PRESS RELEASE DECEMBER 13, 2023

# DBRS Morningstar Upgrades Novo Banco's Long-Term Issuer Rating to BB (high), Trend Stable

BANKING ORGANIZATIONS

DBRS Ratings GmbH (DBRS Morningstar) upgraded the credit ratings of Novo Banco, S.A. (novobanco or the Bank), including the Long-Term Issuer Rating to BB (high) from BB (low), and the Short-Term Issuer Rating to R-3 from R-4. The trend on all credit ratings is Stable. The Bank's Intrinsic Assessment (IA) has also been upgraded to BB (high) while the Support Assessment was maintained at SA3.

The Bank's Long-Term Deposit Rating was upgraded to BBB (low) from BB, 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.

At the same time, novobanco's Long-Term Critical Obligations Rating was upgraded to BBB from BB (high), which is two notches above the IA, in line with the standard notching approach outlined in our banking methodology. The Critical Obligations Ratings reflect DBRS Morningstar's 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 upgrade reflects novobanco's significant improvement in earnings and capital that exceeded DBRS Morningstar's expectations, supported by higher interest rates as well as the successful completion of the turnaround process which has led to a material reduction in the stock of legacy problem assets. Net attributable income increased significantly in 9M 2023 mainly on the back of higher interest revenues, while the Bank's capital position strengthened further, supported by organic capital generation and RWA reduction. The Bank's gross NPL ratio continued to fall to 4.2% in Q3 2023. Despite closing the gap with its peers, novobanco's asset quality metrics are still weaker than the EU average.

The Stable Trend reflects DBRS Morningstar's expectation that the Bank will maintain sound capital buffers and an adequate liquidity position as well as consolidating the improvements achieved in terms of recurrent profitability and asset quality. In our view, the Bank's performance should continue to benefit from higher interest rates, although some margin pressure is expected.

CREDIT RATING DRIVERS

An upgrade would likely be driven by further improvements in asset quality, and a sustained improvement in profitability, while maintaining adequate capital buffers.

A downgrade could result from a material weakening of the Bank's capital levels and/or a significant worsening in asset quality. A sharp deterioration in the liquidity position could also lead to a downgrade.

## CREDIT RATING RATIONALE

### Franchise Combined Building Block (BB) Assessment: Moderate

The Bank has a relatively stable franchise as the fourth largest bank in Portugal, and a leading franchise in SME and Corporate banking with a market share of around 14.5% for corporate loans at end-September 2023.

At end-September 2023, novobanco had 4,209 employees vs. 4,139 at end-September 2022 (+70 YOY) while the number of branches remained constant at 292 YTD. At the same time, the Bank has continued to invest in digitalization and branding and, as part of its strategic refocus on the core business in Portugal. In February 2023, novobanco received notification from the Directorate General for Competition (DG Comp) about the completion of its restructuring plan. This was an important milestone in the Bank's turnround process.

### Earnings Combined Building Block (BB) Assessment: Good/Moderate

In DBRS Morningstar's view, the Bank has significantly improved its earnings capacity mainly as a result of the successful restructuring process and higher interest rate environment.

In 9M 2023, novobanco reported a consolidated net profit of EUR 638.5 million, up from EUR 428.3 million a year earlier, mainly driven by higher interest income on the back of higher rates and taking into account the Bank's large exposure to floating rate loans. This translated into an ROE of 20.0%, up from 16.8%, as per DBRS Morningstar's calculation.

Net interest income significantly increased to EUR 831 million up YOY from 406 million in 9M 2022, with the average yield on interest earning assets increasing in 9M 2023, to 3.98% from 1.56%. The bulk of the Bank's floating rate loan book has largely re-priced as of 9M 2023. For 2024, NIM should remain solid although we expect some margin pressure from higher remuneration for deposits and a potential gradual reduction in interest rates throughout 2024.

Loan provisions increased to EUR 65.7 million from EUR 39.5 million in 9M 2023, largely reflecting management overlays. The Bank reported a cost/income ratio of 32%, significantly down from 51% a year earlier, driven by higher core revenues which more than offset cost pressures from ongoing digitalization efforts and higher inflation.

### Risk Combined Building Block (BB) Assessment: Moderate

Since 2017, novobanco has made significant progress in de-risking its balance sheet, with the provision of capital support through the Contingent Capital Agreement (CCA) from the Portuguese Resolution Fund playing a key role in this process. Novobanco's gross NPL stock fell by 12.5% to EUR 1,205 million at end-September 2023, from EUR 1,376 million at FY 2022. This was mainly supported by cures and recoveries and write-offs. The Bank's gross NPL ratio fell to 4.2% at Q3 2023 from 4.3% at FY 2022, which is still higher than the European average. The NPL coverage ratio was sound, leading to a net NPL ratio of 0.7% at end-September 2023.

Credit quality risks from rising interest rates have been limited for the time being, but risks remain on the rise taking into account the ongoing economic slowdown and the pressure on borrowers' debt affordability due to the rapid increase in interest rates. The Bank's asset base also shows a large exposure to debt securities, of which the majority is held at amortised cost. The increase in interest rates has led to the formation of unrealised losses, however, the potential capital impact however appears contained.

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

The Bank's current funding structure depends largely on deposits. Total deposits amounted to EUR 28.1 billion, representing 66% of total assets at end-September 2023. Deposit volumes remained largely resilient, with total deposits slightly declining by 1% compared to end-2022. Around 73% of the Bank's deposit base is made of retail deposits. The increase in rates led to a shift from demand deposits to time deposits, and a higher cost of funding, with the average deposit rate increasing to 66 bps at end-September 2023 from 15 bps a year earlier. The Bank also has exposure to the ECB, with EUR 1.1 billion in total funds at end-September 2023, which has reduced significantly YOY, following the phase out of TLTRO.

The Bank has a liquidity buffer of around EUR 13.3 billion, corresponding to around 47% of its deposit base. The Bank's regulatory liquidity ratios remain adequate, with the liquidity coverage ratio (LCR) reported at 136% at end-September 2023, down from 210% in FY 2022 largely due to TLTRO repayments, whilst the net stable funding ratio (NSFR) increased slightly to 118% from 116% at end-June 2023, and is lower compared to peers.

Capitalisation Combined Building Block (BB) Assessment: Weak/Very Weak

At end-September 2023, the Bank reported a fully-loaded CET1 and total capital ratios of 16.5% and 19.3%, respectively. This represents a significant improvement compared to the levels reported at end-2022 (13.1% and 15.5%). Capital ratios have benefitted from improving organic capital generation, alongside a reduction in RWAs in 2023, and provided adequate buffers over minimum capital requirements under SREP applicable for 2024. While we recognize the Bank's significant improvement since end-2022, our view on capital still takes into account the heavy losses reported until YE-2020, and a relatively limited track record of organic capital generation.

Novobanco's capital ratios do not include the potential capital payment under the CCA scheme. The capital paid to novobanco in 2021 was lower than the amount initially requested. This led to an arbitration process with the Resolution Fund, and the outcome of this still remains unclear.

Further details on the Scorecard Indicators and Building Block Assessments can be found at: https://www.dbrsmorningstar.com/research/425233.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

The Governance factor has a relevant effect on the ratings, political risk is still considered, reflecting the current disputes between the Bank and the Resolution Fund.

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

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (4 July 2023) https://www.dbrsmorningstar.com/research/416784/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings.

Notes:
All figures are in EUR unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations (22 June 2023) https://www.dbrsmorningstar.com/research/415978/global-methodology-for-rating-banks-and-banking-organisations. In addition DBRS Morningstar uses the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings https://www.dbrsmorningstar.com/research/416784/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings in its consideration of ESG factors and the DBRS Morningstar Global Criteria: Guarantees and Other Forms of Support (28 March 2023) https://www.dbrsmorningstar.com/research/411694/dbrs-morningstar-global-criteria-guarantees-and-other-forms-of-support.

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

The sources of information used for this credit rating include Morningstar Inc. and Company Documents, novobanco Press Release Q3 2023 and H1 2023 Results, novobanco 2016-2022 Annual Reports. DBRS Morningstar considers the information available to it for the purposes of providing this credit rating to be of satisfactory quality.

DBRS Morningstar 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. DBRS Morningstar's outlooks and ratings are under regular surveillance.

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. DBRS Morningstar understands further information on DBRS Morningstar historical default rates may be published by the Financial Conduct Authority (FCA) on its webpage: https://www.fca.org.uk/firms/credit-rating-agencies.

The sensitivity analysis of the relevant key rating assumptions can be found at: https://www.dbrsmorningstar.com/research/425234.

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: March 29, 2023

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For more information on this credit or on this industry, visit www.dbrsmorningstar.com.

## Ratings

### NB Finance Ltd.

| Date Issued | Debt Rated | Action | Rating | Trend | Attributes |
|---|---|---|---|---|---|
| 13-Dec-23 | Senior Notes Guaranteed by NB | Upgraded | BB (high) | Stb | EU U |

### Novo Banco Luxembourg Branch

| Date Issued | Debt Rated | Action | Rating | Trend | Attributes |
|---|---|---|---|---|---|
| 13-Dec-23 | Long-Term Deposits | Upgraded | BBB (low) | Stb | EU U |
| 13-Dec-23 | Long-Term Senior Debt | Upgraded | BB (high) | Stb | EU U |
| 13-Dec-23 | Short-Term Debt | Upgraded | R-3 | Stb | EU U |
| 13-Dec-23 | Short-Term Deposits | Upgraded | R-2 (middle) | Stb | EU U |

### Novo Banco, S.A.

| Date Issued | Debt Rated | Action | Rating | Trend | Attributes |
|---|---|---|---|---|---|
| 13-Dec-23 | Long-Term Issuer Rating | Upgraded | BB (high) | Stb | EU U |
| 13-Dec-23 | Short-Term Issuer Rating | Upgraded | R-3 | Stb | EU U |
| 13-Dec-23 | Long-Term Deposits | Upgraded | BBB (low) | Stb | EU U |
| 13-Dec-23 | Long-Term Senior Debt | Upgraded | BB (high) | Stb | EU U |
| 13-Dec-23 | Short-Term Debt | Upgraded | R-3 | Stb | EU U |
| 13-Dec-23 | Short-Term Deposits | Upgraded | R-2 (middle) | Stb | EU U |
| 13-Dec-23 | Long Term Critical Obligations Rating | Upgraded | BBB | Stb | EU U |
| 13-Dec-23 | Short Term Critical Obligations Rating | Upgraded | R-2 (high) | Stb | EU U |
| 13-Dec-23 | Subordinated Debt | Upgraded | BB (low) | Stb | EU U |
| 13-Dec-23 | Long-Term Senior Debt - EUR 5 billion EMTN Programme | Upgraded | BB (high) | Stb | EU U |
| 13-Dec-23 | Senior Non-Preferred Debt - EUR 5 billion EMTN Programme | Upgraded | BB | Stb | EU U |

| Date Issued | Debt Rated | Action | Rating | Trend | Attributes |
| --- | --- | --- | --- | --- | --- |
| 13-Dec-23 | Subordinated Debt - EUR 5 billion EMTN Programme | Upgraded | BB (low) | Stb | EU U |

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