Beat the Big Five Banks With This Under-appreciated Bank Stock Yielding 4%

Description

It was only roughly a month ago when Canada's five largest banks were attracting considerable attention from short-sellers and were the five most shorted stocks on the TSX. While they continue to garner considerable negative attention with **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) now the most shorted stock, Canada's sixth largest mortgage lender **National Bank of Canada** (TSX:NA) continues to fly under the radar.

Credible underlying results

Despite first-quarter 2019 revenue and net income being flat compared to a year earlier, National bank still reported some notable results that were superior to many of its larger big six peers. Average loan and acceptances expanded by 7.5% year over year to $146 million, while credit quality remained high, with National Bank reporting a 4% quarter over quarter decline in the value of gross impaired loans (GILs) and a GIL ratio of 0.41%.

National Bank's GIL ratio is significantly lower than many of its Big Six peers, including Toronto-Dominion, which reported a ratio of 0.78% for the same period after experiencing a 16% year over year increase in the value of its GILs. That spike in impaired loans can be attributed to Toronto-Dominion's U.S. banking business, where the collapse of a major utility caused them to rise at a rate that was far greater than expected.

The quality of National Bank's loan portfolio, along with its low exposure to the red-hot housing markets of Vancouver and Toronto are among the reasons that it hasn't attracted the same degree of attention from short-sellers. Toronto-Dominion, however, continues to garner negative attention from U.S. hedge funds because of is significant exposure to those housing markets, along with a belief there is a large portion of lower quality mortgages in its credit portfolio.

National Bank also reported a solid first-quarter return on equity of 17.2%, which, while 1.5% lower than the equivalent period a year earlier was higher than many of the larger lenders, including Toronto-Dominion, which reported a ROE of 12.2% for that period. That is an important metric to note because it indicates that National Bank is performing better than many of its peers when it comes to unlocking

value for shareholders.

The bank also announced an efficiency ratio of 55.1% for the first quarter, which was superior to Toronto-Dominion's 58%, indicating that National Bank can more cost effectively generate revenue from its assets.

National Bank, like all of Canada's major banks, is adequately capitalized reporting a common equity tier one capital ratio of 11.5% at the end of the first quarter 2019. This is well above the regulatory minimum and indicates that it can weather any economic slump.

As a result of this solid underlying performance, which was only dragged down by the poor performance of National Bank's financial markets operations, the bank elected to reward loyal investors with yet another dividend hike. This is the ninth straight year in which the bank has hiked its dividend, giving it an attractive yield of just over 4%. A payout ratio of just over 41% coupled with National Bank's growing earnings as well as firmer margins ensures that the dividend is sustainable and that there is room for further dividend increases.

Why buy National Bank?

While National Bank may not possess the same profile of its larger peers, it continues to unlock value and reward investors through regular dividend hikes. It is this combination of dependable growth, relatively low risk compared to the larger mortgage lenders and steadily growing dividend that makes it an ideal addition to any portfolio.

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3. TSX:TD (The Toronto-Dominion Bank)

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