Key Takeaways from Toronto-Dominion Bank's Q3 Results

Description

Toronto Dominion Bank (TSX: TD)(NYSE: TD) is the sixth largest bank in North America by branches and has 22 million clients.

The Canadian Retail Banking operation currently makes the largest contribution to net income at 66% followed by 26% from the U.S. Retail Banking and the balance from the Wholesale Banking operations.

An all-time record

Third quarter 2014 profit came in at $2.1 billion with diluted earnings per share of $1.11, 41% ahead of the previous year. This stellar outcome was partly caused by a relatively weak third quarter last year and very solid 2014 performances from Canada Retail and Wholesale.

At the overall group level, the return on equity, as a key measure of performance, improved slightly to 16.3% during the quarter. The expense ratio (that is non-interest expenses as a portion of total revenue) was slightly higher than a year ago at 53.8%. This was caused by a variety of factors including higher variable pay linked to the performance of the Wealth Management and Wholesale Banking divisions.

The provision for credit losses was 29% lower than the previous year and reported at 0.28% of average loans as a result of generally favourable credit conditions. This is one of the lowest provisions made in recent TD Bank history and when combined with the considerable real estate exposure, should be a risk factor that investors will have to consider when interest rates start to increase meaningfully.

Outstanding results from Canada Retail division

The Canadian Retail banking division, which includes personal and commercial banking, insurance and wealth management, turned in a super performance with profit jumping by 54% to $1.4 billion from a low 2013 base.

Nevertheless, all the operating metrics at the retail bank moved in the right direction with return on equity improving to an exceptionally high 43.4% and the expense ratio also improving to 42.1%.

Furthermore, net interest income improved by 7% compared to last year on the back of solid loan and deposit growth. Income from other activities including wealth management, insurance and the newly acquired Aeroplan credit card portfolio improved by 13% compared to last year.

When will U.S. Retail start to emulate Canada Retail?

The U.S. Retail division reported a net profit of US$518 million, 4% higher than a year earlier. This includes a slightly higher US$69 million contribution from the stockbroker, TD Ameritrade. In Canadian Dollar terms the results looked somewhat better helped along by the weaker reporting currency.

Although there were signs of improvement, the U.S. operation continues to operate at a fraction of the level of profitability of the Canadian Retail division and at considerably higher expense ratios. This was discussed in more detail in my recent note on the topic – investors should not give up hope to see improvement in the foreseeable future.

Solid contribution from the Wholesale division

The smaller Wholesale Banking division, which includes capital markets services and corporate lending, made a profit contribution of $216 million, which was 46% more than a year ago. This was attributed to a broad-based improvement across all business segments.

Trading related revenues amounted to $325 million for the quarter with five trading days resulting in trading losses. It is still a remarkable achievement, but slightly worse than the result achieved by the **Royal Bank of Canada** (TSX: RY)(NYSE: RY) team who reported only one loss-making day during the last quarter!

Further all-round improvement expected for the fourth quarter

The bank is on record stating that the objective is to grow earnings per share by 7%-10% for the full year; the first nine months delivered earnings per share 23% higher than a year ago. Things seem to be on track to comfortably exceed this target.

Sound financial and operational performance leading to strong stock price performance

The excellent results have been well-anticipated by the market with the share price moving up by 7% since the previous results and by 32% over the past year. In my view the stock is still not expensively valued at a 12-month forward price to earnings ratio of just over 12 times and a dividend yield of 3.5%. An improved performance in the U.S. operation and better net interest margins in a higher interest rate environment provide further upside potential.

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