Q1 2015 CONFERENCE CALL

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PRESENTATION

Operator

Please be advised this conference call is being recorded. Good afternoon, and welcome to the BMO Financial Group's Q1 2015 earnings release and conference call for February 24, 2015. Your host for today is Ms. Sharon Haward-Laird, Head of Corporate Communications and Investor Relations. Ms. Haward-Laird, please go ahead.

Sharon Haward-Laird - *BMO Financial Group – Head of Corporate Communications and Investor Relations*

Thank you. Good afternoon everyone and thanks for joining us today. Our agenda for today's investor presentation is as follows:

We will begin the call with remarks from Bill Downe, BMO's CEO followed by presentations from Tom Flynn, the bank's Chief Financial Officer and Surjit Rajpal, our Chief Risk Officer.

After their presentations we will have a short question and answer period where we will take questions from pre-qualified analysts. To give everyone an opportunity to participate, please keep it to one or two questions and then re-queue.

Also with us this afternoon are Frank Techar, Chief Operating Officer, Cam Fowler from Canadian P&C, Mark Furlong from U.S. P&C, Darryl White from BMO Capital Markets and Gilles Ouellette from Wealth Management.

On behalf of those speaking today, I note that forward-looking statements may be made during this call. Actual results could differ materially from forecasts, projections or conclusions in these statements.

I would also like to remind listeners that the Bank uses non-GAAP financial measures to arrive at adjusted results to assess and measure performance by business and the overall Bank. Management assesses performance on both a reported and adjusted basis and considers both to be useful in assessing underlying business performance.

Bill and Tom will be referring to adjusted results in their remarks unless otherwise noted. Additional information on adjusting items, the Bank's reported results and factors and assumptions related to forward-looking information can be found in our annual report and our first quarter report to shareholders.

With that said, I will hand things over to Bill.

Bill Downe - *BMO Financial Group - CEO*

Thank you, Sharon, and good afternoon. We appreciate everyone joining us on the call today.

The economic environment in the first quarter has been unsettled, underscored by movements in oil prices, lower long-term interest rates and a rapid decline in the Canadian dollar. Against this backdrop, BMO's underlying business results in the first quarter were solid.

U.S. Personal and Commercial Banking and Traditional Wealth posted good results. Our Canadian P&C business continued to grow although at a slower pace than we saw last year. And results in Capital Markets improved from Q4 but continued to be impacted by the current environment. Our Insurance business, which is sensitive to long term interest rates, faced a significant headwind from declines in long term rates during the quarter.

Tom is going to take you through the financial results in a few minutes but I wanted to speak first to some of the elements that give us continuing confidence in the Bank's ability to respond to evolving market conditions and deliver sustained growth.

Net income[1] in the quarter was $1.0 billion or $1.53 per share. Excluding the impact of the decline in long-term rates and loan accounting, earnings[1] were up 5% year-over-year.

Both loans and deposits were up 9% from a year ago.

Credit performance in the quarter continued to be good as higher provisions were largely driven by lower recoveries compared to last year, and Surjit will provide more detail on that shortly.

BMO's Common Equity Tier 1 ratio remained strong, at 10.1%. During the quarter, we repurchased 3 million shares reflecting our commitment to return capital to shareholders.

As I said, I would summarize the underlying results in the quarter as solid.

Turning to the operating groups; Our combined Personal and Commercial Banking earnings[1] were $708 million, up 6% year-over-year, demonstrating the power of having almost 1600 branches serving our customers across our North American footprint.

In Canadian Personal and Commercial Banking, earnings[1] were $503 million, up 4% year-over-year. This growth was lower than the strong performance we have seen over the previous six quarters.

But we remain confident in the foundations we have built and our ability to adapt to the changing market environment. We have a clear strategy for how we will compete in this business which we described in some detail last month at our Investor Day.

Every part of the strategy is based on a deep understanding that our customers believe that money is personal and their bank should be too. And how we merge the digital and physical environment only serves to reinforce these concepts.

This quarter we launched our combined BMO Banking and InvestorLine iPad app, becoming the first major Canadian bank to have a single app which provides customers access to both personal banking and self-directed investment accounts all in one place. And we continue to see very positive results from the second release of our mobile banking app, with over 4 million downloads in total. We also launched BMO DepositEdge which provides businesses with the ability to deposit cheques remotely.

And while this was a slower quarter for Canadian P&C, we expect better results in the second half of the year.

Our U.S. Personal and Commercial Banking business had another good quarter, continuing to demonstrate the improving trends in revenue and earnings growth that we delivered in the second half of 2014. Net income[1] was $205 million, or $172 million in source currency. Pre-provision, pre-tax earnings[1] growth was strong, up 6% in source currency from last year.

Total loan growth was also strong with balances up 10% year-over-year. Core commercial lending growth remained robust, with double-digit growth in C&I loans. Our pipelines remain strong.

In the context of a still strengthening U.S. economy, the benefits of our U.S. footprint are becoming increasingly apparent.

1 – on a reported basis: Net income in the quarter was $1.0 billion or $1.46 per share. Excluding the impact of the decline in long-term rates and loan accounting, earnings were up 3% year-over-year; Combined Personal and Commercial Banking earnings were $694 million, up 6% year-over-year; Canadian Personal and Commercial banking earnings were $502MM, up 4% year-over-year; U.S. Personal and Commercial banking net income was $192 million, or $161 million in source currency, pre-provision, pre-tax earnings growth was 8%in source currency from last year

Wealth Management earnings[1] in the quarter were $186 million including the impact of the significant decline in long-term interest rates during the first quarter. When long-term rates eventually rise there will be a corresponding benefit in our Wealth Management business.

Our Traditional Wealth business posted net income growth of 28% year-over-year reflecting good organic growth in client assets and the addition of the acquired F&C business. Assets under management and administration increased to over $800 billion.

BMO Funds were recently recognized as one of the top performers in 2014 in the Barron's Lipper Fund Family Ranking, coming in second among U.S. fund providers. After introducing 21 new funds over the past two years, BMO Global Asset Management now has 45 U.S. funds with $14 billion in assets under management.

Annual earnings in Traditional Wealth have grown at a compound rate of 24% over the past 5-years.

Capital Markets results improved from last quarter despite the impact of credit and funding valuation adjustments but were down from the strong levels we experienced in the first three quarters of 2014.

Our Capital Markets business remains well-positioned in the current environment with good opportunities to gain share in the U.S. mid-cap market.

Before I wrap up, I want to take a minute to acknowledge Eric Tripp who has been a leading force in BMO Capital Markets for 30 years. Eric was President of BMO Capital Markets from 2008 until late last year, when he stepped down in anticipation of his retirement. Eric is also a mentor to many people in Capital Markets and a champion for diversity in our company. Eric will be leaving BMO in the spring and I want to thank him, on behalf of all of us in the organization, for his many great accomplishments in BMO Financial Group.

To conclude, as I said at our last earnings call, the current operating environment poses both challenges and opportunities. In this environment, we are keeping a close check on expense growth. At the same time, with our advantaged business mix, our diversified North American footprint and our clear and consistent focus on customer experience we expect revenue growth to pick up over the remainder of year.

And with that Tom, I'll turn it over to you.

Tom Flynn - *BMO Financial Group - CFO*

Thanks Bill and good afternoon.

Turning now to slide 8, Q1 EPS[1] was $1.53 and net income[1] was $1.0 billion. As Bill said, underlying business results for the quarter were solid, up 5% excluding the impact of long-term interest rates on insurance and loan accounting, reflecting the benefits of our diversified business model.

Two of the larger items in this quarter's results were stock-based compensation for employees eligible to retire, which reduced EPS by $0.09, and the impact of interest rates on the Insurance business, which reduced EPS by $0.06. Our Capital Markets business was also impacted by some additional market driven items, which I will speak to in a few minutes.

Revenue was $5.1 billion, up 13% from last year or 10% excluding the impact of the stronger U.S. dollar, driven by growth in Canadian P&C and Wealth Management. As you have seen, beginning this quarter and to align our disclosure with

1 – on a reported basis: Wealth Management earnings in the quarter were $159MM; Q1 EPS was 1.46 and net income was $1.0 billion

peers, we will report insurance claims, commissions and changes in policy benefit liabilities, or CCPB, as a separate line item on the income statement. Previously, this item was reported as a reduction in insurance revenue.

Revenue was up 5% from the prior year, excluding the CCPB adjustment.

Net interest income was up 5% year-over-year and 2% from the prior quarter due to volume growth, and the impact of the stronger U.S. dollar, partially offset by lower net interest margin and lower revenue from purchased performing loans.

Non-interest revenue was up 20% from last year and 15% from the prior quarter primarily due to a significant increase in insurance revenue. Excluding insurance, non-interest revenue was up 6% year-over-year with increases in particular in Traditional Wealth-related revenues, in part due to the acquisition of F&C, partially offset by lower trading revenues, underwriting and advisory fees, card fees and security gains.

Q1 expenses[1] were up 11% from the prior year. Excluding the impact of the stronger U.S. dollar and the addition of F&C expenses were up 4% reflecting higher technology, regulatory and employee costs.

Expenses were up from Q4 due to the stronger U.S. dollar and $87 million pre-tax, or $61 million after-tax of stock-based compensation for employees eligible to retire that is expensed in the first quarter each year. Excluding these two items, expenses[1] were down 1% from the prior quarter.

The effective tax rate of 12.2% was down from Q4 primarily due to higher tax-exempt income offset in part by a provision for prior period's income taxes. The rate was 24.7% on a teb basis, down from the prior year and up from Q4.

Moving to slide 9, our Common Equity Tier 1 Ratio was 10.1%, unchanged from Q4 as higher CET1 capital was offset by higher risk weighted assets.

Risk weighted assets increased meaningfully in the quarter with $14 billion of the $16 billion increase due to the stronger U.S. dollar. The capital ratio has been managed so that it is not significantly impacted by this U.S. dollar-driven increase. The remaining increase of $2 billion in RWA was due to business growth and higher market risk partially offset by changes in methodology and improvements in book quality.

Our book value per share increased 10% in the quarter to $52.98 per share.

Moving now to our operating group performance and starting on slide 10, Canadian P&C results reflected a shifting economic environment with net income[1] of $503 million, up 4% from last year. Revenue was up 3% reflecting higher balances and fees. Revenue growth is expected to be higher in the second half of the year and expense growth lower and with this, we expect better operating leverage.

Total loans were up 4% and deposits were up 7% from last year. Personal loan growth was solid and impacted by our decision to limit growth in longer term auto loans last year.

NIM was down 3 basis points from last quarter largely due to lower loan spreads in personal lending. NIM is expected to be flat to slightly up for the remainder of the year.

Expenses increased 6% year-over-year and 2% from Q4 reflecting continued investment in the business including the impact of costs associated with a changing business and regulatory environment.

Moving now to U.S. P&C on slide 11, we continued to see an improving trend consistent with the second half of 2014. In Canadian dollar terms net income[1] was $205 million up 14% from Q1 last year. In U.S. dollars, net income[1] was up 3% benefitting from higher revenue and disciplined expense management.

1 – on a reported basis: Q1 expenses were up 12% from the prior year; Expenses were down 1% from Q4 on a basis that excludes the stronger U.S. dollar and $87 million pre-tax, or $61 million after-tax of stock-based compensation for employees eligible to retire; Canadian P&C net income of $502 million up 4% from last year; U.S. P&C net income was $192 million up 15% from Q1 last year, in U.S. dollars net income was up 5%

Revenue of US$720 million was up 1% from last year driven by higher volume, partially offset by lower NIM and fee revenue. Loan growth was strong, at 10% year-over-year, with continued very good double-digit growth in C&I balances.

Revenue was relatively stable quarter-over-quarter despite a NIM decline of 9 basis points. The NIM change was driven by competitive pressures on loan spreads and a change in mix, including loans growing faster than deposits.

Expenses continue to be well managed and were down year-over-year and quarter-over-quarter.

As Bill mentioned, our total Personal and Commercial Banking business net income[1] was up 6% from last year.

Turning to slide 12, BMO Capital Markets net income of $221 million was down year-over-year and increased from Q4. Results this quarter were impacted by several market-driven items including a charge for credit and funding valuation adjustments of $41 million pre-tax or $31 million after-tax, and also by FX and deferred compensation hedging items and slower investment banking activity.

Revenue was down 5% year-over-year as good trading revenue was more than offset by credit and funding valuation adjustments and lower investment and corporate banking revenues, in part due to lower securities gains. Revenue was up 14% from the fourth quarter due to higher trading revenue.

Excluding the impact of the stronger U.S. dollar, expenses were down 2% from the prior year due to lower employee-related expenses partly offset by higher costs driven by a changing business and regulatory environment. Expenses were up 9% from the prior quarter due to higher employee-related expenses including $23 million for stock-based compensation for employees eligible to retire, increased support costs and the impact of the stronger U.S. dollar.

Moving on to slide 13; Wealth Management had good underlying business growth in the quarter.

Traditional wealth earnings were up 28% driven by revenue growth of 26% due to the benefit from the acquired F&C business and higher fee-based revenue from strong growth in client assets.

Insurance net income was down from the prior year primarily due to a $41 million after-tax charge from movements in interest rates in the current quarter compared to a $7 million charge a year ago.

Traditional Wealth net income was up 16% from the prior quarter driven by business growth. Net income in Insurance decreased quarter-over-quarter as Q4 was above trend and in Q1 we had the impact from lower interest rates.

Putting these two units together total Wealth Management net income[1] was $186 million, up 2% from the prior year and down 26% from Q4.

Expenses were up year-over-year primarily due to the acquisition of F&C, higher revenue-based costs and the impact of the stronger U.S. dollar. Expenses were elevated consistent with Q4 due to $27 million in stock-based compensation for employees eligible to retire in the current quarter, and the settlement of a legal matter in the prior quarter.

Assets under management and administration were up 43%, 18% excluding F&C, driven by the stronger U.S. dollar, market appreciation and growth in new client assets.

Turning now to slide 14, the Corporate Services segment had a net loss of $74 million compared to a net loss of $41 million in Q1 of last year and the prior quarter.

Excluding the impact of the group teb adjustment on revenue and taxes, year-over-year results were lower primarily due to lower credit recoveries, higher regulatory expenses, higher taxes and the impact of the stronger U.S. dollar, partly offset by higher revenue largely due to treasury-related items.

1 – on a reported basis: total Personal and Commercial banking business net income was up 6% from last year; Total Wealth Management net income was $159 million down 9% from the prior year and 29% from Q4

To conclude, despite a number of moving parts that impacted our results in the quarter, the underlying business performance was solid, and continues to demonstrate the benefits of our diversified business mix.

With that, I will turn it over to Surjit.

Surjit Rajpal - *BMO Financial Group - Chief Risk Officer*

Thank you Tom and good afternoon everyone.

We had another quarter of strong credit performance. Starting on slide 16, specific PCLs were $163 million, $7 million lower than in the prior quarter.

In Canada, total losses in the Personal and Commercial business were stable while in the U.S., losses were lower.

Moving to the next slide, formations this quarter were $424 million, a decrease of $110 million dollars compared to the prior quarter.

Gross impaired loans increased quarter over quarter solely due to the FX impact. Our GIL ratio was relatively flat at 69 basis points.

Turning to the topic of interest on slide 18, our oil and gas exposure remains low at 2% with about 60% of it to investment grade borrowers. The portfolio grew by $1.1 billion this quarter with a third due to FX and the majority of the balance coming from a couple of large investment grade customers. We are diligently monitoring our commercial and consumer portfolios in Alberta as well as in other oil-producing provinces, and we remain prudent in our underwriting practices.

As Bill discussed at the RBC investor conference, we stress-tested our loan portfolio at $35 a barrel for 2015 and $50 a barrel for 2016. Under this stress scenario, incremental losses from the oil and gas portfolio and the knock-on effects from the commercial and consumer portfolios are very manageable.

Of note, a low oil price scenario is expected to benefit our U.S. loan book and our exposure in the non-oil producing provinces.

I will now turn it over to the operator for the question and answer portion of today’s presentation.

QUESTION AND ANSWER

Operator

(Operator Instructions)

Our first question is from Sumit Malhotra from Scotia Capital. Please go ahead.

Sumit Malhotra - *Scotia Capital - Analyst*

Thanks. Good afternoon. First question is going to be for Cam Fowler, and specifically in regards to the commentary in Canadian P&C revenue. So the statement that, first off, you feel confident that you'll be able to hold NIMs flat to slightly up for the balance of the year, and couple that with your view that revenue trends get better as the year goes on, what are you seeing in either the macro backdrop or specific to BMO that gives you the confidence that those two items are achievable?

Cam Fowler - *Bank of Montreal - Head of Canadian P&C*

Thanks, Sumit. It's Cam speaking. On the NIM side, we're down 3 points on the quarter. That's a little bit of pressure on the personal lending spreads, specifically in indirect auto and mortgage NII.

I expect that we'll get much of that, if not most of that, back in the second quarter, and I think through the balance of the year, the reason I think we'll be stable to up modestly, is that we'll have the combined benefit of improved spreads on the variable loans. I think we'll have better balances and performance in the payments business, and I think we'll continue to do very well on the deposit side, both personal and commercial; checking on the personal side, and fee deposits on the commercial side, those have helped us. So that's what I think about NIM.

With respect to the revenue, linked point, I just think there's more earnings power for us in the back half of the year in a few areas, where we haven't done quite as well in the first quarter. Payments is one area. I think we have more opportunity in commercial lending. And then as you know, because I've discussed on previous calls, we dialed things down a little bit in the longer amortization component of the indirect auto business, 72 months and beyond.

And for that reason and one or two others, we're quite slow in that bit of the market right now, and I'd expect based on the activity that we have in the market and the business development successes that we're having, that we'll enjoy better growth in that in the back half of the year. For those reasons, I think revenue will be stronger.

Sumit Malhotra - *Scotia Capital - Analyst*

One more here and then I'll requeue. We might have to tag Tom in. In making the statements about net interest margin, are you contemplating any further action by the Bank of Canada in terms of the overnight rate, and your view that you can hold NIM stable to current levels or even improve it?

And then secondly, card fees were down decently on a percentage basis this quarter. Just hoping for an update here. I believe the Finance Minister, in the announcement made in November, had given the parties until April to implement the agreed-upon changes to the interchange fee structure. Can you talk about whether that implementation has taken place at BMO, and if not, how that affects your revenue outlook, particularly for the back half of the year? And I'll leave it there.

Cam Fowler - *Bank of Montreal - Head of Canadian P&C*

Okay. I'll start with your follow-up question on NIM. It's difficult to say what will happen with the Bank of Canada or with competitive response. My own view is that we should be able to hold onto stable NIM in this business through the year.

With respect to the card business and fees specifically, we're down a little bit on fees this quarter linked to interchange, and specifically customer buying behavior on the retail side, which is contributing about half of the miss on the fee side. The other half is the combined impact on the corporate side, which is interchange and some slightly higher rewards costs.

With respect to the interchange adjustments and their effective date for April 1, we are positioned to move in-line with the expectation of the changes upon the network for that time. And so, those dates stand.

Sumit Malhotra - *Scotia Capital - Analyst*

Okay. So the decline this quarter had nothing to do with the decreases having been implemented, there were other factors at play, and you're expecting that to come into place to begin April?

Cam Fowler - *Bank of Montreal - Head of Canadian P&C*

That's right.

Sumit Malhotra - *Scotia Capital - Analyst*

Thanks for your time.

Operator

Thank you. The next question is from Steve Theriault with Bank of America Merrill Lynch. Please go ahead.

Steve Theriault - *BofA Merrill Lynch - Analyst*

First, maybe just to follow up, Cam you mentioned doing better in commercial in half two. I noticed coming into the quarter, it looked like industry loan growth on the commercial side was accelerating through your fiscal Q1. I noticed your loan growth was down a little.

So maybe to start, just a quick update in terms of, are you giving up a little bit of market share? Are you seeing competition spike at all? Would appreciate your perspective there.

Cam Fowler - *Bank of Montreal - Head of Canadian P&C*

Commercial loan growth at 7% is a decent number for us right now I think. I take your point about the acceleration that's taking place. Ours is a tale of two halves. On the upper end of the mid-market, we're moving along quite well. And in the core business, we are at a slightly lower number. We get to a blended 7.

The core business has just come through a major platform change through the course of 2014 where we replaced our lending platform, which is going to be a great positive for the business going forward, and we've just been digesting that from a capacity perspective over the last couple of quarters. One of the reasons I think that we have good opportunity in the back half of the year is that we'll have moved through that change, and the traditionally very strong core commercial business will be moving better.

And it's quite healthy, in terms of what's happening by industry and by geography, and by segment there. So that's the reason for that.

Steve Theriault - *BofA Merrill Lynch - Analyst*

So you'd expect that overall industry momentum to persist through this year, despite puts and takes across the economic backdrop?

Cam Fowler - *Bank of Montreal - Head of Canadian P&C*

Yes. I mean, difficult for me to say. It feels very healthy and reasonably competitive right now.

Steve Theriault - *BofA Merrill Lynch - Analyst*

Okay. And if I could, just a quick question for Tom, I noticed unrealized gains were up quite a bit in the quarter to the highest level we've seen in some time, looking at page 17 of the Supplemental.

Just a couple questions on the back of that, is that just on the back of lower rates? And might this imply that we'll see a rise in securities gains in future quarters if rates stay low? I also noted a footnote suggesting some of these gains may be offsetting certain hedges, so a little context there would be helpful, Tom, thanks.

Tom Flynn - *Bank of Montreal - CFO*

Sure. So the unrealized gain number is up significantly, as you said, to $850 million from $450 million. The lion's share of that is simply driven by lower rates, positively impacting fixed income portfolios, and the majority of the portfolio would be hedged with derivatives. And so I wouldn't read anything into this increase as it relates to an expectation for higher security gains going forward, given that most of the portfolio is hedged on an all-in basis.

Steve Theriault - *BofA Merrill Lynch - Analyst*

Thanks for that.

Operator

Thank you. The next question is from John Aiken from Barclays. Please go ahead.

John Aiken - *Barclays Capital - Analyst*

Good afternoon. Surjit, the point that you made was that there really was no real impact on credit quality, and I don't think anyone's terribly surprised by that. But when we look at the loans past due non-impaired, we did see a significant uptick, particularly in the bucket over the last month. Now, I know this is early days, but is a lot of that, particularly on the consumer side, is that largely concentrated in Alberta, or are there other factors at play here that I may not have drilled down to well enough?

Surjit Rajpal - *Bank of Montreal - Chief Risk Officer*

Thank you. Let me start out by saying that whenever a quarter ends on a weekend, it's not unusual to see the early stage delinquencies to go up, and they generally get resolved right after the weekend, and that has been the case with most of the delinquencies that we saw going out in this quarter for us. Having said that, we have not seen yet any delinquency increases in the regions where unemployment is expected to increase as a result of oil prices, or where unemployment is high right now. But needless to say, we're watching very carefully given the economic environment and the economic factors that are taking place, but nothing observable at this time for us to be able to report on it.

John Aiken - *Barclays Capital - Analyst*

Great. Thanks, Surjit.

Operator

Thank you. The following question is from Gabriel Dechaine from Canaccord Genuity. Please go ahead.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Just on the expense commentary that was made earlier, and how that's underpinning part of your strong second-half outlook for the Canadian P&C business. Can you give me a sense of what your core expense growth can be in that business? And maybe at the consolidated level, what kind of expense growth the Bank can sustain, considering initiative spending and regulatory costs, how much of that has become a permanent structure, cost structure, I guess?

Cam Fowler - *Bank of Montreal - Head of Canadian P&C*

Gabriel, it's Cam Fowler speaking. Thanks for the question. I'll start and then I'll pass it to Tom.

If you look at the expense growth in the Canadian business, it's relatively evenly split between our priorities around customer growth, the digitization of our Bank, and some of the regulatory capabilities that we've been pursuing recently. We also have the employee costs in the first quarter, which you're well familiar with. Those are all built-in.

When I think about the question with respect to sustainable costs for the Canadian business, I always have in mind the relative revenue opportunity that's in the market right now, and in a slightly lower growth environment, my number's probably a little bit lower. So numbers between 3 and a half to 4 and change seem to me to be the types of numbers we should be aspiring to. And I would expect that as the year goes by, we travel towards those types of numbers in the Canadian business.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Thanks.

Cam Fowler - *Bank of Montreal - Head of Canadian P&C*

Tom, maybe you'd answer the enterprise question.

Tom Flynn - *BMO Financial Group - CFO*

For the enterprise, I'd say a few things. As we look forward, we'll be managing expenses tightly across the Bank, and we're expecting moderate expense growth from current levels over the balance of the year. In Q1, as you know we have the eligible to retire, which increases the expenses in the quarter. So without that next quarter, we would expect the expense level to be down, and expense growth for the year to be, adjusted for the currency, which is significant, in the lower single digits.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Okay. And maybe for Tom or Bill, I don't know, maybe there's a sense of impatience out there to see the banks pull back on costs, because what we see in the press really, about the slowing Canadian economy and the actions by the Bank of Canada, tied to weaker GDP growth prospects. The disconnect between all that and the expense inflation we're seeing at the Bank, I guess my question would be, how much lower do they have to get from what we're seeing today before BMO or the industry really hunkers down on costs? I'm just curious about that.

Bill Downe - *Bank of Montreal - CEO*

Maybe I'll take a shot at that question, Gabriel, because it's one that we do give considerable thought to. The investment spend that the industry's making, and specifically that we're making in technology to track the change in consumer behavior, as mobility, more online ramps up, and it's ramping up relatively quickly, it's not a tap that you turn off and turn on intermittently.

So I think that those expenditures, you really have to look at a 12 month or 12 to 18 month time horizon, to think about ramping them up or down. And in the end, I would expect that the economies that come from many of those changes will start to track in relatively soon. So I think we're going to see the benefits of some of that elevated investment, both in consumer satisfaction, the ability to originate more business online, and just a streamlining of operations.

On the broader question of the management of information in response to the appetite that global regulators have for more granular data, I think that we're probably, as an industry, 75% or 80% of the way through that process. So I think looking out late 2015 into 2016, you'll also see some benefit. I think your underlying question is if economic growth were to slow, or real growth were to slow to zero, would we continue with the level of investment and expenditures that we have? And I think candidly, as we don't think that's a high probability scenario, but if that were to occur, I think the response would be to simply slow down the rate of investment. Extend the investment period out over two or three years instead of the time horizons that we now have.

I do think that there is the ability to adjust, should economic growth slow more than we have in our plan. But I think Tom's comments, with respect to expense growth, really relate to an overall belt tightening in the current environment, and extracting some economies from the investments that we're making.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Thank you for that. Appreciate it.

Operator

Thank you. The following question is from Robert Sedran from CIBC. Please go ahead.

Robert Sedran - *CIBC World Markets - Analyst*

Just as a quick follow-up, and I hate to keep flogging the same issue, I think there's a bit of a dislocation in that the market is expecting the second half of the year to be harder than the first half of the year. So, is the message from BMO basically $40 to $50 oil, interest rates do what they do, you're comfortable that your second half is going to look better than your first half, there's no real storm coming, is that the message we're supposed to take away from this?

Tom Flynn - *Bank of Montreal - CFO*

It's Tom. I don't think we're expecting a big storm. Clearly, parts of the country are adjusting to the lower price of oil, and there will be some credit losses there, but we're not seeing signs of those yet, and we don't expect them to be problematic.

And in P&C Canada, as Cam has talked about, we see things in the business that lead us to believe that we've got upside in the second half, relative to the current quarter. And then as well, in Capital Markets, at the end of last quarter, we talked about how we expected Q1 to be up from a relatively weak Q4, but not fully back to normal. And I think that's what you saw this quarter.

The earnings were better than the fourth quarter, which we expected them to be, but not fully back to the average level of last year, in part because of some valuation items, and in part because investment and corporate banking is a little softer. So as we look at the business, we certainly think that we've got upside from the Capital Markets number that we reported in the quarter, this quarter.

Robert Sedran - *CIBC World Markets - Analyst*

Okay. And so that actually just takes me to the next question I had. Thanks for the color, Tom.

The CVA, FVA impact in the quarter, how much of that was FVA? I was under the impression that last quarter was the vast majority of the impact, and going forward, it would almost not even be worth talking about. Was I wrong on that?

Tom Flynn - *Bank of Montreal - CFO*

The majority of the combined impact was CVA, and so there was some FVA, but it was in the clear minority of the total. And the combined was above average, as you know. In part, because this quarter credit spreads widened, and given the move in the FX rate, some of our exposures increased. Those two things drove a larger than normal increase, and most of that was driven by the CVA, which really wouldn't be atypical because CVA is sensitive to counter party credit spreads, which were out in the quarter and the exposure size.

Robert Sedran - *CIBC World Markets - Analyst*

Following those credit spreads is the best way to try to figure this out, and not worry too much about the FVA, is that fair?

Tom Flynn - *Bank of Montreal - CFO*

That's fair.

Robert Sedran - *CIBC World Markets - Analyst*

Thank you.

Operator

Thank you. The next question is from Meny Grauman from Cormark Securities. Please go ahead.

Meny Grauman - *Cormark Securities - Analyst*

Question about the U.S. business, talk about margin pressure coming from competition and business mix. I'm just wondering if you can give us a little more detail in terms of the mix there, what was driving the decline in the margins? And then the second question is just on the expenses, down 2% year-over-year. I'm wondering what's driving that? Is that something that you see as a positive looking forward over a number of quarters?

Mark Furlong - *Bank of Montreal - Head – U.S. P&C*

Okay. So first let me do margins. We had really strong loan growth again, particularly on the commercial side and it's diverse, it's across markets and segments. And so as we continue to grow that portfolio, the new loans that we had come on, the spreads are a little bit less than the spreads that are in the portfolio today. There's a little repricing that takes place as well too.

But that's just kind of the normal competitive pressure in the United States. I don't think there's anything unusual to that. In fact, we looked at our peer group and our loan growth was substantially stronger than our peers in the U.S., and we had just a couple basis points more margin pressure than they had. So that's really -- that's what was going on with margin.

From an expense standpoint, we're very focused on managing our expenses very well, and we'll continue to pay a lot of attention to that throughout the year. As you saw, the operating leverage popped, and that's going to move around a little bit during the year, and so we'll be attentive to that as well too. We're not in a downward trend on expenses.

There's always a little bit of timing from quarter to quarter, but we're going to be conscious of what the growth and expenses look like on a year to year basis, but manage it tightly. As you look across our quarters that are in the Supplementary Package, you get a pretty good sense of what the run rate of expenses are. While it moves around a couple million dollars, I think we found a pretty good place, and we think we can manage it relatively tightly, though it will move a little bit between the quarters.

Meny Grauman - *Cormark Securities - Analyst*

There's nothing in terms of notable initiatives that are part of this quarter?

Mark Furlong - *Bank of Montreal - Head – U.S. P&C*

Well, no, I think we always have initiatives under way to try and manage the expenses, but there isn't any initiative other than trying to be better at what we do and more efficient at what we do, and inside different business lines there are various initiatives but not one of those things that you'd read about in the newspaper. But just the things that it takes to be better and better at your business every year.

Meny Grauman - *Cormark Securities - Analyst*

Okay. Thank you.

Operator

Thank you. The next question is from Mario Mendonca from TD Securities. Please go ahead.

Mario Mendonca - *TD Securities - Analyst*

Good afternoon. I have a couple of questions, I think we mostly can go through fairly quickly. Mortgage delinquencies in Canada did seem higher. I suspect it was mostly seasonality. Is that fair?

Surjit Rajpal - *Bank of Montreal - Chief Risk Officer*

I wouldn't say it was seasonality. You have to look at it in the context of where they've been in the past. If you look at it on a year-over-year basis, I think they've come down 3 points.

Look at the trend. It's very much in the range that one would expect right now. I wouldn't consider that seasonality. Nor would I consider this blip anything indicative of where the losses are. We're not seeing any losses increase either at this point.

Mario Mendonca - *TD Securities - Analyst*

You acknowledge that quarter-over-quarter the delinquency was up a little bit in Canada.

Surjit Rajpal - *Bank of Montreal - Chief Risk Officer*

That is correct. I wouldn't think it is -- 3 basis point change is not that significant.

Mario Mendonca - *TD Securities - Analyst*

Sure. Moving on to oil and gas. I see that the drawn is up. The undrawn is also up.

It's the undrawn that surprised me a little bit. Maybe the question is did the drawn increase essentially come from taking down the undrawn? Is that what we're looking at?

Surjit Rajpal - *Bank of Montreal - Chief Risk Officer*

No. It's a combination. There's two or three things that happened. One, we have the FX rate as well. That takes care of I think roughly about a third of the change would be because of FX, because FX did change the drawn and the undrawn amounts almost in a similar fashion. That said, we did have some new drawings in our existing borrowing, from our existing borrowers, and then there were new loans. I think all in all, it's a combination of those three factors, where new commitments and FX would cause a little bit of a higher undrawn balance.

Mario Mendonca - *TD Securities - Analyst*

Okay. Liquidity seemed a lot higher this quarter, things like repos, available-for-sale securities, cash. Is this just normal business activity? Was there something special going on?

Tom Flynn - *Bank of Montreal - CFO*

It's Tom, Mario. It was normal business. The two largest drivers were number one, the change in the U.S. dollar, and a decent portion of the liquidity is in U.S. dollars. And then secondly, Q4 is a bit of a seasonal low point from a liquid asset perspective, so there was a bit of a bounce back given that.

Mario Mendonca - *TD Securities - Analyst*

Just finally, on the ROE, and maybe this is a little more of a detail question. The Company's outlook for the ROE or guidance, or whatever, is materially higher than the ROE we've seen this quarter and the prior quarters. That 15% ROE, is that even a realistic outlook in the near term, or even in the medium term?

Tom Flynn - *Bank of Montreal - CFO*

It's Tom. So a few things. The ROE in the quarter, in part, reflects the significant increase in book value that we saw, and that increase relates in part to the higher carrying value for our foreign investments in OCI. And with that, the book value per share is up 10% in the quarter, which is nice, and the higher book value insulates the capital ratio from the higher Canadian dollar value of the U.S. risk weighted assets.

With the higher book value, the ROE has a bit of a negative impact. Some of that will flow through to next quarter, because the period-end book value was higher than the average for the quarter as a whole, given when the currency moved. And with the higher book value, I'd say the target range that we have out there will take a little longer to achieve. And clearly, will be pretty tough in the current year, given where we are, but we remain committed for working towards that number in the mid-term. And those numbers are mid-term target numbers that we put forward, and so that's how we think about it.

Mario Mendonca - *TD Securities - Analyst*

Okay. Thank you.

Operator

Thank you. The next question is from Brian Klock from Keefe Bruyette & Woods. Please go ahead.

Brian Klock - *Keefe, Bruyette & Woods, Inc. - Analyst*

Good afternoon and my question's for Surjit. Surjit, again, I guess sort of a follow-up here on the oil and gas side. In Canada, I guess forgetting about the FX impact, it did look like you had about $500 million, $600 million of oil and gas increase there on the drawn. So I guess how much of that was E&P and upstream, versus the oil field services. Do you have that breakout available?

Surjit Rajpal - *Bank of Montreal - Chief Risk Officer*

I don't have an exact breakdown of the two but a lot of it was E&P, and a lot of it was investment grade.

Brian Klock - *Keefe, Bruyette & Woods, Inc. - Analyst*

Okay. And then a follow-up question for Mark Furlong, and I'm sorry if I missed this. But I guess what are your expectations for loan growth and the NIM for the next two or three quarters this year?

Mark Furlong - *Bank of Montreal - Head – U.S. P&C*

Well, on loan growth, I think we feel pretty good about what we've done, particularly on the business side, and on the commercial side. So I'm not sure that we're good enough to predict percentages, but we continue to feel that we'll have good growth for the rest of the year and consistent with some of the trends we've seen in the last few quarters. So I'd say we feel pretty positive about that.

And the consumer side, I think as the consumer picks up in the United States, we'll see a little bit of expansion there, but right now it's down slightly in the quarter and the near term that probably doesn't change. Maybe by the back half of the year, we'll see some growth there.

From a NIM perspective, as I mentioned in the first conversation, we expect that we'll continue to have some modest downward pressure on NIM, though not to the extent that we saw this quarter. However, the other side is that there's some upside benefits that we'll see when the Fed begins to raise rates at some point down the road.

Brian Klock - *Keefe, Bruyette & Woods, Inc. - Analyst*

Okay. Appreciate that. Thanks for your time.

Operator

Thank you. The next question is from Peter Routledge from National Bank Financial. Please go ahead.

Peter Routledge - *National Bank Financial - Analyst*

A question for Darryl. I thought trading revenue looked pretty good this quarter, particularly in equities. And I mean, underwriting revenue actually didn't seem that bad, given what's going on in the quarter. So maybe if you can explain what happened to each, and then what's your outlook for each in 2015?

Darryl White - *Bank of Montreal - Head of BMO Capital Markets*

Thank you for the question. I think the trading revenues in fact were quite good in the quarter. We were pleased with the revenue in the business.

I'd point to a couple things. The rates, if you're in the Supp Pack, you'll see that the rates revenues were decent and the numbers that you see in there are after the impact of the valuation adjustment that Tom summarized before. So it was quite a good quarter in rates.

It was also good in equities. And in equities, as you know, as we said before, in some quarters we have client activity which is lumpy in nature, and some quarters we don't, and this quarter we happened to have a bit of that. If you look back over history you'll see that jumps around. I think when you put the two of those things together, it was quite a good quarter for us across the trading businesses.

And you asked a question on outlook. That's obviously a much harder question to answer. It will depend on market conditions. Assuming stable market conditions, we're confident in the outlook for the rest of the year.

Peter Routledge - *National Bank Financial - Analyst*

Turning to underwriting. What industry segments did your revenues come from in this quarter?

Darryl White - *Bank of Montreal - Head of BMO Capital Markets*

We don't break that down specifically, but I guess what I would be comfortable telling you, is that it was fairly well diversified, and frankly a better balance than we've seen in the past, which you might expect with the pullback of some of the resources revenue. We saw a fairly diversified set of underwriting revenues across different asset classes, as well as across geographies.

Peter Routledge - *National Bank Financial - Analyst*

I don't want to corner you into guidance, but obviously the oil and gas sector isn't going to be great this year, but other sectors might do better because energy costs go down. Assuming that sort of scenario plays out, and we have pretty decent growth in the U.S., you're pretty confident in your ability to deliver underwriting revenues in and around where we've been this quarter?

Darryl White - *Bank of Montreal - Head of BMO Capital Markets*

When I step back and look at the underlying performance of the quarter, and if you look at our revenues overall, you see the underwriting revenues, you see the trading revenues, $921 million of total revenue, that includes the impact of the valuation adjustments. If you excluded that impact you'd see that our total revenues are in fact better than the average of what we had last year. So when I look at the operating potential of the business going forward, it's pretty difficult to call quarter to quarter, as you'd imagine, but we said at the end of last quarter that we expected a better performance in this particular quarter, and I guess I would say over time, I would continue to be confident in that statement.

Peter Routledge - *National Bank Financial - Analyst*

All right. Thank you. Just Tom, what was the methodology change for RWA?

Tom Flynn - *Bank of Montreal - CFO*

The methodology change related to us continuing to move a portion of our US portfolio towards full AIRB treatment, away from standardized. So, similar in character to what we saw last quarter.

Peter Routledge - *National Bank Financial - Analyst*

How long does that go on for?

Tom Flynn - *Bank of Montreal - CFO*

It can vary. So, I think our advice would be, look at the number we had this quarter. We're happy to have it this quarter, and I wouldn't necessarily bake anything into the future. But that said, we're not fully phased in on the AIRB at this point.

Peter Routledge - *National Bank Financial - Analyst*

In the United States?

Tom Flynn - *Bank of Montreal - CFO*

Correct.

Peter Routledge - *National Bank Financial - Analyst*

All right. Thank you.

Operator

Thank you. The following question is from Sohrab Movahedi from BMO Capital Markets. Please go ahead.

Sohrab Movahedi - *BMO Capital Markets - Analyst*

Thanks. Tom, you talked about the ROE target being probably more of a medium-term target now. You also have some EPS growth targets out there, and operating leverage numbers out there. How do you feel about the shorter term achievability of those types of targets out there?

Tom Flynn - *Bank of Montreal - CFO*

I guess the first thing I'd say is we explicitly don't give short-term guidance, and they're mid-term guidance figures. We described the way we feel about the year on this call and on the last quarter. We're always working hard to achieve positive operating leverage.

Some quarters are easier than others. But I'd say for the year, we're absolutely focused on that across the Bank and across our operating groups. And on the earnings target side, I'd rather not be any more specific than pointing to the mid-term nature of the target that's out there.

Sohrab Movahedi - *BMO Capital Markets - Analyst*

So, if I was going to ask the question slightly differently, which one of these three medium term targets would you say are the most difficult to achieve? Which one would it be, do you think?

Tom Flynn - *Bank of Montreal - CFO*

I think that takes your question back to the first question.

Sohrab Movahedi - *BMO Capital Markets - Analyst*

Okay. Thank you.

Operator

Thank you. The following question is from Darko Mihelic from RBC Capital Markets. Please go ahead.

Darko Mihelic - *RBC Capital Markets - Analyst*

Just a question on the card revenues, you pointed to two things that caused them to be a little bit under range I suppose. One is customer behavior. I guess less purchases, and then, I guess on the corporate side, there were higher reward costs. If I was a conspiracy theorist, I'd think people are using their points to buy groceries, and they're also using their card less, because they're nervous about the future. Do you have good data capture? Is any of this actually happening in certain geographic regions, or is the data capture just not good enough to dispel that conspiracy theory?

Cam Fowler - *Bank of Montreal - Head of Canadian P&C*

I would say it's early days, Darko, on that one. It's not totally clear what has gone on over the last 90 days or so. I referenced one thing that we're clear on, which is slightly different spending behaviors in terms of what's being bought and where it's being bought compared to what we might have anticipated. We don't have a longer data set on that just yet, and so we'll see.

I think regardless, the fundamentals for our business are as I described, which is the ability for us to activate on the premium side, the new accounts we brought on last year, and to do a really good job on the core of our business in the next 12 months, is what's best for our business. And behavior will be what behavior will be. We'll see. But I still do see there to be meaningful upside for us in the payments business, towards the back half of the year.

Darko Mihelic - *RBC Capital Markets - Analyst*

And what about actual pickup of new accounts? Has that slowed as well?

Cam Fowler - *Bank of Montreal - Head of Canadian P&C*

It's down just a little bit. It's not a big number. On the premium side, we wouldn't have expected the growth in new accounts over the last few months to be quite as large as it was over the 12 before, just because we're not in the market quite as loudly.

But it is going quite well. And more recently, growth in originations in the branch and online are picking up. So I would say it's a balanced and sort of normal year, with a slightly slow start.

Darko Mihelic - ***RBC Capital Markets - Analyst***

Okay. Thank you. And then I don't know if I picked up, Surjit did you mention the watch list, if there's any increases in the number there?

Surjit Rajpal - ***Bank of Montreal - Chief Risk Officer***

No, there is no increase.

Darko Mihelic - ***RBC Capital Markets - Analyst***

Okay. Great. Thanks very much.

Operator

Thank you. The following question is from Gabriel Dechaine from Canaccord Genuity. Please go ahead.

Gabriel Dechaine - ***Canaccord Genuity - Analyst***

Actually one of my questions was asked. But figured I'd ask about the buyback. You were pretty active during the quarter. Do you expect to remain as active in 2015?

Tom Flynn - ***Bank of Montreal - CFO***

It's Tom. I won't answer the specifics of the question, but we were active in the first quarter, as you saw. The capital ratio continues to be very strong. And so I would say based on our actions in the past and the strength of the ratio, it wouldn't be unreasonable to assume that there would be some level of activity under the buyback over the next couple of quarters.

Gabriel Dechaine - ***Canaccord Genuity - Analyst***

Okay. And then just another one on the cards, different type of question, though. A few of the banks have reemphasized -- last year was the year of the higher-end card initiatives, and it seems like there's more of a shift towards the lower end of the market, and cashback cards as well. Do you have any initiatives there that you're undertaking?

Cam Fowler - ***Bank of Montreal - Head of Canadian P&C***

We have several product activities under way that you'll see come to market through the course of the year. We like cash back.

Gabriel Dechaine - ***Canaccord Genuity - Analyst***

Okay. Thanks.

Operator

Thank you. The following question is from Mario Mendonca from TD Securities. Please go ahead.

Mario Mendonca - *TD Securities - Analyst*

Good afternoon. A question for Tom Flynn. Page 11 of your Report to Shareholders referred to potential application of Basel III floor for RWA. What will be helpful to understand there is, are we talking about mortgages, like RWA floor for mortgages, or what products are we talking about, and does this really matter? It would be impossible for us to think about how big this is, how important this is to the bank.

Tom Flynn - *Bank of Montreal - CFO*

We added that comment to the disclosure, and really rather than referring to any particular product, we're acknowledging a discussion that's going on among regulators globally, related to the extent to which risk weighted assets are model-based versus standardized factor-based, and the extent to which you use floors when using models. And so really, we're not saying that we think this will be a really big issue. We're just acknowledging that there's a debate going on, and it's something that we're watching, and it could be of interest to people. And really nothing more than that.

On the mortgages specifically, I guess the only thing I'd add is, as you know, the majority of the Canadian portfolio is government insured, and I would say we have no reason to think that the risk weightings related to government insured product will change. And so we're totally comfortable with that.

Mario Mendonca - *TD Securities - Analyst*

Am I right in saying that was just a couple of summers ago that OSFI's position on floors for mortgages was clarified, and so far is saying there was no intention of doing so? Is that a fair statement?

Tom Flynn - *Bank of Montreal - CFO*

I forget the exact timing, but there was a clarifying statement to that effect that was made, and I think that's the message that people took from comments that were made. And so they've expressed that point of view on the topic.

Mario Mendonca - *TD Securities - Analyst*

Finally, IBG loans up 11% quarter-over-quarter. I think a lot of that's currency. Anything else?

Darryl White - *Bank of Montreal - Head of BMO Capital Markets*

You got about half of it right there, Mario. It's about half currency and half fundamental growth in the business.

Mario Mendonca - *TD Securities - Analyst*

Thank you.

Operator

Thank you. This concludes today's question-and-answer session. I'd like to bring you back over to Ms. Sharon Haward-Laird. Please go ahead.

Sharon Haward-Laird - *Bank of Montreal - Head of Corporate Communications & IR*

Thank you everyone. We're happy to take any follow-up calls in Investor Relations, and with that, we'll end the call. Thanks everyone.