3 Upcoming Growth Opportunities for Toronto-Dominion Bank

Description

The past five to 10 years have been a fantastic time to be a Canadian bank shareholder, and a shareholder of **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) in particular.

Over the past 10 years, TD's dividend has had a median growth of 11%, and has had a return on equity of 16% (above the long-term average of 14%). Even better, over the past five years, TD has led its peers in terms of overall shareholder returns with a 16.5% compound annual growth rate.

Unfortunately, many analysts are expecting Canada's banks to enter a period of low growth, thanks to low interest rates, over-indebted Canadian consumers, and low GDP growth. For this reason, banks need to work even harder to find growth.

Fortunately, TD has many options at its disposal

1. TD is well positioned to grow earnings when rates rise

Interest rates in both the U.S. and Canada have fallen to historical lows, and while this benefits TD in the sense that it increases lending activity, sustained periods of low interest rates are a major headwind.

This is because about 58% of TD's revenue comes from net interest income, or the difference between the income TD receives from loans and what it spends on deposits. As interest rates fall, the net interest margin TD earns declines. Due to the fact that the bank has a large amount of low- or no-cost deposits, it is limited in how much it can reduce rates on deposits to maintain margins.

Fortunately, TD is very well positioned to benefit from a rise in U.S. interest rates, which is expected to occur sometime this year. TD began a program in 2013 to shorten the duration of its U.S. assets, which means that when interest rates do rise, TD's assets will re-price to the higher rate quicker because the duration is shorter.

In addition, about 75% of TD's deposit base are chequing and savings accounts, which represents the highest concentration of these types of deposits among the big banks. These types of transaction accounts are less rate sensitive, and when interest rates rise, TD will not need to pass as much of the increase on to these customers, since customers using transaction accounts are less focused on yield.

Analysts at TD Bank estimate that a 1% increase in the U.S. interest rates would add about 640 million annually to TD's earnings by the fifth year after the increase (or about 6% of current pre-tax profits). They also estimate that in the first 12 months after a 1% increase, TD would receive an additional $100 million boost from TD Ameritrade's net interest income.

2. TD is geared to a recovering U.S. economy

About 33% of TD's revenues currently come from its U.S. retail segment, which means TD is well positioned to benefit from growth in the U.S. economy. Firstly, the strong U.S. economy relative to Canada means a stronger U.S. dollar.

For TD, this means that when its U.S. earnings are translated back to Canadian dollars, it will see a boost to earnings. Each $0.05 increase to the CAD/USD exchange rate is expected to add 1% to earnings per share.

The U.S. economy is also growing at a faster rate than Canada's economy, and the U.S. consumer has considerably lower debt levels. This means stronger employment levels, better housing demand, and demand for loans. This will allow TD's U.S. segment to have much better loan growth.

Canadian loans are expected to grow by 6% in 2015 versus 7% in the U.S.

3) TD may make more acquisitions

Finally, TD's CEO has indicated that it is looking to expand its U.S. presence through small acquisitions. The company currently has a very strong capital position, which means it has the capacity to comfortably purchase assets that can add to returns.

The bank has expressed interest in potentially acquiring more credit card portfolios, like it did with **Target** or **Nordstrom** recently. This would be a high-return way to spend capital, and the bank has also said it may consider acquisitions in the wealth-management space.

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