



Royal Bank of Canada (RY)

Updated August 24th, 2022 by Kay Ng

Key Metrics

Current Price:	\$95	5 Year CAGR Estimate:	12.8%	Market Cap:	\$133B
Fair Value Price:	\$109	5 Year Growth Estimate:	6.5%	Ex-Dividend Date:	10/25/22
% Fair Value:	87%	5 Year Valuation Multiple Estimate:	2.8%	Dividend Payment Date:	11/24/22
Dividend Yield:	4.2%	5 Year Price Target	\$149	Years Of Dividend Growth¹:	10
Dividend Risk Score:	B	Retirement Suitability Score:	A	Rating:	Buy

Overview & Current Events

The Royal Bank of Canada – hereafter RBC – is the largest bank in Canada by market capitalization, and the country’s largest bank by total assets. RBC offers banking and financial services to customers primarily in Canada and the U.S. and is a member of the Big 5 Canadian banks. The financial institution operates in five business units: Personal & Commercial Banking (37% of FY2021 revenue), Wealth Management (27%), Insurance (11%), Investor & Treasury Services (4%), and Capital Markets (21%). Its revenue mix is roughly 59% Canada, 25% the U.S., and 16% international.

RBC is cross-listed on the Toronto Stock Exchange and the New York Stock Exchange, trading under the ticker RY on both exchanges. All figures in this research report are in U.S. dollars unless otherwise noted.

On 8/24/22, RBC reported its fiscal Q3 2022 earnings results. Compared to the prior year’s quarter, its net income fell 17% to C\$3,577 million and its diluted earnings-per-share (“EPS”) dropped 15% to C\$2.51. Notably, management put aside a reserve of C\$340 million in the form a provision for credit losses (that dragged down results) in the face of the possibility of a recession across North America. In contrast, the fiscal Q3 2021 results were boosted by the release of provisions of C\$540 million. RBC’s personal and commercial banking businesses in Canada and the U.S. showed strength via double-digit volume growth and experienced tailwinds from rising interest rates. Its businesses that are sensitive to the financial markets did take a hit. Specifically, its Capital Markets segment net income fell 58% to C\$479 from a year ago. Its fiscal Q3 return on equity (“ROE”) was 14.6% (down 5.0% from a year ago). The bank’s capital position remains intact with a Common Equity Tier 1 ratio at 13.1% versus 13.6% a year ago. The fiscal year-to-date results show a bigger picture with much more stable results versus a year ago. Net income down 2% to C\$11.9 billion, diluted EPS drop of 1% to C\$8.31, and ROE of 16.7% (down 2.5%). Although impaired loan levels remain low, RBC does not count out the possibility of a recession driven by central banks driving rising interest rates to combat the still high inflation. We reduced our 2022 EPS estimate by 1.0% to US\$8.85 in light of the latest results.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$5.00	\$5.20	\$5.36	\$4.99	\$5.06	\$5.88	\$6.26	\$6.72	\$6.04	\$8.68	\$8.85	\$12.13
DPS	\$2.27	\$2.48	\$2.60	\$2.47	\$2.44	\$2.66	\$2.93	\$3.06	\$3.19	\$3.43	\$3.98	\$5.45
Shares¹	1,469	1,441	1,449	1,450	1,494	1,453	1,439	1,430	1,420	1,427	1,399	1,378

RBC’s EPS performance has been stable – compounding its EPS by 6.3% per year from 2012-2021, despite forex volatility. Management targets a medium-term growth rate of about 7%, but we set our estimate with a growth rate of 6.5% through 2027 to account for forex risk. Near-term earnings are pressured from high inflation, high interest rates, and a North American economy that could enter a recession. Notably, during highly uncertain economic times, the federally-regulated bank may be restricted from raising dividends. In the past when this happened, RBC remained a strongly capitalized bank and as soon as regulators allowed it, it began raising dividends again. The forex volatility could lead to changes in the effective yield that U.S. shareholders will ultimately receive. RBC has a more diversified business mix than its peers, which should lead to a lower-risk, lower volatility stock. We estimate a dividend growth rate of 6.5% through 2027.

¹ Dividend growth in C\$; Shares in millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	11.4	12.1	13.1	12.3	11.8	12.8	13.1	11.9	11.5	12.6	10.7	12.3
Avg. Yld.	3.8%	3.6%	3.7%	4.5%	3.6%	3.3%	4.3%	3.9%	4.6%	3.1%	4.2%	3.7%

Because of the bank's size, above-average stability, and entrenched presence in the U.S. market, RBC tends to trade at a premium to its peers in the Canadian banking industry. From 2012-2021, RBC's average price-to-earnings ratio ("P/E") was 12.3 and averaged a yield of 3.8%. We think it's fair to give RBC a fair P/E of 12.3. Using our estimate for fiscal 2022 EPS, the bank is currently priced at a price-to-earnings multiple of 10.7, which makes the stock slightly discounted. RBC's yield likely won't stray far away from about 4% in the long run. As a Canadian stock, RBC's dividends may be subject to a 15% dividend withholding tax for U.S. investors. This tax can potentially be avoided by investing in RBC shares through a retirement account.

Safety, Quality, Competitive Advantage, & Recession Resiliency

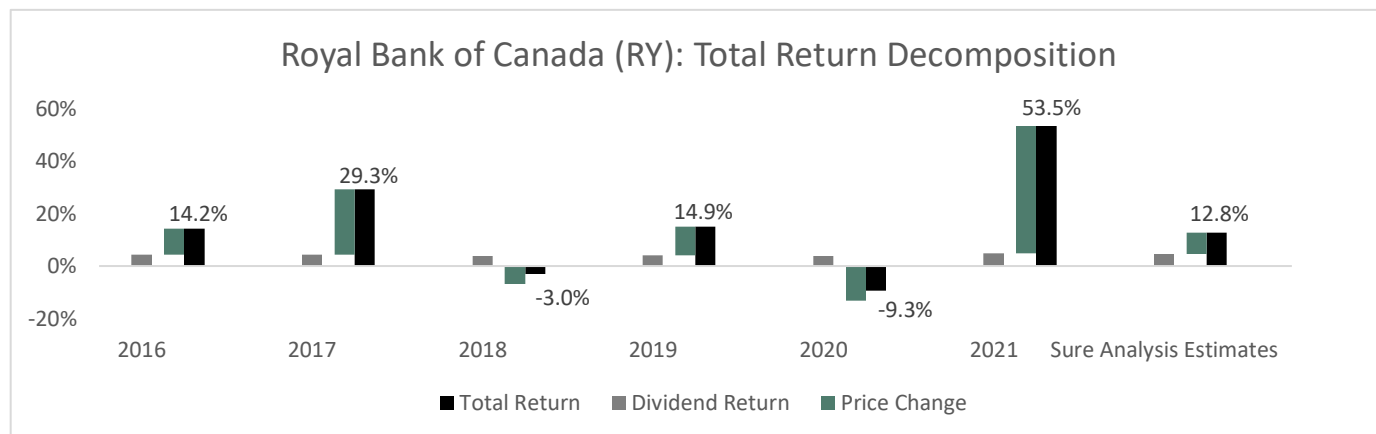
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	45%	48%	49%	49%	48%	45%	47%	46%	53%	40%	45%	45%

During the Great Recession in 2007-2009, the quality stock increased its dividend every year (in the local currency of Canadian dollars), except for fiscal 2009 and 2010 in which it maintained the dividend. During that period, its adjusted EPS remained fairly stable and had a magnificent run from fiscal 2011 to 2019. The quality bank once again showed resilient earnings in fiscal 2020 in the midst of a pandemic. The regulator, Office of the Superintendent of Financial Institutions, once again stepped in to prevent the federally-rated Canadian banks to raise dividends during the pandemic. Investors were happy to know that the restriction was lifted in November 2021. RBC normally has a payout ratio of under 50%. The payout ratio was elevated a bit in fiscal 2020 but quickly came back down to below 50%. Competitive advantages are difficult to come by in banking, but RBC's franchise value, based on its history and scale, is a close substitute. We see RBC's brand as a valuable asset and one that should help it weather this and future economic downturns.

Final Thoughts & Recommendation

We rate RY as a Buy now. We forecast 12.8% in total returns annually over the next five years, consisting of a yield of 4.2%, 6.5% earnings-per-share growth, and a 2.8% tailwind from valuation expansion.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	25242	27194	27874	25892	26125	28343	30964	31362	32299	36281
SG&A Exp.	9039	10053	10123	9333	9334	10192	10707	10985	11345	13146
D&A Exp.	922	1002	1076	1004	1166	1236	1284	1455	1970	2060
Net Profit	7375	8087	8177	7997	7847	8738	9638	9676	8504	12748
Net Margin	29.2%	29.7%	29.3%	30.9%	30.0%	30.8%	31.1%	30.9%	26.3%	35.1%
Free Cash Flow	-2953	6036	12799	18382	19306	27802	12043	9032	101306	46783
Income Tax	2018	2065	2483	2093	2143	2449	2587	2290	2196	3641

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets (\$B)	825.3	820.2	839.9	816.1	879.8	945.4	1017.3	1085.2	1219.4	1376.9
Cash & Equiv. \$B)	238.7	236.2	232.6	267.8	321.2	484.4	511.0	494.2	120.3	157.4
Accounts Receivable	5757	5106	4757	3495	3993	4431	5098	5647	5226	5851
Goodwill & Int. Ass.	10173	10598	10199	9194	11780	12069	12061	12083	12050	12366
Total Liabilities (\$B)	779.2	773.0	791.2	767.5	826.4	887.4	956.4	1021.7	1154.3	1297.2
Accounts Payable	9844	6233	5534	4299	4279	4682	6617	6330	7103	8477
Long-Term Debt	7617	7101	167833	182734	166623	177996	192070	206266	196599	242051
Shareholder's Equity	39462	41084	43411	43338	47932	52549	56061	59099	60587	74191
LTD/E Ratio	0.17	0.16	3.57	3.87	3.15	3.09	3.16	3.25	3.02	3.04

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	0.9%	1.0%	1.0%	1.0%	0.9%	1.0%	1.0%	0.9%	0.7%	1.0%
Return on Equity	19.8%	20.1%	19.4%	18.4%	17.2%	17.4%	17.7%	16.8%	14.2%	18.9%
ROIC	14.2%	15.0%	6.0%	3.6%	3.5%	3.8%	3.9%	3.7%	3.2%	4.4%
Shares Out.	1469	1441	1449	1450	1494	1453	1439	1430	1420	1427
Revenue/Share	17.19	18.54	19.20	17.86	17.48	19.22	21.35	21.77	22.61	25.43
FCF/Share	-2.01	4.12	8.82	12.68	12.92	18.86	8.30	6.27	70.90	32.79

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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