



Bank of Montreal (BMO)

Updated March 1st, 2023 by Kay Ng

Key Metrics

Current Price:	\$96	5 Year CAGR Estimate:	12.2%	Market Cap:	\$68B
Fair Value Price:	\$110	5 Year Growth Estimate:	5.5%	Ex-Dividend Date:	04/27/23
% Fair Value:	87%	5 Year Valuation Multiple Estimate:	2.9%	Dividend Payment Date:	05/26/23
Dividend Yield:	4.5%	5 Year Price Target	\$144	Years Of Dividend Growth¹:	10
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 2,000 branches (including Bank of West branches) in North America. Bank of Montreal produces about C\$14 billion in net income annually. It generates about 45% of earnings from the U.S. (including Bank of the West) and the rest primarily from Canada. 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 Q1 2023 financial results on 2/28/23. For the quarter, compared to a year ago, adjusted net revenue increased 2.6% to C\$7,294 million, adjusted net income fell 12% to C\$2,272 million. Adjusted diluted earnings per share ("EPS") declined by 17% to C\$3.22.

For its Canadian Personal and Commercial Banking segment, it saw revenue growth of 9%, thanks to higher net interest income from higher net interest margins. However, adjusted net income declined 2% to C\$980. The U.S. Personal and Commercial Banking segment saw adjusted net income rising 3% to C\$699 million thanks to a stronger U.S. dollar. Both segment results were weighed by higher expenses and higher provision for credit losses (PCL). The Wealth Management segment's adjusted net income declined 12% to C\$278 million due to weaker global markets and higher expenses. The Capital Markets segment saw adjusted net income decrease 28% year over year to C\$510 million primarily because the prior year quarter's results were particularly strong. The bank's common equity tier 1 ratio remained solid at 18.2%, up from 14.1% a year ago. The adjusted return on equity was still good at 13.4% versus 18.8% a year ago.

Executing on its North American growth strategy, the bank completed the acquisition of Bank of the West from BNP Paribas on February 1, 2023, for a cash purchase price of \$13.8 billion. The transaction doubled BMO's U.S. footprint, particularly, providing immediate scale in the highly attractive market of California, which has the largest population and economy in the U.S. In light of recent results, we lowered our fiscal 2023 EPS estimate to \$9.95.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$5.91	\$5.79	\$5.23	\$5.66	\$6.27	\$6.81	\$7.09	\$5.95	\$10.13	\$9.85	\$9.95	\$13.00
DPS	\$2.88	\$2.82	\$2.60	\$2.56	\$2.72	\$2.94	\$3.06	\$3.15	\$3.37	\$4.03	\$4.27	\$5.99
Shares¹	644	649	643	646	648	639	640	646	650	677	693	722

From 2013 to 2022, the bank increased EPS by 8.6% in C\$ but when translated to US\$, the growth rate dropped to 5.8% 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 2028, we use a 5.5% growth rate, to be cautious. We estimate dividend growth of 7.0% per year through 2028, 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 2023 dividend estimate based

¹ Years of Dividend Growth in Canadian dollars; Shares in millions.

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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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	10.8	11.5	11.4	11.0	11.7	12.0	10.6	10.0	11.2	10.4	9.6	11.1
Avg. Yld.	4.2%	3.9%	4.5%	3.6%	3.4%	4.5%	4.0%	5.3%	3.5%	3.9%	4.5%	4.1%

From 2013-2022, BMO's average price-to-earnings ratio was about 11.1. From 2018 to 2022, it was 10.8. 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 9.6 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	49%	49%	50%	45%	43%	43%	43%	53%	33%	41%	43%	46%

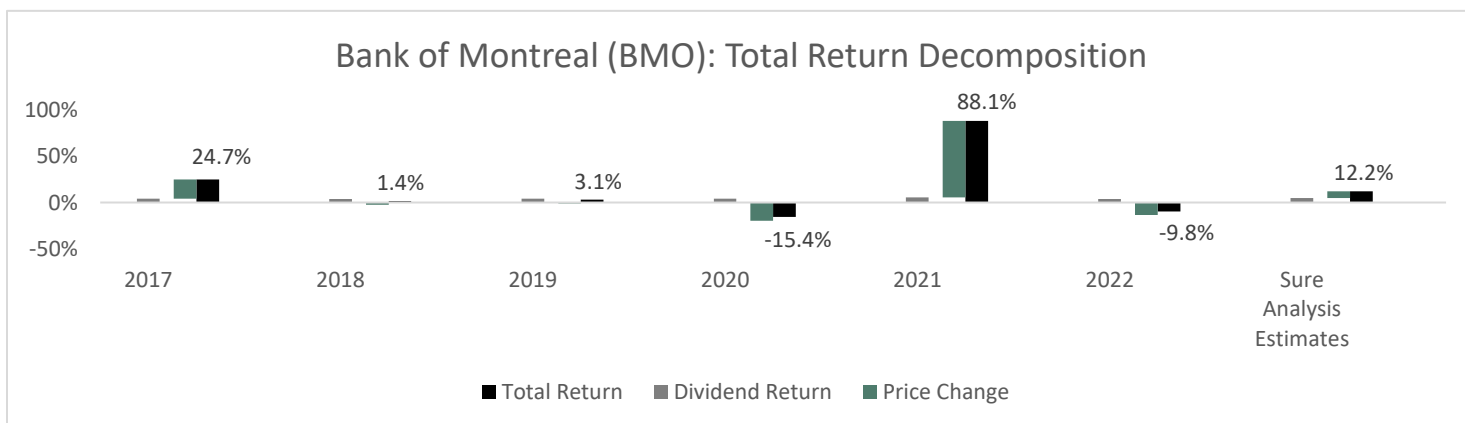
During the Great Recession, BMO maintained the same dividend from fiscal 2009 to 2011 before resuming dividend growth afterwards. Similarly, the regulator restriction led to a dividend freeze of 8 quarters during the COVID-19 pandemic. The solid bank came out with a dividend increase as soon as the ban 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 12.2% in total annualized returns over the next five years for an investment in BMO at current prices, consisting of a yield of 4.5%, 5.5% earnings-per-share growth, and a 2.9% 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	16509	16569	15457	15798	16608	17673	19060	18615	21388	19996
SG&A Exp.	6483	7110	6716	6731	6886	6850	8376	7180	8042	6702
D&A Exp.	681	686	635	624	670	702	744	1057	1133	1075
Net Profit	4051	3925	3521	3486	4081	4238	4332	3791	6163	10514
Net Margin	24.5%	23.7%	22.8%	22.1%	24.6%	24.0%	22.7%	20.4%	28.8%	52.6%
Free Cash Flow	10623	-3363	1391	-2518	1619	13233	21199	37047	34230	2726
Income Tax	1035	829	754	830	988	1524	1139	931	1990	3378

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets (B)	512.3	525.6	487.6	512.8	553.1	589.4	647.2	712.5	797.4	837.1
Cash & Equivalents	31107	30803	36219	26910	30469	38451	43130	49873	81953	68482
Accounts Receivable	6618	6719	5844	6732	6036	3413	3518	3520	4121	4903
Goodwill & Int. Ass.	5085	6612	6288	6380	6550	6589	6656	6738	6168	5495
Total Liabilities (B)	482.6	494.0	457.3	481.2	518.5	554.6	608.4	670.1	751.0	784.9
Accounts Payable	8075	7825	7381	8249	8658	8716	9501	9410	11149	12441
Long-Term Debt	25145	24447	19819	116458	132181	124845	148195	138567	150945	161511
Shareholder's Equity	26561	27925	27487	28671	31268	31541	35229	38959	43471	50251
D/E Ratio	0.88	0.80	0.66	3.69	3.82	3.58	3.82	3.26	3.25	3.09

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	0.8%	0.8%	0.7%	0.7%	0.8%	0.7%	0.7%	0.6%	0.8%	1.3%
Return on Equity	15.4%	14.4%	12.7%	12.4%	13.6%	13.5%	13.0%	10.2%	15.0%	22.4%
ROIC	7.1%	7.1%	6.6%	3.5%	2.6%	2.6%	2.5%	2.1%	3.3%	5.1%
Shares Out.	650	648	647	646	652	645	640	642	649	666
Revenue/Share	25.41	25.55	23.88	24.45	25.47	27.40	29.76	28.99	32.97	30.04
FCF/Share	16.35	-5.19	2.15	-3.90	2.48	20.52	33.10	57.69	52.77	4.09

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

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