

THOMSON REUTERS

FINAL TRANSCRIPT

O1 2017 Grupo Financiero Banorte SAB de CV Earnings Call

EVENT DATE/TIME: 04/28/2017 10:00 AM GMT

CORPORATE PARTICIPANTS

Carlos Alberto Arciniega Navarro *Grupo Financiero Banorte, S.A.B. de C.V. - MD of Treasury*

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

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

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

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance*

Ursula Margarete Wilhelm Nieto -

Ursula Wilhelm -

CONFERENCE CALL PARTICIPANTS

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

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

Carlos Rivera *Citigroup Inc, Research Division - Senior Associate*

Daer Labarta *Deutsche Bank AG, Research Division - Senior Analyst*

Ernesto María Gabilondo Márquez *BofA Merrill Lynch, Research Division - Associate*

Germán Velasco -

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

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

Philip Finch *UBS Investment Bank, Research Division - MD, Global Banks Strategist, and Latam Banks Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Good day, and welcome to the Banorte First Quarter 2017 Earnings Conference Call. Today's call is being recorded. At this time, I would like to turn the conference over to your host, Ursula Wilhelm. Please go ahead.

Ursula Margarete Wilhelm Nieto -

Thank you, Paula. Good morning. This is Ursula Wilhelm, Head of Investor Relations. Thank you for joining us today. I want to welcome you to the conference call, where we will discuss the first quarter results of Grupo Financiero Banorte. Before I turn the call to Marcos, let me remind you we may make some forward-looking statements during this conference. Now, I'm pleased to turn it over to Marcos Ramírez, our CEO.

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

Thank you, Ursula. Thank you, everybody. Good morning, everybody. Thank you all for the opportunity to discuss the earning results today. I want to provide some details of the very strong results we achieved this quarter.

Please turn to Slide 2 of the presentation, in which you can see that earnings per share accelerated to MXN 1.99 per share in the first quarter of the year, growing 24% with respect to a year ago. We have achieved this result conducting the business responsibly, growing with our existing customer base and within our established risk framework. In this context, the group generated net income of MXN 5.5 billion, showing a 5% sequential growth.

These results continued to show how the pillars of our 2020 plan continued to bear fruit, particularly on 2 fronts: the first one, the use of our multi-channel platform and business analytics to align incentives to provide the most profitable products to our existing customers; second, moderate cost increases as we run the business; and third one, advances in of our capital management plan. We have been able to show progress in this with our shareholders to higher dividends and quicker distribution.

This quarter's financial indicators continued to move towards long-term financial goals in all fronts: double-digit growth, strong profitability expansion of NIM to 5.5%, ROA to 1.8%, ROE to 15.7%, consistent positive operating leverage supporting our lower efficiency ratio of 44.5%, and good quality loans with NIM PLs at control 1.8%.

Moving to Slide 4. The interest rate cycle, along with higher inflation, continued to play well on the balance sheet. Assets are repricing. Net interest income is growing faster than loans, and we are managing liabilities to contain funding costs. All in all, the net interest margin already expanded 50 basis points in this quarter alone, and Banxico rose rates again by 75 basis points. Hence, additional margin expansion of at least 10 basis points in the next quarters is possible. So the main guidance is revised upwards.

On the lending business, Slide 5. There has been a lot of speculation of a market slowdown. While our loan growth was flat in the quarter, this is very specific to a few prepayments on the commercial and government books and also to the fact of the lower exchange rate on the dollar-denominated loan book. We continued to see appetite for loans from companies, and we have a good-quality pipeline that will materialize in the credit book over the coming quarters. The consumer book grew 4% sequentially with good-quality growth in all products. Our SME portfolio expanded at 12% annual rate. So we do not foresee any risks to meet -- meeting our double-digit loan growth guidance this year.

Asset quality metrics remain solid and stable. Moderate provision expenses of MXN 3.2 billion led to a low 2.3% cost of risk. Given the stable performance in credit metrics, we are just over cost of risk guidance range between 2.3% and 2.6%. Overall, new NPL formation is under control. There was a duration only in the commercial book with an increase in NPLs of MXN 245 million. We expect this to be temporary and should not result in charge-offs.

Moving to insurance on Slide 6. The company achieved net profit of MXN 885 million, 3% lower than last year, and excluding the result from Afore, which is now owned by the insurer. By adjusting earnings for the onetime effect related to Solvency II in the first quarter of last year, quarterly earnings grew by MXN 178 million or 19% annual. Adjusted retained payments grew 3% on the back of large renewals that took place in the first quarter and also new premium [orientation].

Claims are up 16% versus the prior year, resulting for increased claims on the commercial vehicle portfolio. Since last year, the insurance industry has seen an increase of 21% in claims on auto insurance, derived from more than theft of commercial vehicles and cargo, as well as higher-cost vehicle spare parts are indexed to the exchange rate. We have taken measures to offset this, and claims should stabilize going forward.

Afore had a very strong quarter, with net profits climbing 14% versus a year ago, partially benefiting from the interest rate cycle. The insurance company booked MXN 362 million in profits on the 50% of stake it owns of Banorte.

Pensiones Banorte, the annuities company, reached bottom line of MXN 174 million, 42% higher than the prior year. A more dynamic pension market and the benefit of high inflation on the inflation index investment support this result.

Solida posted a net loss of MXN 630 million this quarter, which is related to the homebuilders' assets, and is explained as follows.

First, our mark-to-market valuation loss of MXN 209 million derived from the declining share prices of these companies during the quarter, which impact the evaluation of the equity warrants that Solida received in the restructural agreements. These assets are registered in this derivative accounts and their valued mark-to-market every month on the P&Ls.

Second, a write-down of MXN 428 million to adjusted value of its investment projects, and resuming the construction and conclusion of these projects has been slower than anticipated. We expect to make an additional MXN 200 million write-down per quarter this year to further adjust these assets to fair value.

While we don't have any control on the share price performance of these companies, we believe further negative evaluation impacts going forward should be minimal, supported in part by the recent announcement made by the INFONAVIT related to the future of the low-income housing market, suggesting better growth prospects overall.

Finally, although we already made the proper announcement, I want to highlight that we completed the sale of Inter National Bank, the financial institution we used to own in the state of Texas. The transaction closed on March 30, and proceeds from the sale were USD 260 million. As we have communicated, we expect to maintain extraordinary dividend payment to shareholders on the same proceeds. Once all required approvals are finalized, this process should only take a few months.

I conclude here my comments and open the microphone for questions. Thank you very much to everybody. Ursula?

Ursula Wilhelm -

Paula, if you can help us with the Q&A, please?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll take our first question from Carlos Macedo.

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

A quick 2 questions actually. First one. We're seeing you accelerate loan growth to consumers. At the same time, all of your peers are pulling back from the consumer market and then essentially being more cautious, given the economy. I understand that your process is to seek out your own clients and grow through those means. And it's been vindicated by asset quality in that segment, even though it's more of a denominator effect than a numerator effect in that sense. Could you give us a little bit of a view? I know you talked about meeting your guidance for the year overall, but on the consumer book specifically, what are you seeing that's different than your peers are seeing? And what should we expect for the remainder of the year? Second question, regarding capital. You are close to 14% in terms of common equity Tier 1, and of course, the extraordinary dividend payment should have an impact on that. You did raise the payout recently. Is that something that you expect to do again? I mean, if growth does slow down, even if you get to the level of growth you're expecting, you probably are still going to accumulate a little bit of capital, particularly if you do get to 20% ROE in a few years. What's the mindset there?

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

Thank you. Related to consumer, we look a lot to the formal employment, and we don't look to the competitors. We tried to do our best, and we think that we can do a lot more that we are doing. That's why we are growing faster than the others, and we will keep on that. Maybe, Casillas can give us a little bit of color about the employment, because that's our framework in which we work, no?

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

Thanks, Marcos. Thanks, Carlos, for the question. Just to complement a little bit what Marcos said, I mean, you had followed this formal employment numbers that, as Marcos said, we are -- we follow very closely, and formal employment has grown significantly. It has not decelerated at all. Actually, numbers are at -- I mean, formal employment, this continues to grow at -- to the figures. So in this context, this is most important. Actually, when we were assessing growth for this year with the uncertainties, with the potential policies from the new U.S. administration, despite we absorb those into our GDP forecast and

all that, one of the most important things was that the effect will be felt in investment, but not in formal employment, at least at the beginning of the year. And this is what we have seen. Actually, the numbers have been -- are actually quite better. So in this context, I mean, if you combine the group formal employment numbers with our policy of focusing in our own clients, then you can get the numbers we have -- we are observing.

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

Okay. I mean, just -- so if I could just follow-up. I mean, last year, formal employment was growing at a very fast pace as well and yet you didn't -- you're accelerating your loan growth now. Presumably, as you reached the end of the year with GDP growth decelerating, unemployment might stop improving, and then -- I mean, is there a view that your -- that it's not going to be quite that trend for unemployment, that it's going to stay as low as it has been, and that formal employment will continue to increase at double digits?

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

Let me -- this is Gabriel again, 2 things here, Carlos. You're right. One the one hand, it's very important to highlight that a lot of these new jobs are actually not exactly new jobs. A lot of them are formalization of jobs. So in this context, this has been part of the labor [MAC] reform that was approved back in 2012, as you know. So in this context, once these workers are formalized, usually what it happens is that, well, they change from having probably a checking account to a payroll account. Once they have their payroll account, then in our case, we are able to provide a payroll loan, and if things go well, then we are able to provide other products. So in this context, once we see formal employment increasing, you don't see credit growing at the same pace on a contemporaneous times. There is a time lag between that happening and we providing the credit. So in this context, that's why you see this lag in this part. That's on a one hand. On the other, is that -- well, Marcos and Rafael and also Arturo saying, we have been also implementing new things, improving the channels we use, et cetera. So that has also have an impact on this. Now...

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

Exactly, Carlos. We still have over a handful of things to do. Manuel Romo will give us some more color about that to that considerable step.

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

Yes. Hi, Carlos. Just to complement Gabriel, internally, we are optimistic on the trends of loan growth for a couple of reasons. First, we still have a huge base of cross-sell opportunities from existing debit and payroll customers that currently are -- we know much more about them because of the analytic tools and the multi-channel strategy that we have been implementing in the past years. So if you divide the question between, for example, the credit card growth, we see a very stable consumption from beginning of the year until now, that is driving the growth of the credit card portfolio double digit, what you see. Then if you have the rest for personnel payroll, additional lines, continuous checks, everything

comes from multi-channel propensity models. Basically, analytic tools ties up with multi-channel origination strategies. So as a matter of fact what we have is more customers, more channels, more analytics, and that is what's that is driving the growth in the consumer lending with very, very good quality, with a very good profile of customers.

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

Let's go to the capital issue, a good issue, by the way. Rafael?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance*

Hi, Carlos, just the last part on the consumer piece. Remember that Manuel says we are actively seeking all the channels and things and propensity model and it's very pretty strongly sourced, but also you have to consider that we have 12 million clients out there folding, that are just sitting there, that just lately we have been able to -- under every single piece of the law complying with it, able to tap those clients, and we're just starting to do so. Only 600,000 clients are shared by the bank, so the potentially huge, and we know all the information about the clients. So you will continue to see a pretty good growth in that on a very secure and permanent basis. On the capital base that you mentioned, we have now total cap 16.67%, because we get the benefit of the inflows for the INB. We will distribute those. We just ask the board to be -- that allow us to go to the assembly and ask for those still extraordinary dividend to be pay out to the shareholders, an also at the same time, we will be paying the full amount of the -- of 2016 profits also in June. So then, again, that 16.6% that's currently at record levels, we'll go to a much reasonable levels that at the end of the year will be around 15.9%. That still is a very strong capital base with a Tier 1, core Tier 1, that's around 16 -- 12.9%. So you're still going to see a lot of movement in the capital base in order to make that efficient with the dividend payout that will stay at 40%, and that MXN 7.7 billion, plus an additional extraordinary dividend of MXN 3.5 billion to be paid in June. Okay?

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

Rafael, just one question. Is there, like, an optimum level of capital that you want to operate? I mean, 12.9% is relatively high. Peers around the region really talk about 12%. Is that -- would that be a reasonable level? I mean, where do you look down the line 3, 4 years?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance*

Carlos, yes, I think, where we feel comfortable with it is around 12% to 12.5% in core Tier 1. That's where we want to be. And it's going to be trending to that number. That's, I think, up very solid capital base. And as you mentioned, we already increased the ROE for the bank at very reasonable levels of 15.7%, and with the payout of the dividends and that remain of the dividends, you still have to add to that number for the end of the year around 35 basis points more to the ROE. So we are keeping an eye as clearly been solid, strong, but at the same time, efficient on the capital base.

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

One thing just -- this is Gabriel Casillas one again. Just one thing, Carlos, about that just to make sure if I answered the question properly in terms of the following months, I mean, we think it's highly likely that the growth rate of new formal jobs could decelerate in the next few months. However, the 2 things we do not see and we decelerate one is the conversion from informal to formal workers, and that's great for banking system and for us, and the other one is what we are going to continue to do. So in this context, this is why we are so confident with our guidance and the good numbers.

Operator

And moving on, we'll to Ernesto Gabilondo.

Ernesto María Gabilondo Márquez BofA Merrill Lynch, Research Division - Associate

A few questions from my side. First, we're looking to get expenses for all this quarter. It was 12% year-over-year, while your guidance implies 6% to 7.5% growth. So can we assume lower expenses grow in the next quarters? Secondly, from your point of view, which are the main challenges ahead? Could they be related to the economic slowdown, high inflation levels, normalized NIM benefits at some point after getting close to an end in the hiking cycle or the external and internal risk due to NAFTA negotiations or political uncertainty and next presidential elections? Anything related to that will be much appreciated. And finally, do you have any news with the U.S. bank? Are you willing to pay an extraordinary dividend? Is that right? When are you planning to do it?

José Marcos Ramírez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO and Proprietary Director

First, the expenses should normalize, and Rafael is going to give us some colors about that. The third one is as the INB that we will, as soon as everything is -- it's okay in a few months, we will pay that as a dividend. Around June we expect that -- to do that. And first, let's go to the expenses, and then I will come back to the main challenges.

Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance

Ernesto, thanks for the question. The expenses, you have to look at the expense line in a peculiar way for first quarter because we anticipate unlock most of the expense denominated in dollars, especially in software and hardware, in order to be comfortable that, that would not be jumping back and forth with that. So the number that you see on expenses for the first quarter is MXN 350 million above on a normalized basis. So what you will see in the coming months and trending to the end of the year is that we will comply with the guidance that we gave at the beginning of the year, but right now we took advantage of some very good discounts and also to lock out most of the software and hardware expenses. So we anticipate MXN 150 million that, if you want to normalize, you have to pull those numbers out from the first quarter on the expense line.

José Marcos Ramírez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO and Proprietary Director

Going a little bit to the main challenges, and we have a lot, but I think the big one is execution. That path is the right path, and we need to do everything like we are doing right now. The cross-selling is the name of the game. So the internal issues, the more we work in the internal as we are working, we don't care

too much about what's going on external because the volatility is there, but the reality is another things. So we will take care of the reality. We don't take too much time looking to all this volatility, because nobody knows where are we failing, and we expect to land it perfectly. So we will continue with execution, execution and execution, and that's our main purpose here, no? And I think that's it.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance*

If I just may add, I think what Marcos mentions is, it's very, very important that -- and I think it's a strong message for the -- from the bank and from the management. I mean, we redid the budget at the end of the year because there were so many concerns and things. But when we really go to the field and talk to the commercial bankers and go to the companies and thing, I mean, everybody was confident because no changes in the budget for the year for the companies related to exports and things were happening. So -- but we have seen in the first quarter is that, as Marcos says, reality is a lot stronger than really a speculation and all that has been going around. And the other thing that, I think, is quite important about this -- the execution and reality is that we continue to be very solid in recurring earnings. I mean, trading, as you saw, is still on the guidance that we gave you, MXN 700 million to MXN 800 million. So we are not depending on anything. We are not taking aggressive positions in order to benefit from volatility. We are concentrating on recurring earnings that keep on growing at a pace of 32%, 34% per year. Trading is very, very controlled, very stable at MXN 700 million -- above MXN 700 million, but not jumping up and down and playing the house on the volatility.

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

This is Gabriel. Ernest, I just want to highlight a couple of things from the macro side. I mean, what you mentioned -- I think, for the bank, definitely Rafael and Marcos said exactly what they think, but for the contrary, at the overall level -- and there is no doubt that the main challenges ahead are 2, potential U.S. policies and the Mexican elections in 2018, but there are 3 issues here I want to highlight. One, the exchange rate, dollar-mex, is more solid now that Central Bank has hiked rates more than 300 basis points, as you know, and has implemented this FX NDF. So it's not moving as it used to. I mean, the peso right now is not the same peso of the Brexit. So now that we see some issues happening in the world, the peso is less vulnerable. Number two, in terms of potential U.S. policies, every week, every day that goes by, reality rights, and that's something that a lot of Mexican asset prices have already taken into account. And in this context, it seems that the full confidence is coming back to Mexico. In terms of the indices, because as Marcos and Rafael said, reality has been quite good. And number three, terms of the Mexican elections in 2018, I mean, there's -- we are far away from it. So why don't we see in the polls. I think they are completely unrelated to what we are going to see in the result next year. Of course, we can discuss a lot about it, but I just want to leave it like that. Thank you.

Operator

And next we'll go to Jason Mollin with Scotia Bank.

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

Financial Services

You did mention some of a -- some negative hits to book value in the quarter due to INB, the final impact and the market-to-market valuation of, for instance, the homebuilders. And this did follow a big hit to book value last quarter. Actually, book value declined MXN 800 million in the quarter, despite the MXN 5.2 billion in earnings we had, again, from INB and other mark-to-market with the volatility we have. But my question is related to the comment -- I just wanted some clarification that we should expect to see another MXN 200 million per quarter in adjustments this year, is that -- if I understood that correctly? And then maybe you can give us some feeling for what's in the balance sheet. Of course, mark-to-market of securities, that's the reality of what it is. But the group still has, I think it's about MXN 25 billion in intangible and goodwill, if we should expect anything there, any kind of adjustments or impairments? And my second question is just maybe a bit of an update on competition. We have seen some of your competitors paying up for demand deposits, and if that's something that you think could negatively impact the cost of funding for the system going forward, if there were to be either incumbents paying higher rates on deposits or a new entrant that's trying to do the same?

José Marcos Ramírez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO and Proprietary Director

And the second one is the easy one, for me at least. We don't look at our competitors. We have a solid base of customers and that -- and now we can say that, so you will see that we will move there and everything is okay inside in the bank, no? And the first one is a clarification about all these movements. I will ask Rafael Arana to give you some color, please.

Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance

Thank you, Jason. As you mentioned, yes, there has been adjustments on the book value related to the shares, that we exchange for the nonsecure loans that we have with the homebuilders. And as Marcos mentioned that at the beginning, there has been a new law that has been very well received on the market for the development of the housing in Mexico, and we saw last week some improvement in the value of the shares. We are very conservative on that, and we just don't follow up the market up and down on a daily basis. We do it on a conservative basis on the market, and when we don't have certainty about the permanent side of the value, we always go to the downside. So we still see some benefits on that part. The adjustment that you also see -- and I will not -- when we are talking about the valuation of the projects and that's also part of the adjustments, that, that doesn't go -- that it's not related to the shares and to the value. It's related to the value of the projects that, as you know, the companies, the 3 big companies, were quite strong be able to really run again into production. One of the companies went back to the judicial process. So but now what see -- have seen in the first quarter for the 3 companies is that, finally they are really trying to reach a much more stable and upward trend in the production and selling on houses. So we are confident that the projects that has been sitting idle there and that we just have to adjust the value. We'll start to regain its value on the next quarters. On a conservative basis, we are thinking that MXN 200 million per quarter for adjustment in the projects, basically, is prudent to have. Maybe it will not happen, but it's prudent at this point in time. So that's another goodwill piece. As you know, in Mexico, you cannot eliminate or adjust goodwill. So that will continue to be sitting there. There will not be -- there would be no movement on the goodwill there. So that's the way the Mexican

rules are.

Ursula Margarete Wilhelm Nieto -

And just to clarify, Jason -- this is Ursula, on the intangibles and the goodwill that Rafael mentioned, it is related to the Ixe acquisition and also through the acquisition of the Afore. And there are no -- we don't expect to do any changes in the ownership of those assets.

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

And (inaudible) a little bit color on the (inaudible) you don't? I mean, with rates having gone up, clearly, low-cost funding is very valuable, demand deposits that are paying almost nothing. Obviously, there is a - the cost -- the operating cost to get them. But is there any view that just the market will change a little bit, that this -- I don't want to call it a free ride, because you guys have worked hard for those deposits, but the new entrants come (inaudible) and pay a lot more.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance*

Jason, I will pass to Manuel and then maybe to Carlos, but I would really reaffirm what Marcos says. One of the key capabilities of the bank is the ability to gather deposits, because we have a very diversified transactional banking, business banking. And overall, it's a service banking business that we do provide. And people are willing to hold at a very low cost of funding side if you provide the right service and things. And that's not new. That has been ongoing for many years, and Banorte has always been a key player in keeping the cost of funds down and being able to grow demand deposits at least 12% to 14% per year. But I will transfer that to Manuel and to Carlos, if they want to add anything on this.

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

Just to complement, Jason, because the funds is 10% lower year-on-year, and really the strategy behind that, as Rafael is mentioning is, under the proceeds that we're gathering from the market, we are very focused on DDAs and the profile of the account are exactly the profile of customers that we want. So we have creamed, so to speak, our base of close to 5 million customers, really creamed out an increase of productivity of the good customers that we have. So it's not only for us the deposit business. The DDAs is not only gathering a checking account, and the average balance that comes from the market is what it is. No, we work with it. We work with the customer, use the checking account and really see that the average balance -- you can also see on our numbers that the average balance per account of DDAs is growing around 5% or 6% year-on-year. That's number one. And number two, we have also a very active management of expensive accounts in which we are paying too much and really something that we continue working with customers to go back to the cheap funding, which is very productive for us and the very expensive accounts that we do not want, we go back to the market and leave it.

Carlos Alberto Arciniega Navarro *Grupo Financiero Banorte, S.A.B. de C.V. - MD of Treasury*

Yes, maybe this sounds strange to you, and -- but if you have a full-service bank, you provide a service. As

you provide the usability and the ease of use to the clients, the clients are willing to stay with you because of the number of services that you provide them. You do the mobile, you do the web, you do the call center, you do everything, so you keep lowering your operational expenses to serve the client. But also, the client is willing to be with you because of the kind of services and the quality of the services that you provide. And it's not just the funding, it's the whole value proposition that we provide to the market.

Operator

Next, we'll go to Philip Finch with UBS.

Philip Finch UBS Investment Bank, Research Division - MD, Global Banks Strategist, and Latam Banks Analyst

Just 2 question from me, please. One is -- so I think, we'll top-down. We've seen a pretty impressive recovery in ROEs over the last 1 or 2 years, and you've repeatedly said how you have this 2020 vision for 20% ROE, which, obviously, is now looking a lot more credible with improvement in ROEs. Can you help us understand how we get there from here? What is it we need to see? Is it margins going up much further? Is it cost coming down? Or is it a leverage gain that you -- as you were saying earlier that -- the core Tier 1 capital has to be much lower. Can you just try and give us a picture of what are key drivers to get us from 15.7% ROEs today to that 20% level? And the second question is to do with just margins. We saw a very impressive 50 basis points expansion in the first quarter, sequentially. How much of that was due to higher policy rate? How much of it was it due to the insurance premium renewals? And going forward, how much more can we see in terms of increases from policy rates going up? And Marcos, I think you said in your presentation right at the start that you think NIM could go -- could expand by at least another 10 basis points in the second quarter. Is that correct? Did I hear you say that correctly?

José Marcos Ramírez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO and Proprietary Director

Yes, I said that, and it's correct. That is 10 basis points. And working the part from here to the year 2020, we will work in all fronts, the capital, the cost, the income, all of them. And I will ask Rafa Arana to give you some color about the transition from where we are and where we want to be in the 2020. But the numbers that we have, and we'll revise and revise, we will go there and we are -- on that, we are ahead of the provisions and we will get there. And why don't you give us...

Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance

Yes, thank you, Marcos. And then I'd ask to Ursula to give us some additional information about the margin. Thank you for the comment about the ROE. Yes, we have seen pretty good expansion on the ROE, and we continue to read very positive numbers for the end of the year. So you have to add to the current ROE at least 30 to 35 basis points more because of the management on the capital base and the expansion on the net income. And we -- as Marcos mentioned, when we designed the path for the 2020, we are almost 8 months ahead of the plan because of the increase in the interest rates and also that we have been able to control the cost of risk very nicely. So that is 2 levers that are playing in our favor in a very strong and a very rich way. So we expect to end the year around 16.1%, maybe 16.2% for the ROE, and we'll continue to manage the capital base. As you mentioned, you will continue to see inflows in the

capital base because, as you've seen, the net income is growing nicely about 16% and loan growth is around 11%, 12%. So accumulation of capital is a fact. We are committed to stay with a payout ratio of 40% and be very prudent but very vigilant of additional capital that we can pay in extraordinary dividends as we see fit. So yes, we are confident. If you look at the numbers for the bank of the ROE, I think the numbers for the bank is -- for the quarter were 18.8%. And as you know, that's already considered that release from the INB. So the bank now is sitting at 18.8% and will continue to expand from there. The insurance business is above 50% on the ROE. Pensions, close to 30% and above. So -- and therefore, now it's regaining its growth. So overall, we see that all the things that we needed to have in order to achieve the 2020, the main laggard was really the bank that was hitting at 14% to 15%. Now the bank jumped to 18.8% and we'll continue to keep managing the capital of the bank. So yes, we are very confident to reach those numbers based upon the path that you can project from the numbers on this quarter. I will ask Ursula if she can provide us with information about the NIM that you request, Philip.

Ursula Margarete Wilhelm Nieto -

Yes, thank you. If you look at the chart that we have on Page 4 of the conference call document, I think that's really a reflect where the NIM is coming. The NIM for the group was 5.5% in the quarter. And out of this, about 2.2 percentage points came from the insurance company and the pension company. Remember, on insurance, we have a very strong renewals of premiums in the first quarter. That is partly what helped the margin. And on the pension company, we have the benefit of inflation. This first quarter, inflation is almost double of what it was last year at the same period, and therefore, that affected positively the inflation-indexed investments that the pension company has. But also, if you see also in the chart, the margin of the banking business is also growing. It increased 30 basis points versus the first quarter, and this really reflects 3 things: growth in assets; repricing of the loan book, mainly the nonconsumer books; the investment book also is repricing. If you see the NII breakdown, you will see a very strong growth in NII coming from repo and investment book. And also the -- what we have been doing on the funding cost that Manuel described, it is very, very important to manage the funding cost during the rate hike because the deposits and liabilities overall reprice faster than assets. So this is what you have on the NIM.

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

Just one thing, Philip. This is Gabriel Casillas. You mentioned -- you asked how many rate hikes from Central Bank we might see this year. Just to share our view really quick here. Well, we think Banxico will hike the reference rate by 50 basis point more this year. It'll be 2 25 basis point hikes, particularly following the U.S. Fed, depends on whether you said dollars, of course. In our view, Banxico believes that they are very close to the neutral rate at this point. And moreover, the yield curve from a U.S. Treasury spread standpoint looks inverted, suggesting that the market is actually is counting the possibility of an easing cycle at some point in the second half of next year. However, even though the exchange rate is less venerable and inflation might increase a little bit from now to July, we do expect that CPI growth will converge to something around 5.7% by year-end and then towards 3% in 2018. We think it's very likely. So Banxico board members really want inflation to get back to 3% next year, and they want to make sure

this happens. So in this context, this is why we think that. Even though they think they're getting closer to the neutral rate, they might have to accompany the U.S. Feds, at least this year.

Philip Finch *UBS Investment Bank, Research Division - MD, Global Banks Strategist, and Latam Banks Analyst*

Gabriel, that's helpful. Maybe I'll just ask a follow-up question then. Given that we're still looking for policy rate to continue rising, albeit at a lower, can we then assume that net interest margins, or at least credit spreads, next year should still continue rising at least a little bit?

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

Yes. Yes, that's, as Ursula mentioned, the books, especially the consumer takes longer time to reprice but this impairment is repricing on that. Yes, we expect that to continue to happen. To be honest, we don't like high interest rate hikes because eventually that can hurt the loan growth. But at this point in time, we have been able to really manage our clients on a very risk-adjusted margin base, and that's been very helpful for the clients. We have been helpful for us to keep the NPLs down and cost of risk down. So we have been able to manage the right risk with the right clients and increase the price where we need to increase the price based upon risk-adjusted margin base. But we are very selective and being very careful in keeping the risk-adjusted margin going up, not just the price going up.

Operator

Moving on, we'll go to Carlos Rivera with Citi.

Carlos Rivera *Citigroup Inc, Research Division - Senior Associate*

A couple of questions from my side. The first one is regarding the government loan book. It is declining 4% year-over-year. And I know that most of the portfolio has all the guarantees. But you mentioned in the press release that your strategy is to reduce the concentration of the portfolio. So what level would you want to have there? I know you're talking about the government loan book as a percentage of our total loan book? Or you're trying to diversify among within the government loan book? And my second question is regarding the strength of a subsidiaries, and we saw pretty significant quarter-over-quarter growth in the net income. So just wondering if these has anything to do with higher rates. So if you could just remind so little bit of the -- how do they affect the your main subsidiaries, like insurance, may be higher investment income and some release of technical reserves? Or the annuities benefiting from high inflation? If you could just give us a little bit color there would much appreciate it.

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

The first one, the government loan book, a matter of diversified or not. No, it's a matter of business. We will decrease the book because one decline among the government paid off, and we are looking to do more business with them. So it's a matter of good business for everybody, not it's not a matter of diversification, and we will continue to do business with them in the future, and you will see that book growing in the next months and at the end of the year. Around, I would say 10% also, all the books. And taking care of the subsidiaries, maybe, Rafael, if the solution is going help us..

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance*

Well, with respect to the insurance company -- I mean, well, first of all, let me tell you that for both the insurance company and the annuity company, we match -- we tend to match as much as possible assets with liabilities. We're respective insurance company. Our portfolio is mainly short term, and therefore, yes, we will have some benefits from the interest rates hikes in insurance company. Even though the reserves that we have in company are not as large because we don't have, as you are very much aware, in long term -- long-term insurance and the short term. So that's why we don't have a huge base of reserves, but just to some extent there are -- I mean, higher rates will benefit a little bit our book in that respect. Now regarding the annuity company, well, we've not charted with liabilities. I mean you have just heard from Ursula that, that benefited the NIM. But I should mention that with respect to the net income of the company, actually that effect is neutralized because of the this matching of the assets on liabilities. That means to say, I mean, we have, with higher inflation, we have a higher yield rates, but we have to pass those through to our clients. So that is not affecting net income in the annuity company. Actually, the annuity company is growing very healthy in terms of net income due to the fact that we have been more efficient in terms of identifying those pensioners to that chart. Not longer there because they die, and they not have any longer the benefits. And also, because we are increasing our loan portfolio to those customers. So yes, I would say that for the annuity company, most of the increase in the net income comes from strategies that are helping us with hiking over our current income.

Operator

And moving on, we'll go to Germán Velasco with BBVA.

Germán Velasco -

A couple of questions from my side. The first one is regarding the new guidance that you have provided for NIM and cost of risk, just wondering why is it not reflected in the final net income. Why do you maintain the same guidance for net profit? And the second question is regarding the amount to be paid as an extraordinary dividend in June. Can you repeat the dividend per share that we should expect to be paid?

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

The second one, we sold the bank in USD 260 million, so the exact payment should be around that. And the first one, we moved the NIM right, the cost of risk, right? And we are moving the target. Instead of going to the low part of the -- we are going to the high part of the bracket, no? So we are closing the gap and moving in the higher part of the bracket that we announced. And maybe in the future, we remove it, but we prefer to do that things right, and that's why we are only moving -- closing the gap and that's what we are doing. I don't know, Rafael, you want to say something around?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance*

No, I think Marcos said it right. I think we still -- being prudent of the evolution, I mean, I think it's much

more. The more we advance from the year, the more precise we'll be on our guidance. We continued to see goods expansion on the NIM, better behavior on the cost of risk. With no expenses will be online, the upper -- I would say, the upper range of the net income seems much more feasible than at the beginning of the year. So we will continue to adjust the guidance as we see fit in the second quarter and in the third quarter. The number that you add per share is MXN 4 per share, but you also have to add the extraordinary dividend of the INB, that is MXN 3.5 billion, that will be paid along with the MXN 7.7 billion in June that will cover the full amount for the 2016 profit. I think it's a big advance for the group. The shareholders have been with us for many years. They have sometimes to wait for more than a year and 2 years to be paid for the full year that the profits happen now. We have now paying the full '16 on June, plus the additional MXN 3.5 billion of the INB. So, it's MXN 4, plus the MXN 3.5 billion, divided by the number of shares, the 2.7 billion shares that we have.

Operator

And next we'll hear from Marcelo Telles with Crédit Suisse.

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

Well, one of my questions was just answered regarding guidance, so my other question is regarding your liquidity position. And when I look at your LCR, we saw a deduction to 93%. And if you compare that to some of your peers, that's kind of on the low side. So I was wondering if there is any -- I mean, any plan to try to improve your LCR and if that would probably pose some sort of risk to your NIM expansion story in case you have to fund, let's say, with longer-tenure bonds, if that could be any impact there? Or perhaps the calculations just doesn't reflect the real liquidity of the banks. If you elaborate on that, that would be great?

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

Thank you, Marcellus. It's a pleasure to say hello to you. Yes, we have expensive funding, and we decide to keep it way, and that's why the liquidity ratios change. Obviously, we can do it again and go for a defunding. But so far, we don't need it, and that's why you see that numbers. And I don't know what else to say, but that's the reason...

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance*

Now there's something that you will continue to see that number going up and down as we see fit. So there's no concern from us on that part. And remember that we have a big position also, that we do on behalf of clients, so that has to do with the money markets -- and think -- and the treasury. But no, we are very confident of the performance of the liability side and the funding side for that we provide for the loan books. So this is much more on a tactical basis for the training and for the money market desk. And the other part that -- sorry, Marcelo, the second question was?

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

No, no. Actually, this the only question I had. The other one was on the guidance, I think, was just about to say that your guidance seem conservative in light of updated increase in your NIM extension, expectation and your lower cost of risk. And I think you just mentioned that probably the high end of the range. It's already, let's say, more achievable in terms of your earnings, and you could revisit that down the road, is that the case?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance*

That's exactly the case, and thank you for reminding me of that. Yes, we continue to be on a very real base on-the-ground analysis, and that's what is supporting the guidance. I think, on the second part of the year, we will continue to adjust the guidance to the performance of the bank. But at this point in time, I think this is the right message to send to you guys.

Operator

And next we'll go to Carlos Gomez with HSBC New York.

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

Two questions. First, can you give us an update on the agreement with IBM? Has it run out completely? And there were some success metrics and possible payments. Were those actually achieved? And second, I would like to ask about your tax rate. There's a big contrast between your tax already being higher and that of one of your main competitors were reported it now, which is lower, and they mentioned that tax accounting helps them lower the tax rate. Is that not the case for you? Sorry, inflation accounting, inflation accounting helps them.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance*

Yes, yes. The first one that you ask about the INB?

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

IBM, the success metrics.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance*

The success metrics for IBM are quite simple. It's -- they are related to reaching the ROE of 20%, the cost income ratio that we at the beginning put it at 45%, now we are lowering that to 42% for the 2020. The (inaudible) ratio that has to reach 2.2% products pipeline on the month, on overall the -- including the month's retail, and also that we achieve a fully operational multi-channel platform that allow us to reach numbers close to 40% on the 20% -- on the 2020 on the alternate channels, considering the total mix of sales that branches and multi-channels from out there and that channels have to achieve. So we are -- those are the metrics, as you see are quite simple. Obviously, we have metrics concerning the delivery date and the performance and how we see the applications to be used for the clients. But I see, on the financial side, those are the ones that we follow. And on the tax rate, yes, you're right, the tax rate also

will be going down in order to achieve the guidance that we gave you guys. That is around 28% to 29%. Right now it has to do with some adjustment that we have on the provisioning side related to the way that we have to pay taxes on the provisions and the write-offs. So that will be leveling off in the remaining of the year.

Operator

And next we'll go to Tito Labarta with Deutsche Bank.

Daer Labarta Deutsche Bank AG, Research Division - Senior Analyst

Just a couple of questions. First, just following up on your net interest income. With a spike in the insurance net interest income that we saw in the quarter, you mentioned there were some seasonality to that. And so, I know you increased your NIM guidance. But could NIM fall just from this quarter maybe as that insurance net income normalizes? Just want to get a better sense of how that's going to evolve. And then my second question. Fees fell quite a bit in the quarter, but very strong growth year-over-year. I think, on the last conference call, you mentioned around 10% to 12% growth for the full year. Is that still kind of what you're thinking in terms of fee income growth for the full year?

José Marcos Ramírez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO and Proprietary Director

The first one is -- Rafael is going to help this one. Go ahead.

Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - General Director of Operations, Administration & Finance

Yes, with respect what we can expect in the NIM because of the insurance, remember that mainly it comes because of the increase in the interest rate. Sorry, in the inflation rate. So it will depend going forward on the behavior of this variable. So if it keep going soft, which I don't see, and perhaps Gabriel can give some color on this, but that will depend on that. But remember, as I just mentioned that we're the annuity company. It is for the net income that has no effects, because if we obtain the higher -- because of inflation, an increase in the NIM, we will -- we have to pass those through to the government pensioners.

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

The second, the fee side. Yes, we have a very strong quarter on fees, all related to banking fees were up very strongly, and that has to do a lot with the way now we deliver the value proposition to the clients, and as Manuel mentioned, in a bit ago that we now value the client, what's the price that we have to put on a client based upon the usage of the bank. So maybe, it seems a little bit low, the banking fees, but as I mentioned before, the second part of the year, yes, we will adjust the numbers if we succeed. At this point in time, yes we have a very strong -- and if you project the quarter, you are right in asking us, "Why you don't change the guidance?" But we still have to see the evolution of all the value propositions that we are delivering to the market, and we will come back to you guys in the second part of the year.

Operator

(Operator Instructions) It appears there are no further questions. I'll turn it back our presenters for any additional or closing comments.

José Marcos Ramírez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO and Proprietary Director*
Well, thank you very much. See you next quarter, and I hope the news will continue. Thank you all. Bye.

Operator

And that does conclude today's conference. We'd like to thank everyone for their participation. You may now disconnect.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes

In the conference calls upon which Event Briefs are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT BRIEFS REFLECTS THOMSON REUTERS'S SUBJECTIVE CONDENSED PARAPHRASE OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT BRIEF. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2017 Thomson Reuters. All Rights Reserved.