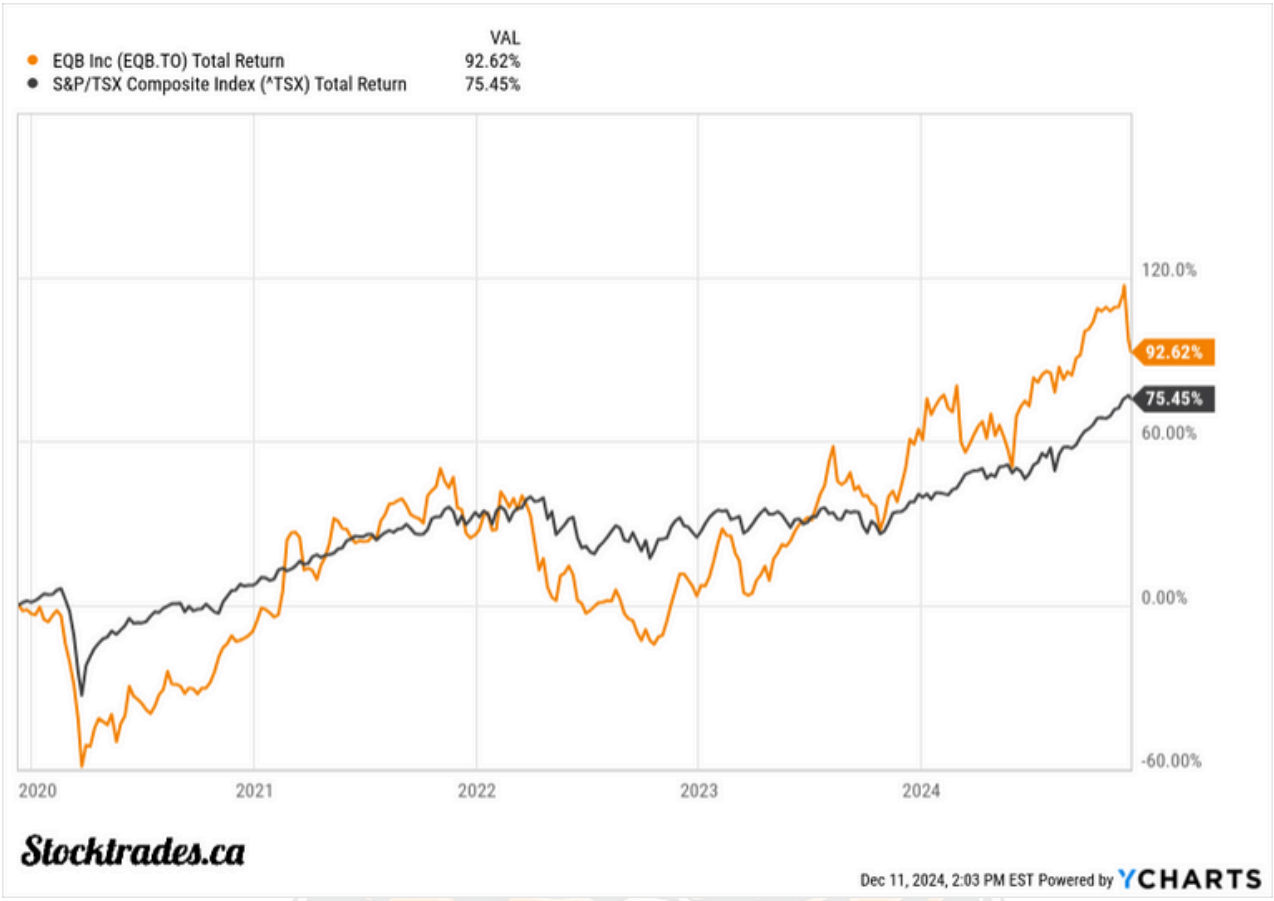
STOCKTRADES PREMIUM COMPANY SUMMARY

EQUITABLE GROUP

EQB.TO

UPDATED DECEMBER 11, 2024

NOTE: DAN IS LONG EQB



EQB Inc operates through its wholly owned subsidiary, Equitable Bank, Canada's Challenger BankTM. It serves Canadians through two business lines, Personal Banking and Commercial Banking. The company differentiates by providing a host of challenger bank deposit services, alternative single-family lending, reverse mortgage lending, insurance lending, specialized commercial financing and equipment leasing. It offers various accounts to the consumer such as Savings Plus Account, Joint Savings Plus Account, TFSA Savings Account and US Dollar Account.

Focus Areas	Score (0/100)	Focus Areas	Score (0/100)
Valuation	56	Dividend	95
Profitability	45	Outlook	64
Risk	50	Debt	20
Returns	92	Growth	62
Overall	55		

*Our Risk Rating: Our opinion of the overall risk an investment presents. Can be shown as Defensive (DEF), Moderate (MOD), or Aggressive (AGG). By no means is this an indication of future potential gains or lower volatility.

PROS

- Industry leading 15% ROE
- Consistent dividend raises on a quarterly basis. The company has more than doubled the dividend over the last 2 years
- Although not a value play anymore, still provides strong growth in terms of earnings and the dividend
- Acquisition of Concentra makes it the 7th largest bank by assets in Canada
- Two decades of consecutive top and bottom line growth
- A large percentage of its mortgage portfolio is insured
- CET 1 ratio of 14.7%, stronger than many Big 6 Banks

CONS

- A recession is somewhat impacting growth. Provisions are rising and gross impaired loans are creeping upwards
- Large exposure to lower quality mortgages
- Not as many products as major institutions, meaning less diversity when it comes to earnings
- Due to growth, its dividend yield is small compared to other financial stocks
- Although still strong, growth is slowing because of higher rates
- The valuation gap has closed and we'd view the company as fairly valued
- Its main growth driver right now is deposit based. If competition ramps up or GIC rates start to fall, the attractiveness of its products could dip

OVERALL THESIS

One of the negative associations with alternative lenders is the fact that they typically take on higher risk. Not so for EQB, which has one of the most robust loan portfolios, as evidenced by their "credit losses (CL) to total loan value (TLV)" during the pandemic. Equitable is quickly becoming a welcomed alternative to the Big Banks. It is adding customers at a rapid pace and continues to expand the breadth of its offerings. It has added products like the EQ Bank Tax-Free Savings Account, EQ Bank RSP Savings Account, and EQ Bank Joint Savings Plus Account - all of which offer much higher interest rates than the big banks. It has a reverse mortgage program and a suite of US products. The more the company adds services/products, the more customers are likely to make the switch, and this is becoming clear over the last few years. The acquisition of Concentra Bank is helping this company fuel further growth and continue providing exceptional shareholder value. With 20 consecutive years of earnings and revenue growth, few companies have achieved this consistency on the TSX Index. The chronic undervaluation of EQB due to its perceived higher-risk portfolio has disappeared. However, our thesis of this company being one of the strongest financial growth plays in North America is still well intact and has been reaffirmed numerous times whenever the company makes increases to its guidance.

POTENTIAL RISKS

As we've seen this past year, financial stocks are vulnerable to a weakening economy. Credit risk is arguably the most considerable risk, which takes the form of provision for credit (or loan) losses. PCLs are a forward-looking estimate in which financials like EQB identify loans that they are unlikely to recover. They write them off as losses and end up taking a hit on earnings. EQB is also at risk as a higher growth stock if growth slows.

The company has ambitious annual objectives in which it expects to grow earnings by double digits annually and grow the dividend by 20-25%. Should it miss on these, investors could expect price weakness. While not unique to EQB, as a digital bank, cyber security is also a risk.

Beta	**1.4**
Alpha	**3.4**
Our Risk Rating	**Mod***
Max Drawdown	**61%**

Any hack or adverse cyber security event could have significant, immediate, and long-lasting impacts. In short, depending on the severity of the attack, it could be devastating. Equitable Bank will no doubt grow more in a thriving economy.

If Canada were to enter a recession, especially considering Equitable's reliance on mortgages, it could be impacted for two reasons. For one, the market would perceive its portfolio of mortgages as higher risk, as most come to Equitable after a major bank shuts them down.

Secondly, the housing market would likely slow in a recession, thus Equitable's growth. Another notable risk is interest rate risk. Equitable will be exposed to the ebbs and flows of interest rates, which will impact the profitability and attractiveness of its products. And finally, with a large-scale acquisition like Concentra, there is a chance that synergies could take longer to come to fruition, or they could be less than anticipated.

Finally, it is important to understand that Equitable Bank is a deposit-heavy bank. This means they are relying heavily on new customers via deposit methods like GICs, savings accounts, etc. This is why we are seeing the large-scale customer growth right now that they are. However, if competition were to ramp up in the space, which we already see with Wealthsimple's lucrative offerings, growth could slow for Equitable. It needs to continually adapt and offer the best suite of products possible to continue the trajectory of its client growth.

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VALUATION

	TTM	5 Year Average	Industry Average
P/E	10.13	8.25	13.15
P/S	3.14	2.95	3.18
P/B	1.25	1.14	1.10
P/FCF	N/A	N/A	N/A
PEG Ratio (FWD)	0.45	N/A	N/A

Since 2018, we have expressed that Equitable Bank was chronically undervalued relative to the other major institutions in Canada. And due to an exceptional streak of strong results, that valuation gap has closed, and Equitable is trading at what we would feel is a fair value. The company is trading at a slight premium to its historical price-to-earnings ratio and a premium to its average price-to-book ratio. In fact, this is the first time, other than a brief stint during its IPO, when the company has traded at a higher book value than some of the other major institutions here in Canada.

This is a notable milestone and a sign that the market is warming up to this challenger bank. In terms of whether or not you should still consider Equitable Bank at what we feel are fair valuations, we go back to the old Buffett saying.

"It's better to buy a wonderful company at a fair price than a fair company at a wonderful price."

The company stumbled a bit in the fourth quarter after missing its annual targets due to some large provisions, but I'm not really all that worried over the long-term.

Looking further out, we can use some basic assumptions to get a projected potential share price. If we assume Equitable hits next year's guidance, follows that up with 15% earnings growth in the four years after that, and issues 10% more shares, we come to earnings per share of $19.28. Using the bank's current 5-year average PE ratio, we get a share price of $153.29.

If the market finally decides to permanently reward Equitable's growth through a higher PE multiple, share price estimates can get even higher. For example, suppose Equitable Bank were to hit the same growth targets projected above but be rewarded a 10x earnings multiple. In that case, we come to a share price of $192.80, which would be just under a 100% increase in share price at its current levels.

With a recession on the horizon, tempering expectations is important, even with the string of

rock-solid quarters. Considering the current economic uncertainty, we'd be more comfortable taking the lower end of estimates as our targets, especially with the company's soft close to Fiscal 2024.

COMPETITOR ANALYSIS

	EQB	GSY	FN
P/E	10.13	9.99	13.81
P/S	3.14	1.93	4.54
P/B	1.25	2.28	3.88
P/FCF	-	-	-

Equitable has historically commanded lower price multiples than competitors such as Goeasy Ltd (GSY). However, because of the weakening economy and the fears around the sub-prime market, it is now more expensive. Still, even though they are both considered alternative lenders, they operate in different industries, so it isn't a perfect apples-to-apples comparison. We can also compare it to First National, a mortgage-heavy lender similar to Equitable. In this case, we see that EQB is trading at a larger discount to First National.

All these lenders remain attractively valued at this time. Overall, we view Equitable as the most attractive, even after its large-scale runup in price. It is also important to note that Home Capital Group, a company that is, in our opinion, inferior to Equitable, was acquired in late 2022 for approximately 1.1 times book value. As of this updated report, Equitable Bank is trading at 1.3x its book value, confirming our thesis that the company is fairly valued at this time.

DIVIDEND ANALYSIS

Annual Dividend	Payout Ratio (EPS)	5 Year Dividend Growth %	Dividend Growth Streak
1.96	15.4%	18.18%	13

Make it twelve consecutive quarters in which Equitable announced a dividend raise. This past quarter management announced another 4% raise to the dividend. It will now pay $1.96 annually. If we look to when the dividend freeze was lifted in late 2021, Equitable has now more than doubled the dividend since that time.

Before the pandemic, Equitable grew the dividend at one of the fastest paces among all

Canadian Dividend Aristocrats. The company is targeting 20-25% annual dividend growth moving forward, and in 2023 it hit 24%. Considering the payout ratio is only around 19% of earnings, we have no doubt it will hit that mark.

Continue to expect smaller, quarterly increases to the dividend for Equitable Bank. This was the strategy pre-pandemic, and it looks to be one it will continue with moving forward.

RECENT EARNINGS

Earnings Estimates	2025	2026	2027
EPS	$12.07	$13.73	N/A
Revenue	$1.27B	$1.388B	N/A

After a long streak of rock-solid quarters, Equitable Bank reported what I feel is its weakest quarter in years. In fact, this was one of the larger misses in earnings relative to estimates I have witnessed since I started covering the company in 2019.

However, it's certainly not doom and gloom, and the bulk of the miss was from likely one-time provisions when it comes to an equipment company the company loaned capital to that is in a bit of financial difficulty.

Earnings per share of $2.51 missed expectations for $2.909, and revenue of $321M came in just shy of the $325M estimated.

Before I get into the overall results on the year, I'll speak on the provisions. Provisions for credit losses increased to just under $90M in Fiscal 2024, and a large booking of PCLs in the fourth quarter is what caused the earnings miss primarily. The bright spot is that 71% of those PCLs came from a single company, the Pride Group, a trucking and logistics company currently going bankrupt.

Because of this, the spike in provisions is likely to be a one-off, and the company should get back on track in terms of earnings growth in 2025.

When we look to full-year numbers, the bank closed out the year with EPS of $11.03 and customer growth of 28%. The bank now has over 513,000 customers and is continually growing its base on the back of rock-solid new products.

The company's assets under management grew by 14% year over year, and book value per share now sits at $77.51, a double-digit increase.

As mentioned above, the company bumped the dividend by 4.2%, a historically lower number than we are used to. I do believe it is because of those higher provisions.

The bank's CET 1 ratio sits at 14.3%, making it one of the better-capitalized banks in the country, and its 15% return on equity in 2024 is also right up there with some of the best-performing Canadian institutions like Royal Bank.

Overall, it was a strong year from Equitable, overshadowed by some one-time provisions that should be forgotten about in 2025 as it continues to carve out its path as a challenger bank.

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