



## Why National Bank of Canada Fell 5% on Friday. Is it a Buy?

### Description

**National Bank of Canada** ([TSX:NA](#)) is Canada's sixth-largest bank. Canadian banks are normally pretty stable investments, yet on Friday, October 2nd, National Bank of Canada had a big move. It fell over 5%. There are three factors that contributed to the bank's drop, which were outlined in the bank's October 1st press release.

### Common share dilution

First, the bank announced a common share offer of \$300 million, equating to 7.16 million shares at \$41.9 per share. The purpose of this is to strengthen its capital base.

Originally, National Bank of Canada had about 333 million outstanding shares. With the addition of 7.16 million shares, original shareholders' stakes in the business are diluted by 2.1%. The expected closing date of the share offering is around October 9, 2015.

### Restructuring costs

Second, the bank is transforming the business to meet the changing needs of customers and to achieve greater operational efficiency. So, National Bank of Canada expects to take restructuring charges of roughly \$85 million in the fourth quarter. It equates to \$64 million after tax, or 19 cents per share. The bank expects to save an ongoing pre-tax cost of \$35 million from this restructuring initiative.

As a result of this restructuring, a few hundred employees will be affected.

### Potentially substantial investment loss

Third, National Bank of Canada holds a 24.9% equity interest in Maple Financial Group Inc.'s subsidiary, Maple Bank GmbH.

National Bank of Canada stated in the press release, "[Maple Bank GmbH] is subject to an investigation by German prosecutors regarding alleged tax irregularities for taxation years 2006-2010... Given the seriousness of the reported allegations and the actions which may be taken by

German regulatory authorities to address risks as to the continued viability of Maple Bank GmbH, National Bank considers its investment at risk of substantial loss. National Bank's investment in Maple Financial Group Inc. had a carrying value of \$165 million as of August 31, 2015."

## Valuation

The bank's shares are trading at a multiple of roughly 8.7 at \$40.9 per share. In the past, it had normally traded around a multiple of 10.5. That multiple implies shares should be worth around \$47 based on 2014's earnings. With the share dilution, the shares should be worth around \$46 based on 2014's earnings.

## Recent dividend history

The bank last raised its dividend in June at an annualized rate of 8.3%. From 2010 to the present, the bank's dividend has grown at an annualized rate of 10.9%. The juicy 5.1% yield is compelling.

## Conclusion: should Foolish investors buy today?

Sometimes, businesses offer common shares to raise capital. It's the normal course of doing business. Restructuring is a good thing for the business and shareholders, if it reduces costs and improves efficiency.

On October 2nd, one of the directors bought \$41,900 worth of shares at \$41.9 per share. However, no one knows the extent of the damage of the Maple Financial Group investment. Even the bank is only able to say it is "at risk of substantial loss" at this point. As a result, the cautious investor should wait for the extent of the damage to be clear before buying National Bank of Canada.

Still, the bank has done well historically. Before the financial crisis in 2007, the bank's earnings per share was \$2.83 per share, and it achieved \$4.48 per share by 2014. This equates to 6.8% annualized growth over the seven years.

Further, the bank is trading roughly at an 11% discount, without including the investment damage. So, the long-term investor could buy a small position in the bank at this point if they believe in the management's ability to lead the company like it has in the past. Then wait until the Maple Financial Group issue clears up before deciding on the next step.

If investors want to avoid the three issues outlined altogether, consider investing in **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)), Canada's third-largest bank, that has a similar yield of 4.9%. Both banks just paid out their quarterly dividend. So, if you buy now, in the first year you'd get a yield of 3.8% from National Bank of Canada and 3.7% from Bank of Nova Scotia.

## CATEGORY

1. Bank Stocks
2. Investing

## 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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