EVENT: CANADIAN WESTERN BANK Q1 CONCALL
TIME: 13H30 E.T.
REFERENCE: CANADIAN WESTERN BANK-CC-030311
LENGTH: 30 MINUTES
DATE: MARCH 3, 2011

OPERATOR: Good afternoon. My name is Stephanie and I will be your conference operator today. At this time I would like to welcome everyone to the Canadian Western Bank first quarter 2011 financial results conference call.

All lines have been placed on mute to avoid 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 the # key. Thank you.

Tracey Ball, Chief Financial Officer, you may begin your conference.

TRACEY BALL (Chief Financial Officer, Canadian Western Bank): Thank you very much, Stephanie, and good morning or good afternoon, as the case may be, and welcome to the 2011 first quarter results conference call for Canadian Western Bank.

Before we begin, please note that conference call graphs, quarterly results news release, and supplemental financial information are available on the Bank's website at cwbankgroup.com in the Investor Relations section.

And just before we begin I'd like to draw your attention to our forward-looking statement advisory, which is one slide 8.

And the agenda for today's call is on slide 2. Joining me today is Larry Pollock, President and Chief Executive Officer. Also in attendance are Executive Vice Presidents Bill Addington, Chris Fowler, Randy Garvey, and Brian Young.

We know there are other banks reporting today, so I will start by providing a very brief summary of our first quarter financial highlights, and then turn things over to Larry for an overview of outlook and strategy. We will leave as much time as necessary for Q&A at the end of the call.

Moving to slide 3: The Bank recorded very strong first quarter performance highlighted by 4-per-cent quarterly loan growth, record total revenues, and our 91st consecutive profitable quarter, a period spanning nearly 23 years. Very strong quarterly loan growth reflected good performance across all lending sectors, and contributed to 17-per-cent growth over the past 12 months.

Net income of $44 million was up 10 per cent over the same quarter last year, while diluted earnings-per-common-share increased 4 per cent to reach $0.54. Higher growth in net income over diluted earnings per common share reflects both the increased dilution of warrants due to a higher average Canadian Western Bank share price, and the issuance of additional common shares mainly contributed to the equity portion of our consideration for National Leasing in February 2010.

We also had 2.9 million warrants convert to common shares in the quarter. The exercise of warrants, combined with those purchased in cancelled to date under our normal course issuer bids, leaves approximately 10.1 million warrants still outstanding. And this compares to the total number issued in 2009 of approximately 15 million.

Record total revenues of $121.8 million represented a 21-per-cent increase over the same period last year, reflecting the combined positive impact of a 32-basis-point improvement in net interest margin to 2.88 per cent, very strong loan growth, and 8-per-cent growth in other income.

Within other income this quarter, gains on sale of securities of $4.2 million were mainly realized as we commenced the repositioning of our securities portfolio out of preferred shares of other financial institutions. This is because under Basel III, investments in other financial institutions will be subject to capital deductions once the amount surpasses a certain threshold.

We remain very well capitalized with a tier one ratio of 11.6 per cent and a total capital ratio of 16.5 per cent. Our tangible common equity ratio was also strong at 8.9 per cent.

Based on the Bank's straightforward capital structure, including the already strong based tangible common equity, we expect to be compliant with the new Basel III capital rules well before the transition requirements take effect in 2013. That said, we intend to publish our Basel III pro forma numbers in the second quarter of 2011 after we develop appropriate assumption and finalize our detailed review and analysis.

Turning to slide 4. Our overall credit quality remains satisfactory with the dollar level of gross impaired loans decreasing for the third consecutive quarter. The reduction in impaired loans reflects our ongoing success in resolving problem accounts, as well as the positive implications of a more robust economy.

Yesterday our board of directors declared a quarterly cash dividend of $0.13 per common share. This dividend remains unchanged from the previous quarter, but is 18 per cent higher than the quarterly dividend declared a year earlier. The quarterly cash dividend on our preferred shares was also declared.

Based on first quarter performance, the current common share dividend remains below our target payout range of 25 to 30 per cent of net income available to common shareholders. And we will continue to review the dividend payment on a quarterly basis.

Slide 5 shows actual results compared to our fiscal 2011 targets. As shown, our strong performance early in the year has us well positioned to achieve all of these objectives. While reported year-over-year loan growth will likely reduce somewhat in the second quarter, reflecting the addition of National Leasing on February 1st, 2010, the overall volume in the pipeline for new loans appears strong and is consistent with an improved business outlook and increased economic activity.

Our quarterly provision for credit losses of $6.2 million was up $0.8 million from last quarter, and represented 23 basis points of average loans. The higher provision measured against average loans compared to recent years reflects the addition of National Leasing in 2010, and remains within our 2011 target range of 20 to 25 basis points.

I will now turn things over to Larry who will provide additional comments on our outlook and strategy beginning with slide 6.

LARRY POLLOCK (President and Chief Executive Officer, Canadian Western Bank): Thanks, Tracey.

This slide shows our current level of gross impaired loans measured as a percentage of total loans. The dollar level of gross impaired loans increased for the third straight quarter, and overall credit quality remained within expectations. The provision for credit losses added slightly to the dollar level of the general allowance this quarter, and actual write-offs are expected to remain within the Bank's historical range of acceptable levels.

The total number of accounts classified as impaired was up slightly from the previous quarter, but decreased 17 per cent compared to a year earlier. While there are many positive signs the credit cycle continues to run its course and we expect the dollar level of gross impaired loans will fluctuate until the economic recovery strengthens further.

Slide 7. This slide highlights our main strategic priorities. The Bank's objective for 2011 is to focus on our competitive advantages and improve across each area of our organization. We believe we can continue to grow our market share, and we are well positioned to take advantage of new growth opportunities, particularly in our core Western Canadian markets.

As part of our long-term commitment to add value to shareholders, we will also continue to invest in our people, infrastructure and technology to support future growth.

A key technology highlight this quarter was the successful launch of the Bank's new loan origination system. This system is expected to provide significant efficiencies, as well as enhance our portfolio management capabilities. It will also give us flexibility to consider switching to the advanced methodology for calculating risk-weighted assets in future years, which we believe will significantly benefit our regulatory capital ratios.

We have plans to further develop the branch network in 2011 with the expected opening of a new full-service banking location in Richmond, B.C. This will represent our 40th branch in Western Canada. We also have plans to relocate and expand our main branch in Edmonton, as well as our Regina branch. Our objective is to offer business and personal banking services through 50 CWB branches by 2015.

There are great opportunities to further develop and grow all of our subsidiaries and operating divisions. Performance in National Leasing continues to exceed our expectations. We are committed to building on our position as leader in small- and mid-ticket leasing, and believe there are opportunities for both organic growth and potential acquisitions in this space. Canadian Direct Insurance and our trust services companies are also maintaining strong momentum after posting great performance in 2010.

We continue to evaluate ways to most efficiently or effectively deploy capital, and the recent clarity around Basel III requirements will be a significant benefit as we move forward in this regard.

Our very strong first quarter performance continued to build off our record results last year, and represents an excellent start for 2011. We expect there will be ongoing challenges, including increased competition. Our disciplined underwriting, strong balance sheet, and strong capital base have us well positioned to capitalize on growth opportunities. Based on what we are seeing today we are particularly optimistic about the potential in our key areas within Western Canada.

I'll now turn things back to Tracey.

TRACEY BALL: Okay. Thank you, Larry. And that concludes our formal presentation for today's call. At this time I'll ask Stephanie to begin the question-and-answer period.

OPERATOR: At this time I would like to remind everyone in order to ask a question, please press * then the number 1 on your telephone keypad. We'll pause for a moment to compile the Q&A roster.

Your first question comes from John with BMO Capital Markets. Please go ahead.

JOHN REUCASSEL: Thank you. She didn't want to venture and try my last name I guess. Tracey, just a couple of questions, just the securities that are locked in the portfolio, the pref shares, there's about 9 billion left, is it safe to say those are all held or that you're going to sell all those pref securities, Tracey?

TRACEY BALL: I'm not sure where you got the number 9 billion. I think it's…

JOHN REUCASSEL: Sorry, unrealized gains left on the prefs is 9 billion.

TRACEY BALL: Nine million.

JOHN REUCASSEL: Nine million, excuse me.

TRACEY BALL: We want to be big, but we're not that big.

JOHN REUCASSEL: But is that the number we should think that's going to… is that a good indication of the gains we should expect over the next couple of quarters or?

TRACEY BALL: Well it's not like we're going to completely reposition the portfolio at one time because we do look at replace those preferred shares with other preferred shares that we can get from other industries besides financial institutions.

And I'd also point out that all the preferred shares that we have right now are not all financial institution preferred shares.

So we'll take a measured approach as we continue to start to position that portfolio, but yes, you can expect more gains in 2011 from that repositioning. But we're trying to make sure that we don't take our yield down too quickly.

JOHN REUCASSEL: Okay. And on the $4.2 million in net gains in this quarter, what is – and I apologize if I missed it – what is the appropriate tax rate to use on that?

TRACEY BALL: It's just regular tax income because preferred shares are inventory…

JOHN REUCASSEL: Okay.

TRACEY BALL: … from a banking point of view. There's no capital gain.

JOHN REUCASSEL: Right. I just wanted to make sure. Okay.

Larry, the loan growth, if we… Could you talk about the growth that's come from drawdowns of existing lines? If you look through acquisitions and new loans, what does a draw down look like and how is it going so far in the second quarter as well?

LARRY POLLOCK: Chris could maybe help me a little bit on this one, but my view is that most of the growth we've seen has been from drawdowns on existing or new construction lending. But…

CHRIS FOWLER (Executive Vice President, Canadian Western Bank): And commercial banking, we had some increases there.

LARRY POLLOCK: Yes.

CHRIS FOWLER: That's mostly term loans, and we had very strong growth in commercial banking in this last quarter. And a lot of the growth in the real estate side comes from approved loans that, as the project proceeds, there's drawdowns.

JOHN REUCASSEL: Okay. So most of the non-acquisition related loan growth has been drawdowns, is that a fair…?

LARRY POLLOCK: Well it'd be new approvals that were drawn down, plus drawdowns of prior approved loans.

JOHN REUCASSEL: Okay.

CHRIS FOWLER: Because the last year a lot of the real estate construction loans were actually paying out because they were being completed. And just recently we've started to put on a lot of new ones that are drawing in their initial stages. So I guess part of the answer there, John would be there are significant drawdowns yet to come on existing approvals.

JOHN REUCASSEL: Okay. Okay. Maybe that... And last question, the plans to buy back stock on the warrants, are you anticipating being in the market shortly after this conference call or could you talk a little bit about the capital plans there to offset the dilution?

LARRY POLLOCK: Well we have had in 2010 a normal course issuer bid for the warrants in place, and it was fully utilized, but it was a 5-per-cent normal course issuer bid. We now have a 10 per cent in place, and have billed half of that roughly. So we still have some room, we have another 5 per cent room to go. And there are, as we say in our script here, there's about 10 million of the original 15 million warrants still outstanding, which, if they were exercised, would produce around $140 to $150 million in new tier one capital, and remove that somewhat difficult dilution calculation that you analysts have to go through.

JOHN REUCASSEL: Okay. Thank you.

OPERATOR: Your next question comes from Dave with RBC. Please go ahead.

DAVE MUN: Hi. Just a question on the potential risk weighting changes. How long before you can apply and get approval for the advanced internal ratings-based model for credit risk? And any thoughts on how beneficial that might be? Thanks.

LARRY POLLOCK: What we’re building internally is with this loan origination system is the capability to generate the data to support a more advanced risk-rating system. And with that risk-rating system we would then have the ability to back test and make the application to go from a standardized approach to the advanced internal ratings-based approach. So it would be in the three- to five-year period to generate that. And it would certainly make a difference on our loan portfolio because we have a lot of loans 100 per cent risk weighted.

DAVE MUN: Great. Thank you.

OPERATOR: Your next question comes from Sumit with Macquarie Capital Markets. Please go ahead.

SUMIT MALHOTRA: Good afternoon. The first question is probably for Larry regarding usages of capital. You’ve mentioned a couple of times now that as these warrants get exercised, it does provide a boost to the capital position of the company. And it seems like in the sector we’ve gone very quickly from the problem of not enough capital to the challenge of too much. So when you think about the capital position of the Bank in the years to come, clearly you’ve started with the increases to the regular dividend or the common dividend. What else comes to mind in terms of usages of starting to use up some of that excess capital that's building for the company?

LARRY POLLOCK: Well certainly dividends is very high on the list, and Tracey mentioned that in her remarks that we are still running below our 25 to 30-per-cent target ratio. So we'll keep that under consideration each quarter, so I can't comment. We just, in fact in December raised our dividend 18 per cent. So we'll look forward to further increases there.

If you look back the last 12 months, we've grown 17 per cent, and I believe if you modelled the 17 per cent out, it would be growing faster… our balance sheet would be growing faster than our capital, internally generated capital. And we feel that we're just in the early… very early stages of our economic recovery. So we don't mind having a little bit of extra capital right now if growth opportunities are being presented to us constantly. We expect to use some of that capital for growth.

The other situation is that under the new Basel III rules, preferred shares will not qualify, and we have a reset coming due. Our only outstanding preferred shares coming due in 2014, early 2014, the capital certainly generated from the warrants was originally contemplated to payout those preferred shares because they both expire on the same day.

So we have a number of options here, and we've seen a number of the warrants already converted. It's quite likely as we raise our dividends and keep progressing that we could see more of those warrants convert as various funds prefer to own the shares rather than just sit on warrants.

I hope that was helpful.

SUMIT MALHOTRA: Yes, that's very helpful. Thank you. And obviously the preferred share issue is something to think about as we go forward. But I wanted to return to your comment on the balance sheet growth, specifically it looks like loan growth got stronger for the Bank as the quarter went on. And your tone in that regard seems to be optimistic. The question I would have right now is given what's happening with oil prices for Canadian Western Bank and the Alberta economy as a whole, does that increase the probability of project activity and improve the economic situation or do we have to start worrying about cost inflation in certain parts of the business?

LARRY POLLOCK: Well, the answer to the first part of your question is absolutely yes. We're hearing very large numbers in capital spend in the oil sands, in particular. And we have had virtually none in the last one or two years. So we're expecting to see a lot of new spend there. We expect to participate in that. And we do watch very carefully the sales that

Caterpillar and John Deere and those types of companies have because a lot of that equipment is absorbed into the oil patch.

The other positive we've seen is conventional activity has ramped up significantly. And to answer the last part of your question about are we gone start to see the crunch in labour and that sort of thing? There is a lot of concern right now about another looming labour crunch, which drives the costs of these projects up to the point where some of them aren't economic to proceed. So where the balance is I'm not sure, but we're not there yet, and we're at the very early stages. And if you look at the unemployment levels in Western Canada, they're lower than all of the rest of Canada.

So we're very optimistic operating in the space we're in today. Last year we had no growth in our Northern Alberta region. We're starting to see some very positive signs of growing there, and we're not seeing slowdowns in our other regions, in British Columbia, in particular. Some of our fastest growing branches are still in British Columbia. So we're really optimistic.

SUMIT MALHOTRA: I guess the good news for all of this is that we don't have to look too far back for the Bank and in history for an example that when all the prices were running up in the '04, '05, '06 period, certainly your loan growth accelerated. It's not like your expense growth was low, but the net benefits still favoured the lending volumes.

LARRY POLLOCK: Yes. The negative though, just to keep everybody aware, is that oil's $100 today. That's only $97.3 Canadian. So the Canadian dollar has strengthened, so the return for Canadian producers has actually gone down because of the currency fluctuations.

SUMIT MALHOTRA: I'll wrap it up with a question for Tracey regarding taxes, not something we usually have to talk about, but there was some very specific numbers provided by the Bank. I believe you were at 27.3 per cent as a tax rate this quarter. And your number was 28.4 per cent is the 2011 target or outlook expected tax rate?

TRACEY BALL: Yes, around 28 per cent would be our effective rate.

SUMIT MALHOTRA: So that's for the full year, including the lower level this quarter?

TRACEY BALL: Yes, that's correct.

SUMIT MALHOTRA: Okay. So we should expect a little bit higher in the back half of the year. But you mentioned some tax cuts that had been enacted by the federal government and also some of the provinces.

TRACEY BALL: Right.

SUMIT MALHOTRA: So if 28.4 is your expected 2011, is it appropriate to assume that it's lower in 2012 and '13 as some of these things continue to move lower?

TRACEY BALL: Yes, it should make a difference.

SUMIT MALHOTRA: Okay. So that's at least some of this quarter's lower rate is going to be sustainable going forward.

TRACEY BALL: That's right.

SUMIT MALHOTRA: Thank you for your time.

OPERATOR: Your next question comes from Robert with CIBC. Please go ahead.

ROBERT SEDRAN: Hi. Good afternoon. Quick question, I guess on the margin. You provide some sensitivities on interest rates, and then you also mention on the flip side that competition may begin to heat up a little bit. When you look at the potential for interest rate increases from the Bank of Canada to start, perhaps even as soon as next quarter, should we start to see the margin creep higher or do you figure those two things will largely offset, and a flattish margin is the right way to look at it?

TRACEY BALL: We are asset sensitive to prime rate increases in interest rates. If it's a gradual increase it'll be a creeping effect. It won't be a big significant effect. And we are seeing, as you commented on, increased competition in certain sectors and from certain institutions and certain regions. So I would suspect that the margin that we have right now is a good margin. We'll get a bit of benefit to offset maybe some of the negatives in the sense that we continue to have all National Leasing new lease originations come on the balance sheet as opposed to being securitized. So that has a positive effect as well.

ROBERT SEDRAN: And I guess that was the second part of the question because it seems like branch deposit growth has been pretty good. You've got…

TRACEY BALL: Yes.

ROBERT SEDRAN: Business mix should also be helping the margin. So when we talk about a flattish margin I guess there are some negative offsets to those positives.

TRACEY BALL: That's right. And the other thing that we're just starting to integrate into our asset liability modelling is we've done quite a bit of work on our core deposits. And we definitely have an ability there to gather more yield depending on what socket we put our core deposits in, which are demand deposits, notice and demand deposits. But that'll be a gradual introduction. But there should be some nice margin opportunities there as well.

ROBERT SEDRAN: Thank you.

OPERATOR: Your next question comes from Michael with Desjardins Securities.

ROBERT SEDRAN: Why don't we have that...

MICHAEL GOLDBERG: Thank you. With the leases in National Leasing gradually moving on to the balance sheet, why did your securitization revenue increase this quarter?

TRACEY BALL: Oh, Michael, I had a scripted answer to that, but I didn't bring it with me, but essentially we should probably just get back to you on that. It does look like an anomaly, but there is a specific reason for it. It's to do with the deferred revenue that… Essentially we already had the cash from what would normally be a holdback. We had provided a letter of credit instead. But it's a bit technical, so we'll get back to you on that.

MICHAEL GOLDBERG: So is it going to stay near this higher level rather than the 1.1, 1.2 level, and declining from there?

TRACEY BALL: I don't think so. I think it'll… But I think we'll get back to you on that.

MICHAEL GOLDBERG: Okay. Now also just to follow up on the warrants, so Larry, do you figure that it was the dividend increase that triggered the increased level of warrant exercised this quarter? Or if not, what do you think it was?

LARRY POLLOCK: It was one large institution that filled an order for stock. There was a large demand for stock, not warrants. So the warrants were acquired and converted.

MICHAEL GOLDBERG: Okay.

LARRY POLLOCK: Some mutual funds, I understand, can't carry warrants. They carry… they just carry a stock.

TRACEY BALL: Essentially the warrant holder wanted to monetize the gain.

MICHAEL GOLDBERG: Okay. And this quarter your heavy equipment finance outstandings increased. And I guess it's been a while since that happened last. When was the last time that you had a sequential increase in your heavy equipment finance outstandings?

LARRY POLLOCK: Well we've had two quarters of increase, so Q4 and Q1. Q4-2010 and Q1. And then the last time we had an increase was Q1-2008. So we had 10 quarters of decline in that portfolio, but now it has turned – well, it's starting to turn the corner the last two quarters.

MICHAEL GOLDBERG: Okay. And if we look through the cycle, as your non-performing loans come down, should we expect that your loss provision would decline also or should we instead be thinking more of the provision running at a percentage of loans or assets in the future? That is at least before we move to expected loss rather than incurred loss.

TRACEY BALL: Michael, I would suggest that for 2011 we're pretty comfortable with our range of 20 to 25 basis points. And I think we still need another couple of quarters of economic recovery to figure if it's going to have a meaningful difference in 2012.

MICHAEL GOLDBERG: Okay. But if the level of non-performing loans did decline materially, would it be reasonable to expect that the provision would go down?

TRACEY BALL: Well it depends because sometimes the loans that you have left are the ones that you have the biggest workout with. So you can have a protracted loss determination. So it's kind of hard to say.

I mean in general, yes, you would expect that that would be the case, like we should be experiencing our highest level of provisioning right now, and that's always a lag to the recession. So we should continue to see that. But we are well reserved.

So there are other considerations with IFRS as well since we have a new proposed expected loss model. We don't know when that'll be made available or if it will be available retroactively or just prospectively from a certain date. It's one thing that we all think about a lot, talk about a lot.

MICHAEL GOLDBERG: Thank you, Tracey.

OPERATOR: Again, if you would like to ask a question, please press * then the number 1 on your telephone keypad.

There are no further questions at this time. I turn the call back over to the presenters.

TRACEY BALL: Thank you, Stephanie. And I'll just mention for those who wish to listen to our annual and special meeting of common shareholders today, a link to the webcast and replay is available on our website. The meeting is in Edmonton today and is scheduled to start at 3:00 o'clock Mountain Time or 5:00 o'clock Eastern Time.

And other than that, thank you very much, everyone, for your continued interest in Canadian Western Bank. We look forward to reporting on our second quarter results on June 2nd. And as usual, if you have any follow-up questions or comments, please call us or contact us by email. Thank you and have a good day.

OPERATOR: Thank you. This concludes today's conference call. You may now disconnect.

****