

Seeking Alpha^α

Long Ideas

Financials

Canada

Scotiabank - Let's Clarify The 15% CAGR Upside

Jun. 29, 2021 9:59 AM ET | **The Bank of Nova Scotia (BNS)** | 27 Comments | 41 Likes

Summary

- Financials are one of the few areas with some upside still left in the current market. Though massive reversal has occurred in most stocks, BNS still has room to run.
- The company expects profits to materially improve during 2021, followed by single-digit growth.
- Based on current forecasts and fundamentals, it's not unlikely that your returns could reach double-digits of 10% per year until 2023.
- That makes Scotiabank an A+ rated, fundamentally sound investment that I believe to be a "BUY" here.



JHVEPhoto/iStock Editorial via Getty Images

So, Scotiabank ([BNS](#)). I actually called this company a "BUY" all the way back in November, which now seems an age ago. Since that time, the company has appreciated impressively, especially considering the 8-month period since that particular article.

About This Article

Ticker Covered	BNS
Author's rating at publication	Bullish
Price at publication	\$48.76
Change	33.31%
Total Return	37.53%

Author's Rating History



[Author's full rating history »](#)

(Source: [Scotiabank article](#))

One oft-ask question I get is where people should invest their money in this market to make sure they

1. beat inflation,
2. get returns,
3. and also get some dividends.

That trio of outcomes is hard to achieve in this market due to the overvalued nature of the situation we're looking at today. This makes it doubly important to highlight opportunities that still offer such scenarios as soon as I spot them. Scotiabank is one such opportunity.



(Source: Scotiabank)

Scotiabank - How has the company been doing?

I mentioned in my last article that Scotiabank, such as all financials, was hit hard by COVID-19. Well, like most financials since that time, the reversion to the mean has been rather spectacular. In fact, as we'll see in the valuation portion of the article, we could characterize this bank as pretty much exactly following its discount valuation trend, which is part of what builds a case for a bull thesis here.

The first part of that, however, is the recent results and current forecasts.

Given the YoY comparison period of 2Q21, it's no surprise that the bank reported truly massive improvements overall, following some of the trends of the sequentially preceding quarter.



(Source: Scotiabank)

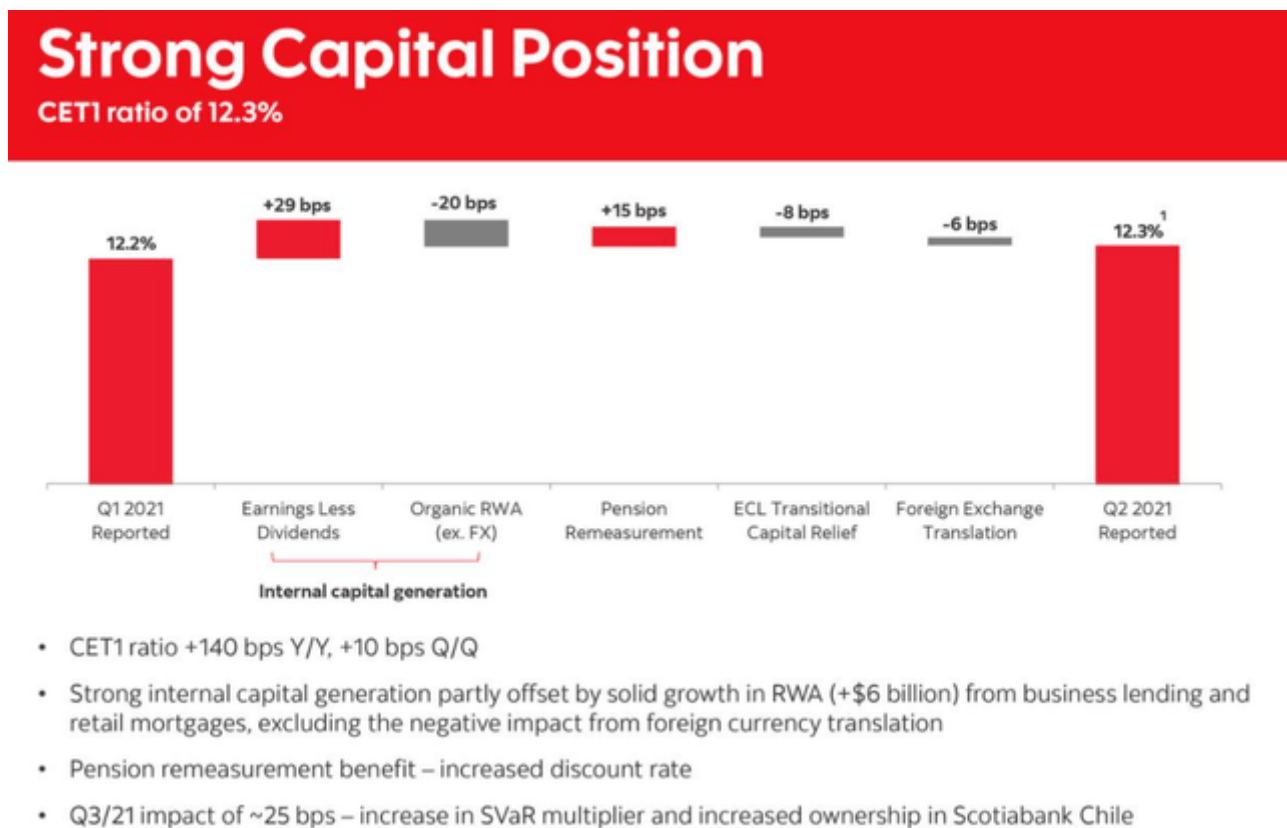
There were plenty of naysayers who put into question the financial viability of many of my favorite financial stocks and larger banks. This is the initial article of a series of financial stock articles where I intend to point out that the potential for mean reversion in most larger, established banks is massive.

By not investing in financials, which now account for around 15-16% of my overall portfolio, you're potentially hampering your returns for next year. Technically speaking, investors now are already a bit "late" on the boat - but that doesn't mean it's not possible to make good returns here.

Despite continued interest rate/margin pressure, BNS managed to improve EPS, net profit, revenues, expenses, and deliver a strong near-15% RoE, which is a 50% Q/Q improvement. Net income was in fact almost double, or a 100% improvement YoY.

The fact that this has gone mostly unhighlighted is pretty amazing to be.

The company retains a very strong capital position. Not as strong as Swedish or Scandinavian banks, which are touching on a 17-19% CET1 ratio, but still respectable, and an overall excellent improvement.



(Source: Scotiabank)

Specifics on the improvements? Scotiabank's customers are depositing more cash, are taking more loans, are seeing fee rebounds as the bank's income normalizes. As the macroeconomic outlook improves, so do the outlooks for banks and for finance overall.

The company's wealth management segment continues pushing boundaries, improving net income by 25% in Canada and 21% internationally, with double-digit revenue increases due to ever more capital entering the market through funds, iTrade, and growth in the private banking segment. The global banking segment is really the only black sheep, as it saw essentially flat net income YoY due to metal businesses winding down. Deposits were up, and loans were up, but the segment was more or less flat YoY. International banking with its focus, however, saw impressive improvements in the triple digits, due to vastly improved credit loss provisions which are no longer needed due to massively improved credit quality.

It's a trend we're seeing not only in Canada but in other parts of the world. Last year, when banks reserved/provisioned massive amounts of capital for potential credit losses, many investors treated this as though it was "gone" and already happened. This is/was not the case, and most of that is now flowing back with provisions normalizing and credit levels improving in lockstep with normalization.

The company, as such, managed the appealing combination of **lower expenses** and **higher contributions** from the key segment, as well as higher overall investment gains, which resulted in a massive improvement in net income, which YoY due to the pandemic was actually in red numbers and didn't turn positive until 4Q20.

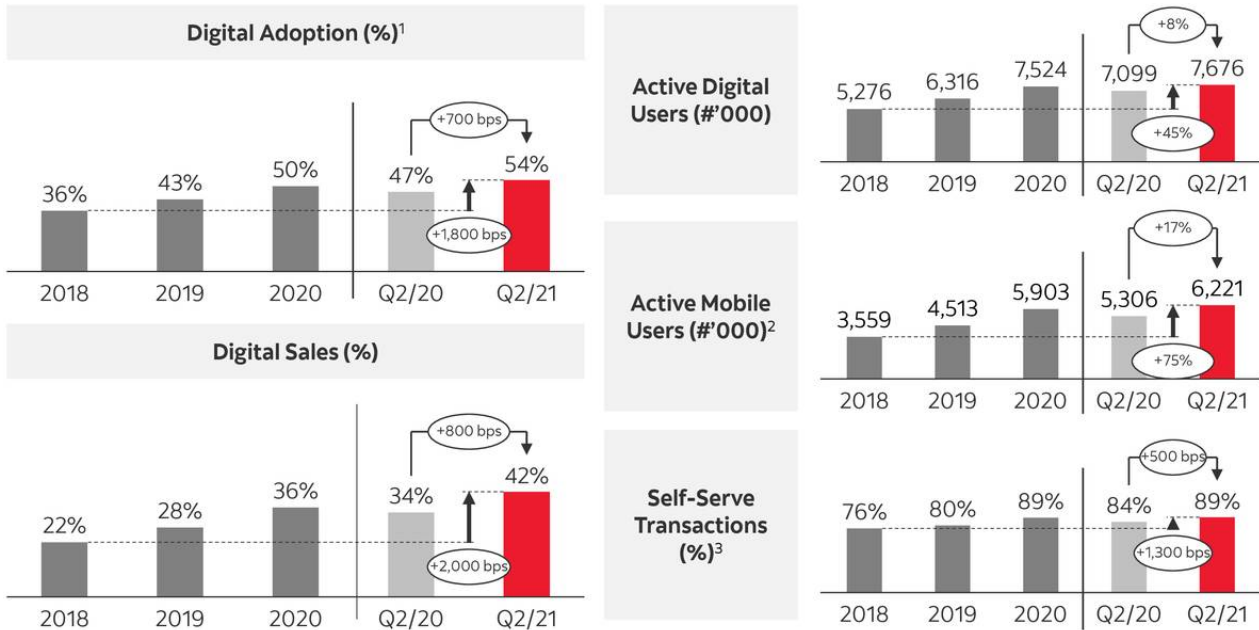
The improved macro outlook is creating ripples across various sectors, and financials are obviously part of these. These trends are global and coupled with the digital improvements made by most banks, it puts larger, well-adjusted banks in the enviable position of having a pandemic-adjusted working strategy with fewer expenses, but with an economy that's recovering to or beyond pre-pandemic levels.

The result, dear readers, can be only one to my mind - profit. The company is expecting 6.5% 2021 GDP growth in the pacific alliance, it has a strong balance sheet, and its overall exposure means that increasing commodity prices, which we have been seeing and which are unlikely to unwind for this year, will result in even better results.

The pandemic trends have resulted in a massively higher adoption for digital...

Digital Progress: All-Bank

- **Canada:** Continued growth in self-serve transactions driven by higher mobile and online usage
- **Pacific Alliance:** Significant mobile user growth across all geographies, particularly in Peru and Mexico



¹CB Digital Adoption definition was updated in Q1/21 to reflect new addressable customer base, excluding indirect-channel acquisitions
²2018 and 2019 use historical estimation based on available mobile user data for Colombia and Chile
³Prior periods from 2018 to 2020 have been restated in Q2/21 to align with current methodology

(Source: Scotiabank)

...which again, affects the bottom line.

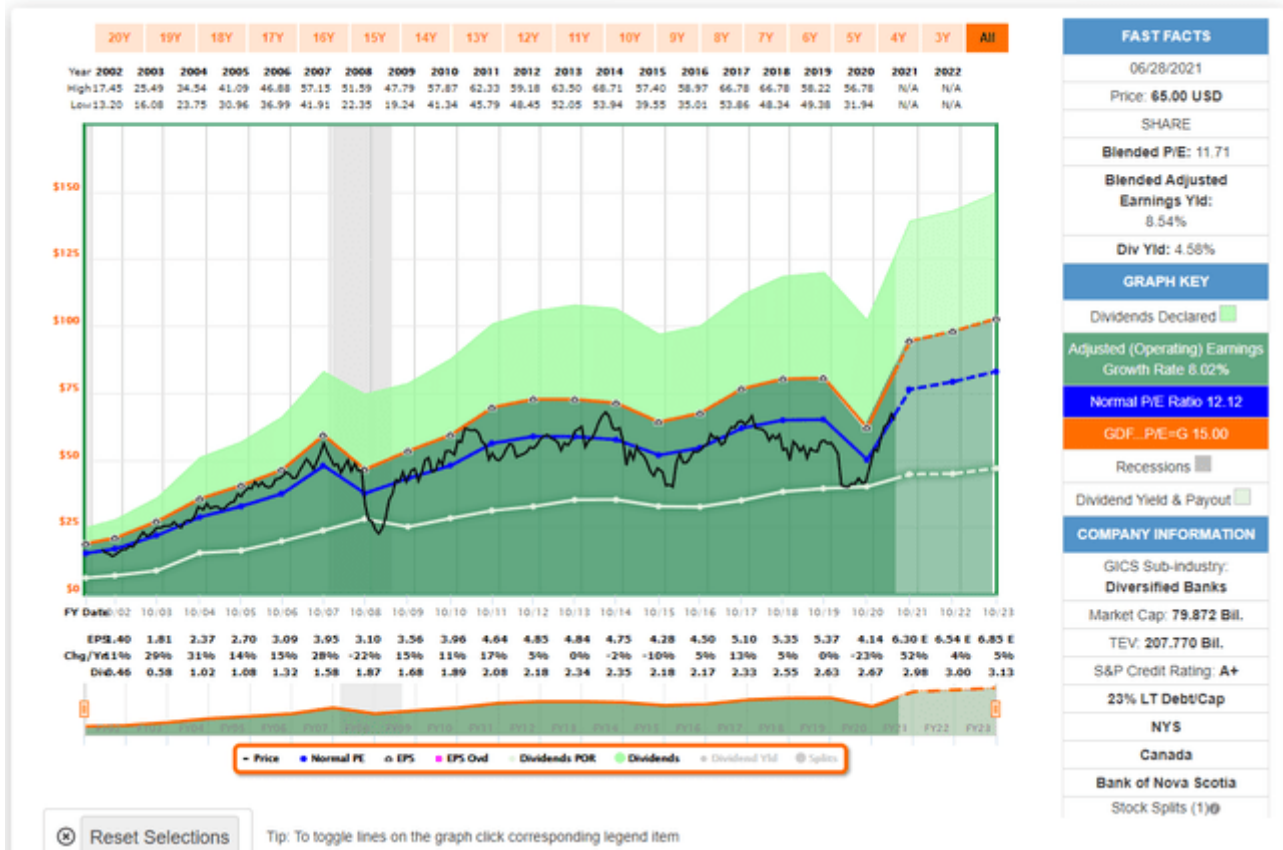
There are plenty of things that speak in favor of the expectations for the company's 2021 results materializing.

Scotiabank - What is the valuation?

These expectations are as follows. As Scotiabank, together with other banks, saw massive negativity during the COVID-19 crisis and at times traded around 8-9X P/E, posting results of -20% EPS for the year, my expectation was for this to normalize in a matter of only years. This has already been exceeded, and the analysts following the company currently expect EPS normalization and growth in 2021, resulting in a 52% EPS growth expectation for FY21.

Price Correlated with Fundamentals **BANK OF NOVA SCOTIA(NYS:BNS)**

Help On/Off

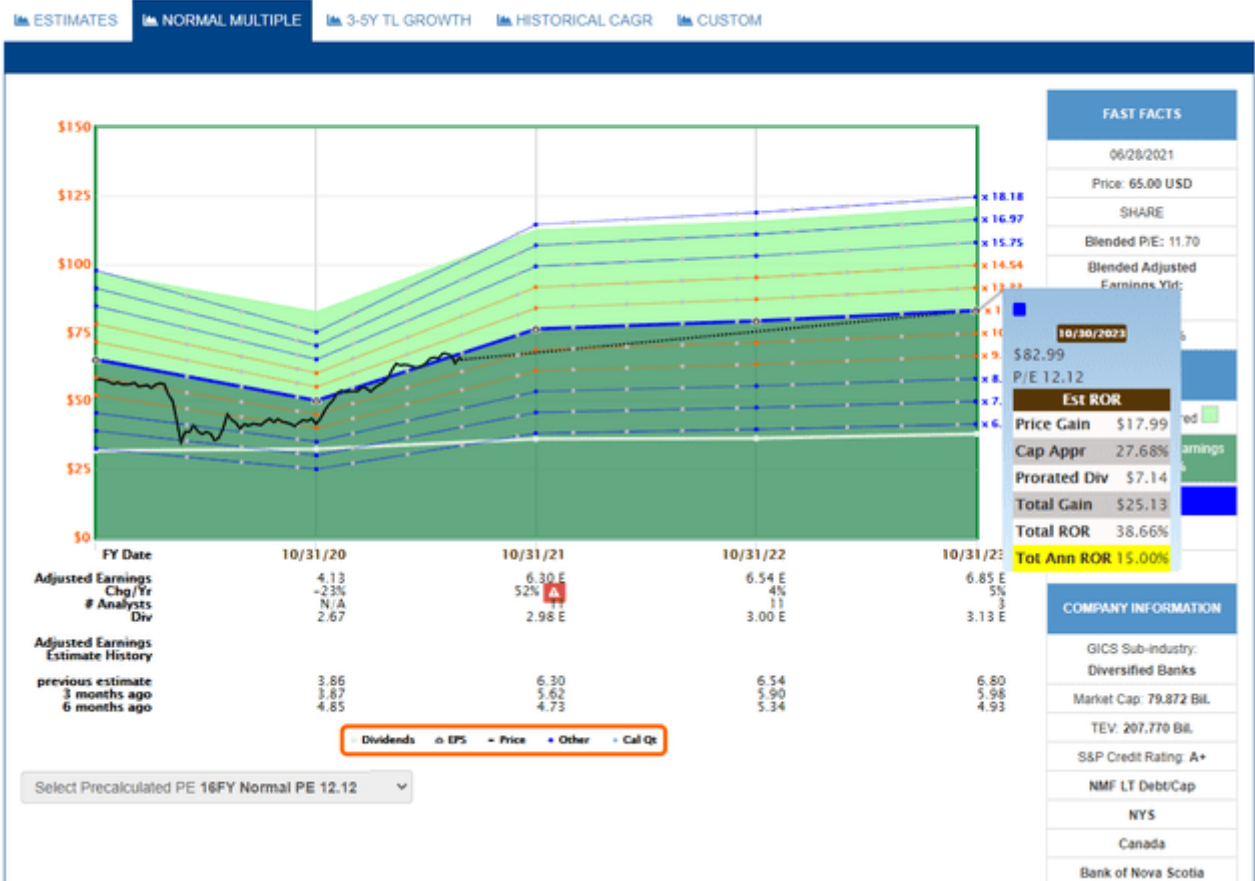


(Source: F.A.S.T Graphs)

Note the near-perfection of the way, over time, the company tracks its 12X P/E ratio outside of periods of extreme volatility. Some wanted to characterize the 2020 drop as a game-changer for banks - I declined to believe this, and it seems to have been the right call.

While not perfect in terms of expectation accuracy, I argue that the combination of actual, improved macro factors together with the company's exposure and already posted results for 1Q-2Q can result in only a massive improvement in overall earnings.

Forecasting Calculators **BANK OF NOVA SCOTIA(NYS:BNS)**



(Source: F.A.S.T graphs)

What I show you here is the expected returns you can get if the company continues to track its 12X P/E, and results come into expectations. Returns would be 15% p.a. until 2023, and even if the company traded at any lower multiple than 8X P/E, which is the pandemic multiple, you would still not be losing money. Your downside, therefore, is extremely well-protected in my book. The company has during exuberance traded as high as 14-15X P/E, at which point I would personally be looking at selling. However, should that materialize, you can expect that 15% to go up well beyond 20% CAGR.

Those are the up and downsides based on the 12X P/E that the company has more or less tracked for 20 years at this point. The company has extremely strong fundamentals, offers an appealing EPS yield of 8.5%, a decent yield of 4.6%. You can buy it both on the NYSE and the TSE - I own the Canadian ticker for higher currency diversification, which I by the way view as a good idea for EU investors able to do the same thing.

Analysts give the company the current overall targets.

Scotiabank (BNS)		Street Targets		
Current Price:	\$65.00	# of Analysts:	2	
Target High	Target Low	Target Median	Target Mean	Target Mean 2020-06-30
\$96.23	\$76.94	\$86.58	\$86.58	\$62.75

(Source: Google Sheets, S&P Global)

The targets for the Canadian ticker more or less mirror these with FX. Analysts give the bank the upside for the results 1-3 years forward, which gives the bank an undervaluation of almost 10%. I would agree with this assessment, given the macro backdrop which, to my mind and in conjunction with quarterly results, show us that the bank will improve its results significantly for the year and that this improvement seems likely to last.

For this, I view this company as a "BUY".

Thesis

I don't see any other approach than the common share being appealing here, given the potential returns to be garnered from investing. BNS is one of the few companies I view as a good "BUY" in today's market. While I've kept a very low profile in terms of buying during this month and haven't touched anything for almost 3 weeks at this point, this is a company I follow closely and one I potentially would buy.

This bank checks all of the boxes for my investment requirements.

1. **This company is overall qualitative.**
2. **This company is fundamentally safe/conservative & well-run.**
3. **This company pays a well-covered dividend.**
4. **This company is currently cheap.**
5. **This company has realistic upside based on earnings growth or multiple expansion/reversion.**

I've been writing much on pharma lately - this isn't pharma, but it's in a not dissimilar position of potential upside. Cheap in this case means below what I consider fair value. There are degrees of cheapness, and while BNS isn't 50% undervalued, it's certainly where I would consider it "cheap" for what you can get in a few years.

Because of these fundamentals and the forecasts mentioned here, I say "BUY".

Do you consider Scotiabank to be a "BUY"? Do you already own the stock? Are you buying more? Let me know.

Thank you for reading.

This article was written by



Wolf Report

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35-ish year DGI investor in private portfolio management for a select number of clients in Sweden. Invests... [more](#)

Disclosure: I am/we are long BNS. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

Additional disclosure: While this article may sound like financial advice, please observe that the author is not a CFA or in any way licensed to give financial advice. It may be structured as such, but it is not financial advice. Investors are required and expected to do their own due diligence and research prior to any investment. Short-term trading, options trading/investment, and futures trading are potentially extremely risky investment styles. They generally are not appropriate for someone with limited capital, limited investment experience, or a lack of understanding for the necessary risk tolerance involved.

I own the European/Scandinavian tickers (not the ADRs) of all European/Scandinavian companies listed in my articles. I own the Canadian ticker of Scotiabank.

41 Likes

27 Comments

Comments (27)

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dunnhaupt

02 Jul. 2021, 8:14 AM



Comments (4.98K) | [+ Follow](#)

I usually don't consider recommendations made immediately after ex dividend. But BNS is a good and safe buy any time of the year.

[↩ Reply](#)

[👍 Like](#)

**Sugar Charlie**

30 Jun. 2021, 5:22 PM

Comments (1.54K) | + Follow

Long all the Big 5 Canadian banks, including BNS, which has been frustrating for several years, mainly because of its mix of business, different from the other big Canadian banks, with a significant investment in LatAm and Asia. As these economies improve, so will BNS, which has been trying to improve its mix with greater emphasis on wealth management.

[Reply](#) [Like \(1\)](#)**jegreen4684**

29 Jun. 2021, 10:15 PM

Comments (69) | + Follow

I've been long on BNS since early 2020. I continue to buy shares regularly.

[Reply](#) [Like \(1\)](#)**youngdividend**

29 Jun. 2021, 8:26 PM

Comments (1.01K) | + Follow

The reason in my opinion why BNS has underperformed their peers is because of the share dilution of previous wealth management acquisitions. They used shares to acquire Jarislowsky and Fraser and also MD Financial. They also used shares to buy ING. So share dilution is the reason in my opinion.

[Reply](#) [Like](#)**dunnhaupt**

02 Jul. 2021, 8:15 AM

Comments (4.98K) | + Follow

[@youngdividend](#)

Smart moves, in my opinion.

[Reply](#) [Like](#)

**dividendhigh**

29 Jun. 2021, 8:04 PM

**Premium** Marketplace

Comments (2.36K) | + Follow

[@Wolf Report](#) - I agree that BNS is a buy and thank you for the article which reinforces that view. It has become my largest bank holding because I added lots of shares cheaply last year. I am waiting for a nice dividend increase. My plan is to add more shares at or below current prices. *(edited)*

[↩ Reply](#) [👍 Like](#)**CJ 105**

29 Jun. 2021, 6:03 PM

**Premium**

Comments (6) | + Follow

Have a small position in one of my IRA accounts and I intend to increase my holdings of BNS.

Also have a position with RY in my regular brokerage account and consider it one of my best if not my best stock with a 32 % gain over the past year.

[↩ Reply](#) [👍 Like \(1\)](#)**rwmorgan48**

29 Jun. 2021, 4:02 PM



Comments (408) | + Follow

Opened a position 9/2/2020 at \$42.62 and added more 11/30/2020 at \$49+ . Been holding steady with 2/3 of a position as I am beginning to worry about real estate valuations/affordability in Canada. It does look like value is \$75 by this time next year. Comments here about SA also now worry me. Usually follow your suggestions but this time.....?

[↩ Reply](#) [👍 Like](#)**amicus**

29 Jun. 2021, 12:56 PM

**Premium**

Comments (12) | + Follow

Long BNS since Nov 2020 and up almost 60% including dividends. Currently enjoying 7% yield on cost. Very happy!!!

[↩ Reply](#) [👍 Like \(2\)](#)

**usiah**

29 Jun. 2021, 11:11 AM

Comments (10.14K) | + Follow

BNS was essentially flat overall for more than 10 years (2010 through 2020). I got tired of waiting for it to show real progress and sold a few years ago. However, have been contentedly holding RY for well over a decade.

Retired dividend-growth investor *(edited)*

[Reply](#) [Like](#) (3)

**aprimian**

29 Jun. 2021, 10:59 AM

Premium **Marketplace**

Comments (53) | + Follow

Retired investor. In at \$42.19 so YOC @ 7%. Believe it has 18 more months of runway on double-digit returns. Keeping a watchful eye on South America, though.

[Reply](#) [Like](#) (2)

**Duras**

29 Jun. 2021, 10:54 AM

Premium

Comments (941) | + Follow

I'm long BNS, bought it for all your well stated reasons, but also for exposure to emerging markets in Central and South America. Have planned to continue buying on dips.

[Reply](#) [Like](#) (4)

**TaiPan**

29 Jun. 2021, 11:13 AM

Comments (4.02K) | + Follow

[@Duras](#)

The international reach of BNS is a double-edged sword: at times it has benefited BNS, but at other times this diversification has hobbled BNS's earnings.

[Reply](#) [Like](#) (5)

**Duras**

29 Jun. 2021, 11:34 AM

**Premium**

Comments (941) | + Follow

[@TaiPan](#) Thank you Taipan. I know it's a mixed bag and hard to call. When I bought it, emerging markets looked good, they may still, although as someone else mentioned here, there are some political developments that may not be helpful. My plan, which I haven't implemented yet was to balance this holding with another bank, preferably Canadian, started looking at CM, but haven't delved yet. Banks aren't my normal stomping ground, if you have any to recommend I'm all ears.

[Reply](#)[Like](#)**usiah**

29 Jun. 2021, 12:06 PM



Comments (10.14K) | + Follow

[@Duras](#)

I'm not TiaPan, but if you're looking for dividend yield/growth, you might check out AQN. If a bank, how about RY? *(edited)*

[Reply](#)[Like \(2\)](#)[See More Replies](#)**Philly62**

29 Jun. 2021, 10:50 AM



Comments (46) | + Follow

I am a long term investor in BNS but I think it's pretty close to full value at these levels. I'm a buyer when it yields ~5%. Holding at these levels.

[Reply](#)[Like \(5\)](#)**GE Smith**

29 Jun. 2021, 10:41 AM



Comments (406) | + Follow

[@Wolfreport](#), re "Do

you consider Scotiabank to be a "BUY"? Do you already own the stock? Are you buying more? ", I overweighted CDN banks last year including \$**BNS**. However I treated it as a "Special situation" not something I want to buy and hold like \$**TD**, \$**NA**, or \$**RY**. As such I sold my \$**BNS** position this month.

[Reply](#)[Like \(1\)](#)

**oilBoss**

29 Jun. 2021, 3:17 PM



Comments (86) | + Follow

[@GE Smith](#) ..same here buying more RY, BMO and TD but just holding BNS. so maybe sell the BNS and drop the proceeds into the first three..??

[Reply](#)[Like \(1\)](#)**Fabien Hug**

29 Jun. 2021, 10:35 AM



Marketplace

Comments (4.86K) | + Follow

I'm long BNS 60% ago. I had the nose to accumulate banks during the last crash.

[Reply](#)[Like \(2\)](#)**murayc1968**

29 Jun. 2021, 10:20 AM



Comments (224) | + Follow

I've been overweight BNS For some time but recently lightened up after recent news on the political situation in Chile. They have recently increased their presence there just when it appears the socialists are poised to take control of the country. Their stated objectives are decidedly anti business and would not be favourable to foreign banking entities.

[Reply](#)[Like \(2\)](#)