National Bank of Canada (NTIOF)

Updated June 27th, 2020 by Kay Ng

Key Metrics

Current Price:	$44	**5 Year CAGR Estimate:**	10.5%	**Market Cap:**	$14.8B
Fair Value Price:	$50	**5 Year Growth Estimate:**	3.6%	**Ex-Dividend Date:**	06/26/20
% Fair Value:	87%	**5 Year Valuation Multiple Estimate:**	2.8%	**Dividend Payment Date:**	08/01/20
Dividend Yield:	4.7%	**5 Year Price Target**	$60	**Years Of Dividend Growth[1]:**	9
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Last Dividend Increase[1]:**	8.1%

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. All figures in this report are in U.S. dollars unless otherwise specified.

The bank reported its fiscal Q2 2020 results on 05/26/2020. Against fiscal Q2 2019, it reported a net income decline of 32% to C$379 million and a diluted earnings-per-share ("EPS") decline of 33% to C$1.01. Return on equity ("ROE") dropped to 10.7% from 17.8%. The big drop in earnings is largely due to an increase in provisions for credit losses in light of the economic impacts from the COVID-19 pandemic. It's important to note that income before provisions for credit losses was C$991 million, a 20% growth driven by revenue growth across all business segments.

The bank's capital position remains solid with a Common Equity Tier 1 ratio at 11.4%**.** Year-to-date, National Bank's net income fell 11% to $989 million. This bank has been more resilient than its bigger Canadian banking peers. It definitely has what it takes to weather this economic downturn, but it could take a few quarters for the macro environment to improve.

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	***$4.08***	***$5.72***
DPS	$1.23	$1.35	$1.56	$1.60	$1.65	$1.52	$1.63	$1.77	$1.84	$2.02	***$2.77***	***$2.77***
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. National Bank generates 19% of revenue from the United States and Cambodia, which help contribute to higher growth long term. This year, it can't be helped that there will be economic contractions due to COVID-19 impacts.

We lowered our estimates in light of the increased near to medium impacts of the coronavirus. Our 2020 EPS estimate is now 15% lower from 2019's. We estimate a growth rate of 7% through 2025, as the economy recovers and 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. The bank is likely to prudently freeze its dividend for now, but it should be able to increase its dividend at about 6% per year through 2025.

1. Years of dividend growth in C$; TTM dividend per share over prior TTM dividend per share in C$; Shares in millions.

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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	***10.8***	***10.5***
Avg. Yld.	4.0%	4.0%	4.1%	4.0%	4.0%	4.2%	3.9%	3.6%	4.0%	3.7%	***4.7%***	***4.6%***

National Bank has traded at an average price-to-earnings ratio of 10.9 from 2010-2019. Given the outlook of lower interest rates and slower economic growth, we lowered the fair P/E to 10.5. Using our 2020 earnings-per-share estimate, the bank trades at a price-to-earnings ratio of 10.8 – which indicates fair value. However, based on normalized earnings, it'd be trading at a P/E of about 9.2 and undervalued by about 12%. So, long-term income-focused investors with an investment horizon of five years or longer can consider the bank stock. The bank's forward yield of 4.7% is also above the decade's average of 4%, which indicates it's modestly undervalued.

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%	***51%***	***48%***

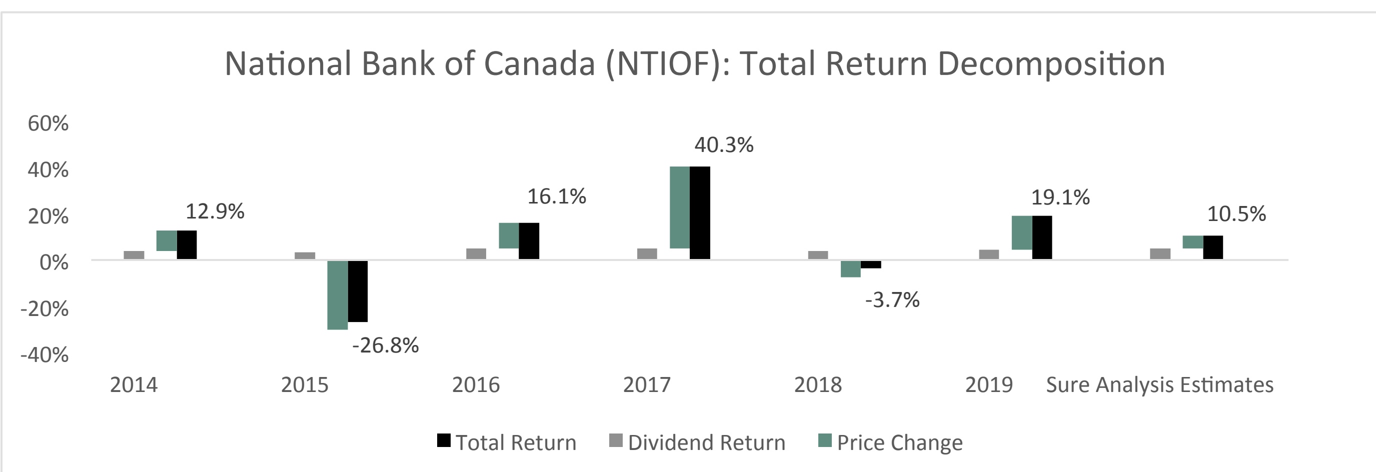
National Bank has a dominant position in Quebec. It also benefits from the effective regulation of the Canadian banking system. The World Economic Forum ranked Canada's banks as among the soundest in the world for the past decade or so, which highlights the fact that Canadian banks — National Bank included — 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 Big Five Canadian banks tend to maintain a payout ratio of about 50%. So, National Bank's payout ratio, in the 40% range in the past, was more conservative. Currently, its payout ratio of about 50% aligns with its bigger peers. Therefore, it should keep paying its dividend despite the current economic downturn. We believe a dividend growth of about 6% through 2025 is possible.

Final Thoughts & Recommendation

National Bank has become less attractive since our last report. We forecast 10.5% in total returns annually over the next five years, consisting of a forward yield of 4.7%, 3.6% earnings-per-share growth, and a 2.8% tailwind from a higher price-to-earnings ratio. The bank is a reasonable buy here for long-term investors focused on income.

Total Return Breakdown by Year



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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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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.