



After Dropping More Than 12% in Less Than Two Months, Is Laurentian Bank of Canada a Buy?

Description

The debate over the extent to which improper disclosures or “problematic mortgages” are indicative of structural issues at Canadian lenders or are simply par for the course and something investors should ignore rages on. With respect to the \$392 million of mortgages, which are being bought back by **Laurentian Bank of Canada** ([TSX:LB](#)) from a third party following an isolated audit of only \$655 million of mortgages, the future remains sufficiently uncertain to warrant the recent sell-off of more than 12% since early December.

At The Motley Fool, contributors have differing viewpoints, with some, such as Joey Frenette, suggesting that “[where there’s smoke there’s usually fire](#),” suggesting investors consider the implications of what a larger company-wide audit would mean for investors. Others, such as fool contributor Will Ashworth, believe this short-term dip represents an excellent opportunity to be “[greedy when others are fearful](#),” citing Warren Buffett and referencing the recent investment made by the Oracle of Omaha in **Home Capital Group Inc.** earlier this year.

My current take on Laurentian Bank is that the company may simply be too risky of an investment for long-term investors looking to hold a Canadian financial institution for a decade or more, given the strength and profitability of Canada’s larger banks and the relative buffer banks such as **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)) and **Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)) have over smaller lenders such as Laurentian. With the global economy overdue for some sort of sell-off, we saw approximately 10 years ago how hard-hit the financial sector (and in particular niche-lenders) was in comparison to more defensive sectors.

That said, who am I to contradict Warren Buffett and his recent purchase of Home Capital? As I mentioned previously, I believe Mr. Buffett’s investment in Home Capital was one born out of capitalistic interest — one that did not benefit the company at the time. As such, I give less credence to this investment as a canary of sorts, indicating that the problems within Canada’s mortgage market are overblown.

Bottom line

I believe all Canadian investors need to assess the long-term risks associated with any investment before jumping in. Whether this \$392 million of problematic mortgages is a one-off or not, one thing is certain: the risk profile of Laurentian relative to its peers just increased. As such, projecting the risk-adjusted future free cash flows of Laurentian requires an adjustment in every investor's equity models.

Stay Foolish, my friends.

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Date

2025/08/16

Date Created

2018/01/27

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