STOCKS DOWN UNDER

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ASX Top 200 Stocks Down Under

"The key is in not spending time, but in investing it."

- Stephen Covey (1932-2012), Author of 'The 7 Habits of Highly Effective People'

NAB

In a league of its own

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Stocks Down Under rating: ★★★★

ASX: NAB
Market cap: A$100.0B

52-week range: A$24.41 / A$30.30
Share price: A$30.44

Since we last covered NAB its share price has increased 11.6%. It is far from the ASX's best performing company but has beaten the ASX 200's 3.4% gain and among the big banks is only usurped by CBA (ASX: CBA). Since Ross McEwan became CEO in late 2019, NAB has nearly doubled its market capitalisation and is firmly entrenched as Australia's second biggest bank. But is it still reasonably valued?

Share price chart

Source: Tradingview

From worst to...first?

We last wrote about Melbourne headquartered NAB on April 12 last year. It provides banking services – particularly deposit accounts and loans - to individuals and businesses. The bank isn't the biggest housing and personal lender, only holding a 14.4% share in the housing lending market and a 9.2% share in personal lending. However, it has a 22% share in the business lending market.

Rewind to three years ago and NAB was shaken the most of all the major banks by the Royal Commission. Commissioner Hayne said NAB "stood apart" from the other three banks in their past conduct. It led to a 20% share price decline in 12 months and claimed the scalps of then CEO Andrew Thorburn and chairman Ken Henry. The bank hired Ross McEwan, then CEO of The Royal Bank of Scotland, just before Christmas.

2020 was another turbulent year for the bank. The COVID-19 pandemic began in March, which led the bank to raise $4.25 billion in fresh capital. At the time, the banks and their investors feared an avalanche of bad debts from customers. But this did not eventuate and, in fact, the exact opposite occurred – there was increased demand for finance, particularly mortgages, but also in the business segment.

A different storm than shareholders anticipated, but a storm nonetheless

Of course, the increased appetite for capital was not in itself a good thing for the banks, because their Net Interest Margins (NIMs) came under pressure, as did their capacity to process mortgages. NAB, however, handled the storm better than its peers.

In FY21, NAB made a profit of $6.4bn, up from $2.6bn in FY20. It doubled its dividend from 60 cents a share to $1.27 and made a 10.7% Return on Equity (ROE). NAB had the strongest growth in its home loan and business lending books at 1.6xand 1.3x the rate of the broader banking market.

And most importantly, NAB's customers are satisfied. While the company's Net Promoter Scores (NPS) are +1 among consumers and 0 among businesses, these are the highest and second highest of the major banks, respectively. This can be attributed to the improvements in customer experience NAB has made. One pertinent example is fast-tracked loan assessments which can approve most customers within a day. NAB had a strong performance in the agriculture sector – business lending in this segment grew 14.2% year on year

What now?

The bank's momentum has continued into FY22, with NAB making a $1.8bn profit in the December quarter. Among the Big 4 banks, investors's primary concern is the increasing pressure on NIMs after so many months of interest rates being at record lows. Although runaway inflation means interest rates will rise sooner rather than later, it is unclear when exactly this will happen.

Inevitably, rising interest rates will be a boost for the banks, but the exact benefit will depend on how fast rates rise. In the interim, we would note NAB's 5-point NIM decline in the most recent quarter was less than any of other Big 4.

One criticism of NAB has been its lower market share in the credit card space. It has sought to address this by acquiring Citigroup's Australian consumer business. This deal was announced last Augus,t and the ACCC gave its blessing three months later. The combined business will be the 2nd largest credit card provider in Australia and will give NAB increased access to transactional data.

It deserves its place

Consensus estimates for NAB forecast $17.6bn in revenue in FY22, which would represent 4.7% growth from FY21 and would be the largest of the Big Four. At Stocks Down Under we typically prefer ratios such as P/E and P/B (Price to Book Value) to value financials. The latter measures a company's market cap relative to its book value – the difference between total assets and liabilities. P/E can be flawed at times due to the fluctuating nature of banks' earnings.

NAB is trading at a P/B of 1.4x, meaning it is being valued at a premium by the market although ratios are typically put into context of other banks' ratios. On P/B, NAB is more expensive than Westpac (ASX: WBC) and ANZ (ASX: ANZ), which have P/B ratios of 1.1x and 1.2x respectively. but it is cheaper than industry bellwether CBA, which is trading at a P/B of 1.7x.

Notwithstanding our preference for P/B over P/E to value banks, we note NAB is trading at an FY22 P/E ratio of 14.3x, which is among the big four ranks in third position only trailing ANZ.

We think NAB is befitting of its current valuation considering its overall performance during the COVID-19 pandemic. While you may not get as high dividends and exposure to the housing market as you would by investing in CBA, we like that NAB is the only other major bank with positive momentum, and the valuation hasn't become excessive. Four stars.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia

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