Banco de Chile 4Q16 and Full Year 2016
Financial Results Conference Call

[Operator]

Good morning everyone, and welcome to Banco de Chile's Fourth Quarter 2016 results conference call. If you need a copy of the press release issued on Tuesday, 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 morning everyone and thanks for joining us today on our conference call for the 4Q and the full year results. To begin I'll present our main achievements for the year, followed by brief comments regarding the macro environment in Chile. Finally, Pablo Mejia, our Head of Investor Relations, will discuss our full year and fourth quarter financial results.

Please turn to slide number 3.

I'd like to start this conference call by highlighting that, once again, Banco de Chile led the Chilean Banking industry in both net income generation and profitability. Considering the weak economic growth, lower inflation rates and several organizational changes made in our management structure, achieving these results is truly outstanding. Additionally, our consistent long-term strategy, the strong commitment of our team and the existence of robust structural advantages have allowed us to remain as the most important bank in Chile.

Specifically, we posted a net income of $552 billion pesos, representing 28% of the total net income generated by the Chilean Banking system. Consequently, the bank recorded a very attractive ROAE of 20%, maintaining an important difference with the average level posted by the industry, which was 11%. As you can see on the slide, these results were explained by a positive increase of 5.4% in Operating Revenues, healthy asset quality indicators, a stable efficiency ratio of 45.4% ranks us first amongst our peers together with focused loan growth in the retail segment.

In 2016, there were important changes in the management structure of the bank, where the most relevant was the appointment of the new CEO, Mr. Eduardo Ebensperger. These and other changes in the bank and subsidiaries had the objective of strengthening our competitive advantages and, as a result, maintaining our leadership position in the local industry. In line with these changes, we defined three strategic pillars in our long-term strategy:

- First, we put the customer at the center of all our decisions with a strong emphasis in service quality and customer experience.
- Our second pillar has the purpose of reaching our maximum level of efficiency and productivity.
- The third pillar aims to strengthen the relationship with society through initiatives based on long-term sustainability.

With this approach, we have been able to reach important achievements throughout the year.

2016 was successful year in terms of building stronger relationships with customers. We reached an impressive net promoter score of 72%, which is the highest level amongst our peers and a record year-end level for us. Additionally, 88,000 new clients joined Banco de Chile, which is 21% more than we registered in 2015. Also, we posted a low attrition rate of 6.1%, 36 basis points better than 2015, which demonstrates our first rate service quality. Finally, I'd like to highlight the alliance we made with IBERIA airline, meaning that today our customers can access more benefits by using their credit cards. This alliance followed the loyalty programs that were signed with Delta and Sky airline last year.

In terms of Innovation, we developed important projects over the year and obtained important recognitions, including the Best Mobile & Digital Bank by Global Finance, for second year in a row, The Best Mobile Banking application by World Finance Magazine. This confirms our leadership in this area and reflects our conviction that being a first class digital Bank plays a critical role in our strategy. In this context, is worth mentioning that we launched two new mobile applications: Mi plata and Mi pass, in 2016, reaching an impressive 1 million downloads and 20 million transactions. We also launched our new personal banking web page, which has better security standards and is easier to navigate. Other relevant initiatives include the pursuit of higher productivity through optimization of our Credichile branch network, the paperless project and the development new business intelligence tools.

Regarding our corporate reputation pillar, we were ranked first among Banks and Financial Institutions in the Attracting and Retaining Talented Employees Ranking, which is conducted by Merco. We were also distinguished as the bank with the Best Corporate Reputation, according to Reptrack Chile. Our Brand, which is one of our main competitive advantages, was also recognized as the Most Valuable in Chile by The Banker. Finally, we actively collaborated with Teleton, a non-profit organization that has various rehabilitation centers across the country. In 2016, more than 10,000 employees of our bank actively participated in this event.

Now, I´d like to invite you to discuss the macroeconomic environment in Chile. Please turn to slide number 5.

In general, the macroeconomic scenario has followed the same trend observed in previous years: a below trend economic growth, led by sluggish private investment and pessimistic confidence indicators. In this context, the economy posted a 1.6% expansion in the third quarter, while it will likely be around 0.5% in the fourth quarter. Consequently, the economy is expected to post a 1.5% expansion in 2016, the lowest figure since the recession in 2009. However, it´s important to highlight the existence of two opposite forces in the Chilean economy.

Most of the Chilean slowdown is due to the persistent contraction in the mining sector, as seen on the upper left chart. According to the monthly economic activity breakdown, also known as Imacec, mining activity fell by -2.8% in the quarter ended in November and also -2.8% year to date. It is also important to mention that copper activity has remained in negative territory since 2015, as a consequence of the end of the mining cycle. However, non-mining activity has been offsetting the weak copper production.

On the positive side, labor market figures have been a positive surprise in the economy thanks to its impressive resilience to the negative GDP cycle. In December, the unemployment rate was down to 6.1%, the lowest number since February of this year, as seen on the bottom left chart. Therefore, the unemployment rate reached an average of 6.4% in 2016, much below the numbers observed in other cycles with below trend growth. Consistent with this robust labor market, numbers from private consumption have continuously been surprising, growing persistently above the rest of the economy, as seen in the bottom right chart. Particularly, retail sales were up by 4.7% in 4Q16, accumulating a 4.0% growth last year. Also, consumption is offsetting the sluggish investment, supporting the positive growth of the GDP.

One of the main adjustments in the Chilean economy has been the downward trend in inflation. As you can see in the upper right chart, both headline and core inflation have fallen significantly, from nearly 5.0% at the beginning of 2016 to less than 3.0% in December. In other words, inflation is lower than the Chilean Central Bank target. The breakdown suggests that the greater part of this variation is due to lower tradable inflation, as a consequence of the recent appreciation of the Chilean peso.

Next, I'd like to share with you our baseline scenario for 2017. Please turn to slide number 6.

Our economic expectations for 2017 are based on a constructive view of the global economy, in line with the latest IMF forecasts and most of the analyst surveys. As seen on the upper left chart, we expect a recovery in the global economy with a higher dynamism especially in Latin America, which is important for Chile. The positive impact is even more important when we take into account the possibility of a weaker currency.

In this context, we expect a slight increase in the economic growth for 2017, increasing to 1.8% from 1.5% this year. Basically, this improvement would be explained by the higher contribution of net exports due to the mix between higher external growth and the weaker local currency, offsetting the negative impact of the less expansionary fiscal policy that has already been announced for 2017. We also expect a convergence to the potential GDP growth rate of nearly 3.0% begin 2018.

On inflation, we expect the CPI to be slightly below the target of 3.0% at the end of this year, although during the first half it will be hovering around 2.0%, as a consequence of comparison base effects. This expected relative stability of annual inflation is a consequence of two opposing forces: a positive contribution for the weaker currency and a negative effect from the below trend economic growth.

In this scenario, the Chilean Central Bank reduced the interest rate from 3.5% to 3.25%. This decision was broadly expected by the market. We expect more rate cuts, as you can see on the bottom right chart.

Now I would like to pass the call to Pablo, who will go over the results in the Banking Industry and Banco de Chile.

[Pablo Mejía]

Thanks Rodrigo. Please turn to slide, number 8.

Net income for the banking industry, adjusted for the effect of a merger of two banks, amounted to $1.9 trillion pesos in 2016, 11% lower than that obtained in 2015, while ROAE during the same period reached 11%, well under the 15% recorded in 2015. This lower level of profitability was due to a variety of factors:

1) Slow growth in operating income of 3% due principally to lower financial income and combined with the weak economic dynamism that limited loan growth reduced sharply inflation and high competition squeezed NIMs. This was partially offset by positive fee revenues that are mainly associated with mutual funds, insurance and credit cards.

2) Higher loan loss provisions of 6% mainly due to the increase in volumes and to additional provisions. As a result, the LLP ratio went from 1.24% in 2015 to 1.19% in 2016. In addition, the delinquency levels remain flat year–on-year at 1.9%.

3) Operating expenses also increased in 2016 by 10.7%, deteriorating efficiency from a ratio of 51.1% in 2015 to 54.9%. The increase in expenses reflects, in part, the

effect of inflation on wages, real salary increases, severance indemnities, as well as significant investments in IT, innovation and security deployed by banks.

In terms of volumes and in line with the slowdown in the economy, total industry loan growth recorded a modest 2.4% real expansion during 2016.

Despite the constant deceleration, housing loans recorded the highest level of growth, with a 6.6% real increase in 2016. This deceleration, which will probably continue and stabilize around 5% in the medium term, is due to the end of the tax benefit for real estate construction companies, which generated an above trend demand for new homes and consequently mortgage loans during the prior years.

Nevertheless, consumer loans stood out positively during the year, registering a real 5.6% expansion, exceeding the industry projections and the level reached in 2015. This performance was surprising when taking into consideration the macro economic scenario, but understandable based on the resilience of the labor market.

Finally, in line with the low investment rates in Chile that limited the financing needs of companies, commercial loans of the banking system registered a small real decrease of 0.2% in 2016. In addition, the depreciation of the peso during 2016 affected the comparison base of US$ denominated loans.

Please turn to the next slide, number 10, to begin the discussion of the BCH Financial results.

Despite the current domestic and international economic environment, our full year 2016 net income reached $552 billion pesos with an ROAE of 20%.

Although net income for year is marginally lower than the figure posted in 2015, if we compare income before tax, this figure actually increases 3% year-on-year. This is due to the fact that the corporate tax rate increased from 22.5% in 2015 to 24.5% in 2016.

On a quarterly basis, we obtained a Net Income of $124 billion pesos, 11% lower than the same quarter last year, mainly due to lower inflation and higher provisions coming from the personal banking segments. In fact, the 4Q16 was the period with the lowest level of inflation since the 1Q15.

Please turn to the next slide, number 11, on Operating Revenues.

Even though we faced an environment characterized by a significant deceleration in loan growth and an important reduction in inflation, we were able to continue growing operating income by 5.4% year-on-year and 1.4% quarter-on-quarter. This was achieved through effective commercial strategies that continued to drive Customer Income growth, as you can see on the chart on the right, by 5.9% year-on-year. This was due to a variety of factors including a rise in consumer and SME loans, an important improvement in lending spreads and respectable growth in fees that were concentrated in transactional services, insurance brokerage and mutual funds.

Before moving on, I want to highlight the increase in spreads. Since 3Q15 our focus at Banco de Chile has been centered on growing loans with a good risk/return relationship. The objective of recovering spreads, which we have commented in past calls, was effectively achieved despite high competition and an overall slowdown in the economy. Lending spreads reached 3.01% in the 4Q16, which is 17 basis points above the same quarter last year and 2.94% for the full year, in line with the level posted last year.

As you will see on the next slide, number 12, loan growth was concentrated in the retail segment, which is more profitable and grows at more attractive rates than the wholesale segment.

Specifically, total loans grew 3.4% year-on-year and 1.5% when compared to the 3Q16. We ended the year with an overall market share of 18%, 33 basis points below the level recorded in 2015. As mentioned this was mainly due to strong competition, especially in the wholesale segment, which saw spreads drop below a level we were willing to lend at in order to maintain a fair balance between risk and return. Thus, commercial loans only grew 0.5% year-on-year while Mortgage and Consumer loans grew faster at 8.0% and 6.4%, respectively.

If we break loans down by segment, as you can see on the chart on the right, retail loans were far more dynamic than the wholesale segment. SME Loans grew 10.1% year-on-year and personal retail banking loans grew 8.3% year-on-year. On the other hand, wholesale loans during this same period decreased 3.2%. As Rodrigo mentioned earlier, our initiatives in the retail segment have been focused on improving customer experience through all of our contact channels as well as our benefits. In this line we reinforced our mobile apps, successfully and smoothly launched a new website for personal banking, entered into new agreements with airlines, amongst other initiatives. We are also currently in the process of implementing a new and improved commercial platform, launching a new corporate website and continuing to roll out our paperless system that should reduce costs but also help to improve response times.

Regarding liabilities, we were very active in the second half of 2016 in placing bonds abroad for approximately US$370 million Dollars. These bonds were placed in Switzerland and Japan at attractive spreads over the benchmark and were primarily intended to increase the maturity of our liabilities.

Locally, we issued approximately US$950 million in UF-denominated senior and subordinated bonds with tenors ranging from five to twelve years. Subordinated bond placements together with the change in the dividend policy, additional provisions and the modification on credit conversion factors arranged by the regulators allowed us to close the year with a very strong Basel ratio of 13.9%, well above the level posted in 2015.

In addition to long-term funding, we continued to prioritize core deposits rather than less stable sources of funding. Along with this, we reinforced our time deposit platforms to attract more deposits at a reasonable cost, especially within the retail banking segment. All of these characteristics significantly contribute to maintain a very competitive cost in local currency of funds of 3.1% versus the industry of 3.8%.

Please turn to the next slide, number 13, on Loan Loss Provisions.

We continued posting good levels of risk in 2016 thanks to our focused and prudent risk management approach, as demonstrated by our loan loss provisions ratio that went from 1.32% in 2015 to 1.25% in 2016.

On the chart to the right is a breakdown of LLP for the year. The level of provisions increased only by 2% year-on-year compared to the 3.4% expansion posted by our loan portfolio, which was concentrated in the retail book.

The main positive changes were:

- A net positive effect of Ch$28 billion due to exchange rate shifts benefiting our US$-denominated allowances for loan losses but with offsetting effect in financial revenues.
- Regulatory changes that lowered allowances on contingent wholesale loans amounting to Ch$5 billion pesos.

The main negative changes were:

- Negative charge of $19 billion mainly related to growth and a deterioration in retail loans in line with the weak economy.

- Additional allowances by an incremental amount of $21 billion pesos. It is important to note that these allowances do not relate to any specific customer or industry sector, but instead to an overall outlook on the evolution of the economy.

Consistent with our trends, we have remained as the bank with the highest coverage ratio of 2 times or 2.8 times when we take into consideration additional allowances.

Finally, we are confident that our unique credit risk management approach, which is deeply present throughout the entire credit process, should continue to allow us to control risk well throughout the economic cycles we face.

Please turn to the next slide, number 14, on Operating Expenses.

As you can see on the chart on the left, operating expenses increased 8.5% year-on-year. As mentioned in our previous calls, the double digit growth that we experienced at the beginning of the year was more related to non-recurring events that were expected to trend down throughout the year, which is exactly what occurred.

As you can see on the chart on the right, the annual expense growth was principally associated to:

i. Severance indemnities in light of organizational restructuring carried out this year, equal to an increase of 80% year-on-year;
ii. A non-recurrent bonus provided to employees of three of our subsidiaries as a result of the completion of a collective bargaining agreement.
iii. IT expenses related to internal developments and software licenses which grew 10% year-on-year.
iv. Greater provisions and write-offs of assets in lieu of payment of 110% associated mainly with two specific lending transactions.

v. The optimization of our Credichile branch network that led us to anticipate rental agreements to unwind contracts. We are in the process of closing 19 of these branches that are dedicated to the lower income segment, which should become effective the first quarter of 2017.

vi. A rise in depreciation expenses as a result of the replacement of ATMs and new IT infrastructure.

In terms of efficiency, our ratio increased slightly from 44.1% to 45.4%, and ranks us first amongst our peers. We are confident that our permanent focus on cost control and new projects that are aimed at improving customer experience and optimizing internal processes should bear fruit in the coming years, which will consequently maintain expense growth lower than our customer income and improve our efficiency levels in the medium term.

Please turn to the next slide, number 15.

As you can see, we have had an attractive and consistent level of profitability over the last years. Despite the challenging scenario, we were able to generate levels that are substantially higher than our peers in both ROAE and ROAA. Currently, both ROAE and ROAA have reached 1.7x and 1.8x times of the industry.

In the long-term, our intention is to maintain a ROAE of around 20% because of the following factors:

- First, we have been changing our loan mix to focus more on the retail segment and there's still opportunities available to continue improving and penetrating this sector.
- Second, we continue implementing new business intelligence tools that should help to generate new and attractive opportunities that anticipate the needs of our customers, improve risk and return and increase our customer base; and

- Third, there is still room to continue improving our productivity, by redesigning our sales and post sales services and becoming more digital, amongst other initiatives, which should translate into sustainable improvements in our efficiency ratio.

Q&A Session

Closing Remarks

Thank you for your questions. Before ending this call, I would like to highlight our five main competitive advantages, as shown page 18, that distinguish us from our peers and allow us to create value for our customers and shareholders in unique way:

- First, our reputation, strong brand recognition and great customer service attracts customers more easily than our peers. Additionally our low levels of attrition rates keep customers at Banco de Chile more than any other bank in Chile.

- Second, our scale allows us to offer a wide variety of products and services to our customers together with one of the largest distribution networks in the country.

- Third, an important competitive advantage when compared to our peers is our prudent risk management, which has allowed us to be able to grow profitably in all customer segments that we serve with outstanding loan loss provisions and low levels of NPL's compared to our peers.

- Fourth, we have the best funding structure in the industry thanks to our market share in demand deposits, which is the largest in the industry. This advantage has provided us with a strong position in cost of funds because of our prestigious history, excellent customer base and our consistent strategy.

- Fifth, we are the private banking institution with the strongest risk rating in Latin America because of our prudent risk management policies and track record in results and profitability.

In summary, our competitive advantages have allowed us to outperform our peers with an attractive ROAE of almost 20% in 2016, positioning us as the most profitable bank in Chile. Our goal is to keep this leadership and continue growing while providing our shareholders with sustainable and attractive returns in the long term.

Thank you for listening and participating in our call; we look forward to sharing our next quarter's results with you.