



The Bank of Nova Scotia (BNS)

Updated November 30th, 2018 by Josh Arnold

Key Metrics

Current Price:	\$73	5 Year CAGR Estimate:	16.9%	Volatility Percentile:	6.7%
Fair Value Price:	\$89	5 Year Growth Estimate:	8.0%	Momentum Percentile:	28.0%
% Fair Value:	81%	5 Year Valuation Multiple Estimate:	4.2%	Growth Percentile:	72.1%
Dividend Yield:	4.7%	5 Year Price Target	\$131	Valuation Percentile:	82.6%
Dividend Risk Score:	C	Retirement Suitability Score:	A	Total Return Percentile:	92.9%

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). 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\$68 billion, and we'll be using Canadian dollars throughout this report.

Scotiabank reported Q4 and full-year earnings on 11/27/18 and results were roughly in-line with expectations. Earnings-per-share rose 8% during the quarter and 5% for the year. Net interest income rose 10% as all of its segments performed well. International Banking saw earnings rise 18% and Canadian Banking earnings were up 7%. Asset growth and net interest margin expanded in the quarter. Separate, Scotiabank acquired Jarislowsky Fraser and MD Financial Management to bolster its wealth management business.

The bank's efficiency ratio is fairly strong at 54.6% in Q4 but was much better for the full year at 52.3%. This is an improvement over 2017's 53.9%, helping to drive operating leverage. Return on equity was 13.8% for Q4 and 14.5% for the year, the latter of which was roughly flat. The bank's common equity tier 1 ratio was 11.1%, which is certainly more than adequate. Gross impaired loans continue to fall as well, with that number coming in at 0.90% in Q4. In short, the bank's Q4 and full-year earnings were a continuation of strength we've seen in recent quarters and full-year earnings were in-line with our expectations. We're out with an initial estimate of \$7.45 in earnings-per-share for fiscal 2019.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS¹	\$3.31	\$3.91	\$4.62	\$5.22	\$5.15	\$5.66	\$5.67	\$5.77	\$6.49	\$6.99	\$7.45	\$10.95
DPS¹	\$1.96	\$1.96	\$2.05	\$2.19	\$2.39	\$2.56	\$2.72	\$2.88	\$3.05	\$3.31	\$3.40	\$4.90
Shares	1,025	1,043	1,089	1,184	1,209	1,217	1,203	1,208	1,199	1,235	1,240	1,270

Scotiabank has compounded its earnings-per-share at more than 8% per year in the past decade, 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 \$7.45 of earnings-per-share in fiscal 2019.

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. In the company's fourth quarter earnings release, Scotiabank noted that it had closed its acquisition of BBVA Chile, building further towards its goal of international expansion. To put its moves into context, Scotiabank now owns the 3rd largest private bank in Chile, the second-largest credit card issuer in Peru, and the fourth-

¹ All figures in Canadian dollars.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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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. Importantly, its core Canadian Banking and Global Banking & Markets businesses remain strong and are providing the capital necessary to continue to go out and purchase international growth.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	11.3	12.8	12.1	10.1	11.3	11.9	11.3	10.9	11.9	10.9	9.8	12.0
Avg. Yld.	5.2%	3.9%	3.7%	4.2%	4.1%	3.8%	4.3%	4.6%	3.9%	4.3%	4.7%	3.7%

Scotiabank has traded at an average price-to-earnings ratio of about 12 over the last decade. Using our 2019 earnings-per-share estimate of \$7.45, the bank is currently trading at a price-to-earnings ratio of 9.8 – 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 4.2% per year over this time period. The yield, which is very high today by historical standards thanks to the low valuation, should moderate to 3.7% or so in the coming years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

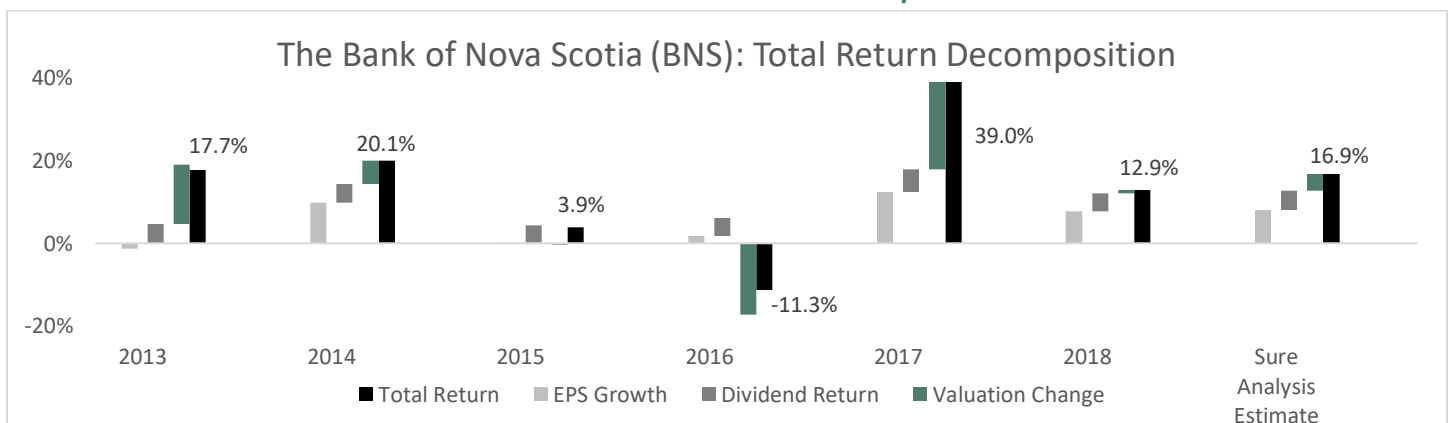
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	59%	50%	44%	42%	46%	45%	48%	50%	47%	44%	46%	45%

Like all financial institutions, the Bank of Nova Scotia's balance sheet is composed primarily of debt, largely in the form of deposits. 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. Given its strong growth outlook, this makes the stock more attractive.

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. We see total annual returns at a robust 16.9% annually in the coming years. These returns should accrue from the current 4.7% yield, a 4.2% tailwind from a rising valuation, and 8% earnings-per-share growth. As a result, the company continues to earn a buy recommendation from Sure Dividend in this quarter's research report.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	14457	15505	16877	19198	20618	23176	23644	25936	26748	28216
SG&A Exp.	4997	5351	6129	6625	7153	7535	7707	8084	8393	8483
D&A Exp.	330	334	413	446	516	526	584	684	761	848
Net Profit	3547	4239	5181	6194	6379	7071	7014	7117	8005	8548
Net Margin	24.5%	27.3%	30.7%	32.3%	30.9%	30.5%	29.7%	27.4%	29.9%	30.3%
Free Cash Flow	-11178	-3174	10962	5858	8774	4667	16144	4188	16584	17395
Income Tax	1133	1745	1423	1568	1737	2002	1853	2030	2033	2382

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets (\$B)	496.52	526.66	594.42	668.04	743.64	805.67	856.50	896.27	915.27	998.49
Cash & Equivalents	43278	46027	54471	47337	53338	56730	78012	50948	62704	65516
Acc. Receivable	N/A	N/A	N/A	3451	2716	2862	3725	3925	3850	4678
Goodwill & Int.	3469	3639	7639	8692	10704	10884	11449	12141	12106	17719
Total Liab. (\$B)	471.19	498.45	562.18	626.67	698.26	756.46	803.02	838.45	853.65	930.81
Accounts Payable	N/A	N/A	N/A	8851	8049	7478	7339	7988	8835	9396
Long-Term Debt	20632	27458	30545	10143	5841	4871	6182	7633	5935	5698
Total Equity	21062	23656	26356	35252	40165	44965	49085	52657	55454	61044
D/E Ratio	0.83	0.99	0.99	0.26	0.13	0.10	0.12	0.14	0.10	0.09

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	0.7%	0.8%	0.9%	1.0%	0.9%	0.9%	0.8%	0.8%	0.9%	0.9%
Return on Equity	17.8%	19.0%	20.7%	20.1%	16.9%	16.6%	14.9%	14.0%	14.8%	14.7%
ROIC	8.4%	8.3%	8.7%	10.8%	12.4%	13.4%	12.3%	11.4%	12.0%	12.1%
Shares Out.	1,025	1,043	1,089	1,184	1,209	1,217	1,203	1,208	1,199	1,235
Revenue/Share	14.23	15.00	15.23	16.55	17.05	18.97	19.19	21.16	21.87	22.96
FCF/Share	-11.00	-3.07	9.89	5.05	7.26	3.82	13.10	3.42	13.56	14.15

Note: All figures in millions of Canadian Dollars unless per share or indicated otherwise.

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