Toronto-Dominion Bank: Should You Buy or Wait?

Description

Concerns about over-indebted households and a potential bubble in the residential housing market have sparked fears about the health of the "Big Five" Canadian banks.

Toronto-Dominion Bank (TSX:TD)(NYSE:TD) has been a leader in the Canadian banking industry for decades and has been viewed as a "must have" for Canadian investors' portfolios.

With TD shares having risen by nearly 100% over the past five years, many Canadian investors are probably asking themselves whether now is a good time to be adding to their positions, or perhaps if they should be cashing in those gains to find something timelier.

TD has averaged an impressive 10% in average sales increases over the past 10 years, while earnings have more than doubled over the same period. The company currently pays a 3.6% dividend yield, having increased the dividend by 9% on March 2 earlier this year.

Accounting for the dividend increase, the company now has a dividend-payout ratio of 46% against forward earnings estimates of $5.20 per share for the fiscal year ending 2017. With an ROE of 13.3% and a 46% payout ratio, this implies that TD should be able to sustain annual dividend increases of 7.2% going forward.

With a payout ratio of just 46%, this means that TD would need to have its earnings cut in half before the payout would reach 100%, or what most would consider "unsustainable."

Keep in mind as well that TD's board of directors did not cut the dividend in 2009, despite a sharp 30% fall in earnings that year in the Financial Crisis.

Is it a good time to buy?

Shares of TD are currently trading at a forward P/E of 12.1 times against 2017 estimated earnings or a 13.1 times trailing P/E against 2016 earnings.

The forward P/E implies a 50% discount against the S&P/TSX market average of 18 times. However, let's not get ahead of ourselves. While the market average is 18 times, TD has historically traded closer to 13 times earnings, implying just 8% upside from today's prices.

The company has a beta of 0.57, or an adjusted cost of capital of 7.8%. With next year's dividend set at $2.40 per share, and a sustainable dividend-growth rate of 7.2%, this implies TD shares should be expected to return 11.2% compounded annually as long as the company can maintain the assumed 7.2% growth rate.

Caveat emptor: buyer beware

What the above fails to acknowledge is the effect of a shock to the company's discount rate. If delinquencies and defaults started to creep up in the company's consumer loan portfolio, or even the company's book of mortgages, investors may find the 7.8% discount rate to be too low in hindsight.

Such an event is not completely unlikely given the current indebtedness of Canadian households.

At this point, TD shares are probably best viewed as a "hold." An 11.2% annual return should still be expected to outperform the benchmark before fees, and the dividend pays you to wait. Yet investors may find that other companies in the market offer better chances to outperform market averages; meanwhile, income investors can probably do better than TD's 3.6% dividend yield.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:TD (The Toronto-Dominion Bank)
2. TSX:TD (The Toronto-Dominion Bank)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Yahoo CA

Category

1. Bank Stocks
2. Dividend Stocks
3. Investing

Date
2025/07/27
Date Created
2017/05/22
Author
jphillips