RBC Stock Price: Is Royal Bank of Canada (TSX:RY) a Buy?

Description

Royal Bank of Canada (TSX:RY)(NYSE:RY) is a stock I have a brief but profitable history with. I bought it earlier this year when **TSX** banks were rallying and grabbed a quick 11% gain in a few weeks. Sensing more value elsewhere, I sold the stock and invested the proceeds in another stock.

It ended up being a mistake. The stock I bought with my RY sales proceeds went down 10%. I then sold that stock and bought into another Canadian bank: **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD). TD Bank has since gone on to deliver solid returns for me.

As you might have guessed, TD Bank is my favourite Canadian bank stock right now. I've bought the stock three times now, and I may be going in for a fourth buy shortly. But still, I think the Royal Bank of Canada is a pretty good investment. Trading at just 12 times earnings, it's a classic value play that any income-oriented investor could make good money off.

Valuation

The core of any bullish thesis on Royal Bank–and Canadian banks in general–rests on valuation. Nobody argues that Canadian banks are likely to produce frothy growth, but they are pretty cheap relative to what growth they do have. Royal Bank of Canada is quite inexpensive, with metrics like:

- Adjusted P/E: 12.3.
- GAAP P/E: 12.5.
- Price to sales: 3.9.
- Price to operating cash flow: 3.8.

These are all pretty solid value metrics. In addition, the stock has a 3.85% dividend yield, which indicates that there's a fair amount of dividend income to be had by buying it.

Growth

Next, we can look at Royal Bank's historical growth and future growth prospects.

For the most recent 12-month period, RY's revenue grew by 12.7%. Its earnings grew 36.4%. The strong growth for the trailing 12-month period is due to the economic recovery from COVID-19. The pandemic caused banks some trouble in 2020. This year, they are recovering from the damage they took last year. In other words, the 36.4% earnings growth isn't as good as it looks: it reflects a bounceback from an extremely bad year.

Still, the 9% compound average growth in earnings isn't bad at all. When you combine value, growth, and dividend yield, you've got the makings of a solid income play here.

Finally, there's the matter of future growth. Canadian banks usually deliver "slow and steady growth," which is to be expected because they collectively have saturated the Canadian financial services market. And there *is* one catalyst that could take growth higher: interest rate hikes. Banks earn higher profit margins on loans when interest rates go up.

If people keep taking out loans in a higher interest rate environment, bank earnings may rise. This isn't guaranteed to happen: the higher rates could discourage borrowing. But the margins, at least, will rise. This is why bank stockholders should be optimistic that the Bank of Canada is set to raise interest rates. Banks are among the few classes of stocks that can gain from rate hikes.

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