3 Reasons to Buy Toronto-Dominion Bank Instead of National Bank of Canada

Description

National Bank of Canada (TSX: NA) has been one of Canada's top-performing bank stocks – its shares are up roughly 75% in the last five years, outpacing each of the big five. Yet the company still trades at only 11.8 times earnings, a lower number than any of its larger competitors.

So National Bank surely must seem like a winning bet. But there are still reasons to prefer one of the other top banks. On that note, below we take a look at three reasons to prefer **Toronto-Dominion Bank** (TSX: TD)(NYSE: TD) instead.

1. Geography

When looking at National Bank's business mix by geography, there is reason to be worried. Last fiscal year, the province of Quebec accounted for 63% of total revenues, which was actually an increase over the previous year. Granted, Quebec's economy is showing signs of recovery, but we all know how quickly that can change. In fact Qeubec's economy is slated to grow by only 1.8% next year, according to RBC Economics. In any case, National Bank's concentration in one province makes its shares very risky.

Meanwhile, TD is much more diversified by geography. The bank has substantial operations all across Canada, and has an even larger branch network in the United States. Put another way, TD has a presence in many different regions, all of whose economies are driven by different factors. So the bank is not putting all its eggs in one basket, making its shares much less risky.

2. Business mix

If National Bank's geographic concentration isn't enough, the company's business mix also leads to concerns. Last fiscal year, Financial Markets accounted for over a third of net income, far more than at any of the big five. This is a big concern, since Financial Markets (more commonly called Capital Markets) is a very volatile business, with little transparency.

TD, on the other hand, is much more of a retail bank, which is less risky. Last year, Capital Markets accounted for less than 10% of TD's earnings. So shareholders can rest a little easier.

3. Capital

Finally, one cannot forget about capital ratios. According to the most recent quarterly data, National has a Basel III Tier I Common Equity (CET1) ratio of 9.1%. This is an improvement from previous quarters, and is strong by international standards. But it's still lower than any of the big five banks. Given National's concentration by geography and its business mix, this is very concerning.

TD's capital ratio is not particularly strong either, coming in at 9.3%. But this is a lot more forgivable given the bank's lower-risk profile. TD is also known to place higher emphasis on risk management – for example its loan standards are known to be particularly tight.

At this point, it should be clear why National Bank has outperformed. It is a more levered bet on the Canadian economy than the big 5 banks are. And the Canadian economy has performed quite nicely over the past 5 years. But if that changes, National is likely more exposed than any of its larger peers. Your best bet is to steer clear.

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Date
2025/07/23
Date Created
2014/09/25
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