



Bank of Nova Scotia: A 4.2% Yield Plus so Much More

Description

Many investors struggle when choosing a Canadian bank stock.

Most realize the pros of having exposure to the sector. Canada's banks have been terrific performers over the years, delivering outstanding capital gains combined with fantastic payouts and dividend growth. They've all leveraged this success into diverse international operations.

The problem is there just isn't much of a difference between Canada's banks. They all have a great business here at home. They're all diversified internationally. They all have close to the same dividend, and they've all done about the same over the last decade. If these investments all look very similar, how is an investor able to choose between them?

Here's the case for choosing **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) over its peers.

International operations

Most of Canada's banks have followed a predictable growth pattern. They gain a strong foothold in Canada, and then turn their attention to the United States.

Bank of Nova Scotia has done things a little differently. It expanded into Central and South America with operations in Colombia, Chile, Mexico, and Peru, among others. Earnings from these countries continue to grow at a much faster pace than from Canada with net income increasing from \$1.08 billion in 2010 to \$1.85 billion in 2015.

Growth from the region should continue to outpace Canada going forward. As the citizens of these countries get richer, they'll increasingly need access to banking services. Such an opportunity doesn't exist in Canada; everybody has access to banking here.

Mortgage lending

The federal government passed a series of changes last week designed to make qualifying for a mortgage more difficult.

That might be bad news for a prospective buyer looking to get into expensive markets like Vancouver or Toronto, but it's good news for Canada's largest lenders. As one of the largest lenders in the mortgage broker market, Bank of Nova Scotia is nicely positioned to benefit.

It works something like this.

The new rules will make it more difficult for non-deposit-taking banks to issue conventional mortgages—loans with a down payment of 20% or more. This opens up the opportunity for Canada's largest banks to steal some of that business.

Mortgage brokers know this better than anyone. Because these folks are primarily interested in the path of least resistance, they'll start sending more of these types of loans to Bank of Nova Scotia, one of the major players in the broker channel. This should provide at least a short-term boost.

Financials

When oil was really hurting, many investors were taking it out on Bank of Nova Scotia. It has approximately 3.4% of its loan book exposed to the commodity, not counting loans to individuals employed in the sector. That weighting is bigger than any of its peers and remains a risk that investors should keep in the back of their minds.

The company's exposure to Canada's housing market is manageable. Approximately 59% of loans are secured by default insurance, and the average loan-to-value ratio of the remainder of the portfolio is 50%.

Over the last 12 months, Bank of Nova Scotia earned \$5.65 per share, putting the company at just over 12 times trailing earnings. The bottom line is projected to improve to \$5.93 per share for 2016 and \$6.31 per share for 2017, putting shares at 11.7 and 11.1 times forward earnings, respectively. That's a very reasonable valuation.

This earnings growth should bode well for the dividend. The current payout ratio is 51%, right where the company wants it. With earnings growth slated to be in the 10-12% range, investors can probably expect the dividend to increase close to that amount in 2017, likely starting with a hike after this quarter is complete.

The bottom line

Bank of Nova Scotia has it all. It has sharp people in charge, manageable exposure to housing, dividend growth, and much more. It also has those international operations, which will likely look better and better as time goes on.

Bank of Nova Scotia has made investors rich over the last few decades. It looks poised to continue doing so for the next few.

CATEGORY

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1. NYSE:BNS (The Bank of Nova Scotia)
2. TSX:BNS (Bank Of Nova Scotia)

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Author

nelsonpsmith

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