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Research Update:

LQ Inversiones Financieras 'A-/A-2' Ratings Affirmed On Banco de Chile Ratings Affirmation; Outlook Remains Stable

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

Research Update:

LQ Inversiones Financieras 'A-/A-2' Ratings Affirmed On Banco de Chile Ratings Affirmation; Outlook Remains Stable

Overview

- Chile-based nonoperating holding company, LQ Inversiones Financieras, continue to show less debt burden and adequate financial policies.
- We are affirming our 'A-' long-term and 'A-2' short-term issuer credit ratings on LQ Inversiones Financieras.
- We continue to expect gradual reduction in the company's debt burden, which could ease what we consider an aggressive dividend payment for Banco de Chile. We also expect prudent and adequate financial policies to remain for the next two years.

Rating Action

On March 26, 2014, Standard & Poor's Ratings Services affirmed its 'A-' long-term and 'A-2' short-term issuer credit ratings on LQ Inversiones Financieras S.A. (LQIF). The outlook remains stable.

Rationale

The ratings on LQIF reflect its status as a nonoperating holding company. As a result, the company is subordinated to its main and sole operating subsidiary, Chile-based universal bank, Banco de Chile. The ratings on the bank, on the other hand, reflect our assessment of its "strong" business position, "adequate" capital and earnings, "strong" risk position, "average" funding, and "adequate" liquidity (as our criteria define these terms). We continue to incorporate into our analysis LQIF's ownership by Citibank N.A. (indirectly) and Quiñenco S.A. (not rated).

For the past 24 months we have seen prudent and adequate financial policies from LQIF's shareholders, which continue to support a lower debt burden. We currently expect the company's subordinated debt (which represents slightly more than 53% of its total debt) to continue decreasing for the next two to three years. The lower debt burden could ease what we consider an aggressive dividend payment for Banco de Chile, which will benefit the bank's overall capital structure.

Despite these improvements, the ratings on LQIF remain one notch below Banco de Chile's stand-alone credit profile (SACP) of 'a' as a result of its dependence on the bank's dividend upstream to service debt. Also, this

structural subordination is based on the bank's SACP and not on its issuer credit rating, because we believe that Banco de Chile would receive support from the government in the event of financial stress, but LQIF would not.

Outlook

The stable outlook LQIF reflects the outlook on that of Banco de Chile. It also incorporates our expectation that the bank will continue to upstream dividends to LQIF so that it can service its financial obligations.

We can raise the ratings on Banco de Chile, and as a consequence on LQIF, within the next 18-24 months if our capital and earnings assessment on the bank improves, as a result of its risk-adjusted capital ratio consistently higher than 10%. The latter can occur if the bank's internal capital generation is stronger than in our-base case scenario, as a result of better net interest margins or provisions that would consumed lower operating revenues, or if credit growth is lower than we currently expect. An upgrade is possible if additional capital injection boosts the bank's total capital base.

A downgrade could occur on both entities if Banco de Chile weakens its risk position, stemming for credit losses of more than 3% for the next 18-24 months, resulting from relaxed underwriting policies or the entrance into riskier segments of the economy, such as low-income population segment. Nonetheless, we view this scenario as less likely to happen in the short term. Nevertheless, if LQIF significantly increases its debt, causing double leverage to increase above 120%, we can also lower its ratings.

Related Criteria And Research

Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology and Assumptions, Dec. 6, 2010

Related Research

- Banco de Chile's 'A+/A-1' Ratings Affirmed; Outlook Stable, March 26, 2013

Ratings List

Ratings Affirmed

LQ Inversiones Financieras S.A.
Counterparty Credit Rating

A-/Stable/A-2

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