THE GLOBE AND MAIL

The returns of this little bank stock are putting the Big Six to shame - and it's still cheap

DAVID BERMAN INVESTMENT REPORTER

PUBLISHED APRIL 26, 2019

While Canada's biggest banks are struggling with slower loan growth, one of the country's smallest lenders is shaking off the trend – and its share price is rallying.

Equitable Group Inc., the country's ninth-largest bank, is up 24.6 per cent this year, about double the average gain of 12.1 per cent for the Big Six. Yet the stock's valuation is among the cheapest in the sector, suggesting plenty of potential.

The Toronto-based financial services firm, which operates as Equitable Bank, is Canada's second-largest non-prime mortgage underwriter – lending largely to home buyers with weak credit histories, such as recent immigrants or self-employed Canadians.

But Equitable also makes commercial loans and it's a retail bank that offers high-interest savings accounts and guaranteed investment certificates (GICs).

It's a space that has faced some controversy in recent years. Canada's housing market is struggling with tighter lending regulations, sky-high home prices in Toronto and Vancouver, and troubling consumer debt levels.

Add in a slowing economy (the Bank of Canada on Wednesday slashed its outlook for economic growth this year, to 1.2 per cent from 1.7 per cent previously) and it is perhaps no wonder that some high-profile investors, such as portfolio manager Steve Eisman of Big Short fame, are betting against Canadian banks.

But Equitable reported a 14-per-cent increase in single family mortgages in its fourth quarter results, year-over-year, even as overall Canadian mortgage growth slumped to a 17-year low of just 3.1 per cent in December. As well, the bank's provision for credit losses – or money set aside for bad loans – ended the year at a minuscule 0.01 per cent of mortgage principal, which suggests that its subprime niche is holding up well.

Strong levels of immigration help: New Canadians – the federal government's annual target will rise to 350,000 by 2021 – make good mortgage customers and support the housing markets of major cities. So the fact that 66 per cent of Equitable's residential mortgage business is in Ontario (dominated by Toronto) might not be a flaw in the bank's business model.

Equitable Bank may also be benefiting from a rival's recent stumble. Home Capital Group Inc.'s regulatory issues in 2017 sent depositors fleeing their savings accounts and caused a severe drop in the subprime mortgage lender's credibility and share price. Though Home Capital is recovering (and its share price has bounced 29 per cent this year), profitability is still well off its highs.

"Clearly, as others have had to retrench a little bit, we've slowly taken advantage of that and gained position in the marketplace," Andrew Moor, Equitable Group's chief executive officer, said in an interview.

The bank now controls about 35 per cent of the subprime mortgage market, he said.

Its high-interest savings accounts and GICs are also gaining traction: Equitable Group's total deposits increased 23.4 per cent in 2018, as consumers find that higher rates of interest are more attractive than a banking model based on bricks-and-mortar branches (Equitable Bank has none).

This doesn't mean that Equitable Group has its sights set on financial domination. The bank doesn't have anything close to the level of financial services and geographic diversification of the Big Six, which don't dabble in subprime mortgages.

But even if it sticks to a relatively narrow niche, Mr. Moor expects that Equitable Group can continue to find growth opportunities.

One is through open banking – an initiative, now being discussed in Ottawa, that would allow financial data to move seamlessly from one institution to another. If moving money from a high-interest savings account at Equitable Bank to a trading account at a Big Six institution is made easier, then Equitable stands to gain (and retain) more customers.

"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," Mr. Moor said.

In the meantime, the stock looks cheap. After reporting its fourth-quarter results in late February, Equitable Bank told analysts that it sees per-share profit growth of 15 per cent to 17 per cent in 2019. Yet the shares trade at just 6.4 times estimated earnings, according to Bloomberg. The stock also trades at just one times book value, compared with two times book value or more for some of the biggest banks.

Marco Giurleo, an analyst at CIBC World Markets, believes that the stock deserves a higher valuation, given the bank's consistent profitability. If the valuation rises modestly to 1.1 times estimated 2019 book value, the share price, which closed Friday at $73.59, would rally to $92, which is Mr. Giurleo's target.

No, don't ditch your dividend-generating Bix Six bank stocks; Equitable Group's dividend yield is a mere 1.6 per cent. But if you're looking for a nimble player that is tapping into immigration trends and a shift toward online banking – and you can handle the risks associated with Toronto's housing market – Equitable Group looks like a good bet.

https://www.theglobeandmail.com/investing/markets/inside-the-market/article-equitable-group-continues-to-find-growth-opportunities/

© Copyright 2019 The Globe and Mail Inc. All Rights Reserved.globeandmail.com and The Globe and Mail are divisions of The Globe and Mail Inc., The Globe and Mail Centre 351 King Street East, Suite 1600 Toronto, ON M5A 0N19 Phillip Crawley, Publisher