Q4 2003 CONFERENCE CALL

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PRESENTATION

Operator

Please stand by your meeting is about to begin. Please be advised that this conference is being recorded. Good afternoon and welcome to the fourth quarter 2003 earnings conference call for November 25, 2003.

Your host for today will be Susan Payne, Senior Vice President Investor Relations. Ms. Payne, please go ahead.

Susan Payne - Bank of Montreal - Senior Vice President, Investor Relations

Thank you operator. Good afternoon, everyone.

This afternoon's brief overview of our fourth quarter results will be provided by Tony Comper, chairman and CEO, Karen Maidment, our CFO, and Mike Maila, head of corporate risk management.

After Mike's presentation, the following members of the management committee will also be available to answer your questions. Bill Downe, deputy chair, Ron Rogers, deputy chair, Rob Pearce, of the personal and commercial client group in Canada, Frank Techar of the Harris Bank, from the private client group Gilles Ouellette, Yvan Bourdeau, investment banking and Lloyd Darlington who he heads up technology and solution and E-business.

At this time I would like to refer our listeners to our Investor Relations web site at BMO.com to view our forward-looking statements and the risk factors pertaining to these statements.

Now I would like to hand the floor over to Tony.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Thanks, Susan and let me just thank everyone on the conference call for joining our call.

Fiscal 2003 was a very successful year for BMO. We succeeded in growing net income 29% from a year ago with all operating groups contributing higher results. We succeeded in improving productivity as I will discuss in a moment and we succeeded in delivering a 33% total shareholder return, and we succeeded in improving business fundamentals in order to lay a new foundation for sustainable earnings growth and higher returns for our shareholders.

We have undertaken an tremendous amount of change at BMO over the past few years while executing our gross strategy with focus, determination and discipline, we have shifted our business mix and implemented a wide range of multiyear initiatives to boost sales, and contain costs all across the enterprise. And as a result we have achieved six consecutive quarters of rising earnings. In addition, we met all the financial targets that we set at the beginning of fiscal 2003.

The $3.59 cash earnings per share grew 27% Or 23.4% if your exclude the nonrecurring items which were in the base that we used for our targets against a target of 10-15% and return on equity again excluding nonrecurring items improved 2.6 percentage points to 16.4% against a target of 14-15%.

Our annual provision for credit losses came in at $455 million, that was much better than the target of at or below $820 million. Our tier one capital ratio of 9.55% also was above our target of at least 8%. And most significantly, in my view, we made good progress on our number one priority for 2003, we improved cash productivity by 260 basis points, or 190 basis points if you exclude nonrecurring items, as all three operating groups improved their own cash productivity ratios by more than 150 basis points.

Our priority focused on improving productivity reflects this management team's conviction that the cost to revenue ratio is the single best internal measure for shareholder value creation across all of our lines of business. Because many of our productivity initiatives are inter connected and far-reaching in their impact, the dollar benefit of any specific initiative is not quantifiable.

One initiative to which we can attach a dollar figure is our disciplined approach to discretionary expenses. Enterprise wide, we reduced professional fees and travel by a total of $72 million compared to fiscal 2002.

Perhaps the most significant way in which we're addressing the revenue side of the productivity equation is through a multi-faceted drive to improve and deepen customer loyalty, in order to earn a larger share of each client's business. Take Canadian retail banking for example, we've made large investments in technology and our sales force in recent years, and we're continuing to invest in the front line people, sales tools, and improved processes and incentives to serve our customers better.

Let me give you a feel for group specific initiatives. The private client group contained costs in 2003 by reducing third party back office and technology expenses, consolidating call center and branch sites, and reducing total staff positions by 8% from a year ago. Most important thing I think to understand about our approach to productivity improvement is that we are making long-term and sustainable changes to how we do business.

These initiatives will gain traction in the years ahead, as we continue to foster sales-related activities while improving profitability on a long-term permanent basis. Our financial targets for 2004 reflect this management team's confidence, and achieving sustainable earnings growth and we set the following financial target ranges for 2004.

Earnings per share growth of 10-15%. Return on equity, 16-18%. Tier one capital ratio of at least 8%. PCLs of $500 million or less and cash productivity improvement of 150 to 200 basis points.

These target ranges take into account the improving though somewhat uncertain economic environments in both Canada and the United States. As we continue to transform BMO into a leading Canadian financial institution operating broadly in Canada and through significant focus franchises in the United States our growth strategy remains unchanged.

Targeting clients who value personalize service, we will deliver our offerings efficiently, prudently and profitably, as we continue to invest in strengthening our core Canadian franchise and selectively and substantially expanding in the United States in personal and commercial, bit market, and wealth management markets.

I think it will come as no surprise that once again in 2004 our number one priority is to continue improving productivity. By driving inefficiencies out of our operations, and building a sustainable high performance business culture we will place special emphasis on improving the overall performance of our U.S. operations.

The management team will be responsible for achieving our financial targets while maintaining BMO's long standing leadership in credit risk management and making the investments and taking actions necessary to accelerate revenue growth while containing cost, there by securing instead of mortgaging our future.

Canada, our most significant challenge is to improve and deepen customer loyalty and we're aggressively tackling this challenge through the significant investment in sales and service initiatives that I mentioned earlier.

In the U.S. one of the biggest challenges is to expand the Harris branch network and grow market share despite increased competition from new market entrance. Major differentiating strength in meeting this challenge is superior customer satisfaction and loyalty.

Strong customer relationships and our consistent community banking model position us well to increase sales to existing customers. They also position us well to be perceived as an acquirer of choice as we continue to expand the Harris Branch network in Chicago, Illinois, and surrounding states. You may have seen yesterday's announcement of the deal to acquire Lakeland Community Bank for $46 million, that is Canadian, which provides a perfect illustration of our capacity to identify and establish a footprint in optimal locations. The two high performing branches in Lake County, Illinois, are already deposit market leaders in high growth locations.

So in conclusion, while much work remains to be done for BMO to be a top performing financial services company, rising results in 2003, and indeed over the past six quarters, would indicate that we are well along the path toward doing precisely that.

Over to you, Karen.

Karen Maidment - Bank of Montreal - Chief Financial Officer and Executive Vice President

Thanks, Tony.

As Tony indicated there was a very good and clean quarter, with very few unusual items. The most significant item that affected the revenue and expenses was the effect of the strengthening of the Canadian dollar. Which decreased revenue by about 4.5%, decreased expenses by a similar amount, and on a year to date basis, decreased revenue by 3 and expenses by 2.

On the bottom line, it was really a minimal impact of about 25 million after tax for the year, and 15 for the quarter. As I said there was a number of small items affecting expenses and other revenue which tended to offset so that dollar per share is a sustainable number and a good base for '04.

In my comments to you last quarter, I indicated that we may incur modest costs in Q4 to best position us for the future. In fact, we did absorb $30 million of severance costs this quarter, and we were still able to achieve our productivity targets.

Slides one and two give you an overview of the Q4 and the year to date numbers. Looking at slide two, for fiscal 2003, you can see that we achieved a productivity target, in fact surpassed it with a 260 basis points improvement. Revenue growth of 4.7%, the decline in credit losses, and all our annual targets achieved.

The net income of $1.875 billion was up $408 million or 29% over fiscal 2002. And as Tony said, there is improvement in all the operating groups. From a sustainability point of view, of that 29%, about 12% would -- I would consider sustainable improvement in the year over year earnings.

Turning to slide four, you can see the change in the cash EPS growth. Year over year, the largest factor were the lower provisions which added .08 and we saw solid business growth of 26 cents, offset by a higher effective tax rate. On a full-year basis, cash EPS grew 76 cents, improved credit performance added 50 cents to that, and solid business growth added 34 cents. Higher taxes offset improvement in security gains and losses.

The effective tax rate is up primarily due to higher tax benefits recognized last year, and a higher proportion of income from higher tax rate jurisdictions. The tax rate for fiscal 2004 is expected to be around 31.5%, and that's what we consider the sustainable rate at this point. The quarter over quarter, the change in EPS was one cent and there were no material unusual items there.

Turning to slide five, you can see our revenue growth, and adjusting for foreign exchange and acquisitions, you can see that we achieved good core business growth. 3.2%, quarter over quarter and 8.6% year over year.

The quarter over quarter growth can be attributed mostly to improved volumes in the U.S. retail and higher margins in investment banking. As well, higher capital market fees and PCG and IBG contributed to this growth. Foreign exchange impacted revenues negatively by 11 million.

On a year over year basis, business growth resulted from improved retail margin, retail volumes, and higher margins in the U.S., improved margins in IBG, and improved capital market performance. Foreign exchange decreased revenue by 97 million compared to last year.

I think the revenue growth demonstrates the results of our commitment to improving our sales culture, and the investment in our sales force is paying off.

Turn to slide six and you can see the net interest margins are up seven basis points over Q3, and flat versus Q4 of last year. Improvement over Q3 was driven primarily by improved margins in IBG as a result of higher collections of interest on formally impaired loans in the fourth quarter.

Lower margins in P&C Canada were offset by higher margins in the U.S. retail and business banking. When we compare ourselves to Q4 of last year, lower margins in P&C Canada were offset by the improved margins in the U.S. retail and IBG.

Net income remained flat quarter over quarter. Net interest income remained flat quarter over quarter, and the decline in the net interest margin was offset by the higher volumes in both P&C and IBG.

Turning to slide eight you can see our expense growth. Core operating expenses are down quarter over quarter and year over year. Performance based compensation is up over both comparative quarters consistent with higher revenues and improved performance.

Foreign exchange impacted expenses positively in both quarter, most notably decreases expenses of 79 million versus Q4 of last year. Operating expenses are down as a result of continued reduction in non-customer facing FTEs. FTEs are down 320 from Q3 and 575 from fiscal 2002.

Continued reduction in consulting and travel spending as Tony indicated, professional fees travel and business development is down 28 million from Q4 of last year, and down 72 million for the full year. We've also successfully renegotiated several vendor contracts, especially in PCG. We've done some consolidation of branch and call center operation and streamlined a number of back office operations.

I think it is also important to note that we managed to reduce our operating costs while absorbing an increase in pension costs to 78 million and other benefit costs of 20, bringing the total benefit increase to $98 million.

Slide nine provides more detail on our expenses for Q4 and as I mentioned the primary driver of the increased quarter over quarter is performance-based compensation. However, we continue to make good progress on managing discretionary costs.

I would like to skip to slide 11 which is our cash productivity ratio and you can see the results of the cost management focus. Despite a slight deterioration quarter over quarter, all operating groups have achieved significant improvement in efficiency in fiscal 2003, and we met our 150-200 basis points reduction in our operating groups over year 2002. In fact, we exceeded our target at the bank level and improving the productivity by 260, and we will continue to focus our efforts on achieving the 150 to 200 basis points reduction in this ratio in fiscal 2004.

I would like to wrap up my comments on slide 12 which illustrates our 2004 targets which Tony ran over. We are committed to achieving them. We think we've had a good year and a good base to continue the strong performance.

That wraps my comments. Over to Mike.

Michel Maila - Bank of Montreal – Executive Vice President, Head of Risk Management Group

Thanks Karen and good afternoon everyone.

Let me walk you briefly through the key highlights of this quarter's risk review. Specific provisions for credit losses at 95 million were up 5 million from the previous quarter. But as you can see, from slide one, the trend is clearly positive in both quarterly and annual provisions since 2001.

As slide two indicates the increase in formations this quarter is due largely to the classification as impaired of five project loans totaling about $148 million, in the U.S. electric power generation sector. As you know, that sector continues to experience difficulty in a number of regional markets in the United States. Let me note, however, that all five newly classified loans have been and remain current on interest payments.

Moreover, as shown on slide three, the overall trend in formations of impaired loans continues downward. In fact, formations in 2003 were at the lowest level in three years both in absolute dollar amount and as a percentage of the loan portfolio.

In addition, formations were again this quarter more than offset by reductions in impaired balances and write-offs. As slide four shows, both repayments relating to loans that we classify as impaired and sales of such loans remain at their relatively high level in the fourth quarter. As we continue to reap the benefits of the value-added by restructuring and workout initiatives, while secondary market prices remain firm.

Looking back at fiscal 2003 as a whole let me also note that about 70% of both impaired loan repayments, and impaired loan sales were achieved in the last two quarters of this year. It is in this context, favorable trends, and formations in PCL that the guidance for fiscal 2004 provisions for credit losses has been set as Tony and Karen have indicated at $500 million or less.

Also, underlying our confidence in our guidance are the following two factors. Our modest exposure to sectors of concern in the commercial and corporate portfolios, and the strong performance and continued stability of our consumer portfolios in both Canada and the United States.

At this point I would like to turn the call over to the conference operator for the question and answer session. Operator.

QUESTION AND ANSWER

Operator

Thank you, we will now begin the question-and-answer session. To place yourself into the question queue please press star one on your touch-tone phone. If are you using a speaker phone please pick up your hand set and then press star one. If your question is being answered and you would like to withdraw your request press star two. Please go ahead if you have any questions.

Your first question comes from Jamie Keating. Please go ahead.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Jamie, are you there?

Jamie Keating - Merrill Lynch Canada - Analyst

I'm trying again. There we are.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

There we go.

Jamie Keating - Merrill Lynch Canada - Analyst

Thanks, Tony. Congratulations on a good quarter, everyone.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Thanks, Jamie.

Jamie Keating - Merrill Lynch Canada - Analyst

I had a quick question on the common equity at year-end, retained earnings balances and you've got a net unrealized loss on a translation of the foreign ops which is to be perhaps expected but in the supplemental there, I'm on page three of the financial statement, Karen, and you've got some disclosure on the net unrealized gains and it looks like taxes are the difference in terms of driving that negative.

I'm not sure I understand how that works. Can you just explain?

Karen Maidment - Bank of Montreal - Chief Financial Officer and Executive Vice President

We hedged the U.S. operations, so technically, you're right, the gains in the hedging should offset, and you can see that in fact they do, the problem is the tax, it is taxed differently. The hedging gains are taxed on an ongoing basis, where as the gain or loss on the investment is taxed only on disposition. So you end up getting some timing differences on the tax side, and that's what affects that number.

Jamie Keating - Merrill Lynch Canada - Analyst

And do those unwind? Is that -- I guess the timing factor only on that.

Karen Maidment - Bank of Montreal - Chief Financial Officer and Executive Vice President

Yeah. If you go back over the last few years you will see that tends to fluctuate and you know the biggest number is this year because of the huge strengthening of the Canadian dollar.

Jamie Keating - Merrill Lynch Canada - Analyst

Terrific. That's it. Thanks, guys.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Thanks, Jamie.

Operator

Your next question comes from Rob Wessel. Please go ahead.

Rob Wessel - National Bank - Analyst

Hi, good afternoon.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Good afternoon, Rob.

Rob Wessel - National Bank - Analyst

I have sort of a general question about U.S. expansion. There are sort of two questions.

I know on the -- I think it is on page four of your presentation, you use the word substantially in -- selectively and substantially expanding in the U.S. I guess there are sort of three parts to that.

First of all, you also give the target for your tier one as a minimum of 8% so I guess would substantial possibly -- could substantial, excuse me -- take you below 8%?

The second thing I wanted to ask was in terms of what states you would be targeting? And third I wanted to know if you could comment on the fact that given you have a reasonably high multiple if this isn't an opportune time for you to consider expanding.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Good questions Rob and I'm trying to remember all three of them. If I miss one come back to me.

Rob Wessel - National Bank - Analyst

I will jump in.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

I guess the best way I can characterize it if you look at the pattern of acquisitions we've made over the past three or four years, that's what you can expect to see us continue to do. So those acquisitions have been focused in the retail and commercial business, and in the private client business, primarily with a modest one which was a product buildout in the investment banking business that we did last summer.

So when we say selectively but substantially, we are going to stay focused on the lines of business that are core to our U.S. growth strategy, retail, commercial, private client and the investment banking business which is a mid-market focused business in the United States for us, different than what we are in Canada, and you can expect to see us continue at that pace.

Obviously, though, for us to move at a fast pace, on the M&A front, a couple of things have to happen. One, the prices have got to be right. We got to adhere to our financial discipline. Making sure that acquisitions meet or exceed a 15% internal rate of return, and so we've got to keep an eye on that.

But the second thing is there have to be willing sellers. And so Frank has got a team that is kind of actively looking at things. You saw the acquisition of Lakeland Community, a smaller bank, but kind of fits into the pattern of building out and there are more of those around but again, it is more of a function of where we're going.

I won't speculate on -- because it is somewhat hypothetical in terms of our capital ratio and I think you asked the question of would we be prepared to go below our target and my instinct is to say no, and that will be part of the financial discipline that we will apply but we do have a very strong capital ratio and our capital management program will, as always, focus on supporting internal growth focusing on the M&A

activity, but over and above what we don't need for that, we don't have a God-given right to hold on to it so therefore when you saw us increase our dividend that is one of the tools we will use and we will also use share buy backs in a modest way to help us manage the capital.

Rob Wessel - National Bank - Analyst

And states you might be targeting?

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

I'm sorry? I'm sorry, specific states.

The obvious one is Illinois but over and above that you got to look for willing sellers. We are kind of a willing buyer and as Bill has commented previously in a couple of presentations we are looking at states that are contiguous to Illinois. For the obvious opportunities that I don't think are you going to see us have a big appetite in the retail and commercial front if we're going far afield of the states that are kind of close to home.

Rob Wessel - National Bank - Analyst

Okay. Great. Thanks a lot.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Thanks, Rob.

Operator

Your next question comes from Jim Bantis. Please go ahead.

James Bantis - Credit Suisse First Boston - Analyst

Hi, good afternoon.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Good afternoon, Jim.

James Bantis - Credit Suisse First Boston - Analyst

Congratulations on a good quarter.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Thanks a lot.

James Bantis - Credit Suisse First Boston - Analyst

I think I'm fighting Susan's cold but the questions that I'm trying to put across are -- excuse me, towards capital management and with the bank's tier one ratio quickly approaching 10%, probably within the next couple of quarters, the payout ratio is at 35%. And the buy back program wasn't very active in the fourth quarter.

Given the business mix that the bank has, and given the modest to moderate U.S. expansion guidelines you just described to Rob, can we see the payout ratio substantially increasing in 2004 and being active towards returning capital back to shareholders? As you said it is not your God-given right to keep it.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

The only comment I will make on that is this year, -- are you still there, Jim.

James Bantis - Credit Suisse First Boston - Analyst

Yes, I am.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

This year, we increased our target payout ratio. Previously, it had been 30 to 40 and now it is 35 to 45. And I think that indicates that's one of the tools that we will use to manage that.

And in fact, we had two dividend increases this year. That is the first time in a long time by the way. First time in about 22 years that we had two dividend increases in a quarter.

It is difficult to say at this point in time exactly what we will do in '04 as the year unfolds, but if we look back at that, I think we can point to each one of the specific areas of managing the capital that we have -- that we have focused on.

James Bantis - Credit Suisse First Boston - Analyst

Great. Thanks.

And my second question is in regards to the legislation or the government release and Paul's on bank mergers and review process by June 30, 2004. Have you heard any news out of Ottawa with the change in the prime minister, whether there will be a delay in terms of releasing those merger review guidelines?

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

I haven't been listening too hard is the honest answer but no, there is nothing further on that front.

James Bantis - Credit Suisse First Boston - Analyst

Okay. Great, thanks very much, Tony.

Operator

Your next question comes from Ian De Verteuil. Please go ahead.

Ian de Verteuil - BMO Nesbitt Burns - Analyst

Hi, it is Ian here.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Good afternoon, Ian.

Ian de Verteuil - BMO Nesbitt Burns - Analyst

Two questions. First of all, page seven of the supplemental pack, the U.S. contribution on private plan was -- actually it looks like the loss rolls a bit, and it surprised me. I would have thought with volumes coming back on the discount brokerage business that those numbers would have looked a bit better.

So I'm wondering if you could shed some light on what occurred there.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Sure. Be glad to. Gilles, are you addressing this question?

Gilles Ouellette - Bank Of Montreal - President and Chief Executive Officer, Private Client Group

Ian, there are a couple of things.

The first thing is that this quarter, in the U.S., and our brokerage business, it has summer months now, which is seasonably slow so we have July, August, and September so that contributed a little bit to this.

But the second reason is that a number of the changes, and we've made a lot of changes in the U.S. in both the private banking business, and the direct investment business, this year, and particularly, you know, midway through the year. And these take a little while to work their way through the P&L. You know, because we -- you saw -- if you take out the acquisition this year, if we take out the two acquisitions, we have actually reduced our head count by 11% and a lot of those were in the U.S.

But when you do those part way through the year, you know, what you save in expense is probably made up by severance costs and so on. So we expect that the changes that we've made this year, at least we know is the changes we've made this year, will have much more impact in 2004 and 2005.

Ian de Verteuil - BMO Nesbitt Burns - Analyst

Is the Harris Direct entity making money at this stage?

Gilles Ouellette - Bank Of Montreal - President and Chief Executive Officer, Private Client Group

It is on a -- it has been profitable on a cash basis for the last two quarters. And it is now profitable on an accrual basis.

Ian de Verteuil - BMO Nesbitt Burns - Analyst

Thanks.

Second question, relates to -- for market share in Canada. It looks as if outside of the -- this small business market, it looks as if share is declining somewhat on most product lines. Can you talk a little bit to what is going on there and how you're dealing with that?

Gilles Ouellette - Bank Of Montreal - President and Chief Executive Officer, Private Client Group

It's a bit complex. Firstly, the numbers that we are reporting in our investor package differ from some of our competitors. Some of our competitors are using all financial institution data. Our numbers are just all bank.

If you were to look at it, and we are talking internally about changing how we report some of this stuff, but on the personal banking side of our business, on an all-in basis, we are growing share, versus all financial institutions. We are losing share somewhat, as you can see in those graphs, versus banks.

But if you are to take out the small banks, and their share improvement, and compare us to the other big banks, we're kind of holding our own to slight improvement, Ian. So in the all FI market, we are growing share. On the all bank market we are losing share somewhat as per those graphs that have you seen, but against our big pier group within Canada, we are holding to growing share slightly.

If that addresses your question. as you pointed out, it has been a fairly steady climb on the small business side of our portfolio.

Ian de Verteuil - BMO Nesbitt Burns - Analyst

On the reasons for the loss of share versus the small banks, presumably you're talking the INGs, PC financials, is it those and is it just pricing that is causing the loss of share?

Gilles Ouellette - Bank Of Montreal - President and Chief Executive Officer, Private Client Group

Yeah, they are a new entrant into the market, with a focused strategy and that strategy is helping them gain share, admittedly from a small base.

Ian de Verteuil - BMO Nesbitt Burns - Analyst

Thanks.

Operator

Your next question comes from Quentin Broad, please go ahead.

Quentin Broad - CIBC World Markets - Analyst

Yes, good afternoon. A couple of questions.

Just on the expense savings side, perhaps Karen, if I look through the sup pack, it looks like the Canadian side in each of the operating divisions looks reasonably well position and it is really the U.S. side and maybe this relates to Tony's assertion, making the U.S. a better operating entity, but can we talk to some of the specific opportunities that might exist in the U.S. platform that are you going to pull on for the 150-200 basis points improvement on the efficiency ratio.

Karen Maidment - Bank of Montreal - Chief Financial Officer and Executive Vice President

Quentin, Gilles' point I think was a key point because in the U.S. we have gone through a fair amount of reduction in the FTE's and particularly in the private client group and we've incurred some severance costs that go into the run rate and that positions us well for the future. We're also integrating a number of acquisitions, so we have the costs associated with those acquisitions, and that positions us well.

The other part of the productivity is the revenue and if you look at the U.S. and you look at the Harris Nesbitt which is the commercial mid-market franchise, what we have in place is a lot of line, a lot of new clients and as you know in the U.S. market there hasn't been a lot of borrowing and we see leverage there, as cap ex expenditures and those type of expenditures start reoccurring and we are in a good position with those clients.

So we are going to get the productivity through continued expense focus, but we do expect some revenue lift in all of our businesses in the U.S.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

So in fact, Quentin, if you look in the sup pack, you can see that the average assets in the U.S. in investment banking group are down 4 to 5 billion dollars on a year over year basis and that is just because clients not only are not utilizing their lines, they are in fact paying down, so they are in a great shape from a balance sheet point of view, from a leverage point of view and why I have confidence on that is we in fact have been gaining clients in the U.S. They're not utilizing their facilities yet, but when we start to see cap ex come back, there is a terrific upside leverage I believe in our commercial mid market business, our investment banking business in the U.S..

Quentin Broad - CIBC World Markets - Analyst

Just as a segue then, if we look on the gross loans and acceptances by industry that you give us, are there specific? Because if we go down the laundry list here, there doesn't appear to be any particular industry segments that are growing. Are there any in particular that you're focused on in the U.S. as you wait -- wait for the recovery or wait for them to start borrowing rather than stabilization effort that has been going on so far?

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

I will get Yvan to comment on it but it is a mix of portfolio that you would expect to see in an eight-state midwest region and that would include manufacturing, it would include financial institutions, it would include agri business and some diversified accounts. Yvan are there any other particular ones that we focus on?

Yvan J. Bourdeau - Nesbitt Burns Investment Banking Group - President and Chief Operating Officer

Not specifically. I agree with those. Diversify the manufacturing business. I mean the midwest is really the basin of the industrial manufacturing sector for the U.S. We are very active there. There is no question it was a very challenging year for the manufacturing sector for all kinds of reasons, one, foreign exchange was not playing in our favor, U.S. dollar was too strong.

Also competition from external out of North America, that were impeding on their own turf and obvious in that kind of environment, productivity gains for themselves were extremely important and what they did is they did reduce their cost base, and they also streamlined their balance sheet and as Karen was saying, as we went through the exercise, obviously they reduced the amount that they were utilizing from our lines. So what we did in that context is we continued to service them, obviously, but we tried to add new clients also in the market, and what we are expecting, and I think all the sign today to the statistic that came out of the U.S., all indicative that we are going to have strong growth from now on. I think we're counting on atleast 4%, and there is no question. I was there again last week, calling on clients, and there is a regain of confidence in the midwest, and we're expecting that it will reposition inventories, which means utilization will increase and they will go into new cap ex, and there is new talk that investment advisory service might increase, as they feel more confident, they may be looking in acquiring or merging with other companies.

So I would say Tony, generally speak, the tone is much more positive and we're looking forward to '04 in fact.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Thanks, Yvan.

Quentin Broad - CIBC World Markets - Analyst

Great, thank you.

Operator

Your next question comes from Heather Wolf, please go ahead.

Heather Wolf - Goldman Sacks - Analyst

Hi, good afternoon.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Good afternoon, Heather.

Heather Wolf - Goldman Sacks - Analyst

Two questions for you.

First, the sequential increase in your U.S. retail lending margin was fairly substantial and I'm curious if you can give some more colour there.

And also, just to follow-up on the commercial, U.S. commercial lending topic, I guess some of your peers in the states are indicating some caution in that commercial lending maybe shifting structurally, that is that more companies in the states are moving jobs to the east and also accessing the capital markets more. I'm curious if you could comment on that.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Okay. Frank?

Frank Techar – Harris Bank – President and Chief Executive Officer

Sorry, Heather, I was fumbling my microphone.

With respect to the margin increase, in Q4, the reason that we saw such a significant increase is really two fold.

One is we took some management action in Q4 to really focus on our CD spreads, because of the competitive marketplace, the spreads were really, really under pressure, and we backed off from a competitive perspective, so yields on our CD book improved pretty dramatically. We also started in Q3, and into Q4, and we saw a result in our net interest margin.

The other reason why we've seen the strength in the net interest margin is just because we continue to add high yielding assets. Both on the home equity front and also the auto business. So because we're adding -- we continue to add a higher percentage, the mix of our -- of our book is changing, and we're seeing -- we're seeing the benefit in the margin.

Those are the two primary reasons for the uptick in Q4.

Heather Wolf - Goldman Sacks - Analyst

Okay. Great.

Frank Techar – Harris Bank – President and Chief Executive Officer

On the -- on the commercial front I don't know if your question really applies to the small business, mid market, or the Harris Nesbitt segment.

We're feeling actually, you know, still pretty confident on the small end, if you look at the growth in our assets this year, at 11%, notwithstanding, you know, what the economy is handing us, we still feel pretty confident that we can grow our volumes. Our clients on the small end are still feeling, you know, pretty good about the prospects of when the economy comes back, they will, you know, they will be in better shape. So we're not seeing anything on a small end with respect to some systemic change in the marketplace where movement of jobs out of the midwest. I don't know, Yvan, if you want to comment on that.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Is your mike on? Okay.

Yvan J. Bourdeau - Nesbitt Burns Investment Banking Group - President and Chief Operating Officer

Heather, from a mid market perspective, first of all, the first comment that I will make is our franchise is very diversified. You know, the aggregate and food sectors will continue to grow in the U.S. and be less subject to foreign competition. The same is true in other sectors where we operate, like service, health care, consumer energy and communication.

One sector that is strategically affected, there is no question about it, is the manufacturing sector. By the same token, if I look at our -- the clients that we deal with, after the last 2 1/2 years, they're coming out of that 2 1/2 years extremely lean and mean, and with the exchange rate adjustment that is taking place in the U.S., there is no question that it can compete much more than it did in the past. So some of them have indeed actually moved facilities or activities into China. Particularly, but nonetheless, they are still growing in the U.S. and as I said declines that we have are actually looking forward to answer the increase in demand that is taking place in the U.S.

There is another dimension also to our franchise in the U.S. is we are providing them with additional services and products that we didn't in the past. Traditionally, two products -- making products that they were using heavily from us and they still do, incidentally, evidently, then being products as well as cash management but we have integrated our commercial platform together with our investment banking platform in the U.S., so we provide them today with integrated services.

And therefore, whether it is high yield, private placement, even IPO and under, we have the sales and trading equity in platform in the U.S. so this will add new features that we didn't have in the past and should allow us to grow in the future.

Heather Wolf - Goldman Sacks & Company - Analyst

Okay. That's great. Thank you very much.

Yvan J. Bourdeau - Nesbitt Burns Investment Banking Group - President and Chief Operating Officer

Thanks, Heather.

Operator

Your next question comes from Susan Cohen, please go ahead.

Susan Cohen - Dundee Securities Corporation - Analyst

Thank you.

Just a question on the high rate of cash collections, if you have them as previously impaired loans, what does your portfolio look like at this point, and do you see further opportunities to get some fairly sizable cash collections going forward?

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

I will get Mike to address that.

Michel Maila - Bank of Montreal – Executive Vice President and Head of Risk Management Group

We do see at this point in the late part of the cycle that's typically when you are going to see over a number of quarters a sizable collections, so I would add to that as well the prospect for recoveries of previous write-offs which we've had, again at the high level this quarter. And indeed reversals of provisions. So from that standpoint, this quarter is indicative of where we are in the cycle.

Susan Cohen - Dundee Securities Corporation - Analyst

Thank you. And perhaps one more question, if I may. Just related to your trading revenues. Obviously, I guess with interest rates doing what they're doing, they're down from the past two quarters, can you perhaps comment on what you might expect going forward on trading revenues?

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Yvan?

Yvan J. Bourdeau - Nesbitt Burns Investment Banking Group - President and Chief Operating Officer

Indeed, we have some reduction in our interest rate trading revenues, and I'm sure you are well cued in as to the reason why it happened.

Obviously the the yield curve is much flatter than it used to be from the second quarter to the fourth quarter of this year and we have some asset that we are maturing from -- from our portfolio and we also had one-time event that took place where we had last year, to compare year over year, we had a loss in the second quarter last year on bonds that we were holding in Teleglobe but this is the past looking forward. Once again, we have a very diversified group of products when it comes to interest rate trading and the most encouraging thing is the fact that now with the growth that is anticipated in the U.S., the psychology of our clients is changing quite a bit and they are now shifting from an neutral activity type of hedging, into being much more proactive, and in fact, if I look at where trading activities from our clients, it has increased substantially since the month of September, and what we are anticipating is that will continue in '04.

The type of trading platform that we have depends approximately 60% on planned activities and 40% on propriety trading and therefore the fact that a majority of our activity is client-driven, and the environment as we're heading, should be more conducive to those kinds of activities, should -- bodes well for us.

So to answer your question in short, I would anticipate that our trading revenue will remain stable and when we have sustainable position in '04. and I would expect that a proprietary trading as interest rates are adjusting upward particularly, would provide us with opportunity to put assets on our books with higher yields that would allow us to generate attractive spreads.

Susan Cohen - Dundee Securities Corporation - Analyst

Thank you very much.

Operator

Your next question comes from Steve Cawley. Please go ahead.

Steve Cawley - TD Newcrest - Analyst

My first question is for Gilles. Gilles, we've seen your active and new account goes down, discount brokerage side. Increased consolidation happening in the discount brokerage segment right now and there's rumors of additional consolidation coming down the line.

Can you comment on your scale and whether or not you feel that you've got the size to defend your position right now?

Gilles Ouellette - Bank Of Montreal - President and Chief Executive Officer, Private Client Group

Yeah, I mean -- I mean we obviously are looking very closely what our competitors are doing, and in terms of account attrition or should I say account take-up and asset growth, and trades, trades in the quarter, I mean I think we're kind of firmly in the middle of the pack.

So, I mean, and that's not a position that we normally like because none of our business are there, so we're working hard to try to -- to move up, on that, and -- but, as you can well imagine, you know, this acquisition of CSFB, which only happened about 18 months ago and then Morgan Stanley online, which is a few months after that, has been -- you know, has been a big job for the people in the U.S. In the past year, we've had to focus on is to change -- change the business model, because I don't know if you remember that far back, but you know, when we bought that business, this is a business that had lost $100 million in what was boom time for the direct investing business, and it was now a year and a half, and some pretty slow times, we're now accrual positive. So I'm really pleased with the job that has been done there.

With respect to scale, you know, we've dealt -- on the operations side, we've dealt with scale because we're clearing through Pershing, and the way we structure this, is that you know, we pay on a per trade and as the trades ramp up, our cost goes down, so -- and we represent, you know, a relatively small part of their volume, so we get the benefit of all the scale and the operation side, and I mean the only question that -- I mean, it is a legitimate question to ask, is on the marketing side, because when you are competing with people like Schwab. I mean these are people that sustain much more money on marketing, but I think what is important for us, and this is what we're focusing on is really, you know, what our costs per account is, and it is clearly, if we spend less money, you know, we should take out fewer accounts but on the account base that we have, I mean I think we feel that we can have -- we can have an impact.

So it is certainly, it is not something we're concerned with, because we have, and I think I've mentioned that in the past; that we have a relatively low cost model. I mean we have a variable operating cost and we have very few offices, so we're not really at this stage not concerned about that. I mean is going the way that we've -- that we've had -- we had anticipated. And with a little help from the markets, I think, that we're going to be fine.

Steve Cawley - TD Newcrest - Analyst

Were you in a position Gilles to take a serious look at Bidwell?

Gilles Ouellette - Bank Of Montreal - President and Chief Executive Officer, Private Client Group

We have a very -- we have -- we've had a team in the U.S., an acquisition team in the U.S., Steve, and we have a look, and all of the investment dealers know that we're looking in the wealth management area, and we've had a look at everything practically everything that's been on the market and you know, we've made bids where we thought the appropriate one, given the kind of internal standards that we have. You know, we bid on some and we've missed some and others that we've got. But we did have a look at Bidwell.

Steve Cawley - TD Newcrest - Analyst

Okay. Maybe one last one for Mike Maila.

Mike, you mentioned that in the quarter you classified five power loans as impaired yet those power companies were all current on their interest payments.

Can you remind me again how you make decisions on classifying loans as impaired if they are current on their interest payments?

Michel Maila - Bank of Montreal – Executive Vice President and Head of Risk Management Group

Yes, Steve, with respect to commercial and corporate loans, really we look at, as the ultimate collectibility of interest and principal and if we have any reasonable doubt, we think the prudent thing to do is put them on non-accrual. Even though they are current, even though they may be trading close to par in the secondary market.

Steve Cawley - TD Newcrest - Analyst

Thank you.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Thanks, Steve.

Operator

Your next question comes from Michael Goldberg. Please go ahead.

Michael Goldberg - Desjardins Securities - Analyst

Thank very much. A couple of questions.

I know it was a small acquisition, Lakeland, but I'm just wondering if you could comment on how it fits in with your 15% IRR parameter, particularly in view of looking at it on a what you paid per branch or per dollar of deposits in comparison with the recently closed transaction that royal was involved in, in Florida, and it looks, you know, in rough numbers, like you paid about three times as much. Can you comment on that?

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Sure. I will get Frank to comment on that, Michael.

Frank Techar - Harris Bank – President and Chief Executive Officer

Yeah, Michael, the Lakeland deal, we're comfortable with it from a purchase price perspective. It met all of our internal hurdles, so we -- you know, we followed the disciplines that we set for ourselves internally. The nice part about the Lakeland acquisition and it is always difficult comparing acquisitions, is the price to last 12 months earnings was 13.4. and that's a relatively low number, and because the Centura acquisition was really done on a branch basis, it is hard to make the comparison.

So you know, I don't -- I can't really comment relative to that one transaction. We think it is an absolutely great fit. Number one and number two market shares in two of the fastest-growing locations in Chicago with an absolutely great team.

So you know, while on the surface, it may look like, you know, the purchase price doesn't justify the acquisition, we think it does. And we think we've got great gross growth prospects in both of those small marketplaces in Chicagoland.

Michael Goldberg - Desjardins Securities - Analyst

Thanks very much. I had one other question.

Just in terms of the interest recapture on the declassified impaired loans, how much was it actually in the latest quarter and how does that compare with the last quarter and a year-ago same quarter.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Mike?

Michel Maila - Bank of Montreal – Executive Vice President and Head of Risk Management Group

Michael, I will have to get back to you for the comparison quarter over quarter and for last year. We will put it up on the web site.

Michael Goldberg - Desjardins Securities - Analyst

Okay and how much was it actually this quarter? The recapture.

Michel Maila - Bank of Montreal – Executive Vice President and Head of Risk Management Group

About 18 million dollars.

Michael Goldberg - Desjardins Securities - Analyst

Thanks very much.

Operator

Your next question comes from Jamie Keating. Please go ahead.

Jamie Keating - Merrill Lynch Canada - Analyst

Hi again. Still a good quarter.

Quick question here on page 11 of the sup pack. Card fees are jumping up and I was wondering if I could just get a little bit of colour on the impact of seasonality or perhaps composition underlying in the card fees and is there any geographic news you can tell us about on that? Also curious to know the impact of other revenues here. It looks like other revenue is up a lot sequentially. Other expenses are down a lot sequentially. And in talking to Lynn, one of the analysts, we also were encouraged to sort of perhaps net some of that against salary expense.

If you could just go through a little bit on the colour on the net benefit of those three items, which I don't know, might have been about 35 million in the quarter and just ask you whether it is sustainable or what is happening there. Probably for Karen.

Karen Maidment - Bank of Montreal - Chief Financial Officer and Executive Vice President

We can provide more detail if you're looking for it but we've had a lot of success with the launch of our mosaic card, so that's been reflected in those numbers. You're right. The other revenue is up from quarter over quarter, 66 to 101, it is about 35 million.

Most of that or a lot of little things that are not sustainable. If you look at other expenses, they are also down by about 62 million and about 45 of that or a lot of little things that kind of net out.

And then again, on comp costs, you will see that they are up 72 million. That includes the 30 million of severance that I referred to, and some other variable-type costs that are about 40 million. And so all those -- those three items tend to net out to about zero and they are all -- while they're all real they are just not sustainable going forward, the change in the quarter over quarter.

Jamie Keating - Merrill Lynch Canada - Analyst

Maybe I should follow-up with you on that one.

Karen Maidment - Bank of Montreal - Chief Financial Officer and Executive Vice President

Okay.

Jamie Keating - Merrill Lynch Canada - Analyst

Thanks.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Rob, you want to address the card?

Rob Pearce - Bank of Montreal - President and Chief Executive Officer, Personal and Commercial Client Group

Yeah, just a couple of comments, Jamie, on the card volume. Firstly, there is a couple of factors in those numbers. One is our card fees on our issuing volume and the other is the 50% interest that we have on fees that come through monaris but notwithstanding all of that, as Karen pointed out we are happy with the mosaic strategy and the position we are taking in the card market and very happy with our business.

The increase in card fees are driven by transaction volume in the main. On a much-improved -- it has been about a decade-journey for Master Card in this country, but a much improved interchange structure than we used to have so volume increases and transaction increases are good for us.

Importantly, there is a very nice growth in both the corporate card, the business card aspect of our business, and in the retail card. Both being driven by our mosaic strategy. So there is nothing unusual in those numbers. It is just transaction-generated.

Jamie Keating - Merrill Lynch Canada - Analyst

Thanks, Rob. Looks good.

Karen Maidment - Bank of Montreal - Chief Financial Officer and Executive Vice President

We will take our last call right now or last question, rather.

Operator

Thank you. Your last question comes from Jim Bantis. Please go ahead.

James Bantis - Credit Suisse First Boston - Analyst

All my questions have been asked and answered. Thank you.

F. Anthony Comper - Bank of Montreal - Chairman and Chief Executive Officer

Thanks Jim and thank you everyone and I know you've got another meeting you have to attend and so thanks everyone for joining the conference call. Susan, do you want to --

Susan Payne - Bank of Montreal - Senior Vice President of Investor Relations

I just wanted to thank everyone again for joining. If here are any further questions you can call us at Investor Relations at 416-867-6656 or e-mail us at BMO.com/Investor Relations. Thank you and good afternoon.

Operator

Ladies and gentlemen, this does conclude your conference call for today. We thank you for your participation and ask that you please disconnect your lines.