BMO Financial Group

Bank of Montreal at the Scotiabank Financials Summit

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We caution that the foregoing list is not exhaustive of all possible factors. Other factors and risks could adversely affect our results. For more information, please refer to the discussion in the Risks That May Affect Future Results section, and the sections related to credit and counterparty, market, insurance, liquidity and funding, operational, legal and regulatory, strategic, environmental and social, and reputation risk, in the Enterprise-Wide Risk Management section that starts on page 73 of BMO's 2020 Annual Report, and the Risk Management section that starts on page 34 of our Third Quarter 2021 Report to Shareholders, all of which outline certain key factors and risks that may affect our future results. Investors and others should carefully consider these factors and risks, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements. We do not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by the organization or on its behalf, except as required by law. The forward-looking information contained in this document is presented for the purpose of assisting our shareholders in understanding our financial position as at and for the periods ended on the dates presented, as well as our strategic priorities and objectives, and may not be appropriate for other purposes.

Material economic assumptions underlying the forward-looking statements contained in this document are set out in the Economic Developments and Outlook section on page 18 of BMO's 2020 Annual Report and updated in the Economic Review and Outlook section set forth in our Third Quarter 2021 Report to Shareholders, as well as in the Allowance for Credit Losses section on page 114 of BMO's 2020 Annual Report and the Allowance for Credit Losses section set forth in our Third Quarter 2021 Report to Shareholders. Assumptions about the performance of the Canadian and U.S. economies, as well as overall market conditions and their combined effect on our business, are material factors we consider when determining our strategic priorities, objectives and expectations for our business. In determining our expectations for economic growth, we primarily consider historical economic data, past relationships between economic and financial variables, changes in government policies, and the risks to the domestic and global economy. Please refer to the Economic Review and Outlook and Allowance for Credit Losses sections in our Third Quarter 2021 Report to Shareholders.

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Examples of non-GAAP amounts or measures include: efficiency and leverage ratios; revenue and other measures presented on a taxable equivalent basis (teb); amounts presented net of applicable taxes; results and measures that exclude the impact of Canadian/U.S. dollar exchange rate movements (i.e. constant currency basis or CCY), adjusted net income, revenues, non-interest expenses, earnings per share, effective tax rate, ROE, efficiency ratio, pre-provision pre-tax earnings and other adjusted measures which exclude the impact of certain items such as acquisition integration costs, amortization of acquisition-related intangible assets, impact of divestitures, reinsurance adjustment and restructuring costs. Bank of Montreal provides supplemental information on combined business segments to facilitate comparisons to peers.

Meny Grauman - *MD, Scotiabank Global Banking and Markets, Research Division*

We're back with the CEO of BMO, Darryl White. Darryl, good to see you again.

Darryl White - *Bank of Montreal - CEO*

Thank you for having us, Meny. It's nice to see you.

Meny Grauman - *MD, Scotiabank Global Banking and Markets, Research Division*

We don't have that much time, so I'm going to jump right into it. And first, I thought I'd start with a broader macro-ish question just in terms of what you're seeing from commercial clients or hearing from commercial clients on both sides of the border? Definitely, that's a key strength of yours, the commercial business. I'm just curious, given the Delta variant is in flux, what are your clients on the ground telling you? Do you notice them getting more conservative, hoarding more cash lately? Or is the recovery still very much front and centre in business owners' minds?

Darryl White - *Bank of Montreal - CEO*

Yes. I'd say, Meny, it's more of the latter than the former. I don't see a big distinction, I will say, off the top between the Canadian commercial client base and the U.S. commercial client base, which, as you know, is about equally sized for us. You often ask, and others ask, about whether there's a geographical distinction, not much. I would say the themes that our commercial clients are telling us, they're seeing an interesting and very helpful demand increase for their products and services. They're having reasonably, I won't say easy, but a facilitated time in terms of driving some price increases for their own products and services. So for us, it looks to a picture of better and improving credit quality.

At the same time, the growth outlook, I would say, is sort of cautiously optimistic, if I could use that overused term. And the way we see that manifesting itself is, if you look at our own commercial growth, Meny, linked quarter, as at, which we think is the best measure of current momentum in the marketplace, so end of Q2 to end of Q3, we saw a 3% lift in commercial loan balances. The first time we've seen that in many quarters, as you know. And that's the experience that our clients are bringing forward.

I think those trends are real, increased demand for their products, better pricing. It's allowing them to think more about investing. They're investing more in technology, particularly as it relates to automation, for example, as they try to address labour shortages. They'll lean in more on automation. They'll also look more carefully at M&A, so we're seeing M&A pipelines pick up, which provides financing opportunities as well on the one hand. And on the other hand, they're experiencing what you'd expect, they're experiencing challenges with labour costs and challenges with supply shortages.

So how does that all boil down and what does it add up to? I think that while the uncoiling of that spring perhaps is taking a little longer than many of us might have expected, I think the combination of that client experience and what we're doing in the meantime, which is adding capacity to our system. We are opening new businesses in commercial in places like Florida, Texas, Colorado, as recently as a couple of weeks ago, you put that capacity expansion together and higher authorizations, the uncoiling happens a little later, but when it comes, it happens a lot stronger than we would have forecasted as well. So you put it all together, we feel pretty good about it on both sides of the border, Meny.

Meny Grauman - *MD, Scotiabank Global Banking and Markets, Research Division*

I wanted to dig into two specific issues. When I speak to investors, this subject of margins and the subject of expenses come up. In both cases, it's kind of a nice problem to have because you've had such great success, such strong results in both drivers. And really, the question comes up, is it sustainable? How are you able to do it? So first, just maybe on the margins, definitely bucking the trends in Canada, but especially in the U.S. And so the simple question is, are you able to achieve those kinds of results, especially in the U.S., where your margins are actually up versus if you look across the peer group, down and sometimes quite substantially? So how does that happen at BMO? I mean how are you able to deliver that?

Darryl White - *Bank of Montreal - CEO*

Okay. You mentioned margins and expenses. You want to do margins first, and then we can do expenses?

Meny Grauman - *MD, Scotiabank Global Banking and Markets, Research Division*

Yes, please.

Darryl White - *Bank of Montreal - CEO*

So look, on NIM, I think the place that we all need to start is our approach and our philosophy on NIM is that we want to manage to stable margins over time within a range, as stable as we can. I think, Meny, the best place to look, it's difficult when you look at geographies or you look at segmentation to do comparisons because I believe that there are methodology differences between one bank to the next. I think it makes it pretty hard for you guys.

What I think is the best or closest opportunity to get to apples-to-apples is if you just look at total bank and you look at total bank ex trading because there, there's really nowhere to hide. Our track record since the beginning of COVID is we're down about 9 basis points through the period of Q1 of 2020 to the end of the quarter that we announced a couple of weeks ago. So down 9 net, by the way. We were down about 23 basis points, and we've recovered 14 of those 23, so we're net down 9. So that sort of achieves in large part our objective of trying to manage to a stable margin. That has outperformed our peers, as you pointed out.

Why is that the case? And do I think it's sustainable? Why is it the case -well, when we start with the premise that we want to manage as stably as we can, we have to look first, I think, the business mix. When you look at business mix, our commercial presence, where we're overweight relative to peers, matters a lot. I think you've heard me say before that 90% of our clients in the commercial book in Canada and the U.S. are either lead or sole relationships. So think about that impact on pricing on both the loan, and the deposit by the way, relative to, for example, businesses where you're effectively a commoditized price taker, we all are in some cases, or it's a syndicated multilateral negotiation as opposed to a sole or lead relationship. So there, I think we have a bit of an advantage on our margin management over time. And you pair that with, I think, some pretty effective dynamic hedging strategies and investment strategies, and we've come out in a pretty good place.

As I look forward on the way up whenever that comes, I think we've been pretty clear on where we think our sensitivity is. About 100 basis points on the way up would drive about $360 million of revenue for us. That puts us, we think, quite in the middle of the pack in terms of sensitivity on the way up. And there may be a little bit of upside to that depending on how long deposits stick around. So it's a good track record, and it's one that we expect to keep up.

Meny Grauman - *MD, Scotiabank Global Banking and Markets, Research Division*

So I think that's a good point because I think some people look at sort of the fact that you were less sensitive on the way down and say, okay, they're going to be less sensitive on the way up. But I think you've said it here and you've said it a few times before, that's not the case. And so I think that's an important point to highlight.

One thing I did want to ask before we move over to expenses is just, especially when I look at the U.S. business, just the tough comp that you'll have starting Q1 '22 in terms of that step-up in margin that you saw early this past year and lapping that. And so the question is, is that a headwind as you see it, as you move into 2022, in terms of the kind of performance we'll see out of the U.S. P&C business, in particular, but broadly speaking, for the bank as a whole?

Darryl White - *Bank of Montreal - CEO*

Yes. Look, let me just say off the top that tough comps are good things to have. It means we've done some things right in the past. So we'll take the tough comps. There will be some tough comps in a lot of businesses along the way, in particular in the area that you're referring to. Yes, look, we could, for sure, see some near-term NIM pressure. But over time, you've heard my answer, I think we're going to see an expansion over time in what the sensitivity is as we get there. And in the meantime, price times volume, right? We've got price. We actually really are consciously building capacity with bankers and new client acquisition.

We're building the capacity so while utilization rates are low, they will grow. And when they grow, they're going to grow off of a bigger base than we had when we went into the pandemic. So when we put it all together, never mind any particular quarter, but when I look out over '22, '23, I'm not worried at all about the delivery in our U.S. segment in particular. In fact, I think it will just continue to improve.

Meny Grauman - *MD, Scotiabank Global Banking and Markets, Research Division*

I want to switch gears to expenses because that's another area where your performance has been phenomenal. And the question just becomes, can it continue? So 7% operating leverage year-to-date, all bank efficiency ratio just over 56% for the year-to-date. I guess investors look at those kinds of numbers, the performance you've had on the expense side and just wonder is it a temporary blip? Is it a function of the restructuring charges that you've taken as recently as Q4 '19? Are you underinvesting in your business? So I was hoping you could address some of those concerns upfront.

Darryl White - *Bank of Montreal - CEO*

Yes. There's a lot in your question. So I think you have to consider that it's a work in progress, and it's a story that we started to talk about a few years ago. You pointed out where we are today, Meny, but if you look at the gap to peers, I mean, we have a pretty clear picture that we hold up in front of ourselves in all of our war rooms here. Our gap to peers peaked in 2018 at 700 basis points. So if you just took raw math, our efficiency ratio, we were around 62%. Then the peer group, as you know, was around 55%. And so we had a 700 basis point challenge in front of us. We called it out. So the first thing we did is we called ourselves out and we said, this isn't acceptable. You heard us 3 years ago at our Investor Day, say, we were going to target taking 400 basis points out of that and getting it down to 58% by 2021. We did that a year ahead of time. And so here we are today at 56%.

And so that gap to peers hasn't quite closed. We've taken about 700 basis points out -- sorry, we had 700 basis points to close. We have about 150 left relative to the peer group, by our math. So the first thing I'd say is we're not done yet because we don't really think there's a good excuse for having a gap to peers. So we think there's more opportunity there.

Having called ourselves out and having challenged it has really ingrained into our DNA. But I will remind everybody that the efficiency ratio isn't just about expense management. We've got a lot of other things going on as well. We think we've outperformed in many areas on revenue. So there's a numerator and there's a denominator. And we've been doing that by making investments. So I'll give you examples. Meny, you asked the question, are we investing as we're doing this. So I'd say, well, first of all, we are not anywhere near the lowest efficiency ratio of our peers. And so yes, we're continuing to invest despite having closed the gap.

Where are we investing? This year, in particular, year-to-date, despite the 7% that you quoted on our operating leverage, we have increased our technology investments this year by 8%. We've increased our marketing expenses by almost 40%, admittedly off a low base, COVID impacted. And we've increased our frontline specialty sales force investment by 15%.

So when I kind of look forward to the sustainability part of your question, I would say we've got a few things going for us. We've made those investments, so we're looking to hit the ground running in F'22 on revenues. Those investments are all driving revenue improvements. We still think we have that slight, not as big as it was, gap to peers with respect to the efficiency ratio itself. And the expense management that we've been delivering will continue. That's why we've made those commitments. May not happen every quarter with the positive leverage that we've been delivering. But over time, we expect to continue to deliver positive leverage.

And the last point is, we've said this before, but it bears repeating. There's the portfolio adjustments that we've made. When we announced the sale of our EMEA business, our GAM EMEA business, we said there's something like a 60 basis point pickup to the enterprise efficiency ratio from that. That hasn't closed yet. So there's a tailwind coming from that next year as well. We may reinvest some of that. We may not pull all of that to the bottom line, but we've got that opportunity as well. So that's kind of what gives me the confidence that the teams have been doing a great job. They've been doing the right things, and I think they've set us up for success going forward too.

Meny Grauman - *MD, Scotiabank Global Banking and Markets, Research Division*

I wanted to talk about the power of relationships in your U.S. franchise. You highlighted that a few minutes ago. You said BMO has the sole or lead relationship for 90% of its commercial clients, U.S. commercial clients, you mentioned that before. When investors hear that in Canada, they wonder how are you able to do that? The U.S. seems to be such a competitive commercial banking environment. How is that achieved?

Darryl White - *Bank of Montreal - CEO*

It's achieved the same way, Meny, in both countries. It is a differentiator for us. We've got highly -- I would say we have highly talented commercial teams. We're a place that people want to come to. We're hiring teams all the time from other places. And we continue to service the client in a way that -- think about it as universal bank servicing to a mid-market, mid-cap space. And that's a pretty attractive value proposition to the mid-cap, mid-market space in the U.S. So are we competing with the big money centres? You bet we are. But we're also competing with a lot of banks that don't have the same capabilities that we do when we're offering that as we grow the installed base of the franchise.

And it's not just about the loan and the deposit, right? For example, we're the only bank that has a cross-border, seamless integrated TPS, Treasury Payment Services, system. We're the only one that can do that for clients to help them with day-to-day needs and strategic needs. We're the only ones who can, for some parts of our marketplace, turn to them and say, we're going to give you what we call a Bank at Work offering, we're going to give a preferred offering to your employees. This is a commercial customer, for example, for our retail offering. And all of a sudden, we've got a better retail offering, we've got a more holistic client relationship.

Or we can bring subsegments of our U.S. market, don't have the capability, the competitive set may not have the capability to bring the capital markets option. So you actually don't have an ability to bring a hedge or a foreign exchange offering. We can do all of that. So that's my point on the universal banking model coming through into that mid-cap, mid-market space off of the relationship model that we've got. And that's what drives the 90% that I talk about. It's pretty attractive, and we like it. And if anything, we want more of it. That's why we continue to expand.

Meny Grauman - *MD, Scotiabank Global Banking and Markets, Research Division*

We'll talk about, hopefully if we have time, more about M&A later. But just in terms of the U.S. set of capabilities, is there any hole in those capabilities that you would like to fill? Anything obvious that you don't have now that you think is important to add to that U.S. franchise or that cross-border franchise more broadly?

Darryl White - *Bank of Montreal - CEO*

No, nothing in particular that I'd highlight, Meny, in the category of hole or deficiency because we try to run almost all of our businesses on a cross-border basis. So the integration of our North-South capabilities in personal business banking, commercial and capital markets and wealth is alive, and we continue to expand in really all of them. If you compare the outcome of that for us relative to 3 or 4 years ago, we were effectively offering our shareholders some form of a trade-off, right?

We were saying, we'll give you more growth out of our U.S. businesses, but it will come at some expense. That expense was lower returns or lower efficiency. Well, today, I've actually got that right in balance. You'll see in our investor presentation, our U.S. segment efficiency ratio is 55%. And I'm telling you our ROE profile of our U.S. segment is comparable to that, that we have at the enterprise or in Canada. So I'm not making the trade-off anymore. I'm able to go at those segments in the U.S., all of them and continue to grow them without diluting the overall outcome and the return to shareholders. That's a pretty attractive place for us to be.

Meny Grauman - *MD, Scotiabank Global Banking and Markets, Research Division*

We talk a lot about your U.S. business. But if I look at the Canadian P&C business, very, very strong results, peer-leading results over a number of quarters now through the pandemic. I guess the question is, help me understand what you're doing differently than peers from a strategic point of view? And how sustainable is the PTPP growth that you're putting up in that business? And again, that's peer-leading growth there. So how sustainable is that? And how are you achieving that?

Darryl White - *Bank of Montreal - CEO*

Yes. You'll see in our slides that -- I think our year-to-date PPPT in our Canadian P&C business is 14%. So it is pretty attractive. A lot goes into that. I talked earlier about our performance on margin management. I would also point though to investments that we've made. We've really increased our front-facing sales force. We are taking share in a lot of categories, including, not brokered mortgages, but proprietary mortgages, including cards, including many segments within personal.

And we have really started to up our game, I would say, on digital. So we are, we think, close to the top of the pack on digital sales. And we're increasing our transactions to somewhere in the 90% of service transactions now in digital. So we're able to deliver capacity, drive it into front-facing sales force, take our efficiency down and our ROE up. Our efficiency now is around 46%, a little below that, in fact. So we're below the average of our peers, which wasn't the case for us a couple of years ago. That's the personal and business banking story that I think is a real great story for us relative to perhaps moments in our past.

When I combine it with the commercial story that we talked about earlier, where we maintain our position as the #2 player in the market in commercial lending in Canada, drives pretty good outcome. So I think the teams have done a terrific job, and we're continuing to invest, as I said a moment ago, and I expect that we'll be able to continue to perform well.

Meny Grauman - *MD, Scotiabank Global Banking and Markets, Research Division*

I wanted to just follow up in terms of new client acquisition. Obviously, a key focus for all the banks really. At your 2018 Investor Day, you talked about the goal of adding, I think it was 1 million new customers by 2022. So just wondering if you could revisit that target, just talk about the strategy in terms of getting new customers in the door and how that's working?

Darryl White - *Bank of Montreal - CEO*

Yes. I guess I would say it's working very well given the environment. When we made that statement, we didn't have our -- we didn't have a pandemic in our forecast. I don't think anybody did. But I will say super round numbers where -- by the way, that was a commitment for 5 years. So it was a commitment to 2023. I'm not picking on your question, but it's relevant because we sort of see ourselves as at the halfway mark on that commitment today. So we ask ourselves, are we actually halfway to the 1 million customers? And the answer is, not quite. We're a little over 1/3.

When I lay that against the environment that we've been in, meaning switching is difficult in a pandemic, so is immigration, by the way. And we have strategies to be really strong, and we've always been very strong in immigration banking. So when you slow those down, it makes it pretty hard to get to the targets on time. But boy, getting 1/3 of the way there or more, given that backdrop, I think, is actually really impressive. So we see that not necessarily as behind, but a win, frankly, relative to the marketplace. And look, if it takes us another year or 2 given the slowdown that we've had from the pandemic, that will be just fine with me. I think the teams are doing a really good job there.

Meny Grauman - *MD, Scotiabank Global Banking and Markets, Research Division*

That's a good point on the pandemic. I wanted to talk about your excess capital position, which is very significant. And maybe start off really with a conceptual question. I mean by my math, you have about $5 billion excess capital, using 11.25% CET1 as a base. So I guess the first question is, is that the right kind of base that you're managing to?

And the second question is, if I think about that number, you could do a buyback -- you could buy back 5% of your outstanding shares, no problem. And the question is, why not do that? And so what else is in the background there as you consider how to deploy that huge amount of excess capital? I think you can call it huge that you have.

Darryl White - *Bank of Montreal - CEO*

Yes. So at 13.4% on our CET1, Meny, I'll just do a little bit of math and then I'll come around to the fundamental of your question. There, we're actually in the top half of our peer group. We're happy about that because we think it gives us lots of flexibility and degrees of freedom as we go forward. I think on the math, at 11.25%, we would actually be well through $6 billion of excess capital by our math. If you went down to 11%, for example, we would be through $7 billion of excess capital. So it's a little bit more than the number that you quoted.

But your point stands, and the question is relevant in any event, which is where does it go and what we're going to do with it. We've been pretty clear on this. We obviously don't make decisions until they're Board approved, but the direction is clear, which is when and if we see the restrictions lifted from a regulatory perspective, we would look first to increasing the dividend on the catch-up. And there, I'm guiding people to our historical payout ratio, which is 40% to 50% range. We were around 43%, just as an interesting data point on an LTM basis before the crisis hit. So look for us to target something around there, maybe day one, maybe a little later. But in any event, we've got a dividend catch-up to do.

And then you sort of say, all right, there's still, to your point, lots left over. What's going to happen? We've had the M&A question many, many times. I'll knock it off quickly. It hasn't changed. We're very interested. We look at a lot of things, but our discipline is unchanged. So we're not interested in chasing the wrong opportunity or the wrong price. If there was something that was right, at the right price, there we are.

But absent that then, the branch in your decision tree is, are we buying back shares? And the answer should be, yes, we would because we don't think it's appropriate to say to our shareholders we're going to sit on a bunch of excess capital for a year or two until something happens to come along. We think, no, rather, we should give it back to them in various forms reasonably quickly. And if we need to go back to them for capital at the right point in time, that's an efficient way to manage your capital structure. So that's our -- I hope that's helpful, Meny. That's our approach.

Meny Grauman - *MD, Scotiabank Global Banking and Markets, Research Division*

Yes. And as the clock ticks down, just digging in a little more in terms of potential acquisition questions. Just curious about how you look at acquisition in the tech space, in particular, in fintech? Is that an area where you would consider making a significant acquisition? And maybe a better way to ask the question, maybe more broadly, is, do you view fintechs as partners or competitors? Is it still to be determined? How do you see that playing out? And what could BMO's role be in terms of maybe bringing some fintechs into the fold? What's your perspective on that?

Darryl White - *Bank of Montreal - CEO*

Yes. Look, the answer to partners, competitors is absolutely yes, they're competitors, they're threats, they're partners. The ecosystem is very well developed relative to when this question would have come years ago. And an answer to where do you go with it is, we're wide open. So we're interested in buying. We're interested in investing. We're interested in partnering, and it's not a new thought. We've been doing it for years. If you look at the partnership that we've got with Google like Google Plex, you look at the partnerships, the marketing partnerships, that we've got with Bankrate, with NerdWallet, LendingTree, Lively, the list goes on. And in some cases, Secure Key, others, we've made direct investments. In some cases, we make partnership decisions. In other cases, we make competitive decisions. So our teams are wide open on this front, Meny, and the story will evolve. And I think we've all gotten better for it as an ecosystem.

Meny Grauman - *MD, Scotiabank Global Banking and Markets, Research Division*

Well, I think with that, that's all the time we have, as they say, but I want to thank you very much, Darryl, for speaking to me today and looking forward to seeing you very soon.

Darryl White - *Bank of Montreal - CEO*

All right. Good luck with the conference, Meny.

Meny Grauman - MD, Scotiabank Global Banking and Markets, Research Division

Thank you very much.
