Toronto-Dominion Bank Has Minimal Downside at $55 Per Share

Description

Canadian investors are much more hesitant to own the Big Five banks than in years past, and it's easy to see why. Low oil prices continue to wreak havoc on the Canadian economy, low interest rates are compressing margins, and consumers remain heavily indebted. As a result, the **iShares S&P TSX Capped Financials Index Fund** has sunk by 2% over the past year, even as the banks have continued to grow earnings.

That being the case, not every bank is equally risky, and **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) is likely the safest among the Big Five. We'll take a closer look below and show why there's very limited downside at $55 per share.

The right exposures

While the decline in oil prices has been bad for Canada's economy, the pain has largely been restricted to the oil-producing regions. And TD has less exposure to the Prairie Provinces (which include Alberta and Saskatchewan) than any of the other Big Five. It's no coincidence that TD also has the lowest exposure among energy companies.

TD's Canadian business is concentrated in Ontario (as one would expect, given the bank's name), and this is a region that benefits tremendously from the low Canadian dollar. Better yet, the bank has a large presence on the U.S. East Coast, which is benefiting from low gasoline prices.

On top of all that, TD is mainly a retail bank (a relatively low-risk business) with less than 10% of earnings coming from wholesale. And the bank has placed a heavy emphasis on risk management ever since a disastrous year in 2002, which certainly should pay dividends in this environment.

A cheap-enough price

In its most recent fiscal year, TD generated $4.61 in adjusted earnings per share. What would have happened to that number in worse scenarios?

Well, let's suppose TD's loan losses were 50% higher. That would have caused adjusted EPS to fall to $4.24 (assuming a constant tax rate). So with a $55 share price, that still equals just a 13 times multiple–very reasonable for a company of TD's quality.

Of course, TD would have no trouble paying its dividend in this scenario, since the annual payout still only equals $2.20 per year. That's a 4% yield with TD at $55 per share.

So, to sum up, if the energy sector slides further into the abyss, or if Canadians find themselves increasingly squeezed, then TD's loan losses should remain well under control. And even if losses spike by 50%, then the shares are still reasonably priced and the dividend is still affordable. Thus, if you're looking for safety, you shouldn't be afraid of this bank stock.

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Date
2025/06/28
Date Created
2016/04/05
Author
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