



It's Time to Be Greedy With National Bank of Canada

Description

Sometimes, investing opportunities come along that almost seem too good to be true.

Take **National Bank of Canada** ([TSX:NA](#)), Canada's sixth-largest financial institution. Even though the company has a demonstrated history of market-beating returns—including reinvested dividends, the stock has gone up 14.6% annually over the last 20 years—investors just aren't giving the company any respect.

Currently, shares trade at just 9.3 times trailing earnings, which is insanely cheap in today's low interest rate world. It also boasts a 5.2% yield after its latest dividend hike. Investors have bid up other blue-chip stocks to valuations of between 15 and 20 times earnings and dividend yields of 2-3%, so what gives with National Bank? Why is it so cheap?

There are a couple of reasons. Firstly, investors are nervous about Canada's financials. Low interest rates look here to stay, which doesn't help margins in the lending business. And many market participants think the banks will get caught in a storm of energy company defaults in 2016. Continued weakness in energy could push Alberta's already fragile housing market to the brink, bringing down other healthier parts of the country with it.

But so far, we're seeing nothing of the sort. National Bank just released earnings that were an improvement over last year's numbers. Net profit came in at \$0.95 per share for the quarter compared to \$0.91 per share in 2014. Other metrics such as return on equity also showed improvement.

Analysts think 2016 will be a good year as well. They collectively predict the company will earn \$4.76 per share in 2016 with that increasing to \$5.02 per share in 2017. That puts the company at just 8.8 and 8.4 times forward earnings, respectively.

No matter how you slice it, National Bank is cheap. It's always been a little cheaper than its peers, but that hasn't hampered returns. And study after study proves that investors who buy cheap stocks end up doing better than investors who buy their more expensive peers.

This got me thinking. When was the last time National Bank traded under 10 times earnings? Did it end

up being a good time to buy the stock?

Looking back

Excluding special items, this is what National Bank's per-share annual earnings have looked like over the past five years.

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| 2011 | \$3.63 |
| 2012 | \$3.93 |
| 2013 | \$4.31 |
| 2014 | \$4.32 |
| 2015 | \$4.51 |

The last time National Bank shares traded below 10 times earnings was the mid-point of 2013. The company earned \$3.93 the previous year, and shares fell below the \$40 mark for most of the first half of the year (these are all split-adjusted numbers). Investors would have picked up shares at \$37.33, which would have been exactly 9.5 times the previous year's earnings.

It wouldn't have taken long to profit from the investment. Shares rocketed up to \$45 each by the end of the year, eventually hitting \$54 by the end of 2014. With shares currently at under \$42 each, most of the gain has been given back, but they're still up more than 20% including dividends, crushing the TSX Composite Index, which is only up 6.5% in the same time.

And if an investor would have gotten lucky enough to sell near the peak, they would have booked capital gains of nearly 40% in about 18 months.

Don't overthink it

There are reasons to be bearish on National Bank right now. Rates are low. Canadian housing is inflated. And National Bank has no exposure anywhere but Canada. These are all legitimate concerns.

But at the same time, these factors are clearly priced into the stock, and then some. The fact is that you're not going to get the opportunity to buy a stock trading so cheaply without a few warts. As long as those issues are manageable, I say it's an opportunity to be seized, not avoided.

Canada's whole banking sector looks cheap. Take advantage of the sale by buying the cheapest of them all, National Bank. I doubt you'll be disappointed with the performance over the long haul.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

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1. Editor's Choice

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1. TSX:NA (National Bank of Canada)

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Date

2025/07/08

Date Created

2015/12/11

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