

Recommendation

Hold

Target Price

\$70.00

Risk

Low

Average Daily Volume

150 day: 1,968,300

Quick Facts

Recent Price	C\$57.95
Symbol	BMO-T
Shares O/S	499 million
52 Wk. Range	\$72.75-\$54.70
% Below High	-20.3%
% Above Low	5.9%
Shrs OS	499 million
Market Cap	\$29 million
Fiscal Year End	October 31

	EPS	Multiple
2006a	\$5.10	11.4x
2007e	\$5.64	10.3x
2008e	\$5.95	9.7x
Book Value	\$28.29	2.0x

BMO FINANCIAL GROUP

(BMO-TSX \$57.95)



Data Source: BigCharts.com

BANK OF MONTREAL (BMO Financial Group) is a diversified financial services organization. BMO provides a broad range of retail banking, wealth management and investment banking products and solutions.

INCREASED TO BUY - 12 MONTH TARGET LOWERED TO \$70.00

BMO Financial Group (BMO) announced cash EPS for Q4/07 of \$0.89 down 35% Y/Y. When adjusted to exclude numerous non-operating items detailed separately below, adjusted operating EPS was \$1.41 which was slightly better than we expected and up 17% Y/Y on an operating basis. The quarter was driven by a strong earnings performance from the capital markets group up 46% Y/Y and as well from the Private Client group with earnings up 27% Y/Y. Adjusted ROE in the quarter was 19.8%.

For the year-ended 2007, cash EPS was reported at \$4.18 down 20% Y/Y. Adjusted operating EPS (excluding commodity losses, restructuring charges and other non operating items) was \$5.64 which represents an 11% Y/Y gain. Adjusted ROE was 19.8% up from 19.3% in 2006. The dividend was increased by 13% over the 12 month period to \$2.80, representing a payout ratio on adjusted EPS of 50%. Managements targeted payout ratio is 45% to 55% of EPS. The Tier 1 capital ratio decreased marginally to 9.5% down from 10.2% at the end of last year.

Management gave a positive outlook for fiscal 2008 indicating a potential earnings increase of 10% to 15% off a low EPS base for 2007 of \$5.24 (our adjusted EPS was \$5.64). This outlook, which suggests a stronger second half of 2008 than the first half, also includes a higher expected level of credit losses. We view this position as positive and have increased our 2008 estimated EPS to \$5.95 from \$5.90. We expect the dividend payout ratio to be in the range of 50% to 52% which suggests further dividend increases over the next

12 months to the \$3.00 to \$3.10 level, an expected increase of 7% to 11%. Our 12 month target was previously lowered to \$70.00 which reflects our lower valuations for bank stocks generally. BMO has the highest yield of the majors at 4.8%. BMO is considered a Buy with an expected total one year return of 25.5%.

Valuation

Based on our 2008 EPS of \$5.95 and our \$70.00 target price in 12 months time, this would imply a multiple on 2008 EPS of 12.9 times which is still well below the average of 13.0 times for RY, BNS & TD. We believe this is reasonable given the challenges facing management as investors will be rewarded with a premium yield of 4.8% versus the banking average of 4.1%.

Adjustments For The Quarter Had A Negative EPS Impact Of \$0.54

The adjustments for the quarter are so numerous that we have summarized them separately below. In total they amount to a negative \$451 million or \$269 million after-tax (\$0.54 per share).

Capital Markets:

1. (\$169 million) - write down of trading, preferred and Structured credit positions (\$0.23) per share.
2. (\$134 million) - write down of Canadian Asset Backed Commercial Paper (ABCP) (\$0.17 per share).
3. (\$15 million) - write down of Capital notes in Structured Investment Vehicles (SIV's) (\$0.02 per share).
4. (\$24 million) - write down in Commodity related losses (\$0.03 per share). This increases the total commodity losses, largely natural gas related, to (\$704 million) or (\$0.64 per share) for fiscal 2007.

Corporate Canada:

1. (\$50 million) - increased in General Allowances or (\$0.07 per share).
2. (\$24 million) - restructuring charge or (\$0.03 per share).

P&C Canada:

1. \$107 million - gain on sale of MasterCard common shares or \$0.16 per share.
2. \$43 million - tax recovery or \$0.09 per share.
3. (\$185 million) - increase in liability for future customer redemptions on credit card loyalty programs or (\$0.24) per share.

High Risk Asset Exposure - Further Significant Losses Seem Low

BMO outlined in detail its exposure to high risk assets and the liquidity support provided. In summary, BMO currently holds SIV positions in the amount of US\$1.0 billion and will hold up to a maximum of CDN\$1.6 billion. BMO has nominal exposure to U.S. subprime mortgages. BMO had a \$6.2 billion position in bank sponsored ABCP's at quarter end which has since been reduced to \$5.6 billion. BMO manages two SIV's namely the Links (US\$18.7 billion) and Parkland (€2.5 billion). BMO has total net investment in both of \$53 million with back up liquidity lines which total slightly over US\$200 million.

Other Quarterly Highlights

- P&C earnings in Canada increased 4% this quarter excluding the three items outlined above which basically offset each other. Continued good loan growth (personal loans & credit cards up 10% Y/Y) was more than offset by a sharp 13 bp drop in interest margins Q/Q and a drop of 6bp Y/Y. There was little operating leverage improvement Y/Y. BMO continues to struggle with the loss of market share in mortgage loans but gained in the personal loan category. Securitization revenues were \$61 million up from \$55 million last year. For the fiscal year 2007 P&C Canada earnings increased by 9%.
- P&C U.S. (Harris) cash earnings increased 28% Y/Y to \$37 million from \$29 million last year. Interest margins decline 23bp Y/Y and 3bp Q/Q. Revenue declined by 3% while expenses were tightly monitored and actually decreased by 10% for a solid increase in operating leverage. For the fiscal year 2007, P&C US earnings were unchanged over 2006.

- Wealth Management Group (Private Client) earnings were strong as the group reported net income of \$107 million up 27% Y/Y. Mutual Fund revenue increased 14% Y/Y to \$148 million and AUM increased to \$97.3 billion for a Y/Y increase of 1%. For fiscal 2007, Private Client earnings increased 15% Y/Y.
- BMO Capital Markets earnings were strong at \$275 million (excluding all of the above items) up 46% Y/Y. Trading revenue was good (excluding commodity losses) as it increased to \$177 million up 96% Y/Y. Underwriting revenue was \$103 million down from \$160 million last quarter and flat Y/Y. For the fiscal year 2007, BMO Capital Markets earnings increased by 25% excluding write downs.
- Security gains other than trading were \$148 million up from \$6 million last quarter up from \$46 million in Q4/06. Most of the gain this quarter was from the sale of MasterCard as noted above.
- Provision For Credit Losses (PCL) in the quarter were \$151 million up from \$91 million last quarter and up from \$16 million in the same quarter last year. This represented 0.29% of average loans, up from 0.18% last quarter. The increase reflected higher volumes and lower recoveries. For 2007 total PLC amounted to \$353 million or 0.17% of average loans up from \$176 million or 0.09% last year. Our estimate for 2008 has been increased to \$500 million from \$350 million. Managements targeted PLC is \$475 million or less and largely reflects higher volumes and a deteriorating credit environment.
- Gross impaired loan formations were \$238 million up from \$106 million last quarter and almost triple the same quarter last year.
- BMO repurchased 1.4 million common shares at an average cost of \$64.83 per share down from 2.8 million shares last quarter.
- Tier 1 capital ratio was 9.5% up from an adjusted 9.3% last quarter but down from 10.2% in Q4/06. The decline in part represents the negative impact of the trading losses.

Definition of Risk Ratings

Low: Low financial and operational risk, high predictability of financial results with stronger than average balance sheet and strong free cash flows. Company may pay substantial dividends or have an active share repurchase program.

Medium: Moderate financial and operational risk, moderate predictability of financial results, positive free cash flows and may or may not pay a dividend.

High: High financial and/or operational risk, low predictability of financial results. Limited financial history, negative free cash flows, adequate working capital and no dividends.

Definition of Research Ratings

The Catalyst research recommendation structure consists of the following categories:

Buy: The stock's total return, including dividends paid, is expected to exceed a minimum of 15% on a risk-adjusted basis, over the next 12 months.

Hold: The stock's total return, including dividends paid, is expected to be between 0% and 15%, on a risk-adjusted basis, over the next 12 months.

Sell: The stock's total return, including dividends paid, is expected to be negative over the next 12 months.

Speculative: The stock's total return is expected to exceed 30% over the next 12 months; however, there is material event risk associated with the investment that could result in significant loss.

Note: Analysts have discretion within 500 basis points of the upper and lower limit of each rating to maintain the recommendation.

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