



## Why I Believe Bank of Montreal Is Undervalued and Has Solid Growth Prospects

### Description

Canada's top banks continue to perform strongly, reporting solid financial results quarter after quarter and continually hiking their dividends, much to the delight of investors. This has made them a firm favourite among investors, thus driving their share prices ever higher and making it difficult to find value in this industry.

But one top 5 bank that stands out as an attractive value while possessing strong future growth prospects is Canada's fourth-largest bank by assets, the **Bank of Montreal** ([TSX: BMO](#))([NYSE: BMO](#)).

### U.S. exposure offers solid growth opportunities

One of the most attractive aspects of the Bank of Montreal is its exposure to the U.S. financial services market, the largest in the world. For the second quarter of 2014, the bank derived 14% of its net income from its U.S. commercial and retail banking business, which while a disappointing 7% drop compared to the previous quarter represented a healthy 3% increase against the equivalent quarter in the previous year.

Importantly for the Bank of Montreal, there are signs that its U.S. business is gaining momentum, particularly with the U.S. economy performing better than expected. Second-quarter GDP growth was stronger than initially anticipated, coming in at a 4.2% annual rate instead of the 4% forecast.

More importantly, this growth was broad-based, with business growth, housing construction, consumption, and exports all contributing. There are also signs the rebound in the U.S. housing market is gaining greater momentum, boding well for increased mortgage demand.

These should feed greater credit demand and see further growth of the bank's U.S. lending portfolio leading greater growth in its bottom line.

### Overall business risk is low

The Bank of Montreal, like all of Canada's major banks, has a conservative approach to risk, as the bank is more than adequately capitalized with a common equity tier 1 capital ratio of 9.7%, well above

the regulatory minimum.

It also has a high-quality credit portfolio with a gross impaired loans-to-total loans ratio of a very low 0.67% at the end of the second quarter. This is 12 basis points lower than the previous quarter, 41 basis points lower than in the second quarter of 2013. It is also the eighth consecutive quarter where the ratio has fallen.

These factors all indicate Bank of Montreal's balance sheet is quite healthy and the degree of financial risk for investors is relatively low.

### Remains attractively priced

One of the most attractive aspects of the Bank of Montreal for investors is that it remains attractively priced compared to its peers. One of the best measures for assessing a bank's value is its price-to-book ratio and Bank of Montreal's at 1.8 is the lowest of the six largest banks in Canada, which indicates that it is undervalued.

Bank	Price-to-Book	Forward Price-to-Earnings
Bank of Montreal	1.8	11
<b>Royal Bank of Canada</b> ( <a href="#">TSX: RY</a> )( <a href="#">NYSE: RY</a> )	2.5	11.5
<b>Toronto-Dominion Bank</b> ( <a href="#">TSX: TD</a> )( <a href="#">NYSE: TD</a> )	2	11
<b>Bank of Nova Scotia</b> ( <a href="#">TSX: BNS</a> )( <a href="#">NYSE: BNS</a> )	2	11
<b>CIBC</b> ( <a href="#">TSX: CM</a> )( <a href="#">NYSE: CM</a> )	2.5	10
<b>National Bank of Canada</b> ( <a href="#">TSX: NA</a> )	2	11

*Source: Company filings.*

The Bank of Montreal also has a relatively low forward price-to-earnings ratio of 11, although this is in line with its peers and can be attributed to conservative estimates regarding earnings growth across Canada's banking industry because of the saturated nature of the financial services market place.

### A steadily growing dividend

The final factor that makes the Bank of Montreal stand out as a value play for investors seeking exposure to Canadian banks is its steadily growing dividend. At the end of the second quarter, it hiked its dividend 3%, giving it a tasty yield of 3.7% coupled with a very sustainable payout ratio of 48%. This is the second-highest yield of Canada's six largest banks, only slightly lower than CIBC's 3.74%.

It is more than likely that Bank of Montreal's dividend will continue to grow with strong earnings growth expected, while the low payout ratio leaves sufficient room for additional hikes.

The Bank of Montreal clearly appears undervalued compared its top six peers, and I believe it offers investors considerable growth opportunities and a steadily growing dividend.

### CATEGORY

1. Bank Stocks
2. Investing

## TICKERS GLOBAL

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2. TSX:BMO (Bank Of Montreal)

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