National Bank of Canada (NTIOF)

Updated March 2nd, 2019 by Kay Ng

Key Metrics

Current Price:	$62	**5 Year CAGR Estimate:**	11.0%	**Volatility Percentile:**	8.9%
Fair Value Price:	$65	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	46.7%
% Fair Value:	96%	**5 Year Valuation Multiple Estimate:**	0.8%	**Growth Percentile:**	52.8%
Dividend Yield:	4.2%	**5 Year Price Target**	$87	**Valuation Percentile:**	57.8%
Dividend Risk Score:	B	**Retirement Suitability Score:**	A	**Total Return Percentile:**	65.9%

Overview & Current Events

National Bank of Canada (or simply National Bank) is the sixth-largest bank in Canada behind the Big Five banks with Royal Bank of Canada (RY) and Toronto-Dominion Bank (TD) leading at the top. National Bank's historical roots go as far back as 1859. Since 1993, it has maintained or increased its dividend per share every year. The bank's 5 and 10-year dividend growth rates are 7.5% and 7.0%, respectively. All figures in this report are in Canadian dollars unless otherwise specified.

In late February, National Bank declared its Q2 2019 quarterly dividend which was maintained from Q1. We expect another dividend hike in Q3. The bank's market cap is $20.9 billion.

National Bank reported its fiscal Q1 results on Feb. 27, 2019. Earnings per share rose 3% for the quarter (compared to the same period in 2017) and 10% in fiscal 2018. The bank reported stable overall results despite challenging markets. Specifically, year-over-year, the net income of the Personal and Commercial segment rose 7% to $246 million, Wealth Management rose 10% to $125 million, U.S. Specialty Finance and International rose 20% to $60 million, but the Financial Markets fell 17% to $170 million. The Financial Markets segment was impacted by lower investment banking revenues and lower gains on investments.

National Bank's efficiency ratio was 42.7% for Q1, 3.9% higher than in Q1 2017. Return on equity was 17.2% for Q1, 1.5% lower than in Q1 2017, while 2018's return on equity was 18.5%. The bank's common equity tier 1 ratio was 11.5% at the end of Q1, which aligns with 2018's and is more than adequate. Net impaired loans came in at 0.3%, which aligned with 2018's. In summary, National Bank's Q1 earnings indicate stability. We maintain our estimate of $6.30 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
EPS[1]	$2.47	$2.89	$3.37	$4.05	$4.40	$4.32	$4.51	$3.71	$5.38	$5.94	***$6.30***	***$8.43***
DPS[1]	$1.24	$1.24	$1.37	$1.54	$1.70	$1.88	$2.04	$2.18	$2.28	$2.44	***$2.61***	***$3.57***
Shares	322	326	321	323	326	329	337	338	340	335	***337***	***346***

In the past decade, National Bank compounded its earnings per share by more than 10% through a global financial crisis and a devastating oil price crash. However, its 5-year earnings-per-share growth is a little over 6%. With a 58% revenue exposure to Quebec, the bank's growth rate is tied closely to the economic health of Quebec. Quebec is the second most populous province in Canada and contributes about 20% of Canada's GDP. It's a stable economy but its GDP growth is estimated to slow to 1.9% in 2019, with lower residential investment. Moreover, with the possibility of a global economic slowdown, lower GDP growth is estimated to continue into 2020 and 2021.

Thankfully, National Bank got some diversification from other provinces, which contribute 29% to its revenue. As well, it generates 13% of revenue from the United States and Cambodia, which help contribute to higher growth.

[1] All figures in Canadian dollars.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	9.4	10.5	10.9	9.1	8.9	10.8	10.4	11.6	10.3	10.6	***9.9***	***10.3***
Avg. Yld.	5.3%	4.1%	3.7%	4.2%	4.3%	4.0%	4.4%	5.1%	4.1%	3.9%	***4.2%***	***4.3%***

National Bank has traded at an average price-to-earnings ratio of about 10.3 over the last decade. Using our 2019 earnings-per-share estimate of $6.30, the bank trades at a price-to-earnings ratio of 9.9 — a small discount from its long-term average price-to-earnings ratio. We believe that the bank is currently trading close to its fair value. The yield of 4.2%, which is slightly below the decade's average of 4.3%, is further proof that the stable dividend-growth stock is fairly valued.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	50%	43%	41%	38%	39%	44%	45%	59%	42%	41%	***41%***	***42%***

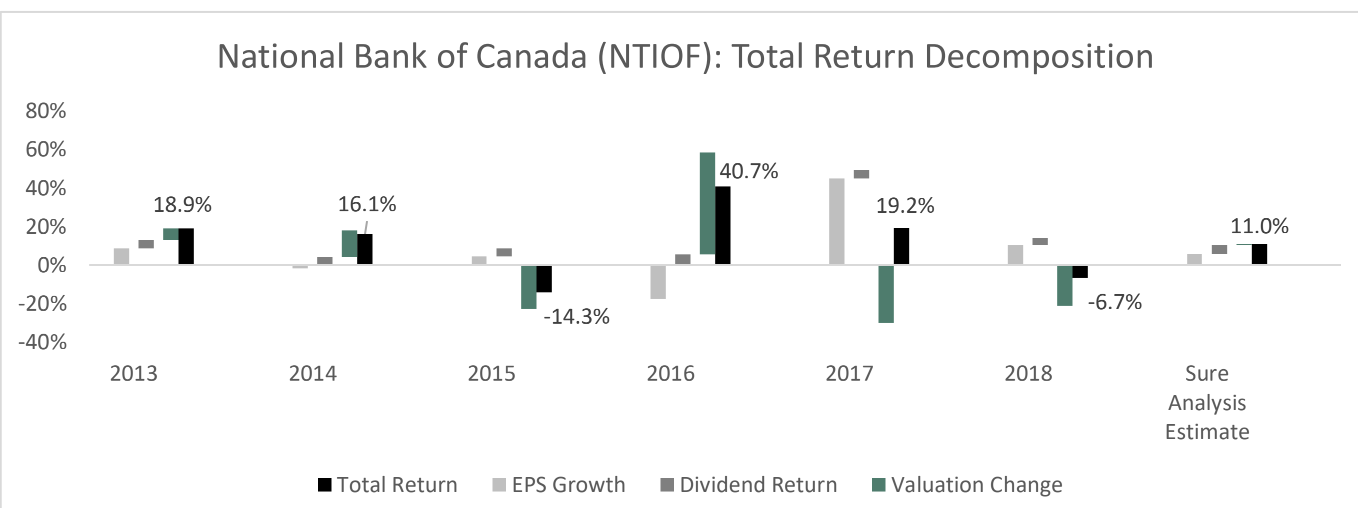
National Bank has a dominant position in Quebec. It also benefits from the effective regulation of the Canadian banking system. The World Economic Forum ranked Canada's banks as among the soundest in the world for the past decade or so, which highlights the fact that Canadian banks — National Bank included — are well capitalized and well managed.

Like all financial institutions, the bank's balance sheet primarily consists of debt, largely in the form of deposits. The company typically maintains a payout ratio in the 40% range, which gives a good margin of safety for solid dividend income or continued dividend growth in the event of temporary downturns.

Final Thoughts & Recommendation

National Bank has a strong dividend history, having maintained or increased its dividend per share throughout two recessions and an oil price collapse. Although fairly valued, the bank can still deliver total annual returns of about 11% in the coming years, thanks to stable growth and its typically low price-to-earnings ratio. As a result, we rate it as a buy at current prices. The bank is a quality stock, but other big Canadian banks, such as Toronto-Dominion Bank, can offer higher growth longer term due to their different growth strategies.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	4436	4289	4666	5284	5125	5420	5720	5825	6574	7138
SG&A Exp.	2004	2064	2208	2437	2425	2630	2763	2815	2987	3149
D&A Exp.	112	120	127	143	150	167	301	417	351	302
Net Profit	854	1034	1224	1561	1449	1469	1549	1181	1940	2145
Net Margin	19.3%	24.1%	26.2%	29.5%	28.3%	27.1%	27.1%	20.3%	29.5%	30.1%
Free Cash Flow	-597	-5694	1809	1577	423	3805	6030	5030	1159	5375
Income Tax	252	221	275	326	252	295	234	225	484	544

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets ($B)	132.14	154.75	166.85	177.90	188.22	205.43	216.09	232.21	245.83	262.47
Cash & Equivalents	2228	2384	2851	3249	3596	8086	7567	8183	8802	12756
Acc. Receivable	N/A	371	497	2151	1526	1315	874	474	489	549
Goodwill & Int.	1143	1224	1590	1841	1962	2270	2336	2552	2648	2726
Total Liab. ($B)	124.46	147.29	159.35	169.66	179.27	194.93	204.74	220.10	232.27	248.12
Accounts Payable	N/A	1093	1856	4301	4463	3963	3820	2882	3327	3598
Long-Term Debt	15238	2033	2000	3936	3883	3353	2922	2459	1084	1780
Total Equity	5388	5350	5719	6458	7487	8484	9531	9642	10700	11526
D/E Ratio	2.35	0.32	0.31	0.55	0.48	0.35	0.28	0.22	0.09	0.13

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	0.7%	0.7%	0.8%	0.9%	0.8%	0.7%	0.7%	0.5%	0.8%	0.8%
Return on Equity	16.9%	19.3%	22.1%	25.6%	20.8%	18.4%	17.2%	12.3%	19.1%	19.3%
ROIC	3.5%	6.4%	12.9%	14.4%	11.6%	11.0%	11.0%	8.2%	13.3%	13.9%
Shares Out.	322	326	321	323	326	329	337	338	340	335
Revenue/Share	13.78	13.13	14.20	16.22	15.67	16.37	17.17	17.14	19.07	20.80
FCF/Share	-1.86	-17.43	5.51	4.84	1.29	11.49	18.10	14.80	3.36	15.66

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