



Bank of Nova Scotia (BNS)

Updated May 28th, 2019 by Kay Ng

Key Metrics

Current Price:	\$70	5 Year CAGR Estimate:	14.1%	Volatility Percentile:	3.2%
Fair Value Price:	\$82	5 Year Growth Estimate:	6%	Momentum Percentile:	38.2%
% Fair Value:	86%	5 Year Valuation Multiple Estimate:	3.1%	Growth Percentile:	76.1%
Dividend Yield:	5%	5 Year Price Target	\$110	Valuation Percentile:	84.6%
Dividend Risk Score:	C	Retirement Suitability Score:	A	Total Return Percentile:	92.8%

Overview & Current Events

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\$64 billion; however, we'll be using Canadian dollars throughout this report.

Scotiabank reported business improvement in fiscal Q2 results on 5/28/19. Revenue increased 10.6% to \$7.8 billion over Q2 2018 thanks to a 6.2% gain in interest income and a 16.2% boost in noninterest income. As well, earnings from the Personal and Commercial banking businesses were up 8% year-over-year while Global Banking and Markets rebounded strongly. The bank's provisions for credit losses soared 63% to \$873 million in Q2. The provisions put a drag on the net income, but they're essentially a needed expense set aside to cover for uncollected loans and loan payments. Higher provisions are to be expected given that Scotiabank is growing its loan book both organically and via acquisitions, but it does reduce earnings in the period the provision forms. Adjusted earnings-per-share were essentially flat, coming in at \$1.70 against \$1.71 in the year-ago period. The bank's capital position also remains quite strong with its common equity tier 1 capital ratio at 11.1%, and its shareholders' equity rose 11% from \$57.2 billion a year ago to \$63.6 billion today. Scotiabank also announced to repurchase up to 24 million, or about 2% of its outstanding shares. Scotiabank also mentioned that in fiscal 2020, it'll start reporting Global Wealth Management as a standalone business segment, which shows the importance of the segment. As well, it'll give a clearer picture of how that part of the business is doing.

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	\$7.11	\$7.25	\$9.70
DPS¹	\$1.96	\$1.96	\$2.05	\$2.19	\$2.39	\$2.56	\$2.72	\$2.88	\$3.05	\$3.28	\$3.48	\$4.65
Shares	1,025	1,043	1,089	1,184	1,209	1,217	1,203	1,208	1,199	1,224	1,218	1,233

Scotiabank has compounded its earnings-per-share at more than 8% per year since 2009, but that's when the bank was coming out from a global financial crisis. Its growth since 2015 was about 6.6% per year. Despite slowing economic growth, we believe the bank is capable of growing EPS by 6% annually on average through 2024. In the first half of the fiscal year, Scotiabank reported diluted EPS of \$3.44, down 3.4% over the same period in the prior year. Therefore, we are revising our EPS estimate to \$7.25 for 2019. The bank's consistent organic and acquired revenue growth continue to drive the top and bottom lines higher in the long run. 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 Mexico, Peru, Chile, and Colombia. These markets are appealing because net interest margins there are significantly higher. In addition, Scotiabank has the size and capital

¹ All figures in Canadian dollars.



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structure to implement a consolidation strategy in these fragmented banking markets. 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-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	11	9.7	11.3
Avg. Yld.	5.2%	3.9%	3.7%	4.2%	4.1%	3.8%	4.3%	4.6%	3.9%	4.2%	5.0%	4.2%

From 2009-2018, Scotiabank traded at an average price-to-earnings ratio of about 11.5. However, we think the more conservative median P/E of 11.3 over the period makes more sense for the anticipated slower growth. Using our 2019 earnings-per-share estimate of \$7.25, the bank is currently trading at a price-to-earnings ratio of 9.7, which is meaningfully below the fair P/E of 11.3. We believe that valuation expansion to about 11.3 can boost the bank's total returns by 3.1% per year over the next five years. The yield, which is relatively high today compared to historical standards thanks to the low valuation, should moderate to 4.2% or so in the coming years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

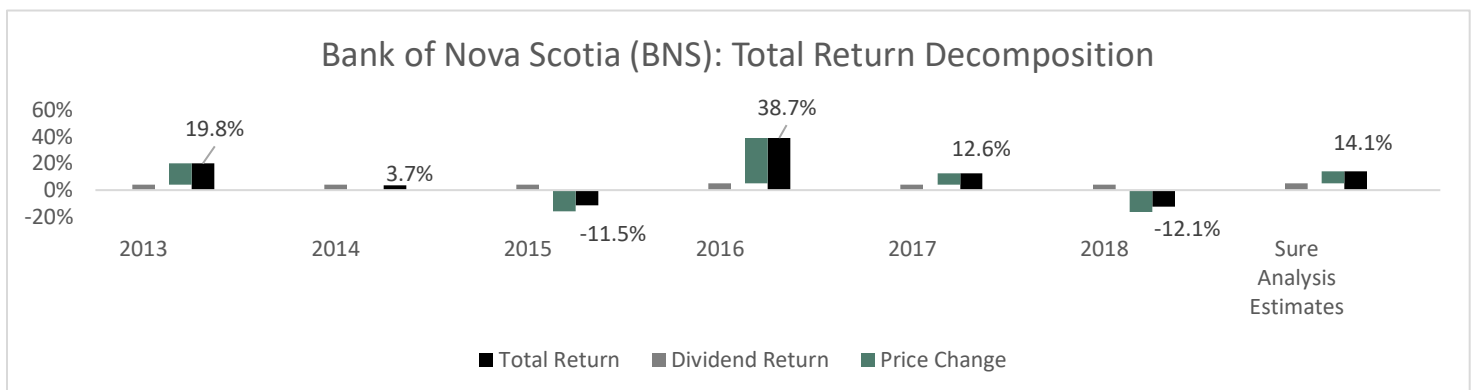
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	59%	50%	44%	42%	46%	45%	48%	50%	47%	46%	48%	48%

Scotiabank's recent-year payout ratios have been about 50%, which aligns with the other big Canadian peers. The ratio also leaves room for continued dividend growth in the event that earnings growth stalls temporarily. The bank's competitive advantage is in its international growth strategy, as it is willing to acquire growth outside of its primary markets. This strategy has worked quite well in recent years and we expect this will continue to be an advantage for Scotiabank for years to come.

Final Thoughts & Recommendation

In total, we see total annual returns of about 14% annually in the coming years. These returns should accrue from the current 5% yield, a 3.1% tailwind from a rising valuation, and 6% earnings-per-share growth. As a result, the bank continues to earn a buy recommendation from Sure Dividend.

Total Return Breakdown by Year



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Disclosure: Kay Ng owns shares in Scotiabank.



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	12411	14923	17104	19107	20225	21269	19052	19560	20452	21931
SG&A Exp.	4290	5150	6211	6593	7017	6915	6210	6097	6417	6593
D&A Exp.	283	321	419	444	506	483	471	516	582	659
Net Profit	3045	4080	5251	6165	6257	6489	5652	5367	6121	6644
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	-9596	-3055	11109	5830	8607	4283	13009	3158	12680	13520
Income Tax	973	1679	1442	1561	1704	1837	1493	1531	1554	1851

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	457659	512153	597930	668178	709436	719419	650664	668077	713437	761051
Cash & Equivalents	39891	44759	54792	47346	50884	50657	56161	34545	46506	47461
Accounts Receivable				3452	2591	2556	2830	2926	3001	3566
Inventories	3198	3539	7684	8694	10212	9719	8698	9050	9436	13505
Goodwill & Int. Ass.	434315	484720	565500	626790	666137	675476	610037	624977	665402	709466
Tot. Liab.				8853	7679	6677	5575	5954	6887	7162
Accounts Payable	19017	26702	30725	10145	5572	4350	4696	5690	4626	4343
Long-Term Debt	19414	23005	26512	35259	38317	40151	37289	39251	43225	46528
Sh. Equity	0.83	0.99	0.99	0.26	0.13	0.10	0.12	0.14	0.10	0.09
D/E Ratio	457659	512153	597930	668178	709436	719419	650664	668077	713437	761051

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	17.5%	19.2%	21.2%	20.0%	17.0%	16.5%	14.6%	14.0%	14.8%	14.8%
ROIC	8.3%	8.5%	9.0%	10.8%	12.5%	13.4%	12.1%	11.4%	12.1%	12.2%
Shares Out.	1,025	1,043	1,089	1,184	1,209	1,217	1,203	1,208	1,199	1,224
Revenue/Share	12.22	14.43	15.44	16.47	16.73	17.41	15.46	15.95	16.72	17.84
FCF/Share	-9.44	-2.95	10.03	5.03	7.12	3.50	10.56	2.58	10.37	11.00

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

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