BMO Financial Group

Q1 2023 Conference Call

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Non-GAAP Measures and Other Financial Measures

Results and measures in this document are presented on a GAAP basis. Unless otherwise indicated, all amounts are in Canadian dollars and have been derived from our audited annual consolidated financial statements prepared in accordance with International Financial Reporting Standards (IFRS). References to GAAP mean IFRS. We use a number of financial measures to assess our performance, as well as the performance of our operating segments, including amounts, measures and ratios that are presented on a non-GAAP basis. We believe that these non-GAAP amounts, measures and ratios, read together with our GAAP results, provide readers with a better understanding of how management assesses results.

Management considers both reported and adjusted results and measures to be useful in assessing underlying ongoing business performance. Adjusted results and measures remove certain specified items from revenue, non-interest expense and income taxes, as detailed on slide 37. Adjusted results and measures presented in this document are non-GAAP. Presenting results on both a reported basis and an adjusted basis permits readers to assess the impact of certain items on results for the periods presented, and to better assess results excluding those items that may not be reflective of ongoing business performance. As such, the presentation may facilitate readers' analysis of trends. Except as otherwise noted, management's discussion of changes in reported results in this document applies equally to changes in the corresponding adjusted results.

Non-GAAP amounts, measures and ratios do not have standardized meanings under GAAP. They are unlikely to be comparable to similar measures presented by other companies and should not be viewed in isolation from, or as a substitute for, GAAP result.

Examples of non-GAAP amounts, measures or ratios include: efficiency and leverage ratios calculated using revenue presented net of CCPB; revenue and other measures presented on a taxable equivalent basis (teb); pre-provision pre-tax income; amounts presented net of applicable taxes; adjusted net income, revenues, non-interest expenses, earnings per share, effective tax rate, ROE, efficiency ratio, and other adjusted measures which exclude the impact of certain items such as acquisition and integration costs, amortization of acquisition-related intangible assets, impact of divestitures, restructuring costs and management of fair value changes on the purchase of Bank of the West. Bank of Montreal provides supplemental information on combined operating segments to facilitate comparisons to peers.

Certain information contained in BMO's Management's Discussion and Analysis dated February 28, 2023 for the fiscal quarter ended January 31, 2023 ("First Quarter 2023 MD&A") is incorporated by reference into this document. Quantitative reconciliations of non-GAAP and other financial measures to the most directly comparable financial measures in BMO's financial statements for the period ended January 31, 2023, an explanation of how non-GAAP and other financial measures provide useful information to investors and any additional purposes for which management uses such measures, can be found in the Non-GAAP and Other Financial Measures section of the First Quarter 2023 MD&A. Further information regarding the composition of our non-GAAP and other financial measures is provided in the "Glossary of Financial Terms" section of the First Quarter 2023 MD&A. The First Quarter 2023 MD&A is available on SEDAR at www.sedar.com and on our website at www.bmo.com/investorrelations.

PRESENTATION

Christine Viau – *Bank of Montreal – Head of Investor Relations*

Thank you and good morning. We will begin the call with remarks from Darryl White, BMO's CEO; followed by Tayfun Tuzun, our Chief Financial Officer; and Piyush Agrawal, our Chief Risk Officer. Also present to take questions are our group heads, Ernie Johannson from Canadian P&C; Dave Casper from U.S. P&C; Dan Barclay from BMO Capital Markets; and Deland Kamanga from BMO Wealth Management.

As noted on Slide 2, forward-looking statements may be made during this call, which involve assumptions that have inherent risks and uncertainties. Actual results could differ materially from these statements. I would also remind listeners that the bank uses non-GAAP financial measures to arrive at adjusted results. Management measures performance on a reported and adjusted basis and considers both to be useful in assessing underlying business performance. Darryl and Tayfun will be referring to adjusted results in their remarks unless otherwise noted as reported. I will now turn the call over to Darryl.

Darryl White – *Bank of Montreal – CEO*

Thank you, Christine and good morning, everyone. We had a very good start to the year with record revenue, adjusted earnings per share of $3.22 and net income of $2.3 billion for the first quarter.

The benefit of our balanced and well-diversified business model was front and centre again this quarter with record revenue and PPPT in our P&C businesses and significantly improving momentum in BMO Capital Markets. The strategic investments we've been making in talent and technology are driving good growth in each of our businesses. Risk remains well-managed with strong performance across our portfolios.

Each of our operating groups delivered return on equity above 15%, even with the higher regulatory capital levels. Our P&C businesses continued to deliver positive operating leverage, while negative operating leverage at the all-bank level this quarter reflected the particularly strong revenue performance in Capital Markets in Q1 last year, as well as the impact of investments we've made over the past year to drive growth. We expect expense growth to moderate through this year with continued momentum in revenue. We remain committed to delivering positive full-year operating leverage on a BMO stand-alone basis as we have for the last five years.

While the macroeconomic environment remains uncertain, we're well-situated to win in any environment. With inflation still at high levels, we expect rates to remain elevated, slowing the economy in the near term. Real GDP in both Canada and the U.S. is expected to rise only modestly this year and we expect central banks to hold off from reducing policy rates until 2024.

We've made deliberate strategic choices to change the shape of our business and further strengthen our performance. We've continued to bolster our capital position in light of the new regulatory capital requirements while supporting customer growth, and we expect our CET1 ratio to be above 11.5% in the second quarter now that the Bank of the West acquisition has closed.

The completion of our acquisition of the Bank of the West on February 1st is a historic moment for BMO and the natural next step in our North American growth strategy. We're excited to welcome thousands of new employees and 1.8 million customers to the BMO family as we come together with a shared vision to drive progress for our customers and communities. I've personally spent a lot of time in market, and the energy level and enthusiasm of the teams and the customers I've met is palpable. Together, we double our U.S. footprint, meaningfully expand our scale and solidify BMO's position as a leading North American bank. We're now a top 10 bank in the United States with a top five position in multiple MSAs. We've expanded our premium commercial banking franchise, which also ranks in the top five in North America, adding complementary verticals and talented bankers in areas like agriculture, food and beverage and wine, and adding new expertise in technology and healthcare banking.

Our enhanced presence is further augmented by a national strategy that extends across the country, with digital retail and payments platforms that serve customers across all 50 states as well as leading national specialty businesses such as transportation and equipment finance, leasing, RV/marine and asset-based lending to name a few. Our one client and north-south integration enables our teams to support clients with our differentiated cross-border expertise as well as wealth and capital markets capabilities. We're taking this opportunity to fully unify our brand, bringing the strength of BMO to new and existing markets and communities.

Over many years, our U.S. segment has been a key contributor to the growth of our business and our success, with a strong foundation and a long track record of combining organic growth with highly successful acquisitions. Through effective integration, strong leadership and our focus on building client relationships, we've delivered consistent market share gains across our businesses. We've steadily increased the contribution from the U.S., significantly improved ROE and efficiency to be accretive to the overall bank, all underpinned by superior risk management.

The closing this month follows a year of collaboration that positioned us to hit the ground running. In fact, we executed our first one-client transaction on February 1 and in just 28 days, we've already delivered on opportunities across our combined teams to deepen client relationships and expand product offerings, and the momentum is building. Once fully cost-synergized, we expect the U.S. to contribute approximately 45% to the bank's earnings on a pro-forma basis, up from 27% five years ago, which helps to fundamentally increase the size and the performance of the bank overall. By the end of 2025, we anticipate that the Bank of the West acquisition will add over US$2 billion in run rate pre-provision pre-tax earnings to BMO.

Turning back to our Q1 results in our operating groups. In Canadian P&C, revenue and PPPT were both up 9% this quarter, with strong consumer and commercial loan and deposit growth driving market share gains. Our performance reflects strategic investments over the last few years and the expansion of our sales teams and technology that have improved our sales-to-service ratio, delivering top-tier digital sales and driving customer acquisition.

Just yesterday, we announced an exclusive partnership with Immigration.ca, a leading provider of immigration resources and essential tools aimed at helping newcomers establish their financial life in Canada. This partnership complements our existing NewStart and SmartProgress programs to help customers make real financial progress and support a smooth transition.

In U.S. P&C, PPPT was up 12% over the last year as we continued to gain momentum in customer growth and satisfaction. We've introduced several new automated solutions in commercial banking to improve efficiency and deliver best-in-class client and employee experiences. And in partnership with Blend, we introduced a fully digitized mortgage refinancing process, boosting convenience for customers.

In BMO Wealth Management, while lower markets reduced revenue compared to last year, our ongoing investments in talent and technology are delivering strong growth in new client assets. We're driving progress for our clients by investing in innovation such as the launch of BMO InvestorLine's ESG Insights tool that helps investors make informed decisions that align with their strategies and with their values. For the 12th consecutive year, we were #1 in net ETF inflows and received the most awards of any ETF provider at this year's annual Fundata Awards, reflecting our leadership in delivering strong risk-adjusted performance for our investors.

BMO Capital Markets diversified businesses displayed growing momentum with the second highest quarter of revenue ever and PPPT of $636 million. The investments we've made in areas like expanding our U.S. rates business, adding Radicle's carbon credit and emissions trading capabilities and expanding electronic trading through Clearpool, are addressing real client needs and contributing to the growth that we need now and for the future. Clearpool is a good example of how we're building on acquisitions, having expanded into Europe within the last year while tripling BMO's electronic trading revenue.

In addition to our financial progress, we're continuously advancing our purpose commitments and are consistently recognized as a global leader in sustainable business practices and financing activities. I want to recognize the incredible contribution by BMO's employees this year, who, during our employee-giving campaign, rallied together to contribute over $31 million to the United Way and thousands of other community organizations across North America, a new BMO record.

This culture of community giving is equally embedded in the culture of our new colleagues at Bank of the West, and I look forward to the good that we will be able to grow together. As we all look forward to a successful integration, we're equally focused on continuing to drive performance in all our businesses. We're starting this year from a position of strength. My confidence in our future has never been higher.

I'll now turn it over to Tayfun.

Tayfun Tuzun – *Bank of Montreal – CFO*

Thank you, Darryl. Good morning and thank you for joining us. My comments will start on Slide 10.

First quarter EPS was $0.30, and net income was $247 million. Adjusting items are shown on Slide 37 and include the impact of fair value management activities related to the acquisition of Bank of the West, which, this quarter, decreased net income by $1.5 billion, as well as a $371 million tax provision related to the tax measures enacted by the Canadian government. The remainder of my comments will focus on adjusted results.

Adjusted EPS was $3.22, and net income was $2.3 billion, down from $2.6 billion last year. Total revenue increased 3% year-over-year, reflecting strong growth in net interest income, partially offset by lower fee income and securities gains. Expenses were up 9% year-over-year reflective of investments made in sales force expansion and technology in 2022 and the impact of compensation increases for our employees during last year. PPPT was lower year-over-year and up 6% sequentially or up 14%, excluding the impact of seasonal expenses recorded in every first quarter.

Performance in our P&C businesses continued to be very strong with year-over-year pre-provision pre-tax earnings growth of 9% in Canada and 12% in the U.S., driven by continued loan growth and margin expansion. Capital Markets performed well with strong quarter-over-quarter revenue growth, and Wealth Management results were lower, reflecting the continued muted market environment.

Total PCL was $217 million, including a $21 million provision for performing loans compared with a total recovery of $99 million in the prior year. Piyush will speak to these in his remarks.

Moving to the balance sheet on Slide 11. Loan growth was 15% year-over-year and 2% quarter-over-quarter. On a constant currency basis, business and government loans increased 15% from the prior year, with strong growth across all operating groups. Consumer balances were up 9%, reflecting diversified growth in the P&C businesses and in Wealth. Average customer deposits increased 8% year-over-year and 2% sequentially as we remain focused on growing our core deposit base. Looking ahead, we expect full year average loan growth to be in the mid- to high single-digit range, reflecting strong diversified pipelines and matching similar growth rates in deposits.

Turning to Slide 12. Net interest income on an ex-trading basis was up 21% from last year driven by strong balance growth and margin expansion. Net interest margin ex-trading was up 11 basis points from last year and down seven basis points from last quarter. There was temporary volatility this quarter related to the balance sheet positioning ahead of the closing of the acquisition.

Higher net margins in our P&C and Wealth Management businesses raised our NIM by two basis points quarter-over-quarter. In Canadian P&C, higher deposit and loan spreads were partially offset by deposit mix, reflecting strong growth in term deposits. In U.S. P&C, where our margin widened by 43 basis points year-over-year, higher deposit spreads were partially offset by lower loan spreads, higher risk transfer costs and the impact from changes in product mix.

Offsetting these increases were two temporary items in the current quarter that lowered our quarterly NIM by four basis points: first, higher cash balances ahead of the closing of the Bank of the West transaction; and second, temporary deposit interest expense in Capital Markets that was fully offset in other non-interest income with no impact to total revenue. A discrete permanent increase in liquid assets for regulatory liquidity requirements lowered our margin by two basis points. Other factors during the quarter included one basis point for the impact of risk transfer transactions quarter-over-quarter.

The year-over-year expansion in our NIM has been a major driver of our PPPT growth in our P&C businesses and as we move beyond the temporary factors over the next couple of quarters, we expect the BMO stand-alone NIM to resume expanding during the second half of the year as deposit spreads begin to stabilize.

With the addition of Bank of the West's balance sheet, we expect the widening NIM to be a core relative strength for BMO. Post-closing, we expect our NIM to widen by approximately 10 basis points for both the second quarter and the full year.

Moving to our interest rate sensitivity on Slide 13. A 100-basis-point rate shock is expected to benefit net interest income by $542 million over the next 12 months. Rate sensitivity for the quarter is elevated as our short-term liquidity was elevated for the Bank of the West closing. We will provide an update on combined sensitivity including Bank of the West next quarter, but overall, we believe we are well positioned for the current environment.

Moving to Slide 14. Expenses were up 9% from the prior year or up 6% excluding the impact of the stronger U.S. dollar and higher performance-based compensation, mainly reflecting the follow-through impact of targeted investments during the last year, including sales force expansion, technology and marketing as well as inflation rather than added expenses this quarter. These investments have been disciplined and strategic and have helped fuel our revenue growth and created efficiency gains in our business. Expenses were down 1% sequentially, excluding the impact of stock-based compensation for employees eligible to retire and seasonality of benefits that is recognized in the first quarter of each year, which together approximated $260 million this quarter.

Our commitment to positive operating leverage continues to drive our dynamic management actions. Coming into this year, as you can see in our quarter-over-quarter trends, with the capacity that we have in place, our incremental investment needs have moderated. As a result, with a follow-through impact of last year's investments subsiding after the second quarter, we expect our year-over-year expense growth to moderate in the second half of the year.

Moving to Slide 15. Our capital position remains strong with a Common Equity Tier 1 ratio of 18.2%. Excluding the impact of the management of fair value changes related to the Bank of the West transaction, the CET1 ratio increased approximately 180 basis points due to our common share issuance, strong internal capital generation and a reduction in risk-weighted assets partially offset by the one-time impact of the tax measures.

Source currency risk-weighted assets were lower, mainly reflecting the benefit from risk transfer transactions, model updates, and changes in book quality. Synthetic risk transfer transactions this quarter added approximately 35 basis points to our CET1 ratio compared to last quarter. The cumulative incremental capital of 120 basis points generated by the fair value management actions since announcement last December will be offset by higher goodwill at closing. As discussed previously, we remain confident that our CET1 ratio will remain above 11.5% in Q2 and continue to build to 12% by the end of the fiscal year.

Turning to Slide 16. We updated our assumptions regarding the acquisition of Bank of the West, excluding purchase accounting impacts, which will be finalized before the end of the second quarter. At announcement, we expected the transaction to be 10% accretive to fiscal 2024 or 8%, excluding transient items related to purchase accounting. Based on our internal plan, we expect accretion in 2024, excluding transient items, to be approximately 7%. The reduction is in part due to stronger BMO stand-alone performance and a revised Bank of the West outlook, mainly reflecting the impact of the later-than-anticipated closing and conversion dates.

We continue to expect the future benefit from annualized expense synergies to be approximately US$670 million and initiatives to be fully executed by the end of the first year after closing, which is now the start of the second quarter of 2024, with the realization of those savings building over the next 12 months. Merger and integration costs, which are excluded from adjusted net income, are now estimated to be US$1.5 billion and the expectation that they will be fully incurred by the end of the second year after close. As Darryl said, we are very optimistic about our future growth with Bank of the West, leading to a very meaningful PPPT lift.

Moving to the operating groups and starting on Slide 17. Canadian P&C delivered net income of $980 million, down 2% from the prior year due to higher provisions for credit losses with strong pre-provision pre-tax earnings growth of 9%. Revenue was up 9% from the prior year. Net interest income increased 14%, reflecting strong balanced growth and higher margins. Expenses were up 9%, reflecting investments in the business, including sales force expansion and in technology and higher salaries and decreased 1% sequentially. Average loans were up 12%, with 11% growth in residential mortgage lending and 16% in commercial loans. Deposits increased 11% year-over-year and 3% sequentially, with strong growth in term deposits.

Moving to U.S. P&C on slide 18. My comments here will speak to the U.S. dollar performance. Net income was $521 million, down 3% due to higher provisions for credit losses with strong pre-provision pre-tax earnings growth of 12%. Revenue was up 12%, with 22% growth in net interest income due to strong loan growth and margin expansion of 43 basis points year-over-year. The decline in non-interest revenue was mainly due to commercial deposit fees, which, during higher interest rate periods, is largely offset in net interest income as well as lower operating lease revenues.

Expenses increased 11% due to higher employee costs and technology investments and remained relatively flat sequentially. On the balance sheet, average loans were up 10% from the prior year, reflecting very strong commercial growth of 11%. Average deposits declined 4% year-over-year and increased 1% from last quarter.

Moving to Slide 19. BMO Wealth Management net income was $278 million, down from $316 million last year. Wealth and Asset Management net income was $208 million, down $54 million as growth in net interest income and new client assets were more than offset by weaker global markets and lower online brokerage transactions. Insurance net income was $70 million compared with $54 million in the prior year. Expenses were up 4% mainly due to the impact of investments made in the business in fiscal 2022.

Turning to Slide 20. BMO Capital Markets net income was $510 million compared to a particularly strong $712 million in the prior year. Pre-provision pre-tax earnings were $636 million, up 43% quarter-over-quarter, reflecting good performance in the current market environment. Compared with the prior quarter, revenue in Investment and Corporate Banking was up 12% due to higher corporate banking revenue and investment banking activity, and Global Markets was up 29% on higher client activity. Expenses were up 5% due to higher operating costs and continued investments in the business, partly offset by lower employee-related costs.

Turning now to Slide 21. Corporate Services net loss was $195 million compared to $130 million in the prior year. Net losses in Corporate Services will continue to be higher than our normal range for the next quarter or two due to the moving parts associated with the Bank of the West transaction, including the impact of the prior buildup of excess capital that is now being deployed in the business post-closing. We expect corporate earnings to normalize towards the end of the year.

To conclude, we had very good operating performance, with record quarterly revenues to start the year. The results demonstrate the advantage of our well-balanced, diversified business mix, which will now be meaningfully enhanced with the addition of Bank of the West starting this quarter. Overall, we continue to focus on managing our company dynamically with a keen focus on continuous efficiency improvements while investing for growth. Our larger presence in the U.S. significantly enhances our opportunities to grow while leveraging our existing platform for more optimal resource allocation.

I will now turn it over to Piyush.

Piyush Agrawal – *Bank of Montreal – CRO*

Thank you, Tayfun and good morning, everyone. We are pleased with our risk performance this quarter. Key portfolio metrics remain strong despite rising rates and continued high inflation. This quarter's performance continues to reflect strong risk management discipline across the bank.

Starting on Slide 23, the total provision for credit losses was $217 million or 15 basis points, down $9 million or one basis point from prior quarter. Impaired provisions for the quarter were $196 million or 14 basis points, flat to the fourth quarter. The strong impaired loan performance is due to low formations, which continue to be below pre-pandemic levels. We do expect impaired provisions to return to more normal levels over time.

Moving to Slide 24. The $21 million provision for credit losses on performing loans reflected increased uncertainty in credit conditions and growth in certain portfolios, largely offset by portfolio credit improvement, including benefits from the risk transfer transactions. We remain comfortable that our $2.5 billion of performing loan allowances provides good loss coverage.

Turning to the impaired loan credit performance in the operating groups. Retail impaired loan losses were $135 million in Canadian P&C and $13 million in U.S. P&C. The quarter-over-quarter increase in impaired PCL is consistent with the expected normalization trend in delinquency rates in unsecured consumer loans and credit cards, which still remain below pre-pandemic levels.

For Real Estate Secured Lending, we continue to view the risk from higher rates as modest, given a high credit quality borrower base and low LTVs. As you can see on slide 27, the riskier segment renewing over the next 12 months is nominal given our portfolio quality.

In our Commercial and Corporate businesses, we saw strong credit performance. In Canadian Commercial, we reported impaired loan provisions of $19 million or seven basis points, down three basis points from last quarter. Our U.S. Commercial business had impaired loan provisions of $35 million or 11 basis points, also down one basis point from last quarter.

Our Capital Markets business had a net recovery of $3 million driven by zero new formations this quarter and some modest reversals. Despite the rising rates in inflation, our wholesale credit quality remains strong with impaired rates below pre-pandemic levels.

On Slide 25, Bank-wide impaired formations were $521 million, and Gross Impaired Loans balance was $2 billion or 36 basis points. Both formations and the Gross Impaired Loan rates continue to be well-below pre-pandemic levels.

Looking ahead, the coming quarter PCL will have a one-time adjustment for the Bank of the West opening allowance. In terms of overall impaired PCL, including the Bank of the West loan portfolio, we expect impaired loss rates to trend in the high teens to low 20 basis points, which is in line with our combined pre-pandemic experience.

To conclude, we are well positioned to manage current and emerging risks given the quality of our portfolio, high allowance coverage and strong risk management capabilities. I will now turn the call back to the operator for the Q&A portion of this call.

QUESTIONS AND ANSWERS

Ebrahim Poonawala – *BofA Securities*

Tayfun, starting on the expenses, when you think about adjusted expense growth of 9% year-over-year, I'm sorry if I missed any specific guidance, but I heard you say it should moderate from here. Just talk to us in terms of if you can put some numbers around what you expect expense growth may be in the back half of the year or for full year 2023 that we should expect ex. Bank of the West impact.

Tayfun Tuzun – *Bank of Montreal – CFO*

Sure. Thanks for the question, Ebrahim. I think the expense growth year-over-year, excluding the impact of foreign exchange was 7%, and excluding the impact of higher performance-based comp, it was 6%. As you know, we have a firm commitment to positive operating leverage, and coming into the year, the speed of investments that we've made in the business last year has slowed down because we have created the capacity that we need to meet our growth targets.

As such, you can look at the quarter-over-quarter change, which was actually down, excluding the seasonal uptick. As we look ahead, we see maybe another quarter of these types of expense growth numbers because we will be lapping last year's expense trends. Once we cross into the second half of the year, I expect, on average, you're going to see a 3% or 4% drop in our year-over-year expense growth, which then gives us the ability to continue to commit to positive operating leverage for the year.

Ebrahim Poonawala – *BofA Securities*

Understood. And I guess with the Bank of the West expense savings, I believe you mentioned 95% savings by 2024, but should we get to that point by the end of fiscal year 2023 in terms of once you do the systems conversion on Labour Day or, by the end of October, you should have most of the savings in the numbers as we think about Q1 2024?

Tayfun Tuzun – *Bank of Montreal – CFO*

Ebrahim, let me remind you that when we announced the transaction, we said that we will capture 100% of the expense synergies within the first 12 months following the closing date and we intend to do the same still. But now that the closing date has moved to February 1 from the original assumption of three months before that when we announced the transaction, it just shifted the date of the full capture. We intend to enter the second quarter of '24 with a run rate and with 100% of the cost savings, exactly the same as we announced back last December.

Ebrahim Poonawala – BofA Securities

Got it. And just one last one on deal-related, Tayfun. You mentioned carrying more liquidity, which had a drag of two basis points on the margin this quarter. Anything else that we should be mindful of in terms of capital stress testing or liquidity requirements coming out of the deal that you have to do or manage to?

Tayfun Tuzun – *Bank of Montreal – CFO*

No, on NIM, I think there is no impact from capital stress testing. There was a total of four basis points of temporary factors. One of them relates to the buildup in liquidity and one of them is in our Capital Markets business, which is fully compensated in NIR. The permanent two-basis-point liquidity was just related to our normal update of our deposit modeling assumptions, and we just happened to have updated them this quarter, which has changed the liquid asset balance on our balance sheet, but none of this relates to any capital stress tests.

Ebrahim Poonawala – BofA Securities

But nothing around the treatment of the U.S. entity changes in a meaningful way post deal versus prior to the deal.

Tayfun Tuzun – *Bank of Montreal – CFO*

No.

Meny Grauman – *Scotiabank Global Banking and Markets*

Just a numbers question on capital. Apologies if I missed it, but are you able to quantify the impact on the Basel III update for Q2, what that is going to be for you?

Tayfun Tuzun – *Bank of Montreal – CFO*

We are obviously finalizing the results of the transition this quarter. I think overall, as we mentioned, I believe, last quarter, there is going to be a benefit, and that benefit potentially could be 35 to 40 basis points for the quarter.

Meny Grauman – *Scotiabank Global Banking and Markets*

Okay. And then, Darryl, I just want to make sure I heard you correctly in terms of the guidance for Bank of the West for 2025. Did you talk about US$2 billion in pre-tax pre-provision earnings benefits? Is that the right number that I have?

Darryl White – *Bank of Montreal – CEO*

You got it right, Meny, and I'll just clarify for you by the end of '25, and I think this is an important point, we're trying to remind everybody that when we have the full benefit of the company on a stand-alone basis plus the cost synergies that Tayfun has just reminded us all of, plus, you may recall, Meny, in Q2 of last year, we announced a range of revenue synergies which we said take a little longer to get to. But I've got to tell you, in the early days of owning the asset, my confidence level has gone up on those revenue synergies. You get to US$2 billion of PPPT. And I'll remind you that those are U.S. dollars.

To use very round numbers to illustrate it for you, you've got US$1 billion of stand-alone PPPT. You've got US$670 million of cost savings. And then if you take the low end of the revenue synergy range that we presented in Q2 of last year, you get a little over US$2 billion. So I rounded it to US$2 billion, which if you compare that to our current run rate for the total company at BMO, that's roughly a 20% lift in the PPPT power of the company by the time we get to the end of 2025.

Doug Young – *Desjardins Securities*

Tayfun, I think you talked a bit about corporate losses being elevated this quarter and expected to be elevated, I guess, in Q2 as well. Can you talk a bit about what's causing that elevation, what the unusual items are? Can you quantify anything there?

Tayfun Tuzun – *Bank of Montreal* **– CFO**

Yes. So I have to tell you that both the quarter preceding a transaction of the size that we are executing and the quarter after the transaction will have some noise. Coming into the quarter, we obviously were sitting on a good amount of capital. There were some transactional costs that were running through the corporate section. And so nothing really unusual going through, but that noise will probably last a couple of quarters here before towards the end of the year, we sort of go back to our regular pieces. And just to remember, this quarter, there's also the impact of the seasonal expenses relative to last quarter.

So nothing really fundamentally big numbers, but a number of small items impacting the trends. Again, I suspect that we will start normalizing trends once we go through the second quarter into the second half.

Doug Young – *Desjardins Securities*

Okay. And then just second on NIMs. I think in the U.S. NIM discussion, it was talked about loan margins declining in the U.S. Can you elaborate a little bit about what you're seeing and what's driving that? And then the synthetic risk transfer, I think you talked about that having a point or two of negative impact. Is there more of that to anticipate as well?

Tayfun Tuzun – *Bank of Montreal – CFO*

Yes, let me take the synthetic. And then I'll turn it over to Dave for comments on the U.S. This quarter on a quarter-over-quarter basis, our NIM was negatively impacted by one basis point due to the increased level of risk transfer transactions. As we look forward, we don't anticipate the activity levels to be high enough to impact future quarterly NIM progress. I mean, I think we will always continue to manage our capital efficiently. But sitting here today, I suspect that the incremental impact this year will be less.

And then to Dave for comments.

Dave Casper – *Bank of Montreal – CEO, BMO Harris Bank N.A. and Group Head, N.A. Commercial Banking*

So the NIM for the year in P&C U.S. was up 43 basis points. We were really happy with that, and that sticks. And that's really a result of a very solid diversified deposit base across both Ernie's business and the commercial business. The decrease in the loan spread is more than offset by the deposit side, that's pretty expected in the times like this with interest rates going up. So nothing significant there, probably a little bit of just a mix in terms of the higher rate loans, probably, we haven't grown as much. Those would be the riskier, but nothing significant. And I expect the NIM to continue to be pretty strong given the deposit base. We haven't -- just I'll throw in, it's going to only get better in terms of overall NIM for the bank when we add the very solid and consistent type of deposit business we'll get with Bank of the West.

Paul Holden – *CIBC Capital Markets*

My first question is related to the loan growth guidance of mid- to high single digits. I believe the guidance last year was or as of last quarter was for high single digits. I think it's just a little bit of a downshift and maybe you can clarify if I'm correct on that one. And then if there is a change, what's driving the change in outlook?

Tayfun Tuzun – *Bank of Montreal – CFO*

Yes, in general, I'll make a comment about the broader loan trends. I think we obviously have seen very strong growth last year, and year-over-year numbers are very strong. And we continue -- we have the capacity to continue, and these numbers are all obviously stand-alone BMO numbers, not including the impact of Bank of the West. And I think in general -- and Dave can comment on some of the commercial aspects, and Ernie can comment on the consumer side. We're mindful of the environment and providing you a reasonable update for what we see today.

Dave, any comments?

Dave Casper – *Bank of Montreal – CEO, BMO Harris Bank N.A. and Group Head, N.A. Commercial Banking*

Yes. I think the guidance we gave you is the same. Obviously, the economy is slowing a little bit. We're not slowing, but the economy is. And to that extent, it depends on where we go. But so far, we've seen a modest moderation just given the economy. Some of our businesses are doing even better. Our businesses that are tied to inventory build like our auto floor plan business is up. Our asset-based lending business is up, where we'd see some modest decline more in the U.S. probably than Canada would be in real estate where the pipelines just aren't as strong. But we continue to be pretty bullish, very bullish long term in terms of where our loan growth has been. It's consistently outpaced the peers as we've added new clients. I expect that to continue.

Paul Holden – *CIBC Capital Markets*

The second question I have is just looking at the Bank of the West slide. You show the deposit expectation today versus prior, so US$72 billion versus prior, so 6.5% decline. And I get there is a runoff in deposits in U.S. banking, but it's probably outpaced the broader industry. So wondering if there is an explanation there on the materiality of the decline.

Tayfun Tuzun – *Bank of Montreal – CFO*

It's in line with what we see overall in U.S. banking, and obviously, we now have the opportunity to work more closely with our new colleagues at Bank of the West. And maybe Ernie can comment on what she sees in terms of the deposit outlook for the company.

Ernie Johannson – *Bank of Montreal – Group Head, N.A. Personal*

Yes. On the U.S. side, that was specific to your question, what we're seeing, obviously, is now the start of some of the surge deposits leaving the everyday banking kind of checking/savings. So that is a norm, and you're seeing migration to higher rates. But if I step back and say what we're thinking about for the U.S. in terms of our entire deposit taking, you have that core stability that we've always had in our existing BMO franchise. That deposit-plus-digital, very steady, sticky deposits, long-term relationships with mass affluent customers.

Now we're adding, as we've said numerous times today, our Bank of the West, and that really doubles our footprint. Now we're 1,000 branches across 32 states, where we're going to be consistently driving stable growth with primary customer relationships, and that's key to us. Then on top of that, as you know, and I referenced this before, we have a digital deposit taking capability. That's the third part of our strategy. And that runs across the entire 50 states. And that is something that drives us our growth in terms of out-of-footprint acceleration and really something that provides us, as an overall bank with a very sustainable model, great capacity to ebb and flow in terms of our deposit growth and, I think, a competitive advantage for us. So that's what we're going to be leveraging going forward. And as we look across the next few months, you're going to see us grow further in our deposit taking from our digital channels.

Gabriel Dechaine – *National Bank Financial*

I want to follow up on that one, actually. Both on loans and deposits of the Bank of the West, the lower numbers versus what you had there at announcement, is that decline factored at all in the reduced accretion expectation? Because it doesn't sound like -- it sounds like that's mostly related to the timing of expense synergy.

Tayfun Tuzun – *Bank of Montreal – CFO*

The current balance sheet and their current business outlook is included in our update.

Gabriel Dechaine – *National Bank Financial*

If the deposit balance decline accelerates, could we potentially revisit this issue?

Tayfun Tuzun – *Bank of Montreal – CFO*

Well, you always revisit when things change in terms of how you update your financial outlook. But at this point, with what we know, this is our current expectation.

Gabriel Dechaine – *National Bank Financial*

Okay. I asked you about credit risk transfers on the Q4 call. I want to ask you about that again -35-basis-point benefit. Thanks for quantifying that by the way. That equates to about over $1 billion of equity or core Tier 1 capital. Will these things boost your capital ratios, obviously, but what's the cost? I mean, if I put your ROE against $1.2 billion of capital, we're looking at around $150 million of earnings. You said it compares favourably to that. So it's probably a lower figure, but maybe you can help clarify.

Tayfun Tuzun – *Bank of Montreal – CFO*

These are very efficient transactions. And as you know, we've been executing these for the past four or five years so we have quite an experience. We estimate the per annum cost of these transactions over lifetime, somewhere between 8% and 9%. These are very good transactions to optimize our returns for our shareholders and continue to support growth on our balance sheet. This is part of how we manage ourselves. They have always been part of that.

Piyush, I don't know if you want to make comments on your end.

Piyush Agrawal – *Bank of Montreal – CRO*

Yes. I think I would just add, as we've said before, it's also a very active risk management tool that banks should employ, among many others. So apart from creating capacity for new business, which you're not seeing right now because it's going to come in through NIM and other earnings over time, they help you in terms of managing portfolio concentration risks in this environment. So I think in the collective suite of the things we are doing, this is a very efficient way in terms of managing our portfolio and at a capital cost that's acceptable to us.

Gabriel Dechaine – *National Bank Financial*

Fair enough – I get the rationale. There's a benefit. I just want to clarify the cost: 8% to 9% of whatever equity number I can associate with the RWA improvement or core Tier 1 improvement.

Tayfun Tuzun – *Bank of Montreal – CFO*

That's correct.

Mario Mendonca – *TD Securities*

I may have missed comments you offered on what the all-bank margin will look like with Bank of the West because there was another call going on while your call was happening. Did you offer any outlook on the all-bank margin, including Bank of the West?

Tayfun Tuzun – *Bank of Montreal – CFO*

Yes, I did. I said that starting in Q2, and my comment applied to Q2 as well as the remainder of the year, there should be about a 10-basis-point lift to our margin once we include Bank of the West.

Mario Mendonca – *TD Securities*

Yes, that's all-bank ex-trading. Is that right?

Tayfun Tuzun – *Bank of Montreal – CFO*

That is correct.

Mario Mendonca – *TD Securities*

Okay. And then one other thing. I want to thank you for slides on page 34 of your presentation. This is precisely the way I wish every bank would show their funding costs and loan margins. But it also, of course, creates a lot of questions, too.

One thing I like doing when I look at slides like this is just comparing the change in the loan spread relative to the change in the customer deposit costs, and what's clear from looking at this is there was asset sensitivity early on, meaning the assets are repricing faster than the cost of customer deposits, but that has almost certainly changed from one quarter to -- in the last few quarters. What we're seeing now is that deposit costs are in there, the rise is not very, but actually rising faster than loan yields. Is that a trend you expect to continue? And if so, would it really tell us that the margin expansion story is now over?

Tayfun Tuzun – *Bank of Montreal – CFO*

Okay. So good question. I will relay the compliments on the slides to our IR group. In terms of the change and the pace of asset repricing versus deposit repricing, we are at the later stages of this rate cycle. So this is a very natural result of the timing. And what we -- as we look ahead, you start actually focusing on the other side of the rate cycle, and you want to make sure that you are protecting the downside while you continue to benefit especially from normalizing loan spreads because as rates move up, loan spreads tend to come under pressure. Now we are -- as we look ahead to the last two or three quarters of the year, we are expecting loan spreads to slowly normalize, and we are also expecting this migration from transaction accounts to term deposits to also normalize.

We probably have another quarter or two with these moves. But what will help our NIM -- and we're not yet declaring that we're past the peak in our NIM. We are still expecting some expansion in the second half of the year based on what I said, while we keep an eye on the downside.

Lemar Persaud – *Cormark Securities*

I appreciate the guidance on the all-bank NIM. That's really helpful. But I'm wondering what's the appropriate starting point. I'm trying to figure out what the appropriate baseline is to tack on the additional 10 basis points of margin expansion for Q2 related to Bank of the West. Is that the 179 basis points on your slide 12 for adjusted?

Tayfun Tuzun – *Bank of Montreal – CFO*

I'm going to ask you for one more quarter of patience on this question because we want to make sure that we have all the final purchase accounting entries because for me to give you a reference point, I do need to know what those adjustments are. If you can just give us another quarter here when we get to the end of the second quarter, when we do our earnings call, we will give you a much more detailed perspective on how to reference going forward, what that should be.

Lemar Persaud – *Cormark Securities*

Okay. And then I want to go back to the Bank of the West slide. There is the updated accretion estimate. Just to be clear, that doesn't include the additional share issuance in response to the OSFI DSB announcement, right?

Tayfun Tuzun – *Bank of Montreal – CFO*

Yes. The December issuance, this most recent issuance is not included because that was not related to Bank of the West.

Lemar Persaud – *Cormark Securities*

Okay. And then not sure if I heard you correctly in the opening remarks, but I think you mentioned the reduction in the 2024 accretion estimate was due to the delayed closing of Bank of the West. Shouldn't that be higher because of the delayed closing because they're comparing a full year at Bank of the West in 2024 versus only three quarters for 2023? What am I missing there?

Tayfun Tuzun – *Bank of Montreal – CFO*

Since at the announcement, when we made the announcement in December of 2021, we assumed that the transaction would close 90 days earlier than where it did. We are one quarter behind in terms of the closing date, which then shifts the capture of all the expense savings, and we get one quarter in 2024 where we actually finalize that capture. That's the only change. It's a calendar change, basically, nothing else.

Joo Ho Kim – *Credit Suisse AG*

Just a quick one here. On your domestic residential mortgage growth, we've seen some slowdown from your peers but not so from BMO and the growth was pretty strong this quarter. So just curious whether that -- where that growth is coming from, whether that's from a certain segment of the customer market or geography. And what's your outlook for growth in that business going forward?

Ernie Johannson – *Bank of Montreal – Group Head, N.A. Personal*

It's Ernie. I'll answer that question. You're absolutely right. Our strategy has been to grow at or above market. Over the past, I would say, 12 months, we've acquired a significant increase in our sales team, and we've been digitizing our mortgage process so that we are a more effective originator of mortgages. That said, we obviously have been benefiting from the fact that you have a pipeline that obviously has a long duration to get through to your balance sheet and that's what you're seeing coming through. Right now, we're seeing originations down the same amount that the market is down. You can anticipate our going forward mortgage balances or growth, I should say, to slow down at what you're seeing from the market overall.

No differences in terms of segments as we're focused again on very quality customers, full share of wallet, bring the mortgage in, bring the rest of their business in, have a primary relationship. There’s no change there. But as I said, you'll see some moderation going into the back half of this year, just as the mortgage market has adjusted.

Nigel D’Souza – Veritas Investment Research

I actually had a follow-up question along the lines of residential mortgages. When I look at your remaining amortization, the portion of mortgages with a negative amortization, I guess these would be fixed payment variable mortgages. For those mortgages, is any portion of the increase in the multi payments being added back the outstanding balance for that mortgage?

Piyush Agrawal – *Bank of Montreal – CRO*

Nigel, it's Piyush. Let me begin and then maybe Ernie can chime in. So I think overall, our performance in the mortgage book continues to be very solid. We've obviously looked at various internal measures and capacity analysis. Just given the strength of the Canadian customer, the customer capacity to pay, we feel very good about the future.

Regarding your question around payments, we've gone back as a pre-emptive measure to several of our customers. As part of the strong relationship, it's not for us to tell them to pay more now. The product allows them to pay as and when they are able. Several customers have taken us up, and 20% have actually put more money in, but we think that the average increase, by the time of renewal, is absolutely manageable for our customers. In fact, it gives them the optionality because many of them, like us, do believe rates will come down. When it comes time for renewal, which the big slug for us is three or four years out, we should be in a very healthy position and actually build customer loyalty. None of those negative mortgages, by the way, have hit any regulatory trigger rate. We feel that we are in a very good position with our customers.

Darryl White – *Bank of Montreal – CEO*

Thank you, operator, and thank you all for your questions. As you've heard today, we continue to have good momentum in our operations across Personal and Commercial Banking, Wealth Management and Capital Markets. Our strong foundation, a relentless focus on execution of our dynamic plan, the addition of the Bank of the West, combined with our leading winning culture and high-performance organization, further enhances our long-term growth opportunities. As I said earlier, I've never been more confident that guided by our purpose-driven strategy, we are uniquely positioned to deliver sustained and consistent financial performance over time.

Thank you for participating in today's call and we look forward to speaking to you again in May.