Q2 2019 Conference Call

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By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties, both general and specific in nature. There is significant risk that predictions, forecasts, conclusions or projections will not prove to be accurate, that our assumptions may not be correct, and that actual results may differ materially from such predictions, forecasts, conclusions or projections. We caution readers of this document not to place undue reliance on our forward-looking statements, as a number of factors – many of which are beyond our control and the effects of which can be difficult to predict – could cause actual future results, conditions, actions or events to differ materially from the targets, expectations, estimates or intentions expressed in the forward-looking statements.

The future outcomes that relate to forward-looking statements may be influenced by many factors, including but not limited to: general economic and market conditions in the countries in which we operate; the Canadian housing market; weak, volatile or illiquid capital and/or credit markets; interest rate and currency value fluctuations; changes in monetary, fiscal, or economic policy and tax legislation and interpretation; the level of competition in the geographic and business areas in which we operate; changes in laws or in supervisory expectations or requirements, including capital, interest rate and liquidity requirements and guidance, and the effect of such changes on funding costs; judicial or regulatory proceedings; the accuracy and completeness of the information we obtain with respect to our customers and counterparties; failure of third parties to comply with their obligations to us; our ability to execute our strategic plans and to complete and integrate acquisitions, including obtaining regulatory approvals; critical accounting estimates and the effect of changes to accounting standards, rules and interpretations on these estimates; operational and infrastructure risks, including with respect to reliance on third parties; changes to our credit ratings; political conditions, including changes relating to or affecting economic or trade matters; global capital markets activities; the possible effects on our business of war or terrorist activities; outbreaks of disease or illness that affect local, national or international economies; natural disasters and disruptions to public infrastructure, such as transportation, communications, power or water supply; technological changes; information and cyber security, including the threat of hacking, identity theft and corporate espionage, as well as the possibility of denial of service resulting from efforts targeted at causing system failure and service disruption; and our ability to anticipate and effectively manage risks arising from all of the foregoing factors.

We caution that the foregoing list is not exhaustive of all possible factors. Other factors and risks could adversely affect our results. For more information, please see the discussion in the Risks That May Affect Future Results section on page 79 of BMO's 2018 Annual Report, and the sections related to credit and counterparty, market, insurance, liquidity and funding, operational, model, legal and regulatory, business, strategic, environmental and social, and reputation risk, in the Enterprise-Wide Risk Management section on page 78 of BMO's 2018 Annual Report, and the Risk Management section on page 26 in BMO's Second Quarter 2019 Report to Shareholders, all of which outline certain key factors and risks that may affect our future results. Investors and others should carefully consider these factors and risks, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements. We do not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by the organization or on its behalf, except as required by law. The forward-looking information contained in this document is presented for the purpose of assisting our shareholders in understanding our financial position as at and for the periods ended on the dates presented, as well as our strategic priorities and objectives, and may not be appropriate for other purposes.

Material economic assumptions underlying the forward-looking statements contained in this document are set out in the 2018 Annual Report under the heading "Economic Developments and Outlook", as updated by the Economic Review and Outlook section set forth in BMO's Second Quarter 2019 Report to Shareholders. Assumptions about the performance of the Canadian and U.S. economies, as well as overall market conditions and their combined effect on our business, are material factors we consider when determining our strategic priorities, objectives and expectations for our business. In determining our expectations for economic growth, both broadly and in the financial services sector, we primarily consider historical economic data provided by governments, historical relationships between economic and financial variables, and the risks to the domestic and global economy. See the Economic Review and Outlook section in BMO's Second Quarter 2019 Report to Shareholders.

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 2019 Report to Shareholders and on page 27 of BMO's 2018 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, restructuring costs, revaluation of U.S. net deferred tax asset as a result of U.S. tax reform and the remeasurement of an employee benefit liability as a result of an amendment to the plan.

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

PRESENTATION

Jill Homenuk – Bank of Montreal – Head of Investor, Media & Government Relations

Thank you. Good morning, 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 Pat Cronin, our Chief Risk Officer. We have with us today Cam Fowler from Canadian P&C; and Dave Casper from U.S. P&C. Dan Barclay is here for BMO Capital Markets and Joanna Rotenberg is here for BMO Wealth Management.

After their presentations, 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.

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. 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 2018 annual report and our second quarter of 2019 report to shareholders.

With that, I will hand things over to Darryl.

Darryl White – Bank of Montreal – CEO

Thank you, Jill, and good morning, everyone.

Today, we announced strong performance for the second quarter with earnings of $1.5 billion and earnings per share of $2.30, an increase of 5% over last year, and this is after absorbing a severance cost in our capital market's pillar. This follows good first quarter results with steady performance in an improved market environment. For the first half of the year, earnings per share are up 7%, in line with our mid-term target range, and we believe we are on track to deliver that same level of growth in the second half of the year as well. This quarter was highlighted by solid momentum across our businesses supported by stable economic fundamentals.

Looking back, as we headed into fiscal 2018, six quarters ago, we highlighted key areas of strategic focus where we planned to accelerate our performance: growth in our U.S. segment; improved efficiency; transformation of our business through innovation; and the importance of our people and culture. At our Investor Day in the fall, we reiterated these strategies and we formalized specific targets for the bank and our operating groups, including achieving 1/3 of our earnings from the United States. We have consistently said that we were confident in the outlook of our businesses in the United States, and we're working to grow earnings from our U.S. segment faster than the overall bank.

We highlighted our progress in distinctive areas of strength at the bank's AGM in April. At the beginning of [2018], our U.S. segment contributed about 25% of the total bank earnings. After several consecutive quarters of strong performance, that contribution has grown to 35% of the bank's earnings so far this year. More broadly, our operating groups are progressing against their strategies. Canadian and U.S. P&C are delivering good results, reflecting strong and diverse loan and deposit growth. Capital Markets and Wealth Management had good operating performance in the quarter in a more constructive market environment.

We are committed to our efficiency target of 58% by 2021. And at the same time, we are taking disciplined actions to execute against our strategy and position the bank for sustainable growth over the long term. For example, we have made organizational changes within our Capital Markets group to align resources with the revenue environment, which impacted operating leverage in the current quarter and will deliver improved efficiency going forward. Our results this quarter include a severance cost, which we absorbed in our Capital Markets group, of $120 million pretax, negatively impacting our adjusted earnings by $0.14 per share.

Our capital position remained strong and is supporting robust organic growth across our businesses, which as we have said, is our top priority. ROE in the quarter was 13.9% and we announced the $0.03 increase to our quarterly dividend or 7% over last year.

Turning to Slide 5, as I mentioned earlier, we are continuing to drive positive momentum from our U.S. platform, which remains a clear differentiator for BMO. Year-to-date earnings were up 29%, driven by strong growth in U.S. P&C and Capital Markets, with pre-provision, pre-tax earnings growth of 20%, positive operating leverage and improved efficiency. We delivered another consecutive quarter of industry-leading commercial loan growth, which continues to be high quality and well diversified across industries and geographies.

As I look across the bank, we are building on our strong foundation and differentiating strengths to grow our businesses and deepen customer loyalty.

For example, in North American commercial banking, our deep sector expertise and collaborative approach to building customer relationships differentiates us in the market, including in the technology sector. This quarter, we introduced a specialized technology and innovation banking group that provides tailored advice and funding to this important industry, as well as integrated cross-border, capital markets and wealth management solutions. These companies are critical to driving innovation and positive change in Canada and we are uniquely positioned to help them grow and compete through every stage of their life cycle.

Wealth Management has an advantaged position in the market, including in the ETF market where we were ranked #1 in Canada for net new asset growth for the eighth consecutive year as well as having leading loan and deposit growth. To further support our strong performance, we are taking actions to grow our position with clients, including bringing together our full-service brokerage and private banking businesses to deliver best-in-class advice to serve clients' increasingly complex needs. The coming together of Asset and Wealth Management under one group head, along with new leadership in BMO Asset Management, positions the Wealth business for continued global growth, building on its strategic advantages.

In Capital Markets, our client-driven strategy is clear and unchanged and is delivering good year-to-date operating performance. Investment and Corporate Banking revenue is up 18% compared to the first half of last year; our acquisition and successful integration of KGS is performing ahead of expectations; and the U.S. business is contributing over 1/3 of Capital Markets' earnings compared to less than 25% at this time last year.

So across the company, we have been making targeted investments in technology that drive customer experience and revenue. As an example, in Treasury and Payment Solutions, we are partnering with MasterCard Send ™ to enable faster cross-border payments for our Canadian clients. For our U.S. customers, we have teamed up Zelle® to offer quick and easy business to customer payments. In U.S. Personal and Business Banking, customers are embracing our new digital capabilities. Since launching our digital account opening platform, we have seen significant increases in digital chequing account applications primarily via mobile devices, which is contributing to our very strong deposit growth.

Our effective use of technology to enable business success, including our agile and collaborative approach to innovation, was recognized this quarter with two Celent 2019 Model Bank Awards.

Collaboration is but one aspect of our distinctive culture, as is our commitment to doing what's right and leveraging our role as a trusted financial advisor to create opportunities for lasting positive change in the world. Consistent with our strong support of gender balance and the advancement of women, I am proud that BMO is the first Canadian bank to sign the UN Women's Empowerment Principles, which provides a global framework to promote gender equality and empower women in the workplace, marketplace and community.

Looking ahead, we remain confident about the resiliency of the Canadian and U.S. economies supported by population growth, low unemployment, modest inflation and stable interest rates. We have good momentum across our businesses that will drive performance in the second half of the year, similar to the first, and the investments we have made position us well for long-term success.

At this point, I'll turn it over to Tom to talk about the second quarter financial results.

Tom Flynn – Bank of Montreal – CFO

Thank you, Darryl, and good morning, everyone.

My comments will start on Slide 8. Q2 reported EPS was $2.26, and net income was $1.5 billion. Adjusted EPS was $2.30, up 5%, and adjusted net income was $1.5 billion, up 4%. Results this quarter reflect continued good performance in our U.S. segment, strong commercial loan growth on both sides of the border, and a stable operating environment. Adjusting items are similar in character to past quarters and are shown on Slide 24.

Net revenue of $5.7 billion was up 8% or 6% excluding the stronger U.S. dollar, with growth across all operating businesses. Expenses increased 10%, or 9% excluding the impact of the stronger U.S. dollar. The BMO Capital Markets severance expense of $120 million pre-tax and the acquisition of KGS accounted for 5% of the expense increase. The remaining 4% was mainly driven by higher technology and employee-related costs.

Year-to-date, expense growth was 7.3%, all-in. Looking forward, for the second half of the year we expect expense growth to be approximately half of that rate. Operating leverage for the quarter was negative, given the impact of the severance expense, and above 1% excluding it.

Moving to Slide 9 for capital, the Common Equity Tier 1 ratio was 11.3%, down 10 basis points from the first quarter. As shown on the slide, the ratio declined as retained earnings growth was more than offset by higher risk-weighted assets. The higher risk-weighted assets were driven by very strong commercial and corporate loan growth across our businesses, which is a reflection of our strength in this area.

Moving to our operating groups and starting on Slide 10, Canadian P&C net income was $615 million, up 5% from last year. Revenue growth was 5%, driven by higher balances across most products, increased noninterest revenue, and higher margins. Total loans were up 6%, with commercial loans up 15%. Mortgage growth through proprietary channels, including amortizing HELOCs, was good at 4%. We also had strong deposit growth, with personal balances up 9% and commercial up 7%. NIM was flat compared to the first quarter and up 2 basis points from last year. Expense growth was 5%, reflecting investment in the business, and operating leverage was positive. The provision for credit losses was $138 million and includes a $16 million provision for performing loans.

Moving to U.S. P&C on Slide 11, and my comments here will speak to the U.S. dollar performance. Net income for the quarter was $314 million, up 12% from last year. Revenue growth was 5%, reflecting higher deposit revenue and loan volumes net of loan spread compression. Average loan growth was 12%, with commercial loans up 15% and higher personal loan volumes. With strong deposit growth of 13%, Q2 marked our third consecutive quarter of double-digit growth in both personal and commercial deposits. Net interest margin was down 10 basis points from last quarter, 3 basis points of the decline were due to lower interest recoveries in the current quarter. The majority of the balance is attributable to loans growing faster than deposits and tighter spreads in commercial lending. Expenses were up 6% from a below-trend level last year, primarily due to higher employee and technology-related expenses. Year-to-date, operating leverage is strong at 2.6% and expenses are up 4%. Provisions for credit losses were low this quarter, largely reflecting a recovery in commercial loans and stable credit conditions.

Turning to Slide 12, BMO Capital Markets net income was $253 million. Strong performance in Investment and Corporate Banking and good results in the U.S. segment were offset by the impact of the severance expense. The U.S. business net income was up 24%, reflecting good diversified performance across both Investment and Corporate Banking and Trading Products, including the benefit of the KGS acquisition, partially offset by the severance expense. Revenue was $1.2 billion and up 18%, or 17% excluding the impact of the stronger U.S. dollar. Investment and Corporate Banking revenue increased 21%, reflecting loan growth and higher debt and equity underwriting. Trading Products revenue was up 16%, with fair value adjustments contributing to above-trend interest rate trading and lower equity trading revenue. We had good client activity in interest rate and commodity trading and slower equity trading activity. Expenses were up 31%, or 29% excluding the impact of the stronger U.S. dollar, with 18% of that growth due to severance expense. The severance expense together with the impact of the KGS acquisition accounted for over 24% of the year-over-year increase in expenses. Provisions for credit losses were $15 million compared to a recovery of $13 million in the prior year.

Moving now to Slide 13, Wealth Management net income was $315 million, up 3% from prior year. Traditional Wealth net income of $236 million was relatively unchanged from last year. Strong net interest income and the benefit of improved equity markets was largely offset by expenses and lower performance fees in Asset Management from a high level last year. Average loans were up 16%, the fifth conservative quarter of double-digit growth, and deposits were up 4%. Insurance net income was $79 million, up 14%, largely reflecting a benefit from market movements in the current quarter relative to unfavourable movements in the prior year. Expenses were well managed, up 2% from last year. Assets under management and administration were up 4%, driven by stronger equity markets and foreign exchange.

Turning now to Slide 14, for Corporate Services, the net loss was $78 million, unchanged compared to last year as lower expenses were offset by lower recoveries for credit losses.

To conclude, the second quarter results reflect continued good momentum across our businesses. Operating groups are well positioned for the opportunities in the environment and are focused on the execution of our strategies.

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

Pat Cronin – Bank of Montreal – CRO

Thank you, Tom, and good morning, everyone.

Starting on Slide 16, the total provision for credit losses this quarter was $176 million or 16 basis points, which is up from 13 basis points last quarter.

Our PCL on impaired loans increased $23 million to $150 million or 14 basis points this quarter, while our PCL on performing loans was $26 million compared to $10 million last quarter. Of note, this quarter had a large U.S. Commercial recovery, absent which the total PCL would have been 20 basis points, which is in line with recent guidance and our ongoing expectations.

Now turning to each of the businesses, in the consumer segment of Canadian P&C, PCL on impaired loans was up marginally quarter-over-quarter, and in the Canadian commercial segment, our impaired provisions were $15 million, increasing from a low level last quarter.

PCL on impaired loans for U.S. P&C increased slightly by $3 million to $18 million. Now, last quarter, you may recall, was characterized by a large consumer recovery related to an insurance settlement, while this quarter includes a similarly sized commercial recovery. As a result of these two items, U.S. consumer provisions are up quarter-over-quarter, while U.S. commercial provisions are down. Excluding the recovery, U.S. P&C provisions on impaired loans are broadly in line with recent experience and expectations.

PCL on impaired loans for Capital Markets was $12 million compared to a $1 million provision in Q1. Variation in Capital Markets PCL is expected for this portfolio, given its size and the nature of the exposures.

The $26 million provision on performing loans in the quarter was primarily due to portfolio growth with smaller increases attributable to modest credit quality movements and some modest changes in our macroeconomic outlook.

Turning to Slide 17, formations increased quarter-over-quarter as business and government formations were higher across a handful of industries, including oil and gas. Within that segment, the majority of formations related to two accounts on which we do not expect to take provisions. Formations in the other industries were related to company-specific events, reflecting normal variability in our corporate/commercial portfolio and with no underlying sectoral trends.

Consumer formations increased, largely in Canadian residential mortgages as a result of the implementation of a new collections platform in the quarter. Looking out over the next few quarters, we expect loss rates will continue to be low in this segment.

The ratio of gross impaired loans to total loans was 53 basis points this quarter, which, while increased slightly from last quarter, is 3 basis points lower compared to the prior year.

The second quarter continued the recent trend of strong wholesale loan growth. Similar to prior quarters, the growth remains broad-based across industries, is from both existing and new clients, and is of a credit quality that is consistent with the broader portfolio.

In summary, our PCL results this quarter, adjusting for the large commercial recovery, were in line with our experience over the past few years and our expectations. Our guidance for PCL over the longer term has not changed.

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

QUESTIONS AND ANSWERS

Ebrahim Poonawala – BofA Merrill Lynch, Research Division – Director

To start out, could you touch on commercial loan growth both in Canada and the U.S.? Very strong both year-over-year and quarter-over-quarter, I know you mentioned it was broad-based, but would appreciate if you can talk about some of the drivers of this growth coming from particular industries and the pricing environment for the business. And also what the sensitivity would be, if macro deteriorates, like, do you still expect this double-digit growth to continue in the back half, that degree of confidence?

Cam Fowler – Bank of Montreal – President of North American Personal & Business Banking

Thanks for the question. It’s Cam Fowler speaking. I will start with the Canadian commercial loan growth and then I will pass to Dave Casper to talk about the U.S. The first thing I’d say, it is strong growth, it’s not a surprise to us. I have mentioned on the last several calls and indeed at our Investor Day that we have been investing in both capacity in the commercial business as well as diversification. And you can see in our NIX line, our revenue line and our balance line, the investment we have made in the commercial business, which is 150 new relationship managers. The growth is of very high quality. I guess, what I would say, we are particularly pleased with the diversification. I think no fewer than 7 or 8 sectors that are growing in the double-digit range. It is particularly well distributed across the country and all regions are also participating at that level. There is no particular sector that I would point to that is outsized or growing beyond the average of the book. So I would start with that quality point. You had a question about the outlook: our quarter-on-quarter number is relatively strong. I wouldn't expect that 5% quarter-on-quarter number to maintain necessarily, so some degree of moderation, perhaps. But for now, from a capacity and diversification perspective, we feel very confident in the book. Dave?

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

It's Dave. Just picking up on where Cam left off, we had a real strong quarter and it has consistently been very strong over the last 5 or 6 years as we try to grow out our commercial business in U.S. Two points: number one, it is growing both geographically to a broader base; secondly, it is growing across all of our specialized sectors. The other thing I would point out is, and really to Cam's point, too – this was an exceptionally good quarter. We have forecasted and said in the past that we would expect two things: our growth would be outside and better than our competitors, our peer competitors; and secondly, it would probably be in the high – 9%-10% is really what we had said. So this was better than we expected. Same comment on quality. And maybe Pat wants to add something.

Pat Cronin – Bank of Montreal – CRO

Yes. Thanks, Dave. And then from a risk perspective, we would look at the growth rate obviously as being high. But we see it really much more as a function of the supply of good risk-adjusted opportunities. If you compare the 22% growth you would have seen year-over-year in wholesale with the similar period in the year before, that growth rate was more like 2%. So it really ebbs and flows based on whether we see good opportunities from a risk-reward perspective. I would agree with both Cam and Dave, we see it as being very well diversified by sector, by geography. It is about a 50/50 split between new and existing clients, so what you would hope to see. Our credit quality is definitely strong. We look at both the overall probability of default of the existing portfolio, which has actually been getting better over time, as well as the weighted-average probabilities of default of the growth that we are seeing over the period. And that we see as actually being better than the credit quality of the overall book. So the quality from a credit perspective is actually quite strong. I can tell you our risk appetite has not changed, nor have our lending standards and practices; our processes are exactly the same as they have been and have served us well for many years. Not surprisingly, being a strong commercial bank, we think we have really strong expertise in risk management, both in the first and second line. As long as the opportunities for good risk-adjusted returns are there, we remain comfortable with the growth rates.

Ebrahim Poonawala – BofA Merrill Lynch, Research Division – Director

That's helpful. And just separately, a quick question for Tom on capital: just looking at the risk-weighted asset inflation this quarter, can you talk about just expectations around organic capital generation going forward? My sense is, as more growth comes from commercial, the U.S., it is going to inflate RWA. So any colour on that would be helpful.

Tom Flynn – Bank of Montreal – CFO

Thanks for the question. As the group has talked about, we feel very good about the growth that we have in our commercial businesses and our corporate businesses. We think deploying capital in those areas is the best place where we can deploy capital. With the strong growth, the ratio was down a little bit in the quarter. Looking forward, we do expect growth to remain good in the U.S., in particular above market, as Dave said. But 15% commercial, both in Canada and the U.S. is a high number. We think that will move down a little bit over time, although remaining strong. And with that, that will help with producing some accretion to the capital ratio. So our normal guidance is to expect the ratio to be up 10 to 15 basis points a quarter. Over the next quarter or two, we are likely in the lower end of that range with the ability because there is a little bit of randomness to the calculation for the number to move around. And then as we move into next year, we expect to be back to the normal guidance of 10 to 15 basis points.

Ebrahim Poonawala – BofA Merrill Lynch, Research Division – Director

And remind us, Tom, should we expect capital ratios to build, are you okay with seeing the CET1 drift higher, or what is the level of that, which you want to operate the bank and maybe could see it over the next year or two?

Tom Flynn – Bank of Montreal – CFO

So I would say we are very comfortable with the ratio itself. The ratio is strong. We've got lots of capital and we feel good about that. And then in terms of where we will operate, it is likely in the range of, give or take, 11% to 11.5%. And so the ratio could drift up a little bit. But as it did that, as you've seen us in the past, we would expect to be active with the buyback. Last year, the ratio was strong and we bought back 10 million shares. And so if the ratio moved up towards 11.5% range, we would expect to be active there.

Meny Grauman – Cormark Securities Inc., Research Division – MD & Head of Institutional Equity Research

Question on the restructuring charge: wondering why wasn't it an item of note? Or maybe to put it in a different way, in the past, you have taken these restructuring charges and excluded them from adjusted results. I'm wondering if there is a change in philosophy in the way you view the treatment of restructuring costs; or is there something unique in this particular charge?

Tom Flynn – Bank of Montreal – CFO

Yes, it's Tom, Meny. Thanks for the question. I would say, to use your words, there was something different or unique in this charge. The severance expense this quarter was in Capital Markets, it reflected an adjustment made by the management of that business. And so we booked the expense in Capital Markets and didn't adjust for it because it was more normal course. In contrast, we have, from time to time, booked enterprise-wide restructuring-related charges in our corporate segment, and we have adjusted. And that would continue to be our practice going forward, if we had a charge like that. The distinction really is between something that is closer to ordinary business versus a bank-wide initiative, which will result in us taking the charge in the corporate segment.

Meny Grauman – Cormark Securities Inc., Research Division – MD & Head of Institutional Equity Research

And just as a follow-up, in terms of the details of that charge, what is specifically about the timing or the nature of the charge that drove the charge? Was this related to some sort of specific issue that you are seeing in Capital Markets?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

It's Dan here. No specific issue and I would emphasize no change in strategy, and through the process we did not close any particular businesses. We generally like where we are and believe we are well positioned for where we want to go. The primary rationale was that we wanted to align our resources with the current market environment. As you know, we have made a strong commitment to deliver on the operating leverage, and this is part of that program for us to deliver on that. I think you will note and you have heard it from Tom's comments earlier, we expect us to contribute to the bottom line immediately, with an expectation of $40 million in savings this year and a run rate of $80 million next year. And so that was the piece behind.

Stephen Theriault – Eight Capital, Research Division – Principal & Co-Head of Research

A couple of things from me. If I could start with a follow-up though. Tom, the direct from higher source currency RWA, can you talk through it a bit there? It was quite high. I am struggling a bit – like loan growth in Q2 didn't look much different than loan growth in Q1. In commercial, loan growth was maybe a little bit stronger in Q2, but why such a much larger drag? Is it mix in terms of the CET1 drag this quarter?

Tom Flynn – Bank of Montreal – CFO

Yes, so a couple of things. Firstly, loan growth was a little bit stronger, but it was strong as well in Q1. I think the biggest difference is that in Q1, we had the benefit of some offsets in a combination of methodology and quality. And so those changes helped mute the total RWA increase. And this quarter, on the risk-weighted assets, it is actually a pretty clean quarter. The growth that you are seeing reflects the underlying growth in the portfolio. There is some FX, but that doesn't impact the ratio because we hedge that. So the big difference is, last quarter, we had a couple of things that helped us, and the growth is higher.

Stephen Theriault – Eight Capital, Research Division – Principal & Co-Head of Research

Okay. That makes sense. And then on expenses, if we exclude the severance charge for this quarter, it is still below 2% operating leverage and you are below for the full year. So, a couple of things, I guess. Is 2% still a reasonable bogey for 2019? And, does the lower than 2% run rate, have you given any more consideration to a larger broader restructuring charge, like we have seen in the past, at more of an enterprise level?

Tom Flynn – Bank of Montreal – CFO

Okay. Thanks for the questions. So if you exclude the severance in the quarter, the operating leverage was about 1.2%. For the first half, it would be about 1.3%. I'll just make a couple of comments about the expense growth itself. So over the first quarter, the expense growth – sorry, the first half, the expense growth has been a little above 7%. That includes about 1.2% to 1.3% of growth coming from each of FX and KGS, and the severance expense added to the growth. And so adjusting for those things, the growth is lower, and we expect growth in the second half to be about half of the first half growth, which was 7.3%, all-in. And then, if you look at our underlying growth in the business, it is actually quite low. So in the numbers, we've got the currency, the acquisition and the severance – if you take those out, in the first half, expense growth is 2.6%. We expect to be below 2% in the second half. So we are focused on containing expense growth and that will help with positive operating leverage. For the year, on an adjusted basis, including the impact of the severance, the 2% will be tougher to hit. We are expecting to be above 1%. And we do think the economics of the Capital Markets severance expense are attractive. In our decision-making we pursue economics over headline numbers. The number for the year will be lower than 2% likely, but the economics are good. If you were to adjust for the severance, we are very much focused on being above 2%. And so we're so focused on that and that's the expectation. And looking forward, the number we are focused on more than any other is the efficiency ratio of 58% in 2021. That basically assumes that we are hitting 2% leverage over the next 3 years. The severance expense won't recur, so it doesn't impact the efficiency ratio number looking forward. And, I'd say, we think we are on track for that.

Gabriel Dechaine – National Bank Financial, Inc., Research Division – Analyst

First question is on credit. And at first glance, it looks like the provision number in the U.S., particularly, is too low relative to the level of formations you had this quarter. But if I peel it back a bit, I reverse that credit recovery, and I don't look at the – I exclude the oil and gas formations where you say you are not going to get a loss – I get through about 30%, I guess, loss rate on the remaining loans. Is that kind of how you look at it, possibly? And, underlying that question as well, given that formations were still high in the U.S., are you seeing any fallout from trade issues in the U.S. trade wars? Because we did see some Ag and Wholesale trade formations.

Pat Cronin – Bank of Montreal – CRO

Yes, well, I will talk specifically to formations. They are definitely up quarter-over-quarter. And as you can imagine, formations will vary a fair bit quarter-over-quarter, especially in Wholesale where you have some lumpy things that come in and out. I think you need to look primarily at the formation rate. Particularly, as the overall Wholesale portfolio is growing, you are going to see the formation numbers start to drift higher just in an absolute sense, but the rate is really what's the most important thing. We see that formation rate being about 18 basis points this quarter. Compare that to Q2 of last year, it was roughly around 16, the four-year average is just around 15, the range is kind of 11 to 22. So the formation rate this quarter is pretty much consistent with that historical range. If I dig underneath it, looking for sectoral trends, there is a little bit of Ag in there, you are right, particularly in the U.S. – as you know we are a dairy lender in Wisconsin and that segment is a bit troubled – there is a little bit of an oil and gas theme in there, but nothing that I would point to as anything that would cause us to expect higher levels of PCL going forward.

Gabriel Dechaine – National Bank Financial, Inc., Research Division – Analyst

Okay. That's a very thorough response. Then my next question is on trading, it seems like over the past few quarters, something magical happens at quarter end and then you have a big spike in trading revenues, and this quarter was particularly strong. Can you help me understand the influence of how your trading book is structured, and maybe some of those fair-value adjustments that took place?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

Sure, it's Dan here. So the revenues this quarter were impacted by the change in the funding rates that affected our structured notes program, which resulted in a gain. That was offset by some valuation adjustments for certain client trades that we had. As we think about those valuation adjustments, it is kind of normal course. Looking at that last trading day of the quarter, it was a very strong trading day to begin with. And so the two measures that I just talked about, the gain and the offset, really are about 75% of that bar that you see.

Gabriel Dechaine – National Bank Financial, Inc., Research Division – Analyst

Okay. And just the last to sneak it in. Do you have any – and, Tom, perhaps you can answer it. The flat yield curve: is that creating any headwinds in your corporate segment, in the liquidity portfolio?

Tom Flynn – Bank of Montreal – CFO

It's really not. Most of the liquidity portfolio we swap back, and so the flattening of the yield curve hasn't had much of an impact to our book, given how we manage it.

Scott Chan – Canaccord Genuity Limited, Research Division – Director of Research of Financials & Financial Services Analyst

Just on the U.S. side, what is your outlook on third-party originations? I only ask that because Greensky has been pretty topical lately with Regions Financial kind of backing out on their commitment because of lower risk-adjusted returns. So I was just wondering how do you see that channel going forward?

Dave Casper – President & CEO, BMO Harris Bank N.A. and Group Head, Commercial Banking

That's not a huge channel for us, and the Greensky specifically is a relatively new partner for us. We are not impacted at all by what you have discussed, it is still small, and we expect it to grow, but it's not going to be a significant part of our business.

Scott Chan – Canaccord Genuity Limited, Research Division – Director of Research of Financials & Financial Services Analyst

Okay. And just on Capital Markets, with all the restructurings, going forward, do you intend to kind of add to any capabilities in Canada or the U.S. over the next year or so?

Dan Barclay – Bank of Montreal – Group Head, BMO Capital Markets

We are always looking at our business overall, in terms of how we like it. As I said earlier, we are feeling very comfortable where we are positioned and don't anticipate anything material. But always, as market conditions evolve, we will add and subtract the necessary investments to look after those market opportunities.

Sumit Malhotra – Scotiabank Global Banking and Markets, Research Division – MD of Canadian Financial Services

First, for Dave, on net interest margin and yield outlook in your business: you had suggested that NIM would step back from Q1 and we saw that maybe a bit larger than I was thinking. Just kind of put this in context, and not necessarily thinking about next quarter, but with Fed rate hikes seemingly off the table and at least some conversation about cuts, just kind of curious as to whether continued compression should now be the outlook for this business going forward; or is the offset coming in pricing on the commercial side; are you seeing any stabilization in loan pricing in the market as a result of maybe baking in some credit risk protection; or is compression, as a result of competition, also a factor we need to bake in here?

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

So there's a couple of questions in there, but I think it was mostly around what you should expect going forward. I'll be happy to unpack what happened in the past few months. Going forward, I would expect much more stabilization. Quarter-to-quarter as you pointed out, there's a lot of things that can happen that move it around. But longer term, I would expect it to be more stable. There could be some drifting downward, more really tied to some pressure on deposits as we continue to grow our loan book. But, long term – more stable, maybe a little bit down on the deposit side. Does that help?

Sumit Malhotra – Scotiabank Global Banking and Markets, Research Division – MD of Canadian Financial Services

What about loan pricing specifically? Is that where you are seeing stabilization, or is the competition for loan growth still putting downward pressure on spreads?

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

So I think it'll always be a factor. Pricing will always be a factor and we compete on everything, but we don't very often win on price. So I don't expect that to be a big factor for us. To the extent that, over time, we actually have – we are booking higher credit quality – there is a natural compression in spreads there with higher credit quality – but, overall, I don't see that competition being very significant for us. I mean it's a factor, but, as I say, we rarely win on price. We compete on everything, but we rarely win on price.

Sumit Malhotra – Scotiabank Global Banking and Markets, Research Division – MD of Canadian Financial Services

And then I'm going to wrap it up with Pat. I think there've been some questions, Pat, on kind of the interplay, if you will, between the very large corporate and commercial loan growth the bank is generating and provision rates or charge off rates that are at the lower end of the sector. And looking at some of your slides over time, the credit performance of BMO has consistently been at the low end of the group, and I think your business mix has spoken to that. Is there anything from an early warning indication? I mean, the market seems to be quite concerned about late cycle. I am not really hearing that tone from the bank. What are the factors that have given you confidence? Is it – relatively new in your role – that commercial growth of 15%, corporate loan growth almost double that, is it still an appropriate risk management approach for BMO in what seems to be a later stage for the cycle?

Pat Cronin – Bank of Montreal – CRO

Yes. Thanks for the question. And, obviously, we read the same things that you do about late cycle. I can put it into really a couple of categories. First, when we look at the current portfolio, notwithstanding the growth, I will go back to my earlier comments, we see a very consistent to actually improving credit quality, both in the overall book and with respect to new additions. We see very good diversification and very strong lending practices. And when I look through formations in GIL, and even watch list, we're just frankly not seeing signs of stress other than small minor pockets and sectors. So that's the first comment I'll make. As we look forward though, first, I look at the views of our own economics group, as we look out through F'19 and F'20, we see a pretty stable environment, frankly. We see, while there is some moderation in GDP growth, but still at relatively stable levels. We see strong unemployment levels, housing prices are fairly stable and, most importantly, fairly stable interest rates. And so I wouldn't call that a super strong economy, like maybe we saw in 2018, but certainly an economy that, in our view, from a risk perspective can sustain continued growth. And then lastly, I don't frankly think about a target growth rate, as I said earlier, that growth rate is really going to ebb and flow based on the supply of attractive opportunities. And we went through a period of growth through 2014-2017 that was pretty much the same as what you would have seen this year. But in between there, we would have seen very low growth rates. And so we are not targeting a specific growth rate, we are targeting attractive opportunities from a credit perspective. From our risk view, what we have seen so far is very consistent with the credit quality that we want. We will obviously monitor things very closely, and we do a lot of things with respect to stress testing for recessions. And so as we look at what the magnitude of those losses can be, both in severe or even very severe scenarios, we don't see an outcome even with a larger wholesale book that would cause us concern relative to the earnings power of the bank.

Mario Mendonca – TD Securities Equity Research – MD & Research Analyst

Could we just go to the recoveries we have seen in the last few quarters? Recoveries are certainly not unique to BMO, we have seen them across the industry, but they have been especially relevant to BMO. What would you say about those two recoveries, the one last quarter and this quarter? They clearly are not related to the same company or industry, but when you look at these sorts of recoveries, and again, not unique to BMO, what is driving this, is there anything macro that might be driving this, or are these idiosyncratic in some respect?

Pat Cronin – Bank of Montreal – CRO

Yes, thanks for the question, it's Pat. I would say it is not macro. I would say it's really more a function of the fact that we are really tenacious about chasing recoveries. The last couple of quarters, these ones would have been ones from years ago that we just simply don't give up on. On top of that, I would say we have a really strong workout team. And so for us, that provision is just the beginning of the story; the workout team spends years going through these files, mostly focused on getting those clients back into performing status and back into the businesses. In situations where we go through a workout, I just think we are really good at recoveries. This one, in particular, relates to a legacy M&I position and a fairly complicated bankruptcy and resolution process that we worked our way through for many years, and we ultimately got paid out. And so I don't think of recoveries as uncommon. I don't think of them as idiosyncratic. I think of them as a normal part of taking PCLs and you get recoveries. And if you are good at working through the PCL process, you are more likely than not to get them.

Mario Mendonca – TD Securities Equity Research – MD & Research Analyst

And this is in financial, that is a broad category. Can you offer anything else on that? The recovery that is.

Pat Cronin – Bank of Montreal – CRO

The specific one?

Mario Mendonca – TD Securities Equity Research – MD & Research Analyst

Yes. You said it was financial, $40 million in recoveries?

Pat Cronin – Bank of Montreal – CRO

Yes, sure. This relates to, as I said, a legacy M&I account that was fully written off when we had purchased M&I. But like I say, even though it was written off, we still worked through a recovery process. It was a financial institution, and so a FDIC resolution process takes a lot longer than others, but we worked our way through it. We did get paid out this quarter and we booked that this quarter against PCLs in accordance with our policy.

Mario Mendonca – TD Securities Equity Research – MD & Research Analyst

Okay, and then on the oil and gas, $126 million impairment this quarter, but you don't expect any PCLs. What specifically about this exposure leads you to believe there would be no PCLs?

Pat Cronin – Bank of Montreal – CRO

Well, that's a bunch of things that can potentially be at work there, but not the least of which would be asset coverage. And so as you know, a lot of the exposure in that sector would be reserve-based lending. And so while they may go impaired, that then triggers a process of either asset sales or a workout. And so when we look at the asset coverage relative to our loan, we feel comfortable. Obviously, that may change as we go along, but at this stage, when we look at what is in that impaired portfolio, we feel relatively comfortable that the PCL experience will be moderate.

Darko Mihelic – RBC Dominion Securities, Research Division – Financials Analyst

I hope you'll indulge me with a couple of questions here. The first one – just going back to Pat, can you just provide a little bit of colour, you mentioned in your remarks that you have implemented a new collections system, and I was just curious – why now? Was there something changed and does this collection system only handle mortgages or does it go across other consumer portfolios?

Pat Cronin – Bank of Montreal – CRO

Thank you for the question. There is nothing particularly magical about the timing; we look to improve our systems all the time. This was a legacy system that was just due for an upgrade and included some significantly improved functionality that we think would be really beneficial to the collections process going forward. As often can happen with implementations of that size, there were a couple of hiccups that caused us to fall behind on collections. But those have been now corrected and resulted in some temporary increases to delinquencies through the delinquency spectrum and also maybe a little bit of higher loss rates. We have applied a lot of additional resources to chase after those delinquencies. But, ultimately, we think it will be beneficial, but it’s just caused a little bit of short-term increase in the delinquency numbers.

Darko Mihelic – RBC Dominion Securities, Research Division – Financials Analyst

And it is just mortgage-specific?

Pat Cronin – Bank of Montreal – CRO

I’m sorry, so, it covers cards and mortgages and personal loans.

Darko Mihelic – RBC Dominion Securities, Research Division – Financials Analyst

Okay. And a second question. Darryl, in your opening remarks, you touched upon your Investor Day but we don’t really have much. I mean, it hasn't been that long, but I would be very curious to understand where you are with respect to your target of $1 billion in savings by 2021. And, if we think about the expense issue, you sort of offered up at one point during your Investor Day, how much it takes to run the bank and how much you are investing in technology. Has that changed significantly since the Investor Day at all?

Darryl White – Bank of Montreal – CEO

Darko, thanks for the question. It hasn't changed significantly. In fact, I would say it hasn't changed at all. So when I look at where we are on our targets that we laid out for you then, as I tried to explain in the opening remarks, we feel like we are very much on target. We are delivering on those savings as we go through. We, in fact, think we will bring in more savings than we thought at the time, and some categories ahead of our targets. The severance cost that you saw on the Capital Markets pillar this particular quarter wasn't on the table when we made that commitment, so that would be net new in terms of those – the savings that Dan outlined. There is another $40 million in here and another $80 million thereafter that we could add to the tally. On the theme of investing in the businesses at the same time, there is also no change there. Darko, we’ve said a few times that as we continue to target 2% operating leverage, and you heard Tom express his confidence on that in the question earlier on the call, we continue to invest in technology. We have, over the last couple of years, had an increase in our technology spend by over 10%, and this year that continues. And despite that, our net cost increases, Tom summarized them for you earlier, once you back out severance and currency and acquisition, are in the mid-2% and going down in the second half of the year. So, net-net, we feel really good about the mix in terms of what we are delivering on operating leverage and what we are delivering on investment and there is no change relative to what we said back in the fall.

Darko Mihelic – RBC Dominion Securities, Research Division – Financials Analyst

Okay. And forgive me for the next – for sneaking in one more question, and it's going to be very frank. The discussions I have had with a lot of investors since your last quarterly update, the number one concern that I have been getting with your company is that there is a concern out there that perhaps you would be willing to make a large acquisition in the U.S. and significantly dilute down shareholders. So the question isn't really the usual capital deployment question, I'm not really interested in that. What I'm interested in – is there anything that has changed in what you look for with respect to an acquisition? Has there been anything that has changed in the landscape in the U.S. that might heighten your appetite for it? And, I’m just curious as to why that comes as a large pushback on your stock in the last quarter and, perhaps, it is just related to your relative valuation, perhaps that’s just it, but I am just wondering if there is anything there that you can talk to. And again, I'm not interested so much in your capital deployment preferences and so on. I'm really just specifically interested in your view on acquisitions and whether or not the appetite's really significantly changed?

Darryl White – Bank of Montreal – CEO

Thanks for the question, Darko. And I think you phrased the question well, has anything changed? The answer to that is flatly no. We have always considered acquisitions. We have taken you through our criteria before. We are disciplined about how we think about it. And at the same time, I don't know how much more deliberate we can be in saying organic growth comes first. We have said it time and time again, and it’s, I think when we look back, we are proving it. When I think about the place people usually go with us is questioning us on appetite for U.S. acquisitions, as you just did, then you look at the fact that we are run rating over $2 billion of annual earnings from our U.S. operations today. We do not have a scale problem in the United States, and we are able to invest with the benefit of the balance sheet that has over $800 billion of assets globally. Our growth rate in our U.S. businesses year-to-date: net income is 29%, almost entirely organic. So when I've said time and time again to this question in investor meetings and with you guys on the call, that we don't feel any compulsion, it is because what we are doing is working. And so I don't know what else to tell you other than, yes, we always look. Yes, we are disciplined. No, nothing has changed. And organic first, and our strategy is working.

Nigel D'Souza – Veritas Investment Research Corporation – Investment Analyst

I know you have spoken to this at a high level for your commercial book as a whole, but I wanted to drill down a bit more and touch on oil and gas again. And I bring this up only because the formation that you are seeing in U.S. oil and gas commercial loans is unique to BMO. So I'm wondering if you could provide – for the first part, I am wondering if you could provide more colour on what is driving that, given fairly robust rally in the commodity price, WTI was near $70 at the end of April. And the second part of the question has more to do with the Canadian side. There’s some discussion now that the spread between WCS and WTI pricing could widen if Alberta relaxes production curtailments. So can you just provide an outlook or a sense of the domestic oil and gas exposure that you have in Canada? And what your outlook is for that book?

Pat Cronin – Bank of Montreal – CRO

Sure, it’s Pat. So thanks for the question. First, let’s put it in context. Our oil and gas portfolio, in its entirety, is 5% of Wholesale loans, so it is relatively modest. And included in there would be – about 51% of that exposure would now sit in the U.S., so, relevant to your WCS versus WTI question, the exposure is relatively modest. In there, it also includes about 40% of the oil and gas portfolio that is in pipelines and manufacturers and refiners that aren't exposed to some of those same things that you referred to. Now, with that said, obviously, we are seeing the same things, formations and GIL are up slightly quarter-over-quarter in the oil and gas sector. As I said earlier, there are some lumpy things that come in there from time to time. I would say there’s probably two or three accounts in there that are driving the majority of what you are seeing quarter-over-quarter. At the moment, we don't see anything thematic in there, those things come in from time to time. As I said before, we'll work through those and based on asset coverage and our view of a sale process, we think we actually will experience, what I would call, moderate PCLs. I'm not going to say none, but nothing that I would say would be a cause for concern for us. And with that said, we are obviously going to watch it really closely. We pay a lot of attention to this sector, we are really good at it. We’ve got years and years of experience in the oil and gas sector, including through some really tough times. And so if you do see a trend of weakness in this sector, we think we are well positioned both from a size perspective, a diversification perspective and an expertise perspective to manage through it.

Nigel D'Souza – Veritas Investment Research Corporation – Investment Analyst

Got it. So I just wanted to quickly just summarize: more idiosyncratic right now and not sectoral. And I’m reading that your expectation is for a stability in commodity pricing. Is that fair in terms of your outlook and the colour that you’ve given?

Pat Cronin – Bank of Montreal – CRO

Yes. I will give you just simply our Economics outlook, which is, that for stable oil and gas prices. If you look at the U.S. Energy Information association, they would have the same kind of an outlook for stable prices – that is relatively speaking our view. And I would agree with your comment that, at this point, it seems more idiosyncratic to us but, like I said, we’ll watch it carefully and if it turns out to be something more than idiosyncratic, we think we are well positioned to weather it and manage it.

Darryl White – Bank of Montreal – CEO

Alright, thank you, operator.

As I summarized earlier, we feel good about our performance in [Q2], having earned through a severance cost with strong operating performance across our businesses. In fact, our performance for the first full half of the year was strong and we are confident in the opportunities to continue delivering good results for the second half, which we expect to be similar to the first. That confidence reflects the progress we are making in executing our strategies, investing in the target areas of strength for sustainable growth and the benefits of our highly diversified but tightly linked mix. In all of our businesses, we are adding customers, expanding relationships, deepening loyalty, which we see in improving Net Promoter Scores.

We are continuously enhancing our technology and digital capabilities. We are collaborating to deliver the best of BMO to our customers, holistically and seamlessly. Canadian Banking, which we didn't talk about a lot on the call, is delivering stable earnings growth, strong loan growth and deposit growth, and strong returns and here, we see widening operating leverage in the back half of the year. The same is true for U.S. P&C, where consistently strong commercial performance is complemented by real momentum in retail and in deposit growth. And we are expecting improving earnings in Wealth and Capital Markets through the end of the year.

And, before closing, I'd like to express my deep concern for our customers and employees in communities affected by severe spring flooding in many of our markets in Canada and the United States, and threatened by wildfires in northern Alberta. Supporting our customers through these extremely difficult times is a priority, and we have provided support indirectly through the Red Cross and are offering financial relief programs directly for our impacted customers.

So thank you all for joining us on the call today and we look forward to speaking with you again in August.