



Why I'd Put Off Buying This Bank Stock

Description

Canadian Western Bank ([TSX:CWB](#)) is mostly thought of as a bank that only serves western Canada. While the bank does two-thirds of its business in western Canada, it has operations all across Canada. With a market cap of \$2.5 billion, it is considerably smaller than the Big Six banks; however, it's still a major player in the banking industry.

The bank has been attempting to grow its main operations company wide, while also growing its other lines of business. Currently, approximately 92% of CWB's revenue comes from interest income. This could weigh on the bank going forward, as the interest rate environment in Canada becomes more uncertain.

Net interest income growth is expected to slow this year due to the higher possibility that the Bank of Canada won't raise interest rates. The possibility still exists that the Bank of Canada could cut rates, which would be a negative blow to CWB's net interest margins. The net interest margins have already seen a slight decline the last few quarters, so that's a risk going forward.

The bank targets loan growth around 10% a year. Despite the fact that it's done well to hit its targets in the past, going forward, loan growth will be pressured, as macroeconomic conditions worsen in Canada.

The loan business consists of five main sectors of lending. The largest, general commercial loans, makes up 29% of the total loan portfolio. Personal loans and mortgages make up 20%. Equipment financing and leasing, and commercial mortgages each make up 18%. The final sector is related to real estate project loans, which account for 15% of the total loan portfolio.

The equipment leasing business has been one of the best growing lines of business for the bank. Total leases have increased 66% in the last four years. Most of the revenue comes from Ontario, Alberta, and Quebec. The business has approximately 80,000 active leases. The division is well run and has a long track record of execution with 44 years of experience in the equipment leasing business.

While the company has done well to diversify its loan portfolio, it is also trying to expand its non-interest revenue. Wealth management, trust services and retail service fees all account for barely any

revenue. Management sees this as an opportunity for an organic way to grow.

In terms of capitalization, the bank is well capitalized, as are all Canadian banks. At end of Q1, the common equity tier-one capital ratio stood at 9.1%. Additionally, the bank has lower leverage than the average of the Big Six banks in Canada. This can be seen as conservative, which, in my opinion, is positive as we head into more uncertain macroeconomic conditions.

The company has increased its dividend each year since 2012. The dividend currently yields 3.7% with the payout ratio sitting at 36%. The long-term target for CWB is a payout ratio around 30%. CWB also boasts 132 straight quarters of profitability. Return on equity is also attractive and consistently above 10%.

The main risks investors should be aware of are economic conditions, which could hinder growth and affect loan performance. The lack of diversity in the revenue sources exposes investors to interest rate risk, although the company has addressed this. Geographic risk exists as well with 65% of the business operating in Alberta and B.C.

The company continues to execute its growth strategy, and [financials remain strong](#). Management has a long track record of achieving targets and the company looks stable. However, due to the uncertain conditions ahead and the pressures being faced in the Alberta and B.C. markets, the company looks fairly valued at current prices. A drop to the low \$20s would make it a lot more attractive.

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Date

2025/08/24

Date Created

2019/05/09

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