Dividend Investors: Should You Buy Bank of Nova Scotia or National Bank of Canada?

Description

The market pullback is making things interesting for dividend investors, especially in the banking sector.

Bank of Nova Scotia (TSX:BNS)(NYSE:BNS) and **National Bank of Canada** (TSX:NA) both offer a yield that exceeds 5%. Let's take a look at the two banks to see if one is a better investment right now.

Bank of Nova Scotia

Bank of Nova Scotia is Canada's most international bank, with full-service operations in more than 30 countries and a core focus on Latin America. The bank has spent more than $7 billion in the past five years to build a strong presence in the region.

Fiscal Q4 2015 net income came in at a solid $1.843 billion, up 8% compared with the same period last year. Diluted earnings per share rose 10% to $1.45.

The bank's international operations have gone through some growing pains, and that has held the stock back in recent years, but a massive restructuring program launched in late 2014 is beginning to bear fruit. Adjusted net income from international banking rose 33% in Q4, driven by strong growth in deposits and loans.

Bank of Nova Scotia pays a quarterly dividend of $0.70 per share that yields 5%. The payout ratio is 48%.

The bank has a drawn oil and gas exposure of $16.5 billion, which represents about 3.5% of the total loan book. This is higher than the other big banks and a reason why Bank of Nova Scotia's shares have underperformed. The exposure is manageable, but investors shouldn't completely blow it off. As of October 31 the bank also had $14.3 billion in undrawn commitments to the energy sector.

Bank of Nova Scotia trades at 9.8 times trailing earnings.

National Bank of Canada

National Bank of Canada had a rough go in last half of 2015, and the difficulties might continue.

The stock took a big hit on the announcement of heavy layoffs and the potential write down of a $160 million investment in Maple Financial Group, a privately owned Canadian company with a German subsidiary that has run into trouble with German tax authorities.

Maple Financial represents less than 1% of National Bank's earnings, so the impact is negligible to the bottom line, but National Bank of Canada also had to issue $300 million in new stock to shore up its capital position.

Despite the difficult times, National Bank delivered decent fiscal Q4 2015 net income of $347 million, 5% higher than the same period in 2014. Diluted earnings per share were $0.95, up from $0.91.

National Bank of Canada is trading at 8.8 times trailing earnings and pays a quarterly dividend of $0.54 per share that yields about 5.4%. The payout ratio is 45%.

Which should you buy?

The diversification of its revenue stream makes Bank of Nova Scotia more attractive. It is also much larger than its peer, which positions it better to ride out current and future challenges.

National Bank of Canada is a bit cheaper and offers a slightly higher yield, but the stock is heavily exposed to the weak Canadian economy, and competition is a concern moving forward.

All of the banks are facing threats from non-bank mobile players, and winning the battle is going to require heavy investments in new technology. National Bank of Canada might simply be too small to win the fight over the long term.

The dividend should be safe at both companies, but Bank of Nova Scotia is probably the better pick for long-term investors.

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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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