

Report to Shareholders

Canadian Commercial Bank

experienced officers, to the Special Credits Division which is specifically charged with managing problem loans. The Bank's problem loan specialists, aided by a lower interest rate environment and an improving Alberta economy, are expected to reverse the trend in non-earning loans, a positive development that emerged in the fourth quarter.

The provision for loan losses increased by \$5.8 million or 64.4% from the previous year. The increase is primarily a function of a 73.6% increase in the loss experience on loans and a 21.2% increase in eligible assets largely attributable to the acquisition of Westlands.

The recent level of loan loss experience substantially exceeds CCB's historical record, a result that will suppress near term earnings potential. Losses were concentrated in real estate loans in Alberta and British Columbia and energy related loans in the U.S. and Alberta. The Bank's well developed strategies aimed at improving the geographic diversification of the loan portfolio are designed to produce greater stability in future earnings.

- Continued deposit diversification through the development of core retail deposits.

The Bank has made important progress in its objective to improve the stability of its deposit base through diversification of deposit sources. Cost effective retail core deposits currently represent more than 20% of domestic deposits compared with only 4% at the end of the previous year. Expansion of the internally developed automated delivery system, broadening of the independent agency network and growth in specialized deposit centres are the key mid-term strategies aimed at generating 40% of domestic deposits from the retail market. The acquisition of Westlands has enabled the Bank to implement an effective core deposit marketing plan in the U.S. Development of this stable cost effective deposit base will enable the Bank to capitalize on growth opportunities in the expanding and diversified California market.

Several negative factors converged in fiscal 1984 to reduce net income to \$0.8 million from \$6.5 million in 1983. While these issues are examined in more detail in the Financial Review, the major factors contributing to CCB's fiscal 1984 performance were:

- The investment in Westlands and its substantial operating losses resulted in a \$6.5 million erosion in CCB's net income,
- Growth in non-earning loans, aggravated by the acquisition of Westlands,
- The cost of carrying non-earning loans in a higher interest rate environment,
- Substantially increased loan losses,
- Significant contraction in domestic loan growth caused by the lack of suitable new business opportunities outside Ontario and heavy loan retirements, and
- Shrinkage in other income reflecting weak loan demand in Canada.

Outlook

The Bank is anticipating a marked earnings improvement in fiscal 1985 although acceptable levels of profitability will not be restored until 1986 as a result of continuing, but reducing, high levels of non-earning loans and loan losses. The substantial negative impact of Westlands' 1984 operating results is anticipated to be non-recurring. Following the establishment of major provisions for loan losses in the pre-acquisition period, Westlands produced a profit contribution during CCB's fourth quarter. Westlands' projected 1985 earnings will be sheltered from income taxes by utilizing large tax loss carry-forwards. CCB's primary goals for 1985 are designed to capitalize on available opportunities that will position the Bank for profitable future growth and return performance ratios to the top quartile of our industry.

The goals for 1985 include:

- An absolute reduction in the level of non-earning loans and loan losses,
- Continued diversification of the asset base through improved marketing strategies in selected markets, with emphasis in Ontario and California,