MOODY'S
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CREDIT OPINION
16 March 2020

Update

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RATINGS

Banco BMG S.A.

Domicile	Sao Paulo, Sao Paulo, Brazil
Long Term CRR	Ba3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Withdrawn
Type	Senior Unsecured - Fgn Curr
Outlook	Rating(s) WithDrawn
Long Term Deposit	B1
Type	LT Bank Deposits - Fgn Curr
Outlook	Positive

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Banco BMG S.A.

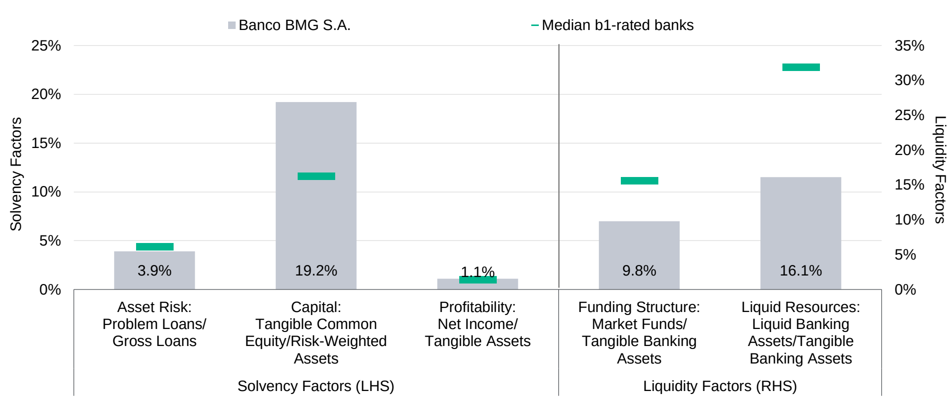
Update following rating affirmation, outlook changed to positive

Summary

The affirmation of Banco BMG S.A.'s (BMG) global ratings and assessments and the change in the outlook to positive, from stable, incorporate the bank's leading market position in the payroll credit card business and its improvement in capitalization. The bank raised BRL1.2 billion in its initial public offering (IPO) in October 2019. This improvement in capital provided the bank with an additional buffer to support eventual losses derived from its fast expansion. The ratings also reflect the challenge to consolidate its strategy and sustain earnings generation, as well as the record-low interest rates and fierce competition in its main line of business. Regulatory changes could also affect its profitability.

BMG's B1 deposit and senior unsecured debt ratings are in line with its b1 Baseline Credit Assessment (BCA) and do not benefit from any government support uplift, given its modest market share of domestic deposits. The upgrade of BMG's Brazilian national scale rating to Baa1.br incorporates the steady improvement in the bank's financial metrics compared with those of its peers with similar creditworthiness.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

Credit strengths

» Robust capital position, which is enhanced by the IPO

» Stable asset risk, given the bank's shift mix toward payroll credit card financing

» Granular funding mix, which predominantly comes from household investors

Credit challenges

» Fundraising supported by brokers and the need to increase market funds to support expected loan growth

» Concentration of loans in a single and highly regulated product, payroll credit card (75% of loans), and excess leverage in the same clientele base through unsecured consumer loans

» Fierce competition with new entrants which affects its profitability

Outlook

The change in outlook to positive from stable reflects our expectation that the bank will maintain solid capital buffer and adequate financial metrics in the next 12 to 18 months.

Factors that could lead to an upgrade

» BMG's ratings could be upgraded if it reports sustained core earnings generation and maintains healthy asset-risk indicators under a fast loan growth strategy.

Factors that could lead to a downgrade

» BMG's ratings could be downgraded if its profitability deteriorates. Downward pressure on its financial profile could also arise from a higher reliance on market funds or large investors, as well as a reduction in its liquid resources and an increase in its asset risk.

Key indicators

Exhibit 2
Banco BMG S.A. (Consolidated Financials) [1]

	12-19[2]	12-18[2]	12-17[2]	12-16[2]	12-15[2]	CAGR/Avg.[3]
Total Assets (BRL Billion)	18.9	16.9	16.3	15.6	17.1	2.6[4]
Total Assets (USD Billion)	4.7	4.4	4.9	4.8	4.3	2.1[4]
Tangible Common Equity (BRL Billion)	2.9	1.0	0.8	0.6	0.5	53.4[4]
Tangible Common Equity (USD Billion)	0.7	0.3	0.2	0.2	0.1	52.8[4]
Problem Loans / Gross Loans (%)	3.8	3.9	4.0	3.9	2.4	3.6[5]
Tangible Common Equity / Risk Weighted Assets (%)	19.2	7.9	7.4	5.0	4.2	8.7[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	12.4	23.4	25.2	29.1	22.0	22.4[5]
Net Interest Margin (%)	18.2	16.3	12.7	7.1	6.1	12.1[5]
PPI / Average RWA (%)	5.1	7.7	3.8	-2.4	0.8	3.0[6]
Net Income / Tangible Assets (%)	2.0	1.0	0.2	0.3	0.5	0.8[5]
Cost / Income Ratio (%)	71.4	56.6	73.0	132.3	88.9	84.4[5]
Market Funds / Tangible Banking Assets (%)	9.8	8.3	11.6	23.8	23.3	15.4[5]
Liquid Banking Assets / Tangible Banking Assets (%)	16.1	18.5	21.1	18.5	15.4	17.9[5]
Gross Loans / Due to Customers (%)	110.7	100.1	101.8	147.0	157.6	123.4[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully-loaded or transitional phase-in; LOCAL GAAP. [3] May include rounding differences due to scale of reported amounts. [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel III periods presented.
Sources: Moody's Investors Service and company filings

Profile

Banco BMG S.A. (BMG) is 77%-owned by the Pentagna Guimaraes family, with a 19% stake traded on the Brazilian stock exchange house. It is a mid-sized bank that focuses on payroll credit card loans, payroll loans and unsecured consumer finance operations. In the corporate segment, the bank offers structured financial services, financing, derivative instruments and guarantee insurance.

As of December 2019, the bank held a market share of less than 0.5% of loans and deposits.

BMG does not operate a retail branch network, but distributes its products and services in Brazil through a sales force comprising independent agents and third-party service providers. In January 2016, the bank launched a new distribution channel – help! loja de crédito, a franchise network that offers credit solutions to retirees and public-sector workers throughout Brazil.

Detailed credit considerations

Fast pace of credit growth and increasing exposure to unsecured personal loans may strain the bank's asset risk

Since the fourth quarter of 2015, BMG has shifted its loan mix toward payroll credit cards, which accounted for 70% of the bank's portfolio in 2019, up from 20% in Q1 2015. Besides benefiting from a long-standing experience in the payroll-related business, the bank has strong market penetration, stemming from its (1) access to a large network of over 2,000 loan brokers, (2) digital platform, and (3) use of 802 loyal branded franchise offices (Lojas Help), which give it a physical retail presence. These franchises give BMG a way of distributing products and services and offering customers a “one-stop-shop concept” that limits competition from mid-sized banks that have a reduced base of retail stores.

Meanwhile, BMG is boosting its payroll credit card lending and retaking payroll lending. This shift in loan mix has gradually improved the bank’s asset risk, with a problem loan ratio for the bank’s payroll credit card business of 3.7% in 2019, well below the double-digit levels of other unsecured runoff loans. Therefore, BMG’s delinquency ratio over 90 days has stabilized at around 3% to 4%, which is higher than the historical average ratio of 1.8% between 2010 and 2015, when low-risk payroll lending was the bank’s main product.

The bank’s future strategy of attending to the existing customer base with unsecured consumer lending raises concentration risk. Currently representing 7% of the bank’s loans, the strategy to expand its portfolio puts pressure on asset risk as the bank raises its customers' debt burden, instead of lending to new clients. This portfolio’s 90-day past due ratio was 28.8% in December 2019. Despite having higher margins and the bank having the authorization to debit customers’ payroll, those customers willing to take on additional debt are typically high-risk clients.

The ba3 score assigned for Asset Risk takes into consideration the shift in the bank's loan mix toward the lower-risk but highly regulated payroll credit card business and the increase in its loan exposure to the same client base by providing them with unsecured consumer lending.

Profitability supported by higher loan gains and lower fund costs

The b1 score assigned for Profitability factors in BMG's successful efforts in delivering stronger operating results in 2019, although the bank was challenged by its focus on a single, highly regulated product and its need to maintain consistent and recurring results.

BMG's net income/tangible assets already improved to 1.97% in December 2019, from 1.03% in December 2018. In 2019, the bank's interest results benefited from higher loan gains and lower funding costs, which partially offset higher credit costs. The bank also reinforced its mass civil provisions, counterbalancing one-off gains related to the revaluation of deferred tax assets (DTA) and gains from the sale of a 30% stake of its insurance company in November 2019.

We expect BMG's profitability to continue to benefit from the increasing loan portfolio within the higher-yielding payroll credit card business and lower funding costs, given better market's risk perception and the fact that most of its funding base is linked to the Selic rate. However, the bank's business strategy has some challenges, including the reliance on a single regulated product, the potential entrance of new competitors and an unexpected increase in expenses

BMG's concentrated loan portfolio and revenue by product exposes it to regulatory risks. In December 2019, 75% of the bank's loan revenue came from its consumer business, with income from loans representing roughly 90% of its operating revenue. The current regulation imposes a maximum 3% monthly rate on payroll credit card financing charges for retirees and pensioners and 3%-5.9% monthly rates for public servants. As a result, any reduction in the maximum rate (these rates were reduced in 2017) would reduce margins on those products, making it harder to generate sustainable earnings.

BMG has put efforts in mitigating this risk by increasing cross-selling, especially of credit and life insurance, to customers through its 20-year bancassurance partnership with a multinational insurer. The bank also announced that it will enhance its credit card acquiring business, through a partnership with Granito, to tap micro and small companies. Meanwhile, a greater focus on more granular lending and lower funding costs, along with increased investments in digitalization, would also help diminish the pressure on profitability.

Given Brazil's recently low interest rates, banks, especially large lenders, may be compelled to compete in the segment to complement their growing payroll loan business.

Capital position, which is high following the IPO, will weaken because of loan growth

BMG's ba2 Capital score reflects its revamped capital structure following IPO launching, which constitutes a strong shield against potential pressures on asset risk.

BMG's Moody's-adjusted tangible common equity (TCE)/risk-weighted assets (RWA) increased to 19.2% in 2019 from 7.89% a year earlier. Meanwhile, the bank's Common Equity Tier 1 capital ratio also improved to 22.4% from 13.8% in December 2018 and 13.4% one year earlier, reflecting BRL1.2 billion of fresh capital raised through the IPO in October 2019. The strengthening of the bank's capital base reinforces its loss-absorption capacity, especially to tap the expected credit growth in riskier segments, including unsecured consumer lending and small and medium-sized enterprises (SMEs) targeted through cross-selling of card acquiring businesses.

The reduced Moody's-adjusted TCE/RWA is mainly weighed down by the bank's large stock of DTA, amounting to BRL2.7 billion in December 2019, which includes DTA from temporary differences related to loan-loss provisions, as per our analytical approach that DTA are only available to absorb losses in limited circumstances. The ratio is also adjusted to exclude goodwill and includes a risk-weighting factor of 100% on the bank's holdings of government securities.

Although BMG's capital position is supported by better internal earnings generation, we expect the bank's capital to reduce within the next 12-18 months, in view of its forecast credit growth and significant dividend payments. The bank's capital adequacy may also be susceptible to regulatory changes, affected by the potential increase in credit risk provisions (such as the implementation of IFRS 9) and by the changes in the payroll credit card segment risk-weighted factor, as occurred in 2018, when the Central Bank increased the risk-weighted factor to 75% from 50%.

More granular funding base, although still dependent on brokers

The b1 score assigned for Funding recognizes the bank's efforts in building a more granular funding base, counterbalanced by a still-large dependence on fundraising through brokers and the expected increase in market funding to support its business growth.

Since 2017, Banco BMG has broadened its access to customer deposits and deposit-like instruments to boost loan growth; yet, a large part of the bank's loan growth stems from work done by third-party brokers. This represents an important shift in mix in the bank's funding base, considering the bank's strong reliance on credit assignments up to 2014.

The BRL 250,000 coverage per individual provided by the local insurance deposit fund (FGC, Fundo Garantidor de Credito) combined with the higher returns offered by SME banks than those offered by large banks, attracted retail customers. This enabled Banco BMG to lower deposit concentrations, with a more granular funding base, and to reduce volatility in times of stress. Individuals represented more than 80% of its funds. Thereby, top 100 investors accounted for less than 20% of such resources in December 2019.

This type of fundraising has been key to support the bank's payroll credit card business, and it will be so important as credit sales were from 2004 to 2010, which was a behind the credit boom of payroll loans in this period. However, the bank is still exposed to changes in the business strategies and commercial interests of third-party brokers, because it lacks direct access to the retail investor base, while brokers control the distribution of the funds they raise.

To offset its reliance on independent brokers for fundraising, BMG developed a proprietary digital platform in 2017, named BMG Invest, which focuses on investments. BMG's proprietary channels already represent the third-most important source of fundraising for the bank, despite facing competition challenges from other mid-sized banks, including Banco Sofisa S.A. (Ba2 stable, ba2)[1] and Banco Daycoval S.A. (Ba2 stable, ba2), that have adopted the same initiative.

We expect BMG to increase market funds to complement its funding base to support the forecast credit expansion through local and international issuances. As of December 2019, complementary resources already included a BRL0.5 billion securitized credit card operation through debentures for a five-year period, in addition to local bank notes of BRL0.5 billion and foreign currency notes of BRL0.8 billion.

Adequate asset and liability management will support loan growth

The a3 score for Liquid Resources reflects the stock of liquid assets held by the bank, coupled with our expectation that its cash position will decrease slightly, considering the forecast loan growth for 2019.

BMG's liquid banking assets totaled BRL3 billion in December 2019, almost fully comprising locally traded federal bonds. This cash base covered 16% of tangible banking assets and 29% of total deposits. Additionally, the bank has proved to have adequate asset-liability management, with the average duration of funds being 728 days, higher than the 472-day average duration for loans in 2019.

BMG's rating is supported by Brazil's Moderate- Macro Profile

Brazil's Moderate- Macro Profile reflects the large size and diversified nature of the country's economy, more credible monetary policy, increasing commitment to address corruption and improve overall government effectiveness, and very low susceptibility to external shocks. However, Brazil's economic rebound, which began in 2017 following a deep two-year recession, has been weaker than expected.

Although public-sector banks continue to account for a substantial portion of total credit, they have been contracting since 2015, which has reduced the market distortions created by their previous aggressive lending policies. Moderate economic growth in 2019 will support modest lending growth over the next 12 months. Consequently, banks will face little to no pressure on their funding needs, while low interest rates and low inflation will improve borrowers' repayment capacity, leading to asset quality stabilization.

ESG considerations

BMG's exposure to environmental risks is low, consistent with our general assessment for the global banking sector. See our environmental risk heat maps for further information. Overall, we believe banks face moderate social risks. Please see our social risk heat maps for more details. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which are partly mitigated by sizable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct are social risks. Social trends are also relevant in a number of areas, such as shifting customer preferences toward digital banking services increasing information technology costs, aging population concerns in several countries affecting the demand for financial services or socially driven policy agendas that may translate into regulations that affect banks' revenue base.

Governance is highly relevant for BMG, as it is to all participants in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven, and for BMG, we do not have any particular governance concerns (with only minor control issues and governance shortfalls identified in recent years, remediated in the normal course of business). Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Given the absence of an operational resolution regime in Brazil, wherein banks are resolved by bailing-in creditors, the impact of failure on a bank's different debt classes in the absence of government support (that is, bailout) is unclear, as we believe that resolution procedures will be determined on an ad hoc basis, rather than being clearly defined ex ante. The expected loss of each debt class is derived from a standardized instrument notching for all nonoperational resolution regime banks.

Government support considerations

We believe there is a low likelihood of government support for BMG's rated deposits, which reflects the bank's small share of deposits and assets in Brazil's banking system.

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

BMG's CR Assessment is positioned at Ba3(cr)/NP(cr)

The CR Assessment is one notch above the bank's Adjusted BCA of b1 and, therefore, above its deposit rating, reflecting our view that its probability of default is lower at the operating obligations than at deposits. Banco BMG's CR Assessment does not benefit from government support, as government support is not incorporated into the bank's ratings.

Methodology and scorecard

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 3
Banco BMG S.A.

Macro Factors		
Weighted Macro Profile	**Moderate -**	**100%**

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	3.9%	ba1	←→	ba3		
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	19.2%	a3	←→	ba2		
Profitability						
Net Income / Tangible Assets	1.1%	ba1	←→	b1		
Combined Solvency Score		baa2		ba3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	9.8%	baa3	←→	b1		
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	16.1%	ba3	←→	ba3		
Combined Liquidity Score		ba1		b1		
Financial Profile				ba3		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Ba2		
BCA Scorecard-indicated Outcome - Range				ba2 - b1		
Assigned BCA				b1		
Affiliate Support notching				0		
Adjusted BCA				b1		

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	1	0	ba3	0	Ba3	Ba3
Counterparty Risk Assessment	1	0	ba3 (cr)	0	Ba3(cr)	
Deposits	0	0	b1	0	B1	B1
Senior unsecured bank debt	0	0	b1	0		(P)B1
Dated subordinated bank debt	-1	0	b2	0		B2

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 4

Category	Moody's Rating
BANCO BMG S.A.	
Outlook	Positive
Counterparty Risk Rating	Ba3/NP
Bank Deposits	B1/NP
NSR Bank Deposits	Baa1.br/BR-2
Baseline Credit Assessment	b1
Adjusted Baseline Credit Assessment	b1
Counterparty Risk Assessment	Ba3(cr)/NP(cr)
Subordinate	B2

Source: Moody's Investors Service

Endnotes

1 The ratings shown are local currency global deposit ratinga nd Baseline Credit Assessment

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CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454