Canadian Western Bank Has 70% Upside Potential

Description

From its 2014 high of over $40, **Canadian Western Bank** (TSX:CWB) has fallen over 45% to about $22. Instead of yielding 2%, it now yields 4.1% after the price decline and has had a 15% dividend hike in 1.5 years.

Why has the price declined?

Canadian Western Bank has 47% of loans in Alberta and Saskatchewan, which are directly affected by low commodity prices. The persistently low commodity prices are worrying. However, the bank has historically navigated well in different environments.

For example, during the financial crisis in 2008-2009, the average of the provision for credit losses of Canada's six largest banks (the Canadian bank average) reached more than 0.8%, but Canadian Western Bank's average was about 0.2%. By 2015 the Canadian bank average declined to about 0.3%, while Canadian Western Bank's was below 0.2%.

I believe Canadian Western Bank runs its business more conservatively because of its concentration in the resource provinces. Another fact that supports that is its conservative dividend.

Dividend and its growth history

Canadian Western Bank's payout ratio is about 34%, while the Big Six Canadian banks' payout ratios are about 50%. During the financial crisis, the big banks froze their dividends, but Canadian Western Bank continued to increase its dividend.

Canadian Western Bank has increased its dividend for 24 consecutive years, placing it in the third place for the Canadian company with the longest dividend-growth streak.

Here's why I believe Canadian Western Bank will make a comeback.

Diversifying and creating value

On March 1, Canadian Western Bank acquired the non-securitized lending assets and other net business assets of Maxium Financial Services Inc. and Desante Financial Services Inc. (Maxium), which has 80% of its business in Ontario.

The acquisitions are expected to have a moderately negative impact on the bank's adjusted earnings per share (EPS) this year. However, the bank expects Maxium to contribute positively to adjusted EPS starting in 2018 and accelerate thereafter. Specifically, the bank believes Maxium has the potential to contribute up to 10% of the bank's consolidated earnings within five years.

Conclusion

In the first quarter that ended in January, Canadian Western Bank's adjusted EPS was unchanged from last year. This year the bank's business performance is likely to remain below its medium-term targets with the backdrops of low commodity prices, pressured net interest margins, and slower economic growth.

However, the bank targets medium-term EPS growth to be 7-12% and has made efforts to diversify its business away from the resource provinces. Additionally, its payout ratio of 34% gives a margin of safety for its 4.1% dividend yield.

As a result, Canadian Western Bank, with a multiple of about 8.4, is a strong value-investment candidate for investors with an investment horizon of three to five years or longer. The bank's normal multiple implies there's a 40% margin of safety, equating to 70% upside potential.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. TSX:CWB (Canadian Western Bank)

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Date
2025/08/23
Date Created
2016/03/04
Author
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