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PRESENTATION

Jill Homenuk ***Bank of Montreal - Head of Investor, Media & Government 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 Darryl White, 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 question-and-answer period where we will take questions from prequalified analysts. We have with us today Cam Fowler from Canadian P&C and Dave Casper from U.S. P&C. Pat Cronin is here for BMO Capital Markets, and Gilles Ouellette is representing BMO 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 accessing underlying business performance. Darryl 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 reports and our first quarter report to shareholders.

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

Darryl White ***Bank of Montreal - CEO***
Thank you, Jill, and good afternoon, everyone. Today, we announced net income for the first quarter of $1.4 billion and earnings per share of $2.12, reflecting a good start to the year.

The bank's operating performance for this quarter is strong, particularly in Canadian and U.S. Personal and Commercial Banking and Traditional Wealth.

Year-over-year growth rates were impacted by a number of revenue items in the first quarter of last year, including a net gain on the sale of nonstrategic assets in our P&C businesses, the benefit of higher long-term rates on insurance and an exceptionally strong Capital Markets performance. I'll come back at the end of Surjit's remarks today to help cut through some of the noise to reinforce the key takeaways we are focused on.

Operating revenue benefited from good balance growth as well as expanding margins driven by a combination of our focus on growing customer deposits together with higher interest rates. Expense growth includes an ongoing investment against our digital agenda. At the same time, we continue to streamline and simplify processes to improve overall efficiency. While operating leverage was negative for the quarter, we anticipate savings as the year progresses and we are confident that we will achieve our 2% target as we have in the last 2 years.

Our approach to effectively managing risk has led to consistent credit performance over time. This is evident again this quarter with PCL on impaired loans stable even while we continue to grow our balances, including in our U.S. segment.

Our capital position remains strong with a CET1 ratio of 11.1%, providing good flexibility to grow the business and return capital to shareholders.

Our U.S. segment overall continues to be a differentiating strength for us. Despite a weaker U.S. dollar, contribution from our operations in the United States continues to grow, demonstrating both the benefits of diversification and the synergies across our platform. We achieved record results in U.S. P&C this quarter, and looking ahead, we are very well positioned for continued success. We expect the economic environment to remain constructive, including the benefit of a lower tax rate, which will add an estimated USD 100 million to our U.S. segment income this year.

Turning to the performance of our operating groups, Canadian Personal & Commercial Banking delivered robust underlying earnings growth of 9% and positive operating leverage of 1.2%. Operating revenue growth of 6% was driven by consistent profitable loan and deposit growth and higher margins. We're focusing on growing customers and deepening loyalty in key segments by delivering exceptional service and value.

For example, we recently introduced a new suite of small business credit cards that offer a wider range of options and improved rates and benefits to business owners. At the same time, we launched online applications to simplify and speed up the process, improving efficiency for the customer and for the bank. Early results are showing very good uptake.

On to U.S. Personal & Commercial Banking, which delivered strong and improved underlying earnings growth of 14% and positive operating leverage of 2.6%. Results reflect continued growth in customers, in loans, in deposits as well as the benefit of higher rates, lower taxes and good credit performance.

So taken together, our P&C businesses are performing very well, delivering good revenue growth, NIAT growth and positive operating leverage. Against the positive economic backdrop and with the investments we are making, we're confident in our outlook for revenue and earnings growth as well as further improvements in efficiency.

BMO Capital Markets earnings were down from an exceptionally strong quarter last year. We continue to bring on new clients in the United States and maintain leading market share in Canada. We're optimistic looking ahead to Q2 as we've seen increases in the pipeline and client activity in a more constructive environment, as well as continued growth at our U.S. franchise.

In BMO Wealth Management, both Traditional Wealth and Insurance delivered good earnings, driven by business growth and strong markets. Across all of our wealth businesses, we're committed to helping our clients achieve their investment goals.

We recently made a number of enhancements to SmartFolio designed to meet evolving customer preferences for supported investing and continued to experience good growth in new customers across all demographics. With BMO's mutual fund and ETF products consistently recognized with top-tier risk-adjusted performance, we have all the elements in place for continued growth.

We remain committed to accelerating growth in the specific areas we're focused on: growing the contribution from our U.S. operations, improving efficiency and at the same time, investing in our digital innovation agenda and deepening customer loyalty.

Across the bank, we're unified in our commitment to our customers, many of whom transact in both Canada and United States. BMO is uniquely and best positioned to serve these customers offering a full spectrum of financing, advisory and wealth management services that competitively differentiate us.

For the 40% of our commercial and Capital Markets customers who are active on both sides of this border, these services include a specialized team to manage the complexities of two different regulatory and legal environments as well as a comprehensive and integrated treasury payments platform. Bringing new cross-border relationships to BMO will continue to be an important part of our U.S. and Canadian growth strategies.

Being a trusted partner is key to attracting and retaining customers and core to forging deep and long-term relationships. Building trust, and acting in the best interest of our customers is a fundamental and differentiating part of our culture.

We are very proud to be one of only 2 Canadian companies and 4 banks worldwide to have been named one of the 2018 world's most ethical companies by the Ethisphere Institute, underscoring the unwavering standard of ethical behaviour at all levels of the bank.

By leveraging our strong culture, we will continue to deliver sustainable earnings growth. Our performance this quarter is evidence that we're making progress against our acceleration agenda.

And with that, I will turn it over to Tom.

Thomas E. Flynn ***Bank of Montreal - CFO***
Thank you, Darryl. My comments will start on Slide 9.

Q1 reported EPS was $1.43 and net income was $973 million. Adjusted EPS was $2.12, and adjusted net income was $1.4 billion.

The Q1 earnings reflect good operating revenue and income performance across our retail businesses in Canada and in the United States.

Reported results this quarter include a revaluation of our U.S. net deferred tax asset of $425 million as a result of U.S. tax reform. As previously disclosed, this one-time, non-cash charge results from the reduction in the U.S. federal tax rate. Going forward, we expect an approximately USD 100 million benefit from the lower tax rate.

Adjusting items in the quarter include the U.S. tax reevaluation and are shown on Slide 25.

Before reviewing our performance in more detail, I'd like to note a few reporting changes in the quarter. As you know, we have adopted IFRS 9 on a prospective basis. With this change, we are recording in our operating group segments' PCL on both a performing and an impaired loan basis.We have also reclassified certain items in the current and prior periods. The reclassifications are not significant and do not impact year-over-year growth rates.

Turning now to the quarterly results. Operating performance was good, and as you have seen, year-over-year growth rates were reduced by a number of positive items in the prior year.

Net revenue of $5.3 billion was down 2% from last year, with growth negatively impacted by 5% from the net gain in the prior year and the weaker U.S. dollar.

Net interest income increased 1% year-over-year or 3% excluding the impact of the weaker U.S. dollar.

Net noninterest revenue was down 3% year-over-year as increases in most line items were more than offset by the net gain last year and lower insurance revenue due to more favourable market movements a year ago.

Expenses were up 2%, or 5% excluding the impact of the weaker U.S. dollar, with increases across most expense categories, including technology-related expenses as the single largest contributor.

Adjusted operating leverage was negative in the quarter and includes a negative 2.5% impact from the net gain in the prior year. We continue to be focused on achieving our 2% operating leverage target for this year as we have for the last two.

The adjusted effective tax rate was 19.5%, in-line with the rate a year ago. The adjusted effective tax rate on a teb basis was 24.7%, also in-line.

Moving now to Slide 10. The Common Equity Tier 1 ratio was 11.1%, down 30 basis points from last quarter. As shown in the slide, retained earnings growth was more than offset by business growth and share repurchases in the quarter. The revaluation of our U.S. net deferred tax asset decreased the ratio by 17 basis points.

The Basel I floor reduced our CET1 ratio by approximately 45 basis points in the quarter. In January, OSFI communicated that effective Q2, the Basel I floor will be replaced by the Basel II floor, which we don't expect to be operative for us in the second quarter.

Moving now to our operating groups and starting on Slide 11. Canadian P&C results reflect good operating performance with adjusted net income of $647 million.

Revenue was down 2% year-over-year. The prior year included the gain on the sale of Moneris and the current period includes a smaller gain related to the restructuring of Interac Corporation. The net impact of these 2 gains reduced year-over-year revenue growth by 8%. Higher balances and deposit spreads contributed to the good underlying revenue performance.

Total loans were up 3%, with personal loans up 2%. As mentioned last quarter, we have scaled back participation in the third-party mortgage market and continue to focus on growing through our own channels where mortgages were up 4% year-over-year. Commercial loan growth was good with loans up 8%.

Total deposits increased 5% with personal deposits up 4%, including strong 10% growth in chequing account balances, and commercial deposits were up 7%.

NIM increased 1 basis point from last quarter.

Expenses were up 7% and include a negative 2% impact from a legal reserve taken in the quarter.

The total provision for credit losses was down $12 million compared to last year, with provisions on impaired loans down $16 million.

Moving now to U.S. P&C on Slide 12. Adjusted net income was $321 million. The comments that follow speak to the U.S. dollar performance.

Adjusted net income of $256 million was up 30% from last year. Growth numbers reflect strong underlying performance and a 16% impact from the loss on the loan sale last year.

Pre-provision, pre-tax earnings growth was 26%, with the loss on the sale contributing 16% of that.

Revenue growth was strong at 11%, with just 5% of that coming from the loss on the loan sale. Operating revenue growth was more than double our growth rate for fiscal 2017 and in-line with our expectations for what we can achieve this year.

Average loan balances increased 6%. Personal loans were up 4%, reflecting the purchase of a mortgage portfolio in the current quarter. Commercial loan growth continued to be good at 7%.

Average deposits were up 1% from the prior year. Momentum was good quarter-over-quarter with personal deposits up 3% and commercial deposits up 6%.

Net interest margin was flat from the prior quarter and would have been up 6 basis points excluding the impact from the mortgage purchase in the quarter.

Expenses were up 3% year-over-year, and operating leverage was positive.

Total provisions for credit losses were down $7 million with provisions on impaired loans up $18 million from last year.

Turning now to Slide 13. BMO Capital Markets adjusted net income was $271 million, down from a strong quarter a year ago.

Revenue of $1.1 billion was down 11%. Trading Products revenue was off from record levels last year. Investment and Corporate Banking revenue decreased slightly as lower investment banking activity was partially offset by higher corporate banking revenue.

Expenses were flat and up 2% year-over-year excluding the impact of the weaker U.S. dollar. Net recoveries of credit losses were relatively stable from last year.

Moving to Slide 14. Wealth Management adjusted income was $276 million.

Earnings in Traditional Wealth were up 8% from last year, driven by business growth and improved equity markets.

Insurance results were solid, but down from the prior year as good business growth was more than offset by more favourable market movements in the prior year.

Adjusted expenses increased 5% mainly due to employee-related expenses and technology investments.

Assets under management were up 8%, and assets under administration declined from the prior year, reflecting a divestiture in the fourth quarter.

Turning now to Slide 15 for Corporate Services. The adjusted net loss was $93 million compared to a net loss of $127 million a year ago. Results were better due to above-trend taxes in the prior year, higher revenue excluding teb and lower expenses.

To conclude, results this quarter reflect a good start to the year and performance demonstrates the benefits of our business mix. As Darryl said, we see attractive opportunities for continued good revenue growth looking forward, and we are focused on achieving our financial targets for the year.

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

Surjit S. Rajpal ***Bank of Montreal - Chief Risk Officer***
Thank you, Tom, and good afternoon, everyone. Starting on Slide 17, the total provision for credit losses was $141 million, comprised of a provision for credit losses on impaired loans of $174 million and a $33 million reduction in allowances on performing loans.

For impaired loans, the PCL was 19 basis points of average net loans and acceptances, a quarter-over-quarter improvement of 3 basis points. This improvement was largely due to low commercial losses in Canadian P&C, partially offset by normalization in consumer losses in the U.S. As explained last quarter, the Q4 U.S. consumer number included the benefit of a sale of legacy consumer loans.

The $33 million reduction in allowances on performing loans was mainly due to an improved economic outlook, particularly benefiting U.S. P&C.

Turning to the next slide. Gross impaired loans were $2.149 billion, a decrease of 2 basis points to 57 basis points.

On Slide 19, the metrics related to the Canadian residential mortgage portfolio remained stable this quarter. We continue to be very comfortable with this exposure.

In summary, the bank's credit performance this quarter was good with low PCLs on impaired loans.

Over the next few quarters, our outlook for losses on impaired loans is consistent with recent experience, reflecting good economic and business conditions.

I will now pass it back to Darryl.

Darryl White ***Bank of Montreal - CEO***
Thank you, Surjit. As I mentioned earlier, we recognize that there is a degree of noise in the quarterly numbers, so to help cut through I wanted to emphasize how management is thinking about the quarter and the outlook going forward. So as we get to the underlying confidence that we have in the business, we would leave you with 4 thoughts.

First, we have the strongest momentum in U.S. P&C that we've had in a very long time. In particular, with 14% underlying NIAT growth, 2.6% positive operating leverage and twice the rate of revenue growth from what we did all of last year, we're indeed very confident in the future. So very positive on U.S. P&C for this outing.

Second, in Canadian P&C, we also delivered strong underlying earnings growth of 9% and positive operating leverage of 1.2% building on last year's performance. So with positive operating leverage in each of the U.S. and Canadian P&C businesses, the negative operating leverage at the total bank level is entirely due to lower revenue in Capital Markets and insurance, which we view as anomalous.

Third, our PCL performance was indeed strong. Risk management is a core strength of the bank, and we are duly proud of this achievement. And fourth, we're confident in our outlook. And as I said earlier, we remain fully committed to our growth targets, including achieving and hopefully beating our 2% operating leverage target for the third consecutive year. You'll be hearing more about our progress in the months ahead, including at our next all bank investor day planned for later in the year, so you can stay tuned for details on that.

And with that, I will turn it over to the operator for questions.

QUESTIONS AND ANSWERS

Nick Stogdill ***Crédit Suisse AG, Research Division - Research Analyst***
My question is on the personal loan growth in the U.S. If we strip out the mortgage purchase, it looks like balances are flat quarter-over-quarter, but still down year-over-year. Maybe you could give us an update on the partnership initiatives that you're looking to form outside the traditional banking channel, and if that's something that could happen in 2018. And how long does it take to onboard a partnership? And what steps do you need to go through?

David Robert Casper ***BMO Harris Bank National Association - President & CEO***
This is Dave. I'll start, but I'll also turn it over to Cam. So as we said in the last analyst call, we're going to participate in the markets that you talked about more going forward than we had in the past, as most of the U.S. banks have. We really hadn't participated with partners in the past, and we expect to do that. When you speak to our core personal growth though, you're correct, year-over-year, it's down without the purchase of the $2 billion of mortgages, which actually was $1.7 billion for the average just so if you've got that in your numbers. But we have had good core growth in our business banking group which is part of personal, in our HELOC business in the Midwest, which is a good positive, and we've been pretty stable in our core mortgages. So I think we're going to have good organic growth in our personal business as we go forward. And maybe I should just turn it over to Cam to talk a little bit more about some of the partnerships.

Cameron Fowler ***Bank of Montreal - President of North American Personal & Business Banking***
Thanks, Dave, this is Cam speaking, I'd add to what Dave has said. We're seeing some customer growth 5 quarters in a row that's very positive. We think that will contribute to organic loan growth later on in the year. Deposit growth continues to be very strong across all products and across all geographies. And on the loan side, beyond the stability that Dave mentioned in the core book as well as good growth that we're seeing in the Midwest, the indirect auto business is coming back for us, and we've had meaningful improvements over the past quarter there as well. On the partnership side - 2 aspects of that - we're very positive on that as one of the channels. We are looking to retool our organic growth channel with the new platform and growth I've just described. I would expect more flow arrangements to make themselves evident before the end of the year, and we continue to stay open to other inorganic ones like the one we discussed last quarter. Hope that helps.

John Aiken ***Barclays Bank PLC, Research Division - Director & Senior Analyst***
I'm just trying to figure out the messaging that you're trying to send to the street with the NCIB announcements. We had an upsize to the ones currently in place, 15 million to 22 million, and then another one is going to follow later on this year for 20 million. But if I take a look at the current program that's in place, we repurchased 8 million of that, that left 7 million remaining on the 15 million and yet we've upsized it to 22 million with only a couple months left. Are we expecting to see some very aggressive repurchase activity in the quarter? And is this messaging that this is more of an aggressive safety valve against where our capital ratio stands? I'm assuming that based on commentary this does not reflect on what the expectations are for organic growth.

Thomas E. Flynn ***Bank of Montreal - CFO***
Okay. Thank you for the question, John. A few things, I'll lead in responding to the last bit of your question. And we do expect good organic growth. And we certainly have the capital position to support that - the ratio is strong. And as you know, we'll have the benefit from the removal of the Basel I floor in the second quarter. All else equal, that would move the ratio up to 11.6% pro forma that change. And then on the buyback, there is a bit of a missing piece that I think will help you sort of piece the numbers together. We have bought back to date 8 million shares, as you've said, the program that we started the year with allowed for 15 million, so we had 7 million of capacity, but we need to subtract from that for some technical reasons, shares that we have purchased for the DRIP program and our employee share purchase program. And together, we bought about 3.5 million shares for those programs. So net, we only had 3.5 million of room on the existing program. And with that, we thought we wanted more capacity to buy back under the existing program before it expired and so we upped the amount. So that piece probably helps reconcile the numbers for you. And with the ratio as strong as it is, we do think we've got some capacity for activity under the program going forward.

John Aiken ***Barclays Bank PLC, Research Division - Director & Senior Analyst***
And then, Tom, just to clarify, with the new programs put in place it does signal a large repurchase versus what we've seen in the past if we fully executed. Is this just more visibility on where we stand with all the regulatory capital changes that have come through?

Thomas E. Flynn ***Bank of Montreal - CFO***
I would say, it's a few things, and it's partly that. We're certainly into the late innings on the regulatory capital change front. It also reflects a very strong capital ratio. Again, we're sitting here pro forma Basel I at 11.6% and that's a strong position. Typically, over the last few years, we've had buyback programs that have been 15 million shares, and we upped it to 20 really reflecting the 2 things that we've talked about, so it's a bit of a move up and not a quantum change at the same time.

Stephen Theriault ***Eight Capital, Research Division - Principal & Co-Head of Research***
Tom - I had a question for Dave - but Tom, you said earlier you don't expect to B II floor to be operative in Q2. Do you have a line of sight as to when that might kick in? My initial assumption was that it was quite a ways down the road, but is it maybe sooner than that?

Thomas E. Flynn ***Bank of Montreal - CFO***
Thanks for the question. We're not expecting the new floor to kick in early days. Exactly when it does will depend on growth in the balance sheet and the composition of the balance sheet. So it is possible, as we head into the new year, give or take, the new floor will be operative. It will depend on how the balance sheet grows. And we would expect, regardless of whether or not it kicks in, to continue to accrete capital and we'd stand by the numbers we've given in the past, which on an average basis through time you should expect to see the ratio go up by 10 to 15 basis points a quarter.

Stephen Theriault ***Eight Capital, Research Division - Principal & Co-Head of Research***
Okay. So for Dave, year-on-year commercial loan growth took a bit of a step back. I can see in Q1, 6% growth. It was 8% growth in Q4. So given all the moving parts, it'd be great to hear your outlook in terms of, are you seeing any pickup in activity or any deceleration in activity? It doesn't look from the industry data that there is much movement post the tax cuts, but it would be great if you could refresh us on an outlook there.

David Casper ***BMO Harris Bank National Association - President & CEO***
Sure. So well just to kind of roll it back a little bit, the overall revenue growth was 6% for all of P&C year-over-year. And that's, I think we said earlier, that's double where we saw it last year at this point. A lot of that is our loan growth, and we expect that speaks specifically to your commercial loan growth. I think I said earlier, on our last call, that I thought by the end of the year we'd be in the mid- to high single digits for our commercial loan growth. And I still think that's correct. We did have a dip in the first quarter, but that was following, I think it was, 6% growth in the quarter last time. And I think I probably signaled that was not sustainable. We borrowed a little bit in that quarter into the first quarter. I think the momentum is there. I see it in all of our businesses, frankly. I think we've probably moved to a different level now in terms of what people were thinking might happen and now what is actually happening. And in the visits I see and the people I see out in the market, I'm very, very confident that the growth will be there. It won't always be in loans, it will be in deposits, it will be in general revenue. So I'm very bullish on where the growth is going to be in our U.S. business whether it's personal or commercial. And our overall revenue, I think, will be well above where it was last year.

The other part that I think -- you didn't really ask this, but I did want to comment specifically on our NIM because it gets to the revenue growth from our deposits. We had good interest rate increases this year. We would've had NIM quarter-over-quarter of about 8% growth just from the growth in the deposits and the improved rates. Because of the purchase of on average $1.7 billion of mortgages, we gave back about 6 basis points for that. So all of these things, we need to feel pretty good about our loan growth, our revenue growth and our expense growth. And last thing, since I may not get the mic back, one thing that wasn't mentioned, we went below 60% for our productivity ratio this year, and that's really the first time we've done that in the U.S. P&C in a long time, we're at 59.7% and I think we'll make progress on that.

Stephen Theriault ***Eight Capital, Research Division - Principal & Co-Head of Research***
Sorry, I was just going to say - the margin ex the mortgage purchase then you're saying would have been more like 3.76%?

David Casper ***BMO Harris Bank National Association - President & CEO***
Yes, that's about right. We gave back 6 basis points for the reduced spread on the mortgages we purchased.

Meny Grauman ***Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research***
Darryl, you're pretty clear about the disappointment in the operating leverage, specifically in the capital markets and insurance. I'm just wondering, when you get a performance like this, do you change the way you look at expense management to become more aggressive in terms of the kinds of things that you're looking to achieve on the expense side going forward?

Darryl White ***Bank of Montreal - CEO***
Meny, thanks for the question. I should clarify if that's what you took away. I'm actually very proud of the operating leverage that we delivered in each of our big P&C businesses. What I said was that the negative operating leverage bank-wide was entirely due to lower revenues in Capital Markets and some of the insurance marks relative to a year ago. So at the overall bank level, I should be clear. I think we've done a very good job on the relationship between our revenues and expenses. With lower revenues in Capital Markets, as you know, that can change pretty quickly over time, so I'm not concerned about that. At the same time, do we have a keen focus on efficiency all the way through the bank? Yes, we do. Last year, we delivered 2% operating leverage at the same time as increasing our technology spend by 13%, so we're operating our technology spend at an elevated level today as we were in the fourth and third quarters of last year. We're going to continue to do that. We would expect the environment in Capital Markets to change as we go through Q2, Q3, Q4. And with that, we are very confident in the delivery of 2% level that I mentioned earlier for the full year as we did the year before and the year before so that would be a three-peat if we do and I'm confident that we will and that would put us, by our estimates, in a pretty rare category.

Meny Grauman ***Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research***
And then if I could just ask on the impact of NAFTA on your customers. I mean, being such big commercial lenders in Canada, what are you seeing -- what are your customers telling you about the uncertainty? And how is it manifesting, specifically in the kind of business that you're seeing?

Darryl White ***Bank of Montreal - CEO***
Yes, it's a good question, Meny. The conversation is alive and well, I would say. But I don't think we're seeing a big impact in terms of how it manifests in the business. For us, we're in a good position and that we can help our customers regardless of where they choose to invest and where they choose to grow whether that's in Canada or the U.S. So whether there is movement as far as NAFTA conclusions are concerned, I feel like we're reasonably well hedged at the Bank of Montreal. Having said that, conversation that is alive and well in both -- in boardrooms and meeting rooms of our Canadian clients as well as our U.S. clients, is one of watch, concern, uncertainty, general advocacy for a positive outlook and conclusion to NAFTA to not have it look too much different than it does today. But at the end of the day, everybody has got their plans in place for alternatives, including ourselves. And in our case, the plan isn't much different from what we're executing on today because we're quite well hedged.

Robert Sedran ***CIBC Capital Markets, Research Division - MD & Head of Research***
I guess, Darryl, you've touched on the revenue performance in Capital Markets that can kind of come and go. But -- and I appreciate that a year ago was a bit of a special period -- when I see revenue down 11%, but expenses flat, that is some pretty meaningfully negative operating leverage. And I am wondering is there some timing issues that perhaps you might see revenues and expenses track more closely when you think about a full year performance? I know in the past, you've talked about investing in the Capital Markets franchise. Is there more spend going on in the U.S. that is less tied necessarily to short-term revenues? Can you give a little bit of colour in terms of how the interplay between these 2 things should play out?

Darryl White ***Bank of Montreal - CEO***
Yes, Rob, Pat just grabbed the mic from me, so I'm going to let him take your question.

Patrick Cronin ***BMO Capital Markets Corp. - CEO***
Thanks for the question, Rob. I would suggest that it was actually an anomalous quarter, both from a revenue and an expense perspective. As Darryl mentioned at the beginning, you're comparing to a really abnormally successful Q1 of last year. And this year, we saw some softness, particularly in the underwriting and advisory line, and so the year-over-year revenue comparison was a tough one. But then on the expense line, there -- as you've seen in previous years, there is some seasonality to the expenses and particularly Q1 where we expensed some of the one-time expenses at the beginning of the year. Those seasonal expenses were quite a bit higher this year than they were in previous years. But similar to the previous year and the year before that, you should see those seasonal expenses come right back out again in Q2. And so that combination we think of better revenue, a much lower expenses to revenue experience in Q2, plus a benign PCL should drive what we think will be a material net income improvement in Q2. So, for expenses, if you took the decline that you saw between Q2 and Q1 last year and the year before that, that should give you about a ballpark of where we think expenses are going to go for Q2 and the balance of the year. And that would be exclusive of any other expense reduction exercises that Darryl talked about as well.

Robert Sedran ***CIBC Capital Markets, Research Division - MD & Head of Research***
Pat, would there have been a meaningfully different performance on the Canadian or the U.S. side of the business? Or were both affected by similar trends?

Patrick Cronin ***BMO Capital Markets Corp. - CEO***
They were both hit by similar trends. The year-over-year, I would say, was more skewed to Canada. It was in our Trading Products businesses. In our Structured Products business, there was some of that client activity last year that didn't recur this year, so it was quite concentrated and much more focused in the Canadian business, although it was a slower quarter as well for the U.S. franchise, but it was at the lower end of where we would expect that business to operate. And again, similar to my overall comments, we would expect to see material improvement in the U.S. corridor in Q2.

Gabriel Dechaine ***National Bank Financial, Inc., Research Division - Analyst***
My first question is on the U.S. P&C balance sheet. The loans-to-deposit ratio, just the net loans to average deposits there, has been creeping up over the past year and I guess, even longer than that, not that mortgage purchase bumped it up as well. Just wondering what the funding strategy looks like there. Do you think you're going to have to step the gas on retail deposits? How ripe is the market for retail deposit gathering? Is it getting more competitive? Or are you going to have to look at wholesale alternatives?

David Casper ***BMO Harris Bank National Association - President & CEO***
It's Dave. I think our strategy really hasn't changed. We have a really strong retail deposit gathering book as you recall, and it's in fact kind of inverse to our loans. We have more commercial loans than we have retail and personal loans. We have substantially more personal deposits than we have commercial deposits. And we're growing deposits as you saw this quarter in both places. So I don't see anything meaningful in terms of needing to go outside in any significant way. I think we continue to grow deposits, it's a focus. And overall, our loan-to-deposit ratio was fairly

close to one-to-one if you look at it in the U.S. P&C business. Tom may have more to add but that would be my take.

Thomas E. Flynn ***Bank of Montreal - CFO***
Not really a lot to add. I thought that covered it.

Gabriel Dechaine ***National Bank Financial, Inc., Research Division - Analyst***
All right. Next question. Look, I don't want to beat a dead horse here on the efficiency and expense topic, but -- and I guess, that you're confident in your operating leverage target for the year. But if we look at the bank, big picture, you've got a pretty high efficiency ratio relative to the peer group. If I go back a couple of years when you did take 2 restructuring charges like most other banks, it wasn't as aggressive as some of the others I saw. I'm just wondering do you think more needs to be done - I'll just put it that way.

Thomas E. Flynn ***Bank of Montreal - CFO***
It's Tom, Gabriel. I'll take that. I'll speak to what has been done and what we plan on doing. So we have been moving the efficiency ratio at the total bank level down and that's coming off of the operating leverage and you've heard us say a couple of times on the call so far that we achieved our 2% operating leverage target in each of the last 2 years. That reflects, we think, a lot of good and hard work across the bank on both the revenue side and the expense side. The restructuring charges that we've taken contributed to that performance. And I'd say, we are focused on doing the same thing this year. And with that, the efficiency ratio will move down as well. And in order to do that, we absolutely are looking at executing on a set of initiatives across the bank, focused on improving efficiency, making processes operate in a more efficient way, introducing more technology into our business in a variety of ways and driving revenue. So there is absolutely more to be done, and we're focused on it going forward as we have been over the last couple of years.

Gabriel Dechaine ***National Bank Financial, Inc., Research Division - Analyst***
Are there any businesses where you could get a big boost from scale enhancement with an acquisition? Which ones would be, I guess, most advantageous to do a deal?

Thomas E. Flynn ***Bank of Montreal - CFO***
Well, you've got a number of hands going up in the room, but I would say we're focused in the first instance on organic growth. We do see good opportunities for organic growth in the businesses we've got. We feel good as we've said about the 6% revenue growth underlying in both P&C businesses. Those numbers in both cases are better than the levels we posted last year. We've seen very good organic growth in our Capital Market business in the U.S., and Traditional Wealth was up 9% in the quarter and had a good quarter, so we see opportunity there. We're driving on the expense side as well, and we expect to have more to say about that as we move through the year and that will help drive the operating leverage. And as well, like we have through time, we'll look at acquisitions to grow our business, and we look to execute on our strategy on the M&A side and to be disciplined at the same time. And through time, we've looked at things in U.S. banking that fit with our business and we've looked to grow our wealth business through transactions that make sense for us. And you've seen that in the past and not unreasonable to expect that over time, you will see that as well going forward.

Doug Young ***Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst***
Just I guess, on the CET1 ratio, Tom, you mentioned your natural accretion is 10 to 15 points. Looks like this quarter, it was 4 basis points, if I exclude buybacks and the deferred tax asset impact, so why so low? And I think there was a $1.4 billion increase in market risk weighted assets, and that obviously had an impact, just wondering what that related to?

Thomas E. Flynn ***Bank of Montreal - CFO***
The number absolutely does move around quarter-to-quarter. And so every time I say 10 to 15 basis points, I do try to say some version of on average through time because in any quarter, the numbers can move around a little bit and you saw some of that in the current quarter. And I would say, nothing in particular, but the number was a little lower, which I wouldn't read a whole lot into. And then on the market risk side, we did have a somewhat higher level of equity auction related market risk and credit risk. And so nothing outsized relative to what we would run through time, but those were the 2 items that contributed to the higher market risk in the quarter.

Doug Young ***Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst***
Okay. And then just, I guess, Surjit, maybe for you. There is a bit of a jump in commercial real estate gross impaired loan formations, $55 million versus $16 million last quarter. Looks like it mostly was in Canada. Just want a little more detail on that. And manufacturing bumped a little bit higher sequentially as well, just want to see if there is any additional details you could give there.

Surjit S. Rajpal ***Bank of Montreal - Chief Risk Officer***
Sure. Thank you. On the commercial real estate side, there was essentially one loan which got impaired because of the delay in the payment. We're working through that one. There is no provision associated with that one, so I don't think that is going to have any negative consequences. It looks like it's pretty good. On the manufacturing side, it's a few small ones. And that typically happens -- manufacturing is such a big and broad segment, but there's no pattern that you can detect from manufacturing. Hope that helps.

Doug Young ***Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst***
Yes.

Sumit Malhotra *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*
Let me stay with Surjit for a moment. So in your commentary, you said you think the level of impaired provisions that we saw this quarter is a decent run rate for what you're thinking based on the outlook. The nonimpaired portfolio that had the $33 million reversal. I know that this is early days for IFRS 9, so just wanted to get your thoughts on this. One of your counterparts who had a reversal as well indicated it was because they had made a positive adjustment to their economic outlook and that triggered the reversal in the quarter. Was that a similar factor that drove this $33 million swing for you?

Surjit S. Rajpal *Bank of Montreal - Chief Risk Officer*
Not exclusively just the economic scenario. The economic scenario that you assume is a big driver of the number that comes out from the model part of the exercise for IFRS 9. There are 2 other elements that determine where that ultimate number lands. One of them is the volume increase in the book itself, and the other one is any idiosyncratic movement that you would have in the portfolio. So if there's any risk migration of a natural kind that you will have, which is specific to your portfolio, which is not necessarily economic outlook based. And in the end, it sometimes can be transferred into economic outlook, but, for example, for competitive reasons, certain companies may do well or may do worse and so you may downgrade them. And once you downgrade them, the allowance that you would put against them changes. And the only other thing is that this is a point in time assessment that we do and it's nonlinear because when it moves from stage 1 to stage 2, you bring in the entire lifetime of losses. And when it reverses, it doesn't go back to lifetime, it goes back to 1 year. So it's hard to make a prediction, but I think you're absolutely right in assuming that the economic factors play the largest role in where this number will be, which is what makes it pro cyclical. So I hope that helps.

Sumit Malhotra *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*
It does. It obviously brings more questions as well because the question that comes readily to mind is, so on a quarter-to-quarter basis, I certainly expect when we go through changes, whether it's underlying trends in your portfolio or economic cycle that this line will have volatility. After this initial implementation, as you're halfway through Q2, do you expect that this line ends up being another positive for you? Or does it settle down until you have a more significant underlying change in portfolio quality? For example, is a recovery of this magnitude something you expect to be a recurring factor?

Surjit S. Rajpal *Bank of Montreal - Chief Risk Officer*
I won't go as far as saying this would be a recurring factor. I think the comment I made was that we see the current economic outlook staying in the good state it is in. And so if it stays the way it is and all things being equal, I would say, it could come down, but the magnitude will be very difficult to predict because for all the other reasons I outlined. But clearly the outlook is good and may get better.

Sumit Malhotra *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*
Okay. And last one for me is for Cam, just want to go to mortgages in Canada. So you talked to us the last couple of quarters about deemphasizing, I'll use the term third-party channels, or non-BMO channels, if that's the right way to phrase it. The balance that you show us in mortgages at about $100 billion, could you remind me how much of that is from channels that you're no longer looking to grow from?

Cameron Fowler *Bank of Montreal - President of North American Personal & Business Banking*
I would say that it is 95% or more. [sic](of Q1 Mortgage Originations)

Sumit Malhotra *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*
95% or more is BMO-specific business or BMO-specific channels?

Cameron Fowler *Bank of Montreal - President of North American Personal & Business Banking*
BMO proprietary channel.

Sumit Malhotra *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*
And so does that $5 billion or so balance trend to 0 over the next couple of years?

Cameron Fowler *Bank of Montreal - President of North American Personal & Business Banking*
I think we'll wait and see how it goes. My expectation is though for certain is the proprietary channels outgrow it, and they will be at or above market and that one will be lower than the rest of the book.

Mario Mendonca *TD Securities Equity Research - MD and Research Analyst*
Just a quick follow-up on that last question. Cam, the reason for deemphasizing these non-BMO channels, is it a risk decision? Is it a margin decision? What led you to that conclusion?

Cameron Fowler *Bank of Montreal - President of North American Personal & Business Banking*
It's a margin decision. Yes, it's an opportunity to deploy that capital elsewhere into higher return areas and to focus more capital on primary customer-based opportunities.

Mario Mendonca ***TD Securities Equity Research - MD and Research Analyst***
So you wouldn't suggest to us then that there is a heightened degree of risk on these non-BMO originated mortgages and whether that's credit risk or some other.

Cameron Fowler ***Bank of Montreal - President of North American Personal & Business Banking***
No. The entire book, back to the $106 billion, we're very, very, confident with the controls we have. We've made participation choices that you recall almost a decade ago getting out of broker as a channel, but the controls that we have across the entire book and, in particular, when we originate third party, they're up to even higher levels of scrutiny in that we double test those. And so no, it's got nothing to do with the confidence in the quality. It's more about margin and where else we'd like to participate.

Mario Mendonca ***TD Securities Equity Research - MD and Research Analyst***
Okay. Separate question then for Tom. This is more technical. When you folks talk about the 2% operating leverage for full year 2018, is your starting point for Q1 '18, is it the minus 4.1 or on a more cleaned up basis, the 1.6?

Thomas E. Flynn ***Bank of Montreal - CFO***
It is off of the minus 4 number. So we're starting in the deficit position. That does reflect the strong Q1 a year ago. The net gains account for about 2.5 points of the 4. And so clearly, we're expecting to do much better in the year. And I would say as well, this quarter, the net gain we had last year hurt us. In Q4, the reinsurance reserve build we had will help us. So there is a bit of a net headwind there, but not as big as you might think excluding that one item.

Mario Mendonca ***TD Securities Equity Research - MD and Research Analyst***
Right. That's where I was going to go, so the benefit then may be somewhat back-end loaded?

Thomas E. Flynn ***Bank of Montreal - CFO***
It will be skewed to the back-end, but we do expect better performance certainly than this in every quarter of the year. So the fourth quarter, given the reinsurance item, has that benefit, but it should be in a different place through each of the quarters of the year.

Mario Mendonca ***TD Securities Equity Research - MD and Research Analyst***
And then sort of a broad philosophical question for Surjit. Every quarter I'm sort of stunned to see how low credit losses are in Canada, domestic retail, I think it was like 18 basis points this quarter. Now Surjit a few quarters back, it was in middle of 2017, you talked about your expectations that PCLs would move to sort of a mid-20s. Has something changed over the last year or so, 6 months that is leading to even lower losses than you'd offered back then?

Surjit S. Rajpal ***Bank of Montreal - Chief Risk Officer***
Well, the economy for one has been doing really well. Unemployment has been low. And so that I think is a principal reason when I do give you these predictions, I'm mindful of what can possibly go wrong, effectively I'm a risk guy, but I think the economic conditions have proven to be good and then our portfolio is of high quality as well. So it's not just economic conditions, but as Darryl mentioned, the quality of the portfolio does matter. And so it serves us quite well in both good and bad times.

Mario Mendonca ***TD Securities Equity Research - MD and Research Analyst***
So without putting words in your mouth, would you say, it's a fair statement, when you see an article in whatever paper, or some think tank talks about Canada and the overleveraged Canadian consumer and they offer an outlook that is clearly different from what we're seeing from BMO and the rest of the banks, would you reconcile your results and your outlook with that outlook by referring us to quality specifically of your bank's loan book? Is that how we can reconcile the more dire outcomes some folks propose and what we're actually seeing today? Is that really only way to reconcile the two?

Surjit S. Rajpal ***Bank of Montreal - Chief Risk Officer***
There's a bit of that, but I think more than that is the immediacy of the dire outcome. A lot of folks outside of Canada that make assessments in Canada assume that something is going to break and break fast and everything is going to collapse all at once, and that's never the case. And I think it's easy to write about and it's sensational, but in reality, when housing as well as debt levels get spoken of, clearly, there is some merit to saying that they are high, but the issue here is that the unemployment levels are low. And with the kind of economy that you're facing, these things will happen slowly even if they did. Even if there were a correction, things will happen slowly. I think there's also a lack of understanding of the mortgage industry itself and how it manifests itself in bank results. I don't believe people have that understanding outside of Canada. So I think that is why it makes more headlines than one would want it to make.

But getting specific to our own book, when we look at our exposures from a portfolio standpoint, we are little bit more heavily weighted in terms of commercial. And consumer, we are a little underweight, not that we should be underweight, I think by all means, Cam should grow, and there is no reason why he shouldn't, but that helps us a little bit in a stress test that we would run with adverse scenarios because the consumer book is more affected more immediately if there was an economic crisis and let's say, unemployment was to go up for some reason. But in the calls that you and I have and the chats we have are always with the 4 quarters ahead of us in mind more than the longer term. Which is why when we talk about long-term averages, we still look at our track record over a long period of time and over the last 20 something years, we had a 40 basis point record. And while we will experience a 19 basis points or so in periods like this, which we have seen for the past several years. In fact, when I look at the numbers over the past several years, our track record has been quite outstanding in terms of how we perform from a PCL basis. And it's been in that same category of a little bit over 20 basis points. I think last year, we were at 22 basis points and the year before that we were at 22 basis points and the year before that, we were 19. So I think we've had a history that has proven that we do know how to manage the risks that we take on our books. So that's all I can point to as being specific to us.

Mario Mendonca ***TD Securities Equity Research - MD and Research Analyst***
And there's just a minute left before the hour, if I could just get to one more point. You made the point that the things don't collapse immediately. And I took that to mean that to the extent that there is a bubble in consumer leverage here in Canada, that it will not collapse, but it will ease slowly and there won't be an abrupt end to it. The challenge that I get from people when I have that discussion is that there is no scenario when bubbles burst gradually. The whole point is that they burst immediately and it's an abrupt adjustment to leverage. So when you say, you don't think it would be immediate, what scenario are you contemplating where consumer leverage would very gradually move down as opposed to the way it has in the past been an abrupt end?

Surjit S. Rajpal ***Bank of Montreal - Chief Risk Officer***
So let me explain what I meant by -- and I'll have to qualify the word collapse because, let us say house prices come down, let's say that is the cause, that is the bubble people talk about. When we stress our portfolios and you bring it down given our loan-to-value ratio on average is about 50% -- 50% is covered half with the value, you don't see any adverse results. What you see happening is the relationship between what caused that collapse and how that will manifest itself in unemployment rates is the one that we need to watch more closely. And that is why I talk about, yes, the collapse is generally -- all of a sudden, there's a market correction, but what does it lead to, what are the economic indicators that are going to be impacted as a results of that. Is it just that people are going to lose money that they thought they had? Or is it going to result in unemployment? And it could be a wealth factor. It just may reduce the wealth of people. And that's what we need to look at. I get a lot of comfort from the fact that if the economic fundamentals stay good, the house that you're living in or you invested in would go down in value and so that's more of wealth effect than it is an economic effect from the standpoint of unemployment right away. Yes, there'll be a slow trickle, people may not build houses anymore, and the housing industry may not have as much of spending, but all these things are phased in much, much slower.

Operator
This concludes the question-and-answer session. I would now like to turn the meeting back over to Ms. Homenuk.

Jill Homenuk ***Bank of Montreal - Head of Investor, Media & Government Relations***
Thank you, and thanks, everyone, for joining us today. We look forward to talking to you again in May with our Q2 results.
