This Underestimated Bank Posts Another Strong Quarter

Description

National Bank of Canada (TSX:NA) reported its third-quarter results last week, which showed a strong performance in each business segment thanks to sustained revenue growth and effective cost management.

The bank's third-quarter profit jumped 10% to $569 million, or $1.52 per share.

Adjusted for special items, National Bank earned $1.53 per share, up 10% from an adjusted profit of $1.39 per share in the third quarter last year and beating analysts' estimates by $0.03.

Earnings beat expectations for the eleventh consecutive quarter.

Canada's fifth-largest lender reported strong gains from each of its core businesses, including a 6% jump in profit from its Canadian retail and commercial banking division to $235 million, which was helped by growing balances in mortgages and loans to businesses.

Revenue rose 6% to $1.8 billion in the third quarter, while expenses rose 4% as the bank continues to focus intensely on containing costs.

The bank addressed the three weaknesses that were bothering investors, namely the recovery of loans from its Credigy personal loan subsidiary, the good performance of its market trading division despite the decline in revenues and the significant improvement in the Common Equity Tier 1 capital ratio.

The return on shareholders' equity was 18.4% in the third quarter, which is the highest in the industry.

The wealth management division continued to make progress with a 10% increase in revenues, 22% increase in profit and 16% increase in assets under administration and under management.

While the wealth management division is doing very well, loan growth in Quebec is slowing as consumers temper their borrowing. The bank also believes that it is not the right time to invest more in its specialty finance subsidiaries at this late stage of the business cycle.

National Bank increased its commercial loan balances by 8% in the third quarter, while many rivals posted double-digit gains. National Bank is managing risk carefully and has occasionally passed on opportunities when the margins on offer didn't justify the risk.

The bank's loan losses rose 31% to $76 million compared with a year earlier, mainly because of a single commercial lending account, which executives described as an anomaly.

The institution is playing safe by delaying any additional investment in emerging markets to 2020.

The subsidiary ABA Bank is expanding with the opening of 11 new branches in the last year, generating 56% growth in loans. While the institution is increasing its portfolio lending, its expenses are increasing so that its contribution to profits has been relatively unchanged for the last four quarters.

Bottom line

While National Bank reported a good third quarter overall, it failed to push up the stock price, which actually fell -0.1% during the day of the earnings release. After soaring 18% over one year, National Bank's stock is slowing down.

National Bank's earnings may have been outshined by **Bank of Montreal**, which released its results just one day before National Bank and showed a stronger earnings beat.

I think that in the short term, National Bank's stock will not rise much, but it is still a good long-term investment. Over the next five years, earnings are expected to grow by 13.5% on average annually, which is higher than the other Canadian big banks. In addition, the five-year PEG is only 0.8, which means the stock is trading at a cheap price relative to its future growth. For these reasons, National Bank remains one of the best Canadian bank stocks to own.

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