

Laurentian Bank

First Quarter 2025 Results

Event Date/Time: February 28, 2025 — 9:00 a.m. E.T.

Length: 48 minutes

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CORPORATE PARTICIPANTS

Raphael Ambeault

Laurentian Bank — Head, Investor Relations

Éric Provost

Laurentian Bank — President and Chief Executive Officer

Yvan Deschamps

Laurentian Bank — Executive Vice President and Chief Financial Officer

Christian De Broux

Laurentian Bank — Executive Vice President and Chief Risk Officer

CONFERENCE CALL PARTICIPANTS

Meny Grauman

Scotiabank — Analyst

Sohrab Movahedi

BMO Capital Markets — Analyst

Paul Holden

CIBC Capital Markets — Analyst

Doug Young

Desjardins Capital Markets — Analyst

Darko Mihelic

RBC Capital Markets — Analyst

PRESENTATION

Operator

Welcome to the Laurentian Bank Quarterly Financial Results Call.

Please note that this call is being recorded.

I would now like to turn the meeting over to Raphael Ambeault, Head, Investor Relations. Please go ahead, Raphael.

Raphael Ambeault — Head, Investor Relations, Laurentian Bank

Bonjour à tous. Good morning and thank you for joining us.

Today's opening remarks will be delivered by Éric Provost, President and CEO, and the review of the first quarter financial results will be presented by Yvan Deschamps, Executive Vice President and CFO, after which we'll invite questions from the phone. Also joining us for the question period is Christian De Broux, Executive Vice President and CRO.

All documents pertaining to the quarter can be found on our website in the Investor Relations section.

I'd like to remind you that during this conference call, forward-looking statements may be made, and it is possible that actual results may differ materially from those projected in such statements. For the

complete cautionary note regarding forward-looking statements, please refer to our press release or to Slide 2 of the presentation.

I would also like to remind listeners that the Bank assesses its performance on a reported and adjusted basis and considers both to be useful in assessing underlying business performance. Éric and Yvan will be referring to adjusted results in their remarks unless otherwise noted, as reported.

I will now turn the call over to Éric.

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Bonjour à tous. Merci Raphael, et bienvenue à notre appel conférence pour le premier trimestre fiscal de l'année 2025. Good morning and thank you for being with us today.

For the first quarter of 2025, we are happy with the progress we've made on executing against our priorities. I would like to take this opportunity to express my gratitude to all our team members for their commitment and hard work.

I'd like to begin by discussing the current economic landscape and the environment we are navigating. As you are all aware, there have been several developments over the past month that could potentially impact the economy and our businesses. We take these into consideration and are ready to adjust as needed. We remain confident in our ability to manage under these circumstances. Impacts will certainly be felt across several industries, and we are still facing many unknowns, but I would like to reiterate that our Bank has strong financial position and that our business strategies are to our advantage,

including the highest insured residential mortgage portfolio rate among Canadian banks and our business model that focuses on specializations in commercial banking.

I want to emphasize that the Bank is fully committed to supporting our customers, households, and businesses, and we are well positioned to face the macroeconomic challenges that lie ahead.

That being said, we are starting 2025 with a positive momentum in our loan growth. We are pleased to report a 3.6% loan growth in Commercial loans quarter-over-quarter. This was mostly driven by our Inventory and Equipment financing specialties. This fueled our Commercial assets concentration to now 48% favorable to our NIM, which grew by 8 bps to 1.85%.

Coming back to Inventory and Equipment financing, we completed our merger of our activities under one brand: Northpoint Commercial Finance. As mentioned previously, we believe that by combining our equipment and inventory financing specialties, we can accelerate growth as we simplify our go to market strategy and enhanced value proposition to address the needs of the full ecosystem, from the manufacturer through the dealers and to the end users.

We are also happy to announce that Northpoint Commercial Finance has partnered with Yanmar America to provide exclusive floor plan dealer financing. This news is aligned with our diversification strategy within inventory financing as these dealers are in the Agriculture and small construction industry. This new partnership, as well as other opportunities, will continue to fuel our organic growth, both in terms of dealerships, as well as open line of credits that are now above \$10 billion. Our utilization rate in inventory financing in the first quarter was at 45% and remains below historical level. We continue to forecast a gradual normalization in utilization rate towards the end of 2025.

Regarding our commercial real estate portfolio, the sustained decrease in interest rates in Canada, combined with the trust we have earned from developers and our industry expertise, has enabled us to expand our unfunded pipeline over the past 12 months. This positive momentum is reinforcing our confidence in continued growth moving forward. Laurentian Bank remains a partner of choice for large scale projects in this industry.

In summary, we are delivering on our commitment of a commercial banking business focused on its specialties by expanding our footprint across these growth engines. As we continue to invest in our strategic priorities, our level of expenses remains elevated with an efficiency ratio exceeding 74%. As mentioned in previous quarters, we anticipate a continued elevated expense level for the remainder of the year. The investments we are making are crucial to supporting the successful execution of our strategic plan and advancing our technological roadmap, which will position us for long-term growth and success.

We are making steady progress on the critical foundational investment outlined in our strategic plan. A key milestone was the successful completion of a comprehensive mainframe upgrade, which has greatly enhanced our operational resiliency. These enhancements are laying the groundwork for our simplification, efficiency gains over medium terms, and paving the way to our future success.

We are experiencing positive outcomes following the creation and implementation of the Chief Commercial Experience role. This has led to an increase in retail customer satisfaction, driven by improved service quality. Additionally, our commercial specialties continue to uphold their excellent customer satisfaction levels.

Finally, we are in a strong liquidity and capital position, which provides us with the financial stability needed to effectively navigate the current macroeconomic uncertainty.

I would now like to turn the call over to Yvan to review our financial performance.

Yvan Deschamps — Executive Vice President and Chief Financial Officer, Laurentian Bank

Merci et bonjour à tous. I would like to begin by turning to Slide 6, which highlights the Bank's financial performance for the first quarter of 2025.

Total revenue for the quarter was \$249.6 million, down 3% compared to last year and stable quarter-over-quarter.

On a reported basis, net income and diluted EPS were \$38.6 million and \$0.76, respectively. We recorded adjusting items for the quarter, which totaled \$800,000 after tax or \$0.02 per share from:

- Restructuring and other impairment charges of \$2 million; and
- A profit on sale of assets under administration of \$900,000.

Additional details are available on Slide 21 and in the first quarter report to shareholders. The remainder of my comments will be on an adjusted basis.

The diluted EPS of \$0.78 decreased by 14% year-over-year and 12% quarter-over-quarter. Please note that the first quarter included an LRCN interest payment, which had an impact of \$0.06.

Net income of \$39.5 million was down 11% compared to last year and down 4% compared to last quarter.

The Bank's efficiency ratio increased by 130 basis points compared to last year and decreased by 70 basis points sequentially. The decrease was driven by the increase in revenues from higher loan volumes.

Our ROE for the quarter stood at 5.3%, down 70 basis points year-over-year and 90 basis points quarter-over-quarter.

Slide 7 shows net interest income up by \$1 million or 1% year-over-year, mainly due to favourable loan re-pricing lags, which was partly offset by lower average earning assets. On a sequential basis, net interest income was up by \$12.3 million or 7%, mostly from the increase in commercial loan volumes, as well as the impact from loan repricing lines. Our net interest margin was up by five basis points year-over-year and up eight basis points sequentially at 1.85%, essentially for the same reasons.

Slide 8 highlights the Bank's funding position. On sequential basis, total funding was up by \$800 million. Deposits from Advisors and Brokers increased by \$800 million and wholesale funding increased by \$400 million as we issued Senior Deposit Notes ahead of an upcoming maturity in the second quarter. These increases were partly offset by a reduction in partnership deposits of \$400 million as customers continue to allocate funds back into market activity. The Bank maintained a healthy Liquidity Coverage Ratio through the quarter, which remains at the high end of the industry.

Slide 9 presents other income of \$62.6 million, which was lower by 14% compared to last year and 1% sequentially. The year-over-year decrease mostly came from lower fees and securities brokerage commissions following the divestiture of the retail brokerage divisions and lower lending fees due to the low commercial real estate activity.

Slide 10 shows adjusted non-interest expenses of \$184.9 million, down 2% year-over-year and up 4% sequentially, mainly from seasonally higher performance based-compensation, employee benefits, and vacation accruals.

On Slide 11, you'll see that our CET1 ratio remained stable at 10.9%. We are in a strong position and well-positioned to redeploy capital. Potential economic turmoil may impact volume growth for the end of 2025 should high tariffs be implemented.

Slide 12 highlights our commercial loan portfolio, which was relatively stable year-over-year and up \$600 million or 4% on a sequential basis. The increase was mostly fueled by the seasonal growth of inventory financing, a portion of which was due to the FX impact during the quarter.

Slide 13 provides details of our inventory financing portfolio. This quarter, utilization rates were 45%, remaining materially below historical averages, normally in the mid-50s, with dealers continuing to take a more conservative approach to inventory restocking.

Our commercial real estate pipeline continued to show positive momentum due to the recent rate reductions.

Slide 14 illustrated that most of our commercial real estate portfolio is focused on multi-residential housing, with our exposure to the office segment holding steady at 3% of our commercial loan portfolio. As noted, the bulk of our portfolio consists of multi-tenant properties. The LTV on the uninsured multi-residential portfolio stands prudently at 61%.

Slide 15 presents the Bank's residential mortgage portfolio. Residential mortgage loans were down 4% year-over-year and down 1% on a sequential basis. We adhere to cautious underwriting standards and are confident in the quality of our portfolio. This is reflected in our 60% proportion of insured mortgages and a low loan to value ratio of 49% on the uninsured portion.

Allowances for credit losses on Slide 16 totaled \$206.9 million, up \$3.1 million compared to last quarter from higher allowances on impaired commercial loans.

Turning to Slide 17, you can see the evolution of our allowances for credit losses in the top left corner compared to the industry. The level of our allowances for credit losses has remained relatively stable since the pandemic period, while the industry released provisions. In the bottom left corner, you'll find the evolution of our coverage ratio expressed as the previous year's allowances for credit losses over the net write-offs incurred over the following 12 months. On that basis, we currently stood at about 30% higher than the industry average in terms of net write-off coverage, well-positioned to face the current uncertainties.

Turning to Slide 18, the provision for credit losses was \$15.2 million, a decrease of \$1.7 million from a year ago due to releases of provisions on performing loans. Sequentially, PCLs were up \$4.8 million, returning to the previously guided level in the high teens. As a percentage of average loans, PCL decreased

by one basis point year-over-year and increased by five basis points quarter-over-quarter to 17 basis points.

Slide 19 provides an overview of impaired loans. On a year-over-year basis, gross impaired loans increased by \$155.3 million due to credit migration in commercial loans and were up \$21 million sequentially. Our disciplined approach to underwriting, along with the high quality and strong collateralization of our loan portfolio—around 93%— enable us to effectively navigate credit migration without material impacts on our ACL and PCL results. We remain committed to a prudent and disciplined approach to risk management.

As we look ahead to the second quarter of 2025, I would like to provide some remarks.

We expect our loan book to be slightly up, as Inventory Financing should continue its seasonal increase, but at a lower pace than Q1 and considering that last quarter's growth was partly supported by the FX variation.

Revenues are projected to be down, mainly from the shorter quarter and from non-recurring loan repricing lags, partly offset by higher Inventory Financing volume. NIM is also expected to be slightly down.

Regarding the efficiency ratio, we previously explained that we are increasing our investments in cloud computing technology. These projects have a higher proportion of operating expenses compared to the traditional capitalized expenses for on-premises technology. The execution is accelerating and high in Q2, and therefore, the level of OPEX is increasing. Our efficiency ratio guidance for the full year remains in the mid 70s, but we expect Q2 to be higher due to the acceleration of projects and the impact of a

shorter quarter on revenues. The investments we are making will not only improve the customer experience in our digital offerings but will also lead to efficiency gains in the medium-term to achieve our financial targets.

Considering the geopolitical and macroeconomic environment, it is difficult to predict the potential outcome on PCLs. Our previous guidance for the year was high teens.

Our tax rate is expected to be in the 19% to 20% range.

Capital and liquidity levels are solid and expected to remain strong for Q2 and the remainder of 2025.

I will now turn the call back to the Operator.

Q & A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press star, followed by the one on your touchtone phone. You will hear a prompt that your hand has been raised. Should you wish to decline from the polling process, please press star, followed by the two. If you are using a speakerphone, please lift the handset before pressing any keys. One moment, please, for your first question.

Your first question comes from Meny Grauman with Scotiabank. Your line is now open.

Meny Grauman – Analyst, Scotiabank

Hi. Good morning. Just wanted to follow up on the outlook that you gave on margins. I think you mentioned that we should expect it to be slightly down, so I just wanted a little bit more color in terms of sort of the magnitude there and trying to understand why as well.

Yvan Deschamps — Executive Vice President and Chief Financial Officer, Laurentian Bank

Thank you for the question, Meny, so what I'll do is I'll start by explaining the eight basis points increase this quarter, and that's going to lead to a better explanation of your—for your question. So, the NIM increased by eight basis points this quarter. Three to four basis points of that came from loan repricing lags and FX. Four to five basis points of that came from the business mix improvement due to the commercial loan growth, and just to—as a reminder, the loan repricing lags relate to our U.S. portfolio, and the way it's done is that the repricing of the variable rate to the customer happens in the month following variation of rate, so since we experienced a few reductions from the Fed, we had an advantage in our Q1 results from that lag in terms of repricing to the customer. So, the loan repricing lag, as well as the FX of three to four basis points, is not expected to recur in Q2, and therefore, that's our guidance of a small reduction in terms of the NIM.

Meny Grauman – Analyst, Scotiabank

Understood, and I just wanted to ask about tariffs, and the first question is just in terms of what your exposure is to sort of areas of the economy that are likely to be more impacted by tariffs in terms of

autos, aluminum, those types of areas of the economy that would potentially be directly in the eye of the storm, and so what the exposure for Laurentian Bank is there.

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Yes. Thank you, Meny, for the question. It's Éric. As we said in the intro, we think the Bank is well-positioned, actually, to face tariffs. For sure, in terms of the Canadian workers and the consumers, it will or could have impact, again, depending on the extension of the tariffs, is there a counter-tariff out there, how long do they last, so a lot of uncertainties still remains. One thing I want to put emphasis on is that our Inventory Financing business is 90% in the U.S., distributing for the vast majority U.S. products from manufacturers. So, from that standpoint, we feel good, and, as we highlighted, the other big segment for us in Canada is commercial real estate, and there, the vast majority is in housing projects, which demand remains strong. We're seeing still momentum with the interest rate decrease last year, so, for us, we believe the portfolio is well-positioned, and it's been resilient to previous events, and we think we're well-positioned to face the uncertainties ahead.

Meny Grauman – Analyst, Scotiabank

In terms of the Inventory Finance business, there's a lot of talk about the auto sector being very much a cross-border business, so tariffs may impact supply chain, but in terms of the kinds of products that you're financing in terms of marine, power sports, trailers, do you have a sense of how much of that supply chain is just within the U.S., or does it connect to Canada and could it be susceptible to sort of disruptions in a tariff war?

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Yes. Meny, this is a great question, and actually, two weeks ago, I was down in—at the boat show in Miami. The overall feeling there was actually quite positive from the industry perspective, and from a tariff war, if that occurs, that sector, if we take it, for example, fiberglass, the feedback we got is that they expect, the manufacturers, a minimal impact. Now, would that be the same for a trailer industry or RV industry that has more aluminum-based type components? It is to be determined. That would build up in a long-term scenario of tariffs, so to be determined in terms of the price of goods, but, as a reminder, we don't do any auto in our Inventory Finance book of business, and we believe that the industries we're in are well-equipped to face uncertainties, but, again, to be determined on the size of that tariff war, if it is to happen.

Meny Grauman – Analyst, Scotiabank

Thanks for the detail.

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Thank you, Meny.

Operator

Your next question comes from Sohrab Movahedi with BMO Capital Markets. Your line is now open.

Sohrab Movahedi – Analyst, BMO Capital Markets

Okay. Thank you. Éric, I just wanted to maybe build on that a little bit. I mean, you held an Investor Day. You laid out a plan for us. How, if at all, do you anticipate tariffs may impact the timing of the delivery of that ambition?

Éric Provost — President and Chief Executive Officer, Laurentian Bank

So, many fronts on the strategic plan, Sohrab, so it's a great question. High level, as I just touched on Inventory Financing, that business will follow the actual economy of the U.S, so it will be trending towards the behaviour of the U.S. economy. As we highlighted, we believe that, right now, we remain at low historical usage of our line of credit that now stands at \$10 billion, and we continue to grow organically that dealer footprint and we're diversifying in other industries, so the team is very efficient in building up that future growth opportunity, and I think that this will continue to fuel our NIM and also create the right level of revenue growth to fuel our strategic plan. Now, can this be slowed down by a lower consumer confidence and a slower growth pace in the American economy? The answer to that would be yes, but we believe still in the ability of our team to create the right level of asset growth from that perspective to sustain the plan.

As for commercial real estate and the Canadian overall market, we think we're well-positioned. Of course, the uncertainty creates kind of a pause in both the business side, as well as the consumer side in terms of either investing or borrowing, so it creates that uncertainty that we start feeling, so this may impact the funding of some of our commercial real estate pipeline that we forecasted for later part of 2025, but, again, there's a lot of unknowns, so right now, we keep steady on the positioning for asset growth with our specialty groups.

The rest will come from the efficiency we are creating through our investments, Sohrab, and this is continuing, actually, as we described. Projects are underway. To be expected increase in expenses in Q2, but we remain on our overall forecast for the year that is mid 70s in terms of efficiency ratio, so, for us, there is uncertainty, but in the medium to long term, it doesn't change our goals and our financial targets for the time being.

Sohrab Movahedi – Analyst, BMO Capital Markets

I mean, that's really helpful, so can I just clarify? I mean, basically, what you're saying is the revenue environment is one thing, but once you've started down the optimization and expense initiatives, you expect to continue on that regardless of the revenue environment, or do you have flexibility to slow that down to continue to hit that, call it, mid 70s expense ratio?

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Yes, throughout the plan, there's a road map that is defined, Sohrab, so the projects that are in flight right now, definitely, there's no plan to reduce or slow down. We will execute, because those are part of our foundational. If we were to face extended tariffs and all that, we are prepared to be agile and make the right decisions to ensure that it makes sense for us financially, but right now, it's all speculation.

Sohrab Movahedi – Analyst, BMO Capital Markets

Yes, I get that, and just one last question, are you—like, does Northpoint, I assume they're in touch with their clients and their borrower base. Can you share with us what, if any, conversations, tariff-related, are being had at Northpoint and in your Inventory Finance with customers?

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Yes. This is, again, a great question. I have to say, the sentiment in the U.S. is quite different than the one we experience right now in Canada. Discussions that I've been involved with are not focused on tariffs, so the dealer base, the consumer confidence after the election of the new administration is more positive, actually, than last year. If I just take, for example, the boat show I attended, so still a positive overall sentiment, I will feel—say, in that ecosystem. Again, that can evolve again if they are to go into tariffs and counter-tariffs, but it still remains speculation, and the overall sentiment at the time being is on the positive side from a U.S. perspective.

Sohrab Movahedi – Analyst, BMO Capital Markets

Okay. Thank you very much for taking my questions.

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Have a good day.

Operator

As a reminder, ladies and gentlemen, it is star, one if you have a question. Your next question comes from Paul Holden with CIBC Capital Markets. Your line is now open.

Paul Holden – Analyst, CIBC Capital Markets

Thank you. Good morning. I want to ask maybe one more additional question on performing allowances and tariffs risk. If I look at your Slide 17, which is a useful slide, it kind of suggests two things to me. One is, if we look back on the 2020 period, you didn't need to increase your performing allowances as much as the big banks did, so maybe there's just less economic sensitivity in your loan mix, so maybe you can address that. But then, also, two, I imagine some of the reason the ACL ratio is elevated today versus pre-COVID is just because of the change in loan mix, so maybe you can also address—second question is, address sort of where your ACL ratio for Inventory Finance and Equipment Finance specifically stands versus the past.

Christian De Broux — Executive Vice President and Chief Risk Officer, Laurentian Bank

Thank you, Paul. This is Christian. So, I would say on our ACL, we've not reduced, after COVID, as other banks have done, because we've been going from one pessimistic scenario to the next, right, so we went through supply chain issues, we went through the rapid rise of interest rates, and now, we're morphing into geopolitical concerns, and so that's why you're not seeing as much ramping up as elsewhere and why we didn't come down as we did before. And, to your other point as to how sensitive we are to the environment, I think our portfolio has a lot of very good fundamentals. If you take a look at our balance sheet, 50% is in residential mortgages, of which 60% is insured. We're 49% loan-to-value on the uninsured part. If you look at our commercial portfolio, the bulk is in commercial real estate and in the residential sector, and if—and the other big portfolio is Inventory Financing, which is, like Éric was pointing out, 90% in the U.S. and will follow the U.S. economy, which is fairly positive today.

Yvan Deschamps — Executive Vice President and Chief Financial Officer, Laurentian Bank

And if I can add, Paul, you're totally right that the commercial mix increased, but that only explains a small portion of the increase in terms of ACL. So, overall, you also need to look at the coverage ratio we have at the bottom there, which shows that we're pretty much covered, 30% higher in terms of net write-offs versus the rest of the industry, so we have a real great position to start with.

Paul Holden – Analyst, CIBC Capital Markets

Okay. Would you be willing to quantify what the impact to your ACL ratio or your provisions would be if you moved to 100% probability on the pessimistic scenario?

Christian De Broux — Executive Vice President and Chief Risk Officer, Laurentian Bank

Christian speaking again. I would point you out to our Note 5 to our financial statements where you can see the swing 100% optimistic, 100% pessimistic.

Paul Holden – Analyst, CIBC Capital Markets

Okay. Okay. Thank you. One additional, or, I guess, two additional questions for me. First off, I think you called acceleration in those planned project investments starting in Q2, so that just has me curious in terms of what's driving the acceleration. Have you made better progress to date than planned, or, I guess, really, what's the reason for accelerating those projects?

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Yes. Thank you, Paul. Actually, I said acceleration probably more to relate to the expense level that we will incur on the OPEX side of things, because, as Yvan mentioned, a lot of components of our

investments are going towards cloud-based type solutions, but they are aligned with the strategic plan we highlighted that were to revamp our foundational and make sure after that we made the right decisions on the digital offering we want to be able to deploy further down the road. So, for us, it's just a continuity of our strategic plan, but in terms of expenses, we're guiding towards that Q2 will incur accelerated expenses on the OPEX side to support the projects that were launched since inception of our strategic plan.

Paul Holden – Analyst, CIBC Capital Markets

Got it. Got it. Okay. That makes sense, and last question for me, I mean, you've added—Laurentian's added a number of dealer relationships over the years. Don't recall you calling them out like you have with Yanmar, so wondering why you're calling out the Yanmar. Is it simply because of diversifying into agriculture, or is it also maybe because of the potential size of that relationship as well?

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Yes. No, I wouldn't qualify the size in terms of dollars as material in the overall portfolio. What you just described is exactly why we call it out. It is aligned with our strategic plan, again, to prove the fact that we are diversifying our industry base. This represents great opportunity in terms of adding new sectors. Agriculture and small constructions were part of the industries we said we would target, and this is just another proof point of the ability of our origination team to be able to land those types of agreements, so this is why we point it out.

Paul Holden – Analyst, CIBC Capital Markets

Got it. Got it. Okay. That's it for me. Thank you for your time.

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Thank you, Paul.

Operator

And a final reminder, ladies and gentlemen, if you have a question or comment, it is star, one. Your next question comes from Doug Young with Desjardins Capital Markets. Your line is now open.

Doug Young — Analyst, Desjardins Capital Markets

Hi. Good morning. Just, hopefully, these are a few clarifications, but a much cleaner quarter from a restructuring charge perspective. Anything else big on the horizon from a restructuring charge perspective that we should be anticipating?

Yvan Deschamps — Executive Vice President and Chief Financial Officer, Laurentian Bank

Not at this point. As mentioned previously, Doug, we continue looking at the various operations. As we get something or an opportunity to optimize and reduce the cost base going forward and maybe more efficient, we're going to do it, but nothing sizable on the horizon.

Doug Young — Analyst, Desjardins Capital Markets

Okay. This might tie in with that one, but can you remind us what else needs to be really done? We've talked a lot about Northpoint and Inventory Financing, but what really needs to be done to improve

the efficiency of the Canadian banking business, and I assume a lot of these projects, that's what it's targeted at and that's what the accelerated or elevated expenses are and the movement to cloud, but can you remind me some of the bigger projects that are really kind of honing in on improving that Canadian banking efficiency and how long that will take to kind of evolve?

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Yes. Thank you, Doug. It's Éric. I think that the plan highlights the fact that our goal is to stop copying the big banks' model. I think this is the big takeaway to create efficiencies in this Bank, and this is what we started is to really focus on where we believe we can win and add value deploying our capital, so the efficiency creation will come through various angles in terms of new revenue generation opportunity, simplify product offering to our retail space, and, again, last year, you saw the actions in terms of divesting our full retail brokerage, as well as discount brokerage. Those are examples of the work that has started and will continue to be done.

As for the efficiency created by projects, we're moving towards a better digital offering that will provide our customers with more self-serve tools, and this is where, on the mid to long term within this plan, we will definitely achieve the momentum to get to our financial goals, which is to be below 60% efficiency ratio and above the 10% ROE target we gave ourselves.

Doug Young – Analyst, Desjardins Capital Markets

And no update on timing? That timing that you gave at the Investor Day is still...

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Well, we're still early in the plan, Doug, so we're nine months into it. Like I highlighted, many of the programs are in flight. That's why we're guiding higher expenses in terms of OPEX for next quarter. The team is fully engaged. I think Yvan also mentioned a big milestone in our mainframe upgrade that occurred this quarter, so very proud of that and the work of the team, so definitely executing, but still early in the plan.

Doug Young – Analyst, Desjardins Capital Markets

Okay, and then, lastly, just on credit, and I get the retail side of it, but what we're seeing across the banking space is a lot more lumpiness on the commercial side, and when I look at the impaired loan formations or impaired loan PCLs, it looks like that's crept higher year-over-year sequentially. If I look at total gross—new gross impaired loan formations, it's more than doubled year-over-year. I assume most of that has come in on the commercial side. You can correct me if I'm wrong. Can you talk a bit about that new gross impaired loan formation specifically related to commercial and what you're seeing? Is there anything in particular that we should be thinking about?

Christian De Broux — Executive Vice President and Chief Risk Officer, Laurentian Bank

Thanks, Doug, for your question. This is Christian. You're right, the GIL is really in commercial. What you're seeing is actually a lot of activity in our GILs, right, so, we also had a record return to performing, record repayment with minimal write-offs, so the large GIL increase that you saw in the past quarters is starting to move into resolution. So, at this time, we're really comfortable with our guidance of high-teens PCL, which is reflecting the high level of collateral backing our deals.

Doug Young – Analyst, Desjardins Capital Markets

Was this mostly Canada or was it the inventory? I assume it's mostly Canada, but the...

Christian De Broux — Executive Vice President and Chief Risk Officer, Laurentian Bank

Yes, by and large, it's mostly Canada.

Doug Young – Analyst, Desjardins Capital Markets

And is this commercial real estate, or is there any particular other segment?

Christian De Broux — Executive Vice President and Chief Risk Officer, Laurentian Bank

Our portfolio is highly diversified, and it's—there's not a sector that is overweight relative to others of any meaningful importance.

Doug Young – Analyst, Desjardins Capital Markets

Okay. Okay, appreciate the color. Thank you.

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Thank you.

Operator

Your next question comes from Darko Mihelic with RBC Capital Markets. Your line is now open.

Darko Mihelic – Analyst, RBC Capital Markets

Hi. Thank you. Good morning. Just a couple of quick questions. First, with respect to the lag impact that you referenced, I just wanted to make sure that I understand it, so there's a repricing that occurred, and as a result of that, next quarter, with the new loans, there'll be less margin. Did I understand that correctly?

Yvan Deschamps — Executive Vice President and Chief Financial Officer, Laurentian Bank

Yes. Thank you for the question, Darko. I'll clarify, and if it's not after what I said, please jump in. So, the way it works is, we got two Fed rate reductions in last quarter, so as the Fed rate reduces, the SOFR cost reduces, which reduces our cost of fund as well. We have contracts in our inventory financing, which are variable rate contracts, but they reprice on a monthly basis, so there's a lag of timing between the time that our cost of fund reduced and the time that we passed it to the customers, so we do benefit from some number of days with an increased margin, which is temporary and non-recurring, and that happened in Q4—sorry, in Q1, and in Q1—in Q2, going forward, those will not recur unless there is additional Fed rate reductions.

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Darko, it's Éric. The margins are stable in terms of profitability. It's just that the timing of the repricing for us creates a good guide when interest rates go down.

Darko Mihelic – Analyst, RBC Capital Markets

I understand, and so, Yvan, when I look at your income statement, is that what I'm seeing in the derivatives line in your cost of funding?

Yvan Deschamps — Executive Vice President and Chief Financial Officer, Laurentian Bank

No, the derivatives one is much more for the general hedging of the Bank in terms of interest rates, so it does not relate to what we're talking about. The impact of what I'm talking about pretty much shows up all on net interest income.

Darko Mihelic – Analyst, RBC Capital Markets

Yes, within the net interest income, there's two components, right? There's the assets and the funding cost, and when I look at that, I see a very big drop in the interest expense from derivatives, so that's what I'm aiming at. Is that not connected to this lagging?

Yvan Deschamps — Executive Vice President and Chief Financial Officer, Laurentian Bank

No, it's not connected to the hedging itself. The hedging is different. This is just a question of cost of fund reduction versus the margin improvement from the fact that there is a lag to the repricing of the customer, so it's not a hedging element. It's really an expense cost and expense revenue.

Darko Mihelic – Analyst, RBC Capital Markets

Okay. Thank you, and then—so I see that on the deposit side as well. Fair enough, and then, just another question with respect to your risk-weighted assets and your capital. If I look at your capital slide, which is Slide 11, essentially, your RWA growth is exceeding your organic capital generation, so the

question is, what kind of growth are you searching for now while you have a high efficiency ratio, which is preventing you from really organically generating enough capital, or another way to ask this is, where do you want to take down your ratio if you get good commercial loan growth?

Yvan Deschamps — Executive Vice President and Chief Financial Officer, Laurentian Bank

In fact, the target didn't change for the whole Bank, so it's really to go below 60% in the medium term. What the advantage we have right now, Darko, is we have a very high capital base, and we can use that capital base to invest in the business to generate the efficiencies we're looking for and to deploy in the assets as we see the growth coming back, so the capital increase, as we got over last year a reduction in the average earning assets, so redeploying it is going to reuse the capital that we pretty much accumulated over the last year or so, but all of that to say, as we generate efficiency, you're going to see, as you mentioned, the internal generation of capital increase, which is going to support additional growth going forward.

Darko Mihelic – Analyst, RBC Capital Markets

Okay, all right. Thank you very much for that. Appreciate that. Thank you.

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Thank you, Darko.

Darko Mihelic – Analyst, RBC Capital Markets

This concludes the Q&A session. I will now hand the meeting over to Éric Provost for closing remarks.

Éric Provost — President and Chief Executive Officer, Laurentian Bank

Thank you. I would like to express my heartfelt gratitude to our employees, customers, shareholders, and all stakeholders for your ongoing support as we transform and reshape Laurentian Bank. Your commitment is vital to our evolution and success. Thank you. Have a great day.

Operator

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