

Lisbon, 12 April 2017

## **NOVO BANCO GROUP ACTIVITY AND RESULTS**

### **for financial year 2016**

(Unaudited financial information)

NOVO BANCO Group's results reflect the operational consolidation effort pursued during 2016. Net operating income amounted to EUR 386.6 million (+209%, from EUR 125.0 million in 2015), bolstered by the improvement in banking income and the reduction of operating costs.

Banking income reached EUR 977.5 million (+11.1% YoY), underpinned by increases in net interest income (+14.2%) and capital markets results (+ 25.2%).

Operating costs were reduced by EUR 163.8 million YoY (-21.7% YoY), to EUR 590.9 million.

The contraction in operating costs allowed for a significant improvement in the efficiency ratio, with the Cost to Income ratio decreasing to 60.4%, which compares favourably with the 85.8% ratio reported in December 2015.

The year's provision charge reached EUR 1,374.7 million, which is EUR 316.8 million more than in the previous year. Impairments include EUR 672.6 million for credit, EUR 315.9 million for securities and EUR 98.2 million for restructuring costs.

The high provisioning level (EUR 1,374.7 million) led to a negative net income of EUR 788.3 million, which compares favourably with the EUR 929.5 million net loss in 2015.

In line with the ongoing balance sheet deleveraging process, particularly targeted at the international portfolio, customer loans contracted by EUR 3.7 billion in 2016 in large part reflecting the transfer to discontinued assets of BESV and NB Asia. In the last quarter of the year customer loans decreased by EUR 0.4 billion, with residential mortgage loans and other loans to individuals remaining flat compared to the end of the 3rd quarter.

In the 4th quarter, customer deposits increased by EUR 0.9 billion, recovering from the downturn at the beginning of the year. Nonetheless, the amount of customer deposits at 31 December 2016, EUR 25.6 billion, was EUR 1.8 billion lower than a year earlier, to a large extent related to the retransfer of bonds to BES.

The targets set in the Restructuring Plan were fully met. Hence, compared to November 2015, the base date for the commitments assumed with DG Comp for the Restructuring Plan, there was an effective reduction of 1,312 employees (including the activities being discontinued), comparing with the target of reducing 1,000 employees on 31 December 2016. The distribution network was downsized to 537 branches (target: 550 on 31 December 2016), corresponding to the discontinuation of 116 units. The operating costs contraction target of -EUR 150 million on 31 December 2016 was also exceeded.

Regarding the 'Side Bank', i.e., the non strategic assets of NOVO BANCO Group, its value, net of provisions, was EUR 8,737 million on 31 December 2016 (Dec. 15: EUR 10,843 million on 31 December 2015).

The estimated regulatory capital ratio Common Equity Tier 1 (CET1) for 31 December 2016 was 12.0%, which compares with 13.5% in December 2015 and is in line with the main Portuguese banks.

<b>FINANCIAL HIGHLIGHTS</b>	<b>31-Dec-15*</b>	<b>31-Dec-16</b>
<b>ACTIVITY (EUR mn)</b>		
Net Assets	57 517	52 333
Gross Loans	37 417	33 750
Customer Deposits	27 364	25 585
Total Equity	5 935	5 148
<b>SOLVENCY <sup>(1)(2)</sup></b>		
Common Equity Tier I / RWAs	13.5%	12.0%
Tier I / RWAs	13.5%	12.0%
Total Own Funds / RWAs	13.5%	12.0%
<b>LIQUIDITY (EUR mn)</b>		
ECB Funds (net) <sup>(3)</sup>	7 040	5 123
Eligible Assets for repo operations (ECB and other)	12 740	13 139
(Total Credit - Credit Provisions) / Customer Deposits <sup>(2)</sup>	113%	110%
Liquidity Coverage Ratio (LCR) <sup>(1)</sup>	77%	107%
Net Stable Funding Ratio (NSFR) <sup>(1)</sup>	87%	99%
<b>ASSET QUALITY</b>		
Overdue Loans > 90 days/Gross Loans	14.5%	17.0%
Overdue and Doubtful Loans / Total Loans <sup>(2)</sup>	15.8%	18.7%
Overdue and Doubtful, net of impairments / Total Net Loans <sup>(2)</sup>	0.2%	2.6%
Credit at Risk/Total Loans <sup>(2)</sup>	22.8%	25.6%
Credit at Risk (net) / Total Net Loans <sup>(2)</sup>	8.6%	10.9%
Restructured Credit <sup>(2)</sup> / Gross Loans	17.7%	23.7%
Restructured Credit not included in Credit at Risk <sup>(2)</sup> / Gross Loans	10.5%	11.9%
Credit Provisions/Overdue Loans > 90 days	107.8%	97.2%
Credit Provisions/Gross Loans	15.6%	16.5%
Cost of Risk	1.98%	1.99%
<b>PROFITABILITY</b>		
Net Income (EUR mn)	-929.5	-788.3
Income before Taxes and Non-controlling Interests / Average Net Assets <sup>(2)</sup>	-1.6%	-1.9%
Banking Income / Average Net Assets <sup>(2)</sup>	1.4%	1.8%
Income before Taxes and Non-controlling Interests / Average Net Assets <sup>(2)</sup>	-17.4%	-17.0%
<b>EFFICIENCY</b>		
General Admin. Costs + Depreciation / Banking Income <sup>(2)</sup>	85.8%	60.4%
Staff Costs / Banking Income <sup>(2)</sup>	45.2%	31.0%
<b>EMPLOYEES</b>		
Total	7 311	6 096
- Domestic	6 571	5 687
- International	740	409
<b>BRANCH NETWORK</b>		
Total	635	537
- Domestic	596	507
- International	39	30

(1) Estimated data for 31 December 2016

(2) According to Banco de Portugal Instruction n. 16/2004, in its version in force

(3) Includes funds from and placements with the ESCB; positive = net borrowing; negative = net lending

\* Restated figures

## RESULTS

In 2016 NOVO BANCO Group resumed normal operation conditions as one of the more entrenched banks in the Portuguese business community, maintaining adequate liquidity and solvency levels, promoting the improvement of profitability and efficiency levels, simplifying processes and streamlining the organisational and functional structure.

Despite the constraints resulting from the new sale process of NOVO BANCO initiated on 15 January 2016, the Banco de Portugal's decision to re-transfer five senior bond issues to BES on 29 December 2015, with strong repercussions on customer funds, and the still sluggish performance of the domestic economic activity and negative interest rates, NOVO BANCO Group reported positive net operating income of EUR 386.6 million at the end of 2016, which is higher than the 2015 result (EUR 125.0 million).

EUR million			
INCOME STATEMENT	2015*	2016	% Change
Net Interest Income	450.7	514.5	14.2%
+ Fees and Commissions	355.6	277.1	-22.1%
<b>= Commercial Banking Income</b>	<b>806.2</b>	<b>791.6</b>	<b>-1.8%</b>
+ Capital Markets	117.9	147.6	25.2%
+ Other Results	- 44.5	38.2	....
<b>= Banking Income</b>	<b>879.6</b>	<b>977.5</b>	<b>11.1%</b>
- Operating Costs	754.7	590.9	-21.7%
<b>= Net Operating Income</b>	<b>125.0</b>	<b>386.6</b>	<b>209.3%</b>
- Net Provisions	<b>1 057.9</b>	<b>1 374.7</b>	<b>29.9%</b>
Credit	739.3	672.6	-9.0%
Securities	236.2	315.9	33.7%
Other Assets and Contingencies	82.4	386.2	....
<b>= Income before Taxes</b>	<b>- 933.0</b>	<b>- 988.1</b>	<b>-5.9%</b>
- Income Tax	- 20.1	- 227.6	....
- Special Tax on Banks	31.4	37.0	17.6%
<b>= Income after Taxes</b>	<b>- 944.3</b>	<b>- 797.5</b>	<b>15.5%</b>
- Non-controlling Interests	- 14.8	- 9.1	38.0%
<b>= Net Income</b>	<b>- 929.5</b>	<b>- 788.3</b>	<b>15.2%</b>

\* Restated figures

The signs of recovery of operating performance are visible in the year's net earnings, which, although negative at EUR 788.3 million, are lower than the loss of EUR 929.5 million recorded in 2015.

Main highlights of the activity developed in 2016:

- banking income totalled EUR 977.5 million (+11.1% YoY), with a 52.6% contribution from net interest income and a 28.4% contribution from fees and commissions; capital markets results reached EUR 147.6 million, and other results totalled EUR 38.2 million;

- operating costs decreased by 21.7% YoY, to EUR 590.9 million, reflecting staff cuts and the improvements achieved in terms of simplifying processes and streamlining the structures. In terms of efficiency, we highlight the fact that operating costs represented 60.4% of banking income, down from 85.8% in December 2015.
- Positive net operating income (before impairment and taxes) of EUR 386.6 million surpassed the 2015 full year net operating income (EUR 125.0 million), evidences NOVO BANCO Group's income-generating capacity;
- The period's total provision charge of EUR 1,374.7 million includes EUR 672.6 million for credit, EUR 315.9 million for securities, EUR 134.5 million for the goodwill of the insurance business and EUR 98.2 million for restructuring costs.

The result was influenced by non-recurring factors: (i) negatively by provisions, namely for restructuring and the goodwill of the insurance business and (ii) positively by the gains registered with the changes resulting from the entry into force of the new Collective Bargaining Agreement (ACT) and with the merger of VISA Europe into VISA Inc. (USA).

## Net Interest Income

The performance of net interest income was impacted by the fact that benchmark interest rates remained on negative ground, and by the need to stabilise funding through customer funds. However, this objective was thwarted by the re-transfer of senior bonds on 29 December 2015, which caused the downgrade of the long-term deposit ratings that combined with the postponement of the sale of NOVO BANCO on 15 September 2015, led to reduction in the deposits of some large institutional and corporate clients.

Despite these constraints, net interest income grew by 14.2% YoY, reaching EUR 514.5 million. This improvement not only reflects a lower level of annulment of overdue interest but also the positive impact of a larger reduction in the cost of liabilities (-54bps to 1.39%, from 1.93% in Dec. 2015) than in the interest rate on assets (- 37 bps).

The net interest margin was 1.10%, underpinned by an average interest rate on financial assets of 2.48% and an average rate on financial liabilities of 1.39%, influenced by the decrease in the cost of deposits to 0.91% from 1.27% in 2015, which compares with an annual average 3-month Euribor of -0.26%.

NET INTEREST INCOME AND NET INTEREST MARGIN	EUR million					
	2015			2016		
	Average Balance	Avg Rate	NII	Average Balance	Avg Rate	NII
INTEREST EARNING ASSETS	48 694	2.85%	1 389	46 823	2.48%	1 166
Customer Loans	38 829	2.80%	1 088	34 695	2.68%	932
Money Market Placements	2 782	1.39%	39	2 480	2.31%	57
Securities and Other Assets	7 083	3.71%	263	9 647	1.84%	177
OTHER NON-INTEREST EARNING ASSETS	-	-	-	-	-	-
<b>INTEREST EARNING ASSETS &amp; OTHER</b>	<b>48 694</b>	<b>2.85%</b>	<b>1 389</b>	<b>46 823</b>	<b>2.48%</b>	<b>1 166</b>
INTEREST BEARING LIABILITIES	47 455	1.98%	938	43 978	1.48%	652
Due to Customers	27 773	1.27%	352	25 123	0.91%	229
Money Market Funding	9 864	0.81%	80	11 442	0.36%	41
Other Liabilities	9 818	5.15%	506	7 413	5.15%	382
OTHER NON-INTEREST BEARING LIABILITIES	1 239	-	-	2 845	-	-
<b>INTEREST BEARING LIABILITIES &amp; OTHER</b>	<b>48 694</b>	<b>1.93%</b>	<b>938</b>	<b>46 823</b>	<b>1.39%</b>	<b>652</b>
<b>NIM / NII</b>		<b>0.93%</b>	<b>451</b>		<b>1.10%</b>	<b>514</b>

The average rate on customer loans, the main component of financial assets (74.1%), was 2.68%. As to liabilities, the average balance of deposits was EUR 25.1 billion, with an average interest rate of 0.91%.

Despite the unprecedented challenge to asset and liability management and to profitability of benchmark interest rates persistently on negative ground, the Group has achieved a sustained recovery of the net interest margin, which rose from 0.93% in 2015 to 1.10% in 2016.

## Fees and Commissions

Fees and commissions on banking services contributed with EUR 277.1 million to the results, which compares with EUR 355.6 million in 2015.

FEES AND COMMISSIONS	EUR million			
	2015	2016	Weight	
			2015	2016
Payments and Account Management	95.0	98.6	24.4%	31.8%
Commissions on Loans, Guarantees and Similar	171.5	128.0	44.0%	41.3%
Asset Management and Bancassurance	79.5	62.3	20.4%	20.1%
Advising, Servicing and Other	44.0	21.1	11.3%	6.8%
<b>SUBTOTAL</b>	<b>390.0</b>	<b>310.0</b>	<b>100.0%</b>	<b>100.0%</b>
Costs with State Guarantees	-34.4	-32.9		
<b>TOTAL</b>	<b>355.6</b>	<b>277.1</b>		

The 22.1% YoY reduction in fees and commissions reflects, on the one hand, the difficulties deleveraging of the private sector (households and corporate segment), and on the other hand the consequences of the reshaping of the Group's perimeter, which reduced the volume of its activity and business risk profile in certain sectors and regions.

In the activity of NOVO BANCO Group we stress the relevance of the following:

- Support services to companies – including guarantees provided, documentary credits, and services related to loan management and other (41.3% of the total);
- Commissions on payment services (31.8% of the total) – cards and payment processing, namely cheques, transfers, payment orders, POS and ATMs, and account management fees; and
- Asset management and *bancassurance* products, which accounted for 20.1% of total fees and commissions.

Fees and commissions include the negative effect of the EUR 32.9 million fee paid by NOVO BANCO in connection to issuing of debt securities guaranteed by the Republic of Portugal (EUR 34.4 million in 2015).

## Capital Markets and Other Operating Results

Capital market results amounted to EUR 147.6 million, which compares with EUR 117.9 million in 2015. The other operating results totalled EUR 38.2 million, being positively influenced by the changes arising from the renegotiation of the ACT (+EUR 28.2 million), and on the negative side, by losses on real estate funds' assets recognised as investment property.

## Operating Costs

Operating costs show a YoY reduction of 21.7%, reflecting the ongoing implementation of the restructuring measures that involved the downsizing of the distribution network and the simplification and scaling down of the organisational structure and processes, with the consequent reduction of the workforce.

EUR million			
OPERATING COSTS	2015	2016	% Change
Staff Costs	397.6	303.5	-23.7%
General and Administrative Costs	285.4	231.4	-18.9%
Depreciation	71.7	56.1	-21.8%
<b>TOTAL</b>	<b>754.7</b>	<b>590.9</b>	<b>-21.7%</b>

Staff costs decreased by 23.7% YoY, to EUR 303.5 million, underpinned by a headcount reduction of 1,215 employees since 31 December 2015, of whom 176 resulting from discontinued activities. Compared to November 2015, the base date for the commitments assumed in the Restructuring Plan, there was an effective reduction of 1,312 employees.

General administrative expenses dropped by 18.9% YoY, to EUR 231.4 million. This reduction, which occurred across most cost categories, reflects the rationalisation and streamlining policy under way.

The reduction in depreciation is explained, among others, by greater selectivity in IT investment, the rationalisation of equipment and the closure of facilities.

The contraction in operating costs also reflects the downsizing of the distribution network in line with the new business reality. In December 2016 NOVO BANCO had 537 branches, which is 98 fewer units than a year earlier.

## Provisions

In 2016 the NOVO BANCO Group reinforced provisions by EUR 1,374.7 million (+EUR 316.8 million over December 2015), the bulk of which was allocated to credit and securities provisions.

EUR million			
PROVISIONS	2015	2016	% Change
Credit and Securities	975.5	988.5	1.3%
Real Estate and Equipment	81.1	126.3	55.8%
Other Assets and Contingencies	1.3	259.9	....
<b>TOTAL</b>	<b>1 057.9</b>	<b>1 374.7</b>	<b>29.9%</b>

The credit provision charge totalled EUR 672.6 million, improving the loan coverage ratio to 16.5%, from 15.6% in December 2015.

Under IAS 37 the costs arising from the restructuring plan, totalling EUR 98.2 million, were included in the provision for restructuring costs. The EUR 88.6 million year's costs with early retirements, redundancy payments, and closure of facilities were considered against the said provision.



## **RESTRUCTURING PLAN**

The Restructuring Plan, submitted to the European Commission by NOVO BANCO's Board of Directors at the end of 2015 and implemented during 2016, was drawn up in close cooperation with Banco de Portugal. It comprised a set of measures, notably viewing concentration in banking and retail and corporate activities in Portugal and Spain, divestment from non-strategic assets and a EUR 150 million reduction in recurring operating costs (excluding the restructuring costs) through staff cuts of 1,000 employees and the downsizing of the distribution network to 550 branches.

On 31 December 2016 the staff cutting target had been met (reduction of 1,312 employees since November 2015), the downsizing of the branches network evolved to 537 branches (comparing with a target of 550) and the reduction of operating costs surpassed the established target (-EUR 150 million).

At the end of November 2016, the Board of Directors of NOVO BANCO issued a set of new measures aimed at further simplifying the structure of the organisation at the level of first-line managers, abolishing 10 central departments and thus reducing the Bank's top level structures by 25.6%. This simplification work was deployed across various areas, namely marketing, commercial and credit recovery.

## **SIDE BANK**

As an integral part of this Restructuring Plan and as agreed between the Portuguese Government and the Directorate-General for Competition (DG Comp), a virtual division has been established between the strategic assets, defined as Core assets, and the non-strategic assets, which were included in a so-called Side Bank and are intended for gradual and orderly divestment, aiming at organisational simplification and the preservation of NOVO BANCO Group's capital.

Concerning these assets and the concept of the Side Bank it was established and agreed that (i) as a rule the exposure to such assets could not increase, save in the case of a marginal increase to support preserving sale value, (ii) they should be sold, discontinued or liquidated but taking into account the maximisation of their value, viewing an estimated reduction in 2016 to EUR 9 billion or less.

Under this exercise the value of non-strategic assets on 31 December 2016 was EUR 8,737 million, net of provisions (Dec. 15: EUR 10,843 million). The reduction achieved (which met the established target) was sharpest in equity holdings and real estate.

## ACTIVITY EVOLUTION

### Funding

The steps taken towards resuming normal operating conditions and consolidating the relationship with the clients positively influenced the recovery of funding. Deposits totalled EUR 25.6 billion on 31 December 2016, having dropped by EUR 1.8 billion (-6.5%) since December 2015. This reduction was more noticeable in the large depositors and reflects the impact of the re-transfer of bonds and the transfer of BES Vénétie and NB Asia to assets being discontinued (EUR -0.4 billion). The last quarter of the year saw a positive trend in deposits, which grew by around EUR 0.9 billion.

CUSTOMER FUNDS	31-Dec-15	30-Sep-16	31-Dec-16	YTD Change		EUR million
				absolute	relative	4Q2016
						absolute change
Deposits	27 364	24 657	25 585	-1 779	-6.5%	928
Other Customer Funds <sup>(1)</sup>	218	302	404	186	85.1%	102
Debt Securities placed with Clients	1 331	998	996	- 335	-25.2%	- 2
Life Insurance Products	5 388	4 895	4 730	- 658	-12.2%	- 165
Off-Balance Sheet Funds	5 642	5 121	5 069	- 573	-10.1%	- 52
<b>Total Customer Funds</b>	<b>39 943</b>	<b>35 973</b>	<b>36 784</b>	<b>-3 158</b>	<b>-7.9%</b>	<b>811</b>

<sup>(1)</sup> Includes cheques and pending payment instructions, REPOS and other funds

### Customer Loans

NOVO BANCO's strategy of support to the domestic business community was underlined by its strict and selective lending policy. This support has been provided across all industry sectors and all companies, regardless of size, placing a particular focus on the exporting small and medium-sized companies and those that incorporate innovation in their products, services or production systems. Corporate loans account for a 66.5% share of the total loan book.

CUSTOMER LOANS	31-Dec-15	30-Sep-16	31-Dec-16	YTD Change		EUR million
				absolute	relative	4Q2016
						absolute change
<b>Corporate Lending</b>	<b>25 908</b>	<b>22 830</b>	<b>22 451</b>	<b>-3 457</b>	<b>-13.3%</b>	<b>- 379</b>
<b>Loans to Individuals</b>	<b>11 509</b>	<b>11 315</b>	<b>11 300</b>	<b>- 209</b>	<b>-1.8%</b>	<b>- 15</b>
Residential Mortgage	9 842	9 742	9 726	- 116	-1.2%	- 16
Other Loans	1 667	1 573	1 574	- 93	-5.5%	1
<b>Customer Loans (Gross)</b>	<b>37 417</b>	<b>34 145</b>	<b>33 750</b>	<b>-3 666</b>	<b>-9.8%</b>	<b>- 395</b>
<i>Domestic</i>	30 946	29 549	29 095	-1 851	-6.0%	- 454
<i>International</i>	6 471	4 596	4 656	-1 815	-28.0%	60
<b>Provisions</b>	<b>5 833</b>	<b>5 630</b>	<b>5 566</b>	<b>- 267</b>	<b>-4.6%</b>	<b>- 64</b>
<b>Customer Loans (Net)</b>	<b>31 584</b>	<b>28 515</b>	<b>28 184</b>	<b>-3 399</b>	<b>-10.8%</b>	<b>- 331</b>

Gross customer loans contracted by EUR 3.7 billion in 2016, of which EUR 1.9 billion (-6.0%) in the domestic activity and EUR 1.8 billion (-28.0%) in the international activity (where the reduction mainly reflects the transfer of BESV and NB Asia to discontinued assets). In the 4th quarter this reduction amounted to EUR 0.4 billion, with residential mortgage loans and other loans to individuals remaining flat compared to the end of the 3rd quarter.

## Securities Portfolio

The securities portfolio, the main source of eligible assets for funding operations with the European Central Bank (ECB), totalled EUR 11.8 billion on 31 December 2016 and represented 22.4% of assets.

The breakdown of the securities portfolio reflects a portfolio management approach based on securities with lower risk and higher liquidity, namely sovereign debt of Eurozone countries, which account for 55.3% of the total available securities. In the last quarter of the year the overall value of the portfolio remained relatively unchanged.

SECURITIES PORTFOLIO	net of impairments			YTD Change		EUR million
	31-Dec-15	30-Sep-16	31-Dec-16	absolute	relative	4Q2016 absolute change
<b>Portuguese Sovereign Debt</b>	2 685	2 945	3 538	853	31.8%	593
<b>Other Sovereign Debt</b>	4 689	3 430	2 971	-1 718	-36.6%	- 459
<b>Bonds</b>	2 671	2 748	2 775	104	3.9%	27
<b>Other</b>	3 307	2 729	2 478	- 829	-25.1%	- 251
<b>Total</b>	<b>13 352</b>	<b>11 852</b>	<b>11 762</b>	<b>-1 590</b>	<b>-11.9%</b>	<b>- 90</b>

The securities portfolio has positive fair value reserve of EUR 151.4 million (Dec. 2015: EUR 104.3 million).

## LIQUIDITY AND CAPITAL MANAGEMENT

### Liquidity

The strategy of liquidity enhancement pursued, with particular focus on the recovery of customer funds and on asset deleveraging supported a EUR 0.9 billion increase in customer deposits in the last quarter of the year.

During the year NOVO BANCO repaid medium long-term debt placed with institutional investors in the amount of approximately EUR 0.4 billion. Moreover, in 2016 the medium long-term debt was further reduced by EUR 0.4 billion (nominal value) through the repurchase of own bonds, including the senior debt tender offer performed in

June. Despite the fact that access to the financial markets remained strongly conditioned, in November NOVO BANCO priced a securitisation of credit rights over SME receivables amounting to approximately EUR 0.7 billion, raising market funding in the amount of EUR 0.4 billion through the placement in the market of Notes of lower subordination.

In November, in view of the improvement and recovery of its liquidity position, the Bank cancelled in advance the entire EUR 1.0 billion bond issue (that was scheduled to mature in December). This was followed in December by the partial early cancellation of EUR 0.7 billion of the EUR 1.0 billion bonds maturing in January 2017. On 17 February 2017, as the EUR 1.5 billion bond issue matured, NOVO BANCO ceased to have any kind of debt instrument guaranteed by the Portuguese Republic.

In this context net funding from the European Central Bank sharply contracted in 2016, totalling EUR 5.1 billion at the end of December, down by EUR 1.9 billion from EUR 7 billion at the end of 2015.

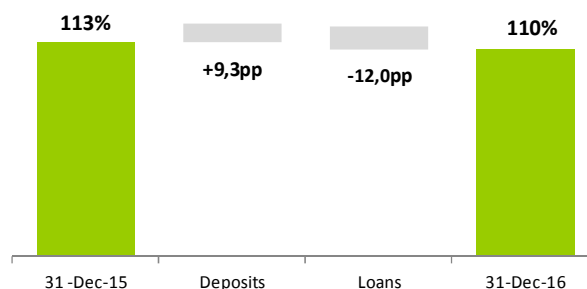
Alongside its deleveraging and funding policy, NOVO BANCO continued to optimise its portfolio of assets eligible for rediscount with the ECB. Hence in December the bank launched a new covered bond issue in the amount of EUR 0.5 billion. At the end of the year, the portfolio of eligible securities totalled EUR 13.1 billion, which compares with EUR 12.7 billion at the end of 2015.

The sovereign debt portfolio (excluding exposure to public debt related to the insurance activity) decreased by around EUR 0.3 billion, to EUR 4.4 billion, being concentrated in European countries. The exposure to Portuguese sovereign debt totalled EUR 2.2 billion, of which EUR 1.4 billion in treasury bills and EUR 0.9 billion in treasury bonds. As to the exposure to other European peripheral countries, in the amount of EUR 2.5 billion, EUR 1.5 billion concerned Italian sovereign debt and EUR 1.0 billion Spanish sovereign debt.

At the end of the year the Liquidity Coverage Ratio (LCR) was 107% (up from 77% at the end of December 2015).

The loan to deposit ratio decreased since December 2015 by 3pp, to 110%, the result of a sharper reduction in customer loans than in customer deposits.

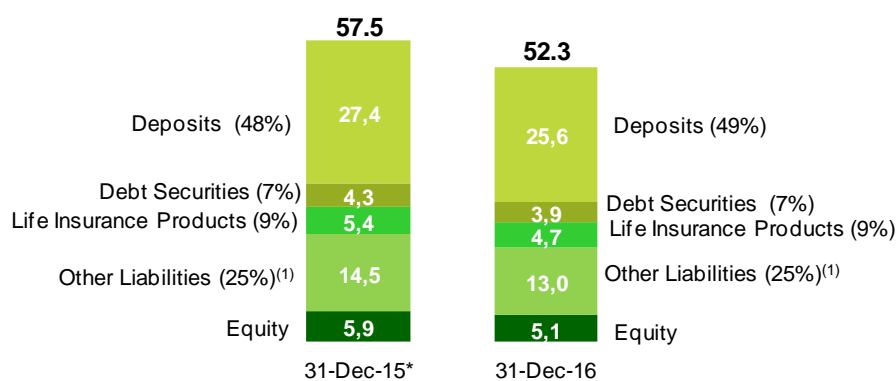
## Loan to Deposit Ratio



Customer deposits, representing 49% of total assets, not only remained the main source of funding but also increased their weight in the total.

## FUNDING STRUCTURE

(figures in EUR billion)



(<sup>1</sup>) Includes ECB Funding  
\* Restated figures

## Capital Management

NOVO BANCO Group's solvency ratios are calculated based on the rules stipulated in Directive 2013/36/EU and Regulation (EU) no. 575/2013, which define the criteria for access to the activity of credit institutions and investment firms and determine the prudential requirements for these institutions, and also in Banco de Portugal's Notice 6/2013, which regulates under said Regulation the phased-in arrangements for own funds. The NOVO BANCO Group is authorised to use the Internal Ratings Based (IRB) approach to calculate credit risk weighted assets and the Standardised Approach to calculate both market risk and operational risk weighted assets.

Under the terms of said rules, the solvency ratios of NOVO BANCO Group, as at 31 December 2015 and 31 December 2016, were as follows:

		EUR million	
<b>CAPITAL RATIOS - BIS III (CRD IV/CRR)</b>		<b>31-Dec-15</b>	<b>31-Dec-16 <sup>(1)</sup></b>
Risk Weighted Assets	(A)	38 168	33 627
Own Funds			
Common Equity Tier 1	(B)	5 142	4 051
Tier 1	(C)	5 142	4 051
Total Capital	(D)	5 142	4 051
Common Equity Tier 1 Ratio (Phased-in)	(B/A)	13.5%	12.0%
Tier 1 Ratio	(C/A)	13.5%	12.0%
Solvency Ratio	(D/A)	13.5%	12.0%
Common Equity Tier 1 Ratio (full implementation)		11.3%	9.8%

<sup>(1)</sup> Estimated Data

The estimated phased-in Common Equity Tier 1 (CET1) ratio for 31 December 2016 was 12.0% (estimated ratio of 9.8% under the full implementation regime applicable as from 1 January 2018).

## ASSET QUALITY

Credit risk indicators have risen since 31 December 2015, on the one hand driven by the increase in overdue loans (+2.5%), and on the other by the contraction of the customer loans book (-9.8%).

CREDIT QUALITY	31-Dec-15		YTD Change	
			31-Dec-16	absolute
Gross Loans	37 417	33 750	-3 667	-9.8%
Overdue Loans	5 791	5 936	145	2.5%
Overdue Loans > 90 days	5 412	5 728	316	5.9%
Credit at Risk <sup>(1)</sup>	8 547	8 636	89	1.0%
Restructured Credit <sup>(2)</sup>	6 634	8 007	1 373	20.7%
Restructured Credit not included in Credit at Risk <sup>(2)</sup>	3 927	4 008	81	2.1%
Provisions for Credit	5 833	5 566	- 267	-4.6%

<sup>(1)</sup> According to Banco de Portugal Instruction n.23/2011.

<sup>(2)</sup> According to Banco de Portugal Instruction n.32/2013.

At the end of December 2016 the overdue loans / gross loans and credit at risk / gross loans ratios were 17.6% and 25.6%, respectively, with the credit at risk coverage ratio standing at 64.5%.

Provisions for Credit amounted to EUR 5.6 billion, representing 16.5% of the total loan book (Dec.15: 15.6%)

ASSET QUALITY AND COVERAGE RATIOS	31-Dec-15	31-Dec-16	Change (p.p.)
Overdue Loans / Gross Loans	15.5%	17.6%	2.1
Overdue Loans > 90 days / Gross Loans	14.5%	17.0%	2.5
Credit at Risk <sup>(1)</sup> / Gross Loans	22.8%	25.6%	2.8
Restructured Credit <sup>(2)</sup> / Gross Loans	17.7%	23.7%	6.0
Restructured Credit not included in Credit at Risk <sup>(2)</sup> / Gross Loans	10.5%	11.9%	1.4
Provisions for Credit / Gross Loans	15.6%	16.5%	0.9
Coverage of Credit at Risk <sup>(1)</sup>	68.2%	64.5%	-3.7
Coverage of Overdue Loans > 90 days	107.8%	97.2%	-10.6
Coverage of Overdue Loans	100.7%	93.8%	-6.9

<sup>(1)</sup> According to Banco de Portugal Instruction n.23/2011.

<sup>(2)</sup> According to Banco de Portugal Instruction n.32/2013.

## COMMERCIAL ACTIVITY

### Retail Banking

In retail banking, 2016 was characterized by a strengthening of individual clients' confidence in NOVO BANCO, driving a EUR 832 million increase in new deposits from clients compared to 2015. Structured Deposits Products production, which reached EUR 138 million, gave a significant boost to this growth. In 2016 NOVO BANCO was actually awarded the "Best Performance Distributor" by Structured Retail Products (SRP), a division of the Euromoney Group, which distinguishes performance in the marketing of structured products. It is also noteworthy that the growth of the deposits portfolio was achieved while significantly reducing its cost (-45bps vs. Dec. 2015).

In Private Banking, the expansion of the offer of investment solutions to investment funds from the best international fund managers, under an open architecture rationale, permitted to reinforce customer funds acquisition.

Loans to individuals also showed very positive results: residential mortgage loans production grew by 110%, bolstered by the introduction of a commitment to reply to loan requests within 24 hours. This innovation allowed NOVO BANCO to get higher spreads than the competition in residential mortgage loans. Consumer loans production soared by 104% YoY. This increase was driven, among others, by the growth of sales through the digital channels.

The Protection and Safety solutions offered by NOVO BANCO also saw an increase in customer preference, with more than 86 thousand Non-Life and Life Risk insurance products sold to retail banking clients that include Health Insurance production growing by 91% over 2015.

The number of credit card holders increased by 8.2% compared to the previous year.

The commercial activity with the small and micro companies included in the retail banking segment also expanded in the period. Production of medium and long term loans and current account loans sharply increased, growing by 49% YoY.

In 2016, 805 companies obtained or renewed the 'SME Leader' status ("PME Líder") through NOVO BANCO, increasing the bank's market share by 2 pp comparing with 2015, a feat that illustrates the quality of the micro and small companies banking with NOVO BANCO and the trust they placed in the bank.

The result of this renewed confidence and the successful commercial efforts undertaken is also patent in the expressive growth of deposits of micro and small companies, which increased by 12% compared to 2015 (+ EUR 293 million).

Alongside the positive evolution of the main commercial indicators, in 2016 NOVO BANCO also intensified its nature of a bank geared towards solutions for the future, focusing on the digital self-service experience as a means of permanent proximity between clients and their bank. The results of this bet are clearly visible:

- in the record 480 thousand frequent digital clients reached in December, which represents a year-on-year increase of 5%;
- in the dynamism of the mobile channel, which at the end of the year exceeded 175 thousand frequent users (61% YoY increase); highlight on the increase of 112% in the small businesses segment, a sign that the use of apps for business management is also in rapid acceleration;
- in the broadening of the channels' offer through the launch in the NB smart app of a large set of new options that aimed to respond to customer requests and further enhance the relationship through the mobile channel. Within this offer, we stress functionalities such as the subscription and management of saving products, the "view only" facility and download of Account Statements, client-customised notifications or the MB NET Virtual Cards, the Certification of Transfer Beneficiaries, in addition to the entire range of business-specific options of the NB smart app, such as the signing of operations submitted through the NBnetwork, Multi-company Access and access to a Consolidated Balance of the accounts of an economic group.

Thanks to the dynamism of the mobile offer, at the end of the year the NB smart app remained the client satisfaction leader in term of banking apps in the domestic market, a position confirmed both by average client assessments in app stores and by Marktest indicators.



In terms of the international recognition for retail customer services, NOVO BANCO was named the best provider of Securities and Custody services in Portugal (2016) by the Global Finance international magazine. This award provides international recognition to the Bank's capabilities and performance in this important business area.

The results of the 2016 Service Quality survey illustrate the overall positive evolution of individual clients' activity indicators, with the percentage of clients 'very satisfied' with customer service reaching 89.0% in Retail banking and 88.5% in Private Banking.

## **Corporate Banking**

During 2016 NOVO BANCO maintained its commitment to support the Portuguese companies, placing a particular focus on companies presenting better risk, the SMEs and the exporting and innovative companies that compete in the global markets, which make it one of the main players in the financing of companies in Portugal. The relevance of this segment is also shown by the share of corporate loans in the total credit granted by the Bank, which is around 68%.

As regards the day-to-day support provided to companies, through Treasury Solutions, NOVO BANCO boasts a complete and innovative offer tailored to the needs of each client, which includes factoring solutions, the management of payments to suppliers and the NB Express Bill. In this regard, we highlight the 35% increase in the factoring portfolio (in the corporate and medium-sized companies segment).

In a context where stimulus to investment is of utmost importance, NOVO BANCO supported domestic companies in pursuing their growth, innovation and internationalisation strategies, notably through protocol credit lines that provide funding to SMEs under very favourable conditions, such as the 'PME Crescimento 2015', the 'FEI Inovação II' (protocol with the European Investment Fund), and the EIB line (protocol with the European Investment Bank), whose production reached EUR 203 million, EUR 160 million and EUR 260 million, respectively. Within the scope of the accelerated implementation of the Portugal 2020 programme, these financing instruments helped to carry forward important investment projects and back up companies' growing working capital requirements.

The trade finance area, an important business area of NOVO BANCO, has provided a wide range of products and specialized advice designed to support international trade. The Bank's expertise and know-how in this segment is evidenced by its market share in this area, which reached 23% in 2016.

## **NOVO BANCO dos Açores**

NOVO BANCO dos Açores, which continues to be the only bank with the head office in the Autonomous Region of the Azores, has developed several protocols and actions with its clients with the objective of reinforcing the quality and safety of its offer of products and services. Customer deposits increased by 3.2% in 2016, while customer loans registered a small decrease of 0.2%. Provisions for credit were reinforced by EUR 0.3 million in 2016, to EUR 24.6 million, with overdue loans rising by EUR 0.4 million, to EUR 18.9 million in the period. At year-end NB Açores had total assets of EUR 648.6 million and posted a net profit for the year of EUR 1.7 million, underpinned by the increase in banking income (+9.9%) and the reduction in operating costs (-4.2%).

## **Banco Electrónico de Serviço Total**

In 2016 the Bank pursued its strategy of innovation leader in the offer of financial products and services in Portugal. Accordingly, it has launched the most comprehensive banking app in the market for Apple Watch - Best Watch, through which clients can access securities, funds and index prices and their investment portfolio through their smartwatch, or at any time view their account balances, movements and overall portfolio, and check the detail of their credit card movements, among others. This launch earned Banco Best the *W3 Awards' Silver* award, in the Mobile Apps/Sites-Finance category. The bank also made available bond trading through the mobile channel, which allows clients access, through their smartphone, to the largest offer of bonds in Portugal, including domestic and international sovereign and corporate debt. Customer loans contracted by 13% relative to December 2015, while customer funds increased by 27%. Banco Best posted a net profit for the year of EUR 2.7 million.

## **Asset Management**

GNB - Gestão de Ativos, which mainly operates in Portugal, Luxembourg and Spain, had total assets under management at the end of 2016 of EUR 12.4 billion, representing a year-on-year reduction of 12%, though the area of investment funds registered an increase of 8%.

In 2016 several extraordinary events had a significant impact on results, namely: (i) the acquisition of the 50% stake held in the unit in Spain, which as from July is fully held and consolidated; and (ii) the costs incurred in connection to NOVO BANCO Group's restructuring process. Note that if the impact of redundancy payments and consolidation of the unit in Spain is excluded, operating costs register a decrease of 13%. The company posted a net profit for the year of EUR 8.6 million.

## **Life Insurance**

Over the last two years GNB - Companhia de Seguros Vida implemented new investment rules for its portfolios, leading to significant capital gains and losses, part of which were previously reflected in the revaluation reserve and were now transferred to the income statement. The company posted a net profit of EUR 96.5 million in 2015 and a net loss of EUR 84.6 million in 2016, with its solvency margin (Solvency II) increasing from 116.9% in 2015 to 169.3% on 31 December 2016.

Financial assets are fully marked to market while liabilities are recorded at historical cost (according to applicable standards). If liabilities were marked to market, the company's net results in 2015 and 2016 would be significantly lower (in absolute terms) and positive in both years. The insurance market maintained the trend seen since 2015, with a decrease in sales volumes that is closely linked to an environment of low interest rates that strongly discouraged the sale of guaranteed capital or interest rate products, as well as to the regulations currently in force (Solvency II), which entail high capital requirements.

GNB Seguros Vida's production totalled EUR 153.1 million in 2016, while the volume of funds under management amounted to EUR 4.5 billion (EUR 5.2 billion on 31 December 2015). The volume of new contracts for life risk products grew by roughly 25% year-on-year, with life risk premia totalling EUR 57.3 million. Operating costs were reduced by 31%, to EUR 7.8 million (from EUR 11.3 million in 2015), thanks to the cost-cutting and streamlining efforts undertaken.

### **International Commercial Banking**

NOVO BANCO Group's international activity in 2016 was marked by the implementation of the restructuring plan for its international units, which namely entailed the sale and discontinuation of some international units as well as the operational optimisation of the branches in Spain, London and Luxembourg.

The restructuring in **Spain** involved the closure of several business centres and the simplification and reshaping of the business model around three customer segments: corporate, retail, and private banking. This restructuring permitted to reduce operating costs by 16.9% year-on-year, with staff costs contracting by 23.3%. During the year there was an overall contraction in business, with a decrease in the volume of assets, assets under management and the number of clients. However, the strong commercial effort undertaken in December permitted to soften the negative performance experienced during the year.

In the **United Kingdom** the referred restructuring of the international business permitted to slash operating costs by 29% compared to the previous year. Total assets amounted to EUR 3.8 billion, of which 43% correspond to the loan portfolio.

In **Luxembourg**, the restructuring and strategic reorientation process was concluded, with operating costs decreasing by 14.7% year-on-year. Total assets amounted to EUR 3.0 billion at the end of 2016.

## MAIN EVENTS

### 2017

- On 9 April NOVO BANCO informed the market about the new management and executive committee structure. Following on the deliberation on changes to the Company bylaws, it should be highlighted, in line with the best Governance practices, a change in its management and auditing structure which will be composed of a Board of Directors, including a Chairman, and an Executive Committee. The new Executive Committee has been approved by the Resolution Fund on 21 December 2016 and received on 7 April 2017 authorization by the ECB for almost all of its new members.
- On 5 April NOVO BANCO informed the market that the Rating Agency Moody's had taken a rating action on NOVO BANCO. The rating action followed the announcement by Banco de Portugal on 31 March 2017 that as part of NOVO BANCO's sale process, a liability management exercise (LME) on senior bondholders will be undertaken with the aim of recapitalizing the Bank. Moody's has placed on review for downgrade NOVO BANCO's Caa1 long-term deposit ratings, downgraded the long-term senior unsecured debt rating to Caa2 from Caa1, and placed it on review for further downgrade. At the same time, Moody's downgraded NOVO BANCO's: (i) standalone Baseline Credit Assessment (BCA) to ca from caa2; and (ii) Counterparty Risk Assessment (CRA) to B3(cr) from B2(cr), and placed it on review for further downgrade. The outlook on the long-term deposit and debt ratings has been changed to Ratings under Review from Developing. NOVO BANCO's short-term deposit and senior debt ratings of Not-Prime and the bank's short-term CRA of Not-Prime(cr) were unaffected by this rating action.
- On 31 March Banco de Portugal issued a press release in which it informed the market about the selection of LONE STAR for the conclusion of the sale process of NOVO BANCO and that the Resolution Fund had signed the contractual documents of the sale. The signing of the sale contract allowed compliance with the term for the sale process established in the commitments assumed by the Portuguese State with the European Commission. After the closing of the operation, the regime of transition bank will no longer be applicable to NOVO BANCO. Under the terms of the agreement, LONE STAR will inject capital in NOVO BANCO totaling EUR 1,000 million, of which EUR 750 million at the closing of the operation and EUR 250 million in a term of up to 3 years. Through the injection of capital to be carried out, LONE STAR will have a 75% stake in the share capital of NOVO BANCO and the Resolution Fund will maintain a 25% stake in the Bank. The agreed conditions include also a contingent capital mechanism, under the terms of which the Resolution Fund, while shareholder, is committed to make capital injections in the case of occurring some conditions cumulatively, related to: i) the performance of a limited group of assets of NOVO BANCO and ii) the evolution of the capital levels of the bank. The possible capital injections to be carried out under the terms of this contingent mechanism benefit from a capital buffer resulting from the injection to be carried out under the terms of the sale agreement and are subject to an absolute maximum limit. The agreed conditions include also safeguard mechanisms for the interests of the Resolution Fund, aligning incentives and auditing mechanisms, notwithstanding the limitations related to State aid rules. The closing of the sale operation is dependent on the granting of the usual regulatory authorizations (including by the European Central Bank and the European Commission) and also on the completion of a liability management exercise, subject to the adherence of bondholders, which will include the non-subordinated bonds of NOVO BANCO, and which,

through the offering of new bonds, will allow the generation of at least EUR 500 million of own funds eligible for the calculation of the CET1 ratio. The sale, once completed, will allow a significant reinforcement of the capital of NOVO BANCO and the entry of a shareholder which assumes a medium and long term commitment with the bank, having the necessary means to execute a plan which ensures, definitively, the full recovery in terms that are compatible with the relevant role that the bank has in the funding of the domestic economy. This was another step in the stabilization of the domestic banking sector, for which the diversification of funding sources allowed by the entry of new investors is an advantage. This development allows also the reinforcement of the credibility of the banking sector through the well-succeeded end of a sale process which was open, transparent, competitive and with international reach,

- On 20 February Banco de Portugal informed the market that it had "decided to select the potential investor Lone Star to a concluding round of exclusive negotiations, with a view to finalising the possible terms of the sale of the shareholding of the Resolution Fund in NOVO BANCO".
- On 17 February, as the EUR 1.5 billion bond issue matured, NOVO BANCO ceased to have any kind of debt instrument guaranteed by the Republic of Portugal.
- On 4 January, Banco de Portugal, "in compliance with its mandate relating to the NOVO BANCO sale process, has concluded that, based on the information currently available, Lone Star is the prospective purchaser best placed to successfully complete the negotiating process and has decided to invite this entity to deepen negotiations".

## **2016**

- On 20 December NOVO BANCO informed that the Rating Agency DBRS had taken a rating action on NOVO BANCO. DBRS decided to confirm the senior long-term debt and deposits rating at CCC (high) and changed the trend to Stable from Negative. The agency confirmed the short-term debt & deposits rating at R-5 with a Stable trend. The change in the trend to Stable from Negative reflects DBRS's view that some of the risks faced by the Bank have materially reduced. The agency also confirmed the Critical Obligation Rating (COR) at BB (low) / R-4, with the trend on the long-term COR revised to Stable from Negative. The agency confirmed a Stable trend on the short-term COR. The rating on NOVO BANCO's senior and unsubordinated notes guaranteed by the Republic of Portugal was confirmed at BBB (low) with a Stable trend.
- On 19 December NOVO BANCO informed that it had on that date cancelled 14,000 senior bonds guaranteed by the Republic of Portugal amounting to EUR 700 million.
- On 18 November NOVO BANCO informed it had launched and priced LUSITANO SME NO. 3, its third securitisation transaction of credit rights in relation to SME Receivables. Deutsche Bank AG, London Branch and J.P. Morgan Securities plc acted as Joint Arrangers and Joint Lead Managers. NOVO BANCO successfully placed the entire amount of EUR 385.6 million of the Class A Notes with institutional investors. The transaction was approved by CMVM and settlement occurred on 22 November 2016.

- On 11 November NOVO BANCO informed that it had on that date cancelled 20,000 senior bonds guaranteed by the Republic of Portugal amounting to EUR 1 billion.
- In a press release dated 4 November 2016, Banco de Portugal announced that the period for investors meeting the eligibility criteria for the sale process of NOVO BANCO to submit their offers ended on that day. Five offers were received, under the two sale methods (Strategic Sale Procedure and Market Sale Procedure) and will henceforth be analysed under the criteria set forth in the respective specifications, disclosed in April last.
- In July NOVO BANCO was elected 'best trade finance bank in Portugal' by the *Trade & Forfeiting Review* international magazine. This award translates the international recognition of NOVO BANCO's capabilities in this important business area, where it is domestic market leader and where it has been asserting its position as the Portuguese financial group with the largest and best offer in support to international trade.
- On 13 July NOVO BANCO informed that on 12 July Banco de Portugal had decided, based on a proposal by the Resolution Fund and subject to the authorisation of the European Central Bank, to appoint Mr. António Manuel Palma Ramalho as Chairman of the Board of Directors of NOVO BANCO, effective from 1 August 2016. The ECB confirmed this appointment on 19 August 2016.
- On 6 July NOVO BANCO informed that Mr. Eduardo Stock da Cunha and Mr. José João Guilherme had resigned their positions as Chairman of the Board of Directors and Member of the Board of Directors of NOVO BANCO.
- On 30 June Banco de Portugal informed it had received four offers for the acquisition of NOVO BANCO. After analysing the proposals, a decision will be taken concerning which of the methods - Strategic Sale Procedure or Market Sale Procedure - will be followed to conclude the sale process of the stake held by the Resolution Fund in NOVO BANCO
- In May NOVO BANCO was named the best provider of Securities and Custody services in Portugal (2016) by the *Global Finance* international magazine. The choice was based on the following main selection criteria: customer relations, quality of service, knowledge of local regulations and practices, the scope of global coverage, competitive pricing, and continued investment in the development of this business line.
- On 31 March Banco de Portugal issued a press release where it disclosed the terms of the new procedure to sell the stake held by the Resolution Fund in NOVO BANCO, following the re-launch of the sale process announced on 15 January 2016.
- On 30 March NOVO BANCO informed that the Rating Agency Dagong Europe had taken a rating action on NOVO BANCO. Dagong Europe decided to downgrade NOVO BANCO's long-term credit rating to CCC+ from B- and its short-term credit rating to C from B. The watch *Evolving* was removed and a *Stable* outlook was assigned for all the ratings. On the same date Dagong Europe decided to withdraw the rating of the following entities: Espírito Santo, plc (Ireland), Banco Espírito Santo North American Cap. LLC and NOVO BANCO's New York Branch. NOVO BANCO informed on that date that there were no debt securities issued by Espírito Santo, plc (Ireland) and that the entities Banco Espírito Santo North American Cap. LLC and NOVO BANCO New York Branch had been closed.



- At the end of January 2016 NOVO BANCO took notice of two lawsuits submitted to the Venezuela Supreme Court (“Supremo Tribunal de Justicia de Venezuela”) by Banco de Desarrollo Económico y Social de Venezuela and Fondo de Desarrollo Nacional against Banco Espírito Santo, S.A. (BES) and NOVO BANCO, regarding the sale of debt securities issued by entities that belonged to Grupo Espírito Santo, in the amount of USD 37 million and USD 335 million, respectively, and requesting the repayment of the amounts invested, plus interest, compensation due to inflation and related expenses. Under the terms of the resolution applied to BES by Banco de Portugal these liabilities were not transferred to NOVO BANCO. Nevertheless a precautionary measures of seizure of assets of BES and NOVO BANCO were enacted in the first half of 2016. The execution of the measure and a decision by the Court to the objection submitted by NOVO BANCO is now pending.
- In January NOVO BANCO was considered the 'best trade finance bank" in Portugal by the *Global Finance* international magazine. The main criteria for this award were transaction volume, scope of global coverage, customer service, competitive pricing and innovative technologies.
- On 15 January 2016 Banco de Portugal announced the re-launch of the sale process of the Resolution Fund's holding in NOVO BANCO.
- On 7 January 2016, following the announcement by Banco de Portugal on 29 December 2015, NOVO BANCO informed that the Rating Agency DBRS had taken a rating action on NOVO BANCO. DBRS decided to downgrade NOVO BANCO's senior long-term debt and deposits rating to CCC (high) from B and its short-term debt & deposits rating to R-5 from R-4. The outlook on the long-term ratings is *Negative* and on the short-term ratings is *Stable*. The Agency confirmed the rating on NOVO BANCO's senior bonds guaranteed by the Republic of Portugal at BBB (low) with *Stable* outlook.
- On 4 January 2016 NOVO BANCO informed the market that, following the announcement by Banco de Portugal on 29 December 2015, the Rating Agency Moody's had taken a rating action on NOVO BANCO and its supported entities. On this date Moody's decided to confirm NOVO BANCO's Baseline Credit Assessment (BCA) at caa2 and to downgrade its senior debt and long-term deposit ratings to Caa1 from B2 and its counterparty risk assessment (CRA) to B2(cr) from B1(cr). The Agency affirmed NOVO BANCO's short-term deposit and senior debt ratings at Not-Prime and the short-term CRA at Not-Prime(cr). The outlook on NOVO BANCO's deposit and senior debt ratings is now *Developing*. The Ba1 rating of NOVO BANCO's senior bonds guaranteed by the Republic of Portugal was unaffected by this decision.

## ECONOMIC ENVIRONMENT

2016 started with a sharp fall in the oil price (to a low of USD 26/barrel in January) and concerns about the slowdown of China and the devaluation of the renminbi. These factors generated global deflationary pressures, feeding expectations of low interest rates for a long period of time - a scenario further reinforced by instability stirred by the United Kingdom's decision to leave the EU, in June. In the first half of the year the yields on the 10-year Treasuries and *Bunds* retreated from 2.27% to 1.47% and from 0.63% to -0.13%, respectively. However, the second half of the year saw an improvement in the outlook for growth and inflation, supported by the impacts of expansionary monetary and fiscal policies and the recovery of the oil price, which contributed to an upswing in industrial activity. In the whole of 2016, the Brent price rose by 55%, to USD 55.4/barrel. The global reflation trend in the second half of the year was enhanced by the result of the US presidential elections in November, which raised expectations of an aggressively expansionary fiscal policy in an economy already close to its potential. This scenario of stronger growth and higher inflation led to a steepening of the yield curves, with the yields on the 10-year Treasuries and *Bunds* climbing to 2.45% and 0.21%, respectively, at the end of the year. In the US, the Federal Reserve lifted the benchmark rates in December by 25 bps, to 0.5%-0.75%. In the fourth quarter the US dollar appreciated by 6.5% against the euro, to EUR/USD 1.054 (3% in the whole of 2016). Despite periods of political uncertainty and financial instability, 2016 was marked by relative stability in global economic growth, which slowed only marginally, from 3.2% to 3.1%. The US and Chinese economies grew by 1.6% and 6.7%, respectively. In the Eurozone, GDP grew by 1.7%. Despite the resilience of economic activity, inflation in the Eurozone remained very subdued (1.1% year-on-year in December), prompting the ECB to increase monetary stimuli twice, in March and December. In this context, the 3-month Euribor fell from -0.131% to -0.319% in 2016.

In Portugal, economic activity grew by 1.4% in 2016 (1.6% in 2015), with a slowdown in consumption, a drop in investment and a higher contribution of net external demand to GDP. However, confidence indicators and domestic demand recovered in the second half of the year, supported by the increase in disposable income and the fall in the unemployment rate (from 12.4% to 11.1% of the labour force). Inflation reached 0.6%. The improvement in financing conditions resulted in the broadening of the flow of new loans to households. However, the declining trend of new loans to non-financial corporation persisted. Despite the improvement in the fiscal balance, the overall context of "reflation" contributed to an increase in the yield on the 10-year Portuguese Government Bonds (PGBs), from 2.5% to 3.8%, with the spread against the *Bunds* widening by 166 bps to 356 bps. The PSI-20 retreated by 11.9% in the year.



NOVO BANCO, S.A.

CONSOLIDATED BALANCE SHEET AS AT 31 DECEMBER 2015 AND AS AT 31 DECEMBER 2016

EUR thousand

	31.12.2015*	31.12.2016
<b>ASSETS</b>		
Cash and deposits with Central Banks	775 608	1 469 259
Deposits with banks	340 209	370 918
Financial assets held for trading	775 039	656 722
Other financial assets at fair value through profit or loss	1 526 193	1 203 807
Available-for-sale financial assets	11 810 712	10 557 972
Loans and advances to banks	1 690 628	724 167
Loans and advances to customers	31 583 759	28 184 426
Financial Assets held to maturity	-	-
Assets with Repurchase Agreement	-	-
Derivatives held for risk management purposes	318 596	222 769
Non-current assets held for sale	3 182 479	7 764
Non-current assets held for sale - Discontinued operations	40 327	1 217 371
Investment properties	54 625	1 206 355
Other tangible assets	312 437	206 459
Intangible assets	221 168	44 663
Investments in associated companies	405 486	158 650
Current tax assets	38 848	30 620
Deferred tax assets	2 523 154	2 603 979
Technical reserves of reinsurance ceded	7 696	6 355
Other assets	1 910 126	3 460 416
Debtors for direct and indirect insurance	3 019	1 086
Other assets	1 907 107	3 459 330
<b>TOTAL ASSETS</b>	<b>57 517 090</b>	<b>52 332 672</b>
<b>LIABILITIES</b>		
Deposits from Central Banks	7 632 794	6 410 033
Financial liabilities held for trading	743 860	632 831
Other financial liabilities at fair value through profit or loss	-	-
Deposits from banks	4 157 132	3 577 914
Due to customers	27 582 142	25 989 719
Debt securities issued	4 224 658	3 817 801
Financial liabilities related to transferred assets	-	-
Derivatives held for risk management purposes	77 846	108 265
Investment contracts	4 043 488	3 396 425
Non-current liabilities held for sale	162 709	1 821
Non-current liabilities held for sale - Discontinued operations	92 893	748 807
Provisions	465 114	364 615
Technical reserves	1 344 216	1 333 567
Current tax liabilities	38 643	16 972
Deferred tax liabilities	12 336	19 301
Equity Instruments	-	-
Subordinated debt	56 260	48 100
Other liabilities	947 625	718 548
Creditors for direct and indirect insurance	17 301	10 945
Other liabilities	930 324	707 603
<b>TOTAL LIABILITIES</b>	<b>51 581 716</b>	<b>47 184 719</b>
<b>EQUITY</b>		
Share Capital	4 900 000	4 900 000
Share premium	-	-
Other equity instruments	-	-
Treasury stock	-	-
Revaluation Reserves	( 249 748)	( 289 082)
Other Reserves and Retained Earnings	2 158 080	1 244 028
Profit / (loss) for the period	( 929 539)	( 788 330)
Interim Dividends	-	-
Non-controlling Interests	56 581	81 337
<b>TOTAL EQUITY</b>	<b>5 935 374</b>	<b>5 147 953</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>57 517 090</b>	<b>52 332 672</b>

\* Restated figures

NOVO BANCO, S.A.

CONSOLIDATED INCOME STATEMENT AS AT 31 DECEMBER 2016 AND AS AT 31 DECEMBER 2015

EUR thousand

	31.12.2015*	31.12.2016
Interest and similar income	1 443 156	1 193 354
Interest expense and similar charges	992 504	678 870
<b>Net Interest Income</b>	<b>450 652</b>	<b>514 484</b>
Dividend income	11 531	37 832
Fee and Commission income	471 499	378 370
Fee and Commission expense	133 454	113 003
Net gains / (losses) from financial assets and liabilities at fair value through profit or loss	( 84 161)	22 905
Net gains / (losses) from available-for-sale financial assets	230 761	116 429
Net gains / (losses) from foreign exchange revaluation	30 092	( 6 576)
Net gains/ (losses) from the sale of other assets	( 12 341)	( 51 736)
Insurance earned premiums, net of reinsurance	38 326	49 201
Claims incurred, net of reinsurance	237 016	167 744
Change in technical reserves, net of reinsurance	166 092	105 345
Other operating income and expenses	( 103 701)	37 041
<b>Operating Income</b>	<b>828 280</b>	<b>922 548</b>
Staff costs	397 564	303 463
General and administrative expenses	285 384	231 352
Depreciation and amortisation	71 713	56 061
<b>Operating Costs</b>	<b>754 661</b>	<b>590 876</b>
Provisions, net of reversals	( 54 512)	52 319
Impairment losses on loans, net of reversals and recoveries	739 323	722 577
Impairment losses on other financial assets, net of reversals and recoveries	313 049	315 884
Impairment losses on other assets, net of reversals and recoveries	60 072	283 929
<b>Provisions and Impairments</b>	<b>1 057 932</b>	<b>1 374 709</b>
Sale of subsidiaries and associates	33	24 325
Negative consolidation differences	222	-
Results from associated companies consolidated by the equity method	16 648	4 074
<b>Profit / (loss) before income tax</b>	<b>( 967 410)</b>	<b>( 1 014 638)</b>
Income tax		
Current tax	58 582	16 330
Deferred tax	( 78 673)	( 243 924)
	( 20 091)	( 227 594)
<b>Income from continuing activities</b>	<b>( 947 319)</b>	<b>( 787 044)</b>
Income from discontinued operations	3 026	( 10 427)
<b>Net Income for the period</b>	<b>( 944 293)</b>	<b>( 797 471)</b>
<b>Attributable to shareholders of the Bank</b>	<b>( 929 539)</b>	<b>( 788 330)</b>
Attributable to Non-controlling interests	( 14 754)	( 9 141)
	( 944 293)	( 797 471)

\* Restated figures

## GLOSSARY

### ***Income Statement***

<b>Fees and Commissions</b>	Fee and commission income less fee and commission expense
<b>Commercial Banking Income</b>	Net interest income and fees and commissions
<b>Capital markets results</b>	Dividend income, net gains / (losses) from financial assets and liabilities at fair value through profit or loss, net gains / (losses) from available-for-sale financial assets, net gains / (losses) from foreign exchange revaluation, and net gains / (losses) on the revaluation of liabilities
<b>Other Results</b>	Other operating income and expenses, disposal of subsidiaries and associated companies, and income/loss of equity accounted associated companies
<b>Banking income</b>	Net interest income, fees and commissions, capital markets results and other results
<b>Operating costs</b>	Staff costs, general and administrative expenses and depreciation and amortisation
<b>Net operating income</b>	Banking Income - operating costs
<b>Net Provisions</b>	Provisions net of reversals, impairment losses on loans net of reversals and recoveries, impairment losses on other financial assets net of reversals and recoveries and impairment losses on other assets net of reversals and recoveries

### ***Balance Sheet / Liquidity***

<b>Assets eligible as collateral for rediscount operations with the ECB</b>	The Eurosystem only grants credit against adequate collateral. This collateral consists of tradable financial securities and other types of assets such as nontradable assets and cash. The expression "eligible assets" is used for assets that are accepted as collateral by the Eurosystem.
<b>Securities portfolio</b>	Securities (bonds, shares and other variable-income securities) booked in the portfolios of financial assets held for trading, other financial assets at fair value through profit or loss and available-for-sale financial assets.
<b>Due to customers</b> Banco de Portugal Instruction n. 16/2004	Sums booked under the following balance sheet accounting headings: [#400 - #34120 + #52020 + #53100]
<b>Net ECB funding</b>	Difference between the amount of funding obtained from the ECB and the amount of loans and advances to the ECB
<b>On-balance sheet customer funds</b>	Deposits, other customer funds, debt securities placed with clients and life insurance products
<b>Retail customer funds</b>	On-balance sheet funds of retail clients
<b>Off-Balance Sheet Funds</b>	Off-balance sheet funds managed by Group companies, including mutual funds, real estate investment funds, pension funds, bancassurance, portfolio management and discretionary management.
<b>Total Customer Funds</b>	On- and off- balance sheet customer funds.
<b>Loan to deposit ratio</b> Banco de Portugal Instruction n. 16/2004	Ratio of [gross loans - (accumulated provisions / impairment for credit according with Instruction n. 22/2011 regarding the reporting of information on credit at risk)] to customer deposits

### ***Asset Quality and Coverage***

<b>Overdue Loans ratio</b>	Ratio of overdue loans to total credit
<b>Overdue Loans &gt; 90 days ratio</b>	Ratio of overdue loans > 90 days to total credit
<b>Overdue and Doubtful Loans ratio</b> Banco de Portugal Instruction n. 16/2004	Ratio of overdue and doubtful loans [overdue credit > 90 days and doubtful loans reclassified as overdue for provisioning reasons (according with Notice 3/95, nr. 4, nr. 1, a)] to total credit. Notice 3/05 was revoked.
<b>Overdue and Doubtful Loans ratio, net</b> Banco de Portugal Instruction n. 16/2004	Ratio of overdue and doubtful loans - [(provisions for credit overdue + provisions for doubtful loans) and/or accumulated credit impairments, pursuant to the definition given in Instruction no. 22/2011 on the reporting of information on credit at risk] and customer loans net of impairments.
<b>Credit at risk ratio</b> Banco de Portugal Instruction n. 16/2004	Ratio of credit at risk [credit with overdue instalments of principal or interest for a period of 90 days or more, restructured credit after being overdue for 90 days or more without adequate strengthening of collateral or full repayment of overdue interest and other charges, outstanding credit with overdue instalments of principal or interest for a period of less than 90 days, but for which there is evidence justifying its classification as credit at risk, namely bankruptcy or liquidation of the debtor] to gross customer loans.
<b>Credit at risk ratio, net</b> Banco de Portugal Instruction n. 16/2004	Ratio of credit at risk - [(provisions for credit overdue + provisions for doubtful loans) and/or accumulated credit impairments, according with the definition in Instruction no. 22/2011 on the reporting of information on credit at risk] and customer loans deducted of accumulated impairment.
<b>Restructured credit ratio</b> Banco de Portugal Instruction n. 32/2013	Ratio of restructured credit due to financial difficulties of the client to total credit
<b>Restructured credit not included in credit at risk ratio</b> Banco de Portugal Instruction n. 32/2013	Ratio of restructured credit not included in credit at risk to total credit
<b>Overdue Loans coverage ratio</b>	Ratio of accumulated impairment on customer loans (on balance sheet) to overdue loans.
<b>Overdue Loans &gt; 90 days coverage ratio</b>	Ratio of accumulated impairment on customer loans (on balance sheet) to overdue loans > 90 days
<b>Credit at risk coverage ratio</b>	Ratio of accumulated impairment on customer loans (on balance sheet) to credit at risk.
<b>Coverage ratio of customer loans</b>	Ratio of impairment on customer loans (on balance sheet) to gross loans.
<b>Cost of Risk</b>	Ratio of credit impairment charges accounted in the period to gross customer loans

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## GLOSSARY

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### ***Efficiency and Profitability Ratios***

<b>Efficiency</b> Banco de Portugal Instruction n. 16/2004	Ratio of staff costs to banking income (net interest income, securities income, net fees and commissions, capital markets results, income from associated companies and subsidiaries and other operating income and expenses).
<b>Efficiency</b> Banco de Portugal Instruction n. 16/2004	Ratio of operating costs (staff costs, general and administrative expenses and depreciation and amortisation) to banking income (net interest income, securities income, net fees and commissions, capital markets results, income from associated companies and subsidiaries and other operating income and expenses).
<b>Cost to Income</b>	Ratio of operating costs (staff costs, general and administrative expenses and depreciation and amortisation) to banking income (net interest income, fees and commissions, capital markets results and other results)
<b>Profitability</b> Banco de Portugal Instruction n. 16/2004	Ratio of banking income (net interest income, securities income, net fees and commissions, capital markets results, income from associated companies and subsidiaries and other operating income and expenses) to average net assets.
<b>Return on average net assets</b> Banco de Portugal Instruction n. 16/2004	Ratio of profit before tax and non-controlling interests to average net assets.
<b>Return on average equity</b> Banco de Portugal Instruction n. 16/2004	Ratio of profit before tax and non-controlling interests to average equity.

This report is a free translation into English of the original Portuguese version. In case of doubt or misinterpretation the Portuguese version will prevail.