Q1 2021 Conference Call

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PRESENTATION

Operator

Good morning, and welcome to the BMO Financial Group's Q1 2021 Earnings Release and Conference Call for February 23, 2021. Your host for today is Mrs. Christine Viau, Head of Investor Relations. Mrs. Viau, please go ahead.

Christine Viau - *Bank of Montreal - Head of Investor Relations*

Thank you. Good morning, and welcome to BMO's first quarter 2021 investor presentation. Our agenda today is as follows: We will begin the call with remarks from Darryl White, BMO's CEO; followed by presentations from Tayfun Tuzun, the bank's Chief Financial Officer; and Pat Cronin, our Chief Risk Officer. We also have with us today, Ernie Johannson from Canadian P&C; Dave Casper from U.S. P&C; Dan Barclay from BMO Capital Markets; and Joanna Rotenberg from BMO Wealth Management.

After their presentations, we will have a question-and-answer period, where we will take questions from prequalified analysts. (Operator Instructions)

On behalf of those speaking today, I note that forward-looking statements may be made during this call. Actual results could differ materially from forecast, 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 an adjusted basis and considers both to be useful in assessing underlying business performance.

Darryl and Tayfun will be referring to adjusted results in their remarks unless otherwise noted 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 2020 annual report and our first quarter 2021 report to shareholders.

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

Darryl White - *Bank of Montreal - CEO*

Thank you, Christine, and good morning, everyone. On our last call in December, I expressed my confidence in the resilience of the economy and our customers to recover from the challenges brought on by the pandemic and in the underlying strength and positioning of our bank to deliver consistent top-tier performance against that backdrop. Our results today this quarter clearly demonstrate our potential.

The key drivers of our very strong performance reflect the execution of our purpose-driven strategy, which are consistent over time: number one, an advantaged business mix, diversified across businesses and geographies positioned for resilience and growth; number two, operating momentum in each business through a focus on customer loyalty and consistent investment in digital capabilities, product innovation and frontline teams delivering leading financial advice; number three, targeted actions to improve efficiency and returns and drive long-term profitability, including simplifying and digitizing processes; number four, differentiated risk management and capital allocation, driving consistent credit outperformance and flexibility for capital deployment; and number five, a steadfast commitment to support the financial well-being of our customers and communities today throughout the economic recovery period and beyond.

Within this framework, we announced today very strong first quarter operating results, with adjusted net income of $2 billion, up 26% over last year and earnings per share of $3.06. We delivered operating leverage of 7.1%, with solid revenue growth of 6% compared to prior year and the prior quarter and a 1% reduction in expenses, and strong pre-provision pre-tax earnings growth of 16% from last year. We continue to execute on targeted efficiency initiatives while strategically investing in key areas for future growth. This quarter's efficiency ratio of 56.3% is an indication of our progress, a significant improvement of 400 basis points from last year. We continue to target stable expenses for the full year.

Credit performance was also very strong, reflecting both the credit quality of our loan portfolio and our commitment to superior risk management over time, as we discussed at our investor event in the fall.

Our capital position continues to strengthen with a CET1 ratio of 12.4%, positioning us well for growth and the eventual relaxing of constraints on returning capital to shareholders. We achieved above target ROE of 15.8%, an increase of 230 basis points from last year.

Our U.S. segment is a key driver of diversified earnings growth now and in the future, contributing over 40% of total bank earnings this quarter. Net income doubled from last year and pre-provision pre-tax earnings were up 48% with an efficiency ratio in this segment of 53.5%.

The United States is making good progress in vaccine distribution with over 17% of the population receiving at least 1 dose as of mid-February. As the rollout continues, and restrictions ease, this, along with further fiscal stimulus and substantial household savings, has led to higher economic growth expectations of 6% for 2021 and 4% for 2022, with both business investment and consumer spending poised to rebound quickly. Our top-tier commercial lending market position, leading deposit share in our core footprint, a growing strategically focused Capital Markets presence and integrated approach to serving the North American market positions us remarkably well for that recovery.

In Canada, while the recovery is projected to accelerate a little later this year, GDP is still expected to grow 5% in 2021 and 4.5% in 2022. Our flagship Canadian P&C business continues to gain momentum in the current environment, with another solid quarter of 4% PPPT growth. Revenue continues to improve sequentially supported by good proprietary mortgage growth, where we're adding mortgage specialists and seeing strong renewal and refinancing rates. We've gained market share in key areas of focus, including retail and commercial deposits, cards and commercial loans. We remain focused on improving efficiency, including our continued branch digitization journey, which is streamlining processes and creating capacity for frontline employees through a better user and customer experience.

U.S. P&C delivered very strong PPPT growth of 24% with higher revenue and effectively managed expenses. While commercial lending growth remained modest this quarter, with overall loan utilizations still below pre-COVID levels, we're continuing to expand and add new clients. The strong credit quality of our portfolio reflects our risk discipline, competitive market position and, in particular, our deep commitment to our clients throughout the pandemic. For example, I want to recognize the tremendous efforts of our Transportation Finance teams who supported the trucking industry and our customers by facilitating hundreds of PPP loans and deferring payments for thousands of carriers through the toughest months of 2020 to keep commerce flowing and customers on the road. These actions position us to grow with our clients as the economic recovery builds.

In BMO Wealth Management, momentum continues to build with PPPT growth of 18%, driven by strong net income and Traditional Wealth up 35% from last year. Our performance reflects actions we're taking to accelerate growth and returns. Consistent with that strategy, we entered into an agreement to sell our private banking business in Hong Kong and Singapore, while investing in key areas of competitive strength. For example, this quarter, we launched new ETFs that offer exposure to transformative market trends, including first in Canada index products, providing access to 5 MSCI Innovation Indices as well as the S&P Global Clean Energy Index. This strategic approach to innovation has maintained our leadership position in ETF market flows for 10 years in a row.

We're also making ongoing enhancements to our online brokerage platforms that offer clients a full spectrum of digital investment options across BMO InvestorLine, adviceDirect and SmartFolio. And we're growing our teams to meet the unprecedented customer demand, which led to record transaction volumes this quarter.

In BMO Capital Markets, strong PPPT growth of 34% reflects actions we've taken over the past few years to further strengthen and reposition the business for sustained strong performance going forward. We've maintained our strength in the Canadian market, ranking #1 in Canadian equity underwriting for 2020. We've made targeted investments in our U.S. franchise, including the addition of KGS, which significantly added to our capabilities and we're deepening our expertise in high-growth sectors such as technology and health care.

In addition to our strong financial results, we continue to deepen our commitment to sustainability and our purpose. As an early signatory to the United Nations principles for responsible banking and a leader in sustainable finance, we're playing a critical role to support the transition to a net-zero carbon economy. In support of an inclusive society, we recently launched BMO EMpower, a 5-year US$5 billion pledge to advance an inclusive economic recovery and address key barriers faced by minority businesses, communities and families.

This quarter, we were named as the top North American bank on the list of Corporate Knights' 2021 Global 100 Most Sustainable Corporations in the World. And just this morning, BMO was recognized by the Ethisphere Institute for the fourth year in a row as one of the world's most ethical companies. Most importantly, we remain resolute in the support of our customers and communities in the face of ongoing challenges related to the pandemic, and we're focused on helping them recover stronger as the economy rebounds. This includes doing our part to support widespread vaccinations as the best way to save lives and reopen the economy.

In conclusion, I'm confident that we've never been better positioned for the future as we drive towards a strong North American economic recovery through 2021 and into 2022.

I'd now officially like to welcome Tayfun to his first quarterly earnings call at BMO. As you know, Tayfun recently joined us as CFO, and we're very happy to have him here. Tayfun, I'll turn it over to you to talk about the first quarter results.

Tayfun Tuzun - *Bank of Montreal - CFO*

Thank you, Darryl. Good morning and thank you for joining us today. I'll start my comments on Slide 10. During the quarter, we had very strong revenue growth despite the low-rate environment and muted loan demand, and we continue to prudently manage expenses. As a result, adjusted pre-provision pre-tax earnings were up 16% with positive operating leverage across each group.

Q1 reported EPS was $3.03 and net income was $2.02 billion. Adjusted EPS was $3.06, up 27% from last year, and adjusted net income was $2.04 billion, up 26%. Adjusting items are similar in character to past quarters and are shown on Slide 30.

Average loans were up 1% year-over-year and relatively flat on a linked-quarter basis. In Canadian P&C, average loans were up 3% and up 1% in U.S. P&C, including 2% growth in commercial loans. Average deposits were up 15% year-over-year and up 2% on a linked-quarter basis, reflecting the highly liquid corporate and consumer balance sheets.

Turning to revenue. First quarter net revenue was $6.4 billion, up 6% from last year and last quarter with good momentum across each of our businesses and particular strength in Capital Markets, benefiting from the enhanced capabilities that we offer our clients and our geographic diversification.

Total bank net interest margin decreased just 1 basis point sequentially and increased 4 basis points, excluding trading, primarily due to higher margins in the P&C businesses, partially offset by lower net interest income in corporate services.

Expenses were down 1% from last year due to our continued focus on expense management. Quarter-over-quarter expenses were up 2%, related to benefits expense in the first quarter of each year, including deferred compensation granted to employees who are eligible to retire and by higher performance-based compensation related to higher revenues.

Operating leverage was 7.1% overall and 4% or higher in each business group. Our efficiency ratio was 56.3%, an improvement of 400 basis points from last year and 240 basis points from last quarter. Expense management will continue to be a top priority for us, while we continue to invest for growth, especially in technology.

The total provision for credit losses was $156 million compared with $432 million last quarter. Our credit results were very strong, and Pat will speak to this in his remarks.

Moving to Slide 11 for capital. Our capital position strengthened again this quarter. The common equity Tier 1 ratio was 12.4%, up 50 basis points from 11.9% in the fourth quarter. As shown on this slide, the increase predominantly reflects the impact of internal capital generation and lower RWA. The decline in risk-weighted assets from the prior quarter was driven by positive asset quality and model changes. Based on our strong underlying organic capital generation capacity, we expect our regulatory capital ratios to continue to grow under the current constraints on capital management actions.

Moving to the operating groups and starting on Slide 12. Canadian P&C net income was $737 million, up 5% from last year, reflecting pre-provision pretax earnings growth of 4%. Revenue was up 1% from the prior year and up 3% from last quarter, showing momentum.Net interest margin increased 6 basis points from last quarter, reflecting higher loan margins and a favorable product mix. Average loans were up 3% from last year, with commercial loans up 1% and mortgages through proprietary channels and amortizing HELOCs, up 9%.

Deposit growth continued to be strong with personal deposits up 7% and 28% growth in commercial deposits, reflecting higher liquidity retained by customers in the current environment. Expenses were down 3% from last year, reflecting lower employee-related costs and other operating costs, partially offset by higher technology-related costs. Operating leverage was positive 4% and efficiency improved 190 basis points to 45.4%. The provision for credit losses was $147 million.

Moving to U.S. P&C on Slide 13, and my comments here will speak to the U.S. dollar performance. Net income of $459 million was up 67% from last year due to lower commercial credit provisions, higher revenue and lower expenses. Pre-provision pre-tax earnings growth was up 24%. Revenue was up 7% from last year and up 9% on a linked-quarter basis, reflecting growth in both net interest income and non-interest revenue. Net interest margin was up 17 basis points sequentially due to the higher loan margins and the impact of accelerated fee income on PPP loans of 6 basis points.

On the balance sheet, average commercial loans were up 2% year-over-year and quarter-over-quarter, while personal lending balances declined. Average deposit growth continued to be strong, up 24% due to growth in commercial deposits. Expenses were down 7%. Operating leverage was strong at 14% and efficiency improved to 47.9%. There was a net recovery of $25 million in the provision for credit losses. Overall, the results show the strength of our U.S. operations and its risk profile.

Moving to Slide 14. Wealth management had very good results with net income of $366 million, up 22% from last year. Revenue increased 5%, and expenses were down 1%. Traditional wealth net income of $294 million was up 35% from last year and 13% from last quarter, reflecting higher noninterest revenue due to stronger global markets, increased online brokerage revenue and higher net interest income. Insurance net income was $72 million, down from a year ago and up from last quarter. Assets under management and assets under administration increased 8% and 9%, respectively.

Turning to Slide 15. BMO Capital Markets had a record quarter with net income of $489 million, up 35% from last year, reflecting particularly strong performance in our trading businesses, and contribution from the U.S., including our investments in KGS. Total revenue was up 15% from last year and 14% from last quarter. Global markets revenue increased 25%, driven by strong client activity in interest rates, equities and commodities trading. Investment and corporate banking revenue was relatively unchanged. Expenses were up 3%, reflecting mostly higher performance-based costs. The provision for credit losses was $43 million.

Turning now to Slide 16 for Corporate Services. The net loss was $143 million compared to a net loss of $105 million last year.

In summary, our business line results display the strength of our diversified business model and the results of our intense focus on expense control, while we continue to invest for growth and efficiency. Looking ahead, we expect the economic environment to improve, especially during the second half of the year with broadening vaccine rollouts and continued global fiscal and monetary stimulus. We expect loan demand to slowly strengthen, along with the pickup in economic activity and contribute to average loan growth. We also expect our full year net interest income to be close to last year's level as our overall NIM should tighten by only a few basis points from here. Full year expenses should remain well managed and in line with last year, with quarterly positive operating leverage throughout the year.

To conclude, we had a very good start to the year and look to continue to enhance our performance with a strong focus on efficiency and smart investments to position our company's performance for further growth and profitability. Overall, we remain confident in our ability to manage through the current environment and deliver against our strategic priorities.

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

Pat Cronin - *Bank of Montreal - CRO*

Thank you, Tayfun, and good morning, everyone. Overall, we were pleased with our risk performance again this quarter, and we saw improvement in most of our key risk metrics from our strong fourth quarter results.

In credit performance, both impaired and performing loan loss provisions showed a second quarter of improvement, underscoring the cautious optimism we previously expressed in the credit outlook.

Starting on Slide 18. The total provision for credit losses was $156 million or 14 basis points, down from $432 million or 37 basis points last quarter. Given the current environment, our overall credit performance was strong this quarter, with impaired provisions of $215 million or 19 basis points, down from $339 million and 29 basis points in the fourth quarter.

We also recognized a release on performing loans of $59 million, which was the result of an improving economic environment and positive credit migration, largely offset by the impact of the uncertain environment on credit conditions, including a modest increase in our adverse scenario weight. With approximately $3 billion of performing loan allowances and moderating loan impairment and provisions, we continue to remain comfortable that our allowance provides adequate provisioning against loan losses in the coming year.

Turning to the impaired loan credit performance in the operating groups, where we saw positive trends in almost all of our business segments. In our consumer businesses, we continue to be encouraged by the resiliency of our retail customers. In Canadian P&C, consumer loan losses were $91 million, down slightly from the prior quarter with moderate delinquency rates in all products and better-than-expected performance from the accounts that have exited payment deferrals. Delinquency amongst those customers that were granted payment deferral remains low at under 2% of balances, with most of the deferrals now having expired.

In U.S. P&C, consumer losses were $13 million, up from the low levels of last quarter and like the Canadian consumer segment benefited from stronger-than-expected performance on the deferral population. In our commercial and corporate businesses, we have seen similarly encouraging credit performance, driven largely by our U.S. performance, where we posted a second quarter of low impaired provisions.

In U.S. commercial, we reported impaired loan provisions of $7 million, a decline from $46 million last quarter. The decline in provisions was driven by very low formations this quarter across all commercial sectors. This improved PCL loss experience included the transportation finance business, where tighter truck capacity and higher spot rates are leading to low delinquency rates, low levels of impairment and solid operating performance in this business.

Canadian commercial also had strong credit performance this quarter with $58 million of impaired loan losses down from $86 million in the prior quarter. Our Capital Markets business also saw improvement in its quarterly provisions, where this quarter's provision for impaired loan losses of $45 million was down significantly from the Q4 provision of $105 million. The decline was driven by low formations across all sectors and particularly in oil and gas, where the pricing environment continues to improve.

On Slide 20, impaired formations at $665 million were very similar to the low level we saw last quarter and consistent with formation levels we experienced pre-COVID. Gross impaired loans declined by $196 million to 74 basis points, down from 78 basis points last quarter. While we are seeing a modest increase in consumer formations and gross impaired loan balances, as expected, with the ending of payment deferral arrangements in that segment, this has been largely offset by a continued decline in commercial formations, particularly in oil and gas, where formations, again, were very low this quarter.

On Slide 22, we provide an overview of those sectors where we have seen material COVID impacts on credit quality, which have been concentrated largely in subsegments of services, retail trade and recreation. These segments have experienced higher levels of risk migration and impaired formations since the start of the pandemic and continue to face headwinds given the macro environment. However, it is important to note that notwithstanding the stress being seen in these sectors, our impaired loan losses across all these segments have been quite modest relative to the formations to date, reflecting strong origination practices and loan structures. We will continue to closely monitor these segments, particularly if there is a protracted time period for lockdowns or vaccine rollouts, which could put further stress on these sectors.

In terms of the outlook, we remain cautiously optimistic given the solid credit performance we've seen in the last 2 quarters, and we expect credit losses through fiscal 2021 to remain manageable. While uncertainty remains in terms of the future path of the pandemic, assuming progress continues to be made with vaccination in our key markets, and we continue to see a reduction in COVID cases, we would expect further releases from our performing provision in the coming quarters and expect our impaired loan loss rate to be in the range of 25 to 30 basis points over the next quarter or so, and then average roughly 30 basis points thereafter.

I will now turn the call back to the operator for the question-and-answer portion of this call.

QUESTIONS AND ANSWERS

Ebrahim Poonawala - *BofA Securities*

I had a two-part question. I guess, Darryl, you alluded to sort of growth outlooks in Canada and the U.S. There is some concern that the delayed vaccine rollout in Canada could delay the recovery over there. If you could talk to in terms of just, has the last 2 or 3 months changed your outlook in terms of how the Canadian business plays out over the next few quarters? And also, if you could comment on just the U.S. growth outlook around commercial lending, there's still a lot of liquidity in the market. Do you see a meaningful pickup in commercial loan growth in the next quarter or two?

Darryl White - *Bank of Montreal - CEO*

Okay. Thanks, Ebrahim. I'll take the first part of your question. And part of the -- second part of your question, I'll invite Dave in for it as well. Look, on the outlook for Canada relative to the U.S., you heard in my prepared remarks, optimism in both places. I think that's the place you have to start. We're looking at an increase in our view in the U.S., given the pace of the vaccine rollout as well as the higher probability of the stimulus package going through at this point. So there, naturally, we have a very positive view on the U.S. We're at 6% GDP growth for 2021.

In Canada, there is a slower pace of vaccine rollout, as you know, but we are equally positive in time. We just think there's a little bit of a lag, maybe it's 3 months, maybe it's 6 months before you get the same level of economic backdrop that you have in the U.S. A consequence of that is probably a little bit longer before the unemployment rate in Canada gets back to where it was pre-COVID relative to the pace the U.S. might get there. But look, when you put it all together, if I'm bifurcating through 2021, Ebrahim, that's one thing, and there might be a lag on pace, but in 2022, I would say to you, we're pretty equally confident in both economies and very positive based on everything we can see.

On commercial loan growth, in both places, look, the client confidence in all the conversations that I'm having, and our people are having, is increasing at a pretty rapid rate, and that effectively, at the end of the day, drives the demand for our commercial loan growth. And we're seeing that on both sides of the border. For the same reasons that I gave you the economic overview.

So Dave, I'll turn it to you to particularize loan growth because I think if I heard you right, Ebrahim, you were asking particularly about expectations for U.S. commercial.

Dave Casper - *Bank of Montreal CEO. BMO Harris Bank N.A. and Group Head, N.A. Commercial Banking*

Yes. Thanks, Darryl. And just a little bit more context around Canada and the U.S. Just because our business on the commercial side is North American and so many of our Canadian clients have a substantial amount of their business in the U.S., Darryl is right, it will lag, but they're seeing the same benefits in the U.S. economy that our U.S. clients are, to some extent, but on a bit of a lag basis. Our loan growth this quarter in the U.S. was better than I expected. I was optimistic last quarter. I'm more optimistic as we go into the rest of the year for the following reasons.

And let me go back first and say, here's some of the issues. This is not -- in the U.S., it's not really a demand issue, it's a supply issue. We have a lot of our sectors that cannot get the inventory they need. And despite that, it gets better and better every year, but this is -- again, it's not a demand issue. And so as supplies open up, as inventories open up, it will just get better and better. Across our sectors, I see growth. We're still probably in both Canada and the U.S., 5 to 7 points below what we would have been pre-COVID in terms of our utilization rate, that gets better every day as the inventory starts to open up. Our trucking business is particularly strong today. Our food business, which has always been a really strong part of BMO, continues to do well as our clients learn how to deliver more to grocery and less to restaurants, different packaging, that's a really strong business. And the M&A activity continues to build as does confidence in our leasing equipment finance business, which is important as the economy picks up. All that to say, it will grow. We expect the -- just as the economy will grow, our loan growth will grow throughout the year, both in Canada and the U.S.

Paul Holden - *CIBC Capital Market*

Continuing on the topic with business loan growth notice that most of the growth this quarter looks to have come from the financial services bucket. So just maybe if you can touch on that specifically and if there's sustainable growth in that financial services loans?

Dave Casper - *BMO Financial Corp. - CEO. BMO Harris Bank N.A. and Group Head, N.A. Commercial Banking*

It's Dave. And I think in the U.S., this is, I think, kind of the beauty of our diversified loan portfolio. As I mentioned, some of the businesses have done really well, and some have not done as well just because -- there isn't enough inventory. Our financial -- one section of our financial services that's done very well, it's a 25-year business for us is what I call our sponsored services business. So that's a business that provides treasury management, interest rate management, wealth management as well as short-term loans to fund bridge capital for capital calls. That business, just because so many of our clients started additional funds this year, as you would have seen in -- as you look around, that business has a kind of a onetime upbeat. So that was primarily most of the growth there. It's always sustainable at some level, but we did absolutely have a peak here. So it really kind of gave us a head start on what we think will be a pretty good year. That is the one part of it. These are -- just so you know, these are investment-grade loans very short term. They last 30 days to 90 days. Is that helpful?

Paul Holden - *CIBC Capital Markets*

That's helpful.

Gabriel Dechaine - *National Bank Financial, Inc.*

I'm going to ask a capital question. And Tayfun, you mentioned the restrictions on distributions. Obviously, that's weighing on your -- or not weighing, allowing you to build capital. And let's talk about M&A. I know it gets asked a lot, but just conceptually, Darryl, what would you be open to geographically? You've got your Midwest base. If there was something that expanded your footprint well beyond that region, would you be open to it?

Darryl White - *Bank of Montreal - CEO*

Yes. Sure, Gabe. Thanks for the question. You're quite right, the excess capital is accumulating. We don't know when those restrictions will come off. But before I get straight to your question, let me just say this, we've been really consistent on the view that the capital is first for the client. Why? Because we're demonstrating, if you look at this quarter, that when we put it to use for the client, it returns for the shareholders.

Secondly, if there are M&A opportunities, we look carefully at them. But look, I think the first thing I'd say is we don't swing at every pitch. And I can tell you, there are a lot of pitches coming across the plate right now, but we're very disciplined as we always have been. We consider the map, which is the question that you're asking. There are opportunities that would be close to home that are synergistic. There are also opportunities that could be more diversified. We do prefer North America to other places, not necessarily exclusively, but that's where our powerhouse is in terms of being a North American bank.

And with all that said, despite the fact that I could point you to lots of great success in terms of the delivery of results from acquisitions, look at M&I, Transportation Finance, KGS, Clearpool, you're seeing all of them come through in this particular quarter. We don't -- I've said this before, we don't feel compelled to expand by acquisition. Why? Because we're delivering pretty good results and growth by deploying the capital into our client businesses.

And remember that M&A isn't always plain vanilla M&A. We consider partnerships as we expand our capabilities. Look what we've done with Google Pay, with Blend, with LPL in U.S. wealth. And so we do scratch away at all of these opportunities as we go forward. So look, I'll just wrap where I've wrapped before on this question, Gabe, if the right opportunity came along that struck a chord in the key things we care about in terms of culture, strategy and financial fit, we're there to act, but we don't feel compelled to do it necessarily in the meantime.

Gabriel Dechaine - *National Bank Financial, Inc.*

Right. I guess, you talked about M&I, and that was one where you had lots of expense synergies, lots of credit marks. Credit marks don't seem to be a big thing these days. Would expense synergies take that much of a bigger priority? Or if you were expanding in a new – like contiguous state, I'm not suggesting out of the U.S. or anything like that. But contiguous states, where there's not as much overlap, operationally is the less synergy, would you still be open to something like that, if the fit was right?

Darryl White - *Bank of Montreal - CEO*

It depends on the circumstance. If the fit was right, when you're in market, you have more synergies. When you are out of market, you may have less synergies, but you have a better diversification and growth story. And in any event, it doesn't mean you have no synergies. So it all depends on the circumstance.

Lemar Persaud - *Cormark Securities Inc.*

Apologies if this has been discussed. I was just late joining the call here. Maybe could you unpack the 17 basis point increase in U.S. margins and maybe offer an outlook for the balance of the year? I think if I heard you correctly, it sounds like backing out the PPP, it's still up 11 basis points sequentially, which is very strong. And even when I look back at your supp pack, it's above pre-pandemic levels.

Dave Casper - *BMO Financial Corp. – CEO. BMO Harris Bank N.A. and Group Head, N.A. Commercial Banking*

So this is Dave, and Tayfun and I are here. If it's specifically to the U.S., yes, it was a good quarter. About 1/3 of that was the PPP, which Tayfun mentioned in the quarter. 1/3 of it was just really a very strong market positioning on our loans and our deposits. We have the ability to, over time, manage our NIM in a way that reflects the fact that we really have great relationships with our clients. Most of them we are lead or sole bank. And 1/3 of it, of the 17 is really of some onetime things. Fees that get amortized when a loan gets paid off, things like that. So I'll turn it to Tayfun as well for more of a general comment on NIM, but that's the U.S. specific.

Tayfun Tuzun - *Bank of Montreal - CFO*

Yes. Thanks, Dave. Yes, I mean, Dave gave you a pretty good picture, which also -- across the bank, there is a lot of focus on loan spreads. And that speaks both to the U.S. side of the business, lending business as well as the Canadian side of the lending business. And that shows up in our NIM progress. I mean, one early observation as incoming CFO, when you look at the last few quarters, there is a remarkable stability in our NIM. All-in NIM is within 1 basis point over the past 3 quarters or so. So kudos goes to the team. They've done a very good job hedging as well as managing both sides of the balance sheet. Last quarter, we gave up about 8 basis points in earning asset yields, but we clawed back 7 basis points on deposits. So there is an equal amount of focus to make sure that our NIM stays in a very stable manner in this highly liquid low-rate environment. And my comments about the rest of the year, takes its cues from what we have done and what we are doing to protect against a contraction, that applies to both sides of the border and our lending businesses.

John Aiken - *Barclays Bank PLC,*

Pat, a couple of quick questions for you. I don't want this line of questioning to lead you to believe that I'm questioning the strong credit results, just trying to figure out a couple of things. When we take a look at consumer delinquencies, the 90 plus days, I think it's Page 24 of the supp pack. We're actually seeing an increase in terms of the delinquency on the residential mortgages on the U.S. side. Is that just symptomatic of the declining relief that's being provided by the government? Or is there something else going on there that I'm not aware of?

Pat Cronin - *Bank of Montreal - CRO*

No. That's principally it. And I think you'll see it's coming up from a relatively low number in prior quarters. So it's a little bit of the deferral expiry rolling through. In the absolute scheme of things, they're all pretty small numbers in that portfolio. But that's what's really happening. It's just a little bit of a higher delinquency as deferrals end.

John Aiken - *Barclays Bank PLC,*

And a follow-on, if I may. When we take a look at the geographic mix of the impaired loans, over the last couple of quarters, we've seen it shifting away from the U.S. and more towards Canada. Granted, this is probably being driven by the economic realities we're seeing in the 2 regions. Is this something that you would expect to see continue given the disparity of the vaccine rollout? Or should we start to see this normalize over the next couple of quarters?

Pat Cronin - *Bank of Montreal - CRO*

Yes. There's a lot of things going on underneath there, John. But the other thing that you probably notice is we had a very large decline in impaired loan formations out of oil and gas. And those have typically almost entirely come out of the U.S. for the past few quarters. So that's going to shift the mix right there by a fair bit. And then as you noted, the difference in the trajectory of the economy is slightly different. You can see that in our MD&A disclosure. Our outlook for the U.S. is a little bit better. So that's driving a little bit. And then there's a slightly disproportionate impact coming from the COVID-impacted sectors. We have slightly higher balances in some of the more impacted sectors in Canada versus the U.S. and those tend to be lumpy, particularly in the commercial portfolio. So that's driving a little bit of it from quarter-to-quarter. But in terms of outlook going forward, I would expect to see formation and impairment of PCL fairly steady to lower in both markets.

Meny Grauman - *Scotiabank Global Banking*

Just going back to capital. Just wondering as a management team, how you square OSFI's moratorium on buybacks with what you're seeing in your results, frankly, the recovery, albeit small, still there and the continued build in CET1. How do those two things make sense to you? I'm curious about that.

Darryl White - *Bank of Montreal - CEO*

Yes. Thanks, Meny. It's Darryl. OSFI has been pretty consistent in their view that, and I'm paraphrasing naturally, but their view that they will look harder at easing those restrictions when they see clear evidence of emergence from the pandemic. And so I'm not going to comment on the appropriateness of that view. I'll just tell you that they've been very consistent in it all the way through, including their public commentary. In the meantime, you see what's happening with our balance sheet and with the sector overall. So I think I'm just going to leave it there. We're not building a business plan on the expectation that OSFI releases the restrictions on any particular date. They've been clear that the virus will drive that outcome, the vaccinations will drive that outcome. And when it does, we'll be prepared.

Meny Grauman - *Scotiabank Global Banking*

And just following up on that. I mean, they'll decide what they decide. But in terms of that sort of idea of seeing a clear recovery, would you subscribe to the view that we are seeing a clear recovery here that, that would be a correct statement from your perspective?

Darryl White - *Bank of Montreal - CEO*

Yes. Look, I'm not a health expert, but from an economic perspective, the answer is yes. I made my comments earlier, I stand by them. I think we're going to have a very strong recovery as we go through the year. If I were a health expert, I'd probably start talking about the risk of variants and the like getting in the way of what I've just said. But assuming continued progress on vaccinations and containment of the virus, I absolutely think we are in for a very strong recovery in North America.

Scott Chan - *Canaccord Genuity Corp.*

My question is just on Capital Markets. Obviously, another exceptional fiscal quarter. Wondering if you can kind of maybe offer what you're kind of seeing so far in this fiscal quarter in terms of pipeline and if there's any differences within the U.S. or Canadian markets?

Dan Barclay - *Bank of Montreal Corp. - Group Head, BMO Capital Markets*

Thanks, Scott. Yes, it was very gratifying for us to see the choices we made in portfolio and investments really start to pay off this quarter. And I anticipate that to continue on as we look forward. Assuming we continue to have constructive market conditions, my expectation is that this type of performance will continue. We're benefiting, obviously, from our geographic diversity, the investments we made, particularly in the U.S. over the last few years and what they've brought to the table as we go forward. And to your question, what we've seen month-to-date in the new fiscal is consistent with the first quarter.

Mario Mendonca - *TD Securities*

Just a quick follow-up on that last question and then another one. Would you say that there's been a structural change in Capital Markets that would leave results this high on a go-forward basis? Or is it very much just a reflection of the activity we've seen in both Canada and the U.S.?

Dan Barclay - *Bank of Montreal. - Group Head, BMO Capital Markets*

I think it's two points, right, on that. So one is the portfolio choices we've made and investments we've made over time are adding real value to the platform, so with and without kind of the pandemic fiscal and monetary stimulus that we've seen. And secondarily, when we look forward to where we're making new investments, I'm anticipating those will have similar type return expectations. So think about the expense management we've been doing, some of the portfolio choices. Those are all driving toward higher long-term performance. I wouldn't say there isn't some market benefit from the monetary and fiscal stimulus. But I think based on my expectations, that will be there for a while.

Mario Mendonca - *TD Securities*

Okay. A follow-up question then for Pat. Pat, why haven't we seen a lot more losses in the affected sectors? Now I understand that some of it relates to just good underwriting decisions when the loans were made. But what's your take on why things have been so surprisingly good even in those sectors?

Pat Cronin - *Bank of Montreal - CRO*

Yes. I mean, I think I have to start with the comment you made. It really is sound underwriting practices at the beginning. We typically don't lend to people that can't weather storms. And we do a lot of sensitivity analysis when we lend to people looking at stress cases like this. And so to some extent, we're not that surprised. Obviously, in some of the very impacted sectors, I think what surprised us at least, is the ability for those clients to weather the storm through a couple of things: one, maximizing the revenue that's available. You think about restaurants as a great example, within the confines of lockdowns, whether it's minimal occupancy or takeout and delivery, they've managed to cobble together what looks like to us, at least, breakeven revenue. Then they're extremely tightly managing expenses. Then they're getting some relief from government support, whether that's wage subsidies, the new HASCAP program will certainly help with that. And then they're tapping into liquidity that they had on hand. And we're seeing that in the hotel sector. We're certainly seeing it in some pockets of retail. The clients are just adapting to the new reality. And Dave touched on this a little bit as well. But figuring out ways to operate within the confines of lockdowns. And I wouldn't argue that they're thriving by any stretch, but we're seeing real stability and in some cases, improvement in credit metrics as they figure out ways to weather the storm. And that's leading to fairly low loss rates. Our loss rate in hotels in the last 12 months is $5 million. Restaurants, it's $12 million. So notwithstanding impairment and stress, a lot of clients working with their bankers really closely are figuring out the right flexibility that they need and then the right things they need to do on their side to manage through the storm.

Doug Young - *Desjardins Securities Inc.*

Maybe sticking with you, Pat, just on the release, and I think in your comments, you talked about the improved FLI and the positive credit migration led to the release. But then you also mentioned that you had a modest increase in adverse scenario weight. Why would you have a modest increase in adverse scenario weight? Can you talk a bit about the thought process behind that?

Pat Cronin - *Bank of Montreal - CRO*

Sure. I guess, first of all, I wouldn't read a lot into the release this quarter. We had a modest increase last quarter. This is, to some extent, fine-tuning what is a fairly adequate provision. But really the dynamic this quarter, and I suspect next quarter as well, is we're clearly seeing positive economic improvement going on over -- from quarter-to-quarter. And that plus fairly clear evidence, as you can see, I'm sure, across all of the disclosure with credit quality improvement in the underlying borrowers. So those two things would actually have contributed to a fairly large release this quarter.

But as a risk team, we have to weigh that against what we saw as rising uncertainty about a potential adverse case. It's not our base case, but a potential adverse case that includes potentially slower rollout of a vaccine that tips those borrowers that are barely hanging on into delinquency or a worst-case where virus variants push us back into a situation that looks more like last March. Again, those aren't our base case, but the risk of those felt higher to us quarter-over-quarter, particularly as we saw variants start to emerge. And so we thought it's better to balance the optimism coming out of the economic environment against that uncertainty, at least for this quarter. And then as we get more information over the next 30, 60, 90 days, we'll weigh that exact same equation up again.

Doug Young - *Desjardins Securities Inc.*

And just a quick follow-up. If we look at the end of Q4, you did give a number if all your ACLs performing, ACLs were in stage one, what your ACL would be for performing loans? Is that a good indicator of what we should anticipate the impaired PCLs to be through fiscal '21? Or is there puts and takes that kind of make that not as relevant to when we're thinking about that?

Pat Cronin - *Bank of Montreal - CRO*

Yes, there are puts and takes that are probably a little bit too detailed to get into in this call. I would say that's probably -- that would be an overestimation at this point of what we think losses are going to be for the next 12 months.

Mike Rizvanovic - *Crédit Suisse AG*

Just a follow-up with Pat on the PCLs. And I'm looking at the Canadian P&C segment specifically. It looks like a very small recovery. And what I'm wondering is, I'm trying to sort of square that with how the economy has progressed since last quarter. Three months ago, we would not have been expecting the severity of the lockdowns coming back the way they have. And I'm just wondering, like even when I look at the GDP base case assumptions that you're putting through your expected credit losses, your base case is a lot lower now for GDP growth for 2021 specifically. So I'm just wondering, maybe I'm looking at the wrong factors here. It seems like it's not just GDP, obviously, but what would have driven that to not result in at least some provisions being added on the performing portfolio?

Pat Cronin - *Bank of Montreal - CRO*

So is your question, why didn't we add more performing provision for the Canadian P&C portfolio?

Mike Rizvanovic - *Crédit Suisse AG*

Yes. Just looking at it sequentially, like where we were a quarter ago and the lockdowns that came about which we would not have known about at that time. I'm wondering why there would not have been some addition here? It looks like a lot of companies in Canada are probably in worse shape today than they might have been 3 months ago, just given the lockdowns.

Pat Cronin - *Bank of Montreal - CRO*

Yes. I think if you look at our economic outlook disclosure in the MD&A, you'll see, generally speaking, across a couple of -- several of the metrics that outlook actually improved quarter-over-quarter. And so the performing provision is much more an indication of the next 12 to 18 months, not what is actually happening in the minute. And so our outlook for Canada got better with respect to housing prices and to some extent, employment, and that's really what drives the majority of the outlook certainly for consumer. And the underlying fundamentals and with respect to credit quality, also, we're fairly stable in that book quarter-over-quarter. So notwithstanding what you might be seeing in the spot environment, delinquencies are relatively stable quarter-over-quarter and certainly consistent with what we were seeing pre-COVID. So the credit quality of the book wouldn't suggest that there was an increase in the provision that was necessary.

Darryl White - *Bank of Montreal - CEO*

Okay. Thank you, and thank you all for your questions. I'm going to wrap up with four quick summary themes for today.

Number one, today's results were clearly very strong. They reflect many of the benefits that are flowing from the strategic actions to strengthen the earnings power of the bank. Number two, we have moved the bar significantly on our expense and efficiency commitments, and we have strategies in place to do even more. Number three, credit quality, as you heard today, remains a differentiator for us as it has for decades. And number four, we have strong momentum, clear potential across our businesses as the environment continues to evolve with our advantage mix that is ready for more, especially with the acceleration in the backdrop of the economy that we've talked about today. I'm pretty confident in the continued execution of our strategy to drive the leading performance that we've now demonstrated to you in successive quarters.

I want to thank all of you for participating in today's call, and we look forward to speaking to you again in May. Thank you.