STOCKTRADES PREMIUM COMPANY SUMMARY

NATIONAL BANK

NA.TO

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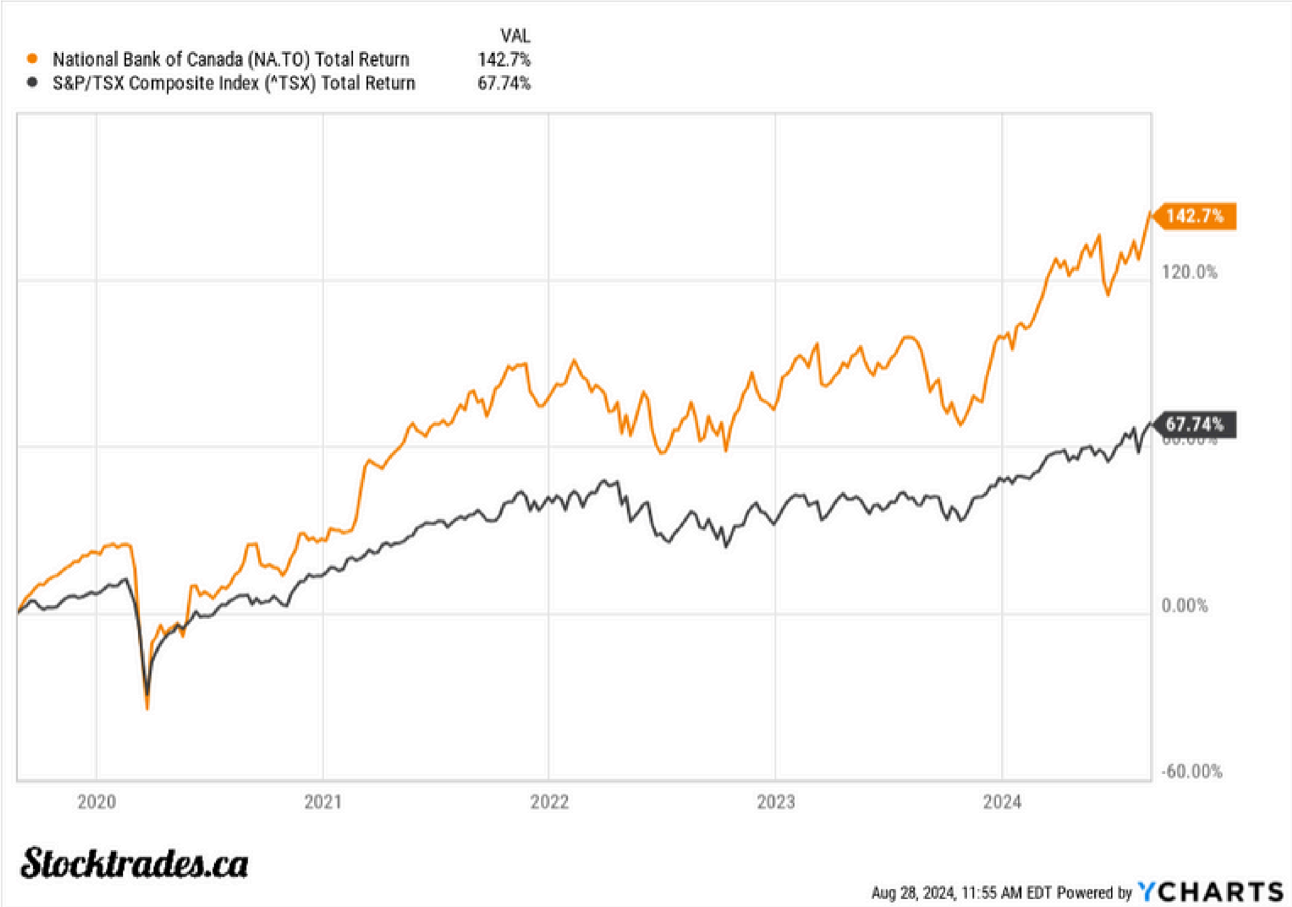

National Bank of Canada is the sixth-largest Canadian bank. The bank offers integrated financial services, primarily in the province of Quebec as well as the city of Toronto. Operational segments include personal and commercial banking, wealth management, and a financial markets group.

OUR GROWTH SCORE: 3.2/5

Sector: Financial Services

Industry: Banks

Current Price: $125

OUR DIVIDEND SAFETY SCORE: 2.2/5

Stock Type: Growth/Income

Our Risk Rating*: Defensive

1 Year Price Target: $118.38

*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

- Best performing Big Six bank over the past 3, 5, and 10 year periods.
- Owns a 14-year dividend growth streak and one of the lowest payout ratios in the industry
- Highest 5YR dividend growth rate among the Big Six banks
- Consistently has among the highest returns on equity
- The most Canadian-focused of the Big Six and as such, the least exposed to less regulated environments
- Has one of the lowest exposures to hot Canadian housing markets
- Acquisition of Canadian Western will give it large exposure to Western Canada

CONS

- Lower-than-average yield compared to its peers
- The most Canadian-focused of the Big Six and as such, is highly reliant on the state of the Canadian macro-environment
- It is also highly concentrated in Quebec (~55% of the business)
- The company is trading at a premium to historical averages due to exceptional results

OVERALL THESIS

Our overall thesis with Canadian banks, mainly the "Big Six" banks, has been simple: We identify the cheapest bank, and we buy that bank. That said, the environment for banks during this period of high rates and continued macro-uncertainty is making us shift our strategy somewhat.

Instead of looking to the cheapest bank today, we're shifting focus and presenting the best-performing banks to members. We already have one as a Foundational, Royal Bank of Canada. The other one that doesn't get near enough credit is National Bank. It often gets left out of the Big 5 conversation since it is the smallest of the bigger banks and because of its regionality.

Approximately 85% of income comes from Canada (55% from Quebec); depending on your viewpoint, this can be a good or bad thing. On the one side, it has the least exposure to higher-growth international and US markets. On the other, Canada's banks are among the best in the world because of the regulated nature of our industry. They are successful because of, not despite, our system, and as the most exposed domestic bank of the Big 6, National Bank has outperformed all the others in recent years. Why? Because those high-growth markets are proving to be more volatile and are undergoing geo-political and macro events of their own. Think of the US regional banking crisis in 2023 and even the borderline failure of NYCB in 2024.

It also benefits from higher returns because it is Canadian-focused and has one of the lowest exposures to hot mortgage markets. Royal and National are also the only banks to report YoY earnings gains in Fiscal 2024. Our shift here is simple: go for one of the best-performing banks in the country amidst the current macro-uncertainty.

POTENTIAL RISKS

Rising interest rates: Once a tailwind for Canadian banks, they have become a headwind. The Bank of Canada deployed its most aggressive rate hike campaign in its history. Even though we've avoided a big recession, the Canadian economy is still teetering on the edge. Inflation is high enough that cuts are not yet on the table, and the longer rates remain high, the harder it is on Canadian consumers.

This adds much uncertainty to the banks' projected earnings, as provisions for credit losses (PCLs) have been highly volatile. Throughout 2023 and into 2024, the banks have been ramping up PCLs. Although we are likely moving into a rate cycle that will result in multiple cuts to rates, there is some uncertainty as to how far they'll come down.

Beta	**1.13**
Alpha	**5.11**
Our Risk Rating	**Def***
Max Drawdown	**48.22%**

Credit risk is also a real threat to banks, especially mortgages. Higher rates put pressure on the ability of borrowers to make payments, notably borrowers with variable-rate mortgages or for whom the mortgage term is up for renewal.

Additionally, there is always a market risk with banks. Poor capital markets will not only continue to put pressure on customer trading activity and inflows to their products, but it will also continue to reduce the value of the bank's assets.

Finally, while the bank's exposure to Canada is one of the main reasons for its outperformance, it can also be a threat to the company, especially due to its high exposure to Quebec. As we mentioned, it has low exposure to hot mortgage markets like Toronto and Vancouver, but on the flip side, it has the highest exposure to Quebec. So, National Bank would be the most impacted if there is a significant downturn in that province.

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VALUATION

	TTM	5 Year Average	Industry Average
P/E	13.10	10.9	12.16
P/S	4.08	3.39	2.97
P/B	1.89	1.69	1.39
P/FCF	N/A	N/A	N/A
PEG Ratio (FWD)	N/A	N/A	N/A

Canadian banks, and any bank for that matter, are relatively easy to evaluate. The company's price-to-earnings ratio and its price-to-book ratio give a good idea of how cheap or expensive a bank is. Ultimately, we want a bank producing the best earnings for the lowest price possible and one that is attractively valued relative to its loan book. Canadian banks usually revert to their historical price-to-earnings ratios when trading at a discount almost 100% of the time.

At the time of writing, National Bank is trading above historical averages. There are a couple of main reasons for this. First, higher provisions for credit losses (PCLs) have negatively impacted recent earnings. Still, the company's share price has held up quite well.

Why is that? As mentioned, National Bank generates some of the highest returns in the industry thanks to its greater exposure to Canada's highly regulated banking environment. Other Big Six banks are dealing with macroeconomic environments that National Bank has somewhat avoided. In terms of P/B - the company is right in line with averages.

From our perspective, National Bank is fully valued here. That said, our strategy this time around is different. Instead of going for the cheapest bank, we wanted to highlight the most reliable and consistent performer.

We also need to consider that Canada dropped interest rates before the US. Why is this a benefit? As mentioned, National Bank has more exposure to the Canadian economy as a percentage of its total loan book.

Mortgage interest payments have doubled since 2022, and there are ~$250 billion mortgages up for renewal this year and an additional $352B in 2025. If rates remain high, Canadian consumers will be feeling considerable pain, which is a position the Bank of Canada likely wants to try to avoid.

For this reason, rates dropping in Canada before the US is likely a tailwind for National at this time. Its higher valuation multiple on a trailing basis is likely because analysts expect more growth moving forward from the company.

COMPETITOR ANALYSIS

	NA	CM	RY
P/E	13	11.35	14.77
P/S	4.08	2.87	4.07
P/B	1.89	1.39	2.02

For the competitors, we've decided to add the banks with the largest Canadian exposure in Royal and CIBC. The Canadian Imperial Bank of Commerce is heavily exposed to Canadian real estate and, as a result, tends to trade at discounted valuations relative to the other major Banks. Royal, on the other hand, is often considered the premiere blue-chip bank. As a result, it tends to trade at a heavy premium to the other institutions. Relative to Royal Bank, National is attractive on a price-to-earnings and book basis, primarily because it should be able to continue to grow faster than Royal due to its smaller nature. In fact, it is positioned to grow faster than any of the Big 6 Banks moving forward. As such, we feel the premium valuation is justified.

DIVIDEND ANALYSIS

Annual Dividend	Earnings Payout Ratio	5 Year Dividend Growth %	Dividend Growth Streak
$4.40	41.6%	10.28%	14

We always like to have at least one of Canada's banks on the Dividend Bull List because they have been among the best dividend stocks in the country. Despite some challenging environments over the past couple of decades, these stocks just keep on paying out reliably, year after year.

At 14 years, National Bank has the longest dividend growth streak among the Big 6 banks, and at 10.28%, it has the highest five-year dividend growth rate. It remains well positioned to out-raise its peers as its payout ratio of 41% is among the lowest in the industry.

National Bank raised the dividend by 3.7% in its second quarter 2024 results. It seems like National Bank is going to be turning to a bi-annual raise schedule, providing smaller, more frequent dividend raises.

The one thing we will mention is that their double-digit dividend growth rate is likely to be unsustainable in this current environment. This isn't unique to National but to all major banks, as the tough macro-environment is impacting earnings, and you will likely see banks be more cautious moving forward until the situation improves. When it does, I fully expect National to revert back to its trend of double dividend annual dividend growth.

RECENT EARNINGS

Earnings Estimates	2024	2025	2026
EPS	$10.07	$10.46	$11.34
Revenue	$11.38B	$12.01B	$13.44B

National Bank reported a strong third quarter of 2024, arguably the strongest quarter out of all the major institutions. Revenue of $2.9B exceeded expectations of $2.85B, and earnings per share of $2.68 topped estimates by 21 cents.

On a year-over-year basis, the company has seen revenue increase by 17% and earnings per share by 23%, some of the highest levels out of all major banks.

Like the other institutions, the bank's Canadian segment is reporting strong growth. Personal and commercial net income is up 15% YoY, and revenue is up 7%. A large chunk of the company's growth on the quarter came from commercial lending, which witnessed a 14% YoY increase in revenue compared to just 4% for personal lending. Deposits were up 6%.

The company's provisions for credit losses stood at $149M, a 34% increase on a year-over-year basis. However, the more important number is that provisions increased by only $4M on a sequential (quarter-over-quarter) basis, just a 2.7% boost. Many investors and analysts are looking for somewhat of a stabilization in provisions, and at this point, we're seeing it from National.

Overall, the resiliency in the Canadian economy, which is surprising to many investors and analysts, is proving to be a tailwind for the bank.

The most notable news on the quarter would be the company's acquisition of Canadian Western Bank for total proceeds of around $5B. Although many investors viewed the acquisition as a bit of an overpayment at the time it was announced, the market has seemingly gotten over this, as the company continues to cruise to new all-time highs based on strong results.

The acquisition will immediately improve the company's exposure to Western Canada. As a larger bank, it should be able to take Canadian Western's client base and generate larger profits from it, being able to offer more products.

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