Q3 2003 CONFERENCE CALL

CORPORATE PARTICIPANTS

Susan Payne
Bank Of Montreal – Senior VP of Investor Relations

Tony Comper
Bank Of Montreal - Chairman and CEO

Karen Maidment
Bank Of Montreal - EVP and CFO

Mike Maila
Bank Of Montreal - EVP and Head of Corporate Risk Management

Frank Techar
Bank Of Montreal - President and CEO of Harris Bank

William Downe
Bank Of Montreal – Deputy chair BMO Financial Group and CEO BMO Nesbitt Burns

Yvan Bourdeau
Bank Of Montreal - President and COO, BMO Nesbitt Burns

Robert Pearce
Bank Of Montreal - President and CEO, Personal and Commercial Client Group

Gilles Ouellette
Private Client Group – President and CEO

Ronald Rogers
BMO Financial Group – Deputy Chair, Enterprise Risk and Portfolio Management

Lloyd Darlington
Technology and Solutions in E-Business – President and CEO

CONFERENCE CALL PARTICIPANTS

Jamie Keating
RBC Capital Markets – Analyst

Heather Wolf
Merrill Lynch – Analyst

Jim Bantis
Credit Suisse First Boston – Analyst

Steve Cawley
TD Newcrest – Analyst

Ian De Verteuil
BMO Nesbitt Burns – Analyst

Rob Wessel
National Bank Financial – Analyst

Quentin Broad
CIBC World Markets – Analyst

Michael Goldberg
Desjardins Securities – Analyst

PRESENTATION

Operator

Please be advised, this conference call is being recorded. Good afternoon everyone, welcome to the quarter 3, 2003 earnings conference call for August 26, 2003. Your host for today's call will be Susan Payne, Senior Vice President of Investor Relations. Ms. Payne please go ahead.

Susan Payne *- Bank Of Montreal - SVP of IR*

Good afternoon, everyone. This afternoon's brief overview of our third 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. From the private client group, Gilles Ouellette; Yvan Bourdeau, Investment Banking; Lloyd Darlington who heads up Technology and Solutions and E-Business; and from Chicago, Frank Techar of the Harris Bank.

At this time, I'd 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'd like to hand the floor over to Tony.

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Thanks, Susan. Good afternoon, everyone. Given that this is an unusually busy results day with three banks reporting, I will be brief. BMO Financial Group had a strong third quarter in what is shaping up as a strong year.

You've heard me say for some time now, that my colleagues and I have been executing our Canada-US growth strategy with determination and discipline while simultaneously transforming our business mix and relentlessly implementing a wide range of sales boosting and cost containment initiatives all across the enterprise. We've undertaken a tremendous amount of change to substantially improve business fundamentals with one goal very clearly in mind, top year performance. Now as we pass the 3/4 mark in what's really a rewarding year for BMO shareholders; on the heels of rising performance across all three operating groups, 46% earnings growth year-over-year and 23% earnings growth since the second quarter alone. We've arrived at a milestone in a long journey that we have mapped out for ourselves. We've reached the point where the results confirm that, as we kind of say to ourselves internally, we are getting it right. I think they provide solid proof that all of our steadfast and unglamorous changes are having the desired effect.

We're creating a customer-oriented, sales friendly, cost conscious, high performance organization. We have got some distance to go achieve top tier performance, but the third quarter results provide the best proof to date of the earnings momentum that BMO has built up quietly over the past five quarters. Management's confidence in the sustainability of this upward earnings trend is reflected in the announcement today of a 6.1% increase in our quarterly dividend. That brings BMO's dividend increase for the year to 17%.

One telling sign post is the 9% jump year-over-year in revenues in the third quarter as expenses remained essentially flat. Even more significant is the positive trend line in relative revenue growth over the past three quarters. Given the challenging economic and very competitive market conditions I really believe that this is promising momentum. What's happening is that the numerous sales focused initiatives that I have described in previous quarters are starting to produce the desired results.

Another telling sign post is productivity, where we're making good progress. The cash productivity ratio improved 5.5 percentage points year-over-year as all operating groups succeeded in their ongoing cost management efforts. If you combine that with rising revenues, effective cost containment positions us well to achieve our goal of lowering the cash productivity ratio in each of the three operating groups by 150 to 200 basis points for the year. You can expect a similar pace of progress in improving the cost-to-revenue ratio in each of the operating groups in 2004 and beyond, as productivity continues to be our number one priority all across BMO.

If I turn now to BMO's outlook for the fourth quarter, we anticipate that strong growth will continue in the Personal and Commercial Client Group; while current performance levels continue in the Private Client Group and the Investment Banking Group, and we expect to surpass all of the annual targets that we set at the beginning of the year. We have, therefore, revised our guidance and now anticipate earnings per share growth for fiscal 2003 of 15 to 20%; that's up from 10 to 15%, and return on equity of 15 to 16%; and that's up from 14 to 15%.

Also, given our favorable credit performance so far this year, we're now estimating that the annual provision for credit losses will be at or below $500 million and that's down from the previously-reduced guidance of at or below $600 million. As for the tier one capital ratio, it stands at 9.21% and that's ahead of the target of at least 8%. That's it for the highlights. Over to Karen. Karen?

Karen Maidment *- Bank Of Montreal - EVP and CFO*

Thanks, Tony. This was a great quarter for BMO. We had strong productivity improvements, lower credit losses, improved core results in all the operating groups; and there were no unusual items. In fact, all comments today are on an as-reported basis. Net income, up $504 million is up 46% over last year; and 23% over Q2. Higher revenue, reduced PCL and flat expenses, despite three more days, drove improvement over Q2. P&C performance improved on higher volumes.

PCG was up reflecting moderate improvements in equity markets; and IBG was also up due to better performance from investment securities. In addition, all groups improved as a result of strong expense control. Turning to slide 3, you can see the change in cash EPS quarter-over-quarter and year-over-year. Quarter-over-quarter, improved performance from investment securities added 7 cents. Lower provisions added a further 4 cents. And foreign exchange took away one cent.

The balance of the increase, 8 cents, can be attributable to good business growth and three extra days in the quarter. The 7 cents that I referred to in terms of the securities is the difference of -- right off the $45 million in second quarter, and a gain in the third quarter of $12 million. You will note from our sup-pack we have unrealized gains up to $415 million from $356 million at the end of the last quarter, so there's upside in this number.

Year-over-year, the story is similar with performance on investment securities adding 16 cents; lower provisions, 8 cents. And foreign exchange took away 3 cents. The balance of the increase, again, 8 cents, can be attributable to strong business growth in all of our operating groups.

Turning to revenue growth on slide 5, and adjusting for improvements in investment securities, foreign exchange and acquisitions; you can see that we've achieved good core business growth at 4.8% quarter-over-quarter, and 5.7% year-over-year. Quarter-over-quarter growth can be attributable mostly to three additional days and to business growth in all the operating groups. Year-over-year business growth resulted from improved volumes and margins in P&C Canada, higher fee-based revenue, and improved M&A revenue and origination.

On slide 6, net interest margins are down over both comparative periods. Net interest income remained flat quarter-over-quarter and the decline in net interest margin was offset by higher volumes in both personal & commercial and IBG and once again, the effects of three more calendar days in Q3. Year-over-year, net interest income improved while margins also declined.

IBG was the biggest contributor to the decline, primarily due to changes in business mix. Personal & commercial margins were stable compared to a year ago, and down from last quarter. There were a number of smaller items impacting the margin in P&C this quarter, but approximately 5 basis points of the decrease relates to competitive pressure and lower interest rates.

Slide 7 demonstrates our commitment to cost management and reducing expenses. Core expenses are down quarter-over-quarter and up only marginally year-over-year as a result of higher pension and employee benefit costs. Performance-based compensation is up from both comparative quarters, consistent with higher revenues and improved performance. Offsetting this increase is the impact of foreign exchange.

As you can see on slide 8, our management team has executed on specific initiatives to achieve this performance. For example, we have reduced FTE in non-client facing positions year-over-year, down 700. We have successfully negotiated certain vendor contracts, especially in PCG; we have optimized branch and call center operations; and we've targeted reductions in consulting and travel and procurement. All while observing significant increase in pension expense over last year.

Moving on to our cash productivity ratio, slide 9 underscores the results of our commitment to translate our cost management programs into a much improved efficiency ratio. All operating groups have achieved significant improvement in the efficiency, and are well-positioned to achieve 150 to 200 basis points reduction in our operating groups over year-end 2002. And we continue to focus on managing expenses through the balance of the year.

I'd like to wrap up on slide 10, which shows our annual targets. As Tony indicated, we're on track to surpass all of our annual operating targets; and as a result annual EPS growth is now estimated to be 15 to 20%, and ROE 15 to 16%. Annual provision for credit loss is expected to be at or below $500 million, and the EPS range of 15 to 20% growth acknowledges some uncertainty in the economic environment.

However, if capital markets activity continues at the current pace, and PCLs remain at current levels, we expect to be at the high end of our new guidance range. We are also in the process of setting our 2004 targets and as we look to achieve further cash productivity improvements in all groups, we may make decisions to incur modest costs in the fourth quarter that will best position us for the future. That wraps up my comments. Over to you, Mike.

Mike Maila *- Bank Of Montreal - EVP and Head of Corporate Risk Management*

Thanks, Karen and good afternoon, everyone. Let me walk you briefly through the key highlights of this quarter's risk review, starting with slide 1. Specific provisions for credit losses at $90 million, were $70 million better than in Q3 of last year, and $30 million better than last quarter. In fact, this is the lowest level of specific provisions, excluding non-recurring items since the fourth quarter of 1999. Gross impaired loans are also down significantly this quarter as a result of two factors. Lower formations of new, impaired loans; and larger reductions in the impaired portfolio relative to the previous quarter.

The first factor is illustrated in slide 2. As you can see, formations are down 29% from Q2; and at $249 million they are, in fact, at their lowest level for a long time. In fact, since Q2 of 2000.

The second factor, namely reductions in impaired balances, is illustrated on slide 3. This quarter we've had a relatively high level of repayments relating to loans that we classify as impaired. This is indicative of the value added by our workout teams as our clients successfully restructure their finances; and in a smaller number of cases, companies emerge from bankruptcy protection. The bulk of the repayments achieved this quarter occurred in the U.S. corporate portfolio; and they originated from a number of sectors including transportation, energy, auto, and retail trade.

In addition to the high level of repayments, sales activity has been significant this quarter, particularly in the cable and auto sectors as secondary market prices firmed up.

Turning to slide 4, the more stable consumer portfolio continues to grow; reaching now 54% of the total loan book, if you add the Canada and U.S. components, versus 50% at the end of fiscal 2002. And this portfolio clearly continues to perform well.

Turning to slide 5, trading and underwriting performance remained profitable this quarter with only three days in the quarter showing a negative P&L. As the value at risk line indicates, the risk level increased somewhat during the quarter as trading books were positioned to take advantage of volatility in the interest rate markets.

Finally, let me point out that we have included in the appendix this quarter, additional information about risk migration within each of the sectors where available. We've also added the steel sector to the list of industry disclosures. At this point, I'd like to turn the call over to the conference operator for the question and answer session.

QUESTION AND ANSWER

Operator

We will now begin the question and answer session. To place yourself into the question queue, press the star 1 on your touch-tone phone. If you are using a speaker phone, pick up your handset and then press the star 1. If your question has been answered and you'd like to withdrawal your request, you may do so by pressing star 2. Please go ahead if you have any questions. Thank you. Our first question comes in from Jamie Keating from RBC Capital. Please go ahead.

Jamie Keating *- RBC Capital Markets - Analyst*

Thank you very much. I wondered if I could just explore with Mike a little more on the loan loss provision outlook, perhaps, and just wondered if you could describe for us what the loss provision run rate would look like in going forward through the cycle?

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Jamie, it's Tony. Good afternoon. We didn't hear your -- your voice trailed off a little bit. Can you repeat that please.

Jamie Keating *- RBC Capital Markets - Analyst*

Sure, Tony. Just looking for Mike's view on what factors will drive the run rate loan loss provision through the cycle and where his best estimate of where loan losses should run through the next business cycle?

Mike Maila *- Bank Of Montreal - EVP and Head of Corporate Risk Management*

Let me speak, Jamie, to the numbers we've provided in the sup-pack, with respect to the expected loss level throughout the year, as through the cycle, the number is around $540 million. So, clearly this current quarter we're running below that level. With respect to any guidance for next year, we will be providing that in November.

Jamie Keating *- RBC Capital Markets - Analyst*

And if I could perhaps, just follow up, as well, thank you, Mike. Just on the cost side here, you've had a neck-snapping improvement in cost of revenue this quarter after having had one in the first quarter, as well. I'm curious about whether we're seeing some step function changes here or whether it's sort of an incremental cost of revenue gain? I'm very impressed with the number and wanted more detail on that, maybe it's for Karen or whatever.

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Yeah, I will comment at a general level, Jamie, if we want follow-up, we can. It's both of the above. So, as I've described before, the whole focus of the performance enhancement program kind of comes in two tranches.

Each one of the business groups are managing their costs and revenues towards specific goals of improving their productivity ratio by 150 to 200 basis points. That's the ongoing management of the costs.

At the broader level, there is a number of enterprise level initiatives which touch all the business groups. So what you're seeing this quarter is both "A" and "B" kind of clicking in. So, there is a combination of just diligent cost management at an operating group level plus the impact of some broader enterprise level initiatives that actually got started about 18 months ago and are starting to get into play right now. Karen, do you want to add anything to that?

Karen Maidment *- Bank Of Montreal - EVP and CFO*

The only thing that I would add is, as Tony said, we've been working on this for a long time and it's all across the organization. It hadn't shown through in the numbers because we've had to incur transition costs; and we also had to pick up $100 million for pension and related costs that really hit us earlier in the year. So, this expense program is not something new; and our focus on productivity is not something new, we're just starting to see the benefits and we expect it will continue.

Jamie Keating *- RBC Capital Markets - Analyst*

Thanks. Terrific quarter.

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Thanks, Jamie.

Operator

Thank you, our next question from Heather Wolf from Merrill Lynch. Please go ahead.

Heather Wolf *- Merrill Lynch - Analyst*

Hi, good afternoon.

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Hi, Heather.

Heather Wolf *- Merrill Lynch - Analyst*

I hesitate to even ask this question given what a good quarter it was, but it seems like the only hiccup was in the U.S. And it seems like each of the various business units is having a little bit of a tough time in the U.S. I'm curious if you could address your outlook for each of the three going forward? And what you're doing to try to improve things there?

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Great, good question Heather. I'm going to get Karen to talk at a summary level and then I'll get Bill and Frank each to perhaps comment.

Karen Maidment *- Bank Of Montreal - EVP and CFO*

There is a variety of issues that are impacting the comparison in U.S. numbers. We've had the effect of the acquisition and the one-time costs. We've also -- on a year to date basis, we have seen some narrowing of spreads as the absolute level of interest rates are down. And some of our credit, the higher credit losses were, in fact, in the U.S.

You also may recall that last year we booked a recovery from the collateralized loan obligations and that went into the U.S. earnings, so, that impacted the change. And FX was obviously a bit of a factor. So there is a lot of little things. In terms of overall improvement, there is a lot of business initiatives focused on improving the earnings and I will turn it to Frank to speak on Chicagoland.

Frank Techar *- Bank Of Montreal - President and CEO of Harris Bank*

Thanks, Karen. Hi, Heather. With respect to Chicagoland, Karen mentioned the effect of the exchange rate. That's really the story. If you look at our growth in volumes, both loans and deposits we are continuing the momentum we started now over a year ago. Our loan balances are still growing at 25% on a year-over-year basis. Our deposit balances are growing at 8% so our balance sheet growth is still continuing.

If you look at page 10 in the sup-pack, it shows our net interest margin on a quarterly basis. We did see a decline from Q3 of last year, and primarily that's been a result of the Fed lowering rates over the course of the last four quarters; but the good news in all of that is for the last couple of quarters, our net interest margin has held firm, notwithstanding the fact that we had another 25-basis point move by the Fed back in June.

So, we believe as a result of some of the management interventions, namely some pricing decisions that we've made, the continuing improvement in our loan-to-deposit ratios; that we're going to start to see firming margins. That, coupled with the growth in our volumes, we think that we're going to continue to see revenue improvement; and just to give you an indication, year-over-year revenue on a U.S. dollar basis for the quarter, was up 10%. So, you don't see it in the Canadian numbers, but the P&C business, the fundamentals; we're still in good shape and we think we've got, you know, we've got some decisions that we can make to continue the momentum.

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Bill, do you want to make a comment on the private line operations in the U.S.?

Bill Downe *- Bank Of Montreal - CEO BMO Nesbitt Burns*

Yes, we're making some progress in the U.S. Thank you, Steve our sup-pack on page 5, we've gone from the previous quarter, which was a loss of $15 million and in one quarter, we've gotten it down to about $6 million. And we've had a modest revenue increase as the translate came in dollars, as Frank mentioned, kind of mitigates that. But the real story down there, though, has been in how we changed the businesses.

As you know, we run two businesses down there, private banking and brokerage. We made some substantial changes during the course of the year. We've had some impact this quarter, but we certainly expect that next quarter and the quarter after to have some continuing impact. So, we're pleased with the progress that we've made, the changes we've made to the business model but I think that, you know, with the tone of the markets down there, I think the next quarter is -- should be a continuation of this trend.

Tony Comper *- Bank Of Montreal - Chairman and CEO*

And in the investment banking group operations in the United States, the big impact there is the fact that on the one hand, we're gaining client base. On the other hand, the existing clients aren't using their credit lines. And that's the majority of the income from that. Yvan do you want to add anything further to that? Or Bill?

Yvan Bourdeau *- Bank Of Montreal - President and COO, BMO Nesbitt Burns*

I think one thing to remember is IBG is probably the group that generates the most U.S. dollar out of its top line; and, therefore, the exchange rate had a big impact on our results. That's point number one. Number two, if you look in our sup-pack page 8, you will see our average loan balance that you're referring to, Tony, has dropped from quarter-to-quarter by $2.6 billion.

About half of that comes from the U.S. and that's where we get the greatest spread, is really from the U.S. So, that's another element that's adding to the amount that you picked up, Heather. And the last point is on the capital market side. This quarter was a difficult quarter particularly in the U.S. and that's a third element that affected our results in the U.S.

Tony Comper *- Bank Of Montreal - Chairman and CEO*

So, I think frankly the point there is that the underutilization of lines as the economy in the U.S. starts to pick up, gives us some operating leverage on that front.

Heather Wolf *- Merrill Lynch - Analyst*

Great. That was a very thorough answer. I just had a quick follow up for Frank, on the retail side, can you give us little colour on whether or not you're more sensitive to margins or volumes there? I would guess that margins would start to improve, but volumes would come down a little bit?

Frank Techar *- Bank Of Montreal - President and CEO of Harris Bank*

Yeah, it's something that we're looking at. Margins we believe, as I mentioned before, are going to start to firm and the expectation, you know, going into next year is, is we should have some good news there. On the volume front, we have been growing at a rapid pace and most of that growth has been in our consumer portfolios. So, the question you ask is a good one, what happens if that volume falls off? We think we've got some things that we can rely on to continue the growth.

Our sales disciplines, we believe, can continue to generate double-digit consumer loan growth. And we've also got some new locations coming on stream as we continue to expand our network. That will help on the revenue side as we go into 2004. And also, if the economy improves, we believe we're going to see a bump in our business banking revenues, as well, to offset some of the consumer declines that we might see. So, overall, we really are pretty optimistic about the sustainability of revenues going into 2004.

Heather Wolf *- Merrill Lynch - Analyst*

Great, thank you very much.

Operator

Thank you. Our next question comes in from Jim Bantis from Credit Suisse First Boston. Please go ahead.

Jim Bantis *- Credit Suisse First Boston - Analyst*

Hi, good afternoon.

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Hi, Jim.

Jim Bantis *- Credit Suisse First Boston - Analyst*

Great quarter and when I look through the numbers, I can come up with most of the explanations and one of the ones that was quite exceptional was the P&C group in Canada. When you look at the supplemental package on page 5, you know, the net contribution had been fairly range bound and I recognize there are three more days in the quarter, but a strong jump up to $208 million; and I wanted to talk about if there are any exceptional items within that number or what the key drivers were to make it sustainable?

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Pretty clean, Jim, but I will get Rob Pearce to fill in.

Rob Pearce *- Bank Of Montreal - President and CEO, Personal and Commercial Client Group*

Yeah, in fact, very clean. I mean basically we've had a fairly sustained over about the last four quarters, Jim, of revenue growth of 7 to 9%, on a pretty consistent basis, you know, quarter-over-quarter. We've got fairly strong momentum on balance sheet growth and on the sales side.

We've got good momentum on NIX control and productivity improvement has been quite market. You know, we're up north of 200 points. Q3 over Q3 and almost 300 points on a link quarter basis. So, all of that kind of stuff added up, but there is nothing extraordinary in the numbers driving them in a positive direction, they're pretty solid across all sorts of things.

Jim Bantis *- Credit Suisse First Boston - Analyst*

That's great. It looks particularly impressive with the nim contraction that Karen highlighted in her slide.

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Thank you, Jim.

Operator

Thank you. Our next question comes in from Steve Cawley from TD Newcrest.

Steve Cawley *- TD Newcrest - Analyst*

Hi, Tony. I've got one question for you. I will be getting skeptical [simplistic] analysis from people saying well, you know, these guys with the potential of mergers happening next year, will try to basically maximize their EPS and book value because they are a very attractive merger candidate. And so I don't really know if these are really solid numbers, if these are -- maybe they're not spending as much as they used to. Maybe if you could point us to maybe just two initiatives or two points that you could make as to why these are run rate numbers?

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Intriguing question, Steve. The -- I wish I had an intriguing answer for you, I don't. But I think when you look, actually the point that Rob made was, and you looked at his comments to the previous question, which is we're seeing revenue growth and we're seeing a little bit of margin compression. That tells me that we're growing the balance sheet and our sales force is being very effective. It's not just in Canada, it's also in our retail and commercial business in the United States.

So, we're managing the business for growth. And I think you're starting to see a number of factors come together, which are all firing on all cylinders. And so, I'm not waiting around for Godot, and I'm not worrying about what might potentially happen on any domestic consolidation front. That's old news. We're just focusing on managing the business; and, in particular, looking at generating our productivity, which we think is the best operating measure we can look at.

Steve Cawley *- TD Newcrest - Analyst*

In terms of initiative spending, Tony, I know there have been a lot of initiatives in the past to improve this efficiency ratio the way we've seen it this quarter, but there is really no slowdown that you're seeing of that?

Tony Comper *- Bank Of Montreal - Chairman and CEO*

No, in fact we continue to make investments, in fact, the appetite for investments exceeds what we would deem to be our capacity to fund those. So, we're being quite selective, but as you would expect, we're going to continue to fund growth in the sales force. Rob has, in fact, added quite a significant number of special sales force people this year. And that's one thing I would point to. We continue to make technology investments from Lloyd's shop into the retail and commercial business at a blinding pace. And so we will continue to absorb that. Karen?

Karen Maidment *- Bank Of Montreal - EVP and CFO*

Steve, the spend to date on capital-type items is around $300 million. That would be the same as in prior years, so, we're focusing on building the business. It's just we're being very focused.

Steve Cawley *- TD Newcrest - Analyst*

Great. One more question for you. In regards to the private client group in the U.S. Will there come a point in time that we'll see the discount brokerage arm split out?

Tony Comper *- Bank Of Montreal - Chairman and CEO*

You mean from a reporting point of view, Steve?

Steve Cawley *- TD Newcrest - Analyst*

I'd like to see the numbers.

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Karen, do you...

Karen Maidment *- Bank Of Montreal - EVP and CFO*

We've provided some of the details in my presentation at the back. You can see some of the volume statistics and --

Steve Cawley *- TD Newcrest - Analyst*

Where is that, Karen, I'm sorry --

Karen Maidment *- Bank Of Montreal - EVP and CFO*

In the supplementary or the appendix, we've provided some details, I can look up the page. But I don't think at this point we will be providing anymore granularity. I think, when you look at our U.S. operations by group, we're already providing an awful lot of detail.

Steve Cawley *- TD Newcrest - Analyst*

It's safe to say that it's not cash net income positive yet?

Karen Maidment *- Bank Of Montreal - EVP and CFO*

It is. Absolutely cash net positive. It has been for a couple of quarters with the exception of the previous one.

Steve Cawley *- TD Newcrest - Analyst*

You don't want that business to get the 25 multiple that the rest of the industry trades at?

Karen Maidment *- Bank Of Montreal - EVP and CFO*

Pardon?

Steve Cawley *- TD Newcrest - Analyst*

I said, you don't want that business to get the 25 times earnings multiple that the rest of the industry trades at or above that?

Karen Maidment *- Bank Of Montreal - EVP and CFO*

Absolutely.

Steve Cawley *- TD Newcrest - Analyst*

Well, then let's get more disclosure! Thanks a lot.

Karen Maidment *- Bank Of Montreal - EVP and CFO*

Page 526, Steve, look at your package, okay?

Steve Cawley *- TD Newcrest - Analyst*

Okay.

Operator

Thank you. Our next question comes from Ian De Verteuil from BMO Nesbitt Burns. Please go ahead.

Ian De Verteuil *- BMO Nesbitt Burns - Analyst*

Thanks. I guess following up on Steve's question on sustainability. Karen, you know, I really think it pointed to a fairly clean quarter here, yet even if I was to get to the upper end of your guidance it would mean you only do 90 cents in Q4; but everything I've heard so far and everything I see in the numbers, it looks like a fairly sustainable, you know, high 90's run rate. Is there something I should be thinking of that would be different as you go forward?

Karen Maidment *- Bank Of Montreal - EVP and CFO*

You're right, if we - at 20% the earnings would be about $450 for the quarter. And if we were replicating this quarter, the 99 cents it would be about 24%. So, we're assuming that capital markets will continue. That's the downside risk, although I think it's a fairly modest one. We're also assuming credit will continue and there's always the uncertainty that you might have a surprise, but at this point, we don't see any.

But the other areas I indicated, as we're looking at our 2004 plan, it's possible and we haven't taken any decisions, but that we can incur a modest amount. When I say modest, probably under $50 million of costs associated with transition to achieve those. So, that's a little color behind the numbers.

Ian De Verteuil *- BMO Nesbitt Burns - Analyst*

Thanks. The second question leads to page 34 of the supplemental pack. It looks as if the bank is -- has taken a fairly significant bet that rates will fall and sort of bigger gapping than you have done in the past. Can you speak to what I should read into that?

Karen Maidment *- Bank Of Montreal - EVP and CFO*

On the structural side, the gap isn't any wider, where it is, is in the IBG side and Yvan could speak a little bit to that.

Yvan Bourdeau *- Bank Of Montreal - President and COO, BMO Nesbitt Burns*

Yes, we've had some, as you can imagine, Ian over the last few quarters, some assets that were put on the books several quarters ago at very attractive rates that were maturing. As we've felt that we're moving towards the end of this third quarter, we've actually added some short-term money market assets on our books, anticipating that the Fed will remain on the sideline for an extensive period of time, certainly until early next year. And we wanted to benefit from the steeper yield curve that exists today in the marketplace.

Ian De Verteuil *- BMO Nesbitt Burns - Analyst*

Should I see that flow through in the trading revenues or does that come through accrual books?

Yvan Bourdeau *- Bank Of Montreal - President and COO, BMO Nesbitt Burns*

On the accrual books.

Ian De Verteuil *- BMO Nesbitt Burns - Analyst*

So, this may have helped spread a little bit in the quarter?

Yvan Bourdeau *- Bank Of Montreal - President and COO, BMO Nesbitt Burns*

Yes.

Ian De Verteuil *- BMO Nesbitt Burns - Analyst*

Thanks.

Operator

Thank you. Our next question comes from Rob Wessel from National Bank Financial. Please go ahead.

Rob Wessel *- National Bank Financial - Analyst*

Thank you, good afternoon. I actually have two quick questions. One is, with respect to the investment securities gains and losses, I mean it was a $12 million gain this quarter, but we had losses in about five of the previous eight.

I just wanted to know, do you feel a little bit better about, you know, maybe the merchant banking portfolio and some of the other items that are influencing that line? Can we feel good that it's at least going to stay zero going forward?

Karen Maidment *- Bank Of Montreal - EVP and CFO*

Rob, it's Karen. We've been really conservative, I think, and prudent over the last -- through the business cycle, the downturn. And we've looked at every aspect of the portfolio, anything that's market value has been below book value for nine months. We've written down, unless there's a very good reason not to.

And that's so we've had write-offs all the way along. They're down to the stage where they're just, you know, $1's and $2 millions. As I said, you would see that the unrealized security gains on page 20 of the sup-pack has actually increased from $356 to $415 million, which implies that there's upside on that.

Rob Wessel *- National Bank Financial - Analyst*

Great. And my second question relates to the competitive environment in Chicago. We've now seen announcements for several powerful financial institutions in the U.S., starting to target that fragmented market. I guess my question is sort of twofold. One is: Do you have a competitive response? Or do you think you need one? And I guess the second one is do you think that competitive response should, you know, could include acquisitions? And third, what would be your appetite for dilution should you feel you do need to make acquisitions?

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Those are good questions. I will get Frank to handle it in detail. Let me just say that the - and I said this before, is that the entrance of some of these significant competitors and very, very high quality competitors, to me, reaffirms the attractiveness of the Chicagoland marketplace and we've been there for a long time, we're building our network and we will continue to build organically with the plans we've already communicated to you. And we'll selectively look at the acquisitions to infield areas that is faster for us to grow by buying as opposed to building. Frank, do you want to pick up that?

Frank Techar *- Bank Of Montreal - President and CEO of Harris Bank*

Sure, Tony. Hi, Rob. A couple of comments, first of all, we're on track to meet our expansion objectives here. And I'll give you a couple of -- a couple of facts that will hopefully give you comfort that it's appropriate given what you've been seeing. We're going to open this year eight new locations and next year we're targeting 10, on top of our 145 that we started the year with. If you look at all of the new expansion in this marketplace since the beginning of the year; there have been, including ours, there have been 83 new locations.

Sixty of them have been WAMU's. So, WAMU has definitely come into the marketplace in a big way with a different business model. If you look at all the other major competitors, Bank of America, who's announced big plans, has opened two. Bank One has opened three. LaSalle bank has opened three more. And TCF has opened two. Those -- what I would characterize are the big players in the marketplace.

We are either at or going to surpass all of their expansion plans here in Chicago for this year; and my expectation would be that would happen next year, as well. So, I kind of view our competitive response in this market where we are, one of the biggest players, is appropriate given our presence at this time. If you look at the acquisition market, we've evaluated everyone in the marketplace, we've held in excess of 80 conversations over the course of the last eight months and we haven't missed anything. In the Chicago marketplace, there have been 12 transactions that have occurred in the last year, 47 branches have changed hands.

So, there's been very little activity here and we're on top of everything that's going on and trying to pry some of these properties loose. So, I really feel comfortable that we're on track. We're pleased with all of our sites. We're not missing anything. We're in the marketplaces and in the communities that we want to be in and I think we're going to be able to continue to compete with anybody who has their eye set on this market.

Rob Wessel *- National Bank Financial - Analyst*

So, just a follow-up, if I'm hearing you correctly and I may not be, you would be considering, you know, buying properties to prevent some of the other larger powerful players, not more powerful, but large and powerful players, excuse me, from entering the market?

Frank Techar *- Bank Of Montreal - President and CEO of Harris Bank*

Yes, we're looking at everything from one and two-branch locations to the remaining large independents who might have 20 or 30 locations in the market. We know the players, we know what the prices are and we think it's highly unlikely that someone's going to come in, using acquisitions, to establish a presence at a price that's going to be easy for them to hit their financial target. So, I just don't see it happening in the short-term. And if it does, we're going to have an opportunity to be at the table.

Rob Wessel *- National Bank Financial - Analyst*

So, last point, just to clarify here, so, then you're not seeing any changes on the ground level from the present -- or at least the interests or, you know, modest incursions into that market?

Frank Techar *- Bank Of Montreal - President and CEO of Harris Bank*

Well, we're definitely seeing competition for sites in the marketplace. But, you know, we're continuing to -- I guess my point is we're continuing to hold our own and compete for those sites and get the locations that we want, relative to our growth expectations. The only other thing where it might become apparent is competition at the customer level and on spreads and pricing; and if you go back to my earlier comment, our net interest margin has really firmed up over the last couple of quarters, so, not withstanding the fact that we have seen a bit more competition and a bit more interest in this marketplace, we think the fundamentals of the business are still holding up.

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Bill, do you want to follow up on that?

Bill Downe *- Bank Of Montreal - CEO BMO Nesbitt Burns*

Rob, I want to make certain that we heard your question correctly with respect to dilution. We're going to maintain the standards that we have for IRR and being cash accretive within two to three years and to Frank's point, we have not seen a lack of price discipline in the market. So, you know, we're not confronting a situation where people are bidding for what we think are key locations at prices that we would have to defend outside our own parameters. So, we think we can build and acquire within the ranges that we've established and continue to do that.

Rob Wessel *- National Bank Financial - Analyst*

That's great. Thank you very much.

Operator

Your next question comes from Quentin Broad of CIBC World Markets. Please go ahead.

Quentin Broad *- CIBC World Markets - Analyst*

Yes, good afternoon. Good quarter, guys. Question for Mike on the credit book. You had mentioned, I think, a question earlier in terms of sustainable levels, Mike. I think 133 is kind of expected loss levels looking at other, plus the 90. What are you seeing, I guess, in the marketplace given your write-off activity plus, obviously, the allocations you're actually making to the operating units that gives you some comfort that, you know, the 90 is the right level. Are you not seeing kind of the -- are you seeing better-than-expected recovery activity or is it that you're not seeing impairment like you might have thought at this point in the cycle?

Mike Maila *- Bank Of Montreal - EVP and Head of Corporate Risk Management*

Quentin, the answer is both. On the impairment side, we're seeing less impairment than we might have expected and on the recovery side, we're seeing better recoveries. You see that in the formation, in the repayments pace that I've highlighted as well as the secondary market prices that are firmed up for a number of these credits. So, the picture is encouraging and explains why we are running below the expected loss level that you would expect through the cycle.

Quentin Broad *- CIBC World Markets - Analyst*

And geographically, Mike, are you seeing it better in the U.S. versus Canada?

Mike Maila *- Bank Of Montreal - EVP and Head of Corporate Risk Management*

I think we've seen better, in relative terms, better performance in the U.S., partly because it performed badly in the past couple of years, so, it's bouncing back a bit more. As Karen indicated earlier, this quarter PCL was mostly in the U.S.

Quentin Broad *- CIBC World Markets - Analyst*

Okay. And on VAR, Mike, I think you're only one of the four banks to have reported so far to show an increase in VAR on your trading book. Anything that we should take away from there? You mentioned very briefly about volatility, but can you just give us a sense, is there more risk being doled out to the trading books at this point?

Mike Maila *- Bank Of Montreal - EVP and Head of Corporate Risk Management*

Quentin, in fact, Yvan just answered that question in a different context. It was essentially the positioning of the trading books with respect to interest rate moves so we were referring to the same point. That's what you pick up in the VAR line.

Quentin Broad *- CIBC World Markets - Analyst*

And one final question for Karen, I guess, to follow on Ian's in terms of sustainable earnings numbers. If you can just go through what the $50 million that you allude to, Karen. What is that to position the bank for?

Karen Maidment *- Bank Of Montreal - EVP and CFO*

My point was just that we've been incurring severance costs and transition-type costs throughout the year as we've been right sizing some of our businesses, making some changes to improve the overall productivity. So, all I was doing is giving an indication that's something we may consider, no decision has been taken, but it would be those types of costs: IT, severance, those kind of costs, if we were to take any.

Quentin Broad *- CIBC World Markets - Analyst*

So, those would not -- if we're trying to reconcile the Q3 numbers, you're saying those aren't in the Q3 --

Karen Maidment *- Bank Of Montreal - EVP and CFO*

Not much. You know, just a couple, $2, $3, or $4 million in Q3. Last year we did in Q4 have, I don't recall the exact number, but it was over $30 million, I think, in those types of costs.

Quentin Broad *- CIBC World Markets - Analyst*

And would that adjustment be designed to try and get you a leg up on a -- on say 150 to 200 basis point gain again in '04 -- I think that Tony alluded to --

Karen Maidment *- Bank Of Montreal - EVP and CFO*

it would, but we wouldn't sacrifice this year's target to achieve it.

Quentin Broad *- CIBC World Markets - Analyst*

Thank you.

Operator

Thank you. Our next question comes from Michael Goldberg from Desjardins Securities. Please go ahead.

Michael Goldberg *- Desjardins Securities - Analyst*

Thanks, I'm going to be following up on a couple of the other questions. First of all, for Mike, could you comment on the prospect over the balance of the year for continued cures, sales and repayments in the impaired loan portfolio? And can you also, you know, you said the outlook is $500 (million) or less. Can you put a -- a lower end on the range that you think that it could be?

Mike Maila *- Bank Of Montreal - EVP and Head of Corporate Risk Management*

Thanks, Michael. Let me deal with the first question. In terms of the prospects for continued sales and repayments, very hard to look ahead on that front. As you know, Michael, perhaps the best indicator is, as I mentioned earlier, the formations, the level of secondary market prices; and also what's happening in the bond markets as far as credit spreads on corporate bonds, you know, actually narrowing over time.

So, as long as these trends hold up at this point in the cycle, the prospects are reasonably good. With respect to the guidance, I think we've provided essentially the whole year guidance and it's essentially saying that the fourth quarter will be at the $140 million or less and I'm not in a position to go beyond that, Michael, you understand.

Michael Goldberg *- Desjardins Securities - Analyst*

The other question I had relates to the possible spending action in the fourth quarter and what would be the impact on, you know, expense reduction expected for 2004 if, in fact, you do take this spending action in the fourth quarter? In other words, for let's say spending $50 million in the fourth quarter, how much expense reduction does that potentially translate into in 2004?

Karen Maidment *- Bank Of Montreal - EVP and CFO*

I think, really, that's hypothetical right now. Because what I was really talking about is possibilities. The key point is that we're going to achieve the 150 to 200 basis points on each group this year and we're going to target that again next year and if we do incur costs, we will be able to talk about it at the end of the fourth quarter.

Michael Goldberg *- Desjardins Securities - Analyst*

Okay. Thanks a lot.

Tony Comper *- Bank Of Montreal - Chairman and CEO*

Thanks, Michael.

Operator

Thank you. Our next question comes in from Jamie Keating from RBC Capital. Please go ahead.

Jamie Keating *- RBC Capital Markets - Analyst*

Hi, again. Follow-up on same subject, but just wanted to focus on the technology, if I could, and perhaps in Rob's business or somewhere, an update on where we stand on the rollout of the optimizer and/or the operating programs and whether that's having a favorable impact as those costs perhaps roll off?

Rob Pearce *- Bank Of Montreal - President and CEO, Personal and Commercial Client Group*

Yeah, Jamie, it's Rob. A couple of things, as you know, pathway connect, which was basically the technological infrastructure into our branches and call centers, we completed in roughly January of this year. The optimizer rollout had gone into the SBB account managers and into the call centers in that same period of time. So, up until the first quarter of this year. We've done no other rollout in the latter half of this year because we've been spending our time on the development of the optimizer desktop which we're going rollout next year to all sales and service and support people in our personal operation.

So, we've gotten the first wave of rollout done, you know, January/February of this year, now we're back into the development game for rollout in '04. Certainly on the benefits side, I mean one of the reasons that you're seeing an improvement productivity in our business is being contributed by a bunch of things, not the least of which is some of the technology and improved customer information systems that we've put out into our system from that, we're getting more sales. From that, we're also getting better service, but importantly just more efficiencies throughout our system and you're seeing it roll through in the numbers.

Jamie Keating *- RBC Capital Markets - Analyst*

Would it be fair to ask Frank where we stand in the U.S., if it's relevant?

Frank Techar *- Bank Of Montreal - President and CEO of Harris Bank*

Sorry, Jamie, the same question here in the states?

Jamie Keating *- RBC Capital Markets - Analyst*

Yes, just to the extent that it's relevant, anyway, Frank, if it's not, don't worry about it.

Frank Techar *- Bank Of Montreal - President and CEO of Harris Bank*

It's not really relevant. One of the things my team has started to have conversations on is the applicability of the platform that Rob's built over the last couple of years. So, we've got some elements that we really like here and we've got some others that potentially need some upgrades, so, we're in the strategic design phase, I guess. So, no real change that I'm anticipating from a technology spend year-over-year.

Jamie Keating *- RBC Capital Markets - Analyst*

Thank you very much.

Karen Maidment *- Bank Of Montreal - EVP and CFO*

Operator, we will now take our last question.

Operator

Thank you. Our last question is from Ian de Verteuil from BMO Nesbitt Burns.

Ian De Verteuil *- BMO Nesbitt Burns - Analyst*

Yes, a question for Rob. Slide 12, you know, we've seen four bank's report here, we've seen, you know, it looks as if the Bank of Montreal has had the best performance on controlling costs in the personal and commercial bank, but it also seems to be the bank that's having some issues, short-term issues, with respect to market share. Do you think those are connected, Rob? Or do you think the cost cutting is not going to have any impact on, meaningful long-term impact on share?

Rob Pearce ***- Bank Of Montreal - President and CEO, Personal and Commercial Client Group***

Yeah, I certainly wouldn't make a direct connection, Ian, between cost cutting and share performance. I think if you stand back at look at share, really on the personal banking side of the business over the last 12 months, you've had lots of ups and downs, but overall, we're down a few basis points. If you look across the big six banks, that's pretty good performance because it's been the small banks that have been the big share gainers. And over the last three months, in other words the most recent performance, it's basically the same story, we're down a couple of basis points, but it's been the small banks that have been gaining share.

On the commercial side, the business banking side of our business, over the last 12 months, we're up over 50 points and we're fast-approaching 20% share on loans under $5 million. So, overall, we're at least holding our own, arguably even better than that, holding our own as it relates to the share position. And again, over that period of time, over the 12-month period, we've had strong revenue growth on a core basis; probably 7 to 9% on a quarterly basis and had the improvements. So, I wouldn't link what we're doing on the cost side to the share game because I don't see a causal relationship there at all, Ian. In fact I think our share performance stands up fairly well, actually.

Ian De Verteuil ***- BMO Nesbitt Burns - Analyst***

Thanks.

Susan Payne ***- Bank Of Montreal - SVP of IR***

Thank you for joining us today. If you have any further questions, either call Investor Relations at 416-867-6656 or e-mail us at BMO.com/investorrelations. Thank you and good afternoon.

Operator

Thank you very much. This concludes today's conference call. Please disconnect your lines and have a wonderful day.