



RBC (TSX:RY) vs. TD (TSX:TD): Is There a Better Buy?

Description

RBC ([TSX:RY](#))([NYSE:RY](#)) and **TD Bank** ([TSX:TD](#))([NYSE:TD](#)) are Canada's two largest banks. Both recently reported second-quarter results that were likely worse than the market expected. The COVID-19 crisis has had a major impact on the banks' customers across North America. Both banks have had to massively increase their provisions for loan losses. Which stock is a better buy, or are the Canadian banks a buy at all right now?

Second-quarter results

In the second quarter, TD allocated \$3.2 billion of provisions for credit losses. As a result, net earnings and earnings per share were down 52% and 53%, respectively. TD's capital ratio fell 70 basis points to 11% (albeit, it is well above the regulatory 10.25% requirement). It was, in fact, the largest drop among the banking peers.

RBC, however, allocated \$2.83 billion for credit loss provisions. Net earnings and earnings per share were down 54% and 55%, respectively. RBC's capital ratio dropped only 30 basis points and sits at 11.7%. Overall, RBC seemed to fair slightly better of the two.

The banks are starting to bounce back

Despite the massive drop in the March market crash, the banks have begun to finally rebound. The rest of the year will still be ugly. However, many analysts and commentators believe that this could be the peak for loan-loss provisions. As a consequence, the markets are choosing to look past some of the short-term effects of the pandemic.

There are, of course, some real economic, political, and social risks that could continue to affect the bank stocks: a second wave of COVID-19, governments weaning off financial support for businesses and families, the potential for increased bankruptcies, and even the U.S. election.

Own only the best in this environment

RBC and TD are the strongest, largest, and best capitalized of the Big Six Canadian bank stocks. If I were to bet on any of the bank stocks and expect them to thrive outside the crisis, it is these two.

One reason I like these two is because they have significant operations in America. The Canadian economy challenged for longer because of [high consumer debt levels](#), larger economic dependence on commodities, and inflated housing markets (and mortgages). Diversification in the U.S. helps alleviate some of these pressures.

RBC or TD?

TD derives 27% of its revenue from U.S. operations (a majority of that from TD Ameritrade). Its U.S. division has been a substantial growth catalyst, and there is potential for further expansion across America. One concern, however, is Ameritrade. As a discount brokerage, it is facing significant competitive pressures (zero-commission trading), and that could dampen margins over the long term.

RBC derives 23% of its revenue from the U.S and 16% of revenues are from other international operations. While Canadian banking is its largest business, diversification outside Canada will probably be its biggest growth driver.

Operationally, 40% of RBC's revenues come outside of banking. This includes capital markets (19%), wealth management (21%), insurance (7%), and investor services (5%). The capital markets, insurance, and investor businesses all posted solid growth in the quarter. In fact, volatile markets can be a tailwind for these divisions, so this is a nice offset to the weakness in banking.

Both banks are trading cheaper than their historical averages. RBC has a price-to-earnings of 12 times and a yield of 4.65%. TD has a price-to-earnings of 10.5 times and a yield of 5.26%. I think [these dividends are safe](#) as long as the pandemic continues to abate and economies recover to some extent.

RBC stock gets my pick

While TD's stock is cheaper and has a better yield, I would likely place my bank bet on RBC's stock. Both have significant U.S. exposure, but I would favour RBC. It has a more balanced and diversified overall portfolio. It has fought hard in past years to create efficiencies and ensure it has a well-capitalized, customer-friendly business. I am not sure I can say the same for TD. As a result, I believe RBC will continue to fetch a premium valuation and outperform the other Canadian bank stocks over the long run.

CATEGORY

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