Brompton Insights

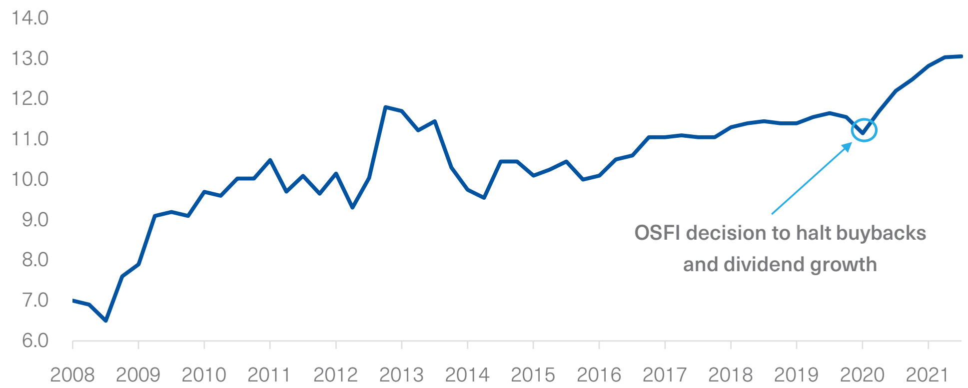
November 2021

Canadian Banks: Show Me the Money!

Fund in focus: Brompton Split Banc Corp. (SBC), Life & Banc Split Corp. (LBS), Brompton North American Financials Dividend ETF (BFIN)

In March 2020, the Office of the Superintendent of Financial Institutions (OSFI) announced that Canadian banks could not increase their dividends or repurchase any shares in an effort to preserve capital in response to the COVID-19 pandemic. This policy worked and the average Tier 1 Common Equity Ratio (CET1 Ratio) for the six largest Canadian banks increased from a 2020 low of 11.2% to 13.1% currently. As a result, on November 4, 2021, OSFI announced that banks could resume dividend growth and share buybacks.

Average CET1 Ratio (Big 6 Canadian Banks)



Source: Bloomberg (November 4, 2021)

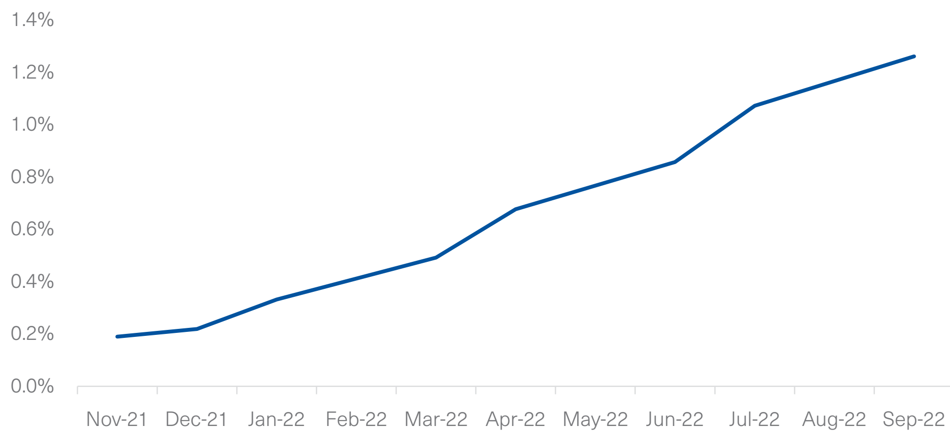
Now that these restrictions have been lifted and given their strong capital levels, we believe that the Canadian banks will prioritize a return to above average dividend growth along with share buybacks, organic growth, and M&A. Based on our analysis below, we believe that the banks could increase their dividends by an average of 18% in 2022 to return to the midpoint of their target payout ratios. Alternatively, dividends would need to increase by 22% for the banks to see a return to their historical average payout ratios.

Ticker	LTM Dividend	2022E EPS (Consensus)	Target Payout Ratio[1]	Est. Dividend at Target P/O	Growth	15-yr Avg. Payout Ratio	Est. Dividend at Avg. P/O	Growth
BMO	$4.24	$12.44	45%	$5.60	32%	51%	$6.35	50%
BNS	$3.60	$7.89	45%	$3.55	-1%	49%	$3.87	7%
CM	$5.84	$14.30	45%	$6.43	10%	47%	$6.72	15%
NA	$2.84	$8.89	45%	$4.00	41%	42%	$3.73	31%
RY	$4.32	$11.14	45%	$5.01	16%	47%	$5.24	21%
TD	$3.16	$7.59	45%	$3.41	8%	44%	$3.34	6%
Average					18%			22%

Source: Bloomberg, Brompton (November 4, 2021); Canaccord Genuity (September 15, 2021)

Along with our expectation for above average dividend growth in 2022, we also believe that interest rates will rise next year, which is positive for the banks. In response to strong economic growth and above trend inflation, the Bank of Canada (BoC) will almost certainly begin hiking rates in 2022, with the market currently anticipating the policy rate to increase by over 100 bps by next September.

BoC Implied Policy Rate (%)



Source: Bloomberg (November 4, 2021)

In addition to above average dividend growth and rising rates, we also believe that there are a number of cyclical and secular tailwinds that are supportive of banks at this time, including:

- a strong economy that remains supportive of loan growth and capital markets activity;
- banks continue to become more efficient by cutting costs, including the rationalization of their branch networks and focusing on digital offerings; and
- banks remain cheap, trading at a discount of 28% to the TSX.[2]

Based on these factors, we believe that Canadian banks represent a compelling buying opportunity for investors at this time.

Brompton's Approach

At Brompton, we have decades of experience investing in Financials and have several products that investors can use to get exposure to the banks, including split share funds that provide leveraged exposure to the banks, and ETFs. The following Brompton funds all trade on the TSX and focus specifically on Financials:

			Annual Compound Returns[4]				
Ticker	**Ticker**	**Dstrb. Rate[3]**	**1-Yr**	**3-Yr**	**5-Yr**	**10-Yr**	**S.I.[5]**
Brompton Split Banc Corp.	SBC	7.7%	123.3%	21.6%	17.9%	17.8%	12.7%
Life & Banc Split Corp.	LBS	12.1%	156.5%	25.3%	17.5%	20.3%	11.3%
Brompton North American Financials Dividend ETF	BFIN	3.9%	62.2%	15.5%	-	-	14.1%

[1] Based on target midpoint. BMO, CM, NA, RY and TD all target a payout ratio of 40-50% of EPS. BNS does not have a formal payout ratio, so we have assumed 45% to be consistent with the other banks.

[2] Source: Bloomberg, as at November 4, 2021. Based on forward price-to-earnings for the S&P/TSX Banks Index and the S&P/TSX Composite Index.

[3] Source: TMX Group Inc. Distribution rate is based on market price as at October 31, 2021. No distributions will be paid on SBC o LBS Class A Shares if (i) the distributions payable on the Preferred Shares are in arrears, or (ii) in respect of a cash distribution, after the payment of a cash distribution by the Company the NAV per Unit would be less than $15.00.

[4] Returns are for the periods ended October 31, 2021 and are unaudited. The table shows the past performance of the Funds. Past performance does not necessarily indicate how the Funds will perform in the future. The information shown is based on Net Asset Value (NAV) per share or unit and assumes that distributions made by the Fund on the shares or units in the periods shown were reinvested at NAV per share or unit in additional shares or units of the Fund.

[5] Inception dates: SBC - November 16, 2005, LBS - October 17, 2006, BFIN – October 18, 2017.

BROMPTON FUNDS

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