Bank of Montreal (BMO)

Updated March 6th, 2019 by Kay Ng

Key Metrics

Current Price:	$63	**5 Year CAGR Estimate:**	14.7%	**Market Cap:**	$40.3B
Fair Value Price:	$83	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	04/30/20
% Fair Value:	76%	**5 Year Valuation Multiple Estimate:**	5.6%	**Dividend Payment Date:**	05/26/20
Dividend Yield:	5.1%	**5 Year Price Target**	$106	**Years Of Dividend Growth[1]:**	9
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Last Dividend Increase[1]:**	6.6%

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$25 billion in revenue each year. At a high level, it generates about 60% of its earnings from Canada and about 32% 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 Q1 2020 earnings results on 02/25/20. For the quarter, net revenue climbed 8% to C$6,031 million. Adjusted net income was C$1,617 million, up 5% year over year. Adjusted earnings-per-share also climbed 4% to C$2.41. BMO's Canadian Personal & Commercial, Capital Markets, and Wealth Management businesses did well with year-over-year adjusted net income growth of 8% to C$700 million, 38% to C$362 million, and 21% to C$300 million, respectively. The bank's provision for credit losses ratio was 0.31%, up 18 basis points year over year but below the big Canadian banks' average. We believe BMO continues to have a focus on prudent lending practices.

The bank's capital position remains quite strong with its common equity tier 1 ratio at 11.4%. Adjusted return on equity was decent at 13.5%. 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. BMO plans to buy up to 12 million of common shares for cancellation.

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	***$7.33***	***$9.36***
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$7.33 (a 3% 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, 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.

1. Years of dividend growth in C$; TTM dividend per share over prior TTM dividend per share in C$; 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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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	12.2	12.5	10.3	10.8	11.5	11.4	11.0	11.7	12.0	10.6	***8.6***	***11.3***
Avg. Yld.	4.6%	5.1%	4.6%	4.2%	3.9%	4.5%	3.6%	3.4%	4.5%	4.0%	***5.1%***	***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 8.6 implies an undervalued stock and there's a 5.6% annual tailwind to total returns as the valuation drifts higher over time towards a fair multiple. We think the yield should not stray far away from 4% in the long run. 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%***

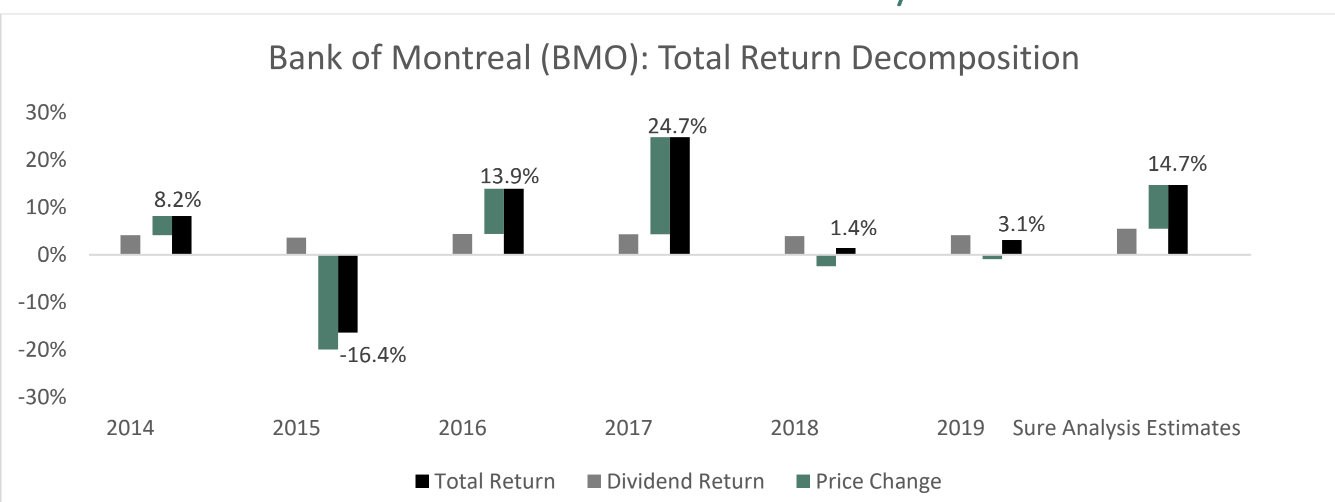
BMO's payout ratio of less than 50% of earnings is very safe. The low payout ratio affords it the ability to continue to raise the dividend in the coming years. We expect the payout ratio to remain below 50% in the foreseeable future.

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 14.7% in total returns annually over the next five years, consisting of a forward yield of 5.1%, 5% earnings-per-share growth, and a 5.6% tailwind from a higher price-to-earnings ratio. Bank of Montreal earns a buy rating from Sure Dividend as a safe income stock that's undervalued.

Total Return Breakdown by Year



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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.

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