Royal Bank of Canada: Is There Concern for This Bank Stock?

Description

Since the beginning of March, **Royal Bank of Canada** (TSX:RY)(NYSE:RY) has given back 5.6% of its value — a pullback that has some investors curious if they should be concerned about this bank stock. And as Canada's largest bank, when it begins to suffer, could the others suffer too?

Fortunately, I'm not too worried about the bank.

The big reason for the uncertainty is due to mortgages. **Home Capital Group Inc.** has created some uncertainty around any company that issues mortgages because of a scandal, and there is belief that the housing market is due for some sort of a correction.

According to the Royal Bank, as of April 30, 2017, it has $246 billion worth of mortgages on the books. Of that, 48% are insured, which means that it would take a serious default for the bank to experience pain. The good news is that only 0.22% of its residential mortgages are +90 days past due, which is actually down from 0.23% in Q1 2017.

Nevertheless, $103.8 billion of these loans are in Ontario, which could finally be reaching peak pricing. Toronto, for example, has put high taxes in place to limit foreign buyers of properties in the city. Without outside money coming into the city, there's less opportunity for sellers who've already overpaid to get out. Without that buying pressure, prices will start to dip, which could lead to some increase in defaults.

However, pundits tend to agree that house prices are likely to drop over an extended period of time, which will keep the bank in a secure position. Therefore, I'm not too worried for Royal Bank. And frankly, the bank is firing on all cylinders.

Revenue was up 8% year over year to $10.3 billion with US$2.8 billion in net income — up 9%. Its diluted earnings per share were $1.85, up 11%, because the bank has been spending quite a bit of its cash purchasing shares back. Compared to Q2 106, the return on equity was up 100 basis points to 17.2%, which is a very good sign. And if we take out the one-time $212 million sale of Moneris Solutions Corporation in Q1, earnings would be unchanged from Q1 to Q2.

Although most divisions did well, a few outperformed. Wealth Management net income was up $45 million, or 12%, to $431 million. Investor & Treasury services was up $54 million, or 39%, to $193 million. And finally, Capital Markets had net income of $668 million — up $85 million, or 15%, from a year ago.

All of this allows the company to pay a generous dividend and invest funds in buying back shares. The bank announced earlier in the year its plan to buy up to $30 million shares, or 2% of the float, by March 2018. This makes each remaining shareholder a bigger owner of the business, and the bank can continue to bolster the earnings per share, which we saw.

Further, Royal Bank pays a quarterly dividend of $0.87, which is a strong 3.72% yield. This was increased by 5% in Q1 2017, which follows a 5% increase the previous year. Should earnings continue to remain strong and grow, I expect management will increase the dividend again next year.

With shares down over 5% from the beginning of March, and the company paying a 3.72% yield, this bank provides an opportunity for investors to add a strong stock to its portfolio.

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Date
2025/08/17
Date Created
2017/06/19
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