

Company Name: Banorte
Company Ticker: GFNORTEO M
Date: 2019-04-30
Event Description: Q1 2019 Earnings Call

Market Cap: 338,863.82
Current PX: 117.52
YTD Change(\$): +21.74
YTD Change(%): +22.698

Bloomberg Estimates - EPS
Current Quarter: 3.131
Current Year: 12.630
Bloomberg Estimates - Sales
Current Quarter: 26377.667
Current Year: 103076.600

Q1 2019 Earnings Call

Company Participants

- Ursula Wilhelm, 'Head of IR and Financial Intelligence'
- Jose Marcos Ramirez Miguel, 'CEO & Proprietary Board Member'
- Rafael Victorio Arana de la Garza, 'COO CFO and General Director of Operations Administration & Finance'
- Fernando Solis Soberon, 'Managing Director'

Other Participants

- Ernesto Gabilondo
- Mario Lucio Pierry
- Jason Barrett Mollin
- Thiago Kapulskis
- Jorg Friedemann
- Carlos Gomez-Lopez
- Enrique Mendoza
- Rui Fernandes

Presentation

Operator

Ladies and gentlemen, good day and welcome to the Banorte First Quarter 2019 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.

Ursula Wilhelm, 'Head of IR and Financial Intelligence'

Thank you, Abby. Good morning everybody. Welcome to Grupo Financiero Banorte's first quarter 2019 results. I'm Ursula Wilhelm, the Head of Investor Relations.

Marcos Ramirez, our Chief Executive Officer will lead the presentation, and at the end we will take your comments. Thank you. Marcos, please go ahead.

Jose Marcos Ramirez Miguel, 'CEO & Proprietary Board Member'

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. So despite a more cautious business environment and the beginning of the new government administration, the quarter evolved like favorably, as you can see in the strong performance in our core businesses.

Moving in full to the results, let's go to slide 3 please where reported net income for the period reached MXN9.9 billion. These results include MXN1.2 billion extraordinary income net of taxes generated from the dissolution of Banorte USA, the INB bank. The recurring net profit for the quarter was plus MXN8.7 billion, 2% above the recurring

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result in the fourth quarter and 29% higher than year ago. Recurring return on equity declined 20 basis points from the last quarter to 19.9% while return on assets expanded 10 basis points to 2.2%.

Moving to revenues on the slide 4. You will see that they grew 2% in the quarter to total MXN25.4 billion, supported by strong growth in net interest income, adequate growth in fees and good results in trading income. Net interest income grew 6% in the quarter, aided by the MXN3.4 billion from Insurance and Annuities Co The net interest margin of the Group reached 5.7%, 32 basis points above the prior quarter reflecting the strong seasonal quarter of the insurance businesses. The NIM of the bank was 6.2%, declining 10 basis points in the period, mainly on the effect of the incorporation of the Interacciones assets on the funding costs, but it increased 20 basis points versus last year.

Overall we are still forecasting the NIM expansion between 10 basis points and 15 basis points for this year. On fees from services, they totaled MXN2.9 billion below the fourth quarter. This is explained for less transactional activity of the beginning of the year and seasonal higher insurance acquisition fees that explain the softer progress. Trading revenues posted a good MXN1.1 billion in the quarter, slightly lower than the fourth quarter results when we reported several transactions with customers that were not repeated in this period.

Moving now to slide 5 please where you can see that expenses remain flat in the quarter while increasing 9% versus last year, in line with our forecast. This includes MXN300 million related to Interacciones and MXN86 million of rents related to the sale and leaseback operation of last quarter. Both the items, while now they are part of the recurring expenses, were not present in the first quarter of last year. The minor growth in expenses is part of the business as usual and comparable to last year.

The recurring efficiency ratio continue its positive downward trend to reach a low 39.4% on the back of positive operating leverage. Now changing topic to credit and asset quality in slides 6 and 7. Overall, the loan book slowed down 2% to end the first quarter, mainly driven by the decline in the balance of government loans as we have anticipated. Mortgages and auto loans grew 2% and 3% sequentially.

The slowdown in the loan portfolio shows our commitment to prioritize quality over growth as we are managing the business being very selective where we want to expand. Despite the soft increase during this period, we remain committed to achieve the loan growth guidance to -- 7% to 9% for this year. And this is not including Interacciones. The quality of the overall portfolio is stable and the NPL ratio remained at 1.7%, unchanged versus the prior period.

The cost of risk result was low at 1.9% and reflected the combination of stable performance, particularly in the consumer portfolios as well as lower growth in the overall credit book. Moving to slide 8, and changing subject, I want to comment on the performance of our long term savings businesses. The insurance operations posted a strong quarter despite the tougher environment, especially in the business related to federal government entities. Overall, retained premiums grew 2% over the last year, reaching MXN9.7 billion.

Technical reserves increased in tandem with renewals while claims were down 11% in the quarter. Insurance earnings reached MXN1.6 billion, 20% above last year. The annuities company achieved net income of MXN272 million on group on the write-in activity. Afore added MXN408 million in profits to the group, 84% higher than the prior quarter on the positive impact of the higher interest rates on its invested capital.

Overall, the long term savings segment contributed with MXN2.3 billion in net profit or 23% of the consolidated net profit of the financial group. With this, I conclude my comments on the quarterly results. We are encouraged by them and believe to be on the right track to deliver on we have all set for this year. Now moving to another topic.

I want to comment briefly on the issue about banking fee. We are pleased with the commercialization of the banking fees and the central bank, involving the government and the senate of this model. We understand and share their sight to increase financial penetration and agree that in order to achieve this goal, the banking services need to reach the low income population. At Banorte, we're engaged in the development of the digital payments platform to service this segment.

We also have banking products with lower or no fees at all available to this segment. We are working to be more transparent to our customers on the cost of transactions and services. Like the government, we believe that competition

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will be the main force to set prices. Switching gears to the economy, it has had good performance in the quarter despite a slowdown in investment.

We are also seeing that the private sector is slowly regaining confidence and coming back to business as usual mode. Inflation is moderating and it's driving economists to predict a potential rate cut by the central bank later in this year. Thank you for listening. With this, I conclude my remarks.

We are pleased to take your questions. Operator, we are ready to take the first question please. (Question And Answer)

Operator

Thank you. (Operator Instructions).

And we will take our first question from Ernesto Gabilondo with Bank of America Merrill Lynch.

Ernesto Gabilondo

Hi good morning Marcos, Rafael and all your team and thanks for the opportunity. My question is on your plans to distribute the social programs to the low income segment of the population, and implementation of CoDi. We have seen many participants that are interested to develop this new ecosystem of digital payment such as Amazon, Mercado Libre, Wal-Mart, fintechs and some private banks.

We have seen that BBVA is already testing CoDi in the streets. So Banorte being the second largest group in Mexico, it will be interesting to know your feelings and expectations to develop the digital payments and what will be the strategy to differentiate from competition? Also if you can add your strategy in biometrics to develop the market, will be much appreciated. Thank you.

Jose Marcos Ramirez Miguel, 'CEO & Proprietary Board Member'

Thank you, Ernesto.

That's a big question. All these of the social programs, the digital payments and biometrics, Rafael is going to help us with this. Thank you.

Operator

We will take our next question from Mario Pierry with Bank of America.

Rafael Victorio Arana de la Garza, 'COO CFO and General Director of Operations Administration & Finance'

No. Hello? Can you hear me, Ernesto? Well, I will continue to the digital payment. We have been investing heavy in the past three to four years on the digital platforms and we have been able to create an aggregating platform on top of all our architecture in the IT that we have now the first -- in being able to really integrate the big players like the Amazons, the PayPals and every -- all these players, plus a bunch of other aggregators on this layer, and we are -- around 50% of all the transaction that we acquire from the acquiring business are now fully digital. So that will continue to advance and in -- so you will continue to see a more evolution on that part.

So our platform allow us to really plug in any of the aggregators that we would like to aggregate to our platform. In the CoDi piece, we have been also quite active with the central bank. We are ready to start a pilot for the CoDi. We see that

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as a big evolution in order to favor the inclusion of the low income on the mass -- especially on the mass retail piece, especially the small stores and things like that, and a big push in order to eliminate cash from the system.

So I think that we have been quite successful in building up our very strong merchant and acquiring business. So we will continue to do so in this new CoDi platform so we are fully and ready to start pilot in this. That will require a specific distribution capability that I think with the sales force that the retail organization has -- I think we will be able to compete quite successfully in this piece. On the third question that you say -- and just to remind you, we have already a debit card with Amazon, fully digital in this piece.

So we are easy to integrate with the players that we would like to integrate. On the biometrics piece, now we are fully deploy all the biometrics in our branches. At this point on time, since this has been ongoing for the last month and a half, 84 of all the transaction now have been -- now are fully identified biometrics and we will continue to evolve to reach the 100% in biometrics. That will continue to evolve more and more into fully capability to do onboarding on a remote basis, based upon these biometric base that we are building up.

So we are quite advanced on these and quite happy with the results of this month and a half that we have been testing this.

Ernesto Gabilondo

Thank you very much Rafa.

Rafael Victorio Arana de la Garza, 'COO CFO and General Director of Operations Administration & Finance'

Thank you.

Operator

And we will take our next question from Mario Pierry with Bank of America.

Mario Lucio Pierry

Yes good morning everybody. Let me ask you two questions related to, first, your fee income generation, which appeared to be a bit on the weak side, especially account management fees. If you can give us some more color on why that's only growing single digits. And then second question is on the operating expenses.

You are showing very solid cost control here. Just wondering if you have already achieved all of the cost synergies that you are expecting from Interacciones or if there's more to go? Thank you.

Rafael Victorio Arana de la Garza, 'COO CFO and General Director of Operations Administration & Finance'

Yeah, on the fee base, Mario, as you know the fourth quarter is always a very active quarter on fee base. Now I think that if you look at the net service fees, we are around 14%, right on target.

What we advised the market to be around 12%. So no, I think the activity continues to be strong. We don't see any weaknesses at all in the fee base. If you see our guidance is right -- even a little above our guidance in this spot.

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On the OpEx side, there have been some concerns about, and let me just guide you through the numbers. As you know, the Interacciones operational expenses was MXN3.2 billion. Now that number has dropped to MXN1.2 billion. That's going to be the recurrent expense line.

If you see on the expense growth compared to one year to the other, as Marcos mentioned, is MXN300 million more. And on the rents, that was related to the lease and sales back, you're looking at MXN80 million per quarter. So is there a possibility to continue to reduce some expenses? I think so, and we are committed to continue to see some synergies coming down from the -- not just for the Interacciones integration, but for many automation processes that we are delivering at the bank. So if you strip out those two numbers that I just mentioned, the MXN1.2 billion and the MXN300 million, we are right on track with what we see, 6% recurrent expense growth without Interacciones and rents that are really inflations plus 150 basis points.

That is really where we would like to be.

Mario Lucio Pierry

Okay, okay. How about if I just go back on the fees?. What I meant here is when I look at basic banking service fees, you only show growth of 8% year on year and when I look at account management fees, that actually contracted 2%, and I'm also talking about year on year.

So I was wondering if there was anything specific in those -- especially in account management fees.

Rafael Victorio Arana de la Garza, 'COO CFO and General Director of Operations Administration & Finance'

No, no, I think you will continue to see the evolution as the other quarters and the next quarter and the third quarter. Especially after the third quarter, a big pickup on the fee. No, we haven't seen anything different from that.

What you also have to remember is that we changed the value add into a value proposition instead of a number of accounts in order to increase the minimum balance that we accept from the clients to be able to open an account with us. So in a way that could we see a less number of accounts, but in -- if you'd see the growth, like for instance in time deposits, it's around 16%, and this related more to this type of a more valued client that we're attracting to the bank.

Mario Lucio Pierry

Okay, thank you.

Operator

We will take our next question from Jason Mollin with Scotiabank.

Jason Barrett Mollin

Yes, hi, thank you My question is on the strategic plan and you were talking for the last years about 20% ROE by 2020, and we're already there in 2019. Can you talk about the outlook and drivers for return on equity going forward? Is it -- are you highly dependent on interest rates? Should that -- if we see, if we expect and what is your expectation for rates? If they come down would that put pressure on returns? How should we think about the drivers? Is it volume growth? Is it efficiency? How should we think about the long term ROE for Banorte from here on?

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Rafael Victorio Arana de la Garza, 'COO CFO and General Director of Operations Administration & Finance'

Jason, thank you for the question. I think this is a quite important question. As you say, we are already 19.9% on recurrent basis for the group, well above for the bank on return on equity around 24.5%.

What we have been building up at the bank is it's really a platform that allow us to keep reaching more to our own client base and increase the value proposition for our clients in order for them to keep all the businesses with us, and keep on reaching more and more value. And at the same time reducing the acquisition cost that you need to have when you are building a franchise. The franchise of the bank and the group is -- you are looking at a franchise around 19 million clients when you integrate the pension company and the bank. So all the efforts in order to keep evolving the ROE will be based upon being the preferred bank for our clients based upon a very efficient distribution platform.

And the most important piece is really coming around July. That is when we're going to be able to really personalize the value offered for each of our clients. We see that as a big push in order to keep reaching into our client base and increasing the number of products and relations that they have with us. That will continue to push the return on equity high because basically what we will be doing is increasing the value of all the already existing clients that we don't have to pay high acquisition costs for them to bring it -- brought into the bank.

So that's -- I think that you will see continue to expand their return on equity. Yes. And if you also look at the structure of the capital base, that grew 20% on last year and we've been able to keep on building capital at a very fast pace. And at the same time, we are not leveraging the bank at all.

If you look at the leverage numbers of the bank are at really almost no leverage at all. So basically will be the deep penetration that we can achieve with our client base based upon all the things that we have been building up and extremely good attraction capabilities that the network and the retail platforms and the corporate and commercial has with our clients. More and more is becoming very familiar for the banking personnel at Banorte to be center in what exactly the value proposition for each of the clients should be that will continue to keep the ROE up. On the interest rates, I think the treasury and risk and the accounting team has been doing an extremely good job in reducing the exposure of the balance sheet in the -- in -- when the interest rates is starting to come down.

We hope they can come down soon. And we have been calculating their sensitivity now that we have completely changed a lot of the structure of the balance sheet. And you are looking in a worst case scenario for 100 basis points around MXN393 million of sensitivity if the interest rates drop 100 basis points. That's the worst case scenario, but at the same time, you have to remember that we have a big chunk of assets that came from Interacciones at around 110 billion of assets that are being everyday funded at a lower cost and a lower costs, and that's a natural protection also for the reduction on rates.

So we are very comfortable with the potential reduction on rates. The sensitivity of the balance sheet completely changed from 1.2 billion that was a year and a half ago to MXN380 million. That is currently the sensitivity that we have.

Jose Marcos Ramirez Miguel, 'CEO & Proprietary Board Member'

Thank you, Jason.

Also this is Marcos Ramirez. We still have, as you can see, a lot of room for improvement. So it's achievable, the ROE for 20%. Not this year, the next year, the answer is yes.

And next year, one year from now, we will launch the next program from the 2020 showing that we still have a life after 2020, and you will see a lot of numbers there, and the idea is to continue with a ROE of 20%. And the last thing is remember that we have the outcome and we have a dynamic hedge there and the idea is to know where the rates are going. But then, after that, we can hedge and we can work on with that issue also, so we feel pretty comfortable for

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now and we are -- we feel pretty comfortable with the future. And as I was saying, next year you will see the next movement of the bank for the next year.

So thank you Jason.

Jason Barrett Mollin

Maybe just a follow up on that. How -- I mean, there is a material change in the sensitivity of the balance sheet to rates going from -- over MXN1 billion per 100 basis points. I'm imagining that's all else equal versus MXN380 million.

Was this done with hedging? Or is this -- how are you managing that exposure?

Rafael Victorio Arana de la Garza, 'COO CFO and General Director of Operations Administration & Finance'

Yes, I can. It's dynamic, as Marcos mentioned. And if you look at three years ago, the fixed cost -- the fixed rate on the balance sheet was around MXN170 billion. Now that number jumped to MXN180 billion.

That is basically the mortgage and the car loans and some of the fixed rate loans. Those loans were really -- the cost of covering those loans were around 8.5% of the -- to all that hedging. That cost has been going down to 3.5%. Three years ago the margin that you were getting on this hedging process on the balance sheet was around 9.2%.

Now that went down to 7.2%, but with this improvement in the hedging process from 8% to 3.5%, because we see a natural evolution of the rates to go down and the natural coverage or the stickiness of the deposit base allow us to do this. You see that the 7.2% that is now the margin on this part of the balance sheet will jump to 8.1% and that will allow us to really reduce the sensitivity to the reduction in grades as I mentioned to you before. Happy to send more information and discuss that in detail, but we are very pleased with the way the protection of the balance sheet on the downward trend of the potential rates to not be an issue for achieving the results of the bank. If you ask us what would be the potential ongoing margin for the bank with a scenario of reducing interest rate? We see potential 6% to 6.2% for the bank a sustainable net interest margin.

Jason Barrett Mollin

Thank you very much. Very clear.

Rafael Victorio Arana de la Garza, 'COO CFO and General Director of Operations Administration & Finance'

Thank you.

Operator

We will take our next question from Thiago Kapulskis with BTG Pactual.

Thiago Kapulskis

Good morning everyone. Thanks for the opportunity to make questions. After actually the good results that you had with a high ROE, the non-recurrent actually numbers that you also had and the deceleration in loan growth. I'm just

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wondering how are you guys thinking about the payout.

Could we see an extraordinary dividend this year given that the CET1 ratio in this Q actually expanded 110 bps sequentially? So if you could give some color on this, it would be helpful.

Jose Marcos Ramirez Miguel, 'CEO & Proprietary Board Member'

Thank you, Thiago. Yes, actually, in one hour from now, we will have the assembly and we will ask for increase of the dividend up to 50% of the earnings of the net income. And maybe in the future we can again make a dynamic distribution depending on what's going on.

Thiago Kapulskis

Great. That was very clear. Thank you.

Jose Marcos Ramirez Miguel, 'CEO & Proprietary Board Member'

Thank you.

Operator

(Operator Instructions). We will take our next question from Jorg Friedemann with Citibank.

Jorg Friedemann

Thank you very much for the opportunity to make questions. So just like to understand a bit the evolution of the loan growth, particularly with regards to the government lending portfolio, which contracted -- I know, substantially quarter-over-quarter.

Just wondering if this is because of the -- is low government deployment in the beginning of the -- I know, mid-term? Or it has to do with this strategic direction of the bank itself to be a bit more conservative in this portfolio given the representativeness of the total loan book? Thank you very much.

Jose Marcos Ramirez Miguel, 'CEO & Proprietary Board Member'

I will let Rafael give you the numbers, but it's mainly driven by the competitors. It's tough and we want to keep at what the rates out there and everybody is fighting and I love that. Rafael, give us the numbers please.

Rafael Victorio Arana de la Garza, 'COO CFO and General Director of Operations Administration & Finance'

Yes, I think as we mentioned on the guidance, we advised the market that we will be reducing the loan growth at the government book. And the reason for that is that we can be very selective on the type of relations and loans that we would like to keep. As Marcos mentioned, there has been also very strong competition from many players now trying to get into the government business because it has been a very secure. And the margins have been going down since the last three years, but we still have a very sizable business that is quite profitable.

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There were some concerns about the margins that we have been achieving from the Interacciones' portfolio and that margin is expanding by the day. The more we increase the retail deposits, the more we increase the margins. So no, it's basically in accordance with our guidance as we set up at the beginning of the year. And also as Marcos says, more competition and in some cases, we are not willing to go at very thin margins to this mark and that we are very comfortable with the size of the portfolio that we have.

So we can be very selective in where we want to play and what relations we want to keep.

Jorg Friedemann

Perfect. Thank you Rafa. Just a follow up there.

I remember that during or right after the announcement of the transaction with Interacciones, that part of the portfolio represent almost 30% of the book. Of course, given this selective that you mentioned, you have been diluting that part of the book to a point that in this quarter it represented 23.3% of the book. So where you see this number going to -- if you could give me some educated guess -- this year and for the coming years?

Rafael Victorio Arana de la Garza, 'COO CFO and General Director of Operations Administration & Finance'

Yes. I think 22% will be, as we mentioned when we did Interacciones deal, because the rate of growth of the consumer continues to be very strong and commercial and corporate, the SMEs also the same.

Just to give you, car loans continue to grow 20%. The mortgage book will continue to grow 13%, 14%. The retail guys are launching an extremely advanced process for the mortgage book, so that will continue to reach maybe 14%, 15% for the year. And the mortgage book, we are very happy with keeping the book at the size that we have.

It's very profitable for us. We will continue to fund that portfolio at a much better cost every single day. So, now, I think we are in the sweet spot that we wanted to have. A very secured portfolio that allow us to have ancillary business on the government side, and continue to expand on the consumer and the commercial and the corporate as we have been doing in the past.

Jorg Friedemann

Perfect. Thank you very much. Thank you.

Operator

We will take our next question from Carlos Gomez with HSBC.

Carlos Gomez-Lopez

Thank you and good morning. You referred to the negotiation regarding the fee limitations that the Senate introduced. Could you perhaps be bit more concrete and give us an idea about the possible timing and the possible financial impact or the range of financial impacts that you would expect? Second, are you going to making any changes to your Afore business with the expectation that the government wants to bring the fees down from 1% to 0.6% of AUMs. And do you expect that to be accompanied by other changes that do not reduce the profitability of the business? Thank you.

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Jose Marcos Ramirez Miguel, 'CEO & Proprietary Board Member'

Thank you, Carlos.

I will answer the second one, the Afore personally, but we still don't have timings. It's a never ending story with -- so we cannot tell you when it's going to happen. It's something and but -- well let's start with Afore personally [ph] please.

Rafael Victorio Arana de la Garza, 'COO CFO and General Director of Operations Administration & Finance'

Sure.

Thank you Marcos. Well with respect to the Afore business they -- well, several changes have been taken place. To begin with, just as the -- an initiative was approved to provide a more flexible regime -- investment regime and that has a positive view. On the other hand, the authorities are committed to the regulator to some extent the -- their ForEx and that would also -- if it's done properly also diminish the cost.

However, there is an intention to the -- of the regulator to have a formula to determine the -- it will be a factor which we will be able to be taking into consideration. As you know, we have to negotiate the commission's fees every year, but they are introducing a formula in which they want to take into consideration the rate of growth of the assets under management and take that into consideration also to negotiate the commission. So it is too soon to tell how these formula will affect us, because it actually was only presented to us yesterday, we have to go through it, understand it. But what they have been given is that -- what they had been saying is that the average commission, not the commission of Afore whole, the average commission of the system -- it would be able to reduce somewhere to an average of 0.7% or 0.77% depending on how much the assets under management of the whole system had been accumulated.

So that's contingent on how these assets grow. And the target that they are -- well, that's a target because it's not something that necessarily will have to occur by law. It's something that will be taken into consideration in the general negotiations, will hinge very sensitive on how the assets under management will grow. So we have to wait and see the details actually to understand all the effects that will take place.

Certainly and that's a possibility, if what happens after we revise and understand these new guidelines and formulas. If the rate of reduction of the commissions is more aggressive then how it has been, well that will certainly affect everything else the same, the profitability of the business. This will be mitigated on the other hand however if all the other positive changes take place. Another one that was discussed very, very importantly to mention yesterday, with the Secretary of the Treasury, with Sub-Secretary, with the Under-Secretary of Treasury and the other regulators is that they also are committed to actually fix the main problem of the system, which is the lower contributions that we do see.

If they fix that, that will also something that will accommodate more aggressive reductions in the future. So it's hard to tell. I will ask for some time to understand all the changes. There are many other changes taking place as well.

They want to change also the way in which the Afore's invest to take into consideration the replacement rates, in what's been known as target dated funds. So there are so many things going at the same time. I think to be able to determine how these businesses will be affected for good or not, I think we will have to wait and see if all these changes that are going to -- at the same time -- and that I will stop there because I don't have more visibility at this point.

Jose Marcos Ramirez Miguel, 'CEO & Proprietary Board Member'

That was Afore, Carlos and, the banking fees is the same.

The initiative that was put forward a few months ago is as you know, in the Senate. But more importantly, President Lopez Obrador was very clear in the banker's association annual meeting a month ago in Acapulco. You remember that the government will not regulate fees, and that it will allow competition to be one of the -- to put -- to push down the

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 YTD Change(%): +22.698

Bloomberg Estimates - EPS
 Current Quarter: 3.131
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fees. Let's see how it moves.

So far we feel pretty comfortable working with the government as we were saying. Thank you.

Carlos Gomez-Lopez

Thank you so much.

Operator

We will take our next question from Enrique Mendoza with Actinver.

Enrique Mendoza

Hi, good morning to all. Considering the strong growth in profit that you already achieved, could you tell us the net income target of the guidance just only including the recovering profits.

Jose Marcos Ramirez Miguel, 'CEO & Proprietary Board Member'

Rafael, please go ahead.

Rafael Victorio Arana de la Garza, 'COO CFO and General Director of Operations Administration & Finance'

As you see the rate of growth for the -- currently it's around 14%, 15% in net interest margin, and we guided that we could see the net income from 35.8% to 36.8% -- total net income, so that's our guidance to see for the year.

Remember, and this is quite important that every time we see a change in administration, usually the rate of growth for the country -- no growth, no more than 1.4%, not 1.5%. And that's impartially that some people consider our guidance to be a little bit more conservative. As we said it's the same when Mr. Trump took office that we rather be conservative on the guidance at the beginning of the year and if things change through the year, we change the guidance for the best. At this point in time we are keeping our guidance to 35.8% to 36.8% net income.

So I think this is what's considered to be conservative and extremely strong profit growth that you have seen 29% net income growth for year on year on recurring basis. Some -- the ROA continue to expand nicely. ROA, that is a critical measure for us, more even so than the return on equity because I think the ROA really shows the strength of the business continuing to expand. So I think all the numbers are moving in the right direction.

Some people think that the loan growth around 7% to 9% is too low. I think it depends. If you are being able to manage 7% to 9% loan growth and keeping the cost of risk at the levels that we are keeping, its equivalent to have a much more aggressive growth with a poorer cost of risk. So we'd rather be quite conservative on the loan growth -- 7% to 9% and be very, I would say vigilant about the cost of risk that has been achieving quite low numbers, even so the integration of Interacciones is what.

Overall I think we are quite comfortable with the NPLs that are running on the consumer and the NPLs that are on the commercial and the corporate, and obviously on the government book. So this is the numbers that I think is even though some people considered conservative, when you see rate of growth of net income of 29%, I think that is not very conservative.

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Enrique Mendoza

No, no, I absolutely understand and agree with you. Although I have other two questions.

I know that you are trying to restrict to just one question. Therefore, I really wait until the moment that you consider appropriate for those.

Jose Marcos Ramirez Miguel, 'CEO & Proprietary Board Member'

Thank you, Enrique.

Rafael Victorio Arana de la Garza, 'COO CFO and General Director of Operations Administration & Finance'

Thank you, Enrique.

Operator

We will take our next question from Rui Fernandes with JP Morgan.

Rui Fernandes

Thank you gentlemen. Can you provide more color on your insurance business? You had another very good quarter 30% ROE And we know that you have a strong seasonality in the first quarter because of the mortgage products, but it still was a very good quarter. So the question here is just is this sustainable? In particular, the loss ratio, it was very good.

So if you can provide some color on what you have been doing the business of -- the insurance business, it's going to be very helpful. And my second question is regarding just a follow-up on how pricing sensitivity for interest rates. Is that MXN280 million business impact for every 100 bps of rates also including other business? Does that number also include potential negative impact from the insurance business or these numbers could be higher if you put the rates and the impact of the rates in the insurance business as well? Thank you

Jose Marcos Ramirez Miguel, 'CEO & Proprietary Board Member'

Thank you, Rui. The first one that was the insurance, I will ask Fred Solis and the second one.

I remember that this is a dynamic hedge, and yes every community included our machinery. When we see the Alco, we take all the positions there, but Rafa is going to say that after. First, the press release even I talked about the insurance topic.

Fernando Solis Soberon, 'Managing Director'

Sure.

Well the insurance business experienced a good quarter, mainly because the combined ratio has been better. But also it's very important to mention that we diminished our catastrophes exposure and to some extent. And that gave us an extraordinary reduction in a reserve, in the catastrophic reserve more or less of MXN148 million before taxes. So that also benefited on an extraordinary basis the business.

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So I would say that if you take that into account, the rate of growth, instead of being 20% would have been 12.5%, net earnings, so that's very important to mention. So we expect the insurance business to be profitable, but -- and keep growing. But it's very important to mention that part of the growth that was experienced in this quarter with respect to the first one was explained due to this extraordinary effect, and that's something that will not happen in the next quarters. However, we expect to see important contribution, as been always the case for the financial group's results.

Operator

(Operator Instructions) And there are no additional phone questions at this time.

Ursula Wilhelm, 'Head of IR and Financial Intelligence'

Okay.

Jose Marcos Ramirez Miguel, 'CEO & Proprietary Board Member'

Thank you all of you and see you in 3 months from now. Thank you.

Operator

Ladies and gentlemen, this concludes today's call, and we thank you for your participation. You may now disconnect.

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