# Q2 2017 CONFERENCE CALL

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**Joanna Rotenberg**

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## CONFERENCE CALL PARTICIPANTS

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**Steve Theriault** *Eight Capital*

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**Robert Sedran** *CIBC World Markets*

**Gabriel Dechaine** *National Bank Financial*

**Nick Stogdill** *Credit Suisse*

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**Non-GAAP Measures**

Bank of Montreal uses both GAAP and non-GAAP measures to assess performance. Readers are cautioned that earnings and other measures adjusted to a basis other than GAAP do not have standardized meanings under GAAP and are unlikely to be comparable to similar measures used by other companies. Reconciliations of GAAP to non-GAAP measures as well as the rationale for their use can be found on page 4 of BMO's Second Quarter 2017 Report to Shareholders and on page 33 of BMO's 2016 Annual Report all of which are available on our website at www.bmo.com/investorrelations.

Examples of non-GAAP amounts or measures include: efficiency and leverage ratios; revenue and other measures presented on a taxable equivalent basis (teb); amounts presented net of applicable

taxes; results and measures that exclude the impact of Canadian/U.S. dollar exchange rate movements, adjusted net income, revenues, non-interest expenses, earnings per share, effective tax rate, ROE, efficiency ratio, pre-provision pre-tax earnings, and other adjusted measures which exclude the impact of certain items such as, acquisition integration costs, amortization of acquisition-related intangible assets, decrease (increase) in collective allowance for credit losses and restructuring costs.

Bank of Montreal provides supplemental information on combined business segments to facilitate comparisons to peers.

## PRESENTATION

**Jill Homenuk** *- Bank of Montreal - Head of IR*

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 presentation, we will have a question-and-answer period where we will take questions from prequalified analysts. To give everyone an opportunity to participate, please keep it to one or two questions and then re-queue. We have with us today Darryl White, Chief Operating Officer; Cam Fowler, from Canadian P&C; Dave Casper from U.S. P&C; Pat Cronin from BMO Capital Markets; and Joanna Rotenberg 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 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 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, as reported. 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 second quarter report to shareholders.

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

**William A. Downe** *- Bank of Montreal - CEO and Executive Director*

Thank you, Jill, and welcome to everyone joining us on the call. Today, we announced net income for the second quarter of $1.3 billion and earnings per share of $1.92. Earnings growth reflects the continued benefit of our diversified business model, which I'll expand upon in a moment, with good contribution from our wealth and Capital Markets business.

On a year-to-date basis, earnings per share grew 21%, including the net impact of nonstrategic assets in the current and prior years. Underlying earnings growth of 11% has been driven by overall good revenue and expense management, resulting in positive operating leverage of over 3%. We remain focused on achieving operating leverage for the year, in-line with our medium-term target of 2%.

Provisions for credit losses were up this quarter. On a year-to-date basis, the ratio of provisions to loans is 23 basis points, relatively stable to last year reflecting good continued credit quality. Surjit will provide detail in his remarks.

Our capital position remains strong with a CET1 ratio of 11.3%, ROE was 13.1%. And today, we announced an increase to our dividend of $0.02 per common share bringing our quarterly payout to $0.90, up 5% from last year.

Moving to Slide 5. I'll review a few highlights from our operating groups.

Canadian Banking continued to have diversified balance sheet growth in both the commercial and personal businesses, with loans up 5% and deposits up 8%. Net income grew 1% from a strong quarter a year ago.

Consistent with our vision of delivering an exceptional customer experience across our channels, we continue to invest in expanded product capabilities and functionality. In Business Banking, we introduced MasterCard products that provide a range of reward options tailored to the specific requirements of commercial customers. These new integrated card products combine convenience, flexibility and functionality in a comprehensive and simplified business payment solution.

We continue to make our digital banking experience more attractive for customers that increasingly value the convenience of self-serve and the ability to manage their money anytime, anywhere. For example, e-transfers, which have quickly become a preferred method for sending funds, are now included free of charge with all personal banking plans.

In U.S. P&C, net income was impacted by higher commercial loan loss provisions this quarter. While there's been a general moderation in loan and deposit growth in the U.S., reflective of slower-than-anticipated business activity in the quarter, we're well positioned to continue to build on the strength of our U.S. franchise. In this environment, expenses remain well controlled and the business continues to achieve positive operating leverage.

We're committed to growing our retail and commercial business by continuing to enhance our existing platform and leveraging it to retain and attract customers.

On the retail side, we introduced new chequing products that are simple, differentiated and tailored to diverse and evolving banking needs. At the same time, we continue to enhance the experience of customers in ways that are important to them. This quarter, we announced a partnership with Allpoint that expands our no-fee ATM network by over 43,000 locations and provides convenient access anywhere in the United States.

While our Commercial Banking business is firmly anchored in the Midwest states, we continue to expand nationally into key markets where our team of experienced commercial bankers brings a combination of industry expertise, local market knowledge and differentiated cross-border banking capabilities. We recently opened a new office in Columbus, Ohio, adding to offices in cities such as Atlanta, Dallas and in Southern California.

BMO Capital Markets delivered another strong quarter, driven by momentum in our investment and corporate banking businesses on both sides of the border. Our client-focused U.S. business continues to deliver solid results, as we expand lead relationships with established companies across North America. Net income was up 12% in the quarter and 28% on a year-to-date basis, driven by diverse sources of revenue, good expense management and continued operating leverage. We're well positioned to deliver solid results for the full year.

In Wealth Management, we had strong performance in an improved environment with a disciplined focus on efficiency. Our Traditional Wealth business had good AUM/AUA growth of 13%. This quarter, we added 4 global sector ETFs for a total of 90 listings. Since first launching ETFs in 2009, BMO Asset Management has captured the most inflows in the Canadian ETF industry for the past 6 years.

Overall, the competitive advantage we have in the current environment is threefold.

First, our mix of complementary businesses; it's well diversified across products, key geographies and customer segments. We have a highly profitable Canadian P&C business built on BMO's strength and long legacy, as a commercial bank.

In our Personal Business, our focus is on continuing to grow primary customers, combined with a disciplined approach to lending. Today, our mortgage portfolio represents just 27% of our total loan book, well below the Canadian peer average. Our priority continues to be the strength in customer relationships by providing a broad range of advice-based services.

BMO's well-established brand and relationship-based approach is consistent across all areas of our business. U.S. P&C, Capital Markets and Wealth Management each contributed approximately 20% of bank income, and growth in these businesses has been targeted and deliberate. Over time, this mix will continue to deliver resilient earnings and shareholder value.

Second, we've invested significantly in technology over the last 5 years. We've been specific in our approach, starting with our underlying architecture that leverages the power of large scalable systems. This has enabled us to develop and launch new digital solutions, in a fraction of the time and cost, and apply them across the bank. We're using sophisticated data analytics to provide more personalized customer experiences seamlessly across channels and we're digitizing processes, both in the branch and back office.

This digital transformation is supporting deeper customer relationships. More than 50% of Canadian customers now engage with us digitally, completing over 30 million mobile transactions so far this year. And with 16% of product sales done via digital channels, we've created the capacity for more meaningful advice-based conversations in our branches.

And finally, in all the dimensions of change we're managing across the bank, everything begins and ends with the customer. Consistent with our first strategic priority to deepen customer loyalty, we're creating a more personal bank for a digital world. As Darryl transitions into the CEO role, he'll continue to focus on growing the bank's customer base, expanding BMO's responsiveness to market opportunities and ensuring consistent operating discipline across the bank. Building on our track record of innovation and ability to anticipate and manage change, the bank will continue to deliver on financial performance.

And now I'll turn it over to Tom, to present the Q2 results in more detail.

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**Thomas E. Flynn** - ***Bank of Montreal - CFO***

Thank you, Bill. As shown on Slide 8, reported EPS for the quarter was $1.84 and net income was $1.25 billion. Adjusted EPS was $1.92, up 11% and net income was $1.3 billion, up 12% from last year. As Bill mentioned, results this quarter reflect the benefit and resilience of our diversified business mix. As a reminder, last year, reported net income included a restructuring charge of $132 million after tax, and both reported and adjusted net income included the impact of an investment write-down of $79 million after tax.

Adjusting items this quarter are similar to past quarters and are shown on Slide 25. Adjusted net revenue of $5 billion was up 7% from last year. Net interest income was marginally lower year-over-year. Adjusted net noninterest revenue was up 15% with growth across most product areas, including underwriting and advisory fees and investments in associates and joint ventures, partially offset by lower trading revenue. Adjusted expenses were up 5% from last year and up 4% in constant currency terms. On a net revenue basis, adjusted operating leverage was 2.3% and the efficiency ratio was 63.8%. On a reported basis, efficiency was 65.1%. The adjusted effective tax rate was 17.1%, down from 19.6% a year ago and was 27% on a teb basis, up from approximately 26%.

Moving to Slide 9. The common equity Tier 1 ratio was 11.3%, up from 11.1% last quarter. As shown on the slide, the increase reflects capital growth largely from internal capital generation, partially offset by higher risk-weighted assets. Source currency risk-weighted assets were up from the prior quarter, mainly due to business growth.

Moving to our operating groups and starting on Slide 10. Canadian P&C adjusted net income was $531 million, up 1%. Revenue growth of 3% was driven by higher balances across most products and increased non-interest revenue, partially offset by lower net interest margin. Total loans were up 5%, with Personal up 4% and Commercial up 8%. Total deposit growth was good, with both Personal and Commercial deposits up 8%. NIM was down 2 basis points from last quarter due to product mix and the low rate environment. Expense growth was 5%, with ongoing investments in the business, and operating leverage was negative 1.6%. Provisions for credit losses were stable compared to last year.

Moving to U.S. P&C on Slide 11. Adjusted net income was $260 million. The comments that follow speak to the U.S. dollar performance. Adjusted net income of $194 million was down 10%, primarily due to higher credit provisions. Revenue was down 2% due to lower loan spreads and volumes, partially offset by higher deposit revenue. Average loan balances declined 2%, as lower personal loans including the sale of auto loans in Q1, were partially offset by growth in the commercial portfolio. Excluding auto loans, loans were up 3% from last year. Net interest margin increased 3 basis points from Q1 due to the benefit of higher interest rates net of loan spread compression. Expenses continued to be well-managed and declined 2% year-over-year. On an adjusted basis, operating leverage was positive 0.8%. Credit provisions were up from last year, as higher provisions from the commercial portfolio were partially offset by lower consumer provisions.

Turning to Slide 12. BMO Capital Markets adjusted net income was $322 million, up 12% from last year. Revenue was $1.2 billion, up 13%, driven by a strong performance in the Investment and Corporate Banking Business, including a good contribution from the U.S. business.

Revenue in our Trading Products Business was down from a strong level a year ago. Expense growth of 8% reflects higher costs associated with business growth, including higher employee-related costs. Operating leverage was 4.7% and efficiency was 57%. Provisions for credit losses were relatively stable compared to last year and up from last quarter.

Wealth Management on Slide 13 had adjusted net income of $272 million, up significantly from a year ago. The business benefited from good underlying operating growth in both Traditional Wealth and Insurance, and our continued focus on expense management. Adjusted earnings growth in Traditional Wealth was high, in part because of the investment write-down a year ago. Underlying business growth was also good at 17%. Insurance earnings were up 8% from last year. Adjusted expenses increased just 1% from a year ago, as higher revenue-based costs were largely offset by the benefit of productivity initiatives. Assets under management and administration were up 13% due to improved equity markets and favorable foreign exchange.

Turning now to Slide 14 for Corporate Services. The adjusted net loss was $90 million compared to $98 million a year ago. Results improved due to above-trend non-teb revenue, which was largely offset by higher expenses from a below-trend level a year ago, and credit provisions were lower.

To conclude, our business has continued to grow and these results demonstrate, again, the benefits of our diversified business mix.

And with that, I'll hand it over to Surjit.

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

Thank you, Tom, and good afternoon, everyone. Starting on Slide 16, our PCLs are $259 million or 28 basis points, up 19 basis points from the prior quarter. Year-to-date, PCLs are at 23 basis points. The quarter-over-quarter increase was primarily due to higher corporate and commercial losses in Capital Markets and U.S. P&C.

Looking at Canadian P&C, provisions for Consumer and Commercial were up modestly from the prior quarter and remain relatively stable. Provisions in U.S. P&C increased $30 million quarter-over-quarter. Most of the increase was in Commercial, reflecting normal variability in the commercial loan portfolio. Capital Markets PCL was $46 million, resulting from 2 accounts in unrelated industries. Last quarter, we had a recovery of $4 million, primarily from the oil and gas sector.

On Slide 17, formations were $752 million, up from $509 million in Q1. A small number of loans in oil and gas, transportation, services and wholesale trade accounted for most of the increase. Gross impaired loans increased by $203 million with the impact of a strong U.S. dollar representing over 1/3 of the increase. The GIL rate was up 3 basis points to 63 basis points for the quarter.

Turning to Slide 18. The performance of our Canadian residential portfolio remains strong. Delinquencies are relatively flat quarter-over-quarter and our loss ratio remains low. In GTA and GVA, we have not seen any deterioration in performance and both portfolios demonstrate better loan-to-value, delinquency and bureau scores compared to the national average.

In summary, economic conditions continue to strengthen and the credit environment remains benign. We continue to expect losses in the mid-20 basis points, subject to quarterly variability.

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

## QUESTION AND ANSWER

**Ebrahim Poonawala** *- BofA Merrill Lynch*

I guess just the first question. Surjit, if I can start with -- I think you ended your comments saying economic conditions are strengthening and you expect credit outlook to remain benign. I think if you could help us unload those issues, in terms of where in the economy you're seeing strength and how is that translating to your business. And secondly, when we talk about a benign credit outlook, obviously there's been a lot made out of the whole issues around Home Capital. How do you look at that? And in your seat, how do you assess risk to the mortgage market and to your portfolio, both resi and non-resi, for the rest of the year?

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

Well, that, Ebrahim, is a very broad question, and I'll try to answer it as best as I can. From my perspective, when I talk about the economic environment getting stronger and a benign credit environment, it really is helping us in terms of all our portfolios. Now the reason I bring up the issue of variability in commercial is, there will be times that, for business reasons, certain clients of ours do not do as well. And they would not do well regardless of the benign economic environment because some of them do get impacted by competitive factors that come into play in their various industries. For the past year, we've been talking about oil and gas being a very strained sector and that seems to be something that's not entirely behind us, but largely behind us. And even though I've seen, this quarter, an increase in the formations of the oil and gas sector, I'm still extremely comfortable with that portfolio because if you look at the GILs, they've actually come down. And when I look at that portfolio from the point of view of how our clients are doing and how the borrowing base determinations have gone in the spring borrowing season, we've had most of our customers have -- to the extent we finished that process, have had their borrowing bases either go up or remain steady. For only, let’s say, about low single-digit customers, where their borrowing bases actually go down. So that sector has done really well, and that has been a cyclical concern for the last several quarters, if you will.

The broad issue with respect to what you've noticed in this quarter, and I guess what's prompting your question, is the fact that we've had 28 basis points relative to the 19 basis points last quarter. And we haven't seen any pattern in any single sector that would cause us to sit up and say, look, we need to worry about this on a basis that's disproportionate. And I say the same thing about the Canadian housing market, which I said in my remarks, it's still continuing to perform well. So what do I worry about? I like to see things from the stress perspective. And to that extent, we stress all our portfolios that are of size, and then we see how they perform under stress. And when we do that, I have no reason to be uncomfortable with any particular sector at this point in time. And the benign credit environment is certainly helping us. What wouldn't be a benign credit environment would be one where the economy stops growing and interest rates go up rapidly, both happening in unison. And we don't see that happening, but we do stress all our portfolios on the basis of conditions that we don't see or foresee in the short term. I hope that gives you some flavour.

**Ebrahim Poonawala** *- BofA Merrill Lynch*

That's helpful. I'm just trying to assess in terms of the what the downside risk, to your point, are to the economy and how do you -- given all the moving pieces and the noise, how do you handicap the downside risk to the economy as you think about at least the next couple of quarters and for the rest of the year?

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

You just said a couple of quarters and the next year? In a benign environment, to expect mid-25 basis point loss is a very reasonable number. It's not excessive at all. It is a very reasonable number. When you look at our long-term average, and we've had probably one of the best track records from a PCL perspective of anyone, it's about 40 basis points or so over a 30-year period. And to look at 25 basis points, or mid-20s, as something relevant to a benign environment is entirely reasonable, which is why that's the guidance I've been giving in the past and continue to give at this point in time as well.

**Ebrahim Poonawala** *- BofA Merrill Lynch*

Understood. If I can switch to capital for a second. We saw a decent internal sort of capital generation this quarter. I think if we can just talk about in terms of, how do you see capital build and is there are any other capital relief trades sort of in the pipeline over the next few quarters? And then just talk about capital deployment priorities between buybacks. You talked about enhancing the U.S. franchise. I'm wondering if M&A is an option in the U.S. for now.

**Thomas E. Flynn** *- Bank of Montreal - CFO*

It's Tom, I'll answer that. So a few things. Number one, we're pleased with where the capital ratio ended in the quarter at 11.3%. Clearly, at that level, we're in a very strong position and we feel good about that. We increased the dividend in the quarter, which reflects the capital position, and if not more importantly, the income growth that we've had. And as we think to the future and capital deployment, a couple of things. The first would be that we have renewed our normal course issuer bid. The approval for that was received during the quarter. And given the capital ratio, it wouldn't be unreasonable to expect some level of activity in the program over the balance of the year. And then as it relates to growing the business, our first use of capital is always to grow our businesses organically. As we've talked about before, we do expect to generate net capital after doing that. And on the M&A side, I'd say we continue to consider opportunities and we've shown that we'll be responsive to them as it makes sense, but there's nothing really specific to say about the current environment or what we're looking at the current time on that front.

**Meny Grauman** *- Cormark Securities Inc.*

Just a question about the operating leverage in Canadian P&C. After 6 straight quarters of positive operating leverage, you delivered negative operating leverage. And I'm wondering if you believe that you'll be able to deliver positive operating leverage going forward in Canada without resorting to another restructuring charge. If you look at the data, now the cynical view suggests that you have restructuring charges and then the operating leverage turns positive and then, it kind of dies out. And so I'm wondering how you read that data and what your perspective is on that.

**Cameron Fowler** *- Bank of Montreal - Group Head of Canadian Personal & Commercial Banking*

Sure, Meny. Thanks for the question. It's Cam Fowler speaking. So we feel there's some strong underlying growth in the quarter on the balance sheet side, you can see that, in particular in the Commercial Business, retail deposits as well. It didn't translate as well into revenue this quarter. A couple of reasons for that: Number one, rate headwinds; and number two, we're a little softer on the card side, as you'll see, specifically in NIR and specifically within NIR interchange. So we're a little bit lighter on revenue. And then on the NIX side, you could see that we were up a bit at 4.8%. We're -- as I have said on this call many times, undertaking quite a bold transformation of our Canadian banking system, and the approach we've been taking is to self-fund that. That means that we have a structural cost program where we look for opportunities to remove costs from the traditional base and reinvest portions of that into 2 areas, primarily our digital capabilities, number one; and number two, more on advice-based sales. For the past 6 quarters, as you pointed out, we've synchronized those movements and they resulted in positive operating leverage. We didn't synchronize it perfectly this quarter and I think that can be expected from time to time.

With respect to my outlook, I don't think we should take the cynical view on this one. There was a charge. This portion of the business, the Canadian bank, participated in the charge, and we will achieve the anticipated benefits associated with that. But that charge is actually a small part of the broader change going on in the Canadian bank. And with the magnitude of role changes and digital investments going on, much of what we do happens through redundancy and turnover, et cetera. So stepping back from it all and the broad battery of changes we have going on, the specific answer would be, I do expect to return to positive operating leverage in the back half of the year. We'll do that through some modest improvements in revenue, I'd expect, and some improvements on the NIX side, but that we'll have it back together in Q4. Hope that helps.

**Meny Grauman** *- Cormark Securities Inc.*

And then if I could just ask a quick question on housing. In the MD&A, you talked about the recent actions of the government, and you say that you expect it to moderate your overheated GTA housing market. And I'm just wondering if that's purely a forward-looking view. Or are you seeing any evidence -- I know it's still early, but are you seeing any evidence that you could point to that says, yes, we are seeing some slowdown in the GTA housing market?

**Cameron Fowler** *- Bank of Montreal - Group Head of Canadian Personal & Commercial Banking*

Yes, 2 things. First, I'd just reiterate the point that Bill made at the top, which is against the backdrop of the broader industry, our book is smaller relative to peers. That's true nationally, it's true in Toronto in particular. It's difficult to judge right now what the impact of the various changes that have been announced will be but I will say much like we experienced in Vancouver, where we were growing at market-ish, changes happened in the market, we felt that in our pipeline and in our growth to follow, and we're starting to see signs of that in Toronto here, where you'll have seen the news that sales are down in the mid-teens, listings are up 45%, 46%, prices are growing at a rate half of what they were. That's a couple of weeks of data and not a month, but early indicators are that we will start to see some softening. And from my own perspective, that is good. Softening in the Toronto market is a good thing and it looks like that may be where we're headed.

**Stephen Theriault** - ***Eight Capital***

I have a couple of questions for Dave. Before, Cam, while we have you, just going back to the expenses on the restructuring front. Is the full run rate now in your division? I think the statement was made that it was sort of mid-2017 from the previous restructuring charges. That would be sort of fully in flight. Are you fully in flight at the end of Q2? Or is there still a little bit more to come?

**Cameron Fowler** - ***Bank of Montreal - Group Head of Canadian Personal & Commercial Banking***

We're very near, and we'll certainly enjoy the full benefit through the course of '18.

**Stephen Theriault** - ***Eight Capital***

And then for Dave, two things. First, on the margin, not up as much as expected. Maybe you can help us by splitting out the 3 basis points of improvement between the benefit from the Fed rate hike, the loan margin compressions, slower C&I growth and any other meaningful components. And if you can dovetail that into an outlook for the second half, that would be great.

**David R. Casper** - ***Bank of Montreal - Group Head of U.S. Personal & Commercial Banking***

Okay. Well, I would say net, we were -- as you know, we were 3 basis points. We got probably a little bit more than double of that this time around due to the rate increase, which we had for the quarter, offset by a couple of things. And by the way, included in that -- included on the positive side would be a reduction in our indirect auto, which had lower spreads. So those are the positives. The negatives would be, we did not have the interest rate recoveries that we've had in the past. We didn't see those this quarter, and those go from quarter-to-quarter. It's hard to predict that. And then we would also have some continued diminution in the spread, mostly in the commercial book. So that kind of lays out where you would see it, but the -- and I would say the outlook, absent any rate increase, we would have guided in the past, and I wouldn't change it much, a couple of basis points down in the quarter. But with the rate increase, that would obviously be beneficial to us. Does that help?

**Stephen Theriault** - ***Eight Capital***

So -- yes. So of the 3, it would be -- you said double, so 6 positive from the Fed and the indirect auto and then I guess 3 negative from the lack of recoveries, the C&I and maybe a couple of other things.

**David R. Casper** - ***Bank of Montreal - Group Head of U.S. Personal & Commercial Banking***

It's where I'd say the benefits were the rate increase as well as the reduction in the indirect auto portfolio, offset by what we talked about before.

**Stephen Theriault** - ***Eight Capital***

Okay. And then on C&I specifically, guidance from some of your U.S. competitors has been, I thought, pretty bearish when they reported Q1. So I wanted to ask about your outlook, what you're seeing on the ground with respect to C&I. Obviously, the growth has decelerated quite quickly, but maybe you could update us on what you expect sort of through the rest of the year.

**David R. Casper** - ***Bank of Montreal - Group Head of U.S. Personal & Commercial Banking***

Sure. Again, I guess I'd just take you back to kind of level set. We have had in the U.S., very strong and well-above industry commercial growth from the last couple of years, mid-teens organic. Absolutely, it has come down. We have seen the same thing as other banks and what you've heard from the industry. That said, I'm still pretty positive about the longer term and certainly by the end of the year. Our clients are, for the most part, pretty enthusiastic. They are perhaps slowing a bit just waiting to see what might happen. But generally, they're enthusiastic and feel good about the economy, and we would also feel good. And I would say, specifically to your question, if you looked at our year-over-year loan growth on the commercial side, I would expect growth in the mid to high single digits, which would be down from what we've experienced in the past, I think certainly up from what we've seen so far, and I would expect to be at or above the industry.

**Stephen Theriault** - ***Eight Capital***

And just one final thing. That sounds reasonably constructive. But as I look through the numbers, if we were to assume that C&I balances remain flat through the end of October, given that's been such a big positive delta for your division, would that entail, do you think, negative revenue growth through the second half in that bear case versus mid to high single-digit growth levels?

**David R. Casper** - ***Bank of Montreal - Group Head of U.S. Personal & Commercial Banking***

Well, if we had flat growth for the entire year in Commercial?

**Stephen Theriault** - ***Eight Capital***

For the rest of the year.

**David R. Casper** - ***Bank of Montreal - Group Head of U.S. Personal & Commercial Banking***

Yes. Well, it would be harder to have positive growth if that part of the business, which is a very large part of the business today, had no growth, it would be tough to have positive growth in the whole business, absolutely. I don't expect that to happen.

**Nick Stogdill** - ***Credit Suisse***

Just sticking with Dave. My question is on the transportation business in the U.S., and I was hoping to get a bit more colour on both the growth and credit outlook, as some other companies have talked about softness in the U.S. trucking and transportation market. And I know a couple of quarters ago, you did talk about there being some overcapacity in that industry and that does appear to be stabilizing. So maybe just an update there. And then related to that, there were some PCLs on the transportation line that have been trending up, and I think that was expected, but just maybe a little more colour on what's driving that.

**David R. Casper** - ***Bank of Montreal - Group Head of U.S. Personal & Commercial Banking***

Sure. Why don't I cover the first part, and I'll let Surjit talk about the PCLs, if there's anything specific I can add. The transportation business is actually doing quite well. The overall industry, and when I talk about the industry I'm going to talk about new Class A truck sales, and Class A are the large trucks that you see and that's what this business does, is it finances largely those purchases. That's a business that they've been in, and now we've been in, for 35 or 40 years and have a very large market share. So that business, the new truck sales, is down -- probably it was down 20% in '16, not for us, but for the industry, and probably expected to be 10% to 15% down for fiscal '17. And so that naturally brought our new business down with it, but by the way, not nearly as much as the industry. As we look forward, and particularly into the back half of '17 and into '18, we're seeing a couple of things. We're seeing new truck sales start to pick up. But more importantly, in driving our customers, we've seen pretty good growth in spot rates, which is the rates that people will pay truckers to haul their traffic. Those spot rates have gone up significantly over the last couple of months, and we expect those to continue to grow. And we've seen less supply in the market, particularly with new trucks. There just haven't been as many and now, that's starting to pick up. So the demand/supply is starting to work more in our favour, after a number of quarters where it moved the other way. That said, it's a really good strong business. We continue to grow the market share there, and I've been really happy with it to date. Does that help on the colour?

**Nick Stogdill** - ***Credit Suisse***

Yes, that's helpful. And then just on the credit with Surjit, I noticed the formation in transportation as well this quarter, maybe colour on that as well.

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

Yes, I'll give you, first, colour on the PCLs in the Transportation Finance business. What we've seen in the past 2 quarters is that there's been a slight tick down in the PCL rate in our Transportation Finance business in the U.S. So after the fourth quarter of '16, it's been coming down slightly. And I'd agree with David, in that the outlook certainly is bearing itself out. And you're right, you do read a fair number of articles in the newspapers about overcapacity, but the reality is that they're not going up. And having said that, you do notice a number of increases, you do see a higher formation in the transportation line. And what I want to tell you, that line is --

it actually does not relate to the Transportation Finance business that we bought from GE. This is actually legacy business that we had, and in fact, it's not even truck-related. So the PCL that we have and the formations are actually quite different and distinct, legacy and not truck related.

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**Robert Sedran** - ***CIBC World Markets Inc.***

I just wanted to follow up first with an answer that Tom gave regarding the buyback. Tom, I'm curious on the DRIP because we've been adding -- it looks like about 3 million shares a quarter for the last couple of quarters. Is the likelihood that you'll start buying those shares in the market rather than issuing from treasury? And curious as to why that hasn't been happening already, especially after the big jump in the ratio.

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**Thomas E. Flynn** - ***Bank of Montreal - CFO***

Yes, sure, a couple of things. The first is that given the difference between when we declared the dividend and pay it, there's quite a lead time related to the signaling on whether or not the DRIP will be on or off. And so we left the DRIP on for the quarter that's just past, given that the declared dividend that was paid in the quarter occurred quite a while ago now. And then looking forward, the DRIP discount is off, as I think you know. And I would assume that we're satisfying the remaining shares that we need to issue for the DRIP, buying in the market as opposed to issuing from treasury. So that source of dilution will stop.

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**Robert Sedran** - ***CIBC World Markets Inc.***

Okay. So the potential for a buyback would be a net buyback then, not just to help offset some of that?

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**Thomas E. Flynn** - ***Bank of Montreal - CFO***

I think that's a reasonable view. We do have some issuance, as you know, from options. It's a smaller number, but I think there's a reasonable prospect for a net reduction over the back half.

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**Robert Sedran** - ***CIBC World Markets Inc., Research Division - Executive Director of Institutional Equity Research***

Okay. And I just wanted to ask about the card fee line. It's the lowest that it has been in quite some time and curious to know what's going on there. And if you can give a sense of which side of the border it's happening on as well, please.

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**Cameron Fowler** - ***Bank of Montreal - Group Head of Canadian Personal & Commercial Banking***

It's Cam speaking. Thanks for the question. It's happening on the north side of the border in Canada. Almost all of this is -- the Canadian Business, almost all of it is obviously interchange-related and specifically industry interchange-related. The business is, to me, performing broadly well. I think I've guided to low single-digit balance growth and mid-plus single-digit revenue growth. We're not there this quarter on the revenue, but I expect we'll return there for Q3 and Q4.

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**Robert Sedran** - ***CIBC World Markets Inc.***

Can I ask Cam why if it's interchange pressure, you'd expect the revenue growth to return? What's the source of interchange fee pressure this quarter?

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**Cameron Fowler** - ***Bank of Montreal - Group Head of Canadian Personal & Commercial Banking***

Well, you know that the industry's changing and the networks have undertaken a voluntary reduction to get to a lower blended rate in the last 1.5 years, 2 years than they were before that. And 2 things happened. Number one, buying behavior changes quarter-to-quarter so your NIX on interchange can change. We've had a dose of that this quarter. But in addition, the networks do what they need to do to ensure that they're coming in the range that they need to come in. And that can move around a little bit each quarter. And this quarter, we had a little more of it and I'm expecting to see that even back out.

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**Gabriel Dechaine** - ***National Bank Financial, Inc.***

First question I have is on the Basel I floor. It popped up again today, about $2 billion of RWA. It's not much, but between that and some of the actions, at least visible ones, we saw you take this quarter like that RMBS deal, which I think was more capital-related in relation to the floor. It appears that you're still around the floor. You breached it this quarter. It's a recurring issue. How much more flexibility do you have to deal with that? And then at what point does it become a revenue issue, as in you have to start limiting growth or shedding assets?

**Thomas E. Flynn** - ***Bank of Montreal - CFO***

Yes, it's Tom. A few things. I guess at the top, we tried to guide to an expectation that the floor could be operative in any quarter going forward, even though it wasn't last quarter. And the floor is managed as a part of managing our overall capital position. And so it's not a huge surprise to us that it's back given that, that was a possibility, and we were just a little below it being operative last quarter. The capital ratio still grew and grew by about the amount that we would expect in a typical quarter. And on that front, we've guided, as you know, to on average over time, a 10 to 15 basis point bump per quarter. There is some ongoing ability to manage around the RWA growth. There's a little bit of a cost to that, and we did have a question on that on the last call, but I'd say it's not significant in the context of the earnings and really not that significant to overall. So we're viewing the floor really just as one of many parts of managing the capital ratio and treating it that way, as we grow the business and manage the overall capital positions.

**Gabriel Dechaine** - ***National Bank Financial, Inc.***

It doesn't sound like you're going to be balance sheet constrained or if so, in any material way?

**Thomas E. Flynn** - ***Bank of Montreal - CFO***

No. I'd say that common equity Tier 1 ratio was 11.3%.

**Gabriel Dechaine** - ***National Bank Financial, Inc.***

And that -- that RMBS, was that capital-motivated? Or is that testing the waters for more to come?

**Thomas E. Flynn** - ***Bank of Montreal - CFO***

It was principally driven by capital considerations. So there's some potential on the funding side, but the driver really was on the capital side.

**Gabriel Dechaine** - ***National Bank Financial, Inc.***

Okay. And then my next question's on credit for Surjit, and everybody is focusing on Canada, the big bad housing issue. And the credit signals, to me at least, are looking a bit more worrisome south of the border. We're seeing some weakening of credit card, delinquency data, auto sales and used auto prices and retailers experiencing some difficulties. Now these are early stages, and they might right themselves over the next few months, who knows, but it doesn't look great. And your comments though, sound pretty confident - you don't sound too worried. Is that really a statement that these exposures are pretty small for BMO and that's why you're not worried, as opposed to general market commentary? Because they are small, like cards aren't a big business in the U.S. for you, auto lending you've shrunk it. I don't think your retail exposure is that big either. Is that where really the basis of your comments are from?

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

That is largely the reason for my comfort. Having said that, you're right, there are some segments that, in the U.S., they're watching for -- there are issues with some companies on cards, on student loans, that could be an issue, and in auto as well, subprime auto. So we watch developments in those areas as well, but those are areas that we are not focused on and are small for us. In fact, we're not in 2 of those 3 areas in any big fashion at all, but you're absolutely right in your assessment.

**Gabriel Dechaine** - ***National Bank Financial, Inc.***

Your comment, if you were talking about the broader market, are you any more worried today than you would have been 6 or 8 months ago?

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

You're talking about the consumer market in the U.S.?

**Gabriel Dechaine** - ***National Bank Financial, Inc.***

Yes, the U.S. generally because if there is a problem somewhere, there is always contagion concerns, right?

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

No. I am not terribly worried about the U.S. market. I think the outlook in the U.S. and all the rhetoric around spending and the outlook, which is found, to some extent, in the equity market and the shape in which they are in, I think it's all pointing positive and so I'm not terribly concerned now. We're not seeing anything in the economic parameters that would cause us to feel differently, at this point.

**Sumit Malhotra** - ***Scotiabank Global Banking and Markets***

Surjit, I think you're right, 28 basis points of PCL isn't that different than you had guided us to, but I figured I'd ask you a couple on credit anyway. The first one, just for Transportation Finance. Oftentimes, when a bank acquires a portfolio, we see a cleanup, if you will, of the book initially and then it starts to season. You said in a previous answer that the uptick in formations wasn't related to that book. But is some of the increase in U.S. NPL or formations related to the seasoning of the Transportation Finance portfolio?

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

The Transportation Finance business, you've got to understand, is a cyclical business and we recognized it as a cyclical business when we actually bought it. And the uptick that you saw in the first few quarters after we bought it was a result of -- there was a lot of over-buying in the industry and we knew that it was at the top of the cycle. And I think what Dave explained is, that part of the cycle is slowly coming to an end and we're going through a more stable period and that the over capacity is slowly getting lessened. So I think that's where we stand as far as the transportation business is concerned, not out of line in terms of what a cyclical business would experience.

**Sumit Malhotra** - ***Scotiabank Global Banking and Markets***

And then just on business or corporate and commercial provisions, on the whole. With the exception of the oil and gas swinging from recovery to provision, most of the buckets where we see the increase, service industries, wholesale trade, it's not issues or areas of your portfolio that, in my view, the market's been overly concerned about. And in your view, is there anything tying some of these increases that we see on specific industry lines in corporate and commercial together? Or is this just a couple of one-offs that went in the wrong direction this quarter compared to what they've done in the past?

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

I think there are a couple of one-offs, and that always happens. There are idiosyncratic reasons for companies going sideways, and that's in every portfolio. We expect that to happen. Despite our best judgment, some companies don't do as well through the years, and that's part of the reason. One of the reasons also, when you look at it on a netted-out basis is the issue of recovery which also comes into play. And recoveries are also a factor in terms of where our PCLs finally land. And I've been explaining this to you, there's 2 elements. One is the variability in commercial and the other one is the recoveries, which, over the past several years, you are accustomed to seeing large numbers come our way, and those numbers have shrunken because we do have a much smaller portfolio, from the point of view of an impaired book.

**Sumit Malhotra** - ***Scotiabank Global Banking and Markets***

And that's what gets you back closer to the 25-basis point range.

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

That's right. Which is why I say, you've got to now look at it in a normal environment unimpacted by what we experienced for a number of years in the past.

**Sumit Malhotra** - ***Scotiabank Global Banking and Markets***

Okay. I'm going to close with a 2-parter for Cam Fowler, just on revenue and P&C Canada. So first off, on consumer loan growth, it was down sequentially in Q2. That's not surprising. I think we saw the same thing a year ago. Usually, we see a healthy uptick in real estate-related lending in the second half of the year. In the wake of some of the changes in the market of late, do you expect that second half rebound in consumer loan growth and real estate loan growth is still a likely occurrence? Or has that been dampened somewhat? And then just on the credit card issue, does this any way relate to lower spend on the back of some of the AIR MILES news late in 2016?

**Cameron Fowler** - ***Bank of Montreal - Group Head of Canadian Personal & Commercial Banking***

Thanks, I'll start with the second one. A little bit, not a lot. The story is primarily linked to the interchange. I will say the performance in our AIR MILES book is not as strong as it has been, in large part due to what has gone on with that important partner to us over the past year. Our customers really value that program, and it's not gone smoothly. So my expectation is that one turns itself around and will improve. It's certainly not helping, but it's not the story here. With respect to the former, 2 points. Number one, it is fair to say that Q2 consumer loans are, ex. mortgage, are a little bit lighter. There's some seasonality in there, as you say, but I would say there's also participation choice there. CSCs are down, and we have made -- I talked about that on this call, through the course of the past few years, we made choices there where we would like to be more selective and perhaps less active in the longer AM higher LTV business. And that has put us in the negative growth category on CSC. Offsetting that, there's positive growth in other areas that we're focused on. So there's more health there than, perhaps, what the surface number looks like. It is not a number that's very large and it's not a number that I would want to be very large, to be honest, at this point, but it's right where I think we would want it. Your final point is in light of what's going on with housing, what are my expectations for the back half of the year. I think we'll wait and see on that one. There is clearly some slowing down in the biggest story in the market, which is Toronto, and we're an at-market participant in that. So there could be -- and I would expect there to be maybe a point or so reduction in balance and limited impact on revenue in the back half of the year. The focus for us, as I said earlier in the call, though, is to make sure that we're keeping the commercial loans and commercial deposits growing at high-single digits as they are now and have been in the past, and keeping that retail deposit growth as high as possible at 8% and if we can, keep the chequing account growth at double-digit.

**Doug Young** - ***Desjardins Securities Inc.***

I guess, I'll stick with Cam. Two questions. I guess, Cam, are you noticing any increased competition in the commercial market in Canada? I've heard anecdotal evidence or points around it? Just want to get some colour from yourself. And then I guess on the non-interest expense line, it sounds like there was a mismatch in terms of it was chunky this quarter, chunkier than you would've expected. Can you size how much of that -- what the chunkiness was in the technology and sales force expenditure this quarter?

**Cameron Fowler** - ***Bank of Montreal - Group Head of Canadian Personal & Commercial Banking***

Sure. Answer number one, with respect to commercial competition is yes, that it is up. It isn't a story, I don't think that's different than the past 4 or 5 quarters, linked to all the themes we've been discussing on this call and the view on housing and the opportunity relative to the consumer, the commercial business is more attractive. So yes, more competition, but the growth that we're seeing at high single-digits loan and deposit is happening across the country. There isn't a division that's struggling in that regard, and deposits and loans across several verticals actually. So it's healthy. There's more competition but I don't think it's inhibiting in any way, our ability to compete as one of the largest players. Your second question was with respect to NIX. We're up 4.8% -- that's $40 million. Circa half is on the digital investments. Bill said off the top of the call where our digital focus is: point number one, is on architecture, so that we can compress our release cycles and our unit costs; point number two, is on data, so we can have more context in our conversations with regulators and customers; point number three, is on the digital experience and we had a bunch of releases in that regard this quarter; and point number four is on digital process. So we're focused on all of those areas. The measurements we're most interested in, Bill alluded to a couple of them, are digital penetration, which for us is really important. We're at about 50% right now, and we'd like to get to 70%. We're up from 30% just a couple of years ago. And then digital sales is another one, 16% now. I expect we'll be at 18% to 19% digital sales by the end of the year, which is up from 12% 2 years ago and we're traveling to 30%. So we need to spend that money to hit those numbers. Hitting those numbers gets our multichannel engagement up. And when our multichannel engagement is up, our loyalty is up and that's how the system works.

**Doug Young** - ***Desjardins Securities Inc.***

And just on the commercial competition, is that part of what's driving some of the NIMs down? I know you didn't mention it, but is there any pressure from the commercial competition? Or do you expect that to unfold over the next year?

**Cameron Fowler** - ***Bank of Montreal - Group Head of Canadian Personal & Commercial Banking***

It's difficult for me to predict the next year, but I don't think it's a meaningful driver on the NIM right now. The NIM right now is really more of a cards mix.

**Jill Homenuk** - ***Bank of Montreal - Head of IR***

Thanks, everyone. Appreciate you joining us today. Enjoy the summer, and we'll talk to you again in August.