Bank of Montreal (BMO)

Updated December 6th, 2019 by Kay Ng

Key Metrics

Current Price:	$75	**5 Year CAGR Estimate:**	10.7%	**Volatility Percentile:**	65.5%
Fair Value Price:	$83	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	50.2%
% Fair Value:	91%	**5 Year Valuation Multiple Estimate:**	2.0%	**Growth Percentile:**	54.8%
Dividend Yield:	4.3%	**5 Year Price Target**	$106	**Valuation Percentile:**	76.5%
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Total Return Percentile:**	79.5%

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 about 1,500 branches in North America. Bank of Montreal produces about C$24 billion in revenue each year, and it currently trades with a market capitalization of C$64 billion. At a high level, it generates about 60% of its earnings from Canada and about 30% from the U.S. The bank is cross-listed in both New York and Toronto; we use U.S. Dollars throughout the report unless otherwise noted.

Bank of Montreal posted fiscal Q4 earnings and 2019 results on 12/03/19. For the quarter, net revenue was up 5% to C$5,777 million. BMO took a restructuring charge of C$357 million largely related to cutting the workforce by about 5% and a benefit from the remeasurement of an employee benefit liability in the prior year of C$203 million, which shifted earnings. Adjusted net income was C$1,607 million, up 5% year over year. Adjusted earnings-per-share also climbed 5% to C$2.43. The bank's provision for credit losses (PCLs) climbed 45% to C$253 million against the comparable quarter a year ago. This is not a major concern as the quarter's PCLs ratio of 0.23% is only up 5 basis points year over year and aligns with the big Canadian banks' average. We believe BMO continues to have a focus on prudent lending practices. The bank increased its quarterly dividend to C$1.06 per share, which is 6% higher year over year.

The fiscal year results include net revenue growth of 6% to C$22.8 billion and adjusted net income growth of 4% to C$6.2 billion, which, on a per-share basis, translated to C$9.43 for 5% growth.

The bank's capital position remains quite strong with its common equity tier 1 ratio at 11.4%. As BMO continues to generate more earnings than it distributes to shareholders, we expect its capital position to remain strong with the ability to weather economic downturns.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$4.78	$5.22	$6.04	$5.91	$5.79	$5.23	$5.66	$6.27	$6.81	$7.09	***$7.37***	***$9.41***
DPS	$2.70	$2.84	$2.81	$2.88	$2.82	$2.60	$2.56	$2.72	$2.94	$3.06	***$3.23***	***$4.32***
Shares[1]	566	639	651	644	649	643	646	648	639	640	***638***	***629***

Bank of Montreal's earnings-per-share performance has been stable in the past decade despite forex volatility. From 2010 to 2019, the bank increased its earnings-per-share by 4.5% per year, while its five-year earnings-per-share growth was 4.1%. We forecast earnings-per-share of roughly US$7.37 (a 4% growth) in fiscal 2020 and growth of 5% annually thereafter through 2025 given the expectation of an economic slowdown.

This rate of growth is fairly low partly also because BMO has been hitting records for earnings due to its 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 5% 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, meaning there is downside risk to earnings. If credit quality deteriorates, margins will suffer meaningfully,

1. Shares in millions.

although no evidence of this is present today. We are optimistic that the bank will continue to perform well, but with more tapered growth over the next few years.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2024
Avg. P/E	12.2	12.5	10.3	10.8	11.5	11.4	11.0	11.7	12.0	10.6	***10.2***	***11.3***
Avg. Yld.	4.6%	5.1%	4.6%	4.2%	3.9%	4.5%	3.6%	3.4%	4.5%	4.0%	***4.3%***	***4.1%***

From 2010-2019, BMO's average price-to-earnings ratio was about 11.3. We think that's a fair ratio for our forecasted growth rate of 5% and the safe above-average yield that the bank offers. The current ratio of 10.2 implies there's a 2% annual tailwind to total returns as the valuation drifts higher over time towards a fair multiple. We think the yield will remain at about 4%. As a Canadian stock, BMO's dividends may be subject to a 15% dividend withholding tax for U.S. investors. This tax can potentially be avoided by investing in BMO through a retirement account.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	56%	54%	47%	49%	49%	50%	45%	43%	43%	43%	***44%***	***46%***

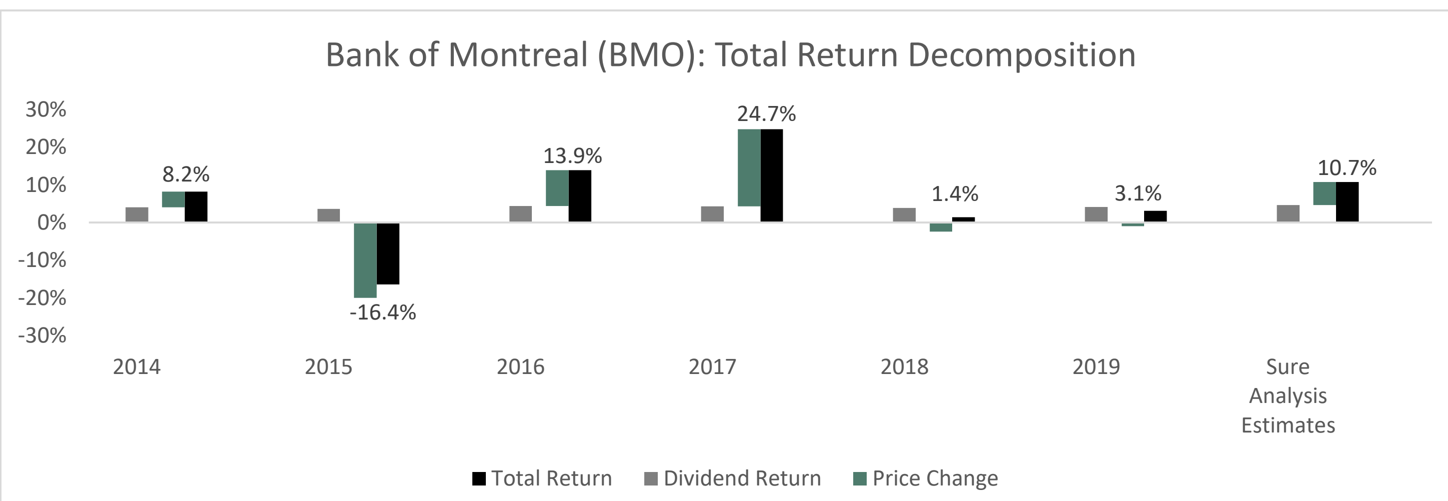
BMO's payout ratio of less than 50% of earnings is very safe. The low payout ratio affords it the ability to continue to raise the dividend in the coming years. We expect the payout ratio to remain below 50% in the foreseeable future.

The bank's competitive advantage is in the long history and reputation of its brand, as well as its large size (it's the 8th largest bank by asset in North America), and the fact that it's one of the Big Five banks, in a smaller market like Canada. Recessions are tough for banks, but BMO performed admirably during the last one by maintaining its dividend in the Canadian currency.

Final Thoughts & Recommendation

Bank of Montreal has become less attractive since our last report. We forecast 10.7% in total returns annually over the next five years, consisting of a forward yield of 4.3%, 5% earnings-per-share growth, and a 2.0% tailwind from a higher price-to-earnings ratio. Bank of Montreal is a good income for investors seeking stability and decent returns.

Total Return Breakdown by Year



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1. Shares in millions.

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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	11751	14131	15853	16509	16569	15457	15798	16608	17673	19060
SG&A Exp.	5159	5542	6375	7273	7872	7457	7440	7518	7472	9008
D&A Exp.	452	545	679	681	686	635	624	670	702	744
Net Profit	2704	3082	4063	4051	3925	3521	3486	4081	4238	4332
Net Margin	23.0%	21.8%	25.6%	24.5%	23.7%	22.8%	22.1%	24.6%	24.0%	22.7%
Free Cash Flow	-6800	990	9551	10623	-3363	1391	-2518	1619	13233	21199
Income Tax	661	888	870	1035	829	754	830	988	1524	1139

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets ($B)	426	504	526	512	526	488	513	553	589	647
Cash & Equiv.	21994	25807	26287	31107	30803	36219	26910	30923	39673	44436
Accounts Rec.			9202	6618	6719	5844	6732	6036	3413	3674
Goodwill/Int. Ass.	2364	5242	5270	5085	6612	6288	6380	6550	6589	6656
Total Liab. ($B)	405	476	495	483	494	457	481	519	555	608
Accounts Payable			9903	8075	7825	7381	8249	8658	8716	9501
Long-Term Debt	4826	6205	4094	3812	4387	3355	3309	3920	5169	5312
Shareholder's Eq.	17126	23631	26195	26561	27925	27487	28671	31268	31541	34729
D/E Ratio	0.25	0.23	0.14	0.13	0.14	0.11	0.10	0.11	0.15	0.14

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	0.7%	0.7%	0.8%	0.8%	0.8%	0.7%	0.7%	0.8%	0.7%	0.7%
Return on Equity	15.1%	15.1%	16.3%	15.4%	14.4%	12.7%	12.4%	13.6%	13.5%	13.1%
ROIC	10.9%	10.3%	11.9%	12.0%	11.3%	10.1%	10.2%	11.1%	10.8%	10.3%
Shares Out.	566	639	651	644	649	643	646	648	639	640
Revenue/Share	20.87	23.28	24.44	25.41	25.55	23.88	24.45	25.47	27.40	29.76
FCF/Share	-12.07	1.63	14.73	16.35	-5.19	2.15	-3.90	2.48	20.52	33.10

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