stocks are in fact rated Neutral) would include names like: Anima, Autogrill, Brembo, BFF Banking Group, Brunello Cucinelli, Carel, Credem, De' Longhi, ENAV, Garofalo Health Care, IMA, Interpump, Iren, Marr, Rai Way, REPLY, SeSa, Technogym, Tinexta and Unipol SAI.

PIR products are set to be revived by the new regulation, following YTD 2019 outflows worth €800m. PIR funds were affected by the set of rules included in the 2019 budget law, which introduced a rule to invest at least 5% (of 70% of PIR investment) in securities listed in MTF (multilateral trading facilities) and at least another 5% in venture capital funds. These rules halted the positive collection trend observed in 2017-18, due to the limited liquidity of these two asset classes, in particular the venture capital funds. In detail PIR funds recorded c.€800m outflows in 9M19 and no additional products were launched by management companies during the year, and the number of existing products remains unchanged at 72. By product, equity funds and balanced still account for the majority (40% and 37% of the total, respectively), followed by flexible funds (17% of total) and fixed income funds (6%).

Italy - PIR products cumulated inflows (€bn)



Source: Mediobanca Securities, Assogestioni

Through a bipartisan agreement, the Lower and Upper Houses approved the amendments on PIR products, which remove the rules introduced last year, i.e. 3.5% investment threshold on venture capital funds and securities listed on MTFs. Besides, new PIR scheme includes the following:

1. At least 70% of inflows invested in equities (or bonds) issued by listed or non-listed Italian companies (or EU companies with an established presence in the country). This portion of the portfolio is considered as qualified investments;
2. 30% of the above 70% (ie, 21%) invested in equities (or bonds) issued by companies not included in the FTSE MIB index;
3. 5% of the above 70% invested in equities issued by companies not included in the FTSE MIB and FTSE Mid Cap index, therefore Small caps and securities listed on MTFs.

Furthermore, the amendment introduced the possibility for pension funds and “Casse di Previdenza” to invest in multiple PIR products, with the ceiling of maximum 10% allotment of their AuM.

The new set of rules are effective from 1 January 2020 and new product launches may take place following the issue of enabling decrees by the Government in 1Q 2020E.

Awaiting the launch of new PIR products, it is worth noting that existing “old” PIR funds registered an overall positive performance this year. Focusing on the top-10 PIR products (in terms of AuM), we observed that returns since the inception are now by far into positive territory.

Italy - Top 10 PIR funds (for AuM) – Net performance

Type	YTD performance	Performance since the inception
Flexible A	7.4%	0.0%
Flexible B	18.0%	11.9%
Balanced A	10.3%	10.2%
Balanced B	12.7%	15.5%
Balanced C	9.1%	7.9%
Equity A	24.7%	18.1%
Equity B	22.0%	16.5%
Equity C	24.0%	9.8%
Balanced D	19.2%	14.6%
Balanced E	15.0%	9.0%

Source: Mediobanca Securities, Bloomberg, Prices as of 05 December 2019

MB CUTS 2020/21 EPS MAINLY IN OIL-RELATED, AUTO & BRANDED GOODS

Since January we have cut our 2019/20 EPS for Italian Large caps by 6% on average. If we focus our analysis, excluding utilities and financials, we registered a 13% reduction vs. our January EPS expectations due to the negative contribution of the Automotive (estimates down by 15% on average), Oil and Telecom, partly offset by an upwards revision in other Industrial companies (Buzzi Unicem, Piaggio, Interpump and Autogrill).

Mediobanca 2020-21 EPS forecasts for this ex-financial cluster were 5% below consensus with more conservative assumptions factored in for Buzzi Unicem, Leonardo, ENI, and Hera. In the Financial space, our 2020-21 estimates remain c.3% below consensus both in the mid-cap and in the large cap space.

In this document, and based on more conservative macro assumptions, we are cutting our 2020/21 EPS by a further 7% on 25 cyclical stocks. Downwards earnings revisions are mainly concentrated in Oil, Branded Goods and Automotive sectors.

Here below a brief summary of main reasons of estimates' change by cluster:

- **OIL:** We reduced our FY20/21 EPS estimates for **Saras** by 30-40%, as we made more conservative assumptions on refining margins reflecting a weakness in diesel and gasoline crack spreads. We also reduced our FY19/20 EPS estimates for **Tenaris** by 3-11% due to the ongoing reduction in drilling activities across North America, where operators now tend to focus more on cash flow generation, rather than volumes growth; and due to the weaker pricing environment. We also reduced our FY20/21 EPS for **Maire Tecnimont** by 3-6%, as we expect a change in revenues mix driven by higher construction work to have a marginally negative impact on the company's bottom line;
- **Branded Goods:** our cautious stance stems from business disruption in Hong Kong due to persistent social unrest, only partially offset by stronger domestic demand in Mainland China. We have made a EPS cut for Aeffe, on weak earnings momentum and for **Tod's** where we assume top-line recovery to lag behind in a tougher macro environment, with actions taken likely to bear results on a longer time horizon. We have also made minor EPS adjustment for **Technogym** in the low single-digit, as we assume long term guidance of mid-to-high single digit top line growth intact. Conversely for **Brunello Cucinelli** we have raised 2019-21 earnings estimates, on strong earnings momentum confirmed by 10% top line growth in FY19;
- **Automotive & Industrials:** With regards to **CNH**, our estimates' revision now reflects a more cautious stance on both the Agriculture division and the other most cyclical business of the Group, i.e. Trucks and Construction. About Agriculture segment, the adoption of a more cautious stance also reflects the quite prudent scenario recently provided by Deere factoring in US market volumes expected down 5% in 2020. On **Pirelli**, we have adopted a more cautious view on margins reflecting worsening assumptions on the D&A and other costs inflation. In the industrial space, we raised our estimates for **Buzzi Unicem** by 3% on average, assuming a stronger contribution at top line level in the US and Italy and factoring the disposal of 25% stake of Kosmos Cement Company. On **Fincantieri**, we reduced our FY20/21 EPS estimates by 5-20% in light of the ongoing production issues experienced at Vard, which we believe will continue to affect the company's profitability in 2020, and to some extent in 2021. We also assume a more moderate top-line growth and margin evolution in 2021;
- **TMT**: we cut by 3% our OpFCF (EBITDA-CAPEX) for **TIM**'s domestic business in 2019-21, assuming rationalization of FSR will continue and MSR improving (-2% in 2020 from -8% in 19). The impact of a more conservative outlook is more visible on Italian media, as it translates on an average EPS cut of c.6% across the space. While we continue to believe TV will outperform, we now assume a decline for Italian advertising market in 2020 (exl. OTTs contribution).

- **Banks**: we update 2019-21E estimates by introducing wage inflation agreed by the unions and the Italian banking association in December, the changes introduced by the 2020 budget law and stock-specific adjustments. In particular, we embed the deal with Nexi at ISP, a lower one-off LLP and NII impact related to the sale of €850m NPLs at UBI, the deal with Prelios signed with BMPS, UBI and BAMI and the purchase of Banco di Sardegna's saving shares at BPE. All in all, we fine-tuned reported EPS by low single digit in 2021. We have not changed target prices given the minor underlying changes and the one-off nature of the meaningful changes.

The table below summarizes the changes in our forecasts for the period 2019-2021:

Italy - Change in Estimates: New Estimates for 2019-21 & new TPs

	New Reported Net Profit			EPS Change			Target Price		Rating
(€m)	2019E	2020E	2021E	2019E	2020E	2021E	New	Old	
Banca Ifis	123	133	116	-9.7%	15.2%	0.0%	14.5	14.5	Neutral
Buzzi Unicem**	320	336.4	323.9	0.6%	3.8%	4.6%	23.3	23.1	Outperform
Brembo	**230**	**249**	**271**	**0.0%**	**-2.0%**	**0.0%**	**12.0**	**12.0**	**Neutral from O**
CNHI	1,066	1,155	1,439	-0.4%	-7.0%	-3.9%	12.6	12.8	Outperform
Pirelli	485	434	552	0.0%	-3.3%	-2.6%	5.6	5.7	Neutral
Ferrari	712	816	928	-0.9%	-5.8%	-5.6%	147	147	Neutral
UnipolSAI	592.3	655.8	709.2	-8.2%	-5.1%	-3.9%	2.5	2.5	Neutral
Unipol	827.9	515.6	558.9	-4.9%	-5.9%	-6.6%	5.5	5.5	Neutral
Anima	178.0	177.2	177.0	3.8%	1.5%	3.0%	5.3	4.6	Outperform
Cattolica Assicurazioni	108.2	122.0	130.6	-8.0%	-11.5%	-11.3%	7.0	7.7	Neutral
FinecoBank	267.1	301.6	323.8	0.0%	4.9%	3.6%	11.0	10.0	Neutral
Telecom Italia*	3,137	3,100	3,111	-0.5%	-3.0%	-4.4%	0.79	0.76	Outperform
ePRICE	-29.2	-12.0	-4.8	nm	nm	nm	0.53	2.36	Neutral
Rai Way* **	**62.5**	**61.5**	**63.1**	**-0.1%**	**-2.6%**	**-2.3%**	**7.02**	**7.02**	**Neutral from O**
Mondadori******	**32.6**	**39.0**	**39.2**	**-3.5%**	**2%**	**3%**	**2.35**	**2.35**	**Neutral from O**
GEDI	**-17.1**	**10.1**	**12.5**	**0%**	**-11%**	**-8%**	**0.46**	**0.55**	**Neutral from O**
RCS	65.3	67.7	66.3	-14.7%	-9.7%	-9.2%	1.02	1.07	Neutral
Cairo Communications	57.6	58.4	60.5	-16.1%	-13.5%	-9.0%	3.85	4.11	Outperform
Tod's	8.7	13.6	24.0	0.0%	-25.0%	-5.0%	32.5	34.0	Neutral
Technogym	88.0	93.0	103.0	-2.0%	-3.0%	-5.0%	10.0	10.0	Neutral
Diasorin	174.7	178.5	196.2	0.0%	-1.2%	-0.4%	102	102	Neutral
Saras	**50.7**	**177.4**	**101.8**	**-35.1%**	**-33.7%**	**-45.8%**	**1.65**	**2.05**	**Neutral from O**
Fincantieri	**78.0**	**109.0**	**164.1**	**-1.3%**	**-20.6%**	**-5.1%**	**1.00**	**1.30**	**Neutral from O**
Maire Tecnimont	109.4	107.4	115.3	3.1%	-6.3%	-2.6%	3.60	3.80	Outperform
Tenaris	759.1	780.0	995.6	-2.8%	-11.2%	3.6%	10.3	10.5	Neutral
Piaggio	47.0	56.0	73.7	-1.5%	-4.8%	-4.1%	3.0	3.0	Outperform
Brunello Cucinelli	55.1	57.4	64.3	4.0%	3.0%	3.0%	34.0	31.7	Neutral
Aeffe	**13.0**	**14.1**	**17.3**	**-2.0%**	**-18.0%**	**-22.0%**	**2.20**	**2.50**	**Neutral from O**
Tesmec	2.3	5.8	8.6	nm	-20.3%	-11.6%	0.56	0.60	Neutral
EPS change - Weighted Average				**-1.9%**	**-4.9%**	**-3.3%**			
EPS change - Simple Average				**-4.0%**	**-7.4%**	**-5.8%**			

*Source: Mediobanca Securities, * Domestic OpFCF (EBITDA-Capex), **excluding US capital gain , ***estimates' revision made on 12 December, **** estimates' revision made on 19 November*

Italy Banks - Change in Estimates: New Estimates for 2019-21 & new TPs

(€m)	New Reported Net Profit 2019E	2020E	2021E	EPS Change 2019E	2020E	2021E	Target Price New	Old	Rating
Unicredit*	3,950	2,788	3,945	0.0%	0.0%	0.0%	15.9	15.9	Outperform
Intesa Sanpaolo**	4,062	4,345	3,644	0.0%	21.9%	-1.3%	2.1	2.1	Underperform
Monte dei Paschi di Siena***	216	122	224	0.0%	0.0%	-2.1%	1.8	1.8	Neutral
Banco BPM	788	414	483	2.7%	-2.4%	-0.2%	2.0	2.0	Neutral
UBI Banca****	253	438	506	27.8%	-2.4%	-1.2%	3.3	3.3	Outperform
BPER Banca	397	291	341	0.5%	-2.3%	-0.1%	4.5	4.5	Neutral
Banca Popolare di Sondrio	160	102	100	-0.6%	-1.0%	-1.0%	2.0	2.0	Neutral
Credito Emiliano	188	178	178	0.0%	0.0%	0.0%	6.7	6.7	Outperform
Credito Valtellinese	66	36	49	3.1%	0.0%	-3.9%	0.07	0.07	Neutral
EPS change - mid&small cap				**4.1%**	**-1.6%**	**-0.9%**			
EPS change - with large caps				**0.8%**	**9.3%**	**-0.7%**			

** UCG EPS Change refer to Net Profit*

**ISP EPS change in 2020E driven by capital gains*

****MPS EPS change refer to Adjusted EPS*

***** UBI EPS change in 2019 driven by lower cost de-risking*

Source: Mediobanca Securities

OUTLOOK BY SECTOR

BANKS – RERATING STILL HAS LEGS

We acknowledge that banks' earnings are not on an upward trajectory owing to negative rates and sluggish and unsupportive macro. We also reckon that regulation (Targeted Review of Internal Models (TRIM), EBA guidelines, EBA default definition, Basel IV at some point) will keep eroding banks' capital, preventing the accumulation of surplus capital. However, the recent progress in trade talks and the clear outcome of the elections in the UK would point to easing global tensions, which – together with the recent comments from the FED and the ECB - would indicate that policy rates will not be cut further in the Euro Area. Moreover, the long part of the yield curve - which looks to have already stabilised on a higher level after the collapse suffered in August and early September - may benefit from easing global tensions. In other words, we argue that credit business margin compression may not intensify further and regulatory pressure can be dealt with by organic capital generation, while we are seeing positive signs on this front with article 104a of recently introduced regulation CRD V as the latest one of a longer string.

Meanwhile, valuations are undemanding, with Italian banks' 3-year looking forward PE (2021E) positioned at around 7.2x (only ISP is positioned just below 10x), which stands well below the normalised PE since 2005 (excluding crises periods from the normalisation), peaking at almost 20% at UCG, at c15% at CREDEM and at c10% at UBI, mirroring that of the EU banks sector, with only ISP trading PE multiple higher than the normalised levels. Similarly to the EU banks sector, 3-year forward PEs are positioned below those of crisis-free periods.

Sustainable projected profitability, no share count risk and undemanding valuations are at the heart of our tactical rotation into Banks from Utilities/Insurers. Banks offer investors the possibility of entering a sector trading at deep discount versus the historical normalised average without compromising on dividend yields (the average yield of UCG, UBI and CREDEM hovers over 5%, with UCG just below 7%), as 4.5% average yield positioned right in the middle of that of Utilities (just above 4%) and Insurers (c5.5%).

No support from EPS (but the market already knows it) …

Cautious on EPS trends and wary of temporary net profit- boosting measures

The banking sector faces weak volume growth, negative rates, pressure on fee margin and regulatory pressure on capital from further risk reduction, not allowing for sizeable benefit on cost of risk/NPE from lower rates. The measures introduced by the ECB (tiering and higher Targeted Long Term Refinancing Operations incentive) only marginally compensate the headwinds. Some banks, such as ISP, find support in adding government bonds on balance sheet, while others (e.g. UCG, CVAL and BPSO) are streamlining the revenue line by not replacing expiring bonds. Hence, we remain cautious on mid-sized banks EPS trend, where economies of scale are tougher to achieve, while preferring banks with not heavily relying on carry trade and directional calls to temporary boost net profit.

NII under pressure from negative rates, weak loan growth and MREL compliance

The current ultra-low rates environment (3-month Euribor -0.38%, 5-year mid swap rate at -0.20%, 10-years German Bund at -0.3%) sets a challenging scenario for Italian banks, with Net Interest Income hampered by the material tightening of loan yields and weak loan growth, partially mitigated by the benefits from tiering and lower cost of funding.

In detail, Banca d'Italia data suggest that the sharp decline in the yield curve observed since June (3M Euribor -5bp vs. October) has only partially been reflected in a 4bp lower commercial spread on the back book in October, where loan yields are declining and deposit rates remain stable around c37bps. At the same time, we see rates on new business remarkably accelerating their compression in Q3, 50/70bp below the back book. Also, lending volumes growth stands just above zero (+0.3% adjusted private sector lending YoY, -1.4% adjusted corporate lending), therefore the outlook on NII remains weak under threat in the short and medium term.

In our sector note Saving the baby from the bathwater we simulate that interest rates persisting at current levels would drive to an average 9% negative impact on 2021 EPS, before accounting for MREL issuances but including the benefits from tiering and balance-sheet growth.

Selected Italian Banks – EPS impact, breakdown by driver Estimated in MB Report Saving the baby from the bathwater, 8 October 2019

	Benefit from lower cost of funding	Pressure from lower asset yields	Impact of balance sheet growth	Tiering	Net EPS impact
BAMI	19.3%	-29.6%	1.5%	0.5%	-8.8%
BPER	6.3%	-17.8%	1.1%	0.4%	-10.3%
BPSO	6.1%	-27.2%	1.6%	3.8%	-19.5%
CREVAL	14.6%	-29.3%	1.6%	0.8%	-13.2%
UBI	11.8%	-15.9%	1.1%	1.6%	-3.0%
UCG	6.8%	-12.4%	0.4%	1.2%	-4.1%
ISP	5.3%	-16.1%	0.9%	0.8%	-9.1%
MPS	8.1%	-19.9%	0.6%	0.5%	-10.7%
CREDEM	12.9%	-18.0%	1.3%	0.2%	-3.6%
Total	**10.1%**	**-20.7%**	**1.1%**	**1.1%**	**-9.1%**

Source: Mediobanca Securities

The aggregate 9% impact on profitability from persisting low rates compares with -5% at European banks. We see five main reasons behind:

- The small profitability of Italian banks makes modest swings in the revenue base be reflected in large shocks at bottom-line level, especially for BAMI, BPER, CVAL, MPS, POPSO and UBI;
- The benefit from collapsing sovereign yields and mid-swap rates is capped by the small amount of ML-term funding maturing in 2019-21. With the exclusion of UBI, ML-term funding (ex TLTRO) accounts for only c15% of deposits and for 15% of the assets sensitive to rates;
- Italy is characterised by an intense competition in corporate (we calculate -30bps repricing over the past four years) and the corporate book is generally 2x larger than the mortgage book (where we note +100bps repricing versus the past). This leads expiring corporate loans to be originated not only at lower benchmark rates but also with lower spreads.
- Italian banks' sovereign exposure maturing in 2019-21 is generally >1.5x larger than the amount of ML-term funding (ex TLTRO), excluding BPER, CE and UBI. The impact from collapsing sovereign yields is larger for the assets side than for the liabilities side.
- Italy suffers from a chronical lack of growth, meaning that the impact on NII from volumes expansion is very limited. CREDEM and UBI could suffer less than peers, the former due to almost not existent sovereign exposure expiring over the next three years and a relatively good profitability (for Italian standards), the latter due to a relatively higher reliance on ML-term funding.

In our sector note QE easing the MREL malaise we also simulate the NII impact deriving from the implementation of MREL by 2021. Regulatory gaps and the lack of officially stated requirements makes ambitious the exact computation of the requirement's impact. Hence, we performed a worst case scenario, assuming all banks in the subsample will need to comply with the O-SE standards by 2021, also assuming the full coverage of AT1 and T2 buckets. The analysis results in an amount of around €18bn which still needs to be issued for MREL and 2019 SREP purposes, mirrored in an average EPS impact of -15%. When allowing for SREP flexibility, i.e. removing the assumption of full AT1 and T2 buckets coverage in the short-term for banks with lower profitability vs. the theoretical At1 coupon, the EPS impact from MREL gets halved to c.10%. We highlight that most likely CVAL will not have to comply with MREL given its LSE status. In addition, we see UBI as the least impacted as with the 2019 issuances it is already compliant with MREL/subordinated requirement.

Selected Italian Banks – Estimated EPS impact from Complying with MREL Estimated in MB Report QE easing the MREL malaise, 8 October 2019

	Estimated MREL Issuances	EPS impact (worst case)	EPS impact Adjusted
BAMI	2.7	-18.8%	-13%
BPE*	0.8	-7.5%	-4%
BPSO	0.5	-28.7%	-7%
CREVAL	0.5	-25.1%	-17%
UBI	0.9	-10.5%	-1%
UCG	9.1	-4.3%	n.a.
ISP	0.3	-0.5%	n.a.
MPS	2.8	-35.7%	-26%
CREDEM	0.5	-7.3%	-4%
Total	**18.0**	**-15.4%**	**-10.3%**

*Source: Mediobanca Securities, *not including Unipol*

Fees to still bring some relief to NII pressure but much depend on markets

AuM in Italy grew by double digit in 2019, thanks to a dreadful Q418, a change in sentiment in August and persistent negative rates. We see AuM growing in 2020-21 but a reduced pace as rates remain low and markets stable, partially compensating NII pressure. Yet, we also acknowledge AUM margin, especially up-front fees, could suffer from the negative-rate environment and the introduction of zero-fee passive funds in the coming years.

In detail for Q4, Assogestioni preliminary data on asset under management (month of December is not captured) unveil positive dynamics in the value of the aggregate in the last quarter of the year. Hence, the 1.4% QoQ increase in AuM has some upside potential following the inclusion of December inflows, still due to be released. Entry fees are expected to reflect the positive trend observed in net collection over the month of October and November. Analysing inflows into asset management (refer to the chapter "ASSET GATHERERS – HOLDING UP WELL"), we note most networks achieved positive monthly inflows, a good pace confirming the solid performance of last year. We see ISP, CE and UBI well positioned to benefit from solid AM inflows, as AM fees represent >35% of the companies' fee income.

Selected Italian Banks – Average Assets Under Management

	Q318	Q418	Q119	Q219	Q319	Q419*	Δ QoQ	Δ YoY
Intesa	397	386	392	396	410	417	1.7%	8.1%
ANIMA	103	149	177	179	187	188	0.5%	26.2%
Pramerica	60	58	60	61	64	65	2.0%	11.8%
Amundi	199	190	188	190	191	193	1.1%	2.0%
Arca	32	31	31	32	32	33	1.7%	5.6%
CREDEM	13	18	18	19	20	20	2.9%	13.2%
BPER	4	3	3	4	4	4	4.9%	11.5%
Aggregate	**807**	**835**	**869**	**880**	**908**	**920**	**1.4%**	**10.2%**

**October and November 2019*

Source: Assogestioni, Mappa mensile del risparmio gestito

Selected Italian Banks – Net Fee Income Breakdown by Service, 2018

	Factoring	Asset Mgmt	Insurance	Current Acc.	Lending	Guarantee	Coll. Paym.	Other
ISP	1%	35%	17%	17%	10%	4%	6%	11%
UBI	1%	41%	11%	14%	14%	2%	8%	9%
BAMI	0%	37%	6%	12%	22%	4%	9%	9%
BPE	1%	28%	8%	20%	16%	3%	16%	8%
CVAL	1%	20%	10%	21%	15%	1%	20%	11%
BPSO	7%	15%	6%	11%	16%	8%	21%	16%
Aggregate	1%	35%	14%	16%	13%	3%	8%	10%

Source: Mediobanca Securities, company data

When focusing on banking fees, we note new lending production has been extremely positive in October across all credit categories. More in details, we see residential mortgages new business at the record highs of €9bn, finally reflecting interest rates collapsed at historical lows; whereas consumer credit and corporate loans were up 30% and 8% in October versus last quarter average, also including some expected seasonality. Although we welcome signs of recovery in Italy's lending activity, we remain cautious waiting for next months' data to confirm any potential inversion of the trend. Should this trend be confirmed, we might see some support from lending fees as well as AUM fees.

Selected Italian Banks – New Lending Production in the First 9-Month of 2019

	New Business - Corporate loans			New Business - Residential Mortgages			New Business - Consumer Credit		
	Volume	QoQ	YoY	Volume	QoQ	YoY	Volume	QoQ	YoY
Q417	33,529	16.9%	(7.3%)	5,688	15.3%	(20.2%)	2,933	5.0%	39.7%
Q118	31,505	(6.0%)	0.1%	5,471	(3.8%)	(16.6%)	3,295	12.3%	33.7%
Q218	32,296	2.5%	3.3%	6,033	10.3%	(4.4%)	3,644	10.6%	29.1%
Q318	30,890	(4.4%)	7.7%	5,155	(14.6%)	4.4%	3,005	(17.5%)	7.6%
Q418	34,273	11.0%	2.2%	5,961	15.6%	4.8%	3,374	12.3%	15.0%
Q119	32,231	(6.0%)	2.3%	5,251	(11.9%)	(4.0%)	3,749	11.1%	13.8%
Q219	33,471	3.8%	3.6%	5,091	(3.0%)	(15.6%)	3,760	0.3%	3.2%
Q319	32,091	(4.1%)	3.9%	4,918	(3.4%)	(4.6%)	3,317	(11.8%)	10.4%
October	36,917	15.0%	7.7%	9,076	84.5%	52.3%	4,382	32.1%	29.9%

Source: Mediobanca Securities, Banca d'Italia

Provisions helped by low rates but constrained by regulation

Italian banks have gone through a massive de-risking process in the past 4 years, in which they managed to reduce their NPE stock by 50% and Non-Performing Exposures (NPE) ratio by 10 p.p. Yet, mid-sized banks are still hovering around 10% gross NPE ratio, while ISP and UCG are quickly heading towards 5%.

An environment entailing loan yields at current levels or lower, declining unemployment rate and weak but stable GDP growth could support cost of risk reduction among Italian banks. Yet, the pressure to continue the reduction of NPE, Pillar 1 calendar provisioning, the addendum on NPE flows and stock will keep the cost of risk relatively high around 60-65bp in 2020-21.

Help from cost efficiencies needed to offset wage inflation and NII pressure

In the past decade, Italian banks have been through sizeable downsizing, leading to a 20% and 30% reduction in workforce and branches. In the coming years, though, we see the cost-to-income ratio to inertially increase mainly driven by revenue pressure (low rates, subdued loan growth and lower contribution from govies), with increasing wage inflation and the never-ending need for investments. Hence, we strongly believe banks will once again look for more efficiency in the cost base and turn to early retirements.

On wage inflation, we flag that on 19 December the Italian Banking Association and the Italian unions found an agreement for the renewal of the national collective contract, which will stay in force until 2022 once the contract is finalised. The main novelty brought by the new agreement is an average €190/month wage increase to be realized in three tranches, compensating for inflation dynamics. The level agreed compares to the €135/month wage hike proposed by the ABI, vs the €200/month requested by the Unions. Other innovations include the removal of the 10% penalty on entry-wages for new hires and strengthened contributions (now to €3.5k) incentivising new hires in Southern regions. More in details on the economic treatment, the wage increase articulates across seven seniority profiles, ranging from €135/month for the most junior category up to €255/month for the most senior. The bargained hikes will be realised in three yearly tranches, from 1st January 2020 to 1st January 2022. We fine-tuned our wage inflation estimates for Italian banks in our coverage, recognizing the average monthly salary hike worth €80 in 2020, €70 in 2021 and €40 in 2022. If on one hand we acknowledge the assumption could be conservative as c.40% of Italian banks workforce is aged above 51 years, on the other we believe banks could undertake mitigation measure to delay or reduce the effective salary cost increase. Our new assumptions on wage inflation are revised to an average of >2% in 2020-21, progressively decreasing towards 2022. The impact on EPS is only marginally negative as the agreement was not too far from our previous assumptions.

Italian Banks - National Collective Contract – Agreed levels of wage increase (€/month)

	Jan-20	Jan-21	Jan-22	Total
← Seniority →	107	94	54	**255**
	93	82	47	**222**
	89	78	44	**211**
	85	74	42	**201**
	80	70	40	**190**
	69	60	35	**164**
	65	57	33	**155**
	62	54	31	**147**
	56	49	28	**133**

Source: Unita' sindacale Falcri - Silcea - Sinfub, Mediobanca Securities

In our sector note Not all of the same kind: UBI to Outperform we run a cost rationalisation exercise, among mid and small sized banks, pointing to potential 3% cost cuts by 2021 for a double-digit EPS uplift at the cost of a 20bp CET1 ratio. In our view, ISP and BPE are the best positioned, since they have already planned cuts to branches and headcount supporting the evolution of 2020-21E net profit, while any top-up could find a less hostile attitude from the trade unions.

We also provide a proxy of investments for the past seven years and note that BAMI is ahead of peers, while CVAL and BPSO are quite behind, which may be counter-balancing some cost rationalisation effort in the coming years, given the unforgiving and unique competitive advantage digitalisation can provide commercial strategies and operations.

The recent publication of the new UCG business plan confirmed that cost cuts will aim more at offsetting wage inflation and investment spending than to reduce the absolute cost base.

MEDIOBANCA SECURITIES

No surplus capital but – more importantly – no share count risk

Headwinds ahead but tailwinds could compensate

In the recent past banks disclosed capital hits driven by the regulation with different timings. Thus, we estimate capital adequacy with a look-through approach by considering all regulatory impacts (bar Basel 4) along with potential tailwinds. We conclude that, excluding any change in the Italian sovereign spread and the acceleration of the NPE reduction, banks could maintain CET1 ratios above 12% in 2021.

Italian banks, along with European banks, have been and will be facing several regulatory changes, most of which are resulting in sizeable headwinds on capital. Among them, we mention:

- **EBA guidelines** – EBA introduced new rules on Probability of Default (PD) estimation, on Loss Given Default (LGD) estimation. Together with the treatment of defaulted exposures, the EBA guidelines are expected to be implemented by 1 January 2021 and bring a more conservative discount rate of recoveries, the inclusion of LGD exposure that are being worked out in calculations, and the introduction of a conservative margin, as most remarkable changes. So far, UCG, ISP, CVAL and UBI have disclosed the impact the implementation of these guidelines could have on their CET1 ratios, namely 180bp, 90bp, 85bp – estimated as -60bp net of the c25bp benefit from the SME supporting factor - and 30-40bp. Our simulations lead to an impact ranging from 40bp to 60bp for the other domestic Italian banks.
- **Targeted Review of Internal Models (TRIM)** – TRIM is a harmonization exercise the SSM is undertaking across all European banks. The harmonization pertains to the calculation of credit risk RWA under AIRB. From the empirical evidence we have seen in Spain, all banks have seen their RWA go up, regardless of their positioning vs. peers. Despite some names already reported hit on capital due to TRIM, we see Italian banks as exposed to further headwinds, especially BPSO (-50bps) and BPE (-42bps).
- **Calendar provisioning** - We summarize the regulatory and supervisory approach as follows:
  - **Regulatory approach**: the Pillar 1 requirement entails the coverage of new NPLs derived from exposures that originated after 26 April 2019, according to the calendar provisioning in Table 3 in communication on supervisory coverage expectations for NPEs. The difference between Pillar 1 provisions and accounting provisions is to be deducted from capital;
  - **Supervisory approach on NPE flows (Addendum on flows)**: the Pillar 2 measure represents a recommendation and not a requirement, yet non-compliance triggers dialogue with the supervisor. It entails the application of the calendar provisioning in Table 3 in communication on supervisory coverage expectations for NPEs to new NPLs derived from exposures that originated before 26 April 2019.
  - **Supervisory approach on NPE stock (Addendum on stock)**: the Pillar 2 measure entails calendar provisioning for the NPLs older than 7 years for secured NPLs and older than 2 years for unsecured NPLs.

The ECB's supervisory expectations vary by bank should be seen as the base from which the discussion between banks and the supervisor starts. The outcome of the supervisory dialogue will be taken into account in the SREP assessment (Supervisory Review and Evaluation Process) from 2021. Below we simulate the impact of all three. More detail could be found in the notes Saving the baby from the bathwater and in Not all of the same kind: UBI to Outperform. We note that CE and UBI are less impacted than the other small-mid domestic banks on account of its lower exposure to unsecured lending and lower default rates, while the other domestic banks broadly show a similar impact. UCG and ISP show the lower impacts (5-10bp per year in 2021-27).

Selected Italian Banks – Estimated CET1 impact due to Pillar 1 calendar provisioning, 2019-27E

	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E
UBI	0.00%	0.00%	0.00%	0.02%	0.04%	0.08%	0.12%	0.16%	0.21%
BAMI	0.00%	0.00%	0.02%	0.05%	0.09%	0.15%	0.23%	0.28%	0.33%
BPE	0.00%	0.00%	0.01%	0.04%	0.08%	0.13%	0.21%	0.27%	0.32%
CVAL	0.01%	0.01%	0.03%	0.07%	0.11%	0.17%	0.26%	0.32%	0.36%
BPSO	0.00%	0.00%	0.01%	0.04%	0.07%	0.13%	0.22%	0.27%	0.33%
ISP	0.00%	0.00%	0.00%	0.00%	0.01%	0.02%	0.05%	0.07%	0.09%
UCG	0.00%	0.00%	0.00%	0.01%	0.01%	0.02%	0.05%	0.07%	0.08%
CE	0.00%	0.00%	0.00%	0.01%	0.03%	0.05%	0.08%	0.10%	0.12%
BMPS	0.00%	0.00%	0.00%	0.03%	0.06%	0.11%	0.21%	0.27%	0.31%
Aggregate	**0.00%**	**0.00%**	**0.00%**	**0.02%**	**0.03%**	**0.05%**	**0.09%**	**0.12%**	**0.14%**

Source: Mediobanca Securities

Selected Italian Banks – Estimated CET1 impact due to the Addendum on NPE flows, 2019-27E

	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E
UBI	0.00%	0.00%	0.07%	0.10%	0.24%	0.31%	0.30%	0.30%	0.29%
BAMI	0.00%	0.02%	0.18%	0.17%	0.33%	0.42%	0.41%	0.40%	0.39%
BPE	0.00%	0.00%	0.17%	0.16%	0.33%	0.41%	0.40%	0.39%	0.38%
CVAL	0.03%	0.02%	0.26%	0.22%	0.40%	0.46%	0.44%	0.43%	0.42%
BPSO	0.00%	0.00%	0.17%	0.17%	0.33%	0.42%	0.41%	0.40%	0.40%
ISP	0.00%	0.00%	0.07%	0.05%	0.10%	0.14%	0.12%	0.11%	0.11%
UCG	0.00%	0.00%	0.07%	0.05%	0.10%	0.13%	0.11%	0.10%	0.10%
CE	0.00%	0.00%	0.05%	0.06%	0.11%	0.15%	0.15%	0.00%	0.00%
BMPS	0.00%	0.00%	0.16%	0.16%	0.30%	0.40%	0.40%	0.04%	0.04%
Aggregate	**0.00%**	**0.01%**	**0.10%**	**0.08%**	**0.16%**	**0.20%**	**0.19%**	**0.16%**	**0.15%**

Source: Mediobanca Securities

Selected Italian Banks – Estimated CET1 ratio impact due to the implementation of the Addendum on the stock, 2020-21E

	UBI	BAMI	BPE	CVAL	BPSO	ISP	UCG	CE	BMPS	Sector
2020E CET1 ratio	0.10%	0.00%	0.02%	0.04%	0.00%	0.00%	0.00%	0.00%	0.00%	0.01%
2021E CET1 ratio	0.26%	0.45%	0.19%	0.23%	0.19%	0.07%	0.11%	0.00%	0.15%	0.16%

Source: Mediobanca Securities

Among the tailwinds we mention the extension of the Small Medium Enterprises (SME) supporting factor to be introduced in 2021. In detail, the CRR2 (link) approved in early 2019 broadened the scope of the SME supporting factor (SF), which implies a discount to RWA (applicable to both internal (AIRB) and standardised (STD) models) leading to an estimated 20bp CET1 ratio relief. Earlier, provisioning entailed a 23.81% reduction in RWA for <€1.5m exposure; now this 23.81% discount is applicable to exposures <€2.5m, while for the part exceeding €2.5m, the discount has been lowered to 15%. The new SF is expected to come into force in early 2021. BAMI and BPE quantified impacts of 20-30bp and €480m lower RWAs, respectively, whereas CVAL mentioned it on its BP presentation. BAMI's indication points to a 7% reduction in AIRB RWAs for SMEs, while BPE's implies a 5% reduction. We use a -6% average as a proxy for the others. The CET1 ratio impact we estimate is quite similar across banks at between 20bp and 30bp. In addition, we have company specific measures, such as sales and migration of standardized exposures to AIRB.

Article 104a CRDV to allow for capital flexibility

The revisions of CRD V, already law since May 2019, envisages (art.104a) that an institution shall meet the additional own funds requirement (P2R) with own funds that satisfy the following conditions:

a) at least three quarters of the additional own funds requirement shall be met with Tier 1 capital;

b) at least three quarters of the Tier 1 capital referred to in point (a) shall be composed of Common Equity Tier 1 capital.

This means that 56% of the P2R can be covered with CET1, 19% with AT1 and 25% with Tier 2 instruments. P2R is currently 100% covered by CET1, therefore the measure introduced by CRDV would free up CET1 capital, while leaving unchanged the MDA at overall capital level, as AT1 bucket would move to 1.875% (from 1.5%) and Tier 2 bucket to 2.5% (from 2%).

Finally, the directive envisages that the regulator may require the institution to meet its additional own funds requirement with a higher portion of Tier 1 capital or CET1 capital where necessary and considering the specific circumstances of the institution.

This, jointly with the UCG €2.5bn buybacks extend the string of signs suggesting in 2019 EU regulation has turned more pragmatic (see Enria 1, Enria 2), further supporting our more constructive stance on EU banks (see Saving the baby from the bathwater, 8 Oct 19). As we consider phasing in of Basel IV likely, art 104 would support capital return, provided it is used by healthy banks in demand with debt investors and no hike in P2R.

2020 budget law to bring minor changes to tax rates

The Draft Budgetary Plan unveiled by the Italian Government proposes not to allow the deductibility of write-downs and losses on credits as well as the 10-year deductibility for IRES and IRAP purposes of the impairments resulting from the application of IFRS9, for 2019 tax period.

The final version of the Budget Law did not mention any limitation to the deductibility of write-downs and losses on credits reported in 2019, but reduced the deductibility of IFRS9 and past credit losses in the fiscal year 2019. In addition, the budget law re-introduced ACE (Aiuto alla Crescita Economica) with effect form 2019. ACE was removed by the 2019 Budget law and is a tax benefit calculated on capital increases made in 2011-18, with a rate of 1.3%, down from 1.5% in 2018.

Intervention in recovery plans could curb 3-9bp CET1 ratio

On 31 December 2019, Banca Popolare di Bari announced in a press release the decision of the Interbank Deposit Protection Fund (IDGF) to intervene in the bank's rescue plan through the injection of €310m. On the same day, Italian press (Il Sole 24 Ore, 31st December 2019) was reporting the FITD would have deliberated to commit up to €700m in the Popolare's recapitalisation. The IDGF is funded by contributions pledged by member banks, under a mandatory (DGS) and a voluntary scheme (IVS). We estimate the potential breakdown of the additional contribution to the fund among Italian banks by considering the intervention in Banca Carige in 2018.

As the statute of the FITD deliberates the fund must achieve financial resources equal to 0.8% of protected deposits by 2024, we would expect the institution to require extraordinary contributions to banks such to compensate the outflows suffered for recent interventions. Summing up, these include c.€300m injected in Banca Carige (and excluding the €318m for the subscription of the subordinated loan in December 2018, which has already been claimed), €310m already deliberated in favour of Banca Popolare di Bari, and additional c.€400m which could potentially come in 1H2020 as per what the press is suggesting. Having no visibility on the temporal distribution of potential extraordinary claims, we simulate the EPS impact on 2020E net income to make an idea of the consequences, although admitting a higher dilution in time would be expectable considering the hefty 6% average dilution in IT banks profitability.

Selected Italian Banks – Simulated EPS Impact from Potential Extraordinary FITD claims

	Simulated Stake in the FITD	EPS impact for €310m intervention in BP Bari and €300m in CRG	EPS impact for €700m intervention in BP Bari and €300m in CRG	CET1 impact for €310m intervention in BP Bari and €300m in CRG	CET1 impact for €700m intervention in BP Bari and €300m in CRG
ISP	25%	-2.4%	-3.9%	-3bps	-5bps
UCG	20%	-2.9%	-4.8%	-2bps	-3bps
BAMI	9%	-8.8%	-14.5%	-5bps	-9bps
BPE	4%	-6.1%	-10.1%	-5bps	-9bps
BMPS	5%	-17.2%	-28.6%	-3bps	-5bps
CE	3%	-7.4%	-12.3%	-9bps	-15bps
CVAL	1%	-15.7%	-26.0%	-6bps	-10bps
BPSO	2%	-6.6%	-11.0%	-4bps	-6bps
UBI	7%	-6.4%	-10.7%	-5bps	-8bps
Aggregate		**-3.6%**	**-5.9%**	**-3bps**	**-9bps**

Source: Mediobanca Securities, company data, FITD

+30bp CET1 ratio help from the MtM of government bonds in 9M, slightly down in Q4

We have recently seen slight widening of the Italian spread, up 20bp QoQ due to Italian 10-year bond yield moving up more than the German one. Italian banks retain sizable Italian government portfolios (mostly valued at fair value through OCI) with a 3-4-year average duration, which contributed positively to CET1 ratios (30bp in 9M19). The recent widening would curb on average c5bp CET1 ratio vs. Q319. We see CE and ISP as the most exposed with c10bp lower CET1 ratio. Conversely, we see UBI, CVAL and BPE as the less impacted on capital, due to lower portfolio size and shorter duration.

Italian vs. German Sovereign Bond Yields Across Different Maturities, Q4 2019 vs. Q3 2019

	Italy 30/09/2019	Italy 16/12/2019	Change	Germany 30/09/2019	Germany 16/12/2019	Change	Spread 30/09/2019	Spread 16/12/2019	Change 30/09/2019
1Yr	-0.25%	-0.19%	5bp	-0.70%	-0.66%	4bp	45bp	46bp	1bp
2Yrs	-0.27%	-0.06%	21bp	-0.77%	-0.61%	16bp	51bp	55bp	4bp
3Yrs	**-0.12%**	**0.22%**	**33bp**	**-0.82%**	**-0.59%**	**23bp**	**70bp**	**81bp**	**10bp**
4Yrs	**0.00%**	**0.37%**	**38bp**	**-0.82%**	**-0.55%**	**27bp**	**82bp**	**92bp**	**11bp**
5Yrs	0.21%	0.68%	47bp	-0.78%	-0.48%	30bp	98bp	115bp	17bp
10Yrs	0.82%	1.41%	59bp	-0.57%	-0.19%	39bp	139bp	160bp	20bp

Source: Bloomberg, Mediobanca Securities analysis

Selected Italian Banks – Estimated CET1 Impact from MtM of Italy's Sovereign Exposures, Q4 19 vs. Q3 19

€bn	Q3 Total IT portfolio	Q3 IT Govies (FVOCI)	CET1 impact	Q319 CET1 ratio post	Total IT Govies as % of CET
CVAL	4.1	0.7	-0.01%	14.7%	2.9x
CE	3.3	1.2	-0.11%	14.7%	1.6x
BPSO	6.4	1.8	-0.07%	15.5%	2.4x
BAMI	19.3	5.9	-0.03%	12.0%	2.4x
UBI	10.0	5.6	-0.01%	12.1%	1.4x
BPE	6.4	0.7	-0.02%	12.0%	1.5x
BMPS*	15.4	5.7	-0.04%	12.56%	2.1x
ISP	35.8	24.1	-0.11%	13.0%	0.9x
UCG*	54.0**	35.4	-0.03%	12.6%	1.1x
Aggregate	154.8	**81.3**	**-0.04%**	**12.7%**	1.3x

*Source: Mediobanca Securities, company data, *BTP-BUND spread, **Q2*

…stability and yield could refresh the sector's appeal

Undemanding valuation and decent yield to gain relative appeal…

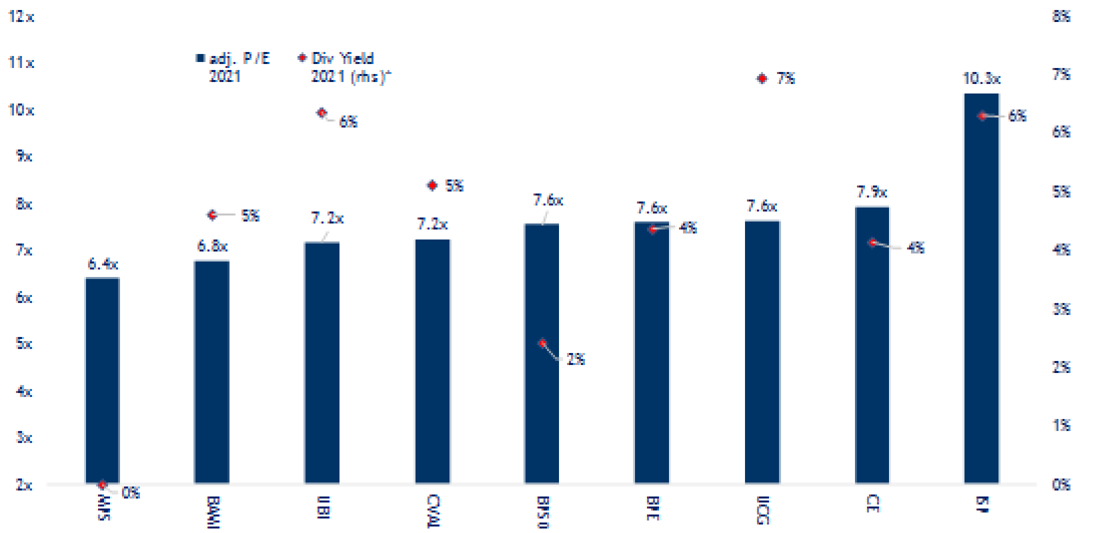
Italian banks have done well in 2019 - but with a wide dispersion – -c20% to +c40%. Yet, valuations stay undemanding with 2021 P/E of c.7x and a large discount to tangible equity (TE), excluding ISP and CE. Current valuations imply dividend yields of 2-7% which base on profitability levels incorporating the negative interest rates stick around for the next two years. Albeit in the absence of EPS support, we deem dividend yield sufficient to attract investor interest from other sectors, potentially triggering a repositioning on a sector which shows light investor presence.

…with positive and negative exogenous factors

We see banks heavily affected by exogenous elements: political stability, macro, regulation. Stabilisation across these is necessary for our case of yield appeal relative to other sectors. On the negative side, a deterioration in the European/Italian economies and/or an exacerbation of political instability could trigger a de-rating. On the positive front, support on the regulatory side and M&A could trigger a rally.

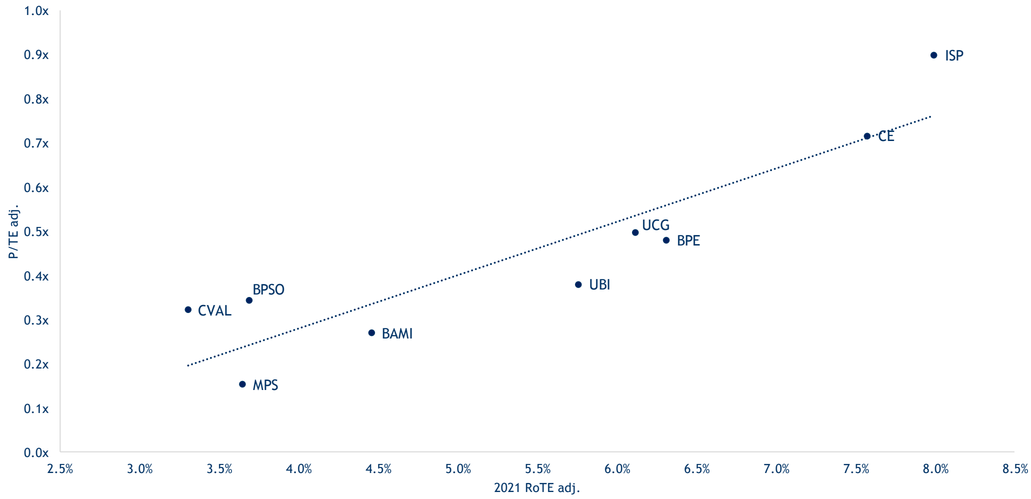
We exclude the above from our base case which is made of macro stagnation, political and regulatory stability. We stay selective, with UCG (top pick), UBI and CE Outperform all other names Neutral and ISP Underperform.

Selected Italian Banks - Adjusted P/E vs Dividend Yield, 2021E



Source: Mediobanca Securities, Bloomberg

Selected Italia Banks - P/TE vs RoTE adj. 2021E



Source: Mediobanca Securities, Bloomberg

UCG (O, TP €15.9) From a restructuring to a dividend story

Management continues on a relentless risk-reduction (NPE reduction, disposal of riskier geographies, settling of pending litigations), capital strengthening and efficiency enhancements so that UCG is a structurally safer bank than three years ago, confirmed by the further reduction in the SREP requirement for 2020. Yet, share price is stuck at the rights issue level with implied COE in the high teens and adjusted P/E is still trading at high single digit discount to the sector. We believe stabilisation and more visibility on profitability, further cost cuts and a clearer mid-term path to capital return will bring share price re-rating. The 2019-23 Business Plan confirmed the transformation in a capital return story from hiking DPS payout to 50% (including buybacks). This makes UCG one of the highest yields in the sector (7%), while still trading at a discount to P/E.

ISP (U, TP €2.1) low conviction on high DPS yield funded by capital gains

In 2019 the bank had gone (and continues to go) very long bonds blessed the halving of Italian sovereign spread boosting trading and capital, also adorned by the adoption of the Danish Compromise (DC). On top of this, earnings were galvanized by strong markets pushing fees up, while NII lingered. We see ISP on 0.95x P/TE for 8% RoTE and 11.7x 2020 P/E (post AT1), discounting c30% premium to the sector, as excessive for the current strategy based on carry-trade and directional calls on rates and credit spreads. The bulls justify this with ISP's perceived superior safety, reflecting in the 8% DPS yield (falling to 6% in 2021). We see ISP among the few names EU banks trading like gold, at very high premium. Instead, we prefer to buy silver at the price of copper (Saving the baby from the bathwater), particularly as we see ISP re-risking to fend off profitability pressures, with yield only 1p.p. above the sector average.

UBI (O, TP €3.3) and CREDEM (O, TP €6.7) our preferred mid-small sized names

In our note Not all of the same kind: UBI to Outperform, we highlight the differences among UBI, BAMI, BPE, CVAL and BPSO concerning the quality of the franchise, the resiliency of revenues, rate sensitivity, potential cost cutting and capital buffer after regulatory headwinds. In our opinion, UBI should trade at a higher multiple on account of its less volatile revenues, more profitable and conservative underwriting policies and higher operating leverage with room to improve on costs. We welcome the acceleration in de-risking in 2019, at the same we believe the market would like to see a stabilisation of the loan book and cost cuts in the next business plan to offset NII pressure to gain more confidence on the name. The stock has re-rated by +11% since early October but has still room to go, in our view.

Our stance on CREDEM remains constructive owing to its superior balance sheet strength (CET1 ratio of the banking operations at c15% - equal to a buffer on SREP ratio at around 600bp s- Gross NPE ratio at around 4%, NPL coverage ratio at c85% including the shortfall to expected loss) and to a best-in class (for Italian standards) RoTE at >9%. Such balance sheet strength could allow CREDEM to improve significantly its capital return capacity, an issue that – sooner or later – management will have to address.

BPER re-rated 30% since October and it is now trading on 0.5x P/E for c6.5% RoTE in 2020. Such performance saturated the upside to our €4.5 target price. As we are aligned with BBG consensus on net profit and we see no particular catalyst ahead aside from potential M&A, we maintain a Neutral rating.

On BAMI we reiterate our Neutral ahead of the business plan, as, on one hand, our EPS stands high-single digit below consensus in 2020-21E on lower NII and higher costs.On the other, we see the stock as potentially offering more upside on revenues catch-up vs. peers.

We are Neutral on CVAL due to relative valuation, as it is trading on >10x 2021E P/E at premium vs peers pricing in over-delivery on cost cuts and higher capital return, which we deem premature at this stage.

We remain Neutral on BPSO due to relative unattractive valuation and no visibility on the main catalyst for the stock, i.e. the ECJ ruling on the Popolari reform, whose date is still unclear. The ECJ decision is key, as we believe that the conversion into joint stock company could open the door to M&A scenarios.

We are Neutral on MPS as the distressed valuation is balanced by the uncertainty surrounding the level of what could be a sustainable return and capital adequacy. MPS MPS's current multiple (0.2X TE) looks appropriate to us. First, MPS is delivering 2% RoTE and we believe returns should remain anchored at this level in the foreseeable future, as NII pressure is unlikely to fade anytime soon and risk cost at 50/55bps looks compatible with Italy's weak macro in which new inflows of soured loans look matching (or almost matching) the organic curtailment. We see RoTE reaching 3% in 2020E, but this could be endangered by the need of issuing MREL eligible liabilities. Second, with a Gross NPE ratio at 12.3% in 2019E including the disposals under way (13.6% excluding fixed income securities from loans), there is no doubt MPS needs to carry-on and accelerate its de-risking and sales look as the only viable way. We calculate that 5% Gross NPE ratio could bring the CET1 Ratio to c11%, a level we do not regard as comfortable in light of further possible risks arising from litigations and regulatory headwinds (TRIM, EBA guidelines, Basel IV).

INSURANCE - FACING CHALLENGES

The premium at which insurers trade versus banks looks stretched to us. Compared to the average normalised PE since 2005, we calculate that banks' 3-years looking forward PE are positioned around 15% below that of insurers. Similarly, insurers' PEs are roughly aligned to the crisis-free levels, while banks trade at around 10%-15% discount. We may accept insurers trading at some premium to banks, but 15% looks too generous to us as ultra-low rates represent a challenging environment for banks and insurers.

Rates are due to stay lower for a long period, and this will lead insurers to find ways to offset this. Corporate bond exposure has generally gone up over the past 8 years, with BBB exposure increasing by 16p.p. (from 33% to 49% in 2018), outpacing the 10p.p. increase in the overall market. We also note that book value gearing for BB and below has doubled in the sector.

As such, insurers already played out a search for yield via corporate bonds and BBB. We also flag that the current 10-20bps dilution per annum in running income can be offset via a 0.1-0.2p.p. improvement in combined ratios, something not easy, given the solid starting point of most companies in our coverage.

From a top-line standpoint, Motor tariffs have declined since May this year (-0.7% on average). In addition, declining car registration does not bode well for the development of average premiums going forward. Non-Motor is the business all companies are focusing on, but the correlation to GDP dynamics makes us a bit sceptical about its growth.

As far as Life Insurance is concerned, 2019 has proved to be flat yoy so far, despite showing a very risk-off mix, with traditional products up 16% yoy and Unit Linked down 26% yoy. We, therefore, see increasing challenges ahead for insurers, which is why we remain cautious on this space.

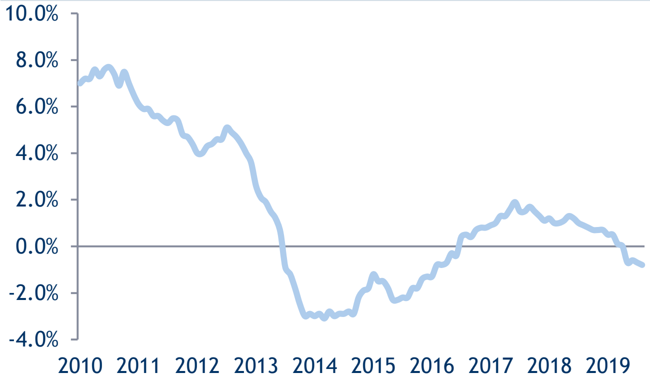
Motor tariffs decrease and weakening GDP weighs on Non-Motor

Last year, we were moderately positive on the Motor business, following the positive trajectory of tariffs and average premiums increasing by 1.4% in 2017 and 1.0% yoy in 2018. However, the latest data reported by Eurostat point to a 0.7% decline in tariffs in 3Q19. On top of this, car registrations fell by 1.6% yoy as of October 2019, and this adds uncertainty to the overall development of average premiums for the forthcoming months.

Beyond that, insurers are trying to focus on their Non-Motor businesses in order to generate some top-line growth. We believe that efforts may not generate the desired results in the short term, given the correlation with GDP and its sluggish expectations in the near term (+0.1% qoq in 1Q and 2Q19, and +0.8% in FY2020E according to the latest forecasts from Bank of Italy [made in July]).

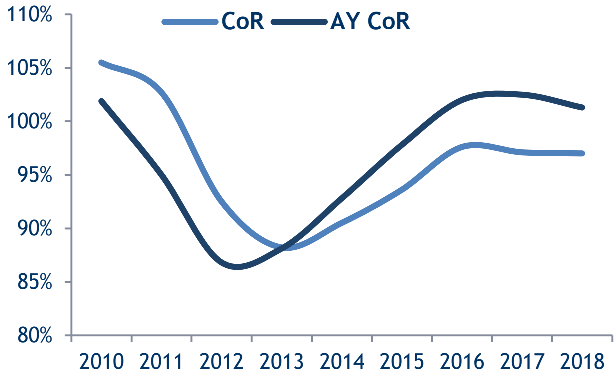
Such a negative scenario may be exacerbated by the fact that Motor TPL did not achieve satisfying technical performance in the last few years. As shown in the chart below on the right-hand side, after adjusting the combined ratio for prior years, the Italian motor insurance sector did not generate any profit at a technical level over the past two years. As a matter of fact, accident-year CoR was 101.3% in 2018, an improvement compared to 102.5% recorded in 2017, but still in accounting for technical losses.

Italian motor insurance tariffs (yoy change)



Source: Mediobanca Securities, Eurostat

Italian motor insurance CoR and AY CoR



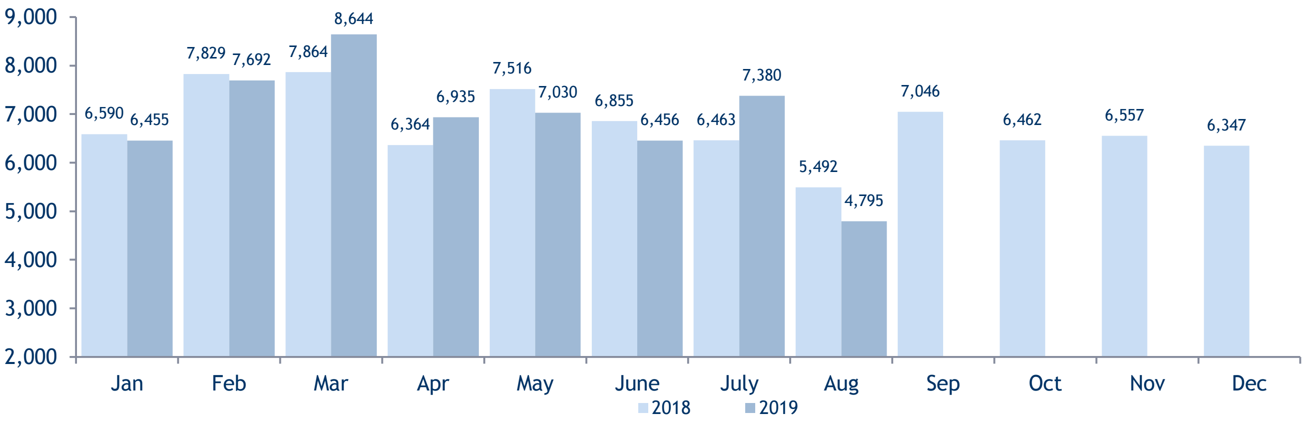
Source: Mediobanca Securities, ANIA

Overall, the motor business is facing a new challenging period, with companies struggling in a competitive environment characterised by decreasing motor tariffs and declining car registrations. On Motor TPL, despite AY CoR improving by 1.2% yoy in 2018, it is hard to see break-even at a technical level in the short term. Equally, Italy's stagnation could dent insurers' buoyant expectations of growth potential in Non-Motor. Finally, we see little room for cutting costs, considering that most companies already conducted significant cost-optimisation initiatives when motor tariffs dropped in 2013-16.

Life business sticky, but with a defensive mix

As far as Life insurance is concerned, new business premiums (NBP) in 8M19 were marginally up (+0.7%) with respect to the previous year. In absolute terms, cumulative NBP totalled €55.4bn in 8M19 (vs €55.0bn a year ago). Despite limited growth (also due to a tough comparison, as NBP grew by 4% yoy in 2018), we believe the business is resilient, as it is supported by an interest rate environment that stimulates investments in traditional products.

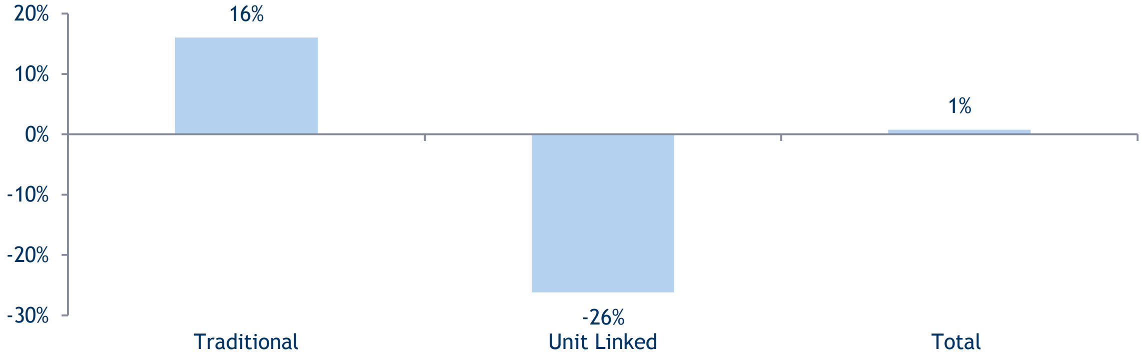
Monthly NBP, 2018 vs 2019 - €m



Source: Mediobanca Securities, ANIA

In more detail, the two main life insurance products, traditional and Unit-Linked policies, showed an opposite pace in the year, posting a 16% increase and a 26% decline, respectively. These trends are, in our view, due to specific market conditions, which characterised 2018-19. Firstly, the ECB's monetary policy drove rates in a deeper negative area; as a consequence, clients decided to invest in traditional products with capital guarantee to have some positive returns. Secondly, following the negative equity market performance in 2H2018, investors have limited their exposure to Unit-Linked products.

9M yoy change in NBP

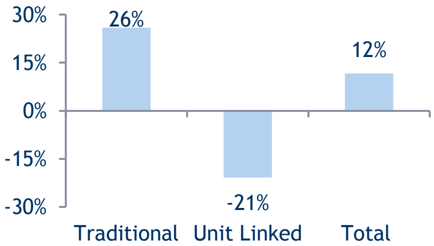


Source: Mediobanca Securities, ANIA

The breakdown by channel also offers interesting insights:

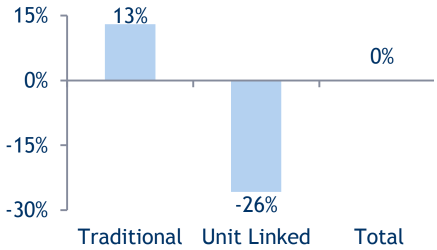
- The 8M19 yoy growth recorded was mainly attributable to agencies, up 12% yoy, offsetting the drop reported by financial advisors (-6% yoy). Banks and post offices were flat;
- Clients' choices were uncorrelated by channels. As a matter of fact, traditional products were strongly positive in all three channels, while sales of Unit Linked were weak across the board.

8M19 yoy change in NBP: Agencies



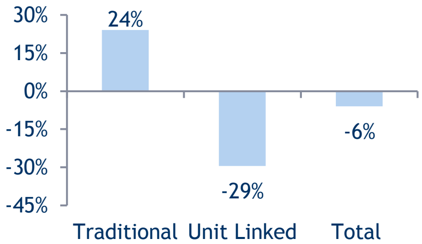
Source: Mediobanca Securities, ANIA

8M19 yoy change in NBP: Banks/post offices



Source: Mediobanca Securities, ANIA

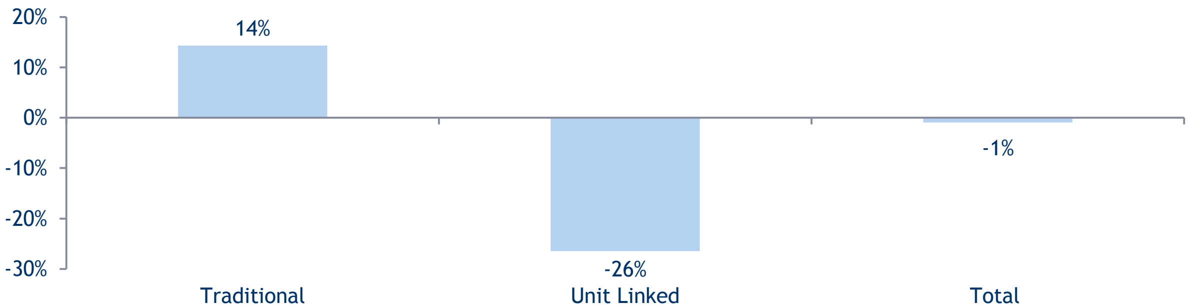
8M19 yoy change in NBP: Financial advisors



Source: Mediobanca Securities, ANIA

We believe it could be informative to focus just on the three months from June to August, as it shows clients' behaviour in a period characterised by falling rates and volatility in the market. New premiums were down 1% yoy, with traditional policies growing (+14% yoy), but not enough to fully compensate the reduction in Unit Linked, a sign of a deteriorating scenario compared to the first part of the year. We, therefore, believe that if uncertainty, both at the national and the international level, continues in 2020 too, NBP related to Unit-Linked products might continue to suffer, while traditional policies would only marginally offset such a decrease.

Jun-Aug yoy change in NBP



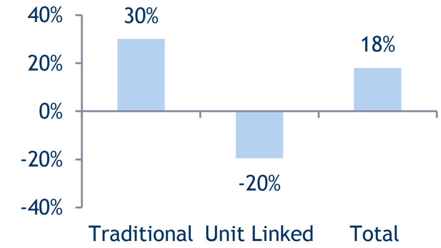
Source: Mediobanca Securities, ANIA

We consistently performed the same analysis by channel, and derived some relevant conclusions for financial advisors. FAs had c.€800m lower premiums in the period compared to the previous year, and this might reflect advisors' more constructive stance on pure asset management products (ie funds of funds, managed accounts, etc.) following sound market performance to date.

At the same time, Agencies continue to perform well (+18% yoy), consistent with the trend in the entire year (a €441m increase yoy in new business premiums).

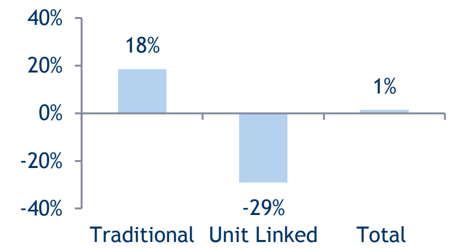
Finally, banks and post offices were flat yoy, showing no significant impact across the summer.

Jun-Aug yoy chg. in NBP: Agencies



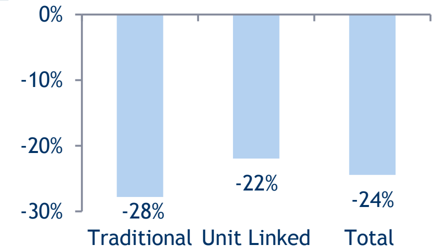
Source: Mediobanca Securities, ANIA

Jun-Aug yoy chg. in NBP: Banks/post offices



Source: Mediobanca Securities, ANIA

Jun-Aug yoy chg. in NBP: Financial advisors



Source: Mediobanca Securities, ANIA

Low rates manageable as long as technical profits support it

Falling interest rates this year have again raised the question of how the sector will cope with the pressures these low (or negative) rates bring.

We recently analysed the topic in our sector note "*Comfortable with the risk of re-risking*", with a particular focus on i) credit risk; ii) possibility of alleviating pressure with technical profits and iii) potential opportunity offered by alternative assets.

On credit risk, we found some evidence of a ramp-up in credit risk since 2010. Corporate bonds as a percentage of total investment assets have gone up in about half the number of companies in our EU insurance coverage.

Corporate bond exposure shows mixed trends across the sector

Corporate bonds as % of total investment	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18	FY 10-FY 18
Allianz	25%	27%	27%	28%	29%	31%	34%	34%	35%	9%
AXA	34%	32%	31%	31%	29%	34%	35%	34%	34%	0%
Generali	27%	22%	22%	23%	26%	27%	29%	28%	23%	-4%
Hannover Re	25%	30%	32%	35%	35%	0%	31%	30%	28%	3%
Munich Re	15%	15%	11%	12%	12%	12%	12%	12%	12%	-4%
SCOR	19%	18%	20%	23%	25%	26%	29%	38%	42%	23%
Swiss Re	13%	16%	17%	24%	26%	27%	30%	33%	33%	20%
Gjensidige		62%	65%	65%	68%	74%	72%	72%	66%	5%
Topdanmark	4%	3%	3%	3%	2%	1%	1%	0%	0%	-4%
Sampo	49%	51%	51%	45%	51%	54%	58%	58%	59%	11%
Aegon	39%	38%	38%	37%	36%	36%	37%	32%	31%	-8%
NN			21%	21%	19%	13%	14%	19%	19%	-2%
Ageas	9%	12%	14%	15%	19%	20%	21%	20%	19%	10%
Aviva	15%	18%	22%	9%	9%	10%	9%	8%	8%	-7%
Direct Line	45%	41%	57%	65%	69%	75%	83%	85%	85%	40%
Simple average	**25%**	**27%**	**29%**	**29%**	**30%**	**29%**	**33%**	**34%**	**33%**	

Source: Company Data, Mediobanca Securities

Within corporate bonds, the BBB and below bucket has, on average, shown an increase of 16p.p. (2010-2018), above the increase of c.10p.p. in the US market.

Corporate bond risk profile has increased for BBB and below by an average of 16p.p.

BBB and below as % of corporate bonds	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18	FY 10-FY 18
Allianz	37%	46%	48%	52%	53%	56%	54%	55%	57%	**20%**
AXA	31%	33%	41%	44%	45%	44%	45%	45%	46%	**15%**
Generali	19%	22%	35%	48%	54%	57%	60%	61%	65%	**46%**
Hannover Re	18%	30%	36%	35%	36%	44%	50%	54%	55%	**37%**
Munich Re	44%	47%	47%	54%	53%	59%	58%	64%	71%	**27%**
SCOR	38%	35%	38%	35%	34%	34%	34%	33%	39%	**0%**
Swiss Re	48%	49%	51%	53%	56%	59%	62%	59%	61%	**13%**
Gjensidige	38%	43%	39%	42%	43%	48%	54%	52%	54%	**16%**
Topdanmark	49%	51%	37%	28%	29%	39%	0%	0%	0%	**-49%**
Sampo		33%	45%	50%	40%	41%	41%	42%	47%	**47%**
Aegon	44%	44%	45%	48%	50%	51%	50%	51%	54%	**10%**
NN			20%	23%	23%	24%	33%	45%	47%	**27%**
Ageas	15%	24%	37%	46%	53%	54%	61%	62%	63%	**48%**
Aviva	44%	46%	49%	42%	39%	37%	37%	39%	44%	**0%**
Direct Line	6%	11%	15%	23%	30%	32%	33%	36%	38%	**33%**
Average	**33%**	**37%**	**39%**	**41%**	**42%**	**45%**	**45%**	**47%**	**49%**	

Source: Company Data, Mediobanca Securities

Also, book value gearing to BBB and below corporate bonds has almost doubled in the sector (from 0.5x to 1x, on average). This includes the EU life businesses as well (including policyholder assets).

BBB gearing of book value has increased across the sector since 2010, from 0.5x to 1x

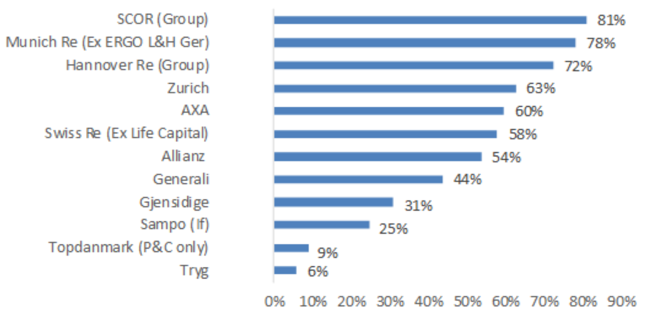
BBB and below, as % of s/h equity	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18
Allianz	0.9x	1.3x	1.3x	1.6x	1.5x	1.7x	1.8x	1.9x	2.2x
AXA	0.9x	1.0x	1.2x	1.2x	1.1x	1.2x	1.3x	1.3x	1.6x
Generali	1.0x	1.0x	1.4x	1.9x	2.2x	2.5x	2.8x	2.7x	2.6x
Hannover	0.3x	0.5x	0.6x	0.7x	0.6x	0.7x	0.7x	0.8x	0.7x
Munich Re	0.6x	0.6x	0.4x	0.5x	0.5x	0.5x	0.5x	0.6x	0.7x
SCOR	0.4x	0.3x	0.4x	0.4x	0.4x	0.4x	0.4x	0.6x	0.8x
Swiss	0.3x	0.4x	0.4x	0.5x	0.5x	0.6x	0.7x	0.7x	0.9x
Gjensidige		0.6x	0.6x	0.6x	0.8x	0.9x	1.0x	0.9x	0.8x
Topdanmark	0.1x	0.1x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x
Sampo	0.0x	0.3x	0.4x	0.4x	0.4x	0.4x	0.4x	0.4x	0.4x
Aegon	1.1x	0.9x	0.8x	1.0x	1.0x	1.1x	1.2x	0.9x	1.0x
NN			0.2x	0.3x	0.2x	0.2x	0.3x	0.7x	0.7x
Ageas	0.1x	0.2x	0.3x	0.5x	0.7x	0.6x	0.9x	0.8x	0.8x
Aviva	1.3x	1.4x	2.4x	0.9x	0.7x	0.6x	0.6x	0.6x	0.6x
Direct Line	0.1x	0.1x	0.2x	0.4x	0.4x	0.5x	0.6x	0.6x	0.6x
Average	**0.5x**	**0.6x**	**0.7x**	**0.7x**	**0.7x**	**0.8x**	**0.9x**	**0.9x**	**1.0x**

Source: Company Data, Mediobanca Securities

Lastly, on high yield (ie below BBB), the book value gearing shows several stocks around the 10% book value gearing – significant, but under control.
With regard to the second point (ie the possibility of alleviating pressure with technical profits), we looked at how important investment income is to a typical P&C income statement. We concluded that for EU multiliners, P&C investment income is a bit more than half of P&C operating profit.

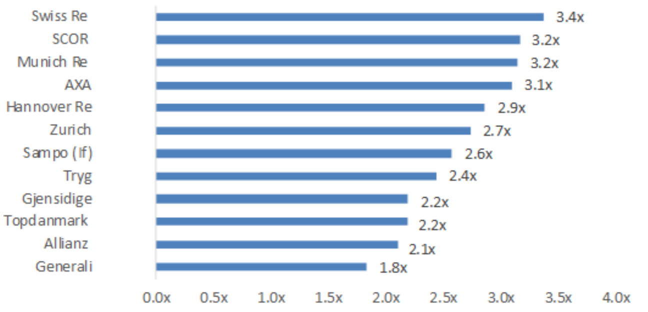
Surprisingly enough, reinsurers show more gearing (about three-fourths) to investment income, and this could be a function of more reserves, while Nordics show very low gearing to investment income.

Investment income as a % of earnings, 2020E



Source: Mediobanca Securities

P&C asset gearing to premiums, 2018



Source: Mediobanca Securities

We calculated how much P&C COR needs to improve for a 1p.p. yield compression on all P&C assets, and the answer here is c.2p.p. for the primary sector and c.3p.p. for reinsurers. This seems encouraging to us, as current dilution in the running income of insurers generally stands at 10-20bps per annum. That means the need for a 0.2p.p. improvement in CoR to offset such dilution. This is not easy, given where some companies are currently running at (eg 91.8% CoR at Generali in 1H), but not impossible too, as efficiency might still be far from being reached.

On the third point related to the opportunity to exploit alternative investments, Allianz is certainly a case study at the European level. Alternative assets are now at 20% of group-wide AUM, up from 12% in 2013, and Allianz continues to look to grow this asset pool. The current volume in this asset class is €135bn (FY 18), and the medium-term target is to increase this to €170bn.

Allianz: Alternative assets are now €69bn higher than 2019

€bn	2013	2014	2015	2016	2017	2018	2013-2018
Alternative assets	65.9	74.5	92.1	100.6	111.5	135.0	69.1
Mid-term targets	80.0	110.0	110.0	140.0	140.0	170.0	90.0
Total AUM for Allianz	**536.7**	**614.6**	**640.1**	**653.1**	**664.4**	**672.8**	**136.1**
Alternatives, as % of AUM	*12%*	*12%*	*14%*	*15%*	*17%*	*20%*	*8%*
Alternatives vs s/h equity	**1.3x**	**1.2x**	**1.5x**	**1.5x**	**1.7x**	**2.2x**	**0.9x**
Mid-term target as % of curr. AUM	15%	18%	17%	21%	21%	25%	10%

Source: Company Data

Allianz splits new money reinvestment yield by asset class and business. The interesting thing is that real asset class saw €12.8bn of new money coming in in 2018, and this was at a 4% yield. This well explains why all major insurers are diversifying their investments in this area and why more will come as long as rates remain that low.

ASSET GATHERERS - HOLDING UP WELL

Within the financial space, we find asset gatherers enjoying hefty multiples, well ahead of those of banks and insurers. The sector looks already reflecting most of the positive factors listed below. However, unlike for insurers, suggesting a tactical rotation into banks from asset gatherers does not look appropriate to us as ultra-low rates and fading concerns on trade tensions will likely support inflows into AUM benefiting asset gatherers.

Net inflows have remained solid throughout 2019, with a pace of €200m inflows into asset management products per month confirmed by all financial advisors' networks. Though it is not easy to predict how flows will develop this year, a scenario of lower rates for longer is a positive for the asset management sector. Recruitment remains an important complementary part of the asset gathering business.

Most companies have carefully reduced such a component to a physiological level, with the exception of Azimut, for which it is above the historical average and close to its record high. As far as margins are concerned, we note that the repricing made by Banca Mediolanum and Azimut last year was completed, with no major consequences in terms of attrition. Cost control in the sector remains high, with Fineco standing out with a 37% C/I ratio (while Azimut and Banca Generali are both in the 50% region, and Mediolanum at 60% post-repricing).

Despite a strong performance throughout 2019, we still find interesting upside for Anima and Poste Italiane. In the first case, we see an attractive valuation (10x 2020E PE) coupling with a recovery in net inflows and the possibility to play the PIR theme both as a manager or an eligible investable stock in the Italian Mid-Cap index. As far as Poste Italiane is concerned, the development of its Motor TPL operations, and some new projects in the acquiring business are solid catalysts to keep attracting investors' interest.

Analysing inflows into asset management in 11M19, we note that all networks achieved average monthly inflows above €200m, a good pace confirming the solid performance of last year. Anima is the only exception, with overall performance in negative territory as it discounted a weak performance in March-May. Custody and current accounts reported similar monthly flows, with the exception of Mediolanum.

Italian Asset Gatherers – 9M19 net inflows - €m

€m	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Tot	Average
ANIM	126	-8	-205	-288	-443	141	132	24	233	166	132	10	1
AZM	554	247	521	471	164	702	517	189	305	300	292	4,261	387
AuM	*315*	*145*	*184*	*234*	*18*	*732*	*338*	*17*	*221*	*33*	*4*	*2,239*	*204*
AuC	*239*	*102*	*337*	*237*	*147*	*-30*	*179*	*172*	*84*	*267*	*288*	*2,022*	*184*
BGN	429	445	536	545	475	407	314	315	309	367	373	4,515	410
AuM	*45*	*367*	*198*	*206*	*196*	*178*	*366*	*125*	*186*	*248*	*296*	*2,411*	*219*
AuC	*385*	*78*	*338*	*339*	*279*	*229*	*-52*	*190*	*123*	*119*	*77*	*2,105*	*191*
BMED	233	447	462	343	259	291	268	336	-51	364	305	3,257	296
AuM	*172*	*304*	*319*	*275*	*94*	*262*	*302*	*313*	*183*	*163*	*142*	*2,529*	*230*
AuC	*61*	*143*	*142*	*68*	*165*	*29*	*-34*	*23*	*-234*	*201*	*163*	*727*	*66*
FBK	348	571	792	508	489	626	420	396	197	386	384	5,118	465
AuM	*139*	*207*	*337*	*254*	*36*	*446*	*58*	*122*	*320*	*516*	*352*	*2,787*	*253*
AuC	*210*	*364*	*455*	*254*	*453*	*180*	*361*	*274*	*-123*	*-130*	*32*	*2,331*	*212*

Source: Mediobanca Securities

A comparison with last year shows the strong acceleration of BGN in custody thanks to certificates and private placements.

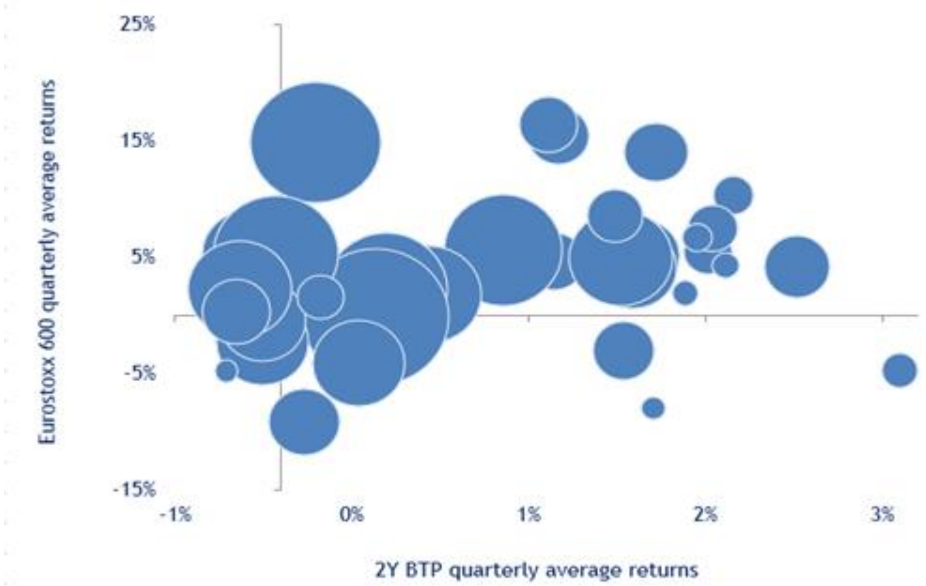
Italian asset gatherers – 9M18 net inflows - €m

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Tot	Average
ANIM	335	64	183	311	-812	-473	522	396	319	-73	64	836	76
AZM	449	391	35	104	1,148	241	775	215	241	287	355	4,241	386
AuM	*263*	*222*	*-54*	*-17*	*1,031*	*51*	*474*	*49*	*79*	56	196	2,349	214
AuC	*186*	*168*	*89*	*121*	*117*	*190*	*302*	*167*	*161*	231	160	1,891	172
BGN	465	555	554	474	603	502	410	241	310	231	205	4,550	414
AuM	*385*	*78*	*338*	*339*	*279*	*229*	*-52*	*190*	*123*	-64	32	1,984	180
AuC	*137*	*182*	*160*	*78*	*85*	*49*	*-50*	*22*	*-223*	295	173	2,567	233
BMED	167	461	354	400	252	472	290	206	96	204	301	3,203	291
AuM	*132*	*318*	*328*	*269*	*169*	*437*	*319*	*205*	*124*	112	212	2,625	239
AuC	*34*	*144*	*26*	*131*	*82*	*35*	*-30*	*1*	*-29*	92	89	575	52
FBK	412	609	638	577	686	674	499	357	328	439	206	5,424	493
AuM	*253*	*145*	*330*	*259*	*264*	*312*	*183*	*101*	*76*	-1	174	2,096	191
AuC	*159*	*464*	*308*	*318*	*423*	*362*	*316*	*255*	*252*	439	31	3,329	303

Source: Mediobanca Securities

Identifying a trend for 2020 is not easy. However, the correlation between flows and interest rates/equity market performance gives an idea of the possible evolution ahead. The bubbles in the chart below display net inflows (the larger the bubble, the stronger the inflows) as a function of both these variables.

Net inflows as a function of BTP yields and European equity performance (2Q03-3Q19)



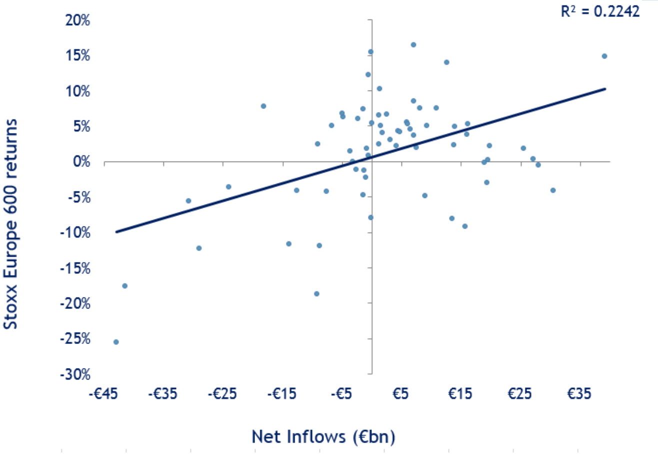
Source: Mediobanca Securities

The following scatter plots show the relationship between net inflows and European equity markets, separately from the relationship between net inflows and interest rates.

The best fitting lines graphically represent two linear regressions. The direct relationship between equity market performance and net inflows can be grasped easily: the fitted line is positively sloped.

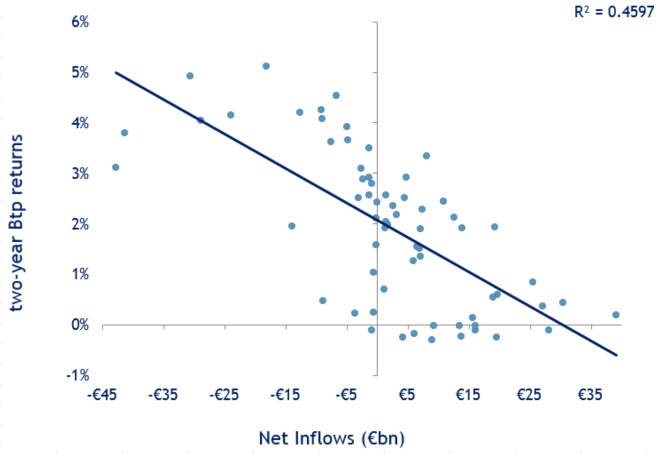
Likewise, the hypothesis of an inverse relationship between net inflows and bond market performance is further supported by a negatively sloped best fitting line. However, the first regression's lower R^2 confirms what is suggested by the bubble chart: the explanatory power of BTP yields (R^2=0.46) is greater than the one of returns over the Stoxx Europe 600 (R^2=0.22).

Net inflows into IT funds vs EU equity Perf. (2Q03 - 3Q19)



Source: Mediobanca Securities, Assogestioni, Bloomberg

Net inflows into IT funds vs 2YR IT BTPs (2Q03 - 3Q19)



Source: Mediobanca Securities, Assogestioni, Bloomberg

Overall, we believe a scenario of lower rates on government bonds for longer is a positive for the asset management sector. Though it is impossible, at this stage, to make strong calls on how the equity market will look like in 2020, we believe the interest rate component suggests a moderately positive outlook on flows.

Cautious approach to recruitment, with the exception of Azimut

Recruitment remains an important complementary part of this business. Companies have different attitudes towards this component, and we find plenty of evidence in the table below. The most cautious players remain BMED and FBK, whose hiring stands at a low 4%. On the opposite side of the spectrum, we flag BGN and AZM, at 7% and 9%, respectively. Some volatility is present, too, with BGN making an extra effort in 2014-17. At present, we note three of four companies are running well below the 2012-1H19 average, while AZM is currently running above the average.

Italian asset gatherers – Newly recruited FAs as a percentage of FAs at the beginning of the period

	2012	2013	2014	2015	2016	2017	2018	1H19	Average
Azimut	8%	11%	9%	10%	9%	6%	9%	10%	**9%**
Banca Generali	4%	6%	15%	8%	9%	8%	5%	4%	**7%**
Banca Mediolanum	4%	7%	4%	4%	4%	2%	2%	3%	**4%**
Fineco Bank	4%	6%	5%	5%	3%	4%	3%	2%	**4%**

Source: Mediobanca Securities

We then calculated churn rates derived as a difference in the total number of FAs at t0 and t1, net of the total number of recruited FAs, divided by the total number of FAs at t0. We derive similar results for AZM and BMED – both at 6% - and at BGN/FBK – both at 3%. Despite the fact that such an analysis might underestimate the effect of advisers retiring (with portfolios being retained and reallocated to other existing FAs) and FAs being asked to leave (low AuM/FA, for example), we believe it still offers good insights into the dynamics at each network. Equally, the time series shown below is wide enough to smooth eventual one-off effects such as a temporarily clean-up in the network.

Italian asset gatherers – Churn

	2012	2013	2014	2015	2016	2017	2018	1H19	Average
Azimut	7%	6%	5%	7%	10%	6%	3%	3%	**6%**
Banca Generali	5%	4%	3%	3%	4%	3%	3%	1%	**3%**
Banca Mediolanum	8%	5%	5%	4%	10%	4%	4%	4%	**6%**
Fineco Bank	3%	0%	1%	1%	6%	5%	4%	3%	**3%**

Source: Mediobanca Securities

The difference between hiring and churn gives the net growth in the number of FAs. It is interesting to note that AZM and BGN are the two networks increasing the most, though for different reasons: AZM is hiring more FAs, while BGN is well balancing hiring with limited churn.

On the other hand, we note that BMED and FBK have not reported significant growth in the number of FAs, with both companies rather focusing on increasing the number of clients or the share of wallet of their existing customer base.

Italian asset gatherers – Net growth in the number of FAs

	2012	2013	2014	2015	2016	2017	2018	1H19	Average
Azimut	0%	6%	3%	3%	4%	0%	5%	4%	**3%**
Banca Generali	-1%	2%	12%	4%	7%	5%	3%	2%	**4%**
Banca Mediolanum	-4%	2%	0%	0%	-1%	-2%	-2%	-1%	**-1%**
Fineco Bank	1%	5%	4%	4%	0%	-1%	-1%	0%	**1%**

Source: Mediobanca Securities

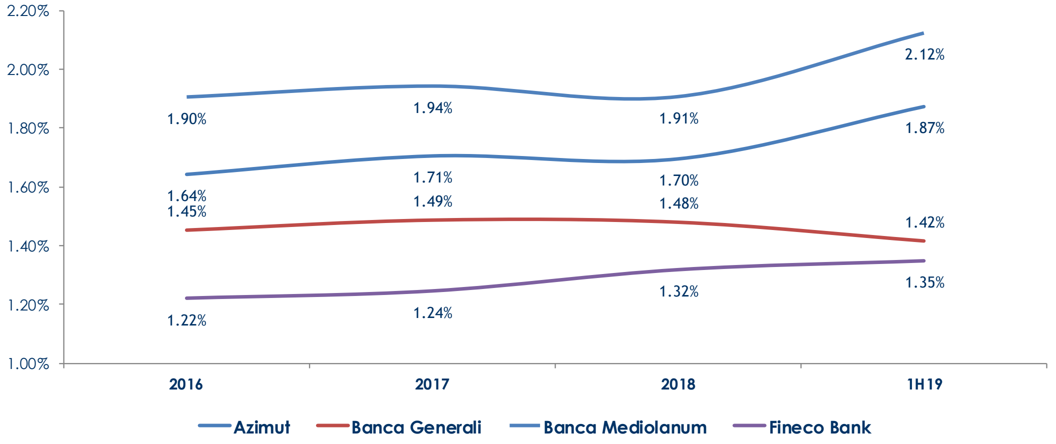
Repricing having an impact: pre-tax margin at 30-50bps

In the first quarter of 2019, Banca Mediolanum and Azimut announced a re-pricing of their “other fees”. Such a measure was taken to counterbalance a shift in the calculation of performance fees from monthly to annual, with an estimated negative impact, on average, of 50-60bps.

It is interesting to note that Banca Generali did not follow and shows a much lower gross revenue margin compared to its two peers. In the case of Banca Generali, BG Selection keeps charging performance fees on a monthly basis, but the product has been put in run-off, while the newly launched Lux IM has an annual calculation mechanism.

As such, Banca Generali decided to smooth the transition from monthly to annual calculation and decided not to raise pricing to offset such an effect. Last but not the least, Fineco keeps improving the profitability of its managed assets thanks to the increasing share of guided products.

Selected Italian asset gatherers - Gross management fees (including repricing of other fees)



Source: Mediobanca Securities

As far as efficiency is concerned, the four companies are equally well placed, with Fineco standing out at 37% (but admittedly with a sizeable component of NII in its revenues), while Azimut and Banca Generali are both in the 50% region. Mediolanum C/I ratio stands a bit higher (60% post-repricing.

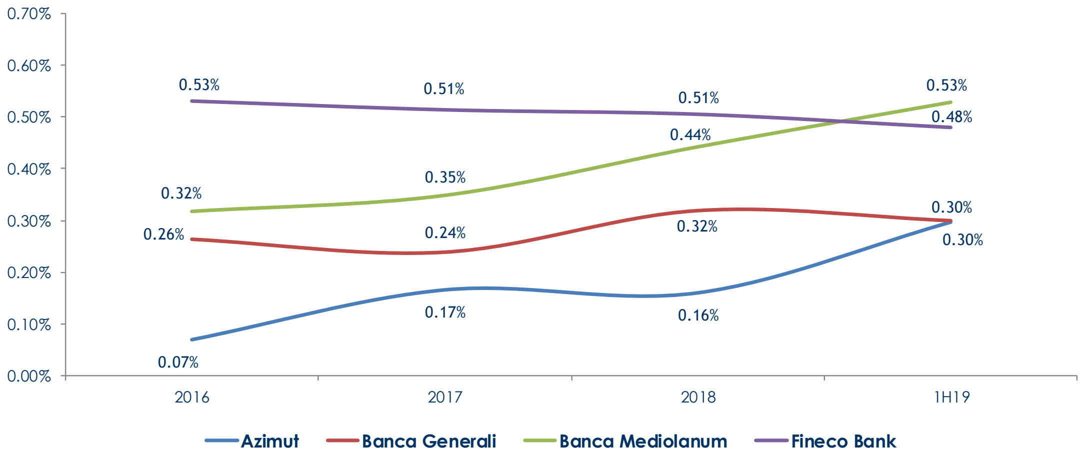
Selected Italian asset gatherers – C/I ratios (ex performance fees)

	2016	2017	2018	1H19
Azimut	70%	58%	62%	51%
Banca Generali	54%	56%	48%	50%
Banca Mediolanum	80%	81%	72%	60%
Fineco Bank	40%	40%	39%	37%

Source: Mediobanca Securities

We also calculated the trend in pre-tax margin (ex performance fees) and noticed overall stability for Fineco and Banca Generali, while the repricing made by Mediolanum and Azimut supported an increase in their recurring profitability.In more general, we see the sector ranging between 30bps on average TFA at AZM and BGN and up to ca. 50bps at BMED and FBK.

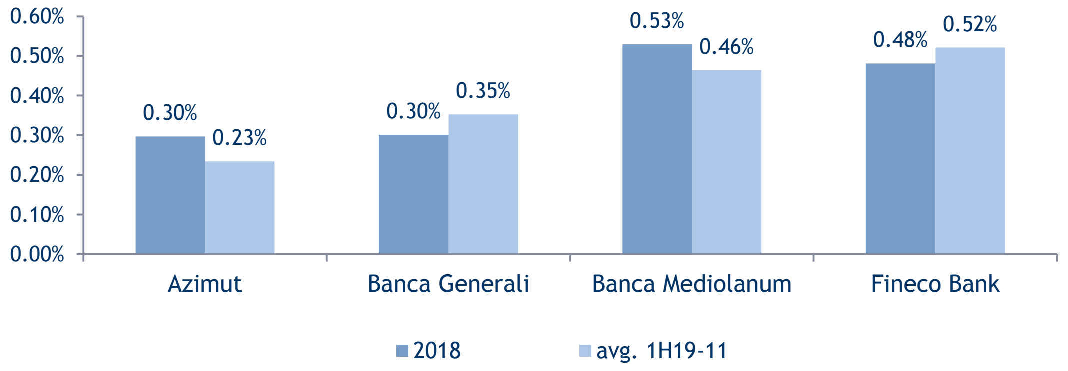
Selected Italian asset gatherers – Pre-tax profit margin (ex performance fees)



Source: Mediobanca Securities

We finally note that current profitability is not too far from the last 8-year average.

Selected Italian asset gatherers – Pre-tax profit margin: current vs average of 2011-1H19



Source: Mediobanca Securities

Going illiquid: AZM first AM to launch illiquid assets for retail

On 25 September, Azimut hosted an event where it launched "Azimut Libera Impresa", its private market platform, which according to the company links real economy with asset management.

Comparing the private market/family wealth ratio among European countries, the UK's stands at 4.4%, France's at 1.2% and Italy's at 0.26%. Therefore, there is some evidence that the private market in Italy is still an untapped business. This market has considerable potential if 1% of €9.2tn of Italian households' wealth is invested in those solutions (ie €92bn).

Azimut set the bar high, aiming at collecting €10bn AuM in the next five years. The product offer consists of 8 funds dedicated to private equity, venture capital and private debt. Private markets currently represent 1% of the group's total asset, but the company share would reach at least 15% by 2024.

Demos 1, in particular, is the first retail close-end private equity fund in the world, with a minimum subscription amount of €5k vs the usual €250k-500k asked by competitors. Demos has a target of €350m in AuM, to be invested in Italian SMEs, with a turnover in the range of €30m-€250m and an average ticket size of €20m-€60m.

What we found interesting is regulators' favourable approach to the sale of illiquid assets to retail investors (though putting a 10-20% cap on the overall portfolio as we understand).

We also believe those products are likely to have management fees at 250-300bps (with performance fees potentially added on top in the case of private equity funds). Hence, potentially a good combination of new products potentially offering more diversification, better returns – in the case of private debt funds - than current investments in fixed income and generous margins for the distributor. The price to pay is certainly illiquidity, with all the consequences that this brings.

SPECIALTY FINANCE – CREDIT MANAGERS SEEK CONSOLIDATION IN A MORE MATURE MARKET

Transactions of Italian NPLs touched a peak in 2018 at more than €100bn, boosted by GACS securitisations that allowed large and small banks to strongly deleverage their balance sheets. Going forward, even in presence of much lower traded volumes (c.€35-40bn p.a.), the market is expected to maintain a good liquidity, sustained by growing transactions on Unlikely-to-Pay (UtP) and an increasing component of secondary transactions.

With the bulk of the banks deleverage now behind them, large credit servicers are seeking consolidation in order to increase their competitive strength in the Italian more challenging market.

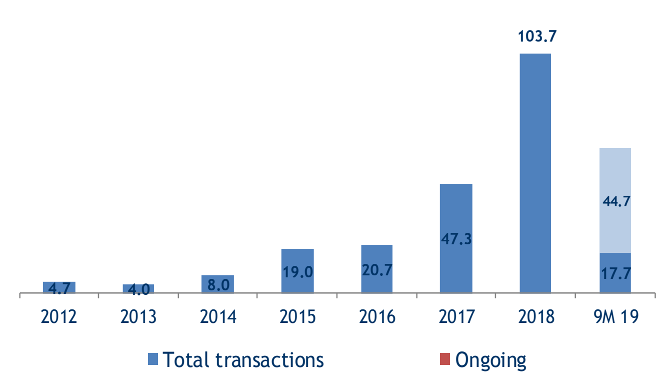
While all major players have declared their intention to participate at this consolidation process, no deal has been closed so far showing how complex aggregations may be both in terms of governance and for the necessity to clearly define a long term servicing contract.

A liquid NPE market even after 2018 peak, with more UtP and secondary market deals

In 2018 NPEs sales in Italy reached the record level of €104bn according to Debtwire, more than doubling with respect to the previous year and accounting for around 50% of European NPE sales. In 2018 the Italian market was boosted by some jumbo deal BMPS €24bn GACS securitizations, the transfer of €18bn of assets to SGA from the regional banks BP Veneto and Vicenza, Intesa's sale to Intrum of €10.8bn NPE and a several other GACS. Overall, GACS accounted for about 50% of total volumes sold and the market remained largely focused on mixed secured and unsecured portfolios, while specialized deals accounted for around 15% of total traded volume. While secondary deals were still limited in 2018, accounting for around 1% of total, transactions of UtP portfolios increased reaching about 10% of total, boosted by the transfer of c.€9bn of assets from the Venetian banks to SGA.

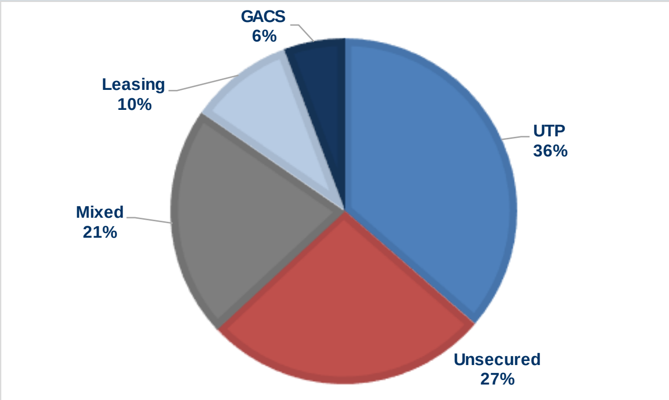
As at September 2019 Debtwire reported c.€17.7bn of closed deals and c.€44.7bn of live transactions pointing to about €40-45bn in 2019, a level that would place again Italy at the top of European NPE markets. GACS gave a lower contribution to 2019 sales as banks have rushed to finalise operations in the last months of 2018 due to the risk that the government would not renew the scheme. UtP represent about one third of the total volume of deals closed in 9M19 and half of the outstanding pipeline. The growth of the secondary market and more UtP deals should characterise the Italian market also in 2020 with total transaction volume stabilising at around €40bn.

Italy - NPE transactions: Gross Book Value (€ bn)



Source: Mediobanca Securities on Debtwire and PWC data

Italy - NPE transactions: Breakdown (9M 19)



Source: Mediobanca Securities on Debtwire data

Italian credit management: a more mature and concentrated sector….

The Italian credit management sector is now more mature and concentrated. M&A activity is the last few years has been strong, driven initially by acquisitions of Italian debt collectors by international debt purchasers and by the sale of bank's captive management platforms to third parties. The Italian credit management sector is now characterized by the presence of a handful of large players – doValue, Cerved, Intrum/Intesa, Prelios, Credito Fondiario, and a high number of small operators mainly active on small ticket unsecured NPLs and trade receivables (debt collectors).

Italian Credit Managers – Ranking by AUM (excluding master service)

	Company	AUM (€ bn)	Investor/shareholder
1	doValue	79.5	Fortress (50.1%)
2	Cerved CM	52.9	Institutional investors
3	Intrum/Intesa	41.1	Intrum (51%)
4	Banca Ifis	22.8	Fustenberg Family (50.2%)
5	AMCO	20.3	Ministry of Finance (100%)
6	Prelios CS	19.3	Davidson Kempner (100%)
7	Credito Fondiario	15.1	Elliott

Source:PWC, Mediobanca Securities

… Ready for a new wave of consolidation

With the bulk of the banks' deleverage now behind them, large credit servicers are seeking consolidation in order to increase their competitive strength in the Italian more challenging market. On the other hand, consolidation is a need for smaller players (DCA) still struggling to reach acceptable profitability levels. Furthermore, in line with what happened in other markets as Spain and the Nordics, large players are exploring less crowded markets like Greece, where the local NPL market is taking off.

A third driver for M&A could be represented by private equity funds willing to liquidate their investment in the sector or seeking the integration of their assets into larger and more complete management platforms.

Banca Ifis and Credito Fondiario kicked off this new phase of the sector's concentration process last August, announcing their intention to create a common platform for future NPL investments and for NPL management. Negotiations were ended in October, due to the difficulties encountered in defining an agreement satisfactory for both parties. Indeed, Ifis/Credito Fordiario'd experience shows how complex this type of aggregations may be both in terms of governance and for the necessity to clearly define a long term servicing contract while, in case of involvement of banks, optimising capital impacts.

Also Cerved is exploring possible opportunities to valorize its credit management unit, including its disposal and the combination with other players or investors. Indeed, in the management's view, the sector is consolidating and Cerved CM would benefit of a larger size and of a strong link with an investor, as the market is now driven by a model that sees credit managers and investors moving together.

BFF is our pick in the specialty finance space

BFF is our favourite name in the specialty finance space, while we are restricted on Cerved and Neutral on Banca Ifis. BFF (O; TP €6.5) couples an attractive risk profile with undemanding valuation (2020E PE of 8.2x with 38% RoTe) and a 7.6% and 10.1% dividend yield on 2019 and 2020 respectively. Banca Ifis (N; TP €14.5) presents similar PE multiples (8.2x on 2020) but much lower ROTE (6.1%) and lower dividend yield on 2020 (7.6%). We see the presentation of its new business plan at mid-January 2020 as a key step for Banca Ifis. Indeed, a clear and convincing business plan, able to explain 1) where the group is willing to grow, 2) how this growth will be achieved despite the bank's relatively tight capital structure and 3) the magnitude and drivers of the expected cost cuts, is an essential pre-requisite, in our view, to a more positive stance on the stock.

Mediobanca acts as advisor of Cerved for the evaluation of potential strategic alternatives with reference to its subsidiary Cerved Credit Management Group S.r.l.

UTILITIES – NETW0RKS LOOK LIKE FULLY PRICED; THE REAL GROWTH OPPORTUNITIES SHOULD COME FROM THE NEW ENERGY DEAL

The persistence of a low interest rate environment has favoured the outperformance of the utilities sector and its underlying multiple expansion as they have been seen as reliable bond-proxies. While we believe that the low interest rate environment is here to stay due to subdued growth and low inflation prospects, we think the tactical short-term trade of overweighting Banks over Insurers & Utilities is well-supported due to the currently significant valuation gap.

So, while the Italian regulated Utilities enjoy a stable regulatory framework at least until 2021 and their strong Balance sheets should support dividend policies, we believe that trading at premiums on equity RAB >30%, most of these stocks have already reflected those macro-related tailwinds and it is difficult to defend the value case.

That said, we believe that the energy transition & the development of the circular economy concept under the so-called European New Energy Deal opens the opportunity for a new wave of capex, which we identify in following three main blocks: (1) New renewable energies to substitute thermal-based technologies. Importantly renewables are now highly competitive without subsidies; (2) An integrated energy network infrastructure that should ensure efficient consumption & security of supply; and (3) The strengthening of the Water distribution network and new Waste management facilities to close the country's strong infrastructural gap. In this context, we favour Enel (O) and Iren (O).

Strong Balance Sheets and reliable dividend remain key

The persistence of a low interest rate environment has favoured utilities sector during 2019, making it relatively more attractive and consequently reflecting a multiple expansion. As we explained in the first chapter, we believe a low rate environment is here to stay due to subdued growth and low inflation prospects. However, we think the tactical short-term trade of being overweight Banks over Insurers and Utilities still has steam due to the currently significant valuation gap.

Looking at the evolution of 3yr forward consensus PE premiums/(discounts), Utilities trade at their historical average premium to the market, meaning that the sector is effectively accurately priced.

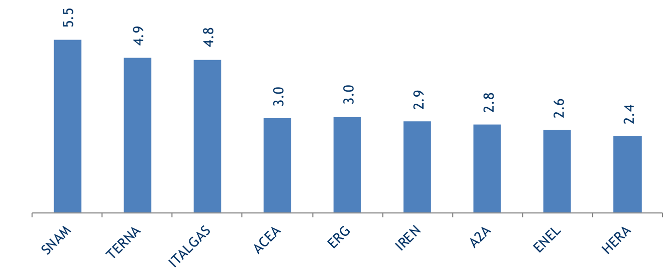
Utilities - 3-Years Forward Consensus PE Discount to Market, 2009-19

Source: Mediobanca Securities, Factset consensus

Regulates utilities enjoy a stable regulatory framework at least until 2021 and their strong Balance sheets should support dividend policies. This is also reflected in their premium on equity RAB: Terna currently trades at c.45% and Snam at c.30%, above their historical average.

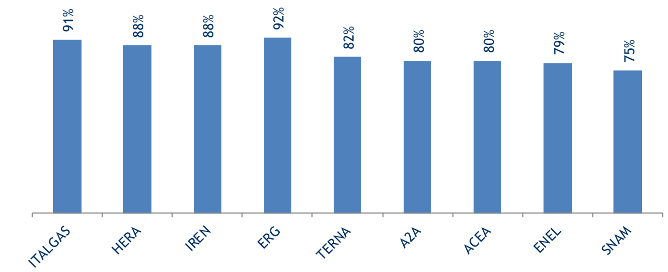
In a period of ultra-low rates, companies have accelerated in making some liability management. The average Net Debt to EBITDA stays at c.3.5x, higher in the case of regulated utilities at c.5.0x and c.3x for companies more exposed to cyclical businesses. We believe that this provides with plenty of flexibility on growth options. On top of this, the average cost of debt is very low (c.2.5%) and the % of debt at fixed rate is >80% on average.

Italian Utilities – Net Debt/EBITDA (2019E)



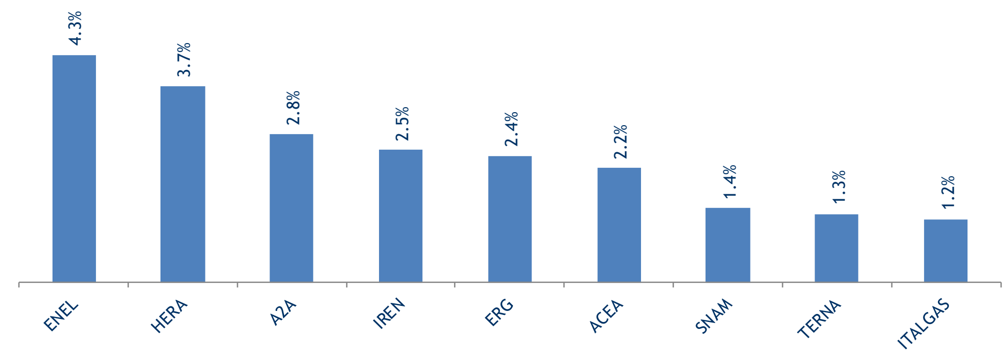
Source: Mediobanca Securities

Italian Utilities – Fixed Borrowing rates (9M19)



Source: Mediobanca Securities

Italian Utilities – Cost of Debt (%)



Source: Mediobanca Securities based on companies data

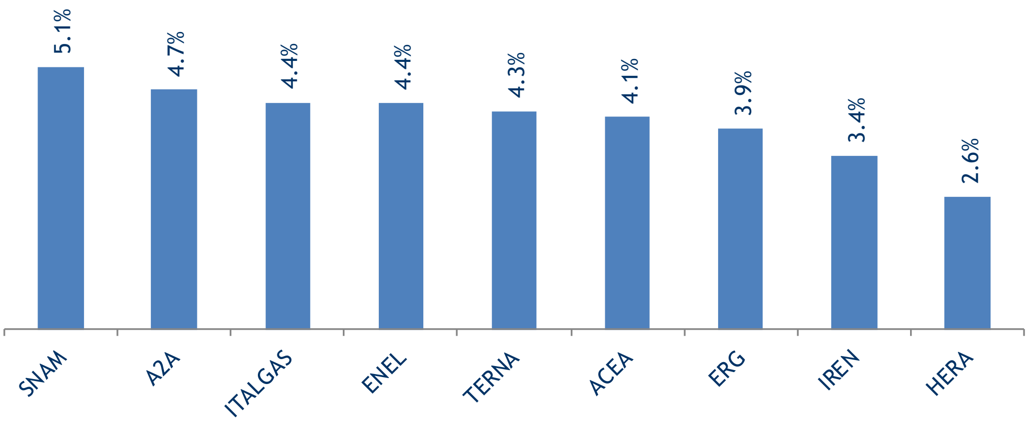
The chart below shows the companies' dividend policies and current dividend yield.

Italian Utilities – Dividend Policies

Company	Dividend Policies
ENEL	"Explicit and minimum" DPS commitment: €0.32 in 2019, €0.35 in 2020, €0.37 in 2021 & 0.40 in 2022. This corresponds to a +7.7% CAGR in 2019/22. Pay-out at 70%, corresponding to higher "implicit dividends"
SNAM	+5% DPS CAGR to 2022 from the basis of a higher 2018 DPS of €0.2263.
TERNA	DPS annual growth commitment of +7% to 2021 from the basis of 2018's €0.2332/share. And the 2021 DPS (€0.2857) is considered as a floor for years 2022 & 2023, when dividend will be based on a 75% pay-out policy.
A2A	€0.0775/share in 2019 and €0.080 in 2020, and then +5% CAGR in 2021 & 2023
ITALGAS	Dividend will be the higher of: (1) the amount resulting from 2017's DPS (€0.208/share) increased by +4% per year or (2) The DPS equivalent to 60% of the consolidated net income
HERA	Explicit DPS commitment: €0.10/share in 2018, €0.10 in 2019, €0.105/share in 2020, €0.105/share in 2021 & €0.11/share in 2022
IREN	2019 DPS at €0.092/share (+10%) and +10% DPS CAGR to 2024. The company has indicated that the new dividend policy corresponds to a 50% dividend pay-out policy in 2019 and 60% by 2022.
ACEA	Minimum Dividend of €0.75/share
ERG	DPS with a floor at €0.75/share until 2022

Source: Company data, Mediobanca Securities

Italian Utilities – Dividend Yield (2019E)

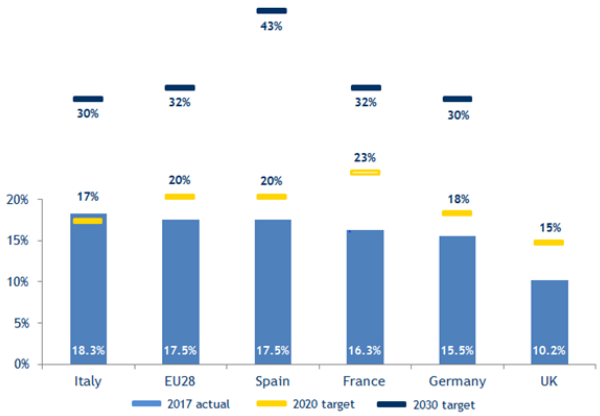


*Source: Mediobanca Securities, *pricing at 6 January 2020*

Energy Transition to support new wave of investments

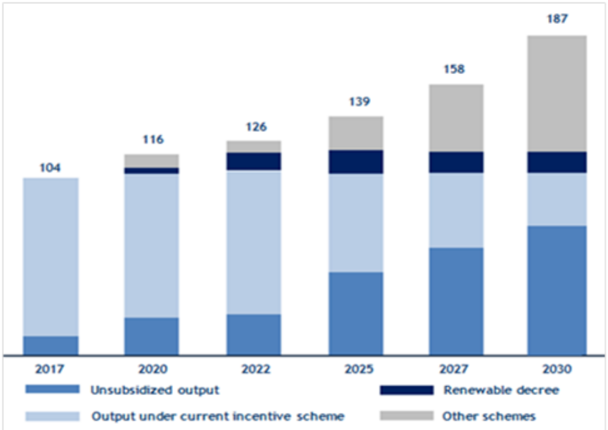
Italy, with c.20% share of gross energy consumption covered by renewables in 2017, is the country among major European economies to have reached 2020 target imposed by the EU. Itay's latest National Energy and Climate Plan for the period 2021-2030 includes that the total production of renewables by 2030 should reach 187TWh, equal to 30% of the internal consumption and should translate into an increase in capacity of 3x the existing solar and 2x the existing wind. In terms of investments, this should correspond to €30bn. To achieve that, Italy's proposal to accelerate renewables development is to promote auctions that will award capacity through Contracts for Difference, PPA (power purchase agreements), the reduction of regional price differences and repowering and revamping of plants.

Renewables share of total energy consumption by country



Source: GSE

Italy electricity output from renewable sources (TWh)



Source: PNIEC

With the approval of the **Renewable Decree ("FER 1")** Italy will hold a round of auctions for a total of 8GW that will be a further step towards the achievement of 2030 target. We believe that the outcome for these (long-awaited) auctions, will be an interesting indicator to show the competitiveness that these companies have reached. And also the implementation of a new capacity market should be important for traditional generators since this could provide more stability to their cash flows.

In the 2020 DEF (Document of Economic and Finance), regarding the energy and environment sector, the Government reiterates the intention to approve the **"Green New Deal"** that will be mainly focused on the protection of the environment against climate change. Il Sole 24 Ore reported (7 January) that the Italian Government would have allocated, in the new budgetary law, €33bn to be spent in the next

15 years. The sources would include €20.8bn allocated to the "Green Fund" for initiatives related to climate change and circular economy, and the remaining c.€13bn will be allocated to municipalities (€4bn), Regions (€5.5bn) and local entities (€3bn) to invest in initiatives including energy efficiency for public buildings, green transports, land security. The key efforts would be on circular economy, decarbonization, emissions reduction, energy efficiency, innovative projects, environmental sustainability.

Government also sees **gas as an important source for energy transition**, especially "green gas". Snam's Hydrogen Conference in October had the presence of PM Giuseppe Conte, Minister for Economic Development Stefano Patuanelli and the Chairman of Arera Stefano Besseghini. While electrification is a strong global underlying trend, still c40% of total mid-term energy consumption is likely to be thermal-based. And here, hydrogen may play a role to complete decarbonisation in activities such as: (1) Trasport: heavy traffic, ships, trains & airplanes; (2) Building heating & (3) Feedstock for petrochemicals and fertilizers. Italy could use its existing infrastructure with Northern Africa, together with the Southern Italian renewable energy plants, to bring/produce competitive green electricity to produce then the so-called "green hydrogen". At the conference constructive proposals were presented on how to create the conditions for an effective decarbonisation using the existing energy infrastructures. Obviously the key aspect remains the cost competitiveness of the hydrogen technology and that would take some time to be completed, but if confirmed, this may certainly make regulators/politicians look at gas infrastructures through different lenses.

Stable regulatory framework for networks

Italy's energy networks follow a RAB-based remuneration that is composed by (1) A regulatory period for the WACC, which lasts for six years (2016-21), with an interim review in 2018 applicable to 2019-21, where the main exogenous parameters have been revised (risk free rate, country risk premium, inflation, gearing, cost of debt, tax rate) and (2) A regulatory period to set the tariff parameters including the Beta of the business, x-factor, reference opex, capex, incentives, WIP.

The WACC regulatory period runs until 2021 (it was updated in 2019). The Italian Energy regulator published the final ruling 639/2018 (to see the report, click here), that fully confirmed the values we published in our note, "*WACC from 2019 could increase by +20/30bp*" on 2 October, being what we called the "best case scenario" (to see the report, click here). The increase of the regulatory WACC by 20/30bp was explained by the higher spread of the Italian Sovereign bond vs. the German bonds. Importantly, the regulator has maintained the same framework and criteria to update the WACC formula, something that provides stability to the current framework and is obviously a positive.

Note that for Gas Networks, the WACC was fixed only in 2019, while for 2020 and 2021 it was subject to the final ruling of the fifth regulatory period starting from 2020 which included also the review of the Beta parameter. Also in this case, the Beta parameter was confirmed for gas transmission and distribution, again providing an element of stability.

Apart from that, the ARERA is working to set up the framework for the introduction of the Totex system for the energy networks that is unlikely to happen by 2020 as previously expected. The Totex is a new mechanism that foresees incentives to be linked to the benefits for the system and to efficiency spending both in terms of Capex and Opex.

Regulation for Water & Waste should support badly needed investments

Italy continues to show a significant infrastructural gap in the Waste and Water business. In waste, the transfer of the competencies to regulate to the Energy Regulator ARERA should provide more transparency and stimulate efficiency and investments. In water, the regulatory framework was able to put in place the right support for investments, which has allowed to significantly increase the tariff since 2012. However, the level of losses in the country continues to be very high.

Starting from the **waste business**, the key principles of regulation has been outlined in the intervention of their Chairman Stefano Besseghini at the Italian Lower House in October:

- **Willingness to promote the concept of a Circular Economy** – ARERA believes that the new regulatory framework for waste management business should be create the conditions for the promotion of the whole concept of the circular economy in Italy.
- **Enhancement of operational efficiency & promotion of innovation** – ARERA intends to create the conditions for a high correlation between the quality of the service and its cost recognition, introducing a system for customers' evaluation and promoting innovation and the development of new treatment facilities.
- **Need for a gradual implementation and asymmetric approach** – ARERA has indicated that the implementation of a new regulation for the waste business will require a gradual introduction of the new regulatory framework and asymmetry in the regulatory proposals.

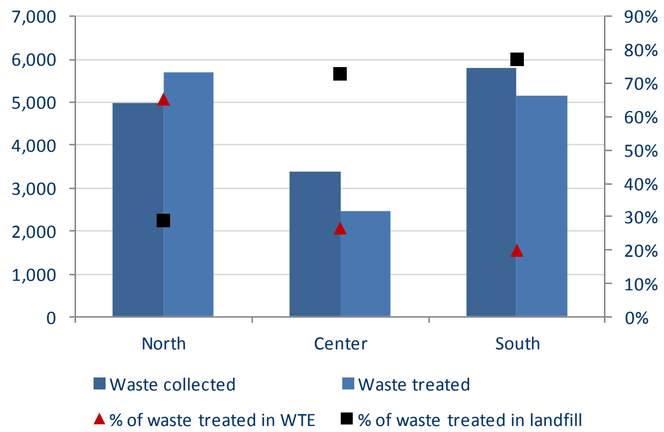
ARERA published in November the new regulation for the period 2018/21. It is a new WACC-based regulation that includes an allowed return of 6.3% (at the upper end of the range of the first consultation document of 5.6-6.3%). It also introduces standard costs (based on data from 2018 & 2019) and incentives to minimize use of landfills.

The chart below shows the number of waste incinerators in Italy, with a clear concentration in the Northern part of the country.

Italy – Number of waste incinerators (2017)

Source: ISPRA, Mediobanca Securities

Italy – Waste collected/treated by geography (ktons, 2017)



Source: ARERA, Mediobanca Securities

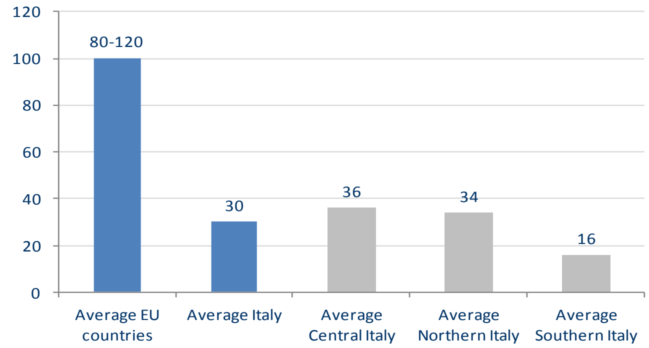
We believe that ARERA intends with this new regulatory scheme to improve the quality of the service, homogenize service and guarantee level of transparency. We also believe that the improvement in the regulation is a necessary step to create a virtuous circle that leads to higher investments and better service. Current EBITDA exposure to waste management of the largest local multi-utilities is the following: Hera (25% of EBITDA), A2A (25%), Iren (20%), & Acea (5%).

We also see large capex opportunity in **water.** We highlight that the level of investment per capita in Italy is much lower than that for other European countries, according to data provided by utility association Utilitalia. In addition, the level of investment is very low in Southern Italy, with higher investments in the northern part of the country.

This is also reflected in tariffs. Levels of tariffs in Italy's main cities are much lower vs other European cities. In addition, levels of losses for Italian networks vs France, Germany and the UK are higher, at 38-45% vs below 20% in other countries, confirming that there is a strong necessity to reduce the infrastructure gap. This is particularly true in Southern Italy, where loss levels can reach 50-60%.

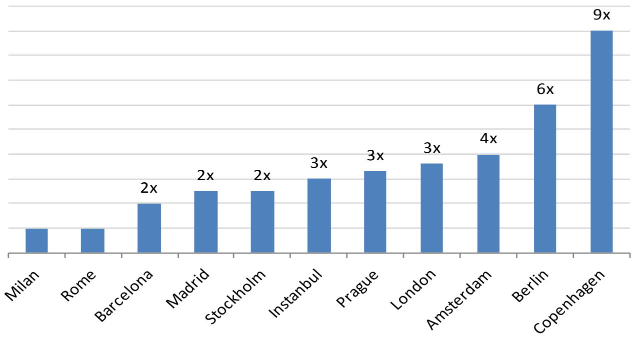
MEDIOBANCA SECURITIES

Water investment per capita: Italy vs the EU (€/inhabitant)



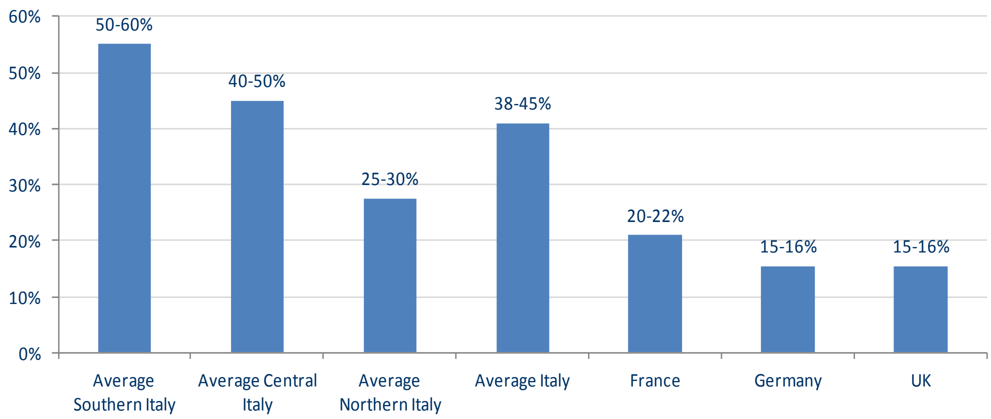
Source: Utilitalia 2017, Mediobanca Securities

Average water tariff in EU cities



Source: Utilitalia 2017, Mediobanca Securities

Average level of losses: Italy vs EU countries (%)



Source: Utilitalia 2017, Mediobanca Securities

ARERA published in December the final parameters to set the remuneration for the regulatory period 2020-23. The regulator has set the new WACC at 5.24% (marginally down from current 5.3% and towards the upper-end of the range proposed in the consultation document of 4.8-5.5%). The overall framework was maintained, and ARERA has introduced incentives related to the resiliency of the distribution network & potential gains from energy efficiency remains in hands of the operators.

This regulation should be instrumental to promote additional capex in the water distribution network, something that we believe should help to reduce of the system's losses and to reduce the so-called "Water Service Divide". The local multi-utilities with the higher exposure to water distribution are: Acea (45% of EBITDA), Hera (25%) and Iren (20%).

Discussion over the possible nationalization of the water business presented by M5S's member of Parliament Federica Daga suffered a strong delay during 2019. Il Sole 24 Ore published (8 December) that M5S's MP Federica Daga and PD's MP Chiara Braga may be working on a joint proposal for the water business that would be particularly focused on the need to increase investments in the South of Italy. The new proposal could be presented in January. The joint proposal should maintain the regulation of the sector in the hands of ARERA and remove the early termination of concessions to operators. For the South of Italy, it should include the creation of a public company (with public shareholders that may open also to private shareholders) that should accelerate the investment in Southern Italy and therefore reduce the current infrastructural gap.

Consolidation between local multi-utilities remains a key trend

Consolidation has been a recurrent theme in the sector for a long time. While the Madia Decrees are now an old story, we have assisted to several small-scale deals from local multi-utilities in their reference areas, that have moved on mainly due to sector trends rather than Government support.

Most of the deals happened in the waste sector and in the supply segment, due to the high fragmentation of these sectors and in the case of supply, due to the incoming liberalization of the market. One of the largest deals that have been reported by the press is the acquisition from the Italian infrastructure fund F2i and the Spanish Asterion of Sorgenia, one of the biggest Italian utility with 3GW of generation assets and c.270k retail clients. This deal has gone through a highly competitive process which has seen the interest also from Iren and A2A (in consortium with EPH).

Below we provide a recap of the main transactions completed by the largest local multi-utilities and possible deals at which they could be currently interested:

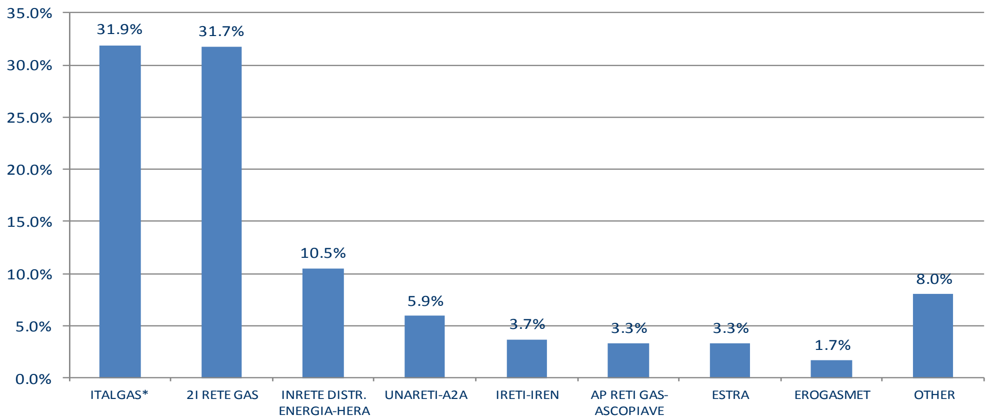
- **Hera (O)** announced in June 2019 to have reached an agreement with Ascopiave, that was one of the most awaited transactions in the sector. The partnership agreement included the acquisition from Hera of Ascopiave's retail clients (mostly gas) in exchange of Hera's gas distribution assets, paying a multiple of €790/client or c.11x EV/EBITDA. Furthermore, the company completed some acquisitions in the waste and supply segment, 4 of them in 2019 (CMV, Sangroservizi, Megas.Net and Blu Ranton);
- **A2A (N)** completed in October 2018 the tender offer on Acsm-Agam which has allowed the company to move forward with the project of the multi-utility in Lombardy region. This transaction has involved six utilities: Acsm-Agam, Aspem, Aevv, Acel Service, Aevv Energie and Lario Reti. Before that, A2A made another important acquisition in Lombardy which is the 51% of Linea Group Holding (a multi-utility in Southern Lombardy region). Besides these largest transactions, A2A recently signed an agreement with the utility of Lombardy AEB to explore a possible industrial partnership and also (Il Sole, 20 December) with the utilities in Veneto Agsm (Verona) and Aim (Vicenza).
- **Iren (O)** latest relevant acquisition was ACAM La Spezia, completed in December 2017 through a paper deal. However, the company has been very active on consolidation, buying small companies operating in the supply and waste business. At the latest business plan presentation, CEO Bianco said that the company was looking at also at mid-large opportunities, mentioning the interest in Sorgenia and CVA.
- **Acea (O)** has accelerated its consolidation process and mainly in the waste sector in Italy. In 2019 the company acquired 90% of Demap and 60% of Berg, operating in the waste treatment. It also acquired 65% stake in a portfolio of 18 PV plants of 20MW in Italy. In 2018, it has completed the acquisition of Pescara Gas Distribuzione, marking its first entry into the gas distribution segment.

Other key themes: Liberalization of supply market & gas auctions

There are other key themes for the sector that are under discussion at the Government and at the Regulator level, which are relevant for the competition of the sector:

- **Gas distribution tenders still suffering delays** - The consolidation of the gas distribution sector is a long-discussed theme and tenders for gas distribution concessions have been continuously delayed so far. The gas distribution market is still highly fragmented and the government has pushed for consolidation in order to create larger concessions that are called ATEM (or minimal territorial areas). Many concessions have already expired and are managed in a "*prorogatio regime*" by the current operator. The current legislative framework seeks to reduce the number of operators with the creation of 177 ATEMs. While the number of operators has been cut over time, there continue to be a considerable number (c.210 as of 2017). The main operator Italgas expects most of the tenders to happen mainly from 2022. So far, only two auctions have been awarded (Turin and Aosta Valley to Italgas) and the auction in Milan, which was won by A2A, has been annulled after a legal dispute with the other operator 2i Rete Gas.

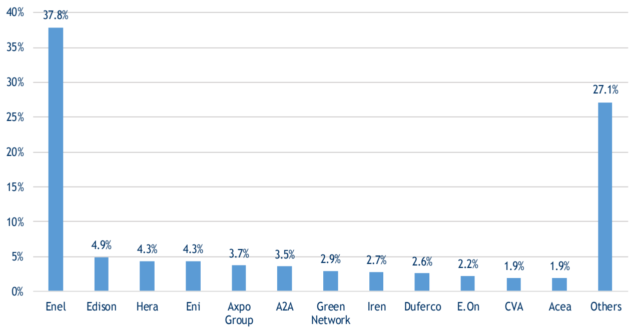
Market share in the Italian Gas Distribution Market



*Source: *Including Affiliates at 4.1%, Italgas presentation 2019/25 Business Plan, Mediobanca Securities*

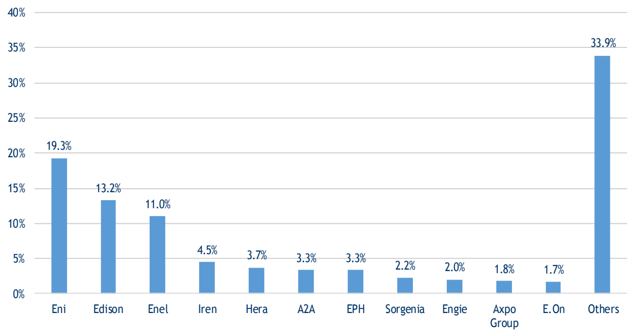
- **Full liberalization of the electricity market delayed to 2022** – With the publication of the Milleproroghe Decree, the full liberalisation of the electricity supply market has been officially delayed to January 2022 (from previous July 2020), two year later than initially planned. We believe that the full liberalisation of the electricity market should offer an opportunity for the local multi-utilities to increase their market shares in their areas of reference, taking market share from the incumbent (Enel), while margins should contract. The charts below show the market share of the main operators in the retail segment, both electricity and gas.

Italy – Electricity Supply – Market Share (2018)



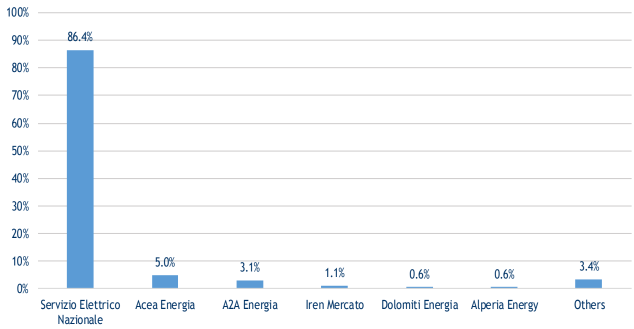
Source: ARERA Annual report

Italy – Gas Supply – Market Share (2018)



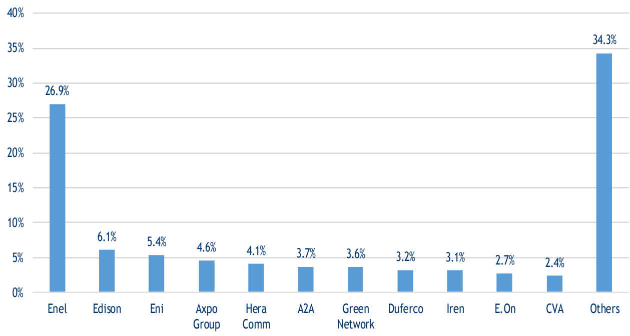
Source: ARERA Annual report

Electricity - Main players in the Protected segment (2018)



Source: ARERA Annual report

Electricity - Main players in the Liberalized segment (2018)



Source: ARERA Annual report

TRANSPORT INFRAS - FOCUS REMAINS ON REGULATION

Share prices of Italian transport infrastructure players rose, on average, ~25% in 2019 (vs. the 27% average for all European stocks), underperforming the market (+28%) but outperforming the Dow Jones Brookfield Europe Infrastructure index (+16%). While low interest rates were a tailwind for all, each company had its own specific drivers: Atlantia (+14%) traded mostly in line with the newsflow that was very volatile, ASTM (+59%) reduced the holding discount following the merger with SIAS, SIAS (+28%) was subject to a partial tender offer before being merged into ASTM, Enav (+27%) benefited from expectations of a favourable regulatory review and AdB (unchanged) reported strong fundamentals but remain subjects to unfavourable regulatory changes. Regulation was the dominant topic with strong interventions of ART in motorways and airports and the due regulatory review for Enav (positive) and Bologna Airport (negative).

At macro level, low interest rates and the new unconventional monetary measures announced by the ECB were on one hand certainly supportive, but on the other hand the proof of deteriorating growth prospects and weak inflation. As for traffic growth: i) motorways were weak (0.5% in 9M) due the economic slowdown; ii) airports remained healthy (4.0% in 11M) sustained once more by the low prices and new destinations offered by LCCs; iii) air navigation was again very strong (+6.6% in 11M) thanks to a best-in-class service quality. For 2020, we expect to see a deterioration of the operating leverage due to weak top line improvement with low traffic growth, downward pressure on tariffs and an increased focus on maintenance spending.

However, we believe that stocks' performance will be driven mostly by company-specific themes, in particular in motorways. We downgrade Atlantia to Neutral (TP €22.1) on the perception of a less attractive risk/reward profile that the stock offers and resume the coverage of ASTM with an Outperform rating (TP €32.9) as we find that the merger with SIAS strongly contributes to the creation of new international sector leader.

We confirm our positive stance on Enav as we think that the optimization of the capital structure may finally materialize and remain Neutral on Bologna Airport due to the limited upside the stock offers. With a totally different business model (concession catering) and North America representing 80% of its FY20 profits, Autogrill remains exposed to the expansionary phase of the US cycle.

Atlantia: Downgrade to Neutral on deteriorated risk/reward profile

We downgrade Atlantia to Neutral and cut our TP to €22.1 (7% upside) on the perception of a less attractive risk/reward profile that the stock offers given: i) the uncertainty surrounding the announced review of the ASPI concession; ii) new investigations started by the Court of Genoa on the noise barriers and maintenance works in the tunnels; iii) negative impact from the announced tariff cuts in the Liguria Region; iv) the persistent unrests in Chile; v) the increasing competition for new concessions, as shown by SIS' recent victory for the new contract for the A3 motorway; vi) the recent downgrades of Atlantia, ASPI and AdR by S&P and Moody's that may have a negative impact on the new financing; vii) the higher volatility of the stock with the 2H19 beta rising to 1.1 from the usual 0.7 range.

The Italian Government introduced with the Milleproroghe Decree new rules for the termination of motorway concessions imposing the book value as the indemnity to be paid in all cases and the immediate effectiveness of a potential ruling in this respect with the transfer of the asset to Anas. Although we recognize that the Decree still needs to be approved by the Parliament and that ASPI is negotiating an agreement with the authorities, as confirmed by ASPI's CEO Tomasi, we have no visibility on the outcome. On the other hand, we are less worried about the motorway sector review that the MIT intends to implement as, in our understanding, any change will be agreed, as confirmed by the MIT's request to all motorways impacted by the FY20 tariff freeze to submit a proposal for the update of the financial plan.

We also acknowledge that visibility may recover in the next few months following: i) ASPI's approval of the new FY20-23 business plan scheduled for next week, according to press; ii) a potential agreement with the Government on the review of the ASPI concession which may come by January 30, the deadline indicated by the press for the voluntary termination of the contract; iii) the conclusion of the investigations of the Genoa Court.

ASTM: The rise of a new international motorway leader

In a separate report published today, we resume the coverage of ASTM with an Outperform rating and a TP of €32.9. The new ASTM emerging from the merger with SIAS was born on 31 December 2019. We view positively the transaction as: i) it creates a single, larger, streamlined and more efficient company with the stock increasingly visible, liquid and attractive for international investors; ii) it combines the concession and EPC businesses under the same roof, thus facilitating synergies and making ASTM more competitive when bidding for new concessions or starting new projects, something that we find relevant in a persistently low interest rate environment where competition for brownfield assets from financial investors remains high.

We recognize that the newsflow on the sector has been unfavourable in the past quarters following the Morandi bridge collapse and the announced Government's intervention for a regulatory review. While the MIT intends to increase the competition, leave more risk on the operators, minimize toll increases and impose efficiency with the new tariff model elaborated by ART, we continue to believe that any change has to be the result of a negotiation with the concessionaires.

Following the merger with SIAS, ASTM is today stronger to compete at international level in both the concession and construction businesses, something that is materializing in Brazil with Ecorodovias and in the US with Halmar. Solid financial profile leaves the room to capture new opportunities such as the new concessions for the A5+A21 motorways (€1.9/sh additional value, MBe), for the A10-A12 motorways and, potentially, the acquisition of the control of Sitaf. By a market perspective, the new ASTM should raise its weight in the Ftse Italia Mid Cap from 2.1% to 3.8%, thus benefitting from the re-launch of the Individual Saving Plans.

Enav: Ready for capital structure optimization

We confirm our positive view on ENAV following Eurocontrol's preliminary ruling on the FY20 en-route tariff of €66.02/SU that was in line with our expectation of €66.0. While no details were provided on the regulatory framework for RP3, we believe that the outcome should not be distant from our assumption of 2.0% for the efficiency factor and 5.0% overperformance on the allowed cost base in RP2.

At the 3Q results ENAV reiterated the FY19 guidance of: i) revenue growth flat to low-single digit (MBe 1.2%); ii) EBITDA margin ~32%, defined as prudent (MBe 32.4%), down from 33.4% in FY18); iii) capex of ~€115-120m (MBe €117m); iv) dividend increase of 4% y/y (MBe 7.0%), in line with its dividend policy of 80% minimum of the normalized equity FCF (MBe 88%). Hiring of 100 junior employees was announced, although already included in the FY18-23 business plan; half in 4Q19 and half in early FY20. We adjust our FY19-21 estimates to include more negative balance revenues and slightly lower opex with a minimal impact on EPS (1.4% on average). However, we raise our TP to €5.9/sh as we shift our valuation to 2020-end.

Importantly, ENAV also opened to a review of the available options for the optimization of the capital structure once the regulatory review is completed. We continue to see ample room for a dividend increase, as ENAV is cash positive (FY19 NFP €33.1m, MBe) and we already factor in an annual 7% annual growth in FY19-22E. With valuation upside, no balance sheet constraint, dividend upside and no Brexit exposure, we believe ENAV remains an attractive investment case.

Autogrill: Outperform confirmed on profitability improvements and US exposure

We confirm our positive stance on Autogrill, as we think the stock should be sustained by favourable business and currency trends in the US. We also confirm our optimism about Autogrill's capability to continue to raise the profitability in FY20 (+40bps at EBITDA margin level) thanks to self-help initiatives sustaining top line growth and the benefit from the early retirement plan in Italy of FY18.

In this regard, we remind that at the 8M trading update the company fully confirmed the FY19 guidance: i) revenues of €5.0bn (MBe €4,981m); ii) underlying EBITDA in the €450-470m range (MBe €458.1m); iii) EPS in the €90-95c range (MBe €90c) including the €125.5m capital gain from the disposal of the Canadian motorways; iv) underlying EPS of €47c (MBe €46c). Labour cost inflation in the US was confirmed as the main headwind (7M average +4.6%), something that Autogrill continues to offset successfully with top-line growth, including pricing. In the international division, we expected full recovery to be achieved only in FY20. As we make no major changes to our FY19-21 estimates, we confirm the €11.9 TP. IRR implied in our new estimates is an attractive 9.0%. With the stock at 6.4x FY20 EV/EBITDA, Autogrill is trading at a discount of 11% to the concession catering sector and 27% to SSP, something that we find excessive.

Bologna: Regulatory changes may deteriorate strong fundamentals

Our unchanged cautious stance on Bologna Airport is essentially due to the regulatory risk and limited upside the stock offers to our TP of €12.4. As for the regulation, we remind that AdB's management explained at the 3Q results that ART approved the overall framework applied in the calculation of the FY20-23 final tariff proposal agreed with the air carriers, but requested some adjustments driving to a sharper decline in FY20 vs. the 5.4% we calculated as implicit in the final proposal and a small annual increase for the rest of RP2, while we expected a small decline of -1.1%. Consequently, our current estimates now factor in a 7.8% decline for the FY20 tariff and an average +0.2% increase in FY21-23. The management stated to be satisfied with the allowed remuneration rate given the overall environment, but no disclosure was given (MBe 7.11% real pre-tax, down from 8.90% in RP1). While no exact view was taken on ART's new model still under elaboration (see our note on 6 September *ART proposes to shift airports to a soft hybrid-till system*) that AdB will apply in FY24, we recognize that AdB should be impacted negatively as the new model penalizes operators paying high incentives to carriers and introduces a new efficiency factor already in the tariff formula.

On valuation, we see the current strong fundamentals mostly priced in the current share price and at risk of deterioration due to the new tariffs. As for the FY19 outlook, the company further raised in November its traffic guidance from >8% to ~10% confirming a slowdown in the last two months of the year (4.3% implicit), but said to expect a growth in the low single-digit range in FY20 (MBe +2.2%), including also a closure of the airport for a few days for works, as already happened in September 2018 (-100k pax in 4 days). Winter capacity is seen in line with last year and no expansion is expected for the summer capacity.

While we continue to believe that AdB is a well-managed company with a very solid track record and attractive opportunities for further growth ahead, we recognize that the less favourable regulatory review reduces the attractiveness of the investment case.

Regulation remains the key topic, in particular for motorways

Regulation remains the key topic in the sector, with entirely new models proposed for both motorways and airports.

Motorways: implementation of new ART's model has to be agreed

In regard to motorways the government that announced a revision of the entire sector already in mid-2019 aiming to increasing competition and efficiency in the sector. No details have been reported so far but both Ministers of Infrastructure – Toninelli (5S) first and De Micheli (PD) with the new government – stated that the new tariff model elaborated by ART (see our note on 25 February *ART proposes more efficiency for all motorways*) will be the starting point. Importantly, ART Chairman himself confirmed that the new implementation of the new model needs to be part of an agreed change of the concession contract. In our understanding, the key points of the new model are the following:

- It's a **RAB-based system** with the RAB given by the book value of the intangible assets;

- **Remuneration** agreed on past projects is confirmed if not subject to reviews. However, it remains unclear to us how it will be translated into the new formula. Proposed remuneration of 7.09% (for all motorways) includes an expected reduction vs. the previous review, but is above the latest rates outlined by ART in 2018 for Autobrennero (5.70%) and Autovie Venete (6.16%);
- **Negative traffic risk is entirely held by the concessionaire** rather than being externalized given the tollroad operator the right to recover the missing return on invested capital. On the contrary, positive risk is capped by the revenue sharing mechanism;
- **Business risk is mostly carried by the concessionaire** that has all the responsibility for any cost overrun. However, in case of unpredictable events, re-equilibrium of the financial plan may be requested;
- **An increase of productivity** is already included in the formula, therefore implying a lower regulated opex allowed in the calculation of the tariff increase. Such annual factor is determined by ART based on a benchmarking analysis on the historical data of the concessionaire and varies between 0.39% of the A6 Turin-Savona and 6.26% of the A56 Naples ringroad (2.22% for ASPI and 5.37% for SIAS' A4 Turin-Milan);
- It includes **adjustments** to factor in: i) the potential lower opex compared to the estimated amount due to delays in investment spending; ii) a minimum threshold for the quality of service in order to disincentives the opportunistic behaviour to cut opex; iii) the potential lower capex deployed compared to the agreed amount due to delays.

While most of the impacted operators appealed against the new model already during the consultation period in spring, the MIT confirmed its plan and explained that the FY20 tariff increases were frozen pending a review to be finalized in 1H. In particular, the plan would be to ask the concessionaires to submit a new proposal for the update of the expired financial plans by 30 March and to approve them by 30 June in order to apply the FY20 increase only for 2H.

While we have no visibility on the outcome of the negotiations for the revision of the contract, we continue to believe that the concessionaires would be open to accept changes as long as they are value neutral. A solution remains that of introducing terminal values to let operator reach the agreed remuneration, as recently happened in the case of SIAS' A4/A33 cross financing scheme (€880m for the A4 and ~€350m for the A33, MBe).

Airports: ART's competence over large airports is not self-evident

Regulatory changes have been proposed for airports as well. In particular, ART proposed a new model in September to be applied to small and mid-sized airports already under the supervision of ART and to the large airports (Rome, Milan and Venice) today regulated by ENAC. The new model looks to us less favourable than the current ones due to a soft shift from the dual-till of a hybrid-till system and to the inclusion of an efficiency factor in the formula (see our note on 6 September *ART proposes to shift airports to a soft hybrid-till system*). In our understanding, airports with higher utilization of the assets, developed commercial businesses and paying high incentives should be in principle those impacted the most. In particular, just the obligation to return extra-profits from the non-regulated business would have, in our calculation, a nil impact for Atlantia's AdR and an average 2.4% decline of the applicable tariff in RP3 FY24-28 for AdB. Moreover, AdR's legal framework looks solid to us as it explicitly states that the tariff discipline must be centred around a dual till regime.

The key change proposed by ART is the shift to a hybrid-till system from the currently predominant dual-till system. In particular, the perimeter of the regulated activities would include not only the core aviation business but also the commercial one since part of the extra-margin from the latter is deducted from the allowed cost base of the former in order to reduce the applicable tariffs. Therefore, the allowed return on the capital invested in the non-aviation business remains entirely to the operator and only part of the profit in excess of it is passed to the air carriers.

While AdB will apply this new model in the next regulatory period FY24-27, ART's proposed competence over large airports is not self-evident, in our understanding as: i) lacking Italy a transport authority, ENAC was authorized in 2009 to sign new contracts with the large airports in order to incentivize much needed capex spending and with rules valid for the entire duration of the concession; ii) ART confirms the principles of certainty and stability of the regulatory framework; iii) 3) law 37/2019 provided ART with the power to act as Independent Supervisory Authority over the *Contratti di Programma* between ENAC and the three major airports and over the concession contracts.

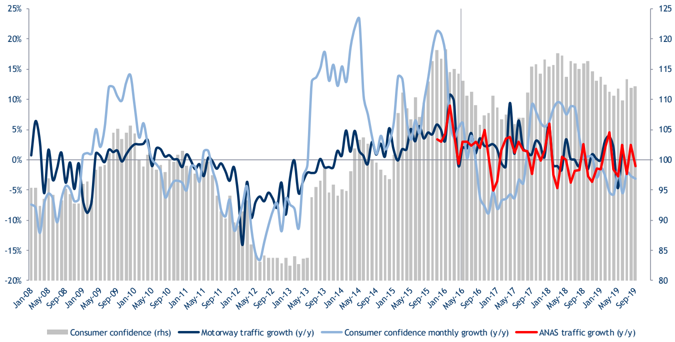
Air navigation services: RP3 framework as good as expected

As for air navigation services (ENAV), we remind that 2019 has seen the finalisation of the framework for the new regulatory period 2020-24 (RP3) but no exact details have been provided yet. However, in December Eurocontrol released the applicable tariffs as of 1 January for both the en-route and terminal navigation services. As for Italy, while the en-route tariff of €66.02/SU was in line with our estimate of €66.00, the terminal tariffs came was slightly below MBe. Eurocontrol explained that these tariffs are preliminary and may be changed once the regulatory review is completed in early 2020. No disclosure was provided on calculations. We positively view the applicable en-route tariff of €66.00/SU being in line with our estimates based on an efficiency target for RP3 of -2.0%, an outperformance on the real allowed cost base of 5.0% and a traffic volume of 10.5m SUs. Although the tariff announced is only preliminary, we assume Eurocontrol's calculation is based on the latest available data and therefore would not expect significant changes. As for the terminal tariffs, we remind that zone 1 and 2 are regulated by Eurocontrol through the application of efficiency targets; the figures below our estimates are a small negative as imply a lower allowed costs, something ENAV may comply with delivering further efficiencies. Finally, as for terminal zone 3, we remind that it's based on a cost-recovery mechanism; therefore, we would expect no impact on profitability from the tariff below MBe.

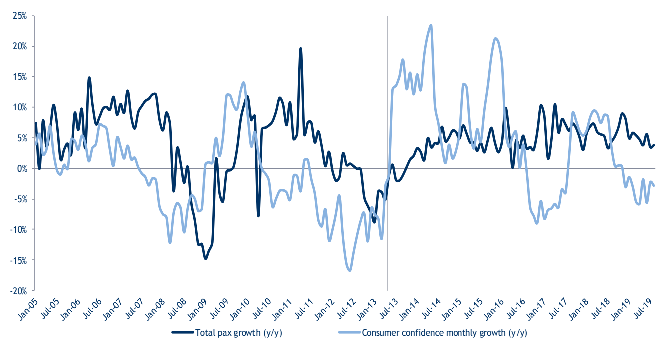
Traffic growth weakening on an unfavourable macro outlook

As regards traffic growth, the 0.5% growth for motorways in 9M19 (0.3% for ANAS in 11M) was broadly in line with the 0.4% of 2018 and below the 3.1% average for 2015-17 as a result, in our view, of the weakening macro momentum. Our assumption for FY20 of 1.0% is based on a 1.5x correlation with the 0.5% consensus estimate for GDP growth and a positive 0.3% impact from the leap year effect; Atlantia should benefit from the re-opening of the Polcevera bridge in Genoa, but could be negatively impacted by the traffic restrictions on several viaducts for safety reasons. ASTM will benefit from the consolidation of ATIVA (since December 2019).

Italian motorways and ANAS traffic growth, FY08-19



Italian air traffic growth, FY05-19



Source: Aiscat, Assaeroporti and Mediobanca Securities

As for air traffic, FY19 was another positive year, with passengers increasing 4.0% in 11M, sustained essentially by LCCs' adding capacity in all airports and FSCs increasing the offer on the long-haul routes. Among large airports, we highlight SEA-owned Milan Malpensa, with +17.3%, with the support also of FSCs. AdR's Fiumicino reported only +1.4%, but the outlook is encouraging with the expected re-launch of Alitalia. For the time being, we factor in 3.0% for both AdR and +3.5% for Bologna Airport.

In regard to ENAV, we highlight the strong performance of the en-route business (+6.6%), sustained by an improvement in free routing and despite lower jet fuel costs (-8%, on average, in FY19), which we view positively as it confirms the attractiveness of the Italian airspace thanks to the high quality of service.

Increased Government's focus on the sector, in particular on motorways

Transport infrastructure have been recently at the centre of the political debate and an area of direct intervention by the Government due to: i) assets are usually owned by the State and managed directly (i.e. railways) or through concession agreements (i.e. most of motorways, airports and ports); ii) transport services are essential for users; iii) investments in this sector sustain long-term economic growth and employment. The latest messages on the sector from the Government included in draft budget law are the following:

i) The **revision of the motorway concessions as a priority** for the government is confirmed, aiming to greater transparency and competitiveness and a better equilibrium between the interests of the public and of the private operators;

ii) **Airports were mentioned as a key asset** for a modern country;

iii) The government intends to **accelerate capex spending** for the upgrade of the assets and maintenance works for viaducts and tunnels along the ANAS network. Interestingly, the document highlighted the need of such upgrade due to the increase of traffic volumes and reminds the supervisory role of the MIT;

iv) **Investments in railways** will be also encouraged, as already envisaged by the business plan of the Italian Railway Network operator (RFI);

v) Overall, the strategy is to **incentivize investments in infrastructure** in general reducing the burocratic burden for the operators. In particular, several parts of the Contract Law will be changed in order to have a more certain and clear regulatory framework. The government also intends to utilize more efficiently the funds made available by the EU in order to re-launch the TEN-T corridors, in particular in the South.

On a separate note, we highlight that the political debate over motorway concessions has been very intense in 2019 following the collapse of the bridge in Genoa and the investigations on the alteration of safety reports by ASPI. With the Milleproroghe Decree at the end of December, new rules on the termination of concession contracts were introduced for all operators: i) an indemnity value in case of revocation equal to the book value and any other rule is null; ii) potential damages to the State in case of negligence would be deducted by the amount of the indemnity value; iii) the revocation is immediately effective with no need to pay the indemnity first; iv) the change of the legal framework imposed by the law-decree cannot trigger the voluntary termination of the concession by the operator; v) the immediate transfer to Anas of the management of the asset until a new concession is awarded. We remind that the Decree needs to be approved by the Parliament within 60 days to be valid.

Moreover, a report of the Court of Auditors in December drew an excessively favourable picture for the concessionaires and highlighted the need: i) to find a balance between return on capital and protection of public and consumer interests, in a context of effective implementation of the principles of competition and management efficiency; ii) to proceed with the rapid introduction of a tariff system that allows a return on invested capital, compatible with that of the market for investments of comparable risk and to accelerate the procedures for the tender of expired agreements; iii) for greater effectiveness of controls on the infrastructure network and verification of investments in order to overcome the inefficiencies found including rules excessively favourable for the operators, the length of procedures to award new concessions and the decline of investments; iv) of a more efficient intervention of the regulator, i.e. starting the tenders for new concessions before the old ones expire; v) of a clearer picture of the responsibilities between the different regulatory entities, such as the MIT and ART. Consequently, political leaders sustained from time to time the view of a stronger role of the State in the management of these companies.

The press suggested that the Government would be re-considering the separation between FS (Italian Railways) and ANAS and the latter to be acquired by CDP at a price of €2.5bn; ANAS would then increase its focus on greenfield projects thanks to the financing from CDP. In a second stage, these assets would be put in a vehicle to be opened to infrastructure funds, similarly to what happened with CDP Reti. Should this plan materialize, private operators may face more competition in winning new projects or in the auctions for new concessions.

M&A remains a key theme; ASTM the stock to monitor

Similarly, to the past few years, we see M&A to remain a relevant theme in the sector, sustained by strong FCF generation and persisting low interest rates, driven by a deterioration in the macro outlook and the expansionary monetary policies of the ECB. In 2019 we saw Abertis buying 50% of Mexican RCO for €1.5bn, ASTM buying a 5% of SIAS before the merger for ~€200m, SIAS acquiring stakes in ATIVA in Sitaf for ~€100m, Autogrill buying Pacific Gateway Group for ~€50m and selling the Canadian motorways for €170m and ENAV acquiring IDS for ~€50m.

Atlantia remains carefully observed, with a net debt/EBITDA ratio at 5.3x following the Abertis deal and RCO takeover. While we find the total amount of debt sustainable *per se*, we recognize that a revocation of the ASPI concession by the Government with the indemnity value reported by the press of €6-8bn is a risk as it would not be enough to entirely repay the net debt of €10.5bn with a potential default, as recently highlighted by ASPI's CEO Tomasi. Moreover, a potential deterioration of the FCFs from ASPI due to rising opex and an increasing cost of the new debt, following the downgrades by S&P and Moody's, make deleveraging a priority over the acquisition of new assets, in our view. Consequently, the speculative appeal of Getlink (Not Covered) and Bologna Airport (N) decreases. We remind the latter also has a pact comprising 46.5% of its shares.

On ASTM, the focus remains on the potential consolidation of Ecorodovias. According to press, the trigger would be the addition of new concessions (the Brazilian government announced 9 auctions in 2020) with an initial capital commitment requiring a capital increase of potentially BRL 1.5-2.0bn. We calculate that a minimal capital increase of BRL 300m would be enough to reach control, should ASTM subscribe Primav's portion in full; FY20 net debt / EBITDA would increase from 1.8x to 2.4x.

Autogrill also remains active confirming its interest for small/mid-size delays both on the acquisition and on the disposal front.

As for the rest of the sector, we remind the press reports at the end of the summer suggesting that SEA (Milan airports) and Sacbo (Bergamo airport) would be again in talks on a potential merger. The local Chamber of Commerce would apparently be eyeing a sale of its controlling stake of Catania Airport.

OIL - MACRO: BALANCE BETWEEN DEMAND RISKS AND RIG COUNT; DEPRESSED REFINING MARGINS

Our view on oil prices remain unchanged, as we expect Brent to average US$65/bl in 2020. Concerns around a potential negative impact of the macro slow-down on oil demand are likely to exert some pressure on oil prices in the short-term. The ever-more important energy transition theme is also likely to exacerbate the already negative sentiment, adding new uncertainty on whether oil demand could continue to grow into the end of next decade. However, when we look at 2020, we believe that the supply-side is likely to emerge as the key overriding factor determining the fate of oil prices.

Across North America, a fast-declining US rig count could lead to lower than expected growth rates in US crude oil production, which could potentially turn negative by the end of 2020. This could provide a significant boost to the oil price outlook, leading to a much tighter oil supply/demand balance next year. Geopolitical factors could also represent a meaningful driver for oil prices in 2020, in light of the recently increased tensions in Middle East. However, as we expect a de-escalation between US and Iran, we also assume geopolitical risk premium to reduce during 2020.

Within this context, we favour Saipem (OP), which should benefit from relatively stable oil prices, and a revival of offshore capex spending, which has been significantly depressed in recent years. We also believe that Saipem is well-place to capture the growth in the offshore renewables business, as wind farms are now approaching a size that allows them to compete with the economics of Oil&Gas projects once adjusted for execution risk. We also believe ENI (OP) could benefit from stable oil prices, given its attractive production growth outlook. Its sector-leading efforts to reduce CO2 emission in the Upstream should make the group one of the favourite Energy companies for ESG investors.

Instead, we believe Tenaris (N) should continue to suffer from reduced investment plans in North America, which are likely to continue into 2020; and from the political uncertainty in Argentina. In addition, we believe consensus downgrades are likely for Saras (N), given the depressed outlook for refining margins. We believe this is mainly driven by weak demand in China, which comes with an increased supply following the start-up of two major downstream plants in the country.

Lower US Production; Depressed refining margins

- **EIA expend a global oil oversupply in 2020:** With its most recent Short-Term Energy Outlook (STEO), the EIA marginally downgraded its 2019 oil demand growth expectations to 0.7% y/y (vs. 0.8% previously). As a result, the Administration now sees marginal oversupply of 0.11m bl/d in 2019 (vs. -0.04m bl/d previously). However, following OPEC's decision to deepen production cuts in effect from 1 Jan 2020, EIA now assumes that OPEC will limit its production levels throughout 2020. Hence, the EIA reduced its global oil oversupply estimate for 2020 to 0.14m bl/d (vs 0.30m bl/d previously), while marginally increasing its 2020 Brent forecast by 0.7% to US$60.51/bl. This is also based on global oil demand growth estimate unchanged at 1.4% y/y, and on an average OPEC production of 29.2m bl/d in 2020. We believe this should represent good news for oil prices, and the wider Energy sector.

- **OPEC helps clearing oversupply:** OPEC+ recently announced its intention to implement new production cuts of 0.5m bl/d, in addition to the 1.2m bl announced at the end of 2018. The core OPEC countries are expected to share 0.37m bl/d of cuts, while other non-OPEC producers will reduce their output by an extra 0.13m bl/d. In addition to this, Saudi announced that it will continue to implement an additional voluntary production curtailment of 0.4m bl/d, pushing the total output cut from the OPEC+ group to 2.1m bl/d. This represents one of the sector's deepest output reduction in decades. As such, the Kingdom is likely to produce 9.7m bl from the start of 2020, which represents a 0.3m bl/d reduction from the

November levels, and 0.1m bl/d from its 2019 average. This compares to a previous quota of 10.3m bl/d. Saudi Arabia suggested that its willingness to reduce the output below its quota remains subjected to other members achieving a 100%. This assurance was provided by an unusual presence of the Iraqi and Nigerian Oil Ministers at the OPEC+ press conference, stating that by year-end their respective countries will finally comply with their given quotas. We believe that the new production agreement by OPEC+ sufficiently address the oversupply expected in 2020, as it will imply a reduction in OPEC output level to 29.1m bl/d in 2020, down from 29.8m bl/d forecast in 2019.

- **US production expected to grow by 1.4m bl/d into YE20:** EIA currently forecasts US crude oil production to increase by 1.3m bl/d and 0.9m bl/d in 2019 and 2020 respectively; to 12.3m bl/d and 13.2m bl/d. This compares to an average crude oil production of 9.4m bl/d in 2017. This also means that US production will increase 1.4m bl/d between October 2019 and December 2020 based on EIA projections, which also appears too optimistic to us, given the reduction in drilling activities.

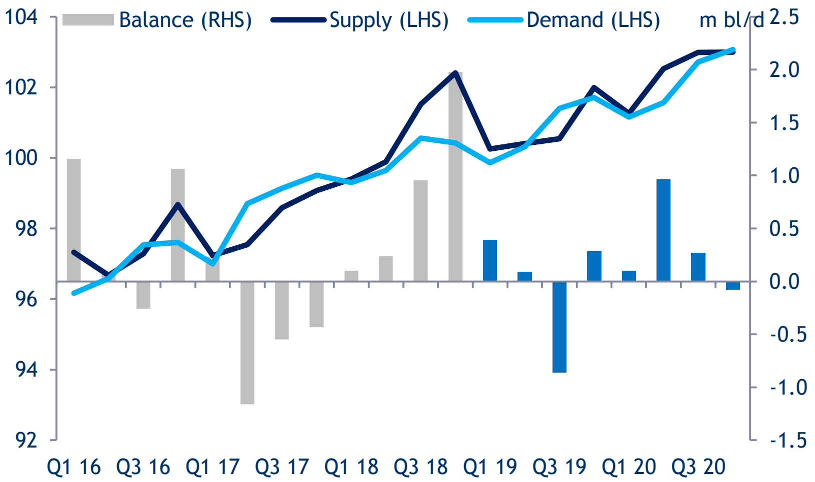
- **Lower rig count represents downside risk to EIA forecasts:** The Baker Hughes weekly rig count continues to point to a significant reduction in drilling activities across the US, falling to the lowest level since April 2017. Since the start of the year, the US rig count declined by over 300 (c.30%), due to a combination of factors including lower oil prices, bottleneck issues in the Permian and an increased focus of small operators towards free cash flow rather than volumes growth. The decline is even more marked in the gas rig count, which fell by c. 30% year-to-date. We believe that such a marked reduction in drilling activities is likely to have a meaningful impact on US crude oil production levels, since underlying decline rates of new wells brought on-stream in the Permian are currently above 70% per year. However, we are also mindful that there is a large stock of well that have already been drilled but not yet completed (DUC), which require little incremental capex to produce oil. Although DUCs can delay the negative impact of a lower rig count on production growth rates, the number of DUCs, which relentlessly increased across the US, started to decline in recent months, and we expect this trend to accelerate.

- **Parent-child issues could also support oil prices:** Concho Resources (n/c), one of the largest Permian independent players fell by more than 30% after highlighting production issues in July 2019 that forced the company to review its growth forecasts for 2019. Although the group’s FY19 production guidance was only marginally revised down to 22%-26%, from 23%-27% previously, it flagged critical problems at its key “Dominator” project. This is where Parent-Child spacing was determined to be 50% too close, meaning that wells drilled at a later stage, interfered with existing wells, leading to an overall decline in productivity. We believe this could also raise doubts around the strong production growth rates seen in the Permian, which could ultimately lead a tighter global oil supply-demand balance, thus supporting oil prices.

- **Unpredictability of geopolitical risk:** Geopolitical risk could represent an even more powerful factor in the oil supply and demand calculations. As we witnessed in early 2020 and in September 2019, escalation of tension in the Middle East could lead to extreme volatility in oil prices. Yet, despite an almost unprecedented attack to Saudi Arabia oil facility, oil prices erased their geopolitical risk premium within days. A ballistic missile strike against US bases also only briefly pushed Brent prices above US$70/bl. As we expect a de-escalation of the tensions between US and Iran, we do not embed any risk premium in our oil price assumptions for 2020. Another important factor that could alter the supply/demand equation is a potential lifting of the US sanctions against Iran, which had the effect of reducing the country’s oil production by 1.7m bl/d to 2.1m bl/d in September 2019. Should the Iranian barrels come back to market, it could lead to material increase in global oil inventories, unless offset by lower production from fellow OPEC members. Yet, this appears unlikely in the short-term after recent events.

- **IMO boost to refining margins…:** Complex refineries able to process heavier crude oil into the new lower-sulphur compliant fuel oil are likely to materially benefit from the new IMO 2020 regulations. These will be introduced on 1 January 2020, and mandate ship owners to switch from fuel oil with a 3.5% content in sulphur to a cleaner one with a much lower sulphur content of 0.5%, which is likely to demand a material premium. Although the volume sold of the new compliant fuel are still relatively low, early indications suggest that the new 0.5% compliant fuel oil could trade at a large premium of $250-280/ton or >€30/bl vs. its "dirtier" predecessor. This means that the new fuel oil crack-spreads could trade close to the more valuable diesel. This implies a positive crack spread of US$5-10/bl for the new fuel oil, up from negative US$30-35/bl for the non-compliant fuel oil.
- **…but diesel and gasoline are now under pressure:** The benchmark refining margin compiled by Saras (EMC) experienced a significant decline in recent weeks, falling to negative US$3/bl, down from US$5/bl at the start of October. Some of the recent weakness could be explained by extreme depressed levels of the high-sulphur fuel oil. However, this is only part of the story, since Saras estimates the distortive effect at just negative US$1.5/bl. We believe diesel cracks also contributed significantly to the lower EMC, which in turn are driven by a combination of weaker demand in SE Asia, and new supply, which came online in 2020.
- **Petchem margin are also recovering:** Demand in the petrochemical industry is highly correlated with the global economic activity. Historically, petchem product consumptions grew 1.3-1.4x the global GDP growth rate. As such, the negative revision global GDP forecasts seen during 2019 had a material impact on demand for petchem products, which translated into weaker petchem margins. However, ever since bottoming mid-2019, petchem product prices in particular ethylene cracks spreads significantly improved vs. ethane given the weakness in gas prices witnessed globally. In longer-term, IEA estimates growth in primary petrochemicals demand to remain healthy at c.3% CAGR between 2020-30.
- **Gradual increase in Oil&Gas capex:** We believe the Oil&Gas sector is witnessing gradual recovery in Oil&Gas activities, which are likely to underpin the order intake of European Oil Services in the coming months. Our analysis of consensus estimates for the largest 100 listed companies shows that global capex is likely to increase 5% in 2019 (although this is down from 7% expected in June-19), and by a further 3% in 2020. A number of large awarded are likely to be sanctioned in coming months, including Nigeria LNG, and Mamba subsea (Mozambique), Limbayong (Malaysia), Jafurah (Saudi A.), Liza Phase 3 (Guyana). In addition, the international offshore rig count is also improving, as it increased by 30% after bottoming out at the end of 2017. We believe this also provides further evidence of the gradual recovery in the offshore.

Figure 1: EIA forecast global oil supply to overshoot demand in 2020



Source: EIA, Mediobanca Securities

Change in ratings and estimates

SARAS, Downgrade to Neutral: Global refining margins are currently weaker than what we had anticipated, which we believe could lead to significant revisions in FY20 consensus estimates for Saras. Diesel crack spreads only marginally recovered from the recent unexpected weakness. Our confidence in a further progression in middle distillates prices remains limited, given the slowdown in economic activities in SE Asia, which comes with an increase in supply, following the start-up of new mega-refining plants. As such, the well-known adage of a supportive IMO could may not play a key role in supporting middle distillates cracks going forward. In addition, the EMC could come under more pressure from gasoline prices, which show strong negative seasonality, while recent geopolitical events raise the likelihood of higher oil prices. Finally, Saras is likely to have sizeable maintenance in H1 20, which could cap its premium over the EMC. All this leads us to review our 2020 refining margins assumptions, and our Target Price down to €1.65/sh from €2.05/sh. On our new numbers, we see Saras trading on PE of 7.7x in FY20. But, with only 15% potential upside to our new TP, we see our investment case for Saras losing its shine. As such, we downgraded our rating to Neutral from Outperform.

SARAS - Mediobanca New vs Old estimates

		New est.			vs. old			Old est.	
	FY19	FY20	FY21	FY19	FY20	FY21	FY19	FY20	FY21
	EURm	EURm	EURm	%	%	%	EURm	EURm	EURm
Comp. EBITDA	319	534	298	-10%	-18%	-29%	353	648	420
Comp. EBIT	129	344	158	-21%	-26%	-45%	164	465	287
Adj. Net Income	51	177	102	-35%	-34%	-46%	78	267	188

Source: Mediobanca Securities

TENARIS, TP down 2% Neutral maintained: We believe that the ongoing reduction in drilling activities across North America will continue to represent a headwind for Tenaris, as the rig count is often used as proxy for its sale of OCTG. Such reduction is also in part driven by the presence of large number of wells that have been already drilled but not yet completed (DUCs), which require little additional capital expenditures to be brought on-stream. North America represented 50% of the group's FY18 revenues, and its exposure to this region is likely to increase during FY20, following the acquisition of IPSCO. As we adopt more conservative assumptions for the US market, we reduced our FY19-20 EBITDA estimates by 1-5%, while increase our FY21 estimate by 7%, as we expect IPSCO to become accretive, helped by a recovery in the US rig count. As such, we marginally reduced our Target Price by 2% down to €10.3/sh, which implies a limited potential upside. Therefore, we maintain our Neutral rating.

TENARIS - Mediobanca New vs Old estimates

		New est			vs. old			Old est	
	FY19	FY20	FY21	FY19	FY20	FY21	FY19	FY20	FY21
	US$ bn	US$ bn	US$ bn	%	%	%	US$ bn	US$ bn	US$ bn
Selling price	2,116	2,028	2,097	-1%	-3%	-1%	2,127	2,090	2,123
Volumes	3,250	3,618	3,825	1%	10%	11%	3,230	3,300	3,450
Net sales	7.29	7.76	8.45	0%	6%	9%	7.28	7.35	7.78
Adj. EBITDA	1.40	1.45	1.74	-1%	-5%	7%	1.41	1.52	1.64
Adj. Net Income	0.76	0.78	1.00	-3%	-11%	4%	0.78	0.88	0.96

Source: Mediobanca Securities

MAIRE, TP down 5% Outperform re-iterated: Maire's latest quarter was a terrible one for the group. Q3 revenues came in 20% below expectations, with order intake at the lowest level in two years. Yet, we believe that not all is lost. Despite the revenue miss, management reiterated its previous EBITDA, and more importantly, its YE19 net cash guidance. We believe this should reassure investors about potential execution issues, following a large working capital build recorded during H1 19. We also think that the recent revenues miss may be just a temporary hiccup, rather than a sign of more structural downtrend. As such, we continue to believe that this stock remains a compelling idea for investors looking to gain exposure to the strong growth trends in the Downstream sector, and in particular across the Petrochemicals, which should witness a 3% CAGR in 2020-30 (IEA). In addition, we believe Maire is also well placed to capture a new wave of investments in UAE, North America and FSU, which are key markets for the group. As we tweak our forecasts, we increased our FY19 EPS estimate by 3%, but reduced our FY20/21 estimates by 3-6%, as we now forecast slightly weaker revenues. As such, we reduced our Target Price by 5% to €3.6/sh, from €3.8/sh Yet, this still implies over 40% potential upside. As the stock already trades at a 50% discount vs. peers, we re-iterate our Outperform rating.

MAIRE - Mediobanca New vs Old estimates

		MB New			vs. Old			MB Old	
	FY19	FY20	FY21	FY19	FY20	FY21	FY19	FY20	FY21
	€ bn	€ bn	€ bn	%	%	%	€ bn	€ bn	€ bn
Revenues	3.4	3.6	3.8	-2%	-4%	-1%	3.4	3.8	3.8
EBITDA	0.23	0.22	0.23	7%	-2%	2%	0.22	0.23	0.23
Adj. Net Income	0.11	0.11	0.12	3%	-6%	-3%	0.11	0.11	0.12

Source: Mediobanca Securities

TMT - IMPROVING OUTLOOK FOR THE MOBILE BUSINESS; ON-GOING NETWORK SHARING PROCESS; MACRO HEADWINDS TO AFFECT ADVERTISING TRENDS

We anticipate less challenging competitive dynamics in 2020 for mobile business. The ongoing increase in tariffs will bring good news for Tier1 operators, as a nice increase in mobile ARPU could come, and this could pave the way for an inflection point in the mobile service revenues trend. Competition on fixed-line business is ongoing, and we anticipate in 2020 also Sky will launch its fixed-line business, leveraging on its Pay-TV customer base.

Discussions over the setup of a single fiber network are ongoing: joint efforts in ultra BB deployment (public and private) could speed up the process (and save money), which would be good news for TI and Open Fiber, as well as for the country, in our view. Governance and valuation represent the key topics to be discussed and are crucial to achieving a deal that could unlock significant value for the parties involved, if properly implemented.

2019 has been an intense year for the EU towers on the M&A side. When looking at 2020, we believe it's fair to argue operators will focus in Italy in implementing announced deals, while we see consolidation in the broadcasting towers as likely once finally more colour on the re-farming process will be provided. In Europe another sparkling year is just around the corner, as several towers' portfolio will likely join the market: Vodafone, CK Hutchison and eventually DT and Orange. The deal announced by CLNX in Portugal on the 2nd of January is backing our view.

On the advertising side, a subdued growth in 2020 remains a key reason of concern, especially if the coming months will confirm weaker trends in global and Italian GDP, with particular focus on domestic consumptions. Hence we believe next year's trend for national advertising collection would not be that different, with sport events (2020 Olympic Games and Euro Cup) eventually providing some support.

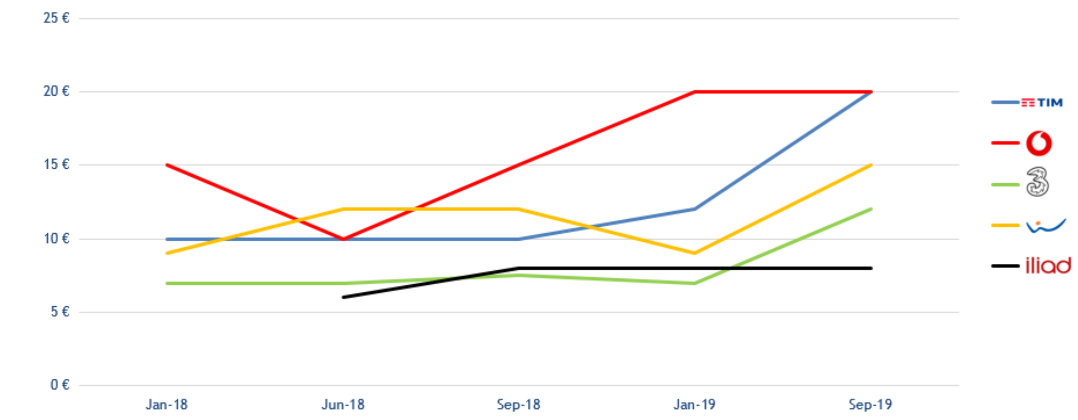
The mix of less competitive market dynamics, potential catalysts (TI's CMD set for March 11 in Milan) leads us to reiterate our preference for the telecom sector (Telecom Italia) vs media and towers (we move rating on GEDI, MN and RWAY to N from O, to cash in our calls and given limited upside to fundamentals).

Mobile competition is cooling down

We anticipate less challenging competitive dynamics in 2020, following several quarters of high pressure on tariffs. Some encouraging signals materialized this summer when domestic press anticipated that mobile tariffs increased from €8.78/month to current €11.68/month, implying 33.7% increase, citing as a source a survey from *SOS tariffe*. The increase would be 55.7% yoy (€13.71/month) when considering Tier1 operators only: Wind Tre, Tim and Vodafone. At the same time, the operators have increased the traffic offered in the plans, from 18.56Gb/month to 38.46Gb/month (107% yoy).

We performed a survey as well on most popular offers between Italian mobile operators and the results confirms the price recovery trend is ongoing for all the operators, but Iliad. TIM and Vodafone have visibly increased their entry tariffs to c. €20 (from €10) and c. €20 (from c. €15), respectively. Wind and Tre are also increasing prices, confirming a more aggressive stance. Yet, below-the-line market remains competitive (with particular reference for win-back promotions), but we see this update as pretty encouraging.

Most popular offer tariffs evolution Italian mobile operators

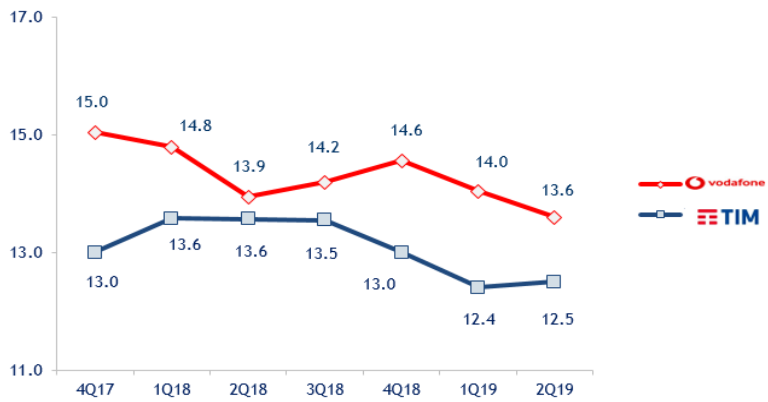


Source: Mediobanca Securities

In its quarterly release published on 16 October, Agcom confirmed that TI is still the market leader in the sector: TIM, Vodafone and Wind Tre market shares were 30.3% (i.e. 31.6m lines), 29.0% (i.e. 30.3m lines) and 28.5% (29.7m lines), respectively. SIM with data stood at 53.4m (vs 54.6m at the end of the previous quarter) and the average data usage at 5.85GB/month (vs 5.44GB/month in 1Q19).

We think an increase in tariffs will bring good news for Tier1 operator in the last part of the year, as a nice increase in mobile ARPU could come, and this could pave the way for a turning point in the mobile service revenues trend.

TIM-VODAFONE mobile ARPU evolution



Source: Mediobanca Securities, Companies websites

A single fiber network to speed up ultra BB deployment

In June 2019 TI informed it has signed a NDA with Cassa Depositi e Prestiti (CDP) and Enel aimed at starting discussions to evaluate possible forms of integration between TIM's and Open Fiber's fibre optic networks, including corporate operations. Enel also confirmed negotiations in a statement. This update follows the NDA signed back in February by TI and Open Fiber.

The Italian Government has endorsed the implementation of a single fixed-line network: Stefano Patuanelli, Minister for Economic Development, confirmed at a hearing in the Lower House the support to unique fiber network, which will bring benefits over the current situation. He also remarked the role of the State in the infrastructure must be central, adding a majority stake in the potential newco is not needed. Also, the Minister for Innovation Paola Pisano has remarked that infrastructure duplication isn't a convenient solution from an economic standpoint, confirming the Government is eyeing the dossier. Finally, the Undersecretary to Economic Development Stefano Buffagni reiterated Government's support for a single network.

Press coverage on the topic has been intense in recent months:

- On 3 August *Il Sole 24 Ore* flagged option of having an infrastructure fund securing the 50% stake owned by Enel in Open Fiber, as an option to facilitate a deal.

- On 18 October, the financial daily *MF* reported today that TI and Open Fiber have intensified talks to find an agreement on how to implement the single network project. The article reports several funds have an interest for the dossier, flagging ongoing discussions over the valuation (flagging a narrower range, €4bn to €6bn for OF) and governance (with TI reported to have interest on maintaining a controlling stake).

- On 21 October, Rome-based daily newspaper *Il Messaggero* reported fifteen infra funds have received a confidentiality agreement, including Macquarie, Ardian and F2i, which can be the leader of investors group. Under the new scheme, a consortium of funds could secure the full control of Open Fiber, for an amount between €3bn and €4bn. After that, CDP may increase its stake in TI to 12% and OF may be integrated with Flash Fiber (where TI has an 80% stake, with the remaining 20% owned by Fastweb).

- On 25 October *Reuters* reported that more than a dozen of Tier1 infra and sovereign wealth investors including Ardian, Brookfield, GIC and Macquarie have signed or are considering signing NDA agreements to prepare bids for a stake in Open Fiber. The article adds the funds are expected to discuss initial proposals for a possible investment before Christmas but any formal bids will only come next year, adding that the process was only expected to gain traction once the final structure had been clarified. Finally, *Reuters* reports people familiar with the matter have said a whole series of options are under review ranging from investment funds buying all of Open Fiber and then folding in TI's fiber business to TI and an investment fund, or funds, taking minority stakes of up to 49% each.

- On 29 October, *MF* reported TI has started selections to appoint a financial partner for the acquisition of Open Fiber. The new partner should allow TI to avoid potential Antitrust issues in grey areas. Debate is now focusing on the new governance, with particular reference to the control of the new entity. The article flags potential interest from Antin, Allianz Capital, Ardian, GIC and Macquarie.

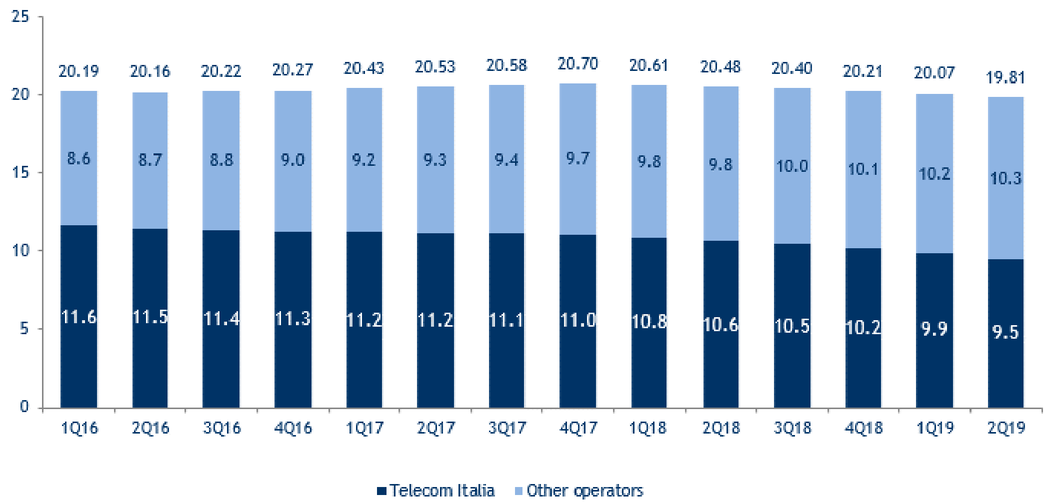
- On 5 December, press reported statements from Luigi Gubitosi, CEO at TI, saying plan to combine co. fiber's network with Open Fiber makes sense and should proceed, as creating a single fiber network is the most efficient way to have a modern infrastructure for the country. Mr Gubitosi criticised Open Fiber for being slow to roll out its fast fibre network and of building "fibre to nowhere", adding public data showed delays in rolling out fibre to so-called economically non-viable areas in Italy had risen despite the use of €1.5bn of public funding. In the same day, Open Fiber said in a statement a plan to tie up TI with Open Fiber to create a single fiber network in Italy is "*neither favoured by other players nor consistent with competition principles*".

- On 16 December, *Il Sole 24 Ore* confirmed a short-list of infra funds interested in the TI-Open Fiber dossier will come by mid-January, confirming interest for F2i, KKR, Allianz Capital. With debate on governance ongoing, a plan B for TI could be represented by a network spin-off, with infra funds entering the capital of the newco trough a dedicated capital increase

Joint efforts in fiber deployment (public and private) could speed up the process (and save money), which would be good news for TI and Open Fiber, as well as for the country, in our view. Governance and valuation represent the key topics to be discussed and are crucial to achieving a deal that could unlock significant value, if properly implemented. Competition on fixed-line business is ongoing, and we anticipate in 2020 also Sky will launch its fixed-line business, leveraging on its Pay-TB customer base.

In the meantime, on 18 October the Italian TLC regulator AGCOM published its quarterly update on the Italian telecom sector up to June 2019: data confirms BB penetration is speeding up. TI is by far the leading player with 48.1% market share but lost more than 300k lines (or 1ppt) qoq, followed by the second leading player Vodafone with a 14.7% market share (0.2 ppt up qoq); Wind Tre at 13.5% (+0.3 ppt qoq) and Fastweb at 13.6% (+0.5 ppt qoq). Smaller operators are almost flat comparing to the previous quarter and are still below 10% on an aggregate basis.

Italian market: Fixed line access (m)



Source: Mediobanca Securities

Broadband lines increased by 120k qoq in 2Q19 to 17.16m. We believe it is worth flagging two different trends within broadband lines accesses: ADSL is decreasing (330k lines qoq, now at 7.59m), while other technologies are increasing by 450k accesses in the quarter. As of June '19, TI's market share is 43.2%; Vodafone's 16.3%; Fastweb's 15.1% and Wind Tre's 14.1%.

Fast broadband lines with speed >10Mbps reached ca.78% (+04 ppt qoq) of broadband accesses as of June 2019. Interesting to note, fast connections increased in 2Q19: BB among 30 and 100 Mbit/s grew up 60k and above 100 Mbit/s increased 300k, (while the remaining ones decreased by 250kt) and now accounts for respectively 28% and 22% (up 2 ppt qoq) of all broadband access.

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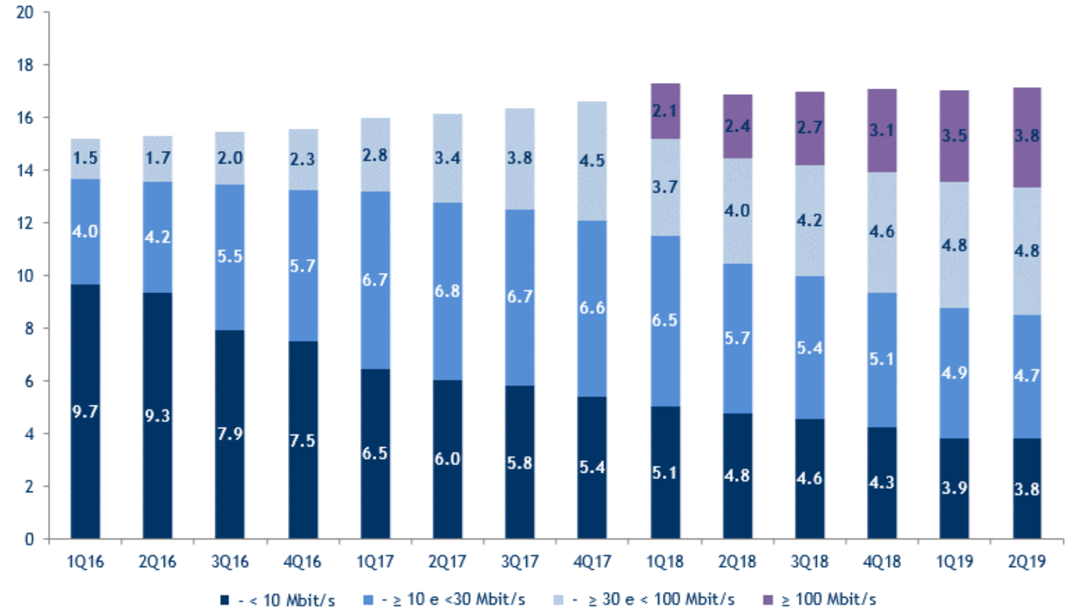
Italian market: Broadband access lines (m)



Source: Mediobanca Securities

European towers consolidation ongoing, Italy at the forefront

2019 was a turning point for EU towers as the long-awaited process of separation of telcos from their network infrastructure accelerated. As a consequence, consolidation in the space revamped, with Cellnex taking the lion's share in Europe and Inwit implementing a transformational deal that allowed the company to double its size and becoming the market leader in the domestic market. **When looking at 2020, we believe it's fair to argue operators will focus in Italy in implementing announced deals, while we see consolidation in the broadcasting towers as likely once finally more colour on the re-farming process will be provided. In Europe another sparkling year is just around the corner, as several towers' portfolio will likely join the market: Vodafone, CK Hutchison and eventually DT and Orange.**

In line with our expectations, the simultaneous occurrence of the 5G revolution and the increasing strategic need for MNOs to divest passive infrastructure as an option to free up financial sources translated into an EU towers market becoming even more relevant, and the trend is set to continue in 2020.

On 26 July, Vodafone announced the setup of Europe's largest Tower Company: 61.7k sites across 10 countries, €1.7bn revenues, €900m EBITDA, €200m Capex (including maintenance and expansion). The group anticipated it will be an independent company, with a dedicated management and it should be operative from May 2020. Vodafone announced the intention to monetize a substantial proportion of the TowerCo over the next eighteen months, presenting three strategic options:

- Selling a minority stake to large investors,
- Selling a minority or majority stakes at an individual country level, and/or
- Considering a potential IPO.

Vodafone CEO Nick Read confirmed the control of towers infrastructure is a strategic priority for the British company.

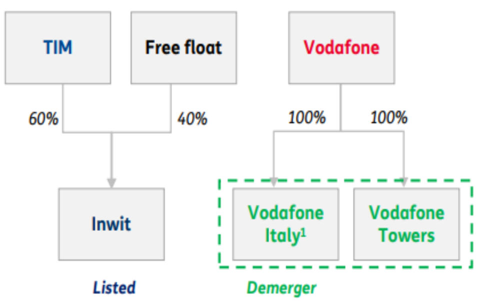
Vodafone Towers by geography

Source: Mediobanca Securities, Company presentation

On 26 July 2019 TIM and Vodafone announced in a joint press release the signature of the agreement to extend their existing passive network sharing agreement with INWIT and for an active mobile network sharing partnership. The companies will combine their respective passive networks within INWIT, which will encompass 22k towers, hence becoming the biggest independent Italian tower company and the second largest in Europe. TIM and Vodafone will result in having equal stakes (37.5% each, with the option of reducing the stakes down to 25%) and equal government rights on INWIT.

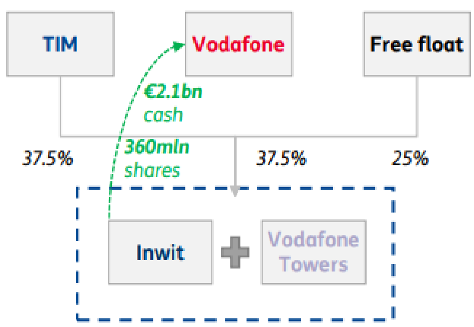
The companies will also cooperate on the joint roll-out of active 5G in cities up to 100k inhabitants, ensuring a broader roll-out of the technology leveraging on an efficient cost structure. Vodafone and TIM intend to upgrade their respective mobile transmission networks, adding higher-capacity optical fibre cables ("Fiber-to-the-Site" or "backhauling"). The transaction is subject to approval by INWIT's non-controlling shareholders at a general meeting (the so-called whitewash procedure) and does not involve a public tender offer for INWIT's shares. The combination should be completed in the first half of the 2020.

Step 1: Set- up Vodafone Towers



Source: Mediobanca Securities, Company Data

Step 2: INW acquisition of a stake in Vodafone Towers

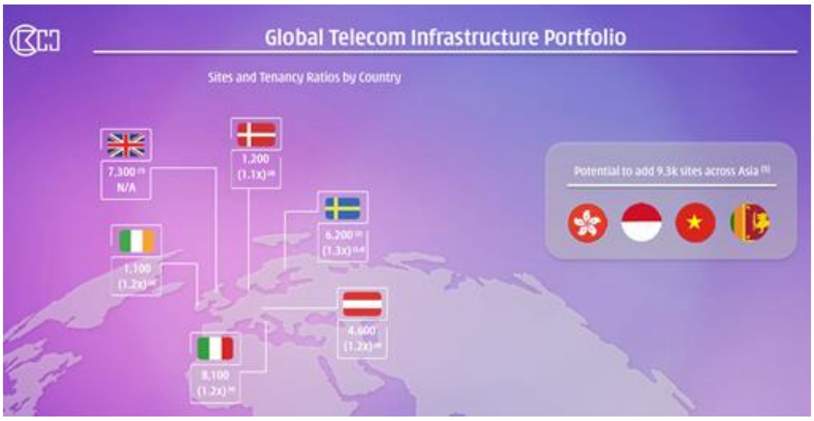


Source: Mediobanca Securities

Also CK Hutchinson Holding in early August announced the setup of a new holding company, CK Hutchison Telecom, which consolidates CKHH Group's European operations and HTHKH under one holding entity.

CK Hutchison Networks, which will group the 28,500 tower asset interests into a separately managed wholly-owned subsidiary of CK Hutchison Telecom, with a dedicated management team, focused on optimizing the asset portfolio and maximizing returns on invested capital. Tenancy ratio of 1.2x across 6 markets in Europe (8.1k sites in Italy, 7.3k in the UK, 6.2k in Sweden, 4.6k in Austria, 1.1k in CH and 1.1k in Ireland). Potential to add 9.3k sites in Asia.

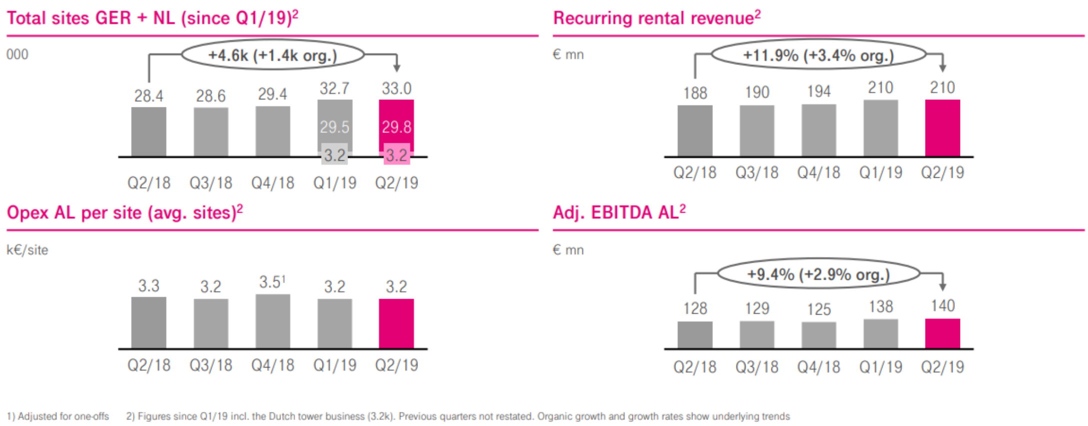
CK Hutchison Networks



Source: Mediobanca Securities, Company presentation

Finally, when looking at EU towers, we would also highlight that following the US commission provided the green light to the T-Mobile-Sprint deal, DT may opt for a speedup in the process of separating its passive network from the rest of the business. Also, Orange unveiling its new plan on December 5 anticipated an updated view on infrastructures.

Deutsche Telekom, towers as of 2Q19



Source: Mediobanca Securities, Company presentation

On January 2nd, CLNX announced the acquisition of OMTEL, the main tlc infrastructure operator in Portugal. It operates 3,000 sites (25% of the market) and will roll out 400 in the coming four years. The agreement values the company €800m. Cellnex growth plans let expect that this build-to-suit (BTS) programme could be enhanced with 350 additional sites until 2027. The estimated investment for this build to suit plan is €140m. This acquisition will allow CLNX to enter the eighth market in Europe, further consolidating its strategy aimed at becoming the leading player in the EU tower sector.

When moving to broadcasting towers, the delay in the re-farming process negatively affected the potential consolidation process. We continue to see a strong link, that's the reason why we are confident something concrete could happen in 2020.

Key articles from domestic press seem to suggest things are moving into the right direction:

- On 28 June, *Il Messaggero* reported F2i CEO Renato Ravanelli, during a BoD meeting, mentioned the option of a deal with Rai Way. Such move would be in line with the fund's objective to complete the broadcasting towers the consolidation process, following the acquisition of Persidera and the tender offer launched on EI Towers in 2018. In such a scenario, a new governance would be put in place, with MS and Rai having similar holdings in the merged entity. F2i would also play a central role in easing the antitrust approval and from a political perspective.

- On 12 July, F2i's CEO Renato Ravanelli arguing "*there's nothing concrete on the table*" when asked about an aggregation between Rai Way and EI Towers. However, he reiterated the fund is a supporter of the sector integration (*Reuters)*.

- On 30 September, Mediaset's management during its first half results conference call answering to a question over the potential merger between EI Towers and Rai Way, remarked the support on consolidation process in tower sector while adding at the moment MS as minority shareholder has not been informed of any tie-up talks between the two companies.

- On 22 October, *MF* reported that Mediaset may consider to sell its 40% stake in EIT. According to the article MS no longer considers towers business strategic, hence the company could sell the assets following ahead interesting offer. Italian infrastructure fund F2i should be interested in the potential negotiation. However, international financial operators could also show interest in the stake. The article adds this potential disposal may boost the consolidation with Rai Way, to create a unique operator in the broadcasting tower market.

- On 10 December, RWAY has signed an agreement with RAI for the implementation of gradual interventions on the DTT network required by the refarming process, and renewed the terms of the service contact with incremental revenues of c. € 16m per year from 1 July 2021 and conditions for seven-year contract until 30 June 2028 (impact to be full captured at EBITDA level). RWAY will upgrade investments by €150m. A new business plan is expected to be approved by the board in the first quarter of the new year.

Macro uncertainty still affecting advertising trend

On 12 December, Nielsen unveiled October 2019 data on the Italian advertising market. The overall market posted was down 5.2% YTD (-2.9% yoy in the month); when including OTTs contribution, the advertising market is up 0.6% in yoy in the month (0.7% drop in 10M19). More in detail, TV collection reported a c.2% yoy decrease in October, which translates into 5.2% yoy drop in 10M19. On single operators Mediaset was down 5% yoy in the month (leading to YTD performance of -9%) and Rai was basically flat (-1.5% YTD). On the other hand, Sky and Discovery were up 2% and 12% respectively in October (overall flat in 10M19). Print collection overall was down 10% in the month and down 12% YTD. Positive spots were Radio and digital segments which recorded 2.9% and 2.5% expansion (ex OTTs) YTD.

Italian advertising investments y/y growth

	Oct 2019	10M19
Market	-2.9%	-5.0%
Newspapers	-10.0%	-10.4%
Magazines	-8%	-14.3%
TV	-1.7%	-5.2%
Radio	-2.8%	2.9%
Internet (ex. OTTs)	5.1%	2.5%

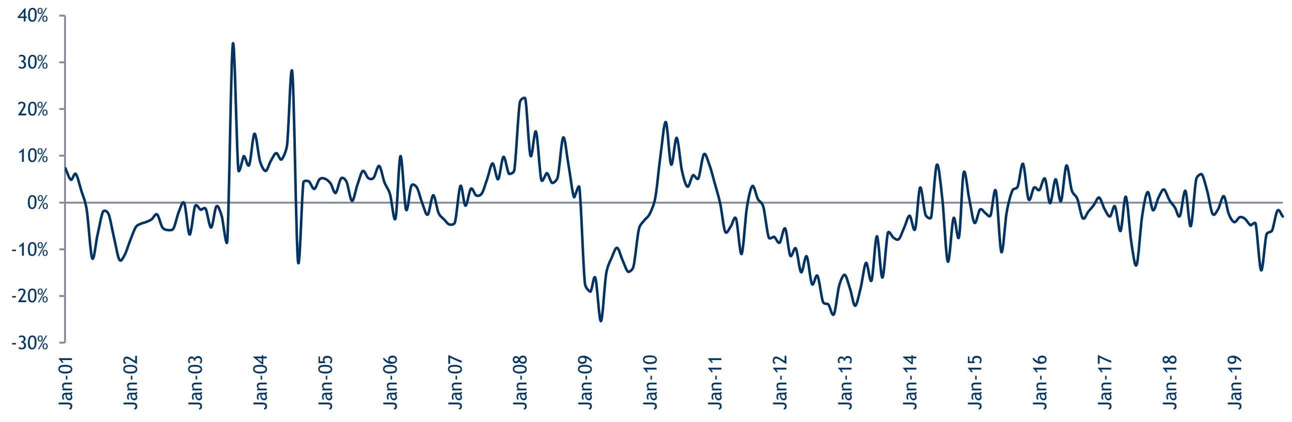
Source: Mediobanca Securities, Nielsen

Alberto Dal Sasso, MD at Nielsen, highlighted a 3% yoy cumulated growth is needed in November and December to meet a stable trend in the full year collection (we adopted at the beginning of the year a more cautious stance), adding this could appear as a challenging target, when taking into consideration the consumer confidence is deteriorating.

In July Zenith anticipated a 1% yoy growth for Italian advertising market this year, while a more pessimistic view is taken by UPA and WPP which they expect respectively 0.5% yoy and 2% drop. Such a dispersion indirectly confirms how visibility is low and the trend is expected to remain uncertain for the upcoming months.

For what concerns our outlook 2020, a subdued growth remains a key reason of concern, especially if the coming months will confirm weaker trends in global and Italian GDP, with particular focus on domestic consumptions. Hence we believe next year's trend for national advertising collection would not be that different, with sport events (2020 Olympic Games and Euro Cup) eventually providing some support.

Advertising spending yoy monthly evolution (2001-10M19)



Source: Mediobanca Securities, Nielsen

We believe Italian media will continue to explore different ways to react to such a challenging trend.

First, Radio and online shall confirm the positive path confirming inelasticity and resilience with respect to the overall market. The former has been growing consistently since 2015 and at end of October Fcp Assoradio unveiled the figures for radio advertising collection in September, confirming the positive trend in the year (+3.7% 9M19), driven by a 13.4% yoy increase in September, which implies a c. +10% jump in the third quarter of the year.

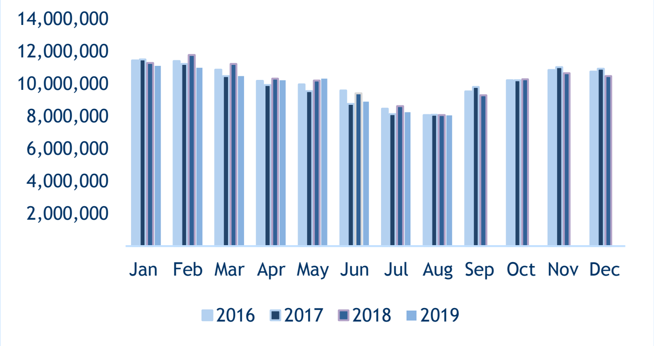
We anticipate print will remain under pressure also in 2020. Year-to-date, the sector recorded another double-digit drop in collection (-11.8% yoy), with a further deterioration in the trend in August -16.6%).

This is the reason why we encourage media companies operating in this sector (CAI, GEDI and RCS) to speed up their transition towards digital: we believe flagship brands should explore marketing opportunities abroad (above 5m people, with 500k Italians expatriated in the last ten years) and take a more aggressive stance on their business model, simultaneously reducing free contents available on their platform). At the same time, we believe synergies on printing plants and other forms of cooperation still may be explored; also, we don't rule out M&A opportunities and corporate actions will come.

Over 2019 MN has experienced a restructuring process, with the disposal of MN France and part of its Italian magazine's portfolio. At the same time, MN is strongly focusing on books, in particular, the company is focused on the educational and professional segment to expand its business. In our view, in 2020 the company will continue to invest, also through M&A, in this area.

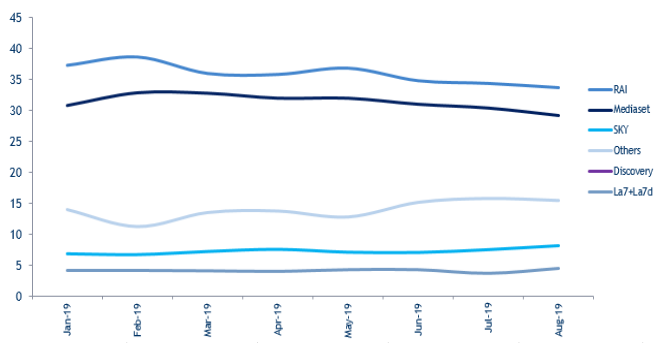
Finally, while we continue to see television as central in the media mix, we anticipate a flattish trend for the sector in 2020, also thanks to the contribution of the sport events. YTD, sector is down 6% but we believe some improvement could come in next few months. In such a context, with ongoing structural pressure, we continue to believe sector consolidation will remain central to fight the increasing relevance of OTTs. Mediaset has launched its Pan-European project, integrating the Italian and Spanish business as a first step.

Average number of daily viewers/month



Source: Mediobanca Securities, Auditel

2019 monthly audience share of the top 5 broadcaster



Source: Mediobanca Securities, Auditel

6% average EPS cut for media names

We cut by 3% our OpFCF (EBITDA-CAPEX) for **TIM**'s domestic business in 2019-21, assuming rationalization of FSR will continue and MSR improving (-2% in 2020 from –8% in 19). The impact of a more conservative outlook is more visible on Italian media, as it translates on an average EPS cut of c.6% across the space. While we continue to believe TV will outperform, we now assume a decline for Italian advertising market in 2020 (exl. OTTs contribution). We move our rating to Neutral from Outperform on GEDI, Mondadori and Rai Way, i) in order to cash in our calls and ii) given the limited upside to fundamentals.

INDUSTRIALS – SAILING IN UNCERTAIN MACRO WATERS

After the peak reached in 2018, global economic activity declined factoring the negative impact of ongoing trade tensions between China and the US which generated an across-sector capex postponement. After several months of reduction in a row, Global PMI started to show some early sign of stabilisation with Chinese indicator returning in expansionary territory. In the US manufacturing data remain positive, while Eurozone was the most affected by this global tariff dispute showing a marked contraction.

The recent agreement on a phase-one deal, between China and the US, may represent a relief for Industrial names finally unlocking some customers' capex decisions. Context in the consumer space, was less worrying to date and confidence data have been resilient both in EU and the US.

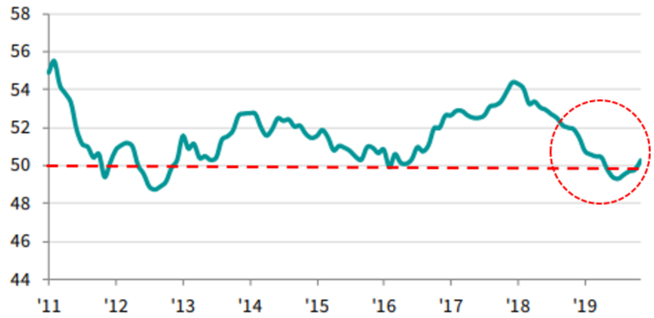
In this uncertain context and ahead of a tough first part of 2020 for capital goods which suffered from a slowing demand coupled with destocking, we reiterate our preference for Prysmian (O) – a beneficiary of the European Energy Deal, Leonardo (O) – rising Geo-Political tensions in Middle-East may trigger incremental Defense spending and Piaggio (O) – positively affected by the ongoing replacement cycle in EU.

While we downgrade Fincantieri to Neutral from Outperform on the back of persistent execution issues at Vard and of slowing intake potentially posing additional downside risk. Among low-beta stocks (Consumers, Healthcare), we remain cautious on Diasorin (N) and Campari (U), where current valuation does not give any upside.

Some (Tentative) signs of recovery

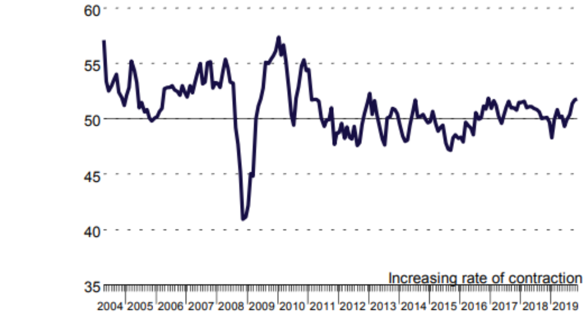
Since mid-2019, global manufacturing showed tentative signs of recovery with PMI readings edging back into expansion territory and scoring the seven-month high in November. On top of this, data from China signalled a marginal improvement in the industrial activity with PMI showing signs of reversal (above 50).

2011-2019 - Global Manufacturing PMI



Source: Mediobanca Securities, IHS Markit

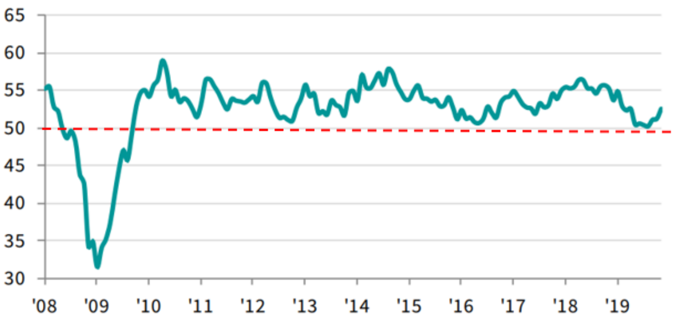
2004-2019 - China Manufacturing PMI



Source: Mediobanca Securities, IHS Markit

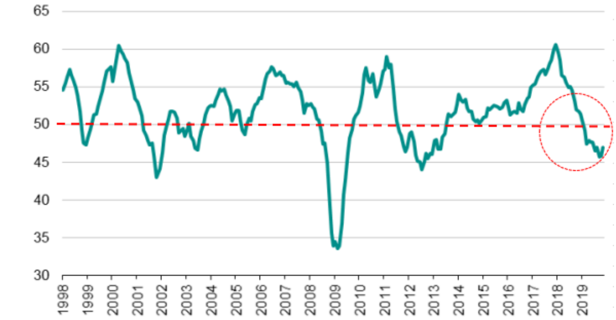
Focusing on the developed countries, the registered a decoupling between the US, showing positive data, and Europe, close to 7-year lows.

2007-2019 – US Manufacturing PMI



Source: Mediobanca Securities, IHS Markit

1999-2019 – EU Manufacturing PMI



Source: Mediobanca Securities, IHS Markit

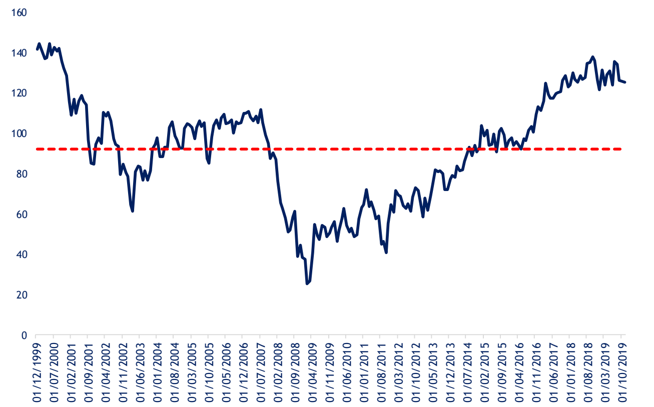
On December 13, the US and China reached an agreement on a Phase One trade deal that requires structural reforms and other changes to China's economic and trade regime in the areas of intellectual property, technology transfer, agriculture, financial services, and currency and foreign exchange. The Phase One agreement also includes a commitment by China that it will make substantial additional purchases of US goods and services in the coming years. Importantly, the agreement establishes a dispute resolution system that ensures prompt and effective implementation and enforcement. The United States has agreed to modify its Section 301 tariff actions in a significant way. The US will be maintaining 25% tariffs on approximately USD250bn of Chinese imports and 7.5% tariffs (vs previous tariffs set at 15%) on approximately USD120bn of Chinese imports.

With regard to Consumers, the broad picture was less worrying to date, compared to that of manufacturers, and confidence data have been resilient. Looking at the consumer indicators, the trend looks supportive both in EU and the US, as they remain well above their long-term average, not far from peak levels. This is particularly true for the US consumer sentiment.

2005-2019 – Euro Area Consumer Confidence Indicator

Source: Mediobanca Securities, European Commission

1999-2019 – US Consumer confidence



Source: Mediobanca Securities, BBG based on CCB data

Italy's Consumption Data: a soft landing thanks chiefly to TMT

Latest figure released by Confcommercio (Italian general confederation of enterprises, professions and self-employment) for the Confcommercio Consumer Indicator (CCI) in November showed some slowdown vs October (-0.4% yoy from +0.6% yoy in October and +1.3% yoy in September), due both to demand of services (+0.5% from previous +1.1%) and to demand of goods (-0.7% yoy in November from +0.4% in October).

By sector, in October Telecommunications was once again the best performer (+5.0% yoy), with Shoes & apparel (+0.8% yoy), Home care (+0.2% yoy), and Hotels & out-of-home food consumptions (+0.1% yoy) closing as well in positive territory. On the other hand, Personal Care (-0.4% yoy), Leisure (-0.5% yoy), Food&beverage & tobacco (-0.8% yoy), and Transports (-3.2% yoy) were down yoy.

Focusing on the Hotels & out-of-home food consumptions, we flag that November data (+0.1%) shows a slowdown compared to the +0.7% posted in October and the +1.1% growth pace posted in 3Q.

We remind that CCI refers to goods and services representing 55% of overall consumption in Italy and that the CCI indicates volume growth and is seasonally adjusted. Italy clearly represents just a portion of total sales for most of the companies in our Mediobanca Consumer coverage space, however CCI indicator helps to assess the trend in consumptions' mix. CCI trend overall mirrored the figure of Consumer confidence, which moved fairly laterally throughout 2018, before starting to reflect signs of uncertainty in 2019. As far as inflation is concerned, Confcommercio expects prices to be up by 0.2% yoy in December, hence implying a +0.6% yoy increase in December 2019 vs December 2018.

The sterilisation of 2020 safeguard clauses on VAT is positive news for the consumer sector, and may help to support consumer confidence which was dented by persistent political uncertainty throughout 2019. Within the consumer space, we reiterate our preference for **De' Longhi (O)**, while we maintain a Neutral stance on **Marr and Fila.** On **Campari (U)**, we keep our cautious view because the company is still trading at premium vs. its closest peers. The sustainable growth potential of key brands is out of discussion but in the absence of material outperformance in terms of margin expansion, we expect the current premium to narrow in the low-single digit area.

FINCANTIERI, Downgrade to Neutral: Vard continues to represent a headache for Fincantieri. As the group appears to have made good progress with its Offshore division, Vard Cruise is now becoming a new issue, having delivered sizeable losses in the first nine months of 2019. This is now affecting Fincantieri's main Shipbuilding division. Without Vard, management indicated, Shipbuilding EBITDA margin would have been 300bps higher last quarter, and well above 10%. Unfortunately, this trend is likely to continue in 2020. This is also when the company will publish a full review of the economics for all Vard vessels scheduled for delivery in 2020-22, which therefore raises the risk of a kitchen-sink. In contrast, the Naval business remains strong, having a healthy pipeline of opportunities. They include the US FFG(X), the Saudi Naval Expansion II, as well as various programs for the Italian Navy, which could support a re-rating of the shares. As we now adopt more conservative margin assumptions, we reduced our FY19-21 EBIT estimates by 1-13%; and our Target Price to €1.0/sh from €1.3/sh, which implies a more limited potential upside of 11%. As such, we downgraded our rating to Neutral from Ouperform.

Change in estimates

PIAGGIO - Change in 2019-21 estimates

(€m)	FY-19 NEW	FY-19 OLD		FY-20 NEW	FY-20 OLD		FY-21 NEW	FY-21 OLD	
Net revenues	**1,518**	**1,521**	**0%**	**1,615**	**1,619**	**0%**	**1,760**	**1,765**	**0%**
YoY %	9.2%	9.5%		6.4%	6.4%		9.0%	9.0%	
EBITDA	**221**	**222**	**0%**	**234**	**239**	**-2%**	**263**	**268**	**-2%**
EBITDA margin %	14.6%	14.6%		14.5%	14.8%		14.9%	15.2%	
YoY %	9.5%	9.9%		6.0%	7.7%		12.1%	12.1%	
EBIT	**107**	**108**	**-1%**	**118**	**123**	**-4%**	**147**	**152**	**-3%**
YoY %	15.2%	16.0%		10.6%	14.2%		24.0%	23.5%	
Net Profit	**47.0**	**47.7**	**-1.5%**	**56.0**	**58.8**	**-4.8%**	**73.7**	**76.8**	**-4.1%**
YoY %	30.2%	32.2%		19.0%	23.1%		31.7%	30.7%	
Net Debt	**414**	**413**		**375**	**365**		**301**	**289**	

Source: Mediobanca Securities

Diasorin – Change in 2019-21 estimates

	2019E			2020E			2021E		
(€m)	New	Old	% Ch	New	Old	% Ch	New	Old	% Ch
Sales	**710**	**710**	**0.0%**	**749**	**779**	**-3.8%**	**824**	**842**	**-2.1%**
YoY	6.2%	6.2%		5.5%	9.7%		9.9%	8.0%	
Adj. EBITDA	**282**	**282**	**0.0%**	**296**	**305**	**-3.1%**	**325**	**330**	**-1.4%**
margin	39.7%	39.7%		39.5%	39.2%		39.5%	39.2%	
Adj. EBIT	**224**	**224**	**0.0%**	**234**	**244**	**-3.9%**	**260**	**265**	**-1.7%**
margin	31.6%	31.6%		31.3%	31.3%		31.6%	31.5%	
Net profit	**175**	**175**	**0.0%**	**179**	**181**	**-1.2%**	**196**	**197**	**-0.4%**
FCF	188	188	0.0%	171	168	2.0%	177	180	

Source: Mediobanca Securities

MEDIOBANCA SECURITIES

Buzzi Unicem - Change in 2019-21 estimates

(€m)	2019E old	2019E new	% Ch	2020E old	2020E new	% Ch	2021E old	2021E new	% Ch
Revenues	3,140.9	3,140.9	0.0%	3,129.4	3,171.3	1.3%	3,098.1	3,133.2	1.1%
EBITDA	**680.7**	**683.2**	**0.4%**	**684.3**	**701.0**	**2.4%**	**656.0**	**671.4**	**2.4%**
EBITDA recurring	**656.7**	**659.2**	**0.4%**	**660.3**	**677.0**	**2.5%**	**632.0**	**647.4**	**2.4%**
EBITDA margin	20.9%	21.0%		21.1%	21.3%		20.4%	20.7%	
EBIT	431.3	433.8	0.6%	434.9	451.6	3.8%	404.3	419.7	3.8%
Net profit	318.2	320.0	0.6%	324.0	417.1	28.7%	309.5	323.9	4.6%
Adj. Net profit	**318.2**	**320.0**	**0.6%**	**324.0**	**336.4**	**3.8%**	**309.5**	**323.9**	**4.6%**
Net debt	**734.0**	**732.1**	**-0.3%**	**426.9**	**331.5**	**-22.4%**	**137.0**	**66.8**	**-51.2%**

Source: Mediobanca Securities

Tesmec - Change in 2019-21 estimates

(€m)	2019E Old	2019E new	% Chg.	2020E Old	2020 new	% Chg.	2021E Old	2021E New	% Chg.
Sales	**216.1**	**203.8**	**-5.7%**	**230.2**	**220.1**	**-4.4%**	**238.2**	**228.9**	**-3.9%**
Reported EBITDA	**30.8**	**26.1**	**-15.4%**	**33.7**	**32.3**	**-4.1%**	**35.9**	**34.3**	**-4.4%**
EBITDA margin	**14.3%**	**12.8%**		**14.6%**	**14.7%**		**15.1%**	**15.0%**	
EBIT	11.5	7.2	-37.2%	13.9	13.0	-6.5%	16.8	15.7	-6.7%
EBIT margin	5.3%	3.5%		6.1%	5.9%		7.0%	6.8%	
Net profit	5.0	2.3	-53.2%	7.2	5.8	-20.3%	9.8	8.6	-11.6%
Net debt	**100.9**	**108.9**		**96.4**	**106.6**		**91.2**	**101.5**	

Source: Mediobanca Securities

Fincantieri: Change in 2019-21 estimates

		MB New			vs. Old			MB Old	
	FY19	FY20	FY21	FY19	FY20	FY21	FY19	FY20	FY21
	€ bn	€ bn	€ bn	%	%	%	€ bn	€ bn	€ bn
Revenues	5.85	6.32	6.77	0%	0%	-1%	5.85	6.32	6.81
EBIT	0.23	0.29	0.37	-1%	-13%	-3%	0.24	0.33	0.38
Adj. Net Income	0.08	0.11	0.16	-1%	-21%	-5%	0.08	0.14	0.17
Adj. Net Debt	0.77	0.82	0.70	0%	28%	37%	0.77	0.64	0.51

Source: Mediobanca Securities

AUTOMOTIVE – TOO EARLY TO RE-RATE

The Automotive & Parts stocks underperformed the SXXP also this year despite the already poor trend reported in 2018. Over the last 12M SXAP was up 13% with a recovery over the last quarter, underperforming the SXXP by 7%. The Auto index underperformance is likely to reflect the 19E EPS Consensus reduction which was in the range of -21% for the car-makers, -21% for car components and -28% for tyre players, while it has likely factored in the recently announced solution of the US/China trade war.

Automotive volumes have been impacted by 1) trade war between the US and China, 2) new regulation that is expected to affect Auto players starting from 2020 results, 3) slowdown of the cycle and 4) low visibility on the trend in China. In this market scenario, car production and retail sales are foreseen down respectively 6% and 4% in FY19.

Visibility on the Automotive sector is rather limited over the next 12 months as main car-makers remain pretty cautious about sales/production of two key markets China and Europe which cumulated represent more than 50% of total registrations. In 2020, we expect global retail sales remaining slightly negative as well as production capacity, although with an uptick compared to the poor performance reported in 2019.

We reckon that the Automotive sector's valuations look pretty attractive with next 3Y PE at 7.3x, or 6% below last 14 years normalized average, and we reckon that negative sales and production are progressively improving. However, we also note that other features may cap any re-rating in the short-term such as the introduction of new more stringent regulation in Europe and a delayed positive impact from the resolution of the trade war between US and China. Moreover, we note that 20E Cons. is assuming a still hardly achievable EPS increase of 15% for the car-makers, 21% for the components suppliers and 30% for the tyre makers.

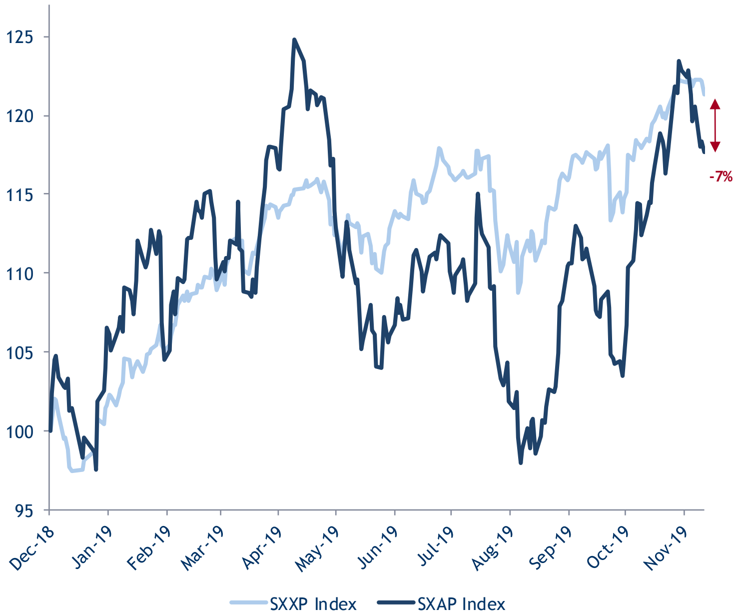
Among our coverage, we have a positive stance on Exor, which has a corporate action of the underlying assets that may push for a shrinking of the holding discount, and CNHI (AG looks at the trough). On the opposite, we are more cautious on Ferrari (fair valuation, strong 2019 price performance) and Brembo. In this report we downgrade Brembo to Neutral from Outperform, keeping a €12/sh. target price, following the strong price performance (+26% in 2019) that led stock valuation to a fair level of 7.2x 20E EV/EBITDA and 14.5x PE. About Pirelli, we have a cautious stance in light of both the low volumes/price visibility in Europe and the slow start of the winter tyre sales. That said, it's worth reminding that Feb. 11 CMD may represent a catalyst for the stock as a new restructuring may increase visibility on the FY20 targets.

Weaker SXAP performance in 2019 and poor valuation…

In 2019 SXAP underperformed the main index by 700b.p. being up 13 YTD% vs European Stocks up 22%. Auto index performance

- Was pretty negative until August, when SXAP was down 3% YTD vs SXXP up 11%
- Recovered over the last part of the year (+15% in two months) on the back of the press comment about the trade war resolution

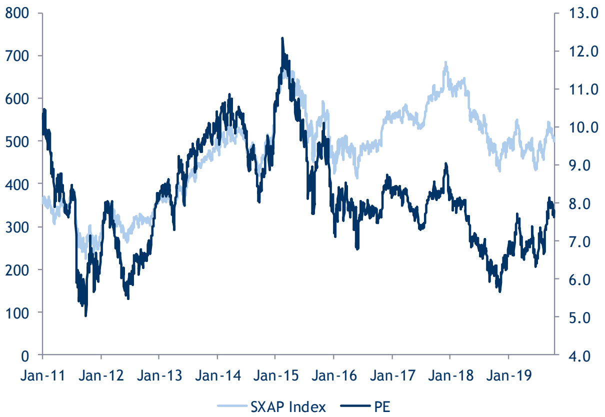
YTD performance: European Auto and Component vs. SXXP index



Source: Bloomberg

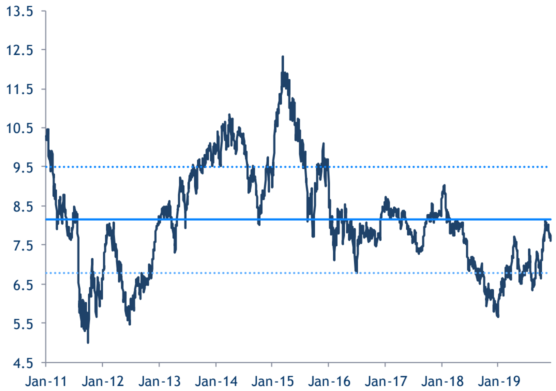
SXAP P/E valuation remained pretty undemanding in 2019. Compared to the across-the-cycle P/E multiple, today's level remains touch below the average, 35% from the 5-year historical low.

SXAP: index price and PE evolution



Source: Bloomberg

SXAP PE dynamics through the cycle

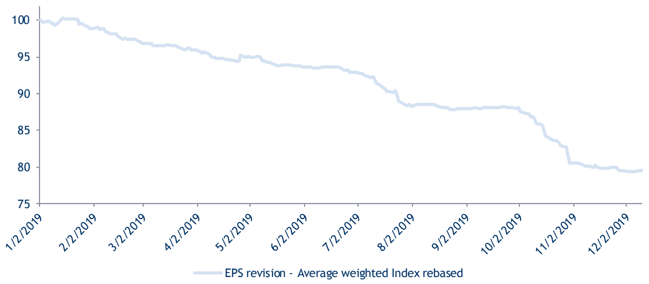


Source: Bloomberg

… due to negative car production that led to a material Consensus revision.

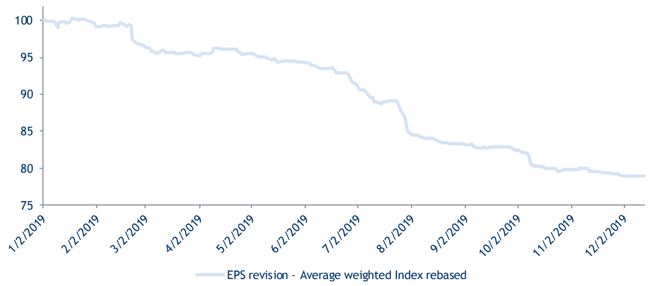
Current valuation is justified by the Consensus estimates revision experienced in 2019, as well as the uncertainty about the main sector trend over the next 12 months. Indeed, since the beginning of 2019 EPS Consensus estimates have been cut by 21% for both the car-makers and Component suppliers, -28% for the tyre makers and -5% for the Trucks players.

Car-makers, 19E EPS revision -21% YTD



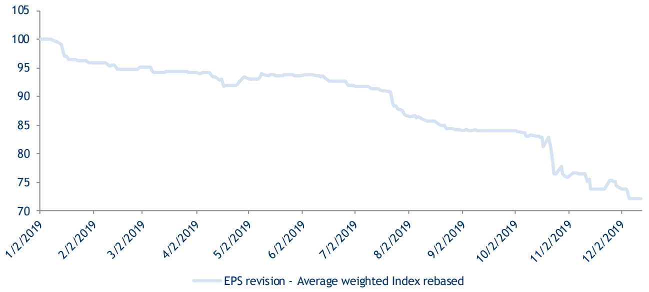
Source: Mediobanca Securities

Components supp, 19E EPS revision -21% YTD



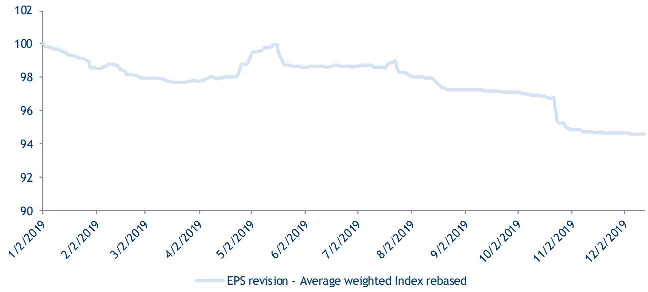
Source: Mediobanca Securities

Tyres, 19E EPS revision -28% YTD



Source: Mediobanca Securities

Trucks, 19E EPS revision -5% YTD



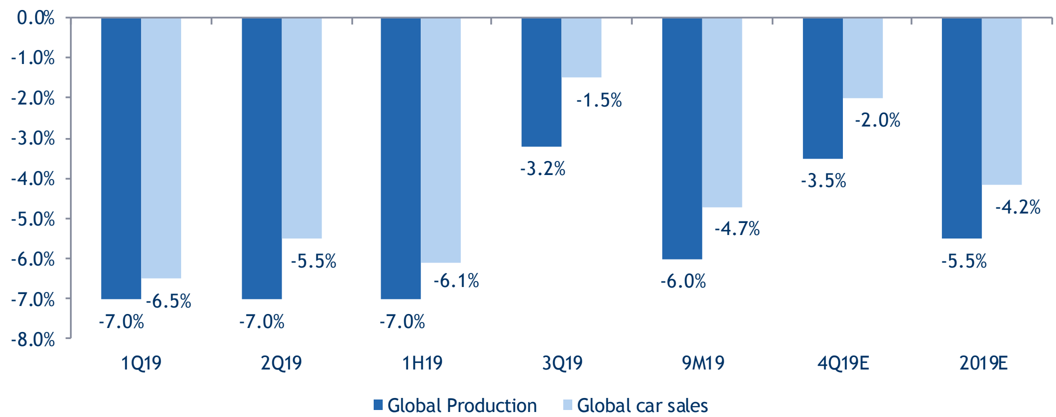
Source: Mediobanca Securities

The estimates revision was the result of a macro scenario that has been substantially deteriorating over the year compared to the FY19 outlook provided by the main car-makers and car components suppliers in January.

Both global retails sales and cars production were initially expected 1) to be slightly negative in 1H19 and 2) rebounding in 2H19 also thanks to easy comparison base in the Chinese market. As showed in the following Figure, both cars production and retail sales were weak in 1H19, decreasing respectively by 7% and 6%, experiencing only a minor uptick in 3Q19 when cars production reported a 3% drop, retail sales -1.5%.

In 4Q19E, we expect cars production to remain below last year level (-3.5%), as well as global retail sales (-2%), leading to a FY19 production that we project down 5.5%, with retail sales -4.2%.

2019E Global car production/retail sales by quarter

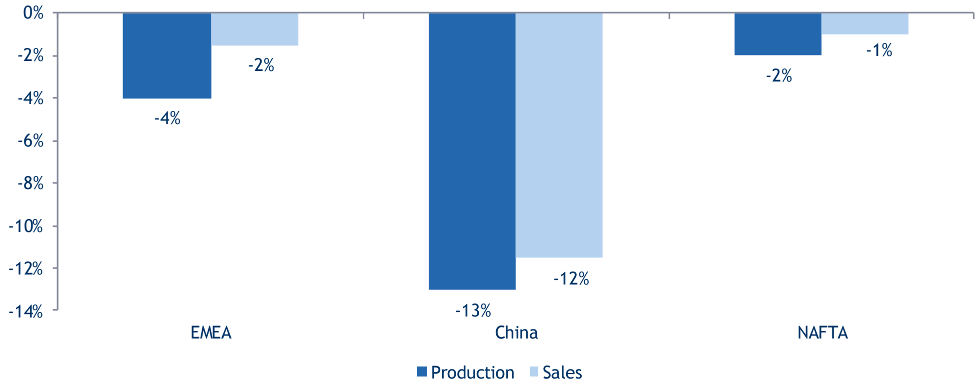


Source: Mediobanca Securities

2019 Drop of car sales/production mainly impacted by China

Among the main geographical markets, 9M19 cars production/sales have been impacted by China that was down double digit over the period with a 6% drop in 3Q19. Also EMEA and NAFTA were negative both in terms of production and sales over the period.

Main geographical markets, 9M19 production/sales



Source: Mediobanca Securities

In 2019 the main reasons leading to a general reduction of car sales are represented by

- Trade war mainly impacting on China and, as a second derivative, on a potential slowdown of the Macro scenario at global level. Tariffs between US/China and, potentially, US/EU could affect the level of export in the car industry.
- New regulations. The introduction of new more stringent regulations/incentives for buying new cars have been the reason for a slowdown in markets such as EU and China.
- US market at a peak. 2019 US SAARS are expected at above 17m, i.e. a level still close to the peak achieved in 2015-2016.

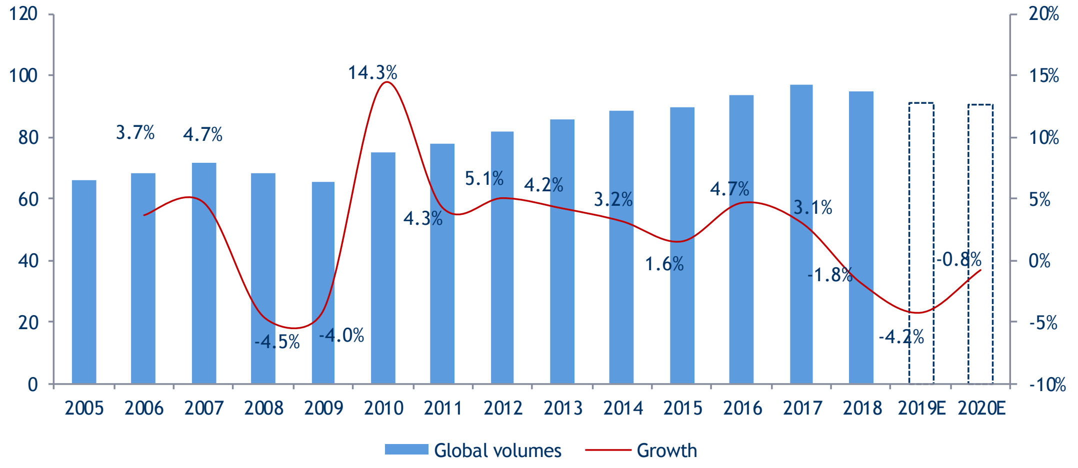
2020E outlook is uncertain, poor visibility in Europe and China…

Despite a very poor 2019 Automotive trend, visibility on next year remains very weak with main car-makers and car components suppliers keeping a quite cautious outlook on the car sales and production trend. Low visibility is mainly due to

- Trade war resolution that may have a delayed effect, mainly affecting the Chinese economy
- Slowdown in the European macro picture which could affect the Auto industry
- European markets also affected by destocking and new regulation on CO2 emissions
- US market which is still considered at a peak and could slow-down at faster pace compared to the last years

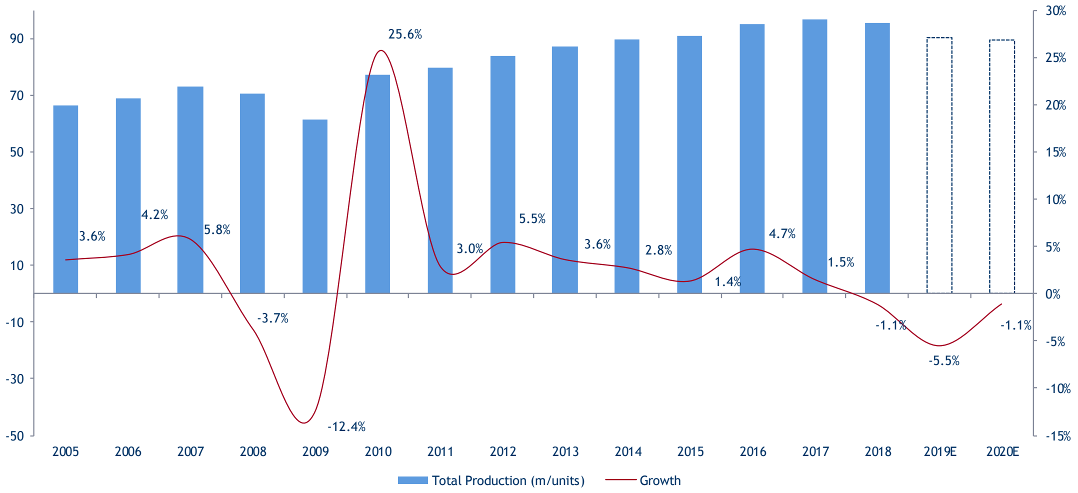
All in all, only Lat.Am. may experience a rebound of volumes mainly resulting from a recovery in Brazil. In our models, **we assume a flat trend of both global volumes and production in 2020**. We expect volumes down almost 1% in 2020, with a production which could decrease by a similar amount.

Global Car sales (m/units): 20E MB est. pointing at -1% vs -4% in 19E



Source: Mediobanca Securities

Global Car production (m/units): 20E MB est. pointing at -1% vs -6% in 19E

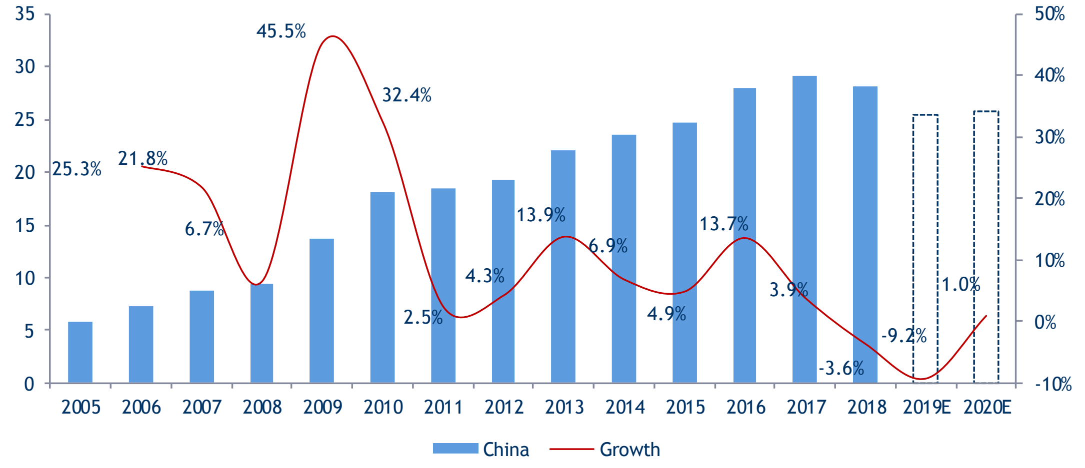


Source: Mediobanca Securities

We recap the main assumptions underlying our forecasts:

- **Chinese market (30% of global car sales) -** We assume a still negative trend of volumes in 1H20 on which visibility is still very low for the main car-players and cars components, with a slight rebound starting from 2H20. Consequently, we expect volumes to be stable in 2020 with no material trend inversion compared to a very poor performance forecast in 2019 (-9% YoY factoring in -3% in 4Q19). We believe that a potential acceleration may come from 1) the first phase of the trade war resolution, impacting over the year, 2) Government incentives, on which there is no visibility.

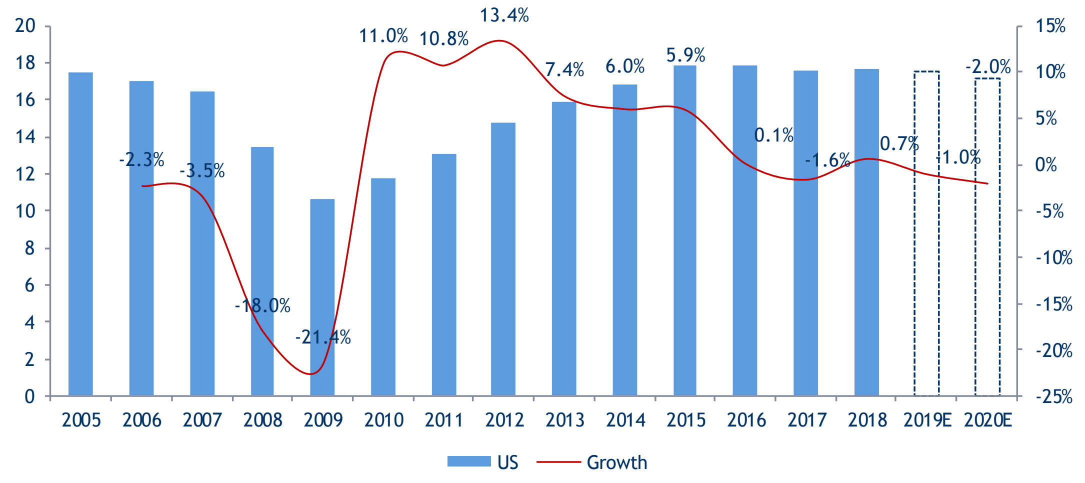
China - Car sales expected up 1%



Source: Mediobanca Securities

- **US market (18% of global car sales) –** We assume 2019 US car market to close almost in line with 2018, remaining at above 17m SAAR, only 2% below the peak achieved in 2017. In 2020 we expect market to decrease by around 2%, reflecting a minor slowdown in the cycle. In this contest, we assume the switch from passenger cars to the more profitable light-trucks and SUVs to continue also in 2020.

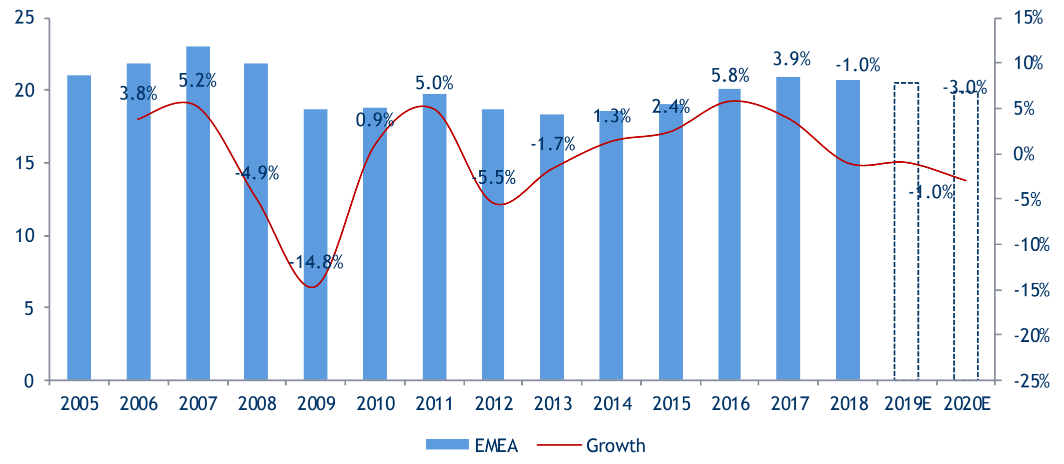
US - Car sales foreseen down 2%



Source: Mediobanca Securities

- **EMEA market (22% of global car sales):** after the poor trend reported in 9M19 (-1.5% YoY) impacted by the tough comparison base related to WLTP regulation introduced last year, we assume 4Q19 volumes to increase by 1% YoY, leading to a FY19 performance of -1%. About 2020, we expect market registrations down 1%, reflecting: (1) a worsening macro scenario, (2) introduction of the new regulation (market CO_2 emissions target at 95g/Km) pushing the sales of less polluting vehicles, (3) risk of Brexit, with UK representing 15% of the European volumes.

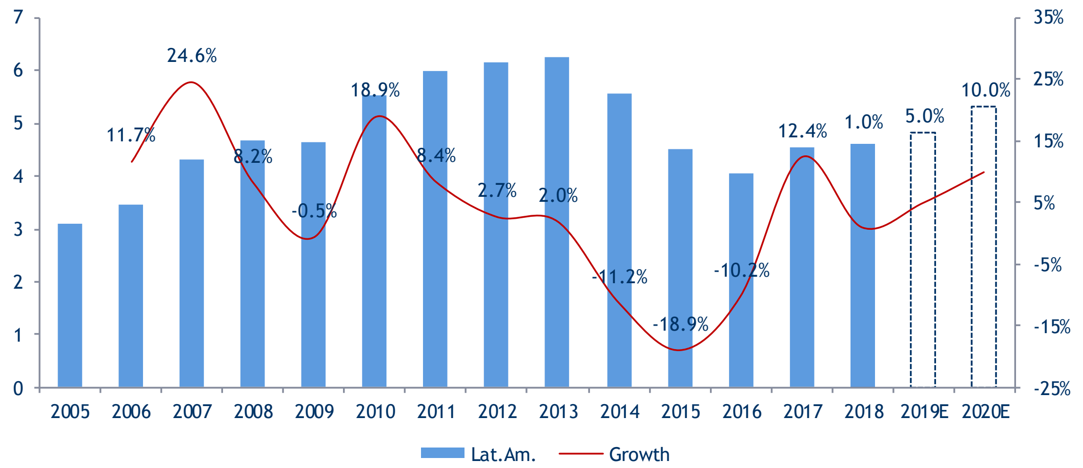
EMEA - Car sales forecast down 3%



Source: Mediobanca Securities

- **Latam market (5% of global car sales):** we expect Brazilian market to drive a recovery in this area, leading to a 10% increase in 2020.

LatAm - Car sales expected strong thanks to Brazil

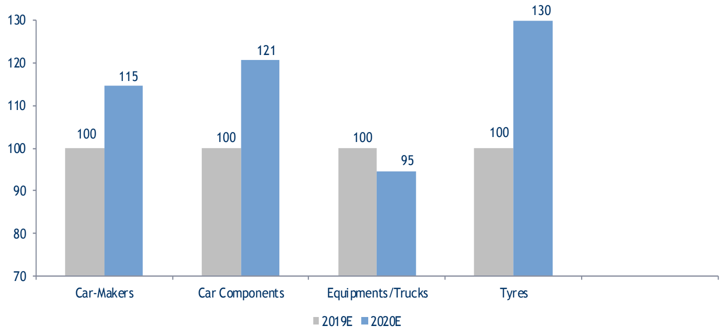


Source: Mediobanca Securities

… not reflected in the 20E Consensus estimates.

It's worth noting that, despite the quite uncertain scenario on car sales/production at global level, the EPS Consensus estimates are still factoring a quite challenging growth in 2020. Indeed, Car-makers net profit are predicted to increase by 15% in 2020E, car components +21% and Tyre makers +30%. These forecasts look demanding in our view and leave some room for a potential downside over the first part of the year when we expect all the main market players to provide more cautious targets.

Rebased Sector Consensus EPS: challenging 20E vs 19E



Source: Mediobanca Securities

Main changes in estimates

Brembo – Change in 2019-21 estimates

€m	2018	2019E			2020E			2021E		
		OLD	NEW	DIFF%	OLD	NEW	DIFF%	OLD	NEW	DIFF%
Sales	2640	2,607	2,607	0%	2,655	2,624	-1%	2,729	2,693	-1%
Chge%	8%	-1%	-1%		2%	1%		3%	3%	
EBITDA	501	514	514	0.0%	526	519	-1.4%	540	544	0.7%
Margin	19.0%	19.7%	19.7%		19.8%	19.8%		19.8%	20.2%	
EBIT	345	323	323	0.0%	352	344	-2.1%	365	369	1.0%
Margin	13.1%	12.4%	12.4%		13.2%	13.1%		13.4%	13.7%	
Net profit	238	230	230	0%	255	249	-2%	268	271	1%
Chge%		-4%	-4%		11%	8%		5%	9%	
EPS	0.71	0.69	0.69		0.76	0.75		0.80	0.81	
Chge%		-4%	-4%		11%	8%		5%	9%	
Net Debt/(Cash)	137	332	332	0.0%	176	178	1.1%	33	32	-3.6%

Source: Mediobanca Securities

CNHI – Change in 2019-21 estimates

$m	2019E			2020E			2021E		
	OLD	NEW	DIFF%	OLD	NEW	DIFF%	OLD	NEW	DIFF%
Industrial sales	26,487	26,487	0.0%	26,896	26,185	-2.6%	27,487	26,762	-2.6%
Chge%	1%	1%		2%	-1%		2%	2%	
Total sales	28,401	28,401	0.0%	28,809	28,100	-2.5%	29397	28,675	-2.5%
Industrial Trading profit	1,508	1,492	-1.0%	1,791	1,641	-8.4%	2003	1,900	-5.1%
margin	6%	6%		7%	6%		7%	7%	
Total Trading profit	1,988	1,972	-0.8%	2,271	2,120	-6.6%	2483	2,380	-4.1%
margin	7.0%	6.9%		7.9%	7.5%		8%	8.3%	
Adj Net profit	1,141	1,136	-0.4%	1,345	1,251	-7.0%	1521	1,461	-3.9%
Chge%	12%	12%		18%	10%		13%	17%	
Adj EPS	0.84	0.84	-0.4%	0.99	0.92	-7.0%	1.12	1.08	-3.9%
Chge%	12%	12%		18%	10%		13%	17%	
Net Debt/(Cash)	515	520	0.9%	229	299	30.5%	136	238	74.6%

Source: Mediobanca Securities

MEDIOBANCA SECURITIES

Pirelli – Change in 2019-21 estimates

€m	2018	2019E			2020E			2021E		
		OLD	NEW	DIFF%	OLD	NEW	DIFF%	OLD	NEW	DIFF%
Sales	5,195	5,316	5,316	0.0%	5,377	5,377	0.0%	5,524	5,524	0.0%
Chge%	-3%	2%	2%		1%	1%		1%	3%	
EBITDA Adj	1,235	1,302	1,302	0.0%	1,369	1,349	-1.5%	1,490	1,470	-1.3%
margin	23.8%	24.5%	24.5%		25.5%	25.1%		25.5%	26.6%	
EBIT Adj	955	933	933	0.0%	990	970	-2.0%	1,092	1,072	-1.8%
margin	18.4%	17.6%	17.6%		18.4%	18.0%		18.4%	19.4%	
Net profit	432	485	485	0.0%	449	434	-3.3%	567	552	-2.6%
Chge%		12%	12%		-7%	-11%		26%	27%	
Adj EPS	0.58	0.59	0.59	0.0%	0.59	0.57	-2.5%	0.68	0.66	-2.2%
Chge%		3%	3%		-1%	-3%		15%	15%	
Net Debt/(Cash)	3,180	3,480	3,480	0.0%	3,193	3,208	0.5%	2,756	2,780	0.9%

Source: Mediobanca Securities

Ferrari – Change in 2019-21 estimates

€m	2018	2019E			2020E			2021E		
		OLD	NEW	DIFF%	OLD	NEW	DIFF%	OLD	NEW	DIFF%
Group Sales	3,420	3,744	3,744	0.0%	3,996	4,009	0.3%	4,221	4,220	0.0%
Chge%	0%	9%	9%		7%	7%		6%	5%	
Adj. EBITDA	1,114	1,290	1,290	0.0%	1,500	1,472	-1.9%	1,685	1,669	-0.9%
margin	32.6%	34.5%	34.5%		37.5%	36.7%		39.9%	39.6%	
Adj. EBIT	825	948	941	-0.8%	1,110	1064	-4.2%	1,261	1212	-3.9%
margin	24.1%	25.3%	25.1%		27.8%	26.5%		29.9%	28.7%	
Net profit	785	718	712	-0.9%	866	816	-5.8%	983	928	-5.6%
Chge%		-8.5%	-9.4%		20.6%	14.6%		13.6%	13.8%	
Adj EPS	3.5	3.9	3.9	-0.8%	4.7	4.4	-5.8%	5.3	5.0	-5.6%
Chge%		12.5%	11.5%		20.7%	14.6%		13.6%	13.8%	
Net Debt/(Cash)	340	373	302	-19.1%	50	87	n.m.	-136	-61	n.m.

Source: Mediobanca Securities

BRANDED GOODS - MACRO SLOWDOWN TAKES A TOLL ON GROWTH; M&A SUPPORTS VALUATION

The overall sector had a positive performance in 2019, despite a challenging macro backdrop. On the other hand, political news-flow in Italy has had a limited impact on branded goods players in 2019. Italian branded goods are indeed more exposed to global macro trends than to country-specific themes.

For 2020 there are three themes that are likely to dominate the scene: (1) Hong Kong disruption and the impact that it might have on profitability; (2) The evolution of the trade tension between Europe and US; (3) Sector consolidation.

Indeed, already last year the sharp deterioration in macro environment has added a considerable amount of volatility: Hong Kong demand outlook (6-7% of the sector sales on average) has been negatively impacted by ongoing social protests since July, and with Chinese tourist flow plummeting retail sales have dropped substantially in the region. Besides Hong Kong, concerns related to trade war should continue to weight on the sector, although leather goods and most of RTW Made in Italy had not been targeted by tariffs so far.

Consensus numbers for 2019 and 2020 are still factoring-in a fairly supportive macro outlook in our view, despite downside risks to the global economy. This also reflects a 3Q reporting season that has been overall more supportive than initially anticipated on the top line. Since January 2019 we have reflected the deteriorating macro environment cutting Italian Branded Goods EPS estimates for 2020 by 20% on average. A substantial part of this cut is attributable to the impact of Hong Kong protests. In this report we are further trimming 2020 estimates by mid-single-digits.

The European Branded Goods sector trades at 28x 1Y forward, c.30% premium to the 10-year historical average. Within the sector, Italian players have historically traded at double-digit premium to the European sector, reflecting M&A potential, mono-brand strategy and potentially higher growth prospects.

In the space we like Brunello Cucinelli (NEUTRAL) as its business is highly sustainable and very predictable, which makes it a safe investment. We keep our confidence in Moncler's ability to overcome macro headwinds and to run the business properly even in tougher macro conditions and maintain NEUTRAL rating mostly on demanding market multiples, also supported by M&A appeal. We maintain a cautious view on Ferragamo (UNDERPERFORM), on its expensive valuation, despite some improvements on sales mix that might restore confidence in the margin recovery over time. We also have a cautious view on Tod's (NEUTRAL) as the turnaround story is not gaining traction in this challenging environment. We downgrade Aeffe from OUTPERFORM to NEUTRAL on weaker sales momentum and no operating leverage this year.

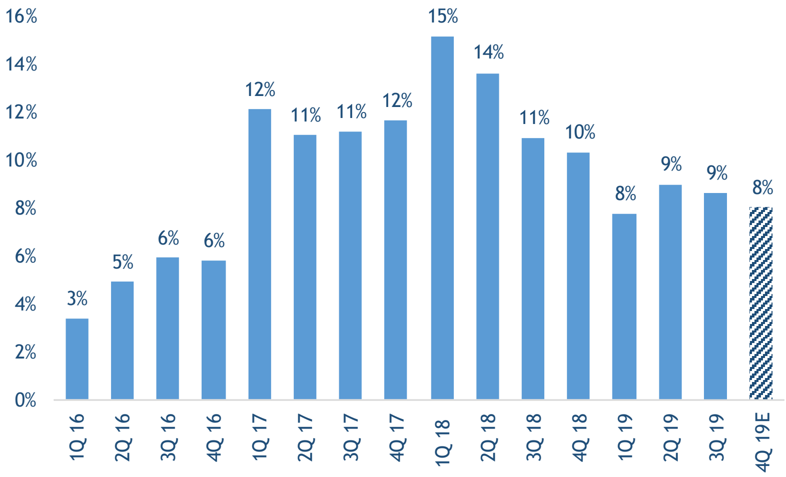
Review of 2019: demand growth pace is normalizing

2019 has been a challenging year for branded goods as geo-political instability and deteriorating macro environment put a strain on investors' confidence in the ability to deliver growth. The year has started with yellow vests torching high-streets in France - one of the key markets in Europe – amid concerns that Chinese demand could decline as the result of the global economy cooling down. Since June 2019 new concerns have cast shadows on the sector outlook and specifically politically unrest in Hong Kong and the threat that trade war could spill over, with US imposing tariffs on European luxury goods.

Overall demand slowed in 2019 to high-single digit, compared with double-digits growth in both 2017 and 2018. 1Q19 was the lowest point in terms of demand growth in our sample of European branded goods companies, also reflecting a tough comparison base. Despite expectations of a dramatic impact of Hong Kong protests on sector demand, this has not materialized, and 3Q19 results were quite supportive. Our forecasts factor in a further small deterioration of the demand for 4Q due to continued weakness in Hong Kong.

The growth rate in the industry has been very dispersed with some players fully able to capture the strong growth of luxury goods demand (e.g. Moncler, Brunello Cucinelli alongside French megabrands and groups) and other players in a turnaround phase (Ferragamo, Tod's, Geox).

European luxury average constant currency growth*



*Source: Mediobanca Securities, company data; *simple average of cFX quarterly demand for Kering, Brunello Cucinelli, LVMH Fashion & Leather, Salvatore Ferragamo, SMCP, Hugo Boss, Tod's Group, Moncler, Hermès*

Our picture for 2019 is fully consistent with the trends highlighted by Altagamma/Bain for the personal luxury goods market and by Global Blue for the European Tax-free Shopping. According to Altagamma/Bain, in FY19 the global personal luxury goods market reported growth of +7% YoY (+4% ex forex), sustained by solid mid-term fundamentals that should drive CAGR 2019-2025 between 3% and 5% or €335-375bn by YE2025.

Growth was again supported by the Chinese cluster which contributed 90% of the 2019 demand growth, and now account for 35% of the total. This resulted from a rebound of local spending sustained by governmental policies and Chinese consumer flows repatriation. In most regions however local spend was stronger than tourist demand (+11% and +3% yoy expected respectively), particularly in Americas (+5% yoy overall) where a vigorous consumer confidence was supportive. Conversely local demand in Europe (+2% yoy overall) was mildly positive with a differentiated performance by country.

On the other hand, the socio political situation in Hong Kong is reshaping the luxury market in Asia, following a 30-40% traffic drop from political tension and 40% decline in tourist arrival. This drives expectation of a deep redesign of the luxury landscape there, with physical retail network (consisting today of roughly 1k mono-brand luxury stores) likely to be strongly downsized.

No big differences are to be noticed in terms of trend by age cluster and distribution channels:

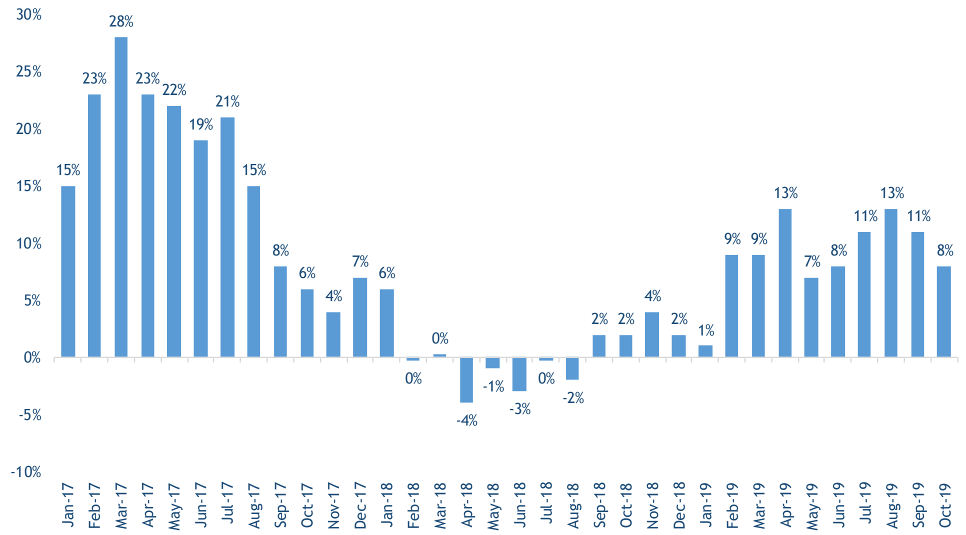
- Millennials and GenZ have showed an increasing willingness to buy luxury, and in 2019 they contributed 100% to demand growth, therefore increasing their contribution to total demand to 35% (vs. 31% in 2018) and seen rapidly approaching 50% of market value by 2025. A growing contribution to growth should also come from Gen Z which has already doubled its contribution from a tiny 2% to 4% and is seen at 10% of the total demand by 2025;
- In 2019 the online channel continued to outperform (+22% yoy), gaining share vs. physical channels (12% of total luxury goods markets in 2019 vs. 10% in 2018). Asia is the key region (31% of the total), accessories and beauty kept the lion's share of growth being an easier on line category (they accounted for 43% and 19% resp.in 2019). We also flag that nowadays 75% of purchases are online influenced, which suggests the great relevance of digitalization.

As far as tax free shopping in Europe is concerned, data from Global Blue confirmed that 2019 has been a positive year, with a double-digit yoy increase in purchases at the end of October YTD (+10%

yoy) and +8% over the last three months. This follows a much weaker trend in previous year, where the 3 month rolling performance was negative over the period April-August. Italy has outperformed (+16% yoy) and even accelerated in the last 3 months (+23%)

More notably Italy represents a top choice as destination for "Elite" shoppers, accounting for 17% of the total high end shoppers across Europe, with an average spend of €27k per shopper and purchase done in Italy accounting for 43% of shoppers' wallet. Almost 40% of Elite shoppers are Chinese.

Tax free spending in Europe (3M rolling average)



Source: Global Blue

European branded goods outlook 2020: spotlight on M&A

Heading into 2020 we maintain a cautious approach, as the initial signs of current trading suggest that the business might remain under pressure for the branded goods sector. We see three main themes to characterize sector outlook in 2020:

- Hong Kong disruption;
- Trade war and US tariffs on European goods;
- Sector consolidation.

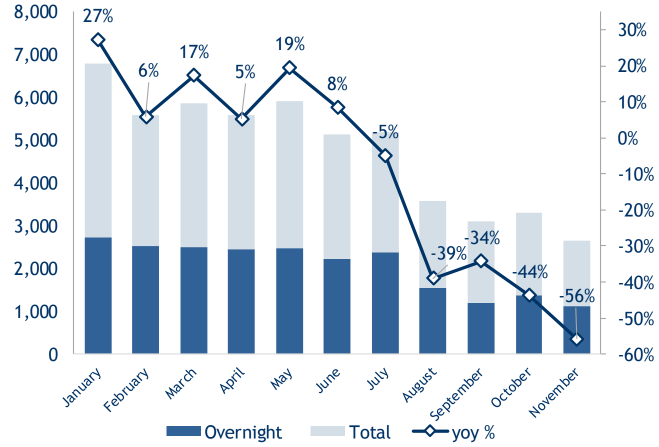
a) Business disruption in Hong Kong retail has become even more evident

Hong Kong is quickly losing its shine as the core Asian luxury hub. The secular trend started in 2014 and worsened last summer, as protests hammered luxury demand in the city since August/September, with no signs of improvement.

With Chinese tourist flow plummeting, retail sales have dropped and the region is on track to knockoff at least 1-2% of industry demand in the short-term. The impact on margin is difficult to assess although in the affordable luxury space profit warnings have been issued blaming Hong Kong (SMCP and Hugo Boss). Specifically:

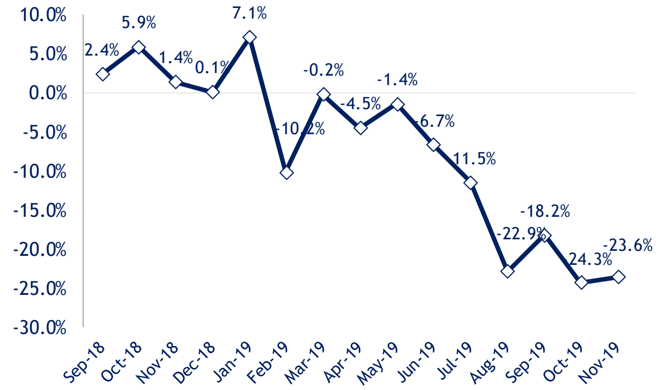
- Retail sales showed a negative trend all through 2019, with significant worsening since July and August but reaching the lowest point in Q4, according to official statistics;
- Official statistics reported that the number of visitor arrivals dropped in October and November (-44% and -56% resp.) even deteriorating on August-September (-39% and -34% respectively);
- The sharp decrease in visitors has been particularly tough for apparel, footwear and allied products, down 37% in October and over 40% in Jewellery and Watches.

Hong Kong Visitor Arrivals (# k)



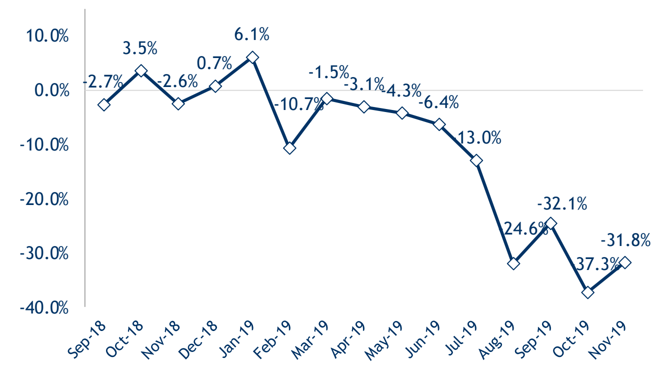
Source: HKTB Research

Hong Kong Retail Sales Index



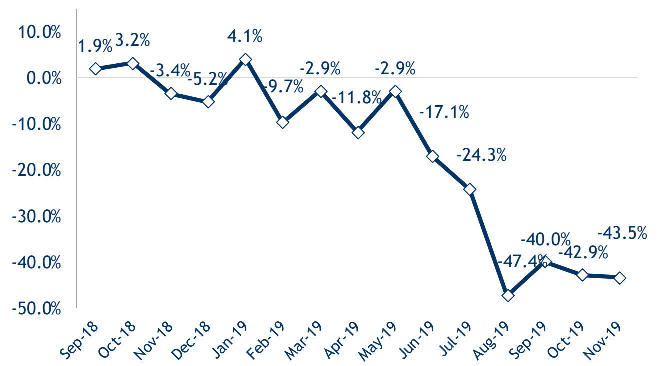
Source: Hong Kong Census and Statistics Department

HK sales index – clothing, footwear



Source: Mediobanca Securities

HK sales index – jewellery, watches and clocks

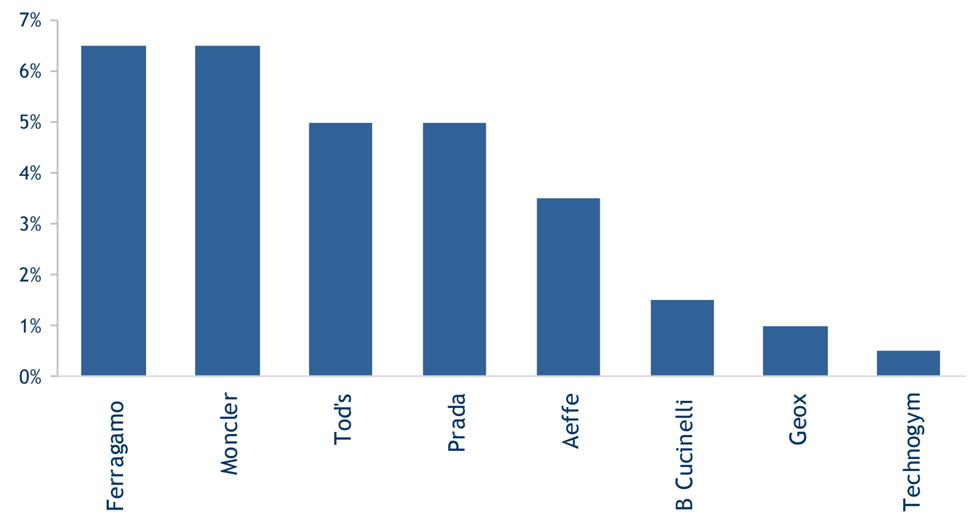


Source: Mediobanca Securities

On average **Hong Kong represents 6-7% of sales** for the companies in our coverage with the vast majority of customers represented by Mainland Chinese travellers. For our Italian luxury goods players, sales in the exposure to Hong Kong is reported in chart below.

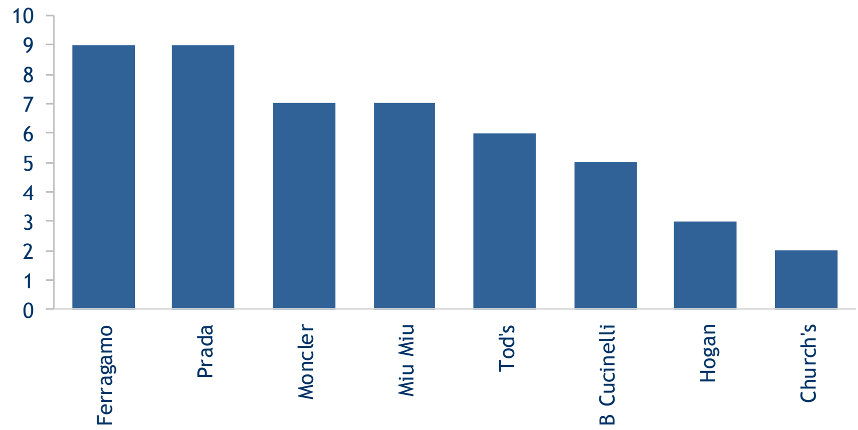
However the impact on profitability will depend on the ability to renegotiate rents, which might prove challenging, as confirmed by LVMH's decision to close one store in the city.

Italian Branded goods – Hong Kong as a % of sales



Source: Mediobanca Securities, Company Data

EU Branded goods – # stores in HK



Source: Mediobanca Securities, Company Data

b) Trade war: US administration targets France, for the time being

Another source of macro-related concerns stems from trade war threats and the potential impact on the macrocycle and global GDP growth trends. Following WTO decision to provide the green light to retaliate against European goods, concerns on levies to be applied to branded goods have become more tangible. US received the go-ahead to impose tariffs on as much as USD7.5bn worth of European exports annually in retaliation for illegal government aid to Airbus SE. EU branded goods impacted by the measure include, among others, RTW from the UK only, Wines and Spirits.

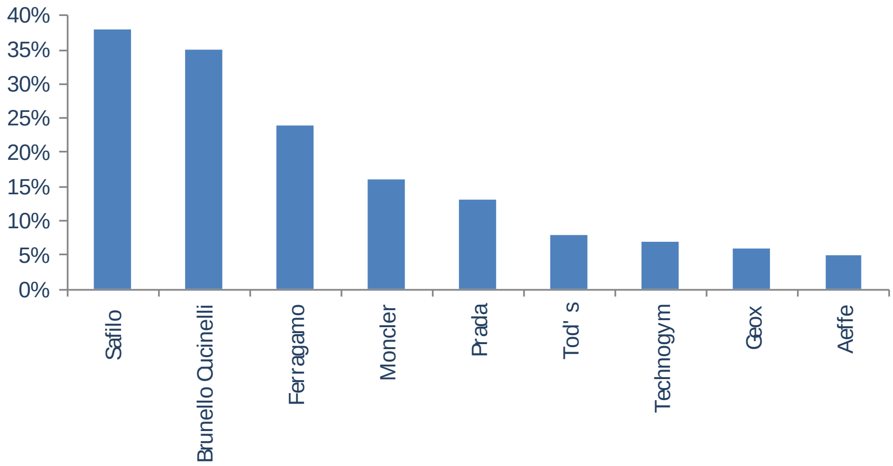
Moreover, at the beginning of December 2019 US administration proposed up to 100% tariff on French goods in retaliation for the digital tax implemented by France. The list of proposed tariffs covers beauty products and handbags. The United States Trade Representative (USTR) did not specify an effective date for the proposed tariffs but said that the same tariff could be applied on other countries (Italy and Austria). If applied, those tariffs would be a negative for the European branded goods industry overall, and even more so if tariffs are then extended to cover product from other countries and specifically Italy. Most EU branded goods players have no manufacturing capacity in the US.

Hence we believe that if additional tariffs are applied, brands are likely to pass them through wholesale/retail prices, leading to a potential negative impact on volumes, more than on margins. Despite that, we believe that in general terms, tariff's impact is unlikely to hurt significantly luxury players' performance, for the following reasons: (i) Demand elasticity to prices is fairly limited for luxury items, especially for the high-end of the spectrum; (ii) Import duties might drive additional tourist demand in Europe (in 2019 Global Blue highlighted significant increase in US tourist spending in Europe, mainly as a consequence of dollar strengthening).

Within our Italian branded goods coverage, Brunello Cucinelli (35%), Ferragamo (24%), have the largest exposure to the Americas without having production capacity there. Similarly, Italian companies have no manufacturing capacity in France, so they are not expected to have any effect from potential tariffs on French goods.

Global geopolitical tensions might impact "feel good" factor but are unlikely to spoil demand trends in the short term.

Italian branded goods: exposure to North America



Source: Mediobanca Securities, company data

c) Sector consolidation drives re-rating

Sector consolidation has always been in the agenda for luxury conglomerates over the last decade but it is now more likely to be in their agenda in 2020. At the end of November LVMH announced that it agreed to buy Tiffany in all-cash deal which values the US Jeweller USD16.2bn. The deal is expected to close in mid-2020, after anti-trust clearances at 3.7x 19EV/Sales 20.8x 19EV/EBIT and 27.7x 19PE not much different from those of LVMH at that time. The deal makes a lot of sense, as it allows to more than double LVMH's size in the hard luxury business, and increase the contribution of Watches& Jewelry from 9% to 16% of group revenues, and from 7% to 13% of group operating profit. On FY2020 it should be EPS accretive by approx. 5% without considering any synergies. Without unveiling any integration plan, LVMH's management sees benefits from integrating Tiffany to arise from (i) retail, in terms of both improving sales density (historically lower in US stores) of the existing network and network development; (ii) product expansion toward complementary categories, such as watches and leather accessories. On this regard engagements jewelry and silver collections will keep their key role, the latter especially as an entry price category.

Few weeks later, unexpectedly Bloomberg reported that Kering held exploratory talks to buy Moncler. In a press release the main shareholder softly denied ongoing negotiations, just stating that he "*maintains contacts and interacts with investors and other sector participants including Kering* […] *At the moment however there is not any concrete hypothesis under consideration*". The statement suggests that a potential deal is unlikely in the short-term, but it does not rule out further consolidation in the sector.

A proactive approach by both Kering and LVMH lately would signal that M&A is becoming an even more important growth lever for the largest players in the industry. This is fueled by historically low gearing levels and low cost of funding and should drive additional re-rating on the branded goods sector, as the scarcity of prays in the industry implies premium multiples. Sector average valuation now at c.28x 1Y-forward, following almost 10% re-rating in the last three months, is already at c.30% premium to historical average, despite challenging fundamentals.

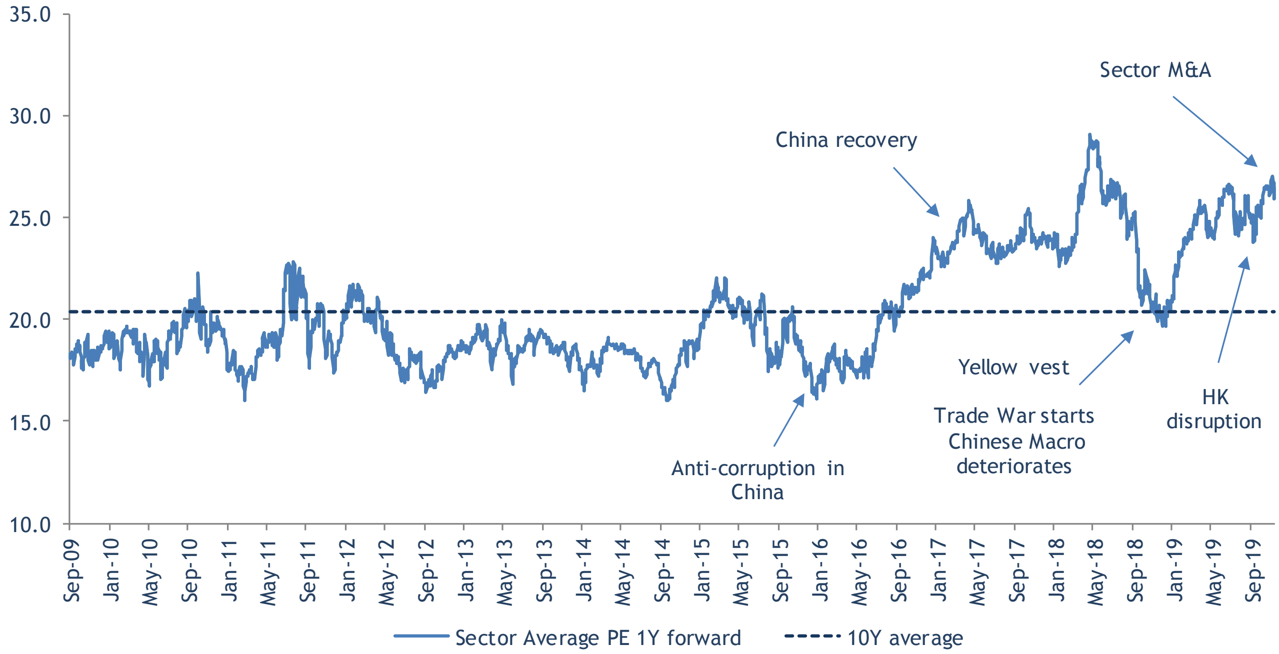
Within our coverage, Ferragamo is in our view the name that could most likely benefit of the rekindling of M&A talks, due to its fragmented shareholders' structure and turnaround strategy that has yet to yield results.

Valuation and estimates change

The European Branded Goods sector trades at 27x 1Y forward, c.30% premium to the 10-year historical average. Within the sector, Italian players have historically traded at a premium to the European sector, reflecting M&A potential, mono-brand strategy and potentially higher growth prospects.

M&A has indeed turned into the biggest driver for sector re-rating, especially after LVMH has announced the acquisition of Tiffany in November and Bloomberg has reported Kering's interest in Moncler in December.

Sector average PE (September 2009-September 2019)



Source: Mediobanca Securities

Share price performance has been indeed quite de-correlated from company-specific organic performance expectations, especially towards the end of 2019.

Italian branded goods – Sector valuation multiples* (ex-IFRS16)

	EV/Sales		EV/EBITDA		EV/EBIT		Adj. P/E	
Company	**2019E**	**2020E**	**2019E**	**2020E**	**2019E**	**2020E**	**2019E**	**2020E**
Aeffe	0.7x	0.6x	6.5x	6.3x	10.3x	9.8x	16.1x	14.8x
Brunello Cucinelli	3.9x	3.6x	22.3x	20.4x	30.4x	27.0x	42.2x	40.5x
Ferragamo	2.2x	2.1x	14.6x	13.9x	21.9x	20.8x	35.1x	32.6x
Geox	0.4x	0.4x	9.4x	7.0x	nm	33.9x	nm	84.1x
Moncler	6.0x	5.2x	17.0x	14.5x	19.2x	16.3x	26.4x	24.7x
Prada	2.8x	2.7x	16.4x	14.7x	28.1x	24.1x	49.7x	40.1x
Safilo	0.3x	0.3x	11.6x	4.2x	nm	14.3x	nm	56.8x
Technogym	3.5x	3.2x	16.5x	14.7x	21.0x	18.3x	27.4x	25.7x
Tod's	1.5x	1.4x	22.3x	20.1x	77.9x	64.8x	nm	97.9x
Average	**2.4x**	**2.2x**	**15.2x**	**12.9x**	**29.8x**	**25.5x**	**32.8x**	**46.3x**

*Source: Mediobanca Securities; * prices updated as of 7 January, 2020*

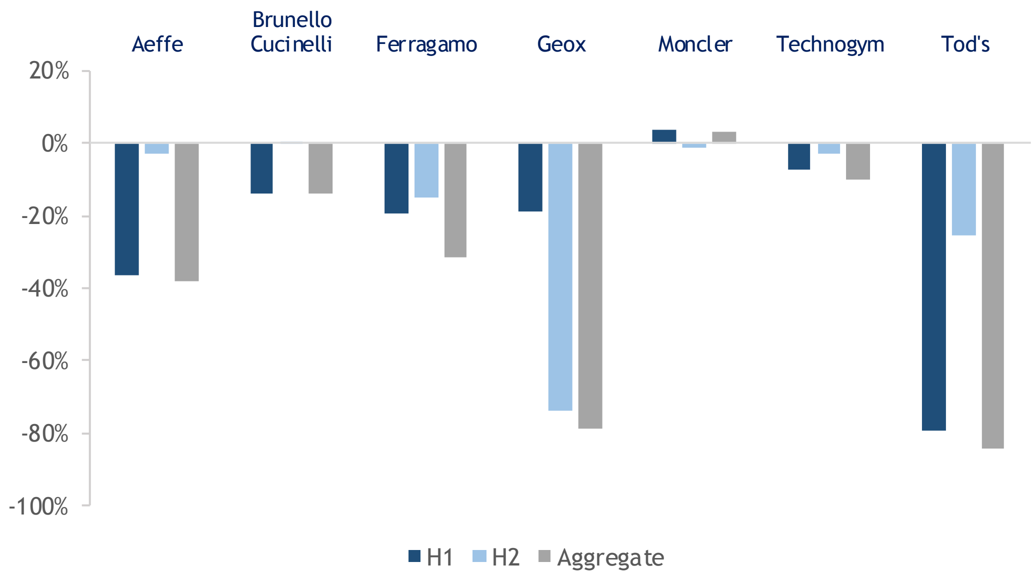
Estimates changes

Our cautious stance stems from business disruption in Hong Kong due to persistent social unrest, only partially offset by stronger domestic demand in Mainland China.

Since January we have reflected the deteriorating macro environment cutting Italian Branded Goods EPS estimates for 2020 by 20% on average. More specifically, between January and July, we have lowered our EPS estimates by 13%, with Moncler being the only player recording a positive revision, attributable to a very strong end to the winter season. Since July, when Hong Kong discontent turned into social unrest, the pace of revision continued with 7% earnings cut on average, with Brunello Cucinelli proving to be the most resilient. Rather, following 10% yoy top-line growth reported in FY19, we have increased 2019-21 EPS estimates by 3-4% on average. We have kept our NEUTRAL rating while increasing our TP to €34.0 from €31.7/share.

We show the earnings revision in the chart below.

Figure 2: Italian branded goods - Cumulated EPS cut during 2019



Source: Mediobanca Securities, company data

In addition, we are further trimming our 2020 numbers for most players as highlighted below.

We have made a double-digit EPS cut for **Tod's** where we assume top-line recovery to lag behind in a tougher macro environment, with actions taken likely to bear results on a longer time horizon. We keep our NEUTRAL rating and cut our TP to €32.5 from €34 per share.

We have also made minor EPS adjustment for **Technogym** in the low single-digit, as we assume long term guidance of mid to high single digit top line growth intact. NEUTRAL rating and Tp of €10.0 confirmed.

We downgrade **Aeffe** from Outperform to Neutral target price from €2.50/share to €2.20/share, following a double digit earnings cut on weak momentum and no margin recovery expected in 2020.

AEFFE - Change in 2019-21 estimates

€m	2019e			2020e			2021e		
	OLD	NEW	DIFF%	OLD	NEW	DIFF%	OLD	NEW	DIFF%
REVENUES	347.1	347.1	0%	358.9	350.1	-2%	376.8	360.6	-4%
Chge%	0.1%	0.1%		3.4%	0.9%		5.0%	3.0%	
EBITDA	37.3	36.5	-2%	40.1	34.9	-13%	46.3	36.9	-20%
Margin (%)	10.8%	10.5%		11.2%	10.0%		12.0%	10.2%	
EBIT	23.8	23.0	-3%	27.6	22.4	-19%	34.8	25.4	-27%
Margin%	6.9%	6.6%		7.7%	6.4%		9.2%	7.1%	
NET PROFIT	13.3	13.0	-2%	17.3	14.1	-18%	22.3	17.3	-22%
Chge%	-20.5%	-22.1%		33.2%	8.3%				
EPS	0.12	0.12	-2%	0.16	0.13	-18%	0.21	0.16	-22%

Source: Mediobanca Securities

Brunello Cucinelli - Change in 2019-21 estimates

€m	2019e			2020e			2021e		
	OLD	NEW	DIFF	OLD	NEW	DIFF	OLD	NEW	DIFF
REVENUES	599	609	2%	648	658	2%	703	712	1%
Chge%	8.1%	9.9%		8.1%	8.0%		8.5%	8.3%	
EBITDA	104	106	2%	113	115	1%	125	127	2%
Margin%	17.3%	17.3%		17.5%	17.5%		17.8%	17.8%	
EBIT	75	78	4%	84	87	3%	92	95	3%
Margin%	12.5%	12.7%		13.0%	13.2%		13.1%	13.3%	
NET PROFIT	53.2	55.1	4%	55.7	57.4	3%	62.2	64.3	3%
Chge%	4.8%	8.6%		4.7%	4.3%		11.8%	11.9%	
EPS	0.78	0.81	4%	0.82	0.84	3%	0.91	0.95	3%

Source: Mediobanca Securities

Technogym - Change in 2019-21 estimates

€m	2019e			2020e			2021e		
	OLD	NEW	DIFF%	OLD	NEW	DIFF%	OLD	NEW	DIFF%
REVENUES	683	680	-1%	737	730	-1%	796	785	-1%
Chge%	7.8%	7.2%		7.9%	7.4%		8.0%	7.4%	
EBITDA	148	146	-2%	163	160	-2%	182	175	-4%
Margin (%)	21.6%	21.4%		22.2%	21.8%		22.9%	22.3%	
EBIT	116	114	-2%	132	128	-3%	150	143	-5%
Margin%	17.0%	16.8%		17.9%	17.5%		18.8%	18.2%	
NET PROFIT	89	88	-2%	96	93	-3%	108	103	-5%
Chge%	-4.0%	-5.8%		7.8%	6.7%		11.9%	10.0%	
EPS	0.45	0.44	-2%	0.48	0.47	-3%	0.54	0.51	-5%

Source: Mediobanca Securities

Tod's – Change in 2019-21 estimates

€m	2019e			2020e			2021e		
	OLD	NEW	DIFF%	OLD	NEW	DIFF%	OLD	NEW	DIFF%
REVENUES	904	904	0%	941	926	-2%	979	965	-1%
Chge%	-3.9%	-3.9%		4.0%	2.4%		4.1%	4.2%	
EBITDA	60	60	0%	74	67	-10%	83	80	-3%
Margin (%)	6.7%	6.7%		7.9%	7.2%		8.4%	8.3%	
EBIT	17	17	0%	28	21	-26%	38	35	-7%
Margin%	1.9%	1.9%		3.0%	2.2%		3.8%	3.6%	
NET PROFIT	8.7	8.7	0%	18.2	13.6	-25%	25.2	24.0	-5%
Chge%	-81.5%	-81.5%		108.9%	56.4%		38.4%	76.4%	
EPS	0.26	0.26	0%	0.55	0.41	-25%	0.76	0.73	-5%

Source: Mediobanca Securities

MEDIOBANCA SECURITIES

REAL ESTATE – NEED TO BE HIGHLY SELECTIVE

2020 is likely to be characterised by continuing low interest rates coupled with a weak macro outlook for Italy. While low interest rates support the investment in real estate, subdued macro requires high selectivity in terms of locations and segments. This is due to sustain the performance of the office segment with respect to the retail one, and, in terms of locations of the largest cities (Milan and Rome).

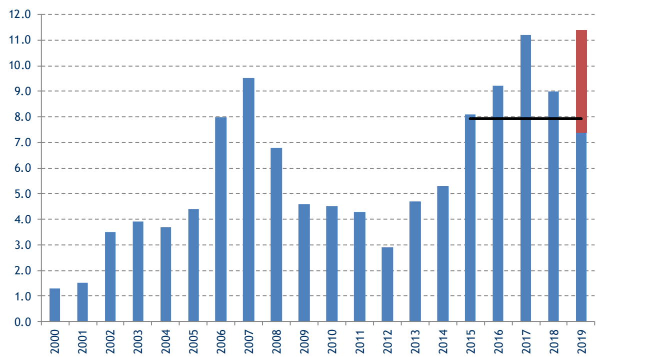
The slow improvement of the Italian residential sector is continuing. Transaction volume are growing at a low single digit rate, hold back by low bank financing availability due to tight credit standards. Price recovery remains limited to Milan and a handful of medium cities but is taking momentum. 0.2% price increase in 2019/2020 should be followed by 0.7% growth in 2021 and +1.1% in 2022.

Strong investment volume boosted by foreign capital

Based on preliminary data, 2019 closed with record high investment volume in Italian CRE. After a 40% increase in the first nine months, sector's players expect total investments to exceed €11bn in the year (c.25-30% up yoy), well above the average level recorded in the last 5 years of around €8.0bn p.a.

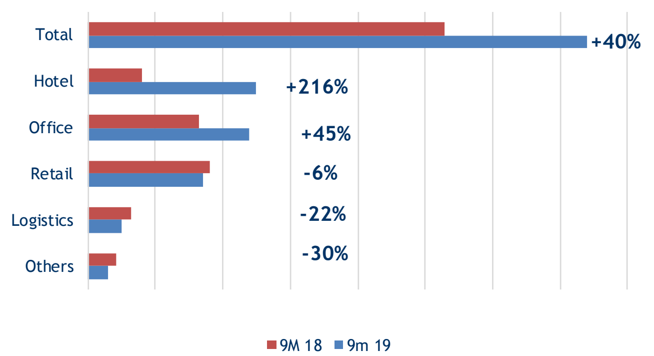
Demand, traditionally highly focused on offices, regarded more subsectors, with hotel and logistic taking a larger share, and more locations. The investment in the office sector reached €2.4bn, up 45%, while, thanks to some large single deals, hotels more than tripled to €2.5bn. Retail appears by far the weakest segment showing a 6% decline in 9M 19 despite a good third quarter, reflecting the impact on this sector of changing consumer habits.

Investment volume (€ bn)



Source: CBRE, BNP Paribas, DTZ, Coima Res, Mediobanca Securities

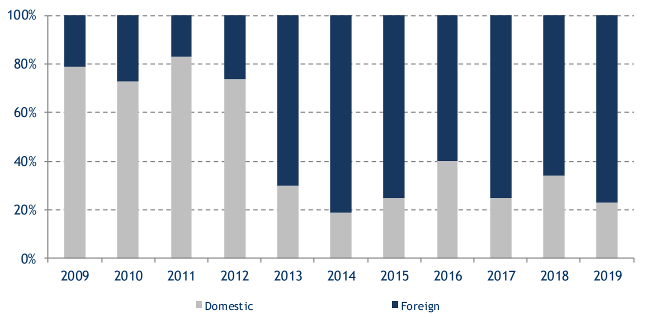
Investment volume by asset class (€ bn) – 9M 19



Source: CBRE, Coima Res, Mediobanca Securities

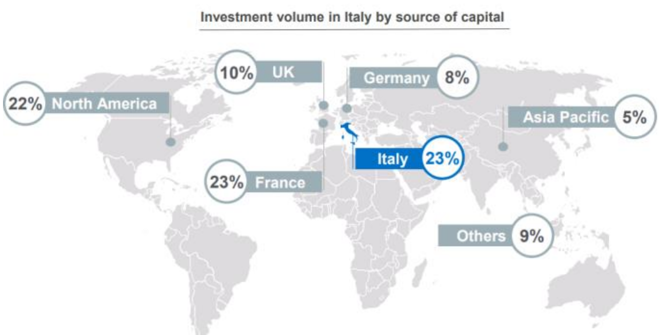
Foreign capital accounted for 77% of total investment volume, with US and French investors as the most active players in 9M 19.

Investment volume by source of capital



Source: CBRE, BNP Paribas, Coima Res, Mediobanca Securities

Investment volume in Italy by source of capital – 9M 19



Source: CBRE, Coima Res, Mediobanca Securities

Yields compression in prime assets; expansion in secondary ones

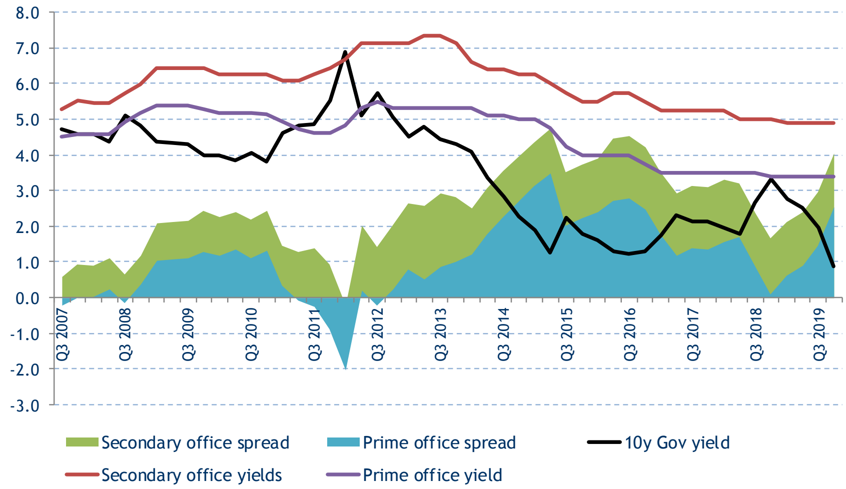
In the office segment, prime yields remained stable at YE 2018 lows in Milan (3.4%) and declined slightly in Rome to 3.75%, while some semi-central markets recorded a compression. Prime rents in Milan are on the rise, sustained by strong take up (+15% in 9M 2019) and low availability of grade A product. Milan is characterised by a strong corporate environment with 50% of all multinationals active in Italy located in Milan and 25% of all start-ups. Prime rents in Milan are seen up by 8% in total in the next three years, after a 22% increase in the period 2013-3Q 19.

A similar polarisation between prime and secondary assets is visible also in the retail segment. While high street prime yields remained stable at 3.0%, all other segments showed some yield expansion in the last quarters.

Flattish office yield, coupled with a steep decline in 10y bond yields in 2019, led to a strong expansion in the risk premium of the sector from the YE 2018 low (risk premium defined as the spread between yields on real estate and yields on government bonds). Such a risk premium, that was only slightly above zero at YE 2018, is now at more than 250 bps for prime and 400 bps for secondary offices.

Going forwards, while low interest rates are expected to continue to represent a positive drive for real estate investments, we expect the market to remain selective both in terms of sectors, preferring offices over retail, and location, with a continuing focus on Milan and Rome.

Italian office prime and secondary yields vs BPT yields (%)



Source: CBRE, Cushman & Wakefield, CRES, Thomson Reuters, Mediobanca Securities

Residential prices finally up

The slow improvement of the Italian residential sector is continuing. Transaction volume increased by around 6.7% in 2018 and 2019 is set to close 2.2% up to 592k, below the original expectation of c.4% increase. Despite a high potential demand (approx. 2.5m households would be intentioned to acquire a new house), house transactions are not picking up as potential demand is largely dependent from bank financing. Subdued macro outlook coupled with tight credit standards limited house transaction growth while the share of transactions financed by banks decreased from 58% in 2018 to 52% in 2019. Assuming a similar scenario (subdued macro and tight credit standards), Nomisma expects a 0.4% reduction in house transaction volume in 2020.

Price recovery remains limited to Milan and a handful of medium cities but is taking momentum.

2019 closed with a 0.2% increase in house prices, the first positive sign after 10 years of continuing declines that cut average prices by almost 25% from 2008's peak. Nomisma expects a 0.2% increase in 2020, 0.7% growth in 2021 and +1.1% in 2022. Average price data are the result of strongly different trends in the various cities with Milan leading the pack with a 3% increase in prices in 2019 and a 2.3/2.6% increase expected in 2020/2021. On the other hand, 6 out of 13 cities are expected to remain in negative territory in 2020 and 3 in 2021.

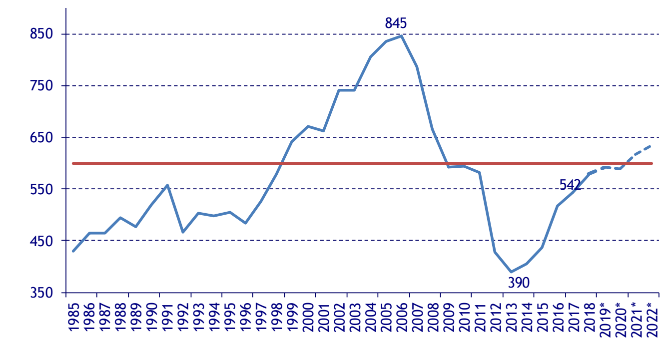
MEDIOBANCA SECURITIES

Italy – Real Estate: YoY price changes

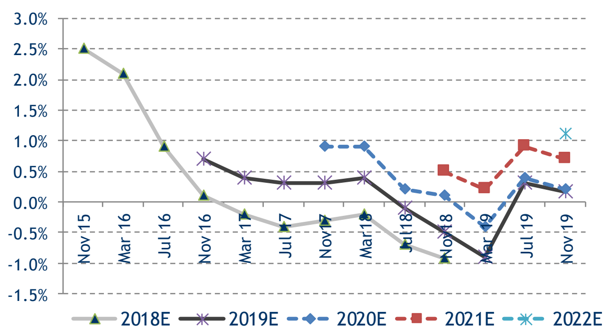
November 2019 estimates	Residential	Retail	Office
2020	0.2%	-0.1%	-0.5%
2021	0.7%	0.3%	0.0%
2022	1.1%	0.6%	0.5%

Source: Nomisma, Mediobanca Securities

Italy - Total House transactions ('000)



Italy - Residential price Estimates (YoY change)



Source: Nomisma, Mediobanca Securities

Coima Res to capture the positive trend of Milan office market

In Real Estate we favor Coima Res (Outperform, TP €9.32) over IGD (N; TP €7.50), reflecting the market preference for high quality segments/assets/locations. Coima Res enjoys an 89% exposure to Milan office market with 49% in the Porta Nuova high growth business district; this attractive positioning could improve further through the investment of the c.€40m current available firepower. Coima Res is trading at a 28% NAV discount to our 2019E estimates with a 3.4% dividend yield. The undemanding valuation is coupled with a low-risk profile, thanks to the company's focus on the Milan office market and low LTV.

As for IGD, in our view, we maintain a Neutral stance on the stock as undemanding valuation (47% NAV discount with 8.1% dividend yield in 2019/2020) and the support derived from growing inflow into PIR may offset its low FFO growth and NAV pressure.

ITALIAN MID CAPS – TRADING AT DISCOUNT VS. LARGE CAP; MIND THE PIR REGULATION

In 2019 the Italian Mid cap cluster experienced a positive re-rating, partly recovering the ground lost in 2018. This trend was not supported by PIR inflows. The Italian Mid-caps now trades at 15.5x 1YFWD earnings, at discount vs large caps and European Mid-caps, while 10% above their mid-cycle average.

The YTD re-rating was mainly the result of a multiple expansion, while earnings started to show some cracks. The recent worsening of global macro indicators, due to tariff tensions, triggered since June a further 6% cut on our EPS estimates for the Mid Cap cluster (ex-financials).

We believe that the recent change of the PIR regulation should be supportive for the whole index and favour companies showing sustainable DPS, above-average return on investment and free cash flow generation.

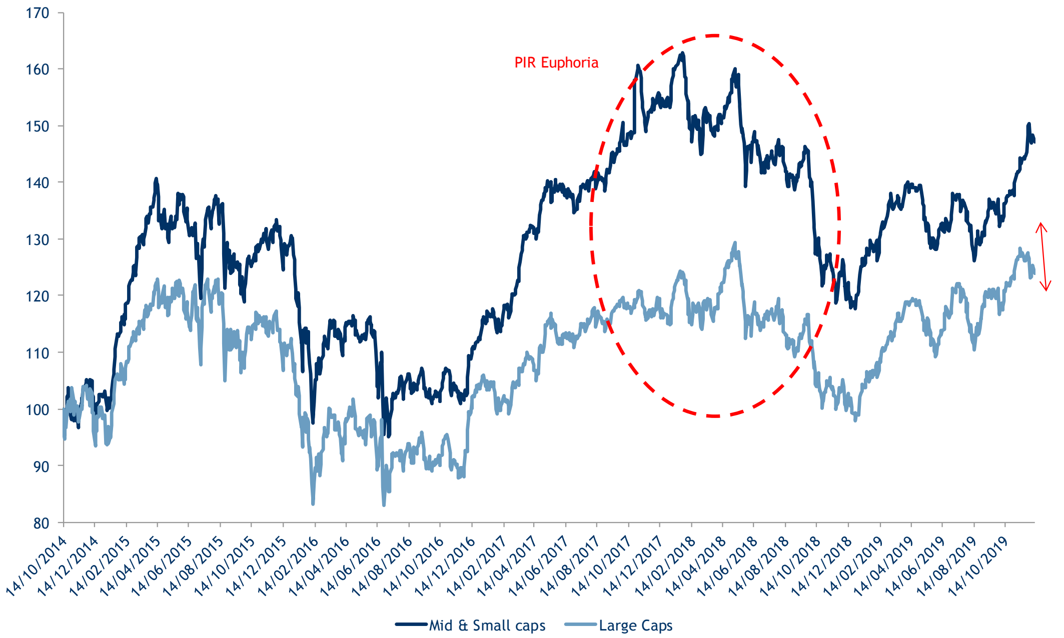
A PIR portfolio selection, to be held for the longer investment horizon of the scheme, should include, in our view, the following names: Autogrill, BFF Banking Group, Interpump, Iren, ENAV, SeSa.

Significant re-rating during 2019; Despite lack of PIR support

Since the launch of the Mediobanca Mid & Small cap product (mid-October 2014), our proprietary index tracking the performance of the cluster has increased by c.45%. In 2018, uncertainties linked to the Italian Budget Law approval, coupled with the macro outlook becoming complex amid the global tariff dispute, were the main drags hindering the index's performance.

Following the subdued performance of 2018 (-22%), the index posted c.20% increase in 2019 (without any support from the PIR inflows) also helped by lower spreads.

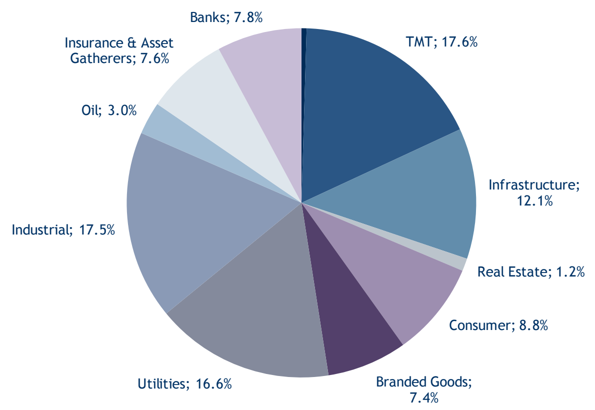
Market performance of MB mid & small caps vs large caps since product launch



Source: Mediobanca Securities, Thomson Reuters Datastream

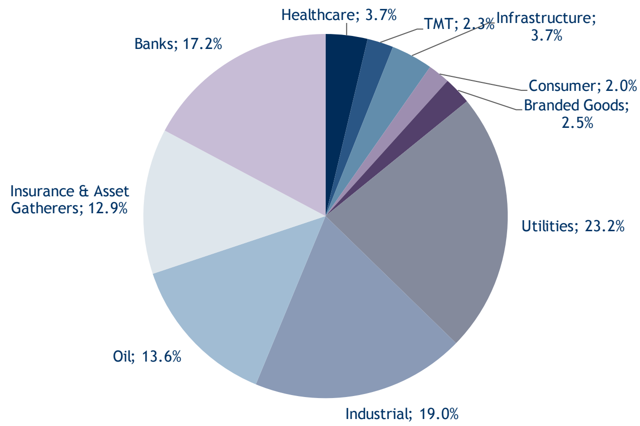
It is worth noting that the recent relative outperformance of the Mid & Small cap cluster vs Large Cap Index (+6%) was chiefly due to the change in PIR regulation. The breakdown of the Mid & Small cap cluster did not experience material changes since our latest update, with the only additions of Garofalo Health Care, as we recently initiated the coverage, and Unipol SAI, which was replaced by Banca Generali in the main Italian index.

MB's mid & small caps by sector



Source: Mediobanca Securities

MB's large caps by sector



Source: Mediobanca Securities

The deep correction observed in 2018, led to a significant multiple compression of the Italian Mid Caps cluster, which traded at discount vs through-the-cycle average. In 2019, the cluster has experienced a positive re-rating and now trades at 15.5x 1YFWD earnings, which is 10% above the FY06-FY18 average.

Looking at the through-the-cycle spread between Mid & Small and Large caps, the overall mid & small cap cluster currently trades at c.3% discount vs Large Caps. This compares with historical average premium of c.4%. The picture does not change significantly even if we exclude financials with the cluster trading at mid-single-digit discount vs large caps.

Mediobanca mid & small caps vs large caps: historical 1YR FWD P/E (on consensus estimates)

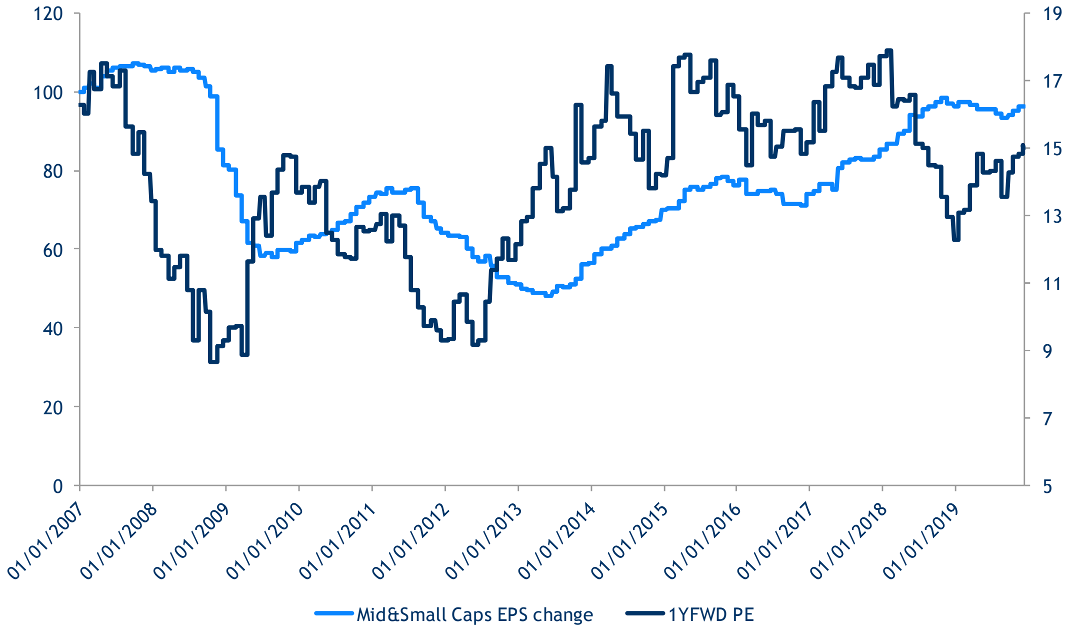
	FY 06	FY 07	FY 08	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18	FY 19	1Y FWD	Average FY06-18	Upside /(Downside)
Mid & Small	16.2x	16.1x	10.7x	12.3x	12.8x	11.4x	10.6x	14.4x	15.7x	16.6x	15.4x	16.9x	15.6x	14.1x	15.7x	14.2x	-9.5%
Large cap	14.6x	14.8x	10.8x	11.3x	12.5x	11.1x	10.3x	13.1x	15.0x	16.7x	15.6x	16.5x	16.0x	14.8x	16.1x	13.7x	-14.9%
Premium/ (Discount)	**11.0%**	**9.4%**	**-0.9%**	**8.7%**	**2.1%**	**2.8%**	**2.6%**	**10.4%**	**4.5%**	**-0.4%**	**-1.5%**	**1.9%**	**-2.5%**	**-4.9%**	**-2.6%**	**3.7%**	
Large cap**	12.2x	12.5x	8.5x	11.5x	10.3x	8.7x	9.2x	11.4x	13.8x	15.2x	12.7x	13.6x	11.1x	10.2x	11.1x	11.6x	4.2%
Premium/ (Discount)**	**32.7%**	**29.5%**	**25.8%**	**6.8%**	**24.2%**	**30.2%**	**14.6%**	**26.8%**	**13.8%**	**9.8%**	**21.2%**	**23.9%**	**39.7%**	**38.3%**	**41.1%**	**23.0%**	
Mid & Small ex-fin.	16.7x	16.7x	10.9x	12.0x	13.0x	11.9x	11.3x	15.5x	15.5x	17.4x	16.2x	17.9x	16.7x	15.4x	17.2x	14.7x	-14.1%
Large cap ex-fin.	15.3x	15.9x	11.8x	11.3x	13.2x	12.3x	11.4x	13.8x	13.8x	17.9x	17.7x	18.6x	18.2x	17.1x	18.3x	14.7x	-19.8%
Premium/ (Discount)	**9.2%**	**5.2%**	**-8.3%**	**6.0%**	**-1.5%**	**-3.2%**	**-0.3%**	**12.3%**	**12.3%**	**-2.3%**	**-8.4%**	**-3.7%**	**-8.4%**	**-9.9%**	**-6.3%**	**0.7%**	

Source: Mediobanca Securities, Thomson Reuters Datastream **prices as of 10/12/2019,**Mkt Cap Weighted*

Mid caps are now trading at above 15x 1FWD P/E, as multiples re-rated on a YTD basis. Such a level remains below the peak reached at the end of 2017 in the region of 18x (helped by the first PIR introduction) and c.35% above the bottom levels observed in 2009 and 2012.

This YTD re-rating couples with a declining earnings' trend observed (with Mid & Small caps' EPS down by c.3% YTD). The following chart shows the 1YR forward multiple of the Mediobanca Mid & Small cap index over more than ten years and the trend in earnings at the aggregate level.

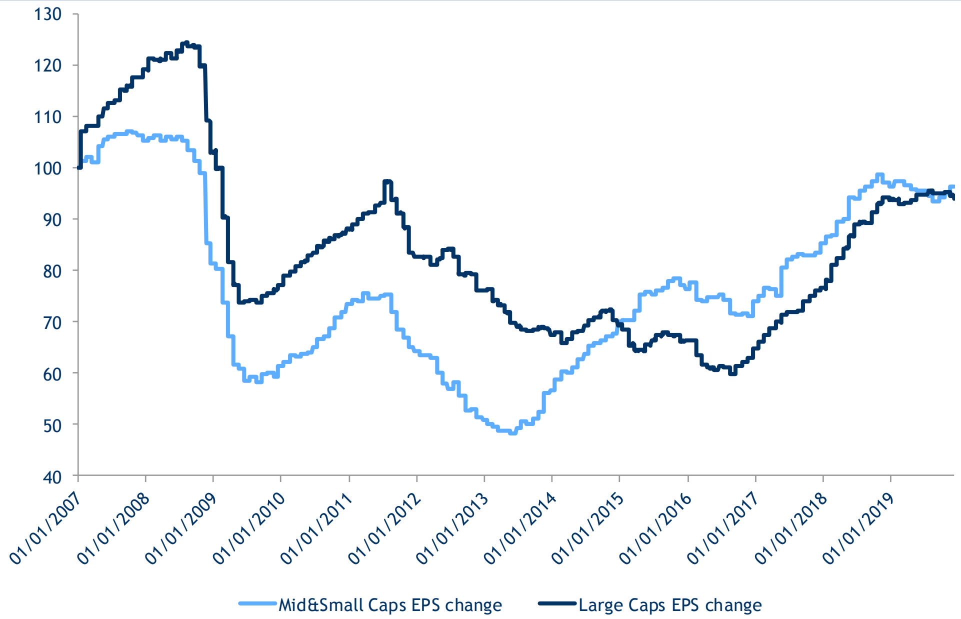
Mid & Small cap index – 1YR FWD earnings vs. 1Y FWD P/E



Source: Mediobanca Securities, Thomson Reuters Datastream

Restating the 1YFWD earnings trend for the recent reshuffle of both indexes, we note that large caps and Mid & Small ones are still below the 2008 earnings level. By cluster, Mid & Small caps have started to show a downward trend in earnings, while large caps' earnings path has remained stable so far.

1YR FWD earnings trend – mid & small cap vs large cap index



Source: Mediobanca Securities, Thomson Reuters Datastream

Since June (when we published the Italian Mid Cap report), we have downgraded our 2019-20 EPS estimates by c.6% on average for Mid & Small Caps, excluding Financials. We note that our estimates for Mid & Small are 4% below consensus estimates for 2020-21. On 2020, our estimates imply a double digit growth in earnings.

FY2019-21E cumulated earnings for Mediobanca Mid & Small caps (€m) vs Consensus

(€m)	MBe FY1E	MBe FY2E	MBe FY3E	CONS. FY1E	CONS. FY2E	CONS. FY3E	MBe vs CONS. FY1E	MBe vs CONS. FY2E	MBe vs CONS. FY3E
Mid & Small Caps ex-Financials	3,936.1	4,554.7	4,806.9	4,080.8	4,779.4	5,023.8	-3.5%	-4.7%	-4.3%
Mid & Small Caps Financials	1,694.0	1,502.0	1,555.4	1,701.1	1,541.6	1,636.7	-0.4%	-2.6%	-5.0%
Mid & Small Caps Total	**5,630.1**	**6,056.7**	**6,362.3**	**5,781.9**	**6,321.0**	**6,660.5**	**-2.6%**	**-4.2%**	**-4.5%**

Source: Mediobanca Securities, Thomson Reuters Datastream

Italy's Mid-caps vs EU: 6% discount reflects domestic & macro concerns

Since June, Italian Mid-caps narrowed the valuation gap vs other European mid cap indexes. 2020 P/E multiple of European Mid-caps now stands at 15.7x, reflecting a 6% premium vs. Italian mid-caps. All European mid-caps over the past six months rerated but still remain below their relative peak multiples.

With an earnings trajectory overall negative across Europe over the last six months, the multiple expansion observed YTD was also the result of a positive price trend. Italian Mid-caps currently trade at a 6% discount vs the EU average. This negative gap is touch above its historical mid-single-digit discount, reflecting a tougher macro environment in Italy and abroad which translated into a severe earnings' revision in the past six months (2019 EPS down 9%). Among the best performers, we find German mid-caps (up 26% in 2019), a trend justified by the expectation of a gradual easing of trade tensions. The YTD earnings trajectory across Mid cap indexes is overall similar, and the average F1 P/E multiple of European Mid-cap indices has expanded since January as the main result of a price trend (from 13.6x to 15.7x; it was above 16x two years ago).

F1 & F2 PE multiple of the European Mid cap indexes

		-8Y AVGE	-1Y AVGE	2019E P/E	2020E P/E	Upside Potential vs. -8Y AVGE	Upside Potential vs. -1Y AVGE
	FTSEMIB Index	13.5	10.7	11.9	11.3	19%	-5%
ITALY	ITMC (MIDEX)	16.2	14.6	16.3	14.7	10%	-1%
	MID vs. LARGE	20%	36%	37%	30%		
	DAX 30	12.9	13.5	15.6	13.9	-8%	-3%
GERMANY	MDAX	17.2	18.9	21.8	19.4	-11%	-2%
	MID vs. LARGE	34%	40%	40%	39%		
	CAC 40	14.0	14.2	16.1	14.4	-3%	-2%
FRANCE	CAC MID 60	18.3	17.1	18.7	16.0	15%	7%
	MID vs. LARGE	31%	20%	17%	11%		
	FTSE 100	13.8	12.8	13.4	12.6	9%	1%
UK	FTSE 250	14.6	13.6	15.3	14.2	3%	-4%
	MID vs. LARGE	6%	7%	14%	12%		
	IBEX 35	13.6	12.0	13.1	12.1	13%	-1%
SPAIN	IBEX MEDIUM CAP	17.1	13.7	14.9	13.2	29%	3%
	MID vs. LARGE	26%	14%	14%	9%		
	LARGE CAP avge ex ITALY	**13.6**	**13.1**	**14.5**	**13.3**		
	FTSEMIB vs. AVGE	**-0.5%**	**-18.1%**	**-18.2%**	**-14.6%**		
	MID CAP avge ex ITALY	**16.8**	**16.3**	**15.4**	**13.6**		
	ITMC (MIDEX) vs. AVGE	**-3.5%**	**-7.4%**	**-7.8%**	**-6.1%**		

Source: Mediobanca Securities, Bloomberg, Priced as of 10 December 2019.

Focusing on Italy, the table above highlights a decent re-rating (from 12.1x to 14.7x P/E) based on consensus earnings estimates. The Italian Mid cap index currently trades at a 6% discount vs the Mid cap index average (it was a 12% discount last June). This negative gap of Italian mid-caps vs European indices is now touch above the historical average (i.e., mid-single digit discount), reflecting a tougher macro environment in Italy and global GDP deceleration, partly offset by the expected positive impact from new PIR regulation.

MEDIOBANCA’S COVERAGE: KEY MULTIPLES

Italy – Key Multiples of Listed Financial Companies (2019/2020)

Company	SECTOR	Adj. P/E 2019	Adj. P/E 2020	P/TE 2019	P/TE 2020	Adj. RoTE 2019	Adj. RoTE 2020	DPS yield 2019	DPS yield 2020
Anima Holding*	Asset Gatherer	9.2	9.3	-3.29	-3.27	n.m	n.m	4.1%	4.6%
Azimut Holding*	Asset Gatherer	10.3	14.2	12.59	12.28	180.4%	87.6%	6.8%	7.3%
BFF Banking Group*	Bank	9.2	8.3	3.40	3.18			7.5%	10.0%
Banca Generali*	Asset Gatherer	13.8	14.1	4.43	3.90	35.1%	29.4%	4.9%	5.2%
Banca Ifis*	Specialty Financials	9.0	8.2	0.51	0.49	5.8%	6.1%	7.6%	7.6%
Banca Mediolanum*	Bank	11.4	15.6	2.97	2.85	27.7%	18.7%	4.9%	4.9%
Banca Monte Dei Paschi di Siena	Bank	10.0	5.7	0.17	0.16	1.7%	2.9%	0.0%	0.0%
Banca Pop. Di Sondrio	Bank	5.4	9.1	0.34	0.33	6.3%	3.6%	2.4%	2.4%
Banco BPM	Bank	7.0	7.0	0.30	0.29	4.4%	4.1%	1.5%	3.3%
BP Emilia Romagna	Bank	10.4	9.8	0.55	0.52	5.3%	5.2%	2.9%	3.0%
Cattolica Assi.ni*	Insurance	11.5	10.2	0.77	0.75	6.8%	7.4%	6.3%	7.0%
Credem	Bank	9.0	9.5	0.71	0.68	8.2%	7.1%	4.1%	4.1%
Creval	Bank	16.4	13.7	0.30	0.30	1.9%	2.2%	0%	3.7%
Finecobank*	Asset Gatherer	27.0	23.6	6.81	6.13	29.8%	28.7%	2.9%	3.1%
Generali*	Insurance	12.2	11.0	1.15	1.12			5.2%	5.4%
Intesa Sanpaolo	Bank	10.0	11.7	0.94	0.93	9.8%	8.0%	7.9%	7.9%
Poste Italiane*	Specialty Financials	11.7	10.7	1.27	1.36	11.8%	12.2%	4.5%	5.3%
UBI Banca	Bank	8.8	7.7	0.42	0.41	4.9%	5.4%	4.2%	5.8%
Unicredit**	Bank	8.4	7.8	0.62	0.61	8.3%	7.9%	6.5%	7.3%
Unipol Gruppo Finanziario*	Insurance	7.6	7.1	0.65	0.62	9.1%	8.9%	5.5%	5.5%
Unipol-SAI*	Insurance	12.4	11.2	1.6	1.5	11.7%	13.6%	5.8%	6.0%

** RoE instead of RoTE and P/BV instead of P/TE; Priced as of 7 January 2020; ** UCG includes buyback (approx. 1.5% yield in 2019-20).*

Source: Mediobanca Securities,

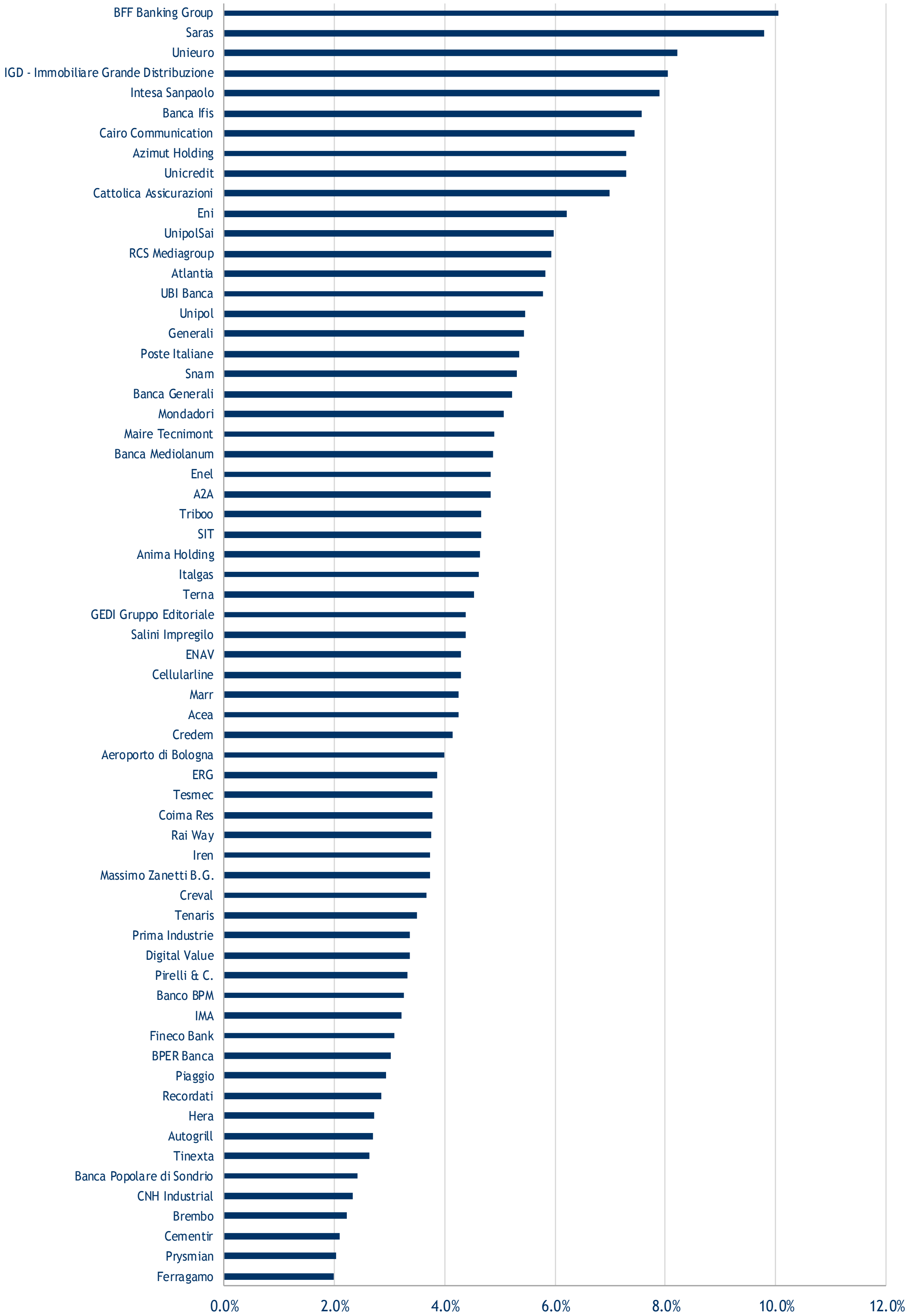
Italy – Key Multiples of Listed Companies (2019/2020)

	EV/SALES			EV/EBITDA			EV/EBIT			Adj. PE			DIV. YIELD		
Company	**2018**	**2019E**	**2020E**	**2018**	**2019E**	**2020E**	**2018**	**2019E**	**2020E**	**2018**	**2019E**	**2020E**	**2018**	**2019E**	**2020E**
A2A	1.4	1.6	1.6	7.3	8.4	8.2	15.2	16.2	15.0	13.8	16.6	14.8	4.6%	4.7%	4.8%
Acea	1.9	2.3	2.3	5.8	6.9	6.9	11.3	14.1	13.6	10.6	14.3	13.4	5.3%	4.2%	4.3%
Aeffe	0.9	0.7	0.6	7.3	6.5	6.3	10.6	10.3	9.8	16.9	16.1	14.8	0.0%	0.0%	0.0%
Aeroporto di Bologna	4.6	3.4	3.5	13.5	9.5	10.5	20.7	13.6	16.7	29.7	20.1	23.2	3.0%	3.9%	4.0%
Amplifon	3.3	3.8	3.4	19.7	23.4	19.6	29.0	36.7	29.0	33.7	40.5	36.0	0.9%	0.6%	0.7%
Antares Vision	n.a.	4.9	3.8	n.a.	17.6	13.9	n.a.	18.4	14.4	n.a.	26.7	21.7	0.0%	0.0%	0.0%
Astaldi															
ASTM	n.a.	1.9	2.2	n.a.	5.1	5.9	n.a.	8.7	8.8	n.a.	9.8	11.7	2.1%	4.7%	5.6%
Atlantia	9.9	5.6	5.5	16.3	8.7	8.5	30.6	16.6	16.0	23.3	19.3	16.1	3.9%	4.4%	5.8%
Autogrill	0.7	0.6	0.6	8.5	6.7	6.1	21.9	9.1	12.0	36.2	21.9	17.0	2.0%	2.4%	2.7%
Brembo	1.5	1.5	1.4	8.1	7.8	7.3	11.7	12.4	10.9	16.2	15.8	14.2	1.9%	2.1%	2.2%
Brunello Cucinelli	3.8	3.9	3.6	22.3	22.3	20.4	30.5	30.4	27.0	45.8	42.2	40.5	1.0%	1.0%	1.2%
Buzzi Unicem	1.3	1.3	1.2	6.7	6.2	5.5	11.0	9.8	8.5	12.6	13.1	12.5	0.7%	0.6%	0.7%
Cairo Communication	0.7	0.6	0.6	4.9	5.0	4.7	7.1	6.7	6.2	7.4	6.3	6.2	4.5%	7.4%	7.4%
Campari	5.1	5.4	4.9	20.2	21.2	18.4	23.1	24.9	21.3	31.8	33.5	29.1	0.7%	0.7%	0.7%
Carel	3.4	4.3	3.9	20.5	21.7	19.0	25.5	28.2	24.8	24.4	35.1	31.4	1.1%	1.1%	1.1%
Cellularline	1.7	1.3	1.1	8.0	5.7	4.7	11.8	7.9	6.3	8.5	6.0	6.1	3.3%	4.3%	4.3%
Cementir	1.2	1.2	1.1	6.1	6.0	5.4	9.5	10.3	9.1	10.6	12.0	10.7	2.1%	2.1%	2.1%
Cerved															
CNH Industrial	0.6	0.6	0.6	5.3	5.1	4.8	8.7	8.6	7.9	15.3	13.1	11.9	1.7%	2.2%	2.5%
Coima Res	13.7	13.5	13.1	25.7	20.2	19.6	25.7	20.2	19.6	16.4	24.5	24.1	3.7%	3.4%	3.8%
Danieli	0.4	0.2	0.2	4.9	2.9	2.9	10.7	6.9	6.4	19.3	16.9	13.3	0.5%	0.9%	0.9%
De' Longhi	1.8	1.3	1.2	12.3	9.2	8.6	15.4	12.5	11.8	21.6	16.4	16.5	1.5%	1.8%	1.8%
Diasorin	6.5	8.8	8.2	17.0	22.1	20.7	21.3	27.7	26.1	28.3	37.0	36.2	1.1%	1.1%	1.1%
Digital Value	0.3	0.4	0.4	3.3	5.2	4.6	3.7	6.0	5.2	7.4	10.5	9.7	0.0%	3.3%	3.4%
ENAV	2.7	3.2	3.1	7.9	10.0	9.6	14.4	17.9	16.8	20.2	25.8	24.6	4.7%	4.0%	4.3%
Enel	1.5	1.9	2.0	6.9	7.9	8.1	11.4	19.5	12.4	10.1	22.5	14.3	5.9%	4.4%	4.8%
Eni	0.8	1.0	0.9	3.3	3.9	3.6	6.4	7.1	6.2	12.1	16.1	12.0	5.4%	6.0%	6.2%
ePRICE	0.4	0.2	0.4	nm	nm	nm	nm	nm	nm	nm	nm	nm	0.0%	0.0%	0.0%
ERG	5.0	5.7	5.3	8.5	9.1	8.5	19.2	22.7	19.7	25.1	30.3	24.5	4.2%	3.9%	3.9%
Ferragamo	2.6	2.2	2.1	16.2	14.6	13.9	23.2	21.9	20.8	41.2	35.1	32.6	1.6%	1.8%	2.0%
FCA															
Ferrari	5.9	7.4	6.9	18.0	21.6	18.8	24.4	29.6	26.0	25.1	38.6	33.7	1.0%	0.8%	0.9%
Fila	2.4	1.9	1.8	19.5	10.8	9.7	29.3	16.2	13.8	32.6	16.0	14.0	0.5%	0.7%	0.8%
Fincantieri	0.6	0.5	0.5	8.1	7.8	6.7	12.1	12.8	10.6	19.5	19.6	14.0	0.8%	1.1%	1.3%
Garofalo Health Care	1.6	2.9	2.4	9.9	15.7	11.2	13.4	21.7	14.7	17.9	25.3	19.4	0.0%	0.0%	1.0%
GEDI Gruppo Editoriale	0.5	0.5	0.5	9.6	6.8	5.7	nm	20.8	13.4	nm	nm	23.0	0.0%	4.4%	4.4%
Geox	0.7	0.4	0.4	12.4	9.4	7.0	39.2	nm	33.9	nm	nm	84.1	1.1%	2.5%	-2.1%
Health Italia	2.7	2.3	1.7	16.4	10.7	7.0	20.0	18.9	10.3	78.8	nm	26.9	0.5%	1.6%	0.9%
Hera	1.3	1.5	1.5	7.5	9.1	9.1	15.2	18.3	18.4	14.6	19.9	19.5	3.6%	2.6%	2.7%
ICF group	1.0	0.8	0.7	9.2	6.6	5.7	82.1	62.8	33.1	17.9	12.0	10.5	0.0%	0.0%	0.0%
IGD - Immobiliare Grande Distribuzio	12.0	11.1	11.2	16.8	14.2	14.4	17.0	14.3	14.6	9.8	8.2	8.0	7.1%	8.0%	8.0%
IMA	2.0	2.1	1.9	11.7	11.9	10.7	14.1	15.9	14.3	22.1	19.0	19.3	2.8%	3.0%	3.2%
Interpump Group	2.5	2.6	2.4	11.2	11.1	10.3	13.7	14.2	13.3	18.4	18.2	17.7	0.8%	0.8%	0.8%
INWIT															
Iren	1.7	1.9	1.8	6.9	7.9	7.6	12.6	15.6	15.3	12.2	14.1	13.6	3.7%	3.4%	3.7%
Italgas	6.6	7.2	7.4	9.2	10.1	10.2	17.1	17.9	17.9	12.4	13.4	13.0	4.9%	4.4%	4.6%
Leonardo	0.6	0.7	0.6	4.8	4.7	4.3	10.9	8.4	7.5	7.0	11.8	10.2	1.5%	1.3%	1.3%
Maire Tecnimont	0.3	0.3	0.2	5.9	3.8	3.6	6.5	4.8	4.5	11.8	7.5	7.6	3.0%	4.5%	4.9%
Marr	1.0	0.9	0.9	14.1	12.1	11.6	17.0	15.6	14.9	22.6	20.2	19.2	3.4%	4.1%	4.3%
Massimo Zanetti B. G.	0.5	0.5	0.5	6.1	5.7	5.3	11.8	12.8	11.7	10.9	11.7	10.7	2.7%	3.4%	3.7%
Mediaset															
Moncler	5.7	6.0	5.2	16.2	17.0	14.5	18.2	19.2	16.3	23.6	26.4	24.7	1.2%	1.1%	1.2%
Mondadori	0.6	0.7	0.6	7.3	6.6	5.6	11.0	9.5	7.8	22.8	15.8	13.2	0.0%	3.0%	5.1%
Nexi															
Piaggio	0.9	0.9	0.8	5.9	6.3	5.7	12.8	12.9	11.4	20.9	20.7	17.4	4.3%	4.0%	2.9%
Pirelli & Co.	2.0	1.7	1.6	9.5	7.0	6.8	14.9	11.4	11.1	12.2	8.8	9.1	2.5%	3.7%	3.4%
Prima Industrie	1.0	0.7	0.7	9.9	7.7	6.8	15.9	18.3	14.4	16.4	17.8	15.9	1.3%	3.4%	3.4%
Prysmian	0.9	0.7	0.7	17.8	9.4	8.6	41.5	14.1	12.7	36.5	13.1	12.2	1.9%	2.0%	2.0%
Rai Way	5.6	7.6	7.6	10.4	12.8	12.7	14.6	18.7	19.0	20.8	26.3	26.7	4.8%	3.8%	3.7%
RCS Mediagroup	0.8	0.7	0.7	4.9	5.0	4.8	6.6	6.5	6.3	6.7	7.9	8.5	5.5%	5.9%	5.9%
Recordati	5.1	5.9	5.4	13.8	15.9	14.4	15.6	18.6	16.7	20.6	23.9	21.3	3.0%	2.6%	2.9%
Reply	1.9	2.2	1.9	13.6	13.5	11.9	14.8	16.6	14.5	20.4	23.5	21.2	0.9%	0.7%	0.7%
Safilo	0.4	0.3	0.3	8.4	11.6	4.2	nm	nm	14.3	nm	nm	56.8	0.0%	0.0%	0.0%
Saipem	0.6	0.6	0.6	6.1	5.0	4.2	nm	10.5	7.9	nm	30.8	15.9	0.0%	0.0%	0.0%
Salcef Group	1.2	1.2	1.1	6.0	5.7	5.1	7.9	7.0	6.3	13.1	11.9	10.4	7.8%	3.6%	3.6%
Salini Impregilo	0.4	0.3	0.2	4.6	3.7	3.4	30.2	6.2	5.2	13.4	8.6	7.0	0.0%	3.1%	4.4%
Saras	0.2	0.2	0.1	8.2	5.4	2.8	24.5	14.6	4.5	68.0	26.8	7.7	4.3%	4.9%	9.8%
SeSa	0.3	0.3	0.4	6.5	6.8	8.4	8.8	9.6	12.1	15.5	16.1	19.6	2.2%	1.9%	1.4%
SIT	0.8	0.7	0.7	6.9	5.3	4.9	12.7	10.3	9.3	10.8	10.5	9.7	3.3%	4.5%	4.7%
Snam	9.5	10.4	10.6	11.8	12.9	12.9	17.7	19.3	19.4	13.5	14.7	14.6	6.0%	5.1%	5.3%
Technogym	3.1	3.5	3.2	14.7	16.5	14.7	18.5	21.0	18.3	24.1	27.4	25.7	1.9%	1.4%	1.6%
Tinexta	1.8	2.6	2.4	6.6	9.2	7.8	9.0	13.5	10.6	9.0	13.3	12.2	3.6%	2.4%	2.6%
Telecom Italia	2.3	2.3	2.2	5.9	5.2	5.2	77.3	11.9	11.9	nm	8.9	9.1	0.0%	0.0%	0.0%
Tenaris	2.5	1.8	1.8	12.4	9.2	9.5	21.5	14.9	15.0	22.6	18.2	17.7	2.4%	3.5%	3.7%
Terna	7.9	8.8	8.8	10.5	11.8	11.8	15.9	17.6	17.8	13.4	16.1	16.0	4.9%	4.2%	4.5%
Tesmec	0.7	0.7	0.7	6.9	5.8	4.6	35.5	20.9	11.4	nm	18.3	7.3	0.0%	0.0%	3.8%
Tod's	2.0	1.5	1.4	16.3	22.3	20.1	26.8	77.9	64.8	39.2	nm	97.9	1.8%	0.5%	1.0%
Trevi Fin.	3.9	4.0		64.5	48.6		nm	nm		nm	nm		0.0%	0.0%	
Triboo	1.0	0.6	0.6	9.2	5.3	4.3	nm	20.4	11.6	nm	26.6	15.4	3.5%	4.7%	4.7%
Unieuro	0.2	0.1	0.1	6.9	3.3	3.4	14.6	6.4	6.2	7.5	5.5	5.9	6.8%	9.2%	8.2%
Weighted Avg	4.0	4.4	3.9	16.4	17.2	15.1	22.0	25.1	21.8	31.2	29.9	28.1	1.3%	1.2%	1.2%
	3.2	3.6	3.3	16.4	18.0	15.6	21.9	24.0	20.6	29.0	30.7	27.1	1.3%	1.3%	1.4%
	5.6	7.0	6.5	15.0	18.6	17.0	17.8	22.7	20.7	23.6	29.6	27.7	2.1%	1.8%	2.0%
	7.4	5.5	5.5	19.4	13.7	10.5	29.4	17.1	16.2	26.8	21.2	18.9	2.8%	3.1%	3.8%
	1.2	1.1	1.0	5.8	5.0	4.7	10.6	8.9	7.9	14.8	17.5	13.1	4.4%	5.1%	5.3%
	2.0	3.3	3.1	8.3	10.7	9.5	12.5	15.3	13.5	14.4	20.6	18.1	2.2%	2.8%	2.2%
	12.4	11.8	11.8	19.2	16.1	16.1	19.3	16.2	16.2	11.6	13.4	13.1	6.2%	6.6%	6.7%
	2.0	2.0	1.9	6.8	6.5	6.4	62.8	12.2	11.9	16.6	11.4	11.7	0.5%	0.7%	0.7%
	3.6	3.8	3.9	8.1	9.1	9.2	13.6	18.8	14.7	12.0	20.0	14.9	5.4%	4.4%	4.7%
Simple Avg	**4.6**	**4.7**	**4.5**	**12.8**	**12.8**	**11.6**	**23.3**	**17.8**	**15.9**	**18.2**	**18.9**	**17.1**	**3.6%**	**3.7%**	**3.8%**

Source: Mediobanca Securities, Priced as of 7 January 2020

MEDIOBANCA SECURITIES

Italy – Dividend yield (FY20E)



Source: Mediobanca Securities, Priced as of 7 January 2020

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Proportion of all recommendations relating to the last quarter					
Outperform	Neutral	Underperform	Not Rated	Restricted	Coverage suspended
37.35%	47.47%	14.79%	0.00%	0.39%	0.00%

Proportion of issuers to which Mediobanca S.p.A. has supplied material investment banking services relating to the last quarter:					
Outperform	Neutral	Underperform	Not Rated	Restricted	Coverage suspended
0.00%	0.00%	0.00%	0.00%	0.00%	0.00%

The current stock ratings system has been used since 25 September 2017. Before then, Mediobanca S.p.A. used a different system, based on the following ratings: outperform, neutral, underperform, under review, not rated. For additional details about the old ratings system, please access research reports dated before 25 September 2017 from the restricted part of the "MB Securities" section of the Mediobanca S.p.A. website at www.mediobanca.com.

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Date of report production: 08 Jan 2020 - 16:51

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