



3 Simple Reasons Investors Should Buy National Bank of Canada

Description

Investing can be incredibly complicated—if we allow it to be.

Every time I want to be humbled, I crack open one of the finance books I own, which is nothing more than a textbook for advanced studies. That lasts for about five minutes before I'm confronted with some sort of formula that uses Greek letters.

I truly believe investing doesn't have to be hard. Billionaire Warren Buffett said it best when he said, "I don't look to jump over seven-foot bars. I look around for one-foot bars that I can step over." In other words, it's better to wait for a very obvious opportunity than to use all of your analytical skills to identify a sub-par one.

I think **National Bank of Canada** ([TSX:NA](#)) represents such an opportunity today. Here are three simple reasons why.

Valuation

National Bank is the cheapest of the big Canadian banks on a number of metrics.

Let's just focus on two that I think are the most important: the price-to-earnings ratio and the dividend yield.

At first glance, it doesn't really appear National Bank is that cheap. Google Finance says it trades at nearly 14 times trailing earnings, which is higher than all of its peers.

But that number is skewed from a one-time write-off in its investment in Maple Bank. If we exclude that, National Bank trades at under 10 times earnings. And, according to analyst estimates for 2017, shares trade at just 9.5 times forward earnings. You won't find many stocks that cheap in today's market.

Then we come to the dividend yield, which I believe is a reasonable representation of value. National Bank currently yields 4.6%, which is only beat by one peer: **Canadian Imperial Bank of Commerce** and its 4.8% yield.

National Bank also delivers superb dividend growth. Five years ago, it paid a quarterly dividend of 37.5 cents per share. These days, the payout is 55 cents per quarter. That's growth of approximately 8% per year. It also has a payout ratio of about 50%, which is quite reasonable.

Growth potential

National Bank has investment banking operations in the U.S. and owns a smattering of retail banking assets in obscure places like the Ivory Coast, Mauritius, and Cambodia. It also owns a minority stake in a bank in Mongolia.

Investors like the international diversification. They just wish the company would be more serious about it. In total, investments outside the U.S. are worth less than \$400 million. National Bank has a market cap of \$16.25 billion. In other words, they don't really matter.

That doesn't mean the company isn't looking, however. It's pursuing a much bigger acquisition in a developing market somewhere. Management is just being patient, making sure they don't pay too much for assets.

Underperformance

I know an investor who has a simple way of choosing bank stocks. He loads up on the one or two that underperformed the market during the last five-year cycle.

During the five years from 2006 to 2011, **Royal Bank of Canada** did relatively poorly, especially during 2011. So he bought it. It's rallied nicely since, increasing close to 90%. Once we include dividends, it's a great investment.

National Bank has lagged its peers over the last five years as investors continue to be nervous about its Canadian-focused operations. If we follow the rule, today would be a good time to buy.

Buying a company with a large dividend is one way of buying something undervalued; so is buying the laggard of a group. I'm a big believer in reversion to the mean.

The bottom line

Investing doesn't need to be hard. All investors need are a few compelling reasons to buy. National Bank is cheaper than peers on a number of metrics. It continues to deliver solid results here in Canada. And it has great international growth potential. All of these simple reasons combine to make a very interesting investment thesis.

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1. Bank Stocks
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3. Investing

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1. TSX:NA (National Bank of Canada)

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