Banco de Chile: Comments on the
Second Quarter 2016 Financial Results

(ISABEL ALLENDES – INTRODUCTION)

Good morning everyone. Thank you for joining our call today where we will share with you our comments on Banco de Chile's second quarter 2016 financial results.

We will begin with a brief overview of the economic environment and our corporate strategy, followed by an analysis of Banco de Chile´s 2Q 2016 results.

I will now turn the call over to Rodrigo Aravena.

(RODRIGO ARAVENA- ECONOMY)
Please turn to slide number 3.

Good morning, it's a pleasure for me to share with you our comments on the economic environment in Chile and our corporate strategy.

The recent evolution of the global economy has revealed the existence of less favorable external conditions for Chilean economy. Since Chile is the most opened country in the region, changes in the external scenario have a first order impact in the evolution of domestic economy. In particular, we think there are two main trends to be highlighted.

The first of them is the materialization of several downside risks in the global economy, which led to a reduction in the global GDP forecast by the IMF for both 2016 and 2017, mainly due to worse perspectives to advanced economies, according to the last world economic outlook. According to the IMF estimates, Latin-American countries will have a contraction of 0.4% this year and only a modest recovery of 1.6% next year (led by the weak cycle in Brazil), while growth in China (which is the main trade partner of Chile), will also fall, from 6.9% last year to 6.6% and 6.2% in 2016 and 2017, respectively. Additionally, is worth mentioning that the IMF considered a downward bias in its baseline scenario, mainly due to the uncertainty caused by the Brexit, among other risks.

The second change is the persistence of lower commodity prices, relative to previous years. Amid this scenario, copper prices have also fallen, as seen in the top right chart. This year, average copper price has been 2.1 dollars per pound, which is 14% lower than the 2015 average and it is also 28% below to the peak posted in January of last year. Since mining is one of the most important sectors in the GDP and plays a relevant role in fiscal revenues, lower prices has contributed to reduce the GDP growth and to lift the fiscal deficit.

In this context, GDP remains weak, hovering around 2.0%, as seen in the bottom left chart. This year, it has accumulated a 1.7% expansion, as a result of a 2.0% growth in the first quarter and a 1.3% increase in the second. It followed the 2.1% and 1.9% expansion in the previous two years. The breakdown shows that mining sector has remained in negative territory, while several consumption indicators have also lost dynamism, even though they are still in positive territory.

The good news is that the unemployment rate has remained lower than expected, as seen in the bottom right chart. It posted a 6.9% rate in the quarter ended in May, 40 bps higher relative to one year ago. However, several indicators began to show signs of deterioration in the labor market: the job creation has been led by self-employment, rather than waged employment, and the real wage bill growth is decreasing. Additionally, it is worth mentioning that job creation is still led by the housing sector, due to the higher demand as a consequence of the VAT tax rate increase considered in the tax reform. Since this is a temporary effect, a higher unemployment rate is likely.

Please turn to slide 4:

Now, I'd like to share with you our baseline scenario for the main macroeconomic variables:

On activity, we expect the GDP to remain in the range between 1.5%-2.0% for the remaining of this year, and we also expect a slight recovery to 2.0% in 2017. It is important to remember that potential GDP for Chile is nearly 3.0%. The main reasons behind this below trend expansion include the slowdown in some trade partners, lower copper prices and the less expansionary fiscal policy. But we expect a modest rebound in 2017 as a consequence of the weaker currency and the slight recovery in some trade partners, such as some Latin-American countries.

On the inflation side, we expect the CPI to converge to the 3.0% target in the next quarters (from the current 4.2% annual rate), which is consistent with the below trend growth and the higher unemployment rate. However, is important to mention that the weaker exchange rate has been the main reason why the CPI has remained above the central bank range since the second quarter of 2014, so the dollar trend can cause a deviation of this expectation.

In this scenario, the Central Bank has maintained the interest rate at 3.5% this year. In the last meeting, the board revealed a more neutral bias, although it also mentioned the need of increasing the rate in the future. However, we don't see changes in the reference rate in the short run, as a consequence of the higher risks in the global economy and the lack of a rebound in the domestic activity. Furthermore, we acknowledge the possibility of rate reductions in the case that the economy fails in showing recovery signals.

Please turn to slide number 6:

Now, I'd like to share with you the main aspects of our long run strategy.

In recent years we have been able to accomplish our goals, despite having to deal with significant challenges; such as a highly competitive financial market, new regulations that have resulted in raising costs, more demanding customers, and all this in a less dynamic economic environment.

Nevertheless, the route of our success within this tough atmosphere has been the effective execution of a consistent customer centric strategy that has been upheld over the years. As you can see on the slide, each one of our strategic pillars ain to achieve this objective by accompanying our customers through their entire life cycle. By strongly focusing on this concept, customers choose us over other banks as we provide better products, services and advice and inspire more confidence, thus maintaining our leading position in retail and wholesale banking.

More specifically, as shown on slide 7:

One of the fundamental pillars of our strategy is to provide first rate service to our customers. In order to reach this goal, we have implemented diverse actions such as a creating a culture that is more focused on the customer than the product; developed incentive programs for our account managers, which takes much more into consideration service quality and recommendation than before; and undertook changes in organizational structure in our branches in order to provide our customers with closer and tailored services. These changes have improved response times while bringing about a decrease in complaints from customers. As a result, we have seen important advances in our net promoter score over the years, ranking us first amongst our peers. Similarly, we have reduced customer attrition to record levels, substantially better than our peers.

Furthermore, we are aware that in order to compete in this industry, it's necessary to continue simplifying and redesigning processes while incorporating new technologies where possible. For this reason, we have been working to quickly implement innovation in online channels as part of this core strategy. Accordingly, in recent years we have improved the stability of our platforms and launched new world-class mobile apps that have been a huge success, as you can see on the charts on the right. In addition, we are in the final phases to launch a new website for both companies and personal banking; and at the same time we are implementing technologies and simplifying internal processes to become a paperless bank. These advances should improve the delivery of products and services to our customers while making their transactions more convenient, effective and secure. Also, all of these developments should translate into improved cost efficiency over the coming years, based on the automation of diverse front-to-back processes.

The successful transformation of our culture to become more focused on the customer has been only possible thanks to the commitment and dedication of an exceptional group of associates whose professionalism, team spirit and deep sense of ethics allow us to continually create value for our stakeholders. In line with this, we are constantly trying to make Banco de Chile an attractive place to work for our employees while promoting career development. As you can see on the slide, through many different studies we rank very well in climate and satisfaction, thus this provides us with motivated and committed employees. Also, we believe this can only be achieved by developing our employees through in house training programs which are very valued for our staff.

Finally, we also are very proud to say that we were once again recognized as the best financial institution to attract and retain talent by Merco, and recognized as the most reputable Chilean financial institution by Reputation Institute.

We are certain that these initiatives are necessary to continue being the leading bank for the retail and wholesale segment, as Pablo will discuss on the following slides.

(PABLO MEJIA- BCH FINANCIAL RESULTS)

Thank you Rodrigo. My comments will follow the presentation starting on page 9.

We earned $151 billion pesos in the second quarter of 2016, thanks to our diversified business model, more normalized level of inflation and our focus on exceeding our customers' financial needs. As I'll describe in further detail throughout the presentation, these factors allowed us to continue growing customer revenues, despite headwinds from a more unfavourable environment. Due to greater dynamism experienced the previous year, we achieved attractive growth rates in retail banking by growing that loan book by 13% YoY and deposits 11% YoY. Also, NPLs have remained stable as a result of a labour market that shows signs of deterioration but still good absolute figures. On the other hand, efficiency reached 43% and profitability continued above the 22% level with a market share in net profits of 26%.

So while the activity of the first half of this year has continued slow and the outlook doesn't show a clear improvement, our commercial focus seeks to growing selectively in segments that provide an appropriate balance between risk and return.

Please turn to slide 10

Operating income this quarter reached an impressive level of $476 billion pesos, up 14% YoY, thanks to both non-customer and customer revenue growth.

Non-customer income grew by 32% YoY and was mainly driven by the sale of AFS securities, which results were recognized previously in Other Comprehensive Income for approximately $59 billion pesos. This was partially offset by the effect of lower inflation in the quarter when compared to the same period last year, affecting the contribution we receive from our net UF asset exposure and due to the early redemption of two series of long-term corporate bonds that had been initially issued at discount amounting to approximately $7 billion pesos. However, even though this early redemption impacted negatively our NII figure this quarter, it will reduce net interest expenses in the future by about $11 billion pesos since we refinanced these bonds at lower interest rates. Additionally, during the quarter we recorded a decrease in revenues associated with the

USD asset position that hedges our exposure to US$ denominated loan loss allowances by roughly $3 billion pesos given the appreciation of the Peso against the US dollar. The offsetting positive effect was recorded in loan loss provisions which will be discussed in more detail on the following slides.

In turn, overall Customer income grew by 6.3% YoY. Specifically, interest revenues grew by about5.4% YoY and fees by 9% YoY. The expansion in interest revenues was led by a 9% YoY growth in loans, mainly related to retail banking together with attractive growth in DDA balances by almost 9% YoY and, the positive effect of higher nominal interest rates. Additionally, in spite of high competition and an overall slowdown in loan growth, we continued to improve lending spreads this year, ending the quarter at 2.94%. This figure is particularly positive if one takes into consideration that mortgage loans have been the main driver in growth the last 12 months. In terms of fees, the greatest dynamism has been in the retail segment; in particular we experienced growth in credit cards, ATM usage and mutual funds management.

As you can see in the upper left chart, our business strategy has permitted us sustainable and consistent growth in customer revenues, quarter after quarter. While this progress has slowed due to lower dynamism of the industry, we managed to perform a solid and diversified base of income generation that allows it to be more resilient against economic cycles of low growth as we are currently facing.

Please turn to slide 11 on Retail Banking Trends

As I mentioned, we are a bank that differentiates itself from other competitors by focusing on providing personalized experience to our customers. Along these lines, we have taken important steps to implement improvements, among others, a new and innovative platform that uses internal and external information to optimize product offering and also to determine appropriate pricing to each customer. This business development, undoubtedly, provides us with an important tool to increase our share-of-wallet in the long run. We are also continually analyzing new potential customers and preapproving them with banking products, thus increasing the productivity of our sales forces. This coupled with our improved digital contact channels, as mentioned earlier in the presentation, provide the basis of profitable growth potential in future years. By capitalizing on our relationships with our current customer base and taking full advantage of new customers, we are certain that we will continue to see attractive growth figures in target segments.

Thanks to these initiatives, we have grown our retail loan book and demand deposits by 13% YoY and 11% YoY, respectively. The credit expansion was mainly driven by growth in retail commercial loans, personal banking loan products, as you can see on the table on the right. The most dynamic growth product has been credit cards, growing 18% YoY. We have boosted this product by introducing new benefits to our loyalty program. Today we have agreements with Iberia, Delta and Sky Airlines, which provides our customers with excellent alternatives to accumulate travel rewards with credit card purchases. These programs allow us to further consolidate our value proposition.

Please turn to slide 12 on wholesale banking trends…

In wholesale bankings, trends have been much weaker than what we have seen in retail banking. A less dynamic economy together with low confidence levels due to diverse reforms carried out and the end of the commodity cycle have delayed investments and in turn reduced demand for loans by companies. As such, loan growth for this segment has only grown by 3.9% YoY and decreased 0.4% QoQ, mainly due to less active foreign trade and, to a lesser extent, leasing loans. Nevertheless, we continue to strengthen our relationships with these customers, increasing demand deposits by 5% YoY, and improving our non-lending revenues based as a percentage interest income, as you can see on the chart on the bottom right.

Turning to risk on slide 13.

Loan loss provisions this quarter reached $93 billion, an increase of 57% YoY. This increase was due to the establishment of additional allowances amounting to $52 billion pesos in the 2Q16. In turn, our Board took a prudent approach and booked these allowances to address potential portfolio deterioration as a result of persistent economic growth below potential levels, which in turn is expected to continue for an extended period of time as a result of weak internal business and consumer confidence levels, low copper prices and external uncertainties. This has led to subdued investment, lower private consumption and labor market figures that have worsen slightly, all in a context that has left the government with little room to implement expansionary fiscal and monetary policies to boost growth.

Another element supporting the decision to establish these additional provisions is well-known lag between economic growth and loan loss provisions. As can see in the lower right graph, there is an inverse correlation between GDP growth and LLP, where in years with important changes, such as the 2004:2008 period, there is a clear lag on LLPs.

On the other hand, this was partially offset by a non-recurrent allowance release of $9.6 billion pesos due to a regulatory change that reduced the credit conversion factors for certain contingent loans from 50% to 35%, a mix and growth of $5.8 billion pesos principally related to an upgrade of one corporate customer and the previously mentioned FX effect on US$-denominated loan loss allowances by roughly $3 billion pesos.

As shown on slide 14, Operating Expenses increased $33 billion pesos from a year earlier.

This increase was driven by a variety of factors including non-recurrent items, expenditures intended to support our normal course of business and ongoing costs associated with recurrent operations.

Personnel expenses increased by approximately $10 billion pesos or 12% YoY. On a recurrent basis, salaries rose nearly $3 billion pesos or 6% YoY, due to both the effect of inflation on our payroll and a small expansion of less than 1% in headcount. The rise in headcount has been concentrated in front office positions, in line with our customer centric strategy and our ambition of providing a tailored service to our clients. We also recorded two important non-recurring personnel expenses. First, higher severance payments related to organizational restructuring and second, a special bonus granted to the staff of one of our subsidiaries for the completion of a collective bargaining process.

In terms of administrative expense, this line item grew $11 billion pesos YoY or 15.1%. About 60% of this expansion is explained by IT-related expenses, including maintenance, internal developments, information security devices and software licenses. These expenditures reflect our commitment to operational excellence and, as mentioned earlier, they are intended to enhance the stability and security of our core platforms while innovating in leading-edge mobile apps and remote channels. To a lesser extent, admin expenses were influenced by marketing and product delivery costs increasing $1 billion pesos YoY, due to advertising campaigns that have been planned and distributed in a more uniform way in 2016 when compared to 2015 and to the renewal of customer credit and debit cards with new and improved security features.

Other operating expenses rose by $10 billion pesos YoY, mainly due to non-recurring legal contingency provisions of $7 billion pesos in 2016 and $2 billion pesos related to a profit-sharing system embedded in a credit card partnership with a telecom company.

Adjusting expenses by these extraordinary items leads to a 12% YoY growth figure for the 2Q16 and 10% YTD. We expect that the expenditures associated with strengthening internal platforms and remote channels will gradually provide improved operational efficiency and increase customer profitability across all business segments. Also, we have combined these actions with a permanent focus on cost control and initiated different projects aimed at improving and optimizing internal costs such as our paperless project that focuses on reducing printed documents, streamlining workflows, electronically tracking digital documents and reducing fraud risks associated with hard copies. This initiative, along with many others, should continue allowing us to keep our efficiency levels at adequate rates while also better serving our customers.

Our capital levels, as shown on slide 15, remained strong ending the quarter with a ratio of 13.4%, an increase of 53 basis points over last year. This increase was due to a stronger tier I capital base as a result of capitalization of earnings and two other important factors. First, the $52 billion pesos of additional provisions are considered in Chile as tier II capital. This resulted in an additional 32 basis points of this type of capital. Second, there was a regulatory change that reduced the conversion factors for certain contingent loans from 50% to 35%, raising our ratio by 32 basis points. These gains were partially offset by the decrease in OCI, due to the sale of AFS securities mentioned earlier.

In line with higher capital requirements expected from regulators due to Basel III, we have anticipated these new demands by incorporating some changes in our capital management. First of all, we recently adjusted our dividend policy from 70% of distributable earnings to 60%. This change is already affecting the level of provisions for minimum dividends we recognize in equity and, therefore, improving our capital adequacy ratio. On the other hand, we have begun to explore new sources of Tier I capital as permitted by Basel III. In fact, as expected by the market, the implementation of Basel III in Chile should allow banks to use additional Tier I instruments, such as perpetual bonds or preferred stocks. This new framework gives us room to reinforce our capital adequacy in the future. We have also avoided issuing subordinated bonds over the last three years, as Basel III defines much more restrictive standards for Tier II capital than the current Chilean regulation.

All of these potential choices, together with a solid position in terms of Tier I core capital, permit us to feel confident with respect to the implementation of Basel III in Chile as we are certain that we will fully comply with new capital standards. Nevertheless, we are still waiting on pending definitions in terms of weightings for risk-weighted assets calculation, the treatment of deferred tax assets and phase-in arrangements for capital buffers. We expect to have a clearer idea this year on these matters as long as the implementation of Basel III and the extent of this reform is approved by the congress and enacted by the Chilean government.

However, Basel III is not only related to capital requirements but also to new liquidity standards. In this regard, retail deposits are a more stable source of funding and, therefore, very appreciated under Basel III. Aligned with this view we have increased our focus on retail deposits by adjusting the operational structure of branches and incentives for account managers. These actions have permitted us to maintain our solid market position in retail deposits while preparing more competition for these kinds of liabilities in the future. On the other hand, over the last five years we have carried out a funding diversification strategy intended to increase the duration of our liabilities by placing long-term bonds in Chile, but particularly abroad. Thanks to this initiative we have been able to reduce the maturity gap between assets and liabilities by approximately 90 days. Also, long-term bonds have replaced volatile deposits from wholesale customers and borrowings from financial institutions.

Although the Chilean regulator has not defined a specific threshold for liquidity standards, we are taking all of the required steps to comply with the new requirements.

Please turn to slide number 16.

On this final slide, you can see how Banco de Chile has once again outperformed our peers in four different aspects of this first half of the year thanks to the various initiatives mentioned throughout this presentation including projects to improve our value proposition to key segments, process optimization, sales effectiveness, service quality, among others.

On the top left you can see that we lead among our main peers with a 7.2% operating margin. This is due to a mix of factors including a diversified loan portfolio, a high cross-sell model, low cost of funds due to demand deposit leadership, excellent risk rating and an effective business strategy.

Second, our LLP ratio excluding additional provisions remains at very good levels, once again reflecting our effective risk policies and capacity to adapt to a challenging economic scenario.

Third, our efficiency ratio of 45.1% compares well against our peers and has room to improve through new projects and initiatives similar to those recently mentioned.

And finally, on the bottom right you can see a comparison of return on average equity for Banco de Chile and our peers for the first six months of the year. Undoubtedly, we continue to lead the industry in terms of ROAE of 21% due to our superior competitive advantages and our demonstrated capacity to implement our strategy.

Before we turn it over to questions, I would like to say that this first half of the year has been challenging due to higher uncertainty and a less dynamic domestic and external economic environment. Despite this less favourable scenario, we have continued to consolidate our leadership position, improve customer experience and reduce attrition. This has been possible through effective changes we have realized in our service models and the better use of business intelligence. We are confident that our consistent customer centric strategy will allow us to continue outperforming our peers and creating greater value for all our stakeholders.

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

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