The Bank of Nova Scotia (BNS)

Updated August 28th, 2018 by Nick McCullum

Key Metrics

Current Price:	$77	**5 Year CAGR Estimate:**	14.2%	**Volatility Percentile:**	8.4%
Fair Value Price:	$84	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	31.1%
% Fair Value:	92%	**5 Year Valuation Multiple Estimate:**	1.8%	**Valuation Percentile:**	76.5%
Dividend Yield:	4.4%	**5 Year Price Target**	$124	**Total Return Percentile:**	90.5%

Overview & Current Events

The Bank of Nova Scotia (often called Scotiabank) is the third-largest financial institution in Canada behind the Royal Bank of Canada (RY) and the Toronto-Dominion Bank (TD). These three banks along with the Bank of Montreal (BMO) and the Canadian Imperial Bank of Commerce (CM) form the 'Big Five' Canadian banks, which have majority market share in the Canadian financial services industry. Scotiabank operates in three segments – Canadian Banking, International Banking, and Global Banking & Markets – and is cross-listed on the Toronto Stock Exchange and the New York Stock Exchange. The bank's market capitalization is US$73 billion.

In late August, Scotiabank reported (8/28/18) financial results for the third quarter of fiscal 2018 (the bank's financial calendar ends on October 31st). In the quarter, total revenue increased by 4.2% while adjusted net income increased by 6.7% and adjusted diluted earnings-per-share rose by 4.8%. The company's results through the first nine months of the fiscal year were even better. Scotiabank generated revenue growth of 4.8%, adjusted net income growth of 9.3%, and adjusted diluted earnings-per-share growth of 9.2%. Despite the company's robust performance, Scotiabank's stock fell by approximately 2% as the company's revenue number came in slightly below expectations.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS[1]	$3.06	$3.31	$3.91	$4.62	$5.22	$5.15	$5.66	$5.67	$5.77	$6.49	***$7.00***	***$10.30***
DPS[1]	$1.92	$1.96	$1.96	$2.05	$2.19	$2.39	$2.56	$2.72	$2.88	$3.05	***$3.25***	***$4.75***

Scotiabank has compounded its earnings-per-share at 8.7% per year through the decade ending in 2017, a difficult time period that saw the global financial crisis as well as one of the worst oil price crashes in history. Looking ahead, we believe that the bank is capable of 8% annualized earnings-per-share growth over full economic cycles. The bank does not provide earnings guidance, but we believe that it is likely to generate around $7 of earnings-per-share in fiscal 2018. Applying an 8% growth rate to this figure gives a 2023 earnings-per-share estimate of approximately $10.30.

Scotiabank has a noticeably differentiated growth strategy when compared to its peers in the Canadian banking industry. While other banks have focused on expanding into the United States, Scotiabank's future growth should come primarily from its rapidly-expanding International Banking segment, which provides banking services in emerging economies like Colombia, Chile, and Mexico. These markets are appealing because net interest margins are significantly higher. In addition, Scotiabank has the size and capital structure to implement a consolidation strategy in these fragmented banking markets. This acquisition-focused growth strategy can be seen in the company's recent financial releases. In the company's third quarter earnings release, Scotiabank noted that it had closed or is about to close on the following bolt-on acquisitions: BBVA Chile; Citibank's Consumer and Small Business operations in Columbia; Jarislowsky Fraser; Banco Cencosud Peru; MD Financial; and Banco Dominicano del Progreso. Collectively, these acquisitions mean that Scotiabank will now own the 3rd largest private bank in Chile, the second-largest credit card issuer in Peru, and the fourth-largest full-service financial institution in the Dominican Republic. Based on these activities, we believe that Scotiabank's acquisition-based growth strategy is likely to be the lynchpin of its growth moving forward.

[1] All figures in Canadian dollars.

Disclosure: This analyst has a long position in the security discussed in this research report.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	15.7	11.3	12.8	12.1	10.1	11.3	11.9	11.3	10.9	11.9	***11.0***	***12.0***
Avg. Yld.	4.0%	5.2%	3.9%	3.7%	4.2%	4.1%	3.8%	4.3%	4.6%	3.9%	***4.3%***	***3.9%***

Scotiabank has traded at an average price-to-earnings ratio of 11.9 over the last decade. Using our 2018 earnings-per-share estimate of $7.00, the bank is currently trading at a price-to-earnings ratio of 11.0 – slightly below its long-term average price-to-earnings ratio. We believe that valuation expansion will provide a modest tailwind to Scotiabank's future total returns. If the company can revert to a price-to-earnings ratio of ~12 over the next 5 years, this will boost its total returns by 1.8% per year over this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

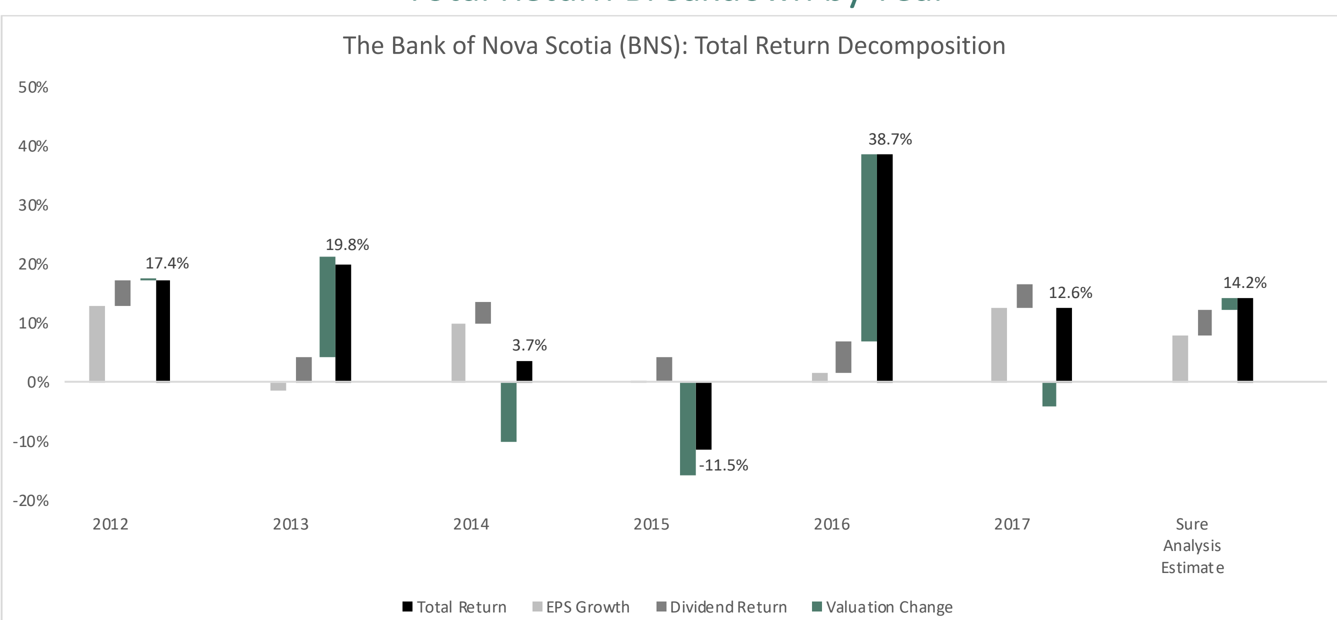
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
Debt/A	95.6%	94.9%	94.6%	94.6%	93.8%	93.9%	93.9%	93.8%	93.5%	93.3%	***93.5%***	***93.5%***
Payout	62.7%	59.2%	50.1%	44.4%	42.0%	46.4%	45.2%	48.0%	49.9%	47.0%	***46.4%***	***46.1%***
Std. Dev.	29.0%	28.3%	14.3%	13.2%	11.5%	12.1%	12.8%	16.0%	15.8%	10.1%	***14.0%***	***14.0%***

Like all financial institutions, the Bank of Nova Scotia's balance sheet is composed primarily of debt. The company typically maintains a payout ratio between 40% and 50%, which leaves plenty of room for continued dividend growth in the event that earnings growth stalls temporarily. What truly stands out about Scotiabank's quality metrics is the financial institution's extraordinarily low stock price standard deviation, which is among the lowest in our investment universe.

Final Thoughts & Recommendation

The Bank of Nova Scotia has an excellent dividend history (it maintained its dividend during the 2007-2009 financial crisis, unlike virtually all of its U.S. peers) and should continue to grow its earnings at a compelling rate over the foreseeable future. Simultaneously, the bank trades at a *discount* to most of its peers south of the border. While this is partially due to a 15% withholding tax that U.S. investors pay on BNS dividends, it's important to know that this withholding tax is waived if BNS shares are held in a retirement account. Little has changed with respect to Scotiabank since our last quarterly update. The company continues to earn a buy recommendation from Sure Dividend today.

Total Return Breakdown by Year



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