Q2 2021 Earnings Call

Company Participants

- Fernando Solis Soberon, Managing Director, Long Term Savings
- Gabriel Casillas Olvera, Deputy Director General of Economic Analysis
- Jose Francisco Martha Gonzalez, Payments, Digital Banking & IT Managing Director
- Jose Marcos Ramirez Miguel, Chief Executive Officer & Regular Director
- Rafael Arana de la Garza, Chief Operating Officer & Chief Financial Officer
- Tomas Lozano Derbez, Head of Investor Relations, Financial Intelligence & M&A

Other Participants

- Alonso Garcia, Analyst
- Arturo Langa, Analyst
- Carlos Gomez Lopez, Analyst
- Edson Murguia, Analyst
- Eduardo Rosman, Analyst
- Ernesto Gabilondo, Analyst
- Jason Mollin, Analyst
- Jorge Kuri, Analyst
- Thiago Batista, Analyst
- Tito Labarta, Analyst
- Unidentified Participant

Presentation

Tomas Lozano Derbez {BIO 20387400 <GO>}

Good morning.

I'm Tomas Lozano, Head of Investor Relations, Financial Intelligence and M&A. Welcome to Grupo Financiero Banorte's Second Quarter Earnings Call for 2021. Please note that today's presentation may include forward-looking statements that are subject to risks and uncertainties, which may cause actual results to differ materially.

Our CEO, Marcos Ramirez, will provide highlights for the quarter, which show the evolution of a continued recovery in the Mexican economy although some sectors are still affected by the COVID-19 pandemic. Later on, Rafael Arana, our COO and CFO, will provide further detail on asset quality, rate sensitivity and updates to our guidance. We will conclude our call with a Q&A session.

Thank you. Marcos, please go ahead.

Jose Marcos Ramirez Miguel {BIO 4413879 <GO>}

Thank you, Tomas, and good morning, everyone.

It's good to be here with you once again. The second quarter of the year was marked by a sense of economic recovery. GDP growth estimates for Mexico have been revised upwards, now reaching close to 6% driven by the strong commercial ties with the US economy, together with our faster than expected reopening of different industries in Mexico. Tourism has also surged, with occupancy rates in the Mexican Riviera and Estados, reaching more than 80%. However, the rest of the country has had a lower occupancy, while business tourism is still lagging. Despite having a slow start, the vaccination program in Mexico has evolved positively with more than 50 million doses supplied for the most vulnerable sectors of the population. And now a bouncing towards the younger age groups.

As the second wave of contagion spreads in Mexico and around the world, we have not lowered over that and will continue to observe strict measures to protect our customers and employees and will continue to implement prudent risk policies. The increased economic activity during the quarter took its toll on inflation, which reached 5.9% in June, thus driven the Central Bank to make an expected 25 basis hike to the reference rate, reaching 4.25%, ending our cotton cycle that lasted for more than two years. Our economic analysis teams expects additional hikes to the reference rate for the rest of 2021, estimating it to end the year around 5%. Later on Rafael will walk into more detail regarding our sensitivity rates and available to us.

Another relevant milestone during the quarter was the outcome of the mid-term elections in June. As no party being qualified majority in the Lower House, it is expected that some pent-up investments on business decisions across different government and commercial sectors should begin to materialize throughout the second half of the year and into 2022.

Shifting gears into the financial results, slide number 4. Net income for the group has not only recovered, with June's results are really reaching pre-pandemic levels. Capital accumulation at the group level still has an impact on ROE. However, return on equity at the bank was above 20% in June, reaching 20.7%. In line with the regulators guidelines, we have resumed dividend payments, distributing 25% of the 2019 net income in May. And we have received authorization from the board to distribute 25% of the 2020 result, which will be paid later in this year.

Slide number 5. Net interest income from the loan portfolio increased 2% versus the previous quarter. However, on the group level, NII was affected by results from the insurance businesses, which was impact not only by a seasonal decline in premium origination, but also by higher COVID-related claims, as we will see later in our results by subsidiary. Non-interest income was impacted primarily by lower trading results, which were affected by mark-to-market valuation on some instruments derived on the recent decrease in interest rates.

Net fees, slide number 6, saw a relevant 2% increase during the quarter. Digital adoption from our claim-based has driven a 10% increase in electronic banking piece. Economic reactivation is evident in both higher fee of these transactions and more active consumer loan origination fees, which had an 8% decrease during the quarter. However, we are still relying on external sales forces for mortgage and auto loan origination, which increased amounts of fees paid.

Moving now to slide number 7, we continue to see solid loan growth in the consumer sector. Our key priority in mortgages and payroll loans. Growth was partially offset by a great event prepayments in our corporate and government portfolios, which led our total loans to a minus 1% contraction during the quarter. However, throughout the pandemic, we have gained 116 basis points in our total loan market share, driven by important gains in our commercial and consumer portfolios.

Slide number 8, asset quality continues to perform ahead of our expectations, with NPL ratio totaling 1.4% in the quarter, gradually, returning to a normal operating levels across all product lines. We continue to work hand-in-hand with customers that it will enable to resume bank payments after they came out of the relief programs, which as of today accounts for 0.8% of our total loan portfolio, well below our initial estimates as you know.

Looking at our results by subsidiary, slide number 9. The most relevant impact during the quarter is evident in our insurance business, which relatively continues to register higher claims for COVID-19-related basis. Although lower than the previous quarter, claims in our life and health insurance portfolios are still high as the pandemic is not yet behind us and cases from the third wave continue are still among us. The reason starting inflation and the subsequent reference rate hikes from bank, also had an impact in reserves and financial results in annuities and insurance businesses. However, revenue diversification in the financial group helps to partially offset this effect. I think in the previous quarters, we have included supplementary ESG information in the conference call presentation for your review.

With this, I conclude my remarks. And now Rafael Arana will give you additional details on the main operating and financial updates, as well as some positive updates to our guidance based on current trends. Rafael, please go ahead.

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

Thank you very much, Marcos, and thank you for attending the conference.

Let me just start with a brief recap of where are we standing. There was -- and thank you for the notes that we received from the analysts, those notes helped us a lot to concentrate exactly what you need to know about the evolution of Banorte. As Marcos said, I think we have to separate things into two parts. The first one, as you know, during the pandemia was to control the pandemia, to control the cost of risk, to control the evolution of the potential deterioration of our portfolio, and I think Banorte did a pretty good job on that part.

There were some concerns at the beginning that our provisions were too low. But we were based upon the numbers that we have, we were comfortable about the numbers. Right now when you look at the evolution of the income statement and also on the balance sheet, let me just give you a brief part concerning and taking into account that the first part during the pandemia was to control their deterioration of the risk. It was very difficult to grow and to that part so it was basically to control expenses, to control the risk and also to become a much more efficient bank and continue the evolution and transformation into the digital space.

The positive that we now see is that EPS continues to move into the right directions. So we see EPS recovering and trending again to the growth rate that we have before the pandemia. The loan growth, and there were some concerns about it, say, well, if you're getting the results, but there is a lack of growth. Yes, there is lack of growth especially on the corporate and on the government book, but we see very good trends for the third and for the fourth quarter and the government book once the elections are over, we will be recovering the growth in that part and the corporate, as Marcos said, we start to see some build up on the pipeline.

The consumer is performing better than expected. Right now, we see good numbers, double-digit numbers in the mortgage book. Car loans continue to reach close to double-digit and credit cards start to recovery, once the consumer start to relever again the part, payroll loans also positive. Positive growth of the consumer that is the book that give us better returns is performing better than expected commercial is starting to build up again. So we see a third and fourth quarter much better on the corporate and the government and a continuous strength on the mortgage on the consumer book. So the consumer will continue to do well. Now we see 7% growth in the quarter, and we will continue to do so.

So credit is better. Provisions are much better than expected on that part. So as we mentioned, the loan growth is mixed, but real growth opportunities as we mentioned also Marcos will make a very strong remark about that we continue to gain market share under this circumstance. So minority is in a position based upon the liquidity and the balance sheet that they have, that we can go into the market and buy the loans that we would like to buy. The liquidity is quite high, is costing us on the net interest margin even though the margin is better than expected. But liquidity is at 210% because, obviously, there is no place to -- the rate of growth of the liquidity doesn't match the rate of growth of the loan book. So liquidity is building up. We will see a downward trend towards the end of the year because of this build up of the pipeline that we have on the commercial and on the corporate and the government.

Capital generation continues to evolve. As you know, we already paid 25% of net income of 2019, and we will be paying in the third, fourth quarter the 25% of 2020 on that part, but capital continues to build up at a very good pace putting Banorte in a very strong position on the balance sheet. We know it doesn't work. But the more efficient way to warehouse capital, but at this point in time, based upon regulation, that is where we are on that part.

NIM is holding pretty well based upon the cost of funds and the evolution of the consumer book. There were some concerns on some notes that I read about expenses should be lower based upon the lack of growth. I think we are controlling expenses pretty well. As you know, we always commit ourselves to inflations for 100 and 150 basis points. I think at this point in time, we will be at least 100 basis points below inflation on expenses. We continue to invest where we need to invest that is in the transformation, but expenses are very controlled on the other side, personnel and everything that is not related to transformation on that part.

I would say that COVID, as you say, there's still some things to resolve. The third wave, fourth wave on that. That's why we are being prudent with the release of provisions. Some note says that we achieved the results based upon the relief operations. I want to note that we only use MXN150 million in the quarter of those provisions that are related to COVID. So basically, that was the total amount that we released in the second quarter on that. And that really proves the fact that the portfolios and recoveries are performing much better than that. So 78% of the provisions are still in case we need those provisions to be applied. So we only have been using MXN150 million in the second quarter of that and 78% of the provision still are on the book to be used if needed.

The other things that are, say, in a nutshell that these are usual times with our liquidity going up of provisions better than expected, a lack of growth in some of the parts of the portfolios with good growth in other parts of that portfolio, some things are very important to be related is that I would say people are asking when the cost of risk is going to trend again at the end of the day. So the usual numbers that Banorte runs that will happen usually around at the end of the fourth quarter on that part.

When we see again stable numbers on the cost of risk and also on the provisions are built. So I think we are right on target what we expect when we build up the additional provisions. And it is going to be room for relief of those provisions. We have to see how things evolve on the potential COVID issues, but we are confident that we can release some provisions stats by the way those provisions -- those additional relief operations is not included on the guidance that we are giving by the net income by the end of the year.

In the graph that you see, basically is what I just mentioned about the provision and the evolution of the cost of risk on the write-off rate. The write-offs that we still pending on the, I would say, the consumer part of the book, is still that some write-offs needs to happen on the mortgage book and some of the SMEs, but well below what we expected when we start building the provision. Those write-off usually will -- they will happen at the end of the third quarter and at the end of the fourth quarter on the SME. I want to remember -- I want to recall that in SMEs with 48% of the portfolio is on the NAFIN guarantee. So we are confident that we have enough provisions and that the portfolio is performing better than expected on the mortgage book and NPLs are just 1.1%, 1.2% NPL ratio, so better than expected even before that we apply them the write offs.

If we move into the next page, I think a relevant part is the net interest margin. As you can see in the graph, there has been a very aggressive drop on the rates, as you know, from 8.6% to 4.3%. But when you look at the bank's NIM is now approaching the 6% that is 4.9% and it has been very resilient because of the cost of funds that we have been trying to achieve. Right now we are 46% of status, and we would like to be at the end of the year around 40% offset this to continue the downward trend on the evolution of the cost of funds and really that will push up the net interest margin along with no more interest rates reduction in the near future. So the NIM, a pretty good story. The mix is in the funding side is improving 72% in our demand deposits. So that's also a good story. We are not where we want to be on the cost of funds, so there is still room for improvement on that from the 46% to the 40% as I mentioned to you on that part.

On the next page, there has been also a questions about what's the sensitivity. As you know, we are asset sensitive as it has been in the past. So we will continue to see an evolution of the sensitivity in the balance sheet now to a good performance for the balance sheet. So we expect the sensitivity on the balance sheet to continue to evolve on a much positive numbers, closing maybe depending on how fast and how deep the interest rates go up to 100 basis points, close again to the usual number that we have the MXN1 billion, MXN1.2 billion.

The next page, please. Expenses, there were some comments that, as I mentioned before that we needed to be more aggressive on the cost side. I think we have been as aggressive as we can. But we are not touching the transformation piece. We continue to evolve on the digital space as I mentioned before. And there's also been questions about that when we will start to producing the numbers Rappi and for the digital bank. I think we need to wait at the end of the year for the Rappi numbers.

I will give you in a nutshell, we are right on target to achieve the 400,000 very fast that we commit to into the market and the milestones that we need in order to continue to invest. We are right at 200,000 as I mentioned, and we don't see any problem to reach the 400,000 at the end of the year. Once we have all the yeah the acquisition cost and the evolution of the numbers on the risk side, we will start producing metrics, not really the income and balance sheets, but the metrics concerning about our commitments to the market when we signed the deal with Rappi.

On the digital bank, we continue right on track. We are waiting for the license to happen. We are, as I mentioned before, at the end of July, we started to test family and friends. The initial stages of the product evolution and presence to the market. So we are also right on target on that. As you know, both of those initiatives, we expect to breakeven around the 30-year on both of them. But we will continue to provide once we normalize the run of the businesses metrics in order for you to see the evolution of those two.

So expenses on the control will be the low inflation and we -- right as I -- where we will see the guidance, we see that we will continue to be on a downward trend on the expenses. This is creating an issue concerning the cost income ratio, because the cost income ratio is around 44% that is well -- it is quite high compared to the usual 40%, below 40% that we run the bank with it. One thing that is important to consider in the cost income ratio is that because of the need to create those provisions on the insurance business and the margin has been affected and is affected in the margin of the group around MXN2.2 billion.

So if you go and put that on a recurrent basis because once we start going back to normal, that we think that's going to happen at the end of the third and the fourth quarter on the insurance business, which you will continue to see a good evolution on the cost income ratio not because of the rate of growth of expenses because of the lack of growth on the revenue side, mainly on the insurance side that is caused by extraordinary items like the COVID issues and the technical reserves pile up. So you will continue to see a good evolution of the cost to income ratio, once we normalize the COVID issue with the insurance business. So expenses under control, cost-income ratio book what we would like to be, but these are very specific reason and is a non-recurrent one.

On the next one, basically, the capital. This has been a questions related to what's going to happen with the payout ratio. As you know, our commitment to the market is to stay at 12% to 12.5% on the core Tier 1. We had 15.2%, most of the dividend to be paid is already warehouse at the group. So there's still a lot of room to the payout ratio and once we get the goal from the authorities, we will start to normalize again the payout ratio. Do you see also in this graph, the numbers about liquidity is extremely high. We really like to own the liquidity numbers of the bank around 135 to 140, but this is because of the lack of growth on the loan book.

But I want to stress, again, the first part of the process was to control the pandemia, really take care of the capital base, take care of the liquidity. I think we did a good job on that part. Now we have some good patches of growth and the consumer, and we expect some good growth also on the corporate and the government side in the next months. But the first part was to control and to take good care of the balance sheet and on a capital based on the liquidity basis, I think also, we've also did a good job on that part and now we are ready to go back into the market. As you can see on the gain in the market share, minorities really extremely well positioned for growth in that part.

So please next. Now if we like to give you a heads up about the change of the guidance, there is no dramatic changes on the guidance, but they show a trend. The loan growth, we are reducing the loan growth because we expect good growth in the third and the fourth quarter. We only have two more quarters to grow the book on the corporate on the government book. I think we will achieve the numbers that are there. On the consumer, we are already there on that part.

NIM contraction, we see better numbers on the NIM contraction. I think it will be trending more to the minus 10 based upon what we mentioned about the evolution of the funding side and mix and the growth on the mandate parties. Expense growth below inflation, 4.2% to 4.6% that's where we want to be on that part. Efficiency, once we start normalize the provisions on the insurance side, we will trend again to the 41% to the 42%. The cost of risk, better than expected, and I think that will continue to be a good story on this part. The tax rate stays the same.

Net income, we now are pushing our numbers, and it's important on the net income to consider that we are not taking into account any relief or provisions on this number that I'm giving to you of those 78% that are still pending to be released on the market. Return on equity for the group from 16.5% to 17.5%. This is important to notice that this is our final numbers for the year, this is not the adverse number for the year. And the return on equity of the bank we now see that the numbers should be more close to the 19% by the end of the year. We already see at -- in June as I mentioned to you, numbers about 20% of the return on equity for the bank.

The GDP inflation rate, inflation is very sticky. So it will put pressure on the interest rates on an upward trend. And GDP 6%, 6.5%. But this is a confusing number because what we need is more confidence in the investor side to really be aggressive on the investment side and look at corporate book more on to that.

With this, I close my remarks and now I pass the word to Marcos again.

Questions And Answers

A - Tomas Lozano Derbez {BIO 20387400 <GO>}

Thank you. Thank you, Marcos and Rafael. Now we will continue with our Q&A session. Please raise your hand on the platform, and we will admit you when your turn comes. Questions will be ordered automatically on the first-come-first-serve basis. Also in turn, myself will be calling the name of the person that is next on the line. 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.

We will start the first question from Ernesto Gabilondo from Bank of America. Ernesto, please unmute yourself.

Q - Ernesto Gabilondo {BIO 16384492 <GO>}

Hi, good morning, Marcos, Rafael, and good morning to all your team, and thanks for the opportunity. My first question is on NIMs. Your new guidance is showing no pressure and it seems that it implies an important expansion in the second half. So do you think this is a combination of no longer having the same impact in the insurance business, plus higher rates and low mix, considering that the retail started to grow this quarter? And also, as you mentioned by better funding costs, so I would like to know what will be really the driver for the NIM?

My second question is on asset quality. As you mentioned and there is in your presentation asset quality has been behaving better than expected, especially in consumer and mortgage loans. However, we notice a pickup in the NPLs of corporate loans. So can you elaborate if this is related to a specific corporate? And finally, my last question is if you can elaborate on your Google strategy and how would you pretend to use it with your digital banks? And also related, how can remittances business help you to bring funding for your new platforms and potentially attend the own bank segments? Thank you.

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

Well, thank you. There's a lot of questions. (Technical Difficulty) you name it, it's all of them, yes, all the expansion, the headwinds that if all this is going to help and the combination, we still don't know exactly how much of each of them, but all of them we are very positive that all these new happen now. I wouldn't go first with Francisco Martha with the Google strategy, and then we start the other questions. Martha?

A - Jose Francisco Martha Gonzalez {BIO 19073751 <GO>}

Thank you, Ernesto. The alliance with Google has several different options and different streamlines. We are going to work on the strategies around cyber security. We're going to work on a strategy around open banking, we're going to run on a strategies around data and help us collect the data, artificial intelligence and all the search engines that Google Cloud has. So and nonetheless, we are also working with them in how to take advantage of their quarter and their working methodology. So we're going to leverage that not only in the digital banks, not only in the rapid card alliance and in the initiative of the digital bank, but also in the digital transformation that we are doing in Banorte. So we already have some three different projects. One, migrating solutions to the cloud. We're going to migrate the ERP as I mentioned, implementing some cyber security tools within Banorte, the digital transformation in Banorte. So it's a range of a lot of opportunities that we are seeing with this alliance.

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

Thank you, Martha. Please, Fernando, about the asset quality in the corporate loans.

A - Fernando Solis Soberon {BIO 15414779 <GO>}

Sure. Thank you, Marcos. I will say, Ernesto, that regarding the wholesale loan book and specifically the corporate loan book, up to now we are dealing with isolated delinquencies and remote passed due loan cases. However, we are very well aware and on the look out of any hint or indication of a systemic risk type of case and/or situation. This is not of the indication up to now. We consider that this metric is going to be lower as soon as this month because of sustainable payment. That status, it's going to decrease by the metric you're looking at. So we are not worried at this case, and we have seen that recovery rates write-offs of grocers had all gone very, very well and this metric is just we will improve in the short term.

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

Thank you, Fernando. Maybe Rafael, can you help us with the remittances?

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

Yeah. As you know, we are very important player on the remittances business and the good thing about the digital offering into the market is that because the acquisition cost is so low and a lot of the remittances now are flowing on a digital space. We can really offer our way to range of segmentation process to the low end of the market with the remittances are very, very low cost of acquisition that will help us our funding as you mentioned on that part. So that one of the key elements of the digital offering is that once you reduce the origination costs and the acquisition costs, you can really serve a wide range of segments with a specific value propositions for each of them. So we see a very good opportunity. We are already doing a lot of digital on the remittances side. I think we have been doing in the last two years. But once we offer the full range of value propositions digital bank, remittances will be a key element on that to serve, I would say, the low end of the market that can become bank arising of a very efficient way to the digital offering.

A - Tomas Lozano Derbez {BIO 20387400 <GO>}

We'll now take our next question from Eduardo Rosman from BTG. Eduardo, please go ahead.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Hi everyone, so thanks for the opportunity here. I have actually two questions regarding, let's say, regulation and FinTech ecosystem. I think that first one would be interesting if you could share with us an update on quality. As you know, like in Brazil, PIX has been a huge success. So why Cody has not worked in Mexico yet. And what are your expectations for it going forward? This would be my first question.

And the second one, also compared to what's happening in Brazil. We've been seeing like a boom in Brazil in FinTech ecosystem, right. Naturally, this is hurting the valuation of Brazilian banks, right. And in Mexico, I think we are probably going to see that as well, right. So we do have a new bank, MercadoLibre investing more and talking to more about growing in Mexico. How do you see below the landscape for that in Mexico? I know that Banorte has been doing some partnerships in some investments as well to prepare itself. So it would be interesting if you could share your thoughts on these two subjects. Thank you.

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

Thank you, Eduardo, very interesting. Yes, the boom that we are watching in Brazil is going to be in the same the FinTech ecosystem in Mexico. So in some other time, we will be prepared and that's why we have all aware capacities looking at for sure the scenario. So I will ask Francisco Martha to share what's going on with Cody and also with the FinTech ecosystem.

A - Jose Francisco Martha Gonzalez {BIO 19073751 <GO>}

Thank you, Marcos. Thank you, Eduardo. Let me start with the Cody one. Although the number of transactions has been growing tremendously, at least for us, the transactions that we have sent year-over-year has grown more than double and there we see transactions is like 40%, 50%, let's say. We agree that it has not been able to launch as expected. The way we see it is that there is no any incentive in the market for the people to transform their money to the digital money. And Cody is built for people that already has an account and even we have, for example, the possibility to create an into account in the web served in the web, in the Banorte's web. And you can use that for Cody. There is no incentive to transform your cash into the digital world. So we are working with the authorities to be more inclusive in the ecosystem and be able to really move towards financial inclusion.

About the Fintech boom in Brazil and Mexico, soon you will include in your new bank and MercadoLibre, sometimes you will include Tropicana for sure. We are seeing it. We are seeing the banking commission approving the FinTech, some of the FinTechs. Some of them will have a lot of conditions. But obviously, the market is moving towards that. But I would like to remark that neither FinTech or nirvana and the banks are they will not. So there is a lot of grain notes in the middle. And we have to work with them. We are using some of the FinTechs that are in the market for example for our payments for our marketplaces. So it's more a matter of taking advantage of them, and them taking advantage of our capabilities. Because at the end, what we believe is that the customer needs the trust and the trust is not easy to build and Banorte has a lot of trust of our customers.

Q - Eduardo Rosman {BIO 16314825 <GO>}

No. Great. Just a follow-up here on the Cody subject, because I think you mentioned something very interesting, the incentives, right. So what could change do you think if I don't know, maybe if the government starts paying all the benefits through these digital accounts and may be incentivate kind of people to use that digital money maybe this would force merchants as well to start accepting right maybe this would be a way to think about it? And the other thing would be as far as I know, and correct me if I'm wrong, only banks are allowed to manage Cody, right. I think in Brazil, we do have, let's say, payment institutions some other FinTechs, which are able to be part of PIX, right. And actually it's different, right. But would that probably do you think if those two things happen, what do you think that maybe things could accelerate for Cody?

A - Jose Francisco Martha Gonzalez {BIO 19073751 <GO>}

Yeah, for sure. But let me tell you that not only banks can manage Cody big retailers are already managing Cody like Walmart and Comercial Mexicana. They are using Cody. But at the end, you need to have an account, but I agree with your first statement. If we are able to ask that the services that the government provides, let's say, power, energy, water, they need to be debited automatically in an account that will create a more financial inclusion. So we are asking them for example to include QR codes for the transport in Mexico, the buses and some other transportation. And let me tell you, I'm looking at my notes, I don't exactly know the perfect amount, but we are talking with them because there is -- if we are able, the same way that we have the end to accounts that require less documents and know your customer easier procedure. If we can also exclude and obviously not, it's not our decision, but if we can also exclude some kind of accounts from the taxes regulation, that will create a more financial inclusion.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Okay, thank you. Thank you very much for your answer.

A - Jose Francisco Martha Gonzalez {BIO 19073751 <GO>}

Thank you, Eduardo.

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

If I just may add one thing about what Francisco mentioned, I think the evolution in Mexico concerning the FinTechs and things is more similar to what is happening in the US that the systemic banks, the large banks are becoming faster and much more agile investing a lot in transformation and digital and having digital offerings into that. And during the pandemia, as Francisco mentioned, I think people also look for a strong entities to have the money with. On the payments side, on the transaction, maybe there is a room for that. But what we see in the evolution of the pandemia and what's the trend in the US and in Mexico is that the big banks are becoming more and more and more agile and bigger and faster in order to really complement the digital offering in the market.

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

Thanks, Rafael.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Thank you.

A - Tomas Lozano Derbez {BIO 20387400 <GO>}

Thank you. We will take now the next question from Thiago Batista from UBS. Thiago, go ahead please.

Q - Thiago Batista {BIO 15398695 <GO>}

Yeah. Hi guys, thanks for the opportunity. I have two questions. The first one is a follow-up on asset quality. When you look to the NPL ratio of Banorte, if you, I can say, well below the pre-COVID level that used to be, let's say, close to 2%. Do you see this NPL ratio returning to this pre-COVID level? Or are you seeing any change in your portfolio that may maintain your NPL ratio below the pre-COVID level? So this is the first one.

The second one is about payout ratio and the capital of the bank in the future. If you consider the second payment of dividend this year, your core capital will be very strong in my calculation over 40%, probably one of the highest among competitor banks. And when I look for the Mexican bank situation, I do not see loan growth more than double digits or achieving the double-digit level. And if I assume ROE of Banorte returning to the high teens, the bank will generate a lot of capital. So my question is, do you see a much higher payout ratio in the future for minority? Or do you see other ways to deploy this capital, if there is any special segment where M&A should make sense? So trying to see how your capital will evolve in the future and how to deploy this capital?

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

Well, Thiago, thank you, Thiago. And the second is the top one, of course. We are alert, and we don't know still what are we going to do. But we can do everything. So that's a good news. We saw as soon as we have, I'll do to start the year, we will go with you. But, yes, you're right. We are creating a lot of capital, which is -- and we will see what are we going to do in the near future and then maybe for the year. And the first one is also very interesting. We will go to the 1.9% around that and then depending if the consumer loans more than the orders, obviously, the consumer needs more reserves and also, so we will change because of the good reasons maybe to 2.1 around that. I will leave it to Fernando to give you more color on that.

A - Fernando Solis Soberon {BIO 15414779 <GO>}

Yeah, I will. Thank you, Thiago, for the question. That's a question that we make ourselves daily and obviously, asset quality predictability has significantly increased. There is more clarity in the retail say side of the loan book, and we expect to approach a normalized rate risk metrics scenario no later than the end of this year. When we look at the past due loan segment of our loan portfolio, it is being successfully managed in an assembly line type approach that is from delinquency management all the way up to legal collection if necessary. Recovery rates, write-offs, foreclosures are going off very well and up to now, past due loan portfolio sales are not being considered.

On the contrary, we are buying, not selling and recovery rates have been performing very well. Structurally speaking, we will leave any possible structural change on quality credit metrics together, and we are very expectant due to weakness there. And we have taken a very active role in managing the past due loan portfolio and managing the wholesale side of the loan book, as well as the retail side of the loan book. So we remain very optimistic on quality loan growth prospects and up to now, these past due loan ratios have been performing very well, as you have seen.

A - Tomas Lozano Derbez {BIO 20387400 <GO>}

Thank you. We will now take our next question from Tito Labarta from Goldman Sachs. Tito, please go ahead.

Q - Tito Labarta {BIO 20837559 <GO>}

Hi, good morning, everyone. Thank you for taking my question. A couple of questions also. First, following up, I guess, on margin. But specifically on the insurance part of it, when do you think that the insurance business begins to normalize? Do the claims normalize already in 3Q? Do you think you still have some pressure on the claims related to COVID in 3Q and 4Q? So just to get some color on how much the insurance will benefit margin going forward? And just to clarify, the guidance is for the bank margin already for the group, just want to make sure I understood on that. And then just one quick follow-up on the dividends, just any color you can give on your conversations with the authority, if you think you will be able to pay out more of this year or will you only be able to do the 25% of 2019 and 25% of 2020 this year? Any color you can give on that would be helpful? Thank you.

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

I will start with the third one that is really been the conversation with authorities, they know what's going on worldwide. Actually in Mexico, so they need to know worldwide what's going on and they move to Mexico. That sounds like that on these (Technical Difficulty). So we will hear from them soon and as soon as of we know that we are in control is going to be like in the old times. Let's say that and also let's wait a few months and that's it. We have like two, three months we get rest of the world. That's my point of view. So they will move as soon as what is ready and we are ready, which moves me to a the first question now. The insurance business will normalize. I don't know, we hope that would normalize very soon in some other obtained that fair way this year, a more loss things were we have a lot of people sit, but they are not valued. So it's totally different now again and maybe Fernando Solis can give us more color on that. Fernando, are you there?

A - Fernando Solis Soberon {BIO 15414779 <GO>}

Yes, Marcos. Yes and actually the question that you always ask me kind of the ways going forward the insurance business. I'm optimistic, I think it will tend to normalize. I do believe that things will be better hope so due to the fact, one is that something that Gabriel always mentions. I mean the protocols in hospitals and the way to deal with quality has improved. So even though we are experiencing more cases lately, we see them to be less severe, and we are experiencing less deaths because of that. And also the vaccination, even though it has not gone as fast as we would like to, it's likely that the population that we insure is more biased towards being vaccinated already so. Therefore, even though if they also get sick, it's not very likely that they will die. And that's really what has occurred at the book, the insurance mainly is a life insurance.

Actually, in the health the lines of business, if things are now looking much better. So yes I do think that we will see better -- much more income because we will not be as much in claims. And also, we will not have to writing the incurred, but not incurred, but not reported reserves because we have been, as you know, accumulating a lot of money in this reserve and hopefully, it will be more than enough. So I'm optimistic, but we will see as Marcos is saying, I mean there is a lot of uncertainty regarding COVID going forward because we don't know if some of the new mutations of COVID will become not only more severe, but also that the vaccines will not work for them. So it's something that we are not considering, hopefully, that will not happen. And if that's the case, I do believe that things will start to get better as we move forward.

Q - Tito Labarta {BIO 20837559 <GO>}

Thank you. That's very helpful. If I could just have a follow-up there, any color you can give to maybe, I know it's still early in the quarter, but just through July, are you already seeing claims coming down, I guess, relative to the peak? Or any color you can provide just how July has gone on the insurance?

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

Actually that's been the case, the claims have been reduced.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay. Great, thank you. And the other one on the NIM, just to clarify. The guidance is for the bank or is it for the group?

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

Tito, the guidance for the group and for the full year.

Q - Tito Labarta {BIO 20837559 <GO>}

Great, thanks so much. Thank you, everyone.

A - Tomas Lozano Derbez {BIO 20387400 <GO>}

Thank you, Tito. Now we will take our next question from Jorge Kuri from Morgan Stanley. Jorge, please go ahead. Jorge, please unmute yourself. Okay, if not, we will go now with Jason Mollin from Scotia. And Jorge, if you want to ask a question later, please raise your hand. Jason, please go ahead.

Q - Jason Mollin {BIO 1888181 <GO>}

Hello, can you hear me?

A - Tomas Lozano Derbez {BIO 20387400 <GO>}

Yes, perfectly.

Q - Jason Mollin {BIO 1888181 <GO>}

Great. I have two follow-up questions. First on the NIM and one of the drivers of looking to reduce the cost of funds. I think Rafael, you mentioned from 46%, 58% to 40%. Can you talk about what's going to drive that? Is that with TA increasing and you guys maintaining? Or what's the strategy to reduce that percentage?

And secondly, I guess, related to asset quality. But you talked about write-offs, especially in consumer and mortgages and SMEs need to come. If you can talk about what we should be expecting there? You did mention the guarantees in the SME book. Maybe you could talk a little bit about how that works as well? Thanks.

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

Rafael, please walk him through the NIM, please.

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

Yeah. The NIM, as you mentioned, Jason, is related to status. What I said is not to Tier 2 status to go to the 40% to said is, what is driving that. As I mentioned to you, liquidity is extremely high 210% at this point in time. Our liquidity will start to reduce because those funds are not being needed. So we can reduce the price of those funds that we warehouse during the pandemia to be ready for any nature or extraordinary liquidity, so that will reduce our cost of funds. And another very good story is the rate of growth of the demand deposits at the network and the commercial entities of the bank that we have been growing close to 12% on year-on-year with loan growth around 6% overall. So you see a buildup of cheap deposits are pretty fast on that. And we see that accelerating on the capacity for the commercial part of the bank networks and all the other entities to be very efficient in the race of deposits.

What's driving that? I think the simplicity that you can open an account at the bank, all the digital offerings that we can -- that you can open accounts in a digital space pretty fast and pretty easy, and all the services that we provide for SMEs and other transactional banking also, so I think it's a combination of many things, but all of them are working nicely. So that's our goal to reach the 40% on status base at the end of the year. So we are confident we can achieve that on that part.

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

Thank you, Rafael. Let's move to the warranties of size, 70 something, 75 something.

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

Yeah, 77% the number of loans and 45%, Jason in terms of balance.

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you. And what we see, but we will see write-offs in the third and fourth quarter. Should they be similar to what we saw in the second quarter? Or will they accelerate?

A - Jose Francisco Martha Gonzalez {BIO 19073751 <GO>}

No, I think they will be similar to that, and I think we don't expect to see a huge pickup on that is much more similar to what have been going on until today. And the reason for that is that you have a specific regulations for -- as you know, we reduced the write-off period for the SMEs from 19 months to 9 months. So that's why that buildup of provision will happen until the fourth quarter on that part. But we don't see any extraordinary numbers going up on that. If you look on the NPLs of SMEs right now are pretty low compared to the history of Banorte. And the reason for that is the weakening of the bar a lot of the book in June, past June on the write-off that we did on the SME.

The other part of that has to do with the write-off on the mortgage is also the period that we need in order to the write-off, but having NPLs around 1.2%, 1.3% compared to the usual 1% that we run that book, we don't see any aggressive write-off that we need to do in the third and the fourth quarter.

Q - Jason Mollin {BIO 1888181 <GO>}

Right, thank you, very much.

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

I'd also add, Jason, that collateral execution on behalf of these government or bank agencies it is immediate. We have a special process in which we check, if office communication is 100%, we just collect or execute the collateral. There is no delay, and we currently are working with nothing, FEGA, FONAGA and FIRA. So that's been functioning very well. Those programs are on a case-by-case basis, but the majority are sectorial based, depending on economic activity. That will give you more color in what those kind of guarantees work.

Q - Jason Mollin {BIO 1888181 <GO>}

I appreciate that.

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

Jason, just one more thing. When we approach at the beginning of the change of the new government coming into place every time that happens usually get the SME affected by liquidity, so we bought a lot of guarantees before that. Then the pandemia hit, but we're already good in a very good position with 48% of the book already on the NAFIN guarantees. The rate of claims that we have in that part at round on a monthly basis around MXN90 million, MXN70 million on that part of guarantees. So I think it cost us because it reduces the profitability of the SME book, but this has been pretty good for the health of the portfolio.

Q - Jason Mollin {BIO 1888181 <GO>}

Interesting, thank you very much.

A - Tomas Lozano Derbez {BIO 20387400 <GO>}

We will go back to Jorge Kuri from Morgan Stanley. Jorge, please go ahead.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi, can you hear me?

A - Tomas Lozano Derbez {BIO 20387400 <GO>}

Yes, we can.

Q - Jorge Kuri {BIO 3937764 <GO>}

Great. Thank you. Sorry for the previous time. Thanks for the opportunity. Hope everyone is doing great. I have two questions on your guidance, if I may. The first one is on the provision on the cost of risk, you are at 1.9% to 2.1% and having a tough time and seeing how can you get to those levels? It just seems like a really big ramp up in provisions in the second half of the year. You did 1.5% in the first half. So in order to get to that midpoint of 2%, the provisions for the second half would have to be like 2.5% of average loans. How do you get there? I mean, do you think maybe there's a potential upside to these numbers that provisions can be lower? Or is there anything that we're not seeing that you are? But 2.5% for the second half is a really big jump versus where we are now. And then I'll ask a second question. Thanks.

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

If I may start, and then, Jorge, remember that when you see the drop because of the relief programs, you basically put on the standstill for like six months in some of the portfolios on that part. So if you look at the graph that we project on how the evolution of the cost of risk goes on the book, then we see what you call a big ramp up, it's really the normalized number that we have been running the portfolio of that because that really is coming back to normal, it's not that these are big ramp up. If you consider that, you have to consider when we were on a standstill basis like for six months on that part. So when you compare the numbers, you have to take into account that process.

When you talk about that the big ramp up on the numbers is really no, we saw pretty normal tenancy that will be below that the current number, the usual numbers that are not to run the cost of risk. So what we've seen is a better number. Once you take into account that relief programs that we did, so by aiming to have around 2% cost of risk at the end of the year, 2.1% is even much better than before the pandemia. So the ramp up that you are talking about is really taken into account all these standstill process that happened when you're going into the relief programs.

And once you normalize to growth, as Marcos mentioned, on the consumer and everything like that, then you start getting into the usual numbers that Banorte had been running, but these numbers are going to be below the usual numbers that Banorte has been running the cost of risk. So it's really not a ramp up, it's a normalized process in order to go. Once you clean the portfolios, you go back to normal, and you take away all the remains of the relief programs that have been into that.

So I think you will see that a lot more clarity on the third quarter, but it's really what we see and are really looking, these are an extraordinary behavior of the portfolios that we have been taking ourselves. Fernando mentioned, you will see some issues on the corporate that we sorted out and balanced that out, but we don't see any ramp up concerning that TDT ratio or anything like that. That's why we are changing the guidance to going below the normal numbers that Banorte has been running the cost of risk.

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

And I made as Rafa, if I can, these lower part of the interval being 1.9%, it's a metric that our clients for the 12-month period that has the benefit of a longer timeframe. But also, I would say, and I think I can say that the 12-month average of that metric is already 1.9% as of now.

So what that tells you Jorge is that we are being conservative. And yes, there is some upside expected in managing these type of metric, so -- and that's the case because we have seen throughout our internal processes of origination all the way up to collection. So they have been performing very well.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. And then so, if indeed you are going to see 2.5% in the second half again in order to get to that 2%, should that -- and again, I didn't mean ramp up in the sense that is extraordinarily high. I see historically your provisions have been higher, I'm just talking about a ramp up second half versus first half of this year. And so then what provides the offset, so what -- how do you --

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

I'll tell you first quarter, if I may, is that the historic number for cost of risk is going out of that 12-month window, I think that explains what you're seeing or you're producing in a different language. And I think will add to that internal initiatives that we have in order to execute in a very good level of performance.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Maybe we take those -- this offline. And let me ask my second question, if you don't mind, it's on the credit also on the guidance sorry -- on the credit growth, in order to get to that 5% to 7% growth year-on-year, the quarterly for the third and fourth quarter would have to have like 3% sequential growth for both quarters, you know, for you to get to that number, which is evidently a pretty strong ramp up relative to what we saw in the first half of the year, which was basically flat or actually slightly down. So what gives you confidence that you can accelerate as rapidly over the next three months and then again over the next subsequent three months?

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

Do you want me to Marcos to go into that.

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

Jorge, the first thing is that, remember, the big tickets come from the government book and from the corporate book. The consumer is already getting into that numbers and will continue to go above that numbers on that part. The credit card was the one that was lagging and now is recovering. So we don't see an issue on the consumer to up that. So the big tickets need to come from the corporate and through the government on the federal side and on the states and municipalities. We stopped completely the lending process because of the elections since the beginning of the year on the government -- on the government book basically on the states and municipalities. So now we are back into the market on that. On the corporate side, I would say honestly that's the tricky one because it has to do with the confidence that people has about investing and we think that was now that the elections are over and we see a lot more balancing power in the houses, confidence is coming slow but it's coming back again.

So that's where we are really thinking that those tickets will come from that -- from the restart of the government lending part and also from the corporate pipeline that is already building up. The commercial I would say is more advanced in that pipeline. I think we've seen much more than that.

And remember that because of the elections happens on that there were a lot of prepayments on the corporate part, some of those will come back again and minorities in a position, because of the balance sheet that we have to really go for those loans once now that the companies feel more comfortable about investing in that. So, as you say, it's a ramp up, yes, this is -- this one relates to ramp up and but we think we can do that based upon the potential demand that we could have because we restrained that demand before the elections.

Q - Jorge Kuri {BIO 3937764 <GO>}

Great, thanks.

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

Thank you, Jorge.

A - Tomas Lozano Derbez {BIO 20387400 <GO>}

Thank you. Now we will go with Alonso Garcia from Credit Suisse. Alonso, please unmute yourself.

Q - Alonso Garcia {BIO 2507089 <GO>}

Hello, everyone. Good morning and thank you for taking my question. My question is on the fee side, I mean what sort of net fee growth is embedded in your net income guidance for the year? I mean so far we have seen a very nice recovery in core banking 28% year-to-date compared to last year but have also seen pressure on the fees paid. So, all in, net fees as flat year-to-date. So, could you please elaborate on the sources for pressure on the fees paid side. And yes, what is your expectation for net fees for the portfolio? Thank you.

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

Thank you. Rafa please.

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

Yes. Alonso, thank you. And as you said, I think I would like to separate out your question into two things. The first one, as you mentioned, we see a very strong recovery on the activity of the bank on the transactional side, as you mentioned, the fees -- the banking fees are really well above that and the fees paid are basically related to the external sales force that we needed to develop in order to keep on moving on the needle on the mortgage side and on the car sales.

So fee space that are up 31% as you see on the numbers. This fees are part of the origination thing on the acquisition costs that you paid that once you once you apply the loan, but we need to reduce that sales force dependency once we see much more normalized think on the -- on how customers are coming back to the normal relationship with the bank.

And also at the same time, we are working a lot on the digital origination part on the mortgage side and on the car loans side like launching marketplaces and things like that. So the pressure is coming from these external sales forces that you will see a reduction in the coming months on that part. And you will continue to see good growth on the transactional and activity fees coming from the banking side. But just 31% was the cost of staff -- this external sales forces that is past of the acquisition cost of loans that stay for with us for 15 -- 12 years. So you face that once, but you keep the benefit for the next 12 years. And on the car loans for around three or four years. But you will see a reduction in that part in a downward trend in the coming months Alonso.

Q - Alonso Garcia {BIO 2507089 <GO>}

Thank you, Rafa. And based on that, what is the sort of net fee growth that you are incorporating to your income guidance?

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

I think the net fee growth should be about I would say well above the loan growth, so it should be around 12%, 11% to 12%.

Q - Alonso Garcia {BIO 2507089 <GO>}

Got it. Thank you very much Rafa.

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

Thank you.

A - Tomas Lozano Derbez {BIO 20387400 <GO>}

We will now take the next question from Edson Murguia from Finamex. Edson, please go ahead.

Q - Edson Murguia

Hi, good morning. Thank you for taking my questions. I have a couple of them. The first one is on service fee but specifically on electronic banking. Of course, if you compared to the second part '20 versus second part of '21, there is an increase of 58%. However, when you compare to the first quarter '21, there is a 10% increase.

So the question regarding this is, this 10% as an overall it's because higher volume or higher fee from electronic banking services?

The second one is regarding on our brokerage business. You mentioned in the earnings report, 126% in trading income and 9% in increases in fee charges, if I remember correctly. So I was wondering if you can give us more color about this, and the tailwind is on inflation, last week, we heard from Jamie Dimon -- saying that inflation is not transitory and whatever that means. However, what is your expectation on inflation, it's transitory, it's not maybe we are going to see a high inflation from not only the rest of 2021 maybe 2022. And thank you so much.

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

Thank you, Edson. I will start with the third one, the inflation, and these Gabriel. Gabriel, walk ahead please.

A - Gabriel Casillas Olvera

Thanks, Marcos. Thanks Epsom for your question. Yeah, we think that inflation, there are big chunks there that are definitely transitory or temporary like you know commodity prices and certain things there, which you know, the supply side will actually respond to the demand shock. But definitely, there will be some not so transitory pressures and I think the places like Mexico will experience that. So we are expecting inflation to end this year at 6.1% and inflation to end the year 2022 at 4%. If you need like a more elaboration -- do you need me to elaborate more, just tell me we can do it offline.

Q - Edson Murguia

Thank you, Gabriel.

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

(Multiple Speakers) The first one, it's on -- it's volume. At the end, it's volume, the 10% increase that you were highlighting, it's based on volume.

Q - Edson Murguia

Okay, makes sense. I could follow up on this. So basically maybe let's say in for the second half of the year, let's say it's going to be like a trend around 10%, no single digit number?

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

(Multiple Speakers) No, it will be around 11%. If you go to the numbers on the service fees, like for instance our fund transfers second quarter of '20 to second quarter of '21 are growing close to 12%. If you go to account management fees, that is basically the more than I have been affected because of the opening of accounts that were on a physical now we move to digital, that's the only one that has been reducing on that around from minus 3%.

But the electronic banking services are going now 40% as by convention about volume. There is no change in line. So you see any line on the fee side is going up in important way, you just talk about trading, what's going on the trading side, the trading up compared to second quarter of '20 was up 32% and it's basically about its activity and volume on that part.

So, I think related to your question, what we see is the bank becoming much more active than before the pandemia, a lot has been pushed by electronic numbers and digital origination pieces, but the bank is fully active now on that and that's why you see the growth well above the -- on the fee side, well above the loan growth on that part.

And that will continue in the third and will peak on the fourth quarter.

Q - Edson Murguia

Okay, thanks so much (inaudible) last one. Regarding on being fully back at the offices, what are your expectations it seems like as an industry or the banking industry, it's like in a hybrid mode, so could you give us a little bit more color or your comments on this?

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

We will take it easy -- some of the not so easy. So we don't want to be the first one and announce a fee, so it's working. So we will go like this three more months and we will see from there. And then we will go to the hybrid (inaudible) because we love to do that. Remember, when we have, this is longer one two three is become running in the year other mix in centers for the customers for our investors and also for the employees.

So if we can move on that hybrid model and it's working, we want to be there. So the idea is to move slowly in the right direction, and see what happens and adapt to the circumstances.

Q - Edson Murguia

Thank you.

A - Tomas Lozano Derbez {BIO 20387400 <GO>}

Thank you. Now we'll move to Carlos Gomez from HSBC. Carlos, please go ahead. Hi, Carlos can you unmute yourself please. Okay, Carlos, if you want to ask a question later on, just raise your hand again, now we will go with Arturo Langa. Arturo, please go ahead.

Q - Arturo Langa {BIO 18675469 <GO>}

Hi, good morning and thank you, Thomas. Thank you Marcos. Thank you Rafa and everybody. So I know you've talked in detail about this already, but one of the scenarios that maybe could play out is third wave of COVID and corporate especially with much less desire to have a credit demand now because of the lack of visibility.

And on the flip side, as inflation creeps up, maybe you could see some pressure in terms of deposits of especially institutional deposits looking to maybe have a higher share of time deposits or things like that. So it contrasts a little bit with your outlook on NIM, but I just wanted to ask the question specifically, should I attach like a high probability of that being a potential worst-case scenario? Do you see anything like that as a concern or what is the degree of confidence that you have in the scenario that you presented in your earlier remarks? Thank you.

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

I think what you mentioned is has to do with two things. First, you have to take into account that we have excess liquidity, and that liquidity is costing us but that liquidity will be (inaudible) again into the market, because we don't need that and that basically some of that liquidity has a high cost, so that will continue to trend the cost of funds down to support our expansion on the margin. The growth in the consumer book will continue to be there. It has been there. The third wave of the pandemia if it happens as you know and Marcos mentioned has different variants now about people continues to work. Now it seems like we learn to live with this issue. So it's not like the first one that everything was locked down.

So now you see activity going on with different ways of related demand and supply and things like that, so I think that will continue to be there. And on the funding side when usually happens to happen during the pandemia is the consumers tend to save money a lot.

So that helps bank on the funding side, it doesn't help a lot on the lending side, but on the funding side continues to do so. I mean you have a stock of lowest royalty like Banorte has to big stock of loans on that, that you can serve them with a lower cost of funds that will also support your margin even if loan growth is noteworthy where you want loan growth to be.

So I don't see anything that could really hurt the margin unless there's a tragedy going on on the market that we don't ambition that.

Q - Arturo Langa {BIO 18675469 <GO>}

No, that makes a lot of sense. I think my follow-up question would be in the total number of clients that you have, if you compare for example your banking clients with your insurance clients, I think that penetration continues to be quite low, just maybe what would be your outlook in a couple of years in terms of cross-sell and maybe where the cross-sell ratio is right now where you want it to be?

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

Yeah, the cross-sell ratio is close to 2.1% and we need that number to really ramp up to the 2.3%, 2.4% on the cross-sell ratio, a lot has been doing in the digital analytics piece in order to really move into personal loss rates to decline. I think you will start to see that in the remaining of the much more aggressive training into that.

I think we have a very good source of our relationship with the mortgage group that we are becoming one of the leaders in the market on the mortgage origination front. So that's also a very important piece. The same on the car loans side. Now, we see a rebound also on payrolls and payrolls, you have to segment those by earnings.

But we also see that potential in that, but I think our main goal is to really, really become a relationship bank. I know everybody's talking about that, but we are putting everything one all the pieces in place in order to really achieve that based upon the lifetime value of the client offering the client not by (inaudible). So all those changes that have been going on, but it takes time to really implement, I think we are now fully into implementation mode into that part.

Q - Arturo Langa {BIO 18675469 <GO>}

Thank you, Rafa.

A - Tomas Lozano Derbez {BIO 20387400 <GO>}

Thank you. We will go back to Carlos Gomez Lopez from HSBC. Carlos, please go ahead.

Q - Carlos Gomez Lopez {BIO 18817238 <GO>}

Yes and apologies for the lack of technical proficiency but simple question similar to Jorge, your tax rate so far this year has been on average 24%, you are guiding for 26%, 27%, so that would imply something like a 29% in the second half. Is there a particular reason for the tax rate to be so high?

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

The only reason is the expansion on the revenue side that you need to pay more taxes on that, that will be the only reason for that.

Q - Carlos Gomez Lopez {BIO 18817238 <GO>}

Okay, thank you very much.

A - Tomas Lozano Derbez {BIO 20387400 <GO>}

Thank you. And now we will take our last question from Federico of (inaudible). Federico, please go ahead.

Q - Unidentified Participant

Yes. Can you hear me?

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

Yes perfectly, thank you.

Q - Unidentified Participant

Yes, thank you. Marcos, Rafa for the conference. A pair of question if I may. The first one is going back to the question of (inaudible), when I looked at the first two quarters, the provision was about around MXN6 billion. If we assume this 1.9, 2.1, that 1.9 that you expect for the year, we have to assume something like MXN10 billion in the second part of the year. This is, and I understand that the seasonality that you have always, but this is, again, this is big sum, you are more conservative you're expecting something there? This is the first question. And the second question, sorry, if I may, is when I see the past due loans, there was a big jump quarter over quarter in the size of corporate. This is related to one particular loans or there is any other answer?

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

Thank you, Federico. Rafael, please go ahead.

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

Yeah. I will tell you Federico that, yes, you name it for the second half of 2021, we are expecting a seasonally higher cost of risk, that's the short answer to your question. And for the second question that you are making, I will tell you that those cases are isolated, I would doubt that some of the economic activities that corporate NPLs incurred by the second quarter of this year, such as the Cardboard Consumer Packaging business, we have our non-performing loan of that type. Another example is a city hotel with character problems on behalf of the entrepreneur, so as you can see and I wonder if you exemplify any other case but those NPL cases in the corporate side are exemplified by that type of activity. And they are not systemic risk, you make sure. So we are comfortable and obviously we do not expect that these situations comes to an end until the third quarter of this year. So that will give you some color about the NPLs that corporate banking has incurred in the second quarter of this year.

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

Yes. And also, Federico, the second half, we're expecting less prepayments, better loan growth and overall I think it is very important not to mention again that the guidance as Rafael mentioned at the beginning is conservative and does not consider any reversal of provisions.

Q - Unidentified Participant

Perfect. Last question now from my side, if you can remember us how is the participation of the banking glitch.

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

Around 3%.

Q - Unidentified Participant

Around, sorry?

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

3%.

Q - Unidentified Participant

3%. Okay, thank you guys.

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

Thank you, Federico.

A - Tomas Lozano Derbez {BIO 20387400 <GO>}

Thank you, everyone. With this, we conclude our presentation. Thank you very much.