



Bank of Nova Scotia (BNS)

Updated August 27th, 2019 by Kay Ng

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|---------------------------------|-------|
| Current Price: | \$69 | 5 Year CAGR Estimate: | 14.8% | Volatility Percentile: | 3.0% |
| Fair Value Price: | \$82 | 5 Year Growth Estimate: | 6.0% | Momentum Percentile: | 43.7% |
| % Fair Value: | 84% | 5 Year Valuation Multiple Estimate: | 3.5% | Growth Percentile: | 55.1% |
| Dividend Yield: | 5.3% | 5 Year Price Target | \$110 | Valuation Percentile: | 71.0% |
| Dividend Risk Score: | C | Retirement Suitability Score: | A | Total Return Percentile: | 76.5% |

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 using BNS as the ticker. The bank’s market capitalization is US\$63 billion; however, we’ll be using Canadian dollars throughout this report.

Scotiabank reported good fiscal Q3 results on 8/27/19. Revenue increased 10.9% to \$8 billion over Q3 2018 thanks to a 7.1% gain in interest income and a 16% boost in non-interest income. This led to earnings growth of 8.7% year over year to \$2.5 billion. The Canadian Banking segment saw stable earnings growth of 2.9% to \$1.2 billion; the highlight goes to the International Banking that increased earnings by 20% to \$941 million thanks largely to acquisitions from the prior year. The bank’s provisions for credit losses increased by 32% to \$713 million in Q3. The provisions weigh down 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 came in at \$1.88 against \$1.76 in the year-ago period – an increase of 6.8%. The bank’s capital position also remains quite strong with its common equity tier 1 capital ratio at 11.2%, and its shareholders’ equity rose 4.4% from \$60.8 billion a year ago to \$63.5 billion today. Furthermore, Scotiabank increased its quarterly dividend by 3.4% (or 5.9% against the comparable quarter a year ago) to \$0.90 per share. Recall that in fiscal 2020, Scotiabank will start reporting Global Wealth Management as a standalone business segment, which will show the importance of the segment and 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 | \$3.49 | \$4.67 |
| Shares² | 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 EPS 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 nine months of the fiscal year, adjusted earnings per share are essentially flat and we’re maintaining our EPS estimate of \$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

¹ All figures in Canadian dollars.

² Shares in millions.

Disclosure: Kay Ng owns shares in Scotiabank.



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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 structure to consolidate 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 | 9.5 | 11.3 |
| Avg. Yld. | 5.2% | 3.9% | 3.7% | 4.2% | 4.1% | 3.8% | 4.3% | 4.6% | 3.9% | 4.2% | 5.3% | 4.3% |

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 9.5, 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 3.5% 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 4.3% or so in the coming years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

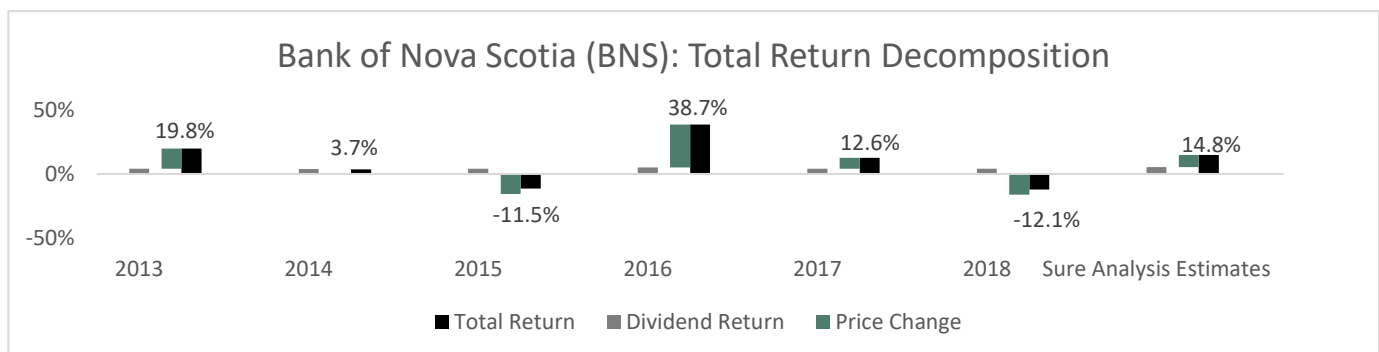
| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 59% | 50% | 44% | 42% | 46% | 45% | 48% | 50% | 47% | 46% | 48% | 48% |

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 14.8% annually in the coming years. These returns should accrue from the current 5.3% yield, a 3.5% 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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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 (\$B) | 458 | 512 | 598 | 668 | 709 | 719 | 651 | 668 | 713 | 761 |
| Cash & Equivalents (\$B) | 40 | 45 | 55 | 47 | 51 | 51 | 56 | 35 | 47 | 47 |
| Accts. Receivable (\$B) | | | | 3 | 3 | 3 | 3 | 3 | 3 | 4 |
| Goodwill & Int. Ass. (\$B) | 3 | 4 | 8 | 9 | 10 | 10 | 9 | 9 | 9 | 14 |
| Tot. Liab. (\$B) | 434 | 485 | 566 | 627 | 666 | 675 | 610 | 625 | 665 | 709 |
| Accounts Payable (\$B) | | | | 9 | 8 | 7 | 6 | 6 | 7 | 7 |
| Long-Term Debt (\$B) | 19 | 27 | 31 | 10 | 6 | 4 | 5 | 6 | 5 | 4 |
| Sh. Equity (\$B) | 19 | 23 | 27 | 35 | 38 | 40 | 37 | 39 | 43 | 47 |
| 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 | 17.5% | 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. | 1025 | 1043 | 1089 | 1184 | 1209 | 1217 | 1203 | 1208 | 1199 | 1224 |
| 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.

Disclaimer

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