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Research Update:

LQ Inversiones Financieras S.A. Assigned 'A/A-1' Issuer Credit Ratings; Outlook Stable

Primary Credit Analyst:

Sergio Fuentes, Buenos Aires (54) 114-891-2131;sergio_fuentes@standardandpoors.com

Secondary Contact:

Cynthia Cohenfreue, Buenos Aires (54) 11-489 1-2161;cynthia_cohenfreue@standardandpoors.com

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Overview

- We are assigning 'A/A-1' ratings to LQ Inversiones Financieras S.A.
- The potential imposition of supervisory barriers to dividend payments from subsidiary Banco de Chile to comply with prudential requirements and pay its own debt constrains the rating.
- The stable outlook reflects that of Banco de Chile, and our expectation that the company will receive sizable dividends from Banco de Chile, allowing it to serve its financial obligations.

Rating Action

On Sep. 8, 2011, Standard & Poor's Ratings Services assigned its long-term 'A' and short-term 'A-1' issuer credit ratings to Chile-based financial holding company LQ Inversiones Financieras S.A. (LQIF). The outlook is stable.

Rationale

The ratings on LQIF are based on its role as the nonoperating holding company of Banco de Chile. The counterparty credit ratings also reflect the potential imposition of supervisory barriers to dividend payments from Banco de Chile.

The ratings on LQIF benefit from the strong franchise of LQIF's sole operating subsidiary as the second-largest bank in Chile; its sound income source underpinned by the strong and sustainable earnings profile of Banco de Chile S.A.; and the low-risk political and regulatory environment in Chile. Moderating features include a controlling parent, Quiñenco S.A. (unrated), whom we consider to be weaker than Banco de Chile--but this factor is, in our view, mitigated by the participation of Citigroup Inc. (A/Negative/ A-1) in LQIF's strategic decisions. Another feature moderating the rating is LQIF's high reliance on one asset's dividend flow for debt repayment.

LQIF is rated one notch below its sole operating subsidiary, Banco de Chile. In order to service its own debt, LQIF depends on dividends from Banco de Chile, and we consider that the regulator, Banco Central de Chile, could limit the regulated subsidiary's ability to upstream cash to the holding company if the bank were unable to meet minimum prudential requirements.

LQIF's sole operating subsidiary, Banco de Chile, provides a wide range of universal banking products and services for individuals, small and midsize enterprises, and large corporations in Chile. The bank enjoys a strong market position of second in terms of total loans and deposits in Chile, with 19.4%

and 18.7% market shares, respectively, as of Dec. 31, 2010. The relatively large economies of scale combined with the bank's good operating efficiency and low provisions result in a high profitability. This is evidenced in a return on average assets (ROAA) that reached a relatively high level of 1.8% in 2008-2010 (2.1% in 2010), which compares highly favorably with other similarly rated peers.

The bank has improved its operating efficiency quite significantly after its merger with Citibank Chile in January 2008, with noninterest expenses-to-revenue and personnel expenses-to-revenue ratios that reached 50.2% and 23.3%, respectively, in 2010, compared with 56.1% and 29.9% in 2008. In addition, the bank enjoys a healthy asset quality, partly as a result of the solid performance of the Chilean economy and its relatively large corporate loan portfolio--the bank posted nonperforming loans (NPLs) of only 1.2% of total loans as of Dec. 31, 2010. Also, net charge-offs represented only 1% of total loans in 2010, and loan loss reserves a high 2.1x of NPLs as of Dec. 31, 2010.

Banco de Chile enjoys a fluid access to funding, with its relatively large, stable, and low-cost deposit base that reached about US\$26 billion and represented 72% of total liabilities as of Dec. 31, 2010. In addition, the bank posted an adequate capitalization, with adjusted total equity-to-total adjusted assets ratio of 7.7% as of Dec. 31, 2010. We expect the bank to maintain capitalization levels in spite of a relatively aggressive dividend payout in 2011.

During 2010, net income amounted to Chilean pesos (CHP) 378 billion (US\$808 million), a 46.8% increase on the previous year's. Earnings mainly benefited from higher net interest income, fees, and commissions, and lower provisions, resulting from the higher business volume and improved economic environment. Higher net interest income resulted from the positive effects of higher inflation levels (improving inflation-adjusted assets) and 9% loan growth when compared with the previous year. We expect total loans to continue to recover based on the favorable Chilean economy. We expect Banco de Chile to continue to enjoy high profitability and healthy asset quality in 2011.

LQIF is owned by Quiñenco S.A. and Citigroup, Inc in equal proportions, with Quiñenco S.A. holding 59.32% of the voting rights in Banco de Chile. Regardless of any increase in participation by Citigroup, Inc., however, the shareholders' agreement provides that Quiñenco S.A. will remain in control of LQIF and the corporations that are directly or indirectly controlled by LQIF. Banco de Chile is LQIF's main operating company (through direct and indirect ownership), and holds 58.24% ownership of SM-Chile S.A., a holding company that controls Banco de Chile and Sociedad Administradora de la Obligación Subordinada S.A. (SAOS), a subsidiary whose sole objective is to repay a subordinated debt to the Central Bank of Chile. This subsidiary was created as part of a reorganization in 1996, which was due in part to the bank's 1989 repurchase from the Central Bank of certain non-performing loans that Banco de Chile had previously sold to the Central Bank during the Chilean banking crises, and later exchanged for subordinated debt. Under the terms of a

repayment obligation in favor of the Central Bank that SAOS assumed to replace the Central Bank subordinated debt, SAOS may be required to sell some of Banco de Chile's shares to the public in order to meet its obligations with the Central Bank. In exchange for assuming the Central Bank indebtedness, SAOS received from SM-Chile S.A. 63.6% of Banco de Chile's shares as collateral for this indebtedness and now holds 32.89% of Banco de Chile's shares.

Outlook

The stable outlook reflects that on Banco de Chile, and our expectation that LQIF will receive sizable dividends from Banco de Chile, allowing it to serve its financial obligations. The ratings could come under pressure as a result of a significant deterioration in Banco de Chile's profitability and dividend-payment ability; if there were a dilution in its ownership or control over Banco de Chile; if there were a significant increase in LQIF's debt levels, diminishing our view of the company's financial flexibility; or if there were a decrease in Banco de Chile's rating or in the ratings of LQIF's corporate shareholders.

Related Criteria And Research

- Criteria | General Criteria | Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Criteria | Financial Institutions | Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Criteria | Financial Institutions | General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- Criteria | Financial Institutions | Banks: Financial Institutions Group Provides More Transparency Into Adjustments Made To Bank Data, April 26, 2007
- Criteria | Financial Institutions | Banks: Bank Rating Analysis Methodology Profile, March 18, 2004

Ratings List

Rating Assigned

LQ Inversiones Financieras S.A.

Issuer credit rating

A/Stable/A-1

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

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