BMO Financial Group

Q4 2005 CONFERENCE CALL

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PRESENTATION

Operator

Good afternoon and welcome to BMO Financial Group's fourth quarter 2005 conference call for November 29, 2005. Your host for today is Susan Payne, Senior Vice President of Investor Relations. Ms. Payne, please go ahead.

Susan Payne - *Bank of Montreal - SVP, Investor Relations*

Good afternoon, everyone. This afternoon's brief overview of our fourth-quarter results will be provided by Tony Comper, President and CEO, Karen Maidment, our CFO, and Bob McGlashan, our 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 -- Bill Downe, Deputy Chair; Yvan Bourdeau from Investment Banking; Lloyd Darlington, Head of Technology and Solutions; from the Private Client Group, Gilles Ouellette; Rob Pearce from the Personal and Commercial Client Group in Canada; and Frank Techar of the Harris Bank.

At this time I would like to caution our listeners by stating the following on behalf of those speaking today. Forward-looking statements may be made during this call and there are risks that actual results could differ materially from forecasts, projections or conclusions in the forward-looking statements. Certain material factors and assumptions were applied in drawing the conclusions or making the forecasts or projections in the forward-looking statements, and you may find additional information about such material factors and assumptions and the material factors that could cause actual results to so differ in the caution regarding forward-looking statements set forth in the news release, or in our investor relations website at bmo.com.

With that now said, I'd like to hand the floor over to Tony.

Tony Comper - *Bank of Montreal - President and CEO*

Thanks, Susan, and good afternoon, everyone. Before I begin, I just want to underscore the importance of Susan's comments regarding forward-looking statements. And of course, as we know, there are new requirements coming into play, and that's why we spent some time focusing on that.

BMO delivered record net income in 2005, ending the year on a strong note. We surpassed four of the five financial targets that we set for the year, including the targets for EPS growth and return on equity, improved the cash productivity ratio by 120 basis points, building on significant improvements in the previous two years. But we missed the target of 150 to 200 basis points enterprise-wide. And as I told this audience in the second and third quarters, we knew that the productivity target would be challenging as we continued to invest in business growth.

The fourth quarter was by far the strongest of the year. A healthy lift in revenue enabled us to grow earnings 20% from a year ago and 22% from the third quarter. Core operating performance is up strongly from a year ago, creating good momentum for the year ahead.

We made progress during the year on increasing business referrals and meeting more of our customers' needs through broad-based customer service initiatives. And that includes such things as the sales councils that we have developed in Canada and the One Harris initiative in the United States.

One of the highlights of 2005 was the sale of Harrisdirect for an after-tax gain of $18 million. We sold this business at a time and in a manner to the benefit of both customers and shareholders. And I think that demonstrates our ability to tackle issues head-on in response to changing competitive realities. We are determined to build on BMO's strengths, while taking the appropriate steps to create shareholder value.

Another highlight was the successful consolidation of the Harris Bank charters into one national charter with no disruption to customer service. And that was the latest in a series of major investments to create a highly efficient back-office while maintaining the best of the Harris community banking heritage.

These investments, plus the invaluable experience that we have gained from our acquisitions to date, position us well to increase revenues while managing costs as we continue the expansion of our Harris personal and commercial operations beyond the Chicago area and Northwest Indiana and the Midwest. I'd also note that we raised quarterly dividends twice in fiscal 2005, as dividends declared rose 16% from 2004 to $1.85 a share.

Turning now to our outlook for 2006, we're anticipating stronger growth in the Canadian economy as the negative impact of the strong Canadian dollar dissipates and continued solid growth in the U.S. economy. I'd also note that loan losses are likely to increase in our industry as we enter the next phase of the credit cycle. However, we believe that our consistent approach to risk management will result in lower relative losses for BMO as the business environment changes. And experience shows that we gain market share through this part of the cycle.

In light of the brighter economic outlook, our credit leadership, a strong fourth quarter, and the progress that we're making on key initiatives, we are aiming to deliver, as you can see on the chart, 5 to 10% growth in earnings per share, and that's from a base of $4.59, excluding changes in the general allowance; return on equity of 17 to 19%; the specific provision for credit losses of $400 million or less; and a Tier 1 capital ratio of at least 8%. And we are aiming to improve the cash productivity by 100 to 150 basis points, this time with an accent on the revenue side of the equation. Having created a strong culture of cost discipline over the past several years, we will continue to make progress in containing costs while making the investments that are essential for future growth.

On this slide we list BMO's strategic priorities for 2006 as we continue to execute our strategy to grow our core Canadian businesses and accelerate expansion into the United States. As we close in the on our goal of expanding the Harris network to 200 branches in the Greater Chicago area -- and that includes Northwest Indiana -- we're now aiming to increase our network to 350 to 400 branches over the next five years. And we will continue to hunt for Personal and Commercial acquisitions that will accelerate progress toward our goal to transform Harris into a super-regional player as the leading personal and commercial bank in the U.S. Midwest.

Our Tier 1 capital ratio of 10.25% provides us with the capital strength and flexibility to invest in organic business growth and respond to acquisition opportunities, while continuing to return profits to shareholders, and that's in the form of dividends. Now, while productivity remains a top priority, the emphasis as I said will be on revenue growth. All BMO colleagues across the enterprise will be focusing intensely on delivering exceptional service and meeting more of our customer needs.

To support our revenue-generating activities, we are increasing capital expenditures across all of our businesses in 2006. We see good opportunities to grow revenue in all three operating groups. For example, in the Personal and Commercial Client Group in Canada, we have upgraded our technology and continue to invest in our distribution network, including replacing our entire ABM network. Importantly, we are also introducing a new approach to managing relationships with our primary personal banking customers, which involves adding relationship managers in our branches to actively provide advice and support.

In our U.S. Personal and Business Banking network, growth will continue to come from de-novo expansion and acquisitions. In Harris branches, the focus will be on increased sales training and growing same-store branch revenue. In the Private Client group, we see good opportunity to increase our share of existing clients' investable assets in key businesses on both sides of the border. And in the Investment Banking group, we are continuing to focus on integrated coverage to bring the best solutions to our clients, and we are refining our sector focus in the U.S. to match our product and service capabilities with high-growth opportunities. With the strategic steps that we're taking, our credit strength, the positive outlook for the Canadian and U.S. economies, we are well positioned to meet BMO's targets for the year ahead.

Karen, over to you.

Karen Maidment - ***Bank of Montreal - CFO***

Thanks, Tony, and good afternoon. Looking at the financials, I'm pleased to report we had an outstanding quarter. Net income for the quarter was at a record $657 million, up $106 million, or 20% from a year ago. Of particular note, revenue growth this quarter was 16% and the revenue to expense growth differential was 6.7%. And I will speak more about that later.

Operating results in the fourth quarter were up strongly from a year ago in spite of higher provision for credit losses, and even after excluding certain significant items that increased earnings, which are listed on slide 3. And on the capital side, we achieved an ROE off 19.8% and ended the year with a strong Tier 1 capital ratio of 10.25%.

There's a few significant items this quarter that I'd like to point out, and these are listed on slide 3. There's a gain on the sale of Harrisdirect of $18 million booked in other income in the U.S. business of PCG; the gain on the sale of common shares of TSX totaling $32 million, split equally between the Private Client Group and the Investment Banking Group in investment security gains; the gain on the sale of the Calgary office tower in the amount of $19 million, recorded in other income of corporate support; and the adjustment to P&C Canada's card fees of $26 million as a result of further refinements made to the methodology related to the rewards program. So, even if you exclude these items, cash EPS was $1.22, representing a 15% year-over-year increase on a similarly adjusted basis. Still a very strong quarter.

Looking at group net income on slide 5, all operating groups' performance was up year-over-year. P&C had strong earnings growth, up 14% to $305 million, with higher volumes in both Canada and the United States, stable margins in Canada and a lower effective tax rate.

P&C Canada was up 15%. Similarly, the Private Client Group continued to achieve good year-over-year growth, especially in full-service investing and mutual fund businesses, posting earnings of $107 million. Even excluding the gains on the sale of Harrisdirect and the TSX shares, PCG's earnings were up 38% year-over-year.

IBG's earnings were up 34 million, or 18%, year-over-year, largely due to improved capital markets and the $16 million after-tax gain on the sale of the TSX common shares. Finally, corporate support results were down $20 million from a year ago, primarily due to increased PCL, including last year's $50 million pre-tax reversal of the general allowance, partially offset by the $19 million gain on the Calgary office tower.

Slide 6 shows the year-over-year and quarter-over-quarter change in cash EPS. Quarter-over-quarter cash EPS increased $0.23, or 21%. One-third of the increase was due to business growth, another third was due to the significant items I noted earlier, and the rest was due to provision for credit losses and taxes. Year-over-year, the increase in cash EPS was $0.21, or 19%, driven by similar factors.

Slide 7 shows the business growth quarter-over-quarter of $156 million, or 6.4%, achieved across all operating groups. P&C Canada represented $53 million, or about a third of the growth, from higher volumes. PCG represented $30 million, or about 20% of the growth, from full-service investing in mutual funds. And IBG represented $50 million, or about another third of the growth from stronger trading revenues, M&A, equity underwriting and commissions. Year-over-year business revenue growth was a very strong 13.5%, driven by improved performance in all our operating groups. And as I mentioned before, the revenue to expense growth differential was almost 7% this quarter.

On slide 8 you'll see that total Bank margin was 158 basis points at Q4, down 7 basis points from last quarter and down 24 basis points from a year ago. Looking at it by group, quarter-over-quarter you'll see that P&C Canada is up 4 basis points, while PCG's -- while Chicagoland is down 7 due to market conditions and business mix. Chicagoland's loans have been growing faster than its deposits, which has had some effect on its margins.

IBG's net interest margin declined 13 basis points quarter-over-quarter, principally as a result of two factors -- one, the rising short-term interest rates in the U.S. that compressed spreads in the interest-sensitive businesses, and also lower trading net interest income, reflecting the funding cost on the increased equity and commodities trading assets, which generated significant non-interest trading revenue.

Turning to slide 9, you can see expenses grew $57 million quarter-over-quarter and $143 million year-over-year. And although expenses are well controlled across the organization, there were some increased costs during the quarter related to continued investments made in our Canadian distribution network, severances and the timing of certain projects. Performance-based compensation costs increased year-over-year due principally to higher PCG sales-related commissions and an increase in IBG due to lower levels in '04.

As you'll see on slide 10, there was an improvement in the cash productivity ratio both quarter-over-quarter and year-over-year. It was 60.9% in Q4, which represented a 350 basis point improvement year-over-year and 285 basis point improvement quarter-over-quarter. For fiscal 2005 the cash productivity ratio was 62.6%, which represented an improvement of 120 basis points over 2004, short of our target of 150 to 200. However, over the last three years we've improved our productivity by 540 basis points.

Slide 11 shows our U.S. performance in source currency, and you can see the results totaled $86 million, up $19 million from the quarter-over-quarter and $37 million year-over-year. PCG's net income for the quarter included the $15 million gain on Harrisdirect, and during the year P&C Chicagoland incurred approximately $17 million of costs to integrate new businesses and the effect of the charter consolidation, as compared to only $3 million the prior year.

Slide 12 shows our Tier 1 capital ratio was 10.25%, well above our stated target of a minimum of 8. And while our total capital ratio was 11.76%, the Bank's risk-weighted assets decreased $800 million quarter-over-quarter to 150.8 billion, principally related to the sale of Harrisdirect. And as we indicated last quarter, the sale closed this quarter. After the deduction of transaction costs and other adjustments, the sale resulted in a $49 million gain that was recorded in the results of PCG U.S. This is outlined on slide 13. Because of certain tax selections we made to facilitate the transaction for the purchaser, the after-tax gain on the sale amounted to $18 million.

Turning to slide 14, and as Tony mentioned, you will see we surpassed four out of five of our financial targets for the year. And although we significantly improved productivity ratio over the last two years, we fell short of our target this year.

Looking up towards 2006 and wrapping up on slide 15, you can see -- and drawing your attention again to the caution regarding forward-looking statements, our five financial targets are -- EPS growth of 5 to 10% as compared to 2005, excluding the general, off of a base of $4.59. Excluding all

PCLs, EPS growth must be at least 9% to achieve the low-end of our target and would have to be as high as 14% to reach the high-end of our target; secondly, specific PCL of $400 million or less; third, improved cash productivity of 100 to 150 basis points; four, return on equity of 17 to 19%; and fifth, Tier 1 capital ratio of at least 8%.

Now I will turn it over to Bob.

Bob McGlashan - ***Bank of Montreal - Chief Risk Officer***

Thanks, Karen, and good afternoon, everyone. Before I begin, I too would like to draw your attention to the caution regarding forward-looking statements on slide 1.

I have a short presentation with three key messages. First, as you can see on slide 2, BMO continues to maintain its historic strong credit performance and sustained PCL advantage over our competitors.

On slide 3, credit quality continued to improve this quarter, impaired loan formations remained at lower levels, and year-end gross impaired loans at $804 million are the lowest we've experienced in the last several years.

On slide 5, new specific provisions remained low compared to historical levels. Reversals in recoveries for the quarter were lower than Q3. The low level of reversals and recoveries is expected at this point in the credit cycle, given the smaller pool of gross impaired loans. PCL was $57 million for Q4, a decrease of $16 million from Q3.

On slide 6, on a comparative basis, Q4 and fiscal 2005 specific PCL both represented 13 basis points of average net loans and acceptances, including reverse repos, relative to Q3 at 17 basis points and fiscal 2004 at 4 basis points. Specific PCL remains low compared to the Bank's 15-year average of 38 basis points and Canadian competitor weighted average of 62 basis points, reflecting BMO's continuing clear competitive advantage in this area.

Second, as shown on slide 7, our target PCL for fiscal 2006 is $400 million or less. The increase over fiscal 2005 is due to an expected increase in the level of new specific provisions and, in light of very low gross impaired loan balances, lower levels of reversals and recoveries. This represents 22 basis points of average net loans and acceptances -- still a very low level -- and consistent with this period in the cycle, well below our 15-year average of 38 basis points, though beginning to trend up.

Looking forward, we expect the credit environment to remain stable in early 2006, with potential weakness developing in the latter part of the year. While we continue to track a number of sectors, including auto, airline, forestry, and those sectors most sensitive to rising energy prices, none represent a material risk. We also remain attentive to those factors that could affect credit quality in the consumer, corporate and commercial portfolios, including continuing high energy costs, the impact of the sharp appreciation of the Canadian dollar relative to the U.S. dollar on export sectors, and a potential impact of rising interest rates.

I will highlight that our corporate and commercial portfolio is well diversified, and approximately 90% of our consumer portfolio, including credit cards, is secured. Excluding credit cards and residential mortgages, approximately 80% of BMO's consumer loans are secured, which is higher than the Bank's peer group average.

Slide 8 illustrates our exposure to the auto manufacturing and supply sectors. And of note, there were no significant losses in the sector this quarter or last.

Finally, slide 9 shows our trading and underwriting performance has been relatively stable, with six days during the quarter with a negative P&L, the largest of which was $5 million on September 30th, attributed to credit holdbacks and valuation adjustments, primarily in capital markets. The largest P&L gain was 13 million on August 29th, mostly due to a price move in natural gas.

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

QUESTION AND ANSWER

Operator

(OPERATOR INSTRUCTIONS). James Keating, RBC Capital Markets.

James Keating *- RBC Capital Markets - Analyst*

Congratulations on a terrific quarter here. Question for you, Tony. On forward earnings growth, the target therein, as Karen described, 5 to 10% -- I think disaggregating the potential for an increase in loan loss, if it were to normalize back to the $400 million level, it looks like you need 10 to 15 or maybe even a bit more than that underlying EPS growth. Could you just describe what you see as the environment for revenue growth here? I think you had a better revenue growth in this quarter, and I'm wondering from a makeup perspective, Tony, what you're envisioning for revenue versus expense gaps to try and get that underlying earnings growth of 10 to 15, or maybe 11 to 16, whatever you need to net out to the 5 to 10%.

Tony Comper *- Bank of Montreal - President and CEO*

It's a good question, Jamie, and I will make a general comment and then I will turn it to Rob and to Frank to fill in the details. We're seeing a pretty healthy economic environment in both Canada and the United States. That's point number one. And we think that notwithstanding some of the proverbial exogenous variables that we've seen, in Canada that would include energy prices and the Canadian dollar, we still remain pretty bullish on economic growth in the Canadian environment. In the States, same thing, notwithstanding the increased energy prices, we think the U.S. economy is in pretty good shape and we think that our outlook for '06 is that it's going to continue to grow. So, that's going to underpin what we are expecting from a growth perspective in our core businesses, our organic growth in both Canada and the United States. Rob, do you want to add something to that?

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

I'd just add a couple of things. Firstly, volumes remain pretty good. Certainly the consumer side of our business remains quite strong. And the commercial side, which tends to bounce around a little, we've got some decent growth there. So, the volume side has been pretty solid, and I see that continuing. And margins have been stable. And while we are up a few basis points this quarter, the reality -- that bounces around too, just a couple of basis points here or there. But overall for the year, margins have been pretty stable in our business. So if we can get some volume growth at give or take the levels that we've been at, with stable margins, we can spend some money and still improve our NIX and invest in our business and still drive up a modest double-digit growth to the bottom line, and improve productivity within the range of the targets that we put out. That's what we're trying to do. But really at the end of the day, volume has been pretty good, margins have been pretty stable, and that's a decent environment for us to operate in and grow the bottom line.

Operator

Steve Cawley, TD Newcrest.

Steve Cawley *- TD Newcrest - Analyst*

Hi, Tony. The announcement last week from Goodale -- has it at all changed your mentality as it relates to your payout ratios, and can you envision them going higher in the future?

Tony Comper *- Bank of Montreal - President and CEO*

It's an interesting point. I think what it points to is that in general -- I don't want to segue off into this -- but when we're talking about productivity of the Canadian economy, one of the issues we know is tax treatment. And if you looked at Jack Mintz of the CD Howe, his recent publication on Canada's relative tax competitiveness, we're kind of down the list. So, I think that anything that he does to help improve our competitiveness is going to be beneficial. And I think that's good. We will on an ongoing basis review our dividend policy and look at whether we think our target payout ratio, which you may recall we moved up from 30 to 40% to 35 to 45% -- we will look at that in the context of government policy changes that they've made.

Steve Cawley *- TD Newcrest - Analyst*

But in terms of capital deployment, your focus is still more towards expanding your franchise via acquisition than it would be returning capital to shareholders.

Tony Comper *- Bank of Montreal - President and CEO*

That's correct.

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

Second question. Karen, you in the press release gave four onetime items that net-net have positive implications for your reported numbers. If I go to page 17 in your presentation, it's the first one after the appendix, I see that there was -- in P&C Canada that there was really offsetting positives offsetting the $40 million reduced card fees. So, number one, why didn't you make note of that in the beginning of the press release? And number two, if you could help refresh my memory, I don't think that this is the first time I've seen you take charges on the card business. So, is this becoming recurring, and why shouldn't I view this as a recurring item rather than onetime?

Karen Maidment - ***Bank of Montreal - CFO***

We did bring forward the four items to the press release which were really the large items. And you're right; on slide 17 we show some other, more -- I would say more normalized and more smaller items that had some offsetting effect on the P&C Canada's bottom line, but not significant enough to warrant separate disclosure or separate attention as a significant item at the bank level.

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

But in combination, they do come to 40 million pre-tax.

Karen Maidment - ***Bank of Montreal - CFO***

Yes, there's lots of little items that -- across the whole enterprise of 5 and $10 million, positives and negatives. So, what we did was bring forward the most significant ones. And those are the ones that are outlined on that slide. In terms of the air miles adjustment, you're right, we did make an adjustment last year. Last year was primarily related to increasing consumer usage of air miles. So we increased our accruals. This year we fine-tuned our methodology and our models, and they're very sophisticated models for estimating redemption. So, this $40 million adjustment really relates primarily to that. So going forward, you can almost think of it like an actuarial model. And the methodology won't change going forward. But as consumer behavior changes, you can expect some modest adjustments in terms of that liability.

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

I don't mean to be snarky, Karen, but if this has happened twice in the last four quarters, then I start getting worried about your actuarial assumptions.

Karen Maidment - ***Bank of Montreal - CFO***

It's not --

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

I'm saying actuarial to go back to the life insurance. But you know what I'm saying.

Karen Maidment - ***Bank of Montreal - CFO***

Actually, last year -- as I said, post-9/11 travel started increasing and the usage of air miles started increasing, and as you can see, there have been lots of advertisements. And so, that was an adjustment related to the fact that consumers started using them more. As a result of that, we went through a pretty extensive process this year to develop a very sophisticated model. And that's what we did. And so the $40 million relates to adopting that model. So, there won't be any changes going forward in terms of methodology. But as I said, if consumers start using it more, there will be modest increases going forward.

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

Modest increases.

Karen Maidment - ***Bank of Montreal - CFO***

Or decreases.

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

One last one for Frank. P&C Chicagoland -- tough place to do business, and deposits looked to be, the area on slide 21, where we saw a pretty big volume fall-off in the quarter. I'm just wondering, is this just the competitive environment? Does it have something to do with rate increases in the U.S.? Can you give a little colour on what happened on the deposit front?

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

The deposit number is down on this quarter. I think it's a combination of a couple of things. Again, we're faced with what we can glean from the reported numbers in the marketplace. I think we are seeing a little bit off a shift in consumer preferences with rates going up. And with the market behaving a little differently, we think that we are seeing a general market trend for balances leaving bank deposit accounts, although that's really hard to get your finger on. And the second piece is it just continues to be a competitive space. And we are continuing to just look at all the tactical things we can do to address that. Last year we were in a bit of the same situation. We had kind of flat growth from a deposit perspective. And after the first of the year, we always come out with some customer offers that historically have been very attractive, and we're working on those again. So, part of it is a bit of timing, given how we approach the marketplace, and I think part of it might be a change in the environment that we're seeing, along with all of the other banks.

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

Should this worry me, Frank?

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

I don't know. You've got to make that call, Steve. My view would be we've been here for a long time and have been very competitive and been very successful in growing our deposit base and continuing to compete and grow our share. And we are intent on doing that moving forward. So, it's a quarter, and you can draw from it what you will. We're still really confident that we've got a competitive model, and we're going to continue to compete in the marketplace.

Operator

Andre Hardy, Merrill Lynch.

Andre Hardy - ***Merrill Lynch - Analyst***

Two questions -- one for Frank Techar, one for Yvan Bourdeau. For Frank, can you help us understand how you will improve efficiency at the same time as you are opening a lot of branches? And for Yvan, one of your competitors has made a pretty significant retreat from global structured products. How big a business is that for you? And without commenting on your competitor, can you tell us as to what you view as being the risk benefit of being in that business, if you are in it?

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

I'll go first. Relative to our level of investment here in Chicago, we're not intending on changing what we've been doing over the last couple of years. So, I would characterize our de-novo branch expansion as balanced. We're going to continue to look at five to 10 branches a year, which we've been doing over the last couple of years, and continue to invest in some infrastructure work that we need to do, like the charter consolidation this past year. And the only thing I can point to is over the last three years, we have continued to hit our target of 150 to 200 basis points in productivity improvement. And we still think that's a reasonable target for the business moving forward, notwithstanding the level of investment that we will continue to make in growing the franchise. And it's all predicated on whether or not we can continue to grow the topline. This year's revenue growth was 14% on good core growth, coupled with some small bolt-on acquisitions. And we are continuing to move down a similar path as we go into 2006.

Andre Hardy - ***Merrill Lynch - Analyst***

Are you in a position to invest a lot more this year, given that you won't have expenses related to the charter integration?

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

We're undertaking right now a bit of a branch technology refresh. And so that's where we have earmarked some of those dollars that we spent last year with the charter consolidation work.

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

Thank you for your question. The first thing I would mention on a relative basis, we are not as broadly involved in structured products as some of our competitors. We are very focused in that area. And the area where we actually shine, in my opinion, is in the area of the equity-linked notes. We started that business last year. And you may or may not know that this year has been a very -- in '05, fiscal '05 has been a very successful year for us. We have placed close to $1.7 billion Canada in notes across the country. And this was done primarily through, a good portion of it through our own distribution network, but also in cooperation with other firms, financial institutions that distribute financial instruments to the retail front.

The product has provided us with a very steady income and a very attractive return on equity, attractive productivity ratio. It is, obviously, as we are building up this product, I think we will continue to contribute even more in '06 and '07. And now we're looking into a possibility of extending the reach for that product into the U.S. for that product line. Basically it's a good story. It's a story that doesn't carry all that much risk. It is a risk that we're comfortable with and the returns are attractive.

Andre Hardy *- Merrill Lynch - Analyst*

But so far it's been primarily a domestic business?

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

Yes, it has.

Operator

Ian de Verteuil, Nesbitt Burns.

Ian de Verteuil *- BMO Nesbitt Burns - Analyst*

Karen, looking at the securities gains, this year securities gains of 165; last year 175. When I look at your part of unrealized, it looks fairly low at this stage. Isn't the Bank going to face a lot less security gains into '06? And if not, are there any particular items that you're aware of, maybe the MasterCard IPO, anything like that that you're banking to make your earnings forecast?

Karen Maidment *- Bank of Montreal - CFO*

Ian, you're right; the securities gains have been pretty flat year-over-year, but the unrealized gains are pretty minimal at this stage. And we are continuing to build portfolios and trying to create unrealized gains. But it's possible that the level will be down lower next year. You will notice trading gains have been up this quarter. And we think that part of the reason trading gains have been up is because of the commodities business and the energy sector. And that's one of our strengths. So, we hope that that will continue. And there's other -- there's other types of earnings that could come our way. But things like the MasterCard IPO you can't really count on, because we don't know at this point. But when and if it comes our way, it would be another source of earnings.

Ian de Verteuil *- BMO Nesbitt Burns - Analyst*

Which gets me to the second question, which is the growth in the commodity business. I presume that shows up in the other line in trading, which was up to $43 million this quarter. When I looked, the notionals on these derivatives, and everything -- not just notional, there's replacement costs, credit risk equivalent -- all are up significantly. I guess, Yvan, maybe you could provide some colour on who exactly the clients are, why is this business sustainable, and why is there an opportunity for you at this stage?

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

First I would like to comment in general about the environment relative to commodities. We're primarily involved in two commodities, oil and natural gas, and it's truly a North American franchise from our point of view. Our sales and trading platform is in New York, with sales offices in Calgary, Houston and Chicago. In the last three to four months, I think we all know the dramatic price increases that we've experienced in the commodity field for both natural gas and oil. And obviously, that played an important role to our franchise in two ways.

First of all, it provided us with the opportunity to service the increased need of our clients, mainly on the producer side, but also on the buy side, as both sides were trying to hedge themselves against the structural move that took place in these two commodities. So obviously, that provided us with a natural flow that enabled us to do extremely well. And you're correct; the commodity gains are recorded on page 12 in the other category.

Looking at the franchise itself, we deal only with clients that have been approved by the CLP process. And we have in place a monitoring risk system that monitors on a daily basis our exposure on a net and on a gross basis against those names, and we feel very comfortable that that process is sound, and so far has been, in fact, flawless. I think -- I don't think we have experienced a single credit loss in that area.

In terms of looking forward, there's no question that the fourth quarter has been very conducive for us in terms of commodity trading, just because of the environment that I just described. Looking forward, oddly enough, even if the price have dropped a little bit beginning of fiscal '06, that has triggered an interesting phenomenon where both producer and buyers have certainly become more active, because they felt that maybe that's an opportunity for themselves to hedge themselves again. So, so far, I would say that the environment is nearly as conducive as it was in the fourth quarter, and (indiscernible) the most conducive for that particular trading area for us in '05. And provided that the price stay around the current level, we anticipate that level of activity should remain relatively stable.

Operator

Mario Mendonca, Genuity Capital.

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

I want to understand the guidance just a little bit better. I've heard 5 to 10%, and I recognize that that's adjusting for the general reserve releases. What I'd like to understand is the underlying thought process, specifically as it relates to net interest margins in your IBG business in the U.S. particularly. What do you envision there? What's consistent there with your 5 to 10% EPS growth guidance?

Karen Maidment - ***Bank of Montreal - CFO***

We have assumed fairly consistent level of margins going forward, both in Canada and U.S., in our outlook. The way we look at it is 5% is about $1.20 a share a quarter. And I'm not assuming that it will emerge on an even basis, but it gives you a sense. And you look at 10% is around $1.26, and the variation really depends on how well we do with PCL's and how well the underlying environment is. So at the 5%, what we're saying is we need to earn through what we earned this quarter, excluding the nonrecurring items, and we've got a lot of business growth that's underlying each of our businesses with a focus on revenue. We think that will help us through some of the headwinds on the credit side. To go to the high-end of the range is going to require conditions to be different than they are right now in terms of our outlook, particularly on the credit side.

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

To be just a little bit clear on something, when you say margins consistent with where they are, are you referring to the average for 2005 or where it came in this quarter, let's say the IBG margin?

Karen Maidment - ***Bank of Montreal - CFO***

I'll get Yvan to speak on that.

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

Maybe I will just broaden a little bit my answer so you get a full picture with regard to the U.S. To answer specifically your question, if we -- the way we look at our margin in the U.S., we look at them in terms of the core margins and, therefore, we exclude the items that happen -- onetime items, such as recoveries or cash collection. So, if I look at the margins in Q4 in the U.S. versus Q3 in '05, actually our margins have increased by 6 basis points.

One trend that is emanating out of the U.S. from the lending perspective is the margins have definitely stabilized towards the second quarter and the third quarter, and now for the first time we sense that it's starting to turn. Obviously, 6 basis points is not enormous, but it is a signal that things are improving.

I'm asked the question quite often, so I might as well address it right now, in terms of our balances and rate of utilization in the U.S. I will give you that information, which, I think, will give you the full picture in terms of the U.S. state of affairs at this point in time.

If you look at the average asset in the U.S. from a lending perspective, in U.S. dollar terms, at the end of Q4, our balances were $11.6 billion U.S. And if you were to look at a year ago, at the end of Q4 '04, they were at $10.5 billion. So, we had over the year our average balance have increased by 1.1%.

In terms of utilization, at the end of Q4 '05 the rate of utilization in the U.S. was 47.5%, and at the end of Q3 it was actually 52.1%. So, you would be wondering why is that happening. The main reason for that is we've had a slight increase in our outstanding loans from Q3 to Q4. But what has happened to us, which I think is a positive sign, is at the end of July '05, our commitments in the U.S. in Canadian dollar terms were $26.7 billion, and at the end of October, three months later, they were actually at $29.4 billion, which is nearly an increase of $3 billion during those three months. So, as you can see, our commitments have increased at a much faster rate than our loan balances. And given the point we are right now in the cycle, where I think we're turning, we would see an intrinsic increase in the rate of utilization. We think this bodes well for us.

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

And that sounds like what we saw last quarter as well. I think you explained a similar phenomenon last quarter.

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

Yes, that is correct. So, the trend is persisting. We would like, obviously, that to accelerate at a faster rate. But definitely the trend is persisting.

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

Just a point of clarification for me, on page 10 of your supplement, Yvan, you refer to an improvement in the margin. And maybe you could help --

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

I'm referring here to the lending margins. The point that I would like to refer you back to is, Karen made a statement upfront in terms of the IBG margins. In our case, you truly have to look at the overall revenue of IBG as opposed to solely either net interest-earning margins, or the net interest income. And the reason for that is there is a large component, particularly in the last two quarters, that has affected our margin because of the rise in interest rates, not so much in terms of our interest rate-sensitive businesses. Of course, those were affected as well. But more important is as our trading asset balances were increasing, the funding costs associated with those assets have actually increased, which has actually reduced our net income margins, but has increased our NIR. So, that's why you have to look at the overall revenue in IBG to have a pretty good sense as to what the core revenue looked like. And Karen would like to add --

Karen Maidment - ***Bank of Montreal - CFO***

I can just break down the explanation of that, because I know it's something that's a little different this quarter. And as Yvan said, the underlying margins are pretty stable. It's the decline in large part is related to the commodities trading that we referred to earlier. And if you think about it, when we enter into derivative contracts with our customers, they're marked to market and they're put in the non-interest revenue line. And then we hedge the contracts by purchasing futures, and their marked to market and they're in the same line. So basically what you get in the “other revenue” is the profit on those trades or contracts. But then we need to post cash collateral to support the hedging. And the cost of the cash collateral is charged against the net interest margin. And so that's what's bringing the margin down. But you've got the profit in the NIR line. So, as Yvan says, you kind of have to look at them together to see the overall impact.

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

I probably don't have the time to do it now, but maybe that is the appropriate way. We'll look at total revenues to those assets. If we looked at it that way, are you suggesting we would see a little more stability in that margin?

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

Yes, I would say so.

Operator

Susan Cohen, Dundee Securities.

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

You mentioned that you're going to be redoing your ABM network. Do you have any approximation of what the cost of this undertaking would be and about the timeframe that you would do it in?

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

The plan is by -- certainly by this time next year to have it completed. We've already started. I think we've got probably about 100 to 150 done already. Most of it is capital expense, because we both have to oftentimes retrofit some of the furniture and fixtures to the walls within the branches and put in new hardware. And some of it -- a considerable amount of it, actually, is in the T&S shop, in the Technology and Solutions shop with improved fraud security and operating systems and those things. It doesn't have a huge non-interest expense impact in the coming year, because most of it is capital expenditure and it will be amortized out over a respectable period of time.

Operator

Michael Goldberg, Desjardins.

Michael Goldberg - ***Desjardins Securities - Analyst***

First question is for Tony. Tony, you talk about potential acquisitions, opportunities in the United States again. And I'm wondering, given the continued flattening in the yield curve, the pressure that this exerts on earning power, are you feeling more or less encouraged that those opportunities, both the bolt-on and maybe something a little bit more ambitious than bolt-on, may actually materialize?

Tony Comper - ***Bank of Montreal - President and CEO***

Thanks for the question. If I can kind of re-put it, so I make sure I'm understanding it. Are you telling me that there might be more motivated sellers as a result of what's going on down there?

Michael Goldberg - ***Desjardins Securities - Analyst***

Right.

Tony Comper - ***Bank of Montreal - President and CEO***

That's anecdotally what we are observing. We haven't actually seen it materialize, although comments that we are getting back suggest that it's a bit of a tough slug at this point in time, specifically for properties that we might be attracted to. But we haven't seen it -- other than anecdotally, I couldn't put a pin in it.

Michael Goldberg - ***Desjardins Securities - Analyst***

So, do you feel more or less encouraged, as I said, that you will actually find more of these opportunities?

Tony Comper - ***Bank of Montreal - President and CEO***

I'm pretty encouraged. And the reason I'm encouraged is that we're pretty active with our M&A team in the areas that we're interested in. So, we're seeing anything that's on offer pretty well. Let me characterize it that way. And I think that I'm pretty optimistic that we're going to see some things. But again, it's opportunistic. It's going to be lumpy, as it has been in the last few years. But I am more encouraged this year than I might have been last year.

Michael Goldberg - ***Desjardins Securities - Analyst***

My next question has to do with the apparent tax rate on the gain on Harrisdirect. Why does it seem to be so high?

Karen Maidment - ***Bank of Montreal - CFO***

As I indicated in the comments, that when we entered into the transaction with the seller, we made an election so that we would pay some additional taxes. And that was factored into the purchase price.

Michael Goldberg - ***Desjardins Securities - Analyst***

Maybe we could follow it up off-line; I'm not sure I understand the reasoning behind that election. But as I said, maybe we could talk about this off-line.

Karen Maidment - ***Bank of Montreal - CFO***

It was just a simple election that worked in the favor of both parties, and so we paid -- we received more on the purchase price and we elected to pay additional taxes.

Michael Goldberg - ***Desjardins Securities - Analyst***

Okay. Finally, this is for Bob McGlashan. The loan quality data that you showed, showed 38 million gross impaired in auto suppliers in the fourth quarter. And I'm wondering was that a loan or loans that was actually classified in the latest quarter?

Bob McGlashan - ***Bank of Montreal - Chief Risk Officer***

No, a lot of that was already there. But it's been kind of dribbling in. So it's not a single big loan, if that's your question.

Operator

(OPERATOR INSTRUCTIONS). James Keating, RBC Capital Markets.

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

This question is for Rob. I'm curious to get an update on domestic retail banking pricing, if I could, just in products. And maybe just a quick review of your market share here. It seems to me you're still driving pretty good growth on the residential mortgages, but the loans broadly beyond that, perhaps on a market share basis. You enlighten me; I'm trying to get a read on your mix and how competitive it is out there.

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

On pricing, I think we are battling it out in the marketplace in Canada. And while margins are pretty stable, I think the competitive environment is putting pressure on margins. So, as I've said for many, many quarters and in many conversations with you specifically, Jamie, I see more downward pressure than upward pressure. But I'm encouraged with the stability in margins overall, and that's certainly quite a different environment than we faced over the previous couple of years.

The share story is becoming quite encouraging actually. On the Personal side, we've got total Personal share pretty stable. And if you look at the underlying product shares, including -- the one that's been particularly troublesome to us has been the personal lending share. And while it continues to decline, it's really quite modest now. We've got the pace much more respectable. Mortgages have been up a little bit. Consumer loans have been down a little bit. And we've got some mix issues between our mutual fund business and our deposit business. But overall on the personal side, we have pretty stable market share position overall, and obviously we're trying to grow it. But the first thing you've got to do in this game of trends is at least get it stabilized. And I'm quite encouraged actually with the progress we've been making on that side, and the initiatives that we've got coming in '06 to try and drive some more growth, with particular emphasis on the consumer lending side, in our unsecured lending portfolio, in our auto businesses and those types of things.

And on the commercial side, which the only reliable data that we've got that we think is reliable is the loans -- excuse me -- zero to $5 million, but we actually grew that 7 basis points this year. That bounces around quarter-by-quarter. But year-over-year we're up, which is consistent with what we're trying to do. More of that in '06.

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

Just on the latter, how is pricing in commercial banking? Are you feeling any heat from some of the others trying to encroach on your space?

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

Pricing is certainly not up, and credit terms certainly are not more conservative, Jamie. So, you've got pressure on both of those. We're battling it out day to day in every community in this country for that business.

Operator

Rafael Bello, Citigroup.

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

I just wanted to come back to the issue of potential acquisitions in the U.S., and maybe you can let me just state this. I think that I agree with you that there may be more sellers, but obviously for a reason; probably they are not seeing the return on their capital. And certainly that's what we are seeing, it's becoming an increasingly difficult banking environment in the U.S., so the returns on capital tend to be lower. So, if you could just share with us how do you think you can make money. Assuming that you pay a premium for that capital of these banks that are out there, the pressure of providing an adequate return on investment capital would be tough. Could you just elaborate on what is your overall strategy of how you think that you can do things differently than the banks here in the U.S.?

Tony Comper - ***Bank of Montreal - President and CEO***

That's a good question. Basically the strategy is fairly straightforward. We've got a pretty well-established and significant at-scale network within the Chicagoland, Illinois, and now Northwestern Indiana area. So there's obviously two opportunities. We're not going to give up on our discipline with respect to our expectations of internal rate of return, which should equal or be greater than 15%. But when you're looking at some of the smaller to medium-sized properties, two things occur, one of which is the obvious synergies of adding them into our platform. And now that we have kind of standardized, as a result of project enterprise, in terms of one common platform, that's one obvious area that we can get kind of economies of scale and synergies. And we're seeing that in the acquisitions we have done. The other one of which is in general with some of the smaller to medium-sized properties, you don't find the breadth of the product range that we have at the Harris. So there's an opportunity on the revenue side by providing the full suite of product capabilities that we have in the Harris. So, on those two fronts is generally where the internal rate -- when we're doing the calculations, the IRR numbers come from.

Operator

Ian de Verteuil, Nesbitt Burns.

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

Two technical questions for Karen. Karen, the change in accounting rules that will force you to assume dilution on some of the preferreds, which we know will never convert, that's around $0.06. Is that assumed in your forecast?

Karen Maidment - ***Bank of Montreal - CFO***

Yes it is.

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

So, your 5 to 10% growth of 459 is after whatever number you come up to there that assumes an additional -- that assumes $0.06 dilution from this accounting change?

Karen Maidment - ***Bank of Montreal - CFO***

That's correct.

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

The second question relates to the gain, comes back to this question on the gain on Harrisdirect. There was a $25 million cost for the estimated reimbursement of Harrisdirect mutual fund program fees. Can you explain what that is?

Karen Maidment - ***Bank of Montreal - CFO***

That was an arrangement between Harrisdirect and our Harris Insight Funds, and we have made -- prior to selling Harrisdirect, we made a reimbursement for program fees over a number of years that were under dispute. That's what that related to.

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

Does that mean Harris Insight won't be managing those funds anymore?

Karen Maidment - ***Bank of Montreal - CFO***

The funds that Harrisdirect -- Harris Insight will not be managing the funds anymore. That's correct.

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

Okay. I will follow-up off-line. Thank you very much.

Operator

This concludes the question-and-answer session. I will now turn the conference back to you.

Susan Payne - ***Bank of Montreal - SVP, Investor Relations***

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/investorrelations. Thank you and good afternoon.

Operator

Ladies and gentlemen, this concludes your conference for today. You may disconnect your lines, and thank you for your participation.