



## Despite This Bank Stock's Run, it's Still a Buy

### Description

I've covered a lot of Canadian banks in my time, but one I haven't written about is **Equitable Group** ([TSX:EQB](#)), Canada's ninth-largest bank.

Heading into May, EQB stock was up more than 24% year to date, double the returns for the Big Six. That caught my attention. I love smaller stocks that are outperforming the blue chips.

Then the calendar turned from April, and it's been downhill ever since losing 5.5% for May through May 23.

Since I haven't followed the stock, I'm going to assume the correction was a bit of profit-taking.

To be sure, I'll take a look at its business to confirm that nothing's changed in the bank's fundamentals to scare investors out of their positions.

### The downside

When looking for a little information on an unfamiliar stock, it pays to reach out to Motley Fool colleagues who've written about the company. Ambrose O'Callaghan did a piece on EQB in March. He explained why he's staying away from Canada's second-largest alternative lender.

Although O'Callaghan was generally positive about its long-term business plan and its 2018 results, he felt that new [deposit rules](#) being introduced by the Office of the Superintendent of Financial Institutions could affect the bank's 2020 results. Quoting a **National Bank** report that these rules could cut EQB's 2020 earnings by 10%, O'Callaghan felt that the EQB valuation was a little too high.

As EQB was in or near overbought territory, March wasn't the time to be buying its stock.

Since then, it's gone sideways.

Another potential negative is the fact that 66% of the company's residential mortgages are in Ontario with a big emphasis on Toronto. I say potential because home values are still extremely high and the equity in those homes is also very high; it's going to take a significant economic correction to affect this

portfolio of mortgages, but we know from experience it can happen.

## The upside

One of the things I like about EQB's bank is that it doesn't have any physical branches. That keeps costs down. In Q1 2019, EQB's efficiency ratio was 41.1% — 320 basis points higher than a year earlier, but still very low. The efficiency ratio is the bank's non-interest expenses as a percentage of its net income. The lower, the better.

By comparison, **VersaBank**, another of Canada's digital banks and a [favourite](#) of mine, had an efficiency ratio of 52% in the first quarter.

Another positive is that EQB has managed to take market share from **Home Capital Group** since its regulatory issues in 2017. In the fourth quarter, EQB's single-family mortgages increased by 14% year over year at a time when mortgage growth is slumping.

In the first quarter, it grew alternative single-family mortgages by 15% and prime single-family mortgages by 48%. Sequentially, it improved the two categories by 3% and 4%, respectively.

However, it's not just about residential mortgages. It grew its conventional commercial loans by 24% year over year in the first quarter to \$3.9 billion. Including equipment leases and insured multi-unit residential mortgages, the company's commercial business accounted for 32% of its total loan portfolio.

## The bottom line on Equitable Group stock

An exciting future development for EQB revolves around "open banking," an initiative that exists in other parts of the world that would allow for the seamless movement of financial data from one institution to another, providing the bank with the opportunity to more easily build its deposit base.

"We certainly believe that a future that involves an open banking environment is coming. And we've been building our systems to be ready for that for the last two to three years," CEO Andrew Moor said recently.

While the company isn't nearly as diversified as the Big Six based on geography or lines of business, it's very good at what it does.

Furthermore, its valuation is much cheaper than the Big Six. Long term, I think buying on this latest correction and putting some cash aside for a future correction is a brilliant move.

EQB is a buy.

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