Betting on This Top Dividend Stock Is Worth the Risk

Description

Canada's top banks provide one of the best avenues from which to earn a steadily growing dividend income. Canadian lenders are well-protected from an excessive competition. In fact, they operate in an oligopoly, where "Big Five" banks dominate the domestic market.

From this sector, I have picked Bank of Nova Scotia (TSX:BNS)(NYSE:BNS) today to analyze its income potential for investors looking to buy and hold banking stocks.

BNS stock: a recent slump is a buying opportunity

This is probably the best time this year to buy Bank of Nova Scotia, Canada's third-largest lender. Its stock has fallen about 8% since reaching this year's high in January for all the wrong reasons.

The bank, which is aggressively expanding in South America, is being punished for concluding some mega deals that some investors think may take time to bear fruit.

Some of its biggest deals in the past 12 months include the majority stake in BBVA Chile for $2.9 billion, a $950-million transaction to acquire Jarislowsky Fraser Ltd., the Montreal-based independent investment firm. Last month, Scotiabank announced an agreement to acquire MD Financial Management, an Ottawa-based wealth management firm that targets Canada's health practitioners, for about $2.6-billion.

This massive buying activity, which involves transactions of worth $7-billion, may have short-term implications, as the lender deploy funds and uses its balance sheet to raise money to fund these deals. Over the longer-term, however, it's all good news and very supportive of Scotiabank's bottom line growth.

During the second quarter, Scotiabank showed investors how important its international business has become for its bottom line. Strong loan and deposit growth helped push profits from the South American region by 14% to $675 million in the three months ended April 30.

After the recent deal activity in the region, Pacific Alliance is forecast to contribute 30% to the bank's total revenue over the next three years, up from 23% at a time when it's hard for lenders to grow in Canada.

The recent slump in Scotiabank shares opens a good entry point for long-term income investors. The lender has paid a dividend every year since 1832, while it's hiked its payouts in 43 of the last 45 years. With the payout ratio of about 40%, there is a plenty of room for the bank to continue hiking its $3.28 a share annual dividend.

The bottom line

Trading at $76.27 at the time of writing with an annual dividend yield of 4.32%, BNS stock is trading close to the 52-week low. With the 12-month consensus price estimate of $88 a share, I see BNS valuations are compelling enough to place a long-term bet on this top dividend payer.

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hanwar