Can National Bank of Canada (TSX:NA) Outperform the Other Big Five Banks in the Next Decade?

Description

Have you heard that the big Canadian banks are great investments that offer stable dividend income and returns? What about our sixth-largest bank, **National Bank of Canada** (TSX:NA), which is often under the radar because it's not one of the Big Five?

Table 1 below shows that National Bank outperformed the other big banks to in terms of total returns and dividend generation power since before the last recession more than a decade ago.

Bank	[1] Annualized total returns	[2] Dividends received	[3] Dividend growth rate	[4] Starting yield	[5] Yield on cost
National Bank	10.2%	$7,285	7.9%	3.7%	8%
Royal Bank of Canada	7.8%	$5,434	8.4%	3.7%	7.6%
TD Bank	9%	$5,541	9.4%	3.2%	8%
Bank of Nova Scotia	5.9%	$5,229	6.7%	3.5%	6.7%
Bank of Montreal	6.8%	$5,584	4.4%	3.9%	5.4%
Canadian Imperial Bank of Commerce	4%	$4,545	5.6%	3.6%	6.1%

Table 1

[1] Annualized total returns since fiscal 2008 (right before the last recession)

[2] Dividends received from a $10,000 initial investment since fiscal 2007

[3] The compound annual growth rate of the dividend per share from fiscal 2007-2018

[4] Starting yield in fiscal 2007

[5] Yield on cost by fiscal 2018 based on a $10,000 initial investment in fiscal 2007

Why did National Bank Outperform in the last decade?

Table 2 below offers insight as to why National Bank outperformed in the last decade. First, it traded at the cheapest price-to-earnings ratio (P/E) at the start of the period. Second, its earnings-per-share growth in the period was above average. Third, it ended the period at a higher P/E than when it started.

The lower the P/E you pay for the same earnings growth (given all else equal), the cheaper you paid for a stock, and the higher your returns should be.

Earnings growth leads to dividend growth

Earnings-per-share growth should lead to higher stock prices, and in the case of Canadian bank stocks, dividend growth as well. Essentially, investors can assume higher dividend growth from higher earnings growth.

Indeed, National Bank's above-average earnings growth of 7% per year led to decent dividend growth of 7.9% in the period.

Bank	[1] Starting P/E	[2] Earnings growth	Current P/E	[3] Estimated earnings growth
National Bank	9.7	7%	10.2	3.2-13.5%
Royal Bank of Canada	13.3	6.5%	11.8	5.3-7.3%
TD Bank	12.4	7.6%	11.3	6-10.8%
Bank of Nova Scotia	13.3	5.3%	10.4	5.5-7.7%
Bank of Montreal	11.1	4.3%	10.7	3.9-7.5%
Canadian Imperial Bank of Commerce	12	3.3%	9.1	1.6-4.8%

Table 2

[1] P/E in fiscal 2008

[2] Adjusted earnings per share growth rate from fiscal 2007-2018

[3] Estimated earnings per share growth rate for the next three to five years

Can National Bank outperform in the next decade?

Whether National Bank will outperform its bigger peers in the next 10 years depends on its earnings growth. Currently, its earnings growth is estimated to be 3.2-13.5% per year over the next three to five years, which is a wide range. If its earnings growth is near the high end of the range, it will likely outperform all of its bigger peers because of its low P/E currently.

However, that’s a big “if” because National Bank largely has its business in Canada. Specifically, in fiscal 2018, it generated 87% of its revenue in Canada and only 13% outside Canada.

National Bank generated 58% of its revenue in Quebec, which means that its growth has a strong correlation with the economic growth in Quebec.

Its 80% stake in Credigy, a specialty finance company focused in the U.S., contributed 9% of revenue in fiscal 2018. It also has a 90% stake in ABA Bank, which gives National Bank strong growth exposure to the emerging market of Cambodia with a high return on equity of 31%.

Both seem to be high growth drivers of National Bank, but they won’t be as impactful to National Bank’s top and bottom line as the health of the Quebec economy. Therefore, if you’re bullish about the Quebec economy, you should pick up some National Bank shares and get a sustainable 4.2% yield for starters.

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kayng