Key Takeaways From Royal Bank of Canada's Results

Description

Royal Bank of Canada (TSX: RY)(NYSE: RY) is the largest bank in Canada and ranks twelfth globally based on market capitalization. Its Canadian banking operation makes the largest contribution to revenue at 63%, with equal contributions from the U.S. and other international operations. Personal and commercial banking is the largest business unit, followed by the capital markets division and wealth management.

Second quarter profit was better than expected

Its second quarter of 2014 financial results were better than expected, with earnings per share 18% ahead of the previous year. The overall business performed well, with all divisions except for insurance reporting improved results. The star performance came from the capital markets division, which is involved in trading and investment banking, where profits improved by 32% to $507 million. The weaker Canadian dollar also resulted in higher translated foreign currency profits adding about 2% to the growth in EPS. The return on equity of the overall business, as a key measure of performance, also improved slightly to 19.1% during the quarter.

One of the few concerning factors from the second-quarter results was the lower provision for credit losses, which was recorded at 0.23% of average net loans. This was driven by lower provisions in the Canadian banking and wealth management operations and was partly offset by higher provisions in the Caribbean operations. Clearly, the operating environment is supportive of lower provisions, but provisions were previously at this level in 2005.

Further all-round improvement expected for the third quarter

Consensus EPS expectations for the third quarter are set at $1.55, which will represent an increase of 6% compared to the previous year. The third quarter of 2013 was a very good quarter for Royal Bank of Canada — the year-over-year comparisons will therefore prove somewhat difficult.

Royal Bank is on record as stating that its objective is to grow EPS by 7% or more for the full year, achieve a return on equity of 18% or more, and have a dividend payout ratio in the range of 40% to 50%. The company seems to be on track to meet and possibly exceed these objectives.

The personal and commercial banking division is the largest and most stable contributor to profits. Key profit drivers were the growth in loans and deposits, the net interest margins achieved, and the provisions raised for bad debts. Limited growth is expected in this division, with hopefully no further negative developments on the Caribbean operation that caused a $100 million hit in the first quarter of the current year.

The other key contributor to profit is the capital markets division, where profits are more volatile and dependent on investment banking and trading activities. The environment for investment banking activities improved as financial markets recovered over the past few years, leading to higher profits for the bank. The outcome of these trading activities is unpredictable, but the previous quarter delivered an excellent result, with revenue increasing by 31%.

Wealth management should have a solid quarter supported by the improvement in equity markets, while the treasury services and insurance divisions should also be able to improve their results.

The bank's long-standing CEO, Gordon Nixon, stepped down on August 1, handing the reins over to David McKay, former head of personal and commercial banking. These would therefore be the last quarterly results overseen by Mr. Nixon.

The share price has been performing well

The share price has been doing well over the past year, adding 25% plus a dividend of around 4%. The shares are still not expensively valued at a historical P/E ratio of 13.5 times, and with profit growth seemingly moving along at a stable pace, they could continue to do well.

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Date
2025/08/21
Date Created
2014/08/18
Author
deonvernooy