



Investors: Should National Bank of Canada Be Your Top Bank Pick?

Description

There's a lot to like about Canada's banks, even if the economy is somewhat tepid right now.

Perhaps the biggest reason is limited competition in the sector. Six financial institutions dominate Canada's banking landscape, commanding more than 80% of the market share. And while certain banks might have slight advantages in certain areas of the market—like in the mortgage or consumer-lending space, for instance—the fact is the average consumer can't really notice a difference.

If one bank doesn't have a distinct competitive advantage over its peers, then there's little threat of customers fleeing to a competitor en masse. Thus, the biggest risks to Canada's banks isn't competition; it's a systematic risk that affects each bank equally, like the Canadian housing bubble.

From my perspective, that leaves just a few questions investors need to ask themselves when looking at a Canadian bank stock. The matter of valuation is always important, and so is the potential for growth. Additionally, investors should take a look at a bank's operating area and see if the majority of its loans are in a geographical location that is risky. **Canadian Western Bank** and its exposure to Alberta is an example of that.

After taking a look at those questions, it's obvious which bank is the best suited for Canadian value investors today. Let's take a closer look at why **National Bank of Canada** ([TSX:NA](#)) continues to be my top pick in the sector.

It's the cheapest

I think it's really tough for a bank doing billions of dollars in loans to be really careful underwriting. And as bull markets stretch on, the lending criteria tends to get a little looser. This means I'm extremely skeptical when a bank tries to tell investors they've reinvented the world of underwriting.

Thus, if I think operations at Canada's banks are mostly the same, I should really only be concerned with valuation. And from that perspective, National Bank is by far the cheapest in its sector.

To keep it simple, let's look at three different valuation tools: the dividend yield, the price-to-earnings

ratio, and the price-to-book ratio.

National Bank's dividend is the highest of all its peers, coming in at 4.8%. The next highest is **Canadian Imperial Bank of Commerce** ([TSX:CM](#))([NYSE:CM](#)), which has a dividend yield of 4.5%. That 0.3% might not seem like much, but for every \$10,000 invested, it translates into \$30 per year in extra income.

National Bank's P/E ratio is also the lowest among its peers, coming in at just 9.6. The next lowest is also from CIBC, which has a P/E ratio of right around 11. National's discount is approximately 10% compared with the next cheapest peer and about 15-20% compared with the average of its peers.

Finally, the company's price-to-book ratio is 1.4. It should come to no surprise that this number is also lower than its peers. The rest of the sector trades at between 1.5 and 1.7 times book value.

Not only is National Bank cheaper than its competitors, but it has a potential upcoming catalyst that could help it bridge the valuation gap.

Getting bigger

Although National Bank is no slouch in terms of size—it does boast more than \$250 billion in assets, after all—management needs to expand the bank's footprint.

Right now, National is huge in Quebec and has sizable operations in Ontario and Atlantic Canada. But west of the Ontario border, it barely exists. The company also has very little international exposure.

It's obvious what the company needs to do to counter this. Management needs to make an acquisition to beef up its presence either in the west or internationally. Canadian Western Bank would be a logical choice; so would some of the many regional banks down south. Remember, many of National Bank's competitors got their international start by doing the same thing.

National Bank is a great value, that much is obvious. With one big move by management, the stock could shrink the valuation gap between it and its peers. And while investors wait for that to happen, they're paid nearly 5% annually. It's for these reasons that National Bank is my top pick in Canada's financial sector.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:CM (Canadian Imperial Bank of Commerce)
2. TSX:CM (Canadian Imperial Bank of Commerce)
3. TSX:NA (National Bank of Canada)

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