Contrarian Investors: Is It Time to Buy Bank of Nova Scotia?

Description

The Canadian banks rarely go on sale, but **Bank of Nova Scotia** (TSX:BNS) (NYSE:BNS) has pulled back to the point where the stock is starting to be an interesting candidate for a value pick.

Let's take look at the current situation to see if Bank of Nova Scotia deserves to be on your buy list today.

International operations

Bank of Nova Scotia has invested billions over the past decade or so to build a large international business, with the bulk of the focus being on Mexico, Peru, Chile, and Colombia. These four countries represent the core of the Pacific Alliance, which is a trade bloc set up to promote the free movement of goods and capital.

As the middle class grows in this market of more than 220 million consumers, Bank of Nova Scotia should see demand increase for loans and investment products. In addition, businesses that plan to take advantage of the trade agreements and expand among the Pacific Alliance countries need a host of cash management services, and Bank of Nova Scotia's presence in all four countries makes it a strong competitor to provide the help.

Growth

Bank of Nova Scotia continues to make strategic acquisitions in Latin America and at home. For example, the company is spending US$2.2 billion to purchase a majority interest in BBVA Chile in a deal will double Bank of Nova Scotia's market share to 14% in that country. The bank also announced an agreement to acquire a 51% position in Banco Cencosud in Peru.

In Canada, Bank of Nova Scotia is bulking up its wealth management operations. The company already closed the $950 million purchase of Jarislowsky Fraser and is now buying MD Financial Management at a price of $2.6 billion.

These purchases should help boost revenue and earnings in the coming years and provide support for continued dividend growth.

Dividends

Bank of Nova Scotia has a strong track record of increasing the payout. The current distribution provides a yield of 4.3%.

Valuation

At the time of writing, Bank of Nova Scotia Scotia trades at $76 per share, or roughly 11 times trailing 12-month earnings. This is quite a bit cheaper than its larger peers. A small discount might be warranted, given the size and focus of the international operations, but the market might not be pricing in the long-term growth prospects.

Risks

Uncertainty surrounding the outcome of the NAFTA discussions presents some risk due to Bank of Nova Scotia’s significant operations in Mexico. Overall, the international group contributes close to 30% of Bank of Nova Scotia’s profits, and Mexico is a big part of that mix.

In Canada, rising interest rates could slow down mortgage growth, and there is a risk that some homeowners will have to sell when the time comes to renew their mortgages. If a wave of homes hits the market at the same time, prices would fall and the banks would be at risk of taking some losses.

That said, most analysts predict a soft landing for the housing market, and Bank of Nova Scotia’s mortgage portfolio is capable of riding out a downturn. Insured mortgages represent 47% of the loans and the loan-to-value ratio on the uninsured mortgages is 54%.

Should you buy?

A meltdown in trade talks between the U.S., Canada, and Mexico could put additional pressure on Bank of Nova Scotia’s stock in the coming months, but the long-term growth outlook for the bank should be positive. If you have some spare cash on the sidelines, it might be worth adding Bank of Nova Scotia to the portfolio while the stock is out of favour.

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