

PALOS

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Weekly Commentary

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By Charles Marleau CIM[®] and William Mitchell CIM[®]

Equitable Group – Capitalizing on The Digital Banking Trend

Equitable Group Inc (TSX: EQB) is a Canadian financial services company that provides first mortgage financing across Canada. Branding itself as Canada's **Challenger Bank™**, the company specializes in multi-unit residential and alternative single-dwelling mortgage financing. EQB has grown to become the country's ninth largest independent Schedule I bank, and its shares were added to the TSX Composite Index in 2019. Among Canada's Schedule I banks, EQB has the distinction of having no 'brick and mortar' physical branches. As a branchless 'virtual bank', EQB remains focused on offering superior customer service.

As a nationally licensed, CDIC insured deposit-taking institution, Equitable also issues Guaranteed Investment Certificates (GICs), engages in traditional retail and commercial lending and offers reverse mortgages. The digital platform provides state-of-the-art banking services. The EQ Bank Savings Plus Account offers Canadians the functionality of a traditional chequing account as well as attractive savings rates. With attractive features like unlimited Interac e-Transfers and bill payments to payroll deposits and no monthly fees, we can see why EQB is attracting depositors from across the country. Prior to Covid-19, account applications were running at an average of 2,610 per month. In the third quarter, this number saw a sharp increase to 8,413 per month.

On November 4, EQB reported their third quarter earnings with results that were much stronger than the market anticipated. Adjusted Earnings per Share (EPS) came in at \$4.13, up 33% year over year (analysts' consensus was at \$3.00). The market was anticipating a much larger reserves requirement due to Covid-19 uncertainty. EQB reported \$2.4 million in reserves compared to a consensus of \$10 million. Furthermore, EQB efficiency ratio was impressive. EQB saw experienced expanding Net Interest Margins (NIMs) and solid origination activity from record Greater Toronto housing activity and pricing. EQB performance has validated the company's business model and, in our opinion, EQB remains undervalued and underappreciated. What's not to like about a 19% ROE?

EQB reiterated their commitment to stringent risk management principles. Given recent economic uncertainty, EQB is managing risk by deferring some capital spending and delaying the hiring of new employees. The company's technological capabilities allow for tremendous flexibility and agility. Operational risk is being further managed through diversification and potential acquisitions that will allow for a widened menu of products and services. On the commercial mortgage front only 3.7% of mortgages have exposure to the retail segment and a mere 0.7% to hotels.

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We continue to see significant value in EQB and despite the impact of Covid-19, the Canadian residential real estate market remains resilient. It's fair to say that Covid-19 has not been all gloom and doom as the market anticipated. With an ROE forecast of 13-14% through 2022, we believe a 1.1x Price -to-Book (P/B) is more than adequate, and still leaves plenty of room to pre-COVID peak of ~1.5x. EQB's digital only platform offers a competitive advantage given the realities of social distancing and working from home. The changes we've seen in how Canadians manage their finances is a trend that's likely to continue and EQB is well positioned to capitalize. With that said, I am of the opinion the EQB will return to a premium to book value. We currently hold shares in the Palos Equity Income Fund and the Palos Income Fund LP.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$8.12	4.22%
Palos Equity Income Fund - RRSP	PAL101	\$5.89	4.64%
Palos Merchant Fund L.P. (Dec 31, 2019) ²	PAL500	\$1.71	20.15%
Palos WP Growth Fund - RRSP	PAL210	\$11.18	46.00%
Palos-Mitchell Alpha Fund ³	PAL300	\$10.18	-1.89%
S&P TSX Composite (Total Return with dividends reinvested)			0.57%
S&P 500 (Total Return with dividends reinvested)			12.77%
S&P TSX Venture (Total Return with dividends reinvested)			27.82%
Chart 2: Market Data ¹			Value
US Government 10-Year			0.90%
Canadian Government 10-Year			0.73%
Crude Oil Spot			US \$40.13
Gold Spot			US \$1886.20
US Gov't10-Year/Moody BAA Corp. Spread			245 bps
USD/CAD Exchange Rate Spot			US \$0.7616

¹ Period ending November 13, 2020. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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