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PRESENTATION

Operator

Good afternoon, ladies and gentlemen. Welcome to the Laurentian Bank Conference Call.

I would now like to turn the meeting over to Miss Gladys Caron. Please go ahead.

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

Merci. Bienvenue. Good afternoon, everyone. Our press release for the Second Quarter of 2013 Results was issued today on Canada NewsWire and is posted on our website. This afternoon, the review will be provided by our President and CEO, Réjean Robitaille, as well 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 their names and titles on Slide 21 of the presentation available on our website. Réjean and Michel 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

And thank you, Gladys, and good afternoon, everyone. Second quarter of 2013 was another strong quarter. Net income reached $35.1 million or $40.5 million on an adjusted basis. This is 12 percent higher than a year earlier. We are pleased that revenue growth was strong and expense growth was well contained. Consequently, adjusted operating leverage remains positive. Balance sheet growth continued over the past 12 months with loans and deposits increasing by 17 and 13 percent, respectively. The sound quality of our loan portfolios was also contributed to our good performance.

The strategies that we have been deploying to expand our revenue base have been paying off. For example, our initiatives which focused on generating other income are proving to be very effective as income from the sale of mutual funds, card services revenues and credit insurance income increased on a combined basis by more than 15 percent year-over-year. Furthermore, despite the persistence of low interest rates and slowing consumer loan demand, net interest income increased owing to the AGF Trust acquisition.

With respect to our recent acquisitions, I would like to mention that the integration of MRS is almost complete and we are therefore, turning our efforts towards the integration of AGF Trust businesses.

We believe we are on track to meet our financial objectives for 2013, as shown on Slide 4. Given our commitment to shareholders to better realize the value in each of our business segments and to prudently manage capital, the Board of Directors has approved a one cent increase in our quarterly dividend to $0.50 per share.

I will now call upon Michel to review the second quarter of 2013 financial results. Michel?

Michel Lauzon, Chief Financial Officer

Thank you, Réjean. I will begin on Slide 5, which presents the second quarter of 2013 results compared with the second quarter of 2012. Total revenue reached $214.9 million or 8 percent higher than a year ago, driven by increases of 9 percent in net interest income and 6 percent in other income. Our subsidiary, AGF Trust, added $18.8 million to revenues for the second quarter of 2013, of which $18.3 million was reported in the B2B Bank segment and $0.5 million was reported in the other segment. The provision for loan losses was $9 million in the second quarter of 2013; $1.5 million higher than in the second quarter of 2012. Adjusted non-interest expenses, excluding T&I costs, totaled $153.7 million or $9.9 million higher than a year earlier. This represents only a modest increase as it includes $7.8 million of new operating costs from our latest acquisition. In the second quarter of 2013, adjusted diluted EPS and adjusted ROE reached $1.29 and 12.1 percent, respectively, compared with $1.31 and 13 percent in the second quarter of 2012. AGF Trust's contribution to net income totaled $6.2 million, $0.6 million higher than in the first quarter of 2013, largely due to lower expenses and lower provisions.

Furthermore, on March 15, 2013, the bank repurchased the Class A Preferred Shares Series 9 at par for $100 million. Therefore, a final dividend of $1.5 million equating to $0.05 per common share, was paid during the quarter, in addition to the $2.5 million paid on the other (inaudible) outstanding series of preferred shares.

I'll now discuss the main factors behind the bank's performance during the second quarter of 2013.

Turning to Slide 6, net interest income of $140.4 million in the second quarter of 2013 increased by $12.1 million from a year earlier. AGF Trust contributed $18.3 million to net interest income, of which $17.8 million was reported in B2B Bank and $0.5 million in the other segment. NIM in the second quarter of 2013 was 1.68 percent, down 5 basis points from the 1.73 percent reported a year ago. Accounting for the decline were the continuing very low interest rate environment, higher yield curve in competitive pricing. This was partially offset by AGF Trust's higher margin loans which added 5 basis points to NIM. NIM was nonetheless higher by 5 basis points sequentially as the maturity of high coupon securitization liabilities and lower liquidity levels helped to raise margins in the second quarter.

Second, other income of $74.4 million rose 6 percent from the second quarter of 2012, as shown on Slide 7. The increase was broad-based, reflecting improvements in most revenue streams, specifically card service revenues grew by 10 percent and credit insurance income and income from the sale of mutual funds each increased 21 percent. With respect to Mutual Fund sales, the RSP season was very strong with positive momentum being generated from the Mutual Fund Distribution Agreement with Mackenzie Financial.

Furthermore, other, other income grew by 25 percent reflecting the sale of the $94.7 million of commercial mortgage loans which led to the recognition of $3.7 million gain. This is consistent with our syndication strategy. Recall that in the second quarter of 2012, the bank sold $77 million of commercial loan real estate portfolio, resulting in a $3.1 million gain in other income. Offsetting these improvements was a $1.3 million decline in treasury and financial market operations owing to lower net security gains.

Third, as highlighted on Slide 8, the provision for loan losses amounted to $9 million in the second quarter of 2013, $1 million higher than in the first quarter and $1.5 million higher than a year earlier. Despite these modest increases, provisions remain at a very low level, reflecting continued good credit quality and a stable employment and business conditions in Canada. AGF Trust accounted for $2.5 million of loss provisions in the second quarter of 2013 compared to $3.2 million in the first quarter of 2013. A detailed breakdown shows that the provision for loan—personal loans and VISA cards increased by $1.6 million compared to a year earlier, largely owing to the addition of AGF Trust provisions. The provision for residential mortgage loans rose by $374,000 reflecting portfolio growth, while commercial mortgage loan losses fell by more than $2.5 million as the portfolio remains sound. Provisions for commercial loans increased by $2 million from a year earlier as there were no material reversals of provisions in the second quarter of 2013.

Slide 9 highlights the gross impaired loans at the end of the second quarter totaled $117.7 million, 8 percent lower than at the end of the first quarter of 2013 and 20 percent lower than a year earlier. Increases due to the acquired personal and residential mortgage loan portfolios were more than offset by improvements in the commercial loan portfolios. In the second quarter of 2013, the provision for loan losses, as a percentage of average loans and acceptances, stood at 0.14 percent. This is a very low loss level and we expect that provisions could gradually revert to more normal levels. However, our low and relatively stable credit risk profile, as demonstrated by this loss ratio, should continue to compare favourably to the banking industry as a whole.

Turning to Slide 10, the efficiency ratio. Excluding transaction and integration costs for the second quarter of 2013, improved to 71.5 percent compared to 72.4 percent in the second quarter of 2012. In addition, operating leverage was positive at 1.2 percent year-over-year on the same basis.

Slide 11 highlights the T&I costs in the second quarter of 2013 totaled $6.1 million compared with $7.6 million in the prior period. Of the $6.1 million, MRS accounted for $1.8 million while AGF Trust accounted for $4.3 million. With the MRS integration almost complete, B2B Bank is now prioritizing the AGF Trust integration. The timeline for its completion has been finalized. In order to maintain our promise of quality service to the financial advisors who do business with us and their clients, we have planned the systems conversion and client integration over an 18-month period from the date of acquisition. Thus, most of the account conversion will be completed by the end of this calendar year. However, owing to the heightened activity during the RSP season, final synergies involving data cleanup, process streamlining, will be achieved by the third quarter of 2014.

Turning to Slide 12, operating expenses related to the AGF Trust operation totaled $7.8 million in the second quarter versus $9 million in the first quarter of 2013. Non-interest expenses, excluding the impact of AGF Trust and T&I costs, increased by only 1 percent year-over-year.

Slide 13 highlights the continued growth in the balance sheet over the past 12 months, helped by acquisitions. Loans and BAs totaling $27 billion rose by $3.9 billion of which residential mortgages increased by $2.2 billion. Personal loans increased $1.5 billion. Commercial loans and mortgages grew by $0.2 billion. However, excluding the sale of a $94.7 million commercial mortgage portfolio, commercial loans and mortgages increased by 6 percent. Deposits totaled $23.8 billion, $2.7 billion higher than a year ago. On a sequential basis, loans and BAs rose by $0.2 million—million (phon), with growth subdued to slowing demand in a cooling housing market. Commercial loans increased as the bank capitalized on higher demand from its business clients. Commercial mortgages, excluding the aforementioned portfolio sale, rose by 4 percent. Deposits were relatively unchanged on a sequential basis. Retail deposits remain a very stable source of funding for the bank with personal deposits representing 82 percent of total deposits at the end of the second quarter of 2013.

As at April 30th, 2013, the Tier 1 common equity ratio was 7.6 percent compared to 7.5 percent as at January 31st, 2013, as is shown on Slide 14. The increase was largely driven by internally generated capital, which increased common equity, while total risk assets remains relatively unchanged. As well, close to 97,000 new shares were issued during the quarter under the Dividend Reinvestment and Share Purchase Plan. The bank remains comfortably capitalized.

I will now turn to the performance of our four business segments.

Slide 15 shows that Retail and SME Québec contributed $9.7 million to net income, $1 million lower than the year earlier. Total revenue increased by $1.4 million from the second quarter of 2012. We are pleased that our initiatives to improve other income are bearing fruit, as higher income from the sale of mutual funds and deposit fees contributed to strong growth in other income of 14 percent. However, this was not sufficient to offset the impact of the persistently low interest rate environment which resulted in net interest income declining by 4 percent. Loan losses were up $1.1 million, while loan volumes increased by 4 percent year-over-year. Non-interest expenses remained well contained growing by 2 percent year-over-year.

Slide 16 highlights the Real Estate and Commercial segments' contribution to net income of $16.4 million in the second quarter of 2013, 3 percent lower than in the second quarter of 2012. Margin compression resulted in net interest income declining by $1.9 million. Contributing to other income was a previously mentioned sale of a $94.7 million real estate loan portfolio for which a $3.1 million gain was reported in this segment. The bank will continue to deploy its syndication strategy to take advantage of market opportunities which benefit risk in capital management. Loan losses decreased by $1.8 million compared to a year ago, reflecting overall improvement in the commercial mortgage portfolio and some credit quality but were $1.4 million higher sequentially as the first quarter of 2013 benefited from a $2 million settlement. Non-interest expenses increased $0.9 million year-over-year due to regular salary increases and a higher allocated cost.

As shown on Slide 17, B2B Bank's contribution to adjusted net income was $15.2 million excluding T&I costs in the second quarter of 2013, a 44 percent improvement from the second quarter of 2012. AGF Trust contributed net income of $5.9 million to the B2B Bank business segment. Net interest income increased by 54 percent to $47.2 million, owing to acquisition-related loan and deposit volumes. Other income fell by $0.2 million in the second quarter of 2013. A slightly lower B2B Bank dealer services, sourced fees on investment accounts were partly offset by a $0.5 million contribution from AGF Trust. As you may recall, B2B Bank dealer services is a new entity that absorbed the activities of the MRS companies. Loan loss provisions of $3.2 million in the second quarter included $2.5 million of provisions relating to the AGF Trust portfolios. Non-interest expenses increased by $7.7 million, all of which is accounted for by the addition of $7.7 million of AGF Trust expenses. Higher allocated costs, increased salary and pension costs were offset by realized cost synergies.

As shown on Slide 18, Laurentian Bank's Securities in Capital Markets' contribution to net income was $3 million in the second quarter, a 7 percent increase from the second quarter of 2012. Revenues increased by 4 percent due to improved training and retail brokerage activities. Non-interest expenses increased by $0.4 million reflecting higher performance based compensation, commissions and transaction fees.

The other sector presented on Slide 19 posted a negative contribution to net income of $3.7 million in the second quarter of 2013, compared with a negative contribution of $4.7 million in the second quarter of last year.

Net interest income improved by $0.5 million, largely due to the maturing of high high-coupon securitization liabilities, while other income decreased $0.9 million mainly as a result of lower security gains.

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

Réjean Robitaille, President and Chief Executive Officer

Thank you, Michel. And we are pleased with our earnings growth and are convinced that our strategies to build and develop the bank will continue to unlock shareholder value. Specifically, higher margin commercial activities have become increasingly important to the bank, accounting for 44 percent of adjusted net income in the second quarter of 2013. We are continuing to increase the number of account managers and add to the number of specialized industries and niches that we serve. In addition, this quarter we rolled out our CRM system to the small and medium enterprises account managers. All of these initiatives should help perpetuate solid growth going forward.

Moreover, we plan to further leverage our CRM system soon to be deployed through Real Estate and Commercial segment. It should be noted that the CRM, which was first used in Retail Banking, is contributing to its 14 percent growth in fee income. This tool continues to provide the bank with a competitive advantage particularly in the Québec market.

As well, our Mutual Fund Distribution Agreement with Mackenzie Financial is gaining traction. Fund sales have been strong, contributing to mutual fund assets under administration increasing by 18 percent year-over-year.

In another vein, we have made some changes to the organization of the bank in recent weeks subsequent to the departure of Luc Bernard, who was in charge of the Retail and SME Québec segments. As of now, Stéphane Therrien, Executive Vice President, Real Estate and Commercial, will be responsible for the SME Québec group. As well, Gilles Godbout will become Head of Retail Banking operations. Gilles, who have lead this division in the past will assume these Retail Banking functions in addition to his current responsibilities as Executive Vice President, Operations and Systems.

Having completed a successful RRSP season, B2B Bank is now prioritizing the integration of AGF Trust. Activities such as reviewing mortgage processes, credit reviews, program analysis and more, are underway. The residual activities related to the integration of MRS Trust, consisting primarily of process optimization, will be achieved when AGF Trust is fully integrated. In this way, all three entities will be combined into one and efficiently operating on a single platform so as to realize the expected synergies.

Laurentian Bank Securities and Capital Markets, despite a challenging backdrop, grew earnings by 7 percent year-over-year and 11 percent quarter-over-quarter. This validates its business model. Furthermore, with its good pipeline of investment banking transactions, LBS is well positioned to take advantage of a market recovery.

In March, Isabelle Courville assumed her role as Chairwoman of our Board of Directors. She has been a Director of the bank since 2007. As an engineer and a lawyer by profession she was, until recently, President of Hydro Québec distribution. The bank is privileged to have as its Chair, a person with such knowledge and abilities.

To conclude, we had another strong quarter. Moreover, we are pleased that our book values has increased by 15 percent over the past two years and that our capital base and our solid financial results have supported seven dividend increases over the past 14 quarters. To perpetuate this trend, we will continue to effectively execute our strategies, and in this manner, enhance shareholder value.

I will now turn the floor back to Gladys.

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

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.

QUESTION AND ANSWER SESSION

Operator

Thank you, Ms. Caron. Questions will now be taken from the telephone line. Please press star, one, at this time if you have any questions. There will be a brief pause while participants register. Thank you for your patience.

The first question is from Sumit Malhotra with Macquarie Capital. Please go ahead.

Sumit Malhotra, Macquarie Capital

Good afternoon. First question is for Michel. I think I missed some of your comments on the preferred dividend line this quarter. I think you were perhaps discussing the fact that you had a redemption that took place partway through and then you had a new issue as well. So, if I could just get you to repeat a little bit of that and then the punch line is, is the pref div expense that we see on the income statement this quarter heavier than it will be on a run rate basis?

Michel Lauzon, Chief Financial Officer

You're correct, Sumit, the pref expense reflected three—the—a full dividend on the three series, Series 9, 10 and 11 but we retired Series 9 midway through the quarter paying a full dividend, and so next quarter we should only have dividend on the remaining two series and the impact on EPS was $0.05.

Sumit Malhotra, Macquarie Capital

Oh, $0.05. Okay, so I'm just looking back here and I can probably calculate some of this myself, but if you have it handy, so you were at $2.5 million as the payment last quarter; $4 million this quarter, what do...

Michel Lauzon, Chief Financial Officer

And...

Sumit Malhotra, Macquarie Capital

What do we see going forward as the run rate level?

Michel Lauzon, Chief Financial Officer

Would be 2.5.

Sumit Malhotra, Macquarie Capital

Two and a half is the right number, okay. Thank you for that. I missed some of that in your comments.

Michel Lauzon, Chief Financial Officer

Yes.

Sumit Malhotra, Macquarie Capital

Another factor that or a factor that helped the bank this quarter was the net interest margin and there you talked about some maturity of what we'll call some higher cost funding during the quarter. So, first off, could you give us a little bit more information there and is that something that took place midway through the quarter? In other words, is there a further benefit from this to come?

Michel Lauzon, Chief Financial Officer

It happened towards the end of the first quarter, so we had the full benefit in the second quarter and was a high coupon CMB that matured and the replacement assets that were matching that and matured in Q3, at the end of Q3 last year, so March were depressed a little bit in Q4 and Q1 and they recovered in Q2. We should expect margins to stay pretty much in the same area of about 163 to 164 basis points plus or minus 3 or 4 basis points but possibly at the high end of that band over the next one or two quarters.

Sumit Malhotra, Macquarie Capital

And maybe related to that, it seems like we're getting close to the end of reporting season here for the banks. It seems like we've seen the loan growth slow down that we all expected for a few years, start to take place more noticeably this year but particularly this quarter for most banks, the net interest margin trend was less severe in terms of decline. Are you from, from your position seeing perhaps more rational behavior from the Canadian banking sector now that the loan growth has started to slow and nobody wants to be getting hit on both sides? Is that a fair commentary for what we're seeing in the market?

Michel Lauzon, Chief Financial Officer

Margins are—pricing is still very competitive in all segments. We've seen some pretty aggressive mortgage pricing and we're seeing some aggressive GIC pricing. As we mentioned in prior calls, in some instances we decided not to play that thin margin game and would protect margin at the expense of some volume but also it's been a while since rates have been low and so a lot of the repricing has been done. There's still some trickling through but yes, the rate of decline has subdued somewhat.

Sumit Malhotra, Macquarie Capital

Is it more on the funding side than on the asset side?

Michel Lauzon, Chief Financial Officer

It would be on the asset side.

Sumit Malhotra, Macquarie Capital

Well, sorry, what I mean is, are you—is there still some further benefit, the same way you had this quarter, from higher cost funding starting to roll off that we might see help to stabilize margin, as well?

Michel Lauzon, Chief Financial Officer

Margins should have stabilized already but the, as I said, margins could remain on the upper side of that band I mentioned for the next three to six months and should subside back down to the 163, 164 level, and maybe with some slight trending down afterwards as we still keep on feeling the effect of the very low interest rate environment.

Sumit Malhotra, Macquarie Capital

Last question for me; it's probably going to be for you again, Michel. It's on expenses and specifically, the sub-segment you call the premises and technology line. That line for a couple of reasons, was up something like $4 million quarter-over-quarter. A pretty large increase given the stability we've seen there and if anything I thought as the—as you continue to work through the synergies from the transactions we would start to see some of these costs move lower. So, can you provide a little bit of colour on what happened there specifically? It looks like on the technology line, you'd had a relatively large increase this quarter.

Michel Lauzon, Chief Financial Officer

Yeah, that we—a couple of things. We had some recovery, some contractual recoveries in Q1 that helped us a little bit. In Q2, with personal, we have the effect of, the full effect of the introduction of the harmonized sales tax. We had some pretty large systems both on the regulatory front coming into stream which increased amortization costs and there are—there were expansion, some of the lease premises for some of the technology people in the quarter and we haven't yet seen a reduction in lease premises in the acquired businesses yet.

Sumit Malhotra, Macquarie Capital

So would this—would—so based on that last point, you haven't seen them yet, is it reasonable to expect that this line was higher than what we'll normally see? Because if you look back over the last number of quarters it was pretty stable in the 30, 80-ish million dollar range.

Michel Lauzon, Chief Financial Officer

As I indicated in my comments, we should be realizing full synergies towards middle of next year, so that's probably when we can hope to achieve some cost savings in terms of rental costs.

Sumit Malhotra, Macquarie Capital

Thanks for your time.

Operator

Thank you. The next question is from John Reucassel with BMO Capital Markets. Please go ahead.

John Reucassel, BMO Capital Markets

Thank you, and I just want to go back to the net interest margins for a second and on Slide 6, was the ability—was the shift from 163 basis points to 168, was that all due to the deposits, that reduction in the lower cost—or high cost deposits at AGF or?

Michel Lauzon, Chief Financial Officer

No...

Réjean Robitaille, President and Chief Executive Officer

Michel, once again, if you want to...

Michel Lauzon, Chief Financial Officer

No, John, what's shown on the slide really the—what we're seeing is two different things happened or as it’s shown on the Slide 3. Basically, the lower interest rate environment has cost us about 8 basis points on a year-over-year basis, then we had mentioned in a prior call that we had a heightened level of liquid asset which were providing a drag on margins and we meant to reduce those somewhat in the quarter, that helped by 2 basis points, and that AGF Trust business does carry a higher margin and overall, that helped our margins by 5 basis points. We had minus 10 on one side, plus 5 on the other for a net benefit of 5; a net drag of 5 year-over-year. If you're looking at sequentially, then the high coupon CMB that matured, helped us on a sequential basis.

John Reucassel, BMO Capital Markets

Okay. Okay, that's what I was looking at, the sequential.

Michel Lauzon, Chief Financial Officer

Yeah.

John Reucassel, BMO Capital Markets

So, when you talk—and so just to make sure, this—when you talk about net interest margins going forward, you're talking 163 to 164, plus or minus 3 basis points.

Michel Lauzon, Chief Financial Officer

Right.

John Reucassel, BMO Capital Markets

Okay, so the 168 you're saying is too high, so it's probably going to migrate towards the lower end of the 160.

Michel Lauzon, Chief Financial Officer

Towards the end of the year.

John Reucassel, BMO Capital Markets

Towards the end of the year, okay, okay. Just want to make sure I understood that. And then, just on the CET1 ratio, for Réjean, what is the right, you know, your at 7.6 percent, I’m just wondering has your view of where you need to be changed at all, do you—when you operate longer term, where would you like that ratio to be?

Réjean Robitaille, President and Chief Executive Officer

Well, as Michel mentioned in his comments, we are quite comfortable with the actual level. That said, I would say that we would like to see strong capital ratios, that's part of the first priority that we have when we manage capital, so I would say a little bit higher than that. They're depending of how the market might evolve. I think that we need a sufficient cushion. Right now, it is the case but I will certainly like to see this ratio a little bit higher in the quarters to come.

John Reucassel, BMO Capital Markets

So, you're not willing to say, you know, you'd really like 8 to 8.5 long term; that you're just—will—you're going to see...

Réjean Robitaille, President and Chief Executive Officer

Well, I think that we will...

John Reucassel, BMO Capital Markets

How things evolve, is that what you're...

Réjean Robitaille, President and Chief Executive Officer

That we'll have also to take that into consideration versus the others. We are not—and we are not (inaudible) that the 8 percent level that was asked for the other bank, we're not in that area but depending of how market might evolve eventually, I think that we need to make sure that the difference of, and this is not that high, and at the same time want to remind you that we are comparing with that apple versus oranges because we are still under the standardized methodology, as you know, and by switching eventually to the AIRB methodology will certainly help and make a lot of potential, I'd say, capital management opportunities going forward.

John Reucassel, BMO Capital Markets

Okay, and then just on the commercial real estate, the portfolio of loans that was sold, again, if I'm—I'm sorry if I missed this, if you answered the question, but what is the nature of that, is that mainly in Québec or is it in Ontario or where is it? What was...

Réjean Robitaille, President and Chief Executive Officer

Okay.

John Reucassel, BMO Capital Markets

Why was the decision to sell this portfolio? Was it just good pricing on it or could you give us some sense or some...

Réjean Robitaille, President and Chief Executive Officer

Yeah.

John Reucassel, BMO Capital Markets

Colour around that portfolio sale?

Réjean Robitaille, President and Chief Executive Officer

I'll ask Stéphane Therrien to answer this question. Stéphane...

Stéphane Therrien, Executive Vice-President, Real Estate and Commercial Financing

Yeah.

Réjean Robitaille, President and Chief Executive Officer

With commercial activities.

Stéphane Therrien, Executive Vice-President, Real Estate and Commercial Financing

We mentioned in Q2 of last year we created a syndication desk to be able to proactively manage our risk weighted assets as well as our credit risk, so these loans were across Canada, to answer your first part of the question, and the main purpose was to manage again, capital and credit risk.

John Reucassel, BMO Capital Markets

Okay, so is there—is it just happened to happen in Q2 or could it happen any quarter?

Stéphane Therrien, Executive Vice-President, Real Estate and Commercial Financing

It just happened to be in Q2 of last year and this year.

Réjean Robitaille, President and Chief Executive Officer

It could happen in any other quarter.

Stéphane Therrien, Executive Vice-President, Real Estate and Commercial Financing

Yeah.

Réjean Robitaille, President and Chief Executive Officer

That's something that we want to continue to look at in the coming quarters.

John Reucassel, BMO Capital Markets

Okay, but, and is it concentrated in any industry segments?

Stéphane Therrien, Executive Vice-President, Real Estate and Commercial Financing

No, we don't know.

Réjean Robitaille, President and Chief Executive Officer

No.

John Reucassel, BMO Capital Markets

Okay. Thank you very much.

Réjean Robitaille, President and Chief Executive Officer

Thanks, John.

Operator

Thank you. The next question is from Scott Chan with Canaccord Genuity. Please go ahead.

Scott Chan, Canaccord Genuity

Good afternoon. Just on AGF Trust, you've had two quarters where net income's been about $6 million per quarter. If you annualized that, you get $24 million. Do you stand, still stand by your guidance of $28 million to $30 million in net income for 2014 and in terms of what you're talking about in starting the integration process, is there going to be any synergies this year or is the bulk going to be in the next three quarters next year before you finalize in Q3?

Réjean Robitaille, President and Chief Executive Officer

Okay, I'll ask François Desjardins, Head of B2B Bank to answer this question, Scott.

François Desjardins, Vice-President, Direct Financial Services

Okay. Thanks, Scott. As you said, the current run rate is around 24. We expect that to remain steady for the next few quarters. I believe at this point though, that we were maybe a little conservative on the 28 to 30 income targets, which should come in at six to eight more than what our current run rate is, so 30, 32, but if that come a little later and the full impact of that would be Q3 2014.

We should see a little bit of synergies in first two quarters of 2014 but the bulk of it will be in the third quarter.

Scott Chan, Canaccord Genuity

What gives you more confidence that the initial guidance is a bit conservative compared to what you're thinking now?

François Desjardins, Vice-President, Direct Financial Services

Well, we've been running the business for close to nine months now, so just taking a look at the different plans, as I had said in a couple of quarters ago, you know, that 28 to 30 is a combination of things, right? It's a top line by going downwards a little bit, loan losses certainly heading upwards and then the cost synergies making up for that and more and at this point, we believe that revenues will hold better than expected. So, other factors being the same.

Scott Chan, Canaccord Genuity

Okay. Thanks. Just on one line item. I noticed the rent and property tax increased $1 million sequentially or about 10 percent. Was that more on the rent side or maybe just a bit more colour on the increase sequentially?

Michel Lauzon, Chief Financial Officer

That's mostly the rent side.

Scott Chan, Canaccord Genuity

Just higher rent agreements or...

Michel Lauzon, Chief Financial Officer

Yeah...

Scott Chan, Canaccord Genuity

Anything...

Michel Lauzon, Chief Financial Officer

As I mentioned on a prior question, we did lease some extra space to house some IT people related to all the projects we're running right now.

Scott Chan, Canaccord Genuity

Okay, and just last question maybe for Michel, just on the tax rate. At 21 percent the last two quarters, is that a good run rate kind of going forward?

Michel Lauzon, Chief Financial Officer

No, our run rate should be as I—prior guidance was 23 to 25; we just happened to have a more favorable mix in terms of taxable income this quarter which helped us. It's not something we'd see as it necessarily recurring.

Scott Chan, Canaccord Genuity

Okay. Yeah, that's what I thought. Okay, thanks, guys.

Operator

Thank you. The next question is from Michael Goldberg with Desjardins Securities. Please go ahead.

Michael Goldberg, Desjardins Securities

Thank you. It looks like you have the $4.3 million of net declassifications of commercial mortgages during the quarter. Is that level of rehabilitations related, at all, to the sale of commercial mortgages?

Louis Marquis, Senior Vice-President, Credit

Not at all.

Réjean Robitaille, President and Chief Executive Officer

Louis, would you answer that question?

Louis Marquis, Senior Vice-President, Credit

Not at all.

Michael Goldberg, Desjardins Securities

Okay. How much interest recapture was there on the commercial mortgages that were declassified from impaired during the quarter?

Louis Marquis, Senior Vice-President, Credit

Again, there was none. Under current accounting rules we actually—the impaired loans we accrued—we account for interest on a monthly basis and they get diverted to loan losses so they're—anytime we reclassify a loan nowadays, there's no interest recapture at all.

Michael Goldberg, Desjardins Securities

Oh. Okay, thank you.

Operator

Thank you. The next question is from Nixus Dogdool (phon) with Credit Suisse. Please go ahead.

Nixus Dogdool, Credit Suisse

Hi, good afternoon. I just had a couple of questions for François. First, can you give us a sense of the allocation of the investment loan collateral at B2B Trust? How much is in Canadian equities versus global equities versus fixed income?

François Desjardins, Vice-President, Direct Financial Services

No, we never disclose any of the details for the collateral on any of the investment loan portfolios that we have.

Nixus Dogdool, Credit Suisse

Okay. What about the LTV of the investment loans at B2B Trust, are you able to disclose that or has it been disclosed?

François Desjardins, Vice-President, Direct Financial Services

It has never been disclosed.

Nixus Dogdool, Credit Suisse

Okay, and then just one on AGF. Are you able to tell us or give us some guidance on what the anticipated decline in the loan book may be over the next six quarters? I'm just trying to—I just wondered if you could walk us through how you think about the revenue loss, revenue losses on that versus what may come through PCL improvements?

François Desjardins, Vice-President, Direct Financial Services

Sure. From a—the AGF Trust book you can go through the history. We had some decline in the investment loan book and an according decline in the deposit book. What we see is a continuation of that decline but starting to see some stabilization of it and we plan that to stabilize that decline in the investment loan book over the several next quarters. The deposit book is now a part of the B2B Bank overall book, so we manage the need for funding overall for the total of the bank, so that's now, you know, disassociated with that book, per se. We are seeing some growth actually in the mortgage book even though there might be some market contraction in demand and for sure, everybody's feeling it. We're still seeing some growth in that book, so that's how we see things going in future.

Réjean Robitaille, President and Chief Executive Officer

Michael, so just on the previous questions about loan-to-value; yes, we haven't published any numbers on this but I might ask Louis Marquis to give you a little bit more colour about the quality of that portfolio on the credit basis side.

Nixus Dogdool, Credit Suisse

Thank you.

Louis Marquis, Senior Vice-President, Credit

One of the reason we don't go into publishing those numbers is that they're actually underwritten on the quality of the borrower. So, we need the collateral as just an extra for us and that portfolio has generated for B2B Bank, one of the best quality portfolios we have in the bank. Our loan losses through all the cycles have been below 10 basis points, which is much better to add to the portfolio. It is a reflection of the quality, the underlying quality of the borrower's notwithstanding the value of the collateral.

Nixus Dogdool, Credit Suisse

Okay, thank you very much.

Operator

Thank you. As a reminder, you may queue up for questions at any time by pressing star, one, on your telephone keypad.

The next question is from Shubha Khan with National Bank Financial. Please go ahead.

Shubha Khan, National Bank Financial

Thanks. So, just a quick follow-up on the NIM here, maybe for Michel. So, as you mentioned in your prepared remarks, a part of the margin expansion this quarter was driven by the reduction in liquidity. I know that there was a reduction in replacement assets due to the CMB maturity, but it still looks like the liquid assets are at, you know, historically low levels. So as we look ahead, how should we think about liquidity? Should we expect it to be roughly in line with current levels or roughly 19 percent of total assets or what's the best way to think about this?

Michel Lauzon, Chief Financial Officer

If you look at just the balance sheet and you look at securities, you have to remember that some of those securities are in the operating book of the security subsidiary, Laurentian Bank Securities, so what we look at when we look at operating liquidity or excess liquidity, we exclude those portfolios and we take haircuts (phon) on some of the others and so right now, we're still running with slightly higher excess liquidity than what we'd like so we could see $200 million to $300 million contraction from the end of the quarter over time, but they tend to be lumpy. It goes up and it can be up and down $50 million in a day but we're trying to trend lower and help margin as a result. We managed to do that in the first half of the year and it has helped margin; whereas it had subtracted from margin in late—latter part of last year. So, hopefully we should continue to see some slight improvement there as we go forward and we manage liquidity lower. So right now, I feel we're very comfortable with our level of liquidity and, in fact, we feel that we're slightly a bit over liquid in the current situation.

Shubha Khan, National Bank Financial

Okay, so to the extent that you see any further compression in underlying loan-to-deposit spread, do you feel that you could offset that with a reduction in liquidity then?

Michel Lauzon, Chief Financial Officer

The size of the portfolio is certainly a factor and here we're talking to $25 billion portfolio versus a $1 billion—or $2 billion portfolio, so I don't think one can offset the other but it can certainly help to attenuate any negative trends.

Shubha Khan, National Bank Financial

Okay. Got it and if I can turn to non-interest expenses again; specifically salaries and benefits and I apologize if I missed it in your prepared remarks, but is, you know, if I look at headcount, which looks like it was largely unchanged versus last quarter, trying to understand what drove the sequential decline in core sort of compensation expenses, particularly employee benefits.

Michel Lauzon, Chief Financial Officer

A couple of things. We had good performance in our staff benefits in terms of collective insurance where the cost went down. We also had, and I'm trying to see what you're specifically—that would be the main factor on the benefits side. In terms of staff costs, we've actually, we did some staff rationalizations in the beginning of the first quarter which helped on a pipeline basis into Q2 and there are three less days in the second quarter, as well.

Shubha Khan, National Bank Financial

Okay, and then final question just on, just turning to regulatory capital. To follow-up on your earlier comments about the negative impact on the common equity Tier 1 ratio as a result of the use of the standard approach, how far is the bank from transitioning to AIRB?

Réjean Robitaille, President and Chief Executive Officer

Well, I'll ask Pierre Minville, our Chief Risk Officer, to answer the question, Shubha.

Pierre Minville, Executive Vice-President and Chief Risk Officer

In fact, it's a two phases project, so we'll be, upon approval by us, we will—should be able to add a first implementation early 2016 and the final phase in early 2018.

Shubha Khan, National Bank Financial

Perfect, thank you very much.

Operator

Thank you. Once again, please press star, one, if you have any questions or comments.

There are no further questions registered at this time. I'd now like to turn the meeting back over to Miss Caron.

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

Thank you everybody 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.

Operator

Thank you. The conference call has now ended. Please disconnect your lines at this time. Thank you for your participation.
