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CREDIT OPINION
19 March 2024

Update

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RATINGS

Novo Banco, S.A.

Domicile	Lisboa, Portugal
Long Term CRR	Baa1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Ba1
Type	Senior Unsecured - Dom Curr
Outlook	Positive
Long Term Deposit	Baa1
Type	LT Bank Deposits - Fgn Curr
Outlook	Positive

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Novo Banco, S.A.

Update following rating upgrade; outlook remains positive

Summary

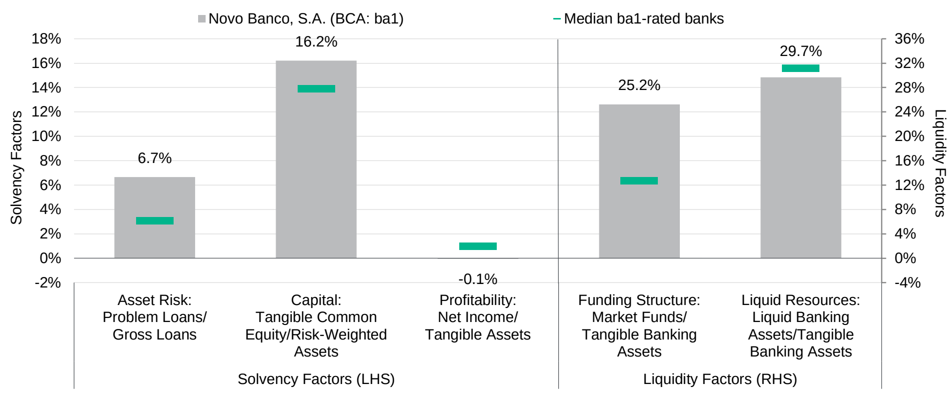
On 8 March 2024, we upgraded Novo Banco, S.A.'s (Novo Banco) long-term deposit ratings to Baa1 from Baa2, with its outlook remaining at positive.

Novo Banco's long-term deposit ratings of Baa1 and long-term senior unsecured debt ratings of Ba1 reflect the bank's BCA of ba1; the outcome of our Advanced Loss Given Failure (LGF) analysis, which results in a three-notch uplift for the deposit ratings and no uplift for the senior debt ratings; and our assumption of a low probability of government support, which results in no further rating uplift.

Novo Banco's BCA of ba1 reflects its significantly improved credit profile as a result of a de-risking strategy pursued over several years in accordance with a restructuring plan agreed with the European Commission which has been successfully completed. In particular, Novo Banco's BCA reflects its prevailing asset quality weaknesses despite significant de-risking, strong profitability metrics and improved loss absorption capacity amid high capital levels. The BCA also reflects Novo Banco's still high reliance on ECB and short-term funding.

Exhibit 1

Rating Scorecard - Key Financial ratios



Source: Moody's Financial Metrics

Credit strengths

» Significant reduction of non performing assets (NPAs) achieved over recent years.

» Profitability metrics will remain strong over the outlook period

» Customer deposits are the bank's main source of funding.

» Improved liquidity buffers.

Credit challenges

» Asset risk remains weak.

» Capital levels will reduce once the bank resumes dividend payments.

» Reliance on short-term funding is still high.

» Risk that largest shareholder, being a private-equity firm, may prioritise high short-term returns over long-term stability.

Outlook

The positive outlook on Novo Banco's long-term deposit and senior unsecured debt ratings is predicated on the view that the improvement in the bank's credit profile could be sustained over the next 12 to 18 months. The positive outlook on the senior unsecured debt ratings also reflects that these ratings could be upgraded in case the volume of senior unsecured debt and/or subordinated instruments were to increase without a significant increase in tangible banking assets.

Factors that could lead to an upgrade

An upgrade of Novo Banco's long-term deposit and senior unsecured debt ratings could be prompted by an upgrade of its BCA.

The bank's BCA could be upgraded if recent improvements in its credit profile are sustained over the next 12 to 18 months. The bank's senior unsecured debt ratings could also be upgraded in case the volume of senior unsecured debt and/or subordinated instruments were to increase or remain at current levels without a significant increase in tangible banking assets.

Factors that could lead to a downgrade

Novo Banco's long-term deposit and senior unsecured debt ratings could be downgraded following a downgrade of the BCA. The bank's BCA could be downgraded if its financial profile weakens due to an erosion of its solvency, or if its combined liquidity profile was to deteriorate from current levels.

Novo Banco's deposit ratings could also be downgraded should the bank's volume of loss-absorbing liabilities shrink or in case it expands its balance sheet more than the rating agency currently expects, such that it increases the loss severity.

Key indicators

Exhibit 2

Novo Banco, S.A. (Consolidated Financials) [1]

	06-23[2]	12-22[2]	12-21[2]	12-20[2]	12-19[2]	CAGR/Avg.[3]
Total Assets (EUR Million)	43,900.2	45,995.0	44,618.5	44,395.6	45,295.9	(0.9)[4]
Total Assets (USD Million)	47,895.1	49,088.1	50,557.5	54,320.5	50,844.6	(1.7)[4]
Tangible Common Equity (EUR Million)	4,024.0	3,579.7	2,982.1	2,828.8	3,822.6	1.5[4]
Tangible Common Equity (USD Million)	4,390.2	3,820.5	3,379.1	3,461.2	4,290.8	0.7[4]
Problem Loans / Gross Loans (%)	4.8	5.3	6.9	9.7	12.7	7.9[5]
Tangible Common Equity / Risk Weighted Assets (%)	16.2	15.4	10.8	9.5	11.4	12.7[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	24.5	29.2	40.4	55.2	60.4	41.9[5]
Net Interest Margin (%)	2.5	1.5	1.4	1.3	1.2	1.6[5]
PPI / Average RWA (%)	3.6	2.5	1.8	-0.4	-0.2	1.4[6]
Net Income / Tangible Assets (%)	1.7	0.6	0.4	-3.0	-2.2	-0.5[5]
Cost / Income Ratio (%)	34.3	41.3	43.9	139.4	123.6	76.5[5]
Market Funds / Tangible Banking Assets (%)	20.0	25.2	27.4	25.6	24.8	24.6[5]
Liquid Banking Assets / Tangible Banking Assets (%)	24.8	29.7	30.6	25.7	26.0	27.4[5]
Gross Loans / Due to Customers (%)	90.0	88.9	90.3	95.6	95.1	91.9[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Ratings and company filings

Profile

With total assets of €43.5 billion as of the end of December 2023, Novo Banco is Portugal's (A3 stable) fourth-largest bank. As of the end of December 2023, the bank had 290 branches plus 20 corporate centers, and 4,209 employees.

The sale process of Novo Banco was closed on 18 October 2017, after Lone Star acquired a 75% stake in Novo Banco's capital, becoming its majority shareholder. As part of Novo Banco's sale process, which was approved by the European Commission (EC), a "contingent capital agreement" (so called CCA) was set up and managed by the Resolution Fund. Under this mechanism, Novo Banco can be compensated up to a limit of €3.89 billion for losses related to a predefined portfolio of problematic assets, subject to the breach of a capital ratio trigger (CET1 below 12%) and some additional requirements. The mechanism is in place until December 2025, and this date can be extended, under certain conditions, by one additional year. Since 2017, Novo Banco has received €3.4 billion out of the €3.89 billion approved under this support mechanism.

The Portuguese government presented to the EC a restructuring plan prepared by Lone Star, that aimed to ensure the viability of Novo Banco by 2021 and that has successfully come to an end. Over this period, Novo Banco significantly reduced its stock of legacy assets, although they remain high when compared to peers. The restructuring has also translated into significant improvements in the bank's profitability metrics. This is particularly important as the funds under the CCA are now close to be exhausted (€485 million left), and the inability of the bank to generate organic capital could compromise the bank's current capital levels.

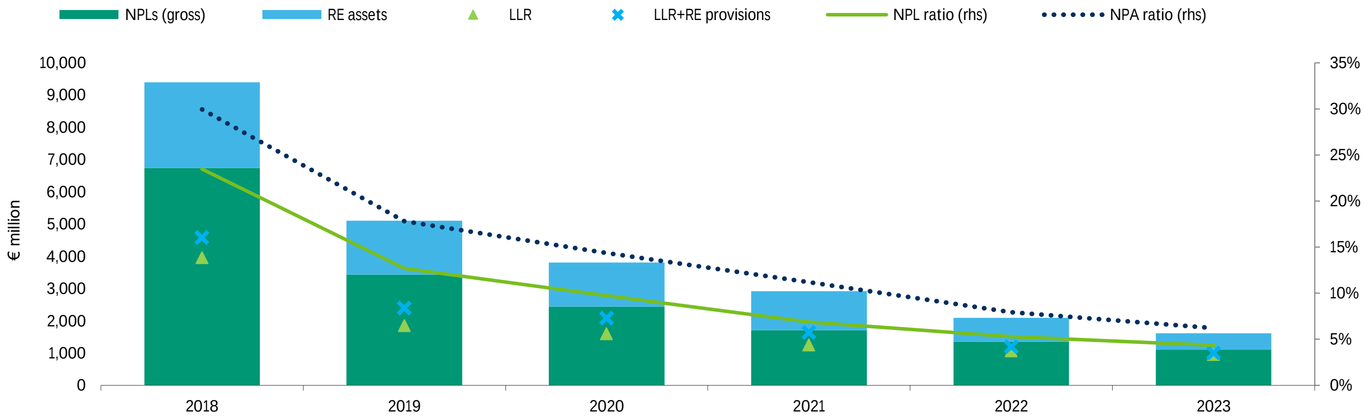
Detailed credit considerations

Asset risk will remain weak

We assign Novo Banco an Asset Risk score of ba2, in line with its macro-adjusted score. This assessment takes into consideration our expectation that Novo Banco's still large stock of NPAs (nonperforming loans [NPLs] + foreclosed real estate assets) will be broadly stable over the outlook period, as the elevated interest rates and high cost of living will continue to erode both households' and corporate finances and will have a bearing upon the bank's asset quality, offsetting the positive impact of ongoing recoveries and sales.

Between 2018 and 2023, Novo Banco has significantly reduced its stock of NPAs principally by several large portfolio sales. As a result, the bank's NPL ratio declined to 4.3%[1] as of the end of December 2023 down from 5.3% at the end of 2022. We have estimated Novo Banco's NPA ratio at around 6.2% as of December 2023, below our estimated NPA ratio of 7.9% as of the end of December 2022.

Exhibit 3
Still weak asset risk despite the significant decline in the stock of NPAs

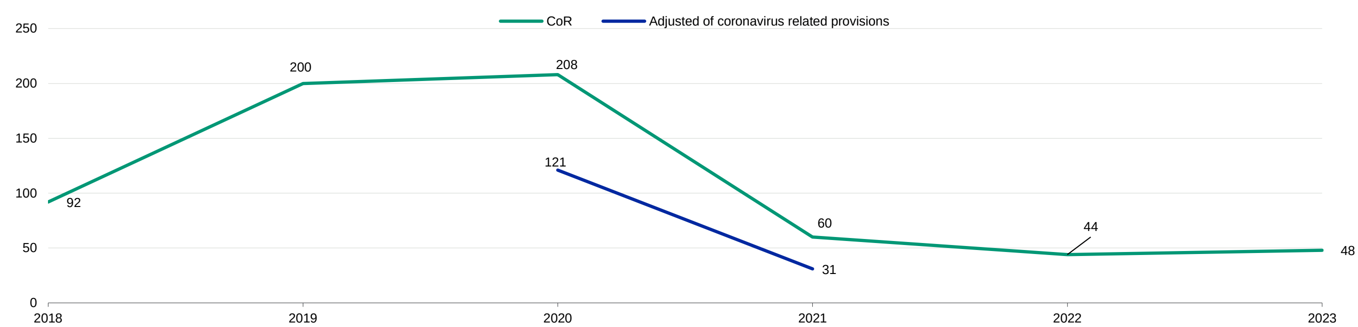


Source: Moody's Ratings and Novo Banco's financial report

Although we acknowledge the significant reduction in Novo Banco's stock of NPAs, the bank's asset quality metrics still compare poorly with those of its domestic and European peers. The average NPL ratio for Portuguese banks was 3.1% as of the end of September 2023 and the EU average was 2.2%[2] as of the same date (latest available data).

In 2023, cost of risk[3] remained in line with the one of 2022 at 48 basis points[4] (see Exhibit 4). Going forward, Novo Banco expects normalized cost of risk levels of around 50 bps per year.

Exhibit 4
Cost of risk trending towards more normalised levels
Loan loss provisions to gross loans



Source: Novo Banco's financial report

Novo Banco's coverage ratio (loan-loss reserves as a percentage of NPLs) stood at 84.3% as of the end of December 2023, up from 77.5% at end-December 2022 and well above the system average of 58.1% as of September 2023[5]. The coverage of NPAs was 62.1% as of the same date (56.8% by year-end 2022).

High capital levels will reduce once the bank resumes dividend payments

We assign a baa3 Capital score to Novo Banco, five notches below the Macro-Adjusted score. We make this negative adjustment to reflect: (1) the unpaid 2021 CCA call, that amounts to €209 million (already deducted from the bank's regulatory capital but not from our key capital metric, tangible common equity[TCE]); and (2) the negative impact on capital once Novo Banco resumes dividend payments.

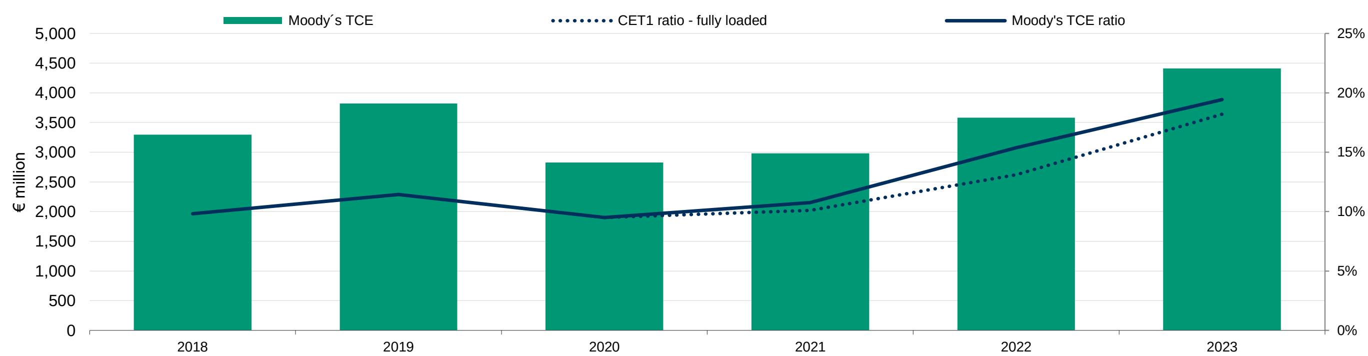
Novo Banco's capital metrics have significantly improved in 2023 because the bank is subject to a dividend ban agreed under the CCA. Although capital metrics will continue improving until the end of the CCA (December 2025), we expect the bank's capital to return to more normalized levels once this dividend ban is lifted.

The bank's TCE/risk-weighted assets (RWA) ratio stood at 19.4% as of December 2023, up from 15.4% at end-December 2022. This improvement is primarily attributable to a 2% reduction in Moody's adjusted RWA largely influenced by the lower risk-weighting we apply now to Portugal's sovereign debt, reflecting the upgrade of the Portuguese sovereign rating to A3, as well as the incorporation of the net income for the period. If we deduct the unpaid 2021 CCA call from the bank's TCE ratio, this would go down to 18.5%.

Novo Banco reported a fully loaded CET1 ratio of 18.2% and a total capital ratio of 21.0% at end-December 2023, against the European Central Bank (ECB) minimum requirements of 9.5% and 14.3%, respectively. The funds available under the CCA, which were key to preserve the bank's capital amid the large losses Novo Banco booked over the past years, are now close to be exhausted (€485 million are available up to date). However, we note that Novo Banco's CET1 ratio now stands well above the 12% ratio trigger, and we believe it will continue above these levels until the end of the CCA (December 2025). As such, we believe it is highly unlikely that Novo Banco asks for additional funds under this mechanism.

Exhibit 5

High capital levels will return to more normalized levels once the dividend ban is lifted



Source: Moody's Ratings and Novo Banco's financial report

Profitability metrics will remain strong over the outlook period

We assign a Profitability score of baa1 to Novo Banco. This reflects Novo Banco's strong profitability metrics, as well as our expectation that future improvements in profitability will be limited, as the repricing of floating rating loans to higher rates comes to an end, and the cost of deposits, operating costs and cost of risk increase.

Novo Banco reported a net profit of €743 million in 2023, compared to €561 million a year earlier and equivalent to a net income to tangible assets ratio of 1.7%.

Novo Banco's recurring pre-provision income (PPI) increased by 42% YOY, mainly driven by the 83% increase in net interest income that more than offset the 7% increase in operating costs.

Bottom-line profitability was negatively impacted in 2023 by higher impairment and provisions that increased to €174 million, up from €111 million in 2022.

Novo Banco's efficiency levels have also improved as a result of the deep restructuring of its operations and the improvement in operating income. The bank reported a cost-to-income ratio of 33%[6] for 2023 (30% just considering recurring items), down from 49% in the same period a year earlier.

Mainly funded by customer deposits, but still high reliance on short-term funding

Novo Banco's market funds to tangible banking assets ratio stood at 18.4% at end-December 2023, equivalent to a Funding Structure score of baa2. We assign a Funding structure score of ba1, to reflect the bank's still high reliance on short-term funding primarily in the form of market repos.

Novo Banco is mainly deposit funded, with customer deposits representing 81% of the bank's total funding. Out of the total amount of customer deposits, 74% are retail deposits. The bank's reported loan-to-deposit ratio stood at 81% as of December 2023, broadly in line with December 2022.

Novo Banco's market funding is mainly composed of ECB funding, that amounted to €1.0 billion as of the end of December 2023, equivalent to a 2% of total assets and market repos for an amount of €5.2 billion. In July 2021, the bank returned to market activity for the first time since June 2018 and issued €300 million senior preferred notes accompanied by a tender of €160 million. In June 2023 and in March 2024, Novo Banco issued €500 million subordinated debt and €500 million senior preferred debt, respectively.

Novo Banco has a final MREL requirement of 23.47% of its total risk exposure amount (TREA) plus the applicable combined buffers, that needs to be fulfilled by 1 January 2026. After the recent issuance of €500 million senior preferred debt, Novo Banco has reached an MREL ratio above 27%.

Novo Banco has a Macro-Adjusted Liquid Resources score of baa2, to which we made a negative adjustment of two notches to ba1, to reflect: (1) the expected decrease in liquid assets once the bank repays the bulk of its ECB funding; and (2) the encumbrance of some of the liquid assets that are not readily available for the bank.

Novo Banco had a buffer of ECB-eligible liquid assets mainly in the form of sovereign bonds amounting €13.6 billion (net of haircuts) as of the end of December 2023, in line with 2022, and including €5.4 billion in cash, that covers the expected repayment of the remaining TLTRO-ECB funding of €1.0 billion.

Novo Banco reported a liquidity coverage ratio of 163% as of December 2023, compared with 210% by year-end 2022, mainly reflecting the TLTRO III reimbursement. The net stable funding ratio stood at 118% as of December 2023 from 113% in 2022.

ESG considerations

Novo Banco, S.A.'s ESG credit impact score is CIS-3

Exhibit 6
ESG credit impact score

ESG considerations have a limited impact on the current rating, with potential for greater negative impact over time.

Source: Moody's Ratings

Novo Banco's **CIS-3** reflects the moderate rating impact of the bank's governance risks stemming from past risk management shortcomings which led to the implementation of a restructuring program and which still weigh moderately on its credit profile. Environmental and social factors have a limited impact on the bank's rating to date.

Exhibit 7
ESG issuer profile scores

Source: Moody's Ratings

Environmental

Novo Banco faces moderate environmental risks primarily because of its portfolio exposure to carbon transition risk as a diversified bank. In line with its peers, the bank is exposed to mounting business risks and stakeholder pressure to meet broader carbon transition goals. In response, Novo Banco is developing its climate risk and portfolio management capabilities and is actively transitioning its lending portfolios to achieve carbon neutrality targets.

Social

Novo Banco is exposed to high industrywide social risks particularly related to customer relations risk and associated regulatory and litigation risks, requiring high compliance standards. These risks are mitigated by Novo Banco's developed policies and procedures. Novo Banco's high cyber and personal data risks are mitigated by the bank's sound IT framework.

Governance

Novo Banco's governance risks are moderate, stemming from past risk management deficiencies which led to severe asset quality deterioration and the implementation of a restructuring program agreed with the European Commission. The successful completion of the program has led to an improvement in the bank's financial strategy and risk management practices. However, the track record of sustainable performance has yet to be established. Novo Banco is controlled by Lone Star, which owns 75% of its capital. Therefore, the bank is exposed to potential outside influence by the controlling shareholder on the bank's management and board. The risk is however mitigated by the presence of independent directors which are majority in the board and Portugal's developed institutional framework.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Loss given failure

Novo Banco is subject to the EU Bank Recovery and Resolution Directive, which we consider an operational resolution regime. We assume residual TCE of 3% and post-failure losses of 8% of tangible banking assets, a 25% runoff in junior wholesale deposits and a 5% runoff in preferred deposits. We assign a 26% proportion of junior deposits. These metrics are in line with our standard assumptions. We also take into account full depositor preference, whereby junior deposits are preferred over senior debt creditors in accordance with the law that was passed by the Portuguese government in March 2019.

For Novo Banco's deposit and senior unsecured debt ratings, our LGF analysis reflects the likely impact on the loss given failure of the combination of its own volume and subordination. Our LGF analysis indicates an extremely low loss given failure for deposits and a moderate loss given failure for senior unsecured debt, which leads us to position these ratings three notches above and in line with the BCA, respectively.

Government support

We assign a low probability of government support to Novo Banco's ratings, which results in no uplift for the deposit and senior debt ratings.

Counterparty Risk Ratings (CRRs)

Novo Banco's CRRs are positioned at Baa1/Prime-2

The CRRs are positioned three notches above the Adjusted BCA of ba1, reflecting the extremely low loss given failure from the high volume of instruments that are subordinated to CRR liabilities.

Counterparty Risk (CR) Assessment

Novo Banco's CR Assessment is positioned at Baa1(cr)/Prime-2(cr)

The CR Assessment is positioned three notches above the Adjusted BCA of ba1 based on the buffer against default provided to the senior obligations represented by the CR Assessment by subordinated instruments amounting to 21.6% of tangible banking assets.

The main difference from our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations, rather than expected loss; therefore, we focus purely on subordination and take no account of the volume of the instrument class. The CR Assessment does not benefit from any systemic support uplift, in line with our support assumptions on deposits and senior unsecured debt.

Methodology and scorecard

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 8

Novo Banco, S.A.

Macro Factors							
Weighted Macro Profile	**Strong -**	**100%**					

Factor	**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	6.7%	ba2	↑↑	ba2	Quality of assets	Expected trend
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - fully loaded)	16.2%	a1	↓↓	baa3	Stress capital resilience	
Profitability						
Net Income / Tangible Assets	-0.1%	caa2	↑↑	baa1	Expected trend	
Combined Solvency Score		ba1		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	25.2%	ba1	↑↑	ba1	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	29.7%	baa2	↓↓	ba1	Asset encumbrance	
Combined Liquidity Score		baa3		ba1		
Financial Profile				baa3		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				A3		
BCA Scorecard-indicated Outcome - Range				baa2 - ba1		
Assigned BCA				ba1		
Affiliate Support notching				0		
Adjusted BCA				ba1		

Balance Sheet	**in-scope (EUR Million)**	**% in-scope**	**at-failure (EUR Million)**	**% at-failure**
Other liabilities	10,890	24.8%	14,185	32.4%
Deposits	28,688	65.5%	25,762	58.8%
Preferred deposits	21,229	48.4%	20,168	46.0%
Junior deposits	7,459	17.0%	5,594	12.8%
Senior unsecured bank debt	2,241	5.1%	2,066	4.7%
Dated subordinated bank debt	694	1.6%	500	1.1%
Equity	1,315	3.0%	1,315	3.0%
Total Tangible Banking Assets	43,828	100.0%	43,828	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	21.6%	21.6%	21.6%	21.6%	3	3	3	3	0	baa1
Counterparty Risk Assessment	21.6%	21.6%	21.6%	21.6%	3	3	3	3	0	baa1 (cr)
Deposits	21.6%	4.1%	21.6%	8.9%	2	3	3	3	0	baa1
Senior unsecured bank debt	21.6%	4.1%	8.9%	4.1%	2	0	0	0	0	ba1
Junior senior unsecured bank debt	4.1%	4.1%	4.1%	4.1%	0	0	0	0	0	ba1
Dated subordinated bank debt	4.1%	3.0%	4.1%	3.0%	-1	-1	-1	-1	0	ba2

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	baa1	-	Baa1	Baa1
Counterparty Risk Assessment	3	0	baa1 (cr)	-	Baa1(cr)	
Deposits	3	0		-	Baa1	Baa1
Senior unsecured bank debt	0	0		-	Ba1	(P)Ba1
Junior senior unsecured bank debt	0	0		-	(P)Ba1	(P)Ba1
Dated subordinated bank debt	-1	0		-	Ba2	(P)Ba2

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Ratings

Ratings

Exhibit 9

Category	Moody's Rating
NOVO BANCO, S.A.	
Outlook	Positive
Counterparty Risk Rating	Baa1/P-2
Bank Deposits	Baa1/P-2
Baseline Credit Assessment	ba1
Adjusted Baseline Credit Assessment	ba1
Counterparty Risk Assessment	Baa1(cr)/P-2(cr)
Senior Unsecured -Dom Curr	Ba1
Junior Senior Unsecured MTN	(P)Ba1
Subordinate -Dom Curr	Ba2
Commercial Paper -Dom Curr	NP
NOVO BANCO S.A., LUXEMBOURG BRANCH	
Outlook	Positive
Counterparty Risk Rating	Baa1/P-2
Bank Deposits	Baa1/P-2
Counterparty Risk Assessment	Baa1(cr)/P-2(cr)
Senior Unsecured -Dom Curr	Ba1
NB FINANCE LTD.	
Outlook	Positive
Bkd Senior Unsecured	Ba1

Source: Moody's Ratings

Endnotes

1 Following Moody's criteria

2 Source: European Banking Authority's Risk Dashboard

3 Measured as loan loss provisions to gross loans

4 Including management overlays

5 As per European Banking Authority (EBA)

6 Excluding markets and other operating results

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CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454