

# Report to Shareholders

## Second Quarter 2003

### National Bank announces 18% increase in earnings per share for second quarter 2003

- *Net income up 13% to \$138 million*
- *14% growth in net income for Personal and Commercial*
- *Credit quality remains excellent*
- *Quarterly dividend increased by 7.7%*

**MONTREAL, May 29, 2003** – National Bank of Canada declared net income of \$138 million for the second quarter ended April 30, 2003, for an increase of 13% compared to \$122 million for the corresponding period of 2002. Earnings per share were \$0.73 for the quarter versus \$0.62 for the second quarter of 2002, up 18%. Return on common shareholders' equity was 14.8% for the second quarter of 2003 compared to 13.1% for the corresponding period in 2002.

Strong growth in net income for the quarter versus the same quarter of 2002 was chiefly attributable to the reduction in the provision for credit losses. In addition, Personal and Commercial recorded net income of \$72 million, for an increase of 14%. Wealth Management posted net income of \$17 million for the quarter, unchanged from the corresponding quarter of 2002, while net income for Financial Markets was down \$41 million to \$37 million.

Commenting on these results, Réal Raymond, President and Chief Executive Officer, underscored the Bank's consistently strong performance. "Despite difficult economic conditions in the second quarter marked by volatile financial markets, the National Bank continues to perform well and to pursue its profitability objectives."

	For the quarter ended April 30		
	2003	2002	%
<b>Net income</b>			
Personal and Commercial	72	63	+14
Wealth Management	17	17	-
Financial Markets	37	78	-53
Other	12	(36)	
<b>Total</b>	<b>138</b>	<b>122</b>	<b>+13</b>
<b>Earnings per share</b>	<b>\$0.73</b>	<b>\$0.62</b>	<b>+18</b>
<b>Return on common shareholders' equity</b>	<b>14.8%</b>	<b>13.1%</b>	

	For the six months ended April 30		
	2003	2002	%
<b>Net income</b>			
Personal and Commercial	163	132	+23
Wealth Management	36	40	-10
Financial Markets	101	135	-25
Other	4	(39)	
<b>Total</b>	<b>304</b>	<b>268</b>	<b>+13</b>
<b>Earnings per share</b>	<b>\$1.61</b>	<b>\$1.35</b>	<b>+19</b>
<b>Return on common shareholders' equity</b>	<b>16.3%</b>	<b>14.1%</b>	

Mr. Raymond singled out, in particular, the solid performance of the Personal and Commercial segment and the steady results obtained by Wealth Management despite weak trading on the part of investors.

"We remain committed to fostering greater synergy between the various asset management platforms and distribution networks. The Bank is also stepping up its efforts to improve efficiency and to manage its operating expenses more effectively," Mr. Raymond added.

Moreover, the Board of Directors approved a 7.7% increase in the quarterly dividend, raising it from 26 cents to 28 cents per share.

For the six-month period ended April 30, 2003, net income was \$304 million, for an increase of \$36 million or 13%. Earnings per share rose 19% to \$1.61 for the first half of 2003 as against \$1.35 for the same period a year earlier. The decline in the provision for credit losses was again the main reason for the increase in net income for the first half of the year.

As at April 30, 2003, specific and general allowances exceeded gross impaired loans by \$179 million compared to \$159 million as at October 31, 2002, and \$92 million a year earlier.

By the end of the quarter, the Bank had repurchased 82% or 7.5 million common shares out of a total 9.1 million under its normal course issuer bid.

## Business Development

During the second quarter, the Bank continued to deploy its strategy aimed at further improving customer service. Last year, the Bank took steps to make its services more accessible by extending business hours at 60 of its branches in Quebec and introduced an extensive training plan to further develop the competencies of its front-line personnel. The Bank recently consolidated its efforts in this regard with the introduction of a brand new program intended to help employees in both the Personal and Commercial and Wealth Management segments foster closer ties with their customers. The various measures introduced this past year are yielding favourable results as evidenced by the latest round of surveys which show a steady improvement in customer satisfaction.

Quality customer service also means offering innovative products and services tailored to meet customers' specific needs. The Bank continued to stand out in this regard during the quarter by introducing several highly competitive mortgage offers geared to meeting the expectations of different types of homebuyers. In a similar vein, the Bank also scored an industry first with the recent launch of its Personalized Financing Guide, which makes it easy to identify the borrower profile of its customers and, based on this information, to offer them the financing solutions best suited to their needs.

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Quarterly financial statements are available at all times on the National Bank of Canada website at [www.nbc.ca/investorrelations](http://www.nbc.ca/investorrelations).

### Conference call on results for the second quarter of fiscal 2003

- A conference call for financial analysts will be held on **May 29, 2003 at 2:30 p.m. Eastern time.**
- Access by telephone:  
**1-800-273-9672 or (416) 695-5806**
- The conference call will be webcast live at [www.nbc.ca/investorrelations](http://www.nbc.ca/investorrelations)
- The Report to Shareholders, supplementary financial information and a slide presentation will be available on the investor relations page of the National Bank's website shortly before the start of the conference call.

### Recording of the conference call

- A recording of the conference call can be heard until June 5, 2003 by calling 1-800-408-3053 or (416) 695-5800. The access code is 1415955.
- A recording of the webcast will also be available on the Internet after the call at [www.nbc.ca/investorrelations](http://www.nbc.ca/investorrelations).

## Management's Analysis of Financial Condition and Operating Results

The following text presents management's analysis of the Bank's financial condition and operating results as presented in the unaudited consolidated financial statements for the second quarter and first half of 2003.

### Strategic Objectives

The National Bank published its strategic objectives for fiscal 2003 in its 2002 Annual Report. The table below compares these objectives with the results for the second quarter and first half of 2003.

	Objectives	2 <sup>nd</sup> quarter results	First six-month results
Growth in earnings per share	5% - 10%	18%	19%
Return on common shareholders' equity	14% - 16%	14.8%	16.3%
Tier 1 capital ratio	8.75% - 9.50%		9.8%
Dividend payout ratio	30% - 40%		33%*

\* Based on earnings per share for the last four quarters excluding the impairment charge for an investment

## Analysis of Results

### Operating Results

For the second quarter ended April 30, 2003, the National Bank earned net income of \$138 million, for an increase of 13%, compared to \$122 million for the second quarter of 2002. Earnings per share were \$0.73 for the quarter versus \$0.62 for the corresponding period of 2002, up 18%. Return on common shareholders' equity rose to 14.8% for the second quarter of 2003 as against 13.1% for the quarter ended April 30, 2002.

For the six-month period ended April 30, 2003, the National Bank recorded net income of \$304 million compared to \$268 million for the same period of 2002, representing an increase of 13%. At \$1.61 for the first six months of 2003, earnings per share were up 19% versus \$1.35 for the corresponding period of 2002. Return on common shareholders' equity rose to 16.3% for the first half of 2003 versus 14.1% for the six-month period ended April 30, 2002.

### Revenues

Total revenues for the second quarter of 2003 were \$773 million, a decrease of \$41 million from the \$814 million recorded for the corresponding period of 2002.

Net interest income amounted to \$343 million for the second quarter of 2003, down \$13 million from \$356 million for the corresponding period a year earlier. Net interest income for Personal and Commercial rose by \$11 million or 4% to reach \$300 million, mainly due to an increase of close to \$1 billion in deposits from small and medium-sized enterprises. This increase was more than offset by the approximately \$10 million reduction in net interest income resulting from asset and liability matching and the cost of financing the acquisition of Altamira. Other income for the quarter totalled \$430 million as against \$458 million for the second quarter of 2002, for a decline of \$28 million. Capital market fees were down \$30 million owing to reduced trading by individuals. Gains on investment account securities and income from trading activities were down \$15 million in relation to the second quarter of 2002, when the Bank recorded \$14 million in revenues generated by merchant banking investments. Moreover, income from trust services and mutual funds rose \$17 million owing mainly to income from Altamira.

For the first six months of 2003, total revenues amounted to \$1,608 million, for an increase of \$32 million over the same period of 2002. The acquisition of Putnam Lovell and of Altamira generated \$60 million. The gain on the initial public offering of the Toronto Stock Exchange contributed \$26 million. However, net interest income was down \$39 million chiefly due to lower income from asset and liability matching.

### Operating Expenses

Operating expenses for the second quarter of 2003 amounted to \$529 million, up \$38 million from \$491 million for the corresponding period of 2002. The acquisition of Putnam Lovell and Altamira added \$31 million to operating expenses compared to the same quarter of 2002.

For the six-month period ended April 30, 2003, operating expenses amounted to \$1,077 million, for an increase of

## Management's Analysis of Financial Condition and Operating Results (cont.)

\$85 million, including \$65 million attributable to acquisitions. If the impact of the acquisitions is excluded, the increase in operating expenses was 2% compared to the first six months of 2002.

### Results by Segment

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The revenues of each segment are presented on a taxable equivalent basis, i.e., they are grossed up to make the income earned on certain securities comparable with income from other financial instruments. An equivalent amount was added to income taxes. In addition, the provision for credit losses of each operating segment is based on expected losses which are calculated using statistical analyses. The difference between expected losses and actual losses is charged to the "Other" heading.

#### Personal and Commercial

Personal and Commercial posted net income of \$72 million for the second quarter of 2003, up 14% from \$63 million for the corresponding period of 2002. Revenues were \$447 million, for an increase of \$16 million or 4%. Net interest income, which totalled \$300 million, rose \$11 million owing mainly to the increase of close to \$1 billion in the volume of deposits from small and medium-size enterprises. Other income was up by \$5 million to \$147 million primarily attributable to commercial lending fees and revenues from credit card and insurance activities. Operating expenses for the quarter were \$282 million compared to \$273 million for the second quarter of 2002. The efficiency ratio was 63.1% versus 63.3% for the same period a year earlier. Lastly, expected loan losses declined by \$4 million or 7% from the corresponding period in 2002, reflecting the good quality of the loan portfolio.

For the first six months of 2003, net income for Personal and Commercial rose 23%, from \$132 million for the first six months of 2002 to \$163 million. Revenues were \$915 million, for an increase of \$44 million or 5%. Nearly 50% of the increase was attributable to Personal Banking while the other 50% was due to credit card and insurance activities. Operating expenses were \$555 million, up 1.5% compared to the first six months of 2002. The efficiency ratio improved, going from 62.8% in the first six months of 2002 to 60.7% in the first six months of this year.

#### Wealth Management

Net income for the Wealth Management segment totalled \$17 million for the second quarter of 2003, unchanged from the corresponding quarter a year earlier. Revenues amounted to \$154 million this quarter versus \$157 million for the same period in 2002. Lower retail brokerage revenues were offset in part by the addition of \$14 million in revenues from Altamira. At \$126 million, operating expenses were down \$5 million, primarily because of variable expenses related to the decline in brokerage revenues, which were offset in part by Altamira expenses.

For the six-month period ended April 30, 2003, net income for Wealth Management amounted to \$36 million as against \$40 million for the same period a year earlier. The decline in activity by individuals on capital markets accounted for most of the decrease.

#### Financial Markets

For the second quarter of 2003, Financial Markets posted net income of \$37 million, down \$41 million. Revenues for the quarter reached \$187 million, for a decrease of \$43 million or 19%. A gain generated by merchant banking investments in the second quarter of 2002 accounted for \$14 million of this variance. The use of market value to record credit derivatives reduced the segment's revenues by \$18 million. The remainder was attributable to lower corporate financing volumes. At \$117 million, operating expenses rose \$17 million mainly as a result of the addition of Putnam Lovell expenses. Expected loan losses were \$12 million for the second quarter of 2003 compared to \$8 million for the same period in 2002.

For the first six months of 2003, net income for Financial Markets was \$101 million, down \$34 million from the same period a year earlier. Revenues were \$424 million for the six-month period compared to \$427 million for the first half of 2002. The addition of Putnam Lovell revenues was offset by the decline in corporate financing revenues. Operating expenses were \$245 million for this six-month period versus \$193 million for the same period a year earlier. Most of the increase was attributable to Putnam Lovell operating expenses. The provision for credit losses for the six months was \$22 million as against \$21 million for the same period in 2002.

## Management's Analysis of Financial Condition and Operating Results (cont.)

### Other

Net income for the "Other" heading totalled \$12 million for the second quarter of 2003 compared to a loss of \$36 million for the same period in 2002. The lower provision for credit losses was chiefly responsible for this improvement. The provision for credit losses for the "Other" heading includes the difference between expected losses charged to operating segments and actual loan losses incurred. The favourable \$89 million variance compared to the second quarter of 2002 was primarily attributable to the \$100 million loss for the telecommunications sector and the \$30 million reduction in the general allowance for credit risk.

For the first six months of 2003, net income for the "Other" heading was \$4 million as against a loss of \$39 million for the corresponding period of 2002. The favourable \$285 million variance for the provision for credit losses was primarily due to the revision of the estimated allowance of \$185 million in the first quarter of 2002, the \$100 million loss for the telecommunications sector and the \$30 million reduction in the general allowance for credit risk. The "Discontinued Operations" heading includes the \$118 million net gain generated by the sale of U.S. asset-based lending operations in the first quarter of 2002.

### Risk Management

#### Credit Risk

The provision for credit losses for the quarter was \$41 million as against \$130 million for the corresponding quarter of 2002. For the first six months of fiscal 2003, credit losses were \$82 million

compared to \$375 million for the same period a year earlier. Excluding the revision of the estimated allowance of \$185 million recorded in the first quarter of 2002, the provision for credit losses was reduced by \$108 million for the six-month period.

As at April 30, 2003, allowances for credit losses exceeded impaired loans by \$179 million compared to \$159 million as at October 31, 2002, for an improvement of \$20 million. New formation of gross impaired loans (less recoveries) amounted to \$37 million for the quarter compared to \$29 million for the previous quarter.

The ratio of gross private impaired loans to total tangible capital and allowances was 13.3% as at April 30, 2003 versus 14.1% as at October 31, 2002.

#### Market Risk – Trading Activities

The VaR (Value-at-Risk) method is one of the main tools used in managing trading-related market risk. The VaR measure is based on a 99% confidence level and uses two years of historical data for its computation. Market risk management is described in greater detail on page 49 of the 2002 Annual Report.

The following table entitled "Trading Activities" illustrates the distribution of market risk by type of risk, namely, interest rate, foreign exchange and price risk, including commodity and equity risk. Global VaR as at April 30, 2003 was down \$1 million from the previous quarter mainly due to lower interest rate risk on trading activities.

### Trading Activities <sup>(1)</sup>

(millions of dollars)

Global VaR by risk category	For the quarter ended April 30, 2003				For the quarter ended January 31, 2003			
	Period end	High	Average	Low	Period end	High	Average	Low
Interest rate	(2)	(5)	(3)	(2)	(3)	(4)	(3)	(3)
Foreign exchange	(1)	(2)	(1)	–	(1)	(1)	(1)	–
Price	(3)	(4)	(3)	(2)	(3)	(4)	(2)	(1)
Global VaR <sup>(2)</sup>	(4)	(6)	(4)	(3)	(5)	(5)	(4)	(3)

<sup>(1)</sup> Amounts are presented on a pre-tax basis and represent one-day VaR.

<sup>(2)</sup> Global VaR takes into account the correlation effect from each of the risk categories through diversification.

## Management's Analysis of Financial Condition and Operating Results (cont.)

### Balance Sheet

As at April 30, 2003, the Bank's total assets amounted to \$75.8 billion as against \$74.6 billion as at October 31, 2002 and \$74.7 billion as at April 30, 2002. The table below presents the main loan and deposit headings.

Average monthly volumes (millions of dollars)	April 2003	October 2002	April 2002
<b>Loans and acceptances*</b>			
Residential mortgages	17,529	17,452	17,146
Consumer loans	4,432	4,467	4,377
Credit card receivables	1,424	1,383	1,270
Business loans	15,223	15,342	15,923
Bankers' acceptances	3,614	3,341	3,709
	<b>42,222</b>	<b>41,985</b>	<b>42,425</b>
<b>Deposits</b>			
Personal (balance)	23,234	22,607	22,572
Off-balance sheet personal savings (balance)	46,605	45,636	42,292
Business and government	8,977	7,648	7,873

\* including securitized assets

Residential mortgage loans totalled \$17.5 billion as at April 30, 2003, up 2% from a year earlier. Excluding indirect loans, personal loans have risen by almost 11% since April 2002 to \$3.7 billion. Credit card receivables increased by 12% year over year to reach \$1.4 billion as at April 30, 2003. At \$18.8 billion, business loans and acceptances were down \$0.8 billion chiefly because of corporate loans and acceptances and international loans. Since October 31, 2002, business loans and acceptances have increased by close to 1%, largely through loans and acceptances to small and medium-sized enterprises.

Personal deposits have risen by more than \$660 million since April 30, 2002 and by close to \$630 million since October 31, 2002 to total \$23.2 billion at the end of the quarter. Total personal savings administered by the Bank and its subsidiaries have grown by \$1.6 billion since October 31, 2002 to reach \$69.8 billion. As at April 30, 2003, business and government deposits were up more than \$1 billion from April 30, 2002 and October 31, 2002, chiefly because of deposits from small and medium-size enterprises.

### Capital

Tier 1 and total capital ratios, in accordance with the rules of the Bank for International Settlements, were 9.8% and 13.9% respectively as at April 30, 2003 compared to 9.6% and 13.6% as at October 31, 2002. The improvement in capital ratios was mainly attributable to the issue of \$200 million in preferred shares, offset in part by the common share repurchase program.

On May 15, 2003, the Bank redeemed first preferred shares, Series 12, for an aggregate consideration of \$125 million. As a result of this redemption, capital ratios were reduced by approximately 30 basis points.

### Dividends

At its meeting on May 29, 2003, the Board of Directors declared regular dividends on the various classes and series of preferred shares as well as a dividend of 28 cents per common share, payable on August 1, 2003 to shareholders of record on June 26, 2003.

## Highlights

(unaudited)	Quarter ended April 30			Six months ended April 30		
	2003	2002	% Change	2003	2002	% Change
<b>Operating results</b>						
(millions of dollars)						
Total revenues	\$773	\$814	(5)	\$1,608	\$1,576	2
Net income	138	122	13	304	268	13
Return on common shareholders' equity	14.8%	13.1%		16.3%	14.1%	
<b>Per common share</b>						
Net income	\$0.73	\$0.62	18	\$1.61	\$1.35	19
Dividends paid	0.26	0.24	8	0.52	0.45	16
Book value				20.28	19.53	4
Stock trading range						
High	35.15	34.93		35.15	34.93	
Low	31.26	29.14		29.95	24.70	
Close	34.90	33.40		34.90	33.40	
<b>Financial position</b>						
(millions of dollars)						
				April 30 2003	October 31 2002	
Total assets				\$75,791	\$74,611	2
Loans and acceptances				45,185	43,800	3
Deposits				50,184	51,690	(3)
Subordinated debentures and shareholders' equity				5,615	5,493	2
Capital ratios - BIS						
Tier 1				9.8%	9.6%	
Total				13.9%	13.6%	
Impaired loans,						
net of specific and general allowances				(179)	(159)	
as a % of loans and acceptances				(0.4)%	(0.4)%	
Assets under administration/management				139,854	140,737	
Total personal savings				69,839	68,243	
Interest coverage				8.10	7.39	
Asset coverage				3.13	3.02	
<b>Other information</b>						
Number of employees				16,961	17,285	(2)
Number of branches in Canada				488	507	(4)
Number of banking machines				809	826	(2)

## Consolidated Statement of Income

(unaudited)  
(millions of dollars except per share amounts)

### Interest income and dividends

Loans  
Securities  
Deposits with financial institutions

### Interest expense

Deposits  
Subordinated debentures  
Other

### Net interest income

### Other income

Capital market fees  
Deposit and payment service charges  
Trading activities and gains on investment account securities, net  
Card service revenues  
Lending fees  
Acceptances, letters of credit and guarantee  
Securitization revenues (Note 7)  
Foreign exchange revenues  
Trust services and mutual funds  
Other

### Total revenues

### Provision for credit losses

### Operating expenses

Salaries and staff benefits  
Occupancy and amortization  
Computers and equipment  
Communications  
Other

### Income before income taxes, non-controlling interest and discontinued operations

### Income taxes

### Non-controlling interest

### Income before discontinued operations

### Discontinued operations

### Net income

### Dividends on preferred shares

### Net income applicable to common shares

### Number of common shares outstanding (thousands)

Average - basic  
Average - diluted  
End of period

### Income before discontinued operations per common share

Basic  
Diluted

### Net income per common share

Basic  
Diluted

### Dividends per common share

	Quarter ended			Six months ended	
	April 30 2003	January 31 2003	April 30 2002	April 30 2003	April 30 2002
<b>Interest income and dividends</b>					
Loans	460	466	460	926	956
Securities	126	150	128	276	266
Deposits with financial institutions	32	37	43	69	97
	618	653	631	1,271	1,319
<b>Interest expense</b>					
Deposits	235	257	238	492	506
Subordinated debentures	26	27	27	53	55
Other	14	14	10	28	21
	275	298	275	573	582
<b>Net interest income</b>	343	355	356	698	737
<b>Other income</b>					
Capital market fees	120	136	150	256	278
Deposit and payment service charges	42	42	42	84	84
Trading activities and gains on investment account securities, net	33	51	48	84	48
Card service revenues	13	12	12	25	24
Lending fees	49	50	47	99	91
Acceptances, letters of credit and guarantee	15	19	14	34	31
Securitization revenues (Note 7)	44	54	49	98	95
Foreign exchange revenues	18	17	17	35	32
Trust services and mutual funds	51	54	34	105	67
Other	45	45	45	90	89
	430	480	458	910	839
<b>Total revenues</b>	773	835	814	1,608	1,576
<b>Provision for credit losses</b>	41	41	130	82	375
	732	794	684	1,526	1,201
<b>Operating expenses</b>					
Salaries and staff benefits	292	317	286	609	568
Occupancy and amortization	49	45	45	94	89
Computers and equipment	61	63	58	124	115
Communications	20	21	18	41	36
Other	107	102	84	209	184
	529	548	491	1,077	992
<b>Income before income taxes, non-controlling interest and discontinued operations</b>	203	246	193	449	209
<b>Income taxes</b>	58	73	63	131	44
	145	173	130	318	165
<b>Non-controlling interest</b>	7	7	8	14	15
<b>Income before discontinued operations</b>	138	166	122	304	150
<b>Discontinued operations</b>	-	-	-	-	118
<b>Net income</b>	138	166	122	304	268
<b>Dividends on preferred shares</b>	8	5	5	13	12
<b>Net income applicable to common shares</b>	130	161	117	291	256
<b>Number of common shares outstanding (thousands)</b>					
Average - basic	178,348	182,728	188,794	180,574	189,636
Average - diluted	179,666	183,905	190,260	181,821	190,814
End of period				175,670	185,109
<b>Income before discontinued operations per common share</b>					
Basic	0.73	0.88	0.62	1.61	0.73
Diluted	0.72	0.88	0.62	1.60	0.73
<b>Net income per common share</b>					
Basic	0.73	0.88	0.62	1.61	1.35
Diluted	0.72	0.88	0.62	1.60	1.35
<b>Dividends per common share</b>	0.26	0.26	0.24	0.52	0.45

## Consolidated Balance Sheet

(unaudited)  
(millions of dollars)

	April 30 2003	January 31 2003	October 31 2002	April 30 2002
<b>ASSETS</b>				
<b>Cash resources</b>				
Cash and deposits with Bank of Canada	328	302	245	249
Deposits with financial institutions	5,255	6,130	6,619	8,083
	<b>5,583</b>	<b>6,432</b>	<b>6,864</b>	<b>8,332</b>
<b>Securities</b>				
Investment account	6,989	7,325	6,712	6,401
Trading account	14,224	11,669	13,179	11,677
Loan substitutes	63	64	76	75
	<b>21,276</b>	<b>19,058</b>	<b>19,967</b>	<b>18,153</b>
<b>Loans</b>				
Residential mortgage	13,148	12,962	12,867	12,217
Personal and credit card	5,920	5,744	5,561	5,930
Business and government	20,216	19,094	20,680	19,130
Securities purchased under reverse repurchase agreements	3,419	3,426	2,366	5,162
Allowance for credit losses	(646)	(635)	(662)	(762)
	<b>42,057</b>	<b>40,591</b>	<b>40,812</b>	<b>41,677</b>
<b>Other</b>				
Customers' liability under acceptances	3,128	3,134	2,988	3,027
Assets held for disposal	225	281	313	567
Premises and equipment	241	246	255	238
Goodwill	660	660	661	283
Intangible assets	184	184	184	12
Other assets	2,437	2,539	2,567	2,381
	<b>6,875</b>	<b>7,044</b>	<b>6,968</b>	<b>6,508</b>
	<b>75,791</b>	<b>73,125</b>	<b>74,611</b>	<b>74,670</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>				
<b>Deposits</b>				
Personal	23,234	23,000	22,607	22,572
Business and government	22,741	21,400	22,582	21,635
Deposit-taking institutions	4,209	5,530	6,501	6,879
	<b>50,184</b>	<b>49,930</b>	<b>51,690</b>	<b>51,086</b>
<b>Other</b>				
Acceptances	3,128	3,134	2,988	3,027
Obligations related to securities sold short	6,331	6,085	5,542	6,182
Obligations related to securities sold under repurchase agreements	4,358	3,293	4,416	4,690
Other liabilities	5,742	4,473	3,996	3,652
	<b>19,559</b>	<b>16,985</b>	<b>16,942</b>	<b>17,551</b>
<b>Subordinated debentures</b>	<b>1,553</b>	<b>1,581</b>	<b>1,592</b>	<b>1,630</b>
<b>Non-controlling interest</b>	<b>433</b>	<b>458</b>	<b>486</b>	<b>488</b>
<b>Shareholders' equity</b>				
Preferred shares	500	500	300	300
Common shares	1,583	1,633	1,639	1,628
Retained earnings	1,979	2,038	1,962	1,987
	<b>4,062</b>	<b>4,171</b>	<b>3,901</b>	<b>3,915</b>
	<b>75,791</b>	<b>73,125</b>	<b>74,611</b>	<b>74,670</b>

## Consolidated Statement of Cash Flows

(unaudited)  
(millions of dollars)

	Quarter ended April 30		Six months ended April 30	
	2003	2002	2003	2002
<b>Cash flows from operating activities</b>				
Net income	138	122	304	268
Adjustments for:				
Provision for credit losses excluding discontinued operations	41	130	82	375
Provision for credit losses attributed to discontinued operations	-	-	-	(50)
Amortization of premises and equipment	13	13	24	25
Future income taxes	(5)	(14)	1	(3)
Adjustment upon foreign currency translation of subordinated debentures	(28)	(6)	(39)	(7)
Losses (gains) on sale of investment account securities, net	9	(20)	(4)	(28)
Change in interest payable	(2)	(41)	(3)	(100)
Change in interest receivable	(8)	27	5	46
Change in income taxes payable	79	(18)	85	92
Change in unrealized losses (gains) and amounts payable on derivative contracts	73	(151)	301	(66)
Change in trading account securities	(2,555)	354	(1,045)	(685)
Change in other items	1,160	(17)	1,429	132
	<b>(1,085)</b>	<b>379</b>	<b>1,140</b>	<b>(1)</b>
<b>Cash flows from financing activities</b>				
Change in deposits	254	561	(1,506)	(350)
Redemption and maturity of subordinated debentures	-	(9)	-	(10)
Issuance of common shares	4	4	11	8
Issuance of preferred shares	-	-	200	-
Common shares repurchased for cancellation	(194)	(184)	(240)	(184)
Preferred shares redeemed for cancellation	-	(100)	-	(192)
Dividends paid	(5)	(47)	(101)	(96)
Change in obligations related to securities sold short	246	452	789	803
Change in obligations related to securities sold under repurchase agreements	1,065	(1,444)	(58)	283
Change in other items	(3)	(3)	(7)	(3)
	<b>1,367</b>	<b>(770)</b>	<b>(912)</b>	<b>259</b>
<b>Cash flows from investing activities</b>				
Change in loans	(1,192)	(341)	441	1,047
Change in securitization of assets	(265)	(75)	(626)	(643)
Proceeds from sale of asset-based loans	-	-	-	2,540
Purchases of investment account securities	(5,667)	(4,628)	(11,432)	(8,988)
Sales of investment account securities	5,994	5,149	11,171	9,420
Change in securities purchased under reverse repurchase agreements	7	(432)	(1,053)	(1,121)
Change in premises and equipment	(8)	(8)	(10)	(13)
	<b>(1,131)</b>	<b>(335)</b>	<b>(1,509)</b>	<b>2,242</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(849)</b>	<b>(726)</b>	<b>(1,281)</b>	<b>2,500</b>
Cash and cash equivalents at beginning of period	6,432	9,058	6,864	5,832
Cash and cash equivalents at end of period	5,583	8,332	5,583	8,332
<b>Cash and cash equivalents</b>				
Cash and deposits with Bank of Canada	328	249	328	249
Deposits with financial institutions	5,255	8,083	5,255	8,083
Total	5,583	8,332	5,583	8,332
Interest and dividends paid	282	365	678	779
Income taxes paid (recovered)	(15)	97	46	42

## Consolidated Statement of Changes in Shareholders' Equity

(unaudited)  
(millions of dollars)

	Six months ended April 30	
	2003	2002
<b>Capital stock at beginning of period</b>	1,939	2,160
Issuance of common shares	11	8
Issuance of preferred shares (Note 6)	200	-
Repurchase of common shares for cancellation (Note 6)	(67)	(48)
Redemption of preferred shares, Series 10 and 11 for cancellation	-	(192)
<b>Capital stock at end of period</b>	<b>2,083</b>	<b>1,928</b>
<b>Retained earnings at beginning of period</b>	1,962	1,956
Net income	304	268
Dividends		
Preferred shares	(13)	(12)
Common shares	(95)	(86)
Income taxes related to dividends on preferred shares, Series 10,11,12 and 13	(1)	(2)
Premium paid on common shares repurchased for cancellation (Note 6)	(173)	(136)
Share issuance expenses, net of income taxes	(3)	-
Unrealized foreign exchange losses, net of income taxes	(2)	(1)
<b>Retained earnings at end of period</b>	<b>1,979</b>	<b>1,987</b>
<b>Shareholders' equity</b>	<b>4,062</b>	<b>3,915</b>

## Notes to the Consolidated Financial Statements

(unaudited) (millions of dollars)

*These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended October 31, 2002. Certain comparative figures have been reclassified to comply with the presentation adopted in fiscal 2003.*

### 1. Significant Accounting Policies

These unaudited interim consolidated financial statements of the Bank were prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and the accounting policies adopted in the Bank's most recent annual report for the year ended October 31, 2002, with the exception of the new standards described in Note 2 and the recording in the first quarter of 2002 of the difference between the general allowance for credit risk according to the guidance provided by the Superintendent of Financial Institutions Canada and according to Canadian GAAP, as described in Note 28 to the 2002 annual consolidated financial statements.

Had the Bank followed Canadian GAAP in the first quarter of 2002, net income would have decreased by \$57 million, the provision for credit losses would have increased by \$97 million, income taxes would have decreased by \$40 million, and basic and diluted net income per common share would have decreased by \$0.30. Furthermore, return on common shareholders' equity would have decreased by 6.26%.

## Notes to the Consolidated Financial Statements (cont.)

### 2. Recent Standards Adopted

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#### Stock-Based Compensation

On November 1, 2002, the Bank adopted the requirements of the standard of the Canadian Institute of Chartered Accountants (the "CICA") entitled "Stock-Based Compensation and Other Stock-Based Payments". It establishes standards for the recognition, measurement and disclosure of stock-based compensation and other stock-based payments made in exchange for goods and services. A description of these new accounting policies and the impact of the adoption of this new standard on the consolidated financial statements for the first six months of 2003 are presented below.

#### A. Stock Appreciation Rights (SAR) Plan

In accordance with this new standard, SARs are recorded at fair value by valuing, on an ongoing basis, the excess of the stock price over the exercise price of the option. The new standard applies to SARs outstanding at the date of the adoption of the recommendations and to subsequent awards. The Bank's obligation, which results from the variation in the stock's market price, is recognized in income on a straight-line basis over the vesting period, namely, four years, and a corresponding amount is included in "Other liabilities". When the vesting period expires and until the SARs are exercised, the change in the obligation attributable to variations in the stock price is recognized by increasing or decreasing the compensation expense for the period in which the variations occur. With regard to SARs outstanding as at the date of the adoption of the recommendations, the application of the new standard's transitional provisions, taking into account the liability previously recognized by the Bank, did not require any cumulative adjustment to the balance of retained earnings as at November 1, 2002. Furthermore, the new standard had no material impact on the consolidated financial statements for the first quarter of 2003.

#### B. Stock Option Plan

As encouraged in the new standard, the Bank has chosen to adopt the fair value-based method to record stock options

awarded subsequent to November 1, 2002. The fair value of the stock options is estimated on the grant date using the Black-Scholes model. The cost is recognized using a straight-line method over the vesting period, namely, four years, as an increase in the compensation expense and the contributed surplus. When the options are exercised, the proceeds and the contributed surplus are credited to common share paid-up capital. For options awarded before November 1, 2002, the Bank continues to apply the accounting policy described in Note 1 to the 2002 annual consolidated financial statements.

The fair value on the grant date of the options awarded in 2003 was estimated at \$6.90 using the Black-Scholes model. The following assumptions were used: i) a risk-free interest rate of 4.54%, ii) an expected life of options of six years, iii) an expected volatility of 27% and iv) an expected dividend yield of 3.36%.

The impact of the adoption of the fair value-based method on the consolidated financial statements for the six months ended April 30, 2003 was an increase of approximately \$1 million in compensation expense and in contributed surplus.

#### Disclosure of Guarantees

On April 30, 2003, the Bank adopted the requirements of the CICA's Accounting Guideline 14 entitled "Disclosure of Guarantees" (AcG-14). This Guideline broadens the definition of guarantees and requires that the guarantor disclose significant information on the guarantees which it has provided.

AcG-14 defines a guarantee as a contract (including an indemnity) that contingently requires the guarantor to make payments (either in cash, financial instruments, other assets or shares of the entity, or provision of services) to the beneficiary due to (a) changes in interest rate, security or commodity price, foreign exchange rate, index or other variable, including the occurrence or non-occurrence of a specified event, that is related to an asset, a liability or an equity security of the beneficiary of the guarantee, (b) failure of a third party to perform

## Notes to the Consolidated Financial Statements (cont.)

under a contractual agreement or (c) failure of a third party to pay its indebtedness when due.

Significant guarantees issued by the Bank and in effect on April 30, 2003 are described below:

### *Letters of guarantee*

In the normal course of business, the Bank issues letters of guarantee. These letters of guarantee represent irrevocable assurances that the Bank will make payments in the event that a client cannot meet his financial obligations to third parties. The Bank's policy for requiring collateral security with respect to letters of guarantee is similar to that for loans. Generally, the term of these letters of guarantee is less than four years. The maximum potential future payments for letters of guarantee totalled approximately \$1 billion as at April 30, 2003. The general allowance for credit losses recorded covers all credit risks including those relating to letters of guarantee.

### *Liquidity facilities*

The Bank provides backstop liquidity facilities under asset-backed commercial paper conduit programs administered by the Bank further to securitization operations. These backstop liquidity facilities may only be drawn upon if, after a market disruption, the programs would be unable to access the commercial paper market. These guarantees have a duration of less than one year and are renewable periodically. None of the backstop liquidity facilities provided by the Bank have been drawn upon to date. As at April 30, 2003, the maximum potential future payments that the Bank may be required to make under these backstop liquidity facilities was \$575 million. No amount has been accrued in the Consolidated Balance Sheet with respect to these liquidity facilities.

### *Derivatives*

In the normal course of business, the Bank enters into written put options to meet the needs of its clients and for its own risk management and trading activities. Put options are contractual agreements by which the Bank grants the purchaser the

right, but not the obligation, to sell by or at a pre-determined date, a specific amount of currency, or a commodity or financial instrument, at a price agreed to when the option is contracted. Written put options sold that qualify as a guarantee under AcG-14 include primarily over-the-counter currency options with companies other than financial institutions and over-the-counter stock options when it is probable that the counterparty holds underlying securities. The terms of these options vary based on the contracts but do not exceed two years. The maximum potential future payments with respect to these options sold totalled \$431 million as at April 30, 2003. At that date, the Bank had recorded liabilities of \$6 million in the Consolidated Balance Sheet with respect to these written put options.

### *Securities lending*

In accordance with securities lending agreements the Bank has signed with certain clients who have previously entrusted it with the safekeeping of their securities, the Bank, as an agent for these clients, lends their securities to third parties and indemnifies these clients in the event of loss. In order to protect itself against all potential losses, the Bank requires from the borrower as security a cash amount or highly liquid marketable securities with a fair value greater than that of the securities loaned. The fair value of the securities loaned totalled \$1.5 billion as at April 30, 2003. No amount has been accrued in the Consolidated Balance Sheet with respect to potential indemnities resulting from securities lending operations.

### *Sale of a business and operations*

Under agreements with respect to the sale of a business and operations, the Bank agreed to indemnify the purchaser for losses incurred resulting from certain types of claims from the Bank's past conduct of the business or operations, as well as any representations and guarantees that may have been incorrect on the date when they were made. In cases where the maximum potential future payments are limited by the agreements, the amount for all such agreements totalled approximately \$260 million as at April 30, 2003. One agreement does not limit the maximum potential future payments if the

## Notes to the Consolidated Financial Statements (cont.)

guarantee is enforced and, the nature of these commitments prevents the Bank from estimating the maximum potential liability that it may be required to pay. The applicable period of the various indemnification clauses are described in the agreements and may vary. In addition, further to one of the agreements concerning the sale of operations, the Bank has agreed to repurchase the assets sold that did not comply with certain representations made by the Bank with respect to these assets. The Bank's commitment with regard to the repurchase of certain assets sold ends in July 2003. No amount has been accrued in the Consolidated Balance Sheet with respect to these indemnification agreements.

### *Business acquisition*

In June 2002, the Bank purchased Putnam Lovell Group Inc., a U.S. investment bank. The aggregate consideration paid on closing amounted to \$27 million and consisted of 807,294 common shares of the Bank valued at \$26 million at that date plus a cash payment of \$1 million. An additional amount consisting of 476,119 common shares of the Bank valued at \$15 million at that date will be paid in 2004, contingent upon certain profitability objectives being achieved. The value of the common shares was based on the average closing price of the shares of the Bank over a period of several days preceding the date on which the number of shares was determined, namely, June 18, 2002. No amount has been accrued in the Consolidated Balance Sheet with respect to this additional consideration.

### *Director and Officer indemnification*

In accordance with its by-laws, the Bank indemnifies its directors and officers, for the duration of their mandate, and indemnifies any individual who, at the Bank's request has acted as a director or officer of an entity in which the Bank is a shareholder or creditor. The Bank indemnifies them in accordance with its by-laws, for all charges, costs and expenses as a result of any lawsuit or administrative proceeding in which the directors or officers are sued as a result of their service. The Bank has purchased directors' and officers' liability insurance. The nature of these indemnification agreements prevents the Bank from making a reasonable estimate of the maximum potential future payments that the Bank may be required to make. No amount has been accrued in the Consolidated Balance Sheet.

### *Other indemnification agreements*

In the normal course of business, including securitization activities, the Bank enters into contractual agreements other than the ones described above. These agreements require that the Bank compensate the counterparties for costs incurred as a result of litigation, changes in laws and regulations (including tax legislation), claims with respect to past performance, incorrect representations or the non-performance of certain restrictive clauses. The nature of these commitments prevents the Bank from estimating the maximum potential liability that it may be required to pay. The duration of these agreements is described in each contract. No amount has been accrued in the Consolidated Balance Sheet with respect to these agreements.

### *Other guarantee*

In accordance with a mutual guarantee agreement required by a regulatory authority, a subsidiary of the Bank agreed to guarantee all the commitments, debts and liabilities of an affiliate to the maximum of its regulatory capital, namely, \$22 million as at April 30, 2003. This guarantee expires on the date the investment in the affiliate is sold or sooner if deemed appropriate by the regulatory authority. To date, this guarantee has not been drawn upon and no amount has been accrued in the Consolidated Balance Sheet with respect to the agreement.

## **3. Recent Standards Pending Adoption**

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### **Variable Interest Entities**

In April 2003, the CICA approved, subject to written ballot, a new Accounting Guideline on Consolidation of Variable Interest Entities. This Guideline is harmonized with the corresponding U.S. standard and includes instructions on determining the primary beneficiary of variable interest entities and the beneficiary that will therefore have to consolidate them. The Guideline, expected to be issued in June 2003, will apply to all annual and interim periods beginning on or after January 1, 2004. The Bank is currently evaluating the impact of this new Accounting Guideline.

## Notes to the Consolidated Financial Statements (cont.)

### Disposal of Long-Lived Assets and Discontinued Operations

In 2002, the CICA issued a new standard entitled "Disposal of Long-Lived Assets and Discontinued Operations", which establishes standards for the recognition, measurement, presentation and disclosure of the disposal of non-monetary long-lived assets. Long-lived assets to be disposed of other than by sale should continue to be classified as held-for-use until their disposal. Long-lived assets held for sale that meet certain criteria should be presented separately on the balance sheet and measured at the lower of their carrying value or fair value, less cost to sell.

Furthermore, according to this new standard, the definition of discontinued operations has been broadened. This change may affect the presentation of future discontinued operations.

This new standard will apply to discontinued operations underway, subsequent to a commitment to follow a plan, as of May 1, 2003. These new requirements should not have a material impact for the Bank.

### Impairment of Long-Lived Assets

In 2002, the CICA issued a new standard entitled "Impairment of Long-Lived Assets", which establishes standards for the recognition, measurement and disclosure of the impairment of long-lived assets. This standard stipulates that an impairment loss should be recognized when the carrying value of a long-lived asset intended for use exceeds the sum of the undiscounted cash flows expected from its use and eventual disposition. The impairment loss is to be measured as the excess of the carrying value of the asset over its fair value. The Bank will adopt this standard effective November 1, 2003.

## 4. Loans and Impaired loans

	Gross amount	Impaired loans			Net
		Gross	Specific allowance	Country risk allowance	
<b>April 30, 2003</b>					
Residential mortgage	13,148	9	3	-	6
Personal and credit card	5,920	29	15	-	14
Business and government	20,216	429	202	21	206
Securities purchased under reverse repurchase agreements	3,419	-	-	-	-
	42,703	467	220	21	226
General allowance <sup>(1)</sup>					(405)
Impaired loans, net of specific and general allowances					(179)
<b>October 31, 2002</b>					
Residential mortgage	12,867	23	3	-	20
Personal and credit card	5,561	33	12	-	21
Business and government	20,680	447	220	22	205
Securities purchased under reverse repurchase agreements	2,366	-	-	-	-
	41,474	503	235	22	246
General allowance <sup>(1)</sup>					(405)
Impaired loans, net of specific and general allowances					(159)

(1) The general allowance for credit risk was taken for the Bank's loans in their entirety.

## Notes to the Consolidated Financial Statements (cont.)

### 5. Allowances for credit losses

For the 6-month period ended

	Specific allowance	Allocated general allowance	Unallocated general allowance	Country risk allowance (loans and securities)	April 30 2003	April 30 2002
Allowances at beginning	235	296	109	22	662	879
Transfer of allowance for assets held for disposal	-	-	-	-	-	(31)
Amounts related to discontinued operations	-	-	-	-	-	(65)
Provision for credit losses	82	-	-	-	82	375
Write-offs	(122)	-	-	(1)	(123)	(402)
Recoveries	25	-	-	-	25	6
Allowances at end	220	296	109	21	646	762

### 6. Capital Stock

#### Issued and fully paid as at April 30, 2003

First preferred shares	
5,000,000 shares, Series 12	125
7,000,000 shares, Series 13	175
8,000,000 shares, Series 15	200
	500
175,669,746 common shares	1,583
	2,083
6,719,315 stock options outstanding	N/A

#### Issuance of preferred shares

On January 31, 2003, the Bank issued 8,000,000 first preferred shares with a non-cumulative preferential dividend payable quarterly in an amount of \$0.365625 per share, Series 15, for an aggregate consideration of \$194,665,000, net of commissions totalling \$5,335,000.

These shares are redeemable at the Bank's option, subject to the prior approval of the Superintendent of Financial Institutions, as of May 15, 2008, in whole or in part, at \$26 per share if they are redeemed before May 15, 2009, at \$25.75 per share if they are redeemed during the 12-month period prior to May 15, 2010, at \$25.50 per share if they are redeemed during the 12-month period prior to May 15, 2011, at \$25.25 per share if they are redeemed during the 12-month period prior to May 15, 2012, and at \$25.00 per share if they are redeemed as of May 15, 2012, in each case, plus all declared and unpaid dividends at the date fixed for redemption.

#### Repurchase of common shares

On January 20, 2003, the Bank made a normal course issuer bid for the repurchase of up to 9,100,000 common shares over a 12-month period ending no later than January 19, 2004. Purchases were made on the open market at market prices through the facilities of The Toronto Stock Exchange. Premiums paid above the average book value of the common shares were charged to retained earnings. As at April 30, 2003, the Bank had repurchased 7,485,366 common shares at a cost of \$240 million, which reduced common equity capital by \$67 million and retained earnings by \$173 million.

#### Redemption of preferred shares

On May 15, 2003, the Bank redeemed, for cancellation, all Series 12 non-cumulative first preferred shares at a price of \$25 per share, plus declared and unpaid dividends up to the redemption date.

### 7. Securitization

#### CMHC-guaranteed mortgage loans

During the second quarter of 2003, the Bank securitized residential mortgage loans guaranteed by the CMHC totalling \$281 million through the creation of mortgage-backed securities. The Bank sold all these securities. The Bank received cash proceeds totalling \$281 million and retained the rights to future excess interest in the amount of \$8 million. Transaction costs of \$0.8 million were recognized in the Consolidated Statement of Income under "Securitization revenues".

## Notes to the Consolidated Financial Statements (cont.)

### 8. Segment Disclosures <sup>(1)</sup>

#### Quarter ended April 30

(taxable equivalent basis)  
(unaudited) (millions of dollars)

	Personal and Commercial		Wealth Management		Financial Markets		Other		Total	
	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002
Net interest income <sup>(2)</sup>	300	289	22	22	69	77	(39)	(27)	352	361
Other income <sup>(2)</sup>	147	142	132	135	118	153	48	36	445	466
Total revenues	447	431	154	157	187	230	9	9	797	827
Operating expenses	282	273	126	131	117	100	4	(13)	529	491
Contribution	165	158	28	26	70	130	5	22	268	336
Provision for credit losses <sup>(3)</sup>	51	55	–	–	12	8	(22)	67	41	130
Income before income taxes, non-controlling interest and discontinued operations	114	103	28	26	58	122	27	(45)	227	206
Income taxes <sup>(2)</sup>	42	40	10	8	21	44	9	(16)	82	76
Non-controlling interest	–	–	1	1	–	–	6	7	7	8
Income before discontinued operations	72	63	17	17	37	78	12	(36)	138	122
Discontinued operations	–	–	–	–	–	–	–	–	–	–
Net income	72	63	17	17	37	78	12	(36)	138	122
Average assets	38,555	38,261	656	794	36,462	39,028	(5,563)	(7,012)	70,110	71,071

#### Six months ended April 30

(taxable equivalent basis)  
(unaudited) (millions of dollars)

	Personal and Commercial		Wealth Management		Financial Markets		Other		Total	
	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002
Net interest income <sup>(4)</sup>	612	588	45	44	140	169	(77)	(54)	720	747
Other income <sup>(4)</sup>	303	283	271	273	284	258	79	71	937	885
Total revenues	915	871	316	317	424	427	2	17	1,657	1,632
Operating expenses	555	547	257	255	245	193	20	(3)	1,077	992
Contribution	360	324	59	62	179	234	(18)	20	580	640
Provision for credit losses <sup>(3)</sup>	104	113	–	–	22	21	(44)	241	82	375
Income before income taxes, non-controlling interest and discontinued operations	256	211	59	62	157	213	26	(221)	498	265
Income taxes <sup>(4)</sup>	93	79	21	20	56	78	10	(77)	180	100
Non-controlling interest	–	–	2	2	–	–	12	13	14	15
Income before discontinued operations	163	132	36	40	101	135	4	(157)	304	150
Discontinued operations	–	–	–	–	–	–	–	118	–	118
Net income	163	132	36	40	101	135	4	(39)	304	268
Average assets	38,447	38,497	664	797	36,849	38,849	(5,742)	(7,099)	70,218	71,044

#### Personal and Commercial

This segment comprises the branch network, intermediary services, credit cards, insurance, commercial banking services and real estate.

#### Wealth Management

This segment comprises full-service retail brokerage, discount brokerage, mutual funds, trust services and portfolio management.

#### Financial Markets

This segment consists of corporate financing and lending, treasury operations, which include asset and liability management, and corporate brokerage.

#### Other

This heading comprises securitization operations, gains on the sale of operations, certain non-recurring items, discontinued operations and the unallocated portion of centralized service units.

(1) Since November 1, 2002, the Bank has modified the composition of its reportable segments in order to reflect changes to its organizational structure. The comparative figures have been restated to take these changes into account.

(2) Net interest income was grossed up by \$9 million (\$5 million in 2002) and other income by \$15 million (\$8 million in 2002) to bring the tax-exempt income earned on certain securities in line with the income earned on other financial instruments. An equivalent amount was added to income taxes.

(3) Provisions for credit losses for the segments are determined based on expected losses, which are established through statistical analysis. The difference between actual losses and expected losses is recorded under the "Other" heading.

(4) Net interest income was grossed up by \$22 million (\$10 million in 2002) and other income by \$27 million (\$46 million in 2002) to bring the tax-exempt income earned on certain securities in line with the income earned on other financial instruments. An equivalent amount was added to income taxes.

## Economic Commentary

### Review of the Canadian economy

Powered mainly by consumer spending and residential construction, the Canadian economy posted growth of 3.4% in 2002 and again outperformed its main economic partner, the United States, for the fourth consecutive year. With growth of 16.0%, the residential construction sector turned in its best performance since the real estate boom of 1987. A 3.9% drop in business investment for the year as a whole was offset by higher inventories. Exports firmed up slightly, although they remained below the record level reached in 2000. However, manufacturing of computer and telecommunications products fell to a new trough with a decline of 17.2% for the year.

On the regional level, economic growth was more robust in the east of the country than in the west. Growth in almost all the Atlantic provinces exceeded the national average. New Brunswick, the sole exception in this regard, was nevertheless able to achieve respectable growth of 3.3% on the strength of strong demand for refined petroleum products, timber wood, paper and seafood products. Prince Edward Island finally had a good potato harvest while Nova Scotia, with its large tire factories, was able to benefit from the increased automobile production in North America. But the best economic performance in the country was turned in by Newfoundland and Labrador, which posted growth of 13.4%, mainly because the new oil field in Terra Nova came on stream. Unfortunately, the economic environment became less promising at the beginning of 2003, following the moratorium implemented on all cod fishing.

Economic growth was 4.3% in Quebec compared to 3.9% in Ontario. Quebec benefited from a strong upsurge in residential construction, which jumped by 26.1% versus 11.7% in Ontario. However, this spread was neutralized by much higher stockpiles of inventory in Ontario and the contraction in international exports in Quebec, particularly for aircraft and telecommunications equipment. In fact, the stronger economic growth in Quebec was ultimately attributable to public-sector investment. Nevertheless, the province's economy accounted for over a third of the increase in number of hours worked Canada-wide.

The automobile sector was one of the leading contributors to Ontario's economic growth in 2002, but saw a net slowdown at the beginning of 2003 when American car dealers were stuck with excess inventory. However, Ontario is well positioned to take advantage of the expected recovery in U.S. corporate investment spending in 2003.

Although Manitoba's annual growth of 2.4% was below the national average for 2002, the province's unemployment rate was one of the lowest in the country at 5.2%. GDP in Saskatchewan fell for the second year in a row, as drought, insect infestations and late rainfall served to pull down agricultural output by 23.7%.

Drought was also a factor in Alberta, where livestock and agricultural production fell by 28.4%. Output from oil fields shrank by 0.9% as a result of declining U.S. demand and falling energy prices also resulted in a dropoff in investments for oil and gas extraction. Manufacturing output dipped by 1.5%, owing to the marked declines affecting machinery, fertilizers and pesticides. Exports also slumped for the first time in 16 years. Under these conditions, economic growth slowed to 1.7%. Despite the uncertain outlook, the labour market remained healthy with employment gains of 3.1%. This explains why consumer spending continued to be vigorous and how residential activity climbed by 23.4%. Ongoing hirings indicated that Albertans were confident that their economy was only going through a temporary bad patch in 2002 and this optimism was confirmed by the rise in energy prices. In 2003 and 2004, Alberta will be one of the provinces vying for the best economic performance in Canada.

British Columbia posted economic growth of 1.8% in 2002. Although exports edged 0.8% higher for the year, declines were recorded for coal, natural gas and metals. Total exports had already fallen by 4.3% in 2001.

In 2003, the Canadian economy will be able to draw on certain reserves, as illustrated by the continued high levels of housing starts. After a decade of being unable to see any discernible improvement in their standard of living, Canadians are taking advantage of low interest rates, a strong labour market and lower income taxes to express pent-up demand. Judging by the high levels of housing starts that have been sustained, this latent demand has not yet been exhausted. Despite the SARS episode, domestic conditions remain satisfactory. The actual risk to the economy will come from external factors. We are still counting on the U.S. economy to recover in the second half of 2003, which, by extension, will spur Canada's economy to grow by 2.9% in 2003 and 3.2% in 2004.

## Bank News

**The SMEs of the National Bank recognition program:** On April 10, the Bank launched its 10th annual recognition program, which honours the exceptional performance of small and medium-sized enterprises from all regions of Quebec. One province-wide winner will be selected from among all the regional winners in each of the following categories: Small Business, SME, Agricultural SME and Export SME. The four winners will also benefit from extensive coverage in the print media and on television.

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**Commerce survey of Quebec's most admired companies:** The Bank moved up considerably in the ranking of Quebec's 150 most admired companies according to the latest annual survey conducted by the business magazine *Commerce* and the firm Léger Marketing. The Bank is now in 48th place, which is 10 places higher than last year, and continues to hold the top spot among financial institutions.

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**Défi Sportif:** Reflecting its concern about equality and the integration of people with disabilities, the Bank was a partner in the 20th anniversary edition of *Défi sportif*, the largest event for disabled athletes in North America, which brought together over 2,000 athletes of every calibre and age. For the next three years, the Bank will also be sponsoring the National Bank *Défi sportif* team of champions. This team, consisting of 16 athletes selected by their trainers for their sports performance and communication skills, will act as spokespersons for the event.

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**Daffodil Ball:** Réal Raymond, President and Chief Executive Officer, was co-chairman of the 10th annual Daffodil Ball, held in Montreal on April 24. This prestigious benefit event, the largest of its kind organized by the Canadian Cancer Society, raised \$1.3 million for the organization.

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**National Bank Bursaries program:** The Bank revealed the names of the 22 young athletes from various regions of Quebec and Ontario who will share the \$50,000 in student bursaries available under the National Bank Bursaries program. Now in its 11th year, the program has awarded a total of \$400,000 since its creation in 1993 to some 280 athletes in various Olympic or Paralympic disciplines, thereby encouraging them to achieve their goal of one day competing at the Olympic Games.

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**National Bank Financial Canadian Bank CEO Conference:** On April 9, Réal Raymond, President and Chief Executive Officer, participated in the National Bank Financial Canadian Bank CEO Conference organized by National Bank Financial for its institutional investor clientele. In his speech, Mr. Raymond recalled the Bank's recent achievements and explained how they fitted into his business plan and development goals. He also stated that he deplored the slowness with which the federal government was handling the bank merger file, and reiterated the National Bank's position on the matter. The conference, at which the CEOs of all six major Canadian banks participated, was remarkably well attended and proved a great success.

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### Caution regarding forward-looking statements

*As part of its analyses and reports, National Bank of Canada from time to time makes forward-looking statements concerning the economy, market changes, the achievement of strategic objectives, certain risks and other related matters. By their very nature, such forward-looking statements involve inherent risks and uncertainties. It is therefore possible that express or implied projections contained in such statements will not materialize and will differ materially from actual future results. Such differences may be caused by factors which include, but are*

*not limited to, changes in Canadian and/or global economic conditions, particularly fluctuations in interest rates, currencies and other financial instruments, market conditions, technological changes or regulatory developments. Investors and others who base themselves on the Bank's forward-looking statements to make decisions should carefully consider the above factors as well as the uncertainties they represent and the risks they entail. The Bank therefore cautions readers not to place undue reliance on these forward-looking statements.*



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## General Information

### Investor Relations

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Financial analysts and investors who want to obtain financial information on the Bank are asked to contact the Investor Relations Department, by telephone at (514) 394-0296, by fax at (514) 394-6196 or by e-mail at [investorrelations@nbc.ca](mailto:investorrelations@nbc.ca). For more information about the Bank and its publications, you can visit the Bank's website at [www.nbc.ca](http://www.nbc.ca)

### Direct Deposit Service for Dividends

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For security purposes, the National Bank offers its shareholders the possibility of having their dividend payments deposited directly to an account at the financial institution of their choice, provided it is equipped with an electronic funds transfer system.

Additional information may be obtained from the Registrar, National Bank Trust, at 1-800-341-1419 or (514) 871-7171, or by e-mail at [clientele@tbn.nbc.ca](mailto:clientele@tbn.nbc.ca)

### Dividend Reinvestment and Share Purchase Plan

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The National Bank offers holders of its common or preferred shares a Dividend Reinvestment and Share Purchase Plan through which they can reinvest their dividends in common shares of the Bank without paying any commissions or administration fees.

Participants in the Plan may reinvest all cash dividends paid on their eligible shares or, if they wish, make optional cash payments of at least \$500 per payment, to a maximum of \$5,000 per quarter.

Additional information may be obtained from the Registrar, National Bank Trust, at 1-800-341-1419 or (514) 871-7171, or by e-mail at [clientele@tbn.nbc.ca](mailto:clientele@tbn.nbc.ca).

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