

Is Toronto-Dominion Bank (TSX:TD) Stock Undervalued?

Description

Toronto-Dominion Bank ([TSX:TD](#))([NYSE:TD](#)) stock has not been having a great few months. It started to recover this month after a rough October, but was down again as trading closed this past Friday.

With TD stock taking a beating, many investors are wondering if it's time to buy the dip. Ultimately, it depends on the stock's valuation. Is TD stock priced low enough to justify buying now, or does it still have further to go? The answer to this question will help us understand whether TD is getting hit for good reason or just being dragged down by broader market doldrums.

It helps to start by comparing TD to its peers.

More expensive than its peers

Broadly speaking, TD is more expensive than other "Big Five" banks. Whereas TD's peers have P/E ratios hovering around 10, TD's is closer to 13. However, this may be justified if TD's growth is stronger. And in many cases, it is. TD posted 12% earnings growth in Q3 compared to -3% for **Bank of Nova Scotia** and 11.4% for **Royal Bank of Canada**.

Broadly speaking, it appears that TD's growth can justify its somewhat above-average valuation. But to understand its growth, we'll need to break it down in more detail.

Growth breakdown

In Q3, TD's revenue growth was 6% and its [earnings were up 12%](#). On the surface, 12% earnings growth looks high for a big bank, but remember: that's on top of very meagre revenue growth. If earnings are up simply because of lower costs somewhere in the business, then those earnings may be on shaky grounds.

And looking at TD's Q3 earnings highlights, that appears to be the case. In the Corporate segment of its business, TD lost \$113 million compared to \$150 million in the same quarter last year. This decreased loss seems to account for how TD was able to produce high earnings growth on meagre revenue growth. The report attributes this to "the impact of U.S. tax reform," which makes sense because U.S. retail banking is one of the fastest-growing parts of TD's business. So, if this tax reform proves to be politically short-lived, TD's earnings growth may be, too.

A strong and growing dividend

Last but not least, TD pays a dividend that yields about 4% at the time of this writing. And here's some good news: TD's payout ratio is just 45%, which means that the company spends less than half of its earnings on dividends. So, the bank has room to increase the dividend — and remain solvent while doing so — even if earnings growth is mediocre. TD management has a [solid history](#) of dividend increases, and this should continue into the future. So, even if last quarter's frothy earnings growth was

a one-time thing, TD investors can expect their dividend to reach upward for a long time.

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