Q2 2003 CONFERENCE CALL

CORPORATE PARTICIPANTS

Susan Payne
BMO Financial Group – Senior VP of Investor Relations

Tony Comper
BMO Financial Group – Chairman and CEO

Karen Maidment
BMO Financial Group – CFO

Michel Maila
BMO Financial Group – Head of Corporate Risk Management

William Downe
BMO Financial Group – Deputy Chair

Frank Techar
The Harris Group – President and CEO

Gilles Ouellette
Private Client Group – President and CEO

Yvan Bourdeau
Investment Banking Group – President and COO

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

Robert Pearce
Personal and Commercial Client Group – President and CEO

CONFERENCE CALL PARTICIPANTS

Jim Bantis
Credit Suisse First Boston - Analyst

Robert Wessel
National Bank Financial- Analyst

Steve Cawley
TD Newcrest- Analyst

Heather Wolf
Merrill Lynch- Analyst

Ian de Verteuil
BMO Nesbitt Burns - Analyst

Michael Goldberg
Desjardins- Analyst

Quentin Broad
CIBC World Markets- Analyst

Trevor Bateman
CIBC World Markets- Analyst

Jamie Keating
RBC Capital Markets - Analyst

PRESENTATION

Operator

Good afternoon and welcome to the BMO Financial Group Second Quarter 2003 Conference Call for May 27, 2003. Your host for today is Susan Payne, Senior Vice President of Investor Relations. Miss Payne, please go ahead.

Susan Payne *- BMO Financial Group - Senior VP of Investor Relations*

Thank you, operator. Good afternoon everyone and thank you for participating in today's conference call. This afternoon's overview of our second quarter results will be provided by Tony Comper, Chairman and CEO, Karen Maidment, our CFO and Michel 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 from the Personal and Commercial Client Group in Canada, Frank Techar from the Harris Bank, from the Private Client Group Gilles Ouellette, Yvan Bourdeau, Investment Banking 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'd like to turn the floor over to Tony.

Tony Comper *- BMO Financial Group - Chairman & CEO*

Thanks Susan, welcome everyone.

My colleagues and I are very pleased to discuss BMO's performance in the second quarter when earnings rose 36% from a year ago to $409 million. This was characterized by solid growth in the personal and business banking and improving credit performance which drove higher profitability as earnings per share grew 35% and the return on equity increased 3.6 percentage points to 15.2%. Year to date, net income is up 20% over the same period last year.

Revenue growth was challenging in the uncertain operating environment. Our personal and commercial business in both Canada and the U.S. demonstrated their ongoing earnings stability, credit performance significantly improved, the capital levels further strengthened, we made steady progress in our ongoing efforts to contain costs as a key element of our priority focus on improving productivity.

A Key driver of higher profitability was credit performance, with the quarterly provision for credit losses at $120 million, that was significantly improved from the level of $320 million a year ago. We are now estimating that BMO's annual provision for credit losses will be at or below $600 million for the full year 2003. That's $100 million better than the first quarter's estimated annual provision of $700 million and well ahead of the $820 million target we established at the end of the fourth quarter.

As Mike Maila will explain in more detail, we have reduced the estimate based on our favorable loan loss experience in the first half of the year. I'll turn now to operating group performance.

The investment banking group earnings increased 7% from a year ago, and the private client group earnings decreased only slightly. I think both of those are notable achievements in the challenging environment. However, the personal and commercial client group made the most significant contribution to earnings growth once again this quarter. That was characterized by strong volume growth in both Canada and the U.S. and higher net interest margins in Canada, which contributed to revenue growth of 6% and earnings growth of 12% for this group.

Our Canadian retail and business banking operations which provide earnings stability even during uncertain economic, market and geopolitical conditions delivered net income growth of 15% and revenue growth of 9%. Specifically, retail and commercial deposits grew $2 billion or 7% from a year ago and loans and acceptances grew $6 billion. That's also a 7% increase.

In the small business arena, which is a priority market for the BMO financial group, as you know, market share per loans up to $5 million increased 55 basis points year-over-year, to 19.59% as we continued to gain on the market leader.

In the U.S. retail and business banking, loans grew $2 billion U.S. or 25% from a year ago. That was mostly due to mortgage and other consumer loan growth. Positive growth also continued to be strong increasing 9% or $1.1 billion, that's in U.S.

As you know, we are in the process of expanding the 145 branch Harris Bank network to 200 branches over the next three to five years through acquisitions or new branch openings and we are undertaking this expansion in an increasingly competitive marketplace which many of you have noted.

We recognize that large market entrants in the Chicago area will be fierce competitors for market share with aggressive pricing and product offerings, distinctive distribution strategies, branch expansion plans and increased brand spend. At the same time, smaller banks will seek to retain business by accepting below market returns and there will be highly competitive bidding for core deposits.

We face the new competition secure in the knowledge that Harris's existing physical presence and prime locations cannot be replicated at any price. Nor can its well-established highly regarded brand, deeply ingrained community orientation and the strong bonds with more than 1 million existing retail clients.

Another competitive advantage is our strong start in securing the best possible new locations at a time when the market's appetite for expansion far outstrips the availability of suitable real estate. We've got a pretty intimate knowledge of this market and we are on track to open seven new branches this fiscal year in high potential locations. So far we have negotiated real estate deals for an additional five branches and that brings the total number of secured sites to 12 for the year.

We've got a lot of work ahead of us but we've got a lot going for us as well. And I wouldn't trade our franchise in Chicago for anyone else's bar none.

Turn now to productivity and I want to reconfirm this afternoon that productivity improvement continues to be our Number 1 priority. Numerous initiatives are well underway, all across the enterprise to very substantially improve BMO's performance on this key measure. And what's more, our efforts are beginning to produce the desired results. Expense-to-revenue ratio has reached it's best level in four quarters. We have improved the productivity ratio by 110 basis points the fourth quarter alone and all three operating groups are continuing to make good progress toward their target of reducing their group based cash productivity ratios by 150 to 200 basis points by year-end.

In order to understand how our intense focus on productivity is translating into changed behavior at the line business level, take a look at one of them. I'm talking now about the direct investing business in the United States. We have completed two U.S. direct investing acquisitions since the first quarter of 2002, in an operating environment that turned out frankly to be much more challenging than anticipated, and while awaiting the revenue lift that will come when Capital Markets strengthen, we took immediate cost-cutting action.

Specifically we reduced expenses by approximately $100 million, that's U.S., in fiscal 2002 through acquisition synergies. That allowed us to achieve a 29% reduction in full-time equivalent staff while maintaining very high service levels.

We identified back office enhancements and vendor contract concessions that will further reduce operating costs by an estimated 20% in 2003. And we chose to use an external supplier for back office functions so that the costs will expand and contract in line with market activity, that's a particularly attractive feature during periods of low activity.

We are going to have more progress to report next quarter on our numerous performance enhancement initiatives. I'll turn now to the financial targets that we set for 2003.

Management team is confident that we're on track to meet our annual targets. Earnings per share are up 18.8% so far this year comfortably ahead of the annual EPS target of 10 to 15%. Return on equity and tier one capital are also squarely on target, and the annual provision for credit losses, at $270 million for the year to date, it's substantially ahead of target.

I'm going to conclude my introductory comments with a brief observation on our ongoing strategic expansion.

In April, the BMO Financial Group signed an agreement to acquire Gerard Klauer Mattison, a New York-based mid market investment banking boutique, structured as a 100% share swap valued at approximately $30 million U.S. This transaction scheduled to close in June will have a nominal cash EPS impact and very comfortably meets our internal rate of return on investment objective of 15%. It's modest in size but the acquisition represents the most recent proof of this management team's abiding commitment to fully integrated Canada-U.S. expansion. It establishes a solid equity research, sales and trading platform in the United States under the Harris Nesbitt Gerard brand, how we're characterizing it, cost effectively rounding out our offering for the mid market clients served by Harris Nesbitt. At the same time, it strengthens our Canadian franchise by providing increased research on U.S. companies to Canadian clients, and it expands equity capital market and research capabilities to the North American media, communications and energy sectors.

The strategic steps we are taking will ensure that BMO remains the best positioned of all of our Canadian competitors to flourish in the North American economic space. The first in Canada to establish a solid U.S. beachhead in anticipation of the market forces that are now in play. As evidenced by our latest acquisition and the ongoing expansion of our U.S. branch network, we are going to continue to be a leader in developing a solid and enduring U.S. franchises that is integrated north-south as well as it is east-west. We are also one of the first in the peer group to transform our business mix to ensure consistently higher returns to shareholders. We believe that our financial results in the first half of this year indicate that we are on the right track.

I'm going to ask Karen Maidment, our Chief Financial Officer to provide you with more details on the financials. Karen?

Karen Maidment - ***BMO Financial Group - CFO***

Thanks, Tony.

This quarter was a clean quarter in that we did not have any nonrecurring items, nor in the comparable quarters, and there weren't a lot of unusual items either. As you know, credit drove the increase in earnings but there's more to the story. And I'd say there's, in addition to credit, three major positives this quarter and one challenge. One of the positives is the P and C performance, 6% revenue growth, net income up 12% and in Canada net income up 15%. Secondly, IBG and PCG held their own in a very difficult and challenging environment. Somewhat offsetting the revenue challenges by tight expense management. And thirdly, expense growth was flat year-over-year, and while we absorbed increased pension, and benefit costs, excluding the effect of acquisitions, expenses were down 2% due to reduced FTE restraint spending, and lower performance-based comps.

On the challenging side, revenue growth continues to be a challenge in this environment which leads to a higher productivity ratio than we would like. As Tony mentioned, we are well-positioned to achieve our targets for the year.

And before I get into more of the analysis, I'd like to talk about two issues which are on Slide 3 that are of topical interest. One is the accounting for the VIE's, the variable interest entities. We have two types. The multi-seller conduits as well as structured investment products.

As we disclosed at the end of last year, the total amount of these are about $50 billion but the amounts that it relate to are securitizations are only $6 billion of that. We're currently in the process of looking at restructuring alternatives and at this point, due to the complexity, we don't know how much we'll be bringing on the balance sheet, but it will certainly be less than the $50 billion.

The second topical issue is the exchange rate. And as you can see from this slide, while it did impact our revenue, and our expenses, and, therefore, our productivity ratio, the approach that we take is to hedge the earnings every quarter so the after-tax effect of that on the earnings is zero. We, from the balance sheet point of view, we fund our U.S. investments with U.S. dollars so we are matched from that point of view.

There is an impact of currency changes on the currency translation account, in the shareholder equity due to the tax deductibility of the hedging products. But that's something that fluctuates from year to year based on the exchange rate. So overall, no impact on the bottom line as a result of the change in the Canadian dollar.

Turning to Slide 4, you can see a picture of our U.S. operations. I wanted to point out that while Q2 '02 was high at 56.7%, it was artificially high because of the CLO securitization gains that were recorded in Q2 of '02. So when we look at it this quarter, we still have some downward pressure because of the improved performance in our Canadian operations relative to U.S., the strengthening Canadian dollar, and the amortization costs associated with the wealth management businesses. But the revenue contribution continues to be around 30%.

Turning to Slide 5, you can see the revenue growth on a linked basis as well as year-over-year. Revenue was down $110 million from the first quarter with three fewer days in Q2 and a weaker U.S. dollar contributing to that, as well as lower client-driven transaction volume.

Higher investment write-downs in our non-core portfolio were offset by higher non-interest trading revenue related to a commodities derivative. In addition, Q1 benefited from the TSE or TSX IPO of $32 million.

Excluding acquisitions revenue was down $39 million from a year ago, and that was a result of the lower client-driven transaction volumes, the weaker U.S. dollar, and that was only partially offset by the improved spreads in the Canadian retail and business banking businesses.

Slide 6 shows the net interest margins over the last year by quarter. And you can see that the net interest margin is relatively stable quarter over quarter.

Year-over-year, the margins did decline mainly due to changes in business mix in IBG where there's been growth in lower spread Capital Markets businesses and continued strategic reductions in the high-spread corporate lending portfolios. As you can see, the margins of P&C have been stable in the current competitive environment.

I'd like to turn to Slide 7, or Slide 8 and look at some of the expenses to show some color into the details of the expenses. As I mentioned earlier, year-over-year expense growth was 0.5%, but excluding the effect of acquisitions, it was down 2% due to the lower FTE's down 780 over last year and 194 over the previous quarter.

Also, discretionary spending has been restrained and performance based comp has been linked directly to the performance of the group. The remainder of the slides give you more color on some of the operating group performance which I've commented on.

So I'd like to turn to Slide 13 which shows a picture of our U.S. business from a retail and mid market perspective. As we promised in the first quarter, we wanted to provide a more apples to apples comparison of our U.S. business and many of our Canadian and U.S. competitors include the U.S. mid-market commercial businesses in their retail and business banking financials. We on the other hand manage and report at Harris Nesbitt as part of the investment banking group because we believe there's enhanced opportunities to cross-sell products and get greater efficiencies from the integration of Harris Nesbitt into the IBG's but this table, which is new on page 16, and is also shown in the press release, shows the addition of the Harris Nesbitt mid -market lending and cash management business as the Harris Nesbitt number and provides a more complete picture of the U.S. retail and business banking operations.

You'll note, for example, that 48 percent of our U.S. revenues or 72% of our U.S. earnings come from stable low risk personal and commercial business and the expense-to-revenue ratio was down about 3.4 percentage points to 60.8. In terms of the outlook as Tony said, we're very comfortable with the guidance for the year.

We continue to see growth in P&C, we continue to see very challenging markets for the market sensitive businesses but we've achieved some offset in the fact that the provision for credit losses has been lower than guidance and we're planning on continuing to improve productivity across the group. With that, I'll turn it over to Mike.

Michel Maila - ***BMO Financial Group - 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 credit on Slide 1. Asset quality conditions remained essentially stable in the second quarter and credit performance improved yet again this quarter. Let me address each of these 2 aspects in turn. As highlighted on Slide 2, loans which we classified as impaired this quarter originated mostly in the U.S. portfolio. About a third of the gross impaired loan formation pertained to the power generation and automotive sectors.

As Slide 3 indicates, however, impaired loan formations are only one part of the story. The other part relates to the active management of the impaired loan portfolio, which over the past six months has generated $282 million in repayments relating to loans that we classify as impaired. Also of note is that during the second quarter, $70 million in assets relating to restructured loans and impaired loans were sold for $21 million more than the net book value of the original loans. This $21 million reversal illustrates two points: First, the significant added value that restructuring and workout efforts can produce from time to time, and secondly, the appropriateness and indeed the conservatism of our provisioning and valuation practices at the time when we classified loans as impaired in the first place.

Also contributing to the continued stability of asset quality conditions is the steady growth of the more stable consumer portfolio as a proportion of the overall loan book. 52% now versus 50% last quarter and 48% a year ago. And this portfolio continues to perform well in terms of low and stable delinquencies and provisions.

Turning briefly to recent events in Ontario and then in western Canada, Slides 5 and 6 provide the relevant exposure highlights.

Based on recent stress testing of these relatively modest sub-portfolios, we are comfortable at this time that the bank's asset quality condition is unlikely to be adversely impacted in any material way as a result of these events.

Moving now to credit performance, let me make a couple of points. First, actual loan loss experience over the past two quarters as Tony and Karen have indicated has clearly turned out to be better than expected. Secondly, stress testing of our exposures to current and potential problem sectors provides additional comfort that our revised guidance for the provision for credit losses this year, namely being at or below 600 million, is indeed appropriate.

Turning finally to market risk on Slide 8, three brief comments. First, the trading revenue of $33 million recognized in mid-March relates to the unwinding of commodity derivative contracts with a counter party. Secondly, the temporary increase in the value at risk measure in mid-April relates to a couple of profitable equity underwriting transactions. And finally, there were only two days in the quarter with a negative P&L and in both cases these were small and well within the value at risk measure.

At this point, I'd like to turn the conference call over to the operator for the question and answer session. Operator?

QUESTION AND ANSWER

Operator

To place yourself in the question queue, please press "star 1" on your touch-tone phone. And if using a speakerphone, please pick up your hand set and then press "star 1". To withdraw your request, press star two. Please go ahead if you have any questions. Your first question comes from Jim Bantis from Credit Suisse First Boston. Please go ahead.

Jim Bantis *- Credit Suisse First Boston - Analyst*

Hi, good afternoon.

Tony Comper *- BMO Financial Group - Chairman & CEO*

Good afternoon, Jim.

Jim Bantis *- Credit Suisse First Boston - Analyst*

A couple quick questions, please. One in terms of the credit quality and just touching Mike's comments at the end. One of the bank's biggest strengths that it has had over the past 24 months has been the small business banking and the market shares a testament to that. I wanted to follow up again with respect to the weakness in the commercial sector when you think the SARS issue, the rising Canadian dollar rolling over the auto sector. Mike, you talked about stress testing, but to what extent should we turn about deterioration in the small business and commercial portfolios?

Tony Comper *- BMO Financial Group - Chairman & CEO*

We're not concerned about it actually, Jim, in fact, if you look at not just now but if you go all the way back to the last time we had a significant recession, one of the things that's been pretty rock solid has been our credit losses in the small business area. One of the reasons is that we've got a very, very disciplined approach to credit risk management in that shop. A significant percentage of the credit adjudication is all highly automated which allows us to not just do it cost effectively, but also have a consistent set of standards that we run across the country. Mike and Rob do you want to add anything?

Michel Maila *- BMO Financial Group - Head of Corporate Risk Management*

Just to confirm that our stress testing includes that section as well, Jim.

Jim Bantis - ***Credit Suisse First Boston - Analyst***

Okay, that's great.

Operator

Your next question is from Robert Wessel from National Bank Financial.

Robert Wessel - ***National Bank Financial - Analyst***

Good afternoon. I have sort of one question with sort of four subparts, if you will, about your U.S. expansion. Can you address the issues in terms of acquisition in the U.S? A. Your appetite for acquisitions in terms of the amount you might spend. B. What sort of business line you would target, you know. C. Whether it would be primarily cash or if you would contemplate issuing equity, and I guess the final point is whether your expansion strategy would be focussed solely on Chicago or whether or not you're contemplating a market extension deal, market extension transaction, excuse me, somewhere else in the midwest?

Tony Comper - ***BMO Financial Group - Chairman & CEO***

Good question, Rob, I'll make a couple of opening comments and hand it over to Bill to talk about it. If you looked at the -- well, let me start with the fact that basically three lines of business in the U.S., as we have in Canada. The retail and commercial business in Chicagoland, the private client business, which is more national in coverage, if I can characterize it that way, we're in about 21 or 22 of the fastest growing urban locations in the United States with assets that are either direct investing assets, trust assets, classic banking assets, et cetera, which we're combining into one comprehensive wealth management product offering in that area. And the third business is the Harris Nesbitt mid market business primarily concentrated in the eight-state midwest region but with specialty focus in media telecommunications in New York and the energy sector in Houston. Those are the three businesses.

And if you look at the pattern of acquisitions that we have done over the last few years, they've basically been targeted towards those three businesses but primarily concentrated towards the wealth management or private client business and the retail and commercial business in Chicagoland. That will continue to be the focus. The acquisition of the institutional equity business of GKM which we've talked about, we were on the lookout on the hunt for that kind of business for several years now. We didn't see the need frankly to acquire a large wholly integrated investment bank to get to the product features that we needed with the institutional equity thing, so that completed the product round-out. And consider that we're done in the investment banking business by way of M&A activity in the U.S. So the pattern you're going to see is us looking for both organic growth but also on the M&A front, looking for build-out capabilities or let me characterize it as bolt-on acquisitions in the retail commercial front and in the private client front probably following the similar pattern to what you've seen us do so far. Bill, do you want to add anything to that?

William Downe - ***BMO Financial Group - Deputy Chair***

I would just reinforce the point that our appetite, Rob, hasn't changed. We've been pretty consistent in talking about wealth management and retail banking. You asked two questions that I would like to specifically speak to, one is business mix, I think that we have not shown degree of acquisition in the retail banking business or in the future. Frank's been very up front about building up our branches in the Chicago area, that was another one of your comments but also acquisitions…

Robert Wessel - ***National Bank Financial - Analyst***

I guess, I'm sorry, you're fading out a little bit for my line anyways. Just a quick -- because up to this point, we've seen mostly or at least primarily wealth management in terms of incremental acquisitions and very little on the way of retail, though some small stuff. Are we likely to see that invert in that the majority of the acquisition proceeds that you expend going forward are likely to be retail and less wealth management?

William Downe - ***BMO Financial Group - Deputy Chair***

Well, as you know, we develop a pipeline of acquisition targets and it's very difficult to tell when specific properties are going to be available in terms that are attractive to us. We're certainly putting a lot of resources into the retail side so you will see a pick up in that. But the wealth management business still has an extremely good profile in the long run and it will stay on our radar screen.

Robert Wessel - ***National Bank Financial- Analyst***

Okay.

William Downe - ***BMO Financial Group - Deputy Chair***

With respect to whether we would use cash or stock for an acquisition, I'll let Karen modify my statement if she likes but given the size of acquisitions that we've been making over the last two or three years, we have the capacity to continue doing that with the resources on hand.

Karen Maidment - ***BMO Financial Group - CFO***

It would really depend on the situation. It would be situation-specific.

Robert Wessel *- National Bank Financial - Analyst*

Great, thank you very much.

Operator

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

Steve Cawley *- TD Newcrest - Analyst*

Hi. In regards to your productivity improvements, I'm trying to get a sense of what the basis, you're saying 150 to 200% improvement by the end of 2003. So let's say with your personal and commercial client group last year, your fiscal 2002 ratio was 64.8%. So then I should assume in my model for 2004 that you're going to get at least 63.3% productivity ratio?

Tony Comper *- BMO Financial Group - Chairman & CEO*

Karen?

Karen Maidment *- BMO Financial Group - CFO*

We're trying to get 150 to 200 basis points reduction on the cash productivity ratio that would be disclosed for each of the business group in the sub-pact.

Steve Cawley *- TD Newcrest - Analyst*

So then even lower because this is 64% that I see here, so 62 1/2 is what -- is your minimum target there, is that right, Karen?

Karen Maidment *- BMO Financial Group - CFO*

For the personal and commercial?

Steve Cawley *- TD Newcrest - Analyst*

Uhm-hmm.

Karen Maidment *- BMO Financial Group - CFO*

Which is the base you were using?

Steve Cawley *- TD Newcrest - Analyst*

Fiscal 2002.

Karen Maidment *- BMO Financial Group - CFO*

Yes, 64.

Steve Cawley *- TD Newcrest - Analyst*

Right, and so 150 less than that is your target?

Karen Maidment *- BMO Financial Group - CFO*

Yep.

Steve Cawley *- TD Newcrest - Analyst*

Now, what are the assumptions that you're using on revenue growth to get that target?

Karen Maidment *- BMO Financial Group - CFO*

I'm not really in a good position to give revenue growth assumptions, but we do anticipate revenue growth to continue to be pretty reasonable in the P&C area. In the other areas, we're not anticipating huge upticks in revenue, and we'll have to achieve it through cost savings. Rob, do you want to speak to revenue growth in P&C?

Rob Pearce *- BMO Financial Group - Personal & Commercial Client Group*

Well, certainly in P&C Canada, I mean, sales are pretty good and the balance sheet continues to grow, albeit at a little bit of a slower pace than a year ago, but we're still getting substantial growth there. And I think you've got spreads have moved up as we've come off the historic low interest rates that we were dealing with.

So we have got some decompression in our book which has helped margins. And mortgage refinancing which hurt us a lot about a year ago, nor aren't in our books they're much more normal levels. I think looking forward, you're continuing to get in some balance sheet growth and we'll get some spread improvement. And obviously on the expense side, it's a day in, day out matter to keep expenses down. I think on that basis, the productivity targets that Karen and Tony mentioned are certainly within scope.

Steve Cawley *- TD Newcrest - Analyst*

Karen, we've got 63.6% as the average for the first half of this year. So.

Karen Maidment *- BMO Financial Group - CFO*

We got a ways to go.

Steve Cawley *- TD Newcrest - Analyst*

But you want to hit 62 1/2 for the full year 2003?

Karen Maidment *- BMO Financial Group - CFO*

No.

Steve Cawley *- TD Newcrest - Analyst*

Sorry, so -- because I see for 2003, like on that Slide 4 that you've got in the presentation package, are you saying then the average for 2004 will be somewhere in the 62 1/2% range? I just want clarification exactly what your target is.

Karen Maidment *- BMO Financial Group - CFO*

Yeah. So 64 for 2003. Now, we also have a few areas where we'll see some year-over-year revenue lift because you recall in the third and fourth quarter, of last year, we did have some write-downs particularly in the IBG that hit revenue, but we're not anticipating a big robust return of the environment.

Steve Cawley *- TD Newcrest - Analyst*

Okay. My focus is really on the personal and commercial. And so I'm going to be looking for a 62 1/2% for Q4, 2003?

Karen Maidment *- BMO Financial Group - CFO*

That's the combined target for Canada and U.S.

Steve Cawley *- TD Newcrest- Analyst*

All right. That's what I was going to hear. On to the U.S. on page 13 of the supplemental, on the profitability, it was $28 million in the quarter and I know that you're basically saying that the U.S. dollar had no impact on the profitability. Would the hedging profits also be included in this $28 million or would they have been included in corporate and other?

Karen Maidment *- BMO Financial Group - CFO*

In corporate and other.

Steve Cawley *- TD Newcrest - Analyst*

So what would have been the profitability of the U.S. P&C were it not for the U.S. dollar deterioration in the quarter?

Karen Maidment *- BMO Financial Group - CFO*

To give you a sense of the FX impact, I've got some -- the FX impact for the group for P&C, if you looked at Q3 versus Q2, would have been about $2 million on net income bringing it down and year over year would have been about $2 million.

Steve Cawley *- TD Newcrest - Analyst*

So, $2 million. What was the full gain from the hedge that was included in corporate this quarter?

Karen Maidment *- BMO Financial Group - CFO*

$7 million.

Steve Cawley *- TD Newcrest - Analyst*

Great. And one more. It is the last slide in the presentation package, the distribution of the daily P&L in trading. The $35 million that you referred to as the commodities derivative gain.

Karen Maidment *- BMO Financial Group - CFO*

Right.

Steve Cawley *- TD Newcrest - Analyst*

It's pretty tough to get credit for something like this without it being really viewed as one time. Is this something that was worked on for an extended period of time? Like what could you argue in terms of making - view that as a normal operating profit?

Karen Maidment *- BMO Financial Group - CFO*

It was more opportunistic in a volatile market. But when we look at the run rate, we also had a significant amount of write-downs. We wrote down quite a bit on our non-relationship portfolio in IBG, a little bit of merchant banking and things like that. So when we look at the net revenue impact on IBG, it's pretty minimal.

When you look at the commodities gains as a positive, but the write-downs would be an offset to that.

Steve Cawley *- TD Newcrest - Analyst*

So basically you see that you've got a big gain and so then you say to yourselves we're not going to get credit for it, we might as well take advantage of the scheme by writing off other things?

Karen Maidment *- BMO Financial Group - CFO*

Not really. The way we look at the write-offs is every quarter, we look at the book value and the market value of the investments and if they've been -- if the book value -- if the market value's under the book value for more than nine months and we don't have a reason to believe it's going to increase in the next year we'll write it down. As long as the environment remains as sluggish as it has been, there's always going to be a little bit of that. But I think this quarter in particular, because of the geopolitical issues and because of the just general state, I think they were higher than what we would see going forward.

And that's so from our point of view, as we analyze the results, we don't assume that we're going to have that level of write-offs, but we also don't assume we'll have that level of commodity gain.

Steve Cawley *- TD Newcrest - Analyst*

Thanks, Karen.

Operator

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

Heather Wolf *- Merrill Lynch - Analyst*

Hi, good afternoon.

Tony Comper *- - BMO Financial Group - Chairman & CEO*

Good afternoon, Heather.

Heather Wolf *- Merrill Lynch - Analyst*

Two questions for you: First, the U.S. growth management division is still having a little bit of trouble generating some profit. I'm curious if you have a feeling for when that division might turn profitable?

Tony Comper *- BMO Financial Group - Chairman & CEO*

Bill?

William Downe *- BMO Financial Group - Deputy Chair*

Heather, as you know, this past quarter, particularly was very difficult in the revenue side and obviously the war, in February and March were particularly difficult. And we've been working, as Tony mentioned earlier, we've been working our cost side here for the last year ever since we made the acquisition. We're starting to see some light at the end of the tunnel. This quarter we were cash income negative. I think the process is going to be first thing we're going to be cash income positive, then we're going to be accrual income positive, and then on from there. So we don't think it's going to be in the very distant future, I think we're -- we've got a feeling here we're right around very soon.

Heather Wolf *- Merrill Lynch - Analyst*

Okay. And my second question, Karen, you mentioned incentive compensation and you said that it was in line with, I forget the exact wording but something to the effect of in line with the revenue generation.

Karen Maidment *- - BMO Financial Group - CFO*

Yeah, the business performance.

Heather Wolf *- Merrill Lynch- Analyst*

Can you give us just a feel for how you measure that, and what the comps were?

Karen Maidment *- BMO Financial Group - CFO*

Uhm, what we do is -- and what I was referring to, is the short-term compensation, which is really based on annual targets and performance year-over-year. So what we do is look at the current year, the current performance, and what our outlook is for the year, and then we accrue that so that we're trying to be always in step with the performance. That actually is driven part of the expense increases in P&C in Canada in particular because last year at this point the outlook wasn't as strong as this year. So the accrual on the incentive comp and P&C Canada would be higher this year than it was last year.

On the other hand, IBG and the compensation as you can appreciate is fairly complicated but is driven based on key predetermined formulas. The compensation is down because the business volume is down.

Heather Wolf *- Merrill Lynch - Analyst*

So if you were an outside investor like ourselves, how would you go about analyzing this stability or lack thereof in the incentive comps for BMO, and how sustainable those lower levels of incentive comp is going forward?

Karen Maidment *- - BMO Financial Group - CFO*

Well, it's very much in step with the performance at this point. My view is that we're -- we will continue to accrue at this level if the performance is here at this level. If the performance increases you're going to see higher accruals, if it decrease you're going to see lower.

Heather Wolf *- Merrill Lynch - Analyst*

Okay. And would you just suggest us looking at, you know, incentive comp-to-revenues, that type of analysis or

Karen Maidment *- BMO Financial Group - CFO*

It really varies by the groups. Yvan, do you want to speak about IBG, which would probably be the most complex?

Yvan Bourdeau *- BMO Financial Group - Investment Banking – President and COO*

The only point I would like to add, Heather, is in addition to the comments provided by Karen, we take also into consideration the targets that were given to us from the productive ratio point of view. We look at whether driver would provide or generate in terms of compensation pool given the performance, but then we look at the overall IBG. And what is a productive ratio of IBG overall versus the target and the comps could be affected they're to achieve, at the end, the target on the productivity ratio.

Heather Wolf *- Merrill Lynch- Analyst*

Okay. Thanks.

Operator

Your next question comes from Ian de Verteuil, Nesbitt. Please go ahead.

Ian de Verteuil *- BMO Nesbitt Burns - Analyst*

Thanks. A couple of my questions follow up on Steve Cawley's earlier question. The $35 million one-day trading revenue number, if I'm correct it was $33 million which is a termination of a derivative counterparty agreement, which is, if I'm correct from the --

Karen Maidment *- BMO Financial Group - CFO*

That's correct, Ian.

Ian de Verteuil *- BMO Nesbitt Burns - Analyst*

Is there - it seems to be some debate on this and there's a note to the financials regarding litigation. Can you provide any color on this?

Karen Maidment *- BMO Financial Group - CFO*

The only thing that we can say is that this was a result of unwinding a series of contracts when the counterparty was downgraded, and the markets were very volatile. And so a large trading of revenue was achieved. We believe we booked quite a conservative amount in our earnings this quarter, but as we noted in the press release, there's litigation and a statement of claim and so at this point, we don't have any further comment, but should we receive -- when we receive more money, we'll put it to the bottom line.

Ian de Verteuil *- BMO Nesbitt Burns - Analyst*

Okay.

Karen Maidment *- - BMO Financial Group - CFO*

Yvan might want to add to that.

Yvan Bourdeau *- BMO Financial Group - Investment Banking Group – President and COO*

I would add one technical point is when the termination took place, just like to emphasize that it was done in accordance with the ISA agreement and quite specific as to how we go about those termination.

Ian de Verteuil *- BMO Nesbitt Burns - Analyst*

So you would have had a loss on this hedged derivative position, the counterparty was downgraded, you were able to collapse the derivative under the ISA loss that you would have booked previously; is that correct?

Yvan Bourdeau *- BMO Financial Group - Investment Banking – President and COO*

It is a bit technical in the sense that once these agreement calls for the contracts to be unwind on a notional basis as opposed to a net basis and for each contract, you have to ask some specific bids from professional counterparties in the marketplace and then we unwind the overall position. And the net result of that is a result that you see presently.

Ian de Verteuil *- BMO Nesbitt Burns - Analyst*

Okay. The second question is, I think in Mike's comments on loan losses, there was a $21 million reversal on loan losses. I was wondering if I could get some color around what that was?

Michel Maila *- BMO Financial Group - Head of Corporate Risk Management*

Thanks, Ian. Without going into the specific client details, essentially it's the case where we were able to sell loans that were restructured and impaired loans at a price exceeding the net book value. So you can think about it as having a loan marked on our books at 50 cents on the dollars and selling it for 80 cents. You get the reversal of 30 cents back of your provisions.

Ian de Verteuil *- BMO Nesbitt Burns - Analyst*

So does that come through in the corporate line, is that why the corporate loan loss number is negative?

Michel Maila *- - BMO Financial Group - Head of Corporate Risk Management*

Yes, correct.

Ian de Verteuil *- BMO Nesbitt Burns - Analyst*

Thank you.

Operator

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

Michael Goldberg *- Desjardins - Analyst*

Thank you. Are you still comfortable with your U.S.-direct investment acquisitions can produce an IRR in excess of 15% given the cumulative losses that you've incurred post acquisition? And under what circumstances would you be at risk of a goodwill impairment charge on these acquisitions? Thank you.

Tony Comper *- BMO Financial Group - Chairman & CEO*

Well, let me start off by saying actually your second question first, Michael, it's Tony. We look at the valuations on an ongoing basis, every month and every quarter, in fact,. And so we're pretty comfortable that the valuations that we've got it right. I'm going to ask Karen to comment on the overall profitability and our outlook and whether we're meeting the hurdle rates on the investments.

Karen Maidment *- BMO Financial Group - CFO*

As Gilles said earlier, the revenue has been much less than we anticipated because of the very difficult environment. We have taken out all the costs that we anticipated, plus some, and we're continuing to focus on that to drive the profitability. For the goodwill, we look at the -- you know the accounting rules are you don't look at it against legal entities, you look at it against reporting units. We look at it against the client investing unit and which would include the full service and the direct. And we're very comfortable with the goodwill. The goodwill on the CSFB acquisition itself is the only goodwill on our books is tax deductible, it's about 380 after tax. And we're comfortable with that.

Michael Goldberg *- Desjardins - Analyst*

Thank you.

Operator

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

Quentin Broad *- CIBC World Markets - Analyst*

A follow-up on Michael's question. I think at the time you had somewhere around 470 odd thousand active accounts and a million total accounts at CSFB. I'm wondering just what those numbers might look like today. I think you suggested you had retained four of six senior executives. Is that still the case in terms of the people managing the business? And then Karen, on your last point, were goodwills associated with reporting units. On an economic bases, which is I guess where we get most concerned, there still appears to be an impairment whether you paid -- I guess the question is: Are you still convinced your IRR at 18% at the time is still an achievable IRR over reasonable time frame here? Notwithstanding whether GAAP requires you to write it down.

William Downe *- BMO Financial Group - Deputy Chair*

Let me speak about the accounts. I think the active account number now is about 375,000, and the -- our experience in terms of account attrition is a little bit worse than the competition. There's a couple of reasons for that. The first one is that we had to merge basically four different platforms or four different businesses under one platform. As you know, Harris Direct in the U.S. is the merger of four different businesses the largest one being CSFB Direct. When we merged these businesses they were at slightly different price points but the net result is that some of these businesses, some of these clients, when we introduced the Harris CSFB Direct price point, it rose their prices. And some of them decided to leave. So that's one reason. Secondly, is that we were one of the last ones to introduce an inactivity fee, and that kind of shook some of the smaller accounts. But certainly what we're seeing currently, all of that is stabilized and what we're seeing currently is there's been a pick up in the business in the March, April, May time frame. And from anything we can tell from our peers is that our revenue pick up on trades per day is -- exceeds what the average is for our peers. So we're pretty comfortable with that part.

Karen Maidment *- BMO Financial Group - CFO*

Quentin, it's Karen. Back to your point on an economic basis, you're right, there's a lot less room in terms of excess book-to-fair market when you just look at the direct investing business on its own. We have looked at it, we've looked at it compared to market multiples and we're still comfortable with the value of the goodwill. But certainly, if markets do not return, in the midterm, it will certainly be an issue.

Quentin Broad *- CIBC World Markets - Analyst*

Thanks. And in terms of the growth in Harris in terms of de novo branch openings, I can't remember exactly the timeline, but I thought the number was about 50 branches and I thought it was over three years, and it sound like from Tony's comments you've secured 12 locations for this year. So obviously that's on a pure numbers basis, tracks behind the 50. Has there been any change to the kind of de novo expansion vis-a-vis bolt-on acquisition expansion?

Tony Comper *- - BMO Financial Group - Chairman & CEO*

No, it's a good question, Quentin. But in fact, I think we said it was three to five years was the time frame that we were going to do that 50 branch expansion, not three years, but I'm going to get Frank Techar, who's with us, to comment specifically on how it's going in terms of the branch expansion relative to our expectations.

Frank Techar *- BMO Financial Group - President & CEO Harris Bank*

Quentin, a couple of points. The first one is the numbers that Tony mentioned earlier in that we've got 12 sites under contract right now since the end of the quarter, we actually have two more. We're up to 14. And our target for this year is to have 23 sites under contract. It doesn't mean we're going to start construction immediately, but with the competitive pressures in the market, our target at 23 on top of our 145 branches gets us to 168. So if we can deliver against our target this year, we're going to be well on the way to the number over the next three to five years, which is the time frame that we've set out. Any acquisition activity that we might undertake over the next couple of years is just going to get us there faster so we're on target if we have to do it all ourselves and we're hopeful that with the conversations we're having, something's going to happen on the acquisition front to get us there quicker.

Tony Comper *- BMO Financial Group - Chairman & CEO*

But the fact of the matter is, Quentin, this is not duck soup. The best locations are not just kind of lying around, it really requires some scrambling and it requires a pretty good knowledge of the marketplace itself and what the best locations are because even a relatively modest shift of a block or two could make a consequential impact on parking and drive times and other things of that note. So we think that one of our advantages is the fact that we've compared to some of the newer competitors, we really have an on the ground understanding of exactly what the geography is in the sweet spots that are attractive. That's why we've been able to move ahead on locking up the sites that we've done so far.

Quentin Broad *- CIBC World Markets - Analyst*

Thank you.

Operator

Your final question comes from Jim Bantis from Credit Suisse First Boston. Please go ahead.

Jim Bantis *- Credit Suisse First Boston - Analyst*

Hi, just wanted to follow up again in terms of the cost control, I know it's the bank's top priority for 2003. When you look at the achievements made this quarter, really it's narrowed down to two things in the respect of currency lift that's reduced expenses out of the U.S., and compensation control. Can you talk about the next leg in terms of expense savings and how we can feel comfortable with the details behind the priority? Thanks very much.

Tony Comper - - *BMO Financial Group - Chairman & CEO*

Yeah, we've talked about it a little bit before, but basically the way I'll characterize it and then I'll turn it over to Karen, is we're moving on what I would call two tracks. Track Number 1 is the business group's pounding away and looking at every single element of expense and they have those targets that we've mentioned of 150 to 200 basis point improvement. On the second track, we have what we would call our performance enhancement program, which is a series of eight initiatives focussed on both revenue and cost, they're bigger items, a lot of them are oriented around processes, whether they be sales processing or business processes and, therefore, they kind of take more time to get out, if I can characterize it that way. And so a lot of those have not really kicked in in full flight yet. And so they're a little bit on the come. But we will continue to pursue those two tracks and articulating the objectives that Karen has talked about and that I talked about. Karen, do you want to add anything further to that?

Karen Maidment - - *BMO Financial Group - CFO*

I guess I would go back to the point that you're right, expenses have come down because of compensation. Compensation is driven by FTE's so it's not just variable compensation, it's actually real FTE reduction that's taken place. And because compensation is 60% of our costs, that's where you're going to continue to see cost savings, coming from process improvement, re-engineering in the back office, while we continue to put the resources on the front line to boost the revenue.

Jim Bantis - *Credit Suisse First Boston- Analyst*

In terms of the Track 2, Tony, and the eight initiatives, is that really a next year's event, '04?

Tony Comper - *BMO Financial Group - Chairman & CEO*

It's -- yeah, for the most part. I mean, it's over time, like it's not as though we're kind of just waiting for things to start, but it does take sometime to get through it, the initial phases, to get the momentum built up and then you'll start to see it flow. But it will be more impactful later, than now.

Jim Bantis - *Credit Suisse First Boston - Analyst*

Okay, great. Thank you.

Operator

Your final question comes from Trevor Bateman from CIBC World Markets. Please go ahead.

Trevor Bateman - *CIBC World Markets - Analyst*

Hi, good afternoon.

Tony Comper - *BMO Financial Group - Chairman & CEO*

Good afternoon, Trevor

Trevor Bateman - *CIBC World Markets - Analyst*

Just a question following up on the accounting changes regarding BIE.. You had mentioned that you've not quantified the potential impact, but as you are exploring different restructuring options, could you speak to how the economics of this business is for you, could change and as well the economics for your clients? Will they continue to sell their receivables into some of these multi-seller conduits in the future?

Yvan Bourdeau - *BMO Financial Group - Investment Banking – President and COO*

Just a few comments, Trevor. First of all, as usual, we're coming up with the industry at large with some solution for our clients, and it seems that whenever we acted on behalf of third parties to find ways to finance a receivable, we will be able to come up with a vehicle that will actually address this, enable us not to retain or consolidate the asset on to our balance sheet. In terms of profitability, there are some of the alternatives I've been contemplated, that may impact us by a few basis points in additional costs. But it is not material. And, therefore, we feel that the businesses, whether in Canada or the U.S., are involved in those areas. We will continue to be profitable. In fact, at this point in time, we have one, within IBG, one of our highest ROE content and we anticipate even after the additional cost to establish the new VIE's, they will continue to be very attractive.

Trevor Bateman - *CIBC World Markets - Analyst*

Do you have a sense whether or not [INAUDIBLE] will grant relief during any sort of transition period?

Yvan Bourdeau - *BMO Financial Group - Investment Banking – President and COO*

There's some discussion being held but there's nothing specific at this point in time.

Trevor Bateman - *CIBC World Markets - Analyst*

Thank you very much.

Tony Comper *- BMO Financial Group - Chairman & CEO*

I want to go back to some of the comments about the direct investing businesses that we're in. Point Number 1, is there's absolutely no question, this has been a tough period of time. I've been around for, I won't say how long, but it's a long, long time, and I haven't seen a patch this extended in terms of market slowdown. Point Number 2, this is a mature business, it's not like something new, it's been around since 1975. And so the economic model of how to make this business work in good times and in bad I think has been well-established and I think it's a credit to Gilles and his guys, they've been able to in the revenue drought, which is what we've seen because the market activity in the last while they've been able to get the expense base way down, i.e. get the business model tuned to the environment. So there's lots of leverage on the upside and we like the business and we've got the best technology. Gomez ranked us Number 1 in Canada. We're Number 4, I believe, on Gomez in the U.S., and so it's good technology. The assets under administration are holding up well. The client trading activity is starting to show visible signs of life in the universe, and so on balance, I'm pretty optimistic about the prospects for this particularly when the markets start to come back.

Susan Payne *- BMO Financial Group – Senior VP of Investor Relations*

Thank you, operator. Thank you for joining us today. If any of you have any further questions, please either call investor relations at (416) 867-6656 or e-mail us at www.bmo.com/investor relations. Thank you and good afternoon.

Operator

This concludes today's conference call. Please disconnect your lines and thank you for your participation.