Dispelling 2 Myths About the Bank of Nova Scotia

Description

The sharp collapse in oil prices, a slowing Canadian economy, and fears that Canada's frothy housing market is heading for a meltdown has left investors concerned about the outlook for the **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS).

However, despite this negative outlook I believe that it offers investors one of the best long-term growth opportunities among Canada's banks, and is less risky than some pundits believe.

Now what?

If we take a closer look at the two main risks the bank is facing, it is easy to see just how overblown this negative perception has become.

Firstly, the Bank of Nova Scotia continues to garner negative headlines concerning its exposure to the energy patch because of the collapse in oil prices.

It has almost $16 billion in loans outstanding to the energy patch, and this has caught the eye of analysts and investors as oil companies continue to struggle financially in the current harsh operating environment. On face value, this seems like a big number, but when we consider that it has loans under management of $453 billion, this is just a drop in the ocean because it represents a mere 3% of its total loans. It is also far less than the exposure the Bank of Nova Scotia has to a number of other industries, including retail and real estate.

More tellingly, just under 2% of its total impaired loans are located in the oil industry. This is far lower than many other industries in its lending portfolio, with utilities, retail and real estate being the top three contributors to its impaired loans.

Clearly, its exposure to the energy patch, while worrying, is neither as significant nor as detrimental as it first appears.

Secondly, any significant cooling of Canada’s overly frothy housing market will have a marked impact on the Big Five Banks, including the Bank of Nova Scotia.

This is because the housing boom and ever-higher house prices have been a boon for the banks and a key driver of their relentless earnings growth in recent years. In the case of the Bank of Nova Scotia, residential mortgages make up almost half of its total loans, and of these, just over 80% are located in Canada. As a result, its Canadian banking business delivers almost half of its net income.

However, unlike many of its peers that are focused predominantly on the domestic market, like **Royal Bank of Canada**, **Canadian Imperial Bank of Commerce,** and the **Bank of Montreal**, it is able to mitigate this risk because of its solid international banking footprint. Bank of Nova Scotia operates in over 55 countries globally, with a substantial presence in the fast-growing and under-banked economies of Latin America, including Mexico, Chile, Colombia, and Peru.

Even after factoring in strikingly lower commodity prices and the impact this is having on those economies, it is expected that their 2015 GDP will expand at a far greater rate than Canada’s. This creates considerable growth opportunities that will allow the Bank of Nova Scotia to offset any dip in growth caused by a weaker Canadian economy and cooler housing market.

So what?

While investors are right to be concerned with a range of headwinds set to impact the performance of Canada’s banks, I believe this concern is overblown in the case of the Bank of Nova Scotia. It still offers considerable growth prospects that will unlock value for investors for some time to come.

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