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Q3 2024 GRUPO FINANCIERO BANORTE SAB DE CV EARNINGS CALL

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PRESENTATION

Tomas Lozano *Grupo Financiero Banorte SAB de CV - Executive Director - Investor Relations, Corporate Development and Sustainability*

Good morning, everyone. I'm Tomas Lozano, Head of Corporate Development, Financial Planning, Investor Relations and ESG. I would like to welcome you to Grupo Financiero Banorte's third quarter earnings call.

We will begin today's presentation with our CEO, Marco Ramirez who will provide an update of the political and macroeconomic events that surrounded our third quarter's operation, followed by an overview of the group's main results. Our quarterly update on sustainability as well as details on our capital and an update on the shares we bought for the buyback program.

Then Rafael Arana, our COO will walk us through the evolution of the margin and balance sheet sensitivity as well as details on asset quality and efficiency among other relevant updates. 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. On page 2 of our conference call deck, you will find our full disclaimer regarding forward-looking statements. Thank you, Marcos. Please go ahead.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you, Tomas. Good morning, everyone. Thank you for joining us today. The third quarter of the year show a sound evolution for Banorte regardless of the current operating environment. High-frequency economic data continued to show signs of a slowdown, thus bringing us to adjust our GDP growth expectation for 2024 to 1.3%.

Nevertheless, we still perceive a strong inertia in domestic demand driven by resilient consumer fundamentals. For 2025, we forecast GDP growth of 1% given the current global headwinds despite the Mexican resilience derived from its high dependence to the US.

Annual headline inflation continues to trend down, yet it is still above the Central Bank target of 3%. Nevertheless, core inflation decreased for the 20th consecutive month and it's already within Banxico variability range. We estimate inflation to end the year at 4.7% and 4.4% in 2025.

Regarding monetary policy, we expect two additional cuts this year, reaching 10% by December and 200 basis points cuts throughout 2025, reaching 8% by the end of next year. Volatility in the Mexican currency is expected to persist, mostly given the uncertainty regarding the upcoming US elections in November. As a result, we forecast [MXN0.909] per dollar by the end of 2024 and MXN20.9 in 2025.

On the political front, Claudia Sherman took office at the beginning of October. And during her initial speech, the President reinforced the importance of one, sustaining healthy fiscal policies. Two, enhancing and protecting local and foreign investments in the country. Three, collaborating with the private sector infrastructure projects through public-private associations. Four, preserving strong relationships with the United States and Canada to boost nearshoring, and five, maintaining the autonomy of the Central Bank.

So far, the administration has held discussions with both Mexican and foreign business leaders to foster trust-based relationships among the different stakeholders. Moreover, the unveiling of the economic package of 2025 on November 15 should provide further insight about the investment and fiscal priorities of the administration.

Let's focus now on the results of the quarter on slide number 3. The sound performance of the group was driven by expansion in the loan portfolio, resilient margins and larger net fees. Notably, despite greater loan origination in our consumer book, asset quality remains solid with NPLs stable at 1% and cost of risk slightly down to 1.6%, evolving better than expected, given healthy behavior of new vintages in our different portfolios and the calibration of our internal models.

NII sensitivity on the local currency balance sheet has become almost neutral to monetary cycles, decreasing to MXN36 million for every 100 basis point change in the reference rate and reaching MXN531 million in the foreign currency book, further shielding our balance sheet from the easing cycle and increasing our reliance in selective lending and stable deposit volumes.

Rafael Arana will provide more details on this. Our strong capital adequacy ratio stood at 19.2%. Later in the call, I will go deeper into our strategy for capital optimization. Slide number 4, our net income continues to grow, showing a 7% year on year increase to MXN14.2 billion.

Additionally, accumulated net income for 2024 reached MXN42.5 billion, 8% higher versus the same period of last year, driven by the expansion across most business lines reflected on a 150 basis point increase in ROE to 22.7%.

On slide number 5, the quarter results by subsidiary show relevant contributions for all sectors. The bank's net income remained relatively flat in the quarter, mostly related to lower noninterest income despite good core banking dynamics. With accumulated figures, net income from the bank grew 7%, driven by loan volume and mix as well as positive evolution of net fees. Operating expenses grew in line with our expectation for the year.

Altogether, these results yielded a sound 29.5% ROE for the bank, up 180 basis points versus the same period of last year. Our insurance business grew 28% in the cumulative comparison, driven by greater premium growth in the corporate and government sectors.

Annuities expanded 11% in the quarter, normalizing the effect of inflation-related movements observed during the second quarter. With accumulated figures, it showed 17% growth, given its greater participation in social security allocations. The brokerage sector quarterly and annual increases were mostly explained by securities valuation and larger business operation.

As for the Afore business, its performance was driven by higher yields on financial products. Slide number 6, the loan portfolio continues to expand, reporting double-digit growth. The corporate book had a remarkable 24% year on year growth, followed by commercial with 10%, driven by greater business activity across multiple sectors as well as our ongoing efforts to strengthen relationships with SMEs, which are starting to capitalize from our investments in the segment.

During the quarter, FX variation had a positive impact for the dollar loan book, representing 40% of our total portfolio. Our government book grew 2% in the year, impacted by some prepayments. The consumer portfolio in slide number 7, continues to show double-digit growth.

Credit cards were up 26% in the year due to greater transactionality. It is worth mentioning that during the fourth quarter, we were launching two new products addressing the revolving credit needs for our payroll holders as well as those of younger demographics. These products are expected to help us develop comprehensive relationships with these clients.

Nevertheless, we maintain our cautious approach in credit cards to avoid compromising our asset quality metrics. The auto portfolio held at a similar pace, increasing 23% year on year, mainly driven by our current commercial alliances with different dealerships and ongoing positive dynamics in that sector.

Payroll loans grew 9% in the year despite our prudent approach with clients in government entities with administration changes related to the elections. Finally, mortgage loans showed a 7% annual expansion, keeping our focus on building a stronger high lifetime value clientele.

On slide number 8, asset quality remained solid in the quarter, with NPLs relatively stable at 1% despite our higher growth in the consumer segment. It is noteworthy that cost of risk has gone down, driven by the assertiveness of our internal model and our hyper personalization efforts to engage with high-value customers with better risk profile that limit unexpected losses.

Fees, on slide number 9, grew 7% in the quarter, mainly due to greater core banking fees and transactionality in investment funds. With accumulated figures, net fees grew 20% led by higher activity in consumer products and related businesses, supported by a still strong private consumption.

Furthermore, we continue to increase our digital transactions. As of the third quarter of the year, the number of digital active clients grew 11% versus the third quarter of 2023.

Turning to slide number 10. We are proud of our NPS, Net Promoter Score evolution, which remains on track to achieve a 90 point NPS score. The enhancement of our digital capabilities, which enable us to operate as a digital bank with branches together with the strength of our human digital interactions is what differentiates us holding a competitive advantage in the market.

Our self-service capabilities are driving value in person experiences, reflected in the high NPS score in all our interactions to different channels. Once again, this demonstrates that our investments in technology and hyper personalization are paying up, creating a depreciated engagement with our customers.

This one is recognized by the banker, ranking us its most innovative bank in Latin America Award in 2024, and many other worldwide acknowledgments emphasizing the innovation, usefulness and transformation in our digital initiatives.

Shifting gears to ESG on slide number 11. I would like to highlight Banorte's participation in the 17th Annual Financial Education week, where we have the chance to share financial education essentials and interact with a diverse audience of more than 2,700 students, and young professionals, highlighting the importance of creating a budget, the benefits of starting a savings culture and the relevance of keeping a healthy credit score among other buckets.

On the environmental front, we continue with our efforts to grow our sustainable finance group using the proceeds of the green and social bond issued earlier this year. Regarding the operation of our buyback program, we have already bought back [MXN10.7 billion] out of the available (inaudible) billion representing an approximate 70.3 billion shares.

This morning, we call for a shareholders meeting to propose their cancellation. Our capital allocation strategy focuses on providing the highest possible total return to our shareholders, considering the best balance between buybacks and extraordinary dividends.

Last but not least, I'm proud to share with you that Grupo Financiero Banorte is celebrating 125 years of operating in the market. 125 years of transforming, strengthening and committing to our country, growing together with Mexico, most importantly with you, our stakeholders. What started as a small banking in Monterrey in 1899 has now become one of the leading financial groups in Mexico.

Our business diversification, our transformation through technological and digital divestments, our customer-centric model and most importantly, the flexibility of that differentiated working culture have been among our strongest assets to move forward in both grey and blue skies alike.

Looking ahead, our focus on hyper personalization, diligent risk management, strict operational efficiency, together with our continuous investment in technology and human capital will keep Banorte as a strong and competitive franchise to face both traditional and digital players in the market.

I would like to thank you for your support and trust throughout this journey and we look forward to many more years of development and growth.

Now I will leave you with Rafael Arana, who will drop into detail of the financial results of the quarter. Rafael, please go ahead.

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

Thank you, Marcos, and thank you all for attending the conference. As Marcos mentioned and I will just provide the most important metrics about the bank and also some of the metrics about the group. The balance sheet continues to be our main strength on how we have built the balance sheet in order to support and be able to take advantage of the downward trend on the rates, as you can see.

And there's something important to notice about this. Some people has questioned that if we were not so fast in really positioning the balance sheet on the downward trend. I would say that it's difficult to put the right frames to do that. But what we can see now is that the direction and the strategy was exactly the right one.

That's -- and this is also quite important. This has cost us around MXN2 billion to position the balance sheet. But if you project the already benefit of that positioning for the next year, we're already at the rates as is today is giving us close to MXN1.8 billion in additional margin for the next year.

So it's like we paid for one year, and we will get the benefits for the next five years, based upon the tenure that we have on the fixed rate part of the book. So that's important to notice about the balance sheet. The second one is that the group continues to deliver pretty strong return on equity 22.9% and that's not on a tangible basis. If you go on tangible and you take out the goodwill on the Afore business, the goodwill of the group will jump very close to 24% return on equity. The bank is producing 31.1%, as Marcos mentioned, close to 228 basis points compared to the last year.

This is also considering that we are still holding 13.9% on the core Tier 1. So that really shows the efficiency of how do we manage the capital base and the balance sheet and all the results that provide that benefit for the bank.

The transformation for the bank as Marcos mentioned, is a day-to-day operation of the bank. We have a continuous transformation. Marcos showed the graph that shows the bank in (inaudible) that shows that Banorte is really a digital bank that can compete with anyone that comes into the digital space.

And that position ourselves that the NPS continues to grow in the right direction. The clients like the way they deal with the bank at the branches. The branches continue to keep improving the NPS on a daily basis, and the digital operations and the digital self-serve capacity of the bank also continues to improve the NPS on a channel by channel basis.

The net interest margin of the group is at 6.5%, pretty strong, if you look 77 basis points compared to last year. And what is also remarkable is the Banorte bank that is at 6.7%. Some people are concerned about how we continue to expand the margin even when the interest rates go down and it has to do with the position of the balance sheet and the fixed rate part of the book and also the good trading funding costs that we now have experienced based upon how we are managing the funding base of the bank that I'll go in a minute how the funding base is producing pretty strong returns on the margin side.

But also giving us a pretty strong foundation on noninterest bearing deposits, interest-bearing deposits, time deposits and also if we need to go to a market for specific reasons and also we go with the market with a very strong benefit for Banorte.

So the funding base, liquidity funding is trending in the right direction and is going to continue to improve the margin as we go towards the end of this year and on the next year. The capital base has already been explained, 13.9% core Tier 1. After -- and this is quite important after we -- on the call that we did on the Tier 1 and also by funding the dividends up to the group, most of those dividends. So that continues to be a very strong core Tier 1.

Obviously, there's concern that is too much that we should return more money on the balance sheet for the investors. Obviously, we're always looking to really return the most value to our investors and that could be on a buyback basis or also could eventually, potentially be an extraordinary dividend, but we have to wait to see how the macroeconomics and the US elections really happens. So Banorte is in a position to manage either way on that part.

And that's quite important because that flexibility. We have achieved that flexibility by managing the bank in a very conservative way, but also in a very high growth pace. When you go to the net interest income of the bank -- of the group. We will go in a minute for the bank.

But you could see on the noninterest income growing, the annuity effect continues to confuse some of our investors, but I think it's a very detailed explanation on the pages on the report. But what is worth mentioning is that net NII of loans and deposits increased on a quarter to quarter basis 4%. And that's a very, very strong number to have on the loans and deposits.

So I would say that NII is trending in the right direction. Everything concerning the revenue side also mix, we will see in a minute how the fees are evolving. But what we can really say is that, we have a very productive loan base and a very sound funding base that is continuously trending in the right direction to a lower cost than the funding side.

If you go to the ratio of the bank, it will show you, basically, as we mentioned, the margin of the bank at 6.7% coming from 6.4%. That really shows all this management that we have been doing on the funding, on the loan growth and how we position ourselves in the market.

And this is quite important when you look at how Banorte is positioned in the market, we are never on the high end of the price base. We are always on the mid to the low end of the price. We never compete on price, we compete on the service and on the risk that we like to serve the clients.

The NII of the Banorte Bank, as you can see, 7% on a year to year basis is a quite good trend and that trend will continue as we go through the end of the year and in the next year. Net fees are a very, very strong numbers, and it shows exactly why the bank continues to evolve in the right direction because we are transforming more and more the activity of the bank in a very productive way, opening of new accounts, transactional banking services fees from the commercial for the corporate, for the government base.

All the bank is transforming its activity every single day in a much more productive activity, not just activity, but really activity that is profitable for us and serving our clients in the right way.

It is not that we are increasing the cost of the fee and the price of the fees. It's really the activity that the bank is producing in the market. We are gaining market, we are gaining clients. The clients like the way they interact with the bank, and that is giving us a pretty strong growth on the fees.

It's not because we increased the price on the fees. If we go to the -- I would say, and this has to do with a lot of work for many people at the bank, the treasury, the risk accounting, everyone looking on how to really position ourselves in the right direction for the downward trend on the rates.

You can see now that the sensitivity on the peso group it's only at MXN36 million that basically we are in a neutral basis on the sensitivity. So the balance sheet has been managed on the way up of the rates in the right direction, in the downward trend of the rates also in the right direction. So to position the bank on a neutral basis, has cost us some money, but we will give us money for the next five years at least.

On the foreign currency, we will start to also being more aggressive on reducing the sensitivity. There are more tools to use on the foreign currency balance sheet. I don't -- we need still to see how aggressive the Fed is going to be. It's going to be 25 basis points or 50 basis points downward trend. But when you look at the sensitivity on the NII, we almost erased the sensitivity on the NII.

And that's not easy to do and that's something that is the result of very, very intelligent work for my people. The next one really shows some of the key metrics, the return on asset 2.6% is a very strong number, 2.6%. The net income of the bank 7% on a year to year basis.

And also, I will also try to address that the net income of the bank is already being affected by the forgone interest that -- and not just the bank, the group for the forgone interest on the buyback program that is close to MXN570 million and will by the end of the year, reach around MXN650 million on a reduction on the margin rates.

The return on equity of the bank as we mentioned before, 31.1% with a very strong capital base. So that really gives you the -- how efficient the management of, I would say, how do we use the capital to improve the returns of the bank in every single space of the bank.

If we move to the next one, the managerial NIM, that's in order to -- because some of you have asked us to extract the annuities effect on the NIM. As you can see on the graph, the NIM with ex-insurance and annuities in order to have a much more rational number that is not depending on the inflation rates and affection and the effect on the annuities.

The cost of funds, and this is -- even if you will see that it shows that -- it seems that the cost of funds jumped to 49.3%, but that has to do with the pace of reduction of the set date compared to the tier. The set date most of the term deposits are linked to the set date space.

So when the set date starts to go down, we have to wait for some people put the term deposit to 30 days, other people to 60 days or to 90 days or 120 days. So you need to get all the process ongoing. So you will see a continuous downward trend that will -- the PA will eventually chase the set date and the set date will raise the lagging effect that has on this renewal of the term deposit base because every time that you basically go on a fixed rate on the term deposit, we have to wait for the renewal at 90, 20 or 30 days or 45 days.

So that's what you see as a small pickup on the funding cost. But when you look at the margin base and improving the margin, that really shows exactly how we are managing the asset side and funding side that give us a better margin that is expected.

Another very important thing is that noninterest bearing deposits are growing 8% on a year to year basis because there have been some questions about the effect of the some of the announcement of the new bank other new banks or try to be banks in the market.

What effect, as you can see, we continue to gather non-interest bearing deposits at a very good pace, 8% on a year to year basis. And term deposits are growing close to 20%. And term deposits are well below the rates that some of those players are paying in the market. Why?

Because we base on relationship base not on a product by product basis. So when a client comes to the bank, he gets a full suite of products that he can monetize and see that they get a much better view when they monetize all the relationship with us.

So funding pretty strong, growing in the right direction, at a good pace, at the right cost. So now we will move to what some people are quite, I would say, concern about how sustainable is these numbers on the risk side. And when you look at the graph on the cost of risk and I will ask Gerardo in a minute to please join us on the conversation.

Cost of risk continues to go down in a very important way, in a steady way. And at the same time, you see that loan growth is exactly what we produced on the guidance to be 13% ex-government. So we have very sound loan growth and the cost of risk continues to go in the right direction. Write-off rates is very steady, we are not a bank that jumps and cleans the book on, I would say, on a non-program basis.

So we are very steady on the write-off rates and credit provisions are right on line what we expect below, what we expect at the beginning of the year. So these numbers also take into account that if you take away (inaudible). We are at [1.5%. If you add, we are at 1.6%]. So on the cost of risk, I will not say more because I will let Gerardo say.

But this is something that Banorte has shown that it's not just in a onetime effect. It's a continuous effect of how do we manage the bank. Please, Gerardo.

Gerardo Viezca *Grupo Financiero Banorte SAB de CV - Chief Risk Management and Credit Officer*

Thank you, Rafael Arana. Good morning, everyone. Over the past several years, our commitment to loan quality has yielded as you can see, exceptional results, demonstrating the strength and resilience of our portfolio.

Through prudent underwriting and robust risk management, we have successfully maintained a high standard of performance even amidst changing economic conditions. I would say that this success reinforces our confidence in our approach, not only for current stability, but as a sustainable model for the future and we remain focused on long-term growth ensuring our lending practices continue to deliver value to our stakeholders as well as supporting the broader financial well-being of the communities we are serving.

Together, we look forward for building on this strong foundation for years to come. And additionally, let me emphasize the importance of regulator approved internal risk -- credit risk models. Their contribution has been very relevant because regarding loan origination, portfolio management and loan recovery processes, this contribution has been substantial.

These models have been providing structure, reliable and compliant framework for managing credit risk, operational efficiency and portfolio performance. They support profitability, stability and risk mitigation. And I will say that after years of work, our loan quality measures are very stable as Rafael was telling you and also have been predictable and better than ever.

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

And I would like also to say that our mobile hyper personalization is the foundation is the risk by client, not by product anymore. And that's what give us a very, very, I would say, a big difference in the market when you addressed by client and not by product, the risk base.

So everything on the bank, the foundation of the bank that we deliver to the client is based upon sound risk metrics. If we like the risk, we like the client and we can even be very aggressive on how we can sometimes sacrifice some margin in order to bring the clients that we would like to have at the bank. On the expense side, as you can see, we are at 35.5% cost to income ratio.

Some people have asked us -- we had a meeting yesterday and said what would be the cost income ratio if you go to a current basis and ex (inaudible) Futuro and Bineo, the cost income ratio will be 33.7% that will be the cost income ratio that we will have.

So the recurring expenses is 7.3% and 5.2% is the extraordinary expenses coming from Bineo and (inaudible). So the operating leverage continues to be very positive and we will continue to have that operating leverage in a positive way.

So the cost to income ratio, I think we are peaking at a cost income ratio cost, and we will continue to push that number down for the next year. The bank's regulatory capital as you can see, is at 13.9% core Tier 1, 19.2% overall capital ratio, well above the TLAC requirements.

And this is -- this is really shows, as I mentioned at the beginning after the AT1 call. So that really shows you the capacity of bank to generate capital. I will address now the issue about dividends and buybacks. We have been, as Marcos mentioned, at very -- I would say, active on the buyback program and some people say, why you don't activate more the buyback program. The buyback program allow us to go up to MXN32 billion. We have used around MXN10.7 billion.

And that's a strategic tool for us to try to defend the value of the share. At this point in time, there are several, I would say, issues that needs to come clear for us in the next month. One is the US elections, another one is the presentation of the budget in Mexico.

What exactly will be the programs that the President has announced that we think will allow the market to become much more confident about Mexico in the coming weeks. But we have all the tools to manage the best return for the shareholders.

If we will see a space after these events to go for an extraordinary dividend, we will do that. We will need to reactivate and activate the buyback program, we will activate the buyback program. So we have all the tools in our hands.

So don't think that we are being, I would say, not looking at the market in a very close way. We are very, very attentive of how the market behaves, but we also understand that there are many issues that are not under control that needs to be clarified in the next weeks, not months, weeks. And I will be very clear about that.

So now let me move into the guidance because there have been some questions about the guidance. The guidance basically, the loan growth as we've mentioned, ex government will be very close to the 13%. The net interest margin of the bank, as you can see now, is at 6.5%. So we are right on track.

The recurring expenses is where we are even below the expense growth. The efficiency ratio shows a better number, but we have to wait for the end of the year cost of risk. Now we adjust the cost of risk because the cost of risk is trending better than expected.

Tax rate is where we are and the net income shows already the effect of the reduction of the foregone interest of the buyback program that we have been used. And so that's where you see the reduction of (inaudible). I will not say that's the final number.

We continue to see very strong loan growth in October, especially on the consumer side. And a very good trend on the funding side. So that could give us a pickup still on the net income. The return on equity of the bank is on line with the guidance, pretty sound numbers, the same for the group, and the ROA is showing a much better number than expected at the beginning of the year. Another very important issue is that when we project all the numbers of the bank, the GDP was expected to be very close to 3%.

We are delivering this number with a GDP of 1.1% to 1.5%. This is important to notice because there have been some concerns about what's going to happen in the next year, okay. We will have been able to manage the bank at a GDP trend of around 1.1% and we continue to see strong loan demand on the consumer and also on the corporate basis on that part, and SME also showing some resilience on that part.

That allows that its GDP for the next year is around 1% to 1.1%, we could still see reasonable loan growth close to low double-digit numbers or very close to double-digit numbers. But we will see that as we continue to see when the guidance comes full in place in January.

But it's important to notice that as we speak today, we continue to see reasonable performance on the loan at a GDP of 1.1%. So I would say that the other thing is that the interest rate that we expect by the end of the year will be around 10% for the full year. So with that, I conclude my remarks.

QUESTIONS AND ANSWERS

Tomas Lozano *Grupo Financiero Banorte SAB de CV - Executive Director - Investor Relations, Corporate Development and Sustainability*

Thank you, Rafael. Now we will continue with our Q&A session. (Event Instruction)

Tito Labarta, Goldman Sachs.

Tito Labarta *Goldman Sachs & Company, Inc. - Analyst*

Hi, good morning everyone. Thank you for the call and taking my questions. And thanks to some of the points on the uncertainty that's going on and that you still expect a pretty healthy loan growth for next year. But maybe just to hone in a little bit on that point, as you mentioned, Rafael even with 1% GDP growth, you're delivering double-digit loan growth and could maybe even do that again next year.

Just what could be the downside or where could the downside come from? Like in what environment would loans grow single digits? Would asset quality be deteriorating? Is there anything that you're hearing or seeing? I know there's a lot of uncertainty where you could see that type of scenario?

And if that scenario were to arise and you're growing your loan book, let's say, 0% to 5%, would you be more aggressive in returning capital given the strong capital you have? Thank you.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you, Tito. Rafa, please go ahead.

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

Tito, let's -- what I'm saying that based upon the numbers that we have today, we could achieve very close to double-digit growth or almost double-digit growth. But let me just give you one very important question -- one very important issue.

If employment continues to hold, that's the foundation of where we think that we could achieve that number. If employment start to weakens, then that will affect and then you will see loan growth from 7% to 9%. So that's the way we see it.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Alex if you want to add something? Sure.

Alejandro Padilla *Grupo Financiero Banorte SAB de CV - Chief Economist and Managing Director of Research*

Yeah, sure. Thank you, Alejandro Padilla, Chief Economist. Well as Rafael was mentioning before, when you analyze GDP dynamics in Mexico, the main driver of the economy has been product consumption. Indeed, this morning, the third quarter GDP was released and it was on the upside. It's in a positive way, especially coming from domestic demand.

And the domestic demand is mainly driven by labor market, as Rafa was saying and also by strong remittances and a better position of Mexican households. And in this regard, as we are waiting for the economic package in 2025, the most likely outcome is that in terms of government spending, they will continue to deliver strong social programs that will benefit household income.

So that's why we think that's at least from the domestic side, it's going to be positive. And thinking about risks, well, we are contemplating this 1% GDP growth for next year with one condition that the US will continue without any recession. We don't think that the US will get into recession, indeed. Also today's first quarter GDP of the US was quite strong.

Labor market has been also very resilient in the US. So we are forecasting that the US will grow around 1.7% next year, and that's going to be positive for Mexico because 56% of the economy, we have calculated that is highly dependent on the US.

Tito Labarta *Goldman Sachs & Company, Inc. - Analyst*

That's very helpful. Thanks, Alex and Rafa. And on the second point, would you consider returning more capital in a slower growth environment?

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

It depends as Rafa said, we want to keep all the tools here and we want to bring you the best for you. So if that's the solution and we expect to invest it, we don't have to work to invest, we will return more capital. The answer is yes.

Tito Labarta *Goldman Sachs & Company, Inc. - Analyst*

Great. Thank you, Marcos. And if just one quick follow up, I forgot to ask. Has there been any other talks of earlier in the year before the elections? There were talks about reducing some tax benefits for the banks. Have you heard anything else from the government about any potential impacts on the banks?

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Not so far? Nothing at all.

Tito Labarta *Goldman Sachs & Company, Inc. - Analyst*

Yeah, okay. Perfect. Thank you, Marcos.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you, Tito.

Operator

Ernesto Gabilondo, Bank of America.

Ernesto Gabilondo *Bank of America - Analyst*

Hi, good morning. Thank you. Hi, good morning Marcos and Rafael. Thanks for the opportunity to ask questions. My question will be only one in terms of Bineo. So we saw it had a loss of MXN247 million. It was around 1.7% of the consolidated earnings.

So today, it's working as friends and family, probably you will launch it to the open market next year. So we just want to understand what could be the size of the loss for every quarter in Bineo. I don't know if at the beginning could be a little bit higher or the 2% of the net income? Or that should be the level we should be expecting going forward? Thank you.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you. That's a good question because maybe we should say that in the business plan, we saw that we are going to lose money for one, two years. So we need to explain this because it's the way to do that business. Rafa, please go ahead.

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

If you look at the total expense numbers, as you mentioned, it's around [MXN1.2 million] a year. We don't expect that number to grow from that because, as you know, we are using most of the scale of the bank in order to produce the economies of scale on the cost side.

So that number should stay as is and maybe even improve a bit on that part. So you will not see an expansion on the cost line. I think that we reached the limit on the cost side, and you shouldn't expect more coming from that line.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you, Rafa. Is that okay, Ernesto.

Tomas Lozano *Grupo Financiero Banorte SAB de CV - Executive Director - Investor Relations, Corporate Development and Sustainability*

Ernesto, I think you have a mute on your microphone.

Eduardo Rosman, BTG.

Eduardo Rosman *BTG Pactual - Analyst*

Hi, everyone. One question here regarding the results from the other subsidiaries, right? You mentioned that the bank is delivering a 31% ROE, which is very strong, right? And that -- with the hedges that you did, you're very likely going to be able to protect the ROE from a bigger decline once interest rates go down, right? So can you please elaborate on the other subs? The ROE there, I still see room for improvement. So if you can discuss a little bit where do you see room for improvement in which one can that be relevant? Thank you.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you, Eduardo. Rafa, please go ahead.

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

If you go to the return on equity, you see that I think we have opportunities to grow the business on the insurance side. I think we still have low penetration on our customer base on the bancassurance side. I think we can still do more on that.

I think there are more insurance products coming to the market to address the new issues, the new services that the insurance company needs to deliver to our clients. The annuities business continue to be quite solid on that part.

There have been some questions about trading. And since trading had a good quarter there was like -- it was a big jump on the quarter. But if you look at trading for us, it has always been around -- now if you look at total revenue against trading is 5% and it has been a very steady line for many years. So I think the bank will continue to push forward. And remember that the bank is the main distributor of the insurance business.

So as long as the bank continues to grow and expand has been the case in the mortgage side, in the car loans, in credit cards, in payrolls, in bank, the insurance business will continue to grow. And in addition, there will be some in the open market. The annuities business, we are very close to the leaders in that market. So it's pretty good returns. It's a pretty sound business.

So no issues on that. So what we have to protect is basically the affording, the pension company that as we move forward to the coming years, the effect of the reduction on the fees starts to normalize more, but you will see return on equity of the Afore not on a tangible basis, maybe reaching the 14%.

If you go to tangible, then that number will be very close to 10%. So I think the way the return on equity has been set off, the leasing company could also improve the return on equity on that. We can see a lot more activity on the leasing and factoring company. So that could also improve some of the returns for the group. But that's overall, we don't see any weakness really on any of the businesses.

Eduardo Rosman *BTG Pactual - Analyst*

Oh great. Thanks a lot for the detailed answer. If I could just follow up on Ernesto's question on Bineo, right? I still -- I know that we're still in a work in progress, but do you think that this will be like the entity or the brand that will kind of compete with the new entrants like Nu and MercadoLibre? Or do you think that competition will take place kind of across the board, including the Banorte brand, right?

So how should we think about it? It's a different entity, a different brand or we should think about like look, it's just -- it's the whole thing that will be competing?

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

The first thing that you have to notice is if you are competing against bank or fintechs, when the fintechs become banks, then the competition becomes among banks and will be a much more fair play because capital numbers, liquidity, compliance, everything will be on the same level. That's the first question.

So if you see competition that banks against fintechs, I think the slide that Marco presented that Banorte is a bank and lenders you see the power of Banorte and the digital bank. But obviously, Banorte has an issue on the cost structure that is delivered in the 34%, 33% of income ratio for the next years. So that could be seen for some people that is the disadvantage to compete in the market.

But when you see that the combination of human and digital that Banorte has and not only Banorte, but BBVA has the same, that gives us an edge when you see the balances that we open at the branches and the services that we provide on the overall.

So when we launch a full value proposition for Bineo, that will be open for any customer on the banking side and also on the fintech side. And some of the clients of Banorte could choose to go for that if they like to live only on digital and that will be okay for us on that part. But we will compete with every single one in the market for the clients. The only thing that we will not compete is on a product driven basis.

We will always compete in a relationship basis by providing all the services and needs that the client needs. We are not just on a product driven bank. That hasn't worked for us in the past, and I don't think that's the way forward for us.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you, Rafael.

Eduardo Rosman *BTG Pactual - Analyst*

Thank you very much.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you.

Operator

Renato Meloni, Autonomous.

Renato Meloni *Autonomous Research LLP - Analyst*

Hi, everyone. Thanks for taking my questions here. So first, I would like you to give a bit more clarity on the balance sheet optimization that led to this bank NIM increased to 6.7%. Just trying to understand here if this is a sustainable level or this is going to revert back to lower levels going forward, especially because the low-end yield or the NIM on the loans was still stable this quarter.

And then just secondly, a quick question here on provisions. Just trying to understand the reduction in the commercial and corporate and government book, if there were some reversals there or if it was just a change in the model that you mentioned and trying to also gauge what's the normalized level here? Thank you.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you, Renato. We will start with the second one, the provisions of the product. So Rafa, please.

Gerardo Viezca *Grupo Financiero Banorte SAB de CV - Chief Risk Management and Credit Officer*

Yes. As one can see, if you take a look, you take a deep dive into our commercial lending business, you will see that what we have is that the commercial portfolio registered less dynamism versus the first half of 2024 as in the third quarter of '24.

The portfolio rose 5% quarter-over-quarter and 16.2% year over year driven by great dynamism in tourist areas such as Riviera Maya, Rivera Gaviota, Los Cabos. What you can see is that regarding provisions and the increase in the commercial side of the loan book, we are not detecting a pattern either by a sectorial view or by a geographic view. So our provisions are no sign of credit deterioration or asset quality deterioration in the commercial side of the business.

If you take a look at the corporate side, during the third quarter of 2024, we saw a mild slowdown versus the growth pace observed during the first half of 2024. The portfolio, the corporate loan portfolio grew 7.8% quarter over quarter and 23.6% year over year driven by great demand in sectors such as real estate, financial sector, transportation, logistics, manufacturing.

And on the other hand, we saw a slower pace in sectors such as oil and gas as well as in infrastructure projects. So that's the long dynamics in these two parts of the loan portfolio. And the asset quality in the corporate side has been superb, has been excellent, and we are -- we remain very confident that in the commercial side and the corporate side, in the wholesale loan book is going to remain very predictable and stable.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you, Gerardo. Rafa, the NIM are we maintaining that?

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

As you know, Renato, the projection for the guidance that was below where the NIM is. So I think a sustainable NIM and one thing that is worth mentioning is that when you look at the mix of the portfolio, 57% of the portfolio now is at fixed rate.

So that will more than compensate the reduction on the rates. So that positioning of the book is what really cost us to MXN2 billion last year, but that will get the benefit for the next five years. And the variable rate part of the book will be always moving as when the tier goes down, that variable rate part of the book will goes down.

But that's the advantage of Banorte. The variable rate part of the book when the rates were going up, we were very asset sensitive on that part and was the one who was really delivering the push on the margin side.

And let's say that the fixed rate part of the book was mostly neutral. Now the fixed rate part of the book is picking up on the margin side with 57% of the book in fixed rate, and the variable rate part of the book will follow the tier trend. But that's already been compensated on one to the other.

Remember that the variable rate part of the book is 43% of the total book. So we feel very confident that 6.4% is a very, very steady margin for us on the coming years.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you, Rafa.

Renato Meloni *Autonomous Research LLP - Analyst*

Great. Thank you. It's clear. So the message is that the bank NIM will converge here to the guidance then?

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

Exactly when -- if you see on maybe on the next two to three years will converge to the guidance because you will continue to see a pickup on the margin for the next year and for the end of this year.

Renato Meloni *Autonomous Research LLP - Analyst*

Great. Thank you.

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

Thank you.

Tomas Lozano *Grupo Financiero Banorte SAB de CV - Executive Director - Investor Relations, Corporate Development and Sustainability*

Olavo Arthuzo, UBS.

Olavo Arthuzo *UBS - Analyst*

Yes. Thank you. Jose Marcos, I have a question on Bineo, but it's a kind of a different approach because I just wanted to understand how relevant has been the launch of the money pockets or money boxes. I mean the current customer base, what is the percentage of clients that has invested into it?

And if you could just also please give us the amount in pesos that has been invested in pockets at Bineo that would also be great. Then I'll go to my second question.

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

Remember that we haven't advertised any on that. So basically, it's on the friends and families. So the numbers that you still see is quite low on that. But what is good that we have a full activation on the pocket side and we can really provide a client what they want.

But you need to wait when we really do the big launch on the Bineo to really understand the dynamics of the clients. The number of clients right now is nonrelevant compared to the potential of the Bineo brand, honestly. That's what I can say.

Olavo Arthuzo *UBS - Analyst*

Okay. So just a follow up. When do you expect this to gain traction, so?

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

We are aiming to have the full value proposition in place in the first quarter of next year. And we'll get the full traction because you will get the payroll, you will get the mortgages, you will get car loans, you will get mutual funds, you will get the credit cards, you will get the debit that is already the pockets, the funding. So you get a full -- because Banorte needs to compete on a relationship basis, not on a product driven basis. So -- and that has to happen in the first quarter next year.

Olavo Arthuzo *UBS - Analyst*

Okay. No, that's great, Rafa. And also a follow-up question on this topic, but more broadly related to the Bineo (inaudible). Is there anything to share with us about the benefits of adopting that technology of payment in Mexico, Rafa? Because I just wanted to understand what are the best thoughts on that. How many customers are transacting using Bineo? Any update on this regard will also be greatly appreciated.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Go ahead, Rafa.

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

The technology is good. I think it's a good technology. This is -- but we have a structural problem here that is the informality of the market. So we need to move to a much more formalized market in order to have the advantage that Brazil has got in big or things like that. So clients still are heavy on cash even if the technology is pretty good, honestly, it's pretty good.

So I think the more benefits are given into the labor force, the more employment continues to grow and benefit, you are moving much more into financial inclusion. Even on the remittance side, we are playing a very hard game on remittances to really move the financial inclusion on remittances and buildup accounts and on that part of the market.

But I think more on the regulatory side needs to happen like, let me just give you an example. Why not every single public service needs to be paid from an account, a digital account with no cost, but that will really allow those types of technologies to be quite useful for the client.

Olavo Arthuzo *UBS - Analyst*

So the top of the most the marginal pretty for the bank, right?

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

Right?

Olavo Arthuzo *UBS - Analyst*

Okay. Well, thank you very much, Rafa. Thank you very much, Marcos.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you.

Operator

Yuri Fernandez, J.P. Morgan.

Tomas Lozano *Grupo Financiero Banorte SAB de CV - Executive Director - Investor Relations, Corporate Development and Sustainability*

I think, Yuri disconnected, so we can follow with Jorge Kuri, Morgan Stanley.

Jorge Kuri *Morgan Stanley & Co. LLC - Analyst*

Hi, everyone. Good morning. And thanks for taking my question. I wanted to ask about deposits. Your deposit growth rate decelerated a lot during the year. You started the year growing at 17%, 18%. And now this quarter, your deposit growth rate was 8% year on year. That's lower than your credit growth, which is 11%.

I'm wondering if there is something to be read about competition for deposits from the digital banks in a Nubank, just looking at the CBM disclosure, Nubank has gone from $0 billion to $4 billion in deposits over the last 12 months, which is no longer a small number, right?

I mean that would be like equivalent to around 7% of your deposits. And then you also have many more competitors (inaudible) et cetera, et cetera. So what do you think explains the slowdown in deposit and just the absolute level of growth in deposits below your credit growth? And to what extent do you think that if these platforms continue to overpay for deposits for long, it will start to change the competitive dynamics for deposits in the system? Thank you.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

That's a good question because here, deposits, deposits, deposits is the name of the game we agree on that. And the rates are going down and that's going to be good for everybody. But the one is there compared with the other peers and the new competitors. I would ask Rafa to give you some numbers.

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

Jorge, I think one number that you should be looking is a noninterest bearing deposits that have been growing at 8% for the year. And we -- based upon the dynamics that we see on that part, that is the top part to fund, you will see that by the end of the year, that number will be very close to loan growth, the noninterest bearing deposits.

So that's the key issue for us to really see how powerful the service proposition that we delivered to the market could bring noninterest bearing deposits that have to do a lot with payroll service to the companies and individuals. So that's what the big number. The other big number is term deposits.

Term deposits are growing 20% for the year. So when you add everything up, you can really fund the growth on the book based upon this. But the term deposit base, what is good about the term deposit base is not just the growth, is that the term deposit base is converging to a much lower funding cost than we needed to put in place when rates were around [11.15%].

So if you ask me if there's pressure in the market for the Nubank for the (inaudible) on that, of course, it is for some of the people that likes to take advantage of that. And usually, what happens and we can see that because you can see where the transfer money goes from Banorte to Nubank or to the others, that is basically money that moves, take advantage of the rates and then come back to pay the services and loans that they have with the bank.

That number is around MXN3 billion that compared to the other -- to the big number that we have on the funding side is really a very, very small number. It's not that we are not very attentive to that. But what we have seen, and we are very, very pleased is that the noninterest bearing part of the book is really growing at a very, very good pace. And you will see that the numbers of noninterest bearing by the end of the (technical difficulty) question.

Jorge Kuri *Morgan Stanley & Co. LLC - Analyst*

Thank you, Rafa. If I can just squeeze one additional question. I thought this was going to come out earlier, but it hasn't. And since your last quarterly earnings, the big development in Mexico, obviously, is the judicial reform. Given how much banks in general rely on the courts for repossessing assets, executing guarantees, deal with labor and civil lawsuits that are normal in your world.

To what extent this changes your ability to lend, your appetite to lend, the pricing, the provisions? How does this new judicial reform potentially impact the loan side of the business? Thank you

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Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you. I will pass this to Carlos González. Please go ahead.

Gerardo Viezca *Grupo Financiero Banorte SAB de CV - Chief Risk Management and Credit Officer*

Well, hello, Jorge, I will say that we've been working in very important contractual risk mitigants in order to deal with the effects of this constitutional reform of the judiciary system. We can protect our rights through contractual mitigants that minimize credit risk.

If we look at several key ingredients, which I'm going to give you an example. The first ingredient is going to be collateralization and secured lending. We are more than ever looking for those credit structures like asset backed collaterals. The pledging of receivables is one example.

Also, when there is the opportunity, we will work with cash collaterals. Also, the second main ingredient in dealing with the potential effects of this judiciary reform is to look for third-party guarantees in order to protect our sources of payment.

I will add a third front in which we have been working, which are the modification of some covenants like the financial covenants, negative pledges and more information covenants to be closer than ever to our customers to see their performance, to see what arises and to take proactive actions in an early manner.

A fourth ingredient in which we consider we have some mitigants is more intensive use of SPVs, special purpose vehicles and using bankruptcy remote structures to see how can we deal with these type of deterioration or potential deterioration, which we have not seen as of yet, but we are preparing for that kind of a scenario.

We are intensifying the use of escrow accounts and also control agreements. With dedicated escrow accounts and some deposit and control agreements in that regard. And also, we are using more than ever cross-default clauses in order to deal with the potential impact of these.

Another thing that our team is working in is trying to analyze and change whenever it is possible, jurisdiction and arbitration clauses. That's going to become and it is still very important. We have had some experience in the past regarding that front, but we will deal with it in that manner whenever it is possible.

We know that in the commercial side and the corporate side of the business and the wholesale loan book, there is big possibilities to protect ourselves regarding these ingredients. And also, we have been looking for political risk mitigation, working hand-in-hand with local investors, local entities and also the development banks whenever it is possible regarding any size of the loan book.

That's the actions that we have been taking previously trying to foresee the effects of this judiciary reform, which obviously we are trying to protect our rights and also to make our customers feel comfortable in a reasonable manner because of these effects.

Jorge Kuri *Morgan Stanley & Co. LLC - Analyst*

Thank you. That's very clear.

Gerardo Viezca *Grupo Financiero Banorte SAB de CV - Chief Risk Management and Credit Officer*

Thank you.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you, Jorge.

Tomas Lozano *Grupo Financiero Banorte SAB de CV - Executive Director - Investor Relations, Corporate Development and Sustainability*

Carlos Gomez-Lopez, HSBC.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Can't hear you, Carlos.

Carlos Gomez-Lopez *HSBC - Analyst*

Now, you can hear me.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Yeah, thank you.

Carlos Gomez-Lopez *HSBC - Analyst*

Okay. No, thank you so much. So I actually wanted to follow up on the judicial reform. And again, I understand the mitigants that you are going to introduce. And that's of course, what you have to do. When do you expect that the changes in the judges and the structure of the courts will start to affect operationally what you do on a day-to-day basis?

Is that something that you expect already in the beginning of next year, end of next year 2025, et cetera? And if I can follow up, totally unrelated, can you give us some more information about the Rappi joint venture (inaudible)? Thank you.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Yes. First one, it's a good question because it's not going to be immediately. Our lawyers think that two or three years. So it's going to be a long way to work and to see how we adapt to that. And the Rappi one, I will ask Paco Martha is right here with us, Paco?

Jose Francisco Martha Gonzalez *Grupo Financiero Banorte SAB de CV - Chief Digital Business Development Officer*

Thank you, Carlos. We keep working with Rappi in the joint venture. We have more than 1 million cards, 75% of them active month-over-month. We already crossed the MXN5,000 million on the portfolio. And as we mentioned in the previous call, three months ago, we are now in black numbers, reaching the black numbers starting on April of this year.

So the business is moving forward. The loans are well managed. The users are heavily using the card. We have more or less the same transactions per month in the credit card, in the Rappi cards as we have in Banorte card. So in a nutshell, that's what's happening in the Rappi card business.

Carlos Gomez-Lopez *HSBC - Analyst*

Do you see any potential cannibalization between Bineo and Rappi?

Jose Francisco Martha Gonzalez *Grupo Financiero Banorte SAB de CV - Chief Digital Business Development Officer*

You know that only 6% of the customers that we have in Rappi card are also customers on Banorte, not only in credit card, in general. And you can see that Rappi card has 75% -- 76% of the customers below 36 years and that numbers in Banorte is 30%.

So we don't see really a cannibalization, but more than an additional credit card that people is using. You know that in Mexico is frequently to have one, two, three or more credit cards. So it's not that moving towards there it's leading Banorte.

Carlos Gomez-Lopez *HSBC - Analyst*

Thank you so much.

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

Thank you, Carlos.

Jose Francisco Martha Gonzalez *Grupo Financiero Banorte SAB de CV - Chief Digital Business Development Officer*

Thank you.

Tomas Lozano *Grupo Financiero Banorte SAB de CV - Executive Director - Investor Relations, Corporate Development and Sustainability*

Andres Soto, Santander.

Andres Soto *Santander Investment Securities Inc. - Analyst*

Perfect. Good morning to all. Thanks for the presentation. I have just a couple of questions. The first one is regarding cost of risk. You are improving a little bit your guidance this year based on a very positive performance that we have seen so far. It's interesting that this happens at the same time that you downgrade your GDP expectations.

So I would like to understand regarding your risk model, if GDP is not the key parameter that we should look at? Or is it a rather employment, as you mentioned before, and it will require for employment to deteriorate for you guys to need to make an adjustment to the risk model and for that to be reflected as additional provisions.

And more broadly speaking, when I look at Banorte prior 2018, cost of risk was at about 2%. Now you are running at, let's say, 1.8%, and this despite a significant shift in your loan mix. So I would like to understand what can we expect for the medium term, also considering this deteriorated Mexico growth outlook?

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thanks, Andres. The first one, the cost of risk, Gerardo Salaza, please go ahead.

Gerardo Viezca *Grupo Financiero Banorte SAB de CV - Chief Risk Management and Credit Officer*

Okay, thank you. Thank you, Marcos. I will say, first of all, that regarding the growth drivers of the loan book. At the same time, that we are considering a lower GDP growth, we are also considering a lower interest rate. And that's very important for you to consider because that's the income effect and the substitution effect to take into consideration regarding the parameters that we have announced in this call.

Also, I will try to complement some other growth drivers in which, they are not only the macroeconomic drivers of growth for the loan book. Obviously, those drivers are very important. As Rafael Arana was saying, the unemployment rate is key for our models and also it is key trying to deliver some performance because our loan book is dependent on the economic growth, consumer confidence and income levels, and the unemployment rate is going to be, one very important indicator of that.

But we have to add some other drivers, which are more endogenous, which are under our control in order to provide growth of the loan book. I will say that there is a market and customer demand drivers will see loans at a lower price if the interest rates continue to go down. Also, we consider ourselves to have better products for the hyper personalization, Rafael Arana and Marcos was mentioning.

And also, we have low pricing drivers. We are willing to price our loans in low levels because we have the structure and cost of risk is low, as you can see. And in order to do that, we have been transforming that key element in the Banorte's strategy into a competitive advantage regarding our peers.

Also, I would have to add that regarding growth of the loan book, you have to take into consideration the capital and risk management drivers that we possess. The capital strength of Banorte, in which we account for sufficient capital to support growth is one key ingredient to support that growth.

And also, our liquidity position makes funds available for loan disbursements. So we are in pace of trying to provide a healthy loan growth for the next years.

Andres Soto *Santander Investment Securities Inc. - Analyst*

Thank you so much. And then if also, the medium-term cost of risk expectations?

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Yeah, the cost of risk expectations for the medium term, I would say, Andres, will be between 1.8% till 2.2% that's going to be the range. We know that we are below that for the moment, 1.66% is the cost of risk as of now, but we're taking a very conservative view on the potential behavior of this indicator.

Gerardo Viezca *Grupo Financiero Banorte SAB de CV - Chief Risk Management and Credit Officer*

And we will move to consumer products.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Yeah.

Andres Soto *Santander Investment Securities Inc. - Analyst*

So understood. So it will be similar to the pre-COVID level, but with a better loan mix, I would say.

Gerardo Viezca *Grupo Financiero Banorte SAB de CV - Chief Risk Management and Credit Officer*

That's correct. Yes. The retail book is going to be more important throughout the years.

Andres Soto *Santander Investment Securities Inc. - Analyst*

Right. And finally, on expenses, do you guys have any -- when we started the year, we had a very positive expectations for the Mexican economy, a lot of investment coming up, and you guys also reflected that in terms of your expansion and growth -- expense growth that you're forecasting. When you look at 2025, should we looking at expense growth double digit, high single digit? What level will be reasonable for you guys next year?

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Rafa?

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

I mean I would -- we will really push to single-digit expense growth that's our goal. And we are doing everything in our hands to do that. What we are doing basically integrating everything on the operational side, on the HR side, accounting side, all the back office functions have been integrated into one for the group, that is going to give us a very reasonable reducing expenses.

And also you have to consider that most of the big spending cycle about hiring the bankers, 1.2 -- a1,200 bankers that we hired for the near shoring SME and commercial and corporate, now has -- it's already improved production, so that also will increase the revenue side and we don't need to add more costs on that in that base.

Bineo and Rappi will continue to wait on that. So we have to lower the recurring base of the cost base that is now sitting at 7.3%. And that's the one that we are working to that and not allow the entities Bineo and Rappi to increase the expense side. So I think it's a long shot, but we are aiming to have a reduction to a single-digit expense growth next year. I know it's a long shot, but we are fully working on that.

Andres Soto *Santander Investment Securities Inc. - Analyst*

Perfect. Thank you so much. So just to summarize, you are expecting some, I would say, some efficiency improvement next year, better margins, some deterioration in cost of risk. It will be fair to say that you will be targeting similar levels of ROE to this year. Or it's too early to tell?

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

No, I think ROE will be -- will continue to be very close to the number that we have. I think our goal on the bank level is around 28%. We are around at 31.1% right now. But I think 28% is what we are aiming to have on that part. Why? Because there's still a potential to manage the capital base on a much efficient way.

Why we haven't done that because the world is not quiet. So -- but we have -- if you go to a number that we have promised the market to be from 13% to 13.5%, you will see an immediate jump on the return on equity with basically the same numbers that the bank produces as today. So we have many levers, but we would like to keep some capital base and still deliver very strong return on equity. And I think we have been able to do that in the past years.

Andres Soto *Santander Investment Securities Inc. - Analyst*

Absolutely. That's very clear. Thank you so much.

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

Thank you.

Operator

Nicola Riva, Bank of America.

Nicolas Riva *Bank of America - Analyst*

Thanks very much. Thank you, Rafa, Marcos for the chance to ask questions. So my question is on capital. So this quarter, at the end of September, you called the MXN600 million outstanding in the six and three quarters.

So with that -- let's say, your CET1 is at 13.9%, so let's call it roughly 14% CET1. The message I get from your comments in this call is that you're not going to be accumulating more capital more CET1. If anything, this number is going to be stable or really decline a bit, you pretty much don't have any Tier 2 outstanding.

I think there's less than $100 million outstanding on the 2031s. That's only, I think, 20 basis points of Tier 2 capital. And then you have the AT1, but you just called the six and three quarters without a capital replacement. So capital requirements in Mexico are very high with TLAC implementation. So by the end of next year, you're going to need to have 17.9% total capital.

And again, doing the math, roughly 14% CET1, which is going to be probably stable or going down, you have 500 basis points of AT1, but you have another five calls and again, you just called the six and three quarters without a capital replacement.

So my question would be, if you are thinking of raising more Tier 2 or AT1, as you call the next purpose again, to meet that very high capital requirement of 17.9% total capital by the end of next year? Thanks.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Nicolas, you have the big, big picture, you are totally right. And what else we can say, yes, we are planning to raise more capital. The problem is the market. We don't need it, but it's good to have it. So we will be there and we will see how the market reacts.

And if we see the window, yes, we will issue more Tier 2 or whatever is good for the bank. And you have the whole picture. And so you know what are we going to do this.

Nicolas Riva *Bank of America - Analyst*

So Marcos, follow-up there. Then in that case, in the past, you have shown a preference to raise AT1 compared to Tier 2 despite theoretically lower cost of issuing Tier2. Is that necessarily going to be the case going forward, a preference to replace AT1s with new AT1 capital as you call, the AT1s?

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Yes. We prefer the AT1s because for us, it work better, and it's a matter of what's better for our balance sheet. So we prefer the AT1, yes.

Nicolas Riva *Bank of America - Analyst*

Okay. Thanks very much, Marcos.

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you.

Tomas Lozano *Grupo Financiero Banorte SAB de CV - Executive Director - Investor Relations, Corporate Development and Sustainability*

Thiago Batista, UBS.

Thiago Batista *UBS - Analyst*

Yeah, guys. Thanks for the opportunity. I have a question on the government lending book. We saw a decline of almost 2% Q on Q. The year expansion is about let's say 2%. So my question is, this recently weak performance of risk portfolio was more a decision of the bank decide to be more conservative with the credit card for government lending or lower demand because of all the changes?

And also, I'm just trying to understand how dilutive is this business for the ROE of the bank. We know that the cost of risk is probably close to zero. Interest rates much smaller, but how dilutive is this business for the ROE of the bank?

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thanks, Thiago. Yes, we saw some prepayments last year. Remember that we are changing our cycle with the new President. But it's a good business for us. Remember, it's not only the lending part, we work with the government with a lot of pieces.

So for us, it's very important to be with them and to -- and it's good for the country too. So it's a win-win situation, we want to be there. You will see in this year that we will start to be on track again, and we see a lot of things to do. Rafa wants to say something here. Rafa?

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

On the dilution side, there's no dilution for a very simple reason. The use of capital is very, very low for the government book. Because remember that we -- when we lend to the government entities, we set up on a trust that we control the trust. So we get the funds coming from the federal budget into the trust. So as you can see, NPLs are zero and the usage of capital is very low.

Obviously, the margin is what is thing. The margin in these loans is thinner than on the margin on the corporate side. But the return on equity usually is higher than the corporate on the commercial side. So as Marcos said, the advantage of the government book is the ancillary business that you received from that relationship. So no, there's no dilution on the ROE from the government book.

Thiago Batista *UBS - Analyst*

Very clear. Thanks

Tomas Lozano *Grupo Financiero Banorte SAB de CV - Executive Director - Investor Relations, Corporate Development and Sustainability*

Thank you, Thiago. We're almost over on time. We have two final questions. Please, we ask you to only present one question. We'll continue with Igor (inaudible) Thiago, please unmute your microphone. Thiago. yeah, thank you.

Unidentified Participant

Hi, everyone.

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

Hi, Igor.

Unidentified Participant

Can you hear me?

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Yes, perfectly.

Unidentified Participant

Yes. So thank you for the call and taking my question. Regarding cost of funding, we were expecting a continuous decrease. However, we saw a jump from [47.8% to 49.3%]. So I kindly would like to understand the main reasons that contributed for this and just confirm how you are seeing the evolution of design considering the Mexico cuts on policy rates, please?

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Thank you, Igor. Let's go, Rafa.

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

Igor, we said at the beginning of the call that you have a different pace on the set date and the tier. Tier related to the asset side and set date more related to the funding side. Remember that on the funding side on the term deposit base those gets renew on a 30, 45, 90 days. So when you see a disconnect about the pace of how fast the set date is going down compared to the tier. You have to wait for the renewal of the term deposits to get adjusted to the new rate.

That's where you see a [49.8% jump, but you will see that lag closes by the end of the year, that you should see those numbers very close to 47%] something at the end of the year. And then the pace of the tier and set date will be much more aligned. That's the reason for that jump, not at the funding cost overall because you saw a jump on the margin side on that part. That's the reason.

Unidentified Participant

Okay. That's super clear. Thank you.

Rafael Arana De La Garza *Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer*

Thank you

Operator

Edson Murguia, SummaCap.

Edson Murguia *SummaCap - Analyst*

Hi, good afternoon. Thank you for taking my questions. I know I have to go for one. And my question is a follow-up on what Dr. Salazar said about the risk mitigation that you are doing or you will do for the following months, weeks or years.

Cash collateral, third-party guarantees, modification of covenants and the SVPs, how those risk mitigation regarding on the judicial reform will affect the loan growth portfolio for the following quarters?

Jose Ramirez Miguel *Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director*

Gerardo Salazar, please.

Gerardo Viezca *Grupo Financiero Banorte SAB de CV - Chief Risk Management and Credit Officer*

Sure. Thank you, Edson. I will say that the growth dynamics have not been affected as of yet. That's the main reason that we are providing a range of growth of 10% to 12%. So these risk mitigants providing that we are still seeing GDP growth, a tight labor markets with a low unemployment rate that makes us confident that looking forward we will see growth happening with the same quality standards that we have provided as of now.

Unidentified Participant

Okay. Well, thank you so much and happy 125th year.

Rafael Arana De La Garza ***Grupo Financiero Banorte SAB de CV - Chief Financial and Operating Officer***

Thank you, the Anniversary.

Jose Ramirez Miguel ***Grupo Financiero Banorte SAB de CV - Chief Executive Officer, Director***

Yes, that's right. Thank you very much.

Tomas Lozano ***Grupo Financiero Banorte SAB de CV - Executive Director - Investor Relations, Corporate Development and Sustainability***

Thank you. With this, we conclude our presentation. Thank you very much for the interest in Banorte. Bye-bye.

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