

Will Toronto Dominion Bank Win in the U.S.?

Description

The main strategic focus of **Toronto Dominion Bank** ([TSX: TD](#))([NYSE: TD](#)) is retail banking. It has become very good at it in Canada, as evidenced by numerous accolades for customer service and a high level of profitability.

During 2013, more than 65% of the bank's profit was derived from Canada and another 26% from the U.S. However, while the retail banking operation in Canada is hugely profitable, its operations in the U.S. are considerably less so. The question is whether TD Bank can increase profitability in the U.S. to a level closer to Canada's.

TD Bank already owns considerable operations in the U.S., including a top 10 personal and commercial banking operation with more than 8 million customers and 1,297 retail branches. Other operations include a substantial credit card portfolio, auto lending, wealth management, and a 40% interest in TD Ameritrade, the No. 1 online securities trading firm in the U.S.

The total U.S. retail banking operation contributed just over \$1 billion to the bank's profits in the first two quarters of 2014. This is the equivalent of only 40% of the profit of the Canadian retail banking operation.

The table below indicates that the Canadian retail banking operation has a considerably higher return on equity, a much larger loan book, a lower provision for credit losses, and a substantially lower cost to income ratio compared to the U.S. operation. These factors probably also explain the vast difference in the level of profitability as measured by the return on equity.

Item	Canadian Retail Banking	U.S. Retail Banking
Net Income (year-to-date 2014)	\$2.69 billion	\$1.04 billion
Return on Equity (year-to-date average)	43.8%	8.6%
Average deposits (Q2 2014)	\$247 billion	\$218 billion
Average loans (Q2 2014)	\$325 billion	\$119 billion
Cost-to-income ratio	42.5%	64.3%
Provision for credit losses/credit volume	0.29%	0.56%
Number of retail branches	1,174	1,297

Will TD Bank be able to improve its profitability in the U.S.?

TD Bank has been working on the development of its U.S. business for the past decade through acquisition and organic growth. It is already a top 10 bank there and now has the scale, platform, and reputation to further develop and grow its business in that country.

The latest results indicate a solid improvement in U.S. banking profits, with a 13% year-over-year increase. Results were driven primarily by strong loan and deposit volume growth, favourable credit movements, and strict expense management. TD Ameritrade contributed U.S.\$70 million in profits, an increase of 35% compared to the second quarter of last year, due to strong trading and revenue growth.

TD's Canadian retail business is exceptionally profitable and it is unlikely that the U.S. operation will reach this level of profitability. A comparison with some of the comparable U.S. banks, including **Wells Fargo** ([NYSE: WFC](#)) and **US Bancorp** ([NYSE: USB](#)), indicates that there is room for improvement on key ratios such as the cost-to-income ratio and credit management.

However, the major opportunity for TD Bank is to grow the banking business organically and/or through acquisition in order to optimally use its current infrastructure and well-regarded reputation. Its retail banking operations are located in seven of the 10 wealthiest states, with a U.S.\$2.2 trillion deposits market and access to nearly 70 million people, indicating considerable room for growth.

Valuation does not incorporate upside potential in the U.S.

Consensus estimates indicate that TD Bank should continue to increase profits and dividends at an 11% rate per year over the next three years, while the bank itself targets a 7%-10% profit growth rate. Should the bank succeed in lifting the U.S. operation's profitability somewhat closer to the Canadian level, these forecasts could prove conservative.

The valuation of TD Bank is relatively cheap when compared to the overall stock market and in line with the other main Canadian and American banks. TD Bank is valued at a 12 times its forward price/earnings ratio and a 3.4% dividend yield.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:TD (The Toronto-Dominion Bank)
2. NYSE:USB (US Bancorp)
3. NYSE:WFC (Wells Fargo)
4. TSX:TD (The Toronto-Dominion Bank)

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Date

2025/08/21

Date Created

2014/06/17

Author

deonvernooy

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