



# ROYAL BANK OF CANADA FIRST QUARTER RESULTS CONFERENCE CALL WEDNESDAY, FEBRUARY 25, 2015

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## **DAVE MCKAY, PRESIDENT & CHIEF EXECUTIVE OFFICER**

Good morning everyone and thank you for joining us today.

RBC had a record first quarter with earnings of over 2.4 billion dollars, up 17 percent from last year, or up 12 percent excluding items in the prior year related to our Caribbean operations<sup>1</sup>.

Our results were driven by record earnings in Personal & Commercial Banking and a very strong quarter in Capital Markets. Our performance also reflects record earnings in Investor & Treasury Services, continued strength in Insurance and solid underlying earnings in Wealth Management.

Our capital position remains strong and I am pleased to report that this morning we announced a 2 cent, or 3 percent increase to our dividend, bringing our quarterly dividend to 77 cents a share.

Overall RBC had a great start to the year, and I'd like to highlight three key strengths of our quarter.

First, is our record earnings in Canadian Banking.

We have the number one or number two market position in all retail and business product categories, and we continued to gain market share across all of our core businesses while maintaining strong margins.

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<sup>1</sup> These are non-GAAP measures. For additional information, see Note to Users.

We continued to innovate and enrich our customer value proposition and we've executed strategic marketing programs which helped drive solid volume growth of 5 percent over last year.

This growth includes continued momentum in deposits, reflecting our focus on growing core chequing accounts, a key anchor product for us. As I've explained before, clients typically start their relationship with us through a chequing account, and we can typically sell an additional 2 to 3 products within the following 3 months.

We also had strong fee-based revenue, which was up 13 percent from last year, largely reflecting the power of our branch network to distribute mutual funds to our clients and we've achieved double-digit growth every quarter for more than two years.

A second key highlight is Caribbean banking, which was profitable this quarter following two years of restructuring, during which we repositioned the business and took out significant costs.

While there are ongoing economic headwinds, we believe our Caribbean business can continue to deliver strong performance.

A third highlight is the strength of our global businesses.

Capital Markets generated particularly strong trading results, especially in the U.S., as client activity increased on improved market conditions and increased volatility. We also had higher M&A activity and solid growth in our U.S. and European investment banking and lending activities.

Investor & Treasury Services also had an outstanding quarter, driven by high levels of client activity in the foreign exchange markets and higher custodial fees.

In addition, Global Asset Management performed well with strong growth in client assets, and we continued to extend our reach to institutional investors in the U.S. and select global markets through several new mandate wins this quarter.

While we are pleased with our first quarter results, recent changes in the macro environment have created some headwinds. Let me provide some insight into how we are navigating the environment.

The price of oil declined 40 percent in Q1. While we've seen some stabilization and recovery over the past few weeks, the price of oil remains at levels that challenge the profitability of the sector.

To date, we haven't seen any significant weakness in our oil and gas credit portfolio, or in our retail portfolios in the Prairies.

Within this environment, we're conducting extensive stress testing to help us understand the potential impacts of persistently low oil prices on our business. And, we're actively monitoring our portfolios on an ongoing basis to ensure we maintain significant visibility into early warning signs.

I would highlight the potential for some positive effects from lower oil and gas prices. For example, lower energy prices are expected to lead to increased consumer spending which will help support GDP growth.

Additionally, a weaker Canadian dollar and an improving U.S. economy benefit our manufacturing sector. For example, in Ontario, exports in Q4 were up 17% year-over-year in December, and on a national level we saw wholesale volumes up nearly 9% from a year-ago in December, the strongest annual rate of growth since April 2010.

The impact of a lower oil price has also contributed to the depreciation of the Canadian dollar relative to the U.S. dollar. We expect our dollar will remain under pressure as the U.S. economy is projected to outperform the Canadian economy.

This quarter we benefitted from the translation of our strong U.S. earnings into Canadian dollars. As Janice will touch on, there was a negative impact on our capital ratios from foreign exchange, however, we hedge our balance sheet outside of Canada to offset much of the impact.

As you saw at the end of January, the Bank of Canada unexpectedly cut the overnight rate, partly in response to the macro headwinds I've just discussed, and it's possible we may see another rate cut as early as March.

We've demonstrated very strong margin performance in Canadian Banking, though another rate cut would add incremental margin pressure.

Within a low rate environment we will have to be even more diligent about managing costs and driving efficiencies. From the significant investments we've made in recent years we believe there's more we can do, particularly through the use of technology and digitization.

Notwithstanding these headwinds, I am confident that RBC's diversified and agile business model positions us well to continue to capitalize on opportunities created by the changing market environment.

I believe RBC's geographic diversification is a key strength. As we demonstrated this quarter, our global businesses in Capital Markets, I&TS and Global Asset Management have strong momentum and complement our Canadian franchise. In fact, in Q1 we generated approximately 34 percent of revenue and 26 percent of earnings from our U.S. and International businesses, and City National will only increase our diversification.

We have a strong track record of driving efficiencies, while also investing in our businesses for the long term.

We also have a strong capital position, which gives us the flexibility to deploy capital to grow our business and return capital to shareholders, as we did with today's announcement of a 3% dividend increase.

And our strong capital position enabled the recently-announced City National acquisition, which we believe will create a powerful platform for long-term growth in the U.S.

I will now turn it over to Janice to provide more details on our first quarter results.

**JANICE FUKAKUSA. CHIEF ADMINISTRATIVE OFFICER AND CHIEF FINANCIAL OFFICER**

Thanks Dave and good morning everyone.

As Dave mentioned, we had a record quarter, with earnings of over 2.4 billion dollars, up 364 million dollars or 17 percent from last year, or up 272 million dollars or 12 percent excluding last year's loss on the sale of RBC Jamaica and other charges in the Caribbean<sup>2</sup>. Sequentially earnings were up 123 million dollars or 5 percent.

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<sup>2</sup> These are non-GAAP measures. For additional information, see Note to Users.

We delivered a strong return on equity<sup>3</sup> of 19.3 percent, driven by record earnings in Personal & Commercial Banking and Investor & Treasury Services, strong performance in Capital Markets, and solid underlying results in Wealth Management and Insurance.

As Dave noted, a significant portion of our revenue is generated outside of Canada. Given that the Canadian dollar declined 7 percent on average relative to the U.S. dollar over last year, our earnings benefitted from foreign exchange translation of 41 million dollars and this was predominantly in Capital Markets.

I would also point out that approximately half of our balance sheet is denominated in U.S. dollars so the weaker Canadian dollar had a significant impact. In fact, approximately half of the growth in our balance sheet this quarter was related to FX.

Turning to capital on slide 8. Our Common Equity Tier 1 ratio was 9.6 percent, down 30 basis points from the prior quarter as strong internal capital generation was more than offset by higher risk-weighted assets reflecting FX and business growth, mainly in Capital Markets.

Of the total increase in risk-weighted assets this quarter, over half was due to FX and the balance was volume growth.

Through our hedging program, we offset approximately three-quarters of the impact of FX on our capital ratios.

I would note that this quarter our capital ratio was also impacted by a lower discount rate which increased our pension obligations.

Looking forward, we continue to target a CET1 ratio of 9.5 percent with a buffer of 20 to 30 basis points.

We expect that through internal capital generation, our CET1 ratio will increase in the coming quarters as we work towards closing our previously announced acquisition of City National, which is targeted for the fourth calendar quarter of 2015.

During this time we expect to maintain our ongoing capital management program which includes funding organic growth and returning capital to shareholders through dividends and also share buybacks, at the margin.

Overall we are comfortable with our capital position, and our solid financial performance supports our announced dividend increase.

I would also point out that this quarter we began disclosing our Basel III leverage ratio which was 3.8 percent, above the Basel III minimum of 3 percent.

Let me now turn to the quarterly performance of our business segments, starting on slide 9.

Personal & Commercial Banking reported record earnings of over 1.2 billion dollars, up 184 million dollars or 17 percent from last year on a reported basis. Excluding last year's losses and provisions in Caribbean Banking, net income was up 92 million dollars or 8 percent. On a sequential basis earnings were up 104 million dollars or 9 percent.

Canadian Banking reported record earnings of over 1.2 billion dollars, up 83 million dollars or 7 percent from last year. Our performance reflects strong growth in fee-based revenue of 13

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<sup>3</sup> ROE may not have a standardized meaning under generally accepted accounting principles and may not be comparable to similar measures disclosed by other financial institutions. For additional information, see Notes to Users.

percent mainly from higher mutual fund distribution and credit card fees, as well as solid volume growth of 5 percent.

Sequentially, Canadian Banking earnings were up 10 million dollars or 1 percent. I would remind you that our results last quarter included favourable net cumulative accounting adjustments of 40 million dollars after-tax.

This quarter our net interest margin was 2.68 percent, up 2 basis points sequentially. Excluding certain accounting adjustments last quarter which lowered our margins by 3 basis points, our net interest margin was down 1 basis point sequentially as a result of ongoing competitive pressures.

Turning to expenses. This quarter Canadian Banking's expense growth was in line with revenue growth.

Expenses increased from last year due to higher staff costs, which included higher share-based compensation reflecting the annual accrual for employees eligible to retire. We also continued to invest in infrastructure and marketing strategies to grow our businesses.

Going forward, we continue to target operating leverage for Canadian Banking in the 1 to 2 percent range, and we believe that our operating leverage should continue to improve throughout the year.

Turning to Caribbean and U.S. Banking, our results reflect a strong quarter of positive earnings in the Caribbean where we've done a lot of work to restructure our operations, including costs taking out and improving our pricing model.

Turning to slide 10, Wealth Management had earnings of 230 million dollars, down 5 million dollars or 2 percent from last year, and down 55 million dollars or 19 percent from last quarter.

We had after-tax restructuring costs of 27 million dollar related to the repositioning of our U.S. and International Wealth Management businesses, which we believe we are now half way through. We also had PCL of 13 million dollars on a couple of our international accounts.

Excluding the restructuring charges, earnings in Wealth Management were up 22 million dollars or 9 percent over last year and reflect solid growth in our Global Asset Management and Canadian Wealth Management businesses. Assets under management and assets under administration were up 17 percent and 14 percent, respectively, over last year, due to FX, capital appreciation and net sales.

This growth was partially offset by lower transaction revenue reflecting lower client activity and fewer new issuances due to the volatile market conditions this quarter.

Wealth Management expenses were elevated this quarter, largely reflecting the restructuring costs I just mentioned, as well as foreign exchange translation.

Our expenses also reflect higher staff costs, mainly in Global Asset Management where we're continuing to invest for the long-term as this business is a key growth platform for RBC.

Moving to Insurance on slide 11. Net income of 185 million dollars was up 28 million dollars or 18 percent from last year largely due to higher earnings from two new U.K. annuity contracts, improved claims and policyholder experience, as well as net investment gains.

Sequentially net income was down 71 million dollars or 28 percent as last quarter we benefited from both favourable actuarial adjustments reflecting management actions and assumptions changes, as well as a cumulative adjustment related to outstanding retrocession claims.

I would also note that our Insurance results now include the negative impact of a change in Canadian tax legislation which began impacting our foreign affiliates in November 2014. The tax law change will continue to impact the Insurance segment's tax rate going forward.

Investor & Treasury Services had a record quarter, with earnings of 142 million dollars, up 36 million dollars or 34 percent from last year and up 29 million dollars or 26 percent sequentially.

This quarter we benefited from exceptionally high levels of client activity in the foreign exchange forwards market and higher foreign exchange transaction volumes. This was largely driven by favourable market conditions, including increased market volatility which we don't believe will continue to the same degree going forward.

Turning to Capital Markets, we had a strong quarter. Net income of 594 million dollars was up 89 million dollars or 18 percent over last year.

As I mentioned, earnings in Capital Markets benefitted from foreign exchange translation. FX and market volatility were also large components of business growth, particularly in our secured funding business where activity was very strong this quarter.

Our equity and fixed income results improved, reflecting higher client activity from favourable trading conditions, including increased market volatility. I'd like to highlight that our European fixed income results have improved substantially as we've refocused the business.

We also had higher M&A activity in Canada and the U.S., and solid growth in our U.S. and European investment banking and lending activities.

Compared to last quarter, net income was up 192 million dollars or 48 percent driven by revenue growth across most of our businesses which was offset in part by higher variable compensation.

I would remind you that last quarter's earnings were unfavourably impacted by funding valuation adjustments and our exit of certain proprietary trading strategies which together totalled nearly 100 million dollars.

Overall it was a very strong first quarter for Capital Markets.

Our pipeline looks strong and heading into the second quarter and we feel good about how our businesses are performing.

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

**MARK HUGHES, CHIEF RISK OFFICER**

Thanks Janice and good morning.

Turning to slide 15, our credit quality remains strong, and in fact improved from last quarter.

Provisions for credit losses on impaired loans this quarter were \$270 million or 24 basis points, down \$75 million or 7 basis points from last quarter mainly reflecting lower provisions in Caribbean Banking and Capital Markets.

Caribbean & U.S. Banking PCL was \$18 million, down \$60 million sequentially as last quarter included increased provisions on our impaired residential mortgage portfolio in the Caribbean.

This quarter, as Janice mentioned, Wealth Management had provisions of \$13 million related to a couple of international accounts.

With respect to Capital Markets, this quarter we had provisions of \$5 million largely related to a single account in the Utilities sector.

Let's turn to slide 16 which focuses on our Canadian Banking retail portfolio.

Provisions in Canadian Banking were \$234 million or 26 basis points, down \$2 million or 1 basis point from last quarter.

Our credit card provisions remained near historical lows at 245 basis points, up 14 basis points sequentially due to seasonality.

Provisions in our small business portfolio decreased 15 basis points from last quarter.

Our residential mortgage portfolio, which is well diversified across Canada as highlighted on slide 17, makes up 65 percent of our retail portfolio. It continues to perform well with provisions this quarter of 2 basis points, consistent with our historical performance.

Given the decline in oil prices, I will make a few comments about our exposure to this sector and how we're managing our portfolio.

As you can see on slide 19, we've enhanced our disclosure this quarter to provide more transparency on our wholesale oil and gas exposure, which was previously reported as part of the Energy sector along with utilities.

Our drawn loan book exposure to the oil and gas sector represents around 1.5% of RBC's total loan book. Over 60% of our loan book is to exploration and production companies, while around 20% is to drilling services companies, and the remaining balance is to integrated companies, refiners and distributors.

We have not yet seen any stress in our portfolio. As expected, we are seeing some clients drawing on their lines given the environment.

We have identified names that could be under pressure if oil prices remain at current levels for a further sustained period, and we're closely monitoring those companies for any early warning signs.

We are also monitoring retail portfolios and this allows us to proactively reach out to clients and engage in a discussion if we see early signs of financial stress.

Beyond active monitoring, we have stress tested both our wholesale and retail portfolios given a \$45 oil price for a sustained period of time, a significant increase in Canadian unemployment and interest rates, a national downturn in the real estate market, and a recession in Alberta.

Under this very extreme scenario we have determined that the potential losses would be manageable and within our risk appetite.

Turning to slide 20, gross impaired loans and new impaired formations increased this quarter, largely due to the two International Wealth Management accounts I mentioned earlier, as well as foreign exchange.



Turning to slide 21, in the first quarter average Market Risk Value-at-Risk increased \$7 million to \$33 million due to the implementation of funding valuation adjustments, or FVA, at the end of the prior quarter and the impact of the depreciating Canadian dollar.

Our first quarter Average Market Risk Stressed VaR was \$107 million, up \$29 million from the prior quarter largely due to the implementation of FVA.

While Stressed VaR was elevated in the first quarter compared to recent historic levels, it has since returned to a more normalized level.

We had three days of trading losses in the quarter, with none of the losses exceeding VaR.

Overall I am pleased with our credit performance this quarter and am comfortable with how we're managing our businesses from a risk perspective given the macroeconomic headwinds.

With that I will open up it up to Q&A.

**DAVE MCKAY, PRESIDENT & CHIEF EXECUTIVE OFFICER**

Before we end the call, I'd like to reiterate how pleased we are with our record first quarter results.

While the industry faces some headwinds, as I noted in my earlier remarks there are a number of reasons why I am confident that the RBC franchise is strong and well positioned to manage through this environment and continue delivering long-term value to our shareholders.

Thank you for joining us, and have a nice day.

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**Note to users:**

We use a variety of financial measures to evaluate our performance. In addition to generally accepted accounting principles (GAAP) prescribed measures, we use certain key performance and non-GAAP measures we believe provide useful information to investors regarding our financial condition and result of operations. Readers are cautioned that key performance measures such as ROE and non-GAAP measures, such as earnings and revenue excluding Corporate Support, earnings excluding specified items related to the sale of RBC Jamaica as previously announced on January 24, 2014, results excluding provisions related to post-employment benefits and restructuring charges in the Caribbean, adjusted net interest margin and Capital Markets trading and geographic revenue excluding specified items do not have any standardized meanings prescribed by GAAP, and therefore are unlikely to be comparable to similar measures disclosed by other financial institutions.

Additional information about our ROE and non-GAAP measures can be found under the "Key performance and non-GAAP measures" section of our Q1/2015 Report to Shareholders and our 2014 Annual report.

Definitions can be found under the "Glossary" sections in our Q1/2015 Supplementary Financial Information and our 2014 Annual Report.