3 Reasons to Buy National Bank

Description

The Federal Reserve announced it would end its taper program in October, and today hinted it could raise interest rates starting in the first half of 2015. In Canada, inflation hit 2.3% in May, higher than the threshold that the Bank of Canada sets in its monetary policy.

default watermark

This new economic environment is good news for financial institutions like **National Bank of Canada** (TSX: NA), which generates the majority of its revenues from both lending and financial markets. Here are three reasons why I think you should look into National Bank.

4% dividend yield and a balance sheet to back it up

National Bank offers the highest dividend yield of all the big banks in Canada with a 4.12% yield as of today and is up 11% in the last three years. It speaks highly of the faith management has regarding future profitability considering it's nowhere near the biggest bank. As a comparison, **Bank of Nova Scotia** (TSX: BNS)(NYSE: BNS) gives you only 3.53% while being almost six times bigger.

A look at the balance sheet shows us that National Bank is in good health to keep that dividend high in the coming years. Its current Tier1 common ratio — A Tier1 common ratio or CET1 is a ratio calculated as the equity capital of the bank divided by its entire risk-weighted assets (a fancy word to define all the assets held by the bank weighted by its credit risk) — is at 11.90%. The national average is 11.95%, and **Royal Bank of Canada** (TSX: RY)(NYSE: RY) is at 9.60%. Without getting into much detail what's important to recognize is that the minimum requisite for the CET1 is determined by regulatory entities and the higher it is, the safer.

In the case of a low ratio , a bank will need to either diminish the amount of assets it owns (diminishing its ability to generate profits) or increase its equity capital by issuing additional capital. At 11.90% National Bank is safe to operate without any risk of insufficient capital in the future.

One of the cheapest of its peers

The company is also one of the cheapest of its peers when evaluating it on a price-to-tangible book value per -share. Contrary to industrial or consumer discretionary companies, depository financial institutions should be valued on a price-to-book ratio rather than on a price-to-earnings one. I prefer the price-to-tangible book value per-share because it removes all the goodwill effect and allows me to value the financial institutions for its pure worth. If we look at the average of the big banks in Canada, the price-to-tangible book value is at 2.73 where National Bank is at 2.67 and Royal Bank is at 3.27. A ratio over two is not cheap on an absolute basis, but we have to remember that unlike certain banks in the U.S., Canadian ones are in much better financial health.

Excellent exposure to performing sectors

More than 75% of National Bank's revenues comes from both financial markets, personal and commercial lending business. In an economy where the Federal Reserve is ending its tapering program and looking to increase rates in 2015, the volatility that this will bring will be beneficial for the financial division of National Bank. Rising rates, on the other hand, will help the personal and commercial division make more money along their various loans. It will not be the best for us consumers, but as investors, we want higher rates so that banks can increase their net interest margins and with a return on equity over 20% we can anticipate National Bank's earning power to increase as the volume of loans grows.

Great play for the long term

A Canadian bank is not a growth play; it is a solid foundation for long-term retirement portfolios. Getting a four percent dividend yield reinvested every year is a great way to benefit from compounding interest, and with Canada's pre-disposition to limit the amount of banks in the country we can be rest assured that National Bank's best days are ahead of it.

default watermark

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)
2. NYSE:RY (Royal Bank of Canada)
3. TSX:BNS (Bank Of Nova Scotia)
4. TSX:NA (National Bank of Canada)
5. TSX:RY (Royal Bank of Canada)

Category

1. Investing

Date
2025/07/01
Date Created
2014/07/17
Author
fdenault

default watermark