Canadian Western Bank Is Still Deeply Discounted

Description

When stock prices stray away from the company's normal multiples, they will eventually revert to the mean. If a company is overvalued, it'll either fall back to align with its earnings or trade sideways until earnings catch up.

Likewise, if a company is selling at a discount for one reason or another, it'll eventually rise to align with its earnings, unless the company's fundamentals are weakened and earnings fall in line with the price.

Standing strong

In **Canadian Western Bank's** (TSX:CWB) case, I believe it is facing problems, but it remains a strong company. The regional bank has 41% and 6% of its loans in Alberta and Saskatchewan, respectively, which puts pressure on its share price because oil prices remain low; the WTI oil price is below US$40.

So far, the company has been standing strong though. In 2015 its net interest income of $546.9 million was 8.2% higher than it was the year before. And it achieved revenue of $734.4 million, 18.7% higher than the previous year. Those were the results of its combined operations.

During the year, the company sold some non-core assets. The results from continuing operations in 2015 were as follows: net interest income of $543.5 million was 8.8% higher than the year before, and it achieved revenue of $610.8 million, which is 4.8% higher than the previous year.

Its earnings per share (EPS) only fell 5% in the fiscal year 2015, while its price per share fell about 30% from about $32 to $23.

In the first fiscal quarter of 2016 that ended in January, the bank experienced strong loan growth of 12%. However, the net interest margin was 2.48%, 11 basis points lower than the previous quarter, implying lower profitability. As well, it achieved EPS of 66 cents.

Dividend

Despite the challenges Canadian Western Bank has been facing, it still managed to hike its quarterly dividend by 9.5% last year, continuing its trend of yearly dividend increases. Last year was the bank's 24th year of dividend growth. In fact, the bank is one of three publicly traded companies in Canada that has achieved that growth.

Using Canadian Western Bank's 2015 EPS, its quarterly dividend of 23 cents per share (an annual payout of 92 cents per share) implies a payout ratio of just 35%, which gives a good margin of safety for its dividend.

Conclusion

Canadian Western Bank's targets for the medium term include 7-12% EPS growth and a dividend-payout ratio of about 30%. So far, the bank experienced 0% EPS growth in the first quarter of the fiscal year 2016.

The shares are discounted by 37% from its normal multiple, implying there's 60% of upside from the $24 level if the bank reverts to the mean. No one knows when that will happen, so shareholders must be patient. In the meantime, shareholders can collect a decent 3.8% dividend yield.

Cautious investors should consider the bank between $20 and $22 where it shows some support.

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1. TSX:CWB (Canadian Western Bank)

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