

Royal Bank of Canada

Best-in-class execution needed to mitigate macro headwinds

Reiterate Rating: NEUTRAL | PO: 130.00 CAD | Price: 122.62 CAD

3Q23 results: positives

3Q23 results were in line with our expectations. Positives: capital build, common equity tier 1 (CET1) ratio +40bp QoQ to 14.1%, expectations for a 12%+ pro-forma ratio for HSBC Canada acquisition (closing expected CY-1 Q24); Canadian segment net interest margin (NIM) +3bp QoQ with funding cost pressures persistent but stabilizing which is expected to drive continued NIM expansion (asset betas challenged due to competitive pressures); stronger capital markets revenue.

3Q23 results: negatives

Expenses came in higher (+21% YoY; been a factor all year) vs. BofA/consensus (+13/15%), partly driven by stronger capital markets revenue. Mgmt. reiterated focus on controlling expense growth (headcount reduction, pullback in discretionary spending) which is expected to moderate to mid-single digits YoY in 4Q23; US retail bank (CNB) delivered a loss, NIM pressure/elevated credit costs. 3Q23 adjusted EPS of \$2.84 beat BofA/consensus \$2.69/\$2.70 estimates, helped by a lower tax rate (Exhibit 1).

No 2024 rate-cuts = consumer squeeze

Mgmt. comments during the earnings call support our view that EPS growth is likely to remain challenged in a higher for longer rate backdrop. While the Canadian segment NIM could drift higher (+ve for revenue growth), the absence of rate cuts in 2024 is likely to exert pressure on the Canadian consumer as a greater volume of mortgages reprice to higher interest rates. This poses downside risks to credit quality/loan growth outlooks. No change to FY24e EPS of \$11.65; FY25e +3.5% to \$12.85 on better revenue growth.

Stock could garner interest

The stock trades at well-deserved premium at 10.3x 2024e P/E vs 9x peer median and 1.6x P/YE23e book value vs. ~15% ROE (return on equity) forecast. That said, we think a cautious macro backdrop combined with increased confidence in mgmt. achieving positive operating leverage in 2024 could garner investor interest on the other side of 3Q earnings season. Moreover, synergies stemming from HSBC Canada should provide an idiosyncratic lever to defend against a tough operating environment, in our opinion. We roll forward our PO methodology to 2024 P/E (50% weight) and P/YE24e book value (50%) and maintain \$130 PO. See risk/reward as balanced. Reiterate Neutral rating.

Estimates (Oct) (C\$)	2021A	2022A	2023E	2024E	2025E
EPS	11.26	11.10	11.33	11.65	12.85
GAAP EPS	11.06	11.05	10.29	11.03	12.64
EPS Change (YoY)	41.3%	-1.4%	2.1%	2.8%	10.3%
Consensus EPS (Bloomberg)			11.18	11.79	12.72
DPS	4.32	4.96	5.34	5.52	5.80
EPS (RY - US\$)	8.95	8.62	8.36	8.59	9.48
DPS (RY - US\$)	3.43	3.85	3.94	4.07	4.28
Valuation (Oct)					
P/E	10.9x	11.0x	10.8x	10.5x	9.5x
GAAP P/E	11.1x	11.1x	11.9x	11.1x	9.7x
Dividend Yield	3.5%	4.0%	4.4%	4.5%	4.7%

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Refer to important disclosures on page 6 to 9. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

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Timestamp: 24 August 2023 07:38PM EDT

24 August 2023

Equity

Key Changes

(C\$)	Previous	Current
2023E Rev (m)	54,713.7	56,702.1
2024E Rev (m)	57,402.6	58,370.3
2025E Rev (m)	59,889.4	61,516.1
2023E EPS	11.18	11.33
2025E EPS	12.42	12.85

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Stock Data

Price (TOR / NYS)	122.62 CAD / 90.31 USD
Price Objective	130.00 CAD / 96.00 USD
Date Established	25-May-2023 / 25-May-2023
Investment Opinion	A-2-7 / A-2-7
52-Week Range	116.74 CAD - 140.18 CAD
Market Value (mn)	171,088 CAD
Average Daily Value (mn)	574.45 USD
Shares Outstanding (mn)	1,395.3 / 1,395.3
BofA Ticker / Exchange	YRY / TOR
BofA Ticker / Exchange	RY / NYS
Bloomberg / Reuters	RY CN / RY.TO
ROE (2023E)	15.3%
ESGMeter™	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

iQprofileSM Royal Bank of Canada

Income Statement Data (Oct)

(C\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Interest Income	20,002	22,717	24,961	27,519	29,862
% change	-4.5%	13.6%	9.9%	10.2%	8.5%
Net Fee Income	NA	NA	NA	NA	NA
Securities Gains / (Losses)	NA	NA	NA	NA	NA
Total Operating Income	49,548	48,942	56,702	58,370	61,516
Operating Expenses	(25,808)	(26,773)	(30,730)	(31,500)	(31,916)
% change	2.6%	3.7%	14.8%	2.5%	1.3%
Provisions Expense	753	(484)	(2,438)	(3,427)	(3,832)
% change	-117.3%	NA	403.8%	40.5%	11.8%
Operating Pre-Tax Income	20,993	20,196	19,385	20,838	23,156
Operating Net Income to Comm S/Hold.	15,779	15,537	14,315	15,344	17,584
GAAP Net Income	16,323	15,861	14,842	16,503	18,183

Balance Sheet Data (Oct)

(C\$ Millions)	2021A	2022A	2023E	2024E	2025E
Total Assets	1,706,323	1,917,219	1,970,631	2,143,941	2,212,083
Average Interest Earning Assets	1,334,164	1,477,658	1,592,726	1,760,431	1,844,800
Total Gross Customer Loans	741,537	841,590	867,615	974,081	1,027,715
% change	8.2%	13.5%	3.1%	12.3%	5.5%
Total Customer Deposits	738,343	803,882	785,532	801,361	817,388
% change	10.4%	8.9%	-2.3%	2.0%	2.0%
Tangible Equity	76,753	82,497	88,850	86,750	96,566
Common Shareholders' Equity	92,078	100,857	106,979	113,539	123,056

Key Metrics (Oct)

(C\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Interest Margin	1.50%	1.54%	1.57%	1.56%	1.62%
Effective Tax Rate	22.2%	21.4%	23.4%	20.8%	21.4%
Loan / Deposit Ratio	100.4%	104.7%	110.4%	121.6%	125.7%
Tangible Common Equity / Assets	4.5%	4.3%	4.5%	4.0%	4.4%
ROA	0.97%	0.86%	0.81%	0.78%	0.83%
ROE	18.9%	16.5%	15.3%	14.7%	15.1%
RoTE	22.7%	19.6%	18.4%	18.5%	19.5%
Dividend Payout Ratio	39.1%	44.9%	51.9%	50.1%	45.9%
Efficiency Ratio (Cost / Income Ratio)	52.1%	54.7%	54.2%	54.0%	51.9%

Quality of Earnings (Oct)

(C\$ Millions)	2021A	2022A	2023E	2024E	2025E
Total Non-Interest Inc / Operating Inc	59.6%	53.6%	56.0%	52.9%	51.5%
NPLs plus Foreclosed Real Estate / Loans	0.3%	0.3%	0.4%	0.4%	0.4%
Loan Loss Reserves / NPLs	0%	0%	0%	0%	0%
Loan Loss Reserves / Total Loans	0%	0%	0%	0%	0%

Company Sector

Banks-Multinational/Universal

Company Description

Royal Bank is the largest Canadian bank by market capitalization. Royal has 1,200 branches across Canada and is first or second across virtually all product lines in terms of market share on the retail front. Management has built out a sizable global wholesale operation and as a result is deriving a larger proportion of its earnings from wholesale businesses than has been typical.

Investment Rationale

While we view RY as a best-in-class franchise and one that is particularly well positioned to compete in a digital first banking world, we risk/reward elsewhere as balanced given a premium valuation compared to peers.

Stock Data

Average Daily Volume	6350,439
Shares / Common - Dual Listed	1.00

Quarterly Earnings Estimates

	2022	2023
Q1	2.82A	3.10A
Q2	2.95A	2.65E
Q3	2.55A	2.84E
Q4	2.78A	2.74E

Key Changes

(US\$)	Previous	Current
2023E EPS	8.25	8.36
2025E EPS	9.16	9.48

Exhibit 1: RY 3Q23 earnings variance table

Earnings results vs. BofA and consensus estimates

RY 3Q23 (C\$mn)	Actual	Cons	vs. Cons	BofAe	vs BofAe
Consolidated					
Net Income	3,957	3,746	5.6%	3,737	5.9%
Revenue (net of PBCAE)	13,113	12,826	2.2%	12,558	4.4%
Expense (ex-PBCAE)	7,751	7,332	5.7%	7,208	7.5%
PTPP	5,362	5,494	-2.4%	5,350	0.2%
PCLs	616	649	-5.1%	622	-1.0%
Tax Rate	16.7%	22.6%	-590bp	21.0%	-430bp
Issuance/(Buybacks) (mn shares)	0.0	(1.0)	-100.0%	0.0	-
Adjusted EPS	2.84	2.70	5.2%	2.69	5.6%
Personal & Comm					
Net Income	2,134	2,032	5.0%	2,059	3.6%
Revenue	5,563	5,545	0.3%	5,429	2.5%
Expense	2,319	2,300	0.8%	2,187	6.1%
PTPP	3,244	3,245	0.0%	3,242	0.0%
PCLs	305	487	-37.4%	441	-30.8%
Loan Growth (QoQ)	1.6%	0.9%	70bp	0.6%	100bp
NIM	2.74%	2.70%	4bp	2.68%	6bp
Cap Markets					
Net Income	938	809	15.9%	737	27.3%
Revenue	2,663	2,342	13.7%	2,467	7.9%
Expense	1,620	1,335	21.4%	1,480	9.4%
PTPP	1,043	1,008	3.5%	987	5.7%
PCLs	209	100	109.9%	88	136.8%
Wealth					
Net Income	674	890	-24.3%	866	-22.2%
Revenue	4,418	4,747	-6.9%	4,471	-1.2%
Expense	3,498	3,549	-1.5%	3,260	7.3%
PTPP	920	1,198	-23.2%	1,211	-24.0%
PCLs	102	67	53.0%	93	9.4%
Insurance					
Net Income	227	168	35.1%	158	43.7%
Revenue	1,848	1,208	52.9%	943	95.9%
Expense	1,544	1,087	42.0%	736	109.7%
PTPP	304	121	150.5%	207	46.9%
PCLs	0	0	-	0	-
Corp					
Net Income	(101)	(100)	1.0%	(85)	19.3%
Revenue	(3)	(149)	-98.0%	(178)	-98.3%
Expense	259	66	292.4%	119	117.6%
PTPP	(262)	(215)	21.6%	(297)	-11.9%
PCLs	0	0	-	0	-

Source: BofA Global Research estimates, VisibleAlpha, company filings

BofA GLOBAL RESEARCH

Price objective basis & risk

Royal Bank of Canada (YRY / RY)

Our \$130 PO (USD \$96) is based on applying a P/BV multiple of 1.6x (50% weight) to our YE24e BV and an 11x P/E (50% weight) multiple to our 2024e P/E. These multiples are a premium to the 10x P/E and 1.2x P/B for the group. We see a premium valuation as warranted given RY's superior EPS/ROE defensibility and franchise diversity.

Downside risks to our price objective are: 1) a Canadian and/or U.S. recession that would drive higher than expected credit costs, 2) deterioration in capital markets activity 3) a dramatic shift in the interest rate outlook, 4) unforeseen risks tied to the integration of HSBC Canada.

Upside risk to our PO is: (1) a stronger economy/growth, (2) better than expected synergies from the HSBC Canada acquisition, and (3) economic soft landing that leads to reduced funding cost pressures while asset quality holds-up.

Analyst Certification

I, Ebrahim H. Poonawala, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

North America - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Citigroup Inc.	C	C US	Ebrahim H. Poonawala
	Cullen/Frost Bankers Inc	CFR	CFR US	Ebrahim H. Poonawala
	East West Bancorp, Incorporated	EWBC	EWBC US	Ebrahim H. Poonawala
	Fifth Third Bank	FITB	FITB US	Ebrahim H. Poonawala
	First Bancorp Puerto Rico	FBP	FBP US	Brandon Berman
	First Horizon Corporation	FHN	FHN US	Ebrahim H. Poonawala
	Goldman Sachs	GS	GS US	Ebrahim H. Poonawala
	JPMorgan Chase & Co.	JPM	JPM US	Ebrahim H. Poonawala
	KeyCorp	KEY	KEY US	Ebrahim H. Poonawala
	M&T Bank	MTB	MTB US	Ebrahim H. Poonawala
	Morgan Stanley	MS	MS US	Ebrahim H. Poonawala
	New York Community Bancorp	NYCB	NYCB US	Ebrahim H. Poonawala
	Synovus Financial Corp.	SNV	SNV US	Ebrahim H. Poonawala
	The Bank of New York Mellon Corporation	BK	BK US	Ebrahim H. Poonawala
	Toronto-Dominion Bank	TD	TD US	Ebrahim H. Poonawala
	Toronto-Dominion Bank	YTD	TD CN	Ebrahim H. Poonawala
	U.S. Bancorp	USB	USB US	Ebrahim H. Poonawala
	Wells Fargo & Company	WFC	WFC US	Ebrahim H. Poonawala
	Western Alliance Bancorp	WAL	WAL US	Ebrahim H. Poonawala
NEUTRAL				
	Ally Financial	ALLY	ALLY US	Brandon Berman
	Associated Banc-Corp	ASB	ASB US	Brandon Berman
	Bank of Montreal	BMO	BMO US	Ebrahim H. Poonawala
	Bank of Montreal	YBMO	BMO CN	Ebrahim H. Poonawala
	Bank of Nova Scotia	YBNS	BNS CN	Ebrahim H. Poonawala
	Bank of Nova Scotia	BNS	BNS US	Ebrahim H. Poonawala
	Citizens Financial Group	CFG	CFG US	Ebrahim H. Poonawala
	Comerica Incorporated	CMA	CMA US	Ebrahim H. Poonawala
	Huntington Bancshares Inc.	HBAN	HBAN US	Ebrahim H. Poonawala
	Regions Financial	RF	RF US	Ebrahim H. Poonawala
	Royal Bank of Canada	RY	RY US	Ebrahim H. Poonawala
	Royal Bank of Canada	YRY	RY CN	Ebrahim H. Poonawala
	State Street Corporation	STT	STT US	Ebrahim H. Poonawala
	Truist Financial	TFC	TFC US	Ebrahim H. Poonawala

North America - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
UNDERPERFORM				
	Bank of Hawaii Corp.	BOH	BOH US	Brandon Berman
	Canadian Imperial Bank of Commerce	CM	CM US	Ebrahim H. Poonawala
	Canadian Imperial Bank of Commerce	YCM	CM CN	Ebrahim H. Poonawala
	First Hawaiian Inc.	FHB	FHB US	Brandon Berman
	Prosperity Bancshares Inc.	PB	PB US	Ebrahim H. Poonawala
	Texas Capital Bancshares Inc.	TCBI	TCBI US	Brandon Berman
	The PNC Financial Services Group, Inc.	PNC	PNC US	Ebrahim H. Poonawala
	Zions Bancorp	ZION	ZION US	Ebrahim H. Poonawala

IQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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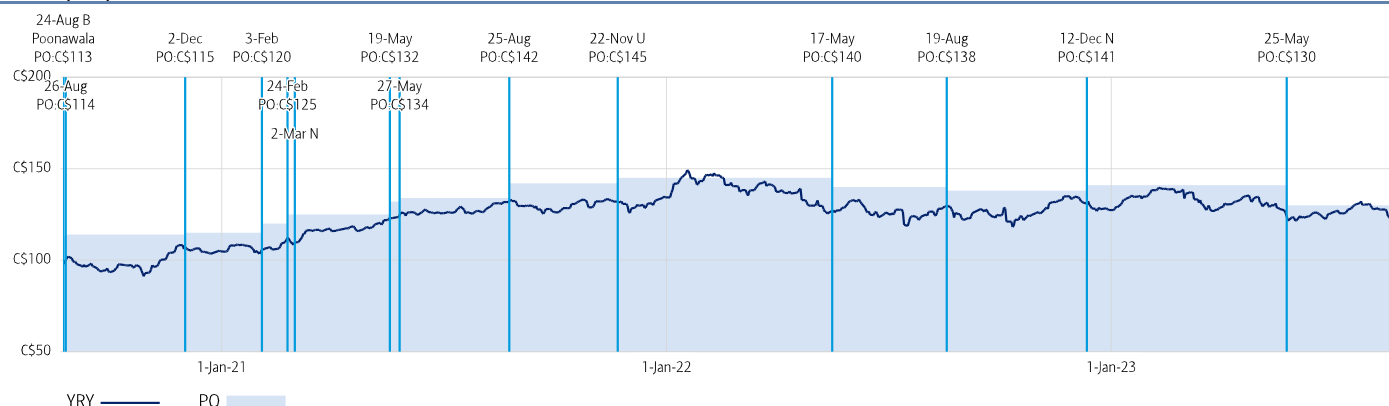
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Disclosures

Important Disclosures

Royal Bank (YRY) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Royal Bank (RY) Price Chart



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Equity Investment Rating Distribution: Banks Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	98	50.52%	Buy	81	82.65%
Hold	45	23.20%	Hold	33	73.33%
Sell	51	26.29%	Sell	37	72.55%

Equity Investment Rating Distribution: Global Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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