Unpopular Opinion: TD (TSX:TD) Did Surprisingly Well in Q2

Description

Last week, the **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) released its earnings for the second quarter. As predicted, it came with some eyebrow raising items, like a 52% earnings decline and a several billion dollar increase in provisions for credit losses (PCLs). Most of this was attributable to the COVID-19 pandemic. The lockdown hit many businesses and individuals hard; as a result, many loan accounts became questionable.

With all that said, TD's Q2 results were pretty good in the circumstances. Revenue was pretty much flat, and the lower net income was mainly due to non-cash expenses. In normal circumstances, it wouldn't have been a great quarter. But it wasn't a disaster either. Here's why.

PCLs drove most of the earnings decline

The biggest reason why TD's earnings fell in Q2 was because of PCLs. PCLs are funds set aside for expected future loan losses. The amount is reduced from net income. PCLs are not cash losses. If they do not materialize, PCLs may be reduced in the future. In that case, we'd see a spike in earnings following the initial dip.

Of course, bank executives aren't stupid. Their PCL numbers are based on rational calculations, and this year likely *will* see more defaults than normal. However, that doesn't mean TD will ever see the $3.2 billion in credit losses they're expecting. If the COVID-19 re-opening goes smoothly, the bank's loans may perform better than expected. In that case, TD will be able to reverse its PCLs in the future.

Bright spots in TD's Q2 earnings

In addition to the fact that TD's Q2 PCLs may not reflect actual future cash losses, there were some other bright spots in the release.

One of those was revenue. It came in at $10.5 billion, up from $10.2 billion. As of the end of April, the bank had been taking in more revenue than it did in the same quarter a year before. That's particularly encouraging when you look at TD's reporting schedule. Unlike most companies, whose first quarters end on March 31, TD's second quarter ended on April 30. This means that its most recent quarterly report covered a period with two full months of COVID-19 lockdowns.

This in turn means we may not see much bigger declines from here on. Companies that just recently reported Q1 earnings for periods ended March 31, will do even worse in Q2. That's because the quarter in question only had one month of COVID-19 lockdowns, while Q2 will have three. **Air Canada**, for example, will almost certainly fare worse in Q2 than Q1.

TD, by contrast, had two full months of lockdowns in the period it just reported. Depending on how swiftly businesses re-open in its service areas, it may have the worst behind it. That's an enviable position to be in at a time when many businesses are down for the count, with no end in sight.

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