

RATING ACTION COMMENTARY

Fitch Upgrades Novo Banco to 'BBB'; Outlook Stable

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Fitch Ratings - Paris - 13 Dec 2024: Fitch Ratings has upgraded Novo Banco, S.A. (Novo Banco) Long-Term Issuer Default Rating (IDR) to 'BBB' from 'BBB-' and Viability Rating (VR) to 'bbb' from 'bbb-'. The Outlook on the Long-Term IDR is Stable. A full list of rating actions is below.

The upgrade reflects the improvement in Fitch's assessment of the operating environment for Portuguese banks' to 'bbb+/stable' from 'bbb/positive', coupled with Novo Banco's finalised business model restructuring and strengthened financial profile.

KEY RATING DRIVERS

Business Profile, Capital Drive Ratings: Novo Banco's ratings reflect its adequate franchise in Portugal and stable business model geared towards retail and commercial banking, which result in healthy profitability and satisfactory capital buffers above regulatory requirements. The ratings also incorporates a stable funding profile and improving asset quality, albeit still weaker than higher-rated domestic peers.

More Resilient Operating Environment: The Portuguese banking sector has significantly increased its resilience to shocks due to loan book deleveraging and structurally improved asset quality, profitability and capitalisation. We expect lower indebtedness, together with falling interest rates and healthy GDP growth (above eurozone average) to supports business volume growth for Portuguese banks.

Adequate Franchise: Novo Banco is the fourth-largest bank in Portugal with a market share of about 9% and 10% in deposits and loans, respectively. The successful restructuring transformed Novo Banco into a cost-efficient and simplified bank focussing on traditional banking services to corporates and retail customers. Management is preparing the bank to be listed, while increasing the revenue diversification and prudently growing the loan book.

Improved Risk Profile: The material reduction in legacy bad assets should continue following the recent termination of Contingent Capital Agreement (CCA) with the Portuguese Resolution Fund. Novo Banco has a slightly higher share of loans to SMEs and corporates than peers, but underwriting standards are prudent and in line with industry standards. The bank has recently reduced its earnings sensitivity to interest rates.

Decreasing Problem Assets: Novo Banco's impaired loans ratio dropped to about 4% at end-September 2024, which is higher than most Portuguese peers, partly due to the lengthy work-out of assets under CCA. We expect the ratio to converge towards 3% in 2025-2026, supported by active management of legacy bad loans and sound underwriting of new loans. Novo Banco's legacy foreclosed real estate assets decreased to a manageable 0.8% of total assets at end-September 2024, still slightly higher than most Portuguese peers. High impaired loans coverage mitigates residual risks from legacy problem loans.

Strong Profitability: Novo Banco's profitability compares well with most mid-sized southern European peers. It benefits from a good domestic franchise and sound cost-efficiency. Novo Banco's 9M24 operating profit rose increased to about 4% of risk-weighted assets (RWAs; 2023: 3.6%), benefiting from higher interest rates. We expect this ratio to decrease to about 3.5% in 2025, due to interest rate cuts. Earnings should remain strong over 2025-2026, due to lower interest rate sensitivity, further growth of fee-generating businesses and loan growth.

Satisfactory Capital Buffers: Novo Banco's buffers over regulatory requirements have improved significantly since end-2022, due to materially stronger profitability, high retention of capital, while materially reducing unreserved problem assets. The bank's fully-loaded common equity Tier 1 (CET1) ratio at end-September 2024 was 20.7% (including 9M24 results). We expect it to remain above 16% in 2025-2026, excluding potential significant share buy-backs or dividends. Our assessment also incorporates strong Basel leverage ratio.

Stable Funding, Adequate Liquidity Buffer: The funding is predominantly sourced from a stable and granular retail deposit base that fully funds the loan book. The loans/deposits ratio was about 87% at end-September 2024, as per Fitch's calculation. Funding has recently been diversified by use of repos, covered bonds and unsecured debt. We view Novo Banco's successful issuance of senior debt as a significant improvement in investor confidence. The bank uses unsecured wholesale funding mainly for compliance with minimum requirements for own funds and eligible liabilities (MREL).

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating**Action/Downgrade**

Negative rating pressure could arise if the bank's operating profit falls below 2% of RWAs for an extended period and impaired loans ratio durably grows above 4%. We would also downgrade the bank's ratings should the CET1 ratio fall materially below 14% without a credible plan to restore it above that level, following higher appetite for growth or significant payouts to shareholders.

Factors that Could, Individually or Collectively, Lead to Positive Rating**Action/Upgrade**

An upgrade of Novo Banco's ratings would require growing market shares in Portugal, increased business diversification towards recurring non-interest income and further asset-quality improvement. The bank's ability to maintain its satisfactory capital ratios would also be key for an upgrade. This may be reflected, for instance, in an impaired loans ratio closer to 2%, operating profit/RWAs consistently above 3.5%, and the CET1 ratio above 16%. A potential upward revision of the operating environment would also be rating positive.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

The Short-Term IDR has been affirmed at 'F3' and is the lower of two options mapping to a Long-Term IDR of 'BBB', driven by Novo Banco's funding and liquidity score of 'bbb'.

The long-term deposit rating has been upgraded to 'BBB+' from 'BBB'. It is one notch above Novo Banco's Long-Term IDR, reflecting full depositor preference in Portugal and the structure of the bank's resolution buffer, which includes senior preferred debt. The short-term deposit rating of 'F2' is the lower of two options mapping to a long-term deposit rating of 'BBB+', driven by Novo Banco's funding and liquidity score of 'bbb'.

The long-term senior preferred debt rating has been upgraded to 'BBB' from 'BBB-'. The rating is aligned with the bank's IDRs because we expect that it will meet its MREL with a combination of senior preferred and junior debt instruments. We do not expect the buffer of senior non-preferred and more junior debt to exceed 10% of RWAs. The short-term debt rating is aligned with the Short-Term IDR.

GOVERNMENT SUPPORT RATING (GSR)

Novo Banco's GSR of 'no support' reflects our view that although external extraordinary sovereign support is possible, it cannot be relied on. This is because senior creditors can no longer expect to receive full extraordinary support from the sovereign if the bank becomes non-viable.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

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Novo Banco's senior preferred, and deposit ratings are primarily sensitive to changes in Novo Banco's IDRs. The short-term IDR, senior preferred and deposit ratings are also sensitive to the funding and liquidity score. In addition, the senior preferred long-term debt rating could be upgraded if Fitch expects that Novo Banco will either meet its MREL without recourse to senior preferred debt or if the buffer of senior non-preferred and more junior debt exceeds 10% of the resolution group's RWAs on a sustained basis.

An upgrade of the GSR would be contingent on a positive change in the sovereign's propensity to support the bank. In Fitch's view, this is highly unlikely, although not impossible.

VR ADJUSTMENTS

The operating environment score of 'bbb+' is below the 'a' implied category score due to the following adjustment reason: level and growth of credit (negative).

The asset quality score of 'bbb-' is above the 'bb' implied category score due to the following adjustment reason: historical and future metrics (positive)

The earnings and profitability score of 'bbb' is above the 'bb' implied category score due to the following adjustment reason: historical and future metrics (positive).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
Novo Banco, S.A.	LT IDR	BBB Rating Outlook Stable		BBB- Rating Outlook Stable
	Upgrade			
	ST IDR	F3	Affirmed	F3
	Viability	bbb	Upgrade	bbb-
	Government Support		ns Affirmed	ns
long-term deposits	LT	BBB+	Upgrade	BBB
Senior preferred	LT	BBB	Upgrade	BBB-
short-term deposits	ST	F2	Upgrade	F3
Senior preferred	ST	F3	Affirmed	F3

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Bank Rating Criteria \(pub. 15 Mar 2024\) \(including rating assumption sensitivity\)](#)

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Novo Banco, S.A.

EU Issued, UK Endorsed

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