Banco de Chile: Comments on the Third 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 third 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 3Q 2016 results. **I will now turn the call over to Rodrigo Aravena.**

Good morning everyone. It's a pleasure for me to share with you my comments on the Chilean economy and our consistent long-term strategy.

I would like to start with the macro analysis. Please turn to slide number 3.

GDP continues growing slower than Chile's potential rate. After GDP was up 1.5% in the second quarter, it will likely expand 1.7% in the third quarter. That said, the economy is expected to grow by 1.6% this year, below the 2.1% observed in 2015. On the supply side, as seen on upper left chart, the mining sector has led the slowdown, while the rest economy –mainly services- has remained growing on average 2.0%. The demand-side breakdown shows that investment remains weak, while consumption is still supporting the GDP growth, in part as a consequence of the resilient labor market. As seen on the upper right chart, the unemployment rate has remained stable around 7.0%, low level relative previous years.

In the last months, most of the macro analysis has been centered on two issues: first, the fall in the annual inflation rate, which dropped to 3.1% in September, as a consequence of the lower than expected 0.2% inflation in that month. As you can see in the bottom left chart, both headline and core inflation have decreased. We think it has been a consequence of both the below trend GDP growth and the stability in the exchange rate, as the weaker currency led the CPI in the last two years. The second issue is the reduction in the fiscal spending growth announced for 2017, which is expected to fall to 2.7%. It will be the third adjustment in a row, as seen on the bottom right chart. This cut aims to offset lower structural revenues as a consequence of the decrease in potential GDP growth and copper prices. In all, the government expects only a slight increase in the fiscal deficit, from 3.1% of the GDP to 3.3% in 2017, resulting in a net fiscal debt still close to 0%. Therefore, Chile's government maintains a strong financial position.

I'd like to share with you our baseline scenario for the next year. Please turn to slide number 4.

On activity, we expect a modest recovery next year. We estimate GDP to increase to 2.0% in 2017, and a convergence to 3.0% in the following years, as seen on the upper right chart. Most part of this estimate is explained by the expected better dynamism in the global economy, as seen on the top left chart, where you can see IMF estimates released in the last World economic outlook. Additionally, the persistent weaker exchange rate can provide a further support to the GDP.

On inflation, we see the existence of two opposite forces: persistent below trend growth that can lead to a higher output gap and therefore lower CPI. On the other hand, we see risks in tradable inflation, as we expect a slight depreciation in the exchange rate. In all, we estimate the inflation to remain hovering around the central bank target: 3.2% this year and 3.0% in 2016.

Due to this, we see room for monetary policy rate cuts in 2017. Although the Central Bank has maintained the overnight rate at 3.5% since January of this year, we think the recent drop in inflation and the persistent below trend growth will leave space for an expansionary monetary policy.

Please turn to slide 6.

Despite the weak economic environment that has persisted during the last few years, we have consistently posted excellent returns in terms of return on average equity and return on average assets. As you can see on the slide, we have managed to maintain and in certain years even widen the gap with the industry. In terms of ROE, we surpassed the industry by 1.6 times and in ROA we exceeded the industry by 1.8 times.

These consistent, high levels of profitability are a result of our superior competitive advantages as you can see on the next slide, number 7.

[Strong Brand; Top of Mind]

First, we consider that we have the best brand in the Chilean banking industry. Year after year, we have consistently outperformed our competition in many different attributes including Top of Mind; when customers are asked if they were to switch to another bank, which bank would they choose; and Security and Solvency. Thanks to our strong brand and excellent customer service, we attract customers more easily and they stay with us longer than our competition.

[Scale]

Second, we are number one or number two in most of the products and services that we offer. We are the second largest bank in total loans, the largest in commercial loans, second in mortgage loans, excluding Banco Estado, and second in consumer loans.

We also have the best fee based business in the industry with a market share of more than 20% thanks strongly to our ability to generate solid relationships with customers and to our wide range of products and services. This means that we have the scale, branch network, customer base and customer knowledge to continue growing, with an adequate risk return relationship, and that our customers choose us for more than just debt products, but for other services as well such as insurance brokerage, mutual fund management, among others.

[Funding]

Third, we have the best funding structure in the industry. Non-interest bearing deposits represent almost 25% of our total sources of funds with the highest market share of 23%. Additionally, it is important to point out that over 50% of this figure is from retail customers. This is very significant and no bank in Chile has this advantage.

Moreover, our excellent risk rating of A+ from Standard and Poor's and Aa3 from Moody's provides us with better spreads when issuing bonds. Both these, among other advantages, provide us with this very low cost of funds of only 3.3%.

[Risk Management]

Another very important competitive advantage is our superior risk management. As you can see, we have consistently recorded low delinquency ratios and have maintained high coverage ratios, both significantly better than our peers and the system.

Over the last 10 years, this solid track record has resulted, on average, in a lower loan loss provisions ratio when compared to our peers. For each 10 basis point change in our LLP ratio represents $25 billion pesos in the P&L given our loan book size.

[Corporate Governance]

Another important differentiating element is our strong corporate governance practices, which played a successful role in setting, controlling and obtaining long-term objectives. As you can see, we have many committees and meetings in order to achieve these goals and keep our board members well informed to make the best decisions for our bank and our stakeholders.

Now, I'd like to share with you our main strategic focus going forward. Please turn to slide 8.

We are a universal bank that provides our customers with a wide range of products and services to meet their financial needs. Our clients range from the largest multinational corporations to consumer finance. For this reason, we strive to develop differentiated value offerings and tailored banking solutions in order to be the best bank for our customers.

Accordingly, the customer is always at the center of our decisions. We pursue to establish long-term commercial relationships –primarily based on trust and service quality– while accompanying them thorugh their whole lifetime.

In these efforts, efficiency and productivity are crucial matters. Nowadays, customers not only demand high quality standards but also timely services and responses. These trends motivate us to adopt world class processes and IT platforms in order to maintain a customer's loyalty in the long-run while optimizing our cost base.

On the other hand we want to be the best place to work and the best investment for our shareholders while maintaining suitable interaction with all of our stakeholders. We believe that strengthening corporate sustainability will be a key success factor in banking business.

In order to achieve these objectives, collaboration is crucial. For that reason, we have continued to reinforce our corporate values and teamwork culture.

All of these actions reflect our commitment to our strategic vision and customer satisfaction.

Now, I will pass the call over to Pablo who will discuss in greater detail the results this quarter.

Please turn to slide 10

We had another solid quarter of earnings, reaching an ROAE of 20%, which is equal to $145 billion pesos, only $6 billion below the level recorded last quarter and up $11 billion YoY. This excellent result has been met in an environment of lower inflation and a weaker economy. As you will see in the following slides, operating income amounted to $428 billion, 10% lower than the previous quarter due to certain extraordinary revenues and flat YoY. Operating income and fees continued growing both in QoQ and YoY terms while NPLs improved. Efficiency ratio rose to 46.2% in the quarter mainly due to lower inflation YoY and extraordinary operating revenues when compared to the prior quarter. We are also very proud to say that we continue leading profitability in the industry this quarter and have the highest market share in net income of 27% in the quarter and year to date.

Please turn to slide 11.

As mentioned, operating revenues were down 1% YoY due to lower inflation revenues recorded under non-customer income. Inflation as measured by the UF reached only 0.7% in 3Q16 versus 1.5% in 3Q15.

More importantly, total customer income grew 6.9% YoY. The expansion in customer interest income of 7.1% was led by a 4.1% YoY growth in loans, mainly related to retail banking together with DDA growth by almost 5% YoY. 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 2.96%, 9 basis points above the same period last year. In terms of fees, this line item grew 6.5% YoY with the greatest dynamism concentrated in the retail segment. In particular, we experienced important growth in fees from credit cards, insurance brokerage, stock brokerage and to a lesser degree mutual funds management. However, I should point out that the increase in net credit card fees was due to the effect of the exchange rate on our Premium Dollars program, which impacted us negatively in 3Q15 and positively in 3Q16.

Please turn to slide 12 on Retail Banking Trends

As we have mentioned in prior calls, our focus in the retail segment has been on improving customer experience through all of our contact channels as well as benefits. This quarter we launched the new retail banking website for our individual customers. It was implemented smoothly and we are very confident that this improved channel should provide our customers with a better and more simple but complete platform to manage all of their financial needs. In addition, this should lead to improvements in efficiency in the future.

Thanks to many initiatives, our retail loan book continues to expand at a double digit pace. As you can see on the chart on the right, this was driven by:

1) Credit cards, up 19% YoY, thanks to the improvement of benefits we provide customers such as recent new loyalty programs associated with local and international airlines;
2) Retail commercial loans, up 11.2% YoY as SME continue to have a good demand for loans and low risk;
3) Mortgage loans, up 10.6% YoY, and
4) Consumer loans to middle and upper income individuals, up 8.8% YoY

Our focus is not only on the asset side of our retail business but also on liability management. As such, we have successfully continued to grow our retail base in both current account deposits and time deposits. As you can see on the charts on the bottom, current account deposits grew 8% YoY and Time Deposits grew 10% YoY.

Please turn to the next slide 13

We have the largest retail debtor customer base in Chile with almost 1.2 million personal banking clients. These and other potential customers navigate our webpage far more than any other bank in Chile. This is a huge advantage in order to capture new customers and bank our current customers better. As such, we have made important initiatives to improve customer experience on all of our contact channels. We have driven online sales by implementing world-class mobile apps and we have recently launched a new online banking web platform for personal banking which should help continue to drive online sales and transactions. The results of these initiatives are shown on the charts on the right. As you can see, online banking monetary transactions grew 40% since 2014 and consumer loan sales on alternate channels has grown today to represent nearly 50% of all transactions. It's also important to mention that we have one of the largest ATM networks in Chile, with an impressive uptime of 99%, and they are substantially more productive than our peers.

Please turn to slide 14 on wholesale banking trends…

In wholesale banking, the less dynamic economy together with low confidence levels and the end of the commodity cycle have delayed investments and in turn reduced demand for loans by companies. This low demand for loans and our focus on managing a good relationship of risk and return has translated to a YoY decrease of 4%. As you can see on the chart on the right, this occurs in all products. However, its important to remind you that we acquired a portfolio in the 3Q15 that was mainly related to the wholesale segment. Isolating this effect, wholesale loans would have slightly grown by 0.5% YoY. Finally, in line with Rodrigo's comments earlier in the presentation, we are confident that we should begin to see better economic activity and this should help loan growth.

Please turn to slide 15.

Loan loss provisions this quarter reached $65 billion, down 38% YoY. This drop was due to the establishment of additional allowances amounting to $31 billion pesos in the 3Q15 and the positive effect of the appreciation of the Chilean peso against the US$ this quarter and the strong depreciation in the 3Q15 which benefited allowances for loan losses denominated in US$. Asides from this, we continue to see good credit behaviour in both retail and wholesale lending. Even when adjusting for these factors, our LLP ratio remains basically flat YoY. In addition, we recorded an improvement of 8 basis points in NPL YoY and QoQ.

If we break these figures down by segment, retail LLP deteriorated slightly in the quarter but remained flat YTD when compared to last year. On the other hand, the wholesale segment improved during the quarter and YTD. This improvement was associated to higher provisions in 2015 of a specific customer having financial difficulties.

As shown on slide 16, Operating Expenses increased only 6% from a year earlier.

This more gradual increase was driven by a variety of factors including less non-recurrent items. Specifically, personnel expenses increased by approximately $10 billion pesos or 11% YoY. On a recurrent basis, salaries rose nearly $4 billion pesos due primarily to the effect of inflation on our payroll. We also recorded non-recurring personnel expenses from special bonuses granted to the staff of two of our subsidiaries, Banchile stock brokerage and Banchile Mutual fund management companies, for the successful completion of collective bargaining processes which amounted to $2 billion pesos. Finally, variable compensation and other benefits (health insurance) accounted for about $2 billion pesos.

In terms of administrative expenses, this line item grew only 7% YoY, or $5 billion pesos. The rise was mainly associated to higher expenses in IT-related items, building related expenses and marketing.

Other operating expenses rose by $5 billion pesos YoY, mainly due to non-credit contingency provisions in 3Q15

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, maintaining expense growth lower than our customer income and in the medium term improve efficiency levels.

Please turn to the last slide of our presentation on recent achievements

Before moving on to questions, I want to go over a series of recent achievements and recognitions we have received, which have certainly been a result of our consistent long-term strategy, which relies heavily on putting the customer at the center of our decisions and continuously searching for new ways in improving productivity and efficiency.

As you can see on this slide, we have a huge list of recent achievements. First, we received numerous recognitions from prestigious international entities such as Global finance, The Banker and Latin Finance. More importantly, the market also recognized our solid performance and their confidence in the bank through the successful issuance of over $250 million in senior and subordinated bonds at very attractive spreads in the Japanese and local markets.

Second, we made significant efforts and investments in innovation, in line with our strategy and improving efficiency and productivity. We launched a new personal banking platform, integrating the latest technologies available and provided a service that is faster and more stable. We also implemented a new foreign currency platform for buying and selling dollars online, breaking with past schemes and offering something completely new and modern. These innovations, along with new apps for mobile banking, permitted us to be recognized as the Best Consumer Digital Bank in Chile by the Global Finance.

Third, throughout our history we have prided ourselves for being committed to our employees. We successfully negotiated three collective bargaining agreements with unions in our subsidiaries and in the second quarter we were recognized by Merco, a prestigious corporate reputation monitoring company from Spain, as the best financial institution that attracts and retains talent in the country. We are certain that both of these matters demonstrate the relationship and the capacity of our employees~~.~~ Without dedicated and motivated employees we could not be the bank that we are today.

On the commercial front, we increased our retail customer base opening more than 28,400 current accounts in the third quarter, equal to an impressive increase of almost 30% over the same quarter last year and at the same time improving significatively our attrition rates.

Lastly, we continued to demonstrate excellent customer service during the quarter. This is especially relevant as customers are increasingly more demanding than in the past.

These are just a few of the accomplishments that have been realized this year. We have demonstrated that we are capable of providing attractive and stable returns to our shareholders despite more difficult and challenging economic times. Infact, despite the harder environment, we grew accumulated net income by almost $10 billion pesos when compared to the same 9 month period last year. We also strive to provide better service and financial products to our customers and we are continually trying to evolve to deliver these services through channels that customers demand.

Thank you and if you have any questions, we would be happy to answer them.