National Bank of Canada (NTIOF)

Updated December 8th, 2019 by Kay Ng

Key Metrics

Current Price:	$54	**5 Year CAGR Estimate:**	9.3%	**Volatility Percentile:**	60.5%
Fair Value Price:	$54	**5 Year Growth Estimate:**	5.5%	**Momentum Percentile:**	69.6%
% Fair Value:	100%	**5 Year Valuation Multiple Estimate:**	0.0%	**Growth Percentile:**	61.5%
Dividend Yield:	4.0%	**5 Year Price Target**	$71	**Valuation Percentile:**	52.1%
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Total Return Percentile:**	56.7%

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. The bank's market cap is C$24 billion. National Bank's historical roots go as far back as 1859. Since 1993, it has maintained or increased its dividend per share every year. All figures in this report are in U.S. dollars unless otherwise specified.

The bank reported its fiscal Q4 and 2019 results on 12/4/2019. National Bank is a rarity in that it posted solid earnings growth for fiscal Q4 with growth across all its business segments – net income increased 7% to C$604 million year over year. On a per-share basis, earnings increased 10% to C$1.67.

For fiscal 2019, National Bank achieved stable business growth and record profitability. Its revenue increased 4% to C$7.4 billion, net income increased 4% to C$2,322 million, and earnings-per-share climbed 7% to C$6.34. Growth occurred in all segments except for the Financial Markets. Specifically, the net income of the Personal and Commercial segment rose 8% to C$1 billion, the Wealth Management segment rose 8% to C$500 million, the Financial Markets segment fell 6% to $720 million, and the U.S. Specialty Finance and International segment rose 26% to C$280 million. The return on equity was strong at 18.0%.

National Bank's efficiency ratio stayed stable at 54.5%. The bank's common equity tier 1 ratio stayed flat at 11.7% at the end of fiscal 2019, which is quite strong. In summary, National Bank's earnings indicate persistence and stability. The bank also increased its dividend by 4.4% to C$0.71 per share.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$3.11	$3.44	$3.97	$3.95	$3.93	$3.51	$3.26	$4.23	$4.51	$4.80	***$4.99***	***$6.52***
DPS	$1.23	$1.35	$1.56	$1.60	$1.65	$1.52	$1.63	$1.77	$1.84	$2.02	***$2.18***	***$3.06***
Shares[1]	326	321	323	326	329	337	338	340	335	334	***335***	***340***

From 2010 to 2019, National Bank compounded its earnings per share by 4.9%, while its five-year earnings-per-share growth was roughly 4.1%. With 81% revenue exposure to Canada and 55% revenue exposure to Quebec, the bank's growth rate is tied closely to the economic health of Canada and in particular to Quebec. Quebec is the second most populous province in Canada and contributes about 20% of Canada's GDP. Canada and Quebec have stable economies, but their GDP growth is estimated to slow to 1.7% and 1.8%, respectively in 2020. Moreover, with the possibility of a global economic slowdown, low GDP growth is estimated to continue through 2021. National Bank generates 19% of revenue from the United States and Cambodia, which help contribute to higher growth.

Our initial 2020 estimate of US$4.99 represents 4% growth. Thereafter through 2025, we set an estimated growth rate of 5.5% as National Bank can grow its client base with a focus on newcomers, millennials, professionals, people from 50-64 years old, and small and medium businesses. Moreover, the bank can increase its dividend at a faster rate than its earnings growth due to having a relatively low payout ratio. We estimate the dividend will grow 8% in 2020 and 7% on average per year thereafter through 2025.

1. Shares in millions.

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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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	11.5	10.6	9.4	10.1	11.4	10.2	12.7	11.6	10.2	11.3	***10.9***	***10.9***
Avg. Yld.	4.0%	4.0%	4.1%	4.0%	4.0%	4.2%	3.9%	3.6%	4.0%	3.7%	***4.0%***	***4.3%***

National Bank has traded at an average price-to-earnings ratio of 10.9 from 2010-2019. Using our 2020 earnings-per-share estimate, the bank trades at a price-to-earnings ratio of 10.9 – which is fairly valued. The yield of 4%, which is at the decade's average of 4%, is further proof that the stable dividend-growth stock is fairly valued.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	40%	39%	39%	41%	42%	43%	50%	42%	41%	42%	***44%***	***47%***

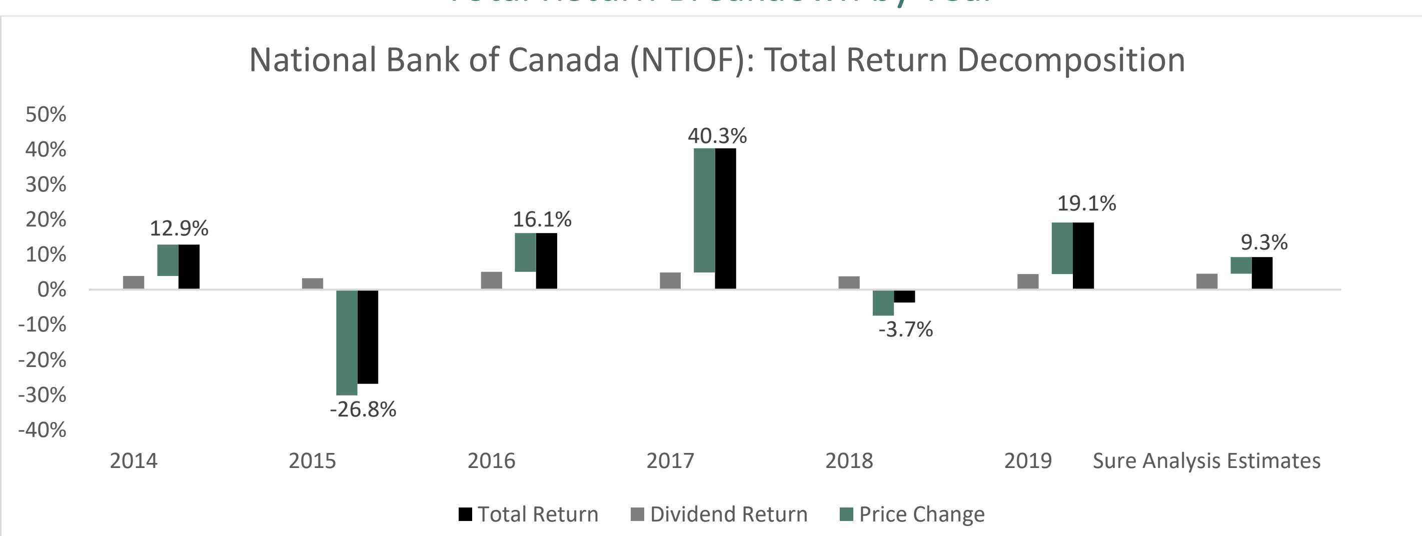
National Bank has a dominant position in Quebec. It also benefits from the effective regulation of the Canadian banking system. The World Economic Forum ranked Canada's banks as among the soundest in the world for the past decade or so, which highlights the fact that Canadian banks — National Bank included — 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 and continued dividend growth in the event of temporary downturns. Because the stock's current payout ratio is in the low 40% range, we believe dividend growth rate can be higher than its earnings growth rate at, say, 7% through 2025.

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 annualized returns of about 9.3% over the next 5 years, thanks to a 4% yield and stable earnings growth of 5.5%. As a result, we rate it as a hold at current prices and a buy on meaningful dips. The bank is a quality stock, but other big Canadian banks 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	4128	4729	5259	5027	4974	4609	4393	5027	5548	5566
SG&A Exp.	1986	2238	2425	2379	2414	2226	2123	2284	2448	2481
D&A Exp.	115	129	142	147	153	243	314	268	235	247
Net Profit	995	1240	1554	1421	1348	1248	891	1483	1667	1697
Net Margin	24.1%	26.2%	29.5%	28.3%	27.1%	27.1%	20.3%	29.5%	30.1%	30.5%
Free Cash Flow	-5480	1833	1569	415	3492	3697	3899	958	4178	5851
Income Tax	213	279	324	247	271	189	170	370	423	348

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets ($B)	150	168	178	180	183	164	173	192	200	214
Cash & Equivalents	2318	2868	3250	3431	7220	5748	6100	6861	9723	10403
Accounts Receivable	361	500	3046	2040	1740	1188	1480	1313	1966	1435
Goodwill & Int. Ass.	1190	1599	1841	1872	2027	1775	1902	2064	2078	2140
Total Liab. ($B)	143	160	170	171	174	156	164	181	189	202
Accounts Payable	1063	1867	4302	4258	3539	2902	2148	2593	2742	2652
Long-Term Debt	1977	2012	3937	3704	2994	2220	1833	845	1357	1517
Shareholder's Equity	5203	5753	6459	7143	7576	7241	7187	8340	8785	9363
D/E Ratio	0.32	0.31	0.55	0.48	0.35	0.28	0.22	0.09	0.13	0.14

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	0.7%	0.8%	0.9%	0.8%	0.7%	0.7%	0.5%	0.8%	0.9%	0.8%
Return on Equity	19.6%	22.6%	25.4%	20.9%	18.3%	16.8%	12.3%	19.1%	19.5%	18.7%
ROIC	6.6%	13.2%	14.3%	11.6%	11.0%	10.8%	8.2%	13.3%	14.1%	13.4%
Shares Out.	326	321	323	326	329	337	338	340	335	334
Revenue/Share	12.64	14.39	16.14	15.37	15.02	13.84	12.92	14.58	16.16	16.49
FCF/Share	-16.78	5.58	4.82	1.27	10.55	11.10	11.47	2.78	12.17	17.33

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