Comments on the 2Q12 Financial Results
Banco de Chile

Good afternoon and welcome to Banco de Chile's second quarter 2012 conference call. It's a pleasure for me to share with you our comments on this quarter's financial results.

To begin, I would like to mention that this was another positive quarter in terms of activity in the Chilean economy and the Banking Sector. As for us, we maintained a solid performance that allowed us to continue leading the banking industry in net income, posting solid earnings of Ch$107 billion pesos in the quarter despite the lower than normal inflation. This was a product of solid results from our core business, strong loan growth which allowed us to rank first in the banking industry and our efforts to continue to control expenses proactively. During the quarter, we were also very active in terms of funding, taking advantage of our excellent credit rating which Standard & Poor's recently upgraded by one notch from "A" to "A+", thanks in part to our robust risk policies which have permitted us to post consistently lower risk ratios than the industry.

With that, let me turn the presentation over to Pablo and I will be available at the end of the call to answer questions in the Q&A session.

Good afternoon. Thank you, Arturo and thank you all for joining us today. Please turn to **slide number three.**

I would like to begin by reviewing the macro economic figures. During the quarter the Chilean economy has maintained robust economic growth amid the financial tensions in developed countries and the slowdown in emerging economies. This performance has surprised even the Chilean Central Bank, which has pointed out that the expected deceleration in our economy has been more moderate than anticipated at the end of last year.

During the quarter, the economy is estimated to have grown by 5.4% YoY after an expansion of 5.6% during the first quarter. At a disaggregated level, the sectors which have most positively affected growth have been those related to domestic demand, such as Commerce, Services and Construction. The aforementioned has been crucial to sustain levels of unemployment below 7.0% and maintain good prospects for our economy in the medium term.

In terms of prices, after a sharp rise in inflation during 4Q11, annual CPI growth has returned within the Central Bank's target range, mostly as a consequence of the fall in prices of tradable goods such as food and fuel. At the end of the first semester, CPI has accumulated a growth of only 0.4%, and 2.7% YoY. According to the latest survey of economic expectations prepared by the Central Bank, inflation is expected to close near the lower range of the Central Bank’s target.

Regarding the monetary policy, the Central Bank has closely monitored developments in the international and local economy, taking a neutral position since the beginning of the year and maintaining the monetary policy interest rate unchanged at 5.0%. This approach permits to develop an expansionary monetary policy if it’s needed, or the opposite, if inflation rises substantially. However, and according to consensus expectations, the rate will remain fixed at this value for the rest of the year.

Please turn to **slide number four.** Despite the solid path that our economy has demonstrated regarding activity, there are signs that estimate a slowdown during the rest of the year that we would like to share with you.

In terms of aggregate demand, private consumption has experienced a downward trend in recent quarters, consistent to GDP growth and its historical patterns. Investment during the first quarter experienced a higher slowdown, as a consequence of a sharp decline in investment in machinery and equipment. Only construction investment continues to grow around 11% YoY, in line with this sector's GDP and with the lag which this sector commonly maintains with respect to the economic cycle.

On the side of international trade, there is a slower growth in exports due to both, lower prices of our main export products, such as copper, and lower international demand associated with the slowdown in the global economy. Imports have also decreased expansion, associated with normalization in spending patterns of individuals and companies.

These factors allow us to estimate that for the second half the year, the economy should reduce its growth rate, but moderately, assuming a scenario where the Eurozone does not continue to deteriorate. Thus, we expect an expansion of 4.8% for GDP in 2012, a figure above our previous estimates at the beginning of 2012.

Notwithstanding the volatile global economy, it's important to point out that Chile continues to maintain very strong and solvent figures. First, Chile has great access to financial and debt markets, due to its low sovereign risk with a CDS spread of about 100 basis points and a moderate amount of public debt of levels slightly above 10% of GDP which permits the implementation of counter-cyclical policies without deteriorating public finances. Second, Chile is an open and diversified economy with an important participation in emerging markets, which are those countries that show the greatest potential in terms of growth. And finally, both the Government and the Central Bank have substantial savings and reserves, which together in May 2012 represent 26% of GDP. In summary, Chile is in an excellent financial position; this in turn would assist considerably to mitigate the potential negative effects of a more complex international environment.

Please turn to **slide number five.** Regarding the Chilean banking system, if we exclude Corpbanca Colombia operations, total loans grew by 4.3% in the 2Q12 and an annual increase of 16.1% in nominal terms.

Among the reasons for the higher growth when compared to the prior two quarters, we can mention the good performance of our economy in the first half of 2012, the expectations of companies which are still optimistic and the positive effect of the higher exchange rate on US$ denominated loans all of which contributed to expand commercial loans by 5.5% in the quarter. On the contrary, individual loans grew at a slower pace despite a strong labor market as a result of a more cautious approach from both demand from customers and supply from banks in accordance to the Chilean Central Bank Credit Survey.

In line with the previous quarters, we expect a moderate loan growth in the following quarters due to the expected slowdown in local economy and persistent uncertainty in the global financial markets in the way on how the Eurozone crisis will be solved. Accordingly, we expect total loans to grow at a rate of about 13% in nominal terms by year end.

In terms of results, quarter-on-quarter net income recorded a decrease of Ch$31 billion pesos, reversing the upward trend showed in recent quarters. In terms of the variation when compared to the same period last year, net income decreased by Ch$89 billion pesos, associated with greater operating expenses and higher loan loss provisions charges, as a result of an economic environment with greater uncertainty which more than offset the negligible annual increase of operating revenues. It's important to point out that the modest change in operating revenues is due to the effect of lower inflation experienced during the quarter when compared to the same quarter last year and prior quarters.

In terms of profitability ROAC reached 16% in 2Q12, slightly below that achieved in the 1Q12.

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

- The second quarter remained very profitable despite the lower than average inflation, posting earnings of $107 billion pesos, a decrease of 6% as compared to the same period last year and a decrease of 12% quarter on quarter.
- Notwithstanding, we continued to consolidate our leadership position in the Chilean Banking Industry, recording the highest quarterly and accumulated net income figure for the year and the highest return on average capital of over 25%. This translated into a market share of almost 28% which is almost 300 basis points higher than the same period last year, demonstrating the outstanding performance reached as compared to our peers.

In terms of Operating revenues, **slide number seven,** we posted Ch$326 billion in the second quarter of 2012. This figure is very note worthy because:

- We have been capable to post these results despite the low second quarter inflation of 0.42% when compared to the previous quarter of 1.07% and especially when compared to the second quarter of last year when inflation was 1.44%.
- Fees from our mutual funds and stock brokerage businesses continue to put pressure on total fee revenue due to the still volatile environment which has investors more cautious, translating into less stock brokerage transactions and higher volumes in fixed income funds which are less profitable.

Nevertheless, we have achieved results which are comparable to last year's figure through:

- Solid loan expansion in profitable segments without sacrificing spreads,
- Higher contribution of our non-interest bearing deposits, and
- Strong fee growth from traditional banking products as we continue to grow our core business.

We are confident that our retail and wholesale segments will continue to deliver good results in the second half of the year which should reduce in a large extent the impact of the expected lower inflation figures, particularly during the third quarter of 2012.

On the following slide, **number eight**, we have a closer look at our loan volumes, which continued their upward trend with double-digit growth rates year-on-year, although at slower pace. Actually, our loan book increased by 16% in a 12-month period and 3.5% Quarter-on-Quarter, demonstrating a moderate uptick in the quarterly expansion regarding the 2.2% posted in the 1Q12.

The above mentioned Year-on-Year expansion was fuelled by a higher growth in retail banking, rather than wholesale banking. Actually, as shown on the charts on the right, our retail banking portfolio continues growing strongly at a rate of 18% Year-on-Year, although at lower Quarter-on-Quarter pace. The annual performance has to do with significant advances in middle and upper-income individuals, as well as SME's, based on a differentiated commercial strategies focused to provide products and services that fit our customers' needs.

In this line, I would like to highlight our successful initiatives to increase our penetration in credit cards and mortgage loans. In terms of credit cards, through our continuously improving customer loyalty programs, we have achieved an increase in outstanding balances of 26% Year-on-Year as well as an important increase in fees. Similarly, we have succeeded in increasing our presence in residential mortgage loans, based on comprehensive plans to reach customers, as well as our competitive rates. As a result, we also maintain a stellar performance in this product, with a 22% Year-on-Year advance. Both these products are very important to our strategy as they generate long-term relationships with customers.

As for SMEs, we have designed a relationship-based service model and tailor-made financial services that have prospered especially in regions outside of Santiago. This quarter we also became the leading supplier of government-secured financing, granting during the first semester the largest amount of FOGAPE loans within the Chilean banking industry.

In terms of total consumer loans, we have continued to grow strongly, posting an attractive year-on-year growth of 14% despite stricter credit risk controls.

Regarding our wholesale loan book, we recorded a 13% Year-on-Year growth and a significant Quarter-on-Quarter uptick of 4.1%. This is a consequence of a still dynamic commercial activity faced by large companies, especially in regions where we have recorded a 17% Year-on-Year increase in loans. In this segment we have been especially active in loans related to Foreign Trade and Leasing, which have increased both above 20% Year-on-Year.

Our strategic aim is to continue consolidating our leadership positions in both retail and wholesale banking. We have put forth an important effort to increase our nationwide distribution network, improve remote channels and automate processes to better service our customers. Our recent strategic decisions intend to maintain a suitable risk-return relationship in order to assure a profitable growth in these segments. This objective has resulted becoming the largest bank in the industry in terms of total loans with a market share of 19.2% and most importantly, we have been able to expand our loan book without sacrificing lending spreads.

In connection with asset quality, as shown in the next slide, **number nine,** loan loss provisions have increased from of $37 billion pesos in the second quarter of 2011 to $50 billion pesos in the second quarter of 2012.

The annual increase is mainly explained by volume growth especially in retail loans, non-credit quality related issues such as the effect associated to the variation in exchange rates in both quarters and higher levels of delinquent loans.

Actually, as shown in the chart in the lower left hand side, an improving trend in delinquencies was observed in the in the first half of 2011, which translated into very low loan loss provisions during that semester. This tendency was followed by a more moderate rise beginning August 2011, in line when delinquent loans began to increase, reaching a peak of 1.35% in April of 2012, or a 20 basis point increase regarding the lowest point attained in July 2011. The increasing trend in past-due was the result of:

1) A moderate slowdown in the local economy after a period of high growth,
2) A negative payment behavior in the lower income consumer market following the La Polar event,
3) The effects of the "Bicentennial Write Off" promoted by the Chilean government, which determined the Credit Bureau must eliminate all negative information for debts below approximately US$5,000 from historical records, and finally
4) Seasonal effects as historically collection efforts are less effective during the holiday periods.

As a result, our management adopted diverse measures in order to reduce our ratio of delinquent loans, such as tightening acceptance criteria during the credit assessment for the lower income segment, adjusting pricing in our commercial model in order to compensate the higher level of risk and most importantly, implementing different initiatives intended to enhance the collection process.

The latter included a rise in specialized personnel for collection duties, changes to collection strategies and procedures by incorporating new methods to approach past-due customers, as well as guidelines for the different stages in the collection process. All of these initiatives assisted in controlling delinquency in loans to individuals by 13 basis points during the 2Q12, reaching 1.2% as of June 2012; substantially below our Peers of 2.8% and the rest of the banking sector of 2.7%.

We are confident these measures should contribute to maintain a superior and efficient risk-return relationship within both our retail and wholesale segments, while our loan loss provisions ratio, as **demonstrated on the next slide, number ten,** should remain below the average posted by our peers and the local banking industry.

Moreover, we consider that we remain as one of the safest and most prudent banks in the local industry with a past-due loans coverage ratio of about 2 times and countercyclical allowances that amount to Ch$95 billion, which is the highest level amongst privately-owned institutions and is equal to 48% of our total past-due loans.

Also, as you can see on the chart on the right, the rating agency Standard & Poor’s recently raised our long-term foreign currency credit rating by one notch, from ‘A’ to ‘A+’. This upgrade has been mainly due to our strong risk position, which in turn is supported by our ability to consistently post superior credit risk figures than our peers and based on our operating revenues which are more focused on the core banking business rather than proprietary trading. Thus, we are honored to have the highest credit rating issued from S&P amongst LATAM privately-owned banks.

Moving on to slide **number eleven**, we can see that our operating expenses remain controlled, recording a 5% decrease over the same quarter last year. Before I explain the main drivers behind this variance I would like to highlight the stability we have achieved in our cost base, especially in the last four quarters, with charges that are around Ch$155 billion per quarter.

This variance compared to the same quarter last year was the result of:

- Greater personnel and administrative expenses. Whereas the rise in personnel expenses were associated with the 12 month accumulated inflation, since wages are indexed to the CPI rate, salary increases related to the collective bargaining process carried out in 2011, and a moderate increase of headcount in our call center and collection areas to cover our growing commercial activity. In terms of Administrative expenses, this rise was mainly prompted by the expansion of our distribution network that translated into greater expenses related to rentals and maintenance.
- These factors were more than offset by lower other operating expenses due to the recognition of about Ch$23 billion in the 2Q11 associated with a contingency provision established to reflect the impact of our collective bargaining process.

In terms of efficiency, our cost-to-income ratio dropped by more than 3% as compared to the figure posted in 2011, whereas our cost-to-assets ratio decreased by roughly 20 basis points in the 2Q12 with respect to 2Q11. Our improvements in efficiency are not only related to our strict cost control policies, but also to economies of scale that we have obtained as a result of our loan growth, and increasing productivity in our branches due to a customer base that increased by 5.3% Year-on-Year.

Also, worth noting is that as a result of lower inflation we recorded a lower contribution from our UF net asset position, which translated into an increase in efficiency ratio of approximately 150 basis points in the 2Q12.

When compared with the industry, as you can see on the bottom left side, we continue to compare very favorably to the average cost-to-income ratio of 52% posted by the industry, excluding Banco de Chile. It is important to mention that we have continued to effectively manage our core expense base, which has grown at lower rates than our assets and operating revenues. We believe that we can continue to improve these efficiency ratios by increasing productivity, closely controlling expenses and by taking advantage of economies of scale. We plan to achieve this through initiatives which are listed on the right side of the slide.

On the following slide, **number twelve,** is a closer look at our funding and capital ratios.

In terms of non-interest bearing deposits, we have grown almost 7% over last year, maintaining our leading market share of 23%. This growth was driven by a solid year-on-year expansion of 16% in individual deposits, far above the negative growth posted by industry excluding Banco de Chile and CorpBanca.

Another very important point to mention in terms of funding is the strong increase in bonds that went from representing from about 9% to slightly less than 14% of total funding. Specifically, during 2011 and 2012 we issued around US$3 billion dollars in bonds in the local and foreign markets which included US$110 million in Mexican bonds, about US$400 million in Commercial Papers in the US market and US$2.3 billion in local peso denominated bonds. Through these placements we have increased the duration of our funding book which is very important for liquidity. Our large volumes in demand deposits, together with our excellent credit rating and very large retail customer base have allowed us to continually post the lowest average cost of funding in the Chilean Banking Industry of only 3.8% as of June 2012 as you can see in the bottom left side of the slide. When compared to our peers and the banking system, we maintain an advantage of almost 50 basis points in cost of funding.

Regarding our capital base, our capital ratios remain strong and significantly above the regulatory limits despite the high growth in loans during the last year. As a result, our Tier 1 ratio reached 8.7% at the end of the quarter while our Total Capital ratio amounted to 12.4%.

Now to finish off, I would like to briefly go over our superior performance during the first half of 2012 in terms of different indicators, as demonstrated on the next slide, **number thirteen**.

The bars of each chart, except the last chart on Return on Average Assets, represent market share as of the first quarter and the columns to the right of each chart represents the change in basis points with respect to last year's figure for the same period.

In terms of ***operating income, net of loan loss provisions***, we continued our trend and ranked first with an impressive market share of 22%. This is especially favourable when considering that our overall market share in loans is about 19%. This has been achieved through:

- A profitable product mix,
- A strong fee based business – the highest in the industry,
- Our leadership position in non-interest bearing deposits and our high credit rating leading to the lowest cost funding in the banking sector, and lastly
- Our superior credit quality as a result of our prudent risk approach.

On the next chart, Operating Expenses, we obtained a market share of 19.6% which is similar to our loan market share and is 156 basis points below last year's figure, growing significantly less than all of our main competitors.

In Net Income, for the second consecutive quarter, we placed first with a market share of almost 28% in the first half of 2012 and a gain of 278 basis points.

Finally, where we continue to stand far apart from the competition and the average in the industry is in Return-on-Average Assets, which continues to reach outstanding levels of above 2% in the semester, far exceeding all of our competitors.

Now if you have any questions we would be happy to answer them.