Ignore Bank of Nova Scotia's (TSX:BNS) Earnings Miss and Buy Its Stock Today

Description

Canada's most international bank, **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), reported some mixed and somewhat disappointing second quarter 2019 earnings. The bank missed on earnings despite solid gains from international banking as well as global banking and markets propelling its stock lower, causing it to be down by almost 12% for the year to date.

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Scotiabank's woes can be blamed on a sharp uptick in provisions for credit losses and higher expenses. As a result, the bank reported earnings per share of $1.73 on a diluted basis, which was $0.01 per share lower than the consensus analyst forecast of $1.74.

Outlook is not as poor as believed

While Canada's banks continue to face domestic headwinds and are attracting considerable attention from U.S. short sellers, including the renowned Steve Eisman, who profited from betting against the U.S. credit bubble, Scotiabank's latest decline has created an opportunity for investors.

Key to Scotiabank's misery was a worrying 63% year over year increase in the value of credit loss provisions to $873 million. That was mainly driven by a steep uptick in provisions in international banking triggered by a combination of unfavourable macroeconomic data for Mexico, recent acquisitions in Latin America and hurricane-related provisions.

Bank-wide gross impaired loans rose by almost 5% year over year in value to $5.4 billion, leading to a gross impaired loan (GIL) ratio of 0.89% which was one basis point (bps) lower quarter over quarter and down by six bps from a year earlier. The decline in GILs indicates that the worst in the credit cycle for Scotiabank is over.

Furthermore, the bank's GIL ratio while higher than many of its big five peers is still quite low, indicating that credit quality remains strong.

Solid growth ahead

Unlike its peers, however, Scotiabank is positioned to benefit from the improved economic outlook in Latin America with its operations in the Pacific Alliance nations of Mexico, Peru, Colombia and Chile acting as significant growth drivers. For the second quarter, adjusted net income from international banking grew by almost 14% year over year to $787 million driven by a 28% increase in revenue from Scotiabank's business in Pacific Alliance countries and a notable 42% increase in loans.

There is every indication that earnings from those Pacific Alliance nations will continue to grow at a steady clip because the economies of Mexico, Colombia, Chile and Peru have returned to growth and will continue to expand at a healthy clip.

Global banking and markets has also returned to growth, reporting a notable 25% quarter over quarter increase in reported net income to $420 million led by higher fee and commission revenues, although this was still down by 6% year over year. If the ruckus concerning fears of a renewed trade war between the U.S. and China dies down, then global banking and markets earnings should continue to grow as trading and capital markets activity increases.

While adjusted expenses spiked by 8% year over year to almost $4 billion, they can be attributed to the costs associated with acquisitions including the completion of the purchase of BBVA Chile and wealth manager MD Financial. As the integration of those businesses concludes, Scotiabank's expenses should fall, thereby boosting profitability.

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Foolish takeaway

Scotiabank is well positioned to benefit from stronger economic growth in Latin America. As the costs related to business acquisitions decline and it focuses on improving the quality of its Latin American loan portfolio, profitability will grow. While investors wait for this to occur, they will be rewarded by Scotiabank's sustainable dividend yielding almost 5%.

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