Q4 2024 Conference Call

BMO Financial Group

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December 5, 2024 / 8:30AM, Q4 2024 Bank of Montreal Earnings Call

PRESENTATION

Christine Viau – *Bank of Montreal – Head of Investor Relations*

Thank you, and good morning. We will begin with remarks from Darryl White, BMO's CEO; followed by Tayfun Tuzun, our Chief Financial Officer; and Piyush Agrawal, our Chief Risk Officer. Also present today to take questions are Ernie Johannson, Head of BMO North American Personal and Business Banking; Nadim Hirji, Head of BMO Commercial Banking; Alan Tannenbaum, Head of BMO Capital Markets; Deland Kamanga, Head of BMO Wealth Management; and Darrel Hackett, BMO US CEO. As our call will end at 9:30, I would ask you to limit to one question during the Q&A to give everyone a chance to participate.

As noted on slide 2, forward-looking statements may be made during this call, which involve assumptions that have inherent risks and uncertainties. Actual results could differ materially from these statements. I would also remind listeners that the bank uses non-GAAP financial measures to arrive at adjusted results. Management measures performance on a reported and adjusted basis and considers both to be useful in assessing underlying business performance. Darryl and Tayfun will be referring to adjusted results in their remarks unless otherwise noted. I'll now turn the call over to Darryl.

Darryl White – *Bank of Montreal – CEO*

Thank you, Christine, and good morning, everyone. A year ago, we anticipated that higher interest rates and a slowing economy would present a more challenging environment for business activity, loan demand, and credit provisions. In response, we outlined a clear plan and took early action to dynamically manage our businesses including controlling expenses, while continuing to invest and support our customers. Against that backdrop, we delivered resilient operating performance.

At the same time, credit performance deteriorated more than we anticipated. Impaired loss rates exceeded our historical range, impacting our overall results with net income for the year of $7.4 billion and earnings per share of $9.68, both down from a year ago. We continue to prudently manage our portfolio and are working closely with clients that are facing challenges. We expect quarterly provisions to moderate through 2025.

Despite a challenging year, there is much to be proud of, including significant progress advancing our strategic priorities. Pre-provision, pretax earnings grew 5% to a record $13.4 billion with growth across all operating groups. We met our commitment to positive operating leverage in each of the last three quarters and for the full year at 1.6%. Our efficiency ratio improved by almost 100 basis points to 58.6%, with sustained cost discipline.

Across our businesses, we accelerated growth in our core customer base. We delivered more one client connected solutions that built loyalty and expanded client relationships, and we grew deposits by $61 billion or 9%. We successfully managed evolving regulatory expectations, including the transition to a Category 3 bank in the US.

Our CET1 ratio increased meaningfully by 110 basis points from last year to 13.6%, creating ample capacity to support our clients and return excess capital to our shareholders. These are all indicators of the strength and the health of our franchise. And this morning, we announced a dividend increase of $0.04 to $1.59 per share, a 5% increase over last year and our intention to repurchase common shares under an NCIB. Each of our business lines delivered good PPPT growth this year with momentum that is expected to accelerate performance going forward.

In Canadian P&C, PPPT was up 11%, with record revenue driven by good loan and deposit growth. We continue to grow market share in key categories, including deposits, mortgages, and credit cards, supported by a record year in net core customer growth and peer-leading checking and savings account acquisition. We're solidifying deep relationships through customer-centric onboarding journeys with nearly 50% becoming primary customers within the first six months.

U.S. P&C grew PPPT 4% as cost synergies more than offset the impact of market conditions on revenue growth. We've grown core retail customers across the country and in our Western markets, including California. We're successfully shifting the branch model to be advice-centric, achieving deeper customer relationships and higher mobile banking engagement, which is now driving above peer average checking account growth in California.

In North American Commercial Banking, we continue to have strong client loyalty scores across Canada and the U.S. and leading TPS capabilities driving deposit growth and deeper client relationships. The pace of referrals from the commercial bankers to other business lines doubled from the start of the year as we focus on bringing the best of BMO to all our clients. Our integrated online banking for business platform is a key driver of growth with an over 10% increase in active users this year.

In BMO Wealth Management, PPPT was up 10% and with good growth in client assets. We continue to strengthen our ETF offerings and mutual fund performance, driving strong net flows. Our first place ranking in the J.D. Power 2024 Canada Wealth Management digital experience study is a recognition of our focus on technology modernization and delivering innovative digital client experiences.

BMO Capital Markets grew PPPT by 7% in a mixed environment with strong trading performance, reflecting growth in our securitization business, while the M&A environment in Canada remained muted. We're seeing signs that market activity is now accelerating, and we're poised to build on our leadership position, including a number one position in U.S. Agency CMO issuance and a top two position in Canadian investment banking and ECM. Globally, BMO was recognized as the best Metals and Mining Bank of the Year by Global Finance Magazine for the 15th consecutive year.

Across our businesses, we advanced our digital first strategy, powered by AI data and technology modernization to drive tangible customer and business value. For example, BMO Insurance launched an AI-powered digital assistant designed to enhance the underwriting process for advisors, eliminate complexity and simplify the client experience. And we were recently recognized by the Digital Banker with five global retail banking innovation awards for leadership in digital innovation, customer experience, and delivery excellence.

We consider these outcomes as foundational assets that underscore the health of our franchise and the strength of our North American platform as we move with pace into a more constructive environment in 2025. Although risks remain from still restrictive interest rates, ongoing geopolitical tensions and potential trade protectionist measures, we're optimistic that Central Bank easing and expansionary fiscal policies will begin to set the stage for relief for Canadian and U.S. clients and support a moderate pickup in growth in both countries. This optimism is reflected in my recent conversations with clients.

Looking forward, our top priority is rebuilding return on equity to achieve our target of 15% over the medium term. We have a clear path focused on disciplined execution across four specific areas.

First, improved performance in our U.S. segment, including lower PCLs as we leverage our expanded scale and optimize our business mix. The weaker banking environment over the past 24 months in the US impacted our core performance with lower-than-expected business activity and balance sheet growth. We partially offset these headwinds by overachieving on cost synergies, and at the same time, we've made critical investments in the future. The U.S. remains an attractive growth market with a GDP more than 10x the size of Canada and an environment that is now set to perform well. With an advantaged position as a Top 10 US bank, we're executing on our strategy to compete in an improving environment. Revenue synergies are on track and building, benefiting from early one client successes. Our full run rate PPPT expectations are intact, and as we previously noted, delayed till the end of fiscal 2026.

We're also driving stronger results across the enterprise, including continued risk management discipline and improving market conditions, which will help deliver normalized PCL over time as we continue to manage appropriate risk return targets.

Next, delivering consistent positive all-bank operating leverage by focusing on core operating performance and execution of enterprise priorities.

And finally, disciplined balance sheet optimization by continuing to systemically allocate capital to fuel profitable growth.

We have a robust foundation for accelerating our momentum and delivering on the next phase of growth and ROE improvement. With strong risk and capital management as key enablers, I'm confident in our strategy to drive enhanced shareholder returns. Underpinning this involves our continued focus on attracting top talent as we are adding leaders and teams with deep expertise in key areas, including artificial intelligence and data, U.S. private wealth and U.S. commercial banking.

At BMO, employee engagement and winning culture are critical enablers to sustain business performance and advancing our purpose to boldly grow the good in business and life, and we're proud to have been recognized as one of the most admired corporate cultures in Canada by Waterstone Human Capital. I want to thank our employees for always putting the customer at the center and operating in support of the communities we serve.

I'll now turn it over to Tayfun.

Tayfun Tuzun – *Bank of Montreal – CFO*

Thank you, Darryl. Good morning and thank you for joining us. My comments will start on slide 9. Fourth quarter reported EPS was $2.94, and the net income was $2.3 billion. Adjusting items are shown on slide 39 and include a reversal of a legal provision, which increased net income by $870 million.

The remainder of my comments will focus on adjusted results. Adjusted EPS was $1.90, down from $2.93 last year, and net income was $1.5 billion, down 31% as good PPPT growth of 4% was offset by higher PCLs. Revenue growth, excluding insurance, which was impacted by the transition to IFRS 17 in the prior year, was 2%, with strong performance in Canadian P&C and Wealth and Asset Management, offset by lower results in Capital Markets. Expenses declined 2%. We delivered on our commitment of positive operating leverage for the third consecutive quarter in Q4 and for the full fiscal year and improved our efficiency ratio to 58.3%. PCLs increased $1.1 billion, which Piyush will speak to in his remarks.

Moving to slide 10. Average loans grew 5% year-over-year, excluding the impact of the RV loan portfolio sale and the wind down of the indirect auto book, driven by good growth in residential mortgages and business and government loans. Strong growth in customer deposits continued, with average balances up 9% from last year. Sequentially, term deposits were stable, and there was good growth in everyday banking and commercial operating accounts. In the US, total deposits were up 6% from last year and 2% sequentially.

Turning to slide 11. On an ex-trading basis, net interest income was up 3% from the prior year. NIM ex-trading of 190 basis points was stable compared with last year, and up 7 basis points from last quarter. In Canadian P&C, NIM decreased 3 basis points sequentially, primarily due to loan growth exceeding deposit growth. U.S. P&C NIM increased 5 basis points, primarily due to a sequential decline in loans, while deposit balances continue to grow. At the all-bank level, our Q4 margin benefited from discrete items in treasury and widened meaningfully compared to Q3.

Nevertheless, we are still projecting margin stability at this higher level with some upside potential in the latter part of the year, assuming the current forward curve plays out, and we maintain the benefits of higher longer rates. Together with balance sheet growth, we expect stronger growth in net interest income in 2025. In our P&C businesses, we continue to expect a stable NIM environment even as loan growth in excess of deposit growth pressures business margins.

Moving to slide 12. Expenses continue to be well managed, down 2% from Q4 last year, including a few one-time items this quarter. For the full year, Expense growth of 1% reflected the additional periods included for Bank of the West and AIR MILES as well as the full realization of both the Bank of the West, cost synergies and broader operational efficiencies.

As we look ahead to 2025, we expect year-over-year expense growth to be in the mid-single-digit range and still deliver positive operating leverage as we maintain our dynamic management of expenses relative to our revenue growth and continue to invest for growth. For the first quarter, similar to previous years, we expect to recognize the seasonally higher benefits and impact of stock-based compensation for employees eligible to retire, which we project to be under $300 million.

Turning to slide 13. Our CET1 ratio increased to 13.6%, which includes a 48 basis point benefit from the reversal of the fiscal 2022 legal provision and the associated lower operational risk RWA. In addition, methodology changes in the quarter offset the impact of credit migration on credit risk RWA. Our capital outlook remains strong and is expected to remain above our management target during fiscal 2025, including the impact of our projected share repurchases, pending regulatory approval.

Moving to the operating groups and starting on slide 14. Canadian P&C net income was down year-over-year as a result of higher PCLs, offsetting strong PPPT growth at 6% and positive operating leverage of 1.1%. Record revenue of $2.9 billion was up 5%, driven by higher net interest income, reflecting solid balance sheet growth with loans up 6% and deposits up a strong 10%. Non-interest revenue declined, reflecting the impact of the transition of bankers' acceptances to loans as well as lower card-related revenue. Expenses were up 4%, reflecting higher employee-related operating and technology costs.

Moving to U.S. P&C on slide 15. My comments here will speak to the U.S. dollar performance. Net income decreased due to higher PCLs. Year-over-year growth in PPPT of 2% was driven by lower expenses that offset the impact of lower margins on revenue growth, resulting in positive operating leverage of 2.2%. Loans were up 3%, excluding the impact of the RV loan portfolio sale. Commercial loans were relatively flat year-over-year and deposits were up 6%.

Moving to slide 16. BMO Wealth Management net income reflected year-over-year growth of 35% in wealth and asset management, offset by a decline in Insurance from the impact of the transition to IFRS 17. Wealth and Asset Management revenue was up 12% due to good growth in client assets and market appreciation more than offsetting lower net interest income. Expenses were up by 3% and as higher employee-related costs, including revenue-based expenses, were partially offset by our focus on operational efficiencies. With constructive global markets, we expect to see continued growth in net new client assets as we benefit from strong demand for our product offering and technology and talent investments made in the business.

Moving to slide 17. BMO Capital Markets net income declined year-over-year, primarily due to elevated PCLs. Revenue in Global Markets was down 1% as lower equity trading, including the impact of elimination of certain Canadian dividend deductions, was largely offset by higher rates trading. Investment and Corporate Banking revenue was down 6% due to markdowns on the held-for-sale loan portfolio and lower underwriting and advisory fees, partially offset by higher corporate banking revenue. Expenses were up, mainly driven by higher technology costs, partially offset by lower performance-based compensation. Under more constructive market conditions in 2025, we expect to deliver an average quarterly PPPT above $625 million in Capital Markets.

Turning now to slide 18. Corporate services net loss was $147 million compared with $180 million in the prior year as lower expenses offset lower revenues. In fiscal 2025, we expect higher retained expenses in corporate partially offset by a better trajectory for full year revenues than last year, resulting in higher net losses for the year. Because of the seasonal items, first quarter net loss should be the high point for the year.

In summary, in 2024, while credit provisions have not met our expectations, we delivered solid operating performance with good revenue and PPPT growth and met our commitments on positive operating leverage, while still investing in the business. As we look ahead to 2025, overall, our current view is that the performance drivers are constructive in all of our businesses.

In Canada, the momentum that we have on both sides of the balance sheet should result in similar loan growth trends that we have seen in 2024. We remain well-positioned to generate continued market share gains in our businesses.

In the U.S. our consistent PPPT growth demonstrates the strength of our operating performance. And now with the improving macro background, we expect to benefit from rising growth opportunities across our expanded footprint.

We expect these opportunities to result in stronger loan growth. One final comment on 2025 expectations. Our expectation is that the effective tax rate next year would be in the range of 24% to 25%, which includes the implementation of the global minimum tax. As we look to generate solid earnings growth next year, we are equally focused on delivering the outcomes in line with the progress that we need to make to return to our medium-term ROE targets. Across all of our businesses, resource deployment choices today are predominantly driven by this ambition, and we are confident that the strength of our franchise on both sides of the border will help accelerate our performance and support our progress towards achieving our medium-term targets.

I will now turn it over to Piyush.

Piyush Agrawal – *Bank of Montreal – CRO*

Thank you, Tayfun, and good morning, everyone. My comments will begin on slide 20. For the full year, impaired provisions were 47 basis points, which were higher than we expected going into this year, particularly in the wholesale portfolio. While interest rates were a source of headwinds, there were a combination of other factors, including vintage of origination, newer relationships, and larger hold sizes that combined with changes in consumer preferences contributed to higher losses. This quarter, consistent with my comments on our last call, provisions increased from the prior quarter. And while we expect provisions to remain elevated, we believe that Q4 represents a high point and will begin to moderate through 2025.

The total provision for credit losses this quarter was $1.5 billion compared with a provision of $906 million last quarter. Impaired provisions were $1.1 billion or 66 basis points, up 16 basis points from the prior quarter. Personal and business banking provisions increased $1 million in Canada and $4 million in the U.S. With current unemployment levels in Canada still elevated, I expect retail impaired losses to modestly increase through the first half of next year.

In commercial banking, impaired provisions increased $86 million in Canada driven by the services and retail trade sectors, and $63 million in the U.S. due to higher provisions in the office commercial real estate portfolio and services sector. Our U.S. office portfolio remains well-diversified, and our experience in this sector is in line with our expectations for the cycle. Capital Market impaired provisions increased $111 million, primarily driven by additional provisions taken on prior impairments, most of which have now been fully reserved. In addition, there was a new account in the mining sector relating to an environmental issue.

On slide 21, we provide additional information on our wholesale portfolio. We experienced further migration of accounts into watch list this quarter, primarily reflecting lower debt service coverage ratios. These clients receive heightened attention by management and our special accounts group as we proactively work with them to manage their financing needs. Overall, I remain confident in the quality of our wholesale portfolio with good diversification across industries and geography, and over half rated investment grade.

Moving to slide 22. There was a significant increase in performing loan allowance with a provision of $416 million, primarily reflecting both portfolio credit migration as well as the impact of higher than modeled loss rates that we have observed on certain impaired loans. The impact from credit migration is commensurate with the increase in the watch list where loans in Stage 2 attract a higher provision. We've now added to our performing allowance for 10 consecutive quarters and have good coverage of 62 basis points over performing loans. We expect to continue to build allowances in the coming quarters, although at a lower level than this quarter.

Turning to slide 23. Impaired formations increased to $2.2 billion across various industries. Gross impaired loans decreased to $5.8 billion and the GIL ratio decreased to 86 basis points as a result of higher write-offs.

Looking ahead to fiscal '25, we expect the client-specific challenges that we experienced this year to moderate and the overall portfolio to benefit from the impact of monetary easing and a more constructive business environment. Based on this environment, we expect impaired losses for the full year to be similar to the experience in fiscal '24 in the high-40s basis points with quarterly variability.

At the same time, we continue to monitor the downside risk in the environment including uncertain monetary fiscal and trade policies and unemployment levels. Given the strength of our risk culture, quality of our portfolio, and a prudent allowance coverage, we remain well-positioned to manage current and emerging risks. I will now turn the call back to the operator for the question-and-answer portion of this call.

Gabriel Dechaine – *National Bank Financial – Analyst*

Darryl, you're talking about a more bullish outlook, and I know why you're saying that. In the U.S. particularly, what are you seeing on the credit demand side of things, it's pretty early still for a turnaround, I imagine. How do you expect loan growth to evolve over the course of the year?

Darryl White – *Bank of Montreal – CEO*

I would define us as net bullish, and I say that because there are clearly some crosswinds. We don't know where we're going to land on the pace of monetary and fiscal change. But I will say that if you're asking about the U.S. in particular, there isn't any question that since the election, we've seen pretty broad-based optimism in our client base. When I say that, I think about asset classes and capital markets, I think about our commercial clients in the U.S. overall Noting that there are still some restrictive measures on the cost of capital as well as the threats that are out there with trade policies. But when I say net, I take all that into consideration, so net positive.

I think the second part of your question was around loan growth, we expect the market to be more constructive than it was in 2024 for loan growth, which is not hard because it's been pretty muted for quite a period of time in the U.S. Within that market, we expect to fully participate. I don't have a number for you. We're not going to put a number in the window today on what we expect loan growth to be, but we expect it to be positive, and we should fully participate in that given the strength of our platform.

Gabriel Dechaine – *National Bank Financial – Analyst*

For Piyush, the PCL outlook you gave us a decent sense of what to expect. But the messaging in Q3 was that we'd have high-50s or somewhere in the 60s on impaired over the next few quarters, and we got the mid- to high-60s this quarter. How do you expect the impaired loss ratio to trend over course of 2025? And is there a point at which you'll be releasing performing provisions? I know mechanically, you probably will. But if I look at your coverage ratio, I'm looking at the performing ACL to trailing 12-months impaired, it's still lower than where you normally would be.

Piyush Agrawal – *Bank of Montreal – CRO*

Two parts to the question, both around performing and impaired. Let me start with the impaired portfolio and the outlook we've given you. I guided us to elevated impaired losses in the next one or two quarters. I believe Q4 was a high point. And while it remains elevated as we end the year '25 in my guidance on high-40s, I'm also confident about the moderation from where we ended Q4 as we go into '25. And there's a couple of reasons for my confidence in the guidance I'm giving you today, and that starts with the amount of reviews we've done over the last three quarters and continue to do with our watch list and our formations.

'24 was a challenging year on credit, but it was overshadowed by a few large files. Those large files have now been resolved fully by the end of Q4, there are some of them that we work through. But overall, I will tell you the team has done a granular review. I have done a review myself on our top watch list as well as our top impaired, and it gives me confidence as we go in '25 that we should be climbing down from where we were at the end of Q4.

As it relates to the performing provision, we've been prudent. It's a rigorous process. But overall, right now, while you continue to see an increase from the negative migration, and we will have probably growth in '25, I call that the good cholesterol of why we will be building until we see some leading indicators of a change in the migration, I don't expect to release.
I will obviously give you guidance quarter after quarter as we go through, but I'm pretty confident about where we stand at the end of Q4 in our overall coverages.

Doug Young – *Desjardins Capital Markets – Analyst*

On the capital side, you put an NCIB in place. Just want to get a sense of your intentions. I think, Darryl, in your comments, you mentioned you want to keep the CET1 ratio above a management target. Can you talk about what that CET1 ratio target is? And can you also maybe just infer like what is the CET1 ratio target embedded in getting your ROE back to 15%?

Tayfun Tuzun – *Bank of Montreal – CFO*

Doug this is Tayfun, with a very strong 13.6% ratio at the moment, once we get all the approvals, which we expect to receive somewhere towards the end of the first quarter, probably, I suspect that given the delta between 13.6% and our management target of 12.5%, I suspect that the early on, it will be a bit heavier. But then we will pace the buybacks towards that 12.5% target depending upon loan growth, RWA growth and net income, et cetera. But that is the general approach and built into our medium-term ROE target accomplishment is that 12.5% management target.

Doug Young – *Desjardins Capital Markets – Analyst*

In the ROE waterfall to get back to 15%, you talked about capital optimization, I assume buybacks is a big part of that. What else is embedded in capital optimization? Is there further divestitures of businesses? Can you break out what else would be embedded in there?

Tayfun Tuzun – *Bank of Montreal – CFO*

Yes. The buybacks are part of that quantification. In addition to buybacks, there's clearly continued optimization of allocation of capital to businesses, the underlying client relationships. We truly intend to ensure that our existing relationships are meeting our profitability targets and our return targets at the client level. There's a significant effort in all of our businesses going through the portfolios.

We are also combing through all the portfolios and making sure that at the portfolio level, we are achieving our targets. At the moment, I can't tell you that there are any sizable exits that would require us to meet our medium-term capital targets. But if we do find them, we'll let you know, and we'll just be including them also in our capital optimization targets.

Doug Young – *Desjardins Capital Markets – Analyst*

A follow-up in terms of the business side, the optimization of capital within the businesses, is there any one particular business that you would point to that's more heavy on that side?

Tayfun Tuzun – *Bank of Montreal – CFO*

We're looking at all of them. There is no single focus. All four businesses are going through their relationships and their portfolios.

Matthew Lee – *Canaccord Genuity – Analyst*

On the slide you added on the return to 15% ROE. A big chunk of that is the category U.S. segment improvement. And I know you touched a little bit about loan growth, but maybe what are some of the other items that are included in US sector of improvement? Because that piece of the chart seems like a big kind of a big chunk.

Darryl White – *Bank of Montreal – CEO*

Matthew it’s Darryl, I'll take that. And it's possible that our colleagues running business might want to jump in with some examples. If you read the chart and pay attention to the size of the blocks, it's the biggest block, that's deliberate, just to point that out. That block does include the expected improvement in PCLs as the PCLs relate to the U.S. Segment, just to be clear. And then the next block that you see is the PCLs that are outside of the U.S. Segment.

There's a lot more than PCL improvement that goes into that segment and a lot more includes driving positive operating leverage through all of our businesses in the U.S. It includes taking a real hard look at our now positioning as a Top 10 bank and looking at how we compete in regional markets and it includes likely the allocation of resources to places where we have a right to win, where we compete in multiple business lines and where we can take share and grow profitably and cycle capital in the U.S., within the U.S. to compete more effectively across businesses.

We've got some actions that are sort of already in flight on these themes, and I'm just looking across the table here at Ernie and Nadim, if you want to jump in on any of these.

Erminia Johannson – *Bank of Montreal – Group Head, N.A. Personal and Business Banking*

I'll just follow up on the comment around the revenue growth for the retail side. Darryl alluded to the movement and the acceleration that we're seeing in the California and the Western markets. So part of this ROE rebuild is really to capitalize on that strong growth market. We have a proven retail playbook we use in a North American manner. That's paying out and proving to be accelerating even faster than we actually anticipated on some factors, in particular, digital engagement and digital sales, our sales team's productivity, having more holistic conversations with customers doing some really strong referrals to our wealth business, which supports our NIR growth as well.

That's part of the formula that we have. But the other piece is we're seeing our ability to build new products and capabilities in digital as a result of the scale we now have with about 1,000 branches. You can imagine, building something that has a fixed cost and then applying it to that kind of a size of market allows us to drive further revenue faster. Those are some of the plays that we have in hand. And as I said, we're seeing strong performance now and are closing the gap between what I would say is the performance of our Midwestern market and in our Western markets, which is exactly what the thesis was in our acquisition. Nadim, I'll turn it over to you.

Nadim Hirji – *Bank of Montreal – Group Head, BMO Commercial Banking*

What else is also included in the U.S. Segment, is what Tayfun talked about is particularly for the US segment is capital and funding optimization to redeploy capital from low-returning segments and clients to higher returning segments while maximizing risk-adjusted returns. That's also something to take into account in that box. And another one is the Bank of the West revenue synergies. This is still something that is to come, and it is coming. We're seeing great momentum. We're seeing good pipeline growth, good new client acquisition month-over-month increasing. And that is also a part of what you're seeing there in that box.

Darryl White – *Bank of Montreal – CEO*

More to come on this, Matthew, hopefully those were some good examples in the meantime.

John Aiken – *Jefferies – Analyst*

BMO strategically went to overweight on commercial. And with the experience of 2024 as well as what Piyush was talking about in terms of the watch list increasing, what are the expectations that you have for commercial growth through 2025? I guess where I’m going is, has the experience that you saw last year, is that tempering your appetite for commercial loans moving forward?

Darryl White – *Bank of Montreal – CEO*

John, thanks for the question, I'll just go back to a comment I made earlier, which is when we look at our commercial franchise, we continue to invest in that franchise. It is a leading franchise in Canada and in the United States. I think where you're going is growth going forward in light of the experience in '24. So It's a good question.

We would look to participate with the market. If the market is constructive next year, which we expect it to be, we would expect to be on market. If you look at the last year as an example, where it was muted. There was very little growth in the loan market in the U.S., for example, minus 1%, 0%. We're in that range. We're not very far above it. And I would expect that as we go forward and look at '25 to your question, you should see us move with the market. We're not trying to press ahead and grow at rates that far exceed the market nor do we expect to give up any market share.

Paul Holden – *CIBC World Markets – Analyst*

You gave some pretty good guidance on the Capital Markets PPPT. Just wondering if you can dig into the details a little bit more, particularly, we're hearing better pipeline investment banking, wondering specifically for BMO sort of in that mid-market PE space. What are you seeing there in terms of pipeline and indicated demand from clients, maybe that also funnels into commercial loan growth as well?

Alan Tannenbaum – *Bank of Montreal – Group Head, BMO Capital Markets*

Hi Paul, this is Alan Tannenbaum here. Thanks for the question. As Darryl indicated earlier, we've really seen a pickup in momentum across all of our businesses in the last 30 to 45 days. We saw some of this over the course of the past year, but it's really accelerated here. We're seeing it very broad based. Our trading businesses are very active. Our financing businesses are robust. What really has picked up, which you've touched on is both the M&A processes and activity levels from sponsors.

If you look back over the last couple of years, and we're all aware of the impact of higher rates on financial sponsor activity, which has dampened both M&A and equity issuance from that universe, we're definitely starting to see activity picking up, both pitches, processes starting, and filings. That is part of what gives us the optimism for the PPPT guidance for next year. We feel very good about the momentum.

Nadim Hirji – *Bank of Montreal – Group Head, BMO Commercial Banking*

I'll speak a little bit about the commercial. It's very similar to what Alan said, we are seeing pipelines grow. In Canada last year, we had reasonable loan growth and momentum building over the course of the year, and that momentum is continuing into the Q1 and Q2 of fiscal '25 with good pipeline growth. In the U.S., as Darryl mentioned, it was muted industry for loan growth. Customer sentiment post-election is positive. There is expectation of a pro-business environment and tax regime and lowering of interest rates. This is all positive, and that will work its way through the system. I fully expect loan growth. I think it'll be slower in the first half and probably faster in the second half of the year.

Ebrahim Poonawala – *BofA Securities – Analyst*

Piyush, following up on credit to address two more things. So heard your comments on PCL. Just to address two more things if you can. When we think about the formations, $2.2 billion this quarter, is that feel like based on the work you've done, we are at peak formations, assuming there's nothing that goes wrong with the macro, should we see that $2.2 billion begin to come down starting next quarter? How we should think about losses when you look at the net write-offs jumped quite a bit this quarter, just trying to get a sense of the loss content of these loans that are getting into impaired loans.

Piyush Agrawal – *Bank of Montreal – CRO*

When we look at both formations and the watch list in what's going on, it really is a proactive risk measurement sense to engage, our team of experts and special assets to work with our clients sooner. The way I've assessed the formations into impaired provisions. To give you an example, this quarter, we only took for an impaired provision on a handful of names. What that tells you is going back to our 30-year history of risk performance, we actually have a strong amount of collateral guarantees or covenants in these structures that did not warrant a provision going in.

It's very hard sometimes to give you a perspective of formations to provisions in any quarter. There will be variability. That variability is going to continue. That's what you've seen in the last year. And I've said this on calls earlier, I want to continue repeating that in terms of the variability expectation that our wholesale portfolio skew that we have present.

On the question of write-offs. The write-offs really is, I would say, good hygiene. You've taken the impairment provision. But when you have events, maybe a bankruptcy, a liquidation, or in some cases, a sale of a loan. And in a conservative or a prudent way, I would say, when we think the recovery is not in the short to medium term, even though we don't give up on that file, we take the write-off. It doesn't have a P&L implication, but it's just the right thing to do to take the impaired provision portfolio and take the write-off. And so that's what we reflected probably in a higher number in Q4.

Ebrahim Poonawala – *BofA Securities – Analyst*

Got it. And I guess maybe one for you, Darryl. You talked about optimism on the US outlook. I think there's a lot of optimism a year even on bank M&A in the U.S. As you've been acquisitive over the years in the U.S., give us a sense of given where the franchise is today with Bank of the West, the synergies on the comp, like should we expect BMO to be a participant in deal activity in the US bank M&A world picks up over the next three to six months? Or is 2025 more about just focusing on synergies tied to Bank of the West and think about M&A after?

Darryl White – *Bank of Montreal – CEO*

I'll give you a similar answer that I've given in the past, which is we always consider M&A as an avenue for growth. If you look at our U.S. trajectory over the last many. many, many years, 60% of our growth has been organic and 40% of it has been through episodic acquisitions. The antenna is up, but I will say in this moment, the priority as I look into '25, to your question, is making sure that we've got the flywheel turning well and properly on the ROE optimization exercise that we've talked to you about.

We've got capital to deploy organically for our clients first. Should something come along that makes sense that fits all of the criteria that we think about we would look at it, but that won't be our first choice right now. Our first choice is to drive back to the ROE performance that we've seen from our US businesses historically and reset the platform such that potentially if something subsequently comes along, we'll be in really good shape to be able to act. At this point, I'm trying to be really clear with you on what our priorities are.

Meny Grauman – *Scotiabank – Analyst*

This question is maybe for Darryl or Piyush. Now that you have more confidence around the peak in credit. I was hoping we could revisit your thoughts or lessons or takeaways from this credit episode? It definitely surprised the Street. And just wondering what you draw from this in terms of in terms of lessons going forward?

Piyush Agrawal – *Bank of Montreal – CRO*

Three quarters, of course, provides a lot of learning. From a risk management perspective, we've always gone back and seen what things can be put back into our risk practices across given the strong risk culture we have. We've talked about the interest rates and how that was an impact to probably many clients. But really, in our hindsight, we've picked up in our broad growth.

I think there were some segments of clients that we onboarded in that vintage around '21 and with larger holds, that did not play to our advantage that were the cause of the big losses in '24. I think from there onwards and the guidance we've given to the teams working with Nadim and Alan and the other business heads, we've got an improved process or an enhanced process in many of the areas, whether it is client selection or due diligence, whether it is our risk underwriting criteria, they hold.

Also how much we risk mitigate at inception rather than keep on our books. Those are regular, I would say, par for the course. I'm glad that the teams we work together, both first and second line. And I think that's what you should expect from us, especially with the hindsight of the quarters that have gone by.

Meny Grauman – *Scotiabank – Analyst*

As a follow-up, I think initially, when we saw this credit issue tick up, there was a fear that it might negatively impact growth expectations going forward in the US in particular. From your commentary, it doesn't sound like that, obviously, the environment in the U.S. has changed for the better. I just wanted to confirm that in terms of how this experience will or will not impact the growth outlook going forward for years?

Darryl White – *Bank of Montreal – CEO*

Meny, it's Darryl. I mean you've heard my comments. You've heard Piyush's. As you know, we've got a substantial commercial franchise in the U.S. and a capital markets franchise in the US. So I'd invite Nadim or Alan to jump in on the question of tension between managing risk and growing with the market at the same time.

Nadim Hirji – *Bank of Montreal – Group Head, BMO Commercial Banking*

I would just start by saying in Canada, as you see our loan growth, we've been participating well in the market. We're market relevant and the pipelines continue to grow, and we will move forward with that in '25. In the U.S. as Darryl had talked about earlier, the entire industry saw the muted loan growth. We were minus 2% for the quarter. The range was between minus 1% and 3%. And for the year, we were flat.

Everybody else was pretty much down about 1% or 2%. So we're right in the range. With the customer sentiment improving, we do think the loan demand will come back and our risk appetite is there to grow. It's not a balance sheet-led strategy though. We are here to grow ROE and risk-adjusted returns and optimize our balance sheet and capital, which is what we'll do. But we'll do that deliberately and we will grow the balance sheet as we do.

Darko Mihelic – *RBC Capital Markets – Analyst*

Piyush, with respect to the learnings and everything you laid out for us in terms of trying to help us assess what went wrong. Can you help size this for us? for example, if it's the 2021 vintage, there were higher hold levels at that time, what's the impairment of that portfolio, the size of that portfolio and how should we think about the comfort level going forward? And I say this from a position of knowing that last year, you were comfortable going forward with credit quality. Can you maybe size us that vintage side, the hold size that went wrong and how that's working through the system today and why that gives you comfort?

Piyush Agrawal – *Bank of Montreal – CRO*

Darko, thank you for that question. We ended the year at 47 basis points. A large part of that, as you know, was geared towards our wholesale portfolio. What I would just say within the wholesale portfolio, about half of the losses was geared towards this '21 vintage with a larger size.

My confidence today is because of the amount of work the teams have done parsing through that portfolio size, the expected loss on the general portfolio is in line with our long-term experience, the expected loss, which I have called unexpected and some of the larger files is what drove a higher loss vintage in this.

As I come into the call today, like I have every time, given the amount of work we've done, my goal is to give you the best estimate of where we are in the environment with the portfolio we have and the clients we have and hence, having resolved a large number of those vintages with the losses we've taken in Q4, I'm giving you guidance around the moderation.

Now remember, the high-40s is yet elevated from a long-term average, but it is moderating down as we continue to parse through that book and get it to year-end '25. Of course, as things change and when they change, I'll come back and give you my best guidance.

Darko Mihelic – *RBC Capital Markets – Analyst*

Okay. And the 2022 vintage, why is there no concern with that vintage of loans?

Piyush Agrawal – *Bank of Montreal – CRO*

There is some, but again, those names have been factored in. They're not the same size of the '21. There's nothing thematic around '22 that I can start to pronounce '22 as a problem. The bigger loans, the higher amount of losses came from '21, and that's why I've called those out for you.

Lemar Persaud – *Cormark Securities – Analyst*

For Piyush. I think last quarter, you suggested it felt like I think Q4 and Q1 losses could be the peak. And then we move back towards the long-term historical average as we move through 2025. I think that number was the mid-30s. Correct me if I'm wrong on that one. I'm just trying to figure out how you're thinking about the trajectory in getting to that high-40s guidance. Does it feel like towards the end of 2025, moving back to that historical average as possible, exiting 2025?

Piyush Agrawal – *Bank of Montreal – CRO*

One of the hardest pieces of the guidance really is to predict timing of the quarter of when these losses happen. I have more confidence in the year than I have in any given quarter, and you've seen that in our Q4, where some large files can really skew the difference and take you up a couple of basis points.

While we see us moving towards a long-term average towards the end of '25, early '26, a lot is dependent on the environment and the timing of when these losses will take place. We are seeing, for example, certain recoveries in certain files. At the same time, we are working through some large files. There's a mix of those, which will keep the quarters variable. I'm not going to give you quarterly guidance of when this will happen. But I think the way the portfolio is shaping up and our own practices we put in place, we should get to our long-term averages towards the end of '25 and '26.

Lemar Persaud – *Cormark Securities – Analyst*

I appreciate that. And then just on these questions involving the vintages of 2021, 2022 vintages, and so on. Was there a change in management or something under the hood that you guys made a determination that something needed to be changed in terms of these holds? Like was there any change or epiphany that you guys had that that made it clear that you had to change how you are managing the business post 2021?

Darryl White – *Bank of Montreal – CEO*

It’s Darryl, I’ll take that Lemar. Was there a change in management? No. When we look back to that vintage, but there was clearly for a period of time, a change in practice. You've heard Piyush a couple of times refer to larger hold sizes, for example, with new to BMO clients. And as he said, in hindsight, the client selection as a result of that wasn't exactly ideal.

As far as change is concerned, I can tell you that change has now occurred. As we look at the way we underwrite to similar circumstances today, if I were to do like-for-like, the outcomes that we will produce out of today's vintage and last year's vintage and probably the year before that as well, will be different from the vintage that we're focusing on in the conversation today. I hope that’s helpful.

Darryl White – *Bank of Montreal – CEO*

I do want to leave you with three key messages today.

Firstly, as you heard today, we do believe that our credit is contained and while losses are currently elevated, we do expect the moderation that we've talked about today through 2025.

Secondly, our confidence in the business outlook. While there are some crosswinds, we're net confident in the U.S. and otherwise. And that's underpinned by the decisions we've made with respect to dividend increase and normal course issuer bid today.

And thirdly, we've got a clear path to rebuilding our ROE to the 15% that I've talked about over the medium-term. So with that, I wish everybody a happy holiday season, and I look forward to speaking with all of you again in the new year.