BMO Financial Group

Q3 2005 CONFERENCE CALL

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PRESENTATION

Operator

Welcome to BMO Financial Group's third-quarter 2005 conference call for August 23, 2005. Your host for today is Susan Payne, Senior Vice President of Investor Relations. Ms. Payne, please go ahead.

Susan Payne - ***BMO Financial Group - SVP IR***

Thank you operator, good afternoon everyone. This afternoon's brief overview of our third-quarter results will be provided by Tony Comper, President and CEO; Karen Maidment, our CFO; and Bob McGlashan, Chief Risk Officer. After Bob's presentation, Tony, Karen, Bob and the following members of the management committee will be available to answer your questions. Deputy Chair Bill Downe; Yvan Bourdeau from Investment Banking Group; from the Private Client Group, Gilles Ouellette; Rob Pearce from the Personal and Commercial Client Group in Canada; Frank Techar of the Harris Bank; and Lloyd Darlington, Head of Technology and Solutions.

At this time I would like to refer listeners to our investor relations website at bmo.com to view our caution regarding forward-looking statements and the risk factors pertaining to these statements. Now I would like to turn the floor over to Tony.

Tony Comper - ***BMO Financial Group - President and CEO***

Thanks, Susan. Good afternoon everyone. BMO's Personal and Commercial and Private Client Groups achieved strong growth in the third quarter, as earnings in the Investment Banking Group declined due to unusually strong credit recoveries that we had last year and the current interest rate environment. Overall, earnings did not match our record results a year ago, when we delivered particularly favorable credit performance even for BMO, where credit risk management as you know is a major strength.

Earnings are up $17 million excluding the impact of the increase in our provision for credit losses, this reflects last year's high recoveries, and a reduction in the general allowance for credit losses. The star performance for the quarter came from our Canadian Personal and Commercial operations. Year-over-year revenue growth grew 5%; expenses stayed flat; net income grew 15%; and productivity improved 270 basis points.

We are also encouraged by the uptick in market share for certain personal products and the market share growth in commercial lending, which as you know is another differentiating strength for the Bank of Montreal.

The strategic spotlight this quarter was on Harris. Let me highlight some of the progress that we made toward our goal to become the leading Personal and Commercial Bank in the U.S. Midwest. We opened a new branch in Mount Prospect, Illinois, in April; and with this opening we have grown the Harris community banking network to 171 locations in Chicagoland, and 190 overall if you include Northwest Indiana. Given the Edville acquisition and three additional branch openings scheduled for September, we're thinking that by year-end we will continue to be on target to reach 200 locations in Chicagoland and 20 in Northwest Indiana by 2007.

The Harris charter consolidation, which we've talked about before, was an outstanding success, with no disruption to customer service. Customers can now transact business with greater ease at any Harris Chicagoland location. We anticipate that benefits will start to accrue in 2006 as system modifications and business processes become fully integrated. With this significant initiative completed, we're much better positioned to successfully integrate future acquisitions.

We announced an agreement to acquire Edville Bankcorp and its subsidiary, Villa Park Trust and Savings Bank, for $81 million. While the deal, which is expected to close in the fall of 2005, was small, the Illinois locations are excellent and a superb strategic fit.

We announced an agreement to sell Harrisdirect for approximately $910 million. The deal is expected to close by BMO's year-end. Sometime ago we told the investor community that we were closely monitoring this business in light of the changing competitive landscape. We're confident today that we chose exactly the right time and the right transaction to delivery a win for both customers and shareholders. With the capital and other resources freed up through the sale of Harrisdirect, we're well positioned to continue the expansion of our Harris retail and commercial operations beyond our Chicago-area footprint. You will be hearing more about our plans in the months to come.

Looking ahead to the year-end, we are on track to achieve four of the five financial targets that we set for the year, and we remain focused on all of them, although the productivity target, as I said last quarter, will continue to be challenging. Let me put this challenge in perspective. From 2000 to the end of 2004, BMO's intense focus enabled us to improve cash productivity by approximately 420 basis points. More importantly, we created a pretty strong culture of cost discipline that will serve BMO well for years to come. Momentum has slowed this year in the challenging revenue environment. Year to date improvement in the cash productivity ratio is 40 basis points against our target of 150 to 200 basis points for the year.

On a group-by-group basis, productivity improvement has been strong and indeed ahead of target in both our Personal and Commercial and Private Client Groups. Unfortunately this improvement has been partially offset by productivity deterioration in the Investment Banking Group, where the revenue decline was concentrated primarily in interest rate-sensitive businesses with relatively low variable costs. I would note, however, that the Investment Banking Group continues to have the best productivity ratio of our three operating groups and ranked among the best in our Canadian peer group as of the second quarter.

I have made clear on previous occasions productivity improvement, important long-term goal for BMO, but not at the expense of necessary investments in business growth. Nonetheless we accept full accountability for the target that we have set and are determined to achieve it.

Earlier today, we announced a 6.5% increase in BMO's quarterly dividend to $0.49 a share. This is our second dividend increase this year, bringing the total increase from a year ago to 11%.

Finally, let me just say that this management team remains committed to BMO's strategy of investing in our core Canadian operations, expanding our U.S. retail and commercial network. As shown by the pending sale of Harrisdirect in response to the changing competitive environment, we have and will continue to tackle challenges head on, building on

BMO's strengths while taking the appropriate steps to create shareholder value. Now I will turn it over to Karen. Karen?

Karen Maidment - *BMO Financial Group - CFO*

Thanks, Tony, and good afternoon. Looking at the financials on a reported basis, net income for Q3 was $541 million, down $102 million or 16% from year ago. However, when you account for the fact that last year benefited from an unusually favorable credit performance with record recoveries and a reduction in the general allowance, compared to the specific provision for credit loss of $73 million this quarter, this accounts for $183 million of the change or $119 million in net income. Consequently, excluding the changes in credit, our earnings were up $17 million due to overall growth in our businesses year-over-year.

Turning to slide 4, you can see the group net income. There is a fair variation across the groups. P&C had record earnings year-over-year, up 15% to 307 million with strong volume growth, good expense management, and good contributions from our Chicagoland acquisition. Similarly, PCG continues to achieve solid year-over-year growth, especially in the full-service investing and mutual fund businesses, posting earnings of $63 million. IBG's earnings were down $46 million year-over-year, primarily due to the large recoveries which increased earnings last year by $38 million, and a decline in certain interest rate-sensitive businesses, offset by improvements in M&A and debt underwriting. Finally, the corporate support results were down $100 million year-over-year, primarily due to the change in provision for credit losses, including last year's $40 million reversal of the general allowance.

Slide 5 shows the year-over-year and quarter-over-quarter change in cash earnings per share. Quarter-over-quarter cash EPS decreased $0.13. Q2 '05 was impacted by the reduction in the general allowance and the VIE gain, which is shown in the other items, while Q3 '05 had higher specific provisions for credit losses, accounting for most of the change. Year-over-year the decrease in cash EPS was $0.19, driven essentially by a higher specific provision for credit loss as a result of the unusually high recoveries the prior year, which I have referred to.

Slide 6 shows business growth quarter-over-quarter of 2.3%, largely due to good volume growth in P&C Canada. The Private Client Group was down quarter-over-quarter due to lower client trading activities both North and South of the border. The business growth was offset by the VIE gain in Q2 '05, resulting in an overall growth of $13 million. Year-over-year business growth was 4.1% driven by strong performance in both our retail and Wealth Management businesses, partially offset by a decline in IBG on lower spreads in interest rate-sensitive businesses. The impact of the stronger Canadian dollar had a dampening effect, reducing total revenue growth to 2%.

On slide 7 you will see that the total bank margin was 165 basis points in Q3, up 5 basis points from last quarter and down 22 basis points year-over-year. You will remember last quarter we had the impact of the VIEs; and excluding that the total bank margin declined 7 basis points Q over Q. Looking at it by group, you will see that P&C Canada is up 2 basis points; Chicagoland is down 12 basis points due to competitive market conditions and the interest rate environment, which is also driving the decline in IBG, which is down 7 basis points on a reported basis or 16 basis points excluding the VIEs in Q2.

Expenses on slide 8 were unchanged quarter-over-quarter and grew modestly year-over-year. Although expenses are well controlled across the organization, there were some increases in costs during the quarter in Harrisdirect related to marketing efforts and in IBG as a result of the timing of certain initiatives. Performance-based compensation costs increased year-over-year due to principally higher PCG commissions in the full-service investing, and an increase in IBG. While overall IBG revenue is down, businesses in IBG that are performing well, such as M&A and debt underwriting, have higher variable compensation components.

As I have outlined in the revenue expenses over the last three slides, you'll see on slide 9 that the relationship between revenue and expenses resulted in a year-to-date cash productivity improvement of 40 basis points against our goal of 150 to 200 basis points.

Turning to slide 10, you can see the U.S. performance, which are reported in source currency; and the results were very similar to the overall BMO performance. While Chicagoland continued to perform well, net income of $67 million this quarter was down substantially from Q3 '04 for essentially the same reasons discussed before -- the higher credit recoveries in Q3, and the lower earnings in IBG interest rate-sensitive businesses, in particular the

cash management business. Compared to Q2 '05, which included both the Variable Interest Entity gains and the litigation provision which largely offset, lower results were mostly due to higher provision for credit losses in the current quarter.
On slide 11 you can see that our Tier 1 capital ratio was 9.39%, well above our stated target of a minimum 8%, while our total capital ratio was 11.08%. The bank's risk-weighted assets increased $2.6 billion quarter-over-quarter to $151.6 billion. This increase is primarily due to continued growth in personal and commercial loans in P&C Canada and growth in IBG loan commitments and commodity contracts. IBG loan commitments are mostly an (ph) investment in corporate banking from existing clients' demand for longer-term facilities and new business, particularly in the Canadian oil and gas and U.S. energy sectors. Growth in commodity contracts is due to continued price volatility, particularly in the oil and gas sectors.

As we indicated in our press release and outlined on slide 12, we expect the sale of Harrisdirect to close in the fourth quarter, subject to regulatory approvals. At this point, we expect a modest gain on sale. The sale is expected to add approximately 35 basis points to the Tier 1 capital ratio and about 50 basis points to the tangible common equity ratio, and will remove approximately $700 million of goodwill and intangible assets from our consolidated balance sheet.

On a year-to-date basis, Harrisdirect had a net loss of US$14 million, 10 of which was in the Q3 numbers, related to additional marketing costs and some write-off of IT expenses. Going forward we will be looking at how to appropriately present the results for the remaining PCG U.S. operations, primarily the private bank; and any changes in reporting will be made starting in the first quarter of next year.

Wrapping up on slide 13, based on our year-to-date performance we are well positioned to achieve four of the five targets we set for the year, and we remain focused on achieving all of them. Our targets are on an as-reported basis, with the exception of EPS growth, which excludes the impact of the change in the general allowance in both years. As Tony mentioned, the productivity target will be challenging in the current revenue environment. That concludes my comments and I will turn it over to Bob.

Bob McGlashan - ***BMO Financial Group - Chief Risk Officer***

Thanks, Karen, and good afternoon, everyone. I have a short presentation with three key messages. First, as you can see on slide 3, credit quality was stable this quarter. Impaired loan formations remain at low levels, and Gross Impaired Loans at $932 million are the lowest we've experienced since the end of 2000.

On slide 5, consistent with my comments for the last three quarters, reversals and recoveries have continued to decline. As a result our PCL was 73 million for Q3. While this represents an increase over Q2, the absolute level continues to be low and in line with where we are in the credit cycle. While we anticipate new reservations for 2005 to be less than '04, '05 reversals and recoveries are also expected to be significantly reduced. This is largely as a result of the lower pool of specific allowances and past write-offs from which these arise.

Second, as shown on slide 6, our target specific provision for credit losses for 2005 remains at $275 million or less. This represents 16 basis points of average net loans and acceptances, versus our 15-year average of 39 basis points. Our outlook for the balance of 2005 remains unchanged due to a strong year-to-date performance with specific PCLs of $162 million and the current stable credit environment.

While we continue to track a number of sectors, none represent a material risk. Slide 11 shows that our exposure to the auto manufacturing and supply sector is not material, and there were no significant losses in this sector this quarter or last. The recent opening of the U.S. border to Canadian cattle has improved the outlook of Canadian cattle farming and related sectors. While we continue to monitor this sector closely, losses with respect to the sector have been modest.

Slide 12 shows our credit protection portfolio balance, which is comparable with last quarter.

Finally, slide 7 shows our trading and underwriting performance has been relatively stable, with six days during the quarter with a negative P&L, (ph) the largest of which was $6 million on May 31, attributed to credit holdbacks and valuation adjustments primarily in capital markets. With that, operator, we can now go to questions.

QUESTION AND ANSWER

Operator

James Bantis.

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

Just a couple of questions on the net interest margin front, particularly in the U.S.; and maybe Frank could talk about the 12 bps of decline quarter over quarter. It seemed to be much greater than what your peers had reported in the second quarter. I wonder if you could just maybe add a little color on what was occurring. Was the bank a little bit more aggressive on pricing on deposits or on the loan side?

The second, I just want to talk a little bit more about the IBG margin as well, and where is that going after the 16 bp drop as well?

Frank Techar - ***Harris Bankcorp, Inc. - President and CEO***

It's Frank. Really, I think the way I would address the question is not much of a change from our expectation for the quarter or our expectations going forward. We knew that we were going to continue to see pressure on margins from a competitive perspective. With the yield curve remaining flat, we were not getting any help as far as investing our core deposits. So my outlook is the same.

I think we got hit a little bit harder this quarter primarily because on the loan side, with the short rates going up, and our exposure to the auto portfolio -- the auto portfolio I think took us down a bit more than we had expected and more than we saw in the last couple of quarters.

As we look forward we are going to get to the bottom of the margin compression situation. We are a little bit more optimistic as we are going into this quarter. But we're still feeling the competitive pressures in the marketplace. Everybody is out looking for volume, and it is going to be a tough few more quarters for us.

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

So Frank, you can see this compression going into perhaps Q1 '06 in terms of quarter-over-quarter deterioration?

Frank Techar - ***Harris Bankcorp, Inc. - President and CEO***

I am not expecting any change. The real issue is, what is the magnitude going to be? We just can't predict that.

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

Great, thanks. If someone could address the IBG margin that would be great as well.

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

Jim, it is Yvan speaking. With regard to the IBG, there is an overlap with Frank. I will speak from two aspects on the interest rate environment. The first one is related to the fact, as we all know, the Fed has been increasing 25 basis points each time they meet. Right now we're at 350, and we are anticipating that -- most market participants are anticipating by the end of this year that we will be at 400. I think as you know, when I left earlier today, the two-year notes in the U.S. are at 4%; the five-years at 4.05%, and the 10-years are at 4% - 4.08% .

So the impact of this environment is affecting us first of all in terms of the deposits that are given to us from our cash management clients. Each time the Fed funds goes up, what is happening obviously is we adjust immediately the amount that we pay on the deposit to our clients. Each time that happens we have lower spread emanating out of our cash management business.

If my prediction comes true, that we have two more increases of 25 basis points and then a pause at 4%, then you would see an ongoing erosion of spread with our cash management business. If I give you some perspective as to what that might be, in Q3 versus Q2 for the cash management in the U.S., our margins shrunk by 11 basis points.

There is also the impact in the U.S. of our interest-sensitive businesses; and that is basically our money market assets. It is not so much that we have a bad position; the impact of the interest rate environment reflects itself in two ways. First of all, as the -- our funding costs are increasing, and obviously we reprice our assets at a slower pace, there is a squeeze also in terms of spread. But the second aspect is related to what I was mentioning earlier. With the Fed funds at 3.5%, expecting they go with a 4%, in the two-year note at 4% the risk-reward is just not there for us to renew maturing assets. Therefore there is an opportunity loss for us in terms of not being able to replace some of our maturing assets. That is affecting obviously our margin in the U.S. (technical difficulty)

The third aspect affecting the U.S. business from a margin perspective is our corporate loan spread. In Q3 versus Q2, the spread on our corporate loan narrowed by 9 basis points. This is slower than what we expected in the past. So we're anticipating, a little bit like Frank, that there is still high demand for loans from financial institutions in the U.S. By the same token I think we are reaching a stage in the cycle whereby the decrease in spread is now slowing down. We're anticipating that should flatten out in the next two quarters and hopefully increase from there. So those are the reasons why our margin in the U.S. has shrunk quarter-over-quarter.

Jim Bantis *- Credit Suisse First Boston - Analyst*

Yvan, if I could ask with respect to utilization rates, has there been any change? The data coming out in the U.S. with respect to the C&I loan growth has been positive. Maybe if you could shed some U.S. dollar asset growth quarter-over-quarter as well, that would be very helpful.

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

I will give you several specifics. Quarter-over-quarter, first of all, in terms of outstanding in Canadian dollar equivalent -- in other words we are absorbing here the strengthening of the Canadian dollar -- the average asset in the U.S. of our I&CB portfolio was $14.3 billion. In Q2 it was $13.8 billion. Therefore that is an outright increase in Canadian equivalent of $500 million in our outstanding quarter-over-quarter.

If I compare that to the beginning of our fiscal year here, we had outstanding of $12.9 billion; and therefore since November 1st we have had an increase in our outstanding of $1.4 billion. But what is interesting here which is new is the level of our commitment or authorization is also increased quite substantially in this quarter. It is averaging $27 billion versus last quarter of $25.9 billion; therefore an increase quarter-over-quarter of $1.9 billion.

So with an increase in outstanding of $500 million, and an increase in commitment authorization of $1.1 billion, our utilization rate for the quarter has gone down. But that is not necessarily bad. It is just because the level of authorization has increased more dramatically than our outstanding. It bodes well, if indeed the demand for our facility continued to increase, that we have more utilization on our books. That is basically the story for the U.S.

Jim Bantis *- Credit Suisse First Boston - Analyst*

Thanks, Yvan. I will reach you.

Operator

James Keating.

James Keating *- RBC Capital Markets - Analyst*

Same subject matter really as Jim's. I am sort of queuing in here on page number 10 of the IBG results in the sub pack. I am noticing, I guess the U.S. segment NIM is down roughly 20 million Q on Q. The overall NIM is down 40; so that includes Canada. It may be that the corporate loan book margin squeeze is attributable on the Canadian side; I don't know. But is there any other information there that might help us bridge the gap between the U.S. focus and the overall IBG NIM?

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

We have also had a reduction in spread in Canada. Year-over-year it is 16 basis points.

James Keating - ***RBC Capital Markets - Analyst***

Okay. Excuse my ignorance on what is happening in the loan book here. But the bond spreads, corporate bond spreads, are probably widening a little bit here. Those are unrelated entirely? There is no symbiosis between what is going on in the two markets to you (ph) ? Am I on a red herring there, Yvan?

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

That is correct, yes.

James Keating - ***RBC Capital Markets - Analyst***

The last question is, if I could, the U.S. book again. We're about 20 million down on that number. How much is attributable to corporate versus these other factors you're talking about? Is there sort of roughly half and half, or is there a way to --?

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

You're referring to --?

James Keating - ***RBC Capital Markets - Analyst***

I am in the U.S. specifically.

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

Net income 81 versus 58?

James Keating - ***RBC Capital Markets - Analyst***

Sorry, no. I'm really up on the NIM line again, Yvan. Just curious about you described three factors. I think the third one was the corporate loan spread. Just wondering, is it a third, a third, a third? Can you describe a little bit about --?

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

Yes, I would say the bulk of the reduction comes from the U.S. I would say two-thirds from the U.S. from both the corporate as well as the interest-sensitive businesses. And the remainder would be from other businesses.

James Keating - ***RBC Capital Markets - Analyst***

Okay, thank you very much. That's all I have got.

Operator

Ian De Verteuil.

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

A question again; keep Yvan hopping here. When I look at your noninterest expense, it seems as if there is a bit of a seasonal pattern, where in Q4 it looks as if you true up your accruals. Is that -- when I look at the mix ratio end (ph) quarter, it is sort of the highest it's been in several years. Is there a true up that comes in the fourth quarter of variable comp relative to the performance of the year?

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

From an accrual of the pools perspective, we accrue according to the performance that we obtain from several of our lines of businesses. As Karen was mentioning, some of our lines of businesses this year are actually offsetting some of the revenue decline that we had from our interest-sensitive businesses, where the drivers from a comp perspective are much lower than other businesses, such as M&A and debt underwriting.

That is a prime reason. It is a mix issue in our comp, whereby we're receiving much more contribution out of product lines with higher comp drivers. I will give you an example in M&A, for instance. After three quarters in '05 we have already reached a level of M&A contribution that we had in '04. That really puts into perspective the fact -- and because the driver is the highest in that field -- that is the reason why we have had higher account accrual at this point in time after three quarters.

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

So looking into the fourth quarter here, assuming not a lot of change on the continued strong mix on the M&A side and continued pressure on the spread based businesses -- on the yield curve based businesses, this sort of an x-ray (ph) shows normal.

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

I would say given where we are at the stage in the cycle and the contribution from our different LOBs, that is correct. I think you have noticed, and it's a good observation, that in Q4 normally our productivity ratio actually reduces. That is mainly once we have at the end of the year all of our comp and our contribution, then at that point in time we distribute the actual comps to our employees, our professionals. What happened in the last two years, if you were to look back, we have had actually a comp, a productivity ratio that was lower than the running rate that we had in the previous two quarters.

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

So that would be reasonable to assume that again this year?

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

I cannot say for sure. But this is one thing that we always keep in mind as we move towards the end of the year, as to the targets that were given and also how much we should pay our professionals.

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

Let me get off that topic. It's getting a little bit too close to home, Yvan. Getting into the issue of the benefits of the disposal of Harrisdirect, Karen, I think in your slides you said that the transaction would free up $700 million of goodwill and intangibles. Just in a simplistic sense, you have got about $150 billion of risk-weighted assets; so if I was just to remove 700 million of intangibles on 150 billion, that would free up more like 45 basis points of Tier 1. And that is before you run down any risk rate that is associated with Harris. Is the 35 basis points very conservative?

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

Ian, it is actually -- the number you have is right in terms of 700; but that is goodwill and intangibles. Intangibles don't reduce the Tier 1 capital ratio, because they are under the 5% limit. That is why I've made the point that it's about 35, and it's probably 35 to 40 basis points on Tier 1. It is closer to 50 if I look at the tangible common equity, which would include the goodwill and the intangibles.

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

Okay. Just to make sure I heard you right on the number, Karen, you said that the Harrisdirect lost US$10 million after-tax in the quarter?

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

In the quarter.

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

Okay, thanks.

Operator

Susan Cohen.

Susan Cohen - ***Dundee Securities - Analyst***

You did mention that your pool of recoveries and reversals is much reduced at this point. Do you still have enough to keep this kind of $40 million level going forward for the next several quarters? Or is it closer to empty than that?

Bob McGlashan - ***BMO Financial Group - Chief Risk Officer***

I would love to have that kind of precise foresight, but I am afraid it is a little tougher to call than that. It is hard to imagine it will be zero; but it is not difficult to imagine that it can continue to slide a little from where it is right now, because where this comes from is our Gross Impaired Loans book; and it hasn't been this small for years. It reflects the size of the opportunity for this stuff.

Susan Cohen - ***Dundee Securities - Analyst***

I guess what I'm really trying to get after is a sense of your loan-loss provision going forward. I realize that it is not quite forecasting time yet. But can you give us any guidance as to what you might be looking for, for 2006?

Bob McGlashan - ***BMO Financial Group - Chief Risk Officer***

That we will talk about at the next call.

Susan Cohen - ***Dundee Securities - Analyst***

Okay, thank you.

Operator

Quentin Broad.

Quentin Broad - ***CIBC World Markets - Analyst***

I will just follow up on that question, Bob. Just in terms of the full-year guidance of 275 and what you've got in the bag already on PCLs, and given we are a month into the last quarter, it is curious to me that we are still forecasting about 110-ish or so million of PCLs. Just your thoughts versus the 73 you posted this quarter and why you're retaining that number.

Bob McGlashan - ***BMO Financial Group - Chief Risk Officer***

113-ish actually is what we need for Q4 to hit the 275 number. We would like to miss the 275 obviously. But if you look at the specifics this quarter they were 113, offset by 40 in reversals and recoveries. So you don't need to see the specifics inch up very far, as recoveries might also decline a little bit, to be there. Directionally, those are the two things that I am expecting to see, neither of them material, but both of them enough to cause us to be in that kind of ballpark.

Quentin Broad - ***CIBC World Markets - Analyst***

Do you also -- in your commentary you don't see any changes in terms of the current marketplace. Your commentary seemed to suggest that you're still seeing stability out there from a credit perspective.

Bob McGlashan - ***BMO Financial Group - Chief Risk Officer***

Absolutely. But remember we are talking about such small numbers here right now, relative to the size of our portfolio. A bump can come from anywhere. A $20 million transaction can show up in a nanosecond, and we're not aware of it specifically. But given where we are at now with such small numbers, it is not difficult to see us being at 113 for the fourth quarter. A little bit of volatility.

Quentin Broad - ***CIBC World Markets - Analyst***

Just in terms of the hedge book, Bob, the single name exposure number for autos I think changed, was a material change, down from 200 to 122. Did that just fall off, or was there some other -- was it executed in the quarter? I am just trying to understand what happened to that hedge?

Bob McGlashan - ***BMO Financial Group - Chief Risk Officer***

It was actually managed out against, against what our perceived need was for the book.

Quentin Broad - ***CIBC World Markets - Analyst***

I don't know if Rob Pearce is there, but just in terms of the competitive environment for the deposit market share. It continued to decline, it appears, in P&C Canada.

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

The deposit market share, I think you have got to look at it in total. You've got to look at our retail operating deposit business, our chequing and savings account business, our GIC or term deposit business, and mutual funds, because those things are substitutes for each other. You have got the personal share, the deposit share which is retail operating deposits and term deposits drifting down a little bit. But you have got mutual funds heading up. So I think when you look at those things in combination, it's pretty stable and has been for a little bit of time.

Quentin Broad - ***CIBC World Markets - Analyst***

But Rob, would you prefer -- let me ask you this then. Operating account deposit change, which I would have thought is a stickier product ultimately than mutual funds, is there any material migration there?

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

I think the biggest substitution in those numbers is between term deposits, GICs, and mutual funds, which are quite substitute products for each other.

Quentin Broad - ***CIBC World Markets - Analyst***

Okay. So you are you're saying then that your core deposit levels are remaining stable?

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

Yes, and clearly we are trying to grow them, clearly we would like to be increasing share. But in those numbers it is more term deposits and mutual fund substitutions.

Quentin Broad - ***CIBC World Markets - Analyst***

Thanks.

Operator

Steve Cawley.

Steve Cawley - ***TD Newcrest - Analyst***

Bob, it seems like every time my forest papers analyst talks, I feel like one of his companies is going to blow up sooner than later. I think last quarter I had you at around 600 million of gross loans in the forest product sector. I was hoping you could give us a bit of an update in terms of where you think things stand in that space, and how comfortable you are with the level of allowances that you have set against that group.

Bob McGlashan - ***BMO Financial Group - Chief Risk Officer***

Forest products specifically?

Steve Cawley - ***TD Newcrest - Analyst***

Yes.

Bob McGlashan - ***BMO Financial Group - Chief Risk Officer***

Our exposure in aggregate to forest products is not huge. We have got specific provisions that are really pretty nominal, frankly, at this point.

Steve Cawley - ***TD Newcrest - Analyst***

So you're not too worried about it?

Bob McGlashan - ***BMO Financial Group - Chief Risk Officer***

Absolutely not. We're watching it, but there is nothing there big enough to cause us over worry.

Steve Cawley - ***TD Newcrest - Analyst***

Back over to IBG, one thing I was wondering is -- so it sounds like the money market assets, basically part of the book of business there, you are planning to carry trade (ph). I was wondering what was the duration of those assets. How much have we seen run off in the short term? I am trying to get a sense of how much more meaningful this could be in terms of the margins in IBG.

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

The money market assets probably have a duration in the U.S. close to eight or nine months. That is one portfolio that we have. We have another U.S. money market portfolio in Europe; and that is much shorter. It would be about four months. So in the case of the European/U.S. portfolio, the overall portfolio is down by approximately 15% quarter-over-quarter, and I would anticipate that we will have a similar kind of reduction rate as we move towards December 31st unless the yield curve shape were to change in the U.S. with the duration of about eight to nine months. We have approximately -- we have more of a lumpier maturity profile there, and between now and the end of the year we will have probably close to 30% of the portfolio maturing.

At this point in time, I don't know exactly what we will do as with assets that are maturing as to whether or not we will renew them or not. It will depend on the shape of the yield curve, and what kind of carry we may obtain, and the risk-reward associated with that carry, obviously.

Steve Cawley - ***TD Newcrest - Analyst***

You probably can't answer this, but I will give it a shot anyways. Once you see these levels of maturity, assuming a yield curve that is the same shape that it is today, what kind of impact could that have on your margins?

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

The margin may not deteriorate all that much. But the impact would be more on the revenue front, because if the yield curve doesn't change, most likely we will not replenish our assets as they do mature. Which means that we would have an opportunity cost there, not having the same level of the assets with the spread associated with them.

Steve Cawley - ***TD Newcrest - Analyst***

Okay. Thank you.

Operator

Rafael Bello.

Rafael Bello - ***Citigroup - Analyst***

I was just wondering if you could comment a bit on your U.S. strategy, specifically on acquisitions. Would the sale of Harris make you more aggressive towards trying to acquire some other banks? Or your overall strategy does not change at all?

Tony Comper - ***BMO Financial Group - President and CEO***

It's Tony. Not much change. As we have said consistently, we are on the hunt for acquisitions. I commented on a relatively small one we made. But you will see that kind of pattern, which is -- I would characterize it as opportunistic. So we're looking for acquisitions. I don't think our appetite for acquisitions has changed as a result of the disposition of Harrisdirect. Clearly it gives us more capacity to do it, but our appetite has not changed.

We have three criteria that we will consistently apply. The potential acquisition will be a good fit culturally. It's got to meet the financial criteria. And it has got to be strategic in terms of helping us grow the distribution network. So we're not going to give up on our financial disciplines. Got to meet the financial criteria. But we have said that we are prepared to go larger than what we have done.

I think the -- and a good signal, because -- if you look at kind of the pattern of acquisitions over the last period of time, it is a little bit of a sawtooth, with subsequent transactions getting a little bit bigger than the ones that we may have done earlier. Big change is the fact that now that we have completed Project Enterprise, which is the elimination of all the charters, we've got a common platform. I think we've got a significantly better environment in which to integrate the potential acquisitions that we do.

But again it takes two to tango. You have got to have -- it is nice to want to acquire an asset; it is a quite another thing for the asset to want to be acquired. So the game therefore and the team that we have in place is actively maintaining contacts with all of the, what would be characteristic of all the attractive properties that are in the area of the Harris Bank in the Midwest.

Rafael Bello *- Citigroup - Analyst*

Great. Thank you.

Operator

Michael Goldberg.

Michael Goldberg *- Desjardins Securities - Analyst*

First of all, just a number question. Any gains on sale of impaired loans during the quarter?

Bob McGlashan *- BMO Financial Group - Chief Risk Officer*

No, there wasn't, Michael. It's Bob.

Michael Goldberg *- Desjardins Securities - Analyst*

Second, just following up on Rafael's question, what is the lowest that you would want to go to on tangible common to risk-weighted assets? Given the capital freed up from Harrisdirect, has this changed the parameter at the upper end of the acquisition size that you would consider?

Tony Comper *- BMO Financial Group - President and CEO*

I will answer the second question first. It hasn't changed it, Michael; and I will get Karen to talk about the impact on Tier 1.

Karen Maidment *- BMO Financial Group - CFO*

Michael, we just look at Tier 1 with a goal of 8% to 9%, so that is really the guidelines that we follow.

Michael Goldberg *- Desjardins Securities - Analyst*

Okay. Finally, in terms of the margin compression, I am wondering. You have identified two factors as two big-picture factors contributing to the margin compression. Namely competition and the flattening of the yield curve. Could you give us some idea, 60/40, 50/50, 70/30, how much is due to competition, that is, lower matched margins, versus flattening of the yield curve?

Tony Comper *- BMO Financial Group - President and CEO*

Let's take it U.S. and then Canada. Frank?

Frank Techar *- Harris Bankcorp, Inc. - President and CEO*

Michael, imprecise science, but my view would be the competitive pressures, in the Chicagoland marketplace at least, have not dramatically increased over the course of the last few years. We still have the same number of competitors. It is competitive. With margins being depressed around, there is a bit more activity on grabbing for volume, so that dynamic has changed a bit.

I think from our perspective, we are getting squeezed more because of the flatness of the yield curve rather than some kind of material ramp up in the competitive pressure in the marketplace. So I would say it is weighted more towards the interest rate environment rather than what is going in the market.

Michael Goldberg *- Desjardins Securities - Analyst*

Are you including IBG type business in there also?

Frank Techar *- Harris Bankcorp, Inc. - President and CEO*

I was referring to the P&C business.

Michael Goldberg *- Desjardins Securities - Analyst*

So if we were to say something like 80/20, is that sort of a reasonable picture of this?

Frank Techar *- Harris Bankcorp, Inc. - President and CEO*

Hard to do it on a precise basis, Michael, but directionally I would say that is where I am.

Michael Goldberg *- Desjardins Securities - Analyst*

Okay.

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

In the case of IBG, Michael, it might be slightly higher, I would say, In terms of the contribution towards our margin narrowing from the compression of our corporate book. I would say my guess, pure guess, would be 35% and 65% from the interest rate environment. But that is a guess at this point.

Michael Goldberg *- Desjardins Securities - Analyst*

Okay. What about in Canada and out of P&C?

Frank Techar *- Harris Bankcorp, Inc. - President and CEO*

Certainly from a P&C front I think what you have got -- you have had pretty stable margins now for a number of quarters. Though as I have been saying on these calls and other places, the pressures are still down. They're really down from really two factors; one is competition and the other is mix. I think right now I would probably overweight my analysis to mix. In other words, you have got the mortgage book growing quite rapidly, which is driving down the mix factor. But the competition is still in play, obviously. Those are the two factors. I would weight probably a little bit more towards mix than to competition. But both are contributors.

Michael Goldberg *- Desjardins Securities - Analyst*

Okay, thanks very much. Very helpful.

Operator

Mario Mendonca.

Mario Mendonca *- Genuity Capital - Analyst*

Quick question, and I may have this -- I could be mistaken. The share repurchase activity, am I correct in my observation that it was down noticeably from prior quarters?

Karen Maidment *- BMO Financial Group - CFO*

It's Karen. That is correct. We look at the share repurchase in the context of the overall capital planning philosophy. I think one of the features that Bank of Montreal has is that we have opportunities to deploy our capital into good business opportunities both organically and through acquisition. Therefore, we keep our share buyback plan pretty modest. The plan is 3% or 15 million shares. As a minimum what we want to do is offset the dilution from the DRIP and the options and things like that. That was accomplished earlier in the year, so the buybacks this quarter were fairly minimal.

Mario Mendonca *- Genuity Capital - Analyst*

Is it fair to say then that the opportunities to deploy the excess capital have improved then this quarter versus prior quarters?

Karen Maidment *- BMO Financial Group - CFO*

We think that there are good opportunities to deploy. Yes.

Mario Mendonca *- Genuity Capital - Analyst*

But the move to reduce the number, the magnitude of the share buybacks, is that a reflection of having taken care of the effect of stock options earlier in the year? Or is it really a reflection of BMO seeing something materializing here?

Tony Comper - ***BMO Financial Group - President and CEO***

The former rather than the latter is what I'd say.

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

The objectives have been accomplished. We think the best place to put our excess capital is into the business; and also we increased our dividend as well.

Mario Mendonca - ***Genuity Capital - Analyst***

Part of where I'm going with this is that you talked about your Tier 1 range in the sort of 8.5% to 9% or 8% to 9% range, Karen. You are around what, 9.4, 9.3 right now? In the context of the very strong growth in IBG and even P&C, putting on a fair bit of risk-weighted assets, it would seem if the bank continues to grow the risk-weighted assets and the loan book this quickly it won't be long before we are at the 9%. Is that a reasonable way to look at things?

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

We look at lots of opportunities in terms of raising capital. There are a lot of factors that go into that overall Tier 1 ratio. But the bottom line is we do have opportunities. We are growing organically and we just freed up more capital with the disposition of Harrisdirect. So that is going to give us more to make further acquisitions, if they make sense.

Mario Mendonca - ***Genuity Capital - Analyst***

That's a valid point. Thank you very much.

Operator

James Keating.

James Keating - ***RBC Capital Markets - Analyst***

Same subject matter, a bit of a different tack, and perhaps for both Frank and/or Tony. I'm just looking at what is happening with spreads in the U.S. and U.S. bank share prices, and thinking about the environment as being -- it feels pretty dour right now. Outlook looks a little tough. In the context of that, I just wanted to discuss appetite for U.S. bank acquisitions, and what is driving it, and what sort of long-term view you might feel you need to try to make it value enhancing in the long term. Am I being too pessimistic? Or should we be concerned here?

Tony Comper - ***BMO Financial Group - President and CEO***

I think you are edging a little bit towards the more pessimistic, but I will let Frank deal with this (technical difficulty).

Frank Techar - ***Harris Bankcorp, Inc. - President and CEO***

A couple of things. One is I think with the margin issues in the U.S. right now, our expectation is we are going to see more properties become available. We are seeing more smaller properties become available, and our expectation is that the trend will continue. But the real answer to your other question, which is how are we going to make it work in the future, goes back to what we talked about at our investor day back in June.

We are trying to compete on a full-service model that offers a broad suite of products and services not only in the retail space but the commercial space and the wealth space. I think the banks out there that are going to run into some problems or consider a different strategic option are those that are going to be really focused on the net interest margin space, really focused on the mass consumer marketplace.

So my expectation is the business model going forward is going to hold us in pretty good stead, and that is what we continue to work on. I don't think all players are created equally out there. I think we are going to see properties come to the market that we think we can leverage in a different way.

James Keating - ***RBC Capital Markets - Analyst***

Not to be too Machiavellian about it, is there a bit of a squeeze going on regionally because the big players are trying to make it happen to a degree? It seems to be just a real regional bloodbath.

Frank Techar - ***Harris Bankcorp, Inc. - President and CEO***

Again I just go back to my earlier comments. My sense is it is no different than it was a year ago.

James Keating - ***RBC Capital Markets - Analyst***

Okay. Thank you, Frank.

Operator

Quentin Broad.

Quentin Broad - ***CIBC World Markets - Analyst***

I guess a question for Frank and perhaps Karen. Just understanding the U.S. dollar equivalent P&C Chicagoland, amazingly consistent, Frank, at $30 million of cash net income. But we are obviously also looking for some growth. So two points I guess.

One, can you remind us how much various acquisitions might have come in over the course of 2005 in terms of positive contribution to the 30 million of cash? Secondly, just the perpetual, Frank, the 74.2% U.S. dollar equivalent efficiency ratio. Is there anything in this quarter in terms of the consolidation activity that you have undertaken with the systems that you would say is nonrecurring or perhaps higher than it should be on a recurring basis?

Frank Techar - ***Harris Bankcorp, Inc. - President and CEO***

Quentin, relative to your first question, the net income basis, I assume these numbers are going to be pretty same for the cash net income number. But our net income on a year-to-date basis in '05 is up 27%. If you exclude the acquisitions, we are up 14%. So that gives you some sense of the relative contribution; and primarily that has been Mercantile in the last couple of quarters.

So our plan going forward is to have good core growth on both revenues and net income, augmented by the acquisitions that we're making. I think that is what has happened in this year. I think in the last couple of quarters, we have been hurt a bit on the net income side just because our expenses have been higher as a result of our charter consolidation project; also, a few other branches coming in. So we continue to invest in the business and the expense line is reflecting that investment.

So when you roll that up to the cash productivity line, our objective is to continue to see 150 to 200 basis points of improvement on an annual basis. We are well our way to doing that in this fiscal year, as we did last year and as we did the year before. So we recognize that the number is higher, but we are investing in the business and we think we can do both on a measured basis.

Quentin Broad - ***CIBC World Markets - Analyst***

Frank, just on that, does this become the last year on year quarter where you have had -- I guess you'd have four quarters in a row now, A, of 25 million of GAAP net income and, B, of an efficiency ratio of 73%-ish. So is that a base that you can make material reductions, i.e. the 200 basis points, from?

Frank Techar - ***Harris Bankcorp, Inc. - President and CEO***

I don't know how to answer that question. If you look at what happened in 2004, I think I got the same question in the third quarter last year, where we had relatively flat net income over the course of the year and then we had a ramp-up. So my expectation is, as we continue to invest in the businesses, as we continue to make these acquisitions and add distribution endpoints and manage our expenses, that we will be able to grow that net income line going forward.

So, yes, we have been flat for a couple of quarters, but it is as a result of the investment, not as a result of the growth in the balance sheet or our ability to generate revenue. Because the revenue has been going up over that period of time.

Quentin Broad - ***CIBC World Markets - Analyst***

Thanks, Frank.

Operator

Thank you. There are no further questions.

Susan Payne *- BMO Financial Group - SVP IR*

Thank you, operator. Thanks for joining us today. If you have any further questions, please either call me at area code 416-867-6656 or send us an e-mail at bmo.com investor relations. 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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