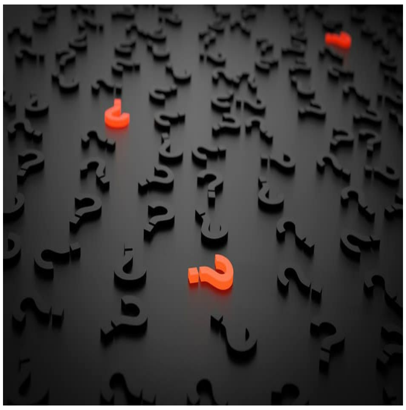

Is Laurentian Bank of Canada or National Bank of Canada a Buy?

Description

Laurentian Bank of Canada (TSX:LB) and **National Bank of Canada** (TSX:NB) are pretty much off the radar of most Canadian bank investors.

Let's take a look at the two Montreal-based banks to see if one might be an interesting pick today.

Laurentian Bank

Laurentian Bank ran into a mortgage fiasco last year when an audit revealed that some mortgage loans sold to a third-party company did not meet proper eligibility or documentation requirements.

In January, Laurentian Bank said it had either repurchased or could eventually buyback loans totalling just under $400 million.

In the fiscal Q2 2018 earnings report and investor presentation that came out at the end of May, Laurentian Bank said the situation has been resolved and that no material impact is expected on the bank's operations, funding, and capital.

Laurentian Bank's common Equity Tier 1 (CET1) ratio, which essentially indicates the company's ability to withstand a financial shock, was 8.6% as of April 30, 2018.

The market isn't overly impressed. Laurentian Bank's stock price at the time of writing is close to $45 per share, down from $60 in late November 2017. The five-year low is about $43 per share, so we are not far off that benchmark.

On the positive side, the bank reported a 25% year-over-year increase in adjusted Q2 net income and raised the quarterly dividend by $0.01 to $0.64 per share. That's good for an annualized yield of 5.65%.

Laurentian Bank trades at just 8.02 times trailing earnings, which looks pretty cheap compared to the larger Canadian banks that are fetching as much as 13.5 times earnings.

Laurentian Bank's market capitalization is about $1.9 billion.

National Bank

National Bank experienced its own troubles in 2015, when it had to raise $300 million to shore up its capital base due to restructuring charges and an anticipated write-down for a bad investment in Maple Financial Group.

The stock fell below $40 in early 2016, but has since recovered. In fact, contrarian investors who stepped in and bought National Bank at the low are now sitting on gains of more than 50%.

National Bank reported solid fiscal Q2 2018 results. Net income and diluted earnings per share rose 12% compared to the same period last year, supported by strong performances in all of its core segments.

The bank finished the quarter with a CET1 ratio of 11.3%, and raised the quarterly dividend by $0.02 to $0.62 per share. That's good for a yield of 3.9%.

At the time of writing, National Bank trades for 11.25 times trailing earnings. The market capitalization is $21.6 billion.

Is one a better bet?

Contrarian investors might look at Laurentian Bank's P/E multiple and think the stock is priced for a financial crisis. That might be true, and the dividend is probably safe, but Laurentian Bank is very small and the low CET1 ratio suggests that a big shock to the Canadian economy could hit the bank harder than it peers.

National Bank is performing well, has improved its capital position, and trades at a reasonable multiple, but the bank really doesn't offer anything better than you can get from two of the larger banks (CIBC and Scotiabank) that trade at lower P/E ratios, offer higher dividend yields, and are equally or better positioned to ride out a downturn in the Canadian economy.

As a result, I would avoid both Laurentian Bank and National Bank of Canada today.

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