FINAL TRANSCRIPT

Laurentian Bank of Canada

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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 of Investor Relations, Laurentian Bank of Canada

Bonjour à tous. Good morning and thank you for joining us for the Laurentian Bank 2024 third quarter results presentation. My name is Raphael Ambeault and I'm Head, Investor Relations.

Today's opening remarks will be delivered by Eric Provost, President and CEO, and the review of the third 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 Investors Centre.

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. Eric and Yvan will be referring to adjusted results in their remarks unless otherwise noted, as reported.

I will now turn the call over to Eric.

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Merci Raphael. Bonjour et bienvenue à notre appel conférence des résultats du troisième trimestre 2024. Good morning and thank you for joining us.

Since the introduction of our strategic plan in May, we have remained focused on implementation and execution in order to achieve the results and targets we've set for ourselves. To that effect, I want to extend my thanks to all our team members for their commitment towards the plan. Let me walk you through what we've accomplished so far.

In capital markets, we successfully completed the divesture of LBS Retail full service brokerage to iA Private Wealth that we announced in April. In addition, earlier this month we announced the sale of LBS discount brokerage to CI Investment Services. We are focusing on where we have expertise, scale and where we can win, and both of these transactions are directly aligned with these objectives.

In personal banking, we created a new position, Head of Customer Experience. This role will improve and enhance the customer experience and brings our employees and decision-making closer to the customer.

In commercial banking, the seasonality impact in inventory financing was strong, bringing the utilization ratio to 43 percent, about 10 percent below historical levels. The lower utilization rates are proof of our dealers' ability to turn their inventory as well as their prudence in restocking. Furthermore, our sales team kept their momentum in increasing our footprint, reaching 440 new on-boarded dealers year-over-year, representing an increase of 7 percent.

As for commercial real estate, we're still observing low levels of new projects being launched. Our pipeline remains healthy with insured multi-residential projects particularly strong. Our teams are well positioned for the rebound, which remains dependent on the pace and level of interest rate reductions in Canada and United States.

Concerning the Leadership Team, following the announcement of Liam Mason's upcoming retirement at the end of the fiscal year, we're thrilled to welcome back Christian De Broux to Laurentian Bank as our new Chief Risk Officer. Christian, who used to be Laurentian Bank's Chief Credit Officer, returns to us after having spent over four years at a global specialty finance company. He brings over more than 30 years of experience in a variety of risk oversight, management and banking roles. We're delighted to have him on board and look forward to leveraging his deep credit knowledge and extensive expertise in risk management.

With respect to earnings, our third quarter results were relatively consistent with the previous quarter on an adjusted basis. As mentioned earlier, we continue to face headwinds in loan volumes, which decreased by $1.2 billion last quarter. With regards to deposits, they are being effectively managed in alignment with our loan and securitization activities.

Despite challenging macroeconomic conditions, our portfolio remains robust. Our conservative underwriting standards as well as the quality and high level of collateral are contributing to a relatively stable level of loan losses. As such, provision for credit losses was down two basis points quarter-over-quarter, now standing at 18 basis points.

Expenses remain elevated as we invest in technology and other strategic priorities to support a stronger foundation and our path to improved digital capabilities, as laid out in the investor day in May. Despite this, our adjusted efficiency ratio for the quarter improved to 73.3 percent, a 50 basis point reduction from the previous quarter.

Regarding capital, our common equity Tier 1 ratio increased to 10.9 percent from 10.4 percent last quarter, reflecting the reduction in loan volumes. We are well positioned to redeploy capital later in 2025 when loan growth resumes, fueled by the expected additional rate reductions.

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

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

Merci Eric, et bonjour à tous. I would like to begin by turning to Slide 7, which highlights the bank's financial performance for the third quarter.

Total revenue was $257 million, down 2 percent compared to last year and up 2 percent quarter-over-quarter. On a reported basis, net income and diluted EPS were $34.1 million and $0.67 respectively. We have recorded adjusting items for the quarter which totaled $8.9 million after tax, or $0.21 per share, and include restructuring and other impairment charges of $6.7 million after tax related to the headcount reduction announced in May, and amortization of acquisition-related intangible assets of $2.2 million after tax. Additional details are available on Slide 21 and in the third quarter report to shareholders.

The remainder of my comments will be on an adjusted basis.

Diluted EPS of $0.88 decreased by 28 percent year-over-year and 2 percent quarter-over-quarter. Please note that this quarter includes an LRCN interest payment which had an impact of $0.06 on the EPS. Net income of $43.1 million was down by 25 percent compared to last year and up 6 percent compared to last quarter. The bank's efficiency ratio increased by 480 basis points compared to last year and decreased by 50 basis points sequentially. The increase year-over-year reflects our ongoing investments in strategic priorities and the impact of lower loan volumes. Our ROE for the quarter stood at 6.2 percent, up 10 basis points sequentially.

Slide 8 shows net interest income down by $11.4 million or 6 percent year-over-year, mainly due to lower loan volume. On a sequential basis, net interest income was up by $1.2 million or 1 percent, mainly reflecting the positive impact of two additional days in the quarter partly offset by lower loan volumes. Our net interest margin was down five basis points year-over-year and one basis point sequentially at 1.79 percent, impacted by lower commercial loan volumes.

Slide 9 highlights the bank's funding position. We are managing our funding in line with our loan book. On a sequential basis, total funding was down $1 billion. Partnership deposits decreased by $300 million as customers continue to allocate funds back into market activity. Deposits sourced from advisors and brokers channel were managed down by $500 million, and wholesale funding decreased by $400 million as we did not replace senior deposit notes at maturity considering our liquidity position. The bank maintained a healthy liquidity coverage ratio through the quarter which remains materially above the industry average.

Slide 10 presents other income of $75.7 million, which was higher by 10 percent compared to last year. Higher income from financial instruments benefiting from constructive financial markets was partly offset by lower lending fees due to tempered commercial real estate activity. On a sequential basis, other income was higher by 4 percent for the same reasons.

Slide 11 shows adjusted non-interest expenses of $188.1 million, up 5 percent compared to last year mainly due to professional fees and other costs to support our strategic priorities, as well as higher regulatory expenses and other costs related to various compliance projects. On a sequential basis, non-interest expenses were up by 1 percent, mainly from higher technology costs.

On Slide 12, you'll see that our CET-1 ratio has increased by 50 basis points to 10.9 percent, primarily due to a decrease in risk-weighted assets. We experienced strong and healthy seasonality during the summer for inventory financing and continued softness in real estate projects. We see these as temporary and are well positioned to re-deploy capital later in 2025, as growth will resume based on time and speed of the expected rate reductions.

Slide 13 highlights our commercial loan portfolio, which was down $1.3 billion or 7 percent year-over-year, and down $700 million on a sequential basis for the reasons I just mentioned.

Slide 14 provides details of our inventory financing portfolio. This quarter, utilization rates were 43 percent primarily due to dealers taking a more conservative approach to inventory restocking because of the macroeconomic conditions. The volume reductions in Q3 also showed consumer resilience in terms of purchasing power despite the current macroeconomic uncertainty. Our commercial real estate pipeline remains healthy but we continue to see developers delaying the start of projects, awaiting further rate reductions.

Slide 15 illustrates that most of our portfolio is focused on multi-residential housing, with our exposure to the office segment holding steady at 3 percent of our commercial loan portfolio. As noted in previous quarters, the bulk of our portfolio consists of multi-tenant properties with minimal exposure to single-tenant buildings.

Slide 16 presents the bank's residential mortgage portfolio. Residential mortgage loans were stable year-over-year and slightly down by 2 percent on a sequential basis. We adhere to cautious underwriting standards and are confident in the quality of our portfolio. This is reflected in our 58 percent proportion of insured mortgages and a low loan-to-value ratio of 48 percent on the uninsured portion.

Allowances for credit losses on Slide 17 totaled $224 million, up $7.1 million compared to last year mainly due to higher allowances on impaired commercial loans.

Turning to Slide 18, the provision for credit losses were $16.3 million, an increase of $3 million from a year ago, impacted by a credit migration on commercial loans. Sequentially, PCLs were down $1.6 million from higher releases in provisions on performing loans. As a percentage of average loans and acceptances, PCL decreased by two basis points to 18 basis points.

Slide 19 provides an overview of impaired loans. On a year-over-year basis, gross impaired loans increased by $175.5 million due to credit migration in commercial loans and were up $74 million sequentially for the same reasons. Our underwriting discipline, including the quality and the high level of collateralization on our loan book at about 93 percent, allows us to weather the macroeconomic conditions and the related 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 Q4, I would like to note a few key points focused on the next quarter. We expect our loan book to be just slightly down, putting pressure on NII. We expect growth to resume later in 2025 with the pace and extent of the anticipated rate reductions. Other income will reduce next quarter due to two main factors: first, the closing of the sale of our retail full brokerage activities to iA on August 2 will negatively impact brokerage fee revenues by about $4 million to $5 million; second, the income from financial instruments were at a record high in Q3 and may normalize. NIM is expected to remain relatively stable, but it will depend on the overall business mix.

Regarding the efficiency ratio, it is expected to be slightly up from Q3 due to revenue pressure just mentioned and the ongoing investments in our strategic priorities. Considering the macroeconomic environment, PCLs are expected to remain in the high teens to low 20s. Capital and liquidity levels are solid and expected to remain strong for Q4.

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 three-tone prompt acknowledging your request, and your questions will be polled in the order they are received. 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 ask about the timing of the rebound in loan growth that you see for '25. Presumably it takes time for activity to react to rate cuts, and it sounds like you don't believe that rate cuts have fallen enough yet to kind of stimulate the demand that you're forecasting, so just if you could help us sort of narrow the focus in terms of timing in '25. Is this more of a late '25 story you're envisioning in terms of seeing loan growth come back here?

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Yes, thank you Meny - it's Eric, and good morning to you, too.

Yes, this is pretty much what we expect, and again, depending on both Canada and U.S. rates, the pace and scale of the reduction, it will depend. As you know, two of our key growth engines, so commercial real estate here in Canada, we still have a healthy pipeline, most of it is in multi-residential, but we still see developers being on the sidelines awaiting for those further rate cuts. So, before those projects are launched, expect it to impact our growth probably later in '25.

As for inventory financing, as I mentioned in my opening remarks, dealers have actually been strong in sales this summer, and the good story there is that we've been able to increase our dealer base by 7 percent year-over-year. The sales team is working to expand those opportunities for future growth, but we're awaiting that easing in interest rates as well from the Fed, so that should have an impact, but dealers will remain cautious, we expect, in terms of restocking at this fall season.

Meny Grauman — Analyst, Scotiabank

What portfolios do you expect to be more sensitive to rates, meaning where do you see—where do you expect to see the reaction first, and then what portfolios might lag?

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Well, the demand is still very strong, Meny, in terms of housing across Canada. It's just that developers are waiting to make sure that the economics make sense for their projects in terms of returns, so I believe that if we do feel the pace of steady reduction, those developers are really waiting to launch new projects, so that could have impact.

Again, consumer confidence in the U.S. has remained strong in terms of purchases throughout the summer, as we see in line utilizations that are way below historical levels at 43 percent for that period, so we believe that if we see an easing, it could be a good story there in terms of rebuilding inventory for the next season, but still to be dependent on the pace of the Fed reduction.

Meny Grauman — Analyst, Scotiabank

Understood, thank you.

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

You’re welcome.

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. Yvan, I assume the higher capital ratios are in anticipation of future loan growth, but what's the risk that some of these impairments may result in higher than modeled or expected loss given defaults? I mean, we've seen this as an issue with some other banks that are also very good lending culture, strong underwriters of credit, but they're getting surprised a little bit with recovery rates when defaults are happening. So, can you give us some comfort that similar things are not about to happen at Laurentian?

Then if we could just get a little bit more commentary as to what's the outlook for formations, do you anticipate continued negative migration here in the portfolio? Thank you.

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

Thank you, Sohrab. I'll start, and maybe Christian is going to add to the answer.

The 10.9 percent, as you mentioned, of CET-1 this quarter, 50 basis point increase came from the loan volume reduction, so reduction in the RWA; and as Eric mentioned, we're awaiting the rate cuts and we expect pent-up demand in inventory financing and in CRE, those that will come back and take some of that capital, so we're currently extremely well positioned from a capital perspective to sustain that and sustain the plan that we're launching as well.

From a credit perspective, our guidance has been clearly for the last two quarters, and is still maintained at the same thing, low 20s to high teens, and pretty much it's what we see for the next quarter or next two quarters, so there is no indication at this point that we would see anything material that would divert from this.

Maybe Christian, if you want to add to this?

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

Thank you Yvan, and good morning.

What I would say is you have to understand that the increase in our impaireds are coming from well-collateralized new formations in commercial, and there's a minimum bite size required to play in commercial markets and this creates volatility in GILs. That being said, we have been and we continue to be disciplined in our underwriting, and that's why you're not seeing variations in the ACL or PCL, and like Yvan said, we are still comfortable with our guidance of high teens, low 20s for PCLs going forward.

As to the forward view on GILs, it's hard to predict in the short term, but longer term with interest rate reductions forecasted, we're expecting our impaired loans to normalize.

Sohrab Movahedi — Analyst, BMO Capital Markets

Okay, that's very helpful, Christian. I just want to put a finer point on this. You are saying I am naïve or I'm thinking too hard if I'm worried about the risk, for example, of you next quarter telling us that you were surprised about the recovery rates on some of these impaired loans?

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

Well, the other thing you have to remember, we're a collateral—you know, we focus strongly on having high collateral behind our loans. Ninety-three percent of our book is collateralized, so I think sometimes the surprise comes from cash flow loans. That's not where we play, right - we play in collateralized loans, and so not expecting to be surprised.

Sohrab Movahedi — Analyst, BMO Capital Markets

And the collateral is usually, what, hard real estate, or can you talk a little bit about some of the new formations this quarter and what's the collateral behind it?

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

It's well diversified. They're new formations, right? It's not concentrated in—you know, geographically or by vintage or industry. It's well diversified across the portfolio, so it'll be a mix of all our business lines.

Sohrab Movahedi — Analyst, BMO Capital Markets

But can you comment on what sort of collateral is behind it, behind the facilities?

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

It could be Real estate, or it could be equipment - you know, that's basically what we're going to have behind our—underpinning our loans.

Sohrab Movahedi — Analyst, BMO Capital Markets

Okay. Thank you very much.

Operator

Your next question comes from Gabriel Dechaine with National Bank Financial. Your line is now open.

Gabriel Dechaine — Analyst, National Bank Financial

Hi, good morning. Thanks for all the Q4 guidance and the longer term guidance on loan growth. Just want to—can you tell me about the income from financial instruments? You were clear there that it was immutably high this quarter. What was the—you know, what is that, anyway?

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

Yes, thank you Gabriel. It's in line with a few of our peers. Capital markets have been—or financial markets, I would say, have been constructive over the last few months, last few quarters, so what we see here is that we have good trading activities in our capital markets team, good fixed income and pref, which is essentially the portfolios that we have to support our customers, have been gaining traction as the interest rates have reduced, and the spreads as well, so good performance, strong team that generated great results this quarter.

Gabriel Dechaine — Analyst, National Bank Financial

Okay, and I know this is kind of a silly question, because it's a line item that moves around a lot and the term normal doesn't mean anything these days, but what would be kind of a run rate number for that line item, based on your historical experience?

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

Yes, with what we have right now, I would say last quarter was a good quarter at 15. This quarter, 19 is a record quarter for the results of this line, so going back to the 15 and if it's a worse quarter, it could be a bit lower than that is a more normalized number.

Gabriel Dechaine — Analyst, National Bank Financial

Okay, and then in response to—I'm not sure I quite understood, but in response to some of the questions that Sohrab was asking, did you give a sense of what to expect in Q4 in terms of credit performance, like similar to this quarter? You know, obviously things can happen the very last day of the quarter, but how do you see things shaping up based on what you know today?

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

What we see, as I mentioned, Gabriel, in my guidance, we see still the high teens to low 20s, so essentially a quarter that will look pretty much like Q2, Q3. We're still in the same ballpark with what we see at this point.

Gabriel Dechaine — Analyst, National Bank Financial

Got it.

Last one, just a clarification, you talked about the mortgage servicing business that you sold that closed on August 2, and you said $4 million to $5 million of revenue. Is that a quarter or a year?

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

Yes, first the business we sold is brokers that were doing full brokerage services to our customers - you know, the brokers when you buy bonds or stock market…

Gabriel Dechaine — Analyst, National Bank Financial

Oh, sorry. Yes, yes.

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

That's what we sold to iA. On a yearly basis that business, including discount business that we announced that we're going to sell to CI, that's roughly about $20 million a year, $4 million to $5 million a quarter, and most of that will be on the other income brokerage fee revenues.

Gabriel Dechaine — Analyst, National Bank Financial

Got it, and what's the bottom line contribution from that business?

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

Yes, the bottom line that business, if we sold it, it's because it's not a space where we could win so it wasn't making that much money, the impact short term is probably a $0.01 or so on the next quarter.

Gabriel Dechaine — Analyst, National Bank Financial

Got it. All right, well thanks, and enjoy what's left of the summer.

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

Thank you.

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Merci Gabriel.

Operator

Your next question comes from Nigel D'Souza with Veritas Investment Research. Your line is now open.

Nigel D'Souza — Analyst, Veritas Investment Research

Thank you, good morning. I wanted to touch on your provisions for performing loans this quarter and the reversal there. It looks like a good chunk of that was driven by this reduction in provisions for stage 2 commercial loans, so wondering if you could elaborate on was that primarily migration out of stage 2, or changes to your model assumptions that led to those lower provisions.

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

Hi, Christian here. It's mainly migration from the performing to non-performing PCL bucket, but there's also a volume impact, obviously, on performing that's playing there, and volume represents somewhere around $3 million for the quarter, so four BPs, so still keeping us in our guidance range.

Nigel D’Souza — Analyst, Veritas Investment Research

Then I guess the macroeconomic piece of this, you are seeing—you know, you cited weaker macroeconomic conditions currently, it's impacting your own growth. How is that expected to feed into performing provisions going forward, and I ask that because if you look at your PCL ratio this quarter, the 20 basis points or so, if you exclude the reversals on performing, it would be closer to 30 basis points, so just wondering how does performing provisions trend from here?

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

Overall, the PCL rate, we're sticking to the guidance of high teens to low 20s. You'll see—you know, if the economic cycle, when it turns, you'll see a little bit of performing PCLs come on board and it'll be offset by lowered PCLs on the non-performing. So, very short term, hard to predict how that will play out, but longer term, that's how we're seeing it.

Nigel D’Souza — Analyst, Veritas Investment Research

Okay. I'll leave it there. Thank you.

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Thank you Nigel.

Operator

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 going back to the CET-1 ratio, and I kind of understand how it flexes with volume growth and you're sitting at a healthy level right now, but I'm just curious, why have a discounted DRIP in place, given where you stand today? I'll start there.

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

Yes, thank you for the question - this is Yvan. DRIP, if I knock it directly, I would say it's a program that we try not to stop and start too often, so at this point, we just decided to play prudent. As we mentioned, we have pent-up demand that we expect is going to come back. We need to support the plan that we're launching, so we're playing safe in terms of capital at this point, and that includes the DRIP, of not trying to turn it on and off, depending on a quarterly basis what's happening.

Doug Young — Analyst, Desjardins Capital Markets

How much would that add to the CET-1 ratio per quarter, roughly? I can kind of roughly think, I'm just curious if you've got that handy.

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

Yes, it's relatively small, Doug. It's a few basis points on a quarterly basis.

Doug Young — Analyst, Desjardins Capital Markets

Okay, that's fine.

Then just on the expense outlook, and going back and thinking through some of the prepared remarks and thinking of the revenue outlook over the next year before we start to see a pivot in loan growth, is—are expenses expected to remain around where we are today, or as you kind of peel off some of these businesses, there's obviously some cost reduction there, or is there some other projects that are rolling off that you should get some efficiencies? I would have—I'm just trying to think of how to think of expenses and the expense ratio in what's otherwise going to be, like, a flat loan growth, flat NIM environment.

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Yes, thank you, Doug - it's Eric. For the line of sight we have in the upcoming quarters, expense levels should remain pretty much where they are right now, and this is due to the investment needed in our foundational technology. Those are the ones that will trigger and drive most of the efficiency impact, so further down into the execution of the plan. Of course, the team is still working on opportunities, just like you saw in the divesting of the two capital market groups in terms of brokerage; but for us, it's really to combine the efficiencies created by our projects, as well as opportunistically revisiting our cost structure, so to be expected still high expenses with the investments we're making over the next few quarters.

Doug Young — Analyst, Desjardins Capital Markets

So, expense ratio is roughly around where we're seeing them today, that's kind of what we should be thinking?

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Yes, and probably just—it could be a little bit more in Q4, just to the fact of the pressure we just mentioned on top line from a revenue perspective, so expect to still put pressure on the overall efficiency ratio.

Doug Young — Analyst, Desjardins Capital Markets

Appreciate the colour. Thank you.

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Thank you.

Operator

Your next question comes from Paul Holden with CIBC. Your line is now open.

Paul Holden — Analyst, CIBC World Markets

Thank you, good morning. A question with respect to the retail bank. When I look at deposit trends, or the decline in deposits and then also the decline in the relevant loan categories, I can't help but wonder if you're seeing customer attrition in terms of—if I think about core branch customers, so maybe you can start with addressing that, please.

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

Thank you, Paul. This is Yvan, I'll take that one. The retail and the deposit, so let's start by the deposit, definitely a reduction in deposits this quarter which is aligned, as we mentioned, with the loans. We try to manage those in line, but if you look at the retail deposits, which is really the key factor in terms of where our focus is in retail and where we track the inflows and outflows, we've been pretty much stable this year in terms of retail deposits. We grew those over the last few years, so we've been successful on that side.

Then on the loan side, the margins currently—or the market, I would say, even in mortgages and some other products are impacted by the state of the market, so mortgages is more slow these days, but we're really, really focusing on retail for the deposits, and we had good success in keeping and protecting those over the last many quarters.

Paul Holden — Analyst, CIBC World Markets

Okay. Can you remind me, based on what you presented at the investor day, sort of when you might expect an inflection in, call it retail deposits to increase with your digital initiative? I think that's still probably maybe a 2026 story, but is there any possibility it could become a 2025 story?

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Hi Paul, it's Eric. I think the '26 guidance is the best horizon right now we're seeing in front of us. It does require the right level of investments into our foundation before we're able to actually launch and see real impact there, so more to come on that front. But definitely as Yvan said, making sure that we protect, that we grow our actual base is aligned also with the plan, and this is why we created a Head of Customer Experience in retail. We're bringing back our employees and leaders closer to our retail customer base, and that, I hope, will fill also into the mix in the coming years.

Paul Holden — Analyst, CIBC World Markets

Okay, thanks.

Last question, it kind of follows up on Doug's question regarding the DRIP, right. Like, when I look at the current valuation, still trading at less than 0.5 times book, I look at the ROE, let's call it 6.5 percent, give or take, it doesn’t—I struggle with the issuing shares at that level. In fact, I would argue why shouldn't you be buying back shares? I get it - strategically you want to grow in commercial loans, but the implied ROE, the implied return of buying back stock today seems pretty compelling, so you know, I think I've asked you this question before but I'm going to ask it again, like, why not go down that route?

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

Thank you Paul, this is Yvan. It's going to be difficult for me to give you a different answer to this one, but if I look by example, just to give you an example, inventory financing is at 43 percent right now. Normally it should be at 50 percent for this, so just that volume would represent something like 30, 40 BPs just to sustain, and I'm not talking about the potential seasonal increase during the winter season after they've restocked. Same thing on commercial real estate - we say that we expect that market to resume as rates are going down, so again, we have open lines with the developers that are open and we need to make sure that we're there.

Maybe you can argue that we're playing safe in the environment, but I don't want to be in a place where I have capital issues and I would need to issue. Obviously we're not there at all, but I don't want to play risky on the other side, and we're comfortable with where we are. We believe it's a good place to be to sustain the organic growth that's going to come back with this business, and we're doing that because we also expect a good return from these investments in inventory, financing, commercial real estate, or the rest of it.

I guess I'll avoid repeating the same I mentioned to Doug for the rest of the answer, but definitely we don't want to turn on and off the DRIP, and the DRIP is relatively small in our capital, so it's not like it was a huge impact on a quarterly basis.

Paul Holden — Analyst, CIBC World Markets

Okay. I'm sorry - I'm just going to have to follow up on this for a minute, because I guess the way I look at it as a financial analyst, right—I mean, if you're buying back stock at roughly half book and with a 6.5 percent ROE, that tells me simply 13 percent return on that capital. Are you suggesting then that you can earn something higher than 13 percent by growing commercial loans, because then that would make sense to me, so is that fair to assume you'd be expecting something higher than 13 percent on organic capital deployment into commercial loans?

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Yes Paul, it's Eric. I'm going to take this one.

I have to put emphasis on the fact that the specialized niche we're in are delivering very healthy margins and returns for our businesses, so that's the logic and rationale that Yvan just explained. We believe that being positioned, and then we are well positioned in terms of capital right now. We believe that redeploying that capital towards those specialty businesses will bring the return to reward the shareholders, so that's why we keep that position.

Paul Holden — Analyst, CIBC World Markets

Okay. Okay, that's it for me. Thank you.

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Merci Paul.

Operator

Next question comes from Stephen Boland with Raymond James. Your line is now open.

Stephen Boland — Analyst, Raymond James

A couple of quick questions. Maybe the first, there was something in your non-interest expense line that said your costs were up because of higher regulatory expenses. Can you clarify what that means?

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

In fact, the line is—includes more items than that. What we said is that the other non-interest expenses over the last year—because it's down quarter-over-quarter, but over the last year, it came from higher professional fees which is pretty much half of it, and you can expect that it's related to the strategic projects we have, but our regulatory expenses are compliance projects.

You can look in the environment right now and it's just not us, right - it's the whole industry with B10, 13, 15, 20, and I can keep going. There’s federal budget elements, there's changes in the Quebec language as well. There is a ton of elements that we want to make sure that we're compliant and we're just staying at a good level in terms of our regulatory obligations, so definitely it does put pressure. We have to stay a good citizen, and that's what we're doing with those investments.

Stephen Boland — Analyst, Raymond James

Okay, that's great.

Then just maybe a little bit more granularity on the construction and land portfolio. I know you mentioned developers are waiting meaning for rate cuts. Is that—is your anticipation that that is 25 basis points or 50 basis points, meaning you're talking to the same developers, I presume on a regular basis? Is it—again, is it 50 basis points or 100 basis points before they start moving on some of the new projects? I'm just trying to get an idea of how sensitive that portfolio is to minor moves in the rates.

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Yes Stephen, it's Eric. I'll take this one. It's a great question.

I think that right now what we're feeling and seeing in the market is definitely on the low-rise multi-res. There's definitely a start in momentum, and this is where our pipeline is the most active, some townhouse projects, Alberta being strong right now in terms of restart and launch of projects. But for sure, to see new condo projects being launched is going to take a deeper cut in terms of interest rates. Inventory levels are still pretty high in the various GTAs, so again, depending on the product, in that sense, the different elasticity, so we feel good about the positioning of the team. But again, we'll have to wait and see how did the rate cuts impact the return of the developers to the scale it was in the past.

Stephen Boland — Analyst, Raymond James

Okay, that's helpful, and I'll sneak one more in. Just on the impairment charges, obviously you've sold off other businesses. Is this kind of the end of it now? I know you're looking to restart growth, but is there a possibility that other non-core businesses get sold off and there's further impairment charges or restructuring charges?

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

Yes, thank you for your question. If you look at what we announced this quarter, the $9 million, we gave you a preview at the end of May that we had done headcount reductions in May - most of it relates to that. Out of the $9 million, there's $1 million that relates to the sale that we've done to iA. There's going to be an additional $1 million you're going to see in Q4 related to that sale, so those are an explanation of the numbers.

In terms of going forward, we have an elevated efficiency ratio. We need to invest in the business. As we mentioned, we're looking at all parts of the business in terms of where we can improve. We may have to restructure some others if we see there's good return and good things for us to do. We may incur additional restructurings in terms of things at this point and projects. Cannot give you much more than that.

Stephen Boland — Analyst, Raymond James

Okay, thanks very much, guys.

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Thank you.

Operator

Ladies and gentlemen, as a reminder, should you have a question, please press star, followed by the one.

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

Darko Mihelic — Analyst, RBC Capital Markets

Hi, my bad. I'm sorry. I wanted to revisit credit quality, and I wanted to sort of dovetail this into both questions that were asked earlier - one is on the collateral and the other is on your Stage 2. I'm going to approach this slightly differently.

When I look at your gross impaired loans as a proportion of your loan book, at 108 basis points, that's almost doubled year-over-year, and last year at this time when you were at 55, the bigger banks were at 49, so you were close to, let's say, average. Today, the others are around 66 basis points and you're at (inaudible), so what this tells me is that you're getting more impairments than others. It's fine that it's collateralized well, but that tells me that the probability of you eventually hitting a few files where the collateral is not maybe as well as you thought it was, or it is rising and so the chances of you having a high outsized loss is increasing over time, because you're simply having more impaired loans, and therefore I would have thought you would actually be increasing your Stage 2 despite the migration out of Stage 2.

Am I thinking about this incorrectly, or is it maybe perhaps that you now have a good handle on the watch list and you see that it should be subsiding relatively quickly, and that gives you comfort that okay, no, we're not going to have a higher—you know, a chance of us hitting a loan or a file here or there that surprises us? Hopefully my question makes sense, and maybe you can talk to the elevated impairments, not just the collateral, and how that's not affecting your performing provision.

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

Thank you Darko, this is Christian. A few things I can say on that, and it's great questions.

In our larger commercial files, our average ticket is about $50 million, so just a few files can move the needle either side every quarter. The other thing too that I would point out to you is on our watchlist, it is trending down year-to-date, so it's confirming the quality of our portfolio. We've seen some migration out of watchlist to impaired, but watchlist is not backfilling at this stage, so we feel pretty good about the state of the portfolio.

Again, we've been running at half the PCL level of other banks, and we're not seeing anything to change that going forward.

Darko Mihelic — Analyst, RBC Capital Markets

Okay, and so am I reading into it incorrectly, though? I mean, the one read is you're very careful and you have good collateral, but on the other hand, because you have more impairments, maybe the ability of your borrowers to pay, maybe that side of underwriting is showing some relative weakness, or am I very incorrect in that it's too early in the cycle? Maybe you can just correct the way I should be thinking about that.

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

Well, there are headwinds affecting all of commercial at this point. Like I indicated earlier, the bite size required for us to play in these larger commercial files brings a certain volatility that can affect our impaired loans - that's what we're seeing now. We have to play through the cycle, and we're sticking with our PCL guidance, high teens, low 20s. If there's one thing where I'm not worried, it's the credit book.

Darko Mihelic — Analyst, RBC Capital Markets

Okay. All right, great. Thank you.

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Thank you, Darko.

Operator

Thank you. That's all the time we have for questions. I would now like to turn the meeting over to Eric.

Eric Provost — President, Chief Executive Officer, Laurentian Bank of Canada

Thank you for joining us on this call today. We remain steadfast on our commitment to executing our strategic plan. The opportunities ahead are vast and the challenges we face have only strengthened our determination. We recognize the importance of investing to lay a solid foundation for our organization, and our focus is on building a more digital and efficient organization to ensure long term success for all our stakeholders.

Thank you for joining us today.

Operator

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