Bank of Montreal (BMO)

Updated March 1st, 2019 by Josh Arnold

Key Metrics

Current Price:	$103	**5 Year CAGR Estimate:**	9.6%	**Volatility Percentile:**	7.3%
Fair Value Price:	$112	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	59.8%
% Fair Value:	92%	**5 Year Valuation Multiple Estimate:**	1.7%	**Growth Percentile:**	22.3%
Dividend Yield:	3.9%	**5 Year Price Target**	$136	**Valuation Percentile:**	67.0%
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Total Return Percentile:**	54.8%

Overview & Current Events

Bank of Montreal was formed in 1817, becoming Canada's first bank. The past two centuries have seen Bank of Montreal grow into a global powerhouse of financial services and today, it has more than 1,500 branches. Bank of Montreal produces more than C$23 billion in revenue each year and trades with a market capitalization of C$66 billion after a recent rally in the stock. Bank of Montreal is cross-listed in both New York and Toronto; we use Canadian Dollars throughout the report.

Bank of Montreal posted Q1 earnings on 2/26/19, and results were largely in-line with expectations. Total revenue was up 6% as a bit of weakness in its market-sensitive businesses was more than offset by strong performances from its personal and commercial banking segments in the US and Canada. Indeed, net income at the US banking unit was up 42% year-over-year, more than offsetting a 10% decline from wealth management and a further 3% decline from the capital markets segment. Market volatility in December of 2018 certainly took its toll on BMO's results, as it did for many of the bank's competitors.

Bank of Montreal's provision for credit losses fell slightly year-over-year despite a larger loan book, which is a testament to BMO's continued focus on prudent lending practices. Its capital position remains strong with its common equity tier 1 ratio at 11.4%, which was flat year-over-year. As BMO continues to generate more earnings than it distributes to shareholders, we expect its capital position to remain very strong with the ability to weather economic downturns.

In total, adjusted earnings-per-share rose 10% year-over-year to $2.32. We are reiterating our estimate for $9.55 in earnings-per-share for fiscal 2019.

The bank also announced it was going to repurchase up to 15 million shares, which is good for over 2% of the float. We've reduced our 2019 ending share count as a result of this updated guidance.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$3.33	$4.75	$5.26	$6.15	$6.26	$6.41	$6.57	$6.92	$7.66	$8.99	***$9.55***	***$11.62***
DPS	$2.80	$2.80	$2.80	$2.82	$2.94	$3.08	$3.24	$3.40	$3.56	$3.76	***$4.00***	***$5.00***
Shares	552	566	639	651	644	649	643	646	648	639	***625***	***615***

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. Since 2009, the bank has produced higher earnings-per-share every year and we expect that will continue for the foreseeable future. We forecast C$9.55 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 playing into our 4% forecast as well as a low single digit tailwind from stronger margins, as well as buybacks. Keep in mind, however, that loan loss provisions are near historical lows and fell further in Q1, meaning there is downside risk to earnings. 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 rising at about the rate of earnings-per-share growth, implying a payout of $5.00 in 2024. That will keep Bank of Montreal firmly in the category of income stock for those seeking a high current yield.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	12.5	12.3	11.4	9.4	10.2	11.9	11.6	11.6	12.5	11.0	***10.8***	***11.7***
Avg. Yld.	6.8%	4.8%	4.7%	4.9%	4.6%	4.0%	4.2%	4.2%	3.7%	3.8%	***3.9%***	***3.7%***

Bank of Montreal's price-to-earnings ratio has moved up meaningfully since our last report and shares are now much closer to fair value. The current ratio of 10.8 still compares favorably to its longer-term average of 11.7, which we see as fair value. That implies there will be a 1.7% annual tailwind to total returns as the valuation continues to drift higher over time. We think the yield will move lower over as the share price outpaces gains in the dividend, but the stock should continue to yield nearly 4%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	74%	61%	56%	47%	48%	49%	50%	51%	48%	42%	***42%***	***43%***

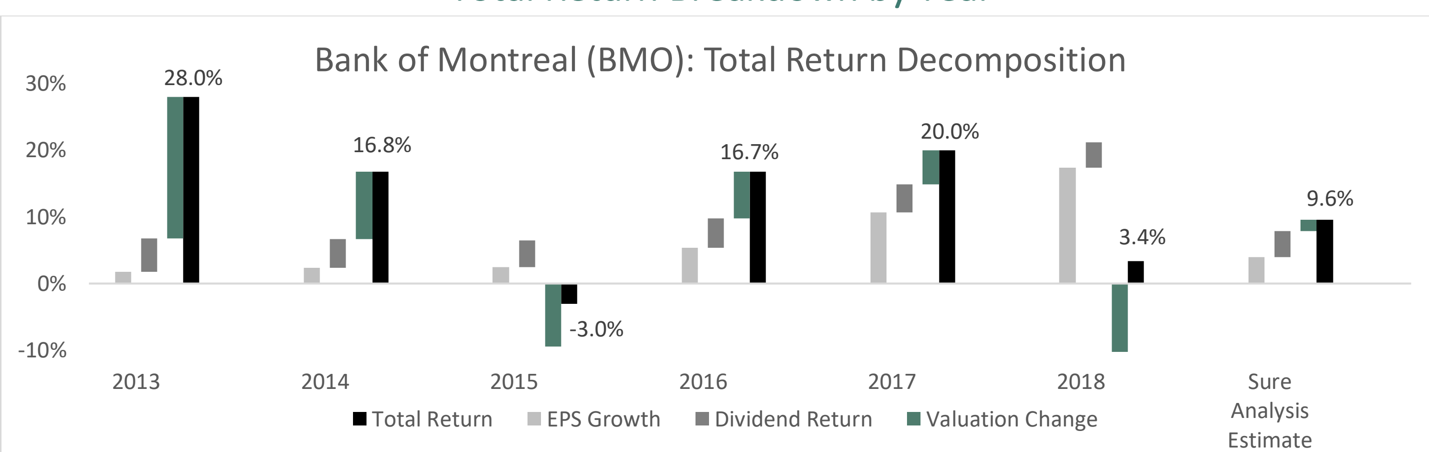
The bank's payout ratio is still just over 40% of earnings so it is very safe. In addition, the low payout ratio affords it the ability to continue to raise the dividend in the coming years. We expect the payout ratio to remain about where it is for the foreseeable future.

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

We are reiterating Bank of Montreal as a buy after the Q1 report. We forecast 9.6% in total returns annually moving forward, consisting of the current 3.9% yield, 4% earnings-per-share growth and a 1.7% tailwind from a higher price-to-earnings ratio. Bank of Montreal is certainly adequate as an income stock and today, it is also trading somewhat under fair value. We see the stock as providing a strong mix of current yield, value and growth potential.

Total Return Breakdown by Year



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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.

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	11064	12210	13943	15929	16830	18054	19182	20947	21874	22870
SG&A Exp.	5321	5360	5468	6405	7414	8578	9254	9865	9984	9766
D&A Exp.	472	470	538	682	694	747	788	828	876	903
Net Profit	1787	2810	3041	4082	4130	4277	4370	4622	5348	5450
Net Margin	16.2%	23.0%	21.8%	25.6%	24.5%	23.7%	22.8%	22.1%	24.4%	23.8%
Free Cash Flow	12414	-7065	977	9597	10829	-3664	1726	-3339	2117	17026
Income Tax	217	687	876	874	1055	903	936	1101	1296	1960

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets ($B)	388.46	437.71	500.58	525.45	537.04	588.66	641.88	687.94	709.58	774.05
Cash & Equivalents	13295	22617	25656	26282	32607	34496	47677	36102	39671	52050
Acc. Receivable	N/A	N/A	N/A	8674	6434	6983	7384	8833	7587	8371
Goodwill & Int.	2229	2431	5211	5269	5330	7405	8277	8559	8403	8645
Total Liab. ($B)	368.26	416.03	472.74	495.36	505.87	553.26	601.97	645.61	665.23	728.32
Accounts Payable	N/A	N/A	N/A	9901	8464	8763	9716	11067	11108	11402
Long-Term Debt	5386	4963	6169	4093	3996	4913	4416	4439	5029	6782
Total Equity	20197	17611	23492	26190	27842	31273	36182	38464	40114	41387
D/E Ratio	0.27	0.25	0.23	0.14	0.13	0.14	0.11	0.10	0.11	0.15

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	0.4%	0.7%	0.6%	0.8%	0.8%	0.8%	0.7%	0.7%	0.8%	0.7%
Return on Equity	9.4%	14.9%	14.8%	16.4%	15.3%	14.5%	13.0%	12.4%	13.6%	13.4%
ROIC	7.2%	10.8%	10.0%	12.0%	11.9%	11.3%	10.3%	10.1%	11.1%	10.7%
Shares Out.	552	566	639	651	644	649	643	646	648	639
Revenue/Share	20.40	21.68	22.97	24.56	25.90	27.84	29.64	32.42	33.55	35.46
FCF/Share	22.89	-12.55	1.61	14.80	16.67	-5.65	2.67	-5.17	3.25	26.40

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.