Comments on the 3Q12 Financial Results
Banco de Chile

Good afternoon and welcome to Banco de Chile's third quarter 2012 conference call. It's a pleasure for me to share with you our comments on this quarter's financial results.

To begin, I would like to outline the main topics of this call. First we will talk a little bit about what has been going on in Chile in terms of the economic environment and the banking industry, followed by a review of our financial results and leading profitability, finishing the call off with a brief overview of our recently approved equity offering.

Please turn to **slide number three**. During the quarter the economy continued to remain strong despite the global economic downturn, achieving economic figures over the market expectations. In GDP, we grew 5.4% YoY in the 3Q12 maintaining the pace of the previous quarter, accumulating an annual increase of 5.4% as of September. The positive expansion of the Chilean economy is explained by sectors such as commerce, construction and services boosted by a solid performance of aggregate demand of above 5%.

In fact, aggregate demand during the last two quarters returned to expansions above GDP, as you can see on the chart on the upper right, driven by higher dynamism of private consumption and a stable performance of investment. This is generated by strong fundamentals such as low unemployment rates (below 7% all year), higher consumer and enterprise confidence levels, a solid banking sector and a dynamic credit expansion.

However, during 2012 sectors related to external demand have been affected by the global economic tensions causing a decrease in growth in exports due to lower external demand and commodity prices as compared to 2011. This, together with a slower decrease in imports, has impacted our current account deficit to reach a level of around 3% of GDP.

Nevertheless, growth expectations for 2012 have been steadily revised upwards. The last economic surveys point to a GDP growth of around 5.0% during 2012 and 4.5% for the next year.

Please turn to **slide number four.** Unemployment continued strong during the quarter with a very low rate of 6.5% in line with the positive evolution of GDP and the sentiment from enterprises. Regarding inflation, CPI evolved slightly below the midterm goal of the Central Bank of 3% reaching a figure of 2.8% YoY at the end of the quarter. On a quarterly basis, during 3Q CPI grew 1.0% meanwhile UF was negative 0.2% due to the lag of which the latter is calculated, still taking into account the negative variation of CPI during 2Q12. According to the last figures of inflation, we expect that CPI will increase by 0.5% during 4Q12 and the UF will change by 1.3% in the same period. So, we expect that at the year-end CPI should reach a level of 2.0% and 2.7% for the UF.

Regarding monetary policy, the Central Bank has kept the interest rate in a neutral value of 5.0% due to an economy that grows at a level near its long term rates, lower unemployment and stable inflation expectations. Regarding this, the market doesn´t expect changes in the coming months.

Please turn to **slide number five.** During 2012 total loan growth for the banking industry has shown volatility among quarters. After a spike in the second quarter, loan volumes grew moderately at 1.5% in the 3Q12. On a yearly basis, total credit reached a 12.5% YoY increase in nominal terms, continuing with the slowdown projected for 2012.

The quarterly moderation was mostly driven by the deceleration in commercial loans which grew 1.1% in 3Q12, boosted by the appreciation of the Chilean peso and the drop in inflation. This was partially offset by an acceleration of consumer loans, in line with the solid fundamentals for private consumption.

In terms of results, net income recorded a decrease this quarter when compared to both the prior quarter and the same period a year earlier. This was mainly due to a reduction in operating income and a rise in operating expenses. The drop in operating income quarter-on-quarter and compared to the same period last year was influenced by the deflation which occurred during the 3Q, affecting the UF structural gap position of the banking system and also to higher operating expenses when comparing the year-over-year figure.

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Please turn to **the next slide number six,** which begins our discussion of our consolidated results.

- The third quarter remained very profitable despite the lower than average inflation, posting a 2% increase as compared to the same period last year and a decrease of 7% quarter on quarter.
- Nevertheless, our solid business strategy has continued to outperform the market and has further consolidated our leadership position in the Chilean Banking Industry. As a result, we recoded CLP 329 billion year-to-date and CLP 100 billion during the quarter, both far exceeding all of our competitors.
- As you can see on the chart on the bottom right, we managed to represent an impressive market share in net income of 32.7% during the quarter, almost doubling our closest competitor and an equally inspiring 28.9% of market share in the year-to-date figure.
- It is also important to mention that the tax reform that increases the company tax rate from 17% to 20% was officially put into place during this quarter, generating a one time net gain in our results due to the normal deferred tax assets banks hold on the balance sheet.

Moving on, the generation of our robust net income figure can clearly be seen in the next slide, **number 7**:

- Despite the drag from the large decrease experienced during the last quarter in inflation and lower financial income from USD/CLP positions due to the appreciation of the Chilean peso, our core business operating revenues have remained very strong, generating CLP 305 billion in the quarter.

- The strong growth trend in our core business is unmistakably seen in the chart on the lower right side, where **Customer Revenues have grown constantly offsetting the temporary reduction of Non-Customer Revenues**. It is also important to mention that this expansion has been generated from our strong loan growth combined with a proactive cross-sell and lending spread management. All of this has been supported by our competitive advantage in funding costs explained by the leadership position we hold in non-interest bearing deposits together with our lower cost of funds in interest bearing liabilities due to our excellent credit ratings.

- Going forward, we expect that our core business will continue to grow strong while non-customer revenues should increase as inflation indexed revenues return to more normalized levels.

On the following slide, **number eight**, is a snap shot of our loan portfolio.

- Total loan volumes grew by about 10% during the 12-month period and were flat quarter on quarter. However, if we break this down by segment, we can see wholesale has grown at a slower pace where we recorded a 4% Year-on-Year growth and decreased by 2.3% during the quarter as a consequence of both a slowdown in the industry and our decision to balance growth and return in light with the risk we assume when approving loans.

- On the other hand, our retail book has continued to grow at double-digit rates of 15% year-over-year and 2.5% quarter-on-quarter, in line with our strategic focus.

- Mortgage loans have posted once again the highest growth of 19% year-over-year and 2.4% quarter-on-quarter, reaching a market share of 17.1% while commercial loans to SMEs also grew strongly at 14% year-over-year and 2.7% quarter-on-quarter.

In terms of our consumer book, this product grew at 11% year-over-year and 2.2% quarter-over-quarter. This lower growth is due to our more prudent approach regarding our lower income consumer division which was put in place in the second semester of last year. Excluding this area, Consumer loans to middle and upper income individuals grew 14% year-over-year and 3.3% quarter-on-quarter.

Before I move forward, I would like to highlight a few of our successful initiatives that we have implemented in order to continue increasing our penetration in the retail segment. First, we have been diligently improving our loyalty programs in order to increase the usage rates in our debit and credit cards. These improvements have generated a growth of 21% year-over-year in revolving credit on cards. Secondly, we have continued increasing our presence in residential mortgage loans, ranking us first in terms of volume growth year-over-year and raising our market share in 109 basis point increase based on comprehensive plans to attract customers, as well as our competitive rates. Finally, we have continued our strategy to increase our penetration in the SME segment by means of a relationship-based service model and tailor-made financial services that have prospered especially in regions outside of Santiago, and have helped to gain an important increase in market share.

In relation to asset quality, as shown in the next slide, **number nine**, LLPs have reached CLP 40 billion in 3Q12, dropping by CLP 10 billion quarter-on-quarter and CLP 5 billion when compared to the same period last year.

- The main drivers for this decrease were:
    1. First, improvements in our wholesale book which were influenced by an important release of provisions related to one specific customer of approximately CLP 8 billion and on the year-on-year figure, the positive effect of the appreciation of the Chilean Peso on provisions for loans denominated in foreign currencies.
    2. Second, greater provisions from our individual book of CLP 15 billion year-on-year and CLP 6 billion quarter-on-quarter which were associated to:
        - Volume growth in consumer loans of 14% with a focus on credit card which have a higher provision rate but have a larger spread
        - A more risky environment that has been present following the La Polar event
        - As well as a one off related to the "Bicentennial Write Off" that eliminated all negative information for debts below approximately US$5,000 from historical records

- These factors have been offset by a proactive management of our loan book where we have slowed growth especially in the lower consumer finance division and implemented important initiatives to enhance the collection process including a rise in headcount of specialized personnel and changes to our collection strategies.

- As you can see on the chart on the left, through these initiatives we have been able to successfully lower our Individual NPLs to loans ratio from a peak of above 1.34% to 1.07%, significantly below the average and our peers.

Moving on to slide **number ten**, we can see that our operating expenses remain under control, recording a 5% increase over last year and just 2% above last quarter. Higher personnel and administrative expenses explain the year-on-year rise. Personnel expenses increased in line with:

- First, the 12 month accumulated inflation, since wages are indexed to the CPI rate,
- Second, salary increases related to the collective bargaining process carried out in 2011, and
- Third, a moderate increase of headcount in our commercial, call center and collection areas to cover our growing commercial activity.

In terms of Administrative expenses, this rise was mainly prompted by an increase in marketing campaigns in order to maintain our leadership position in brand recognition and to a lesser extent outsourced workforce expenses related to credit-assessment and sales personnel.

Through our strict expense management we have maintained our efficiency ratios under control. For example, when we look at our accumulated cost to income ratio, as seen on the chart on the left, this indicator was flat year-over-year, when considering the collective bargaining agreement held last year, at 48.7%. This figure compared very favorably with the average in the industry which was more than 400 basis points higher than our ratio. On a quarterly basis, this cost to income rose in the 3Q due to lower operating revenues, mainly explained by the lower than average inflation for the period. Management maintains a commitment to continue to gradually improve our efficiency ratios.

On the following slide, **number eleven,** is a closer look at our funding and capital ratios.

I think the most important highlight of this quarter is the fact that we have continued diversifying and extending durations in our funding base. In the 3Q we issued bonds in Hong Kong for USD 50 million and subsequently in October we were the first Bank to issue bonds in Peru for a total of USD 28 million. These new issuances are part of our strategy to diversify and to increase our visibility abroad. We also issued local bonds for UF 212 million. All of these issuances have allowed us to increase the duration of our funding book. Similar to our prior bond placements, both of these foreign issuances were placed in local currencies and swapped back to Chilean currency.

On the deposit side, we recorded a solid rise of 9% year–over-year, equal to an increase of 24 basis points in market share, thus maintaining our leadership position with a participation of 23%. This leadership position in financing from demand deposits together with our excellent credit rating of A+, the highest in the LATAM financial industry, and our very large retail customer base have allowed us to continuously post the lowest average cost of funding amongst private banks of only 3.5% as you can see in the bottom left side of the slide. When compared to our peers and the banking system, we maintain an advantage of around 50 basis points in cost of funding.

Regarding our capital base, our capital ratios remain above our regulatory limit of 10% for Basel Index, but as a result of our successful growth strategy they have decreased to a level similar of that we had prior to our last equity offering.

Lastly, on the following slide, **number twelve,** I would highlight how we have capitalized on our equity offering which occurred almost two years ago. During this time we have become the largest bank in terms net income in Chile and we have become the private bank with the best credit rating in Latin America. In addition, we have also quickly recovered our profitability multiples in terms of return on capital with respect to the banking system and our main competitors.

By September, we have generated more than 1.9 times the average return of the system and the 1.4 times the profitability of our peers. In fact this performance even exceeds multiples produced prior to the 2011 capital increase.

Now to finish off, I would like to pass the call over to Pedro Samhan, Chief Financial Officer of Banco de Chile.

Thank you Pablo. Please move to slide number 13.

To begin, I would like to emphasize that our plans in the mid-term are as ambitious as they were in 2011 when we raised capital. Since that time, we have **Grown Larger** than expected, positioning Banco de Chile as the **Leading Financial Institution** in many of our business lines and becoming the **Market Leader in terms of Profitability**.

The recent equity-raising announcement of CLP 250 billion should be priced and initiated around the end of November. This is aimed to support future growth while maintaining capital adequacy ratios. The decision to raise equity is based on:

1) First, we expect that the Chilean economy and financial system in coming years will continue to grow strongly. We project an average growth rate of around 5% for GDP per year for the next three years and consequently we estimate an annual average real growth rate of about 10% per year for total loans of the system. Our goal is to grow above this, while maintaining a clear focus on expanding the retail business.

2) Second, these goals require an appropriate balance between growth and capital adequacy. If our growth reaches the previously mentioned rate and if we hypothetically capitalize 30% of the distributable income of each financial year, by 2015 our Total Capital Ratio will reach near 10%, the minimum required by the local regulator. This new raising will allow us to maintain higher ratios that will continue to support our risk rating classification, thus allowing us to continue to benefit from low cost of funding in local and international markets.

3) Lastly, the Capital Increase should aid in improving the daily trading volumes of Banco de Chile, especially due to the intention of LQIF to not subscribe their shares in secondary rights offering held indirectly through SM Chile. A higher liquidity in our stock is important as it attracts more investors and can affect positively the valuation of our share.

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

<u>Closing Remarks – Pedro Samhan:</u>

Thank you all for joining us in our third quarter 2012 conference call. To close, I would like to highlight our excellent performance during the first nine months of 2012. During this period we have continued consolidating our market position, generating almost 30% of the total net income produced by the banking industry and we have obtained profitability multiples in relation to the banking system which are significantly higher than that obtained prior to the last equity offering. This outstanding performance is clearly a result of our solid business strategy together with our superb execution and our experienced team that has been able to continue creating value for our shareholders. We are confident that we have the tools and competitive advantages to continue doing this.

Thank you again and we look forward to sharing with you our year-end results.