TD Bank: Time to Buy the Stock?

Description

TD (TSX:TD)(NYSE:TD) just reported fiscal third-quarter (Q3) 2022 earnings that came in better than expected. Investors who watch the share price plunge in recent months are wondering if TD stock is now undervalued and good to buy for a Tax-Free Savings Account (TFSA) or Registered Retirement Savings Plan (RRSP) focused on dividends and total returns.

TD Bank overview

TD is Canada's second-largest bank with a current market capitalization of $157 billion. The bank is best known for its strong retail banking operations in Canada, but the future focus of investors will fall on the growing American business.

TD spent billions of dollars over the past 15 years to buy regional banks and build a significant presence in the United States along the east coast. The current branch network runs from Maine right down to Florida and is about to get bigger by more than 400 locations. TD is in the process of buying **First Horizon** for US$13.4 billion. The bank primarily operates in the southeastern part of the U.S., including in Florida, so the deal makes sense. TD expects the purchase to close in the first part of next year and will make TD a top-six bank in the American market.

TD also recently announced plans to buy Cowen, an investment bank, for US$1.3 billion. Cowen will merge with TD Securities, making the group a stronger full-service player in the capital markets segment.

TD earnings

TD reported fiscal third-quarter (Q3) 2022 adjusted net income of $3.81 billion compared to $3.63 billion in the same period last year. In the first three quarters of fiscal 2022, TD generated adjusted net income of $11.36 billion compared to $10.78 billion in 2021. Unless there is a major negative surprise for fiscal Q4, TD is on track to comfortably beat the 2021 results.

TD finished Q3 with a common equity tier-one (CET1) ratio of 14.9%. The banks are required to have a CET1 ratio of at least 10.5%. This means TD is sitting on substantial excess cash that will be used to fund the American acquisitions.

Risks

Investors sold bank stocks in recent months due to rising recession fears. High inflation is forcing households to spend more discretionary income on food, gasoline, and other essential expenses. This means less money is going to other purchases and that will eventually slow down economic growth.

At the same time, the Bank of Canada and the U.S. Federal Reserve are aggressively raising interest rates to cool off the economy to bring down inflation. The added borrowing costs will be a second hit to mortgage holders and businesses with loans. Households will start tapping savings to cover the increase in monthly expenses and highly leveraged property owners could start to default.

If the economy goes through a deep contraction and job losses start to surge, the weakening of the housing market could turn into a crash. This would have widespread economic repercussions and could put TD and its peers in a rough spot.

For the moment, most economists expect a mild and short-lived recession in 2023 or 2024. Unemployment remains near a record low, so people still have jobs to pay their rising bills.

Dividends

TD raised the dividend by 13% late last year. Another double-digit increase is likely on the way for fiscal 2023. TD has a great track record of distribution growth with a compound annual dividend-growth rate of about 11% since the mid-1990s.

At the time of writing, the stock provides a 4% dividend yield.

Should you Buy TD stock now?

TD has historically proven to be a good stock to buy on major pullbacks. The shares currently trade near $86.50 compared to the 12-month high of $109. TD stock is up from the July low around $78 but still looks oversold.

Volatility should be expected in the coming months, but buy-and-hold investors might want to buy TD stock for their TFSA or RRSP portfolios at this level. Further downside should be viewed as a good opportunity to add to the position, and you get paid well to ride out the turbulence.

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