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# MARKET INSIGHTS

The latest Market Insights from the Connected Wealth team



## Canadian Banks Deliver

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Over the past two weeks Canadian banks reported their fiscal first quarter earnings which covered results from the months of November to January. All banks beat expectations, and some beat them handily. We observed the following from the bank results:

- Loan loss provisions remained steady for the most part and in some cases even improved.
- Personal and commercial banking results were quite strong even as some banks saw a decline in their net interest margin.
- After a mixed Q4, wholesale (trading and investment banking) operations were fairly strong across the board in Q1.
- Bank capital positions are very strong, while dividend growth track records remain intact.
- Share price performance has been stellar over the past year, but the Canadian economy still faces a number of headwinds down the road.

### Loan Loss Provisions

The general trend this quarter was either flat or declining loan loss provisions for Q1, which is something investors always like to see. The one notable exception was TD Bank which saw provisions increase from last quarter and would have seen an increase year-over-year if it had not been for \$24 million in recoveries from its wholesale business. Auto loans and credit cards were identified as the main culprits for TD's provision increase. Royal Bank's provisions fell materially as that bank posted its lowest total since 2015.

### Personal and Commercial Banking

Easily the largest contributor to bank earnings, this segment was quite strong as earnings growth did average in the single digits. However, that is very good considering the size of these businesses, especially when net interest margins ticked downwards. The good news is that we have not seen any material stress in this segment just yet, although continuing earnings growth momentum will be challenging for future quarters.

### Q1/17 Earnings and Loan Loss Provisions

	EPS	Average Estimate	LLPs (\$Millions) Q1/17	LLPs (\$Millions) Q4/16	LLPs (\$Millions) Q1/16
Bank of Montreal	\$2.28	\$1.87	173	174	183
Bank of Nova Scotia	\$1.58	\$1.57	553	550	539
CIBC	\$2.89	\$2.57	212	222	262
National Bank	\$1.35	\$1.26	60	59	63
Royal Bank	\$1.87	\$1.76	294	358	410
TD Bank	\$1.33	\$1.27	633	548	642

LLPs = Loan Loss Provisions

Source: Company Reports

### Adjusted Canadian Personal & Commercial Earnings

	Q1/17 (\$Millions)	Q4/16 (\$Millions)	Q1/16 (\$Millions)	Q1/17 Net Interest Margin (%)	Q4/16 Net Interest Margin (%)	Q1/16 Net Interest Margin (%)
Bank of Montreal	575	588	530	2.51%	2.53%	2.55%
Bank of Nova Scotia	981	954	875	2.39%	2.39%	2.35%
CIBC	709	687	684	2.39%	2.45%	2.51%
National Bank	213	191	180	2.24%	2.25%	2.25%
Royal Bank	1380	1275	1290	2.61%	2.63%	2.62%
TD Bank	1566	1502	1513	2.82%	2.78%	2.80%

Source: Company Reports

**Wholesale banking**

It would appear the mixed results from last quarter for the wholesale business may have been a blip on the radar screen as almost all banks posted net income improvements both from last quarter and year-over-year. The one exception was Bank of Montreal which saw a small decline in profitability from Q4. For the most part, trading revenues were healthy and investment banking activity was stable.

**Capital and Dividends**

Tier 1 capital levels for all of the banks increased quarter-over-quarter and in some cases increased significantly, leaving us to conclude that capital levels are solid. With respect to dividend increases, we expected both Bank of Nova Scotia and Royal Bank to increase their dividends as they have done so on a semi-annual basis for some time now. They did not disappoint as Scotia's quarterly dividend increased from \$0.74 to \$0.76 while Royal's increased from \$0.83 to \$0.87. TD Bank also increased its dividend as expected from \$0.55 to \$0.60, but their increases now occur on an annual basis. The big surprise of the quarter was CIBC, which bumped its quarterly dividend yet again (from \$1.24 to \$1.27) and for the 11<sup>th</sup> time in the past 13 quarters. Admittedly CIBC has been playing catch up with its bank peers as it's been behind in raising the dividend over the past decade. But its persistence has paid off as it now has a better dividend growth track record than Bank of Montreal over the past ten years and is catching up to Bank of Nova Scotia.

**Share Price Performance**

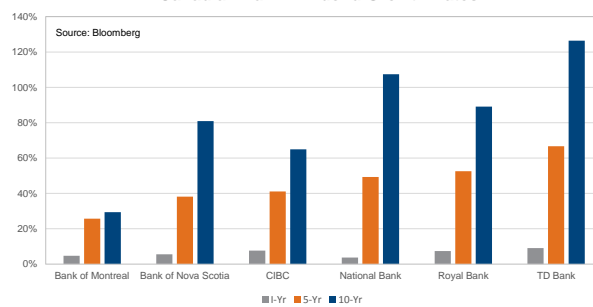
The market had priced in high expectations coming into the quarterly reports, so with those expectations met we did not see a great deal of share price movement over the past couple of weeks. However, if we look at share price performance (excluding dividends) over the past year, shareholders can only smile as returns range from 29% to 53% (the TSX has returned 19% over that same period). The question to answer is whether or not this momentum can continue considering that some valuation metrics are high from a historical perspective? While the Canadian economy has bounced back from the commodity shock of early 2016, we still believe it faces headwinds compared to our U.S. neighbours. Private investment at home has declined, consumers have more debt relative to disposal income than ever before, real estate prices remain elevated and eventually this country will have to deal with a rising interest rate environment, albeit not in the immediate future. So there are risks, and the bank CEOs have been highlighting them, but perhaps not risks that will have a material impact on 2017 earnings. Therefore, the market may be giving the banks a pass for now; however, the problems listed above will have to be dealt with

**Wholesale Earnings**

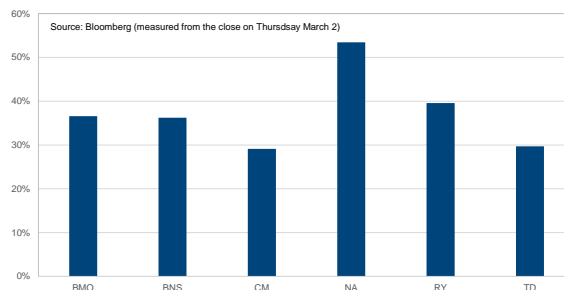
	Q1/17 (\$Millions)	Q4/16 (\$Millions)	Q1/16 (\$Millions)
Bank of Montreal	376	392	257
Bank of Nova Scotia	469	461	366
CIBC	371	276	244
National Bank	183	176	149
Royal Bank	662	482	570
TD Bank	267	238	161

Source: Company Reports

**Canadian Bank Dividend Growth Rates**



**Canadian Bank Share 1-Year Price Performance**



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eventually. We will continue to monitor the business environment for our banks going forward to determine if and when these headwinds will strengthen, but for now Canadian banks have done a respectable job improving profitability and creating value for shareholders.

*Charts are sourced to Bloomberg unless otherwise noted.*

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