Cash in on Higher Oil With This Canadian Regional Bank

Description

Crude has rallied significantly in recent weeks to see West Texas Intermediate (WTI) hovering around the US$75 a barrel mark and up by an impressive 30% for the year to date. While this has been a tremendous boon for beaten-down energy companies, many Canadian oil stocks have remained flat or only made modest gains, making now the time for investors to boost their exposure to oil.

One means of doing so without investing directly in oil stocks is to buy **Canadian Western Bank** (TSX:CWB), which since the start of 2018 has lost almost 16%, thereby creating an opportunity for contrarian investors.

Now what?

At the height of the oil slump, as Alberta's economy collapsed and investment in the energy patch dried up, Canadian Western saw its market value hit hard. Its stock plummeted from an all-time high of over $43 a share in mid-August 2014 to bottom at less than $20 in February 2016. Since then it has experienced a solid recovery, gaining 67% with signs of further upside ahead because of firmer oil.

At the height of the oil slump Canadian Western worked feverishly to diversify its operations and expand the portion of its earnings generated outside of Western Canada. And that, along with Alberta's economy returning to growth, saw the bank report some solid third quarter 2018 results.

Net income shot-up by 11% year over year to a record $62 million primarily driven by strong lending growth which saw loans under management expand by a healthy 12%. Such remarkable credit growth was responsible for Canadian Western's net interest income soaring by 14% compared to a year earlier and total revenue by 12%.

Notably, Canadian Western's credit quality improved over the third quarter. The value of gross impaired loans fell by a noteworthy 20% compared to the equivalent quarter in 2017 giving the bank a gross impaired loans ratio of 0.53%, which was 21 basis points (bps) lower than a year earlier.

Nonetheless, the total allowance for credit losses rose by 4% year over year to $147 million, indicating that Canadian Western is taking a more proactive approach to managing credit risk. This increase was driven by the bank setting aside additional credit loss allowances for undrawn credit exposures and an increase in specific losses.

This ensures that Canadian Western has sufficient resources set aside to cover its non-performing loans.

The bank also finished the third quarter well-capitalized with a common equity tier one capital ratio of 10.5%, which is well above the minimum required by Canada's prudential regulator.

Higher oil and an improving economic outlook for Western Canada will help to drive greater loan growth and lower credit losses, thereby giving earnings a healthy lift. Canadian Western's growth initiatives, including recent acquisitions such as the purchase of $900 million of equipment loans and leases in October 2017, will also boost earnings.

Rising interest rates are poised to support greater profitability and higher earnings. Canadian Western's third quarter net-interest-margin (NIM) was a respectable 2.64%, or 5 basis points greater than for the same period in 2017. That can be attributed to the Bank of Canada hiking the headline rate during that year to 1.5%.

Any further rate hikes, which are likely considering that the Fed has yet to normalise U.S. interest rates, will cause Canadian Western's NIM to expand boosting the profitability of its lending operations.

So what?

It is clear that Canadian Western has finally returned to growth, which will see it unlock considerable value for investors, particularly amid a favourable macro-environment that is supporting loan growth and greater profitability. The bank also has a long history of rewarding investors with a steadily growing and sustainable dividend.

Canadian Western has hiked that dividend for the last 26-years straight, giving it a tasty 3% yield, and there is every likelihood of further increases as earnings grow.

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