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# EDITED TRANSCRIPT

Q1 2018 Grupo Financiero Banorte SAB de CV Earnings Call

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**Mario Lucio Pierry** *BofA Merrill Lynch, Research Division - MD*

### PRESENTATION

#### Operator

Good day, and welcome to the Banorte First Quarter 2018 Earnings Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Ursula Wilhelm. Please go ahead.

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#### Úrsula Margarete Wilhelm Nieto *Grupo Financiero Banorte, S.A.B. de C.V. - Executive Director of IR*

Thank you, Kathy. Welcome to Banorte's first quarter results. I'm Ursula Wilhelm, Head of Investor Relations.

And this morning, Marcos Ramirez, our Chief Executive Officer, will lead the presentation, and at the end of his comments, we will take your questions.

Thank you. Marcos, please go ahead.

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#### José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO*

Thank you, Ursula. Good morning to all of you. Thank you for attending our earnings presentation. I'm pleased to report that we have encouraging results to start the year. The quarter evolved with good dynamics in our core businesses and overall solid performance across all the subsidiaries.

Consolidated net income reached MXN 6.7 billion, grew 22% annually and 4% sequentially, maintaining good momentum. While earnings per share were MXN 2.44, growing at the same pace. ROE increased 10 basis points from the last quarter to reach 18.2%, while return on assets stood firm at 2%.

On Slide 2, you will see that revenues grew 7% quarterly to total MXN 22.4 billion on the back of strong growth in net interest income, adequate growth in fees and good results in trading income. Net interest income grew 10% in the quarter, aided by the MXN 3.1 billion from the insurance and annuities company. The net interest margin of the group reached 5.9%, 300 basis points above the prior quarter. The margin, excluding insurance and annuities, dropped 20 basis points to 5.6% on the higher funding cost and a larger balance of interest-earning assets. There is a strong focus on growing deposits this year. Therefore, we expect a temporary effect on the NIM that should be corrected towards the second half of the year.

We are managing carefully the funding costs, which remained stable as evidenced by the fact that the banks' net interest margin stood firm at 6% in the quarter. We are still forecasting a NIM expansion between 30 -- 20 and 30 basis points during this year.

Fees of MXN 2.6 billion slightly declined sequentially. Lower transactional activity at the beginning of the year, coupled with fewer days than usual during the quarter, displaying the softer progress. Higher acquisition cost and insurance related to premium growth also affected overall fee growth in the quarter. Trading revenues posted up a good result, totaling MXN 866 million. Other income was MXN 607 million, 13% below the prior quarter, or lower revenues from collections and for closed assets mainly.

On Slide 4, expenses increased 7% versus last year, in line with our forecast and efficiency ratio continued the downward trend to 40.9% on a positive operating leverage.

Moving to Slide 5, and elaborating on the performance on our long-term savings businesses. Let me tell you that the insurance operations posted a strong quarter. Retained premiums amounted to MXN 9.5 billion, increasing more than twofold. This growth results from significant renewal activity mainly in life, which currently accounts for 61% of the book, and large property and casualty policies. Technical reserves increased in tandem with renewals, while claims were up 5%. Earnings at MXN 1.3 billion more than doubled the result of last year, including the investment in Afore. The consolidated and reported net profit of the insurance company was MXN 1.7 billion. The annuities company achieved net income of MXN 210 million on good underwriting activity. Afore posted profit of MXN 329 million, 6% higher than the prior quarter. The long-term savings segment contributed with MXN 1.8 billion in net profit or 28% of the consolidated net profit of the financial group.

Moving to the loan portfolio and asset quality on Slide 6 and 7. The loan portfolio increased 1% sequentially with higher growth in consumer loans of 3%. The quality of the overall portfolio improved with the NPL ratio down 10 basis points from December to 1.9%. All the consumer portfolios posted better NPL indicators, while reserve coverage improved and now stands at 137%.

Loan loss provisions were MXN 4.2 billion, resulting in a cost of risk indicator of 2.7%.

Let me highlight that this amount includes MXN 619 million in specific provisions for our corporate exposure which was classified as past due in December. Normalized...

(technical difficulty)

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**Operator**

Please stand by.

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**Úrsula Margarete Wilhelm Nieto *Grupo Financiero Banorte, S.A.B. de C.V. - Executive Director of IR***

Kathy, are you there?

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**Operator**

Go ahead, please.

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**José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO***

I don't know what the cost of risk is, okay.

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**Úrsula Margarete Wilhelm Nieto *Grupo Financiero Banorte, S.A.B. de C.V. - Executive Director of IR***

I'm sorry, we got disconnected, so we will move forward with the conference call.

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**José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO***

Thank you very much. And let's talk about the cost of risk. Normalizing the cost of risk due to a specific case, the ratio was 2.3%, in line with the prior quarter and didn't see the stability in the performance of the consumer and commercial books. We're encouraged by our first quarter results, and we believe we are on the right track to deliver on our 2018 financial goals, which remain unchanged from the guidance indicators that we gave you at the beginning of the year.

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Moving onto the economy. We have set good performance in the first quarter with inflation coming down quickly and now standing at 4.7%. Salary increases improved another (inaudible) at 5.6%. The first quarter also saw a healthy level of retail sales and a stable labor market. These are positive signs that support the expansion on the consumer market that we are targeting this year. NAFTA is alive and is likely to be updated in the next few months, or weeks, with minimal impact to Mexico. Implementation of the energy reform continues to move forward as evidenced by the success of -- from fee which raised over USD 3 billion in new investments. And the balance sheet of the government is stronger with a debt reduction implemented last year.

We are now at the peak of the electoral cycle. The outcome of the vote is still uncertain and some of the candidates' positions are still not very detailed in some areas. Therefore, we do not rule out that domestic financial markets will remain somewhat volatile as we approach Election Day as seen in the past few days in the FX market. Mexico has a strong institutional framework and commitment to an open economy. Banorte has solid fundamentals, good business diversification, a broad customer base and a strong capital position. So both Mexico and Banorte are on a strong footing to overcome uncertainties successfully.

On this note, I conclude my comments, and we are ready to take your questions. Thank you very much. Good morning, Good Friday.

### QUESTIONS AND ANSWERS

#### Operator

(Operator Instructions)

#### **Úrsula Margarete Wilhelm Nieto *Grupo Financiero Banorte, S.A.B. de C.V. - Executive Director of IR***

Kathy, we are now ready to take questions.

#### Operator

(Operator Instructions) And we'll take our first question from Mario Pierry with Bank of America Merrill Lynch.

#### **Mario Lucio Pierry *BofA Merrill Lynch, Research Division - MD***

Let me ask you 2 questions, please. The first one is related to these accounting changes that took place this quarter. I was wondering -- clearly they had an impact on your efficiency ratio in your provisions. So I was wondering if your guidance for the year, if you're going to change your guidance for the year to reflect those accounting changes. The second question is related to your government loan book. Basically, there has been no growth for the last 5 quarters in government loans. A bit surprising, right, that this is happening ahead of elections. But also I wanted to understand how does this tie-in with your -- of your merger with Interacciones? Are you, on purpose, trying to reduce your exposure here? Or if growth is so slow, how does it tie-in with Interacciones, which is primarily a government lender?

#### **José Marcos Ramírez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO***

Thank you, Mario. The first one, no, we are not changing the guidance and Rafael Arana will elaborate a little bit on that, but no. And the government growth that we see is certainly a result of the demand with -- we have on the government. We are not so successful managing the markets. Also if an amount comes, we take it, if it doesn't come, we don't take it and that's it. It moves faster or slower depending on the part of the year, but it's not particularly because we are in the merger with Interacciones. It's because the market became like that. And we are with the wave of the market, that's the reason we're not moving right now, but it's going to be moving in the next months. We have a pipeline -- a strong pipeline and you will see some movements there in the next future. And Rafael, can you talk about it?

#### **Rafael Víctorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO & CFO***

Yes. Mario, thank you for the question. No, we are not changing the guidance, as Marcos says. We, on the provision line, as you know, because of the accounting change that those recoveries now are coming down and reducing the provision mix for the quarter. And the effect on the efficiency ratio because that's going to hit a little bit on the efficiency ratio, was already budgeted for us. So we will not change our guidance, and we are sticking with our goal to be -- to reach the 40% cost income ratio for the year. So no, everything has been balanced out on the budget, so no need to change the guidance. And as Marcos says, on the loan book, as we come into the market when we were on the road show with the merge, we said that on the peak after the merge, the loan book will reach around -- close to

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30% on the loan book for the government loans. But that's slowly, but surely will go down to 26% because of the rate of growth of the other lines of business on the credit side, on the consumer and on the commercial side. And the government book -- we have a very strong position on the government lending part. And we are -- as we mentioned before, we are trying to move a lot more into the infrastructure part of the business that is more in the short-term loans around MXN 350 million, MXN 400 million. That is basically what we are looking on the merge and integration with Interacciones.

### **Mario Lucio Pierry BofA Merrill Lynch, Research Division - MD**

Okay. That's clear, Rafael, but just to get a clarification, right? Because once you do this reclassification here, your provisions to average loans should be lower, right? Because now you have the recoveries there. So why wouldn't your guidance for the year be reduced?

### **Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - COO & CFO**

Well, because if you look at ongoing cost of operations that you will see is around 2.37 for the quarter, around 2.3. And our guidance is around 2.4 to 2.6. So we will see -- and the consumer books are behaving much better than we anticipated at the end of the year when we were making -- doing the budget. So we see that the benefit on the consumer will continue to be there. So maybe, in the second quarter will be a new guidance on the -- possible on the cost of risk. But we have to see if this trend on the world relation on the vintages continues to be there. On the other side, it's basically the recoveries that we were -- we are very successful on the recoveries because of the collection unit that we have. Now that it's been put in on the recovery instead of the other income that wasn't there in the past because of this regulatory change. So that's the reason, it's balanced out that nicely.

### **Mario Lucio Pierry BofA Merrill Lynch, Research Division - MD**

Okay. And since we touched on Interacciones, can you just give us an update on where you are with the merger, getting all the approvals required?

### **José Marcos Ramirez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO**

We're -- maybe in a few days or weeks, we will receive the final approval of the authority. We depend on that and we cannot say, they are going say when exactly. But it's on their side. And -- but we are ready. As soon as they say yes, we have everything implemented down and the merger is going to be very easy and very successful because we have everything done. So as soon as we receive from the authorities, we will tell you and you will see in 1 quarter that everything is going to be very smooth the way we see things.

### **Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - COO & CFO**

You'll remember that we committed to the market that the integration is going to happen in 2 months once we achieved the go from the authorities.

### **Operator**

(Operator Instructions) We'll now take our next question from Jason Mollin with Scotiabank.

### **Jason Barrett Mollin Scotiabank Global Banking and Markets, Research Division - MD of LatAm Financial Services**

I wanted to ask about the net interest margin that you talked about and you show in your presentation coming down in the quarter ex insurance and annuities. On our calculation it also comes down. You mentioned higher funding costs and you're working on that. Maybe if you can talk a little bit about the funding cost environment for Banorte versus the market? And how you think that this will play out for the rest of the year.

### **José Marcos Ramirez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO**

Thank you, Jason. I will give you some light here about the margin. But as we said, we expect to -- in the next future, to increase it 20 to 30 basis points, which is our budget and our forecast. And Rafael is going to give you some light here.

### **Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - COO & CFO**

Yes. Thank you, Jason. And remember that if you do the comparison on a quarter-to-quarter window on the net interest margin, you also have to take into account that in the fourth quarter, you have 94 days and in this quarter it was 92 days. That -- on the margin side, it costs you around MXN 320 million. So if you want to normalize that, you have to add to this quarter MXN 320 million or deduct from the other quarter MXN 320 million. On the funding cost, as you know, we are anticipating the integration with Interacciones, we have been

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extremely successful in gathering the timed deposits. Last year we adjusted the cost at the end of the year to go down to 2.8 of the reference rate. Right now we are sitting at 3.1, and we are comfortable at that cost of funds against the reference rate, because we continue to have a solid growth on the timed deposits. On the demand deposits we also are now regaining the growth. As you know, the first 2 months usually -- even the first quarter usually goes down on the demand deposit side. And in March, we had a very strong pickup on the demand deposits, not just on the timed, also on the demand deposits. So you will see a very controlled cost of funding over the year, around -- ranging from 2.9 to 3.1 on the reference rate. So good growth, good cost control, and we know we are pushing a little bit on the high-end of the cost because of gathering the timed deposit that we want to have once integration with Interacciones comes. So this process is a very defined strategy that we have.

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### **Jason Barrett Mollin *Scotiabank Global Banking and Markets, Research Division - MD of LatAm Financial Services***

That's very helpful. And the 20 to 30 basis points increase in NIM that you're talking about, that's from the full year 2017? We're looking for that in 2018? Or is that from the level we saw in the first quarter with this impact of the number of days?

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### **Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO & CFO***

No. It's for the full year of '18.

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### **Jason Barrett Mollin *Scotiabank Global Banking and Markets, Research Division - MD of LatAm Financial Services***

Okay, versus full year '17. Okay, great.

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### **Operator**

(Operator Instructions) We'll now take our next question from Jorge Kuri with Morgan Stanley.

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### **Jorge Kuri *Morgan Stanley, Research Division - MD***

2 questions, if I may. First on fees. They were up 4% year-on-year, which is a pretty sharp deceleration versus what you did in 2017. And given that a lot of what you were doing with IBM lately had to do with improving fees. I'm just wondering if this was sort of like a hiccup and we expect that number -- you expect that number to go up throughout the year, especially in the context of inflation? You know this is basically no growth and everything else in your business is growing certainly nicely. So I wanted to get an update on that? And then on the corporate case that you mentioned where you had to create provisions, is that performing now? Or is it still not performing? What's the outlook for the recovery of that? Is the exposure fully covered or would you have to make another tranche in the subsequent quarters?

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### **José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO***

Thank you, Jorge. Thank you very much. The first one, there's -- a lot of the explanation is with insurance (inaudible) give us a little bit of light on that. And the second one, we -- according to the law, we were set 45% of these assets, but we think that is more than enough. We will see how it develops during this year. But we decided to take the hit and not think it will go (inaudible) according to the regulation and that's it. And now we are working with this specific company for this specific asset. It's only one case, and we are working with this company now. But Manuel, can you give some little bit of light, and Ursula too.

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### **Ursula Margarete Wilhelm Nieto *Grupo Financiero Banorte, S.A.B. de C.V. - Executive Director of IR***

Yes. Jorge, on the fees, there are 2 elements that affected the growth in this quarter. The first one is related to the insurance company. Because of the high level of premium that they booked in the first quarter, the insurance company also booked the acquisition cost, which is part of the fees paid. And this quarter it was MXN 725 million, which is -- was more than double what we had last year, almost 3 times more than what we had in the previous quarter. So that was one of the big elements. If you look at the components of fees on services, quarterly, there is a decline, which is explained by the seasonality of the quarter. A lower number of rates, we have also the Easter holiday in the quarter versus last year, which was in April. So all this affected the volume of transactionality. But if you look at the year-on-year growth of these fees, we were up on core service fees, 10% up year-on-year, overall 15% up year-on-year, not services, just seasonality.

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### **Manuel Antonio Romo Villafuerte *Grupo Financiero Banorte, S.A.B. de C.V. - MD for Methods of Payment***

Jorge, this is Manuel. This is just to complement Ursula. The strategy for the rest of the core business fees will continue to be mid-teens. Really, right now, the focus is to be competitive. However, as we are providing more services to the customers with regards to channels, with regards to digital -- really the digital transformation behind it. What we are doing is using the fees to move the customers from the

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person-to-person service branches, call center, et cetera, into more the digital world. And we're using the fees to have more incentives, clear incentives customer per customers, no? So really the focus that Ursula was saying is really to continue around 10%, 15% growth year-on-year. But really, you're going to see continuity, if not the speed up of the transition of customers from expensive channels into cheaper channels of the digital world. That's how fees -- we're looking at fees right now.

### **Operator**

We'll take our next question from Carlos Macedo with Goldman Sachs.

#### **Carlos Grien Macedo *Goldman Sachs Group Inc., Research Division - VP***

A couple of questions. First, just specifically change that could -- the presentation given the new rule for recoveries is now blended into your provision expense line. Could you just let us know what the level of recoveries was for the quarter? And whether you would plan on disclosing that going forward, given there is some volatility in that line? Second, loan growth bounced up a little bit. On the consumer side, you're still outpacing the market by a wide margin and also the same thing for mortgages. Given -- I know asset quality is pretty good, but we have some uncertainty coming up with the election and all that. Do you -- is this a level you're comfortable with? Is this something that you expect will continue going forward? Is there no room for you to cut that back? How should we think about that?

#### **José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO***

I will start from the second one. Yes, we're outpacing the market. We think that is because our factory is perfectly aligned, and we are aiming to the right customers and the right clients. So we expect it will be continued, the answer is yes. We don't see any substantial change. We don't see that we need to change our strategy. So we expect it to continue during the elections and after the elections. The answer is yes. I'm going to the first question, the level of recoveries of the quarter, maybe Rafael Arana can help us a little bit?

#### **Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO & CFO***

Yes. Carlos, thank you. The number that you should expect on a quarter-to-quarter basis is to -- from MXN 400 million to MXN 600 million per quarter on the line of recovery that we -- now we're moving into the provision line -- into recovery of that provision line. That's the number that you should expect that is -- I would say, the current -- the recurring number that we get on a quarter-to-quarter on this line.

#### **Carlos Grien Macedo *Goldman Sachs Group Inc., Research Division - VP***

Rafael, do you plan to disclose that number on a quarterly basis?

#### **Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO & CFO***

Yes. It is in the -- it's already disclosed and we will be happy to be more precise on the disclosure, but it's already fully disclosed on the quarterly release.

#### **Úrsula Margarete Wilhelm Nieto *Grupo Financiero Banorte, S.A.B. de C.V. - Executive Director of IR***

If you -- Carlos, this is Ursula. If you -- at the end of the MD&A, there is an accounting section where we usually put information that is relevant, if there were any changes to accounting. On Page 61 of the report, you can find exactly the information that you are asking for. And as Rafael mentioned, on a quarterly basis, around -- between MXN 400 million and MXN 600 million that we used to book as income are related to either provision releases or recoveries of loans that were charged off in the past. And those are now moving into the -- will be reconciled in the reserve account. And -- so this is basically the number and this is the change. Also, all of the 2017 numbers were reclassified, so that every quarter for 2018 you will be comparing apples to apples, okay?

#### **Domingos De Toledo Piza Falavina *JP Morgan Chase & Co, Research Division - Head of Latin America Financials***

Let me ask you a question. If I understood right, the MXN 3 billion growth on premium is predominantly driven by mortgage? And I guess, a follow-up is on the technical reserve, there was a benefit from some of the claims you had provisioned in previous quarters that you're now receiving the reinsurance, and therefore, that drove sort of the profitability higher or no?

#### **José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO***

No. Actually, let me tell you something. We have a very nice growth in the mortgage segment. It was 17% growth. But actually, that's not the main explanation of the growth in the premiums. We also underwrite very large accounts. For instance, we -- in an auction, we were

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granted the life policy of the federal government, and that represents a fortune, MXN 1 billion in pesos, which I would say that's most important. We also -- in the car insurance, we also have a very large policy from PEMEX. And those are big accounts, but would not -- with nice margins, but not as large. So you will see there that we have very large premiums because -- mainly because of these accounts. But I should say that we are doing okay in the other lines of businesses as well. Now with respect to the technical research and what we recovered for the -- from the insurers, actually this is something that -- this is almost -- for the big accounts, we almost do not retain any risk. So whatever we receive from the insurance, we pass it through to our customers.

### **Domingos De Toledo Piza Falavina JP Morgan Chase & Co, Research Division - Head of Latin America Financials**

Okay. And these bigger policies like PEMEX and others, that should be engineering risk, the very large policy, I would expect you to pass it onto reinsurance though, right?

### **José Marcos Ramirez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO**

Can you repeat again, I cannot hear you very well.

### **Domingos De Toledo Piza Falavina JP Morgan Chase & Co, Research Division - Head of Latin America Financials**

Okay, we'll do follow-ups, because the technical, if it is a large policy, you shouldn't have a result growing that much. But -- we'll take it off-line.

### **Operator**

(Operator Instructions)

### **José Marcos Ramirez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO**

We will happily do that and follow up on that. I think it's very -- it's explained on Page 24, but would be happy to go with Fernando and yourself and with anyone that wants to go deeper into this. But it's really an extremely good performance of the business. And the combined ratios improved a lot. So all the key numbers are moving in the right direction. We expect the company -- the insurance company to be around 26% growth of the near income for the year. So it's a very solid business.

### **Operator**

(Operator Instructions) We'll take our next question from Eduardo Rosman with BTG.

### **Eduardo Rosman Banco BTG Pactual S.A., Research Division - Analyst**

So 2 questions here. The first one on your nonbanking results. They represented like almost 30% of the bottom line this quarter. Just wanted to understand how you see these businesses evolve? And how relevant they can be in the future? Just trying to get a sense on how much can come from banking and some nonbanking? Just sort of like (inaudible) in Brazil, they have roughly 30% coming just for insurance. So it would be interesting to see how much you think you can add in extra revenues from these other businesses? And the second question is on your guidance. The midpoint of your guidance range for net income indicates growth of 17% in the first quarter, delivered more than 20%. Your guidance also doesn't include Interacciones, which I assume will also be part of the results. So just wanted to know if you believe that this guidance for net income has upside risks?

### **José Marcos Ramirez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO**

Thank you, Eduardo. A great one. We're aiming that in the whole pie, 52% is going to be the bank and around -- a percentage is going to be other businesses. We're growing everything, but the pace of the other businesses is growing very fast. So we are very happy that we are going to that mix that we expected to grow that -- growing the pie and growing everything, no? And the second one, just our guidance, also includes the (inaudible) financial interaction. It's as soon as we will achieve the gift from the government next quarter, you will see that we will add up the Interacciones group. But it's going to be, obviously, the way I see it, 1 plus 1 equals to 3, no? So we will discuss that in the next quarter as soon as we have the yes from the authorities.

### **Unidentified Company Representative**

And remember that we never include the Interacciones on the, on our goal to reach the 2020. So that's completely out of the program. So the 2020 should be obtained without the Interacciones group. Okay?

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### Operator

We'll take our next question from Jorg Friedemann with Citi.

#### **Jorg Friedemann *Citigroup Inc, Research Division - Director***

Just like to have bit more color, if you could, I know that it's always difficult. But trading income had a very great start of the year. You provide very interesting detail on the results on Page 73, and we can see that most of these results this quarter were built on results from purchase and sale of FX. So just like to know if you could provide a bit more color about your expectations for this line throughout the year given that we could see a lot of volatility in light of elections? So that's it on my end.

#### **José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO***

We are not changing the guidance. I will tell you the number as soon as I've had a view of how much I was trying to get each quarter. The name of the game from us in the inter (inaudible) from clients, going to -- with clients and not cheap. We are aiming per month, that is -- it should be like 600 per quarter, around that, to 600, 300 per quarter, and then we don't think that it is going to be moved too much, no? Obviously, it's very volatile, but that's what -- that we are aiming and we are not changing the guidance, no?

#### **Jorg Friedemann *Citigroup Inc, Research Division - Director***

Okay. Perfect. And if I just could come back to previous questions about net interest margin. I understand that you discussed and continue guiding for 20 to 30 basis points of an interest margin expansion this year. But actually, the first quarter number already shows a significant increase that would put you in a trend above this range of 20 to 30 basis points. I also understand that there is particularly strong fears coming from insurance. But should expect the deacceleration -- would be reasonable to see a deceleration for you to converge to this 20 to 30 basis points going forward? Or do you believe that, maybe, you could sustain these levels for at least one more quarter?

#### **José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO***

I think you should be looking at a 20 to 30. Remember that I mentioned that we are running on the cost of funds. We should be running the cost of funds at this point in time around 280 of the reference rate. We are running at 3.1. And that difference is basically because we are loading the -- on the time deposit base to form the Interacciones integration. So that's the reason that we're really staying with the 20 to 30 basis points on the (inaudible) expansion.

### Operator

Now take our next question from Marcelo Telles with Crédit Suisse.

#### **Marcelo Fedato A. Telles *Crédit Suisse AG, Research Division - MD of the Latin American Equity Research and Head of the Latin American Financials Sector***

I have a couple of questions. The first one is a follow up on your 2020 guidance. What has been, let's say working better than what you've been anticipating in that plan? And where do you think things are kind of below what would expect? I ask that because, I mean, we've seen insurance growing very strongly. It seems like if you compare it to the banking business, aside from the seasonality, it seems the NII was a little bit on the weaker side. Are you seeing a different composition of results down the road? And my second question is with regards to the IBM project, can you just remind us what is left to be done from, let's say a CRN perspective or any strategy implementation? Or also updating systems that you still have to do down the road to continue to improve your ROE further?

#### **José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO***

Let me -- first, going to the 2020 is better than we expected -- before, there are (inaudible) to the numbers. I would like to point out that the -- many are surprised that we want to give and maybe what's working better is that we are working as -- the company is not seen as a -- by parts, no I am responsible for this part or the other part. Everybody is responsible for everything. And we move from one piece to the other. And everybody is welcome to move and to talk about the other. So everybody's working in the same direction, with the same objectives. And that's, in my point of view, that's why we surprise each quarter, and we will -- the best is still yet to come, in my point of view. Because we have a lot of work to do independent of how volatile the market could be and all this. And you will see a lot of results in the future. And that is -- the second on the IBM project. We have the foundations. Everything now is solid to down. But we need to connect everything and we still have a lot of things to do, no? At the beginning, a lot of -- a few years ago, you only -- the customer only

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went to the branches, and now they go to the mobile, they go to the call centers, they go to the ATMs, they go to a, how do you call it? The correspondent agencies. So we are still very young on that. And we still have a lot of things to do, but now that we have foundations, now it's easy to work and to explain what's next. So you will hear from us a lot, talking about connecting all the clients and the client in the middle of everything. And the new bank in the future, how it's going to develop, no? Sorry if I am not talking about numbers, I'm talking about our ideas. But that's my major concern, and it seems that it's going in the right direction, and now we can explain it and now you will see the results because it's easier when you see the results. So that there is a lot of things to be done. There is a lot of room for improvement. And Mexico is huge, in terms of what we can do. So that's why we are very optimistic for 2020 and further. And that's why everything is working, on my point of view, about the expectations, no? I don't know if, Rafael you want to say some numbers here, but maybe ...

### **Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO & CFO***

I think what Michael's mentioned is the key element about the integration of the management team. As you know, there was no -- this point used to be just a product bank and a distribution bank. And then this segment came along 3 years ago, there were initially a lot of fights on the things because it's not easy to incorporate the owner of the client, as we mentioned. But now the distribution guys, the product guys and the segment guys are perfectly aligned on that process. The metrics are perfectly aligned to each other. So there's no messing around -- without the customer experience piece that was also developed very strongly 2 years ago, now is bearing fruit, that everything that goes into the bank has to be approved and tested by the customer experience team, that we now have feedback online with the clients, in every one of our branches' ATMs, to know exactly how they feel about the service and immediately to feedback the pressure points to our network and to the channels. So as Marcus mentioned, a lot of room to improve. If you look at every single one of the metrics, the ROE, the ROA, the NIM, the customer, the products for client, the efficiency numbers, it's really the result of this full integration about the goals of the institution instead of the goals of the segment or the product or the distribution guys. So this is working. As Marcus mentioned, still a lot of room to grow. We are testing a lot of things in the IBM. Artificial intelligence is being tested in the call center, to be fully operational in the next 2 months. A new digital bank is on the way. And we want to be fully in place for the next -- April of next year. The mobile -- the new application of the mobile is coming strongly and in the right --

(technical difficulty)

### **Operator**

We'll now take our next question from Arturo Langa with Itau BBA.

### **Arturo Langa *Itaú Corretora de Valores S.A., Research Division - Research Analyst***

I was wondering if there were any updates, or if you can share any of your opinions regarding the dividend policy going forward, considering the ROE you guys are posting, and the capital ratios you currently have, there might be some room to optimize the capital structure of the banks. I was wondering if you had any ideas in mind, with respect to that.

### **Operator**

(foreign language) Hello? Please stand by.

(technical difficulty)

### **José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO***

Hello, sorry for the disconnection. Are you there?

### **Operator**

Yes, we are.

### **Úrsula Margarete Wilhelm Nieto *Grupo Financiero Banorte, S.A.B. de C.V. - Executive Director of IR***

Kathy are we back in the line?

### **Operator**

Yes you are. You are free to speak.

**José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO***

I don't know much -- where we stay, I don't know -- I was moving into the IBM. I don't know if that was the last part that you heard?

**Úrsula Margarete Wilhelm Nieto *Grupo Financiero Banorte, S.A.B. de C.V. - Executive Director of IR***

Okay, Kathy, are there any more questions?

**Operator**

Yes. Arturo, you may ask your question again.

**Arturo Langa Itaú Corretora de Valores S.A., Research Division - Research Analyst**

Yes, I think I got disconnected during my question, but thank you for taking it. I was going to ask regarding dividend policy. If there are any ideas you guys have in mind in terms of making the capital base more efficient. In my opinion, I think with the ROE you guys are posting, and what we have forecasted for the future, there might be some room to continue to optimize the balance sheet. So I was wondering if there're any ideas you guys are thinking about that.

**José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO***

Okay. Thank you, Arturo. As you know, it's a never-ending story. I'm talking about what are we going to do with -- the idea is to make it more efficient. We don't have a specific movement right now. As soon as we have it, we will tell you. But we are really eager to do it better than we can and to employ the (inaudible) something. Go ahead, Ursula.

**Úrsula Margarete Wilhelm Nieto *Grupo Financiero Banorte, S.A.B. de C.V. - Executive Director of IR***

This year the dividend payout remains unchanged at 40%. We should expect to pay dividends before the end of the first half of the year, in June. Then remember that, once we do the integration with Interacciones, our regulatory capital ratios will be affected by, we have estimated around 100 basis points for a Tier 1 capital ratio, because remember that Interacciones will be merged with basically no equity because part of the transaction price will be the dividend that we'll be paying from Interacciones in cash for -- part of the transaction will be coming from the capital reduction of the Interacciones bank. So this year, we do not have any, let's say, additional movements for the capital because we have to build up capital again for -- after Interacciones is merged. Remember that the management commitment for the Tier 1 capital is to not be below 12%. So we have to rebuild that. So maybe next year we could have some extraordinary dividends. But this is something that we will communicate in due time.

**Operator**

(Operator Instructions) We'll now take our next question from Carlos Gomez with HSBC.

**Carlos Gomez-Lopez HSBC, Research Division - Senior Analyst, Latin America Financials**

Two brief questions. One, if we could revisit once more, the insurance business. You mentioned 26% earnings growth for the year. I guess we want to know what the run rate of the insurance business, I mean given that your new level of activity should be for each quarter. And would -- we should expect volatility going forward, or it might be more stable, this was a one-off? And my second question is more general. How are you seeing loan demand? By now -- we are almost in May, have you seen any either reduction in economic activity or pick up as the year goes on?

**Úrsula Margarete Wilhelm Nieto *Grupo Financiero Banorte, S.A.B. de C.V. - Executive Director of IR***

If anything, in insurance, Carlos -- and I will let Fernando talk about it further, but remember that since the implementation of Solvency II in 2016, we've had the assisted pattern in the insurance, quarters where the first quarter is the strongest quarter in terms of premium volume and net profit because of the renewals that take place in that quarter. So you should expect, as we have seen in the last 2 years, that the second quarter, the insurance number is much lower, both in terms of premium growth and in terms of net profit. Because of this, the seasonality in the accounting of the policy renewals, no? So yes, this is the strongest quarter of the year for insurance. We should continue to see good numbers moving forward, but not as strong as what we saw in this quarter. And therefore, you should expect that in the second quarter, the net interest margin that we reported today for the group at 5.6% might be lower because of less premium growth in insurance. Fernando, would you like to add something?

**Fernando Solís Soberón *Grupo Financiero Banorte, S.A.B. de C.V. - Md of Long Term Savings & General Director of Long Term Savings***

No. I think that you mentioned that quite nicely. I would just say that for the long term, the insurance company will keep growing as long as the -- nearly as long as the mortgage and the car loans to grow in at nice rates. We do foresee a nice future there, and also, remember that one of the products that we would like to cross-sell more to both firms and families is insurance. So I think we will keep growing nicely. But definitely, I think the growth rate will not be as large as what's been seen this quarter. That's certainly the case. And I would say, I mean, my guidance I will not change it. I mean, Rafael mentioned 26%. But I would say, on a more conservative basis, that it will be somewhere between 20% to 26%. But say, it's still premature to tell because, in the near future, we have to be very careful. And I mean -- how the loss ratio is still behaving in some lines of businesses. Also we will see some increases in the cost of insurance and we will not know yet, or we do know yet how much of that is increasing the cost, which we do not know yet because it depends on the moment in which we sell an account, and how much it will cost us to insure, whether that will affect our margins or not. So I'd rather be more conservative. That's why I would like to say my guidance as of today, it's somewhere to end of year for 20% to 26%. And perhaps going back to our previous question, but that I -- I'm not quite sure I understood it quite well, but -- because I couldn't hear it very well, but some of the technical we said that we'd put in place, of course. Some of those technical research will be paid as claims come through. That's part of the business. So again, it will be somewhere between 20% to 26%, I would say, the guidance for this year. And for the long term, I mean as long as the group keeps growing, as long as we cross-sell more, definitely, we have -- we will keep growing. I mean, I do see that.

**Carlos Gomez-Lopez *HSBC, Research Division - Senior Analyst, Latin America Financials***

And regarding economic activity and loan growth for the rest of the year?

**José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO***

Gabriel Casillas is going to help us a little bit in the economy.

**Unidentified Company Representative**

The loan growth, you will continue to see a reasonable growth on the consumer. Commercial and corporate, we are staying the course. So to reach the 8% to 9% loan growth overall for the group, we see that very feasible for us.

**Gabriel Casillas Olvera *Grupo Financiero Banorte, S.A.B. de C.V. - Deputy Director General of Economic Analysis***

Hi, this is Gabriel Casillas, chief economist. Thanks Carlos, for the question. Chief economic activity, as Marcos had already mentioned that, employment has been doing pretty well, as well as real wages. Just want to highlight a couple of things. For this year, on the economic research team, we're expecting GDP to grow 2.5%. We're one of the most optimistic. We have been quite optimistic in the past year for this year. And actually, there are the 3 major reasons: Number 1 is that your global growth is biggest, and as you have heard from the IMF, it's synchronized, and that's good for an open economy like Mexico. Number 2, we are expecting oil outputs to be -- growth around 0, meaning that the oil platform will be stabilized after many years of decline. So that's very important -- actually, just to mention this, last year actually oil output took away 40 basis points from GDP growth. So instead of having grown 2% as we did, we could have grown 2.4%. So that's a major thing. Is it -- now the contribution is going to be 0 instead of negative. And number 3, electoral spending provisionally boosts retail sales by -- in July and August. But on a more structural basis, very important here to highlight, unemployment rate is at its lowest from -- since 2006. Formal employment has been growing extremely well. And now finally that inflation is coming off, real wages are increasing once again, and that's also, as you know, a major thing. So in this context, really growth is doing well and this is also helping loan demand. So we are, continue to be quite optimistic that inflation will continue to converge to something around 4% by year-end, and to the target on 2019. And in terms of growth, just a final comment. We'll have the GDP number for the first quarter of this year in a few days. And it's going to cause a little bit of noise, because it may be little bit low. You will -- might see it at 1.5%, 1.6%. We have to highlight that if you adjust for calendar days, this would mean something around 2.4%, 2.5%, that it's going to be, of course supporting our forecast for the whole year. This has to do with Easter. Easter last year took place in April, and this year it took place in March. So in this context, this famous holy week effect takes away a couple of points from GD. But other than that, we are very optimistic on growth.

**Operator**

(Operator Instructions) We'll take our next question from Jason Mollin with Deutsche Bank.

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### **Jason Barrett Mollin *Scotiabank Global Banking and Markets, Research Division - MD of LatAm Financial Services***

Just a follow-up question on the evolution of the shareholder's equity account. We saw a loss in the valuation of the mark-to-market securities this quarter. We did see a big gain on the hedging, I guess, that offset part of that. But if you can tell us what kind of securities are in that portfolio? And are you expecting to maintain that size going forward?

### **Úrsula Margarete Wilhelm Nieto *Grupo Financiero Banorte, S.A.B. de C.V. - Executive Director of IR***

Basically, Jason, the loss was related to the FX rate. Yes, they will have investment in UMS in dollars, and the FX in the quarter was the one that produced the evaluation loss. But as you mentioned yes, it is still offset by the hedging securities, which had the contrary effect, because of the hedging fees, the FX, it came in -- the result came in on the positive side.

### **Operator**

And it appears there are no further questions at this time. I'd like to turn the conference back to your host for any additional or closing remarks.

### **José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO***

Thank you very much, to all of you. Have a nice Friday, and see you in 3 months, I hope. Thank you.

### **Operator**

That concludes the presentation. Thank you for your participation. You may now disconnect.

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