BMO Financial Group

Q4 2022 Conference Call

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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 Piyush Agrawal, 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. Today, we announced adjusted earnings per share of $3.04 for the fourth quarter, closing out another strong year where we delivered record net income of $9 billion and EPS of $13.23. This year, we continued to execute on our strategy to strengthen and grow each of our diversified businesses to deliver sustained performance. Of note, including 2022, we've achieved consistent pre-provision pre-tax earnings growth and met our commitment to positive operating leverage in each of the last 5 years. Over that period, our efficiency ratio has improved by over 600 basis points to 55.8%. And we remain committed to delivering positive operating leverage and efficiency improvement going forward. We've achieved these consistent results against a rapidly changing economic backdrop that included the worst health challenge of our time and a wide range of interest rate and market conditions.

For 2022, PPPT was up 7%, building on 19% growth last year, and operating leverage was 1.3% as we increased our investment in our business to drive revenue growth and absorb the higher impact of inflation. Return on equity of 15.2% this year remains above our midterm target, even while building capital through the year in advance of the acquisition. Our proven track record of dynamically managing our business and maintaining our strategic focus to deliver resilient operating and credit performance through market cycles gives me confidence that we are built to sustain performance in any environment.

Turning to our operating group performance this year, we continue to benefit from our balanced and well-diversified business model. Investments we've made in our flagship North American Personal and Commercial Banking businesses, together with the benefit from rising interest rates, drove strong revenue growth that more than offset lower results in our market-sensitive businesses.

In Canadian P&C, PPPT was up 15% this year with an efficiency ratio below 45% as we continue to strengthen and invest in our flagship retail and Commercial Banking franchise. We've expanded our sales force and equipped them with digital tools that support them in developing full customer relationships.

We offer highly competitive suite of products and features that help customers make real financial progress, including BMO Insights, Savings Amplifier Account, Same Day Grace as well as BMO Visa Eclipse, offering flexible rewards on everyday purchases. Combined with our award-winning marketing and digital capabilities, these have led to strong customer acquisition, adding nearly 200,000 core net new customers this year.

U.S. P&C had its strongest year on record with PPPT up 16%, reflecting robust revenue growth and a strong operating leverage. In Commercial Banking, we continue to expand and strengthened our presence in attractive markets such as Florida and Texas. We've added new functionality to our leading treasury and payment solutions platform, including enhancing the onboarding experience and digitizing billing, resulting in significant time savings for customers and employees. In addition, we've maintained our #2 deposit share across our core branch footprint. And we've expanded access and reduced fees for underserved customer groups.

With a return on equity of 18% and an efficiency ratio of 48%, we have the foundation and the momentum to execute the next step in our North American growth strategy, building a leading U.S. regional bank together with Bank of the West. We expect the transaction to close in the first quarter of calendar 2023. Upon closing, we will significantly increase our U.S. footprint, providing access to major new markets and offering improved convenience and capabilities across our national customer base.

In BMO Wealth Management, we've made significant progress in transforming our North American platform over the past several years, divesting of lower-return businesses and positioning us to leverage our strength and accelerate future growth. Despite challenging markets in 2022, we delivered underlying revenue growth for the year, reflecting strategic investments in talent, technology modernization and expanded investment capabilities that resulted in a record year for net new asset growth.

BMO Capital Markets diversified businesses delivered resilient performance in a difficult environment with $2.3 billion in PPPT this year. We've maintained peer-leading market share in M&A in Canada and strengthened our position in key categories in the U.S., building a strong foundation that will enable accelerated growth as market conditions improve.

Our competitive performance in 2022 was driven by our leading winning culture and an empowered team aligned to achieving our strategic priorities. We've elevated our focus on One Client leadership, bringing the full suite of BMO's products, services and advice to our clients and further strengthening collaboration and partnership across businesses. For example, over 80% of new InvestorLine clients have a prior retail banking relationship with us. We've also enhanced product and coverage models to holistically serve our clients' Commercial Banking, Capital Markets and Wealth Management needs together.

We've also made significant progress advancing our digital-first approach, aimed at enhancing employee and customer experiences to drive revenue and efficiency.

We've invested across our businesses to modernize technology, expand the use of cloud and employ data-driven analytics. For example, in Canadian P&C, we're delivering open banking solutions that enable commercial clients to integrate their banking and accounts payable and receivable systems through innovative partnerships, such as Fispan and Xero. We've enhanced our online banking platforms, driving loyalty through improved functionality, and growth through market-leading digital sales. With over 90% of service transactions completed through self-serve channels, our frontline employees are able to focus on delivering leading advice when our customers need it most.

As evidence of our progress, we received the highest customer satisfaction ranking in the J.D. Power 2022 Canada Retail Banking Advice Satisfaction Study and our Canadian mobile banking app was recognized as the overall leader in the Q4 2022 Forrester Digital Experience Review for Canadian Mobile Banking Apps with the highest score in six areas.

In support of our ambition to be our clients' lead partner and a transition to a net zero world, we're leading the way with innovative advice and solutions. Through the BMO Climate Institute, we're bridging the science, policy and economics of climate change and supporting our clients as they adopt and scale climate solutions. BMO Capital Markets ranks as the #1 sustainability structuring agent in Canada. And the announced acquisition of Radicle Group, which is expected to close later today, will add to our leadership in carbon credit development capabilities. Our progress in support of a just and sustainable economy was recognized at COP27 as the top-ranked financial institution globally by the World Benchmarking Alliance's new Global Sustainability Benchmark.

As we look ahead to 2023, the macro environment remains uncertain with inflation and higher interest rates expected to slow the economy in the near term. Real GDP growth in both Canada and the U.S. is expected to be close to zero, and we expect interest rates to peak by the end of the first calendar quarter with lowering rates starting in January of 2024.

At BMO, we'll continue to dynamically manage our capital and resources just as we have through the last 205 years to grow our businesses and support our customers. Looking forward, 2023 brings tremendous opportunities to expand our reach, strengthen our businesses and deliver long-term value for our shareholders, both organically and through the addition of the Bank of the West.

As we continue to grow our diverse client base, we have more opportunities than ever to support financial progress for our customers and communities. I'm confident that guided by our purpose-driven strategy, we are uniquely positioned to deliver consistent financial performance over time. I'm proud to be part of a highly engaged, empowered and aligned team BMO, and I thank our employees for your dedication to providing exceptional service to our valued clients.

I'll now turn it over to Tayfun for more details on our financial results for the quarter.

Tayfun Tuzun - *Bank of Montreal - CFO*

Thank you, Darryl. Good morning and thank you for joining us. My comments will start on Slide 9. Fourth quarter reported EPS was $6.51, and net income was $4.5 billion. Adjusting items are shown on Slide 44 and include the impact of fair value management activities related to the acquisition of Bank of the West, which this quarter increased net income by $3.3 billion. As previously disclosed, we also recorded a legal provision, which decreased net income by $846 million. The remainder of my comments will focus on adjusted results.

Adjusted EPS was $3.04, and net income was $2.1 billion, down from $2.2 billion last year as pre-provision pretax earnings growth of 7% was more than offset by higher provision for credit losses compared with a recovery in the fourth quarter of last year. Performance in our P&C businesses continued to be very strong with year-over-year pre-provision pre-tax earnings growth of 13% in Canada and 33% in the U.S. as continued strong loan growth and margin expansion helped grow revenues at double digits. The muted market environment lowered results in Capital Markets as well as in Wealth Management.

Total revenue was up 7% year-over-year, reflecting strong growth in net interest income, partially offset by lower fee income and securities gains as well as the impact of divestitures. Total PCL was $226 million, including a $34 million provision for performing loans compared with a total recovery of $126 million in the prior year. Piyush will speak to these in his remarks.

Moving to the balance sheet on Slide 10. Loan growth was 17% year-over-year and 6% quarter-over-quarter. On a constant currency basis, business and government loans increased 17% from the prior year with strong growth across all operating groups.

Consumer balances were up 9%, reflecting diversified growth in the P&C businesses and in Wealth. Average customer deposits increased 8% year-over-year and 4% sequentially as we remain focused on growing our core deposit base. Looking ahead, we expect full year loan growth to be in the high single-digit range, reflecting strong diversified pipelines and matching similar growth rates in deposits.

Turning to Slide 11. Net interest income was up 18%, and up 27% on an ex-trading basis from last year and up 7% quarter-over-quarter driven by strong balance sheet growth and margin expansion. Net interest margin ex-trading was up 20 basis points from last year and 3 basis points from last quarter due to higher rate environment, partly offset by growth in lower-yielding assets.

During the quarter, the increase in loan yields continued to outpace the increase in cost of customer deposits. In fiscal year 2023, based on the forward curves in Canada and the U.S., we expect high single-digit NIM expansion compared to full year 2022 based on expanded deposit margins and higher long-term rates. As we are approaching the end of this rate cycle, our NIM expansion in the next 12 months will be more moderate than the past 12 months due to changing deposit mix and rising deposit betas.

Moving to our interest rate sensitivity on Slide 12. A 100 basis point rate shock is expected to benefit net interest income by $499 million over the next 12 months, including the impact of higher capital base pre Bank of the West closing. We expect our asset sensitivity to decline post-closing while coinciding with the anticipated end of the current rate cycle. To date, deposit betas have outperformed our expectations, and we expect them to move higher for future rate hikes.

Moving to Slide 13. On a full year basis, expenses were in line with our expectations, up 4% from the prior year or up 2% excluding the impact of the stronger U.S. dollar and higher performance-based compensation. Lower expenses related to the divested businesses were reinvested in targeted areas to drive revenue growth and efficiency improvement including in sales force expansion and technology. We delivered positive operating leverage for the year of 1.3% and improved our efficiency ratio by 70 basis points. We expect to deliver positive operating leverage again next year.

Moving to Slide 14. Our capital position remained strong with a common equity Tier 1 ratio of 16.7%. Excluding the benefit from fair value changes related to the Bank of the West transaction, net of the legal provision, the CET1 ratio increased 37 basis points from the combined impact of strong internal capital generation and common shares issued under the DRIP, partially offset by growth in risk-weighted assets. Source currency risk-weighted assets were higher, reflecting growth in our commercial lending businesses, which was largely offset by capital management actions.

As discussed previously, the cumulative incremental capital of 150 basis points generated by the fair value management actions since announcement last December is expected to be offset by higher goodwill on closing due to the impact of changes in interest rates since the announcement. We remain well positioned to close the Bank of the West transaction, which we expect will be later this quarter.

Moving to the operating groups and starting on Slide 15. Canadian P&C delivered net income of $917 million, down from $933 million in the prior year. Strong pre-provision pre-tax earnings growth of 13% was more than offset by higher provisions for credit losses.

Revenue was up 11% from the prior year. Net interest income increased 15%, reflecting strong balance growth and higher margins. NIM increased 3 basis points from last year due to higher deposit margins. The 6 basis points decline sequentially reflected loan growth exceeding deposit growth, tighter loan margins and a shift to lower spread deposits, which more than offset higher deposit margins. We expect NIM in our Canadian P&C business to expand in 2023 relative to our Q4 margin.

Expenses were up 8% with continued investment in the business, including sales force expansion and in technology and higher salaries. Average loans were up 12%, with 12% growth in residential mortgage lending and 18% in commercial loans. Deposits increased 9% year-over-year and 3% sequentially, with strong growth in term deposits.

Moving to U.S. P&C on Slide 16. My comments here will speak to the U.S. dollar performance. Net income was $489 million, up 19%, with very strong pre-provision pre-tax earnings growth of 33%. Revenue was up 18% with 26% growth in net interest income due to strong loan growth and margin expansion. The decline in non-interest revenue was mainly due to lower operating lease revenue and commercial deposit fees, which during higher interest rate periods, it's largely offset in net interest income. Expenses increased 4% due to higher employee costs and technology investments.

NIM increased 42 basis points from last year and 18 basis points sequentially, predominantly due to higher deposit margins. We expect continued NIM expansion but at a more moderate pace as deposit betas increase. On the balance sheet, average loans were up 14% from the prior year, reflecting very strong commercial growth. Average deposits declined 3% year-over-year and 2% from last quarter, in line with our expectations.

Moving to Slide 17. BMO Wealth Management net income was $298 million, down from $349 million last year. Wealth and Asset Management net income was $221 million, down $70 million as growth in net interest income and new client assets were more than offset by divestitures and weaker global markets. Insurance net income was $77 million compared with $58 million in the prior year. Expenses were down 9% mainly due to the impact of divestitures, partially offset by investments in the business.

Turning to Slide 18. BMO Capital Markets net income was $363 million compared to $536 million in the prior year, reflecting the impact of the ongoing weakness in the market environment, but up 35% quarter-over-quarter. Compared with the prior quarter, revenue and investment in Corporate Banking was up 23%, due to higher Corporate Banking revenue and lower markdowns on loan commitments. Global Markets was up 4% on higher client activity. Expenses were up 19% due to higher technology investments and higher employee-related costs.

Turning now to Slide 19. Corporate Services net loss was $104 million compared to $107 million in the prior year.

To conclude, our overall results for the quarter and the full year were strong and continue to demonstrate the advantage of our well-balanced diversified business mix. We continue to focus on managing our company dynamically to continue growing profitably. Looking ahead to 2023, we expect the economic environment to remain challenging in the near term with continued increases in interest rates, slowing growth and volatility in markets. We expect loan and customer deposit growth in the mid-to-high single digits on a year-over-year basis, and total bank NIM ex trading to expand during the year as interest rates continue to rise.

Overall, we expect the pace of expense growth to continue to slow while sustaining investments in key growth areas. At the same time, we will be maintaining our commitment to achieve positive operating leverage for the year.

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

Piyush Agrawal - *Bank of Montreal - CRO*

Thank you, Tayfun, and good morning, everyone. We had strong risk performance this fiscal year, supported by the steady economic recovery during the first half of the year and the strong risk management discipline across the bank.

Starting on Slide 21. For the fiscal year, the total provision for credit losses was $313 million or 6 basis points. Impaired provisions for the year were $502 million or 10 basis points compared to 11 basis points in 2021. We recognized a release of $189 million from the performing loan provision this year largely due to the economic recovery and reduced uncertainty from the pandemic on credit conditions in the first half of the year. In the second part of the year, we started building provisions on performing loans reflecting the weaker economic environment. Gross impaired loans decreased to $2 billion or 35 basis points compared to 46 basis points a year ago.

Turning now to the current quarter on Slide 22. Despite headwinds from inflation and interest rates, Q4 was another strong quarter in terms of credit performance. Total provision for credit losses was $226 million compared with a provision of $136 million last quarter. Impaired provisions for the quarter were $192 million or 14 basis points, up from $104 million or 8 basis points in the third quarter. Although our impaired provisions for credit losses were up from very low levels in Q3, they remain lower than pre-COVID levels. Similar to last quarter, the strong impaired loan performance is due to low formations and low loss rates on those formations.

Retail impaired losses were $117 million in Canadian P&C and $10 million in U.S. P&C. The modest increase in impaired PCL is consistent with the underlying measures such as a modestly increasing delinquency rate in some unsecured products, which remain well below our pre-pandemic levels.

In our Corporate and Commercial businesses, we reported impaired loan provisions of $25 million in Canadian Commercial, $37 million in U.S. Commercial and $5 million in Capital Markets. And while up from last quarter, they represent a gradual normalization that we have been expecting with no systemic concerns.

Moving to Slide 23. The provision for credit losses on performing loans was $34 million this quarter, reflecting the weaker economic outlook and portfolio growth, largely offset by continued reduction in pandemic uncertainty and portfolio credit improvement, including the benefit of risk transfer transactions this quarter. Given the strong credit profile of our current portfolio and our own forecast for impaired losses, we remain comfortable that our $2.5 billion of performing loan allowances provides adequate provisioning against loan losses. And to put that into perspective, this $2.5 billion provides coverage of 44 basis points over our gross performing loans compared with a coverage of 36 basis points before the pandemic.

On Slide 24, impaired formations were $499 million, and gross impaired loans were flat relative to previous quarter. Both formations and the gross impaired loan rates are still below pre-COVID levels and are low compared to our last decade of performance.

Turning to our mortgage portfolio. Our delinquency rates remain very strong. On Slide 26, you can see that over the coming year, only 12% of our portfolio is maturing, and of that, a very small portion is of lower credit quality. We are proactively reaching out to customers who we think are most likely to have future challenges at renewal and we have had a positive customer response to this outreach. There have not been any observable increase in delinquency at mortgage renewals.

Over the past several months, I've had a chance to review our portfolio and underwriting standards and see for myself the high quality of the portfolio overall, the robust structures and underwriting practices as well as the strong risk management capabilities and discipline. This sound foundation will serve us in good stead as consumers and businesses adapt to the impact of high inflation and interest rate increases while the macroeconomic environment and geopolitical situation remains uncertain.

So while we are pleased with the low impaired losses this quarter, we do expect our impaired PCL rate to gradually move towards our pre-pandemic experience through fiscal '23 in the range of high teens to low 20s in terms of basis points.

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

QUESTIONS AND ANSWERS

Ebrahim Poonawala - *BofA Securities*

Had a question around commercial customer base. One, give us a sense, maybe Darryl or Dave Casper if you're on the line around how the commercial borrowers are holding up in face of the higher interest rates?

And secondly, just a sense of where the demand is coming from. I think, Darryl, you mentioned 0% GDP growth next year. In that backdrop, where are you seeing loan demand coming from? And are there areas where the bank is tightening lending?

Darryl White - *Bank of Montreal - CEO*

Ebrahim, thanks for the question. It's Darryl. Dave is on the line. So Dave, why don't you give it a start? And if I have anything to add, I will.

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

Sure. It's a great question. And the first part of it, the clients, both in Canada and the U.S. are holding up quite well. Their capital bases are strong, probably stronger than pre-pandemic, rates have been so far had kind of a modest impact. It will impact some more than others. But in many cases, our borrowers have interest rate protection.

The demand across our businesses, and I'm talking about the demand our customers see, is probably dropping a little bit as the economy weakens. And I would expect that to probably continue into the new year to some extent as we move into more of a recessionary period. And I think that would probably – we had very strong loan growth this year, very strong in terms of client acquisition as well as large increases in some of our businesses that are revolving. For example, asset-based lending or our auto dealers where they've built that up – Bbut I expect that to diminish a little bit next year, still good growth, still good client acquisition, but overall, probably less than loan growth next year.

And lastly, we spent an awful lot of time in the last couple of months, Darryl, myself, Dan Barclay, Del, everyone, spending time with our clients. There's still optimism. There's still lots of good things going on out there. But there's definitely a little bit less optimism than there was a year ago, just as they wade through all of the dynamics going on in both the U.S. and Canada.

The health is strong. I feel very good about our broad-based growth. And the momentum continues to be very good on both sides of the border and adding the right kinds of clients that will be good clients, both for Commercial, Wealth, Capital Markets, where we really have done a great job, I think, of putting all the businesses together as we think about our clients. That's a long answer. I hope I gave you a good start, and maybe Darryl have some more to add?

Darryl White - *Bank of Montreal - CEO*

Yes. The only thing I would add, Ebrahim, is when I listen to Dave, I agree with all that. And I would say you should think about it in the category of what you might naturally expect to happen. We do see a little bit of slowing down in the client base. We do not see a slamming of the brakes. The consequence of that is we come from a pretty healthy position. The book is healthy. The momentum is good. We tend in this business to outperform the market in most environments. And I would expect that we'll do the same going forward next year.

You probably won't see the loan growth next year that you saw this year. But you're still going to see loan growth because the customers that we select tend to be the good ones, and they tend to have good performance through time. And we tend to go where they go. That's what I think you should expect.

Ebrahim Poonawala - BofA Securities

And then just one quick follow-up, Darryl. There's a lot of chatter about interconnectedness between banks and non-banks. Any risk that you see particularly for the system or for BMO in terms of banks providing leverage to the nonbank entities?

Darryl White - *Bank of Montreal - CEO*

It's a perpetual question, isn't it, Ebrahim? I wouldn't say that I'm seeing that risk enhance the – if I heard you right. I apologize if I've missed the question. But as far as the interconnectedness, I think you said between the banks and the non-banks, I wouldn't see – and I'll turn to Piyush here, who studies this question pretty carefully himself, on both sides of the border - I wouldn't say that in the current environment, there's a pronounced difference. I don't see an enhanced risk. We always monitor it. We look at the trends in the market. But I don't see something today that's concerning me a lot more than it did a quarter or two ago. Would you add anything, Piyush?

Piyush Agrawal - *Bank of Montreal - CRO*

I would just say that the proof is in, if you look at the last one or two quarters, there hasn't been a shortage of events that have happened in the market, and we've all come out very well. So the interconnectedness, while it's there, it's well contained, Ebrahim.

And I think banks like us, which have a very good risk discipline in how we manage our client exposure and which client comes in. So again, within this non-bank space, you've got a wide variety of clients, and I know some have been in the news. But we've actually come out very well. So I actually feel very good about the target market, the client base we have and the structures we have with them. So I wouldn't highlight any area of concern in this space yet.

Meny Grauman - *Scotiabank Global Banking and Markets*

A question on capital. Tayfun, where do you see your CET1 ratio on deal close of Bank of the West, if you could give us an update on that?

Tayfun Tuzun - *Bank of Montreal - CFO*

Yes, sure. I mean, our capital expectations, Meny, really have not changed since last year when we announced the transaction. And now we still expect to be at 11% or above in starting Q2, post-closing the transaction. So that picture has stayed the same for the past four quarters. And obviously, it will continue to build from there. And we feel pretty good about how we've been able to position ourselves for the closing.

Meny Grauman - *Scotiabank Global Banking and Markets*

And so, Darryl, would you feel comfortable being closer to 11% on deal close? Is that still something that is acceptable to you?

Darryl White - *Bank of Montreal - CEO*

Yes, Meny. We're very consistent in our positioning here. We believe today what we believed the last quarter when you asked this question that we'll be in the range that Tayfun talked about. And the answer to your question is yes.

Meny Grauman - *Scotiabank Global Banking and Markets*

Okay. And then maybe just a follow-up in terms of how you're managing capital and the lead up to this deal close. And just a question of – is there anything different in how you're managing capital? And specifically, are there certain types of business that you're saying no to because of your RWA considerations that you would otherwise say as to?

Tayfun Tuzun - *Bank of Montreal – CFO*

Look, I mean, we had very strong loan growth during the quarter. Obviously, that should be a proof that we're still doing all the business with our clients that we have.

Doug Young - *Desjardins Securities*

If I can just follow-up on the CET1 ratio, Darryl or Tayfun. I know you're saying at or above in Q2. But if the deal closes in Q1, I would assume at the end of Q1, you could be below 11%. Is that a fair assumption – and then building above 11%, just so there's – I just want to clarify the message there.

Tayfun Tuzun - *Bank of Montreal - CFO*

Yes. I mean, the comment that I made, we typically have referred to always the quarter following the closing quarter. We could fall below 11% at closing if it closes earlier than the second quarter. But we will move above 11% in the second quarter.

Doug Young - *Desjardins Securities*

And maybe just a follow-on. Is there stuff that you're doing – I know you're growing the loan book. Is there other things that you're doing behind the scenes to kind of free up capital in terms of getting rid of blocks of business or securitization? Anything else to point to?

Tayfun Tuzun - *Bank of Montreal - CFO*

Yes. And as you probably know, and we've talked about this a little bit over the past two or three quarters with our investors. For the past four, five years, we have been users of some of these risk transfer transactions. We're pretty good at it. We're pretty knowledgeable. And this year, it was not much different than past years in the way we have used these tools. And we continue to leverage these capabilities and the knowledge base that we have. Piyush, if you want to comment on that more?

Piyush Agrawal - *Bank of Montreal - CRO*

Yes. I would just say that as part of good risk discipline, any good bank was, probably as a result of many of these risk dynamic practices, saw loan sales, syndication, synthetic transfers. All of these are just part of our toolkit. We've been actively using them. And as we get into the weaker economic cycle, it's a good place to think about your portfolio and dynamically manage. The good part of this also is on the other side, we have investors who are putting pools of capital to play. And so there's a mutual dialogue always happening. And so I think this active risk management that continues and will continue through '23.

Doug Young - *Desjardins Securities*

Great. And then just a second question, just quickly on the NIM. I think you gave – and I apologize if I missed it, but some indication of directionally where you think it will go at the all-bank level. Can you talk a bit more about how it would have to unfold atin Canada and the U.S. and whether it will be more so up front-end loaded or back-end loaded? Any further colour would be helpful.

Tayfun Tuzun - *Bank of Montreal - CFO*

Sure. Absolutely. We feel very good about our NIM, not only this quarter, but probably more importantly, looking into next year. And I suspect that we will continue on a relative basis to outperform just as we have done over the past two, two and half years. I have guided for a high single-digit year-over-year NIM expansion. And you have seen the numbers, I mean, in the U.S., we have very strong NIM expansion. And the two countries are displaying a little bit of different dynamics.

In Canada, there were three factors this quarter that sort of played a role. One of them was a very strong loan growth over deposit growth. So that by itself had almost a 5 basis point type of impact. And mortgage prepayments had a couple of basis points, and then prime-BA spread in a rising rate environment always in the quarter that it happened pressures NIM.

But we expect our NIM in Canada to expand. I'll actually turn it over to Ernie for comments on the business side. I suspect that over the next couple of quarters, we will probably see almost a double-digit expansion in our NIM in Canada.

And for the broader NIM now looking at the dynamics, I suspect that as the rate cycle matures, the increase in the expansion in NIM will slow – will be smaller in the second half of the year compared to the first half. But over to Ernie for comments from the business side.

Ernie Johannson - *Bank of Montreal - Group Head, N.A. Personal*

Thanks, Tayfun. Thanks for the question as well. The notion for us on our NIM is really around having a strong NIM performance, and I think we've had that over the course of this year. Our strong growth on deposits has been really key for us, and that's been a focus. And you'll see that continuing into next year. As Tayfun said, we'll see NIM expansion in next year. It will be focused on our core deposit growth as well as our term deposits. And then as Tayfun mentioned, we're going to see that prime to BA moderate in fiscal '23 as we expect the pace of interest rate increases to slow down. And that will support, obviously, our lending business as we go forward.

We don't see much taking place around our mortgage prepayments, which had a negative impact, to us this quarter. And then as well, just that mix. Sometimes it's lumpy quarter-to-quarter, but our commitment on strong core deposit growth is key. And we've been doing that this year. We've had record levels of customer acquisition and growth in the core portfolio overall. And I'll talk about the personal business, in particular in Canada. What we've seen is a shift yes into our term products as customers migrate from either the equity markets out into our term business or they're migrating from their everyday savings account into term to maximize longer-term earnings.

But what we're also seeing in our business is a full replacement of the shift. So what we have shifted out of our chequing and savings accounts, we've actually replaced, and that's very positive for us going forward to continue to sustain. And we've had flat everyday banking growth, if I can use that terminology, which is important as you see the shift out to term. We're replacing it with good quality deposits, not only from our existing customers but brand-new customers from the street. So we're encouraged about the growth going forward. And just a final comment on the year. We've got a strong performance in P&C Canada, and we see that momentum carrying forward into next year.

Doug Young - *Desjardins Securities*

So just to clarify, Tayfun, you say double digit. Is that off Q4?

Tayfun Tuzun - *Bank of Montreal - CFO*

Yes, it's off Q4.

Gabriel Dechaine - *National Bank Financial*

Just to clarify, the timing of the Bank of the West close, you still expect Q2 of '23? I didn't come across any shift. Your peer kind of pushed it back a little bit for their call today?

Darryl White - *Bank of Montreal - CEO*

Gabe, I didn't see what they had to say. I can only speak to ours. We're saying first quarter of 2023. Is it first fiscal quarter or first calendar quarter, we don't know, but that's a pretty tight range. So as I think about it today, we're sort of rounding third base, and everything is occurring the way we thought it would occur. So I think you can think about it in that range. It's pretty tight and pretty soon.

Gabriel Dechaine - *National Bank Financial*

Got it. Now for the capital position, and I look at the RWA inflation, and I thought with the loan growth, especially in commercial that you had, we would see a bigger number there. But your 4 basis points of core Tier 1 consumption from RWAs. You're usually 20s, up into the 40s. Were you particularly active in the credit risk transfer transaction this quarter? Or is there another explanation there?

Tayfun Tuzun - *Bank of Montreal - CFO*

No. We had a number of credit risk transfer transactions over the past 90 to 120 days that have actually had an impact on the net growth numbers in RWA.

Gabriel Dechaine - *National Bank Financial*

And is there a big revenue you would give, since given those activities?

Tayfun Tuzun - *Bank of Montreal - CFO*

No. The cost of these transactions compare very well with respect to cost of equity in general.

Gabriel Dechaine - *National Bank Financial*

And then the last one, sorry.

Tayfun Tuzun - *Bank of Montreal - CFO*

I was just going to say that Gabe, as part of these risk transfers over time, these are actually positive for the bank because it frees up capital. And so as you're earning fees from clients, you actually get to redeploy capital at the current market price across different areas. So from a risk management, it's a win for the bank. It's a win on the net revenue over time. So I consider this very positive.

Gabriel Dechaine - *National Bank Financial*

And then just a last one there. I'm looking at your wholesale loans, Page 27 of the supplement. The total balance is up $60 billion, $70 billion year-over-year. About 1/4 of that is from the non-bank financial services category. Can you tell me what’s within that?

Piyush Agrawal - *Bank of Montreal - CRO*

You're looking at the overall loan book? So...

Gabriel Dechaine - *National Bank Financial*

Yes. The gross book...

Piyush Agrawal - *Bank of Montreal - CRO*

Yes. Our financials, obviously, is a very macro taxonomy. And so within that, you've got lots of subcategories. So if I break it up between exposures we will have to banks, to broker dealers, other investment companies, and you also have sponsor lending companies, private equity and others. And each of these carry a different risk profile. Obviously, these customers we've had for a very long time. They're well structured. There's different forms of lending in those. And so we feel good about the quality of loans and the performance across each one of these. I don't know if you're referring to something which was in the news recently?

Gabriel Dechaine - *National Bank Financial*

No. It's more plain vanilla. It's a big number. When they jump out, I just want to know what's in there and get a better understanding of it. So of the categories I mentioned, is there one or two?

Piyush Agrawal - *Bank of Montreal - CRO*

No. And they're all well managed, all within our limits, concentrations. All that is good. So I wouldn't add anything that's significant.

Paul Holden - *CIBC Capital Markets*

I want to go back to the credit risk transfer transactions. I just want to better understand how that comes through the P&L if it doesn't have a big impact on revenue. Is it flowing through the expense line? Like there must be some kind of costs associated with it. So just wondering where we can see that. And if there's any disclosure that would help us quantify the size of that program and the potential earnings impact.

Tayfun Tuzun - *Bank of Montreal - CFO*

Yes, Paul, it will come through both depending upon the transaction. We don't have current disclosures that lay it out for you. But let us take that back and see if we can provide a bit more clarity on how those transactions impact our income statement.

Paul Holden - *CIBC Capital Markets*

Okay. That would be helpful. And then second question is with respect to credit line utilization, I guess, particularly on commercial and corporate customers, is it kind of back to pre-pandemic type levels, above, below? And is there any kind of potential headwind there with the debt capital markets now opening back up in a potential terming out of debt, if you will, from customers and then a repay down on those credit lines?

Darryl White - *Bank of Montreal - CEO*

Why don't we have Dave and Dan help you with that question, Paul. Dave?

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

Yes. I think on the commercial side, it's not quite back to pre-pandemic, but it's in a couple of areas where we've had good growth. One I mentioned earlier, our auto dealer business has actually started the return. You'll probably see that there's more cars on the lot, not yet where it was pre-pandemic. But that's actually helped us and increased our outstandings and increased utilization.

The other area is asset-based lending. And that, particularly around now –this will start to slow down – as companies gear up to the holiday season, that builds it up, and then that will come down over time. But nothing outside the normal, and everything is what we would have expected in the past. I'll pass it over to Dan on the Capital Markets side.

Dan Barclay - *Group Head, BMO Capital Markets*

Yes. And I think our experience is we're still below pre-pandemic on utilization. It's up a little bit the last couple of quarters, but nothing that I would say is concerning, a percent or so. And then I think the more robust opening of the markets is good for everybody. So that's a good outcome.

Lemar Persaud - *Cormark Securities*

One thing that stands out to me is the strong sequential mortgage growth relative to peers. Obviously, we're seeing a slowdown across the industry. Can you maybe talk to us about what you're seeing in terms of mortgage spreads? One of your peers suggested that they are getting tight relative to historical levels. And if that's true and the growth is unprofitable, maybe talk to us about the value proposition and taking market share in mortgages at this time. Perhaps it's something around franchising and cross-selling opportunities. Any colour there would be helpful. And then maybe if I missed it, but could you talk about the outlook for mortgage growth looking forward in 2023 in domestic?

Ernie Johannson - *Bank of Montreal - Group Head, N.A. Personal*

Thanks, Lemar. It's Ernie. I will give you a summary of our strategy. And just quickly, our approach in the mortgage market is really about expanding customer relationships with existing customers as well as acquiring new customers. We know that the mortgage business is a core product at a life stage when we can consolidate business with our customers. So we come at it in a couple of ways. We have a very effective mortgage specialist sales team that is out there every day, talking to customers and seeking out more mortgages, more business for us, which in turn brings in new customers to our franchise. That then we actually cross-sell them, if you would use that language, build full relationships with them. And we're very successful. The majority of our customers that come in with a mortgage first, if I can use that, end up being our primary customers. And that is really a fuel for our overall growth, whether it be deposits, credit card, business, et cetera.

We've been successful over the past as we've been retooling that team, our digital capabilities to be able to sell accordingly, and including our HELOC business as well. And so that's been our focus is really around valuable, sustainable customer relationship growth.

In terms of the market right now, as you can imagine, with the prime BA spread, it is a little challenging. It is a very competitive marketplace as all of our competitors are looking as we are for new customer growth. It is profitable. And at the total relationship perspective, it's extremely profitable. Mortgage customers with other products at our bank are phenomenally more profitable than a single service customer.

So our focus is around quality growth, long-term customer relationship build and bringing new customers into the franchise. Moving forward, we think – we see some slowdown in the housing market, we all are experiencing it – we will continue to play at market. Our strategy is to be at market in our proprietary mortgage businesses. So we'll run where the market goes and keep pace in that direction. Hopefully, that answers your question.

Lemar Persaud - *Cormark Securities*

Yes, that's helpful. And then maybe if I could switch gears over to Dave Casper on commercial loan growth. One of the things we've seen coming out of the pandemic is that BMO was able to maintain above-market rates of commercial loan growth, particularly in the U.S. Could you remind us of what drove that outperformance versus your peers? And then secondly, are those factors still present in the current environment?

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

Well, first of all, we have grown really well in the U.S. as we've expanded both geographically and some of our specialties. So I've talked about some of the specialties, and Darryl mentioned some of the geography whether it's Florida, whether it's Texas, whether it's expanding, just we have a very strong franchise. And frankly, we have an excellent record of getting referrals from our existing customers. I expect that will continue. And I'm particularly excited as we move into the new year what's going to happen with our Bank of the West colleagues. These franchises together, they'll both be better. We'll expand geographically. We'll expand through our existing specialties into the West Coast. The momentum that we have right now, I just feel so good about it is it's going to move into the Bank of the West.

So I expect the continued growth in our client acquisition, whether it's loans or deposits. And as I mentioned earlier, our ability to cross-sell into our Capital Markets business and our Wealth business and those businesses referring back into commercial. It's a very, very positive story.

Lemar Persaud - *Cormark Securities*

Okay. So it sounds like you think you can kind of continue to outpace your U.S. bank peers. Is that a fair statement?

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

Well, I expect we'll continue to grow new clients. And one of the key parts of our business is the clients were growing, almost 90% of those, our existing and our new, are either sole – where we're the sole bank, or we're the lead bank. And that's where the actual profitability comes from. Just as Ernie talked about in her business, we are the sole or the lead bank. You're not going to have to fight over all the ancillary services. And I think that's where we will continue to do well given our offering.

Darryl White - *Bank of Montreal - CEO*

Lemar, it's Darryl. If I may just – Dave's answer just now provokes a thought for me, which I think might be helpful to your question, which is when you think about the franchises, the fact that 90% of the clients are sole or lead, that's a very deliberate and unique strategy for us. We've talked about that for years. This builds a premium franchise in Commercial Banking in Canada and the U.S. When you put them together, they're the fourth, fifth largest commercial bank on the continent.

That has important advantages because the fragmented market in the United States that you're questioning Dave on is a really interesting one where we've got a lot of capabilities there for relative to hundreds and hundreds of players in that market structure who arguably don't. And so the share can come there and the ability to have positive client selection as you go through that and add clients, so add capacity through the pandemic and today, not just rely on your existing installed base to do more or borrow more, is very important.

So that's a very deliberate strategy, and it couldn't come at a better time, frankly, because here we are about to add the franchise from the Bank of the West as well. So I think it's really important to acknowledge the job the teams have done in both personal and commercial, but also the market structure that we've quite deliberately decided we wanted to take advantage of.

Mario Mendonca - *TD Securities*

Tayfun and Darryl, you both made the point that your capital expectations around the Bank of the West haven't changed from a year ago when you announced the deal or so. From the outside looking in, it does sound a little different. What I mean by that is I think last quarter, you said you would expect the CET1 ratio to be comfortably above 11% at close, and sub-11% at close isn't comfortably above. So what I'm curious about is what's changed? What made this outlook change from last quarter?

Darryl White - *Bank of Montreal - CEO*

Sorry, Mario, if we led you to believe anything's changed, we didn't communicate very well. Nothing has changed. I think we've pretty consistently, at least we've tried to pretty consistently say that the ratio would be comfortably above 11%, as you say, in the first quarter post close. So we continue to look at the calendar and assume that that's Q2 of this year. And we maintain that that's where we would expect the ratio to be. So that's not – we're not intending to signal any change at all.

Mario Mendonca - *TD Securities*

So comfortably above. Maybe the nuance there is I heard at close and you're now – well, not now, but your message was that it was post close, the quarter after.

Tayfun Tuzun - *Bank of Montreal - CFO*

Yes, it's been always post close, Mario.

Mario Mendonca - *TD Securities*

Correct. Okay. Okay. That's a nuance I didn't pick up on. The other sort of related question is you were clear as some of your peers have been that things are slowing, and we could be heading into some kind of recession, mild or otherwise. How do you think about your capital ratio being, let's call it, a little tight in the near term? How do you think about your capital ratio, how it holds up in an environment where RWA density starts to increase as the economy slows? Do you – does that worry you in any way?

Tayfun Tuzun - *Bank of Montreal - CFO*

So actually, it's a good question. And our position is and has always been since I joined the bank that there are three factors that impact the way we manage capital. One clearly is – primarily is - how the regulators think about capital, and that's sort of outside our sphere of influence.

The second factor is the environment, the current environment and the expected environment. That always plays a role in the way we establish management targets.

And the third factor is our relative capital position to peers. It is very important for us to make sure that we are not an outlier. So as we look forward in the environment that we are going into, those will be the factors that collectively will inform us about where we should establish our management capital levels, and we will share those updates with you as time goes by.

Mario Mendonca - *TD Securities*

So putting it all together then, where you sit today and I know – and this is going to sound blunt, but there would be a very, very modest risk of a capital raise to get this deal done. Is that true?

Tayfun Tuzun - *Bank of Montreal - CFO*

To get the deal done?

Mario Mendonca - *TD Securities*

Yes, to get the deal done to support your capital ratio over the next few quarters. It's unlikely there would be another capital raise. And I ask it bluntly that way because that was exactly the speculation that I was hearing during the quarter. Not from people that are inside the bank, of course, just that's the speculation.

Tayfun Tuzun - *Bank of Montreal - CFO*

Yes. I mean, my comments really involve sort of not just the deal, but how we think about capital overall. As Darryl said and I said for the transaction, we feel that our capital ratios are appropriate.

Joo Ho Kim - *Credit Suisse AG*

Just firstly, on the cards growth, the growth was very strong in Canada for the quarter. Just wondering if you can comment on what you're seeing on the revolving balances. And how you think about cards growth next year? And if that's a meaningful kind of contributor to your margin outlook next year for the business?

Ernie Johannson - *Bank of Montreal - Group Head, N.A. Personal*

Thanks, Joo Ho. It's Ernie. I'll answer the question. Our cards business has had a strong performance improvement year-over-year and continues. It's a function of a number of things. One is we've recently launched out several new very effective products that are relevant for Canadians overall, and as a result, have had record increases in our acquisition. So we're growing new customers into our franchise, cross-selling within our existing franchise. And then overall, we're benefiting from an improvement in general market conditions on spending. So our balances are indeed up.

Our revolve rate, as you point out, revolving balances, they're not up to where they were pre-pandemic. And we don't expect them to be moving there right now. They will over the course of next year. That will, in fact, improve our overall cards business performance. But we're starting to see a nice pickup in our overall business model, whether it be the number of customers we have, their spend and their engagement level. They're spending in a variety of categories. And then also, we're seeing some improvement in our overall balances.

The other thing to note is just recently, we've launched an interesting new product against our card base, which will help again encourage our customers to continue to do the prudent thing around their finances. And it's a little bit like a Buy Now, Pay Later, but a smarter option called PaySmart, which allows our customers, again, to be able to do some small and lending on their credit cards.

So overall, I'd say the performance is strong, will continue and be supportive of our overall revenue growth next year in the personal business and also NIM, as you rightly pointed out, but to a lesser extent, just given the size of the balances involved.

Scott Chan - *Canaccord Genuity Corp.*

I'll keep it to a quick modeling question for Tayfun. On the preferred shares, the dividend in the quarter and just expense in the quarter was – it was a lot higher than last quarter, I think $77 million versus $47 million. Can you remind me the activities in the quarter? And if there's any upcoming activities that you know of? And is this a good run rate going forward?

Tayfun Tuzun - *Bank of Montreal - CFO*

Yes. I think we had a new issuance in the quarter, about $1 billion, and that impacted the quarter-over-quarter change in the coupons. That's the delta between Q3 and Q4.

Scott Chan - *Canaccord Genuity Corp.*

Was it at the start of the quarter?

Tayfun Tuzun - *Bank of Montreal - CFO*

It was in September, I think.

Darryl White - *Bank of Montreal - CEO*

Well, thank you, operator, and thank you all for your questions. I'll conclude the morning with a few key and important themes.

The year's overall results were very strong with PPPT growth of 7%, continued positive operating leverage for the fifth consecutive year. Our expenses remain well managed, particularly given inflationary pressures. We've committed to delivering operating leverage again in 2023. Our credit performance remains strong. We've got significant allowance that enables us to protect and grow the bank. And we're going forward from a position of strength with an advantaged mix that's set to perform in any environment. I'm confident that our purpose-driven strategy will continue to deliver consistent financial performance.

So I want to thank all of you for participating in today's call. We look forward to speaking to you again in the new year. Thank you.