



Why Investors Need to Avoid Canada's Oiliest Bank

Description

The impact of the collapse in oil prices isn't only being felt by energy stocks. It is also having broader ramifications for Canada's economy and a number of companies dependent upon the energy patch. This includes **Canadian Western Bank** ([TSX:CWB](#)), which some analysts now claim to be attractively priced.

Let me show you why this is one bank every investor should avoid.

Now what?

Canadian Western is, by far, Canada's oiliest bank with the largest exposure to the price of crude and the fortunes of the energy patch.

You see, not only does it have loans worth \$600 million to the oil industry on its balance sheet, but it has over 40% of its mortgages located in the energy patch—and then there is its indirect exposure. This indirect exposure is almost impossible to quantify because it essentially accounts for the overall impact that weak oil prices will have on the regional economy and Canadian Western's key earnings drivers.

We are already witnessing higher unemployment, greater financial distress, and weaker property markets in the patch, and this is expected to continue for at least the foreseeable future.

The end result is that demand for credit as a key driver of growth for Canadian Western is set to decline. In fact, it is more sensitive to credit demand and net interest income than its larger peers. This is because it lacks their diversification and has historically focused solely on using lending as a means of growing earnings.

To give you an idea of how this stacks up, the second quarter 2015 net interest income made up 85% of Canadian Western's total revenue, whereas for **Toronto Dominion Bank** it was only 59%. Even the more domestically focused of the Big Six Banks are far less reliant on net interest income, and only makes up 49% of the **National Bank of Canada's** total revenue, and 56% for the **Canadian Imperial Bank of Commerce**.

Clearly, with the economy of the patch coming under considerable pressure, Canadian Western's growth prospects are set to diminish significantly.

Another concern is that no matter which way you look at it, loan defaults in the patch are set to rise. This will have a strikingly negative affect for Canadian Western because businesses will feel the pinch before households, and it has almost 84% of loans made out to regional businesses. The gravity of the situation can be seen in Canadian Western's second quarter 2014 results, where impaired real estate loans shot up a massive 70% year over year. More worrying is that impaired equipment financing and energy loans almost tripled for that period, while impaired commercial loans almost quadrupled.

What is even more disturbing is that almost all of this has occurred before the full impact of the oil rout has been felt.

So what?

Canadian Western may have an attractive dividend-payment history, having hiked its dividend for the last 23 straight years, and appears to be attractively priced, but that is not enough to make it a compelling investment. The headwinds it is facing are already having a noticeable impact on its performance, and this can only worsen over time as the effects of the oil rout and a faltering domestic economy bite deeper.

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1. TSX:CWB (Canadian Western Bank)

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