Bank of Montreal (TSX:BMO) Earnings Report: 3 Numbers You Need to Know

Description

Bank of Montreal (TSX:BMO)(NYSE:BMO) earnings were reported yesterday and they missed expectations. What does this mean for the bank? And what numbers should investors focus on?

EPS: Bank of Montreal earnings disappoint as provisions skyrocket

In the second quarter, Bank of Montreal's EPS fell more than 50% to $1.04 (15% below expectations) due primarily to a sharp increase in provisions for credit losses (PCL). While a big provision was expected, this came in way higher than expectations.

The $1.1 billion PCL charge included a $750 million charge on performing loans due to changing assumptions in the bank's scenarios. The sectors that were hardest hit were the service and the oil and gas sectors (mostly U.S. natural gas accounts). The bank is preparing for a 2.5% loss rate in the oil and gas sector (3% excluding pipelines).

That said, many of the bank's oil and gas producer clients are hedged for the year, which means they might survive this downturn if it doesn't last too long. On the Bank of Montreal's earnings call, management provided even more colour. At $35 oil for the next three years, management estimates that oil and gas would incur a 2% loss rate.

The duration of the downturn is key. And while this is the big unknown, Bank of Montreal is strong enough to withstand this pain for now. Management at Bank of Montreal has a strong track record of risk management, which is continuing in this downturn.

The bank's financial strength, as measured by its CET1 ratio, is healthy at 11%. The CET1 ratio measures the bank's core capital relative to risk weighted assets. Bank of Montreal looks favourable in this regard.

Expenses down 4%: Bank of Montreal’s earnings releaseshows excellent expense control

With expenses falling, Bank of Montreal is setting itself up to better withstand the pandemic crisis. It is also setting itself up to come back strong when things improve. The bank also has plenty of liquidity and a solid balance sheet. All of this supports the thesis that Bank of Montreal is looking attractive today.

6% dividend yield: Bank of Montreal stock is providing a generous yield

Bank of Montreal stock is down 32% from this year’s highs, prompting a sharp rise in the bank’s dividend yield. While this is a strong, healthy yield that investors undoubtedly like, the payout ratio is rising. For the first six months of 2020 it was 64% compared to 45% last year. This is worth keeping a close eye.

While we ponder this and the sustainability of the dividend, we should remember a couple of things. First, this downturn is mitigated by the significant amount of stimulus that the government is injecting into the economy.

Second, this downturn was man made and not a symptom of a structural problem. For these reasons, I think that the duration of the downturn will be shorter than other ones in the past.

Bank of Montreal’s dividend is also supported by the fact that it has one of the lowest exposures to the Canadian personal and commercial banking (P&C) industry. Second-quarter strength in the bank’s wealth management segment illustrates the importance of this.

In Bank of Montreal’s earning report, wealth management posted good asset growth, allowing the segment to hold up well.

Foolish bottom line

Buying stocks that will survive a downturn at downturn valuations can make investors big profits. Bank of Montreal has the capitalization and the balance sheet for this downturn. We should consider buying it for its 6% yield and its potential capital gains.

The bank’s forecast would be at risk if the downturn lasts longer than expected. But if you believe that this downturn will be of limited duration, then Bank of Montreal stock looks attractive.

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