



3 Reasons Bank of Montreal Is Canada's Most Underrated Bank

Description

Bank of Montreal ([TSX:BMO](#))([NYSE:BMO](#)) often gets less attention — and credit — than its large Canadian peers. As the fourth largest bank in the country by market capitalization, Bank of Montreal has generated a 20-year average return-on-equity of 17%, and has performed in line with the peer group for most other time frames.

In addition, Bank of Montreal has generated above average total shareholder returns over the past five years (ranking only behind **TD Bank**), and when adjusting for risk, becomes the top performing of the big four banks during that time frame. Despite being a low risk bank with strong risk-adjusted returns, BMO almost always trades at a discount to its peers, reflecting the fact that investors do not value the stock as highly as its close competitors.

While BMO's earnings growth has been weak compared to peers, likely contributing to this undervaluation, strong risk management and diversification make BMO a smart selection for investors seeking solid returns with below average risk. Here are three reasons BMO is underrated.

1. Strong returns

While it is important to note that past returns do not dictate future returns, they can still be a useful indicator since strong historical returns often flow from fundamental strengths in a company's business model.

Over the past five years, Bank of Montreal has generated total shareholder returns of 15.5%. Total shareholder returns consider both increases in share price, as well as dividends paid to give a more accurate idea of how much a business returned to investors overall. These returns compare to 16.5% for TD Bank, 12% for **Royal Bank of Canada**, and 13.1% for **Bank of Nova Scotia**. Over this five-year period, BMO both outperformed the overall TSX by 6.4%, and the S & P/TSX Financial Services Index by 2%.

Similar returns were noted over a three-year period. For the period ending June 15, 2015, BMO outperformed all its peers with the exception of RBC, with a total return compound annual growth rate

of slightly over 15%.

Most importantly, these returns come with less risk. BMO has a beta of 0.53 (which indicates that if the overall TSX drops or rises by 10%, BMO would drop or rise by 5.3%), and this is an accepted measure of risk or volatility. This is compared to 0.51 for TD Bank, 0.7 for Royal Bank, and 0.62 for Bank of Nova Scotia.

2. Bank of Montreal has strong geographic diversification

Why is Bank of Montreal less risky than its peers? Part of it has to do with the company's strong U.S. exposure. For BMO, this includes its U.S. personal and commercial segment, its U.S. wealth management operations, and its U.S. capital markets operations. Combined, these segments contributed about 26% of adjusted net income in Q2 2015.

BMO's U.S. operations provide a strong diversification benefit due to differing economic environments. This is especially true as of late. Low oil prices, low interest rates, an overleveraged Canadian consumer, and two quarters of negative GDP growth all serve as headwinds to Canadian operations. The U.S. lacks these headwinds. As a net importer of oil, the U.S. benefits from low oil prices, and the country is experiencing above-average GDP growth, which should feed into loan growth for banks as the American consumer re-leverages.

Couple this with the high likelihood of increasing interest rates this year, and the U.S. segment should work to reduce volatility and further improve the risk profile of BMO.

3. BMO has a diversified business model

One of the main factors differentiating BMO from its peers is its large reliance on wealth management. In 2014, BMO expanded further into this domain, acquiring F&C Asset Management for \$1.2 billion. Currently, BMO is ranked Best Wealth Management in Canada for two consecutive years by *Global Banking and Finance Review*.

Focus on wealth management is important because it adds to the fee income portion of a bank's earnings. This is opposed to income that comes from traditional "spread-based" businesses like taking in deposits and making loans, and these types of earnings can be volatile and dependent on interest rates. Wealth management earnings — though dependent to an extent on how equity markets perform — have the potential to be more stable.

In Q2 2015, BMO produced 53% of its revenue from non-interest income, compared to 50% for its big four peers, with a 46% coming from wealth management.

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