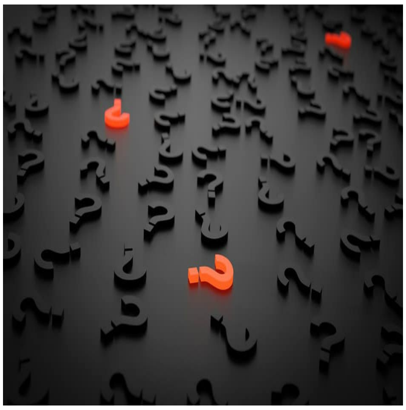

Royal Bank of Canada vs. Toronto-Dominion Bank: Which Is the Better Buy Post-Earnings?

Description

Royal Bank of Canada (TSX:RY)(NYSE:RY) and **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) recently released their respective Q2 2018 results. TD Bank blew away analyst expectations on the earnings front with a $1.62 adjusted EPS, beating the consensus by 8%. Royal Bank delivered a solid but not nearly as impressive earnings beat of its own, clocking in an adjusted EPS of $2.10, which was just over 2% higher than what the street was expecting.

Both banks had pretty solid quarters that benefited from higher net interest margins (NIM), a positive effect from rising interest rates. However, it's clear from the post-earnings trajectory that Royal Bank didn't live up to the expectations of its investors, as shares took a hit to the chin in the days following the release of the results.

Royal Bank's domestic retail segment delivered 8% in year-over-year earnings growth, which was quite sound, but lower than some analysts expected as a result of less than satisfactory operating leverage. The management team was quick to address this though, guiding to the higher end of its original guidance of 2-3% in operating leverage for the second half of 2018.

In addition, management acknowledged the negative impact of B-20 on mortgage growth, but maintained its guidance of 4% in year-over-year mortgage growth.

Overall, Royal Bank delivered what appeared to be a decent earnings report, but in comparison to TD Bank, it certainly seemed like a considerable disappointment.

After another remarkable quarter, TD Bank appears poised to break the 10% EPS growth outlook for the year. The bank is firing on all cylinders and is expected to be a major beneficiary of lower corporate tax rates in its U.S. segment. TD Bank's U.S. business delivered an astounding ~20% in year-over-year earnings growth thanks in part to higher NIMs and relief in the form of lower U.S. taxes. TD Bank remains an absolutely fantastic stock for Canadian investors to obtain an outlet into the red-hot U.S. market. I believe the recent quarter may be the start of a sustained rally to much higher levels.

TD Bank's domestic banking segment was nothing to sneeze at either after clocking in 17% in year-over-year earnings growth thanks in part to its strong operating leverage, which put a slight dent in Royal Bank's armour in the second quarter.

Better buy?

TD Bank blew Royal Bank out of the water this earnings season and as we head into the latter part of the year, TD Bank appears to be the much better bet despite a marginally higher valuation at this point.

I believe TD Bank's premium valuation is worth every penny, not only because of the incredible U.S. business, but because management always appears to be a step ahead of the competition, whether it's through increasing the robustness of its revenue stream or through future-proofing efforts in order to get the edge as we head into an environment in which next-generation tech will be as important as it's ever been.

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