SPEAKING NOTES - NATIONAL BANK OF CANADA
SECOND QUARTER EARNINGS CONFERENCE CALL
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Linda Boulanger – Senior Vice President, Investor Relations

Thank you operator. Good afternoon everyone and welcome to our second quarter presentation.

Presenting this afternoon are:

- Laurent Ferreira, President and CEO of the Bank;
- Marie Chantal Gingras, Chief Financial Officer; and
- Bill Bonnell, Chief Risk Officer.

Also joining us for the Q&A session are:

- Lucie Blanchet and Stéphane Achard for Personal and Commercial Banking. Stéphane is also now responsible for our international activities, namely ABA Bank;
- Denis Girouard, Head of Wealth Management; and
- Étienne Dubuc, Head of Financial Markets, and now responsible for Credigy.

Before we begin, I refer you to Slide 2 of our presentation, providing National Bank's caution regarding forward-looking statements.

With that, let me now turn the call over to Laurent.

Laurent Ferreira, President & CEO

Merci Linda and thank you everyone for joining us.

This morning, National Bank reported solid results for the second quarter, with earnings per share of $2.38. We generated a return on equity of 17.5%, reflecting our highly accretive business model. This performance underscores the strength of our franchise and diversity of our earnings streams.

In the face of macroeconomic uncertainty and US banking turmoil, we remain very comfortable with our strategic positioning and defensive posture.

First, our capital position is strong. With a CET1 ratio of 13.3%, we have flexibility to invest in organic growth across our businesses and a buffer against potential headwinds.

Second, our liquidity position is robust and the Bank benefits from a diversified funding profile.

Third, our credit portfolios continue to perform well. Although our impaired PCLs are low, given the uncertain macroeconomic outlook, we continue to build reserves, consistent with our conservative approach.

On capital deployment, our strategy has always been guided by prudence and discipline, and that remains unchanged. We are focused on maintaining strong capital ratios, providing us with the flexibility to invest in business growth and to return capital to shareholder, when appropriate.

To that end, we announced a 5% dividend increase, raising the quarterly dividend to one dollar and two cents per share. The payout ratio is now at the low end of our target range of 40-50%, which is where we want it to be.

I will now review our business segments.

Personal and Commercial Banking delivered strong performance in the second quarter. PTPP earnings increased by 22% from last year, mainly reflecting margin expansion and balance sheet growth. As anticipated, we continued to see a slowdown in mortgage growth. As such, in the context of higher rates, we remain very disciplined in managing net interest income.

In Commercial Banking, we continued to see strong momentum with loan growth of 3% sequentially. For the second half of the year, we expect commercial loan growth to remain healthy but to decelerate, as businesses continue to adjust to higher borrowing costs.

Wealth Management also performed well. Again this quarter, we generated strong year-over-year earnings growth, supported by our diversified business mix, our large deposit base, and higher interest rates. We also delivered strong asset growth, up 7% from last year, demonstrating the breadth of our franchise.

Financial Markets delivered strong second quarter results, in what has been a challenging environment. Corporate and Investment Banking showed strength, driven by M&A and strong lending activity. Global Markets also delivered strong performance. Results in equities were robust, albeit lower than last year's record level. We were also pleased with the continued momentum in FICC and Securities Finance. The performance of our Financial Markets franchise demonstrates its resiliency, earnings diversification, and ability to quickly adapt to market conditions.

Turning to our **International segment**.

ABA Bank's results reflect continued momentum in balance sheet growth, with loans and deposits up more than 25%. Over time, we have been strategically investing to support strong business growth and network expansion. Our investments are paying off as our client base has grown by 40% over the past year.

ABA's revenue growth in the second quarter decelerated, primarily reflecting current pressure on the deposit margin resulting from: higher rates, migration to term, and a more competitive market for deposits.

Looking forward, we continue to expect double digit balance sheet growth for fiscal 2023. Based on what we are seeing today, margin pressure should ease over the next few quarters. Longer-term, the outlook for ABA Bank remains very attractive, based on Cambodia's strong fundamentals and the reopening for tourism.

I would now like to step back and provide a broader perspective on **Credigy's** business model. Our franchise has demonstrated a proven ability to execute in any macro environment and has shown consistent risk-reward discipline. Our portfolio is high quality, well diversified, and accretive to the Bank's NIM and ROE.

Credigy's opportunity set is driven by liquidity disruptions as much as by credit cycles. During the second quarter, the Fed intervened to address concerns about systemic risks in the US banking system by injecting liquidity, thereby greatly reducing the liquidity disruption. As a result, Credigy's second quarter asset growth was modest.

On the revenue side, the year over year decline reflects the asset mix evolution which now is more secured, longer duration, and has lower LTVs. This is in line with our defensive positioning, given the current landscape.

Regarding the outlook for Credigy, we are pleased with the asset growth delivered in the first half of the year, which supports our double-digit growth target for F2023. Credigy has a long track record of success and we remain confident in our ability to continue to generate high quality earnings in the years to come.

Moving to **the macroeconomic environment** – The economy is adjusting to a higher rate environment and much uncertainty remains around the path of interest rates and inflation. Nonetheless, Canada - where the vast majority of our activities are focused - is structurally strong and well-positioned to weather an economic slowdown. Notably:

- The recent turmoil in the global banking industry underscores the strength and resiliency of the Canadian banking system;
- Our labor market remains robust; and
- Canada's population growth, fueled by immigration, is the highest among the G7 countries and can contribute to sustainable growth.

To wrap-up: The Bank delivered a solid performance and a superior ROE in the second quarter, amidst a challenging environment. Our strategic choices and our defensive posture - with a strong balance sheet and prudent reserves - will continue to support profitable growth and help us navigate the uncertainty.

With that, I will pass it over to Marie Chantal.

Marie Chantal Gingras, CFO & EVP, Finance

Thank you, Laurent, and good afternoon, everyone.

My comments will start on Slide 7. The Bank delivered solid financial results in Q2 despite a less constructive backdrop.

Revenues increased 5% year over year. In particular, we generated solid revenue growth in P&C Banking and Wealth Management, as well as strong performance from Corporate and Investment Banking.

Expenses increased 6% year over year. A significant proportion of our expense growth was driven by last year's FTE growth and wage inflation. Over the past few quarters, we have been prudently managing new hires and job vacancies.

Also contributing to the increase in expenses were past and new technology investments to deliver value for client experience and efficiency. These investments reflect a greater proportion of opex within the expense mix. Higher costs for advertising, business development and occupancy accounted for the remainder of the increase.

Variable compensation was lower in the current quarter as last year's results included a compensation adjustment reflecting the Bank's strong performance.

Our long-standing, dynamic approach to balancing business growth and investments, as demonstrated by our highly efficient businesses, continue to generate a strong all-bank efficiency ratio of 52.6%.

As anticipated and discussed on our last call, operating leverage was negative in Q2 and we expect pressure to persist in Q3. We continue to be strategic and selective in managing expenses, notably related to headcount, technology investments and discretionary spending. While achieving positive operating leverage for fiscal 2023 remains challenging, we continue to target positive operating leverage in Q4. With respect to PTPP earnings, we expect growth in fiscal 2023 to be closer to the lower end of our mid-to-high single-digit target.

In a challenging environment, our disciplined approach to cost management contributes to the resiliency of the Bank.

Now turning to Slide 8. Total net interest income excluding trading increased by 18% from last year, with strong contributions from most businesses.

For P&C Banking, net interest income was up by 20% year over year, mainly driven by deposit margin expansion and balance sheet growth.

Wealth Management continued to benefit from higher interest rates and a strong deposit base of 40 billion dollars, resulting from the diversification of our underlying businesses. This led to a 50% increase in net interest income compared to last year.

For Corporate Banking, we continue to experience strong growth in net interest income year over year, in part driven by strong lending activity.

For USSF&I, net interest income decreased by 3% year over year as balance sheet growth was more than offset by lower margins, as discussed by Laurent earlier.

The all-bank NIM, excluding trading, was 2.09% in Q2.

When looking at NIM sequentially, recall that there were 4 basis points of non-recurring items that positively impacted Q1 NIM, including 20 million dollars of pre-payment revenue at Credigy, and an interest recovery on a previously impaired loan in Corporate Banking.

Second, Treasury's performance in Q1 benefited from positive seasonal effects, which accounted for a difference of about 6 basis points of NIM between Q1 and Q2.

Excluding these items, total Bank NIM ex trading, remained relatively stable sequentially.

Based on what we are seeing today, we also expect NIM to remain relatively stable in Q3. In addition, we expect NII to continue to grow, compared to last year, albeit at a slower pace than in previous quarters. As always, we remain disciplined on both sides of the balance sheet, balancing growth, margin and credit quality.

Slide 9 highlights our balance sheet. Loans grew by 11% year over year. Growth was broad-based, with particular strength in Corporate Banking, reflecting growing working capital needs, acquisition financings and capital markets disruption. Commercial loans grew by 11% year over year, in part driven by continued opportunities in the residential insured segment. As anticipated, growth in personal mortgages is decelerating, driven by housing market conditions. Sequentially, loans grew by 3% at the all-bank level.

Deposits, excluding wholesale funding, grew 17% year over year and 1.4% quarter over quarter, demonstrating again the strength of our diversified model and focus on growing our deposit base across all business segments.

Personal deposits are up 19% year over year and 2.4% quarter over quarter.

Demand deposits in our retail channels, which include Wealth Management, are down approximately 1% sequentially as we experienced some migration, notably from brokerage accounts to High Interest Savings Accounts and GICs.

Term deposits continued to grow in Q2, but at a slower pace than in previous quarters.

Non-retail deposits increased by approximately 16% year over year and 1% quarter over quarter, with all segments contributing to the growth.

Slide 10 presents our strong liquidity position and sound funding profile. Our core banking activities are well-funded through diversified and resilient sources. The Bank has a comprehensive view on deposits which involves all business lines, and we remain disciplined around funding costs. This strategy contributes to a well-diversified deposit base and to the Bank's strong overall performance.

With an objective of maintaining prudent liquidity metrics, the Bank consistently operates at levels that are well above regulatory minimum requirements. We ended Q2 with a Liquidity Coverage Ratio of 155% and a Net Stable Funding Ratio of 118%.

Now turning to capital on Slide 11. Our CET1 ratio improved by 76 basis points to reach 13.3%. Second quarter earnings net of dividends contributed 40 basis points to our ratio, underscoring our strong internal capital generation capacity. In addition, Basel III Reforms contributed 44 basis points to our ratio and a reduction in Market Risk RWA contributed 10 basis points.

Excluding Basel III Reforms and Market Risk, RWA increased by approximately $1.7 billion, representing 18 basis points of the CET1 ratio. Continued asset growth in the Corporate and Commercial Banking books accounted for 12 basis points, while unfavorable rating migration in non-retail portfolios accounted for 6 basis points.

Our capital position is strong. It provides us with flexibility to deploy capital across our segments to support growth and return capital to shareholders.

In conclusion, the Bank delivered solid Q2 results, supported by organic growth across our businesses, industry-leading ROE, solid balance sheet growth and good margins. Despite continued macro uncertainty, with a resilient business model and our disciplined approach to cost, capital and risk management, we are well-positioned for the second half of the year and beyond.

I will now turn the call over to Bill.

William Bonnell, Executive Vice-President, Risk Management

Merci Marie-Chantal and good afternoon all.

Although events in the US banking sector generated higher levels of uncertainty during the last quarter, the performance in our credit portfolios remained strong and continued to follow the trends we discussed on the last call. Strong employment and savings levels continue to help borrowers adjust to the impacts of higher interest rates. This is particularly true in our home province of Quebec where the unemployment rate remains near historical lows and consumer resiliency is strengthened by a greater proportion of two income households and lower debt levels. These factors continue to support the solid credit performance you see on slide 13.

In the second quarter, impaired PCLs rose to $52 million or 10 basis points. Across our domestic retail and non-retail portfolios, slow normalization generated impaired PCLs levels that remain well below prep-pandemic levels. At Credigy, impaired provisions were stable and driven by the normal seasoning of portfolios and at ABA performance continues to match our expectations with provisions well below the peak experienced in the second half of last year.

In light of ongoing macro uncertainty we prudently built additional reserves on performing loans in the quarter. Updates to our scenarios, portfolio growth and migration generated $27 million or 5 basis points of performing provisions, with the majority of these taken in the non-retail portfolios.

Looking ahead, we believe that credit performance will continue to normalize and we expect impaired PCLs to rise over the coming quarters and into next year. However, based on the strong credit performance we've experienced YTD and on current trends in delinquencies, we have lowered our full year impaired PCL target to 10-20 basis points and currently expect to end up in the bottom half of that range.

Turning to slide 14, Total Allowances for Credit Losses increased by 4% to over $1.2 billion. Performing ACLs grew to $975 million which is just 8% below its pandemic peak. On slide 29 in the appendix you'll find details of our allowance coverage ratios. In these uncertain times, we are very comfortable with this prudent level of allowances as well as with our defensive geographic and business mix.

Turning to slide 15, our Gross Impaired Loan ratio was stable at 38 basis points and remains below pre-pandemic levels. Net formations rose sequentially from last quarter, which had benefited from some repayments, and show ongoing slow normalization trends in our domestic portfolios. Net formations in the international segment continue to match our expectations.

On slides 16 and 17 we present the highlights of our Canadian RESL portfolio. The mix remained stable with Quebec accounting for 54% and Insured mortgages accounting for 29% of total RESL. Average LTVs increased slightly to 58% on uninsured mortgages and 53% on Helocs and average credit scores and delinquency rates were stable. Looking at the tail end of the distribution, we find that less than 50 basis points of the RESL portfolio is to uninsured borrowers with credit bureau scores of less than 650 and LTVs greater than 75.

I'll make some comments now about our Commercial Real Estate exposure. As you may remember, in the late-cycle years prior to the pandemic, we frequently discussed on these calls the fact that we had been restraining growth in the CRE sector. During the pandemic we continued to restrain growth in the office and retail segments but we allowed healthy growth in the residential segment, which was primarily related to CMHC-insured loans, to support the supply of affordable and energy efficient housing.

We have been providing details of the CRE portfolio on a slide in our appendices each quarter since the end of 2020, and you'll find it this quarter on slide 30. Ours portfolio is Canadian focused with minimal US exposure. The Office segment represents around 1% of total loans and benefits from the strong underwriting practices and meaningful recourse that are typical in the Canadian market. The retail segment is focused on essential services tenants and has decreased in size over the past 5 years. Our comfort in growing the residential segment comes from both the strong demographic trends in Canada supporting consistent demand for rental lodging, as well as the high proportion of insured lending in this segment. Overall, we remain very comfortable with the size, quality and mix of our CRE portfolio.

Now before closing, I'll summarize by saying that we are pleased with the credit performance again this quarter and remain very comfortable with our defensive positioning, our resilient mix, and our prudent level of allowances.

With that I will turn it back to the operator for the Q&A.