BMO Financial Group

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PRESENTATION

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

Thank you, and good morning. We will begin the call with remarks from Darryl White, BMO's CEO; followed by Tayfun Tuzun, our Chief Financial Officer; and Piyush Agrawal, our Chief Risk Officer. Also present to take questions today are Ernie Johannson, Head of BMO North American Personal and Business Banking; Nadim Hirji, Head of BMO Commercial Banking; Alan Tannenbaum and Dan Barclay are representing BMO Capital Markets; Deland Kamanga from BMO Wealth Management; and Darrel Hackett, BMO U.S. CEO.

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.

I will now turn the call over to Darryl.

Darryl White – *Bank of Montreal – CEO*

Thank you, Christine, and good morning, everyone. Our results this year reflect the fundamental strength and diversification of our businesses. Driven by record revenue and ongoing momentum in Canadian Personal and Commercial Banking and the contribution of the Bank of the West, we delivered good performance in a challenging economic backdrop with net income of $8.7 billion in fiscal 2023. Adjusted earnings per share were $2.81 for the fourth quarter and $11.73 for the year.

Pre-provision, pre-tax earnings grew 5% for the year, driven by 16% growth in revenue, reflecting both organic growth across our businesses and the benefit of acquisitions. Revenue was up 10% in Canadian P&C, 43% in U.S. P&C and 5% in each of Wealth Management and Capital Markets. We continue to have a strong capital position with a CET1 ratio of 12.5%. For the year, return on equity was 12.3%, and return on tangible common equity was 15.8%. And this morning, we announced a dividend increase of $0.04 to $1.51 per share, a 6% increase over last year.

This year, we made significant progress against our consistent strategic priorities to continue to grow and strengthen our bank and enhance customer service and invest in communities. We closed and integrated strategic acquisitions, advanced our digital-first capabilities and increased our focus on delivering interconnected One Client experiences.

With the successful conversion of Bank of the West, which I'll expand upon in a moment, BMO is the most integrated North-South bank on the continent. For our customers joining from Bank of the West, this means an upgrade to the strength and breadth of their bank with access to new capabilities, products and services to help them make financial progress. When we enter a new market, we commit to making progress for our clients and communities. Our BMO EMpower 2.0 plan is set to deliver more than $40 billion to support underrepresented communities and organizations across our U.S. footprint, including loans to minority-owned small businesses, community reinvestment in real estate, affordable housing and neighbourhood revitalization.

We also completed the acquisition of AIR MILES with nearly 10 million active collectors, who will benefit from the stability and rejuvenation of the most recognized loyalty program in Canada. Since we closed in June, we've added already 50 new partners and introduced robust new features, including an updated travel booking platform and a mobile app, leading to four consecutive months of new collector growth and increased engagement.

Our relentless focus on putting customers first and supporting their financial goals with innovative digital experiences and expert guidance continues to be recognized, including being ranked first by J.D. Power in both its 2023 Canada Retail Banking and Online Banking Customer Satisfaction studies with the highest scores among Canada's largest banks. This type of recognition, combined with the continued strong customer loyalty, reinforces the trust our customers place in us, and it's translating into results with strong customer acquisition and deeper relationships. We've had consistent performance in our flagship Canadian P&C business with PPPT growth of 10% this year, reflecting peer leading revenue growth in our retail bank, strong market share in our premier commercial bank and an ongoing focus on efficiency improvement. In addition, our One Client strategy has momentum, and we've set a strong foundation to grow and deepen relationships between personal, wealth, commercial and capital markets clients through our integrated approach and product offering.

The conversion of Bank of the West in September was highly successful. We welcomed 2 million new customers, converted 2.7 million accounts and over 300 systems and reenrolled over 90% of active digital users within the first week. We completed the rebranding of over 500 branches, now serving all customers with one unified BMO brand.

This was a large and complex acquisition requiring exceptional planning and integration across the BMO and Bank of the West organizations, evidence of our ongoing excellence in execution, a key competency at BMO. Our record of improved profitability and efficiency, combined with strong organic growth and successful acquisitions set the foundation for this expansion. Now we are at the starting line to realize the full benefit of our expanded scale, leverage our position as a top 10 U.S. bank backed by the strength of BMO's full $1.3 trillion balance sheet, a key differentiator relative to our U.S. regional competitors.

We're executing against a proven playbook, and we're uniquely positioned to gain share in our new home markets. And momentum is already building with PPPT growth in our U.S. segment of 27% this year to US$4.1 billion, doubling from 5 years ago. Bank of the West customer activity is accelerating as we expected. For example, we've seen a 3x increase in checking accounts sold digitally on our platform, and we've completed thousands of trades and transactions between Bank of the West clients and our Capital Markets businesses. With cost and revenue synergies identified and well underway, we are poised to continue to deliver strong performance.

2023 saw growing challenges in the global economy, impacted by weaker financial conditions and compounded by the escalation of geopolitical crises. While the rate of inflation has fallen from four decade highs, further progress towards normalization could be impeded by persistent inflation and weaker global demand due to higher cost of borrowing. The potential for an economic downturn remains, both in Canada and the U.S. with higher risks north of the border.

At BMO, we have a clear plan to respond to the environmental shift, which we began to anticipate much earlier this year. We've remained vigilant in controlling what we can control. As Tayfun will comment on shortly, we're exceeding our planned cost synergies at Bank of the West and now expect run rate synergies to be over US$800 million, almost 20% higher than our initial estimate of US$670 million and largely in our run rate by Q2 of 2024.

On the revenue side, a high-impact marketing campaign is in place across our expanded footprint, driving strong brand aided awareness, leading to thousands of new appointments with our customers and supporting revenue synergies in line with our expectations. Additionally, actions we announced and started last quarter on efficiency initiatives to optimize legacy BMO workforce, real estate, technology and procurement are expected to result in additional run rate savings of C$400 million and be largely in our run rate by the end of 2024.

We continue to focus on strengthening return on capital through our disciplined, dynamic capital allocation decisions, including the winding down of our indirect auto portfolio and our focus on One Client experiences to deepen customer relationships. Combining these actions with our long-term track record of superior risk management and the full run rate of our acquisitions should differentiate BMO from peers in fiscal 2024 and beyond, driving positive operating leverage and setting us up to compete from a position of strength regardless of the environment.

Our consistent performance enables us to put our purpose into action to boldly grow the good in business and life and support a sustainable and inclusive future. We continue to advance our ambition to be our clients lead partner in the transition to a net zero world through industry-leading sustainable finance and energy transition solutions. This year, we ranked first in the sustainability-linked loan market and launched one of the first sustainability-linked deposit offerings in North America.

As I look ahead, we are focused on a consistent set of strategic priorities and are squarely focused on disciplined execution to deliver sustained performance against our medium-term financial objectives, including delivering positive operating leverage. This year we've added return on tangible common equity of over 18%, as we believe it to be an important measure of our performance across our capital structure. As the bank best positioned to serve more clients across the Canadian and U.S. economies, we're confident in the power of our integrated North American franchise and our strategy to help clients make real financial progress. BMO will continue to leverage opportunities to drive progress across all our home markets.

I want to thank our employees, our customers and shareholders for their commitment to BMO, and I will 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. Before moving to the quarter's results, I would like to update a few of the financial metrics on the acquisition of Bank of the West. With the benefit of almost ten months of operating a larger scale integrated U.S. business and a very successful conversion now behind us, we are in a better position to assess the full strategic and financial value of the acquisition and give you a refreshed financial outlook.

First, we are pleased with the core performance of Bank of the West despite a more difficult U.S. banking environment than we anticipated coming into this year. As a result, we are confirming our 7% net EPS accretion reflecting our updated outlook for the performance of our underlying business and the contribution from Bank of the West.

Second, as Darryl mentioned, with the benefit of directly assessing the resource allocations across the combined franchise, we now expect run rate cost synergies of over US$800 million by fiscal 2025, significantly higher than the previous US$670 million estimate. The increase is driven primarily by a reassessment of technology and operations resource needs. We expect to achieve almost all of these run rate benefits by February 2024. We have realized US$ 220 million of these benefits in 2023, with an additional US$550 million benefit to be realized in 2024. Integration costs are expected to be approximately US$1.9 billion, reflecting higher expenses associated with the later than originally anticipated closing date, higher contract termination costs and pre-conversion expenses, which were instrumental in executing one of the most successful integrations in the industry.

We remain confident in delivering revenue synergies of US$450 million to US$550 million, although timing may be one or two quarters later than initially planned, given a more muted near-term environment for U.S. Banks. Customer acquisition has remained robust even during the pre-conversion period, and we are encouraged by early wins. Similarly, we've maintained strong sales force retention during this time. We are processing significantly more transactions through our existing digital platforms, and we see meaningful opportunities to improve both sales productivity and client penetration in each of our business groups, supported by stronger connectivity between businesses to serve the full needs of our customers. We are confident in achieving an incremental US$2 billion in run rate pre-provision, pre-tax earnings by the first half of 2026, resulting from the acquisition.

Turning to Slide 12. Fourth quarter reported EPS was $2.06, and net income was $1.6 billion. Adjusting items are shown on Slide 40 and include acquisition-related impacts for integration costs and amortization of intangibles, which decreased net income by $433 million and $88 million, respectively. The decrease in reported net income reflected these items and the gain on fair value management actions related to the Bank of the West acquisition in the prior year. The remainder of my comments will focus on adjusted results.

Adjusted EPS was $2.81, down from $3.04 last year, and net income was $2.15 billion, up 1%. Revenue increased 19% with good organic growth and the benefit of acquisitions. Expenses increased 26%, primarily due to the impact from acquisitions. PPPT of $3.2 billion was up 9% driven by strong growth in our Canadian P&C and Capital Markets businesses and the addition of Bank of the West. Total PCL was $446 million including a $38 million provision for performing loans compared with a total provision of $226 million in the prior year. Piyush will speak to these in his remarks.

Moving to the balance sheet on Slide 13. Average loan growth was 18% year-over-year, driven by Bank of the West and good growth in Canadian P&C and Capital Markets. Sequentially, period-end loans were up 4% or 1% on a constant currency basis. Business and government loans were up 2%, with growth across all operating groups. Consumer loans were up 1%, driven by mortgage growth in both Canadian and U.S. P&C, partially offset by declining indirect auto balances. Average customer deposits increased 20% year-over-year due to the Bank of the West and higher balances in Canadian P&C and Capital Markets. Sequentially, period-end deposits were up 4% or 2% on a constant currency basis with growth in Canadian and U.S. P&C and Capital Markets, offset by lower balances in Wealth Management.

Turning to Slide 14. On an ex-trading basis, net interest income was up 16% from the prior year, and net interest margin was up 2 basis points, driven by Bank of the West and higher margins in Canadian P&C largely offset by higher low-yielding asset balances for liquidity purposes in corporate and continued pressure from deposit migration. Net interest margin was down 2 basis points from last quarter, driven by higher margins in U.S. P&C, more than offset by lower net interest income in Corporate Services.

In Canadian P&C, NIM was unchanged from last quarter as favourable balance sheet mix was offset by lower deposit margins due to the continued migration to term deposits. In U.S. P&C, NIM was up 7 basis points, of which approximately 4 basis points was due to a one-time net interest income benefit offset in Corporate Services, with the remaining increase reflecting favorable balance sheet mix, partially offset by continued strong deposit pricing competition. On a full year basis, our overall net interest margin was up 8 basis points from 2022, driven by the impact of Bank of the West and the benefit of higher longer-term yields, partially offset by pressures from higher deposit costs and low-yielding asset balances for liquidity purposes.

Moving to Slide 15. Based on the decision that we made early in the year to curb incremental expenses, our year-over-year underlying expense growth has continued to come down throughout the year. We also have announced additional expense management actions last quarter that will further improve our operational efficiency. This quarter included a $51 million charge related to the consolidation of BMO real estate that will reduce expenses in future periods. As a reminder, we expect to achieve run rate expense savings of $400 million from all these actions by early 2025, in addition to the Bank of the West cost synergies.

The full year expense growth of 24% primarily reflected the impact of acquisitions and higher business development costs as well as the flow-through from last year's investments in sales force and technology. On a normalized constant currency basis, underlying expenses increased 4%, excluding the impact of acquisitions, revenue-based compensation and upfront charges to accelerate operational efficiencies. As we look ahead to 2024, we are confident in our ability to deliver positive operating leverage starting the second quarter, after we reach the first year anniversary of the closing of the Bank of the West acquisition as well as for the full fiscal year. This excludes the impact of the estimated FDIC assessment charge of approximately US$300 million, which we expect to recognize in the first quarter as an adjusting item.

Turning to Slide 16. Our capital position continues to strengthen with common equity ratio of 12.5%, up 20 basis points from the prior quarter. Internal capital generation and shares issued under the dividend reinvestment plan were partially offset by acquisition integration costs in the current quarter. We expect the combined impact of regulatory changes in the first quarter of 2024 and the FDIC charge to be approximately 25 basis points.

Moving to the operating groups and starting on Slide 17. Canadian P&C delivered record net income of $966 million, up 5% year-over-year. PPPT of $1.6 billion increased 13%, partially offset by higher provisions for credit losses. Revenue of $2.9 billion was up 13%, driven by 10% growth in net interest income, reflecting both strong balance growth and higher margins. Non-interest revenue increased 20%, primarily due to higher card fees as well as the acquisition of AIR MILES. Expenses were up 12% reflecting the inclusion of AIR MILES and higher employee-related expenses. Loans were up 6% year-over-year, with growth across both mortgages and commercial loans, and increased 2% from the prior quarter. Deposits were up 12% year-over-year and 3% sequentially across both retail and commercial businesses. We have strong momentum on both sides of the balance sheet. And while we expect some continued moderation in balance growth, we are well positioned for continued market share gains in our businesses.

Moving to U.S. P&C on Slide 18. My comments here will speak to the U.S. dollar performance. Net income was $543 million, up 11%, and PPPT was up 18%, mainly due to the contribution from Bank of the West. Sequentially, revenue was relatively stable with an increase in net interest income mostly offset by a decrease in non-interest revenue. Expenses declined 3% quarter-over-quarter, reflecting lower severance and technology costs. Loans were up 48% from the prior year, driven by Bank of the West and were flat quarter-over-quarter on an average basis and up 2% on a period-end basis reflecting increases in both mortgages and business and government loans. Deposits increased 43% year-over-year and were flat sequentially on an average basis and up 1% on a period-end basis. While the banking environment remains muted, we are well positioned to capture growth opportunities across our expanded footprint and outperform the market as conditions improve.

Moving to Slide 19. BMO Wealth Management net income was $263 million down from $298 million last year. Wealth and Asset Management net income of $213 million decreased 3% from the prior year. Contributions from Bank of the West and growth in new client assets were more than offset by lower net interest income due to migration to term deposits and higher expenses. Insurance net income was $50 million, down from $77 million in the prior year, driven by unfavourable market movements compared with the prior year. Expenses were up 12%, mainly due to the impact of Bank of the West and higher employee-related and technology costs.

Moving to Slide 20. BMO Capital Markets had a strong quarter, with net income of $492 million, up 36% year-over-year and PPPT of $620 million, up 39%. Revenue in Global Markets was up 12%, with strong equities trading activity, and Investment and Corporate Banking was up 29% on higher M&A and underwriting activity. Expenses were up 9%, driven by higher performance-based compensation, technology and transaction-based costs.

Turning now to Slide 21. Corporate Services net loss was $311 million compared with $159 million in the prior quarter and $104 million in the prior year. Results reflect higher expenses, including the charge related to BMO real estate in the current quarter as well as lower revenues.

Looking ahead to 2024, we are encouraged by moderating inflationary pressures, lowering the need to increase policy rates in the U.S. and Canada. With a slower economic growth outlook, we expect loan growth in Canada to continue to moderate and U.S. loan growth, which has lagged Canada in 2023, to gradually improve during the year. We expect the combined loan growth to be in the low to mid-single-digit range, along with similar growth rates for deposits. Our NIM is forecasted to be relatively stable as the benefit of reinvestments at higher rates offsets continued deposit margin pressure. On the expense side, we remain confident that we will achieve positive operating leverage with low single-digit growth, reflecting the additional quarters related to the Bank of the West and AIR MILES acquisitions.

In summary, in 2023, we delivered solid financial results, while we successfully closed and converted the largest bank acquisition in Canadian history. We remain proactive in addressing challenges that's largely related to the cyclical nature of our business and expect the actions that we have taken this year and our continued relative strength in Canada to support strong performance in 2024, with the added benefit of a larger-scale operation in the U.S., which is a significant differentiation for BMO.

I will now turn it over to Piyush.

Piyush Agrawal – *Bank of Montreal – CRO*

Thank you, Tayfun, and good morning, everyone. We had good risk performance this fiscal year despite a challenging year marked by economic and geopolitical headwinds, supported by the strong risk management discipline across the bank.

Starting on Slide 23. For the fiscal year, the total provision for credit losses was $2.2 billion or 35 basis points, including the initial provision for Bank of the West in the second quarter. Adjusting for this onetime charge, total provisions for credit losses were $1.5 billion or 24 basis points. During the year, we added close to $1 billion to the performing allowance, which included the $705 million initial allowance for Bank of the West and a performing build driven by portfolio credit migration and reflecting a forward view of the changing risk environment. Impaired provisions for the year were $1.2 billion or 19 basis points compared with 10 basis points in 2022, consistent with the expected trend to more normal loss rates.

Turning now to the current quarter on Slide 24. Total provision for credit losses was $446 million or 27 basis points compared with the provision of $492 million last quarter. Impaired provisions for the quarter were $408 million or 25 basis points, up 4 basis points from the prior quarter, reflecting the lagged transmission of monetary policy tightening into the economy.

Moving to Slide 25. The provision for credit losses on performing loans was $38 million, primarily reflecting portfolio credit migration, largely offset by an improvement in the forward view of our macroeconomic outlook as well as the lower probability of a hard landing scenario. Given the credit profile of our current portfolio and our forecast for impaired losses, we are comfortable that our performing loan allowances provides adequate provisioning against loan losses with about 3x coverage on trailing 4 quarters impaired losses.

Turning to Slide 26. Impaired formations were $1.8 billion and gross impaired loans increased to $4 billion with the largest increase coming from the business services, manufacturing and commercial real estate sectors. While gross impaired loans increased from very low levels in recent quarters, the GIL ratio of 59 basis points has returned, as expected, to pre-pandemic levels. Despite the increase in formations in business and government lending in this quarter, we did not see large losses coming from them, about 12% rate of losses and formations, reflecting either a collateralized position or the strong underlying credit structures.

Given investor interest, we have included additional information on the Canadian mortgage portfolio on Slide 28. Portfolio credit quality remained strong with low delinquency rates of 15 basis points, average FICO scores of 789 and average LTV of 55%, all of which provide significant risk mitigation. With that said, we do expect that higher interest rates will impact borrowers when they refinance or renew. We continue to actively manage and stress test this portfolio and given that the majority of our customers have multiproduct relationships, our analytical insights indicate customers have the capacity to absorb higher payments.

In fact, about $16.3 billion of mortgages renewed in 2023 at higher interest rates, and these customers are demonstrating strong payment performance despite payment increases of just over 20% on average. A larger portion of our portfolio renews in 2026, by which time we expect interest rates will have moderated and customers will have had time to prepare. We are proactively reaching out to customers, particularly our variable rate customers. We've had a positive customer response to the outreach, resulting in a reduction in mortgages in negative amortization from prior quarter.

As we look to the upcoming fiscal year, we have experienced the credit normalization that we were expecting. Given our current outlook for higher for longer rates and the lagged impact from these interest rate increases, we expect impaired loss rates to trend somewhat higher from Q4 levels in the range of low 30 basis points, still below our long-term average, and then improve as the rates start to come down and the economy begins to strengthen further. Given our strong risk management capabilities, the quality of our portfolio and prudent allowance coverage, we remain well positioned to manage current and emerging risks.

With that, I will now turn the call back to the operator for the Q&A portion of this call.

QUESTIONS AND ANSWERS

Meny Grauman – *Scotiabank Global Banking and Markets*

Piyush, I just wanted to follow up with something that you concluded with in terms of talking about the guidance on, I believe, impaired PCL ratios. You highlighted that you still think that you will be able to be below historic averages. I'm just wondering what gives you confidence in that ability to be below the historic average even next year or this year actually?

Piyush Agrawal – *Bank of Montreal – CRO*

Thanks, Meny. Gross impaired loans obviously were up this quarter, up from historically low levels of impairment from the last few, just coming out of the benign cycle and the pandemic. What we've done is we've gone ahead and looked at all of our portfolios and seen where there is particular stress and already accounted for those in the impaired book. As I look at that pace of impairment, while there might be an increased formation, and that's why you see this increased formation, we think that the amount of impairment coming from those as evidenced this quarter and our history over the last 30 years, we think that we are well adequately provisioned to be in that range of low 30s.

Again, there is an implicit assumption that the economy is improving as you're seeing and we start seeing cuts in interest rates by the end of '24. The economy has been holding up very well. You're seeing positive revisions to economic forecasts, and I think these will play out to our benefit as we go into '24.

Meny Grauman – *Scotiabank Global Banking and Markets*

Just a follow-up. In terms of sort of a higher for longer rate scenario, I mean you talked about and you have the new disclosure, which is helpful in terms of the capacity of customers of borrowers to absorb higher payments. I'm curious how you think about the knock-on effects of that so they can absorb higher payments, but certainly, there must be sort of a cost there to the economy and maybe to other parts of the credit book, especially on the unsecured side. I'm just curious how you think about the knock-on effects of higher for longer if the mortgage book can hold on, but what are the implications beyond that?

Piyush Agrawal – *Bank of Montreal – CRO*

We are beginning to see that, in fact, in the unsecured book, which is why you're seeing delinquencies, go up. I think it's also important that customers are adjusting to the new reality, and that's evident across behaviour patterns. Credit card spend has come down by about 4% faster in the discretionary spend areas yet, balances are still high. We've talked about higher balances of about 30% coming out of the pandemic. Those balances are getting used up but haven't gone down to zero. They're still about 12% higher than pre-pandemic. You saw the statistic on savings, still very rich at about 5% savings rate. There's also an increased amount going into investments.

There are buffer mechanisms as customers are adjusting and this higher increased rate of delinquencies really is around what we expect for prepandemic as well as what we would want for our risk appetite. We are getting compensated for the underwriting we are doing on the revenue line to compensate for some of the increases. It's evident there are weaknesses, but that weaknesses is compared to what you've seen as benign quarters, of the last seven or eight coming out of the pandemic.

Ebrahim Poonawala – *Bank of America Securities*

Sticking on credit, Piyush listening to you around the trajectory of the economy over the next year. It sounds like you're baking in some version of a soft landing where things get a bit worse and start getting better by the end of the year. If you give sensitivity around like what happens, the level of visibility around that guidance when you look at sort of cash flow within your commercial customer base, both in Canada and the U.S., what gives you confidence and insights into that, if you can? Maybe Nadim can chime in on the health of the commercial customer base as well.

Tied to that, you talked about that you've reserved for areas of stress. In my view, we should see areas of stress widen beyond office CRE or lower income FICO consumer into other categories as businesses go bankrupt, et cetera. One, do you share that view? If so, what are the other areas of stress that you're watching right now?

Piyush Agrawal – *Bank of Montreal – CRO*

There's a couple of questions, Ebrahim. Let me try and take one of those at a time. Your first one is just around provisioning and how, what we think about going forward. We built about $1 billion of provision in performing allowance for the year. As you know, IFRS 9, it can be counterintuitive, but it's countercyclical. Over the year, we thought about what the forward forecast was going to be, including a higher weighting of a hard landing or a severe recession, which, as you've seen over the last few quarters, the world is adapted and macroeconomic consensus has gotten better. If you don't think it's better, at least, it's less negative. Both of those are helpful.

As we go into '24, we've built those provisions to give us a coverage of about 54 basis points, which at this point of time is 50% higher than pre-pandemic. A second metric just to put that in perspective is, from a trailing 4-quarter losses, even at 25 basis points that I just talked about, we are at about 3x coverage that would tell you it's very prudent or conservative depending on how you take it. We've thought about that going into '24.

The last one I'll make, then I'll pass it on to Nadim is, by now, we have reviewed every customer once or twice for the impact of that interest rates on the behaviour pattern. You're seeing that in the risk rating migration. You're seeing that in the flow to our impaired loans, and we've factored all of those in even through our deep dives. In fact, previous quarter when we took the big build, it was around sectors of stress like commercial real estate, that the models did not pick up, that's already factored in, and you can see that in our performance in Q4.

Nadim, I don't know what you would add on commercial lending, what you're seeing.

Nadim Hirji – *Bank of Montreal – Group Head, BMO Commercial Banking*

What I would say is very similar to what we talked about in the last quarter. We are seeing stress, of course, in the portfolio. U.S., the stress was earlier than Canada. We are seeing Canada having more stress than we did a couple of quarters ago, but everything is absolutely in line with what we had expected. When you talk to customers, they're looking at their P&L, they're managing their expenses. They are looking at labour rates, which have stabilized, in some cases have come down. Shipping rates have come down. Logistics is down. They're seeing some margin relief there.

Overall, when I look at the portfolio, we feel very comfortable that our customer base is solid. We do think there's going to be some more formations, which we have forecasted already. But the momentum is good. In the U.S., we had said, recall last quarter, that we expect quarter-over-quarter loan reduction to stabilize and then positive into 2024. We were 1% down quarter-over-quarter in the U.S. But if you look at as-at balances, from June to October, we were actually up 1%, which is exactly what we had expected and wanted, and with solid momentum going into 2024 in the pipelines.

Canada, as we had expected, did come down in loan growth numbers. Again, it's as we had said in the last call. Looking into 2024, we're seeing M&A activity starting to come back. Pipelines are starting to improve. We continue to believe that we'll have mid-single-digit growth both in Canada and the U.S. If I was a betting person, probably slightly higher growth in the U.S.

Ebrahim Poonawala – *Bank of America Securities*

Understood. A follow-up, maybe for Tayfun or Darryl. Just strategically, when we think about the balance sheet, are we in optimization mode, like we've done some small business exits or portfolio exits recently. Talk about is there more to do, and just thought process around optimizing capital and the balance sheet and where we are playing offense in terms of taking market share given the pullback, especially with the U.S. regional banks.

Tayfun Tuzun – *Bank of Montreal – CFO*

In terms of capital allocation, Ebrahim, we're always on an on-mode, right? We have to constantly review our balance sheet and make sure that allocation of capital to businesses is taking place for the best interest of our shareholders. We'll continue to do that. We've done a very good job, over the past couple of years in ensuring that we are allocating capital to its best use. In terms of market share gains, obviously, that is a strong point for us. And with the addition of Bank of the West and expanded footprint and a larger customer base, we do see significant opportunities.

The other point that I would make is we closed the quarter at 12.5%, a very strong capital position. We have a pretty modest impact in Q1 of the cumulative impact of the regulatory changes as well as the $300 million FDIC charge. We feel good about our capacity for growth, and we will continue to look for opportunities to allocate capital to its best use on our balance sheet.

Darryl White – *Bank of Montreal – CEO*

Ebrahim, it's Darryl. I'll just pile on, I can't help myself, on the last part of your question on whether this puts us in a position to be a share taker. If you go back to before we grew the bank in the U.S., that was always our objective, particularly in some of our wholesale businesses, and we did that successfully relative to a competitive set that we judged to be pretty good, but in some cases, a little bit weaker than us. Now you roll forward with the integration of our business, the balance sheet that we have in the U.S., $435 billion, the presence in 32 states, the digital bank across the entire nation.

There's really no other way to say it - we didn't do this transaction to not take share. We were good at it before, and we'll be even better at it afterwards. We're a top 10 bank, and the objective is to continue to take share, particularly as markets become more constructive, which has been our power alley in the past as well. We've got the balance sheet to do it because the competitors that we will be looking to take share from don't have that capital ratio.

Gabriel Dechaine – *National Bank Financial*

I'd like to follow on with that line of questioning sort of -- and Ebrahim touched upon the portfolio exits, I believe, none of this has been confirmed by the bank, I don't think, but it sounds like you're getting out of auto lending, indirect auto lending in Canada and the U.S. and maybe the RV, marine lending business in the U.S. Just wondering what do you have to say about that scuttlebutt? Then if there's some legitimacy to that stuff, is there a financial impact that we should be flagging, earnings in particular?

Tayfun Tuzun – *Bank of Montreal – CFO*

We don't comment on scuttlebutts and rumors, Gabe, as you can appreciate. I'll turn it over shortly to Ernie with her comments about the indirect auto loan business. We like the RV business. We have a large-scale operation in the U.S. with the #3 market share that Bank of the West brought to us. It's a good business, and we have very good relationships with our dealers. We are not getting out of that business, no matter what the scuttlebutt may say. I'll leave it there, and then I'll turn it over to

Ernie for the indirect auto piece.

Ernie Johannson – *Bank of Montreal – Group Head, N.A. Personal and Business Banking*

Thanks. On the indirect auto piece, we're winding down that portfolio. As you can imagine, the impact over the next few years will be marginal in each year. And you can typically see an indirect auto book roll in about 3 years or so. That will be the end of it. I really want to reiterate Tayfun's point around our marine, RV business in the U.S. is a 30-year business that has a #3 market share. It was attractive to us as we went into the Bank of the West arrangement, and we're committed to the ongoing originations of that program and are seeing good success as we speak right now.

Gabriel Dechaine – *National Bank Financial*

All right. Thanks for that clarity there. I was a bit surprised with that particular one because you sounded like you liked it, so clearing that up helped. And then on the capital front, the consolidated picture, clearly, you're in a good position. If I look at the call report, your U.S. subsidiary data, and I exclude the AOCI opt out, it looks a little bit lower relative to where you probably want to be. I'm just wondering if you're entertaining, doing something along the lines of what one of your peers did as far as recapitalizing the U.S. business? I know that picture doesn't give the full one of the U.S. operations, so maybe there's a missing link there. What are your thoughts on that positioning?

Tayfun Tuzun – *Bank of Montreal – CFO*

The answer to your question, is an unqualified, no. We actually feel pretty good about our capital position. In the U.S. I think we are at 11.5% at the bank level and a little bit below that at the holding company level. It's a number that is going to continue to accrete at a fast pace. Even with the AOCI, we feel good about it. We are not planning to do anything in the U.S. that is similar to what some of our peer group banks had to do.

Gabriel Dechaine – *National Bank Financial*

Just a quick one here. I want to confirm, you're reiterating the accretion guidance on Bank of the West is 7% accretive to 2024. If you can just state that and then the comment on the revenue outlook for the business. You talked about having $300 million or so of revenue accretion, not in that 7%. The timing of that execution would be an interesting response.

Darryl White – *Bank of Montreal – CEO*

Yes, Gabe, I could help you with that. The answer is, yes, we are reconfirming the 7% accretion target that we talked to you about earlier this year. Secondly, a way to frame the second part of your question is around the $2 billion of PPPT that we had also held up to you all over the course of our discussion of this acquisition. There, we're also sticking with that number. Now you might ask if your synergy number is higher, why isn't the $2 billion also higher? And there, I would say, confidence level has gone up. I think you know it's been our practice to estimate conservatively and then update the Street when objects become closer in the windshield.

At this point, I would say the $2 billion that we put out to all of you includes, number one, the baseline contribution from their core business. Number two, the cost synergies, which have gone up and our confidence level is virtually 100% on those. Then on the revenue synergies, if we get more confident as time goes on, we'll update you there as well. This just goes to show you that we've got quite a bit of room to hit that $2 billion number that we talked about in the past by the first half of 2026.

Doug Young – *Desjardins Securities*

The first question, 25 basis point impact in Q1 from a combination of items. I want to confirm what's in the 25 basis points. That's the FDIC, that's the FRTB, that's the CVA, and that's including the negative amortized mortgage impact, all of that is included in there. Is that correct?

Tayfun Tuzun – *Bank of Montreal – CFO*

Yes, and the last one that I will add to that is the IFRS 17 transition as well. Everything is included in that number.

Doug Young – *Desjardins Securities*
Then if at 12.5% this quarter, you take out 25 basis points and assume organic 25, you're around 12.4%, 12.5% call it. Is that the range at which you're comfortable running at? I don't think you've talked about kind of an operating target range for your CET1 ratio, but can you spell at what you're comfortable with?

Tayfun Tuzun – *Bank of Montreal – CFO*

The comments that we made in the past is that we would be looking for a 50-plus basis point type of cushion to regulatory guidance. In that sense, I suppose next week, we will get some more clarification from OSFI as to what they are thinking about in terms of the remaining 50 basis points of buffer left, but our overall management approach to it is to operate in that 50-plus range, depending upon what the regulatory guidance may end up being.

Doug Young – *Desjardins Securities*

Lastly, on the gross impaired loan formations, and all the explanations that have come through. I'm hoping you can do a bit of a quicker deeper dive. You obviously had the formations. You didn't have a big PCL build. You talked about terms and conditions and collateral giving you confidence. Can you give a sense or a numeric sense of or an example of that term or the collateral that's backing this? We can see loan-to-values for mortgages, we don't have good sense of that to the commercial side. I don't know if there's anything you can give concrete to give a little more confidence around that.

Piyush Agrawal – *Bank of Montreal – CRO*

It broadly goes back to a risk culture and early problem recognition. When you recognize the problem early, you get a workout in a SAMU special team working with our bankers, helping rehabilitate clients. The formation itself, it's a data point. Your question is a good one, which is then how do you think about what's next? Because of the collateral or the structure, and I'll give you an example, when you have bankruptcies that are growing both in the U.S. and Canada, you automatically, the client, you mark the client and the exposure into a formation or into impairment, then you look at your facility, our credit exposure. In many of these cases, we have a fantastic team that does asset-backed lending.

When you think of a large retail client that goes into bankruptcy, we've got a very scientific way of looking at lending across a borrowing base, even though it's in bankruptcy, your losses are zero. It might be a large number in the formation. It's close to zero when it comes to the impairment, which is why the confidence. The same thing goes across many of our secured portfolios. We've seen that even in our commercial real estate book in some cases where a name goes in, but you don't need any provisions only because there's plenty of value in that. I hope that helps and why the confidence around the formations versus impaired losses.

Doug Young – *Desjardins Securities*

No, it does. I probably want to dig a little deeper at another time, but I appreciate the colour.

Darko Mihelic – *RBC Capital Markets*

Just a couple of questions for some clarification, please. Piyush, with respect to the mortgage payment shock that’s in your slide deck here on Slide 28. What is the renewal rate that you’re assuming for these payments in 2023?

Piyush Agrawal – *Bank of Montreal – CRO*

The one you see here on Slide 28, that's just the absolute amount that's maturing in that year. We've told you that the renewal rate for '23, which was about 6%, showed an increase of about 21% in payments. We haven't given that detail on this slide. I'll tell you if I look forward and we have all sorts of sensitivities, if rates didn't come down, they stayed constant, that 21% is in the same 20% to 25% next year and probably a little higher in the year '25. The bulk of, as you see the maturity is coming due in '26.

If I were to go back that out, just to give you more perspective, we've looked at no income change of our borrowers and this higher payment and that equates to about a 5% increase of the total income at the time of origination. We can provide you more details, Darko. At the end, what you see here is just the contractual maturity, and we've done a lot of work around what it would look like at different payment rates.

Ernie, would you add something?

Ernie Johannson – *Bank of Montreal – Group Head, N.A. Personal and Business Banking*

I was curious, your question is the percentage of customers who are renewing because that's really high as 90% of our book will renew with us, if that's part of your question. The statement is that what we're seeing customers renew right now. They're facing an increase. They're able to handle that increase quite nicely. A couple of factors, as you know quite well, 8hey were stressed at a higher interest rate when they were originated. We’ve seen an ability for consumers to adjust and be able to afford the increased payment, which is what you’re also seeing on this slide, which is the regular payments went up, 21% for consumers who are renewing this year between the fixed and variable mortgages, and they are handling it.

Darko Mihelic – *RBC Capital Markets*

My real question was that last bullet point. If you’re suggesting that there’s a 22% increase in the payment for the variable rate mortgage or what rate are they renewing at? There must be an assumption built in there….

Ernie Johannson – *Bank of Montreal – Group Head, N.A. Personal and Business Banking*

That last bullet point are exactly customers today in '23. They're renewing at today's rate. Exactly right.

Darko Mihelic – *RBC Capital Markets*

If they did that in 2024, you were suggesting we would see similar sort of impact?

Ernie Johannson – *Bank of Montreal – Group Head, N.A. Personal and Business Banking*

Correct.

Darko Mihelic – *RBC Capital Markets*

The second question along this same sort of line of questioning is if the average is 22, what do the tails look like? There must have been some customers with a significantly higher increase and clearly, it would have been some with a very small increase. Is there any sort of distribution you can provide?

Ernie Johannson – *Bank of Montreal – Group Head, N.A. Personal and Business Banking*

We do see people having to face a 30% increase this year. That will get higher as we move into '26 ’–if you assume no rate decrease. There would be customers who would potentially be facing 35% or 40% at that tail end again. Going back, and you think about where they were stressed at and their current income as you look at their cash flow in a variety of ways, we feel pretty confident that there is an appetite or an ability to be able to consume that increase, or to handle that increase.

Piyush Agrawal – *Bank of Montreal – CRO*

Darko, the same customers from our outreach programs, have come back and are actually already prepaying voluntarily down quite a bit. There are some who know it's a higher number, but they're waiting for the rate decrease to happen. But we've got very positive outreach and customer reaction around the voluntary prepayments back to lower the negative amortizations.

Darko Mihelic – *RBC Capital Markets*

This is all very helpful. I really appreciate the disclosure. The last lingering question that we're all having around this is, yes, I can see the increase on average for the customers in 2023. Did they renew at a shorter term? How much time before you suspect there will be some cracks for people that are paying these higher payments?

Ernie Johannson – *Bank of Montreal - Group Head, N.A. Personal and Business Banking*

What we're seeing right now is renewing into fixed rate product and also into shorter duration because of the anticipation of rate decreases, which is very prudent on the part of Canadians who are renewing. I want to clarify as well, as you think about that 40% increase, those are going to be smaller numbers at that tail end of it when you think about the increase that consumers are going to be facing on the payment.

Darko Mihelic – *RBC Capital Markets*

Underwriting today, just to finish off this discussion, you're still growing your mortgages, presumably you're doing originations. What does it look like today versus 4 or 5 years ago, are you looking at better GDS/TDS ratios? Is there anything you can point to that suggests that people that you're underwriting today at a higher rate than you would have 4 or 5 years ago are they putting down more down payment, is the LTV lower? What can you tell us about the originations that you're putting on today?

Ernie Johannson – *Bank of Montreal - Group Head, N.A. Personal and Business Banking*

I'll respond in a couple of ways. What we're seeing, obviously, is at a stress rate on top of the high rate that exists today ensures that your customer has more robust cash flow and ability to pay. Our underwriting remains as prudent as it has been in the past, in the sense that we look at loan to value, we look at affordability, we look at their stressed rates that they can afford with an increase in payment. I would say our underwriting remains consistent. The market and interest rates have improved the quality of the customers simply because you have to be stressed at a higher interest rate.

Darko Mihelic – *RBC Capital Markets*

Are you happy with the spreads you're getting on mortgages these days?

Ernie Johannson – *Bank of Montreal - Group Head, N.A. Personal and Business Banking*

Yes. Let me take 2 seconds on that. Our approach to mortgages and all our retail market share growth that we've experienced over the past few years is a function of our strategy around holistic conversations with customers and holistic relationships and growing new customers with those full relationships. When I look at this business, I look at how many customers do we have with primary relationships, which is leading right now in the industry, and also how much we're consolidating our relationships with existing customers. It's not a mortgage strategy per se. It's a retail relationship strategy we're driving.

Paul Holden – *CIBC Capital Markets*

Limiting it to 1 question. The one I want to ask is on Bank of the West, and I want to make this clear. I think I know what the answer is, but you've increased cost synergies 20%, but EPS accretion is expected to be the same. Is that a function purely of the change in the macro environment or has there been any change in customer retention?

Tayfun Tuzun *– Bank of Montreal – CFO*

There is no change in customer retention. We are very happy with both the client retention as well as employee retention. This is due more to the environmental factors that we have seen over the past year.

Paul Holden – *CIBC Capital Markets*

Since that was a quick one, maybe I can sneak one more in. When does the discount come off?

Tayfun Tuzun *– Bank of Montreal – CFO*

We will find out soon what OSFI's intention is. We have this first quarter, we need to get through the impact and make all these changes, and we will assess that during the quarter, and we'll come back to you and give you our perspective.

Mario Mendonca – *TD Securities*

Tayfun, I think in your opening comments, you referred to $1.9 billion of integration costs. Is that a forward-looking number? Or has that already been incurred?

Tayfun Tuzun *– Bank of Montreal – CFO*

No, that is very largely behind us. We have a little bit left, but a significant portion of that is already behind us.

Mario Mendonca – *TD Securities*

On the variable rate mortgages, the 62%, could you talk about what that number was last quarter, the 60% negative amortizing? What it was last quarter and why that number is so high? Your peers seem to be covering around 50, even less than 50.

Piyush Agrawal *– Bank of Montreal – CRO*

Our number, we've got paid down about by $3 billion, so it's a little bit higher. As long as rates remain where they are, if they come down, they continue to come down over time.

Mario Mendonca – *TD Securities*

Why so high?

Ernie Johannson – *Bank of Montreal – Group Head, N.A. Personal and Business Banking*

Let me explain that, why so high. If you'll remember our acquisition growth occurred in a market where variable rate mortgages were the consumer preference. You'll see us having a higher proportion as a result of our growth rate took place in those years, where that product was taken over a fixed rate product. It's essentially a consumer preference during our time of acquisition.

Mario Mendonca – *TD Securities*

I'm not sure if this is because I'm tired or the earnings season has gone on too long, but I kind of hear this message that BMO could very well need more capital if the domestic stability buffer is raised. Am I reading too much into your comments?

Tayfun Tuzun – *Bank of Montreal – CFO*

Yes.

Mario Mendonca – *TD Securities*

I am?

Tayfun Tuzun – *Bank of Montreal – CFO*

We don't need more capital.

Mario Mendonca – *TD Securities*

Just felt that way, listening to some of your comments.

Mike Rizvanovic – *KBW*

I wanted to go back to the mortgage renewals. I'm wondering about is when I look at the expectation for the Bank of Canada overnight rate, it looks like four cuts in 2024, four cuts in 2025 and that would bring us down to a 3% overnight rate. I'm assuming and correct me if I'm wrong, but you'd be looking at a normal upward sloping yield curve. If that is your expectation then it doesn't seem like the 5-year fixed rate would be much different than the 6% it is at today because right now, the 5-year Bank of Canada bond rate is at about 3.65 and then you've got to add that spread on top of that. It doesn't seem like the expectations on the rate side are really conducive of providing relief on this mortgage renewal issue.

And then in that vein, when I look at some of the originations done back in 2021, early 2022, the payment differential, just simple math will tell you that it's somewhere around 70% to 80% for some of your borrowers. This is not just for BMO, but industry-wide. Any thoughts on that? Any colour you can provide would be super helpful.

Ernie Johannson – *Bank of Montreal – Group Head, N.A. Personal and Business Banking*

I'll just remark on your last comment. Our modeling would not suggest that. We look at what the rate is that they took when they applied to the rate that they will be renewing at and don't see it going into that zone. That's one point. The second point I would say is our expectation is that even if the rates stay the same, that we'll be looking at customers facing upward, up to about a 40% increase in terms of at the max, or 45 at the max in that zone, when they renew.

A little different from where your assumptions are. I'll come back to the fact that these customers were underwritten with a very strong performance, and we monitor them today for their increase in cash flow and what they have remaining, their capacity to pay. We feel very confident that these customers are able to absorb the increased shock should there not be a rate decrease.

Mike Rizvanovic – *KBW*

I'm not sure if there's maybe an embedded expectation of amortization extensions there and the hardship rule. The 40% would be higher if I just look at just the straight math of originating a sub 2%, renewing at 6% or even in the mid-5s would be, in some cases, more than 40. So maybe we can take it offline, but I'd love to get more details on that.

Darryl White – *Bank of Montreal – CEO*

Thank you all for your questions this morning. Before we conclude, I would like to take a moment to recognize Dan Barclay, who is in the room with us. After a 30-year career, Dan will be retiring next month. Dan's long track record of client service, ethical leadership, innovation and strategic counsel have been key to the progress we're making across the bank for our clients. Dan on behalf of all of us congratulations on a remarkable career.

Alan Tannenbaum is succeeding Dan and has hit the ground running. His appointment represents a very strong hand off from a high-performing business into a high-performing business. We are at the bank proactively positioned for future growth and confident in the power of our integrated North American franchise with consistent and differentiated performance that will help our clients make real financial progress.

Thanks, everyone. I want to wish everyone a happy holiday season, and we look forward to speaking to you again in the New Year