Will Earnings Help Scotiabank Shares Regain Upward Momentum?

Description

Canada's third largest bank, **The Bank of Nova Scotia** (TSX: BNS, NYSE: BNS) is set to report fiscal fourth quarter earnings before the market opens tomorrow. Shares of the bank commonly known as Scotiabank have been on a tear rising by as much as 13% since the beginning of October before cooling off a touch last week.

Scotiabank is not alone in its rise as peers such as Bank of Montreal and Toronto-Dominion Bank have booked similar performance. Many reasons can be attributed to the rise including a vibrant real estate lending environment and a central bank that continues to fan the fire by delaying interest rate increases. Investors may also be taking comfort in the large dividends being paid by the major banks. Even after the run up, shares of Scotiabank still yield just under 4%.

Now it's time to deliver. Expectations are built into the stock and any miss on Friday will not be a good day for investors.

Picking the minds of the pros

The analysts are currently overwhelmingly positive on the stock with the majority rating the stock a buy or strong buy. There is also a notable contingent rating the stock a hold, but only one with an underperform rating. Even with the recent rise in the price of the stock, shares remain below the consensus price target of $70.00 per share leaving potential upside of nearly 17%.

On the earnings front, analysts are currently expecting $1.32 per share which represents 9% growth over the same period in the prior year. Revenues are also expected to climb a similar percentage and come in at $5.40 billion. Analysts have remained firm on expectations as ratings on the stock have remained nearly unchanged since the last report and they have only chipped a few pennies off the earnings estimate.

Coming off a solid quarter

On the surface, last quarter appeared to be a rough one as net income came in at $1.77 billion versus $2.05 billion during the same period in the prior year. However, after adjusting both quarters for nonrecurring items, the bank reported net income of $1.68 billion for the third quarter of the current fiscal year which represented an increase of 17% over the prior years $1.44 billion. The third quarter benefited from higher net interest income which was boosted by its acquisition of ING DIRECT Canada. Increased fees, higher gains and lower loan loss provisions also contributed to higher earnings.

The bank saw revenue growth across its major business lines including the Canadian banking unit which produced year-over-year revenues that were up 6% after excluding results from the ING acquisition and nonrecurring items. The international banking unit produced revenue growth of 7% after excluding a large gain by the banks associated corporation in Thailand. The associated corporation in Thailand sold a subsidiary resulting in an after tax gain of $150 million.

Pairing organic growth with acquisitions

Scotiabank looks to build on its successful organic growth of assets and deposits produced so far this year by the Canadian banking unit. Asset growth was supported by demand for Canadian mortgages and auto loans during the quarter. The company has also made some key acquisitions including the aforementioned ING DIRECT Canada which is contributing to higher interest income.

The global wealth unit is benefiting from higher fee and brokerage revenue due to an early 2011 acquisition of Dundeewealth, Inc as well as more recent acquisitions of pension fund companies in Latin America. These purchases include a 51% stake in Columbia-based Colfondos and a 50% stake Peru-based AFP Horizonte which were acquired in late 2012 and early 2013, respectively.

The international picture is a little more mixed. Results were up on a year-over-year basis, but slipped quarter-over quarter primarily due to unusually high investment gains and stronger income from associated companies that contributed to the second quarter. The unit saw strong loan growth in Latin America, but sees growth moderating going forward for both Asia and Latin America due in part to lower commodity prices, weaker currencies and predicted tapering of quantitative easing by the Federal Reserve in the U.S.

Final thoughts

Management is confident it will achieve its year-over-year earnings per share growth target of 5-10%. This growth rate would seem achievable going into tomorrow’s announcement of final quarter results given the bank was running ahead of last year by 12% at the end of the first nine months on an adjusted basis.

Going forward, the environment may become more difficult for the bank in the short-term as taper talk by the U.S. Federal Reserve will certainly have an impact. In addition, many are expecting a very competitive lending environment in 2014 putting a squeeze on margins.

Earnings for the fourth quarter would seem poised to at least meet expectations most likely supported by continued strength from its Canadian banking and wealth management units. If the bank is able to surprise to the upside enough to put some of the fears of the future to rest for now it may be enough to restore positive momentum in the shares. Otherwise, I would expect continued weakness in the near-term.

CATEGORY

1. Investing

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1. NYSE:BNS (The Bank of Nova Scotia)
2. TSX:BNS (Bank Of Nova Scotia)

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