



# Bank of Nova Scotia (BNS)

Updated January 3<sup>rd</sup>, 2021 by Kay Ng

## Key Metrics

<b>Current Price:</b>	\$54	<b>5 Year CAGR Estimate:</b>	10.6%	<b>Market Cap:</b>	\$65.5B
<b>Fair Value Price:</b>	\$61	<b>5 Year Growth Estimate:</b>	4.0%	<b>Ex-Dividend Date:</b>	01/04/21
<b>% Fair Value:</b>	89%	<b>5 Year Valuation Multiple Estimate:</b>	2.4%	<b>Dividend Payment Date:</b>	01/27/21
<b>Dividend Yield:</b>	4.9%	<b>5 Year Price Target</b>	\$74	<b>Years Of Dividend Growth<sup>1</sup>:</b>	9
<b>Dividend Risk Score:</b>	C	<b>Retirement Suitability Score:</b>	A	<b>Last Dividend Increase<sup>1</sup>:</b>	1.7%

## 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 reports in 5 segments – Canadian Banking, International Banking, Global Wealth Management, Global Banking & Markets, and Other – 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.

Scotiabank reported fiscal Q4 2020 results on 12/01/20. For the quarter, total revenue fell 3% to C\$7,505 million. Adjusted net income was C\$1,938 million, down 19% year over year. Adjusted diluted earnings-per-share (“EPS”) dropped 20% to C\$1.45. BNS’s big drop in earnings is largely due to prudent loan loss provisioning from the impacts of the global COVID-19 pandemic. Specifically, the provision for credit losses increased 50% to C\$1,131 million from the prior year’s Q4 of C\$753 million.

The bank’s provision for credit losses ratio was 0.73% (against year over year’s 0.53%), as it set aside more money to cover the increase of bad loans from COVID-19 impacts. We believe BNS continues to have prudent lending practices. The provision for credit losses on impaired loans ratio was 0.54%, compared to 0.49% in the prior year.

The bank’s capital position remains quite strong with its common equity tier 1 ratio at 11.8%. Adjusted return on equity (“ROE”) was 11.3% in Q4 compared to Q4 2019’s 13.8%. We expect BNS to be able to weather this economic downturn. However, impaired loan losses could take a few quarters to improve.

For fiscal year 2020, BNS’s revenue climbed 1% to C\$31.3 billion, adjusted net income fell 26% to C\$6,961 million, and adjusted EPS fell 25% to C\$5.36. Adjusted ROE was 10.4% versus 13.9% in fiscal 2019.

## Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
<b>EPS</b>	\$4.64	\$4.85	\$4.84	\$4.75	\$4.28	\$4.50	\$5.10	\$5.35	\$5.39	\$4.14	<b>\$4.58</b>	<b>\$6.56</b>
<b>DPS</b>	\$2.08	\$2.18	\$2.34	\$2.35	\$2.18	\$2.17	\$2.33	\$2.55	\$2.63	\$2.67	<b>\$2.67</b>	<b>\$3.41</b>
<b>Shares<sup>1</sup></b>	1,089	1,184	1,209	1,217	1,203	1,208	1,199	1,227	1,216	1,211	<b>1,223</b>	<b>1,286</b>

Scotiabank’s three-year EPS growth rate was just north of 5.7% in Canadian dollars and 6.2% when converted to USD from fiscal 2016-2019. Due to BNS’s greater exposure to emerging markets, it could take about two years for its earnings to normalize. A growth rate of about 5% can resume after that.

Eventually, there will be a rebound of earnings, but it could take more than a few quarters for COVID-19 to come to pass. Our forecast is based on an assumption of a rebound to normalized earnings in fiscal 2022, followed by a 5% growth rate through fiscal 2026. BNS has maintained the same quarterly dividend of CAD\$0.90 per share for 6 quarters straight. We suspect the regulatory bodies will prevent the bank from increasing its dividend in this time of uncertainty and allow it to resume dividend growth when the skies are clearer. The fluctuations in the forex between U.S. dollars and Canadian dollars will affect the effective yield of U.S. shareholders.

1. Years of dividend growth in C\$; TTM dividend per share over prior TTM dividend per share in C\$; Shares in millions.  
Disclosure: Kay Ng owns shares in Scotiabank.



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## Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	11.0	11.0	12.9	11.7	9.9	13.0	12.5	10.0	11.4	9.6	<b>11.8</b>	<b>11.3</b>
Avg. Yld.	4.0%	4.0%	3.9%	3.8%	4.6%	4.0%	3.6%	4.7%	4.6%	6.2%	<b>4.9%</b>	<b>4.6%</b>

From 2011-2020, Scotiabank traded at an average price-to-earnings ratio of about 11.3. Using our 2021 EPS estimate of \$4.58, the bank currently trades at a price-to-earnings ratio of 11.8, which makes the stock fairly valued in today's environment. However, on more normalized earnings, the P/E multiple is actually closer to 10.0, making the stock undervalued by about 10% for long-term investment. BNS's yield is above average to the market. As a Canadian stock, BNS's dividends may be subject to a 15% dividend withholding tax for U.S. investors. This tax can potentially be avoided by investing in BNS through a retirement account.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	45%	45%	48%	49%	51%	48%	46%	48%	49%	64%	<b>58%</b>	<b>52%</b>

During the Great Recession, Bank of Nova Scotia increased its dividend and only froze its dividend in fiscal 2010 before resuming dividend growth afterwards. We are optimistic that the bank can maintain its dividend in this economic downturn and increase its dividend again in better times ahead.

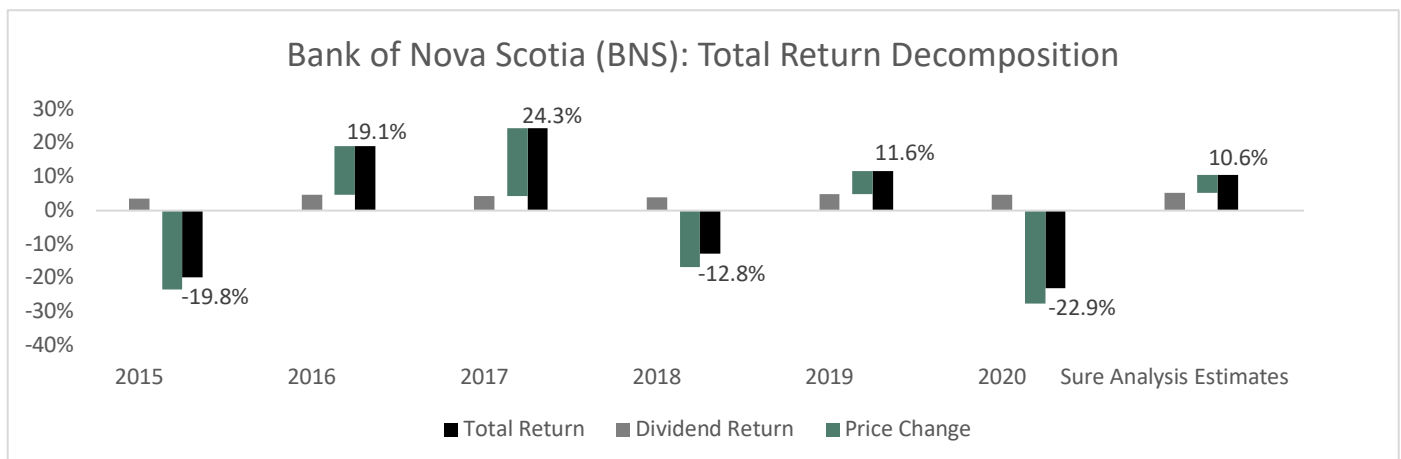
BNS normally has a payout ratio of about 50% that aligns with other big Canadian banks. Its payout ratio was higher than normal in 2020 due to higher provision for credit losses from pandemic impacts. Its payout ratio will likely be higher than 50% as its earnings normalize through 2022.

The bank's competitive advantage is in its international growth strategy, as it is willing to acquire growth outside of its primary markets. When the global economic environment improves, its international strategy should be an advantage for growth.

## Final Thoughts & Recommendation

We see total annual returns of about 10.6% annually in the coming years. These returns should accrue from the current 4.9% yield, a 2.4% tailwind from a rising valuation, and 4% 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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Revenue</b>	17104	19107	20225	21269	19052	19560	20452	21931	22861	23129
<b>SG&amp;A Exp.</b>	6211	6593	7017	6915	6210	6097	6417	6593	7168	7057
<b>D&amp;A Exp.</b>	419	444	506	483	471	516	582	659	792	1150
<b>Net Profit</b>	5251	6165	6257	6489	5652	5367	6121	6644	6313	5042
<b>Net Margin</b>	30.7%	32.3%	30.9%	30.5%	29.7%	27.4%	29.9%	30.3%	27.6%	21.8%
<b>Free Cash Flow</b>	11109	5830	8607	4283	13009	3158	12680	13520	-9188	41576
<b>Income Tax</b>	1442	1561	1704	1837	1493	1531	1554	1851	1860	1148

## Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Total Assets</b>	597930	668178	709436	719419	650664	668077	713437	761051	824907	853050
<b>Cash &amp; Equivalents</b>	45489	47346	50884	50657	56161	34545	46506	47461	35482	57392
<b>Accounts Receivable</b>	3624	3452	2591	2556	2830	2926	3001	3566	3864	3631
<b>Goodwill &amp; Int. Ass.</b>	7684	8694	10212	9719	8698	9050	9436	13505	13264	12772
<b>Total Liabilities</b>	565500	626790	666137	675476	610037	624977	665402	709466	771598	800129
<b>Accounts Payable</b>	8260	8853	7679	6677	5575	5954	6887	7162	6989	6237
<b>Long-Term Debt</b>	6964	10145	5738	4765	5825	5690	4626	4343	5508	5558
<b>Shareholder's Equity</b>	26512	35259	38317	40151	37289	39251	43225	46528	48331	47153
<b>D/E Ratio</b>	0.23	0.26	0.14	0.11	0.15	0.14	0.10	0.09	0.11	0.11

## Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Return on Assets</b>	0.9%	1.0%	0.9%	0.9%	0.8%	0.8%	0.9%	0.9%	0.8%	0.6%
<b>Return on Equity</b>	22.0%	20.0%	17.0%	16.5%	14.6%	14.0%	14.8%	14.8%	13.3%	10.6%
<b>ROIC</b>	14.5%	13.6%	12.4%	13.3%	11.9%	11.4%	12.1%	12.2%	11.0%	8.6%
<b>Shares Out.</b>	1089	1184	1209	1217	1203	1208	1199	1227	1216	1211
<b>Revenue/Share</b>	15.44	16.47	16.73	17.41	15.46	15.95	16.72	17.84	18.27	18.61
<b>FCF/Share</b>	10.03	5.03	7.12	3.50	10.56	2.58	10.37	11.00	-7.34	33.45

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

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