



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

**2016 Annual Report
on the Progress of Business**

2016 Annual Report on the Progress of Business, Grupo Financiero Banorte

2016 was an important year for Grupo Financiero Banorte, the first year of our 20/20 plan, in which we satisfactorily achieved each of the goals set for this period and established the foundations for growth with sustainable profitability according to our strategic plan.

Economic environment. 2016 was a challenging year in terms of economic environment -nationally and internationally- as some of the events occurred were considered unlikely. The news was centered on the United Kingdom's referendum, which resulted in the decision to leave the European Union, as well as on the controversial elections in the United States that ended in the victory of the Republican candidate. In the monetary field, the strengthening of the dollar led to a pronounced depreciation of most of the world's currencies, especially in those of emerging markets' and in particular of the Mexican peso; as well as to the materialization of a more restrictive Fed's monetary policy that derived to a cycle of rising rates.

In Mexico, despite a moderate GDP growth of 2.3%, indicators related to domestic demand reflected a greater dynamism in household spending favored by the downward trend of inflation, recovery in the labor market, growth in the flow of remittances and increased availability of credit. Such is the case for retail sales, which achieved a growth of 8.7% in 2016, the highest growth rate in the past 8 years. On the contrary, the lower dynamism in manufacturing production reflected a poor performance of the external sector on a stronger dollar. However, the manufacturing industry of final goods, as in the case of automotive production, recorded improved performance due to the increased competitiveness of Mexican labor.

In the monetary field, the Mexican Central Bank decided to increase the benchmark rate by 250 basis points in 2016, favoring expectations for the coming years in the banking sector by leaving behind historically low levels of rates that began in 2008.

Moreover, the financial sector turned very competitive as participants aimed to seize the economic environment and the expansion of domestic demand; therefore, banks became very active, especially in the segment of consumer credit and financial products for individuals. Although the Mexican equity market showed little appetite for risk, still some companies and funds went public.

In terms of Credit, GFNorte closed the year with excellent growth in virtually all segments, despite strong competition in consumer, commercial and corporate segments. With respect to consumer loans (consumer and mortgages), Banorte was able to take advantage of good opportunities and coupled with business analytics, these portfolios increased by 17% annually, well above the 14% average of all of the other banks in Mexico, increasing 56bp in market share.

GFNorte's Long Term Savings Sector, which as of 2016 consolidates the Insurance & Annuities companies and Afore XXI Banorte by the equity method according to its 50% ownership; stood out with a 16% growth in net income; all three companies were privileged with profitability and long term customer relations. Annuities and Afore XXI Banorte continue as leaders in terms of assets under management (AUMs) and in number of pensioners.

Results. GFNorte continues to report record net income and further diversification of income sources, favoring recurring revenues. During the year the loan portfolio and deposits increased 14%, improving asset quality as a result of an adequate risk management. Operational and strategic leverage resulted in a relevant increase in recurring revenues and responsible spending growth.

Appropriate business diversification is evident in several aspects: in terms of assets under management by the end of 2016, the three fundamental business pillars were balanced and sound: the banking sector represented 31.2% of the AUMs, the brokerage and mutual funds sector 34.2% and the long term savings sector 34.6% (Seguros Banorte, Pensiones Banorte and Afore XXI Banorte); moreover, in terms of net income, the Bank contributed with 71% and the Long Term Savings Sector with 23% of the Group's profits.

The financial group's accumulated net income for 2016 totaled Ps 19.31 billion, 13% higher vs. 2015. This increase was due to the good performance of the Bank and the Long Term Savings sector. It is worth noting that operating results showed an annual growth of 14%. Regularity in revenues is a strategic factor for Banorte and in 2016 recurring revenues increased by 20%.

Net Interest Income increased 14% annually, reaching Ps 54.04 billion. Core banking fees (account management, fund transfers and electronic banking services) closed 2016 with an annual increase of 16%. Trading revenues for 2016 registered a 20% decrease as result of reduced risk taking and the rising rates cycle that started at the beginning of the year.

Furthermore, the slight growth of only 5.8% in non-interest expenses reflected the strict expense management and the efforts to improve efficiency amid an environment of higher inflation and sharp FX depreciation. Given the aforementioned, the efficiency ratio improved 260 bp during the year to 45.3%.

During 2016, GFNorte's loan portfolio quality performed favorably in all its components, NPL ratio stood at 1.7%, substantially lower than the 2.2% reported last year. Also, coverage ratio strengthened, closing the year at 142%, higher than the 116% reported in 2015.

Regarding of our commitment to maintain solid capitalization levels and provide solid and sound ratios to our shareholders and customers, Banco Mercantil del Norte reported a capitalization ratio of 15.3% according to Basel III rules, comprised of a Core Tier 1 ratio of 12.1%, a Tier 1 ratio of 12.7% and Tier 2 ratio of 2.6%. In 2016, Banorte was designated as a Level II - Domestic Systemically Important Financial Institution by the National Banking and Securities Commission (CNBV), which highlights Banorte's importance in the Mexican financial system.

In 2016 Return on Equity (ROE) for the Group was 13.9%, 65 basis points higher than in 2015. It is worth mentioning that financial group's subsidiaries are generating excellent returns on capital, especially Seguros Banorte with 46.0% Pensiones Banorte with 29.8%. Return on Assets (ROA) for Grupo Financiero Banorte was 1.57% in 2016, 10 basis points higher than last year.

Distribution channels. 2016 was a year of consolidation and growth in which we sought profitability by providing services to over 12 million banking customers. At the end of 2016, the branch network was comprised of 1,092 Banorte branches, 83 Preferred Ixe centers, 20 Inter National Bank (INB) branches and 16 SME centers.

Moreover, we are transforming alternate channels into points of business which formerly served only for consultation purposes. At year-end our network had 24,312 third party correspondents, 7,756 ATMs and 151,948 POS. Of the total monetary transactions carried out through all channels, 82% were conducted outside the branch, that is 757 million monetary transactions; out of these,

13% were made through internet banking and 13.9 million through mobile banking, representing an annual increase of 53%, which is why we continuously add more functionality and better services to these channels.

Banorte, continuously evolving with special focus on digital banking, recently signed an alliance with the global consortium R3 seeking to implement disruptive technologies such as "blockchain" to strengthen and improve efficiency in payment processes and registrations, usage of crypto currency and trading of securities, among others.

Social responsibility and sustainable development. Grupo Financiero Banorte is committed to the environment, our communities and our country, which is why we continue to strengthen our social responsibility and sustainable development programs. For this reason, in 2016 we were included in the Euronext-Vigeo EM 70 Index, which recognized the most advanced practices in sustainability of 70 companies in emerging countries. Moreover, GFNorte was included in the STOXX Global Climate Change Leaders Index, thus becoming the only Latin American issuer to be considered. GFNorte was also selected to participate in the FTSE4Good Emerging Index, of the London Stock Exchange, being the only Mexican financial institution in the Top 10 Latin American companies in this index. Finally, GFNorte was recognized by Alas20 as Leading Company in Sustainability.

We are proud to have been recognized as "Bank of the Year 2016 in Mexico" by the prestigious publication The Banker; besides sustainability, Alas20 awarded GFNorte with the first place in the category of Leading Company in Corporate Governance; and Institutional Investor magazine ranked GFNorte's management team and Investor Relations team for seventh year in a row as one of the best of Latin American banks and Mexican companies.

At Banorte, we work with the firm intention of becoming the best financial group in Mexico and for Mexicans through our "20/20, Perfect Vision" strategy focused on our investors, customers and employees. We concluded the first of 5 years with overwhelming achievements in each of the metrics established.

We constantly focus our efforts on projects that deliver the best services in a working environment that promotes creativity and the continuous improvement of processes and products, results and profitability.

I would like to thank our over 22 million customers for their preference and trust, in addition to our more than 4,000 shareholders, and national and regional Board members for their invaluable support. Finally, I would like to recognize and appreciate the commitment and effort of our more than 27,000 employees for their contribution and dedication to **Grupo Financiero Banorte's transformation with a vision for the future.**

Actuary José Marcos Ramírez Miguel
CEO of Grupo Financiero Banorte