

## Recommendation

Buy

## Target Price

\$86.00

## Risk

Low

## Average Daily Volume

150 day: 2,436,700

## Quick Facts

Recent Price	C\$71.80
Symbol	TD-T
Shares O/S	719 million
% Below High	-6.8%
% Above Low	12.1%
52 Wk. Range	\$64.02-\$77.10
Fiscal Year End	October 31
Share O/S	718 M
Market Cap	\$51.0

	EPS	Multiple
2006a	\$4.66	15.4x
2007a	\$5.75	12.5x
2008e	\$6.30	11.4x
Book Value	\$29.23	2.5x
	<u>Rate</u>	<u>Yield</u>
Dividend	\$2.28	3.2%

## TD Bank Financial Group



Data Source: BigCharts.com

*The TORONTO-DOMINION BANK and its subsidiaries are collectively known as TD Bank Financial Group. TD Bank Financial Group offers a full range of financial products and services through three key businesses: personal and commercial banking including TD Canada Trust, wealth management including the operations of TD Waterhouse, and Wholesale Banking including TD Securities.*

## CONCLUSION: BUY - 12 MONTH TARGET INCREASED TO \$86.00

TD Bank Financial (TD) reported a solid performance last quarter in line with expectations. Earnings were strong in most areas and were of high quality with management strategically avoiding the balance sheet risks experienced by the other majors. We consider TD to have the lowest asset risk of all the Canadian majors with no direct exposure to subprime lending, 3rd party ABCP's, or bank sponsored SIV's. The exceptional Canadian retail performance should continue to be the mainstay of earnings with improved performance being generated out of the U.S.

Adjusted cash EPS was \$1.64 (excluding amortization of intangible). Excluding a general allowance release of \$60 million (\$0.05 per share and the gain on its Visa common shares of \$135 million (\$0.19 per share) adjusted EPS \$1.40 for a Y/Y gain of 17%. Canadian Retail (TD Canada Trust) delivered a continued strong performance and benefited from strong retail loan growth and higher operating leverage. Wealth Management was strong up 31% Y/Y driven by a 41% Y/Y increase in net income at TD Ameritrade. TD Banknorth reported better earnings up 72% Y/Y due largely to the increase in ownership (first full quarter at 100%) however ROE was still only 5.1%. Adjusted operating cash ROE for TD was 19.2% in the quarter.

For fiscal 2007, TD had an impressive year, adjusted cash EPS was \$5.75 up 23% from \$4.66. Adjusted ROE for all of 2007 was 19.3% up from 18.7% in 2006. Canadian Retail net income (54% of total bank) increased 15% Y/Y, Wealth Management net income (18% of total bank) increased 29% Y/Y and TD Securities net income (19% of total bank) increased 24% Y/Y. TD Banknorth represented about 8% of TD Bank's overall net income in 2007.

Our EPS estimate for 2008 has been increased to \$6.30 from \$6.20, representing an increase of about 10% over 2007 and reflects the exceptional risk management. Based on our assumed 41% payout ratio, we expect further dividend increases to the \$2.52 to \$2.58 level over the next 12 months, an increase of about 13%.

## Valuation

We have changed our method of valuation for TD from a component basis using namely (1) Canadian operations including TD Banknorth and (2) TD Ameritrade (“AMTD” 40% owned). We now view the TD as just plain superior to its peers. We have concluded that the TD’s risk level and solid earnings performance deserves at least a 5% premium to our other two top recommendations namely, RY and BNS. On this basis we have increased our 12 month target share price for TD Bank to \$86.00. Total 12-month expected return is 23.0% and we continue to recommend the bank as a Buy.

## TD Banknorth Still A Drag... But Improved Sequentially

TD Banknorth (U.S. Personal & Commercial) continued to drag down TD’s overall performance. This was the second full quarter of TD’s ownership at 100%. TD Banknorth contributed \$124 million (12% of the bank total or about \$0.17 per TD share) up from \$109 million last quarter with some improvement in core earnings. ROE improved slightly to 5.1% up from 4.7% last quarter. Margins, although up 14 bp from last quarter were down 1 bp Y/Y and remain under pressure due to intense competition for both loans and deposits. PCL also was a large factor in the poor performance increasing to US\$34 million in the quarter up from US\$31 million in Q3/07 but up from \$13 million in Q4/06. Net impaired loans were flat Q/Q.

## Other Quarterly Highlights

- TD reported adjusted net income of \$1,021 million up from \$876 million in Q4/06 a gain of 17% Y/Y. All business sectors in Canada had strong earnings performances in the quarter.
- TD Canada Trust (personal & commercial) net income was very strong at \$572 million up 14% Y/Y. Net interest margins declined sequentially and Y/Y by 4bp. Operating leverage was very strong at 6% as adjusted revenues increased by 10% and expenses increased by only 4% Y/Y.
- Canadian Wealth Management had a good quarter reporting net income of \$126 million up 30% Y/Y. The group benefited from higher transaction volume, good equity markets and higher fund management fees. Wealth management AUM increased to \$160 billion a 12% Y/Y increase.
- Wholesale Operations (TD Securities) reported a good quarter with net income of \$157 million down from a record Q3/07 of \$253 million in Q3/07 and up Y/Y by 8% from \$179 million. Capital markets income was up 4% Y/Y.
- Provision for Credit Loss (PCL) increased to \$199 million or 0.43% of loans up from \$142 million in the same quarter last year. PCL rose by 33% Y/Y in TD Canada Trust due to higher credit card volumes and as noted previously were up substantially at TD Banknorth. We expect this trend to continue upward with PCL’s increasing to about \$800 million in 2008 including Commerce Bancorp.
- AMTD (U.S. Wealth Management business) had a very strong quarter contributing earnings of \$75 million (8% of TD’s earnings) or \$0.10 per TD share up over 40% Q/Q and Y/Y. Earnings were driven by record trading volumes up 36% Y/Y. This level of income reflects TD’s equity share (39.9%) of AMTD’s earnings.
- Security gains declined to \$60 million from \$94 million in the previous quarter and from \$87 million in Q4/06. This quarter was below the 8 quarter average of \$88 million. Unrealized gains are still about \$1.1 billion.
- Tier 1 capital ratio increased to 10.3% from 10.2% last quarter but down from Q1/07 at 11.9% due to the acquisition of the remaining shares of TD Banknorth.

## Recent Events:

TD Bank Financial Group (TD Bank) announced on October 2, 2007 that it had reached agreement to acquire Commerce Bancorp Inc. (Commerce) based in New Jersey for US\$8.5 billion. The deal will make the TD Bank the 7th largest bank in North America as measured by branch size and doubles the size of TD Banknorth (TD Banks U.S. banking operation).

- Value per Commerce share is US\$42.00.
- Commerce has US\$48 billion in assets (TD Bank has \$404 billion).
- The deal will be paid 75% in TD Shares and 25% in cash (each Commerce share will receive 0.4142 TD Bank shares and US\$10.50 in cash).
- TD Bank to pay 22.5x 2008 Commerce earnings and 2.95x book value.

- After synergies the effective price would be 13.5x 2008 proforma earnings.
- The transaction includes a break fee of US\$330 million or 3.9%.
- No subprime exposure in US\$16 billion loan portfolio at Commerce.
- Expected to close in March 2008.

TD Bank is adding critical mass in the world's largest retail banking market. This deal is expected to position TD Bank for strong U.S. organic growth as Commerce has experienced higher deposit growth than most U.S. banks through aggressive marketing ("The Power of WOW!") and promotions. After this deal TD Bank will derive 85% of its business in the retail sector reinforcing the TD Bank's retail bank strategy. The TD Bank paid a relatively attractive price for Commerce whereby the negative market reaction yesterday was somewhat a surprise (down by almost 5% or \$2.6 billion in market capitalization). There is little question the purchase solidly positions the Bank in the retail sector including its 40% ownership in TD AMERITRADE. In our view the risks in the deal rest largely with integration issues (merging the three cultures of TD Bank, TD Banknorth & Commerce) and the ability to reduce a large weighting in securities and investments (over 58% of Commerce's assets). In the near term the deal is modestly dilutive and we have lowered our 2008 EPS estimate by \$0.05 to \$6.15 from \$6.20. We are maintaining our Buy recommendation and our one year target of \$85.00 per share.

The impact on the TD Bank is modestly negative until the end of its 2009 fiscal year on earnings, ROE and capital but will provide a substantial base for future organic growth in the retail banking sector in North America.

- Management has indicated that the deal could be dilutive to 2008 EPS by \$0.10 per share.
- Neutral impact on 2009 EPS outlook.
- Eventually expect to see TD Banknorth & Commerce merged but to remain separate for now.
- One time TD Bank restructuring charge of \$US490 million.
- TD Bank's Tier 1 capital ratio to decline to 8.8% from 10.2% but by the time of closing the ratio would likely be closer to 9.1%.
- ROE for the U.S. operation likely to remain under 10% for 2 years and drag TD Banks ROE down to 20% overall from 22% now.
- Commerce has nearly 460 locations throughout New Jersey, New York, Connecticut, Pennsylvania, Washington DC, Virginia, Delaware, Maryland and Southeast Florida.
- US\$48 billion in assets of which US\$16 billion are loans (no subprime mortgages) and about US\$28 billion in securities. Management intends to reduce the size and composition of its securities position and limit its exposure to changes in interest rates.
- 2.4 million customers.
- 15,000 employees.
- Total branches on a combined basis is 2,102, 7th largest in N.A.

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