Bank of Montreal (BMO)

Updated June 9th, 2020 by Kay Ng

Key Metrics

Current Price:	$58	**5 Year CAGR Estimate:**	11.5%	**Market Cap:**	$36.7B
Fair Value Price:	$77	**5 Year Growth Estimate:**	1.2%	**Ex-Dividend Date:**	07/31/20
% Fair Value:	75%	**5 Year Valuation Multiple Estimate:**	6.0%	**Dividend Payment Date:**	08/26/20
Dividend Yield:	5.5%	**5 Year Price Target**	$82	**Years Of Dividend Growth:**	9
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	5.5%

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$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 Q2 2020 earnings results on 05/27/20. For the quarter, net revenue fell 3% to C$5,461 million. The revenue decrease was due to BMO's market sensitive businesses offsetting the growth in its Personal & Commercial businesses.

Adjusted net income was C$715 million, down 53% year over year. Adjusted earnings-per-share dropped 55% to C$1.04. It's important to note that BMO's operational performance remains solid, including expenses declining by 2%. The big drop in earnings is largely due to prudent loan loss provisioning in light of the COVID-19 impact. Specifically, higher provisions for credit losses increased C$942 million pre-tax (or CAD$693 million after tax).

The bank's provision for credit losses ratio was 0.94% (against previous quarter's 0.31% and year over year's 0.16%), as it set aside more money to cover the increase of bad loans from COVID-19 impacts. Based on a weaker economic outlook, BMO had C$705 million provision for credit losses on performing loans in Q2, compared with a C$26 million provision for credit losses on performing loans in the prior year. We believe BMO continues to have prudent lending practices. The provision for credit losses on impaired loans ratio was 0.35%, compared with a low level of 0.14% in the prior year.

The bank's capital position remains quite strong with its common equity tier 1 ratio at 11.0%. Adjusted return on equity was 5.5% in Q2 compared to Q2 2019's 13.9%. We expect BMO to be able to weather this economic downturn. However, management does not expect to see a reduction in impaired loan losses over the next few quarters.

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	***$4.96***	***$7.52***
DPS	$2.70	$2.84	$2.81	$2.88	$2.82	$2.60	$2.56	$2.72	$2.94	$3.06	***$3.17***	***$3.67***
Shares[1]	566	639	651	644	649	643	646	648	639	640	***639***	***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 decline of about 30% in fiscal 2020 but a longer-term growth rate of about 5%. Due to COVID-19 impacts, we're reducing the 2020 EPS estimate to $4.96.

There will be a rebound of earnings eventually, but it could take more than a few quarters for COVID-19 to come to pass. To be prudent, we're updating our forecast, assuming a rebound to normalized earnings in three years, followed by two years of 3% growth rate. BMO has maintained the same quarterly dividend of CAD$1.06 per share for three quarters

1. Years of dividend growth in C$; TTM dividend per share over prior TTM dividend per share in C$; Shares in millions.

straight, whereas in a normal market, it had raised the dividend every two quarters. We updated the 2020 dividend based on the current foreign exchange rate between the C$ and US$.

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	***11.6***	***10.9***
Avg. Yld.	4.6%	5.1%	4.6%	4.2%	3.9%	4.5%	3.6%	3.4%	4.5%	4.0%	***5.5%***	***4.5%***

From 2010-2019, BMO's average price-to-earnings ratio was about 11.3. We think a fair P/E of 10.9 is more suitable for BMO's above-average yield and slower growth over the next five years due to COVID-19 disruptions on the economy. The current ratio of 11.6 makes the stock slightly overvalued. However, based on normalized earnings, it'd be trading at a P/E of about 8.1 and undervalued by about 25%. So, long-term income-focused investors with an investment horizon of at least five years should give the bank stock a closer look. We think BMO's yield should not stray far away from 4.5% 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%	***64%***	***49%***

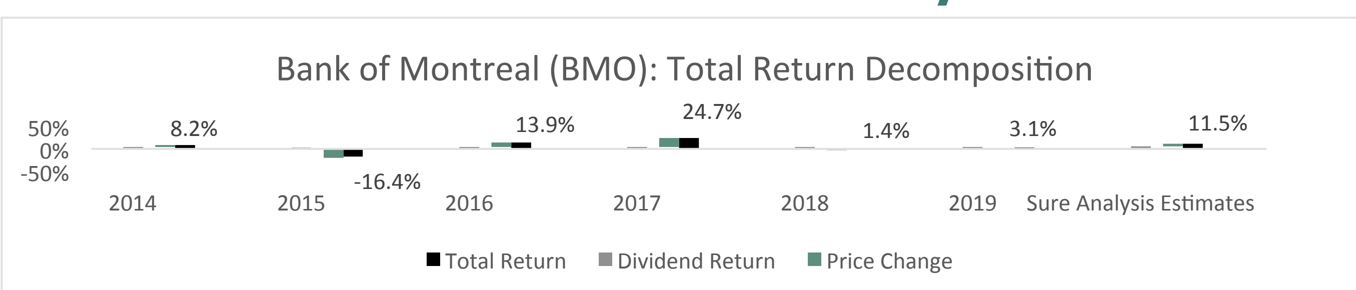
BMO normally has a payout ratio of about 50% that aligns with the other big Canadian banks. This year, like its peers, its payout ratio is going to be elevated due to COVID-19 impacts. We are optimistic that the bank can maintain its dividend in this economic downturn.

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 11.5% in total returns annually over the next five years, consisting of a forward yield of 5.5%, 1.2% earnings-per-share growth, and a 6.0% 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 for long-term investment.

Total Return Breakdown by Year



Click here to rate and review this research report. Your feedback is important to us.

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.

Bank of Montreal (BMO)

Updated June 9th, 2020 by Kay Ng

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.