Y 2020 Earnings Call

Company Participants

- Francisco Martha, General Director, Payment Methods, Digital Banking and Technology
- Gabriel Casillas Olvera, Deputy Director General of Economic Analysis
- Jose Marcos Ramirez Miguel, Chief Executive Officer & Proprietary Board Member
- Rafael Victorio Arana de la Garza, Chief Operating Officer & Chief Financial Officer
- Rene Gerardo Pimentel Ibarrola, Deputy MD of Corporate Banking
- Tomas Lozano, Head of Investor Relations, Financial Intelligence and M&A
- Unidentified Speaker

Other Participants

- Alonso Garcia
- Analyst
- Brian Flores
- Carlos Gomez
- Ernesto Gabilondo
- Geoffrey Elliott
- Gilberto Garcia
- Jason Mollin
- Jorge Henderson
- Jorge Kuri
- Luis Yance
- Thiago Batista
- Tito Labarta
- Victor Galliano
- Yuri Fernandes

Presentation

Tomas Lozano {BIO 20398814 <GO>}

Good morning. I am Tomas Lozano, Head of Investor Relations, Financial Intelligence and M&A. My best wishes to all of you in this new year. Welcome to Grupo Financiero Banorte's Fourth Quarter Earnings Call. Today's 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 these into consideration.

I would like to thank you for answering the survey. The information you provided is very useful for us in order to improve our presentation and information. We are developing the new platform (Technical Difficulty) and more efficient communications.

Our CEO, Jose Marcos, will provide highlights of the second partial lockdown in Mexico and the measures that have been implemented at the group to face these new challenges. He will guide us through the main financial results and will provide an update on our main ESG initiatives. Later, Rafael Arana, our CFO (Technical Difficulty) into the deep (Technical Difficulty) other detail on quality and would provide financial and operating results. To conclude our call (Technical Difficulty) will give you some (Technical Difficulty) Thank you. Jose Marcos, please go ahead.

Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thank you, Tomas. Good morning, everyone. I wish you all a safe and prosperous 2021 and thank you for joining our call. The fourth quarter of 2020 was marked by recovery as different sectors in the economy adapted to the new normal and my optimism and hope as the COVID-19 vaccines proved to be successful and mass distribution was put into action. Unfortunately, this increased activity unleashed a new wave of contagion and partial lockdowns were once again announced in Mexico City and in other states of the country during the last weeks of December.

The daily number of new cases has surged and death tolls have suddenly reached a new high. Hospitals in regularized states are at full capacity forcing activity to take a step backwards. However, this does not mean that we're back to where we started in March of 2020. We are definitely better prepared than before to cope with this situation both as a society and definitely as a financial group.

Business across different industries have come up with new and creative ways to stay afloat, some reinventing the business model and some others skillfully adapting to this new normal. Restaurants have increased home delivery and adapted their menus to make them take-out friendly. Many of them have enrolled into digital apps such as Rappi and Uber Eats enabling them to take online orders for their growing customer base.

Many retailers have strengthened their online shopping facilities and now offer in-store or pickup services. At home, most of us have overcome the learning curve and are now (inaudible) in video calls and remote team work. Therefore, productivity will not be compromised again for most businesses.

At Banorte, we have also become stronger and have remained closer to our customers through enhancement in our mobile app, which provide more ways for our customers to fulfill most of their banking needs with less dependence in our branch network and promoting the use of our digital channels to new and existing customers alike. Rafael will provide more details on our digital initiatives in a few moments.

On the macro level on the Slide number 4, there are also several counterweights that will help Mexico and Banorte to weather these continued challenges and foster growth. Our most recent GDP growth estimates points to a 4% recovery in 2021. The new fiscal stimuli announced by the U.S. government is expected to fuel its economic recovery and also of its closest commercial partners.

Manufacturing supply chains linked to the newly revised North American Trade Agreement will ensure steadily export demand for this sector. Moreover, the U.S. nearshoring strategy has brought increased foreign investor into Mexico and a wide array from China.

Stronger U.S. economy will consequently translate into stronger remittances, which fortunately did not stop during 2020, and are key driver of economic activity for our country. In the domestic front, Mexico Central Bank has sufficient leeway to increase monetary stimulus if required. Our economic analysis team forecast a 50 basis point cut in the reference rate during the second half of 2021. Furthermore, the government has announced 50% minimum wage increase in 2021, which should also fuel economic activity during the year. All together, these measures should outweigh the challenges brought by the second wave of contagion and by other relevant events during this year.

New Mexico will go through midterm elections for Congress and several state governments. This is why we have heard and will continue to have regulatory noise, as different political players try to stand out throughout their political race. As of today, some regulatory initiatives have been postponed such as the one related to the U.S. dollar buybacks by the Central Bank and some others have not gained traction whatsoever, such as some isolated efforts to lower fees or regulate interest rates for financial institutions.

From the bank perspective, we have also implemented immediate actions to tackle with these new challenges. In order to guarantee a safe environment for our customers and employees, we have instructed that all business areas that have been working from home to continue to do so until further notice.

Constant communication regarding preventive measures and close monitoring from our medical staff has ensured timely treatment and isolation of suspicious and confirmed cases. In light of the new lockdowns, we will make a more efficient use of our branch network in the most affected cities, increasing the number of shifts and lowering the staff in our branches. We will also temporarily close or reduce number of branches in locations where all other nearby branches may observe customer traffic without compromising availability and compromising operation.

Moving to Slide 5. From a balance sheet prospective, we decided to shield it from the effects of the COVID-19 by announcing, as you know, an additional MXN2.4 billion provision charge, totaling MXN7.3 billion in additional provisions during the 2020. Similar to what we did in the second quarter of 2020, out of the MXN2.4 billion that were created in December, MXN2 billion were booked as additional loan loss provisions and MXN0.4 billion were used to fully write off certain commercial and critical portfolios that were already partially provisioned.

With these measures, we intended to concentrate the effects of the pandemic in our 2020 results and to have a stronger balance sheet and a normalized cost of risk during 2021. Had we not used part of our additional provisions to write off existing portfolios, the total amount of provisions would have been close to MXN25 billion, well above the three-year average.

Moving on to Slide number 6. In order to better understand the efficiency of our loan loss provision space, I would like to show you the breakdown of our loan portfolio and the degree of expected loss associated to the each segment. As you can see, our largest portfolios have a relatively low expected loss and our consumer portfolio, which naturally entails the higher risk is well diversified by product type with credit cards accounting for roughly a third of this portfolio.

Our commercial and corporate portfolios have a similar profile with SME customers, which carry the highest expected loss within this portfolio accounting for 11.2% of the total commercial and corporate segment or 4.7% of the total loan portfolio. Last but not least, our government portfolio, which accounts for 20% of our total loan book has historically has the lowest expected loss.

On Slide number 7, net income for the quarter totaled MXN30.5 billion, which includes the effect of the additional provisions booked during the fourth quarter. Excluding this effect, recurring net income amounted to MXN35.6 billion, up 1% versus our 2019 results. Regarding profitability indicators, these were consequently affected by provisions. The group's ROE totaled 14.8% for the year and with recurring results 17.1%. ROE for the bank totaled 16.7% and 20.6% when using recurring results.

On the Slide number 8, we look at the main revenue lines for the group, where I would like to highlight the solid net interest income growth during the year despite a 300 basis points decline in the reference rate during the period and the adverse conditions brought by the pandemic.

This on the Slide number 9 has relevant quarterly rebounds driven by a more dynamic economic activity. Holiday shopping and seasonal sales during the (inaudible) boosted transactions during the quarter with POS and mobile leading growth and get into a solid 16% quarterly increase in net service fees.

Regarding loan growth on Slide number 10, despite a more conservative risk policy across our portfolio, the main growth drivers for the quarter and the year were mortgages and auto loans. Our commercial and corporate portfolios also had a solid performance as several customers used liquidity lines to overcome the stagnant dynamics in many relevant sectors during the lockdowns of the pandemic.

At the end of 2020, the vast majority of our relief programs came to an end with better-than-expected results. Rafael will provide more details on these programs. Regarding asset quality, NPL numbers were temporarily low during the life of the relief programs. And as I stated, they have already started a gradual increase towards the normal and the average pre COVID-19 level. However, cost of risk is not expected to peak during 2021, as all the impact of additional provisions was registered in 2020.

On Slide number 11, we can see the loan growth effects on market share by product in 2020. Market share gains for our total loan portfolio were driven by sound performance in commercial and corporate. As customers in these segments used liquidity lines to meet their operating needs. As mentioned before, mortgages and auto loans were also essential components of our growth strategy with a more selective risk criteria in our secure -- our own secure products such as credit cards and bigger loans.

On Slide number 12, I would like to highlight the benefits of businesses diversification within the Financiero group. Our non-banking subsidiaries accounted for over 34% of the group's net income during the quarter and accumulative results for the year were also relevant. The insurance business was impacted by higher claims in the life and health portfolios during the fourth quarter. However, it benefited from lower auto claims as traffic reduced during the lockdowns.

The sound performance of the annuities portfolio was primarily driven by the acquisition of the Sura portfolio as well as by a diligent cost control strategy implemented during the year. Therefore, business benefited from the market effects in such assets valuations. Moreover, it increased its assets under management by 4% during the quarter and by 15% over the year.

As mentioned during our last conference call on Slide number 13, you will find the most relevant updates regarding our ESG initiatives for the group. On the environmental side, Banorte received awards for its collaboration with one of the most relevant reforestation projects in the country called Reforestamos Mexico as well as for its participation in a sustainable mobility initiative in Mexico City and Monterrey.

On the social arena, we are proud of our participation in more than 68 financial education workshops to cover 6,500 beneficiaries across 15 states covering relevant topics such as financial awareness, family finances, savings, digital banking, and investments. We have added an ESG appendix at the end of this presentation with additional details on the quarterly evolution of our sustainable finance loan book evaluation and our project evaluation under the equator principles.

With this, I conclude my remarks, and now, Rafael Arana will provide further insight into our loan relief programs, NIM evolution and will walk us through our 2021 guidance. Please, Rafael, over to you.

Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Yes. Thank you very much, Marcos, and thank you all for being on the call. I would like to run some specific issues that has been of concern to our investors and analysts about what we -- what's exactly the situation that we are facing concerning the relief programs, the clients are out of the relief programs and all the initiatives that we are taking in order to guarantee what we provide as a guidance for you.

As you can see on the slide that we're providing, we basically are under a very specific actions to continue to provide the sufficient strength to our balance sheet through our income statement and also to be quite prudent on the loan growth but at the same time to have a reasonable loan growth. So the loan growth, as you can see and Marcos just provided you the information, we were able also to gain market share in most of the products. The net interest margin on the book, as we can see in a minute, continued to be quite resilient. The capital numbers continued to grow and is as strong as they can be well above our peers and also in quantity and quality of the capital. Expenses are well under control and I will run you into some specific issues about expenses that we did in the fourth quarter of '20.

But I would say that, overall, I would say that the balance sheet continues to be as strong as it can be. The capital base continues to grow. Expenses are under control and the provisioning and all the relief programs that are mostly done by now confirm us what we basically did in the second quarter of '20 about the provisions, additional provisions, that were more than enough at that time. What we really consider when we see the second wave leading especially in Mexico City and other parts of the country, that it will be prudent for us to raise another number of provisions not because we saw that there was an immediate need to do so, but we need to manage risk and at that point in time we see that the risk was increasing, especially we expect to have some lay off from some of the companies in January and February so we anticipate that base upon on the second wave.

So, moving into the next space, I would say that the relief programs are really behaving much better than expected. As you can see now on the numbers that we have basically done on the relief programs, basically the initial numbers of 630,000 clients that joined the programs, 99% of those have finished the programs, of non-paying accounts and I'm talking about accounts, is around 11 -- from 10% to 12%.

But what is relevant to see is what this really means compared to balances, and what this really means compared to the overall size of the loan book of Banorte. If we compare this 10% to 12% of -- against the balances is 6% of the balance of the clients that joined the program. If you transfer that into balances, it's only 6%. And if you consider this 6% compared to the overall size of the loan book is 1%.

So the relief programs proved to be quite efficient to temporal the deterioration of the pandemic and also to support our clients through the cycle. So, this is mostly done, and now we are basically working with that 6% balances that we need to keep working with them through the collection department. I think we are doing a pretty good job also there providing the right relief to our clients and also building up the additional provisions that we need to do so.

So, there were some concerns about what we needed to raise additional provisions was basically as a precaution, not because of the provision that we've built on the second wave was not good enough based upon what we -- on the information that we currently have. But I think it's better for us based upon that we don't know exactly the lockdown on some of the cities will stay. But we found also is what Marcos mentioned that the second lockdown is in a way much better managed by companies, by clients, by everything. So activity hasn't -- obviously reduced a bit, but not as in the first one.

So we are quite surprised about SMEs, the behavior of SMEs. Basically, the main deterioration that we have seen and this was expected and I was worried that we didn't build the provisions on the second quarter was related to basically credit cards that, as you know, is usually the product that you share with other banks and where the risk could increase easily through the cycle. So, very good numbers on the relief programs, 1% to the total loan book, 6% of balances and 10% to 12% on number of clients.

Another issue that we have been following very closely with our investors and analysts is, what's the behavior of the margin, and also what's the increase of the margin on the loan book and what's the behavior of the other cost of funds compared to our peers. As you can see in the graphs to the left on the blue lines, basically we continued to drop the cost of funds at a faster pace than our peers. I think we still have room to go further down on this and we will push down in '21 to continue to reduce the cost of funds at least around 20 basis points.

When you see the net interest margin of the loan portfolio, has moved from 8.2% to 8% compared to a decreasing rate of close to 242 basis points. So, I think has been a resilient portfolio based upon the fact that we have close to MXN300 billion in a fixed rate portfolio that is behaving quite strongly through the cycle.

As you can see also on the graph to the right, we continue to manage the pricing and the yield on the portfolio quite efficiently. If you compare the decreasing rates from 11.8 -- 11.9% that was the peak to 9.3%, we have increased also the yield of the portfolio compared to the reference rate almost 260 basis points. So, I think that has been in a way the results where you see the NIM of the portfolio. This is because of the managing of the pricing of the portfolio and also on the fixed rate part of the book.

When you look at the NIM and we have been separating the NIM of the group and the NIM -- and the net interest margin of the bank, I think the reference rate, as I've mentioned to you before is dropping 260 basis points, the group NIM reduced from 5.6% to 5.3% where you have the insurance retention company, the annuities. But when you look at the bank's NIM that is really our main concern when you see the effect on the rates and how you are really managing your pricing and the yields. The bank's NIMs continue to be extremely resilient at 5.8% in the second quarter, in the third quarter and in the fourth quarter based upon what I just mentioned in the past slide.

So, the NIM continues to be steady. We will talk about EBITDA in a minute about what's our projections for the next year and it's important to separate the NIM of the group and the NIM of the bank.

Another good story is the reduction in the sensitivity on the balance sheet due to the extremely work -- good work of the treasury, the risk people, the market guys and everything that is related to planning and accounting. So, we have been reducing the reference -- the sensitivity from 100 basis points to that was close to MXN1 billion at a point in time to close to MXN0.5 billion in the fourth quarter of '20. And we continue to work on that and I think we will -- we continue to see good potential and continue to reduce the sensitivity of the balance sheet.

The expense line and I'd like to be very clear about what's happened on the expense line through the year. As you know, we conveyed the expense line to be around 4.8 by the year end. But based upon the issues that we saw in the market and that we would like to accelerate what we usually do every year in January, we accelerate the productivity process that we have every year that usually goes around 5% of our personnel expenses. We started that in December. So we increased the cost line by MXN460 million that is basically for the severance payments that's going to happen through the last December and through January. But expenses control, we consider that's going to be a key element in '21. And we also see that the personnel expenses where you see the drop to 4.1 is basically due to what I just mentioned about that increase in the -- in anticipation of the severance payments.

The remaining are related to basically all the expenses related to the operation of the bank, nothing relevant and we also are reducing a lot of the expenses related to physical assets that we have, that also will have an impact for the next -- for this year in the reduction of expenses in rate and occupancy rating in many of the buildings.

The capital of the bank continues to be quite strong. We see a reduction from the third quarter to the fourth quarter of -- from 21.1% to 20.2%, basically is the effect that we have on the extraordinary provisions. But as you see the capital -- the core capital of the bank continues to grow as nicely to 13.7% to 13.9%. We are not leveraging the capital at all -- of the company at all. So, we are the least leveraged bank in the market. And compared to the regulatory ratios, we are well above those and we are not taking any waivers or temporary waivers concerning our capitals.

The dividends that we have mentioned in the past for '19, are fully funded at the group level. So, that is hurting us in a way the return on equity at the group and we expect to be able to pay the dividends of '19 in the first semester of '20. We need to work with the authorities in that, and I think we have proved that we have enough capital and we continue to grow our capital base. And if possible, we will also like to pay a portion of the profit of '20 in the same year. The payout ratio, as you know, for '19 was 50%, and the payout ratio as we're going to present to the assembly for '20, will also will be around 50%.

The liquidity ratio that has also in appointed time we have always have a concern about liquidity ratio, because we know it's expensive to have high liquidity ratios, but we needed to raise that because of the conditions of the economy. We raised that to 194. I honestly think it's too high. So now that we have all the liquidity lines in place and the economy is becoming much more stable, you will see in the coming quarters, our reductions to normal to the liquidity ratio. That will be in the ranges from MXN135 million to MXN145, that also will help our net interest margin in the coming months.

Now I would like to move into the guidance and I know that there has been some concern about it and in this time of difficult process, what's the issue to grant a guidance. But I think we committed to the Board yesterday our budget for the year. And I think since we committed to the Board, now we have to commit to the market at the same level.

The loan growth, we expect to have a loan growth around 6% to 8%. We continue to see good growth in the mortgage book, in the car loans book. Credit cards will regain its growth from a minus 8%, it will regain its growth to 3%. We continue to see good growth in the payroll loans. Now that we know exactly which companies are going to be more stable, so that's going to be a growth around 4%.

Commercial will be around 6% and corporate around 2% and the government book will grow 2% for an overall growth of 6% to 8%, now with a good mix and with a solid growth and taking good care about the origination, Then in contraction that we are talking here basically is concerning the bank.

So, we basically see potential reduction of 15 to 30 basis points. As you know, we have been telling the market that our goal was 585 and then ongoing to have around 565 to 570 million on the net interest margin. I think it would be achievable because of all the issues that we are taking, and all the actions taken into to reduce cost of funds.

A very good issue on the -- on also on the NIM is that the strong growth that we have in demand deposits for last year also helped us to accelerate the drop in the cost of funds and to sustain our margin for '21. Expense growth, we see 3.5% to 4.2% with inflation rate around 4%. As I've mentioned to you, part of this expense growth is based upon the advances that we did in the fourth quarter for the expense lines to have a clean start for the year.

And we're also working in a very diligent plan to have shared services integrated some of the back offices that were not fully integrated into the central -- into the central themes that will allow us to have an additional reductions through the year.

The cost of risk was 2.1% to 2.3% going back to normal. And the cost of risk is very important to note that you will see through the year ups and down on the cost of risk based upon the sequence where you see that the growth in the NPLs and then you start applying the charge-offs to level up the numbers. And also you will see a reduction in the coverage ratio that right now is at record levels based upon all the additional provisions and that number should go down again to the 135.

So, please bear with us through the year that you will see ups and downs on this number. We had number that we're talking here, is that number that you should see trending through the cycle and by the end of the year. You will see right now like for instance in credit cards, you can see NPLs jumping around 7.8% and you will start during that, the charge-offs through the first quarter and turn that number down again to the 5.8%, the usual number.

This is quite important because when you see that our cost of risk is 0.8% and then jumps to 1.1%, then there are some concerns with some analysts says was due to cost of risk jumped 27%. I don't think that's the right way to see it because what you have to compare is to the normal, and the normal is 2.2%. This is basically in a way tainted by all the relief programs and things like that and overall the additional provisions. So -- but we are talking here is going back to the normal on the cost of risk through the cycle and through the year.

Tax rate will stay as we have been 26% to 27%. The net income in November[ph] MXN33.5 billion to MXN35 billion, return on equity from -- for the group from 15% to 16%. This is considering already they are paying of the dividends. This is quite an important to note. The return on equity for the bank is from 18% to 19%. GDP, we are considering a rate of growth of 3% to 4%, inflation 4% and the reference rate to stay at 4%.

If we see any drastic changes in any of the basic numbers, like the reference rate or inflation, we immediately will go to the market and advise any movement that we see on the -- on each of the guidance that we have given to you. I think not many people were -- are comfortable for us to give a guidance, but I think it's our duty to once we present to the Board, to have the same information as the Board to the market.

Tomas Lozano {BIO 20398814 <GO>}

Thank you, Rafael. With this, we conclude our presentation and now we're ready for Q&A. Let me quickly give you some comments on the logistics. Please raise your hand on the platform and we will unmute your audio. Questions will be automatically order on the first come first serve basis. (inaudible) and myself will be calling the name of the person whose turn is next. If there are any technical difficulties, please let us know by using the chat. Thank you. We are now ready to start the Q&A session.

Questions And Answers

Operator

(Question And Answer)

A - Tomas Lozano {BIO 20398814 <GO>}

We will start with Ernesto Gabilondo from Bank of America. Ernesto, please go ahead. Ernesto, you have received -- and unmute.

Q - Ernesto Gabilondo {BIO 16384492 <GO>}

Can you hear me now?

A - Tomas Lozano {BIO 20398814 <GO>}

Perfect. Thank you, Ernesto.

Q - Ernesto Gabilondo {BIO 16384492 <GO>}

Yes. Thank you. Thank you, Tomas. And hi, good morning, Marcos, Rafa, and good morning to everyone. Thanks for your presentation and the opportunity. My question is on asset quality. We saw the NPL ratio that went up, as relief program started to impact the 90 days past due. And in the last conference call, you were expecting the NPL ratio to deteriorate to around 2.2% in the second quarter of this year. So given the NPL deterioration of the quarter and the potential impacts of the second wave, do you continue to see the peak at those levels? Or do you think it could be higher? And do you expect the reserve coverage ratio returning to the 135% that you mentioned in the second one quarter? Thank you.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thank you, Ernesto. And we feel very comfortable with our numbers now and the number today. I will ask Rafa to comment.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Yes. I will start and I will ask Gerardo to comment [ph]. I think to be precise about if it's going to be on the second or the third quarter, Ernesto, based upon the last events of the -- it will be -- I'll -- I think a lot to ask about to be precise. What we can really commit is that the NPL ratio and they will be around the numbers that were just mentioned to you and the cost of risk will be exactly on the guidance that we are giving. I think there will be some movements based upon this lag that we have seen based upon the second wave is going to be on the second quarter or the third quarter, but I -- we don't see that that will have any effect of the final number that we are committing to you.

And thank you for your question, because I think I need to go back again to this, to say, look there's moving parts here. I think the overall trend that we see on the NPL and on the cost of risk is exactly what we anticipated on this. We have created additional buffer on the latest provisions that there will be, but we are confidence to reach the numbers that I -- we just gave to you. I don't know if it's going to be exactly in the second quarter or on the third quarter, but that will be the numbers for the year. I don't know, Gerardo, do you want to add?

A - Rene Gerardo Pimentel Ibarrola {BIO 18270892 <GO>}

Yes. Sure, Rafa. Hi, Ernesto. I will say that we are as always acting on metrics as much as we can. We have been following such factors as the GDP decline, the duration of the economic downturn, the peak of the unemployment rate and so many factors among others. We strongly believe that we are committed to a long-term perspective. However, some significant wild cards remain such as the re-emergence of the second wave as you know, and the size of this second wave, the lockdown duration, the containment strategy successes, the impact of the fiscal or monetary stimulus, and also the therapeutic drugs and vaccine deployment advances.

So if you take that into consideration, what we have tried to do with general provisions and with the level of the PDL ratio is to do a smooth transition between expected losses and unexpected losses. Regarding expected losses, they are already budgeted for 2021. And regarding or with respect to the unexpected losses, we know we have enough capital to encounter tail risks such as a black swan type of risk.

So if you look -- take into consideration the expected losses, we see that the probability of default has increased as you all know, the exposure at default is the same, and loss given default remains to be seen, but we expect it to be a bit higher than before. But the loan portfolio has performed so very well as Rafa and Marcos have said regarding, for example, mortgage portfolios, autos or car loans and payroll loans, et cetera, that we remain very confident that the PDL ratio will perform within the interval that Rafa mentioned for cost of risk, for example.

So I will tell that, these are rational behind the general provisions that we made on December, is to provide clarity and visibility to all stockholders and stakeholders both, everyone involved in the Banorte's business model. In a nutshell, what we're trying to do is, to pro -- to be prudent, cautious and sensible with respect to the situation we're seeing. So we are providing clarity and a market signal to the market, regarding these general provisions and the future behavior of the PDL ratio and the cost of risk. So we are very confident that we are performing within the interval that Rafael has just mentioned.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

And in addition to that, Ernesto, to what Gerardo said, looking at the numbers that -- of the genuine numbers that we see on our collection on a daily basis, what we are looking at collections for January '21 is the numbers that we are looking at the collection that we were having before the pandemia. So, it's clear to us that the portfolio is leveling out exactly as we had before the pandemia. It seems that all the relief that was provided to our clients, and now the level of activity that we are seeing in the market, it's really providing us the confidence to give you the numbers of the cost of risk. Some people said about the extraordinary provisions in December. Let me tell you that basically what the -- that part of the provisions are, is to assure you that those numbers will be achieved.

Q - Ernesto Gabilondo {BIO 16384492 <GO>}

Yes. Thank you very much, Marcos, Rafa and Gerardo.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thank you.

A - Rene Gerardo Pimentel Ibarrola {BIO 18270892 <GO>}

Thanks.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Thank you, Ernesto.

A - Unidentified Speaker

Thank you.

A - Tomas Lozano {BIO 20398814 <GO>}

Now we will take our next question from Thiago Batista from UBS. Thiago, please go ahead.

Q - Thiago Batista {BIO 15398695 <GO>}

Hi, guys. Thanks for the opportunity. I have two questions. The first one about the guidance of ROE. When you look at your ROE guidance, it seems that you are considering a lot of payments of dividends. I know that Rafa already talked a bit about dividends in '21, but can you comment on how on -- or what are you expecting? So when do you believe, it will be possible to pay dividends -- sorry, when you believe it will be possible to resume the dividend payments. If it is only the payment of the earnings of '19 or if you can assume that some of the 2020 earnings should also paid? So if you can talk a little bit more on dividends?

And the second questions -- second question about the 6% of loans of the credit relief program that had not resumed the payments, those loans are already in the NPL ratio? Or are you guys renegotiating those loans? So how you are approaching the client that has not resumed the payments on the credit relief program?

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thiago, the first one, to be honest we still don't know, but we are pushing and talking with the authority. We are getting closer, it seems that it's going to be a (inaudible) during this first semester, but we still don't know, but it seems that we are getting closer, it seems that -- it's seem now the pieces of whether -- it's going to be soon, but we cannot be sure. And the second one, please Rafa.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Yes. Thiago, as Marcos says, we know that the U.S. banks and some European banks are now being allowed to do a dividend pay and also buybacks will be announced pretty soon. So I think based upon the capital numbers that we have, I think we have a good story to go to the authorities and have those payments of dividends to happen on the first semester of '20. We still need confirmation from the authorities as Marcos says. And also, we will ask also to be able to pay, if not all a portion of the net income of '20 in the same year of '21, that's -- that will be our goal because we are just building up capital and is just sitting there in that part.

The other thing that you mentioned about the relief and that is quite important to notice is that, that 6% that you see is been actively managed by our recovery unit. I think long before those clients start to become non-current, we start to work with them really on a very preventive basis once we see the flows on their accounts or the usage of the credit card. So, what we do basically on those restriction is we build up the provisions, we put on down the provisions and we start working with them in order to be able to provide to them enough space for clients that they just need only space and time to regain and be back on their feet.

Let me give you an example. If you have a client that has a mortgage, that has been paying for eight years and suddenly has an issue because they have a reduction on the payroll, we work on them and try to keep them current in a way, we restructure the loan, we extend the payment loans, we put down the provisions, but we are working actively in that 6%. That 6% is not a loss, that's very important to consider, okay?

Q - Thiago Batista {BIO 15398695 <GO>}

Yes.

A - Rene Gerardo Pimentel Ibarrola {BIO 18270892 <GO>}

I want to add to what Rafael is saying is that we have several restructuring schemes and that we also take into consideration several risks segments, and that makes a tremendous difference regarding what the solution for those loans is going to be like payment discounts, like interest payment elimination, interest payment reduction, interest payment deferment, term increases and so forth. We don't -- do not have one-size-fits-all type of restructuring here even though this is retail credit, so please take that into consideration.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

And also I would like and this could sound a little cocky about this, but we have by far the best collections unit in the market. We have been proving that for the last 22 years. And the way these people anticipate and working with the risk people and the (inaudible) people, in order to provide to each client the specific program that they need, I think has been outstanding.

Q - Thiago Batista {BIO 15398695 <GO>}

Very clear. Thank you, Rafa, on this.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thank you, Thiago.

A - Tomas Lozano {BIO 20398814 <GO>}

Hey, we will take our next question from Geoffrey Elliott from Autonomous. Geoffrey, please go ahead.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Maybe you are on mute.

Q - Geoffrey Elliott {BIO 15944940 <GO>}

Yes. Thank you. Thanks. Thanks for telling me. Maybe just very quickly on the dividend to clear that up, and then I've got a more detailed one. Can you tell us what assumption you put into the ROE outlook? I guess the ROE is in part a function of what dividend you're going to pay out.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Rafa?

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Yes. The payout ratio that we have been saying for '19 is 50%, and the payout ratio for '20 is 50% also, that there could be a space for also an extraordinary place if it's feasible for that, that's the assumption that we are putting here.

Q - Geoffrey Elliott {BIO 15944940 <GO>}

Got it. Thank you. And then on the productivity initiative and the charges that you took in 4Q. Can you give us some more detail on what the changes that you're making there? How you're going to improve efficiency going forward by taking these charges?

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Yes. Happy to do so. Let me give you exactly what we are doing. As you know, Banorte is a very well diversified financial group, so we have the annuities company, the insurance company, also the leasing and factoring. And in a way, we have been working a lot in the -- at the bank level to integrate and reduce costs and costs and costs. But now we are moving also into those companies by integrating all the back offices functions to the already existing functions at the bank. So the -- all the HR are coming into one unit, all the guys, all the -- basically HR, everything security, a lot -- some of the issues in technology are also coming into the central unit. Fraud prevention, everything is coming to us as a centralized unit, so we are integrating everything into a shared service type of operations that I think we can move from the current 5% reduction in expenses that we gain through that MXN460 million on December. I think, we could raise that to maybe 2 percentage points more based upon the shared service initiatives.

Q - Geoffrey Elliott {BIO 15944940 <GO>}

Thanks very much.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Welcome.

A - Tomas Lozano {BIO 20398814 <GO>}

Thank you. We will take our next question from Jorge Kuri from Morgan Stanley. Jorge, please go ahead.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi. Good morning, everyone. Thanks for the detailed guidance, very helpful, especially in these volatile times. Hope, everyone is doing well. My first question is on the margin sensitivity in your slide, page -- Slide 19. It shows that on a quarter-over-quarter basis, it's been increasing from MXN428 million in the second quarter to MXN561 million in the fourth quarter. What explains that increase over time? And how do you reduce that number going forward? How much of this is just hedges that expire and then eventually you get the full impact on? Just trying to understand your comments that you can actually get that number to come down further? That's my first question.

Second question is on fees. I know you already did a lot by providing guidance on so many metrics, but if I can ask, what's your view on fees, which was not included in the guidance? They were down last year evidently because of what happened, but how rapidly you think they can recover? And at what level is sort of like a mid to high single-digit reasonable number for this year? Thank you.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thank you, Jorge. Rafa, please go ahead.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Yes, Jorge. I think it's quite important, the question that you asked about the sensitivity. The numbers that you see basically have to do with valuations and with a movement on the -- on some of the positions that we have in pesos or dollars. So, I think the number that you should be looking at is the sensitivity around MXN500 million. That number should be there. There's a potential improvement on that numbers based upon the -- because the funding part, as you know, the deposit size basically are part of a natural hedge that we see -- that we have.

Since last year, we have a very strong growth in demand deposits. As you saw 22% overall growth, in funding was 13%, but demand deposits grew close to 22%. As you know, you provide that information to the authorities based upon that how sticky your deposits are and based upon specific models that we have in different tranches that considers and becoming a natural hedge. So the more we increase that numbers in each of the buckets, we have an additional natural coverage on that. Also as you mentioned, the cost of hedge has gone down quite substantially on that. And the number that we think that we should aim, based upon the size of the balance sheet, and based upon the speed of the potential decreasing rates is around MXN500 million. So I think that would be a very good number to achieve. Maybe we can reduce that based upon these -- this funding strategy that I just mentioned to you. But I think that's -- that would be the number, Jorge, to go.

The other thing that you asked about the fees, if you remember the graph that Marcos showed you on the fee side, we see already a recovery in the fourth quarter on the fees. So the fees that you should look for this year is from 7% to 9% fee growth based upon the numbers that we have on the last quarter. So I think the most important part on the fourth quarter and the third quarter was that, we finally recovered from the decrease that we had in the first semester. And we have a very strong recovery. If you look on a quarter-to-quarter basis, it goes up to close to 16% growth on the fee side.

So I think this digitalization of economy and the position that we have by being the most -- the number one acquirer on digital transaction is allowing us to keep pushing fees off. So, I would say that that's basically it. And I can give you a very, also how efficient we are doing of the balance sheet coverage with cost from the hedging cost of the balance sheet. When we were talking in the -- for instance in '16, it was around 16% of the balance sheet was covered -- was hedged with cost, now we have 2% of the balance sheet hedging with cost.

So I think what you can see, and I'm happy to provide you -- to you and to all this table. We have been able to really manage the balance sheet in an extremely efficient way, not just because of the cost of hedging the balance sheet and the sensitivity, but also the margin for the balance sheet that we have in '16 was 11.2% of the margin on the balance sheet. The margin that we currently have on the balance sheet in'20 based upon all the reduction in rates and things, this is 11.3%. So I think we have been doing a very good job in managing the balance sheet about this and the sensitivity on the balance.

Q - Jorge Kuri {BIO 3937764 <GO>}

Okay. Thanks. Thanks, Rafa, for the detailed responses. If I may add a follow-on question, sorry. The -- your year-end reference rate forecast is 4%. If we end up at 3.5% or 3% for the end of the year, how much can you still manage the balance sheet so that you get may be closer to that minus 30 basis points or you would really have to rethink that NIM contraction to higher levels of what you have?

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

I think that's a -- that's the million-dollar question. But I think the fact that the reduction in the funding side will also be quite aggressive, under the size of our fixed rate portfolio, Jorge. I think we can stick to the number that are even though, if we see a -- an additional reduction in that, because I think the reduction will happen in the second quarter of the year, in the second semester of the year, so on average I think we will be close to the 4%.

Q - Jorge Kuri {BIO 3937764 <GO>}

Great. Thanks again, Rafa. Thank you.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Thank you, Jorge.

A - Tomas Lozano {BIO 20398814 <GO>}

Now, we'll take our next question from Jason Mollin from Scotiabank. Jason, please go ahead.

Q - Jason Mollin {BIO 1888181 <GO>}

Hello. Thank you. Marcos and Rafael, again thanks for the presentation and the Q&A session. Again on dividends, you mentioned 50% payout ratios in 2019 earnings and 50% on 2020 earnings, which is not far from our estimate in the 40% range. But in the guidance, you also mentioned you incorporated these payments for the 2021 ROE. So I'm imagining that -- probably the timing of that. Do you have both of those payments in the first semester? Or are they spread out more evenly during the year in this calculation?

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Well, I think the first one, Jason, the '19 payout, we expect to happen on the first semester, as soon as the regulator will allow us to happen. And the second one, the portion of '21 -- of '20 in the third and maybe at the beginning of the fourth quarter.

Q - Jason Mollin {BIO 1888181 <GO>}

That's helpful. Also on the regulatory front, how dose Banorte assess the risk and impact of potential interest rate caps and fee limitations? Do you think this will be part of the discussion during the midterm elections?

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Rafa, go ahead.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Okay. What we have to be very, very -- I think noise will continue to be there because I think it's a very popular thing to talk about interest rate caps and -- but the fact is that, there's a very simple way and a discussion about that that really has been turning down all these initiatives. Competition in Mexico is extremely aggressive and I think you can see that on the mortgage book, on the car loan book, how aggressive the market is, you can also easily see that on the government book, how the spreads have been going down on the government book. And on -- and the same happens from the corporate and the commercial. So I think that if they try to do anything compared to the interest rates, they will eventually disappear the mid-sized banks that doesn't have a strong funding base. So I think that would be very bad for already an extremely aggressive competition in the market.

On the fee side, there has always been the saying that Mexico charges more than other parts of the world. We have presented those numbers to the authority, and those numbers are well below when you compare us to any developing market and also on the developed markets. So I think that noise is quite popular. It will come a lot through based upon the elections. But I think reality is that competition shows that interest rates are where they need to be, and fees are moving down based upon the fact that the digital economy is taking over and you are basically changing physical fees by digital fees that are already below the physical one. So, I honestly don't see any reason for that and believe me, that will put a lot of pressure for some of the mid-sized banks based upon the funding -- on the funding base of those.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Yes. Having said that, we will have -- I mean we will continue to expect regulatory noise, no, because the political players try to stand out for their political race, but Gabriel Casillas wants to talk about this. Gabriel, go ahead please.

A - Gabriel Casillas Olvera

Thank you, Marcos. I believe that what Marcos and Rafa mentioned, Jason, it's a most important part, competition is the key factor. However, let me just mention again, remember, that we have been talking about how AMLO, our President has been sticking to what he wrote in his books, the book he wrote before the elections, The Exit, that's the title, and the other one towards a moral economy. I mean, he has been sticking to that all the time. Even during the worst recession since 1932 last year, he sticks to a plan, no, fiscal austerity, social programs, the infrastructure programs, he has been envisioned. So, in this context, we do not expect him to really, I mean separate from what he has pointed out in his books, and he didn't mention anything about putting any caps on interest rates. So, I think we're back again on what we have been saying that we can hear a lot of noise as Marcos and Raphael mentioned from legislators, but none of these initiatives will go through as long as they are not part of AMLO's program. So, I think this is one thing that could -- that despite the noise, you could be very comfortable with. Thank you.

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you very much, gentlemen.

A - Tomas Lozano {BIO 20398814 <GO>}

Thank you. We will take our next question from Alonso Garcia from Credit Suisse. Alonso, please go ahead.

Q - Alonso Garcia {BIO 2507089 <GO>}

Good morning, and thank you for taking my question. My first question is on quality on provisions. I mean, you have a 6% coverage [ph] ratio in your risk profile portfolio, only 1% of total loans. And you mentioned in your report that you have -- in the fourth quarter, you have only used 14% over the MXN5 billion of additional provisions that you have created. So I'm just wondering if you could be overly conservative on this front? And if you think that at some point in the year, a release of provisions could be probable? Or if that's completely out of question in your view? I know it's early to probably, but just want to hear your thoughts on that point.

And my second question is, if you could comment on your sustainable ROE for the group? And what would be the timing for converging to that level? Thank you.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thank you, Alonso. Rafa, please go ahead.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Alonso, as you saw and this happens in the U.S., when you saw the reports of the large ones in the U.S., that they start releasing the provisions that they anticipated on that. I think the way we have been working on this, and this is working with the recovery units and with risks is that we are just using the provision, the extraordinary provisions for the COVID deterioration of program. And up to today as you say, it's just a portion of that.

If the portfolio is continue to perform in the way they have been performing up to today, we see that maybe we did more than enough and a potential release of provisions could happen through the cycle. I don't know exactly what would be the number of when that will be happen. But I think based upon what we are looking at, and based upon what we see on January on the collections department, I think that's a possibility. Yes, basically what we did on the MXN7 billion provisions and charge-offs that we anticipated is to paying upfront the cost of risk for '21 in order to taint '21 with any remains of '20 and collude it, that's basically, but that's a possibility? Yes, Alonso, that's a possibility.

The sustainable ROE for the group, and I think we -- you soon will -- you see that that we will release our new guidance for '21 to '23 that will be coming pretty soon. And -- but I can anticipate you that we see the bank on a sustainable ROE around 23%, from 19% to 20% and I think the group should be from 17.5% to 18.5% recurrent ROE around at that point in time.

Q - Alonso Garcia {BIO 2507089 <GO>}

Thank you very much, Rafa.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Thank you, Alonso.

A - Tomas Lozano {BIO 20398814 <GO>}

Now we'll take our next question from Yuri Fernandes from JPMorgan. Yuri, please go ahead.

Q - Yuri Fernandes

Good morning, everyone. Thank you for the opportunity. I also have two questions. The first one on expenses. You mentioned during the call, Rafa, that part of the increasing personnel expenses was related to some severance packages that you should be implementing in December and in January. So my question is, if you're anticipating major decreasing branches, employees like what is the call for 2021? I'm pretty sure this isn't the expense guidance, but just on this more qualitative discussions. And also if you can discuss on expenses for the quarter. We saw professional fees, rents and amortization growing very quickly on a quarter-over-quarter and year-over-year basis. If you can provide some more color why that happened that would be interesting as well?

And my second question is regarding fees. It's clear. The guidance for 2021, the 7% to 8% you mentioned. But for the quarter specifically, we saw the interchange fee at cost line, so the fees you pay growing very quickly, growing like 25% year-over-year. And it's not clear for me, what is the line on the revenues that is of saying those cost is? I guess electronic banking services may be is the line that should be reflecting the increase on your cards transactions. But my point is, was any change on interchange fees in Mexico, why expenses are growing likely higher than revenues? Thank you.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Rafa?

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Yes. Let me go to the last one, because I think it's quite important. What we have in the fourth quarter is basically a very strong pick up on the car sales and the mortgage sales. And on that, you have to pay fees based upon that origination process, because many of those happen right at the dealers, and right at the -- where the houses and buildings happen so. Because there was a very low activity in the second quarter, you see a big pickup on the third and a very important pick up on the fourth.

And also most of the payments that were due also and that will move into '21. We've already paid in '20 in advance for that in that part. So that's basically what -- you see that offset on the origination fees based upon basically on the mortgage side, and on the car loan side, that was basically where those two numbers move, is basically, when you get that from the -- on the returns from the margin that you get on that part and on some of the fees that you collect from the clients, from the -- on the mortgage side and on the car loan side. But the fact is that, we never anticipate such a large pick up on that part, and we also anticipate some of the payments that we see on the trends that we usually pay in 30 days or 45 days, we anticipated in December. So, that's the first one.

In the fees, if you go down into the fees, you will see that a very strong pick up in -- on the fees, what we call the transactional fees that are coming basically from the digital POS and some from the physical POS and some from the activity on the credit and on the debit card. And also on the transactional banking and fees coming from remittances, so I think we have a strong pick up on that part. But on the cost side is basically that pickup in the origination that's happened at the end of the year and some anticipation that we have.

On the branch network, I don't think -- as you know, we haven't had any growth in the branch network for the last three years. And we will relocate 32 branches this year, but we will close 32 branches also. So when we see a reduction in expenses is on physical assets, rents that we used to have in very -- I mean the size of the occupancy rates for our buildings is going down at least 40%, so that will be a part of the expense reduction that you will see through the year. And we are also looking at -- as you know, we did a lease back on some of our buildings on the past, we are also looking to see, if we repurchase those because of the price that we see now on the market, and the benefit for us based upon when we lease back those buildings, but that's basically -- I don't see that happens in the branches.

So the professional fees basically has to do related to all basically origination, collections, restructuring that's happened in the fourth quarter. And remember that, usually in the fourth quarter, you end up closing all of the books, and they were because of also on the pandemia, a delay in some of the collections and some of the invoice presentations that's happened through the year.

So I think the fourth quarter is -- it was a strange quarter on those lines. But we -- (inaudible), is what based upon the activity that we have on the car loans and on the mortgage and also on the credit and debit cards, but basically for building up the business and we anticipate also some of those payments to the dealers and to the brokers in the mortgage houses to anticipate some of the payments in general.

Q - Yuri Fernandes

So I guess like the bottom line here Rafa, if I may summarize is that you anticipate a lot of expenses, it's not only about loan loss provisions, but on the fee side, on the expense side, things should be much more behaved in 2021?

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Exactly, right. Yes. I think we wanted to clean as much as we can in '20 for '21.

Q - Yuri Fernandes

Thank you.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

You're welcome.

A - Tomas Lozano {BIO 20398814 <GO>}

We will take our next question from Carlos Gomez from HSBC. Carlos, please go ahead. Hello.

Q - Carlos Gomez {BIO 15024854 <GO>}

Hello?

A - Tomas Lozano {BIO 20398814 <GO>}

Yes.

Q - Carlos Gomez {BIO 15024854 <GO>}

You can hear me, okay. So again, so I wanted to thank you. Second on the NPLs on Page 53 of the press release, we can see that without the COVID support measures, the total NPLs would be 1.4% of the total loan portfolio instead of 1.1%. When do these support measures expire? And when would these two numbers converge? I realize it's a minor thing, but we wanted to be clear on it. And second, could you give us an update on the Rappi alliance? Thank you.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Rafa, take the first one?

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

The first one, basically, I think -- and I think -- and thank you for the question, Carlos. Because as I told in some of your colleagues, it's difficult to see the exact conversions of the numbers, but what you should see is, when we are trending to the normal, and the normal is the 2% to 2.1%, 2.2%. I think you will see that on trending to that number. So when you see that the NPLs go to 1.8%, I don't think that we had doubled the deterioration of the portfolio, it's basically that -- basically we are going back to the normal numbers that Banorte has been running for the last four years. I think that's the key message from your question. When that will --

Q - Carlos Gomez {BIO 15024854 <GO>}

I mean that is clear, but that's -- I mean actually, first normally it's a bit lower, because now your collection period is -- sorry, your provision period is shorter, right? You did that earlier, your write-off is faster. So we -- I imagine that we would expect a normal NPL which is a bit lower than in the past. And again, no, I completely understand that, that 1.4% is temporary and it will come from the measure, we just wanted to know how long the Central Bank or the national banking commission has given you this -- these allowances?

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

No, it doesn't have to do with the allowances from the Central Bank or the CNBV. I think it's just the dynamics of the loan book. There is (inaudible) Carlos. But I think you will see in the second quarter, a lot of conversions to these numbers on this part. And what you mentioned about the -- that we reduce the charge of process. We reduce that only for the SMEs, that we reduce that from the 19 months to the nine months. But, that already happened in the second quarter of '20. So, now the SME will not be any bubbles building up on the balance sheet.

And this is quite important to remind all of you is that, we are not using any relief programs from the regulators. We are providing a very specific program to our clients, for each of our clients, but based upon the numbers that we have, because we would like to have provisions, we need to put down the provisions and not in a way delay the build-up of provisions, so we are basically using our own models, and our own policies to build up the provisions and the NPLs and the charge-offs.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Carlos, talking about the Rappi Association, we are very happy. You know, they have 15 million clients -- actually they have 9 million clients, that they make at least three transactions per month. And I will ask Franco Martha who's online to give us more color about that. Franco, please go ahead.

A - Francisco Martha

Thank you, Marcos, gladly. Thank you, Carlos. Yes, we are moving forward with the Rappi alliance. As you may be aware, in December, we launched the waiting list for the credit card. And as of yesterday, we had 120,000 customers looking for the credit card and we will open that to the -- we will open it to the market next week before the end of the month. And obviously, we will process simultaneously this 120,000 applications. And in parallel, we also launched last week a program that we called RappiContigo, Rappi with you to help the small restaurants and the bar kitchens that are having some troubles during the pandemic. Within Rappi -- and it's a loan program with MXN200,000 -- MXN250 million in loans. And as yesterday, we have 310 restaurants or applications in the waiting list, and we will process them also during the next week and in the following weeks. So we are moving forward with those two products as today, and we will be integrating more products as we move forward. Thank you.

Q - Carlos Gomez {BIO 15024854 <GO>}

Thank you very much.

A - Tomas Lozano {BIO 20398814 <GO>}

Thank you. We will take our next question from Luis Yance from Compass Investments. Lois, please go ahead.

Q - Luis Yance {BIO 19091786 <GO>}

Thank you, and hi guys. Happy New Year. Thanks for taking my questions. I mean most of them have been answered. But I guess two follow-ups on something you guys mentioned. The first one is on the sustainable ROE for the group that you mentioned perhaps, in the 18% range that's -- when I compared that with what you plan to achieve this year, the 15% to 16%, it's almost 300 basis points improvement over the past three years that you're expecting. So, just wanted to understand, broadly speaking, what would be the drivers for that improvement? Because based on what you've said, on the OpEx side, you seem to be pretty efficient, and you're going to get some additional rewards this year. But going forward whether it's coming in that -- from that direction? Is it just because you're expecting interest rates to normalize much higher. So, if you can share with us what -- what's the assumption behind there? And perhaps this is just a NIM Improvement on that side? Is it on the fee side? Just to get a sense of, how should we think about the biggest drivers for that improvement in the medium-term?

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thank you, Luis. Rafa, please go ahead.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Yes, Luis. I think your question is key to understand the evolution of -- as you know, when we launched 2020, we basically said that we will double the net income that we did that in two years before. And there were specific numbers for ROE that was 20% that we achieved that in '19, before the '20. And basically a lot of those were related to efficiency, investing in technology and also increasing the value per client. I think the key element that we see by pushing forward the numbers is that the value per client that we increase on this five-year program that was 2020, we more than doubled the value per client.

And we -- now that we have all the analytics in place and the multi-channel and the evolution of the digital process, the linkage with Rappi and the new evolution that we're having on the digital would -- and also with our strong position that we have now in corporate and commercial, I think we will continue to expand the value per client at a very -- at a very fast pace, that's one of the main levers. The other one is, as you can see this year, on the guidance, revenue is growing below the expense line. So the expense line that is well controlled at 4%, but the revenue that we have basically projected for '21 is close to 2%. So we have an imbalance that we have to correct that pretty quick. And we would like to really push that forward to this year, in order to regain again the rate of growth well above the expense line.

So most of the businesses and the evolution of the mix of the portfolio is providing us a sustainable rise on the profitability. But also I would like to guide you to the numbers of the architecture of the group. If you see the -- how the annuities businesses is behaving like a growing net income, 51% for the year, and with a very strong return on equity around 25%, you see insurance business around return on equity of 40%, even though they have a tough year because of the pandemia and the provisions that they needed to build because -- to cover those costs. And therefore, is staying around 15%. I think it's going to be tough for the pension company to go above 15%. But I think, the annuities company -- if you look at the annuities company, is coming close to be at the same size of the pension company, and that's a pretty good story, because we are growing that business pretty fast and we can increase the return on equity on that.

Also the broker-dealer is above the number that I just mentioned on a recurring basis. The bank is already -- if you look at what happened with the bank last year, when we build up the provisions and we reduced the return on equity for the bank drastically for the -- in the next month after we did the provisions. We see a very strong pickup in the third quarter for the bank that was already close to 19%. So, we don't see any issues at the bank because we will continue to grow the client base, the profitability of the clients, distribution that are becoming much more less expensive based upon digital, so we can reach a lot of new clients now on a very efficient way.

But also I would say that the bank and also the businesses that I just mentioned to you is where we see this evolution of the other sustainable return on equity for the group. The main issues that you'll see at the group level is the goodwill that we have with the Afore, that is a very large goodwill that is just sitting there. If you go to tangible, we are already there, so we don't see really that we have any issue to really regain that number based upon the size of the business, the quality of the business and also how fast we can really continue to increase the profitability on a client by client basis.

Q - Luis Yance {BIO 19091786 <GO>}

Thanks a lot, Rafael. That was very helpful. And let me ask you last question on provisions. I know you've talked a lot about it. But when you did the first round of additional provisions in the second quarter, the thought was that was enough, right? And then we get this second wave and you decided that it was prudent to add a little bit more.

So I just wonder as we go through this year, there're still clearly uncertainties around there, is there going to be a third wave. Are we going to have a much longer lockdown period in the (inaudible) of the country than what you have projected there. So just wondering how much cushion right now you do have to accommodate, let's say, the lockdowns take a month longer than you expect or if GDP growth is not 3% to 4%, it's 2.5%? Not major deviation but a little bit here and there, would that probably require another round of additional provisions? Are you seeing for those small deviations from what you're expecting? You're comfortable with what you have, and you have enough cushion to maintain what you're seeing as a more normal cost of risk for the year?

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Luis, I think we feel comfortable with this number. And what is important about your question is what Alonso also was mentioning about if there's going to be a release of these extraordinary provisions.

if things get longer, the lockdown or the second wave stays longer than it is, I think the issue is that we will consume more than anticipated the extraordinary provisions. But I don't see honestly any need to build up more provisions right now. I think the fact is how much we can release, if the size of the provision is good enough.

Q - Luis Yance {BIO 19091786 <GO>}

Great. That's very helpful. Thanks, guys.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Thank you.

A - Tomas Lozano {BIO 20398814 <GO>}

Thank you. We'll take our next question from Edson Murguia [ph] Edson, please go ahead.

Q - Analyst

Hi, good morning. Do you hear me?

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Yes, we're able to hear you.

Q - Analyst

Thank you for taking my question, Marcos and Rafael. I have two of them. The first one is related to your guidance on the loan portfolio, because yesterday and again from Fitch, Fitch is expecting that consumer loan as an overall in Mexico will grow around 5%. So I was wondering if you can give us more color about if you are in the same way as Fitch or are you going to be more careful about this consumer growth portfolio for 2021?

And the second one is related that historically from not only in the United States but in Mexico when this crisis usually occur, there is a consolidation in the industry. So, I was wondering if you are expecting to buy, I don't know a portfolio from other institution or if you are watching opportunities in the market?

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

I will start from the second one, Edson. Yes, we may see a consolidation in the industry, we've seen in the world and is going to happen in Mexico. And our duty is to watch what's going on and then go to the board and discuss this if it makes sense to (inaudible). But it's not in our main driver, only we need to be careful and to see what's going on and that's our duty. Our objective now for the year 2023 is to go along and to give you these numbers. And talking about the first one, the guidance of the loan portfolio Rafael is 5%.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Yeah. I can in a way dissect the growth that we see on the consumer. We see on the consumer and the mortgage book at 10%, maybe a little bit higher than that the 10%. We see on the car loans 7%. We see on the payroll loans a rate of 4%, credit cards also 4%, and corporate and commercial will be around 3% and the government book will be 2%.

So if you see this, we are in a way above what Fitch has mentioned in some of the portfolios. And what has to be considered is, when they say 5% and let me put you an example about credit cards, we -- last year, credit card was down close to 6%. So when we say 4% growth this year, it's really a big push for the year. So we see the economy moving, I would say slowly but in the right direction. It's unfortunate what is going on because of all the issues concerning the pandemia and on the plateau that the COVID plateau as reaching in Mexico.

But honestly the country is moving, there is a lot of will to keep on moving on this. And really the main issues are happening outside the banking sector. Because as you know, the banking sector really basically deals with a formal employment and informal employment companies have to try to keep as much as they can, the number of employees and things, but on the informal economy, the hit has been very, very hard.

But this is really happening outside of the banking system. The banking system, in a way if you look at the numbers last year, it was minus 10% GDP growth and you'll see a loan book for Barnote close, if you take away the government book above 8%, this is quite difficult to understand. And also when you see the revenue growth and everything, but the fact is that the formal sector continues to be diligent and trying to overcome the situation the best that we can, but on the informal economy that hit has been very hard.

Q - Analyst

Okay, thank you. It was really helpful.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Thank you.

A - Tomas Lozano {BIO 20398814 <GO>}

Now we'll take our next question from Jorge Henderson from Santander. Jorge, please go ahead.

Q - Jorge Henderson {BIO 21863807 <GO>}

Good morning. Thank you very much for the presentation and for the opportunity to ask questions. So I have two questions. The first, you already provided the guidance on loan growth by segment as you did right now. And you mentioned some growth will be coming from mortgage and auto loans and the rebound of credit card. But what I would like to get is a more in-depth detail on your target asset mix, a bit on the rationale on this for 2021 and also for the medium term, like do you have a target to gain or lose loan exposure on specific segments?

And the second question, you mentioned on your press release that during 2020, mobile transactions in your mobile app increased 44% year-on-year. Do you see this trend accelerating even more for 2021? And could you share what growth do you expect on this? Thank you.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

We'll start from the second one, the mobile transactions. I will ask again Franco Martha to give us more color about that. Franco, go ahead, please.

A - Francisco Martha

Thank you, Marcos. Yeah, well, the mobile transactions where we had a ramp up during the year of about more than 70% increase in the transactions. As you may be aware, we moved out, we created or we enabled more functions and more services in the mobile app. So we were able to let the customers to stay safe and stay in their houses. And we saw the transactions moving towards the digital channels, the web channel stayed the same way, the transactions all around the bank increased and mainly the mobile ones were increasing more than 50%.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thank you, Martha. Anything else, Franco?

A - Francisco Martha

No. Thank you.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thank you. Rafael, the loan growth.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Yes. Jorge, I think if you look at the loan growth and it has to do with what Marcos mentioned and has to do also with the size of provisioning risk, that the current mix that it looks in a way weak on the consumer side because 50% of the total book on the consumer is only 15%. But it's proven at this point in time because we would love to go to the consumers, to go around 18% to 20%, that would be a very balanced loan book when we reach that number with the consumer.

But I would say that the mortgage book will stay around the 20% as we see. I think we will see a bit of increase on the corporate, on the commercial not a lot more, because we are very close to our fair market share there that is 16%. Where we see a continuous evolution and reaching out to the fair market share is in the credit card that we gained market share last year and we have been gaining market share. But we are well below the position that EBITDA has so close to 30% or CD around 26% to 27%. We are reaching the 11%.

So the move that we are aiming to go, when I talk about numbers in the consumer from '18 through '20 is to keep increasing the payroll loans portfolio. That is a portfolio that we can continue to grow easily for the coming years. Also the credit card that we have right now is a very, very loaded card with benefit services, digital origination everything.

So, we see an increase in market share there, we already gained market share last year, but not at a very fast pace. The fast pace will come from car loans, payroll loans on this part. Basically, that will be the big push on the acceleration of that. And also on the mortgage side that is separated from the consumer, I think we will stay at around 20%, 21% of the overall mix. But a key fact is that the payroll loans and the car loans and the credit card will continue to push us up to the 18% to 20%, that is our desired number on the consumer.

Q - Jorge Henderson {BIO 21863807 <GO>}

Thank you very much.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Welcome.

A - Tomas Lozano {BIO 20398814 <GO>}

Thank you. We'll take our next question from Gil Garcia from Barclays. Gil, please go ahead.

Q - Gilberto Garcia {BIO 17390216 <GO>}

Hi, good morning. Thank you for the call. Can you give us any guidance on your expectations for the insurance technical results for the year, which have been rather volatile over the past quarters? Thank you.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

I will ask Fernando Solis to answer all that. Fernando, please go ahead.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Fernando, please go ahead. I think he's got some technical difficulties. I think we can -- (Multiple Speakers)

A - Unidentified Speaker

Okay. Thank you. Yes. What I was -- we have been seeing in the last year, the change in the results as you mentioned were due to technical results and mainly due to the loss ratio. Actually what happened with the book is that we experienced due to COVID after taxes and increasing losses due to COVID in life and in medical expenses around MXN1,433 million, that was a very important hit. And also it was partially compensated in the loss ratio in car insurance. There we had benefits of MXN635 million.

If you take those things into account plus the fact that we also have non-recurrent income due to the fact that we did not pay dividends either, actually, the book would have grown in terms of net income 15% from 2019 to 2020. So actually those are extraordinary effects that probably we put on this book. Those are the main explanation. Otherwise due to normal terms, we do take out these extraordinary effects, we would have experienced (inaudible) increase in net income.

Now what will happen next year -- or this year sorry, of course this year, we are also expecting that COVID will prevail. And actually, we were thinking that perhaps the range will be that in the year -- as you know what will happen will depend on how fast the vaccination takes place in the Mexican population. And we do not see that we will have enough people being vaccinated 70%, 65%, 70% from the first three quarters or perhaps enough for the full year.

So this year in terms of COVID, we believe that the impact will be even higher; of course, this is something that hopefully will eventually pass and we will recover our normal rate of growth in net earnings after that. So that's explained mainly due to this fact.

Q - Gilberto Garcia {BIO 17390216 <GO>}

Thank you.

Operator

Thank you. Just a quick reminder that we have time for three more questions, please, in the interest of time. And the next question will come from Tito Labarta from Goldman Sachs. Go ahead, Tito.

Q - Tito Labarta {BIO 20837559 <GO>}

Hi. Good morning, everyone. Thanks for taking my question. Just a follow-up on your margin, and perhaps it's related to the last question also and the impact that the insurance has on the margin. But on the guidance that you gave, a 15 to 30 basis point reduction, is that at the bank level because I just want to understand at the group level, margin fell like 30 basis points and it has been steadily falling on a quarterly basis.

So just I guess at the group level, do you think that margin has bottomed now? Because if it falls another 30 basis points, the year-over-year reduction will be a lot greater than 15 to 30 basis points guidance you gave. So just want to be able to reconcile the bank margin and the group margin and how that should evolve, particularly I guess on a quarterly basis to get that full year guidance. Thank you.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thank you, Tito. Rafael, please go ahead.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

No, I think Tito-- thanks for the questions. The number that we have mentioned is related to the bank.

Q - Tito Labarta {BIO 20837559 <GO>}

Yeah.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

I think the group as you mentioned has bottomed out already. I think that number has -- is going to be there in that part. So it's basically the bank.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thank you, Tito.

A - Tomas Lozano {BIO 20398814 <GO>}

We'll take our next question from Victor Galliano from Barclays. Victor, please go ahead.

Q - Victor Galliano {BIO 1517713 <GO>}

Thank you very much for the call and the opportunity to ask questions. Just a quick one from me on the margin again. Looking at that Slide 17, really you've done a tremendous job on your cost of funds versus your main peers, but it looks like that's now largely done. Do you think there's any risk? I mean thinking glass half-full for 2021, certainly the second half of it. As the economy recovers and as demand grows that you'll see your main competitors beginning to compete more aggressively for deposits and co-funding. Where do you see the risks aside from obviously your hedging to this -- to your margin from the liability side?

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thank you, Victor. Rafael, please go ahead.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Yeah. I think while we still have room for this, the way we have been evolving on the funding side is that first we needed to take away all the required market funding that we needed in order to fund the Interacciones assets that was done in the third quarter of last year.

So as you say, there was a big portion of that. But still we have for specific accounts that are related to two things because we needed to build up liquidity fast. We also pay in some -- for some accounts close to reference rate or below reference rate, well below market funding, but we needed that to immediately increase the liquidity at that point. That liquidity is not needed anymore. So that will be also a fact of how can we also continue to reduce the cost of funds.

And also as you saw last year, our growth on bank deposits was slower than the market because we let go some of those funds because our demand deposits were growing 22%. We don't expect 22% growth this year on funding, we expect 11% growth, but 7% we expect in demand deposits without cost on that part.

And when you see the compression on the reference rate, that is also taking away some of the big numbers that were in the past when the rates were around 7% that everybody was looking for the 7%, 7.5%. When you are dealing in a world that reference rate is getting close to 4%, 3.5%, I think sensitivity also goes down and it's more related to efficiency, ease of use, location when you can get and get the benefit of funding. Also the payrolls, we continue to grow payrolls pretty fast and that's a very important source of funding at a very low cost. So even though there was, as you say, a big push on the funding side, we still see room for going down on the cost of funds around 20 basis points more. That's our goal for the year.

Q - Victor Galliano {BIO 1517713 <GO>}

Great. Thank you very much.

A - Tomas Lozano {BIO 20398814 <GO>}

And our last question will come from Brian Flores from Citi. Go ahead, Brian.

Q - Brian Flores {BIO 16620694 <GO>}

Hi. Thank you for the opportunity to ask questions. Rafael, you mentioned that you saw positive surprises in the performance of the SME portfolio. Could you elaborate on why do you think this is happening? And how do you see this going forward? And the second is a quick follow-up on the guidance you provided for the growth in these segments. I only caught up the last two portions, and I don't know if you could repeat these. Thank you.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

While we are on the SME, the first issue is that it's 4.7% of the total book. The second issue is that 47% of those are under Nafin guarantees. And the third and most important one is that of the 420,000 SME clients, 29,000 of those have a loan with us. Of those, we have contacted every single one of those.

We know exactly what's the position of the company, if they close, if they are in a slow movement stage, if they are regaining its growth, they expect to regain its growth and we have talked to every single one of them and know the situation. We visit them on a one-to-one basis.

And you see on the SME what is the key element of the SME, the entrepreneurial vision of these people and the resilience of these people, basically what they need most of them is just a little more time to go back on their feet, but they are more than willing to keep on pushing forward. So, that's what Gerardo was mentioning about going on a one-to-one basis and create on a specific program for them.

So, we will continue to see. Obviously, 12% of the SME that reach the relief programs are not paying because they are even closed or they are back on that, but that was expected on that. We were expected much important number on that. So, 12% is for us good enough based upon the size of the crisis. So, I think the resilience of the entrepreneurs, the support that the bank has provided them, the Nafin guarantees, the size of the SME portfolio. And we are not in SMEs related to tourism or things like that or restaurants, our exposure there is extremely low on that part. It's basically, SMEs that are linked to either supply chains or other type of business. But I'm very positive and surprised about the behavior of the SME.

And on the guidance, on the -- I will repeat on the mortgage book 10%, the car loans 7%, the payroll loans 4%, the same that the credit card and that the corporate and commercial loan 3%, and government book around 2%, you can get a range from that of 1 -- plus minus 1%.

Q - Brian Flores {BIO 16620694 <GO>}

That is perfect. Thank you.

A - Rafael Victorio Arana de la Garza {BIO 1982204 <GO>}

Welcome.

A - Tomas Lozano {BIO 20398814 <GO>}

Thank you very much for your interest in Banorte. With this we will conclude our presentation. Thank you.

A - Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thank you very much.