



## Buffet's Key to Bank Valuations

### Description

In a recent CNBC interview, Warren Buffet cited the direct impact that a bank's return on assets (ROA) should have on the book value multiple (P/BV) at which it trades. Basically, the higher the ROA, the higher the multiple. Here's the direct quote:

*"...well, a bank that earns one — 1.3 or 1.4% on assets is going to end up selling above tangible book value. If it's earning 0.6% or 0.5% on assets it's not going to sell. Book value is not key to valuing banks. Earnings are key to valuing banks."*

Buffet was referring to the valuation gap that exists between some of the large U.S. banks but let's see if this logic holds true for the Canadian banks as well.

Company	Return on Assets	Price to Tangible Book Value
<b>Royal Bank</b> ( <a href="#">TSX:RY</a> )	0.9%	2.9
<b>Bank of Nova Scotia</b> ( <a href="#">TSX:BNS</a> )	1.0%	2.6
<b>TD</b> ( <a href="#">TSX:TD</a> )	0.9%	2.5
<b>CIBC</b> ( <a href="#">TSX:CM</a> )	0.8%	2.4
<b>Bank of Montreal</b> ( <a href="#">TSX:BMO</a> )	0.8%	1.9

Source: Capital IQ

## Foolish Takeaway

The distinct relationship that Buffet is referring to is not nearly as well illustrated by the Canadian banks because of the narrow ROA range that exists. Based on these figures however, the valuations ascribed to Royal on the high side and BMO on the low appear slightly out-of-whack with the rest of the group.

The S&P/TSX Composite Index is loaded with resource and financial stocks. Because of this, investors that rely on Canadian Index funds or ETFs severely lack diversification in their portfolio, opening them to undue risks. We have created a special report that outlines an easy to implement strategy and 5 Canadian stocks that reduce the risks involved with passively investing in the Canadian market. [Click here now](#) to receive **"Buy These 5 Companies Instead of Following a Flawed Piece of Advice"** – FREE!

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*Fool contributor Iain Butler does not own shares in any of the companies mentioned at this time. The Motley Fool has no positions in the stocks mentioned above.*

## CATEGORY

1. Investing

## TICKERS GLOBAL

1. TSX:BMO (Bank Of Montreal)
2. TSX:BNS (Bank Of Nova Scotia)
3. TSX:CM (Canadian Imperial Bank of Commerce)
4. TSX:RY (Royal Bank of Canada)
5. TSX:TD (The Toronto-Dominion Bank)

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