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Update Report August 28, 2008

SCOTIABANK

(BNS-TSX $45.45)

Recommendation
Buy

Risk
Low

Target Price
$57.00

Price
$45.45

52-Week Range
$53.50 - $41.95

% Below High
-12.8%

% Above Low
13.5%

Shares O/S
989 million

Market Cap
$46 billion

Average Daily Volume
3,040,670

Year-End
October 31

C$	EPS	& Mult
2007a	$4.02	11.6x
2008e	$3.98	11.7x
2009e	$4.45	10.4x
Book Value	$18.99	2.4x

	Amount	Yield
Dividend	$1.96	4.2%

Analyst
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Data Source: www.BigCharts.com

THIRD-QUARTER REVIEW

HIGHLIGHTS

- Q3/08 Earnings Basically In Line
- No Interest In a U.S. Acquisition and That's Good News
- BNS Remains One Our Top Choices

CONCLUSION

BUY – Target Price Maintained At $57.00

Bank of Nova Scotia (BNS) reported adjusted cash EPS (f.d.) of $0.99, down 4% Y/Y but only marginally below our estimate of $1.00. On a constant currency basis adjusted EPS would have been $0.04 higher. The domestic sector was very strong, helped by good volume growth and better margins Q/Q. International earnings were up 19% Y/Y, but were hurt by the strong Canadian dollars, higher loan loss provisions and a higher tax rate in Mexico. Capital Markets was surprisingly good. Cash ROE in the quarter was 21.2%, down from 21.9% in the same period last year.

We expect the bank to remain focused on expanding its existing platforms in Canada and Central America. Management stated, rather strongly, that it has no interest in a U.S. acquisition, particularly given the current turmoil in the U.S. Domestic is expected to benefit from good loan volumes albeit at a lower growth rate of probably slightly under 10%. International earnings contribution is expected to improve, particularly from the recent acquisitions and a more stable Canadian dollars, however growth in Mexico could remain under modest earnings pressure due to a higher tax rate and higher credit losses.

For both fiscal 2008 and 2009, we are maintaining our forecast EPS at $3.98 and $4.45 respectively. Further dividend increases should be expected, albeit slower than in recent years, in the order of 5% to 7% over the next 12 months. This will bring the annual rate paid to the $2.05 to $2.10 per share level. BNS remains a BUY with a one-year expected total return of 27.0%.

Valuation – Deserving Of a Premium As Earnings Are Well Diversified

BNS is well diversified in its earnings and has demonstrated that again this quarter. International earnings are proving to be a very astute business strategy, despite heavy investment expense in expansion. With over $2.0 billion of excess capital at present, the bank remains well positioned to provide a high return to shareholders and take advantage of attractive acquisition opportunities. We believe the international sector will show solid growth next year, reflecting the branch expansion, acquisitions and a lesser Canadian dollars currency drag. We have maintained our target share price at $57.00. We expect the bank to maintain a premium P/E multiple to the average of the group, and more or less in line with RY and TD.

Other Quarterly Highlights

- **Q3/08 EPS (cash basis f.d.) down 4% Y/Y.** Net income was $978 million or $0.99 per share down from $1,028 million or $1.03 per share last year. Total revenue was $3.5 billion up 9% Y/Y while expenses increased 9%. Expenses included acquisitions and were impacted by the stronger Canadian dollars. Operating leverage was nil this quarter.

- **Domestic banking, including wealth management, increased 16% Y/Y,** reporting net income of $463 million. Revenue increased 9% Y/Y while expenses grew by 2%, for an increase in operating leverage of 7%. Wealth management revenue was flat Y/Y, but mutual fund revenue increased by 8%. Full service brokerage was flat Y/Y. Assets Under Management increased by 21% Y/Y to $37.8 billion. Mortgage loan growth was strong up 14% Y/Y. Interest spreads increased by 3 bp sequentially but declined 4 bp Y/Y. Provision for Credit Loss (PCL) was $99 million down from $102 million last quarter and up from $77 million last year, and largely reflected the increase in loan volumes and higher commercial account provisions.

- **Scotia Capital reported cash net income up 6% Y/Y at $297 million.** Net income was up 16% sequentially, as trading revenues were strong due to good derivative trading and record fixed income trading. Investment banking revenues were relatively good, sequentially up 28%, but still declined 6% Y/Y. We expect investment-banking revenue to remain slow over the next several quarters. Credit losses were minor at $4 million.

- **International net earnings were up 19% Y/Y to $321 million.** Earnings continued to be negatively impacted Y/Y by the stronger Canadian dollars. Revenues were up 30% Y/Y while expenses increased by 25% Y/Y, for a positive operating leverage of 5%. Expenses reflected a $28 million indemnity provision in Peru. The drag in the quarter also included an increase in retail PCL by 120% Y/Y and a higher tax rate in Mexico. Revenue was driven by strong loan growth due to the positive impact of the acquisitions. Other international revenues increased over 35% on strong asset growth. We believe BNS has developed a significant advantage over most of the other major banks and that the international sector will be the driver in net income for the bank over the next two years.

- **Provision for Credit Loss rose 73% Y/Y** to $159 million from $92 million last year, but was only marginally from $153 million last quarter. This quarter saw only small losses at Scotia Capital of $4 million versus recoveries of $10 million last year. Domestic losses were $99 million this quarter, down from $102 million last quarter with commercial PCL over double last year's. International PCL was $56 million, down from $60 million last quarter but up from $25 million in the same period last year. The quarter reflected acquisitions and higher credit card losses.

- **Gross impaired loans were up Q/Q to $2.2 billion from $2.0 billion last quarter** and $1.7 billion last year. New formations were up $377 million in the quarter, driven by three accounts of which two were in the Caribbean. There were declassifications in Mexico. These figures include recent acquisitions in Chile, Dominican Republic and Guatemala.

- **Securities gains were slightly better in the quarter** at $90 million, up from $59 million last quarter but down from $134 million in the same period last year.

- **Unrealized securities gains decreased to $193 million in Q3/08,** down from $571 million at the end of last quarter and down from $960 million in the same period last year.

- **Tier 1 capital increased to 9.8%** from 9.6% last quarter and 9.7% last year. BNS' capital remains one of the strongest of the Canadian banks.

Recent Acquisitions

1. **Increased Stake in Scotiabank Peru:** On May 13, 2008, BNS announced an agreement to purchase Intesa Sanpaolo's stake in Scotiabank Peru. This will increase BNS's ownership to 98% from 78%.

2. **Acquisition of Grupo Atlas Cumbres' Operations in Peru:** On May 20, 2008, BNS announced that Scotiabank Peru will acquire Banco del Trabajo, which is Grupo Atlas Cumbres' operations in Peru. Price was not disclosed, but Banco del Trabajo is one of the largest commercial banks in Peru with assets approximating US$430 million.

3. **Announced the proposed acquisition of E*Trade in July, 2008 for approximately $444 million.** This acquisition is expected to double Scotiabank's discount brokerage business in Canada.