BMO Financial Group

Bank of Montreal to Acquire General Electric Capital Corporation's Transportation Finance Business Conference Call

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PRESENTATION

Sharon Haward-Laird ***- BMO Financial Group - Head of Corporate Communications and IR***

Thank you very much.

Welcome everyone and thanks for joining us today. We are pleased to have this call to discuss this afternoon's announcement. We will begin the call with remarks from Bill Downe, BMO's CEO; Tom Flynn, the Bank's Chief Financial Officer; and Dave Casper, President and CEO of BMO Harris Bank and Group Head, Commercial Banking. Also with us today is BMO's Chief Risk Officer, Surjit Rajpal.

I would note that some people are traveling and they're joining us on the phone. We could have a slight delay before they answer some of the questions. After our comments, we will have a short Q&A period where we will take questions from pre-qualified analysts. To give everyone an opportunity to participate, please keep it to one question and then re-queue. The call will last for 30 minutes.

On behalf of those speaking today, I note that forward-looking statements may be made during this call. Actual results could differ materially from forecast projections or conclusions in these statements. Additional information on factors and assumptions related to forward-looking information can be found in our annual MD&A.

With that said, I will hand things over to Bill.

Bill Downe ***- BMO Financial Group - CEO***

Thank you, Sharon.

I appreciate that some of you may have had only a short time to review the materials on the announcement. And I apologize that we're delayed a little bit in starting because of travel, but I thank you all for joining us.

Today, we announced an agreement to purchase General Electric Capital Corporation's Transportation Finance business. This acquisition builds on our position as a market leader in commercial banking in both the United States and Canada. The Transportation Finance business has many of the characteristics of other segments in which BMO has proven capability. Given our strong capital position, we have the flexibility to take advantage of this unique opportunity to grow our commercial customer base.

BMO has been a disciplined acquirer over time, assessing each potential acquisition against the same criterion: is it a good fit from a strategic, financial and cultural perspective? The acquisition of GE Capital's Transportation Finance business meets each of these criteria. The transaction will further our strategy in the U.S. by adding a leading franchise with a differentiated business model, driven by superior systems and underwriting capabilities.

The transaction economics, which Tom will speak to in a moment, are attractive and, importantly, there's a good cultural fit grounded in the commitment to delivering a superior customer experience. We look forward to welcoming GE's customers and the teams who serve them to BMO later this year.

And with that, I'll turn the call over to Tom.

Tom Flynn ***- BMO Financial Group - CFO***

Okay. Thank you, Bill. And good afternoon, everyone. I'll make some brief comments reviewing the details of the transaction as outlined on slide 3.

As Bill said, we are acquiring GE Capital's Transportation Finance business. The transaction is structured as an asset purchase, with net earning assets of approximately $11.5 billion, or USD$8.7 billion as of June 30, 2015. The final consideration for the transaction will be based on the net earning asset balance on closing, plus a premium. Using the June 30 balances, approximately 90% of the assets were in the U.S. and the remaining 10% in Canada.

In addition to acquiring the earning assets, approximately 600 employees will be joining BMO from GE as part of the transaction. The economics of the transaction are sound. We expect the transaction to add approximately 3% to total bank adjusted net income and to have modest EPS accretion immediately.

I note that adjusted figures exclude one-time costs in the amortization of intangibles. The goodwill and intangible number for the transaction is approximately $450 million and this includes the impact of a credit mark of approximately 1.25% of assets.

With respect to capital, we expect the acquisition to reduce our Basel III Common Equity Tier 1 ratio by approximately 70 basis points. The 70 basis points incorporates the estimated growth in assets relative to the USD$8.7 billion balance at June 15 to close.

Given normal growth in our capital, we would expect the CET 1 ratio of approximately 9.9% for Q1 after closing the transaction. The transaction will be funded using existing balance sheet liquidity, additional deposits and some wholesale funding. In addition, our funding strategy includes a reduction of our U.S. Personal and Commercial Indirect Auto Lending portfolio over the next few years.

The yields on the Indirect Auto portfolio are lower than on the acquired portfolio and so we view this as an attractive repositioning of the balance sheet. The transaction is expected to close during Q1 of our FY2016 and is subject to customary closing conditions.

And with that, I will hand it over to Dave.

Dave Casper ***- BMO Financial Group - President & CEO, BMO Harris Bank and Group Head of Commercial Banking***

Thanks, Tom.

We are very pleased to announce this agreement to purchase GE Capital's Transportation Finance business today. As Bill said, this is a leading franchise, led by an exceptionally strong management team that allows us to build on our recognized leadership in the commercial banking space. I want to take a few minutes and talk to you about the business that we are acquiring and what the transaction means for our U.S. P&C business.

Turning to slide 4: as you know, BMO has a proven strength in commercial banking across North America. We've had great momentum in our U.S. business over the last few years, with 13 consecutive quarters of double-digit year-over-year growth in our C&I loan portfolio.

We've also had very good growth in the deposit side of our business and this quarter, our commercial deposits were up 9%. This growth has resulted in good financial performance with year-to-date net income up 11% from last year in our source currency and up 26% in Canadian dollars.

Turning to slide 5, GE Capital's Transportation Finance business is the largest financier to the truck and trailer segment in North America. It operates across a very broad North American footprint that fits quite nicely within our existing U.S. business and leverages our strength in commercial banking.

This is an established book of business with consistently strong financial performance and good credit quality. Its differentiated and leading business model is built on strong industry knowledge, superior technology and long-standing, diversified customer relationships. Of the business' USD$8.7 billion in assets as of June 30, 2015, about 83% of these are loans and 17% are leases. About 90% of the business and the assets are in the U.S., well diversified across the states. The remaining 10% are in Canada.

We are very pleased that the premier management team in the transportation finance industry, along with approximately 600 employees who have built this business, will be joining BMO Harris. Relationships are extremely critical in this business and the management team, led by Dan Clark, has built this business, customer by customer, throughout the supply chain from the manufacturers to the dealers and ultimately, to the end user. This has resulted in a very good business.

The addition of this portfolio will enhance the profitability and improve the efficiency of our U.S. P&C business. These loans have a higher margin than the average of our existing portfolio so we expect to see an improvement in our overall margin as a result of this acquisition.

If you turn to slide 6, BMO's existing transportation portfolio represents approximately 1% of our total loans. With the addition of this Transportation Finance portfolio, the transportation sector will represent approximately 4.5% of BMO's overall loan portfolio without significant overlap. We will maintain the strong underwriting standards that have characterized this portfolio through time.

And most importantly, we will maintain our focus on delivering a superior customer experience to support both the current customers and the future growth of this business. Looking ahead, I am very excited about the opportunity this business brings to further strengthen our North American Commercial Banking business.

And with that, I'd like to turn it back to Bill.

Bill Downe ***- BMO Financial Group - CEO***

Thanks, Dave.

Well, to sum up, the portfolio represents an attractive enhancement to BMO's U.S. Personal and Commercial Banking business. The products are consistent with our current strategies. The economics of the transaction are attractive, making it a good strategic, financial and cultural fit.

And with that, I'll turn it over to the operator for the question-and-answer portion of today's presentation. Thanks.

QUESTION AND ANSWER

Operator

The first question is from Robert Sedran from CIBC.

Robert Sedran ***- CIBC World Markets - Analyst***

Hi, good afternoon. Tom, I may be missing something obvious here but what is the difference between 3% additive to net income and only modestly accretive to EPS?

Tom Flynn ***- BMO Financial Group - CFO***

That's actually a good question. The 3% number is relative to our adjusted income. EPS is obviously taking that and dividing by the share count.

And we use the word modest in describing EPS because some of the analysts, when they project EPS, incorporate a level of buyback. And so there's not a significant difference between the accretion to EPS and the impact on net income but the number is a little bit different just because of the buyback impact.

Robert Sedran ***- CIBC World Markets - Analyst***

So you talk about modestly accretive in your numbers, and we may have been assuming some level of buyback. That's the only difference.

Tom Flynn ***- BMO Financial Group - CFO***

That's correct.

Robert Sedran ***- CIBC World Markets - Analyst***

And in terms of that credit mark, just curious, assuming it's conservative, maybe not M&I conservative, how will that be treated on the way back into earnings? Have you given any thought to that yet?

Tom Flynn ***- BMO Financial Group - CFO***

We haven't fully decided on that but I think the key point is the comment you made around the size of the M&I mark versus this mark. The portfolio is very significantly smaller and so the transaction accounting impacts are much smaller. We would not at all expect them to have the same impact on our results as the M&I credit mark, in particular.

Robert Sedran ***- CIBC World Markets - Analyst***

Okay. Thank you.

Operator

Thank you. The next question is from Meny Grauman from Cormark Securities.

Meny Grauman ***- Cormark Securities - Analyst***

Hi, good afternoon. I just wanted to ask about potential synergies from this deal and are there any expense savings that are available there and on the revenue side? Are there any possibilities to do more business with those clients that you've contemplated?

Tom Flynn ***- BMO Financial Group - CFO***

I'll comment on the expense side. The answer is we don't really see any significant expense synergies in the transaction. There are some but they're inconsequential and that really reflects the fact that we're buying a business that we think has attractive growth opportunities and adding it onto our existing operations. So the expense savings are not a significant part of the story.

I will ask Dave to comment on the revenue side.

Dave Casper ***- BMO Financial Group - President & CEO, BMO Harris Bank and Group Head of Commercial Banking***

Well, we have many good ideas and the management team has some good plans to continue to grow this business. And we think by being on the BMO platform, there will be opportunities that may not have been available on the GE platform. We don't have a lot baked into this but the management team will be looking particularly where there are good cross-selling opportunities and we think there will be some.

Meny Grauman ***- Cormark Securities - Analyst***

So the Canadian side of this business will continue to be managed out of the U.S. as well?

Dave Casper ***- BMO Financial Group - President & CEO, BMO Harris Bank and Group Head of Commercial Banking***

Well, the Canadian part of the business is a very important part of this business and it has Canadian leadership, which will continue. That would report in, as it does now and to Dan Clark, who runs business and will run this business for us.

Meny Grauman ***- Cormark Securities - Analyst***

Thank you.

Operator

Thank you. The next question is from Sumit Malhotra from Scotia Capital.

Sumit Malhotra ***- Scotiabank Capital - Analyst***

Thanks, good afternoon. Tom, just to go back to the 3% benefit to net income - I missed some of it at the beginning. Is that your forecast for how much the acquisition will boost your 2016 earnings?

Tom Flynn ***- BMO Financial Group - CFO***

We're really taking the earnings that we expect from the business and giving an approximate number so it's approximately 3%. And so I would think of that in terms of being on a quarterly income number of around $1.2 billion on an annualized basis.

Sumit Malhotra ***- Scotiabank Capital - Analyst***

I guess I come to this maybe being a little bit too fine-tuned for the short term. Now obviously, this business, from what you're telling us, will only be in for three quarters of the year but your estimate there is a full-year number?

Tom Flynn ***- BMO Financial Group - CFO***

That's correct. That's an annualized number.

Sumit Malhotra ***- Scotiabank Capital - Analyst***

And then the second part of it, that's a net benefit to income, i.e., taking into account any funding cost or any debt cost that would be associated with the purchase?

Tom Flynn ***- BMO Financial Group - CFO***

That's correct. It's net of the funding and so it reflects a fully funded balance sheet as well. As I said during the comments, as part of the funding but also a balance sheet repositioning, we do plan on reducing a portion of our Indirect Auto portfolio over time. The spreads in our portfolio are lower than on the acquired portfolio but there is a bit of a negative revenue impact from that decision, which we think is a good economic one, and that is baked in as well through the net number.

Sumit Malhotra ***- Scotiabank Capital - Analyst***

You offered us -- or Dave did -- a measure he was referring to, loan yields, or the aggregate net interest margin is better in this business than it is in your existing U.S. P&C business. I'm hoping to put a little bit more meat on those bones, so to speak, so 3.45% is the level you've been trending at in the U.S. Where would you guide us to this portfolio that you're adding? Is it from a similarly funded NIM perspective?

Tom Flynn ***- BMO Financial Group - CFO***

Yes, so a couple of things there. The NIM number that you're referring to is, I think, the net interest margin on our total U.S. P&C segment. And that obviously reflects a blend of the commercial spread, the personal spread and importantly, the deposit spreads.

In our asset yields, we typically, on average, would be somewhat lower because the NIM reflects the spread on the deposit side as well. I would think of the yield on this portfolio as being pretty consistent with the overall NIM on the business, so not significantly different from the overall NIM. But again, that NIM as reported for the segment benefits from the deposit spreads.

Sumit Malhotra ***- Scotiabank Capital - Analyst***

And last one around the same lines. Going back to what Rob was asking in terms of the credit mark - from what you were describing, the credit quality of this portfolio has been quite good so the two part question is, where is the loan loss experience for this business in 2015? And if it's as good as I'm thinking it is, why is a credit mark required?

Tom Flynn ***- BMO Financial Group - CFO***

Well, I guess a couple of things. We're very comfortable with the credit portfolio. It fits within the risk appetite.

The current loss rate on the portfolio is around 25 basis points. The credit mark is required as a part of normal portfolio acquisition accounting so there is no discretion there. And we think the mark that we've taken is a prudent one in the context of the nature of the portfolio and the transaction as we see it.

Sumit Malhotra ***- Scotiabank Capital - Analyst***

Thanks for your time.

Operator

Thank you. The next question is from Darko Mihelic from RBC Capital Markets.

Darko Mihelic ***- RBC Capital Markets - Analyst***

Hi. Thank you. Good afternoon.

No mention of ROE accretion. I'm just curious as to why that might be?

Tom Flynn ***- BMO Financial Group - CFO***

The transaction is accretive to ROE and we didn't put a number in. We don't put every number in the deck but there is, I would say, modest accretion to ROE.

The ROE, as you know, is based on a big number, the size of the book value. It's hard to move that number significantly with any single transaction but it is accretive to the ROE as it to the EPS.

Darko Mihelic ***- RBC Capital Markets - Analyst***

Okay and just to clarify then just the finer point. In an earlier answer, you suggested that there was an assumption of a buyback. This transaction has not really altered the previous assumption of a buyback. Would that be a fair statement, Tom?

Tom Flynn ***- BMO Financial Group - CFO***

I wouldn't quite put it that way. We wanted to give a sense of the size of the business and so the 3% earnings number, as an approximate number, provides that. The accretion is in the same zone but slightly lower because there is some buyback benefit that's incorporated into the street EPS estimates. And so given the capital impact of the transaction, we will be on pause for a period of time with the buyback.

You've seen us over time build capital, have a buyback program, and do acquisitions, pause on the buyback and then put it back on when it makes sense. And so I wouldn't be incorporating the buybacks you had plus the transaction. But we're delivering what we think is good accretion with the transaction in any event and relative to what we think people had in their numbers, again, which incorporated a level of buyback activity.

Darko Mihelic ***- RBC Capital Markets - Analyst***

That's great colour. I appreciate that, Tom.

And just lastly, this was an auction process I'm presuming. Can you clarify, I mean, the length and time of this auction process and were there any soft qualitative factors that helped you win the bid?

Tom Flynn ***- BMO Financial Group - CFO***

I don't think I'd comment on the process itself. This asset clearly is one that is a part of the process that GE is going through with its GE Capital business and they have provided significant disclosures around that. We have been working on it for period of time and certainly had adequate time to do the due diligence that we felt we needed to do.

And then on the softer side point, the only thing I would say is that we do think that we were an attractive acquirer here, in part, because our intention is to largely take the business in its current form, add it to our business and let them grow it over time. And for employees who are part of any transaction, that is the best outcome there can be because they get to continue doing what they like to do and we provide an opportunity for them to do that.

Darko Mihelic ***- RBC Capital Markets - Analyst***

That's great. Thanks very much, Tom.

Operator

Thank you. The next question is Peter Routledge from National Bank Financial.

Peter Routledge ***- National Bank Financial - Analyst***

The first question, I guess, for Dave, you mentioned the GE management team. What retention clauses are in the agreement?

Dave Casper ***- BMO Financial Group - President & CEO, BMO Harris Bank and Group Head of Commercial Banking***

Well, I wouldn't comment on that specifically. This really is the premier management team.

We spent a lot of time, as much as we were allowed during the process, and they will all be part of this. They want to be part of it, as Tom said, and they want to continue to grow the business. I'm confident that they will lead it and do very well for us.

Peter Routledge ***- National Bank Financial - Analyst***

So I guess without retention where it could be they'd walk out the door.

Dave Casper ***- BMO Financial Group - President & Harris Bank and Group Head of Commercial Banking***

As I just said, I wouldn't comment on any retention. Other than to say we are very confident that they are part of this and they want to be part of it and will be.

Peter Routledge ***- National Bank Financial - Analyst***

I'm not sure if Darryl is around but I wonder if there are opportunities for BMO Capital Markets that might come out of deeper relationships with these clients?

Tom Flynn ***- BMO Financial Group - CFO***

It's Tom. I'll take that. Darryl isn't on the call. I would say there's the potential for that but unlikely to be significant and we didn't reflect any potential from that in our economics.

Peter Routledge ***- National Bank Financial - Analyst***

Okay, thanks.

Operator

Thank you. The next question is from the Mario Mendonca from TD Securities.

Mario Mendonca ***- TD Securities - Analyst***

Good afternoon. Tom, I got on the call late so forgive me if you've answered some of these.

The purchase price, I see net earning assets of $11.5 billion, goodwill of $450 million. Does that mean the entire purchase price is about $11.95 billion or is there some other math in here I'm missing?

Tom Flynn ***- BMO Financial Group - CFO***

The only other part of the math is that those numbers are June numbers and we expect to close during Q1 and so the portfolio will grow to close. It could increase by up to another $1 billion in asset size.

Mario Mendonca ***- TD Securities - Analyst***

Okay, so maybe this is $13 billion, all in, but very rough numbers.

Tom Flynn ***- BMO Financial Group - CFO***

That's correct.

Mario Mendonca *- TD Securities - Analyst*

Okay and then you also made reference to the effect on capital, the 70 basis points. Did you talk at all about where you expect the Basel III Common Equity Tier 1 ratio to be at about that time?

Tom Flynn *- BMO Financial Group - CFO*

We did. In the remarks, what we said is that the impact is approximately 70 basis points. We expect to close in Q1 and given normal growth in the ratio through time, we would expect to be at approximately 9.9% in Q1 post-close.

Mario Mendonca *- TD Securities - Analyst*

Okay, and then finally, the reference to the 3% accretion. I've looked at the presentation and the press release, and I haven't found that yet. Did you just offer that in your commentary?

Tom Flynn *- BMO Financial Group - CFO*

Well, we do say in the deck that it's immediately accretive and the 3% colour we provided on the call.

Mario Mendonca *- TD Securities - Analyst*

And that 3% was before the effect of taking a buyback so it's something less than 3%, I guess, is what you're telling me?

Tom Flynn *- BMO Financial Group - CFO*

Marginally, yes.

Mario Mendonca *- TD Securities - Analyst*

Understood. Thanks again.

Operator

Thank you. There are no further questions registered at this time. I'll turn the meeting over back to Ms. Haward-Laird.

Sharon Haward-Laird *- BMO Financial Group - Head of Corporate Communications and IR*

Thank you very much and thanks for everybody joining us on short notice. We appreciate it. If there are any further questions, we'd be happy to take them in Investor Relations. Have a great afternoon. Thank you.