



These 2 Canadian Banks Offer the Most Growth Potential

Description

Most investors feel their money is safe with the Canadian banks. The Canadian banks have a long-standing history of being conservatively run while offering consistent dividend increases for income investors. However, some investors may be overlooking two hidden gems within the sector: **National Bank of Canada** ([TSX:NA](#)) and **Canadian Western Bank** ([TSX:CWB](#)).

National Bank and Canadian Western Bank have the distinct advantage of being much smaller than the “Big Five” Canadian banks. National Bank is currently valued at \$18.1 billion, and Canadian Western Bank is valued at just \$2.3 billion. This pales in comparison to the larger Canadian banks, of which **Canadian Imperial Bank of Commerce** ([TSX:CM](#))([NYSE:CM](#)) is the next smallest at \$43.4 billion — more than twice the size of National Bank and nearly 20 times the size of Canadian Western Bank.

The “small size” advantage can work to these banks’ favour in a number of ways. The smaller size of these companies allows them to grow faster than the larger banks. While the bigger banks may present as more conservative investments, the counter is that they offer less growth. The largest bank, **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)) grew its top line by 2% last quarter compared to nearly 27% growth for National Bank and 11% top-line growth for Canadian Western Bank.

Due to their smaller stature, it’s easier for National Bank and Canadian Western Bank to grow sustainably at a faster rate than the big banks. Simply due to the “law of large numbers,” when Royal Bank increases its deposit book by \$100 million, it equates to 13% growth; however, if National Bank were to grow deposits by an equal amount, it would mean a nearly doubling the size of its deposits. One should expect that the market will certainly pay a premium for this type of growth.

Due to their size and smaller role in the Canadian economy, National Bank and Canadian Western Bank are still considered viable takeover targets. While federal anti-trust regulators would almost certainly block a merger or acquisition involving the Big Five banks, it has long been rumoured that this would not be the case when it comes to National Bank and Canadian Western Bank, be it by one of their Canadian counterparts or potentially even a U.S. or international lender.

From a valuation perspective, National Bank and Canadian Western Bank are priced similarly today. Both are trading at forward price-to-earnings multiples of less than 10 times. Canadian Western Bank trades at a lower price-to-book ratio than National Bank, but it also generated lower returns on equity, which could provide a partial explanation for this discrepancy.

Both banks pay a healthy dividend; National Bank yields 4.14% at a payout ratio of 55%, while Canadian Western Bank yields 3.56% with a 45% payout ratio. The outlook for both companies is positive as well with analysts calling for sales growth of over 10% cumulatively for National Bank over the next two years, and even slightly better growth for Canadian Western bank over the same period.

Should you buy?

Both National Bank and Canadian Western Bank appear to be compelling investments for inclusion in a dividend-growth portfolio. These two banks should expect to benefit from the “small size premium” and should outpace the performance of their larger, more established peers, not to mention the fact that they both present very viable takeover candidates for the right party at the right time.

CATEGORY

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