Warning: This Canadian Bank Just Slashed Its Dividend by 40%

Description

Laurentian Bank (TSX:LB), my least favourite regional Canadian bank, recently dropped a bombshell, slashing its quarterly dividend by a whopping 40% following some horrid second-quarter earnings results.

The Quebec-based regional bank has made a habit of missing analyst expectations over the past year, falling short of expectations four times straight, three of which missed by a considerable amount.

Q2: Earnings miss, dividend reduction for the regional Canadian bank

Shares of Laurentian Bank sold off 9.2% on Friday in response to the dividend cut (shares now yield 5.6%). Although the regional bank stock currently trades at a massive discount to book relative to that of its regional peers and bigger Big Six brothers, I'm still reluctant to recommend a name that has its hands full of baggage.

For Q2, Laurentian Bank clocked in $0.20 EPS, missing analyst expectations of $0.38 by a country mile thanks in part to provisions for credit losses (PCLs), a common sore spot for all Canadian banks, which swelled to nearly $55 million, up significantly from the $9.2 million in PCLs reported in the previous quarter.

The rough quarter brought Laurentian Bank's common equity tier 1 ratio to 8.8%, which, while not abysmal, is still severely lacking relative to its peers.

Size matters when it comes to the Canadian banks, at least with Laurentian

Chris MacDonald, my colleague here at the Motley Fool Canada, recently called Laurentian's dividend cut with impeccable timing.

MacDonald also brought up the fact that smaller, regional banks like Laurentian tend to "deal with smaller, regional companies with higher inherent risk profiles than larger national customers" and that investors who do choose to bear the higher risks involved with the name must "keep a close eye on… capital ratios" to avoid getting left holding the bag amid a vicious downturn.

"When it comes to [the] perceived risk in the financials sector, size does matter," wrote MacDonald. "Larger banks tend to have larger customers with less counter-party risk associated with the financial products sold."

I think MacDonald is right on the money and that bank investors should tread carefully the Canadian bank that has more than its fair share of baggage.

Laurentian Bank: Under a tonne of pressure

Today, Laurentian stock is flirting with those March 23 lows, and the valuation has fallen to unprecedented levels. While it may seem like a good idea to bargain hunt with the heavily out of favour bank stock, I'd urge investors to consider the amplified risks involved with the name relative to the Big Six.

The company had what you could call a mini mortgage crisis of its own just a few years ago when macro headwinds weren't as powerful as they are today. With small- and medium-sized businesses (SMBs) continuing to face the pressure amid the coronavirus crisis, there's no telling how much further Canadian bank stocks can fall.

With a lower-quality loan book relative to some of its bigger brothers, Laurentian could continue leading the downward charge, with a far more difficult road to recovery than its most-established peers.

Foolish takeaway

Laurentian trades at 0.5 times book, a wide discount as far as Canadian banks are concerned. But just because the stock is dirt-cheap based on traditional valuation metrics doesn't mean it can't get much cheaper, especially if a worst-case scenario ends up happening with this pandemic.

To most prudent investors, the risks simply aren't worth the shot at potentially outsized rewards. The margin of safety involved in the name my prove to be an illusion, especially if this pandemic drags on through 2021.

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Date
2025/08/22
Date Created
2020/06/01
Author
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