Comments on the 4Q11 and Year-End Financial Results

Banco de Chile

Good afternoon. It's a pleasure for me to share with you our comments on Banco de Chile's fourth quarter and Year-End 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, please move forward **to slide number 2**. In today's presentation, we will begin with a discussion of the Chilean Economy followed by a brief review of the results in the Chilean Banking Industry. After discussing these topics we will go over the results for the period and the year-end.

As for the economic environment, as you can see in **slide 3**, the Chilean economy continued decelerating during the fourth quarter of 2011, mainly as a result of the lower dynamism in private consumption and a deteriorated scenario in Europe and USA.
In this context, there are still some sectors – basically those associated with domestic demand, such as commerce, services and construction – that continue steering the economic activity, but with a lower dynamism. On the other hand, exporting sectors - such as industry and mining - have evolved below market expectations in 2011, which is principally a consequence of the lower external demand and accumulation of inventories in case of the industry sector.

Also, as shown by the chart in the lower left hand side, despite the slowdown observed in our economy during 2011, unemployment remained stable and at low levels, reaching 6.6% in 4Q11 and a yearly average of 7.1%. Thus, unemployment was the main driver to support private consumption throughout the year.

The higher consumption and also the higher food and transportation prices had an impact on inflation. As you can see on the upper right hand chart, CPI increased above market expectation in the 4Q11, posting a 4.4% YoY variation, which surpassed the

Central Bank's long-term goal range. As a consequence, the Central Bank maintained the interest rate at 5.25% until December 2011, despite a deteriorated global scenario. However and in line with market expectations, the Central Bank decided to decrease the monetary policy rate by 25 bp January 2012, as a result of the moderate slowdown observed in the local economy

Moving forward to **slide 4**, we can notice that the Chilean economy counts on many strengths to face a potential world downturn. In fact, despite the risk that the global recession has lessened, our country maintains low sovereign risk, which can be compared to developed countries, as measured by the CDS. This is the result of an economy that counts on a recognized economic stability and a tempered level of public debt, as shown by the chart on the upper right hand side. These strengths could permit us to develop counter-cyclical policies, but avoiding a deterioration of public finance. In addition, the market also expects that – as a result of still high interest rates – the monetary policy has great room to intervene and promote a higher consumption by easing liquidity.

In addition, as shown on the chart at the lower right hand side, the country maintains significant financial cushion. Actually the Public Treasury holds international reserves of US$ 24 billion that represent 10% of 2011 GDP (estimated). Similarly, the Chilean Central Bank holds reserves of US$ 42 billion that amount for an 18% of GDP. Finally, as an additional strength of our economy we can mention the well-diversified export basket with several business partners, mostly associated with emerging markets.

Going forward to **slide 5**, we can observe that 2011 was an important year for the Chilean banking industry. As you can see, the banking sector posted a $98 billion rise in net income during the 4Q11 as compared to the 4Q10, mainly as a result of a significant amount of additional provisions recognized in the 4Q10 in order to reflect the effect of a new regulation for provisioning individually evaluated loans portfolios and also as a financial reserve to anticipate systemic risks.
As of December 31, 2011 the Chilean banking system reached a net income of $1.7 trillion, which is 8.1% above last year's figure. Despite this important advance, the system's profitability– posted a slight YoY decrease, attaining a ROAC of 19.6% for 2011. This is the result of capital increase processes carried out by some of the main

banks, as well as a higher level of retained earnings, all in order to face the growth in lending activity.
The YoY net income increase was supported by greater operating revenues that result from the outstanding increment in total loans, a higher inflation and a 6% rise in fees and commissions. These factors were partly offset by greater provisions for loan losses and higher operating expenses, in line with a higher lending activity. As for total loans, as shown by the chart at the right hand side, the industry posted a 17% YoY growth steered by commercial, consumer and mortgage loans with doubled-digit advances of 19%, 18% and 12%, respectively.

To conclude, I would like to give you our main thoughts about the Chilean economic outlook. Due the current uncertainty regarding the global economy, we estimate that Chilean GDP will grow at a rate around 4.0% in 2012, which is below the 2011 expansion and in line with the trend observed during the second semester of 2011. Accordingly, we also expect slightly higher unemployment rates for 2012, which should reduce the aggregate demand expansion, while inflation should gradually return to the Central Bank's target range.

As a result of this lower inflation scenario and the slowdown in the economic activity, we cannot rule out an expansionary monetary policy by the Central Bank in order to enhance economy's dynamism, but maintaining inflation within the target values. According to with this macroeconomic scenario - and after the great dynamism posted in 2011 - the system's loan portfolio growth should experience a moderate pace during 2012, reaching a level below 10% in real terms.

On slide**, number 6,** begins the discussion of our consolidated results.

- We posted a 13% year-on-year rise in net income, reaching Ch$429 billion pesos, in terms of EBIT, this translates to a 17% year-on-year growth. Also worth mentioning, is that we posted the highest return-on-average-equity of 24% for the year and significantly closed the net income gap in absolute terms with Santander, as demonstrated on the chart on the upper right side of this slide. Our net income for the year is even more impressive if we consider that during the period we recorded $28 billion in additional salaries expenses related to a collective bargaining agreement with our unions and also established $24 billion in countercyclical provisions.

- On a quarterly basis and as mentioned in previous earnings calls, we have managed to post on average earnings above Ch$100 billion pesos. In spite of the additional countercyclical provision charges recorded during the fourth quarter, we posted Ch$100 billion pesos with a return on average equity of 20%, as demonstrated on the chart on the lower right side of this slide.

On the following slide, **number 7,** there is a closer look at our operating revenues.

- On a year-on-year basis, Total Operating Income increased by 5% over last year. This figure is enhanced to 9% if we exclude the impact of the local accounting rules related to the method how sales of non-performing loans are recorded in our books. Under Chilean GAAP, the value of the loan excludes its related provision in the value recorded as financial income. Hence, we recorded a sale of a corporate non-performing loan in the fourth quarter which decreased net financial operating and FX income by about Ch$42 billion. However, it is important to mention that this loss was more than offset by the release of related allowances by an amount of Ch$45 billion.

The 9% adjusted growth posted in operating income was significantly influenced by our core business activities; specifically the higher revenues generated from our leadership in non-interest bearing deposits, the important expansion of our loan portfolio and our fee based business such as insurance brokerage as well as income generated from the higher usage rates of products such as credit cards and debit cards.

- On a quarterly and adjusted basis, as seen on the chart on the right, we maintained our high revenue generation, growing about 9% over the same period last year. The main drivers for the increase over the 4Q10 were:
  - Higher interest rates that positively affected revenue generation from non-interest bearing deposits.
  - The significant YoY growth in total loans
  - The higher inflation in the 4Q11 with respect to the 4Q10 that led the UF to rise to 1.3% versus 0.5%, generating additional revenues in our net position in UF Assets.

- This was partially offset by:
  - A reduction in fees, associated with lower activity in mutual funds, securities brokerage and financial advisory services, in light of the current global economic conditions.

In terms of loans, this continues to be one of the key drivers for revenue generation. This year, as demonstrated on slide, **number 8,** was another outstanding year in terms of growth. We reached Ch$17 Trillion in loans, a rise of 21% over last year. This was achieved through effective commercial initiatives, such as strategic alliances, new products and the joint efforts of certain commercial divisions. As a result, we gained 59bp in market share, reaching a stake of 19.8% that enabled us to become the largest bank in Chile in terms of loans. In monetary terms, we grew by 3 trillion pesos, 60% higher than our closest competitor, as demonstrated on the chart on the bottom right.

Loans grew firmly in both our retail and our wholesale segments, as shown on the next slide, **number 9.** Loans to individuals and SMEs grew by 21% year-on-year and 5% quarter-on-quarter. It’s important to mention that our efforts in improving our penetration in the SME segment have taken place, growing 20% from 1.8 trillion pesos to 2.1 trillion pesos. It’s also noteworthy to mention our very strong growth in mortgage loans which grew 23% and captured almost 150 basis points in market share, ending the year with a market share of 16.4%. This was achieved through a clear commitment to attract new customers through marketing, competitive pricing, and improved synergies between segments. Consumer loans also grew strongly, capturing 22 basis points over the year and ended the period with a stake of 22.3%.

In terms of our wholesale division, these loans also grew at 21%, in line with the positive economic condition in Chile which resulted in an important financing demand from large companies and corporations.

On the next slide, **number 10**, begins our discussion of credit quality, a clear competitive advantage of Banco de Chile. Total provisions for loan losses reached Ch$125 billion in 2011; 40% below the figure recorded in 2010. This resulted in a loan loss provision to average loan ratio of 0.8% and was influenced by:

- The sale of a non-performing corporate loan portfolio that resulted in the release of allowances for loan losses of Ch$45 billion, as previously mentioned, and
- Countercyclical provisions established that totalled Ch$24 billion, in line with our prudent risk approach

Both events were established in the fourth quarter of 2011, reducing the fourth quarter charge.

As a result, loan loss provisions as a percentage of average loans would have reached 0.9% at year-end, significantly lower than 2010 which reached 1.2% when adjusted for countercyclical and other additional provisions (1.5% unadjusted). As one can see on the chart on the right, loan loss provisions - even when adjusted for these events - remained significantly below the average in the banking industry and our main peer group.

In terms of credit quality, we continue to maintain the highest quality loan portfolio in the industry with a total past-due to loans ratio of 1%, significantly lower than our peers or the banking system and the highest coverage ratio equal to 2.1 times.

Moving on to slide **number 11**, we can observe that operating expenses grew by 13% over last year.

- This increase is mainly the result of our business initiatives related to implement our strategic plans which included the expansion of our distribution network by opening 25 new branches across Chile, our marketing efforts to improve our brand positioning, the implementation of new service models in regions to improve customer satisfaction levels, investments in new technologies such as Murex, a front and back-office system for our treasury area; a development of a new website for online banking; a mobile banking application for cellular phones; and a new data center, just to name a few.

- All these factors led us to increase ***Administrative expenses*** by 9% over last year and our ***core personal expenses*** which grew in line with inflation and our higher business activity.

- As we mentioned in previous calls, we recorded an expense of Ch$28 billion pesos in a special bonus to employees related to the collective bargaining agreements with unions that took place during mid 2011.

As a result, we recorded an efficiency ratio of 50.2%, higher than the 46.6% obtained last year. However, when Operating expenses are adjusted for the collective bargaining bonus and Operating Income is adjusted for the loss related to the sale of a corporate loan portfolio, our efficiency ratio drops to 46.3%, slightly below the figure posted last year; demonstrating our commitment to cost control.

On a segment viewpoint, our core business segments are responsible for our EBIT revenue generation, as shown on the following slide, **number 12.**

EBIT for our **Retail Segment** grew year-over-year by 43%, reaching $260 billion at year end. This YoY rise is mainly the result of greater operating revenues and was also due to lower provisions for loan losses.

In terms of our **subsidiaries**, this segment continued to generate relatively stable revenues for the bank, decreasing slightly by 5% from last year mainly as a result of the higher volatility – in local and global financial markets – that reduced assets under management and equity trading volumes.

In terms of our **wholesale segment**, similar to our retail segment continued growing strong, as demonstrated on the chart on the lower left side of the slide**.** EBIT year-over-year grew by 38%, reaching almost $150 billion at year end. This rise is also mainly due to the result of greater operating revenues and lower provisions for loan losses.

Lastly, in terms of our **treasury segment**, this area decreased significantly its EBIT by 69%. This is explained by the sharp increase in spreads of foreign currency instruments during the second half of 2011 that was mainly caused by the global economy's slowdown, the rise in interest rates which had a negative impact on the sale of fixed-income securities and the decrease of the spread between local and foreign interest rates that has constrained the possibility of arbitrages between local and foreign currency funding.

Nevertheless, we have been very active in terms of liabilities management as you can see on the following slide, **number 13.**

At the beginning of the year, we carried out an equity offering for US$445 million, successfully obtained a syndicated loan of US$200 million with 15 Asian financial institutions - in line with our strategy to strengthen our relationships with this region – and placed approximately US$1.4 billion in AAA senior bonds in the local market. Lastly in December 2011 we registered bonds in Mexico for approximately US$720 million dollars and placed US$110 million dollars in that market with a AAA local rating just prior to the year end.

As for the non-interest bearing liabilities, we continue to be the market leader in current accounts and demand deposits with a 23% market share and as shown on the chart on the bottom right hand corner, we continue to be the bank with the highest proportion of funding from these deposits, which in turn reduces our financing costs.

Now I would like to hand the call over to our CFO, Pedro Samhan,

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Pedro Samhan:

Thank you Pablo. Please move to the next slide, **number 14.**

2011 was an excellent year for Banco de Chile. We grew our loan portfolio by approximately US$6 billion dollars - equivalent to the size of a small bank - placing us for the first time as the largest bank in Chile with a market share of 19.8%. This was a great achievement for Banco de Chile. We made $100 billion in net income in the fourth quarter in spite of the $22 million countercyclical provision and a record figure of $429 billion for 2011 net income. We also posted a return on assets of just over 2% and a return on capital of 28% which was the highest figure in the industry. We achieved this figure in spite of our successful US$445 million capital increase. These figures were clearly attributable to our dominant market position which we continued to strengthen throughout the year. In addition, we opened 25 new branches across the country, we further diversified our funding structure by building relationships in foreign markets and we continued to grow our 1.6 million customer base by adding 14 thousand new SME loans, 100 thousand new credit card customers and incorporating 90 thousand new current accounts. Overall, we are very proud of our performance in 2011 and believe that we have a solid basis to take further advantage of future business opportunities.

If there are any questions we would be pleased to answer them.

Thank you and we look forward to discussing our First Quarter 2012 Results.