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Q1 2022 Grupo Financiero Banorte SAB de CV Earnings Call

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## PRESENTATION

**Tomas Lozano Derbez** *Grupo Financiero Banorte, S.A.B. de C.V. - Head of Corporate Development, IR, Financial Intelligence, M&A and Sustainability*

Good morning. I'm Tomas Lozano, Head of Corporate Development, Investor Relations and ESG. Welcome to Grupo Financiero Banorte's first quarter earnings call. Our CEO, Marcos Ramirez, will provide the main macroeconomic highlights of these first months of the year and will walk us through the most relevant results for the group, including the performance of the loan portfolio, positive asset quality, the gradual recovery of the insurance business as well as some of the most relevant additions to our annual report, which was released at the end of March.

I would like to mention that in addition to the 2021 annual report, we also published our first TCFD report on climate-related risks and opportunities, which reiterates our strong commitment to increase disclosure and integrate sustainability into the core of our strategy. After our CEO's presentation, Rafael Arana, our COO and CFO, will provide a quick summary of the main changes in our financial reports from the adoption of the new accounting standards for the banking system in Mexico.

Later on, he will provide details on the main financial results of the group, including sensitivity to rates, improvements on cost control and the main changes to our updated guidance, which raises our net income expectations for the year. We will then proceed with the Q&A session. Please note that today's presentation may include forward-looking statements that are subject to risks and uncertainties, which may cause actual results to differ materially.

Thank you. Marcos, please go ahead.

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**Jose Marcos Ramirez Miguel** *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Thank you, Tomas. Good morning, everyone. Thank you for joining our call. The first quarter of the year started with good overall results for the financial group, despite some evident headwinds in our operating environment. COVID-19 has been gradually receding. However, it is still present in Mexico and unfortunately, worsening in some countries in the world, still presenting a potential disruption in supply chains.

GDP recovery in Mexico has been mild. Our economic analysis teams estimates annual growth of approximately 2% linked to the positive momentum of the U.S. economy, despite disruptions from the war in Ukraine.

Annual inflation has reached 7.5% in March and is expected to gradually decline in the second half of the year, reaching 6.7% by year-end. Therefore, we still anticipate a more restricted monetary policy in the bonds ahead with rates expected to end the year around 8.25%.

On the political front, we will continue to monitor the legislative agenda after the President's electricity bill fail to pass the Lower House last Sunday in addition to local election next June for 6 state governorships.

Moving on to the bank's operation. After postponing our hybrid return to our offices in January due to the Omicron wave, we have -- we're happy to announce that since early March, we have started working in the (inaudible) while still observing strict sanitary protocols for closed spaces and running random COVID tests of the [patients] to ensure the safety and well-being of all our teams.

Before diving into the financial results, I would like to highlight that since January, we have adopted new accounting principles from the local regulator [with aligning] the IFRS standards. In order to facilitate quarterly and annual comparisons, we have restated our 2021 figures throughout these documents as well as our quarterly financial reports later on, Rafa Arana will provide more color on some of the both relevant effects of these changes in our financials.

Looking at our quarterly results. The solid performance of the group is supported by improving NII, strong fee activity, contained expenses, healthy asset quality and a [shielded] balance sheet pointed into the right direction for the remaining of the year. Starting with profitability.

Slide #4, ROE grew more than 200 basis points in the quarter on the back of solid business performance. Nevertheless, it continues to be pressured, but unpaid dividends and insurance results. We will discuss about the dividends in a moment. (inaudible) is slightly trending down in COVID-related claims. However, they are still above pre-pandemic figures.

We are holding our expectation of normalized claims during the second half of the year. As we will see later on, ROE of the bank and affected by these factors is already above 20%, driven by better NII solid asset quality, efficient expenses and growth in fees.

On Slide #5, NII from the loan portfolio increased 2% quarter-over-quarter and is already incorporating most of the effects of reference rate increases up to December of last year. Noninterest income had an outstanding favorable result, driven by higher trading income and the seasonal effect of insurance premium renewals during the first quarter of the year.

One of the most relevant IFRS changes can be seen in insurance premiums, which are now registered under noninterest income and no longer accounted in net interest income line.

Fees, on Slide #6, were slightly lower during the quarter due to the seasonal effect of higher transactionality in the fourth quarter from the holiday season, by looking at monthly results, we are already seeing a relevant recovery during March, both in BOS and mobile transactions.

Compared to last year, increases in core banking fees were driven by higher origination fees in consumer mortgages and commercial portfolios, as a result of better dynamics in economic activity. Mobile adoption has been increasing underpinned by the more powerful and innovative versions of our mobile app, which was recently launched.

Loan growth on Slide #7 shows moderate quarterly expansion in the consumer portfolio, driven by payroll loans. However, there is a good performance in corporate and government portfolios. Compared to last year, the consumer portfolio was a clear growth leader, primarily driven by payroll, credit card and mortgage loans. As for the commercial and corporate books, we see encouraging trends for the rest of the year.

On Slide #8, asset quality continues to perform ahead of our expectations. NPLs remained at 1% in the quarter, with improvements across most of our portfolios. Analyzing the results by subsidiary, Slide #9. The bank continues to expand on the bank consolidated NII,

asset quality and expense control, showing ROE above 20%. The insurance business posted positive results driven by seasonality in policy renewals during the quarter and gradual improvements in claims for the life portfolio. However, results are still below pre-pandemic levels.

The brokerage sector showed solid results due to higher interest income and inflation premiums in asset valuations. For the Annuities business, while there is growth in [revenue] review generation, it was undermined by higher reserves on inflationary adjustments. In the quarter, the Afore business was impacted in 2 fronts. The first one, as you know, increase due to the cap imposed by recent regulatory mandates effective at the beginning of the year.

And the second one, evaluation of financial products on the back of higher rates impacting the ForEx long-term investments. Slide #10, we provide greater detail into the insurance turn business. showing seasonal quarterly in premium origination and consequently, a gradual recovery in net income, which is expected to continue towards second half of the year.

Switching gears to Banorte working culture on Slide 11. In our daily operations, customer experience is permanently at the core of our strategy. We began by listening to our customers' feedback, identified pain points, learned more about their needs and expectations and thus, began transforming processes and experiences. As a result, our NPS score has been increasing across all channels.

Moving on to Slide #12, please. We are aware that there are many questions regarding the status of the sale of Citibanamex assets. And I want to reiterate, we will be analyzing this for any potential transaction, but we want to be very clear about our main focus, which is the accretion for our shareholders.

If we find a price and a structure that is significantly accretive adjusted by the execution risk and the potential loss of value of the franchise, then we will present the proposal to our Board and to our shareholders. I would also like to stress that for any potential transaction, our capital position will not be compromised.

We will maintain our CET1 at a minimum of 11.4%, and we will have a strong commitment to get it back to at least to our corporate threshold of 12% to 12.5% shortly after. On the Slide #13, I would like to reiterate that regardless of this or any other M&A transaction, Banorte has a life on its own with a very clear commitment to continue executing its strong corporate strategy.

The 3 pillars of our digital strategy are leading us to where we want to be and that is to become the best financial group for our clients, our investors and our employees. Shifting gears to ESG on Slide #14. I'm happy to communicate that in late March, we released our most recent integrated annual report, which underscores the importance of ESG as a fundamental part of our core strategy.

Following international best corporate practices, in this report, we have included, first, greater disclosure in our sustainable initiatives; second, our general quality agenda; third, improvements in customer data protection; and fourth, greater detail in our Board composition and is still set in line with overall corporate strategy.

In addition to this, we have also released our first TCFD report on climate-related risks and opportunities, which sets the first step towards meeting our commitments for a safer, greener and lower impact operation for Banorte.

With this, I conclude my remarks, and now Rafa Arana will give you additional details and the main accounting impacts for our alignment with IFRS. Will talk you through the financial results for the first quarter of the year and will provide an update of our 3 digital strategies and discuss a little bit about the dividends also.

Please go ahead, Rafa.

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**Rafael Víctorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer***

Yes. Thank you. Thank you, Marcos, and thank you all for attending the call. I think it's quite important to notice that we have provided a very clear information concerning the IFRS changes, as you can see on the slide. And through the report, you can see a very detailed cohesiveness on how the numbers used to be and now how we need to present the numbers.

Any more detailed information that you need about the specific issues related to the numbers and you think that we need to go deeper on to the explanation of any, please feel free to call us. I don't want to get into a very detailed information I think a lot of information has already been provided.

But basically, if we would like to do a very quick analysis of exactly what happened, if you look on the asset side, basically, the loan portfolio now is broken into Stage 1, Stage 2 and Stage 3 paying, performing loans in Stage 1 and 2. That created some issues concerning that some adjusters were taken against capital. As you know that every time there's a regulatory change, those goes against the capital numbers. But when you do an (inaudible) of the group and the bank, you end up a number close to MXN 1.2 billion that was adjusted against capital.

That is, in a way, is part of the increase that you see in the coverage ratio that the bank provides now on the numbers for the quarter. On the asset side, also the repos now are not netted at this used to be netted before. So you will see the repo side on the asset side and the repo on the liability side in that part.

Those basic moves basically affect indicators the ROA because you have more on the banking side, the net interest margin also, NPLs and cost to income. But it's fair to say that the numbers concerning net income, net interest margin for the bank, when you go to pesos, are exactly the numbers that used to be and prove exactly what the level of growth is for the operations.

So I think it's better if we concentrate on those numbers, the growth numbers. And if you need any more detailed explanation, happy to go as detail as you want on a one-to-one basis with us -- with you. If we move to the next slide, basically, we continue to provide a very strong focus on the balance sheet. The balance sheet continues to be extremely fortified by 2 things: on the solvency, a part and also on the liquidity side.

The balance sheet also is providing us enough possibilities if we like to compete as we are starting to do in the market for specific clients and loans that we would like We have the balance sheet to do so. We have the capital to do so, and we have the liquidity to do so. And now we're starting to move much more aggressively into that part, as you can see in the following quarters.

On the expense side, I think it's relevant to say that we have been controlling the expenses below inflation. As you know, we front load part of the expense line in the fourth quarter, and that has proved to be a very important measure in order to keep controlling the expense line.

That has to do a lot when we go to the numbers about the cost-to-income ratio. We will see a very important reduction in the cost-to-income ratio because revenue growth has by far outpaced the growth in the expense line. We will go in detail on the expense, but just for you to be close to that numbers.

On the digital transformation of the bank, Marcos has just mentioned, we continue aggressively to move for Banorte to be more and more on a self-service tab on our banking menu as we define that. As Marcos already show you the numbers that Banorte is advancing aggressively into the 2 other strategies that we have, the Rappi one that later, I'm sure you will ask about that.

But we are basically in alignment of all the milestones that we commit to our Board and to the market about the number of cards, the quality of the cards, the quality of the operation, how we are reducing the acquisition cost and how we are penetrating the market and finding exactly where the positioning of this product is going to be at the market.

The digital bank is ready to go-live as soon as we get the licenses. And it's going to be an important surprise the way we plan to launch the digital bank concerning that basically is going to be an evolution from some of the already existing clients on Banorte that could be served on a much better way on the digital bank and also for clients that would like to come to the digital bank to want to be served by basically a digital operation and not an infrastructure operation. But there more detail will be given later on that part.

The NIM of the group based upon some changes on the IFRS, you will see a big drop on the NIM of the group to 6%. The bank NIM seems

that it's going to be a reduction on the NIM of the bank, that's basically what we mentioned about the repos, but that's an expansion on the margin of 18 basis points, and that will continue to do so because as we will see, the cost of funds continue to go down and the mix continues to be in the right direction and also a very important thing on the loan side is that the quality of the group allow us to have, on a risk-adjusted basis, a much better numbers than that we used to have.

And compared to the market, we are outpacing the market in the risk-adjusted margin. Cost of funds I already mentioned to that. On the capital numbers, basically, we continue to grow the capital base, 25.9% as total CAR and the Core Tier 1 that we have this 16.3%.

So this, I think, is time that we can now jump into the dividend policy. We asked the Board yesterday for approval to pay net income of 21 for the dividends, then that we will need to present this to the assembly.

And as soon as the assembly approves that, we will release those dividends into the to our shareholders. That has been a concern about from our shareholders, when we're going to be able. There's a question why we are not releasing the 25% of 25% of '19 and '20 because we haven't got the agreement to do so. So we are moving basically on 50% of '21.

That is a number consistent basically around MXN 6.07 per share, the dividend that we will be releasing to the market as soon as we get the approval from the assembly in that part.

Moving into the next page. I think we move into the bank that I think is, as you know, the main driver of the operation of the group. The return on equity of the bank continues to evolve in a positive way. Now we are reaching the 20.8%. We ended the year slightly above the 20%, but now we are consolidating the number of 20.8% on that part, a very important growth compared to the first -- to the fourth quarter of last year.

And we see this as a continuous strength evolving into the next quarters because of the quality of the group because of the funding cost because of the quality of the results that Banorte is providing.

The net income of the bank also has a very good expansion on that. It reached MXN 7.6 billion in that part. So all the numbers concerning the bank, the net income growth, the return on equity of the bank and the net interest margin of the bank when you go on a similar numbers, the number that you should be seeing before the IFRS changes will be numbers above 6.3% for the net interest income of the bank.

When you adjust by IFRS, it's at 5.2%, but that 5.2% is 18 basis points on a sequential basis. So the net interest margin of the bank will continue to grow in a positive way because of the funding cost and because of the mix and the quality of the book that we have.

If we move into the next one. The NIM expansion on the group has to do also because there's a better performance on the insurance company and have been reducing the net interest margin of the bank and -- but also because of the IFRS changes that basically are not (inaudible) the repos, then you have a benefit and also for the change for the insurance company, we have a benefit on the margin of the group. But now jump from a number of 5.2 to 6.0.

When you go and when we look into the numbers of the peso margin for the bank and the peso margin for the group, I think those numbers stay exactly the same and doesn't affect the net income of the group. The asset quality continues to be at the right track and the right trend.

And this is allowing us to keep and balancing out the lack of growth in the group. There have been some concern about the lack of growth of the loan book. I think the loan book is starting to move into the right direction. We have seen some good signs of that. Obviously, there's concerns about -- in the market about inflation, about the interest rates.

So when we go into the guidance, you will see some adjustment there. But what is important to notice is that we are compensating the lack of growth by far because of the quality of the group and the relationships that we are getting from our clients, not just on the lending side, but also on the fee side, on the transactional banking side, that is provided on the net interest income by client a continuous growth

on that number.

So it's -- I don't think it's fair just to look at loan growth. We have to look at how all those relationships are paying off by giving us funding, by giving us fees, by giving us penetration into the services, payrolls that we provide to the company.

So we are more and more become service bank for our clients. So we have different levers to apply when the loan growth is constrained by market conditions. So we are pretty happy about the penetration on the products per client that we have on the -- especially on the commercial and on the corporate and on the government book.

The credit provisions continue to be online. It's fair to say that we haven't used the MXN 1.8 billion of provisions that were ready to be released last December, but we didn't release those because of COVID. And now we haven't been -- we don't have any need to release those. So we will be releasing those as needed when we need it, as always, on a precautionary basis.

If we move into the next. I think this is something that you know we are chasing the market. Banorte is reducing the cost of funds on a permanent basis. We need to achieve a number below the current 37 that we have. We think we can do that because if you look at the growth on the funding side, noninterest-bearing deposits without costs grew 12% year-on-year and noninterest bearing deposits with a small cost, we have a reduction of close to minus 2% for the year.

So we are shifting demand deposits with cost to the demand deposit without cost. So that is -- that has to do with a lot of good work from the retail branches from the commercial, from the corporate, from the government, from all of the businesses on the bank. We still have to lower that cost of funds, and we will continue to do in the coming months on that part.

So if we move now to another of your question, the margin sensitivity of the balance sheet. As you can see on the graph, it's reaching the 1.1 million on the peso book and 800 on the dollar book. So the balance sheet is exactly where we want it to be. A positive [gap] on the very sensitive on the asset side.

So we are in the right direction. And also relevant to mention is that the results that we obtained on the trading we pretty strong results are not the result of gambling the treasury group, it's a result of the effect of the inflationary [funds] that we collect and also on the services that we provide our clients on the derivative basis that we provide them to cover any potential risk on the rate side.

So we are very close to our clients. They are seeing us more and more as a bank that can provide a full service in any way to provide any protection that they need on the derivative side, on the dollar side, on the peso side. So we are moving into that. So when you see the trading gains, it's not that everything is related to clients.

On the expense side, I think it's relevant to notice that we continue to see that we can end the year below inflation. If inflation reaches the 7.8%, 7.9% that is expected to see, we would be below inflation as we promised the market on our guidance. And if you look at the breakdown on the cost side, on the personnel expenses now are quite under goal, even though we already signed the agreement with the unit on that part. So that already is embedded on that part.

Professional fees are down. Administrative promotionals are down. So you see that strong control of expenses is taking place. Rents and depreciation and amortization is growing 13%. But in the coming months, you will see an important reduction on the rent side. So that number will continue to go down on that part when we finalize and close some of the initiatives that we have on the renting side.

So the profit sharing, as you know, there was a change last year because of the labor reform. Now it's going to be something that is sustained there on that part. And another big part of the on the expense side is the [E] part. But now the E part is also moved into other operating income instead of just being on the last part of the lines on the -- that you will consider part of the expense side.

So strong control on the expense side. I think we are on the right track to be below inflation on that part. There would be some improvement on the rent side. But I think we are right on track -- where we want it to be. Cost income ratio is going down to 37.7, obviously, because of our revenue growth from that part.

So that is a number that we would like to always be below 40, as you know. There was a big expansion on the fourth quarter because of what we did on the front-loaded expenses. But now we are back on track of the numbers that we would like to show the market about the cost and expense control.

On the capital ratios and liquidity, liquidity is also picking up to 222% of liquidity strong liquidity that will allow us to serve our clients that we choose and select to do so in an important way and also the capital ratio, as we mentioned before, 25.9% and 16.3% in Core Tier 1.

Once we pay the dividend, this is important to notice, there will be a reduction of 130 basis points on the Core Tier 1, so we will still be above 50%. And by the time that we paid the dividend, that number will be above the 15%, okay. The leverage ratio continues to be the one of the lowest, if not the lowest in the market compared to the systemic banks.

So really, the least leverage bank with a very strong capital base, with a strong liquidity base and with a strong results in the return on equity in the ROA in the net interest margin, in the cost-to-income ratio, in the cost of risk, in the NPL ratio. So basically, even though the lack of growth is present in the market, we are compensating that by far by all the services that we are providing to our clients and how we are serving them and taking advantage of every single business line that we have, and at the same time, accelerating during the transformation of Banorte and going deep into the digital world and one of the key players on that part.

As we mentioned at the beginning, there will be a change on the guidance based upon the results of the third quarter. And as needed, the guidance will be adjusted. The loan growth, we are reducing from 7% to 9% to 5% to 7% because there has been a reduction on the GDP. And as I mentioned before, even if you see a reduction in the loan growth, the service line and the funding line and all that is related to relationship to our clients will more than compensate our lack of flow.

The NIM expansion under the IFRS 35 basis points. The NIM expansion of the bank, 50 to 70 basis points. The expense growth is exactly the same to 7% to 7.6%. The efficiency ratio now is moving from 41% and 42% to 38% and 39%. Cost of risk, basically reduction from 1.6% to 1.4% and 1.7%. Tax rate, 25%, 26%. There were been some comments about there was a high tax rate in the first quarter. Yes, because there was some provisions taken then that it would be as the year go by, we will compensate those provision with the tax rate of the quarter.

Net income now is moving from MXN 39.5 billion to MXN 41 billion to MXN 40.5 billion to MXN 42 billion and return on equity for the group to 18.5% and ROA to the basically 2.0% to 2.2% taking into consideration all the changes that happened in the IFRS. GDP is a reduction of 3% to 1.5%. Inflation rate is also up from 6% to 7.6%. And the reference rate of Banxico from 6.42% to 7.21%.

Relevant to state that the numbers on the rate -- on the average rate that we are using on the budget 6.5%.

With this, I conclude the comments, I'm happy to take any questions.

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## QUESTIONS AND ANSWERS

**Tomas Lozano Derbez *Grupo Financiero Banorte, S.A.B. de C.V. - Head of Corporate Development, IR, Financial Intelligence, M&A and Sustainability***

Thank you, Marcos and Rafael. Now we will continue with our Q&A session. (Operator Instructions)

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**Unidentified Company Representative**

We'll take the first question from Geoffrey Elliott from Autonomous.

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**Geoffrey Elliott *Autonomous Research LLP - Partner of Regional and Trust Banks***

Clearly, very different set of accounting standards this time as you converge towards IFRS. What are the remaining differences between the financial reporting standards that you're using an IFRS? And is there a time line for further convergence?



And then specifically, in future, could you potentially have to start recognizing the cost of the subordinated debt in the P&L? And are you able to comment on IFRS 17 and what that would mean for the insurance, pension and annuities businesses?

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**Jose Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member***

Thank you, Geoffrey. Good question. Rafa, please...

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**Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer***

Yes. Geoffrey, I will be in fault if I can give you an exact date of the full conversion to IFRS. What you will see is not on the way that we are presenting the numbers because usually, we will disclose some of the questions that you are related to the capital numbers and the positions of some of the key ones, especially and things like that, that affect the capital base.

As you know, we used to report and disclose those without the IFRS need on the -- usually the Page 37 of the report, that has all the movements on a capital basis. As you can see now in the report we are presenting the net income and all the numbers that affect the capital that in a way that is in some way, some of the conversion that you were talking about, some of the metrics of our capital.

On the insurance side, we don't have exact dates that we will converge to (inaudible).

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**Geoffrey Elliott *Autonomous Research LLP - Partner of Regional and Trust Banks***

And do you have a sense of what that would mean for numbers, if you did converge on IFRS 17?

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**Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer***

No. Not -- what was the effect for like for example -- because basically, what has been happening in the Mexico is slowly, every year, there's a conversion even if it's not a big bank like this one, every year, there's a conversion to IFRS. So like, for instance, the conversion this time cost us MXN 1.2 billion against capital, and that was the full cost of the conversion of this part.

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**Unidentified Company Representative**

Daer Labarta from Goldman Sachs.

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**Daer Labarta *Goldman Sachs Group, Inc., Research Division - VP***

Two questions, if I can. Just first on the NIM guidance. Just to understand, why it's a little bit lower. Is that mainly because you're no longer excluding the insurance results? And should we compare that to the restated 2021 numbers right to the 25 to 35 bps increase is based off the new numbers, correct?

And then my second question, just to clarify on the dividend because you said you're still waiting approval on the 25% related to 2019 and 2020, but now you're proposing 50% of 2021. So do you need approval from the regulator for this? Just to understand why do you think you can pay the 2021, but not the 2019 and 2020? And then just related to that, do you think you would then maybe keep some of this for a potential Banamex acquisition, just to understand the full payout picture when you have approval for everything?

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**Jose Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member***

Thank you, Tito. The first one, you are right, it's not comparable. The IFRS is different. So you will see that's why it's lower and it's going to be, no, but it's good, but it's not confirmed.

And the second one, you're right. We are very cautious and we need the permission of the CNBV and they're waiting for it. And that's it. As soon as we get it, we will go with the process now that we talk about to assembly and all this, and we'll (inaudible).

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**Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer***

And the third one, Tito, about the third one, let's -- I think to be now very, very clear. Concerning any information related to the [CD] potential transaction, we will be really on a very closed [mode] by sharing any information. We can share anything related to the bank, but nothing related to the transaction because of the process is ready to start. So NDAs are in place now. So please forgive us if we're some kind of rude on this but we cannot now say anything related to the transaction. When we have something to say, we will say it.

**Daer Labarta Goldman Sachs Group, Inc., Research Division - VP**

Okay. No, completely understand. If I could just clarify just going back on the dividend. So do you need CNBV approval for both the 2021 and of 2019 and 2020? Because it seems like you're ready to pay the 2021, but not the 2019 and 2020, just to understand what exact approvals you need to be able to pay everything?

**Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer**

It's tough to -- it's difficult to understand, Tito. But it's exactly what it is.

**Daer Labarta Goldman Sachs Group, Inc., Research Division - VP**

Okay. So you don't need an approval from CNBV for 2021 or you do, maybe to make a simpler question?

**Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer**

One, no. We don't need.

**Daer Labarta Goldman Sachs Group, Inc., Research Division - VP**

Okay. So you're waiting for approval for CNBV only for 2020 and 2019?

**Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer**

Exactly right, Tito.

**Daer Labarta Goldman Sachs Group, Inc., Research Division - VP**

Okay. And sorry, just one last point. So when do you think you could pay to 2021? Do you have a timing when is the assembly?

**Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer**

The assembly is happening today. So today this will be presented to the assembly for approval. And as soon as we get the approval, the usual process, it usually takes 3 to 4 weeks.

**Daer Labarta Goldman Sachs Group, Inc., Research Division - VP**

Okay. So that could happen this quarter. All right. Perfect.

**Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer**

Thank you for your question because it helped us to clarify to all what's the situation about that very strange '19-'20 and '21.

**Unidentified Company Representative**

We'll take our next question from Ernesto Gabilondo from Bank of America.

**Ernesto María Gabilondo Márquez BofA Securities, Research Division - Associate**

Congratulations on your results. My first question is on Citibanamex. You know when would they be opening the data room to initiate the due diligent process? And then my second question is on the insurance revenues at group level. We noticed them were negative by MXN 3.2 billion. You mentioned that you're expecting a gradual recovery. So how should we think of the net insurance revenues at group level in the next quarters?

And considering that in 2021, after your restatements the net insurance revenues were negative by MXN 50 billion, what should be the pre-pandemic level?

And then my last question is on your comprehensive net income. We noticed the key difference against the reported net income is the valuation of some securities that I believe are -- or were impacting equity. So can you elaborate on that? And with the comprehensive net income being now the base for the dividend payout ratio?

**Jose Marcos Ramirez Miguel** *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Thank you, Ernesto. We will start with the third one, Rafael?

**Rafael Victorio Arana de la Garza** *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

Yes, it has not to do anything about the dividend, Ernesto. The comprehensive results have already been in place. Now that the fact is now they are presented below the net income line. But if you look at the way we have been disclosed the capital movement in the past and the available for sale and both to maturity parts and the effect on the results and on the capital. Those numbers have already been in place for there. So there is no impact on that. When we do the capital numbers, for the dividend, we already take into consideration all these movements because are reflected when we go to the Core Tier 1, that number reflect exactly all those movements that do affect especially the capital ones.

**Ernesto María Gabilondo Márquez** *BofA Securities, Research Division - Associate*

Perfect. So the 50% will be from the MXN 35 billion reported in 2021, right?

**Rafael Victorio Arana de la Garza** *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

Exactly right.

**Jose Marcos Ramirez Miguel** *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Going to this second one the internet revenues of the group level, Rafa, Tomas?

**Tomas Lozano Derbez** *Grupo Financiero Banorte, S.A.B. de C.V. - Head of Corporate Development, IR, Financial Intelligence, M&A and Sustainability*

Sure. Yes. I think it's important to look at 2 sides of the equation. To understand the full impact on the revenue for the insurance business. As you can see on the slide, it has been recovering. However, the number that you are mentioning, it really includes insurance and the annuities part that is the technical result that now moved from the margin but you need to also match that with the part that is in the margin for interest income.

So when you look at the both sides of the equation, you will hit this slow recovery that we're having in the insurance. So basically, to give you a guidance for a technical result would be hard for us because of the inflation. As you know, the have a direct impact from inflation. But I would say that it should be slightly less negative than what you are seeing now.

**Jose Marcos Ramirez Miguel** *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Thank you, Tomas. And the first one, Ernesto, thank you as Rafa said, as of today, we will not say anything about Citi until something happens. Remember, this process they want a lot of months. And it's something happens that you should know we will say and if not means that there is nothing there.

**Unidentified Company Representative**

Thank you. Now we will go with Jorge Henderson from Santander.

**Jorge Henderson Cubillas** *Santander Investment Securities Inc., Research Division - Research Analyst*

Congratulations for the strong results. And we noticed that Afore results were weak during the first quarter, which was in some measure expected by the reduction of fees related to the pension system reform now. But however, it surprised us that the Afore earnings attributable to Banorte were half of what we expected.

We understand that there is an impact on valuation due to higher rates. But what seems a little bit of a little bit surprising for us is the impact you attribute to the reduction of the fees, which is of negative MXN 450 million according to your earnings release. While we expect the net income will only fall around 30% in tandem with the 3 reductions, which fell from around 0.9% to 0.57%.

So I guess my question is if there were any other factors in story such as seasonality, expenses or taxes affecting the results and also on how do you expect that Afore will close 2022?

**Jose Marcos Ramirez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member**

Thank you, Jorge. You said it perfectly. You have the whole picture. We have nothing more to say. And if you cannot count on that income, you should count on -- you should do something in the cost and that's what we are going to do to control and to see what's going in the future and to work and still economies and all this you know that we should do. But your appreciation is perfectly clear and you have the whole picture.

**Jorge Henderson Cubillas Santander Investment Securities Inc., Research Division - Research Analyst**

Okay. So I mean it was a strength because you reported the net income, I mean, attributable to I think it was around MXN 150 million, but I don't know if you see that the reduction of the fee, it was from 0.9% to 0.57%, as I said, and that was only around 30%. So what we expected was that it fell -- would fall 30%, so...

**Fernando Solís Soberón Grupo Financiero Banorte, S.A.B. de C.V. - MD of Product & Segment Development**

Yes. Let me jump in and clarify the numbers. I mean first of all, the reduction was not from 0.9% to 0.57%. Our previous commission was from 0.8 to 0.57. That was 1 of the -- it will give you the numbers -- that's a permanent thing. Then we also have an impact due to mark-to-market valuation and that affects not only from the reduction in the commissions, but also from the asset side, we are receiving less money because of that as well in the commission part. And also, we reduced -- we started to reduce expenses.

And one of the expenses that we are tackling is the expenses on sales force. Now let me give you the numbers that might help, everything is before taxes, but the combined things of the market valuation and the reduction of the commission, that means that in terms of income from commission, it was a reduction of MXN 490 million, then the liquidation costs, where we have to pay for the salesman that we let go, it was around MXN 162 million.

And the other issue is the Afore has to invest in the same way as we -- a certain percentage of the funds is more or less 0.7% we have to invest in the same way as we're investing the money of the -- of our clients. And due to the reduction in the -- because of the market valuation of the assets, we also have a reduction in income in this part, mainly -- sorry, around MXN 168 million. Those are the impacts.

Of course, the first one is permanent and others, I mean -- and going forward, as we're seeing, and we will see how much more we can reduce expenses. Our biggest expense is sales force. But we have to also observe what is happening in the market. And according to what we see, then we will decide the speed and to see how much more we can reduce the cost. And of course, what will happen on the valuation of the assets. but that will depend on how things will come forward in terms of the markets -- sorry for jumping in. Thank you.

**Unidentified Company Representative**

Okay. Just remember that when we define and exactly what has been said by remember that we anticipated an effect close to MXN 800 million for the Afore with all the effects on the reduction on the fees and the reduction on the expense line that will cause on the severance. So what Fernando says, this is work in progress. We are looking at every single line of cost to do so. But the valuation piece that we were not anticipated in the -- how aggressive the rates are been moving on that part. But some of that was already anticipated to the market.

**Unidentified Company Representative**

We will now go with Arturo Langa from Itaú.

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

Congratulations on the results. I have just 1 question. I'm sorry if it's a bit long-winded, but if I were to annualize the first quarter results, this -- usually, it's around 23% of full year income, that gets you something already to something like MXN 47 billion. And when I look at your guidance, you're improving on a lot of lines to guidance, efficiency, cost of risk, et cetera, and moreover, you're going to have this impact from the lower taxes throughout the year.

So is there something I'm missing from this? Or can you help me understand better how to bode those 2 things a much better outlook but not such -- the net income guidance looks a little bit low in my opinion? Just to help me better understand that, that would be helpful.

**Jose Marcos Ramirez Miguel** *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Arturo, what you want me to tell you. I hope you are right. We are not so optimistic as you are. We are cautious here. Remember, the pandemic and the COVID and Ukraine situation, the rates going up, the inflation factor, the political risk, all this that you keep saying and saying. So we think that we are cautious. We think we will make it for it to, but talking about, for instance, it sounds like too optimistic. I hope you are right. That's all I want to say. Rafael?

**Rafael Victorio Arana de la Garza** *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

No, I think Arturo, as we mentioned at the beginning, that we adjust the guidance for this quarter. And as we see fee, we will be adjusting the guidance if there's something relevant that needs to be changed. Your predictions are correct. But I think what Marcos mentioned is really something that has been to take into account. I mean, what is going on with inflation, with the war, with the supply chains with many things, I think it's better to be cautious on that. It's not that we are holding back anything, it's that we are taking into account all the elements, and that has to be as a dynamic program in any scenario, there's a probability that all things could happen on a different way, and that has a reduction on the potential net income for the group. But as Marcos mentioned, it is a cautionary issue.

**Jose Marcos Ramirez Miguel** *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

And remember, Banorte has light its own. That's our statement. So we need to invest -- we are not only running the bank. We are also changing the bank. And if you want to see the future of Banorte and if you want to see us in 5 and 10 years the best bank always, we need to be there, and we need to best. That's why also we need to be cautious and give you a long-term view instead of good year and that's it.

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

No, that's very clear. And just to round out, so basically, the main risk would be more from the political and the macro and what's going on in the U.S. potentially not anything specific to...

**Jose Marcos Ramirez Miguel** *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Thank you, Arturo.

**Unidentified Company Representative**

Thiago Batista from UBS.

**Thiago Bovolenta Batista** *UBS Investment Bank, Research Division - LatAm Equity Research Analyst of Banks*

Hello? Can you hear me?

**Jose Marcos Ramirez Miguel** *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Yes.

**Rafael Victorio Arana de la Garza** *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

Yes, yes.

**Thiago Bovolenta Batista** *UBS Investment Bank, Research Division - LatAm Equity Research Analyst of Banks*

Congratulations on the results. I have basically 2 questions. The first one regarding the level of delinquency ratio. Clearly, a delinquency ratio of Banorte is well below the pre-COVID level. Do you see any strong motivation for this low level of delinquency ratio? Or in a different way, do you see this returning to pre-COVID level or have Banorte changed materially the loan book, the credit standards to maintain delinquency ratio at much lower level than the past?

And my second question is about the JV with Rappi. When do you believe that this should achieve the breakeven? And if you see the number of credit cards issued by the JV becoming bigger than the number of credit card on the bank in the medium term?

**Jose Marcos Ramirez Miguel** *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Thank you, Thiago. I will start with the second one with Banco (inaudible). Can you (technical difficulty)

**Unidentified Company Representative**

(technical difficulty) thank you, Thiago. (technical difficulty) leading (technical difficulty) that's one. And the second one was having all the information from the customers and having a lot of data, not only from the demographic perspective of the data, but also from the behavior perspective. And we are being able to explore all that information, and you can see that in the number of transactions. We are expecting to keep the number of new customers every month and keep exploding the number of credit cards.

In respect of the breakeven, we're seeing the numbers maybe for the first quarter of 2024 or the last quarter of 2023 to reach the breakeven position. Now consider that we are looking also for the banking license and that can change in some way the numbers and the expectations.

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**Jose Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member***

The first one, Rafael, please...

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**Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer***

I'll start and Carlos can complement on this, but we don't have any motivation to keep NPLs at a certain level. It's a result of an extraordinary work from the risk people on the modeling side, on the onboarding side. And what it give us is that risk-adjusted margin for us is a key metric that we follow very closely. But if we see a client that is worth taking into the bank, we will go through it, not only on the consumer but also on the commercial. But you have to be always careful about the NPLs, not as a way that is a motive for us to have a 1% NPL ratio is the result of many, many actions that the bank has taken to improve still onboarding the modeling, the way we treat the clients, the recovery unit and things like that, is giving up 1%, but it could give us 1.3%, 1.4%.

And that is -- what we like to have is always the best numbers in the banking system that allow us to keep the risk-adjusted margin at the levels that we want them to have because we don't want to grow at the expense of risk, we want to grow with the right risk and with the right returns for the shareholders. That is something very important, especially during this time that everybody forgets about the pandemia now any everybody -- but supply chains are closed, the war work is coming.

There's a lot of issues coming on here and the bank keeps performing extremely well on the risk side, on the risk-adjusted margin, on the margin side, on the cost of fund side because of this big evolution that the bank started 7 years ago on the risk side to take into account the modeling, the way we relate to the businesses, what kind of businesses we want to have and all the relationship-based model that we have at the bank.

I don't know if you would like to you...

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**Unidentified Company Representative**

Well, as you said perfectly well Rafael what I would like to complement is just that we have a tremendous high quality in origination, in loan origination, but also, we are very well aware of the quality necessary to make a good recovery. So when we make collections, what we are doing is the convergence of so many teams within the bank. You're talking about geographic sectors, you're talking about different loan products, you're talking about so many people that are very well coordinated within a sale structure sharp teams.

So of course, we will be very motivated to be the best in asset quality regarding credit and all of our assets. But that's a part that we can control up to a point, but we cannot be discretionary about that. We are amazed about this very high quality, and we are amazed because even with IFRS with some prudent -- with the adoption of some prudent accounting rules, we're seeing that credit quality is -- we expressed at the same level that we have before.

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**Unidentified Company Representative**

Thank you. We'll take our next question from Jason Mollin from Scotiabank.

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

I have 2 questions. My first is related to the regulatory environment that you're seeing now. Do you believe there is an even playing field for start-ups, do you think that the regulatory outlook could continue to change? Does this put incumbent banks at a disadvantage? And

do you expect in that context, other changes in how the business needs to be managed? We talked about the fees for Afore is coming down. Are there any other projects that you see in the pipeline?

And my second question is related to the sensitivity of your income statement and balance sheet to changes in interest rates. You talked about the sensitivity in pesos for NII and dollars. But can you talk about the sensitivity of the movements of the mark-to-market on your balance sheet? How are you approaching that? And we did see something related to the IFRS 9, but mark-to-market has been volatile in the past or we've seen some volatility. Can you talk about how the group is managing that volatility on the balance sheet side?

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**Jose Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member***

Thank you, and I will start with the second one the sensitivity (inaudible) this.

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**Unidentified Company Representative**

Yes, I think we're going to start on the (inaudible). Look, the sensitivity, as you know, it's -- we have been managed our balance sheet because we have natural hedges that we are taking full advantage of those on the funding side related to the variable rate interest -- variable rating in the lending side and the fixed rate on the lending side. So that's specifically and those are the numbers that you saw.

On the other thing that you mentioned about the capital movements, those have been, always been there for us now. The fact is that how we are managing those, remember that a big volatility comes from the UMS, from the PEMEX books on that part because they are not -- we haven't been allowed to put on a way that are basically not affecting the results, but affecting the capital side. I think that's the only one that we cannot control because we have been applying to be able to move those papers to a fact that allows for you, especially, not to have those big jumps on the volatility. But everything else is more than controlled, and we don't -- we hardly have any movements on the valuation on the papers that we have. The only ones that really move a lot are the ones that I just mentioned it to you. I don't know (inaudible).

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**Unidentified Company Representative**

Yes, Jason, what I will tell you very briefly about this is that the balance sheet structure reflects an effective positive gap of MXN 1.35 billion. I'm talking about the peso graph. And this accounts for an increase of MXN 19 billion pesos when contrasted to the balance structure of the end of the last year.

So loans, which accounts for the 44% of local currency banking book assets in -- and which is represented by the 36% local book of assets is the main driver of this behavior. So we're taking advantage of these upward movement interest rates because we have a balance sheet configuration, which was prepared months and quarters before that. Everyone was expecting what is just happening now.

The surprises by how much interest rate has been increasing at what velocity and at what pace. So I will also see that in the liability side, the main interest rate sensitivity [configuration] driver comes from term deposits, and this represents 26% of our liabilities. The most -- the second most sensitivity inhibitor are high yield accounts. But what I tell you regarding the consumer loans portfolio, this is a fixed rate asset. So there is no contribution on that regard.

So our -- just to summarize, I will tell you that in the dollar gap and the peso gap we're onward positive, and we are prepared to be around with these 2 currencies combined to have this MXN 2 billion sensitivity that Rafael was mentioning.

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**Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer***

Regarding the first one, Jason, is pretty interesting. As you know, we're moving to the digital arena, and we will compete with anyone. So -- and we want to be the best. And we could do it. But yes, sometimes it's not fair, and you can find arbitrage. So we need a playing field there, and we are fighting, let's say, that work for it with authorities because in the future, you cannot have towards no one banks and authority on this arena. But everybody should move to the arena, but everybody should have the same goals, and we are fighting for part of that.

I am sure that is some matter of time because this -- I don't know how to call it this, get away with things happens, everyone could suffer. So that's not what we think. And if we see a major change in the authorities like the Afore -- all these any major threats, we don't see it. If

we have something to say, we will say it first with you because we want to be very open and very (inaudible). So far, we don't see any threats regarding that matter.

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**Unidentified Company Representative**

Yes. And Jason, I would just like to complement because I think that also you wanted more detail on the -- on what Rafael discussing about the securities. The securities that Rafael discussed, we have very little duration of the portfolio because of the floating rates. You can find the detail on Page 62 of the report. And it's important to mention that for every 100 basis points, let's say, that part of the book now of the securities has a sensitivity of around, I would say, \$40 million is nothing. But basically, this is because of the floating rate. So this is important. And the other thing is that did react to the market that they already are discounting a big hike in rates, and that's why we don't see any material changes that Rafael discussed now.

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**Unidentified Company Representative**

We'll take the next question from Alonso Garcia from Crédit Suisse.

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**Ricardo Alonso Garcia *Crédit Suisse AG, Research Division - Research Analyst***

I have actually a follow-up on Rappi. As you highlighted, yes, there was a nice increase in the average billing of 10% compared to the previous quarter. Although, growth in the number of new cards in absolute terms slowdown compared to the fourth quarter. So first, could you remind us what is your guidance for new cards this year? And if you see the soft start related to seasonality in the first quarter of every year? Or could it be related to some increasing competition in the segment or a more cautious approach on your side? And finally, also on Rappi, if there is any color you can provide at this point regarding the hedge quality performance of this book?

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**Jose Francisco Martha Gonzalez *Grupo Financiero Banorte, S.A.B. de C.V. - MD of Digital Businesses***

Thank you, Alonso. This is Francisco Martha. Thank you, Alonso. On the first one, as you mentioned, the increase in the billing, it's -- we are -- we keep treating the customers, as I mentioned before, taking the advantage of being in a super app. So getting a constant communication with them.

And the number of new accounts that you see, it's mainly because of seasonality. We are seeing now how it's being increased in March and more than that in April, even although the Easter week and all the vacations at least here in Mexico. So we're confident to -- that we're going to be able to reach the 1 million cards by the end of the year.

And the quality of the book, I think it's too early to tell. As you know, the credit cards require some time to mature. But we can tell you that we feel comfortable on how the numbers are moving. We don't see any challenging or any particular concern on the quality of the book.

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**Ricardo Alonso Garcia *Crédit Suisse AG, Research Division - Research Analyst***

Perfect. And just to follow-up. The 1 million is total cards or new cards during 2022?

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**Jose Francisco Martha Gonzalez *Grupo Financiero Banorte, S.A.B. de C.V. - MD of Digital Businesses***

Thank you, Alonso. Now we will go with Nicolas Riva from BofA.

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**Nicolas Alejandro Riva *BofA Securities, Research Division - VP in Credit Research & Research Analyst***

So I have a few questions. The first one -- well, thanks very much for providing the detail about the Stage 2 loans. I wanted to ask you how you are defining these different groups? I guess, it's based on the number of delinquency days. And I guess, for the Stage 3 loans, you are defining them as overview more than 90 days. But if you can say specifically the number of delinquency days for the Stage 2 loans?

And also, this is more broadly when you think about your coverage of delinquent loans, I mean, if I look at the Stage 3 bucket what was -- what you called before the NPLs, we still see a high coverage 211%, but if I look at the coverage of the Stage 2 and Stage 3 loans combined, then I get, of course, a much lower number, which is 114%. When you are thinking about managing the risk in your loan book, how do you think about that coverage? Is there a target for the coverage of both Stage 2 and Stage 3 loans that you have in mind? So



that's my second question.

And then third on Banamex. What I wanted to ask you here is, and I know that you cannot talk much about that potential transaction. But in the event, in the case that you were to acquire Banamex, do you see a need to issue more AT1 bonds. My guess, looking at how much you have in AT1 bonds of something is that you wouldn't need to issue more AT1 capital, but I wanted to hear your thoughts?

And then finally, if you can once again remind us your commitment to calling the purpose you have a perpetual bond, which is callable in July, if you can talk once again about the commitment to calling the purpose?

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**Tomas Lozano Derbez Grupo Financiero Banorte, S.A.B. de C.V. - Head of Corporate Development, IR, Financial Intelligence, M&A and Sustainability**

Nicolas, before we go, sorry, we just received a message saying that [Alonso] answered at the last part couldn't be heard correctly. So we will repeat that.

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**Unidentified Company Representative**

Sorry, Alonso. The number is 1 million cards at the end of the year. So it's the 400,000 that we produce in 2021, plus 600,000 that we are planning to produce in this '22. Thank you.

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**Tomas Lozano Derbez Grupo Financiero Banorte, S.A.B. de C.V. - Head of Corporate Development, IR, Financial Intelligence, M&A and Sustainability**

Now moving again back to Nicolas.

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**Jose Marcos Ramirez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member**

Yes. The [third] one the commitment to calling the perpetual, yes, the third one talking about Banamex. Again, we still don't have any numbers. We still don't have any structure. So we cannot answer that, sorry. And the first one and the second one, I will pass to (inaudible) because yes, a lot has been (inaudible)...

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**Nicolas Alejandro Riva BofA Securities, Research Division - VP in Credit Research & Research Analyst**

Marcos, sorry to interrupt. But just -- I mean, again, if I look at how much -- I'm talking about the potential Banamex transaction, I'm not talking about the transaction itself, but just thinking about how to finance any transaction of that magnitude. If I look at how much you have in AT1 months outstanding, it really seems that such a transaction would need to be funded mostly by equity, especially, if you are committed to keeping a CET1 of at least 11%. Is that a fair assumption that you would basically fund it -- basically with equity and perhaps senior that is needed, but there shouldn't be a need to issue more AT1 capital even if you were to acquire Banamex, is that a fair assumption?

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**Jose Marcos Ramirez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member**

Rafael?

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**Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer**

Nicolas, let me be very clear about it. What you say or what you're saying is right. But there's one very important missing point. If we are really interested on the transaction could go forward. The structure of the transaction is not just on AT1s or anything. I mean, there are many pieces to -- that to be figure to reclarify before that.

So whatever can I tell you that it will be not exactly the way it's going to happen or could happen. So please bear with us the fact that we cannot really say anything about something that we don't know what is exactly the potential value of that product. That's why we are so committed to not say anything until we have really something to say.

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**Nicolas Alejandro Riva BofA Securities, Research Division - VP in Credit Research & Research Analyst**

Understood, Rafael. Okay. Thanks.

**Rafael Victorio Arana de la Garza** *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

Thank you, Nicolas.

**Nicolas Alejandro Riva** *BofA Securities, Research Division - VP in Credit Research & Research Analyst*

And then just moving to the Stage -- yes.

**Jose Marcos Ramirez Miguel** *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

So the Stages 1 and 2 and 3 (inaudible).

**Unidentified Company Representative**

Thank you, Marcos. What I tell you, Nicolas is that when you consider at the loan book, any credit product at Stage 1 is because there is a 0 to 30 days delinquency at most. If you go on to Stage 2, you will have to consider that a delinquency of 31 days going up to 89 days and the box stops there. So there is not any other consideration for Stage 2. And for Stage 3, as you correctly said, it's 90 days onwards or forward. So there is no problem with that classification.

What you will see as a main difference regarding some credit products and loan products is that revolvers such as credit card loans were considered past-due in 60 days in the prior methodology. Nowadays, you consider them past-due in a 90 days timeframe. So you will see that revolvers could cease exposure on variation regarding past-due loans ratios if you take that into consideration.

And regarding commercial loans, for example, you will see that SME loans excluded from commercial loans will increase very slightly because sustained payment performance in the prior methodology was 90 days above 60 days delinquency. Nowadays, these 90 days' additional to a 90 days delinquency. So when you make those considerations regarding different loan products or paid products, you will come up with some things affecting you in a positive way and some things that affect you in a negative way. But you can see that in Marcos's presentation in Page 8, that if you consider everything constant for the fourth quarter of '21 without and with IFRS, we are more or less the same regarding PDL ratios.

**Rafael Victorio Arana de la Garza** *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

And the last part, as recording the coverage ratio we will like to have the usual 135, 140 converge ratio, we are well above that because of all the changes that happened in the methodology and the IFRS and things like that. But the usual number that by modeling give us is 140, 145.

**Nicolas Alejandro Riva** *BofA Securities, Research Division - VP in Credit Research & Research Analyst*

Understood, Rafa. Just one question there because you are much higher than that number of coverage. If I look at the coverage of Stage 3 loans. But again, if I look at the coverage of Stage 2 and Stage 3, then you are at 114%. As management, are you now looking more when managing the bank at that coverage of Stage 2 and Stage 3 combined? And is there a target that you would have in mind for that coverage?

**Rafael Victorio Arana de la Garza** *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

The fact, Nicolas, is that you have to go and look at product-by-product because each different product requires different levels of coverage. So I think we need to -- when we give the 130, 140 is mixing everything together, but some of them have a coverage ratio of 190, 210. So you have to go on a product-by-product basis.

**Unidentified Company Representative**

Thank you. We'll go now with Luis Yance from Compass.

**Luis Yance** *Compass Group PLC - CIO of Compass Mexico & Portfolio Manager of The Local Equity Strategies*

Congratulations on the great results. Just 2 clarifications. The first one on the dividend. I know you mentioned you're still waiting approval to pay the remaining portion of net income for 2019, 2020. Just wanted to confirm that once you get the approval you will go ahead and pay it all this year? Or is there a chance that you might keep some? So that's my question.

And also on your embedded guidance of ROEs between 17.5 to 18.5, what are you assuming there? Did you just pay the 50% of last year's earnings? Or you're assuming that you paid the whole thing? And a related question to that, we've seen other banks actually going ahead and getting the approvals to pay it all. Just wondering, why is it taking so long (inaudible) other fact that you're systemically more important bank or is it just different processes and there've unlock in that part? So that's my first question. And then I'll ask the second one.

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**Jose Marcos Ramirez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member**

As we said, it's a funny situation, and we are trapped there. So as soon as we get out of bisection, we will find out what to do. We will have a happy situation. And we will tell you what to do. And talking about the ROE, Rafa?

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**Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer**

Yes. The ROE guidance that you are getting the 18.5 is considering that we cannot pay the dividend that we are fully loaded on the capital at the group because we are moving also -- we have also the Board to allow us to move dividends from the bank to the group to be ready to have those dividends of the group of the result of 2022.

So you will see that a continuous evolution of more position on the -- at the group level of capital. There will be a reduction, as I mentioned to you, of 130 basis points at the bank level. But no, we are not -- 18.5 is considering that we don't pay those dividends.

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**Luis Yance Compass Group PLC - CIO of Compass Mexico & Portfolio Manager of The Local Equity Strategies**

Okay. Great. And the other question I had was on NIMs. I know that the base is kind of different because of the IFRS changes, but it seems to be that the base to compare NIMs is around 5.5% for last year, right? So if you are -- if you -- I take the midpoint of your range on the NIM expansion, I get to like 5.8% or so for this year. Number one, is that a correct assumption? And two, given that you already did 6% in the first quarter, is it then too conservative to kind of head down on a full year basis, given that you still haven't felt all the positive effects from the recent increase in interest rates and the coming interest rates that are expected to come in the future also the improvements in the insurance business? So just trying to reconcile your guidance and what's going on going forward, and to get a sense of whether within your guidance, that seems to be the line that potentially has more upside risk? Is that fair to assume?

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**Jose Marcos Ramirez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member**

The answer is that we see that something relevant is changing in the next quarter, we will release more information and we will open maybe -- we will give you good news. But the way we see things now, we want to keep it this way. I mean that's the right answer.

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**Unidentified Company Representative**

Thank you. We will take the next question from Carlos Gomez-Lopez from HSBC. We can't hear you, Carlos. You can unmute.

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

My apologies. I'm unmuted now. Sorry for the delay. The first thing, thank you very much for all the disclosures you have given and the clarity in showing how the accounting change affects the different items in the balance sheet and the income statement, I think is very good work. So thank you to all for that.

Second, I don't know if you have mentioned what your expectation for rates? I think you said 8% for this year, but is that the peak? Or do you expect it to go further? And also related to that, I guess, I'm joining the other analysts were questioning why not assume a bigger margin expansion if you're expecting much, much higher rates?

And the last question is on the new presentation of comprehensive income. If I understand correctly, everything that is changes in shareholders' equity is included there with the exception of the interest on the AT1 paper that continues to be excluded. Can you confirm that?

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**Jose Marcos Ramirez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member**

Yes, I will stand for the third one. Rafael?

**Rafael Victorio Arana de la Garza** *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

Yes, third one, you're right. Yes, that's the only one that is not included on that.

**Jose Marcos Ramirez Miguel** *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

And the first one, yes, it's going to be continuous hiking movement, and we have 8.25% for the rest of -- for the end of the year. Maybe the next year is going to continue for 9%. We don't know, but so far, we are talking about this year and picking up to 8%. And we may assume a big margin expansion, we will discuss that in the next conference call, but I guess we see some room for improvement there.

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

All right. So again, the 8.25% is your forecast for the end of the year, but not necessarily the peaking rates, it could be -- it could go higher?

**Jose Marcos Ramirez Miguel** *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Yes. In fact in the next year, because it's going to be (inaudible) never done going up.

**Alejandro Padilla**

Hello? This is Alejandro Padilla, Chief Economist. So just to follow on from your previous question about Banco de Mexico. Well, our expectation in a 12-month horizon is that the reference rate will reach 9 and 1/4. So 8 1/4 will be by the end of this year, but 12 months ahead, it's 9 and 1/4, this tells you that there's still a lot of room for the Central Bank to keep on hiking rates. And this 9 and 1/4 is going to be the terminal rate of this tightening cycle from Banco de [Mexico].

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

All right. That's very clear. And I guess that means that you will have to discuss further how high the margin will go.

**Jose Marcos Ramirez Miguel** *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Thank you.

**Unidentified Company Representative**

(inaudible) with Yuri Fernandes.

**Yuri R. Fernandes** *JPMorgan Chase & Co, Research Division - Analyst*

Congrats for quarter. I had a quick one on loan growth. First, just trying to understand why you're cutting the guidance. We had higher inflation. I know you sounded a bit more cautious on the message here, but shouldn't inflation help a little bit on growth for volumes? And what do you see the trends for products?

And more importantly, on loan growth, like Martin discussed in 2022 is just discuss like the sustainable loan growth for Mexico, right? Because I was checking here the multipliers to nominal GDP. And from 2010 to 2020, Mexican banks used to grow at 1.5x nominal GDP. But since 2018, Mexico base they had been growing at 0.4, 0.5 multiplier and in some years, even negative. So my question is, what needs to happen for Mexico banks recover like this multiplier now start growing above and nominal GDP again, like what is your view here?

And if I may, a second follow-up, I know everybody already asked this a lot, but you delivered almost MXN 11 billion on profits this quarter, right? And usually, when we track historically first are seasonally weaker than other quarters. So my question is, why just MXN 40.5 billion to MXN 42 billion, given you have a lower rate -- you have higher rates, you have a potentially lower effective tax rate, don't you think this earnings guidance is too conservative given the MXN 11 billion you already delivered this quarter? Congrats, again.

**Jose Marcos Ramirez Miguel** *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Thank you, Yuri. I will start with the second one because it's interesting how things move and how fast and how short memories we have. Sometimes, we are very high and sometimes we are very low. So we want to maintain. We don't want to be schizophrenic going up and down.

So yes, it's cautious, but something that could happen in the change of plan, something could happen in the (inaudible) we still don't know. So we want to be conservative. But yes, maybe there is room for improvement as I said and maybe in the next quarter (inaudible) let's hope we have more good news for you. Now, it's -- since very good news because it's not in the models yet.

And the first one, as the first number that we have talking about the GDP was above 3% and now is below 2%. So that make it half of the growth that we were expecting. So -- and you're right, the banks -- we are a multiple in Mexico of the GDP. But it goes half that we said, is a lot. So that's why inflation comes upwards, you are right, but it's not enough. So -- and the best way to say it is not with models is with our work and we see -- and we feel the clients, and we know that the pipeline is there, and there is no way that they are going to grow a lot.

So we want to be cautious because you will see that Mexico is not going to grow. And it is not because of the model. It's because of the reality that we are talking with our clients, and we don't see any big movements there. And we want to be cautiously in the lending because you know that we can lose the bank given in the wrong direction. And that's why that's the answer. Rafael wants to...

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**Rafael Víctor Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer***

Yuri, I think it's important to go on the different type of loans that we have. If you look at the credit card business, the credit card business is going to have a very good year. The payroll loan is the same. Car loans, we have been severely affected by the lack of inventory in the dealers. So it's not that we don't have the capacity to grow, but I think as the inventory starts to grow, we will be going to be able to grow again. The mortgage book, there has been a very fierce competition, and I think we had a good year on the mortgage group.

So you say why you reduced in the 7 to 9? There's a reason for that. As Marcos said, there's many things that take into account. When inflation goes up, the mentality of all the people is to hold cash because they need to have the cash on that because you know where the prices are going to go.

But the bank has a very strong possibility that we could have face the market. And that has to do with what we have been doing on the digital space by reducing the onboarding costs and the servicing costs that we could have a better deal on the expected loss of some of the clients that we currently are not lending to clients that are -- clients of Banorte already that we don't need to go to the market on that part.

If that continues to evolve in the same way that it has been evolving, maybe we will change the guidance not because the GDP, because Marcos says, is a horrible number. But because of the capacity that we have to expand the level of loans that we have with our own clients. We are doing a lot of work in that space. And I think we could provide to you around the third quarter the effect of all the things that we are doing that. And that could really move the loan growth again, not because of the GDP, but because of what we have been doing with our clients.

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**Unidentified Company Representative**

(inaudible) from Citi.

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**Unidentified Analyst**

Just very quickly, I wanted to confirm. I heard you referenced about your strong capital position and how this would allow you to serve or tackle certain clients or carry out certain initiatives. Just wondering what kind of segments, clients or industries are you looking to serve or deepen your market share? Any comment on that would be appreciated.

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**Jose Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member***

I don't know -- we call it the model of the (inaudible). We go for everything. As soon as it's good, we'll take it and we don't want to grow in a segment that diminish another one. We want to go for everything as soon as it's good. And that's why we have not only the bank, we have -- that's our thesis of having a group of -- with subsidiaries, though. Wherever the business is, we want to be there. We want to be in Mexico. And that's why also we want to use the -- all types of challenges because we want to be with our clients, wherever they are. So we don't have any specific goal of specific segments. We want to go for everything as soon as it's good.

**Unidentified Company Representative**

Thank you. We have 2 more questions. The next one is from Carlos.

**Carlos Antonio de Legarreta Diaz GBM Grupo Bursátil Mexicano, S.A. de C.V. Casa de Bolsa, Research Division - Senior Analyst**

This is Carlos Legarreta from GBM. I have 2 very brief ones, actually. The first one is regarding noninterest-bearing demand deposits, those were 12% up year-over-year, and they represent 65% of your demand deposits. Honestly, that's an incredible feat considering the inflationary environment that we have. Can you help us understand what is the driver behind this dynamic? I think Rafa, you already hinted something like that and if you have anything else to add, that would be great.

**Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer**

No, I think Carlos is what you mentioned, I think by being a relationship bank, when we do deal with our clients, we take into account the full relationship with them. The lending part, the service part, the fund part and what we take into consideration with the value of the client. And that does allow us to really be more and more the preferred bank for those clients, and that is what is helping us bringing up all that funding. And the other thing is that once the activity in the branches is coming back, the activity in the branches is giving us a lot of good numbers on the account openings and that account opening is building up this funding base that we're talking about.

The SMEs also is a very powerful source of funds. And all the relationships that we do on the commercial and the corporate and the government is what is giving us along with the playbooks this increasing big drive on the funding numbers. So it's a full relationship-based bank that we do.

**Carlos Antonio de Legarreta Diaz GBM Grupo Bursátil Mexicano, S.A. de C.V. Casa de Bolsa, Research Division - Senior Analyst**

Right. And just to clarify your comment on the dividend proposal for 2021. So the shareholders meeting is today, like you said, are you including that particular proposal in this meeting or are you having a separate shareholders' meeting for that one?

**Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer**

No, it's going to be a separate one. So it will happen around, I would say, 20 to 30 days.

**Unidentified Company Representative**

We'll take the next question from (inaudible)

**Unidentified Analyst**

The first one is related to a couple of comments that Rafa said about the expenses. You mentioned that on the following quarters, you are expecting to reduce specifically on the rents and depreciation and amortization. So I was wondering if you could give us a little bit more details about the strategies that you have been doing so far on the rents of the spaces?

And the second one is related to the trading income. I give my attention that this quarter was really good. And specifically on the derivative side, it's got my attention, it's almost around MXN 1,354 million. So I was wondering if you could give us more details about this or it's related this good performance on the change methodology of asigna?

**Jose Marcos Ramirez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member**

The second one is because we have 2 big payments of inflationary premium rates, I don't know how we call it. And that's why it was a very good quarter. Nothing to do with the new accounting. It was great money, but it's not forever. It's only for this quarter, unfortunately, and that's the reason. And it depends on the rents -- Rafa, please.

**Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer**

No. Yes. I would love to give you more color on that, but taking into account that there are people that's going to be affected on this, so we don't want to go deeply into this. And concerning the other part of what Marcos mentioned about the inflationary thesis is the relation to banking, again, on the renovative side is giving us the capacity to serve our clients and to protect them from the hike in the interest

rates. And that has been extremely active, and we have the balance sheet. We have the technology to support that and the relationship managers to do so. So we are becoming more and more and more important in that area in the banking space. Banorte now is, in some cases, some of the leaders in that space.

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**Unidentified Company Representative**

From Bradesco.

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**Unidentified Analyst**

Congratulations on the results. I have a quick follow-up on the questions regarding your loan growth. So if you could just give us some color on the breakdown and expectations for commercial loans, SMEs and the government loans for the years -- for the year would help?

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**Jose Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member***

Rafa?

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**Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer***

Okay. This is -- please consider this as a preliminary based upon what we see. Credit card will be on the rise to 7% to 9% growth. Payroll will be on the 6% to 8% growth. The mortgage book will be from 8% to 10%. Car loans will be barely 3% positive. Commercial, including the SME, will be around the 5%. And corporate around the 2% to 3%. And the government book around 2% to 3%.

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**Unidentified Company Representative**

Thank you. With this, we conclude our call. Thank you very much.

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**Jose Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member***

Thank you all of you.

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