Q3 2024 Conference Call

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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 Ernie Johannson, Head of BMO North American Personal and Business Banking; Nadim Hirji, Head of BMO Commercial Banking; Alan Tannenbaum, Head of BMO Capital Markets; Deland Kamanga, Head of BMO Wealth Management; and Darrel Hackett, BMO US CEO.

As our call will end at 8:15 this morning, please limit yourselves to one question during the Q&A and re-queue to give everyone a chance to participate.

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 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.

I will now turn the call over to Darryl.

Darryl White – *Bank of Montreal – CEO*

Thank you, Christine, and good morning, everyone. This quarter, we delivered record pre-provision pre-tax earnings of $3.5 billion, up 8% over last year, driven by continued revenue growth in Canadian Personal and Commercial Banking, stronger client activity in our market-sensitive businesses, and the full realization of our cost synergy and efficiency programs.

We met our commitment to positive operating leverage, this quarter at 5.2% and year-to-date at 1.3%, and we remain on track to deliver positive operating leverage for the full year. Operating momentum across our diversified businesses has been steadily improving since the start of the year. And at the same time, the cyclical increase in credit costs has resulted in loan loss provisions above our historical range, which has not met our expectations.

BMO has a long history of superior credit management, and that has not changed. Over many cycles, we've consistently outperformed peers and our portfolios remain strong, diversified and well managed. We investigated the circumstances that led to recent impairments, and the conclusion is, for some customers, the combination of prolonged, high interest rates, economic uncertainty and changing consumer preferences had an acute impact.

This is presented in a relatively limited list of borrowers. For instance, only 15 accounts comprise almost 50% of year-to-date impaired provisions in our wholesale portfolio. During a contracting credit cycle, the timing of wholesale losses can be difficult to predict. While we expect provisions will remain elevated in the near term, as the benefit of central bank easing will take time to transmit, we also expect that we will return to normalized levels in the range of our long-term average during 2025. Piyush will discuss this further in his remarks.

The Bank of Canada is anticipated to continue cutting rates in increments and the Fed to begin reducing rates in September. While GDP growth has strengthened from earlier expectations, we continue to monitor evolving geopolitical events and the pace of unemployment. We're dynamically managing our businesses to support customers and deliver returns across a range of conditions and outcomes.

Turning to our results and operating group performance for the quarter, adjusted net income for the third quarter was $2 billion and earnings per share were $2.64. We've had good balance sheet growth, including robust customer deposit growth across our franchise, supported by a strong capital position with a CET1 ratio of 13%.

Canadian P&C delivered another quarter of record revenue, up 7% year-over-year and PPPT up 12%. Our P&BB business is on pace for our strongest year ever in net customer acquisition with net account growth nearly double industry benchmark and strong customer primacy, a reflection of our award-winning digital and product capabilities and our strong traction with new Canadians.

It's been just over a year since the acquisition of AIR MILES, Canada's most recognized loyalty program. In that time, we've executed against key strategies and investments to revitalize the program, including a new mobile app and expanded ways to earn miles, including offers directly linked to BMO AIR MILES credit cards. The AIR MILES brand relaunch this summer is already seeing early signs of success with double-digit growth in enrolments, app downloads and reward redemptions. With access to over two-thirds of all Canadian households, we're creating differentiation in the market and a foundation to drive customer acquisition and engagement.

In US P&C, we're seeing improving performance with revenue up over last quarter, positive operating leverage of 4.9% and a 300 basis point improvement in our efficiency ratio over last year.

In Commercial Banking, loan and deposit growth is strengthening in Canada, and while softer in the U.S., we continue to acquire new clients and increase deposit penetration. We're growing active users in our leading treasury payment solutions business and we received the Red Dot Award for design concept for redesigning the digital banking experience for small and medium enterprises.

BMO Wealth Management had a strong quarter, with Wealth and Asset Management net income up 44% year-over-year, driven by good growth in client assets with strong net sales in our leading ETF business and net positive mutual fund flows. We're seeing results from our investments in asset management as nearly all global mandates managed by our global equities team performed in the top decile, including the BMO Global Equity Fund, which received a 5-star Morningstar rating.

BMO Capital Markets had PPPT of $625 million, within the range we've guided to, bolstered by strong client activity and revenue performance in Global Markets, M&A, and Corporate Banking. We're growing our capabilities and leadership in target areas in the US ranking #1 in US Agency CMO issuance year–to–date.

Turning to our overall US segment, we're building on over 200 years of experience in our second home market. This fall, we'll be celebrating 40 years since our bold expansion of Harris Bank in Chicago, 15 years since the acquisition of M&I and one year since the conversion of the Bank of the West. Over this time, we've consistently grown through many economic cycles, creating value as a key differentiator for BMO and our customers. From a regional bank with $8 billion of assets in 1984, we're now a top 10 bank with national reach, strong capital and the size and scale to compete across retail and commercial banking, wealth management and capital markets.

We continue to progress on our revenue synergy targets, including strong core personal customer growth with over 35% coming from our new West markets, evidence of our growing brand recognition, strong digital checking account growth and improving branch productivity. We're augmenting talent and capabilities, including, for example, dedicated teams in wine and beverage M&A, and media and entertainment finance in Los Angeles. Transactions between Commercial Banking and Capital Markets in areas like FX hedging and treasury payments are increasing. And this quarter, we closed the biggest referral of the year between Commercial and Wealth Management.

We've delivered consistent pre–provision pre-tax earnings of $1 billion or more in the U.S. for the sixth consecutive quarter with modest balance growth and protecting margins at a rate better than peers. While we surpassed our cost synergy goals, as we've discussed, the currently muted conditions for U.S. banking industry growth have impacted the timing of delivery on the revenue synergies from the Bank of the West. However, the overall environment is now showing signs of inflection and the investments we've made to build the business for success position us to grow profitable market share and strengthen return on equity. At the same time, we're making a difference in the communities we serve through EMpower 2.0, our 5-year commitment to break down barriers faced by underserved communities, businesses, and families in the United States, having already delivered $10 billion of our more than $40 billion commitment.

In summary, our franchise is strong as evidenced by fast-growing deposit customer base, leading customer acquisition, and deepening client relationships. We've delivered on our commitment to positive operating leverage. I'm confident that our risk culture is intact with actions in place to effectively manage risk and improve our credit performance through next year. Our teams are executing on a clear and consistent strategy for sustained operating performance that will endure through credit cycles.

I'll now turn it over to Tayfun.

Tayfun Tuzun – *Bank of Montreal – CFO*

Thank you, Darryl. Good morning, thank you for joining us. My comments will start on slide 10. Third quarter reported EPS was $2.48 and net income was $1.9 billion. Adjusting items are shown on slide 39, and the remainder of my comments will focus on adjusted results.

Adjusted EPS was $2.64, down from $2.94 last year and net income was $2 billion, down 8% as strong PPPT growth of 8% was offset by higher PCL. Record PPPT of $3.5 billion was driven by strong operating performance across our businesses, with positive operating leverage of 5.2%. Excluding lower insurance revenue, which was inflated last year, due to market impacts related to the IFRS 17 transition, revenue was up 2%, and expenses were down 1%, excluding severance in the prior year. PCL increased $414 million, which Piyush will speak to in his remarks.

Moving to slide 11, average loans grew 6% year-over-year, excluding the impact of the RV loan portfolio sale and the wind down of the Indirect Auto book, driven by good growth in residential mortgages and business and government loans. Strong growth in customer deposits continues with average balances up 9% from last year, driven by higher deposits in our U.S. and Canadian Personal and Commercial businesses.

Turning to slide 12, on an ex-trading basis, net interest income was unchanged from the prior year as balance growth was offset by lower margins and up 5% sequentially, including the impact of two additional days in the quarter. Compared with last quarter, NIM was up 1 basis point. In both Canadian and U.S. P&C, NIM decreased 3 basis points sequentially. Lower deposit margins continued to pressure NIM this quarter, but to a lesser extent, as pricing and the shift to term deposits is stabilizing. At the all-bank level, we maintain our expectation of relative margin stability for the remainder of the year. Canadian P&C NIM is expected to tighten mainly due to higher loan growth relative to deposit growth, while US P&C is expected to be modestly higher.

Turning to slide 13, we maintain a relatively neutral position to changes in interest rates, consistent with our strategy, and we believe that we are well positioned for the declining rate environment.

Moving to slide 14, expenses continue to be well managed and declined 5%, driven by the full realization of both the Bank of the West cost synergies and broader operational efficiencies, as well as the impact of higher severance and legal provisions in the prior year, which more than offset underlying growth in operating expenses and business investments. We delivered on our commitment to positive operating leverage again this quarter and expect the same next quarter despite a typical fourth quarter sequential uptick in expenses.

Turning to slide 15, our capital position remains strong with a CET1 ratio of 13%. Internal capital generation was offset by higher source currency RWA, due to asset growth and to a lesser extent, the impact of credit migration as well as an increase in market risk RWA from the low levels in the second quarter. Our capital outlook remains strong and is still likely to remain above our 12.5% management target.

Moving to the operating groups and starting on slide 16, Canadian P&C net income was up 3% year-over-year, driven by strong PPPT performance, up 12%, partially offset by higher PCLs. Record revenue of $2.9 billion was up 7%, driven by higher net interest income, reflecting both solid balance growth and improved margins, while non-interest revenue remained flat. The transition of banker's acceptances to loans resulted in lower lending revenue offset in net interest income. Expenses were up 2%, reflecting higher employee-related operating and technology costs, partially offset by severance in the prior year. Loans were up 6%, with good growth across consumer and commercial products, and deposits were up 11%, reflecting continued growth in transactional and term products across both consumer and commercial clients.

Moving to U.S. P&C on slide 17, my comments here will speak to the U.S. dollar performance. Net income was down due to higher PCLs, while PPPT growth and operating leverage were strong at 6% and 4.9%, respectively. Revenue was down slightly driven by lower non-interest revenue due to lower deposit and card fees in Personal and Business Banking.

Net interest income remained flat with balanced growth offset by a 5 basis point reduction in margins, which has actually performed better than industry trends. Expenses were down, reflecting good expense management including cost synergies and operational efficiencies and lower severance costs. Loans were up 4%, excluding the impact of the RV loan portfolio sale. Deposits were up 4% with strong growth in term and money markets, offsetting decreases in non-interest bearing balances. Sequentially, deposits were up 1% as we see the shift in interest-bearing from non-interest bearing deposits stabilizing.

Moving to slide 18, BMO Wealth Management net income reflected year-over-year growth of 44% in Wealth and Asset Management, offset by a decline in insurance from the impact of the transition to IFRS 17. Wealth and Asset Management revenue was up 7%, reflecting good growth in client assets and market appreciation more than offsetting lower net interest income. Expenses were lower due to severance in the prior year.

Moving to slide 19, BMO Capital Markets net income was up 31% year-over-year, reflecting continued strong PPPT of $625 million in the quarter, consistent with our guidance and partially offset by higher PCLs. Revenue in Global Markets was up 16%, reflecting higher equity and interest rate trading. Investment and Corporate Banking revenue was up 11% on higher advisory fees and corporate banking-related revenues. Expenses were down due to a legal provision and severance in the prior year. Assuming markets remain constructive, we expect capital markets to continue to deliver PPPT within the $625 million to $650 million range guidance provided earlier.

Turning now to slide 20, Corporate Services net loss was $236 million compared with $244 million in the prior quarter as higher revenue and lower expenses offset higher PCL.

To conclude, while as Darryl said our provisions have exceeded our expectations, similar to last quarter this quarter demonstrated continued good operating performance with improving revenues, PPPT, and positive operating leverage in line with our expectations. The steady rise in our operating performance through the credit cycle is the result of the underlying strength of our franchise and our business and geographic diversity.

We will continue to execute on our strategic priorities and invest for growth and look to leverage the strength of our balance sheet and our capital to build lasting shareholder value.

I will now turn it over to Piyush.

Piyush Agrawal – *Bank of Montreal – CRO*

Thank you, Tayfun, and good morning, everyone. First, I'll start with some context for our overall credit position.

Consistent with trends over the last few quarters, we continue to experience credit outcomes reflective of the current credit cycle, notwithstanding the early stages of easing monetary policy in Canada and the potential for rate cuts in the U.S. later this year. Specific client segments continue to feel the impact of prolonged elevated interest rates, tightening of credit conditions as well as shifting consumer demand for products and services.

Moreover, rising unemployment in Canada and reduced pandemic-related liquidity are challenging consumer and business balance sheets. This has led to credit downgrades in our portfolio with higher watch list and impairments. On slide 22, this quarter's total provision for credit losses was $906 million or 54 basis points. Impaired provisions were $828 million or 50 basis points, up 9 basis points from last quarter, largely driven by higher provisions in our wholesale book.

Canadian Personal and Business Banking impaired losses were up $27 million from prior quarter, driven by higher delinquencies and insolvencies and unsecured retail products with our mortgage portfolio continuing to perform well. We continue to take actions to manage losses within these portfolios, including pre-delinquency engagement with customers most vulnerable to payment stress.

In Commercial Banking, impaired losses increased $31 million in Canada and $55 million in the U.S. The Capital Markets loss this quarter was mainly driven by one account in the services sector.

On slide 23, we provide additional information on our business and government portfolio. Over the last few quarters, the wholesale portfolio has experienced negative migration and elevated losses. As Darryl noted, 15 accounts drove almost 50% of year-to-date wholesale impaired provisions. And as I've said before, in a large wholesale portfolio like ours, quarterly provisions can be variable. And in fact, this quarter, two accounts drove the 9 basis point increase in impaired provisions over prior quarter.

Two sectors, we continue to monitor closely are transportation, where the trucking segment has been in a cyclical downturn with weak freight volumes and reduced spot rates, although there are early signs of stabilization; and commercial real estate where the portfolio continues to perform in line with our expectations, including a partial recovery this quarter of a prior provision. The wholesale portfolio remains well diversified with over half rated investment grade.

Moving to slide 24, performing provision for credit losses of $78 million primarily reflected portfolio credit migration. We have added to performing allowances for the last 9 quarters and are appropriately reserved with a total performing allowance of $3.8 billion or 56 basis points coverage over performing loans. We expect credit migration will continue, which in turn will drive increases to the allowance for the next few quarters.

Turning to slide 25 impaired formations of $1.8 billion decreased $141 million due to lower business and government formations. Gross impaired loans increased to $6 billion or 89 basis points with increases primarily in commercial real estate, manufacturing, and transportation. Based on our extensive portfolio monitoring and where we are in this credit cycle, we expect impaired provisions to remain elevated over the next couple of quarters and subject to variability. As rates fall, and unemployment stabilizes, we expect credit performance with a trend towards long-term averages through 2025.

I will now turn the call back to the operator for the Q&A portion of this call.

Doug Young – *Desjardins Securities Inc.*

On the PCL, the guidance was for impaired to be in line with Q2. It was up 9 basis points, and I get that things change. Just curious, what surprised you when you mentioned impaired PCLs likely remain elevated for a few quarters. What gives you confidence that it's going to? You refer to the long-term average in fiscal '25, and is this more midway through fiscal '25, early '25? Just some colour.

Piyush Agrawal – *Bank of Montreal – CRO*

When we look at our overall impaired PCL performance, there are several reasons for this elevated number this quarter. I think as we all know, the current environment is complex and changing rapidly. But overall, when we provided guidance, I would say our retail losses have been in a tight range of what we expected, and that's pretty expected because of delinquencies and what's flowing through that book. It's influenced a little bit by Canadian insolvencies as you've seen those continue to be high.

And then in a large part, our wholesale book has also performed exactly per our expected model. We have a long history of what our loss performance is. And to a large part, the wholesale book has actually performed in line with our expectation. Where it has been a little challenging is the variability on a few large names that we have discussed before. And the variability what I call is unexpected losses that have a lower probability, seem to be a significant part of any credit cycle and that's what you're seeing right now.

We are in a fairly tight range from that expectation. As we look forward, it's hard to give you a number or a range only because of this variability over a quarter, but over a year, we can tell you where it's coming. We expect this will be elevated as we go through the next one or two quarters, starts to start coming down. And by the end of the year, it should start reverting to our long-term average. That's our expectation. We'll provide you more guidance as we get through next quarter.

Doug Young – *Desjardins Securities Inc.*

Just to clarify, you're more expecting the evolution to the long-term average closer to the end of fiscal '25, not through the entire year. And then the 50 basis points, last quarter you said remain elevated and flat sequentially in the 40 basis point range for impaired . We're at 50 now. That 50 is the proper starting point to think about remaining elevated over the next few quarters. Is that correct?

Piyush Agrawal – *Bank of Montreal – CRO*

I would say when we're saying elevated, we know it's a little higher. It's hard to pinpoint a number because of this variability. You look back at this quarter, 9 basis points was two accounts. You look back year-to-date, 50% was 15 accounts. It's these one or two accounts that can move the needle a little bit more, but we expect it to be elevated. Some of it is the economic environment, as you're seeing, again, insolvencies and things like that. But it should start coming down towards the second half of the year because the elevation is in the next one or two quarters.

Meny Grauman – *Scotiabank Global Banking and Markets*

Darryl, I wanted to ask about capital. 13% CET1, a little bit below expectations, but still very strong relative to the range of 12% to 12.5%, which seems to be where most banks are comfortable operating now. I'm just wondering why no buyback given that capital level. Are credit concerns keeping you cautious? And Piyush, you talked about migration during the quarter. I'm wondering if that's part of the story here?

Darryl White – *Bank of Montreal – CEO*

Thanks, Meny, thanks for the question. I think it's just more generalized than that. I remind myself that we just turned the DRIP discount off in Q2. And as we assess the overall environment, I think the short answer to your question would be not yet. I think when we look at the overall environment, we're not yet in a position where buying back shares gets a full green light given the various uncertainties that we see out there. And we also, at the same time, as I've always said, we want to maintain lots of capital for deployment when we see good customer opportunities and the expectation is we'll start to see some expansion opportunities there as we go into 2025. But look, as always, we put all of those things into the hopper and we make our decisions, and we'll update you again at the end of the fourth quarter based on where those conditions are. Is that helpful?

Meny Gauman – *Scotiabank Global Banking and Markets*

Just as a follow-up, where do you see your comfortable operating range in terms of CET1? And is it more elevated now just given the environment?

Darryl White – *Bank of Montreal – CEO*

I don't think it's elevated for the long run, Meny. I think we've talked about 12.5% or above as a reasonable range, and it all depends on circumstances. In the short run, we'll keep a close eye on this year for the next quarter or so, and we'll get back to you. But there's really no change in our posture.

Ebrahim Poonawala – *Bank of America*

A question for Piyush and maybe for Darryl on credit. It seems that you have very limited visibility on credit for now. And two questions come up. One, is there an issue in terms of the bank having too many outsized credits for its size, because for a bank of BMO size, one loan, two loans moving credit meaningfully quarter after quarter is a little bit surprising. So one, just talk through in terms of how you're approaching hold size? Are these all shared national credits in the U.S. and you're having to take these charges as you go through the review with examiners?

And second, just talk through the process given what's happened in the last two quarters, help us gain some confidence that you've done some deep dive reviews, what the outcomes have been and why you have a better handle today than six months ago?

Piyush Agrawal – *Bank of Montreal – CRO*

Ebrahim, thanks for that. I would say let me begin with where we are in terms of our performance. We obviously continue to look at our peers and where we are and I can't comment on any individual bank, but year-to-date second quarter, we were at 35 basis points. Our peer group was at 35 basis points. They're a bit higher right now. We'll see where everybody shapes up.

In the large losses we've had, I would tell you about 70% of those credits, we're not alone. These are syndicated facilities. We have banks north and south of the border in those in different ranges, different sizes and some we're the lead bank and some other lead banks. These aren't unique to BMO. To your point around what have we done? Well, we are always learning from what has happened and what can we change.

And I would say we're not anticipating any radical changes to risk appetite, but we're always making refinements. That's what good risk managers and bankers do to ensure we're capturing the evolving risks in the industry. I would tell you in the large losses, there isn't an industry theme, there isn't a geography theme. These are very episodic, but many of these loans have related to underwriting we have done around the end of the pandemic.
And those were exceptional circumstances, liquidity was high. It carried consumers. It carried companies. Their balance sheets are more liquid. As consumer patterns have shifted, as one of the reasons, many of these companies are right now in a position to have higher leverage or not the same operating performance as we expected. We've gone back, looked at our entire book, combed through underwritings. We've done that. And really, I come down to a handful of accounts that are now on our watch list, which is why we are guiding you to a higher elevated performance for the next few quarters. Just like we've said for retail, this will get through the system. It's the same thing. We believe the position is contained. It will get through the system. It's hard to pinpoint the exact quarter. But in the next one, maybe two, maybe three, these names should clear the system and that is why we are confident in reverting back to our long-term averages.

Darryl White – *Bank of Montreal – CEO*

And Ebrahim, it's Darryl. I would just add to that, that when you look back, I think what we're experiencing here is effectively the delayed consequence of the dynamics that were pretty unique to a pandemic. When you look back at that inflation surge, the unprecedented rise in interest rates, and you consider that time in 2020, for example, when we were all coming to grips with all of those dynamics around pandemic and free money was free money from government stimulus, that free money didn't discriminate where it went. Everybody got it. And that tends to, in some cases as Piyush said, pretty limited list, but it covers up a lot of problems, which then can come back later. Inevitably, when we look through that, there will be companies that are stranded as rates rise, inflation persists, consumer preferences change, especially in certain segments.

Where are we today? I think, well, on the one hand, one might say, we're seeing those conditions reversing and easing. The reality is, in some cases, the impairments and the bankruptcies are just evidencing themselves while the conditions improve, and that's what we have seen in previous credit cycles. Because for some of those instances, it's just too late. And what we're seeing is, therefore, a faster rise with higher losses than we've seen historically. I will say, except for the fact that we have to remember, we haven't had a recession in 15 years, give or take, and when we look back to that recession, this is actually a very similar pattern to what we saw then in our wholesale portfolio, where we ended up having higher losses in our peers for a short period of time, which is unusual relative to a very long period of time. And I think that's kind of where we are now.

The implications as we've done that, I think, you referred to the deep dive, Ebrahim, are straightforward. I mentioned earlier that 50% of our credit losses year-to-date are from 15 accounts. When we looked into whether there are common characteristics in those 15 accounts is actually quite interesting in terms of what it wasn't and what it is. It's not local concentration within geographies in the U.S., for example, it's not BMO legacy versus Bank of the West. There we're pretty much pro rata. It's not a specific industry sector. What it is, is there's a vintage of, I call them, pandemic loans that might have had higher leverage and larger holds than if we were able to do them again, and in some cases, expansion geographies. And in most of those cases, as Piyush pointed out, there were other banks involved. It wasn't unique to us. I think 70% of the time, in fact, they were syndicated facilities.

When I look forward, I think you asked about our confidence in terms of where we go from here. We know what those conditions were. We know how to screen the rest of the portfolio for those conditions and we've done that. And that's why we feel really confident that this is known and it's bounded. And the rest of the portfolio, like 99 point something percent of the portfolio doesn't exhibit those combinations of characteristics. That's what gives us the confidence in a quarter or two that this will be behind us, but we're going to have to fight through it for the next couple of quarters. Is that helpful?

Ebrahim Poonawala – *Bank of America*

That's helpful. And I'll follow up on the shared national credit exposure later. But I had a question for you, Darryl. from an investor standpoint, 10.6% ROE, is there any shot this bank again becomes a 14% ROE? And what will it take to get there?

Darryl White – *Bank of Montreal – CEO*

Well, I will say to you, Ebrahim, we are not backing down on our midterm objective of 15% ROE and that's because we do see a path to get there. Now, near term, with slower economic growth and the high capital levels, that might be a little bit more challenging. But as we go into the medium term, we know how to get there. We know what the levers are. They include the normalized credit that I've just talked about. They include continuing to develop positive operating leverage in the business, continuing to optimize the resources of our business and improving the U.S. environment. And when we get those conditions present, those are the levers that get us there. We're sticking to that.

Mario Mendonca – *TD Securities*

BMO's PCLs, as you've disclosed, have gone from 21 basis points impaired last year to 50 this year, and your peers are something like 24 to 38. Clearly, something's gone wrong. And I appreciate your comments around the pandemic, but the pandemic was not unique to BMO. As you look back, can you identify the failures, like the underwriting failures, the mistakes that the bank made? And the reason I'm asking the question this way is because it has been my experience when a bank goes through something like this, and I think the bank is clearly going through something relative to your peers, that changes need to be made and often those changes lead to subpar growth until the bank figures out what went wrong. The question is two parts, what went wrong relative to your peers? And secondly, does this necessarily lead to a period of below average growth as the bank retools?

Nadim Hirji – Bank of Montreal – *Group Head, BMO Commercial Banking*

In terms of did we do something different, our credit underwriting policies, procedures are robust and we did not make any significant changes to our credit risk appetite over the past several years. I've thought about this and we've taken share in the U.S. in the last few years. It was purposeful. It was more so in specialty segments like ABL, sponsor fund lending and dealer finance. And these are not the areas where we are seeing an increase in impairment. And as you heard from Darryl and Piyush, we're not seeing systemic issues in the portfolio or losses concentrated in any segment geography. It is broad based. We had a growth strategy, but we didn't lose discipline. And we're going to, of course, look at our underwriting and portfolio management practices in a changing environment, but it's going to be to support continued growth and support our clients through these times.

Piyush Agrawal – *Bank of Montreal – CRO*

Mario, it's Piyush. I would just add, again, exactly to the point we've said. If you think about the PCL increase in retail, it's not unique to us. It's systemic. It's the pressures you're seeing from unemployment and insolvencies. Then it gets back to wholesale. And I'm confident we've looked through our files. It's not thematic to a sector. Yes, we have a transportation finance business. The business ratings can change some of the PCL performance.

Transportation, as you know, and we've covered in our remarks, is going through a tough time, a tough cycle. But we've been in the business 40, 50 years. It's still profitable. It just happens to have a higher PCL through a cycle. We are beginning to see some improvements. We hope we'll report those improvements as we go next quarter. And then on the wholesale side, the confidence that I have is because through the reviews of the losses we've gone through, they are broadly in line with our long-term expected loss models.

Where you're seeing are the changes that I call unexpected losses. And these are hard to call. They're hard to call, especially when they're non-credit like events in certain cases, or in many cases, if there's an auditor resignation. Are you going through a cycle where you've got a company for sale with 10 bidders and all of a sudden there's nobody at the end. They all go away. Those lead to some higher numbers and that's just a function of a credit cycle. I think as this wades through in the next one or two quarters, we feel pretty good about this returning back to normal. I think the rate decreases, this is coming in the U.S., the transmission of what's been happening to the Canada Central Bank rate cuts. These are all positives that should flow through the system. We'll get back to you.

Mario Mendonca – *TD Securities*

Darryl, you don't believe there's any reason to take growth down in your Corporate and Commercial business?

Darryl White – *Bank of Montreal – CEO*

No, I think, Mario, it's a good question because I think what Nadim said earlier is important when we assess what's different about BMO, well, our mix is a little bit different, right? We skew more wholesale, we skew more U.S., and we're seeing that there are some losses there. But Mario, it's not a circumstance where we say, alright, that means the strategy is wrong, because the reality is what that doesn't consider is that we've also delivered better longer-term growth through the development of that franchise. That's an enduring franchise with 90% of the accounts having lead or sole relationships with us. And when we look at where the losses are presenting, they're actually not in the areas where we've grown at a much faster rate than market. Where we've grown at a faster rate than market and taken share, we're actually not experiencing the losses. When we look at the question overall, there is a business mix at BMO that leads to this for short periods of time, sometimes, and we're in one of those periods right now. It's as simple as that.

Matthew Lee – *Canaccord Genuity*

You mentioned the watch list and I noticed it's gone to 5% of the book, up from 3% at the end of '23. Can you maybe just talk about what level of credit deterioration the company has to show before they end up on that list? And just maybe you can detail some of the indications looking forward when you put a company on that list?

Piyush Agrawal – *Bank of Montreal – CRO*

We are obviously evaluating credits between our bankers and risk partners throughout a company's journey with us. And as we underwrite, risk rating changes that come through because of higher leverage, weaker cash flows, lower liquidity, is what drives our internal ratings. And when you get to a certain level, you put in a watch list, which really means we are evaluating you more often, we have a higher connectivity with you.

I don't think that's symbolic of a problem that something bad is imminent immediately, but it just gives us a perspective on what the watch list is and are there things we need to be doing with the client, helping the client get back to where they started. I wouldn't read more around the watches other than it's a category that allows us to continue to be highly engaged with the client and start also thinking about risk mitigation strategies, which is appropriate at that point of time. And you've seen that happen through various things we've done around risk mitigation and we continue to do that even now.

Matthew Lee – *Canaccord Genuity*

Okay. That's great. And then maybe on the U.S. expense front. Efficiency ratio dropping a couple of hundred basis points quarter-over-quarter is good progress. Can you maybe put some dimensions around where you expect that ratio to end up over the medium term? Should we be expecting to see a return to the low 50s, high 40s in the next couple of years or are there like mitigating factors that might offset cost reductions there?

Tayfun Tuzun – *Bank of Montreal – CFO*

As Darryl said a moment ago, our broader enterprise target in the medium term continues to be 55%. Along with that, in the U.S., we do expect our efficiency ratio to come down to lower 50s. Obviously, it would require a better revenue environment in the U.S. And we need to realize some of the scale benefits in our efficiency ratio as we grow our U.S. business, but yes, our target remains directionally moving that ratio towards the lower 50s, even to 50% potentially.

Gabriel Dechaine – *National Bank Financial*

I want to follow up on the line of questioning that Mario was going with earlier. In terms of maybe stuff that went wrong over the past couple of years, I know you're saying it's normal and consistent with the industry on the consumer side, but on the commercial side, I'm just wondering if while you were integrating Bank of the West, maybe that watch list wasn't as closely watched as it should have been?

Piyush Agrawal – *Bank of Montreal – CRO*

I can begin, Gabriel. This is Piyush and then maybe Nadim can chime in. We've done, obviously extensive diligence. I've said to you Bank of the West portfolio is fully integrated with ours. We haven't seen any different loss performance from the Bank of the West. There's a few losses this quarter. But year-to-date, it's performing exactly in line with our expectations, exactly in line with the legacy BMO portfolio. I wouldn't say it is a geographic issue or something to do with Bank of the West. Like I said, there aren't industry themes. These are episodic events or credits that are driving some of these issues. But Nadim, I don't know if you would like to add more from the Bank of the West and what we've done.

Nadim Hirji – *Bank of Montreal – Group Head, BMO Commercial Banking*

Yes, I would just add on to exactly what Piyush said. The portfolio is behaving very, very similar from our legacy business and our Bank of the West business. If I look at our new client acquisition activity and the risk profile and the probability of defaults that are coming into the portfolio, the risk culture is very, very similar as well. We've done scrubs of many accounts that Piyush talked about when we talked about the confidence we have and where we're going and that we have this contained and we know what we got. I'm not seeing any big changes in terms of characteristics between our portfolio and Bank of the West.

Gabriel Dechaine – *National Bank Financial*

Okay. And so I understand your credit outlook, in a clear fashion, you're saying the next one to three quarters are going to be in and around the credit experience we've seen this quarter, some variability, I guess, or whatever you're calling it, idiosyncratic situations. But in and around this quarter's level for the next one to three then after that moving towards the normalized level, which would be what?

Piyush Agrawal – *Bank of Montreal – CRO*

We're saying compared to our Q3, we expect Q4, maybe Q1 to be higher. I'm not giving you a guidance around what that number is because of the variability that exists from these names. The next couple of quarters really is one, maybe two, maybe three. But really, it's the next two quarters, given our confidence of the reviews we've done on where this will be. Also, I think the transmission, as we've talked about in many calls, the transmission of central bank policy takes about 6 to 12 months to go through the system. That should start helping the market start helping consumers. And that's why the next couple of quarters are elevated. And then after that, receding back to our long-term normal and our long-term averages are in the range of about 36 basis points that we've seen over the last 30 years.

Gabriel Dechaine – *National Bank Financial*

Okay. And again, this language is important here. You're saying higher than the 36 or higher than what we saw this quarter?

Piyush Agrawal – *Bank of Montreal – CRO*

For the next couple of quarters, higher than what you saw this quarter.

John Aiken – *Jefferies LLC.*

Darryl, I wanted to circle back in terms of your commentary about the timing of revenue synergies from the Bank of the West deal. Now understandably that's being pushed out. But do you still think that you're able to achieve what you originally thought? And can you give us some framework in terms of what you're thinking about timing moving forward now?

Darryl White – *Bank of Montreal – CEO*

John, it's a great question. And the short answer is, yes. When I look at the revenue environment that's persisted for a year and a half now, since we saw some of the failures in the U.S. banking market with higher deposit costs, with competition there and muted loan volumes. That's all it is, right. That's depressed the overall revenue pie for the overall system. You know that. You look across the system. The available wallet is less than we had forecasted. And that's the simple reason as to why we think it takes a little bit longer to get there. But whether we get there is not a question. We are seeing in the meantime within the things that we can control, lots of progress on the P&BB side of the business, lots of progress on the Commercial side of the business and even across our Wealth and Capital Markets. And I'm just looking across the table here, our retail leader, Ernie, is going to jump in and give you some examples of that progress.

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

Thanks, Darryl, and thank you for the question. We're seeing really good momentum in our western markets fuelled by that above-target brand awareness and consideration in the market that's generating, as Darryl mentioned earlier, strong core deposit checking and savings growth. That's really important for us. Our position is always around getting top-tier deposit growth in the U.S. as well as in Canada. We're also seeing a really strong performance from our branch network in terms of achieving the outcomes we had anticipated, they would get to our normal run rate, as we would say, in our more Midwest markets, and we're seeing that.

In particular in California, California is generating about 80% of the productivity that we have in our Illinois and Wisconsin market, just to give you a flavor of the trajectory that they're on. And as I said earlier, digital sales, strong, up 40% year-over-year. The fundamentals are there. It's picking up momentum. And as Darryl said, as the market becomes more invigorated, we're going to see that acceleration just continue. I'll flip it over to Nadim for some comments on Commercial.

Nadim Hirji – *Bank of Montreal – Group Head, BMO Commercial Banking*

Thanks, Ernie. Similarly, I'm also seeing great momentum. When I look at new client acquisition, the momentum is strong. The pipelines are strong. In fact, last quarter was the highest new client acquisition we've had in our western market since integration. The other thing I'd also say is our branding. As you know, we've been able to build a very strong brand in our new markets. This has led us to the ability to make significant progress in building talent. We've had significant successes in adding to our teams and getting us ready, poised for good growth. We added Zepponi & Company to our team. It's an advisory firm in the alcohol beverage business. This is highly complementary to our wine lending business, and we are just now expanding our media finance business into the California market. I would call it that we're making extremely strong progress in a challenging environment.

Darryl White – *Bank of Montreal – CEO*

I'd wrap it, John, by saying this is what scale benefit should ultimately look like in the long run, which has been our thesis, which is in flat environments, which is what we had for the last year-and-a-half, one who can invest and build capacity such that, that capacity is there to take advantage of expanding environments when they come, ends up winning in the medium term. And that's the part of the play that we're in right now and we feel pretty good about it.

Lemar Persaud – *Cormark Securities Inc.*

Thanks for taking my question. Just on credit. I'm just wondering what is really preventing you guys from providing more specific guidance on PCLs given that you have done this deep dive in commercial wholesale exposures? Is it because of uncertainty around the rate environment, unemployment? What are really the few factors preventing you from going there? Because, as you know, most of your peers are able to provide more specific guidance on credit losses at least on the impaired side?

Piyush Agrawal – *Bank of Montreal – CRO*

Thanks, Lemar. It's Piyush. I would just say for the retail portfolio, and we don't give individual business guidance, it's easier there because of the way it flows into what an impairment is. In the wholesale in a benign environment, again, easier. When you get into a situation of a credit cycle where we are, it's always hard. It's always hard to put a number for a quarter. I can guide you for a year, but I can never be able to tell you exactly which quarter and how much amount. And we've seen that. We've talked about this a couple of times.

We know names and impairment. We know what their expected losses might be. But what you're seeing come out, after a long period of a benign environment, into this credit cycle that the variability has been very high for various reasons and it's being compounded because of the rate environment. It's being compounded by credit conditions. It's being compounded by a pullback from regional banks who are also active lenders in many of these areas. All of these could change the situation. But I can see a situation which could be as high as 50 basis points to low 60s, high 50s, low 60s. But I'm not giving a prescriptive guidance just because in the last one or two quarters, one or two accounts can skew that overall number. And that's why it's good to be in the range that it will be higher and then it starts coming down.

Darryl White – *Bank of Montreal – CEO*

Lemar, it's Darryl. I would just say that I get what you guys are wrestling with, which is the difficulty of forecasting with precision. And you'd love our CRO to tell you the date on the calendar and the exact amount that we peak at and that would be great for all of us. But just to get you a little bit more behind the curtain, if you imagine that you can do a reasonable job, we and anybody, at projecting where you think defaults might come from, not perfect, but reasonable, it gets even more difficult when you go to the next level, which is what's the loss given default, and we might have an assumption on what the loss given default is. But in circumstances that are, in some cases, highly unusual, that outcome could be worse. And we've seen a couple of instances where it has been worse than any model would have forecasted because there was no model that forecasted the very dynamics that I talked about earlier in this call. And that's what makes it a little bit challenging.

You know that's a tough part of the cycle. But the good news is, I think you've heard Piyush say pretty clearly on the topic of where we're going from here that he thinks we go a little bit higher here for a quarter or two, but then we return to our long-run average of 36 basis points as we go through 2025. I hope that's pretty helpful. We're not trying to dodge the question. That's a fair bit of guidance we think, at least, and that will depend on the variability that goes around all of that. Is that helpful, Lemar?

Lemar Persaud – *Cormark Securities Inc.*

That's helpful. Yeah, it just sounds like it's, I guess, more because of a mix issue. The other, your peers are probably able to better mask it given they're heavier in retail.

Darryl White – *Bank of Montreal – CEO*

Yeah, perhaps. But I will remind us that our total losses year-to-date are 40 basis points.

Lemar Persaud – *Cormark Securities Inc.*

Okay. And then just another. You guys have mentioned that some of these losses in the commercial and wholesale businesses are syndicated position. I'm assuming you'd see what peers are involved in these loans. When you look across some of your peers that are involved in these loans that went bad, does it feel like elevated PCLs are more just BMO being conservative on credit or are they simply just more meaningful to BMO?

Piyush Agrawal – *Bank of Montreal – CRO*

It's hard to say because every bank gets to choose how they are doing the valuation and where they are in different parts of credit mitigation and capital structure and things like that. I really can't comment on those. I would tell you we haven't shied away from our credit culture. We see a problem we take the impairment. We take our best-case estimate. We revised our best-case estimate every quarter as the situation progresses. And over time, you've seen recoveries. And I think over time, you're going to see recoveries and that's the hope. But in the quarter, we see the impairment. I think it's a good risk practice that we shall continue, which is you take the impairment then and you move forward.

Darryl White – *Bank of Montreal – CEO*

Thank you, operator, and thank you all for your questions today. I would just wrap very quickly by saying our performance reflects both the operating momentum, which will endure and the higher credit cost, which, as you heard, we expect to moderate through 2025. Our strategic goals are firmly in place and that's because we've built a clear, competitive advantage in a highly fragmented U.S. market, capturing our one client opportunities across the relationships and modernizing the digital capabilities of the bank for the future. I'm confident in the power of our integrated North American franchise to deliver long-term value and we look forward to speaking to you again in December. Thank you.