BMO Financial Group

Q2 2022 Conference Call

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Caution Regarding Forward-Looking Statements

Bank of Montreal's public communications often include written or oral forward-looking statements. Statements of this type are included in this document and may be included in other filings with Canadian securities regulators or the U.S. Securities and Exchange Commission, or in other communications. All such statements are made pursuant to the "safe harbor" provisions of, and are intended to be forward-looking statements under, the United States Private Securities Litigation Reform Act of 1995 and any applicable Canadian securities legislation. Forward-looking statements in this document may include, but are not limited to, statements with respect to our objectives and priorities for fiscal 2022 and beyond, our strategies or future actions, our targets and commitments (including with respect to net zero emissions), expectations for our financial condition, capital position or share price, the regulatory environment in which we operate, the results of, or outlook for, our operations or for the Canadian, U.S. and international economies, the closing of our proposed acquisition of Bank of the West, including plans for the combined operations of BMO and Bank of the West, the financial, operational and capital impacts of the transaction, and the COVID-19 pandemic, and include statements made by our management. Forward-looking statements are typically identified by words such as "will", "would", "should", "believe", "expect", "anticipate", "project", "intend", "estimate", "plan", "goal", "commit", "target", "may", "might", "forecast" and "could" or negative or grammatical variations thereof.

By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties, both general and specific in nature. There is significant risk that predictions, forecasts, conclusions, or projections will not prove to be accurate, that our assumptions may not be correct, and that actual results may differ materially from such predictions, forecasts, conclusions or projections. The uncertainty created by the COVID-19 pandemic has heightened this risk, given the increased challenge in making assumptions, predictions, forecasts, conclusions, or projections. We caution readers of this document not to place undue reliance on our forward-looking statements, as a number of factors – many of which are beyond our control and the effects of which can be difficult to predict – could cause actual future results, conditions, actions or events to differ materially from the targets, expectations, estimates or intentions expressed in the forward-looking statements.

The future outcomes that relate to forward-looking statements may be influenced by many factors, including, but not limited to: general economic and market conditions in the countries in which we operate, including labour challenges; the severity, duration and spread of the COVID-19 pandemic, and possibly other outbreaks of disease or illness, and its impact on local, national or international economies, as well as its heightening of certain risks that may affect our future results; information, privacy and cyber security, including the threat of data breaches, hacking, identity theft and corporate espionage, as well as the possibility of denial of service resulting from efforts targeted at causing system failure and service disruption; benchmark interest rate reforms; technological changes and technology resiliency; political conditions, including changes relating to, or affecting, economic or trade matters; climate change and other environmental and social risk; the Canadian housing market and consumer leverage; inflationary pressures; global supply-chain disruptions; changes in monetary, fiscal, or economic policy; changes in laws, including tax legislation and interpretation, or in supervisory expectations or requirements, including capital, interest rate and liquidity requirements and guidance, and the effect of such changes on funding costs; weak, volatile or illiquid capital or credit markets; the level of competition in the geographic and business areas in which we operate; judicial or regulatory proceedings; the accuracy and completeness of the information we obtain with respect to our customers and counterparties; failure of third parties to comply with their obligations to us; our ability to execute our strategic plans and to complete proposed acquisitions or dispositions, including obtaining regulatory approvals; critical accounting estimates and the effects of changes to accounting standards, rules and interpretations on these estimates; operational and infrastructure risks, including with respect to reliance on third parties; the possibility that our proposed acquisition of Bank of the West does not close when expected or at all because required regulatory approvals and other conditions to closing are not received or satisfied on a timely basis or at all or are received subject to adverse conditions or requirements; the anticipated benefits from the proposed acquisition of Bank of the West, such as it creating synergies and operational efficiencies, are not realized; our ability to perform effective fair value management actions and unforeseen consequences arising from such actions; changes to our credit ratings; global capital markets activities; the possible effects on our business of war or terrorist activities; natural disasters and disruptions to public infrastructure, such as transportation, communications, power or water supply; and our ability to anticipate and effectively manage risks arising from all of the foregoing factors.
We caution that the foregoing list is not exhaustive of all possible factors. Other factors and risks could adversely affect our results. For more information, please refer to the discussion in the Risks That May Affect Future Results section, and the sections related to credit and counterparty, market, insurance, liquidity and funding, operational non-financial, legal and regulatory, strategic, environmental and social, and reputation risk, in the Enterprise-Wide Risk Management section of BMO's 2021 Annual Report, and the Risk Management section in BMO's Second Quarter 2022 MD&A, all of which outline certain key factors and risks that may affect our future results. Investors and others should carefully consider these factors and risks, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements. We do not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by the organization or on its behalf, except as required by law. The forward-looking information contained in this document is presented for the purpose of assisting shareholders and analysts in understanding our financial position as at and for the periods ended on the dates presented, as well as our strategic priorities and objectives, and may not be appropriate for other purposes.

Material economic assumptions underlying the forward-looking statements contained in this document are set out in the Economic Developments and Outlook section of BMO's 2021 Annual Report and updated in the Economic Developments and Outlook section in BMO's Second Quarter 2022 MD&A, as well as in the Allowance for Credit Losses section of BMO's 2021 Annual Report and updated in the Allowance for Credit Losses section in BMO's Second Quarter 2022 MD&A. Assumptions about the performance of the Canadian and U.S. economies, as well as overall market conditions and their combined effect on our business, are material factors we consider when determining our strategic priorities, objectives and expectations for our business. Assumptions about Bank of the West's balance sheet, product mix and margins, and interest rate sensitivity were material factors we considered in estimating the fair value and goodwill and intangibles amounts at closing, and assumptions about our integration plan, the efficiency and duration of integration and the alignment of organizational responsibilities were material factors we considered in estimating pre-tax cost synergies.

In determining our expectations for economic growth, we primarily consider historical economic data, past relationships between economic and financial variables, changes in government policies, and the risks to the domestic and global economy. Please refer to the Economic Developments and Outlook and Allowance for Credit Losses sections in BMO's Second Quarter 2022 MD&A.

Non-GAAP Measures and Other Financial Measures

Results and measures in both Management's Discussion and Analysis (MD&A) and this document are presented on an IFRS basis. We use the terms IFRS and Generally Accepted Accounting Principles (GAAP) interchangeably. We use a number of financial measures to assess our performance as described herein, including measures and ratios that are presented on a non-GAAP basis. Readers are cautioned that non-GAAP amounts, measures and ratios do not have standardized meanings. They are unlikely to be comparable to similar measures presented by other companies and should not be viewed in isolation from, or as a substitute for, GAAP results.

Examples of non-GAAP amounts, measures or ratios include: efficiency and leverage ratios calculated using revenue presented net of CCPB; revenue and other measures presented on a taxable equivalent basis (teb); pre-provision pre-tax income; amounts presented net of applicable taxes; results and measures that exclude the impact of Canadian/U.S. dollar exchange rate movements (i.e. constant currency basis or CCY), adjusted net income, revenues, non-interest expenses, earnings per share, effective tax rate, ROE, efficiency ratio, and other adjusted measures which exclude the impact of certain items such as acquisition and integration costs, amortization of acquisition-related intangible assets, impact of divestitures, restructuring costs and management of fair value changes on the purchase of Bank of the West. Bank of Montreal provides supplemental information on combined business segments to facilitate comparisons to peers.

Certain information contained in BMO's Second Quarter 2022 Management's Discussion and Analysis dated May 25, 2022 for the period ended April 30, 2022 ("Second Quarter 2022 MD&A") is incorporated by reference into this document. Quantitative reconciliations of non-GAAP and other financial measures to the most directly comparable financial measures in BMO's financial statements for the period ended April 30, 2022, an explanation of how non-GAAP and other financial measures provide useful information to investors and any additional purposes for which management uses such measures, as well as the effects of changes in exchange rates on BMO's U.S. segment reported and adjusted results, can be found in the Non-GAAP and Other Financial Measures section of the Second Quarter 2022 MD&A. Further information regarding the composition of our non-GAAP and other financial measures is provided in the Glossary of Financial Terms section of the Second Quarter 2022 MD&A. The Second Quarter 2022 MD&A is available on SEDAR at www.sedar.com.

PRESENTATION

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

Thank you, and good morning. We will begin today's call with remarks from Darryl White, BMO's CEO; followed by Tayfun Tuzun, our Chief Financial Officer; and Pat Cronin, Our Chief Risk Officer.

Also present to take questions are Ernie Johannson from Canadian P&C; Dave Casper from U.S. P&C; Dan Barclay from BMO Capital Markets; and Deland Kamanga from BMO Wealth Management.

As noted on Slide 2, forward-looking statements may be made during this call, which involve assumptions that have inherent risks and uncertainties. Actual results could differ materially from these statements.

I would also remind listeners that the bank uses non-GAAP financial measures to arrive at adjusted results. Management measures performance on a reported and 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. And with that, I'll turn the call over to Darryl.

Darryl White - *Bank of Montreal - CEO*

Thank you, Christine, and good morning, everyone. We continued to deliver good financial performance this quarter, driven by broad-based customer loan growth in our North American P&C and wealth businesses and solid results in our market-sensitive businesses.

Second quarter adjusted earnings per share improved to $3.23, with continued positive operating leverage and strong pre-provision pretax earnings growth of 6%. Year-to-date, PPPT is up 12%, driven by strong revenue growth and continued expense management that includes targeted investments for future growth. With operating leverage of 3.3% and an efficiency ratio of 54.7% year-to-date, we are delivering on our commitment for positive operating leverage for the year.

This morning, we also announced a dividend increase of $0.06 to $1.39 per share, an increase of 5% over last quarter and 31% over last year.

We continued to strengthen our capital, including executing the planned equity issuance and are well positioned to support both client-driven balance sheet growth and the Bank of the West acquisition. ROE remains our key area of focus, guiding our strategic investment decisions as we manage the bank and our businesses for sustained profitable growth. Year-to-date, ROE was 17.2%, up from the same period last year as we continue to drive initiatives to improve the profitability of our businesses.

These consistent results demonstrate the ongoing value of our advantaged business mix, including strong contribution from our U.S. segment and the dynamic execution of our purpose-driven strategy.

Our strategy is designed to deliver sustained performance through the cycle, including disciplined capital allocation decisions. Our ongoing investments in talent and technology have delivered resilient performance through the pandemic and we believe will drive sustained performance in a rising rate environment.

The current backdrop presents both risks and opportunities for our customers and for the bank. In the face of some economic uncertainty, our long-standing track record of superior risk management through the cycle has proven to be resilient in protecting and growing the bank. It's underpinned by a strong risk culture and consistent risk appetite with a well-diversified commercial portfolio that is 85% secured, the vast majority of which has a sole or lead customer relationship.

Now with pandemic restrictions largely lifted, the economy is growing and businesses and consumers continue to adapt. Investments in our North American growth strategy, in climate transition and in digital advancements position us to capture these opportunities as we support our customers in navigating the changing environment.

As the eighth largest bank and a top 5 commercial lender in North America, we're uniquely positioned to advise our clients on both sides of the border as the trend to re-globalization accelerates. As supply chains shift North American businesses are investing, automating and building back inventories.

With double-digit commercial loan growth in both Canada and the U.S. this quarter, we're already seeing these dynamics play out. We're further benefiting from ongoing investments to expand our commercial presence, to add talent and extend product and digital capabilities that are attracting new clients and strengthening existing relationships. Our capital markets and commercial banking teams together are accelerating efforts to successfully partner to deliver world-class capital markets services to our mid-market commercial clients. Our one-client, one-bank approach is a clear differentiator for existing and prospective clients.

We've also positioned ourselves for the unprecedented investments that will be needed to catalyze climate action and shift to a cleaner energy production. We're leading key financing activities, leveraging our climate institute and energy transition teams to be our clients' lead partner in achieving their energy transition goals and our collective ambition for a net zero world.

BMO Capital Markets is a Canadian leader in sustainable financings, including ranking as the top underwriter of ESG bonds and the #1 sustainability structuring agent. In addition, our agreement with Export Development Canada will bring innovative sustainable finance solutions to Canadian exporting businesses and help them transition from carbon-intensive operations to those that can eliminate or significantly reduce emissions. And as the market share leader in ESG ETFs in Canada, we continue to expand our innovative suite of products, including a climate-focused solution and are also seeing strong flows in our sustainable mutual funds.

We're innovating for the future with an intentional digital-first strategy poised to capture the shift to advanced digital experiences. We've laid the groundwork with sustained investments in technology that are driving loyalty, efficiency and growth by delivering leading employee and customer experiences that power real financial progress.

For example, we're continuing to roll out enhancements to our online banking experience in Canada, making it faster and easier to use. And we recently ranked first in the Insider Intelligence Canada Mobile Banking Emerging Features Benchmark for 2022. The ranking reflected the strength of select emerging features offered on the BMO mobile banking app with top marks in the categories of digital money management, account management and alerts.

We continue to modernize our technology through cloud. For example, we're converting to a proprietary platform to support risk management analytics, which makes forecasting loan loss scenarios 10x faster, more integrated and cost effective.

Our people are key to our success and our winning culture. Early adoption of technology and innovation has given us the ability to attract and retain the talent that will transform banking and create efficiency for modernizing our platforms. We're actively growing in key technology hubs in Canada and the U.S. including in cities where the Bank of the West has locations.

Bank of the West will further enhance our natural advantages with complementary retail, wealth and commercial businesses; a strong, sustainable lending team; digitally active customer base; and dedicated, talented employees. Tayfun will provide more detail on our integration planning process and the revenue synergies that our combined businesses are expected to deliver.

As we continue to grow the bank, we're steadfast in our purpose-driven commitments to a thriving economy, a sustainable future and an inclusive society. We're proud to have been recognized by the Ethisphere Institute as one of the world's most ethical companies for the fifth consecutive year. This quarter, we announced a $5 billion commitment to support women business owners in Canada, recognizing the impact they have on our communities and the importance of helping them access the capital they need to grow their businesses and through them, our economy.

To conclude, we have a proven dynamic purpose-driven strategy for growth that is underpinned by superior risk management and robust capital, and we're well positioned to deliver sustained performance in any environment.

I'll now turn it over to Tayfun.

Tayfun Tuzun - *Bank of Montreal - CFO*

Thank you, Darryl. Good morning, and thank you for joining us. My comments will start on Slide 10.

Second quarter reported EPS was $7.13 and net income was $4.8 billion. Adjusting items this quarter are similar to last quarter and include revenue of $3.6 billion pretax from fair value management activities related to the acquisition of Bank of the West to mitigate the impact of higher interest rates on the expected goodwill and capital at closing. The details of adjusting items are shown on Slide 36. The remainder of my comments will focus on adjusted results.

On an adjusted basis, EPS was $3.23 and net income was $2.2 billion, up from $2.1 billion last year, driven by strong pre-provision pretax earnings of $2.9 billion, up 6%, reflecting good year-over-year revenue growth across our diversified businesses and disciplined dynamic expense management. Efficiency improved to 55.6% and return on equity was 15.7%. Total PCL was $50 million, and Pat will speak to these in his remarks.

Moving to the balance sheet on Slide 11. Average loans were up 9% year-over-year and 3% quarter-over-quarter. Business and government loans increased 10% year-over-year or 13% excluding the impact of declining balances in our non-Canadian energy portfolio and deconsolidation of our customer securitization vehicle reflecting strong commercial loan growth in Canada and the U.S. Consumer balances were up 9% from the prior year, reflecting strong growth in our Canadian P&C and wealth businesses. Average customer deposits were up 7% year-over-year with growth across all operating groups. Looking ahead, we expect continued strong loan growth in our P&C businesses in the high single digits on a year-over-year basis reflecting strong diversified pipelines.

Turning to Slide 12. Net interest income was up 9% from last year and up 12% on an ex-trading basis with growth across all operating groups. Adjusted net interest margin ex trading was up 5 basis points from the prior quarter, reflecting the impact of rising rates, declining excess liquidity levels and lower low-yielding assets in Capital Markets. On a sequential basis, margin was down 2 basis points in Canadian P&C and up 1 basis point in U.S. P&C, reflecting higher deposit margins, offset by lower loan margins and loans growing faster than deposits. In the second half of the year, NIM in both our P&C businesses and at the all bank level is expected to widen given the rising rate environment.

Moving to our interest rate sensitivity on Slide 13. Overall, our interest rate risk management approach has worked very well, protecting our NIM in the low rate environment. And now we remain well positioned for the rising rate environment. A 100 basis point rate shock is expected to benefit net interest income by $635 million over the next 12 months. Although still early in the rate hike cycle, to date, our deposit pricing and stability has tracked in line with or better than our model assumptions. If deposit betas are 10% lower than what we have assumed, then the benefit under a 100 basis point rate increase would be higher by approximately $50 million.

Turning to Slide 14. Noninterest revenue net of CCPB was down 3% from the prior year and down 9% on an ex-trading basis, primarily due to the impact of divestitures and lower underwriting and advisory fees given market conditions. Sequentially, net noninterest revenue was down 11% or 9% ex trading primarily due to lower underwriting and advisory fees, lending fees and securities gains.

Moving to Slide 15. Expenses were up 2% from the prior year. We delivered positive operating leverage of 1.8% this quarter as we continue to reinvest savings from divestitures into targeted areas to drive revenue growth, including sales force expansion and technology. Sequentially, expenses were down 5%, primarily due to lower employee-related costs, driven by stock-based compensation for employees eligible to retire that are expensed in the first quarter of each year and the seasonality of benefits, as well as the impact of 3 fewer days in the current quarter. As we look ahead, the moderation in our year-over-year expense growth is expected to continue into the second half of the year, including the impact of rising compensation expenses and after delivering positive operating leverage for 8 quarters in a row, we continue to expect positive operating leverage for the year.

Moving to Slide 16. Our capital position continued to strengthen with a common equity Tier 1 ratio of 16%, up 190 basis points from the prior quarter. As shown on the slide, the increase largely reflects the impact of the common share issuance and management of fair value changes related to the Bank of the West acquisition as well as strong internal capital generation. The cumulative impact of the fair value management actions of 90 basis points is expected to be offset by higher goodwill on closing relative to our assumptions at announcement. Source currency risk-weighted assets were higher, reflecting growth in our lending businesses and the impact of the Basel III capital floor adjustment in the quarter.

Before moving to the operating groups, a quick update on the Bank of the West acquisition shown on Slide 17. We look forward to closing the transaction by calendar year-end and our teams are making good progress in preparing for a successful integration. While we shared our cost synergy targets at announcement in December, since then, we have been working to identify revenue synergy opportunities across our businesses. The opportunities identified reflect leveraging BMO's strengths in a larger, very attractive footprint including our digital first and relationship-based approach and an expanded product and service offering for our combined client base. Based on our initial expectations, we expect to be able to achieve pre-provision pretax synergy opportunities in the range of $450 million to $550 million over the next 3 to 5 years, with approximately 60% of that driven by our commercial and Capital Markets and 40% by our personal and wealth businesses. We are on track against the assumptions announced in December including capital generation and expense synergies.

Moving to the operating groups and starting on Slide 18. Canadian P&C delivered net income of $941 million reflecting pre-provision pretax earnings growth of 11%. Revenue was up 11% from the prior year. Higher net interest income reflected good balance growth and stable margins while noninterest revenue increased across most categories reflecting higher customer activity. Expenses were up 11%, reflecting investments in the sales force and in technology with year-over-year growth expected to moderate in the second half of the year. Average loans were up 10% from last year, driven by continued strength in residential mortgage lending and 13% commercial loan growth. Deposits were up 7% year-over-year and flat sequentially.

Moving to U.S. P&C on Slide 19. My comments here will speak to the U.S. dollar performance. Net income was $465 million, up 7% from the prior year, with 5% growth in pre-provision pretax earnings. Revenue was up 5% from last year, reflecting good growth in net interest income. Expenses were also up 5%, primarily due to higher employee costs and technology investments. On the balance sheet, excluding PPP loans, average loans were up 13% from the prior year, including strong commercial loan growth of 14%. Average deposits increased 4% year-over-year and declined modestly from the last quarter.

Moving to Slide 20. Wealth Management net income was $315 million, down from $329 million last year. Traditional wealth net income was $248 million, with good underlying revenue growth of 5%, excluding the impact of divestitures, reflecting higher net interest income from strong deposit and loan growth and higher average client assets, partially offset by lower online brokerage transaction revenue compared to last year. Insurance net income was $67 million, reflecting more favorable market movements this quarter. Expenses were down 9% due to the impact of divestitures, partially offset by investments in the business.

Turning to Slide 21. BMO Capital Markets net income was $453 million compared to $565 million in the prior year. Revenues increased from last year with investment and corporate banking revenue up 3%, primarily due to higher corporate banking-related revenue, partially offset by lower underwriting and advisory revenue. Global Markets revenue increased 1%. Revenues both in Global Markets and I&CB declined from the record levels in the first quarter, reflective of the market environment. Expenses were up 11%, mainly due to investments in the business, including higher technology and talent costs.

Turning now to Slide 22 for Corporate Services. Corporate Services net loss was $111 million compared to a net loss of $120 million in the prior year.

To conclude, we continue to deliver good operating performance across our diversified businesses and expect the dynamic management of the business in a changing economic environment will continue to serve our shareholders well and deliver long-term growth.

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

Pat Cronin - *Bank of Montreal - CRO*

Thank you, Tayfun, and good morning, everyone. We were very pleased with our risk performance again this quarter and saw continued improvement across many of our key portfolio metrics. This strong performance reflects the combination of disciplined risk origination from prior periods and strong risk management disciplines through time.

Starting on Slide 24. The total provision for credit losses was $50 million or 4 basis points, up from a recovery of $99 million or negative 8 basis points last quarter. Impaired provisions for the quarter were $120 million or 10 basis points. And while this was up from very low impaired provisions of $86 million or 7 basis points in Q1, impaired provisions remain well below pre-COVID levels. Similar to last quarter, the strong impaired loan performance is due to low formations and low delinquency rates.

We recorded a release on the provision for performing loans of $70 million this quarter. We did recognize the potential for economic headwinds by increasing the weighting of our adverse scenario as well as reducing parts of our economic outlook in our base case scenario. This was offset by positive credit migration again this quarter as well as a reduction in the judgment we have been applying specific to COVID-related uncertainty. Given the strong credit profile of our current portfolio and our forecast for impaired losses, we remain comfortable that our $2.29 billion of performing loan allowances provides adequate provisioning against loan losses in the coming year.

Turning to the impaired loan credit performance in the operating groups. We saw low loss provisions across all business segments again this quarter. In Canadian Personal and Business Banking, impaired loan losses were $79 million, flat relative to Q1. The U.S. Personal and Business Banking business had impaired loan losses

of $1 million, down from $4 million in the prior quarter. Consistent with prior quarters, strong credit performance across our P&BB businesses was driven by low delinquency and insolvency rates.

In our commercial and corporate businesses, we also saw strong credit performance. In Canadian commercial, we reported impaired loan provisions of $7 million, down from $21 million last quarter. Our U.S. commercial business had impaired loan provisions of $34 million, up from a net recovery on impaired loans of $1 million last quarter. Our Capital Markets business also had strong impaired loan credit performance this quarter with impaired loan losses of $1 million.

On Slide 26, impaired formations were low again this quarter at $333 million, leading to a gross impaired loan balance of $2.1 billion or 41 basis points. Both formations and gross impaired loan rates continue to be well below pre-COVID levels.

Despite some challenging market conditions, trading risk performance was good again this quarter, with 1 loss day as you can see on Slide 26. Despite continued volatile markets, our trading risk performance so far in Q3 has been consistent with Q2.

In terms of the outlook, while the pandemic is not over, the economic impacts continue to diminish, which along with our strong credit performance makes us confident that we can manage through current or emerging headwinds. With that said, our base case economic forecast is for continued economic growth. And should that transpire, there remains modest room for continued releases of the performing loan provision.

As I have previously guided, we do expect our impaired PCL rate to drift slowly back up to a level more consistent with our pre-pandemic experience, which was consistently high teens to low 20s in terms of basis points. While it's difficult to predict the timing of when that level will be reached, given that the current portfolio credit metrics remain quite strong, I would expect that normalization to start towards the end of this year or into fiscal 2023.

During the past 2 years, we have continued to strengthen our risk management capabilities, including automated and data-driven risk mitigation and management processes. In the face of macroeconomic and geopolitical risks, these capabilities, together with a strong current risk profile, strong liquidity and capital levels, a well-diversified portfolio and an adequate allowance, we're confident that we can continue to both manage future risk and support future growth.

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

QUESTIONS AND ANSWERS

Ebrahim Poonawala - *BofA Securities*

I guess a question for Tayfun. So one, you mentioned margin expansion in both P&C and consolidated bank, if you could quantify that a little bit for us? And then in particular, just talk to us a little about U.S. deposits in terms of is there any subset of the growth that you've seen in the last couple of years where you expect deposit outflows? And just how do you expect the behaviour of deposits? I mean you mentioned about deposit betas, but given just the magnitude of rate hikes we're going to see in the U.S. in the second and the third quarters. Just give us a trajectory of where you think -- how quickly do you think deposits begin to reprice and how you are thinking about just the risk of deposit outflows on the back of that.

Tayfun Tuzun - *Bank of Montreal - CFO*

Thanks for the question, Ebrahim. So I'll start with the latter part of your question, and I'll come back to the NIM question. In terms of deposits, outflows as well as deposit pricing, we are pretty much on target, on model with our expectations. In this environment, we have been expecting, first, the deposit growth has slowed down, and then starting in the U.S., we were expecting to see outflows. As both rates are increasing, we're still seeing opportunities that our clients have to place the money elsewhere in their commercial businesses as well as in personal banking. So you can see the numbers on a quarter-over-quarter basis, deposit growth either slowed down, flat or some declines in the U.S., very much in line with what we expected. I suspect that as the central banks continue to aggressively increase interest rates, deposit betas are going to move up. And it's difficult to necessarily move the dial all the way to the end and say whether they will end up higher than the last rate cycle, but it is likely that they will end up higher than the rate cycle based on what we see today.

But in terms of our numbers, what guided us when we said we see NIM expansion into the second half of the year, and I will extend that also into 2023, all of it is in line with what we have modeled. I do expect NIM to meaningfully expand from here in Q3 and in Q4. We may see something close to what we have seen this quarter in our ex-trading NIM, which was 5 basis points in the next couple of quarters. And then based on the rate increases that we're expecting, I think we will continue to see the expansion into 2023, which when you put it all together with our guidance of high single-digit loan growth this year, potentially moving into even next year, that bodes very well for net interest income growth. We had 9% growth year-over-year this quarter. You should see that number to remain very strong for the rest of the year as well as 2023.

Ebrahim Poonawala - *BofA Securities,*

Got it. And just one follow-up, Tayfun. So I understand the hedging to mitigate the goodwill impact at deal close. Does a larger goodwill also imply that the purchase accounting earnings will be higher than you expected? As a result, the EPS accretion, if you add that, will be meaningfully higher than what you announced or am I missing something?

Tayfun Tuzun - *Bank of Montreal - CFO*

No, everything else equal, the higher rate mark will move more into the future quarters after we close the transaction.

Ebrahim Poonawala - *BofA Securities*

And can you quantify how much higher would that be if like things were -- at quarter end, if the deal closed at quarter end?

Tayfun Tuzun - *Bank of Montreal - CFO*

Well, assuming that we have a $3.5 billion pick up this quarter on top of about $500 million last quarter, assuming that basically is the change in the rate mark itself, all of that money would be accreting back to income, the rate mark will be higher by that much.

Ebrahim Poonawala - *BofA Securities*

Got it. So that will come through the life of those loans. Got it.

Meny Grauman - *Scotiabank Global Banking and Markets*

Just a question on Bank of the West. Bank mergers in the U.S. are facing more scrutiny. I think you have the hearing scheduled for July. I'm just wondering, is it reasonable to expect a delay here for the deal close, and why or why not?

Darryl White - *Bank of Montreal - CEO*

Meny, it's Darryl. We don't expect a delay. I would say to you everything that we thought might happen over the course of the year when we announced the transaction on the 20th of December is basically playing out according to expectations, including our capital raise, including the submission to various regulators, including the process as we see it, the meeting that you're referring to in July is a public meeting. It's not a hearing. It's normal course. That was expected as well.

So as we sit here today, we don't really have any -- it's kind of boring for you, I know, but we really don't have any update relative to what we've said before, things are playing out as we expected them to and our best guess remains exactly what we said when we announced the transaction, which is that we would close towards the end of the calendar year.

Meny Grauman - *Scotiabank Global Banking and Markets*

Got it, Darryl. Yes, boring is -- I guess, boring is good, all considered.

But just a question on capital, partly as it relates to the deal. When you announced the deal, you talked about 11% or higher, given how the world has developed since then, should we be thinking about the higher part as being more operational now? How are you thinking about capital?

Darryl White - *Bank of Montreal - CEO*

Meny, I'll give you my sense and Tayfun might want to complement here. We did say that. We said that we expected based on our models at the time that the first quarter post closing, we would be at 11% or higher. As we look at the developments over the 5 months that have followed and we look at our models going forward, we stand by that. In fact, if anything, we might be a little bit ahead of that by some of the capital actions, including the equity issuance, which was a little higher than we went out for. And when we look at where we are at closing and then post closing, that 11%, as I said, we stand by it. And in fact, it could be a little better than that, it could be 11.5% in the first quarter or something like that. Tayfun, would you add to that?

Tayfun Tuzun - *Bank of Montreal - CFO*

Yes. I mean, but those are, just going back to your question, they really don't relate to necessarily our world view of what the world will look like at the time. That's just where we see our capital ratios to be looking at the movements today. So we have not necessarily increased our capital management target at this point.

Meny Grauman - *Scotiabank Global Banking and Markets*

So just to clarify, if you were at 11%, you would be comfortable with that. The regulator would be comfortable with that as far as you understand it?

Darryl White - *Bank of Montreal - CEO*

Yes, that would be our expectation today, yes.

Scott Chan - *Canaccord Genuity Corp*

Sticking to the Bank of the West theme or update. Tayfun, you talked about PPPT of $450 to $550 million over the next 3 to 5 years with commercial and personal. I assume that is all majority incremental revenue. And is that cumulative as you kind of already talked about the expected cost synergies within the transaction?

Tayfun Tuzun - *Bank of Montreal - CFO*

Yes. Scott, it is net revenue synergies. So there is going to be some expenses associated with it, but this is a net number that we are projecting and we are projecting that to be a run rate increase after 3 to 5 years. So it's not necessarily over a 5-year period of time, a cumulative number. When we get towards the end of that time period, we expect to add net revenues between $450 million to $500 million.

And just one more comment. As you can appreciate, because of legal restrictions, we don't have full access to their client information and data. Our teams have done a lot of work around our products compared to their products, their markets, et cetera. So this is actually a very good perspective on the uptick in our performance as we expect. But I have to say that I am optimistic that once we actually get full access to their client base, this number has potentially more room on the upside.

Scott Chan - *Canaccord Genuity Corp.*

Okay. And the 40% personal and wealth, is that more weighted to the latter in terms of wealth management, you think?

Tayfun Tuzun - *Bank of Montreal - CFO*

It's about even actually, to be honest with you, it's even between personal banking and wealth management.

Gabriel Dechaine - *National Bank Financial*

Yes, Darryl, I just want to follow up on your comment there. It sounds like you might be expecting an 11%, 11.5% post-close core Tier 1 ratio. That's surprising, I guess, considering the backdrop. I mean it's a lot different than what we had in December, of course. We've all got our estimates for internal capital generation. Are you anticipating to pull some strategies out of your back pocket like securitization activity or portfolio sales or anything of that nature? Or you're still anticipating getting there or even better than the 11% in normal course?

Darryl White - *Bank of Montreal - CEO*

Yes. So Gabe, I should course correct if I miscommunicated earlier, I think I heard you say that that's different from what we expected 3 months ago. I'll be clear, that's exactly what we expected 3 months ago and 5 months ago when we announced the transaction. So the message we're trying to give you today is that we are unchanged in our perspective of the capital outcome post the transaction after the first quarter. And the only tweak I would make to that is, if anything, a little bit more capital based on where the models have come in and the outlook that we've got today.

And as far as actions are concerned, the second part of your question, we're continuing along in the normal course. The balance sheets are being absorbed in the way that we expected them to and the customer behaviour is what it is as you see the loan growth. We completed the equity issuance, the DRIP is in place, as you know, and it's coming in a little bit stronger than we had modeled. So all told, it round trips to basically what we had expected all along, if not a little bit better. That's the message we're trying to leave you with.

Gabriel Dechaine - *National Bank Financial*

Yes. Maybe I misworded it, I meant the environment has gotten different, not necessarily your messaging. It's consistent despite that change.

Okay. Now about expenses and, Tayfun, I believe I heard you recommitting to a lower expense growth rate in the second half. Because I've got the Q4, you were guiding to flat expense growth for the full year. Q1, you bumped that up to 1.5%, and now you're not changing that. This quarter, we had, what, 2% expense growth a bit above that if you exclude variable comp, but nothing on the wage inflation side that might actually nudge expense growth a bit higher than what we thought three months ago.

Tayfun Tuzun - *Bank of Montreal - CFO*

Yes. Thanks for the question, Gabe. So just to set up the environment, obviously, as I said, this was the eighth quarter in a row that we delivered positive operating leverage, and we are committing to that. So I mean it may not be every quarter, but that's our commitment over reasonable periods of time.

We did have 2% increase. My comment about the second half continuing a more moderate expense growth into the second half of this year relates to the fact that when we started ramping up our investments in technology and sales force, that happened more in the second half of last year. So therefore, we knew that the first half of this year was going to be a bit more challenging. And now going into the third and fourth quarters, you should see similar numbers that you saw from us this quarter, that 2% type of number, a relatively more modest expense growth.

In that number, I should say that last week, we did announce a salary adjustment for our employees between levels 2 and level 7 of 3%. We are seeing more inflation on the salary side, and we made that adjustment last week. My outlook does include the impact of that increase, which is an incremental amount to our discussion back in February.

As you reminded us, we did guide to about 1.5% year-over-year expense increase, excluding performance-based compensation. With this increase, we're now going to take our expense outlook year-over-year, excluding the impact of performance-based comp, to about 2.5% because that sort of is the incremental amount. We are seeing more movements in salaries. But at the same time, we maintain our commitment to positive operating leverage. We're spending a lot of time internally assessing the magnitude and the returns to our investments, and we'll ensure that as we watch the revenue environment, we dynamically manage our expenses accordingly and still achieve that positive operating leverage.

Gabriel Dechaine - *National Bank Financial*

Okay. About 1.5%, 2.5% now?

Tayfun Tuzun - *Bank of Montreal - CFO*

Correct.

Doug Young - *Desjardins Securities*

Just in U.S. banking, it seems like there was a sequential slowdown in commercial loan growth, and I do get that it probably bounces around a bit. So maybe there's nothing in there. But I'm just -- I'm curious as to what you're seeing and then what the pipeline is telling you from a loan growth perspective over the coming year. And maybe you can kind of sprinkle just in terms of utilization rates, where they stand today and where you expect them to kind of migrate to.

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

Sure. This is Dave. Actually, in our commercial business in the U.S., we had almost 3% quarter-over-quarter loan growth on the commercial side. So very positive there and close to 14% if you exclude ex-PPP year-over-year. So really strong, and it continues to be strong. And it's strong across both geographies and our sectors, particularly if there's been inventory build, which has increased our utilization. And that's despite very, very low utilization in two of our businesses, our truck financing and our auto financing. Overall, though, utilization continues to go up as clients build their inventory and see a pretty positive near-term future for the back half of the year. So I would not characterize it as slowing down. I would say it's continuing to go up.

And the last thing I'd say about this is really over the last 8 quarters, we've had 1 quarter where we've actually had lower loan growth. And that does not -- that's including the PPP. So we've continued to build throughout this entire period, adding new customers, growing geographically, adding to our sectors. So I'd say it's really, really positive. But tell me if I didn't answer your question completely, if you've got any follow-up.

Doug Young - *Desjardins Securities*

No. Well, given the macro backdrop, we get lots of questions on what is going to happen with commercial loan growth, and it just doesn't feel like in your discussions and your comments, and you're kind of talking to clients constantly that there's any real change in the outlook. Is that a fair characterization?

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

I'd say a couple of things. There's certainly more uncertainty given some of the continued issues that we all know about, supply chain inflation. But the demand for our clients' products still is outstripping supply. So they're still growing, they're trying to keep up, and the other part of it is there continues to be, both in Canada and the U.S., more movement to onshoring, less reliance on foreign sourcing, more capital expenditure to improve productivity through our manufacturing businesses and still a growth. And I think the North American market, U.S. and Canada, is going to continue to be pretty positive. I don't know, economically, if there's a downturn that's obviously going to impact us. But in the near term, we really don't hear that from our clients. They're still trying to grow and catch up in some cases in terms of still lower inventories.

Doug Young - *Desjardins Securities*

And then while I have you, just the sequential decline in non-interest revenue in the U.S. Can you break that out a little bit? Like I think I'm assuming that's a result of lower investment gains? Or is it, can you talk a little bit more about that?

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

Sure. It's not investment gains at all. There are no investment gains in our U.S. P&C business. There never are. That's mostly a Canadian issue. So the issue, though, is in our first quarter, and really, particularly in December, we had very, very strong syndication gains. And that's – as you recall, at the end of the last year, a lot of transactions try to get done before calendar year-end. So that hit us in the first quarter. And we were up probably 15% or 20% in that business. And that's -- the syndication business is very strong for us. But that's really what the decline was. I think our more normalized NIR would be what we hit this quarter. There'll be some ups and downs. But we have a lot of other parts of that business, our M&A business, our treasury management business, those are all fee-related. And so I think it's still pretty positive, but that was the one issue. It's not securities gains, but it is syndication fees in our loan business.

Paul Holden - *CIBC Capital Markets*

So first question is regarding inflationary borrowing cost pressures on commercial clients. And we've seen a number of public companies come out with disappointing margin numbers. Just wondering if you're seeing any early indications of profit pressures on your customers. And then secondly, sort of how are you monitoring for that going forward?

Pat Cronin - *Bank of Montreal - CRO*

I'll start and then maybe others can jump in. I would say the short answer to your question is no, we're not really seeing that yet. In fact, we're seeing quite the opposite. We're seeing this quarter, again, we saw a positive credit migration across the wholesale portfolio and broad-based in virtually every sector. And that's been a continuation of positive migration that we've seen over the course of the past six quarters in the wholesale business. So the early signs in credit migration, in terms of credit, in terms of impaired formation, you would have seen impaired formations extremely low again this quarter, and in fact, way below pre-COVID levels. And so that's another sign that would suggest that we're not seeing those kinds of things happening.

Now with that said, obviously, we're guiding towards a normalization in rates. And I think some of the wage pressure, debt service cost pressure and energy cost pressure is one of the reasons we think that normalization will occur. But there's always a lag to that, and that's why we're forecasting it to happen towards the end of this year and into next year is probably when you'll start to see some of those effects. But we don't see a material step function in terms of impact. We just see that as a catalyst to get us back to something that feels a bit more normal versus the really abnormally good conditions we're experiencing right now.

Paul Holden - *CIBC Capital Markets*

Okay. I understand. And then I want to go back to the discussion on CET1 and Bank of the West from a little bit of a different angle. I think there's a plausible scenario where the forward-looking indicators could change significantly between now and year-end, again, possible scenario, not fairly the absolute scenario, but possible scenario. What would that do for CET1? Just from the Bank of the West perspective, understand what it might do to BMO CET1. But with the credit reserves you've built into the acquisition, could that absorb higher credit density or you might have to raise more capital to offset that type of scenario?

Tayfun Tuzun - *Bank of Montreal - CFO*

So Paul, we only have a couple of quarters here ahead of us. So there's not a lot of time between now and closing. Yes, as you said, things may change, conditions may change. And depending upon the analysis at closing, those analyses are all performed at closing date, the way they look at closing date. We talked about the fact that we have pretty much neutralized the impact of interest rates.

The credit mark could get bigger. We could have a higher second day reserve if conditions change meaningfully. But I don't expect that to necessarily have a significant impact on our capital ratio as we sit here today. We feel actually -- Darryl said earlier that our capital forecast is actually a little bit ahead of where we thought we were going to be when we announced the transaction back in December. So I feel comfortable that the numbers that we are looking at are quite adequate even if conditions change a little bit here between now and then.

Mario Mendonca - *TD Securities*

Tayfun, just maybe a quick detail question. Those syndication gains that were a little lower in the U.S. business this quarter, where is that reported in your fee income? Like is that just in the line referred to as other revenue?

Tayfun Tuzun - *Bank of Montreal - CFO*

Lending. It's in the lending fees, Mario.

Mario Mendonca - *TD Securities*

Okay. I see it there. That's why it was down. Okay. Now a more broad question. Looking at the nature of loan growth, commercial real estate, construction is still pretty good or, in fact, improving again and fairly strong growth to non-bank financial services companies. I would have thought with the environment changing in Q2, that growth in that area, so to financial sponsors and private equity would have started to slow somewhat. What are you seeing that's continued to drive growth in financial services lending non-bank? And the growth in commercial real estate, what's driving that? Why is that sort of coming back strong?

Tayfun Tuzun - *Bank of Montreal - CFO*

Dave, do you want to take that one?

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

Well, commercial real estate continues to be a very good business for us on both sides of the border. But as you know, we're still on both sides of border pretty significantly underweight in that business vis-a-vis our competitors. It's been good growth, but it doesn't impact as much as it would with others as we grow there. It's still positive. We are still seeing good opportunities. I think it will probably slowdown in some cases. But on both sides of the border, we have really deep relationships with strong long-term real estate clients. And I think that will still continue, although there's certainly some slowdown in some businesses where we haven't been as active. So it won't impact us as much.

As it relates to the financial side, I just want to make sure you're clear on that. The growth in -- and that's mostly in the U.S. - is all in the investment-grade side of our business. So it's providing capital for financial sponsors that are backed by capital calls. It's not -- the growth that we've seen has been much more modest in what we were when financing individual portfolio companies. And that business will ebb and flow based on transaction activity. But I wouldn't want you to assume that, that business that's grown is not -- the growth is almost all investment grade. Does that help?

Mario Mendonca - *TD Securities*

Yes. And I wasn't assuming that that was leveraged lending. I had a feeling that was still the high-quality stuff. But even that business, are there indications that activity with private sponsors or financial sponsors and private equity firms is starting to moderate?

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

It's a good question. There's still -- as my partner, Dan Barclay, reminds me all the time, there's still a couple of trillion dollars of unused capacity out there. It's probably slowed down a little bit since year-end. But we still see pretty good backlogs and the business in the commercial side is clearly more in the mid-market size. So not the

mega deals. So in that area, that continues to be strong area. And I think actually, that will get probably more time with sponsors over time because the multiples in those businesses are a little bit smaller, a little bit lower. So I think it could certainly slow down as activity does. But I would not underestimate the ability of our financial sponsor group, our clients, to continue to invest and do well. But it goes up and down, and it's at a good point right now. Is that helpful?

Lemar Persaud - *Cormark Securities*

I just want to circle back to the net revenue synergies on the back of the last year. So the $450 million to $550 million, is that Canadian dollars or U.S. dollars? And how is that expected to come in, more front-end loaded or back-end loaded?

Tayfun Tuzun - *Bank of Montreal - CFO*

It's in U.S. dollars. At this point, clearly, there's going to be a ramp-up towards the back end of that time period. But I think when you get to year 3, you are going to have a sizable portion of that coming in through the run rate of revenues. Again, as I said, if you can just give us a quarter or two, we will give you a more specific perspective on both the timeline as well as the dollars.

Lemar Persaud - *Cormark Securities*

Okay. That's fair. And I guess then just to clarify, is that -- just because you mentioned it was a net number. So this should be this $450 to $550 million, I don't want to beat it to death, but that should be in addition to the, I guess, $670 million expense synergy guidance that you guys offered at the time of the deal. Is that fair to suggest?

Tayfun Tuzun - *Bank of Montreal - CFO*

That is correct.

Mike Rizvanovic - *Stifel GMP*

Maybe just a quick question for Pat. Just looking at the historical performance on the PCL ratio for Bank of the West longer term. Obviously, a very different experience than what BMO's reporting in the U.S. business. And I'm just wondering when you combine that business, I'm not sure if the book has been sort of changed or will be changed materially to sort of gravitate more toward your comfort level on credit risk, but what does that do to your PCL ratio in like a downward scenario if we do get a recession? And maybe on a run rate basis, is it incrementally positive, negative or somewhat neutral?

Pat Cronin - *Bank of Montreal - CRO*

Thanks for the question, Mike. Actually, I don't actually agree that their credit history is significantly different from ours. When I look at their provisioning rate over the course of time, it's actually reasonably consistent with when we look at their credit profile as well, both in consumer and wholesale, we see it as very consistent with ours and a lot of overlap in terms of the sector exposures and even the weightings of sectors, we see pro forma, the weightings that we're going to have in sectors will be reasonably consistent with what we've got actually right now.

And so we don't anticipate making material changes. The only place that they have a slightly different exposure to us is in the RV and marine segment. That segment performed differently during the financial crisis, so maybe that's what you're referring to. But we like that business as well. We think it's a nice complement to the consumer portfolio.

And I think I have to reiterate, too, that in both the consumer and the wholesale segment, their starting position is the same as ours, which is a really, really strong credit profile, particularly in consumer. And so we're not concerned at this point in time with the merger of their risk profile and ours. We see it as very similar, quite complementary and don't anticipate making any material changes. And it certainly would not affect my guidance in terms of forward PCL.

Mike Rizvanovic – *Stifel GMP*

Okay. It was actually the financial crisis period. So you're saying that, that business is something that you still like and I'm guessing that -- I guess the adjudication in that business has changed over time?

Pat Cronin - *Bank of Montreal - CRO*

It's hard for me to answer that question. As Tayfun said, given some of the legal restrictions, we don't have deep detail on the history of that business. But we know a fair bit about it and we've done a lot of due diligence on the RV and marine portfolio. We like the business, and we like their expertise there. They've got some really, really well-developed analytics. And so we would anticipate continuing to remain there and would not anticipate it materially affecting our risk profile going forward.

Darryl White - *Bank of Montreal - CEO*

Thank you, operator, and thank you all for your questions. I'll conclude very quickly with a few key themes.

Number one, we continue to deliver good financial performance in the second quarter. Number two, we're strategically investing to deliver growth and efficiency over time. Number three, our superior risk management remains a differentiator and we believe it will continue to be. And number four, we have an advantaged business mix that's positioned to take advantage of the global trends that I talked about at the beginning of the conference call.

So thank you all for participating in today's call, and we look forward to speaking to you again in August.