BMO Financial Group

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Hosted by: Robert Sedran – Analyst - National Bank Financial
Guest Speaker: Frank Techar – BMO Financial Group – President & CEO, P&C Canada

Robert Sedran *- National Bank Financial - Analyst*

Okay, our next speaker is Frank Techar, whom we'd like to welcome back to the conference, President and Chief Executive Officer, Personal and Commercial Banking Canada, Bank of Montreal since 2006. Prior to his current role, Frank ran Harris Bankcorp, BMO's personal and commercial bank in the United States, and has also spent time in BMO's corporate bank and its European operations as well.

The Canadian P&C division for BMO has been posting stronger results of late. I'm sure Frank is about to tell us why that's going to continue. Welcome back, Frank.

Frank Techar *- BMO Financial Group - President and CEO, Personal and Commercial Banking Canada*

Thank you, Rob, for that introduction. Good morning, everyone. Before I begin, I'd like to draw your attention to the caution regarding forward-looking statements on Slide 1. I'm going to start this morning by making a few brief comments about our total bank results, but the main focus, as Rob mentioned, of my comments today are going to be on the P&C business in Canada.

On Slide 2, you can see that our reported total bank's first quarter earnings were $225 million or $0.40 per share on a cash basis. Our core businesses are performing well in today's recessionary economic environment and lower revenues in corporate services coupled with increased PCL's primarily on US real estate, muted our first quarter results and the continued strength of our underlying businesses.

Excluding our capital markets environment charges in this quarter we earned $1.09 cash EPS. And contribution from our more stable and reliable retail businesses, P&C and our wealth businesses, was 70% of operating income for the quarter.

Turning to Slide 3, our Q1 Tier 1 capital ratio was very strong at 10.21%. Subsequent to releasing our results, we completed a $275 million preferred share issuance, which will increase our Tier 1 capital ratio by another 15 basis points.

Our tangible common equity to risk-weighted assets ratio was 7.8%, among the highest of the Canadian banks. And our strong capital position is a solid measure to gauge the bank's resilience as it positions us to take advantage of any opportunities for growth arising in the current environment or coming out of this recession.

In this environment, we think managing our capital levels above historic norms is prudent and we will continue to manage to a Tier 1 capital ratio of approximately 10% and a TCE to risk-weighted asset ratio of approximately 7%.

The remainder of my remarks this morning are going to focus on P&C Canada and I'd like to start by saying that I am very happy with the results of the business in Q1 and the performance in Q1. And in fact, we've had two terrific quarters in a row, back-to-back.

Our net income in Q1 of $325 million was up $34 million or 12% year-over-year and that was in large part due to improving margins driven by improving business mix, appropriate pricing actions, and higher prime to BA spreads in the face of higher funding costs. We had solid revenue growth of 7% and strong cash operating leverage of 3.5%.

We had great credit performance in both our personal and commercial portfolios and we're really happy with the market share improvements that we're seeing in many of our products. Year-over-year, our market share in personal loans was up 80 basis points, our personal deposit share increased 22 basis points, and our commercial loan market share increased 56 basis points.

We remain committed to our strategic direction. We're making progress and we are very well positioned for a return to more normal economic growth. We've improved the business in a number of ways. It didn't happen by accident. We made some very tough choices over the last couple of years and we're following a plan and sticking to it.

Our execution is improving and we're measuring our success against our strategy every quarter. And in fact, I want to spend a little bit of time on those measures this morning. There are four of them that I believe are important in measuring our progress against our strategy and against the competition.

Growth in revenue, growth in net income after tax, and our personal and commercial segment loyalty scores are the measures that we're paying particular attention to as we execute our strategy. In 2008, we improved in each of these measures relative to 2007 and we improved even further in Q1 '09. We're making progress and we are narrowing the gap to the competition.

I want to pause for a moment and spend a little more time on this slide. At the end of 2007, we were fifth. We ranked fifth in Canada on both revenue and NIAT growth. At the end of 2008, we had moved up to third place and our Q1 revenue and NIAT growth ranked second relative to the other five Canadian banks. We've clearly made significant progress since the end of 2007, only five quarters ago.

On the loyalty front, between Q1 '08 and Q1 '09 our personal loyalty score has improved 6 points and we've narrowed the gap to the Exemplar by three points. Maybe more importantly, we've moved from fourth place to a tie for third on this measure.

On the commercial front, between Q1 '08 and Q1 '09 our commercial loyalty scores improved 8 points. We've narrowed the gap to the Exemplar by 6 points and we've moved from fourth place to third place.

You can also see that on Slide 6 in our personal segment the changes we have made in a highly-competitive environment has resulted in stronger volume growth and market share gains. Our growth in consumer loans, although beginning to slow, was a strong 21% year-over-year in Q1 and as I've already said, market share was up 80 basis points.

I know some of you may have some questions about whether it's prudent to be growing this portfolio as rapidly as we have been in this environment. We're comfortable with this growth because it is largely driven by our secured Homeowner ReadiLine product, essentially a substitute mortgage product. In fact, 85% of our portfolio is secured, 88% if you exclude our credit card portfolio, and this ratio has not changed recently and we expect to maintain it at this level. Growth in this portfolio also enables us to deepen our relationship with our customers and expand our share of wallet.

Our personal deposit market share was up 22 basis points, as I mentioned. Deposit growth was a key focus when we launched our strategy two years ago. As a result of improved performance management, investment in our branch network and product offerings, we're seeing accelerating growth in both term products and core checking and savings accounts.

Our ongoing efforts to deliver an improved customer experience have also contributed to customers rewarding us with more of their business and we see that in the increase in the number of product categories per customer in our personal segment.

Turning to our commercial segment, our focus is to continue to build on our number two market position. In a tight credit environment, we continue to make credit available to our small and mid-size business clients. But as expected, lending balance growth slowed to 5.8% in Q1, but we're pleased to continue to gain market share, notwithstanding the slowdown in demand in the marketplace.

As a result of credit being repriced worldwide, early last year we began having conversations with our customers regarding their borrowing rate and have been successful in expanding the yield on our entire portfolio over that period. This is having a positive financial impact, while we are not seeing any erosion in our customer loyalty scores and our product categories per customer continue to rise.

We have a track record of sticking with businesses through all market conditions, so our message has been very clear over the last few quarters -- we are open for business.

I know everyone in the room is interested in our expectations for credit losses. As you can see from Slide 8, we continue to enjoy a number one position in losses relative to personal loans. We've maintained conservative underwriting practices over the years and over the last 12 months we've made targeted adjustments for lending strategies to ensure our underwriting is appropriate given the environment.

We've increased staff in our collection departments and special account units and we have a process for early involvement to identify high risk industries and deteriorating accounts. The consumer loss ratio is rising, but it's expected to remain within historic norms. As I said earlier, 88% of our portfolio is secured. Our loss rates continue to be the lowest amongst our peers and we expect to maintain that position.

In credit cards, although losses have been increasing, we continued to have significantly better loss performance than our peers as well. In fact, for the last three months that data is available, we are 100 basis points better than the average for the Canadian banks for credit card loss.

The commercial portfolio is also performing within expected norms. Underwriting practice's continue to be effective. 94% of our commercial advances are secured and we expect to maintain top-tier risk performance despite the uncertain economic conditions.

To me it boils down to a few fundamental beliefs that guide our actions. Any qualified borrower should be able to get a loan, customers deserve fair and competitive pricing, and we're going to do everything we can for our customers that are in distress to get them back on their feet.

We're very pleased with the progress that we've made in the business over a very short period of time. Our strategy is working; it's showing up in the results. We've got great momentum and our best-in-class credit risk management practices in this business is going to continue to be the backbone that gives us confidence that we can continue to grow responsibly through this cycle. So I'll stop and turn it over to you, Rob, for questions.

QUESTION AND ANSWER

Robert Sedran - *National Bank Financial - Analyst*

Frank, can you maybe touch on how far through the restructuring process you are? I guess it would have been in 2007 you sort of began a restructuring process. The results are starting to show through.

Is it complete now and you're just in the process of process improvement and all the rest, or is there still a big, sort of project push to get things to where you want them?

Frank Techar - *BMO Financial Group - President and CEO, Personal and Commercial Banking Canada*

I would suggest we're about in the middle of the work that we have to do. We're obviously pleased -- I'm obviously pleased with the progress that we've made. If I had to kind of reflect on the two planks of our strategy, one being a much more significant focus on customer experience, we've made tremendous progress and have changed the culture in the business, changed many of our business functions and processes in support of that.

I think where we're going to turn our attention as we move through the next couple of years a focus on productivity, focus on our business processes, streamlining those processes and taking our performance management to the next level, and I think there is still a lot of headroom in our business.

And the short answer really, Rob, to your question is we're not going to be finished until we're number one. We have made great progress over the last couple of years, but we know there's more work to do, we know we're not there yet, and we believe we can do it.

Unidentified Audience Member

Well, it's commendable you're making progress in this loyalty area. The gaps still between you and number one and two is still huge. What are they doing that you're not doing?

Frank Techar - *BMO Financial Group - President and CEO, Personal and Commercial Banking Canada*

Well, I think each one of us has a little bit of a different focus and a strategy. We're very pleased and very happy with the reception from the market that we've been seeing relative to our new brand promise and our advertising campaign, which is up on the screen.

Our focus on customer experience has to do with simplification, clarifying the complexity of banking because all banking is complex, even opening an account. In our Company and every other company that does business in this country, it's complex. So the focus of our strategy and our focus on customer experience has to do with eliminating that complexity and really helping our customers choose what is appropriate for them.

I don't think our competitors are playing in that space nearly as much as we envisioned were going to be as we continue to develop our capabilities and continue to improve the business. We do recognize that we have a significant gap to the Exemplar in both our personal segment and our commercial segment.

But again, any short period of time if you look at every one of the competitors on those measures that I put up on the board, we have improved far faster than anyone and you can see the Exemplar is relatively flat over the same period of time.

We think there's no magic in what the others are doing. We're going to stick to our strategy, our brand promise, and the plan that we have and we are very confident that we will be able to close that gap over the next year or so.

Unidentified Audience Member

Yes, hello. Can you talk a bit more about where you're going to spend? Because from what we're hearing from you, your loan book has the very, very lowest risk, but you're Tier 1 is going to be the highest. So what is the reason for that?, I don't see exactly why it's needed. Is it because your payout is going to be very high in '09 and you would like to keep some room in case things go bad?

Frank Techar - *BMO Financial Group - President and CEO, Personal and Commercial Banking Canada*

If I understood the question, I'm not sure I understood it exactly but it was why are we keeping high capital ratios, if we think our credit performance is best-in-class? Is that the gist of the question?

Unidentified Audience Member

Yes.

Frank Techar - *BMO Financial Group - President and CEO, Personal and Commercial Banking Canada*

I think it's two things, and Bill's been pretty direct about this. One is we can't anticipate what will happen in the economic environment over the next year or so. And so having a cushion for anything unforeseen, I think makes sense, and I think you've probably heard that from some of the others as well today. So having that cushion makes sense.

I think the other thing that we are keeping our eye on is opportunities that might present themselves as we go through the next year or so as well from an investment perspective.

Unidentified Audience Member

(Inaudible - microphone inaccessible)

Frank Techar - *BMO Financial Group - President and CEO, Personal and Commercial Banking Canada*

Well, we are not changing our focus on the investments in our core businesses in Canada, so there are opportunities to continue to build and grow in our primary marketplace. I think our acquisition of the AIG Insurance business recently is an example of being opportunistic in using our strong capital position to take advantage of those opportunities.

But we're also paying attention to what's going on in the United States. Ultimately, I think the economy will improve. We'll get a lot more transparency on the government intervention or what they're position is going to be relative to supporting the banking industry in the US. And I think as things become more clear we'd like to be in a position to participate, if we can.

Unidentified Audience Member

Frank, you talked about room expense, a reduction room in the business. I don't recall off the top of my head exactly where your efficiency ratio is with P&C; I want to say low 50s.

Frank Techar - *BMO Financial Group - President and CEO, Personal and Commercial Banking Canada*

We're in the mid 50s.

Unidentified Audience Member

Okay. How low can this ratio go? I know if you look best-in-class globally you can get down into the low 40s. Is that realistic to think Canadian banks can get that low or is the nature of a long, flat country mean that you're going to have the branch network, you're going to have all the different distribution issues you have and so 50 is a more realistic goal?

Frank Techar - *BMO Financial Group - President and CEO, Personal and Commercial Banking Canada*

You know, it's really interesting because if you look at some of those banks that had very low productivity ratios, they're not in that situation today. So you wonder about the sustainability of those models. Their revenues were growing very rapidly as a result of potentially some not-so-prudent underwriting standards.

My point of view would be if you get that productivity number down to the low 50s, in and around 50, which feels like the right place to be. I think if you push further than that, at least recent experience, would suggest that you're really pushing the business model to a place that you're not comfortable with from a risk perspective.

So we'll see. I think the branches and that distribution channel will continue to be important for us going forward, so we're not going to be able to eliminate the investment in the cost that we have in serving communities in whatever marketplace that we're operating in. So I don't believe that we're going to be able to take it down to those very low levels, which I think for the most part have proven to be pretty much unsustainable.

Robert Sedran - *National Bank Financial - Analyst*

We often hear about the impact of re-intermediation on the corporate side of the business. Can you talk to us a little bit about what your nontraditional competitors are doing, both on the deposit side and the lending side, right now?

Frank Techar - *BMO Financial Group - President and CEO, Personal and Commercial Banking Canada*

Well, I think there are probably two main areas that we're seeing changes in. The first one would be the competition for deposits have definitely heated up. As wholesale funding costs have gone up, everyone -- banks and non-banks -- are competing for deposits and the pricing at this moment in time is probably higher than the interest rate environment would normally allow. So there is pressure on pricing on the deposit-gathering pieces of our business.

I think the other thing that's affected us is in the auto business, in our retail auto business, we've really seen the captive step away from a lending and leasing business. We've seen others step away and it's really given us a great opportunity to look at all of the opportunities for business and take the ones that we like.

It's allowed us to increase our yield on some of those products because people have stepped away and it's also allowed us to really take the credits that we are the most comfortable with from a risk perspective. So I view that one as a positive, in particular relative to the auto sector.

But on the deposit side it's been a negative because the competition has been fierce and I would expect it's going to continue to be fierce for some time.

Robert Sedran - ***National Bank Financial - Analyst***

Do you want to touch quickly on what, if any, impact the more recent troubles the car companies have gotten themselves into, how the portfolio is holding up, and what risks are arising or if this is not really an issue for Bank of Montreal?

Frank Techar - ***BMO Financial Group - President and CEO, Personal and Commercial Banking Canada***

Yes, we have about $5 billion in retail auto loans in Canada. The portfolio is performing extremely well. We've got very, very low expectations for having a problem in that portfolio. It's fully secured, as you can imagine. We're very comfortable with the underwriting standards. We continue to make loans, as I just described, and we are not concerned about significant losses coming in that portfolio.

Overall, commercial and corporate exposure for our auto business is a little less than $4 billion. The majority of that is to dealers in Canada. The majority of that business is secured and we're very comfortable with the risk profile.

So we are watching what is happening with the auto business. Quite frankly, I think what we're thinking about is if the auto companies pull out of Canada, the effect on the consumers; loss of jobs, unemployment, those types of things , are probably bigger risks for us rather than the direct exposures that we have to the industry or to the distribution channels that we operate in.

Robert Sedran - ***National Bank Financial - Analyst***

Okay, last question and I'm going to put you on the spot a little bit. Given your background, I'd be remiss if I didn't ask about the US business. I think most people in the room would acknowledge that much of what we're seeing in Canada is probably a cyclical downturn. With the concern in US banking being that it's more, concerns at least that it's a structural downturn and the profitability is permanently being reduced in some of these businesses.

Not necessarily Harris, although feel free to comment on it, but the US industry in general, is it going to be anywhere near what it was going into this downturn, coming out of this downturn?

Frank Techar - ***BMO Financial Group - President and CEO, Personal and Commercial Banking Canada***

I don't know if I'm smart enough to get that far out into the future. I do think one of the levers in the business that people are not focusing enough on is the pricing power. What happens to the industry from a consolidation perspective, how many players exit when we get through this, and what the dynamic of the competitive environment is going to be is clearly going to be different.

But I do believe that pricing and the ability to extract more value and price for risk more appropriately is going to be there once the economy starts to turn around. I think it will take a long time before we push yields and spreads down to the levels that we've seen.

And when I look at our business, I think price is the biggest lever that we have. It's the one that you can affect revenues with the most quickly and it is a very powerful tool that in other environments we've not been able to play that card.

I think in Canada you're seeing that happening now and I think in the United States maybe even to a greater degree in the future. As the business starts to stabilize and sort itself out, I think that that opportunity is going to be available.

Robert Sedran *- National Bank Financial - Analyst*

Do you think margins in Canada can expand even absent of higher interest rates?

Frank Techar *- BMO Financial Group - President and CEO, Personal and Commercial Banking Canada*

We're having a pretty good go at it at this point in time for the reasons that I've mentioned. I suspect not, though. I think all five or six or seven of us are pretty good competitors and I think the competitive environment isn't going to allow a lot of expansion.

But I do believe some of the pricing that we've experienced -- the upward pricing that we've seen over the last couple of quarters -- I think some of it will stick. I'm not sure we can take it much further than we've gone at this point in time, but I think some of it will stick for some time.

Robert Sedran *- National Bank Financial - Analyst*

OK, on behalf of NBF and everyone here, I'd like to thank you for your participation. Thanks, Frank.

Frank Techar *- BMO Financial Group - President and CEO, Personal and Commercial Banking Canada*

Thanks, Rob.