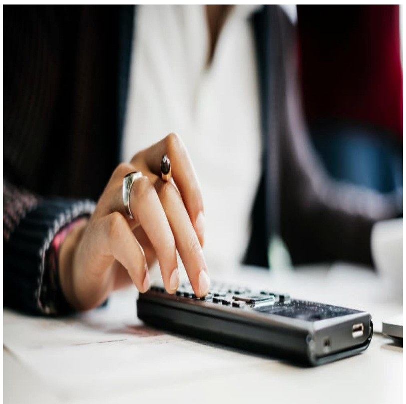

Is Bank of Montreal (TSX:BMO) Stock Undervalued?

Description

Warren Buffett famously said that investors should buy the stocks of great companies and hold forever. At the Motley Fool, we take Buffett's advice to heart and believe in the power of a long-term perspective when it comes to investing.

Although everyone likes to find a good value stock, sometimes it is better to buy the stock of a great company at an okayish price as opposed to the stock of a mediocre company at a good discount. The stocks of businesses with sustainable, excellent performance make the best buy-and-holds.

For this reason, new Canadian investors should focus on the stocks of companies with excellent fundamentals, understandable business models, essential products and services, wide economic moats, solid financial ratios, and good management.

Bank of Montreal

My value stock pick is **Bank of Montreal** (TSX:BMO)(NYSE:BMO), one of Canada's oldest Big Five banks. The TSX banking sector is highly monopolistic, and BMO enjoys little competition, strong margins, and ever-increasing earnings.

BMO stock is also a favourite among dividend-growth investors. The stock pays a dividend of $5.32 per share for a 3.74% yield and has consistently paid and increased dividends for decades, with a very sustainable payout ratio of 34.75%.

Valuing BMO stock

BMO is solid enough of a company that I would not worry about trying to time a good entry price. However, new investors should always be aware of some basic valuation metrics, so they can understand how companies are valued and what factors influence the current share price.

Currently, BMO is currently trading at $143.24, which is near the 52-week high of $154.47. In the current fiscal quarter, BMO’s 52-week low is $112.34. This is useful for giving investors a sense of the price range.

BMO current has a market cap of $94.93 billion with approximately 38.81 billion shares outstanding. This gives it an enterprise value of $180 billion with a enterprise value-to-EBITDA ratio of 10.43, which is slightly lower compared to its sector peers, giving it a more favourable valuation.

For the past 12 months, the price-to-earnings ratio of BMO was 12.24, with a price-to-free cash flow ratio of 2.2, price-to-book ratio of 1.65, price-to-sales ratio of 3.52, and book value per share of approximately $88.88. These metrics suggest that BMO may be somewhat undervalued.

BMO is currently covered by a total of 20 analysts. Of these, nine have issued a “buy” rating, five have issued a “sell” rating, and five have issued a “hold” rating. This is generally a considered a slightly bullish sign, as the majority of analysts consider the stock a buy.

BMO has a Graham number of 154.79 for the last 12 months — a measure of a stock’s upper limit intrinsic value based on its earnings per share and book value per share. Generally, if the stock price is below the Graham number, it is considered to be undervalued and worth investing in, which is the case here with BMO, giving potential investors a good margin of safety.

Is it a buy?

BMO looks undervalued right now, and possesses some excellent fundamentals, a great management team, and a solid economic moat. Long-term investors should consider establishing a position if they have the capital. Over the next 10-20 years, your entry price won’t matter as much if BMO continues its strong track record of growth and profitability. Consistently buying shares of BMO, especially if the market corrects can be a great way to lock in a low cost basis.

CATEGORY

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2. Investing

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