Is This Insanely Cheap Bank a Buy?

Description

It's hard to believe there aren't dark clouds building on the Canadian economic front. Government debt and spending are showing no signs of slowing down. In fact, the government is increasing spending. The latest tax cuts, while good for business, are nonetheless another expenditure that our economy can't afford. Consumer debt is incredible, and it's hard to see how this can end well for the economy.

While banks are an obvious contributor to the growing debt problem that faces this country, the larger Canadian banks should be insulated somewhat from the effects of a downturn. They will be hurt, but they are diversified, have stringent lending practices and are generally focused on higher quality loans. It's the smaller, Canadian-focused banks that may be more exposed.

These fears, combined with a poor third quarter, have driven down the share price of **Laurentian Bank** (TSX:LB) to a degree not seen since the financial crisis of 2008. The trick is to decide whether the fears are overblown, making this a fantastic opportunity to buy, or whether the economic situation is far too dire to even consider investing in a Canadian-focused lender.

Laurentian Bank didn't have the greatest third quarter. Net income was essentially flat as compared to the same quarter the year before, but revenues increased by 5%. The bank is focusing on growing its commercial loan book, which could insulate it somewhat from any downturn in the residential real estate or personal loans.

Nevertheless, its personal and residential loan book is still larger at a combined $23 billion as compared to $12.3 billion in commercial loans. Furthermore, these loans are primarily Canadian, making the bank susceptible to an economic downturn.

But the bank is so cheap that it makes investors wonder if the fears are already fully baked into the share price. Presently, the stock trades at a trailing price to earnings of 7.7 and a price to book of 0.8. This valuation is far cheaper than any of the larger Canadian banks.

The dividend is currently sitting quite high at around 6%. The high dividend reinforces the lack of confidence investors have after the poor quarterly results and the fears over the stability of the Canadian economy. However, the bank raised its dividend earlier this year by 1.5%, so there may be more raises to come if the economy remains intact.

There is no guarantee that problems will arise, and there's is no guarantee that they will occur soon. I have been worried about a debt collapse for a long time now, and nothing has happened. But times don't change slowly, they change rapidly — just look at the changing sentiment in the tech sector. Things go well, and then they don't.

Laurentian Bank is a value play that may pay off in the long run, but uncertainties still abound regarding the ultimate fate of the Canadian economy, the housing market, and the consumer. It is definitely cheap, which might make this an interesting entry point. It also pays a handsome dividend at the current share price, so the income it generates might be worthwhile.

It comes down to a judgment call as to whether the negative news is already priced into the share price. Investors need to decide whether the risks outweigh the rewards, particularly when dark clouds continue to gather on the economic horizon.

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