

# BMO Dividend ETFs

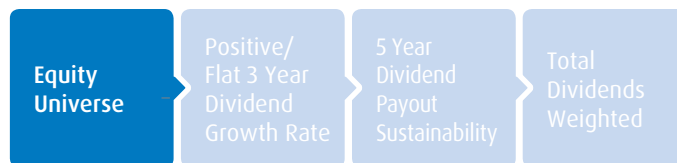
## Portfolio Construction Methodology

- BMO Canadian Dividend ETF (ZDV)
- BMO US Dividend ETF (ZDY, ZDY.U)
- BMO US Dividend Hedged to CAD ETF (ZUD)
- BMO International Dividend ETF (ZDI)
- BMO International Dividend Hedged to CAD ETF (ZDH)

**BMO Dividend ETFs** are designed for income investors who want a high level of sustainable dividend income, as well as the potential for portfolio gains. BMO Exchange Traded Funds has created custom solutions to identify higher yielding dividend equities, while screening for both the historical growth rate, momentum, and sustainability of the dividends, as a quality indicator. The final result are well-diversified core portfolio solutions for income investors.

We have chosen a proprietary approach to managing these ETFs. The ETFs optimize a rules-based portfolio construction strategy and will look to avoid deteriorating companies based on quality and fundamental screening.

### Step 1 – Form the selection universe



Start with securities meeting market capitalization and liquidity requirements. The selection universes contain large cap, mid cap, and small cap candidates. Generally, dividend paying equities tend to be mature, and more stable companies relative to non-dividend payers. REITs and preferred shares are omitted.

### Step 2 – Screen on dividend growth, rank by total dividends available



Eligible companies must have paid a dividend for a minimum of three years and have a positive, or flat, three year dividend growth rate. The remaining candidates are sorted from total dividends available. By focusing on the three year dividend growth rate, a measure is created that is responsive to changing company conditions and doesn't react to small one year declines. This also helps to lower portfolio turnover.

**Example of Dividend Growth Rate**  
Dividend Amount by Year

Company	3 years ago	2 years ago	1 year ago	This year	3 year growth	Fund eligibility
A	\$0.10	\$0.12	\$0.11	\$0.12	20%	IN
B	\$0.10	\$0.12	\$0.08	\$0.09	-10%	OUT
C	\$0.10	\$0.10	\$0.10	\$0.10	0%	IN

Eligible companies require a credit rating greater than or equal to BBB. By screening companies for credit rating this further enhances our focus on higher quality companies. In addition companies must pass a momentum screen, where those ranking in the bottom 10% are excluded. The momentum screen helps ensure the portfolio is positioned to avoid companies with stale momentum.

### Step 3 – Screen on dividend payout sustainability



Payout ratio is defined as dividends paid divided by operating cash flow. The BMO Dividend ETF methodology analyses dividend payout sustainability over a five year period, the four most recent years, as well as analyst forecasts for the next year. This ensures the dividend is funded by ongoing operations and is forward looking. Companies are then graded using an internally developed approach.

### Dividend Sustainability

- Dividend payout ratios are grouped into five buckets, and given a grade of 0-5.
- Each grade from the forecast year and the last four years is multiplied by a weighting factor that considers the trend of the payout ratio, and places emphasis on more recent history.
- The final grade is the sum of each year's grade for the forecast year and the last four years.

Payout Ratio	Grade
0% - 50%	5
50% - 80%	4
80% - 100%	3
100% - 130%	2
130% - 200%	1
200% or negative	0

Year	Multiplier	Weight
Forecast Year	8	20.0%
Most recent	10	25.0%
Most recent - 1	9	22.5%
Most recent - 2	7	17.5%
Most recent - 3	6	15.0%

#### Example of sustainability

Company A				
Year	Payout Ratio	(A) Grade	(B) Multiplier	(A*B) Final
Forecast year	60%	4	8	32
Last year	45%	5	10	50
Two years ago	75%	4	9	36
Three years ago	90%	3	7	21
Four years ago	60%	4	6	24
-	-	-	<b>Total (sum)</b>	<b>163</b>

Company B				
Year	Payout Ratio	(A) Grade	(B) Multiplier	(A*B) Final
Forecast year	250%	0	8	0
Last year	180%	1	10	10
Two years ago	120%	2	9	18
Three years ago	110%	2	7	14
Four years ago	80%	3	6	18
-	-	-	<b>Total (sum)</b>	<b>60</b>

Securities scores will benefit from stable earnings as they will score higher across measurement periods. This will eliminate companies identified as having an increased risk of maintaining their dividend. This consideration is a relative grading, and may depend on the state of the overall economy. The threshold level may be adjusted if warranted by the corporate earnings/cash flow landscape. For example, in an economic slowdown, operating cash flow may be depressed and payout ratios will increase. In this case it may be prudent to adjust the threshold temporarily lower, until economic conditions improve. Also, companies with borderline sustainability scores will have weights reduced to account for uncertainty with regards to dividend sustainability.

The BMO ETFs dividend strategy also considers a share buyback program. This is a tax effective way to deploy excess cash on the balance sheet as it does not result in income for shareholders. Instead it creates upward pressure on prices, by reducing the outstanding share float.

#### Step 4 - Form the portfolio: Total Dividends Weighted



#### Diversified and Sustainable ETF Dividend Solutions

- Top<sup>1</sup> dividends available names that have passed the dividend growth rate screen, the sustainability screen, and the momentum screen included in the portfolio
- Weighting is by total dividend available is subject to sector caps, and an individual security cap of 6%

#### What are the benefits of a Dividends Available Approach?

Using dividends available allows us to reduce the value tilt and capture more capital growth in the portfolio while also increasing the investment in market leading companies.

<sup>1</sup>BMO Canadian dividend portfolios holds 50 companies, whereas the U.S. and International portfolios hold 100 companies.

## Example of Total Dividends Weighting

Suppose three securities were in the portfolio, A, B, and C, with dividends available of \$5MM, \$7MM, \$8MM respectively. The weights of A, B, and C in a total dividends weighted portfolio would be 25%, 35% and 40% as indicated.

Security	Dividends Available	Weight
A	\$5MM	$\$5MM/\$20MM * 100 = 25\%$
B	\$7MM	$\$7MM/\$20MM * 100 = 35\%$
C	\$8MM	$\$8MM/\$20MM * 100 = 40\%$
<b>Total</b>	<b>\$20MM</b>	<b>100%</b>

Sector caps ensure that no one particular sector is over represented, such as Financials, which is often a significant weight in dividend based portfolios<sup>2</sup>. Generally, the portfolios will be tilted towards defensive sectors and away from resources, as companies in defensive sectors tend to have more stable business models and payout more of their cash flow through dividends.

A combination of large, mid and small cap companies enhances diversification and retains growth potential.

Liquidity in the portfolio is monitored to ensure that any holding can be traded with efficiency.

Overall portfolio risk is also regularly monitored. As the portfolio is total dividends weighted, the screened portfolio is reviewed to measure any recurring sustainability risks.

The result is the lower ranked securities may have their weights reduced to manage portfolio level risk.

### Other Considerations

The portfolios are reconstituted in December by analyzing the selection universe using company fundamentals, with the condition of a 20% buffering rule on existing securities to minimize portfolio turnover.

The portfolios are rebalanced every June to target yield weights.

BMO Dividend ETFs offer a robust, diversified solution for investors seeking high levels of sustainable income in Canada, the U.S., and International markets.


ETF Name	Ticker	Management Fee	Currency
BMO Canadian Dividend ETF	ZDV	0.35	CAD
BMO US Dividend ETF	ZDY/ZDY.U	0.30	CAD/USD
BMO US Dividend Hedged to CAD ETF	ZUD	0.30	CAD
BMO International Dividend ETF	ZDI	0.40	CAD
BMO International Dividend Hedged to CAD ETF	ZDH	0.40	CAD

<sup>2</sup>The sector caps are 40% in the Canadian and International portfolios and 25% in the U.S. portfolios.



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