PRESS RELEASE SEPTEMBER 25, 2024

Morningstar DBRS Upgrades Novo Banco's Long-Term Issuer Ratings to BBB, Trend Stable

BANKING ORGANIZATIONS

DBRS Ratings GmbH (Morningstar DBRS) upgraded the credit ratings of Novo Banco, S.A. (novobanco or the Bank), including the Long-Term Issuer Rating to BBB from BB (high), and the Short-Term Issuer Rating to R-2 (high) from R-3. The trend on all credit ratings is Stable. The Bank's Intrinsic Assessment (IA) was also upgraded to BBB while the Support Assessment was maintained at SA3. The Bank's Long-Term Deposit Rating was upgraded to BBB (high) from BBB (low), which is one notch above the IA, reflecting the legal framework in place in Portugal which provides full depositor preference in bank insolvency and resolution proceedings.

Novobanco's Long-Term Critical Obligations Rating was also upgraded to A (low) from BBB, which is two notches above the IA, in line with the standard notching approach outlined in our banking methodology. The Critical Obligations Ratings reflect Morningstar DBRS' expectation that, in the event of a resolution of the Bank, certain liabilities (such as payment and collection services, obligations under a covered bond program, payment and collection services, etc.) have a greater probability of avoiding being bailed-in and are likely to be included in a going-concern entity. A full list of credit rating actions is included at the end of this press release.

KEY CREDIT RATING CONSIDERATIONS

The two-notch upgrade of novobanco into the investment grade territory reflects the Bank's rapidly improved performance across various building blocks, including the Bank's earnings power, its risk profile, and capitalisation. Key financial metrics have advanced at a pace and scale beyond previous Morningstar DBRS expectations. Earnings growth has been supported by the successful restructuring process and from stronger interest revenues. The risk profile improved from the material reduction in the stock of legacy problem assets, and even though the Bank's gross NPL ratio remains above the EU average, the NPL ratio net of provisions is now well placed with EU peers. Furthermore, novobanco over the course of the last year diversified its funding mix through successful debt issuances, and the Bank has strengthened its capital position through organic capital generation and a reduction of risk-weighted assets.

The Stable Trend reflects Morningstar DBRS's expectation that the Bank will consolidate the improvements achieved in terms of profitability and asset quality, as well as maintain sound capital buffers and an adequate liquidity position. Morningstar DBRS is of the view that credit quality could further improve once the bank exits the Contingent Capital Agreement (CCA), from the ongoing clean-up of the balance sheet, and from a longer track record of consistent access to market funding.

CREDIT RATING DRIVERS

Novobanco's credit ratings could be upgraded if the Bank demonstrates a consistent track record in earnings capacity and asset quality, and if there is steady access to a variety of market funding sources.

Conversely, the credit ratings could be downgraded as a result of material weakening of the Bank's capital levels, a significant worsening of its asset quality, or a sharp deterioration in its liquidity position.

CREDIT RATING RATIONALE

Franchise Combined Building Block (BB) Assessment: Moderate

Novobanco has a relatively stable franchise as the fourth largest bank in Portugal by total assets, and a leading franchise in SME and Corporate banking with a market share of around 14% for corporate loans. The Bank has invested heavily in digitalization and branding as part of its strategic refocus on business in Portugal. The Bank's business profile stabilized in recent years and in 2023 it received notification from the Directorate General for Competition about the completion of its restructuring plan. This was an important milestone in the Bank's rapid turnround process. The management team is experienced and appears to be effectively executing its strategy. Morningstar DBRS is of the view that the Bank and it public sector counterparts will successfully resolve any lingering disputes around the CCA, possibly earlier than the CCA's 2025 expiration date. This would free the Bank to further consolidate its balance sheet, pay out dividends, and explore divestment opportunities.

Earnings Combined Building Block (BB) Assessment: Good

Novobanco's earnings capacity has benefitted from a successful balance sheet restructuring that positioned it well to benefit from the recent rapid rise in interest rates. In H1 2024, novobanco reported a consolidated net profit of EUR 370.3 million, which translated into RoTE of 17.4% primarily due to higher interest income. Most of the Bank's loan book is indexed to euro rates, resulting in the average yield on interest earning assets increasing to 4.75% in H1 2024, up from 3.70% a year. By comparison, the average interest on liabilities was 1.91% in H1 2024, up from 1.18% a year ago. The resulting 2.83% NIM in H1 2024 is likely to narrow since the bulk of the Bank's floating rate loan book has largely re-priced and Euribor rates are expected to decline. Yet, Morningstar DBRS is of the view that margins should remain higher than the trend prior to 2022 due to structurally higher interest rates and low deposit beta. The Bank has implemented a hedging strategy that reduces its sensitivity to rate movements. Earnings are also likely to benefit from steady income from fees and commissions as lending volumes gradually increase. The improvement in the Bank's cost-to-income ratio, to 32% in H1 2024 from 49% in end-2022, was driven by higher core revenues than the cost pressures from deposit pay-outs, ongoing digitalization efforts, and costs linked to higher inflation.

Risk Combined Building Block (BB) Assessment: Good/Moderate

Novobanco has made significant progress since 2017 in de-risking its balance sheet, and the reduction in the legacy stock of impaired loans has continued in recent years despite inflationary pressure and higher interest rates. The prevalence of floating-rate loans in Portugal makes borrowers especially sensitive to a rapid rise in rates. However, the Bank's conservative underwriting criteria and the resiliency of the Portuguese economy have limited the impairment of loans. Of course, another price shock that weakens the economy would likely pressure asset quality, but these risks are mitigated by the strong Portuguese labour market and healthy private sector finances. The Bank's gross NPL ratio declined to 4.1% in H1 2024, down from 4.4% end-2023 (or 32% in 2017) due to cures, recoveries, and write-offs. This gross NPL ratio is still higher than the European average, partly explained by the limitation on the potential asset disposals under the CCA. The NPL ratio net of the CCA-related assets, at 2.8%, better aligns with peers. Furthermore, the Bank's 88.4% coverage ratio in H1 2024 reduces the net NPL ratio to 0.5% in H1 2024, ahead of the EU average. As a consequence of strengthened asset quality and coverage ratios, the cost of risk declined to 38bps in H1 2024, from 51bps a year earlier including management overlays.

Funding and Liquidity Combined Building Block (BB) Assessment: Good/Moderate

The Bank's current funding structure is underpinned by stable customer deposits, which increased in H1 2024 by 3.2% to EUR 29.1 billion compared to a year earlier, representing 77% of total funding H1 2024. The cost of funding remains low, though the average deposit rate has gradually increased. The Bank has largely repaid its ECB funding following the phase out of TLTRO. Its ECB exposure was EUR 950 million in H1 2024. Since the start of 2023, Novobanco has demonstrated access to market funding with EUR 2 billion in oversubscribed and competitively-priced issuances. The secured funding strategy focuses on covered bond issuances, while unsecured funding as of June 2024 is MREL-compliant and ahead of schedule. Novobanco's liquidity buffer of EUR 14.9 billion corresponds to 51% of its deposit base, and its regulatory liquidity ratios remain suitable: the liquidity coverage ratio (LCR) reported at 198% in H1 2024, and the net stable funding ratio (NSFR) of 121%.

Capitalisation Combined Building Block (BB) Assessment: Good/Moderate

Novobanco's capital ratios have significantly improved in recent years on the back of strong profitability alongside a reduction in RWAs. The Bank reported a fully-loaded CET1 of 19.9% and a total solvency ratio of 22.7% in H1 2024. This represents a significant improvement compared to the levels reported in H1 2023 (15.1% and 17.8%, respectively), and provided adequate buffers over minimum capital requirements under SREP. Novobanco's capital ratios do not include the potential capital payment under the CCA scheme. The dispute between the Resolution Fund and novobanco in the Arbitration Court regarding the payment requested under the CCA for the 2020 financial year was resolved in June 2024. The court ruled in novobanco's favour, and the Bank remains eligible to access the remaining EUR 485 million until end-2025. It appears highly unlikely that novobanco will require additional support, and its plans to pay out dividends and divest its ownership structure are constrained by the CCA. As such, the agreement will likely be unwound earlier than the end-2025 maturity date. Morningstar DBRS expects capital ratios will decline from their current levels, though remain strong, once the bank reverts to dividend payments.

Further details on the Scorecard Indicators and Building Block Assessments can be found at https://dbrs.morningstar.com/research/439969.

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE CONSIDERATIONS

A Governance factor has changed from the prior credit rating disclosure. Previously, political risk was considered a relevant factor for the ratings, reflecting the previous disputes between the Bank and the Resolution Fund. Those disputes were settled by an Arbitration Court Ruling in June 2024.

There were no Environmental, Social, or Governance factors that had a significant or relevant effect on the credit analysis.

A description of how Morningstar DBRS considers ESG factors within the Morningstar DBRS analytical framework can be found in the Morningstar DBRS Criteria: Approach to Environmental, Social, and Governance Factors in Credit Ratings (13 August 2024) https://dbrs.morningstar.com/research/437781.

Notes:
All figures are in euros unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations (4 June 2024) https://dbrs.morningstar.com/research/433881. In addition Morningstar DBRS uses the Morningstar DBRS Criteria: Approach to Environmental, Social, and Governance Factors in Credit Ratings https://dbrs.morningstar.com/research/437781 in its consideration of ESG factors and the Morningstar DBRS Global Corporate Criteria (15 April 2024) https://dbrs.morningstar.com/research/431186.

The credit rating methodologies used in the analysis of this transaction can be found at: https://dbrs.morningstar.com/about/methodologies

The sources of information used for this credit rating include Morningstar, Inc. and company documents, 2024, 2023, and 2022 quarterly reports and presentations, Novobanco annual reports (2014-2023), European Banking Authority (EBA) and European Central Bank (ECB) data. Morningstar DBRS considers the information available to it for the purposes of providing this credit rating to be of satisfactory quality.

Morningstar DBRS does not audit the information it receives in connection with the credit rating process, and it does not and cannot independently verify that information in every instance.

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. Morningstar DBRS' outlooks and credit ratings are under regular surveillance.

For further information on Morningstar DBRS historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: https://registers.esma.europa.eu/cerep-publication. For further information on Morningstar DBRS historical default rates published by the Financial Conduct Authority (FCA) in a central repository, see https://data.fca.org.uk/#/ceres/craStats.

The sensitivity analysis of the relevant key credit rating assumptions can be found at: https://dbrs.morningstar.com/research/439968.

This credit rating is endorsed by DBRS Ratings Limited for use in the United Kingdom.

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Initial Rating Date: August 5, 2014
Last Rating Date: December 13, 2023

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For more information on this credit or on this industry, visit https://dbrs.morningstar.com.

Ratings

NB Finance Ltd.

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
25-Sep-24	Senior Notes Guaranteed by NB	Upgraded	BBB	Stb	EU U

Novo Banco Luxembourg Branch

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
25-Sep-24	Long-Term Deposits	Upgraded	BBB (high)	Stb	EU U
25-Sep-24	Long-Term Senior Debt	Upgraded	BBB	Stb	EU U
25-Sep-24	Short-Term Debt	Upgraded	R-2 (high)	Stb	EU U
25-Sep-24	Short-Term Deposits	Upgraded	R-1 (low)	Stb	EU U

Novo Banco, S.A.

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
25-Sep-24	Long-Term Issuer Rating	Upgraded	BBB	Stb	EU U
25-Sep-24	Short-Term Issuer Rating	Upgraded	R-2 (high)	Stb	EU U
25-Sep-24	Long-Term Deposits	Upgraded	BBB (high)	Stb	EU U
25-Sep-24	Long-Term Senior Debt	Upgraded	BBB	Stb	EU U
25-Sep-24	Short-Term Debt	Upgraded	R-2 (high)	Stb	EU U
25-Sep-24	Short-Term Deposits	Upgraded	R-1 (low)	Stb	EU U
25-Sep-24	Long Term Critical Obligations Rating	Upgraded	A (low)	Stb	EU U
25-Sep-24	Short Term Critical Obligations Rating	Upgraded	R-1 (low)	Stb	EU U
25-Sep-24	Subordinated Debt	Upgraded	BB (high)	Stb	EU U
25-Sep-24	Long-Term Senior Debt - EUR 5 billion EMTN Programme	Upgraded	BBB	Stb	EU U
25-Sep-24	Senior Non-Preferred Debt - EUR 5 billion EMTN Programme	Upgraded	BBB (low)	Stb	EU U
25-Sep-24	Subordinated Debt - EUR 5 billion EMTN Programme	Upgraded	BB (high)	Stb	EU U

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