2 Bank Stocks Trading Below Book Value

Description

Canadian banks have had a rough 2020. Rapidly escalating provisions for credit losses have wiped out earnings and spooked investors. Accordingly, bank stocks have taken a beating. While they have recovered quite nicely from March lows, there are still some bank stocks that are trading below book value.

Let's take a look at two such bank stocks that are worth considering.

Laurentian Bank of Canada

The common equity tier 1 (CET1) ratio measures a bank's financial strength and its ability to absorb losses. The higher the ratio, the stronger the bank's financial strength. With a CET1 ratio of only 8.8%, **Laurentian Bank of Canada** (TSX:LB) is not in the best of shape. For comparison purposes, banks like TD and RBC have CET1 ratios of well over 10%.

As a reflection of Laurentian Bank's sub-par position, the bank cut its dividend by 40% last week. Before the cut, Laurentian Bank was yielding close to 10%. Now it is yielding 5.2%.

Second-quarter results at Laurentian Bank were hit by the impact of the coronavirus. This is hardly surprising. But in fact, if we look a little closer, we will notice that this quarter was the third quarter that the bank missed expectations. And it was by a lot. The bank reported earnings per share of $0.20 compared to consensus expectations of $0.42, with provisions for credit losses soaring over 268%.

Regional banks like Laurentian lack the size, scale, and diversity that the big Canadian banks benefit from. The bank is predominantly located in Quebec and it serves many of the small to medium sized businesses. Hence, the higher risk profile.

Laurentian Bank trades at 0.6 times book value. While this seems like a really attractive valuation, we cannot ignore the risks. At this historic time of uncertainty and poor visibility, investors would be well advised to stick with the larger banks. This is when we most need to mitigate company-specific risks because the macro risk is high enough.

Bank of Montreal

Bank of Montreal (TSX:BMO)(NYSE:BMO) currently trades at 0.9 times book value with a 5.74% dividend yield. This bank is struggling with the same issues as the rest of the sector – rising provisions for credit losses, huge earnings declines, and rapidly rising dividend payout ratios. But these issues affect some banks more than others.

Bank of Montreal also disappointed in its latest earnings report. But relative to Laurentian Bank's second quarter, the magnitude of BMO's miss was nowhere near as big, at only 15% below expectations. Also, the Bank of Montreal has a strong track record of risk management. And this is continuing in this downturn. The bank's financial strength, as measured by its CET1 ratio, is healthy at 11%.

Bank of Montreal's dividend is supported by the fact that it has one of the lowest exposures to the Canadian personal and commercial banking (P&C) industry. And second-quarter strength in the bank's wealth management segment was promising. It posted good asset growth, which allowed the segment to hold up well.

Foolish bottom line

Laurentian Bank stock and National Bank stock are both trading below book value. But that doesn't mean they are both good buys.

Bank stocks have taken a beating in 2020. While this has presented some good opportunities, not all bank stocks that have fallen are good buys. The macro environment is still very uncertain and loaded with risks. I would therefore focus on strength and risk mitigation. Laurentian Bank is too risky for this environment while Bank of Montreal is a bargain.

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1. Bank Stocks
2. Dividend Stocks
3. Investing

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