Royal Bank of Canada and Toronto-Dominion Bank: How Safe Are Their Dividends?

Description

The Canadian banks have long been favourites among income-oriented investors, and for good reason. None of them have cut their payouts since World War II, and they have been a model for consistency in the international banking scene.

But pressure has been mounting on the banks more recently. The Canadian economy may be in a recession. House prices may be about to pop. And low interest rates are threatening margins.

So, is there any real possibility of the banks cutting their dividends? Well, for such a thing to happen, we'll have to see skyrocketing loan losses, perhaps as a result of a weak economy and slumping house prices.

But how high would loan losses have to get? We take a look below, using Canada's two largest banks as examples.

1. RBC

In fiscal year 2014 **Royal Bank of Canada** (TSX:RY)(NYSE:RY) made roughly $9 billion and distributed just over $4 billion of this profit to shareholders.

In order for RBC to afford this $4 billion in dividends, it would have needed to make $5.5 billion in pre-tax profits. In actual fact, the company made $6.2 billion more than that.

To put it another way, RBC's loan losses could have increased by $6.2 billion, and the company could still have afforded its dividend. For this to have happened, RBC's loan losses would have had to increase by about 500%!

Interestingly, RBC had some big problems with loan losses in 1992, when Canada experienced a real estate slump. At the time, the bank suffered losses equivalent to about 2% of loans. If such a number were reached again last year, then RBC's net income would not have been high enough to cover the dividend. So, one should never say never.

But that was more than 20 years ago, and the bank has made some substantial improvements in risk control since then. These changes helped the bank sail through the economic crisis in 2008 relatively unscathed. So, investors can be very confident in the dividend.

2. TD

The story is very similar at **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), which made $7.9 billion last year and distributed about $3.5 billion to shareholders. Even if TD's credit losses had been 350% higher, the dividend still would have been affordable.

Also like RBC, TD has had its problems before. In 2002 the company incurred $2.5 billion in loan losses, mainly stemming from issues in the telecommunications and utilities sectors. If such an event occurred again, the bank's net income wouldn't be high enough to cover the dividend.

But once again, TD has reformed its risk management practices, and skated by during the economic crisis as a result.

Finally, you should remember that each of these banks are very well capitalized, and wouldn't have to cut their dividends if they had one bad year. Contrast that with Canada's energy companies, and it should become clear where the safe dividends are.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:RY (Royal Bank of Canada)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:RY (Royal Bank of Canada)
4. TSX:TD (The Toronto-Dominion Bank)

Category

1. Bank Stocks
2. Dividend Stocks
3. Investing

Date
2025/07/21
Date Created
2015/08/03
Author

bensinclair