

United Parcel Service

UPS-NYSE

Rating ↓
Market PerformPrice: Jan-31
\$109.13Target ↓
\$115.00Total Rtn
8%

Lowering to Market Perform

Bottom Line: UPS's Q4/16 results and F2017 guidance were 4% and 5% below our expectations. The main variance was a weaker-than-expected operating margin in the U.S. Domestic segment where an unfavorable mix shift and upfront investments in expansion/modernization weighed on results. International results were better than expected but face significant 2017 forex headwinds, expected to drive profitability lower by 4-8% y/y. With capital spending rising, margins/ROIC contracting in the near term, and EPS and cash flow growth muted, the stock lacks a positive catalyst. We lower our rating to Market Perform.

Key Points

UPS's Q4/16 results and F2017 outlook weakened our investment thesis for UPS, at least for the near term. The mix shift in the U.S. domestic network is accelerating, and the company is pulling forward capital spending (facility modernization and expansion) to support the growth and attempt to improve the underlying profitability of the business over the medium term. EBIT margins are expected to remain muted through 2017 and with very moderate momentum for improvement in 2018 as well in the absence of improving industrial production and B2B shipments.

The International segment continued to perform very well in Q4/16 helped by favorable forex, exceeding our expectations. However, forex exposure turns negative in 2017 to the tune of \$400m (higher than the previous estimate of \$300 million) and is projected to reduce segment EBIT between 4% and 8%.

Capex to support the \$2b expansion in Europe and the accelerated initiatives in the domestic network means higher spending for the next few years with management targeting \$4b (~6% of sales and highest since 2006) in 2017 versus our forecast of \$3.2b. The lower profitability and higher capex will pressure ROIC and the projected 2017 buyback, which is now at \$1.8b versus our forecast of \$2.8b.

Overall, our EPS forecast is lowered to \$5.93 from \$6.20 for F2017 and to \$6.35 from \$6.72 previously for F2018.

UPS shares have traded at a five-year average premium of 17% to the S&P 500 with the low end of the range, in line with the S&P 500 market multiple. With ROIC challenged and EPS and cash flow growth muted, we suspect that valuation will remain pressured in the immediate term. We apply an 18x P/E (consistent with the current S&P 500 multiple) to our F2018 EPS to derive a \$115 target price, down from \$130 previously.

Key Changes

Rating	Target	Estimates	Q1/17E	2017E
Mkt↓	\$115.00↓	Revenue	\$15,142	\$64,486
OP	\$130.00	Previous	\$15,226	\$64,510
		EBITDA	\$2,383	\$10,614
		Previous	\$2,457	\$11,047
		EPS	\$1.29	\$5.93
		Previous	\$1.34	\$6.20

This report was prepared by an analyst(s) employed by BMO Nesbitt Burns Inc., and who is (are) not registered as a research analyst(s) under FINRA rules. For disclosure statements, including the Analyst Certification, please refer to page(s) 7 to 9.

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Company Data				in \$
Dividend	\$3.12	Shares O/S (mm)	874.4	
Yield	2.9%	Market Cap (mm)	NM	
AD Vol. (mm)	12.72	Wkly \$Vol (000s)	4,349,830	
BMO Estimates				in \$
(FY-Dec.)	2016A	2017E	2018E	
Revenue	\$60,906	\$64,486↓	\$68,063	
EBITDA	\$10,342	\$10,614↓	\$11,202	
EPS	\$5.76	\$5.93↓	\$6.35	
EV	\$109,894	\$108,226↓	\$10,505	
Consensus Estimates				
	2016A	2017E	2018E	
EPS		\$5.82	\$6.15	
Valuation				
	2016A	2017E	2018E	
P/E	18.9x	18.4x	17.2x	
EV/EBITDA	10.7x	10.4x	9.9x	
QTR. EPS	Q1	Q2	Q3	Q4
2016A	\$1.27	\$1.43	\$1.44	\$1.63
2017E	\$1.29	\$1.47	\$1.51	\$1.67
2018E	\$1.38	\$1.60	\$1.60	\$1.77

Our Thesis

We believe UPS is a premier franchise in the transportation sector with a strong track record of execution, solid growth prospects, industry-leading ROIC, and a high level of shareholder returns. However, with ROIC under pressure and EPS and cash flow growth muted, we suspect that valuation will remain pressured in the immediate term.

United Parcel Service - Block Summary Model

Income Statement		2016A	2017E	2018E
Revenue		60,906	64,486	68,063
<i>Growth y/y %</i>		4.4%	5.9%	5.5%
Operating Expenses		52,788	56,148	59,254
EBITDA		10,342	10,614	11,202
EBIT		8,118	8,337	8,809
<i>Growth y/y %</i>		4.3%	2.7%	5.7%
Net Income		5,104	5,132	5,397
<i>Growth y/y %</i>		3.7%	0.5%	5.2%
Diluted EPS		\$5.76	\$5.93	\$6.35
<i>Growth y/y %</i>		6.0%	2.9%	7.1%
Cash Flow Statement		2016A	2017E	2018E
Cash Provided From Operations		6,473	7,932	8,401
Capex		2,877	4,000	4,000
Free Cash Flow		3,596	3,932	4,401
Dividends		3,160	2,782	2,868
Balance Sheet		2016A	2017E	2018E
Cash and Cash Equivalents		6,626	5,976	5,709
Other Current Assets		13,388	14,097	14,084
Net PP&E		18,800	20,799	22,624
Total Assets		40,401	41,603	43,197
Total Debt		16,214	16,214	16,214
Total Liabilities		36,943	39,612	39,828
Shareholders' Equity		453	1,992	3,369
Key Metrics		2016A	2017E	2018E
Net Debt/EBITDA		0.5x	1.0x	0.9x
EBIT/Interest		21.3x	17.1x	16.1x
Capex/Sales		4.9%	6.2%	5.9%
ROIC		27.9%	26.9%	26.5%

Source: BMO Capital Markets, Company Reports

New Scenarios

Valuation

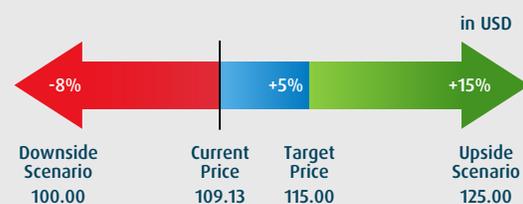
Our target price is based on our 18 times our forward P/E estimate.

Upside Scenario \$125.00

Economic growth improves, which drives increases in demand for package services, particularly for B2B shipments. The target multiple rises to a 15% premium to the S&P 500 consistent with historical averages.

Downside Scenario \$100.00

Economic activity moderates, and demand for package services softens. The target multiple declines to a 10% discount to the S&P 500.



Company Description

UPS is the largest provider of small package services globally. The company's network covers more than 220 countries, including every address in North America and Europe. UPS also has significant complementary businesses, including freight forwarding, contract logistics, freight brokerage, and less-than-truckload operations.



UPS-NYSE
Research



Industry
Research



Company
Models

Q4/16: Positioning the Company for Medium-To-Long-Term Expected to Pressure Results Short-Term

UPS's Q4/16 results and F2017 guidance were 4% and 5% below our expectations, respectively. The main variance relative to our estimates was weaker-than-expected operating margin in the U.S. Domestic segment where unfavorable mix shift and upfront investments in expansion/modernization weighed on results and 2017 outlook. International segment results were better than expected but face significant forex headwinds in 2017 which are expected to drive profitability lower by 4-8% y/y. The Supply Chain and Freight Segment continues to face weak market conditions, albeit the outlook is for potential improvement from H2/17. The Q4/16 performance relative to our expectations is summarized in Exhibit 1.

U.S. Domestic Segment: Results Challenged by Record B2C Mix Shifts

Ground segment revenues were 2.6% lower than our estimates while adjusted operating income trailed our estimates by 13.4%. This lackluster financial performance came despite a 5.0% y/y increase in overall U.S. Domestic average daily volumes (Next Day Air: 4.4%; Deferred: 2.8%; Ground 5.4%), which was a record volume performance for the segment. Historic shifts in product mix fueled by demand for e-commerce solutions led to this adverse financial outcome in addition to inefficiencies resulting from ongoing expansion in the ground network. B2C shipments, which tend to be lower margin, grew by 11.5%y/y to reach a record level of 55% of overall average daily volumes (300-bp increase y/y), which was the largest volumes increase in a quarter. In fact, B2C shipments constituted 63% of average daily volumes in the month of December, which was the highest ever B2C market share month.

B2B shipments were slightly down in the quarter even as growth in return shipments accelerated by double digits. B2B shipments were pressured by several headwinds in the quarter, including weak industrial production trends, revenue management actions on a handful of large accounts, and a strong U.S. dollar. B2B shipments were up slightly in the same quarter in the prior year and hence the higher intensity in mix shift that weighed on segment margins.

International Package: Continues to Deliver Robust Performance

International Package continues to deliver strong performance, delivering double-digit operating earnings growth for the eight consecutive quarter. Operating income was 7.9% ahead of our estimates on the back of strong growth in both domestic (+6.5% y/y) and export (+8.4% y/y) shipments. Volume growth was especially robust in Asia (+20% y/y) and inter-Europe (+10% y/y).

Supply Chain and Freight: Continuing Soft Market Conditions

The Supply Chain and Freight segment's revenues were 1.4% ahead of our estimates, while operating income trailed by 6.1%. The forwarding and the freight units remain challenged by overcapacity in the market.

Exhibit 1: Q4/16 Variance to BMO Estimates

UPS Q1/16 Results					
Summary of Results:					
	Q4/15A	Q4/16A	YoY (%)	Q4/16E	Variance
<i>(\$ Millions, Except EPS)</i>					
Revenues					
Next Day Air	1,760	1,834	4.2%	1,878	-2.3%
Deferred	1,246	1,301	4.4%	1,388	-6.2%
Ground	7,259	7,778	7.1%	7,934	-2.0%
U.S. Domestic Package	10,265	10,913	6.3%	11,200	-2.6%
Domestic	626	637	1.8%	662	-3.8%
Export	2,394	2,561	7.0%	2,555	0.2%
Cargo	155	137	-11.6%	140	-1.8%
International Package	3,175	3,335	5.0%	3,357	-0.7%
Forwarding and Logistics	1,751	1,813	3.5%	1,786	1.5%
Freight	679	686	1.0%	673	1.9%
Other	184	184	0.0%	188	-2.0%
Supply Chain & Freight	2,614	2,683	2.6%	2,647	1.4%
Total Revenues	16,054	16,931	5.5%	17,203	-1.6%
EBITDA	2,710	2,786	2.8%	2,954	-5.7%
<i>EBITDA Margin</i>	16.9%	16.5%	-43bps	17.2%	-72bps
Operating Income (adjusted)					
U.S. Domestic Package	1,346	1,338	-0.6%	1,546	-13.4%
International Package	624	706	13.1%	655	7.9%
Supply Chain & Freight	199	179	-10.1%	191	-6.1%
Total Operating Income	2,169	2,223	2.5%	2,391	-7.0%
Operating Margin					
U.S. Domestic Package	13.1%	12.3%	-85bps	13.8%	-154bps
International Package	19.7%	21.2%	152bps	19.5%	167bps
Supply Chain & Freight	7.6%	6.7%	-94bps	7.2%	-53bps
Consolidated Operating Margin	13.5%	13.1%	-38bps	13.9%	-77bps
Taxes (adj.)					
<i>Effective Tax Rate</i>	32.4%	32.8%	39bps	35.3%	-242bps
Net Income	1,410	1,434	1.7%	1,486	-17bps
<i>Net Profit Margin</i>	8.8%	8.5%	-31bps	8.6%	-17bps
Shares outstanding (millions)	898	876	-2.4%	879	-0.3%
Diluted EPS (adj.)	\$1.57	\$1.63	3.8%	\$1.69	-3.6%
Key Metrics:					
CAPEX	731	950	30.0%	950	0.0%
Volumes					
U.S. Domestic Package:					
Next Day Air	1,515	1,582	4.4%	1,591	-0.6%
Deferred	1,778	1,827	2.8%	1,920	-4.9%
Ground	15,321	16,142	5.4%	16,240	-0.6%
International Package:					
Domestic	1,704	1,815	6.5%	1,755	3.4%
Export	1,271	1,378	8.4%	1,322	4.2%
Avg. Revenue Per Piece:					
U.S. Domestic Package:					
Next Day Air	\$18.74	\$18.40	-1.8%	\$18.74	-1.8%
Deferred	\$11.30	\$11.30	0.0%	\$11.47	-1.5%
Ground	\$7.64	\$7.65	0.1%	\$7.75	-1.3%
International Package:					
Domestic	\$5.93	\$5.57	-6.1%	\$5.99	-7.0%
Export	\$30.38	\$29.50	-2.9%	\$30.68	-3.9%
LTL					
LTL Yield	\$23.44	\$23.42	-0.1%	\$24.14	-3.0%
LTL Tonage per Day	40.7	42.3	3.7%	39.1	8.1%

Source: Company Reports, BMO Capital Markets

2017 Guidance

Management provided a high-level view for 2017 and suggested that it will provide additional details at its investor conference on February 21, 2017, including an update to its expectations into 2019. Some of the notable highlights for 2017 are as follows:

- 1) The company expects a \$400 million headwind in the International segment in 2017 as it transitions from a multi-year hedging program in 2017.
- 2) Due to the currency impact, the company expects EPS to be in the range of \$5.80 to \$6.10 per diluted share
- 3) UPS updated its capex plans and now expects the 2017 capital envelope to be around \$4 billion, which is well ahead of our estimate of \$3.2 billion. The company is accelerating investments in the U.S. Domestic Package segment to support the growth in e-commerce and also to improve profitability per package. The higher capex incorporates the addition of new 14 Boeing 747-8 aircraft announced last quarter, which have an attached cash outflow of \$1 billion in 2017 and another \$1 billion in 2018, slightly moderating slightly to \$610 million in 2019.
- 4) Share repurchases are expected to be \$1.8 billion for the year. This is lower than the estimated \$2.7 billion in 2016 and our projected \$2.8 billion for F2017, but is consistent with the higher capital spending and muted profit growth.
- 5) The company provided other segment-level details around revenue, average daily volumes, and margin expectations, which are summarized in Exhibit 2.

Exhibit 2: Summary of Segment-Level Expectations for 2017

	Revenue	Volume	Margin	Commentary
U.S. Domestic Package	+5% to +7%	+3% to +5%	Slight Improvement	Operating costs temporarily elevated due to increased pace of investments
International Package	+2% to +4%	+4% to +6%	4% to 8% below 2016	Margin adversely impacted by \$400 million FX headwinds
Supply Chain and Freight	+8% to +10%	N/A	Slightly below 2016	Conditions in forwarding and freight sector expected to improve

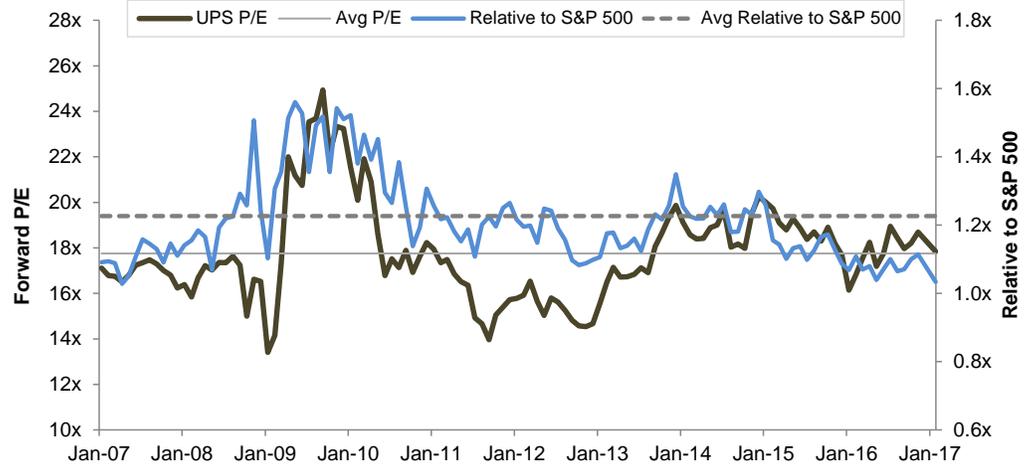
Source: Company Reports, BMO Capital Markets

Increasing Capital Intensity and Moderating ROIC Profile Expected to Keep a Lid on Valuation in the Near Term

Faced with unfavorable mix shifts toward B2C shipments in its U.S. Domestic Package segment, UPS is pulling ahead some capital projects (including hub modernization and greenfield expansion projects) starting in 2017. The company expects a capital envelope of \$4 billion in 2017, well ahead of our estimate of \$3.2 billion. We sense that the capital intensity could remain elevated in the near term, pressuring return on invested capital (ROIC), which has been a source of support for valuation. We expect that the ROIC will moderate by 130 bps in 2017. While investments in the ground network are expected to help lower the company's cost curve and position the company well over the long term, a moderating ROIC profile and muted EPS growth could be a source of pressure to the stock's valuation in the immediate term.

Over the past five years, UPS stock has traded at an average premium of 17% to the S&P, with the lower end of the range in line with the S&P 500 market multiple. We apply an 18x P/E (consistent with the current S&P 500 multiple) on our F2018 EPS to derive our \$115 target price, down from \$130 previously.

Exhibit 3: Historical Valuation



Source: FactSet, BMO Capital Markets

Source: FactSet, BMO Capital Markets

Exhibit 4: Valuation Summary

Company	Ticker	Price 31-Jan-17	Market Cap	Dividend Yield	EBITDA 2016E 2017E	EV/EBITDA 2016E 2017E	EPS 2016E 2017E	P/E 2016E 2017E	Operating Ratio 2015 2016E 2017E						
Less-Than-Truckload															
ArcBest	ARCB	\$31.60	\$828	1.0%	\$136 \$170	6.4x 5.1x	\$0.89 \$1.59	35.4x 19.8x	97.0% 98.4% 97.5%						
Old Dominion Freight Lines	ODFL	\$88.28	\$7,311	0.0%	\$677 \$742	11.1x 10.1x	\$3.58 \$3.97	24.7x 22.2x	83.2% 83.7% 83.1%						
SAIA	SAIA	\$48.05	\$1,233	0.0%	\$159 \$176	8.3x 7.5x	\$1.90 \$2.12	25.3x 22.7x	92.6% 93.4% 93.0%						
YRC Worldwide	YRCW	\$14.93	\$496	0.0%	\$287 \$317	4.4x 4.0x	\$0.67 \$1.19	22.4x 12.6x	98.1% 97.2% 96.8%						
average				0.2%		7.6x 6.7x		26.9x 19.3x	92.7% 93.2% 92.6%						
Truckload															
Heartland Express	HTLD	\$20.60	\$1,716	0.4%	\$191 \$187	8.3x 8.5x	\$0.68 \$0.68	30.3x 30.1x	84.1% 86.2% 85.6%						
Knight Transportation	KNX	\$33.40	\$2,709	0.7%	\$265 \$274	10.2x 9.9x	\$1.17 \$1.20	28.5x 27.8x	84.4% 86.5% 87.0%						
Marten Transport	MRTN	\$22.85	\$749	0.4%	\$139 \$143	5.5x 5.3x	\$1.02 \$1.02	22.4x 22.4x	91.6% 91.6% 91.9%						
Swift Transportation	SWFT	\$22.83	\$3,057	0.0%	\$540 \$572	7.6x 7.2x	\$1.22 \$1.25	18.7x 18.2x	91.3% 94.0% 93.4%						
Werner Enterprises	WERN	\$28.10	\$2,036	0.9%	\$336 \$359	6.5x 6.1x	\$1.09 \$1.18	25.8x 23.7x	90.4% 93.8% 93.3%						
average				0.5%		7.6x 7.4x		25.1x 24.5x	88.4% 90.4% 90.2%						
Intermodal & Logistics															
C.H. Robinson	CHRW	\$76.06	\$10,864	2.4%	\$927 \$982	12.8x 12.1x	\$3.68 \$3.96	20.7x 19.2x	93.6% 93.9% 93.9%						
Echo Logistics	ECHO	\$23.75	\$691	0.0%	\$70 \$83	12.2x 10.3x	\$1.03 \$1.22	23.1x 19.5x	96.4% 96.8% 96.9%						
Expeditors International	EXPD	\$52.08	\$9,515	1.5%	\$715 \$741	11.9x 11.4x	\$2.35 \$2.50	22.2x 20.9x	89.1% 89.0% 89.1%						
Forward Air	FWRD	\$48.19	\$1,458	1.2%	\$139 \$154	10.7x 9.7x	\$2.06 \$2.31	23.3x 20.9x	89.0% 89.6% 88.9%						
Hub Group	HUBG	\$44.35	\$1,480	0.0%	\$166 \$167	9.1x 9.0x	\$2.22 \$2.24	20.0x 19.8x	96.7% 96.5% 96.7%						
J.B. Hunt	JBHT	\$99.08	\$11,129	0.9%	\$1,076 \$1,156	11.3x 10.5x	\$3.81 \$4.16	26.0x 23.8x	88.4% 89.1% 89.1%						
Landstar Systems	LSTR	\$84.60	\$3,568	0.4%	\$254 \$271	13.8x 12.9x	\$3.18 \$3.48	26.6x 24.3x	92.7% 92.9% 92.8%						
Ryder	R	\$77.60	\$4,136	2.3%	\$1,760 \$1,869	5.4x 5.1x	\$5.76 \$5.88	13.5x 13.2x	98.3% 96.0% 95.3%						
XPO Logistics	XPO	\$44.74	\$5,499	0.0%	\$1,243 \$1,361	8.0x 7.3x	\$0.97 \$1.71	46.3x 26.2x	98.3% 96.0% 95.3%						
average				1.0%		10.6x 9.8x		24.6x 20.9x	93.6% 93.3% 93.1%						
Canadian Trucking (CS)															
Mullen Group	MTL-CA	\$18.75	\$1,944	1.9%	\$195 \$235	12.2x 10.1x	\$0.62 \$0.82	30.1x 23.0x	89.6% 89.8% 87.9%						
TFI International Inc.	TFII-CA	\$35.22	\$3,312	2.1%	\$454 \$617	10.8x 8.0x	\$2.12 \$2.43	16.6x 14.5x	93.2% 93.3% 92.1%						
average				2.0%		11.5x 9.0x		23.4x 18.7x	91.4% 91.6% 90.0%						
Package & Courier															
Deutsche Post DHL	DPW-DE	€ 30.96	€ 37,319	2.7%	€ 4,929 € 5,232	8.4x 7.9x	€ 2.14 € 2.22	14.5x 13.9x	95.9% 94.0% 93.7%						
FedEx	FDX	\$189.11	\$50,871	0.8%	\$7,616 \$8,507	7.4x 6.6x	\$10.80 \$11.99	17.5x 15.8x	91.0% 90.0% 90.9%						
United Parcel Service	UPS	\$109.13	\$95,598	2.7%	\$10,511 \$10,830	10.0x 9.7x	\$5.75 \$6.14	19.0x 17.8x	-443.9% -580.2% -708.8%						
average				1.7%		8.7x 8.2x		18.2x 16.8x	-176.5% -245.1% -309.0%						
BMO Estimates															
	Ticker	Rating	BMO CM	Total	EBITDA		EV/EBITDA		EPS		P/E		Operating Ratio		
			PI	Return	2016E	2017E	2016E	2017E	2016E	2017E	2016E	2017E	2015	2016E	2017E
C.H. Robinson	CHRW	Mkt	\$76	2.3%	\$910	\$939	13.0x	12.6x	\$3.56	\$3.70	21.4x	20.6x	93.6%	93.6%	94.1%
FedEx	FDX	Mkt	\$210	11.9%	\$7,637	\$8,452	7.4x	6.7x	\$10.80	\$11.88	17.5x	15.9x	91.0%	90.1%	91.0%
Hub Group	HUBG	Mkt	\$46	3.7%	\$168	\$175	9.0x	8.6x	\$2.21	\$2.31	20.0x	19.2x	96.7%	96.5%	96.7%
J.B. Hunt	JBHT	Mkt	\$100	1.9%	\$1,064	\$1,125	11.4x*	10.8x	\$3.81*	\$4.08	26.0x*	24.3x	88.4%	89.0%	89.4%
TFI International Inc.	TFII-CA	Mkt	\$32	-7.0%	\$437	\$600	11.3x	8.2x	\$1.79	\$2.20	19.7x	16.0x	93.1%	93.5%	92.6%
United Parcel Service	UPS	Mkt	\$115	8.0%	\$10,342	\$10,614	10.2x	9.9x	\$5.76*	\$5.93	18.9x*	18.4x	86.7%	86.7%	87.1%

Net Debt based on most recent quarter

Unless noted otherwise, estimates are consensus

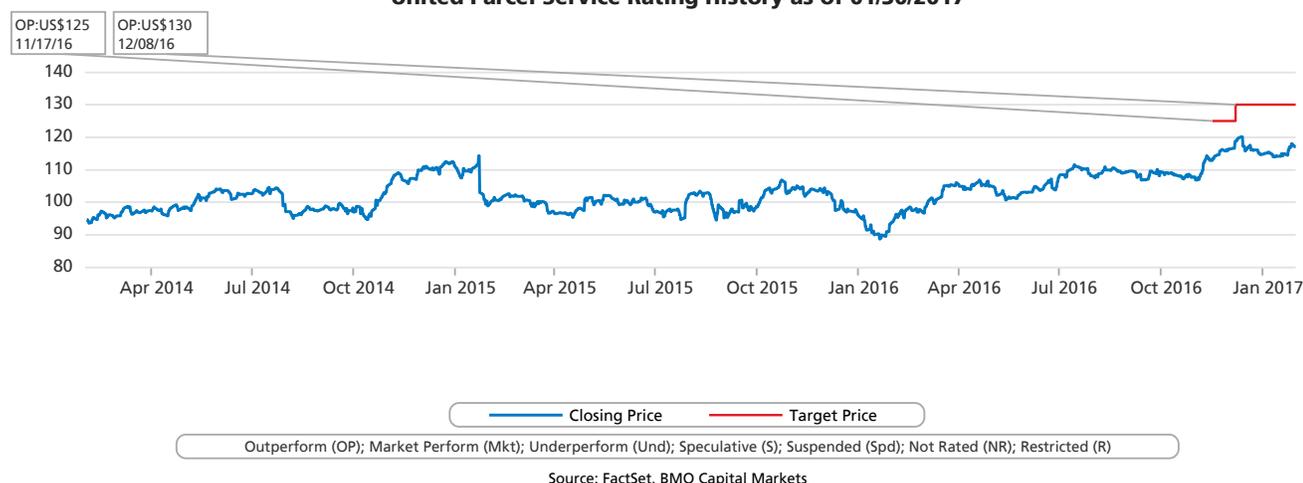
FDX fiscal year ends May 31; estimates are to closest calendar year

OP= Outperform; Mkt = Market Perform; Und = Underperform; NR = Not Rated

*Represents actual results

Source: FactSet, BMO Capital Markets

United Parcel Service Rating History as of 01/30/2017



IMPORTANT DISCLOSURES

Analyst's Certification

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Company Specific Disclosures

Disclosure 16: A BMO Nesbitt Burns Inc. research analyst has extensively viewed the material operations of United Parcel Service.

Methodology and Risks to Price Target/Valuation for United Parcel Service (UPS-NYSE)

Methodology: Our target price is based on our 18 times our forward P/E estimate.

Risks: Package volumes and freight demand fluctuate with economic activity and international trade; large e-commerce customers could elect to build out their logistics capabilities, which would weigh on demand for UPS's package services and potentially increase competition; increasing competition for freight brokerage and forwarding services could reduce net revenue margins and earnings; regulatory changes could have a material impact on the company's profitability.

Distribution of Ratings (January 30, 2017)

Rating category	BMO rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	StarMine Universe
Buy	Outperform	43.1%	20.9%	56.4%	43.0%	55.6%	52.8%
Hold	Market Perform	53.1%	12.8%	42.6%	53.6%	42.8%	41.6%
Sell	Underperform	3.6%	4.8%	1.1%	3.2%	1.6%	5.5%

† Reflects recommendation distribution of all companies covered by BMO Capital Markets debt research analysts.

^ Reflects recommendation distribution of all companies covered by BMO Capital Markets debt research analysts.

^^ Reflects recommendation distribution of all companies from which BMO Capital Markets has received compensation for Investment Banking services as percentage within ratings category.

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Issuer Credit and Sector Credit Recommendation Key (April 22, 2016)

We use the following credit recommendation system definitions:

Issuer Credit Recommendations – Total Return is calculated by reference to the FTSE TMX Canada Universe Bond Index (i.e. price change from the beginning to end of period, including accrued interest).

top pick = Forecast as the analyst's best idea, based on risk/reward, and is expected to significantly outperform the sector from a total return perspective

outperform = Forecast to provide a superior risk/reward and/or total return is expected to be above the sector average

sector perform = Forecast to provide an appropriate risk/reward and/or total return is expected to be in line with the sector average

underperform = Forecast to provide an inferior risk/reward and/or total return is expected to be below the sector average

Sector Credit Recommendations – Total return is calculated by reference to the FTSE TMX Canada Universe Bond Index.

outperform = Forecast to provide a superior risk/reward and/or total return that is expected to be above the average of the index

market perform = Forecast to provide an appropriate risk/reward and/or total return is expected to be in line with the index

underperform = Forecast to provide an inferior risk/reward and/or total return is expected to be below the average of the index

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Ratings Key (as of October 2016)

We use the following ratings system definitions:

OP = Outperform - Forecast to outperform the analyst's coverage universe on a total return basis;

Mkt = Market Perform - Forecast to perform roughly in line with the analyst's coverage universe on a total return basis;

Und = Underperform - Forecast to underperform the analyst's coverage universe on a total return basis;

(S) = Speculative investment;

Spd = Suspended - Coverage and rating suspended until coverage is reinstated;

NR = No Rated - No rating at this time; and

R = Restricted - Dissemination of research is currently restricted.

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Prior BMO Capital Markets Rating System

(April 2013 – October 2016)

http://researchglobal.bmocapitalmarkets.com/documents/2013/rating_key_2013_to_2016.pdf

(January 2010 – April 2013)

http://researchglobal.bmocapitalmarkets.com/documents/2013/prior_rating_system.pdf

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