



How Have Low Oil Prices Really Affected Canadian Western Bank?

Description

Canadian Western Bank ([TSX:CWB](#)) has fallen from a 2014 high of \$43 per share to under \$25 per share—a whopping 42% drop. Investors are worried about the effects of low oil prices on the company. After all, 49% of the bank's loans are in Alberta and Saskatchewan.

How has the crude price affected the share price?

From October to December 2014, the crude oil price fell quickly from US\$95 to US\$50, a fall of 47%. It has oscillated between US\$45 and US\$55 from January to now, a span of almost 10 months.

In that same period, Canadian Western Bank's price fell from \$36 to \$29.5 per share, a fall of 18%. From January to now, its price has oscillated between \$24 and \$28.

As you can see, the bank's share price seems to trade alongside the oil price.

How has the crude price affected the bank's earnings?

The bank's 2015 target ranges for earnings per share (EPS) growth is 5-8%. In its third-quarter corporate presentation, the bank achieved that goal via divestiture gains of \$107.6 million. From that, the bank achieved 65% EPS growth by the third quarter.

Investors should really look at the earnings *before* the one-time gain. After taking away that gain, the EPS change, based on trailing 12-month earnings compared with 2014's earnings, was really -2.5%.

Now that's not as rosy a picture as the earlier 65% growth presented, but the picture isn't that bad either. Shares dropped 42% from the 2014 high, but earnings have only declined by 2.5% year-to-date.

How has the crude price affected the bank's other areas of business?

Canadian Western Bank targets loan growth to be 10-12% for the year. It has achieved 11% growth. Further, the bank has improved its efficiency. Its efficiency ratio was targeted to be 47% or less, but it has achieved 39.3% so far.

The target of return on assets was between 1.07-1.12%, but the bank has achieved 1.67%. Likewise, the return on equity target was 14-15%, but the company has achieved 21.6%.

So, if anything, the low oil price headwind has made Canadian Western Bank become a better business. It improved efficiency and achieved higher returns.

Dividend

At under \$25 per share, Canadian Western Bank almost yields 3.6%. Its payout ratio is 30%. Shareholders should worry about the bank's willingness to grow that dividend going forward, since the bank's target payout ratio is 25-30%.

Still, the bank pays one of the strongest dividends in Canada. It has grown its dividends for 23 years in a row, even during the Financial Crisis, when bigger Canadian banks froze their dividends. So, even if the bank doesn't expand its target payout ratio, the bank is unlikely to destroy its long history of paying dividends.

So, my guess is, at worst, the bank might decide to maintain the quarterly dividend at 22 cents per share for 2016. Even when that happens, the bank's annual payout for 2016 would still be higher than 2015's, maintaining its dividend growth streak.

Valuation

The bank is trading at a price-to-book ratio of 1.1, close to its book value of \$22.01. The bank has traded at a price-to-earnings ratio (P/E) of 15 many times in the past eight years. Even if the shares only head back to a P/E of 12.5, the shares should still be worth \$33, which would imply the shares are discounted by 24.2%.

In conclusion

Canadian Western Bank's business performance is holding up well compared to its share price. Based on a P/E of 15, the shares would be worth around \$39, indicating the shares are discounted by 35%. Using a lower P/E of 12.5, the shares would be worth \$33, implying the shares are discounted by 24.2%.

However, if the crude price doesn't make a recovery, it's unlikely the bank's share price will budge. Investors will need to be patient with Canadian Western Bank and view it as a rare opportunity with potential for long-term substantial gains.

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1. TSX:CWB (Canadian Western Bank)

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