Canadian Western Bank: A Contrarian Play on the Rally in Crude

Description

The collapse of crude has had a sharp impact on Canada's economic fortunes, causing economic growth to slow and creating concerns about the outlook for Canada's banks. One bank that was hit particularly hard was **Canadian Western Bank** (TSX:CWB), which saw its share price plunge by 10% over the last year because of concerns about its exposure to the beleaguered energy patch.

However, with oil rallying over the last month and signs that economic growth is stronger than originally anticipated, the bank is shaping up as a great contrarian play on the rebound in crude.

Now what?

Despite concerns over Canadian Western's considerable exposure to the energy patch (with a focus on western Canada), it delivered some solid results for the first quarter of 2016. Canadian Western reported earnings per share of $0.65, which was in line with expectations and unchanged from the previous quarter and the same period in 2015.

Surprisingly, despite the difficult economic environment being experienced in Alberta, its loan book for the first quarter of 2016 grew by 12% year over year, which caused net interest income to spike by a healthy 7%.

In fact, it is this difficult economic environment that is responsible for a sharp increase in impaired loans. Their total value rose by 40% year over year, although they still only represent 0.55% of the bank's total loans. This highlights that the bank's conservative approach to credit risk and measures to reduce risk in its loan portfolio are working.

Unlike many of its larger peers, such as the **Bank of Nova Scotia**, Canadian Western has very little direct exposure to the energy patch; only 1.6% of the total value of its loans are made to the oil industry.

Canadian Western’s focus on controlling costs is also paying dividends for the bank. It reported one of the best efficiency ratios among Canada’s banks: 47%. This highlights that the bank is capable of effectively deploying its resources in order to generate revenue.

More importantly, the bank remains focused on growing its business by expanding its operational footprint within Canada, particularly in the east, which will reduce its exposure to the energy patch.

Earlier this month, Canadian Western completed its acquisition of Maxium Financial Services Inc. and Desante Financial Services Inc. for $120 million, adding $1 billion in securitized assets and an additional 35,000 customers to its portfolio. This purchase will accelerate its expansion into eastern Canada as those companies already have more than 80% of their businesses in Ontario.

The bank also continues to reward investors with a regular dividend that it has hiked every year for the last 24 years; it now pays a tasty 3.7% yield. This dividend remains sustainable with a low payout ratio of 34%.

So what?

With a share price of a mere 1.1 times its book value per share, Canadian Western appears to be very attractively priced. This is a particularly low multiple that indicates it is deeply undervalued in comparison to the majority of other Canadian banks. Such a low multiple can be attributed to the sharp sell-off of its shares because of market concerns over its exposure to Alberta’s ailing economy and the ongoing weakness of crude.

Regardless of the difficult economic environment, Canadian Western’s solid results, its expansion into eastern Canada, and its attractive valuation make now the time to invest.

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1. TSX:CWB (Canadian Western Bank)

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