Bank of Montreal (BMO)

Updated August 31st, 2022 by Kay Ng

Key Metrics

Current Price:	$93	**5 Year CAGR Estimate:**	14.4%	**Market Cap:**	$62.7B
Fair Value Price:	$119	**5 Year Growth Estimate:**	5.5%	**Ex-Dividend Date:**	10/31/22
% Fair Value:	78%	**5 Year Valuation Multiple Estimate:**	5.1%	**Dividend Payment Date:**	11/28/22
Dividend Yield:	4.6%	**5 Year Price Target**	$156	**Years Of Dividend Growth:**	9
Dividend Risk Score:	B	**Retirement Suitability Score:**	A	**Rating:**	Buy

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 1,400 branches in North America. Bank of Montreal produces about C$12 billion in net income annually. 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 Q3 2022 financial results on 8/30/22. For the quarter, compared to a year ago, adjusted net revenue increased marginally to C$6,631 million, adjusted net income fell 7.0% to C$2,132 million. Adjusted diluted earnings per share ("EPS") declined by 10.2% to C$3.09. Like its other big Canadian bank peers, BMO increased its provision for credit losses for the quarter in anticipation of a weaker outlook in the economy from high inflation and rising interest rates that dampen consumer spending and business investments.

The year-to-date adjusted results illustrate a bigger picture. Adjusted net revenue increased by 5.3% to C$20.3 billion. Adjusted net income climbed 7.4% to C$6.9 billion. Consequently, its adjusted EPS rose 5.9% to C$10.20. The bank's common equity tier 1 ratio remained solid at 15.8%, up from 13.4% a year ago. We maintain our 2022 EPS estimate of $10.74.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$6.04	$5.91	$5.79	$5.23	$5.66	$6.27	$6.81	$7.09	$5.95	$10.13	***$10.74***	***$14.04***
DPS	$2.81	$2.88	$2.82	$2.60	$2.56	$2.72	$2.94	$3.06	$3.15	$3.37	***$4.30***	***$6.10***
Shares[1]	651	644	649	643	646	648	639	640	646	650	***674***	***681***

From 2012 to 2021, the bank increased EPS by 8.9% in C$ but when translated to US$, the growth rate dropped to 5.9% per year. The company estimates medium-term EPS growth of 7-10% per year. However, the actual result would be affected by forex fluctuations between the C$ and US$. Through 2027, we use a 5.5% growth rate, to be cautious. We estimate dividend growth of 7.0% per year through 2027, as its payout ratio is at the low end of its range.

In December 2021, after the regulator, Office of the Superintendent of Financial Institutions, approved of dividend increases again, BMO raised its quarterly dividend by 25.5% (the highest increase versus the other Big Six Canadian banks) to C$1.33. This is a vote of confidence in BMO's strong capital position. We set our 2022 dividend estimate based on the forex rate at writing. Keep in mind that the fluctuations in the forex between U.S. dollars and Canadian dollars will affect the effective yield for U.S. shareholders.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	10.3	10.8	11.5	11.4	11.0	11.7	12.0	10.6	10.0	11.2	***8.6***	***11.1***
Avg. Yld.	4.6%	4.2%	3.9%	4.5%	3.6%	3.4%	4.5%	4.0%	5.3%	3.5%	***4.6%***	***3.9%***

[1] Shares in millions.

Disclosure: This analyst has no position in the security discussed in this research report, but may initiate one in the next 72 hours.

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From 2012-2021, BMO's average price-to-earnings ratio was about 11.1. We think a P/E of 11.1 is fair for the expected longer term EPS growth rate of about 5.5%. The current P/E of 8.6 makes the stock undervalued. We think BMO's yield will not stray far away from a 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	47%	49%	49%	50%	45%	43%	43%	43%	53%	33%	***40%***	***43%***

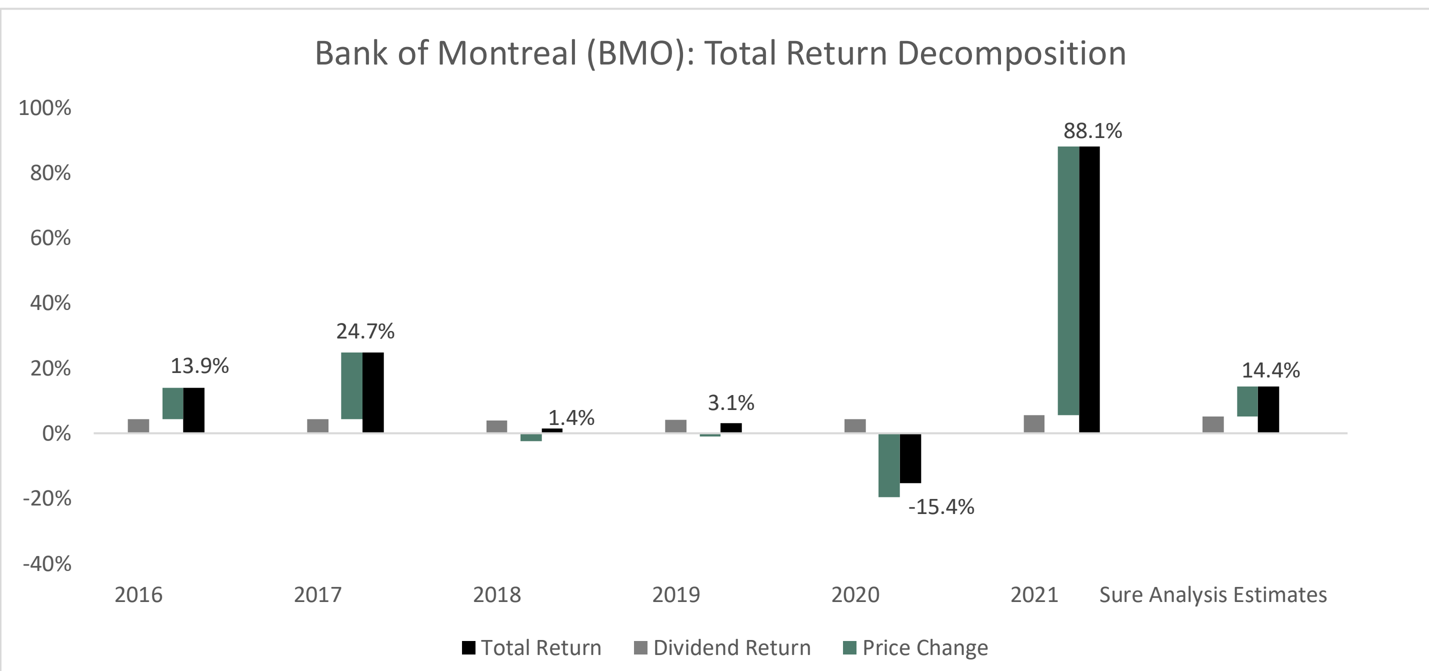
During the Great Recession, BMO maintained the same dividend from fiscal 2009 to 2011 before resuming dividend growth afterwards. Similarly, the regulator restriction led to a dividend freeze of 8 quarters during the COVID-19 pandemic. The solid bank came out with a dividend increase as soon as the ban was lifted. BMO's dividend policy is a payout ratio of 40%-50%. Its payout ratio was higher than normal in 2020 due to higher provision for credit losses from pandemic impacts. We expect BMO's payout ratio to stay within its target range in most years.

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 Six banks, in a smaller market like Canada. Recessions are tough for banks, but BMO performed admirably during the last two (including the one during the pandemic) by maintaining its dividend in the Canadian currency.

Final Thoughts & Recommendation

We forecast 14.4% in total annualized returns over the next five years for an investment in BMO at current prices, consisting of a yield of 4.6%, 5.5% earnings-per-share growth, and a 5.1% tailwind from a higher price-to-earnings ratio. As a safe income stock that's undervalued, Bank of Montreal earns a buy rating from Sure Dividend.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	15853	16509	16569	15457	15798	16608	17673	19060	18615	21388
SG&A Exp.	5586	6483	7110	6716	6731	6886	6850	8376	7180	7727
D&A Exp.	679	681	686	635	624	670	702	744	1057	1133
Net Profit	4063	4051	3925	3521	3486	4081	4238	4332	3791	6163
Net Margin	25.6%	24.5%	23.7%	22.8%	22.1%	24.6%	24.0%	22.7%	20.4%	28.8%
Free Cash Flow	9551	10623	-3363	1391	-2518	1619	13233	21199	37047	34230
Income Tax	870	1035	829	754	830	988	1524	1139	931	1990

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets (B)	525.6	512.3	525.6	487.6	512.8	553.1	589.4	647.2	712.5	797.4
Cash & Equivalents	25228	29952	29341	34524	25451	29804	38411	42997	53789	84519
Accounts Receivable	9202	6618	6719	5844	6732	6036	3413	3518	3520	4121
Goodwill & Int. Ass.	5270	5085	6612	6288	6380	6550	6589	6656	6738	6168
Total Liabilities (B)	495.5	482.6	494.0	457.3	481.2	518.5	554.6	608.4	670.1	751.0
Accounts Payable	9903	8075	7825	7381	8249	8658	8716	9501	9410	11149
Long-Term Debt	29580	25145	24447	19819	116458	132181	144073	148195	138567	150945
Shareholder's Equity	26195	26561	27925	27487	28671	31268	31541	35229	38959	43471
D/E Ratio	1.03	0.88	0.80	0.66	3.69	3.82	4.13	3.82	3.26	3.25

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	0.8%	0.8%	0.8%	0.7%	0.7%	0.8%	0.7%	0.7%	0.6%	0.8%
Return on Equity	16.3%	15.4%	14.4%	12.7%	12.4%	13.6%	13.5%	13.0%	10.2%	15.0%
ROIC	6.4%	7.1%	7.1%	6.6%	3.5%	2.6%	2.5%	2.4%	2.1%	3.3%
Shares Out.	651	644	649	643	646	648	639	640	646	650
Revenue/Share	24.60	25.41	25.55	23.88	24.45	25.47	27.40	29.76	28.99	32.97
FCF/Share	14.82	16.35	-5.19	2.15	-3.90	2.48	20.52	33.10	57.69	52.77

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