Laurentian Bank Quarterly Results Conference Call

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CORPORATE PARTICIPANTS

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PRESENTATION

Gladys Caron, Vice President, Public Affairs, Communications and Investor Relations

Merci. Bienvenue. Good afternoon everyone.

Our press release for the third quarter 2014 results was issued today on Canada Newswire and is posted on our Web site. This afternoon's overview will be provided by our President and CEO, Réjean Robitaille, as well as by our CFO, Michel C. Lauzon.

Other members of our senior management team are also present on this call to answer any questions. You will find their names and titles on Slide 22 of the presentation available on our Web site. Réjean Robitaille and Michel Lauzon will refer to that presentation throughout their speeches.

During this conference call, forward-looking statements may be made, and it is possible that actual results may differ materially from those projected in such statements. For the complete cautionary note regarding forward-looking statements, please refer to our press release or to Slide 2 of the presentation.

I will now turn the floor over to Réjean Robitaille.

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Thank you, Gladys. Good afternoon ladies and gentlemen.

The third quarter of 2014 was another good quarter. Net income reached $40.1 million, and excluding adjusting items, totaled $42.4 million, up 10% from a year earlier. In particular, our disciplined approach to expense management resulted in adjusted non-interest expenses declining by 5% year-over-year. We again achieved positive adjusted operating leverage for the quarter and our efficiency ratio is gradually improving. Furthermore, the credit quality of our loan portfolios remains strong.

We are pleased that the integration of our acquisitions into B2B Bank is almost completed, with the final T&I costs expected to be incurred in the fourth quarter. Now we can direct our attention to business development and working towards gradually increasing revenues.

We are also pleased with our ability to generate organic growth in business services. With a 16% increase in our commercial loans and a 9% increase in commercial mortgages, it is evident that business services are a meaningful contributor to our growth. Furthermore, within our retail activities, we are encouraged by our progress in wealth management, including a 29% increase in income from sales of mutual funds. Lastly, we are pleased that Laurentian Bank Securities' strategy of focusing on the small-cap market is reaping rewards, as fees from underwriting small-cap securities increased.

Before turning the floor to Michel, I would like to add that, after three quarters, as shown on Slide 5, management believes that the Bank is in line to meet its objectives, within the range set out at the beginning of the year.

I will now call upon Michel to review the third quarter of 2014 financial results.

Michel C. Lauzon, Executive Vice-President and Chief Financial Officer, Laurentian Bank

Thank you Réjean.

I will begin on Slide 6 which presents the third quarter of 2014 results compared with the third quarter of 2013. Total revenue reached $219.6 million or 1% less than a year ago. Other income rose by 2% while net interest income decreased by a similar percentage. The provision for loan losses was $10.5 million in the third quarter of 2014, $1.5 million higher than in the third quarter of 2013 but equal to the prior period. We have been working diligently to reduce our costs and continue to see results as adjusted non-interest expenses, excluding T&I costs, totalled $154.4 million, 5% lower than a year earlier and 1% less than the prior period. In the third quarter of 2014, adjusted diluted EPS and adjusted ROE reached $1.35 and 11.9% respectively, compared with $1.27 and 12.0% in the third quarter of 2013. As the Bank issued Series 13 Preferred Shares in April 2014 and redeemed Series 10 Preferred Shares in June, there was a one-time overlap in dividends of $1.2 million, or $0.04 per share, in the quarter.

Turning to the drivers of the third quarter's performance, net interest income of $141.2 million decreased by $3.3 million from the third quarter of 2013. This largely reflected the revenue impact of an expected reduced level of high-margin investment loans as some investors choose to deleverage, as well as a lower level of prepayment penalties on residential mortgages. Slide 7 highlights NIM that stood at 1.65% in the third quarter of 2014, down 3 basis points from a year ago and from the prior quarter. Assuming no further interest rate declines going forward, we believe that the margin compression stemming from the low interest rate environment has run its course.

Second, other income of $78.4 million rose 2% from the third quarter of 2013, as shown on Slide 8. The improvement was driven by a 29% increase in income from sales of mutual funds and a 15% increase in income from brokerage operations which was largely fuelled by improved underwriting activity in small-cap securities. This was partially offset by a decline in income from treasury and financial market operations which had a particularly strong performance a year earlier.

Third, as highlighted on Slide 9, the provision for loan losses amounted to $10.5 million in the third quarter of 2014, equal to the prior period and $1.5 million higher than a year earlier, representing a partial return to a more normalized level. Loan losses on personal loans decreased by $1.2 million from the third quarter of 2013, reflecting lower provisions on point-of-sale and investment loan portfolios, owing to the reduced exposure. Loan losses on residential mortgages declined by $3.0 million as last years' losses were impacted by higher provisions on medium-sized residential real estate projects. The slight sequential increase was a function of volume growth. Loan losses on the combined commercial mortgage and commercial loan portfolios increased by $5.7 million from a year ago and by $2.3 million from the previous quarter as past quarters benefitted from favourable settlements on commercial loans and mortgages. At a 15 basis point loss rate in the third quarter, the underlying quality of the portfolios remains high and benefits from continued low interest rates and favourable credit conditions in Canada.

Slide 10 highlights gross impaired loans which improved slightly on a sequential basis to $106 million. A ratio of impaired loans to total loans and BA's of 39 basis points, as well as the aforementioned good loss ratio of 15 basis points for the third quarter of 2014, demonstrate our low and relatively stable credit risk profile and continue to compare favourably to the banking industry.

Turning to Slide 11, the efficiency ratio, excluding Transaction & Integration costs, for the third quarter of 2014 continued to gradually improve, reaching 70.3% compared to 71.7% in the second quarter of 2014 and 73.3% a year ago. The significant improvement when compared to last year reflects the full impact of integration synergies at B2B Bank, rigorous cost control and efforts to continuously improve processes. Slide 12 provides a snapshot of the improvements in core non-interest expenses over the past five quarters. Moreover, in line with our 2014 financial objectives, adjusted operating leverage continued to be positive quarter-over-quarter and year-over-year.

Slide 13 highlights the Bank's balance sheet. Loans and BA's totalled $27.3 billion, relatively unchanged year-over year. On a combined basis, the commercial loan and commercial mortgage portfolios grew at 11% or 13% when excluding the portfolio sale of $102.4 million in the second quarter of 2014, more than offsetting the 7% reduction in the personal loan portfolio. The latter was mainly a result of the expected attrition in the investment loan portfolio due to profit-taking and some investor deleveraging. Residential mortgage growth remained subdued as we continue to focus on protecting margins in a slowing and competitive market, particularly in eastern Canada. Deposits, totalling $24.2 billion, increased by 1%, in line with the overall slower retail loan growth. Retail deposits represent 78% of total deposits, while we took advantage of pricing differentials favoring institutional funding over broker deposits.

We will now turn to the performance of our business segments.

Slide 14 shows the strong performance of the Personal & Commercial business segment. Its contribution to net income rose 15% to $30.0 million in the third quarter of 2014 compared to a year earlier. Total revenue increased by $1.8 million from the third quarter of 2013. Contributing to the increase in net interest income was strong organic growth in the commercial portfolios, partially offset by lower prepayment penalties on residential mortgages. Contributing to the increase in other income were higher mutual fund commissions and lending fees. Loan losses increased by $2.3 million, largely due to a $3.5 million favourable settlement in the commercial portfolio in the third quarter of 2013. Non-interest expenses decreased by 5% from a year earlier. Lower salaries and other expenses as a result of the optimization of certain retail processes in the fourth quarter of 2013, as well as disciplined control over discretionary expenses, largely accounted for this improvement.

As shown on Slide 15, B2B Bank's contribution to net income was $15.3 million excluding adjusting items in the third quarter of 2014. Total revenue declined by $4.4 million, including a $3.8 million reduction in net interest income. This essentially reflected the decrease in the higher-margin investment loans, as well as margin compression on certain deposits. The provision for loan losses declined by $0.8 million from a year earlier, largely reflecting the reduced exposure to investment loans. Non-interest expenses excluding T&I costs decreased by 5% from the third quarter of 2013, reflecting the full impact of integration synergies that have now been achieved. T&I costs totalled $1.6 million in the third quarter. As the integration work winds down, the fourth quarter of 2014 should be the last quarter where T&I costs are incurred.

As shown on Slide 16, Laurentian Bank Securities & Capital Markets' contribution to net income rose by $0.8 million in the third quarter of 2014 compared to a year earlier. Total revenue increased by $2.5 million mainly as a result of higher underwriting fees on small-cap securities. Expenses rose by $1.3 million due to higher performance-based compensation, commissions and transaction fees.

The Other sector, presented on Slide 17, posted a negative contribution to net income of $5.9 million in the third quarter of 2014, slightly better than a year ago where the negative contribution was $6.7 million.

This concludes my comments. Now Réjean will offer some closing remarks.

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Thank you Michel.

Laurentian Bank has been deploying several strategies to solidify its position as a strong niche player in Canada. Specifically, we have been emphasizing and investing in B2B Bank and our commercial activities. Slide 18 highlights that since the end of 2008, business loans increased by 85% and B2B Bank loans more than doubled. Our ability to grow and develop these activities, both organically or through acquisition, contributes to increased profitability and improved diversification.

Our goal is to have our loan portfolios becoming, over time, increasingly pan-Canadian. Slide 19 shows that since the end of 2008, our loans in Ontario and other provinces have grown by more than 100% and 68% respectively. Furthermore, Slide 20 illustrates that as we put more emphasis on B2B Bank and business services activities, we increase the pan-Canadian diversification of our overall loan portfolios and growth outlook. Today, half of our profitability comes from outside of Quebec. Our teams and product offerings support the gradual pursuit of growth from coast to coast.

To conclude, we remain committed to deploying our strategies so as to continuously improve our operations and generate sustained earnings growth. In doing so, we will unlock the value for our shareholders in each of our business segments.

I will now turn the floor back to Gladys.

Gladys Caron, Vice President, Public Affairs, Communications and Investor Relations

Thank you, Réjean.

At this point, I would like to turn the call over to the conference operator for the question-and-answer session. Please feel free to ask your questions in English or in French.

QUESTIONS & ANSWERS SESSION

Operator

Thank you. Ladies and gentlemen if you would like to ask a question please press Star 1 on your touch-tone phone. If you are using a speakerphone please pick up the handset before pressing any keys.

Once again if you would like to ask a question please press Star 1. And one moment please for your first question.

Your first question comes from the line of Many Grauman of Coremark Securities. Please go ahead.

Meny Grauman of Cormark Securities

Hi. Good afternoon. First question about the comment you made on margin pressure.

You talk about how margin pressure from low rates has run its course and I'm wondering what gives you confidence in that view?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Yes. I'll ask Michel to answer this question.

Michel C. Lauzon, Executive Vice-President and Chief Financial Officer, Laurentian Bank

Thank you Meny. We said that the margins should have stabilized at around 1.65% level plus or minus two or three basis points each quarter.

But there was up until this point some slight downward pressure. Our modeling shows that barring any further decline in interest rates the margin should remain relatively stable plus or minus the normal seasonal fluctuations in mortgage repayment penalties which tend to be higher in Q2 and Q3 and lower in Q4 and Q1.

Meny Grauman of Cormark Securities

And then just wanted to focus in on the redemption of the investment loans and maybe ask for a little bit more color on what you're seeing there and when you first see that drag coming to an end?

Do you see it slowing? And is this a specific Laurentian Bank problem or do you see that this is something that peers across the board are also experiencing?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

For the investment loan side I will ask Francois, Head of B2B Bank to answer this question Meny.

François Desjardins, President and Chief Executive Officer, B2B Bank; Executive Vice-President, Laurentian Bank

Yes thanks Meny. The portfolio it is about $3.9 billion strong. It's been built over time largely through B2B Banks organic growth but more recently by the acquisition of AGF Trust.

That portfolio was already in decline when we bought it and continues to be in decline. But it's also a runoff on the portfolio that has also been generalized by strong messaging from governments and other regulatory bodies in terms of deleveraging.

One of the things that we've noticed here which is industrywide is that as the TSX has hit higher in the last six months we've seen some profit taking.

And although I might be happy about our customers making some money and growing their wealth those customers must be replaced with new ones.

The good news out of that is that the gross sales in the investment loan portfolio have been on the rise and the overall decline is slowing.

I expected to see it slow to a dead stop within 18 to 24 months, hopefully sooner and then back up to positive growth after that.

Meny Grauman of Cormark Securities

When you talk about that slowdown reaching 24 months, does that include sort of any mitigating actions that you can take or is it dependent on that or is it really about sort of bigger picture trends that you're basically tied to?

François Desjardins, President and Chief Executive Officer, B2B Bank; Executive Vice-President, Laurentian Bank

Part of it is market driven as we've seen some profit taking from recent highs in the TSX. But it's also impacted by the fact that we've had back to back acquisitions.

And a lot of our efforts internally and with advisors and dealers have been really hand holding them through the process. Very difficult to do that and to aggressively market any of our products during that.

That's really what our focus will be in the next few months and in - through 2015. So I'm really expecting that our efforts will have a great impact on the slowdown and on positive growth of that portfolio.

Meny Grauman of Cormark Securities

Thanks. And just one more on the revenue synergies segueing, you talk about revenue synergies from the acquisitions emerging in 2015.

I'm wondering if you have any more details on that. If what you've seen over the past few months has changed your view on the scale of those synergies and also the timing of the synergies?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Maybe Francois you could elaborate a little bit more on your mortgage alternative?

François Desjardins, President and Chief Executive Officer, B2B Bank; Executive Vice-President, Laurentian Bank

Yes absolutely. Well overall and I've said this all through the acquisitions, I could just not wait till we could turn our efforts to organic growth.

And we've already started that in the last few months specifically on our HELOC and mortgage portfolios with the re launch of the product about four months ago and an alternative mortgage suite of products that was launched soon thereafter.

We've seen some really good response from these two actions and continued growth. I would say that the last few months have been the best in terms of gross sales in the mortgage portfolio that I've seen in quite a while and I'm very encouraged by that.

That to say I'm still really positive in terms of the outlook for the future. B2B is a powerhouse of, you know, 27,000 financial advisers selling our products. And the teams are ready to go to start marketing and selling our products again. And that's really the focus of next year.

That being said I'm looking for a, you know, single digit overall loan growth. Looking towards the future still looking for south of 55% in terms of efficiency ratio.

And of course always remaining, you know, or maintaining our profitability versus just - you know, trying to go and get market growth. Very important to always maintain the, you know, efficiency in our product lines.

Meny Grauman of Cormark Securities

Thank you.

Operator

Your next question comes from the line of Shubha Khan of National Bank Financial. Please go ahead.

Shubha Khan of National Bank Financial

Thanks. Good afternoon. Just two quick questions, first of all I wanted to confirm that some of the spread compression this quarter was due to the attrition in your investment loan portfolios?

And then as a follow-up to that I'm just wondering whether going forward, you know, whether you anticipate that spread compression stemming from this - from the attrition in this portfolio will be offset through growth in the commercial portfolios and your Alt-A mortgage portfolios? Is that what you're part anticipating?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Michel

Michel C. Lauzon, Executive Vice-President and Chief Financial Officer, Laurentian Bank

Okay. Thank you, Shubha. On a sequential basis, the drop in margin was really because we had some strong interest recoveries in the commercial book in Q2 which did not recur in Q3. So Q2 was a bit elevated and Q3 is a more normalized level.

In terms of going forward you're right. There was a little bit of compression from the investment loan portfolio which outweighed the favorable mix impact from the commercial loan growth.

But as one portfolio whose attrition subsides and the other portfolios growth is maintained that should offset and going forward which is why I'm confident to say that basically margin should stay pretty much where they are within a narrow band.

Shubha Khan of National Bank Financial

Got it, perfect. And just a second question with respect to non-interest expenses, so employee benefits in particular. It moderated quite substantially in the quarter certainly more so than employee salaries or even headcount.

I'm just wondering whether the Q3 number is reflective of a sustainable run rate or will it sort of move around in upcoming quarters?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Michel again

Michel C. Lauzon, Executive Vice-President and Chief Financial Officer, Laurentian Bank

Yes. The third quarter number was favorably impacted by some adjustments to our collective insurance costs. And it should - it was a little bit lower than expected should resume at a slightly higher clip in Q4.

Shubha Khan of National Bank Financial

Okay perfect. That's all my questions. Thanks.

Operator

Once again ladies and gentlemen on your touch-tone phone. And your next question comes from Sumit Malhotra Scotia Capital. Please go ahead.

Sumit Malhotra of Scotia Capital

Thanks. Good afternoon. First question may be to go back to the expense line. We've seen the headcount at the company decrease now for four consecutive quarters.

And certainly the integration of the acquisitions and some of the other efforts you've put forth have started to be more visible here.

Do you think the bulk of these have now run their course and from a headcount perspective it's more of a steady state to where you are now?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Well as you mentioned Sumit, thanks for the question. Most of that, at least half of that was coming from the cost synergies and the integration process through the two acquisitions that we did.

Other things were also partly related to the restructuring that we did in Q4 last year. And at the same time we are always looking at how we do things and how we could improve our processes so that's a continuous process.

So going forward we might see that number decline a bit but relatively to stay at this level I would think.

Sumit Malhotra of Scotia Capital

Well if we put that towards total expenses I have to say it's somewhat unusual to have seen the company outright decrease the expense base on a year over year basis in the first three quarters of this year.

And, you know, given the elevated level of Q4 last year it's almost certainly going to happen again in Q4.

So how do you envision the - what I should call the normalized expense growth of Laurentian as we head into 2015?

Is this a number that you think as we head into '15 it's more the rate of inflation that we should see expenses grow at or do you feel you have the capacity to keep the cost line flat again next year?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Well the rate of inflation is quite slow.

Sumit Malhotra of Scotia Capital

Yes actually it's not much different than flat right yes.

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

That's right. But we mentioned last year that we expected to be below the rate of inflation. As for the year to come we will let's say give you more color on this next quarter.

But the point here is our medium term objective is to gradually decrease our - or improve our efficiency level to 68 cents. So the level of inflation could be a good target in terms of that.

At the same time it is important for us to continue to invest in our business development and mainly through B2B Bank and our commercial activities; things that we have done in the last few years.

And as I said earlier it's a continuous process to look at the way that we're doing things so to automatize some of our operations or to look at optimizing some of those processes. That's something that we will continue to do.

So that's why going forward we are quite confident that in terms of the overall bottom line our medium term objectives is to grow the EPS by 5% to 10% per year.

Sumit Malhotra of Scotia Capital

All right. Another topic is to go back to the net interest margin commentary from Michelle. I think you explain maybe some of the factors that were responsible for the decline this quarter.

I guess maybe to come about this a different way. When I look at just the yield on the loan portfolio so if you leave the funding out of it, it seems like, you know, that one has been showing some signs of stabilization in the last few quarters.

So to put this in this context do feel or is your commentary on NIM somewhat based on the fact that you've reached an inflection point in the loan portfolio in which I mean - by what I mean is the new loans you're writing are at yields that are essentially equivalent to your existing portfolio? Is that the point that we're at now for the company?

Michel C. Lauzon, Executive Vice-President and Chief Financial Officer, Laurentian Bank

Yes. I'd say on the mortgage side that's probably the case. As I mentioned earlier on the call there is a changing mix that we're orchestrating which is offsetting the decline in higher margin investment loans. So you have to factor that in as well.

So prepayment penalties does hit the loan yield number as well. So all of that said, the underlying impact of interest rates barring no further declines have pretty much run its course.

And that's why even though this quarter it was a bit higher because of loan prepayment penalties it could be a bit lower next quarter, the overall run rate at 1.65%. I wouldn't call it an inflection point but I would call it a plateau.

Sumit Malhotra of Scotia Capital

How do you compare let's call it the runoff portfolio and personal from a yield perspective relative to the new initiatives that you've communicated in commercial, and leasing and some of the business oriented portfolios?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Well overall right now I think that it's mitigating the overall impact on NIM. That's what Michelle mentioned. But going forward, the fact that we are putting more emphasis on our commercial activities and our B2B Bank, that's something that we'll continue to grow.

So you've seen a 16% growth in commercial loans. We just launched a few months ago our credit leasing capacity.

And so far the response is quite interesting. On the B2B Bank side, Francois talked about the rollout of the ALT-A mortgage and the fact that also on that side we've seen a significant increase in the gross sales.

So that will definitely mitigate the fact that we have seen a reduction in the investment loan portfolio as well.

We mentioned that at the beginning of the year 2014 would have been a year of transition mainly because we had to let's say build on this and launch those two capacities.

Going forward we are confident that we will benefit from those initiatives.

Sumit Malhotra of Scotia Capital

Thanks for your time.

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Thank you Sumit.

Operator

Ladies and gentlemen there are no further questions at this time. I would like to hand the call back over to Ms. Gladys Caron for closing remarks.

Gladys Caron, Vice President, Public Affairs, Communications and Investor Relations

Thank you all for joining us today.

If you have any further questions do not hesitate to contact us. Our phone numbers are listed on the presentation.

Thank you and have a nice day.

Operator

Ladies and gentlemen this concludes the conference call for today. We thank you for your participation.

You may now disconnect your line and have a great day.