Is Bank of Montreal Really a Better Investment Than Royal Bank of Canada?

Description

Last week, bank analyst Gabriel Dechaine cut **Royal Bank of Canada** (TSX: RY)(NYSE: RY) from buy to hold, while upgrading **Bank of Montreal** (TSX: BMO)(NYSE: BMO) from hold to buy.

Mr. Dechaine mainly cited momentum in Canadian banking for his decisions – BMO has averaged 10% year-over-year growth in the segment, compared to RBC's sector-low growth of 3% in the most recent quarter.

But does that really make Bank of Montreal a better buy than Royal Bank of Canada? Below we compare the two companies.

The case for BMO

Mr. Dechaine makes a very strong point – in Canada at least, BMO continues to deliver excellent results. In the most recent quarter, revenue increased by 6% year-over-year, with expenses increasing by only 4%. As a result, the efficiency ratio, which measures expenses as a percentage of revenue, slipped to 49.7%, an improvement of 0.9% from a year ago. And adjusted net income jumped by 8%. The numbers are just the latest in a series of positive results for the bank.

Meanwhile, RBC is moving at a slower pace – as mentioned, Canadian banking growth was a mediocre 3% in the most recent quarter, and has trailed BMO in previous quarters, too. Volume growth – whether measured by loans or deposits – has also trailed BMO's Canadian operations. This is likely due to a difference in size; BMO is smaller, and putting an emphasis on growth, while RBC's larger size means it can only grow so much.

Better yet, BMO trades at only 11.7 times earnings, compared to 12.8 times for RBC. So why would anyone choose RBC over BMO?

Not so fast!

The arguments are compelling for BMO, but RBC is still likely the better bet. This is mainly due to its size.

In banking, being big allows a company to absorb its fixed costs more easily. And this is a perfect example. RBC has a dominant position in Canada, holding a number 1 or number 2 position in every key Canadian retail banking product. It also has about double the loans, deposits, and employees of BMO's Canadian banking division.

As a result, RBC is more profitable in Canada. To illustrate, expenses totaled only 43.7% in the most recent quarter, six percentage points better than BMO. This gives RBC quite a bit of wiggle room, and bodes very well for the bank in the long term.

Also, RBC's other businesses are stronger than BMO's. More specifically, RBC's Capital Markets and Wealth Management divisions are flying high, with year-over-year net income growth of 66% and 22%, respectively. Meanwhile BMO's U.S. banking business grew only 1%. Low interest rates and intense competition continue to be a concern.

That being said, you're even better off with one of the other big five banks. The free report below reveals which one, and also looks at each of the big five in greater detail.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BMO (Bank of Montreal)
2. NYSE:RY (Royal Bank of Canada)
3. TSX:BMO (Bank Of Montreal)
4. TSX:RY (Royal Bank of Canada)

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bensinclair