

Canadian Banks

From Canada With Love – Initiating Coverage On Royal Bank Of Canada, Toronto Dominion And Scotiabank

- **Canadian Banks Initiation** — We initiate coverage of the three largest Canadian banks with Buy ratings on Toronto Dominion (TD) and Royal Bank of Canada (RY) and Neutral rating on Bank of Nova Scotia (BNS / Scotiabank). Our target prices are \$92, \$67 and \$58, with expected total returns of 18%, 15% and 8% respectively.
- **Buy RY (\$67 TP): More Resilient than Market Implies** — We believe investors can exploit the market's over-discounting in RY shares of fears about an overlevered Canadian consumer. RY's build-out of capital markets should offer upside. The shares currently trade at 11.2x '13E PE and 2.0x '13E PB for 18% sustainable ROE.
- **Buy TD (\$92 TP): Offers Book Value, Dividend Upside** — We think potential capital release from the US ops (5% of BV) and upside to the dividend yield (up to 1%) outweigh the risks currently priced in the shares. The shares trade at 10.3x '13E PE and 1.6x '13E PB for 15.5% sustainable ROE.
- **Neutral on BNS (\$58 TP)** — Subscale international operations and potential under-capitalisation issues offset the benefits of a growing emerging markets franchise and highly profitable Canadian banking operations in our view. At the current price, the shares trade at 11.1x '13E PE and 1.8x '13E PB for 17% sustainable ROE.
- **In-Line Household Leverage vs. Global Comps, Debt Service Ratio at 7.5%** — The market's view on Canadian households, shared by the Bank of Canada, the IMF and Citi economists, is that consumers are over-levered. At 160% debt to disposable income that is the case vs. the US (110%) or the UK (150%) (Fig 137). However, our analysis shows that in a global context, Canadian households are less levered than counterparts in commodity-rich countries (Figs 138 and 139).
- **Canada's Model Regulation** — Canada has had a relatively good financial crisis, at least partly thanks to a hands-on banking regulatory approach. The regulators implemented: an "assets/capital" multiple; macroprudential tightening; Basel 3 (2013); and avoided subprime lending. The appointment of Mark Carney, Bank of Canada's Governor, to the post of Bank of England Governor, is further recognition of the 'Canadian way'. But the market need not fear about the impact of a potential leverage ratio cap *à la canadienne*, in our view: our analysis shows the UK banks are roughly where the Canadian banks are already (Figures 17 and 18).
- **Valuation Methodology** — We value the three banks on three methodologies each: static ROE, static ROTE and a Dividend Discount Model. These approaches result in fair value outcomes whose average we set as our target price. We cross-check our target price with a market-referenced sum of the parts valuation.

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Company	Ticker	Rating		Target Price		Current Year Earnings Estimates	
		Old	New	Old	New	Old	New
Scotiabank	BNS.TO	NA	2	NA	C\$58.00	NA	C\$4.90
Royal Bank of Canada	RY.TO	NA	1	NA	C\$67.00	NA	C\$5.29
Toronto Dominion	TD.TO	NA	1	NA	C\$92.00	NA	C\$7.35

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Our Investment Case: Dividends & Book Value Growth – with Limited Downside

We initiate on Canadian banks with two Buys (RY.CA, TD.CA) and one Neutral (BNS.CA) recommendation

- We initiate on Canadian banks with two Buys (RY.CA, TD.CA) and one Neutral (BNS.CA) recommendations.
- Target Prices are C\$67 for RY, C\$92 for TD, and C\$58 for BNS – offering expected total returns of 18%, 15% and 8% respectively
- Royal Bank of Canada trades on 11.2x 2013E PE and 2.0x 2013E book for 7% 2014E EPS growth and 18% sustainable ROE.
- Toronto Dominion trades on 10.3x 2013E PE and 1.6x 2013E book for 8% 2014E EPS growth and 15.5% sustainable ROE.
- Scotiabank trades on 11.1x 2013E PE and 1.8x 2013E book for 11% 2014E EPS growth and 17% sustainable ROE.
- Dividend yields are attractive, in our view – we expect c. 4% for the three banks

19% total upside to RY shares, 17% to TD, and 11% to BNS

The bottom line of our analysis points to 18% total upside to RY shares, 15% to TD, and 8% to BNS (Figure 1). While we are +1% to +4% above 2014E consensus net profit estimates, we believe that a dividend yield of 4% and re-rating potential could add an additional 8-16% depending on the bank.

Figure 1. Canadian Banks – Sources of Upside to Current Share Prices

Company	2014E Net Profit vs Mkt	Dividend Yield	Expected Rerating	Total Return	Assumed: Growth Rate	Assumed: CoE
RY	4.0%	4.2%	10.7%	18.9%	3.5%	10.0%
TD	1.0%	3.9%	10.1%	15.0%	3.5%	10.5%
BNS	3.0%	4.2%	0.7%	7.9%	4.5%	11.5%

Source: Citi Research

Figure 2. Canadian Banks – Valuation Metrics

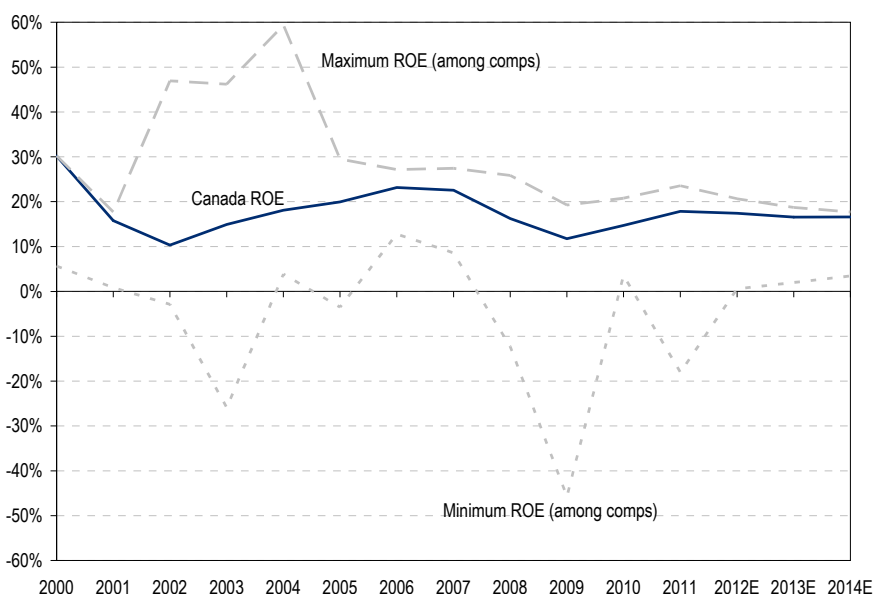
ROYAL BANK OF CANADA		2012E	2013E	2014E	2015E
P/E		12.0	11.2	10.2	9.6
P/BVPS		2.2	2.0	1.9	1.7
P/TBVPS		3.0	2.7	2.5	2.2
ROE		19.3%	18.8%	19.0%	18.6%
ROTE		26.4%	25.2%	25.2%	24.3%
Dividend Yield		3.9%	4.2%	4.6%	4.9%
TORONTO DOMINION		2012E	2013E	2014E	2015E
P/E		11.3	10.3	9.6	8.9
P/BVPS		1.7	1.6	1.4	1.3
P/TBVPS		2.6	2.3	2.0	1.8
ROE		16.3%	16.1%	15.7%	15.5%
ROTE		24.9%	23.7%	22.4%	21.4%
Dividend yield		3.5%	4.0%	4.4%	4.6%
SCOTIABANK		2012E	2013E	2014E	2015E
P/E		11.4	11.1	10.0	9.2
P/BVPS		1.9	1.8	1.6	1.5
P/TBVPS		2.6	2.5	2.2	2.0
ROE		18.8%	16.9%	17.1%	17.0%
ROTE		25.8%	23.1%	23.5%	23.0%
Dividend yield		3.9%	4.2%	4.6%	4.9%

Source: Citi Research, Reuters

I. Sustainable 8-11% Book Value Growth

While Canadian banks' profitability did not reach the heights that some banks globally achieved in the early 2000s, they did not reach the lows that others registered in the late 2000s (Figure 3). This was largely driven by the Canadians' avoidance of subprime lending and high-risk proprietary trading – while maintaining stable leverage.

Figure 3. Canadian Banks Should Remain High ROE Banks in 2013-14E
- ROE for Canadian & Global Comp Banks, 2000-14E (%) *



Source: Company reports, Citi Research. * Bank comps include: average of all banks under Citi coverage, G7, France, Germany, Italy, Japan, UK, US, Australia, Europe, Europe ex-UK, Nordics, EM, EM Asia, EM Far East, EM LatAm, Brazil, Russia, India, China, South Africa.

In our view, earnings growth will come from the following areas:

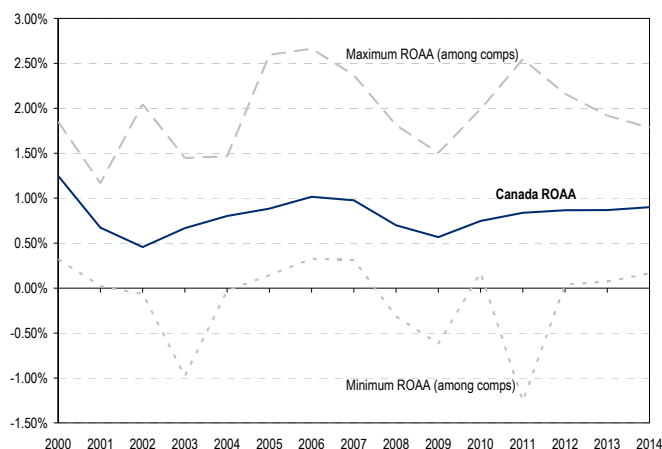
- International operations
- Focus on cost containment
- Selective add-on deals

- While leverage has been stable to falling (recently), ROA has been stable to increasing (recently) – resulting in an overall stable ROE in a global context (Figure 4 and Figure 5). We believe the consistency of the Canadians' ROE should continue, with an expected ROE of 16.6% in 2013 and a similar level in 2014. At first this may seem a challenging statement to make – given investor worries about a levered up Canadian consumer. While loan growth in 2014 should be roughly half the CAGR in 2006-12, our view is that earnings and book value growth in the 8-11% range is realistic even in the face of a slowing consumer sector. Solid capitalisation, on the other hand, should mean stable to slightly increasing payout ratios – thus supporting stable profitability metrics.

In our view, earnings growth would come from the following areas:

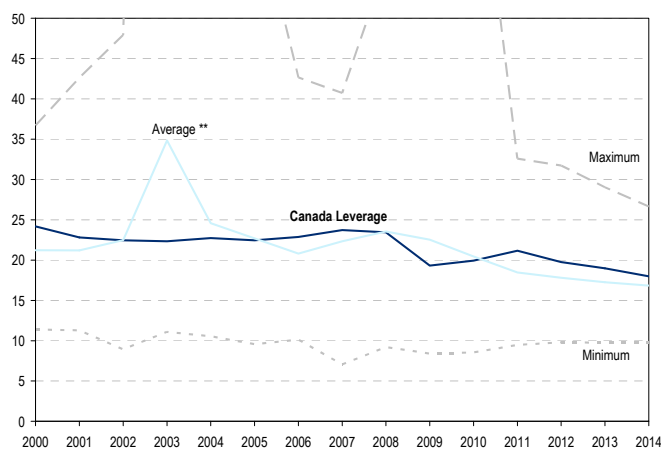
- International operations (US, Latin & Central America);
- Focus on cost containment, especially in Canada; and
- Selective add-on deals in non-mortgage consumer lending (credit cards, auto) as well as a targeted push in corporate lending.

**Figure 4. Flat to Increasing ROA Has Meant Stable ROE...
- ROA for Canadian & Global Comp Banks, 2000-14E (%) ***



Source: Company reports, Citi Research * Bank comps include: average of all banks under Citi coverage, G7, France, Germany, Italy, Japan, UK, US, Australia, Europe, Europe ex UK, Nordics, EM, EM Asia, EM Far East, EM LatAm, Brazil, Russia, India, China, South Africa.

Figure 5. ...Offsetting Declining Leverage - Assets/Common Equity Ratio for Canadian & Global Comp Banks, 2000-14E (%) *

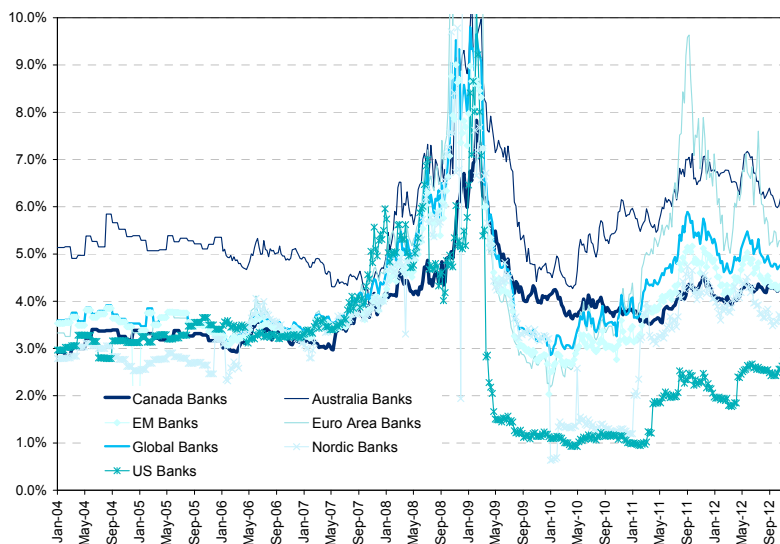


II. Sustainable Payout Ratio

4.2% dividend yield

Canadian banks have been reliable dividend payers, having always paid out at least 25% of earnings to shareholders. In 2009, they paid out more than 70% of their earnings. Currently, they sport a yield of 4.2% (Figure 6) based on a payout ratio of c.45% (Figure 7) – which places them ahead of the well-capitalised Nordic banks and the US banks as a whole, and in line with the EM banks.

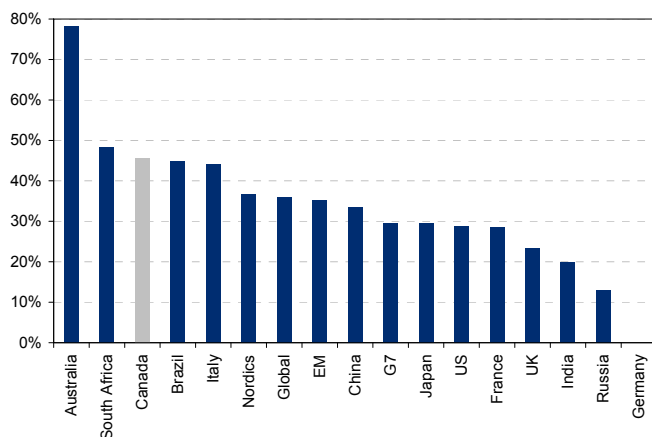
**Figure 6. Canadians' Dividend Yield Is Higher than US, Nordic and in-line with EM Banks':
- Dividend Yield for Select Bank Indices, 2004-Present (%)**



Source: Datastream, Citi Research

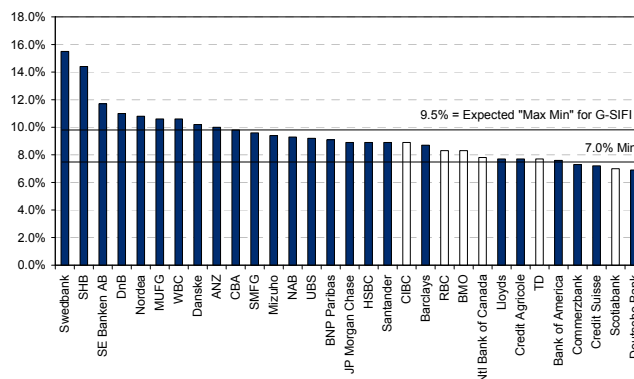
We believe the dividend payouts as a percentage of earnings should remain stable to slightly increasing driven by 1) strong organic capital generation, and 2) expectations of slower volume growth in the domestic Canadian banking businesses.

Figure 7. Canadian Banks Should Rank 3rd by Payout Ratio in 2013
- Payout Ratios for Banks under Citi Coverage, 2013E (%)



Source: Haver, Citi Research

Figure 8. Canadian Banks are Reasonably Well Capitalised on a Core Tier 1 (Basel 3) Basis – Given Canadian Macro Risks *

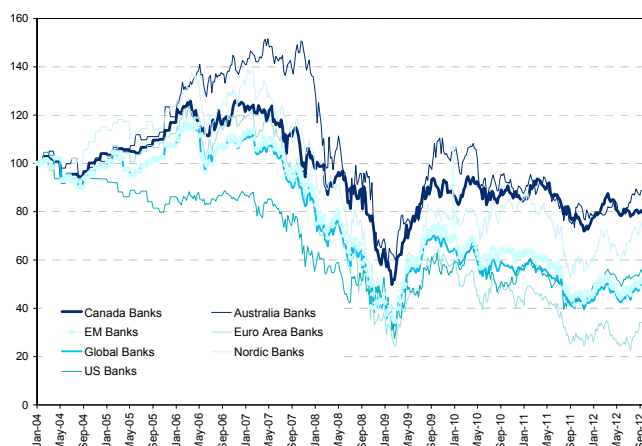


Source: Company reports, Citi Research * For Canadian banks, figures are as of 3Q12A; for the others, numbers are pro-forma 2012E

III. Rerating Potential

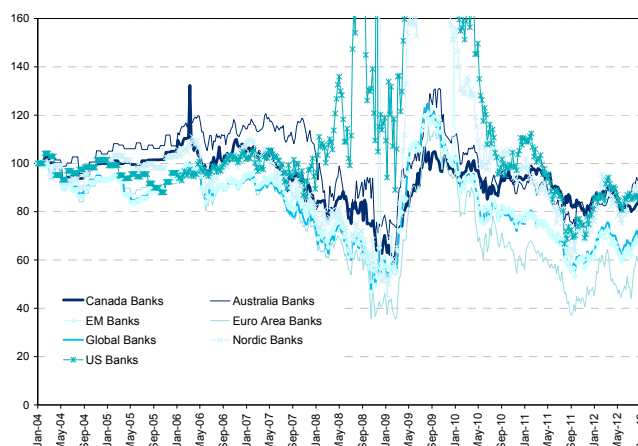
Canadian banks did not de-rate as much as most other banks in the world during the 2008-9 crisis (Figure 9 and Figure 10). While Canada's reliance on the US for exports and FDI is relatively high, the country was undergoing a major energy investment (especially tar sands) and consumer leveraging up (from relatively low levels).

Figure 9. Canadian Banks' Resilient P/B Valuation in the 2008-09 Crash
– Price/12m Fwd Book Value, 2004-Present (2004=100)



Source: Datastream, Citi Research

Figure 10. Canadian Banks' Resilient P/E Valuation in the 2008-09 Crash
– Price/12m Fwd EPS, 2004-Present (2004=100)



Economic resilience helped support the market's earnings growth expectations during the crisis, and thus the relatively benign de-rating (compared to most other bank indices globally). The Canadian Banks index is currently trading at below-average valuations relative to the IBES Canada Aggregate Index (Figure 11 and Figure 12).

Figure 11. Canadian Banks Have on Average Traded at 80% of the All Canada Index P/E+1 Ratio

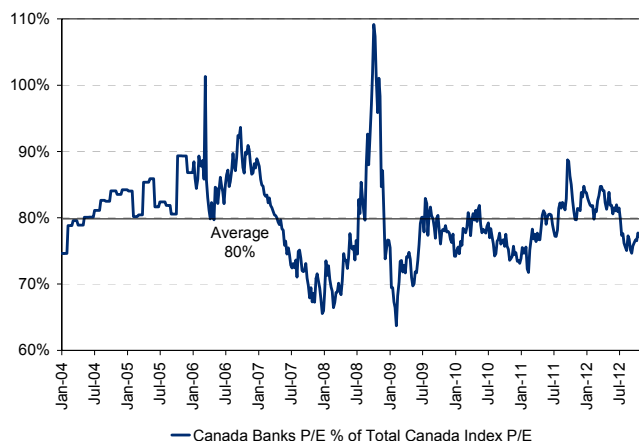
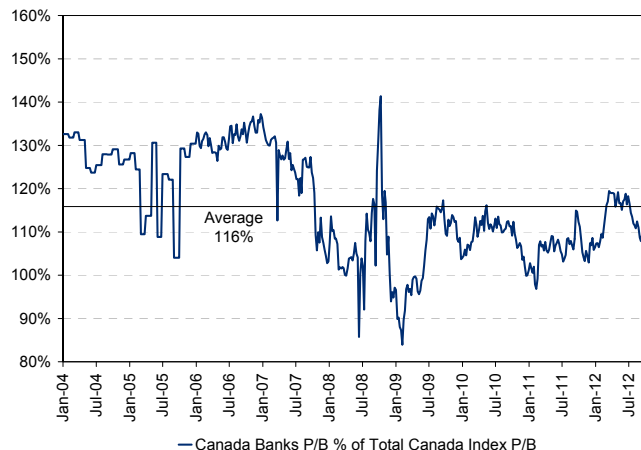


Figure 12. Canadian Banks Have on Average Traded at c.115% of the All Canada Index P/B+1 Ratio



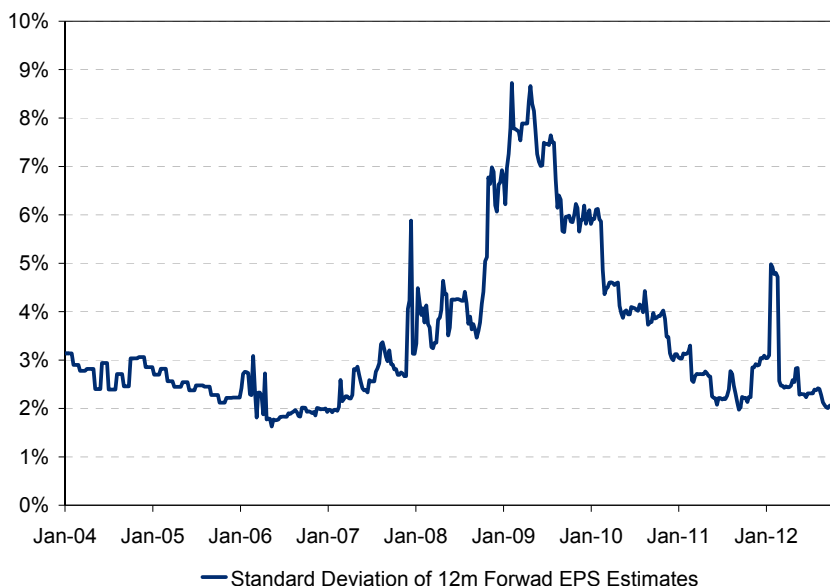
Source: Datastream, Citi Research

De-rating risk is limited, in our view

While meaningful derating of the valuation multiples down to levels seen in January 2009 or January 2011 cannot be excluded as a risk, we believe the downside is limited for a number of reasons:

- Canada's main trading partner, the US, is on the mend in terms of GDP growth and its housing market;
- The US "fiscal cliff" remains an issue but our economists believe it is likely to be resolved in time for businesses to make 2013 investment decisions;
- Canadian banks' regulators, the OSFI and the Bank of Canada, are known for their hands-on approach to bank and consumer leverage – underwriting guidelines have been tightened over the past three years, resulting in soft landing for consumers rather than the rude awakening counterparts across the southern border faced in 2007-9;
- Basel 3 comes into force on 1 January 2013, putting the Canadian banks at the forefront of implementation worldwide (with Australia, Austria and Japan among others);
- The "lower for longer" interest rates worldwide and corresponding search for yield will likely help stabilise any short-term selloffs from a valuation perspective.

Figure 13. EPS Estimates for the Canadian Banks Have Generally Tightened
- Standard Deviation of 12m Forward EPS Estimates for the Canadian Bank Index, 2004-2012



Source: Datastream, Citi Research

We believe the market is over-discounting Canadian macro concerns

We believe the market is over-discounting Canadian macro concerns within the banks' valuation multiples: fears about an over-levered consumer, a housing market bubble and margin pressure from low policy rates should start to reverse over time.

In our view, the market is expressing a marginally bearish view on the Canadian banks – we estimate the market implied cost of equity for the three Canadian banks to be in the 11-12% range. We find these levels high relative to: 1) the theoretically derived cost of equity; and to 2) the cost of equity for banks most comparable to the Canadians. We believe a slightly lower level is more realistic: 10.0% for RY, 10.5% for TD and 11.5% for Scotiabank (also see Figure 1).

Market Implies 11-12% CoE

Using our valuation models, we derive the market-implied cost of equity for the banks by matching the average theoretical price of the share with today's market price (given our small deviation from consensus estimates we believe we can use our models). Our analysis points to a range of 11-12%, with RY at 11%, TD at 11.5% and BNS at 12.0% (Figure 14).

Figure 14. Canadian Banks – Market Implied CoE (%)

Company	Market-Implied CoE	Sensitivity of the theoretical fair value price to 100 bps move in CoE
RY	11.0%	13.0%
TD	11.5%	12.5%
BNS	12.0%	12.5%

Source: Datastream, Citi Research

Theoretical CoE is much lower than market-implied CoE

Theoretical CoE: 7-9%

We derive the theoretical CoE for the Canadian banks using the following assumptions: 1) risk-free rate (10y spot Canadian sovereign bond yield) of 1.7%; 2) Equity Market Risk Premium of 8%; and 3) adjusted betas as calculated by Datastream. The spot risk-free rate is readily observable from market data. The market risk premium level we choose is consistent with the level for the US equity market as derived by StockVal-G and is higher than what our equity strategists assume (6-7%). Our calculations point to 7.2% CoE for RY, 8.7% for TD and 7.9% for BNS (Figure 15).

Figure 15. Canadian Banks – Theoretical Cost of Equity (%)

Company	10y Sov Yield	Beta	ERP	Theoretical CoE
RY	1.70%	0.687	8%	7.2%
TD	1.70%	0.876	8%	8.7%
BNS	1.70%	0.774	8%	7.9%

Source: Datastream, Citi Research

Bank comps are valued on 10-16% by Citi analysts

Comparables: 10-16%

We analysed the cost of equity for banks similar to the Canadians. Our results show that for banks in commodity-driven, stable economies such as Australia and the Nordics, Citi analysts employ CoEs of 10-11.5%. In the US, CoE varies from 9.9% to 15.8%.

Figure 16. Global Comps – CoE Assumptions for US, Australian, Nordic, LatAm and Canadian Banks

	USA	Australia	Nordics	Canada	Memo: LatAm
Risk-free	2.0%	3.2%	1.3%-1.5%	1.7%	5.0%-6.3%
Growth	3.0%	5.0%	0.0%	3.5%-4.5%	8.0%
ERP *	8.0%	7.0%	7.0%	8.0%	5.7%-6.5%
CoE	9.9%-15.8%	10%-11.3%	10%-11.5%	10%-11.5%	10.8%-12.5%

Source: Citi Research * Equity (market) risk premium

What helped Canada go through the 2008-9 crisis largely unscathed – proactive banking regulation or simple luck?

IV. From Canada with Love: Banking Regulation Lessons for UK and Europe

Canada weathered the Global Financial Crisis of 2008-9 better than most other countries. While GDP declined 3.8% driven by a collapse in US demand for Canadian exports, the Canadian banking system did not experience the extreme losses, bailouts and restructurings that befell banks in Europe and Asia. Many claim the resilience of Canada's banks was due to a tough, Canada-specific, approach to banking regulation starting in the late 1990s with Paul Martin's Liberal government. Mr Martin's government famously refused to allow the Canadian equivalent of the Glass-Steagall Act to be repealed.

Critics to this view point to the commodity super-cycle of the early 2000s and, most importantly, luck in avoiding subprime lending, as the two main reasons behind the resilience of Canada's banks. Whatever the reason, Canadian banks are in better shape today than many of their peers in Europe or the US. The latest recognition in that regard appears to come from the Bank of England, which appointed Bank of Canada's Mark Carney to be the Old Lady's 120th Governor for a five-year period starting in July 2013 (see [UK Banks - Bank Sector Implications of a New BoE Governor](#), 26 November 2012, and [Canada Intraday Economic Commentary - Perspectives on Mark Carney's BoC](#), 27 November 2012).

We believe regulators were prudent before prudence came into fashion

The assets to capital multiple cannot exceed 20x, in most cases

We believe that, if anything other than luck is to be credited with Canada's banking resilience, it is the prudence and hands-on approach shown by the country's two banking regulators – the Bank of Canada and the Office of the Superintendent of Financial Institutions (OSFI). Specifically, we would like to highlight the four key points which we think Canada was very good at implementing before most other countries.

■ **Risk-based leverage multiple of no more than 20x. According to OSFI:**

The “assets to capital multiple” is calculated by dividing the institution's total assets, including specified off-balance sheet items, by the sum of its adjusted net tier 1 capital and adjusted tier 2 capital. In the case of derivative contracts, where institutions have legally binding netting agreements the resulting on-balance sheet amounts can be netted for the purpose of calculating the assets to capital multiple. Under this test, total assets should be no greater than 20 times capital, although this multiple can be exceeded with the Superintendent's prior approval to an amount no greater than 23 times. Alternatively, the Superintendent may prescribe a lower multiple. In setting the assets to capital multiple for individual institutions, the Superintendent will consider such factors as operating and management experience, strength of parent, earnings, diversification of assets, type of assets and appetite for risk.

While it is impossible for us to apply the OSFI definition to the UK banks, we have calculated two types of leverage ratios for the Canadian and the UK banks – one non-risk-weighted (Figure 17) and one risk weighted (Figure 18).

Figure 17. Canadian & UK Banks – Tangible Assets / Tangible Common Equity, 3Q12A *

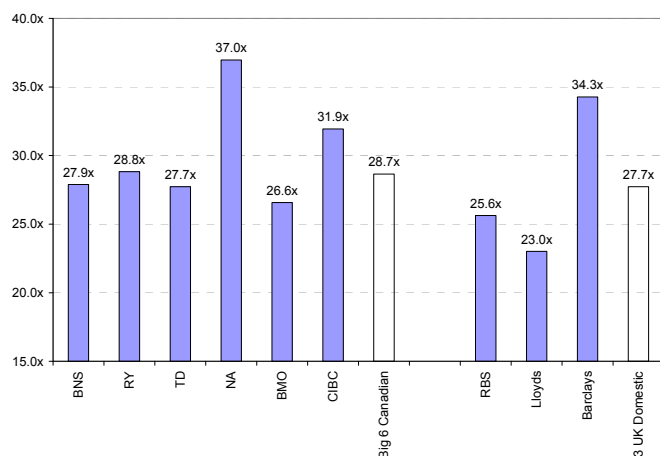
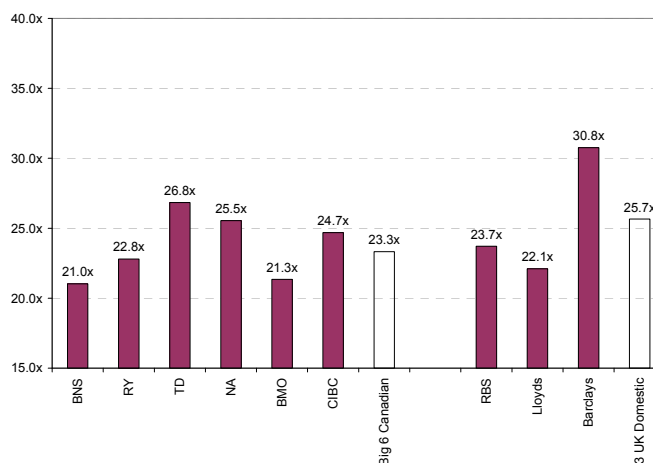


Figure 18. Canadian & UK Banks – Total Assets / Net Tier 1 Capital, 3Q12



Source: Company reports, Citi Research * NA = National Bank of Canada, BMO = Bank of Montreal, CIBC = Canadian Imperial Bank of Commerce

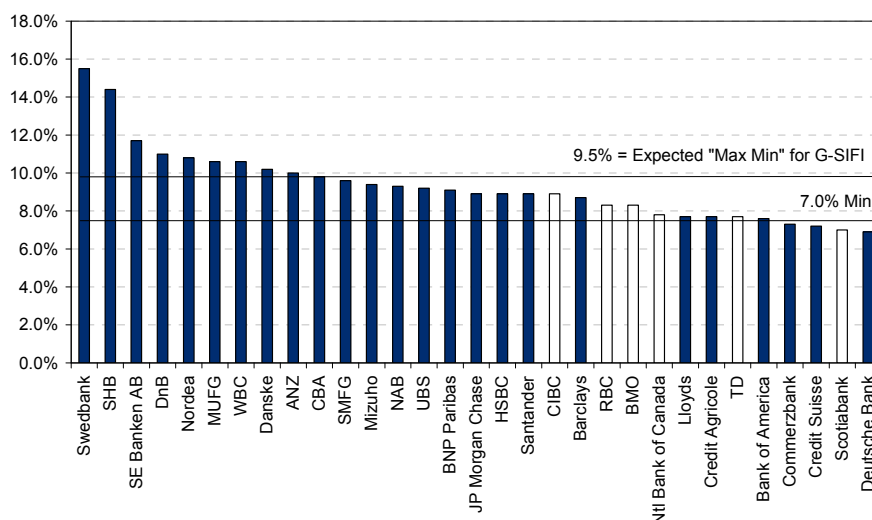
- **No subprime lending:** Canadian banks avoided direct subprime lending in Canada and the US at the insistence of OSFI and the Bank of Canada in the early 2000s. In addition, with the exception of one or two companies, Canadian banks avoided investments in structured credit CDOs.
- **Proactive tightening of underwriting guidelines to cool a housing market bubble:** The OSFI has tightened mortgage underwriting standards four times in the past four years (see the *Household Leverage: A Manageable Threat* section). This proactive approach to asset bubble formation is in stark contrast to the laissez-faire approach employed by the US and most of Europe prior to and following the crisis of 2008-9.

Canadian banks adopt Basel 3 on 1 January 2013

- **Early adoption of Basel 3:** Canadian banks will be required to comply with the phased-in Basel 3 regulations as of 1 January 2013, with detailed Liquidity Coverage Ratio and Net Stable Funding Ratio guidelines coming out in the next year or so. TD noted in its 2011 Annual Report:

In August 2012, OSFI issued a revised Capital Adequacy Requirements (CAR) Guideline which contains two methodologies for capital ratio calculation: (i) the "transitional" method; and (ii) the "all-in" method. Under the "transitional" methodology, changes in capital treatment for certain items, as well as minimum capital ratio requirements, will be phased in over the period from 2013 to 2019. Under the "all-in" methodology, capital is defined to include all of the regulatory adjustments that will be required by 2019 while retaining the phase-out rules for non-qualifying capital instruments. Pursuant to the proposed guideline, OSFI expects all institutions to attain an "all-in" target CET1 ratio of at least 7% by the first quarter of 2013 and an "all-in" target total tier 1 ratio of at least 8.5% and target total capital ratio of at least 10.5% by the first quarter of 2014. The Basel III minimum capital requirements include a 4.5% common equity ratio, a 6.0% Tier 1 capital ratio, and an 8.0% Total capital ratio. In addition, a capital conservation buffer of 2.5% will be required.

Figure 19. Canadian Banks Are Reasonably Well Capitalised on a Basel 3 Basis *



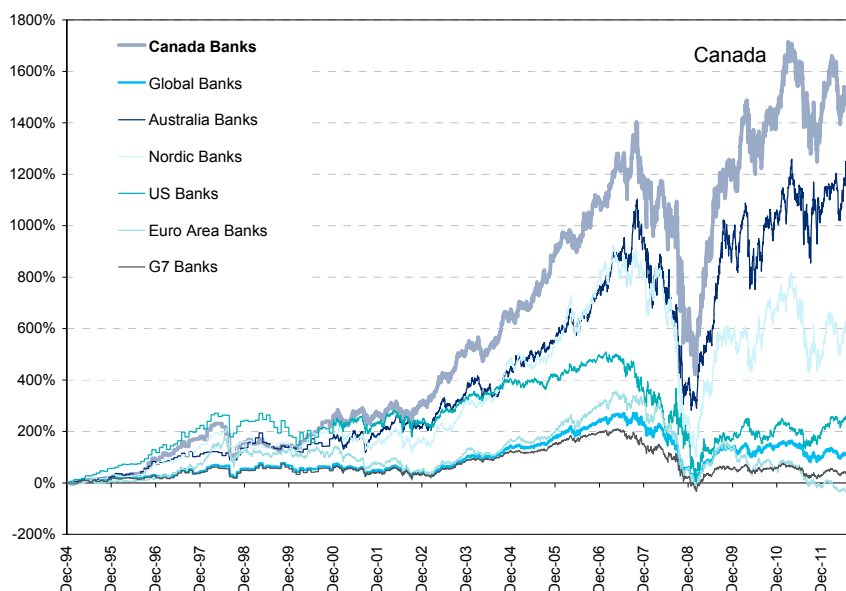
Source: Citi Research * For Canadian banks, figures are as of 3Q12A; for the others, numbers are pro-forma 2012E

Expect Total Returns of 10-20%

An investor who bought Canadian banks in 1994 would have been handsomely rewarded

An investor who bought Canadian banks in 1994 would have been handsomely rewarded. Since then, the MSCI Canadian Banks index has returned a total of c.1620% in US\$ terms – higher than any other major bank group, in developed (DM) or emerging (EM) markets (Figure 20). The next best performers, Brazil and Australia, returned 100% and 200% less respectively. In local currency terms, the outperformance was even more striking.

Figure 20. Canadian Banks Have Outperformed Most Developed Market Banks Worldwide – Total Return for Major DM Banking Stock Indices, 1994-2012 (1994=100) *



Source: Datastream, Citi Research * The trough in 2008-9 represents the peak of the Global Financial Crisis

Canadian banks' top performance has come mainly through higher earnings and book value growth

Canadian banks' top performance has come mainly through higher earnings and book value growth – while valuation has kept relatively stable (Figure 21). Since 2004, the Canadian banks have taken a breather, ceding the top performance title to Australia, Brazil and other emerging-market banks. But even then, earnings and book value growth have remained at the top end of the DM banks, with consistent dividend growth and payout ratios.

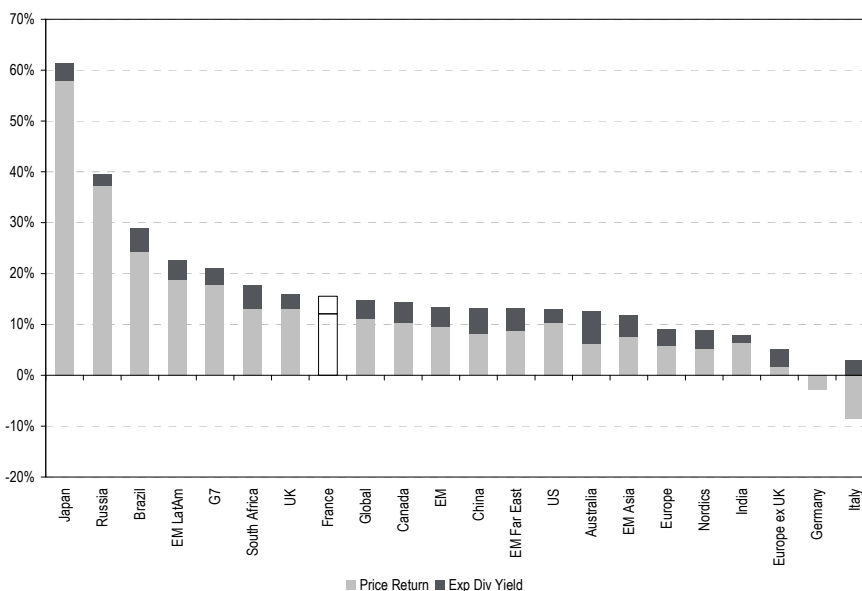
Figure 21. Earnings and BV Estimates Grew More for Canadian Banks than Australian Banks over the 2004-12 Period

RETURNS DECOMPOSED: P/E+1Y AND EPS +1Y *							RETURNS DECOMPOSED: P/B+1Y AND BVPS +1Y *						
	PE+1 Rerating	EPS +1 Est Growth	Dividend Return	Cumulative US\$ TR	FX Effect	Total		PB+1 Rerating	BVPS+1 Est Growth	Dividend Return	Cumulative US\$ TR	FX Effect	Total
Canada	-17%	130%	43%	173%	30%	203%	Canada	-21%	142%	43%	173%	30%	203%
Global	-26%	12%	39%	15%	-	-	Global	-50%	66%	39%	15%	-	-
G7	-26%	-20%	36%	-20%	-	-	G7	-55%	33%	36%	-20%	-	-
Australia	-4%	88%	65%	198%	36%	234%	Australia	-9%	98%	65%	198%	36%	234%
Euro Area	-31%	-44%	44%	-44%	3%	-41%	Euro Area	-66%	14%	44%	-44%	3%	-41%
Japan	-53%	42%	16%	-23%	34%	11%	Japan	-66%	95%	16%	-23%	34%	11%
Nordic	-14%	58%	37%	87%	10%	97%	Nordic	-29%	91%	37%	87%	10%	97%
UK	-26%	-48%	45%	-44%	-12%	-56%	UK	-58%	-8%	45%	-44%	-12%	-56%
US	-18%	-25%	33%	-18%	-	-	US	-49%	21%	33%	-18%	-	-
EM	-29%	232%	28%	200%	-	-	EM	-48%	351%	28%	200%	-	-
EM Asia	-28%	153%	27%	132%	-	-	EM Asia	-31%	164%	27%	132%	-	-
EM Far East	-39%	178%	29%	118%	-	-	EM Far East	-37%	167%	29%	118%	-	-
EM LatAm	-3%	400%	32%	538%	-	-	EM LatAm	17%	313%	32%	538%	-	-
Brazil	-7%	384%	32%	491%	38%	529%	Brazil	-34%	581%	32%	491%	38%	529%
India	14%	223%	12%	311%	-17%	294%	India	5%	251%	12%	311%	-17%	294%
South Africa	40%	80%	36%	242%	-17%	225%	South Africa	-1%	155%	36%	242%	-17%	225%

Source: Datastream, Citi Research * Returns calculated over the period 15 Jan 2004 – 19 Nov 2012. Returns are cumulative total returns for the corresponding MSCI Bank Indices and assume constant holdings over the period.

We believe the banks will perform strongly and expect c.16% total return over the next 12 months, of which c.4% is the expected dividend yield (Figure 22). We expect valuations to remain stable, earnings per share (EPS) to grow at 8-10%, and ROEs to stay in the 15-20% range. Dividend payouts should remain in the 40-50% range with more upside than downside risks.

Figure 22. Canadian Banks Shares Should Outperform Half of G7 and a Number of EM Banks - Expected 12m Total Return for Banks under Citi Coverage



Source: Citi Research

A rally in bank shares worldwide could impact the potential for Canadian banks' share outperformance – given relative 'safe haven' status

Relative to other bank indices globally, the Canadian bank index has lagged. While we think the underperformance is unwarranted, a rally in bank shares worldwide could impact the potential for Canadian banks' share outperformance (given their status as relative 'safe havens'). In the least, we expect performance in line with the Global banks (Figure 22). Among the DM banks, Canadian banks should outperform their peers in the US and the Nordics. Compared to the EM banks, Canada should deliver a higher return than South Africa, India and China.

Company Focus

- Company Update
- Initiation of Coverage

Stefan Nedialkov

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stefan.nedialkov@citi.com

Buy	1
Price (03 Dec 12)	C\$58.74
Target price	C\$67.00
Expected share price return	14.1%
Expected dividend yield	4.3%
Expected total return	18.3%
Market Cap	C\$84,897M
	US\$85,379M

Price Performance

(RIC: RY.TO, BB: RY CN)



Royal Bank of Canada (RY.TO)

Initiating with Buy – C\$67 TP

- **Initiation with Buy, C\$67 TP** — We initiate coverage of RY with a Buy rating, target price of C\$67 and ETR of 18%. We believe that RY's build-out of its wholesale business offers investors upside to earnings estimates. We think investors should also exploit the market's over-discounting of macro fears in the RY shares – worries about an overlevered Canadian consumer and slowing volume growth.
- **'Wholesale' Leader** — RY is Canada's closest answer to a 'wholesale bank'. While not a top-5 player by market share globally, the company has made impressive gains since 2007 – increasing share of deal volumes by over 150 bps in loan syndication, M&A, debt and equity capital markets. We believe Capital Markets will continue to deliver 24% of revenues and 27% of pre-tax profits. The business will likely continue to consume a disproportionate share of Group RWA and capital (c.50%). However, we believe the withdrawal of capacity from the international capital markets over the next few years will provide opportunities for RY to increase scale. We estimate every 1 ppt increase in the ROE of the wholesale business represents 2% upside to our EPS. If management achieves the 'high teen' ROE target, our group EPS estimates could increase by 10%.
- **Margins Bottoming Out** — We believe RY's Canadian banking net interest margin is close to bottoming out. While we conservatively expect an increase to 1.95% in 2013 from 1.94% in 2012 (down from a peak of 2.19% in 2009), there may be upside to our estimates from loan repricing. And should the Bank of Canada increase the target rate (vs. 1% today), margins could increase further. Opportunistic acquisitions in the auto and consumer finance space may provide yet further upside to margins.
- **Valuation** — We value RY on three methodologies: static ROE, static ROTE and a Dividend Discount Model. These approaches result in fair value outcomes of C\$65, C\$68 and C\$68, respectively. We set the average of the three fair value outcomes as our target price (C\$67) and cross-check it with a sum of the parts valuation (C\$57). The difference between the sum of the parts and our target price is relatively large as the former effectively references current market valuations – while we believe RY shares would re-rate on the back of over-discounted macro fears. At our target price, the shares would trade at 12.7x '13E PE and 2.3x '13E PB for a sustainable 18% ROE – while at the current market price, the shares trade at 11.2x '13E PE and 2.0x '13E PB.

EPS	Q1	Q2	Q3	Q4	FY	FC Cons
2012A	1.20A	0.98A	1.46A	1.24A	4.89A	5.00A
2013E	1.26E	1.30E	1.38E	1.34E	5.29E	5.31E
Previous	na	na	na	na	na	na
2014E	na	na	na	na	5.75E	5.68E
Previous	na	na	na	na	na	na
2015E	na	na	na	na	6.11E	6.08E
Previous	na	na	na	na	na	na

Source: Company Reports and dataCentral, Citi Research. FC Cons: First Call Consensus.

Scaling Up in Capital Markets

Figure 23. RY – Revenue Split by Business Segment, 2011 (%) *

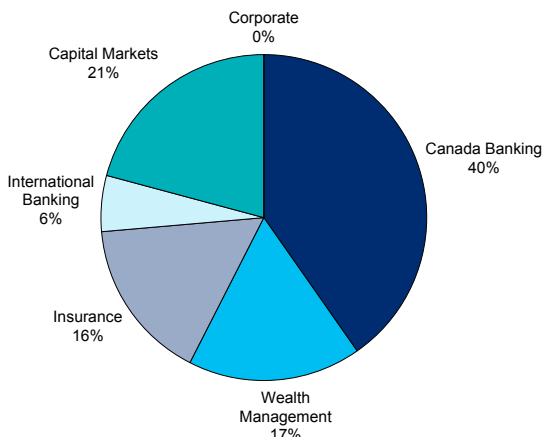
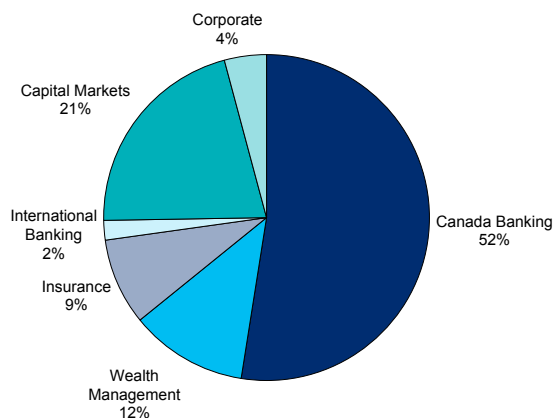


Figure 24. RY – Net Profit Split by Business Segment, 2011 (%) *



Source: Company reports, Citi Research

Largest bank in Canada, largest capital markets player

Royal Bank of Canada (RY) is the largest Canadian bank by assets, with a total of C\$824bn at end 3Q12 or c. 24% of the chartered banks sector. While the bank enjoys meaningful economies of scale in the domestic market, management has differentiated the bank from its domestic competitors by emphasising the capital markets and the wealth management/insurance businesses. Together, these two segments constitute c. 54% of the bank's group revenues and c. 41% of its net profits (Figure 23 and Figure 24).

Figure 25. RY – Capital Markets Revenue Split by Product, 3Q12 *

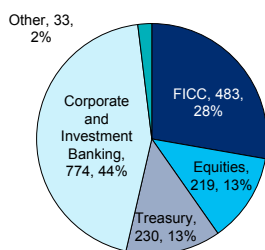


Figure 26. RY – Capital Markets Revenue Split by Geography, 3Q12 *

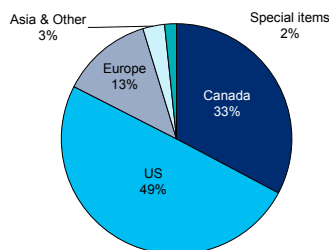
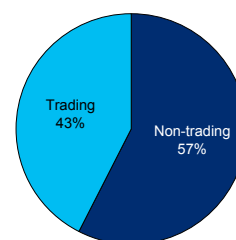


Figure 27. RY – Trading Revenues were 43% of the Total Cap Mkts Revenues in 3Q12 *



Source: Company reports, Citi Research * Based 3Q12 on business segmentation

Capital Markets is the second largest segment within the group, by revenues. The Corporate and Investment Bank represents 44% of the segment's revenues (Figure 25-Figure 27), with the remainder split among FICC (28%), Equities (13%) and Treasury (13%). By geography, the majority of the business is originated in the US (49%) and Canada (33%).

RY consistently ranks in the Top 10-15 worldwide by DCM and ECM business volumes...

RY consistently ranks in the Top 10-15 worldwide by DCM and ECM business volumes – with ECM rankings improving and DCM flat-lining. By announced M&A volumes, RY has historically ranked in the Top 15-20 worldwide but has lately pushed into the Top 15 – likely driven by its ability to lever the balance sheet for M&A-related loan syndication. In fact, the bank is a major player in syndicated

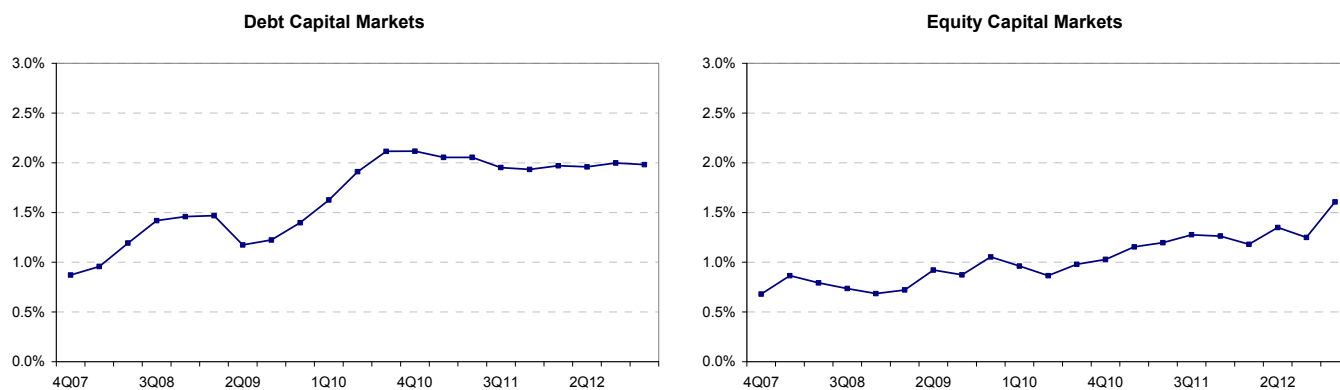
lending, and has recently pushed its rank to just below the Top 10 players (from Top 20 previously). Management remarked on the 3Q12 results conference call:

“Our strength in the U.S. was most evident in the latest Dealogic league tables. Measured by fee revenue, RBC ranked as the 10th largest global investment bank for the first half of 2012 and we have jumped 7 spots to number 10 in U.S. Loans Bookrunner Ranking, increasing our market share to 2.4%, up from 1.1% in 2011. Within the Americas ranking, overall our market share has increased over the past two years to a record 3.9%, up from 2.4% with more than half of this increase coming in the United States.”

...with market share gains in all areas, especially loan syndication, over the past five years

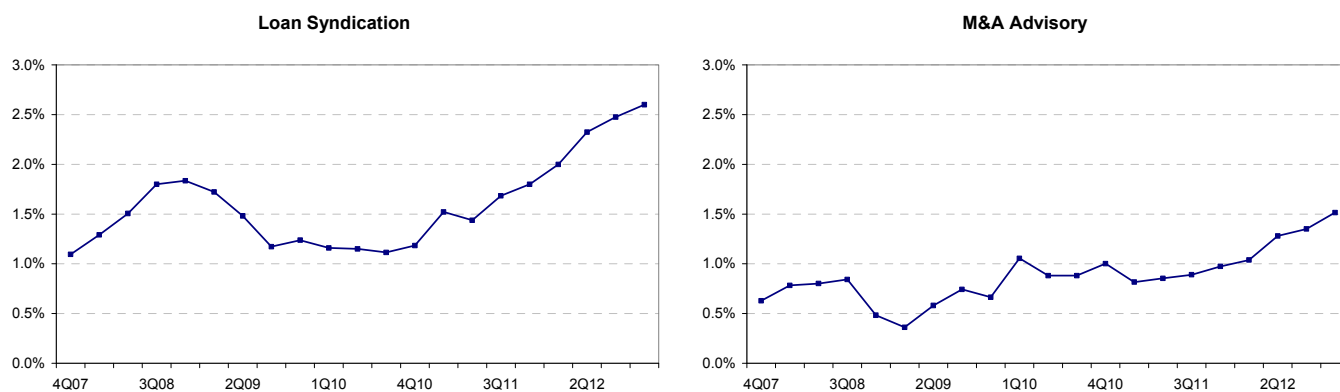
Our own analysis supports management's comments. Figure 29 shows the evolution of market shares in four key areas of the capital markets, lending and advisory business (all on 12m trailing basis). RY has gained in all areas, with loan syndication having the strongest momentum. This is unsurprising to us as 1) the company may be looking to offset slowing volumes growth rates in Canada with the more buoyant international wholesale business; and 2) the French banks have left behind market share by retreating to their home market. Surprisingly, momentum in debt capital markets seems to have hit a glass ceiling.

Figure 28. RY – Dealogic Global Market Shares in Debt & Equity Capital Markets (12m trailing % of deal volumes announced)



Source: Dealogic, Citi Research

Figure 29. RY – Dealogic Global Market Shares Loan Syndication & Advisory (12m trailing % of deal volumes announced)



Source: Dealogic, Citi Research

We are below management guidance on the ROE for Capital Markets – at 15% vs “mid-to-high teens” – and believe RY may surprise positively

In terms of profitability, the capital markets segment currently generates c.16.5% ROE on Basel 2 attributed equity basis. Management guides to ‘mid-to-low teens’ ROE on full Basel 3 basis – rising to ‘mid-to-high teens’ ROE post initiatives involving business growth, legacy run-off and management actions (see RY’s 2Q12 Capital Markets investor presentation). Our segment ROE forecast is for c.15% return on attributed equity over the forecast horizon. We believe the market, like us, does not yet give RY credit for the “mid-to-high teens” guidance given regulatory uncertainty in the US (e.g. Dodd-Frank). However, management actions aimed at improving product cross-sell (from corporate banking to wholesale, and within wholesale) could well result in upside to our forecasts even in an uncertain regulatory environment.

- **We estimate every 1 ppt increase in the ROE of the wholesale business represents 2% upside to our EPS. If management achieves the ‘high teen’ ROE target, our group EPS estimates could potentially increase by 10%.**

Valuation

\$67 target price

We rate RY Buy and assign a **target price of C\$67**. We believe RY shares have meaningful upside potential from: 1) increased scale and profitability in Capital Markets; 2) potential upside to margins; and 3) continued strict cost control.

Three valuation methodologies

We apply three valuation methodologies in order to derive a target price: 1) static ROE; 2) static ROTE; and 3) a Dividend Discount Model. We set our target price at the average of these three outcomes and cross-check against a sum of the parts valuation (Figure 30).

10.0% cost of equity, 3.5% growth rate

We arrive at a **cost of equity** (CoE) through both a CAPM and through peer analysis. Using the CAPM, a risk free rate of 1.7% (10y Canadian sovereign yield), a beta of 0.7 (Datastream calculated) and an equity risk premium of 8%, we arrive at a CoE of 7.2%. However, for most banks in our global banks universe, CoE assumptions are north of 10% (the Japanese banks being the outstanding exception at sub-6%). Banks in Australia and the Nordics, which we view as Canadian banks’ closest comps, have CoE in the range of 10-11.5%. We believe that RY should have one of the lowest CoE among the Canadian banks because of its strong capitalisation relative to the its peers (at 8.4% Basel 3 CT1 ratio as of 4Q12A). We thus settle on 10%.

Figure 30. RY – Summary of Valuation Methodologies and Target Price Setting

Current Price	58.8
Target Price	67.0
Upside	14.1%
Dividend yield	4.2%
ETR	18.3%
Common assumptions	
Cost of Equity	10.0%
Growth	3.5%
Yrs to discount	0.08
Fair Value Outcomes	
Static ROE	64.3
Static ROTE	67.9
DDM	68.4
Average	66.9
>> Sum of the parts	59.3

Source: Citi Research

Figure 31. RY – Valuation Metrics

	At Current Price					At Target Price			
	2012E	2013E	2014E	2015E		2012E	2013E	2014E	2015E
P/E	12.0	11.2	10.2	9.6	P/E	13.7	12.7	11.6	11.0
P/BVPS	2.2	2.0	1.9	1.7	P/BVPS	2.5	2.3	2.1	2.0
P/TBVPS	3.0	2.7	2.5	2.2	P/TBVPS	3.4	3.1	2.8	2.5
ROE	19.3%	18.8%	19.0%	18.6%	ROE	19.3%	18.8%	19.0%	18.6%
ROTE	26.4%	25.2%	25.2%	24.3%	ROTE	26.4%	25.2%	25.2%	24.3%
Dividend Yield	3.9%	4.2%	4.6%	4.9%	Div Yield	3.4%	3.7%	4.0%	4.3%

Source: Citi Research

Static ROE / Static ROTE Approaches

18.0% sustainable ROE

We use static ROE / ROTE valuation methodologies (our standard methodology for the sector), assuming that profitability has normalised by 2014. We use a normalised RoE of 18.0% (ROTE of 23.6%), and assume 3.5% perpetual growth rate – in-line with long-term nominal GDP growth. Using a cost of equity of 10% we reach a terminal book value multiple of 2.2x and terminal tangible book value multiple of 3.1x. Discounting gives us fair values of C\$64 and C\$68, respectively. To demonstrate the sensitivity of our target price to these assumptions/forecasts we have produced a valuation sensitivity table to ROE/CoE (Figure 32).

Figure 32. RY – Static ROE Valuation Sensitivity

CoE	Return on Equity								
	14.0%	15.0%	16.0%	17.0%	18.0%	19.0%	20.0%	21.0%	22.0%
7.0%	87	95	103	111	120	128	136	144	153
8.0%	67	74	80	87	93	99	106	112	119
9.0%	55	60	66	71	76	81	86	92	97
10.0%	47	51	55	60	64	69	73	78	82
11.0%	40	44	48	52	56	59	63	67	71
12.0%	36	39	42	46	49	52	56	59	63
13.0%	32	35	38	41	44	47	50	53	56
14.0%	29	31	34	37	40	42	45	48	51
15.0%	26	29	31	34	36	39	41	44	46

Source: Citi Research

Dividend Discount Model

DDM produces a slightly higher fair value

Our 3-year DDM applies a 10% risk discount rate equal to our cost of equity as explained earlier (Figure 33). We calculate the present value of dividends we expect RY to pay for 4Q12, 2013 and 2014. We also calculate a terminal 2014E book value based on a c.18% 2015E ROE which produces our estimate for fair value at the end of 2014. Summing up the present value of dividends and of the terminal fair value results in our *current* fair value estimate of C\$68.

Figure 33. RY – DDM Valuation

	2012E	2013E	2014E
DPS	0.64	2.48	2.67
PV of DPS	0.64	2.25	2.23
2015E ROE - normalised	18.0%		
Warranted P/BV	2.2		
2014E BVPS	31.4		
Fair value per share (12m fwd)	63.3		
Sum of DPS 2012E-14E	5.1		
Total value per share (12m fwd)	68.4		

Source: Citi Research

Cross-checking against a sum of the parts valuation

Sum of the Parts Approach

For this approach we use 2014E earnings by segment and apply an appropriate P/E +1yr forward multiple to each segment. The sum total of all segment values produces a total company valuation at the end of 2013 which we then discount back by 1 month in order to arrive at the 12m forward company value. In order to arrive at a fair value per share, we divide the total company value 12m from now by the forecast number of shares outstanding at the end of 2013.

In terms of comparable multiples, Figure 250 in the Appendix shows our comps universe.

- **P&C Banking** – closest comparables are the pure plays on the Canadian domestic market: National Bank of Canada, Laurentian Bank and Canadian Western Bank. These trade at 9-11x consensus PE+1yr. We believe the midpoint of this range is a reasonable multiple for RY's Canadian franchise – as RY's operations in Canada are best-in-class in terms of profitability and scale relative to the lower end of the valuation. However, RY does not have the commodity-heavy exposure of Canadian Western (based in Edmonton, Alberta). We settle on 10x for the P&C Banking segment.
- **Wealth Management** – our closest comps are Lazard in the US (trading at 16x Citi PE+1yr) and Julius Baer in Europe (trading at 14x Citi PE+1yr). We take the average of the two multiples to arrive at 15x.
- **Insurance** – we value RY's multi-line insurance business at 10x – the average multiple of the North American insurance peer group as calculated by Bloomberg.
- **International Banking** – these are mainly businesses in the Caribbean and offices in Europe and Asia. Also included in this segment is RBC Investor Services (previously RBC Dexia). We believe the subscale of this business warrants a discount to the average US banks multiple of 10x – we apply 9x instead.
- **Capital Markets** – closest comps are JPM (8x), Goldman (10x) and MS (9x), all on Citi estimates. We pick the average of these as we do not believe RY's capital markets business has a trading or underwriting advantage over peers.
- **Corporate Support** – we assign a multiple of 10x to the segment, the same multiple as the one assigned to Canadian Banking, given that Corporate supports Canadian Banking via the ALM/Treasury function.

Figure 34. RY – Sum of the Parts Valuation

Net Income	2014E	P/E +1	Value
P&C Banking	4,829	10.0	48,290
Wealth Management	955	15.0	14,319
Insurance	467	10.0	4,667
Investor & Treasury Services	340	10.0	3,398
Capital Markets	2,012	9.0	18,110
Corporate Support	-238	10.0	-2,380
Group	8,364	10.3	86,404
Fair value (12m fwd)	85,720		
Shares	1,444		
Fair value per share (12m fwd)	59.3		

Source: Citi Research

Risks

Higher – or Lower – Loan Impairments

Judging by the market's implied cost of equity of RY, *we believe that the market believes* the 'overlevered' Canadian consumer may cause elevated losses for the banks. As we argued earlier in our report, we are of the opinion that even though household debt levels in Canada are relatively high, they remain manageable. Nevertheless, should loan losses approach 2008-9 levels, RY's profitability will suffer and there would be downside risk to our target price. On the other hand, should the cost of risk fall below our forecast of 30-35 bps over the next few years, there would be upside to our earnings estimates and target price.

Higher – or Lower – Margins

We believe that margins are bottoming out for the sector in general and RY in particular due to repricing and what our economists see as upside risk to the Bank of Canada's current targeted overnight rate of 1%. However, should the Bank of Canada decide to target a lower rate (by 25 bps or more), margins are likely to suffer and introduce downside risk to our target price. Should the Bank decide to hike rates (25 bps or more), there may be upside to our earnings estimates and target price.

Dividend Payout Ratio Increases above 50% – or Falls Below 40%

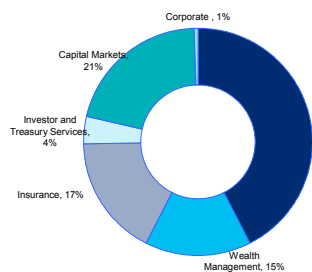
We currently assume 48% payout ratio for RY in 2013-15E which is at the higher end of the company's targeted range of 40-50%. However, if RY management believes that returning more to shareholders is the appropriate strategy for maintaining profitability in a lower volume growth environment, there may be upside risk to our target price. On the other hand, if management or the bank regulator determines that RY should rebuild capital by paying out less than 40%, there may be downside to our total return target.

European Sovereign Debt Crisis

RY has c.\$40bn of exposure to European governments and corporates. While the exposure is manageable within the current European political and macro environment, should the sovereign crisis in Europe deteriorate there may be downside risk to our book value estimates and hence to our target price. Additional volatility is also likely to negatively impact RY's capital markets revenues.

Royal Bank of Canada at a Glance

Figure 35. RY – Revenue Split



Source: Company data, Citi Research

Figure 36. RY – Profit Split

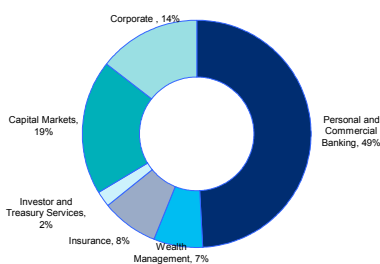


Figure 37. RY – Loan Growth

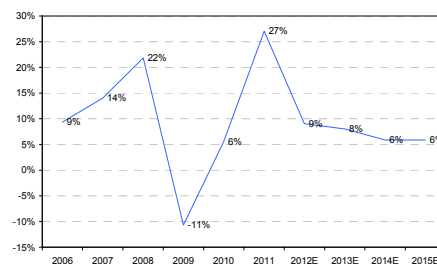
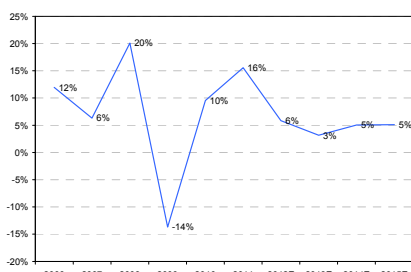


Figure 38. RY – Deposit Growth



Source: Company data, Citi Research

Figure 39. RY - LDR

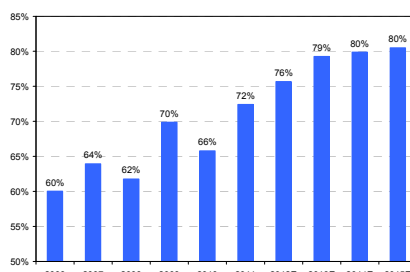


Figure 40. RY - ROE

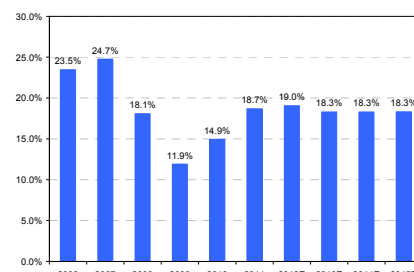
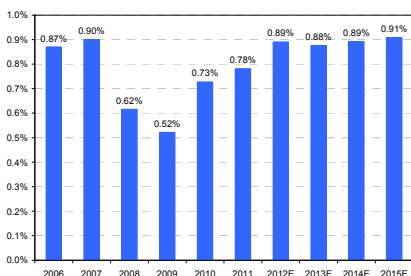


Figure 41. RY - ROA



Source: Company data, Citi Research

Figure 42. RY - NIMs

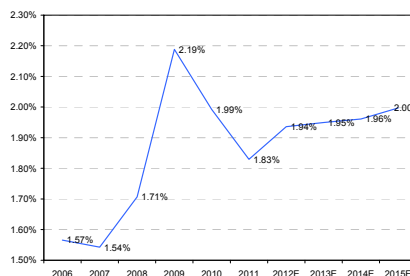


Figure 43. RY – Efficiency Ratio

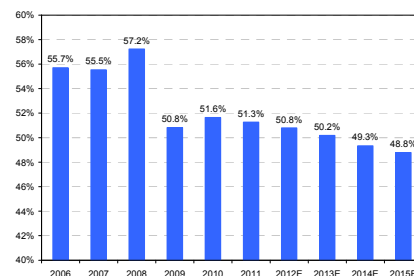
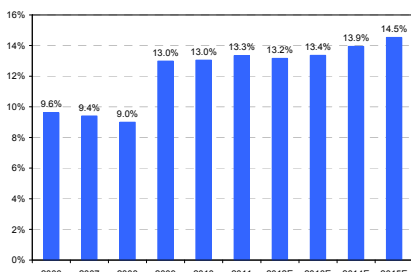


Figure 44. RY – Tier 1 Ratio (Basel 2)



Source: Company data, DataStream, Citi Research

Figure 45. RY – Asset/Equity Multiple, x

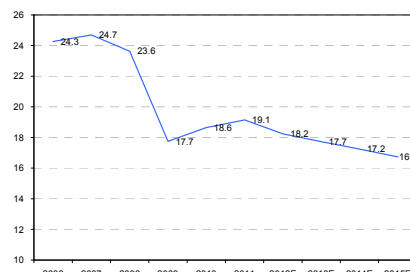
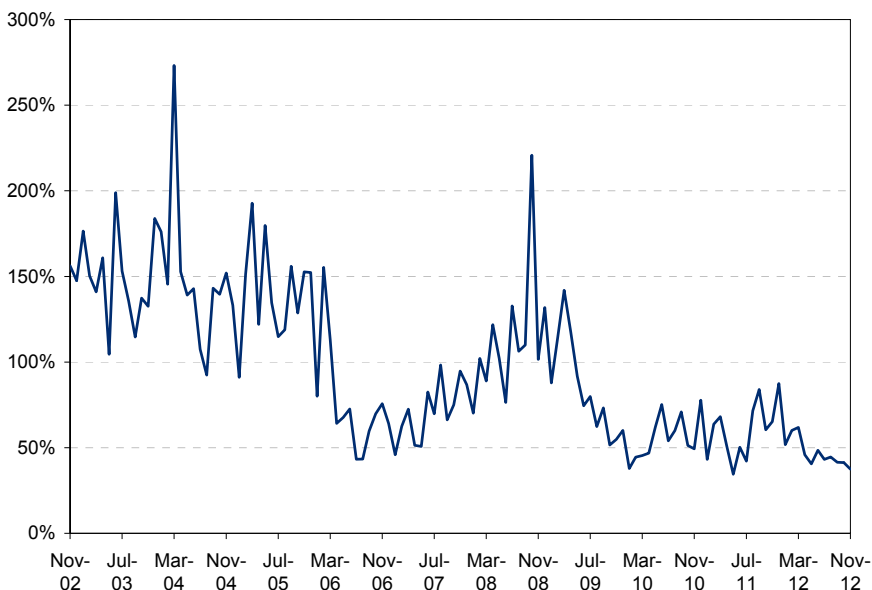


Figure 46. RY – Stock Price



Trading and liquidity

Figure 47. RY – Daily Liquidity Currently at 37% of Shares Outstanding *



Source: Datastream, Citi Research * Annualised.

Share Price Performance and Historical Valuation

Figure 48. RY, TD, BNS – Share Price Chart, 2000-12 (Jan 00 = 100) *

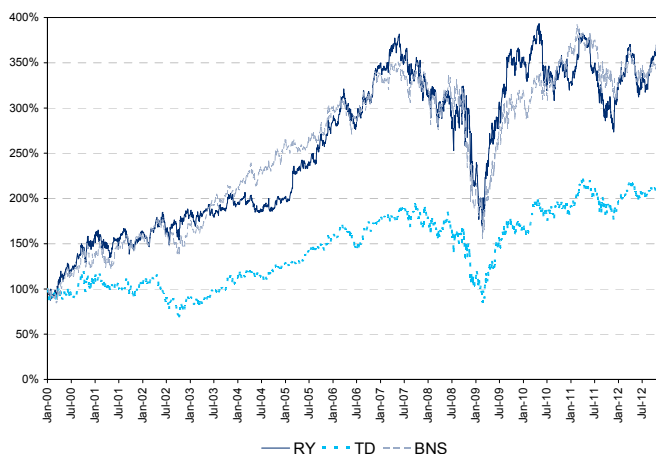
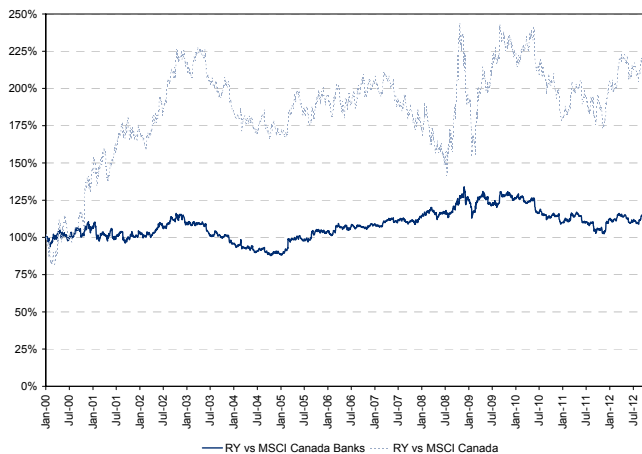
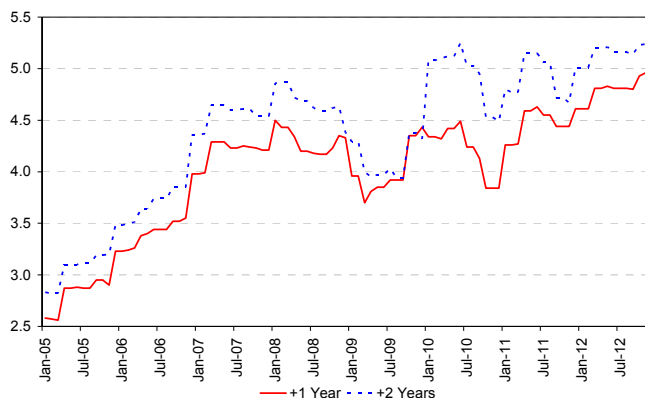


Figure 49. RY – Price Relative to Sector/Canada, 2000-12 (Jan 00 = 100)



Source: Datastream, I/B/E/S, Citi Research * The trough in 2009 represents the low market point during the Global Financial Crisis of 2008-9. The November 2011 trough was driven by the European sovereign crisis.

Figure 50. RY – Consensus EPS Revisions, 2005-12 (\$)



Source: Datastream, I/B/E/S, Citi Research

Figure 51. RY, TD, BNS – +2y Consensus EPS (Jan 05 = 100)

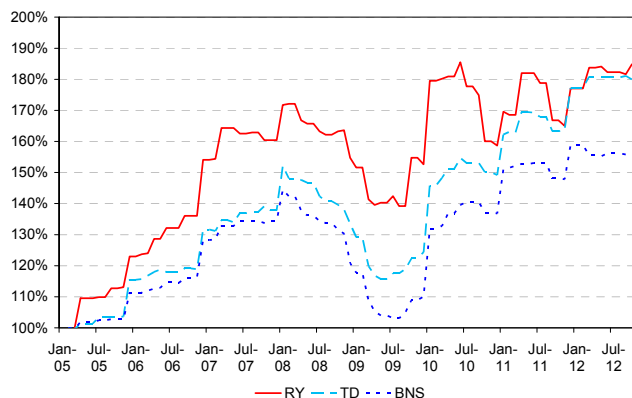
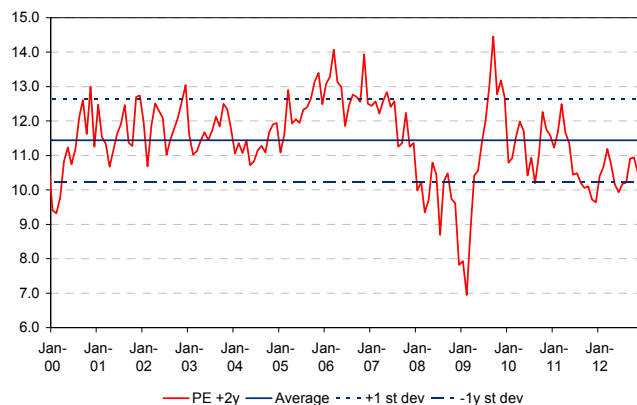


Figure 52. RY – Absolute PE +2y, Jan 00 – Nov 12



Source: Datastream, I/B/E/S, Citi Research

Figure 53. RY – Sector Relative PE +2y, Jan 00 – Nov 12

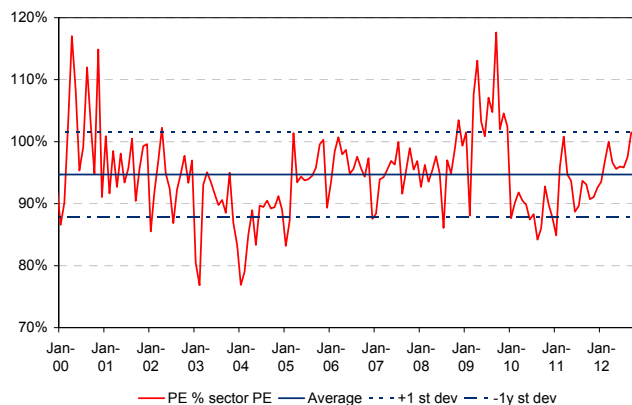
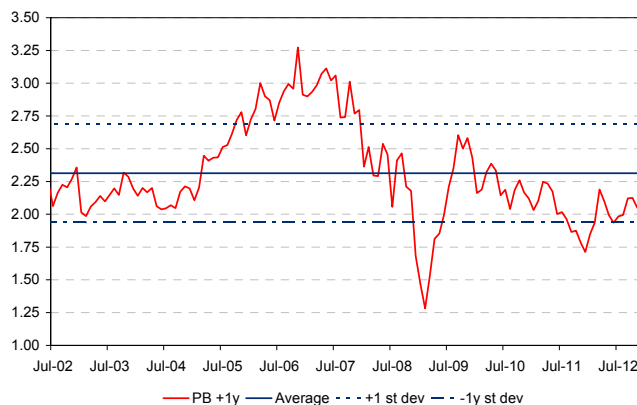
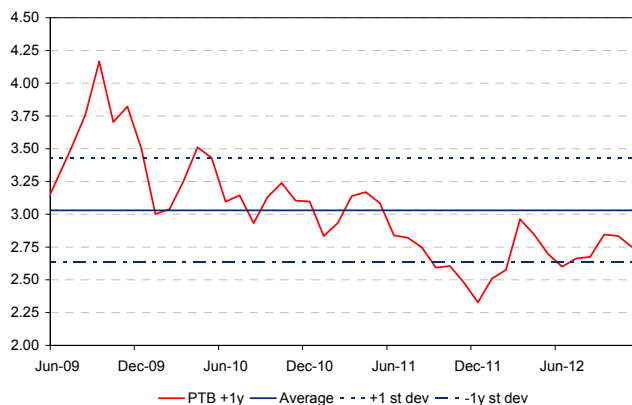


Figure 54. RY – PBV



Source: Datastream, I/B/E/S, Citi Research

Figure 55. RY – PTBV



Management Team

Figure 56. RY – Management Team

President, Chief Executive Officer & Director	Gordon M. Nixon
Chief Financial & Administrative Officer	Janice R. Fukakusa
Chief Risk Officer	Morten N. Friis
<i>Business Heads</i>	
Co-Group Head, Capital Markets	Mark Allan Standish
Co-Group Head, Capital Markets	A. Doug McGregor
Group Head-Canadian Banking	David I. McKay
Group Head-Wealth Management	M. George Lewis

Source: Company reports, Citi Research

Shareholder ownership

Figure 57. Royal Bank of Canada – Top 20 Holders

Holder Name	Parent Co RIC	Position	%O/S
TD Asset Management, Inc.	TD.TO	89,673,697	6.21
BMO Capital Markets (Canada)	BMO.TO	60,194,190	4.17
CIBC World Markets, Inc.	CM.TO	58,667,582	4.06
Bank of Nova Scotia Asset Management	BNS.TO	52,585,342	3.64
RY Global Asset Management, Inc.	RY.TO	44,906,740	3.11
BlackRock Advisors LLC	BLK.N	35,418,838	2.45
I. G. Investment Management Ltd.	Unlisted	34,162,266	2.37
Jarislowsky Fraser Ltd.	Unlisted	27,510,096	1.91
BlackRock Fund Advisors	BLK.N	26,192,975	1.81
Pyramis Global Advisors LLC	Unlisted	21,798,583	1.51
BlackRock Asset Management Canada Ltd.	BLK.N	20,993,230	1.45
CIBC Global Asset Management, Inc.	CM.TO	19,592,057	1.36
BMO Asset Management, Inc.	BMO.TO	15,427,702	1.07
RY Dominion Securities, Inc.	RY.TO	14,708,226	1.02
GWL Investment Management Ltd.	Unlisted	14,449,728	1.00
Fiera Capital Corp. (Investment Management)	FSZ.TO	13,397,881	0.93
Connor, Clark & Lunn Investment Management Ltd.	Unlisted	12,316,952	0.85
Beutel, Goodman & Co. Ltd.	Unlisted	11,077,287	0.77
Norges Bank Investment Management	Unlisted	10,540,780	0.73
Goodman & Co. Investment Counsel Ltd.	Unlisted	8,554,550	0.59
		592,168,702	41.00

Source: Factset; Latest reported holdings

M&A History & Strategy

RY focuses on select and accretive add-on acquisitions which complement the company's capabilities. In October 2012, RY announced the purchase of Ally Financial's Canadian business for C\$3.1bn in cash, inclusive of excess capital (1.75x net asset value excluding excess capital).

In July 2012, RY completed the acquisition of 50% of RBC Dexia Investor Services which it did not already own.

In December 2010, RY acquired BlueBay, a fixed income asset management firm.

Ally Financial Canada, RBC Dexia,
BlueBay

Figure 58. RY – Select M&A Transactions since 1995

Announcement Date	Completion Date	Deal Value US\$m	Deal Status	Target	Target Nationality
23-Oct-12		3,100	Pending	Ally Credit Canada Ltd ("Ally Canada"); ResMor Trust Co	Canada
26-Jan-01	05-Jun-01	2,170	Completed	Centura Banks, Inc.	United States
02-Oct-07	16-Jun-08	2,161	Completed	Royal Bank of Trinidad & Tobago Financial Holdings	Trinidad and Tobago
06-Sep-07	25-Feb-08	1,630	Completed	Alabama National Bancorp	United States
18-Oct-10	17-Dec-10	1,540	Completed	BlueBay Asset Management plc	United Kingdom
21-Feb-08	05-May-08	1,353	Completed	Phillips Hager & North Investment Management Ltd	Canada
28-Sep-00	11-Jan-01	1,223	Completed	Dain Rauscher Corp	United States
03-Apr-12	27-Jul-12	1,117	Completed	RY Dexia Investor Services Ltd (50%)	United Kingdom
01-Aug-01	01-Nov-01	603	Completed	Tucker Anthony Sutro	United States
29-Aug-96	29-Aug-96	351	Completed	Richardson Greenshield of Canada Ltd	Canada
29-Aug-02	29-Jan-03	157	Completed	Admiralty Bancorp Inc	United States
27-Mar-02	22-Jul-02	153	Completed	Eagle Bancshares Inc	United States
13-Mar-00	26-Apr-00	110	Completed	Prism Financial Corp.	United States
17-Jul-03	30-Sep-03	100	Completed	Sterling Capital Mortgage Co (80% interest)	United States
22-May-02	02-Jul-02	90	Completed	Barclays PLC (American Private Banking Operations)	United States
09-Jul-10		80	Not Pursued	PT Bank Maspion Indonesia (30%)	Indonesia
10-Jul-03	21-Nov-03	80	Completed	Provident Financial Group Inc (Florida operations)	United States
21-Jul-98	01-Sep-98	30	Completed	CREDIT SUISSE PRIVATE BANKING NORTH AMERICA	United States
15-Jan-96	15-Jan-96		Completed	Hambros Equities UK Ltd (Equity Research Sales & Trading Business)	United Kingdom
23-Jan-98			Withdrawn	Bank of Montreal	Canada
07-Aug-08	07-Aug-08		Completed	ABN AMRO Holding NV (Canadian commercial leasing division)	Canada
07-Nov-10	07-Nov-10		Completed	Fortis Wealth Management Co Ltd (Wealth management business)	Hong Kong
20-Mar-12			Pending	Coutts & Co (LatAm, Caribbean and African private banking business)	United Kingdom

Source: Dealogic, Citi Research

Financial Statements

Figure 59. Royal Bank of Canada – Group P&L by Year (2009-2015E)

(C\$ millions)	CGAAP 2009	CGAAP 2010	IFRS 2011	IFRS 2012	IFRS 2013E	IFRS 2014E	IFRS 2015E	% chg 2010	% chg 2011	% chg 2012	% chg 2013E	% chg 2014E	% chg 2015E
GROUP INCOME STATEMENT													
Net interest income	10,705	10,338	11,357	12,498	12,980	14,000	14,951	-3%	10%	10%	4%	8%	7%
Non-interest income	15,736	15,744	16,281	17,274	18,253	19,221	20,243	0%	3%	6%	6%	5%	5%
Trading revenue	2,380	1,333	655	1,298	1,558	1,869	2,243	-44%	-51%	98%	20%	20%	20%
Insur prems, invtmt and fee income	4,067	4,485	4,474	4,897	4,535	4,694	4,877	10%	0%	9%	-7%	4%	4%
Fees & Other	9,289	9,926	11,152	11,079	12,161	12,658	13,124	7%	12%	-1%	10%	4%	4%
Total revenue	26,441	26,082	27,638	29,772	31,233	33,222	35,195	-1%	6%	8%	5%	6%	6%
Insur policyhldr benefits, claims & acqn exp.	-3,042	-3,546	-3,358	-3,621	-3,513	-3,646	-3,784	17%	-5%	8%	-3%	4%	4%
Non-interest expense	-13,436	-13,469	-14,167	-15,160	-15,814	-16,578	-17,441	0%	5%	7%	4%	5%	5%
GOP	9,963	9,067	10,113	10,991	11,906	12,998	13,970	-9%	12%	0%	0%	0%	0%
Provision for credit losses	-2,167	-1,240	-1,133	-1,301	-1,464	-1,566	-1,645	-43%	-9%	15%	13%	7%	5%
PBT	7,796	7,827	8,980	9,690	10,443	11,432	12,325	0%	15%	8%	8%	9%	8%
Income taxes	-2,015	-1,996	-2,010	-2,100	-2,440	-2,710	-2,951	-1%	1%	4%	16%	11%	9%
Net income from continuing operations	5,681	5,732	6,970	7,590	8,003	8,722	9,374	1%	22%	9%	5%	9%	7%
Net loss from discontinued operations	-1,823	-509	-526	-51	0	0	0	-72%	3%	0%	0%	0%	0%
Net income	3,858	5,223	6,444	7,539	8,003	8,722	9,374	35%	23%	17%	6%	9%	7%
Minority interests	0	0	-101	-97	-100	-100	-100	nm	nm	nm	nm	nm	nm
Preferred dividends	-233	-258	-258	-258	-258	-258	-258	11%	0%	0%	0%	0%	0%
Net income available to common shrhldrs	3,625	4,965	6,085	7,184	7,645	8,364	9,016	37%	23%	18%	6%	9%	8%
PER SHARE													
EPS - basic	2.59	3.49	4.25	4.98	5.37	5.86	6.22	35%	22%	17%	8%	9%	6%
EPS - diluted	2.57	3.46	4.14	4.89	5.29	5.75	6.11	35%	19%	18%	8%	9%	6%
BVPS	22.4	23.7	23.6	26.8	29.0	31.4	34.3	6%	-1%	14%	8%	8%	9%
TBVPS	16.4	17.9	17.0	19.9	21.7	23.9	26.4	9%	-5%	17%	9%	10%	11%
ROE (avg equity, ex minorities)	12.1%	15.0%	17.6%	19.3%	18.8%	19.0%	18.6%	-	-	-	-	-	-
ROTE (avg equity, ex minorities)	18.4%	20.2%	23.9%	26.4%	25.2%	25.2%	24.3%	-	-	-	-	-	-
DPS	2.00	2.00	2.08	2.28	2.48	2.70	2.87	0%	4%	10%	9%	9%	6%
Dividends - common (\$m)	2,819	2,843	2,979	3,291	3,517	3,888	4,191	1%	5%	10%	7%	11%	8%
Dividends - preferred (\$m)	233	258	258	258	258	258	258	11%	0%	0%	0%	0%	0%
Payout ratio	78%	58%	50%	47%	47%	47%	47%	-	-	-	-	-	-
Common equity (ex minorities)	32,093	34,138	34,889	39,454	41,939	46,042	50,866	6%	2%	13%	6%	10%	10%
Tangible common equity (ex minorities)	23,435	25,768	25,164	29,283	31,355	34,929	39,197	10%	-2%	16%	7%	11%	12%
Common Shares - basic (end)	1,418	1,425	1,438	1,445	1,418	1,438	1,458	1%	1%	0%	-2%	1%	1%
Common Shares - diluted (avg)	1,412	1,434	1,471	1,468	1,444	1,454	1,474	2%	3%	0%	-2%	1%	1%
OPERATING RATIOS													
ROA	0.52%	0.73%	0.78%	0.89%	0.97%	1.00%	1.02%						
ROE on attributed capital	11.9%	14.9%	18.7%	19.3%	19.3%	19.8%	20.0%						
RoAvRWA	1.48%	1.91%	2.27%	2.52%	2.71%	2.78%	2.81%						
LDR	70%	66%	72%	73%	75%	76%	78%						
RWA / Assets	35.2%	38.1%	34.4%	35.2%	36.0%	36.1%	36.2%						
Assets / Equity	22.8	20.5	23.9	21.8	19.8	19.7	19.6						
NIM on average assets	1.54%	1.51%	1.46%	1.54%	1.66%	1.68%	1.69%						
Non-interest income % average assets	2.26%	2.31%	2.09%	2.13%	2.33%	2.31%	2.28%						
PBT % revenues	29.5%	30.0%	32.5%	32.5%	33.4%	34.4%	35.0%						
Efficiency ratio	50.8%	51.6%	51.3%	50.9%	50.6%	49.9%	49.6%						
Tax rate	25.8%	25.5%	22.4%	21.7%	23.4%	23.7%	23.9%						
BALANCE SHEET ITEMS													
Total Assets	654,989	726,206	793,833	825,100	866,377	916,793	972,500	11%	9%	4%	5%	6%	6%
Total Liabilities	618,083	687,255	752,370	779,072	817,792	864,178	915,060	11%	9%	4%	5%	6%	6%
Total shareholders' equity	36,906	38,951	41,463	46,028	48,584	52,616	57,440	6%	6%	11%	6%	8%	9%
Tier 1 common	22,619	25,484	28,291	29,379	30,953	35,430	40,254	13%	11%	4%	5%	14%	14%
Tier 1	31,774	33,972	35,713	36,807	38,396	42,852	47,676	7%	5%	3%	4%	12%	11%
Total regulatory capital	34,881	37,625	41,021	42,347	43,934	48,160	52,984	8%	9%	3%	4%	10%	10%
Tier 1 common ratio	9.2%	9.8%	10.6%	10.3%	11.0%	11.8%	12.5%						
Tier 1 capital ratio	13.0%	13.0%	13.3%	12.9%	13.6%	14.2%	14.8%						
Total RWA	244,837	260,456	267,780	285,508	282,065	301,132	321,245	6%	3%	7%	-1%	7%	7%

Source: Company Reports and Citi Research Estimates

Figure 60. Royal Bank of Canada – Group P&L by Quarter (1Q11-4Q13E)

(C\$ millions)	IFRS 1Q11	IFRS 2Q11	IFRS 3Q11	IFRS 4Q11	IFRS 1Q12	IFRS 2Q12	IFRS 3Q12	IFRS 4Q12	IFRS 1Q13E	IFRS 2Q13E	IFRS 3Q13E	IFRS 4Q13E
GROUP INCOME STATEMENT												
Net interest income	2,795	2,716	2,889	2,957	3,003	3,031	3,289	3,175	3,180	3,217	3,254	3,330
Non-interest income	4,423	4,115	4,008	3,735	4,571	3,893	4,467	4,343	4,565	4,564	4,622	4,502
Trading revenue	721	285	-132	-219	396	349	295	258	250	250	250	250
Insur premis, invtmt and fee income	825	1,086	1,349	1,214	1,550	926	1,323	1,098	1,212	1,159	1,168	995
Fees & Other	2,877	2,744	2,791	2,740	2,625	2,618	2,849	2,987	3,104	3,155	3,204	3,256
Total revenue	7,218	6,831	6,897	6,692	7,574	6,924	7,756	7,518	7,745	7,781	7,876	7,831
Insur policyhldr benefits, claims & acqn exp.	-567	-843	-1,081	-867	-1,211	-640	-1,000	-770	-931	-889	-893	-801
Non-interest expense	-3,669	-3,551	-3,417	-3,530	-3,671	-3,857	-3,759	-3,873	-3,943	-3,953	-3,900	-4,018
GOP	2,982	2,437	2,399	2,295	2,692	2,427	2,997	2,875	2,871	2,940	3,083	3,012
Provision for credit losses	-264	-273	-320	-276	-267	-348	-324	-362	-363	-365	-369	-367
PBT	2,718	2,164	2,079	2,019	2,425	2,079	2,673	2,513	2,509	2,575	2,714	2,645
Income taxes	-722	-482	-396	-410	-549	-516	-433	-602	-578	-598	-635	-629
Net income from continuing operations	1,996	1,682	1,683	1,609	1,876	1,563	2,240	1,911	1,931	1,977	2,079	2,017
Net loss from discontinued operations	-48	-51	-389	-38	-21	-30	0	0	0	0	0	0
Net income	1,948	1,631	1,294	1,571	1,855	1,533	2,240	1,911	1,931	1,977	2,079	2,017
Minority interests	-26	-25	-25	-25	-25	-25	-24	-23	-25	-25	-25	-25
Preferred dividends	-65	-64	-64	-65	-64	-65	-64	-65	-64	-64	-64	-64
Net inc available to common shrhldrs	1,857	1,542	1,205	1,481	1,766	1,443	2,152	1,823	1,842	1,888	1,990	1,928
PER SHARE												
EPS - basic	1.30	1.08	0.84	1.03	1.23	1.00	1.49	1.26	1.28	1.33	1.40	1.36
EPS - diluted	1.26	1.05	0.82	1.01	1.20	0.98	1.46	1.24	1.26	1.30	1.38	1.34
BVPS (ex prefs, minorities)	22.8	23.2	23.8	25.0	24.6	24.9	26.1	26.8	27.1	27.7	28.3	29.0
TBVPS (ex prefs, minorities)	16.2	16.7	17.4	18.4	18.0	18.4	19.2	19.9	20.0	20.5	21.1	21.7
ROE (avg equity, ex prefs, minorities)	22.6%	19.3%	14.7%	17.3%	19.9%	15.9%	23.0%	18.7%	18.7%	19.0%	19.7%	18.6%
ROTE (avg equity, ex prefs, minorities)	31.2%	27.7%	20.7%	24.1%	27.4%	21.6%	31.1%	25.4%	25.3%	25.7%	26.5%	25.0%
DPS	0.50	0.50	0.54	0.54	0.54	0.57	0.57	0.60	0.60	0.62	0.62	0.64
Dividends - common (\$m)	713	713	776	777	778	822	824	867	855	881	879	908
Dividends - preferred (\$m)	65	64	64	65	64	65	64	65	64	64	64	64
Payout ratio	38%	46%	64%	52%	44%	57%	38%	48%	46%	47%	44%	47%
Common equity (ex prefs, minorities)	31,649	32,188	33,420	34,889	36,159	36,624	38,355	39,454	39,326	40,066	40,910	41,939
Tangible common equity (ex prefs, mins)	21,851	22,610	23,915	25,164	26,427	27,052	28,240	29,283	29,053	29,691	30,431	31,355
Common Shares - basic (end)	1,426	1,429	1,437	1,438	1,441	1,443	1,444	1,444	1,425	1,421	1,417	1,418
Common Shares - diluted (avg)	1,474	1,472	1,474	1,466	1,468	1,467	1,470	1,470	1,461	1,449	1,445	1,444
OPERATING RATIOS												
ROA	0.97%	0.81%	0.63%	0.72%	0.87%	0.73%	1.06%	0.88%	0.97%	0.98%	1.03%	0.98%
ROE on attributed capital	24.0%	19.4%	14.6%	17.2%	19.8%	15.9%	22.8%	18.8%	19.6%	19.8%	20.4%	19.5%
RoAvRWA	2.90%	2.44%	1.85%	2.21%	2.47%	2.16%	3.09%	2.60%	2.71%	2.74%	2.86%	2.73%
LDR	73%	73%	72%	73%	73%	74%	75%	76%	75%	75%	75%	75%
RWA / Assets	33.5%	33.4%	34.0%	32.5%	35.1%	33.9%	34.2%	34.0%	35.9%	35.9%	35.9%	36.0%
Assets / Equity	24.7	23.8	23.2	23.9	22.9	21.6	21.6	21.2	20.2	20.1	19.9	19.8
NIM on average assets	1.46%	1.43%	1.51%	1.44%	1.47%	1.54%	1.61%	1.54%	1.68%	1.68%	1.68%	1.70%
Non-interest income % average assets	2.31%	2.17%	2.09%	1.81%	2.24%	1.98%	2.19%	2.11%	2.41%	2.38%	2.39%	2.30%
PBT % revenues	37.7%	31.7%	30.1%	30.2%	32.0%	30.0%	34.5%	33.4%	32.4%	33.1%	34.5%	33.8%
Efficiency ratio	50.8%	52.0%	49.5%	52.7%	48.5%	55.7%	48.5%	51.5%	50.9%	50.8%	49.5%	51.3%
Tax rate	26.6%	22.3%	19.0%	20.3%	22.6%	24.8%	16.2%	24.0%	23.0%	23.2%	23.4%	23.8%
BALANCE SHEET ITEMS												
Total Assets	761,972	768,249	772,141	793,833	815,016	800,371	824,394	825,100	835,880	844,359	852,885	866,377
Total Liabilities	723,457	729,160	732,159	752,370	772,286	757,161	779,469	779,072	789,963	797,684	805,347	817,792
Total shareholders' equity	38,515	39,089	39,982	41,463	42,730	43,210	44,925	46,028	45,917	46,675	47,538	48,584
Tier 1 common	25,319	26,049	26,933	28,291	27,285	27,718	28,717	29,379	28,365	29,097	29,933	30,953
Tier 1	33,801	34,551	34,371	35,713	34,727	35,151	36,160	36,807	35,808	36,540	37,376	38,396
Total regulatory capital	39,064	39,824	39,578	41,021	41,462	40,599	41,698	42,347	41,346	42,078	42,914	43,934
Tier 1 common ratio	9.9%	10.3%	10.3%	10.6%	9.6%	10.4%	10.3%	10.5%	10.4%	10.6%	10.7%	11.0%
Tier 1 capital ratio	13.2%	13.6%	13.2%	13.3%	12.2%	13.2%	13.0%	13.1%	13.2%	13.3%	13.4%	13.6%
Total RWA	256,009	253,235	261,015	267,780	285,508	267,138	278,418	280,609	272,106	275,303	278,514	282,065

Source: Company Reports and Citi Research Estimates

Figure 61. Royal Bank of Canada – Divisional P&L by Year (2009-2015E)

C\$ millions	CGAAP 2009	CGAAP 2010	IFRS 2011	IFRS 2012	IFRS 2013E	IFRS 2014E	IFRS 2015E	% chg 2010	% chg 2011	% chg 2012	% chg 2013E	% chg 2014E	% chg 2015E
PERSONAL & COMMERCIAL BANKING													
Net interest income	7,596	8,095	8,515	9,061	9,424	10,085	10,690	7%	5%	6%	4%	7%	6%
Non-interest income	3,111	3,306	3,510	3,582	3,931	4,186	4,437	6%	6%	2%	10%	6%	6%
Total revenue	10,707	11,401	12,025	12,643	13,355	14,271	15,127	6%	5%	5%	6%	7%	6%
Non-interest expense	-5,350	-5,600	-5,682	-5,932	-6,130	-6,479	-6,777	5%	1%	4%	3%	6%	5%
Provision for credit losses (PCL)	-1,346	-1,333	-1,142	-1,167	-1,177	-1,266	-1,342	-1%	-14%	2%	1%	8%	6%
PBT	4,011	4,468	5,201	5,544	6,048	6,526	7,008	11%	16%	7%	9%	8%	7%
Net Income	2,753	3,099	3,740	4,088	4,475	4,829	5,186	13%	21%	9%	9%	8%	7%
Total assets	275,500	295,200	310,700	331,500	359,013	380,554	403,387	7%	5%	7%	8%	0	0
ROA	1.00%	1.05%	1.20%	1.23%	1.25%	1.27%	1.29%	-	-	-	-	-	-
NIM on average assets	2.76%	2.74%	2.74%	2.73%	2.63%	2.65%	2.65%	-	-	-	-	-	-
PBT/Revenues	37.5%	39.2%	43.3%	43.9%	45.3%	45.7%	46.3%	-	-	-	-	-	-
Efficiency ratio	50.0%	49.1%	47.3%	46.9%	45.9%	45.4%	44.8%	-	-	-	-	-	-
PCL / Average loans	0.52%	0.48%	0.39%	0.37%	0.35%	0.35%	0.35%	-	-	-	-	-	-
WEALTH MANAGEMENT													
Net interest income	397	305	365	393	419	448	479	-23%	20%	8%	7%	7%	7%
Fee-based revenue	2,154	2,362	2,821	2,964	3,164	3,291	3,423	10%	19%	5%	7%	4%	4%
Transactional and other revenue	1,529	1,521	1,522	1,478	1,529	1,591	1,654	-1%	0%	-3%	3%	4%	4%
Total revenue	4,080	4,188	4,708	4,835	5,113	5,330	5,556	3%	12%	3%	6%	4%	4%
Non-interest expense	-3,262	-3,295	-3,586	-3,796	-4,008	-4,022	-4,183	1%	9%	6%	6%	0%	4%
Provision for credit losses (PCL)	0	-3	0	1	0	0	0	0%	0%	0%	0%	0%	0%
PBT	818	890	1,122	1,040	1,104	1,308	1,373	9%	26%	-7%	6%	18%	5%
Net income	583	669	811	763	806	955	1,002	15%	21%	-6%	6%	18%	5%
Assets	20,500	18,400	20,900	20,900	24,122	28,223	32,457	-10%	14%	0%	15%	17%	15%
ROA	2.84%	3.64%	3.88%	3.65%	3.34%	3.38%	3.09%	-	-	-	-	-	-
NIM on average assets	10.51%	12.84%	13.50%	14.18%	13.12%	11.66%	10.55%	-	-	-	-	-	-
Efficiency ratio	80.0%	78.7%	76.2%	78.5%	78.4%	75.5%	75.3%	-	-	-	-	-	-
PCL / average loans	0.00%	0.04%	0.00%	-0.01%	0.00%	0.00%	0.00%	-	-	-	-	-	-
PBT/Revenues	20.0%	21.3%	23.8%	21.5%	21.6%	24.5%	24.7%	-	-	-	-	-	-
INSURANCE													
Net earned premiums (EP)	2,882	3,313	3,533	3,705	3,778	3,921	4,068	15%	7%	5%	2%	4%	4%
Investment income	940	928	703	929	510	516	539	-1%	-24%	32%	-45%	1%	4%
Fee income	241	248	239	263	247	258	269	3%	-4%	10%	-6%	4%	4%
Total revenue	4,063	4,489	4,475	4,897	4,535	4,694	4,877	10%	0%	9%	-7%	4%	4%
Benefits & Expenses	-3,042	-3,546	-3,358	-3,621	-3,513	-3,646	-3,784	17%	-5%	8%	-3%	4%	4%
Non-interest expense	-457	-468	-498	-515	-510	-529	-549	2%	6%	3%	-1%	4%	4%
PBT	564	475	619	761	511	519	544	0%	0%	0%	0%	0%	0%
Net income	527	491	600	714	460	467	489	-7%	22%	19%	-36%	1%	5%
Assets	8,500	9,900	10,500	11,500	13,100	14,017	14,998	16%	6%	10%	7%	7%	7%
PBT/Revenues	13.9%	10.6%	13.8%	15.5%	11.3%	11.0%	11.1%	-	-	-	-	-	-
INVESTOR & TREASURY SERVICES													
Net interest income	838	498	573	668	758	803	852	-41%	15%	17%	13%	6%	6%
Non-interest income	1,084	623	569	657	1,014	1,075	1,139	-43%	-9%	15%	54%	6%	6%
Total Revenue	1,922	1,121	1,142	1,325	1,772	1,878	1,991	-42%	2%	16%	34%	6%	6%
Non-interest expense	-830	-783	-821	-1,134	-1,314	-1,393	-1,476	-6%	5%	38%	16%	6%	6%
Provision for credit losses (PCL)	-21	-15	0	0	0	0	0	0%	0%	0%	0%	0%	0%
PBT	1,071	323	321	191	458	485	515	-70%	-1%	-40%	140%	6%	6%
Net income (loss)	697	222	230	85	321	340	360	-68%	4%	-63%	277%	6%	6%
Total assets	62,800	60,400	70,000	73,600	84,705	85,129	85,554	-4%	16%	5%	15%	0%	0%
NIM on avg assets	2%	1.0%	0.8%	0.9%	1.2%	1.3%	1.3%	-	-	-	-	-	-
Efficiency Ratio	43%	69.8%	71.9%	85.6%	74.2%	74.2%	74.2%	-	-	-	-	-	-
CAPITAL MARKETS													
Net interest income (teb)	2,715	2,283	2,197	2,559	2,779	3,064	3,331	-16%	-4%	16%	9%	10%	9%
Non-interest income	2,996	3,140	3,127	3,629	3,780	4,085	4,413	5%	0%	16%	4%	8%	8%
Total revenue (teb)	5,711	5,423	5,324	6,188	6,559	7,149	7,744	-5%	-2%	16%	6%	9%	8%
Non-interest expense	-3,458	-3,242	-3,487	-3,746	-3,771	-4,075	-4,376	-6%	8%	7%	1%	8%	7%
Provision for credit losses (PCL)	-682	-5	14	-135	-186	-199	-203	-99%	-380%	-1064%	38%	7%	2%
PBT	1,571	2,176	1,851	2,307	2,601	2,875	3,166	39%	-15%	25%	13%	11%	10%
Net income	1,104	1,462	1,292	1,581	1,821	2,012	2,216	32%	-12%	22%	15%	11%	10%
Total assets	295,700	277,400	322,000	349,200	370,559	392,793	416,360	-6%	16%	8%	6%	6%	6%
ROA	0.37%	0.53%	0.40%	0.45%	0.49%	0.51%	0.53%	-	-	-	-	-	-
NIM on average assets	0.92%	0.82%	0.68%	0.73%	0.75%	0.78%	0.80%	-	-	-	-	-	-
Efficiency ratio	60.5%	59.8%	65.5%	60.5%	57.5%	57.0%	56.5%	-	-	-	-	-	-
PCL / Average loans	1.92%	0.02%	-0.04%	0.29%	0.33%	0.30%	0.27%	-	-	-	-	-	-
PBT/Revenues	27.5%	40.1%	34.8%	37.3%	39.7%	40.2%	40.9%	-	-	-	-	-	-

Source: Company Reports and Citi Research Estimates

Figure 62. Royal Bank of Canada – Divisional P&L by Quarter (1Q11-4Q13E)

C\$ millions	IFRS 1Q11	IFRS 2Q11	IFRS 3Q11	IFRS 4Q11	IFRS 1Q12	IFRS 2Q12	IFRS 3Q12	IFRS 4Q12	IFRS 1Q13E	IFRS 2Q13E	IFRS 3Q13E	IFRS 4Q13E
PERSONAL & COMMERCIAL BANKING												
Net interest income	2,143	2,065	2,131	2,176	2,203	2,165	2,391	2,302	2,326	2,338	2,359	2,400
Non-interest income	892	878	868	872	883	863	909	927	958	976	993	1,004
Total revenue	3,035	2,943	2,999	3,048	3,086	3,028	3,300	3,229	3,285	3,314	3,353	3,404
Non-interest expense	-1,376	-1,394	-1,443	-1,469	-1,454	-1,444	-1,508	-1,526	-1,527	-1,541	-1,492	-1,570
Provision for credit losses (PCL)	-286	-275	-311	-270	-251	-318	-300	-298	-298	-293	-295	-292
PBT	1,373	1,274	1,245	1,309	1,381	1,266	1,492	1,405	1,459	1,481	1,566	1,542
Net Income	987	924	882	947	1,012	940	1,102	1,034	1,080	1,096	1,159	1,141
Total assets	306,100	306,600	311,200	318,400	322,600	327,500	335,200	340,500	348,494	351,650	354,806	359,013
ROA	1.29%	1.21%	1.13%	1.19%	1.25%	1.15%	1.32%	1.21%	1.24%	1.25%	1.31%	1.27%
NIM on average assets	2.8%	2.7%	2.7%	2.7%	2.73%	2.64%	2.85%	2.70%	2.67%	2.66%	2.66%	2.67%
PBT/Revenues	45.2%	43.3%	41.5%	42.9%	44.8%	41.8%	45.2%	43.5%	44.4%	44.7%	46.7%	45.3%
Efficiency ratio	45.3%	47.4%	48.1%	48.2%	47.1%	47.7%	45.7%	47.3%	46.5%	46.5%	44.5%	46.1%
PCL / Average loans	0.39%	0.39%	0.42%	0.35%	0.32%	0.41%	0.38%	0.37%	0.36%	0.35%	0.35%	0.34%
WEALTH MANAGEMENT												
Net interest income	90	88	91	96	102	98	98	95	101	102	104	112
Fee-based revenue	659	702	734	726	721	732	742	769	779	786	793	806
Transactional and other revenue	436	426	331	329	365	389	327	397	377	380	383	389
Total revenue	1,185	1,216	1,156	1,151	1,188	1,219	1,167	1,261	1,257	1,269	1,281	1,307
Non-interest expense	-884	-914	-895	-893	-939	-941	-944	-972	-985	-994	-1,002	-1,027
Provision for credit losses (PCL)	0	0	0	0	0	1	0	0	0	0	0	0
PBT	301	302	261	258	249	279	223	289	272	275	278	279
Net income	213	227	192	179	188	212	156	207	198	201	203	204
Assets	19,400	20,600	21,400	22,300	21,300	21,000	21,100	20,200	21,181	22,161	23,142	24,122
ROA	4.39%	4.41%	3.59%	3.21%	3.53%	4.04%	2.96%	4.10%	3.75%	3.62%	3.51%	3.38%
NIM on average assets	13.59%	13.63%	13.72%	13.02%	13.54%	13.94%	14.07%	15.23%	14.72%	14.19%	13.71%	13.36%
Efficiency ratio	74.6%	75.2%	77.4%	77.6%	79.0%	77.2%	80.9%	77.1%	78.4%	78.3%	78.3%	78.6%
PCL / average loans	0.00%	0.00%	0.00%	0.00%	0.00%	-0.04%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
PBT/Revenues	25.4%	24.8%	22.6%	22.4%	21.0%	22.9%	19.1%	22.9%	21.6%	21.7%	21.7%	21.4%
INSURANCE												
Net earned premiums (EP)	881	864	891	897	957	932	902	914	1,001	956	961	861
Investment income	-116	166	399	254	532	-59	363	93	148	143	145	74
Fee income	60	56	59	64	61	53	58	91	63	61	62	60
Total revenue	825	1,086	1,349	1,215	1,550	926	1,323	1,098	1,212	1,159	1,168	995
Benefits & Expenses	-567	-843	-1,081	-867	-1,211	-640	-1,000	-770	-931	-889	-893	-801
Non-interest expense	-122	-121	-126	-129	-129	-126	-126	-134	-135	-129	-130	-116
PBT	136	122	142	219	210	160	197	194	146	142	145	79
Net income	136	123	141	200	190	151	179	194	131	128	131	71
Assets	10,500	10,200	10,600	10,800	11,100	11,400	11,700	11,900	12,200	12,500	12,800	13,100
PBT/Revenues	16.5%	11.2%	10.5%	18.0%	13.5%	17.3%	14.9%	17.7%	12.0%	12.2%	12.4%	7.9%
INVESTOR & TREASURY SERVICES												
Net interest income	132	126	152	163	180	164	152	172	179	186	193	200
Non-interest income	165	177	128	99	145	118	152	242	247	252	255	260
Total Revenue	297	303	280	262	325	282	304	414	426	438	448	460
Non-interest expense	-201	-204	-207	-209	-214	-378	-226	-316	-321	-326	-331	-336
Provision for credit losses (PCL)	0	0	0	0	0	0	0	0	0	0	0	0
PBT	96	99	73	53	111	-96	78	98	105	112	117	124
Net income (loss)	67	70	53	40	83	-121	51	72	74	78	82	87
Total assets	65,100	66,300	71,000	77,100	74,600	68,900	69,300	81,400	82,214	83,036	83,867	84,705
NIM on avg assets	1.0%	1.1%	0.7%	0.5%	0.8%	0.7%	0.9%	1.2%	1.2%	1.2%	1.2%	1.2%
Efficiency Ratio	67.7%	67.3%	73.9%	79.8%	65.8%	134.0%	74.3%	76.3%	75.4%	74.4%	73.9%	73.0%
CAPITAL MARKETS												
Net interest income (teb)	542	563	532	560	604	661	631	663	674	690	697	718
Non-interest income	1,396	835	467	340	852	903	973	950	963	974	985	997
Total revenue (teb)	2,051	1,499	1,133	1,042	1,616	1,710	1,739	1,700	1,765	1,861	1,806	1,808
Non-interest expense	-1,121	-928	-772	-838	-978	-1,014	-981	-1,018	-1,059	-1,079	-1,029	-1,104
Provision for credit losses (PCL)	25	3	-9	-5	-17	-31	-24	-23	-27	-28	-30	-32
PBT	955	574	352	199	621	665	734	659	679	754	747	672
Net income	584	353	230	125	371	371	429	410	418	445	474	484
Total assets	314,100	307,300	313,600	352,900	343,750	334,500	362,400	356,100	359,661	363,258	366,890	370,559
ROA	0.74%	0.46%	0.29%	0.14%	0.43%	0.44%	0.47%	0.46%	0.46%	0.49%	0.52%	0.52%
NIM on average assets	0.69%	0.73%	0.68%	0.63%	0.70%	0.79%	0.70%	0.74%	0.75%	0.76%	0.76%	0.77%
Efficiency ratio	55.7%	64.1%	69.4%	82.9%	63.6%	62.2%	57.8%	58.9%	60.0%	58.0%	56.0%	56.1%
PCL / Average loans	-0.29%	-0.04%	0.10%	0.05%	0.16%	0.27%	0.20%	0.49%	0.30%	0.35%	0.35%	0.35%
PBT/Revenues	45.6%	36.1%	29.7%	16.6%	35.3%	35.8%	40.7%	37.1%	37.5%	39.1%	41.0%	40.9%

Source: Company Reports and Citi Research Estimates

Company Focus

- Company Update
- Initiation of Coverage

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Buy	1
Price (03 Dec 12)	C\$82.93
Target price	C\$92.00
Expected share price return	10.9%
Expected dividend yield	3.9%
Expected total return	14.8%
Market Cap	C\$76,149M
	US\$76,582M

Price Performance

(RIC: TD.TO, BB: TD CN)



Toronto Dominion Bank Group (TD.TO) Initiating with Buy – C\$92 TP

- **Initiation with Buy, C\$92 TP** — We initiate coverage of TD with a Buy rating, target price of C\$92 and ETR of 15%. We believe that potential capital releases from the US operations and upside to the dividend payout ratio outweigh the risks currently embedded in the share price – a slowdown in the US economy and/or asset quality deterioration risks in Canada.
- **Upside on US Impairments & Capital** — Among the major Canadian banks, TD has the most meaningful exposure to the US, both in terms of revenues (27% of the total) and pre-tax profit (16%). We believe TD is best positioned to take advantage of the US housing and economic market recovery in terms of lower impairments. Besides the upside to EPS estimates (we estimate 1% accretion for each additional 10 bps improvement), we believe that the US business could generate excess capital by moving from the Standardised to the Advanced IRB approach for credit risk modelling. The upside could be to the tune of 5% to current 2012E book value and 79% to current 2012E DPS estimates (Figure 63).
- **Upside to the Payout Ratio** — Until earlier this year, TD had one of the lowest dividend payout ratios among the Canadian banks: in 2001, the company paid out 40% of earnings compared to 54% for Bank of Montreal at the top of the range. We believe the payout ratio will increase to 44% in 2014E on the back of: 1) higher management guidance of 40-50% (up from 35-45%); and 2) a guided-to earnings growth towards the “lower end of 7-10%”. In the face of slowing earnings growth, it makes sense from an ROE point of view to pay out a larger chunk of earnings. Every 5ppt increase in the payout ratio increases our expected dividend yield by c. 0.5%.
- **Valuation** – We value TD on three methodologies: static ROE, static ROTE and a Dividend Discount Model. These approaches result in fair value outcomes of C\$89, C\$92 and C\$95, respectively. We set the average of the three fair value outcomes as our target price (\$92) and cross-check it with a sum of the parts valuation (\$92). At our target price, the shares would trade at 11.4x '13E PE and 1.8x '13E PB for 15.5% sustainable ROE – while at the current market price, the shares trade at 10.3x '13E PE and 1.6x '13E PB.

EPS	Q1	Q2	Q3	Q4	FY	FC Cons
2011A	1.72A	1.62A	1.73A	1.74A	6.81A	6.82A
2012E	1.86A	1.82A	1.91A	1.83E	7.35E	7.39E
Previous	na	na	na	na	na	na
2013E	1.92E	2.07E	2.08E	2.03E	8.04E	7.88E
Previous	na	na	na	na	na	na
2014E	na	na	na	na	8.64E	8.47E
Previous	na	na	na	na	na	na

Source: Company Reports and dataCentral, Citi Research. FC Cons: First Call Consensus.

Upside in the US Business

Potential transition to AIRB in the US
could release c. C\$2.2bn of capital

In the 2011 annual report management discussed the transition to the Advanced Internal Risk based modeling (AIRB) approach for credit risk in the US:

*"The Standardized Approach to credit risk is used primarily for assets in the U.S. Personal and Commercial Banking portfolio **and plans are in place to transition to the AIRB Approach.** Under the Standardized Approach, the assets are multiplied by risk-weights prescribed by OSFI to determine RWA..."*

TD Bank (US)'s current average credit risk weight of 47% is well above the average for the rest of the group (17%). We believe this is partially due to downward credit risk migration on the back of the 2008-9 crisis – but more importantly due to the Basel 2 Standardised approach the bank employs.

■ We estimate that, if and when the company decides to implement the AIRB modelling approach, TD could unlock C\$2.2bn of extra capital – a 5% uplift to 2012E Book Value per share or 82% upside to our 2012E dividend forecast (Figure 63).

The actual benefits from the move to AIRB would depend on: 1) the loss experience of the US portfolios up to and including the date of conversion to AIRB; and 2) the choice between point-in-time and through-the-cycle approach, among other factors.

Figure 63. Moving the US to Advanced IRB Could Release c.\$2bn of Capital

	Current (3Q12A)			If US Risk Weights Move Half-Way to the Rest of Group...		
	Assets	Credit RWA	Cr RWA / Assets	Assets	RWA	RWA / Assets
TD Bank (US)	208	97	46.8%	208	66	31.9%
TD Group ex TD Bank (US)	598	102	17.0%	598	102	17.0%
RWA 'Savings' at TD Bank					31.0	
Capital Released at 7% CT1R					2.2	
Per Share (\$)					2.37	
Upside to 2012E BVPS (%)					5.0%	
Upside to 2012E DPS (%)					82%	

Source: Company reports, Citi Research

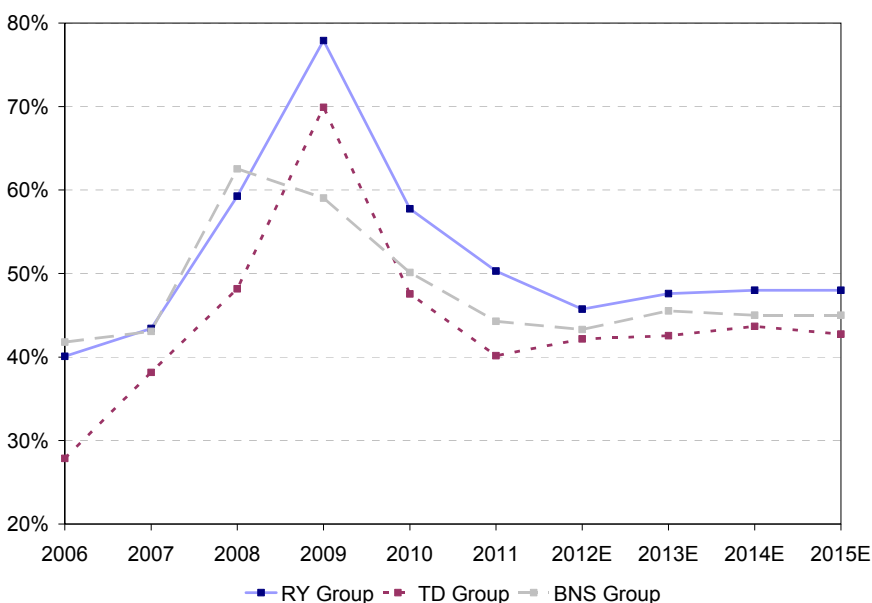
There is room for the payout ratio to increase beyond our 43-44% assumption in 2013-2015

Upside to Dividends and Payout Ratio

TD has historically had one of the lowest dividend payout range targets. Until 3Q12, it targeted 35-45%. Starting 3Q12, management targets a 40-50% payout. Our current estimates assume a “peak” payout ratio of 44% in 2014E over the forecasting horizon. A higher payout ratio is consistent, we believe, with a slowing rate of earnings growth (management guides to the lower end of 7-10%).

- **Should expectations for earnings growth decline further, we believe management may be inclined to pay out more than 44% of earnings as dividends. Every 5 ppt increase would lead to an additional 0.5% expected dividend yield on the current share price.**

Figure 64. TD Has Historically Paid Out Less than RY and Scotiabank - Payout Ratios, 2006-15



Source: Company reports, Citi Research

TD is one of the most efficient Canadian banks domestically – but could still surprise positively on cost control

Upside in Cost Containment in Canada

TD is the second most efficient Canadian bank as measured by efficiency ratio of its Canadian banking operations, after RY. While the difference in the two banks' ratios has historically been in the 100-200 bps range, we believe this is warranted – as TD's customer-centric and branch centric proposition entails higher costs per branch. However, we also build in a gradual improvement in our assumption for 2013-15E to reflect focus on cost control over the forecast horizon.

- **In terms of upside, every additional 100 bps improvement in the efficiency ratio would translate into 1% uplift to our group EPS.**

Figure 65. TD Has the Second Best Canadian Banking Efficiency Ratio Among Peers *

Bank	Segment	2006	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E
RY	Canada Banking	54.0%	50.9%	49.6%	47.8%	47.3%	45.4%	44.5%	44.0%	43.5%	43.0%
TD	Canada P&C	54.8%	51.6%	51.2%	50.0%	47.6%	46.5%	46.2%	45.5%	45.0%	44.5%
BNS	Canada Banking	61.8%	58.3%	55.9%	53.2%	49.5%	51.5%	50.0%	50.0%	49.7%	49.2%
BMO	P&C Banking	59.2%	58.9%	59.5%	55.8%	54.1%	53.8%				
CM	Retail/Business Banking	60.9%	56.4%	58.0%	51.5%	50.7%	50.1%				
NA	P&C	61.9%	60.2%	58.3%	59.3%	57.9%	57.2%				
Average		58.8%	56.0%	55.4%	52.9%	51.2%	50.8%				
Median		60.0%	57.3%	57.0%	52.4%	50.1%	50.8%				

Source: Company reports, Citi Research * Actual 2012 for RY

Valuation

\$92 target price

We rate TD Buy and assign a **target price of C\$92**. We believe TD shares have meaningful upside potential from: 1) exposure to a recovering US economy via improving asset quality and risk weighted assets optimisation; 2) a higher dividend payout ratio; and 3) strict cost control.

Three valuation approaches

We apply three valuation methodologies in order to derive a target price: 1) static ROE; 2) static ROTE; and 3) a Dividend Discount Model. We set our target price at the average of these three outcomes and cross-check against a sum of the parts valuation (Figure 66).

10.5% cost of equity, 3.5% growth rate

We arrive at a **cost of equity (CoE)** through both a CAPM and through peer analysis. Using the CAPM, a risk free rate of 1.7% (10y Canadian sovereign yield), a beta of 0.9 (Datastream calculated) and an equity risk premium of 8%, we arrive at a CoE of 8.7%. However, for most banks in our global banks universe, CoE assumptions are north of 10% (the Japanese banks being the outstanding exception at sub-6%). Banks in Australia and the Nordics, which we view as Canadian banks' closest comps, have CoE in the range of 10-11.5%. We believe that TD should have a slightly higher CoE than 10% to account for US risks, such as the fiscal cliff, Dodd-Frank and housing. We thus settle on 10.5%.

Figure 66. TD – Summary of Valuation Methodologies & Target Price Setting

Current Price	82.9
Target Price	92.0
Upside	11.1%
Dividend yield	3.9%
ETR	15.0%

Common assumptions

Cost of Equity	10.5%
Growth	3.5%
Yrs to discount	0.08

Fair Value Outcomes

Static ROE	89.1
Static ROTE	92.3
DDM	95.1
Average	92.2
>> Sum of the parts	93.2

Source: Citi Research

Figure 67. TD – Valuation Metrics

	At Current Price					At Target Price			
	2012E	2013E	2014E	2015E		2012E	2013E	2014E	2015E
P/E	11.3	10.3	9.6	8.9	P/E	12.5	11.4	10.7	9.9
P/BVPS	1.7	1.6	1.4	1.3	P/BVPS	1.9	1.8	1.6	1.5
P/TBVPS	2.6	2.3	2.0	1.8	P/TBVPS	2.9	2.5	2.2	2.0
ROE	16.3%	16.1%	15.7%	15.5%	ROE	16.3%	16.1%	15.7%	15.5%
ROTE	24.9%	23.7%	22.4%	21.4%	ROTE	24.9%	23.7%	22.4%	21.4%
Div Yield	3.5%	4.0%	4.4%	4.6%	Div Yield	3.2%	3.6%	3.9%	4.2%

Source: Citi Research

Static ROE / Static ROTE Approaches

15.5% sustainable ROE

We use static ROE / ROTE valuation methodologies (our standard methodology for the sector), assuming that profitability has normalised by 2014. We use a normalised RoE of 15.5% (ROTE of 21.8%), and assume 3.5% perpetual growth. Using a cost of equity of 10.5% we reach a terminal book value multiple of 1.7x and terminal tangible book value multiple of 2.6x. Discounting gives us fair value of C\$89 and C\$92, respectively. To demonstrate the sensitivity of our target price to these assumptions/forecasts we have produced an ROE/CoE valuation sensitivity table (Figure 68).

Figure 68. TD – Static ROE Valuation Sensitivity

CoE	Return on Equity								
	11.5%	12.5%	13.5%	14.5%	15.5%	16.5%	17.5%	18.5%	19.5%
7.5%	104	117	130	143	156	169	182	195	208
8.5%	83	94	104	114	125	135	146	156	166
9.5%	69	78	87	95	104	113	121	130	138
10.5%	59	67	74	82	89	96	104	111	119
11.5%	52	58	65	71	78	84	91	97	104
12.5%	46	52	58	63	69	75	81	86	92
13.5%	41	47	52	57	62	67	72	78	83
14.5%	38	42	47	52	56	61	66	71	75
15.5%	34	39	43	47	52	56	60	65	69

Source: Citi Research

Dividend Discount Model

Dividend Discount Model produces a slightly higher fair value of C\$95

Our 3-year DDM applies a 10.5% risk discount rate equal to our cost of equity as explained earlier (Figure 69). We calculate the present value of dividends we expect TD to pay for 4Q12, 2013 and 2014. We also calculate a terminal 2014E book value based on a 15.5% 2015E (normalised) ROE which produces our estimate for fair value at the end of 2014. Summing up the present value of dividends and of the terminal fair value results in our *current* fair value estimate of C\$95.

Figure 69. TD – DDM Valuation

	2012E	2013E	2014E
DPS	0.78	3.28	3.63
PV of DPS	0.78	2.97	2.97
2015E ROE	15.5%		
Warranted P/BV	1.7		
2014E BVPS	57.5		
Fair value per share (12m fwd)	88.4		
Sum of DPS 2012E-14E	6.7		
Total value per share (12m fwd)	95.1		

Source: Citi Research

We reference market multiples for our sum of the parts valuation

Sum of the Parts Approach

For this approach we use 2014E earnings by segment and apply an appropriate P/E +1yr forward multiple to each segment. The sum total of all segment values produces a total company valuation at the end of 2013 which we then discount back by 1 month in order to arrive at the 12m forward company value. In order to arrive at a fair value per share, we divide the total company value 12m from now by the forecast number of shares outstanding at the end of 2013 and arrive at \$93.

In terms of comparable multiples, Figure 250 in the Appendix shows our comps universe.

- **Canadian P&C Banking** – closest comparables are the pure plays on the Canadian domestic market: National Bank of Canada, Laurentian Bank and Canadian Western Bank. These trade at 9-11x consensus PE+1yr. We believe the midpoint of this range is a reasonable multiple for TD's operations – as it is one of the best quality and highest growing franchises in Canadian banking. However, TD, just like RY and Scotiabank, does not have the commodity-heavy exposure of Canadian Western (based in Edmonton, Alberta and trading at 11x consensus PE+1yr).
- **Wealth & Insurance** – our closest comps are Lazard in the US (trading at 16x PE+1yr) and Julius Baer in Europe (trading at 14x PE+1). We take the average of the two multiples to arrive at 15x. For the insurance part, we value TD's multi-line insurance business at 10x – the average multiple of the North American insurance peer group as calculated by Bloomberg. For the segment overall, we settle on 13x.
- **US Banking** – the comps universe are the regional US banks, currently trading at 9-12x Citi PE+1yr (BB&T, Comerica, Keycorp, M&T Bank, among others). We choose 10x as our valuation multiple for TD's US franchise as we believe it accurately reflects TD's earnings growth of 10% in 2013-14 vs. peers at 8-17%.
- **Wholesale** – closest comps are JPM (8x), Goldman (10x) and MS (9x), all on Citi PE+1yr multiples. We pick the average of these as we do not believe TD's capital markets business has a trading or underwriting advantage over peers.
- **Corporate Support** – we assign a multiple of 10x to the segment, the same multiple as the one assigned to Canadian Banking, given that Corporate supports Canadian Banking via the ALM/Treasury function.

Figure 70. TD – Sum of the Parts Valuation

Net Income (adj)	2014E	P/E +1	Value	Value %
Canadian P&C Banking	4,227	10.0	42,270	47%
Wealth & Insurance	1,646	15.0	24,683	28%
US Banking	1,743	10.0	17,429	20%
Wholesale	916	9.0	8,245	9%
Corporate Support	-350	10.0	-3,500	-4%
Group	8,182	10.9	89,127	100%
Fair value (12m fwd)	88,388			
Shares	958			
Fair value/ share (12m fwd)	92.2			

Source: Citi Research

Risks

US Fiscal Cliff & Dodd-Frank

Due to goodwill incurred as part of the Commerce Bank acquisition, TD's operations in the US have historically reported ROEs in the range of 3-8% which we have increasing to 10% by 2015E. While a housing and consumer recovery may accelerate the path on the upside, a potential 'fiscal cliff' event, if it happened, would likely cause a recession in the US and depress TD's US ROE relative to our forecast. Besides the fiscal cliff, the regulatory environment in the US remains uncertain with the Dodd-Frank law not fully clarified and implemented yet. Should capital requirements for TD Bank increase under a full Dodd-Frank implementation, there would be downside risk to our DPS and payout ratio forecasts.

Cost Efficiency in Canada

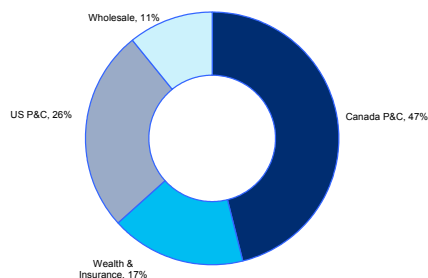
Our forecast of 30%+ ROE (allocated equity) in the Canadian business is predicated on an improving efficiency ratio, from 46.5% in 2011 to 44.5% in 2015. However, TD's business model is customer-centric and branch-centric. Cost cutting which would help shareholders may be detrimental to TD's customer proposition and thus likely resisted by management. On the upside, should TD's efficiency ratio fall significantly below 44.5%, there would be upside to our earnings estimates and target price.

CEO Succession

The contract of Ed Clark, TD's CEO, expires in 2013. Mr. Clark has stated that he would remain CEO on an open-contract basis following the fixed-term contract expiration. Even though Mr Clark has steered the company towards profitable ventures, there could be downside risk to the shares if Mr. Clark's eventual chosen successor is not received well by the markets. On the upside, should Mr. Clark's successor over-deliver on profitability targets in his first year or two of appointment, there may be upside to our target price.

TD at a Glance

Figure 71. TD – Revenue Split



Source: Company data, Citi Research

Figure 72. TD – Profit Split

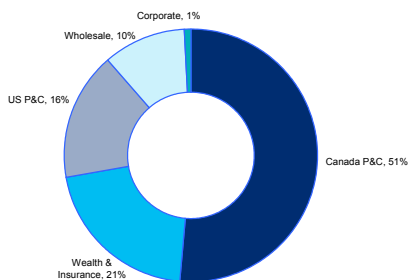


Figure 73. TD – Loan Growth

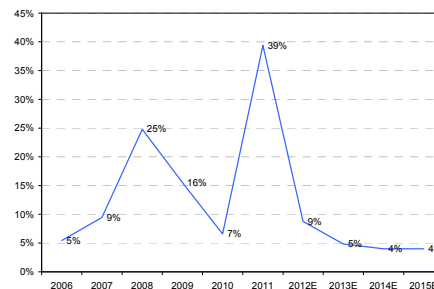
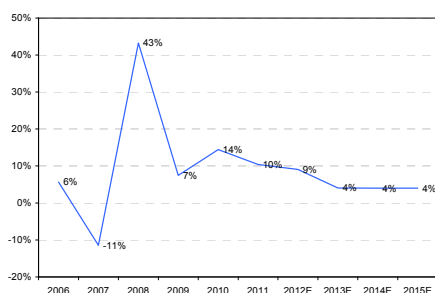


Figure 74. TD – Deposit Growth



Source: Company data, Citi Research

Figure 75. TD - LDR

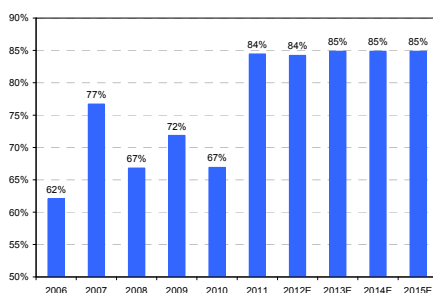


Figure 76. TD - ROE

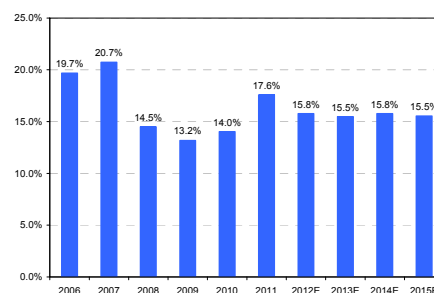
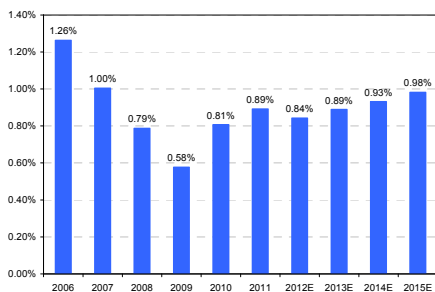


Figure 77. TD - ROA



Source: Company data, Citi Research

Figure 78. TD - NIMs

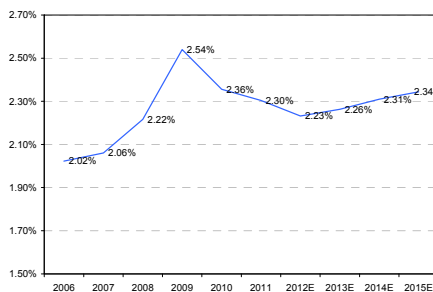


Figure 79. TD – Efficiency Ratio

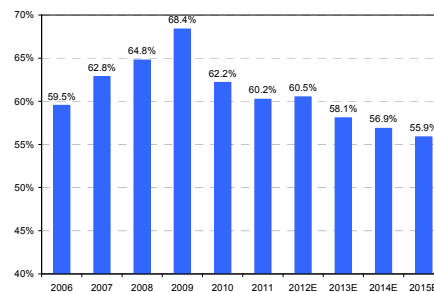


Figure 80. TD – Tier 1 Ratio (Basel 2)

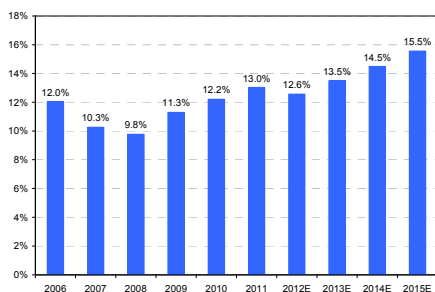


Figure 81. TD – Asset/Equity Multiple, x

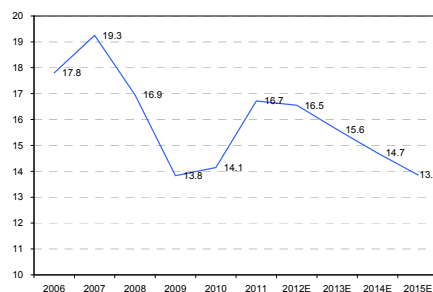
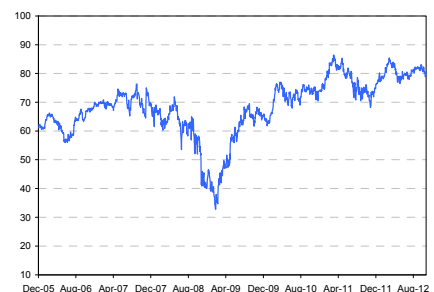


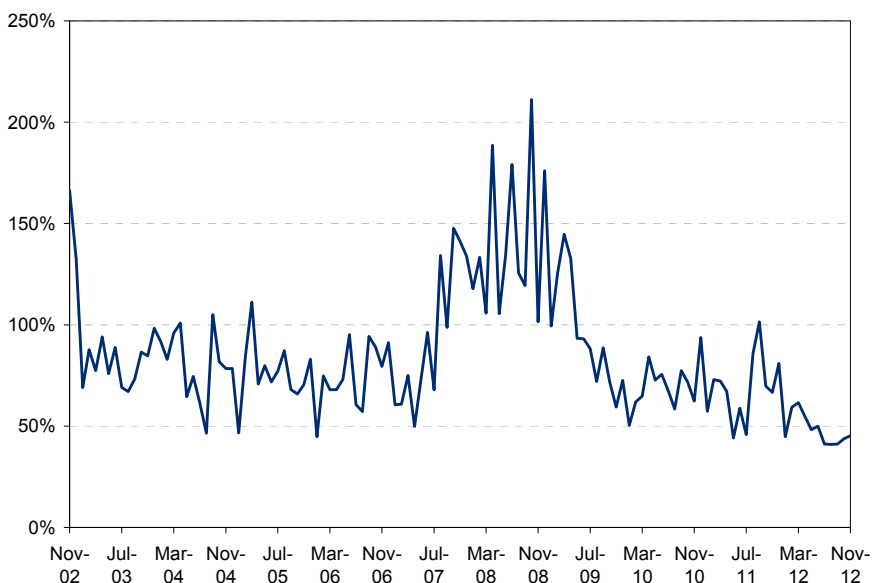
Figure 82. TD – Stock Price



Source: Company data, Datastream, Citi Research

Trading and liquidity

Figure 83. TD – Daily Liquidity Currently at 45% of Shares Outstanding *



Source: Datastream, Citi Research * Annualised.

Share Price Performance and Historical Valuation

Figure 84. RY, TD, BNS – Share Price Chart, 2000-12 (Jan 00 = 100) *

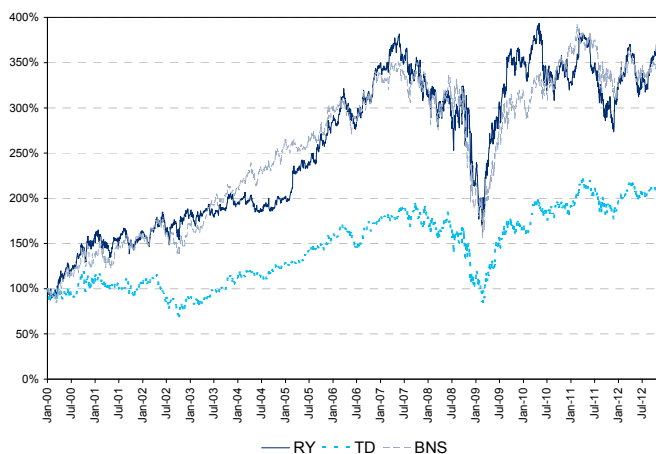
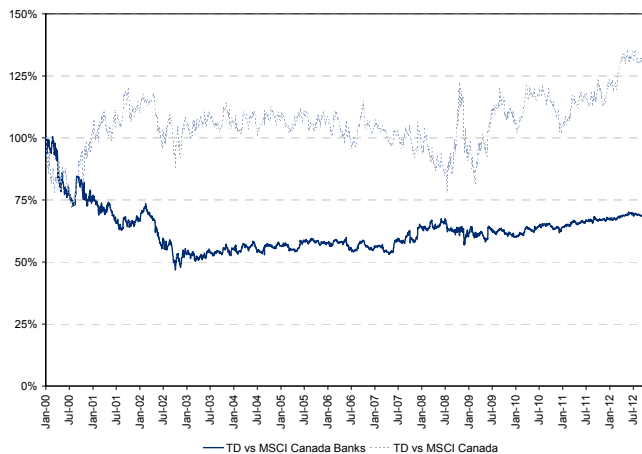
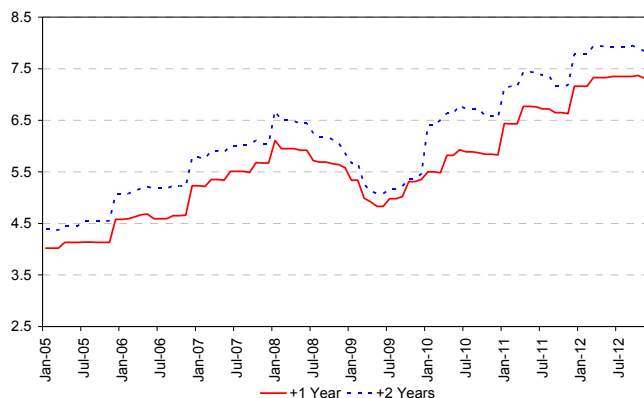


Figure 85. TD – Price Relative to Sector/Canada, 2000-12 (Jan 00 = 100)



Source: Datastream, I/B/E/S, Citi Research * The trough in 2009 represents the low market point during the Global Financial Crisis of 2008-9. The November 2011 trough was driven by the European sovereign crisis. The peak in March 2013 was driven by hopes of a resolution to the European sovereign crisis and optimism on the US economy. The most recent peak, in October 2012, was driven by expectations of solid 4Q12 results among other factors.

Figure 86. TD – Consensus EPS Revisions, 2005-12 (\$)



Source: Datastream, I/B/E/S, Citi Research

Figure 87. RY, TD, BNS – +2y Consensus EPS (Jan 05 = 100)

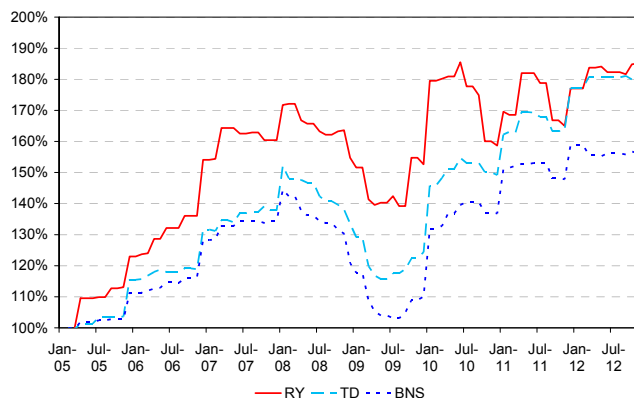
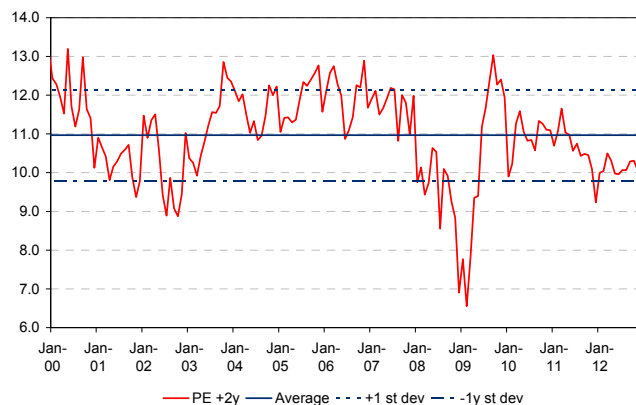


Figure 88. TD – Absolute PE +2y, Jan 00 – Nov 12



Source: Datastream, I/B/E/S, Citi Research

Figure 89. TD – Sector Relative PE +2y, Jan 00 – Nov 12

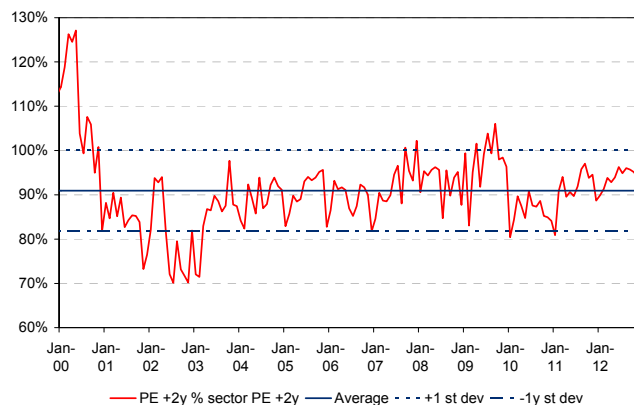
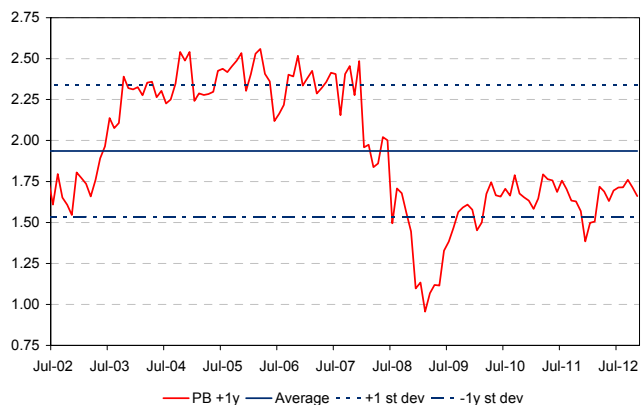
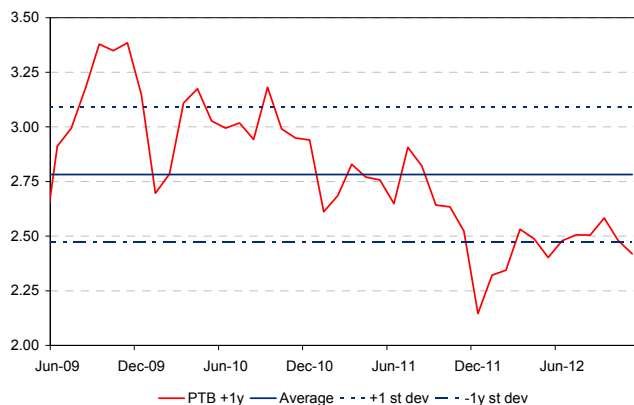


Figure 90. TD – PBV



Source: Datastream, I/B/E/S, Citi Research

Figure 91. TD – PTBV



Management Team

Figure 92. TD – Management Team

Group President and Chief Executive Officer	Ed Clark
Group Head Finance and Chief Financial Officer	Colleen Johnston
Group Head and Chief Risk Officer, Risk Management, Corporate Office, TD Bank Group and President & CEO, TD Canada Trust	Mark Chauvin
<i>Business Heads</i>	
Group Head, Canadian Banking, Auto Finance and Credit Cards	Tim Hockey
Group Head-US Personal & Commercial Banking	Bharat B. Masrani

Source: Company reports, Citi Research

Shareholder ownership

Figure 93. Toronto-Dominion Bank – Top 20 Holders

Holder Name	Parent Co RIC	Position	%O/S
RY Global Asset Management, Inc.	RY.TO	68,491,704	7.52
BMO Capital Markets (Canada)	BMO.TO	41,496,135	4.56
CIBC World Markets, Inc.	CM.TO	38,158,504	4.19
Pyramis Global Advisors LLC	Unlisted	28,777,903	3.16
Bank of Nova Scotia Asset Management	BNS.TO	27,644,344	3.04
BlackRock Advisors LLC	BLK.N	27,238,007	2.99
TD Asset Management, Inc.	TD.TO	25,486,006	2.80
Jarislowsky Fraser Ltd.	Unlisted	18,712,575	2.06
BlackRock Fund Advisors	BLK.N	17,875,987	1.96
Goodman & Co. Investment Counsel Ltd.	Unlisted	16,132,449	1.77
CIBC Global Asset Management, Inc.	CM.TO	15,005,317	1.65
BlackRock Asset Management Canada Ltd.	BLK.N	13,343,824	1.47
BMO Asset Management, Inc.	BMO.TO	12,804,666	1.41
I. G. Investment Management Ltd.	Unlisted	11,115,548	1.22
GWL Investment Management Ltd.	Unlisted	10,679,657	1.17
Connor, Clark & Lunn Investment Management Ltd.	Unlisted	10,093,530	1.11
Fiera Capital Corp. (Investment Management)	FSZ.TO	9,320,228	1.02
Greystone Managed Investments, Inc.	Unlisted	9,000,404	0.99
Capital World Investors	Unlisted	8,979,500	0.99
Beutel, Goodman & Co. Ltd.	Unlisted	8,746,911	0.96
		419,103,199	46.03

Source: Factset; Latest reported holdings

M&A History & Strategy

Regional US banks

TD's M&A strategy has centred on acquiring regional banks in the US and on select accretive, add-on, acquisitions. It also owns 45.3% of TD Ameritrade, the US brokerage operation – the result of a merger between the legacy Ameritrade and the legacy TD Waterhouse operations in the US.

Commerce Bank in 2007

In 2004, TD became the majority shareholder of the US bank Banknorth – TD's first step towards building a significant presence in the US. In 2007, TD completed its purchase of Banknorth. The following year, TD purchased Commerce Bank and consolidated and rebranded its overall US operations as TD Bank. In 2010-11, TD Bank acquired local banks in the Carolinas and Florida, expanding its presence to a total of 15 states (Figure 94).

Chrysler Financial in 2011

In terms of add-on deals, TD completed the acquisition of Chrysler Financial's Canadian auto leasing portfolio in 2011. The auto portfolio added diversification to TD's Canadian business from a risk-reward point of view: while many expected the

cost of risk on auto loans to soar during the crisis of 2008-9, it in fact held up reasonably well.

MBNA Canada portfolio in 2011

Also in 2011, TD acquired the Canadian credit card business of MBNA. In the face of falling Canadian banking margins, the MBNA deal has helped TD report flat to rising margins. In the absence of the MBNA portfolio, the net interest margin in Canadian Banking would have declined -14 bps from 3Q11 to 3Q12. Instead, the margin expanded by +9 bps.

Target credit card portfolio in 2012

In October 2012 TD announced the acquisition of Target's existing C\$5.9bn store and private label credit card portfolio. At the same time, the bank entered into a seven-year agreement under TD will become the exclusive issuer of Target-branded VISA and private-label consumer credit cards to Target's US customers.

Figure 94. TD – Select M&A Transactions

Completion	Value US\$m	Target	Target Nationality
31-Mar-08	7,218	Commerce Bancorp	United States
01-Apr-11	6,300	Chrysler Financial	United States
02-Feb-00	5,305	CT Financial Services	Canada
10-Aug-12	4,049	TMX Group	Canada
01-Mar-05	3,778	Banknorth Group (51%)	United States
20-Apr-07	3,006	TD Banknorth Inc (42%)	United States
31-Jan-06	1,866	Hudson United Bancorp	United States
15-Oct-96	740	Waterhouse Investor Services	United States
01-Dec-11	688	MBNA Canada Bank (Credit card portfolio & other assets)	Canada
01-Mar-02	520	Stafford Trading (Equities options businesses); Letco Trading	United States
02-Jan-07	481	Interchange Financial Services Corp	United States
15-May-06	284	VFC Inc	Canada
01-Oct-10	191	South Financial Group Inc	United States
01-Aug-12	178	Alpha Trading Systems Inc	Canada
01-Aug-12	171	CDS Clearing & Depository Services Inc	Canada
06-Nov-00	130	Newcrest Capital Inc	Canada
08-Nov-05	60	Ameritrade Holding Corp (Canadian brokerage operations)	Canada
20-Apr-10		AmericanFirst Bank (Certain assets)	United States
16-Apr-10		Riverside National Bank	United States
16-Apr-10		First Federal Bank of North Florida (Certain assets)	United States
13-Apr-10		Internaxx Bank SA (25%)	Luxembourg
05-Aug-09		Vancity (Retail Loan Portfolio)	Canada
05-Aug-09		Vancity (Loan portfolio)	Canada
24-Jun-08		ABN AMRO Bank NV (Canadian asset-based lending)	Canada
24-Nov-05		American Express Europe (UK online broking business)	United Kingdom
31-Oct-03		Laurentian Bank of Canada (57 branches)	Canada
09-Jul-02		Natwest Personal Financial Management Ltd (50%)	United Kingdom
29-Mar-99		Trimark Trust (Banking Operations Unit)	Canada
06-Jul-95		Standard Chartered Bank of Canada	Canada

Source: Dealogic, Citi Research

Financial Statements

Figure 95. Toronto Dominion – Group P&L by Year (2009-2015E)

CAD m (unless specified)	CGAAP 2009	CGAAP 2010	IFRS 2011	IFRS 2012E	IFRS 2013E	IFRS 2014E	IFRS 2015E	%Chg 2010	%Chg 2011	%Chg 2012E	%Chg 2013E	%Chg 2014E	%Chg 2015E
GROUP INCOME STATEMENT													
Net Interest Income	11,326	11,543	13,661	15,107	16,565	17,753	18,923	1.9%	18.3%	10.6%	9.7%	7.2%	6.6%
Total Non-Interest Income	6,534	8,022	8,001	8,218	9,208	9,793	10,395	22.8%	-0.3%	2.7%	12.0%	6.4%	6.1%
Total Revenue	17,860	19,565	21,662	23,325	25,772	27,546	29,318	9.5%	10.7%	7.7%	10.5%	6.9%	6.4%
PBT & minorities	3,169	5,777	7,125	7,576	8,951	9,835	10,910	82.3%	23.3%	6.3%	18.2%	9.9%	10.9%
Provision for Income Taxes	-241	-1,262	-1,326	-1,280	-1,719	-1,909	-2,170	423.7%	5.1%	-3.5%	34.3%	11.1%	13.6%
Net income before associates	2,928	4,515	5,799	6,296	7,232	7,925	8,740	54.2%	28.4%	8.6%	14.9%	9.6%	10.3%
Associates	303	235	246	235	256	275	295	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net income – reported	3,231	4,750	6,045	6,531	7,488	8,200	9,035	47.0%	27.3%	8.0%	14.7%	9.5%	10.2%
Adjustment for items of note, net of inc taxes	1,596	584	387	553	360	360	360	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net income – adjusted	4,827	5,334	6,432	7,084	7,848	8,560	9,395	10.5%	20.6%	10.1%	10.8%	9.1%	9.8%
Preferred dividends	167	194	180	180	180	180	180	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Minorities - adjusted	111	106	104	105	105	105	105	-4.5%	-1.9%	1.0%	0.0%	0.0%	0.0%
Common shareholders – adjusted	4,549	5,034	6,148	6,799	7,563	8,275	9,110	10.7%	22.1%	10.6%	11.2%	9.4%	10.1%
PER SHARE													
EPS - Basic - Reported	3.49	5.13	6.50	6.88	7.80	8.41	9.12	47.0%	26.7%	5.8%	13.4%	7.9%	8.4%
EPS - Diluted - Reported	3.47	5.10	6.43	6.75	7.66	8.26	8.96	47.0%	26.1%	4.9%	13.5%	7.9%	8.4%
EPS - Basic - Adjusted	5.37	5.81	6.94	7.48	8.19	8.79	9.49	8.1%	19.6%	7.8%	9.4%	7.4%	7.9%
EPS - Diluted - Adjusted	5.35	5.77	6.81	7.35	8.04	8.64	9.32	7.9%	18.0%	7.9%	9.4%	7.4%	8.0%
BVPS (ex prefs, minorities)	41.0	44.0	42.6	47.6	52.4	57.5	62.9	7.4%	-3.2%	11.6%	10.2%	9.6%	9.4%
TBVPS (ex prefs, minorities)	20.6	25.3	27.3	31.7	36.2	40.9	46.0	22.7%	7.7%	16.4%	14.1%	13.0%	12.5%
ROE (adj) (avg equity, ex prefs, minorities)	14.0%	13.6%	15.8%	16.3%	16.1%	15.7%	15.5%						
ROTE (adj) (avg equity, ex prefs, minorities)	30.8%	25.1%	26.0%	24.9%	23.7%	22.4%	21.4%						
DPS	2.44	2.44	2.61	2.90	3.28	3.63	3.85	0.0%	7.0%	11.1%	13.1%	10.7%	6.1%
Dividends - common (\$m)	2,095	2,144	2,352	2,656	3,056	3,450	3,732	2.3%	9.7%	12.9%	15.1%	12.9%	8.2%
Dividends - preferred (\$m)	167	194	180	180	180	180	180	16.2%	-7.2%	0.0%	0.0%	0.0%	0.0%
Payout Ratio	70%	48%	40%	42%	42%	43%	42%						
Common equity (ex prefs, minorities)	35,325	38,907	39,126	44,373	49,737	55,595	62,043						
Tangible common equity (ex prefs, minorities)	17,764	22,354	25,025	29,589	34,353	39,596	45,404						
Common Shares - basic (end)	859	879	901	916	932	950	969	2%	3%	2%	2%	2%	2%
Common Shares - diluted (avg)	850	872	903	926	941	958	977	3%	4%	3%	2%	2%	2%
OPERATING RATIOS													
RoA	0.58%	0.81%	0.89%	0.84%	0.90%	0.94%	0.99%						
ROE on avg common equity	13.2%	14.0%	17.6%	15.8%	15.6%	15.9%	15.7%						
RoAvRWA	1.61%	2.44%	2.89%	2.80%	2.90%	2.96%	3.09%						
LDR	71.8%	66.9%	84.4%	84.2%	84.8%	84.8%	84.8%						
RWA / Assets	34.0%	32.3%	29.7%	30.3%	31.6%	32.0%	32.3%						
Assets/Equity	13.8	14.1	16.7	16.5	15.6	14.7	13.8						
NIM on Avg Assets	2.02%	1.96%	2.02%	1.95%	1.99%	2.04%	2.08%						
Non Interest Income % average assets	1.17%	1.36%	1.18%	1.06%	1.10%	1.13%	1.14%						
PBT % revenues	17.7%	29.5%	32.9%	32.5%	34.7%	35.7%	37.2%						
Efficiency ratio	68.4%	62.2%	60.2%	60.5%	58.2%	57.0%	56.0%						
Tax rate	7.6%	21.8%	18.6%	16.9%	19.2%	19.4%	19.9%						
BALANCE SHEET ITEMS													
Total Assets	557,219	619,545	735,493	815,048	851,507	889,435	929,237	11%	19%	11%	4%	4%	4%
Total Liabilities	516,940	575,750	691,489	765,798	796,893	828,768	861,919	11%	20%	11%	4%	4%	4%
Total Equity	40,279	43,795	44,004	49,250	54,614	60,667	67,318	9%	0%	12%	11%	11%	11%
Tier 1 Capital *	21,407	24,386	28,503	31,046	35,658	40,588	46,072	14%	17%	9%	15%	14%	14%
Total Regulatory Capital	28,338	31,070	34,978	38,504	43,419	48,427	53,989	10%	13%	10%	13%	12%	11%
Risk-weighted assets (\$bn)	190	200	219	247	269	285	300	5%	9%	13%	9%	6%	6%
T1 Ratio	11.3%	12.2%	13.0%	12.6%	13.3%	14.3%	15.3%						
Total Capital Ratio	14.9%	15.5%	16.0%	15.6%	16.2%	17.0%	18.0%						

Source: Company Reports and Citi Research Estimates * 'Adjusted Net Tier 1' Capital on OSFI definition

Figure 96. Toronto Dominion – Group P&L by Quarter (1Q11-4Q13E)

CAD m (unless specified)	IFRS 1Q11	IFRS 2Q11	IFRS 3Q11	IFRS 4Q11	IFRS 1Q12	IFRS 2Q12	IFRS 3Q12	IFRS 4Q12E	IFRS 1Q13E	IFRS 2Q13E	IFRS 3Q13E	IFRS 4Q13E
GROUP INCOME STATEMENT												
Net Interest Income	3,356	3,259	3,514	3,532	3,687	3,680	3,817	3,922	3,964	4,112	4,181	4,307
Total Non-Interest Income	2,103	1,897	1,870	2,131	1,955	2,070	2,024	2,169	2,190	2,284	2,339	2,394
Total Revenue	5,459	5,156	5,384	5,663	5,642	5,750	5,841	6,091	6,154	6,397	6,520	6,701
PBT & minorities	1,848	1,644	1,798	1,835	1,689	1,990	1,932	1,963	2,108	2,275	2,305	2,263
Provision for Income Taxes	-343	-306	-367	-310	-272	-351	-291	-366	-406	-433	-442	-438
Net income before associates	1,505	1,338	1,431	1,525	1,417	1,639	1,641	1,597	1,702	1,843	1,862	1,825
Associates	57	66	59	64	61	54	62	58	61	63	65	67
Net income – reported	1,562	1,404	1,490	1,589	1,478	1,693	1,703	1,655	1,763	1,906	1,927	1,892
Adjustment for items of note, net of inc taxes	55	120	145	67	284	43	117	109	90	90	90	90
Net income – adjusted	1,617	1,524	1,635	1,656	1,762	1,736	1,820	1,764	1,853	1,996	2,017	1,982
Preferred dividends	49	40	43	48	49	49	49	50	50	50	50	50
Minorities - adjusted	26	25	27	26	26	26	26	26	26	26	26	26
Common shareholders – adjusted	1,542	1,459	1,565	1,582	1,687	1,661	1,745	1,688	1,777	1,920	1,941	1,906
PER SHARE												
EPS - Basic - Reported	1.69	1.52	1.60	1.70	1.56	1.79	1.79	1.73	1.84	1.99	2.00	1.95
EPS - Diluted - Reported	1.67	1.50	1.58	1.68	1.55	1.78	1.78	1.71	1.82	1.97	1.98	1.94
EPS - Basic - Adjusted	1.75	1.65	1.77	1.77	1.87	1.84	1.92	1.85	1.94	2.08	2.10	2.05
EPS - Diluted - Adjusted	1.72	1.62	1.73	1.74	1.86	1.82	1.91	1.83	1.92	2.07	2.08	2.03
BVPS (ex prefs, minorities)	38.2	37.8	39.9	42.7	44.6	44.8	47.0	48.1	49.2	50.5	51.8	53.0
TBVPS (ex prefs, minorities)	22.5	22.8	24.8	27.3	28.5	29.0	31.1	32.1	33.1	34.3	35.5	36.6
ROE (adj) (avg equity, ex prefs, minorities)	16.8%	17.0%	17.8%	16.8%	16.9%	16.3%	16.6%	15.4%	15.8%	16.6%	16.3%	15.5%
ROTE (adj) (avg equity, ex prefs, mins)	29.0%	28.6%	29.1%	26.7%	26.5%	25.3%	25.3%	23.2%	23.6%	24.5%	23.9%	22.6%
DPS	0.61	0.66	0.66	0.68	0.68	0.72	0.72	0.78	0.80	0.82	0.82	0.84
Dividends - common (\$m)	538	585	587	613	615	654	656	714	736	757	761	783
Dividends - preferred (\$m)	49	40	43	48	49	49	49	50	50	50	50	50
Payout Ratio	36%	43%	41%	40%	44%	40%	40%	45%	44%	41%	41%	43%
Common equity (ex prefs, minorities)	34,394	34,191	36,073	39,126	40,664	41,039	43,190	44,373	45,626	47,001	48,397	49,737
Tangible common equity (ex prefs, mins)	20,214	20,593	22,455	25,025	25,952	26,567	28,553	29,589	30,695	31,921	33,165	34,353
Common Shares - basic (end)	882	886	889	901	904	908	912	916	920	924	928	932
Common Shares - diluted (avg)	896	901	903	909	909	913	916	921	925	929	933	937
OPERATING RATIOS												
RoA	0.97%	0.84%	0.86%	0.88%	0.78%	0.87%	0.86%	0.82%	0.86%	0.92%	0.92%	0.89%
ROE on avg common equity	18.2%	17.4%	18.2%	16.9%	17.1%	16.6%	16.7%	15.7%	16.0%	16.8%	16.5%	15.7%
RoAvRWA	3.13%	2.79%	2.90%	2.98%	2.56%	2.79%	2.79%	2.68%	2.83%	2.98%	2.94%	2.84%
LDR	84.2%	87.7%	86.0%	84.4%	83.9%	84.4%	84.0%	84.2%	84.4%	84.6%	84.7%	84.8%
RWA / Assets	30.0%	29.9%	29.1%	29.7%	31.3%	31.3%	30.6%	30.3%	30.4%	31.2%	31.4%	31.6%
Assets/Equity	16.9	17.4	17.4	16.7	17.1	16.8	16.8	16.5	16.3	16.1	15.8	15.6
NIM on Avg Assets	2.09%	1.94%	2.02%	1.95%	1.95%	1.90%	1.93%	1.94%	1.93%	1.99%	2.00%	2.03%
Non Interest Income % average assets	1.31%	1.13%	1.07%	1.18%	1.03%	1.07%	1.03%	1.07%	1.07%	1.10%	1.12%	1.13%
PBT % revenues	33.9%	31.9%	33.4%	32.4%	29.9%	34.6%	33.1%	32.2%	34.2%	35.6%	35.3%	33.8%
Efficiency ratio	58.4%	61.3%	59.5%	61.6%	62.9%	58.6%	59.4%	61.1%	58.7%	57.3%	57.6%	59.1%
Tax rate	18.6%	18.6%	20.4%	16.9%	16.1%	17.6%	15.1%	18.7%	19.2%	19.0%	19.2%	19.4%
BALANCE SHEET ITEMS												
Total Assets	664,084	678,356	713,642	735,493	779,144	773,186	806,283	815,048	823,959	833,069	842,276	851,507
Total Liabilities	624,831	639,309	672,722	691,489	733,596	727,267	758,216	765,798	773,456	781,191	789,003	796,893
Total Equity	39,253	39,047	40,920	44,004	45,548	45,919	48,067	49,250	50,503	51,878	53,274	54,614
Gross Tier 1 capital	43,444	43,040	44,180	46,556	45,096	45,669	46,846	47,845	48,913	50,101	51,308	52,457
Net Tier 1 Capital	29,232	29,355	30,366	32,180	32,658	33,386	34,383	35,382	36,450	37,638	38,845	39,994
Adjusted Net Tier 1 Capital	25,384	25,828	26,764	28,503	28,378	29,102	30,047	31,046	32,114	33,302	34,509	35,658
Total Regulatory Capital	32,235	33,082	33,935	34,978	35,744	36,531	37,505	38,504	39,646	40,910	42,193	43,419
Risk-weighted assets (\$bn)	199	203	208	219	244	242	246	247	251	260	264	269
T1 Ratio	12.7%	12.7%	12.9%	13.0%	11.6%	12.0%	12.2%	12.6%	12.8%	12.8%	13.1%	13.3%
Total Capital Ratio	16.2%	16.3%	16.3%	16.0%	14.7%	15.1%	15.2%	15.6%	15.8%	15.7%	16.0%	16.2%

Source: Company Reports and Citi Research Estimates

Figure 97. Toronto Dominion – Divisional P&L by Year (2009-2015E)

CAD m (unless specified)	CGAAP 2009	CGAAP 2010	IFRS 2011	IFRS 2012E	IFRS 2013E	IFRS 2014E	IFRS 2015E	%Chg 2010	%Chg 2011	%Chg 2012E	%Chg 2013E	%Chg 2014E	%Chg 2015E
CANADIAN P&C BANKING													
Net Interest Income	6,348	7,134	7,190	8,100	8,896	9,565	10,151	12%	1%	13%	10%	8%	6%
Non Interest Income	3,101	3,237	2,342	2,670	2,945	3,180	3,371	4%	-28%	14%	10%	8%	6%
Total Revenue	9,449	10,371	9,532	10,770	11,841	12,746	13,522	10%	-8%	13%	10%	8%	6%
Non Interest Expense	-4,725	-4,934	-4,433	-4,976	-5,388	-5,736	-6,017	4%	-10%	12%	8%	6%	5%
Provisions for Credit Losses	-1,155	-1,046	-824	-1,128	-1,248	-1,357	-1,247	-9%	-21%	37%	11%	9%	-8%
PBT	3,569	4,391	4,275	4,666	5,205	5,653	6,258	23%	-3%	9%	12%	9%	11%
Net Income - Adjusted	2,472	3,095	3,051	3,513	3,900	4,227	4,668	25%	-1%	15%	11%	8%	10%
Risk Weighted Assets (Period End, C\$bn)	64	68	73	76	78	81	83	6%	7%	4%	3%	3%	3%
NIM on average loans	3.76%	3.89%	2.69%	2.70%	2.78%	2.82%	2.85%						
PBT % revenues	37.8%	42.3%	44.8%	43.3%	44.0%	44.4%	46.3%						
Efficiency ratio	50.0%	47.6%	46.5%	46.2%	45.5%	45.0%	44.5%						
PCL % average loans	0.68%	0.57%	0.31%	0.38%	0.39%	0.40%	0.35%						
WEALTH AND INSURANCE													
Net Interest Income	270	336	542	589	632	689	739	24%	61%	9%	7%	9%	7%
Net Insurance Result	0	0	1,167	1,187	1,283	1,348	1,415	0%	0%	2%	8%	5%	5%
Inc from financial instruments designated at fair value through profit or loss	0	0	-2	21	40	30	30						
Other non-interest income	1,935	2,121	2,333	2,316	2,488	2,622	2,753	10%	10%	-1%	7%	5%	5%
Total Revenue	2,205	2,457	4,040	4,113	4,443	4,689	4,937	11%	64%	2%	8%	6%	5%
Non Interest Expense	-1,701	-1,813	-2,616	-2,632	-2,817	-2,945	-3,076	7%	44%	1%	7%	5%	4%
PBT	504	644	1,424	1,481	1,626	1,744	1,861	28%	121%	4%	10%	7%	7%
Net Income - Adjusted	597	641	1,314	1,409	1,533	1,646	1,759	7%	105%	7%	9%	7%	7%
PBT % revenues	27.1%	26.1%	32.5%	34.3%	34.5%	35.1%	35.6%						
Efficiency ratio	77.1%	73.8%	64.8%	64.0%	63.4%	62.8%	62.3%						
Risk-weighted assets (C\$bn)	8.0	8.0	9.0	9.0	9.2	9.4	9.6	0%	13%	0%	2%	2%	2%
US P&C BANKING													
Net Interest Income	3,607	3,579	4,392	4,717	5,356	5,739	6,198	-1%	23%	7%	14%	7%	8%
Non Interest Income	1,117	1,180	1,342	1,479	1,719	1,801	1,945	6%	14%	10%	16%	5%	8%
Total Revenue	4,724	4,759	5,734	6,197	7,075	7,540	8,143	1%	20%	8%	14%	7%	8%
Non-interest expense	-3,213	-2,910	-3,593	-4,294	-4,599	-4,826	-5,130	-9%	23%	20%	7%	5%	6%
Total provisions for credit losses	-948	-646	-687	-686	-698	-743	-790	-32%	6%	0%	2%	6%	6%
PBT	563	1,203	1,454	1,217	1,778	1,972	2,223	114%	21%	-16%	46%	11%	13%
Net Income - Adjusted	909	1,042	1,270	1,425	1,658	1,837	2,043	15%	22%	12%	16%	11%	11%
NIM on average loans	5.95%	6.16%	6.13%	5.23%	5.14%	5.10%	5.10%						
PBT % revenues	11.9%	25.3%	25.4%	19.6%	25.1%	26.1%	27.3%						
Efficiency ratio	68.0%	61.1%	62.7%	69.3%	65.0%	64.0%	63.0%						
PCL % average loans	1.56%	1.11%	0.96%	0.76%	0.67%	0.66%	0.65%						
WHOLESALE BANKING													
Net Interest Income	2,488	1,815	1,659	1,780	1,840	1,919	1,995	-27%	-9%	7%	3%	4%	4%
Non Interest Income	733	1,059	837	830	932	972	1,011	44%	-21%	-1%	12%	4%	4%
Total Revenue	3,221	2,874	2,496	2,610	2,773	2,891	3,006	-11%	-13%	5%	6%	4%	4%
Non Interest Expense	-1,417	-1,395	-1,468	-1,618	-1,691	-1,705	-1,729	-2%	5%	10%	5%	1%	1%
Provisions for Credit Losses	-164	-25	-22	-50	-40	-40	-40	-85%	-12%	127%	-20%	0%	0%
PBT	1,640	1,454	1,006	942	1,041	1,145	1,238	-11%	-31%	-6%	11%	10%	8%
Net Income - Adjusted	1,137	987	815	768	833	916	990	-13%	-17%	-6%	9%	10%	8%
Risk Weighted Assets (Period End, C\$bn)	34	32	35	48	50	52	54	-6%	9%	37%	4%	4%	4%
PBT / Revenues %	50.9%	50.6%	40.3%	36.1%	37.6%	39.6%	41.2%						
Efficiency ratio	44.0%	48.5%	58.8%	62.0%	61.0%	59.0%	57.5%						

Source: Company Reports and Citi Research Estimates

Figure 98. Toronto Dominion – Divisional P&L by Quarter (1Q11-4Q13E)

CAD m (unless specified)	IFRS 1Q11	IFRS 2Q11	IFRS 3Q11	IFRS 4Q11	IFRS 1Q12	IFRS 2Q12	IFRS 3Q12	IFRS 4Q12E	IFRS 1Q13E	IFRS 2Q13E	IFRS 3Q13E	IFRS 4Q13E
CANADIAN P&C BANKING												
Net Interest Income	1,787	1,729	1,834	1,840	1,931	1,967	2,055	2,147	2,173	2,209	2,244	2,270
Non Interest Income	566	564	591	621	640	636	675	719	710	725	735	775
Total Revenue	2,353	2,293	2,425	2,461	2,571	2,603	2,730	2,866	2,883	2,934	2,979	3,045
Non Interest Expense	-1,060	-1,074	-1,106	-1,193	-1,160	-1,226	-1,259	-1,331	-1,286	-1,367	-1,362	-1,373
Provisions for Credit Losses	-215	-192	-205	-212	-283	-274	-288	-283	-305	-310	-315	-318
PBT	1,078	1,027	1,114	1,056	1,128	1,103	1,183	1,252	1,292	1,257	1,303	1,354
Net Income - Adjusted	769	733	795	754	851	838	889	935	968	942	976	1,013
Risk Weighted Assets (Period End, C\$bn)	68	70	72	73	79	79	77	76	76	77	78	78
NIM on average loans	2.75%	2.62%	2.71%	2.66%	2.71%	2.71%	2.79%	2.86%	2.85%	2.85%	2.85%	2.84%
PBT % revenues	45.8%	44.8%	45.9%	42.9%	43.9%	42.4%	43.3%	43.7%	44.8%	42.8%	43.7%	44.5%
Efficiency ratio	45.0%	46.8%	45.6%	48.5%	45.1%	47.1%	46.1%	46.4%	44.6%	46.6%	45.7%	45.1%
PCL % average loans	0.33%	0.29%	0.30%	0.31%	0.40%	0.38%	0.39%	0.38%	0.40%	0.40%	0.40%	0.40%
WEALTH AND INSURANCE												
Net Interest Income	133	134	139	136	144	144	148	153	155	157	159	161
Net Insurance Result	309	254	296	308	281	330	270	306	289	324	350	321
Inc from financial instruments designated at fair value through profit or loss	-27	-2	18	9	10	-17	18	10	10	10	10	10
Other non-interest income	577	594	576	586	564	591	573	588	609	617	625	635
Total Revenue	992	980	1,029	1,039	999	1,048	1,009	1,057	1,064	1,108	1,144	1,127
Non Interest Expense	-659	-648	-640	-699	-639	-653	-632	-708	-676	-682	-707	-752
PBT	333	332	389	340	360	395	377	349	387	427	437	375
Net Income - Adjusted	306	316	349	343	349	365	360	335	365	398	409	361
PBT % revenues	30.8%	32.2%	33.9%	30.1%	34.9%	34.8%	35.7%	31.7%	34.3%	35.9%	35.7%	32.0%
Efficiency ratio	66.4%	66.1%	62.2%	67.3%	64.0%	62.3%	62.6%	67.0%	63.6%	61.5%	61.8%	66.7%
Risk-weighted assets (C\$bn)	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.1	9.1	9.2	9.2
US P&C BANKING												
Net Interest Income	1,102	1,073	1,093	1,124	1,157	1,178	1,180	1,202	1,222	1,328	1,354	1,452
Non Interest Income	300	310	393	339	338	409	346	386	392	426	434	467
Total Revenue	1,402	1,383	1,486	1,463	1,495	1,587	1,526	1,589	1,614	1,754	1,789	1,920
Non-interest expense	-843	-839	-931	-980	-1,185	-953	-1,058	-1,098	-1,129	-1,070	-1,127	-1,273
Total provisions for credit losses	-207	-176	-174	-130	-157	-192	-175	-162	-161	-173	-174	-190
PBT	352	368	381	353	153	442	293	329	323	511	488	456
Net Income - Adjusted	326	316	334	294	353	356	361	355	315	469	450	424
NIM on average loans	6.58%	6.25%	5.96%	5.80%	5.65%	5.70%	5.35%	5.33%	5.30%	5.30%	5.30%	5.58%
PBT % revenues	25.1%	26.6%	25.6%	24.1%	10.2%	27.9%	19.2%	20.7%	20.0%	29.1%	27.3%	23.8%
Efficiency ratio	60.1%	60.7%	62.7%	67.0%	79.3%	60.1%	69.3%	69.1%	70.0%	61.0%	63.0%	66.3%
PCL % average loans	1.24%	1.02%	0.95%	0.67%	0.77%	0.93%	0.79%	0.72%	0.70%	0.69%	0.68%	0.73%
WHOLESALE BANKING												
Net Interest Income	388	395	432	444	443	434	447	456	454	459	463	464
Non Interest Income	342	186	27	282	240	174	191	225	230	232	235	235
Total Revenue	730	581	459	726	683	608	638	681	684	691	698	700
Non Interest Expense	-399	-344	-330	-395	-406	-384	-406	-422	-393	-425	-436	-437
Provisions for Credit Losses	-6	-7	-6	-3	-12	-6	-21	-11	-10	-10	-10	-10
PBT	325	230	123	328	265	218	211	248	281	256	252	253
Net Income - Adjusted	235	188	112	280	194	197	180	197	225	205	201	202
Risk Weighted Assets (Period End, C\$bn)	31	31	32	35	51	48	48	48	49	49	50	50
PBT / Revenues %	44.5%	39.6%	26.8%	45.2%	38.8%	35.9%	33.1%	36.4%	41.0%	37.1%	36.1%	36.1%
Efficiency ratio	54.7%	59.2%	71.9%	54.4%	59.4%	63.2%	63.6%	62.0%	57.5%	61.5%	62.5%	62.4%

Source: Company Reports and Citi Research Estimates

Company Focus

- Company Update
- Initiation of Coverage

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Neutral	2
Price (03 Dec 12)	C\$55.61
Target price	C\$58.00
Expected share price return	4.3%
Expected dividend yield	4.2%
Expected total return	8.5%
Market Cap	C\$65,874M US\$66,248M

Price Performance

(RIC: BNS.TO, BB: BNS CN)



Bank of Nova Scotia (BNS.TO)

Initiating with Neutral – C\$58 TP

- **Initiation with Neutral, C\$58 TP** — We initiate coverage of Scotiabank with a Neutral rating, target price of C\$58 and ETR of 8%. We believe that subscale operations internationally and potential undercapitalisation issues more than offset the benefits of a growing emerging markets franchise and highly profitable Canadian banking operations.
- **Canada's Most 'International' Bank – but Subscale** — Scotiabank has presence in Latin America (Peru, Chile, Colombia), Mexico, Jamaica and Asia (Thailand, China/JV). However, the bank only ranks among the Top 5-10 banks in each country, the only exception being Peru (#3). Because of the disparate strategies in each country and the subscale nature of its businesses, International Banking ROEs have been in the 10-15% range over the past four years. While we expect cost optimisation and some margin recovery to help earnings in the segment, we also forecast a commensurate increase in required capital. Thus, ROEs are likely stay in the 10-15% range over the forecast horizon. We do not believe management will engage in an “asset optimisation” strategy in the medium term as current focus is on growth.
- **Capitalisation Is Wanting** — Scotiabank has disclosed a fully loaded Basel 3 core Tier 1 ratio range of 7-7.5% as of 3Q12. On our estimates, this level is 70 bps below TD's and up to 130 bps below RY's. The bank generates roughly 50-70 bps of capital annually and organically. Assuming no capital dilutive acquisitions are undertaken in the meantime, it would take Scotiabank two years to reach the Canadian regulator minimum of 8.0% (including a minimum D-SIFI surcharge of 100 bps); and at least 3-4 years for the company to reach the market's preferred 9-10% range. In our opinion, options to repair the capital levels could include a capital raise (5% dilutive to our 2012E EPS estimates) or skipping the dividend for up to two years (eliminating the 4.3% expected dividend yield).
- **Valuation** — We value Scotiabank on three methodologies: static ROE, static ROTE and a Dividend Discount Model. These approaches result in fair value outcomes of C\$55, C\$59 and C\$59, respectively. We set the average of the three fair value outcomes as our target price (\$58) and cross-check it with a sum of the parts valuation (\$59). At our target price, the shares would trade at 11.5x '13E PE and 1.9x '13E PB – while at the current market price, the shares trade at 11.1x '13E PE and 1.8x '13E PB.

EPS	Q1	Q2	Q3	Q4	FY	FC Cons
2011A	1.07A	1.37A	1.08A	0.96A	4.48A	4.71A
2012E	1.19A	1.14A	1.68A	1.11E	4.90E	4.75E
Previous	na	na	na	na	na	na
2013E	1.19E	1.26E	1.29E	1.32E	5.06E	5.10E
Previous	na	na	na	na	na	na
2014E	na	na	na	na	5.59E	5.53E
Previous	na	na	na	na	na	na

Source: Company Reports and dataCentral, Citi Research. FC Cons: First Call Consensus.

Scotiabank derives close to 1/3 of revenues from outside North America, is present in a number of countries, but is generally subscale

Canada's Most 'International' Bank – but Subscale

Just like RY with its capital markets business and TD with its US operations, Scotiabank has differentiated itself from a strategic point of view with a focus on international banking. In 2011, the company derived 31% of its revenues, 28% of its net profits and 22% of its loan book from operations outside of North America. Management's goal is to derive 50% of profits from international banking in the longer-term.

Figure 99. Select Indicators of Scotiabank's Market Presence in Chile, Peru and Colombia

Scotia	Sub	Assets	Market Share					
			Assets	rank	Loans	rank	Deposits	rank
Chile	Scotiabank Chile	12,747	4.5%	7th	4.8%	7th	3.4%	8th
Peru	Scotiabank Peru	11,923	14.4%	3rd	14.8%	3rd	13.5%	3rd
Colombia	Scotiabank / Colpatría	7,752	4.2%	8th	5.1%	6th	4.6%	7th

Source: Citi Research, National regulators

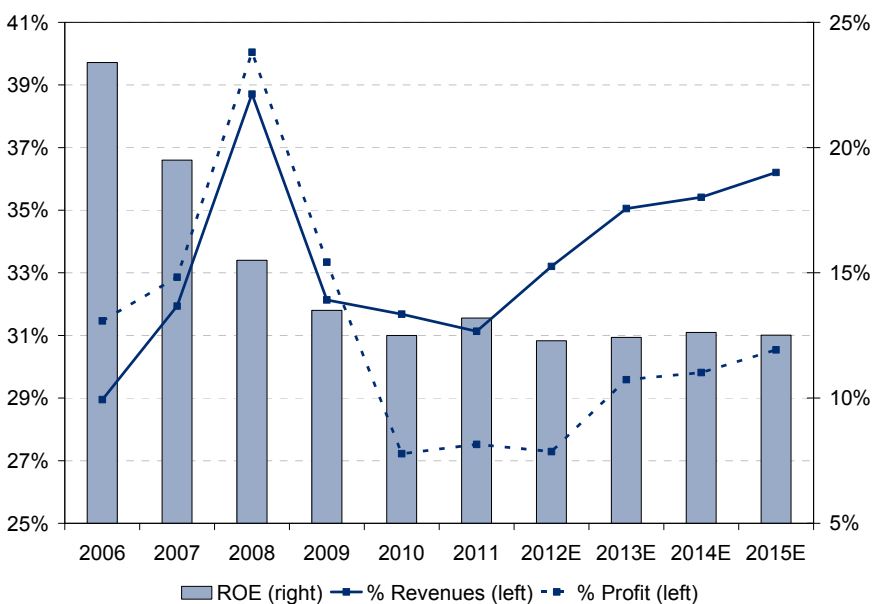
Scotiabank's major international markets of operation are: **Brazil, Chile, China, Colombia, Jamaica, Mexico, Peru, Thailand and Uruguay**. These are all markets with substantial growth potential over the foreseeable future and we like Scotiabank's strategy of having presence in a number of countries, any one of which may become the next 'breakout' market. However, this strategy of "options" has its flipside: it requires continued investment in a number of regions around the globe without necessarily allowing for economies of scale to be reached. In Figure 99 we show select market shares for Scotiabank's businesses in Latin America. In Peru, the bank ranks third which is quite meaningful in such a profitable and growing market. But in Chile and Colombia Scotiabank does not make it into the top 5 – and it is a similar picture in most of the other countries.

The 'subscale issue' has resulted in a low international banking profitability relative to the rest of the group

Historically, the subscale issue has resulted in low international banking profitability – the return on implied economic equity has been below 14% since 2009. The bank's LatAm peers, for instance, have ROEs in the region of 15-25%. The lower profitability also results in a lower relative contribution to the Group's bottom line vs. the Group's revenues. As noted above, International contributed 31% of revenues and 28% of profits in 2011.

- We expect this divergence to continue over the forecast horizon and for ROE to remain below 15%. Our 2013E-15E forecasts already assume: 10-11% asset growth (vs. 10% in 2011), a healthy improvement in the efficiency ratio of 2ppt through 2015E and a strong recovery in the net interest margins from a trough of 384bps in 2011 to 435bps in 2015E (Figure 100).

Figure 100. Scotiabank – International Banking's ROE (on attributed equity) and Contributions to Group Revenues and Group Profits



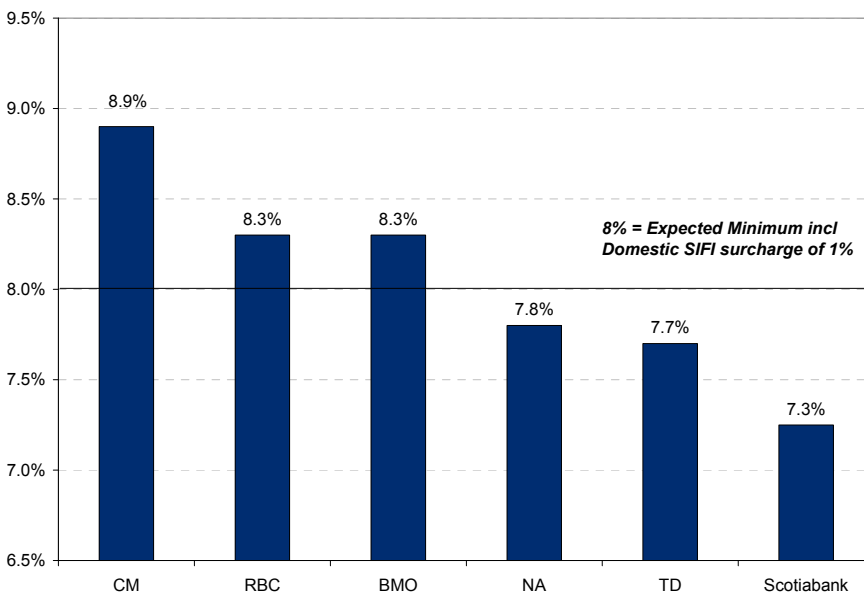
Source: Company reports, Citi Research

Lower Capitalisation and M&A Increase Dividend Risk

The lowest core Tier 1 ratio under Basel 3 among the large Canadian banks

Our other concern with Scotiabank is the company's lower core Tier 1 ratio relative to its Canadian peers. Scotiabank guides to a range of 7-7.5% when the other big 5 banks are in the 7.7-8.9% range.

Figure 101. Scotiabank Ranks Lowest on 3Q12 Core Tier 1 Ratio (Basel 3) *



Source: Company reports, Citi Research * Midpoint of range shown for Scotiabank (company guides to 7-7.5%)

One may argue that, given Scotiabank's capital generation capacity (we estimate 160 bps from end-2012 to end-2015), the bank should be closer to 8.9% by end-2015. However, we worry about two risks.

First, organic capital generation would be lowest among the three banks we analyse in this note: RY should generate 180 bps by end 2015 while TD should generate 220 bps (on current payout ratios).

'Excessive' M&A could result in capital dilution or dividend risks

Secondly, and most importantly, we believe there is meaningful M&A capital dilution risk whereby management continues to acquire international businesses at much above book value and adds risk weighted assets to an already 'fragile' capital position. A capital raise could be an option, especially if the regulator pressures the company to do so. However, raising capital for regulatory purposes even at above book value exposes existing shareholders to dilution risk:

- **We estimate 5% dilution to 2012E EPS should BNS raise C\$4.5bn of capital to reach 9% Core Tier 1 ratio today (assuming 3% pre-tax reinvestment yield on capital raised);**
- **Alternatively, BNS could skip its 2013 and 2014 dividends, which we estimate would generate an additional 200 bps of capital and bring its Core Tier 1 ratio to 9.25%. However, this would eliminate the 4.3% dividend yield which we currently include in our expected total return.**

Thus we are concerned about Scotiabank's capitalisation not simply because of its low starting point under Basel 3 (which can be remedied via a capital raise or a dividend skip), but mostly because of the implications of such actions: dilution to our EPS estimates and/or downside to our dividend yield forecasts.

ING Direct Canada Acquisition

Scotiabank acquired the deposit-rich ING Direct Canada in October 2012

Scotiabank announced the acquisition of ING Direct Canada in October 2012 for C\$3.1bn gross of and C\$1.9bn net of the target's excess capital. Management has stated that one of the attractions of the acquisition is to invest ING Direct's low yielding deposits into higher yielding assets. While Scotiabank expects the transaction to be accretive, we worry about the level of yield Scotiabank could achieve without incurring additional risk. On the flipside, the deposit base of the target and the planned runoff of the acquired mortgage book should help stabilise Scotiabank's Loan/Deposit Ratio at c.80% through 2015E.

Valuation

\$58 target price

We rate Scotiabank Neutral and assign a **target price of C\$58**. We believe upside from the shares is insufficient to offset our concerns about: 1) a sub-scale international business; 2) bottom-of-the-range capitalisation under Basel 3; and 3) limited upside to Canadian banking margins.

Three valuation methodologies

We apply three valuation methodologies in order to derive a target price: 1) static ROE; 2) static ROTE; and 3) a Dividend Discount Model. We set our target price at the average of these three outcomes and cross-check against a sum of the parts valuation (Figure 102).

11.5% cost of equity, 4.5% growth rate

We arrive at a **cost of equity (CoE)** through both a CAPM and through peer analysis. Using the CAPM, a risk free rate of 1.7% (10y Canadian sovereign yield), a beta of 0.8 (Datastream calculated) and an equity risk premium of 8%, we arrive

at a CoE of 7.2%. However, for most banks in our global banks universe, CoE assumptions are north of 10% (the Japanese banks being the outstanding exception at sub-6%). Banks in Australia and the Nordics, which we view as Canadian banks' closest comps, have CoE in the range of 10-11.5%. Banks in LatAm have CoE in the 11-12.5% range. We believe that Scotiabank should have one of the higher CoEs among the Canadian banks due to what we perceive as relative undercapitalisation (on Basel 3) and higher emerging markets exposure. We thus settle on 11.5%.

Our growth rate assumption of 4.5% is 1% above that for the other Canadian banks due to Scotiabank's higher EM exposure. For comparison purposes, our LatAm bank analysts assume a long-term growth rate of 6-8% for banks under their coverage, while our US bank analysts assume a 3% growth rate for their banks.

Figure 102. Scotiabank – Summary of Valuation Methodologies & Target Price Setting

Current Price	55.6
Target Price	58.0
Upside	4.2%
Dividend yield	4.2%
ETR	8.4%

Common assumptions

Cost of Equity	11.5%
Growth	4.5%
Yrs to discount	0.08

Fair Value Outcomes

Static ROE	55.4
Static ROTE	58.9
DDM	58.9
Average	57.7
>> Sum of the parts	59.0

Source: Citi Research

Figure 103. Scotiabank – Valuation Metrics

	At Current Price					At Target Price			
	2012E	2013E	2014E	2015E		2012E	2013E	2014E	2015E
P/E	11.4	11.1	10.0	9.2	P/E	11.8	11.5	10.4	9.6
P/BVPS	1.9	1.8	1.6	1.5	P/BVPS	2.0	1.9	1.7	1.6
P/TBVPS	2.6	2.5	2.2	2.0	P/TBVPS	2.7	2.6	2.3	2.1
ROE	18.8%	16.9%	17.1%	17.0%	ROE	18.8%	16.9%	17.1%	17.0%
ROTE	25.8%	23.1%	23.5%	23.0%	ROTE	25.8%	23.1%	23.5%	23.0%
Dividend yield	3.9%	4.2%	4.6%	4.9%	Div yield	3.8%	4.0%	4.4%	4.8%

Source: Citi Research

Static ROE / Static ROTE Approaches

17.0% normalised ROE

We use static ROE / ROTE valuation methodologies (our standard methodology for the sector), assuming that profitability has normalised by 2014. We use a normalised RoE of 17.0% (ROTE of 23.3%), and assume 4.5% perpetual growth. Using a cost of equity of 11.5% we reach a terminal book value multiple of 1.8x and terminal tangible book value multiple of 2.7x. Discounting gives us fair value of C\$55 and C\$59, respectively. To demonstrate the sensitivity of our target price to these assumptions/forecasts we have produced a valuation sensitivity table to ROE/CoE (Figure 104).

Figure 104. Scotiabank – Static ROE Valuation Sensitivity

CoE	Return on Equity								
	13.0%	14.0%	15.0%	16.0%	17.0%	18.0%	19.0%	20.0%	21.0%
7.5%	88	99	109	119	130	140	150	161	171
8.5%	66	74	82	89	97	105	113	121	128
9.5%	53	59	65	71	78	84	90	96	103
10.5%	44	49	54	60	65	70	75	80	85
11.5%	38	42	47	51	55	60	64	69	73
12.5%	33	37	41	45	48	52	56	60	64
13.5%	29	33	36	40	43	46	50	53	57
14.5%	26	29	33	36	39	42	45	48	51
15.5%	24	27	30	32	35	38	41	44	46

Source: Citi Research

Dividend Discount Model

DDM produces C\$59 fair value

Our 3-year DDM applies an 11.5% risk discount rate equal to our cost of equity as explained earlier (Figure 105). We calculate the present value of dividends we expect Scotiabank to pay for 4Q12, 2013 and 2014. We also calculate a terminal 2014E book value based on a 17.0% 2015E ROE which produces our estimate for fair value at the end of 2014. Summing up the present value of dividends and of the terminal fair value results in our *current* fair value estimate of C\$59.

Figure 105. Scotiabank – Dividend Discount Model (\$m)

	2012E	2013E	2014E
DPS	0.57	2.34	2.55
PV of DPS	0.57	2.10	2.05
2015E ROE	17.0%		
Warranted P/BV	1.8		
2014E BVPS	34.1		
Fair value per share (12m fwd)	54.1		
Sum of DPS 2012E-14E	4.7		
Total value per share (12m fwd)	58.9		

Source: Citi Research

Sum of the Parts Approach

We use market-referenced multiples for our sum of the parts approach

For this approach we use 2014E earnings by segment and apply an appropriate P/E +1yr forward multiple to each segment. The sum total of all segment values produces a total company valuation at the end of 2013, which we then discount back by 1 month in order to arrive at the 12m forward company value. In order to arrive at a fair value per share, we divide the total company value 12m from now by the forecast number of shares outstanding at the end of 2013.

In terms of comparable multiples, Figure 250 in the Appendix shows our comps universe.

- **Canadian Banking** – closest comparables are the pure plays on the Canadian domestic market: National Bank of Canada, Laurentian Bank and Canadian Western Bank. These trade at 9-11x consensus PE+1yr. We believe the midpoint of this range is a reasonable multiple for Scotiabank's operations – as it is one of the best quality and highest growing franchises in Canadian banking. However, Scotiabank, just like RY and TD, does not have the commodity-heavy exposure of Canadian Western (based in Edmonton, Alberta and trading at 11x consensus PE+1yr).

- **Global Wealth Management** – our closest comps are Lazard in the US (trading at 16x Citi PE+1yr) and Julius Baer in Europe (trading at 14x Citi PE+1yr). We take the average of the two multiples to arrive at 15x.
- **International Banking** – our comps universe are the Peruvian, Chilean, LatAm and Asian banks which currently trade at 12-13x Citi PE+1yr. We choose 10x as our valuation multiple for Scotiabank's operations as we believe it accurately reflects the lack of scale in most markets and the risk of expensive acquisitions over our forecast horizon.
- **Global Banking & Markets** – closest comps are JPM (8x), Goldman (10x) and MS (9x), all on Citi PE+1yr. We pick the average of these as we do not believe Scotiabank's capital markets business has a trading or underwriting advantage over peers.
- **Corporate Support** – we assign a multiple of 10x to the segment, the same multiple as the one assigned to Canadian Banking, given that Corporate supports Canadian Banking via the ALM/Treasury function.

Figure 106. Scotiabank – Sum of the Parts Valuation (\$m)

Net Income	2014E	P/E +1	Value
Canadian Banking	2,388	10.0	23,883
International Banking	2,055	10.0	20,546
Global Wealth Management	1,311	15.0	19,660
Global Banking & Markets	1,916	9.0	17,246
Others	-888	10.0	-8,880
Group	6,782	10.7	72,456
 Fair value (12m fwd)	 71,802		
Shares	1,218		
Fair value per share (12m fwd)	59.0		

Source: Citi Research

Risks

Better – or Worse – than Expected Margins from ING Direct Canada Acquisition

Scotiabank management has stated the intent to generate a higher net interest margin on ING Direct's maturing loans (\$29bn over c.5 years) and liquidity (\$30bn of deposits). We estimate that ING currently earns c.0.60% on its assets, significantly lower than the c.2.10% Scotiabank earns in its Canadian segment. As a result, we expect margins in the Canadian segment to decline to 1.94% in 2013E before rebounding to 2.00%. Should management find more profitable routes for investing the liquidity, or should policy rates increase, there could be upside to our NIM forecasts. Conversely, should opportunities for higher reinvestment prove to be limited, or policy rates decline, there would be downside risk to our earnings estimates and target price.

Asset Quality Deterioration – or Better than Expected Improvement – in LatAm

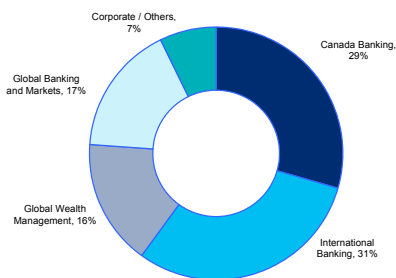
In 2010, Scotiabank experienced a peak in international loan impairments at 104bps of loans – mainly driven by its Caribbean operations. We currently forecast 74bps of impairments in 2012E followed by a slight rise to 80bps in 2013. But given continued austerity and uncertainty in Europe, the impact on the Caribbean may recur in 2013. Should loan losses reach 2010 levels, we estimate Scotiabank's earnings would decline by 3-4%. Conversely, should loan losses come in below 80bps, there would be upside risk to our earnings estimates and target price.

Capital Raise

Our Neutral rating on Scotiabank is largely driven by a higher assumed cost of equity (due to a lower capitalisation vs. peers). On our estimates, Scotiabank reaches 8.5% Core Tier 1 ratio under Basel 3 by the end of 2014. However, should the regulator decide that the bank would need to meet a core Tier 1 ratio under Basel 3 of more than 9% which could be achieved via a dividend "skip" or a dilutive capital raise, there would be downside risk to our target price and estimates. On the other hand, should Scotiabank generate capital organically faster than we expect (e.g. by optimising its international holdings), there may be upside to our target price and estimates.

BNS at a Glance

Figure 107. BNS – Revenue Split



Source: Company data, Citi Research

Figure 108. BNS – Profit Split

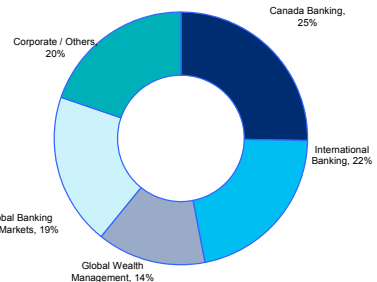


Figure 109. BNS – Loan Growth

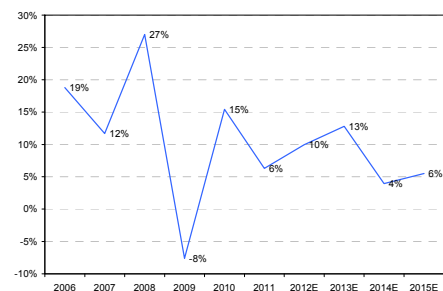
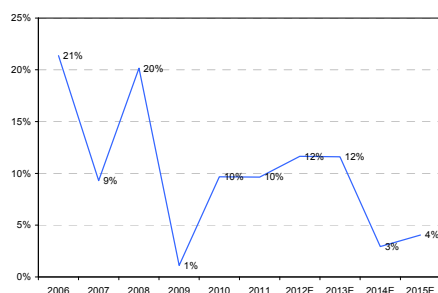


Figure 110. BNS – Deposit Growth



Source: Company data, Citi Research

Figure 111. BNS - LDR

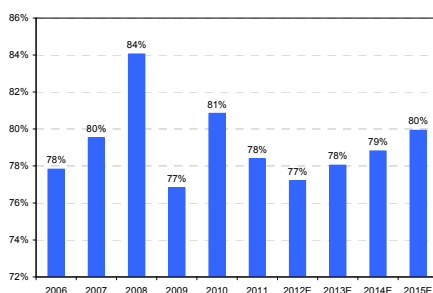


Figure 112. BNS - ROE

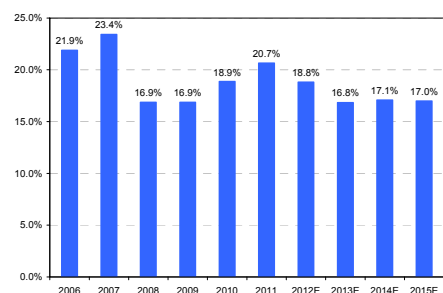
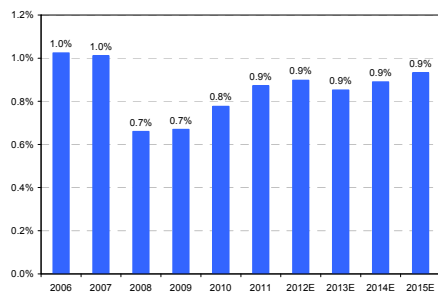


Figure 113. BNS - ROA



Source: Company data, Citi Research

Figure 114. BNS - NIMs

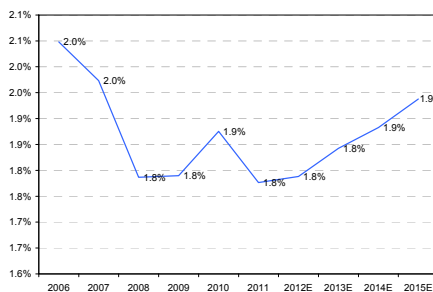


Figure 115. BNS – Efficiency Ratio

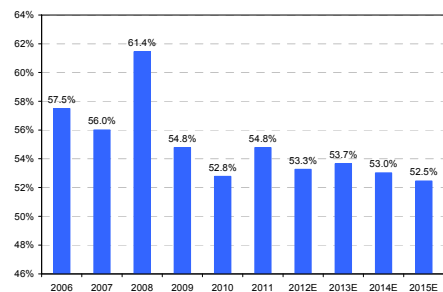


Figure 116. BNS – Tier 1 Ratio (Basel 2)

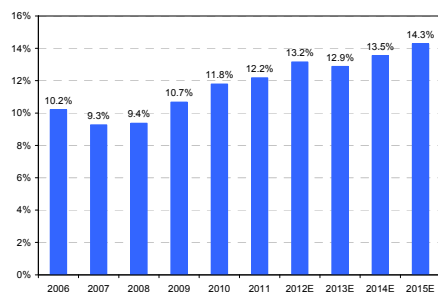


Figure 117. BNS – Asset/Equity Multiple, x

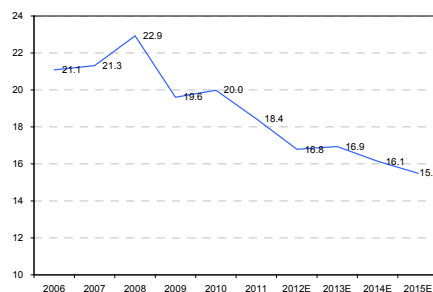
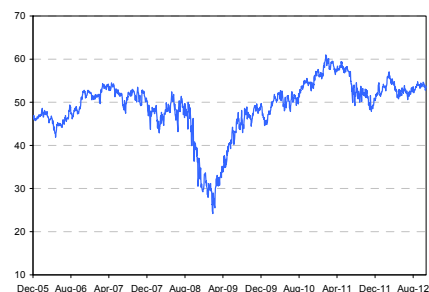


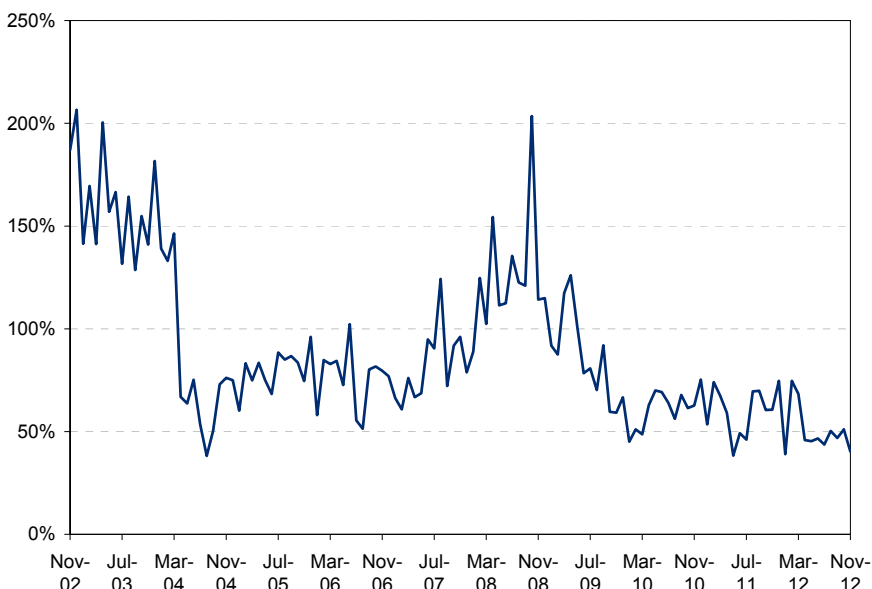
Figure 118. BNS – Stock Price



Source: Company data, Citi Research, DataStream

Trading and liquidity

Figure 119. Scotiabank – Daily Liquidity Currently at 40% of Shares Outstanding *



Source: Datastream, Citi Research * Annualised.

Share Price Performance and Historical Valuation

Figure 120. RY, TD, BNS – Share Price Chart, 2000-12 (Jan 00 = 100)

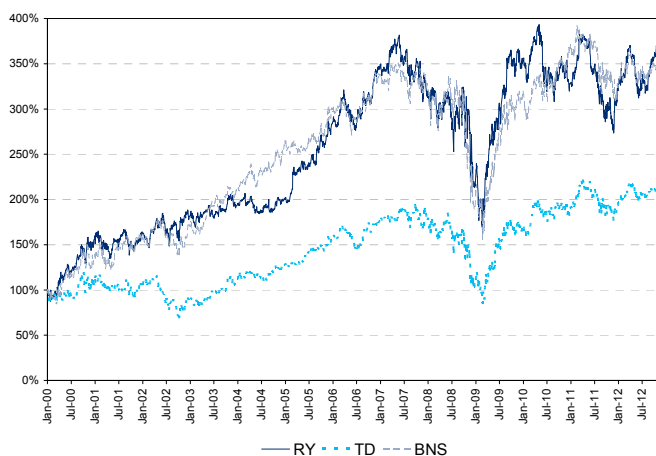
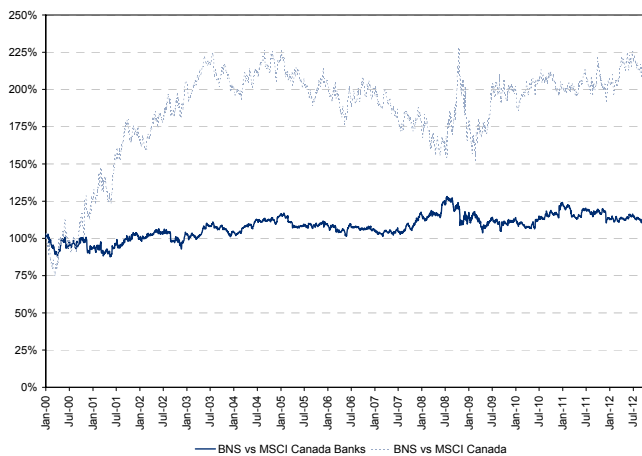
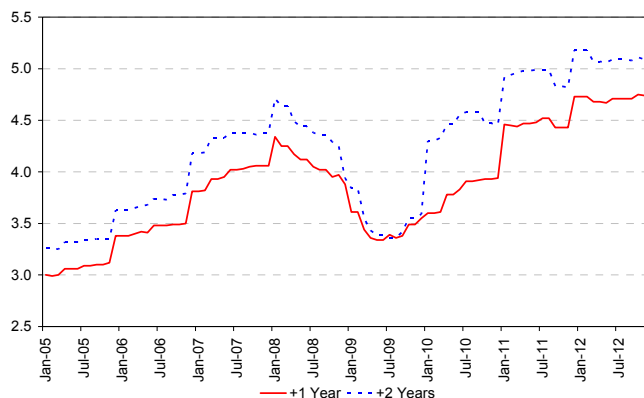


Figure 121. BNS – Price Relative to Sector/Canada, 2000-12 (Jan 00 = 100)



Source: Datastream, I/B/E/S, Citi Research

Figure 122. BNS – Consensus EPS Revisions, 2005-12 (\$)



Source: Datastream, I/B/E/S, Citi Research

Figure 123. RY, TD, BNS – +2y Consensus EPS (Jan 05 = 100)

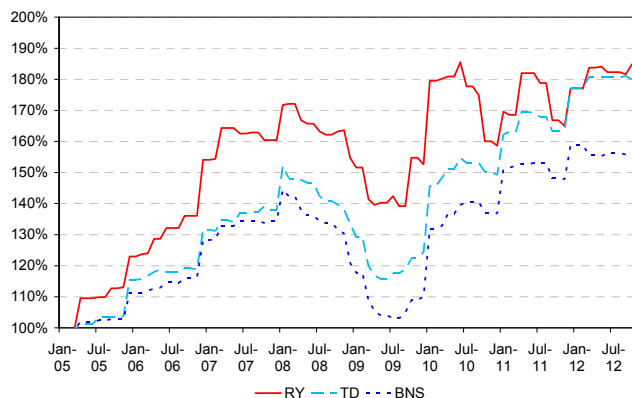
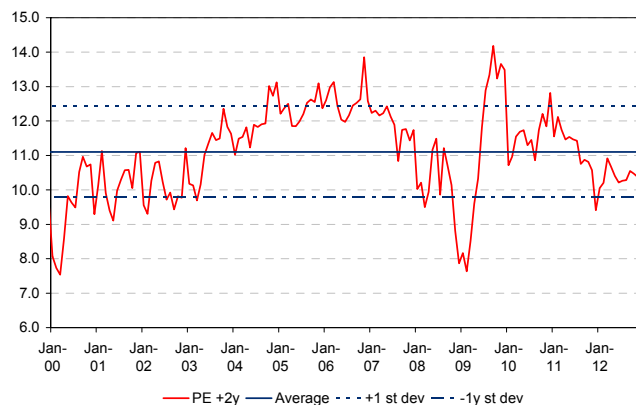


Figure 124. BNS – Absolute PE +2y, Jan 00 – Nov 12



Source: Datastream, I/B/E/S, Citi Research

Figure 125. BNS – Sector Relative PE +2y, Jan 00 – Nov 12

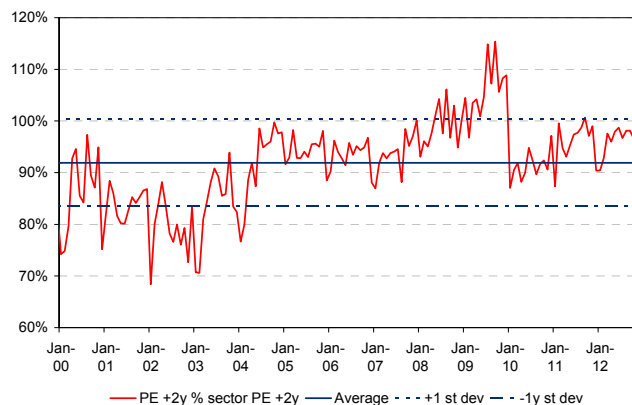
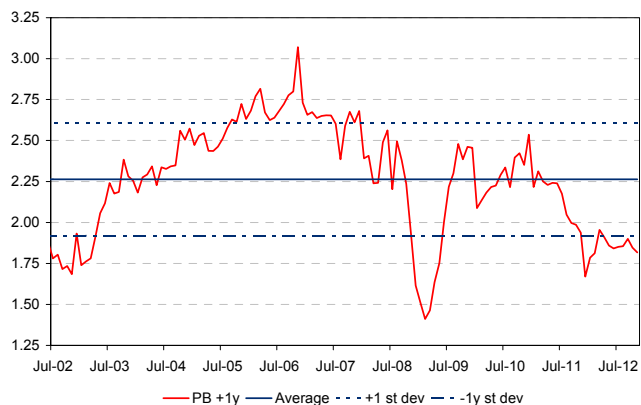
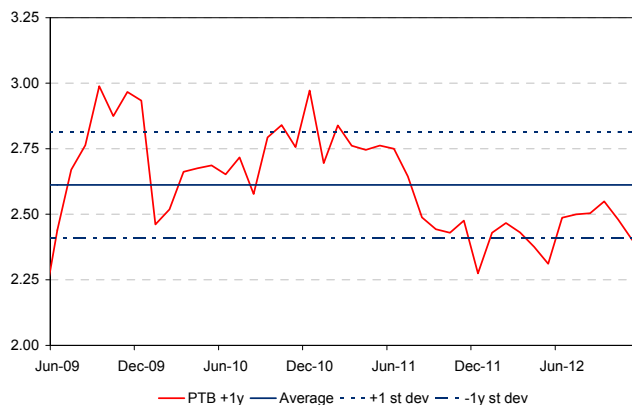


Figure 126. BNS – PBV



Source: Datastream, I/B/E/S, Citi Research

Figure 127. BNS – PTBV



Management Team

Figure 128. BNS – Management Team

President, Chief Executive Officer & Director	Richard E. Waugh
Chief Financial Officer & Executive Vice President	Sean McGuckin
Chief Risk Officer & Group Head	Robert H. Pitfield
<i>Business Heads</i>	
Group Head of Global Capital Markets	Mike Durland
Group Head of Global Corporate	Steve D. McDonald
Group Head-Canadian Banking	Anatol von Hahn
Group Head-Global Wealth Management	Christopher J. Hodgson
Group Head-International Banking	Brian J. Porter

Source: Citi Research, company reports

Shareholder ownership

Figure 129. Bank of Nova Scotia – Top 20 Holders

Holder Name	Parent Co RIC	Position	%O/S
RY Global Asset Management, Inc.	RY.TO	82,548,293	7.20
TD Asset Management, Inc.	TD.TO	82,396,855	7.19
CIBC World Markets, Inc.	CM.TO	48,618,659	4.24
BMO Capital Markets (Canada)	BMO.TO	48,316,085	4.22
BlackRock Advisors LLC	BLK.N	35,438,424	3.09
I. G. Investment Management Ltd.	Unlisted	27,324,844	2.39
Jarislowsky Fraser Ltd.	Unlisted	23,265,350	2.03
BlackRock Fund Advisors	BLK.N	20,743,936	1.81
Goodman & Co. Investment Counsel Ltd.	Unlisted	19,602,329	1.71
BlackRock Asset Management Canada Ltd.	BLK.N	16,638,677	1.45
BMO Asset Management, Inc.	BMO.TO	15,599,083	1.36
Capital World Investors	Unlisted	15,531,800	1.36
Mackenzie Financial Corp.	IGM.TO	12,347,590	1.08
GWL Investment Management Ltd.	Unlisted	12,007,407	1.05
CIBC Global Asset Management, Inc.	CM.TO	11,225,062	0.98
Connor, Clark & Lunn Investment Management Ltd.	Unlisted	10,506,940	0.92
Fiera Capital Corp. (Investment Management)	FSZ.TO	10,161,633	0.89
Pyramis Global Advisors LLC	Unlisted	9,943,579	0.87
Greystone Managed Investments, Inc.	Unlisted	9,780,636	0.85
RY Dominion Securities, Inc.	RY.TO	9,358,685	0.82
		521,355,867	45.50

Source: Factset; Latest reported holdings

M&A History and Strategy

Banco Colpatría, Bank of Guangzhou, Thanachart ...

Scotiabank has made more than C\$8bn of acquisitions within its international banking business since the beginning of the Global Financial Crisis. In most countries, the bank seems to target top 5-10 players as potential acquisitions. In others, Scotiabank pursues a minority or majority stake strategy, such as in China with a 19.99% stake in Bank of Guangzhou and in Colombia with a 51% stake in Banco Colpatría.

Figure 130. BNS – Select Acquisitions and Ownership Stakes

Dresdner Bank, Brasil S.A	100%
R-G Premier Bank of Puerto Rico	100%
Pronto! and Nuevo Comercial S.A., Uruguay	100%
Royal Bank of Scotland's Corporate & Commercial Banking Operations in Chile	100%
Banco Colpatría, Colombia	51%
Thanachart Bank and Siam City Bank	49%
Bank of Guangzhou (BGZ), China	19.99%

Source: Company reports, Citi Research

Figure 131. BNS – Select M&A Transactions

Announcement Date	Completion Date	Deal Value US\$ (m)	Deal Status	Target	Target Nationality
12-Nov-08		3,726	Withdrawn	Grupo Financiero Banorte SA de CV (Stake%)	Mexico
29-Aug-12		3,160	Pending	ING Bank (Canada) (ING Direct Canada)	Canada
22-Nov-10	01-Feb-11	2,411	Completed	DundeeWealth Inc (85.57%)	Canada
06-Oct-08	12-Dec-08	2,066	Completed	CI Financial Income Fund (37%)	Canada
02-Aug-07	26-Nov-07	1,023	Completed	Banco del Desarrollo (99.5%)	Chile
20-Oct-11	18-Jan-12	1,019	Completed	Banco Colpatria Red Multibanca SA (51%)	Colombia
09-Sep-11		728	Pending	Bank of Guangzhou Co Ltd (19.99%)	China
13-May-08	13-May-08	480	Completed	Scotiabank Peru SAA (19.93%)	Peru
14-Jul-08	22-Sep-08	438	Completed	E*Trade Canada	Canada
30-Apr-10	30-Apr-10	416	Completed	R-G Premier Bank of Puerto Rico	Puerto Rico
09-Sep-03	09-Sep-03	351	Completed	Ford Credit de Mexico (Loan portfolio)	Mexico
18-Sep-07	28-Sep-07	339	Completed	DundeeWealth Inc (18%)	Canada
05-Dec-05	09-Mar-06	336	Completed	Banco Wiese Sudameris SA (80%)	Peru
24-Oct-06		316	Not Pursued	Dalian City Commercial Bank (25%)	China
31-Jan-03	28-Apr-03	304	Completed	Grupo Financiero Scotiabank Inverlat SA de CV (36%)	Mexico
13-Jun-06	17-Aug-06	299	Completed	Corporacion Interfin SA	Costa Rica
18-Sep-07	28-Sep-07	253	Completed	Dundee Bank of Canada	Canada
29-Mar-07	03-Jul-07	222	Completed	Thanachart Bank plc (24.99%)	Thailand
03-Feb-09	03-Feb-09	219	Completed	Thanachart Bank plc (24.0126%)	Thailand
14-Feb-06	03-Apr-06	202	Completed	Maple Trust Co	Canada
02-Jul-97	02-Jul-97	200	Completed	Banco Quilmes S.A. (75%)	Argentina
04-Feb-08	04-Feb-08	200	Completed	Banco de Antigua SA; Banco de Ahorro y Credito	Guatemala
29-Mar-00	30-Nov-00	184	Completed	Grupo Financiero Inverlat SA de CV (45%)	Mexico
07-Oct-04	03-May-05	180	Completed	Banco de Comercio de El Salvador SA (59%)	El Salvador
15-Jan-03	15-Jan-04	169	Completed	Bank of Nova Scotia (0.92%)	Canada
21-Jul-99	21-Jul-99	116	Completed	Banco Sud Americano SA (32.6%)	Chile
16-Feb-07	27-Aug-07	95	Completed	FirstBank Puerto Rico (10%)	Puerto Rico
27-Aug-07	27-Aug-07	95	Completed	FirstBank Puerto Rico (10%)	Puerto Rico
10-Sep-97	10-Sep-97	88	Completed	Banco del Caribe S.A.C.A. (25%)	Venezuela
20-Oct-06	14-Dec-06	75	Completed	Dehring Bunting & Golding Ltd (68%)	Jamaica
08-Mar-06	08-Mar-06	60	Completed	Banco Sudamericano SA (65%)	Peru
30-May-97	30-May-97	55	Completed	PT Bank Arya Panduarta Tbk (35%)	Indonesia
15-Feb-96	15-Feb-96	50	Completed	Grupo Financiero Inverlat SA de CV (16%)	Mexico
27-Oct-03	24-Mar-04	44	Completed	Grupo Financiero Scotiabank Inverlat SA de CV (6.3%)	Mexico
16-Jul-97	09-Oct-97	25	Completed	Banco Ahorromet (52.85%)	El Salvador
18-Jun-08	18-Jun-08	25	Completed	Profuturo AFP (42.15%)	Peru
20-May-97	20-May-97	15	Completed	Banco Sudamericano SA (25%)	Peru
28-May-97	02-Jul-97	10	Completed	Mortgage Insurance Company of Canada	Canada
28-Dec-99	28-Dec-99	4	Completed	Banco Sudamericano SA (5%)	Peru
06-Dec-10	29-Jun-11		Completed	Nuevo Banco Comercial SA	Uruguay
06-Dec-10	04-Feb-11		Completed	Pronto!	Uruguay
27-Sep-10	20-Dec-10		Completed	Royal Bank of Scotland Group plc (Chilean business)	Chile
06-Oct-10	06-Oct-10		Completed	BNP Paribas (wealth mgmt biz Panama and the Caymans)	Panama
16-Sep-10	16-Sep-10		Completed	Dresdner Bank Brasil SA	Brazil
01-Mar-10	30-Jul-10		Completed	Royal Bank of Scotland Group plc (Colombian Unit)	Colombia
30-Dec-09	30-Dec-09		Completed	Xian City Commercial Bank (13.2%)	China
04-Mar-09	04-Mar-09		Completed	UBS Energy LLC (Select assets)	United States
04-Aug-08	04-Aug-08		Completed	HSBC Financial Corp Ltd	Canada
20-May-08	20-May-08		Completed	Banco del Trabajo SA	Peru
21-Feb-08	21-Feb-08		Completed	Cidel Bank & Trust Inc (Minority%)	Barbados
11-Oct-06	11-Oct-06		Completed	Bank of America NA (\$900 million precious metals loans)	United States
14-Aug-12			Preliminary discussions	Credito Familiar SA de CV (Stake%)	Mexico

Source: Dealogic, Citi Research

Financial Statements

Figure 132. Bank of Nova Scotia – Group P&L by Year (2009-2015E)

CAD m (unless specified)	CGAAP 2009	CGAAP 2010	IFRS 2011	IFRS 2012E	IFRS 2013E	IFRS 2014E	IFRS 2015E	%Chg 2010	%Chg 2011	%Chg 2012E	%Chg 2013E	%Chg 2014E	%Chg 2015E
GROUP INCOME STATEMENT													
Net Interest Income	8,328	8,907	9,035	10,069	11,586	12,638	13,581	7%	1%	11%	15%	9%	7%
Net Fees & Commissions	4,287	4,401	5,727	6,250	6,899	7,502	8,031	3%	30%	9%	10%	9%	7%
Net Income from Investments	0	0	433	442	494	560	626	0%	0%	2%	12%	13%	12%
Other Operating Income	1,842	2,483	2,402	3,066	2,754	2,970	3,197	35%	-3%	28%	-10%	8%	8%
Non-Interest Income	6,129	6,884	8,562	9,758	10,147	11,032	11,854	12%	24%	14%	4%	9%	7%
Total Revenue	14,457	15,791	17,597	19,827	21,733	23,670	25,436	9%	11%	13%	10%	9%	7%
Taxable Equivalent Adjustment (TEA)	0	-286	-287	-300	-360	-360	-360	0%	0%	5%	20%	0%	0%
Total Revenue (after TEA)	14,457	15,505	17,310	19,527	21,373	23,310	25,076	7%	12%	13%	9%	9%	8%
Total Operating Expenses	-7,919	-8,182	-9,481	-10,401	-11,467	-12,358	-13,153	3%	16%	10%	10%	8%	6%
Gross Operating Profit	6,538	7,323	7,829	9,126	9,906	10,952	11,923	12%	7%	17%	9%	11%	9%
Provision for Credit Losses	-1,744	-1,239	-1,076	-1,232	-1,259	-1,374	-1,501	-29%	-13%	15%	2%	9%	9%
Profit Before Tax	4,794	6,084	6,753	7,894	8,647	9,578	10,422	27%	11%	17%	10%	11%	9%
Income Tax Expense	-1,133	-1,745	-1,423	-1,733	-2,080	-2,308	-2,511	54%	-18%	22%	20%	11%	9%
Net Income	3,661	4,339	5,330	6,162	6,568	7,270	7,911	19%	23%	16%	7%	11%	9%
Net Income Attributable to:													
Non-Controlling Interests in Subsidiaries	114	100	91	181	200	216	233	-12%	-9%	99%	10%	8%	8%
Capital Instrument Equity Holders	0	0	58	31	52	52	52	0%	0%	0%	0%	0%	0%
Preferred Shareholders	186	201	216	220	220	220	220	8%	7%	2%	0%	0%	0%
Common Shareholders	3,361	4,038	4,965	5,730	6,096	6,782	7,405	20%	23%	15%	6%	11%	9%
PER SHARE													
EPS - Basic	3.32	3.91	4.63	5.06	5.14	5.68	6.15	18%	18%	9%	2%	10%	8%
EPS - Diluted	3.31	3.91	4.48	4.90	5.06	5.59	6.06	18%	16%	8%	3%	11%	8%
BVPS (ex prefs, minorities)	20.5	20.8	23.4	28.8	31.3	34.1	37.1	1%	13%	23%	9%	9%	9%
TBVPS (ex prefs, minorities)	17.1	17.3	16.6	21.4	22.5	25.0	27.7	1%	-4%	28%	5%	11%	11%
ROE (avg equity, ex prefs, minorities)	16.9%	18.9%	20.7%	18.8%	16.9%	17.1%	17.0%						
ROTE (avg equity, ex prefs, minorities)	20.0%	22.6%	27.0%	25.8%	23.1%	23.5%	23.0%						
DPS	1.96	1.96	2.05	2.19	2.34	2.55	2.77	0%	5%	7%	7%	9%	8%
Dividends - common (C\$m)	1,990	2,023	2,200	2,589	2,785	3,065	3,346	2%	9%	18%	8%	10%	9%
Dividends - preferred (C\$m)	186	201	216	220	220	220	220	8%	7%	2%	0%	0%	0%
Payout ratio	59%	50%	44%	43%	46%	45%	45%						
Common equity (ex minorities)	21,062	21,728	26,356	34,517	37,828	41,545	45,604	3%	21%	31%	10%	10%	10%
Tangible common equity (ex minorities)	17,593	18,067	18,717	25,635	27,154	30,445	34,060	3%	4%	37%	6%	12%	12%
Common Shares - basic (end)	1,025	1,043	1,089	1,182	1,190	1,200	1,210	2%	4%	9%	1%	1%	1%
Common Shares - diluted (avg)	1,016	1,034	1,108	1,169	1,205	1,213	1,223	2%	7%	5%	3%	1%	1%
OPERATING RATIOS													
ROA	0.67%	0.78%	0.87%	0.90%	0.85%	0.89%	0.93%						
ROE (avg common ex minorities)	16.9%	18.9%	20.7%	18.8%	16.9%	17.1%	17.0%						
RoAvRWA	1.55%	1.99%	2.37%	2.51%	2.45%	2.55%	2.64%						
LDR	76.8%	80.8%	78.4%	77.4%	78.2%	78.8%	79.9%						
RWA / Assets	44.6%	39.5%	39.4%	37.7%	37.4%	37.5%	38.0%						
Assets / Equity (total shrhlders' inc minorities)	19.6	20.0	18.4	16.8	16.9	16.1	15.5						
NIM on average assets	1.66%	1.71%	1.59%	1.58%	1.62%	1.66%	1.71%						
Fees % average loans	1.53%	1.52%	1.79%	1.80%	1.79%	1.80%	1.84%						
PBT % revenues	33.2%	39.2%	39.0%	40.4%	40.5%	41.1%	41.6%						
Efficiency ratio	54.8%	52.8%	54.8%	53.3%	53.7%	53.0%	52.5%						
Tax rate	23.6%	28.7%	21.1%	21.9%	24.1%	24.1%	24.1%						
BALANCE SHEET ITEMS													
Total Assets	496,516	543,970	594,423	681,353	747,185	776,499	812,048	10%	9%	15%	10%	4%	5%
Total Liabilities	471,190	516,752	562,183	640,714	703,035	728,416	759,673	10%	9%	14%	10%	4%	4%
Total Equity	25,326	27,218	32,240	40,639	44,150	48,083	52,376	7%	18%	26%	9%	9%	9%
Gross Tier 1 Capital	28,609	31,153	35,856	42,199	45,710	49,643	53,936	9%	15%	18%	8%	9%	9%
Net Tier 1 Capital	23,650	25,334	28,489	33,879	36,286	39,957	44,249	7%	12%	19%	7%	10%	11%
Total Regulatory Capital	28,588	29,599	32,533	38,463	40,870	44,455	48,660	4%	10%	18%	6%	9%	9%
Risk-Weighted Assets (CAD bn)	222	215	234	257	279	291	309	-3%	9%	10%	9%	4%	6%
Tier 1 Capital Ratio (%)	10.7%	11.8%	12.2%	13.2%	13.0%	13.7%	14.3%						
Total Capital Ratio (%)	12.9%	13.8%	13.9%	15.0%	14.6%	15.3%	15.8%						
Tangible Common Equity / Total Tangible Assets	3.6%	3.3%	3.2%	3.8%	3.7%	4.0%	4.3%						

Source: Company Reports and Citi Research Estimates

Figure 133. Bank of Nova Scotia – Group P&L by Quarter (1Q11-4Q13E)

CAD m (unless specified)	IFRS 1Q11	IFRS 2Q11	IFRS 3Q11	IFRS 4Q11	IFRS 1Q12	IFRS 2Q12	IFRS 3Q12	IFRS 4Q12E	IFRS 1Q13E	IFRS 2Q13E	IFRS 3Q13E	IFRS 4Q13E
GROUP INCOME STATEMENT												
Net Interest Income	2,258	2,141	2,302	2,334	2,380	2,484	2,572	2,646	2,783	2,859	2,934	3,010
Net Fees & Commissions	1,244	1,527	1,467	1,489	1,500	1,577	1,563	1,610	1,673	1,710	1,742	1,774
Net Income from Investments	114	98	112	109	93	120	111	118	119	122	125	128
Other Operating Income	603	942	490	367	716	592	1,343	616	674	684	694	702
Non-Interest Income	1,961	2,567	2,069	1,965	2,309	2,289	3,017	2,344	2,466	2,516	2,561	2,604
Total Revenue	4,219	4,708	4,371	4,299	4,689	4,773	5,589	4,990	5,249	5,375	5,495	5,614
Taxable Equivalent Adjustment (TEA)	-71	-69	-73	-74	-68	-69	-77	-86	-90	-90	-90	-90
Total Revenue (after TEA)	4,148	4,639	4,298	4,225	4,621	4,704	5,512	4,904	5,159	5,285	5,405	5,524
Total Operating Expenses	-2,249	-2,395	-2,348	-2,489	-2,507	-2,565	-2,618	-2,711	-2,814	-2,822	-2,889	-2,942
Gross Operating Profit	1,899	2,244	1,950	1,736	2,114	2,139	2,894	2,193	2,345	2,463	2,516	2,582
Provision for Credit Losses	-275	-270	-250	-281	-265	-264	-402	-301	-305	-312	-318	-323
Profit Before Tax	1,624	1,974	1,700	1,455	1,849	1,875	2,492	1,892	2,040	2,151	2,198	2,259
Income Tax Expense	-375	-353	-397	-298	-413	-415	-441	-464	-488	-518	-530	-545
Net Income	1,249	1,621	1,303	1,157	1,436	1,460	2,051	1,429	1,552	1,633	1,668	1,714
Net Income Attributable to:												
Non-Controlling Interests in Subsidiaries	26	24	24	17	25	56	50	50	50	50	50	50
Capital Instrument Equity Holders	15	14	15	14	13	13	-8	13	13	13	13	13
Preferred Shareholders	51	55	55	55	55	55	55	55	55	55	55	55
Common Shareholders	1,157	1,528	1,209	1,071	1,343	1,336	1,954	1,311	1,434	1,515	1,550	1,596
PER SHARE												
EPS - Basic	1.11	1.42	1.12	0.99	1.23	1.18	1.71	1.13	1.21	1.28	1.31	1.34
EPS - Diluted	1.08	1.39	1.10	0.97	1.20	1.15	1.69	1.11	1.19	1.26	1.29	1.32
BVPS (ex prefs, minorities)	20.6	22.1	22.9	23.5	24.7	26.0	27.9	28.8	29.3	30.0	30.6	31.3
TBVPS (ex prefs, minorities)	17.2	15.5	16.2	16.7	18.0	18.7	20.4	21.4	20.7	21.3	21.9	22.5
ROE (avg equity, ex prefs, minorities)	21.0%	26.0%	19.2%	16.5%	19.7%	18.2%	24.7%	15.7%	16.4%	17.0%	17.0%	17.1%
ROTE (avg equity, ex prefs, minorities)	25.2%	34.0%	27.3%	23.2%	27.4%	25.2%	34.1%	21.2%	22.7%	24.0%	23.8%	23.9%
DPS	0.49	0.52	0.52	0.52	0.52	0.55	0.55	0.57	0.57	0.59	0.59	0.59
Dividends - common (C\$m)	512	561	563	564	567	625	629	768	675	700	701	709
Dividends - preferred (C\$m)	51	55	55	55	55	55	55	55	55	55	55	55
Payout ratio	44%	37%	46%	53%	42%	47%	32%	51%	47%	46%	45%	44%
Common equity (ex minorities)	22,285	24,641	25,605	26,356	28,112	30,566	32,414	34,517	35,276	36,091	36,941	37,828
Tangible common equity (ex minorities)	18,656	17,258	18,138	18,717	20,440	21,933	23,706	25,635	24,916	25,628	26,372	27,154
Common Shares - basic (end)	1,047	1,082	1,085	1,089	1,103	1,141	1,145	1,182	1,184	1,186	1,188	1,190
Common Shares - diluted (avg)	1,081	1,113	1,115	1,118	1,125	1,168	1,160	1,182	1,201	1,203	1,205	1,207
OPERATING RATIOS												
ROA	0.84%	1.06%	0.82%	0.72%	0.87%	0.82%	1.17%	0.78%	0.82%	0.83%	0.84%	0.86%
ROE (avg common ex minorities)	21.0%	26.0%	19.2%	16.5%	19.7%	18.2%	24.7%	15.7%	16.4%	17.0%	17.0%	17.1%
RoAvRWA	2.32%	2.96%	2.33%	2.02%	2.36%	2.31%	3.25%	2.24%	2.36%	2.42%	2.44%	2.47%
LDR	78.5%	74.9%	77.3%	78.4%	76.2%	75.5%	78.0%	77.4%	78.7%	78.5%	78.4%	78.2%
RWA / Assets	38.5%	37.6%	38.3%	39.4%	39.7%	38.3%	37.7%	37.7%	37.1%	37.2%	37.3%	37.4%
Assets/Equity (total shrhlders' inc mins)	20.1	19.4	18.7	18.4	18.7	18.0	17.4	16.8	17.5	17.3	17.1	16.9
NIM on average assets	1.64%	1.49%	1.56%	1.58%	1.55%	1.53%	1.55%	1.57%	1.58%	1.57%	1.60%	1.62%
Fees % average loans	1.60%	1.95%	1.85%	1.83%	1.78%	1.82%	1.77%	1.78%	1.76%	1.71%	1.73%	1.74%
PBT % revenues	39.2%	42.6%	39.6%	34.4%	40.0%	39.9%	45.2%	38.6%	39.5%	40.7%	40.7%	40.9%
Efficiency ratio	54.2%	51.6%	54.6%	58.9%	54.3%	54.5%	47.5%	55.3%	54.5%	53.4%	53.5%	53.3%
Tax rate	23.1%	17.9%	23.4%	20.5%	22.3%	22.1%	17.7%	24.5%	23.9%	24.1%	24.1%	24.1%
BALANCE SHEET ITEMS												
Total Assets	559,415	590,695	587,597	594,423	637,055	659,690	669,970	681,353	723,975	731,647	739,382	747,185
Total Liabilities	531,639	560,196	556,161	562,183	602,918	623,023	631,484	640,714	682,527	689,334	696,170	703,035
Total Equity	27,776	30,499	31,436	32,240	34,137	36,667	38,486	40,639	41,448	42,313	43,213	44,150
Gross Tier 1 Capital	31,186	33,733	34,782	35,856	37,237	39,298	40,087	42,199	43,008	43,873	44,773	45,710
Net Tier 1 Capital	25,410	26,615	27,562	28,489	28,878	30,974	31,874	33,879	33,778	34,579	35,414	36,286
Total Regulatory Capital	29,488	30,957	31,697	32,533	33,292	35,420	36,458	38,463	38,362	39,163	39,998	40,870
Risk-Weighted Assets (CAD bn)	215	222	225	234	253	253	252	257	269	272	276	279
Tier 1 Capital Ratio (%)	11.8%	12.0%	12.3%	12.2%	11.4%	12.2%	12.6%	13.2%	12.6%	12.7%	12.8%	13.0%
Total Capital Ratio (%)	13.7%	13.9%	14.1%	13.9%	13.2%	14.0%	14.4%	15.0%	14.3%	14.4%	14.5%	14.6%
TCE / Tot Tangible Assets	3.4%	3.0%	3.1%	3.2%	3.2%	3.4%	3.6%	3.8%	3.5%	3.6%	3.6%	3.7%

Source: Company Reports and Citi Research Estimates

Figure 134. Bank of Nova Scotia – Divisional P&L by Year (2009-2015E)

CAD m (unless specified)	CGAAP 2009	CGAAP 2010	IFRS 2011	IFRS 2012E	IFRS 2013E	IFRS 2014E	IFRS 2015E	%Chg 2010	%Chg 2011	%Chg 2012E	%Chg 2013E	%Chg 2014E	%Chg 2015E
CANADIAN BANKING													
Net Interest Income	4,785	4,761	4,553	4,731	5,333	5,773	6,062	-1%	-4%	4%	13%	8%	5%
Net Fee and Commission Revenues	2,279	1,371	1,418	1,480	1,594	1,674	1,758	-40%	3%	4%	8%	5%	5%
Total Revenue	7,064	6,133	5,991	6,276	6,959	7,480	7,853	-13%	-2%	5%	11%	7%	5%
Operating Expenses	-3,757	-3,034	-3,084	-3,138	-3,480	-3,718	-3,864	-19%	2%	2%	11%	7%	4%
GOP	3,307	3,099	2,907	3,138	3,480	3,762	3,990	-6%	-6%	8%	11%	8%	6%
Provision for Credit Losses	-702	-651	-592	-492	-471	-508	-549	-7%	-9%	-17%	-4%	8%	8%
PBT	2,605	2,448	2,315	2,646	3,009	3,255	3,440	-6%	-5%	14%	14%	8%	6%
Net Income	1,851	1,732	1,670	1,948	2,212	2,392	2,529	-6%	-4%	17%	14%	8%	6%
Total Assets	186	197	211	224	275	289	303	6%	7%	7%	23%	5%	5%
ROA	1.00%	0.88%	0.79%	0.87%	0.80%	0.83%	0.83%						
NIM on Avg Assets	2.57%	2.42%	2.16%	2.11%	1.94%	2.00%	2.00%						
PBT % revenues	36.9%	39.9%	38.6%	42.2%	43.2%	43.5%	43.8%						
Efficiency ratio	53.2%	49.5%	51.5%	50.0%	50.0%	49.7%	49.2%						
INTERNATIONAL BANKING													
Net Interest Income	3,773	3,546	3,579	4,551	5,320	5,852	6,437	-6%	1%	27%	17%	10%	10%
Net Fee and Commission Revenues	1,480	1,255	1,076	1,281	1,461	1,614	1,776	-15%	-14%	19%	14%	10%	10%
Total Revenue	5,253	5,152	5,389	6,584	7,618	8,382	9,209	-2%	5%	22%	16%	10%	10%
Operating Expenses	-2,960	-2,837	-3,038	-3,674	-4,167	-4,560	-4,973	-4%	7%	21%	13%	9%	9%
GOP	2,293	2,315	2,351	2,910	3,451	3,822	4,236	1%	2%	24%	19%	11%	11%
Provision for Credit Losses	-577	-634	-509	-611	-736	-810	-891	10%	-20%	20%	21%	10%	10%
PBT	1,716	1,681	1,842	2,299	2,715	3,013	3,346	-2%	10%	25%	18%	11%	11%
Net Income	1,429	1,241	1,467	1,764	2,050	2,275	2,526	-13%	18%	20%	16%	11%	11%
Total Assets	87	85	93	110	122	135	148	-2%	10%	18%	11%	10%	10%
ROA	1.64%	1.46%	1.57%	1.60%	1.68%	1.69%	1.71%						
NIM on Avg Assets	4.34%	4.17%	3.84%	4.14%	4.35%	4.35%	4.35%						
PBT % revenues	32.7%	32.6%	34.2%	34.9%	35.6%	35.9%	36.3%						
Efficiency ratio	56.3%	55.1%	56.4%	55.8%	54.7%	54.4%	54.0%						
GLOBAL WEALTH MANAGEMENT													
Net Interest Income	367	406	444	506	534	551	568	11%	9%	14%	6%	3%	3%
Net Fee and Commission Revenues	1,522	2,090	2,205	2,434	2,584	2,749	2,912	37%	6%	10%	6%	6%	6%
Total Revenue	1,889	2,760	3,437	3,540	3,768	4,010	4,250	46%	25%	3%	6%	6%	6%
Operating Expenses	-1,130	-1,615	-1,900	-2,053	-2,148	-2,266	-2,380	43%	18%	8%	5%	5%	5%
GOP	759	1,145	1,537	1,487	1,620	1,744	1,870	51%	34%	-3%	9%	8%	7%
Provision for Credit Losses	-3	0	-2	-1	-3	-3	-3	0%	0%	0%	0%	0%	0%
PBT	756	1,145	1,535	1,485	1,617	1,741	1,867	51%	34%	-3%	9%	8%	7%
Net Income	625	922	1,255	1,153	1,245	1,341	1,437	48%	36%	-8%	8%	8%	7%
Total Assets	11	12	12	14	16	16	17	9%	3%	11%	14%	5%	5%
ROA	5.7%	7.7%	10.2%	8.4%	8.0%	8.2%	8.4%						
NIM on average assets	3.34%	3.38%	3.61%	3.70%	3.43%	3.37%	3.31%						
PBT % revenues	40.0%	41.5%	44.7%	42.0%	42.9%	43.4%	43.9%						
Efficiency ratio	59.8%	58.5%	55.3%	58.0%	57.0%	56.5%	56.0%						
GLOBAL BANKING AND MARKETS													
Net Interest Income	1,427	967	768	781	879	967	1,044	-32%	-21%	2%	12%	10%	8%
Net Fee and Commission Revenues	2,138	1,762	1,198	1,226	1,399	1,611	1,740	-18%	-32%	2%	14%	15%	8%
Total Revenue	3,565	3,196	3,140	3,632	4,087	4,532	4,895	-10%	-2%	16%	13%	11%	8%
Operating Expenses	-1,072	-1,304	-1,482	-1,544	-1,692	-1,836	-1,958	22%	14%	4%	10%	8%	7%
GOP	2,493	1,892	1,658	2,089	2,395	2,697	2,937	-24%	-12%	26%	15%	13%	9%
Provision for Credit Losses	-338	-15	-33	-28	-49	-54	-58	-96%	120%	-14%	72%	10%	8%
PBT	2,155	1,877	1,625	2,060	2,346	2,643	2,879	-13%	-13%	27%	14%	13%	9%
Net Income	1,451	1,319	1,258	1,489	1,701	1,916	2,087	-9%	-5%	18%	14%	13%	9%
Total Assets	183	164	192	219	244	269	290	-10%	17%	14%	12%	10%	8%
ROA	0.79%	0.80%	0.66%	0.68%	0.70%	0.71%	0.72%						
NIM on average assets	0.78%	0.59%	0.40%	0.36%	0.36%	0.36%	0.36%						
PBT % revenues	60.4%	58.7%	51.8%	56.7%	57.4%	58.3%	58.8%						
Efficiency ratio	30.1%	40.8%	47.2%	42.5%	41.4%	40.5%	40.0%						

Source: Company Reports and Citi Research Estimates

Figure 135. Bank of Nova Scotia – Divisional P&L by Quarter (1Q11-4Q13E)

CAD m (unless specified)	IFRS 1Q11	IFRS 2Q11	IFRS 3Q11	IFRS 4Q11	IFRS 1Q12	IFRS 2Q12	IFRS 3Q12	IFRS 4Q12E	IFRS 1Q13E	IFRS 2Q13E	IFRS 3Q13E	IFRS 4Q13E
CANADIAN BANKING												
Net Interest Income	1,160	1,088	1,160	1,145	1,174	1,156	1,197	1,204	1,278	1,315	1,352	1,389
Net Fee and Commission Revenues	349	346	360	363	365	361	375	379	394	397	400	403
Total Revenue	1,523	1,439	1,517	1,512	1,549	1,517	1,620	1,590	1,680	1,720	1,760	1,799
Operating Expenses	-731	-773	-783	-797	-768	-771	-793	-806	-845	-869	-875	-891
GOP	792	666	734	715	781	746	827	784	835	851	885	908
Provision for Credit Losses	-165	-146	-146	-135	-136	-120	-118	-118	-115	-117	-119	-120
PBT	627	520	588	580	645	626	709	666	720	734	766	788
Net Income	451	374	426	419	475	461	521	491	529	540	563	579
Total Assets	206	208	212	216	219	222	227	229	272	274	276	278
ROA	0.87%	0.72%	0.80%	0.78%	0.87%	0.83%	0.92%	0.86%	0.78%	0.79%	0.82%	0.83%
NIM on Avg Assets	2.25%	2.09%	2.19%	2.12%	2.15%	2.09%	2.11%	2.10%	1.88%	1.92%	1.96%	2.00%
PBT % revenues	41.2%	36.1%	38.8%	38.4%	41.6%	41.3%	43.8%	41.9%	42.9%	42.7%	43.5%	43.8%
Efficiency ratio	48.0%	53.7%	51.6%	52.7%	49.6%	50.8%	49.0%	50.7%	50.3%	50.5%	49.7%	49.5%
INTERNATIONAL BANKING												
Net Interest Income	872	848	918	941	1,003	1,137	1,175	1,236	1,281	1,314	1,346	1,379
Net Fee and Commission Revenues	268	251	263	294	291	336	320	334	348	362	371	380
Total Revenue	1,309	1,313	1,332	1,435	1,451	1,663	1,692	1,778	1,834	1,884	1,929	1,971
Operating Expenses	-755	-702	-761	-820	-845	-926	-937	-966	-999	-1,027	-1,061	-1,080
GOP	554	611	571	615	606	737	755	812	834	857	868	891
Provision for Credit Losses	-113	-112	-126	-158	-124	-145	-168	-174	-178	-182	-186	-190
PBT	441	499	445	457	482	592	587	638	656	675	682	701
Net Income	359	394	343	371	391	448	442	483	495	510	515	529
Total Assets	91	90	94	98	102	112	112	115	118	121	124	127
ROA	1.58%	1.75%	1.47%	1.51%	1.54%	1.61%	1.58%	1.68%	1.68%	1.69%	1.66%	1.67%
NIM on Avg Assets	3.83%	3.77%	3.92%	3.84%	3.95%	4.08%	4.20%	4.31%	4.35%	4.35%	4.35%	4.35%
PBT % revenues	33.7%	38.0%	33.4%	31.8%	33.2%	35.6%	34.7%	35.9%	35.8%	35.8%	35.4%	35.6%
Efficiency ratio	57.7%	53.5%	57.1%	57.1%	58.2%	55.7%	55.4%	54.3%	54.5%	54.5%	55.0%	54.8%
GLOBAL WEALTH MANAGEMENT												
Net Interest Income	112	100	111	121	123	126	128	129	131	133	134	136
Net Fee and Commission Revenues	387	631	601	586	586	627	610	611	632	641	651	661
Total Revenue	643	1,111	845	838	859	905	886	890	918	934	950	966
Operating Expenses	-336	-542	-509	-513	-495	-525	-509	-524	-528	-537	-546	-537
GOP	307	569	336	325	364	380	377	366	390	397	404	429
Provision for Credit Losses	0	-1	0	-1	0	0	-1	0	-1	-1	-1	-1
PBT	307	568	336	324	364	380	376	365	389	396	403	429
Net Income	239	494	260	262	288	298	284	283	300	305	310	330
Total Assets	10	13	13	13	13	13	14	14	15	15	16	16
ROA	9.76%	15.44%	7.88%	7.82%	8.73%	8.90%	8.23%	7.91%	8.10%	7.98%	7.85%	8.10%
NIM on average assets	4.57%	3.13%	3.36%	3.61%	3.73%	3.76%	3.71%	3.61%	3.55%	3.47%	3.40%	3.33%
PBT % revenues	47.7%	51.1%	39.8%	38.7%	42.4%	42.0%	42.4%	41.1%	42.4%	42.4%	42.4%	44.4%
Efficiency ratio	52.3%	48.8%	60.2%	61.2%	57.6%	58.0%	57.4%	58.9%	57.5%	57.5%	57.5%	55.5%
GLOBAL BANKING AND MARKETS												
Net Interest Income	196	184	195	193	170	203	202	206	213	217	222	226
Net Fee and Commission Revenues	291	324	301	282	289	330	289	318	334	344	354	366
Total Revenue	857	845	769	669	845	910	910	967	992	1,012	1,031	1,052
Operating Expenses	-401	-383	-328	-370	-390	-365	-374	-415	-446	-395	-413	-439
GOP	456	462	441	299	455	545	536	553	546	617	619	614
Provision for Credit Losses	3	-11	-8	-17	-5	1	-15	-9	-12	-12	-12	-13
PBT	459	451	433	282	450	546	521	543	534	605	607	601
Net Income	335	376	304	243	311	387	398	393	387	439	440	436
Total Assets	182	188	193	203	206	211	227	232	237	242	247	252
ROA	0.74%	0.80%	0.63%	0.48%	0.60%	0.73%	0.70%	0.68%	0.65%	0.73%	0.71%	0.69%
NIM on average assets	0.43%	0.39%	0.40%	0.38%	0.33%	0.38%	0.36%	0.36%	0.36%	0.36%	0.36%	0.36%
PBT % revenues	53.6%	53.4%	56.3%	42.2%	53.3%	60.0%	57.3%	56.1%	53.8%	59.8%	58.8%	57.1%
Efficiency ratio	46.8%	45.3%	42.7%	55.3%	46.2%	40.1%	41.1%	42.9%	45.0%	39.0%	40.0%	41.7%

Source: Company Reports and Citi Research Estimates

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Risks and Opportunities for Canadian Banks

Household Leverage: A Manageable Threat

The Canadian consumer has levered up significantly over the past ten years

The Bank of Canada has included household leverage as one of the five risk factors to the Canadian banking system. The Canadian consumer has levered up significantly over the past ten years. The share of real household consumption in real GDP has increased from c. 52% in 1990 to c. 57% today (Figure 136). This leveraging up has been at least partly driven by a buoyant housing market – with prices rising for most of the past 20 years (Figure 140) and vacancy rates reaching a low 2% in most major cities (Figure 141).

Figure 136. Household Leverage Has Increased to c90% of GDP from c.60% in the Early 1990s...

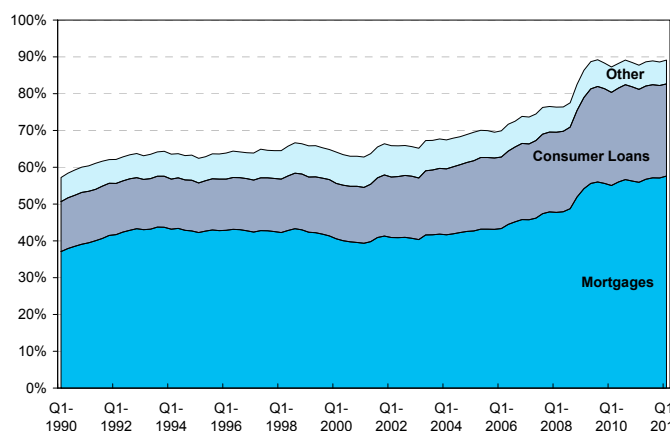
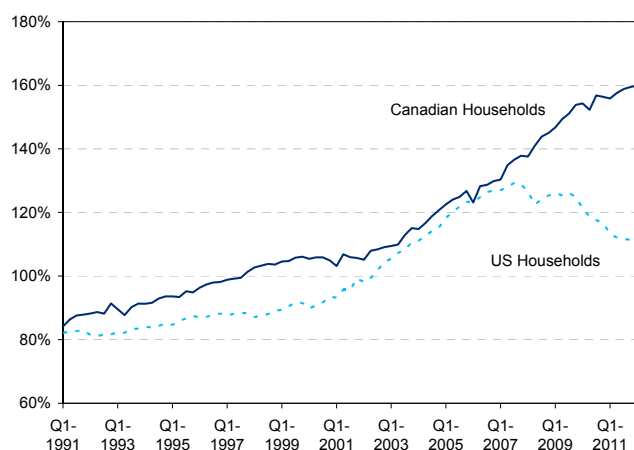


Figure 137. ...While Household Disposable Income Has Lagged - Household Debt % Disposable Income, 1991-2012 (%)



Source: Haver, Citi Research

Citi economists and the IMF believe that household debt is a serious problem for Canada.

Currently, Canadian households are more levered than US households, at least on a disposable income basis, with c. 160% of debt to disposable income compared to 110% in the US (Figure 137). The view of the Citi Canadian and Global economists, as well as the IMF, is that household debt is a serious problem for Canada. Household debt is one of three major downside risks to the Canadian outlook and one of five key risks to the financial system. The Bank of Canada is retaining a slight hawkish bias in large part due to household debt. Moreover, imbalances created by household debt will factor more importantly into the BoC's policy calculus according to the last BoC policy statement.

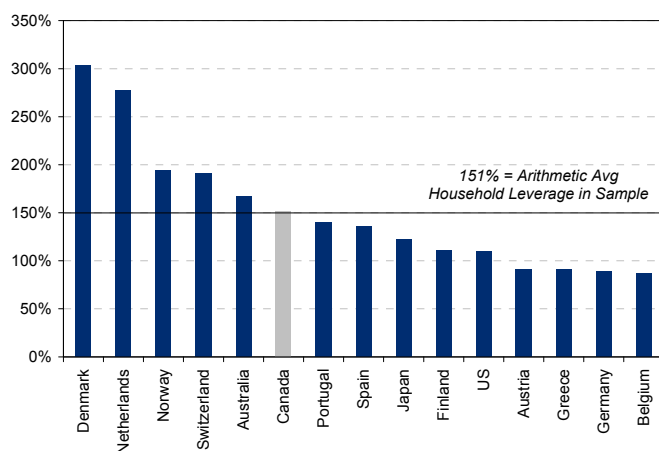
In a global context, Canadian households are less levered than counterparts in other commodity-rich countries

Yet, in a global context, Canadian household leverage appears to be in line with that in other commodity-rich countries:

- On a % of GDP basis, however, **Canadian household leverage is in the middle of our 'global sample'**. Specifically, Denmark, Netherlands, Norway, Switzerland and Australia all have household indebtedness to GDP above Canada's 150% (Figure 138).
- Another mitigating factor in Canada's favour is the **debt service ratio**. At 7.5%, the average debt service burden is down from a high of 11.5% of disposable income in the early 1990s and below the recent peak of 9.0% in 2008. Moreover, Canadian consumer should have an easier time meeting debt payments compared to their US peers, whose debt service ratio is more than 3ppt higher, at 10.7% (Figure 139).

- Thirdly, **mortgage interest is not tax-deductible in Canada** – unlike in the Netherlands and the US, scenes of true housing market bubbles and bursts.
- Lastly, **mortgages are recourse in most of Canada** rather than non-recourse like in the US.

Figure 138. Household Debt % GDP for Select Countries and Sample Average



Source: Haver, Citi Research

Figure 139. Canadian Households' Debt Service Ratio Remains Below that of US Households



Four rounds of macroprudential tightening of mortgage lending in four years

Nevertheless, the Bank of Canada and OSFI, the banking regulator, are on alert. Over the past four years, they have worked with Canada's Department of Finance to implement four rounds of macroprudential tightening of mortgage lending. The latest round, in June 2012, included the following steps:

- Maximum amortisation period lowered from 30 years to 25 years;
- Lowered maximum borrowing for refinancing from 85% to 80% of the home's value;
- Fixed max gross debt service ratio at 39% and max total debt service ratio at 44%; and
- Established that government-backed mortgage insurance is only available for new high loan-to value mortgages if the home purchase price is under C\$1m.

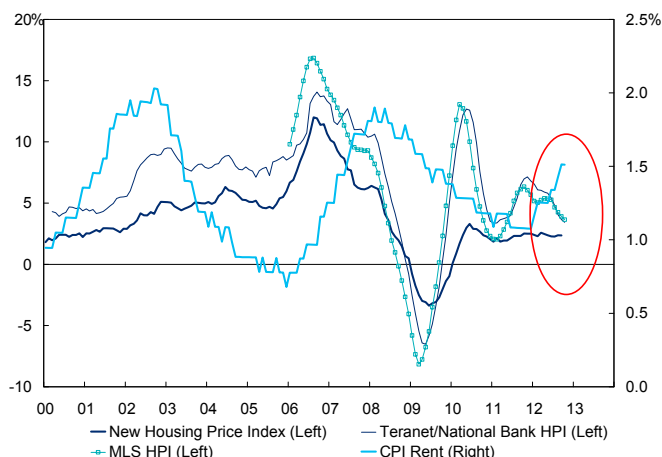
In [Canada Intraday Economic Commentary - Round 4 – Government Tightens Mortgage Market Reins](#), 21 June, our Canadian economists commented that “the latest measures are aimed at encouraging homeowners to pay off mortgages sooner and maintain more equity in their homes. The policies are also meant to dissuade potential homebuyers from over extending themselves with expensive homes and higher debt burdens. On balance, the action was unsurprising given policymakers’ belief that Canadian household debt remains the premier domestic risk to the financial system”.

The tightening ‘rounds’ have started to have the desired effect

Our economists believe the government's tightening of mortgage lending criteria would slow down mortgage lending to be more in line with GDP growth. Indeed, the four rounds of tightening have started to have the desired effect – new housing price growth has stabilised at 2-3% p.a. while existing housing price growth has decelerated from a recent peak of c.6% p.a. to c.3-4% p.a. (Figure 140).

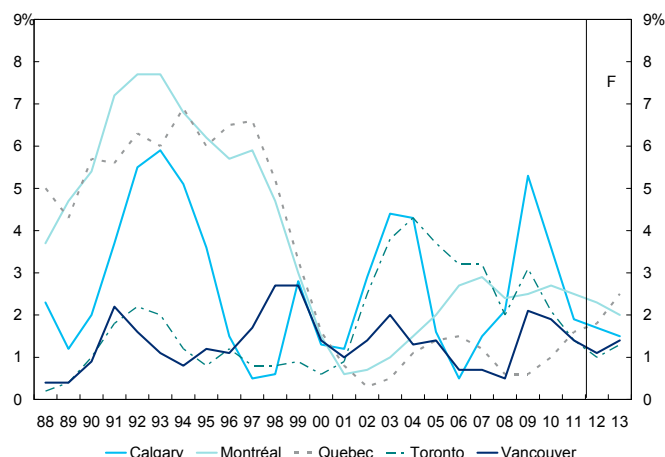
While we are not overly concerned about mortgage credit losses to the banks, we believe that the government-imposed slowdown on mortgage lending could have secondary effects – e.g. to push the banks into riskier non-mortgage lending, such as credit cards or personal lines of credit (Canadian HELOC) where growth could be more robust. Alternatively, some of the banks may choose to capture superior loan growth in less risky areas – at the ‘penalty’ of lower product margins (e.g. auto finance). But again, the regulators seem to be thinking two steps ahead: they have stopped insuring HELOCs altogether.

Figure 140. New Housing Price Growth Has Stabilised while Existing Housing Price Growth Is Slowing Down (YoY %Chg)



Source: Datastream, Haver, Citi Research

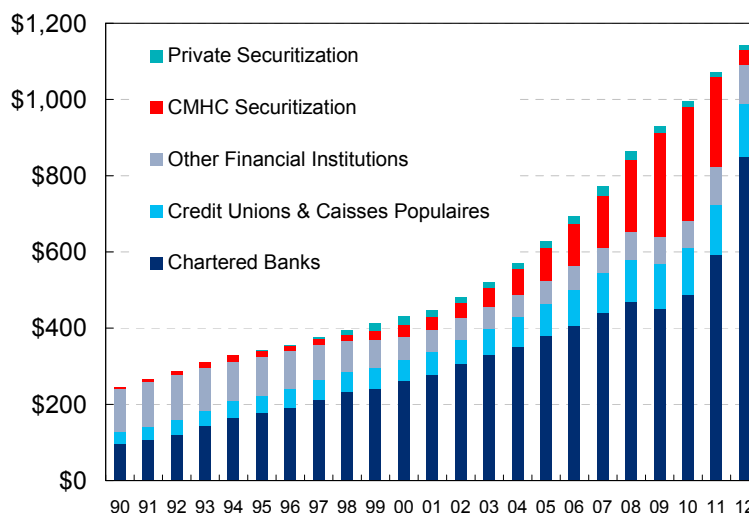
Figure 141. Vacancy Rates in Calgary and Montreal Continue to Decline, in Other Cities Vacancies Are Rising



Mortgage lending in Canada is dominated by the chartered banks

Unsurprisingly, mortgage lending in Canada is dominated by the chartered banks which account for 75% of all outstanding mortgage loans (C\$1.2tn; Figure 142). In our discussions with the banks and the Canadian regulators, the consensus view was that a housing price fall of 10-15% should be manageable for most banks and the system as a whole.

Figure 142. Mortgage Lending in Canada Is Dominated by the Chartered Banks



Source: Haver, Citi Research

Is 12-20% book value erosion from an overvalued consumer realistic?

The Market Is Implying 12-20% Book Value Erosion

Most Canadian banks currently trade below their long-term P/E+1 multiples. We believe that market worries currently focus on consumer leverage and what may happen to earnings should the consumer sector “implode”. Going on this assumption, our analysis points to the market assuming an average 5% fall in earnings from lower volumes and worsening asset quality, with the range for RY, TD and BNS at 1-7%. From a P/B+1 perspective, the market seems to be implying an average hit of 12% to book values, with a range of 12-20% for the three largest banks.

Figure 143. Market Implied Hits to EPS+12m and BVPS+12m from Macro Risks

	PE +2y fwd		PB +2y fwd		Implied downgrade to:	
	Current	LT Average	Current	LT Average	EPS +12m	BVPS +12m
CA Banks Index	10.12	10.71	na	na	-5.5%	na
RY	10.51	10.82	1.83	2.09	-2.9%	-12.4%
TD	10.05	10.85	1.53	1.78	-7.4%	-14.0%
BNS	10.37	10.42	1.64	2.04	-0.5%	-19.6%
Memo:						
BMO	9.64	10.44	1.33	1.68	-7.7%	-20.8%
CM	9.24	9.81	1.84	1.98	-5.8%	-7.1%
NA	9.22	9.19	1.62	1.66	0.3%	-2.4%
LB	7.83	9.22	0.93	0.95	-15.1%	-2.1%
CWB	11.07	10.94	1.47	1.7	1.2%	-13.5%

Source: Datastream (consensus used for non-covered names), Citi Research

Our stress test shows the market is overly worried

We Think the Market Is Overly Worried

In order to frame the potential macro risks to the banks, we run a stress test on asset quality and margins. We calculate hits to earnings on the assumption that the cost of risk reaches peak-2009 levels and margins revisit the lows of 2006-7 (in the case of Scotiabank, 2008-11). Figure 144 shows our macro stress test parameters.

Figure 144. Macro Stress Test Parameters

	PCL / Average Loans			NIM / Average Loans		
	Peak	when	2013E	Trough	when	2013E
Domestic Banking System	0.95%	2009	0.42%	1.52%	2007	1.76%
RY	0.82%	2009	0.33%	1.54%	2007	1.95%
TD	1.04%	2009	0.42%	1.68%	2006	1.95%
BNS	0.62%	2009	0.33%	1.79%	2008, 2009, 2011	1.84%

Source: Company reports, OSFI, Citi Research

Our results point to cumulative hits of c.20-80% to our 2013E earnings forecasts, i.e. the stress test never results in book value erosion as implied by current market multiples. It is also instructive to compare our results with what happened in the crisis years of 2002 and 2008: with the exception of TD in 2002, the three major Canadian banks did not see earnings decline by more than 24%. The domestic banking sector, meanwhile, saw earnings decline -28% in 2002 and -37% in 2008.

Figure 145. Stress Test Results – Hits to 2013E EPS Estimates

	Asset Quality	Margins	Actual 2002	Actual 2008
Domestic Banking System	-22%	-22%	-28%	-37%
RY	-27%	-50%	-18%	-18%
TD	-35%	-30%	>-100%	-10%
BNS	-18%	-5%	-18%	-24%

Source: Company reports, OSFI, Citi Research

We are of the opinion that the market is overly worried about macro risks emerging from the Canadian households.

Hence, we are of the opinion that the market is overly worried about macro risks emerging from the Canadian households. Canada's hands-on regulation, moderating house prices and normal debt service ratio should mean a soft landing rather than the implosion the market seems to be pricing in, in our view.

This is the reason why we believe the cost of equity for the Canadian banks should be 1-2% lower than that currently implied by the market (see section *III. Rerating Potential*).

Government's Involvement in the Housing Market: A Double-Edged Sword

The Government insures C\$572bn, or more than half, of Canadian mortgage and related credit through the CMHC

The Canadian Mortgage Housing Corporation (CMHC), wholly owned by the Canadian government, takes an active role in the country's housing market. The CMHC:

- Insures mortgages against credit risk for the banking system, in parallel with private mortgage insurers;
- Pools mortgages for use in NHA (National Housing Act) securitisations;
- Controls the Canada Housing Trust (CHT) which issues Canadian Mortgage Bond (CMB) to investors – in order to buy NHA securitisations from the banks.

The CMHC currently has an insurance-in-force (IIF) book of C\$576bn (32% of GDP), meaning that c.50% of all Canadian mortgages are insured by the government. Total IIF grew 1.7% over 6M12 (Figure 146). The average LTV on its books is 55%, with high ratio homeowners (>80% LTV at origination) currently at 67% LTV and low ratio homeowners at 44% LTV (Figure 147).

Figure 146. CMHC – Insurance in Force (\$bn)

	30-Jun-12	30-Jun-11	% chg
Total Insurance in force	576.0	566.5	1.7%
High Ratio Homeowner	292.0	285.5	2.3%
Low Ratio Homeowner	244.8	242.8	0.8%
Multi-unit Residential	39.2	38.2	2.6%

Source: CMHC

Figure 147. CMHC – Distribution of Insurance-in-Force by LTV

		30-Jun-12			31-Dec-11
		High Ratio Homeowner	Low Ratio Homeowner	Overall	Overall
LTV Range					
0%	50%	9%	37%	23%	22%
50%	60%	5%	18%	12%	12%
60%	70%	12%	22%	17%	16%
70%	80%	28%	22%	24%	25%
80%	90%	31%	1%	16%	17%
90%	95%	13%	0%	7%	7%
95%	+	2%	0%	1%	1%
Average LTV		67%	44%	55%	56%
Average equity		33%	56%	45%	44%

Source: CMHC

OSFI believes CMHC is adequately capitalised for a 15-20% fall in house prices

Worries have surfaced about the potential liability to the Canadian government should the consumer implode. With a current c.80% total debt/GDP, Canada's government could theoretically soar to 112% of GDP upon a full loss (before collateralisation). In our discussions with the Canadian regulators it was pointed out that CMHC has been subjected to stress tests (results are not published). The insurer was found to be adequately capitalised and to be able to weather house price declines of 15-20%. Historically, fees have covered actual losses.

The Government and regulators are taking a more cautious approach towards mortgage insurance. Recent steps taken include: 1) a tightening of risk factors applied for capital purposes to CMHC's balance sheet; 2) a lowering of the annual limit on mortgage insurance; 3) a prohibition of HELOC insurance; and 4) the permission for banks to use uninsured mortgages in covered bond issuance.

One question remains, however: will less CHMC involvement mean higher mortgage rates for consumers?

Opportunities in Canadian Corporate and International Lending

Canadian Corporate Loans

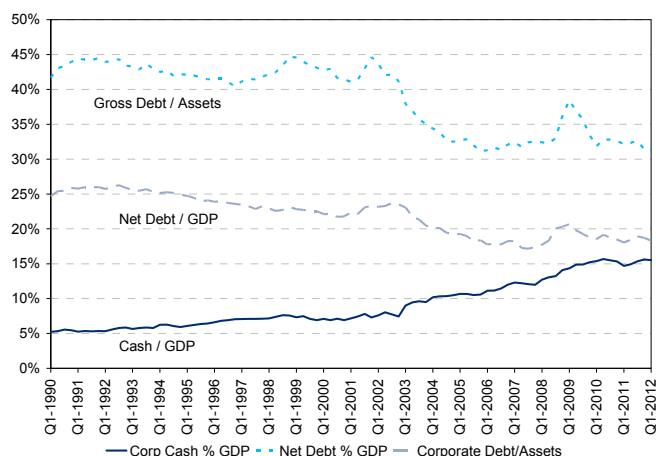
We believe the potential for corporate lending to make up for the slowdown in consumer lending is material

As consumer leveraging, especially that related to housing, comes to an end, the Canadian banks have oriented themselves towards growing their corporate loan books. We believe the potential for corporate lending to make up for the slowdown in consumer lending is material – but should materialise over the medium, rather than the short, term.

Canadian corporates are cash rich and ‘under-levered’

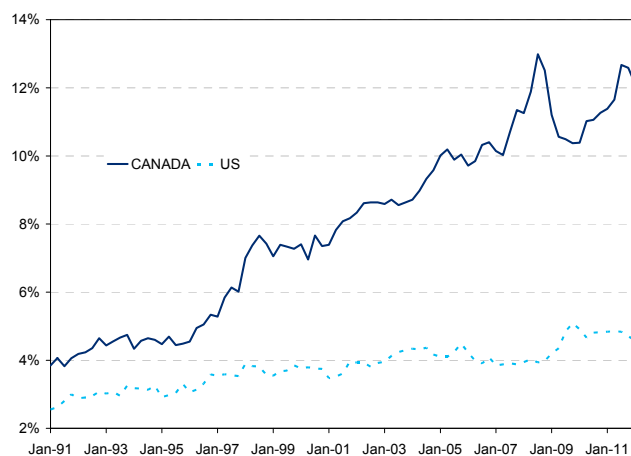
Canadian corporates have generated substantial cash reserves over the past 20 years driven mainly by US demand for Canadian energy products and a booming domestic economy (Figure 148). This strong cash generation has made it more likely that Canadian corporates self-fund investment rather than borrow. In 1991, cash represented 3.8% of assets on the corporate balance sheet versus 2.6% for US corporates (as the closest comparable to Canadian corporates, Figure 149). As of June 2012, cash represented 12.4% of Canadian corporate assets versus 4.5% in the US. Thus corporate leverage in Canada fell to 18% of corporate assets from 24% in 1990.

Figure 148. Cash Represents 16% of Canadian GDP...



Source: Haver, Citi Research

Figure 149. ...and 12% of Corporate Assets vs. 5% in the US

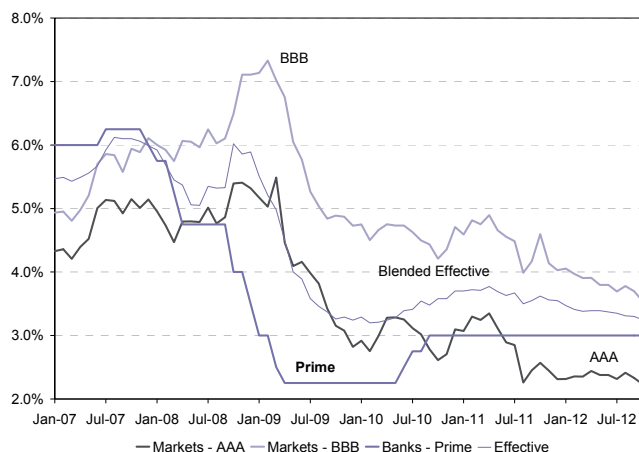


Source: Haver, Citi Research

The banks have become less competitive providers of funding to the corporates

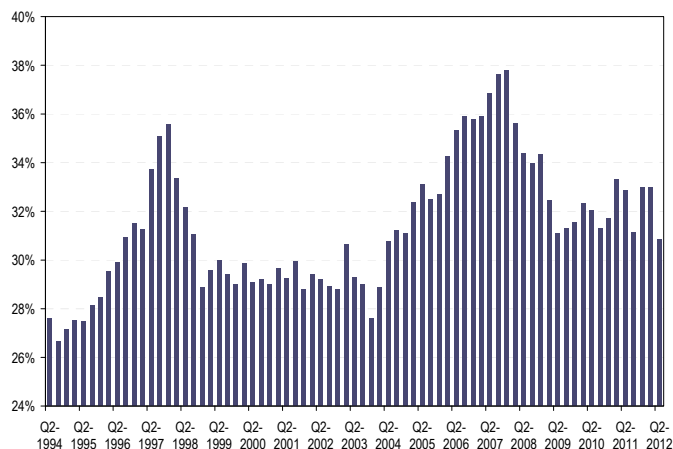
Recently, the banks have become less competitive providers of funding to the corporates – at least in terms of cost. Starting in 2Q10, the Prime Bank Rate (a benchmark of the cost of bank lending to corporates) gradually increased from a low of 2.25% to its present day level of 3.00%. Over the same period, the AAA corporate bond yield declined by 100 bps (Figure 150).

Figure 150. A Rise in the Prime Rate Relative to the AAA Corporate Bond Yield...



Source: Haver, Citi Research

Figure 151. ...Has Coincided with Banks' Share of Corporate Credit Declining to 31-33% of the Total, Down from 37%



Banks' share of corporate lending now stands at 31-33%

Banks' share of corporate lending now stands at 31-33%, down from a peak of 37% (Figure 151). Corporates' deep cash reserves and low corporate yields, largely driven by the global search for yield in a low interest rate environment, have thus resulted in partial disintermediation of the Canadian banks in the area of corporate lending.

The Future

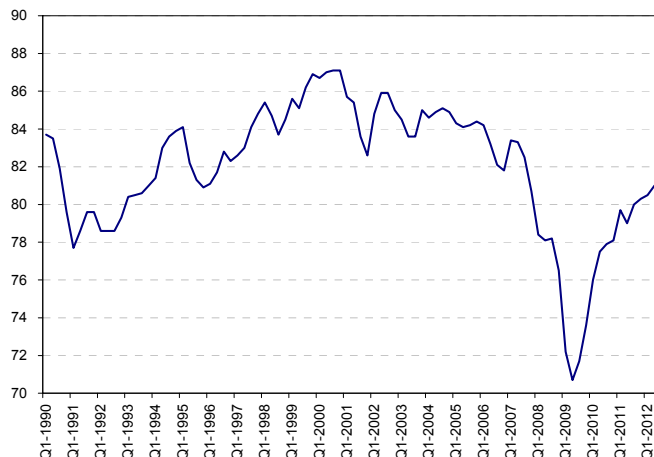
So what would make Canadian corporates take out more loans? We believe two conditions would have to be met:

6-12% upside to sector earnings should banks recapture lost share of lending to corporates

■ **Lower bank lending costs:** while the prime rate is only an indication of the cost of bank credit to corporates (many obtain rates below the prime), the effective business rate as calculated by Bank of Canada shows that chartered banks' "price" for extending credit to prime corporates is above that of the capital markets. While a competitive decrease of banks' business loan rates would likely impact margins negatively, the corresponding increase in volumes may more than offset that decline. There are some indications that banks are starting ease corporate lending conditions to better compete with the capital markets (Figure 153). **We estimate that a reversal of the market share losses suffered by the banks could result in c. C\$55bn of additional corporate loans over three years, equivalent to 5% p.a. increase over and above current corporate growth rates. Under the same upside scenario, sector earnings could increase 6-12%.**

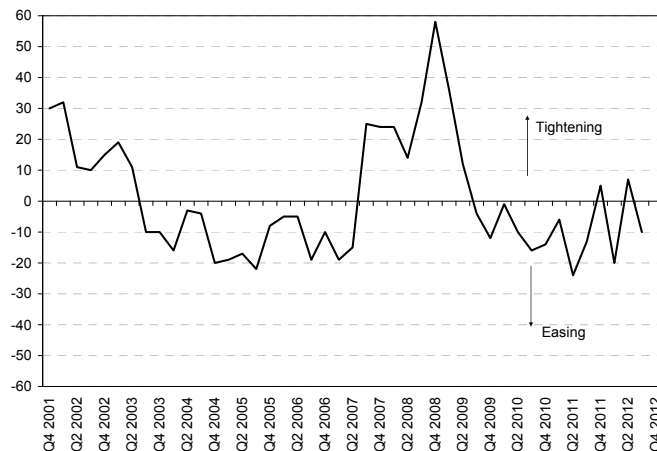
■ **Targeting medium and small corporates:** top-rated corporate credit is in high demand worldwide. One avenue for the Canadian banks to respond to the competition from capital markets would be to increase lending to lower rated corporates, usually medium and small enterprises. While BBB yields in the capital markets have also declined, we believe the banks could pick up quality corporate business with more certainty in that space.

Figure 152. Capacity Utilization Continues to Increase...



Source: Datastream, Citi Research

Figure 153. ...and Corporate Executives Report Easing of Bank Credit



TD has the strongest momentum in corporate lending

The bank with the strongest momentum in Canadian corporate lending yoy, both secured and unsecured, is TD (Figure 154 and Figure 155). Scotiabank also shows positive momentum yoy in the secured corporate lending space.

Figure 154. Business Loans (C\$) Market Shares – 09 / 2012

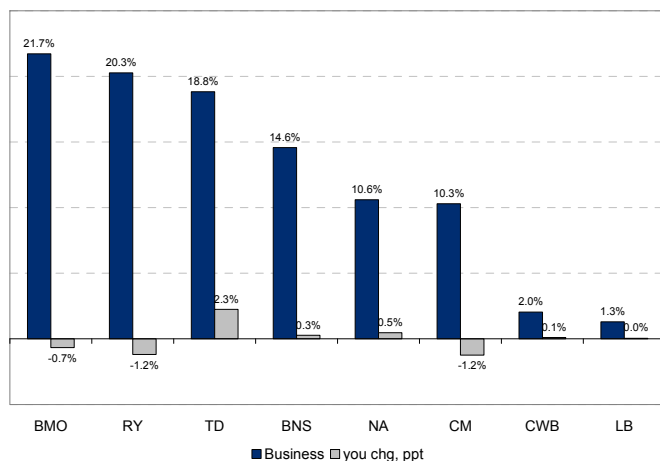
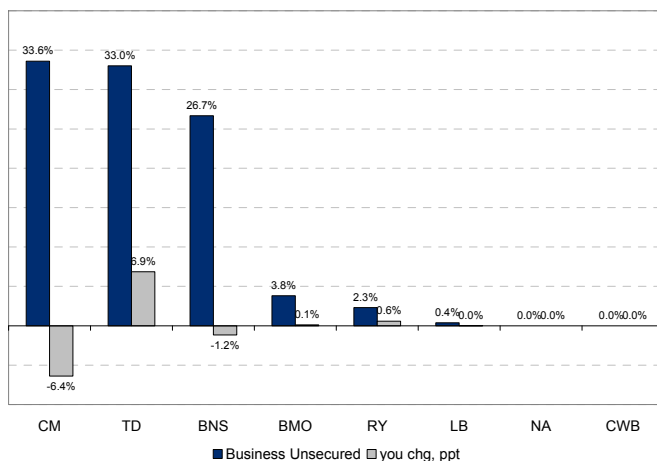


Figure 155. Business Unsecured Loans (C\$) Market Share– 09 / 2012



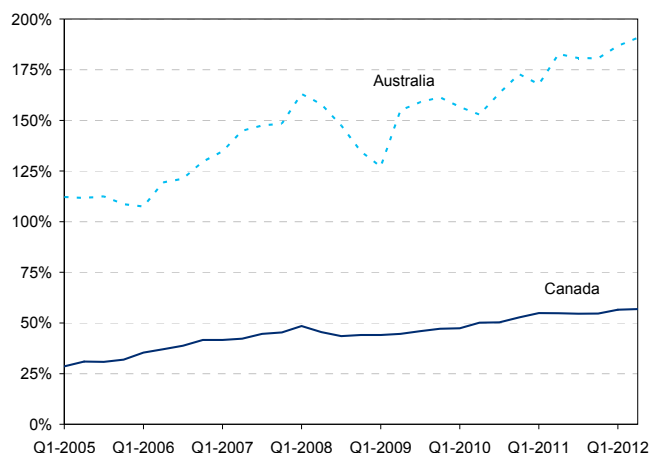
Source: OSFI

International Lending

Over a period of seven years, Canada's banks accumulated cross-border exposures worth 28% of GDP while Australia's banks accumulated claims worth 79% of GDP

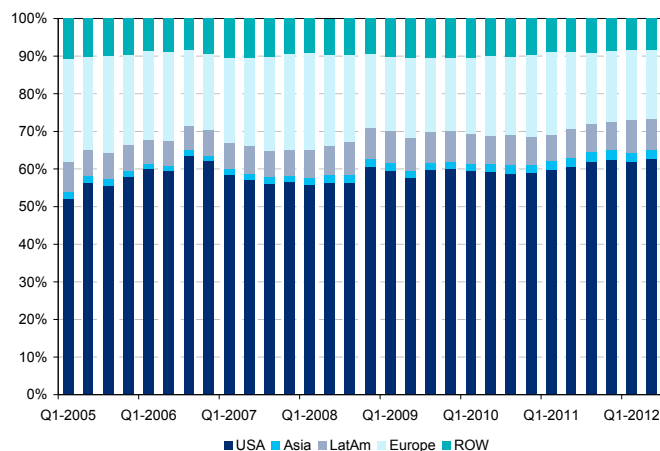
Until the mid-2000s, Canadian banks' cross-border exposures represented 29% the country's GDP – compared to 112% for Australia's banks (Figure 156). Since 2005, Canadian cross-border exposure increased to 57% of GDP, largely driven by a growth in US claims, and to a lesser degree LatAm claims (Figure 157). While meaningful, the increase still pales in comparison to the rise in Australian cross-border exposures to 191% of that country's GDP. So over a period of seven years, Canada's banks accumulated cross-border exposures worth 28% of GDP while Australia's banks accumulated claims worth 79% of GDP.

Figure 156. While Canadian Banks' X-Border Exposures Have Increased Meaningfully, They Still Represent 57% of Canada's GDP – vs 191% for Australia's Banks



Source: BIS, Haver, Citi Research

Figure 157. US Claims Dominate Canadian Banks' X-Border Exposures - Banks' Cross-Border Exposures as % Total, 2005-2012 (%)



Canadian banks' cross-border exposures have generally followed the direction of Canadian exports – the United States

Canadian banks' cross-border exposures have generally followed the direction of Canadian exports – the United States. Most of the big 5 banks have or have had meaningful US operations. **Toronto Dominion** has been successful in the Northeast retail banking market largely via an M&A strategy. Bank of Montreal has focused on corporate lending in the Midwest. On the other hand, Royal Bank of Canada sold its US business last year, while CIBC's operations have shrunk significantly.

Bank of Nova Scotia, on the other hand, has pursued more of an emerging markets strategy. It derives c. 31% of its revenues and c. 28% of profits from markets in Asia and Central/Latin America (mainly through acquisitions). However, Scotiabank lacks scale internationally, usually being the number 5 or so player in most of its markets.

The Future

The Canadian Prime Minister has recently talked about the need for Canada to diversify the customer base of its exports away from the US. While the US is currently recovering economically, the global financial crisis showed to the Canadians the risk of putting all (or almost all) of the country's proverbial eggs in the US basket. As links with Asia and Latin America intensify and trade increases, we expect the Canadian banks' opportunities for export financing, energy/infrastructure financing and corporate lending to increase.

- **On our estimates, Scotiabank should derive 36% of group revenues and 31% of profits from international banking by 2015, an increase of 4 ppt and 3 ppt respectively since 2011.** We believe there is an opportunity for the bank to consolidate its market standing in markets where it is currently present, such as Colombia, Peru and Chile, while pursuing attractive acquisitions elsewhere in Asia and LatAm.
- **In the US, Toronto Dominion and Bank of Montreal are likely to continue to provide a valuable proposition to customers when compared to their US money centre and regional peers.** TD is targeting a #3 ranking by market share in the broader New York City area, which in the words of CEO Ed Clark has deposits worth "75% of Canada's".

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Canada's Banking System

Structure of Canada's Banking System

Four main actors in Canada's banking system

Canada's banking system was one of the most resilient during the crisis of 2008-9. In our opinion, this was not only due to the clear institutional and legal setup, but also to proactive regulators and transparent disclosures. The main 'actors' in Canada's banking system are:

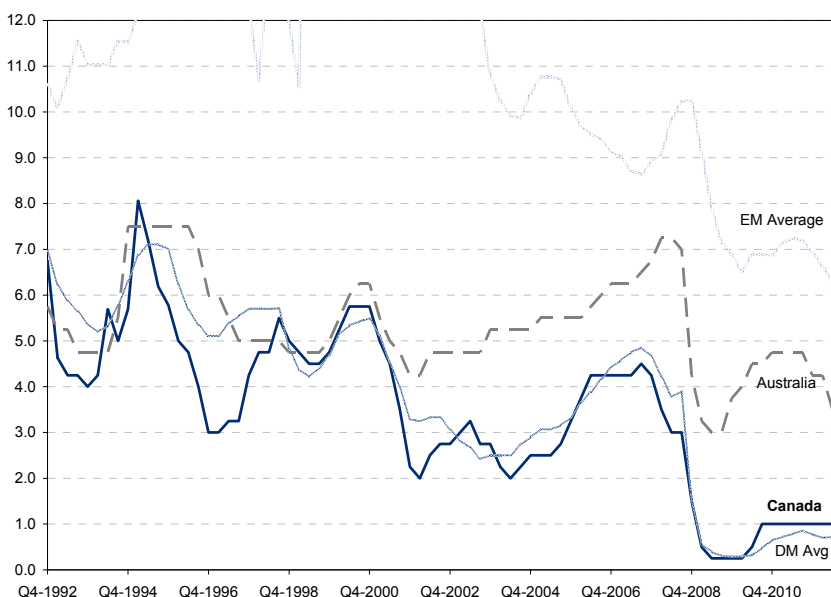
- **Bank of Canada** which sets monetary policy and is a lender of last resort;
- **Commercial banks** which transmit monetary policy into the economy;
- **The Canadian Federal Government**, which can issue macroprudential regulations through the Department for Finance – and provide support to the industry in the form of mortgage insurance, for instance, via the Canada Housing Mortgage Corporation;
- Regulators, i.e. the **Office of the Superintendent for Financial Institutions (OSFI)** which is the primary banking regulator, and the Bank of Canada as a second regulator.

Central Bank and Monetary Policy

Canada's monetary policy is based on two main components: a flexible exchange rate and inflation targeting

Canada's monetary policy is based on two main components: **a flexible exchange rate and inflation targeting**. In terms of FX movements, the central bank generally has had a policy of no intervention, leaving the Canadian dollar ("the loonie") to act as a shock absorber. Inflation targeting was first introduced by the Bank of Canada in 1991. Currently, the target range is 1-3%, with the bank aiming to keep inflation at the 2% midpoint. The Bank of Canada's key interest rate target is the Overnight Interbank Rate which has been managed to a level of 1% since at least 2011 (Figure 158).

Figure 158. Official Key (or Policy) Interest Rates in Canada, Australia, EM and DM (%)



Source: Haver, Citi Research

Lender of Last Resort

The central bank also serves as a lender of last resort via two facilities.

- **Standing Liquidity Facility (SLF)** supports settlement in the payments system by providing collateralised, overnight loans to direct participants in the payments system who are experiencing temporary shortfalls in their settlement balances;
- **Emergency Lending Assistance (ELA)** is collateralised lending for a maximum of six months but can be renewed. It is usually priced by the Bank of Canada at the Bank Rate. According to the central bank, the ELA is meant to be “*extraordinary and provides credit to institutions judged to be solvent, but that are, nevertheless, facing serious and persistent liquidity problems*”. Credit union locals and caisses populaires would not generally be eligible for ELA.

Commercial Credit Institutions

Figure 159. Chartered Banks Represent the Vast Majority of Canada's Commercial Credit System (\$m as of June 2012)

	Chartered Banks *	Trust & Mortgage Companies	Credit Unions & Caisses Populaires	Non-depositary credit intermediation	TOTAL
Assets	3,735	54	288	222	4,299
Loans (CDN business)	1,629	37	239	102	2,007
Deposits (CDN business)	1,334	29	241	0	1,605
Shareholders' Equity	206	4	21	49	280
Assets / Equity	18.2	14.1	13.6	4.5	15.4
LDR (CDN\$ business) **	122%	126%	99%	na	125%
% Split					
Assets	87%	1%	7%	5%	100%
Loans (CDN business)	81%	2%	12%	5%	100%
Deposits (CDN business)	83%	2%	15%	0%	100%
Shareholders' Equity	74%	1%	8%	18%	100%

Source: Bank of Canada, Statistics Canada, Haver, Citi Research * As of July 2012 ** Canadian currency business (mostly in Canada); LDRs for overall business volumes are largely <100% due to excess deposits abroad, mainly in the US

Chartered banks represent 87% of system assets

The Canadian commercial credit system is composed of five different groups of banks, of which ‘chartered banks’ make up the bulk.

- **Chartered banks – 87% of assets** – are Canadian banks registered on the basis of the 1991 Canada Banking act. They include three subtypes:
 - Schedule I banks: domestic Canadian banks (24 currently), including the Big 5 and National Bank of Canada (together, the Big 6)
 - Schedule II banks: subsidiaries of foreign banks (25 currently, of which three are in liquidation);
 - Schedule III: branches of foreign banks (23 full service and five lending-only currently).
- **Government-owned banks** – Business Development Bank of Canada and Alberta Treasury Branches.

Credit unions and *caisses populaires* are most prevalent in Quebec

- **Trust & Mortgage companies** – 1% of assets – these are depositary-taking institutions whose existence technically pre-dates the ‘chartered banks’ concept. In the 1990s and 2000s, a number of chartered banks bought up the large Canadian trusts.
- **Credit unions and *caisses populaires* – 7% of assets** - these are regional, mutually-owned, deposit taking institutions. Desjardins (\$190bn of assets) is the main credit union in Canada (based in Quebec). Fonds de Sécurité de la Confédération Desjardins (CFSCD) and the Credit Union Central of Canada (CUCC) provide liquidity to the credit unions.
- **Non-depositary credit intermediation – 5% of assets** – these institutions predominantly fund in the capital markets.

Figure 226 in the Appendices lists Canada's banks by ownership and type.

Asset Market Shares

Figure 160. Total Assets (CADm) of banks registered with the OSFI

Rank 2011	Rank 2010	Bank Name	Reuters Code	31-Oct-11	31-Oct-10	% chg
1	1	Royal Bank of Canada	RY.TO	751,202	726,206	3.5%
2	2	The Toronto-Dominion Bank	TD.TO	686,360	619,545	10.8%
3	3	The Bank of Nova Scotia	BNS.TO	575,256	526,657	9.2%
4	4	Bank of Montreal	BMO.TO	477,423	411,640	16.0%
5	5	Canadian Imperial Bank of Commerce	CM.TO	353,699	352,040	0.5%
6	6	National Bank of Canada	NA.TO	156,297	145,301	7.6%
7	7	HSBC Bank Canada	HSBA.L*	80,328	72,699	10.5%
8	8	ING Bank of Canada	ING.AS*	38,539	30,843	25.0%
9	9	Laurentian Bank of Canada	LB.TO	24,490	23,800	2.9%
10	10	Manulife Bank of Canada	MFC.N*	20,686	16,696	23.9%
11	11	Canadian Western Bank	CWB.TO	14,772	12,702	16.3%
12	12	Bank of America, National Association	BAC.N	12,058	11,469	5.1%
13	13	CitiBank Canada	C.N*	11,597	10,018	15.8%
14	14	Citibank, N.A.	C.N	8,672	9,386	-7.6%
15	16	MBNA Canada Bank	TD.TO*	8,588	7,394	16.1%
16	15	Dundee Bank of Canada	BNS.TO*	8,132	7,956	2.2%
17	20	Deutsche Bank AG	DBKGn.DE	7,606	4,920	54.6%
18	17	JPMorgan Chase Bank, National Association	JPM.N	6,141	5,558	10.5%
19	18	Societe Generale	SOGN.PA	5,662	5,345	5.9%
20	21	ICICI Bank Canada	ICBK.NS*	5,153	4,902	5.1%
21	23	State Street Bank and Trust Company	STT.N	4,949	3,788	30.7%
22	29	Capital One Bank (USA), N.A.	COF.N	4,732	1,989	137.9%
23	26	Canadian Tire Bank	CDNTF.PK	4,728	3,010	57.1%
24	22	Amex Bank of Canada	AXP.N*	4,181	4,744	-11.9%
25	24	Bank of Tokyo-Mitsubishi UFJ (Canada)	8306.T*	3,295	3,121	5.6%
Total of 25 largest OFSI registered banks				3,275,047	3,021,729	8.4%
Total of all OSFI registered banks				3,311,071	3,051,346	8.5%

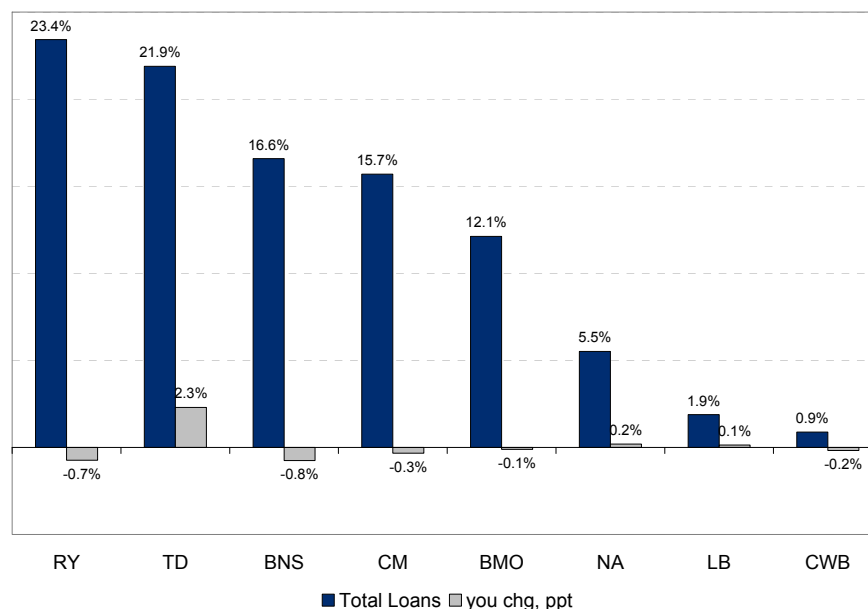
* Reuters Code for parent company

Source: PWC; OSFI (Office of the Superintendent of Financial Institutions of Canada)

Market Shares – Loans

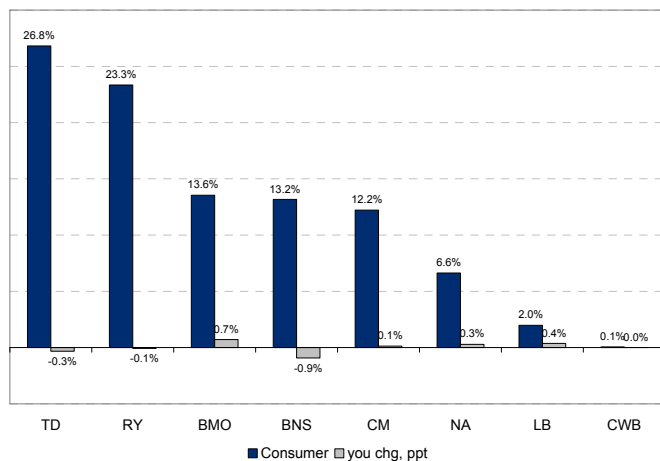
NOTE: Market shares shown are for Canadian \$ loans and are percentages of total domestic bank loans (Schedule I banks, c.90% of the credit system)

Figure 161. Total Loans – 09 / 2012



Source: OSFI, Citi Research

Figure 162. Consumer Loans – 09 / 2012



Source: OSFI, Citi Research

Figure 163. Consumer Unsecured – 09 / 2012

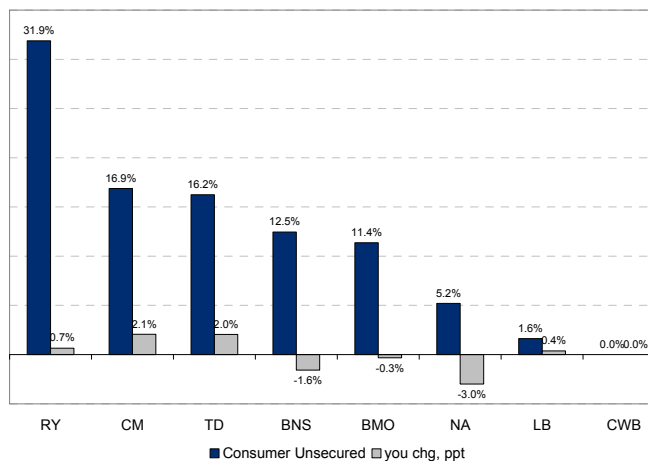
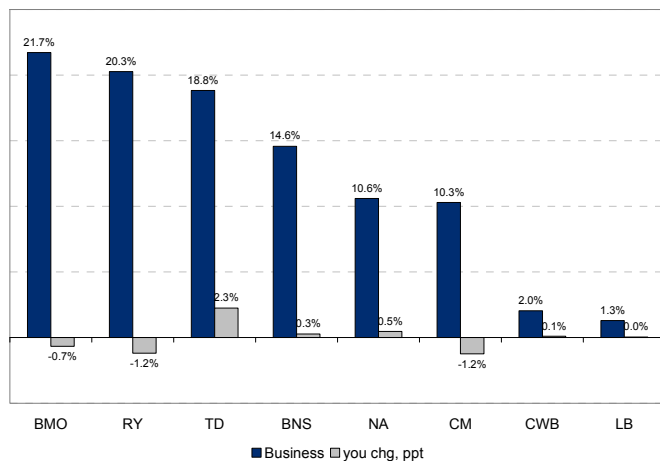


Figure 164. Business – 09 / 2012



Source: OSFI, Citi Research

Figure 165. Business Unsecured – 09 / 2012

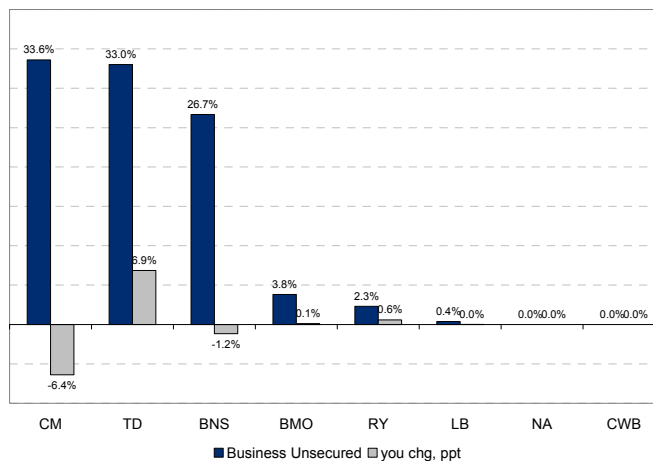
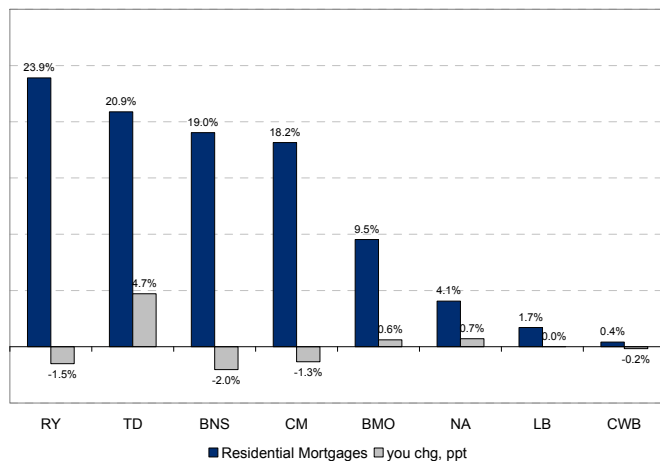
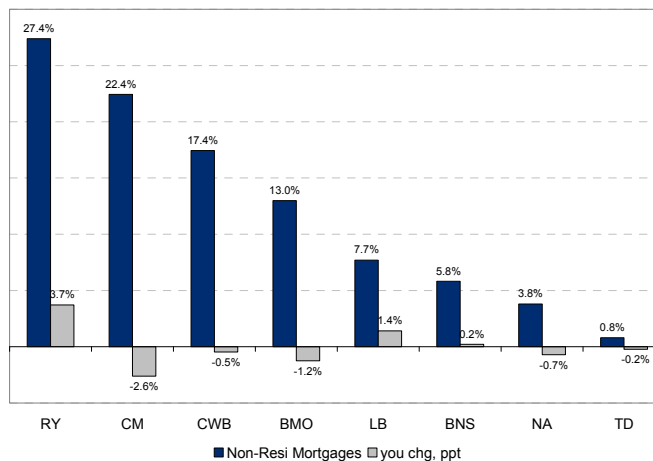


Figure 166. Residential Mortgages – 09 / 2012



Source: OSFI, Citi Research

Figure 167. Non-Residential Mortgages – 09 / 2012



Market Shares – Deposits

NOTE: Market shares shown are for Canadian \$ loans and are percentages of total domestic bank loans (Schedule I banks, c.90% of the credit system)

Figure 168. Total Deposits – 09 / 2012

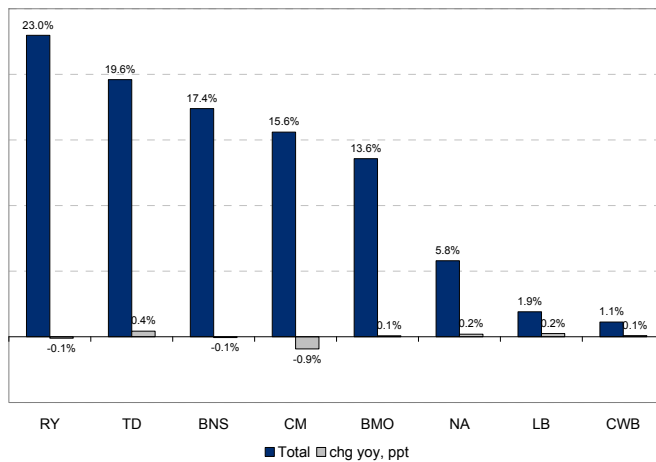
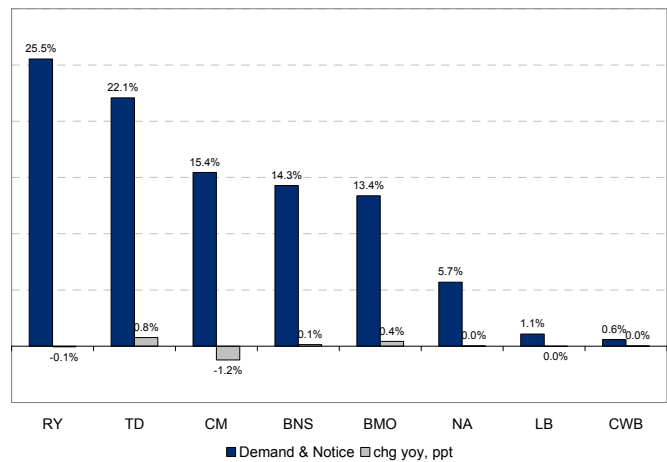


Figure 169. Demand Deposits – 09 / 2012



Source: OSFI, Citi Research

Figure 170. Fixed Term Deposits – 09 / 2012

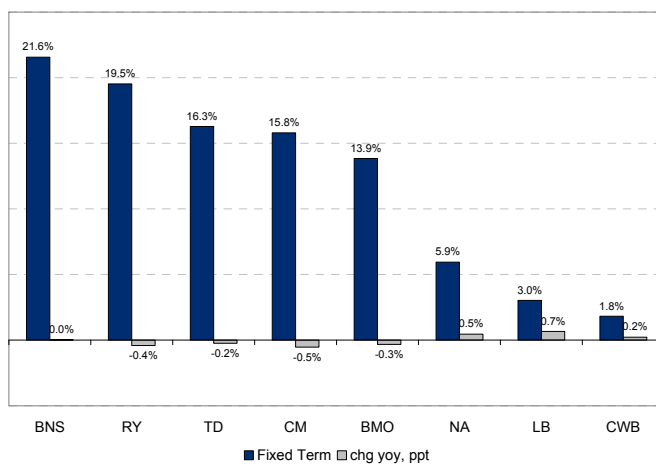
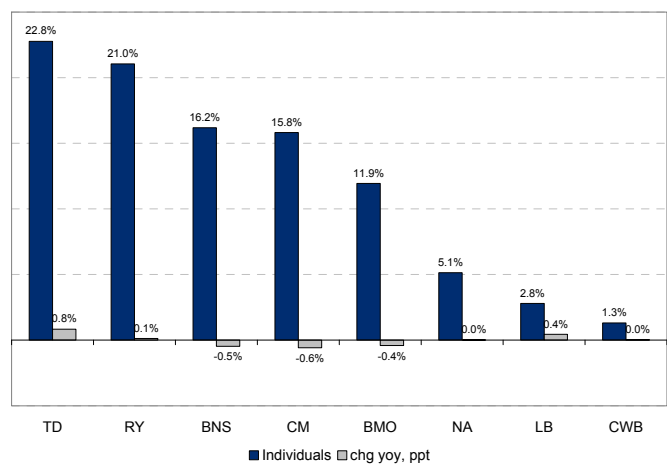


Figure 171. Deposits by Individuals – 09 / 2012



Source: OSFI, Citi Research

Figure 172. Deposits by Businesses – 09 / 2012

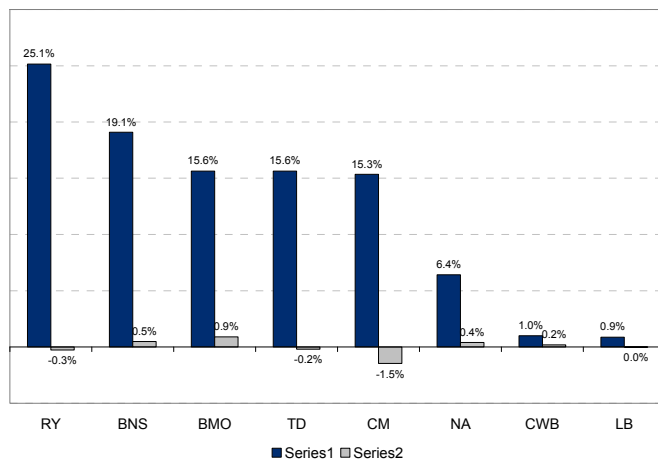
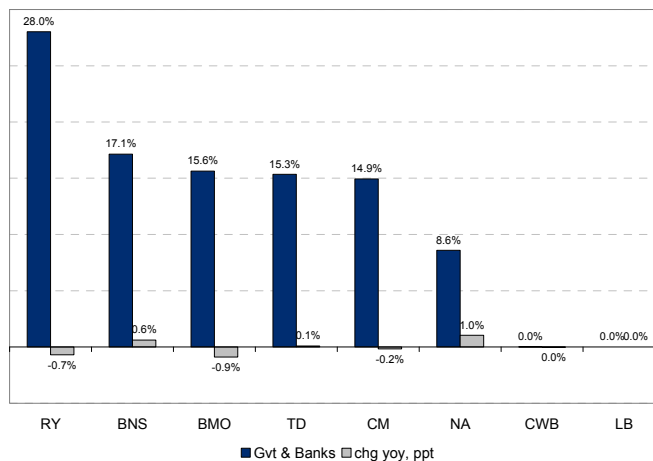


Figure 173. Deposits by Government & Banks – 09 / 2012



Source: OSFI, Citi Research

Fundamental Trends, Balance Sheet & Income Statement

Banking Penetration

Figure 174. Canada Has a Lower Level of Banking Assets-to-GDP vs. Australia – and Close to the US Level if One Includes Fannie/Freddie - Total Assets / GDP, 1991-2012 (%)

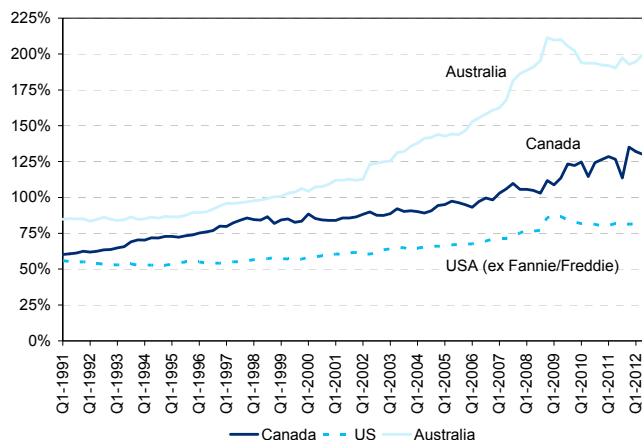
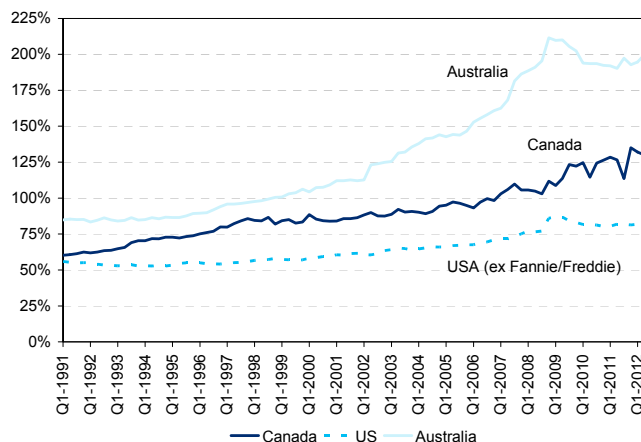


Figure 175. Canadian Lending Penetration Is Not Excessive - Banks' Private Sector Lending % GDP, 1991-2012 (%)



Source: Datastream, Citi Research

Profitability

Figure 176. ROE & ROTE *

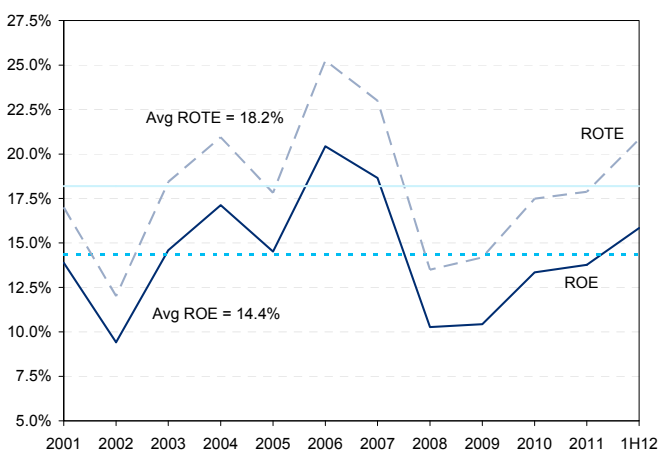
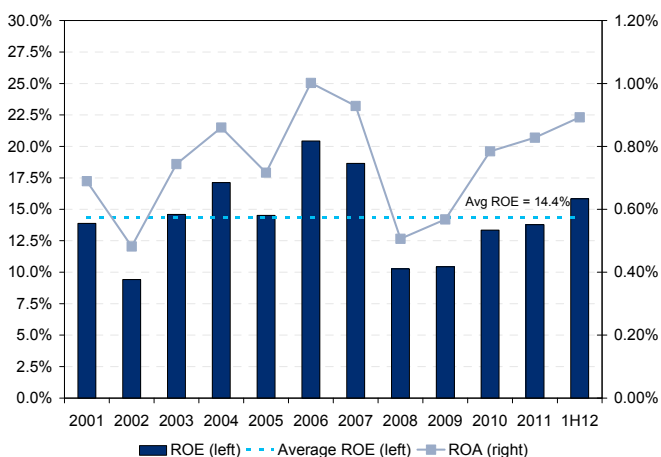


Figure 177. ROE & ROA



Source: Company reports, Citi Research * On average common and tangible common equity

Figure 178. Canadian Domestic Banks – Consolidated Balance Sheet & Income Statement, 2000-2012 (\$bn)

CAD bn	Oct-00	Oct-01	Oct-02	Oct-03	Oct-04	Oct-05	Oct-06	Oct-07	Oct-08	Oct-09	Oct-10	Oct-11	Apr-12	Aug-12
ASSETS														
Cash and cash equivalent	79	79	84	83	73	90	94	106	124	117	140	154	191	193
Canada Govt securities	93	108	105	111	106	120	139	131	210	272	272	287	211	209
Corporate debt (net of allowance)	130	167	163	181	194	223	263	271	285	292	309	317	304	309
Corporate equity (net of allowance)	95	89	97	124	136	161	197	218	139	135	162	169	186	191
LOANS (incl repos)	816	876	883	870	914	1,010	1,123	1,223	1,412	1,385	1,518	1,645	2,046	2,123
Individuals	142	146	159	175	201	231	245	267	316	361	390	412	447	456
Reverse repos	99	127	116	114	116	144	181	192	179	169	229	249	305	326
Business	253	256	234	188	177	194	217	241	345	290	275	311	328	341
Mortgages	285	309	336	356	378	414	445	478	522	510	562	605	889	918
Total Assets	1,405	1,558	1,579	1,605	1,683	1,867	2,087	2,299	2,743	2,623	2,843	3,075	3,405	3,527
LIABILITIES														
Demand and notice deposits	294	337	366	387	425	476	514	541	688	804	896	1,009	1,043	1,094
Fixed-term deposits	672	696	694	680	690	770	863	959	1,080	919	958	1,015	1,060	1,075
Other (=debt?)	34	44	47	45	55	70	74	79	84	75	76	100	97	88
Subordinated debt	27	27	24	23	25	27	27	29	39	37	37	39	40	40
Shareholders' equity	72	80	83	86	89	95	107	106	132	152	165	185	183	192
(a) Preferred shares	9	9	9	9	7	5	6	8	13	19	20	20	18	18
(b) Common shares	16	21	21	22	23	26	27	27	41	49	53	63	66	67
(c) Contributed surplus	0	0	0	0	0	0	1	1	1	1	1	1	1	1
(d) Retained earnings	42	44	45	47	50	58	68	76	78	81	91	102	87	92
(e) Non-controlling interests	5	6	7	8	8	7	7	5	8	7	7	7	7	8
(f) Accumulated Other Comprehensive Income (Loss)								-12	-8	-5	-6	-6	4	6
Total liabilities and shareholders' equity	1,405	1,558	1,579	1,605	1,683	1,867	2,087	2,299	2,743	2,623	2,843	3,075	3,405	3,527
INCOME STATEMENT														
CAD bn	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	1H12	
Net interest income	28.1	31.4	31.3	31.7	31.2	31.1	33.3	39.0	45.5	47.2	50.1	28.5	28.1	
Non-interest income	31.7	28.9	29.9	31.9	35.3	39.7	40.5	27.2	38.8	42.3	46.3	23.6	31.7	
Total Revenues	59.8	60.4	61.1	63.6	66.4	70.9	73.8	66.2	84.3	89.5	96.4	52.1	59.8	
Non-interest expenses	40.7	41.9	41.7	43.1	46.8	44.1	46.4	47.2	53.7	53.6	57.6	30.5	40.7	
GOP	19.1	18.5	19.4	20.5	19.6	26.7	27.4	19.0	30.5	35.9	38.8	21.6	19.1	
Charge for impairment	5.9	8.9	3.7	1.3	1.9	2.1	3.1	5.9	11.6	7.4	5.8	3.3	5.9	
Net income before provision for income taxes	13.2	9.5	15.7	19.2	17.6	24.6	24.3	13.1	18.9	28.5	33.0	18.3	13.2	
Provision for income taxes	3.0	2.0	3.9	5.1	4.9	4.9	4.2	0.6	4.0	7.3	7.0	3.8	3.0	
Net income before discontinued operations	10.2	7.6	11.8	14.1	12.8	19.7	20.1	12.5	14.9	21.2	26.0	14.5	10.2	
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.1	0.3	0.3	0.3	0.2	-1.6	-0.1	0.0	
Net income attrib to equity holders & non-controlling interests	10.2	7.6	11.8	14.1	12.7	19.8	20.4	12.8	15.2	21.4	24.5	14.5	10.2	
Net income attributable to non-controlling interests	0.4	0.5	0.6	0.6	0.4	0.5	0.5	0.2	0.5	0.5	0.4	0.3	0.4	
Net income attributable to equity holders	9.8	7.1	11.2	13.6	12.3	19.3	19.8	12.6	14.8	21.0	24.0	14.2	9.8	

Source: Company Reports

Figure 179. Canadian Domestic Banks – Operating Metrics

Operating Ratios	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	1H12
ROE	13.9%	9.4%	14.6%	17.1%	14.5%	20.4%	18.7%	10.3%	10.4%	13.3%	13.8%	15.8%
ROTE	17.0%	12.0%	18.4%	20.9%	17.8%	25.3%	23.0%	13.5%	14.2%	17.5%	17.9%	20.8%
ROA	0.69%	0.48%	0.74%	0.86%	0.72%	1.00%	0.93%	0.51%	0.57%	0.78%	0.83%	0.89%
Assets/Total Shareholders' Equity	19.4	19.1	18.7	19.0	19.6	19.5	21.8	20.7	17.3	17.2	16.6	18.6
Assets/Total Tangible Shareholders' Equity	24.0	24.1	22.6	22.5	23.9	23.7	27.3	28.8	22.9	22.1	21.7	24.2
Tier 1 ratio								0.1%	0.1%	0.1%	0.1%	0.1%
LDR	84.8%	83.3%	81.5%	82.0%	81.1%	81.6%	81.5%	79.9%	80.4%	81.9%	81.2%	97.3%
LDR (ex repos)	72.4%	72.3%	70.8%	71.6%	69.5%	68.4%	68.7%	69.8%	70.6%	69.6%	69.0%	82.8%
NIM (on avg assets)	1.90%	2.00%	1.96%	1.93%	1.76%	1.57%	1.52%	1.55%	1.70%	1.73%	1.69%	1.76%
Non-NII / Avg assets	2.14%	1.85%	1.88%	1.94%	1.99%	2.01%	1.85%	1.08%	1.44%	1.55%	1.56%	1.45%
Non-NII / Revenues	53.0%	47.9%	48.9%	50.1%	53.1%	56.1%	54.8%	41.1%	46.0%	47.2%	48.0%	45.2%
Trading Income / Revenues	9.5%	5.4%	6.3%	4.4%	5.6%	8.6%	4.9%	-11.4%	5.5%	4.3%	2.2%	4.2%
Marks & Trading Income / Revenues	11.1%	5.0%	6.5%	6.4%	8.2%	10.2%	6.6%	-13.1%	3.6%	4.9%	3.5%	5.3%
Costs / Avg assets	2.75%	2.67%	2.62%	2.62%	2.64%	2.23%	2.12%	1.87%	2.00%	1.96%	1.95%	1.89%
Efficiency Ratio	68.1%	69.4%	68.2%	67.8%	70.5%	62.3%	62.9%	71.3%	63.7%	59.9%	59.8%	58.6%
Provisions / Avg loans	0.81%	1.18%	0.49%	0.16%	0.23%	0.24%	0.31%	0.52%	0.95%	0.59%	0.43%	0.42%
Provisions / Avg assets	0.40%	0.57%	0.23%	0.08%	0.11%	0.11%	0.14%	0.23%	0.43%	0.27%	0.19%	0.20%
Tax Rate	22.5%	20.9%	24.6%	26.4%	27.7%	19.9%	17.4%	4.8%	21.1%	25.6%	21.1%	20.6%
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	1H12
Asset Yield	6.20%	4.77%	4.53%	4.25%	4.52%	5.00%	5.38%	4.86%	3.75%	3.29%	3.31%	3.30%
Cash & Repos	1.77%	1.01%	0.78%	0.83%	1.05%	1.22%	1.43%	1.23%	0.43%	0.32%	0.25%	0.16%
Gvt securities	4.20%	3.80%	3.58%	2.69%	2.54%	2.53%	2.41%	2.15%	2.09%	1.84%	1.90%	1.39%
Other securities	4.26%	3.49%	3.11%	3.21%	3.57%	3.73%	4.08%	3.96%	3.14%	2.49%	2.70%	1.95%
Leasing	3.27%	3.26%	3.41%	2.68%	2.23%	3.24%	2.90%	4.24%	4.18%	3.44%	3.76%	1.92%
Loans	7.52%	5.72%	5.62%	5.23%	5.46%	6.14%	6.59%	5.87%	4.61%	4.17%	4.13%	4.36%
Mortgages	6.65%	5.90%	5.52%	5.03%	4.84%	5.10%	5.35%	5.19%	4.04%	3.74%	3.72%	4.22%
Residential	6.62%	5.84%	5.45%	4.96%	4.73%	4.97%	5.22%	5.07%	3.87%	3.63%	3.58%	4.12%
Non-residential	7.05%	6.80%	6.63%	6.17%	6.37%	6.69%	7.08%	6.55%	5.75%	4.85%	5.07%	5.56%
Non-Mortgages	8.03%	5.61%	5.68%	5.39%	5.92%	6.88%	7.45%	6.31%	4.96%	4.44%	4.39%	4.45%
Individual	8.74%	7.05%	7.25%	7.01%	6.82%	7.55%	8.08%	7.44%	6.32%	5.51%	3.33%	3.85%
Business	7.75%	5.01%	4.88%	4.36%	5.31%	6.44%	7.06%	5.63%	4.02%	3.61%	5.20%	4.89%
Funding Costs	4.18%	2.54%	2.35%	2.10%	2.59%	3.32%	3.77%	3.08%	1.76%	1.33%	1.38%	1.30%
Demand and notice deposits	2.60%	1.19%	1.10%	0.93%	1.18%	1.76%	2.19%	1.62%	0.55%	0.36%	0.48%	0.53%
Fixed term deposits	4.98%	3.08%	2.82%	2.57%	3.07%	3.97%	4.52%	3.93%	2.58%	2.08%	2.03%	1.77%
Subordinated debt	6.62%	5.73%	5.72%	5.77%	5.85%	5.93%	5.83%	5.47%	4.81%	4.75%	4.91%	5.16%
Other	3.78%	2.63%	2.65%	2.37%	3.25%	3.76%	4.00%	2.99%	1.69%	1.30%	1.62%	1.94%
NIM (simple difference)	2.01%	2.23%	2.18%	2.14%	1.93%	1.68%	1.60%	1.78%	2.00%	1.96%	1.93%	2.00%

Source: Company Reports

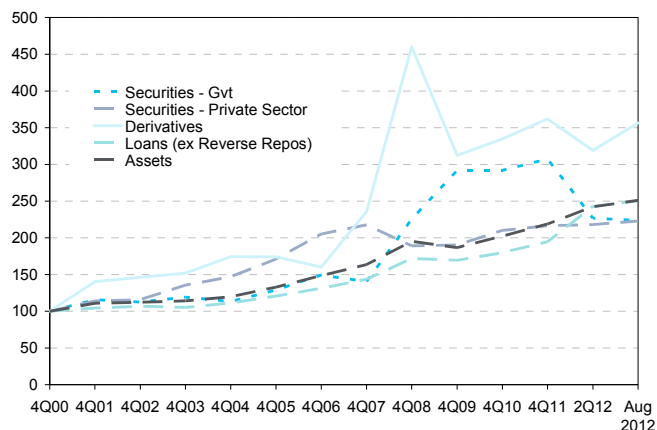
Figure 180. Canadian Domestic Banks – Asset Quality

Gross Impaired Loans (GIL) % Loans	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	1H12
Deposits with financial institutions	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Securities	0.03%	0.02%	0.02%	0.02%	0.00%	0.00%	0.00%	0.01%	0.01%	0.00%	0.00%	0.00%	0.00%
Loans	1.21%	1.50%	1.66%	1.21%	0.76%	0.51%	0.43%	0.44%	0.76%	1.30%	1.26%	0.86%	0.68%
Non-mortgage loans	1.67%	2.10%	2.49%	1.85%	1.16%	0.73%	0.59%	0.55%	0.95%	1.63%	1.49%	0.90%	0.80%
Individuals	0.81%	0.92%	0.73%	0.60%	0.48%	0.44%	0.48%	0.47%	0.59%	0.67%	0.61%	0.56%	0.54%
Business/Others	2.01%	2.53%	3.26%	2.55%	1.61%	0.92%	0.65%	0.60%	1.16%	2.35%	2.14%	1.14%	0.98%
Mortgage loans	0.37%	0.46%	0.35%	0.32%	0.23%	0.21%	0.20%	0.27%	0.44%	0.77%	0.88%	0.81%	0.54%
Residential	0.31%	0.42%	0.29%	0.27%	0.20%	0.18%	0.18%	0.22%	0.39%	0.64%	0.75%	0.70%	0.47%
Non-residential	1.36%	1.16%	1.31%	1.16%	0.88%	0.53%	0.45%	0.85%	0.93%	2.06%	2.10%	1.93%	1.68%
Acceptances	0.14%	0.31%	0.12%	0.10%	0.08%	0.04%	0.04%	0.02%	0.00%	0.02%	0.05%	0.09%	0.09%
Other on-balance sheet	0.13%	0.00%	0.01%	0.17%	0.00%	0.00%	0.00%	0.00%	0.01%	0.01%	0.00%	0.00%	0.00%
Total	0.81%	0.99%	1.08%	0.77%	0.48%	0.32%	0.27%	0.27%	0.49%	0.81%	0.79%	0.55%	0.48%
Specific Allowance for Credit Loss / GIL	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2Q12
Deposits with financial institutions	na	na	na	na	na	na	na	na	na	na	na	na	na
Securities	29%	40%	21%	18%	100%	100%	100%	22%	33%	100%	100%	0%	0%
Loans	45%	45%	41%	44%	50%	49%	52%	43%	33%	27%	25%	31%	22%
Non-mortgage loans	48%	47%	42%	46%	52%	54%	59%	50%	37%	31%	30%	40%	30%
Individuals	65%	58%	64%	66%	73%	78%	75%	67%	60%	56%	45%	45%	17%
Business/Others	45%	45%	40%	44%	48%	47%	51%	43%	31%	25%	26%	38%	35%
Mortgage loans	19%	32%	30%	25%	32%	25%	25%	22%	19%	15%	12%	14%	8%
Residential	12%	30%	31%	24%	32%	23%	24%	21%	19%	14%	11%	13%	5%
Non-residential	42%	38%	25%	31%	30%	36%	33%	23%	21%	16%	16%	18%	22%
Acceptances	3%	1%	0%	0%	0%	0%	0%	0%	na	71%	49%	0%	0%
Other on-balance sheet	na	na	18%	0%	21%	na	100%	67%	15%	38%	50%	64%	100%
Total Specific ACL / GIL	44%	45%	41%	43%	49%	49%	52%	43%	33%	27%	25%	31%	22%
General Allowance / GIL	71%	60%	62%	75%	91%	121%	125%	112%	65%	48%	43%	52%	64%
Total ACL / GIL	115%	104%	102%	118%	140%	170%	177%	155%	98%	75%	68%	83%	86%

Source: OSFI, Citi Research

Assets

Figure 181. Asset Cumulative Growth by Type, 2000-2012 (2000 = 100)



Source: OSFI, Citi Research

Figure 182. Asset Composition, Aug 2012 (\$bn and %)

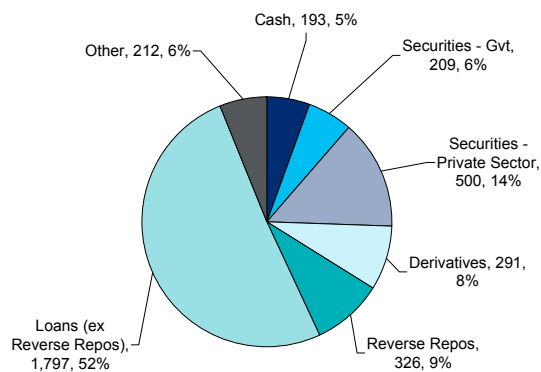
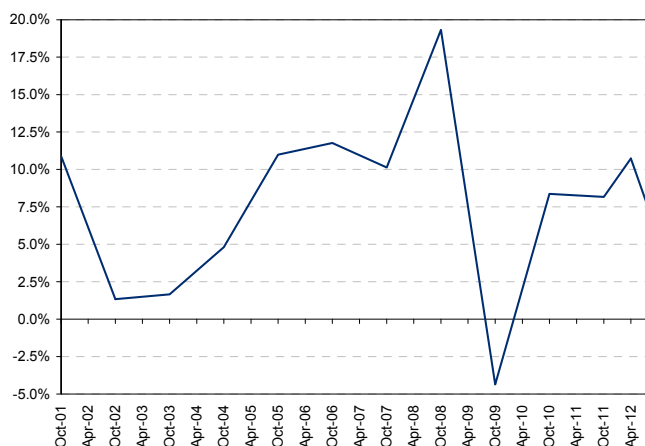
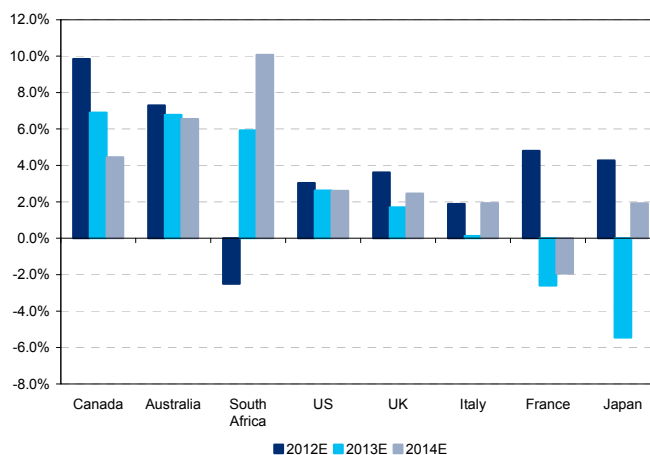


Figure 183. Asset Growth yoy - Historical *



Source: OSFI, dataCentral, Citi Research

Figure 184. Asset Growth - Forecast **



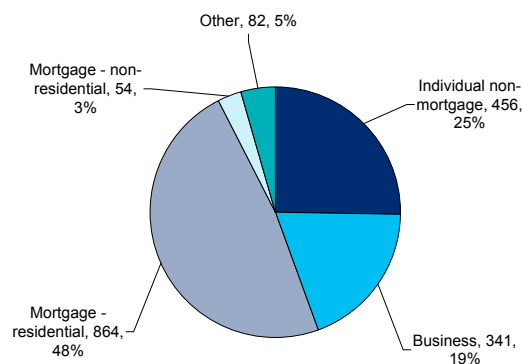
* Domestic banking system as defined by OSFI ** Bank stocks under Citi coverage

Loans

Figure 185. Loan Growth by Type, 2000-2012 (2000 = 100)



Figure 186. Loan Composition, Aug 2012



Source: OSFI, Citi Research

Figure 187. Loan Growth – Total, Historical *

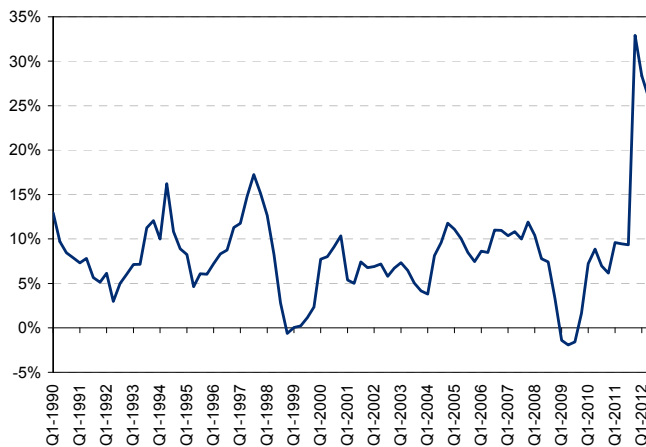
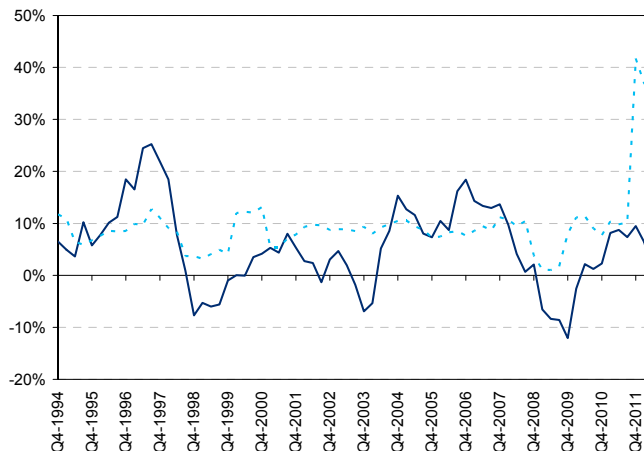


Figure 188. Loan Growth – Business & Household Loans, Historical *



Source: OSFI, Datastream, dataCentral, Citi Research * Domestic banking system as defined by OSFI. In 2011, the Canadian banks adopted IFRS which resulted on previously off-balance sheet securitisations coming on the balance sheet. This largely explains the sharp rise in the loan growth rate in 2011.

Figure 189. Mortgage Loan Growth – Historical

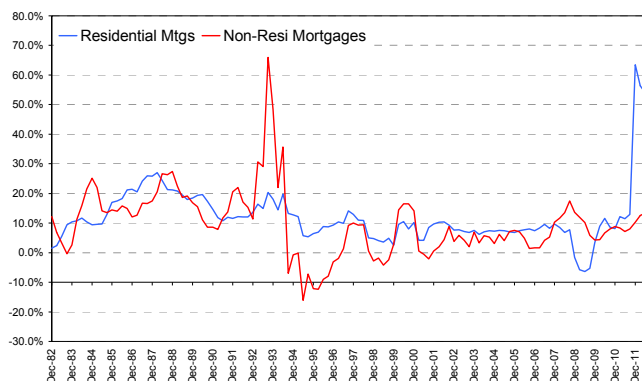
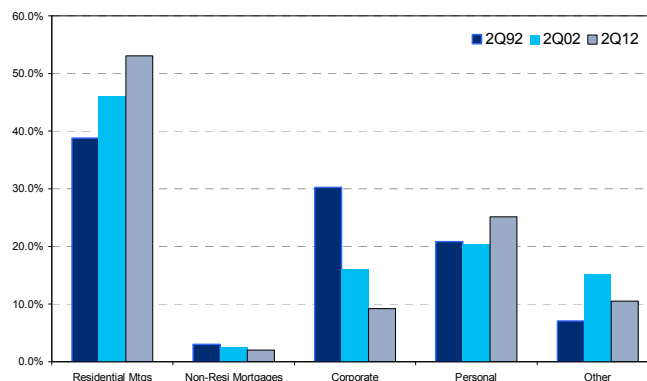
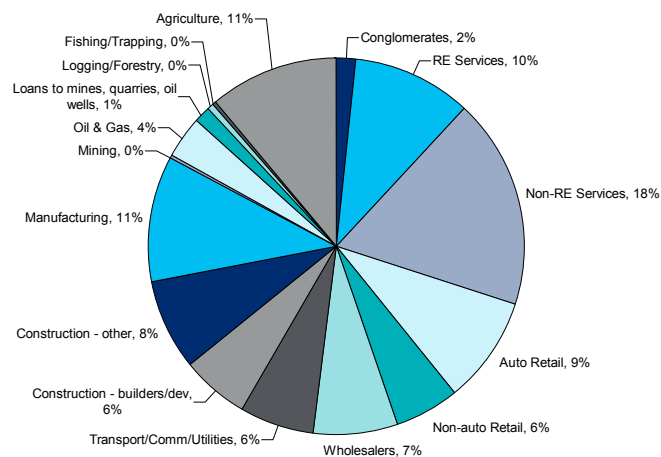


Figure 190. Loan Split – Historical



Source: Haver, Citi Research

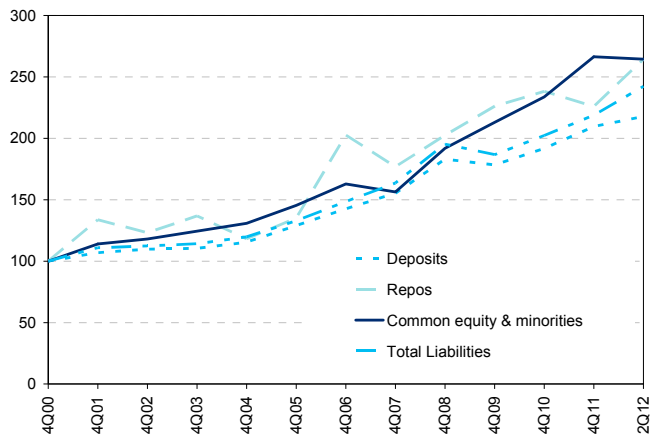
Figure 191. Canada Banks – Business Loans Split (2Q12)



Source: OSFI, Citi Research

Liabilities

Figure 192. Liabilities Cumulative Growth by Type, 2000-12 (2000 = 100)



Source: OSFI, Citi Research

Figure 193. Liabilities Composition, Aug 2012 (\$bn and %)

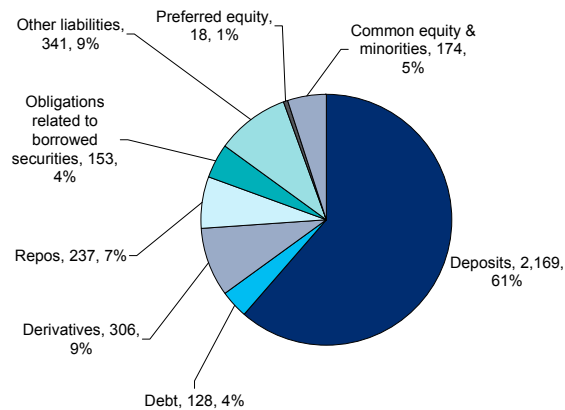
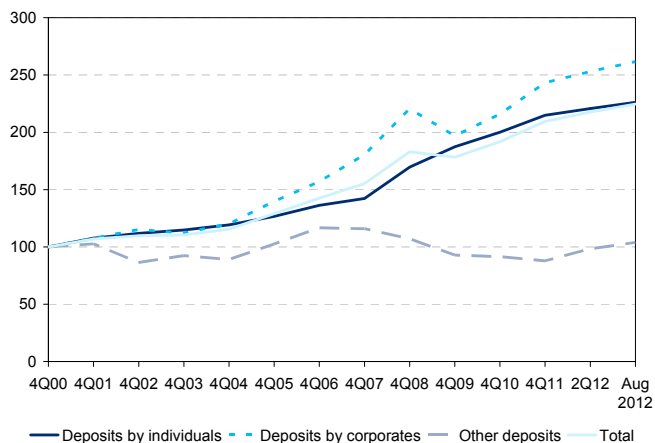
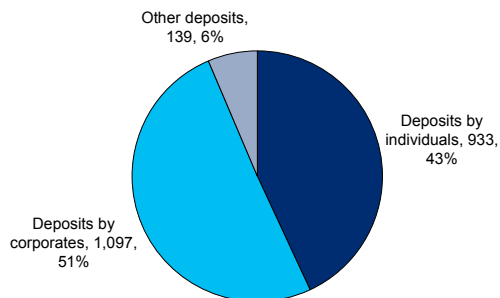


Figure 194. Deposit Growth by Type



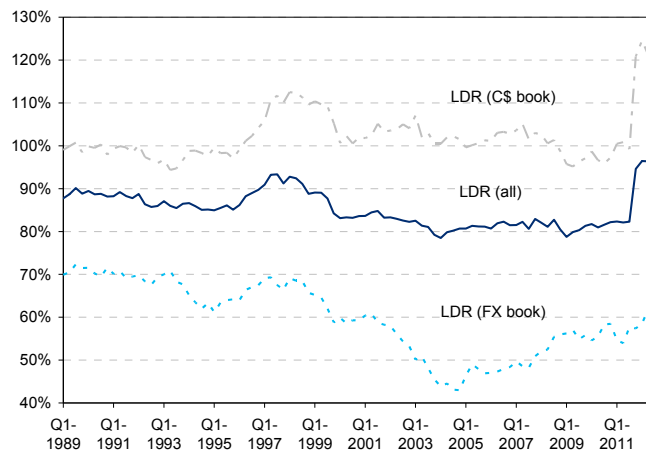
Source: OSFI, Citi Research

Figure 195. Deposit Split by Customer



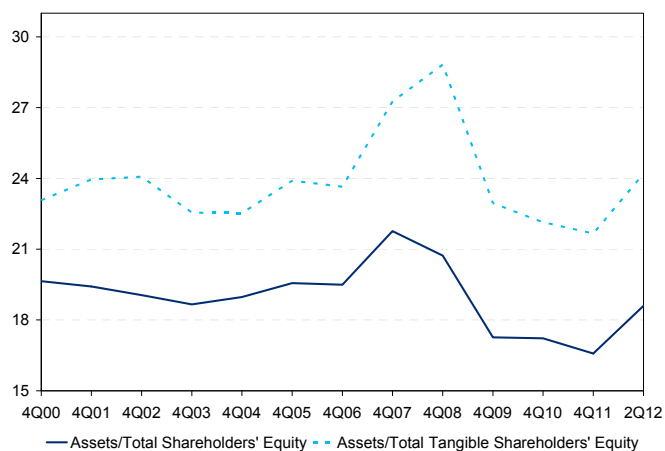
Leverage

Figure 196. LDR by Currency of Book, 1989-2012



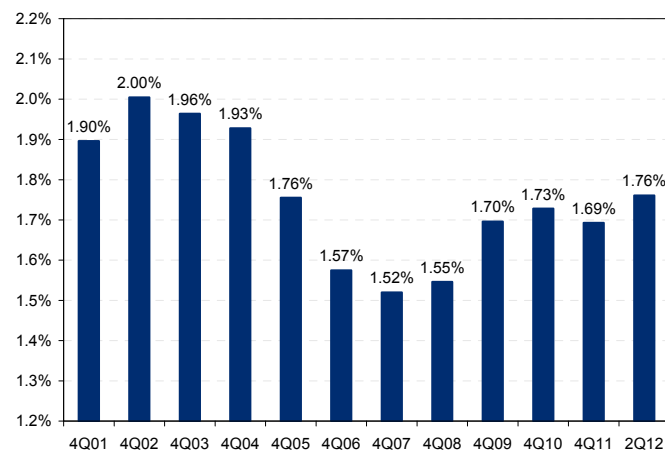
Source: OSFI, Citi Research

Figure 197. Leverage



Net Interest Income

Figure 198. NIM on Average Assets



Source: OSFI, Citi Research

Figure 199. Asset Yield vs. Funding Cost

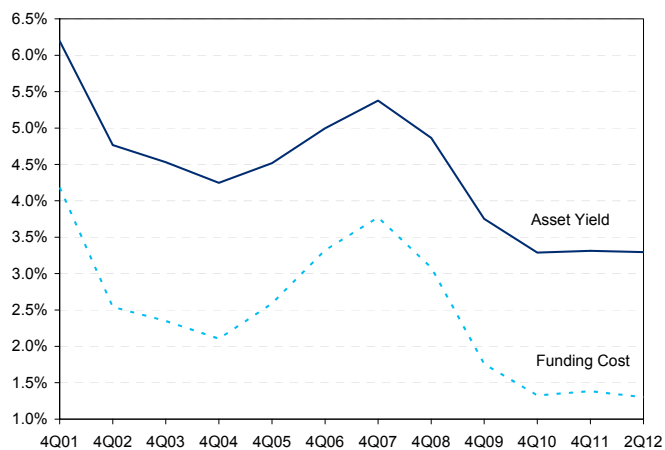
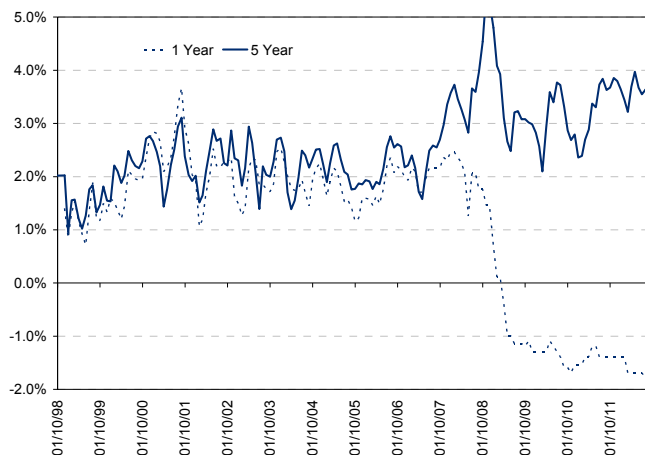


Figure 200. Mortgage Spreads



Source: Haver, Citi Research

Figure 201. Prime Business Loan Spread

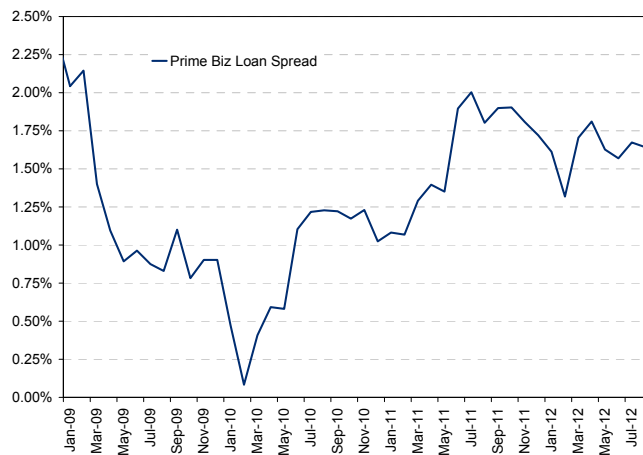
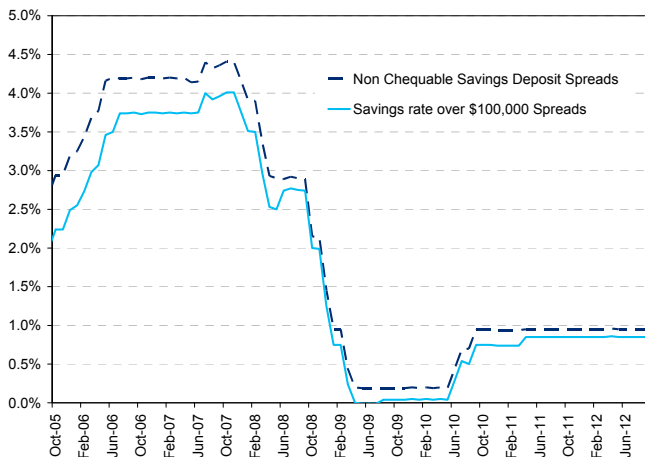
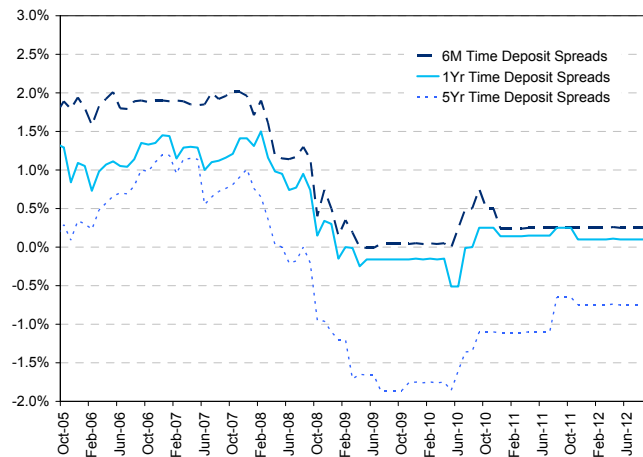


Figure 202. Savings Deposit Spreads



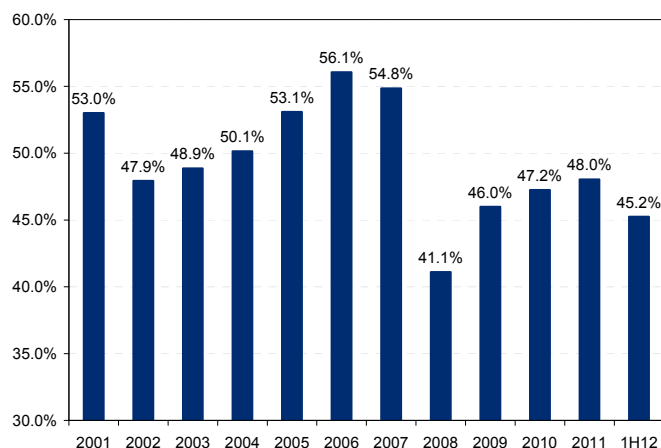
Source: Haver, Citi Research

Figure 203. Time Deposit Spreads



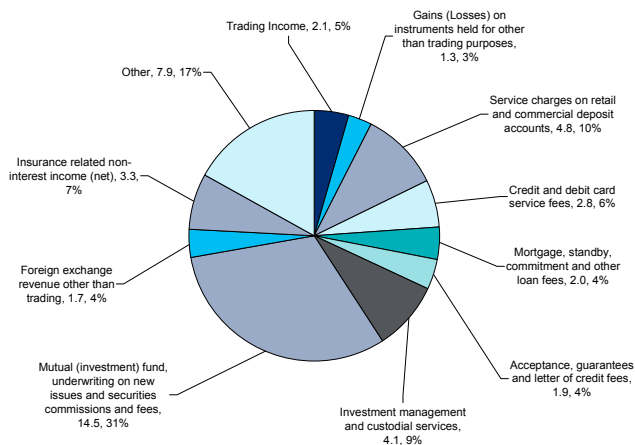
Fees, Commissions and Other Income

Figure 204. Non-NII as % of Total Revenues



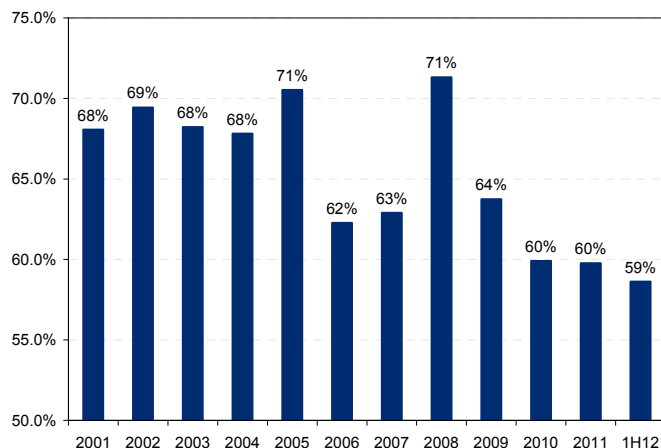
Source: OSFI, Citi Research

Figure 205. Breakdown of Non-NII Income



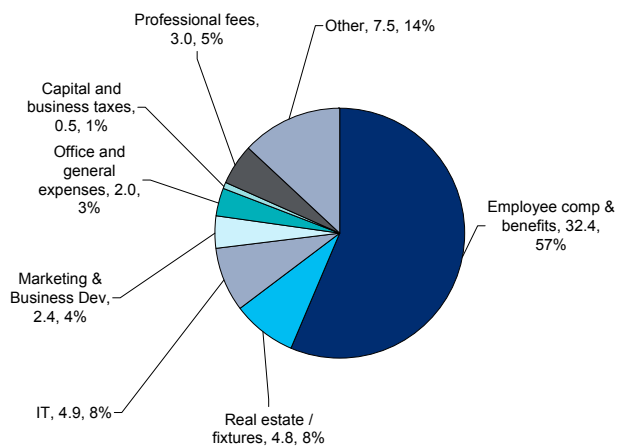
Costs and Efficiency

Figure 206. Efficiency Ratio (Costs / Revenues)



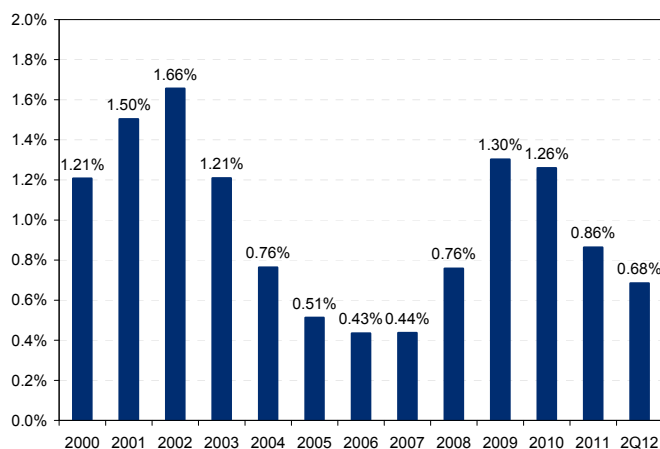
Source: OSFI, Citi Research

Figure 207. Costs Split, 2011



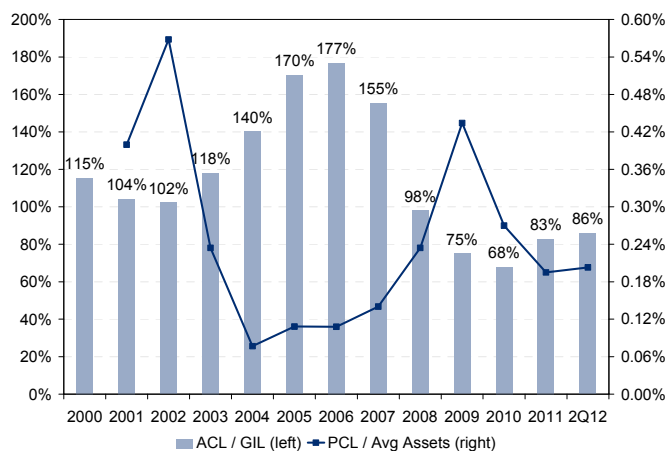
Asset Quality and Cost of Risk

Figure 208. Asset Quality Remains Benign
- Gross Impaired Loans (GIL) % Loan Volumes



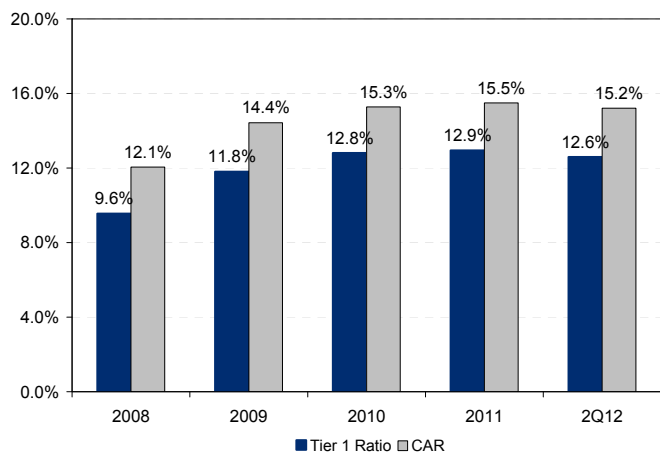
Source: OSFI, Citi Research

Figure 209. Canadian Banks Are Well Covered for Existing GILs
- Allowance for Credit Losses (ACL) % GIL (left)
- Provision for Credit Losses (PCL) % Average Assets (right)



Regulatory Capital and Regulatory Leverage

Figure 210. Tier 1 Ratio (T1R) and Total Capital Ratio (CAR)



Source: OSFI, Citi Research

Figure 211. Regulatory Assets-to-Capital Multiple

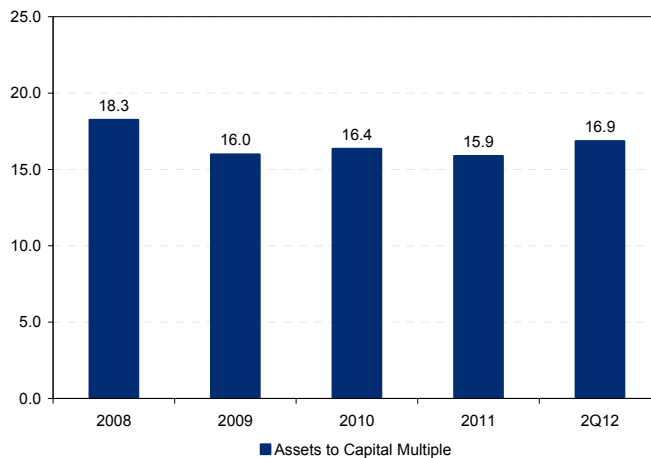
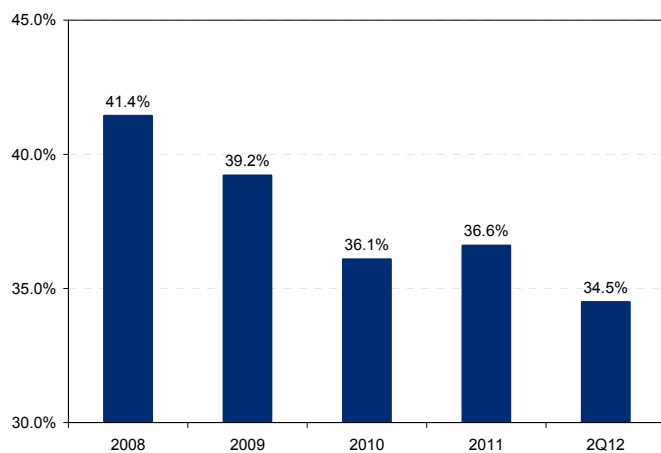
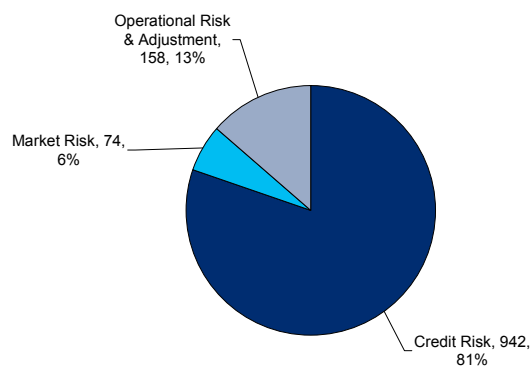


Figure 212. Risk Weights



Source: OSFI, Citi Research

Figure 213. RWA Split



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Canada's Economy

Consumption and Investment Drive Growth

With Thanks to Dana Peterson, Citi's
Canada Economist

Figure 214. Canada — Economic Forecast, 2012-2014F

		2012F	2013F	2014F	Quarters:	2012F	2013F				2014F	
						4QF	1QF	2QF	3QF	4QF	1QF	2QF
Real GDP	YoY	2.1%	2.1%	2.8%		1.7%	1.8%	1.8%	2.3%	2.4%	2.6%	2.8%
	SAAR					2.2	1.9	2.2	2.7	2.9	2.7	3.0
Final Domestic Demand	YoY	1.8	2.2	2.6		1.9	2.0	2.2	2.2	2.4	2.5	2.6
	SAAR					1.8	2.2	2.3	2.6	2.7	2.5	2.5
Private Consumption	YoY	1.8	2.3	2.5		1.8	2.0	2.4	2.4	2.4	2.4	2.5
	SAAR					2.4	2.3	2.4	2.4	2.5	2.5	2.5
Government Spending	YoY	-0.9	1.2	1.4		0.2	0.9	1.2	1.3	1.4	1.4	1.4
	SAAR					1.0	1.4	1.4	1.4	1.4	1.4	1.4
Private Fixed Investment	YoY	5.8	3.2	4.2		4.4	3.3	2.8	3.0	3.9	4.2	4.3
	SAAR					1.2	2.6	3.4	4.6	5.0	3.9	3.9
Exports	YoY	1.9	1.7	5.9		-1.8	0.0	-0.2	3.0	4.2	5.1	6.0
	SAAR					1.2	2.6	3.2	5.0	6.3	6.1	6.8
Imports	YoY	2.4	3.1	4.7		1.9	2.2	2.7	3.3	4.0	4.4	4.5
	SAAR					1.2	3.5	4.5	4.0	4.2	5.0	5.0
CPI	YoY	1.6	1.4	2.0		1.3	1.1	0.9	1.6	2.0	2.2	2.4
Core CPI	YoY	1.8	1.9	2.0		1.6	1.7	1.8	2.2	2.0	2.1	2.1
Unemployment Rate	%	7.3	7.1	6.7		7.4	7.2	7.1	7.1	7.0	6.9	6.6
Current Account Balance	C\$bn	-73.7	-78.9	-71.7		-82.5	-84.4	-77.1	-77.2	-76.8	-72.9	-69.5
	% of GDP	-4.1	-4.2	-3.7		-4.5	-4.6	-4.2	-4.1	-4.0	-3.8	-3.6
Net Exports (Pct. Contrib.)		-0.2	-0.5	0.2		0.0	-0.4	-0.5	0.2	0.5	0.2	0.4
Inventories (Pct. Contrib.)		0.5	0.3	-0.1		0.4	0.1	0.3	-0.1	-0.3	0.0	0.0
Budget Balance (Fiscal Year)	% of GDP	-1.4	-0.9	-0.4								
Federal Budget Debt	% of GDP	33.4	33.2	32.2								
General Govt. Debt	% of GDP	86.2	85.9	84.9								

F Citi forecast. YoY Year-to-year percent change. SAAR Seasonally adjusted annual rate.
Source: Statistics Canada, and Citi Research

Structure of the Economy

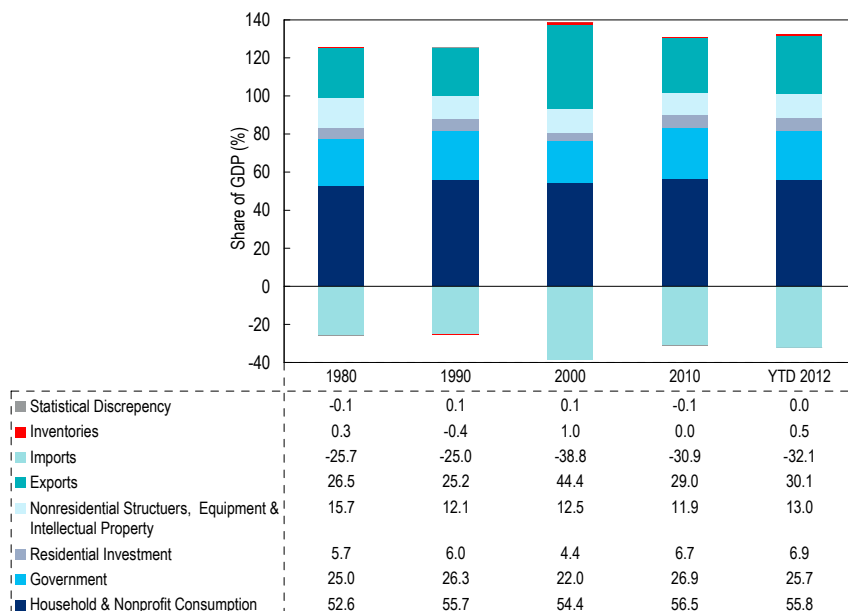
c.57% of the economy is driven by consumption, 25% by government spending, 20% by investment and the remainder by net exports

The Canadian economy is c. 56% driven by consumption, 26% by government spending, 20% by investment and the remainder by net exports and the inventory cycle (Figure 215). Between 1990 and 2000, net exports increased (as the “loonie” was negatively correlated with commodity prices). Since 2000, net exports have subtracted from growth as the Canadian dollar became positively correlated with rising commodity prices – making exports less competitive and imports more attractive to the domestic consumer and corporates.

The share of investment in GDP grew the most over the past 20 years, at the expense of the government's share in GDP

Net exports swung from a contribution of 5.8% of GDP to -2.0% over the same period. Consumption expanded by 1.4% of GDP, bringing the total contribution to 55.8% – still quite a bit lower than in the US (c.70%) and the UK (c.60%). Consumption (especially of durables and services) and corporate investment activity (in intellectual property and machinery) grew the fastest, contributing c.90% to real GDP growth since 1990.

Figure 215. Structure of the Canadian Economy, 1980-2012 (% GDP)



Source: Haver, Citi Research

Since 2002, the strong loonie has subtracted 2.5-3.5% from Canadian export growth

Figure 216 shows the contributions to Canadian exports growth of US demand and the real exchange rate. For most of the period since 2002, the strong loonie has subtracted 2.5-3.5% from export growth while US demand more than made up for the negative FX effect.

Figure 216. Canada - Contributions to Exports Growth (Annual Percent Change), 1998 - 3Q12E *

Cycle:	Pre-Commodity Boom	Extended Comm. Cycle	Recession	Recovery / Expansion
Period:	1998 Q1 - 2002 Q4	2003 Q1 - 2008 Q1	2008 Q2 - 2009 Q2	2009 Q3 - 2012 Q3E
Canadian Exports Growth *	4.7	0.8	-13.0	4.4
Growth Forecast by Cayen's Model	4.0	2.6	-7.1	3.9
Contribution of U.S. Demand (C + I + X)	3.6	6.3	-10.7	6.6
Contribution of Real Exchange Rate	0.5	-3.5	4.0	-2.5

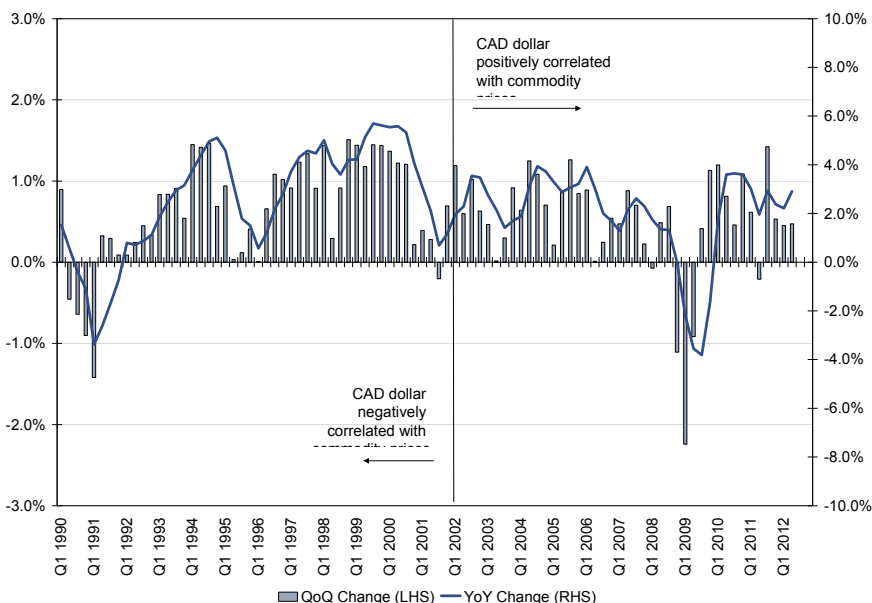
Source: Statistics Canada and Bank of Canada, Citi Research * Annualised growth rates

The Canadian economy contracted c.3.8% during the Global Financial Crisis of 2008-9, less than many other advanced economies

Resilient GDP Growth

On balance, Canada's small, open economy status renders it vulnerable to external forces compared to other larger advanced economies. Yet the Canadian economy's greatest quarterly contraction during the 2008-9 Global Financial Crisis was -3.8% yoy, in 3Q09, less than that of a number of advanced economies. This relative resilience was driven by stable domestic demand, a swift recovery in commodity extraction and processing investment, a government stimulus programme and a monetary stimulus by the Bank of Canada. The resilience and the subsequent bounce-back all the way to 3.6% (2Q10-4Q10) were also facilitated by the low prevalence of subprime loans and structured credit assets on Canadian banks' balance sheets.

Figure 217. Canadian Real GDP Growth, 1990-2002 and 2002-2012 (% yoy and qoq)



Source: Datastream, Citi Research

A sustainable long-run real growth rate of 2.5-3.0% should be achievable

Assuming long-term population growth of 1-1.5% and productivity growth of c1-2%, a sustainable long-run real growth rate of 2.5-3.0% should be achievable.

Commodity Prices

Canada is a major supplier of oil-based and mineral-based commodities

Canada is a major supplier of oil-based and mineral-based commodities to the world – with one major caveat: the country lacks sufficient capacity to refine and ship oil and gas. Figure 218 shows the loose co-movement between Canadian real GDP growth and changes in the Bank of Canada Commodity Price Index. The Bank of Canada has made the point that Canadian GDP benefits from sharply higher oil prices when the reason for the price increase is fundamental (demand and supply) rather than speculative. In their analysis, the bank's economists conclude that a 10% speculative price increase actually decreases GDP by 0.8% as crude oil imports offset the benefit from higher crude oil exports.

But oil export prices are up to a third cheaper than oil import prices

One of the reasons for this discrepancy is that crude oil exports are priced at the Edmonton Par Crude benchmark which usually trades at a discount to the crude import benchmarks (West Texas Intermediate/WTI in US and Brent in Europe). The discount is usually attributed to Canada's insufficient refining and shipping facilities. Two proposed pipelines, Keystone XL (crossing into the US) and Northern Bridge (crossing British Columbia to the Pacific Ocean) are currently under consideration for approval by the US and British Columbia provincial governments, respectively. The pipelines, if and when built, could help close the discount of Canada's crude export prices to the world benchmarks.

In terms of the Canadian commercial banks, an increase in the investment levels for energy production (classic or alternative), especially if spurred by higher gas prices, could mean higher demand for corporate credit.

Figure 218. Canadian Real GDP Growth Loosely Tracks Changes in Commodity Prices

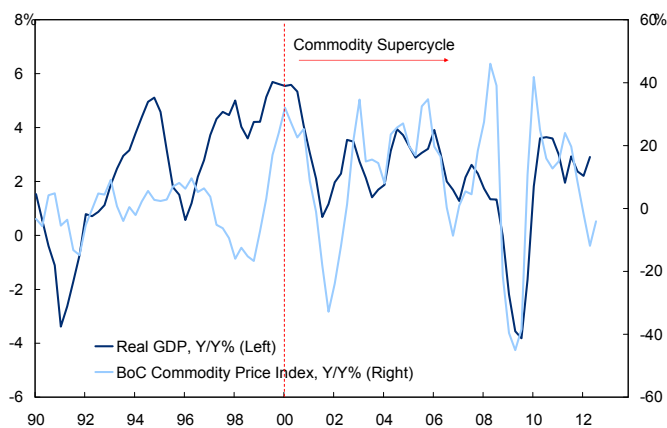
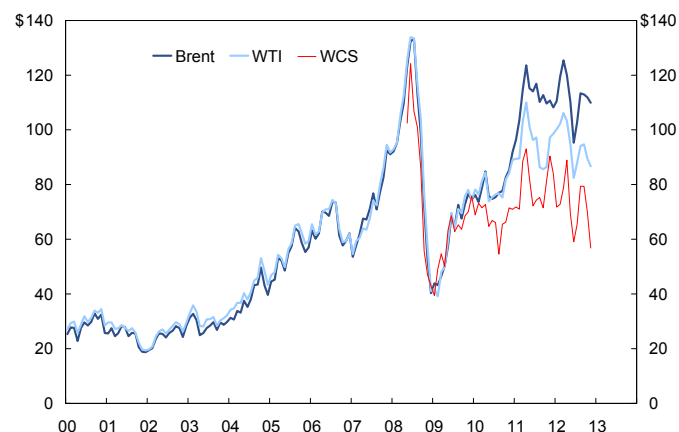


Figure 219. Brent, WTI and WCS Prices Have Diverged Since 2009



Source: Haver, Citi Research

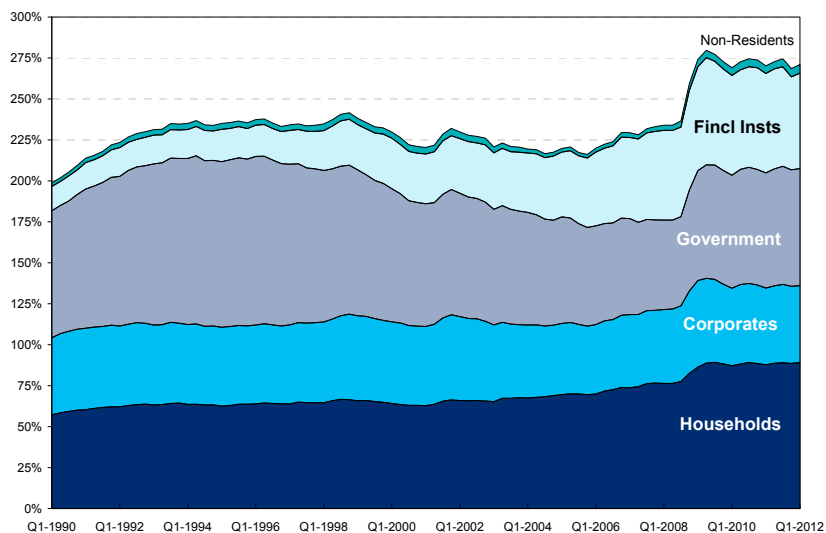
Debt: In Line or Better than Most of G7

Debt levels are in line or lower than those in other advanced economies

Canada has a relatively even distribution of debt across the four main sectors of the economy:

- **Household debt (89% of GDP)** – this level of debt translates into a 91% debt/assets ratio for the household sector vs. 83% in the US. However, on a *net debt* basis (offsetting cash and deposits), the ratio falls to 27% in both countries;
- **Corporate debt (47% of GDP)** – translates into 34% debt/assets ratio (US: 27%) and to 21% on a net basis (US: 22%);
- **Government debt (71% of GDP)** – screens well against the level of most advanced economies which are in the range of 80-130%;
- **Financials debt (58% of GDP)** – compares favourably to the US level of 89% and Australia's 110%, among others.

Figure 220. Canada's Total Debt / GDP Hit a High of 280% in 2Q2009



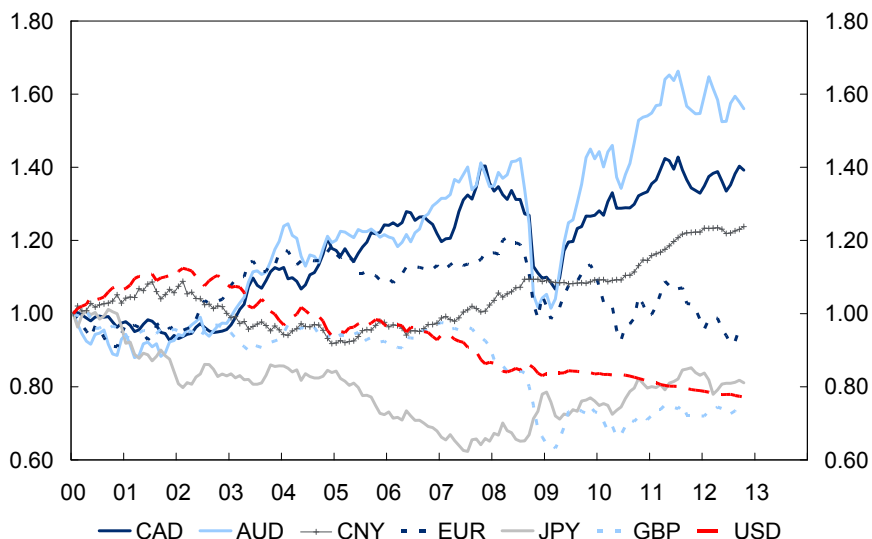
Source: Haver, Citi Research

The Loonie: Pricey

The Canadian dollar (loonie) has appreciated against most currencies since 2000

The Canadian dollar (the loonie) has appreciated against most advanced and emerging market currencies. Besides making Canadian exports more expensive, a pricey loonie makes consumption of imported goods cheaper – thus contributing to the current account deficit.

Figure 221. The Canadian Dollar Has Appreciated Against Most Major Currencies



Source: Haver, Citi Research

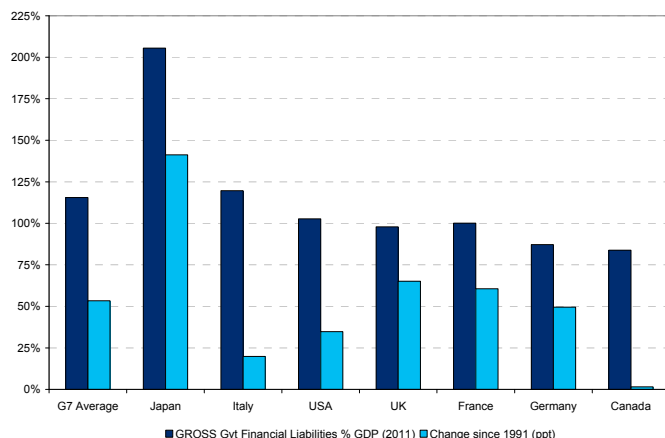
* The base currency is CTERI. The CTERI (Citi Trade Weighted Exchange Rate Index) data is a bidirectional real trade weighted index. The counterparty for each country is an appropriate weighted basket of significant trading partners.

The Government: Fiscally Strong

Fiscally strong government

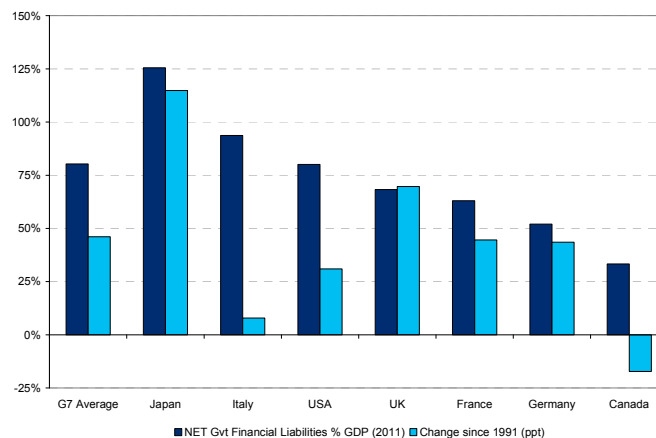
The Canadian government is one of the fiscally strongest governments among its developed markets peers. Federal debt, at 35% of GDP, is slightly less than half of the overall government level (provinces and state-owned enterprises account for the remainder). The budget deficit at -1.2% of GDP is also one of the lowest among the advanced economies.

Figure 222. But Among the G7 Countries, Canada Has Added the Least to its Gross Government Financial Liabilities over the Long Term (as % GDP)...



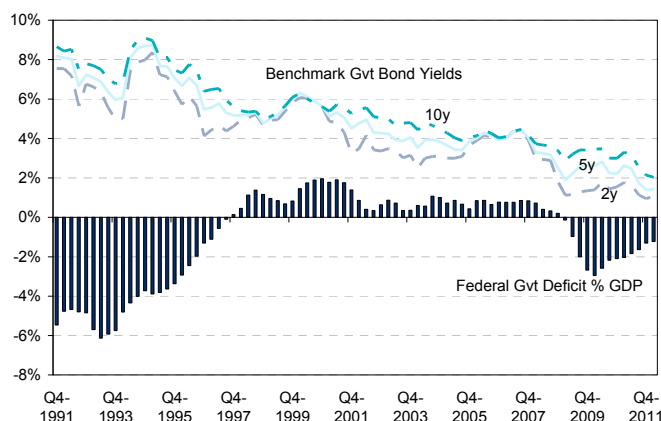
Source: Haver, Citi Research

Figure 223. ...with the Contrast Being Even Starker on a Net Basis



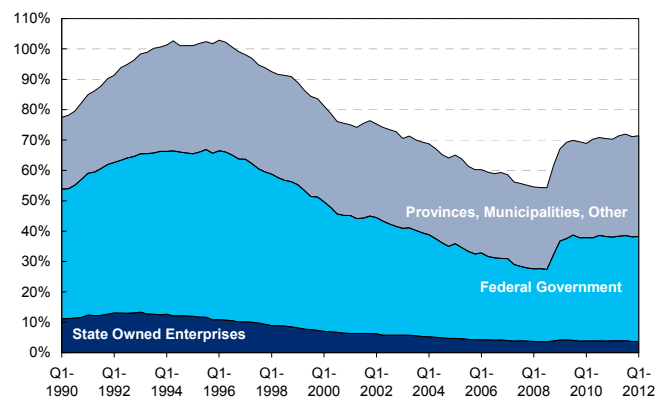
As a result of its fiscal prudence and helped by the global search for yield, the Canadian government has seen its borrowing costs decline dramatically: by 310 bps in the 5yr space (to 1.33%) and 270 bps in the 10yr space (to 1.78%).

Figure 224. The Federal Government Deficit Is on a Declining Trajectory



Source: Haver, Datastream, Citi Research

Figure 225. Canada's Government Debt-to-GDP Has Increased +17 ppt Since 2008 – More at the Federal Level (+11 ppt) than at the Provincial Level (+6 ppt)



Risks to the Canadian Inflation Outlook

The Bank of Canada noted the following three upside and three downside risks to the Canadian inflation outlook over the 2012-14 forecast period (October 2012 Monetary Policy Report):

- **Upside:** Global inflationary pressures could be more persistent than currently projected if potential output in advanced economies is lower than anticipated or if the substantial, additional monetary policy stimulus provided by major central banks boosts prices more than expected.

- **Upside:** Growth in Canadian exports could be stronger than expected if exporters improve their competitiveness more rapidly than currently assumed or if output growth in the United States is stronger than projected.
- **Upside:** While residential investment in Canada has softened recently after reaching record-high levels, it could regain momentum, thereby reinforcing existing imbalances.
- **Downside:** Failure to contain the crisis in Europe is the most serious risk facing the global and Canadian economies. The effects on Canada through financial, confidence and trade channels would be substantial, given the size and importance of the euro area to the global economy.
- **Downside:** Demand for Canadian exports could be weaker than expected if the authorities in the United States do not smooth the path of fiscal consolidation to avoid the fiscal cliff, if the slowdown in emerging-market economies is greater than expected, or if unconventional policy measures undertaken by foreign authorities have an outsized effect on exchange rates.
- **Downside:** Continuing high household debt levels in Canada could lead to a sharper-than-expected deceleration in household spending. If there were a sudden weakening in the Canadian housing sector, it could have sizeable spillover effects on other areas of the economy.

Risks to the Financial System

The Bank of Canada noted the following five risks to the Canadian financial system in its June 2012 Financial System Review:

- Euro Area sovereign debt;
- Economic weakness in other advanced economies;
- Canadian household finances and the housing market'
- Global imbalances; and
- Low interest rate environment in major advanced economies.

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Appendices

Appendix: Active Financial Institutions in Canada

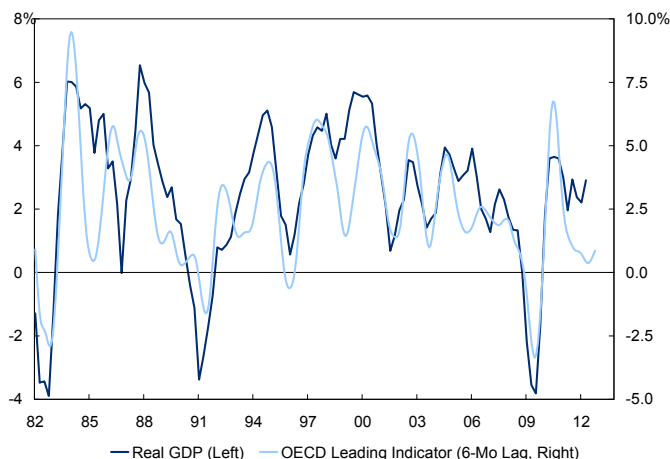
Figure 226. Active Financial Institutions, by bank size and charter type, (as at August 2011)

Big Six Banks			
	Bank of Montreal Bank of Nova Scotia	Canadian Imperial Bank of Commerce National Bank of Canada	Royal Bank of Canada Toronto-Dominion Bank
Non-Big Six Banks			
	Foreign Subsidiary	Other Domestic Bank	Trust and Loan Company
Large	AMEX Bank of Canada Bank of Tokyo-Mitsubishi UJF (Canada) BNP Paribas (Canada) Citibank Canada HSBC Bank Canada ICICI Bank Canada ING Bank of Canada MBNA Canada Bank	Bridgewater Bank Canadian Tire Bank Canadian Western Bank Laurentian Bank of Canada Manulife Bank of Canada	AGF Trust Company Equitable Trust Company Home Trust Company MCAN Mortgage Corporation Peoples Trust Company RY Dexia Investor Services Trust ResMor Trust Company
Medium	Bank of China (Canada) Industrial and Commercial Bank of China (Canada) Korea Exchange Bank of Canada Mega International Commercial Bank (Canada) Shinhan Bank Canada Société Générale (Canada) State Bank of India (Canada) Sumitomo Mitsui Banking Corporation of Canada UBS Bank (Canada)	Bank West First Nations Bank of Canada General Bank of Canada HomeEquity Bank Pacific & Western Bank of Canada President's Choice Financial	Community Trust Company Effort Trust Company League Savings and Mortgage Company M.R.S. Trust Company Peace Hills Trust Company
Small	CTC Bank of Canada Habib Canadian Bank	Alterna Bank Citizens Bank of Canada DirectCash Bank Jameson Bank	BNY Trust Company of Canada Caledon Trust Company Computershare Trust Company of Canada Concentra Trust Equity Financial Trust Company Fiduciary Trust Canada First Data Loan Company, Canada Industrial Alliance Trust Inc. Investors Group Trust Co. Ltd. Legacy Private Trust Oak Trust Standard Life Trust Company State Street Trust Company Canada Valiant Trust Company

Source: Bank of Canada Review, Summer 2012

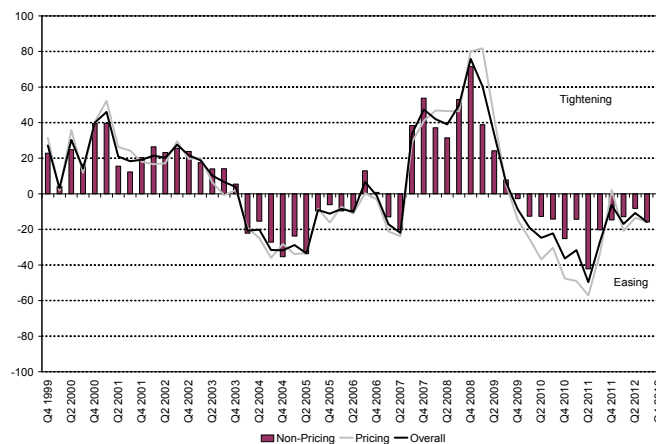
Appendix: Economic Indicators

Figure 227. The OECD Leading Indicators for Canada's Real GDP Growth Is on the Up



Source: Haver, Citi Research

Figure 228. Senior Loan Officer Survey Points to Continued Easing, Albeit Less So YoY – Canada Senior Loan Officer Survey, 1999-2012



Source: Datastream, Bank of Canada, Citi Research

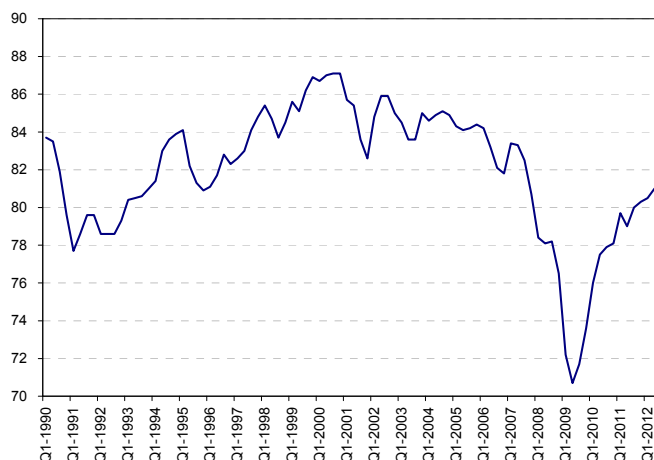
Industrial Indicators

Figure 229. Canada – Industrial Data Summary

	CPI	Avg Hourly Earnings	Industrial Price Index	Crude Petroleum Export	Natural Gas Price	Capacity Utilisation
	Index	yoy % chg	Index	Index	Cents/m3	%
Q2-2011	119.7	2.2%	114.8	250.1	22.8	79.0%
Q1-2012	121.5	2.3%	115.4	272.6	19.6	80.5%
Q2-2012	121.6	2.9%	115.6	240.3	16.6	81.0%
Q3-2012	121.6	3.6%	114.7	171.7	37.8	na
Annual						
2008	114.3	4.4%	111.7	268.7	36.5	77%
2009	115.2	2.5%	107.9	214.3	24.4	74%
2010	117.8	2.1%	110.8	215.2	24.4	78%
2011	120.9	2.1%	115.1	255.8	21.3	80%
Change yoy						
	%	ppt	%	%	%	ppt
2009	0.8%	-1.9%	-3.3%	-20.2%	-33.0%	-2.9%
2010	2.2%	-0.4%	2.6%	0.5%	-0.1%	4.5%
2011	3.1%	0.0%	3.9%	18.8%	-13.0%	2.2%
Latest	1.6%	2.2%	-0.1%	-29.8%	72.7%	na

Source: Haver, Citi Research

Figure 230. Capacity Utilisation



Source: Datastream, Bank of Canada, Citi Research

Figure 231. Industrial Price Index

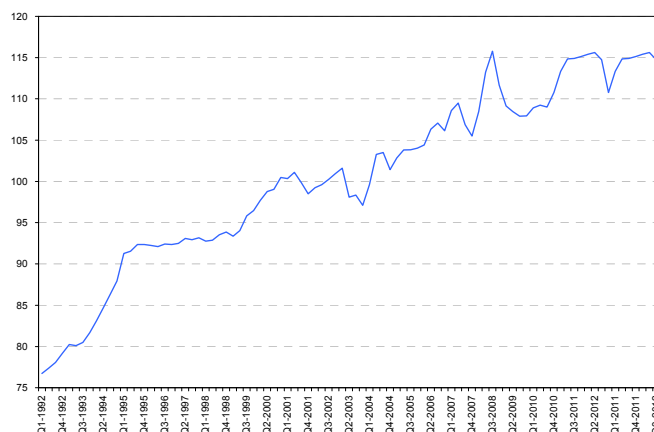
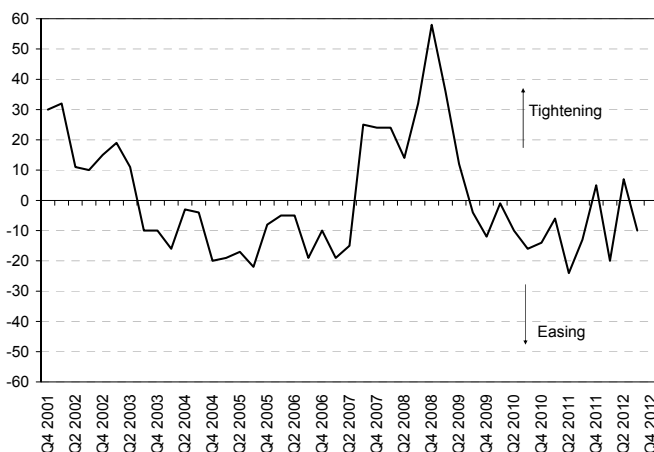


Figure 232. Canadian Businesses Think the Banks Have a Slight Easing
Bias: Bank of Canada Business Survey – Credit Conditions, 2001-2012



Source: Datastream, Bank of Canada, Citi Research

Figure 233. Average Hourly Earnings Growth YoY %

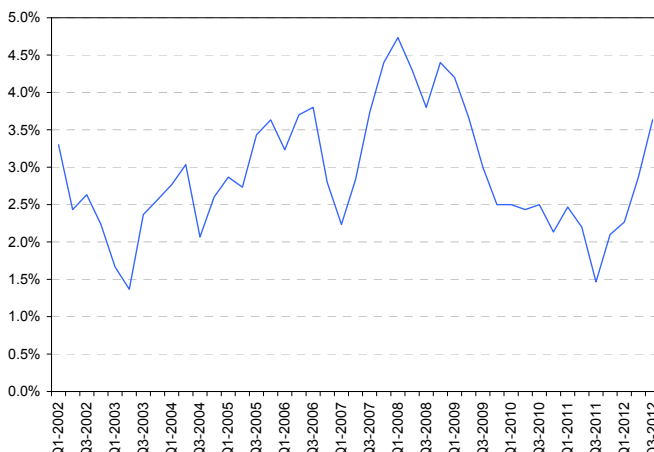


Figure 234. Crude Petroleum Export Price Index

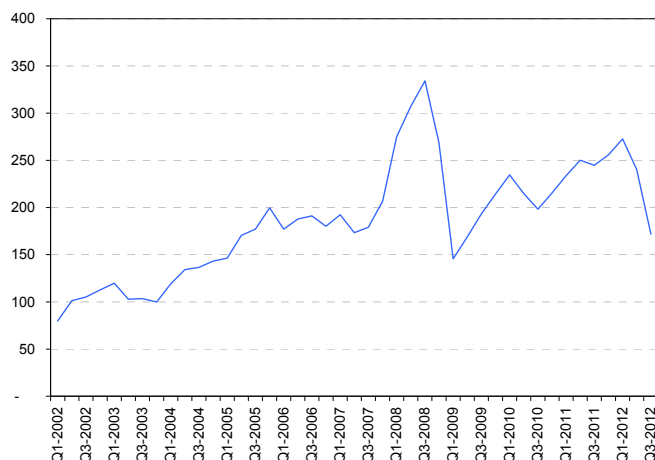
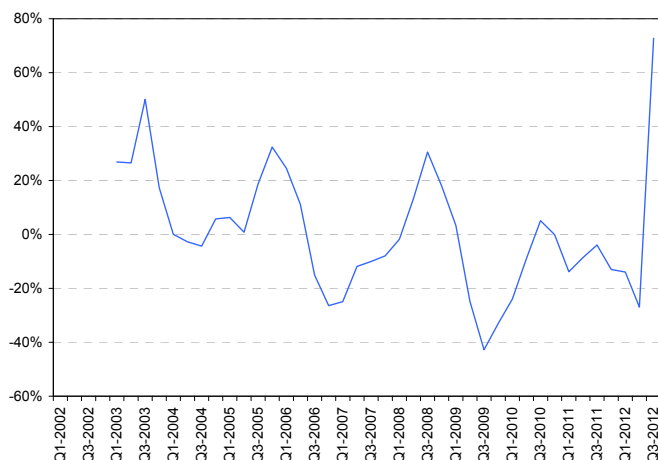


Figure 235. Natural Gas Price Change YoY, %



Source: Datastream, Bank of Canada, Citi Research

Figure 236. Consumer Price Index, yoy change

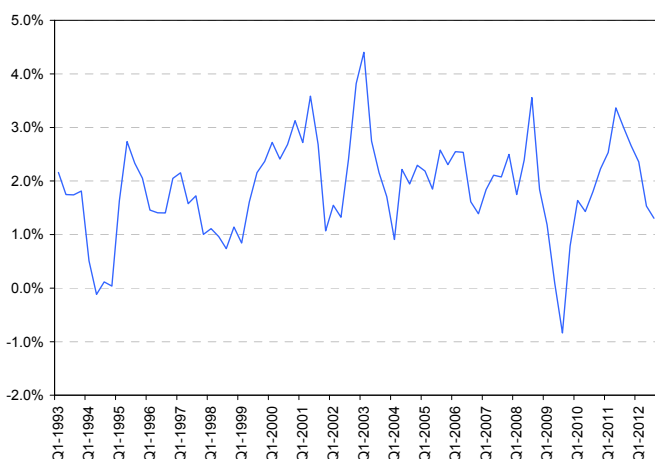
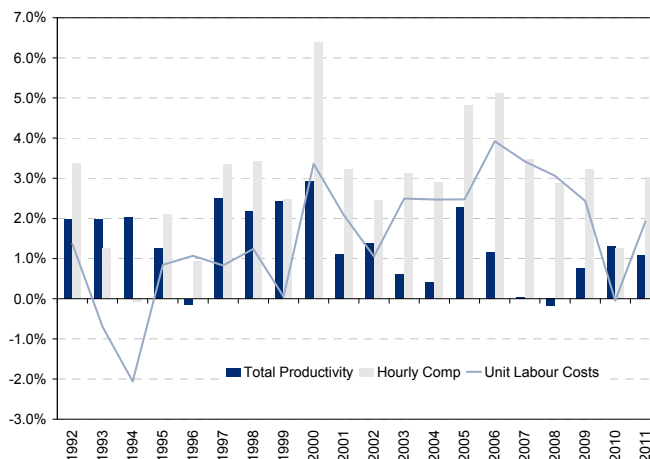


Figure 237. Unit Labour Costs & Components



Source: Haver, Citi Research

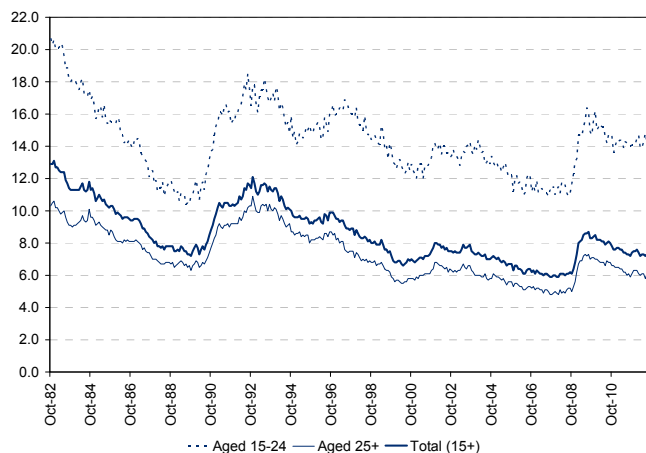
Labour Market

Figure 238. Canada – Labour Market Summary

	Population (15+) 000s	Unemployment Rate (15+) %	Participation Rate (15+) %	Unit Labour Costs Index
1991	21,664	9.8%	65.9%	79.0
1996	23,092	9.4%	64.6%	79.4
2001	24,597	6.9%	66.2%	85.5
2006	26,319	6.6%	67.1%	96.7
2007	26,691	6.3%	67.6%	100.0
2008	27,090	5.9%	67.5%	103.1
2009	27,470	7.3%	67.1%	105.6
2010	27,815	8.2%	66.8%	105.5
2011	28,131	7.7%	66.7%	107.6
Change yoy, ppt	%	ppt	ppt	%
2008	1.5%	-0.4%	-0.1%	3.1%
2009	1.4%	1.4%	-0.4%	2.4%
2010	1.3%	0.9%	-0.3%	0.0%
2011	1.1%	-0.5%	-0.1%	1.9%

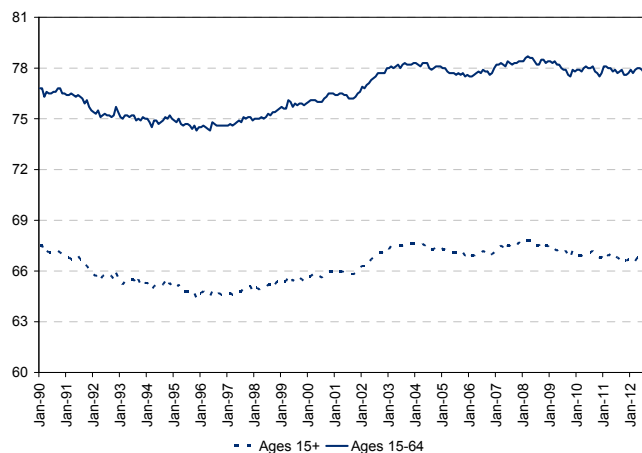
Source: Datastream, Citi Research

Figure 239. Unemployment Rate in the 15-24yrs Age Group Remains High (%)



Source: Datastream, Citi Research

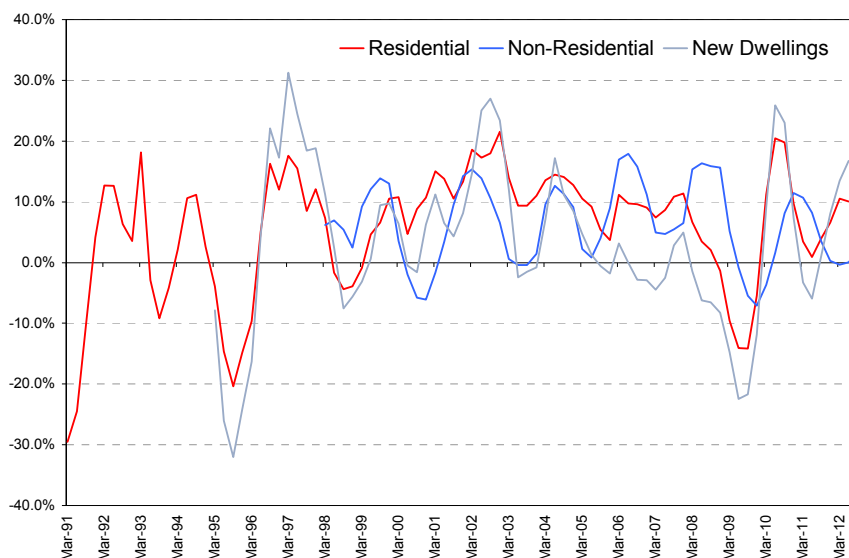
Figure 240. Participation Rate Close to Peak (%)



Housing: Investment and Affordability

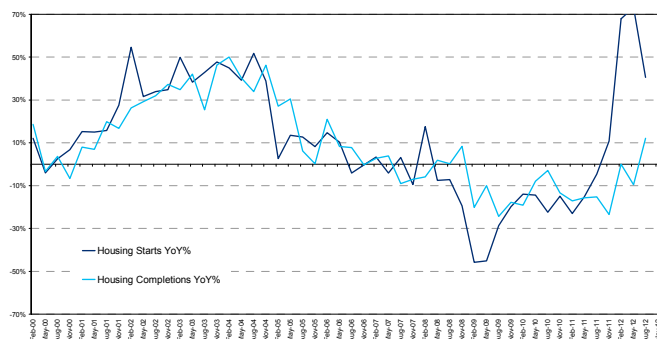
Residential housing investment has grown 300% over the past 15 years, double the rate of non-residential at 145%. Since 2007 residential growth (19%) lags non-residential growth (28%).

Figure 241. Construction Investment (YoY Chg)



Source: Datastream, Citi Research

Figure 242. Housing Starts / Completions (YoY Chg)



Source: Datastream, Citi Research

Figure 243. Permits Growth YoY %Chg

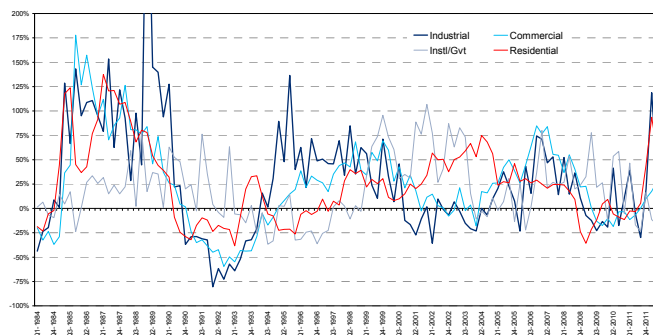
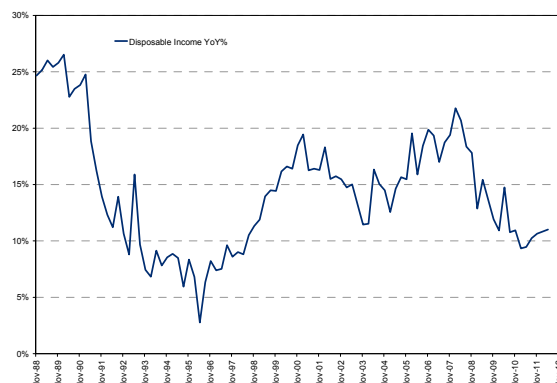


Figure 244. Housing Affordability Index YoY %Chg *



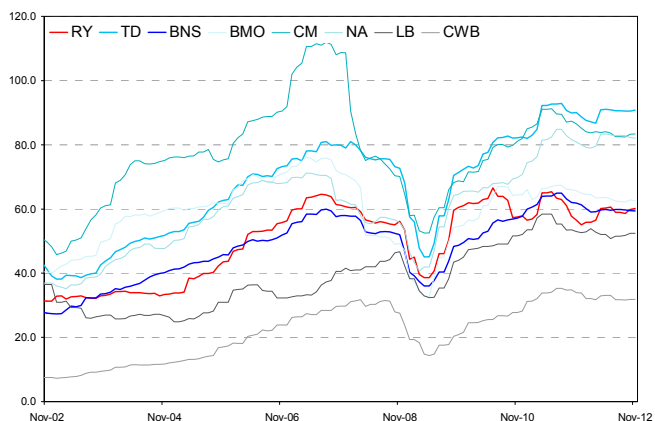
Figure 245. Disposable Income YoY %Chg



Source: Datastream, Citi Research * Ratio of the average quarterly mortgage payment to the average quarterly income. A higher index means less affordability.

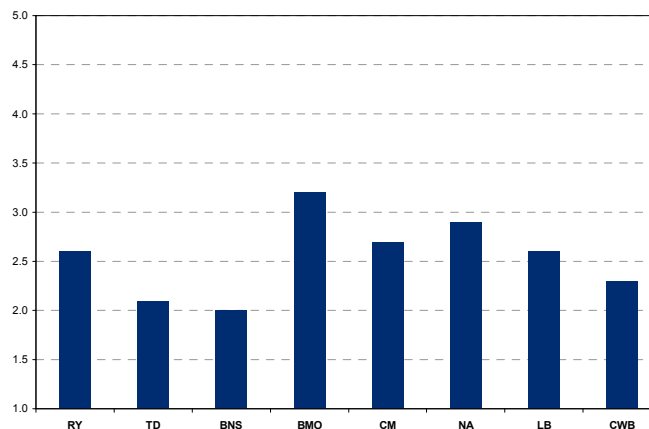
Appendix: Average Analyst Target Prices and Recommendations

Figure 246. Average TP Evolution



Source: Datastream

Figure 247. Average Analyst Recommendation (1.0 = Strong Buy; 5.0= Strong Sell)



Appendix: Global Comps – Fundamentals

Figure 248. Global Banking Comps by Geography/Grouping

ROE	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012E	2013E	2014E
Canada	15.0%	14.2%	10.0%	14.8%	18.1%	17.9%	23.2%	22.6%	16.2%	11.7%	14.7%	17.9%	17.3%	16.6%	16.9%
Global	19.1%	10.0%	9.7%	20.2%	18.2%	16.3%	17.6%	16.0%	6.0%	7.3%	10.6%	9.4%	9.9%	11.1%	11.6%
G7	17.2%	12.7%	11.5%	31.7%	21.9%	13.4%	15.7%	14.6%	-0.7%	2.6%	6.0%	3.8%	5.4%	7.5%	8.0%
France	17.9%	13.9%	10.2%	11.4%	14.7%	16.1%	15.7%	10.3%	2.7%	4.5%	8.4%	5.4%	4.5%	7.3%	7.8%
Germany	11.3%	0.8%	-2.9%	-25.9%	3.8%	10.4%	12.8%	13.0%	0.0%	-45.7%	14.7%	4.0%	2.6%	2.0%	4.3%
Italy					11.8%	12.3%	15.4%	14.0%	5.2%	3.6%	3.5%	-18.1%	0.6%	2.6%	3.4%
Japan				238.6%	59.4%	-3.5%	13.2%	8.6%	5.7%	-8.4%	5.3%	8.0%	7.0%	6.7%	6.5%
UK		17.7%	15.0%	17.4%	17.2%	18.0%	18.0%	21.6%	-12.3%	6.1%	5.0%	4.3%	2.6%	7.9%	9.1%
US	19.7%	11.0%	16.2%	14.7%	16.2%	16.0%	17.3%	12.2%	1.4%	4.1%	6.1%	6.3%	7.9%	8.6%	9.1%
Australia	22.0%	12.6%	17.7%	16.1%	17.0%	18.9%	20.9%	20.7%	17.8%	10.8%	14.5%	15.5%	13.4%	14.0%	14.1%
Europe	21.8%	10.1%	7.6%	10.6%	15.6%	17.6%	18.6%	16.8%	-1.5%	5.5%	7.3%	1.9%	3.1%	6.8%	8.1%
Europe ex UK	21.8%	9.4%	6.9%	10.0%	15.1%	17.5%	18.7%	15.1%	2.3%	5.2%	8.2%	0.9%	3.3%	6.3%	7.6%
Nordics	17.4%	15.9%	10.9%	13.8%	16.5%	18.5%	19.5%	18.7%	11.3%	5.5%	9.5%	9.5%	9.9%	10.5%	11.0%
EM	8.4%	8.5%	10.7%	22.3%	16.3%	16.4%	15.9%	17.1%	15.1%	14.5%	17.3%	18.0%	17.2%	16.4%	16.1%
EM Asia	7.3%	10.4%	10.2%	25.1%	16.5%	15.7%	14.4%	15.7%	14.5%	14.9%	17.1%	18.0%	17.3%	16.6%	16.1%
EM Far East	5.7%	10.1%	9.9%	25.5%	15.8%	16.2%	14.3%	16.1%	15.5%	16.1%	18.0%	19.1%	18.1%	16.9%	16.3%
EM LatAm				18.7%	20.8%	27.3%	25.4%	24.1%	23.6%	16.9%	19.0%	18.3%	16.7%	16.9%	17.3%
Brazil				18.9%	22.1%	29.5%	27.2%	26.2%	25.8%	16.4%	18.5%	17.6%	16.0%	16.3%	16.7%
Russia			18.0%	10.8%	11.5%	25.8%	26.4%	19.0%	10.0%	-3.0%	17.0%	23.5%	20.7%	18.7%	17.4%
India	17.7%	12.4%	12.2%	20.3%	22.1%	19.4%	17.1%	16.4%	16.5%	15.8%	16.4%	16.6%	16.5%	16.1%	16.9%
China			46.9%	46.2%	17.0%	16.0%	14.4%	16.7%	18.7%	19.2%	20.8%	21.5%	20.5%	18.7%	17.7%
South Africa	25.0%	14.4%	14.5%	15.4%	21.0%	23.8%	26.8%	27.4%	22.4%	13.1%	13.9%	15.2%	14.8%	16.6%	17.8%
ROA	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012E	2013E	2014E
Canada	0.64%	0.62%	0.45%	0.65%	0.79%	0.79%	1.02%	0.98%	0.70%	0.57%	0.75%	0.84%	0.86%	0.87%	0.91%
Global	0.83%	0.51%	0.49%	0.29%	0.63%	0.75%	0.87%	0.80%	0.29%	0.38%	0.62%	0.55%	0.61%	0.71%	0.79%
G7	0.60%	0.59%	0.61%	-0.14%	0.45%	0.56%	0.69%	0.62%	0.00%	0.07%	0.29%	0.18%	0.28%	0.40%	0.53%
France	0.51%	0.42%	0.32%	0.38%	0.46%	0.49%	0.49%	0.32%	0.07%	0.11%	0.26%	0.16%	0.13%	0.24%	0.29%
Germany	0.32%	0.02%	-0.06%	-0.58%	0.09%	0.27%	0.33%	0.31%	0.00%	-0.62%	0.17%	0.09%	0.09%	0.07%	0.16%
Italy					0.63%	0.60%	0.77%	0.83%	0.34%	0.25%	0.27%	-1.26%	0.04%	0.18%	0.23%
Japan				-0.98%	-0.03%	0.14%	0.61%	0.49%	0.26%	-0.23%	0.22%	0.33%	0.30%	0.31%	0.32%
UK		0.94%	0.81%	0.89%	1.05%	0.84%	0.74%	0.75%	-0.31%	0.23%	0.23%	0.21%	0.13%	0.39%	0.73%
US	1.61%	1.17%	1.57%	1.26%	1.28%	1.36%	1.50%	1.11%	0.10%	0.27%	0.52%	0.58%	0.75%	0.86%	0.88%
Australia	1.20%	0.76%	1.04%	0.96%	1.03%	1.06%	1.06%	1.03%	0.85%	0.56%	0.82%	0.89%	0.78%	0.84%	0.84%
Europe	0.77%	0.39%	0.29%	0.41%	0.59%	0.65%	0.68%	0.59%	-0.04%	0.21%	0.32%	0.04%	0.12%	0.30%	0.45%
Europe ex UK	0.77%	0.35%	0.25%	0.38%	0.52%	0.61%	0.67%	0.53%	0.08%	0.21%	0.35%	-0.03%	0.12%	0.27%	0.34%
Nordics	0.77%	0.71%	0.47%	0.58%	0.68%	0.72%	0.76%	0.74%	0.42%	0.21%	0.41%	0.41%	0.43%	0.48%	0.52%
EM	0.69%	0.62%	0.65%	0.79%	1.04%	1.02%	1.06%	1.17%	0.96%	0.95%	1.17%	1.24%	1.20%	1.16%	1.25%
EM Asia	0.66%	0.77%	0.60%	0.78%	1.01%	0.94%	0.90%	1.00%	0.86%	0.89%	1.06%	1.16%	1.13%	1.10%	1.20%
EM Far East	0.58%	0.78%	0.60%	0.76%	0.89%	0.92%	0.92%	1.08%	1.00%	0.98%	1.12%	1.25%	1.22%	1.16%	1.13%
EM LatAm				1.36%	1.45%	2.15%	2.15%	2.15%	1.76%	1.50%	1.68%	1.56%	1.40%	1.38%	1.39%
Brazil				1.45%	1.47%	2.19%	2.17%	2.08%	1.81%	1.47%	1.63%	1.47%	1.30%	1.29%	1.30%
Russia			2.04%	1.07%	1.19%	2.60%	2.66%	2.37%	1.17%	-0.28%	1.99%	2.55%	2.16%	1.92%	1.78%
India	1.03%	0.72%	0.58%	1.11%	1.25%	1.17%	1.14%	1.07%	1.23%	1.25%	1.28%	1.28%	1.27%	1.26%	1.31%
China			0.44%	0.63%	0.74%	0.74%	0.80%	1.02%	1.11%	1.07%	1.17%	1.29%	1.27%	1.19%	1.14%
South Africa	1.85%	0.87%	0.82%	0.83%	1.18%	1.37%	1.49%	1.53%	1.62%	0.85%	0.98%	1.13%	1.13%	1.28%	1.38%
Assets/CE	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012E	2013E	2014E
Canada	23.9	22.8	22.5	22.3	22.7	22.7	22.9	23.7	23.4	19.3	19.9	21.2	19.6	19.0	18.0
Global	21.4	21.1	22.5	29.2	24.5	22.3	20.3	21.6	22.4	18.1	16.9	16.7	16.2	15.5	15.3
G7	27.9	24.7	24.0	41.6	28.4	27.9	24.3	25.2	29.1	23.4	21.3	20.8	20.1	18.8	18.5
France	33.6	33.1	29.8	30.7	33.0	32.7	31.4	35.8	41.2	33.1	31.5	32.6	31.7	29.1	26.7
Germany	36.7	42.6	47.9	42.0	43.6	35.0	42.7	40.7	56.6	95.6	77.3	30.9	27.7	27.2	26.0
Italy					18.5	20.2	20.0	14.7	15.0	13.3	13.3	16.2	14.8	14.8	14.8
Japan				222.2	72.7	64.9	33.9	31.7	32.8	43.6	31.3	26.7	25.4	22.0	21.3
UK		17.9	19.1	19.7	17.2	24.0	24.3	28.8	38.1	22.2	20.7	20.5	20.7	20.0	19.2
US	11.4	11.3	11.4	12.7	10.8	11.7	10.6	11.7	13.6	12.3	11.5	11.0	10.5	10.4	11.0
Australia	16.1	16.4	16.7	16.8	16.5	18.7	19.6	20.7	20.6	17.9	17.4	17.4	16.9	16.6	17.0
Europe	25.4	26.0	25.8	26.9	26.2	27.3	27.0	27.6	32.3	23.6	22.6	23.2	22.6	21.8	20.9
Europe ex UK	25.4	26.8	26.4	27.5	28.9	28.1	27.6	27.2	30.3	24.1	23.5	24.4	23.5	22.5	21.7
Nordics	22.5	22.9	23.6	23.6	24.4	26.3	24.9	25.6	28.0	23.4	22.8	23.9	22.5	21.5	20.6
EM	14.3	13.5	20.4	29.3	21.1	15.7	14.7	17.9	16.5	15.3	14.3	14.4	14.2	14.0	13.9
EM Asia	13.9	13.3	23.2	37.3	23.8	16.7	15.4	20.6	17.7	17.0	15.6	15.4	15.1	14.9	14.8

EM Far East	13.5	12.7	23.9	40.4	30.3	16.5	14.7	20.4	16.2	16.6	15.4	15.1	14.7	14.4	14.3
EM LatAm				13.6	13.7	12.0	11.7	11.4	14.2	11.2	11.4	11.8	11.9	12.5	12.2
Brazil				13.0	14.5	12.7	12.4	12.8	14.9	11.2	11.6	12.0	12.2	12.9	12.7
Russia			8.9	11.1	10.6	9.6	10.1	7.1	9.2	8.4	8.5	9.5	9.8	9.8	9.8
India	16.7	17.8	18.7	18.1	17.6	16.0	14.8	15.8	12.2	13.0	12.4	13.2	12.7	12.8	13.0
China			-29.0	-121.0	-898.3	20.8	16.3	32.5	17.1	18.8	16.9	16.4	15.9	15.5	15.4
South Africa	15.5	16.4	17.4	18.8	17.5	17.6	18.1	18.0	16.6	14.6	13.8	13.2	13.1	12.9	12.8

PAYOUT RATIO	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012E	2013E	2014E
Canada	39.3%	39.4%	41.4%	43.3%	42.6%	45.4%	36.5%	42.0%	56.9%	70.6%	52.5%	45.9%	44.9%	45.3%	45.6%
Global	33.6%	57.6%	55.0%	81.5%	44.9%	42.6%	41.2%	42.9%	84.7%	50.5%	35.0%	42.8%	39.5%	35.6%	36.5%
G7	28.3%	43.2%	42.5%	-101.2%	52.3%	43.9%	36.8%	41.6%	-292.9%	103.0%	31.1%	61.3%	41.9%	32.1%	35.2%
France	27.0%	31.9%	43.1%	41.8%	38.1%	40.9%	45.6%	42.6%	72.2%	48.5%	41.3%	20.0%	44.6%	26.9%	32.9%
Germany	23.2%	170.3%	-14.6%	0.0%	33.1%	26.2%	28.6%	34.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Italy					15.9%	32.9%	33.1%	29.6%	5.7%	28.2%	26.9%	-3.2%	180.3%	46.6%	41.1%
Japan				-1.9%	-38.0%	26.8%	6.7%	9.8%	31.2%	-29.9%	21.2%	28.1%	30.4%	29.4%	29.8%
UK		45.7%	54.9%	48.7%	56.1%	54.9%	55.0%	50.5%	-41.7%	33.2%	42.2%	54.4%	93.2%	32.2%	36.3%
US	33.4%	50.1%	37.1%	48.5%	51.1%	50.2%	46.8%	65.8%	1908.0%	32.4%	15.6%	28.3%	26.0%	29.6%	34.0%
Australia	56.4%	80.4%	66.4%	74.3%	69.7%	69.6%	66.1%	67.0%	73.9%	85.7%	74.5%	74.0%	82.3%	78.4%	78.3%
Europe	26.5%	56.7%	69.5%	53.8%	45.0%	42.9%	42.5%	44.5%	-185.0%	46.0%	38.6%	472.5%	89.9%	38.5%	39.3%
Europe ex UK	26.5%	58.7%	72.6%	54.6%	40.8%	39.7%	39.7%	41.1%	93.5%	52.1%	37.6%	-204.9%	88.2%	42.1%	40.9%
Nordics	42.2%	50.7%	65.6%	50.2%	43.2%	43.6%	40.3%	39.7%	13.2%	52.9%	42.1%	38.4%	37.8%	38.7%	41.3%
EM	63.2%	57.2%	42.6%	27.7%	38.5%	39.9%	46.7%	44.1%	46.5%	41.5%	36.0%	33.8%	34.2%	33.8%	33.7%
EM Asia	71.2%	48.7%	53.0%	26.7%	38.8%	40.3%	51.3%	49.8%	53.5%	44.3%	37.8%	34.9%	35.9%	35.6%	34.7%
EM Far East	84.3%	50.6%	51.9%	26.1%	27.1%	26.6%	44.2%	42.5%	38.8%	40.5%	36.3%	33.6%	34.0%	34.4%	34.2%
EM LatAm				49.3%	35.0%	31.2%	37.7%	30.6%	38.3%	37.9%	40.1%	40.4%	37.6%	34.6%	36.7%
Brazil				58.4%	37.4%	35.0%	41.3%	37.1%	35.6%	41.3%	41.4%	40.8%	38.7%	38.2%	38.0%
Russia			10.3%	18.4%	19.0%	7.9%	9.2%	12.8%	11.9%	-18.6%	10.3%	12.9%	12.9%	13.4%	17.0%
India	34.8%	37.3%	62.3%	33.0%	31.4%	34.1%	36.5%	35.6%	33.5%	32.6%	32.1%	21.1%	21.5%	19.9%	17.7%
China			0.0%	0.8%	0.9%	8.6%	39.8%	42.1%	38.1%	38.9%	35.2%	32.6%	33.4%	33.6%	33.6%
South Africa	26.6%	50.3%	48.5%	55.3%	41.3%	41.8%	41.8%	41.5%	42.5%	49.5%	47.3%	57.1%	49.9%	48.6%	48.8%

T1 RATIO	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012E	2013E	2014E
Canada	6.1%	6.5%	7.0%	7.7%	7.7%	7.6%	10.4%	9.6%	9.3%	11.7%	12.4%	12.9%	12.9%	13.3%	14.1%
Global	8.5%	8.3%	8.5%	9.1%	8.3%	8.4%	8.4%	8.0%	8.8%	10.0%	10.7%	11.4%	15.6%	12.0%	12.1%
G7	7.5%	7.5%	8.0%	8.3%	8.1%	7.9%	7.8%	7.4%	8.2%	9.7%	10.5%	11.5%	22.9%	12.8%	13.0%
France	8.2%	7.8%	8.2%	8.7%	7.9%	7.9%	7.9%	7.6%	8.3%	10.1%	11.0%	11.5%	13.0%	12.9%	13.7%
Germany	5.7%	6.0%	7.3%	7.3%	7.5%	8.3%	6.7%	6.9%	10.1%	10.5%	11.9%	11.1%	13.4%	12.6%	13.2%
Italy					7.4%	7.0%	7.6%	6.7%	7.0%	8.0%	8.7%	9.9%	11.5%	11.9%	12.1%
Japan						8.4%	6.4%	7.0%	7.6%	8.0%	10.1%	11.1%	51.9%	12.4%	12.4%
UK		7.8%	8.2%	7.9%	8.4%	8.2%	8.7%	7.7%	8.4%	11.3%	10.4%	12.4%	13.3%	14.1%	14.6%
US	7.0%	7.3%	7.4%	8.2%	8.6%	8.3%	8.6%	7.4%	9.2%	10.1%	11.4%	11.6%	11.9%	12.3%	11.9%
Australia	6.9%	7.0%	7.4%	7.8%	7.5%	7.9%	7.4%	7.3%	7.9%	8.9%	9.3%	10.0%	10.4%	10.1%	10.3%
Europe	8.2%	8.0%	8.4%	9.1%	8.0%	7.8%	7.9%	7.4%	8.2%	10.3%	10.5%	11.9%	13.0%	13.4%	13.9%
Europe ex UK	8.2%	8.0%	8.4%	9.3%	7.8%	7.7%	7.7%	7.2%	8.1%	9.8%	10.5%	11.6%	12.9%	13.1%	13.5%
Nordics	7.0%	7.1%	7.2%	7.3%	7.6%	7.1%	7.4%	7.2%	9.1%	12.3%	12.9%	13.8%	15.4%	16.1%	16.8%
EM	10.7%	9.9%	9.6%	9.7%	9.1%	9.2%	10.1%	10.0%	9.7%	10.1%	10.8%	10.6%	10.9%	11.0%	11.1%
EM Asia	11.4%	10.4%	9.7%	9.8%	9.0%	9.1%	10.2%	9.8%	9.6%	9.8%	10.7%	10.6%	10.9%	11.0%	11.1%
EM Far East	11.7%	10.7%	9.9%	10.0%	8.8%	9.2%	10.2%	10.0%	9.8%	9.6%	10.4%	10.4%	10.6%	10.7%	10.8%
EM LatAm									9.4%	10.4%	10.1%	11.0%			
Brazil									9.6%						
Russia			14.7%	12.6%	10.9%	10.9%	10.5%	14.2%	11.5%	12.6%	12.0%	10.7%	10.3%	10.5%	10.5%
India	9.8%	8.9%	8.6%	8.4%	8.1%	8.5%	9.3%	8.0%	10.1%	10.2%	10.7%	10.0%	10.8%	10.3%	10.0%
China			6.2%	6.4%	8.0%	8.6%	10.6%	10.6%	9.8%	8.9%	9.8%	10.0%	10.2%	10.3%	10.4%
South Africa	9.8%	7.7%	7.1%	7.4%	9.2%	9.1%	8.7%	8.5%	10.1%	12.1%	12.6%	13.5%	12.8%	13.8%	14.2%

Source: Citi Research

Figure 249. Global Banking Comps by Geography/Grouping (cont'd)

NIM	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012E	2013E	2014E
Canada	2.07%	2.24%	2.29%	2.15%	2.07%	2.00%	1.84%	1.82%	1.89%	2.19%	2.08%	1.98%	2.00%	2.07%	2.12%
Global	1.50%	1.82%	1.95%	1.87%	1.97%	1.98%	1.95%	2.01%	2.12%	2.18%	2.21%	2.36%	2.42%	2.50%	2.47%
G7	0.98%	1.72%	1.85%	1.64%	1.94%	1.90%	1.86%	1.72%	1.85%	1.78%	1.83%	1.80%	1.70%	1.68%	1.71%
France	0.56%	0.62%	0.75%	0.89%	0.95%	0.72%	0.64%	0.60%	0.75%	1.02%	1.10%	1.07%	0.98%	0.98%	1.03%
Germany	0.83%	0.78%	0.81%	0.79%	0.77%	0.78%	0.74%	0.71%	0.82%	0.93%	0.93%	1.10%	0.87%	0.83%	0.83%
Italy					2.05%	1.83%	1.91%	1.98%	2.10%	1.86%	1.65%	1.59%	1.50%	1.46%	1.50%
Japan				1.50%	1.53%	1.45%	1.41%	1.33%	1.34%	1.31%	1.34%	1.32%	1.28%	1.25%	1.24%
UK		2.60%	2.52%	2.39%	3.65%	3.45%	3.43%	2.39%	2.37%	2.18%	2.26%	2.23%	2.11%	2.08%	2.14%
US	3.81%	4.48%	4.63%	3.59%	3.51%	3.38%	3.56%	3.35%	3.69%	3.49%	3.31%	3.08%	2.88%	2.77%	2.70%
Australia	2.84%	2.74%	2.67%	2.55%	2.39%	2.28%	2.20%	2.10%	1.97%	2.13%	2.19%	2.20%	2.11%	2.08%	2.05%
Europe	1.09%	1.27%	1.42%	1.36%	1.54%	1.51%	1.45%	1.42%	1.56%	1.65%	1.64%	1.61%	1.53%	1.54%	1.59%
Europe ex UK	1.09%	1.18%	1.35%	1.29%	1.17%	1.09%	1.04%	1.06%	1.20%	1.44%	1.40%	1.36%	1.30%	1.32%	1.37%
Nordics	1.42%	1.60%	1.41%	1.35%	1.22%	1.14%	1.05%	1.06%	1.17%	1.26%	1.18%	1.22%	1.25%	1.28%	1.31%
EM	2.51%	2.79%	2.94%	2.81%	3.35%	3.45%	3.41%	3.18%	3.20%	3.03%	3.01%	3.06%	2.99%	2.91%	2.88%
EM Asia	2.40%	2.50%	2.55%	2.60%	3.13%	3.17%	3.13%	2.85%	2.89%	2.48%	2.49%	2.64%	2.60%	2.51%	2.47%
EM Far East	2.29%	2.41%	2.52%	2.58%	2.52%	2.64%	2.69%	2.89%	2.93%	2.37%	2.49%	2.59%	2.58%	2.50%	2.44%
EM LatAm				7.21%	6.73%	7.33%	7.19%	6.66%	5.71%	6.28%	6.11%	5.93%	5.68%	5.44%	5.31%
Brazil				8.08%	6.98%	7.68%	7.41%	6.75%	5.76%	6.51%	6.28%	6.10%	5.87%	5.56%	5.37%
Russia			7.90%	4.36%	4.96%	6.25%	5.80%	5.29%	5.67%	6.42%	5.77%	5.48%	5.17%	5.27%	5.33%
India	2.84%	2.91%	2.71%	2.85%	3.04%	3.16%	3.15%	2.96%	2.82%	2.91%	2.84%	3.20%	3.23%	3.20%	3.24%
China				2.63%	2.52%	2.57%	2.57%	2.93%	3.01%	2.30%	2.43%	2.61%	2.61%	2.50%	2.42%
South Africa	2.82%	2.96%	3.01%	3.00%	2.77%	2.80%	2.87%	3.02%	3.13%	2.97%	2.91%	2.93%	3.04%	3.13%	3.23%
Non-NII/Assets	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012E	2013E	2014E
Canada	2.25%	2.25%	2.00%	1.83%	1.87%	1.93%	2.03%	1.65%	1.51%	1.55%	1.58%	1.55%	1.50%	1.51%	1.54%
Global	1.81%	1.72%	1.43%	1.19%	1.20%	1.31%	1.33%	1.33%	0.96%	1.34%	1.38%	1.32%	1.27%	1.29%	1.31%
G7	1.58%	1.68%	1.53%	1.04%	1.02%	1.13%	1.18%	1.17%	0.71%	0.93%	1.00%	0.94%	0.92%	0.95%	0.96%
France	1.73%	1.58%	1.31%	1.31%	0.96%	1.11%	1.17%	1.05%	0.61%	0.65%	0.81%	0.77%	0.56%	0.67%	0.70%
Germany	1.06%	0.75%	0.66%	0.21%	0.68%	0.89%	0.76%	0.63%	0.29%	0.44%	0.68%	0.30%	0.67%	0.71%	0.74%
Italy					1.69%	1.47%	1.42%	1.28%	0.97%	1.09%	1.07%	1.15%	1.13%	1.07%	1.09%
Japan				0.51%	0.45%	0.49%	0.52%	0.50%	0.39%	0.33%	0.35%	0.41%	0.45%	0.41%	0.41%
UK		1.98%	1.64%	1.66%	1.69%	1.42%	1.40%	1.37%	0.67%	1.09%	1.13%	1.10%	1.03%	1.05%	1.09%
US	1.53%	2.36%	2.46%	2.48%	2.12%	2.20%	2.42%	2.10%	1.84%	3.06%	2.96%	2.58%	2.63%	2.64%	2.58%
Australia	1.71%	1.86%	1.57%	1.34%	1.50%	1.49%	1.33%	1.19%	1.21%	0.89%	0.97%	0.98%	0.96%	0.91%	0.91%
Europe	1.92%	1.70%	1.34%	1.29%	1.25%	1.35%	1.31%	1.18%	0.60%	0.96%	1.01%	1.00%	0.90%	0.94%	0.97%
Europe ex UK	1.92%	1.68%	1.32%	1.26%	1.17%	1.33%	1.29%	1.11%	0.57%	0.92%	0.97%	0.96%	0.85%	0.89%	0.92%
Nordics	1.34%	0.98%	0.73%	0.80%	0.81%	0.95%	0.87%	0.77%	0.71%	0.80%	0.72%	0.68%	0.63%	0.63%	0.64%
EM	1.12%	1.09%	1.08%	0.91%	1.12%	1.11%	1.10%	1.14%	1.15%	1.03%	1.05%	1.09%	1.02%	1.00%	1.00%
EM Asia	1.02%	0.99%	0.77%	0.63%	0.97%	0.93%	0.98%	0.93%	0.84%	0.84%	0.89%	0.85%	0.85%	0.85%	0.85%
EM Far East	0.92%	0.90%	0.67%	0.56%	0.63%	0.55%	0.54%	0.63%	0.58%	0.62%	0.65%	0.75%	0.72%	0.73%	0.75%
EM LatAm				2.06%	2.34%	2.68%	2.59%	2.30%	2.88%	2.15%	2.19%	2.41%	2.29%	2.01%	1.96%
Brazil				1.93%	2.20%	2.73%	2.55%	2.29%	3.16%	2.14%	2.21%	2.44%	2.34%	2.00%	1.92%
Russia			4.17%	3.84%	2.17%	2.24%	2.23%	1.65%	1.33%	1.20%	1.60%	1.44%	1.44%	1.43%	1.39%
India	1.54%	1.49%	1.58%	1.61%	1.79%	1.46%	1.40%	1.25%	1.45%	1.56%	1.35%	1.19%	1.20%	1.16%	1.15%
China			0.22%	0.28%	0.37%	0.32%	0.29%	0.43%	0.52%	0.58%	0.59%	0.69%	0.67%	0.68%	0.70%
South Africa	2.69%	3.36%	2.22%	2.21%	2.33%	2.58%	2.59%	2.42%	2.66%	2.33%	2.52%	2.84%	2.86%	2.78%	2.85%
Costs/Assets	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012E	2013E	2014E
Canada	2.62%	2.66%	2.60%	2.43%	2.42%	2.42%	2.16%	1.81%	1.99%	1.96%	1.90%	1.87%	1.83%	1.86%	1.87%
Global	1.97%	2.15%	1.93%	1.58%	1.53%	1.56%	1.50%	1.53%	1.50%	1.63%	1.66%	1.70%	1.62%	1.61%	1.60%
G7	1.47%	1.95%	1.87%	1.30%	1.31%	1.34%	1.31%	1.28%	1.14%	1.29%	1.33%	1.31%	1.23%	1.24%	1.23%
France	1.44%	1.40%	1.33%	1.31%	1.15%	1.13%	1.07%	1.02%	0.98%	1.06%	1.16%	1.22%	1.05%	1.05%	1.09%
Germany	1.17%	1.17%	1.10%	1.06%	0.97%	1.10%	0.83%	0.82%	0.83%	1.04%	1.05%	1.30%	1.05%	1.07%	1.03%
Italy					2.02%	1.84%	1.63%	1.55%	1.71%	1.57%	1.53%	1.67%	1.46%	1.44%	1.39%
Japan				0.69%	0.63%	0.64%	0.67%	0.68%	0.59%	0.67%	0.65%	0.60%	0.62%	0.65%	0.63%
UK		2.42%	2.04%	1.98%	2.08%	1.64%	1.52%	1.40%	1.14%	1.24%	1.31%	1.31%	1.22%	1.18%	1.19%
US	2.21%	3.49%	3.45%	3.20%	2.74%	2.66%	2.74%	2.55%	2.17%	2.86%	2.91%	2.91%	2.83%	2.75%	2.66%
Australia	2.08%	2.05%	1.83%	1.63%	1.77%	1.79%	1.63%	1.37%	1.46%	1.15%	1.29%	1.34%	1.31%	1.23%	1.21%
Europe	1.95%	2.02%	1.77%	1.58%	1.47%	1.47%	1.31%	1.26%	1.21%	1.28%	1.31%	1.38%	1.24%	1.24%	1.24%
Europe ex UK	1.95%	1.99%	1.76%	1.55%	1.36%	1.43%	1.27%	1.21%	1.24%	1.30%	1.32%	1.41%	1.25%	1.26%	1.26%
Nordics	1.47%	1.36%	1.14%	1.07%	1.02%	1.05%	0.90%	0.87%	1.00%	0.91%	0.85%	0.86%	0.78%	0.78%	0.77%
EM	1.68%	1.90%	1.86%	1.72%	1.85%	1.82%	1.74%	1.71%	1.79%	1.62%	1.61%	1.68%	1.62%	1.57%	1.56%
EM Asia	1.48%	1.48%	1.46%	1.37%	1.57%	1.52%	1.45%	1.45%	1.43%	1.29%	1.27%	1.32%	1.31%	1.29%	1.29%

EM Far East	1.34%	1.35%	1.39%	1.33%	1.31%	1.33%	1.29%	1.37%	1.39%	1.20%	1.19%	1.25%	1.26%	1.28%	1.28%
EM LatAm				5.61%	5.45%	5.37%	5.04%	4.18%	4.40%	3.65%	3.57%	4.01%	3.74%	3.25%	3.18%
Brazil				5.73%	5.39%	5.49%	5.06%	4.11%	4.66%	3.76%	3.65%	4.12%	3.90%	3.30%	3.18%
Russia			6.35%	5.14%	4.18%	3.83%	3.43%	3.09%	3.29%	2.58%	2.75%	3.04%	2.83%	2.93%	2.86%
India	2.17%	2.17%	2.02%	1.99%	1.95%	1.95%	1.99%	1.78%	1.76%	1.87%	1.61%	1.66%	1.78%	1.66%	1.64%
China			1.49%	1.31%	1.29%	1.24%	1.16%	1.28%	1.32%	1.14%	1.12%	1.18%	1.21%	1.22%	1.23%
South Africa	3.30%	3.90%	2.50%	2.61%	2.58%	2.78%	2.64%	2.45%	2.73%	2.50%	2.75%	3.06%	3.10%	2.95%	2.93%

Provs/Assets	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012E	2013E	2014E
Canada	0.25%	0.38%	0.63%	0.17%	0.03%	0.06%	0.08%	0.10%	0.22%	0.35%	0.21%	0.18%	0.18%	0.18%	0.19%
Global	0.21%	0.30%	0.34%	0.29%	0.22%	0.20%	0.22%	0.27%	0.57%	0.82%	0.50%	0.41%	0.37%	0.36%	0.35%
G7	0.15%	0.29%	0.29%	0.24%	0.17%	0.15%	0.19%	0.23%	0.50%	0.79%	0.48%	0.36%	0.27%	0.26%	0.24%
France	0.15%	0.15%	0.16%	0.16%	0.07%	0.05%	0.05%	0.10%	0.26%	0.41%	0.25%	0.31%	0.20%	0.20%	0.17%
Germany	0.15%	0.19%	0.28%	0.26%	0.18%	0.13%	0.15%	0.07%	0.31%	0.49%	0.30%	0.23%	0.23%	0.23%	0.21%
Italy					0.32%	0.26%	0.24%	0.26%	0.45%	0.72%	0.60%	0.68%	0.70%	0.63%	0.59%
Japan				0.24%	0.10%	0.03%	0.16%	0.05%	0.09%	0.35%	0.19%	0.07%	0.04%	0.08%	0.09%
UK		0.44%	0.48%	0.38%	0.39%	0.35%	0.39%	0.36%	0.72%	1.10%	0.64%	0.50%	0.34%	0.30%	0.27%
US	0.16%	0.59%	0.50%	0.41%	0.25%	0.30%	0.41%	0.66%	1.55%	1.76%	0.90%	0.41%	0.28%	0.28%	0.28%
Australia	0.18%	0.25%	0.21%	0.17%	0.15%	0.13%	0.11%	0.11%	0.30%	0.47%	0.28%	0.20%	0.22%	0.20%	0.21%
Europe	0.11%	0.17%	0.22%	0.17%	0.15%	0.14%	0.15%	0.19%	0.43%	0.68%	0.44%	0.46%	0.39%	0.34%	0.30%
Europe ex UK	0.11%	0.15%	0.20%	0.16%	0.10%	0.09%	0.10%	0.12%	0.30%	0.52%	0.36%	0.45%	0.41%	0.36%	0.32%
Nordics	0.05%	0.10%	0.08%	0.10%	0.02%	0.01%	0.02%	0.01%	0.20%	0.54%	0.20%	0.13%	0.15%	0.12%	0.10%
EM	0.78%	0.79%	0.80%	0.63%	0.49%	0.46%	0.48%	0.51%	0.78%	0.76%	0.49%	0.46%	0.45%	0.45%	0.46%
EM Asia	0.85%	0.71%	0.73%	0.58%	0.45%	0.41%	0.44%	0.48%	0.65%	0.48%	0.32%	0.32%	0.29%	0.30%	0.31%
EM Far East	0.90%	0.71%	0.72%	0.57%	0.53%	0.40%	0.41%	0.39%	0.60%	0.34%	0.31%	0.30%	0.30%	0.31%	0.31%
EM LatAm				1.10%	1.12%	1.30%	1.56%	1.36%	1.97%	1.92%	1.49%	1.76%	1.83%	1.53%	1.45%
Brazil				1.32%	1.20%	1.47%	1.78%	1.43%	2.08%	1.99%	1.57%	1.90%	2.03%	1.65%	1.54%
Russia			1.28%	1.07%	0.88%	0.66%	0.52%	0.44%	1.91%	4.82%	1.57%	0.23%	0.46%	0.80%	1.08%
India	0.56%	0.70%	0.78%	0.70%	0.86%	0.28%	0.23%	0.37%	0.43%	0.52%	0.55%	0.53%	0.68%	0.69%	0.67%
China			0.59%	0.53%	0.46%	0.33%	0.34%	0.39%	0.60%	0.26%	0.25%	0.29%	0.29%	0.31%	0.31%
South Africa	0.57%	0.60%	0.55%	0.42%	0.27%	0.21%	0.30%	0.37%	0.82%	0.97%	0.78%	0.73%	0.83%	0.70%	0.75%

C/I Ratio	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012E	2013E	2014E
Canada	65%	65%	66%	69%	69%	69%	62%	61%	63%	61%	60%	59%	59%	58%	57%
Global	64%	66%	64%	59%	56%	55%	54%	55%	58%	54%	54%	56%	55%	54%	53%
G7	61%	62%	61%	58%	56%	55%	55%	55%	61%	58%	57%	59%	59%	58%	57%
France	64%	65%	67%	65%	66%	64%	63%	66%	75%	66%	63%	65%	71%	65%	64%
Germany	65%	80%	83%	123%	73%	67%	59%	66%	77%	82%	69%	93%	72%	72%	68%
Italy					61%	59%	55%	54%	59%	56%	58%	59%	57%	57%	55%
Japan				47%	47%	46%	47%	50%	52%	57%	54%	52%	52%	53%	52%
UK		57%	56%	56%	54%	54%	53%	52%	61%	55%	56%	58%	59%	56%	55%
US	50%	58%	56%	57%	55%	53%	50%	53%	50%	53%	57%	64%	63%	62%	62%
Australia	54%	52%	53%	53%	54%	54%	52%	51%	51%	47%	47%	48%	48%	46%	46%
Europe	69%	72%	71%	67%	62%	60%	58%	58%	70%	58%	59%	61%	62%	60%	58%
Europe ex UK	69%	74%	73%	68%	65%	62%	59%	61%	74%	60%	60%	63%	63%	61%	59%
Nordics	56%	58%	61%	56%	57%	53%	52%	53%	56%	51%	54%	55%	52%	51%	49%
EM	50%	55%	51%	52%	50%	50%	49%	47%	46%	46%	46%	45%	45%	45%	45%
EM Asia	47%	47%	47%	47%	47%	48%	47%	45%	44%	46%	44%	43%	44%	44%	44%
EM Far East	45%	45%	46%	47%	45%	46%	45%	43%	43%	45%	42%	41%	42%	43%	43%
EM LatAm				68%	65%	57%	56%	53%	47%	50%	49%	49%	49%	48%	48%
Brazil				65%	64%	56%	55%	52%	47%	51%	50%	49%	49%	48%	47%
Russia			58%	71%	68%	52%	50%	54%	47%	37%	42%	48%	49%	49%	47%
India	54%	53%	49%	48%	45%	46%	48%	48%	46%	43%	43%	42%	41%	41%	40%
China			52%	49%	47%	48%	45%	42%	41%	43%	41%	39%	40%	41%	42%
South Africa	61%	60%	60%	61%	60%	59%	55%	53%	52%	53%	57%	56%	56%	55%	53%

Source: Citi Research

Appendix: Global Comps – Valuation

Figure 250. Select Global Bank Valuation Comps (prices as of 30 Nov 2012 close)

Company Name	Price	Rating/Risk	Mkt Cap USD (M)	P/E (x)			P/B(x)				Div Yield		RoAE		
				2012E	2013E	2014E	2012E	2013E	2012E	2013E	2012E	2013E	2012E	2013E	2014E
Canadian Banks															
Bank of Montreal *	CAD 59.67		39,050	10.3	9.9	9.3	1.48	1.38	NA	NA	4.7%	4.9%	14.4%	13.9%	14.1%
Canadian Western *	CAD 29.10		2,304	12.6	11.3	NA	1.68	1.51	NA	NA	2.2%	2.4%	14.8%	14.5%	NA
CIBC *	CAD 80.20		32,625	9.9	9.5	8.9	2.10	1.89	NA	NA	4.6%	4.8%	22.0%	20.5%	19.9%
Laurentian Bank *	CAD 45.01		1,273	8.7	8.1	NA	1.04	0.96	NA	NA	4.2%	4.6%	12.2%	12.2%	NA
National Bank of Canada *	CAD 77.58		12,571	9.8	9.4	8.9	1.84	1.65	NA	NA	4.0%	4.4%	19.6%	18.3%	17.7%
Royal Bank of Canada	CAD 58.90	1	85,612	12.0	11.2	10.2	2.20	2.00	3.00	2.70	3.9%	4.2%	19.3%	18.8%	19.0%
Scotiabank	CAD 56.00	2	66,713	11.4	11.1	10.0	1.90	1.80	2.60	2.50	3.9%	4.2%	18.8%	16.9%	17.1%
Toronto Dominion	CAD 82.98	1	76,628	11.3	10.3	9.6	1.70	1.60	2.60	2.30	3.5%	4.0%	16.3%	16.1%	15.7%
Canadian Banks Agg			316,777	11.1	10.4	9.6	1.76	1.69	NA	NA	4.0%	4.3%	17.2%	16.9%	16.9%
US Banks															
Bank of America	USD 9.86	2	106,272	24.7	11.6	8.6	0.48	0.47	0.72	0.69	0.4%	2.7%	2.0%	4.1%	5.5%
BB&T	USD 28.17	1	19,709	10.4	9.4	8.8	1.00	0.94	1.58	1.44	2.8%	3.4%	10.2%	10.5%	10.5%
Comerica Inc	USD 29.59	2	5,632	11.2	12.3	12.3	0.79	0.75	0.87	0.82	1.9%	2.4%	7.3%	6.2%	6.0%
Fifth Third	USD 14.64	2	13,139	8.9	8.8	9.1	0.97	0.92	1.18	1.10	2.5%	3.0%	11.4%	10.9%	10.3%
Goldman Sachs	USD 117.79	1	55,355	9.4	9.2	8.1	0.84	0.81	0.91	0.87	1.5%	1.7%	9.5%	9.1%	9.9%
Huntington Banc	USD 6.17	1	5,274	9.5	9.5	8.8	0.95	0.93	1.07	1.03	2.6%	3.2%	11.3%	9.9%	10.8%
JP Morgan Chase	USD 41.08	1	156,162	8.1	7.9	7.8	0.80	0.75	1.06	0.97	2.9%	3.3%	10.5%	10.0%	9.6%
Keycorp	USD 8.08	2	7,544	9.5	10.1	9.0	0.75	0.71	0.85	0.80	2.2%	2.8%	8.0%	6.8%	7.6%
Lazard	USD 29.45	2	3,701	49.1	17.3	12.0	5.52	4.21	13.82	7.56	2.7%	3.3%	11.7%	30.2%	35.9%
Morgan Stanley	USD 16.87	2	33,307	NM	8.9	6.9	0.55	0.52	0.63	0.61	1.2%	1.8%	0.0%	6.1%	8.0%
M&T Bank Corp	USD 97.73	2	12,510	12.9	11.8	11.2	1.35	1.24	2.19	1.73	2.9%	2.9%	9.6%	10.1%	10.2%
New York Comm Bancrp	USD 13.01	3	5,713	11.3	13.7	15.3	1.01	1.00	1.79	1.76	7.7%	5.8%	9.1%	7.4%	6.5%
PennyMac Mortgage	USD 24.65	1	1,452	8.1	7.6	7.4	1.21	1.16	1.21	1.16	9.0%	9.7%	15.3%	15.7%	15.5%
PNC Finl Svc	USD 56.14	2	29,690	9.9	8.5	8.1	0.83	0.78	1.12	1.01	2.8%	3.1%	7.0%	8.1%	8.0%
Regions	USD 6.67	2	9,425	9.5	9.5	8.9	0.62	0.59	0.95	0.87	0.6%	1.9%	6.9%	6.3%	6.7%
SVB Fin	USD 55.22	1	2,458	15.0	16.0	14.2	1.35	1.26	1.35	1.26	0.0%	0.0%	9.5%	8.2%	8.6%
SunTrust Banks	USD 27.15	2	14,629	7.5	10.6	9.9	0.71	0.68	1.04	0.97	0.7%	1.8%	9.7%	6.5%	6.8%
US Bancorp	USD 32.26	2	60,661	11.2	10.2	10.1	1.75	1.62	2.38	2.15	2.4%	2.9%	17.2%	16.6%	16.3%
Wells Fargo	USD 33.01	2	173,774	9.9	9.3	9.2	1.19	1.11	1.60	1.45	2.7%	3.6%	13.0%	12.5%	12.2%
Zions Bancorp	USD 20.07	2	3,696	17.8	12.2	10.6	0.76	0.72	0.97	0.90	0.2%	1.2%	4.5%	6.0%	6.5%
US Banks Agg **			758,133	10.9	9.3	8.7	0.83	0.79	1.10	1.02	2.6%	3.3%	9.5%	10.0%	10.2%
Nordic Banks															
Danske Bank	DKK 98.35	2	17,267	20.5	9.9	7.3	0.72	0.67	0.85	0.78	0.0%	1.5%	3.5%	7.0%	8.9%
DnB	NOK 71.60	1	20,573	8.9	7.8	7.1	0.91	0.84	0.96	0.88	3.1%	4.2%	10.6%	11.1%	11.3%
Swedbank	SEK 122.90	2	20,901	10.2	9.8	9.0	1.29	1.21	1.45	1.35	4.9%	5.1%	13.1%	12.8%	12.9%
Nordea	EUR 7.01	2	37,000	9.5	9.0	8.1	1.01	0.94	1.15	1.06	4.1%	4.4%	10.7%	10.8%	11.2%
SE Banken AB	SEK 53.55	3	17,627	10.2	10.1	9.4	1.01	0.95	1.19	1.11	3.7%	4.0%	10.2%	9.6%	9.8%
SHB	SEK 236.50	2	22,442	11.2	10.6	9.9	1.43	1.34	1.54	1.43	4.4%	4.8%	13.3%	13.0%	13.0%
Nordic Banks Agg			135,809	10.6	9.4	8.3	1.02	0.95	1.15	1.06	3.6%	4.1%	10.5%	10.9%	11.3%
Australian Banks															
ANZ Banking Grp	AUD 24.69	1	69,992	11.5	10.6	10.1	1.64	1.55	1.98	1.84	6.0%	6.3%	14.7%	14.8%	14.6%
Bendigo&Adelaide	AUD 8.11	2	3,402	9.7	9.7	9.3	0.77	0.76	1.20	1.16	7.6%	7.9%	6.6%	8.1%	8.1%
Bk Of Queensland	AUD 6.99	2	2,251	21.3	9.0	8.3	0.74	0.73	0.91	0.89	7.4%	7.4%	2.1%	7.9%	8.5%
Commonwealth Bank	AUD 60.81	1	102,038	13.6	12.9	12.3	2.29	2.20	3.00	2.79	5.6%	5.9%	17.8%	17.3%	17.6%
Macquarie Grp	AUD 32.81	2	11,604	14.9	12.7	10.7	0.94	0.90	1.06	1.01	4.7%	5.7%	6.8%	7.5%	8.7%
NAB	AUD 24.29	2	58,276	10.1	9.8	9.3	1.47	1.37	1.56	1.44	7.4%	7.5%	10.7%	12.6%	12.8%
Westpac	AUD 25.56	1	82,125	11.7	12.1	11.7	1.77	1.72	2.43	2.33	6.6%	6.9%	14.1%	14.2%	14.4%
Australian Banks Agg			329,687	12.0	11.5	10.9	1.71	1.63	2.10	1.97	6.2%	6.5%	14.3%	14.7%	14.8%
Aggregates															
Canadian Banks			316,777	11.1	10.4	9.6	1.76	1.69	NA	NA	4.0%	4.3%	17.2%	16.9%	16.9%
US Banks			758,133	10.9	9.3	8.7	0.83	0.79	1.10	1.02	2.6%	3.3%	9.5%	10.0%	10.2%
Nordic Banks			135,809	10.6	9.4	8.3	1.02	0.95	1.15	1.06	3.6%	4.1%	10.5%	10.9%	11.3%
Australian Banks			329,687	12.0	11.5	10.9	1.71	1.63	2.10	1.97	6.2%	6.5%	14.3%	14.7%	14.8%

Source: Citi Research * Based on consensus estimates. ** Includes all US financials (ex insurance) under Citi coverage

Figure 251. Ratings and Current Prices of Companies mentioned (Local Currency)

Company Name	Reuters Code	Rating	Current Price (Local curr)	Company Name	Reuters Code	Rating	Current Price (Local curr)
Canadian Banks				Nordic Banks			
Bank of Montreal	BMO.TO	N/R	59.67	Danske Bank	DANSKE.CO	2	98.35
Canadian Tire Bank	CDNTF.PK	N/R	79.076	DnB	DNB.OL	1	71.25
Canadian Western	CWB.TO	N/R	28.95	Swedbank	SWEDa.ST	2	122.9
CIBC	CM.TO	N/R	80.2	Nordea	NDA1V.HE	2	7.01
Laurentian Bank	LB.TO	N/R	44.645	SE Banken AB	SEBa.ST	3	53.55
National Bank of Canada	NA.TO	N/R	77.63	SHB	SHBa.ST	2	236.5
Royal Bank of Canada (RBC or RY)	RY.TO	1	58.73				
Scotiabank (Bank of Nova Scotia)	BNS.TO	2	55.67				
Toronto Dominion (TD)	TD.TO	1	82.7				
US Banks				Australian Banks			
American Capital Agency Corp	AGNC.O	2	31.55	ANZ Banking Grp	ANZ.AX	1	24.69
American Capital Mortgage Invst Corp	MTGE.O	2	25.54	Bendigo&Adelaide	BEN.AX	2	8.11
Annaly Capital	NLY.N	2	14.61	Bk Of Queensland	BOQ.AX	2	6.99
Apollo Comm	ARI.N	2	16.67	Commonwealth Bank	CBA.AX	1	60.81
Ares Commercial	ACRE.N	1	16.36	Macquarie Grp	MQG.AX	2	32.81
Bank of America	BAC.N	2	9.9	NAB	NAB.AX	2	24.29
BB&T	BBT.N	1	28.28	Westpac	WBC.AX	1	25.56
Capital One Bank (USA), N.A.	COF.N	1	57.88				
Citibank, N.A.	C.N	N/R	34.47	European & Asian Banks			
Comerica Inc	CMA.N	2	29.54	Barclays	BARC.L	1	2.475
Fifth Third	FITB.O	2	14.64	BNP Paribas	BNPP.PA	1	43.23
First Horizon Ntl	FHN.N	2	9.55	Commerzbank	CBKG.DE	2H	1.39
First Niagara	FNFG.O	2	7.54	Credit Agricole	CAGR.PA	2	5.979
Goldman Sachs	GS.N	1	118.94	Credit Suisse	CSGN.VX	1	22.14
Huntington Banc	HBAN.O	1	6.165	Deutsche Bank AG	DBGn.DE	2	34.52
JP Morgan Chase	JPM.N	1	41.14	HSBC	HSBA.L	1	6.388
Keycorp	KEY.N	2	8.06	Lloyds	LLOY.L	1	0.46245
Lazard	LAZ.N	2	29.31	Mizuho	8411.T	1	132
M&T Bank Corp	MTB.N	2	97.62	Santander	SAN.MC	2H	5.998
Morgan Stanley	MS.N	2	16.88	Societe Generale	SOGN.PA	1	28.365
Nationstar	NSM.N	2	30.72	Sumitomo MFG	8316.T	1	2660
New York Comm Bancrp	NYCB.N	3	13	UBS	UBSN.VX	1	14.63
PennyMac Mortgage	PMT.N	1	24.49				
PNC Finl Svc	PNC.N	2	56.12				
Regions	RF.N	2	6.66				
Starwood	STWD.N	1	23				
SunTrust Banks	STI.N	2	26.92				
SVB Fin	SIVB.O	1	55.22				
US Bancorp	USB.N	2	32.3				
Wells Fargo	WFC.N	2	33.12				
Western Asset	WMC.N	1	20.74				
Zions Bancorp	ZION.O	2	20.07				

Note: Ratings: 1 = Buy; 2 = Neutral, 3 = Sell; H = High Risk
Source: dataCentral, Citi Research

Royal Bank of Canada

Company description

Royal Bank of Canada (RY) is a diversified financial services company. RY provides personal and commercial banking, wealth management services, insurance, corporate and investment banking and transaction processing services on a global basis. Its International Banking segment includes its banking businesses in the United States and Caribbean, as well as RBC Dexia Investor Services. RBC Bank in the United States provides a line of products and services through 426 banking centers and approximately 480 automatic teller machines (ATMs). RY also provides customized trust, banking, credit and investment solutions to clients in 21 countries worldwide.

Investment strategy

We have a Buy rating on Royal Bank of Canada (RY). RY is the largest bank in Canada by assets and in its domestic market RY is the most cost-efficient bank. Our investment strategy is based on three points:

1) We believe that RY's build-out of its wholesale business offers investors upside to earnings estimates: we estimate every 1 ppt increase in the ROE of the wholesale business represents 2% upside to our EPS. If management achieves the 'high teen' ROE target, our group EPS estimates could potentially increase by 10%.

2) We also think the market is over-discounting macro fears in RY's shares - especially worries about an overlevered Canadian consumer and slowing volume growth.

3) We believe RY's Canadian banking net interest margin is close to bottoming out. While we conservatively expect a small increase in 2013, there may be upside to our estimates from loan repricing. And should the Bank of Canada increase the target rate (vs. 1% today), margins could increase further. Opportunistic acquisitions in the auto and consumer finance space may provide yet further upside to margins.

Valuation

We have a C\$67 target price on RY. We value the shares using three approaches:

1) Reported P/B warranted equity valuation; 2) Tangible P/B warranted equity valuation; and 3) Dividend Discount Model. We set our target price at the average of these outcomes and cross-check against a market referenced sum-of-the-parts valuation. Our Cost of Equity assumption is 10.0% and our perpetual growth assumption is 3.5%.

Risks

1) Higher – or lower – loan impairments: should loan losses approach 2008-9 levels, RY's profitability will suffer and there would be downside risk to our target price. On the other hand, should the cost of risk fall below our forecast of 30-35 bps over the next few years, there would be upside to our earnings estimates and target price.

2) Higher – or lower – margins: should the Bank of Canada decide to target a lower rate (by 25 bps or more), margins are likely to suffer and introduce downside risk to our target price. Should the Bank decide to hike rates (25 bps or more), there may be upside to our earnings estimates and target price.

3) Dividend payout ratio increases above 50% – or Falls Below 40%: if RY management believes that returning more to shareholders is the appropriate strategy for maintaining profitability in a lower volume growth environment, there may be upside risk to our target price. On the other hand, if management or the bank regulator determines that RY should rebuild capital by paying out less than 40%, there may be downside to our total return target.

4) European sovereign crisis: RY has c.\$40bn of exposure to European governments and corporates. While the exposure is manageable within the current European political and macro environment, should the sovereign crisis in Europe deteriorate there may be downside risk to our book value estimates and hence to our target price. Additional volatility is also likely to negatively impact RY's capital markets revenues.

Toronto Dominion

Company description

Toronto-Dominion serves approximately 20.5 million customers in four businesses operating in a number of locations in financial centres worldwide: Canadian Personal and Commercial Banking, including TD Canada Trust, TD Insurance, and TD Auto Finance Canada; Wealth Management, including TD Waterhouse and an investment in TD Ameritrade; U.S. Personal and Commercial Banking, including TD Bank, and TD Auto Finance U.S.; and Wholesale Banking, including TD Securities. On April 1, 2011, the Bank acquired 100% of the outstanding equity of Chrysler Financial. On December 1, 2011, the Company announced that it completed the acquisition of substantially all of MBNA Canada's credit card portfolio, as well as certain other assets and liabilities, from Bank of America Corporation.

Investment strategy

We have a Buy rating on Toronto Dominion shares. TD is also one of the nimblest and fastest-growing players in the Northeast US and one of the two most customer-centric banks both in Canada and the US. Our investment strategy is based on three points:

1) US Upside: We believe TD is best positioned to take advantage of the US housing and economic market recovery in terms of lower impairments. Besides the upside to EPS estimates (we estimate 1% accretion for each additional 10 bps improvement), we believe that the US business could generate excess capital by moving from the Standardised to the Advanced IRB approach for credit risk modelling. The upside could be to the tune of 5% to current 2012E book value and 79% to current 2012E DPS estimates.

2) Payout Ratio: We believe that TD's payout ratio will increase to 44% in 2014E on the back of: 1) higher management guidance of 40-50% (up from 35-45%); and 2) a guided-to earnings growth towards the "lower end of 7-10%" (a higher payout maintains ROE in a slower earnings growth environment). Every 5ppt increase in the payout ratio increases our expected dividend yield by c. 0.5%.

3) Additional Cost Control: if management overdelivers on cost control in the Canadian business, every additional 100 bps improvement in the efficiency ratio would translate into 1% uplift to our group EPS.

Valuation

We have a C\$92 target price on TD. We value the shares using three approaches: 1) Reported P/B warranted equity valuation; 2) Tangible P/B warranted equity valuation; and 3) Dividend Discount Model. We set our target price at the average of these outcomes and cross-check against a market referenced sum-of-the-parts valuation. Our Cost of Equity assumption is 10.5% and our perpetual growth assumption is 3.5%.

Risks

- 1) Dodd-Frank reform: should capital requirements for TD Bank increase under a full Dodd-Frank implementation, there would be downside risk to our DPS and payout ratio forecasts. Conversely, should the implementation of the Dodd-Frank rules be watered down, there may be upside risk to consensus estimates for earnings and capital.
- 2) Cost control in Canada: cost cutting, which would help shareholders, may be detrimental to TD's customer proposition and thus resisted by management - potentially resulting in downside risk to our estimates. On the upside, should management over-deliver on costs, there would be upside to our earnings estimates and target price.
- 3) CEO succession: the contract of Ed Clark, TD's CEO, expires in 2013. Mr Clark has stated that he would remain CEO on an open-contract basis following the fixed-term contract expiration. Even though Mr Clark has steered the company towards profitable ventures, there could be downside risk to the shares if Mr Clark's eventual chosen successor (likely to be Tim Hockey) is not received well by the markets. On the upside, should Mr Clark's successor over-deliver on profitability targets in his first year or two of appointment, there may be upside to our target price.

Scotiabank

Company description

Bank of Nova Scotia (Scotiabank) is a diversified financial institution offering a range of products and services, including retail, commercial, corporate and investment banking to more than 18.6 million customers in more than 50 countries around the world. The Bank has four business lines: Canadian Banking, International Banking, Scotia Capital and Global Wealth Management. In January 2012, the Company closed its acquisition of 51% of Banco Colpatria.

Investment strategy

We have a Neutral rating on Scotiabank's shares. While Scotiabank is the most 'international' of the domestic Canadian banks, we believe the company faces two important challenges in the medium term:

- 1) Subscale Means Low International ROE: the bank only ranks among the Top 5-10 banks in each country, the only exception being Peru (#3). Because of the disparate strategies in each country and the subscale nature of its businesses, International Banking ROEs have been in the 10-15% range over the past four years. ROEs are likely stay in that range over the forecast horizon. We do not believe management will engage in an "asset optimisation" strategy in the medium term as current focus is on growth.

2) Potential undercapitalization: Scotiabank has disclosed a fully loaded Basel 3 core Tier 1 ratio range of 7-7.5% as of 3Q12. On our estimates, this level is 70 bps below TD's and up to 130 bps below RY's. In our opinion, options to repair the capital levels could include a capital raise (5% dilutive to our 2012E EPS estimates) or skipping the dividend for up to two years (eliminating the 4.3% expected dividend yield).

Valuation

We have a \$58 target price on Scotiabank. We value the shares using three approaches: 1) Reported P/B warranted equity valuation; 2) Tangible P/B warranted equity valuation; and 3) Dividend Discount Model. We set our target price at the average of these outcomes and cross-check against a market referenced sum-of-the-parts valuation. Our Cost of Equity assumption is 11.5% and our perpetual growth assumption is 4.5%.

Risks

1) Better – or worse – than expected margins from ING Direct Canada: should management find more profitable routes for investing the liquidity, or should policy rates increase, there could be upside to our NIM forecasts. Conversely, should opportunities for higher reinvestment prove to be limited, or policy rates decline, there would be downside risk to our earnings estimates and target price.

2) Asset quality deterioration – or better than expected improvement – in LatAm: should loan losses reach 2010 levels, Scotiabank's earnings would decline by 3-4%. Conversely, should loan losses come in below 80 bps, there would be upside risk to our earnings estimates and target price.

3) Capital raise: should the regulator decide that Scotiabank would need to meet a core Tier 1 ratio under Basel 3 of more than 9% via a dividend "skip" or a dilutive capital raise, there would be downside risk to our target price and expected total return target. On the other hand, should Scotiabank generate capital organically faster than we expect (e.g., by optimising its international holdings), there may be upside to our target price and expected total return target.

Notes

Notes

Appendix A-1

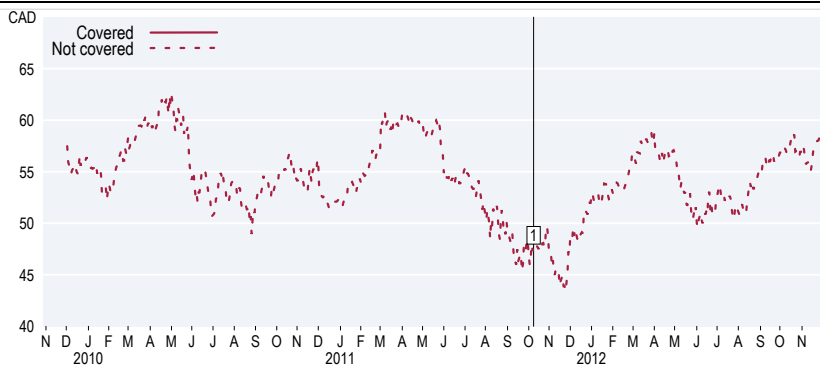
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Ratings and Target Price History
Fundamental Research



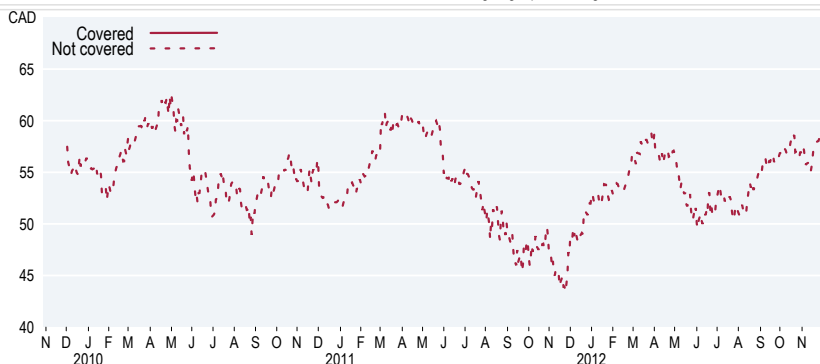
	Date	Rating	Target Price	Closing Price
1	8-Oct-11	Stock rating system changed		

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Rating/target price changes above reflect Eastern Standard Time

Royal Bank of Canada (RY.TO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

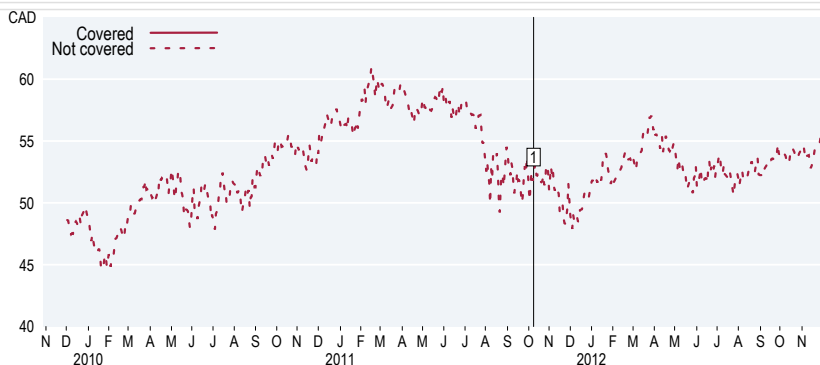


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Scotiabank (BNS.TO)

Ratings and Target Price History
Fundamental Research



	Date	Rating	Target Price	Closing Price
1	8-Oct-11	Stock rating system changed		

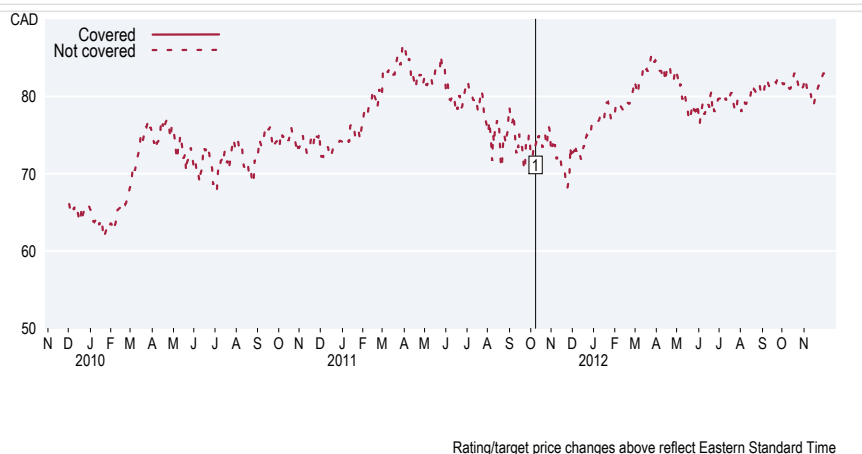
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Scotiabank (BNS.TO)
Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)



Toronto Dominion (TD.TO)
Ratings and Target Price History
Fundamental Research



Date	Rating	Target Price	Closing Price
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Toronto Dominion (TD.TO)
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