BMO Financial Group

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PRESENTATION

John Aiken – *Barclays Capital - Analyst*

Coming next up BMO Financial Group, very happy to have Tom Flynn here. He's CFO, in the role I think for just six months. So have the very detailed questions on the P&L ready for him. But anyhow, Tom, thank you very much and we look forward to your presentation.

Tom E. Flynn – BMO Financial Group - EVP and Chief Financial Officer

Thank you, John for that introduction, brief as you promised. And it's good to be back to the conference this year. Good morning, everyone.

When I spoke here a year ago, I outlined our U.S. growth strategy as we looked to build scale in our Midwest footprint. At that time, we had steadily grown our U.S. business over the course of a decade with nine individually relatively small acquisitions, employing a methodical approach designed to ensure the right fit and the right price. As I indicated a year ago, we thought the valuations were starting to become more reasonable providing attractive opportunities to meaningfully expand.

Today, a year later, I can tell you that with the acquisition of Marshall & Ilsley that closed in July. We were successful in identifying and crystallizing a key step in our U.S. strategy. We had a strong core bank in the U.S. a year ago, and clearly the M&I transaction builds on that strength and improves scale.

I'll be covering two main topics this morning. First, I'll outline BMO's investment story which is underpinned by a strong and stable foundation, a diversified business mix, sound risk management, strong capital and attractive dividend and what we believe our differentiated levers to grow in what looks like a lower growth environment. Second, I'll take you through each of our four businesses in more detail reviewing their key priorities and performance.

Before I begin, please note the caution regarding forward-looking statements. For your information further details about such statements are available in our public filings. All financial numbers in this presentation unless otherwise noted are in Canadian dollars.

An investment in BMO is underpinned by a strong and stable foundation and a history that goes back almost 200 years in Canada and 125 years in the United States. The earnings power of the bank has supported our commitment to shareholders. BMO has the longest running dividend payout record of any company in Canada at 182 years. We have an attractive dividend yield supported by our target payout ratio of 45% to 55%.

Our year-to-date financial results underline BMO's momentum and earnings power. For the first three quarters of the year revenue increased 10% from 2010 to $9.8 billion. Adjusted net income[1] exceeded $2.4 billion, 16% above last year. Adjusted EPS[1] increased 13% to $4.02 and ROE was 16.1%. The adjusted income numbers add back acquisition, related integration expenses and the amortization of intangibles.

I'll now provide an overview of the markets where we do business in North America.

In Canada, we operate in three markets Western, Central and Atlantic with total GDP of $1.5 trillion. Both the West and the Atlantic regions are economically driven by natural resource industries. In Central Canada the emphasis is more on manufacturing similar to our U.S. market. Canada's unemployment rate is 7.3% and compares favourably to other countries. The Canadian housing market has remained resilient supported by record low mortgage rates, healthy growth in jobs and immigration and a sound policy framework.

1 - on a reported basis: YTD net income $2.4B, 14% above last year; EPS increased 11% to $3.91

Our fourth large market is the U.S. Midwest where our core operations cover a six-state area. Markets in this footprint include Chicago, Milwaukee, St. Louis, Indianapolis, Kansas City and Minneapolis-St. Paul. The Midwest economy is doing well in the U.S. context. Unemployment in the Midwest has been running below the U.S. national average since March 2010. In June, it was at 8.4%. Year-over-year wage gains in five of the six states have exceeded the national average.

And looking forward over the next five years, our economics group expects growth in the Midwest to exceed the national average. Together, these four markets form a T centered in the heart of North America, an enviable footprint and market presence aligned geographically with industries and sectors where we have deep knowledge and proven capabilities.

BMO is diversified by business mix. Our businesses generated $12.2 billion in revenues and $2.8 billion in net income in 2010.

Personal and Commercial bank in Canada is our flagship business and the largest contributor to the banks revenue and earnings. We serve more than 7 million customers from a national distribution network offering a full range of products and services. We hold a strong number two market share position in commercial lending for loans of $5 million or less.

Our Personal and Commercial Banking U.S. business was significantly expanded with the acquisition of M&I. We've built on our strong established base to create a leading Midwest regional bank renamed BMO Harris Bank.

Our 680 branches provide a significant footprint in our core U.S. market, where we have over 3 million customers and strong retail deposit market share positions: Number one in Wisconsin, number two in Chicago and number three across our Midwest markets overall.

Private Client group, which is our wealth management business, serves the full range of client segments with a broad offering including full service and direct brokerage, mutual funds, institutional asset management, private banking, Ultra-High Net Worth and insurance. Assets under management and administration are $152 billion and $277 billion respectively with recent acquisitions, adding a $153 billion in client assets, largely from M&I. Together these businesses represent the banks North American retail operations and are expected to contribute over 75% to revenues and net income.

BMO capital markets is our fourth operating group providing a full range of products and services to corporate and institutional and government clients. We operate from 26 offices and five continents. We have a full offering of investment and corporate banking services including equity and debt underwriting in M&A, as well as a full suite of sales and trading products with leading equity research.

Our approach to risk management is to provide appropriate and an independent oversight of risk. Our objective is to have a leadership position in the integrated risk management consistent with our strong credit history. This slide highlights our strong performance over the last two decades compared to peers. During the recent downturn, our credit measure was elevated relative to the Canadian peers given the size of our U.S. loan portfolio. We have performed well comparing like portfolios in the U.S. to U.S. peers.

Our total loan book is $207 billion, with 68% of loans in Canada and 28% in the U.S. The U.S. mix is 37% consumer with the remainder commercial. M&I added $29 billion in loans and is diversified across industries. The M&I portfolio has been subject to extensive due-diligence and we've established what we believe to be a prudent credit market to fair value the portfolio.

Capital management at BMO has always been disciplined with consistent and prudent approaches used to the deployment of capital. BMO has a strong capital position, our Basel II Common Equity Ratio was 9.1% at the end of the third quarter, and our Tier 1 ratio was 11.5%.

Our pro-forma Basel III Common Equity Ratio was estimated at 6.6% at the end of Q3. We remain confident in our ability to meet the Basel III, 2019 requirements by the beginning of 2013.

In the global economy there is still major challenge to work through. Clearly the situation in Europe is cause for concern for everyone. That said, we believe in the underlying resiliency of the Canadian and the U.S. economies.

We also have confidence in the future performance of our business and the results that we'll generate even during the period of potentially slower economic growth. We think we have attractive levers for growth in the current environment and here are some examples.

Commercial lending has always been a differentiator for BMO. We have a number two position in Canada and a very strong business in our P&C U.S. group. We intend to grow here by leveraging our established lending relationship to build deeper share of wallet, growing fee income, attracting more commercial deposits and using our proven model to take share. Our strength in commercial should serves us well as we expect more credit growth in this area than in the personal side of the business.

Our BMO Capital Market business in the U.S., represents a second source of leverage in a low growth environment. We've made significant investment in this business over the last few years, including upgrading talent and sharpening sector expertise, building out and expanding coverage of U.S. institutions with strengthened equity research and distribution.

In the Wall Street Journal's annual Best of the Street Research Survey BMO Capital Market held the six top-five finishes which placed us fifth overall. And we are investing in our U.S. fixed income platform. The retooled U.S. capital market business is well positioned to take advantage of opportunities and to improve returns.

The third growth driver will be the lift achieved from the integration of M&I. On July 5th, we closed the acquisition transforming our U.S. retail operations by adding scale and capabilities. Taking the best from both banks we'll build a much stronger bank overall. We expect to generate in excess of $300 million in pre-tax cost synergies with full realization on a run rate basis by the end of 2013. I would add that we're applying greater rigor generally to the management of expense at the bank, not just in areas related to integration.

I'll now provide a brief update on the integration of M&I. The integration is moving forward as planned. The management team is in place with all top and level two leadership positions confirmed prior to or on close. We've identified and are actively managing major integration risk.

The integration governance structure is managed through a dedicated project management office with clear objectives for the integration of operating units, system integration, capturing synergies as well as branding and branch conversions. And we're successfully harmonizing risk processes aand integrating BMO's strong credit discipline. Our new U.S. retail brand BMO Harris Bank has been well received.

Let me now turn to our operating group priorities and performance, but first a word of explanation. For segmented reporting purposes BMO charges expected loss to the operating groups to provide an indication of the risk the business has underwritten. The difference between expected loss and actual loss is charged to corporate.

Let's start with Personal and Commercial Banking Canada, which has a track record of strong performance over the past two years, or holding top tier positions in both revenue and net income growth. This strong performance reflects a number of key priorities including building capacity by expanding specialized sales forces and distribution channels.

Improving our processes and technology to free up frontline capacity and reduce operating cost and leveraging our strengths and relationships to increase share of wallet. In the first nine months of fiscal 2011, P&C Canada revenues were up 5% to $4.5 billion, net income was up 13% on an actual loss basis. We're pleased with our performance so far this year, which reflects momentum in the business and also the investments that we are making in it.

Turning to the U.S. Personal and Commercial banking business, our priorities are to firstly successfully integrate M&I, taking the best of the best from both organizations, which will create a much stronger bank. Secondly to improve performance through managing sales productivity, managing costs and optimizing our expanded distribution network. Maintain strong customer loyalty and our goal in the commercial side of the business is to be the undisputed leader in commercial banking in the Midwest.

Revenues were US $1.4 billion in 2010 and are US $1.2 billion year-to-date. Net income in source currency was up 27% to $204 million, reflecting improved NIM and higher deposit balances.

For the total bank overall, our third quarter included 26 days of M&I results given the day that the acquisition closed on. This added $117 million to revenue and $32 million to adjusted net income[1] in the quarter.

Over the past 10 years, Private Client Group has steadily increased its earnings contribution to the bank and today contributes almost 20%. Key priorities for this business include effectively partnering across business segments to maximize cross-sell opportunities. And in particular leveraging our personal and commercial client base to drive growth, which we've done very well in Canada and think there are opportunities to replicate in the U.S. We're also selectively investing to expand our business. For example, our new ETF family recently surpassed $3 billion in AUM. We've increased the number of investment advisors and private bankers and we've enhanced our insurance offering. Revenues were $2.2 billion in 2010, net income $460 million.

Year-to-date revenues were up 13% to $1.9 billion with net income of $374 million, up 13% from last year with very strong year-over-year growth of 35% in our traditional Wealth business and lower results in insurance.

BMO Capital Markets has an established track record of success. Key priorities for this group are to align capital and capabilities with client opportunity, to focus on strategic sectors and to strengthen our business in the U.S., as mentioned earlier. Year-to-date net income increased 28% to $771 million; ROE was 22.9%, up from 18% last year.

As we look ahead, BMO is focused on executing against its key priorities, which are shown on the screen. Our businesses are well positioned to deliver in a differentiated way in the current environment
.
Thank you for your attention and I'd now be pleased to answer any questions.

John Aiken – *Barclays Capital - Analyst*

Tom, thank you. I didn't think we'd catch up in one presentation but anyhow...Any questions from the floor?

1 - a loss of $10MM on a reported basis

Q & A

Audience Member

I have three questions related to commercial real estate and these results from the heavy commitment of the M&I loan book to commercial real estate. So the first question, I was wondering if you could talk a little bit about the composition of the CRE loans that you got in the M&I purchase. Tell us a little more about those loans?

And then my second question is in the quarter you just reported you moved some commercial real estate loans out of the M&I portfolio. But also out of the Harris portfolio to corporate. I was wondering if you could talk a little bit about that and whether that implies those relationships are running down. And third is, whether there is a broader opportunity in commercial real estate here with the withdrawal of some competitors in that market and with values being somewhat stressed.

Tom E. Flynn – BMO Financial Group - EVP and Chief Financial Officer

Okay. Thank you for those questions. To deal with the first in the U.S. our commercial real estate portfolio is a little under $10 billion, roughly 75% of that came from M&I, and they had a concentration in commercial real estate, some of you will know. We feel comfortable with the exposure that we've got, to a meaningful degree, because we've taken what we believe to be a prudent credit mark against the acquired commercial real estate that M&I had. And we did detailed due diligence in December, established a credit mark at that time, came up, came out and updated that credit mark in our third quarter.

And the mark in the third quarter in total, not just against commercial real estate, was about $3.5 billion, which was inline with our number that we came up with in due diligence. So we think that the mark protects us to a meaningful degree from the risk in the portfolio. The portfolio is diversified across developer, and investor owned. Investor owned is ballpark three times size of the developer portfolio, and the portfolio is diversified across the footprint that M&I has.

And I think the number is at 45% of the investor owned is in the state of Wisconsin, which has been impacted like every other state by the downturn, but to a lesser degree.

To comment on what we moved to Corporate, we moved around $1.5 billion of M&I commercial real estate to our Corporate segment out of the operating business and around $1 billion of our legacy Harris, commercial real estate loans to commercial [sic]. The thinking here was that we're planning on exiting that part of the portfolio and the move had two big benefits.

The first is that it will allow our risk management workout people to focus on the portfolio and to manage it down in a deliberate way, which we are confident that they will be able to do effectively.

And secondly, it basically removes the distraction that could result for the people running the business if we had those loans in the business segment. So as we see it, we've liberated the business management team to focus on the go forward business, and we've put the Commercial Real Estate that we are working out into the right hands with the risk people focused on in corporate. It will take time to work this portfolio out and it will trend down towards zero over a period of three to four years give or take.

Last question related to the opportunity in commercial real estate. And you know, its true that's spreads are wider and many players have backed away from the market and there is free financing to be done so that presents an opportunity. Our current posture with respect to the sector is that we're being selective.

And with the acquisition of M&I, we've got a portfolio that is not small, and we’re comfortable with it. We don’t think its outsized, but it's not small. And so our focus is on winding down the run-off parts of it and selectively expanding with our core clients but the total size of the portfolio will decline somewhat as we run off the part of the portfolio that's in corporate so its not, I would say, a significant area for growth given the position that we've got.

Audience Member

How big is your delinquency in Agriculture credit lending in the heartland of Middle America? And is there any kind of collateral management as far as how can you help farmers in these weather conditions and in a bad economy in terms of their lending purposes?

Tom E. Flynn – BMO Financial Group - EVP and Chief Financial Officer

So, I just want to make sure I got the question related to delinquencies in Ag lending? I don't have exact numbers for you, so I can't be precise, but what I would say it has not been a big problem for us from a loss perspective at all.

And generally we like the business and Bank of Montreal and Harris Bank both have very good agricultural lending practices. It's true on both sides of the border it's an area of strength for us and M&I had a good business in that area. So we feel very, very comfortable with our ability to be an effective competitor in the area it is one of our focus sectors and it hasn't been an issue from a loss perspective to date.

We talked on our Q3 conference call about the seasonality in the portfolio and as we look at our commercial portfolio and think about growth, the fall part of the season is one when inventories are building and drawn down the increase on lines, so currently we've got relatively low utilization from the Ag part of the portfolio, when we expect that to build up as it normally does at this point of the calendar.

Audience Member

Could you possibly comment on the strategic value of the old M&I Arizona and Florida branches and systems which were recently created for the snowbirds down in those areas, and that's been a lot of the issues that cause that bank to become available to you?

Tom E. Flynn – BMO Financial Group - EVP and Chief Financial Officer

Yeah, yeah so I'll comment on that at a high level. M&I had operations in both Arizona and Florida. The position in Arizona is concentrated in Phoenix where the share position is number four, number five with about 50 branches. And so our view is that we need to reposition that business to focus much less on commercial real estate which was an area of focus for them in the market generally.

But we think that given the footprint that we've got there and also the existing business that Bank of Montreal did in that market through its wealth management business where we've been active for a number of years it's a market that will work for us longer term. Again the credit market helps with dealing with the issues that existed in the portfolio and we've got a good management team there that we have confidence in and we see a period of working through a tough environment and the sustainable business there.

In Florida, the footprint is smaller and we are in more markets and so over time we will be looking at the ability to create branch density and we will think about whether we've got the right position in the right market. The Snowbird strategy is one that sounds great in theory and on paper, but our experience has been that its actually not a big driver of results, its an important capability to be able to have for our part of the market, but fundamentally when you are in those markets you need to be able to compete locally to be successful.

John Aiken – *Barclays Capital - Analyst*

Tom a follow on to that question is that there has been a lot of discussion out of BMO in terms of the expense synergies that are coming out of M&I and I think that's fairly well recognized. But in terms of looking five, seven, ten years out what's the outlook for revenue synergies and one thing that I'm particularly interested is on the private client side of the business, because in M&I, that was the flavour of the acquisition and I think it's swept down to the road.

Tom E. Flynn – BMO Financial Group - EVP and Chief Financial Officer

Yeah. So I'm happy to comment on that. We've externally talked much more about the cost synergies and very little about the revenue synergies, because the market probably rightly takes show me attitude with respect to those. But we do think that there are good opportunities for revenue synergies from the transaction.

On the wealth side, this transaction really significantly increases the size of our wealth business M&I had around $150 billion of combined AUM and AUA, so a good size wealth business. And we've been in the private banking and the institutional assets management business in the U.S. for a long time and have a good business.

So we see opportunities at a high level just from taking again, the best capabilities from both organizations and also looking to distribute product that we manufacture through a bigger distribution system.

So as an example of that M&I had a mutual fund business. We think there are opportunities from a distribution capability there. We've got a good investment management capability in our Harris operation and we think there are opportunities to leverage M&I distributions there.

From a cost perspective, there are some opportunities on the private banking side as well. And our model was to serve sort of the mid and upper end part of the market well with a relationship coverage model, but to serve smaller accounts through a centralized approach and M&I didn't have that centralized approach for its smaller accounts. And so overtime, we will look to basically consolidate the administration and management of the smaller accounts into a centralized model which will free up capacity for M&I front line people to generate more revenue growth. And we think there is a revenue lift there and there is also a cost saving because we can service those accounts centrally on a lower cost basis.

On the banking side of the business, there are good opportunities. One of the biggest that we see is in Treasury Services or Cash Management for the commercial market, and we've got a good capability and just a bigger distribution network to leverage that over. And we think that that's going to be a good opportunity for us.

And then again when you got two banks that, that each had strengths and a good core business and you put them together and you take the best people, the best products, the best processes, the best systems, and we think there is good leverage in that, and we feel good about it.

One final comment, I'll make which is a soft one but it's actually a very important one, is that there has been really great buy in to the transaction from the M&I workforce. That bank went through a difficult period through the downturn as many others did and it was harder to play offense for the bank given the issues that it was dealing with. And with the transaction, the bank is back to playing offense and people are charged up about competing in the market place, and there is a huge amount of leverage that comes from unleashing the potential and the energy of our big employee base and the reception has been fantastic and has exceeded our expectations.

Audience Member

Could you share with us the bank's thinking regarding the appropriate size and structure of capital at your U.S. banks subsidiary including the the potential role of hybrids in double leverage?

Tom E. Flynn – BMO Financial Group - EVP and Chief Financial Officer

Sure. I guess our fundamental approach has been that the bank needs to be and has been appropriately capitalized and well capitalized. And we have that approach both at our bank operating company and at our bank holding company where under old rules, which are being phased out there was the ability for foreign banks to have less capital in the holding company and we did not take advantage of that because we thought it was appropriate to keep the entity well capitalized.

Our capitalization has been focused on core common as opposed to non-common capital and we have a small REIT preferred that we've issued in U.S. entity and we're unlikely to increase that in any meaningful way. So I'd say the focus is on keeping a strong core capital, which is what is most important to regulators and most important generally to the market.

And from a double leverage perspective, we've raised capital for the acquisition of M&I. It was fully financed with stock. And so we feel comfortable obviously with the overall capital position of the bank and each of the parts along the chain down to the operating bank.

Audience Member

Could you comment on the impact of the Canadian dollar being in at parity or above parity with the dollar and what it does for the opportunities in your business?

Tom E. Flynn – BMO Financial Group - EVP and Chief Financial Officer

Sure. So the Canadian dollar is trading around par with above parity a little earlier in the year. And the before becoming the CFO I was the CRO for about three years and pre-crisis the Canadian dollar was very strong as well. And we kept on waiting for the fallout to come in the Canadian manufacturing base, because of the strength in the dollar. And every quarter we'd wait for it and the reality is, we didn't see a significant fallout and haven't to-date either. And we asked ourselves why, and our conclusion was that Canadian industry had to become competitive given global competition. And an adjustment process took place over a decade plus with industry becoming more competitive, rationalizing operations moving some production, and with that the industrial base was able to withstand the strong dollar in a way that surprised us on the upside. And that's the general statement, there are industries that get affected at these times, but overall, the industry has held up remarkably well and we're not seeing significant weakness in that at the current time.

Audience Member

Thanks. Just on dividend, you've had a flat dividend for three years, can we expect once you meet Basel '13? Is that kind of the issue with this dividend growth, I guess?

Tom E. Flynn – BMO Financial Group - EVP and Chief Financial Officer

So we've had a flat dividend for – and as you say about three years, maybe little more. Our view on this is that we have the highest dividend payout policy of the Canadian banks at 45 to 55%. We're in that range currently and so we've got an attractive yield, and people don't need to wait for an attractive yield. They've got it today which in a low rate environment we think is a big plus for this stock and for our investors.

We don't plan on increasing the dividend in the near-term, it's partly a function of Basel III as you've suggested and we want to make progress against the Basel III standards before we increase the dividend. But I think I do believe the bigger point is that, the current yield in absolute terms and relative terms is attractive.

Audience Member

To follow the last question, do you anticipate a G-SIFI surcharge for BMO and/or a domestic capital overlay from your domestic regulator above and beyond what might be required for Basel III specifically?

Tom E. Flynn – BMO Financial Group - EVP and Chief Financial Officer

We're not expecting G-SIFI surcharge for sure and we're not on the list and wouldn't expect to be. The question of whether Canada adopts an N-SIFI approach is still an open question. And the answer to that it is not clear. So, it's too early for us to comment on that.

Audience Member

When you acquire the U.S. banks, do you change the assumptions on your pension funds and the rates of returns on the mix so they simply stay where they are basically located?

Tom E. Flynn – BMO Financial Group - EVP and Chief Financial Officer

I'm quite sure and we can confirm this for you offline that, M&I did not have a defined benefit pension plan that would give rise to that issue as a defined contribution arrangements. So, there is no issue in that regard.

Audience Member

Maybe this is for your former half rather than your current one but your thought that you collected the exit real estate, exit commercial real estate portfolio to the comparative merits of working it loan-by-loan for an extended period of time versus how developed the virtual market is for quicker exits in some of these credits?

Tom E. Flynn – BMO Financial Group - EVP and Chief Financial Officer

Yeah our position on that is that we're not a forced seller. And we won't sell on prices that we think aren't reflective of value and the plan is to work with this over a period of time which will be years and so our expectation is that we'll be working out the portfolio and we'll take advantage of opportunities to sell pieces when they present themselves and we think the value represent fair value.

M&I as you may know had been quite active at selling into the market and really did do a very good job of working down its real estate exposures over about a two year period. And so we've got very developed capability on the bulk sale side. And we continue to stay close to the market and some of the most senior people at M&I who are involved in that activity and did the good job managing it down are still with us today. So, the approach is basically to be flexible, to be opportunistic and to be focused on two things. The first is managing the portfolio down, which we want to do, and the second is doing a good job from a value perspective.

John Aiken – *Barclays Capital - Analyst*

We have time for one final question. Well Tom so you did leave the door open on your Chief Risk Officer role, I was looking at the slide in your presentation where BMO is going through the cycle again and provisions have been declining. You've done a very good job illustrating how well you've done in the U.S. against your peer group. Is this something that you think they can extrapolate over the acquisition; you will be able to continue to add performance given your risk adjudication work out and everything else like that.

Tom E. Flynn – BMO Financial Group - EVP and Chief Financial Officer

Over a long period of time, BMO has a track record of outperforming peers on credit loss and we view ourselves as having a conservative credit position and from a risk appetite perspective, we say that we want to have a level of loss that is below peers. And so that's our fundamental philosophy and as we integrate M&I we are bringing our risk disciplines and philosophies to their business and so we would expect to operate on the same basis that would see us outperforming U.S. banks, like portfolio, to like portfolio. We need to go through the process obviously of working out the legacy portfolio. We've got the benefit of the mark to do that. But the go-forward approach would be to keep the traditional BMO approach

John Aiken – *Barclays Capital - Analyst*

Tom, thank you very much for your time and we really appreciate the presentation.