RBC (TSX:RY) Might Lose +$71 Million Over a Bankruptcy, But it's Still a Solid Bet

Description

The pandemic and the lockdowns have hit every business differently. Retail businesses that rely solely on foot traffic have suffered, while the e-commerce businesses have boomed. Fine-dining restaurants saw revenues declining, while fast-foods and delivery businesses are saw sales spike. But overall, discretionary spending has taken a hit, and people are more focused on saving money and reducing costs.

No business is isolated in a vacuum, especially in today's complex socio-economic society, and almost all businesses are connected to banks somehow. A negative consequence of this relationship is that if the business goes down, the banks suffer losses as well.

Royal Bank of Canada (TSX:RY)(NYSE:RY) is about to suffer a similar loss because of an educational institution.

The $71 million loss

Public educational institutions operate on a tight budget. They usually don't have enough liquidity to survive protracted periods of reduced revenues. That's what happened to Laurentian University, which owes about $91 million to three major banks, and the lion's share of this debt is with Royal Bank — i.e., $71 million.

The university has recently filed for court protection under CCAA. The financial pressure of the pandemic, augmented by few enrollments and growing deficits, were the reason the university gave for the bankruptcy request. The university will get secured financing from a boutique firm to keep its doors open for the 9,300 students currently enrolled there.

The people investigating and involved with this bankruptcy are speculating that it might not be the last financial institution to seek bankruptcy protection from their creditors.

Royal Bank stock

The $71 million loss will be a hefty blow to the bank's finances and is likely to skew the quarterly results substantially. And the worst part is that the university might not be the only significant borrowers to go bankrupt. A few more losses of this magnitude, and Royal Bank's first quarter of the year might turn out worst than 2020's first quarter.

But the stock is still a solid bet. The bank has recovered from its 2020 crash, and the current valuation is just 1.9% down from its pre-pandemic peak. It's offering a juicy 4% yield at a safe 54.8% payout ratio. The balance sheet is still balanced, and its substantial local and foreign presence is still promising.

The economy might be going through a withdrawal phase. As the government grants slowly fade out, the effects would be felt by a lot of businesses and individuals, but once the rough phase is over, the economy might finally start to heal and grow. And Royal Bank might re-adopt its pre-pandemic growth pace.

Foolish takeaway

Royal Bank of Canada might not be an excellent short-term bet, not unless the country goes through another market crash. But as a long-term investment or a dividend stock for passive income, Royal Bank of Canada might be considered an evergreen bet. As an institution that is probably too big to fail, the bank might be able to swallow the $71 million loss with good grace and pull through.

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