Should You Buy Royal Bank of Canada (TSX:RY) Stock Now?

Description

Royal Bank of Canada (TSX:RY)(NYSE:RY) just reported fiscal Q2 2020 results that missed analyst expectations. The company also provided an indication on how the bank perceives loan risks over the coming months.

Let's take a look at the current situation to see if Royal Bank is a buy for your TFSA or RRSP portfolio today.

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Earnings

Royal Bank generated $1.5 billion in net income and adjusted earnings per share of $1.03 for the the quarter that ended April 30. This represents a 54% drop compared to the same period last year. Analysts anticipated better results.

Royal Bank set aside $2.83 billion in provisions for credit losses (PCLs) in the quarter. This indicates loans the company has identified that could potentially go into default. Banks tend to be conservative when it comes to PCLs, so the actual losses could turn out to be smaller.

Royal Bank said it has provided payment deferrals for a term of up to six months on $59 billion of mortgages, credit cards, auto loans, and other personal loans outstanding. In addition, the bank reported $17 billion in business loan payment deferrals in Canada. American PCLs for businesses totalled US$1.8 billion at City National Bank, a subsidiary.

Risks

Investors wonder if the housing market could be at risk of a crash. Canada's official unemployment rate hit 13% in April. The May number will likely be higher.

Royal Bank finished fiscal Q2 2020 with $274 billion in Canadian residential mortgages. It also had $38 billion in home equity lines of credit (HELOCs) on the books. The uninsured mortgages total $196.2

billion with a loan-to-value (LTV) ratio of 52%.

The LTV is important. The metric indicates how far the value of the assets would have to drop before the bank would take a loss on the disposition of the property. Canada Mortgage and Housing Corporation (CMHC), the government agency that insures mortgages, recently cited a potential drop in house prices of 9-18%.

Royal Bank provided mortgage payment deferrals for 14% of the accounts and a total of $47.2 billion in loans. In the event the jobs situation doesn't improve materially before the end of the year, the bank could see defaults rise on these loans.

Upside

Royal Bank entered the crisis with a CET1 ratio of 12%. This means it had a strong capital position to enable it to ride out the downturn. As of April 30, the CET1 ratio remained high at 11.7%.

The bank said it intends to maintain the dividend payout. This is important for investors who rely on dividends for income or use the distributions to buy more shares as part of their retirement planning process.

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Government aid to consumers and businesses should help mitigate bankruptcies and subsequent loan defaults. In a recent statement, Bank of Canada (BOC) governor Stephen Poloz said the economy is currently trending along the BOC's best-case scenario for the pandemic crisis.

Should you buy Royal Bank stock?

The stock trades for $90 at the time of writing and provides a dividend yield of 4.8%. Investors who had the courage to buy at the March low near $72 are already sitting on some nice gains. Those with a buy-and-hold strategy might want to start nibbling on the stock at the current price and look to add to the position on any weakness.

Royal Bank is a solid company, and the stock should continue to recover as the economy improves. The shares traded at $109 in February, so there is decent upside opportunity.

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