Italian non-financial companies economic outlook 2018
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The projections in this study reflect Cerved Rating Agency’s opinion on the economic and financial situation and the general risk level of Italian non-financial companies in 2018.

The study is the product of the analysis of the Global, European and Italian macroeconomic historical data between 2000 and 2017 and the forecasts for 2018 combined with specific individual data between 2000 and 2017 related to Italian non-financial companies with turnover exceeding €5 million.
A number of assumptions have been adopted for the projections exposed in this study, more specifically:

- The Italian economy is expected to grow at a slower pace in 2018 with GDP forecast at 1.5% compared to 1.6% recorded in 2017;
- The inflation rate is expected to decrease from 1.4% recorded in 2017 to 1.2% in 2018, remaining below the European Central Bank target rate of 2.0%;
- The average price of oil is expected to be close to $60 a barrel in 2018 whilst the prices of non-fuel commodities are expected to remain mostly unchanged;
- Actual exchange rates are expected to remain relatively stable at the levels of the last three months of 2017, i.e. we do not expect the average Euro/US Dollar exchange rate to exceed 1.2; at this level exports will gain pace driven also by a general improvement in the economic cycle and therefore resulting in a higher demand;
- The European Central Bank is expected to leave the key interest rates at the present low levels and to continue to apply non-standard monetary policy measures, i.e. net asset purchases at a monthly pace of €30 billion until the end of September 2018; despite the reduction in size of the net asset purchases, Italian credit institutions are likely to expand their credit activities, partially also due to a significant reduction in the amount of non-performing loans, thus supporting the momentum;
- The investments are expected to gain strength due to fiscal incentives, higher domestic demand and supportive credit conditions;
- In the next twelve months we do not envisage room for a significant change in Italian economic and financial policies, in particular regarding the fiscal system and public debt reduction, due to the result of the general political elections scheduled in Italy for 2018; moreover, we believe that the results of the referendum for autonomy held in Lombardy and Veneto will not have any significant impact on the general economic trend in 2018;
- Finally, the study does not consider the impact of extraordinary events, such as an undesirable further escalation of USA-North Korea and/or USA-Iran disputes or the European disintegration processes, on the economic and financial trends underlying the analysis.
This research aims to present two outputs:

- projected economic and financial performances in 2018 of the Italian non-financial companies;
- the expected risk level of such entities at the end of 2018.

The sample extracted for the analysis consists of Italian joint stock and limited liability companies with turnover exceeding €5 million and includes on average roughly 50,000 entities per year, operating in 10 macro industries (manufacturing further detailed in 10 micro-sectors); the related revenues in 2016 amounted to €1.8 billion, representing 76.9% of total revenues of all Italian joint-stock and limited liability companies;

The World, European and Italian historical (2000-2016) and estimated/projected (2017-2018) macroeconomic data are combined with specific individual company data with the aim of obtaining accurate and reliable forecasts;

The Cerved database was the main source for the analysis of economic and financial performances of the companies included in the sample; Cerved Rating Agency database highlighted the risk level of such entities based on the credit rating activities performed by the Agency;

The research output affirms that gradual recovery of Italian non-financial companies is expected to continue in 2018, both in terms of revenue growth and improvement of the financial structure, primarily for manufacturing and accommodation and food services industry; the trend is mainly fostered by positive global economic cycle, low interest rates and favorable regulatory framework supporting firm funding, investments, innovation and employment;

The general risk level in 2018 is assumed to remain approximately at the levels recorded at the end of 2017; a slight improvement in terms of rating upgrades is expected for 9% of the companies analyzed mainly concentrated in the manufacturing, wholesale and retail trade, and the accommodation and food service industry.
GROWTH IS PREDICTED TO GAIN STRENGTH

The predicted global economic growth rate is 3.9% in 2018 (against 3.6% in 2017). According to the International Monetary Fund forecast in 2018 the two biggest world economies, US and China, will grow at 2.7% and 6.6% rate respectively.

CONSUMER PRICE INFLATION RATE TO RISE

The global consumer price inflation rate is expected to rise assisted by higher commodity prices. Oil price averaged $54/barrel in 2017 and is predicted to remain close to $60/barrel in 2018, whilst oil consumption is forecast to record an uptick of 1.4% in 2018. In addition, also metal prices are expected to increase modestly in 2018.

TRADE TO INCREASE

Global world trade is predicted to increase further in 2018, fostered by a recovery in manufacturing activity and an increase in investment, especially in advanced economies. In addition, a recovery for the commodity exporters is expected.

GLOBAL RISKS REMAIN TILTED TO THE DOWNSIDE

These include increased trade protectionism, as well as economic policy uncertainty, possible adversity in the financial system due to easy monetary conditions, and, over the longer term, weaker potential growth. In addition, the upcoming political events and the current political uncertainties may negatively affect the general economic conditions.
EURO AREA GDP GROWS, UNEMPLOYMENT FALLS

GDP growth in the euro area rose around 2.1% in 2017 and is predicted to continue at a broadly similar pace in 2018. Furthermore, the unemployment rate will continue to follow a declining trend and is forecast to fall to 8.7% in 2018 (from 9.2% in 2017).

INFLATION RATE TO BE STABLE

Consumer price inflation accelerated at the beginning of 2017 mainly due to a rise in energy prices. The harmonized index of consumer prices (HICP) is estimated at 1.5% in 2017. In 2018 the impact of energy inflation is expected to decline resulting in a lower inflation rate outlook (approximately 1.4%).

INDUSTRIAL PRODUCTION IMPROVEMENT

Investments will accelerate and the international environment will contribute positively to an increase of exports (in line with the global growth), which will be one of the principal driver of an industrial production improvement in 2018.

FURTHER CREDIT ACTIVITY EXPANSION

Across the euro zone countries, companies are benefiting both from eased lending conditions and increase in the number of alternative lenders. The total amount of loans to households and non-financial corporations grew by approximately 1.4% in 2017 whilst in 2018 it is predicted to increase more slowly especially in the non-financial corporate sector.
GDP GROWTH IS UNDER WAY TO CONSOLIDATE IN 2018

From 2000 to 2017 the Italian economy was more vulnerable compared to other highly developed countries, in particular those of the euro area.

The Italian real GDP at the end of 2017 was roughly at the same level recorded in 2000, whilst the euro area countries and specifically Germany and France experienced a considerable growth in the same period (18.8%, 20.5% and 19.8% respectively).

The Italian GDP has started to increase moderately only since 2014, mainly due to an improvement in domestic demand, but its growth still remains below the growth rates of the majority of euro zone countries. The poor performance of the labor and total productivity factor accounts for most of the difference.

An ageing population and a weak labor market participation have also contributed negatively to potential growth. Structural reforms, in particular the Jobs Act, and tax incentives on new labor contracts contributed to the increase in employment, making the Italian labor market more flexible and efficient.

In 2018 we expect the economic growth to be slightly below the level reached in 2017. The trend will be sustained by the world economy positive cycle, including higher levels of international trade volume. Italian companies will benefit from favorable credit lending conditions due to an expanding credit activity of the banking system and low interest rates.

Whilst the Italian government adopted a set of dynamic and diverse policies for 2018, we believe that some of those previously introduced have already contributed to the GDP growth in 2016 and 2017, thus reducing the combined effect in 2018.
**THE NUMBER OF ACTIVE COMPANIES HAS INCREASED BUT...**

The number of active companies in Italy, registered at the Chamber of Commerce as of December 31st, 2016 amounted to 5,145,995, 305,629 more than in 2000 (6.3%).

The increase in registered active companies is the result of the positive trend from 2000 to 2008 (9.8%), partially cancelled by the decrease from 2009 to 2016. In 2017 a slight improvement is expected to be recorded, however the number of active companies remains below its peak value (5,316,104 entities) reached at the end of 2008.

Exhibit 11 shows both the trend of active Italian companies in the period 2000-2016 and their breakdown by legal form. We observe that the increased number of Joint Stock Companies, and particularly Limited Liability companies (120.6%), was able to compensate the decrease in Unlimited Partnerships (-6.2%) and Sole Proprietorships (-7.9%).

**COMPANIES ARE ABANDONING TRADITIONAL SECTORS**

Exhibit 12 shows the breakdown of the Italian active companies at the end of 2000 and 2016 by industry.

It can be observed that in many traditional sectors the number of active companies decreased, e.g. in agriculture (-29.4%) and manufacturing (-22.6%), whilst the number of companies increased in construction (27.3%) and wholesale and retail trade (3.9%).

A very significant rise in the new registered companies (45.6%) occurred in other industries, in particular in the service industry offering information and communication, IT and professional, scientific and technical services.
NUMEROUS BANKRUPTCY AND OTHER LEGAL PROCEEDINGS TO DECREASE FURTHER

From 2000 to 2016 the number of bankruptcies and other legal proceedings, protests and prejudicial acts in Italy mirrored the general trend of the Italian economy.

After reaching its minimum level in 2007 (5,969), the number of bankruptcy procedures in the period 2009-2014 increased dramatically reaching its peak value of 15,608 in 2014. With the improvement in the economic and financial environment, starting from 2015 the number of bankruptcy procedures decreased sharply in all macro sectors returning approximately to the levels recorded from 2000 to 2006. A positive trend was recorded also in 2017, bankruptcy procedure initiated for 11,937 companies, -11.3% when compared to the same period in 2016. In absolute terms the highest number of bankruptcy procedures was recorded in the service sectors, followed by the construction and manufacturing.

Worth mentioning is the design of a new Italian bankruptcy law that should be approved by October 2018. The regulatory framework aims at more efficient resolutions of cases of company crisis supporting continuity of its operating activities and safeguarding the interest of creditors by introducing innovative solutions such as pre-crisis warning mechanisms.

Other legal proceedings, after reaching its maximum level in 2013 (3,593) in 2016 came down to 1,993, and the trend continues in 2017 evidencing 1,866 procedures, -6.4% when compared to the same period in 2016.

In the last five years new protests and prejudicial acts have also shown a decreasing trend, with -52.7% and -7.0% of acts respectively in 2017 compared to the numbers recorded in 2013.
CORE INFLATION RATE TO RISE

Italian headline inflation will experience a modest decline in 2018 compared to the previous year (1.2% and 1.4% respectively). Core inflation, however, is predicted to increase to 1.2% in 2018 (up from 1.0% in 2017).

EXPORTS AND IMPORT ARE ACCELERATING

Exports and imports will both accelerate in 2018 (4.1% and 4.4% respectively), mirroring the positive trend and expectations in global trade and the rising of the external demand. Machinery and equipment industry will still remain in “pole position” due to companies generous investment and tax incentives. In general, in 2018 Italian exports will increase more in the Extra European Union countries.

INVESTMENT CONTINUES TO GAIN STRENGTH

Investment has gained strength and will continue to do so at a relatively fast pace, supported by effects of the tax incentives (Stability Low, 2017), low interest rate and improvements in business confidence. Indeed, investments are expected to increase 3.0% in 2018 (up from 2.4% in 2017). Construction investments are forecast to accelerate slightly, also thanks to more resources earmarked for public investment.
NO ROOM FOR SIGNIFICANT PUBLIC DEBT REDUCTION

At the end of 2016 the Italian government debt-to-GDP ratio was significantly above its level at the beginning of the century. In particular, as of December, 31st, 2016 the ratio was 132.6% (26.2% with respect to 100% recorded at the end of 2000). In the same period the ratio for the euro area increased from 68.1 to 91.3% (34.1%), in Germany from 58.9% to 68.3% (15.9%) and in France from 58.6 to 96.0% (63.8%).

At the end of 2017 the Italian government debt increased further to more than €2,300 billion, 135.0% of GDP. The debt servicing, in terms of interests, accounts roughly 5.0% of Italian GDP.

In our view the high level of government debt represents a key factor limiting Italian economic growth and contributes ex ipso to increasing country risk with a possible negative impact on the stability of the international financial system. A possible increase in interest rates would raise the cost of debt service potentially triggering a crisis due to larger governmental deficits, a slowdown in economic activity and growing debt refinancing difficulties due to higher risk perceived by investors.

Hence, it seems that a significant reduction in government debt should be the main goal of the Italian economic and financial policy; in our opinion, however, the achievement of such a result is not realistic neither in the short, nor in the medium term due to the following factors:

- economic growth in the coming years is expected to be moderate, not sufficient to be the main source of the government debt reduction;
- macroeconomic policy is expected to prioritize investments, employment, social security and welfare rather than government debt reduction;
- even if the inflation rate hits the target value (2.0%) the impact on the government debt in the short term is not expected to be considerable;
- finally, in Italy election will take place in spring 2018, with a new government taking over the economic program that has already been approved and become fully executive.
CREDIT ACTIVITY TO BE EXPANDED, INTEREST RATES TO REMAIN AT VERY LOW LEVELS

As of December 31st, 2016 the volume of bank loans granted to Italian non-financial corporations amounted to €860.4 billion.

The period 2000-2016 was characterized by two different trends: from 2000 to 2011 the annual outstanding loans value increased by 84.1% (€454 billion, reaching in 2011 its highest level ever of €993 billion thanks to 5.7% CAGR, far above the Italian GDP growth), whilst in the period from 2012 to 2016 loans decreased by 13.4%, (€130 billion) reflecting a negative -2.8% CAGR. The loan reduction hit sharply construction and manufacturing (accounting for about 40.0% of all loans) which experienced -22.7% and -13.5% decrease in loan volumes, whilst agriculture, forestry and fishing and wholesale and retail trade (including repairs of motor vehicles and motorcycles) had more limited loan contraction (-0.8% and -5.3% respectively).

In the observed period, due to the negative impact of the global financial crisis 2007/08 and to structural changes in the world economic and financial environment, a radical decrease in interest rates was recorded. In 2017 the interest rates charged to Italian non-financial corporates were on average less than half compared to those charged in 2000. In the medium term, low interest rates will remain a positive factor, fostering investments and consumption.

NON-PERFORMING LOANS TO BE FURTHER REDUCED DUE TO INNOVATIVE MEASURES

The credit crunch had a huge and dramatic impact on the Italian economy, hitting especially small businesses which are not able to survive in a radically changed market conditions. The evidence of such outcome can be seen not only through the decreased number of active companies, but also via the enormously increased volume of the non-performing loans (NPLs). In particular, these loans amounted to €324 billion at the end of 2016, of which €154 billion were granted to the non-financial corporations as shown in table 1:

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<tbody>
<tr>
<td>Amount (€ billion)</td>
<td>40.7</td>
<td>31.2</td>
<td>154.3</td>
</tr>
<tr>
<td>CAGR (base year 2000)</td>
<td>8.69</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CAGR (base year 2008)</td>
<td>22.13</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NPL ratio (%)</td>
<td>17.93</td>
<td></td>
<td></td>
</tr>
<tr>
<td>N° debtors</td>
<td>216,074</td>
<td>190,881</td>
<td>446,393</td>
</tr>
<tr>
<td>Average debt/debtor</td>
<td>188,167</td>
<td>163,248</td>
<td>345,604</td>
</tr>
</tbody>
</table>

Following the principles outlined in the ECB guidelines published in March, in 2017 Italian Banks made significant progress in reducing the amount of the NPLs – estimated to be over €50 billion debt reduction. Any further actions aimed to improve the banking balance sheets should not increase the financial hardship of still operating companies.
MODEST ROLE OF ITALIAN EQUITY CAPITAL MARKETS

Despite the number of listed companies increasing from 297 to 421 in the period 2000-2017, the role of the stock markets remains modest in Italy.

As of December 31st, 2017 the market capitalization was €640 billion (37.5 of the estimated Italian GDP in 2017) representing only 78.2% of the overall market capitalization recorded in 2000 (equal to €818 billion, 68.7% of GDP), mainly due to an unfavorable economic cycle in the observed period.

This situation shows the structural weaknesses of the Italian economic and financial system, especially when compared to other highly developed European economies. The low propensity to raise equity capital through organized markets is linked to an unfavorable macroeconomic and fiscal framework, as well as to the predominance of SMEs, mostly unfit for listing and presenting cultural obstacles (i.e. company owners and managers are often reluctant to accept wider company control and transparency).

Hence, self-financing and bank borrowing remain the main sources of finance for Italian companies which are, generally speaking, undercapitalized with a negative impact on their investment capabilities. Very frequently the lack of medium-long term financing means forces companies to focus their attention on running current activities, postponing or abandoning strategic projects, fundamental for company growth.

A wide range of innovative initiatives have been undertaken with the aim of fostering market based company funding, in particular:

- AIM (Alternative Investment Market) – a specialized market segment dedicated to SMEs growth (95 companies and market capitalization around €5.6 billion as of December 2017);
- ELITE - a programme designed to help SMEs prepare and structure for the next stage of growth their through access to long-term financing opportunities;

- PIR – Piani individuali di risparmio (Individual Savings Plan) - an innovative way to fund Italian SMEs by offering retail investors, resident in Italy, tax incentives (full exemption of 26.0% income tax) if the savings stay invested for at least five years. A minimum of 70.0% of such credit assets must be invested in financial instruments issued by Italian or foreign (EU and EEA) companies permanently established in Italy.
ITALIAN DEBT CAPITAL MARKET IS GROWING
BUT STILL REMAINS BEHIND NEEDS

At the end of 2016 the outstanding amount of debt securities issued by Italian financial and non-financial corporations was €861.5 billion, 51.0% of the country’s GDP. The table below shows the breakdown by issuer type of Italian, German, French, British and United States outstanding amounts of debt securities as of December 2016 issued by financial and non-financial corporations with the respective debt-to-GDP ratio.

Despite the outstanding debt at the end of 2016 being almost double compared to 2000, it represents only 2/3 of its peak value reached in 2012 (€1,290 billion, Exhibit 23). The main reason for such a significant debt reduction is the huge bond reimbursement realized by banking institutions from 2013 to 2016 and the related negative net flow of debt securities (respectively -80, -153, -106 and -67 billion of euro as shown in Exhibit 24).

The decrease in debt securities funding of Italian banks has been compensated by a wider use of deposits and resources available under the Eurosystem refinancing operations framework.

The outstanding amount of debt securities issued by non-financial corporations at the end of 2016 also doubled its value with respect to the amount recorded at the end of 2000. The main characteristic of this cluster is the high concentration of issuances/debt to a small number of issuers.

Due to both more favourable general economic conditions and active ECB monetary policy, bond yields have decreased significantly providing room for a convenient fund raising.

Since the introduction of a new regulatory framework (‘Decreto Sviluppo’) in 2012 up to October 2017 Italian market saw 300* small-size listed bond issues (i.e. so called minibonds) amounting approximately to €14.3 billion. Issued mainly by SMEs, they offer interesting yields to institutional investors.

*) Source: Business support S.p.A. – Minibonditaly.it

### Table 2: Outstanding securities debt (£ Million)/Debt-to-GDP ratio (%)

<table>
<thead>
<tr>
<th></th>
<th>Italy</th>
<th>Germany</th>
<th>France</th>
<th>United Kingdom</th>
<th>United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt securities outstanding</td>
<td>739</td>
<td>1,279</td>
<td>1,331</td>
<td>2,281</td>
<td>14,271</td>
</tr>
<tr>
<td>Debt to GDP (%)</td>
<td>44.0</td>
<td>34.0</td>
<td>47.0</td>
<td>84.0</td>
<td>85.0</td>
</tr>
<tr>
<td>Debt securities outstanding</td>
<td>123</td>
<td>157</td>
<td>190</td>
<td>486</td>
<td>549</td>
</tr>
<tr>
<td>Debt to GDP (%)</td>
<td>7.0</td>
<td>4.0</td>
<td>21.0</td>
<td>18.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Total</td>
<td>862</td>
<td>1,436</td>
<td>1,921</td>
<td>2,767</td>
<td>14,820</td>
</tr>
<tr>
<td>Debt to GDP (%)</td>
<td>51.0</td>
<td>38.0</td>
<td>58.0</td>
<td>102.0</td>
<td>88.0</td>
</tr>
</tbody>
</table>

*Source: Bank of Italy and Cerved Rating Agency elaboration*
DATA AND METHOD

This research focuses on Italian non-financial companies with an annual turnover exceeding €5 million. With the aim of using only reliable data, joint stock and limited liability companies have been considered; only these entities, according to Italian law, file complete annual financial statements in the Chamber of Commerce together with anagraphical company data; other legal forms, such as unlimited partnerships and sole proprietorships, are not included in this sample due to the lack of publicly available standardized financial data.

We believe that this cutoff is reasonable and allows us to perform a methodologically correct analysis. In 2016 the above mentioned companies, despite representing only 4.2% of all registered and active joint stock and limited liability companies, accounted for 76.9% of their total turnover.

Moreover, cluster specialization has been obtained by NACE activity classification from A to J (thus not including in the sample financial and insurance companies and some service industries). The statistics regarding specific industries provide important key data and enable us to examine historical and prospective trends and cross-sector comparisons.

The Cerved database, which contains legal, anagraphical, financial and market information on all Italian registered legal entities (approximately 6 million, comprising 5 million active ones) was the most important database used for this research. Long time series and broad homogenized and standardized data, covering different economic cycles, were the building blocks to perform the regression and predictive analysis.

Historical and forecast macroeconomic data and analysis performed by the International Monetary Fund, OECD, the World Bank, European Central Bank, Bank of Italy and ISTAT completed the dataset used for the analysis.

The relevant observation period comprises the years between 2000 and 2016. Table 3 describes some characteristics of the sample:

Several analyses were performed in order to examine the structural differences within the sample in terms of company legal form and geographical area (Exhibit 25), company age (Exhibit 26) and company size and industry. As a result, we verified a considerable heterogeneity of companies, in particular with regard to the company size across various industries.
Furthermore, in order to guarantee more detailed and accurate analyses and projections we decided to create a static pool to show consistently long time horizon economic trends (17 years), by sealing off all the active companies over the 2000-2016 horizon. The outcome obtained by considering the behaviour of specific variables related to the companies included in the static pool was extended as a performance indicator for the whole sample (turnover over €5 million and industry from A to J).

According to the European Community’s definition of SMEs, using annual turnover and employee headcount as quantitative criteria, the initial sample of companies and the static pool can be classified by size classes on the basis of the financial statements for the year 2016, as shown in Table 4:

For the sake of this analysis we defined specific size classes for each industry, thus deviating from the European Commission’s recommendation which presents undifferentiated upper and lower bounds of quantitative criteria for SMEs in all industries. To define the thresholds of such classes, we used both a statistical approach (a specific cluster procedure by minimizing the within-cluster turnover standard deviation) and a judgmental approach, by relying on the experience and opinion of our industry expert analysts. Table 5 shows the results of such analysis referring to the sample in 2016 (45,288 entities) and the NACE sections from A to J. Moreover, the NACE section C and G were further disaggregated into sub-industry classes, as shown in Exhibit 27, in order to consider the specific business differences within these NACE sections, thus ensuring a good fit and a satisfactory accuracy of the estimation.
Exhibit 28 shows the breakdown of macro industries analysed including disaggregation of the NACE section C (manufacturing) and G (wholesale and retail trade repair of motor vehicles and motorcycles).

In order to carry out the analysis and projections this study is focused on we used simple multiple linear regression model for each industry and company size classes, considering macroeconomic and individual, companies’ economic and financial data.

The analysis enables us to develop an econometric model used to estimate likely credit quality changes (in terms of rating class and probability of default) for single industries and company size classes.
PERFORMANCE INDICATORS TO IMPROVE FURTHER

The annual financial statements available through public registers provide a clear economic and financial picture of the Italian joint-stock and limited liability non-financial companies. The individual historical data available from 2000 to 2016 enriched with 2017 preliminary results and with the expected 2018 macroeconomic scenario enabled us to build up the 2017 and 2018 projections regarding the following four performance indicators related to the analyzed sample: 1) growth rate - revenues YoY % change; 2) EBITDA margin; 3) net financial debt/EBITDA and 4) net financial debt/Equity. Afterwards, the median values of the resulting data were used to obtain the summary output, which we consider as a representative proxy for the overall market.

From 2000 to 2016 the observed companies experienced a very irregular trend, both in terms of growth rate and EBITDA margin. In the aftermath of the global financial crisis, the lowest growth rate value (-12.0%) was recorded in 2009; manufacturing, transporting - storage and wholesale and retail trade were the industries showing the biggest fall of business volume (-15.5%, -12.1% and -10.4% respectively), whilst water supply, accommodation and food service and electricity and gas showed the highest level of resilience to the adverse economic and financial environment (-0.1%, -2.3% and -2.6% respectively). Exhibit 29 shows that, in terms of median value, there are no significant differences in the growth rate taking into consideration company size classes as we previously defined them. Only from 2010 the growth rates turned positive but still remaining below the levels recorded in 2000.

The analysis of the EBITDA margin changes in the same period also does not highlight significant differences between large companies and SMEs as shown in Exhibit 30. The lowest median EBITDA margin value (5.2%) was recorded in 2012, regarding in particular accommodation and food service, transporting and storage and agriculture sectors (2.8%, 4.0%, 5.2% respectively), while electricity and gas, ICT and water supply were relatively immune to the unfavorable economic and financial circumstances (showing 11.3%, 10.9% and 10.5% EBITDA margin respectively). At the end of 2016 the median EBITDA margin (6.0%) still remains below the levels recorded in 2000 (7.2%).

Positive trends emerging from the last publicly available financial statements (2016), the 2017 preliminary results and the optimistic macroeconomic forecasts for 2018 confirm improvement of the Italian economy. Looking ahead, we expect the Italian non-financial companies to continue to experience gradual recovery in 2018. They are going to take advantage of the favorable global economic cycle, low interest rates and supportive regulations that, inter alia, foster the use of alternative, non-bank financial sources for company funding. The financial resources raised through Individual Savings Plans (PIR – Piani individuali di risparmio), introduced by the 2017 Budget Law are driven, in primis, by a favorable tax regime for savers, and might become an important additional source for SMEs funding, injecting new liquidity. The government objective fixed €68 billion as a target value and in 2017 nearly €10 billion had already been raised.
So far, one of the main obstacles PIR are facing is the limited number of available assets which may lead to a possible concentration of this financial resources in a small share of the market, comprising mainly relatively large companies as shown by the early data in 2017.

Another obstacle to rapid adoption of the newly available financial resources is the lack of a standardized and broadly accepted methodology for the risk assessment of potential bond issuers.

Generally speaking, in 2018 we expect SMEs to contribute more significantly to growth, employment and innovation whilst, on average, the respective EBITDA margin will remain broadly stable (as shown in Exhibit 31). However, 2018 will still be a challenging year for SMEs and innovative startup companies as they will have to face tougher barriers in accessing bank credit and/or approaching capital markets compared to large companies. We also expect some new innovative solutions aimed at meeting SMEs financial needs to become effective; the SMEs current financial structure together with new business opportunities prove their ability in terms of rational use of the additional financial resources.

The new investments will allow most industries to thrive also assisted by the Italian Government’s adoption of the National Industry 4.0 Plan.

The companies which will take up this opportunity may improve their cash-flows even in the short-medium term. Finally, companies with strong international market positioning and large product diversification will have stronger sales and margins growth.

The key ratio values recorded from 2000 to 2016 related to the analyzed entities show the improved financial health of the companies, proving good capability to strengthen their equity base as shown in Table 6:

| Table 6: Key Financial Statement Indicators (median) |
|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Liquiditiy ratio| 1.4             | 1.2             | 1.4             | 1.4             | 1.5             |
| EBITDA interest coverage | 6.8             | 6.4             | 7.6             | 9.8             | 12.6            |
| ROE             | 7.1%            | 4.1%            | 4.3%            | 5.7%            | 6.4%            |
| Equity ratio    | 25.2%           | 29.4%           | 33.1%           | 34.0%           | 35.0%           |
| Financial liabilities/Total | 30.4%           | 29.5%           | 31.5%           | 31.4%           | 31.0%           |

Source: Cerved database and Cerved Rating Agency elaboration
Growth still on track, but more uncertainties on the horizon

ITALIAN NON-FINANCIAL COMPANIES ECONOMIC OUTLOOK 2018

The recorded financial ratios in the 2000-2016 horizon indicate that on average:

- Liquidity maintained a satisfactory level in the whole observed period; due to the positive economic cycle in 2017 and 2018 we expect a slight improvement in the ratio;
- The EBITDA/Interest coverage ratio almost doubled its value in 2016 compared to what was recorded in 2000 primarily due to a general reduction in the interest rates, particularly in the last three years; we believe that in 2017 and 2018 the average ratio value will remain roughly at the same level recorded in 2016;
- In 2016 ROE shows further improvement, but is still slightly lower compared to the value recorded at the beginning of the observed period mainly due to the equity base strengthening trend;
- Equity Ratio rose from 25.0% to 35.0% due to a significant increase of equity capital; in 2018 we expect further strengthening of the ratio;
- Financial Liabilities/Total Assets ratio remained mostly unchanged – financial debts representing roughly 30% of the total assets.

A positive trend regarding the net financial debt was also observed: in fact, in 2016 70% of the sample improved their NFD/EBITDA and 73% the NFD/Equity.

Positive performances were found especially in the SMEs segment as shown in Exhibit 32: in particular referring to NFD/Equity, small and medium-sized companies recorded a positive trend standing respectively at 0.92 and 0.89 in 2016 compared to 1.32 and 1.36 in 2000.

Hence the financial risk profile appears to be well balanced, leaving no room for specific concerns regarding the prospects of the Italian non-financial companies in 2018. In 2016 the median values for the total sample referring to NFD/Equity and NFD/EBITDA remained respectively at 0.89 and 3.89 levels respectively.

Looking ahead, we expect these indicators to remain at healthy levels in 2017 and 2018 with a slight improvement in NFD/EBITDA and a broadly stable level of the NFD/Equity ratio as shown in Exhibit 33.
GROWTH AND PROFITABILITY IMPROVEMENT SPANNED OVER ALL SECTORS

Exhibit 34 shows the relative positioning of the 10 macro-industries in the short-medium term considering the median values related to revenue growth rate and EBITDA margin.

The historical median values are calculated on the basis of financial data obtained from the annual financial reports 2014-2016 filed in the Chamber of Commerce public registers; the projected median values for 2017 and 2018 are the result of the analysis of this study.

As expected, there are significant differences in positioning between different industries, in terms of both historical and projected values.

In 2018 we expect manufacturing and accommodation and food services to maintain top positions, already reached in 2016 and 2017.

For the electricity, gas, mining and quarrying industry 2018 may be the turning point, showing the first positive signals after experiencing some difficulties over the last few years.

None of the other industries show significant changes in 2018 compared to their 2016 positioning.
FURTHER STRENGTHENING IN COMPANIES’ FINANCIAL STRUCTURE

Exhibit 35 shows the relative positioning of the 10 macro industries in the short-medium term considering the median values related to NFD/EBITDA and NFD/Equity ratios.

The historical median values are calculated on the basis of financial data obtained from the annual financial reports 2014-2016 filed in the Chamber of Commerce public registers; the projected median values for 2017 and 2018 are the result of the analysis of this study.

There are even more significant differences in positioning between industries regarding NFD/EBITDA and NFD/Equity ratios when compared to growth rate and EBITDA margin differences.

Generally, in the observed period there is no evidence of significant changes among industries considering their relative positioning related to NFD/EBITDA and NFD/Equity ratios.

In 2018 we expect accommodation and food services and information and communication services to maintain top positions, already reached in 2016 and presumably confirmed in 2017.
Italian non-financial companies economic outlook 2018

Growth still on track, but more uncertainties on the horizon

OTHER KEY INDICATORS

Exhibit 36: Equity ratio by industry

Exhibit 37: EBITDA interest coverage by industry

Table 7: Liquidity ratio by industry

Table 8: ROE by Industry

Source: Cerved database and Cerved Rating Agency elaboration
Growth still on track, but more uncertainties on the horizon

ITALIAN NON-FINANCIAL COMPANIES ECONOMIC OUTLOOK 2018

As a conditio sine qua non for market survival many companies will be involved in a “winning the innovation game”, process translated into a considerable capex expenditure directed at process optimization which inevitably must be accompanied by innovative marketing and commercial strategies. The companies, especially smaller ones, which are not ready ‘to play the game’ remaining risk averse, are likely to fall behind.

Key financial indicators referring to the industry, in terms of net financial debt to equity and net financial debt to EBITDA, are likely to remain overall stable in 2018.

In our view the best performing manufacturing industries in 2018 will be the following:

Automotive
- extensive vehicles replacement process in 2018;
- high competition pressure, China maintaining a key role;
- high level of innovation in mobility and connectivity;
- new strategic partnerships and M&A;
- conservative stand towards EBITDA margin improvement.

Chemistry & Pharmaceutics
- solid macroeconomic fundamentals will support the revenue growth, driven mainly by large companies;
- on average a stable EBITDA margin of about 10% is expected; global presence is a must to achieve higher level of profitability;
- R&D remain key factors for further market expansion;
- moderate level of M&A operations in 2018, slowing down when compared to those carried out in the previous year.

Machinery & Equipment
- revenue growth in 2018 up to nearly 2.5% reflecting the fact that all manufactures remain focused on R&D and NPI (new product introduction);
- cost management strategies are going to persist, but, generally speaking, with no significant impact on EBITDA margin in 2018;
- heavy equipment manufactures still under pressure in 2018 to provide engineering capability and capacity.
Energy and gas

Italian companies operating in the energy industry are facing a complex market environment, with many open questions about risks related to regulations, a drop in consumption, high competition levels and EBITDA erosion. Generally we expect a more stable landscape in terms of commodity prices and consumption. However, risk regarding prices and volumes will remain strong, resulting in a higher volatility of revenues. In our view, the current margin pressure is unlikely to ease over the next two years. The final overcoming of the so-called “Maggior Tutela Regime” may lead to almost zero margin for the retail operators. We expect industry participants to continue to focus their attention on cost efficiency and on protecting profitability by embracing new business models and examining the role that digital technology can play in improvement of EBITDA margins. We believe that the above described strategies will be a central topic for the operators intending to attract capital. We also believe that energy producers could see a slight debt increase in 2018 aimed at improving productivity and synergies. Finally, in 2018 we envisage a significant number of M&A operations in the sector led by synergy effects such operations might produce.

Water supply, waste management and sewerage

In recent years, the water supply, waste management and Italian sewerage industry has recorded a slower growth compared to the pre-crisis period. However, due to the last two years’ important investments in the water infrastructure, waste sorting and recycling, Italy ranks as one of the top European countries in terms of growth rate of recycling and packaging recovery. We believe that the expected general increase in industrial output will produce a slight growth in water consumption and waste treatment. The demand for sustainable solutions will continue to persist, requiring new investment in technologies based on a customer-centric and sustainable approach, aimed at improving efficiencies and facilitating reuse. Expectations also reflect our view in terms of wider government interest and spending in this industry. We expect profitability to remain broadly in line with the results obtained in 2016.

Construction

After a weak increase in revenues recorded by the construction industry operators in 2016 and the modest result anticipated in 2017, both reflecting a deteriorating demand and decreased volumes of bank loans (mainly those for small and medium-sized companies), we expect 2018 to be the turning point for this industry. We foresee that the volume of residential and private non-residential constructions will remain at relatively low levels in 2018 and that the positive trend in housing renovation and public works investments will continue, taking advantage of the allocated funds established by the Budget Law for 2017. Small and medium-sized businesses focused on residential construction may face a slight profitability erosion, while we believe some growth in EBITDA margin may be recorded by large Italian companies operating internationally. Due to the high perceived risk, historically there has been a strong financial market mistrust of the construction companies, which we believe is likely to ease over the coming years.

Wholesale and retail trade

During the crisis period wholesale and retail trade industry faced a sudden interruption of the gradual growth that had taken place up to that moment, mainly due to a loss in real purchase power and in consumer confidence, also translated into profitability erosion. In 2016 the data showed how the industry is moving toward a recovery period. Looking forward, in 2018 we expect to record a steady revenue growth supported by an increase in global trade and improved consumer confidence. Despite the foreseen growth, operators will continue to face consistent pressure mainly in the retail segment due to the high proliferation of new retail purchase channels and market fragmentation.
Transportation and Storage

After a troubled 2016, characterized by an overcapacity and a decrease in commodity demand hitting shipping revenues in particular, we foresee a moderate overall recovery in 2018, driven mainly by an increase in international shipments and air traffic. The growing number of innovative startups will continue to persist, increasing the competitive pressure in the industry. We anticipate a constant growth of e-commerce enabling a quick reaction of on-line retailer and logistics providers. We believe that operators will continue to invest in new high-tech solutions experimenting new models of mobility and smart logistics.

Despite very strong competition, we expect the median operating margins to remain steady. However, global political uncertainties and related risks are strong with possible quick and sharp negative impact on business volumes and margins of the companies operating in these industries.

Accommodation and food services activities

In the last two years operators in the accommodation and food service activities industry, mainly medium and small sized enterprises, have seen steady revenue growth and satisfactory profitability ratios. Many operators were focused on reviewing their business models and offering additional services to their customers, a necessary strategy to maintain or expand market positioning, strengthen margins and improve customer experience. We expect the revenue growth to continue in 2018 with a minimal median margin improvement. We believe accommodation and food service activities will attract new capital investments in 2018 to help the ongoing transformation process and improve the accommodation infrastructure and services.

Information and communication technologies

The Italian information and communication technology industry took longer to recover from the economic crisis, recording overall a negative median growth rate until 2014. Software, services and innovation technology were the major contributors to revenue growth (as a percentage) in 2016. Over the forecast period, we foresee a modest revenue growth for the ICT operators as a whole, while the technology industry will continue to achieve rapid growth, focusing on maintaining the competitive pace of innovation. In our view, a key challenge for the ICT operator may be the availability of matching skills. The outlook is relatively stable in terms of profitability and key financial indicators.

The following two pages show the details of the previously discussed key performance indicators:
January 2018

Growth still on track, but more uncertainties on the horizon

ITALIAN NON-FINANCIAL COMPANIES ECONOMIC OUTLOOK 2018

Exhibit 38: Growth rate and EBITDA margin manufacturing sectors

Exhibit 39: NFD/Equity and NFD/EBITDA for manufacturing sectors

Source: Cerved database and Cerved Rating Agency elaboration
Italian non-financial companies economic outlook 2018

Growth still on track, but more uncertainties on the horizon

**Exhibit 40**: Growth rate and EBITDA margin for wholesale and retail trade sectors

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Source: Cerved database and Cerved Rating Agency elaboration

**Exhibit 41**: NFD/Equity and NFD/EBITDA for wholesale and retail trade sectors

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Source: Cerved database and Cerved Rating Agency elaboration
Italian non-financial companies economic outlook 2018

Growth still on track, but more uncertainties on the horizon

ITALIAN NON-FINANCIAL COMPANIES ECONOMIC OUTLOOK 2018

RATINGS WILL REMAIN BROADLY STABLE

The following section presents a risk profile analysis based on Cerved Rating Agency’s outstanding and monitored public and private ratings issued from 2013 to 2017 on Italian non-financial companies and operating in the industries discussed in this study (data as of 31 December).

Exhibit 42 and Table 9 show an overview of 1-year effective default rates over the 2000-2017 horizon related to the sample bankruptcy and other legal proceedings and debt restructurings as default events.

The default rate trend shows a general improvement from 2014 onwards, both by company size classes and by industry; however, considering the entire sample, the overall default rate still remains higher when compared to its pre-crisis level, especially regarding smaller companies operating in the construction sector.

Exhibit 43 shows the effective default rates over 2013-2017 horizon based on Cerved Rating Agency’s definition which considers as default events:

- bankruptcy and other legal proceedings;
- debt restructuring;
- missed or delayed disbursement of a contractually required interest or principal payment, i.e. missed payment on bonds, material protests (on cheques or trade bills) or prejudicial acts (judicial mortgages, distraint of property).

The effective default rates over the 2013-2017 horizon show decreasing trend and satisfy the monotonicity constraint regarding all Cerved Rating Agency’s rating classes (Exhibit 44).
The analysis of historical rating distributions in the same period shows clear differences in terms of modal rating class by company size. As shown in Exhibit 43 the modal rating class for the large companies is A3.1, B1.1 for the medium and B1.2 for small companies (considering company size classes as they have been defined ad hoc by Cerved Rating Agency for the purposes of this study).

Overall, the corporate rating distribution in the observed period is skewed towards the investment-grade rating categories (i.e. Cerved Rating Agency rating classes from A1.1 to B1.2) representing 70.0% of the whole sample; 25.0% is concentrated in the safety (A rating classes) and 45.0% in the solvency (B1.1-B1.2) classes.

We anticipate the rating distribution to remain broadly unchanged in 2018, with the rating migration concentrated mainly in the B category.
Italian non-financial companies economic outlook 2018

Growth still on track, but more uncertainties on the horizon
Despite the expected rating migrations for individual entities, in 2018 the current industry modal rating classes are unlikely to change. On the other hand, stable and positive outlooks will prevail in the manufacturing industry, wholesale and retail trade and accommodation and food service. This is due to the increase in the number of companies active in these sectors which will maintain and/or improve their business and financial performances. Indeed, as shown in Table 11 in 2018, the rating outlook remains differentiated by industry, whilst in terms of the expected general probability of default we foresee a modest improvement (3.49%) compared to the one recorded in 2017 (3.66%).

### Slight Improvement in General Creditworthiness

In our opinion in 2018 the creditworthiness of the observed Italian non-financial companies will remain stable for almost 86% of entities. Migration of ratings is expected to be moderate resulting in approximately 14% of rating upgrades (9%) and downgrades (5%) at the end of 2018 compared to the outstanding ratings at the end of 2017. The vast majority of the rating changes (92.1%) will be limited to one-class migration as shown in the 1-year projected transition matrix (Table 10). We believe that more than one third of the expected downgrades will be concentrated in the energy, gas, mining and construction sectors. Over the last years the average credit profile of companies active in these industries has been relatively weak and due to the forecast market and regulatory conditions we do not envisage opportunities for a significant risk profile improvement in 2018.

### Table 10: 1-year transition matrix

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</table>

Source: Cerved database and Cerved Rating Agency elaboration
Growth still on track, but more uncertainties on the horizon

### Table 11: Ratings and probability of default 2018 outlook by industry

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<thead>
<tr>
<th>NACE</th>
<th>Micro Industry</th>
<th>Ratings outlooks</th>
<th>Average PD 2017</th>
<th>Average Forecast PD 2018</th>
<th>Expected trend</th>
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<td></td>
<td>Stable</td>
<td>Upgrade</td>
<td>Downgrade</td>
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<td>A - Agriculture, forestry and fishing</td>
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<td>Total</td>
<td>84.9%</td>
<td>11.6%</td>
<td>3.6%</td>
<td>3.64%</td>
</tr>
<tr>
<td>D - Electricity, gas, steam and air conditioning supply</td>
<td>80.4%</td>
<td>5.8%</td>
<td>13.8%</td>
<td>3.08%</td>
<td>3.22% ↑</td>
</tr>
<tr>
<td>E - Water supply; sewerage; waste</td>
<td>88.7%</td>
<td>5.9%</td>
<td>5.3%</td>
<td>4.91%</td>
<td>4.95% ↑</td>
</tr>
<tr>
<td>F - Construction</td>
<td>85.1%</td>
<td>5.6%</td>
<td>9.3%</td>
<td>5.94%</td>
<td>6.03% ↑</td>
</tr>
<tr>
<td>G - Wholesale and retail trade; repair of motor vehicles and motorcycles</td>
<td>Automotive</td>
<td>82.1%</td>
<td>14.7%</td>
<td>3.2%</td>
<td>3.23%</td>
</tr>
<tr>
<td></td>
<td>Retail</td>
<td>88.2%</td>
<td>6.8%</td>
<td>5.0%</td>
<td>4.52%</td>
</tr>
<tr>
<td></td>
<td>Wholesale</td>
<td>91.6%</td>
<td>4.3%</td>
<td>4.1%</td>
<td>3.13%</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>90.1%</td>
<td>6.0%</td>
<td>3.6%</td>
<td>3.63%</td>
</tr>
<tr>
<td>H - Transporting and storage</td>
<td>83.5%</td>
<td>6.7%</td>
<td>9.9%</td>
<td>4.29%</td>
<td>4.33% ↑</td>
</tr>
<tr>
<td>I - Accommodation and food service activities</td>
<td>87.0%</td>
<td>8.6%</td>
<td>4.5%</td>
<td>4.03%</td>
<td>3.89% ↑</td>
</tr>
<tr>
<td>J - Information and communication</td>
<td>89.9%</td>
<td>6.4%</td>
<td>3.8%</td>
<td>3.69%</td>
<td>3.64% ↑</td>
</tr>
</tbody>
</table>