MOODY'S LOCAL | Panamá

RATING REPORT

Committee meeting:
September 01, 2022

Update

MMG Bank Corporation and Subsidiaries

Summary

Moody's Local affirms MMG Bank Corporation and Subsidiaries' (MMG Bank, the bank or the entity) issuer rating at AA.pa, as well as the rating of its Commercial Papers program for up to $50.0 million at ML 1.pa.

The current ratings are supported by the importance of the bank and its subsidiaries (the MMG Capital Holdings Group) to the various business segments in which they operate, as well as by the group's participation in the development and promotion of the Panamanian capital market through debt structuring, advisory services, investment fund management. The current ratings benefit from the bank's business model, which differentiates itself from traditional banking through advisory and equity management services, reflected in the off-balance-sheet assets under management (AUM), which in turn provide sources of recurring income from equity management, investment banking and securities brokerage fees. Despite the slight tightening in AUM at the end of H1 2022 associated with market trends, the fees from these services exceeded those registered a year earlier, offsetting lower financial revenue resulting from lower interest earned on MMG Bank's investment portfolio due to an interest rate adjustment. According to the bank's management, off-balance-sheet assets do not entail credit risk as the risk lies with the client, while reputational and operational risks are managed by the entity.

The ratings also take into consideration the geographic diversification of the bank's operations, as well as the bank's new jurisdiction incorporated at the end of 2021[1], which will support the likely growth in its various businesses. The entity's adequate consolidated solvency was also considered, which, despite being adjusted at the end of March 2022 because of the increase in risk-weighted assets (RWA), remains well above the regulatory minimum (8%) and the national banking system's (SBN) average (15.46% as of March 31, 2022). The bank maintains low delinquency rates, and a high percentage of the gross portfolio is backed by collateral, despite the deterioration as of the cutoff date. The decrease in modified loans below the SBN average was also taken into consideration. According to Agreement No. 2-2021, most of these loans fall under the subnormal category and a high percentage is backed by collateral. However, it is important to strengthen the monitoring and collection processes to avoid a deterioration in the bank's portfolio quality. This analysis also takes into consideration the high quality of the investment portfolio that provides support during liquidity stress. The extensive experience of the bank's management and board of directors is also positive.

However, the bank's ratings are limited by a high borrower concentration in the loan portfolio. Although this concentration reflects its business model's orientation toward the corporate segment, it increases the business exposure to unfavorable economic cycles or an unexpected deterioration of a borrower.

RATING*

MMG Bank Corp. and Subsidiaries

Domicile	Panama
Entity	AA.pa
Negotiable Securities	ML 1.pa

(*) The suffix '.pa' reflects risks only comparable in Panama. For further details on the definition of the assessed ratings and instruments, see Appendix I.

CONTACTS

Leyla Krmelj
VP Senior Credit Officer
Leyla.Krmelj@moodys.com

Linda Tapia
Analyst
linda.tapia@moodys.com

Cecilia González
Associate Analyst
cecilia.gonzalez@moodys.com

CLIENT SERVICES

Panama	+507 214 3790

[1] Partnership in Puerto Rico.

The analysis also takes into consideration the depositor concentration, which, together with the high share of demand deposits within the funding structure, adds financing volatility because of a large scale of withdrawal of funds by clients. The reputational risk to which the bank might be exposed is also considered, which, if it materializes, would have a significant impact on the AUM, as well as on the balance-sheet funding associated with the managed assets. According to the bank's management, MMG Bank conducts adequate due diligence of each client, thoroughly evaluating the source of funds, among other factors. Thus, the bank has managed to keep under control any reputational risks associated with money laundering issues. There is a greater mismatch in short-term tranches as a result of the high share of demand deposits, a risk that is likely to be mitigated by the bank through credit facilities with financial institutions and investments for repos as part of the contingency plan. Finally, the bank continues to strengthen its technological systems related to the traditional banking business.

As of March 31, 2022, assets contracted 4.12%, influenced by a reduction in assets of 41.62%, associated with dividend payouts and withdrawals of funds, as well as to support the growth of the loan and investment portfolio. The gross loan portfolio increased 16.23% in H1 2022, mainly driven by loans for the domestic sector (consumption, margin and commercial lending). In line with the bank's business model (corporate and high-profile private consumption), the level of borrower concentration is high, with the 20 largest borrowers representing 33.80% of the gross loan portfolio (32.77% as of September 2021). In terms of loan portfolio quality, the delinquency ratio[2] increased to 0.93% in H1 2022 as a result of residential mortgage transactions, remaining well below the SBN's average (4.82% in the same period). According to the bank, the delinquency ratio recovered to its historical levels in July 2022. The level of coverage of the bank's problem and nonperforming loans was significantly reduced to 38.55% in March 2022, from 555.96% in September 2021. This was explained by the increase in problem loans, particularly mortgage loans, so the creation of provisions was not required. This explains the coverage reduction, below the historical coverage maintained by the bank. This analysis does not take into consideration the collateral on problem and nonperforming loans, which accounted for 48% of the cash-backed portfolio (19% backed by investments and 18% by real estate) as of the end of March 2022. This is also reflected in the limited coverage of bad debt (loans under the Subnormal, Doubtful and Irrecoverable categories).

As for the results for the period, there is a favorable trend in the gross financial margin as a result of lower funding costs, associated with the preference of clients to maintain demand deposits given the current market conditions. Thus, the financial results remained stable in nominal terms compared with a year earlier. Fee income increased 4.53% because of higher AUM in more profitable portfolios, boosting financial results and absorbing higher provisioning expenses due to a growing portfolio. However, lower net income of 60.43% from the sale and valuation of securities resulted in a 2.23% contraction of operating balance. Higher general and administrative expenses from increased salaries and personnel expenses (9.02%) strained operating efficiency, which remained above the historical average. As a result, the bank's balance was affected, dropping 14.11% from a year earlier; however, the return on average assets (ROAA) and the return on average equity (ROAE) remained stable, comparing favorably with the SBN average.

There was a slight tightening in the solvency ratio to 20.52% from 23.06%, as a result of lower regulatory funds (14.11%) associated with: dividend payouts of $10.8 million (89.26% of profit in 2021); a reduced share of the bank (below 51%) in MMG Panama Allocation Fund, becoming part of the investment portfolio through profit or loss; and a $2.2 million loss in investment securities, mainly in fixed-income securities.

Moody's Local will continue to monitor the financial performance of MMG Bank and the development of its key financial metrics, mainly monitoring the coverage ratio on problem and nonperforming loans, and on bad debt. The mismatches during the period under assessment are likely to be reversed in the short term and therefore will not affect the risk rating. Moody's Local will report in a timely manner any changes in the entity's perception of risk.

Factors that could lead to an upgrade

» Progressive increase in the business scale and market share, both at the level of direct loans and in AUM

» Lower concentration of demand deposits funding, as well as a permanent reduction in the concentration of largest depositors

» Permanent decrease in borrower concentration

Factors that could lead to a downgrade

» Sustained deterioration in asset quality

[2] Delinquency ratio: (problem + nonperforming loans)/gross portfolio.

- Adjustment in the capital adequacy and solvency ratios
- Decrease in liquidity ratios
- Sustained decline in assets on balance sheet and AUM with an impact on cash flow generation and profitability ratios
- Materialization of reputational risk
- Regulatory and/or legal changes affecting the bank's business development

Limitations during the assessment process

- None

Key metrics

Table 1
MMG BANK CORPORATION AND SUBSIDIARIES

	Mar-22	Sep-21	Sep-20	Sep-19	Sep-18
Gross placements ($/thousand)	279,204	238,430	240,342	244,943	249,918
Capital adequacy ratio (CAR)	20.52%	23.06%	21.57%	25.14%	25.71%
Legal liquidity ratio	57.69%	57.23%	53.30%	57.07%	77.38%
Problem and nonperforming loans[1]/gross loans	0.93%	0.07%	12.99%	0.01%	0.06%
Loan reserve[2]/problem and nonperforming loans[1]	150.20%	2,324.49%	16,080.29%	15,737.86%	2,159.58%
ROAE	16.15%	15.50%	15.28%	17.57%	18.36%

[1] The audited financial statements as of September 30, 2020, incorporated modified loans into the problem loans, resulting in a delinquency ratio of 12.99%.
[2] Includes specific and dynamic reserves.
Source: MMG Bank Corp. / Author: Moody's Local

Recent developments

For Q1 2022, the bank paid dividends of $10.8 million, representing 89.26% of the profit registered as of year-end 2021.

The spread of the coronavirus and the measures taken by the Government of Panama to address the health crisis significantly affected economic activity, which was reflected in a 17.95% contraction in GDP in 2020 and an increase in unemployment rate to 18.5% from 7%. As of December 31, 2021, according to data from the National Institute of Statistics and Census of Panama (INEC), a significant 15.34% recovery in GDP resulted from the total reopening of the economy; however, in absolute terms, productive activity was still below pre-pandemic levels. The progress of vaccination in the country (as of April 29, 2022, 71.3% of the population had received two doses, and 35.2% had received a booster dose) significantly decreased the number of hospitalizations and deaths, which limits the risk of a new wave of infections leading to further lockdown and quarantine measures. The GDP is likely to grow 6.5% in 2022 and 5.00% in 2023.

From the beginning of the pandemic, the government, the Superintendency of Banks of Panama (SBP) and the Superintendency of the Securities Market of the Republic of Panama (SMV)[3] have taken various measures to sustain the payment chain and banking system solvency. Agreement No. 2-2020, dated March 16, 2020, stipulated the modification of the original terms of loans to provide economic relief to customers whose payment capacity was affected by the pandemic, creating a category called "Modified Loans". On September 11, 2020, through Agreement No. 9-2020[4], the SBP created the Modified Special Mention category, and required the creation of a reserve equivalent to the highest amount between the provision under the International Financial Reporting Standards (IFRS) for the Modified Special Mention portfolio and a generic provision of 3.0% of the gross balance of the Modified Loan portfolio, including uncollected accrued interest and capitalized expenses. On October 21, 2020, through Agreement No. 13-2020, the SBP announced that financial institutions until June 30, 2021, could continue to reassess the loans of borrowers affected by the pandemic and who, by the time of the first amendment, were up to 90 days in arrears.

On June 11, 2021, through Agreement No. 2-2021, the period for restructuring Modified Loans was extended until September 30, 2021, if they met certain characteristics. In the same month, through the General Resolution of the Board of Directors SBP-GJD-0003-2021, the parameters for reporting Modified Loans in the loans by sector data (*átomo de crédito*) (AT-03) were established and five sub-

See Moody's Local research: https://www.moodyslocal.com/country/pa/research
[3] The SMV has taken new measures to change the issuance terms as a result of the impact on the cash generation of companies because of the halt in economic activity (06.15.20).
[4] New measures established by the SBP for the treatment of modified loans are positive in preserving the stability of the financial system (10.06.20).

categories were created: Modified Normal (loans modified before June 30, 2021, in compliance with new terms and conditions, and pending the completion of six consecutive months of payment); Modified Special Mention (loans modified before June 30, 2021, in grace period for principal or interest); Modified Subnormal (loans restructured from July 1 to September 30, 2021, in compliance with those terms); Modified Doubtful (customers who contacted the bank before June 30, 2021, but their current financial position did not make them eligible for restructuring); and Modified Loss (customers who, as of July 1, 2021, had totally or partially breached the terms and conditions agreed upon in the last amendment or who, as of June 30, 2021, had not contacted the bank).

Loans showing payment compliance for six consecutive months will be restored to the Normal category in accordance with the provisions of Agreement 4-2013, while loans not complying with the new terms and conditions for a period exceeding 90 days will be restored to the Subnormal category under Agreement No. 4-2013, with subsequent shifts according to the delinquency ratio and the provisions set forth by the Agreement. As of December 31, 2021, Modified Loans ($9,252 million) represented 16.78% of the total internal loan portfolio of the Panamanian financial system, down from 43.25% as of year-end 2020. By subcategory, 21% were registered under Modified Normal, 21% under Modified Special Mention, 41% under Modified Subnormal, 10% under Modified Doubtful and 7% under Modified Loss. As of February 2022, the latest information available from the regulator, the Modified Loan portfolio fell to $7,606 million, representing 13.73% of the total portfolio. In addition, the SBP issued the Official Notice No. 132, stipulating that each bank is responsible for developing, within their internal policies, the criteria and procedures applicable to write off the loans under the Modified Doubtful and Modified Loss categories, as provided for in the General Resolution of the Board of Directors SBP-GJD-0003-2021. Banks completed by February 28, 2022, the submission of the operating plan implemented and approved by the board of directors for the write-off of these loans.

On December 22, 2021, through Agreement No. 6-2021[5], it was provided that banks must ensure compliance with IFRS for credit risk coverage, taking into consideration the increased credit risk of loans in relation to their initial recognition (revoking Section 8 of Agreement No. 2-2021 on the 3.0% generic provision). The Agreement provides that it will be the responsibility of the banks' senior management and board of directors to ensure that adequate procedures are in place to ensure sufficient provisions, while external auditors shall check the reasonableness of the provisions accounted for by the banks as part of their auditing process. Similarly, the SBP may make observations or require adjustments to the provisions. The Agreement set forth additional provisions concerning the restriction on the reversal of provisions for the Modified Loan portfolio and the write-off of accrued interest receivable related to the portfolio. The Agreement also set forth the suspension, from January 1, 2022, of the recognition of interest, for income purposes, under interest receivable and interest earned on Modified Loan accounts that significantly increased their risk compared with their initial recognition and which present objective evidence of loss incurred (impaired loans) and may be recognized as income only when they have been paid by the borrower.

[5] New guidelines established through Agreement No. 6-2021 are positive for assessing the Modified Loan portfolio credit risk (12.27.21).

MMG Bank Corporation and Subsidiaries

Main items in the financial statement

(Thousands of dollars)	Mar-22	Sep-21	Mar-21	Sep-20	Sep-19	Sep-18
TOTAL ASSETS	**631,579**	**658,687**	**547,077**	**604,148**	**644,719**	**657,645**
Cash and cash equivalents	113,044	193,622	114,591	156,241	110,693	92,487
Investments	226,615	212,013	212,013	193,557	276,947	303,030
Current loans	274,524	238,266	240,710	209,110	244,923	249,775
Problem loans	2,565	152	12	31,208	0	0
Nonperforming Loans	36	12	180	24	20	143
Gross loans	**277,125**	**238,430**	**240,902**	**240,342**	**244,943**	**249,918**
Accrued interest receivable	3,067	3,141	3,663	2,420	1,464	1,158
Bad loan provision	(757)	(632)	(432)	(539)	(194)	(208)
Net loans	**279,396**	**240,892**	**244,132**	**242,176**	**246,069**	**250,679**
Furniture, fixtures and equipment	4,440	4,669	4,894	5,119	5,599	6,208
TOTAL LIABILITIES	**563,146**	**579,194**	**475,142**	**527,244**	**568,299**	**584,873**
Deposits	550,678	564,510	456,210	506,415	538,003	533,196
TOTAL EQUITY	**68,434**	**79,493**	**71,935**	**76,904**	**76,421**	**72,772**
Common shares	20,000	20,000	20,000	20,000	20,000	20,000
Accumulated profit/loss	47,093	53,084	46,813	51,820	51,461	48,329
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**631,579**	**658,687**	**547,077**	**604,148**	**644,719**	**657,645**

Main Items in the Income Statement

(Thousands of dollars)	Mar-22	Sep-21	Mar-21	Sep-20	Sep-19	Sep-18
Financial income	9,297	18,637	9,478	19,838	21,808	19,750
Financial expenses	(3,553)	(7,283)	(3,734)	(7,297)	(8,627)	(7,499)
Gross financial result	**5,744**	**11,354**	**5,744**	**12,541**	**13,181**	**12,251**
Net fees	7,192	14,041	6,632	12,927	13,807	14,361
Bad loan provision	(125)	(14)	58	292	(20)	(64)
Net financial result	**12,771**	**25,343**	**12,500**	**25,744**	**26,941**	**26,548**
Other income	476	2,823	1,049	1,186	1,409	802
Operating expenses	(7,648)	(14,337)	(7,310)	(13,809)	(13,825)	(12,670)
Net income	**4,772**	**12,121**	**5,556**	**11,712**	**13,107**	**13,238**

(*) The audited financial statements as of September 30, 2020, incorporate Modified Loans within the problem loans.

MMG Bank Corporation and Subsidiaries

Financial ratios

Liquidity	Mar-22	Sep-21	Mar-21	Sep-20	Sep-19	Sep-18
Cash and cash equivalents[(1)]/total deposits	20.53%	34.30%	25.12%	30.85%	20.57%	17.35%
Cash and cash equivalents/demand and savings deposits	29.44%	47.00%	37.93%	48.01%	36.64%	29.36%
Cash and cash equivalents/assets	17.90%	29.40%	20.95%	25.86%	17.17%	14.06%
Liquid assets + investments/total deposits	61.68%	71.86%	62.77%	69.07%	72.05%	74.18%
Net loans/total deposits	50.74%	42.67%	53.51%	47.82%	45.74%	47.01%
Net loans/total funding	50.68%	42.61%	53.41%	47.73%	45.74%	47.01%
Top 20 depositors/total deposits	39.80%	38.75%	45.87%	43.71%	32.47%	28.38%
Cash and cash equivalents/top 20 depositors	51.58%	88.52%	54.76%	70.58%	63.36%	61.13%
Legal liquidity ratio	57.69%	57.23%	53.12%	53.30%	57.07%	77.38%
Solvency						
Capital adequacy ratio[(2)]	20.52%	23.06%	22.79%	21.57%	25.14%	25.71%
Tier 1 capital/RWA	20.66%	22.76%	22.47%	21.27%	24.75%	25.23%
Total liabilities/equity	8.23x	7.29x	6.61x	6.86x	7.44x	8.04x
Equity exposure[(3)]	-1.91%	-4.59%	-4.73%	35.59%	-4.03%	-4.06%
Asset quality						
Problem loans/gross loans	0.93%	0.06%	0.01%	12.98%	0.00%	0.00%
Problem and nonperforming loans/gross loans	0.94%	0.07%	0.08%	12.99%	0.01%	0.06%
Problem loans, nonperforming loans and write-offs/gross loans	0.94%	0.08%	0.08%	12.99%	0.02%	0.06%
Loan reserve/problem loans	39.09%	599.44%	5558.28%	3.07%	N/A	N/A
Loan reserve/problem and nonperforming loans	38.55%	555.95%	359.15%	3.06%	987.94%	145.31%
Dynamic reserve/gross loans	1.05%	1.22%	1.21%	1.21%	1.19%	1.16%
Loan reserve + dynamic reserve/problem and nonperforming loans	150.20%	2324.49%	1870.05%	12.36%	15737.86%	2159.58%
Loan reserve/bad debt[(4)]	38.69%	506.79%	2510.65%	37420.13%	N/A	N/A
Top 20 borrowers/gross loans	33.80%	32.77%	33.60%	34.15%	35.33%	32.16%
Profitability						
ROAE*	16.15%	15.50%	17.12%	15.28%	17.57%	18.36%
ROAA*	1.92%	1.92%	2.15%	1.88%	2.01%	2.02%
Net financial margin	137.37%	135.98%	131.89%	129.77%	123.53%	134.42%
Net operating margin	60.23%	74.20%	65.83%	66.14%	66.60%	74.33%
Net margin	51.33%	65.04%	58.62%	59.04%	60.10%	67.03%
Return on performing assets	3.23%	3.02%	3.48%	3.25%	3.42%	3.08%
Funding cost*	1.39%	1.34%	1.47%	1.36%	1.52%	1.31%
Financial spread*	1.84%	1.68%	2.01%	1.89%	1.89%	1.78%
Other income/net income	9.98%	23.29%	18.88%	10.12%	10.75%	6.06%
Efficiency						
Operating expenses/financial income	82.26%	76.93%	77.12%	69.61%	63.39%	64.15%
Operating efficiency [(5)]	57.02%	50.81%	54.45%	51.81%	48.68%	46.22%
Additional information						
Number of borrowers	601	596	657	660	637	521
Average loan ($)	411,786	381,188	358,740	374,159	427,341	527,798
Number of offices	1	1	1	1	1	1
Write-offs LTM ($/thousand)	15	15	0	0	35	0
Write-offs LTM/gross placements + write-offs LTM	0.01%	0.01%	0%	0.00%	0.01%	0.00%

(1) Cash and cash equivalents = cash and bank deposits.

(2) CAR = capital funds/RWA.

(3) Equity exposure = (problem and nonperforming loans – loan reserves)/shareholders' equity.

(4) Bad debt = deposits from borrowers in Subnormal, Doubtful and Irrecoverable Loan categories.

(5) Operating efficiency = operating expenses/earnings before operating expenses and provisions.

Appendix I

Rating history

MMG Bank Corporation and Subsidiaries.

Instrument	Previous rating (as of 09.30.21)[1]	Current rating (as of 03.31.22)	Current rating definition
Entity	AA.pa	AA.pa	Reflects very high capacity to pay principal and interest under the agreed terms and conditions. The difference between this rating and the one above is minimal.
Revolving Negotiable Securities Program (up to $50 million)	ML 1.pa	ML 1.pa	Highest quality. There is certainty about the payment of principal and interest under the agreed terms and conditions.

[1]*Committee meeting dated February 25, 2022.*

Appendix II

Details of rated instruments

Revolving Negotiable Securities Program for $50.0 million – Resolution SMV No. 618-17

Program	
Issuer	MMG Bank
Program amount:	$50.0 million
Amount placed as of 03.31.22:	$3.0 million
Program duration:	Up to 10 years
Maturity:	Up to 365 days from the issuance date
Rate:	Annual fixed, to be defined at the time of placement
Interest payment:	Monthly
Capital payment:	Upon maturity
Support:	Issuer's general loan

Statement of importance

The security rating is only a professional opinion on the credit quality of the security and/or the security issuer related to the payment of the obligation represented by that security. The rating assigned or issued is not a recommendation to buy, sell or hold the security and may be subject to revision at any time. Also, this rating is independent and has not been influenced by other activities of the rating agency. Documents including the Code of Conduct, the rating methodologies used by Moody's Local PA, Panama's rating categories and the current ratings are available on Moody's Local PA's website www.moodyslocal.com. Additionally, the present opinion results from the rigorous application of the rating methodology "Metodología de Calificación de Entidades Financieras e Instrumentos Emitidos por Estas". The information used in this report covers audited financial statements as of September 30, 2018, 2019, 2020 and 2021, as well as interim financial statements as of March 31, 2021 and 2022 from MMG Bank Corporation and Subsidiaries. Moody's Local informs market participants that all information contained herein has been obtained from the rated Entity mainly and from sources deemed reliable, so no audit activities have been carried out. Moody's Local does not guarantee its accuracy or completeness and is not responsible for any errors or omissions herein. Updates to this rating report are made according to the current regulations**.**

MOODY'S LOCAL