



# ROYAL BANK OF CANADA THIRD QUARTER RESULTS CONFERENCE CALL WEDNESDAY, AUGUST 22, 2018

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From time to time, we make written or oral forward-looking statements within the meaning of certain securities laws, including the "safe harbour" provisions of the United States Private Securities Litigation Reform Act of 1995 and any applicable Canadian securities legislation. We may make forward-looking statements in these speakers' notes from the August 22, 2018 analyst conference call (the speakers' notes), in filings with Canadian regulators or the SEC, in reports to shareholders and in other communications. Forward-looking statements in these speakers' notes include, but are not limited to, statements relating to our financial performance objectives, vision and strategic goals. The forward-looking information contained in this document is presented for the purpose of assisting the holders of our securities and financial analysts in understanding our financial position and results of operations as at and for the periods ended on the dates presented, as well as our financial performance objectives, vision and strategic goals, and may not be appropriate for other purposes. Forward-looking statements are typically identified by words such as "believe", "expect", "foresee", "forecast", "anticipate", "intend", "estimate", "goal", "plan" and "project" and similar expressions of future or conditional verbs such as "will", "may", "should", "could" or "would".

By their very nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties, which give rise to the possibility that our predictions, forecasts, projections, expectations or conclusions will not prove to be accurate, that our assumptions may not be correct and that our financial performance objectives, vision and strategic goals will not be achieved. We caution readers not to place undue reliance on these statements as a number of risk factors could cause our actual results to differ materially from the expectations expressed in such forward-looking statements. These factors – many

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We caution that the foregoing list of risk factors is not exhaustive and other factors could also adversely affect our results. When relying on our forward-looking statements to make decisions with respect to us, investors and others should carefully consider the foregoing factors and other uncertainties and potential events. Material economic assumptions underlying the forward-looking statements contained in these speakers' notes are set out in the Overview and outlook section and for each business segment under the Strategic priorities and Outlook headings in our 2017 Annual Report, as updated by the Overview and outlook section of our Q3/2018 Report to Shareholders. Except as required by law, we do not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by us or on our behalf.

Additional information about these and other factors can be found in the risk sections of our 2017 Annual Report and in the Risk management section of our Q3/2018 Report to Shareholders.

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

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Good morning everyone, and thanks for joining us.

We reported record earnings and record revenues in the third quarter, against a strong economic backdrop. We have been investing to grow organically in our key markets. And our investments are paying off. All of our large businesses saw strong earnings growth in the third quarter, and we had market share gains in our core franchises. Our focus on risk and cost control is leading to strong credit quality, as well as efficiency improvements in our retail banking and wealth management businesses. We are also managing capital efficiently, to drive a premium ROE and long-term shareholder value. Our capital ratios grew in the quarter, even as we invested to grow client relationships, and our CET1 ratio is now over 11 percent. I am pleased to announce a 4 cent increase to our dividend this morning, bringing our quarterly dividend to 98 cents per share.

Before expanding on our results, I would like to touch on the macro environment. Globally, we are seeing rising protectionism and trade uncertainty, which is translating into some volatility in financial markets, as well

as instability in countries like Turkey and Venezuela, where we do not have any material direct exposure. Although geopolitical and trade risks have risen, our core markets remain stable. GDP growth remains healthy, and employment trends remain strong in North America, which bodes well for our near-term outlook.

Against this solid economic backdrop, our Canadian Banking business generated record revenue this quarter, surpassing 4 billion dollars. We are leveraging our unique assets, such as scale in distribution and payments, to drive client activity and market share growth. For example, we service our clients holistically across our broad product suite, including deposits and investments, which are growing over 7 percent. We are seeing strong industry demand for commercial credit, and the investments we have made in commercial banking continue to support double-digit business loan growth. There has been a lot of discussion on the recent disruption in the rewards and loyalty space, including the reduction of average interchange fees by 10 basis points starting in May 2020. We believe that having control over our proprietary loyalty program - along with leading scale and partnerships - makes RBC Rewards a unique and privileged asset. Given the depth and breadth of our leading program, we have the flexibility to offset much of the potential impact from the reduction in interchange fees. We offer a comprehensive and superior value proposition to our 5 million RBC Rewards customers, with significant scale and partnerships. This includes being able to use points to pay for virtually anything at the point of purchase - the first loyalty program in the country to provide this level of value and flexibility. With card purchase volumes up 11 percent, we are growing organically and at a premium to the market.

In Wealth Management, we achieved another record quarter for AUM and revenue. We increased our advisor base again in the quarter, which is one of industry's largest and most productive advisor bases. Advisor trust, a strong distribution network and strong product performance are key to driving net sales; and RBC Global Asset Management continued to capture outsized market share. We generated positive mutual fund inflows in a very tough quarter for the industry, which saw net redemptions in many Canadian asset classes. In recognition of its advisor services and innovation, RBC Global Asset Management was awarded 'Fund Provider of the Year' by Wealth Professional Canada.

In U.S. Wealth Management, our strong momentum continued. This business now represents almost 60 percent of total U.S. revenue, and we expect a higher contribution from this business to overall earnings in the future. We added commercial and private bankers to our growing teams in Nashville and Atlanta. We further diversified our commercial banking portfolio by adding to our professional services and aerospace teams. And we expect strong loan growth to continue at City National. During the quarter, City National also announced the acquisition of Exactals, based in Los Angeles. The company is a unique payments provider for the entertainment industry, leveraging Artificial Intelligence tools to provide innovative payments solutions to clients of all sizes. Our two companies have had a strong partnership over the years, and we look forward to helping the firm continue its growth.

Our Capital Markets business generated very strong results this quarter. We have supported our clients' financing needs across the globe, and generated record revenue in Corporate and Investment Banking. We have been hiring top-calibre bankers to expand our presence in the U.S. and in Europe, while leveraging past investments in these growing regions. This has led to more relationships with larger, global investment-grade clients. For example, this quarter we acted as a joint bookrunner on Vodafone's 11.5 billion dollar bond offering, one of the largest U.S. high-grade offerings this year. We were also appointed as joint lead arranger on Walt Disney's 36 billion dollar debt financing to support its acquisition of select assets of Twenty First Century Fox. Our trading businesses also performed well, and we generated higher revenue in equities trading. This was underpinned by strong client engagement in a constructive environment, award-winning equity research content and an innovative trading platform.

In conclusion, we continued to execute on our strategy to invest prudently for sustainable growth and strong returns for shareholders. I am very proud of our continued innovation across the organization. At our Investor Day in June, we introduced our RBC Ventures platform, which is focused on reimagining the role we play in our clients' lives. To date, we launched 9 Ventures, and have already registered over two hundred thousand users, even with limited marketing in early stages. Another successful initiative is our "RBC Amplify" student program, which provides students with real world business challenges to solve – and allows us to build a talent pipeline around the world. This summer, the program generated 15 patent applications, which is up 50 percent from last year. Overall, I am pleased with how our progress is paying off with record results this quarter. We have met our financial objectives year-to-date, and we are well positioned to meet those objectives for the full year. Before I conclude, I would like to comment on the wildfires impacting a number of regions, including British Columbia and California. It's a devastating situation for many communities across North America, and we are committed to supporting our clients and employees who are being impacted. The efforts of first responders, and the acts of kindness from local teams and neighbors, speak volumes about the difference we can make when we pull together to support our communities.

With that, I will now pass it over to Rod.

**ROD BOLGER, CHIEF FINANCIAL OFFICER**

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Thanks Dave and good morning everyone.

Starting on slide 6, we had strong third quarter earnings of 3.1 billion dollars up 11 percent from last year. Diluted EPS of 2.10 dollars was up 14 percent. We had higher than normal severance costs last year, which provided a lift to earnings growth this quarter. This was mostly offset by a 90 million dollars increase in PCL on Performing Loans, which I will touch on shortly.

Revenue from retail banking was bolstered by strong client volumes and rising rates, and our wealth management franchise continued to benefit from strong net sales and market appreciation. Our expenses were up 6 percent from a year ago, or 8 percent<sup>1</sup> excluding the severance we took last year. While we have been investing strategically in technology and ventures, we have delivered strong operating leverage this quarter in both Canadian banking and wealth management. Our investment discipline is leading to revenue growth opportunities in our core franchises, and we expect to drive efficiencies as we set out at our Investor Day in June. The increase in PCL on Performing Loans largely reflects accounting rules, as well as solid volume growth. Cautionary elements were reflected in our Stage 1 and 2 provisions as external risks to the macroeconomic outlook have risen. The complex nature of IFRS 9 accounting creates quarterly volatility despite strong underlying fundamentals. I would point to our year-to-date PCL on Performing Loans, which was just 79 million dollars or 2 basis points. Our credit quality remains strong as evidenced by lower impaired loans, continued low PCL on Impaired Loans and overall favorable credit trends. Our Effective Tax Rate was slightly above 20 percent in Q3. Given our business mix outlook, we expect our total effective tax rate to be near the low end of a 21 to 23 percent range over the course of a year.

Turning to slide 7, we have added U.S. disclosure to reflect the importance of this geography as a key driver to our growth strategy. Earnings in the U.S. were up 30 percent from last year on a U.S. dollar basis as we continued to invest in top talent and win business.

Turning to slide 8, our CET 1 ratio grew to 11.1 percent, up 20 bps from last quarter. Our strong internal capital generation in the quarter was partly offset by higher RWA reflecting improved growth in client relationships while maintaining our strong risk profile.

Moving to our business segments on slide 9. Personal and Commercial Banking reported earnings of 1.5 billion dollars. And Canadian Banking net income of nearly 1.5 billion dollars was up 11 percent year-over-year. This was driven by an 8 percent increase in revenue from higher spreads reflecting rising rates as well as solid volume growth across most products, including strong card purchases growth as well as higher

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<sup>1</sup> Our Q3 2017 results included higher than normal severance costs, which were \$120 million pre-tax in the quarter. Results excluding severance are a non-GAAP measures. For more information see the Note to users.

investment AUA. As Dave mentioned, we have seen a healthy normalization in Canadian housing and our mortgage portfolio continues to grow. We saw mortgage growth of nearly 6 percent year-over-year and increased renewals of nearly 92 percent. Net interest margins of 2.74 percent increased 13 basis points year-over-year and were flat quarter-over-quarter. We had expected some NIM improvement in the back half of this year. Although this is still possible, mortgage pricing competition has increased, and if this persists, then the benefit from a Q4 rate hike could be realized in Q1 instead. For now, we expect NIM expansion of up to 3 basis points over the next two quarters. Recall that we typically see prime- bankers' acceptance spread compression in the weeks ahead of an expected Bank of Canada rate increase, putting temporary downward pressure on margins. This happened in Q3 and may happen again in Q4.

Turning to expenses, we continued to make thoughtful investments in talent and technology to support digital initiatives and long term growth in our Canadian Banking business. Our non-interest expense growth of 3 percent year-over-year was partially offset by higher severance in the prior year.

We recorded positive operating leverage of 5.0 percent or 3.7 percent<sup>2</sup> if you exclude severance. On a year-to-date basis our reported operating leverage was 1.3 percent, or 2.7 percent<sup>3</sup> excluding severance, the Moneris gain last year and Interac gain this year. We continue to expect our operating leverage to be at the high end of the 2 – 3 percent range in the near term.

Turning to slide 10, Wealth Management reported earnings of 578 million up 19 percent year-over-year driven by growth in both our U.S. and non-U.S. businesses. Cash earnings were 626 million dollars. This quarter also included a gain related to the sale of a mutual fund product and the transfer of its associated team which was mostly offset by a loss on an investment in an international asset management joint venture.<sup>4</sup> Excluding the joint venture loss, Global Asset Management revenues were up 5 percent<sup>5</sup> due to higher AUM driven by capital appreciation and net sales.

Canadian Wealth Management revenue was up 10 percent as a result of higher fee-based revenue. This was driven by higher fee-based assets due to capital appreciation and solid net sales from referrals, as well as continued momentum from strategic hiring. We continue to drive down the efficiency ratio of our non-US wealth management business to 68.5 percent for the quarter, down from over 70 percent a year ago. We

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<sup>2</sup> Our Q3 2017 results included higher than normal severance costs, which were \$120 million pre-tax in the quarter. Results excluding severance are a non-GAAP measures. For more information see the Note to users.

<sup>3</sup> Our Q1 2017 results included our share of a gain of \$212MM (before-and after-tax) related to the sale of the U.S. operations of Moneris Solutions Corporation (Moneris gain on sale). Our Q3 2017 results included higher than normal severance costs, which were \$120 million pre-tax in the quarter. Results excluding severance are a non-GAAP measures. Our Q1 2018 results included a gain of \$27MM after tax (\$31MM pre-tax) related to the reorganization of Interac. Results excluding these gains are non-GAAP measures. For more information see the Note to users.

<sup>4</sup> \$26MM after-tax (\$40MM before-tax) gain related to the sale of a mutual fund product and transfer of its associated team, and a \$24MM after-tax (\$27MM before-tax) loss on an investment in an international asset management joint venture in Q3 2018.

<sup>5</sup> Results excluding the \$24MM after-tax (\$27MM before-tax) loss on an investment in an international asset management joint venture in Q3 2018 are non GAAP measures. For more information see the Note to users.

focus on positive operating leverage in every segment, and operating leverage for total Wealth Management was 2 percent in the quarter, and 3.8 percent year-to-date.

In U.S. Wealth Management, including City National, revenue was up 14 percent year-over-year in U.S. dollars due to strong 15 percent loan growth and double digit loan originations at City National. We also saw benefits from higher U.S. interest rates and the U.S. tax reform, as well as higher fee-based revenue. Excluding the gain mentioned earlier, revenue was up 11 percent<sup>6</sup>. Net income from this business was about 200 million dollars, and you can see this disclosure on slide 23.

Moving to Insurance on slide 11. Net income of 158 million dollars was down 2 percent from last year reflecting increased expenses supporting sales growth and client service activities and partially offset by improved international claims experience.

On slide 12, Investor & Treasury Services earnings of 155 million dollars were down 13 percent year-over-year. This was largely driven by lower funding and liquidity earnings as the prior year benefited from interest rate movements. Our investments in technology also grew in order to drive growth and efficiency. Revenues in our asset services business continued to benefit from improved margins, strong sales and growth in client deposits.

In Capital Markets on slide 13, earnings of 698 million dollars were up 14 percent year-over-year, marking our second highest quarter. In addition to higher revenues in our equity trading business, we saw higher loan syndication in the U.S. on higher volumes and higher equity origination activity in North America despite a declining global fee pool. There was also moderate growth in our North American corporate loan book after a period of portfolio optimization. Looking ahead, we have strong RWA growth, with a robust deal pipeline as we hire new bankers, win business and gain share with no change in risk appetite.

In Conclusion, we are pleased with our results this quarter as we continued to invest in future growth for our clients.

With that, I will now turn the call over to Graeme.

## **GRAEME HEPWORTH, CHIEF RISK OFFICER**

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Thank you Rod and good morning. During the third quarter, we continued to see a strong macro-economic backdrop in Canada and the United States, as both economies exhibited low unemployment, steady inflation and solid GDP growth. This macro-economic backdrop continued to deliver a positive and stable credit

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<sup>6</sup> Results excluding the \$26MM after-tax (\$40MM before-tax) gain related to the sale of a mutual fund product and transfer of its associated team in Q3 2018 are non-GAAP measures. For more information see the Note to users.

environment, and our baseline expectation is that it will continue in the near term. However, as Dave mentioned earlier, there is some uncertainty related to trade and other geopolitical events. As such, we have taken this uncertainty into account in our credit provisions on performing loans this quarter. We are actively monitoring our exposure to trade-related developments and remain confident that we can manage within our risk appetite.

Overall, our credit quality remained strong as evidenced by PCL on Impaired Loans as shown on slide 15. Slide 16 shows our PCL on Impaired and Performing Loans by business line. In Canadian Banking, PCL on Impaired Loans remained relatively flat quarter-over-quarter with lower PCL in Commercial, offset by Personal Lending and HELOC. Caribbean Banking also had lower PCL on Impaired Loans. In Wealth Management, PCL on Impaired Loans decreased 10 million dollars from last quarter, primarily reflecting recoveries associated with loans returning to performing status at City National. In Capital Markets, the quarter over quarter decline was driven by recoveries on a few accounts as well as low levels of new impaired loans. As mentioned earlier, the increase in PCL on Performing Loans reflects both volume growth as well as the greater uncertainty in the macro-economic outlook. Year-to-date PCL on Performing Loans was 79 million dollars or 2 basis points, which is largely in line with the growth of our portfolio.

Turning to slide 17. Gross Impaired Loans have declined to a relatively low level of 2.3 billion<sup>7</sup> dollars. This was largely driven by our wholesale portfolio with repayments, loans returning to performing status, and low levels of new formations all contributing to the decline in the quarter. Our gross impaired loan ratio of 40 basis points was down 7 basis points from last quarter.

On slides 18 and 19, we have more detail on our Canadian Banking portfolio. Consumer debt levels have made households more vulnerable in the event of an economic downturn. However, rising rates and the cooling housing market have tempered growing consumer debt leading to a slight improvement in consumer debt to income levels. We continue to focus on consistent and prudent underwriting standards and portfolio monitoring practices, ensuring resilience through all phases of a credit cycle.

Overall, we are pleased with the credit performance of our lending portfolio. We expect PCL on impaired loans to largely be in line with our ratios year-to-date, although we may not see the same level of recoveries in our wholesale book that we saw this quarter. The baseline for PCL on performing loans should be aligned with portfolio growth, though we may experience some volatility on a quarterly basis. Together, we expect our PCL ratio in the near term to be at the low end of our typical 25-30 basis point range.

With that operator, let's open the lines for Q&A.

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<sup>7</sup> Effective November 1, 2017, GIL excludes \$229MM of acquired impaired loans (ACI) related to our acquisition of City National Bank that have returned to performing status. As at July 31, 2018, \$20 million of ACI loans that remain impaired are included in GIL.



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

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Well, thank you for your questions and your participation in today's call. I think to characterize our quarter, we are very happy with the results. As you saw, strong core growth across our core businesses in Capital Markets and retail commercial and in Wealth Management both in Canada and in the United States. And so we are very happy with our customer franchise growth, market share gains and good cost control, strong capital levels and ROEs. So overall, we are feeling good about the momentum and looking very positively towards Q4. So thank you, and we'll see you next quarter.

**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, including results excluding gains related to the reorganization of Interac this year and the sale of Moneris last year, a gain related to the sale of a mutual fund product and the transfer of its associated team and a loss on an investment in an international asset management joint venture in Q3 2018 and results excluding severance 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" sections of our Q3/2018 Report to Shareholders and our 2017 Annual Report.

Definitions can be found under the "Glossary" sections in our Q3/2018 Supplementary Financial Information and our 2017 Annual Report.