Is the Mortgage Slump Holding Back Toronto-Dominion Bank's (TSX:TD) Growth?

Description

TD Bank (TSX:TD)(NYSE:TD) is the darling of Canadian bank stocks. Although eclipsed by **RBC** in terms of revenue and market cap, it has been the biggest gainer of the Big Six, rising 46% (plus dividends) over the past five years.

Recently, however, concerns have arisen over the possibility that a housing slump will hurt TD's earnings. Since banks make much of their money off mortgages, any decline in domestic home prices can put a major dent in revenue. TD is somewhat less exposed to this than most Canadian banks, as its U.S. retail business makes up over 30% of its total earnings. However, after a somewhat disappointing Q1 earnings report, some are worried that the housing market may be taking TD down with it.

To see whether that's the case, we'll first need to understand what exactly happened in Q1.

Q1 earnings miss

TD Bank's Q1 report included a number of items that some considered disappointing. Chief among those was net income, which came in at $2.5 billion — a year-over-year increase of just 2.4%. EPS came in at $1.57, $0.15 short of analyst expectations. Revenue increased more, at 5.4% year over year, but both sales and profit growth metrics were down from past quarters.

Are mortgages the culprit?

It's one thing to point out that TD had a lacklustre quarter in Q1, but quite another to show what the culprit was. Given all the talk about the housing slowdown, that seems like a good place to start.

According to TD's Q1 report to shareholders, the bank had $225.7 billion in mortgages in Q1, up from $225.1 billion in the previous quarter. While there's some growth happening here, it's a paltry percentage increase, and may partially account for why TD's revenue growth slowed in Q1. Although "total mortgages" is not the same as "interest earned on mortgages," it stands to reason that little growth in mortgages would result in little revenue growth as well.

U.S. retail still kicking

One bright spot in TD’s Q1 report was the bank’s U.S. retail results. U.S. retail has recently been TD’s ace in the hole, and that didn’t stop in Q1, which saw the segment grow at 30% year over year. That is completely expected, because TD is still a small player in the U.S., with tonnes of room to grow. Currently the eighth-largest bank in the country, TD barely has any presence on the west coast, so it has tonnes of room for expansion in what’s already its fastest-growing market.

With all that said, TD’s Q1 growth WAS disappointing. Although there were some bright spots in the Q1 report, revenue and earnings growth simply failed to keep up with past performance. It looks like the housing slump may be a part of that, although a big downturn in wholesale banking could be the bigger issue. We’re also seeing early indications that U.S. housing is heading into a slump of its own, so even TD’s much-praised U.S. retail business could take a hit in the months ahead.

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