



Why Investors Should Avoid Canadian Western Bank

Description

There are growing concerns among analysts about the outlook for **Canadian Western Bank** ([TSX:CWB](#)). The oil rout, combined with fears over the direction of what has been a frothy Canadian housing market, is set to hit Canadian regional banks particularly hard.

Now what?

Canadian Western operates predominantly in Alberta and is heavily exposed to the fortunes of the energy patch. As a result, I expect the oil rout, and ongoing uncertainty about the outlook for oil, to be a significant headache for the bank.

The impact of the oil rout can already be seen in the bank's 2014 results, with net impaired loans as a percentage of total loans growing by five basis points. The key driver of this was a significant jump in the value of impaired commercial loans, which more than doubled compared with 2013. The root cause of this was due to an overall drop in business activity in the patch. Commercial services providers were the first to feel the heat as demand for their services significantly declined overnight.

The bank has considerable direct exposure to the oil industry. Its energy lending portfolio totals \$600 million. As oil companies continue to struggle in the current harsh operating environment, and with many smaller companies struggling to survive, the value of impaired loans in this portfolio is set to grow. This will force the bank to increase its provisions for those loans, diverting funds from more productive activities, thereby impacting its profitability and efficiency.

The bank's extensive exposure to the regional housing market also raises considerable concerns.

For February 2015, sales activity in Alberta's housing market declined by 27% compared with the equivalent period in 2014, and the average provincial housing price fell by 5%. Now, with oil companies continuing to lay off employees, I expect sales activity and prices to continue to fall, which will hit Canadian Western hard on two fronts.

First, it will see demand for its mortgage products decline and this will impact its ability to grow its bottom line.

Second, as oil workers and their families struggle to meet loan repayments, the volume of impaired mortgages will rise, placing greater pressure on the bank's balance sheet. This will cause the volume of provisions to rise, and in concert with falling credit demand, this will have a significant impact on Canadian Western's bottom line.

So what?

Canadian Western may be attractively priced, with a share price of 1.4 times its book value and 10 times its projected 2015 earnings, but as you can see, that is because the market is "baking in" the risks associated with the bank. The bank is overly reliant on the patch, with considerable direct and indirect exposure to oil prices. With the outlook for the patch and oil prices increasingly uncertain, this is one regional Canadian bank that I would avoid at this time.

CATEGORY

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TICKERS GLOBAL

1. TSX:CWB (Canadian Western Bank)

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