Bank of Montreal (BMO)

Updated September 1st, 2018 by Josh Arnold

Key Metrics

Current Price[1]:	$107	**5 Year CAGR Estimate:**	5.5%	**Volatility Percentile:**	3.9%
Fair Value Price[1]:	$95	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	66.6%
% Fair Value:	112%	**5 Year Valuation Multiple Estimate:**	-2.2%	**Total Return Percentile:**	40.6%
Dividend Yield:	3.7%	**5 Year Price Target**	$115	**Valuation Percentile:**	32.2%

Overview & Current Events

Bank of Montreal was formed in 1817, becoming Canada's first bank. The past two centuries have seen BMO grow into a global powerhouse of financial services and today, it has more than 1,500 branches. Bank of Montreal produces more than C$22 billion in revenue each year and has a market capitalization of C$68 billion.

Bank of Montreal reported third quarter earnings on 8/28/18 and results were strong. Revenue rose 7% and adjusted earnings-per-share increased 16%. Return on equity increased from 13.3% in the comparable quarter last year to 15.0% this year on an adjusted basis, while credit loss provisions fell. Bank of Montreal's efficiency efforts are paying off and strength was seen across all of its major reporting segments. The bank continues to take full advantage of healthy economies in both the US and Canada, and our estimate of C$8.15 in earnings-per-share for this year remains unchanged after the Q3 report.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS[1]	$3.77	$3.33	$4.75	$5.26	$6.15	$6.26	$6.41	$6.57	$6.92	$7.66	***$8.15***	***$9.85***
DPS[1]	$2.80	$2.80	$2.80	$2.80	$2.82	$2.94	$3.08	$3.24	$3.40	$3.56	***$3.94***	***$4.75***
Shares	502	552	566	639	651	644	649	643	646	648	***638***	***640***

Bank of Montreal's earnings-per-share performance has actually been very stable in the past decade, a period in which most banks have struggled. Earnings bottomed out in 2009 but it was still very profitable while other large financial institutions went out of business. Since that time, the bank has produced higher earnings-per-share every year and we expect that will continue for the foreseeable future. We forecast C$8.15 in earnings-per-share this year and 4% annual growth thereafter given the high level of performance Bank of Montreal continues to exhibit.

This rate of growth is fairly low simply because Bank of Montreal is already hitting records for earnings due to its very high levels of profitability. It is therefore going to be challenging to continue to boost profitability as the base it is working from is quite high. However, we do see low single digit revenue growth as playing into our 4% forecast as well as a low single digit tailwind from stronger margins, as we saw in Q3, from operating leverage. Keep in mind that as loan loss provisions are near historical lows. Accordingly, margin expansion will likely prove difficult. If credit quality deteriorates, margins will suffer meaningfully, although no evidence of this occurring exists today. We are optimistic that the bank will continue to perform very well but at this point, its growth outlook is a victim of its own past success.

We see the dividend as rising at about the rate of earnings-per-share growth, implying a payout of $4.75 in 2023. That will keep Bank of Montreal firmly in the category of income stock for those seeking a high current yield.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	13.1	12.5	12.3	11.4	9.4	10.2	11.9	11.6	11.6	12.5	***13.1***	***11.7***
Avg. Yld.	5.7%	6.8%	4.8%	4.7%	4.9%	4.6%	4.0%	4.2%	4.2%	3.7%	***3.7%***	***4.1%***

[1]Figures in Canadian Dollars

Bank of Montreal's price-to-earnings ratio has been quite steady in the past decade despite the tumultuous environment that has existed for banks during that time. The current ratio of 13.1 compares unfavorably to its longer-term average of 11.7, which we see as fair value. That implies there will be a 2.2% annual headwind to total returns from a valuation that is slightly in excess of fair value. We think the yield will remain around where it is today, in the area of 4%, as the share price and dividend growth approximately pace each other's growth.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2023**
ROA	0.48%	0.50%	0.68%	0.68%	0.80%	0.79%	0.74%	0.69%	0.67%	0.73%	***0.70%***	***0.72%***
Debt/A	95%	95%	95%	94%	94%	94%	94%	94%	94%	94%	***94%***	***94%***
LLP/Loans	0.6%	0.8%	0.5%	0.4%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%	***0.2%***	***0.2%***
Payout	75%	74%	61%	56%	47%	48%	49%	50%	51%	48%	***48%***	***48%***
Std. Dev.	40%	35%	18%	10%	11%	13%	10%	15%	14%	13%	***15%***	***18%***

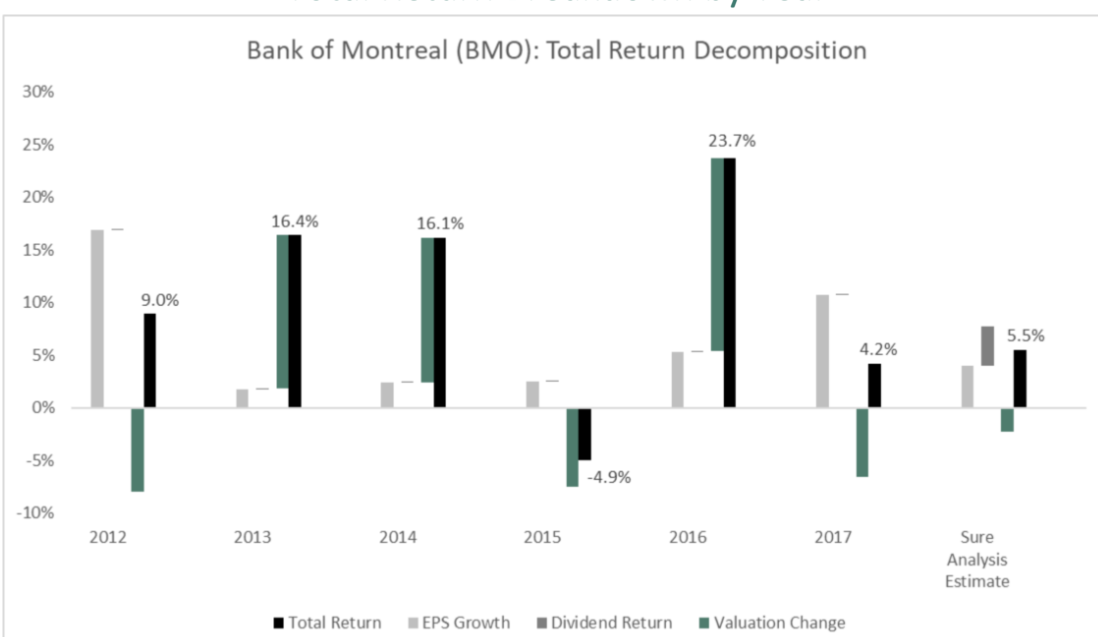
Bank of Montreal's quality metrics have improved markedly in the past decade, meaning that further improvement will likely prove difficult. Return on assets and loan loss provisions as a percentage of total loans have moved firmly in the right directions since the Great Recession of 2008/2009 and we think it will have a difficult time further improving these key metrics. We do think they'll remain around where they are today, so we certainly aren't bearish.

Bank of Montreal's competitive advantage is in the long history and reputation of its brand as well as its immense size in a smaller market like Canada. Recessions are tough for banks, but Bank of Montreal performed admirably during the last one, something which shareholders can expect moving forward given the strength this company is showing today.

Final Thoughts & Recommendation

Overall, we see Bank of Montreal as being a hold at current prices and not a buy, although it is trading slightly in excess of fair value at present. We forecast 5.5% in total returns annually moving forward, consisting of the current 3.7% yield, 4% earnings-per-share growth and a 2.2% headwind from a lower price-to-earnings ratio. Bank of Montreal is certainly adequate as an income stock and today, that is likely the only reason to own it. For those seeking value, a lower entry price is needed. We like Bank of Montreal's fundamentals, but the stock is trading well in excess of fair value today.

Total Return Breakdown by Year



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[1]Figures in Canadian Dollars

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.