

Banco de Chile 3Q20 Financial Results Conference Call

Operator

Good afternoon everyone, and welcome to Banco de Chile's third Quarter 2020 results conference call. If you need a copy of the press release issued yesterday, it is available on the company's website.

Today with us we have Mr. Rodrigo Aravena, Chief Economist and Senior VP of Institutional Relations, Mr. Pablo Mejia, Head of Investor Relations and Daniel Galarce, Head of Financial Control.

Before we begin, I would like to remind you that this call is being recorded, and that information discussed today may include forward-looking statements regarding the company's financial and operating performance. All projections are subject to risks and uncertainties, and actual results may differ materially. Please refer to the detailed note in the Company's press release regarding forward-looking statements. I will now turn the call over to Mr. Rodrigo Aravena. Please go ahead.

Rodrigo Aravena

Good afternoon everyone. Thank you very much for attending this conference call today. In the first part of this webcast, I'll present our view of recent developments in the business environment. Then, Pablo Mejia, our Head of Investor Relations, will go over strategic advances and financial results achieved by our bank during the third quarter.

Let me start with our view of the economy. Please move to slide number 3.

Several signs suggest that the bottom of the negative cycle was seen in the second quarter of this year. Chile's activity is also improving when compared to most countries in the region, which is highly attributable to our sound fundamentals, strong economic policy responses, and the improvement in covid-19 evolution. I'll go into greater detail regarding factors later on in the presentation.

The chart on the top left shows the magnitude of this recovery. After the 43% annualized drop in the second quarter, GDP increased 21% in the third quarter. Consequently, the activity reduced its annual decline rate from 14% to 9% in that period. This rebound has been explained by higher dynamism in several sectors related to domestic consumption, which have also been influenced by the withdrawal of personal savings from pension funds as well as the implementation of other government support programs.

This potential turning point in the economic cycle has increased domestic prices. The CPI went up by 0.6% in September, which was well above the market consensus and from levels observed in previous months. Consequently, the annual inflation rate went up to 3.1% in September, rising 60 bps from August, as the chart on the upper right clearly shows.

As seen in most countries, the labor market has suffered the main negative consequences from this pandemic, as shown on the chart on the bottom left. As a matter of fact, unemployment rate rose sharply from 7% in February to 13% in July. This deterioration resulted from the 20% and 15% declines in employment and labor force, respectively. Nevertheless, some potential "green shoots" are taking place in line with the gradual but steady recovery of the overall activity. This can be seen in the bottom right chart, where the employment has been improving since August.

These positive signs are highly attributable to the gradual lift of mobility restrictions due to the lower spread of Covid-19. I'd like to briefly refer to this factor, which has undoubtedly had a key role in this recovery. Please move to slide number 4.

In our previous conference call, we mentioned that Chile was under strict lockdowns since second quarter of this year. As a result of these measures, we have seen a positive evolution in several indicators related to the pandemic, making possible to ease mobility restrictions.

The chart on the upper left shows the drop in active cases of Covid-19 in Chile, with an impressive pick-up in the number of recovered people. Additionally, the share of positive test has remained at levels around 5%, well below other Latin American countries. Thanks to this, as you can see in the chart on the bottom left, local authorities have been reducing the number of areas in quarantine. While 54% of the population was under quarantine in July, this number went down to 19% in October. This change contributed to the greater mobility in the country, as the bottom right chart suggests. The impact on activity was greater: the proportion of GDP affected by the lockdown fell from 65% to 15% in the same period. This trend, together with strong fiscal and monetary policies and favorable copper prices have been critical for this improvement.

All these factors have led to better expectations for the future, which I'd like to discuss now. Please move to slide number 5.

We are aware of the unusual uncertainty that we face, not only in Chile but also in the world. That's why, in this particular environment, I'd like to emphasize three main assumptions that we take in our baseline scenario: first, we assume that social distance restrictions will remain most of the next year, which is consistent with a gradual pace of recovery in both GDP and employment. Second, we also assume the absence of further domestic shocks as we experienced last year. Finally, copper prices will continue providing support for the Chilean economy.

This table summarizes our forecasts for this and the next year. We see a recovery in GDP to 4.5% in 2021, from a 5.3% drop this year, which positively compares with other countries in the region. The table on the right shows that, according to the IMF forecasts, Chile will have the best performance in Latam.

We expect an inflation rate increasing from 2.4% this year to 2.8% in 2021, still below the 3.0% target set by the Central Bank.

Since banks are a perfect reflection of the economy, this new normal has had significant implications in the financial sector, as we will discuss in the next slide. Please move to page number 6.

The Chilean banking industry has shown an important resilience in this pandemic. Despite the crisis, which was accompanied by lower inflation, employment, and interest rates, banks were able to adapt their strategies to deal with this scenario.

Total net income slightly increased on a sequential basis to \$473 billion pesos in the 3Q20, adjusted by Itau figures. This result, however, was 19% below the same period of last year. Consequently, ROE fell from 12% in the 3Q19 to 9% in this period. In a broad sense, profitability was affected by the following factors: first, a weaker loan mix. Second, higher cost of risk due to new criteria to account for government guaranteed loans and additional provisions. And third, the negative impact of lower inflation and interest rates as well as the flatter yield curves.

It's also important to pay special attention to the evolution of delinquency rates, which have remained at very low levels, as the chart on the bottom left shows. Nevertheless, this should be a temporary situation since figures have been supported by specific factors. One of them is the impact of SME's reprogrammed loans, which remain in the grace period. Another factor is the impact of the 10% withdrawal from pension funds since, according to the Central Bank, nearly 15% of these resources were spent in reducing past-due loans, as you can see in the chart on the

bottom right. Therefore, it is reasonable to expect higher delinquency rates in the future, after these effects end.

Despite this complex environment, Banco de Chile was able, once again, to accomplish good results not only in financial terms but also in strategic advances. Please move to slide 8.

Banco de Chile has had a successful and proven track record of consistent and robust results. Since we aspire to continue being the most sustainable and profitable Bank, we are continually reinforcing three key areas of our long-term strategy: digital transformation, efficiency and productivity, as well as sustainability.

We firmly believe that strengthening these strategic areas will allow us to support long-term growth and will help us in the future challenges that arise in the new business and social environment.

Please move to slide 9 where we begin to highlight some of our initiatives in Digital Banking.

The pandemic has accelerated how we use technology in our daily lives. This had pushed us to work harder and faster in all of our digital banking solutions in order to provide our customers with financial products and services they demand.

We are proud to announce that in September we set a new standard for digital banking in Chile, officially launching our new digital 100% online onboarding bank account, called Cuenta FAN. This is a far superior product when compared to what is available in Chile today and, thanks to this, our launch was a total success. In less than two months, we already have over 90 thousand new FAN customers. The demand from customers opening Cuenta FAN accounts nearly doubled the amount reached by a similar product from our main competitor, as you can see on the top

right of this slide. For instance, we launched the product in the second half of this year and we reached almost the same amount of new accounts but in a much shorter time frame.

There are many advantages to our account that are driving this demand. Just to name a few, a Cuenta FAN customer becomes a Banco de Chile customer, allowing them to receive all discounts and benefits of a regular client. There are also no entrance or maintenance fees and this account grows with the customer. It starts as a debit account, and later, if the client qualifies and desires, becomes a current account. As the FAN customer has additional financial needs, we can offer them other products, creating new cross-selling opportunities. Most of our new FAN customers are younger than 45 years old and we are using this product to build closer relationships with people from these segments.

Before moving to the next slide, I'd like to mention that the cost of this account is very low when compared to a traditional account. At the origination, we don't require costly credit checks and extensive customer background reviews that affect delivery times. It is also important to mention that ongoing costs for these accounts are marginal since we already have the installed capacity and back office processes.

Please turn to slide number 10.

As I mentioned in the previous slide, one of the main advantages of Cuenta FAN is that these clients have access to all discounts and benefits of a Banco de Chile customer. Our premium loyalty program includes exclusive discounts with the main delivery platforms such as Uber Eats, Pedidos Ya and Rappi. We also have a unique program called Big Five, with discounts of up to 40% in big chains, including Starbucks, Papa Johns, and others. In addition to this, we have partnerships for most demanded events in Chile and alliances with stores and services from a wide range of segments that go from technology, transport to telemedicine and leisure. This

strong loyalty program is one of the fundamental drivers of the success of our Cuenta FAN and assists in increasing our relationships with customers to become their main bank account.

Please turn to slide 11

Cuenta FAN is only one part of our strategy to strengthen our digital experience at Banco de Chile. We are continually renewing, improving and rethinking how we can deliver our products and services better through the channels our customers are demanding.

For this reason, we have been updating many of our front office digital platforms, bringing more agility and security to our channels. One of the latest advances is our new webpage that offers a superior customer experience and incorporates analytic tools. It is more modern, secure, intuitive and inclusive. We also integrated on our webpage a heat map, which provides us with valuable information to understand our customer preferences even better.

In addition to this, we renewed our apps Mi Banco and Mi pago with new technologies that allows for faster, easier, and safer transactions. Behind our front-office improvements, we also had significant advances in our digital back office operation. Undoubtedly, the pandemic accelerated our digitalization, as in a short period of time we had to deal with an important increase in the usage levels of our digital channels. To mention some numbers, we received 23% of the total pension fund withdrawal and processed 100% online over 400 thousand loans in Personal banking to support our customers' liquidity needs. All these efforts are part of an ambitious digital roadmap that aims to make our institution the benchmark in digital banking in Chile.

Now Pablo Mejia, our Head of investor relations, will continue to present the rest of our advances and Banco de Chile's results.

Thank you Rodrigo, Please turn to slide 12

The successful implementation of our strategy has provided our customers with the best experience in the industry. Even during this challenging time, we have continued to innovate and strengthen our brand and lead in many different indicators as you can see on this slide. For example, we continued to lead the industry in customer satisfaction, with a wide gap to our closest competitors. This solid track record of customer experience has been provided through our proven ability to not only have best customer service but also to offer the best products through the channels our customers demand. I should mention that the surveys shown on this slide for customer satisfaction is a fairer representation of banking customers opinion as a whole. These surveys use a more representative sample of banking customers and not predominantly our own customers. It's also important to highlight that for a third year in a row, we were distinguished with the national award for customer satisfaction in 2020, as you can see on the right.

Another relevant point I want to mention is the strength of our brand. In many surveys we rank first. For example, we have posted once again the highest brand recognition in the Chilean industry and we led with a very wide gap to our competitors in the survey where customers are asked if they were to switch to another bank, which bank they would choose, as shown on the charts on the left. We are also considered to be the safest bank in terms of Security and Solvency, as shown on the chart on the bottom.

This leading position in both customer experience and brand is extremely valuable in light of new regulations, where it will be much easier for customers to switch from one bank to another. To date, we have more customers requesting information on switching to our bank versus our customers requesting a change to another bank. We are confident that these attributes should assist us in maintaining a low attrition rate, as you can see on the chart to the right.

Please turn to the next slide, number 13.

In our 127 years of history, we have accompanied the development of Chile and supported the country especially in more difficult times like today. Our commitment to be a sustainable bank is a fundamental pillar of our strategy. Along these lines, I would like to share some initiatives on this matter before moving to the quarterly results.

Given our concern for our customers, we were the first bank to implement a national support plan for our retail banking and commercial clients. This plan included a series of special measures to support our customers so they could cover their most urgent financial needs.

We are deeply committed to supporting Chile's SMEs, as we believe they are the driving force of our economy. In this line, we launched the Fifth National Entrepreneur Challenge with more than 56 thousand participants.

Furthermore, we have also implemented many actions in order to mitigate the consequences of the pandemic for vulnerable groups in Chile. Some initiatives we would like to highlight is that we delivered essential products to almost 9 thousand vulnerable families all over the country and held a campaign that raised over \$16 billion pesos to benefit elderly people affected by the pandemic.

All these efforts, among others, maintain our bank as the financial institution with the best performance in terms of the actions taken during this health crisis, as seen in the chart on the upper right.

Our sustainable business model was also recognized once again by The European, in the Global Banking & Finance Awards 2020 in the categories of "Bank of the Year", "Innovative Digital Bank of the Year", and "Best Bank for Financial Inclusion" in Chile. These awards acknowledge the relevant progress we have made in digital transformation and its contribution to our business.

In addition, Banco de Chile ranked first in the general ranking of Merco Talento Chile 2020, which positions us as the best company in the country to attract and retain talent. Finally, we are honored to be recognized for our Outstanding Crisis Leadership by Global Finance. This clearly shows how we as a financial institution went above and beyond to assist customers, protect employees, and provide critical support to society at large.

Please turn to slide 15 to begin our discussion on our results for this quarter.

We recorded a net income of \$88 billion pesos with an ROAE of almost 10%. Our lower bottom line was mainly the result of higher provisions, attributable to our prudent and conservative risk management approach that aimed at setting adequate levels of provisions. We consider this approach is particularly important today given the magnitude of the crisis we are facing globally. Net income was also affected by a decrease in NIM, which was a consequence of a combination of factors, including lower CPI, and the sharp decline in interest rates and loan mix. This was partially offset by strong cost control.

Despite this, it is important to highlight that we still posted the highest year to date net income in the Chilean Banking industry and we have, by far, the highest level of coverage. Apart from having the highest profitability and the best credit risk indicators in the industry, we also outperform the banking system in terms of capitalization levels.

Please turn to slide 16.

Operating revenues recorded a year-on-year decrease of 12%, principally due to unfavourable trends in inflation, interest rates, loan growth and fees. Specifically, inflation dropped 0.5% in the 3Q19 as compared to 0% this quarter, impacting non-customer income. Also, given monetary policy actions taken by Central Banks, interest rates decreased sharply this year while yield curves flattened, which resulted in lower contribution of our demand deposits to our funding and less chance to benefit from term gapping. Additionally, we had a reduction in high margin loan

products as consumer loan demand shrank. Second, the main driver of loan growth during the second and third quarters of 2020 was focused on Fogape government guaranteed commercial loans which only carry a 3.5% interest rate. These effects were partly offset by better performance of our AFS and trading portfolios due to the shifts observed in interest rates.

In this context, NIM fell from 4.1% last year to 3.1% this quarter, as you can see on the table on the bottom left. About 1/3 of this decrease was caused by the lower CPI we had this quarter. The remaining part is explained by the effect of the lower contribution of demand deposits to our cost of funds and term gapping given sliding interest rates. It is worth mentioning that, as mentioned in previous calls, net interest income has been also affected by the negative impact of mortgage loan renegotiations that took place in the second half of 2019 and the regulation regarding automatic payments of overdraft lines that went into effect in January 2020. The drop in NIM has also been explained by greater exposure to low margin and low risk assets, such as Central Bank short-term bonds, used to comply with reserve requirements linked to the strong increment posted by demand deposit balances.

Also, since strict lockdowns began to be lifted just by mid-august, our fee income has been impacted during the last quarters. Particularly, revenues from transactional services such as checking accounts, credit and debit cards, as well as ATMS were down due to lower transactionality and spending. Similarly, fees linked to loan origination, such as insurance brokerage, also decreased, while fees related to assets under management dropped as a result of market volatility that led customers to switch from higher margin equity funds to fixed income.

Nevertheless, the good news is that we have begun to see some improvement in different indicators across the bank that could imply that the worst for fee income generation is behind us. Before moving to the next slide, I want to highlight that we continue being the leading bank in the industry with a wide gap to our peers in fees and net operating income margin, as you can see on the charts to the right.

Please turn to slide number 17.

Total loans reached \$31 trillion pesos this quarter, increasing 6% year-on-year and up 1.5% quarter-on-quarter.

Demand for loans, excluding Covid loans, improved slightly in the third quarter from the weak levels reported in the previous one, in line with the 3Q20 Chilean Central Bank Credit Survey. This report showed that both demand and supply had improved slightly QoQ for all retail loan products and that credit restrictions had been reduced to companies. Nevertheless, this was accompanied by weaker demand for loans from the later due partly to the high volume of Covid loans and the still uncertain outlook for the economy.

For Banco de Chile, most of the dynamism in loan growth was created by the Fogape loan program, as shown on the diagram to the right. Specifically, total commercial loans grew \$2 trillion pesos year-on-year but \$1.8 trillion was related to these loans with government guarantees for companies with sales up to \$10 million dollars per year. As a reminder, the Covid loans were part of the government's stimulus package for companies that provided guarantees of up to 85% for working capital loans. We are pleased that we have assisted our customers and Chile by taking part in this program. Most of these loans were provided to small and medium sized enterprises, which explains the growth of 21% as shown on the chart on the bottom of this slide.

On the other hand, personal banking loans only grew 1.3% year-on-year and actually dropped 0.9% quarter on quarter, as you can see on the chart on the bottom right of this slide. This result is consistent with the subdued economic growth. This caused a reduction in household spending, which meant less demand for both consumer and mortgage loans. We expect that the dynamism of personal banking loans should begin to improve gradually in the next months as the economy recovers. In this regard, data revealed by the national chamber of commerce show that household consumption, for instance, would be showing some signs of modest recovery.

Please turn to slide 18.

Our leading funding structure has been made possible through our ability to provide the best service experience that our customers value and ultimately establishes Banco de Chile as their primary bank account for both retail and wholesale customers. Over the past 12 months, our solid brand and soundness have provided us with a strong increase in demand deposits, which rose an impressive 45% year-on-year and equally remarkable 11% on a quarterly sequential basis.

Consequently, our funding structure has significantly changed year-over-year. Today our demand deposits represent 32% of total funding, well above our peers, as shown on the bottom right chart. More importantly, DDAs held by non-financial counterparties, which are a stable source of financing, represent around 80% of the total amount. Also, we took advantage of the liquidity facilities provided by the Central Bank from which we obtained mid-term funding denominated in pesos and bearing the monetary policy interest rate. These funding sources have mostly replaced time deposits held by financial counterparties, particularly in local currency. Our well-diversified funding base, as seen in chart on the left, is undoubtedly an important competitive advantage of Banco de Chile.

Finally, our strong Tier 1 capital base of 11.6% together with our superior credit risk ratings, allows us to place debt with good conditions, giving us a leading level of cost of funding of only 1.6% in local currency. We are confident that we can take advantage of the opportunities that will be presented during this period to strengthen our relationships with our current customers, as well as continue increasing our share of wallet, especially through our digital contact channels. Likewise, initiatives like the FAN account should allow us to keep on expanding our customer base while bolstering our market-leading position in core demand deposits.

Before moving to the next slide, I'd like to mention that we are well prepared to face Basel 3 future phase in requirements, which is in line with our historical guidance.

Our solid track record of generating an attractive bottom line has been a result of our consistent and prudent risk policies that focuses on growing responsibly and sustainably overtime. Please turn to slide 19.

A key component of managing credit risk in Banco de Chile is the governance structure for this topic, in which the board of directors plays a vital role and actively participate in the whole process including assessment, strategies and guidance of the bank for accepted risk levels, for developing and validating provision models, as well as to define additional provisions.

As you can see on the chart on the left, cost of risk this quarter rose to \$113 billion pesos, up from \$89 billion pesos last year but below the level posted of \$139 billion during the previous quarter. However, our NPL ratio continued dropping from 1.17% in the 3Q19 and 1.33% in the 2Q20 to a mere 0.98% this quarter.

The year-on-year rise on loan loss provisions was due mostly to a recalibration of our internal provisioning models for group-based evaluated portfolios in order to incorporate new information in the context of Covid, with an impact of \$71 billion pesos. This was partly offset by a release of additional provisions during the month of September for \$78 billion pesos of the \$105 billion additional allowances that we proactively recorded this year. This was only a small portion of the total additional allowances we have booked on our balance sheet over the years and as you can see on the chart to the right, we have by far the highest level of these reserves in the industry. To note is that these allowances, even after this release, are three times larger than our main competitor. This figure of cost of risk also includes the full impact of loan growth in Covid FOGAPE loans, most of them granted during the 3Q20, and the full adoption of the provisioning treatment set by the regulator for these types of loans.

It's important to note that we continue to see positive payment behavior from our customers and that this has translated into low levels of NPLs and a reduction of charge-offs. It is also important to note that we had a temporary rise in NPLs and charge-offs as a result of the weaker macro environment in Chile due to the social crisis that began in the 4Q19. As a result of decisions that were undertaken during these events, our early overdue portfolio began to rise. Nevertheless, we adjusted our collection procedures and began an improving trend in overdue loans. Despite this change, some overdue loans were not recovered and in line with the

temporary rise in NPLs, we saw a brief rise in regulatory charge-offs that has now more than normalized. However, as we mentioned earlier in the presentation, we must pay close attention to how these indicators evolve, as they could be benefiting from the financial assistance that customers received from both the government and banks as part of the measures taken during the crisis. We can't rule out that, in the coming quarters, we see a rise in delinquencies as these payment holidays and other benefits come to an end.

Nevertheless, our prudent risk policies have made Banco de Chile the most prepared bank to continue facing this weak cycle. All of what I've talked about demonstrates the quality of our portfolio and how our prudent risk management is bearing fruits during this difficult period. By having a consistent commercial and risk strategy, we have been able to grow our portfolio responsibly and profitably over the long-run. We are confident that this risk approach should distinguish us among other banks in the coming quarters.

Please turn to slide 20

During this quarter, we continued our focus on cost control, as we believe that reaching efficiency in our operations is even more relevant in this challenging scenario. As you can see on the chart on the left, total operating expenses fell 5.9% year-on-year, equivalent to \$13 billion pesos of savings.

The drop in yearly costs was driven by both lower salaries as well as a reduction in administrative expenses, as shown on the chart to the right. Particularly, we had a reduction in salary expenses, related to lower severance indemnities from organizational restructuring that took place in 2019 as well as lower variable compensation as a result of the current situation. As for Administrative expenses, the main savings were associated with higher expenses in 2019 associated with the development and implementation of internal projects in order to improve our efficiency and deploy digital transformation initiatives. In addition, we introduced changes in our service models

that allowed us to reduce costs in outsourced services. Likewise, the use of more effective channels for advertising and customer loyalty enabled us to reduce marketing expenses.

Thanks to our cost control efforts, we recorded a slight improvement in our accumulated efficiency ratio that reached 44.6%, clearly outperforming the average level posted by the industry that actually increased during the same period. We also recorded a positive indicator of expenses to total assets of 1.86% this quarter, versus the 2.33% recorded one year earlier.

Please turn to slide 21

Even though it is difficult to predict how the pandemic will evolve, since some countries are evidencing increases in Covid cases and a return to lockdowns, we clearly see some signs suggesting that the worst was left behind us. As you can see on these charts, we have begun to see a gradual increase in origination for consumer and mortgage loans as well as a steady rise in terms of new current account openings. We are also seeing a slight improvement in credit and debit card purchases. The low figures seen in prior months was due to the strict lockdowns and low mobility in Chile and this caused a significant impact to credit origination as well as activity in our transactional products. We are pleased to see a gradual normalization in these figures and this should translate into better income generation as well in the coming quarters. We are confident that the better perspectives for the economy, together with our superior competitive advantages, will allow us to continue being the best long-term alternative for our investors.

Thank you for listening and if you have any questions, we would be happy to answer them.