Moody's LOCAL | Panamá

CREDIT OPINION

Committee meeting:
May 19, 2023

Update

RATING*

MMG Bank Corporation and Subsidiaries

Domicile	Panama
Entity	AA.pa
Negotiable Securities	ML A-1.pa
Outlook	Stable

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

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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 and the rating of its revolving negotiable securities program for up to $50.0 million at ML A-1.pa. The outlook is stable.

This report is informed by a new Financial Lenders Methodology[1], which was approved by the board of directors of Moody's Local PA Calificadora de Riesgo S.A. The methodology establishes new criteria for evaluating financial holding companies, new equivalences between the long-term and short-term financial strength ratings, as well as new criteria for evaluating the different types of subordination of financial instruments. The current ratings of MMG Bank have not been affected by the application of the new methodology.

The current ratings are informed 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 by the group's participation in the Panamanian capital market through debt issuance, loan structuring, financial advisory services and 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). In addition, these services provide sources of recurring income through equity management, investment banking and securities brokerage fees. For Q1 2022-2023, AUM registered a favorable trend despite increased market risk, and the fees from these services remain relatively stable compared with a year earlier. This, together with higher financial revenues, both from the loan portfolio and the investment portfolio, led to an improvement in the entity's financial margin. 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.

In addition, this report also takes into consideration the geographic diversification of MMG Bank's operations, as well as a new jurisdiction incorporated in 2021[2], which supports the likely growth in its various businesses, as reported by the bank. On the other hand, the entity's adequate levels of solvency are also considered, as reflected in its capital adequacy ratio (CAR) that is positioned well above the regulatory minimum (8%) and the national banking system (SBN) average (15.26% as of December 31, 2022). The bank has controlled delinquency ratios, despite deterioration in the last periods evaluated, together with higher coverage levels for problem and nonperforming loans and for bad debt. The bank also maintains a high percentage of gross portfolio backed by collateral. According to information provided by the bank, as of December 2022, the entity maintained restructured loans that migrated from the modified loan portfolio, with customers meeting the conditions for reinstatement to the portfolio under Agreement No.4-2013 before the cutoff date.

[1]The Financial Lenders Methodology was approved and published on May 15, 2023. For information about Moody's Local rating scale and Financial Lenders Methodology, please access https://www.moodyslocal.com/country/pa/methodologies.

[2]Partnership in Puerto Rico, beginning operations in November 2022.

Similarly, the ratings take into consideration the high quality of the investment portfolio, along with access to contingent credit facilities, which allows to reduce the risk in the event of liquidity stress. The extensive experience and professionalism of the bank's management and board of directors are also significant.

However, the bank's ratings are limited by high borrower concentration in the loan portfolio. Although this concentration reflects the bank's corporate segment-oriented business model, it increases the business exposure to unfavorable economic cycles or an unexpected deterioration of a borrower. This risk is likely to be mitigated, as indicated by management, by the high level of collateral of its loan portfolio. In this regard, the bank is exposed to a corporate client (liquidation process) and, as indicated by management, the loan provision will be 100% by May.

This report also takes into consideration depositor concentration, despite reduction in the assessment period. This, together with the high share of demand deposits within the funding structure, adds volatility amid an unexpected 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 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 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. The bank continues to strengthen its technological systems related to the traditional banking business.

For Q1 2022-2023, MMG Bank recorded a 3.44% decrease in gross placements compared with September 2022, mostly driven by the reduction in the domestic sector-oriented loan portfolio. This reduction was mainly driven by the decrease in consumer (-$16.6 million) and commercial (-$6.0 million) loans, which could not be offset by the increase in margin loans[3] (+$10.0 million). In line with the bank's business model (high-profile private and corporate consumer loans), the level of borrower concentration is high, with the 20 largest borrowers accounting for 31.43% of the gross loan portfolio (32.82% as of September 2022). As indicated by management, this is mitigated by the high level of collateralization of the bank (44% secured credit facilities with cash deposits, 25% securities/investments and 200% real estate).

In terms of the portfolio quality, the delinquency ratio (nonperforming and problem loans) remains under control at 1.02%, well below the SBN average (4.19% as of December 2022). The ratio increase is associated with a corporate client, whose loan provision was 60% as of December 31, 2022, reaching 100% in May 2023, as indicated by the bank. On the other hand, the coverage ratio on problem and nonperforming loans increased to 73.81%, from 41.47% in September 2022, still below the historical levels reported by the bank, in line with what was reported by the SBN. Similarly, the coverage ratio on bad debt (loans under the subnormal, doubtful and irrecoverable categories) increased to 55.71%, from 42.90% in 2022, mainly reflecting higher reserves for the period, associated with the above-mentioned corporate loan. The development of off-balance-sheet AUM, at the customer's risk and expense, remains favorable (+5.93%).

The structure of funding sources remains unchanged, with retail deposits being the main source of funding (85.46%), despite the contraction recorded during the period (-6.97%) associated with the cancelation of a back-to-back loan. Depositor concentration remains high (top 20: 33.37%), although there was a significant improvement compared with year-end (40.67%). This improvement takes into consideration the deposit renewal rate, as well as the internal liquidity risk policies that require, among other things, maintaining liquid assets to cover liquid liabilities at risk at all times, according to information provided by the bank's management. MMG Bank maintains debt instruments in the capital market by issuing negotiable securities, with a low level of use. The bank also has a high credit quality investment portfolio (63% international investment grade and 15% local investment grade) that allows it to access liquidity. In 2023, there was a sale of positions in the portfolio, some of which were placed in more liquid, high-quality and short-term instruments, and other portion was used to settle deposits. This explains the trend of the liquidity ratio, which remains at 56.88%, in line with the banking sector average (57.17%). For the asset-liability matching, as of the assessed cutoff date, the bank presented negative gaps in the short-term tranches, reflecting the high share of demand deposits within funding sources; however, the bank's internal policies include keeping liquid liabilities at risk covered at all times with high-quality liquid assets.

The bank's equity increased 5.95% as of December 31, 2022, positively driven by the profit for the period, as well as the reduction in unrealized loss on investment securities to $4.2 million, from $5.0 million in September 2022. The increase in equity also explains the

[3] Loans collateralized by the client investment portfolio managed by MMG Bank through registered off-balance-sheet AUM.

increase in the consolidated CAR, which was 25.86% in December 2022 (24.71% in September 2022), remaining well above the banking system average (15.26% as of December 31, 2022).

The bank's profit for Q1 2022-2023 was $3.1 million, 21.09% higher than that a year earlier. This report also takes into consideration the favorable trend in the gross financial margin as a result of a decline in funding costs, associated with the clients' bias toward maintaining demand deposits, as well as higher revenue, mainly from the investment portfolio. Net fees remain stable. The above considerations allowed for the absorption of higher provisioning expenses of $1.1 million mainly associated with the creation of provisions for the above-mentioned corporate loan, including margin adjustments. General and administrative expenses increased 6.39%, mainly because of salaries and personnel expenses. However, operating efficiency improved driven by higher revenue, which also benefits the bank's profitability ratios.

Moody's Local will continue to monitor the financial performance of MMG Bank and the development of its key financial ratios, informing the market in a timely manner of any changes in the entity's perception of risk.

Factors that could lead to an upgrade

» Progressive increase in the bank's 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 continuous reduction in the concentration of largest depositors

» Continuous decrease in borrower concentration

Factors that could lead to a downgrade

» Sustained deterioration in asset quality

» Adjustment in the capital adequacy and solvency ratios

» A decline in the 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 or legal changes, or both, affecting the bank's business development

Limitations during the assessment process

» None

Key metrics

Table 1

MMG BANK

	Dec-22	Sep-22	Sep-21	Sep-20
Gross placements ($/thousand)	265,879	275,363	238,430	240,342
Capital adequacy ratio (CAR)	25.86%	24.71%	23.06%	21.57%
Legal liquidity ratio	56.88%	67.42%	57.23%	53.30%
Problem and nonperforming loans[1]/gross loans	1.02%	0.97%	0.07%	0.01%
Loan reserve[2]/problem and nonperforming loans[1]	181.33%	150.70%	2324.49%	16080.29%
ROAE	11.25%	10.33%	15.50%	15.28%

[1] The audited financial statements as of September 30, 2020, incorporated modified loans into the problem loan category, resulting in a delinquency ratio of 12.99%. This was amended in the audited financial statements as of September 30, 2021.
[2] Includes specific and dynamic reserves.
Source: MMG Bank Corp. / *Author: Moody's Local*

Recent developments

In January 2023, the bank paid dividends of $7.1 million, representing 92.90% of the profit registered as of year-end 2022.

On September 14, 2022, MMG Bank obtained approval from the Puerto Rico Office of the Commissioner of Financial Institutions (OCFI) to begin operations, through its subsidiary MMG Bank International Corp.

As of October 1, 2022, there were changes in the management structure after the retirement of Marielena Garcia M., Investment Banking Senior Vice President (VP), and Mario de Diego G., Legal Advisor. These positions have been filled by Roger Kinkead (former Director of Investment Banking and Corporate Finance), who became the new VP of Investment Banking, and Natibeth Kennion (former Deputy Legal Counsel and Compliance Manager), who holds the position of VP Legal and Compliance. Both executives have more than 10 years of experience in banking and have developed their careers at MMG Bank.

As of December 31, 2022, Panama's National Institute of Statistics and Census (INEC) recorded GDP growth of 10.81% in the last 12 months, which reflects the economic recovery of various sectors. To date, Panama has a sovereign rating of Baa2, with a negative outlook, assigned by Moody's Investors Service (MIS), which also projects GDP growth of 4.1% in 2023 and 4.5% in 2024.

Following the announcement of the state of emergency and its subsequent impact on several sectors of the economy, the Superintendency of Banks of Panama (SBP), through Agreement No. 2-2020 dated March 16, 2020, established measures to modify the original terms on corporate and consumer loans, to provide financial relief to customers whose payment capacity had been affected by the pandemic. The Agreement created a "modified loans" category, through which banks could review the terms and conditions of loans, in terms of interest rates and maturities, allowing them to grant grace periods by maintaining the loan classification as of the effective date of the provision.

Then, on November 1, 2022, through Agreement No. 12-2022, the parameters and guidelines were fixed for the definitive restoration of the modified special mention loan portfolio to Agreement No. 4-2013. This Agreement established that banks shall migrate the modified loan portfolio under the modified special mention loan category to the categories of Agreement No. 4-2013. It was also established that if a customer has other weaknesses that could affect their payment capacity, the restoration of modified loans shall be carried out to the applicable highest-risk category.

In addition, all the loans in the modified special mention loan portfolio restored to Agreement No. 4-2013 were considered as restructured loans. Therefore, the conditions set forth in Article 19 of Agreement No. 4-2013 must be met so that the loans could be reclassified to a lower-risk category, and the six-month period was effective from the date of migration (restoration) to the Agreement.

On the other hand, corporate or individual (consumer and mortgage) modified loans under the modified special mention loan portfolio that maintained grace periods and were registered under the normal, special mention and subnormal categories were classified in the subnormal category of Agreement No. 4-2013. Likewise, corporate or individual (consumer and mortgage) modified loans that maintained grace periods for the payment of principal and interest, and were under the doubtful and irrecoverable categories were classified in the doubtful and irrecoverable category of Agreement No. 4-2013.

For the write-off of all loans under the irrecoverable category, the guidelines of Article 27 of Agreement No. 4-2013 shall be followed, and the respective deadlines were effective from the date on which the loan was restored to the terms of this Agreement. For the credit risk coverage, banks constituted provisions on the loan portfolio restored to Agreement No. 4-2013, ensuring compliance with IFRS and taking into account the significant increase in risk. In addition, banks established the specific provisions required by the Agreement. Finally, as part of the new guidelines set forth through Agreement No. 12-2022, any denomination of the modified special mention loan category was removed from accounts as of December 31, 2022.

On the other hand, on March 28, 2023, the SBP published Agreement No. 02-2023, through which it seeks to strengthen the corporate governance of the supervised entities. The Agreement requires that banks and owners of bank shares ensure that their shareholders, members of the board of directors, senior management and key personnel have recognized expertise, reputation, moral and economic solvency at all times, regardless of the nature, complexity and risk profile of the entity.

On the other hand, through General Resolution of the Board of Directors SBP-GJD-R-2023-01034 dated April 11, 2023, the General Resolution of the Board of Directors SBP-GJD-0005-2020 was repealed. While the latter resolution was in force, risk assets classified in categories 7 and 8, whose regular weights were 125% and 150%, respectively, were temporarily weighted as part of category 6, whose weight is 100%. Although the former resolution is effective from its enactment, the provisions will be reflected in the closing report of June 2023.

MMG Bank

Main items in the financial statement

(Thousands of dollars)	Dec-22	Sep-22	Dec-21	Sep-21	Sep-20	Sep-19
TOTAL ASSETS	**605,078**	**636,805**	**633,968**	**658,687**	**604,148**	**644,719**
Cash and cash equivalents	159,124	137,660	134,566	193,622	156,241	110,693
Investments	166,265	207,594	225,983	212,013	193,557	276,947
Current loans	263,178	272,704	260,267	238,266	209,110	244,923
Problem loans	2,653	66	154	152	31,208	0
Nonperforming loans	47	2,593	0	12	24	20
Gross loans	**265,879**	**275,363**	**260,422**	**238,430**	**240,342**	**244,943**
Accrued interest receivable	n.a.	27	n.a.	3,141	2,420	1,464
Bad loan provision	1,993	979	754	(632)	(539)	(194)
Net loans	**263,886**	**276,117**	**259,668**	**240,892**	**242,176**	**246,069**
Furniture, fixtures and equipment	4,105	4,216	4,485	4,669	5,119	5,599
TOTAL LIABILITIES	**532,470**	**568,272**	**561,090**	**579,194**	**527,244**	**568,299**
Deposits	517,111	555,848	546,189	564,510	506,415	538,003
TOTAL EQUITY	**72,608**	**68,532**	**72,878**	**79,493**	**76,904**	**76,421**
Common shares	20,000	20,000	20,000	20,000	20,000	20,000
Accumulated profit/loss	53,321	50,104	45,345	53,084	51,820	51,461
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**605,078**	**636,805**	**633,968**	**658,687**	**604,148**	**644,719**

Main items in the income statement

(Thousands of dollars)	Dec-22	Sep-22	Dec-21	Sep-21	Sep-20	Sep-19
Financial income	6,816	20,375	4,557	18,637	19,838	21,808
Financial expenses	2,159	(7,247)	1,794	(7,283)	(7,297)	(8,627)
Gross financial result	**4,657**	**13,129**	**2,764**	**11,354**	**12,541**	**13,181**
Net fees	3,748	14,161	3,725	14,041	12,927	13,807
Bad loan provision	1,059	1,764	47	(14)	292	(20)
Net financial result	**7,216**	**25,502**	**6,445**	**25,343**	**25,744**	**26,941**
Other income	349	(11)	361	2,823	1,186	1,409
Operating expenses	(4,038)	(16,140)	(3,795)	(14,337)	(13,809)	(13,825)
Net income	**3,092**	**7,643**	**2,553**	**12,121**	**11,712**	**13,107**

(*) The audited financial statements as of September 30, 2020, incorporated modified loans into the problem loan category, resulting in a delinquency ratio of 12.99%. This was amended in the audited financial statements as of September 30, 2021.

MMG Bank

Financial ratios

Liquidity	Dec-22	Sep-22	Dec-21	Sep-21	Sep-20*	Sep-19
Cash and cash equivalents[1]/total deposits	30.77%	24.77%	24.64%	34.30%	30.85%	20.57%
Cash and cash equivalents/demand and savings deposits	43.08%	36.35%	36.10%	47.00%	48.01%	36.64%
Cash and cash equivalents/assets	26.30%	21.62%	21.23%	29.40%	25.86%	17.17%
Liquid assets + investments/total deposits	62.92%	62.11%	66.01%	71.86%	69.07%	72.05%
Net loans/total deposits	51.03%	49.67%	47.54%	42.67%	47.82%	45.74%
Net loans/total funding	50.97%	49.62%	47.48%	42.61%	47.73%	45.74%
Top 20 depositors/total deposits	33.37%	40.67%	n.a.	38.75%	43.71%	32.47%
Cash and cash equivalents/top 20 depositors	92.20%	60.89%	n.a.	88.52%	70.58%	63.36%
Legal liquidity ratio	56.88%	67.42%	57.60%	57.23%	53.30%	57.07%
Solvency						
Capital adequacy ratio[2]	25.86%	24.71%	24.52%	23.06%	21.57%	25.14%
Tier 1 capital/RWA	25.34%	24.19%	23.51%	22.76%	21.27%	24.75%
Total liabilities/equity	7.33	8.29x	7.70	7.29x	6.86x	7.44x
Equity exposure[3]	-3.02%	-1.97%	-5.19%	-4.59%	35.59%	-4.03%
Asset quality						
Problem loans/gross loans	1.00%	0.02%	0.06%	0.06%	0.00%	0.00%
Problem and nonperforming loans/gross loans	1.02%	0.97%	0.06%	0.07%	0.01%	0.01%
Problem loans, nonperforming loans and write-offs/gross loans	1.09%	1.03%	0.06%	0.08%	0.01%	0.02%
Loan reserve/problem loans	75.12%	1678.51%	669.54%	599.44%	N/A	N/A
Loan reserve/problem and nonperforming loans	73.81%	41.47%	669.54%	555.95%	3986.70%	987.94%
Dynamic reserve/gross loans	1.09%	1.53%	1.11%	1.22%	1.21%	1.19%
Loan reserve + dynamic reserve/problem and nonperforming loans	181.33%	150.70%	2549.30%	2324.49%	12.36%	15737.86%
Loan reserve/bad debt[4]	55.71%	42.90%	676.71%	506.79%	37420.13%	N/A
Top 20 borrowers/gross loans	31.43%	32.82%	n.a.	32.77%	34.15%	35.33%
Profitability						
ROAE*	11.25%	10.33%	16.51%	15.50%	15.28%	17.57%
ROAA*	1.32%	1.18%	1.95%	1.92%	1.88%	2.01%
Net financial margin	105.86%	125.16%	141.41%	135.98%	129.77%	123.53%
Net operating margin	51.74%	45.90%	66.06%	74.20%	66.14%	66.60%
Net margin	45.36%	37.51%	56.03%	65.04%	59.04%	60.10%
Return on performing assets	3.74%	3.22%	n.a.	3.02%	3.25%	3.42%
Funding cost*	1.42%	1.29%	n.a.	1.34%	1.36%	1.52%
Financial spread*	2.32%	1.94%	n.a.	1.68%	1.89%	1.89%
Other income/net income	11.28%	-0.14%	14.15%	23.29%	10.12%	10.75%
Efficiency						
Operating expenses/financial income	59.24%	79.21%	83.27%	76.93%	69.61%	63.39%
Operating efficiency [5]	46.13%	59.17%	55.40%	50.81%	51.81%	48.68%
Additional information						
Number of borrowers	646	586	n.a.	596	660	637
Average loan ($)	407,354	434,681	n.a.	381,188	374,159	427,341
Number of offices	1	1	n.a.	1	1	1
Write-offs LTM ($/thousand)	192	180	n.a.	15	0	35
Write-offs LTM/gross placements + write-offs LTM	0.07%	0.61%	0.00%	0.01%	0.00%	0.01%

*Last 12 months.

(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 = placements from borrowers in subnormal, doubtful and irrecoverable loans categories.

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

Appendix I

Rating history

MMG Bank

Instrument	Previous rating (as of 09.30.22)[1]	Previous outlook	Current rating (as of 12.31.22)	Current outlook	Current rating definition
Entity	AA.pa	-	AA.pa	Stable	Issuers or issues rated AA.pa with very strong credit quality relative to other local issuers and transactions.
Revolving Negotiable Securities Program (up to $50 million)	ML 1.pa	-	ML A-1.pa	Stable	Issuers rated ML A-1.pa with the highest capacity to pay short-term obligations relative to other local entities and transactions.

[1]*Committee meeting dated February 8, 2023.*

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 12.31.22:	$2.0 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 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 views contained in the report result from the rigorous application of the current Financial Lenders Methodology. The information used in this report covers audited financial statements as of September 30, 2019, 2020, 2021 and 2022, as well as interim financial statements as of December 31, 2021 and 2022 from MMG Bank. 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 credit opinion are made according to the current regulations.