Can the Bank of Nova Scotia Build on the Record Earnings Achieved in 2013?

Description

On Friday of last week, The Bank of Nova Scotia (TSX: BNS, NYSE: BNS) reported earnings for its fiscal fourth quarter and year ended October 31, 2013 announcing a new record for annual net income. The report of this record setting year was enough to put a little heat under the shares which rose as much as 3% in the days following the announcement as investors digested the results. The stock had languished during the week leading up to the announcement falling nearly 4.0%. Shares have since cooled and now trade near preannouncement levels.

The top and bottom line

For the year, net income for Scotiabank set a new record coming in at $6.70 billion which compared positively to the $6.47 billion reported for the prior year. Adjusted and fully diluted earnings per share were $5.14 which was slightly ahead of the consensus analyst estimate of $5.13 and slightly beat the company's stated goal of growing EPS by 5 to 10% with growth of 10.2%. Revenues for the fiscal year also topped analyst estimates coming in at $21.66 billion versus $21.39 billion projected by the pros.

Fourth quarter earnings were also nearly in line with expectations with net income increasing 12% over the prior year to $1.70 billion. Earnings per share of $1.31 were only slightly below the consensus estimate of $1.32 per share. Revenues were slightly ahead of estimates coming in at $5.49 billion versus an estimate of $5.40 billion.

Leading the way

The Canadian banking unit led the way with a record year and the fourth quarter represented the second consecutive quarter of record net income. The unit's net income of $2.3 billion and $593 million supplied roughly one-third of the bank's total earnings for the fiscal year and fourth quarter, respectively. The Canadian banking unit is benefiting from its acquisition of ING Direct Canada which was completed just over one year ago. The unit also saw higher margins, lower loan loss provisions and strong asset growth from its existing lines within Canada.

The Canadian unit could continue to be the shining star within the organization. Management intends to further leverage the ING Direct acquisition in the future. In the spring of 2014, ING Direct will be rebranded as Tangerine. The bank intends to build on the value proposition offered by ING Direct sought by self-directed customers with the expectation of growing deposits and forming new banking relationships.

Meeting expectations

With any company, management's ability to meet internal goals is always important for investor confidence. Mission accomplished for Scotia's team. Key objectives included earning a return on equity of between 15 and 18%, generating earnings per share growth of 5 to 10%, maintaining a productivity ratio of less than 56% and preserving strong capital ratios. At the end of the fiscal year, management was able to check each one off as a success with return on equity of 16.4%, earnings per share growth of 10.2%, a productivity ratio of 53.5% and an all-in Basel III Tier 1 ratio of 9.1%.

Investors seemed pleased overall that management delivered on its promised objectives. In laying out new medium-term goals, the bank stuck with similar objectives and targets. The one minor change was to switch the objective of maintaining a productivity ratio of less than 56% to producing positive operating leverage. Positive operating leverage will further enhance the productivity ratio and management believes it is a more granular measurement and better for tracking the overall business.

Final thoughts

Scotiabank boasts as being Canada's most international bank; however it will again most likely lean on a strong performance from the Canadian banking unit to meet its objectives. In order to achieve the necessary results, the bank will continue to take advantage of its ING DIRECT acquisition and build upon the existing deposit base. In addition, management intends to become a customer's primary bank by ensuring an easy and consistent experience across all business lines in order to further grow assets.   Similar steps are being taken within the international banking unit to land long-term primary banking relationships as well as ongoing efforts to reduce structural costs.

So is Scotiabank a sound investment for 2014? If management continues to deliver on stated objectives, shares of the bank should continue to grind higher in a flat to positive market and provide some downside support if the markets turn sour.   This combined with a dividend that was boosted twice in 2013 and is now yielding 3.9% should allow investors to earn a reasonable 8 to 10% total return in 2014.

CATEGORY

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