

## ISSUER COMMENT

# Novo Banco's 2014 Results Reveal Persistent Asset Quality and Profitability Weaknesses

From [Credit Outlook](#)

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Last Monday, [Novo Banco, S.A.](#) (B2 review for downgrade, E/ca review for upgrade<sup>1</sup>) published its 2014 financial statements, which included sizable losses and showed that the bank's asset quality metrics had weakened. The results are credit negative for the bank because they call into question the bank's ability to generate capital from internal sources.

On 3 August 2014, the Portuguese authorities approved the resolution of Banco Espírito Santo (BES, unrated) and the immediate creation and capitalisation of a temporary bridge bank called Novo Banco. Portuguese authorities expect the Portuguese Resolution Fund, which owns 100% of Novo Banco, to divest the bank before August 2016. Through this sale, the Portuguese government intends to receive the bulk of the €4.4 billion loan it granted to the Resolution Fund, and which was needed to fund a €4.9 billion capital injection into Novo Banco.

The publication of Novo Banco's year-end 2014 financial results sheds some light on the bank's current credit quality, the details of which had been limited before last Monday. Persistently weak financial indicators highlight the challenges the Portuguese government will face in recovering in its entirety the loan it made to the Resolution Fund via a sale of Novo Banco. Furthermore, if the loan is not entirely reimbursed through the proceeds of Novo Banco's sale, it could have negative implications for Portuguese banks given that the Resolution Fund is financed through bank contributions and banks could be required to bear a portion of any sale shortfall.

From its creation on 4 August 2014 through 31 December 2014, Novo Banco's stock of nonperforming loans (NPLs) climbed 17.3%, which when combined with a 3.8% decline in gross loans resulted in an NPL ratio of 16.5% at the end of 2014. By comparison, the Portuguese banking system's average was 11.4% at the end of September, the latest data available. This negative performance reflects Novo Banco's persistent asset quality challenges despite the fact that when Banco Novo was created the most problematic exposures remained at BES.

 <p>#1 US Credit Rating Agency: 2012, 2013, 2014</p>	 <p>#1 US Municipal Research Team in Smith's All-Star Voting: 2014</p>
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Published every Monday and Thursday morning, Moody's [Credit Outlook](#) informs our research clients of the credit implications of current events.

<sup>1</sup> The bank ratings shown in this report are Novo Banco's deposit ratings, its standalone bank financial strength rating/baseline credit assessment and the corresponding rating outlooks.

Novo Banco's rapid increase in NPLs has resulted in a still-high burden of credit provisions, which when combined with impairments related to its securities portfolio, led the bank to report a loss of €467.9 million for 2014 because pre-provision profit was insufficient to offset such charges.

Novo Banco's deteriorating asset quality and profitability jeopardize the bank's ability to preserve its capital base. Because of Novo Banco's ongoing balance sheet deleveraging, its capital ratios remained broadly stable despite having recorded large losses, with the bank reporting a phased-in common equity Tier 1 (CET 1) ratio of 9.6%<sup>2</sup> at the end of December 2014. This ratio exceeds Bank of Portugal's minimum regulatory threshold of 7%, but it compares unfavourably to the system's average of 12.6% phased-in CET1 at the end of September 2014.

Although the latest news is credit negative, Novo Banco's standalone rating remains on review for upgrade and could be raised if it is clear that the bank is fully and effectively protected from problematic exposures and contingent liabilities related to BES' insolvency, and if the high degree of uncertainty around the bank's credit profile is resolved. Novo Banco's deposit and debt ratings remain on review for downgrade and could be lowered if we think there is a lower probability of government support once our review is complete.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moodys.com](http://www.moodys.com) for the most updated credit rating action information and rating history.

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<sup>2</sup> Novo Banco's phased-in common equity Tier 1 ratio was 9.8% at the end of December 2014, considering the special regime for deferred tax assets approved by the Portuguese government in August 2014 and to which the bank has adhered.

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