Are Investors Overlooking Bank of Montreal?

Description

When reviewing Canadian financial media, most investors would likely agree that **Bank of Montreal** (TSX:BMO)(NYSE:BMO) doesn't get nearly as much, or not as favourable coverage as its larger peers.

This is despite the fact that BMO has been a solid performer—BMO's shares have grown by 21% over the past five years. BMO's five-year average total shareholder return (which factors in dividends) of 15.5% was second only to **Toronto-Dominion Bank**, which is at about 16%.

Importantly, BMO has obtained these solid results with less volatility than its peers. Going forward, BMO's retail and U.S.-focused business model, strong credit quality, and capitalization give investors an opportunity for low-risk growth in the financial sector.

Here are a few reasons to consider BMO.

1. BMO's recent acquisition improves its growth outlook

BMO recently announced a massive acquisition of **General Electric's** Transportation Finance division, which will lead to BMO acquiring up to $13 billion of transportation sector loans and leases. About 90% of these loans and leases are located in the U.S., with the remainder in Canada.

For BMO, this purchase was an all-around win, as it allows BMO to deploy its excess capital to expand its overall exposure to the growing U.S. economy, as well as expand its exposure to U.S. commercial lending, which is one of BMO's strength areas.

The acquisition will expand BMO's U.S. loans from 29% to about 32% of the portfolio, and will give BMO exposure to the entire U.S. economy as GE's Transportation portfolio is well diversified across the entire United States. GE's Transportation Finance business is currently the largest transportation financier to the U.S. truck and trailer segment in North America, with 20% market share.

This acquisition will be about 3% accretive to earnings, and will also provide BMO with an opportunityto expand margins in its U.S. business, since the acquired portfolio has a higher margin than BMO's existing loan portfolio.

BMO also plans to gradually shift some of its existing auto-purchase lending portfolio over to the new portfolio of commercial transportation loans. Since auto-purchase lending is lower margin, this will provide BMO further opportunity to expand margins.

2. BMO is a fairly low-risk bank

BMO's large exposure to the U.S. economy reduces overall risk since it provides diversification away from the Canadian economy and the various headwinds that Canada is facing. One of these major headwinds is oil prices and, fortunately, BMO has very limited exposure to this sector.

Currently, only about 2% of BMO's overall lending portfolio is to the oil sector. This is on the lower end of oil sector exposure for the banks, with only TD having less oil exposure than BMO.

BMO recently conducted stress tests on its oil and gas portfolio, assuming $35 per barrel oil for one year, followed by $50 per barrel for the next year, and the results indicated that its provision for loan losses (the amount of earnings that the bank needs to reserve to cover losses on loans) would climb from 0.20% of loans outstanding to 0.40%. This is below its historical average provision for credit losses.

BMO is also very well capitalized. The bank has a common equity tier 1 ratio (CET1) of 10.4%, which is the second highest of all Canadian banks. After BMO's latest acquisition, this is expected to drop to about 9.7%, but should recover to 10% by the end of Q1 2015 as bank continues to generate profits.

BMO is also Canada's most liquid bank. This means that a large portion of BMO's assets can be easily turned into cash. In the event of a recession or other economic risk, BMO would easily be able to meet its obligations to depositors.

3. BMO's valuation is currently attractive

The bank is currently trading at 10.45 times its next 12-month earnings, which is below the historical average of 11.4. This gives BMO upside as the Canadian economy improves.

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