Why I Remain Bullish on Canadian Western Bank Despite the Rout in Crude

Description

The harsh operating environment in the energy patch has weighed heavily on **Canadian Western Bank** (TSX:CWB). Its share price has fallen by 8% over the last year. Regardless of the pessimistic outlook surrounding the energy patch, with consulting firm Deloitte estimating that a third of North American energy companies will go bankrupt during 2016, Canadian Western is as an attractive investment.

Now what?

Canadian Western reported some solid results for the first quarter 2016 with net income of $52.1 million, a mere 1% drop compared with the same period in the previous year. It was able to report these impressive results even after allowing for the headwinds that it has been experiencing, including lower margins with its net interest margin (NIM) falling because the Bank of Canada reduced the headline rate.

This is an impressive feat given the difficult operating environment, and it demonstrates the resilience of Canadian Western's business to the economic slump being felt in its core market of Alberta.

Even after accounting for the economic downturn in the patch, which saw an 11-basis-point increase in impaired loans year over year, the value of gross impaired loans to the balance of loans outstanding was still a mere 0.55%. While there is the potential for this number to rise, I don't see it increasing to dangerous levels because of Canadian Western's conservative approach to managing credit risk.

Even with the patch representing Canada Western's core market, it has very little direct exposure to the beleaguered oil industry. The total value of loans issued to oil and gas companies only amounts to 1.6% of the value of all loans issued. This is significantly less than any of the Big Five banks. Even if all borrowers were to default, which is highly unlikely, it would have very little long-term impact on the bank's balance sheet or its finances.

Canadian Western also has very little overall exposure to Canada's housing market, which some pundits claim is on the verge of a catastrophic meltdown.

You see, almost 83% of the value of all loans issued are commercial loans rather than personal loans or residential mortgages. Its total exposure to residential mortgages, including lines of credit, only amount to 14% of the value of its loan portfolio.

A pleasing aspect of Canadian Western's performance is that despite the difficult economic environment, it reported an impressive efficiency ratio of 47.2%. This ratio is particularly important when assessing a bank's performance because the lower the ratio, the more efficiently it is using its resources to generate revenue. It is also well below the efficiency ratios of the Big Five banks and highlights the agility of Canadian Western's business.

Furthermore the bank's acquisition of Maxium Group, which provides loans, leases and structured finance principally in Ontario, will reduce its dependence on western Canada.

Let's not forget that tasty 3.5% dividend yield with a payout ratio of 34%, which remains sustainable even if Canadian Western's earnings were to take a big hit because of the economic downturn in the patch.

So what?

It is easy to forgive investors for being concerned about the outlook for Canadian Western as its business is primarily focused on Alberta and other parts of western Canada that have been sharply impacted by the sharp collapse in crude.

Nonetheless, the bank continues to perform strongly and has demonstrated the resilience of its business to weak oil prices. This makes now the time to invest.

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