



Royal Bank of Canada (TSX:RY) Beats on Earnings

Description

In the past few months, **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)) has been taking some heat. Although the stock is up about 13% year-to-date, it has been trading sideways since the middle of April. While a broader **TSX** slump could be partially to blame, another likely cause is a rash of negative publicity; recently it came out that hedge funds like Neuberger Berman were shorting Canadian Banks, with RBC being [one of the main targets](#).

News of these shorts came after several months of falling housing prices—including in previously hot markets like Vancouver—as well as reports of declining consumer credit quality. Both of these factors would have a negative effect on Canadian banks, which depend on mortgages and consumer loans to make money. However, against the apparent odds, Royal Bank managed to pull off a Hail Mary in Q2 and narrowly beat on earnings (despite higher provisions for loan losses). Here's how it all breaks down:

Net income and diluted EPS

In Q2, Royal Bank posted \$3.2 billion in net income, up 6% year over year, and \$2.2 in diluted EPS, up 7% year over year. These growth figures may not sound astonishing, but they beat analysts' expectations, mainly because sentiment toward Canadian banks is fairly negative at the moment. Granted, these results represent only a very slight beat, but they could be enough to make RBC stock a buy at current prices.

Segment by segment breakdown

Royal Bank's Q2 growth was driven by gains in capital markets, personal & commercial banking, and wealth management. Of those three sectors, Capital Markets was the biggest growth engine, up 17% year over year. It should be mentioned that there were some lousy results in the mix as well; for example, RBC's Investor & Treasury Income unit declined by a steep 29%. On the whole, though, there was more good than bad, and Canada's largest bank pleasantly surprised everyone.

Provisions for credit losses

Probably the biggest concern area in RBC's Q2 report was its provisions for loan losses (PCL). This is a special line item for banks: it represents money put aside to cover possible loan defaults; in Q2 it increased 59% on \$441 million worth of loans. The problem here is not so much that the money isn't being invested or that it's eating into profits, but rather the fact that it lends credence to the claim that banks are in for pain stemming from [future defaults](#). It remains to be seen whether that will happen, but from these results it looks like the banks themselves are bracing for it.

Foolish takeaway

RBC is Canada's largest bank for a reason. With over 150 years of steady and stable growth, it has stood the test of time. Although RBC doesn't have the growth prospects that some of its U.S.-centric competitors have, it's still able to moderately grow, albeit at a subdued pace. After the publication of Q2 results I'd call it a modest buy.

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