Banco de Chile: Comments on the Fourth Quarter 2015 Financial Results

(VICTORIA GUBBINS – INTRODUCTION)

Good morning, it's a pleasure for me to share with you our comments on Banco de Chile's fourth quarter and full year 2015 financial results. Today with us we have Arturo Tagle, Chief Executive Officer; Rolando Arias, Chief Financial Officer; Rodrigo Aravena, Chief Economist and Senior VP of Institutional Relations; Pablo Mejia, Head of Investor Relations; and Daniel Galarce, Head of Research.

We will begin with an introduction and comments from our CEO, followed by a brief overview of the 2015 economic environment and financial system results and then continue with an analysis of Banco de Chile´s 4Q and full year 2015 results.

I will now turn the call over to our CEO, Arturo Tagle.

(ARTURO TAGLE- BCH ACHIEVEMENTS, 2015 OVERVIEW)

Thank you for joining us today to discuss our year-end results.

2015 was another year of challenges for both the economy and the financial industry. The past couple of years have been marked by a slowdown in the economy, mainly led by lower copper prices, a deterioration in investment expectations and low levels of consumer and business confidence.

In spite of this weak economic environment and important reduction in inflation, we were able to maintain operating income flat year-on-year through effective commercial strategies that made it possible to post solid growth in loans, demand deposits and fees and efforts to recover spreads during the second half of the year due to the strong competition we have faced.

These positive figures were complemented by effective risk management, which allowed us to maintain the loan loss provisions ratio aligned with 2014, closing the year with a figure of 1.3%.

In terms of cost control, we achieved a good efficiency ratio of 44%. Although this is slightly higher than 2014, it continues to compare very favorably to our peers and the banking industry.

As a result, and based on our consistent long-term strategy, we could post another year of attractive results by reaching a bottom line of $559 billion pesos and a return on average equity of 21%. Once again we led the Chilean banking industry in net income with a 25.3% market share in 2015.

These results, based on more recurring revenues and not inflation, generated net distributable earnings of $463.5 billion pesos, which is basically the same amount obtained last year. This permitted our Board of Directors to propose an attractive dividend per share in 2016 of approximately $3.4 pesos per share, in line with last year. At the same meeting, the board modified the level of provisions for minimum dividends from 70% to 60% of distributable net income. This change will help us maintain an adequate capital ratio for future growth and is also especially relevant in light of the implementation of Basel III in Chile, which may require higher levels of capital.

These good financial results would have not been possible if it weren't for many other accomplishments that we achieved during the year.

First, thanks to our commercial initiatives, loans reached $ 24.6 trillion pesos, equal to 18.3% market share, an annual increase of 26 basis points. The retail segment was the main driver of this growth. Mortgage loans led this increase, rising an impressive 18% YoY. Strong demand for housing created by the expected impact of the tax reform on prices and a scenario of especially favorable interest rates explain this phenomenon. Complimented with our successful commercial strategy, we gained 47 bp of market share in this product, ending the year with a stake of 17.6%.

In consumer loans, we grew 12% YoY, which translated into market share of 21%, up 48 basis points when compared to December 2014. Despite the complex economic scenario, we posted record sales in consumer installment loans through our traditional and internet channels.

As for SMEs, we continued to promote pre-approved credit, which allowed us to grow commercial loans in this segment by 10% YoY. We also continued to strengthen our relationship with these customers by carrying out many seminars and events across the country.

In the wholesale segment, we grew 9% YoY. Part of this growth was due to the successful acquisition of a commercial loan portfolio of $564 billion pesos from another local bank. We closed this deal in record time, thanks to our deep knowledge of customers, proven expertise of our staff and our business scale. Based on these attributes we were able to purchase this portfolio without incurring additional operating costs. Apart from the additional growth, this acquisition provided us with loans that have attractive spreads.

Regarding liabilities, we issued a record amount of approximately USD1.9 bn dollars in senior bonds. This is in line with our aim to diversify the financing structure in both duration and markets. Similarly, this strategy allows us to position ourselves better for the new liquidity requirements that will soon be implemented in Chile.

In addition, we continued to develop and implement initiatives to improve the value offerings provided to our customers. Hence, we strengthened our Mobile Banking platforms by adding new apps to the suite of Banco de Chile applications. Our focus on innovation in mobile contact channels has not only been appreciated by our customers but also by international publications and organizations. These include FELABAN, Global Finance magazine, Global Banking & Finance Review magazine, who recognized Banco de Chile for innovation and as the best digital bank in the country for 2015.

We also enhanced the range of benefits offered to customers by entering into two strategic alliances with Delta and Sky Airlines, which allows our customers to accumulate points that can be redeemed to purchase tickets for international and domestic flights. These alliances are in line with our strategy to continue strengthening our credit card business and deepening our relationships with clients by providing them with a complete set of products and services while reinforcing loyalty.

In mutual fund management, we increased our average AUM by 13%, maintaining our leadership position in the industry with over 20% market share. This was achieved by providing our customers with personalized advice on choosing their investments, reinforcing service models to institutional clients and the strong risk-adjusted performance of our mutual funds. Our results were also recognized through several awards that placed us as the leading fund manager in Chile.

We also moved forward in various initiatives to reinforce banking penetration in Chile. With these goals in mind, we continued strengthening "CuentaChile," a debit account for our consumer finance segment that provides these customers with products and services that weren´t previously available to them and were made accessible through an extensive network of more than 2.000 service points.

Also, this was a very positive year for investment banking. We took part in many important local transactions, which were recognized with several awards including Best Investment Bank in Chile by LatinFinance, Best International Bond placement, Best IPO Operation and IPO Agent by Deloitte and a local newspaper, Diario Financiero.

Finally, we have continued implementing various initiatives in line with our commitment to the community during the year. In particular, I would like to mention our collaboration with Teletón, a non-profit organization that has various rehabilitation centers throughout the country and holds an annual charity event since 1978 and that we have actively supported since it began. This year, over 9.000 Banco de Chile employees participated voluntarily in this event. We also continued contributing towards other social activities and organizations focused in promoting entrepreneurship and accessibility to quality education in Chile.

Now, Rodrigo Aravena, our Chief Economist, will briefly discuss the macro environment.

Thank you Arturo. Please turn to slide 5

According to market consensus from the Chilean Central Bank’s Economic Expectations Survey, the Chilean economy grew around 1.6% in the fourth quarter of last year, and therefore it ended up expanding nearly 2.0% in 2015, as seen on the top-left chart. Consequently, the GDP posted a below trend economic growth for second year in a row. For 2016, the Central Bank estimates a GDP expansion between 2% and 3%, but private estimates from the Economic Expectations Survey are closer to 2%. The main reasons behind this weak economic growth include low copper prices, the slowdown in the main trade partners and domestic confidence measures remaining in pessimistic territory.

As the second chart shows, the labor market continued to display resilience in the fourth quarter: the unemployment rate stood at 5.8% in December, a low figure relative to the recent history. However, wages continue to show a moderation in the margin: real wages increased 1.5% YoY in November after growing around 2.5% in real terms during the first quarter. Consequently, there has been a slowdown in the real wage bill.

As the bottom-left chart shows, the slowdown in China, and the emerging world in general, was reflected in Chile's trade balance during 2015: total exports fell 16.3%, while imports fell 12.8%. By sectors, the steepest decline was given by copper exports—which account for half of the total—with an 18.2% yearly contraction. Both agriculture and manufacturing exports declined 7.9% and 15.2%, respectively. In this context, the Central Bank expects the current account deficit to reach 1.7% of GDP for 2015, well below the rest of Latin-American countries.

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Since a large portion of goods included in the CPI basket are imported, inflation has been hovering above the Central Bank's 4% tolerance ceiling as a result of the weaker exchange rate. As the top-left chart shows, the consensus of the Economic Expectations Survey expects annual inflation to fall to 3.5% this year, after posting a 4.4% increase last year. Despite below-trend economic growth, only a gradual inflation convergence is likely because second-round effects from the weaker currency and indexation effects will likely remain this year.

As it was the case of commodities in general, the price of copper fell in 2015. Apart from driving the depreciation of the peso (see bottom-left chart), such copper changes induced low government revenues last year. While around 2006 the state-owned mining company contributed 5.4% of the GDP to the government, in 2015 such figure is expected to be only 0.3% of GDP by the official Budget Office from the Ministry of Finance. Accordingly, the government will reduce its annual spending growth to 4.4% in 2016.

Finally, even though the economy is growing slowly, the persistence of headline inflation above the 3.0% target led the Central Bank to increase its monetary policy rate in 50 basis points during 4Q15, up to 3.5%. The baseline scenario of the Central Bank for 2016 -outlined in its Monetary Policy Report of December- considered two additional 25-basis-points hikes during the year, in line with the market consensus.

Now I will pass the call over to Pablo Mejia, our Head of Investor Relations to give a review of the banking industry's results and to present Banco de Chile's fourth quarter financial results.

Thank you Rodrigo and good morning everyone. My comments will follow the presentation starting on page 8.

The local banking industry posted a 6.4% YoY real growth in total loans during 2015. In nominal terms this was an increase of about 11% YoY. Similar to us, the strong growth in mortgage loans was the main driver of this increase due to the implementation of value added tax on new homes and attractive low interest rates.

As for results, the industry posted an 11.0% YoY decrease in net income. This was mainly explained by operating expenses increasing 5.2% YoY due largely to the effect of FX and inflation on administrative expenses and personnel expenses. Credit risk posted a moderate growth, mostly offset by lower countercyclical allowances and higher recoveries of non-performing loans. Based on these figures, the industry posted a YoY decrease in profitability from a Return on Average Equity of 18.2% in 2014 to 14.9% in 2015.

Please turn to slide number 10, for our quarterly and full year results.

We had another year of good results, although lower than 2014 but still impressive when you consider the current economic environment and lower inflation. Net income for the year reached almost $560 billion pesos, equivalent to an ROAE of 21%. On a quarterly basis, net income reached $140 billion pesos, 5% above the prior quarter and 9% above the same quarter last year. It's important to mention that there have been a few extraordinary events during the last quarters, such as the positive effect of the increase on the corporate tax rate on deferred tax assets in the 3Q14, the negotiation with unions in the 4Q14 and countercyclical provisions in both the 2H14 and the 3Q15. Nevertheless, our results this year demonstrated momentum across a variety of key business drivers, as you will see in the course of this presentation.

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As Arturo mentioned, we have continued to show strong loan and deposit growth throughout our diversified business model, with the exception of consumer finance loans. Total loans grew 12.3% YoY and 2.2% QoQ, allowing us to gain market share in commercial, consumer and mortgage loans. Overall, market share at the end of the year reached 18.3%, almost 30 basis points above a year earlier. Demand deposits also grew an impressive 20.1% YoY and 14.2% QoQ. Thanks to this growth, we were able to continue diversifying our customer base while offsetting lower non-customer income –mainly inflation- posting operating revenues in line with 2014 at $1.6 trillion pesos. This increase can be seen on the charts to the right.

It's also important to point out the excellent evolution of our fee income which continued growing at attractive rates.

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The strong growth in fees is thanks to our leading position in customers in the upper income segment and our ability to be the primary bank account for most of our retail and wholesale customers. This has provided us with stable and growing fees. As you can see on the chart on the left, net fees are mainly generated from our retail division and subsidiaries, which are mostly retail related. These two segments represent 87% of our total fee income while the remaining 13% is generated from our corporate wholesale areas.

This mix provides us with a superior position versus our peers in this source of revenue. On the chart on the right you can see that the main fees that drove this growth were:

- Mutual Funds, up $12 bn YoY thanks to previously mentioned business drivers
- DDAs, Credit Cards, Sight accounts and ATM fees, up $10 bn due to an increase in current account holders and a renegotiation of interbank ATM fees which took effect in the 3Q15 and was retroactively applied
- Insurance, up $5 bn YoY, thanks to our growth in retail products together with new commercial business initiatives, and
- Financial Advisory fees, up $5 bn, thanks to important deals associated with both M&A and debt structuring.

Please turn to slide 13 on Loan Loss Provisions.

As mentioned earlier, we continued to post good levels of risk in 2015, as a result of our focused and prudent risk management approach. Loan loss provisions remained steady when compared to last year at 1.3%. On the chart on the right is a breakdown of LLP. The level of provisions increased only by 7% YoY compared to the 12% expansion posted by our loan portfolio. The increase was due to:

- First, we set additional allowances amounting to about $31 billion pesos during the 3Q15. These allowances were made in view of the slowdown in the local economy. 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. When compared to 2014, this increased our LLP by $8 billion pesos.

- Second, local regulatory changes affecting the methodology for mortgage loans provisioning with a one-time net impact of Ch$5.0 Bn. on loan loss provisions.

- Third, a net effect of Ch$4 billion due to exchange rate shifts affecting our US$-denominated allowances for loan losses.

- Fourth, the net effect of greater loan volumes, change in mix and risk behavior in LLP was equivalent to Ch$1 billion when compared to 2014.

In terms of our coverage ratio, we maintain the highest level amongst our closest competitors with a multiple of 2 times. This ratio is increased to 2.5 times when we take into consideration additional allowances. We are confident that our unique credit risk management philosophy which is deeply present throughout the entire credit cycle should continue to assist us to maintain reasonable levels of NPLs in this economic cycle.

Please turn to slide number 14 on Operating Expenses.

As you can see on the chart on the left, operating expenses remained relatively stable YoY, growing only 2%. This was due to higher non-recurrent personnel expenses in 2014 for about $45 billion pesos, associated with the collective bargain agreement with our unions. Excluding this, operating expenses grew on an adjusted basis 8% YoY. The main factors that explain this increase are:

- First, the effect of inflation on salaries, as they are adjusted twice a year by CPI variation. This explains an important part of the salary increase while the rest is explained by real wage growth, based on merit; performance bonuses; variable compensation; benefits associated to the bargaining process and a slight rise in head count. Likewise, some administrative expenses items are also denominated in UF and, therefore, they are affected by inflation.
- Second, the effect of the appreciation of the dollar versus the peso on certain IT service contracts
- Third, advertising expenses explained by recent campaigns we have undertaken in order to announce new strategic alliances

In terms of efficiency, our ratio increased moderately from 43.4% to 44.1%, but still compares favorably to our main peers at 47.2% and the industry as a whole.

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Before moving on to questions, I would like to emphasize attractive level of profitability during the last years. Despite difficult economic cycles, we have generated high returns to our shareholders, posting levels that are substantially better than our peers in both ROAE and ROAA. Currently, ROAE and ROAA have reached 1.4 and 1.5 times the industry average, respectively.

We are confident that we are a bank capable of maintaining ROAE's around 20% in the long-term because:

1) First, we have room to continue to improving our loan mix
2) Second, we believe that we can continue increasing the profitability of both our retail and wholesale book by further improving our relationships with customers thus increasing share of wallet, and
3) Third, there is still room to continue improving our productivity levels which should translate into sustainable improvements in our efficiencies.

Thank you for listening to our presentation. If there are any questions, we would be happy to answer them.

Closing Remarks – Arturo Tagle, CEO

Thank you for your questions. Before ending this call, I would like to emphasize our five main competitive advantages that make a difference and are an essential part of how we create value for our customers and shareholders:

- First, we have the most recognized brand in the Chilean financial market, allowing us to attract and retain customers more easily,

- Second, our size and business scale allows us to offer a wide selection of products and services to all of our customer segments and reach better efficiency levels. In other words, we have an important knowledge of our customers and what they need at every stage of their life cycle.

- Third, our risk rating ranks us the strongest private bank in Latin America thanks to our well-known risk management procedures and track record in results and profitability. This provides us with better spreads than our competition when placing bonds, which contributes to improve profitability.

- Fourth, our superior risk management undoubtedly distinguishes us from other banks in Chile and in the region. This has allowed us to grow profitably in all of the segments we serve with good loan loss provisions and NPL ratios.

- Fifth, our leadership in demand deposits has provided us with a clear advantage in cost of funds, thanks to our long and prestigious history, excellent customer base and our focused and consistent strategy.

All of these competitive advantages will surely allow us to continue growing and providing our shareholders with sustainable and attractive returns. **Thank you for listening and participating in our call; we look forward to sharing our next quarter's results with you.**