



# Bank of Nova Scotia (BNS)

Updated February 28<sup>th</sup>, 2023 by Kay Ng

## Key Metrics

<b>Current Price:</b>	\$49	<b>5 Year CAGR Estimate:</b>	14.7%	<b>Market Cap:</b>	\$59B
<b>Fair Value Price:</b>	\$64	<b>5 Year Growth Estimate:</b>	4.8%	<b>Ex-Dividend Date:</b>	04/03/23
<b>% Fair Value:</b>	78%	<b>5 Year Valuation Multiple Estimate:</b>	5.2%	<b>Dividend Payment Date:</b>	04/26/23
<b>Dividend Yield:</b>	6.2%	<b>5 Year Price Target</b>	\$80	<b>Years Of Dividend Growth<sup>1</sup>:</b>	11
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	A	<b>Rating:</b>	Buy

## 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 4 core business segments – Canadian Banking, International Banking, Global Wealth Management, and Global Banking & Markets. The bank stock 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 Q1 2023 results on 2/28/23. For the quarter, on an adjusted basis, revenue fell 1% to C\$7,980 million with expenses up 6% to C\$4,443 million. Adjusted net income declined 14% to C\$2,366 million, which translated to adjusted earnings-per-share (“EPS”) also falling 14% to C\$1.85.

The Canadian Banking business saw adjusted net income falling 10% to C\$1,088 million due to higher provision for credit losses (PCLs), reflecting a less favorable macroeconomic outlook. For this segment, expenses rose faster than revenue as the bank blamed “higher personnel costs driven by staffing and inflation, and technology costs.” Revenue fell 7% for the Global Wealth Management segment because of lower fee income from lower trading volumes and lower assets under management. Management also explained that overall expenses rose from higher personnel costs, performance-based compensation, and costs to support business growth. The adjusted return on equity was 13.4%, down from 15.9% a year ago. The bank’s capital position remained solid with its Common Equity Tier 1 ratio at 11.5%. In light of the latest results, the bank stock dipped about 6% on the day. We update BNS’s fiscal 2023 EPS estimate to US\$5.95.

## Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>EPS</b>	\$4.84	\$4.75	\$4.28	\$4.50	\$5.10	\$5.35	\$5.39	\$4.14	\$6.15	\$6.26	<b>\$5.95</b>	<b>\$7.52</b>
<b>DPS</b>	\$2.34	\$2.35	\$2.18	\$2.17	\$2.33	\$2.55	\$2.63	\$2.67	\$2.85	\$3.13	<b>\$3.09</b>	<b>\$3.91</b>
<b>Shares<sup>1</sup></b>	1,209	1,217	1,203	1,208	1,199	1,227	1,216	1,211	1,224	1,191	<b>1,203</b>	<b>1,264</b>

Scotiabank’s five-year EPS growth rate was just north of 5.4% in Canadian dollars and 4.2% when converted to USD from fiscal 2017-2022. Inflation and interest rates are much higher than in the recent past, which don’t bode well for the economy, as both business and consumer spending would be dampened. Moreover, BNS could have more volatile earnings because of its exposure to international markets and different currencies. A relatively strong USD would weaken its results when translated into USD. For now, we give BNS an EPS growth rate of 4.8% (and corresponding DPS growth rate) through 2028. We set our 2022 dividend estimate based on the forex rate at writing. Keep in mind that the fluctuations in the forex between U.S. dollars and Canadian dollars will affect the effective yield for U.S. shareholders.

## Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
<b>Avg. P/E</b>	12.9	11.7	9.9	13.0	12.5	10.0	11.4	9.6	12.4	10.2	<b>8.3</b>	<b>10.7</b>
<b>Avg. Yld.</b>	3.9%	3.8%	4.6%	4.0%	3.6%	4.7%	4.6%	6.2%	4.7%	5.1%	<b>6.2%</b>	<b>4.9%</b>

<sup>1</sup> Years of Dividend Growth in C\$; Shares in millions

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From fiscal 2013-2022 and 2018-2022, Scotiabank traded at an average price-to-earnings ratio of about 11.4 and 10.7, respectively. We use the more conservative P/E of 10.7 as our target due to the more negative outlook. Using our 2023 EPS estimate, the bank currently trades at a price-to-earnings ratio of 8.3, which makes the stock undervalued. BNS's yield is above average to the market, making it appealing to income investors. 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	48%	49%	51%	48%	46%	48%	49%	64%	46%	50%	52%	52%

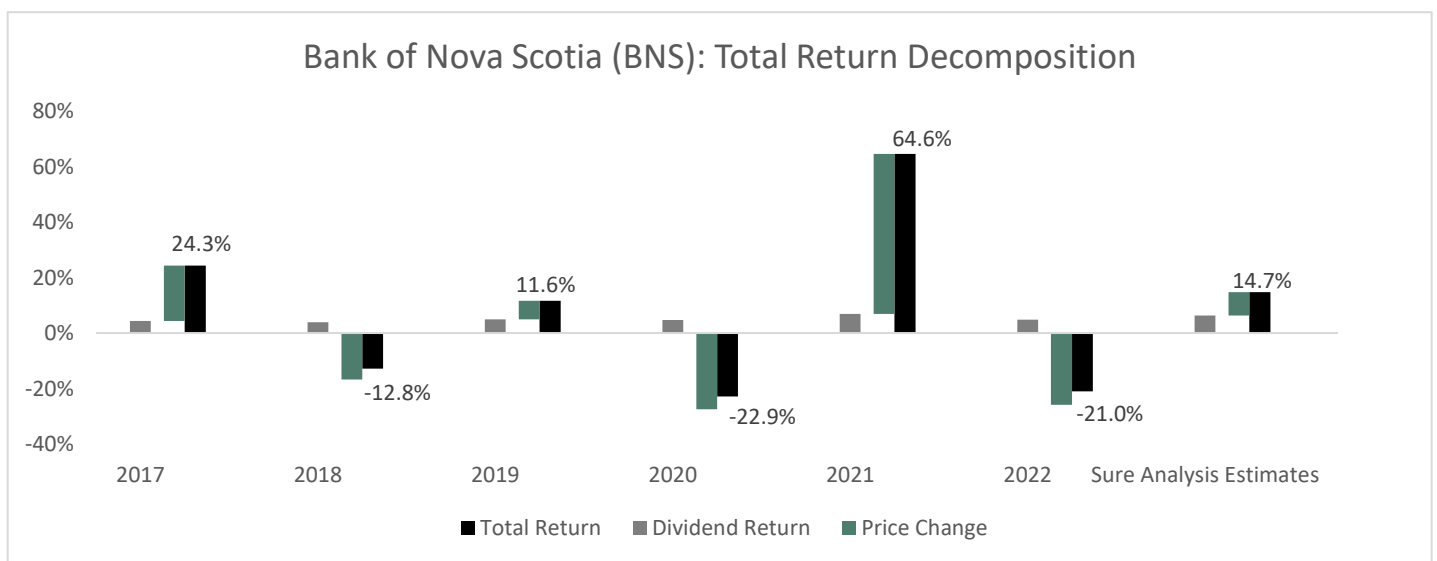
During the Great Recession, Bank of Nova Scotia increased its dividend and only froze its dividend in fiscal 2010 before resuming dividend growth afterwards. Similarly, the OSFI regulatory restriction led to a dividend freeze of 9 quarters because of the pandemic (and potential impacts to the economy). The stable bank came out with a dividend increase as soon as the ban was lifted. BNS normally has a payout ratio of around 50% that aligns with other big Canadian banks. Its payout ratio was higher than normal in fiscal 2020 due to a higher provision for credit losses from pandemic impacts. BNS's payout ratio has normalized, and we expect it to stay more or less in the 50% range.

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. Scotiabank's international focus is on Latin America geographies like Mexico, Peru, and Chile. For the time being, this global strategy is weighing on its results but its juicy dividend is still sustainable from its earnings.

## Final Thoughts & Recommendation

While the rest of the Big Six Canadian Banks increased their dividends in calendar Q4 2022, BNS did not. So, the market is correct to discount its valuation currently. We see total annual returns of about 14.7% annually in the coming years. These returns should accrue from a yield of 6.2%, valuation expansion of 5.2%, and 4.8% earnings-per-share growth. As a result, the high-yield stock earns a buy recommendation from Sure Dividend.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Revenue</b>	20,225	21,269	19,052	19,560	20,452	21,931	22,861	23,129	24,571	24,193
<b>SG&amp;A Exp.</b>	6,615	6,532	5,860	5,763	6,083	6,246	6,823	6,746	7,110	7,236
<b>D&amp;A Exp.</b>	506	483	471	516	582	659	792	1,150	1,201	1,189
<b>Net Profit</b>	6,257	6,489	5,652	5,367	6,121	6,644	6,313	5,042	7,650	7,702
<b>Net Margin</b>	30.9%	30.5%	29.7%	27.4%	29.9%	30.3%	27.6%	21.8%	31.1%	31.8%
<b>Free Cash Flow</b>	8,607	4,283	13,009	3,158	12,680	13,520	-9,188	41,576	-10,547	12,716
<b>Income Tax</b>	1,704	1,837	1,493	1,531	1,554	1,851	1,860	1,148	2,282	2,142

## Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Total Assets (B)</b>	709	719	651	668	713	761	825	853	956	992
<b>Cash &amp; Equivalents</b>	50,884	50,657	56,161	34,545	46,506	47,461	35,482	57,392	69,655	48,419
<b>Accounts Receivable</b>	2,591	2,556	2,830	2,926	3,001	3,566	3,864	3,631	3,515	3,986
<b>Goodwill &amp; Int. Ass.</b>	10,212	9,719	8,698	9,050	9,436	13,505	13,264	12,772	13,398	12,369
<b>Total Liabilities (B)</b>	666	675	610	625	665	709	772	800	897	937
<b>Accounts Payable</b>	7,679	6,677	5,575	5,954	6,887	7,162	6,989	6,237	7,198	9,232
<b>Long-Term Debt</b>	5,572	195,192	181,271	165,540	169,238	180,354	192,719	161,570	195,471	225,971
<b>Shareholder's Equity</b>	38,317	40,151	37,289	39,251	43,225	46,528	48,331	47,153	52,248	47,872
<b>D/E Ratio</b>	0.13	4.56	4.59	3.95	3.62	3.63	3.76	3.16	3.42	4.20

## Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Return on Assets</b>	0.9%	0.9%	0.8%	0.8%	0.9%	0.9%	0.8%	0.6%	0.8%	0.8%
<b>Return on Equity</b>	17.0%	16.5%	14.6%	14.0%	14.8%	14.8%	13.3%	10.6%	15.4%	15.4%
<b>ROIC</b>	12.5%	4.5%	2.5%	2.5%	2.9%	3.0%	2.6%	2.2%	3.3%	2.9%
<b>Shares Out.</b>	1209	1222	1232	1226	1223	1229	1251	1243	1225	1208
<b>Revenue/Share</b>	16.73	17.41	15.46	15.95	16.72	17.84	18.27	18.61	20.06	20.03
<b>FCF/Share</b>	7.12	3.50	10.56	2.58	10.37	11.00	-7.34	33.45	-8.61	10.53

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

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