Santander Chile

FOURTH QUARTER 2022 EARNINGS CALL

Date: 3.2.2023

Participants:

- Emiliano Muratore, Chief Financial Officer
- Robert Moreno, Head of Investor Relations
- Cristian Vicuña, Head of Strategic Planning
- Claudio Soto, Chief Economist

Mediator:

Good morning and welcome to Banco Santander Chile's fourth quarter 2022 results conference call. I will now hand over to Mr. Emiliano Muratore to begin the presentation.

Emiliano Muratore:

Good morning everyone. Welcome to Banco Santander Chile's fourth quarter 2022 results webcast and conference call. This is Emiliano Muratore, CFO. I'm joined today by Robert Moreno, Head of Investor Relations, Cristian Vicuña, Head of Strategic Planning and Claudio Soto, Chief Economist. Thank you for attending today's conference call.

Today we will be discussing the trends and results seen in the fourth quarter and give some insight into our expectations for this year. Our successful digital strategy and customer-oriented product offering continues to attract new clients indicating great growth opportunity going forward. To begin, I invite Claudio Soto to give us an update on the micro scenario beginning on slide four.

Claudio Soto:

Thank you, Emiliano. The economy has continued slowing down although at that slower piece than expected. According to the latest figure of the central bank, GDP grew 2.7% in 2023. Above our previous estimate of 2.25%.

Consumption has been more resilient than expected and investment has rebounded as postponed projects were resumed in second part of last year. Also, a weak peso has helped the external sector of the economy. Moving forward, we forecast the economy will continue slowing down as financial conditions remain tight. While political uncertainty has moderated, it is still relatively high and will continue conditioning investment.

On the other hand, the economy will benefit from the reopening of China, which has pushed up copper prices. All in all, we estimate the economy will contract between 1% and 1.5%. In 2024, we would see a recovery back to its trend. The liberal market remains relatively weak and employment has been oscillating around 8% and total employment is still below its pre-pandemic trend.

This year, the unemployment rate may increase slightly as the economy moderates. The current account deficit, which was widening until the third quarter of last year, should start shrinking during the following month as domestic demand contracts and term of trade improve. Inflation remained elevated but has shown some signs of slowing down. December CPA was in line with expectations after a negative surprise in October and a positive one in November. Finishing the year with a 12.8% increase year in year.

During the first quarter CPA will continue increasing fast in part due to seasonal factors, but from the second quarter onwards, we will see a moderation due to the slackness of the economy, the appreciation of the currency and the fall of fuel prices. As a result, we expect the CPA inflation will be running at 4.75% by the year's end. The central bank concluded its hiking cycle with a monetary policy rate at 11.25% in October.

We expect the board will begin initial cycling during the second quarter as inflation moderates. In high level of the monetary policy rate, once they begin cutting, the board will proceed at a fast pace. As a result, we expect the monetary policy rate to finish the year between 6% and 6.5%.

The government position improved in 2022 amid strong revenues and a sharp falling in expenditure. All in all, the fiscal balance ended with a surplus of 1.1% of GDP somewhat lower than what we were expecting. Gross debt increased moderately up to 37% of GDP. This year, there will be a mild expenditure expansion with gross debt climbing up to 39% of GDP. As a result, public finance will remain in good shape.

On slide five, we have the details of two of the main reforms of the government, a tax reform and a pension reform. So far, progress has been slow. For them to advance in Congress, a political agreement must be done with the position with a majority in the Senate. Therefore, the discussion on these reforms will require certain compromises by the government. We do not expect they're going to be approved anytime soon.

On the 4th of January of 2023, the new FinTech law became officially law. It updates the relation of financial in on the financial industry, recognizing the existence of new business models based on technology. According to the law, new technological players will be under the regulation perimeter of the CMF. Also, the law regulates open finance establishing that new that consumer are the owners of their financial information. Although there are pieces of regulation that are still due by the CMF, we consider this new law a step forward that opens different opportunities for the financial industry.

On slides six and seven, we have some details about the constitutional process which should be finished by the end of this year. This new process entails proposing a new constitution with a defined framework of main ideas. The new text is expected to be ready by November 2023 and there will be a referendum with mandatory participation on December 17th, 2023 to accept or reject this new draft.

Cristian Vicuña:

Thank you, Claudio.

We will now move on to slide nine to begin discussing our positive client and business trends. Year to date, the bank's net income totaled 809 billion, an increase of 3.8% compared to the same period last year. With this results, our year to date return over average equity reached 21.6%. In line with our guidance, our net income to shareholders in the fourth quarter reached 102 billion weaker than previous quarters and mainly due to lower MIMS in the quarter, as inflation decelerated and interest rates continued to rise.

As we show on slide 10, this was offset by very strong results from our business segment. The net contribution from our business segment increased 19.7% year to date with all segments presenting a significant price in profitability. It is important to note that the result from our client segments exclude the impact of inflation and the cost of our liquidity and therefore present a clear view of the sustainable and long-term trends of our business.

Moving on to slide 11, the results of Santander Corporate and Investment Banking or CIB have been impressive during the year. Total net contribution from this segment increased 49.3% year-over-year driven by an increase in all profit lines items. Net interest incomes was 49.1% year-over-year due to the increase in loans and a higher spread earn over deposits.

Also noteworthy was the year-on-year increase in treasury income of 44.4% and 19.8% in fees income, in line with this segments focused on non lending income. Net contribution from the middle market increased 30.6% year-over-year with an increase in total revenues of 20.4% due to a 19% growth in net interest income as a result of a better loan and deposit spread and volume growth. Additionally, commissions increases by 25.7% in line with the greater client activity with the bank.

On slide 12, we show the results from our largest segment, which is legal banking, which include the results from individuals and SMEs.The net contribution from this segment increased 6.2% year-over-year. The margin increased 9% year-over-year due to a better mix of funding and loan growth. Fees in this segment strongly increased by 15.1% year-over-year led by card fees due to higher usage and increased customer base, as well as fees generated by Getnet.

Provisions increased 43.9% year-over-year mainly due to a normalization of asset quality of our retail loans after historically low levels of non performing loans due to the increasing liquidity of our clients during the pandemic. Operating costs increase in a controlled manner by 3.2% year-over-year, as the bank continues its digital transformation generating greater operating efficiencies.

This positive results can be broken down to a single key factor. Client growth as can be observed from the left of this slide or active individually clients that is clients that have a minimum average balance and interaction levels are growing 7.2% year-over-year and our check account customers are growing at an impressive 13.5% year-over-year. Our SME client base is also evolving ably with active clients increasing 14.6% checking account clients are up 29.4% and loyal clients have grown 7.4% year-over-year.

As we show on a slide 13, the success of Santander lives among individuals is now being replicated in the SME market. This clearly demonstrates the versatility of this digital platform. With minimum additional investment, life has opened a new segment of growth in the SME market that previously was unable to digitally open a checking account.

Not only is life growing quickly, it is also rapidly monetizing, as we show on slide 13, total life clients increase 22% in 2022 with active clients increasing 13% and loyal clients growing 21% year-over-year.

The major innovations in 2022 were the expansion in CSME market and the ability to open a US dollar checking account a hundred percent digitally for an additional fee.

Santander life's clients are also rapidly being monetized with gross income from life's clients increasing 44% year-over-year, demand deposit remain high at 931 million surpassing by many times the amounts client have deposit in similar competing platforms.

The other important driver of our SME client base is Getnet, as shown on slide 15. Getnet has rate sold some 157,000 pos. 91% of GA Net's clients are SMEs, are target clients, and 99% of the pos are solds through the bank's distribution channels. Getnet is currently processing 580 billion in monthly sales. This product has been quick to monetize generating 27 billion pesos in fees year to date during 2022, Getnet launch e-commerce attracting some 800 8500 business with some 5 billion pesos in transactions in the month of December.

On slide 16, we show how we continue to innovate and evolve our brand solutions. In the fourth quarter of 2022, we launched the work startup.This is an initiative that aims to offer an integrated solution to all the entrepreneurial needs and especially to increase bank penetration, carrying out pilot programs with the bank and even offering financing.

It is directed at companies that have three main characteristics, firstly for them to be initiating activities and presenting and accelerating growth. Secondly, that technology is part of the value proposal and third, that the proposals will be scalable to a real problem.

Thanks to all these initiatives, we can see on slide 17 how we consistently continue to lead our main competitors in net promoting score, after a slide deep in our net promoter score at the beginning of the year following some necessary changes implemented to improve cybersecurity protection, the NPS has rebounded to our digital platforms: app, website, compact center and work effect, continue to be highly valued by our customers. In 2022, we also fulfill all of our banking targets as can be seen on slide 18 and are well on our way to fulfilling all of the goals we set for 2025.

On slide 19, we highlight some of our most recent achievements. Once again, we received the top employer certificate for the fifth consecutive year, this positions us as one of the companies with base labor conditions in Chile. Secondly, our ESG rating on behalf of sustain analytics was significantly upgraded. We improved our rating from 29.9 million risk to 15 low risk reaching the best score among Chilean banks.

Robert Moreno:

Thank you, Cristian, for that excellent highlight of our strategy.

We will now move on to discuss to discussion of the balance sheet and results. So moving on to slide 21, we start with loan growth which grew 5.5% year-over-year and remained flat in the quarter. During the quarter, loan growth was subdued mainly as a result of the translation loss produced by the 12% quarter on quarter appreciation of the Chilean peso against the dollar.

Approximately 20% of our commercial loans are denominated in foreign currency mainly dollars, especially in the middle market segment, the large corporate segment continue to grow by 3.4% Q/Q and 32% year-over-year due to various successful large loan operations and the fact that large companies continue to seeking short term financing through corporate loans because of local fixed

income market remains somewhat illiquid. Retail banking loans grew 1.8% Q/Q and 5.5% since December 2021.

With loans to individuals increasing 11% year-over-year and 3% quarter over quarter, consumer loans increased almost 5% Q/Q, and 6% compared to the close of 2021. This was driven by an increase of 23% in the year by Santander Consumer, our subsidiary that sells outer loans and a 20.6% increase in credit cards.

During the pandemic, credit card loans decreased 7% as clients reduced large purchases such as travel and hotels, which yields credit card loans. At the same time, many clients paid off credit card debt with the liquidity obtained from government transfers and pension fund withdrawals in fourth quarter '22. As household liquidity levels returned to normal and holiday travel resume, credit card loans began to grow again, and this trench should continue to be visible in 2023.

Origination of new mortgage loans has fallen as inflation and remains and rates remain high. As per SMEs, the demand for new loans remains moderate after a strong increase in 2020 and 2021. For the Fogape programs, given above SMEs segment loan book decreased 5.7% Q/Q, and 20.6% year-over-year as SMEs repaid Fogape loans.

For 2023, despite negative GDP growth, we expect loans to grow in the mid-single digit range. Consumer loans will continue to be led by the rebound of credit card loans. SMEs will probably benefit from a new Fogape program to be announced soon. At the same time, we expect similar growth rates as the average portfolio in our corporate segment.

On slide 22, we show the evolution of our funding. Total deposits decrease 3.4% year-over-year and 4.3% Q/Q, as the bank focuses on reducing funding costs, the central bank continue to raise the monetary policy rate which reached 11.25% and the yield curve is sharply inverted. In order to control funding costs, we have been maintaining our market share and demand deposits while replacing wholesale time deposits with longer term funding sources that today are much cheaper than time deposits.

Moving on to slide 23, we can see how the movements of volumes raise and inflation has been affecting our margins. The UF variation continued to decrease from the highs of mid 2022 and reached 2.5% in the quarter. This was coupled with an increase in the average monetary policy rate. Both of these factors drove down. The bank's NIM to 2.2% in the quarter and 3.3% for the full year. As shown on this slide, this is mainly a phenomenon that affects our non-client NIM or the net interest margin from our ALM activities including the UF gap and our liquidity. The client NIM, which is defined as the NII from our business segment over interest earning assets has and will remain stable in 2023.

On slide 24, we give further insights into our margins for this year. For every 100 basis points decline in inflation, our NIM falls on average by 20 basis points. And for every 100 basis points rise in the average monetary policy rate, our NIM falls by 30 basis points. Our base case scenario for 2023 is an average monetary policy rate of 9.2 and a UF inflation for the full year of 5.3. Under this base scenario, the bank's NIM in 20 20 23 should reach 2.8% starting below this level in the first quarter of 2023 and rising back to levels of 3.6% by the end of this year.

Moving on to asset quality on slide 25, the rise in the NPL ratio to 1.8% in the quarter is mainly related to household liquidity levels gradually returning to post pandemic levels and a softer economy. This has mainly affected clients who are already impaired pre pandemic. The coverage of NPLS has of December

reached 185% and has been no reversal of the voluntary provisions. As we can see on slide 26, these overall positive asset quality indicators led to a cost of credit of 1% for the full year. In line with our guidance for the year.

During 2022, our regulator, the CMS published the draft, the new standardized provisioning model for consumer loans. We expect this new model to be implemented in the second half of 2023. Our initial estimate is an increase in provisions of between 100 and 150 billion pesos, mainly in our lending and credit card portfolios. We are permitted to use voluntary provisions to comply with this new regulation.

During the fourth quarter, we saw cost of credit picking up reaching 1.2%. This was mainly due to specific clients in the middle market segment and construction sector. Given the trends and our economic outlook for this year, we are updating our guidance for cost of credit for 2023 to 1.112%.

On slide 27, we move on to non net interest income revenue sources which continue showing exceptional growth trends. The income increase 16% year-over-year and 1.2% Q driven by higher client activity. New products such as Getnet and the growth of our client base as previously described, we expect these trends to continue in 2023.

As shown on slide 28, we can also see the bank's efforts to continue increasing productivity and to control cost. Operating expenses increase 6.7% year-over-year and decreased 5.7% due Q over Q will be low inflation trends. The bank continues ahead with its 260 million technology investment plan for the years 2022-2024, and because of these investments we're expecting cost to grow significantly below inflation levels in 2023.

As shown on slide 29, the bank continues with its process of optimizing the branch network. This year we have closed 12% of our branches and have opened 11 new work cafés that are not only a major improvement in client experience but are also more efficient. As a result of these initiatives, coupled with our digital strategy, productivity is rising significantly with volumes per point of sale increase in 16.2% and volumes per employee increasing 8.5% year-over-year.

Moving on to slide 30, we observe an excellent evolution of our capital ratios. At the end of the fourth quarter. The bank reported a core equity, a CET1 ratio of 11.1% up from 9.2% in December 2021. Our total CET1 increased 20.6% compared to a 0% rise in risk weight assets year-over-year. Despite lower net income falling rate and inflation expectations benefited OCI inequity and therefore bulk value growth has outstripped net income, a trend that should be also visible in 2023.

With this high capital level, we expect to maintain our historical payout of 60% over 2022. Earn this still requires final board and shareholder approval in April 2023. With this payout, our current dividend yield is close to 8%.

At slide 31, we would conclude with some guidance. Despite 2023 being a somewhat more challenging year, on the macro front, we believe our strong client activities will continue expanding. Coupled with this, we will continue with our investment program which focus on digitalization and automatization. We will continue investing to improve our leading MP scores as well. We also expect client growth to remain robust as in 2022 led by Santander light and Getnet.

In terms of loan growth, we expect mid-single digit growth with a focus on all segments and non NII to expand by at least 15%. NIM should contract to 2.8, but with solid client NIMs. As the NPR comes down, we expect NIMS to rebound to 3.6 by year end. Asset quality should deteriorate somewhat, but the cost

of risk will remain at a manageable level of 1.1 to 1.2%. Cost control will be a major focus and we expect low single digit expansion of cost. Regarding capital book value growth should continue and as we mentioned we currently have an attractive dividend yield.

In summary, we will start the year with ROEs in the low teams. As the year progresses, ROEs should improve and for the full year we are guiding an ROE of 18%. With this I finished my presentation and we will gladly answer any questions you may have.

Mediator:

Thank you. We will now move to the question and answer section. If you would like to ask a question, please press star two on your phone and wait to be prompted. So our first question comes from Yuri Fernandes from J.P. Morgan. Please go ahead.

Yuri Fernandes:

Hi, guys. Thank you for the percent of asking questions. I have a first question regarding your ROE guidance, the 18% you are calling for 2023. And Robert is very clear the path, right like a mark challenging first half and ROE is improving the second half.

But when we look to the margin guidance, that basically implies in 50 deep degrees on your needs right from 3.3 to 2.8. We have a hard time getting to the 18% for the full year because you have around 50 trillion pesos on interest earning assets and these pressure on margins it cost them 200 billion, 250 billion pesos on your NII.

And with the other numbers like GNA, the things we have it's hard to get to those 18%. So my question is where is the source here? Is lower taxes? Maybe higher fees? Other than very good GNA and these NII pressure, what could be the drivers for you to reach those 18%? And I can ask a second question after to reply this one. Thank you.

Robert Moreno:

Okay, Yuri, so you have the margin, a picture clear. So the margins will for the 2022 or 3.3 for the full 2023 will be two point eight's, a 50 basis point. So NII will probably fall. So the good that's let's say the difficult part as we said before, the ALM is the main responsible for that. The client name should be relatively stable as here. The key thing for NII is the velocity at which the central bank lowers monetary policy.

On the one hand we know that for that to happen inflation comes down, that's kind of a headwind, but that's only a headwind in the very short term. If that triggers a rapid decline in rate, the faster that goes down the better. So today think of this as more a play on, let's say on rates falling than inflation's coming down. So the faster rates come down, the better it will be for outlook for NIMs. But given the base scenario, that's 2.8%. Provisions should grow a bit but under control.

And then from there on we should have quite good news. Okay, so first of all it's fees. Fees we're expecting is that 15-20% growth the same that includes fees and treasury. We continue to see, and this is something we try to stress with Christian Vicuña, in the beginning of our presentation. Everything that's client related is doing very, very well.

You saw the results of corporate banking, middle market retail, so for there, everything that's client growth, everything that's non lending should continue to be pushed. Just to give you an example, we increased SME checking accounts by 30% last year. We grew individual checking our grounds I think believe by like 20. So everything that's product usage, Getnet, that's good news.

And then there's cost. And when we talk about cost, we're talking about personnel, administrative depreciation and other operating expenses. And in other operating expenses we should have including those items, we should have a very, very low growth of costs. Obviously we've talked about 2%, it could be even lower. So probably the difference in your model is other operating income and other operating costs, which we're going to see a big improvement.

There, for example, we have a lot of insurance cyber costs, we did a lot this 2022 to improve that. So a lot of things are going to come down there as well. So that's going to be a big boost to the bottom line to get to the 18. Taxes, no taxes with lower inflation we're not... We'll be paying like 16-17, okay? But overall everything that's not margins is going to leave... we feel confident with the 18% ROE.

Yuri Fernandes:

No, that's super clear, Robert. So NII maybe a little bit of cost of risk, the detractors and all the other lines helping you to have a better 2023. I have a second one regarding capital, and by the way, congrats. I guess our capital position was under pressure we switched 2021. We had a lot of mark to mark and equity shareholders actually suffering a little bit, but this was a good quarter for capital.

So if you can explore a little bit more what drove the RWA down, I guess you comment on some derivative strategy and also the mark to mark. So basically it's clear the message, right? You keep the 60% payout on dividends, but could we see ongoing capital improvements in similar levels? Again, explain a little bit the change and we wait ahead for your capital position. Thank you.

Emiliano Muratore:

Hello, Yuri, thank you for your question. So in the quarter, basically the main source of risk related assets contraction. Let's say that the overall reason assets to stay flat for the year was the market risk with assets as maybe as we have discussed in the past with you and the market and then the children regulation for market risk is the standard model, the more basic approach to lesson three. So basically that penalizes, let's say, the more sophisticated business as the one we have. I mean we are the leaders in the real derivative market in Chile thus far. So the bigger the book, the bigger assets and that's without considering the real sensitivity or the real risk of the book.

So basically what we have started in the fourth quarter and we plan to keep for this year, it's a big program of compression of positions have been basically netting down or netting out, balancing positions without risk and leaving both positions out of the box.

And so that's what helped risk asset then in terms of mark to market of our inflation hatches, I mean the fall in the inflation in the second part of the year and then the recent months also helped the market of our inflation hedges. So going forward we are still optimistic about our capital position. We still see some room in of efficiency in the risk with asset coming from market risk. So that will be a tailwind for this year, book value also doing well in this new scenario of inflation, moderating interest rate also going down.

So as going forward we think that we going to stay, I don't know, from 10.5 to 11% CET1 with relatively easy, even today with our 11.1 after paying the 60% in April in case the board decides to propose it on the AGM to approve it. Even with that, the ACD one should be at that 0.5 or higher, which would be the highest CET1 after dividend in the recent year. So we are optimistic going forward in terms of capital book value and risk with assets trend.

Yuri Fernandes:

Oh, that's super clear. Thank you very much.

Mediator:

Thank you. Our next question comes from Carlos Gomez from HSBC. Please, go ahead.

Carlos Gomez:

Hello, good morning. Thank you for taking my question. In the past you have talked about the update of regulation on provisions for the consumer portfolio and how you would have to provision more for that, any changes in that and what is your expectation?

And second, going back to the initial question about the margin, I mean you emphasize a lot that rates are going to come down and what the impact is going to have would if rates stay up and don't decline as you expect. Would that be positive or negative for you? And could you give us an order of magnitude? Thank you.

Emiliano Muratore:

Hello Carlos. Thank you for your questions. In terms of the new voluntary new provisioning for consumer loans, no change. I mean we still are expecting an impact between a hundred and 150 billion pesos in the stock of provisions that maybe the recent development is that at the beginning it was expected to be in place during second quarter of this year. Now there has been a postponement of in the process, so we are seeing it now for second half or maybe last quarter of this year. But no change in so far in the impact we are foreseen.

And in terms of your question about the sensitivity to integrate definitely if the rates go down at the slower pace or is going to be worse for us, and the opposite if they go down at a faster pace and that's why we included the heat map, we call it, on slide 24, where there you can have the different impacts at different inflation and monetary policy rates.

You can see that in case, the average monetary policy rate for the year stays like a hundred basis point higher than our base case. We have an impact in name of 30 basis points and well basically there you have the... It is quite linear, the effect. So it's as a matter of you, let's say, put in what you think the average one police say rate could be. We include this to access chart basically because inflation definitely will also be different if rates are different. So that's why we think that it's important to have both sensitivity in the same chart to play. If you are more on a hawkish side higher inflation and higher rates, what would happen and if you are more on the dovish side, what would happen with lower inflation and lower rates.

Carlos Gomez:

Thank you very much. And this is very clear and thank you very much for showing this slide. To what extent can you change this during the year? I mean this is your structural position presumably as of now. If you change your view, if you think rates are going to evolve in a different way, can you change this in the next two, three months or is this set for just your video?

Emiliano Muratore:

No, I mean I would say that the midpoint, let's say for the name of the year, it would be around there, I mean what we can change. And if you compare this chart to the one we showed last quarter, you will see that the sensitivity to inflation went down because basically we reduced the UF gap, so the sensitivity to inflation now basically we kind of secured higher levels of inflation, so now we have less risk to that. And at the end managing this is a matter of what trajectory of interest rates the market has implied in the prices because basically we can change this by adapting the sensitivity by paying fixed rates or receiving fixed rates.

And basically today we see that what the market is implying it's close to our base case scenario in terms of inflation and trajectory for interest rates. So we don't see any significant value in fixing or logging in data scenario. So that might change in the future if basically the market starts discounting a more hawkish or doish scenario that make us, let's say take a position there. But so far we expect to have this position in at least for the first part of the year.

Carlos Gomez:

Thank you so much.

Mediator:

Thank you. Just a reminder, if you would like to ask a question, please press star two. Our next question comes from Tito Labarda, from Goldman Sachs. Please go ahead.

Tito Labarta:

Hi, good morning, thank you for the call. I'm taking my question. I guess I'll follow up to you's question on the ROE guidance and sorry to ask on a little bit more short term basis, but even getting to that low teens for next quarter, just maybe if you can help us think how do you think the interest rate will evolve? When do you expect rates to start to come down?

And also even the evolution a little bit on the inflation because it seems inflation should probably be lower in one cube, but rates still not coming down. So not even sure how the margin would improve next quarter to get to that low teen ROE, particularly because this quarter had the negative tax rate. So if you can just help us think about, so just how that ROE's going to evolve throughout the year with your macro assumptions on a kind of shorter term basis. I would appreciate it. Thank you.

Robert Moreno:

Okay, Tito. So in the first quarter, as we said, the names in the fourth quarter are like 2.2, they should be like 2.2 in the first quarter at the same time. Remember there's a lot of seasonality and cost in the first quarter, so that's going to help. But effectively the ROE in the fourth quarter was in the 10% range, in the first quarter, there's a lot of moving parts, but the margin is slightly lower. Provisions should be

stable or lower fees more or less the same and costs a seasonally lower as well. So overall I think the first quarter.

And also there's what I was talking with Yuri, there was I think cost is going to be a big difference. So in the end you end up having a very similar net income in the first quarter and then going on, basically what we have is the seasonality of the rates.

And here I think I turn it over briefly to cloud. If you can mention that and then I'll wrap it up.

Claudio Soto:

Yeah. Well, in term of inflation in the first quarter we will have two things that are important to have in mind. First of all, there was a change in taxes on services that will impact the CPI in January that will be transitory. There will be a hike in prices due to this one-offs and that will help with the UF. And then in March we usually have high inflation Chile because of seasonal factors. So we will have a first quarter with a relatively high CPI.

Then the decision for cutting rate by the central bank will be done, we expect during the second quarter. There are three meetings in the second quarter. So it could be in any of those meetings, but at that moment we expect inflation will be going down in a very clear trend that will help the central bank to cut rates in a very rapid fashion. You have to have in mind that the monetary policy rate in Chile is particularly high if you compare pills, cycles, fourth trades or if you compare to other countries, the tighten in Chile was very aggressive and therefore we expect also the cutting phase will be also aggressive.

Robert Moreno:

So basically it also first quarter names around two. And then as we follow what we expect to be the base scenario and rates and inflation, second quarter inflation, UF inflation's always season a little bit higher, but basically NIMS of 2.6, 2.7, the second quarter, third quarter, 2.9, fourth quarter, 3.6, more or less that, depends on your interest asset earning growth as well. Okay, so we are seeing some volume growth as we said, five, 6% overall you get a name of 2.8 for the full year.

And as we said before, this coupled with very good non NII risk rising a bit, but it also a lot of things on the cost. So this gives you an idea of the sensitivity we talked about, it's quite sensitive to the fall and the monetary policy and there's a big difference between first quarter NIMS and fourth quarter.

And the other thing that this is also a little detail, but something I wanted to mention is that we still have a significant amount of liquidity held in the held to maturity portfolio and that all comes due in 2024.So basically there we have... Remember that's the collateral against the central bank lines. We took cheap funding from the central bank, we had to hold collateral. Some of that is held to collect, so it doesn't affect the volatility of equity, but obviously those are a low rate. So this is looking forward to 2024, which obviously is a far, far away. But in 2024 we kind of returned to normal interest rates, normal inflation, the FSE is paid back. A lot of this collateral, it has exact same maturity.

So in 2024 we should also have a jump in it. Okay, even with inflation coming down and given that we finished the FSE program, our house to collect portfolio should be repriced at a higher rate. So basically in 2024, once again it's quite far away. We're looking back at NIMs of 3.3 0.5, or at least where we left off in the fourth quarter. So basically we have to kind of travel through this first half. But from then on

as a central bank it lowers rates. And obviously in 2024 when the central bank financing comes due rates should definitely have an upward trend, sorry, NIMs, an upward trend.

Tito Labarta:

Great, thanks Robert and Claudio, is very clear. Just one quick follow up, I guess, should we also expect a negative tax rate in one queue? We saw this quarter.

Robert Moreno:

Okay, so regarding the negative tax rate, basically that to make a taxes are complicated, but a simple answer, even though the remember that for tax purposes in Chile you still do inflation accounting, not in our financial books, but in our tax books, everyone, every company, every person, you still do tax accounting. So our equity continues to grow cause of inflation. Okay, so basically that monetary correction of capital was larger than, let's say, net income. So that's why you have a reversal of tax in the fourth quarter.

In the first quarter it should be still very low because we're still having some inflation and our book value has been growing as you saw, as we mentioned before, our book value for different reasons has been expanding at a faster face and the book value is readjusted for tax purposes by price level restatement. So said that our tax rate should kind of have a similar trend as ROE in a certain sense we're starting out low and then paying much higher tax. I don't know if it'll be negative, but the tax rate should be very low single digits or low teens and then slowly rising as a year and finishing of the year on an average of like 17%. But once again, it should be relatively steep like the ROE.

Tito Labarta:

Okay, perfect. That's very clear, Robert. Thank you.

Mediator:

Thank you. So our next question comes from Anand from White Oak Capital. Please go ahead.

Anand Bhavnani:

Thank you for the opportunity. Two questions from my end. One the 260 million CapX, can you give us some details around it? What is it about and in which quarters do you intend to spend this?

Robert Moreno:

Sorry that you're asking about our investments?

Anand Bhavnani:

Yeah, the $260 million investments that you're talking about, what is that?

Robert Moreno:

Okay, so basically we usually do an investment plan that expands three years. So we're in the middle of our 260 million investment plan that we announced in 2022, sorry for 2022 to 2024. It's roughly equal

per year. And that's just digital. Obviously there's other investments and fixed apps, whatever. But basically that entails the transformation of the branch work, automatization, everything, that's the new robots taking a lot of the systems and products to the cloud.

So basically it's a big overhaul in line with the digital transformation that a lot of companies are and banks are doing worldwide. And for us, it's very important because obviously with margins coming down we're cost conscience, okay, we're doing a lot to control costs, but the idea here is not to touch the technological part, so not to cut costs today and then have to reinvest or invest more in the future.

So basically, we've been reducing branches, headcount has been coming down a bit. There's other costs initiatives, but the whole investment plan, which is transformation of the branch office, the front end transformation of the back end operations, which means a lot of automatization and digitalization and other technological improvements is covered by that plan, which is 260 million total and roughly one third per year. And then maybe by the end of this year we'll announce a new plan for the next three years.

Anand Bhavnani:

Okay. And from the corporate tax perspective, given the current changes in the constitution being contemplated, is it fair to expect that this corporate tax rate of 17 would not continue and it should rise in the future by a certain percentage point? And if yes, then what is the expectation you have for the increase in corporate tax rate?

Robert Moreno:

So in Chile, the corporate tax rate is 27, in your tax book, so we're always paying 27 in our tax accounting. But when you look at it, our financial and remember that for tax accounting you have to readjust for inflation account. And basically what that means for banks is that your equity is increased by inflation every year. So if you have equity of 110% inflation at the end of the year, your equity and your textbooks goes to 110, that additional 10 is a tax loss in your textbooks. So that's why the effective tax rate is lower than the statutory tax.

So therefore as inflation rises, the monetary price level restatement of equity goes up and your effective tax rate goes down as inflation slowly normalizes. The tax rate will go up in an inflation, a normal inflationary environment with inflation around 3-4%. Our effective tax rate should be around 21%. Okay? And that should be the normal in line with the 27%, corporate tax rate plus the monetary price level statement of equity.

Emiliano Muratore:

And in terms of the discussion about the constitution or the tax reform, it's not under discussion and increasing in the corporate tax rate. I mean the discussion goes in other direction, more on the personal and the wealth tax and all that, but no discussion so far on increasing the corporate tax rate.

Anand Bhavnani:

Sure, thank you and all the best.

Robert Moreno:

Thank you.

Emiliano Muratore:

Thank you.

Mediator:

Thank you. So we have one more question from Mario Abreu from T. Rowe Price. Please go ahead.

Mariel Abreu:

Hi, thank you for the time. I have two questions. One, if you can remind us what are your refinancing needs for this year and next, and how do you plan to cover for those? And are liquidity conditions still pretty favorable overall? I don't know, if you can comment about that.

And the second question, it's on asset quality. I'm looking at your nonperforming loans and it almost doubled for consumer, the increase was also pretty meaningful even for commercial and mortgages. Is that all explained by the change in liquidity conditions or is there something else perhaps you can give a little bit more color on maybe a specific industry or products that are driving that as well? Thank you.

Emiliano Muratore:

Okay, so thank you for your question. I mean regarding the first one, our funding needs for this year are, let's say, below the average. We usually have on a yearly basis I would put it in the 1 billion dollar ballpark. So we are comfortable with that and we plan basically to use the same mix we have been using lately between deposits coming from clients and institutional investors. I mean some bilateral funding lines from banks abroad. And I'm very active on the capital markets domestically and abroad.

I mean more on the private placement side, even though this last few days, weeks, I mean the public capital markets abroad have improved dramatically. And so now even public transactions in the US markets and other public markets could be an option. So on the funding niche for this year, we are quite comfortable and about the liquidity conditions, the domestic capital market is in better shape than used to be in the middle of the pension fund withdrawals and all that tension the market had. Now situation it's better even though the total sizes of the transactions are not the ones we had in of the best moment of the market, but the situation is quite favorable, definitely any potential risk of additional pension fund withdrawals would put pressure on that.

But it's not, let's say, our base case for the year. And the good news is that public markets abroad also are improving and that give us much more flexibility either to tap the domestic or international markets for our funding needs which are below the average on a yearly basis. Bob, we want to comment on as quality-

Robert Moreno:

Yeah. So as a quality regarding consumer lending, that's really the rebound at post end of excess liquidity. So that's just going to go back to where it was pre-pandemic. It might overshoot a little bit depending on how strong the recession is. But remember last year I believe NPLS and consumer were

like 0.9%. We had never seen it that low. And clearly this is a direct result of normalizing liquidity and the levels of last year were extremely low.

The good news is that we still have very high coverage. We haven't touched the voluntary provisions and for good or for worse with we're going to add on 120 billion, 150 billion more of provisions in consumer. Obviously redirecting voluntary, it's not going to have an effect on the P&L, but the consumer coverage is going to be under the year at very high.

Mortgage, I think it's very similar, even though I think mortgage, there is some impact of the higher inflation and rates, especially higher inflation. We always talk about the good news on margins, but obviously higher inflation results in higher mortgage payments and there was a little bit of impact there. Once again, still very low and we have much higher coverage. And the value of collateral, it's still quite good, even though it's done very conservatively.

In commercial loans a bit the same. But in commercial loans there has been some sectors with a little more weakness. And as we said in the presentation and in the management commentary, I would say particularly in the quarter of the construction sector, without being not even near a crisis, that there has been some weakness in the construction sector. And that drove up provisions, especially in the middle market. In the middle market, it's a broad segment, but it includes everything construction and real estate.

The real estate developers have been very, very, I'd say healthy. But when you have very little construction going on and with high rates, obviously construction companies of all sectors are probably the ones that are suffering the most. In Chile, we have 1% of our loan book, I believe in construction. So that will be a weakness probably for a while until rates go down and until real estate developers begin their projects again. So basically...

And then there's the segments, restaurants, all of that. Those are coming out of the pandemic getting better but still weak. And then with the recession it's kind of hard to go through a pandemic and now our recession. So some of those sectors, which once again they're like 1% of the loan book, but there should be some weakness as the economy slow down. So therefore that's why we finished the year with the cost of credit of 1%, but in the last quarter of 1.2, and we think for this year the average will be 1.1-1.2. Okay. So once again arise, but still we have a lot of coverage. We haven't touched our voluntary provisions, so we think that 1.1-1.2 is quite realistic.

Mariel Abreu:

Okay, thank you very much.

Mediator:

Thank you. We have a question from Daniel Mora Ardila Credicorp Capital. Please go ahead.

Daniel Mora Ardila:

Hi, good morning, and thank you for the presentation. I have just one question and it's regarding derivatives. What is the strategy regarding derivatives? For example, if we see the first three quarters of 2022, when you see the accounting hedge of interest rate risk, it represent ROE 48% of the total interest expense without considering their adjustment net interest income. So considering also that the relative

decrease from 17 trillion pesos to 11 in this quarter, what will be the fact of this on margins going forward? What will be the strategy for derivatives, and what will be the fat of the decrease in derivatives for margins going forward? Thank you so much.

Robert Moreno:

Okay, so there's two effects there and there are kind of unrelated. So first of all, we have, let's say, three big groups of derivatives that are in the balance sheet. One is the biggest is what we do with clients. A client needs a forward or an interest rate swap, and that is all managed with advanced risk metrics, et cetera. And those are basically matched on the asset liability. But given that we're a big bank where a lot of clients come to ask for protection, especially against effects movement, so our derivatives and little bit what Emiliano said before, in Chile, the accounting for derivatives, basically you have the asset and liability and there isn't much netting.

So basically when the Chile peso depreciated, that inflates the asset and liability of our derivative volumes, but the net doesn't really change. So the big growth you saw and the derivatives as a percentage of assets and liabilities was because as a bank that does a lot of forward derivatives, especially with clients and these type of things, the depreciation of the peso leads to an inflation of that volume and liability. And then when the peso appreciates that comes down.

Emiliano Muratore:

And also the compression we have been performing in order to net that out and to reduce with assets for the capital ratio has also-

Mediator:

Sorry, just bear with us a moment. I think we're having one or two tech technical difficulties.

Please bear with us just a moment. We've lost the host, but we're just trying to reconnect now. Thank you.

Thank you for your patience. If you just hold on for a few more minutes, we're just reconnecting the host. Thank you.

Apologies for the delay. We're still trying to reconnect the host. If you can please continue to be patient. We'll try and reconnect them now. Thank you.

Speaker 12:

Hello. Anything else? Hello?

Robert Moreno:

Yeah, okay. Okay, sorry.

Robert Moreno:

Sorry, sorry. I connected, I was really inspired, but now I don't know why I left off. So basically I was talking about, so when the peso appreciates the volume at the liability of the root is false-

Emiliano Muratore:

Why don't you ask When you ask where do you left out?

Robert Moreno:

Do you know... If anyone will tell me where I left off?

Or I'll just summarize it up. And then we have the UF gap. So we control the UF gap using cashflow hedges and those are, the asset is in mark to market withdrawn mortgages, but the derivative is against equity. So that explains during 2022 why part of the year we had a loss in OCI because as inflation expectations went up, that produces a loss. But as inflation expectations go down, even though there's an impact on margins, the book value grows.

So there's another reason for book value growth because of these cash flow hedges. And that's always going to be that way, but as long as long-term inflation expectations remain anchored with the central bank, what the central bank wants, that shouldn't be a noise. This happens when you have big sharp turns and inflation expectations.

And then there's a third type of derivative, which is a derivative we use in order... Because remember, we always talk about we're long inflation and we're also short liability sensitivity to rates. And part of that sensitivity to short term rates is also done through hedging, but those type of hedges are not recognized against equity. The cost of those hedges or those swaps are recognized in net interest income, both the cost of that and the mark to market.

So when you look at our NII, you're going to see that last year, 2022, we had a big increase in what is valuation, what is inflation, because we increased the inflation gap. Well, we also as a policy, we go long inflation, but we don't like to be on both sides of the equation to go long inflation and long rates because if inflation goes down, rates usually go down, maybe not at the same moment, but our biggest fear here is that if inflation goes down, rates will go down.

So basically through what we have today is a situation where we see that inflation is going down and therefore rates should begin to go down and therefore this year if rates begin to go down, not only will you have a decrease in funding cost, but also that increase in the value of that, those swaps, which is also included in NII, we'll also start to reverse.

Okay, so long story short, with inflation and rates coming down, you're going to see an improvement in the book value because of the OCI and you're going to see an improvement in margins. I don't know if that was clear or not.

Daniel Mora Ardila:

Yes. Perfect. Very clear. Thank you so much. Thank you so much for the explanation.

Mediator:

Thank you. So we have a question from Alonso Aramburu, from BTG Pactual, please go ahead.

Alonso Aramburu:

Yes. Hi. Can you hear me?

Robert Moreno:

Yes.

Emiliano Muratore:

Yes.

Alonso Aramburu:

Yes. Okay, thanks. Yeah, I wanted to follow up on the return on equity. Clearly it's going to be lower in the first half of the year, increasing in the second half. For you to get to 18%, you probably need to be closer to 20% towards the second half of the year. And you're talking about potentially margins being even higher in 2024. So my question is, when you look at your sustainable ROE, potentially in a mid cycle situation with rates, let's say around four or five normalized inflation, should we think that your sustainable ROE is now above 80%? Given this trend and this momentum, 2024 looks like it would be probably closer to 20%.

Robert Moreno:

Okay. So basically we've always stated that the long-term ROE is 17-19% because there's always, it's hard to tell the future now, but basically as we said, if we go back to normal rate and inflation with margins going back to their historical standards, what we don't know is things like unexpected legislation or things like that, or risk is going to be.

But if everything goes back to normal, we don't have any surprises. A 19% ROE is in the long term, is absolutely feasible. We keep the range 17-19 to take an account of unknowns, but clearly going back to normal levels of inflation and rates and our strategy continues to be successful. 19% ROEs, the high end of that range is clearly absolutely feasible for the long term.

Alonso Aramburu:

Okay, perfect. Thank you, Robert.

Mediator:

Thank you. We have a follow-up question from Anand, from White Oak Capital Anand. Please go ahead.

Anand Bhavnani:

No, thank you for note. Sorry. Thank you for the opportunity. Three questions. The credit cost for the full year, the guidance is 1.1 to 1.2, in terms of quarterly, do we have any expectation of whether it'll be like frontloaded or backloaded? That's question one.

Robert Moreno:

Okay. It should be a front loaded, maybe second and third, but as I said, this has a lot to do with the evolvement of the economy. So as we're seeing the weaker economy now and then picking up at the end of the year. Sometimes there's lags and asset equality, but I would say that it's going to be probably higher in the beginning of the year, coming down towards the end. And obviously the goal of the bank is to reach a cost of credit for 1% in 2024.

So our view is that it'll be higher in the first half coming down, especially in the fourth quarter, probably.

Emiliano Muratore:

But with not much steep-

Robert Moreno:

Yeah.

Robert Moreno:

Yeah. Exactly.

Emiliano Muratore:

Yeah. The trend should be loaded but not significantly-

Robert Moreno:

Yeah. So basically as we said, we 1.2, maybe a little bit higher in the beginning and then going down to 1.1. So it doesn't change too much like the margins, for example.

Anand Bhavnani:

Perfect. Secondly, when you are answering the previous question on derivatives, there was explanation about three different aspects. First was about the client predicted derivative. The last one was about our balance sheet. We are long inflation and short health. So in the middle you explained about the US account, if possible. Can you explain it once? I couldn't get that.

Robert Moreno:

Okay. So the UF Chilean banks are very plain vanilla, but we have this special thing called the UF, which is the currency. It's basically inflation linked pesos. And the bank, by the nature are most long-term loans in Chile index to inflation. As a result, since banks usually are taking deposits, which in Chile are either non-interest bearing or time deposits. And time deposits tend to be a stable source of funding, but very short contractually.

So think of it this way, we're capturing nominal pesos and we're lending US. So we're lending inflation linked and we're mainly capturing pesos that are not inflation linked. And this produces the inflation gap. And as if we do nothing, the inflation gap goes very, very high. And that would indicate the bank

would be taking on too much, too much interest rate risk. And so we have a put a cap on how large the inflation gap could be in order to control that gap.

You can issue inflation linked bonds, which we do, but there's not enough in the Chilean market. So the other way to control the inflation gap is through derivatives. And those are the derivatives that we do under cash flow hedging. So we're basically you do is you take a bundle of mortgages and you take a derivative and we basically lower or we control the UF gap. So it is very efficient as sadistically, it's very well documented, but since that is technically defined as a cash flow hedge, that cash flow hedge by accounting rules everywhere under IRS has to go against equity debt.

So if we did a bond, you would have the asset and liabilities Okay. Matched and you would have no mark to market. If you don't use a bond in UF and use derivatives, the accounting forces you not to mark to market the asset, but the derivatives, and that's the part that goes under equity. Going a little bit further, remember that under Basel three, those cash flow hedges don't go under CET1. So as we phase in CET1, these cash flow hedges will have no impact on capital. But today and Chile we're not there yet in terms of the phasing end.

So this impacts capital and impacts CT one, even though later on the CT one will not be impacted by these cashflow edges. So as inflation expectations come down, we should see that impact of these derivatives fall or have less impact on capital. And under Basel three in the future this will have zero impact, either positive or negative. I don't know if that makes it more clear or not.

Anand Bhavnani:

No, that's perfectly clear many times. And the last question is, this derivative of these three varieties are a reasonable part of overall operation from the counterparty risk perspective. How do we get confidence that the counterparties are good enough to honor this? So can you give us a sense of who are the counterparties? Are these international different banks or central bank in some case or domestic corporates? So how do we get confident that these derivatives will be honored if there is excessive volatility?

Emiliano Muratore:

Yeah, so...

Hello, can you hear me?

Anand Bhavnani:

Yeah, I can hear you.

Emiliano Muratore:

So the big chunk of the loan book, because Robert, I mean we have this activity with clients with when are basically the counterpart is one of our clients, either corporate, some kind, sometimes SME sometimes incorporates depending on the profile of the client and the sophistication or the clients. Some of them do have collateral agreements that basically have a daily revision and posting of collateral for the physician. And in that sense, basically we assess the equivalent credit risk of the relatives as a loan to the clients. So that is part of our credit risk management with clients.

I mean, some of them use their lines with the relatives and if we grant a loan maybe without, we don't have space for the relatives and the other way run. So it's just on the client basis is it's just part of the creative exposure management we do with any clients and the relatives. It's just another product that we factor in that exposure.

And then when we, let's say, we hedge or we go to the market to hedge that exposure to clients there, the counterparts are basically banks. I mean either domestic or international banks, depending on the product for, I don't know, a peso swap. Sometimes it's a local bank and for a dollar swap, usually it's an international counterpart, but it's there. We have all of them with collateral agreement with CSAs on with daily revision and on daily motor market and, let's say, either cash or very high quality collateral, when you have bilateral trading.

And then you have a significant part of derivation through clearing houses like LCH or CME. And even we have a COMMER which is the local CCS here. So from the great exposure point of view, the relatives portfolio is quite secure because it's either collateralized on a daily basis or managed as any other exposure to clients within our risk management policies.

Anand Bhavnani:

Yeah, thank you.

Robert Moreno:

Yeah, just one follow up. We have in our financial statements when we publish them from the full year, but we always include a table that shows the derivatives liabilities, which ones have the threshold and the collaterals and the big majority do daily margin calls. So that's a really good, basically we put that because we want to make sure that people feel comfortable that this is correctly done.

Anand Bhavnani:

Sure. I have follow up, if I may.

Mediator:

Go ahead.

Emiliano Muratore:

Yeah, yeah, absolutely.

Anand Bhavnani:

Yeah. So of the overall derivative book, how much is exchange traded versus bilateral?

Emiliano Muratore:

Yeah, I don't have the number here in mind,

Robert Moreno:

But I would say that 80% or more has a daily posting collateral and CSA that's in that note I was talking about. Yeah, that's the important thing.

Emiliano Muratore:

Because even if it is bilateral with bank, we have also daily marketing calls. I mean that the difference is if you're doing with a clearing house or you're doing it on the capital basis, but even are highly collateralized.

Robert Moreno:

Yeah. Threshold zero that basically every day. So yeah, that portfolio, especially the client has, we have no trouble. There's a lot of moving parts, but basically the client business has been very safe and as Emiliano said, that's included. For example, we do a big deal with a large Chilean corporate that's included in their credit and exposure. So no, that has worked very well.

Emiliano Muratore:

And the trend is to go to clearing houses and then when we can because it's efficient from the capital point of view for us and for the counterpart. So the trend there is to go to more clear, centrally clear.

Anand Bhavnani:

Sure, sure. And lastly, from a capital consumption perspective, all these derivative assets on the balance sheet, what percentage of capital it's consumed by these, or what is the risk asset that come from these derivative assets?

Emiliano Muratore:

I mean the double exposure for market risk in our case is around like 15, 17% of the risk asset, which is large. But again, because in Chile we are under the standard approach on the base three. So if you look at our market risk exposure under the European base three version, which is the one we report to our company, our risk with assets for market risk are like one fourth of what we see here in Chile.

So if you look at our assets on the Chilean version, market risk represent 15, 70% of the asset. But if you see that same picture under the European version that the allows the use of internal models are the ones we use to manage our derivative business, that goes to one 4th basically, I don't know 4-5% of the risk weighted assets.

Anand Bhavnani:

Thank you very much. You are very patient and we are very comprehensive. All the best.

Emiliano Muratore:

Okay. All the best, would you-

Robert Moreno:

Okay. Well yeah, I think we'll conclude here. And so if anyone has more questions or comments, please contact us. So thank you very much everyone, and talk to you soon.

Mediator:

That concludes the call for today. Thank you and have a nice day.