Bank of Montreal Is Down 5% in 1 Month: Time to Buy?

Description

Over the past month, **Bank of Montreal** (TSX:BMO)(NYSE:BMO) has given up 5% of its value, despite paying out a $0.90 dividend at the end of July. Any time a mammoth like Bank of Montreal sheds market cap, investors that are looking for a strong company with an equally strong dividend begin to get curious.

So, is it time to start picking up shares of Bank of Montreal? It helps to understand why the company is down to determine if it is going to go up.

Some investors are concerned that the Canadian economy might not be strong enough — specifically, their concern is the housing market. Ever since the Financial Crisis, after which housing prices increased, pundits have been saying that banks are at risk.

But if we look at Bank of Montreal, 55% of its $104 billion in Canadian residential loans is insured. Even then, it would require a serious drop in home valuations, which I don't see coming, to negatively impact the bank to an extreme. Housing prices will drop some, especially in Toronto, which has experienced tremendous gains, but I don't see a systemic risk coming that will hurt Bank of Montreal.

Bank of Montreal had a rough quarter. Credit losses increased to US$68 million, and its U.S. division reported a 7% drop in adjusted net income. Frankly, an increase in credit losses that small really isn't worth losing sleep over.

So, we understand why the company is down … should we buy?

Absolutely. Thanks to investors overreacting, the company is now trading at an inexpensive price-to-earnings multiple of 11.58. When compared to its competitors in the Big Five, Bank of Montreal is actually the cheapest when looking at that ratio.

Further, despite some of the bad headlines, the quarter was strong for Bank of Montreal. Its adjusted net income was up 12% to $1.29 billion compared to Q2 2016. On top of that, its adjusted return on equity was 13.1% — this is 1% higher than a year prior. The return on equity is an important figure because it demonstrates that the bank is returning a greater profit compared to the company's book value.

And finally, the company has consistently boosted the dividend without its payout ratio changing all that much. Last quarter, the dividend increased from $0.88 to $0.90. Currently, the payout ratio is in the mid-40% range, which is perfect for the bank. This means the company would have to see a serious drop in cash flow for the dividend to be at risk.

Ultimately, I like Bank of Montreal as an investment. The market has given up 5% in the past month, despite a relatively strong quarter and a boost to the dividend. It’s possible that the housing market could cut into the company’s earnings some, but it won’t be an extreme, systemic hit like the Financial Crisis.

My advice is simple: pick up shares while others are afraid of the company. With a nearly 4% yield, it’s a good time to start buying. And if you’re a long-term holder, reinvest the dividend back into the company, so you can boost your earnings later in life.

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