BMO Financial Group

Q4 2004 CONFERENCE CALL

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PRESENTATION

Operator

Good afternoon and welcome to the BMO Financial Group's fourth-quarter 2004 conference call for November 23, 2004. Your host for today is Susan Payne, Senior Vice President of Investor Relations. Ms. Payne, please go ahead.

Susan Payne - Bank of Montreal - SVP, IR

Thank you operator. Good afternoon everyone. This afternoon's brief overview of our fourth-quarter results will be prodded by Tony Comper, President and CEO; Karen Maidment, our CFO; and Bob McGlashan from Risk Management. After the comments, we will go to the Q&A with the following members of the management committee also available to answer your questions. Bill Downe, Deputy Chair; Ron Rogers, Deputy Chair; from the Investment Bank, Yvan Bourdeau; Frank Techar of the Harris Bank; Rob Pearce, from the Personal and Commercial Client Group of Canada; from the Private Group, Gilles Ouelette; and Lloyd Darlington, who heads up Technology and Solutions in e-Business.

At this time, I would like to refer our listeners to our Investor Relations Website at BMO.com to view our forward-looking statements and the risk factors pertaining to these statements. Now I will turn it over to Tony.

Tony Comper - Bank of Montreal - President and CEO

BMO delivered record net income in 2004 as our earnings grew 29 percent and we achieved or surpassed all of our annual financial targets, in our view is an extremely successful year. Earnings per share rose 29 percent; that was well above the target of 10 to 15 percent as all 3 of our operating groups improved both their productivity and earned record net income.

Return on equity rose to 19.4 percent and that was against a target of 16 to 18 percent. Credit performance was outstanding as credit losses came in at only $67 million before the reduction of 170 million of general allowances for credit losses and that compares very favorably to our target of $500 million or less. Overall our outstanding credit performance drove two-thirds of the increase in annual net income.

We delivered these results while maintaining a tier 1 capital ratio of 9.81 percent and that is comfortably above the target of at least 8 percent. While making good progress on productivity which was our top priority for this year, we improved the cash productivity ratio by 155 basis points and that is in line with our target of 150 to 200 basis points.

Also ended the year on a solid note as fourth-quarter net income rose 10 percent compared to a very good final quarter in 2003. Now while quarterly results declined relative to the preceding quarter, this was not unexpected in light of the slow down in capital markets and the unusually high recoveries of credit losses that we experience in the third quarter. As we said at the time, the high level of recoveries was unsustainable and the timing of further recoveries was unpredictable.

Shareholders benefited from our strong financial performance during the year as we raised quarterly dividends twice for a 26 percent increase in dividends from 2003. Total return on investment in BMO common shares was 20 percent for the year following a 33.4 percent return in 2003 and our five-year total shareholder return we consider our primary measure of shareholder value creation rose to 18.9 percent and that was up substantially from 12.9 percent at the end of 2003.

Discipline management, Boca strategy execution enabled us to deliver these returns despite the economic conditions were more challenging than we had anticipated as margins and revenues felt the pressure of lower-than-expected interest rates, the weaker than expected U.S. dollar and highly competitive markets.

As we turn to look ahead to 2005, we are projecting that the Canadian economy will grow at a moderate annual rate of about just north of 3 percent, somewhere around 3.1, 3.2 percent. Consumer spending and business investment will be supported by low interest rates though exports will be constrained by the higher Canadian dollar. Interest rates will continue to rise very gradually while the Canadian dollar should hover around 83 cents U.S.

The continued economic expansion will support growth in personal and commercial lending and fee-based banking. I think that the U.S. economy will grow strongly in 2005 though moderate from the rapid pace of 2004 because of less support of both monetary and fiscal policies. U.S. interest rates should continue to increase at a modest pace that will lessen the demand for residential mortgages. However, continued strength in capital spending could increase demand for business loans.

Rising short-term interest rates will lead to a flattening of the yield curve. We anticipate that earnings growth throughout the Canadian Financial Services Industry will moderate from the high levels achieved in 2004 as we move past the peak in credit recoveries toward a more normal stage of the credit cycle. In the context of this outlook, we are targeting earnings per share growth of 3 to 8 percent in 2005 and that is on a base of $4.21. This base figure excludes the gain of 21 cents per share in 2004 which was related to the reductions of the general allowance for credit losses.

Following our unusually low credit losses in 2004 and resuming a return to a more normalized credit environment, we are targeting a provision for credit losses in 2005 of $400 million or less. This target translates into approximately 24 basis points of anticipated average net loans and acceptances in 2005. That compares with an average of 39 basis points over the past 15 years.

We are also targeting return on equity of 17 to 18 percent, tier 1 capital ratio of at least 8 percent and an improvement in our cash productivity ratio of 150 to 200 basis points. As has been a case for the past 2 years, productivity remains at the top of our list of enterprise priorities for 2005. In the U.S. where our efforts to improve business performance in 2004 produced a 26 percent increase in net income, our priority is to continue our intense focus on improving performance. In addition, we

will accelerate growth in the United States through both organic growth and continued retail banking acquisitions.

In fiscal 2004, we agreed to invest more than $560 million in the acquisition of 3 community banks in the Greater Chicago area moving us closer to our goal of becoming the leading personal and commercial bank in the U.S. Midwest. The most recent of these purchases, Mercantile Bancorp in Northwest Indiana is scheduled to close by early in 2005. We are starting to deliver on our promise to expand the Harris Branch Network in the states surrounding Illinois and we intend to continue delivering on this promise.

Heading into the next fiscal year, we remain committed to our overall growth strategy, strengthening our established businesses in Canada and improving and selectively expanding our U.S. franchise. We believe that we are headed in exactly the right direction and we have the results to prove it. Over to you, Karen.

Karen Maidment - Bank of Montreal - CFO and EVP

As Tony indicated we had earnings of 563 million this quarter, up 10 percent or 50 million over last year and down 14 percent from the unusually strong Q3. Our return on equity for the quarter was 17.8 percent. On a year-over-year basis we benefited from improved credit which drove $70 million of the increase but excluding the provision for credit losses, net income declined 20 million or 4 percent.

Each group's operating performance was up as P&C had strong volume growth and lower revenues and lower revenues in IBG and PCG in a weakening marketing environment were offset by very strong expense control. However corporate revenues were down due to $18 million of higher security gains last year and the impact of the sustained low interest rate environment on the U.S. investment earnings this year.

Quarter-over-quarter results declined as expected due to the unusually high level of recoveries and interest collections in Q3 as well as the declining markets in Q4.

Last quarter you will recall that IBG benefited from a $39 million reduction in its provision for credit losses on a recovery on a loan that had been previously written off by the group in 2001. This one large recovery plus interest recovered on the loan added 59 million pretax to IBG or 38 million after-tax.

The $13 million net recovery of credit losses consists of a $37 million specific provision which was more than offset by a $50 million reduction in the general allowance. Our tier 1 capital ratio remained strong at 9.81 percent. The ratio is up quarter-over-quarter due mostly to decrease in risk weighted assets in part due to lower foreign exchange rates and that other capital issuance as we issued 600 million of innovative tier 1 capital, partially offset by 400 million redemption in preferred shares.

As Tony indicated, we met our annual cash productivity improvement target of 150 to 200 basis points achieving 155 basis point improvement in a year. This is the result of a spread of just under 3 percentage points between revenue and noninterest expenses. However as revenues have declined this quarter, our cash productivity ratio has deteriorated 40 basis points year-over-year and 110 basis points quarter-over-quarter. As Tony mentioned cash productivity improvement remains our number one priority going forward.

Slide 4 shows the changes in cash EPS compared to the third quarter of this year and the fourth quarter of last year. Quarter-over-quarter, cash earnings per share decreased 17 cents driven by last quarter's unusually high credit recoveries and the softening markets in IBG and PCG. Year-over-year, the increase in cash EPS was 10 cents driven by the reduction of the general allowance this quarter combined with a lower specific provision for credit losses.

P&C continues to experience strong volume growth while PCG and IBG were impacted by lower origination fees in trading revenue offset by reducing expenses. As I mentioned earlier corporate net income other than credit declined to due to the lower securities gains and the low-interest rate environment impacting the U.S. investment portfolio.

For the year on slide 5 you can see that credit drove 74 percent of the EPS increase with the remainder due to business growth.

Turning to slide 6, you can see revenue growth and the improvement in P&C revenue was more than offset by lower revenue in IBG and PCG as markets continued to slow and the third-quarter IBG benefiting from higher interest collections. In addition to the lower securities gains and investment portfolio earnings in the U.S. also negatively impacted growth. As a result, core business growth is down both quarter-over-quarter and year-over-year.

You will note that we had an adjustment to the quarter to our liability associated with our customer loyalty rewards program of $14 million reflecting increased redemption rates. On a go forward basis we have increased our provisioning against this liability and the run rate is about 5 to 7 million a quarter. If you adjust for the weaker U.S. dollar revenue growth was up 5.9 percent year-over-year.

We are fairly well hedged against currency fluctuations because our U.S. denominated balance sheet is relatively matched. In addition we have a program in place which hedges our U.S. denominated earnings on a 90-day basis and as a result has been able to manage the impact of the sharp decline in the U.S. dollar on our income statement and the impact was between 4 and $5 million on a quarterly basis.

On slide 7 you can see that despite the weaker U.S. dollar and challenging market conditions in the last half of the year, we have experienced revenue growth of 3.7 percent with 4 percent from business growth or 6.2 percent in total excluding the effect of the currency.

On slide 8, net interest margins on a total bank basis have decreased both quarter-over-quarter and year-over-year. Year-over-year the net margin is down 4 basis points. The decrease in P&C Canada is due to a shift in customer preference toward lower spread products; for example, mortgage and premium rate savings accounts, as well as competitive pressure on loans and spreads declining on deposits due to the low interest rate environment.

The decline in P&C U.S. is primarily due to the ongoing pressures on longer-term funded liabilities in a low-interest rate environment. And the decline in IBG is the result of lower asset levels and higher short-term rates.

On a quarter-over-quarter basis, P&C Canada's net interest margin remained relatively steady while the P&C U.S. decline is due to volume pressure in a rising rate environment and continued competitive pricing in the marketplace. The decrease in IBG's net interest margin quarter-over-quarter includes a 6 basis point impact of interest collections I mentioned in Q3 on loans that were previously written off.

Slide 9 provides a breakdown of our expense growth. Total expenses are down approximately 3 percent from the linked quarter and last year driven by the weaker U.S. dollar and lower performance-based compensation. The decline in performance-based comp is largely in IBG and PCG and related to the slowing of market activity and the lower revenues. Operating expenses in the quarter include 20 million of severance costs and certain other back office consolidation expenses in PCG while the fourth quarter of 2003 had lower miscellaneous expenses.

Slide 11 shows that overall for fiscal 2004 expenses grew only 1 percent with the impact of acquisitions and increased performance-based comp largely offsetting the impact of the weaker dollar. Operating expense control was strong at this level.

On slide 12 as previously mentioned, our year-to-date cash productivity has improved 155 basis points achieving our target. However as revenue for market-based businesses has declined, the total bank cash productivity has increased both quarter-over-quarter and year-over-year.

Slide 13 shows our performance against our fiscal '04 targets and as Tony mentioned, we have achieved or exceeded all of the targets we established at the beginning of the year with both EPS and ROE exceeding the target.

Slide 14 shows our proposed fiscal 2005 targets. EPS growth of 3 to 8 percent from a base of $4.21 which I will describe more fully in a minute. Specific provisions for credit losses, increasing to $400 million or less. Annual cash productivity improvement of 150 to 200 basis

points and ROE of 17 to 18 percent, and finally a minimum tier 1 capital ratio of 8 percent.

Slide 15 demonstrates in a simplistic way the impact of the change in the credit cycle on our EPS targets and our EPS over the last 3 years. After a record year and very low levels of credit losses, our EPS growth target is being set at 3 to 8 percent off the base of $4.21. $4.21 is the accrual earnings per share earned in 2004. The accrual earnings per share was $4.42 to about 21 cents for the general allowance and that gives you $4.21. I know some analysts look at it from a cash basis and the cash reported earnings were $4.57. If you take off 21 cents for the general, your base is and $4.36 and 3 to 8 takes you to $4.49 to $4.71 which is approximately the same level.

While on the surface the target may not seem high, it will require substantial improvements in noncredit operating performance to achieve. For example, to achieve 3 percent EPS growth with a specific provision for credit losses of 400 million, we will need to increase other operating earnings by approximately 300 million. We expect this will be achieved by continuing volume growth and focus on expense management, in P&C in Canada, improved economic climate, the impact of acquisitions, branch expansion and continued organic growth in Chicago land's banking, revenue and expense initiatives and an improved lending environment in IBG, sustained revenue growth and strong emphasis on costs in PCG and expense management and continued tax initiatives from our corporate group.

Further, to reach the high end of the EPS target of 8 percent, other operating earnings would have to increase by approximately 400 million and would require significant improvements in the current underlying economic climate including a more robust capital market activity and lower than targeted provision for credit losses.

Finally I'd like to draw your attention to a number of accounting changes that we will be adopting commencing in fiscal 2005. Starting November 1, 2004 we are required to consolidate our variable interest entities known as the off balance sheet items that were set up to assist our customers with the securitization of their assets in order to provide them with another source of funding. As a result, assets and liabilities will be increased by about $21 billion and there will be an adjustment to opening and retained earnings; however, the impact on net income in future periods is not expected to be significant.

When we adopt the new rules we will not restate the prior period financial statements. We will adopt the new accounting rules requiring the classification of preferred shares and capital trust securities as liabilities or equity. Under the new rules, 1.1 billion of our capital trust securities and 450 million of our preferred shares will be reclassified as debt. And the adoption of these rules is expected to increase interest expense by approximately 100 million and to decrease net income by approximately 25 million for fiscal 2005. However, this change will not have any impact on earnings per share or net income available to common shareholders.

When we adopt the new rules, we will restate our consolidated financial statements to reflect the change in prior years.

Finally we will adopt new rules related to Merchant Banking subsidiaries where we will be accounting for these investments at fair value. The November 1, 2004 adjustment to fair value will be recorded in income for the first quarter of 2005 and changes in fair value subsequent to November 1, 2004 will also be recorded in income. However the impact of this change of fiscal 2005 really depends on future changes in fair market value and therefore can't be determined at this time.

That wraps up the financial review and I will turn it over to Bob to talk about credit.

Bob McGlashan - Bank of Montreal – EVP, Head of Corporate Risk Management, Enterprise Risk and Portfolio Management

Good afternoon everyone. Today I have a very short presentation with 3 main messages. First, we remain in a stable part of the credit cycle and the continued reduction in both impaired loans and impaired loan formations demonstrate continued improvements in the credit quality of our loan book. On slide 4, this is further evidenced by a total PCL recovery of $13 million

for the quarter including a $50 million reduction of the general allowance.

The corporate portfolio continues to be in a net recovery position while the level of PCLs in the consumer portfolio remain stable and the commercial portfolio absent the reversals and recoveries experienced in Q3 return to a more consistent level.

On slide 5, reduced levels of reversals and recoveries have resulted in an increase in specific PCL for the quarter. In addition, new specific reservations had increased to $107 million in Q4 largely due to an abnormally low level of new reservations in IBG last quarter.

Second, our target-specific provision for credit losses for 2005 is $400 million or less which represents 24 basis points of average net loans and acceptances versus our 15-year average of 39 basis points. New reservations for 2004 totaled $510 million. We anticipate that new reservations in 2005 will be at the same level. 2004 reversals and recoveries were $443 million.

However, we anticipate that 2005 reversals and recoveries will be significantly reduced largely as a result of the dramatic reduction in the size of the impaired loan book, 42 percent reduction, together with a 53 percent reduction experienced in GIL formations and a moderation in loan sales activity in the secondary market from the strong levels we experience in 2003 and the first half 2004.

However let me underscore the point we've made in previous quarters that reversals and recoveries are extremely difficult to predict. We continue to track a number of sectors, 2 of which are detailed in the appendix to this presentation on slides 11 and 12, although none represent a material exposure to our forecast.

Interlaced in our view are the issues of sustained and/or increasing strength in the Canadian dollar and oil prices. Finally, our trading and underwriting performance has been stable with 5 days during the quarter with a negative P&L, the largest of which was $2.7 million.

With that, operator, we can now go to questions.

QUESTION AND ANSWER

Operator

(OPERATOR INSTRUCTIONS) Steve Cawley.

Steve Cawley - TD Newcrest - Analyst

Really appreciate that slide number 5, the risk review. I just want to reconcile that with the statistical supplement page 8 where you have got the U.S. earning 55 million in cash net income. There is an $89 million discrepancy between reversals and recoveries in Q3 and Q4. Is that pretty much all being reflected in the discrepancy between the 120 million in the U.S. investment banking net income in Q3 versus the 55 million in Q4 or maybe a better way to ask it is can give us a split where the 89 million is put into the various divisions?

Karen Maidment - Bank of Montreal - CFO and EVP

Do you want to go over that once more? We can get back to you on it because it is a fairly (multiple speakers).

Steve Cawley - TD Newcrest - Analyst

I will just simplify it. On slide 5 of the risk review, you've got recoveries and reversals of 70 million this quarter. You had 150 million last quarter, so there is a discrepancy of 89 million quarter-over-quarter. Is there a way to break out for me where the 89 million really hits and is it pretty much all I would suspect in the U.S. investment banking division?

Karen Maidment - Bank of Montreal - CFO and EVP

Yes, most of it is in the U.S. investment banking division which had a very large amount of recoveries and reversals in Q3.

Steve Cawley - TD Newcrest - Analyst

Okay. So when you look at the 55 million again, just back to what is a sustainable level for the U.S. investment bank. Is 55 sustainable, Karen? Was there any thing else walking in the quarter?

Bob McGlashan - Bank of Montreal – EVP, Head of Corporate Risk Management, Enterprise Risk and Portfolio Management

There wasn't.

Steve Cawley - TD Newcrest - Analyst

And this is the level we've seen in quite some time.

Bob McGlashan - Bank of Montreal – EVP, Head of Corporate Risk Management, Enterprise Risk and Portfolio Management

In fact, what I mentioned earlier in Q3 it was an abnormally low number for the investment bank. This quarter reflects something that we would have been expecting a little bit closer to the truth. But we are still an aggregate at very low PCL levels across the piece, in the investment bank in particular.

Steve Cawley - TD Newcrest - Analyst

Because the average assets from that U.S. Investment Bank to keep on falling off here and that is something that in the quarter would have surprised me because some of your U.S. peers were starting to show some commercial pick up and we are not seeing it in your numbers.

Yvan Bourdeau - BMO Nesbitt Burns, Investment Banking - President and COO

Thanks for your question. First of all, if you look at our Harris Nesbitt Midwest which is our largest portfolio of loans in the U.S., in U.S. dollar terms quarter-over-quarter it actually went up by 100 million. Once you translate into Canadian dollar, the balance is actually down about 900 million. I don't know if you are comparing us to U.S. Regional Bank.

Steve Cawley - TD Newcrest - Analyst

I am.

Yvan Bourdeau - BMO Nesbitt Burns, Investment Banking - President and COO

U.S. Regional Bank don't have the impact with the Canadian dollar, so we are also experiencing a slight improvement in the utilization of our facilities but a Canadian dollar appreciation is more than offsetting that increase in utilization.

Steve Cawley - TD Newcrest - Analyst

Yvan, can you tell me roughly what is the line usage percentage right now? Do you know what that is off hand?

Yvan Bourdeau - BMO Nesbitt Burns, Investment Banking - President and COO

Off hand, I don't know. I will have to check. My best guess would be about 30 to 35 percent.

Steve Cawley - TD Newcrest - Analyst

And that is about flat from last quarter.

Yvan Bourdeau - BMO Nesbitt Burns, Investment Banking - President and COO

That is about flat from last quarter. Yes.

Steve Cawley - TD Newcrest - Analyst

I'll limit myself to one more. Karen, the VIE disclosure always seems to perplex me and this quarter is not an exception. You have got $28 billion of assets and liabilities that are going to bump up next quarter. In terms of the impact on the tier 1, I believe that if this was all going to be included in your capital ratios which it looks like it won't for the next 2 quarters that you would get 100 percent risk weighting on those assets so that would have a pretty material negative impact on your tier 1 ratio.

Karen Maidment - Bank of Montreal - CFO and EVP

That is right, Steve. Those are the multi-seller conduits so they are client assets and the way the accounting rules work is they are required to be consolidated. The 21 billion would take the tier 1 capital ratio by about 130 basis points but OFSI has granted capital relief in terms of their risk weighting, they've given us a zero risk weighting for 2 quarters, to the industry. So by the end of the second quarter, we will have restructured or done something. I don't expect that the capital ratio will be declining by that amount.

Steve Cawley - TD Newcrest - Analyst

So, I have heard this from the others as well, it seems like I have been waiting for these restructurings to take place for some time and if it is pretty easy to do it, why did you have to get Capital relief for these next 2 quarters, why didn't you just restructure these right away and can you restructure them that easily for the third quarter?

Karen Maidment - Bank of Montreal - CFO and EVP

We can restructure them. The problem is the U.S. accounting rules and the Canadian accounting rules are not in sync. So it is hard to restructure them to meet both rules and that is why OFSI has given some relief on this. The U.S. accounting bodies are relooking at the underlying accounting rules and that is why everyone is facing the same issue.

Steve Cawley - TD Newcrest - Analyst

And once you restructured them, you will have no net income impact?

Karen Maidment - Bank of Montreal - CFO and EVP

They're not going to have any net income impact anyway. So we bring 21 billion on the balance sheet but no net income impact, just

capital impact. And we'd restructure them to get the capital relief and if we couldn't, we would raise sub debt or look at other capital management activities.

Steve Cawley - TD Newcrest - Analyst

Which could cost a little bit of money to do?

Karen Maidment - Bank of Montreal - CFO and EVP

Yes, pretty minimal.

Steve Cawley - TD Newcrest - Analyst

Thank you.

Operator

Jamie Keating.

Jamie Keating - RBC Capital Markets - Analyst

Good afternoon all. I've got a couple of quick questions I hope, one for Rob Pierce and it might spill over into Frank Techar. Just looking at net interest margins Rob, you were right. You predicted these margins were headed down for a while yet. It wasn't necessarily the consensus and it appears you were correct on that. Do you now have an updated prediction for us on how you feel about the next couple of quarters? I think at one point you were hypothesizing that spreads could flatten out, level off somewhere here. IS that still a reasonable prediction? I wonder if Frank could also just address -- I'm a little caught off guard by how much these spreads have come down south of the border.

Rob Pearce - Bank of Montreal - President and CEO of Personal & Commercial Client Group

One of Karen's slides laid out the last 5 quarters. You will see that on a quarterly basis our NIM for this year has been somewhere between 270 and 275 and it is pretty stable at that level. As you know, we are of the view that as interest rates rise we are expecting the margins to stay stable. The competitive pressures will continue to push it down. The consumer preferences will continue to push it down. But we think as rates move up that those 2 will offset each other -- or those 3 things will offset each other.

The good news is for this year it has been pretty stable across all 4 quarters and we do see that continuing.

Frank Techar - Harris Bank - President and CEO

In the U.S., if you look at the Q4 decline in margin from 375 to 361, that was as a result of primarily 2 things. The first one is we are seeing some competitive pressure and primarily it has been driven in our mortgage book. 8 basis points of that decline has come from the mortgage portfolio. Another 3 basis points in Q4 actually came from the inclusion of the NLSB assets on our balance sheet in Q4. They actually had a lower margin than we did and when we include them, it dropped our overall.

So those were the 2 main factors for the Q4 decline. If you go back a couple of quarters ago, I think I said as we started the year we were trying to manage our net interest margin for '04 at or near the '03 level. If you look at the full year we are down about 12 basis points. Part of that has to do with the acquisition issue that I just raised. Part has to do with the movement of some low yielding assets; our Muni bond portfolio I think we talked about a quarter or so ago.

Part of it has to do with the fact that we did see a bit more competitive pressure in the marketplace. As we go into 2005, I think where we are standing right now we would expect to see some more pressure on margins in 2005. Our expectation is though as we come out of '05 with the rates going up we think we are going to start to see that abate. We are still pretty confident that our volume growth is going to carry us through 1 more year of pressure on the margin side.

Jamie Keating - RBC Capital Markets - Analyst

Thanks Frank. Maybe a follow-up here if I may. Just Rob's side, you are right, the margin is probably more stable and I give him credit for it. The market shares fell again at this quarter I think. Was there anything to be alarmed about there or is there any good explanations for the various domestic market shares?

Rob Pearce - Bank of Montreal - President and CEO of Personal & Commercial Client Group

Certainly on the commercial share, we backed off a little bit this quarter. We continue to rank number 2 overall and it continues. We love this business. It remains a big priority for us. If you look at the data, there's a couple of things. Firstly, most of the share decline is at the small end, loans under 250,000. The numbers in any given quarter impacted by a bunch of things too -- portfolio purchases which one of the competitors we believe did who bought a vendor financing portfolio and some reclassifications amongst the competitors. But clearly it has been down.

We've got to take some actions to get that down turned around. And also have to consider the fact too, Jamie, that on the commercial side the reported numbers are for loans 5 million and under which is a very important market too and a market we love. But it ignores the strength that we've got in the corporate finance business that we build out in Canada over the last 5, 6, 7 years. Those numbers don't get reported because they tend to be loans above 5 million.

On the personal side, we've seen some decline mainly in the consumer lending business which is -- and term deposits which in part are driven by some decisions that we made on pricing. But I think the big message overall is that the sales volumes are still very good. Our pipelines remain very strong, our balance sheet growth continues to increase and an increasing rate so what we would call momentum in this business. Our margin performance overall has been pretty stable which means we're not trading out margin for share or for volume. It is kind of hanging in there.

Jamie Keating - RBC Capital Markets - Analyst

That's helpful. Thank you, Rob.

Operator

Quentin Broad.

Quentin Broad – CIBC World Markets - Analyst

I think you mentioned and someone else did to, a caller, in terms of 24 basis points, I guess it was Bob, of loans and acceptances is the 400 million. I assume that loans acceptances and not repos which would then put your loan and acceptance average balance to about 166.6 billion which is up a good healthy 4, 5 percent from the year end. I'm just trying to figure out where exactly you expect that to come from, which side of the border and given your economic outlook whether that is going to be heavily business and government type lending versus consumer?

Bob McGlashan - Bank of Montreal – EVP, Head of Corporate Risk Management, Enterprise Risk and Portfolio Management

We are not expecting a lot of difference actually in where the new reservations come from next year over this year which is relatively well spread and relatively balanced. We ended up with light reservations, lighter than we would have expected in the commercials sectors. Having said that, the retail and small business sectors kind of plug along at a pretty consistent level. We are not expecting a change there. So for '05 the real swing is not a meaningful change in the volume of formations or what is going on with respect to the level of reservation but rather the recoveries. We are really expecting to see a lot less in the way of reversals and recoveries than we saw last year.

Tony Comper - Bank of Montreal - President and CEO

(multiple speakers) Quentin, did we respond to your question? I don't think we did? You were looking for loan growth?

Quentin Broad – CIBC World Markets - Analyst

Yes.

Tony Comper - Bank of Montreal - President and CEO

Sorry, I will get Rob and then Frank to talk about where we are going to see the loan grown and then Yvan can come is as well.

Rob Pearce - Bank of Montreal - President and CEO of Personal & Commercial Client Group

Certainly in the Canada side the consumer remains pretty strong and mortgage pipelines while they've come off their peak of late spring or early summer, they remain very healthy. The consumer lending business and auto sector, those things remains strong and the card business has actually been picking up quite nicely with a bunch of the marketing programs we have been doing.

On the commercial side, loan growth for the last number of years has been pretty choppy and while we have got October Q4 over Q4 growth in our commercial lending portfolio of about 3.5 to 4 percent, that is pretty sluggish. We are still expecting at some point that that market is going to come back. I think the dampening effect as Tony laid out in his economic answer is -- there's a lot of businesses in this country that are adjusting to an 84 cent dollar right now. We've got to see how that plays out.

Tony Comper - Bank of Montreal - President and CEO

But the fact of the matter is, and I've been tracking this actually over the last 18 months and what we've seen is we have seen outstanding commercial loan balances actually declining over the last 18 months until about 3 months ago where they started to turn the corner and are starting to move up in the vicinity of 2.5 to 3.5, 4 percent. So that's Canada. Frank, do you want to talk to U.S. and then I will get Yvan as well to talk to the Harris Nesbitt portfolio?

Frank Techar - Harris Bank - President and CEO

Quentin, on the P&C side in the U.S., I am really not expecting much of a change from this year. We are still expecting personal loans both home equities and autos to continue to perform at their very robust level. We would have expected a decline this year. It didn't happen notwithstanding the increases in rates and the competition. We think we can sustain this plus 20 percent growth in those 2 categories. We've seen a big falloff in mortgage volumes and our expectation is we are down at a level that is probably sustainable as we go into 2005. We are not going to see much of a change over Q4.

We're not really expecting to see any decline in the consumer side to be made up on our commercial business. We are putting a lot of focus and energy into that particular segment and we are hoping that any softness on the consumer side we will be able to make up on the commercial side as the economy starts to pick up a bit here.

Tony Comper - Bank of Montreal - President and CEO

Yvan, do you want to talk about IBG, both sides of the border?

Yvan Bourdeau - BMO Nesbitt Burns, Investment Banking - President and COO

Yes. Thank you Tony. In Canada we had a good year in terms of utilization of our facilities and we expect this will be maintained. Looking at '05, we think our growth will come actually from the U.S. and there is mainly 3 factors supporting that. The first one you probably saw recently there was some statistics coming out really indicating that businesses had depleted their inventories and we feel that the demand is still there and they will have to adjust and

therefore they will have to replenish inventory which normally leads to higher utilization of our lines.

Second is that the U.S. dollar has been declining for some time now so we feel the lag effect is over. The American Company should become more competitive and therefore be able to export their products offshore which once again should lead to a higher utilization of our lines.

The third factor is really related to CapEx. I have been saying that for the last 2 quarters. Up to now, I was expecting our clients to actually invest in new plants and new facilities but they have confined their CapEx to maintenance. Given what I just described and the previous 2 factors, we are expecting there will be some form of additional CapEx heading toward additional capacity in the U.S. These 3 factors should improve the utilization rate of our facilities and therefore our loan outstanding in the U.S.

Tony Comper - Bank of Montreal - President and CEO

I think Quentin, the answer to your question on repos is the number does include repos.

Quentin Broad – CIBC World Markets - Analyst

Sorry, it does?

Tony Comper - Bank of Montreal - President and CEO

It does.

Quentin Broad – CIBC World Markets - Analyst

Okay. And then, if I can, Karen, you are right it seems to me that at 400 million of PCLs perhaps there is some stretched goals in terms of the earnings growth. You mentioned expenses in P&C Canada, some expenses in IBG, but if I go and look at the same currency data that you very helpfully provide on each individual operating segment, it looks like a U.S. groups are tracking higher NIX ratios and in particular IBG U.S. even if we don't even look at last quarter.

But run rates per Steve Cawley's comment I think -- expenses there looked up dramatically if we kind of looked back to Q3, 2003 revenues -- same revenues up 34 million in expenses and then P&C U.S. same currency U.S. expense ratios running at 72, 73 percent which obviously is dramatically higher than where you perhaps need them or where your peer group is. So can we hear anything about specific U.S. activity around cost initiatives that are going to help drive the 150 to 200 out next year?

Karen Maidment - Bank of Montreal - CFO and EVP

You are right; some of the productivity ratios in the U.S. businesses are higher than in Canada. All of our businesses have productivity targets next year, both north and south of the border to achieve the 150 to 200 basis point improvement. In the U.S. some of the extra costs are as a result of the investments in the new branches, in the acquisitions and as I mentioned, PCG incurred about $10 million this quarter alone on severances and back office consolidation costs. So there are more costs like that in the run rate and we are investing them because we expect to get further productivity improvements in all of the groups next year.

Quentin Broad – CIBC World Markets - Analyst

But there is nothing specific that you are going to take out, particularly for IBG with that expense loan this quarter versus that revenue run rate?

Karen Maidment - Bank of Montreal - CFO and EVP

No, really what we would like to see the revenue growth in IBG as the utilization growth and also as the environment becomes more attractive for putting assets on the balance sheet.

Quentin Broad – CIBC World Markets - Analyst

Thank you.

Operator

Shannon Cowherd (ph).

Shannon Cowherd - Citigroup - Analyst

Could you just clarify for me the 25 million? You are saying it doesn't impact your 2005 EPS or will it? If it does, is it included in your 2005 earnings outlook?

Karen Maidment - Bank of Montreal - CFO and EVP

I am not sure which 25 million you are referring to.

Shannon Cowherd - Citigroup - Analyst

The 25 million for the accounting adjustment, the adoption of the new rules, you sort of went over it, the $100 million decrease.

Karen Maidment - Bank of Montreal - CFO and EVP

That will not impact the earnings per share. It impacts the net income but because the cost is currently charged as preferred share dividends, they are deducted in order to get net income for common shareholders and the EPS calculation. It won't impact earnings per share but it brings down net income.

Shannon Cowherd - Citigroup - Analyst

And just in general, given the competitive environment in Canada, what strategies can you employ if any, to help prevent the continued erosion of net interest margins? Specifically, I noticed there was a huge hit in fourth quarter to the Private Client Group. Can you just elaborate on that a little bit?

Karen Maidment - Bank of Montreal - CFO and EVP

In terms of the net interest margin in Canada as Rob indicated, we think it will stabilize with different pressures of rates going up giving it some relief but offsetting by changing consumer preferences and the competitive market but we think that the net interest margin is at a more stable level. The IBG margin came down this quarter but it was unusually high last quarter so it is more at a stable level as well.

The PCG was the $20 million of expenses related to severance and back office consolidation. I don't know Gilles, if you want to add more color to that?

Gilles Ouellette - Bank of Montreal - President and CEO of Private Client Group

We took a charge this quarter for some restructuring, some severance and etc. Without that charge, we would have had a record quarter. This would have been our best quarter so we felt we made a lot of improvements this quarter.

Shannon Cowherd - Citigroup - Analyst

Thank you.

Operator

Susan Cohen.

Susan Cohen – Dundee Securities - Analyst

Can you talk a little bit about your payout ratio targets going forward?

Karen Maidment - Bank of Montreal - CFO and EVP

Payout ratio target is 35 to 45 percentage points, and as you know we moved it up a little while ago and that is where we are continuing to leave it. We increased the dividends twice this year for 26 percentage points and are

comfortable that we are right in the right place of the range right now.

Susan Cohen – Dundee Securities – Analyst

So given that earnings growth is likely to slow next year, you wouldn't at this point consider increasing your payout to 40 to 50 as some of the other banks have done?

Karen Maidment - Bank of Montreal - CFO and EVP

I think that would be premature to make that assumption. I think 35 to 45 is where we are comfortable right now.

Susan Cohen – Dundee Securities - Analyst

A second question if I may. Can you talk about what your budget for acquisitions might be for 2005?

Tony Comper - Bank of Montreal - President and CEO

Impossible to predict, Susan, is the honest answer to that, and what we have to do is we have to think about -- we don't have a specific budget, so that is point number 1. But if you look at the pattern of the acquisitions that we have been doing over the last couple of years, although they are opportunistic because it takes two to tango if I can characterize it that way; in other words, it is one thing for us to want to be desirous and to do an acquisition. It is another thing for the acquired party to want to be acquired.

So it is a bit lumpy, but I think we have now had a pattern that you can reasonably expect us to continue to pursue. It is very difficult to predict, though, exactly when some of these transactions precisely might hit.

Susan Cohen – Dundee Securities - Analyst

Great. Thank you very much.

Operator

Ian De Verteuil. Please go ahead.

Ian De Verteuil – BMO Nesbitt Burns - Analyst

This is a question that relates to slide 15 of Karen's package, of Karen's slide deck. Very precise targets, Karen. From what I can get out of this, it looks as if you are directing to, let's broadly say, a 4.60 of cash EPS for '05, which means on average you have got to do $1.15 a quarter. And in this quarter you did $1.10, but if I were to take the loan losses to the run rate you're directing, you would only have made 95 cents. So it means that on a run rate basis for all of '05, you've got to have a 22 percent growth in everything else. Is there something in this quarter that we should view as unusual that makes the 95 cents adjusted for the higher PCL, that makes the 95 cents not a good basis to consider?

Karen Maidment - Bank of Montreal - CFO and EVP

A couple of points. There are some unusual items this quarter. They only net out to make a couple of cents so we haven't really focused on those. We're also not directing you to the middle of the range. What we're trying to say is that as you have seen, the ability to predict recoveries and reversals is very, very hard. We have put our guidance on the credit losses assuming the ongoing new provisions are at the level that they have been running at. And so at the low end of the range, there is still a lot of work to be done. At the high end of the range, it would require better credit than we are currently expecting.

Ian De Verteuil – BMO Nesbitt Burns - Analyst

So the 3 to 8 isn't assuming 400 million of loan losses?

Karen Maidment - Bank of Montreal - CFO and EVP

What I was trying to say is that 8 percent and 400 million of loan losses you would require a substantial increase of noncredit type operating earnings and that would really depend on very robust markets conditions that we are not sure will exist. So it is a stretch range.

Ian De Verteuil – BMO Nesbitt Burns - Analyst

The second question relates to page 8 of the slide -- of the supplemental pack and I guess it comes back to the question that Quentin and Steve have been after here. The U.S. IBG in 53 million in this quarter on 23 million of loan losses in Q1 and Q2 it in 90 million on the same level of loan losses and obviously it looks as if revenues were quite weak this quarter even in U.S. dollar terms. Is there anything -- should we assume that there is a good bounce back? Trading looked a little bit light and I know there were comments on spreads. The loan levels are down even in U.S. dollars. Is there any reason to think that the revenue rate this quarter is unusually low?

Yvan Bourdeau - BMO Nesbitt Burns, Investment Banking - President and COO

There is a few items that you are aware of that Karen highlighted. If you go back to last quarter close to $59 million was the result of our large cash collection. If you were to normalize our revenue line quarter-over-quarter, actually the revenue goes down by 30 million. There are 2 elements there that are affecting us that are unusual this quarter. One, we took a write-off on systems that cost about 5 million U.S. And also in our case we had some severance that amounted in U.S. close to 4 to $5 million that will not be repeated in the next quarter. So these are 2 elements that are unusual if you wish.

Other than that, I would say that 1 element in the U.S. that we are being affected by is obviously the interest rate environment. When I left just before this meeting the 2-year note was trading at about 292 and the 10-year was at about 415 and the 6-month LIBOR is around 250. There is no question that a yield curve is flattening at a very rapid rate. The market is not moving on the long end. We are anticipating the Fed to move again on December 15, by another 25 basis points and to be probably in the 275 to 3 percent range by late spring.

Under those conditions given the importance of our U.S. repo books as well as our money market book, we felt that it would not be wise for us in terms of risk reward to replenish as our current assets were maturing to replenish with new assets because our risk reward wasn't there. But that is one factor that has definitely affected us in Q4 and unless the shape of the curve changes, it will continue to affect us moving forward.

In terms also of expenses in U.S. dollar terms we were slightly up in Q4 and that is related to some investments first in terms of human resources. We did some high-profile hire that you may have read in the press, related to our equity capital markets group, also to our M&A and we felt it was the appropriate thing to do. Looking forward we are expecting that in '05 those investments will play off and the M&A pipeline particularly in the U.S. will be stronger than it was in '04.

Another item is in terms of our own CapEx, we had to invest in IBG, in our cash management product line particularly. And in Q4, that was the first time really that some of the amortization was coming through and that once again is just we need to update our system and maintain them very competitive and that is another element that affected us in U.S. terms. Those are really the factors that affected us quarter-over-quarter.

Ian De Verteuil – BMO Nesbitt Burns - Analyst

Thanks for the very detailed response.

Operator

Jim Bantis.

Jim Bantis – CSFB - Analyst

Just a couple of quick questions. One with respect to buyback activity. There hasn't been a lot of talk about that and whether it is reflected in the growth targets. Secondly, the question for Rob Pearce in the context of the market share for the personal loans. We have seen significant deterioration in that marketshare although I understand that volumes are up for the industry as a whole. Perhaps you can just give a little bit more color what product area that BMO needs to do a little bit more work on?

Karen Maidment - Bank of Montreal - CFO and EVP

On the buyback activity, essentially our program that was outstanding last year was designed to offset the dilution at the stock options and it pretty much did that at 6.2 million shares. Going forward, we have the same program -- a new program but the same objective in place so it is not reflected in the growth targets.

Tony Comper - Bank of Montreal - President and CEO

Thanks Karen. I will get Rob to respond to your question on personal loan market share.

Rob Pearce - Bank of Montreal - President and CEO of Personal & Commercial Client Group

Jim, the share has gone down for a bunch of reasons including some pricing decisions that we made on some investments as part of our investment leading business. But the real emphasis and the real action in the consumer lending business is personal lines of credit. That is a strong product for the marketplace. We are historically somewhat underdeveloped in that product. Sales in that product are very good. The growth in our product is very good but we are starting from a relatively low position. It will be the personal line of credit product and the homeowner line of credit product which has our attention and will continue to get our attention going forward.

Jim Bantis – CSFB - Analyst

Great. Thanks very much.

Operator

Cameron Hurst.

Cameron Hurst - Portales Partners - Analyst

Good afternoon. I had a question probably for Frank and Yvan regarding the commercial and corporate loan demand that you're seeing in the Midwest. Some of the competitors that have been listening to the regionals in that area, it seemed that the further east their footprint went, the stronger the loan demand they had. So I was wondering if you could comment around the type of -- the tangible and qualitative and quantitative aspects that you are seeing for the type of loans growth and demand that you are expecting, not just as the line you said which you said was flat but what you're actually seeing in terms of present demand?

Tony Comper - Bank of Montreal - President and CEO

We'll start with Yvan, and then I will hand it over to Frank.

Yvan Bourdeau - BMO Nesbitt Burns, Investment Banking - President and COO

First of all, let me give you a bit of a breakdown. The bulk of our lending assets in the U.S. is really in the Midwest with Harris Nesbitt Midwest. It constitutes the vast majority of our assets. It is a very diversified portfolio however; people would assume that it is purely manufacturing but it is also in the healthcare, it's also in the servicing industry and the food industry, agri business as well. There is a very good diversification in that portfolio.

What seems to be consistent in the Midwest is that there is probably a steadier state of economic growth in the Midwest and less volatility that would be experienced on the east and the west corridor. So at this point in time, it is affecting us negatively in the sense that if an area is more stable over time but we anticipate

that the demand will pick up in a next 12 months.

We do have a portfolio in the energy sector which is in Houston and as you can imagine that sector is being very proactive and we have done extremely well from an M&A and advisory fee point of view. Our balances have increased not substantially but have increased year-over-year and that is primarily just because we specialize in exploration and production and our producers obviously are more active than they were 12 months ago.

We have also a portfolio in the medium communication world which is based in New York City and that portfolio has been stable and it is also a midmarket portfolio.

Frank Techar - Harris Bank - President and CEO

Cameron, if you look at page 19 of the deck that Karen walked through, you will see what the loan growth looks like on the commercial front in the U.S. You can see that over the course of the last 5 quarters it has been averaging around 10 or 11 percent. The big bump in Q4 is as a result of the inclusion of New Lenox in the totals and if you exclude New Lenox, you get down to around 10 percent. So we are seeing really consistent growth in our commercial portfolio at about the 10 or 11 percent level.

If you look behind those numbers a bit what you will find is that about two-thirds of that growth is coming from real estate related activity either owner occupied real estate that we are financing or builder/developer primarily on the retail front, the consumer front. That activity in this marketplace around Chicago has been very strong, continues to be very strong.

The growth on the more general C&I front has been weaker although there has been some indications that that is starting to pick up with the pick up in the economy. I think Yvan mentioned a couple of those points earlier talking about his business. Our expectation is our hope is that as we go into 2005, that C&I activity will start to pick up a bit but most of our growth is being driven by real estate related activity.

Cameron Hurst - Portales Partners - Analyst

Are you seeing any more intense competition in pricing?

Frank Techar - Harris Bank - President and CEO

A bit. I think everybody -- you say you're listening to others in the market. We are all challenged I think in the C&I segment, so yes, the competition is pretty tough. But we haven't seen a huge back off on either terms and conditions or price at this point in time. It seems to be still a bit of a rational market at least at this point.

Cameron Hurst - Portales Partners - Analyst

Sorry, rational or irrational?

Frank Techar - Harris Bank - President and CEO

Rational.

Cameron Hurst - Portales Partners - Analyst

Thank you both.

Operator

Michael Goldberg.

Michael Goldberg - Desjardins Securities - Analyst

First question for Bob McGlashan. You said that the forecast loss provisions based on 24 basis points of loans and acceptances. Would you still consider 39 basis points though to be a more normal credit provisioning rate for the bank?

Bob McGlashan - Bank of Montreal – EVP, Head of Corporate Risk Management, Enterprise Risk and Portfolio Management

Yes, considered it sort of a cycle neutral. It is an average over 15 years which would certainly pick up a full cycle. The sense of 24 is less than 39 suggests we are on a right side of the cycle still.

Michael Goldberg - Desjardins Securities - Analyst

My other question is the $20 million charge in PCG, is that all related to U.S. operations?

Karen Maidment - Bank of Montreal - CFO and EVP

It is about half in the U.S. and half in Canada.

Michael Goldberg - Desjardins Securities - Analyst

Okay. Also were there any additional gains this quarter on sales of impaired loans?

Rob Pearce - Bank of Montreal - President and CEO of Personal & Commercial Client Group

There was. It was either 2 million or zero. I am trying to remember here. It was $2 million, it was nominal.

Michael Goldberg - Desjardins Securities - Analyst

Okay. Finally I think it is, in terms of the new accounting for VIEs and how they get restructured one way or the other, will they continue to count as part of risk-weighted asset? On a 100 percent basis? Even once you've gotten the -- you are over the relief period.

Karen Maidment - Bank of Montreal - CFO and EVP

No, we will go through restructuring process or some kind of arrangements and we wouldn't expect that.

Michael Goldberg - Desjardins Securities - Analyst

So what should we be thinking of as far as the ultimate impact once you've gone through the restructuring?

Karen Maidment - Bank of Montreal - CFO and EVP

We will have to update you at the end of the first quarter on that.

Michael Goldberg - Desjardins Securities - Analyst

Thanks.

Operator

Jamie Keating.

Jamie Keating - RBC Capital Markets - Analyst

These are quick. One, securities gains, was it primarily in equities? Number 2, the Merchant Bank portfolio could you just discuss if it is in the money now or directionally how far it is in or out? And the last point is I wondered if I might trouble Yvan or whoever for an update on the capital markets outlook, underwritings and M&A?

Karen Maidment - Bank of Montreal - CFO and EVP

Securities gains were both equities and fixed but there were a number of equities. In terms of the Merchant Bank, the total portfolio is about 550 million with the individual investments ranging between 5 and 20 million on average. And the unrealized gains on that portfolio are included in the unrealized gains on the equities on page 19 of the supplemental pack which has a $60 million amount of unrealized gains but that also includes other equities in that portfolio.

Jamie Keating - RBC Capital Markets - Analyst

So it is in the money though something less than 60?

Karen Maidment - Bank of Montreal - CFO and EVP

Yes.

Jamie Keating – RBC Capital Markets - Analyst

And just the pipeline?

Yvan Bourdeau - BMO Nesbitt Burns, Investment Banking - President and COO

Yes. If you look at our performance in the area of M&A and advisory, you see we had a very good year in '04 and the pipeline is reasonable at this point in time. So we feel that it is sustainable in '04. The M&A and advisory fee performance was probably not as good in the U.S. and as I said earlier, once expectiong that this will improve in '05.

In terms of equity and debt origination, same thing as in '05. We had a very good year and we expect that the pipeline is also reasonable and so we expect that will continue in '05. In terms of securitization, the same thing. The pipeline was a little bit softer incidentally in Q4 but this is a fairly lumpy business and we expect that it will be back to our normal rate or improved rate compared to Q4 in '05.

The only area of concern and I mentioned earlier is in capital markets where our interest rate sensitive business given the shape of the yield curve, we're really dependent on that. And I would say at this point in time, I would be not as optimistic as the other businesses I described to you because we feel the risk reward does not warrant us in replenishing the assets that are maturing.

Jamie Keating - RBC Capital Markets - Analyst

Thank you very much, Yvan.

Operator

Ms. Payne, there are no further questions. Please go ahead.

Susan Payne - Bank of Montreal – SVP, IR

Thank you, operator; and thank you for joining us today. If you have any further questions please either call investor relations 416-867-6656 or email us at bmo.com/investorrelations. Thank you and good afternoon.

Operator

This concludes today's conference call. Please disconnect your lines and have a great day.

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