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Q2 2024 EQB INC EARNINGS CALL

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REFINITIV

An LSEG Business

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CONFERENCE CALL PARTICIPANTS

- **Operator**
- **Meny Grauman** *Scotiabank - Analyst*
- **Lemar Persaud** *Cormark Securities - Analyst*
- **Geoff Kwan** *RBC Capital - Analyst*
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PRESENTATION

Operator

Welcome to EQB's Earnings Call for the Second Quarter of 2024 on Thursday, May 30, 2024. [Operator Instructions] It is now my pleasure to turn the call over to David Lee, Associate Director of Investor Relations for EQB.

David Lee *EQB Inc - Investor Relations*

Thanks, Sylvie, and good morning, everyone. Your hosts today are Andrew Moor, President and Chief Executive Officer; Chadwick Westlake, Chief Financial Officer; and Marlene Lenarduzzi, Chief Risk Officer. For those on the phone lines only, we encourage you to also log on to our webcast to view our accompanying presentation. There on slide 2, you'll find EQB's caution regarding forward-looking statements as well as the use of non-IFRS measures on this call.

All figures referenced today are adjusted, where applicable or otherwise noted. [indiscernible] change in fiscal year to end on October 31 for 2023 onward, quarterly comparison periods throughout fiscal 2024 will compare to the closest historical period. The second quarter ending April 30 will be compared to the prior quarter Q1 2024 ending January 31 and prior year Q1 2023 ending March 31. The year-to-date figures are presented as at or for the 6 months ended April 30, 2024, compared to March 31, 2023.

It is now my pleasure to turn the call over to Andrew.

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Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

Thank you, David, and good morning, everyone. Since the beginning of our new fiscal year, our team has done some really good work in serving our purpose of driving change in Canadian banking to enrich people's lives. The reward for that work has been strong customer account growth, active customer engagement, market share gains and results for shareholders that compare favorably with EQB's high-performance standards set over the past 20 years. When I think about our purpose of enriching people's lives, we do that by deliberately choosing to only operate and allocate capital within Canada rather than expanding out to new geographies.

We believe there is much to do for people living in this country and we can deliver the best returns for shareholders with this strategy. [We think] our stride here, and I'm particularly excited about our two latest innovations in Canadian Banking that will expand our ability to deliver on this purpose. I'll speak to those advancements on today's call, but first, my thoughts on quarterly financials and our outlook for the second half of 2024.

With record revenue, record pre-provision pretax earnings, 7% year-over-year EPS growth, ROE once again, well above 15% and a 22% year-over-year increase in dividends, there is a lot to like about our results in this most recent quarter, including the fact that performance was achieved in a higher for longer interest rate environment. If we annualize our results since November, we reported over $1 billion in revenue and $433 million in earnings, both new records all while achieving return on equity of 15%.

However, our outlook for the second half is supportive of something better as we continue to realize on the growing value of our franchise, see increasing earnings for our multiunit insured lending business through associated securitization activity and benefit from what we believe will be lower provisions for credit losses. Credit risk is understandably getting more airtime as Canadians cope with higher borrowing costs brought on by current monetary policy. After cresting in Q1, gross impaired loans in our commercial loan book reduced by $58 million in Q2, reflecting positive resolution on a number of loans.

We've made further progress since quarter end. Directionally, this is what we had anticipated and communicated in our call with you last quarter. We continue to see positive trends in our commercial book. Based on our assessments, we are confident in our ability to resolve the majority of the remaining commercial real estate loans within the reserves already taken. These loans are secured and the weighted average LTV on newly formed commercial impaireds was 51% in Q2. As a reminder, 77% of our total commercial loans under management are insured through various CMHC programs, and we have long prioritized loans secured by buildings where people live, have proven to be an attractive asset type.

In the Personal Loan book, the rate at which we added impaireds declined quarter-over-quarter. So far in May, we have seen good resolution activity amongst those loans that were impaired at quarter end. We have a high degree of confidence that losses will be minimal in the single-family book and that we're well reserved. Our [real stats] in the personal book have also declined in the 30- and 60-plus day periods. I think it's important to recognize that nearly 90% of our customers have already renewed into today's higher interest rate environment as the average term end of an Equitable mortgage is about two years.

While other banks may face a so-called mortgage renewal cliff has reported about half of their outstanding mortgages are held by borrowers have yet to face our rates. Our borrowers have already adjusted. Chadwick will speak to PCLs in more detail. On PCL, 75% or about [$80 million] related to runoff portfolios inherited from the purchase of Concentra and our equipment leasing business. As I discussed last quarter, leasing has experienced the aftermath of a cyclical downturn in the long-haul transportation market.

Local transportation accounts for less than 1% of the bank's total assets. We're seeing encouraging signs of improvements in this industry. It certainly feels like we reached the trough of the credit cycle this quarter with what could be viewed as peak PCLs. Our expectation is that we will see lower provisions going forward. While this has been a challenging period, we largely anticipate areas of pressure. We're making good headway in resolving problem loans using our well-developed collection capabilities. And we have clearly demonstrated the importance of our prudent lending approach combined with the resilience of the equitable borrower.

A move by the Bank of Canada next month or in July to reduce interest rates would be helpful to Canadian users of credit and for lenders would reenergize mortgage demand in the back half of 2024 and beyond. We certainly have the view that a stronger market for new originations in our mortgage businesses is around the corner given pent-up demand in the housing market. In the meantime, higher renewal rates, lower unscheduled payments and growth in high-quality portfolios led to a 13% or $7.3 billion increase in loans under management over the past year, keeping us on pace with gross guidance. To single out a couple of related developments, we are gaining substantial momentum in our Wealth Decumulation business.

A combination of insurance lending and reverse mortgage loans are up 57% year-over-year and 20% since November to over $1.7 billion. EQ was one of two banks in the reverse mortgage business with a compelling offering and effective marketing we believe

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we've substantially increased our share of both the broker channel and the consumer direct market. The growing of Canadian society and the need to access equity to fund retirement provides a solid backdrop for this business. The same optimistic outlook is true of the bank's multiunit business, substantial demand for new rental housing to meet the needs of Canada's growing population, combined with the bank's longstanding market leadership position [reported] 35% year-over-year growth in our insured multiunit portfolio.

Here we are seeing demand for both CMHC insured construction loans that offer developers varieties of incentives to build and insured long-term loans that often flow from this initial mortgage. With this demand, we expect to realize higher earnings from associated securitization activities, that expectation is embedded in our outlook for the second half of the fiscal year. Foundational to the long-term franchise value of EQB, EQ Bank experienced a 36% year-over-year increase in a number of customers with the support of our highly successful Second Chance Deuxieme chance campaign, featuring respectively, Dan and Eugene Levy and Diane Lavallee and Laurence Leboeuf and growing use of payroll deposits, a sign that customers increasingly rely on us as their primary bank.

Our next frontier is the introduction of EQ Bank's innovative Notice Savings Account and EQ Bank's Services for Small Businesses. Take each in turn, EQ Bank's new Notice Savings Account, we just launched yesterday provides customers with a flexible new way to earn more money on funds than keeping aside for short-term purposes. Based on our own research showing that 55% of Canadians contribute to their own rainy-day fund, we think there's a huge need for this kind of product. Our customers can choose between 10- and 30-day notice periods. In return, we offer more interest than what's available from traditional demand savings products.

For EQ Bank, this new product provides an extra level of deposit stability and a faster payments world. We're very excited to be out of the gate with EQ Bank for small business, which represents a target market of millions of underserved Canadians with hundreds of billions of deposits. Last month, we introduced a product to a subset of business customers to test our capabilities and learn from their experiences, and we'll be expanding this to a full launch later this summer. This all-digital [indiscernible] solution provides entrepreneurs with high daily interest and great access to innovative payment solutions.

To conclude my comments, you should expect us to continue investing in building franchise value and realizing in the months ahead using our proven disciplined method of capital allocation to consistently earn 15%-plus ROE while steadily increasing our dividend for investors. As we enter this next phase of the economic cycle, it gives me great comfort to know that we have a proven and committed team of business leaders in place at all levels to execute our strategies. We've worked hard to build our workforce and talent development programs over many years.

In that vein, I'd like to give a shout out to our talented capital markets and treasury teams for their success in raising funding in the Deposit Note and Covered Bond market in Europe that Chadwick will talk about in his comments. We're proud that LinkedIn recognized our efforts by choosing Equitable Bank as one of Canada's Top 4 employers for workplace growth and progression. We're always happy to accept bragging rights for awards like this. But what's most important is that our team is delivering for our customers and shareholders year in, year out in keeping with our [corporate] purpose. I'm proud of my colleagues, and I thank them for their incredible efforts.

Now over to Chadwick.

Chadwick Westlake *EQB Inc - Chief Financial Officer, Senior Vice President*

Thanks and good morning. With our fiscal year-end change to October 31, I'll remind you that for year-over-year comparisons, we are presenting Q2 2024 relative to Q1 2023, which is the closest period. For quarter-over-quarter, as you would expect, we are comparing to Q1 2024. In a challenging macroeconomic environment, we closed another solid quarter with a record topline revenue growth of 6% quarter-over-quarter and 20% year-over-year to $317 million.

Despite the elevated provision for credit losses and operating expenses compared to Q1, which I'll speak to shortly, we continue to achieve our objective of greater than 15% return on equity, landing at 15.9%, plus book value per share growth of 14% from prior year. Capital remained strong with CET1 of 14.1% and a total capital ratio of 15.3%. The reduction of 10 basis points in capital from Q1 is due to a portion of our excess capital being deployed in the quarter to pay down EQB HoldCo debt facilities that were initially set up and used to fund part of the acquisition of Concentra Bank. I'll offer some additional context now on a few key performance measures before opening the call to our analysts for Q&A.

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First, margin. NIM expanded 10 basis points from Q1 to 2.11%. I'd attribute five key factors to the expansion: increasing yields in several asset classes in our personal portfolio, higher prepayment income over Q1, expanding benefits of our funding diversification strategy, including growth in lower-cost EQ Bank deposits, high single-family renewal rates as well as the effect of fewer days in the quarter that is isolated to Q2. Our conventional lending businesses have generally increased to plan with yields higher across asset classes, as you see in our financials. Total loans under management increased 13% year-over-year, led by Wealth Decumulation higher by 57% as Andrew highlighted, and single-family uninsured growth of 4% year-over-year.

Excluding insured multiunit residential mortgages, commercial loans are 9% higher year-over-year, led by strong growth in our insured construction loans, specialized finance and loans to small businesses with a sequential decline in equipment financing. Combined assets increased 2% over Q1 led by personal lending with more of the commercial growth over Q1 on the insured side. All lending is being well priced to our ROE calculator on every deal, which has been evident in this margin expansion and trending as expected for the first half of 2024.

Moving to funding; in the second quarter, we generated great success in the evolution of our wholesale programs with over $1 billion in new funding from the completion of a $300 million deposit note issuance with the largest ever number of investors and the fantastic outcome of a EUR 500 million Covered Bond issuance in Europe, which represented Equitable Bank's largest ever Covered Bond offering and the first ever issuance of a social Covered Bond by a Canadian bank. Approximately two-thirds of the more than 100 Covered Bond investors were new to our program and it was 8x oversubscribed.

These milestones serve as a testament to investor conviction in our bank's credit quality and ability to repay, plus our focus on responsibility with this social bond issuance. On the EQ Bank front, deposit growth of 4% in Q2 reflected our best sequential growth in two years. This expands the lower deposit beta advantage of these deposits. Transactions increased 153% year-over-year, reaching roughly $10 million in the quarter and customer engagement is at the highest levels yet. As Andrew mentioned in his remarks, with the launch of Small Business Banking and new Notice Savings Accounts, we expected a positive momentum to continue building throughout the year and to maintain our ability to grow EQ Bank with a general range of 7x to 10x customer lifetime value to cost of acquisition.

Combined with expert treasury management, our long-term efforts to diversify and strengthen sources of low-cost funding are a differentiator for EQB. Next point, our growth story of non-interest revenue or NIR; NIR increased 76% year-over-year and accounted for 16% of total revenue in the second quarter, crossing our 2022 Investor Day target of increasing to 12% to 15%, more than double from a couple of years ago. We're seeing these revenue lines increasing with strategic growth and gains on sale from our multiunit residential securitization business, consistent fee income from Concentra Trust, expanding [payment] revenue and a full quarter contribution of ACM Advisors in Q2.

ACM's asset management revenue is captured under fees and other income on a consolidated basis. For insured multiunit residential, [we will have] $22.6 billion in loans under management, up 35% year-over-year. $17.6 billion of this amount has been derecognized through the CMHC, CMB and NHA MBS programs. As a reminder, these mortgages are not prepayable or have their cash flows fixed, so the assets can be derecognized when securitized and sold. The corresponding event and spread differential results in upfront non-interest revenue in that reporting period. Gains on sale and income from retained interest amounted to $23.2 million for Q2, representing a 62% increase year-over-year.

We expect to maintain this level of revenue in coming quarters as indications of the insured multiunit commercial pipeline remain robust, and the Bank of Canada continues its CMB primary purchase participation in all fixed-rate CMB syndications as announced in the 2023 fall economic statement. We intend to maintain a strategic focus on growing non-interest revenue as a percentage of total revenue. And as we lean into 2025 guidance later this year, you will see that range expand higher than the prior goal of 15%. Now on to some additional context on credit; last quarter, we signaled that our expectation was for a peak level of PCL in Q2, elevated from Q1.

And as signaled, PCLs increased 43% sequentially to $22 million comprised of $24 million in Stage 3 PCL and a $2 million reduction in Stage 1 and 2 provisions. However, as a reminder, Q1 included a onetime $7 million PCL benefit in the consumer lending portfolio from an agreement to increase cash reserves to secure against losses. When you take that into account, total PCL booked in Q2 was nearly consistent to slightly better quarter-over-quarter. The Stage 1 and 2 provision reduction was based on a more positive outlook in our economic data inputs. This is not a surprise at this point in the cycle, and you can find these estimates outlined in our financial statements.

The largest drivers here over Q1 was a better 12-month forecast for GDP, a higher 12-month and up to 5-year HPI outlook, which moved from a negative long-term outlook to modestly positive and the commercial price index estimates also improved. Stage 3 provisions were primarily attributed to $13.2 million non-performing equipment financing compared to $11.5 million last quarter. The

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PCL ratio in equipment financing increased to 4.2% as expected compared to 3.76% in Q1, which, again, is not surprising given the challenges seen in the long-haul transportation sector. Our guidance has been consistent here the past couple of quarters and remains.

We expect these will begin normalizing in the second half of 2024. The majority of our commercial losses, excluding equipment financing, were primarily attributed to non-core Concentra loans that are running off. These allowances are determined on a loan-by-loan basis and supported by up-to-date independent property appraisals. Despite a positive number of commercial loans reaching resolutions in Q2 and moving out of the impaired status, these provisions were appropriate given current recovery plans. Our net allowance for credit losses increased to $113 million, up $5.8 million or 5% quarter-over-quarter, primarily due to additions from our commercial lending portfolio.

As a result, the bank's net ACL ratio increased 1 basis point to 23 basis points in Q2. Switching now to our investments in EQB; non-interest expenses increased 7% quarter-over-quarter to $143 million. Approximately one-third of the increase was related to marketing spend primarily associated with the very successful Second Chance campaign, which continues to translate to significant customer growth for EQ Bank. The full quarter impact from the acquisition of ACM Advisors accounted for over 10% of the expense growth, while higher technology and product costs, representing about a quarter of the increase were encouraged to support the successful product launches Andrew referenced for EQ Bank as well as our investments into expanding cloud capabilities, cyber and fraud enhancements.

The remainder of the expense growth is attributed to costs for the strong topline growth in the business, including FTE increasing 1.5% from Q1. We have the ability to move fast and smart at managing our spend levels. We are investing through the cycle, making effective long-term trades that will benefit us in the years to come, but we are prepared to reduce our pace of spending if conditions don't trend to our expectations. I'd expect to see sequential positive operating leverage in Q3 with lower single-digit non-interest expense growth in the next couple of quarters.

Achieving ROE guidance will remain paramount over an efficiency target. To wrap up, the second quarter demonstrates another differentiated quarter for EQB and illustrates how our strategy is paying off for customers and shareholders, with their businesses growing and performing well through the credit cycle. Our diversification and sources of revenue funding is driving strong topline momentum. With the first half of 2024 complete year-to-date ROE of 15.7% and a constructive outlook for the second half of the year, anchored in our ROE guidance, we feel confident in executing our strategy and delivering strong results.

Now we'd be pleased to take your questions. Sylvie, if you can open the line for our analysts?

QUESTIONS AND ANSWERS

Operator

Thank you, sir. [Operator Instructions] And your first question will be from Meny Grauman at Scotiabank.

Meny Grauman *Scotiabank - Analyst*

First question on the margin. Obviously, we saw a big step up on a sequential basis. Chadwick, you highlighted the factors. Just wanted to disaggregate the factors that you think will persist versus ones that maybe are a little bit more temporary or a little bit more volatile and basically get it -- what should we expect for margin performance going forward through the second half of the year?

Chadwick Westlake *EQB Inc - Chief Financial Officer, Senior Vice President*

Yeah, thanks for the question. It was a great expansion in margin, and a lot of that was as planned. The one nuance I'd say for the quarter was the fewer days in the quarter. That wouldn't persist and that might represent a couple of basis points there. But in general, if conditions continue for our strategy and plan, you could see consistent stability in that margin. Say, for example, a couple of basis points, you could call it was from higher -- towards normalizing prepayment income. That depends again on how market conditions persist as an example. But this really fundamentally reflects, as I mentioned, the strength in our funding benefits and how we're pricing our assets and our focus on conventional lending. So those conditions should continue, which I think adds to that

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strength and stability to our margin.

Meny Grauman ***Scotiabank - Analyst***

On the funding side, did something fundamentally change? I mean what we've seen is relative stability over the last few quarters and now sort of a step-up here, 10 basis points sequentially. And it does seem like you're putting a lot of emphasis on the funding side of the equation. So just curious about that.

Andrew Moor ***EQB Inc - President, Chief Executive Officer, Director***

Well, I mean, certainly, I do think we're going to see some good tailwinds from things like the Covered Bond, as Chadwick mentioned. The other thing that's kind of interesting around prepayment income. When interest rates jump dramatic and you've got relatively low mortgages, clearly, the prepayment income drops meaningfully. It's a hard one for us to predict. It depends on consumer behavior. But how those mortgages reset to higher rates, I would expect that that income would be prevailing at a slightly higher rate. I have to say I was positively surprised by just [Technical Difficulty] numbers flow through, so.

Chadwick Westlake ***EQB Inc - Chief Financial Officer, Senior Vice President***

That's right. And it's -- the only other way to look at it to Andrew's point, Meny, is this has been quarters and years in the making, right? You're really seeing this benefit translate now with how our funding diversification is paying off. And you see that in the asset and yield tables in the financials and the benefit of the wholesale programs. And really, that strength, as I mentioned, of the lower deposit beta EQ Bank and that strong growth, that's really translating here too.

Meny Grauman ***Scotiabank - Analyst***

Got it. And then in terms of PCL ratio guidance, I mean it sounds like you're reiterating what you communicated in Q1 in terms of a peak here in Q2. I'm just curious, the glide path down from here. Do we -- how quickly do we go back to the PCL ratios that we saw in Q4? Q1 had some unusual aspects that you highlighted, but is it a slow move back to kind of the low single-digit PCL ratio? How do you think about that?

Andrew Moor ***EQB Inc - President, Chief Executive Officer, Director***

I mean certainly, I have reasonable confidence that over the next couple of quarters, we're going to start to see more meaningful shifts towards a more historical loss rates across the various assets we have. As I mentioned, I'm sort of getting more and more confident about the outlook for the long-haul transportation leasing business. But I think there's still some uncertainties there that -- certainly [as] we get out 6 months from now, we should be in a much lower level there. And I would say I've done much more detailed work on the commercial side, feeling really comfortable about the provisions we've already taken.

So those provisions going forward, we should be taking less in the way of losses there. Not expecting the impaireds to drop quite so fast though some of these things will take a little bit of time to resolve. So the story might be impaireds not dropping so quickly over the next quarter, probably dropping more in Q4 but a reduced provision level in the -- flowing through the P&L. I mean that's how I'm thinking about it. And certainly, as you can probably gather from my comments, there's been a lot of work done in this area to kind of give us lots of confidence around make sure we're communicating properly. But it's always a little bit tricky obviously, to forecast the future.

Chadwick Westlake ***EQB Inc - Chief Financial Officer, Senior Vice President***

Yeah, we can talk more offline actually, but it would -- it is pretty good momentum into Q3 and Q4 in terms of how quickly that normalizes given so much has been isolated the equipment financing to Andrew's point. So you take that out of the equation and you get back towards normalized level.

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Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

Just recall over the years, for many years, we ran like 1 basis points and 2 basis points of loss annually. So it's -- these quite -- gives the strength well for us.

Operator

Next question will be from Lemar Persaud at Cormark.

Lemar Persaud *Cormark Securities - Analyst*

Let me start off a little bit big picture one here. It's for Chadwick or Andrew. Is there anything that when you look across the business that should cause the earnings power of this business to drop, what I'm trying to get at is, should we now be thinking of EQ as more of a 16% ROE bank or is there some reason that I'm not thinking of where the 15% you could revert back to the 15% range because I just don't see it right now.

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

I mean certainly that's how it feels to me. As mentioned there's always little -- whether it's 15% or 16%, frankly, does -- there are little things within any quarter that can move that back. I think of us as a sort of 15% to 17% bank year in, year out. That's what we've done. The mid-part of that range is 16% and frankly, I feel more confident than ever about this bank. Our technical capability is the strength of the executive team, the people around us. The things -- sometimes we sort of say now we're bigger it's harder to execute on things. On the other hand, now we're bigger, we've got talent around the table. We've got technical expertise. We understand markets that we didn't understand a decade ago.

So I'm feeling pretty confident about that -- I mean, more confident than I've ever felt about this bank despite the headwinds of higher interest rates. So yeah, no, I think that's the way to think about it. I mean, as I -- we continue to project the kind of core value-generating model is that we generate that 15% to 17% return on equity. Reinvest the vast bulk of that back into the bank with a rigorous capital allocation program to make sure we generate 15% plus on the capital reallocated. And that just drives its earning growth story, which has prevailed for a more decade. So I see nothing changing over the next little while. Obviously, big macro things could, we're never blind to that and thinking about that, but it certainly feels like a great market to be operating in Canada with a great business model.

Chadwick Westlake *EQB Inc - Chief Financial Officer, Senior Vice President*

The other way to think about it Lemar, we completely agree with you in your hypothesis. The 10-year average is 16%, on every single deal. Everything we do is anchoring this ROE in the pricing of 15% to 17%. So we [agree] with the hypothesis and have full conviction.

Lemar Persaud *Cormark Securities - Analyst*

Okay. That's helpful. And then just on credit, it sounds like we're through the challenges in long haul trucking and these equipment finance leases. But maybe could you just expand on what gives you the confidence in the commercial ex equipment financing, which did bump up this quarter? And then I'll put this comment out there, just maybe food for thought. It would be helpful if you guys could -- I know it's a tough one, but if you could -- guys could provide some numbers around even the impaired PCLs outlook in a future quarter, that would be helpful. So maybe just talk about like the commercial ex equipment finance.

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

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Yeah. So we'll take that advice on the second one offline, and we'll try to sort of think about how to reframe to be helpful to all of you on the call. I mean, I think the nice thing about commercial is that you could actually look at building-by-building and many of the buildings, either I or one of the senior commercial team actually [walked] the building. So we know the value of these buildings. We understand the real estate. And we understand the provisions we've taken against it and who would be in the market for this building if it came up. So I think it's a fairly -- it's much easier to give you more confidence about those numbers that we've taken the provisions we need to take.

Sometimes things run to impaired position. So even though the loan-to-value is less than 50%, the borrower gets cash strapped. So it shows up as an impaired. It will resolve. It won't result in losses. And I think that's what we're seeing in a lot of our impaireds on the book is relatively comfortable loan to values. It will just take time to resolve through new capital being brought in, the property being sold, that kind of thing. Of course, there are one or two on the edge of that, the higher LTVs, where we've done a particularly deep dive to really understand what the resolution process is and having done that work with Marlene and her team -- that's what allows me to have confidence that we've taken the provisions are necessary, and we can proceed with confidence knowing that we shouldn't surprise you going forward.

Chadwick Westlake *EQB Inc - Chief Financial Officer, Senior Vice President*

[indiscernible] comment, Lemar, would be the point I used specifically in my comments with noncore, right? So these are pretty isolated in terms of what you saw for the commercial, I explained.

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

Yeah, maybe I should jump in on that a little bit. I touched on my script, over $5 million of the losses came from things that we never intended to continue to be in the business when we bought Concentra. I mean I think possibly we should have taken a bit of a sharper knife to that in terms of putting provisions up when we bought -- bet the bank, but they appear to be in good shape. These are not things that we lend on and won't be deliberately won't be lending in the future, this type of asset class. And so that caused a little bit of noise in the quarter. Having said that, the Concentra acquisition itself more broadly has really worked out to every -- to beat our expectations. So this is the only problem that arises from it and we're pretty happy.

Lemar Persaud *Cormark Securities - Analyst*

And then just my final question maybe for Chadwick. You mentioned stability in margins what -- how does that change if we see potential rate cuts in Canada through the end of 2024. Is that inclusive of your view on rate cuts in Canada?

Chadwick Westlake *EQB Inc - Chief Financial Officer, Senior Vice President*

Yes. I'll give us more fulsome comment offline. But remember, we don't take a view on interest rates [indiscernible] 1-year duration of equity. We term out our book. It's very strategic how we manage this margin and the expansion has been very deliberate. So it is a simple honest answer of yes, this is strategic.

Lemar Persaud *Cormark Securities - Analyst*

Okay. Fair. So that includes like the consensus view on rates bottom line.

Chadwick Westlake *EQB Inc - Chief Financial Officer, Senior Vice President*

Yes.

Operator

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Next question will be from Geoff Kwan at RBC.

Geoff Kwan *RBC Capital - Analyst*

I want to ask on the personal side. The gross impaireds have almost doubled over the past couple of quarters. For the portion, I guess, that would be on the residential side. How many properties are we kind of talking about? Is it a vintage year issue, geography, borrower type? And how do you kind of expect these impaireds to trend over the next several quarters?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

Yeah. So I can give some color on that, Geoff. So it's over 200 loans. And in terms of geography, a little bit of focus on Ontario than the West. A little bit was well tilted to the larger loans in our books at decent LTVs. And I would the kind of general lack of liquidity in the housing markets probably let alone the impaired piece. The good news is almost 30% of the impaireds we are reporting at quarter end in this book have actually cleaned up since quarter end.

So we are seeing good activity in resolving some of these issues -- so it does seem people with larger mortgages probably facing higher interest rate shock on the people that naturally might think probably having the biggest stress of leading these impaired positions. Fundamentally these impaireds to come from the loan being more than 90 days past due. Did I give you some good color, Geoff, is that [Technical Difficulty]?

Geoff Kwan *RBC Capital - Analyst*

Yeah. And just like kind of going forward, given rates just kind of see high cost of living is high, your average loan has been kind of two years. Are you expecting to see that the impaired they elevated or improve or possibly go higher, a bit higher from here?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

What it looks like with the kind of current trends is sort of more flattish over the next couple of quarters. So not expecting to have to make more in the way of provisions that we feel we're well provided. But the impaireds will come down more slowly. I think there probably is going to be more liquidity in the housing market once we start to see the bank kind of move to an easing trend and that will help move, but we're not expecting that to drop dramatically, very quickly, but we do expect it to gently tail down from here.

Geoff Kwan *RBC Capital - Analyst*

On the small business banking solution, I know it's very early days here, but just curious what the early takeaways have been? Also how the product compares to what the big six banks are offering in terms of features and relative pricing because you did mention that it's a no-fee product?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

Yeah. So it's very similar to how you think about our personal banking product and EQ Bank. So no fees free money movement, interest on the balance in the account. So the kind of same propositions or everyday banking solution inside EQ Bank. And for many of our customers, part of the value profit is being able to see in a single pane of glass, the small business balance and their personal bank so that you can -- because many of these are going to be owner operators, we believe we will be thinking about money in the small business account as being their money in effect, of course, it's a different legal entity.

So it's really trying to approach that need for that market. What will be coming will be integration to accounting packages will make people's lives easier for running their businesses that way with kind of the payment solutions you would expect, so request-to-pay and other solutions that are going to make a small business person's life much easier. And it's all digitally enabled. So I think a lot of the feedback we're getting is a lot of having to go into the branch to set up accounts and so on with a more traditional banking infrastructure is very much digitally enabled digital -- a good digital onboarding flow and then many of the innovations we've brought

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to the market with EQ Bank.

So we're excited about the progress on that. And I think we'll probably next quarter as we actually get into market, we'll give a bit more color on the roadmap for that solution. I would say, standing it up, we've got a great onboarding piece, but it is kind of a minimum viable product to get going, and you can expect many much more from the next couple of years. We're really inspired by what we see in other markets for small business, particularly in the UK, where one [indiscernible] Bank has captured more than 10% of the market in a matter of just a few years by bringing this kind of digital-first solution to market.

Geoff Kwan *RBC Capital - Analyst*

Just one last question I had was on the reverse mortgage side. Do you have an estimate of what your market share on originations are right now? And is it still just a two-player market?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

It is a two-player market from a bank perspective. So the funders -- two funders, two banks funding it. And we've still got lots of room to grow. Probably our biggest competitor is probably 3x or 4x bigger than in terms of originations somewhere in that area. We don't have great data, but it feels like that.

Geoff Kwan *RBC Capital - Analyst*

Okay. And sorry, you were saying two banks, are there nonbank players? Like I guess my question more broadly, are there?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

No. There are people that you'll see in the market who are originating reverse mortgages. Fundamentally, those mortgages end up on either our balance sheet or the other competitor or reverse mortgages.

Chadwick Westlake *EQB Inc - Chief Financial Officer, Senior Vice President*

Remember, Geoff -- so we think this market has huge growth potential for where it is. Even if you look at the size of it today, it's still a 5x, 6x ex growth market over the next many years in Canada. So it's -- we're growing in the right places and providing an important service to Canadians here.

Operator

Next question will be from Paul Holden at CIBC.

Paul Holden *CIBC - Analyst*

First question is I do want to ask about the equipment finance and particularly the transportation loans. Just hoping to get some data points to help us understand why the potential losses are contained from here. So I think you'd previously identified a $200 million cohort of loans that were the source of a particular credit losses. Wondering if that's still the case or if it's expanded at all from that cohort? And maybe you can give us sort of a sense of to what extent you've worked through that $200 million in terms of resolving the losses and what still needs to be worked through?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

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I think, Paul, it would be great if you had a chat with Chadwick offline on this one because this is a bit more sort of data to kind of unveil I think, just pretty satisfy need rather than kind of give us a sound bite. So kind of -- there has been a little bit where we thought we had some greater protection underneath, it's expanded a little bit. But as I said, Chadwick probably give you more color that we could be usually provided on the call.

Paul Holden *CIBC - Analyst*

Okay. Next question is regarding the growth at EQ Bank. You've highlighted the phenomenal customer growth, 36% year-over-year. If I look at deposits, it's kind of lagging that growth rate. So where I want to go with this is really how should we think about that kind of customer growth translating to deposit growth? What's kind of been maybe what's caused the difference in the last year and why that difference may not be as significant going forward, assuming it won't be?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

Yeah. I think you're right on there. I mean, we are adding customers. We are adding more people putting their payroll in the system for sure. I think where we are -- what we're trying to tackle and we talked about it a little bit in terms of this notice deposit is this customer that's really a bit more rate sensitive and probably doesn't need the money as quickly. So not somebody using his everyday bank account but somebody more thinking about this as kind of a long-term savings vehicle.

So some of our everyday savings account customers were definitely of that character. And so we're trying to address that with this higher interest rate notice deposit solution that will keep, we believe, more deposits or keep it attract more deposits into the platform. But I think you're right. The average deposit clearly, as you can see from the math, the average deposit has dropped a little bit over the last year.

Chadwick Westlake *EQB Inc - Chief Financial Officer, Senior Vice President*

Paul, important to our strategy over the last year or two has been not to chase temporary campaigns that exist in the market and going after [hard] money. We've been focusing on growing the core franchise customers that will stick with us through payroll and to Andrew's point, more or less deposits come with that, but the franchise grows and more of those deposits will come back over time as competitor campaigns also expire. But that's where we have higher conviction on the stability and the continued steady growth in those deposits.

Paul Holden *CIBC - Analyst*

Got it. And I guess the follow-up question I have with that then sort of the new customer growth you've experienced over the last year, I mean, it implies to me it's probably relatively small balances to start and maybe potential growth with those customers you've already added. Is that fair?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

I think that's entirely fair. I think we actually have a fairly high share or certainly a much higher share of first-time home savings account market than would be our natural market share. And which is obviously great for us because those people are presumably going to be buying a house at some point in the future. But as you know, so I think there's limit on a first-time home savings account is $7,000, right? So that's different than the kind of average deposit in our platform around -- more like $20,000. So -- but every year rolls around, presuming it's going to another contribution of $7,000, and so you see the deposit balance has grown.

Paul Holden *CIBC - Analyst*

Last question for me is regarding single-family mortgage uninsured. The volumes versus margins. So volume growth has obviously slowed for reasons that I think are well understood and cited by you. But at the same time, you've seen a pretty good margin

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expansion, I think, on that product as existing borrowers have maybe stayed with EQB a little bit longer and renewed at higher rates. And I guess the question I want to ask is like, is there a little bit of an inverse correlation here. Like you've talked to rates coming down should help volumes, but maybe that maybe that's going to be somewhat negative on the margins you've earned on that product. Is that -- is it fair to sort of think about those two being inversely correlated margins and volumes?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

I think you may be on something a little bit at the margin. One of the reasons why you see the margin -- generally speaking, the consumer is paying the same spread over our cost of funds over the term of the mortgage. So you're not really seeing margins expand because, for example, we expanded that margin. Our costs are a little bit lower on a renewing mortgage. So in terms of kind of commission costs, processing costs, some of the kind of out-of-pocket processing fees, which actually do some of those do flow through the NIM line. So to the extent that our book is more and more of a renewal book than a new book, as you point out, then you're likely to see a little bit of margin expansion. That's probably what you're observing. So yeah, I think it's probably fair that you would see a little bit of NIM compression as we start to see a relatively higher percentage of the business being new business.

Operator

Next question will be from Etienne Ricard at BMO Capital Markets.

Étienne Ricard *BMO Capital Markets - Analyst*

With deposit growth picking up at EQ Bank, how do you expect declining rates to impact demand for EQ Bank. Do you see rate cuts as a net positive for deposit growth to the extent you maintain your current 2.5% rate while others may actually decrease rates?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

I think it's hard to say. As rates went up, clearly, there was more sort of deposit seeking -- interest rate seeking behavior, but people realize that perhaps they weren't getting the right treatment of the current bank and we have a bit of a beneficiary from that. But we're certainly hopeful that we've built our brand to be strong enough -- position us strong in the market. And as you point out, I noticed deposits in particular, will stand out as having a relatively strong rate in the marketplace as rates decline. So I think it probably provides a somewhat positive backdrop to the growth in the portfolio.

Operator

Next question will be from Gabriel Dechaine at National Bank.

Gabriel Dechaine *National Bank - Analyst*

First question on the [Technical Difficulty] I haven't seen you since Montreal. The prepayment income there, you used the word normalizing. I just want to try to understand the dynamic of what's driving that type of income? I wouldn't think it's borrowers refinancing because we're in a high rate environment. Is it the paydowns or the borrowers that are going to the conventional loans with other institutions? What's the story there? And if you can give me a number there, like how much of the 10 basis points, so I don't know if you mentioned that.

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

Yeah, I think if you could deal with that piece with Chadwick offline. But if I can just explain the dynamics of the prepayment calculation, so it's coming from loan liquidations prior to the maturity of the loan, which could either come from the sale of the property or indeed somebody look into do a refi moving to another bank, let's say, to do a refinance because then you want to take

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money off the table. And so typically, the way that calculation is done is the -- it's the difference between the rate on the mortgage and the prevailing interest rates.

So if the rate on the mortgage is relatively low and prevailing interest rates have risen, then the calculation of the prepayment penalty due to us will be lower as the -- as we reprice the mortgages up to higher rates, relative to broader interest rates in the market, then you'll see the calculation have an increased amount. So with the same number of loans being prepaid, then the margins could kind of come up a little bit. And what we saw as interest rates went through the first sort of [indiscernible] cycling was a drop -- cycle was a drop in prepayment income because we had exactly the opposite dynamic. We had low interest rate mortgages, which we're fine with us because we funded them with low interest rate GICs, but when it came to prepayment, the amount was just a little bit less.

Gabriel Dechaine *National Bank - Analyst*

Okay. So if -- from a volume standpoint, if rates are cut and market activity picks up, you should see more of that type of income.

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

Yes, we should see more because you would see people presumably liquid any mortgages prior to maturity with a higher propensity because they would have refi opportunities or maybe to sell a house for other reasons in the way they have going on today. I would say it's not necessarily a good news story. So yeah, we've got the higher prepayment income, but obviously, we lose the assets. So it creates income upfront, but it's not necessarily a good thing to see that higher liquidation rate.

Gabriel Dechaine *National Bank - Analyst*

All right. All right. Good point. And then on the credit story here. I just want to maybe get more of a visual sense from you, if you will. The gross impaired loan balances were down a bit overall, but we still saw a pickup in the equipment finance portfolio. It sounds like you're through the worst of it in the trucking portfolio could see a bit more in Q3, but then a drop off in -- not to the same degree we saw this quarter, but then it really drops off in Q4 and the PCL tracking that kind of slope downward the trajectory? Is that how you're anticipating and things to play out?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

I think you've framed that really well as a visual. I'm feeling really good that we may take enough provisions for commercial single family. And I'm feeling good about trucking, but I feel much more confident to be able to give you a message around that in Q3. I think on the Q3 reporting.

Operator

Next question will be from Graham Ryding at TD Securities.

Graham Ryding *TD Securities - Analyst*

On the personal PCLs, there were some reversals this quarter despite your arrears moving higher. And I think the broader stats suggest the Canadian consumers, the trends are weakening somewhat, particularly for unsecured consumer lending. So was that entirely model driven or why are you comfortable in reducing your allowances in this area when you're seeing your arrears build?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

Chadwick can help [indiscernible] with the more technical response, but we deal with one of the kind of major data providers in a global brand name around our economic forecast, which, as you know, are what we use to calculate our Stage 1 and Stage 2

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provisions. And as [indiscernible] mentioned in his script, that entity had been actually forecasting a decrease in home prices over the next 5 years compound.

As I said, this is the biggest one. I'm just giving you go more a CEO kind of big picture story here. They flip from having a view of declines in home prices over the next 5 years incurred to modest increases. That shows a fairly meaningful impact on kind of model-driven calculations. And I felt a little bit uncomfortable, frankly, on some of this, but we were always very rigorous around following our models to make sure we're making appropriate divisions -- appropriate provisions. And it seemed as we thought through that, that it was appropriate to take the action we did.

Graham Ryding *TD Securities - Analyst*

Just remember, Graham, and the other point I mentioned, you mentioned unsecured and consumer for our book, right, nearly 98%, 99% if you consider cash reserves, just about 100% secured different business mix than others that you're seeing. So always remember business mix plus the models make it more unique in terms of our strength and why we have the lowest losses of all peers in Canada.

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

So this all relates to single-family mortgages.

Graham Ryding *TD Securities - Analyst*

Okay. Okay. That's fair. Just jumping to your guidance and the different sort of components behind that. It sounds like you feel most pieces that drove the NIM expansion this quarter are sustainable outside of maybe the days in the quarter piece. Correct me if I'm wrong there. So when I'm looking at your sort of outlook for the year, would you say you're equally confident in your ability to sort of achieve your loan growth targets and also your expectation for PCLs to be lower in the second half or do you see one of these areas potentially more uncertain than the others?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

I think we've talked quite a bit about PCL. So I have a high degree of conviction around that one, again, always with the caveat that predicting the future has always had its uncertainties. But I wouldn't be saying the things without kind of having done the work to be able to have that level of conviction. We're seeing good activity in the loan growth side. So I feel [indiscernible] otherwise, we would be clear about our messaging. I would say that if we hear noise that the bank account would actually pivoting and starting to tighten rates or something else or the -- the political mood changes in the country that can always have an impact on loan growth.

It's not terribly sensitive because driving earnings this year now basically, the loans that are going to drive the earnings are already on the book. So there's definitely some room for our customers are going to make that call to book those loans. But I still feel pretty good about it. We see to be well positioned in the marketplace with our key suppliers or brokers and so on. Our teams are doing a great job. We just put a new technology system to make it faster for us to turn around a loan and reduce the cost of that. So there's a lot of good tailwind, I guess, to that loan growth story, but that's probably where the variables lie.

Chadwick Westlake *EQB Inc - Chief Financial Officer, Senior Vice President*

Yeah. It's that 8% to 12%. Remember, that's the overarching loans under management guidance you may be referring to as well Graham. And do we have a conviction on the 80% to 12%, yes, we do at this time and the core asset classes, especially the ones that we talked about, the Wealth Decumulation, the multiunit lending. It would take some idiosyncratic events to take that off our flight path right now. And one thing I'd say, again, we've talked a lot about this year for a couple of quarters now that we thought the first half would play it a little bit different than the second half. This is playing out as we expected in our guidance, and we have a consistent track record of doing what we said what we're going to do. So we expect that will play out as well on the balance sheet for the second half.

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Graham Ryding *TD Securities - Analyst*

Okay. Understood. If I could just do one more. The originations on the personal side, I think they were down like 29% year-over-year. So I was a little bit surprised just given housing market activity, I think, is up year-to-date. So maybe you could just sort of try to flesh out why the disconnect there? Is the near -- is the sort of prime side of the market, maybe stronger than the near prime or are you seeing elevated competition? Maybe just some commentary there.

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

Yes, I think it's more related to that first point. I think my understanding is we do operate in the primary short space, but not in the sort of core prime space. My sense is that that's where the activity that -- the traditional borrower that segment that we address is still -- we're holding share pretty well. That's what all our data suggests we're holding share pretty well -- it is a segment and kind of where is the growth story.

Chadwick Westlake *EQB Inc - Chief Financial Officer, Senior Vice President*

Yeah. It's where Andrew is going, it's the higher remember, originations were one thing, but probably the expectation was higher renewals, which has different economic benefits and our renewal rates continue to increase quarter-over-quarter. So I focus on the total portfolio and how we thought we were going to arrive there as well.

Operator

Next question will be from Nigel D'Souza at Veritas Investment Research.

Nigel D'Souza *Veritas Investment Research - Analyst*

I have a few follow-up questions for you. The first on net interest margins, and you touched on this, but I was wondering if you could expand on the 10 basis point improvement quarter-over-quarter and the five factors you outlined. Any numbers you could put on how much it attributes to each factor or should we just assume it's about 2 basis points to each of those?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

Okay. If you wouldn't mind, Nigel, we're kind of getting closer to time. Could you take that offline with Chadwick? I think we've been a little careful to kind of break it down into that level in detail, but I'm sure Chadwick can give you some color that would be helpful to you.

Nigel D'Souza *Veritas Investment Research - Analyst*

Sure. Okay. I'll pivot and ask maybe broader question. On the rate dynamics, the impact on the margins, if we get rate cuts, there's higher prepayment penalties for that to be offset by lower margins on new business volumes. And then your term deposits will take longer to be priced. Could you just refresh me, like if we do get one to two rate cuts as expected, is that immediately NIM accretive or is that NIM accretive in 2025?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

I don't think we're really saying it's NIM accretive. It's NIM neutral, to be clear. So there's a number of offsetting factors there. So to the degree to which we reprice our -- first of all, the term deposits don't really matter, right? That's all matched. So that as Chadwick talked about, we run 1 year duration of equity back to we've got a term deposit with a fixed term on it, then we've got a mortgage

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with a fixed term on the other side here some other fixed fixed-price assets so that the asset and the liability will reprice on the same basis. There's a lot more complexity where you're dealing with demand deposits.

So the everyday savings accounts within EQ Bank -- how fast we choose to change rates on that is a management decision that we make, and there will be some trade-off between the lower cost of funds there and what that does to deposit growth. There are also some options embedded in the mortgage product itself. So some of the floating rate mortgages, for example, particularly on the commercial side, have flows associated with them. So as rates generally drop as prime drops, some of those mortgages will hit floors and that the spreads will improve for us in those mortgages as rates come down. So is this fairly complicated story. I'm sure our treasury team, and Chadwick will be happy to give you more color on that. But in general, those things start to offset each other in the book.

Nigel D'Souza *Veritas Investment Research - Analyst*

That makes sense. And then just a quick question on credit. I think in the MD&A, it was mentioned that single-family residential early stage delinquencies declined quarter-over-quarter. I just wanted to confirm if that's correct. And then -- could you speak to how that ties to the broader trends we're seeing where delinquencies are picking up in the near prime space and there's more [Technical Difficulty] consumer.

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

You were starting to break up a little bit. I think that the question as I understood it was that the early stage early stage [indiscernible] and 30 and 60 plus have been declining single family. I think we can confirm that is the case. I'm sorry, second half of the question, you broke up a little bit.

Nigel D'Souza *Veritas Investment Research - Analyst*

Sorry, the second half was just the broader industry trends. They appear to be higher delinquency rates for near prime mortgages and also more strain on households with the higher for longer rate environment. So just trying to reconcile how you're seeing improvements on delinquency rates, while the broader environment is a bit more strained?

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

I mean these are improvements against our own book, of course, and we do have higher [indiscernible] as the potential of the assets and the Canadian Bankers Association was reporting 17 basis points across the industry, I think. So we've got higher impaireds on that at this point. And [indiscernible] of course, because our customers have already been through the rate repricing that we discussed earlier. So we're comparing an apple with the banana here.

Operator

There are no further questions. Mr. Moor. Back to you for closing comments.

Andrew Moor *EQB Inc - President, Chief Executive Officer, Director*

Thank you so much, Sylvie. Before we leave today, I'm pleased to note that after many years of advocacy and this is a really positive thing for Equitable but we're pleased to see that the federal government finally is legislating the start of open banking -- like I've spent half of my career talking about this. The first part of the Consumer-driven Banking Act is being tabled with Part 2 to come this fall. There should be a significant interest to everyone on this call as well as all Canadians as we gear up for what we hope will be a more competitive and innovative future or financial services.

I look forward to speaking on this topic at the upcoming Open Banking Expo on June 11 in Toronto. Meantime, please check out our new and innovative EQ Bank Deposit Notice product. Opening an account is a great way to add context to your EQB investment

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thesis and even add value to EQB. We look forward to speaking to you on our third quarter call at the end of August. Thank you. Have a great day and a great summer.

Operator

That concludes today's call. You may disconnect your lines.

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