

## TRANSCRIPT OF A CONFERENCE CALL ON GRUPO SECURITY RESULTS AS OF JUNE 2016

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**Mr. Renato Peñafiel (CEO of Grupo Security)**

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The results for the group are nominally similar to last year.

We begin with this table that shows the direct profit for each business area (Lending, Insurance, Asset Management and Other Services). It also explains how the components that represent each business area aggregate to profit for the group. Profits from the business areas sum to CH\$57,498 million, whereas group profit was CH\$45,416 million as of June 2016.

This has been affected by two important issues. Firstly, group operating expenses were CH\$4,913 million. These operating expenses contain cost synergies with other group companies. This account is only the expenses account. The revenue account associated with these services is included in profits for each business area.

Secondly, finance costs of CH\$5,611 million. These include the Group's direct finance costs, plus the costs incurred by the only subsidiary that holds debt of this nature, which is Inversiones Seguros Security (ISS). This company financed the acquisition of Cruz de Sur. Consequently, this subsidiary debt and its interest are included in the figures, which helps to explain total group finance costs.

The CH\$2,851 million in inflation adjustments is basically Chilean price-level restatement and fluctuations in exchange rates. "Others" includes refunds from the IRS, which are sporadic and happen once a year.

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This has been a very good semester for the group. However, you can see that our profits have been steady. All the group's core businesses have reported a healthy commercial performance, which is aligned with our own budgets.

For example, the Bank's commercial areas, Commercial Banking and Retail Banking, are on budget and performed as forecasted within a difficult macroeconomic environment. The sale of premiums for various products and services has also been in line at the insurance company. And this result has been repeated by the asset management area. There were other aspects that have mitigated against profit growth.

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This page shows trends in the bottom line for each subsidiary. This result should be analyzed in detail. For example, the Bank appears to have achieved practically the same profit, although it does include some extraordinary costs that I will mention later, which change the Bank's result.

The result at Valores for this year excludes the sale of the Santiago Stock Exchange share that took place last year. The result for the General Fund Manager includes incorporating Banco Penta's asset management business, and there is a decrease due to some one-time effects.

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Profit for the Bank is similar to last year, if the necessary adjustments are made.

Profit for Commercial Banking grew by 62.2% compared to the previous year. Profit for Commercial Banking was CH\$24,476 million, which is similar to the consolidated profit for the Bank, of CH\$25,459 million. Retail Banking, and the Treasury had joint profit of CH\$12,940 million.

However, the Board noticed the Bank's good performance during the year, as financial margins grew within Commercial Banking and Retail Banking. So it decided to bring forward amortization of intangible assets of CH\$10,143 million, which is almost the last line on the Bank's income statement.

Furthermore, Retail Banking had higher expenses of CH\$3,010 million, which incorporates adjustments implemented during the year.

The Bank's risk figures have improved. Last year we made some changes to risk management at the Bank. This resulted in higher provision costs particularly during the second half of last year, which have not been repeated this year.

Profit for Factoring is very similar to last year. There is almost no variation to profit, risk and efficiency rates. Given the lower volumes of business, the spreads have tended to fall a little, which has resulted in lower profits, whereas risk levels and everything else have been constant and in line with forecasts.

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Here we have the indicators for the Bank. The efficiency ratio is in the first line and the figure of 54.23% highlighted with a circle. Why has it increased from 45.84% last year to 54.23% this year? Basically due to the higher costs caused by intangible asset impairment. If the efficiency ratio is adjusted for these costs it falls to 49.5%, which is under our 50% target.

The net interest margin (NIM) has grown from 2.62% to 3.38%, as a result of Retail Banking representing a greater share of the Bank's performance. The Core Capital and Basel Convention indicators have been improving, due to capitalizations and retained earnings.

In particular, the Basel III Convention will be implemented in Chile in the future, where intangible assets are deducted from equity. In this regard, it is practically equivalent to conduct a capital increase of CH\$10 billion or to totally amortizing intangible assets of CH\$10 billion. We decided that as the regulatory and accounting opportunities arise we should preempt this change.

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Here we have a comparison of the Bank with its peer banks. The Bank's adjusted efficiency ratio of 49.5% is less than its peer banks, which are at 52.9%. Gross operating income divided by total assets is 3.79%, compared to 3.84% for peer banks. There are no fundamental differences regarding its return on assets or its return on equity.

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As you know, the Insurance Area sold its interest in Penta-Security during the first quarter. This resulted in a net gain after tax of CH\$14,937 million.

What has happened to the life insurance company during this year? Basically it has had a good commercial performance with improved contribution margins and higher premiums. But this positive result has been negatively impacted by its return on investment, where resource generation fell by CH\$11,305 million during the first half of the year. This explains the fall in profits during the first half of the year.

Expenses at the insurance company are reasonably stable.

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The largest insurance policy at Protecta was credit life insurance. However, before we acquired this company, the policy was being liquidated as the claimant had been sold.

There was also a greater adjustment to its technical reserves, primarily due to the sale of annuities.

In spite of these effects, the company's bottom line was affected less than the remainder of the industry.

What has happened to this company, due to changes in annuity regulations? There has been a change in the aggregate annuity market in Peru. The market has fallen by 25.2%, while we have risen by 10.1%.

This has been caused by a new law on the sale of annuities. This has been offset by the company's diversification, and ability to establish itself in niche markets, despite these products being developed over a relatively short period.

Our vision for the company is to secure greater market share in the future. In fact we currently have a 7.1% share of the market, compared to 4.9% in June 2015. We hope to continue increasing our market share, even though the market has shrunk.

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We had an increase of 35.3% per annum in funds under management in the asset management business. This has two causes. First, the merger with Banco Penta's asset management business. Secondly, growth in the distribution of international funds that we represent.

As general warnings for this industry, we can confirm that there has been a change in customer preferences, from riskier products toward less risky products with lower remuneration. This has affected our revenue generation, as fund remuneration has fallen from 1.12% to 0.93% in a year.

Furthermore, we have some additional one-time costs for the first half of the year arising from the merger with the asset management business at Banco Penta, which is now complete, but is still being reflected in our income statement.

Moreover, by this time last year we had sold the Santiago Stock Exchange share. These gains and expenses are probably not going to affect next year's results.

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There are no fundamental changes in Other Services. Profitability is stable, despite falling business volumes. Commercial business both in Chile and Peru, particularly in some specific sectors such as mining, have had a significant impact on the sales of air and land services. This has been offset by higher revenues from airline commissions and services.

This effect has meant that there should not be a significant impact on Travel Security in Chile this year. Although this is more likely to occur in Peru, where the effects have been more significant, and it has been more difficult to deal with the slowdown.

The real estate area profit will be lower due to anticipated transfers of ownership for sales of its real estate assets last year.

Nevertheless, the real estate area has several projects that have not been fundamentally affected by the economic slowdown. We have observed that asset sales are taking longer to close in general across the industry. This means that decision-making is returning to its normal pace, as last year the issue of VAT on real estate sales accelerated buying decisions.

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To summarize the group's traditional businesses, the Bank's loans have grown faster than the industry (+10.1% YoY vs +7.7% YoY); Factored receivables grew by 2.6% (while the industry fell by 4.7%); mutual funds managed by Inversiones Security have grown by 8.0%, impacted by the incorporation of Penta; and direct premiums in life insurance have increased by 20.3%.

From a commercial perspective we have achieved growth despite the macroeconomic adversity in Chile and internationally. Our results have been fairly stable at each of the companies. We have taken advantage of the Bank's substantial profitability to amortize intangible assets, which has an effect as stated on the Bank's capitalization ratios under the Basel III Convention. The life insurance company had positive operational results compared to previous years, although the lower profit is basically due to lower financial investment returns.

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What do we see for the next six months? What will our position be at the end of the year? We believe that loans will continue to decelerate across all segments of the industry. We have perhaps a more segmented commercial approach, and we believe that this year we are going to outgrow the industry once more. We are already perceiving higher levels of risk, which will probably be captured between now and the end of the year, and even more so next year. I believe that 2017 is going to be a poor year in terms of risk and asset growth.

The insurance company has been adjusting its portfolio during the first half of the year in order to reduce the volatility of its financial investments during the second half. Lower profit of Ch\$11,305 million was a result of lower investment returns, and we have already recovered a significant part of this shortfall during the months of July and August. So, the second half of the year is going to be significantly different from the first half, with respect to both provisions and portfolio adjustments.

Our focus on efficiency, particularly at the Bank, is concentrated mainly on the commercial and operational structures. We are undertaking a staff reduction process, and by the end of the year we expect to see a significant impact on the efficiency ratio, adjusted for the increase in intangible asset amortization. We expect this to be within forecast, which is under 50%.

Our vision for the second half is better than for the first, with respect to routine business. It is true that the first half was affected by the increased profit from the sale of Penta-Security, which was "neutralized" by the intangible asset amortization at the Bank and lower income from financial investments.

We believe internally that the first half was positive, because this extraordinary gain allowed us to incur anticipated expenses that we would have incurred anyway, and allowed us to begin a clear adjustment process both for our portfolios and our commercial and financial structures.

### **Analyst 1**

I have a question for Renato with regard to risk, as he believes that next year could be more complicated than this year. The last two quarters have seen provision expenses at Banco Security that have been substantially lower than over the previous twelve months. I would like to ask what is the normal provision cost as a proportion of loans for Banco Security, and how do you expect this to evolve over the second half of the year, and next year?

### **Renato Peñafiel**

My comment on risk refers to the market as a whole rather than just for the Bank. It referred to industry in general. Risk management in Retail Banking is closely linked to the unemployment rate, which we are expecting to exceed 7% next year. It affects all fronts, obviously including the Commercial Banking sector, where we are more focused than other financial institutions.

However, our provision policy and risk analysis changed last year, and we now anticipate some risk decisions. The Bank's provision expenses for the first half of the year have been significantly lower than last year, particularly with respect to the second half, because we made a discreet one-time adjustment. We believe that the Bank should maintain its sequence of risk analysis.

Examining our total provisions and loans, we currently have a combined risk index for Commercial and Retail Banking of 1.84%. Even during the maximum risk periods, I believe that we will never exceed 2%. I believe that we are going to remain where we are.

### **Analyst 1**

Do you have any comments regarding provision expenses, which include changes to provisions and debt charge-offs?

### **Manuel Widow (Planning and Management Manager at Banco Security):**

I think that an analysis of the future requires us to discard an overall perspective and examine the issue for each business segment, and within each segment for each product, particularly for Retail Banking.

Obviously, Commercial Banking does not expect the situation to continue that we have seen during the first half, which has been extremely good. This situation is the result of applying new criteria that are more acidic. Therefore, we anticipated losses during the second half of last year, which resulted in fewer losses due to risks during this year. Obviously, this cannot continue and should return to normal.

We need to examine the issue within Retail Banking by product. We already made an adjustment to mortgage lending, due to changes in regulations, so we should not encounter any significant variations in the future. As the unemployment rate increases, and it is deteriorating, there could be an increase in losses due to risks for consumer lending. However, the characteristics of our portfolio are such that this increase should be considerably lower for us than for the industry.

### **Analyst 1**

Normal provision expenses over loans for you would be 1%?

### **Manuel Widow**

Again, examining this index in overall terms is a little messy. I believe that it would be more correct to examine it for each business.

Anyway, provision expenses will increase to the extent that Retail Banking represents a greater proportion of our business, but we still have some way to go to reach 1%.

### **Analyst 2**

I would like to continue the discussion regarding the quality of the portfolio. I wanted to ask for a little more information regarding the NPL improvements this quarter. What was the reason? All through this year we have been wondering what will happen as unemployment rises, as the economy slows down, and as you have shown us in the results there is an improvement in the portfolio over 90 days overdue. I would like to know if you can explain what is happening.

### **Marcela Villafaña (Head of Investor Relations)**

We performed a major revision in the Bank's risk criteria during the second half of last year, and you can see that NPL coverage increased significantly for the total portfolio, primarily within the commercial portfolio where these indices were lowest. We had 88.1% coverage of the overdue commercial loan portfolio in June last year, and we are now at 122.7%. The commercial portfolio was closely reviewed, and more provisions were created where additional potential impairment was detected, due to this change in the economic cycle. Although we expect unemployment to increase in the future and the economy to remain sluggish for several more quarters, we have already anticipated the corresponding provisions, so our indices will improve.

### **Analyst 2**

Furthermore, focusing on the commercial portfolio, the NPL portfolio was 1.89% at June 2015, and it has now fallen to 1.58%. Not only was there an increase in coverage, but there was also a decrease in NPL. I would like to understand a little better the reason for this improvement, and what you expect in the future.

## **Manuel Widow**

This is influenced by portfolio management regarding loan charge-offs. We have been careful throughout this review of the overall portfolio, and when creating provisions. We have also taken the decision to charge-off some loans where we believe that there is no chance of recovery, and clearly this improves these indices.

## **Analyst 2**

How do you expect the commercial portfolio to perform in the future? Should we continue to see an improvement in NPL in terms of risk and of portfolio quality? Will coverage be stable?

## **Fernando Salinas (Planning and Development Manager at Grupo Security):**

We can expect stable coverage, after the adjustments we carried out. Currently the indices after adjustments have not moved in the opposite direction. We don't expect to see any further improvements, but we do expect the indices to stabilize.

## **Manuel Widow**

That is correct, provided another significant case does not appear that could affect us. But at the moment, we don't expect anything significant to happen that would make these indices worse. On the contrary, we hope that they will continue as they are.

## **Marcela Villafaña**

If you have more questions, you may call us by telephone and send emails. We are available to answer any questions that you may have.

Thank you for connecting and we will stay in touch.

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