Why Bank of Montreal's Latest $11.5 Billion Acquisition Is a Win for Investors

Description

In early April, **General Electric** (NYSE:GE) announced that it intends to sell off most of its GE Capital Finance arm over the next two years. Almost immediately, analysts speculated that Canadian banks, **Bank of Montreal** (TSX:BMO)(NYSE:BMO) in particular, would be eager to scoop up valuable loan portfolios.

Those analysts were right. In early September BMO announced that it would be acquiring GE Capital Transportation Finance unit—$11.5 billion worth of loan and lease assets and North America's largest commercial transportation sector lender.

Analysts almost unanimously viewed this deal favourably, and it's understandable why—the acquisition allows BMO to expand further into the growing U.S. economy and away from the weak Canadian economy. Below the surface, however, are a few other big reasons why this deal is a major win for shareholders.

1. The acquisition boosts BMO's diversification

One of the best aspects of the GE deal is that it boosts BMO's diversification both geographically and with regards to its assets. About 90% of the assets acquired are located in the U.S., and 10% are located in Canada.

Analysts estimate that the assets could be worth about $13 billion by the time the deal closes due to growth, and this would increase BMO's total U.S. loans from 29.8% of the portfolio to about 32% of the total portfolio.

Importantly, the U.S. assets being acquired are well diversified across the United States. This is important because BMO has traditional been centred in the U.S. Midwest, which is a slow-growing region economically. BMO will now have a larger presence in markets like California, Texas, and New York.

BMO will also be diversifying its portfolio by increasing its exposure to transportation loans. BMO currently only has 1% of loans outstanding to the transportation sector, and this should increase to

4.5% after the acquisition.

This kind of diversification not only reduces risk for BMO, but also enhances growth, since the U.S. economy is expected to outperform the Canadian economy, and the transportation sector has resilient demand that will grow alongside the economy.

2. BMO will see a boost to earnings and margins

One of the most attractive parts of this deal is that BMO will see an immediate 3% boost to net income and a similar boost to earnings per share. BMO will be issuing no shares to make the acquisition, choosing to fund it with existing resources instead, and this allows the acquisition to be accretive.

BMO also expects the acquisition will improve margins. The loans on the acquired portfolio have higher margins than the average for BMO’s U.S. business, and overall margins should move up as a result.

In addition, BMO plans to gradually reduce some of its exposure to auto-purchase lending, and will shift those deposits over to the new portfolio of assets. The yields on auto-purchase lending are low because it is a very competitive business, and by repositioning its balance sheet, BMO can increase its yields even more.

3. BMO can afford the transaction

Currently, BMO is Canada’s most well-capitalized bank. The bank had a common equity tier 1 ratio, or CET1, (the main measure of capitalization) of 10.4%, compared with a 9.9% average for Canadian banks.

The CET1 is basically a measure of how much capital a bank has relative to assets. Capital consists of things like retained earnings and shareholders equity, and BMO’s strong earnings each year have been adding to capital.

BMO is also very liquid, meaning a large portion of that capital is tied up in liquid assets like securities and cash instruments, for example. The high capital levels mean that BMO can do something like make an acquisition (which would increase its overall assets relative to capital, and reduce it capital ratio), and still be well within a safe zone.

BMO estimates the transaction will reduce the CET1 ratio from 10.4% to 9.7%, still a very safe level, and this should grow back up to the 10% range by the end of 2016.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:BMO (Bank of Montreal)
2. NYSE:GE (General Electric Company)
3. TSX:BMO (Bank Of Montreal)

Category

1. Bank Stocks
2. Investing

Date
2025/09/28
Date Created
2015/10/01
Author
amancini