

## Bank Update – TD

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# Banking Overview

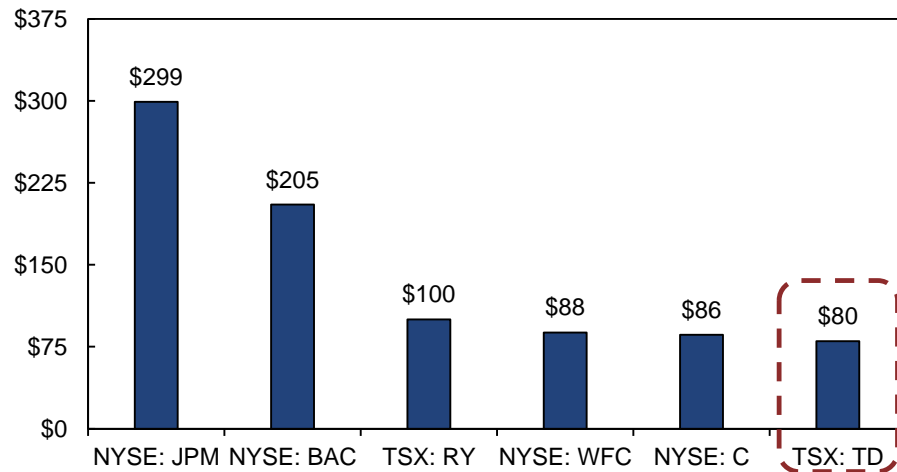
## How Banks Operate

- **Net Interest Income (NII):** Borrowing money and lending it out at a higher rate.
  - Equal to interest earned on assets (loans or fixed-income securities) less the interest paid on liabilities (deposits)
- **Non-Interest Income (Fee Revenue):** Underwriting, sales and trading, account and transaction fees, insurance, advisory services and much more
  - Canadian banks' top-line has grown ~7% annually in both the NII and Fee segments, over the last decade
- **Operating Expenses:** Compensation costs and other costs that are incurred to run the physical and virtual operations of a bank. It typically accounts for ~60% of revenues (vs ~70% in the early 2000s)
- **Provision for Credit Losses (PCL):** Estimate of potential losses from bad debt or other credit that is likely to default. It is treated as an expense on a bank's financial statements
  - Estimated based on the economy's strength. PCLs were about 9 – 14% of Canadian banks' revenue during 2009 and are now ~20 – 30% of revenue.

## Important Financial Metrics & Ratios

- Canadian Banks tend to use high leverage with assets representing ~18x equity. This is carried out due to the low-risk nature of their assets and stable source of deposits
- **Net Interest Margins:**  $(\text{Interest Income} - \text{Funding Expenses}) / \text{Assets}$
- **Efficiency Ratio:**  $\text{Operating Expenses} / \text{Revenues}$
- **PCL Ratio:**  $\text{PCL} / \text{Bank's Loan Book}$
- **Return on Assets (ROA):**  $\text{Net Income} / \text{Assets}$
- **Fee Income to Total Income:**  $\text{Fee Income} / \text{Total Income}$
- **Return on Equity (ROE):**  $\text{Net Income} / \text{Shareholders' Equity}$
- **Price to Earnings (P/E):**  $\text{Share Price} / \text{EPS}$
- **Price to Book (P/B):**  $\text{Share Price} / \text{BVPS}$
- **CET 1:**  $\text{Tier 1 Capital (S/E + Retained Earnings)} / \text{Risk-Weighted Assets (RWA)}$
- **LCR:**  $\text{HQLA} / \text{Total Net Cash Outflow}$

## Top Six North American Banks by Market Capitalization (US\$B)



## Different Approaches to Bank Valuation

P/E

P/B

Dividend Discount Models

# Toronto-Dominion Bank

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*To be or not TD...*

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# Business Overview



## Overview

- Toronto-Dominion Bank (TSX: TD) is Canada's second-largest bank by market capitalization (~\$106B) and the largest by total assets (\$1,694B) as of Q3/20
- TD currently has ~1,087 retail branches in Canada and 1,220 branches in the U.S.
- Earnings mix (excluding corporate and others) is as follows: Canadian Retail Banking (59%), U.S. Retail Banking and Ameritrade (33%), and Wholesale Banking (8%)
- TD Bank has the largest Canadian-U.S. retail banking franchise among the Canadian banks with operations in the northeast region and Florida. TD also has small wealth and capital markets operations in Europe and Asia. The revenue mix is generally 60–65% Canada, 25–30% U.S., and 10% in other international countries.
- TD Bank is a leader in many retail products and is known for its customer service and convenience in both U.S. and Canada

## Recent News – Transactions

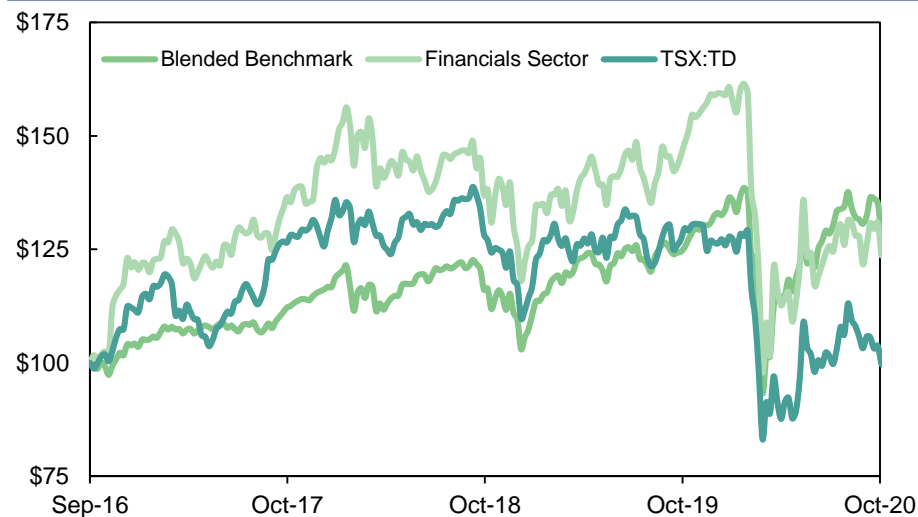
- In November 2019, TD announced its support for the acquisition of TD Ameritrade Holding Corporation (TD Ameritrade) by The Charles Schwab Corporation (Schwab). As a result, the bank will exchange its ~43% in TD Ameritrade for a ~13.4% stake in Schwab. The transaction was completed in October 2020 with TD confirming 13.5% in Charles Schwab
- In January 2019, TD's long-term loyalty program agreement with Air Canada became effective in conjunction with Air Canada completing its acquisition of Aimia Canada Inc. TD will become the primary credit card issuer for Air Canada's new loyalty program when it launches in 2020 through to 2030

## North American Retail Branches



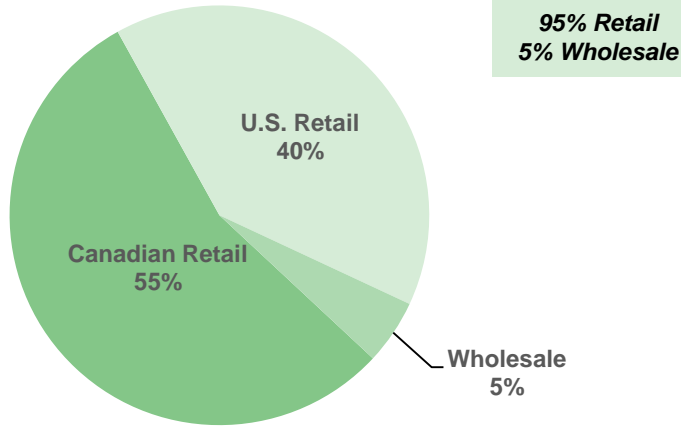
**2,307 retail location in North America**

## Holding Period Trading Performance (Indexed to \$100)



# Business Segments

## Segments



## U.S. Retail

Personal Banking	Business Banking	Wealth
<ul style="list-style-type: none"> <li>Personal Deposits</li> <li>Consumer Lending</li> <li>Credit Card Services</li> <li>Auto Finance</li> </ul>	<ul style="list-style-type: none"> <li>Commercial Banking</li> <li>Small Business Banking</li> </ul>	<ul style="list-style-type: none"> <li>Advice Based Business</li> <li>Wealth Advice</li> <li>Asset Management</li> </ul>

**Strategy:**

- Deliver consistency and excellence in sales and service to drive more meaningful interactions and better serve the needs of customers
- Deepen customer engagement through delivering a personalized and connected experience across all channels
- Continue to invest in data and technology

## Canadian Retail

Personal Banking	Business Banking	Insurance	Wealth
<ul style="list-style-type: none"> <li>Personal Deposits</li> <li>Consumer Lending</li> <li>Real Estate Secured Lending</li> <li>Credit Cards and Merchant Solutions</li> <li>Auto Finance</li> </ul>	<ul style="list-style-type: none"> <li>Commercial Banking</li> <li>Small Business Banking</li> </ul>	<ul style="list-style-type: none"> <li>Property &amp; Casualty</li> <li>Life &amp; Health</li> </ul>	<ul style="list-style-type: none"> <li>Direct Investing</li> <li>Wealth Advice</li> <li>Asset Management</li> </ul>

**Strategy:**

- Applications of AI and data Analytics to deliver best in class customer service
- Enhance end-to-end omni-channel capabilities to support key customer journeys, enabling a seamless, intuitive and legendary customer experience
- Grow market share by providing best-in-class products and services with an emphasis on underrepresented products and markets
- Be recognized as an extraordinary workplace where D&I are valued

## Wholesale Banking

Global Markets	Corporate & Investment Banking	Other
<ul style="list-style-type: none"> <li>Sales &amp; Trading</li> <li>Research</li> <li>Debt &amp; Equity Underwriting</li> <li>Client Securitization</li> <li>Trade Finance</li> <li>Prime Brokerage</li> </ul>	<ul style="list-style-type: none"> <li>Corporate Lending</li> <li>Syndications</li> <li>Debt &amp; Equity Underwriting</li> <li>Advisory Services</li> </ul>	<ul style="list-style-type: none"> <li>Accounting Adjustments</li> <li>Investment Portfolio</li> </ul>

**Strategy:**

- Maintain top market share in Canadian Franchise
- Adding new clients and deepening relationship value by maturing product and advice offerings
- Drive innovation and build data and analytical to enhance client value
- Maintain focus on managing risk, capital, balance sheet, and liquidity

# Historical Growth



## Growing Platform and North American Scale

### 2000-2004 – A Canadian Leader

- Acquisition of Canada Trust (2000)
- TD Waterhouse privatization (2001)

### 2005 –2010 – Building U.S. Platform

- TD Waterhouse USA / Ameritrade transaction (2006)
- Privatization of TD Banknorth (2007)
- Commerce Bank acquisition and integration (2008-2009)
- Riverside and TSFG acquisition (2010)
- TD Waterhouse privatization (2001)

### 2011-2015 – Acquiring Assets

- Acquired Chrysler Financial auto finance portfolio (2011)
- Acquired MBNA credit card portfolio (2011)
- Acquisition of Target (2012) and Nordstrom (2015) credit card portfolios
- Became primary issuer of Aeroplan Visa and acquired 50% of CIBC's Aeroplan portfolio (2014)

### New Capabilities and Partnerships

- Acquired Epoch (2013)
- Acquired Scottrade Bank in connection with TD Ameritrade's acquisition of Scottrade (2017)
- Acquired Layer 6 and Greystone (2018)
- Canada Credit Card Loyalty Program Agreement (2018)
- Announced ownership stake in Schwab to follow Schwab's acquisition of TD Ameritrade (2019)

### Increasing Retail Focus and U.S. Expansion



### From Traditional Dealer to Client Focused North American Dealer

### 2000-2004 – Foundation for Growth

- Acquisition of Newcrest Capital (2000)

### 2005-2010 – A Client Focused Dealer

- Strategically exited select businesses (structured products, non-franchise credit, proprietary trading)

### 2011-2017 – Building in the U.S.

- Acquisition of Canada Trust (2000)
- Achieved Primary Dealer status in the U.S. (2014)
- Expanded product offering to U.S. clients and grew our energy sector presence in Houston (2015-2016)
- Acquired Albert Fried & Company, a New York-based broker-dealer (2017)

### Integrated North American Dealer

- Broadened global market access to clients by opening offices in Tokyo and Boston (2018)
- Continue to maintain top-two dealer status in Canada<sup>2</sup>

~\$34.8 B spent on acquisitions since 2000

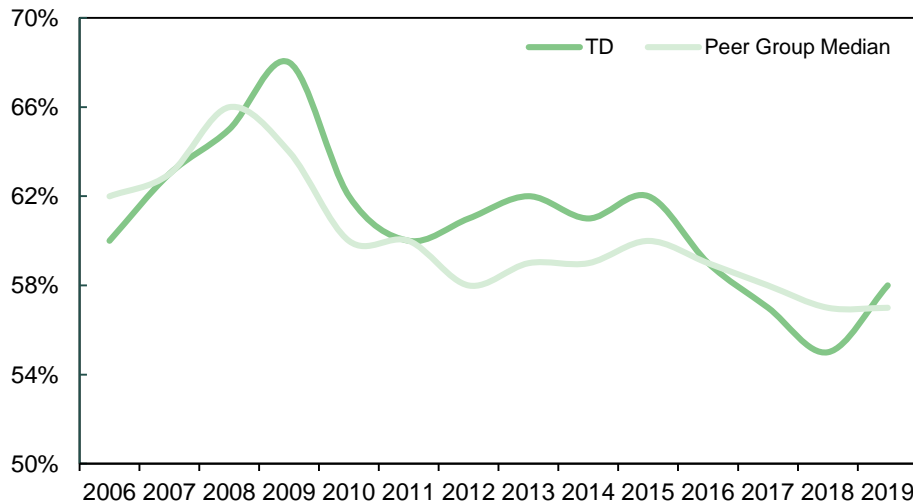
# Canadian Peers



## Canadian Landscape



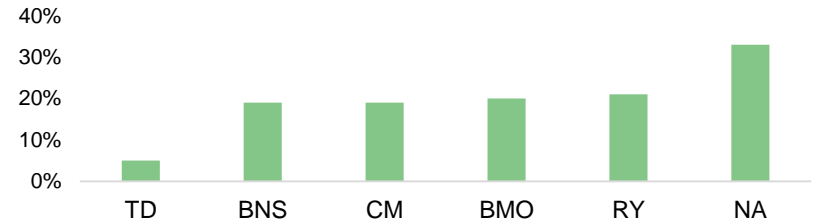
## Efficiency Ratio



Source: Street Research

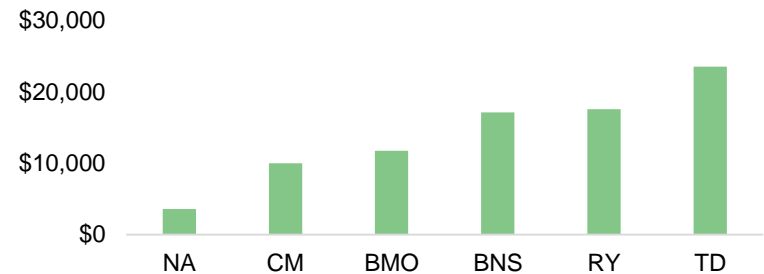
## TD Wholesale vs Peers FY 2019

- Wholesale banking divisions have become more diversified than in the past, and while forecasting individual line items is nearly impossible, it would be unusual for all businesses to do poorly (or very well) at the same time in a normal environment
- Having wholesale banking divisions has increased revenue volatility for banks, but it has also lowered exposure to PCL in down cycles. As the credit cycle played out and loan losses rose, the banks had revenue sources that they did not have in the past to offset rising loan losses



## TD Retail Banking vs Peers FY 2019

- Loans to individuals make up approximately 59% of the banks' total loan portfolios held on balance sheets with residential mortgages making up ~40% and personal loans ~19%.
- Employment growth, GDP growth, and appreciation in housing prices are good indicators of growth in mortgage balances, while employment growth, GDP growth, and disposable income can be used as indicators for personal lending

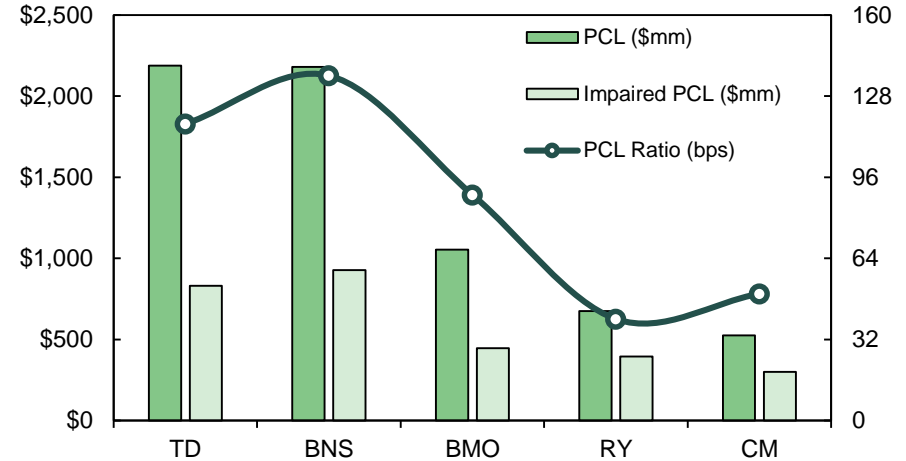


# Provisions for Credit Losses

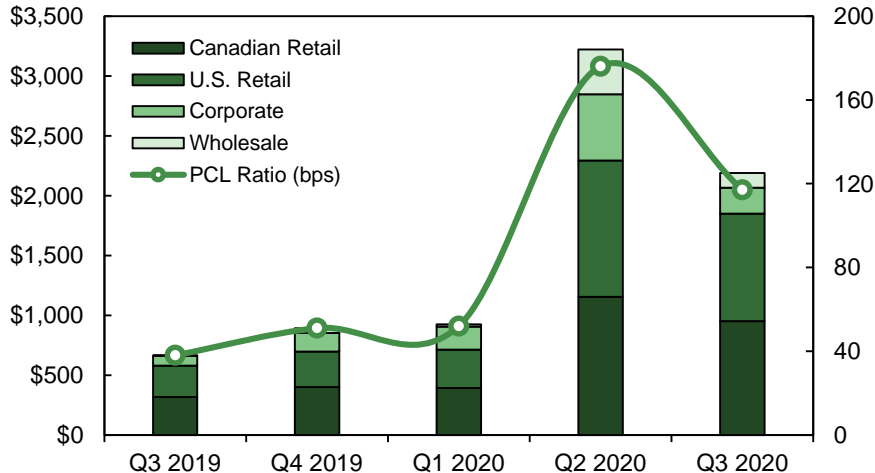
## What are they?

- **Provision for Credit Losses (PCL):**
  - Amount added to the allowance for credit losses to bring it to a level that management considers adequate to absorb all credit related losses in its portfolio
- **Allowance for Credit Losses (ACL):**
  - Estimate of the debt that a company is unlikely to recover. It is taken from the perspective of the selling company that extends credit to its buyers
- **IFRS 9 Financial Instruments**
  - IFRS 9 was issued on July 24, 2014 to replace IAS 39 *Financial Instruments: Recognition and Measurement*
  - IFRS 9 includes requirements for recognition and measurement, impairment, derecognition and general hedge accounting.
- **Under IFRS 9, PCL are recognized regardless of whether there has been an actual event of loss.**

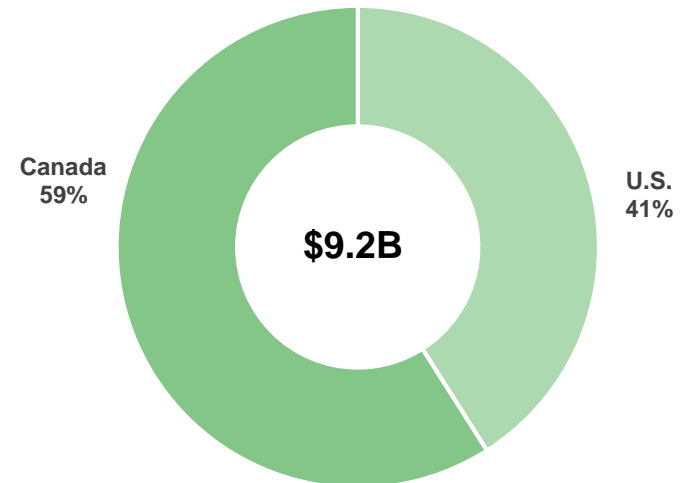
## Q3 2020 Peer PCL Comparison



## PCL Mix (\$mm) vs PCL Ratio



## ACL (\$B)

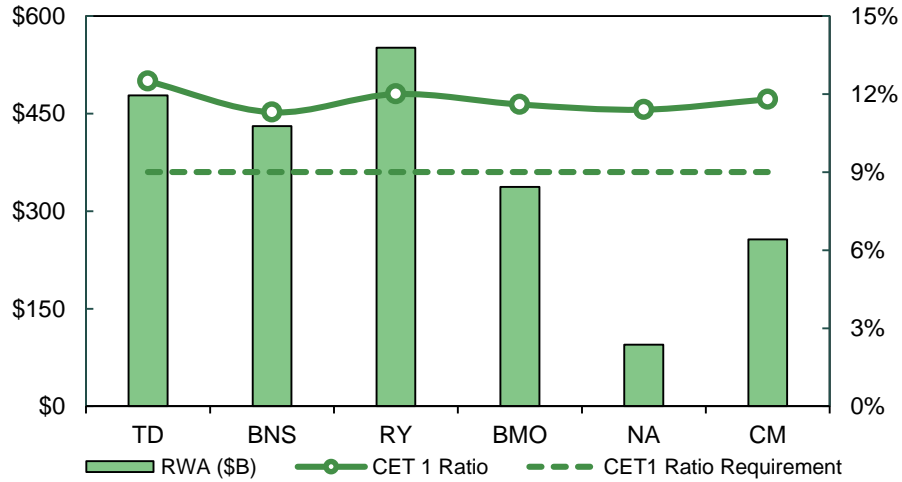




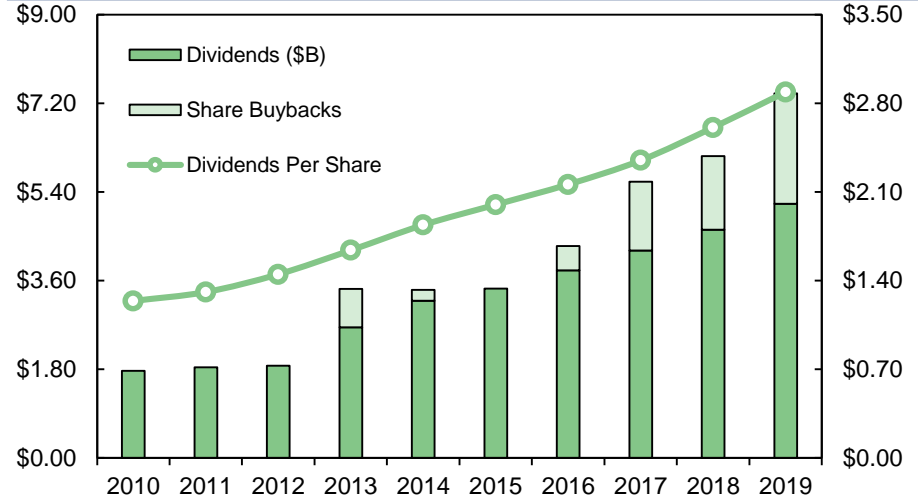
# Financial Metrics & Performance



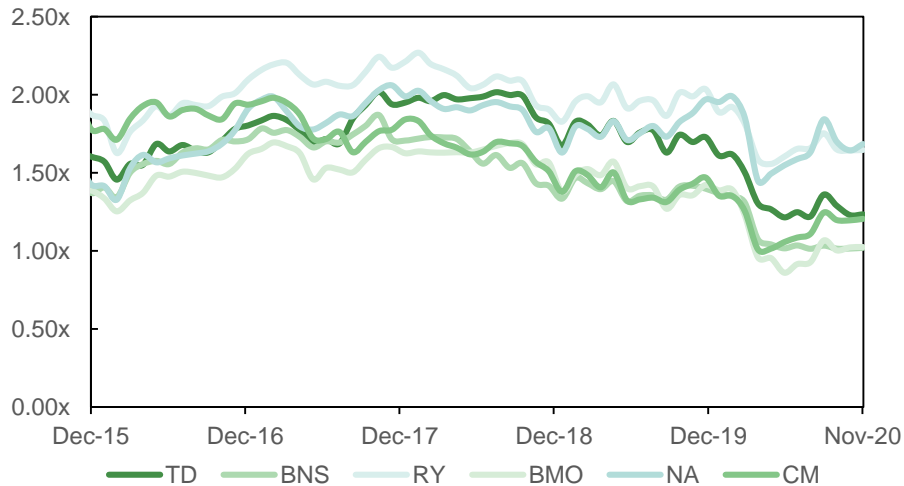
Basel III Ratios (Leverage Ratios)<sup>(1)</sup>



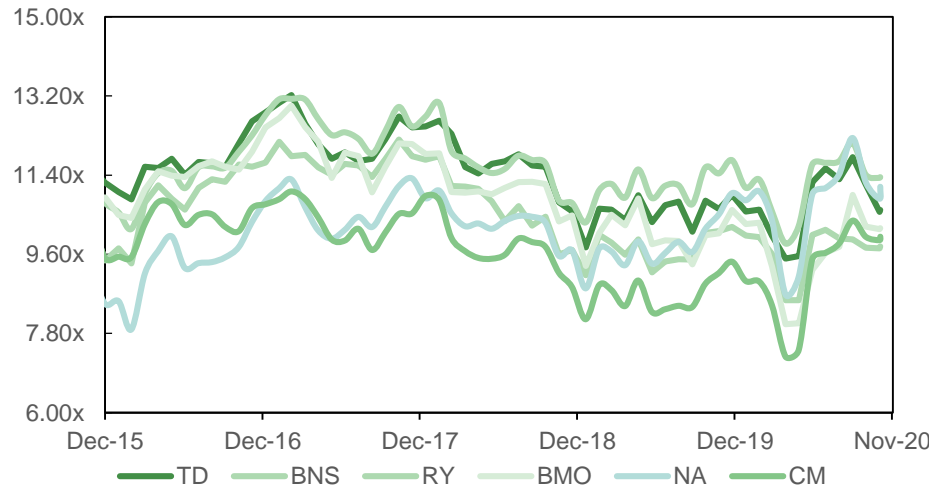
Total Shareholder Return (Dividends + Share Repurchases)



Price/Book Multiple vs Peers<sup>(2)</sup>



Price/Earnings Multiples vs Peers<sup>(2)</sup>



(1): The large Canadian banks have a required CET1 ratio of 9.0% while the Canadian benchmark is 7.0%  
 (2): All TSX listed equities

# Economic Outlook

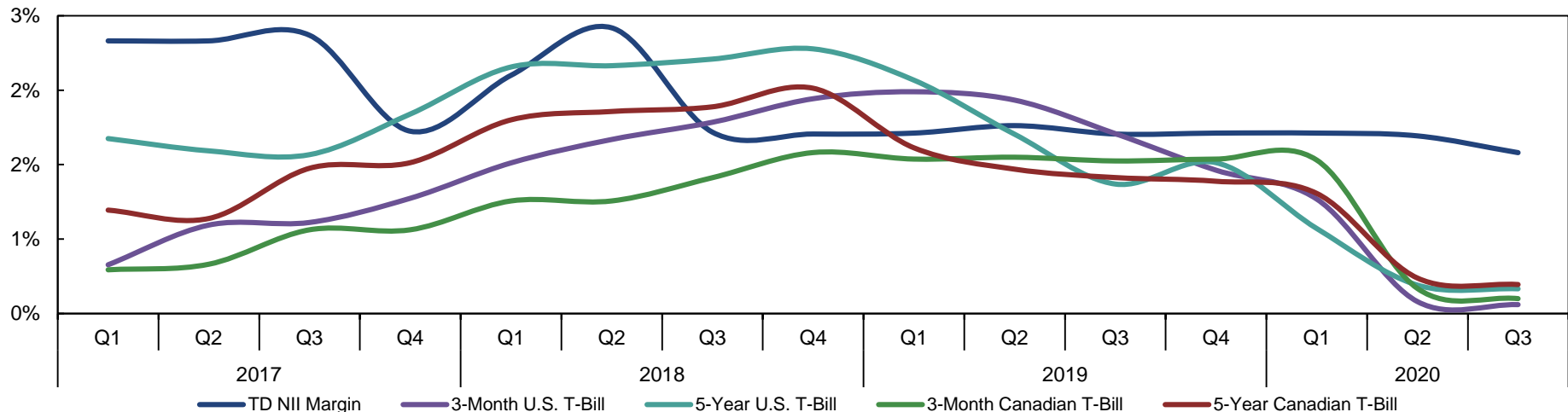
## Canadian Environment

- **Real GDP:** Grew by 1.2% in August, which is lower than July's 3.1% rise. Overall economic activity is ~5% below pre-pandemic levels
- **Inflation (CPI):** The annual inflation rate in September rose to 0.5% from 0.1% in August
- **Unemployment Rate:** Equal to 9% in September, below the monthly high of 13.7% seen in May and above the pre-pandemic level of 5.6% in February
- **Business Confidence:** Canada's manufacturing PMI has been above the 50% level for four consecutive months after bottom in the low 30% range in April
- **Housing Starts:** Annual rate of housing starts in September fell by 20% from August's numbers, but remain in line with average readings in 2019. Starts from January to September were up 1% YoY and many economists expect this momentum will continue for the near-term

## U.S. Environment

- **Real GDP:** Rose at an annual rate of 33.1% in Q3 2020, showing a strong recovery from Q2 2020's 31.4% QoQ decline
- **Inflation (CPI):** The U.S. Labor Department's CPI has risen in for consecutive months. September's data rose 0.2%, August's rose 0.4%, and July and June's rose 0.6% each after falling the prior three months
- **Unemployment Rate:** Has fallen to 7.9% in September from its peak of 14.7% in April.
- **Business Confidence:** the U.S. ISM manufacturing PMI has stayed above the 50% level for five consecutive months. October's reading of 59.3% has been the best reading since the COVID-19 pandemic began
- **Housing Starts:** Rose 1.9% on an annual basis during September. Building permits for furthering residential developments continue to grow as well, with many economists expecting this strength to continue into 2021

## TD Net Interest Margin & U.S. and Canadian Treasuries

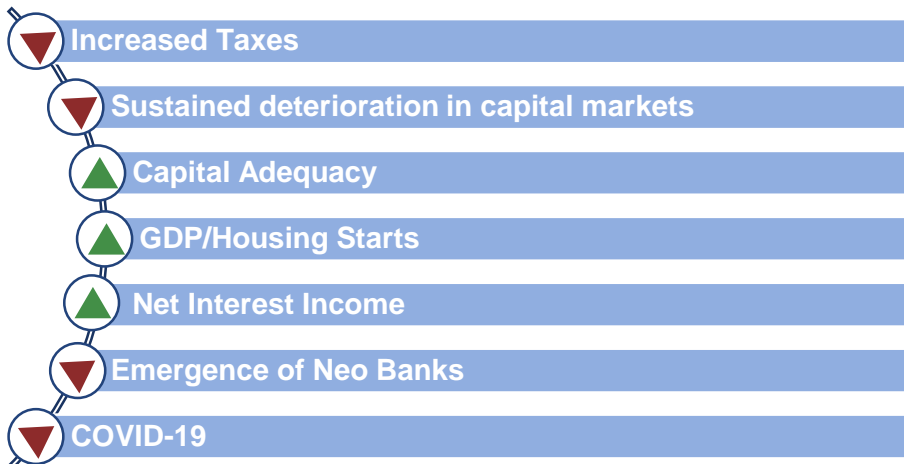


# Revisiting Investment Thesis & Valuation

## Original Investment Thesis

- **INITIAL THESIS**
  - The CPMT's initial thesis on TD was that through the stock, the Fund was able to achieve diversification into the US retail banking market
  - This thesis held up when the CPMT did not have access to US equities
  - The Fund now holds JPM to achieve U.S. and global diversification
  - Now, we are able to compare TD with other banks that have significant retail exposure such as JPM
- **REVISED THESIS**
- TD still provides exposure to US banking, but JPM provides it on a larger scale with the added benefit of international diversification and larger wholesale segment
- TD's history of strong dividend growth and exposure to Canadian Retail are potential reasons for TD to remain in CPMT's financials portfolio

## Risks & Catalysts



## Valuation

- TD was valued using a P/BV multiple of 1.2x
- Historically CPMT has valued banks using a blend of DDM and P/E, however, in times of uncertainty – P/B is a better metric

Comparables Assumptions & Outputs	
2020E BVPS	\$54.57
Forward P/B	1.2x
<b>Implied Share Price</b>	<b>\$65.49</b>
Implied Price	\$65.49
Current Price	\$59.02
<b>Implied Upside</b>	<b>11%</b>

Book Value Calculation		
	2019A	2020E
Total Shareholder's Equity	\$87,591	\$93,922
Preferred Equity	\$5,800	\$5,800
<b>Ending Book Value</b>	<b>\$93,391</b>	<b>\$99,722</b>
<i>Book Value Per Share</i>	\$51.11	\$54.57
<i>Cash Earnings Per Share</i>	\$6.20	\$7.48

## Street Estimates

<b>Average TP</b>	\$65		\$69
	\$65		\$64
	\$63		\$59
	\$60		\$71
	\$71		\$68

# Investment Recommendation

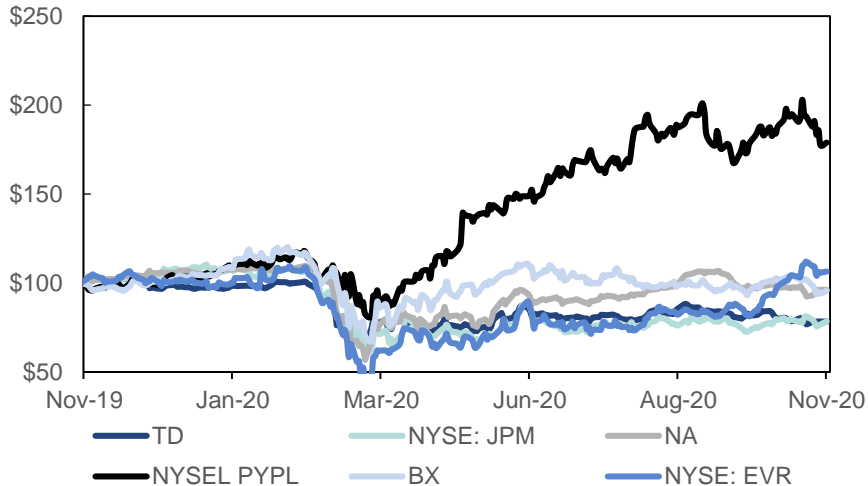
## Investment Decision

<b>ACTION</b>	<b>TRIM</b>
<b>CONVICTION</b>	<b>1</b>
<b>CURRENT PRICE</b>	<b>\$59.02</b>
<b>TARGET PRICE</b>	<b>\$65</b>
<b>IMPLIED RETURN</b>	<b>11%</b>

## Investment Criteria

Strong Balance Sheet	✓
Growing Free Cash Flow	✓
Competitive Advantage	-
Quality Management	✓
Attractive Valuation	-

## Other Financial Names Have Outperformed TD



## Possible Swaps – conduct after Due Diligence

J.P.Morgan

