Mexican Banks

What do higher rates mean for Mexican banks?

Equities

Americas
Banks

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Upside risk to margins with further policy rate hikes

As Mexico moves further into a tightening cycle, we see upside risk to sector margins and earnings. Forthcoming 2Q16 margins should start to see the benefit from 75bp of hikes over the past six months. Looking ahead, our Economics team forecasts policy rates to rise by another 50bp this year and 75bp in 2017. A sensitivity analysis shows that a 100bp rate hike could lift sector EPS by 3.3% and ROE by 40bp in 2017, all else being equal.

UBS Mexico financials trip key message: sector fundamentals solid & improving

During our financials trip to Mexico last week, a consistent message from regulators and banks alike is that the underlying fundamentals of the banking system remain robust. Banks have healthy levels of funding, liquidity and capital while financial support from the Finance Ministry has enabled Pemex to pay 90% of its suppliers, alleviating a major potential area of credit risk. Banks we met also indicated that higher policy rates would be positive for margins.

Remaining overweight Mexican banks within a LatAm/EM banking context

At a time when we are seeing falling credit demand and rising NPL risks across emerging markets, lending in Mexico has improved and broadened with system loan growth rising from 8.2% in Oct-14 to 13.2% in Apr-16 while NPLs have declined from 3.3% in Aug-14 to 2.6%. Given the sector's early-cycle characteristics, higher policy rates are not expected to choke credit demand or undermine asset quality but should raise margins, underpinning earnings and ROE: we forecast sector 2016 EPS at 14.4% (versus 3.8% for EM banks), with ROE rising to 13.9% in 2017E from 13.4% in 2016E.

Top picks: Banorte & Inbursa; SanMex our least preferred name

We continue to prefer large cap banks to small cap financials (for our latest views on Mexican small cap financials see "SME finance 2H outlook: still growing strong"). Among large-cap banks, our top picks are **Banorte** (Buy, consumer banking upside; US bank sale) and **Inbursa** (Buy, retail/branch expansion upside) both being well placed to benefit from the new credit/tightening cycle. Given less valuation upside potential, **Santander Mexico** (Buy) is our least preferred name.

Figure 1: Mexican financials: valuation summary

	Ticker	Rating	Price LC	Price Target LC	Upside (%)	Mkt Cap (USD millions)	P/E 2016E	P/E 2017E	P/BV 2016E	P/BV 2017E	Adj. ROE (%) 2016E	Adj. ROE (%) 2017E	Dividend Yield 12-month Fwd (%)
Banorte	GFNORTEO.MX	Buy	97.20	109.80	13.0	14,439	13.9x	11.9x	1.8x	1.6x	13.8	14.4	1.6
Inbursa	GFINBURO.MX	Buy	30.32	47.00	55.0	10,828	14.1x	12.1x	1.7x	1.6x	12.9	13.5	2.3
Santander Mexico	SANMEXB.MX	Buy	32.98	35.60	7.9	11,972	14.6x	13.4x	1.8x	1.7x	12.8	13.0	3.2

Source: UBS estimates. Banorte, Inbursa and Santander Mexico PTs are derived from Gordon Growth Model. Prices as of 20 June 2016.

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Mexican Banks

UBS Research THESIS MAP | MOST FAVORED | LEAST FAVORED

Inbursa, Banorte | **Santander Mexico**

PIVOTAL QUESTIONS

Q: Is there a macro/micro disconnect?

In our view, the bottom-up fundamentals of the Mexican banking system continue to improve with higher credit demand and lower loan loss provisions, culminating in higher profitability and returns. Yet, in recent months, GDP growth expectations have been coming down raising the question whether there is a disconnect between top-down macro trends versus bottom-up micro fundamentals. Meetings last week with the Central Bank, Ministry of Finance and a number of banks suggest the macro growth outlook remain promising built around a more robust macro framework that is less susceptible to external shocks/lower oil price with reform benefits still to come. *more →*

Q: Is there upside risk to margins?

After seven years of policy easing, Mexico appears to have entered a new interest cycle. The 25bp policy rate hike in December 2015 by the Mexican central bank was followed by a surprise 50bp in February 2016, pushing the benchmark rate to 3.75%. Our macro colleagues currently forecast policy rates to rise by another 50bp to 4.25% by the end of 2016 and by another 75bp to 5.0% in 2017. At meetings with banks during our financials trip to Mexico last week, management indicated that they thought there could be another one or two more rate hikes this year depending on what happens to the Fed Funds rate and the Mexican peso. *more →*

Q. Why has Pemex-related credit risk receded?

The oil price has come down ~54% since its peak in June-14 although it has recovered by 88% from its recent low of February-16. Oil price weakness has created market concerns over energy credit risk for banks. In our view, these concerns have been considerably alleviated following financial support by the Ministry of Finance (MoF) to Pemex and its key suppliers. *more →*

WHAT'S PRICED IN?

Current valuations largely in line with market expectations

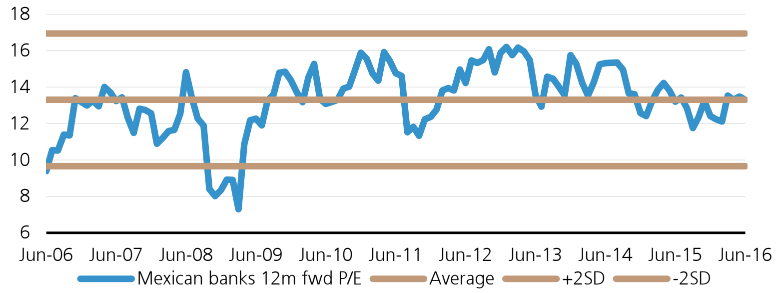
The market seems to be in line with the earnings outlook for 2016 with consensus 1-year forward PE multiples in line with its long-run valuation average of 13.3x.

UBS VIEW

We reiterate our overweight stance on Mexican banks. During our financials trip to Mexico City last week, a consistent message from regulators, the central bank, Ministry of Finance as well as from banks themselves was that the underlying fundamentals of the banking system remain robust. Banks' balance sheets remain healthy in terms of asset quality, funding, liquidity and capital while profitability and returns are solid and improving. Given the sector's early-cycle characteristics of rising loan growth and improving asset quality and as the sector enters and benefits from a new interest rate cycle, we believe Mexican banks will be well positioned to deliver superior earnings growth that we forecast at 14.4% in 2016 and 14.2% in 2017, well above EM banks that are estimated at 3.8% in 2016E and 10.9% in 2017E.

EVIDENCE

Mexican banks valuations – consensus 1-year forward P/E

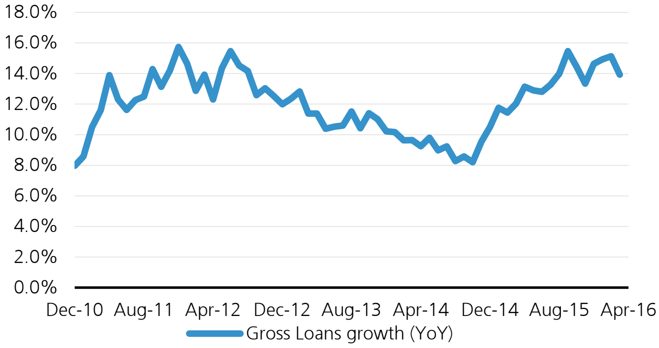


Source: I/B/E/S MSCI Aggregates, Thomson Financials DataStream, UBS

OUR THESIS IN PICTURES

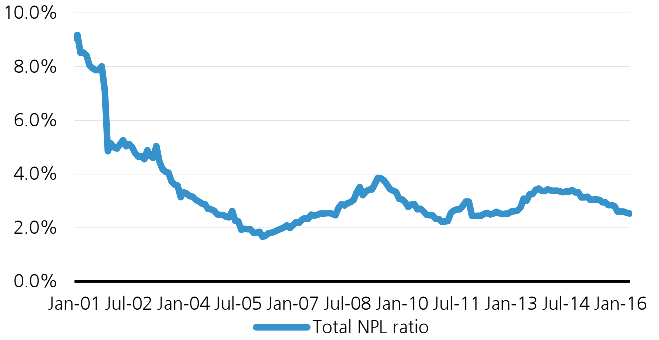
return ↑

Mexican banks system gross loans growth



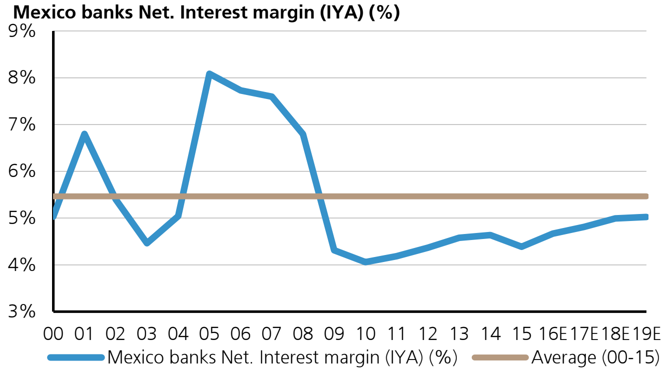
Mexican banks system loan growth has been 8% or above since December 2010. Since this rate troughed in October 2014 the rate has trended upwards and is now at 13.2%. Given early stage of the credit cycle, we do not think higher policy rates will choke future credit growth

Mexican banks NPL ratio



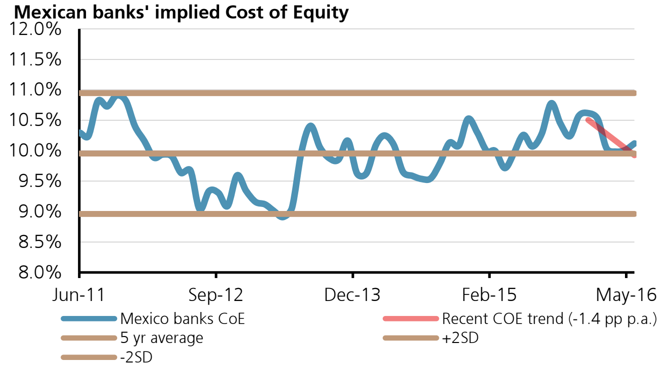
The rate of growth of Mexican banks system NPLs has been slowing since October 2013 and is the lowest since early 2013. Again higher policy rates are not expected to undermine asset quality given the sector remains at an early stage of the cycle

Mexico banks Net. Interest margin (IYA) (%)



Large Mexican banks have been improving their loan mix and as a result net interest margins have been trending upwards since 2010, and we expect this trajectory to continue with rising policy rates

Mexican banks' implied Cost of Equity



As risk appetite returns, Mexican banks' implied cost of equity has come up to 10.1% just above the historical average of 9.9%

Sources for exhibits above: 1) & 2) Bank of Mexico & UBS calculations; 3) UBS estimates 4) I/B/E/S MSCI consensus data, Thomson Financials DataStream and UBS calculations

 return ↑

Q: Is there a macro/micro disconnect?

UBS VIEW

In our view, the bottom-up fundamentals of the Mexican banking system continue to improve with higher credit demand and lower loan loss provisions, culminating in higher profitability and returns. Yet, in recent months, GDP growth expectations have been coming down raising the question whether there is a disconnect between top-down macro trends versus bottom-up micro fundamentals. Meetings last week with the Central Bank, Ministry of Finance and a number of banks suggested the macro growth outlook remained promising built around a more robust macro framework that is less susceptible to external shocks/lower oil price with reform benefits still to come.

EVIDENCE

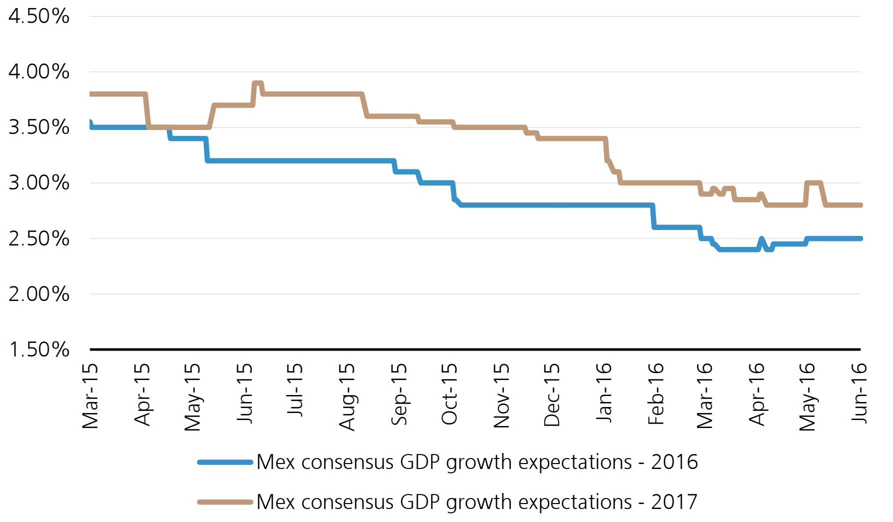
Consensus 2016 GDP growth expectations have come down from 2.8% at the start of this year to 2.5% currently, largely on the back of government spending cutbacks to achieve a balanced budget in 2017 and related to Pemex. However, in the past two months, consensus 2016 economic growth forecasts have picked up slightly from a year-low of 2.4%. For 2017, consensus expectations are for GDP growth of 2.8%, down from 3.4% at the start of the year.

Domestic demand is the key driver of growth given improvements in real wage growth due to low inflation and gains in formal employment. Labour market reform has forced employers to incorporate workers into payroll which has led to an increase in formality.

Fiscal reform has also been under-appreciated. Mexico continues to diversify away from oil, as highlighted by the magnitude of the tax intake/offset to lower oil (tax) revenues. The level of tax revenues is actually the same despite increased volatility in oil prices.

Bottom-up, a consistent message from our financials trip to Mexico City last week was that the underlying fundamentals of the banking system remain robust. Banks' balance sheets remain healthy in terms of asset quality, funding, liquidity and capital, surpassing Basel III requirements while profitability and returns are solid and improving.

Figure 2: Consensus expectations: Mexico GDP growth



Source: Bloomberg; UBS

return ↑

Q: Is there upside risk to margins?

UBS VIEW

After seven years of policy easing, Mexico appears to have entered a new interest cycle. The 25bp policy rate hike in December 2015 by the Mexican central bank was followed by a surprise 50bp in February 2016, pushing the benchmark rate to 3.75%. Our macro colleagues currently forecast policy rates to rise by another 50bp to 4.25% by the end of 2016 and by another 75bp to 5.0% in 2017. At meetings with banks during our financials trip to Mexico last week, management indicated that they thought there could be another one or two more rate hikes this year depending on what happens to the Fed Funds rate and the Mexican peso and further hikes in 2017.

Figure 3: Mexico's macro outlook

	2015	2016E	2017E
GDP growth (%)	2.5	2.2	3.0
Central Bank Policy Rate (year-end) (%)	3.3	4.3	5.0
CPI (year-end) (%)	2.1	2.9	3.1
Y/E FX rate (USD/MXN)	16.25	18.75	18.25

Source: UBS estimates

EVIDENCE

Mexican banks are asset sensitive. A number of banks last week indicated that higher policy rates would enhance net interest income (NII), earnings and returns. Focusing on listed commercial banks under our coverage, we estimate that a 100bp hike in policy rate would raise net interest margins by 9bp over a one-year period, the most being at Banregio (by 40bp) and the least at Santander Mexico (by 7bps). In terms of net interest income, this would rise by P$2.5bn, over the same period.

Figure 4: Impact of a 100bp hike in policy rate

	Boost to NII (P$m)	NIM impact
Banorte	1,200	0.11%
Santander Mexico	800	0.07%
Inbursa	540	0.14%
Banregio	419	0.40%
Aggregate	**2,540**	**0.09%**

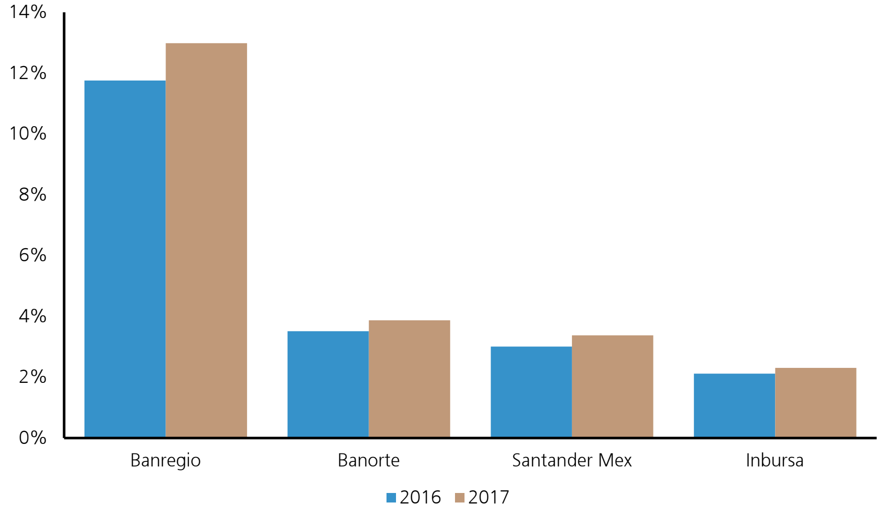
Source: UBS estimates

WHAT'S PRICED IN?

Among the banks under our coverage, adjusted for the remaining months of the year, we estimate a 100bp rate hike would lift 2016E EPS by 3.3% and 2017E by 3.5%, raising sector ROE to 13.7% (or by 40bp) in 2016E and to 14.5% (by 50bp) in 2017E, all else remaining equal. By bank, Banregio is the most sensitive to rising policy rates: a 100bp rate hike would increase the bank's 2016E EPS by 11.8%. This is followed by Banorte (+3.5%), Santander Mexico (+3.0%) and Inbursa (+2.1%).

Assuming a 100bp hike in policy rates, adjusted earnings estimates would bolster Mexican banks' valuations with the sector trading on an implied PE 2016E multiple of 14.3x and 2017E of 12.3x.

Figure 5: Impact of a 100bp rate hike on earnings



Source: UBS estimates

Figure 6: Impact of a 100bp hike in policy rate

	2016E		2017E	
	Before	After	Before	After
Earnings (P$m)	51,071	52,759	58,872	61,019
ROE	13.3%	13.7%	14.0%	14.5%
P/E x	14.7	14.3	12.8	12.3

Source: UBS estimates

Q: Why has Pemex-related credit risk receded?

UBS VIEW

The oil price has come down ~54% since its peak in June 2014 although it has recovered by 88% from its low of 11 February 2016. Oil price weakness has created market concerns over energy credit risk for banks. In our view, these concerns have been considerably alleviated following financial support by the Ministry of Finance (MoF) to Pemex and its key suppliers.

EVIDENCE

Among the listed commercial banks under our coverage, aggregated credit exposure to Pemex is 2.3% of total loans while there's another 2.3% lending exposure to Pemex suppliers. By bank, Santander has the largest exposure to Pemex at P$18.5bn (or 3.4%) while Banorte is most exposed to Pemex suppliers at 2.5% of loans.

Following financial support by the MoF, last month, Pemex paid P$92bn to meet obligations to suppliers and contracts (click here). This represented around 90% of overdue balances to all suppliers. Separately, a P$15bn credit line from three development banks including Nafinsa will also enable Pemex to pay back 90% of its service providers imminently, underpinning stability and confidence in the sector (click here).

WHAT'S PRICED IN?

At the start of the year, we feared that energy credit risk could become the next "homebuilders" asset quality challenge for the sector and tarnish the improving delinquency trends that the banking system has been witnessing since the end of 2014. Financial support by the MoF that has enabled Pemex to pay most of the outstanding overdue balances to its suppliers has considerably reduced credit risk related to this area, a view shared by all the banks we met last week.

Given Mexican banks have delivered modest share price performance this year, up 1.6% in local currency (-7.0% in US$), with the sector trading on consensus 1-year forward PE estimates of 13.3x PE, in line with the historical 10-year average, we think market concerns on this risk area should start to come down sharply.

Figure 7: Banks' Pemex exposure

	Pemex	Pemex's suppliers	Comments
Banorte	2.5%	2.5%	Exposure only to large Pemex suppliers
Santander Mex	3.4%	2.4%	Set aside P$1bn of provisions for suppliers in 2015; budgeted for another P$300m of provisions
Inbursa	0.0%	0.9%	Exposure of US$150m to three jack-ups companies
Aggregated	**2.3%**	**2.3%**	

Source: Company data

Valuation

Bank management we met last week indicated that, while fundamentals have performed well year to date, they would wait till 2Q16 results before making any changes to their full-year guidance. In the same manner, we await second quarter results before considering making any additional changes to our current earnings estimates.

Mexican banks' superior earnings growth

Reflecting the cautiously optimistic tone from bank management during our trip last week, for Mexican banks under our coverage, we forecast sector EPS growth at 14.4% in 2016 and 14.2% in 2017. This compares to EPS growth among EM banks of 3.8% in 2016 and 10.9% in 2017.

Figure 8: Mexican banks' EPS growth outlook

	EPS			EPS growth (%)	
	2015	**2016E**	**2017E**	**16/15e**	**17/16e**
Banorte	6.17	7.00	8.16	13.4%	16.7%
Banregio	5.43	6.37	7.19	17.3%	12.8%
Inbursa	1.86	2.15	2.50	15.8%	16.2%
SanMex	2.09	2.26	2.47	8.3%	9.1%
Mexican Banks	**15.55**	**17.78**	**20.31**	**14.4%**	**14.2%**

Source: UBS estimates

UBS vs consensus

Our earnings estimates for Mexican banks are currently 0.3% above consensus estimates in 2016 and 1.8% below in 2017.

Figure 9: UBS vs consensus

	EPS 2016E		EPS 2017E		UBS vs. Consensus	
	UBSe	**Consensus**	**UBSe**	**Consensus**	**2016e**	**2017e**
Banorte	7.00	6.98	8.16	8.09	0.2%	0.8%
Banregio	6.37	6.40	7.19	7.55	-0.4%	-4.8%
Inbursa	2.15	2.03	2.50	2.37	5.9%	5.3%
SanMex	2.26	2.32	2.47	2.68	-2.6%	-7.8%
Mexican Banks	**17.78**	**17.73**	**20.31**	**20.69**	**0.3%**	**-1.8%**

Source: Bloomberg and UBS estimates

Valuation

Our valuation methodology for banks is based on a Gordon growth model, which assumes for Mexican banks an average sustainable ROE of 15.0%, average COE of 10.3% and a growth factor of 6.0%.

Currently, Mexican banks trade on 14.2x PE and 1.8x PBV with 13.4% ROE on 2016 estimates. On 2017 estimates, they are on 12.5x PE and 1.7x PBV with 13.9% ROE.

Figure 10: Mexican banks' ROE

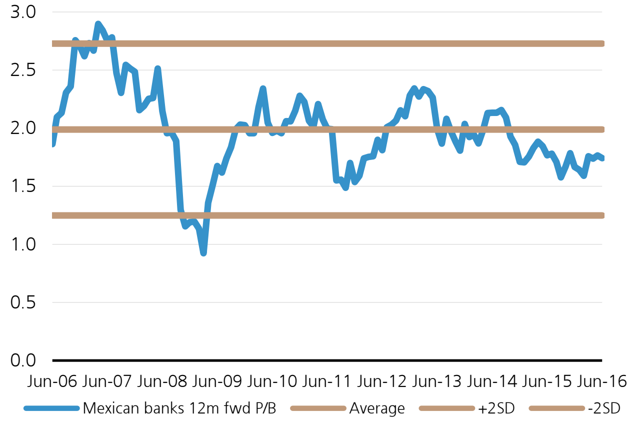
	ROE			change (bps)	
	2015	**2016E**	**2017E**	**16/15e**	**17/16e**
Banorte	13.26	13.76	14.45	50 bps	69 bps
Banregio	17.31	17.77	17.79	46 bps	2 bps
Inbursa	12.17	12.85	13.55	68 bps	70 bps
SanMex	12.87	12.85	13.01	-2 bps	17 bps
Mexican Banks	**13.02**	**13.40**	**13.90**	**39 bps**	**50 bps**

Source: UBS estimates

Consensus forward valuations

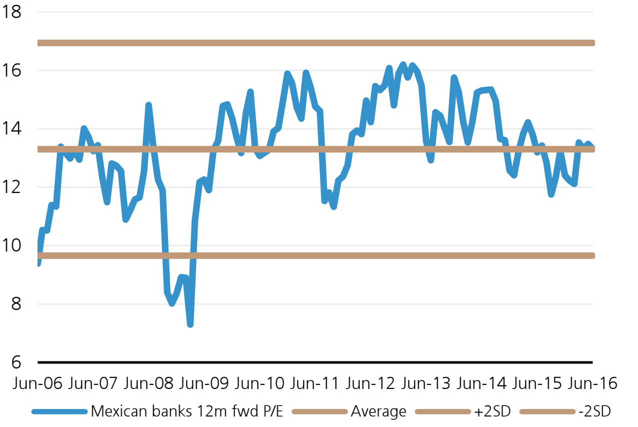
Although Mexican banks have slightly out-performed EM banks year-to-date with the sector up 1.6% in local currency (-7.0% in US$) versus EM banks that are down -0.8%, sector valuation, based on consensus 1-year forward PE multiples, at 13.3x PE, in line with its historical 10-year average of 13.3x. In terms of consensus 1-year forward PBV, the sector is trading on 1.7x below its historical average of 2.0x.

Figure 11: Mexican banks: consensus 1-yr forward PBV



Source: I/B/E/S MSCI Aggregates, Thomson Financials DataStream, UBS

Figure 12: Mexican banks: consensus 1-yr forward PE



Source: I/B/E/S MSCI Aggregates, Thomson Financials DataStream, UBS

Figure 13: Valuation summary

	Ticker	Rating	Price LC	Price Target LC	Upside (%)	Mkt Cap (USD millions)	P/E 2016E	P/E 2017E	P/BV 2016E	P/BV 2017E	Adj. ROE (%) 2016E	Adj. ROE (%) 2017E	Dividend Yield 12-month Fwd (%)
Mexican Banks													
Banorte	GFNORTEO.MX	Buy	97.20	109.80	13.0	14,439	13.9x	11.9x	1.8x	1.6x	13.8	14.4	1.6
Banregio	GFREGIOO.MX	Buy	98.00	115.00	17.3	1,721	15.4x	13.6x	2.6x	2.3x	17.8	17.8	2.0
Gentera	GENTERA.MX	Neutral	33.21	38.00	14.4	2,932	14.7x	13.1x	3.3x	2.9x	22.4	22.0	1.1
Inbursa	GFINBURO.MX	Buy	30.32	47.00	55.0	10,828	14.1x	12.1x	1.7x	1.6x	12.9	13.5	2.3
Santander Mexico	SANMEXB.MX	Buy	32.98	35.60	7.9	11,972	14.6x	13.4x	1.8x	1.7x	12.8	13.0	3.2
Unifin	UNIFINA.MX	Buy	47.14	62.00	31.5	891	14.5x	12.1x	3.4x	2.9x	24.7	26.0	1.7
Brazilian Banks													
Banco do Brasil	BBAS3.SA	Sell (CBE)	16.59	16.00	-3.6	14,002	5.3x	4.3x	0.5x	0.5x	10.8	12.1	5.1
Bradesco	BBDC4.SA	Neutral	24.61	27.50	11.7	40,257	8.3x	7.7x	1.3x	1.2x	17.3	16.5	4.3
Itau Unibanco	ITUB4.SA	Buy	29.40	36.00	22.4	52,686	8.7x	7.8x	1.5x	1.4x	18.4	18.6	4.6
Santander Brasil	SANB11.SA	Sell	17.87	16.00	-10.5	19,905	12.5x	10.9x	1.2x	1.2x	9.6	10.7	5.7
Andean Banks													
Bancolombia	CIB.N	Sell	34.58	30.00	-13.2	8,315	10.5x	10.5x	1.3x	1.2x	12.9	13.0	3.0
Davivienda	DVI	Buy	27880.00	34000.00	22.0	4,158	7.7x	6.9x	1.3x	1.1x	17.4	17.0	0.0
Credicorp	BAP.N	Buy	151.84	155.30	2.3	12,111	12.7x	11.7x	2.3x	2.0x	19.7	20.0	2.3
Santander Chile	BSAC.K	Neutral	18.95	19.90	5.0	8,928	12.2x	10.6x	2.1x	1.9x	18.2	19.5	4.9
Argentine Banks													
Galicia	GGAL.O	Neutral	31.85	36.00	13.0	3,058	11.0x	11.6x	2.9x	2.4x	33.3	27.9	3.5
Frances	BFR.N	Sell	21.28	21.00	-1.3	3,808	13.0x	15.2x	3.1x	2.6x	29.1	23.2	1.5

Source: UBS estimates. Note prices as of 20 June 2016

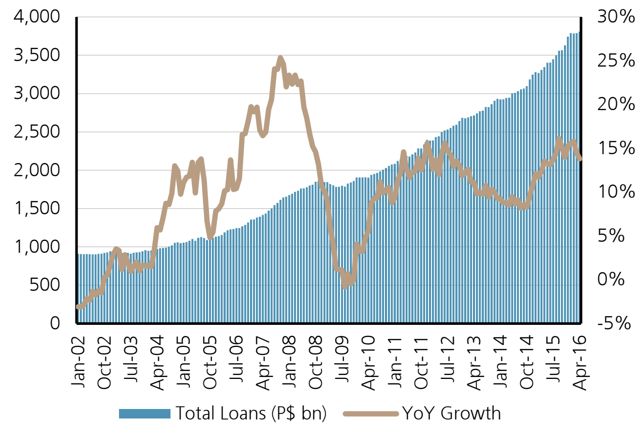
Investment strategy

Overweight Mexican banks

Following our financials trip to Mexico last week, we reiterate our positive stance on the banking sector. A consistent message from meetings with regulators, the central bank, Ministry of Finance as well as from banks themselves is that the underlying fundamentals of the banking system remain robust. Banks' balance sheets have healthy in terms of asset quality, funding, liquidity and capital while profitability and returns are solid and improving.

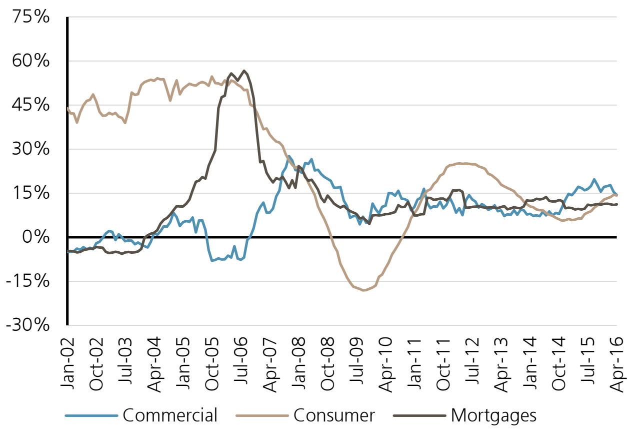
Against a backdrop of falling credit demand and rising NPL risks in emerging markets (see report), Mexican banks have witnessed loan growth rise from 8.2% in Oct-14 to 13.2% in April 2016 with NPLs down 52bp over the past year. Since August 2014, system-side NPL ratio has fallen from 3.3% to the current level of 2.6%. Alongside rising policy rates that should boost NIM, the sector's early-cycle characteristics are expected to underpin earnings and ROE: we forecast sector 2016 EPS at 14.4% (versus 3.8% for EM banks), and 14.2% in 2017, with ROE improving to 13.9% in 2017E from 13.4% in 2016E.

Figure 14: Total Loans (P$bn) vs YoY Growth



Source: CNBV and UBS

Figure 15: YoY Growth in Loans (by segment)



Source: CNBV and UBS

Stock picks

As the new credit cycle picks up and, given the start of a new tightening cycle, we have a preference for large-cap banks over small-cap financials (click here). We believe large-cap banks such as Banorte, Santander Mexico and Inbursa are well placed to benefit from volume growth and higher margins. Given government support to Pemex and their suppliers, the large-cap banks are also best positioned for reduced energy-related credit risk.

Our top picks are **Banorte** (Buy, margin upside; US bank sale) and **Inbursa** (Buy, retail/branch expansion upside) both being well placed to benefit from the new credit/tightening cycle. Uncertainties over management changes and retail banking strategy make **Santander Mexico** (Buy) our least preferred name among the large-cap Mexican banks

Banorte

Margin risk to the upside

Equities

Americas
Diversified Financial

12-month rating	Buy
12m price target	P109.80
Price	P97.20

RIC: GFNORTEO.MX BBG: GFNORTEO MM

Trading data and key metrics

52-wk range	P99.43-76.51
Market cap.	P270bn/US$14.5bn
Shares o/s	2,773m (ORDB)
Free float	81%
Avg. daily volume ('000)	5,485
Avg. daily value (m)	P530.2
Common s/h equity (12/16E)	P149bn
P/BV (12/16E)	1.8x
Tier 1 ratio	14%

EPS (UBS, diluted) (P)

	UBS	Cons.
12/16E	7.00	6.98
12/17E	8.16	8.09
12/18E	9.58	9.50

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NIM upside: a 100bp hike in policy rate could boost 2016E earnings by 3.5%

A faster rate of policy rate hikes and prospects of further policy hikes suggest upside risk to NIM. Management NIM guidance for a 10-20bp increase now looks conservative with a rise of 30-40bp more likely with further policy rate hikes. A sensitivity analysis shows that a 100bp rise in policy rates (we've already had 75bp in the past six months) could raise NIM by 11bp and earnings by 3.5% in 2016E.

Asset quality behaving well; Pemex credit risk receding

Overall, asset quality is behaving well with management seeing cost of risk as stable and in line with guidance of 2.2%-2.4% in 2016. Banorte has loan exposure of 2.5% to Pemex and another 2.5% to its suppliers. Following financial support to Pemex by the Ministry of Finance that has enabled Pemex to pay 90% of all its suppliers, management now views credit risk related to Pemex to be considerably lower.

Financials trip takeaways: a constructive outlook

Management indicated that they are on track to reach their 2016 loan growth guidance of 12-14%. There is likely to be upside risk to margins given loan mix shift and with further rate hikes: Banorte forecast policy rates at 4.25% by year-end 2016 and 5.0% by year-end 2017. Efficiency remains a key focus with further systems upgrades and multi-channel origination to boost cross-selling, underpinning efficiency gains (cost/income target of 42-43% by 2020). The bank remains confident that it will successfully sell its Texan bank this year which could boost group ROE by 80bp.

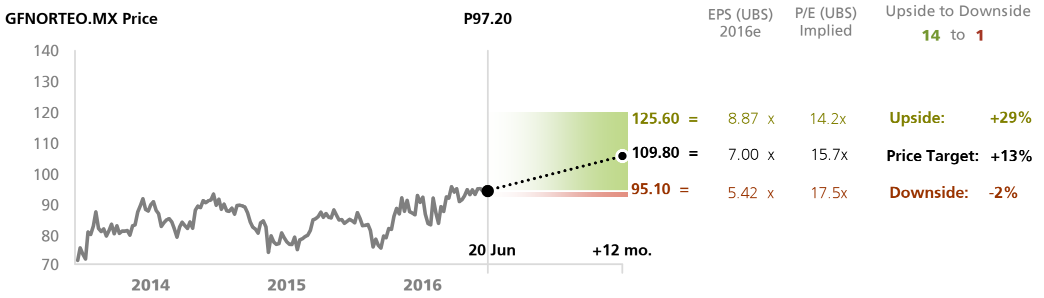
Valuation: Buy, PT Ps 109.8 (Gordon growth model derived):

We remain positive on Banorte given its improving loan growth prospects, better asset quality/provisioning trends and efficiency upside, especially with the IBM strategic alliance that is paving the way for improved cross-selling and attractive earnings growth momentum. Further rate hikes would provide upside risk to margins and earnings, in our view. The stock is trading on 13.7x PE and 1.8x PBV on 2016 estimates, and on 11.8x PE and 1.6x PBV on 2017 estimates.

Highlights (Pm)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	52,080	59,373	61,961	69,097	75,808	86,021	93,814	105,953
Profit before tax	17,834	21,121	23,454	26,130	30,807	36,190	38,648	46,178
Net earnings (local GAAP)	13,508	15,228	17,108	19,404	22,634	26,583	28,346	33,867
Net earnings (UBS)	13,669	15,228	17,108	19,404	22,634	26,583	28,346	33,867
Tier 1 ratio %	12.8	13.7	13.2	14.3	14.5	14.7	14.6	14.7
EPS (UBS, diluted) (P)	5.41	5.49	6.17	7.00	8.16	9.58	10.22	12.21
Profitability/valuation	**12/13**	**12/14**	**12/15**	**12/16E**	**12/17E**	**12/18E**	**12/19E**	**12/20E**
ROE (UBS) %	14.2	13.2	13.3	13.8	14.4	15.3	14.7	15.8
P/PPOP (diluted)	8.9	8.1	7.5	7.2	6.2	5.3	4.7	4.0
P/BV x	2.2	2.0	1.7	1.8	1.6	1.5	1.3	1.2
P/BV (UBS) x	2.8	2.5	2.2	2.2	2.0	1.7	1.5	1.4
P/E (UBS, diluted)	15.9	15.9	13.8	13.9	11.9	10.1	9.5	8.0
Net dividend yield %	1.3	0.5	1.2	1.4	2.5	2.9	3.4	3.9

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of P97.20 on 20 Jun 2016 19:35 EDT

UPSIDE / DOWNSIDE SPECTRUM



Banorte is trading at 13.9x PE16E (as of 20-Jun-2016)

Value drivers	Loan growth	NIM	LLP as % of Average Loans	EPS change from base	Sustainable ROE
Ps 125.6 upside	15.0%	5.01%	2.07%	26.8%	15.50%
Ps 109.8 target	12.4%	4.81%	2.37%	-	14.50%
Ps 95.1 downside	10.0%	4.61%	2.57%	-22.5%	13.50%

Our scenarios depend on assumptions in three key lines: loan growth, net interest margin, loan loss provisions.

Upside (Ps 125.6): Our upside scenario for 2016 assumes loan growth of 15%; NIM being increased by 20bps above our current estimate, to 5.61%; and loan loss provisions (as a percentage of average loans) decreasing 30bps, to 2.07%. We estimate upside risk to 2016E EPS of 26.8% to Ps 8.87. In our upside scenario we use sustainable ROE of 15.50%. The derived valuation per share would be Ps 125.6.

Base (Ps 109.8): Our base scenario for 2016 assumes loan growth of 12.4%; NIM at 4.81%; and loan loss provisions (as a percentage of average loans) at 2.37%. We estimate base 2016E EPS at Ps 7.00, with sustainable ROE of 14.50%. Our price target is Ps 109.8.

Downside (Ps 95.1): Our downside scenario for 2016 assumes loan growth of 10%; NIM being decreased by 20bps below our current estimate, to 4.61%; and loan loss provisions (as a percentage of average loans) increasing 20bps, to 2.57%. We estimate downside risk to 2016E EPS of 22.5% to Ps 5.42. In our downside scenario we use sustainable ROE of 13.50%. The derived valuation per share would be Ps 95.1.

Banorte: consumer banking strategy

Mexico Financials trip takeaways

Last week, we hosted a financials trips in Mexico City in which we had meetings with the central bank, banking regulator as well as a number of banks, listed and non-listed as well as non-bank financials. In the following company sections, we will highlight the key takeaways for the three large-cap banks under our coverage.

IBM strategic alliance: Management provided a constructive view on its consumer banking strategy with new technologies and systems integration key drivers for growth and higher returns. The bank's consumer banking strategy:

- Has provided Banorte with the tools to undertake major data projects, multi-channel origination, a more customer centric approach to the

profitability of the consumer bank (increasing products per customer through analytics and segmentation);

- Prepared Banorte for new technologies and new entrants via the transformation of the back office, becoming more compatible with new technologies and new players via new web and mobile architecture, centred around the customer;

- Involves systems integration: i) analytics (making merchant acquiring business more efficient), ii) multi-channel origination (ATMs, web based and call centers), iii) online origination for credit cards and debit accounts for new entrants, iv) service (CRM) through big data analytics - target client better, and v) origination;

- Today, IBM is rolling out tests of ATM origination for payroll loans; By 3Q16, it expects to have on-line origination for cards (Banorte brand & partners), debit accounts (new wave of accounts where customers don't have to go to branch).

Product breakdown: Banorte is averaging 1.8x products per customer, targeting 2.4-2.5x by 2020. Total number of customers at Banorte over the past 3 years at 11-12m has remained unchanged but the composition has shifted with a more efficient origination process screening out non-profitable customers. Cross selling is priority to boost fees - the bank is looking for fee growth of around 13% in 2016.

Upside risk to margin: In 1Q16, NIM went up by 30bp (on a recurring basis), already more than the 20bp rise in 2016 guided by management at the start of the year. At the start of the year, management were looking for policy rates to rise by 40bp in 2016, yet by February 2016, policy rates had already gone up 50bp. Looking ahead, Banorte's Chief Economist forecasts policy rates at 4.25% by year-end 2016 and 5.0% by 2017. Management reaffirmed that for every 100bp hike in rates, net interest income would rise by P$1.2bn on a full year basis

Loan growth on track: to meet their full year guidance of 12-14%. Corporate lending is coming back - not seeing very much corporate debt pre-payment. Focus on additional channels – guiding for 15-17% growth in payroll lending. The bank has resumed SME lending, expecting growth of 6% this year from 0% in 2015. Management is aiming to increase consumer (ex-mortgage) book exposure from 15% currently to 20%.

Efficiency gains: Additional headcount reductions in 1Q16 should reduce costs by P$500m of – this follows cost savings of P$1.2bn in 2015. As such, the bank thinks it can achieve a cost/income level of below 47% this year with a target of 45% sustainable over the medium term. It has a long-term cost/income forecast of 42-43% by 2020.

Improving asset quality: Overall, asset quality is behaving well with management seeing cost of risk as stable and in line with guidance of 2.2%-2.4%. Pemex credit risk was considered to be considerably lower given financial support by the Ministry of Finance that has enabled Pemex to pay 90% of all its suppliers.

Sale of US bank: management is actively seeking to sell INB, its US bank. It came close to disposing of the US bank in January 2016 but market volatility delayed the sale. Management remains confident it will be able to sell INB this year. The sale of the US bank would remove US$120m of goodwill and potentially raise the group's ROE by 80bp.

Banorte (GFNORTEO.MX)

Profit & Loss (Pm)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
Net income interest	39,535	44,718	46,492	53,987	16.1	59,018	9.3	67,404	73,132	82,931
Total non interest income	12,545	14,655	15,469	15,110	-2.3	16,789	11.1	18,617	20,683	23,021
Total income	**52,080**	**59,373**	**61,961**	**69,097**	11.5	**75,808**	9.7	**86,021**	**93,814**	**105,953**
Total cash expenses	(27,600)	(29,232)	(30,295)	(31,799)	-5.0	(32,638)	-2.6	(34,701)	(36,538)	(37,879)
Pre-depreciation operating profit	**24,480**	**30,141**	**31,665**	**37,298**	17.8	**43,170**	15.7	**51,320**	**57,276**	**68,073**
Depreciation & amort (excl. goodwill)	0	0	0	0	-	0	-	0	0	0
Operating profit pre provisions	**24,480**	**30,141**	**31,665**	**37,298**	17.8	**43,170**	15.7	**51,320**	**57,276**	**68,073**
Total provisions	(7,557)	(10,240)	(9,413)	(12,480)	-32.6	(13,936)	-11.7	(17,018)	(20,894)	(24,614)
Operating profit post provisions	**16,923**	**19,901**	**22,253**	**24,818**	11.5	**29,234**	17.8	**34,302**	**36,382**	**43,459**
Income from associates & JVs (pre-tax)	1,130	1,220	1,201	1,311	9.1	1,573	20.0	1,888	2,266	2,719
Other pre-tax items	0	0	0	0	-	0	-	0	0	0
Profit before tax (UBS)	**18,053**	**21,121**	**23,454**	**26,130**	11.4	**30,807**	17.9	**36,190**	**38,648**	**46,178**
Exceptionals (incl goodwill)	(219)	0	0	0	-	0	-	0	0	0
Profit before tax	**17,834**	**21,121**	**23,454**	**26,130**	11.4	**30,807**	17.9	**36,190**	**38,648**	**46,178**
Tax	(3,555)	(5,668)	(6,106)	(6,506)	-6.5	(7,909)	-21.6	(9,291)	(9,922)	(11,855)
Profit after tax	**14,279**	**15,453**	**17,348**	**19,624**	13.1	**22,899**	16.7	**26,899**	**28,726**	**34,323**
Other post-tax items	0	0	0	0	-	0	-	0	0	0
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	(771)	(225)	(240)	(220)	8.4	(264)	-20.0	(317)	(380)	(456)
Net earnings (local GAAP)	**13,508**	**15,228**	**17,108**	**19,404**	13.4	**22,634**	16.7	**26,583**	**28,346**	**33,867**
Net earnings (before pref divs)	**13,508**	**15,228**	**17,108**	**19,404**	13.4	**22,634**	16.7	**26,583**	**28,346**	**33,867**
Net earnings (UBS)	**13,669**	**15,228**	**17,108**	**19,404**	13.4	**22,634**	16.7	**26,583**	**28,346**	**33,867**

Per share (P)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
EPS (local GAAP, basic)	5.35	5.49	6.17	7.00	13.4	8.16	16.7	9.58	10.22	12.21
EPS (UBS, diluted)	5.41	5.49	6.17	7.00	13.4	8.16	16.7	9.58	10.22	12.21
PPOP (diluted)	9.69	10.87	11.42	13.45	17.8	15.56	15.7	18.50	20.65	24.54
Net DPS	1.13	0.44	1.01	1.37	36.6	2.47	79.8	2.80	3.26	3.83
BVPS	38.46	44.32	48.84	53.68	9.9	59.37	10.6	66.16	73.11	81.49
BVPS (UBS)	30.39	35.42	38.43	43.89	14.2	49.58	13.0	56.37	63.33	71.70

Balance sheet (Pm)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
Banking assets (year end)	1,006,788	1,097,982	1,198,476	1,276,529	6.5	1,374,511	7.7	1,488,602	1,613,408	1,755,537
Banking assets (average)	961,677	1,052,385	1,148,229	1,237,502	7.8	1,325,520	7.1	1,431,557	1,551,005	1,684,473
Total assets (year end)	1,006,788	1,097,982	1,198,476	1,276,529	6.5	1,374,511	7.7	1,488,602	1,613,408	1,755,537
Risk weighted assets (RWA) (year end)	456,331	511,057	551,643	616,739	11.8	717,201	16.3	835,534	969,840	1,124,208
Risk weighted assets (RWA) (average)	451,742	483,694	531,350	584,191	9.9	666,970	14.2	776,367	902,687	1,047,024
Customer loans	425,038	471,768	518,188	583,570	12.6	669,026	14.6	769,798	880,587	1,007,685
Customer loans (average)	413,235	448,403	494,978	550,879	11.3	626,298	13.7	719,412	825,192	944,136
Interest earning assets (average)	875,744	944,997	1,059,279	1,121,651	5.9	1,200,717	7.0	1,297,541	1,407,296	1,530,263
Customer deposits	443,740	497,922	561,462	613,955	9.3	672,921	9.6	737,627	808,634	886,563
Common s/h equity (year end)	106,657	122,922	135,451	148,891	9.9	164,683	10.6	183,504	202,796	226,030
Common s/h equity (average)	96,133	115,092	129,013	141,037	9.3	156,671	11.1	173,972	193,078	214,300
Total SHF (equity, pref & MI) (year end)	108,691	124,672	137,351	150,826	9.8	166,618	10.5	185,439	204,731	227,965
Total SHF (equity, pref & MI) (average)	98,600	116,681	131,012	144,089	10.0	158,722	10.2	176,028	195,085	216,348
Net tangible assets	86,325	99,975	108,491	123,678	14.0	139,470	12.8	158,291	177,583	200,817

Balance sheet structure (%)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
Loans / banking assets (year end)	42.2	43.0	43.2	45.7	5.7	48.7	6.5	51.7	54.6	57.4
Deposits / banking assets (year end)	44.1	45.3	46.8	48.1	2.7	49.0	1.8	49.6	50.1	50.5
Loans / deposits	95.8	94.7	92.3	95.1	3.0	99.4	4.6	104.4	108.9	113.7
Total SHF / banking assets (year end)	10.8	11.4	11.5	11.8	3.1	12.1	2.6	12.5	12.7	13.0

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Banorte (GFNORTEO.MX)

Capital adequacy (Pm)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Tier 1 capital	58,585	69,995	72,817	88,126	103,917	122,738	142,030	165,264
Total capital	69,619	77,996	80,509	95,568	114,914	137,233	161,560	188,526
Risk weighted assets (RWA) (year end)	456,331	511,057	551,643	616,739	717,201	835,534	969,840	1,124,208
Core tier 1 ratio %	11.5	12.7	12.4	13.6	13.9	14.2	14.2	14.3
Tier 1 ratio %	12.8	13.7	13.2	14.3	14.5	14.7	14.6	14.7
Total capital ratio %	15.3	15.3	14.6	15.5	16.0	16.4	16.7	16.8
Tangible equity	84,291	98,225	106,591	121,743	137,535	156,356	175,648	198,882
Equity / assets %	10.6	11.2	11.3	11.7	12.0	12.3	12.6	12.9
Tangible equity to tangible assets %	8.6	9.2	9.1	9.7	10.2	10.7	11.1	11.5

Asset quality (Pm)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Non performing assets	13,655	14,293	11,903	12,518	15,750	18,929	23,506	26,899
Total risk reserves	14,289	15,287	13,813	13,770	17,325	20,822	25,857	29,589
NPLs / loans %	3.1	2.9	2.2	2.1	2.3	2.4	2.6	2.6
NPL coverage %	104.6	107.0	116.0	110.0	110.0	110.0	110.0	110.0
Provision charge / average loans %	1.8	2.3	1.9	2.3	2.2	2.4	2.5	2.6
Net NPAs / shareholders funds %	(0.6)	(0.8)	(1.4)	(0.8)	(0.9)	(1.0)	(1.1)	(1.2)

Profitability (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Net interest margin (avg assets)	4.11	4.25	4.05	4.36	4.45	4.71	4.72	4.92
Provisions / operating profit	30.9	34.0	29.7	33.5	32.3	33.2	36.5	36.2
ROE (UBS earnings)	14.2	13.2	13.3	13.8	14.4	15.3	14.7	15.8
RoAdjE (UBS earnings & equity)	18.3	16.5	16.6	17.1	17.5	18.1	17.1	18.1
RoRWA (UBS)	3.20	3.19	3.26	3.36	3.43	3.46	3.18	3.28
RoA (UBS earnings)	1.48	1.47	1.51	1.59	1.73	1.88	1.85	2.04

Productivity (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Cost income ratio	53.0	49.2	48.9	46.0	43.1	40.3	38.9	35.8
Cost / average assets	2.87	2.78	2.64	2.57	2.46	2.42	2.36	2.25
Compensation expense ratio	35.0	30.7	28.8	29.1	27.9	25.3	24.8	22.2

Growth (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenue	13.0	14.0	4.4	11.5	9.7	13.5	9.1	12.9
Operating profit pre provisions	16.4	23.1	5.1	17.8	15.7	18.9	11.6	18.9
Net earnings (UBS)	21.8	11.4	12.3	13.4	16.7	17.4	6.6	19.5
Net DPS	113.0	-61.0	128.5	36.6	79.8	13.4	16.7	17.4
Total assets (year end)	9.8	9.1	9.2	6.5	7.7	8.3	8.4	8.8
Customer loans	5.9	11.0	9.8	12.6	14.6	15.1	14.4	14.4
Customer deposits	4.6	12.2	12.8	9.3	9.6	9.6	9.6	9.6

Value (x)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Market cap/revenues	4.2	4.1	3.8	3.9	3.6	3.1	2.9	2.5
Market cap/deposits	0.5	0.5	0.4	0.4	0.4	0.4	0.3	0.3
P/PPOP (diluted)	8.9	8.1	7.5	7.2	6.2	5.3	4.7	4.0
P/E (local GAAP, basic)	16.1	15.9	13.8	13.9	11.9	10.1	9.5	8.0
P/E (UBS, diluted)	15.9	15.9	13.8	13.9	11.9	10.1	9.5	8.0
Net dividend yield %	1.3	0.5	1.2	1.4	2.5	2.9	3.4	3.9
P/BV x	2.2	2.0	1.7	1.8	1.6	1.5	1.3	1.2
P/BV (UBS) x	2.8	2.5	2.2	2.2	2.0	1.7	1.5	1.4

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Inbursa

Walmex expansion gaining credibility

Branch expansion laying foundations for retail growth upside

At the end of May 2016, all 500 points of sales within Walmex stores had been opened, increasing total branch numbers to c900. With the new branch openings, Inbursa is confident it can sell 600,000 cards this year, rising to 3.0m cards over five years. The bank also hopes to attract P$50bn of deposits (or 20% of the current loan book) in the next five years from cross-selling deposits to new card holders.

Well positioned from higher rates

Inbursa is a major beneficiary of rising rates in three ways: 1) via higher net interest income (NII): according to management, a 50bp hike in local policy rates could boost NII by P$270m within a year – on this basis, we calculate a 100bp rate hike would boost Inbursa's NIM by 14bp; 2) unlike other Mexican banks, its trading income would also rise to around P$800m/quarter (from P$700m/quarter); while 3) should long-term rates also go up, it would also benefit from its interest-rate swap positions.

Financials trip takeaways: retail expansion strategy on track

The rollout of branch expansion is completed. Card sales have picked up to 70,000 in May 2016, from 60,000 in April 2016 and 30,000 in January 2016 although cross-selling of deposits will take 12-18 months longer. Inbursa also appears to be well positioned for rising rates, both at the short and long-end of the yield curve. Asset quality is behaving well with exposure to Pemex (suppliers) limited to 0.9% of the loan book. The bank has P$10.8bn of catastrophic reserves, the reversal of which could be delayed by a year.

Valuation: Buy (Key Call); PT Ps 47.0 (Gordon growth model derived)

As the bank's retail expansion ambitions gain traction and credibility, we expect sentiment towards the stock to improve. We believe Inbursa's strong earnings growth outlook and rising ROA profile underpin current valuations.

Equities

Americas
Diversified Financial

12-month rating	**Buy**
12m price target	**P47.00**
Price	**P30.32**

RIC: GFINBURO.MX **BBG:** GFINBURO MM

Trading data and key metrics

52-wk range	P37.34-27.82
Market cap.	P202bn/US$10.9bn
Shares o/s	6,667m (COM)
Free float	34%
Avg. daily volume ('000)	2,919
Avg. daily value (m)	P96.4
Common s/h equity (12/16E)	P117bn
P/BV (12/16E)	1.7x
Tier 1 ratio	18%

EPS (UBS, diluted) (P)

	UBS	Cons.
12/16E	2.15	1.99
12/17E	2.50	2.32
12/18E	2.65	2.64

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Highlights (Pm)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	23,259	24,918	25,133	30,610	36,412	40,540	44,969	50,125
Profit before tax	13,370	16,168	15,390	18,099	23,131	24,564	26,469	28,612
Net earnings (local GAAP)	16,292	18,091	11,725	14,335	16,654	17,686	19,058	20,600
Net earnings (UBS)	10,090	13,763	12,378	14,335	16,654	17,686	19,058	20,600
Tier 1 ratio %	17.8	19.4	18.9	18.0	18.3	18.3	18.1	17.8
EPS (UBS, diluted) (P)	1.51	2.06	1.86	2.15	2.50	2.65	2.86	3.09

Profitability/valuation	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
ROE (UBS) %	12.6	15.3	12.2	12.9	13.5	13.1	12.9	12.8
P/PPOP (diluted)	13.8	14.0	13.9	9.5	7.7	7.0	6.3	5.7
P/BV x	2.7	2.5	2.3	1.7	1.6	1.4	1.3	1.2
P/BV (UBS) x	2.7	2.5	2.3	1.7	1.6	1.4	1.3	1.2
P/E (UBS, diluted)	21.7	17.7	19.5	14.1	12.1	11.4	10.6	9.8
Net dividend yield %	5.6	1.0	1.2	1.5	2.3	2.8	3.0	3.2

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of P30.32 on 20 Jun 2016 19:35 EDT

UPSIDE / DOWNSIDE SPECTRUM

Inbursa is trading at 14.1x PE16E (as of 20-Jun-2016)

Value drivers	Loan growth	NIM	LLP as % of Average Loans	EPS change from base	Sustainable ROE
Ps 49.4 upside	16.7%	5.2%	1.29%	13.0%	18.5%
Ps 47.0 target	13.7%	4.9%	1.69%	-	18.0%
Ps 29.4 downside	10.7%	4.5%	2.19%	-16.2%	16.0%

Our scenarios depend on assumptions in three key lines: loan growth, net interest margin, loan loss provisions.

Upside (Ps 49.4): Our upside scenario for 2016 assumes loan growth of 16.7%; NIM 30bps above our current estimate at 5.2%; and loan loss provisions (as a percentage of average loans) decreasing by 40bps, to 1.29%. We estimate upside risk to 2016E EPS of 13.0% to Ps 2.43. In our upside scenario we use sustainable ROE of 18.5% and CoE of 10.3%. The derived valuation per share would be Ps 49.4.

Base (Ps 47.0): Our base scenario for 2016 assumes loan growth of 13.7%; NIM at 4.9%; and loan loss provisions (as a percentage of average loans) at 1.69%. We estimate base 2016E EPS at Ps 2.15. Assuming a sustainable ROE of 18.0% and CoE of 10.3%, our price target is Ps 47.0.

Downside (Ps 29.4): Our downside scenario for 2016 assumes loan growth of 10.7%; NIM 40bps below our current estimate at 4.5%; and loan loss provisions (as a percentage of average loans) increasing by 50bps, to 2.19%. We estimate downside risk to 2016E EPS of -16.2% to Ps 1.80. In our downside scenario we use sustainable ROE of 16.0% and a CoE of 11.5%. The derived valuation per share would be Ps 29.4.

Inbursa: retail expansion upside

Mexico Financials trip takeaways

Branch expansion: by the end of May 2016, all 500 points of sales within Walmex stores will have been opened. This has raised total branches at Inbursa to around 900. The bank has no plans to open additional branches/points of sales within Walmex at this stage. Capex related to branch opening and staff hire will keep operating expenses elevated at around P$2.3bn per quarter in the first half of the year but should fall back to P$2.1bn-2.1bn in the second half of the year.

New card issuances: in May 2016, the bank sold 70,000 cards, up from 60,000 cards in April, and considerably higher than car issuances of 30,000 cards in January 2016 and 35,000 in February 2016. Year-to-date, they have issued around 300,000 cards – management are confident that can meet their 600,000 new card target this year, aiming for 3m cardholders over 5 years.

Card share gains: The co-branded cards offer a 3% discount for every purchase at Walmex stores. So far card acceptance has been high with 97% of cards sold activated in the same month. Average card balances have increased from P$8,000 in 2012 to P$12,000 today. Inbursa is taking market share from other banks. In Mexico, 7.5m people own 22m cards. Inbursa currently has 2m cards, double the number of cards a year earlier.

Cross selling: Management is aiming to convert one third of card holders to become depositors. In five years, its target cardholders of 3m would convert into 1m depositors. The bank expects average deposits to be P$50,000 per account. It takes 12-18 months for a card holder to also become a depositor.

NIM sensitivity: Management thinks local policy rates could rise further alongside further hikes in Fed Fund rates. Management indicated that a 50bp hike in local policy rate could boost net interest income (NII) by P$270m before tax within a year. On this basis, we calculate a 100bp rate hike would boost Inbursa's NIM by 14bp.

Strong lending growth: given the focus on retail lending such as cards together with the continuation of infrastructure lending, management thinks loan growth in 2016 could range from 17-20% with the retail book growing at least 20%. Together with NIM expansion, NII growth of at least 20% is expected this year.

Pemex exposure limited: Inbursa has no direct exposure to Pemex but around US$150bn (P$2.6bn) of debt to three "jack-up" suppliers that provide platforms for drilling and exploration. As the loans are all performing, no specific provisioning has been set aside.

Delay in insurance reserve reversal: Inbursa now has P$10.8bn of catastrophic reserves. Management indicated the reversal of this insurance reserve (via the equity base), originally due with the introduction of Solvency II in April 2016, has been delayed, possibly by a year.

Inbursa (GFINBURO.MX)

Profit & Loss (Pm)	**12/13**	**12/14**	**12/15**	**12/16E**	*% ch*	**12/17E**	*% ch*	**12/18E**	**12/19E**	**12/20E**
Net income interest	13,204	14,717	15,457	19,420	*25.6*	23,838	*22.7*	26,910	30,178	34,056
Total non interest income	10,056	10,201	9,676	11,190	*15.6*	12,574	*12.4*	13,630	14,791	16,069
Total income	**23,259**	**24,918**	**25,133**	**30,610**	*21.8*	**36,412**	*19.0*	**40,540**	**44,969**	**50,125**
Total cash expenses	(7,384)	(7,506)	(7,726)	(9,374)	*-21.3*	(10,289)	*-9.8*	(11,721)	(13,089)	(14,691)
Pre-depreciation operating profit	**15,875**	**17,412**	**17,407**	**21,235**	*22.0*	**26,123**	*23.0*	**28,819**	**31,880**	**35,434**
Depreciation & amort (excl. goodwill)	0	0	0	0	-	0	-	0	0	0
Operating profit pre provisions	**15,875**	**17,412**	**17,407**	**21,235**	*22.0*	**26,123**	*23.0*	**28,819**	**31,880**	**35,434**
Total provisions	(3,198)	(2,067)	(3,140)	(4,292)	*-36.7*	(4,358)	*-1.5*	(5,729)	(7,003)	(8,542)
Operating profit post provisions	**12,676**	**15,345**	**14,268**	**16,944**	*18.8*	**21,765**	*28.5*	**23,090**	**24,877**	**26,892**
Income from associates & JVs (pre-tax)	694	823	1,122	1,156	*3.0*	1,365	*18.1*	1,474	1,592	1,720
Other pre-tax items	0	0	0	0	-	0	-	0	0	0
Profit before tax (UBS)	**13,370**	**16,168**	**15,390**	**18,099**	*17.6*	**23,131**	*27.8*	**24,564**	**26,469**	**28,612**
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	**13,370**	**16,168**	**15,390**	**18,099**	*17.6*	**23,131**	*27.8*	**24,564**	**26,469**	**28,612**
Tax	(3,256)	(2,390)	(2,956)	(3,770)	*-27.5*	(6,477)	*-71.8*	(6,878)	(7,411)	(8,011)
Profit after tax	**10,114**	**13,778**	**12,434**	**14,330**	*15.2*	**16,654**	*16.2*	**17,686**	**19,058**	**20,600**
Other post-tax items	6,203	4,328	(652)	0	-	0	-	0	0	0
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	(24)	(15)	(56)	5	-	0	-	0	0	0
Net earnings (local GAAP)	**16,292**	**18,091**	**11,725**	**14,335**	*22.3*	**16,654**	*16.2*	**17,686**	**19,058**	**20,600**
Net earnings (before pref divs)	**16,292**	**18,091**	**11,725**	**14,335**	*22.3*	**16,654**	*16.2*	**17,686**	**19,058**	**20,600**
Net earnings (UBS)	**10,090**	**13,763**	**12,378**	**14,335**	*15.8*	**16,654**	*16.2*	**17,686**	**19,058**	**20,600**

Per share (P)	**12/13**	**12/14**	**12/15**	**12/16E**	*% ch*	**12/17E**	*% ch*	**12/18E**	**12/19E**	**12/20E**
EPS (local GAAP, basic)	2.44	2.71	1.76	2.15	*22.3*	2.50	*16.2*	2.65	2.86	3.09
EPS (UBS, diluted)	1.51	2.06	1.86	2.15	*15.8*	2.50	*16.2*	2.65	2.86	3.09
PPOP (diluted)	2.38	2.61	2.61	3.19	*22.0*	3.92	*23.0*	4.32	4.78	5.31
Net DPS	1.85	0.38	0.42	0.44	*4.8*	0.70	*60.2*	0.84	0.90	0.97
BVPS	12.32	14.59	15.92	17.54	*10.2*	19.33	*10.2*	21.15	23.11	25.22
BVPS (UBS)	12.32	14.59	15.92	17.54	*10.2*	19.33	*10.2*	21.15	23.11	25.22

Balance sheet (Pm)	**12/13**	**12/14**	**12/15**	**12/16E**	*% ch*	**12/17E**	*% ch*	**12/18E**	**12/19E**	**12/20E**
Banking assets (year end)	360,195	385,743	439,722	509,886	*16.0*	561,386	*10.1*	563,944	630,961	713,448
Banking assets (average)	350,281	372,969	412,732	474,804	*15.0*	535,636	*12.8*	562,665	597,452	672,204
Total assets (year end)	360,195	385,743	439,722	509,886	*16.0*	561,386	*10.1*	563,944	630,961	713,448
Risk weighted assets (RWA) (year end)	261,458	314,426	333,052	385,740	*15.8*	444,731	*15.3*	511,512	588,528	677,983
Risk weighted assets (RWA) (average)	245,197	287,942	323,739	359,396	*11.0*	415,236	*15.5*	478,122	550,020	633,255
Customer loans	199,079	202,981	237,479	270,014	*13.7*	311,306	*15.3*	358,053	411,963	474,580
Customer loans (average)	188,061	201,030	220,230	253,746	*15.2*	290,660	*14.5*	334,680	385,008	443,271
Interest earning assets (average)	317,670	328,395	346,233	397,589	*14.8*	461,757	*16.1*	517,496	580,341	654,922
Customer deposits	89,879	83,434	92,636	101,580	*9.7*	111,392	*9.7*	122,158	133,971	146,932
Common s/h equity (year end)	82,165	97,305	106,120	116,938	*10.2*	128,893	*10.2*	141,009	154,063	168,174
Common s/h equity (average)	80,293	89,735	101,712	111,529	*9.7*	122,916	*10.2*	134,951	147,536	161,119
Total SHF (equity, pref & MI) (year end)	82,165	97,305	106,120	116,938	*10.2*	128,893	*10.2*	141,009	154,063	168,174
Total SHF (equity, pref & MI) (average)	80,293	89,735	101,712	111,529	*9.7*	122,916	*10.2*	134,951	147,536	161,119
Net tangible assets	82,165	97,305	106,120	116,938	*10.2*	128,893	*10.2*	141,009	154,063	168,174

Balance sheet structure (%)	**12/13**	**12/14**	**12/15**	**12/16E**	*% ch*	**12/17E**	*% ch*	**12/18E**	**12/19E**	**12/20E**
Loans / banking assets (year end)	55.3	52.6	54.0	53.0	*-1.9*	55.5	*4.7*	63.5	65.3	66.5
Deposits / banking assets (year end)	25.0	21.6	21.1	19.9	*-5.4*	19.8	*-0.4*	21.7	21.2	20.6
Loans / deposits	221.5	243.3	256.4	265.8	*3.7*	279.5	*5.1*	293.1	307.5	323.0
Total SHF / banking assets (year end)	22.8	25.2	24.1	22.9	*-5.0*	23.0	*0.1*	25.0	24.4	23.6

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Inbursa (GFINBURO.MX)

Capital adequacy (Pm)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Tier 1 capital	46,472	61,104	63,107	69,537	81,492	93,608	106,662	120,773
Total capital	47,437	61,104	63,107	69,537	81,492	93,608	106,662	120,773
Risk weighted assets (RWA) (year end)	261,458	314,426	333,052	385,740	444,731	511,512	588,528	677,983
Core tier 1 ratio %	17.8	19.4	18.9	18.0	18.3	18.3	18.1	17.8
Tier 1 ratio %	17.8	19.4	18.9	18.0	18.3	18.3	18.1	17.8
Total capital ratio %	18.1	19.4	18.9	18.0	18.3	18.3	18.1	17.8
Tangible equity	82,165	97,305	106,120	116,938	128,893	141,009	154,063	168,174
Equity / assets %	22.8	25.2	24.1	22.9	23.0	25.0	24.4	23.6
Tangible equity to tangible assets %	22.8	25.2	24.1	22.9	23.0	25.0	24.4	23.6

Asset quality (Pm)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Non performing assets	8,752	7,429	7,256	8,438	8,773	10,429	11,999	13,823
Total risk reserves	27,002	15,354	10,696	12,088	13,744	16,323	19,908	24,750
NPLs / loans %	3.9	3.4	2.9	3.0	2.7	2.8	2.8	2.8
NPL coverage %	308.5	206.7	147.4	143.3	156.7	156.5	165.9	179.1
Provision charge / average loans %	1.7	1.0	1.4	1.7	1.5	1.7	1.8	1.9
Net NPAs / shareholders funds %	(22.2)	(8.1)	(3.2)	(3.1)	(3.9)	(4.2)	(5.1)	(6.5)

Profitability (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Net interest margin (avg assets)	3.77	3.95	3.74	4.09	4.45	4.78	5.05	5.07
Provisions / operating profit	20.1	11.9	18.0	20.2	16.7	19.9	22.0	24.1
ROE (UBS earnings)	12.6	15.3	12.2	12.9	13.5	13.1	12.9	12.8
RoAdjE (UBS earnings & equity)	12.6	15.3	12.2	12.9	13.5	13.1	12.9	12.8
RoRWA (UBS)	4.12	4.78	3.84	3.99	4.01	3.70	3.46	3.25
RoA (UBS earnings)	2.89	3.69	3.01	3.02	3.11	3.14	3.19	3.06

Productivity (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Cost income ratio	31.7	30.1	30.7	30.6	28.3	28.9	29.1	29.3
Cost / average assets	2.11	2.01	1.87	1.97	1.92	2.08	2.19	2.19
Compensation expense ratio	31.7	30.1	30.7	30.6	28.3	28.9	29.1	29.3

Growth (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenue	4.8	7.1	0.9	21.8	19.0	11.3	10.9	11.5
Operating profit pre provisions	0.5	9.7	0.0	22.0	23.0	10.3	10.6	11.1
Net earnings (UBS)	14.8	36.4	-10.1	15.8	16.2	6.2	7.8	8.1
Net DPS	NM	-79.5	10.5	4.8	60.2	18.6	7.8	8.1
Total assets (year end)	5.8	7.1	14.0	16.0	10.1	0.5	11.9	13.1
Customer loans	12.4	2.0	17.0	13.7	15.3	15.0	15.1	15.2
Customer deposits	-7.9	-7.2	11.0	9.7	9.7	9.7	9.7	9.7

Value (x)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Market cap/revenues	9.4	9.8	9.6	6.6	5.6	5.0	4.5	4.0
Market cap/deposits	2.4	2.9	2.6	2.0	1.8	1.7	1.5	1.4
P/PPOP (diluted)	13.8	14.0	13.9	9.5	7.7	7.0	6.3	5.7
P/E (local GAAP, basic)	13.4	13.5	20.6	14.1	12.1	11.4	10.6	9.8
P/E (UBS, diluted)	21.7	17.7	19.5	14.1	12.1	11.4	10.6	9.8
Net dividend yield %	5.6	1.0	1.2	1.5	2.3	2.8	3.0	3.2
P/BV x	2.7	2.5	2.3	1.7	1.6	1.4	1.3	1.2
P/BV (UBS) x	2.7	2.5	2.3	1.7	1.6	1.4	1.3	1.2

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Santander Mexico

New management: a shift in strategic approach

Equities

Americas
Banks, Ex-S&L

12-month rating	**Buy**
12m price target	**P35.60**
Price	**P32.98**

RIC: SANMEXB.MX **BBG:** SANMEXB MM

Trading data and key metrics

52-wk range	P34.85-24.52
Market cap.	P224bn/US$12.0bn
Shares o/s	6,777m (ORDB)
Free float	25%
Avg. daily volume ('000)	4,007
Avg. daily value (m)	P129.5
Common s/h equity (12/16E)	P124bn
P/BV (12/16E)	1.8x
Tier 1 ratio	12%

EPS (UBS, diluted) (P)

	UBS	Cons.
12/16E	2.26	2.35
12/17E	2.47	2.67
12/18E	2.70	3.04

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Shifting from volume growth towards profitability

Although the newly appointed CEO and CFO both have an investment banking background, Mr Mena, the new CFO gave reassurances that retail expansion remains a priority for the bank. New management has also implemented a strategic shift away from share gains/volume growth with greater focus on profitability as illustrated by management emphasis on risk based pricing. If successful, this will likely slow balance sheet growth but should underpin returns and capital ratios.

Higher rates to boost NII but weighing on trading revenues

Following the 75bp hike in policy rates over the past six months, the bank expects to see another 25bp rate hike this year followed by two more 25bp hikes in 2017. A 100bp hike in policy rate would equate to an increase in net interest income of P$800m (pre-tax) within a one year period. On this basis, we calculate a 100bp rate hike would boost SanMex's NIM by 7bp.

Financials trip takeaways: slow growth but higher returns?

Management reported seeing a slowdown in corporate credit demand but demand for consumer lending remains solid where they are guiding for growth of 10-12% this year. Reflecting the bank's new risk based pricing, SME lending growth is expected to decline to low mid-single digit by the year-end from 22% last year. NPLs also went up in April 2016 with the classification of its Abengoa exposure as non-performing.

Valuation: Buy, PT Ps 35.6 (Gordon growth model derived)

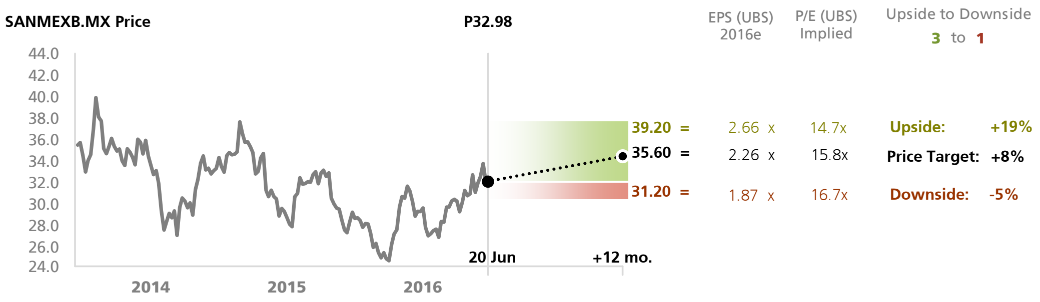
As the third-largest bank in Mexico, we think SanMex is well positioned to benefit from a pick-up in economic activity and the cyclical upturn. Under new management, the strategic focus is expected to shift from volume growth to enhancing profitability and returns. SanMex is trading at 14.5x and 1.8x on 2016 estimates, and on 13.3x PE and 1.7x PBV on 2017 estimates.

Highlights (Pm)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	53,651	55,387	61,048	67,450	75,426	83,288	92,312	101,941
Profit before tax	21,812	17,356	18,242	20,096	23,228	25,420	28,603	31,629
Net earnings (local GAAP)	20,876	14,014	14,141	15,321	16,720	18,298	20,590	22,769
Net earnings (UBS)	16,061	14,014	14,141	15,321	16,720	18,298	20,590	22,769
Tier 1 ratio %	12.8	12.8	12.1	12.2	12.1	12.0	11.9	11.8
EPS (UBS, diluted) (P)	2.37	2.07	2.09	2.26	2.47	2.70	3.04	3.36

Profitability/valuation	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
ROE (UBS) %	16.2	13.9	12.9	12.8	13.0	13.2	13.8	14.1
P/PPOP (diluted)	8.0	7.1	5.7	5.6	4.9	4.3	3.8	3.4
P/BV x	2.7	2.1	1.8	1.8	1.7	1.6	1.4	1.3
P/BV (UBS) x	2.8	2.2	1.9	1.9	1.7	1.6	1.5	1.4
P/E (UBS, diluted)	16.0	16.1	14.3	14.6	13.4	12.2	10.8	9.8
Net dividend yield %	8.1	1.5	3.3	3.1	3.3	3.6	4.0	4.6

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of P32.98 on 20 Jun 2016 19:35 EDT

UPSIDE / DOWNSIDE SPECTRUM



Santander is trading at 14.6x PE16E (as of 20-Jun-2016)

Value drivers	Loan growth	NIM	LLP as % of Average Loans	EPS change from base	Sustainable ROE
Ps 39.2 upside	14.4%	4.4%	3.20%	17.7%	15.15%
Ps 35.6 target	11.4%	4.2%	3.40%	-	14.40%
Ps 31.2 downside	8.4%	4.0%	3.60%	-17.4%	13.40%

Our scenarios depend on assumptions in three key lines: loan growth, net interest margin, loan loss provisions.

Upside (Ps 39.2): Our upside scenario for 2016 assumes loan growth of 14.4%; NIM being increased by 20bps above our current estimate, to 4.43%; and loan loss provisions (as a percentage of average loans) decreasing by 20bps, to 3.20%. We estimate upside risk to 2016E EPS of 17.7% to Ps 2.66. In our upside scenario we use sustainable ROE of 15.15%. The derived valuation per share would be Ps 39.2.

Base (Ps 35.6): Our base scenario for 2016 assumes loan growth of 11.4%; NIM at 4.23%; and loan loss provisions (as a percentage of average loans) at 3.4%. We estimate base 2016E EPS at Ps 2.26, with sustainable ROE of 14.4%. Our price target is Ps 35.6.

Downside (Ps 31.2): Our downside scenario for 2016 assumes loan growth of 8.4%; NIM being decreased by 20bps below our current estimate, to 4.03%; and loan loss provisions (as a percentage of average loans) increasing by 20bps, to 3.6%. We estimate downside risk to 2016E EPS of 17.4% to Ps 1.87. In our downside scenario we use sustainable ROE of 13.4%. The derived valuation per share would be Ps 31.2.

Santander Mexico: a shift in strategic approach

Mexico Financials trip takeaways

New management: we met for the first time Mr Didier Mena, the new CFO of Santander Mexico. Although the newly appointed CEO and the new CFO have an investment banking background, Mr Mena gave reassurances that retail expansion remains a priority for the bank. New management has also implemented a strategic shift away from share gains/volume growth with greater focus on profitability as illustrated by management emphasis on risk based pricing. If successful, this will likely slow balance sheet growth but should underpin returns and capital ratios.

Credit growth slowdown given shift to risk based pricing: management reported seeing a slowdown in corporate credit demand but demand for consumer lending remains solid where they are guiding for growth of 10-12% this year. Reflecting the new CEO's focus on profitability rather than volume growth, the bank's new risk based pricing is one reason why SME lending growth is expected to decline from 22% last year to 12.1% in April 2016 and possibly to low mid-single digit by the year-end.

More competition but pricing still rational: Santander also noted that they are seeing more banks returning to the SME lending market, notably Banamex and Banorte, however, overall competition appears to be rational with limited signs of disruptive pricing behaviour.

NIM upside potential: The bank expects to see another 25bp rate hike this year and two 25bps hikes next year so that by the end of the year the policy rate stands at 4.0% and by year-end 2017 at 4.5%. In terms of sensitivity, according to management, a 100bp hike in policy rate would equate to an increase in net interest income of P$800m (pre-tax) within a one year period. On this basis, we calculate a 100bp rate hike would boost SanMex's NIM by 7bp.

Cost growth: management does not expect to grow branches but will focus on efficiency in branch location, network and footprint, including investing in alternative channels such as mobile banking. For 2016, it is guiding for cost growth of 6.5% (excluding deposit insurance fees).

Pemex exposure: Santander Mexico has P$18.5bn of lending exposure to Pemex and another P$13bn of debt exposure to Pemex's suppliers. It has set aside no provisions for Pemex but last year set aside P$1bn of provisions for three suppliers that it plans to write-off in 1Q16 or 2Q16, something that could lower the NPL ratio. For 2016, it has budgeted an additional P$300m of provisions for Pemex suppliers.

NPL to go up: SanMex gives guarantees to Abengoa that are in turn guaranteed by Santander Group in Spain. The only uncovered exposure is US$20m that is expected to be restructured. Management indicated that reported NPL went up in April 2016 as the Abengoa exposure was classified as non-performing. At ICA, exposure is via five project finance facilities, four are performing with cash flows made via a trust structure. The fifth facility is problematic but provisioned for. In terms of its P$1.3bn exposure to Urbi, the bank has set aside 85% provisions.

Santander Mexico (SANMEXB.MX)

Profit & Loss (Pm)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
Net income interest	36,030	37,578	42,632	48,591	*14.0*	55,474	*14.2*	62,477	70,866	79,940
Total non interest income	17,621	17,809	18,416	18,859	*2.4*	19,952	*5.8*	20,811	21,446	22,001
Total income	**53,651**	**55,387**	**61,048**	**67,450**	*10.5*	**75,426**	*11.8*	**83,288**	**92,312**	**101,941**
Total cash expenses	(21,673)	(23,820)	(25,643)	(27,683)	*-8.0*	(29,621)	*-7.0*	(31,695)	(33,596)	(35,612)
Pre-depreciation operating profit	**31,978**	**31,567**	**35,405**	**39,767**	*12.3*	**45,805**	*15.2*	**51,593**	**58,716**	**66,329**
Depreciation & amort (excl. goodwill)	0	0	0	0	-	0	-	0	0	0
Operating profit pre provisions	**31,978**	**31,567**	**35,405**	**39,767**	*12.3*	**45,805**	*15.2*	**51,593**	**58,716**	**66,329**
Total provisions	(12,852)	(14,289)	(17,244)	(19,760)	*-14.6*	(22,675)	*-14.8*	(26,281)	(30,231)	(34,830)
Operating profit post provisions	**19,126**	**17,278**	**18,161**	**20,007**	*10.2*	**23,130**	*15.6*	**25,312**	**28,485**	**31,499**
Income from associates & JVs (pre-tax)	82	78	81	89	*10.0*	98	*10.0*	108	119	130
Other pre-tax items	0	0	0	0	-	0	-	0	0	0
Profit before tax (UBS)	**19,208**	**17,356**	**18,242**	**20,096**	*10.2*	**23,228**	*15.6*	**25,420**	**28,603**	**31,629**
Exceptionals (incl goodwill)	2,604	0	0	0	-	0	-	0	0	0
Profit before tax	**21,812**	**17,356**	**18,242**	**20,096**	*10.2*	**23,228**	*15.6*	**25,420**	**28,603**	**31,629**
Tax	(2,852)	(3,341)	(4,100)	(4,771)	*-16.4*	(6,504)	*-36.3*	(7,117)	(8,009)	(8,856)
Profit after tax	**18,960**	**14,015**	**14,142**	**15,325**	*8.4*	**16,724**	*9.1*	**18,302**	**20,594**	**22,773**
Other post-tax items	1,918	0	0	0	-	0	-	0	0	0
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	(2)	(1)	(1)	(4)	*-300.0*	(4)	*0.0*	(4)	(4)	(4)
Net earnings (local GAAP)	**20,876**	**14,014**	**14,141**	**15,321**	*8.3*	**16,720**	*9.1*	**18,298**	**20,590**	**22,769**
Net earnings (before pref divs)	**20,876**	**14,014**	**14,141**	**15,321**	*8.3*	**16,720**	*9.1*	**18,298**	**20,590**	**22,769**
Net earnings (UBS)	**16,061**	**14,014**	**14,141**	**15,321**	*8.3*	**16,720**	*9.1*	**18,298**	**20,590**	**22,769**

Per share (P)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
EPS (local GAAP, basic)	3.08	2.07	2.09	2.26	*8.3*	2.47	*9.1*	2.70	3.04	3.36
EPS (UBS, diluted)	2.37	2.07	2.09	2.26	*8.3*	2.47	*9.1*	2.70	3.04	3.36
PPOP (diluted)	4.72	4.66	5.23	5.87	*12.3*	6.76	*15.2*	7.62	8.67	9.79
Net DPS	3.08	0.51	1.00	1.04	*4.3*	1.10	*5.9*	1.20	1.31	1.52
BVPS	13.98	15.56	16.75	18.37	*9.6*	19.73	*7.4*	21.23	22.96	24.81
BVPS (UBS)	13.48	15.03	16.03	17.63	*9.9*	18.99	*7.8*	20.50	22.23	24.07

Balance sheet (Pm)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
Banking assets (year end)	821,797	937,384	1,184,857	1,332,208	*12.4*	1,469,920	*10.3*	1,624,767	1,799,158	1,996,102
Banking assets (average)	785,989	879,591	1,061,121	1,258,532	*18.6*	1,401,064	*11.3*	1,547,344	1,711,963	1,897,630
Total assets (year end)	821,797	937,384	1,184,857	1,332,208	*12.4*	1,469,920	*10.3*	1,624,767	1,799,158	1,996,102
Risk weighted assets (RWA) (year end)	543,725	596,952	664,122	728,436	*9.7*	808,901	*11.0*	900,367	1,004,594	1,123,655
Risk weighted assets (RWA) (average)	516,431	571,337	631,866	700,746	*10.9*	744,529	*6.2*	854,634	952,480	1,064,124
Customer loans	378,710	448,590	528,002	591,109	*12.0*	668,131	*13.0*	756,384	857,700	974,457
Customer loans (average)	368,407	430,394	502,512	573,339	*14.1*	641,112	*11.8*	726,109	823,814	936,340
Interest earning assets (average)	731,842	815,813	991,001	1,150,077	*16.1*	1,268,240	*10.3*	1,403,320	1,555,778	1,728,234
Customer deposits	404,668	459,624	516,432	578,404	*12.0*	647,812	*12.0*	725,550	812,616	910,130
Common s/h equity (year end)	94,692	105,374	113,538	124,375	*9.5*	133,631	*7.4*	143,802	155,506	167,980
Common s/h equity (average)	99,438	101,032	109,869	119,241	*8.5*	128,473	*7.7*	138,222	149,090	161,282
Total SHF (equity, pref & MI) (year end)	94,701	105,384	113,549	124,386	*9.5*	133,642	*7.4*	143,813	155,517	167,991
Total SHF (equity, pref & MI) (average)	96,264	100,043	109,467	118,967	*8.7*	129,014	*8.4*	138,727	149,665	161,754
Net tangible assets	91,287	101,812	108,671	119,388	*9.9*	128,644	*7.8*	138,815	150,519	162,993

Balance sheet structure (%)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
Loans / banking assets (year end)	46.1	47.9	44.6	44.4	*-0.4*	45.5	*2.4*	46.6	47.7	48.8
Deposits / banking assets (year end)	49.2	49.0	43.6	43.4	*-0.4*	44.1	*1.5*	44.7	45.2	45.6
Loans / deposits	93.6	97.6	102.2	102.2	*0.0*	103.1	*0.9*	104.2	105.5	107.1
Total SHF / banking assets (year end)	11.5	11.2	9.6	9.3	*-2.6*	9.1	*-2.6*	8.9	8.6	8.4

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Santander Mexico (SANMEXB.MX)

Capital adequacy (Pm)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Tier 1 capital	69,409	76,697	80,328	88,600	97,856	108,027	119,732	132,206
Total capital	86,531	96,517	103,639	111,911	121,167	131,338	143,043	155,517
Risk weighted assets (RWA) (year end)	543,725	596,952	664,122	728,436	808,901	900,367	1,004,594	1,123,655
Core tier 1 ratio %	12.8	12.8	12.1	12.2	12.1	12.0	11.9	11.8
Tier 1 ratio %	12.8	12.8	12.1	12.2	12.1	12.0	11.9	11.8
Total capital ratio %	15.9	16.2	15.6	15.4	15.0	14.6	14.2	13.8
Tangible equity	91,278	101,802	108,660	119,377	128,633	138,804	150,508	162,982
Equity / assets %	11.5	11.2	9.6	9.3	9.1	8.9	8.6	8.4
Tangible equity to tangible assets %	11.2	10.9	9.2	9.0	8.8	8.6	8.4	8.2

Asset quality (Pm)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Non performing assets	14,043	17,455	18,248	18,608	21,738	25,412	29,733	34,820
Total risk reserves	16,222	16,951	19,743	18,980	21,955	25,540	29,852	34,820
NPLs / loans %	3.6	3.7	3.3	3.1	3.2	3.3	3.4	3.5
NPL coverage %	115.5	97.1	108.2	102.0	101.0	100.5	100.4	100.0
Provision charge / average loans %	3.5	3.3	3.4	3.4	3.5	3.6	3.7	3.7
Net NPAs / shareholders funds %	(2.3)	0.5	(1.3)	(0.3)	(0.2)	(0.1)	(0.1)	0.0

Profitability (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Net interest margin (avg assets)	4.58	4.27	4.02	3.86	3.96	4.04	4.14	4.21
Provisions / operating profit	40.2	45.3	48.7	49.7	49.5	50.9	51.5	52.5
ROE (UBS earnings)	16.2	13.9	12.9	12.8	13.0	13.2	13.8	14.1
RoAdjE (UBS earnings & equity)	16.7	14.4	13.4	13.4	13.5	13.7	14.3	14.6
RoRWA (UBS)	3.11	2.45	2.24	2.19	2.25	2.14	2.16	2.14
RoA (UBS earnings)	2.33	1.56	1.30	1.22	1.21	1.19	1.21	1.21

Productivity (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Cost income ratio	40.4	43.0	42.0	41.0	39.3	38.1	36.4	34.9
Cost / average assets	2.66	2.66	2.36	2.20	2.14	2.07	1.98	1.89
Compensation expense ratio	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Growth (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenue	9.0	3.2	10.2	10.5	11.8	10.4	10.8	10.4
Operating profit pre provisions	9.9	-1.3	12.2	12.3	15.2	12.6	13.8	13.0
Net earnings (UBS)	0.6	-12.7	0.9	8.3	9.1	9.4	12.5	10.6
Net DPS	12.0	-83.4	94.6	4.3	5.9	8.9	9.3	15.9
Total assets (year end)	9.5	14.1	26.4	12.4	10.3	10.5	10.7	10.9
Customer loans	11.7	18.5	17.7	12.0	13.0	13.2	13.4	13.6
Customer deposits	11.6	13.6	12.4	12.0	12.0	12.0	12.0	12.0

Value (x)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Market cap/revenues	4.8	4.1	3.3	3.3	3.0	2.7	2.4	2.2
Market cap/deposits	0.6	0.5	0.4	0.4	0.3	0.3	0.3	0.2
P/PPOP (diluted)	8.0	7.1	5.7	5.6	4.9	4.3	3.8	3.4
P/E (local GAAP, basic)	12.3	16.1	14.3	14.6	13.4	12.2	10.8	9.8
P/E (UBS, diluted)	16.0	16.1	14.3	14.6	13.4	12.2	10.8	9.8
Net dividend yield %	8.1	1.5	3.3	3.1	3.3	3.6	4.0	4.6
P/BV x	2.7	2.1	1.8	1.8	1.7	1.6	1.4	1.3
P/BV (UBS) x	2.8	2.2	1.9	1.9	1.7	1.6	1.5	1.4

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Valuation Method and Risk Statement

Inbursa PT is Gordon Growth Model derived, with a CoE of 10.3%, sustainable ROE of 18.0% and growth of 6.6%..
Banorte PT is Gordon Growth Model derived, with a CoE of 10.3%, sustainable ROE of 14.3% and growth of 5.8%.
SanMex PT is Gordon Growth Model derived, with a CoE of 10.4%, sustainable ROE of 14.4% and growth of 5.9%.
Banregio PT based on residual income model.
In addition to industry- and company-specific risks, there are potential risks inherent in investing in emerging market countries. Potential emerging market related risks include, but are not limited to, the volatile nature of the currency, regulatory and socio-political risk, and abrupt potential changes in the cost of capital and economic growth outlook. Valuations can also be affected by "contagion" from developments in other emerging and developed markets.

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UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage[1]	IB Services[2]
Buy	FSR is > 6% above the MRA.	49%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	26%
Sell	FSR is > 6% below the MRA.	14%	19%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 March 2016.
1:Percentage of companies under coverage globally within the 12-month rating category.
2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category.
4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

KEY DEFINITIONS: Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months. **Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium). **Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation. **Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case. **Equity Price Targets** have an investment horizon of 12 months.

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UBS Limited: Philip Finch; Peter Carter. **UBS Brasil CCTVM S.A.:** Frederic De Mariz; Mariana Taddeo.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Banorte[7]	GFNORTEO.MX	Buy	N/A	P97.20	20 Jun 2016
Banregio[7, 16a]	GFREGIOO.MX	Buy	N/A	P98.00	20 Jun 2016
Inbursa[7]	GFINBURO.MX	Buy	N/A	P30.32	20 Jun 2016
Santander Mexico[5, 16b]	SANMEXB.MX	Buy	N/A	P32.98	20 Jun 2016

Source: UBS. All prices as of local market close.
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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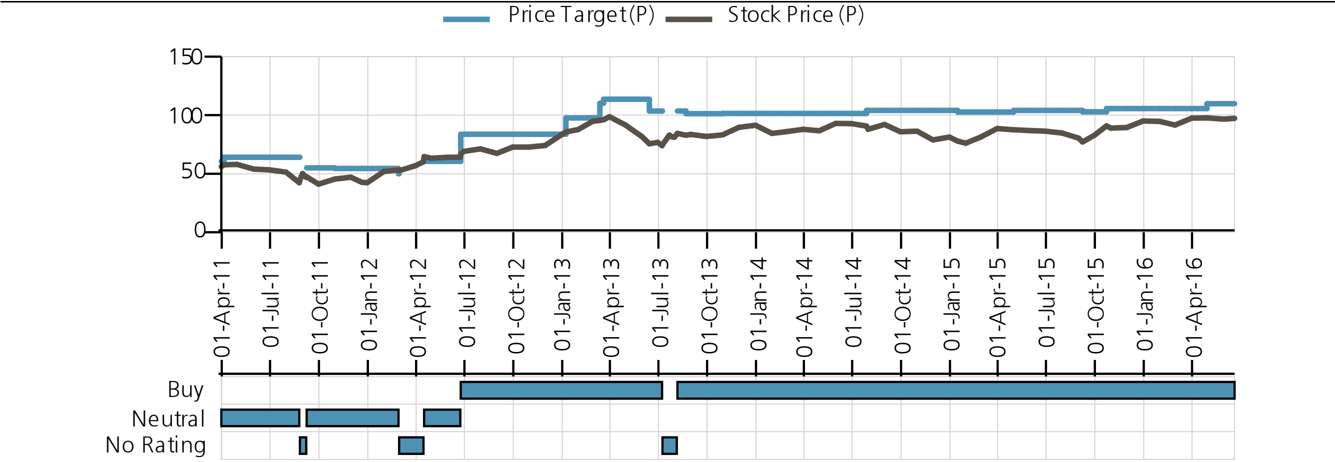
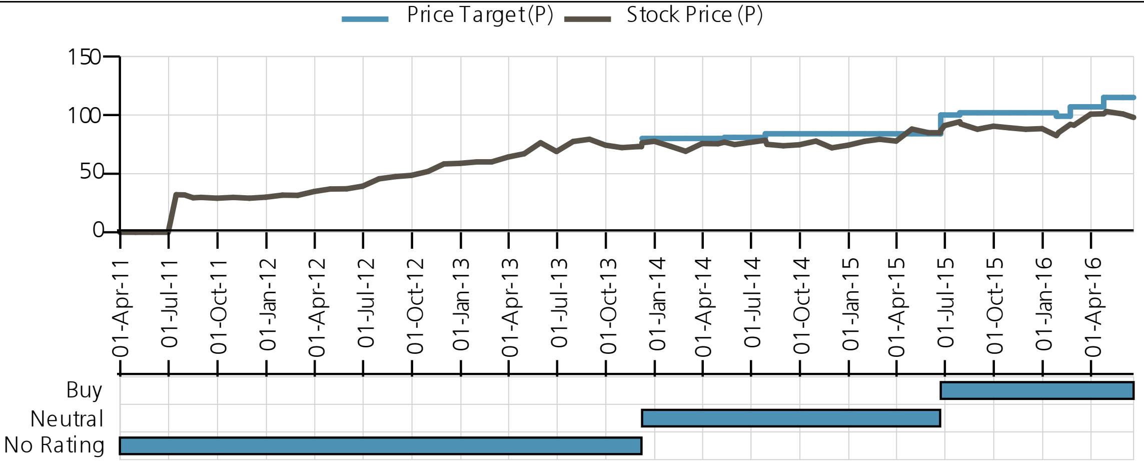
Banorte (P)



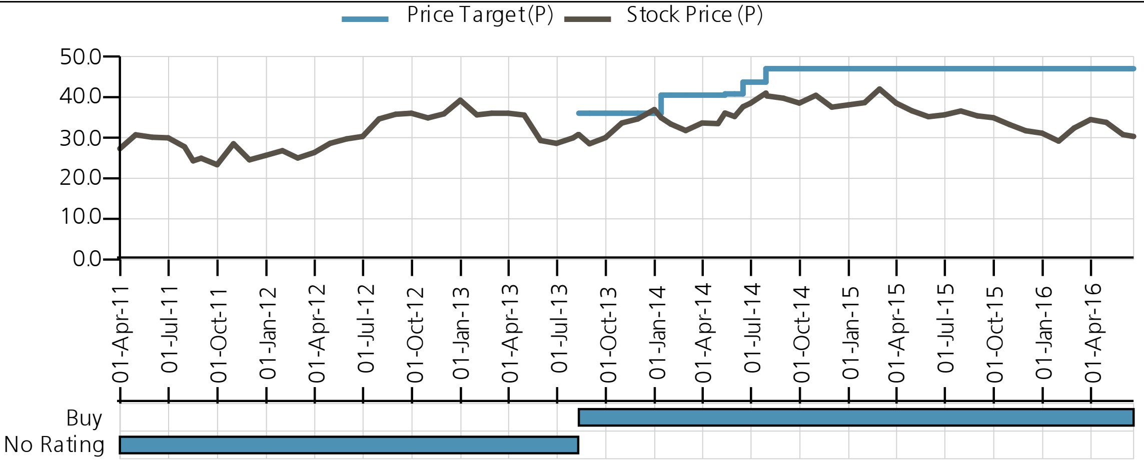
Source: UBS; as of 20 Jun 2016

Banregio (P)



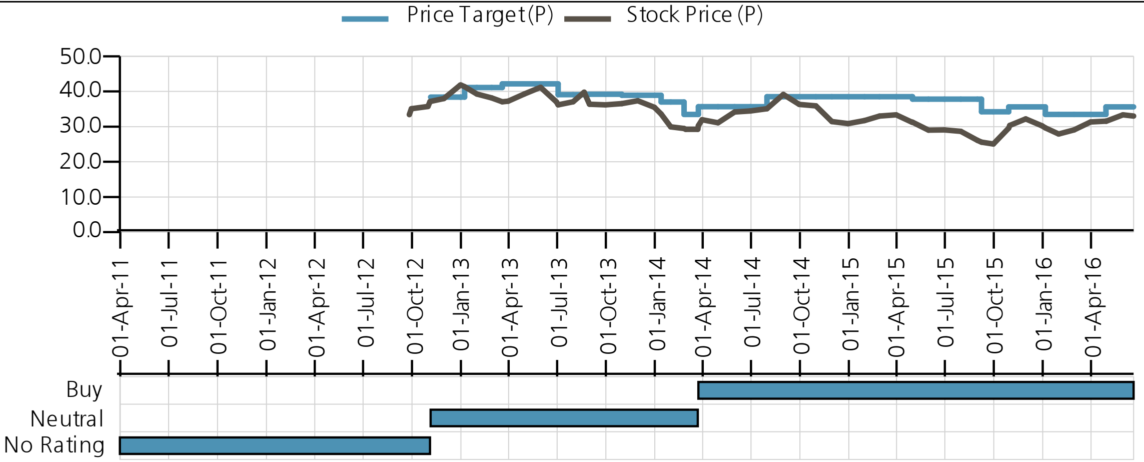
Source: UBS; as of 20 Jun 2016

Inbursa (P)



Source: UBS; as of 20 Jun 2016

Santander Mexico (P)



Source: UBS; as of 20 Jun 2016

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