Comments on the 3Q11 Financial Results

Banco de Chile

Good afternoon. It's a pleasure for me to share with you our comments on Banco de Chile's third quarter 2011 financial results. Joining us is Mr. Pedro Samhan, Chief Financial Officer of Banco de Chile.

As a reminder, a link to the slide presentation is available on our webpage, www.bancochile.com, within the investor relations site.

To begin, I would like to share with you, on **slide number 2,** the third quarter highlights.

- During the period, the Chilean economy has continued moderating economic growth to a level closer to its long term rate.
- In terms of the Banking industry, ROAE has remained strong, although at a lower rate than recorded in prior quarters, with loan growth accelerating to 5% QoQ.
- In terms of Banco de Chile, we posted the highest quarterly net income figure in the Chilean financial industry. More importantly, on a quarterly and an accumulated basis, we posted the highest return-on-average equity in the industry.
- Our loan growth has also remained strong during the quarter, allowing us to capture market share in both retail and wholesale lending.
- In terms of our focus to continue growing in retail, this has not only translated to a significant growth in terms of loans but also to an important increase in earnings before income taxes.
- Finally, I would like to mention that our efforts to improve stock liquidity have also been achieved. We've managed to significantly increase our daily trading volumes during the last two years. This has been achieved thanks to our excellent performance as well as a conscious effort to make the bank more attractive and visible to investors.

Please move forward to the next slide, **number 3.**

- During the first semester, the Chilean economy posted strong GDP growth associated to a dynamic demand and a lower comparison base as a result of the 2010 earthquake. During the third quarter, the economy slowed, returning to a level closer to their long-term rates.
- At the sector level, industries associated with domestic demand such as commerce, and services have shown the highest dynamism. In addition, Construction and financial services are also showing a strong performance. However, export sectors such as industry and mining have grown slower than expected, especially the latter associated to supply problems such as strikes and lower-grade ores.
- Despite the economic slowdown, unemployment has remained stable during the year, reaching 7.4% in 3Q11. This figure has been fundamental for the performance of private consumption and credit expansion.
- Important to note is that the Chilean economy has strong growth fundamentals, such as the dynamic labor market, solid financial system, favourable trade terms, diversified export basket and controlled inflation, which should allow us to maintain growth rates during the following years, in line with the historical trend.

Inflation, as described in the following slide **number 4** and measured by the general price index, has remained stable, fluctuating slightly above 3% over the past 3 months, reducing inflation expectations, which during the second quarter experienced an important increase associated to higher commodity prices.

- As of September, the accumulated CPI rate is 3.0% and is estimated that by year-end this figure will grow around 3.5%. However, it’s important to mention that core inflation remains closer to 2%.
- Consistent with the aforementioned and with the external economic environment, the Chilean Central Bank suspended raising the Monetary Policy Rate which began the year at 3.25% and has remained at 5.25% since June.
- According to market expectations, the Monetary Policy Rate is not expected to experience further increases, and may decrease during the coming months.

Recent international events have questioned the macroeconomic stability of developed countries, the next slide, **number 5**, describes a few of the strengths of the Chilean economy, which would aid in the event of further deterioration in the international economy.

- First, Chile has a very low sovereign risk, when measured through CDS spreads, we compare very similarly to countries such as Germany and France and if compared to other emerging economies we excel.
- We are viewed positively because Chile has maintained an outstanding performance in terms of stability, a low public debt and is complemented by the structural surplus rule which isolates public spending during economic cycles.
- As of September 2011, the economic and social stabilization fund accumulated US$13 billion, representing over 5% of GDP. Additionally, the Central Bank holds reserves of approximately US$38 billion, representing 16% of GDP.
- Another important factor is our well-diversified export basket with business partners from all over the world, of which most are concentrated in emerging economies.

In relation to the Chilean banking system, the next slide, **number 6**, demonstrates the positive figures posted during the third quarter.

- Return-on-equity remained strong at 17%. However, this was lower than the prior quarter or the same period last year due mainly to lower operating revenues and higher provisions for loan losses.
- Operating revenues decreased quarter on quarter due to lower margins as a result of a decrease in revenues from inflation indexed assets and higher competition as well as a decrease in fee income.
- In relation to the higher loan loss provisions recorded during the quarter, we understand that the rise is not associated to a deterioration in the macroeconomic environment, but more related to isolated events and business growth.
- Loan growth, as demonstrated on the chart on the right, accelerated during the period. This strong increase was led by a rise of almost 6% in commercial loans, influenced by the sharp rise in the USD/Chilean peso exchange rate, and to a lesser extent consumer loans which grew by almost 4% and mortgage loans which rose by 2.5%.

On the next slide**, number 7,** begins the discussion of our consolidated results.

- As mentioned earlier, we posted another solid quarter with respect to the financial industry in terms of net income, recording the highest figure in the sector.
- This is clearly demonstrated on the chart on the upper right. Our net income of Ch$98 billion pesos during the quarter generated a 21% return-on-average equity and ranked us well above our nearest competitors.
- Year to date, we have recorded Ch$329 billion in net income, closing the gap significantly with the financial leader and posting the highest return-on-average equity of 25%. In addition, it's important to note that we have also posted the highest return-on-average assets amounting to 2.22%, or 28 basis points higher than the next leading competitor.

On the following slide, **number 8,** there is a closer look at our operating revenues.

- On a quarterly basis, we maintained our high revenue generation, growing 9% over the same period last year.
- The main drivers for the increase over the 3Q10 were:
  - First, greater yields from our non-interest bearing liabilities, as a result of higher interest rates.
  - Second, a strong rise in our loan portfolio.
  - And third, additional revenues from a US/Peso hedge associated to allowances denominated in US dollars.

This was partially offset by two main factors:

- A decrease in income from the management of our balance sheet gaps as a result of lower inflation and higher funding costs.
- In addition, there was a reduction in spreads due to higher competition and a portfolio with a larger mix of corporate and residential mortgage loans.

- Similar to prior quarters, revenues from our core business segments have led growth, as shown on the chart on the right.
- The retail segment has grown by 11% over last year while our Wholesale segment increased by 23%.
- Our subsidiaries, which include Stock Brokerage and our Mutual Fund businesses have remained relatively flat year-on-year due to the weaker economic outlook which led customers to seek safer investments, thereby decreasing stock trading turnover and a transition to fixed income mutual funds and other safe investments such as time deposits.
- Finally, the Treasury area decreased operating revenues by 44% mainly due to higher funding costs and rate changes in the UF/Peso swap spread.

Another key competitive strength is our solid fee based revenue generation capability, as demonstrated on the following slide, **number 9.**

- Our solid fee generation is based on our attractive value offering which we provide our customers, thus generating opportunities to increase cross-sell and up-sell ratios in every segment we serve. Most importantly:
  - Checking accounts and credit card fees grew by 12% over last year thanks to a rise in product usage rates, especial credit cards which increased by 34% and represent almost 13% of our total fees, and to an expansion of our ATM network
  - Also, important to note is the strong growth in insurance fees as a result of our firm growth in retail and our ability to effectively cross-sell customers with products that suit their needs.
- This growth was offset by lower business activity in our securities brokerage firm mainly as a result of a reduction in the stock trading turnover and a 9% decrease in average assets under management in our mutual fund business, in line with the a riskier external environment and uncertainty regarding future developments in the local and international financial markets. In addition, we also recorded lower fees from loans due to a decrease in prepayments from corporate customers.

- As compared to our peers, we are the leading bank in terms of fee generation. We capture 26% of all fee generated by the banking industry, substantially greater than our closest competitors. Moreover, fees produce 25% of our total operating revenues and cover more than 50% of our operating expenses, clearly setting us apart from our peers.

Loan growth continues to be one of the key drivers for revenue generation. This quarter, as demonstrated on slide, **number 10,** was another outstanding quarter in terms of growth.

- On a year-on-year basis, we grew 23% and quarter-on-quarter, an impressive 6%.
- When compared to the top five banks, we ranked second in terms of both quarter-on-quarter volume growth and in terms of market share expansion where we captured 17 basis points during the period. However, year-on-year we ranked first in terms of growth with a very strong market share expansion of 102 basis points.

In addition, we have maintained our solid growth figures in retail banking, as demonstrated on the following slide, **number 11.**

- The charts on the left, show that loans to individuals and to SMEs are growing at a very strong year-on-year pace of 20% and 19%, respectively. Important to note is that loans to individuals have accelerated their rate of growth from 4% to 5% this quarter, with the most important increase in consumer loans that went from 1.9% last quarter to 4.8% this quarter, capturing 17 basis points and closing the quarter with a market share of 22.3%.
- Mortgage loans continue to excel, growing at a rate of 5% this quarter and have captured 117 basis points in market share over the year, reaching 16.0% as of June.

- As for our loans to SMEs, this area is also growing very strongly with a rate of 19% year-on-year and represents roughly 12% of our total loan portfolio.
- On the wholesale front, our loans in this segment have grown very strongly at 26% year-on-year reaching 8.5 trillion.
- We associate the strong growth in commercial loans to our competitive lending offering together with the positive business sentiment that has driven the high investment rate. Nevertheless, it's important to mention that part of this increase in wholesale lending was due to the strong 9.3% rise in the USD/Peso exchange rate as 20% of our commercial loans are denominated in US dollars.

On the next slide, **number 12**, begins our discussion of credit quality, a key competitive advantage of Banco de Chile.

- Loan loss provisions reached 1.1% during the quarter. However, as mentioned earlier, the sharp rise in the US/Peso exchange rate negatively affected our provisions in US dollars, leading to an increase in provision levels. However, this is hedged in other operating revenues. Excluding this effect, our loan loss provisions would have been 0.94% during the quarter.
- In terms of delinquencies, as measured by our total past-due loan portfolio, which includes the principal amount and instalments that are 90 days overdue, there has been a consistent improvement from 1.41% in the 2Q10 to 0.97% in the 3Q11.
- Year to date we continue to maintain the lowest loan loss provisions ratio as demonstrated on the chart on the right. In this regards, we are confident that we maintain a superior and efficient risk-return ratio within both our retail and wholesale segments. This includes our ability to manage effectively all aspects of the credit cycle, including a rigorous credit assessment aligned with our segmentation policy; firm controls to guarantee proper application of credit policies; and detailed monitoring of changes in portfolio risk.

Moving on to slide **number 13**, we can observe that our efficiency ratio increased during the third quarter reaching 49.1%, due to the following factors:

  - An extraordinary charge of almost Ch$6 billion pesos in additional salary expenses related to the collective bargaining process.
  - The remaining rise in expenses is primarily from IT, outsourced sales force expenses and maintenance and rental expenses as a result of our higher business activity and branch network growth.
  - Additionally, it's important to note that the sharp rise in the USD/Chilean peso exchange rate raised Co-branding expenses significantly, which are related to our incentive program, due to the fact that these costs are based in USD.

- Excluding the temporary effect of the collective bargaining agreements, our cost to income ratio would have been 47.2% in the 3Q11, in line with prior periods.
- As mentioned in other calls, I would like to stress that our strategy continues to search for new ways to improve our operating efficiency through projects that aim, among other objectives, to continue increasing productivity in our branches, improving online sales channels, redesigning core processes and automating back office activities.

Moving on to slide **number 14**, I would like to discuss in further detail the strong results of our Retail Segment.

- As one can observe on the chart on the left, our retail business, in line with our long-term objectives, is growing strongly, posting a 22% increase in terms of earnings before income taxes. On the contrary, our other segments have remained relatively flat with the exception of the Treasury area which decreased net income due to the strong rise in the monetary policy interest rate, raising funding costs faster than interest earned and rate changes in the UF/Peso swap spread that negatively impacted the results of derivative positions in 3Q11 as compared with results in 3Q10.

- The main drivers behind the increase in our Retail segment's EBIT were the following:
    - The strong growth in all credit products which rose almost 20% YoY with a significant rise in credit card loans of 28% YoY.
    - The positive effect of higher interest rates on the contribution of the segment's non-interest bearing liabilities
    - And a solid rise in terms of fees which grew by 10% over last year and were mainly due to higher revenues from insurance brokerage and an increase in the usage rates of transactional products.

We believe that the retail business continues showing important growth opportunities. For this reason we have invested in expanding our branch and ATM network, as demonstrated on the next slide, **number 15**.

- As you can see, we have strongly expanded both our Branch and ATM networks by 7% and 14%, respectively. This has led us to have one of the largest branch and ATM networks in Chile with 429 branches and just over 2,000 ATMs as of the end of the third quarter.
- As we mentioned during the beginning of the year, our plan for 2011 was to open 31 new branches. Most of these branches will be opened by the end of the fourth quarter, as you can see on the chart on the right.

Now before I hand over the call to our CFO, Pedro Samhan, I would like to briefly mention the improvement in the liquidity of our stock. Please move to the next slide, **number 16**.

- For the past few years, the Bank has increased its efforts to improve the liquidity of our shares.
- Since 2008, our total daily average trading volume has increased from just under US$2 million to US$7 million as of October 2011.
- We believe that this rise is due to our excellent results, our equity offering which increased our free float to 15% and a conscious effort to make the bank more visible.

Now to finish off, I would like to hand the call over to Pedro Samhan, Chief Financial Officer.

Pedro Samhan:

Thank you Pablo. Please move to the next slide, **number 17.**

- The third quarter has been very challenging due to the uncertainty in international markets as well as its effect on the local market.
- Despite this, we were able to post solid growth figures in terms of loans, which grew 23% over last year as well as in demand deposits, one of our key competitive advantages, which grew 8% year-on-year.
- In addition, we recorded a 7% gain in accumulated net income which translated into a 25% return-on-average equity and closed the gap significantly with the leading competitor to only Ch$7 billion.
- And finally, our solid balance sheet and business strategy has been recognized by international rating agencies, who have ranked us amongst the most solid financial institutions worldwide.

Now if you have any questions we would be happy to answer them.