2004 Financial Performance Review

This section provides a review of our enterprise financial performance for 2004 that focuses on the Consolidated Statement of Income included in our consolidated financial statements, which begin on page 83. A summary of our enterprise financial performance for 2003 is outlined on page 34. A review of our operating groups strategies, achievements and performance follows the enterprise review.

Highlights

- Revenue increased $341 million or 3.7% in 2004 and was higher in each of our client operating groups.
- Revenue growth was attributable to improved volumes in both Personal and Commercial Client Group and Private Client Group, and to net gains on investment securities and higher underwriting and commission revenue in Investment Banking Group.
- The provision for credit losses improved by $558 million. Specific provisions for credit losses fell by $388 million and there was a $170 million decrease in the general allowance. The improvement was attributable to favourable credit conditions and effective loan realization practices.
- Non-interest expense increased at a relatively modest 1.1% in 2004, consistent with the 0.9% increase in 2003 and reflective of our focus on productivity.
- The expense-to-revenue ratio (or productivity ratio) improved by 160 basis points to 64.1%. The cash productivity ratio improved by 155 basis points to 63.0%.

Non-GAAP Measures

BMO uses both GAAP and certain non-GAAP measures to assess performance. Securities regulators require that companies caution readers that earnings and other measures adjusted to a basis other than generally accepted accounting principles (GAAP) do not have standardized meanings under GAAP and are unlikely to be comparable to similar measures used by other companies.

Cash earnings and productivity measures may enhance comparisons between periods when there has been an acquisition, particularly because the purchase decision may not consider the amortization of intangible assets to be a relevant expense. Cash EPS measures are also disclosed because analysts often focus on this measure, and cash EPS is used by Thomson First Call to track third-party earnings estimates that are frequently reported in the media. Cash measures add the after-tax amortization of intangible assets to GAAP earnings to derive cash net income (and associated EPS) and deduct the amortization of intangible assets from non-interest expense to derive cash productivity measures.

BMO, like many banks, analyzes revenue, and ratios computed using revenue, on a taxable equivalent basis (teb). This basis includes an adjustment that increases GAAP revenues and the GAAP provision for income taxes by an amount that would raise revenues on certain tax-exempt securities to a level that would incur tax at the statutory rate. The effective income tax rate is also analyzed on a taxable equivalent basis for consistency of approach.

Net economic profit is another non-GAAP measure. It represents cash earnings available to common shareholders less a charge for capital, and is considered an effective measure of added economic value.

GAAP and Related Non-GAAP Measures Used in the MD&A

($ millions, except as noted)

	2004	2003	2002
Net interest income per financial statements (a)	**4,922**	4,899	4,829
Non-interest revenue	**4,551**	4,220	3,924
Revenue per financial statements (b)	**9,473**	9,119	8,753
Taxable equivalent basis (teb) adjustment (c) (see page 28)	**139**	152	106
Net interest income (teb) (a+c) (d) (1)	**5,061**	5,051	4,935
Non-interest revenue	**4,551**	4,220	3,924
Revenue (teb) (e) (1)	**9,612**	9,271	8,859
Provision for income taxes per financial statements	**1,008**	688	424
Taxable equivalent basis adjustment	**139**	152	106
Provision for income taxes (teb) (1)	**1,147**	840	530
Non-interest expense (f)	**6,157**	6,087	6,030
Amortization of intangible assets	**(104)**	(105)	(87)
Cash-based expense (g) (1)	**6,053**	5,982	5,943
Net income	**2,351**	1,825	1,417
Amortization of intangible assets (net of tax)	**78**	79	75
Cash net income (1)	**2,429**	1,904	1,492
Preferred share dividends	**(76)**	(82)	(79)
Charge for capital (1)	**(1,230)**	(1,119)	(1,045)
Net economic profit (1)	**1,123**	703	368
Non-interest expense-to-revenue ratio (2) (%) ((f/b) x 100)	**65.0**	66.7	68.9
Non-interest expense-to-revenue (teb) ratio (1) (2) (%) ((f/e) x 100)	**64.1**	65.7	68.1
Cash non-interest expense-to-revenue (teb) ratio (1) (2) (%) ((g/e) x 100)	**63.0**	64.5	67.1
Net interest margin annualized (%) ((a / average assets) x 100)	**1.82**	1.86	1.95
Net interest margin (teb) annualized (1) (%) ((d / average assets) x 100)	**1.88**	1.91	1.99
EPS (uses net income) ($)	**4.42**	3.44	2.68
Cash EPS (1) (uses cash net income) ($)	**4.57**	3.59	2.83

(1) These are non-GAAP amounts or non-GAAP measures.
(2) Also referred to as productivity ratio and cash productivity ratio.

Foreign Exchange

The Canadian dollar equivalents of BMO's U.S.-dollar-denominated net income, revenues, expenses, income taxes and provision for credit losses in 2004 and 2003 were lowered relative to the preceding year by the weakening of the U.S. dollar. The adjacent table indicates average Canadian/U.S. dollar exchange rates in 2004, 2003 and 2002 and the impact of lower rates.

At the start of each quarter, BMO enters into hedging transactions that are expected to partially offset the pre-tax effects of exchange rate fluctuations in the quarter on our U.S.-dollar-denominated net income for that quarter. As such, these activities partially mitigate the impact of rate fluctuations within a single quarter, but the sum of the hedging gains/losses for the four quarters in a year is not directly comparable to the impact of year-over-year exchange rate fluctuations on earnings for the year.

Each one-cent decrease (increase) in the Canadian/U.S. dollar exchange rate, expressed in terms of how many Canadian dollars one U.S. dollar buys, decreases (increases) BMO's quarterly earnings by approximately $1 million before income taxes, in the absence of hedging activity.

The gain or loss from hedging transactions in future periods will be determined by both future currency fluctuations and the amount of the underlying future hedging transactions, since the transactions are entered into each quarter in relation to expected U.S.-dollar-denominated net income for the next three months. The effect of currency fluctuations on our net investment in foreign operations is discussed in the Provision for Income Taxes section on page 33.

Effects of the Lower Canadian/U.S. Dollar Exchange Rate on BMO's Results

($ millions, except as noted)

	2004	2003
Canadian/U.S. dollar exchange rate (average)		
2004	**1.313**	
2003	**1.435**	1.435
2002		1.571
Reduced revenues	**(243)**	(264)
Reduced expenses	**177**	181
Reduced provision for credit losses	**11**	27
Reduced income taxes	**15**	11
Reduced net income before hedging gains	**(40)**	(45)
Hedging gains	**8**	18
Income taxes thereon	**(3)**	(6)
Reduced net income	**(35)**	(33)

MD&A

Acquired Businesses

BMO Financial Group has selectively acquired a number of businesses in advancing our Canada-U.S. growth strategy. These acquisitions have incremental effects on revenue and expenses that affect the year-over-year comparison of operating results. The adjacent table outlines acquisitions by operating group that had an incremental effect on BMO's revenue, expenses and net income for 2004 relative to 2003, and for 2003 relative to 2002, to assist in analyzing changes in results.

For acquisitions completed in fiscal 2004, the incremental effects are the revenues and expenses of those businesses that are included in results in fiscal 2004. For acquisitions that were completed in fiscal 2003, the incremental effects on results in 2004 are the revenues and expenses of those businesses from the beginning of fiscal 2004 until the one-year anniversary of their respective dates of acquisition.

For 2003 acquisitions, the incremental effects on results for 2003 relative to 2002 are the revenues and expenses of those businesses that are included in results in fiscal 2003, and for acquisitions that were completed in fiscal 2002, the incremental effects on results in 2003 are the revenues and expenses of those businesses from the beginning of fiscal 2003 until the one-year anniversary of their respective dates of acquisition.

Impact of Acquired Businesses on Year-over-Year Comparisons

($ millions)

Business acquired		Increase (decrease) in: Revenue	Expense	Net income	Cash net income
Personal and Commercial Client Group					
New Lenox State Bank					
Acquired June 2004 for $314 million					
Lakeland Community Bank					
Acquired March 2004 for $49 million					
Total purchases of $363 million					
Incremental effects on results for:	**2004**	**20**	**15**	**3**	**4**
Private Client Group					
Sullivan, Bruyette, Speros & Blayney Inc.					
Acquired January 2003 for $20 million					
Select assets of myCFO, Inc.					
Acquired November 2002 for $61 million					
Morgan Stanley Individual Investor Group online accounts					
Acquired May 2002 for $153 million					
Northwestern Trust and Investment Advisory Company					
Acquired April 2002 for $19 million					
CSFB*direct*					
Acquired February 2002 for $854 million					
Total purchases of $1,107 million					
Incremental effects on results for:	**2004**	**2**	**4**	**(2)**	**(2)**
	2003	105	154	(31)	(13)
Investment Banking Group					
Gerard Klauer Mattison*					
Acquired July 2003 for $40 million					
Incremental effects on results for:	**2004**	**69**	**87**	**(11)**	**(10)**
	2003	17	26	(5)	(5)
BMO Financial Group					
Purchases of $1,510 million					
Incremental effects on results for:	**2004**	**91**	**106**	**(10)**	**(8)**
	2003	122	180	(36)	(18)

*Renamed Harris Nesbitt Gerard

Revenue

Revenue on a taxable equivalent basis (see page 26) rose $341 million or 3.7% in 2004 to $9,612 million, driven by growth in all operating groups. The weaker U.S. dollar lowered revenue growth in each of the operating groups and lowered BMO's overall revenue growth by $243 million or 2.6 percentage points, while the incremental effects of acquired businesses added $91 million or 1.0 percentage points to revenue growth. The $341 million increase was almost entirely due to increased non-interest revenue, as higher net interest income in personal and commercial banking was largely offset by declines in Investment Banking Group and Private Client Group.

BMO, like many banks, analyzes revenue on a taxable equivalent basis (teb). The teb adjustments for fiscal 2004 totalled $139 million, down from $152 million a year ago.

Personal and Commercial Client Group revenue rose on higher volumes and the inclusion of revenues from acquired businesses. These increases were partially offset by the impacts of lower net interest margins and lower card fees, including an adjustment related to rising reward redemption rates in our customer loyalty program. Private Client Group revenue also increased, as successful revenue-generating initiatives and improved market fundamentals drove higher commission and fee-based revenues. Investment Banking Group revenue rose due to higher securities trading commissions and underwriting fees as well as net investment securities gains, compared with net losses a year ago, and the inclusion of revenues from Harris Nesbitt Gerard.

Taxable equivalent basis
Revenues reflected in our MD&A are presented on a taxable equivalent basis (teb). The teb adjustment increases GAAP revenues and the provision for income taxes by an amount that would increase revenues on certain tax-exempt securities to a level that would incur tax at the statutory rate, to facilitate comparisons. The effect is disclosed on page 26 and in Table 7 on page 72.

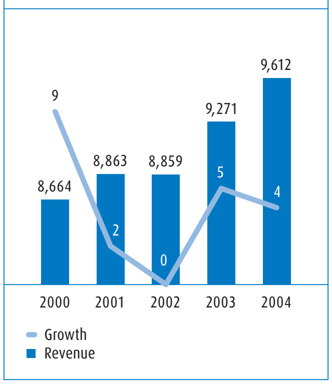
Net interest income is comprised of earnings on assets such as loans and securities, including interest and dividend income and BMO's share of income from investments accounted for using the equity method of accounting, less interest expense paid on liabilities such as deposits. See page 26.

Net interest margin is the ratio of net interest income to average assets, expressed as a percentage or in basis points. See page 26.

Revenue ($ millions)

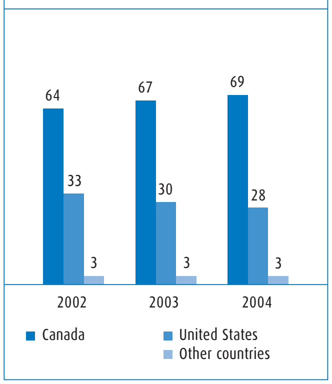
For the year ended October 31	2004	2003	2002	2001	2000
Net interest income (teb)	**5,061**	5,051	4,935	4,641	4,338
Year-over-year growth (%)	**0.2**	2.3	6.3	7.0	(1.8)
Non-interest revenue	**4,551**	4,220	3,924	4,222	4,326
Year-over-year growth (%)	**7.8**	7.6	(7.1)	(2.4)	23.2
Total revenue	**9,612**	9,271	8,859	8,863	8,664
Year-over-year growth (%)	**3.7**	4.7	–	2.3	9.3

Revenue ($ millions) **and Annual Growth** (%)



Revenue growth was solid for the second straight year as all groups increased their revenues.

Revenue by Country (%)



The weak U.S. dollar has limited the proportion of U.S. revenue in the past two years.

Net Interest Income

Net interest income for the year was $5,061 million, an increase of $10 million from 2003. The benefits of volume growth in Personal and Commercial Client Group were partially offset by reduced net interest margin in the competitive low interest rate environment. Average assets of $270 billion were $6 billion or 2% higher than a year ago, as the group's average assets increased $9 billion, while Investment Banking Group's average assets fell $3 billion. The increase in assets occurred notwithstanding the lower Canadian/U.S. dollar exchange rate. Asset growth in Personal and Commercial Client Group was derived from robust residential mortgage markets and strong consumer and commercial loan growth in Canada and the United States. The decline in Investment Banking Group assets was primarily in interest-rate-sensitive businesses, in anticipation of rising interest rates, and in loan balances due to both weak corporate demand and the group's strategy of exiting certain non-core relationships.

Change in Net Interest Income, Average Assets and Net Interest Margin

	Net interest income (teb) ($ millions)		Change		Average assets ($ millions)		Change		Net interest margin (in basis points)		
For the year ended October 31	2004	2003	$	%	2004	2003	$	%	2004	2003	Change
P&C Canada	**2,760**	2,685	**75**	**3**	**101,181**	93,844	**7,337**	**8**	**273**	286	**(13)**
P&C United States	**684**	633	**51**	**8**	**17,908**	16,065	**1,843**	**11**	**382**	394	**(12)**
Personal and Commercial Client Group (P&C)	**3,444**	3,318	**126**	**4**	**119,089**	109,909	**9,180**	**8**	**289**	302	**(13)**
Private Client Group (PCG)	**499**	541	**(42)**	**(8)**	**5,326**	5,292	**34**	**1**	**937**	1,022	**(85)**
Investment Banking Group (IBG)	**1,305**	1,393	**(88)**	**(6)**	**141,691**	144,418	**(2,727)**	**(2)**	**92**	96	**(4)**
Corporate Support, including Technology and Solutions	**(187)**	(201)	**14**	**7**	**3,686**	4,347	**(661)**	**(15)**	**nm**	nm	**nm**
Total	**5,061**	5,051	**10**	**–**	**269,792**	263,966	**5,826**	**2**	**188**	191	**(3)**

nm – not meaningful

BMO's overall net interest margin declined 3 basis points to 1.88%. Net interest margin was lower in all operating groups, as all were affected by the competitive low interest rate environment. The overall decline was limited by changes in asset mix related to the strong asset growth in Personal and Commercial Client Group, which has high net interest margins relative to Investment Banking Group. Personal and Commercial Client Group net interest margin was also affected in Canada by a shift in customer preferences toward our lower margin products and in the United States by the addition of lower-yielding assets.

Private Client Group net interest income declined due primarily to the lower net interest margin earned in term investment products. The low interest rate environment has caused spread compression and softened customer demand. The group's net interest margin is significantly higher than other groups, as the net interest margin calculation represents net interest income as a percentage of total assets. The group's primary source of net interest income is term investment products, which are liabilities.

Investment Banking Group net interest income fell because of lower corporate lending volumes, as well as compressed spreads in the group's interest-rate-sensitive businesses associated with rising short-term interest rates that increased funding costs.

Non-Interest Revenue

Non-interest revenue, which comprises all revenues other than net interest income, increased $331 million or 8% from 2003. The incremental effects of acquired businesses increased non-interest revenue by $91 million, while the impact of the weaker U.S. dollar reduced 2004 non-interest revenue by $123 million.

Securities commissions and fees were up 18% and contributed about half of the overall increase in non-interest revenue. These fees consist largely of full-service and self-directed retail brokerage commissions within Private Client Group, which account for about three-quarters of the balance, and institutional equity trading commissions within Investment Banking Group. Fees increased in both operating groups, benefiting from higher equity market valuations and higher client trading volumes, particularly in the first half of 2004. The inclusion of Harris Nesbitt Gerard's results for a full year was a significant component of the growth in Investment Banking Group revenue.

Deposit and payment service charges, which represent income earned on both retail and commercial deposit accounts, declined $10 million due to lower income earned by Investment Banking Group.

Lending fees rose $24 million, primarily within Investment Banking Group.

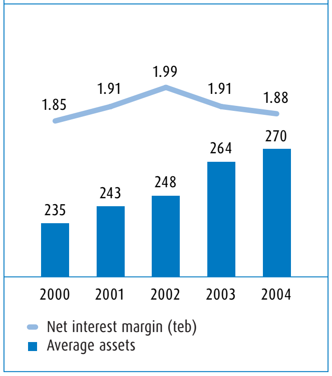
Card fees fell $29 million, having been affected by $65 million of adjustments related to rising loyalty reward redemption rates. Otherwise card fees would have grown as they did in 2003 on higher levels of activity, driven in part by the continued success of our Mosaik MasterCard.

Investment management and custodial fees were relatively unchanged, as they were affected by the weaker U.S. dollar.

Mutual fund revenues increased $57 million or 18%, reflecting volume growth and improved equity market valuations.

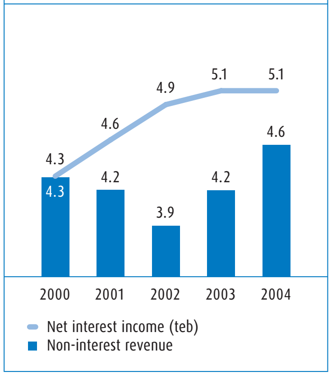
Securitization revenues decreased $67 million or 27% due to lower credit card loan securitizations and lower gains on sales. Securitization revenues are detailed in Note 7 on page 95 of the financial statements.

Average Assets ($ billions) **and Net Interest Margin (teb)** (%)



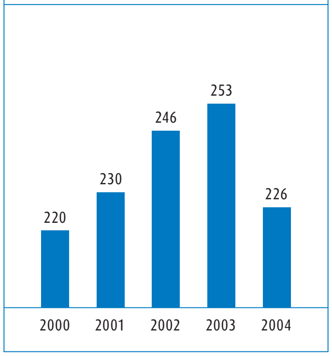
Assets rose in personal and commercial banking, while net interest margins fell in all groups.

Net Interest Income (teb) and Non-Interest Revenue ($ billions)



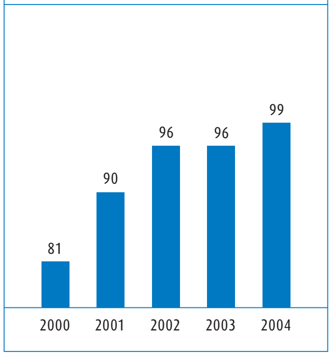
Non-interest revenue growth has outpaced growth in net interest income.

Assets under Administration ($ billions)



Assets declined because of the weaker U.S. dollar and the discontinuance of a low-revenue-producing sub-custodial arrangement.

Assets under Management ($ billions)



Assets under management grew in spite of the weaker U.S. dollar.

Non-Interest Revenue ($ millions)

For the year ended October 31	2004	2003	2002	Change from 2003 $	Change from 2003 %
Securities commissions and fees	**1,055**	894	813	**161**	**18**
Deposit and payment service charges	**746**	756	732	**(10)**	**(1)**
Trading revenues	**200**	275	209	**(75)**	**(27)**
Lending fees	**317**	293	306	**24**	**8**
Card fees	**261**	290	260	**(29)**	**(10)**
Investment management and custodial fees	**307**	303	314	**4**	**1**
Mutual fund revenues	**378**	321	309	**57**	**18**
Securitization revenues	**177**	244	329	**(67)**	**(27)**
Underwriting and advisory fees	**343**	268	228	**75**	**28**
Investment securities gains (losses)	**175**	(41)	(146)	**216**	**+100**
Foreign exchange, other than trading	**177**	160	151	**17**	**11**
Insurance income	**139**	124	105	**15**	**12**
Other	**276**	333	314	**(57)**	**(17)**
Total	**4,551**	4,220	3,924	**331**	**8**

Underwriting and advisory fees increased $75 million, primarily due to higher equity underwriting fees. Debt underwriting fees also rose strongly, while merger and acquisition fees were essentially unchanged from a year ago.

Investment securities gains were $175 million, compared with net losses of $41 million in 2003. There were $63 million of write-downs in 2004, compared with $153 million in 2003. The gains in 2004 were offset in part by a $58 million reduction in net interest income related to losses on unwinding hedges associated with investment securities that were sold. Unrealized gains on investment securities declined $226 million to $86 million, partially due to realized gains in 2004.

Foreign exchange, other than trading, rose due to more active markets and insurance income again showed strong growth, reflecting further increases in volumes.

Other revenue decreased $53 million due to lower origination and other mortgage fees in U.S. personal and business banking and due to other sundry net reductions.

Table 7 on page 72 provides further detail on revenue and revenue growth.

Trading-Related Revenues

Trading-related revenues are primarily dependent on the volume of activities undertaken for clients, who enter into transactions with BMO to mitigate their risks or to invest. BMO earns a spread or profit on the net sum of its client positions by profitably neutralizing, within prescribed limits, the overall risk of the net positions. BMO also assumes proprietary positions with the goal of earning trading profits. While proprietary positions expose the organization to profit or loss, the positions and their risks are closely managed and profit or loss from these activities is generally not the most significant factor affecting the level of trading-related revenues.

Revenues from trading-related activities totalled $472 million, compared with $508 million in 2003. Trading-related revenues included net interest income of $272 million and non-interest revenue of $200 million. The $36 million decrease in interest and non-interest trading revenues from 2003 was attributable to lower interest rate and other trading revenues. Interest rate trading revenues were affected by low volatility and associated declines in deal flow in 2004. Commodity derivatives trading revenues, which are included in other trading income, included revenue from the termination of positions with a counterparty in 2003. Equity and foreign exchange trading revenues increased. Equity trading was stronger as a result of improved volatility, particularly in the first half of the year, which improved trading opportunities. Growth in our equity trading business also contributed to the improvement in equity trading income. Foreign exchange revenues rose due to improved trading opportunities. The Market Risk section on page 62 provides further information on trading-related revenues.

Trading-related revenues include net interest income and non-interest revenue earned from on and off-balance sheet positions undertaken for trading purposes. The management of these positions typically includes marking them to market on a daily basis. Trading revenues include income (expense) and gains (losses) from both on-balance sheet instruments and off-balance sheet interest rate, foreign exchange (including spot positions), equity, commodity and credit contracts.

Interest and Non-Interest Trading Revenues

($ millions)

For the year ended October 31	2004	2003	2002	Change from 2003 $	Change from 2003 %
Interest rates	**204**	241	180	**(37)**	**(15)**
Foreign exchange	**85**	69	69	**16**	**23**
Equities	**152**	86	56	**66**	**75**
Other	**31**	112	86	**(81)**	**(72)**
Total	**472**	508	391	**(36)**	**(7)**
Reported as:					
Net interest income	**272**	233	182	**39**	**17**
Non-interest revenue – trading revenues	**200**	275	209	**(75)**	**(27)**
Total	**472**	508	391	**(36)**	**(7)**

Provision for Credit Losses

In 2004, our results included a net recovery of credit losses of $103 million. As outlined in the Provision for (Recovery of) Credit Losses table, the net recovery consisted of $67 million in specific provisions offset by a $170 million reduction in the general allowance. In 2003, there was a $455 million provision for credit losses, comprised entirely of specific provisions.

As can be determined from the table, specific provisions for credit losses peaked in the 2001–2002 period, declining sharply in both 2003 and 2004. In 2004, specific provisions for credit losses declined to 4 basis points of average net loans and acceptances. This compares with a recent peak of 60 basis points in 2001 and an average of 34 basis points over the past five years. The recent improvement is attributable to favourable credit conditions, effective loan realization practices and a strong secondary market for loan sales.

The most significant factor influencing the provision for credit losses is the level of formations of new impaired loans – identified as additions to impaired loans and acceptances in the Changes in Gross Impaired Loans and Acceptances table. Formations peaked in 2001–2002 at approximately $2 billion in each of those years, declining sharply in 2003 and again in 2004 when they totalled $607 million. Partially as a result, new specific provisions declined to $510 million from levels exceeding $1 billion in 2001 and 2002.

Another significant factor affecting the level of specific provisions is the amount of reductions arising from reversals of previous allowances and recoveries of prior write-offs. Favourable credit conditions, coupled with effective loan realization practices that include strong cash collections and loan sales, resulted in substantial reversals and recoveries during the past two years, as indicated in the table. In 2004, sales of gross non-performing loans totalled $440 million, with resulting reversals and recoveries totalling $71 million. In 2003, sales of non-performing loans totalled $288 million, with related reversals and recoveries totalling $23 million.

Gross impaired loans and acceptances totalled $1,119 million in 2004, compared with $1,918 million a year earlier. Significant reductions occurred in the electric power generation, wholesale trade and communications sectors. At year-end, gross impaired loans as a percentage of equity and allowance for credit losses improved to 6.75% from 12.15% a year ago.

At October 31, 2004, the allowance for credit losses totalled $1,308 million, compared with $1,791 million a year earlier. The decline was attributable to improved credit quality and lower levels of impaired loans and acceptances. The general allowance, which totalled $1,010 million at year-end, remains adequate, representing 74 basis points of risk-weighted assets. In addition, BMO uses credit default swaps to mitigate credit exposures; they totalled $830 million in 2004 and $323 million in 2003.

BMO has no significant exposure to those industry sectors considered to be of most concern in today's economy. These include the automotive, airline, electric power generation, forestry, and Canadian cattle farming and related sectors. Nonetheless, we remain attentive to those factors that could affect credit quality, including sustained high energy prices, the impact on export sectors of the sharp appreciation of the Canadian dollar relative to the U.S. dollar and the potential impact of rising interest rates.

Credit risk management is discussed further on page 60. In addition, Tables 11 to 19 on pages 76 to 79 provide detailed loan and loan quality data.

Looking forward, we expect the credit environment to remain strong in 2005, an outlook supported by low corporate default rates, low levels of impaired loan formations and an expectation of moderate to strong economic activity in North America. Accordingly, we expect the 2005 provision for credit losses to be $400 million or less, with the increase over the current year largely due to lower levels of reversals and recoveries.

Provision for (Recovery of) Credit Losses (PCL) ($ millions, except as noted)

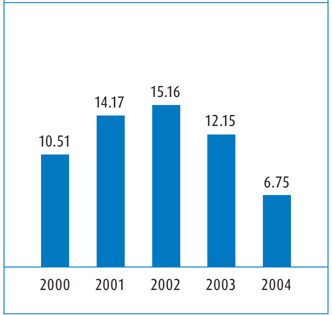
For the year ended October 31	2004	2003	2002	2001	2000
New specific provisions	**510**	846	1,063	1,023	458
Reversals of previous allowances	**(312)**	(303)	(175)	(103)	(124)
Recoveries of prior write-offs	**(131)**	(88)	(68)	(40)	(44)
Specific provisions for credit losses	**67**	455	820	880	290
Increase in (reduction of):					
General allowance	**(170)**	–	–	100	110
Country risk allowance	**–**	–	–	–	(42)
Provision for (recovery of) credit losses	**(103)**	455	820	980	358
PCL as a % of average net loans and acceptances	**(0.07)%**	0.30%	0.56%	0.66%	0.25%

Changes in Gross Impaired Loans (GIL) and Acceptances

($ millions, except as noted)

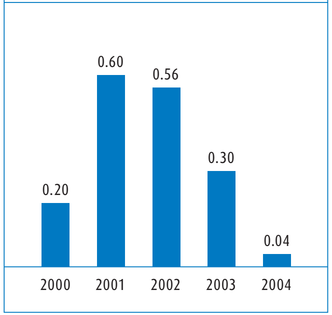
	2004	2003	2002	2001	2000
GIL, beginning of year	**1,918**	2,337	2,014	1,501	1,092
Additions to impaired loans and acceptances	**607**	1,303	1,945	2,041	1,106
Reductions in impaired loans and acceptances	**(936)**	(1,156)	(738)	(830)	(446)
Write-offs	**(470)**	(566)	(884)	(698)	(251)
GIL, end of year	**1,119**	1,918	2,337	2,014	1,501
GIL as a % of gross loans and acceptances	**0.71%**	1.30%	1.54%	1.37%	1.04%

Gross Impaired Loans and Acceptances as a % of Equity and Allowances for Credit Losses



Low impaired loan formations and effective loan remediation improved our credit quality.

Specific Provision for Credit Losses as a % of Average Net Loans and Acceptances



There was an unusually low provision for credit losses in 2004 but provisions in 2005 are expected to rise.

Non-Interest Expense

Non-interest expense increased $70 million or 1.1% to $6,157 million. In 2003, non-interest expense had risen $57 million or 0.9%. The factors affecting the low levels of expense growth in the past two years are quite similar in nature and in their impact. The dollar and percentage changes in expenses by category are outlined in the Non-Interest Expense table. The factors contributing to the 1.1% increase in 2004 are set out in the Contribution to Non-Interest Expense Growth table.

As explained on page 27, the incremental effects of businesses acquired in 2004 and 2003 increased expenses in 2004 relative to 2003 by $106 million (1.7%). As further explained on page 27, the lower Canadian/U.S. dollar exchange rate reduced costs in 2004 by $177 million (–2.8%). Higher performance-based compensation costs, associated with BMO's 29% increase in net income, increased expenses by $90 million (1.4%), and higher pension costs increased expenses by $30 million (0.5%). Pension costs are included in other employee compensation in the Non-Interest Expense table. A change in accounting policy to capitalize costs of certain internally-developed software in 2004 reduced expenses by $47 million. That change, and more particularly, our focus on productivity, limited growth in other expenses to $21 million or 0.3%.

Productivity

The expense-to-revenue ratio (productivity ratio) improved 160 basis points to 64.1% in 2004. BMO's overall ratio in any year is affected by the relative strength of the revenues in each operating group. The expense-to-revenue ratio of each group is typically quite different because of the nature of their businesses. In 2004, as in 2003, all operating groups increased revenues more than expenses, in both absolute and percentage terms. As a result, all operating groups again improved their expense-to-revenue ratios.

Personal and Commercial Client Group is BMO's largest operating group and its productivity ratio of 62.8% improved by 100 basis points from last year, due to volume-driven revenue growth in both Canada and the United States and controlled expense growth. The productivity improvement was mitigated by a $65 million adjustment to card fees, as explained on page 29. Excluding that adjustment, the productivity ratio improved 190 basis points.

Private Client Group's expense-to-revenue ratio was 81.1%, a 560 basis point improvement from a year ago. As in 2003, the improvement was reflected in significantly higher earnings. The group has been successful in reducing non-revenue-based costs, while revenue-generating initiatives and an overall improvement in market conditions led to higher revenues even though overall expenses declined.

Investment Banking Group's expense-to-revenue ratio improved by 100 basis points to 50.5%. The improvement was tempered by the inclusion of results of recently-acquired Harris Nesbitt Gerard and higher performance-based compensation associated with improved results.

We improved our cash productivity ratio in 2004 by 155 basis points to 63.0%, achieving the organization's top priority of improving this ratio by 150 to 200 basis points.

The **expense-to-revenue ratio (or productivity ratio)** is our key measure of productivity. It is calculated as non-interest expense divided by total revenues (on a taxable equivalent basis), expressed as a percentage. See page 26.

The **cash productivity ratio** is calculated in the same manner, after removing the amortization of intangible assets from non-interest expenses. See page 26.

Examples of initiatives to enhance productivity are outlined in the 2004 Review of Operating Groups Performance that starts on page 35. We will continue to focus on improving productivity in 2005, and we are again targeting a 150 to 200 basis point improvement in cash productivity.

Table 8 on page 73 provides further detail on expense and expense growth.

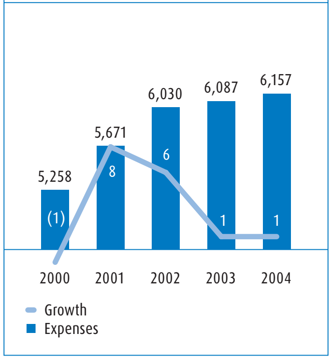
Non-Interest Expense ($ millions)

For the year ended October 31	2004	2003	2002	Change from 2003 $	Change from 2003 %
Performance-based compensation	**1,148**	1,058	941	**90**	**8**
Other employee compensation	**2,484**	2,520	2,462	**(36)**	**(1)**
Total employee compensation	**3,632**	3,578	3,403	**54**	**2**
Premises and equipment	**1,252**	1,264	1,280	**(12)**	**(1)**
Communications	**138**	162	173	**(24)**	**(15)**
Other	**1,031**	978	1,087	**53**	**5**
Amortization of intangible assets	**104**	105	87	**(1)**	**(1)**
Total	**6,157**	6,087	6,030	**70**	**1**

Contribution to Non-Interest Expense Growth (%)

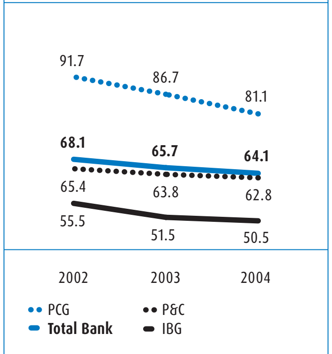
For the year ended October 31	2004	2003	2002
Acquired businesses	**1.7**	3.0	5.5
Currency translation effect	**(2.8)**	(2.9)	0.6
Performance-based compensation	**1.4**	1.5	(0.3)
Pension expense	**0.5**	1.3	1.2
Other	**0.3**	(2.0)	(0.7)
Total non-interest expense growth	**1.1**	0.9	6.3

Expenses ($ millions) **and Annual Growth** (%)



Expense growth was modest in 2004 and 2003.

Expense-to-Revenue Ratio by Group (teb) (%)



All groups improved productivity again as BMO achieved its overall productivity target.

Provision for Income Taxes

The provision for income taxes reflected in the Consolidated Statement of Income is based upon transactions recorded in income, regardless of when such transactions are subject to income taxes, with the exception of the repatriation of retained earnings from foreign subsidiaries, as outlined in Note 21 on page 114 of the financial statements.

As explained on pages 26 and 28, BMO adjusts revenue to a taxable equivalent basis for analysis, with an offsetting adjustment to the provision for income taxes. As such, unless indicated otherwise, the provision for income taxes and associated tax rates are stated on a taxable equivalent basis in this MD&A.

On a taxable equivalent basis, the provision for income taxes in the Consolidated Statement of Income was $1,147 million, compared with $840 million in 2003. The increase was attributable to higher net income before income taxes, a higher proportion of income from higher tax-rate jurisdictions and the recognition of proportionately lower tax benefits in 2004, as well as the impact on current income taxes of the Ontario income tax rate increase in the first quarter. These factors were partially offset by federal and Alberta income tax rate decreases. On a taxable equivalent basis, the effective tax rate was 32.2% in 2004 (31.7% excluding a $19 million future tax adjustment in the first quarter), compared with 30.8% in 2003. The components of variances between the effective and statutory Canadian tax rates are outlined in Note 21 on page 114 of the financial statements.

Excluding any special adjustments, we estimate that the effective tax rate in 2005 will be 31% to 32% and consider that rate to be sustainable.

BMO hedges the foreign exchange risk arising from our net investment in our U.S. operations by funding the net investment in U.S. dollars. Under this program, the gain or loss on hedging and the unrealized gain or loss on translation of the net investment in U.S. operations are charged or credited to retained earnings, but usually are approximately equal and offsetting. For income tax purposes, the gain or loss on hedging activities incurs an income tax charge or credit in the current period, which is charged or credited to retained earnings; however, the associated unrealized gain or loss on the net investment in U.S. operations does not incur income taxes until the investment is liquidated. The income tax charge/benefit arising from a hedging gain/loss is a function of fluctuations in exchange rates from period to period. The $710 million gain on hedging our net investment in U.S. operations in 2004 was subject to an income tax charge in retained earnings of $254 million. Refer to the Consolidated Statement of Changes in Shareholders' Equity on page 85 of the financial statements for further details.

Table 8 on page 73 details the $1,717 million of total government levies and taxes incurred by BMO in 2004.

2003 Financial Performance Review

Earnings

Earnings per share rose $0.76 to a then-record $3.44 in fiscal 2003 and net income increased $408 million or 29% to $1,825 million. Growth was driven by a lower provision for credit losses, business growth in all operating groups and lower net losses on investment securities.

Return on equity was 16.4%, compared with 13.4% in 2002. The increase was due to higher net income in 2003.

Revenue

Revenue increased $412 million or 5% to $9,271 million in 2003, driven by a $116 million or 2% increase in net interest income and a $296 million or 8% increase in non-interest revenue. Revenue growth was increased 1.4 percentage points by the incremental effects of acquired businesses, but was lowered 3 percentage points by the impact of the weaker U.S. dollar. Our three client operating groups each had revenue growth of more than 4%. Personal and Commercial Client Group revenue rose on continued strong volume growth in both Canada and the United States, although the impact of U.S. growth was offset by the lower exchange rate. Canadian growth was primarily in the personal banking segment, where retail deposits, card services and residential mortgages were particularly strong. Private Client Group revenue rose on improving market fundamentals and stronger performance in direct and full-service investing and in investment products. Investment Banking Group revenue benefited from stronger income trust origination activity and higher trading revenue. There was a $71 million increase related to including taxable equivalent basis adjustments for dividend revenue in taxable equivalent basis revenue, while a $105 million reduction in net investment securities losses also contributed to BMO's revenue increase.

Provision for Credit Losses

The provision for credit losses was $455 million in 2003, a decline of $365 million from $820 million in 2002, due to improved credit performance experienced in 2003. Provisions for credit losses in the then-troubled communications sector alone were $399 million in 2002, but declined to $7 million in 2003 due to the development of significantly fewer new problem loans and to proactive reductions in exposure to the sector.

Non-Interest Expense

Non-interest expense rose $57 million or 1% to $6,087 million in 2003. The expense-to-revenue ratio of 65.7% improved 240 basis points from 2002, as all operating groups improved their productivity ratios by increasing revenues more than expenses. The net increase in expenses was primarily attributable to higher employee compensation costs, due to higher performance-based compensation and higher pension costs, partially offset by reduced professional fees and travel costs. The incremental effects of businesses acquired in 2002 and 2003 increased expenses in 2003 by $180 million; however, the weaker U.S. dollar reduced costs in 2003 by $181 million; as such, these two factors offset each other.

Operating Groups Results

Personal and Commercial Client Group net income rose $130 million or 16% to $937 million in 2003. Revenue rose $262 million or 6% to $4,824 million, driven by strong volume growth in both Canadian and U.S. operations. Revenue was substantially unchanged in the United States as the effect of strong deposit and loan growth was offset by the impact of the lower Canadian/U.S. dollar exchange rate. Non-interest expenses increased $91 million or 3% to $3,075 million. In Canada, expenses increased as higher performance-based compensation, higher employee benefit costs and spending on initiatives to improve customer service more than offset the effects of initiatives to contain costs. Costs declined in the United States.

Private Client Group net income increased $65 million or 82% to $144 million in 2003. Earnings growth was achieved primarily through effective cost containment initiatives implemented in response to challenging market conditions, along with moderate revenue growth. Revenue increased $113 million or 7% to $1,737 million, driven by acquired businesses and strategic initiatives. Excluding acquisitions, revenue on a comparable basis was up $8 million from 2002. Revenue growth was reduced 3 percentage points by the impact of the lower Canadian/U.S. dollar exchange rate. Non-interest expenses increased $15 million or 1% to $1,505 million due primarily to the incremental effects of acquired businesses. Excluding acquired businesses, non-interest expenses on a comparable basis were reduced $78 million or 5% due to cost management initiatives and the weaker U.S. dollar.

Investment Banking Group net income increased $120 million or 20% to $721 million in 2003, driven by higher revenues as well as lower expenses. Revenue increased $110 million or 4% to $2,656 million. Revenue in 2003 was reduced $127 million by the weaker U.S. dollar; however, year-over-year revenue growth benefited from a $92 million reduction in net investment securities losses in 2003. Trading-related revenue was up $149 million, driven in part by higher commodities derivatives trading revenue from a gain on termination of certain positions with a counterparty. The change in determining taxable equivalent basis amounts contributed to revenue growth, while equity origination fees were also higher. The increases were partially offset by lower interest income due to the narrowing of spreads earned as higher-yielding assets matured, reflecting a flatter yield curve environment, and lower corporate lending volumes. Non-interest expenses of $1,369 million were $44 million or 3% lower than in 2002, despite the inclusion of expenses related to Harris Nesbitt Gerard. The weaker U.S. dollar reduced expenses by $51 million. Employee costs were down from the prior year because of reductions in performance-based compensation and staffing levels. Premises costs and other expenses were also lower.

Corporate Support net income was $23 million, compared with a net loss of $70 million in 2002. The improvement was attributable to a $391 million decline in the provision for credit losses, partially offset by a $73 million decline in revenue and higher income taxes. There was lower revenue from our securitizations and investment portfolios. Expenses were substantially unchanged.