

2006 Financial Performance Review

This section provides a review of our enterprise financial performance for 2006 that focuses on the Consolidated Statement of Income included in our consolidated financial statements, which begin on page 92. A review of our operating groups' strategies and performance follows the enterprise review. A summary of the enterprise financial performance for 2005 is outlined on page 77.

Highlights

- Revenue increased \$154 million or 1.5% in 2006, but increased 5.9% excluding *Harrisdirect's* revenues in 2005 and the impact of the weaker U.S. dollar.
- Revenue growth in P&C Canada was attributable to volume growth as well as a customer loyalty card reserve increase in 2005 and a gain on the MasterCard IPO. P&C U.S. revenue growth was attributable to loan growth, acquisitions and new branches. Private Client Group revenue growth was driven by higher mutual fund fees and direct investing commissions, excluding *Harrisdirect's* results and gains on asset sales in 2005. Investment Banking Group revenue growth was driven by higher trading revenues, improved merger and acquisition fees and higher commissions.
- The provision for credit losses was comparable to a year ago at \$176 million, the second-lowest since 1998 (2004 was the lowest). Specific provisions for credit losses were \$211 million and there was a \$35 million reduction in the general allowance, both of which were also comparable to amounts in the previous year. Gross impaired loans declined from the already low levels of 2005.
- Non-interest expense increased 0.3% in 2006, but increased 6.1% excluding *Harrisdirect's* expenses in 2005 and the impact of the weaker U.S. dollar. Expense growth on this basis was in part due to business initiatives to improve future profitability and to higher performance-based costs.
- The expense-to-revenue ratio (or productivity ratio) improved by 77 basis points (bps) to 62.8%. We improved the cash productivity ratio by 25 bps to 62.4%, following a total improvement of 538 bps in the three previous years.
- The effective income tax rate was 23.6%, down from 28.8% in 2005, in part due to income tax initiatives.

Non-GAAP Measures

BMO uses both GAAP and 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 useful 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 equivalent to amounts that would incur tax at the statutory rate. The effective income tax rate is also analyzed on a taxable equivalent basis for consistency in 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)	2006	2005	2004
Net interest income per financial statements (a)	4,744	4,787	4,798
Non-interest revenue	5,241	5,052	4,551
Revenue per financial statements (b)	9,985	9,839	9,349
Taxable equivalent basis (teb) adjustment (c)	127	119	139
Net interest income (teb) (a+c) (d) (1)	4,871	4,906	4,937
Non-interest revenue	5,241	5,052	4,551
Revenue (teb) (e) (1)	10,112	9,958	9,488
Provision for income taxes per financial statements (f)	717	874	971
Taxable equivalent basis (teb) adjustment	127	119	139
Provision for income taxes (teb) (g) (1)	844	993	1,110
Non-interest expense (h)	6,353	6,332	6,169
Amortization of intangible assets	(44)	(94)	(104)
Cash-based expense (i) (1)	6,309	6,238	6,065
Net income	2,663	2,396	2,295
Amortization of intangible assets (net of income tax)	36	74	78
Cash net income (1)	2,699	2,470	2,373
Preferred share dividends	(30)	(30)	(31)
Charge for capital (1)	(1,439)	(1,324)	(1,230)
Net economic profit (1)	1,230	1,116	1,112
Non-interest expense-to-revenue ratio (2) (%) ((h/b) x 100)	63.6	64.4	66.0
Non-interest expense-to-revenue (teb) ratio (1) (2) (%) ((h/e) x 100)	62.8	63.6	65.0
Cash non-interest expense-to-revenue (teb) ratio (1) (2) (%) ((i/e) x 100)	62.4	62.6	63.9
Net interest margin annualized (%) ((a/average assets) x 100)	1.53	1.61	1.82
Net interest margin (teb) annualized (1) (%) ((d/average assets) x 100)	1.58	1.65	1.88
EPS (uses net income) (5)	5.15	4.63	4.40
Cash EPS (1) (uses cash net income) (5)	5.23	4.78	4.55
Effective tax rate (%) (f/income before income taxes)	20.7	26.3	29.5
Effective tax rate (teb) (1) (%) (g/income before income taxes)	23.6	28.8	32.4

(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 2006 and 2005 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 2006, 2005 and 2004 and the impact of lower rates.

At the start of each quarter, BMO enters into hedging transactions that are designed to partially offset the pre-tax effects of exchange rate fluctuations in the quarter on our expected U.S.-dollar-denominated net income for that quarter. As such, these activities partially mitigate the impact of exchange rate fluctuations, but only within that quarter. As such, 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 annual earnings by approximately \$6 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 exchange rate 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 exchange rate fluctuations on our net investment in foreign operations is discussed in the Provision for Income Taxes section on page 41.

Impact of Business Acquisitions (Sales)

BMO Financial Group has selectively acquired and sold a number of businesses in advancing our North American growth strategy. These acquisitions and sales increase or decrease revenue and expenses, affecting year-over-year comparisons of operating results. The adjacent table outlines acquisitions and sales by operating group that affected BMO's revenue, expenses and net income for 2006 relative to 2005, and for 2005 relative to 2004, to assist in analyzing changes in results.

For the acquisition completed in fiscal 2006, the incremental effects are the revenues and expenses of that business that are included in results for fiscal 2006. For acquisitions completed in fiscal 2005, the incremental effects on results for 2006 are the revenues and expenses of those businesses from the beginning of fiscal 2006 until the first anniversary of their respective dates of acquisition.

For fiscal 2005 acquisitions, the incremental effects on results for 2005 relative to 2004 are the revenues and expenses of those businesses that are included in results for fiscal 2005, and for acquisitions completed in fiscal 2004, the incremental effects on results for fiscal 2005 are the revenues and expenses of those businesses from the beginning of fiscal 2005 until the first anniversary of their respective dates of acquisition.

Harrisdirect was sold in October 2005, the last month of fiscal 2005. As such, the reduction in results for 2006 relative to 2005 was the 2005 revenue, expenses, net loss and cash net income of the business that was sold. The sale was completed to redeploy capital to higher-return businesses.

Effects of the Weaker U.S. Dollar on BMO's Results

(\$ millions, except as noted)

	2006 vs. 2005	2005 vs. 2004
Canadian/U.S. dollar exchange rate (average)		
2006	1.132	
2005	1.214	1.214
2004		1.313
Reduced net interest income	(63)	(87)
Reduced non-interest revenue	(107)	(126)
Reduced revenues	(170)	(213)
Reduced expenses	112	145
Reduced provision for credit losses	4	1
Reduced income taxes	28	19
Reduced net income before hedging gains	(26)	(48)
Hedging gains	3	10
Income taxes thereon	(1)	(4)
Reduced net income	(24)	(42)

Impact of Business Acquisitions (Sales) on Year-over-Year Comparisons (\$ millions)

Business acquired/sold	Increase (decrease) in:			
	Revenue	Expense	Net income	Cash net income
Personal and Commercial Banking				
Incremental effects on results for: 2006	17	29	(7)	1
2005	75	51	13	17
Villa Park Trust and Savings Bank				
Acquired December 2005 for \$76 million				
Mercantile Bancorp, Inc.				
Acquired December 2004 for \$194 million				
New Lenox State Bank				
Acquired June 2004 for \$314 million				
Lakeland Community Bank				
Acquired March 2004 for \$49 million				
Total purchases of \$633 million				
Private Client Group				
Incremental effects on results for: 2006*	(253)	(243)	5	(27)
2005	-	-	-	-
Harrisdirect				
Sold October 2005 for \$827 million				
resulting in a gain of \$49 million				
(\$18 million after tax)				
BMO Financial Group				
Incremental effects on results for: 2006	(236)	(214)	(2)	(26)
2005	75	51	13	17
Purchases of \$633 million and sales of \$827 million				

*Includes the \$49 million (\$18 million after tax) gain on sale in 2005.

Revenue

Revenue on a taxable equivalent basis (see page 34) rose \$154 million or 1.5% in 2006 to \$10,112 million, driven by growth in P&C Canada. The weaker U.S. dollar lowered revenue growth in each of the operating groups and reduced BMO's overall revenue growth by \$170 million or 1.7 percentage points, while the net impact of businesses sold and acquired reduced growth by \$236 million or 2.4 percentage points. The \$154 million increase was entirely due to higher non-interest revenue, as increased net interest income in P&C Canada was offset by a decline in Investment Banking Group. Excluding the impact of the *Harrisdirect* sale and the weaker U.S. dollar, revenue growth was 5.9%.

BMO, like many banks, analyzes revenue on a taxable equivalent basis (teb). The teb adjustments for fiscal 2006 totalled \$127 million, up from \$119 million a year ago.

P&C Canada revenue increased \$260 million or 6% due to volume growth, higher insurance income, a 2005 adjustment to increase customer loyalty card reserves that lowered credit card fees, and a gain on MasterCard Incorporated's IPO. P&C U.S. revenue increased \$9 million or 1%, but increased \$74 million or 8% excluding the impact of the weaker U.S. dollar. The increase was due to loan growth, acquisitions and new branches.

Private Client Group revenue declined; however, after excluding the operating results of *Harrisdirect* and \$74 million of gains on asset sales in 2005, revenue increased \$135 million or 8%.

Growth was driven by higher mutual fund fees and direct investing commissions. Investment Banking Group revenue increased \$39 million or 1%. The weaker U.S. dollar lowered IBG revenue growth by \$96 million or 3 percentage points. There was higher trading revenue, improved merger and acquisition fees and higher commissions.

Net Interest Income

Net interest income for the year was \$4,871 million, a reduction of \$35 million from 2005. The net effect of businesses sold and acquired reduced net interest income by \$52 million, while the impact of the weaker U.S. dollar further reduced net interest income by \$63 million. A significant decline in Investment Banking Group's net interest income offset strong growth in P&C. There was strong volume growth as average assets increased by \$13 billion. Overall net interest margin was lower in a competitive environment, continuing a four-year trend.

On November 1, 2004, we commenced the consolidation of certain of our customer securitization vehicles, pursuant to the adoption of the Canadian Institute of Chartered Accountants' (CICA's) new accounting requirement on the consolidation of VIEs. This lowered net interest margin as it resulted in the inclusion of approximately \$21 billion of average assets in BMO's

Taxable equivalent basis (teb)

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 34 and in Table 7 on page 80.

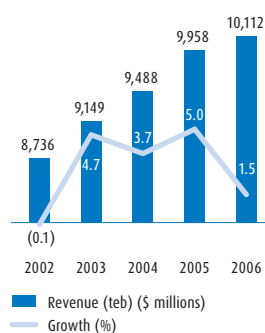
Net interest income is comprised of earnings on assets, such as loans and securities, including interest and dividend income and BMO's share of income from investments accounted for using the equity method of accounting, less interest expense paid on liabilities, such as deposits.

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

Revenue (\$ millions)

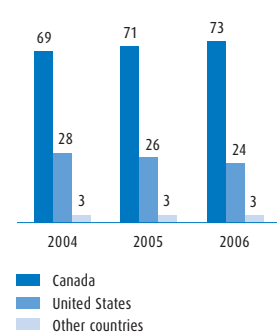
For the year ended October 31	2006	2005	2004	2003	2002
Net interest income (teb)	4,871	4,906	4,937	4,929	4,812
Year-over-year growth (%)	(0.7)	(0.6)	0.2	2.4	6.3
Non-interest revenue	5,241	5,052	4,551	4,220	3,924
Year-over-year growth (%)	3.8	11.0	7.8	7.6	(7.1)
Total revenue (teb)	10,112	9,958	9,488	9,149	8,736
Year-over-year growth (%)	1.5	5.0	3.7	4.7	(0.1)

Revenue and Annual Growth



Revenue grew 5.9% excluding the impact of the *Harrisdirect* sale and the weaker U.S. dollar.

Revenue by Country (teb) (%)



The weak U.S. dollar and the late 2005 sale of *Harrisdirect* reduced the proportion of U.S. revenue.

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

For the year ended October 31	Net interest income (teb)				Average assets				Net interest margin		
	(\$ millions)		Change		(\$ millions)		Change		(in basis points)		
	2006	2005	\$	%	2006	2005	\$	%	2006	2005	Change
P&C Canada	2,940	2,829	111	4	114,364	105,963	8,401	8	257	267	(10)
P&C U.S.	740	732	8	1	21,890	21,055	835	4	338	348	(10)
Personal and Commercial Banking (P&C)	3,680	3,561	119	3	136,254	127,018	9,236	7	270	280	(10)
Private Client Group (PCG)	569	577	(8)	(1)	6,545	7,061	(516)	(7)	871	819	52
Investment Banking Group (IBG)	773	966	(193)	(20)	161,811	157,234	4,577	3	48	61	(13)
Corporate Services, including Technology and Operations	(151)	(198)	47	24	4,521	5,189	(668)	(13)	nm	nm	nm
Total	4,871	4,906	(35)	(1)	309,131	296,502	12,629	4	158	165	(7)

nm – not meaningful

balance sheet. On April 29, 2005, we completed the restructuring of these VIEs; consequently, the VIE assets were no longer included in BMO's balance sheet as of that date. BMO's net interest margin for fiscal 2005 was approximately 6 basis points lower than it would have been if we had not been required to consolidate VIE assets in those periods, and Investment Banking Group's net interest margin was approximately 4 basis points lower.

In P&C Canada, there was strong volume growth in mortgages, personal and commercial loans and commercial deposits. In P&C U.S., there was robust loan growth but its effect was reduced by the weaker U.S. dollar. Net interest margin was 10 basis points lower in both Canada and the United States. In Canada, net interest margin was affected by loan pricing in a competitive market, particularly the mortgage market early in 2006, and by total loans growing faster than deposits. In P&C U.S., net interest margin was affected by competitive pressures on loan pricing. A changing product mix also contributed to reduced net interest margin in P&C U.S., as customers shifted to lower-spread deposits and fixed-rate loans in the rising interest rate environment. Loan growth also exceeded deposit growth in the United States, contributing to the reduction in net interest margin. The overall decline in net interest margin was mitigated by pricing decisions in certain deposit categories in both Canada and the United States.

Private Client Group net interest income declined modestly, but was up strongly when adjusted for the sale of *Harrisdirect*, because of improved margins in term investment products and moderate balance growth. 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's average assets increased \$5 billion, but increased \$16 billion excluding VIE assets in 2005. There was growth in both corporate loans and low-margin capital markets assets, driven largely by client demand. The group's net interest income and net interest margin declined sharply, in large part due to the higher funding costs associated with the expansion of our commodity and equity trading businesses. The decline was also due to lower spreads in our interest-rate-sensitive businesses related to rising short-term interest rates and a flatter yield curve, our strategy of reducing non-core assets and lower spreads on corporate loans, partially offset by growth in assets.

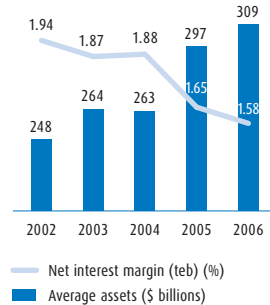
Corporate Services net interest income fluctuates in response to activities related to certain balance sheet positions and BMO's overall asset-liability position.

Non-Interest Revenue

Non-interest revenue, which comprises all revenues other than net interest income, increased \$189 million or 3.8% from 2005. The net impact of businesses sold and acquired reduced 2006 non-interest revenue by \$184 million, while the impact of the weaker U.S. dollar further reduced non-interest revenue by \$107 million.

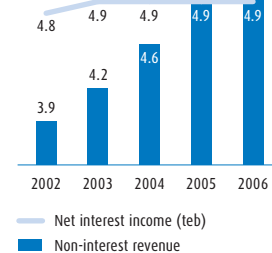
Securities commissions and fees declined \$41 million or 4%, but would have increased by about the same amount excluding the results of *Harrisdirect*. These fees consist largely of full-service and self-directed retail brokerage commissions within Private Client Group, which account for about 70% of the balance, and institutional equity trading commissions within Investment Banking Group. Fees increased in both operating groups, excluding *Harrisdirect*, a result of higher equity market valuations and higher client trading volumes, with stronger growth in IBG.

Average Assets and Net Interest Margin (teb)



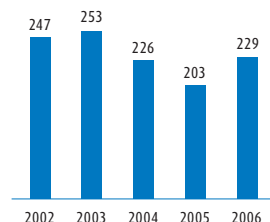
Assets grew \$12.6 billion, or \$24 billion adjusted for VIE assets, while net interest margins again declined in both P&C and IBG.

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



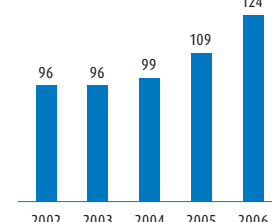
The sale of *Harrisdirect* and the weaker U.S. dollar limited revenue growth. Declining margins have also affected growth in net interest income.

Assets under Administration (\$ billions)



Assets under administration have overcome the weaker U.S. dollar and the sale of *Harrisdirect* to surpass 2004 levels.

Assets under Management (\$ billions)



Mutual fund growth drove an increase in assets under management, despite the weaker U.S. dollar.

Non-Interest Revenue (\$ millions)

For the year ended October 31	2006	2005	2004	Change from 2005	
				\$	%
Securities commissions and fees	1,051	1,092	1,055	(41)	(4)
Deposit and payment service charges	729	734	746	(5)	(1)
Trading revenues	633	413	200	220	53
Lending fees	337	313	317	24	8
Card fees	396	334	261	62	19
Investment management and custodial fees	298	305	307	(7)	(2)
Mutual fund revenues	499	437	378	62	14
Securitization revenues	100	113	177	(13)	(12)
Underwriting and advisory fees	407	357	343	50	14
Investment securities gains (losses)	145	165	175	(20)	(12)
Foreign exchange, other than trading	187	180	177	7	4
Insurance income	204	162	139	42	26
Other	255	447	276	(192)	(43)
Total	5,241	5,052	4,551	189	4

Deposit and payment service charges, which represent income earned on retail, commercial and corporate deposit accounts, declined \$5 million due to lower income from Investment Banking Group's cash management services.

Lending fees increased \$24 million, in part due to business growth. In 2005, approximately \$11 million of lending fees earned by Investment Banking Group were recorded as other revenue during the period we consolidated the VIEs.

Card fees rose \$62 million or 19%. Further refinements made to the methodology used to determine the liability associated with our customer loyalty rewards program resulted in a \$40 million reduction in credit card fees in 2005. Otherwise, the increase in card fees was driven in part by the continued success of our Mosaik® MasterCard and by the 2005 maturity of a portion of our credit card loans that were previously securitized. In the fourth quarter of 2006, we securitized \$1.5 billion of credit card loans. This is expected to reduce card fees and net interest income in 2007, largely offset by increased securitization revenues and lower provisions for credit losses.

Investment management and custodial fees declined slightly, as they were again affected by the weaker U.S. dollar.

Mutual fund revenues increased \$62 million or 14%, after having increased 16% in 2005, again reflecting volume growth and improved equity market valuations.

Securitization revenues decreased \$13 million or 12%, primarily due to lower gains on sales of loans. Securitization revenues are detailed in Note 7 on page 103 of the financial statements.

Underwriting and advisory fees increased \$50 million or 14%. Merger and acquisition fees were again sharply higher in a strong market. Higher debt underwriting fees were offset by lower fees from equity issues. On October 31, 2006, Canada's federal government announced its intent to levy taxes on income trust distributions in future years, lessening the benefits and desirability of income trust structures. The announcement may affect advising and underwriting fees in future periods but we are not able to estimate the effect at this time, as other product revenues may rise.

Investment securities gains were \$145 million, compared with \$165 million in 2005. In 2005, net investment securities gains were increased \$50 million by gains recognized on a change in accounting for merchant banking investments and \$50 million by a gain on sale of TSX common shares. In 2006, results included a \$38 million gain on MasterCard Incorporated's IPO. Unrealized gains on investment securities increased \$58 million to \$55 million.

Foreign exchange, other than trading, continued to show steady growth.

Insurance income increased 26% and now accounts for \$204 million of revenue, up 65% in the past three years.

Other revenue fell \$192 million to \$255 million, as results for 2005 included \$44 million of revenue recognized on restructuring VIEs, a \$29 million gain on sale of the First Canadian Centre Calgary tower and a \$49 million gain on sale of *Harrisdirect*.

Table 7 on page 80 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

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-Related Revenues (\$ millions)

For the year ended October 31	2006	2005	2004	Change from 2005	
				\$	%
Interest rates	204	247	204	(43)	(17)
Foreign exchange	129	89	85	40	45
Equities	173	145	152	28	19
Other	159	107	31	52	49
Total	665	588	472	77	13
Reported as:					
Net interest income	32	175	272	(143)	(82)
Non-interest revenue – trading revenues	633	413	200	220	53
Total	665	588	472	77	13

are closely managed and profit or loss from these activities is generally not the most significant factor affecting the level of trading-related revenues.

Trading-related revenues were very strong in 2006, as in 2005, but declined over the course of the year. Trading-related revenues include both net interest income and non-interest revenue. Net interest trading-related revenues were low to negative in each quarter of 2006 as the associated funding costs of the assets exceeded interest earned on them. Many of our trading assets are non-interest bearing and, net of associated funding costs, most trading revenue in 2006, as in 2005, consisted of mark-to-market gains, which are included in non-interest trading revenues.

Revenues from trading-related activities totalled \$665 million, compared with \$588 million in 2005. Trading-related revenues included net interest income of \$32 million, compared with \$175 million in 2005, and non-interest revenue of \$633 million, compared with \$413 million in 2005. The \$77 million increase in interest and non-interest trading-related revenues from 2005 was largely attributable to commodity derivatives, with solid growth in equities and foreign exchange trading revenues. Interest rate trading revenues declined from the strong results of 2005. Commodity derivatives trading revenue, which is included in Other trading-related revenues in the table above, was up appreciably due to favourable trading conditions and increased client activities associated with high volatility in energy prices. Higher trading revenues in 2006 were consistent with increased levels of trading securities (see page 57) and higher levels of Market Value Exposure in BMO's trading positions (see pages 69 and 70). Trading-related revenues were considerably lower in the fourth quarter of 2006, largely due to a reduction in commodity derivatives revenues primarily driven by reduced client activity, declines in market prices and implied volatility in crude oil contracts, and our position in natural gas contracts. These factors resulted in a small trading loss in commodity derivatives in the fourth quarter. The Market Risk section on page 69 provides further information on trading-related revenues.

Provision for Credit Losses

Credit conditions remained favourable in 2006, as BMO recorded a \$176 million provision for credit losses, consisting of \$211 million of specific provisions partially offset by a \$35 million reduction in the general allowance for credit losses. These amounts were comparable to the \$179 million provision recorded in 2005, comprised of specific provisions of \$219 million and a \$40 million reduction in the general allowance. The 2006 reduction in the general allowance was primarily due to a \$1.5 billion credit card loan securitization.

As illustrated in the adjoining table, in the current credit cycle, specific provisions for credit losses peaked in the 2001–2002 period, declined sharply in 2003 and 2004, and returned to more moderate but still low levels in 2005 that continued through 2006. The beneficial effect of lower levels of new specific provisions over the past two years has been somewhat moderated by declining levels of reversals of previous allowances and recoveries of past write-offs, which peaked in 2004. The relatively high level of reversals and recoveries in 2004 was largely due to the success of our effective loan realization practices, including strong cash collections and loan sales. Sales of gross impaired loans in 2004 were facilitated by high levels of gross impaired loans from which to effect sales, as well as a receptive secondary market. Lower levels of reversals and recoveries in 2005 and 2006 were expected at this point in the credit cycle.

In 2006, sales of gross impaired loans totalled \$53 million, with resulting reversals and recoveries of \$34 million. This compares with sales of \$102 million and related reversals and recoveries of \$22 million in 2005.

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 adjacent Changes in Gross Impaired Loans and Acceptances table. As with specific provisions, these formations peaked in 2001–2002, steadily declining thereafter to the current lows of \$423 million and \$420 million in 2005 and 2006, respectively. Partially as a result of this trend, at October 31, 2006, gross impaired loans and acceptances had declined to \$666 million, with notable reductions occurring in the communications and power generation sectors mainly in 2004 and 2005.

At October 31, 2006, the allowance for credit losses totalled \$1,058 million, compared with \$1,128 million a year earlier. The decline was attributable to improved credit quality in the performing loan portfolio, lower levels of impaired loans and acceptances and the reduction in the general allowance. The general allowance, which totalled \$905 million at year-end, remains adequate, representing 56 basis points of risk-weighted assets. In addition, BMO uses credit default swaps to mitigate single-name and sector credit exposures. At October 31, 2006, the notional value of these instruments totalled \$1,084 million, compared with \$1,274 million a year earlier.

BMO's loan book continues to be comprised largely of more stable consumer and commercial portfolios that, excluding securities borrowed or purchased under resale agreements, represented 83.1% of the loan portfolio at year-end, compared with 86.7% in 2005. We continue to monitor those industry sectors considered to be of most concern in the current economy, including automotive and forestry, as well as those sectors particularly sensitive to high energy prices, a strong Canadian dollar and a softening of the U.S. economy. BMO's exposure to these sectors remains well within acceptable levels.

Looking forward, we expect the credit environment to remain relatively stable in 2007, with potential weakness developing in the latter part of the year. This outlook is based on our expectations of continuing low corporate default rates, low levels of impaired loan formations and relatively stable economic

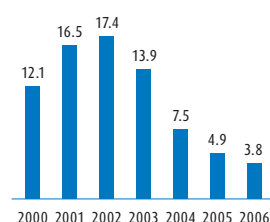
Provision for (Recovery of) Credit Losses (PCL) (\$ millions, except as noted)

For the year ended October 31	2006	2005	2004	2003	2002	2001	2000
New specific provisions	410	407	510	846	1,063	1,023	458
Reversals of previous allowances	(87)	(121)	(312)	(303)	(175)	(103)	(124)
Recoveries of prior write-offs	(112)	(67)	(131)	(88)	(68)	(40)	(44)
Specific provisions for credit losses	211	219	67	455	820	880	290
Increase in (reduction of):							
General allowance	(35)	(40)	(170)	–	–	100	110
Country risk allowance	–	–	–	–	–	–	(42)
Provision for (recovery of) credit losses	176	179	(103)	455	820	980	358
PCL as a % of average net loans and acceptances (%)	0.09	0.11	(0.07)	0.30	0.56	0.66	0.25

Changes in Gross Impaired Loans (GIL) and Acceptances

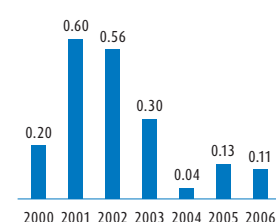
(\$ millions, except as noted)	2006	2005	2004	2003	2002	2001	2000
GIL, beginning of year	804	1,119	1,918	2,337	2,014	1,501	1,092
Additions to impaired loans and acceptances	420	423	607	1,303	1,945	2,041	1,106
Reductions in impaired loans and acceptances	(220)	(319)	(936)	(1,156)	(738)	(830)	(446)
Write-offs	(338)	(419)	(470)	(566)	(884)	(698)	(251)
GIL, end of year	666	804	1,119	1,918	2,337	2,014	1,501
GIL as a % of gross loans and acceptances (%)	0.35	0.46	0.71	1.30	1.54	1.37	1.04

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



Lower impaired loans and higher equity have led to ongoing improvements in BMO's credit condition.

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



Provisions remain low, as favourable credit conditions continue.

conditions across North America. Accordingly, we expect the 2007 provision for credit losses to be \$400 million or less, with the increase over the current year largely related to the credit cycle and an expectation of increasing levels of new specific provisions and lower levels of reversals and recoveries.

Credit risk management is discussed further on page 68. Note 4 on page 100 of the financial statements and Tables 11 to 19 on pages 84 to 87 provide details of BMO's loan portfolio, impaired loans and provisions and allowances for credit losses.

Non-Interest Expense

Non-interest expense increased \$21 million or 0.3% to \$6,353 million. The factors contributing to the 0.3% increase are set out in the Contribution to Non-Interest Expense Growth table.

As explained on page 35, the net effect of businesses sold and acquired in 2006 and 2005 reduced expenses in 2006 relative to 2005 by \$214 million (-3.1%). The reduction was due to the October 2005 sale of *Harrisdirect*, our U.S.-based direct investing business. As further explained on page 35, the lower Canadian/U.S. dollar exchange rate reduced costs in 2006 by \$112 million (-1.6%). Excluding solely the sale of *Harrisdirect* and the weaker U.S. dollar, expense growth was 6.1%. Higher performance-based compensation costs increased overall expenses by \$45 million (0.6%). This increase was attributable to Investment Banking Group, where fee-based revenues, which typically have relatively higher variable costs, were strong compared to 2005. Revenues in interest-rate-sensitive businesses, which typically have relatively lower variable costs, were lower in 2006. Generally speaking, the other operating groups had lower performance-based costs in 2006. Other factors include remaining business-based costs and increased overall expenses in 2006 by 4.4%.

The dollar and percentage changes in expenses by category are outlined in the Non-Interest Expense table. Table 8 on page 81 provides more detail on expenses and expense growth.

Other employee compensation expense includes salaries and employee benefits, and was \$28 million higher. Salaries expense was unchanged from 2005 and has been relatively stable over the past five years, as the number of employees did not change significantly through 2005 (see page 80) and performance-based compensation and employee benefits costs have increased in significance in recent years. Severance costs were lower and the sale of *Harrisdirect* and the weaker U.S. dollar have also helped keep cost increases in check. Our staff levels increased by close to 1,200 in 2006 due to the addition of front-line staff in P&C Canada, business growth, acquisitions and initiatives. Expenses included P&C Canada initiatives such as the expansion of our sales force, further investment in the physical distribution network, including replacing almost the entire ABM network, and enhancement of technology for front-line sales and service representatives to increase capacity and improve customer service. In P&C U.S., there were acquisition-related expenses, costs of new branch expansion, costs associated with volume increases and expenses of implementing our new technology platform. In Private Client Group, there were increased investments in our sales force and U.S. investment management business.

Premises and equipment costs decreased \$53 million. Rental costs increased but were partially offset by reductions in depreciation of furniture and fixtures and property tax expense, as in 2005 we sold two properties we continue to occupy. Computer and equipment costs declined due to the sale of *Harrisdirect*. Other expenses increased \$51 million. There were higher professional fees due to consulting services that supported development, our plans for future changes in work flows to achieve cost reductions and other initiatives in 2006, as well as increased legal fees related to business activities. The amortization of intangible assets decreased due to the sale of *Harrisdirect*.

Productivity

The expense-to-revenue ratio (productivity ratio) improved by 77 basis points to 62.8% in 2006. 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 has typically been quite different because of the nature of their businesses. However, the ratios have been converging, as Private Client Group has made significant productivity improvements while a changing revenue mix has increased Investment Banking Group's productivity ratio. In 2006, as in 2005, both P&C Canada and

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 34.

The **cash productivity ratio** is calculated in the same manner, after removing the amortization of intangible assets from non-interest expenses. See page 34.

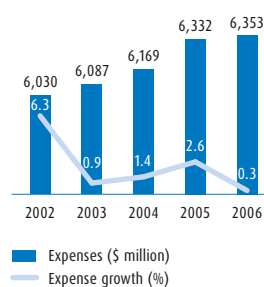
Contribution to Non-Interest Expense Growth (%)

For the year ended October 31	2006	2005	2004
Businesses sold/acquired	(3.1)	0.8	1.8
Currency translation effect	(1.6)	(2.3)	(3.0)
Performance-based compensation	0.6	1.9	1.7
Other factors	4.4	2.2	0.9
Total non-interest expense growth	0.3	2.6	1.4

Non-Interest Expense (\$ millions)

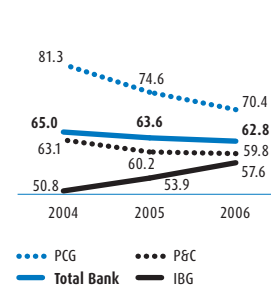
For the year ended October 31	2006	2005	2004	Change from 2005	
				\$	%
Performance-based compensation	1,322	1,277	1,160	45	4
Other employee compensation	2,502	2,474	2,484	28	1
Total employee compensation	3,824	3,751	3,644	73	2
Premises and equipment	1,211	1,264	1,252	(53)	(4)
Other	1,274	1,223	1,169	51	4
Amortization of intangible assets	44	94	104	(50)	(53)
Total	6,353	6,332	6,169	21	-

Expenses and Annual Expense Growth



Expense growth was low, but was 6.1% excluding the impact of the sale of *Harrisdirect* and the weaker U.S. dollar.

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



Productivity improved again in each group except IBG, which was affected by its revenue mix.

Private Client Group excluding *Harrisdirect* increased revenues more than expenses, in both absolute and percentage terms, thereby improving their productivity ratios.

P&C Canada is BMO's largest operating segment, and its productivity ratio of 56.8% improved by 74 basis points from last year, after having improved by 311 basis points in 2005. The productivity improvement resulted in part from the increase in customer loyalty card reserves in 2005 and the gain on the MasterCard IPO in 2006. Private Client Group productivity improved by 421 basis points to 70.4%. Excluding the sale of *Harrisdirect* and gains on asset sales in 2005, the ratio improved by 219 basis points, reflecting strong revenue growth and continued effective expense management. The productivity ratio in P&C U.S. deteriorated by 184 basis points because of investments

in integrating acquisitions, branch expansion, costs associated with volume increases and improving the branch technology platform. Investment Banking Group's expense-to-revenue ratio deteriorated by 369 basis points to 57.6%. The change was due in part to a further shift in the revenue mix toward businesses with higher variable costs as well as VIE revenues included in 2005 results. Investment Banking Group's productivity ratio was the second best in its peer group in both 2005 and 2006.

We improved BMO's overall cash productivity ratio in 2006 by 25 basis points to 62.4%, after having improved the ratio by 538 basis points over the three previous years. We fell short of our annual target of improving enterprise-wide productivity by 100 to 150 basis points due to a change in our business mix as well

as continued investment in our retail businesses to achieve future earnings growth.

Additional examples of initiatives to enhance productivity are outlined in the 2006 Review of Operating Groups Performance, which starts on page 42. In 2007, we are targeting to improve our cash productivity ratio by 100 to 150 basis points. We plan to achieve this by driving revenues through an increased customer focus, by ongoing expense management, and by working to create greater efficiency and effectiveness in all support functions, groups and business processes that support the front line. While specific measures have not yet been determined, we expect workforce reductions, primarily in non-customer-facing work groups.

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 taxation by tax authorities, with the exception of the repatriation of retained earnings from foreign subsidiaries, as outlined in Note 23 on page 124 of the financial statements.

As explained on pages 34 and 36, BMO adjusts revenue to a taxable equivalent basis for analysis, with an offsetting adjustment to the provision for income taxes. The adjustment was \$127 million in 2006, up from \$119 million in 2005. Unless indicated otherwise, the provision for income taxes and associated tax rates are stated on a taxable equivalent basis in this MD&A.

The provision for income taxes charged against earnings was \$844 million, compared with \$993 million in 2005. In 2006, there were recoveries of prior years' income taxes, including \$26 million of recoveries in the third quarter. There were \$66 million of recoveries in 2005. The effective tax rate in 2006 was 23.6%. The low effective rate was due to tax recoveries as well as business-based initiatives and the favourable resolution of certain tax matters. The effective tax rate in 2005 was 28.8%. In 2005, there was a high tax rate on the gain on sale of *HarrisDirect*, primarily due to tax elections, and \$29 million of non-taxable revenue from restructuring VIEs. The components of variances between the effective and statutory Canadian tax rates are outlined in Note 23 on page 124 of the financial statements.

Excluding any special adjustments, we expect that the effective tax rate in 2007 should be 25% to 28% 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 \$451 million gain on hedging our net investment in U.S. operations in 2006 was subject to an income tax charge of \$156 million recorded in retained earnings, compared with a \$297 million gain on hedging and a \$101 million income tax charge in 2005. Refer to the Consolidated Statement of Changes in Shareholders' Equity on page 94 of the financial statements for further details.

Table 8 on page 81 details the \$1,283 million of total government levies and taxes incurred by BMO in 2006.

Non-Controlling Interest in Subsidiaries

Non-controlling interest in subsidiaries increased \$18 million to \$76 million in 2006, primarily due to the issuance of \$450 million of BMO BOATS[®], Series E, in late fiscal 2005.

Note 18 on page 116 of the financial statements provides more detail on non-controlling interest in subsidiaries.

Transactions with Related Parties

In the ordinary course of business, we provide banking services to our joint ventures and equity-accounted investees on the same terms that we offer to our customers. A select suite of customer loan and mortgage products is offered to our employees at rates normally accorded to our preferred customers. We also offer employees a subsidy on annual credit card fees.

In addition, we provide certain banking services to entities that are affiliated with our directors. We offer these services

on the same terms that we offer to our customers. Stock options and deferred share units granted to directors are discussed in Note 26 on page 128 of the financial statements.

Preferred rate loan agreements are discussed in Note 26 on page 128 of the financial statements. There were no amounts advanced under these preferred rate loan agreements in 2006 or 2005.

The foregoing Provision for Credit Losses, Non-Interest Expense and Provision for Income Taxes sections and the following 2006 Review of Operating Groups Performance and Quarterly Earnings Trends sections of this Annual Report contain certain forward-looking statements, in particular regarding our outlook for certain aspects of the Canadian and U.S. business environments in 2007, our productivity ratio, effective income tax rates and our strategies and priorities for 2007. By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties. Please refer to the Caution Regarding Forward-Looking Statements on page 28 of this Annual Report for a discussion of such risks and uncertainties and the material factors and assumptions related to the statements set forth in such sections.