

GRUPO FINANCIERO BANORTE, S. A. B. DE C. V.

**ANNUAL REPORT ON THE PROGRESS OF THE
BUSINESS IN 2020**

Annual Report on the Progress of the Business in 2020, Grupo Financiero Banorte.

“We have worked very hard to strengthen our digital tools to be closer to our clients. We will go forward to always honor our slogan: to be “The Strong Bank of Mexico.”

Macroeconomic Environment

Mexico

The world experienced a strong and unexpected health crisis in 2020 which effects extended to a great amount of areas beyond health, such as the economy and society at large. Governments had to face a very difficult dilemma: control the contagion curves through social distancing policies or partial closing down of activities at the expense of the economy. During the second quarter of the year we experienced the worst economic recession since the Great Depression of 1929 due to this dual crash, both in the supply –disruption in the global supply and value chains and closing down of companies– and demand –abrupt fall in the income received by both families and companies.

This complex situation required an unseen economic policy answer in the world. Central banks cut their interest rates at the same time and started liquidity injection and credit programs. At the same time, governments led fiscal stimulus programs never seen before, near 15% of the world GDP, according to the International Monetary Fund.

Together with the effort of many families, authorities and companies, we, at Banorte, joined this call to implement various measures, from the deferment of payments in credit cards and automobile credits, payroll, mortgages, personal credits and pymes to our clients directly or indirectly affected by the pandemic to the extension until 2021 of our integral reconstruction program due to the 2017 earthquakes called Banorte Adopts a Community. In addition and always prioritizing the health of our clients and our workers, we created innovative schemes to take care of the users of our services, such as the possibility of having appointments with our executives at our branches through technological platforms.

During the second half of the year, the world started to experience a recovery derived from the launching of reopening programs and sanitary protection measures, the effects of the economic policy measures and a more promising expectation on the development of different vaccinations manufactured by pharmaceutical companies. This situation was also reflected on the performance of international financial markets showing an important breath after the strong risk aversion and disruption existing from March to May.

Faced with this complex panorama, Mexico suffered a drop in the GDP close to 8.5% during the year, the worst level since 1932, with a very important contraction in practically all sectors, even though the most affected were those associated to investment, consumption –mainly of durable assets– and services –especially, amusement and entertainment, which are more dependent on social interaction. External demand was the most impacted at the beginning of the pandemic but it achieved a higher dynamism towards the end, supported on the fiscal and monetary programs in the United States of America and the reactivation of its economy.

In Mexico, the answer to the economic policy mainly came from Banxico, which decreased its reference rate in 300 base points during the year –from 7.25% to 4.25%- in addition to implementing a series of measures or facilities to strengthen the financial position of both companies and families. In general, the strong contingency lived in 2020 had a very important adverse effect in the economy, generating aftermaths which could last longer and structural changes that will require a higher adaptation and flexibility by families, companies and governments.

Group Results

We, at Grupo Financiero Banorte, know that one of our competitive advantages is the thorough knowledge we have of the needs of our clients. Based on that, we were the first bank in Mexico to start, in March, a support program for our consumption clients and pymes. The support programs originally granted some four-month grace periods, as an average, and later on, one- or two-month extensions in some particular cases. Approximately, 630 thousand clients enrolled in these programs, which main objective was to keep us hand in hand with our clients and support them during the contingency.

Net Interest Income

Net interest income, without insurance or pensions, grew 2% annually, derived from, to a great extent, the efficiencies in the funding cost thanks to the 31% decrease in interest expenses and a 1% increase in income from portfolios interest, while the total portfolios grew 5% during the year.

The Net Intermediation Margin (MIN), without insurance nor pensions, decreased 28 base points to reach 5.3% at the end of 2020, mainly derived from the adjustment in the price of variable rate products as a result of the strong 259 base points decrease in the reference average rate 28-day TIIE during the year.

Regarding Net Interest Income (IIN) for insurance and pensions, they experienced an 8% increase resulting from a 22% growth in net interest income in spite of the affectation on the technical results, which reflects a \$4,312 million pesos increase in premium income which could not compensate the increase in technical reserves –mainly in pensions– and a 17% increase in the accident rate.

In brief, net interest income of GFNorte recorded an 3% during the year and faced with a rate decrease environment, the MIN only decreased 32 base points during the year, remaining in 5.3%, while the reference rate of Banco de México decreased 300 base points during the year to finish at 4.25%.

Credit Provisions

With a very complex year due to the Covid-19 pandemic, where the economic activity experienced a strong contraction and unemployment levels reached an evident increase, Banorte proactively anticipated the effects of its portfolios deterioration and recorded additional provisions during the second and fourth quarters of the year for a total of \$7,274 million pesos of which \$5,000 million pesos were additional reserves and \$2,274 million pesos were advanced write-offs in the portfolios of the different products. Regarding 2019, the total amount of provisions meant an increase of \$6,584 million pesos or 43%.

Non-financial Income

In comparison with 2019, non-financial income contracted (11%) mainly due to the recognition of non-recurring gross income in the amount of \$1,661 million pesos resulting from the conversion of Banorte USA during the first quarter of 2019. By eliminating extraordinary income, contraction would only be 4%. In addition, non-financial income were impacted by less income from net commissions derived from the effects of the pandemic and less brokerage revenues faced with a lower position of instruments and derivatives.

Non-financial Expenses

Non-financial expenses increased 6% compared to the previous year due to higher expenses in personnel derived from inflation as well as for the compensation expenses provision associated with the restructure of the operation to face the new environment resulting from the pandemic and an increase in fees and rent expenses. If we had not considered the expenses associated to restructure, expenses growth would have been 4.6% per annum.

Net Profits

There is a contraction of 16% in net profits in comparison with 2019, due to the additional recognition of advanced provisions during the year. With recurring figures –without the extraordinary income of the first quarter of 2019 from Banorte USA and without the additional provisions of the year- accrued net profits for 2020 grew 1% in spite of the strong contraction in the economy and the decrease in reference rates.

Profitability

The 14.8% ROE during 2020 reflects the recording of advanced provisions, as well as the concentration of capital derived from the temporary suspension in the payment of dividends following the recommendations of the authorities. With recurring figures, it was 17.1% during the year. ROA recorded 1.8% and with recurring figures, it reached 2.1%.

Deposits

In comparison with 2019, deposits increased 13%. Term deposits decreased 5%, while on-demand deposits increased 22% as a result of the efforts made to increase balances with clients and the resulting decrease in higher cost interbank funding in line with the strategy to improve margins.

Current Portfolios

Faced with an uncertain environment, liquidity needs and support for consumption clients and pymes, the current credit portfolios grew 5% during the year. Not taking into consideration the government portfolios, portfolios recorded a 9% annual growth with a positive behavior in practically all segments, exception made of credit cards, as expected according to the circumstances prevailing during the year. This growth allowed to increase our market share in 108 base points.

Overdue Portfolios

In 2020, the balance of the overdue portfolios decreased \$3,875 million pesos due to the combined effect of advanced write-offs in the amount of \$3,348 million pesos applied during the year and because the effects of the pandemic were not materialized in full thanks to the extension of the support programs. The overdue portfolios indicator, compared to 2019, improved in 55 base points due to the above.

Reserves Requirement and Preventive Credit Provisions

At the end of the year, the balance of reserves for overdue portfolios increased significantly faced with the extraordinary recording of additional provisions in the amount of \$7,274 million pesos, of which \$4,868 million pesos were registered during the second quarter of the year and \$2,406 million pesos in the fourth quarter, anticipating a probable deterioration in portfolios resulting from the pandemic.

The reserve coverage index amounted to 224%, a lot higher than the percentage of the previous year, as a combined result of the increase in provisions, advanced write-offs and an increase in overdue portfolios.

Capitalization Index

Banorte has distinguished itself for having maintained a solid capitalization index above the regulatory minimum indexes, with low leverage indexes, which reflect the strength of the balance.

The capitalization requirements established to this date by the Mexican authorities and the international standards called Basel III Directives in force since 2013 have been adopted.

At the end of 2020, the capitalization index (ICAP) of Banorte was 20.18% taking into consideration credit, market and operation risks and 26.69% only taking into account credit risks and the fundamental capital level was 13.90%. If no additional reserves would have been created in June and December 2020, the ICAP would have been 20.10% with a fundamental capital of 13.85%

Relevant Events

Thanks to the efforts of our members to better serve the needs of our clients, during 2020 we achieved the following:

- The Banker appointed Banorte as Bank of the Year.
- We reforested Mexico. Conafor, BIOFIN/PNUD and Universidad Anáhuac recognized Banorte for the best corporate initiatives in favor of Mexican forests.
- Banorte and Rappi offer RappiCard, an innovative value proposal with the best in financial services and electronic commerce.

- ALAS (Asociación Latinoamericana de Seguridad) granted Grupo Financiero Banorte its ALAS 2020 awards in various categories: responsible investment, corporate government and sustainability.
- Afore XXI Banorte is recognized by the National Commission of Retirement Savings System (Consar) as the number one manager in operative capacity.
- Grupo Banorte is number third in the Best Places to Work ranking in the Banking, Insurance and Bonds sector.
- Afore XXI Banorte and Operadora de Fondos are classified as A+ in the Principles of Responsible Investment report, on an A average degree in the sector.
- Banorte is number 9 as one of the best companies to work for in the areas of diversity and inclusion, according to the Great Place to Work rating agency.
- Banorte was rated as the best bank in Mexico in the Lafferty 1,000 Global Banking Database ranking where we outstand among one thousand banks thanks to our focus on our clients.
- Institutional Investor ratifies the solidity and leadership of Banorte as a financial group and the best executive team in the finance and banking sector in Mexico and number two in Latin America.
- For the tenth consecutive year, Grupo Financiero Banorte obtained the ESR award from Cemefi, as recognition of our commitment to a socially responsible management.
- Best Workplaces granted Banorte the Computrabajo award as the best company to work for in Mexico.
- Banorte is the most valuable brand in the 2020 Banking 500 ranking of the prestigious The Banker publication when reaching number 137 in the world.
- Afore XXI became the first Afore to sign the Principles of Responsible Investment of the United Nations.
- Afore XXI obtained for the first time the Socially Responsible Company (ESR) award.

Reflection

Faced with the future, our strategic priorities will be to continue the digital transformation of Banorte, innovating, strengthening and adding functionalities to the web and mobile channels, as well as increasing the offer of products and services through our strategic alliance with Rappi in order to satisfy the needs of each one of our clients. As to the credit portfolios, we will grow wisely, taking advantage of our analytic capacities to know each client better to offer them our products in a more efficient manner.

We will continue to focus on maintaining our discipline in costs and improving our efficiency and profitability indicators. Finally, but not less important, we will continue to strengthen our capital base, aligned with the vision of our being the Mexican Strong Bank and the best financial services institution in Mexico.

As regards the integration of the sustainability of our operation, since 2009 we are part of important national and international initiatives which have allowed us to be the spearhead of priority issues in the sector and agents for change regarding environmental, social and corporate government matters. In this sense, we will always be in favor of initiatives looking to contribute to the sustainable development of country.

We are strongly committed to the Sustainable Development Objectives (ODS) and the Paris Agreement and in 2018 we became the founding members of the Responsible Banking Principles (PBR) where we worked for two years until we achieved the implementation thereof. Throughout this Report you will find the actions taken to strengthen our commitment to a more sustainable economy.

Our achievements during 2020 are the result of the support, trust and preference of our shareholders and clients and the great effort and contribution to results of the Board of Directors and all the members of GFNorte.

To all of you, our sincere appreciation.

Cordially yours,

Act. José Marcos Ramírez Miguel

Chief Executive Officer of Grupo Financiero Banorte