1 Canadian Bank Stock to Buy and Forget

Description

If there's only one Canadian bank stock to buy and forget, **Royal Bank of Canada** (TSX:RY)(NYSE:RY) would be on the top of the list for many investors.

Despite far-and-wide pandemic impacts this year, the quality bank has been super resilient. Thereby, it's been able to protect its dividend.

RBC stock is a resilient bank

RBC is the largest bank in Canada by market capitalization. It operates core businesses in Canada and the United States. Its fiscal year 2020 (FY 2020) revenues are diversified across Canada (59%), the U.S. (25%), and 34 other countries (16%).

Royal Bank experienced the greatest impact from the pandemic in fiscal Q2 from economic lockdowns. Since then, the impacts progressively diminished through fiscal Q4.

Specifically, the bank's provisions for credit losses (PCL) on impaired loans was 0.37% in fiscal Q2 (versus 0.29% in fiscal Q2 2019). By the end of the fiscal year, its PCL on impaired loans had fallen to very low levels of 0.15%, which demonstrates the high quality of its loans portfolio.

Due to lower interest rates, the bank's net interest margin was 1.55% for the year, down from fiscal 2019's 1.61%.

The bank's return on equity had rebounded to 16% by the end of the fiscal year, which is a magnificent improvement from fiscal Q2's 7% level. Consequently, its FY 2020 return on equity was 14.2%, down from FY 2019's 16.8%.

Importantly, Royal Bank is financially strong. It ended the year with a Common Equity Tier 1 ratio of 12.5%, which was the strongest it's been in the last two years.

Royal Bank's line of defence

Royal Bank's diversified business mix helps maintain the stability of its earnings. In FY 2020, its revenue was diversified as follows: Personal and Commercial Banking (37%), Wealth Management (26%), Capital Markets (21%), Insurance (11%), and Investor and Treasury Services (5%).

This varied business model led to revenue growth of 2.6% to $47 billion and net income that only declined 11% to $11 billion in FY 2020. Similarly, diluted earnings per share of $7.82 was down 11%. This resulted in a payout ratio of 55% for the year, which supports a solid dividend.

A probable scenario is a rebound in earnings in fiscal year 2021, which will lead to a normalized payout ratio. Therefore, regulators could potentially allow for a dividend increase in RBC sometime next year. If not, investors should at least be confident that its dividend is safe.

Going forward

RBC believes stronger economic growth could occur in the second half of fiscal 2021. At about $105 per share at writing, RBC stock is within fair-valuation range. This is under the assumption that there will be a decent rebound in fiscal 2021 earnings on the backdrop of vaccine distribution and a more normalized economy.

Post 2021, it's likely that Royal Bank will be able to increase its earnings per share by more than 5% a year. If so, the stock will have a fair value of at least $130 per share by 2025. When combined with its 4.1% dividend, estimated total returns will be about 8.5% per year.

The Foolish takeaway

Royal Bank is a great stabilizer for a diversified portfolio. It'd be a buy-and-forget stock for conservative investors, especially if you buy it when it's cheap. Right now, the quality stock is fairly valued.

If you're satisfied with a return of about 8.5% per year, you're welcome to nibble some shares at current levels. It'll give you decent passive income with an initial dividend yield of 4.1%.

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