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PRESENTATION

Operator

Welcome to EQB's Second Quarter Analyst Call and Webcast on August 10, 2022.

It's now my pleasure to turn the call over to Richard Gill, Vice President, Corporate Development and Investor Relations at EQB. Please go ahead, Mr. Gill.

Richard Gill - *EQB Inc. - Senior Director of Corporate Development & IR*

Thanks, Pam, and good morning. Your hosts today are Andrew Moor, President and Chief Executive Officer; Chadwick Westlake, Chief Financial Officer; and Ron Tratch, Chief Risk Officer.

For those on the phone lines only, we encourage you to log on to our webcast as well to see our accompanying slide deck, including Slide 2 containing EQBs caution regarding forward-looking statements, and Slide 3 concerning non-IFRS measures. All figures today are adjusted or applicable or otherwise noted.

It's now my pleasure to turn the call over to Andrew.

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

Thanks, Richard, and good morning, everyone. This is our first earnings call under our EQB umbrella, reflecting our shareholder approved name change from Equitable Group. EQB is a name that we think dovetails perfectly with our Challenger Bank image, and we look forward to socializing it with our shareholders.

For our core operations, Q2 performance was one for the record books. Conventional loan growth increased 36% year-over-year. Net interest income was up 18% compared to last year. Thanks to effective margin management by our treasury team, NIM was strong and consistent with our own guidance. We performed in line with our own industry-leading track record on credit, and we had added thousands of new EQ Bank customers. In short, all the things you've come to expect from Canada's Challenger Bank. And yet this was a tough quarter report. Despite taking a by the book approach to achieve and ultimately deliver strong core earnings growth, our efforts then in Q2 were offset by mark-to-market declines primarily in our strategic investment portfolios due to a downdraft in North American equity markets.

What we've loaned by participating alongside really smart fintech invest entrepreneurs since our first strategic investments over 5 years ago is incredibly valuable to the advancement of our Challenger Bank approach and our all digital platforms. As part of this capital allocation, we invested in fintechs for knowledge and access, not for investment gains. One of the focus, we have had the benefit of positive mark-to-market P&L gains on some of these investments over the past few years and continue to generate a very strong ROE on our portfolio. The strategic investments in Q2 -- Q1 2022, we booked a gain of CAD 15.9 million, but in the second quarter, we had a partial reversal of some of those gains, lower revenue overall for Q2. Chadwick will have more to say about these fair value and mark-to-market adjustments. He will talk from some of the 6 months year-to-date highlights, including North Star ROE performance of 15.6% and the benefit of funding diversification, including our now nearly CAD 900 million European common bond program.

For my part, I'm going to share thoughts on what you can expect from a performance (inaudible) effective for the balance of the year, lots of positives in my estimation. I'll talk about the tactical adjustments made to respond to heightened economic and market risk. For our Q&A, Ron will contribute his subject matter expertise as we did in our Investor Day, a recording of which is available on our website and worth referencing for more information on mature and proven risk management strategies.

Turning to our outlook, I will say that performance, including conventional asset growth of 36% year-over-year across our core personal and commercial lines, puts us on track to achieve our earnings guidance for 2022. This guidance envisions NIM -- consistent NIM, 8% to 10% adjusted EPS growth over 2021, and adjusted ROE of 15% plus. Asset growth in 1 quarter creates natural earnings momentum in ensuing quarters. We're confident in confirming our guidance because when we published it, we assumed that market activity would moderate during our forecasting horizon. And because our conventional asset growth was well ahead of guidance over the first half of 2022 in virtually all parts of the bank.

To get deeper into outlook, we do expect the 4 increases in the Bank of Canada's overnight rate since March, with more to follow as early as September, will reduce activity in property markets in the second half of 2022. Luckily, we've seen a variety of market forecasts, all point to sales volume declines of varying proportions. While those forecasts and our own risk appetite suggests that origination in our Personal and Commercial Bank segments will most likely reduce from last year, I think context is important. We expect a reduction compared to the very strong originations posted in the first -- in the past few quarters in both segments. But even with that, we expect to achieve on guidance conventional portfolio growth by the time our books closed on December 31st. As a reminder, that guidance is a 10% to 15% growth in conventional commercial loans and 12% to 15% growth in conventional personal loans compared to December 2021. In my view, this is all doable in the context of the outlook for the housing markets supported by our team's performance in the first half of the year.

Looking at recent performance, our alternative single-family business certainly set a high bar. We bested annual guidance so far with portfolio growth of 35% year-over-year. These results included a 6% increase in Q2 alone, was driven by higher originations and a decline in loan attrition. Respect to our market share position in the broker channel, supported by a fundamental focus on good service augmented by our new Equitable Connect broker bottle, will also play to our advantage in securing the high-quality origination opportunities that we covered in a tighter market.

In the period of greater housing market stability will challenge today's home loans with a mortgage. But the case can certainly made a strong employment opportunities for Gen Y and Z cohorts, rising immigration and shortage of housing stock in our regions focus will provide the support the market needs to be healthy in future years.

As Ron told you at Investor Day, our risk appetite is designed for the long term, and we are prudent bankers and risk on and risk got environments alike. The risks we see today include the Bank of Canada's response to elevated inflation and our expectations of changing collateral values. Accordingly, the assets we put on the books in recent quarters adjudicated such that the average LTV on the bank's uninsured residential mortgage portfolio was 57% at the end of June. While health price declines would naturally cause that ratio to increase, we still have plenty of protection. That said, and to be prudent, we ratcheted back on LTVs in certain areas, suburban areas in Ontario. Adjusted debt service coverage ratios on certain mortgage products, and we're taking a more cautious view to refinancings.

To be clear, these are tactical moves consistent with our past practice, not wholesale changes in our already sound approach. The fundamental factor that works in our favor at Downmarket is that we land in large urban areas which are buttressed by forces such as population growth and diversified sources of employment. The outlook for the accumulation business is very positive. We continued gain profile of market share in assets. Year-over-year, our reverse mortgage portfolio grew nearly 2.5x to CAD 421 million and 38% in the second quarter alone, with June being our best month for originations yet. While this business is not as closely correlated to housing market trends of single family, we also made tactical moves to tap up our reverse mortgage lending approaches.

Portfolio growth in insurance lending amounted to 95% year-over-year and a very solid 24% in Q2 itself. While trending a little below our 100% 2022 growth guidance, we believe we can end 2022 on or above target as we gain strength from partnerships with 9 leading life insurers. On the commercial bank side, total asset growth year-over-year was 25% and 11% in the quarter, which puts us well ahead of annual guidance. Every part of our commercial business expanded year-over-year and sequentially. I'm particularly pleased with recent growth in our Commercial Finance Group, specialized finance and equipment leasing portfolios. Looking ahead, we do expect the pace of conventional commercial originations to slow in the second half, but we also anticipate lower loan attrition than we've seen in recent quarters. We expect to meet annual guidance for asset growth.

When we think of the many positives of running a diversified commercial bank, a top consideration is our strong position in the partner lending. Apartments are an attractive source of housing for many Canadians and will continue to be in the event of a recession. This asset class has also experienced rapid rent depreciation and lower vacancies. Another positive is our multiunit insured mortgage business. Year-to-date, you would have seen that we have grown the portfolio by 15%, outpacing guidance for the full year of 0% to 5%. We expect our performance to continue in the final half of 2022 and some technical dynamics in the marketplace will act to strong tailwinds.

From a risk management perspective, the commercial team and frankly, our own customers dialed back on construction lending and demand for such products earlier this year in order to be prudent while there is a greater uncertainty around the cost of finished products and in the online collateral values. In Equipment Leasing, we continue to shift the portfolio in favor of high credit quality business. 2/3 of new assets in our Bennington book are comprised of prime leases, and we are focused on more economically resilient business sectors with overall excellent margins and ROE well above our 15% target. Challenger Bank has committed to long-term growth and proactively next move is to adjust its risk appetite. These changes are fundamental to our reputation as an institution with much lower loan losses than our peers, a reputation that was reinforced over the first half of 2022, with related loan losses of just CAD 2.4 million on a portfolio of CAD 40 billion plus. The levels of arrears are the lowest in my entire 15 years as CEO of Equitable.

An important reminder also is that under IFRS 9 rules, when a bank originates new business, we book new provisions. With our high growth in originations of CAD 4.5 billion in Q2, these provisions were also naturally higher in Q2, even though losses may not ultimately be realized. The majority of small losses that we actually did incur were within our leasing portfolio, which is where we expect to see them with the offset and the returns are much higher with this form of lending. As you heard at Investor Day, we never sacrificed loan quality or comprise risk management for growth. Each and every transaction must meet our stringent lending criteria.

While preparing for new market reality has been an obvious priority, we have not lost a single step in moving forward on all the exciting initiatives you heard about at Investor Day. I'll mention just a couple as it relates to EQ Bank. We're introducing our payments card this fall, a move that will invite our customers to use our all-digital platform as their primary bank as well as a great place to save. The difference between these 2 realities is a whole lot more functionality for EQ customers who will be able to pay wherever MasterCard is accepted. We're also looking forward to the full launch of EQ Bank in Quebec, a move that will leverage our proven technology to bring a differentiated value proposition to a large digitally savvy population.

Equitable Bank has a really good customer following in Quebec through our brokered deposit and broker mortgage businesses. Our presence there for over a decade should give our early marketing efforts a boost. These 2 advancements will allow us to build back EQ Bank's recent momentum, which featured year-over-year growth in our customer base of 26%, including over 13,000 new customers in the second quarter. Another 5,000 Canadians joined us during July alone. Of equal importance, there now more than 285,000 Canadians at the end of July, the trust that banking is to EQ are using the platform more than ever. Digital transactions increased 7% in the second quarter and we saw continued growth in products held by each customer. While doing great value to EQ customers, EQB has benefited from improved economics as customer lifetime value grows while customer acquisition costs remained stable.

Thinking about the deposit market generally, rising interest rates should act as a catalyst for continued growth in demand for saving solutions, particularly of those offered by Canada's Challenger Bank through EQ Bank, but also within the rest of our now CAD 15.9 billion deposit business. Rising interest rates have caused investors to take a much more active interest in GICs with issuances through the major broker platform, up more than 2.5x in June 2022 compared to the same month last year. The significant increase in liquidity in GIC market is certainly encouraging for our approach to business.

Our outlook would, of course, would not be complete without mentioning how much we look forward to completing the acquisition of Concentra Bank. As you saw in the quarter, we received unconditional clearance from the competition bureau of Canada, so a good check mark there in terms of ongoing regulatory review. As that process proceeds, our transformation management office continues its important work with the help of Concentra's team to ensure that we hit the ground running quickly and bringing our 2 organizations together. The scale impacts and opportunity benefits are significant and we're excited by what we can do together, deliver value for customers, including credit unions and all EQB stakeholders.

While it's important for you to know that our performance prospects remain strong as we are managing for heightened risks in the housing market, you should also know that all eyes remain on task with respect to produce industry-leading returns on equity. As a result of our risk management approach, we will continue to lever confidence in this rising interest rate environment and achieve our traditional 15%-plus ROE when the book flows on the year, adjusted for Concentra costs closing and integration costs. It's too early to put a pin on the wall on 2023 guidance. But as with last year, we will offer initial guidance together our Q3 results in November.

I'm also pleased to note that EQB shareholders can now look forward to the third dividend increase of 2022 (inaudible) increase of 7% sequentially or 68% year-over-year is in keeping with our long-term commitment to grow our dividend while reinvesting an attractive ROE. As CEO, I see one of my major accountability is being to ensure that we reach our longer-term goals by allocating capital in a disciplined manner, such as EPS and book value per share grow at a compound rate of over 15% annually. Though not every year, will always be consistent towards our 5-year average targets. We shared our economic value, a model at our recent Investor Day, but to reinforce what I said, 15% annual compounding takes us towards an EPS of 18%, 20% and 2027, a book value of CAD 127.98 and a dividend of around CAD 4 using 2022 consensus estimates at the baseline.

The recent quarterly results give me more confidence than ever that this is achievable, although we're going to have to hustle hard, to work hard to get there. To summarize, I'm confident in our ability to build value for our shareholders in the quarters ahead as we're able to reinvest in our many businesses to create consistent compounding capital.

Now over to Chadwick.

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Thanks, Andrew. Our bank entered and exited the first half of 2022 with strong capital and liquidity, resilient margins and strategic momentum. As Andrew said, we are again confirming our earnings guidance for the year, which takes into account core, personal and commercial banking business performance year-to-date, including net interest income and fee-based income growth. Our expectations for continued risk-managed expansion in our conventional lending portfolio as well as the current and quickly evolving market sentiment on Canadian housing, inflation and rising rates. There are 2 distinct areas to cover this quarter with core and noncore considerations. Core performance remains strong and stable, positioning us well for the rest of 2022 and into 2023. While not core earnings, part of our broader strategy does include priorities that have an impact on our quarterly noninterest income, including realized and unrealized changes in the value of strategic investments as well as fair valuing certain securities through the P&L to offset fair value changes in derivatives.

Given these mark-to-market and fair value adjustments were a sufficiently large outlier for us in Q2, I'll first start with additional clarity here before moving to comments on our earnings engine that is progressing well to annual guidance. For the CAD 2.5 million net loss we booked in noninterest income in Q2, you can see the reconciliation on the slide in the Q2 investor presentation and in our MD&A. There are 3 main drivers to consider for reconciling noninterest income in Q2.

First, fee-based growth, which we view as core revenue. At CAD 7.9 million in Q2, this is up a solid 41% year-over-year. It's a priority to continue to grow this revenue over coming years as we comment on regularly through new products and services. Then there are 2 sides to the coin for how you can look at the negative offsets in the quarter. It's important because of these types of offsets. While I say regularly, we don't manage for the quarter, but we do set targets and expectations for the average across quarters in the short term and most importantly, for the medium term. First side of the coin is the strategic investments. You can think of this as around 2/3 of the negative net impact for Q2. This line item was marked down through the P&L by about CAD 8.7 million in Q2 with unrealized losses. With corresponding gains booked of a positive CAD 15.9 million in Q1, we remain at a net gain year-to-date of CAD 7.2 million. To add even greater transparency, we started reporting the strategic investment line more clearly as of the Q2 2021 MD&A.

Even after including the negative impact in Q2, we booked cumulative gains of nearly CAD 20 million on these investments over the past 4 quarters. I indicated at our Investor Day that I expected strategic investments to come down for at least a quarter or 2 from Q1 2022 levels. And that's exactly how it played out, consistent with the significant declines in North American equity markets and also private market corresponding write-downs. This includes an investment such as Portage funds, Framework Venture funds and WealthSimple. We continue to be enthusiastic about these investments. And to repeat what Andrew said again, we don't actually make these investments for the gains, but we do generate well above target ROE notwithstanding on. There is potential for further moves up and down on a mark-to-market basis in coming quarters. This is the volatility that comes with accounting treatment of recognizing changes through the P&L regularly even when they're unrealized.

Then the other side of the coin is primarily the impact of fair value gains and losses on derivative financial instruments. This comes back to accounting treatment and includes the treatment of cost of funds, hedging and CMB swaps. Unlike items such as changes in the value of strategic investments, gains and losses on derivatives used for hedging often reflect timing mismatches, where income or expense recorded in any period will be reversed over the life of the derivatives. There are a couple of lines on net out in the MD&A, but as you see in the slide in our investor presentation, you could view these generally as a net fair value negative adjustment of CAD 3.9 million in Q2.

Our hedging has been effective at reducing interest rate risk and reinvestment risk, but again, can be impacted in a particular quarter when there were very significant shifts in interest rates. From an outlook perspective, we do not forecast the impact of mark-to-market or fair value adjustments in our guidance given the variable and noncore nature. I'll also make note of gains on sale from securitization activities, which are booked under noninterest income. These are expected to normalize and improve from Q2. But I'll caution as always that these gains fluctuate from period to period based on volumes you recognized, which are driven by consumer preferences. Diversifying and increasing noninterest income by growing fee-based and other income with new products and services is part of our core business strategy and will provide long-term benefits and stability to this revenue line. This growth will be very positively accelerated upon closing our agreement to acquire Concentra Bank.

Now turning back to the core business of EQB. Performance was strong in both the quarter and for the first 6 months of 2022. This reflects disciplined risk-managed capital allocation in a fluid but generally constructive economic environment. As usual, and as Richard noted upfront, all the numbers I quote are the adjusted numbers we publish, which exclude Concentra Bank related acquisition and integration costs. At CAD 167.6 million, quarterly net interest income was ahead of Q2 last year by 18% and up sequentially from Q1 by 3% on strong stable margin performance. While core revenue was of the usual high-quality and personal and commercial business lines grew sequentially compared to Q1, the marks and accounting treatment of fair value adjustments are referenced under noninterest income resulted in total revenue still up 4% year-over-year in Q2, but down 12% sequentially, resulting in diluted EPS of CAD 1.75 for Q2 with ROE at 12.1%.

Even with that, diluted EPS for the first half of 2022 was still record-setting at CAD 4.40 per share, 10% above last year at the top end of our 8% to 10% growth guidance, and ROE landed at 15.6% year-to-date. That's aligned with our historical ROE average and on target for the year's guidance of 15% plus. Book value per share increased 16% to a record CAD 59.5 per share, well ahead of full year guidance of 12% growth. Now Andrew already profiled a strong growth in our lending portfolio, so I'll move right to providing comments on our sources of funding, where the story is equally positive.

During the quarter, we completed our second European covered bond issuance, this time in the amount of EUR300 million and a spread of 20 basis points over euro/mid-swaps, meaning from a comparison to GIC pricing, relative pricing on our second issuance was even better than our first. Based on the timing, the benefits of this second issuance won't be fully flowing through the quarterly results yet. Our capacity for covered bonds will further increase with Concentra Bank and we may proceed with another issue for the end of 2022. Our broker deposit business expanded again to CAD 12.8 billion, with double-digit year-over-year increases in both term and demand deposits. Volumes in this channel are exceptionally high based on customer preferences for GICs, also corresponding to the selloff in equity markets. While this will continue to become a lower relative proportion of our funding stack over time, the opportunity for broker deposits has been excellent in 2022. And as Andrew profiled, EQ Bank showed strong growth in customers and all measures of engagement. We expect it will perform the guidance by the end of 2022.

Moving to our NIM or net interest margin, our 2022 guidance was for consistent to moderate expansion in NIM from the 1.81% at the end of 2021. Trending to date is right on point. In Q2, NIM was 1.81% and year-to-date stood at 1.84%. We see the positive effects of the asset mix shift towards higher-yielding conventional loans on a year-over-year basis, although this was offset by a couple of factors, including an expected decline in prepayment income. We profiled in-depth, how we manage margin and the ROE on every dollar we lend and invest at our June Investor Day with great details shared by our world-class Treasurer, Tim Sharon. I encourage you to listen to my finance update section and the playback on our Investor Relations website if you haven't had the chance yet for this content. In a rising rate environment, our margin strength and potential is also being enabled by the scale of our EQ Bank deposits with our everyday savings account. This has proven to be the best digital bank in Canada, plus a great source of lower cost, diverse funding with margin expansion contribution.

Moving to expenses, or again, what we view as our investments in the bank. In Q2, we continued to invest in people, process and platform innovations. With core revenue growing at double-digit pace, noninterest expenses were up 16% year-over-year. Normally, this would allow us to achieve a trending of positive operating leverage. However, the marks against our noninterest income within Q2 reduced revenue, thereby inflating efficiency for the quarter to 45.8%. The impact was not so dramatic on a year-to-date basis when efficiency was 41.1%. If noninterest income was more normalized to recent trending, efficiency would have remained tight to our 40% average range.

Expense growth in Q2 year-over-year was mainly due to a 24% increase in compensation and benefits as we expanded our FTE by 29% to over 1,300 Challengers. Expense growth generally reflects our focus on acquiring the best talent, including in both banking and technology and compensating our top talent accordingly. This momentum and growth will slow in the second half of 2022. For process, including our corporate and marketing categories, expenses were up 10% year-over-year on a combination of factors, including campaigns promoting our new and growing offerings in reverse mortgage and insurance lending and building the EQ Bank brand in the Canadian marketplace. In platform, product costs and technology were up 13% year-over-year and 1% quarter-over-quarter.

Baked in here is amortization of investments for projects completed over the past 12 months and a continued increase in innovation investments as we prepare for more product and service enhancements. Looking ahead, we expect relative expense growth to be lower compared to the growth in the first half of 2022. We will actively manage our investments in the bank accordingly towards our general target of approximately flat operating leverage on an annual basis. Again, that excludes costs associated with our agreement to acquire Concentra Bank.

All integration-related spending remains on target. As a reminder, the integration expense budget we communicated at the onset was CAD 45 million to CAD 50 million, which relates back to our previously communicated goal of generating mid-single-digit EPS accretion within the first year of closing the acquisition. In the quarter, these costs were CAD 3.6 million or CAD 0.08 per share after tax. CAD 2.7 million of that was specifically for acquisition and integration-related expenses and the rest was the dividend equivalent amount paid to subscription receipt holders in accordance with the terms of the offer, which shows up as an interest expense until those roll into common equity. Corresponding updates on our expectations on transaction synergies will be provided following the closing, including updated guidance for EQB.

On the next slide, you can see the trend line for credit metrics. Another great chapter in EQB's long history of prudence and risk management responsiveness. Andrew mentioned the low level of realized loan losses in the quarter, which is an outcome of our approach and the health of the economy. Following 5 consecutive quarters of net PCL benefit booked due to improving macroeconomic variables, in Q2 we resumed a more normal pattern and booked a PCL expense of CAD 5.2 million. The majority of this PCL expense in Q2 reflects the growth in our business with higher Stage 1 and a shift in macroeconomic variables in our models that contributed to higher stage 2. However, the Stage 2 is not a result of higher delinquency.

Net impaired loans contributed a small amount, but over a third of that NPL relates to one loan where we don't expect to take a loss. Net impaired loans declined to 18 basis points of total loan assets compared to 22 basis points at March 31 and 41 basis points a year ago. The improvement over the last year reflects a reduction of CAD 36.7 million in conventional commercial loans, CAD 17.5 million in single-family mortgages and a CAD

2.7 million reduction in equipment leases. The 4 basis point sequential improvement reflected the full discharge of one delinquent commercial loan.

EQB remains well reserved with allowances as a percentage of total own assets at 14 basis points at quarter end. This is lower than 19 basis points a year ago, but in line with pre-pandemic rates. In coming quarters, PCLs are expected to be consistent with Q2 levels, assuming current economic forecasts proved to be accurate and borrow behavior is consistent with what our credit loss models anticipate. Excluding PCLs as a consideration, our 2022 guidance for pre-provision pretax earnings growth was 12%. Year-to-date, we're precisely on target at 12%.

Moving to capital. Our current CET1 level of 13.5% means we continue to operate at the top end of all bank peers in the S&P TSX Composite Index, and we remain ahead of our 2022 guidance of 13% plus. This stability reflects a combination of organic regulatory capital growth and a capital investment in Equitable Bank funded through EQB's funding facility established in Q1, offset by conventional loan growth and corresponding risk-weighted assets. Risk-weighted asset growth does remain above our target level of around 15% on average across years, and Q2 was up 29% year-over-year to about CAD 14.7 billion. This higher RWA growth is all within our risk appetite framework. With actions we've taken and our expectations for the portfolio of coming quarters, we do see a general return to our targeted range over time. Upon closing the Concentra acquisition, we expect to continue a CET1 ratio of 13% plus.

To summarize, core business performance was strong in Q2 and the momentum created in all lending positions us to deliver our 2022 guidance. We're attuned to changing risk dynamics and have adjusted our underwriting to protect shareholder capital such that we have confidence in lending in this environment. Our messages at our June Investor Day are the anchor point. We're continuing to build a bank that we expect will generate 15% to 17% ROE on average over the next 5 years and beyond, same as the past 10 years. We're building innovative products and services for Canadians. We're bringing needed and significant change to Canadian Banking to enrich people's lives. We're building technology capabilities distinct from all peer banks in Canada, and our business model is built and proven to perform across all economic cycles. We don't manage to the results in a quarter, but we are very thoughtful about our guidance across an average of quarters. I again encourage you to check out the June Investor Day replay posted on our Investor Relations website if you haven't had the chance.

Pam, can you now please open the line for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question. first question comes from Meny Grauman with Scotiabank.

Meny Grauman - *Scotiabank Global Banking and Markets, Research Division - MD of Financial Services Equity Research & Analyst*

A question on originations, they beat expectations. Is there any color in terms of the timing as the quarter went on? Did you see a more pronounced slowing towards the end of the quarter? And then if you could talk to what you're seeing early in Q3, if there's anything notable there in terms of the pace of originations?

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

Meny, I think applications is obviously predates closing. So we continue to see strong closings in loans right through quarter end. And we've definitely seen a bit of a slowdown continuing in terms of new applications through July here. But there's still a bit spotty. I think yesterday was similar to the prior year. So it's definitely not entirely consistent. There's definitely activity in the real estate market contrary to some of the -- some of the commentary we're reading, but we are seeing a bit of a slowdown to start the quarter.

Meny Grauman - *Scotiabank Global Banking and Markets, Research Division - MD of Financial Services Equity Research & Analyst*

And are there any portfolios in particular and any specific loan categories or sort of any way to focus on areas that are weakening more than others? Or if you could highlight anything more specific in terms of where you're seeing more weakness compared to the broader book.

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

Yes. I mean, let's start the strengths as well. So we continue to see the priorities in the West generally seem to be bucking the trend of it, which perhaps you would expect with improved commodity markets there. And this is a bit of a negative going back 5 years ago for Equitable. So showing the strength of standing into those markets. As is widely reported in the press, the slowdown is probably mostly around the Ontario markets, which is obviously a critical market for the whole country and for us.

Meny Grauman - *Scotiabank Global Banking and Markets, Research Division - MD of Financial Services Equity Research & Analyst*

In terms of -- Andrew, you talked about tactical moves in the mortgage book, including adjusting LTVs in some areas. Can you just give us a little bit more color in terms of where you're making those changes? And maybe clarify what's driving you to make those changes? Are you seeing certain dynamics that you don't like? Or is this more about being proactive?

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

Yes, I think we always trying to be proactive, Meny, and sort of think through how consumer preferences might be changing. So you get a few things going on, obviously, on interest rates rising, but you also got the pandemic kind of moving more into the rearview mirror. So the view is that -- and we saw asset prices or house prices moving upwards most over the last couple of years in areas further from the city centers as people were looking for more space to work from home, place for the kids to play that type of thing.

We're expecting that trend and we are seeing that preference start to swing back to more higher density of living. So the result of that is that we're more concerned about those areas where large commutes would be required to get back into the major urban centers, and that's where we focused our efforts in terms of sort of just being a little more -- we're still constructive by being a little more concerned about those areas. We also think that people that are already stressed and therefore looking for refinancing might be -- might be an area that we just need to show that additional caution in this environment. So that's another area we're quite focused on. But I would say this is very much kind of trimming rather than wholesale change, as I mentioned, and consistent with our past practice has been proven through cycles up and down.

Operator

Your next question comes from Etienne Ricard with BMO Capital Markets.

Etienne Ricard - *BMO Capital Markets Equity Research - Analyst*

On the funding side, what level of competition do you expect on deposit markets over the next few quarters, given that, on one hand, loan growth appears to be slowing, while on the other hand inflation pressures could be draining household savings. So how do you see those 2 dynamics interplay on the cost of deposits?

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

Yes, certainly, I'll all speak to EQ Bank, and maybe Chadwick will talk more to the wholesale -- the wholesale, for the broker GIC market so that makes sense. On EQ Bank, I think we're just differentiating ourselves from the competition. We have the best digital experience of any bank in Canada. And as I mentioned in my remarks, we're adding more features and capability with our payments card coming soon and launching in Quebec. I saw some recent -- even as recently as yesterday saw our NPS scores, how customers are thinking about is those are improving quarter-over-quarter. So I think we're moving into a whole different environment and creating a different category almost. So super confident about that and what that means for our shareholders and for funding costs.

And as I mentioned, a huge liquidity in the brokered deposit market, just extraordinary. I don't know if I called out in the script, but the volumes in the [Cannex] market are up 2.5x year-over-year. Chadwick, if you can maybe just have some comments on what that means for cost and deposits that would be helpful. Yes. You've certainly seen that trend, as you've probably seen directly that the pricing has certainly moved up on the broker deposit boards. But our market share has maintained pretty well consistent in this, and we've certainly taken on some more deposits. But the important benefit to remember, as you know, is the diversification in our funding. So we're not entirely reliant on that channel.

And from a -- I wouldn't necessarily view as a competition perspective, well a lot of people want the funding there. We may do more, for example, in the covered bond market, right, as well we did that issuance, and we may do another one worthy in the wholesale side, the unsecured wholesale, so those margins have widened, but they're still pretty tight when it comes to secured wholesale and the covered bond market. That's part of why Europe is such an excellent choice for it.

So we can dial up and change our levers accordingly. So competitive, yes, but we have great options. And I think the balance will result in some continued relative tailwind in our funding. And again, reminder, once the Concentra Bank closes, that's going to expand our options and diversification even further. And just looking to buy a GIC, I recommend you look at the EQ Bank platform, you'll find the rate is pretty attractive there. Hey, Chad, like the one point, it's even to that point, though, the beauty of our diversification strategy, we don't have to always have a top of market price, right? Because of our diversification, we can focus on margin management. It's a very important billing factor too.

Etienne Ricard - *BMO Capital Markets Equity Research - Analyst*

Chadwick, on one of your last points on the covered bonds and deposit notes. Given where spreads are today, how do you plan to scale issuances over the next year?

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Yes. It's probably what I would say, without being conclusive as you'd see maybe a higher propensity likelihood for another covered bond versus another deposit note in the near term. But I think the normal expectations of the cadence we've set, have 1 to 2 deposit notes per year, and at least one covered bond issuance per year should continue. So you can see another covered bond, as I mentioned, it's early -- possibly as early as this fall as that market is exceptional stuff.

Etienne Ricard - *BMO Capital Markets Equity Research - Analyst*

Okay. And lastly, just on your accumulation segment. How is demand for reverse mortgages holding up in a higher rate environment relative to a traditional mortgage? I mean, in other words, given the lack of scheduled repayments, how do you think about the reverse mortgage affordability when rates rise?

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

I mean, affordability doesn't really change from the consumer's perspective because as you say, there's no payment to be made. Where we do adjust our actuarial models and thinking about the LTVs that we are lended, and as I did mention in my remarks that we've also tinkered with that a little bit and kind of cut back LTVs a little bit in the face of relatively higher interest rates vis-a-vis the expectations for the housing market. So we're feeling pretty good that we've got the risk appetite filed correctly. We continue to see, as you saw, very strong demand for reverse mortgages, perhaps tempered a little bit over the last 2 or 3 months as people have seen the higher house seeker shock effectively on the underlying interest rates that will accrue on the mortgage.

But again, we've got some strong tailwinds are a preference for moving away from communal living as a result of the pandemic, the broader acceptance of the product. And don't forget, we're 1 of 2 lenders in this space, and we believe we're cementing a really strong franchise in the business.

Operator

Your next question comes from Geoff Kwan with RBC Capital Markets.

Geoffrey Kwan - *RBC Capital Markets, Research Division - Analyst*

My first question was just on the originations in the quarter. It was a good number. Your key competitor also, I think had a pretty good number there. Just trying to get a sense from your side as to what was driving it? Was it just a matter of strong sales activity in the spring with the deals closing by quarter end? Or was there some market share gains from other direct competitors, maybe some people at the banks that were falling into your lap or alternatively some people on the mix side that are higher quality that you might have been able to get at a better rate because they might have been less appetite.

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

Yes. I think we continue to dial in on the broker experience. And I mentioned, we've opened up a new portal in the quarter that I think it was already in part at the beginning the year, but really got a broader brokers during the quarter. So we're feeling good about market shares. As you know, the data can be a bit hazy in that area, but fairly good about that. Don't think we're really yet seeing any spillover from the big banks, but that may well be one of the outcomes as we move forward here with GDS ratios and TDS ratios getting tougher. But I don't think we've already seen that flow through yet.

Geoffrey Kwan - *RBC Capital Markets, Research Division - Analyst*

Okay. And just my second question is, if we -- looking ahead here to 2023, if we see greater EPS growth pressure, let's say, we're in a more -- or a much softer housing market environment, loan losses are rising. Do you still stick with the dividend growth strategy given the payout ratio is still really low? Or is there a scenario where you might slow or even kind of halt the dividend growth? And I'm just trying to understand here if there's a reasonable scenario where you might deviate from what you've articulated on your dividend growth strategy over the next couple of years.

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

I think, Jeff, we can always create scenarios. But as you know, we're pretty committed to this program. And I would -- by the way, I wouldn't necessarily expect rising losses in our single-family books. I don't think we expect losses and maybe stresses, but not losses -- so -- and frankly, a slowing growth in the book actually leads to more regulatory capital accumulation. So I would expect that we are pretty committed to living with this dividend, not going to be prudent if the need is to preserve capital, but I think it's extremely unlikely we're going to get to those kinds of scenarios. I think our investors should be confident that we're going to live with our 20% to 25% dividend -- compound dividend growth over the next few years. As you point out, our dividend payout ratio is very low compared to the other banks. It's core part of our value creation model, but there's a lot of run for us there.

Operator

Your next question comes from Lemar Persaud with Cormark.

Lemar Persaud - *Cormark Securities Inc., Research Division - Research Analyst*

Just maybe on these mark-to-market losses on the strategic investments. So I just want to circle back to that. Would it be fair to say that in the quarter with the end today, you wouldn't see much more in terms of mark-to-market impacts on the strategic investments, derivatives loans and investments. So I think the CAD 8.7 million and CAD 3.9 million losses in Q2 from traffic slide?

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

If we were to end today, if we were to end Q3 today, how would that be playing out? Is that the question?

Lemar Persaud - *Cormark Securities Inc., Research Division - Research Analyst*

That's right.

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

I think it would be hard to say, frankly. I haven't even seen July's results yet. So I know that some of the ones that are more observable in the market are actually up since quarter end, but I don't think we can make a generic comment about where we expect to be in Q3.

Ronald Tratch - *EQB Inc. - Senior VP & Chief Risk Officer*

Yes. So I know where you're going, Lemar. It's obviously the activity is pretty negative in the quarter, but that's why it could be up, it could be down, but we're taking a bit of a neutral stance, and that's why we said we don't forecast those lines. But we could say it was certainly some pretty extreme activity in the past quarter. And obviously, even lots of headlines on this topic, but we took some prudent actions. And obviously, as we refer to these as unrealized losses to that point too, right, we haven't exited these positions. So you're right that they could be marked up or down further, but I think there'll be some volatility for a while longer in these markets.

Lemar Persaud - *Cormark Securities Inc., Research Division - Research Analyst*

Okay. Okay. And then maybe just moving on, I guess, to kind of operating leverage. I know that you guys are still confident in kind of the neutral operating leverage for the year on an adjusted basis, that would imply quite a bit of an improvement from the first half of the year. I think it's negative 4.4%. So talk to me about what gives you the confidence in that? What kind of levers you have to adjust maybe expenses up or down and the assumptions baked in from a revenue growth perspective?

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

Yes. I mean I think one of the interesting things with operating leverage is there's 2 elements of that, right? The cost sits on the numerator and then the -- you're running to your denominator. So what you saw here was frankly more of a denominator issue than a numerator issue in the sense that with those mark-to-market changes that you just talked about, it drove down the value of the denominator. But fairly, we're always pretty diligent about looking after our cost base. We travel in the regular part of the plane and we don't have private jets and that kind of stuff. So we keep a really tight focus on costs. As with an expectation of lower originations through the next quarter or 2, we certainly haven't been adding to our underwriting teams in the way that we used to. So there is a bit of room to constrain costs there. But I can assure you, obviously Chadwick keeps the BDI on the -- at his team. And I think we're on top of it to -- we wouldn't be expressing this level of confidence if we hadn't done a pretty detailed time to be able to give you that confidence.

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Yes, and remind to you, Lemar. So part of the delta that you're seeing with other banks, right, we were targeting approximately flat because we have the best efficiency ratio by them all, right? So it's -- the goal is, in general, maintain our competitive advantage through efficiency and our bet on digital. So operating leverage was just indicated. We want to stay in that range versus saying we are going to be precisely x percent in efficiency. But to the normalized point or year-to-date point, we're still within that, right, even around the 41%. But it's -- not to be more of a guide points. Our first point is always going to be the ROE as our lead anchor either way.

Lemar Persaud - *Cormark Securities Inc., Research Division - Research Analyst*

Okay. That's great. And then just last one for me then. Just a high-level question. But given the increased macroeconomic uncertainty, are you seeing any hesitation from commercial borrowers, maybe discussions about pushing out planned CapEx, that sort of thing? Or are all signs still flashing green?

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

So I think as I mentioned in my remarks, if you talk about, say, our commercial borrowers, we have engaged kind of business-to-business relationship mature relationships with many of these players. They're certainly concerned about a lot of conversation about inflation and construction costs. So not choosing to go in the ground with new projects as a result of deflating prices, being concerned about where ultimately they're going to be able to sell the product at that kind of conversation. So I think the bank account is having its impact on the market in terms of slowing down new construction starts, which is presumably one of the things we're trying to do is take some demand out of the economy. So that -- those conversations are going on.

Having said that, we've got a great -- it does seem like there's a lot of optimism about the longer-term story for building housing and other kinds of real estate in Canada's major cities, you take a 5- to 10-year view, and we continue to keep our customers close to us so that as those opportunities being clear, inflation gets more and gets under control, we'll be well positioned with our clients.

Operator

Your next question comes from Graham Ryding with TD Securities.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Maybe I'll stay on the same theme. Just, I think it was a record quarter for commercial originations. What, I guess, the commercial sectors, in particular, drove that volume and just it seems like a fairly fluid market. So maybe just some commentary on your comfort level around sort of pretty active originations in the quarter?

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

Yes. I mean a lot of apartments lending was a big driver. Many of that -- much of that ending up, which will provide the pipeline as a reminder for some of our CMHC activity. So sometimes we're originating these is, we would call them a CMHC bridge loan. So these are good apartment buildings that perhaps the purchaser is planning to increase the rents. Once we increase the rents, they're going to assume CMHC (inaudible) insurance and they will securitize it in the CMHC pooling. So that was certainly a big one in the quarter, continuing funding into pre-committed construction programs I think would be another good.

We also saw our specialized finance group continue to really step up, and that's -- I really love that business. It's -- it seems like it's got some operational complexity, but we've really got a good group of specialized lenders that we send funds do in that area. So I think right across the board, frankly, our commercial teams just did a fantastic job. And I know they're very confident, they've got -- they did also a fantastic job of doing a deeper dive into the risks in the portfolio, and I'm feeling really good about. We have a great team on top of that.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Okay. Perfect. On the specialty finance, can you just elaborate on that? I think there is a fair amount of lending sort of private mix, is part of that business. Can you sort of talk about your comfort level there? Or that now perceived to be a higher risk area in the market right now?

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

Yes, -- I mean, many would perceive that as high risk. And generally speaking, we're landing somewhere around 70%, 75% margin against first lien mortgages with a waterfall type structure, so a private securitization structure. A lot of operational risk controls in behind the scenes there. So -- and to knowledgeable people in the space. So it feels like a pretty low-risk sector to us. And that's been our experience. We've never had a loss in that portfolio.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Okay. Great. And then my last question, just the -- maybe just Chadwick's color on sort of the key inputs in your credit loss model that drove the higher of the PCL expenses this quarter. I wasn't surprised to see that I think the outlook for employment over the next 12 months and your models seem to improve quarter-over-quarter. So it likely wasn't employment that was driving the higher -- the PCL expense this quarter? Do you want to Rob to…

Ronald Tratch - *EQB Inc. - Senior VP & Chief Risk Officer*

Sure. Sure, Graham. This is Ron here. Yes, the key inputs in our models is consistent with most of the industry is unemployment, like you just noted as well as GDP, and from Q1 to Q2 I've described the changes in our forecast as very moderate changes. But what we saw in the quarter was in the near term, reflecting what we're currently seeing in the actual markets with respect to unemployment being stronger than were anticipated a quarter or 2 ago. And then as you get out to about the 15 to -- 15th month into the portfolio seeing some moderate reduction in the strength in unemployment numbers. And so what that does in our book is for the Stage 2 losses, which I'll remind you are a lifetime losses approach to Stage 1, which is just a 12-month look. When you get out there that far to the forecast, those low unemployment numbers do result in a modeled increase in our Stage 2. But it is a modeled increase. And as Chadwick noted it, our Stage 2 did not grow as a result of current delinquency.

Operator

(Operator Instructions) your next question comes from Jaeme Gloyn with National Bank Financial.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

First question, just on the NIM and the drivers quarter-over-quarter within compression, you guys are talking about in the MD&A, higher funding costs for prepayment, higher yields on that cash. So my first observation here is the net impact of these drivers seems likely to remain negative in the next quarter, so we should expect NIM to push down quarter-over-quarter. Is that fair?

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

I actually don't think so, no, quite clearly. So what you're not really -- there's a couple of things behind that. You're not seeing some margin expansion you may see from the lower funding costs from EQ Bank coming through to the fall. EQ Bank is diamond in the Equitable Bank crown and it's going to really show for you in Q3 and Q4 here in terms of that funding cost. The other thing is that Chadwick is not boasting proudly enough about the covered bond program. We got another covered bond program done in Q2. And you haven't really seen the -- there's lot of funding costs associated and if that start to flow through the statements (inaudible) we'll see that lower funding costs flow through in its entirely for Q3. So no, I think I'm optimistic that NIM will -- the numbers you see even in the quarter were pretty marginal changes, and that can be -- that can always happen. But I think in general, we're feeling confident about the outlook for NIM with expansion.

Ronald Tratch - *EQB Inc. - Senior VP & Chief Risk Officer*

Like Jaeme, if you look at, for example, with EQ Bank, that's interest point is really important one to crystallize. We already have a great everyday rate on that. And with Bank of Canada up 225 basis points so far this year, EQ Bank is up 40 basis points here at that level of expansion too, within what we're doing extremely well for Canadians. So it's a great opportunity for us. So it's a bit of a timing as well. That's why you see the flow through coming a little bit later.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Got it. Got it. And still on the NIM, I noticed that business mix, it had been a positive NIM driver for the past several quarter-over-quarter and year-to-date comparisons, but it's not a driver whatsoever in this quarter. And I was wondering if there is -- is there anything more to that given that conventional loans are still growing more -- far more rapidly than insured loans?

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

(inaudible) is much behind that. Generally, in my broader comments, if you look at NIM by business line, if you look out over the next couple of quarters, you should see pretty much stability. So as I mentioned, you might see some slightly faster growth in the multifamily loans on book, which do have a skinnier margin with them. And then we're still expecting NIM to be.

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

And you did see the yields go up, revenue, when you look for it in the MD&A, you did see the yields go up when you have the product-by-product breakdown they did increase quarter-quarter, and some of that pricing will continue to increase. So that you'll see that especially on the yield side.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Okay. Okay. Shifting to the PCL guidance. My understanding is that it should be in line with that or consistent with Q2 levels. Is that guidance -- does that apply to each of the asset classes or just on the aggregate?

Chadwick Westlake - *EQB Inc. - Senior VP & CFO*

Sorry, Jim, we're just having a hard time hearing you. I think what you're asking is just back to the point I made on will PCLB consistent. So I guess there's a couple of things, right? So we made the point that part of YP sales increased because the business increased. So if we have slightly lower originations could they be slightly lower in Stage 1, yes, that could be true. Part of why we said there could be some consistencies it depends as well on consumer credit behavior and the macroeconomic variable assumptions that we have. So those 2 will be connected here. But for the general tone, we said was some level of normalized consistency. I don't know if Andrew could add.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Yes, it was more on asset class perspective. Is that a comment on the aggregate business? Or just -- or does it also apply to each asset class?

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

Yes, we wouldn't expect to see any sort of additional piece in differential PCLs by assets. I think Chadwick's comment about loan -- portfolio growth slowing a bit, should mean there isn't too much pressure on PCL this current quarter unless something surprises us between now and quarter end.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Okay. Great. And with the Concentra acquisition, I presume you have a little bit more insight as to the performance of that business than maybe what we can see in public filings. Are there any of Concentra's key performance metrics? Are they vastly different than at the time of the acquisition. For example, has growth been stronger, weaker? Same thing for NIMs, PCL, things along those lines.

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

It's certainly -- earnings are stronger than we anticipated when we concluded the deal. At this point, I wouldn't like to comment much more on that, but I'm sure you can see it in the (inaudible) filings. So probably better than you might have expected, but there's a number of moving parts behind that. We sort of need to peel that apart as we want to tell our story in a more integrated way with Concentra, I think just to pick that up that single -- some of the single variables out without the broader story about how much synergies we can get and so on. I think the way that Chadwick continue to frame it as accretive to EPS is still the right way to think about it and nothing that we've seen out of the more recent performance data would change our broader perspective to extreme.

Operator

Mr. Moor, there are no further questions at this time. Please proceed.

Andrew R. G. Moor - *EQB Inc. - President, CEO & Director*

Well, thanks, Pam, and thanks, everybody, for their interest today. As there are no further questions, we look forward to reporting our third quarter results in November. Thank you for listening today, and goodbye for now.

Operator

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