Why This Canadian Bank Stands Out From the Rest

Description

For the last few decades, shares of Canadian banks have been on an almost uninterrupted rise. Sure, there have been some speed bumps — like the Great Recession, where **Canadian Imperial Bank of Commerce** (TSX: CM)(NYSE: CM) took a big write-off related to Enron in 2005, or like **Toronto Dominion Bank's** (TSX: TD)(NYSE: TD) struggles in 2002 — but for the most part investors have been rewarded. In hindsight, those speed bumps represented a great buying opportunity.

What about today? There are several factors that could hurt the banks. The biggest one is the state of the Canadian housing market, which will hurt every bank if it crashes. Not only that, but it's easy to see how a sustained weakness in housing would push the Canadian economy into a recession, which would further add to the pain.

Because of this concern, Canada's banks are pretty cheap. They trade at reasonable P/E ratios and continue to raise dividends on an annual basis. However, there's one that I like better than all the others, and it's **National Bank** (TSX: NA). Here are three reasons why.

1. It's cheaper

Even after the stock's recent run-up, shares of National Bank are still cheaper than its competitors. Both TD Bank and Canadian Imperial trade at a P/E ratio of 13 times, while National's P/E is less than 12 times. National also trades at less than twice book value, while the rest of the sector is at greater than twice book value. Because of this discount, the company's dividend is better than those of its competitors, coming in at 3.9%.

National Bank has historically traded at a discount, but this won't be the case forever. Investors who buy now and hold for a while can look forward not only to the same return as the overall sector, but also a bit of a bonus if this discount goes away.

2. An upcoming catalyst

Even though National Bank is Canada's sixth-largest bank, it often gets lost in the shuffle. This is partly because the company is purely Canadian, while its competitors have significant assets outside the country.

Eventually, National's management will take steps to remedy this. The most likely move is to make an acquisition in the United States, which has a virtual smorgasbord of small financial institutions to choose from. There are thousands of small banks in the U.S., and chances are the company can find at least one that it likes.

It won't happen overnight, but National will start to trade in line with its competitors when it has a significant amount of its revenue coming from outside of Canada.

3. Rising rates

Eventually, interest rates will start heading higher. That's bad news for the Canadian consumer, but good news for the banks.

As rates rise, interest rate spreads should rise with them. Additionally, higher rates will encourage more people to put money in the bank, attracted to suddenly acceptable GIC rates. Since deposits represent a cheap source of funding, this increases profits from lending, any bank's main business.

Like the rest of the sector, National has done a good job diversifying itself away from being a pure lender. However, lending still represents a huge part of its business, and an even greater percentage than its peers. The company will benefit more than the rest of this sector when rates rise.

Canadian investors would do well to invest in any of Canada's banks. They have good brands, solid balance sheets, and prudent managers. However, National Bank is just a little cheaper, and has a little more growth potential. For those reasons, I'd give it the nod ahead of its competitors.

CATEGORY

1. Investing

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1. NYSE:CM (Canadian Imperial Bank of Commerce)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:CM (Canadian Imperial Bank of Commerce)
4. TSX:NA (National Bank of Canada)
5. TSX:TD (The Toronto-Dominion Bank)

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