



Royal Bank of Canada Goes Hollywood

Description

Royal Bank of Canada ([TSX:RY](#))([NYSE:RY](#)) is moving into Hollywood and buying L.A.-based **City National Corp.**(NYSE:CYN) in a cash and stock deal.

What should investors know about City National?

Well, it is a private and commercial bank that serves high net worth clients and commercial customers, including Arnold Schwarzenegger. *Barron's* has ranked the bank as one of America's top 40 wealth managers for the last 14 years.

This move is RBC's attempt to grow its wealth management business in the U.S. and the company says while there may be more acquisitions in the future, its current focus is short-term organic growth. The deal will cost RBC US\$5.4 billion, which amounts to US\$93.80 per share of City National. By the end of Friday's trading, RBC shares closed at \$75.42 while shares of City National were at US\$88.99.

Is this a good deal for RBC?

Although shareholders didn't seem too happy about this deal (RBC shares fell about 5% on the announcement), in the long run, I reckon this looks like a good deal for the bank. Below are what I think are the positives and negatives.

The positives

By taking over City National, RBC taps into the United States' high net worth market. This is desirable for the bank's growth. RBC has previously tried (and failed) to enter the U.S. market (remember Centura Bank?) and this deal is another attempt at getting U.S. exposure, but with a different strategy.

Second, RBC is likely to benefit from a strong U.S. dollar. If the U.S. economy continues to gain strength, exposure to its dollar will help RBC. To an extent, this could help counter the current weakness in the Canadian dollar and low interest rates (if the banks decide to pass on the recent rate cut to customers).

Third, City National is a quality bank with a good reputation and promising growth potential. Its lending operations have seen good double-digit growth over the last few years and 70% of its loans focus on commercial lending.

Finally, RBC poses to benefit from several potential synergies to the amount of about US\$140 million after tax.

The negatives

On the other hand, there are some reasons for investors to have their doubts about this deal.

First, RBC has paid full price for City National and about 21 times City's expected 2016 estimated earnings (hat tip to Canaccord Genuity).

Second, synergies from the deal are expected to come only in 2020. That's a fairly long time in an unpredictable environment.

Finally, RBC has previously tried unsuccessfully to enter the U.S. market and so it is natural for investors to be skeptical about the bank's largest acquisition in the U.S.

Having said that, RBC CEO Dave McKay is very confident about the deal and believes City National ticks all the boxes he and his team have laid out for their U.S. strategy. He also said the biggest lesson learned from the failed Centura deal was that the company needs to buy the highest-quality franchise and build on it.

City National is expensive, but quality doesn't come cheap. And that's what RBC is currently looking for.

Buy or bail?

Although the deal looks promising, RBC's track record of entering the U.S. hasn't been great. I suggest waiting for some time before buying the stock. For those investors who already hold the stock in their portfolio, I'd recommend staying put too.

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