Canadian Banks Q2 Reports Start Next Week

• Overview

- The Canadian banks Q2 earnings season will commence Wednesday 26-May, with the release of the Bank of Montreal's Q1 earnings before market open and will continue through 1-Jun when Bank of Nova Scotia reports before the bell. Ahead of Tuesday's BMO report, we take a quick look at some of the main items of focus for the quarter, we will summarize some of the analyst commentary and provide current FactSet consensus forecasts for some key metrics, as well as some performance data.
- General expectations from the Q2 reports seem to be very positive with several of the analysts referring to the recent results from the U.S. banks as providing a degree of optimism as they await the Big 6 results. The banks are viewed to be in a solid position with upside from credit loss reversals, record earnings in Capital Markets and Wealth Management and a revival of personal and commercial loans as long as the ongoing rebound in the economy continues.
- Expectation is for Q2 EPS to increase as strong forecasted growth reflects a large anticipated decrease in PCLs with the banks releasing a potentially large portion of their current performing loan loss reserves. Loan growth is expected to remain slow until the economy is to fully reopen due to stimulus and excess cash lessening the need for credit cards and commercial lending.
- Revenues are expected to be flat y/y with a lower NIM that should be offset by strong growth in the banks fee-based businesses that have been aided by constructive markets and increased trading revenues. Slow loan growth and lower margins are expected to hamper NII growth with OSFI data for March indicating loan growth of only ~0.4% in the first two months of the quarter.
- Capital markets are seeing potential of increased volumes from Q1 and growth in investment banking should also increase due to the recent elevated activity in M&A. The ongoing strength in fee income and a moderately steeper yield curve should continue to produce double-digit PTPP earnings growth over the next few quarters.
- We saw a few ratings changes from the analysis all of which are noted in the analyst commentary. Much like with the Q1 reports, the potential factors that could weigh in over the next quarter seem to be more positive and revolve around the expectation of a large reversal in credit loss provisions, the continued roll-out of the coronavirus vaccine and the expected acceleration of economic recovery as government lockdowns and support programs wind down.

• National Bank Financial analyst Gabriel Dechaine

- States that U.S. banks have been reporting another quarter of broad credit provision reversals which has indicated an expectation for comparable results from the Canadian banks
    - Sees some banks reporting reversals in certain segments but on a consolidated basis still anticipates net provision expenses to be reported
- Views its comparable y/y as difficult with Q2-20 Capital Markets performance including record FICC trading revenues but sees the results coming in solid on an absolute basis due to supportive equity markets and recovery of equity issuance activity
    - Notes that BMO.CN and RY.CN are notably well positioned

- Anticipates P&C banking segments will see a quarter built on loan growth from mortgage volumes but not from anything else significant as commercial lending remaining flat and credit card balances still ~15% below pre-pandemic levels
- Believes that Q2 results will be similar to Q1 showing strong credit metrics, solid Capital Markets and building CET1 ratios that are offset by anemic core business growth indicators
- Views H2-21 as positive with OSFI eliminating capital distribution restrictions, expectation of material credit provision reversals and a restart of consumer loan growth

- **Veritas Investment Research analyst Nigel D'Souza**

  - Sees the banks in an solid position with upside from credit loss reversals, record earnings in Capital Markets and Wealth Management and a revival of personal and commercial loans as long as there is not a decline in financial market conditions
  - Anticipates the banks Q1 to be an upside surprise on earnings due to the large reversal it will see in PCLs with the Big Six potentially releasing close to half their current performing loan loss reserves
  - Believes that loan growth will remain slow until the economy is to fully reopen due to stimulus and excess cash lessening the need for credit cards and commercial lending
    - Believes that in Q2 consumer and commercial balances will be slightly higher for domestic banking segments
  - Predicts record results for Capital Markets and Wealth Management for Q2 for all six banks due to the recent results that have been reported by the U.S. banks and their assumptions for AUM increases
  - As of 11-May, upgraded NA.CN, RBC.CN and TD.CN to buy expecting NA and RY to see strong results from Capital Markets and solid AUM growth in Wealth Management and for TD to see solid reversals in PCLs
  - Maintains a buy rating for BMO.CN a sector outperform rating for CM.CN and sector underperform for BNS.CN

- **BMO Capital Markets analyst Sohrab Movahedi**

  - Anticipates cash earnings to increase ~110% y/y for the Big 5 (BMO not covered) due to the easy comp from Q2-20
  - Indicates that the average bank index forward P/E can improve to ~12.0x 2022E EPS from ~11.1x due to the positive operating environment. improved outlook, steeper yield curve, reduced credit costs and focus on operating leverage
    - Raised target prices for the Big 5 with RY.CN receiving the highest multiple at ~12.8x and CM.CN the lowest at 11.6x
  - Believes there will be flat revenue y/y and ~6% lower NIM that will be offset by strong growth in the banks fee-based businesses which have been aided by constructive markets and increased trading revenues
  - Expects PTPP earnings to be flat or slightly down based on its general flat revenues and blend of revenue that biased towards higher non-interest expense to revenue ratio
  - Sees credit costs decreasing y/y but slightly above the low levels seen in the previous quarter

- Views the banks entering a new business cycle anticipating strong momentum in revenues from expansion/reopening, focus on improved operating leverage/expense management and reduced credit costs due to the release of reserves

• TD Securities analyst Mario Mendonca

- Believes that Q2 EPS will increase ~123% y/y which is down ~7% q/q as solid forecasted growth echoes an anticipated ~85% y/y decrease in PCLs due to an ~$8.4B decrease in performing loan PCLs
    - Sees the market shifting to growth, notably in PTPP earnings, due to the solid credit levels and improved credit outlook
- Anticipates an average ~1% increase in PTPP earnings for the Big Six with a wide imbalance within the group
    - Sees BMO reporting the leading PTPP growth result within the group due to lower NIM sensitivity to falling interest rates and more exposure to capital markets revenue
- Indicates that their Q2 EPS expectations are 7-14% above consensus and after adjusting their PCL and NIM forecasts, their FY21 and FY22 EPS are between 9-12% above consensus
    - Notes that due to positive U.S. bank results and an improved outlook, they have adjusted performing loan reserve releases of ~10bps in FY21 and 4bps in FY22
- Expects ongoing strength in fee income and a moderately steeper yield curve continuing to produce double-digit PTPP earnings growth by the end of FY21 and into FY22
- Notes their belief that the banks will outperform insurance companies in the near future as they anticipate that investors will follow the expected solid earnings above consensus

• CIBC Capital Markets analyst Paul Holden

- Believes that slow loan growth and lower margins will hamper NII growth as OSFI data for March indicates loan growth of only ~0.4% in the first two months of the quarter and sees a moderated sequential decline of ~1% for NII
    - Sees NIMs coming in flat q/q due to no movement in short-term rates
- Refers to the quick recovery seen in fee income and anticipates this to reappear in Q2 with growth of ~2% q/q as moderate growth is expected in card fees, banking fees and lending fees
- Indicates that capital markets are seeing potential of increased volumes from Q1 and believes that growth in investment banking should also increase due to the recent elevated activity in M&A
    - Sees capital markets-related revenue increasing by ~11% q/q on average
- States that banks are currently holding excess performing credit allowances as delinquencies continue to be low and expects total PCL ratio to be ~31bps on average which is ~10bps ahead of last quarter
    - Updated estimates for large provision turnaround in Q4

- Expects to see positive operating leverage of ~1.5% on average

- **FactSet Estimates**

- BMO.CN -- 26-May before market open
  - EPS (ex-items) C$2.75 (12 estimates; range C$2.25-3.07) vs C$3.06 in prior quarter
  - Revenues C$6.15B (10 estimates; range C$5.73-6.47B) vs C$6.37B in prior quarter
  - Net interest margin 1.59% (6 estimates; range 1.24-1.93%) vs 1.62% in prior quarter
  - Efficiency ratio (adj.) 56.9% (5 estimates; range 55.9-58.4%) vs 56.3% in prior quarter
  - PCLs C$235.3M (7 estimates; range C$-11-411M) vs C$156M in prior quarter
  - CET1 Ratio 12.6% (9 estimates; range 12.3-13%) vs 12.4% in prior quarter
  - Dividend C$1.06 vs C$1.06 in prior quarter
- BNS.CN -- 1-Jun before market open
  - EPS (ex-items) C$1.75 (12 estimates; range C$1.61-1.95) vs C$1.88 in prior quarter
  - Revenues C$7.83B (10 estimates; range C$7.7-8.24B) vs C$8.07B in prior quarter
  - Net interest margin 1.94% (7 estimates; range 1.66-2.71%) vs 1.87% in prior quarter
  - Efficiency ratio (adj.) 52.6% (6 estimates; range 50.8-53.8%) vs 51.8% in prior quarter
  - PCLs C$689.5M (6 estimates; range C$572-805M) vs C$764M in prior quarter
  - CET1 Ratio 12.3% (9 estimates; range 12-12.5%) vs 12.2% in prior quarter
  - Dividend C$0.9 vs C$0.9 in prior quarter
- CM.CN -- 27-May before market open
  - EPS (ex-items) C$3.01 (12 estimates; range C$2.74-3.39) vs C$3.58 in prior quarter
  - Revenues C$4.8B (10 estimates; range C$4.68-4.91B) vs C$4.96B in prior quarter
  - Net interest margin 1.65% (7 estimates; range 1.27-2.46%) vs 1.6% in prior quarter
  - Efficiency ratio (adj.) 57% (5 estimates; range 54.6-59.5%) vs 54.15% in prior quarter
  - PCLs C$234M (7 estimates; range C$-2-377M) vs C$147M in prior quarter
  - CET1 Ratio 12.4% (9 estimates; range 12.2-12.6%) vs 12.3% in prior quarter
  - Dividend C$1.46 vs C$1.46 in prior quarter
- NA.CN -- 27-May before market open
  - EPS (ex-items) C$1.99 (12 estimates; range C$1.83-2.26) vs C$2.15 in prior quarter
  - Revenues C$2.17B (11 estimates; range C$2.07-2.24B) vs C$2.22B in prior quarter
  - Net interest margin 1.85% (8 estimates; range 1.36-2.45%) vs 2.18% in prior quarter
  - Efficiency ratio (adj.) 53.1% (7 estimates; range 49.3-56.1%) vs 51.7% in prior quarter
  - PCLs C$82.1M (8 estimates; range C$-2-120M) vs C$81M in prior quarter
  - CET1 Ratio 12.1% (10 estimates; range 11.8-12.4%) vs 11.7% in prior quarter
  - Dividend C$0.71 vs C$0.71 in prior quarter
- RY.CN -- 27-May before market open
  - EPS (ex-items) C$2.51 (12 estimates; range C$2.35-2.75) vs C$2.66 in prior quarter
  - Revenues C$11.05B (6 estimates; range C$10.67-11.36B) vs C$11.67B in prior quarter
  - Net interest margin 1.45% (5 estimates; range 1.29-1.55%) vs 1.48% in prior quarter
  - Efficiency ratio (adj.) 55.3% (6 estimates; range 50.1-57.2%) vs 56.1% in prior quarter
  - PCLs C$273.3M (6 estimates; range C$-22-503M) vs C$110M in prior quarter
  - CET1 Ratio 12.6% (9 estimates; range 12.4-12.8%) vs 12.5% in prior quarter
  - Dividend C$1.08 vs C$1.08 in prior quarter
- TD.CN -- 27-May before market open

- EPS (ex-items) C$1.76 (12 estimates; range C$1.59-1.96) vs C$1.83 in prior quarter
- Revenues C$9.9B (10 estimates; range C$9.49-10.69B) vs C$10.03B in prior quarter
- Net interest margin 1.7% (8 estimates; range 1.25-2.96%) vs 1.56% in prior quarter
- Efficiency ratio (adj.) 55.5% (7 estimates; range 52.7-57.9%) vs 53.1% in prior quarter
- PCLs C$480.3M (7 estimates; range C$-6-1024M) vs C$313M in prior quarter
- CET1 Ratio 13.7% (9 estimates; range 13.4-14.1%) vs 13.6% in prior quarter
- Dividend C$0.79 vs C$0.79 in prior quarter

• Performance Data

- BMO.CN +19.7%
- BNS.CN +9.9%
- CM.CN +13.5%
- NA.CN +21.7%
- RY.CN +9.5%
- TD.CN +10.3%
- S&P/TSX Composite +5.4%
- S&P/TSX Capped Financials +12%
  - Stock performance data is from closing price on last day before the previous quarter's earnings release (excl. dividends). Index performance data is from closing price on last day before the first bank earnings release last quarter

Source: CG - IA Solutions, Reuters, Wall street Journal