Is It Time to Load Up on This Dirt-Cheap Bank Stock?

Description

Canada's five largest banks get all the attention, and rightfully so. They are true behemoths.

There are few other investments in the world that can match Canada's biggest bank stocks. These companies enjoy a dominant market share, cost of capital advantages, and have all successfully expanded outside of Canada. And, most important, all have made investors rich over a long period.

But that doesn't mean that the big banks are infallible. Many Canadians simply refuse to deal with them, preferring to do their banking with credit unions or regional players.

Small banks can expand into more niche businesses, something a large bank might not bother with. And a smaller bank offers better growth prospects too, often combining that with a cheaper valuation.

And perhaps most important, an investment in a smaller bank comes with upside potential on a takeout. One of the dirty secrets of the Canadian banking industry is the largest banks don't really grow that much organically, so they'll look to acquire competitors to juice the top line.

Let's take a closer look at one of these smaller competitors, **Canadian Western Bank** (TSX:CWB), which looks to be a pretty compelling investment opportunity today.

The skinny

Canadian Western Bank is a regional bank with operations primarily in Canada's three westernmost provinces, although it has expanded into Ontario lately. The company has 42 branches, an active equipment leasing division, wealth management offices, a division that works with mortgage brokers, and a specialty franchise finance division that specializes in lending to potential restaurant and hotel franchise owners.

Together this combines to form a bank with more than $29 billion in assets and a market cap on the **Toronto Stock Exchange** just over $2.5 billion.

Recent performance has been rock solid. In the company's most recent quarter, it posted revenue growth of 10% versus the same quarter last year, with profits increasing 7%. Earnings jumped from $0.75 to $0.80 for the quarter, with analysts expecting the bottom line to be approximately $3.20 per share this year.

The opportunity

The investment opportunity is pretty simple. Canadian Western Bank offers investors a better growth profile than its largest competitors while trading at a cheaper valuation. This is a powerful combination.

Let's start with that growth profile. As I mentioned earlier, the bottom line is expected to hit $3.20 per share this year before growing to $3.47 per share next year. I suspect that analysts are being a touch conservative because there's the possibility of a global recession hitting sometime in the next 18 months.

With 10% consistent revenue growth and a little more efficiency, Canadian Western Bank could hit $3.60 or $3.70 per share in earnings in 2020.

Shares trade at just 9.1 times projected 2019 earnings at writing, making Canadian Western Bank one of Canada's cheapest bank stocks. Combine that with the bank's solid growth potential and we have a compelling investment thesis.

But wait: it gets better. If one of the bank's competitors acquires it, it would result in a nice premium for shareholders. The obvious suitor is **National Bank of Canada**, which hasn't expanded much from its Quebec roots. The big criticism for National Bank over the years is that it needs to get bigger. Acquiring Canadian Western Bank would be an easy way to do so.

Finally we have CWB's dividend, which is a rock-solid payout that currently yields 3.7%. The company has delivered stellar dividend growth in recent history, hiking its payout each year since 2011. The payout has increased by approximately 8% over the last year.

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