Canadian Western Bank Is Not a Value Trap

Description

Canadian Western Bank's (TSX:CWB) operations are primarily in western Canada, causing the bank to slide 32% and lose roughly $831 million in market cap last year. The bank now has a compelling 4.1% yield. This yield was last seen in the financial crisis and has only happened twice in the last 10 years.

The bank is far from being a value trap

Compared with fiscal year 2014, the bank's earnings per share in the fiscal year 2015 that ended in October only declined by 5%. During this 12-month period, the bank's share price fell about 41% from $39 to just under $24.

Today the shares are even cheaper at $22.20 per share, trading at a multiple of 8.4. The bank's business performance is much better than its price performance.

Most importantly, the bank continued its 24th consecutive year of increasing dividends. Its last increase was in December, an annualized rate of 9.5%, bringing the annualized payout to 92 cents based on a quarterly dividend of 23 cents. Yet the bank's payout ratio is still only 34%.

Compare this to the Big Five Canadian banks, whose payout ratios are 45-50%. Arguably, Canadian Western Bank's dividend requires a larger margin of safety because it has a bigger piece of its business in provinces such as Alberta.

Loan concerns

The biggest concern about Canadian Western Bank is that 41% of its loans are in Alberta. Even though only 2% of its loans are directly related to oil and gas production, it doesn't change the fact that the Albertan economy has weakened. So, there's a higher chance of defaults for other Albertan loans.

From 1997 to 2014, Canadian Western Bank's provision for credit losses as a percentage of loans was below that of Canada's Big Six banks for the most part. Only between 2004 and 2006 was it higher.

Particularly during the financial crisis, there was a wider spread, but it was in favour of Canadian Western Bank. At that time the bank's provision for credit losses was lower by 60 basis points. Comparatively, in 2014 its provision for credit losses was 12 basis points lower. This indicates that Canadian Western Bank is even more careful about its lending than the Big Six banks on average.

Diversifying for the better

Canadian Western Bank recognizes its concentration in Alberta and is making an effort to diversify. In late December the bank announced the acquisition of Maxium Group for up to $120 million. Maxium Group, having over 80% of business in Ontario, is a meaningful step for the bank to diversify away from Alberta.

Chris Fowler, the president and chief executive officer of Canadian Western Bank, indicated that this acquisition provides attractive returns on capital. Its value is expected to be drawn out starting in the third year as it's an acquisition with a long-term view in mind.

Conclusion

From Canadian Western Bank's business performance, I think it is doing significantly better than what the market gives it credit for. Near its 52-week low, it is priced at a low valuation and yields 4.1%. And it has a low payout ratio of 34%. I believe the bank is a great addition to any diversified portfolio as an income and value investment.

In my opinion, Canadian Western Bank is one of the top stocks to own if you have an investment horizon of at least three to five years.

CATEGORY

1. Bank Stocks
2. Investing

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1. TSX:CWB (Canadian Western Bank)

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