



# Bank of Nova Scotia (BNS)

Updated November 26<sup>th</sup>, 2019 by Kay Ng

## Key Metrics

<b>Current Price:</b>	\$57	<b>5 Year CAGR Estimate:</b>	12.5%	<b>Volatility Percentile:</b>	4.2%
<b>Fair Value Price:</b>	\$82	<b>5 Year Growth Estimate:</b>	6.0%	<b>Momentum Percentile:</b>	41.2%
<b>% Fair Value:</b>	89%	<b>5 Year Valuation Multiple Estimate:</b>	2.4%	<b>Growth Percentile:</b>	57.2%
<b>Dividend Yield:</b>	4.9%	<b>5 Year Price Target</b>	\$85	<b>Valuation Percentile:</b>	83.3%
<b>Dividend Risk Score:</b>	D	<b>Retirement Suitability Score:</b>	C	<b>Total Return Percentile:</b>	89.7%

## 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. We'll be using U.S. dollars throughout this report unless otherwise stated. The bank's market capitalization is \$69 billion.

Scotiabank reported fiscal Q4 and full-year 2019 results on 11/26/19. Revenue increased 4% to C\$8 billion over Q4 2019 thanks to a 2.7% gain in net interest income and 12.5% boost in non-interest income. This led to earnings growth of 1.6% year over year to C\$2.3 billion.

For the full year, revenue increased 8.3% to C\$31 billion over fiscal 2018 thanks to a 6.1% gain in net interest income and 11.1% boost in non-interest income. There were no surprises for the bank's Canadian Banking segment, which continues to show stable growth (specifically, adjusted net income growth of 1.6% to C\$4.5 billion), and its International Banking segment that experienced double-digit adjusted earnings growth of 13% to C\$3.2 billion. However, the net income for its Global Banking and Markets segment fell 12.7% to C\$1.5 billion due to lower net interest income and higher non-interest expenses. Year over year this led to adjusted earnings-per-share of C\$7.14, up marginally by 0.4%, return on equity of 13.9%, and operating leverage of -2.1%. (Negative operating leverage means expenses grew faster than revenue.) All said and done, Scotiabank has much room for improvement to reach its medium-term objectives of +7% earnings-per-share growth, return on equity of +14%, and positive operating leverage.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$3.96	\$4.64	\$4.85	\$4.84	\$4.75	\$4.28	\$4.50	\$5.10	\$5.35	\$5.39	<b>\$5.65</b>	<b>\$7.56</b>
<b>DPS</b>	\$1.89	\$2.08	\$2.18	\$2.34	\$2.35	\$2.18	\$2.17	\$2.33	\$2.55	\$2.63	<b>\$2.76</b>	<b>\$3.69</b>
<b>Shares<sup>1</sup></b>	1,043	1,089	1,184	1,209	1,217	1,203	1,208	1,199	1,224	1,247	<b>1,247</b>	<b>1,310</b>

Scotiabank's three-year EPS growth rate was just north of 7% in Canadian dollars and 6.2% when converted to USD. Given the recent underperformance, we came up with an initial EPS estimate of C\$7.50 for fiscal 2020, representing 5% growth in the Canadian currency, or US\$5.65. Longer term, we're giving it a more conservative growth rate of 6% versus management's medium-term target of 7%. Dividend growth should follow earnings growth.

Despite slowing economic growth, we believe the bank is capable of growing EPS by 6% annually on average through 2025. The bank's consistent organic and acquired revenue growth will likely 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 structure to consolidate these fragmented banking markets. To put its moves into context, Scotiabank now owns the 3<sup>rd</sup> largest private bank in Chile, the second-

1. Shares in millions.

Disclosure: Kay Ng owns shares in Scotiabank.



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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 business remains strong, providing the capital necessary to continue to go out and purchase international growth, while its Global Banking & Markets business may be volatile.

## Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	14.6	11.0	11.0	12.9	11.7	9.9	13.0	12.5	10.0	11.4	<b>10.0</b>	<b>11.3</b>
Avg. Yld.	3.5%	4.0%	4.0%	3.9%	3.8%	4.6%	4.0%	3.6%	4.7%	4.6%	<b>4.9%</b>	<b>4.3%</b>

From 2010-2019, Scotiabank traded at an average price-to-earnings ratio of about 11.8. 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 2020 earnings-per-share estimate of \$5.65, the bank currently trades at a price-to-earnings ratio of 10, which is a modest discount from the fair P/E of 11.3. We believe that valuation expansion to about 11.3 can boost the bank's total returns by 2.4% 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

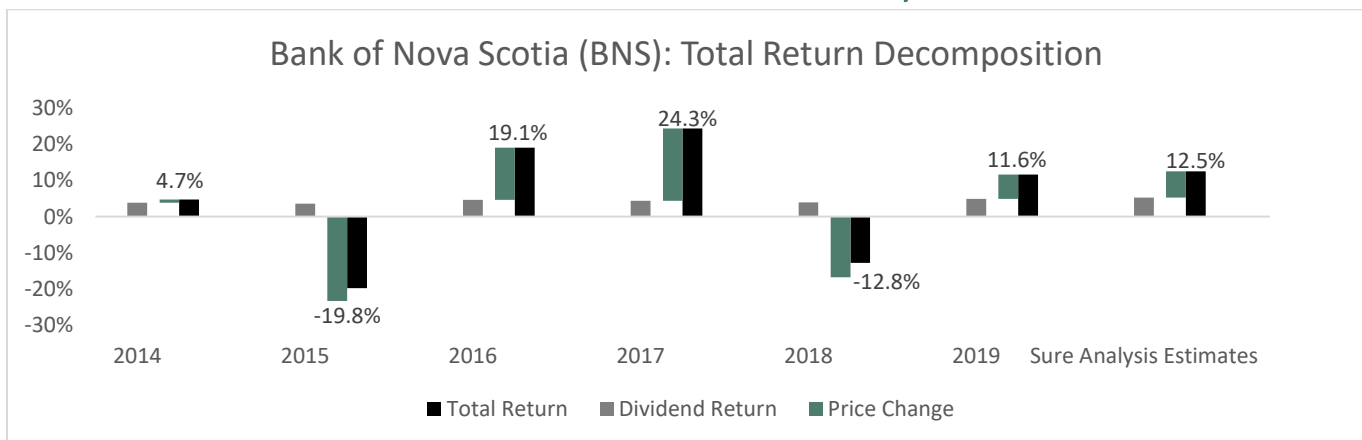
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	48%	45%	45%	48%	49%	51%	48%	46%	48%	49%	<b>49%</b>	<b>49%</b>

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 12.5% annually in the coming years. These returns should accrue from the current 4.9% yield, a 2.4% 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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1. Shares in millions.

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## Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Revenue</b>	14923	17104	19107	20225	21269	19052	19560	20452	21931	22861
<b>SG&amp;A Exp.</b>	5150	6211	6593	7017	6915	6210	6097	6417	6593	7168
<b>D&amp;A Exp.</b>	321	419	444	506	483	471	516	582	659	792
<b>Net Profit</b>	4080	5251	6165	6257	6489	5652	5367	6121	6644	6313
<b>Net Margin</b>	27.3%	30.7%	32.3%	30.9%	30.5%	29.7%	27.4%	29.9%	30.3%	27.6%
<b>Free Cash Flow</b>	-3055	11109	5830	8607	4283	13009	3158	12680	13520	-9188
<b>Income Tax</b>	1679	1442	1561	1704	1837	1493	1531	1554	1851	1860

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total Assets (B)</b>	512	598	668	709	719	651	668	713	761	825
<b>Cash</b>	44759	54792	47346	50884	50657	56161	34545	46506	47461	35482
<b>Accounts Rec.</b>			3452	2591	2556	2830	2926	3001	3566	3864
<b>Goodwill &amp; Int. Ass.</b>	3539	7684	8694	10212	9719	8698	9050	9436	13505	13264
<b>Total Liabilities (B)</b>	485	566	627	666	675	610	625	665	709	772
<b>Accounts Payable</b>			8853	7679	6677	5575	5954	6887	7162	6989
<b>Long-Term Debt</b>	26702	30725	10145	5572	4350	4696	5690	4626	4343	5508
<b>Equity</b>	23005	26512	35259	38317	40151	37289	39251	43225	46528	48331
<b>D/E Ratio</b>	0.99	0.99	0.26	0.13	0.10	0.12	0.14	0.10	0.09	0.11

## Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Return on Assets</b>	0.8%	0.9%	1.0%	0.9%	0.9%	0.8%	0.8%	0.9%	0.9%	0.8%
<b>Return on Equity</b>	19.2%	21.2%	20.0%	17.0%	16.5%	14.6%	14.0%	14.8%	14.8%	13.3%
<b>ROIC</b>	8.5%	9.0%	10.8%	12.5%	13.4%	12.1%	11.4%	12.1%	12.2%	11.0%
<b>Shares Out.</b>	1,043	1,089	1,184	1,209	1,217	1,203	1,208	1,199	1,224	1,247
<b>Revenue/Share</b>	14.43	15.44	16.47	16.73	17.41	15.46	15.95	16.72	17.84	18.27
<b>FCF/Share</b>	-2.95	10.03	5.03	7.12	3.50	10.56	2.58	10.37	11.00	-7.34

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

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