



## Why Did Bank of Nova Scotia Fall After an In-Line Quarter and a Dividend Hike?

### Description

On February 28, **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) reported an impressive first quarter (Q1) 2017; the bank increased revenues and profitability and met analyst expectations. It even increased the dividend, but shares still fell 2.79% from the previous close of \$79.25 to \$77.04 during the day.

Why?

For a start, the bank reported diluted earnings per share of \$1.57, which is up almost 10% from a year ago, surpassing analyst expectations by a penny. Net interest income rose by 3.5% year and non-interest income was 13% higher. Even the return on equity at 14.3% was slightly higher than what it was a year ago.

The quarterly dividend was hiked 3% to \$0.76 per share. A dividend increase is a sign that management is highly confident of future financial performance and is almost sure to maintain paying the higher dividend “forever” since any attempt to cut the dividend sends the negative signal that the financial future looks troublesome and could lead to a fall in the stock price.

It is normally expected that when a listed entity reports such positive performance and even hikes its dividend, the stock market would reward it by pushing the stock price higher. However, this was not the case for Bank of Nova Scotia. The reason behind the tanking stock price after reporting a seemingly great financial quarter could be intriguing.

### Could it be mere profit taking?

Bank of Nova Scotia shares have had a good run since November 2016 from the \$70 mark to a high of around \$82 on February 21, 2017. The stock was also up nearly 50% from its February 2016 trading range. It is therefore possible that investors have been taking some nice profits since February 23, but why now?

### Loan book growth rate could be under pressure

A large portion of the bank's lending portfolio is comprised of residential mortgages and consumer loans. As of January 31, 2017, these loans amounted to \$322 billion. There was no change from October 31, 2016. The loan book only changed in composition from \$242 billion in real estate secured loans in October 2016 to \$243 billion by January 31, 2017. With the persistent low interest rate environment and low margins, only low single-digit net interest earnings growth can be expected going forward.

### **Fears of increased earnings volatility**

Investors could be worried that the reported stellar performance may not be repeatable in the very near future. The bank's core banking margin was 2.40% — up just two basis points year over year. However, it was fee income from higher banking, underwriting, trading revenues, and wealth management fees that provided much of the boost.

This is a very problematic situation as trading revenues and banking fees are not very reliable sources of sustainable earnings growth. They can be volatile in nature. In Bank of Nova Scotia's case, growth may just have been a function of the United States election euphoria which may not be repeated in the coming quarters.

### **Investor takeaway**

Bank of Nova Scotia is a well-managed international financial services provider with a cost-cutting program that is already yielding fruit, as \$90 million in cost savings has already been realized in the last quarter. Profitability has improved the bank's capitalization, making it stronger. Better still, the bank has reported an increase in core deposits in retail savings and chequing deposits — the cheapest source of bank funding.

Bank of Nova Scotia's future profitability still looks great. It may be advisable to buy the current dip.

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