



3 Reasons to Invest in National Bank of Canada Over the Big 5

Description

Canada has one of the best banking systems in the world, dominated by five large banks. **Canadian Imperial Bank of Commerce, Royal Bank of Canada, Bank of Montreal, Bank of Nova Scotia, and Toronto-Dominion Bank** collectively command about 80% of market share. Naturally, these five huge financial institutions dominate news headlines and investor attention.

But there are other great financial companies in Canada. Some are large, diversified banks akin to one of the Big Five, just with a smaller asset base. Others dominate a niche that the big banks have chosen to ignore. Examples of this might be unsecured loans at elevated interest rates or specialized forms of mortgage lending.

There's an easy case to be made for buying one of these financial companies instead of their more established peers. They will sometimes trade at a lower valuation, even though they have better growth profiles. They often pay dividends that are even more generous than the 4%+ yields offered by the Big Five. And they dominate a certain market or niche, making it difficult for a competitor to take away market share.

With that in mind, let's take a look at why **National Bank of Canada** ([TSX:NA](#)) could potentially end up being a better investment than any of the Big Five.

Valuation

Canada's banks haven't been immune from the recent market sell-off. Thanks to this, the whole sector is trading at a very reasonable valuation.

National Bank is the cheapest stock in a cheap sector. It trades at just 9.4 times trailing earnings, while the rest of the sector trades between 10 and 13 times earnings. Next year, the company is projected to earn \$4.88 per share, putting it at just 8.7 times forward earnings. That's one of the cheapest forward P/E ratios in Canada.

If U.S. interest rates creep up, there's a good chance Canadian rates could rise in sympathy, even if the Bank of Canada sits on its hands. Higher interest rates would be very good news for a company

like National Bank that gets much of its revenue from lending out money.

Niche business

National Bank is Quebec's largest financial institution, with a notable presence in Ontario and the Maritimes. It barely has any exposure to anywhere west of Ontario.

This offers a couple of advantages for investors. Because National Bank is a focused play on the eastern part of the country, it means that the bank has very little exposure to Alberta and the weakness the oil-rich province is experiencing. That kind of pure play is also easier to analyze and value.

There's also potential for growth. As far as I can tell, the reason why National Bank trades at such a low valuation compared with its peers is because it has no foreign exposure. If it made an acquisition in the U.S., I suspect it would slowly return to trading at the same P/E ratio as its peers.

Finally, there's the potential for it to even expand here at home. A perfect acquisition target would be beaten-up **Canadian Western Bank**. It's small enough that National Bank could swallow it up, and there's no geographic overlap.

Great dividend

It isn't often you can find a dividend-growth stock with a yield of close to 5%, but National Bank offers just that. The current yield is 4.92%.

Since the company was forced to pause dividend growth during the Great Recession, it's been a great stock for investors looking for steady income increases. At the beginning of 2010, the quarterly payout was just \$0.31 per share, growing to \$0.52 per share right now. That's an increase of 60% in just over five years.

There's potential for the dividend to continue increasing, too. The company pays out less than 50% of its net income in dividends. Even if it has a couple of years where earnings don't increase, it can still afford to up the dividend without getting close to paying out 100% of earnings.

National Bank might be the best value in the financial sector today. Combine that with the generous dividend and the potential for growth, and there's a very easy argument to be made for buying it instead of Canada's other banks.

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