Are Things Really as Bad as they Appear at the Bank of Nova Scotia?

Description

Like the other big 5 Canadian banks, the **Bank of Nova Scotia** (TSX: BNS) (NYSE: BNS) has shown itself to be a very profitable operation. But there are growing concerns among investors about the state of the bank's health.

For instance, the downgrading of Scotia's ratings outlook to negative earlier this year by global credit agencies fueled a touch of unease. Also causing some despair was the bank's recent announcement that it intends to take $451 million in pre-tax charges for its fiscal fourth quarter 2014. Many now feel that the outlook for Canada's third largest lender is weakening.

But this couldn't be further from the truth and as I will show, Scotiabank continues to offer investors the best long-term growth outlook of the big 5.

What do the write downs really mean?

These write-downs represent a clearing of the decks as the bank focuses on consolidating its recent acquisitions in its consumer lending portfolio and international business.

A significant component of these charges relates to the bank writing down the value of a range of impaired loans in its Caribbean business. Like other banks operating in the region, Scotia's operations continue to struggle due to a prolonged economic weakness in the Caribbean and an uncertain outlook.

While this has alarmed investors, there is little cause for concern with less than 1% of its total loans-under-management (LUM) located in the region. This is significantly less than Latin America, which accounts for just over 3% of its LUM and remains one of its bastions of growth.

Another significant portion of the write-downs relates to charges incurred as a result of restructuring its Canadian and international banking divisions. The bank is focused on reducing employee head count and boosting efficiencies to make these businesses more cost effective and boost its bottom-line.

This is an important measure with these divisions combined, generating over half of Scotia's net income. Scotia's not alone in seeking efficiencies on the home front as others too have flagged internal restructures as a key means of boosting margins in a saturated domestic financial services market.

Risk and performance indicators are impressive

The degree of risk associated with Scotiabank remains low, with all of the bank's key risk indicators well within acceptable levels. Most important of these is Scotia's low gross impaired loans as a ratio of LUM which at the end of the fiscal third quarter was a very healthy 0.9%.

It also remains well capitalised with a common equity tier 1 capital ratio of 10.9%. Well above the regulatory minimum and one of the highest ratios among its Canadian peers.

More impressively the bank continues to report an impressive return-on-equity, which for the fiscal third quarter was 20.8% coupled with a return-on-assets of 2.4%. This illustrates the bank is generating an impressive margin from its operations and the assets held on its balance sheet.

Appears attractively priced

After a recent pullback, Scotia is trading with an attractive valuation of 1.9 times book value. This is lower than the price-to-book ratios of its big five peers with the exception of the **Bank of Montreal** (TSX: BMO) (NYSE: BMO), which is trading with a share price of 1.7 times its book value per share.

When its solid footprint in the rapidly growing emerging economies of Latin America is considered in conjunction with recent acquisitions which bulked up its consumer lending business, the bank is well positioned for further growth.

More importantly with it receiving nearly a quarter of its net income from outside of Canada, it is less reliant upon the domestic economy for bottom-line growth. When considered in conjunction with the implementation of these cost saving measures and management willingness to clear the decks, I believe the recent share price weakness offers a solid opportunity for long-term investors.

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