Laurentian Bank Quarterly Results Conference Call

Wednesday, June 4, 2014 – 2:00 PM ET

C O R P O R A T E P A R T I C I P A N T S

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P R E S E N T A T I O N

Operator

Good day ladies and gentlemen, and welcome to the Laurentian Bank Second Quarter 2014 conference call.

As a reminder, this conference is being recorded. At this time I would like to turn the conference over to Ms. Gladys Caron.

Please go ahead Ms. Caron.

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

Yes, bienvenue, good afternoon everyone. Our press release for the second quarter of 2014 results was issued today on Canada Newswire and is posted on our web site.

This afternoon review will be provided by our President and CEO, Rejean Robitaille as well as by our CFO, Michel Lauzon.

Other members of our senior management team are also present on this call to answer any questions. You will find the names and titles on slide 20 of the presentation available on our web site.

Rejean 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 Rejean Robitaille.

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Thank you, Gladys, and good afternoon ladies and gentlemen. The second quarter of 2014 was another solid quarter. Net income reached $31 million, or $39.4 million, excluding adjusting items.

We are pleased our focus on commercial activities has momentum, as commercial loans increased 18% year over year, following a 17% increase in the first quarter of 2014. This is contributing to improving our business mix, and diversifying our portfolios.

Furthermore, the credit quality of our loan portfolios remains strong, with a loan loss ratio at a comparatively low 16 basis points. As well, our disciplined approach to expense management resulted in adjusted non-interest expenses remaining stable quarter over quarter, and year over year.

Adjusted operating leverage for the quarter was positive, and our efficiency ratio is gradually improving. We are also pleased to have reached an (early) settlement with AGF management, of the contingent consideration related to the AGF Trust acquisition, for $10 million.

This agreement allows for more efficient management of the loans, removes any uncertainty regarding future payments, and further builds on the valued relationship between B2B Bank and AGF.

The environment remains challenging, characterized by intense competition, more modest consumer loan demand, and historically low interest rates. Given this context, we are personally - our targeted efforts to improve efficiency, maximize operating leverage, and deliver the synergies related to our acquired businesses, while maintaining a solid balance sheet.

To this end, then, please, with the issuance of $125 million of Basel III compliant preferred shares, which, combined with the redemption of $110 million of Series 10 preferred shares in June, strengthens and optimizes our capital structure, and lowers our funding costs.

Slide 4 compares our adjusted results for the first six months of 2014 to our targets. After the first half of the year, our performance is in line with the financial objectives that we established for 2014. We believe that the bank is on track to meet these objectives for the full year, as well.

Given our strong results, and solid capital, the Board of Directors has approved a one cent increase in our quarterly dividend to 52 cents per share. This represents the eighth dividend increase over the past four years, for a 44% increase in the quarterly rate over that period.

Moreover, the dividend yield on Laurentian Bank shares, at 4.3%, is the highest among Canadian banks and insurance companies. I will now call upon Michel to review the second quarter of 2014 financial results. Michel?

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

Thank you, Rejean. I will begin on slide 6, which presents the second quarter of 2014 results, compared with the second quarter of 2013. Total revenue reached $216.9 million, or 1% higher than a year ago, driven by a 5% increase in other income, while net interest income decreased slightly.

The provision for loan losses was $10.5 million for the second quarter of 2014, $1.5 million higher than in the second quarter of 2013, but equal to the prior period. We have been working hard to reduce our costs, and are seeing results, as adjusted non-interest expenses, excluding T & I costs, total $155.5 million, unchanged from a year earlier.

In the second quarter of 2014, adjusted diluted EPS, and adjusted ROE reached $1.29, and 11.9% respectively, compared with $1.24 and 12.2% in the second quarter of 2013. Before discussing the main factors behind the bank's performance during the second quarter of 2014, I would like to elaborate on one of the adjusting items in the quarter.

As a result of an amendment to the original share purchase agreement for AGF Trust, between B2B Bank, and AGF Management, there was a non-tax deductible charge of $4.1 million, which represents the last revaluation of the contingent consideration to impact reported earnings. The final contingent consideration now amounts to $10 million, and will represent the last payment for the purchase of AGF Trust.

Turning to the drivers on the second quarter's performance, net interest income of $138.7 million, decreased by $1.7 million from the second quarter of 2013. This largely reflected the revenue impact of a reduced level of investment loans. Slide 7 highlights NIM that stood at 1.68% in the second quarter of 2014, unchanged from a year ago, and up two basis points from the prior period. The unfavorable impact of re-pricing maturing loans and deposits, in the very low interest rate environment, was offset by higher interest recoveries, and a better asset mix.

Second, other income, of $78.2 million, rose 5% from the second quarter of 2013, as shown on slide 8. The improvement was driven by a 32% increase in income from sales of mutual funds, and a 17% increase in income from brokerage operations, compared to a year earlier. This was partially offset by decline in income from treasury and financial market operations, owing to lower trading revenues.

Third, as highlighted on slide 9, the provision for loan losses amounted to $10.5 million in the second quarter of 2014, equal to the prior period, and $1.5 million higher than the year earlier. While losses on personal loans increased from an unusually low level in the first quarter of 2014, the commercial mortgage loan portfolio benefited from favorable settlements, and improvements. Other commercial portfolios experienced increases in provisions, albeit from a very low level. At a 16 basis point loss rate in the second quarter, the underlying quality of the portfolios remains high, and continues to benefit from low interest rates, and favorable credit conditions in Canada.

Slide 10 highlights gross impaired loans, which improved sequentially to $107 million, a ratio of impaired loans to total loans and BA's of 39 basis points. As well, with the aforementioned loss ratio of 16 basis points for the second quarter of 2014, demonstrated our low and relatively stable credit risk profile, and continued to compare favorably to the banking industry.

Turning to slide 11, the efficiency ratio, excluding transaction and integration costs, for the second quarter of 2014, continued to gradually improve, reaching 71.7%, compared to 71.8% in the first quarter of 2014. However, this represents a significant improvement, when compared to 73.5%, for all of 2013, reflecting higher other income, integration synergies, rigorous cost-control, and streamlining of operations.

Moreover, in line with our 2014 financial objectives presented at year-end, adjusted operating leverage was positive quarter over quarter, and year over year. Our rigorous approach to expense management and our efforts to streamline operations have generated efficiency gains. As a result, non-interest expenses on slide 12, when excluding T&I costs, were held flat quarter over quarter and year over year.

Slide 13 highlights the bank's balance sheet. Loans and BA's totaled $27.2 billion, up 1% year over year. Residential mortgages grew by 1%, as we continued to focus on protecting margins in a slowing but competitive environment. Personal loans have declined by 7%, largely reflecting attrition in the investment loan portfolio.

This was the result of profit-taking due to favorable market conditions, as well as continued investor deleveraging. Our strategy to target higher-margin loans to commercial businesses continued to bear fruit, with portfolio growth of 18% year over year. As well, commercial mortgage loans, excluding the sale of a $102.4 million portfolio, grew by 8%, for an overall increase of over $100 million. Deposits totaling $23.8 billion were virtually unchanged from a year earlier, in line with the overall slower loan growth. Retail deposits still represent 81% of total deposits.

We will now turn to the performance of our business segments. Slide 14 shows the very strong performance of the personal and commercial business segment. Its contribution to net income rose 22%, to $3.3 million, in the second quarter of 2014, compared to the year earlier.

Total revenue increased by 4% from the second quarter of 2013, driven by 5% increase in net interest income. Contributing to the growth in net interest income were interest recoveries of $2.5 million, strong commercial loan growth, and improved margins. Contributing to the growth in other income, were higher mutual fund commissions and lending fees that were partially offset by lower gains on loan sales.

Loan losses increased by $1.6 million owing to higher collective provisions on personal and commercial loans which were partially offset by favorable settlements in the commercial mortgage portfolio.

Non- interest expenses declined by 3% year over year, largely due to a decrease in head count, resulting from the optimization of certain activities in the fourth quarter of 2013, as well as disciplined control over discretionary expenses.

As shown on slide 15, BTB Bank's contribution to net income was $13.5 million, excluding adjusting items, in the second quarter of 2014. Total revenue declined by $3.6 million, including a $3.8 million reduction in net interest income. This reflected a 6% decrease in the loan portfolio year over year, largely due to the attrition in investment loans. As previously mentioned, this reflected profit-taking, thanks to strong capital markets, and continued investor deleveraging.

Provisions for loan losses were virtually unchanged from a year earlier. Non-interest expenses, excluding T&I costs, decreased by $2.2 million, or by 7%, from the second quarter of 2013, largely owing to realized integration synergies. As mentioned earlier, a non-tax-deductible charge of $4.1 million, resulting from the last revaluation of the final contingent consideration related to the AGF Trust acquisition, impacted reported earnings.

As shown on slide 16, Laurentian Bank becurities and Capital Markets' contribution to net income decreased by $0.4 million in the second quarter of 2014, compared to the year earlier. Total revenue was $0.6 million higher, mainly as a result of higher underwriting fees related to small-cap equity securities. Expenses rose by $1.1 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 $7 million dollars in the second quarter of 2014, compared to the negative contribution of $3.1 million in the second quarter of 2013. While total revenue decreased slightly, non-interest expenses increased by $4.3 million, largely due to higher unallocated technology expenses, related to new initiatives aimed at improving I.T. infrastructure, and online services. This concludes my comments, now Rejean will offer some closing remarks.

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Thank you, Michel. Our strategy of specialization for commercial activities is demonstrating tangible results, and is contributing to the strong commercial loan growth of 18%. As well, our leasing and equipment financing platform is now up and running. We have already completed several transactions and are gradually building a solid pipeline. Commercial activities are among the bank's priorities, and we are confident that this operation will continue to be an engine of growth.

B2B Bank added two new mortgage programs to its product suite at the end of April. Along with insured and conventional mortgages, B2B Bank provides alternative and expanded mortgage solutions, creating a more comprehensive offering. This is yet another step to strengthen B2B Bank's position as a leader in serving financial advisors and brokers in Canada.

I would also like to reiterate, that as the integration of the B2B Bank acquisitions winds down, cost synergies continue to materialize as was evident by the 7% decline in adjusted non-interest expenses in the second quarter. Initiatives for revenue synergies will gradually begin in 2015. Furthermore, as the bulk of the integration costs are behind us, and the growth of retained earnings should accelerate and going forward provides the bank with additional flexibility.

Enhancements to our retail internet offering are also meeting with success. Thanks to significant improvements to the bank's Web site, the number of LBC direct users has increased by 30% since the launch of our new platform last August. Ongoing investments to support retail activities will ensure that client needs, expectations and preferences are met, while simultaneously improving the efficiency of the bank.

As for Laurentian Bank Securities, its strategy of focusing on the small cap market segment was again validated, as it hosted its first annual small cap equity conference, in April. The event was very well received, with 35 corporate issuers presenting, and almost 200 additional investors from across Canada in attendance. This success positions LBS to further leverage their small cap capability.

Lastly, the diversification of our business, as presented on slide 20, both by sector and geography, continues to be a priority. With continued growth, particularly in commercial operations and at B2B Bank, the proportion of the portfolio originated across Canada should continue to increase.

To conclude, as we execute our strategies to generate stronger revenue growth, better control operating costs, maximize synergies, and diversify activities, we are delivering sustainable development, and long-term earnings growth to enhance shareholder value. I will now turn the floor back to you, 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.

QUESTION & ANSWER 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 the keys.

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

And your first question comes from Shubha Khan of National Bank Financial. Please go ahead.

Shubha Khan of National Bank Financial

Hi, good afternoon. So, my first question relates to the personal loan portfolio. I guess the attrition in the investment loan portfolio seems to have abated from the rate that we've seen over the past 12 months or so.

Just wondering whether that means that the customers who are, you know, the likeliest to leave when you acquired AGF Trust have now done so, and so the slower rate of attrition in the second quarter is really just a reflection of the broader macro-environment, or would you expect the pace of attrition to revert to the higher rate that we've seen in the last few quarters or so?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Okay, well, let's see, Shubha, thanks for the question. Personal loan, there, well, there is several types of loan in that line. Most of the decrease came, though, from the investment loan portfolio. But we also had some decrease from the point of sales, or the (merchant) loans that we still already have the, well, roughly a few hundred, a few million dollars left in this quarter.

But I would ask Francois to give you a little bit more color on the investment loan portfolio. Francois Desjardins of B2B Bank.

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

Thanks. Two parts to your question about the overall AGF portfolio, it's performing to where it should be, and to our expectations. We knew that when we bought the AGF trust portfolio, it was in decline, it continues to be in decline, but slowing, and what we said it would stabilize over time.

The real shift in market has been, we chose some profit-taking, and we've had more exits on the B2B Bank portfolio than what we would have liked. Of course, great for customers, but our actual growth of new sales has actually been really good. So we're expecting that collectively we'll still see some decline in the portfolio, but a slowing decline.

Shubha Khan of National Bank Financial

Okay. And then staying with B2B Bank, I guess you were still heavily involved with the integration efforts in the quarter, so that seems to have weighed on growth in residential mortgages. Can we assume that the work is now largely done, and, you know, starting in the third quarter, the focus will now shift back to originating loans?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

On the mortgage side the shift has already occurred.

Shubha Khan of National Bank Financial

Okay.

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

Because that piece of the business has been successfully completed we launched our alternative mortgage products suite in April. We have initial results that are very positive and we've also re-launched just general growth initiatives with our sales forces, and are getting really positive results from that.

There are some integration elements that are more on the advisor side, so that affects the investment lending portfolio. And we will see some more growth initiatives more at the end of the year. Largely, though, our integration activity will be done by the end of Q3. Even though there might be some financial spillage into Q4, most of the work is behind us after Q3.

Shubha Khan of National Bank Financial

Okay. That's helpful. And then, final question, just on head count, it looks like there was another, I guess, 2% sequential decline. Is all that related to the integration efforts or were there further cost optimizations similar to what you saw in Q4?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Michel Lauzon will answer this question for you.

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

To answer you, there was some related to integration efforts in B2B and some attrition in the retail network during the quarter and as well as continued efforts to control costs as we go forward.

Shubha Khan of National Bank Financial

Okay. Got it. Thanks.

Operator

And your next question will come from the line of Scott Chan of Canaccord Genuity. Please go ahead.

Scott Chan of Canaccord Genuity

Good afternoon guys. My first question is for Michel. Maybe I was confused on your remarks in terms of AGF Trust Contingent consideration. Did you say the final payment was this quarter the total $10 million or there's another $10 million to come?

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

No, the final - the final payment was $10 million.

Scott Chan of Canaccord Genuity

Right

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

But when the - when the transaction was originally concluded in August of 2012, there was a $5.9 million provision that was taken at that time, which was the present value of the expected payment at the time.

Scott Chan of Canaccord Genuity

Yes.

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

And what was left between the $10 and the $5.9 was a $4.1 million, which was taken this quarter.

Scott Chan of Canaccord Genuity

Okay. Okay. I got you. Just turning to the - to the loan side and maybe on the commercial side with the new equipment and financing group. You talk about a pipeline. I imagine this group is relatively new. Can you maybe comment on the pipe line and kind of what to expect over the next few quarters?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

I will ask Stephane Therrien, the head of commercial to answer this question.

Stéphane Therrien, Executive Vice President Business Services

Well, as you just point out, Q2 was really our first full quarter for this team. So we're obviously really happy to report that we dispersed our first transaction. Yes, we built a solid pipeline, a bit early to comment on the size of that pipeline at the time being.

That being said, we're very happy about the market and customer response and we're confident that going forward, 25% of the growth in commercial sectors should come from leasing operation.

Scott Chan of Canaccord Genuity

Twenty-five percent?

Stéphane Therrien, Executive Vice President Business Services

Yes.

Scott Chan of Canaccord Genuity

Of the - all commercial or just the commercial segment?

Stéphane Therrien, Executive Vice President Business Services

Just the commercial sector

Scott Chan of Canaccord Genuity

Just the commercial, okay. And maybe just the last question, just generally, you know, RSP season in its past. Any kind of themes that kind of came out that were maybe a bit different than last year? Or was it generally kind of the same?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank
Can you - can you say it again, (Scott)? Sorry, we...

Scott Chan of Canaccord Genuity

Yes, just with RSPs and - you know, were there any themes that B2B Bank had come to? I noticed that mutual fund sales were a lot stronger. You know, looking at the asset growth. But was there anything that kind of, you know, maybe that, you know, that should be highlighted on the RSP season or is it just general normal course of business?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Okay. I'll let Francois, first of all, talk about the RSP season at B2B Bank and then ask Gilles Godbout head of retail to talk about the one on the retail side. So, François, do you want to start?

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

There wasn't anything special about the last RSP season. I got to admit that we met our target and we're happy with and pleased with our results on all product line. But you have to remember that we could have done much more if we weren't still in the integration period. So we're really looking forward to a - the next RSP season where this integration finally will be behind us.

Scott Chan of Canaccord Genuity

Okay

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Gilles on the retail side

Gilles Godbout, Executive Vice-President Retail Services, Laurentian Bank

And on the retail side, yes, there's nothing special, really to report, either. We are very pleased with the - our mutual fund growth. So, as you see, we have 30% revenue growth from last year ((inaudible)). And we're also focusing more on non-deposit ((inaudible)). We met our expectation there.

Scott Chan of Canaccord Genuity
All right, perfect. Thanks guys.

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

Thank you, (Scott)

Operator

Once again, ladies and gentlemen, if you would like to ask a question, please press Star0 1 on your touch-tone phone. And your next question will come from the line of Darko Mihelic from RBC Capital Markets. Please go ahead.

Darko Mihelic from RBC Capital Markets

Hi, thank you. I was looking at slide 9 and I just have a couple of questions with respect to your provision for loan losses.

The first is with respect to the recoveries and commercial mortgage loans. Maybe perhaps the best way to look at this - at this category is to think what is a more normalized level of losses from your commercial mortgage book, please?

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

I'll let Louis Marquis out of credit answer this question. I think also that we have to look at that on a global thing. So Louis…

Louis Marquis, Senior Vice-President Credit, Laurentian Bank

Any line of business that we're going through it good credit cycle. And any line that attempts to bring a lot of noise. You've seen losses in the previous quarter that were recovering this quarter. And, as a result, I tend to like to look at the total loan losses as more reflection of the run rate of the bank, then any particular line, which will bring noise from quarter to quarter.

That being said, the real estate market in Canada is strong. So I do not expect strong ((inaudible)) in the next while.

Réjean Robitaille, President and Chief Executive Officer, Laurentian Bank

The important portfolio is commercial. That portfolio is quite strong.

Darko Mihelic from RBC Capital Markets

Okay. And maybe just to revisit the AGF settlement. Michel, just to be clear, there's nothing else coming in Q3? And I'm just curious because it was - I guess you penned the agreement on May 30, but you just decided to have this charge in Q2. So there's nothing - there's nothing else that's coming with respect to this settlement? And maybe, just to confirm, there's no real impact here in capital, is that --

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

There is an impact on capital because it did affect reported earnings.

Darko Mihelic from RBC Capital Markets

Okay

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

But it was a marginal impact. It was a couple of basis points. And so - on a rounded basis, CET1 stayed at 7.6. And the - there is no future impact expected from the AGF settlement. This is the final settlement of the purchase price for the AGF trust.

Darko Mihelic from RBC Capital Markets

Okay. Thank you. And then just one last question from me with respect to the initiatives that you spoke of, where, effectively, looking at slide 17 of the presentation, you highlight here $4.3 million mainly due to higher unallocated technology expenses.

Was that kind of a one-off in the quarter? Or should we consider that those expenses persist?

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

Those expenses could persist. There have been a lot of expenses on - for regulatory systems. And we have not yet finalized how those expenses will be reallocated to business units. They could stay in the other sector for a while. But for the time being, we - they were kept in the other sector.

Darko Mihelic from RBC Capital Markets

Understood, okay. Thank you.

Operator

And there are no further questions at this time. Please continue.

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

Are we still waiting for other questions then? No further or do you...

Operator

There are no further questions at this time, but if you would like to queue up for more questions, you may press Star 1 on your telephone keypad.

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

I guess there are no further questions. So thank you all for joining us today.

If you have any further questions, we would be happy for you to contact us. Our phone numbers are listed on the presentation.

Thank you.

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.