How Does the Charles Schwab Acquisition Impact TD Bank (TSX:TD) Investors?

Description

The **Charles Schwab Corporation**, a brokerage firm based in San Francisco, is expected to announce a deal to acquire **Toronto-Dominion Bank's** (TSX:TD)(NYSE:TD) American brokerage subsidiary **TD Ameritrade**.

The deal could be worth as much as US$26 billion (C$34.6 billion), making it one of the largest and most consequential acquisitions in the financial industry this year. This unexpected union consolidates the U.S. brokerage sector further. But what impact would this have on Canadian investors holding TD stock? Here's a closer look.

Growth driver

TD Bank has been one of Canada's best performing banks for a while. The stock has more than doubled while the dividends have expanded at an annual rate of 10% for the past 10 years.

Much of the company's superior performance was driven by growth in its American operations. TD Bank holds 42% of TD Ameritrade – the ninth largest financial service provider and one of the biggest brokerage firms in the U.S. Ameritrade's 3% dividend yield and 223% stock price appreciation since the global financial crisis boosted TD Bank's returns immensely.

Exposure to the American market insulated TD from the domestic economy and gave investors hope of continued expansion for the foreseeable future. However, a paradigm shift in the American brokerage industry this year caused the stock to lose nearly a third of its value.

Great timing

In October, Charles Schwab, one of the largest brokerage firms in the world, said it would eliminate its $4.95-per-trade commission for stock traders on its platform.

Zero-fee trades were expected to be devastating for competitors like Ameritrade, and investors fled the stock. Commissions and brokerage fees on stock trades contributed the majority of Ameritrade's revenue. Within a week of Schwab's announcement, Ameritrade had lost 28% of its market value.

Schwab's acquisition saves the company and unlocks value for TD Bank just as the competition is heating up.

At the time of writing, the company is worth US$22.41 billion, which means the acquisition is at a 6.1% premium to the market price. If the deal is sealed by next year, TD Bank could unlock US$10.9 billion (C$14.5 billion) in cash.

Not only does the deal allow the Canadian bank to avoid losses on its American brokerage business due to zero-fee trading, but it also boosts the company's cash hoard for other acquisitions and future expansions. The cash could also be handed back to shareholders in the form of dividend, boosting the stock's already impressive dividend yield of 3.8%

However, I wouldn't expect the deal to move the needle much. TD Bank already holds $393 billion in cash and cash equivalents on its books. A further $14.5 billion would have marginal impact on the company's expansion and growth strategy overall.

That may be the reason why TD's stock didn't seem to react to the news today – the stock price is flat.

Bottom line

TD Bank shareholders should be relieved that Schwab's acquisition saves their American subsidiary from intense price competition. Meanwhile, the deal could unlock billions in cash to fuel future expansions or further dividends.

I expect the company to either offer a boosted dividend or deploy the cash in an acquisition of its own. TD still needs to diversify its business and grow beyond the domestic market.

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