



3 Can't Miss Quotes for Bank Investors From This Past Earnings Season

Description

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3 Can't Miss Quotes for Bank Investors From This Earnings Season

Canada's banks reported blockbuster results this week. Four of the Big 6 posted record second quarter profits and all six beat analyst expectations. These numbers should quiet the bears who have been calling for a cooling housing market and slower consumer spending.

But far more interesting than the headline numbers are the comments from management during the conference calls. Canada's banks touch every segment of the economy. Hidden in plain sight are nuggets of wisdom that allow the diligent analyst to spot hidden investment opportunities. Let's take a look at my three favorite quotes and what they might mean for shareholders.

The consumer is doing fine...

The Canadian consumer is doomed. Right? Household debt as a percentage of disposable [now exceeds that of the United States pre-housing bubble](#). The low interest rate debt binge is over and consumers will be forced to retrench. Or at least that's what I've been told. Tim Hockey, Group Head of **Toronto Dominion's** (TSX:TD, NYSE:TD) Retail Banking division, disagrees.

"We're feeling a little more optimistic right now about the outlook than we would've been this time last quarter. [We've] seen some green shoots, if you will. But having said that, we still feel that it's not going to be returning to the heyday of consumer lending or real estate secured lending that you would have seen a number of years ago, but probably stronger than you would've gotten an answer from me three months ago."

A [common theme among all of the banks](#) was a strong performance from their domestic retail divisions. The country's largest financial players, **Royal Bank** (TSX:RY, NYSE:RY) and TD, each reported 7% and 12% net income growth in their consumer lending operations. All of their peers posted strong results as well.

This means one thing: a catastrophic decline in retail lending is probably off the table. All of that talk isn't playing out in the financial results and the industry is raising their expectations. Investors should too.

...but bankers remain cautious about the housing market

In spite of bubble warnings from doomsayers, the Canadian real estate markets continues to chug higher. Earlier this month, the Canadian Real Estate Association [released numbers](#) showing that retail home sales and housing prices rose significantly in July. But Frank Techar, CEO of **Bank of Montreal's** ([TSX: BMO](#)) retail arm, provided some colour behind the move.

"I do think there's a little bit of bring forward with respect to the perception that rates are going up. So there might be a little flush of activity as a result of that. It's very hard to put your finger on, though. It's more anecdotal than anything. And my expectations is that the overall market growth moving forward is likely to slow a bit."

So while the consumer appears to be okay, Canadian bankers remain cautious on real estate. Higher interest rates and government attempts to cool the housing market will have an impact...eventually. Investors shouldn't get too excited about these positive numbers.

Cost cutting driving profit growth

In the face of a tough lending environment, cost cutting has emerged as a hidden growth driver for the bottom line. Here's how Janice Fukakusa, CFO of Royal Bank, described the impact of expense management at the country's biggest financial institution.

"While continuing to invest in our business to improve productivity and efficiency, we will limit that rate of growth in our expenses through our strong cost management program. Despite the slow growth interest rate environment, we expect to continue to drive our efficiency ratio lower and generate positive operating leverage."

And this isn't just optimistic conjecture from Ms. Fukakusa. Royal's efficiency ratio, a measure of non-interest expenses as a proportion of operating revenue, improved 60 basis points year-over-year to 44.5% after adjusting for the Ally acquisition.

The banks have done a great job in controlling expenses in recent years and this is a big reason as to why they've surpassed analyst expectations. And with top-line growth expected to slow further, cost cutting will become the main profit driver going forward.

Foolish bottom line

These contradictory statements tell me one thing: the outlook for the Canadian banking industry is muddled. Without some sort of new catalyst, the big collapse that the doomsayers have prophesized is unlikely to emerge. Rather, it will be a challenging environment with lots of headwinds. But given that investors were pricing in a crash only a few months ago (remember [the Great White Short](#) anybody?), Canadian banks as a group may be undervalued.

The Canadian banks are a great source of yield, but if you're looking for a more diversified approach to

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Date

2025/09/10

Date Created

2013/08/30

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