What Would it Take for Toronto-Dominion Bank to Cut its Dividend?

Description

Since 1970, **Toronto-Dominion Bank** has raised its dividend more than 60 times, and never cut it once. But these days there are some legitimate concerns about the banks, and TD has gotten caught up in the mix. In fact, its shares are down by nearly 10% in the last 12 months, even though its earnings and dividend have grown.

So, what exactly would it take for TD to cut its dividend?

What if its loan losses skyrocketed?

Let's start by taking a look at TD's results through the first three-quarters of this year. Over this time, net income totaled $6 billion, and $2.6 billion was paid out in dividends. Meanwhile, the bank incurred $1.2 billion in loan losses.

So, even if loan losses tripled and took an extra $2.4 billion bite out of net income, TD's net income would still be enough to cover its dividend. Of course, if loan losses spiked, the bank would also have to pay less tax. Thus, if credit losses quadrupled, the dividend would *still* be affordable.

It helps that TD pays less than half its net income to shareholders. By comparison, many Canadian companies—particularly those in the energy sector—pay out more in dividends than they make in income.

What if its energy loans went bad?

Canadian bank shareholders are understandably worried about low oil prices. But TD has relatively little exposure to the sector.

To illustrate, TD had less than $3 billion in loans outstanding to energy producers as of October 31, 2014. That's equivalent to about 0.6% of total loans.

By comparison, the bank has about $4 billion of excess capital, assuming all banks want to keep at least a 9% CET1 ratio. Thus, TD could easily preserve its dividend even if all its oil and gas loans went to zero.

What if there were a housing crash?

The exact effect of a housing crash is harder to quantify. But there are some reasons why TD shareholders shouldn't be nervous.

To start, nearly two-thirds of all mortgages are insured by the CMHC. So, they carry practically zero credit risk. Among the remaining mortgages, TD typically only lends about 70% of the home's value. As long as house prices don't decline by at least 30%, there's very little risk of credit loss on the typical new loan.

Does this mean you should buy TD stock?

At $52 per share, TD trades for less than 13 times earnings. That's not bad for a company that's consistently growing its bottom line. And its 3.9% dividend yield is quite nice for such a rock-solid payout.

Without question, TD stock is a far better opportunity than it was one year ago. If you're looking for a staple in a dividend portfolio, this just may be it.

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