Bank of Montreal (BMO)

Updated January 9th, 2021 by Kay Ng

Key Metrics

Current Price:	$79	**5 Year CAGR Estimate:**	9.4%	**Market Cap:**	$50.5B
Fair Value Price:	$77	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	01/29/21
% Fair Value:	102%	**5 Year Valuation Multiple Estimate:**	-0.3%	**Dividend Payment Date:**	02/26/21
Dividend Yield:	4.2%	**5 Year Price Target**	$103	**Years Of Dividend Growth[1]:**	9
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Last Dividend Increase[1]:**	2.9%

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 its fiscal Q4 and full-year 2020 earnings results on 12/01/20. For the quarter, net revenue climbed 4% to C$5,986 million. Adjusted net income was C$1,610 million, which was marginally higher year over year. Adjusted earnings-per-share (EPS) dropped marginally to C$2.41 from C$2.43. BMO's operational performance was solid with non-interest expense declining by 11% versus Q4 2019. The bank's provision for credit losses (PCL) ratio was 0.38% (against previous quarter's 0.89% and year over year's 0.23%). So its PCL ratio improved markedly from Q3. Based on a more prudent outlook on a recovering economy, BMO had C$93 million PCL on performing loans in Q4, compared with a C$23 million PCL 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 0.30%, compared with 0.21% in the prior year. The bank's capital position remains quite strong with its common equity tier 1 ratio at 11.9%.

In fiscal 2020, BMO's net revenue rose 3% to C$23,478 million, adjusted net income fell 17% to C$5.2 billion, while adjusted EPS declined 18% to C$7.71. Adjusted return on equity was 10.3% compared to 2019's 13.7%. BMO's operations and financial position remains strong.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$5.22	$6.04	$5.91	$5.79	$5.23	$5.66	$6.27	$6.81	$7.09	$5.95	***$6.48***	***$9.49***
DPS	$2.84	$2.81	$2.88	$2.82	$2.60	$2.56	$2.72	$2.94	$3.06	$3.15	***$3.27***	***$4.48***
Shares[1]	639	651	644	649	643	646	648	639	640	646	***647***	***650***

From 2011 to 2020, the bank increased EPS by only 1.5% per year due primarily to the pandemic triggered economic contraction in 2020 and secondarily to a weakened US$ against the C$. Its EPS is expected to grow at an above average rate over the next term as the economy recovers. The company estimates medium-term EPS growth of 7-10% per year. The low end of the estimate aligns with BMO's EPS growth by 7.5% per year in C$ from 2011 to 2019.

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 assume a rebound to normalized earnings in two years, followed by three years of ~7% growth rate. We conservative estimate dividend growth of about 6.5% per year through 2026 – a rate that roughly follows its earnings growth. BMO has maintained the same quarterly dividend of CAD$1.06 per share for 5 quarters straight, whereas in a normal market, it had raised the dividend every 2 quarters. We updated the 2021 dividend based on the current foreign exchange rate between the C$ and 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.

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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	12.5	10.3	10.8	11.5	11.4	11.0	11.7	12.0	10.6	10.0	***12.1***	***10.9***
Avg. Yld.	5.1%	4.6%	4.2%	3.9%	4.5%	3.6%	3.4%	4.5%	4.0%	5.3%	***4.2%***	***3.0%***

From 2011-2020, BMO's average price-to-earnings ratio was about 11.2. 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 12.1 makes the stock moderately overvalued. However, based on normalized earnings, it'd be trading at a P/E of about 11.1 and essentially fairly valued. We think BMO's yield should not stray far away from the 4% yield range 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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	54%	47%	49%	49%	50%	45%	43%	43%	43%	53%	***50%***	***47%***

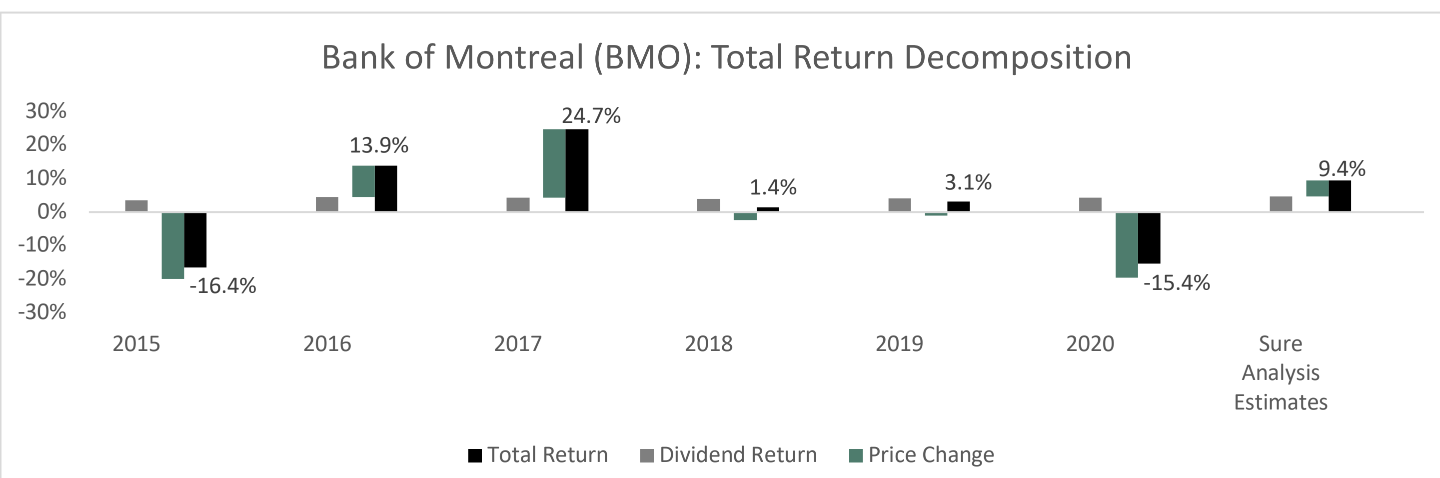
BMO normally has a payout ratio of about 50% that aligns with the other big Canadian banks. Last year, like its peers, its payout ratio was elevated due to COVID-19 impacts. We are optimistic that the bank can maintain its dividend in this economic downturn and normalize its payout ratio over time.

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 9.4% in total returns annually over the next five years, consisting of a forward yield of 4.2%, 6.0% earnings-per-share growth, and a 0.3% headwind from a lower price-to-earnings ratio. Bank of Montreal earns a hold rating from Sure Dividend as a safe income stock that's fairly valued for long-term investment. It'd be a buy on meaningful dips.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	14131	15853	16509	16569	15457	15798	16608	17673	19060	18615
SG&A Exp.	5542	6375	7273	7872	7457	7440	7518	7472	9008	7691
D&A Exp.	545	679	681	686	635	624	670	702	744	1057
Net Profit	3082	4063	4051	3925	3521	3486	4081	4238	4332	3791
Net Margin	21.8%	25.6%	24.5%	23.7%	22.8%	22.1%	24.6%	24.0%	22.7%	20.4%
Free Cash Flow	990	9551	10623	-3363	1391	-2518	1619	13233	21199	37047
Income Tax	888	870	1035	829	754	830	988	1524	1139	931

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	503.5	525.6	512.3	525.6	487.6	512.8	553.1	589.4	647.2	712.5
Cash & Equivalents	24986	25228	29952	29341	34524	25451	29804	38411	42997	55603
Accounts Receivable	7801	9202	6618	6719	5844	6732	6036	3413	3518	3520
Goodwill & Int. Ass.	5242	5270	5085	6612	6288	6380	6550	6589	6656	6738
Total Liabilities	475.5	495.5	482.6	494.0	457.3	481.2	518.5	554.6	608.4	670.1
Accounts Payable	8203	9903	8075	7825	7381	8249	8658	8716	9501	9793
Long-Term Debt	38854	29337	25005	24391	19769	19960	21890	24263	25939	26500
Shareholder's Equity	23631	26195	26561	27925	27487	28671	31268	31541	35229	38959
D/E Ratio	1.47	1.02	0.87	0.80	0.66	0.63	0.63	0.70	0.67	0.62

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	0.7%	0.8%	0.8%	0.8%	0.7%	0.7%	0.8%	0.7%	0.7%	0.6%
Return on Equity	15.1%	16.3%	15.4%	14.4%	12.7%	12.4%	13.6%	13.5%	13.0%	10.2%
ROIC	5.0%	6.4%	7.1%	7.1%	6.6%	6.9%	7.6%	7.3%	7.0%	5.7%
Shares Out.	639	651	644	649	643	646	648	639	640	646
Revenue/Share	23.28	24.44	25.41	25.55	23.88	24.45	25.47	27.40	29.76	28.99
FCF/Share	1.63	14.73	16.35	-5.19	2.15	-3.90	2.48	20.52	33.10	57.69

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