



What Does Bank of Nova Scotia's Expansion in Latin America Mean for Investors?

Description

The **Bank of Nova Scotia** ([TSX: BNS](#))([NYSE: BNS](#)) continues to increase its footprint in Latin America as part of its growth strategy focused on generating revenue and bottom line growth by expanding into emerging markets.

The bank is already the third-largest in Peru and the fifth-largest in Colombia, with the strategy being a crucial plank in creating growth and giving it an edge over the majority of its top five peers — particularly those like the **Royal Bank of Canada** ([TSX: RY](#))([NYSE: RY](#)) and the **Canadian Imperial Bank of Commerce** ([TSX: CM](#))([NYSE: CM](#)), which have chosen to focus primarily on the Canadian market.

Emerging economies offer considerable growth potential

While both have shown strong earnings growth in Canada and hold significant market share, they lack the growth potential of those peers looking offshore for growth opportunities. This includes Bank of Nova Scotia, **Toronto Dominion Bank** ([TSX: TD](#))([NYSE: TD](#)), and **Bank of Montreal** ([TSX: BMO](#))([NYSE: BMO](#)). However, it is Bank of Nova Scotia's growing presence in emerging markets that I believe offers a better risk/reward trade-off than Toronto Dominion's or the Bank of Montreal's expansion into the U.S. This is because unlike the U.S. or Canada, Latin America is heavily under-banked.

In Colombia, Peru, and Chile, three of the countries where Bank of Nova Scotia is focused on growing its presence, domestic credit provided to the private sector by banks represents an average of only 41% of total GDP for those countries, whereas in Canada it is 130% and in the U.S. 184%.

All three of these economies are expected to grow rapidly, at rates greater than the majority of developed economies. For 2014, the GDP of Peru, Colombia, and Chile is forecast to grow by around 5%, which is significantly higher than Canada's 2% and 3% for the U.S. Furthermore, in Peru and Colombia, significant portions of the population do not have a bank account. With increasing wealth and a rapidly growing middle class, the demand for banking products, in particular deposit and

consumer lending products, will grow exponentially.

As a result, these countries offer a range of growth opportunities for banks that are superior to those available in Canada and the U.S.

The acquisition boosts Bank of Nova Scotia's consumer lending portfolio

In a bold move, Bank of Nova Scotia acquired a 51% stake in the financial services business of Chile's largest retailer and Latin America's third-largest retailer, **Cencosud**, for \$280 million. The deal gives it access to Cencosud's credit card customers, allowing it to boost its unsecured consumer lending, as well as giving it another channel to cross-sell other financial products. Cencosud has a significant presence across Latin America, with department and grocery stores as well as a substantial credit card business in Chile, Colombia, Peru, and Brazil.

This acquisition certainly boosts the bank's presence in Latin America. It also ties in nicely with the bank's strategy of growing revenue through increased exposure to the lucrative unsecured lending space and its recent acquisition of a 20% stake in **Canadian Tire's** financial services division.

However, it does expose the bank to a greater degree of risk, with unsecured consumer lending being higher-risk than secured lending such as mortgages. The region, with the exception of Chile, is also well-known for corruption, opaque legal systems, security issues, and somewhat unstable governments, with many jurisdictions perceived to have a high degree of geopolitical risk.

This reflects that the bank has increased its appetite for risk, which caused ratings agency Moody's to [downgrade its outlook](#) for the bank's financial strength to negative.

While countries like Peru and Colombia are perceived to be high-risk, Chile, as the most advanced and stable economy in Latin America, is perceived to be low-risk. In its Corruption Perception Index, Transparency International gave Chile a score of 22, which is the lowest in Latin America and only marginally higher than the score of 19 awarded to the U.S. This indicates that Chile has the lowest level of geopolitical risk in Latin America and is perceived to be only marginally riskier than the U.S.

Another compelling aspect for investing in credit operations in Latin America is the higher margins that are available. The bank is already generating a healthy net interest margin of 4% from international banking, which is double the 2% generated by Canadian banking.

This sees international banking contributing more than a fifth of Bank of Nova Scotia's net income, and this can only grow as result of the Cencosud acquisition. The acquisition is a positive for the bank and its shareholders despite the perceived higher degree of risk. This bodes well for boosting its net interest margin and bottom line, increasing the potential of another dividend hike in the short term.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)
2. TSX:BMO (Bank Of Montreal)
3. TSX:BNS (Bank Of Nova Scotia)

4. TSX:CM (Canadian Imperial Bank of Commerce)
5. TSX:RY (Royal Bank of Canada)
6. TSX:TD (The Toronto-Dominion Bank)

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