Bank of Nova Scotia vs. National Bank of Canada: Which Should You Own?

Description

Over the last century, Canada's banks have been as dependable as investments can get.

Think of all the issues they've had to deal with. There have been two world wars, the Great Depression, hyperinflation, interest rates approaching 20%, the financial crisis of 2008-09, and countless company-specific blowups. And yet, through all that, these titans of Canadian business have not only survived, but prospered, raising dividends on an annual basis pretty consistently.

But which should you choose to put in your portfolio? My recommendation is relatively simple. Buy the bank that is the cheapest and hold it over the long term. Of course, figuring out which one is the cheapest isn't so cut and dry. What do we use as the definer of cheap? Is it the P/E ratio? Or is it the stock's performance over the last five years? Those both seem like reasonable metrics, so let's go with them.

The cheapest bank on the TSX from a P/E perspective is **National Bank of Canada** (TSX:NA), which only trades at 10.9 times earnings. The worst performer has been **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS). Let's take a closer look at these two financials.

The business

One of the knocks against National Bank has been its lack of foreign exposure. Every other major Canadian bank has expanded outside of Canada's borders, but National remains committed to home. As the smallest of the group, there is even potential for the company to expand in Canada, since it still has a relatively strong concentration in Quebec.

Bank of Nova Scotia has a good Canadian banking business spread across the country. It's in the middle of the pack when it comes to mortgages, deposits, wealth management, and credit cards. The company also has significant operations in Latin America and Asia, with 65% of its most recent yearly income coming from outside of Canada. That's good news if the Canadian dollar continues to depreciate.

Dividends

Both companies pay rock solid dividends of more than 4%, and both have offered consistent growth.

Starting with Bank of Nova Scotia, we have a company that currently pays a 4.2% dividend, and announced yet another dividend increase when it released earnings last week. Since 2010, the company has increased its quarterly payout from $0.49 per share to $0.68 per share, a growth rate of approximately 7%.

National Bank also yields 4.2%, recently raising its dividend in the fourth quarter of 2014. Since 2010, it has increased its quarterly payout from $0.31 per share to $0.50 currently, which is a growth rate of 10% compounded annually. National Bank also boasts a better payout ratio, spending 46% of its net income on dividends, compared to 49% for Bank of Nova Scotia.

Housing exposure

Many analysts say Canada's housing market is in a bubble. Which of these companies would fare the best if there was a sustained nationwide decline in real estate prices?

Neither would do very well, but I'd say Bank of Nova Scotia would likely be the worse performer. National Bank doesn't have near the exposure to overheated markets as Bank of Nova Scotia does. Thanks to its acquisition of ING, Bank of Nova Scotia had a 15% market share of Canada's mortgages in 2014, while National Bank had just 3%, most of which were concentrated in Quebec.

Every bank will decline if Canada's housing market collapses, but National should weather the storm better than most.

Which do I prefer?

I think both banks are reasonably valued at today's levels. But if I were to choose one, it would be National Bank. The company has great dividend growth and trades at the cheapest valuation of its peers. Plus, it's been one of the best performers in the sector of late. Eventually, investors will start valuing the company in line with its peers, which should provide a little additional upside.

CATEGORY

1. Bank Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

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

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