Banorte

Fourth Quarter 2019 Earnings

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CORPORATE PARTICIPANTS

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PRESENTATION

Operator
Good morning, and welcome to the Banorte Fourth Quarter 2019 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your touchtone phone. To withdraw your question, please press star then two. Please note that this event is being recorded.

I would now like to turn the conference over to Ursula Wilhelm Nieto of Investor Relations. Please go ahead.

Ursula Wilhelm Nieto
Thank you, Kate. Good morning, everybody. Thank you for being here with us. Welcome to Grupo Financiero Banorte's Fourth Quarter and Full Year 2019 Earnings Call.

Today, the presentation may include forward-looking statements that are subject to risks and uncertainties, which may cause actual results to differ materially. We ask you to take this into consideration.

Marcos Ramirez, Chief Executive Officer, will provide an overview of the results. Thank you, and I leave you to Marcos.

Marcos Ramirez
Thank you, Ursula. Good morning, everybody. First, I want to wish you a very successful year. Thank you for listening to the conference call. We have a lot to tell you in this hour. I will go over the results, and Rafael Arana will add more color in some relevant areas, and we'll share with you our 2020 outlook. Then we'll open for questions.

We are pleased with the results achieved both in the quarter and throughout 2019. It was quite a challenging year that required a clear strategy to overcome the lack of growth in the country. Our strategy, I shared with you through the various meetings and calls that we had along the year, focused on improving return on assets, not necessarily by growing them, but by taking care of the funding costs and the risks associated with them. The strategy paid off as reported earnings and profitability are strong and aligned to the goals set a year ago. It was not easy. We had to change course several times as things evolved differently than originally planned. In the end, this demonstrates the advantages of Banorte. Its flexibility and diversification allow us to adapt to changing conditions and still achieve a constant stream of earnings.

Now moving to the actual results. Please turn to the slide 3 as I review the fourth quarter first. As usual, it was the strongest quarter, both in terms of growth and profitability ratios. Reported net income was MXN 9 billion, resulting in earnings per share of MXN 3.12. Return on equity reached 19% and return on assets was 2.3%, expanding 5 basis points.

The NIM of the banking business, on slide 4, expanded 30 basis points to 5.9%. The funding cost finally reached a more normalized level for Banorte, as in December, it reached 46% of the market rate, which is TIIE, as you know.

Trading revenue, on slide 4, normalized from the high result booked last quarter, ending at MXN 872 million, while net fees grew 33% and other income 3%. Expenses remained flat, ending in a cost-to-income ratio of 40.6%, up 40 basis points on a slightly reduced operating leverage.

The loan book, on slide 5, was up 4%, supported by growth in all segments, excluding payroll loans, where, usually, there is lower demand at the end of the year. Credit quality was remarkable. The NPL ratio declined 30 basis points to 1.7% as every loan segment showed improvements in delinquency ratios. Additionally, we reduced the balance of delinquent loans from homebuilders by MXN 1.1 billion, partly by a write-off of MXN 278 million and partly by our loan sale transactions were MXN 643 million. The cost of risk of 2% was down 50 basis points on lower reserve requirements for deterioration. Reserve coverage strengthened at 138%.

Now for the full year. Reported earnings were MXN 36.6 billion, 14% higher than last year. While reporting earnings were MXN 35.3 billion, up 17%, return on equity reached 20.1%.

Moving to subsidiaries on slide 6. The bank earnings were MXN 26.99 billion, MXN 27 billion, 11% higher. Insurance profits were MXN 3.9 billion and grew 14%. Annuities reached MXN 1 billion, with earnings up 26%. Afore had a very good year with earnings up 28% at MXN 1.6 billion.

Full year earnings and profitability ratios of the consolidated group were aligned along the goals committed with the market, as you can see on slide 7. All-in loan growth came lower at 2%, excluding the government book. But, this was the result of our decision to improve risk-adjusted profitability at the credit book, even if it dropped down the loan balances at the time when the market was willing to lend at very thin spreads, as you remember.

At December, the capital adequacy ratio of the bank, showed on slide 8, remained very strong at 18.6%, while the CET1 ratio was 12.7%. CAR, the capital adequacy ratio, declined 180 basis points against the prior quarter as the bank [indiscernible] up of the holding company a dividend of MXN 6.5 billion. We maintain our commitment to manage the bank with a strong capital position, while maintaining an attractive dividend payout ratio at the holding company.

Now, I want to move to our outlook for the 2020. We are anticipating a recovery of the Mexican economy mainly in investment. In overview, a 0.8% GDP forecast will come from four sources. The first one, the 2019 transitory shocks are gone. The second, the fact that 2020 will no longer be a first year in the government, so we expect businessmen to reactivate several investment projects postponed. In overview, investment will be particularly boosted by the implementation of the Phase 1 of the National Infrastructure Plan as well as the US ratification of the USMCA. The third one, the year 2020 is a leap year. This adds 26 basis points to the GDP. And the fourth one, we expect the state-owned PEMEX will increase crude oil production for the first time in more than a decade.

Recall that credit in Mexico has been growing at a rate of 1.5 times nominal GDP growth, which we are expecting at around 4%, and we plan to continue to take advantage of this and more.

With this, I conclude my comments, and now I will pass the microphone to Rafael Arana, who will give you more details on some of the numbers of the quarter and will also share with you our financial targets for the year. Rafa, the microphone is all you.

Rafael Arana
Thank you, Marcos. Thank you. I would like to go on—if you could follow me, please, to slide 9, where I think we could explain, as Marcos mentioned at the beginning of the conference, what was exactly the strategy that we follow in order to face quite a difficult market in the expansion of the credit growth but how do we manage the funding cost of how now we are returning, as Marcus mentioned, to the original,

very close to the original funding cost that Banorte has been able to sustain for several years.

If you go to the graph to the right, you will see that when—basically, you will look at two very important numbers. The first one is what was the return that we were obtaining on the loan portfolio, that was 8.6% before the integration of Interacciones, with a cost of funds against the reference of TIIE of 42 basis points. When we started the integration of Interacciones, we mentioned to you that the Interacciones funding cost was coming at a TIIE plus 20 basis points, and that we would really like to manage that down at the beginning to 40 to 46 basis points. And then, through the year, we committed to go lower than that.

And you will see in the graph in the red line how this evolved through the year. But, you can see on the red line, the return, the NIM for the loan portfolio went down from 8.6% in the third quarter of '18. It started to reduce drastically up to the first quarter of '19. That reached 7.7% of the return of the loan book. This was expected because of the funding cost of Interacciones, and then also that we released MXN 93 billion of funding cost that was coming from Interacciones at a very high cost. This was not an easy task to do, but you can see on the second quarter of '19, we started really to recover from that. And, when you look at the numbers on the fourth quarter of '19, we are now even better than the NIM that was before the integration of Interacciones, with already at a reduction in the interest rates. This was basically the strategy that Marcos described to you. Now our funding cost is sitting now at close to 44% of TIIE. And, I think we could lower that again to the 42% that we have been maintaining through the last three years before the integration.

So this really shows exactly what was the strategy and how do we execute the strategy. The synergies on the funding costs now are sitting at 110 basis points less, much better than we anticipated. And, this really allow us to—if we move now to the graph to the left—see the expansion of the margin of the bank, that when we see the numbers in the third quarter that we start to reduce the net interest margin of the bank from 6.5% to 6.3%, but now we're back to 6.6% of the net interest margin of the bank. If you just look at the numbers of December, for the net interest margin of December of '18, it was 5.4%, and the numbers for the net interest margin on December for the bank is sitting at 5.9%. This give us a very important advantage to start the year with a difference of 50 basis points compared to how we start the year in January of '18. So, the strategy paid off. It was not an easy strategy to execute.

Another very important thing to notice on this graph is that if you look at fourth quarter of '18, basically, the balance of the bank and in the size of the loan book was almost the same after the integration. There was almost no reduction in the size of the loan book, but the problem was not the size of the loan book, but the cost of the funding costs. So when you look at the numbers, we let go some of the government loans. It was basically to continue to execute the strategy, as we mentioned that it was much more profitable for the bank to continue to reduce the funding costs that go into a very aggressive pricing competition strategy that some of our competitors following this.

This strategy paid off, as you can see on the margin. But it was difficult, I think, for the market to really understand how was the execution of this strategy. Now we can really show to you how this worked through the year. And it was, I think, exactly what we promised to you about how we're going to be managing the assets on a very profitable way and not on a very aggressive growth strategy that will cost us dearly on the margin and on the net interest income.

If now we move to the next point that I think is worth mentioning is aligned with this strategy of really keeping a very close eye on the profitability of the book on the funding side and on the pricing on the book of the loans, a very important achievement for the bank was that the net interest margin after provisions reached record levels for the bank through the year. And this is the result of a very careful monitoring of the credit risk and also the execution on the recovery side, and basically, on the origination. And, most of the internal models that have been developed in the last five years now are fully into execution and is giving us very good numbers on the origination risk for the bank.

Another very remarkable number is the return on assets. Return on assets on a recurring basis continues to expand, and it really shows all that we have mentioned before: the funding strategy, how we have been managing the asset side, the origination side, the risk side. And now, it's reaching at a point of 2.3% return on assets that is really the record for the bank. And at the same time, the cost of risk is close to 2%. That is also very good numbers compared to the numbers that we have been having in the past.

Another thing that I think is important to notice is that when we have a very extraordinary third quarter concerning the trading gains, there were some concerns about how we're going to recover that for the fourth quarter. And, the recovery really came from the recurring side of the business. If you look at in the third quarter of '19, the trading gains reached MXN 2.3 billion, but if you look at how do we recover this from the fourth quarter, a portion of that comes from the interest income, another part comes from the net fees and another part from the recurring part of the trading revenue.

So, a very important part of these numbers is that the recurring side of the business is, again, providing the revenues that we expect for the recurring side of the business to provide. It has not been an easy year because of the lack of growth in the loan book but I think we compensate that in a very important way by how do we manage the funding costs, how do we manage the risk side. And, we have seen in the fourth quarter, as Marcos mentioned to you, an increase in the loan book, not just on the government book that I think we will see other projections for the year, but the commercial and corporate book we expect also.

And, I think it's remarkable to look at exactly like the corporate and the commercial book proceed through the year, facing a very strong contraction of the loan growth. If you look at the numbers that we have provided, and if we could go on a line-by-line basis, even with a reduction in the loan book, the profitability of those business were above 16% for the year, and basically providing a lot of services to the companies, a much better—because we decided to keep the clients that we have been doing business for many years, providing much better services, fees went up, the margins went up. And, it was basically by providing a top-of-the-line service and a top-of-the-line capabilities for these companies to manage.

So it was a difficult year, as Marcos mentioned, but I think we really take advantage of the very loyal and very strong customer base that we have. We have all the levers and processes to really continue to reduce our funding cost. The risk side of the business will continue to be—I was taking care of all the pieces that we need in order to have a very good origination and recovery on the side. Some people are concerned about if this is sustainable or not. I think we have much better models now. We have a much better recovery process now at this point in time. And, the way that we have been delivering in the consumer side by basically continue to do authorized or preauthorized credit, I think we will continue to provide good numbers through the year.

If I now go to the guidance—and I think it was important for you to know why we are providing to you this guidance based upon what we achieved on the past year. Loan growth, we anticipate based upon the nominal GDP, if you multiply that by 1.8% to 2%, that has been the case for Mexico in the past years, we could reach numbers from 6% to 8%. We continue to see expansion on the margin, as I have mentioned to you. We still see 2 percentage basis points lower on the overall funding cost for the bank. The expense line is going to be from 5% to 5.5%. And, this, again, will put us on the line that we have been always inflation plus 150 basis points.

It's also worth mentioning that even though we have been, again, very disciplined in the expense line, we continue to invest on the technology side at the same pace that we have been investing in the past five years. The efficiency ratio will be raised from 38% to 39%. Cost of risk will be from 1.9% to 2.2%. The tax rate, 26% to 27%. And, there have been some concerns about the reduction on the tax rate and this has a very simple explanation. In the past before the recovery of the assets of the homebuilders, those were nondeductible because we couldn't really apply any of the deductions of the losses of the homebuilders against any sales on the investment projects or on the land that we possess.

Since we repossessed most of the land last year, now we are actively selling those projects and land. We achieved close to MXN 800 million of selling with a profit around MXN 200 million of that. So now we can apply—those nondeductible deduction in the past are deductible now. So, you will continue to see a very balanced tax rate around 26% to 27% compared to the 27% to 28% that was in the past. And, the reason for that was that part of the known—the possibility of the investment projects on the homebuilder side. That thing is now moving ahead, and we will continue to have this normalized tax rate.

Net income will be from MXN 37.5 billion to MXN 38.8 billion. We are aiming, as we have been communicated to you, to have double-digit growth in the low teens, and we think we can achieve this.

Return on equity will move from 19.6% to 20.1%. There has also been some comments that in order for us to achieve the return on equity, we will be managing aggressively the capital in order to release that and achieve the return on equity. As we have always committed to you, the return on equity that we are measuring and everything that we are providing to you in this guidance is based upon recurrent earnings. We are not putting extraordinary earnings in order to achieve the return on equity. The return on equity should be achieved, the same that the guidance that we are providing to you based upon recurrent earnings.

GDP that we expect is 0.8% and inflation 3.5%, and the average reference rate will be 6.5%.

With this, I finish my comments, and now it's open for questions.

Marcos Ramirez
Thank you, Rafa.

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-answer session. To ask a question, you may press star then one on your touchtone phone. If you're using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. Those listening through the webcast may submit questions by clicking the word Questions on your screen.

At this time, we will pause momentarily to assemble our roster. Our first question is from Jason Mollin from Scotiabank. Go ahead.

Jason Mollin
Thank you. I have two questions. My first is on the capitalization level and optimizing that and expected dividend payout, for instance, or buying back shares. Your CET1 is at 12.7%. I guess that's over 60% above the minimum. Can you give us some guidelines in what you're anticipating in your return on equity outlook?

And as a driver, my second question is related to that. You have a net interest margin outlook of an expansion of 5 to 15 basis points. Rafa, you were just explaining how you're working on the funding side and how positive the evolution has been there and that you expect that to continue. Can you talk a little bit on the loan yields and competition by segment to give us a sense of where you see that side of the equation in the NIM moving? Thank you.

Marcos Ramirez
Thank you, Jason. The first one, we do not expect right now to change the dividend policy. But maybe in the future, we will talk with all you guys if something changes, but not right now. We feel comfortable with the level that we are paying.

And the second, Rafa, please go ahead.

Rafael Arana
Yes. As Marcos said, I think it's worth to notice that, as you mentioned, we always look at every single side of how do we make efficient for our shareholders the capital base. Yesterday, we asked for the Board to increment the size of the potential buybacks that we could do on the market, just to have much more leeway on that part. But I think, as Marcos says, we are comfortable with our 50% dividend rate. We always see whatever comes and see what's better for the shareholders. At this point in time, we are contemplating also every single possibility to make this much more efficient for you. But the return on equity that we will deliver will be basically, as I mentioned to you, on a recurrent basis and also taking into account the same dividend policy that we have.

On the second one that you mentioned, competition was very strong through the process of the hike in the interest rates, especially on the mortgage side and in the car loan side. That was a very strong competition with BBVA basically and also for Scotia. I think we did a very good job, the retail guys, the product guys, the distribution guys, and that put also a very tight pressure on the margins, especially for this type of loans that are fixed-rate loans.

Now that the interest rates are coming down, what you will see is now that the expansion in the margin on those portfolios is already starting to happen, and that is part of how we are balancing out the reduction in the rates and also the expansion in the margin. If you look at the numbers of the fixed-rate books, that was basically the car loan books and the mortgage book and part of the payroll book, it was MXN 170 billion three years ago. And now, we are sitting on MXN 290 billion of these fixed-rate loans. So, this is basically what is going to hold on, on the margin.

Competition will continue to be strong as has been having in the past. The only, I would say, irrational competition that we faced in the past, and we let go that part, some of the loans, was in the government book that now is being much more normalized in the past two months. And now with the funding cost that we now have, if we would like to compete again aggressively in some of the special loans that we would like to keep, now we are in a possibility to do so without affecting the profitability of the book.

Jason Mollin
That's helpful. I mean, so even with declining rates, declining policy rates and market interest rates, your actions, you're stating that the asset sensitivity is actually broken down, meaning that you're liability-sensitive or you can manage the book and actually increase your margins with lower rates. So, that's a very different path than we've seen in the past.

Rafael Arana
Exactly right, exactly right. I think the treasury has been doing an extremely good job on how we hedge

now the coverage and the cost of the funding on the hedges.

Jason Mollin
Great. Thank you very much.

Operator
Our next question is from Thiago Batista from UBS. Go ahead.

Thiago Batista
Hi, guys. Thanks for the opportunity. I have two questions. The first one, on the loan growth guidance that you gave about 6% and 8%, can you share with us the dynamics that we're expecting in the segments? Which segments should lead to the expansion? If government book can continue to improve [background noise]? So, the main dynamics of the loan growth in 2020.

The second one, if you can comment, if you can share with us your perception about the implementation of the CoDi, the Cobro Digital. I noted you are still in the first couple of months or even weeks. But how was this first phase of implementation of CoDi? How were the factors of this by the clients? So if you can share with us the main view about the CoDi?

Marcos Ramirez
Thank you, Thiago. The loan growth is in corporate, around 5%; in commercial, around 10%; in government, only 3%; automobile, 13%; mortgage, 11%; credit cards, 12%; and payroll loans 7%. The average of all this goes to 6% to 7% to 8%.

And then about the CoDi, Paco [ph] Martha will give us more color.

Jose Francisco Martha Gonzalez
Hi, Thiago. Good morning. We launched CoDi according to the regulation in the last quarter of last year. We have now more than 50,000 customers using the solution with almost 30,000 transactions being processed through the platform. We don't expect this to affect in a negative way to the customer. More than that, it's another payment method that they have in both applications that we are offering now in both apps, mobile banking and the paper one. And so, we are expecting to offer them a different payment method, not only for the persons but also for persons doing business.

Thiago Batista
Okay. Thank you.

Operator
Our next question is from Gabriel Nobrega from Citibank. Go ahead.

Gabriel Nobrega
Hi, everyone, and thank you for the opportunity to ask questions as well. Given your GDP guidance of 0.8% this year and also a slower economic backdrop for Mexico, are you seeing any upticks in delinquency in your books? Is there anything worrying you now? And, I'll make a second question afterwards. Thank you.

Rafael Arana
I will start on, I think, the credit guidance. But, I think if you look at the numbers for every one of the portfolios, the mortgage book, the credit card book, the car loan book, the payroll book, commercial, government, have been at record lows on this. And this is really the execution of a very predictive model that the risk guys developed in the past years, extremely good execution on the recovery and

anticipation side and the origination process that we continue to deal basically were on client base. That has been the results.

We are very vigilant, and we'll continue to do so. The roll rates are looking good. But as always, there's always a possibility to do so.

Marcos Ramirez
Mr. Carlos de la Isla will give us more color about that.

Carlos de la Isla
Hello, Gabriel, as Rafa mentioned, on the consumer portfolio, we still see good conditions. As you know, salaries have been behaving better than before, and there's really no unemployment yet, so we're expecting that portfolio to continue in good form.

On the commercial side, on the corporate side, we've been very selective, not just on the industries, but also on the geographies. The country has been growing at different paces in the different areas. The North is still in relatively good terms so we're very careful on choosing, as I said, the industry, but also the geographies. And, we've been paying very close attention to the different projects that we're being involved in so we're not expecting any particular increase in the cost of risk.

Gabriel Nobrega
That's perfectly clear. Thank you. And as for my second question, it's actually on the fee income line. I understand that it increased well [ph] different quarter, and it was also helped by the reversion on the insurance expenses side. But I just wanted to understand what are you expecting for 2020? And, are you beginning to see an increase of your loyal customers actually paying off? Thank you.

Rafael Arana
On the fee side, as you mentioned, I think it's very good that you clarify the issues on the insurance side. I think that the basic banking fees went up 8%, and that's the number that we should be really concentrated on that. I think that's the number that we should be looking also at least for the next year.

Ursula Wilhelm Nieto
On the insurance side, let me just clarify that. We did not reverse any provisions. What we just did was our reclassification. Maybe Fernando, the head of the business, explained it in the third quarter so he will explain to you what happened this quarter, so it's clear. But, from a net income and a revenue standpoint, there was no effect at all.

Fernando Solis Soberon
That's right. In insurance, remember that last time we explained that we were experiencing an increase in the loss ratio in a big account, and therefore, we decided to increase our provisions. But, the way in which the statutory rules of the National Insurance Commission, we're not allowed to put it in the incurred but not reported reserve, until we change the methodology in that reserve. Therefore, the only way in which we could put the reserve for these funds aside on a very caution way was to put it on the commissions, provision on commissions, to be paid to insurance.

But, once we obtain the new methodology being accepted by the insurance commission, we just need what we just explained last quarter that once we have this authorization, we would move that reserve from that part of—that was put in the commission side, that's a commission to be paid, it was classified, and it was put where it belongs once we have the authorization, which is in the incurred but not with the reported reserve.

That’s why there is no effect because of the renovation in the results of the insurance book. But, it should be mentioned what we said last time is that we are very conservative, and we decided to put aside these funds and to keep observing the behavior of these very big accounts. And, according to what happened, it will either be paid in losses or it will be released. At this point, we cannot tell, but that’s what happened.

Gabriel Nobrega
Alright, that’s perfectly clear. Thank you.

Marcos Ramirez
Thank you very much.

Operator
Our next question is from Nicolas Riva, Bank of America. Go ahead.

Nicolas Riva
Yes, thanks for taking my question. I have a question on the fixed income side. We have seen so far this year a number of LatAm banks coming to the market with senior bonds, banks in Brazil, in Chile and in Colombia. Last year, you issued the perps. And if I look at your capital levels, there doesn’t seem to be a need to issue Basel III bonds. On the senior side, do you have any needs in terms of funding US dollar loans to issue senior bonds? Or what’s your outlook in terms of potential bond issuance? Thanks.

Rafael Arana
Thank you. No, as you mentioned, the strategy that we have been following is to really eliminate all the Tier 2 and non-efficient notes that we had in the past. As you know, we have been doing some tender offers to our notes in the past months. What we will like to continue to do is to completely eliminate all the non-efficient notes that we still have around $300 million.

And also, we have been seeing a very big opportunity in order to provide funds in dollar terms for some of our companies. So, maybe we will—we are always looking at the possibilities and opportunities, but I think there’s still a possibility because we’ll like to continue to do some tender offers to the outstanding notes in the coming months. So, maybe we will like to go again into the market. It depends on the conditions. And, it’s not that we need to do so. If we can make the balance sheet more efficient, we will go to the market in that part.

Nicolas Riva
Thanks.

Operator
Our next question is from Alonso Garcia from Credit Suisse. Go ahead.

Alonso Garcia
Good morning, everyone, and thank you for taking my question. I have actually some follow-ups. First, in terms of loan growth, to clarify if guidance this year includes or not the government portfolio.

And also, I mean, the 6% to 8% guidance of loan growth, it represents a meaningful pickup from current levels. So, I wanted to check with you if you have observed, since the last part of last year and the beginning of this year, more appetite for trade already from corporates, from the commercial side? Or what is making you comfortable that you can achieve that guidance? And if you expect that 6% to 8% to be in line with the system or would that represent, in your view, some market share gains? Thank you.

Marcos Ramirez
Thank you, Alonso. Yes, the guidance includes the government portfolio. As I told you, so far, we are thinking a 3% increase in the government portfolio.

But Rene is going to talk a little bit about the corporate.

Rene Pimentel
Yes, hi, Alonso. This is Rene Pimentel from corporate banking. Basically, last year was definitely, as you know, a complicated, a very challenging year in terms of the loan portfolio. We received significant prepayments to our portfolio, around MXN 17 billion, so that's around 12% of the portfolio, which we had to compensate. But we did see a significant pickup towards the end of the year. It mainly had to do with a very strong pipeline that we had built throughout the year, which, at the end, with this lower cost of funds described by Rafa, allowed us to participate in certain transactions, which we wouldn't have participated in early in the year. So, this allowed us to grow quarter-on-quarter around 4%. We're continuing to see this dynamic in the first quarter. We believe that this 5% that Marcos mentioned is very much achievable.

Also, as a strategy, what we focused on last year is we launched a loan syndication desk, which we didn't have. This has allowed us to distribute the risk better and enter transactions where we weren't players before, not only invited to loan syndications but also leading transactions, which has enhanced our commissions.

And so, it was a challenging year, but we're very happy with the results. Our bottom line at the end of the year grew 16%, as Rafa mentioned. So, we're capable of maintaining the quality of our portfolio, which is going to be the focus for 2020. And with this momentum, enhanced by the lower cost of funds, we believe that it's very much achievable.

Alonso Garcia
Okay. Thank you very much. And, just one final follow-up. In terms of capital, you mentioned that you were basically analyzing every single possibility in order to keep the structure optimal. But I want to check if M&A is included in this sort of opportunity that you would be willing to look at or to consider to keep capital optimal? Thank you.

Marcos Ramirez
Thank you, Alonso. As we said, we will keep saying that we are open to all possibilities. And, our duty is to see what's going on in the market, and then we are not the people who will decide. No? We will show all the possibilities and the assembly will say if they want to go ahead or not. We don't have anything in the pipeline right now but we want to maintain open that possibility as all of the others.

Alonso Garcia
Thank you very much.

Operator
Our next question is from Geoffrey Elliott from Autonomous. Go ahead.

Geoffrey Elliott
Hello, thank you very much for taking the question. Can you, first of all, confirm on the NIM outlook, what the base for that is? Are we looking at the bank NIM or the group NIM? And then is the base the full year 2019 figure or the 4Q figure? And then, I'll have a follow-up after that.

Marcos Ramirez
Ursula?

Ursula Wilhelm Nieto
Yes. On the 5% to 15% expansion in the NIM that we cite in the expected numbers for 2020 is at the group level. But obviously, it has to flow really from the bank because that is where, let's say, the credit business is. So, you will also see movement in the NIM of the bank in the upward direction, but it will be reflected in the group. Ultimately, it's at the group level.

Geoffrey Elliott
And the base is the 2019 5.6% or the 4Q 5.7% or the December 5.9%?

Ursula Wilhelm Nieto
Well, the base is the 5.7% quarter number because at the end of the day, we do report on a quarterly basis, and that is what we follow with our investors. We cited the 5.9% December number because, really, we wanted to show you that the improvement is already evident there. And, we are starting 2020 with a much stronger base of NIM than what we had in December '18. But, really for comparative purpose and for following results, you should look at the quarter numbers.

Geoffrey Elliott
Got it. So the message is really the NIM expanded during Q4. December, you got to the 5.9%. And then, I guess, to get to the plus 5 to plus 15 basis points, you'd be a bit above the 5.7%, but below the 5.9%. That's kind of where you're expecting to track during 2020?

Ursula Wilhelm Nieto
That's right.

Geoffrey Elliott
Thank you.

Ursula Wilhelm Nieto
Thank you, Geoffrey.

Operator
Our next question is from Arturo Langa from Itaú BBA. Go ahead.

Arturo Langa
Hi, everybody, and thank you very much for taking my question as well. Just two brief questions. But, on the risk management side, I believe that there is an implementation of a new accounting standard set to be in place by the CNBV around September. I think it's IFRS 9, I think, which I was wondering if that will have any effects, especially in the mortgage book.

And then my second question is regarding spreads. I think what we saw in the recent years is as interest rates went up above 8%, banks sort of absorbed or compressed their spreads. And, I was just wondering how you see that coming on the way down? Those would be my two questions. Thank you.

Marcos Ramirez
Thank you. The first one about the accountability of, let's say, in the risk management, de la Isla is going to give some color. And the second one is very interesting what's happening in these kind of countries with the spreads when the rates go down. So I will ask Rafa to give us some light there.

Carlos de la Isla
Yes, Arturo. IFRS will start ruling in January of next year. And, the overall effect that we estimate is about MXN 900 million, but that will impact our equity position. As for mortgages, in particular, the impact will be around MXN 200 million. But as I said, all those effects will go directly to equity.

Rafael Arana
And on the next questions what you mentioned about the compression in the spreads, it was really, as we mentioned at the beginning, a difficult process to sustain the profitability of the book, especially the mortgage book and the car loan book. I think the decision that the bank realizes that we were going to go for really top-of-the-line clients in order to reduce the expected loss. And, as you can see in the numbers for the past two loans is around 1% for the mortgage book and for the car loans. So, by having a very low expected loss, we were able to maintain the profitability of the portfolio.

If you compare our numbers to the market numbers, we have around 200 basis points of difference compared to the market. That's what's really sustained the profitability, the quality of the book because the prices in the market was really already set up by the competition. So really, the strategy was to be able to compete with those prices with a much better risk in order to really keep the risk-adjusted margin up. And I think the mortgage team and the car loans team and the distribution team did an extremely, extremely good job in this.

Arturo Langa
Perfect. Just to be completely clear, but the implementation of IFRS, you said January next year? So just to be 100% clear, it's January 2021, right?

Carlos de la Isla
Yes, correct.

Arturo Langa
Okay. Thank you very much for your answers. It's very helpful.

Marcos Ramirez
Thank you, Arturo.

Operator
Our next question is from Yuri Fernandes from JPMorgan. Go ahead.

Yuri Fernandes
Thank you, gentlemen. I have a first question regarding the Afore. It was a very good year, so if you can explain what drove the 28% increase in earnings. I saw here the AUM grew healthy 18%, but just checking if there is something else and how you see the results evolving this year.

And my second question is actually a follow-up on Jason's questions regarding the dividend policy. If I'm not mistaken, your policy today is from 60% to 50% of previous year earnings. And if that's the case, I'm having a hard time reaching the 19.6% to 20% ROE guidance you have. Because, given like the 194 billion shareholders ex-minorities you're posting, even at the top of your guidance, it's hard to reach the 20% ROE if you keep the 50% policy. So just checking here if I'm missing something on the dividend and regarding the ROEs.

I was thinking also about the IFRS 9 implementation. But given it's only going to take place in 2021, not sure if this will hit your equity in the end of 2020, right? So just checking here because it's hard for me to reach the ROE guidance. Thank you.

Marcos Ramirez
Thank you, Yuri. You're right, it's not easy task. But first, the Afore—

M
Well, with respect to the Afore, I mean, mainly what explains the results is the behavior of the asset markets. I mean we obtain a return, more or less, around 15% on the assets under management. So, we have a very, very good year. Therefore, assets grew very strongly. And that's, I would say, the main reason for the explanation of the result.

Actually, in relative terms, we're also in very good shape because we were the second, in terms of performance, player in the market. So, we have the absolute that helped the whole industry, but also on the relative side, we had a very good year. So, that's basically what explains the results for this year.

That's why for the next—I mean for the current year, we do not expect such an important return on assets. We are expecting also a very difficult environment in the sense that we reduced the commissions that we charged on the assets under management, 8 basis points, but also the industry as a whole reduced the commissions in a very important way, in a much important way that we observed in the past.

So, what will happen in the future with respect to that, it's hard to tell because, certainly, all of us facing this reduction in the commission, even though the assets under management are larger than we expected, and that will protect, to some extent, the income, it's going to be very interesting to see what will happen with competition because this is a reduction for all the players who are significant.

It's likely, but I cannot tell you for certain that perhaps the commercial expense will be reduced, and that will also determine what will happen at the very end with net earnings. So I think that will determine it, and we're working on that. And therefore, we are very conservative as well in the projection. We will not see a strong result in next year, but it will not be as bad as many may think because of this reduction. It will depend very strongly what will happen with the reaction of the other players.

Marcos Ramirez
Thank you. Rafa?

Rafael Arana
I think what you mentioned is correct. I think Banorte has been, in the past years, a net generator of capital based upon the subsidiaries' capacity to provide the dividends to the group and also the size of the growth of the loan book. Because you're already considering the ex-minority piece reaching the return on equity, I think in a way, we think based upon what Rene told you about the corporate and things, I think even though we are looking at a 6% to 8% loan growth and 0.8% GDP, we also are looking to see on the first quarter in order to see the possibilities of the managing of the capital to see what's really going to be the size of the loan growth. And, I think we hope it could be a good surprise for the market, but we have to wait for the first quarter to really be much more precise about the capital management piece.

Yuri Fernandes
Thank you, Rafa. Thank you for the answers.

Marcos Ramirez

Thank you, Yuri.

Operator
Our next question is from Neha Agarwala from HSBC. Go ahead.

Neha Agarwala
Thank you for taking my question. Congratulations on the results. I have three questions. First, in terms of composition of your loan book, how much exposure do you target for your government loans? Given that you want to grow government loans at about 3%, so there will be some dilution in terms of composition. So what is the target for this year or the coming two, three years?

Second question is on the fee regulation that we talked about last year. Are the discussions still going on? And, can we expect any announcement in March?

And lastly, now that we are already in 2020, and you will achieve your 2020 target, what should we expect for the coming three to five years? Will your focus be on growth, on profitability, on dividends? What is it that you're planning for the bank in the medium term? Thank you so much.

Marcos Ramirez
Thank you, Neha. Well, let's go for first one, the competition in loan book and the target for 2020.

Ursula Wilhelm Nieto
Well, good morning, Neha, and thank you for your questions. For the government book, as Marcos mentioned, we expect to grow this book in 2020, around 2%. We really have no target in terms of market share or any of that because really, there continues to be this drive to maintain profitability above anything else, so there is no rush to grow. What we expect differently this year is that we should see a little bit more demand coming up in this market other than what we saw until 2019, where there was really no new demand of new financing. It was all refinancing of existing assets. So, this is one thing.

In terms of new regulations—

Marcos Ramirez
As we know, so far, there is no regulation, nothing in the Senate right now. So, if something new arise, everybody will know. But so far, that's in a quiet period, and we are working as normal.

And the third one, what should we expect in the strategy in growth and dividends, Rafa?

Rafael Arana
The strategy in growth, I think, Neha, you said it perfectly. The best asset that the group has is the customer base that we have. We have a very large customer base that we have been working in the past, more and more increasing the value and the relationship with these clients by releasing a lot of analytics and technology, and we are just beginning to do so. So, in the next three years, you will see a lot of evolution in this part that will increase the lifetime value for our clients in a permanent and sustainable way in order to continue to achieve the metrics that we have provided the market in a recurrent basis.

On the dividend side, as we mentioned, our policy right now is up to 50%. And, we always are looking at ways to keep our investors on the most comfortable way by really managing, through the year, the evolution of the capital base. And, I think that will continue to be the case.

Neha Agarwala
So should we consider this 20% ROE a sustainable level?

Rafael Arana
Yes, the 20% ROE, based upon the similar conditions, should be our aim.

Neha Agarwala
Thank you so much.

Ursula Wilhelm Nieto
If I may, just a comment because we got a question online specifically again on the potential fee regulation. Just to clarify, as we said, that we are not foreseeing anything to change so far so just to make it clear for the person who asked online.

Operator
Our next question is from Claudia Benavente from Santander Banco. Go ahead.

Claudia Benavente
Hi. I only have a follow-up question regarding the capital level. I'm not sure what I'm missing. But, if I use your guidance, and in order to reach the maximum 20.1% ROE, you basically need your shareholders' equity in 2020 to remain unchanged. And for that to happen, you'll have to—or increase the dividend payment or I don't know, do a buyback program. So, I'm not sure what's considering the estimates to reach the 20%. Thank you.

Rafael Arana
Claudia, I think you said it. I think that's why we have opened the possibility of the buybacks. We have opened the possibility of additional dividend. And, you also have seen in the past years that we have been buying portfolios, especially on the annuity side that has been provided extremely profitable for us. That's a number that when you look at the margins that provide on the annuities book, it has been going down because of the size of portfolio, but the profitability of the portfolios will continue to go up.

So, we are always looking for opportunities. I think we will continue to look at portfolios, like we have been doing in the past, and continue to manage the capital base that we have been doing in the past. I think it will be an unfair way to measure the bank to say that we are with our hands tied in order not to reach the best, more efficient way to release capital to the market. But, we are not like to play the game is to leverage the bank in order to really achieve the 20% return on equity. That should be attained, as we have been doing in the past four years, based upon recurrent growing sustainable earnings in that. If additional capital should be managed, we will do so.

Claudia Benavente
No, no, I agree, I agree with your points. It's basically because I was looking to the past, and you've been growing the shareholders' equity like by over 10% every single year. The only two years where it grew 4% was when we saw an important increase on the dividend payments. But, yes, maybe buying portfolios could make sense. I was just trying to wonder what was the assumption that you had incorporated. Thank you, Rafa.

Rafael Arana
No, no. Thanks, Claudia. I think that's the case as you mentioned, and we are always on how we are efficient on a portfolio base, how we look at a strong bank for our tenets of instruments that we have, but also not to be inefficient, but also not to be playing the leverage game.

Claudia Benavente
Great. Thanks.

Operator
Again, if you have a question, please press star then one. My next question is from Ernesto Gabilondo from Bank of America. Go ahead.

Ernesto Gabilondo
Hi, good morning, Marcos, Rafa, and good morning, everybody. Sorry I entered late to the call, but my question is on your cross-selling ratio. I believe you have done a very good job in improving this ratio, but how much room do you see closer to the industry levels? And, what will be your strategy to cross-sell banking products to the Afore's clients?

And then my second question is, when do you expect to provide medium-term guidance?

Marcos Ramirez
Thank you, Ernesto. The second one, we will give it at the mid of this year, June, July, around that. We are working, obviously, already on that. It's a continuation of the 2020.

And the first one, the cross-sell ratio, first, the industry levels are totally different depending on how you compare and how you do the metrics. So, we compare with ourselves and with our methodology, because I think it's different. And, we are aiming to the 2.2 so far for the end of this year. And we will launch, whatever it's going to be, as I told you, in July and for the next years.

Ernesto Gabilondo
Perfect. Thank you.

Ursula Wilhelm Nieto
Kathy, I believe this was the last question that we had in the queue. Is that correct?

Operator
Yes. We have no further questions over the phone in the queue at this time. So, this concludes the question-and-answer session. I'd like to turn the conference back over to Ursula Wilhelm Nieto for closing remarks.

CONCLUSION

Ursula Wilhelm Nieto
Marcos, [speaker off-mic].

Marcos Ramirez
Thank you much, and see you in three months more, I hope, with exciting news. Thank you very much.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.