Canadian Western Bank

Fourth Quarter Fiscal 2018 Financial Results Conference Call and Webcast

Event Date/Time: December 6, 2018 — 11:00 a.m. E.T.

Length: 67 minutes

CORPORATE PARTICIPANTS

Matt Evans
Canadian Western Bank — Senior AVP, Strategy & Investor Relations

Chris Fowler
Canadian Western Bank — President and Chief Executive Officer

Carolyn Graham
Canadian Western Bank — Executive Vice President and Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Stephen Theriault
Eight Capital — Analyst

Sumit Malhotra
Scotiabank — Analyst

Robert Sedran
CIBC Capital Markets — Analyst

Gabriel Dechaine
National Bank Financial — Analyst

Meny Grauman
Cormark Securities — Analyst

Sohrab Movahedi
BMO Capital Markets — Analyst

Darko Mihelic
RBC Capital Markets — Analyst

Richard Roth
TD Securities — Analyst

Scott Chan
Canaccord Genuity — Analyst

Stephen Boland
INFOR Financial — Analyst

Nigel D'Souza
Veritas Investment Research — Analyst

PRESENTATION

Operator

Good morning. My name is Leonie, and I will be your conference Operator today. At this time, I'd like to welcome everyone to the CWB's Fourth Quarter Fiscal 2018 Financial Results Conference Call and Webcast. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, please press *, followed by 2. Thank you.

I would now like to turn the call over to your host, Mr. Matt Evans. Please go ahead.

Matt Evans — Senior AVP, Strategy & Investor Relations, Canadian Western Bank

Thank you, Leoni. Good morning and welcome. My name is Matt Evans as Leonie said, and I am the Head of Investor Relations for CWB. Presenting to you today is Chris Fowler, CWB's President and Chief Executive Officer, and Carolyn Graham, our Executive Vice President and Chief Financial Officer.

Before we begin, please note that the conference call graphs, quarterly results news release, and annual MD&A with audited financial statements are available on our Investor Relations website at cwb.com.

I'd like to remind listeners and webcast participants that statements about future events made on this call are forward-looking in nature and are based on certain assumptions and analyses made by management. Actual results could differ materially from expectations due to various material risks and uncertainties associated with CWB's business. Please refer to our forward-looking statement advisory on Slide #16.

I'll now turn the call over to Chris.

Chris Fowler — President and Chief Executive Officer, Canadian Western Bank

Thank you for joining us today. The agenda for today's call is on the second slide. I'll begin with our fourth quarter and fiscal 2018 performance highlights before commenting on the continued execution of our Balanced Growth strategy and our positive outlook for 2019. Carolyn will follow with details on our financial results before we move to the question-and-answer session.

Moving to Slide 3. Fiscal 2018 was an excellent year for CWB. This morning, we reported very strong fourth quarter and full year results with performance ahead of most of our medium-term targets. Through strategic execution of CWB's Balanced Growth strategy, we delivered on our transformation agenda.

We delivered very strong 16 percent growth of common shareholders net income, 12 percent growth of pretax, pre-provision income, positive operating leverage, strong credit quality, and with an 8 percent increase, delivered a higher common share dividend for the 26th consecutive year.

We delivered broader geographic and industry diversification through a combination of accelerating performance within our branch footprint, ongoing strong contributions from our established businesses with a national presence, and the highly accretive and strategic acquisition of business assets. We also made progress against our Balanced Growth strategy to diversify funding sources within a very competitive environment for core deposits.

Over the past several years, we have materially transformed CWB's capabilities to win market share by developing full-service client relationships. The ongoing strategic technology investments and focused business transformation we have undertaken will ensure our capability to meet the rapid pace of change within our industry.

We are making significant progress toward the upcoming transformation of our capital and risk management processes, and we are on track to apply, in fiscal 2019, for transition to AIRB. We accomplished all of this while at the same time delivering excellent financial results. This is an important part of our transformation that will open significant untapped future growth opportunities. It will put us on a more equal footing with our large bank competitors and support higher return on equity by equipping us to target businesses that generate the most attractive risk-adjusted returns.

As we head into fiscal 2019, there's a degree of uncertainty affecting sentiment within the Canadian economy and particularly in Alberta. At CWB we are highly accustomed to delivering on our strategy through periods of uncertainty. Our approach to serving our clients doesn't change with the price of a commodity or a turn in the cycle. The significant expansion of our geographic footprint and material transformation of our tools and capabilities has made CWB far more resilient to regional economic disruptions and much better equipped to win market share and create long-term value for stakeholders.

As we consider the full scope of opportunities and near-term challenges ahead of us, I remain confident in our ability to hit our financial performance targets again this year. This year, we delivered very strong 13 percent loan growth with organic growth at 10 percent and 3 percent contributed by the acquisition on January 31st. I'm pleased to say the acquired portfolio delivered exactly the performance we expected.

Slide 4 shows the significant progress we've made against our Balanced Growth objectives for geographic diversification. Ten years ago, Ontario and Eastern Canada comprised less than 5 percent of our book. Through significant and purposeful transformation, these markets now account for 26 percent of our total loan portfolio with 27 percent growth in 2018 alone. British Columbia has continued to expand and is the largest proportion of our book at 34 percent of our total portfolio. This year, we grew 9 percent in BC. Alberta now represents 32 percent of our overall portfolio, down from more than 50 percent 10 years ago and more than 40 percent when we entered the commodity price downturn in fiscal 2015.

We also achieved further industry diversification this year. Growth in general commercial loans and equipment financing and leasing was very strong at 18 percent and 23 percent respectively, with general commercial leading the way in dollar terms. General commercial represents our largest lending category at 28 percent of CWB's portfolio. It also represents the most significant segment of Canada's economy and provides excellent opportunities for CWB to deliver our full range of products and services to business owners. We have specifically targeted growth in this category over the past several years, and we have executed on that strategy very effectively.

Personal loans and mortgages represent 20 percent of overall loans with an 11 percent increase this year. We have minimal unsecured personal loan exposures. CWB Optimum mortgage grew 10 percent in 2018, down from 20 percent growth last year. The lower growth rate reflects a 5 percent decrease in alternative mortgage originations partially offset by an increase in the renewal rates with existing borrowers to 77 percent, up from 70 percent last year.

Overall growth of residential mortgages is expected to be consistent with the growth rate across the rest of the book in fiscal 2019 as we continue to win market share. We expect A mortgages to represent an increasing proportion of mortgage growth reflecting continued investment in our securitization capabilities.

Growth in real estate project lending has been moderate the last few years. This category now represents 15 percent of our book, down from 17 percent last year and more than 20 percent ten years ago. Real estate project lending in Alberta was almost $150 million lower compared to last year, reflecting the successful completion of development projects along with reduced new activity.

We deliver specialized expertise in real estate development and have built a very strong market position by partnering with top developers. We choose well-supported projects with sound loan structures, strong presales, and adequate down payments. Within the parameters of our established risk appetite, we will continue to finance well-capitalized developers as such opportunities arise.

Now a few comments on oil and gas exposures. Slide 5 highlights changes in our energy exposure over the past several years and the current composition of our very small portfolio of loans to oil and gas producers. We materially changed our risk appetite for oil and gas production loans in view of the challenges faced by all lenders in 2015 and '16. The inability of lenders to exercise normal security realization processes due to the approach taken by the Alberta Energy Regulator contributed to losses across the industry and we chose to exit that market segment.

Normalized for this extraordinary situation that generated 18 basis points of provisions, our 2016 provision for credit losses was 20 basis points, entirely consistent with our normal range as our historic recourse processes were unaffected for the balance of our portfolio in Alberta and all of our other geographies. Loans to oil and gas producers are now immaterial at less than 1 percent of our overall portfolio.

Eighty percent of our $130 million portfolio are loans syndicated with the large Canadian banks, 75 percent of the exposures are large natural gas producers, 15 percent are midstream natural gas processors, and 10 percent are to heavy oil producers. Our heavy oil exposure represents 0.05 percent of our overall portfolio. Natural gas exposures are heavily skewed to energy-rich plays in natural gas liquids, which continue to offer superior returns to dry natural gas. The large producers in our portfolio continue to successfully market their gas production.

Our loans to oil and gas service companies represent approximately 2 percent of CWB's portfolio. As we've discussed before, these exposures are very well secured with collateral generally comprised of standard industrial equipment. While rig utilization remains relatively low, active rig counts in November were up slightly from last year, as were recent auction prices in both Edmonton and Grand Prairie, Alberta, reflecting stable demand for equipment.

As we look forward, we remain committed to grow CWB's market share and deliver double-digit annual loan growth whenever prudent. Further geographic and industry diversification remains important to our strategic objectives, and our pipeline of new organic growth opportunities across all provinces continues to expand. At this time, we expect loan growth in fiscal 2019 to be strong across our national geographic footprint.

With that, I'll turn the call over to Carolyn.

Carolyn Graham — Executive Vice President and Chief Financial Officer, Canadian Western Bank

Good morning. As Chris mentioned, CWB Financial Group delivered a very strong fourth quarter and fiscal 2018. Driven by record quarterly revenue, our fourth quarter common shareholders net income and pretax, pre-provision income were up 6 and 7 percent respectively compared to the fourth quarter 2017. Diluted and adjusted cash earnings per common share increased 6 and 5 percent respectively. Adjusted for the impact of gains on sale related to the CWT strategic transactions in both quarters, fourth quarter growth of adjusted cash EPS was approximately 15 percent.

Fourth quarter net interest income was up 11 percent, as the positive impact of very strong, 13 percent loan growth was partially offset by a 2 basis point decrease in net interest margin to 2.61 percent.

The provision for credit losses as a percentage of average loans of 19 basis points was down 1 basis point from the same period last year. These factors were partially offset by higher noninterest expenses to support business growth, lower noninterest income, higher income taxes, and increased acquisition-related fair value changes, reflecting continued strong performance within CWB Maxium.

On a full year basis on Slide 7, common shareholders net income and pretax, pre-provision income were up 16 percent and 12 percent respectively. Strong earnings growth primarily reflects 11 percent growth of total revenues, strong credit quality, and disciplined expense control. Growth of diluted and adjusted cash EPS was very strong at 15 and 14 percent respectively, well ahead of our medium-term target for growth of cash EPS.

The increase in total revenues reflects 13 percent growth of net interest income and 7 percent lower noninterest income. Within noninterest income, growth in wealth management revenue was more than offset by the impact of the CWT strategic transactions, lower credit related fee income, and decreases in other categories. We continued to invest in our capabilities and position CWB for future growth with noninterest expense growth of 8 percent.

Higher full year net interest income was driven by the combined positive impact of very strong 13 percent loan growth and a 4 basis point increase in net interest margin.

The next slide demonstrates our solid track record of net interest income and total revenue growth over the past five years along with the changes in net interest margin. Despite a volatile and competitive operating environment, we have continued to win client relationships, grow our business presence, and deliver steady increases in earnings throughout the cycle.

Taking a closer look at the net interest margin changes over the past year, our margin decreased 2 basis points in the fourth quarter from the same period last year. Higher asset yields and favourable changes in asset mix were more than offset by increased funding costs with impacts from both the Bank of Canada rate increases and competitive factors along with changes in our funding mix. These changes in funding mix partly reflect an ongoing shift in depositor preference toward longer duration, fixed-term deposits within the rising interest rate environment.

Net interest margin decreased 3 basis points sequentially as increased funding costs and changes in funding mix, similar to the ones I've just described, more than offset higher asset yields. Competitor factors affecting deposit costs were particularly apparent this quarter. Full year net interest margin of 2.60 percent increased 4 basis points, consistent with our expectations. The change primarily reflects increased asset yields from the higher interest rate environment partially offset by changes in funding mix and funding costs.

Looking ahead, we expect to deliver double-digit percentage growth of noninterest income in fiscal 2019 through the combined positive impact of strong loan growth and higher net interest margin. Coupled with the benefit of rising interest rates, including current expectations for one additional Bank of Canada rate increase in early calendar 2019, we currently expect continued strategic execution to support net interest margin improvement in 2019, similar to the improvement achieved in 2018.

Turning to Slide 9, this year we made good progress to grow and diversify our funding sources. We maintained solid access to capital markets with record issuance of senior deposit notes, delivered growth and securitization for both equipment leases and residential mortgages, and continued to grow branch-raised deposits. We expect growth in branch-raised deposits to support net interest margin over the medium term, and our strategy is targeted to deliver new capabilities to accelerate the expansion of this key funding channel. New products and online capabilities were introduced during fiscal 2018 to support strong performance against these goals. Going forward, our growing market presence will include further development of digital capabilities and targeted development of our full-service branch network.

Our strong fourth quarter efficiency ratio of 46.7 percent on Slide 10 compares favourably to 46.8 percent in the same period last year. The annual efficiency ratio of 45.7 percent improved by 80 basis points from last year, and operating leverage for the full year was positive 1.9 percent, consistent with our medium-term target. Strong performance on both metrics of operational effectiveness reflects the combined positive impact of higher revenues from ongoing loan growth and higher net interest margin as well as the effective management of discretionary expense growth.

CWB's annual efficiency ratio over the past three years is approximately 46 percent, and we expect our efficiency ratio to fluctuate around this level over the near term. We also expect to deliver positive operating leverage on a full year basis with quarterly volatility possible based on the timing of expenditures.

Turning now to Slide 11, overall credit quality remains consistent with our risk appetite and reflects CWBs secured lending business model, disciplined underwriting practices, and proactive loan management. On a full year basis, the provision for credit losses of 20 basis points is consistent with our traditional range of 18 to 23 basis points and was three basis points lower than last year.

We implemented IFRS 9 on November 1, 2018. Going forward, provisions related to performing loans are expected to be more volatile due to the implementation of a forward-looking expected credit loss model. The model incorporates key economic variables such as unemployment rates, residential mortgage rates, gross domestic product growth, housing resale price growth, the Canadian-US Dollar exchange rate, interest rates, and oil prices. While IFRS 9 will change the timing of the recognition of credit losses, the actual amount of credit losses realized over the life of a particular loan, represented by write-offs net of recoveries, will not be impacted by this accounting change.

Turning to Slide 12, gross impaired loans represented 53 basis points of total loans, down from 72 basis points last year. While Alberta-based loans represent 32 percent to CWBs overall loan portfolio, impaired loans within Alberta accounted for 56 percent of total impairment, and that’s down from 63 percent last year. This higher, relative concentration of impaired loans in Alberta remains consistent with our expectations and mainly reflects the lagging impacts of the 2015/2016 regional recession. Gross impairments outside of Alberta represented 34 basis points of total non-Alberta loans, compared to 40 basis points last year.

We expect impaired loans as a percentage of total loans to remain consistent with our risk appetite, and we remain confident in the strength, diversity, and underwriting structure of the overall loan portfolio. In our prior experience, write-offs have been low as a percentage of impairment.

Slide 13 shows our very strong common equity Tier 1 capital ratio of 9.2 percent at October 31st under the standardized approach for calculating risk-weighted assets along with our strong Tier 1 and total ratios of 10.3 and 11.9 percent respectively. At 8.0 percent our Basal III leverage ratio remains very conservative.

We consumed incremental capital this year with the acquisition of business lending assets at the end of the first quarter, with the impact of organic loan growth mostly offset by the growth of retained earnings. Going forward, all capital levels will remain strong.

Yesterday, our board declared a cash dividend of $0.26 per common share, up 8 percent from the dividend declared in the same period last year, and unchanged from the prior quarter. The dividend payout ratio this quarter was approximately 36 percent of common shareholders income against our medium-term dividend payout ratio target of approximately 30 percent.

Every quarter, we evaluate common share dividend increases against the capital requirements under the standardized approach as well as opportunities to create value for shareholders through various forms of capital deployment, including support for ongoing strong and balanced asset growth and activation of the normal course issuer bid. In view of the current dislocation between our share price, our view of CWB's intrinsic value, and our strong levels of capital, we believe there's a buying opportunity for us here. And we will file the required notifications in due course of our activity.

With that, I'll turn the call back over to Leonie for the question-and-answer session.

Q&A

Operator

Thank you. Ladies and gentlemen, as a reminder, should you have a question, please press *, followed by 1 on your touch-tone phone. If you're using a speakerphone, please lift your handset before pressing any keys. One moment please for your first question.

Your first question is from Steve from Eight Capital. Steve, please go ahead.

Stephen Theriault — Eight Capital

Thanks very much. A couple things for me, probably starting with Chris. In terms of loan growth, it would help to have a better handle, I think, on how important Alberta is relative to your 2019 plans just obviously given the volatility. So if Alberta growth—obviously it's gone from little bit of shrinkage to, I think, 9 percent growth this quarter. If it goes back to zero or close to zero, what does that mean in terms of what you think you can do for next year? And maybe talk a little bit about what that might assume in terms of redirecting your efforts in capital towards Ontario and BC?

Chris Fowler

We've obviously looked at what that impact would be, and as we look forward, we're budgeting Alberta to be essentially similar loan growth to what we experienced in fiscal '18. So looking forward, if we see a big drop in Alberta to say half the loan growth, what we would anticipate still meeting is our midterm operating targets. So it is an important part of our bank, and clearly, it's an area that we have seen volatility a few times in the last 10 years, and we've been able to still continue to maintain double-digit growth. We've only really had two years where we didn't have double-digit growth with 2009 and 2017 overall. So Alberta continues to be important. If we think about the—as I say, a lower half of the loan in Alberta compared to this past year would still have us meet the midterm targets.

Stephen Theriault

Okay. While I have you, you've had the ECN business for a while. And over and above the simple asset purchase, can you talk a little bit about the degree of success you've had so far in establishing relationships, enhancing your Ontario distribution? And wondering, I'm not sure if this is a fair question. But if we look at the organic loan growth this year of around 10 percent, excluding ECN, would you attribute any of that to having done the ECN deal indirectly? And are you getting some traction in Ontario relationship-wise in terms of having done that deal?

Chris Fowler

Absolutely. It's been a great acquisition for us. It's performed precisely as we expected. In terms of our originations of new credit, about $100 million of that came from the client base at ECN. So very positive. So we really see that growth opportunity very consistent with our risk appetite and certainly as supportive of NIM, EPS, ROE, and is positive to our operating leverage.

Stephen Theriault

Thanks. And last thing for me, just on credit. The personal loans and mortgages, I see the gross impaireds are up a little over 5 million. For the most part that's been a stable line item. So, Carolyn, maybe, what's driving that? Is it some mortgage noise in Optimum? Or is it from the branch? Can you just give a little clarity there?

Carolyn Graham

It's a combination of both. Nothing that would say would be systemic across a particular geography or area.

Stephen Theriault

But is it across mortgages, and that's why we're not seeing anything on the PCL side, or secured book in general, or?

Carolyn Graham

Personal, it would be almost entirely, if not all, mortgages that are in the past due and impaired categories.

Stephen Theriault

And again, mixed across the branch and the Optimum?

Carolyn Graham

Yes.

Stephen Theriault

Okay. Thank you.

Chris Fowler

Thanks, Steve.

Operator

Thank you. Your next question is from Sumit from Scotiabank. Please go ahead.

Sumit Malhotra — Scotiabank

The comments from Carolyn just now on the buyback, looking back in your filings, you are already approved, right? I think I see one here that you're approved for a 1.8 million share NCIB. So is there anything in addition that has to be done for you to actually allocate capital towards share repurchases?

Carolyn Graham

No. All of the approvals are in place, and the bid is active.

Sumit Malhotra

And just philosophically for you, Chris, I mean I think you guys have dutifully filed the paperwork for the NCIB every year. But in my time covering the Company, I don't think you've actually repurchased stock. As you pointed out, there's been other moments in time where perhaps there was dislocations in valuation. What is it about this time that leads you to believe that buybacks are a better use of capital allocation for CWB than some of your normal course organic initiatives?

Carolyn Graham

I'll start first, and then we'll turn it over to Chris.

We’ve had preferred share or warrant normal course issuer bids in the past but have only had a common share NCIB since September of 2017. So only for a relatively short period of timeand not in the last period of Alberta volatility and low oil price.

Chris Fowler

So where we sit today is we’ve got a very strong level of CET1. So we’ve always, as I mentioned to Steve, we have had double-digit growth in, other than two years, in most years in the last 25. So we really wanted to allocate capital to growth, and that’s been our focus. So obviously, there’s three ways you can use capital, growth dividends, or buyback. Clearly, we’ve always been focused on growth. We’ve done well with the acquisitions we’ve made in the last three years, with Maxium, Franchise Finance, and the ECN portfolio. So those were good allocations of capital. I mean, clearly today we’re sitting at a multiple and a share price that is not attractive to us. We have the NCIB in place. So our goal is to move forward and allocate capital appropriately.

Sumit Malhotra

Thank you for that. Over to credit quality. And, Carolyn, sorry, I had to jump off the line, I may have missed some of your comments as it related to IFRS 9. So I heard part of what you were saying is that while the new regime may change the timing of provisioning, it doesn’t impact, at the end of the day, what actually is required for a given loan. But from a pure numbers perspective, we look at your provisioning has been pretty consistently in the 20-ish basis points range. As you think about year one under IFRS 9, do you anticipate any kind of major change in the level of provisioning? Will the expected loss methodology result in a higher level initially? Or is that not the case?

Carolyn Graham

I think, all else being equal, we would expect, in regular times, that are PCL under an IFRS 9 ratio would probably fall within the range of that historic target of around the 18 to 23 percent. As we think about where we are right now and the first quarter, when we'll report IFRS 9 for the first time, there are shifts going on in. market expectations around the macroeconomic forecast that we use to calculate and estimate our risk-based expected credit losses. So we could be a bit higher. I don't think we're going to be significantly higher, right?

Chris notes 38 basis points a good target for us if oil price volatility comes into play? But as Chris mentioned, the 38 basis points we reported in 2016, 18 basis points of that related to the small portfolio challenges in the way that we exercised our security based on the regulatory action. Barring that, we were 20 basis points, so absolutely at our normal range, and 5 basis points of that went to the collective in 2016. So we think some volatility, but we don't think significant swings.

Sumit Malhotra

And then, lastly, in and around the expectations for maybe credit and loan growth. Chris, you mentioned you—I certainly appreciate the fact that your portfolio, from both a geographic and a product perspective has diversified in recent years. But you've always been very candid about the fact that even if you're overall energy producer exposure isn't quite high, a lot of the commercial business in Alberta did take its cue from business activity in the oil patch. So you've had a turnaround in your Alberta loan growth over the past year.

When we think about the environment we're setting up for now, especially if there's renewed pressure on employment levels in the province, is it reasonable to think that that growth that you've experienced in Alberta, and I think you're up 9 percent year over year, we are heading back to a period where balances here are going to be flat to down going forward?

Chris Fowler

Our approach in Alberta, I mean, obviously we've been here for 30 years. There's been more than one of these commodity price volatility situations. Historically, what has occurred is it's created opportunity for us. I mean we've been able to actually capture more clients. I mean we certainly did that in 2009 and '10 and came out of the global financial crisis stronger with a very strong, stable clients. And we are very picky in how we look to underwrite it and for it to fit within our risk appetite.

So looking into this year coming up, I mean clearly there is uncertainty. I mean our discussion of Alberta over the last few years since 2014- 15 when this prior commodity price volatility hit was that we would be prudent, we'd be careful, but we would certainly support our strong Alberta clients, of which there are many. And then so as we look forward, we would continue to follow that path. It's been, obviously, a strong, good market for us over the years. We expect it to continue to be a strong, good market. And we will look to support our good clients as we look forward.

Sumit Malhotra

Thanks for your time, guys.

Chris Fowler

Thank you.

Carolyn Graham

Thanks.

Operator

Thank you. Your next question is from Robert from CIBC Capital Markets. Robert, please go ahead.

Robert Sedran — CIBC Capital Markets

Hi. Good morning, everybody. I just want to follow up. I guess both Steve and Sumit have touched on it. I just want to follow up slightly on some of the macro assumptions that are underlying the outlook. I mean, at a high level, Chris, would you say that it's a macro environment that is consistent with what we're seeing in 2018? Slight better? Slightly worse? I mean, you've mentioned concerns over the outlook are creeping in in the market. I'm curious if that's crept into your outlook as well.

Chris Fowler

Well, I would say that we're always conservative and prudent as we think about where we're going to allocate capital and decide how we would grow and focus on. And our growth is primarily in business owners and building up the loan book. And our focus, as we look into this year, we will always balance those risks against what we believe the opportunities are.

Historically, times of volatility has created opportunity for us. And we will continue to be prudent. As Carolyn mentioned, in 2016, when we experienced E&P losses, there was no change in our historic loss rate across the balance of our portfolio. So and as we've seen as 2016 turned into '17 and '18, there isn't like a lingering effect there that has changed our PCL. So we continue to be focused on what is the prudent, reasonable approach, and we absolutely take into effect those macroeconomic indicators.

Robert Sedran

Okay. And just to follow up. Thank you, but just to follow up, I guess, on the other side of net interest income, the margin outlook, Carolyn mentioned during the quarter particularly competitive deposit pricing, and it's certainly in line with what we've been hearing about the market. Is the outlook—I guess I'm trying to understand. Let's say the Bank of Canada doesn't feel the need to move in the new year. Let's say the competition continues. Does the margin outlook deteriorate materially from what you're looking at? Or is it just a bit more of a headwind that you have to fight through?

Carolyn Graham

Well, I would say that it's more of the headwind. So our NIM projection expecting a year-over-year about the same incremental increases as we saw in 2018 is based on conservative assumptions. We had one Bank of Canada rate increase in there but expecting competition for branch-raised deposits to continue to be intense, continued depositor preference shifting the duration of fixed-term deposits. So most of that is baked in. So if the Bank of Canada increase doesn't come or comes more towards the end of the year than the beginning, it would probably be in the range of a single basis point-ish one way or the other. So it would be a headwind more than a material impact.

Chris Fowler

And I'd just add to that, Rob. The other side of this equation is in the last year, we delivered even more capabilities to generate more of the deposit business from our clients. We brought on remote deposit capture, our virtual branch. So we have really expanded our capabilities, not just in Western Canada, but also in Ontario. So we have many more avenues to grow this business than we ever have in the past, and it's improving every year as we really lever our technology investments and our ability to really grow out our infrastructure.

Robert Sedran

Okay. Thanks, folks.

Carolyn Graham

Thanks.

Chris Fowler

Thanks, Rob.

Operator

Thank you. Your next question is from Gabriel from National Bank Financial. Gabriel, please go ahead.

Gabriel Dechaine — National Bank Financial

Thanks. Yeah. So if the Bank of Canada doesn't raise rates, you think the margin will be flattish next year? Is that the gist of it?

Carolyn Graham

No. I said it would change our outlook in the range of 1 basis point-ish.

Gabriel Dechaine

Oh. Okay. So you said you expect similar increase to what we saw this year. So like 4 whatever?

Carolyn Graham

Yeah.

Gabriel Dechaine

That would knock off a point. Okay. Then in the quarter, and it was nice to see that the branch-raised deposits were up quite meaningfully and especially on the demand and notice side. I would have expected to see better margin performance on a sequential basis as a result. Were there any promotional activities that maybe had an effect there this quarter?

Carolyn Graham

No. we haven't done anything that I would call a promotional activity. We have increased some of the rates on our administered rate deposits just based on cumulative Bank of Canada increases. But nothing that is onetime or short term or any of that in our portfolio. Sometimes the impact of branch-raised deposit growth, it depends on the composition of that deposit growth.

Gabriel Dechaine

Right

Carolyn Graham

What kind of deposits it's in. And it sometimes also depends on where that growth comes in the quarter, whether the impact comes that quarter or more in the following quarter. So combination of all of those things.

Chris Fowler

And I, just to reinforce, Gabe, as I mentioned to Rob's call, we have expanded our infrastructure. So we have more points of contact, better product speed, and more opportunities to continue to grow demand and notice.

Gabriel Dechaine

Okay. And you mentioned the product, the Canadian Western Trust product, and that's in that demand and notice category, I assume.

Carolyn Graham

Yes. That's right.

Gabriel Dechaine

Like what does it look like? I guess I can go on the website there, but how big of that 7.6 billion demand and notice component is that particular product line? Roughly.

Carolyn Graham

In the neighbourhood of about 2 billion.

Gabriel Dechaine

Okay.

Carolyn Graham

And it would be made up of primarily insured deposits that are the accumulation of individual registered and investment accounts.

Gabriel Dechaine

Okay. It's a higher interest rate product then?

Carolyn Graham

It's a mixture.

Gabriel Dechaine

Okay. Then the credit performance. The impaired loans, the balance was flat sequentially, but it was nice to see the decline in the project loan impairments. It's a hot button topic these days. It did come down off of a spike we saw in Q3. Were those the same projects, and they just cured real quickly? Or is it just the cure of older ones I suppose?

Carolyn Graham

I think we'll have to come back. Yeah. I don't have that right off the top of my head, Gabe. We'll come back on that.

Chris Fowler

Yeah.

Gabriel Dechaine

Okay. And sticking to this credit theme. And you mentioned the IFRS 9 sensitivity, the changes to the macroeconomic outlook. Well, we got one yesterday from the Bank of Canada that wasn't very positive and especially for Alberta. Does that mean that—what kind of transition impact are we going to see? Did you quantify that anywhere? When we—

Carolyn Graham

The November 1st transition adjustment is an increase to retained earnings of about 23 million and a 10 basis point lift in our CET1 ratio.

Gabriel Dechaine

A lift.

Carolyn Graham

So the collective allowance under IFRS 9 on November the 1st will be about $30 million lower than it is under IAS 39.

Gabriel Dechaine

Oh, okay. So the transition is it's going down. Okay. That's interesting. I wouldn't have expected that. All right. That's it from me. Thanks.

Chris Fowler

Thank you.

Carolyn Graham

Thanks, Gabe.

Operator

Thank you. Ladies and gentlemen, as a reminder, should you have a question, please press *, followed by 1.

Your next question is from Meny from Cormark Securities. Please go ahead.

Meny Grauman — Cormark Securities

Hi. Just following up on that IFRS 9 discussion and transition. What's driving that benefit to you? How wouldyou understand that?

Carolyn Graham

So I think to start with, I would just sort of start with the comment that IAS 39 and IFRS 9 are inherently different accounting methodologies. So I am continually told not to compare them, but I will. Both of them, our estimates under both of them are underpinned by our historic credit loss experience, the history that we have of effective underwriting and management of accounts, and another key difference with IFRS 9 is that we have now started to use our AIRB models as the underpinning of that estimate. So that brings us better data granularity, better segmentation of the portfolio. So we just have a better estimate, one compared to the other.

Two key differences that comprise the majority of the transition adjustment that I think they're specific changes or differences between the two accounting methodologies and I think probably have more impact on our secured portfolio than they have on our peer groups.

So the first one is that under IAS 39, credit losses are calculated on 100 percent of committed but undrawn facilities. Under IFRS 9 there is an estimate of exposure at default that looks at historic experience around what proportion of lines are drawn prior to a client defaulting on their facilities. So that had a fairly material impact on our estimate.

And then the second factor was that under IAS 39, about a third of our portfolio had a loss emergence period that was greater than one year. So we were recording losses on a third of our portfolio at more than 12 months of losses, whereas under IFRS 9, only stage 2 loans are recorded at more than 12 months of losses. So those two factors had the most significant impact of the transition adjustment.

Meny Grauman

Okay. And then I appreciate that there's a lot of economic variables that go into the estimates going forward but wondering how granular is it. Do you have explicit forecasts for Alberta level economic indicators? So how important is that in that estimation process?

Carolyn Graham

So we do consider in our PD calculations the composition of our portfolio as best we can. And our LGD calculation, so the loss given default, those are geared towards the location of the security.

Meny Grauman

Okay. And then if I could just ask a question on taxes. It looks like the tax rate came in lower than what we've seen over the last little while. So I just wanted to come from that and see what was driving that, and what the outlook is going forward?

Carolyn Graham

So the key thing in quarter four is that we had another small CWT gain, a portion of those gains are non-taxable, so that had an impact on the Q4 tax rate. We had a little bit of year-end true-up to just validate our overall provisions. I think that the outlook for 2019 is about 27 percent. It's back in the back of the annual MD&A, but I think it's 27 percent, so not much change from the all-in 2018 rate.

Meny Grauman

Right. Thank you.

Operator

Thank you. Your next question is from Sohrab from BMO Capital Markets. Please go ahead.

Sohrab Movahedi — BMO Capital Markets

Thanks. I just wanted to go back to capital for a second. Chris, I think you said that you are still on track for the AIRB approval to be implemented hopefully starting for fiscal 2020. Is that fair?

Chris Fowler

We're fully on track on providing our final application in fiscal '19 with expected go live in fiscal '20. Exactly.

Sohrab Movahedi

Okay. And, Carolyn or Chris, were you surprised? Or were you planning on this IFRS 9 transition being a net benefit?

Carolyn Graham

I would say we weren't surprised. We know that at their heart, both of them are based on our historic credit experience. We knew we had a secured book and that might have an impact. And then through 2018, we have been working hard to adapt our AIRB models and the data that they're providing into the PCL calculation.

Sohrab Movahedi

Okay. And I know you are running some of these kind of portfolios in parallel now. Are you seeing anything under the AIRB from a credit improvement or the duration or risk-rated asset basically fluctuation that is abnormal or out of expectations?

Carolyn Graham

I'd just say it's too early to make any comments on the AIRB impact. We're still working our way through.

Chris Fowler

Yeah. But I would say that the opportunity for us with the AIRB transition is improved accuracy in our risk assessments. It does give us a much more quantitative measurement that really allows us to think about portfolios at risk differently, and it certainly will be impactful as we look at, for example, IFRS 9. So it does increase our accuracy of risk quantification.

Carolyn Graham

And the other thing that we're already realizing the benefits of is the capability it gives us around stress testing.

Chris Fowler

Yeah.

Carolyn Graham

Based on, in our disclosures, we talk about the macroeconomic factors that impact a range of portfolios, but we've already started to utilize those capabilities.

Sohrab Movahedi

Okay. And so I guess having that greater confidence, Chris, presumably factors into yours and the management's team's and the board's kind of decision-making pattern as to whether or not deploying capital in your own company, in your own stock is better than growing loans, I suppose, or buying other companies.

Chris Fowler

Well, as I said out front, our goal in life is to grow. That's the first use of capital. We're sitting in a very strong capital position. And we're sitting with a market that's not recognizing our performance. So we're going to manage our situation appropriately.

Sohrab Movahedi

Thank you.

Chris Fowler

Thank you.

Carolyn Graham

Thanks.

Operator

Thank you. Your next question is from Darko from RBC Capital Markets. Please go ahead.

Darko Mihelic — RBC Capital Markets

Hi. Thank you. Good morning, everyone. And most of my questions have been asked and answered. So I thought maybe I'll take a detour and ask Chris a different question which is up until now most of your acquisitions that I've seen, apart from insurance, were really centred around the loan book and growing. Chris, is there any opportunity out there or is there any thought been given to acquiring something that would help on the deposit side?

Chris Fowler

Well, we would be very interested in an acquisition that would help on the deposit side. The challenge there is where would we find that? I mean we've certainly looked at different credit unions as opportunities. That's a challenging acquisition for a bank to make for a credit union, given it's a mutual. We certainly are very attentive to all forms of acquisition that can help us as we think about growth.

Darko Mihelic

Fair. I guess where I'm going with this as well is you've also made some acquisitions on the asset management side.

Chris Fowler

Yes.

Darko Mihelic

Is there anything that can be perhaps explored as well to not only for the deposit side of the equation but also for other forms of other income?

Chris Fowler

Yes. Again, on the asset management side, we still see that as another opportunity for us as we really look to providing full-service business solutions to business owners. So as we think about the asset management side, clearly there's opportunities as we broadened our geographic footprint, as we look beyond Western Canada, so potentially for Ontario for acquisitions there. So we are actively looking at what is possible there. Clearly, we will make that decision when we see the one that fits kind of our key measurements, which is accretive, strategic, and cultural fit. So we are continuing to look very actively there.

Darko Mihelic

Okay. Thank you. And just, Carolyn, just with respect to the process for AIRB, there's an application now that you're filing, I guess, in 2019. The anticipation is that you go live in 2020. Is there anything else that could actually occur? In other words, I guess what I'm asking is do you have any sort of outlook on the potential benefit early in 2020? And could the environment alter a potential perceived benefit that we might be looking for in 2020? In other words, if Alberta were to go into recession, is there anything macro-wise, in other words, that could harm or derail the AIRB process?

Carolyn Graham

My quick response to that is no. We believe that our historic credit quality, which plays into the AIRB calculations of risk-weighted assets is compelling and material when compared to the capital required of a standardized bank. So even considering internal floors or overall floors, that there is benefit to be had there for us.

Darko Mihelic

And macro simply doesn't play?

Carolyn Graham

It's a factor. But we believe there is still significant room given the conservatism of the standardized approach.

Darko Mihelic

Okay. Great. Thanks very much for your time.

Chris Fowler

Thank you.

Carolyn Graham

Thanks, Darko.

Operator

Thank you. Your next question is from Richard from TD Securities. Richard, please go ahead.

Richard Roth — TD Securities

Thank you. Digging into your NIM guidance, you're basically guiding to 3 or to 4 basis points of expansion in '19 versus '18, but '18 included unusually high liquidities as part of the acquisition you made. So when I look at H2 '18 versus your guidance for '19, you're basically looking at flat NIMs. Is that sort of the correct interpretation?

Carolyn Graham

If that’s what the math works out to, right? I haven’t sort oflooked at it in that specific way. But it is going to be another year of puts and takes. Right? The potential for potentially rate increases but also intense competition for deposits as well as shifting in depositor preference. So again, a lot of puts and takes, headwinds and tailwinds, and over the (unintelligible) that’s what we think for the overall impact.

Richard Roth

Okay. So now when I look at your guidance—

Carolyn Graham

And at the—sorry. Sorry, Richard. And at the same time, double-digit net interest income growthwith that NIM projection.

Richard Roth

Yeah. I was just going to talk about that. So if I look at, therefore, the NII target in the context of let’s call it 3 basis points of NIM expansion, the bulk, therefore, is still coming from volume growth. Your commentary earlier suggested that you’re looking at 9 percent-ish volume growth in Alberta in your budget. What do you have for BC?

Chris Fowler

Similar growth. Yeah.

Richard Roth

Similar.

Chris Fowler

So BC, we still see as economically strong. They have a lot of infrastructure building that's occurring there as well along with our sort of equipment finance and general commercial opportunities. So yeah. We see BC as a continued strong source of long growth.

Richard Roth

Okay. And presumably, when you do your own internal forecasts, you're not doing your forecasts in October. You're doing it six months plus earlier than that. How has your estimation or expectations for BC and Alberta loan growth changed in the last six months for 2019?

Chris Fowler

I would say BC has not changed.

Richard Roth

It is not? And what's Alberta doing?

Chris Fowler

Well, I mean we have a fairly recent event here.

Richard Roth

Yeah.

Chris Fowler

I guess we think about August, when the Federal Court put a hold on the Trans Mountain Pipeline. So I think that's certainly taken wind out of Alberta's sails. But just if you think back of all the conversations we've had about Alberta since 2014, '15, we've had a very muted view of how this economy will progress. So we've been very conservative as we think about growth in Alberta. And we think 32 percent of our book now is Alberta. So we have 68 percent of our book that's not. We've had significant growth in Ontario. We tremendously increased our capabilities there to deliver continued growth with a number of different business lines that have good long history of positive performance in Ontario.

So we're not dependent on Alberta for growth. It's certainly a very important part of our business, and we will continue to focus and deliver there, but we have other options for growth as well.

Richard Roth

Are you not concerned that you'll see a sort of repeat of '16 as it pertains to volume growth being effectively flat in that province and then at the same time potentially seeing a slowdown in BC, especially project loans, which is where you guys have a large footprint, and that could potentially derail your double-digit NII guidance?

Chris Fowler

I think there's always potential for variances in different growth areas. And I think what we've proven over the last 25 years is that we've delivered double-digit growth. And we are very proactive in how we look at our opportunities. We certainly have made a significant investment in broadening our geographic footprint and going from 5 percent 10 years ago, to 26 percent in Ontario now. So we have great growth opportunity there.

BC, we have risen to one of the top lenders in project lending, as you mentioned. So we are first call there. So we will get our fair share of business. And there is still population growth in BC and migration is still positive. There is factors there that show that there is continued activity. But clearly, our participation in any loan book or loan portfolio or geography is we focus on our risk appetite, prudent underwriting, and ensuring that we're picking the right counterparties.

Richard Roth

Okay. Thank you.

Chris Fowler

Thank you.

Operator

Thank you. Your next question is from Scott from Canaccord Genuity. Scott, please go ahead.

Scott Chan — Canaccord Genuity

Good morning. Chris, just a follow-up on the last question. If Western Canada's going to be a bit slower, do you expect Ontario to kind of pick up the slack like it did in '18 in terms of achieving your medium-term target?

Chris Fowler

Well, that's certainly part of our Balanced Growth strategy that as we looked at our business, we looked at our very strong history of growing growing and credit management and very profitable outcomes that we wanted to have other options. So we don't want to be that a slowdown in one particular area affects the entire balance sheet. We want to have options. So certainly, the growth in Ontario has been very positive. So we would continue to focus on that. And we look to continue to add resources to our capabilities there.

Scott Chan

And just on Optimum, where do you see kind of the growth outlook heading into fiscal '19?

Chris Fowler

Well, we stated our growth outlook on Optimum would be consistent with the total book. So we would expect low double-digit as we look into fiscal '19. And that really is based over a broader geographic footprint than we historically have.

Scott Chan

Right. And—

Chris Fowler

And the other side of that too is that it is one of the first books that we put on AIRB. So we've got some good experience in how we categorize and quantify our risk there. Plus, in terms of our investments in our other capabilities, we've increased our abilities to do more securitization, which includes CMB and NHA MBS that we didn't do before, which gives us access to more A mortgages and insured A mortgages. And Optimum is part of that equation. So we would see growth across the spectrum of residential mortgages. And then a lot of that comes from our investment in our capabilities.

Scott Chan

And just lastly, Chris, just going back to the buyback, do you consider tangible book value per share when you're kind of thinking about using the buyback? Obviously, the stock is still above that right now. And just kind of thinking about your thoughts on dilution on that front?

Chris Fowler

Well, as we think about the NCIB, I mean clearly, we believe our stock is not reflecting our performance. And again, we are very well capitalized. We want to continue to grow our bank. But if we need to deploy capital in an NCIB when we are being undervalued, we will choose to do that.

Scott Chan

Got it. Appreciate it. Thanks a lot.

Chris Fowler

Thank you.

Carolyn Graham

Thanks, Scott.

Operator

Thank you. Your next question is from Steven from INFOR Financial. Stephen, please go ahead.

Stephen Boland — INFOR Financial

Just a quick follow-up on Darko's questions. Carolyn, will there be ongoing disclosure about how the parallel track is working with the AIRB during this fiscal year?

Carolyn Graham

No, we won't. We haven't considered disclosing.

Stephen Boland

Okay.

Carolyn Graham

We do the calculations with ourselves, but the ultimate approval and the amount and timing of capital relief available is a negotiation with the regulator.

Stephen Boland

Okay. So we won't find out until early 2020 then what the prognosis is?

Carolyn Graham

I would say yes.

Stephen Boland

Okay. Thanks very much.

Operator

Thank you. Your next question is from Nigel from Veritas Investment Research. Please go ahead.

Nigel D'Souza — Veritas Investment Research

Thank you. So I actually just had two quick follow-ups for Carolyn. The first one was on comments regarding your gross impaired loans for the personal and residential mortgage bucket. Carolyn, you noted that that was almost entirely related to past due mortgages. And given that mortgages typically require a 90- to 180-day delinquency for impairment, is there any specific factor in the quarter that caused that uptick? And is it possibly related to lower self-curing? So in other words, homeowners having a tougher time transacting in a real estate market and selling the property when volumes were down? So appreciate any colour there.

Carolyn Graham

So just to clarify, I was lumping together the past due and the gross impaireds, but they are two distinct numbers that don't have any overlap in them. I don't think there's a factor in there of borrowers taking longer to be able to sell their properties or cure things. It's just what we're seeing that there's a rate factor in there. It's what we're seeing from individual borrowers.

Nigel D'Souza

Okay. That—

Chris Fowler

And, Nigel, our portfolio in residential mortgages, and believe it's in the supplemental in terms of our loan to value. They're very conservative. So we've historically ran a very low net charge operate there. Our branch base is in the 1 basis point range and our Optimum mortgage is in the 4 basis points range. So we have a very good credit history and performance in that book.

Nigel D'Souza

Okay. Appreciate the colour, it's really helpful. And just one last quick question, if I may, on IFRS 9. And you mentioned the net benefit to capital. I know it's early, but is it possible you could just provide any insights or elaborate on how you think provisions in stage 1 and stage 2 might play out in F '19? Do you think it's neutral in terms of reversals versus net buildup? Or do you think the impact to capital and how the P&L gets impacted is not correlated at all?

Carolyn Graham

I think it is correlated. At this point, the transition adjustment is based on our expectations around the macroeconomic conditions looking forward over the life of our portfolio. So I can't comment today on how that'll evolve over the next four quarters. I think if we think only about the first quarter, I would say that strictly from everything we read in the media that between October 31st and today, there has been a deterioration in the economic forecast. So we will work our way through that. But can't really opine over how the whole year will move.

Nigel D'Souza

I appreciate the commentary. It's very helpful. Thank you.

Carolyn Graham

Thanks, Nigel.

Chris Fowler

Thank you.

Operator

Thank you. We have a follow-up from Sohrab from BMO Capital Markets. Please go ahead.

Sohrab Movahedi

Hey. Thank you, guys. Thanks for your patience. I just had one quickie. You talked also about, Carolyn, when during the '15, '16 time frame you were talking about the stress testing that you were running and the types of loss rates and what have you. And you were talking about stress testing right now. And I'm just curious. Have any of the factors around the stress testing that you're running today, given what you know today, any more or less punitive than what you were doing a couple of years back?

Carolyn Graham

I don't think they represent significantly different results, right. Other than that we are seeing more of a benefit today from the way that our portfolio has diversified compared to where we were in 2015, '16. So not on overall quality or how things might move, but given the composition of our portfolio.

Sohrab Movahedi

So when you run the stress test today, you're actually feeling a little bit better about the future than you would have, let's say, a couple of years ago?

Chris Fowler

I would say, Sohrab, we have better information. I mean, we have made a significant investment in the way that we operate our bank. We have moved down the road with our—in particular, the AIRB process has really helped us quantify our risk exposures with much more granularity, and so we have a much more accurate approach to the way we can approach it. So I guess the answer is yes.

Sohrab Movahedi

Perfect. Thank you very much.

Operator

Thank you. There are no further questions at this time. Please proceed, Mr. Fowler.

Chris Fowler

Thank you, Operator. And thank you all for being with us as we close the earnings season for Canada's banks. As we head into the new year, I want to thank our people for their passion and commitment to help both our clients and CWB achieve our strategic goals. Through continued execution of our Balanced Growth strategy, including the upcoming transformation of our capital and risk management processes, we have an incredible opportunity to create exceptional client experiences for business owners across Canada.

We continue to invest with a clear purpose to significantly transform our business and enhance our capabilities to deliver continued growth for all our stakeholders. Alongside our tremendous teams, I'm eager to achieve our full potential together.

So thank you very much for your continued interest in CWB Financial Group. We look forward to reporting financial results for the first quarter of fiscal 2019 on March the 7th. With that, we wish you all a good morning and a happy holiday season. Thank you.

Operator

Ladies and gentlemen, this concludes your conference call today. We thank you for participating and ask that you please disconnect your lines.