2 Reasons to Buy Bank of Nova Scotia

Description

Canada's third-largest bank by assets, **Bank of Nova Scotia** (TSX: BNS)(NYSE: BNS), continues to offer a compelling investment story for investors. Not only is it the only major Canadian bank with solid exposure to high-growth emerging markets — particularly in Latin America — but it also continues to acquire interests in domestic businesses with solid growth potential.

This has seen the ratings agency Moody's express some concerns regarding the bank's increasing appetite for risk. However, given the saturated nature of Canada's financial services market, it provides solid growth opportunities.

1. Acquisitions could result in strong growth potential

Bank of Nova Scotia has already made two accretive acquisitions this year that will boost its growth potential. The first of these acquisitions was the purchase of a 20% stake in **Canadian Tire's** (TSX: CTC.A) financial services business for $500 million.

This acquisition significantly boosts its presence in the unsecured consumer lending space and gives it access to Canadian Tire's 1.8 million active customer accounts. The cross-selling opportunities alone are tremendous and give the bank the opportunity to introduce those customers not only to consumer lending but also to mortgages, wealth management, insurance, and other financial products.

This forms a key part of the bank's strategy of putting credit cards front and centre so as to draw customers into its payments system with a combination of rewards and cash-back products. It also allows Bank of Nova Scotia to more quickly play catch-up with the other large banks, where it has traditionally lagged in the fast-moving, high-margin consumer lending sphere.

However, investors would be advised not to expect the deal to deliver any significant short-term gains to the bank's bottom line. It expected to take some time for the bank's services and products to penetrate Canadian Tire's customer base.

The other significant acquisition was its purchase of a majority interest in the retail credit card business of Chile's largest retailer, **Cencosud** (NYSE: CNCO), for U.S.$280 million. This gives it access to

Cencosud's considerable client base; Cencosud has 2.5 million credit cards with more than U.S.$1.2 billion in Chile, making it the third-largest supplier of credit cards in Chile, which is Latin America's most mature economy.

This gives Bank of Nova Scotia increased exposure to one of Latin America's fastest-growing economies, which is estimated by the World Bank to grow by 4.9% for 2014 and 5% for 2015 — more than double the 2% forecast for Canada.

It also further cements the bank's presence in the region, where it is the third-largest bank in Peru and the fifth-largest in Colombia.

2. Acceptable risk levels despite despite Moody's concerns

Obviously, any increased exposure to unsecured consumer lending is far riskier than secured lending. However, the bank has traditionally taken a conservative approach to risk management, which is why it came through the global financial crisis relatively unscathed.

Its key risk indicators have continually remained well within acceptable levels. It also has one of the lowest impaired loans ratios of Canada's top five banks. This ratio, which is a key measure of risk in a bank's balance sheet, given that loans are key assets for the fiscal second quarter of 2014 (calendar first quarter), was a mere 0.45%.

This is lower than **Toronto Dominion's** 0.48% and **Bank of Montreal's** 0.79%, but it is equal to **Royal Bank of Canada's** ratio and significantly higher than **Canadian Imperial Bank of Commerce's** 0.3%.

The bank is also well capitalized with a Tier 1 Common Capital Ratio of 9.8%, which is well in excess of the regulatory required minimum and superior to many of its peers. This ratio is higher than Toronto Dominion's 9.2%, as well as Royal Bank of Canada's, Bank of Montreal's, and Canadian Imperial Bank of Commerce's 9.7%.

Overall, while both transactions certainly increase the degree of risk in Bank of Nova Scotia's balance sheet, the reward available to the bank and its investors is significant. Not only does it boost the size of its credit card business, but the second acquisition also gives it exposure to one of the fastest-growing and most mature economies in Latin America. It also gives the bank an edge over its remaining top five peers, with each heavily reliant upon the Canadian market to generate the majority of earnings.

Furthermore, because the bank's risk indicators are well within acceptable parameters and because of management's historically conservative approach to risk, I am confident that the bank will appropriately manage risk while maximizing the reward. Barring any catastrophic global economic events, I would expect to see both acquisitions over the medium term start to make significant contributions to the bank's bottom line.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)

2. TSX:BNS (Bank Of Nova Scotia)

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Date
2025/10/02
Date Created
2014/07/30
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