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THE TRUST INDUSTRY

The trust industry has historically been involved in fiduciary functions (some firms more than others) acting as trustees, transfer agents and registrars, pension fund managers, etc. While this area provides a good revenue base, superior growth now comes from intermediary activities whereby companies accept deposits and invest the funds, primarily in mortgages. Profitability is determined by volume and the "spread" between rates paid for and earned on funds. The industry is faced with the tough task of matching revenue levels from their investments and deposits. Their basic cost of money is tied to short term interest rates which are quite volatile and extremely competitive, especially in the guaranteed investment certificate sector. Mortgage loans are for a fixed period. Thus earnings trends tend to reflect interest rate cycles with margins squeezed in times of high rates.

In recent years, mortgage loans have generally been made for five years which has reduced the impact of interest rate changes compared with the former practice of issuing mortgages with 20 and 25 year terms. Thus, mortgages are now more closely related to deposits.

During the 1967-1974 period, the net interest spread ranged from a high of 1.51 in 1972 to a low of .80 in 1974. The after-tax return on equity has been below average ranging from 6.12% in 1970 to 10.83% in 1973, the most profitable year in history.

Total revenue of trust and mortgage companies rose during the period at an average annual rate of 19.4%. Interest income has gone up at an annual rate of 20% while growth in fees and commissions from estates, trusts and agencies has been much

slower at 7.8% per year. The entry into real estate during the 1970s has paid off in good growth as revenues have appreciated from \$21.1 million in 1970 to \$138.1 million in 1974, although this area remains small in terms of the total picture. Inflation has hit operating expenses hard. Since 1970, salaries have been rising at an annual rate of 15.8% but now represent a smaller proportion of expenses.

Government regulations tie borrowing and lending to a multiple of paid-up capital. Recent amendments in legislation have permitted trust companies to increase the deposit ratios. Also, subordinated debentures are now allowed under certain circumstances. These changes enable increased lending power and improved earnings potential.

Trust and loan companies are quite dependent on mortgages handling about 50% of all such loans in the private sector. Mortgages comprise approximately 75% of the industry's total assets. The chartered banks, given broader scope under the last revision to the Bank Act, have come on to be a very competitive force, increasing their mortgage commitments to about 20% of total private mortgages.

THE OUTLOOK

Despite continuing high interest rates, further earnings gains are forecast this year based on a more buoyant demand for mortgages in response to government measures stimulating housing and higher returns from trustee services. Nevertheless, we are restricting our commitments in the industry in view of upcoming developments which are likely to be impor-

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TRUST AND MORTGAGE PERFORMANCE STATISTICS

	1967	1968	1969	1970	1971	1972	1973	1974
After Tax Return on Average Total Assets (%)	0.66	0.61	0.61	0.55	0.81	0.88	0.82	0.58
Net Interest Rate Spreads (%)	1.35	1.25	1.16	1.02	1.40	1.51	1.25	.80
After Tax Return on Average Equity (%)	7.06	6.49	6.53	6.12	9.45	10.73	10.83	8.55
Assets excluding Estates, Trusts & Agencies (\$Millions)	4,353	4,980	5,771	6,564	7,470	8,601	10,509	12,443
Mortgage Loans (\$Millions)	913.1	1,295.8	1,651.5	1,528.2	2,503.1	2,143.8	4,454.7	3,790.9

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tant in assessing the operating environment and future earnings growth.

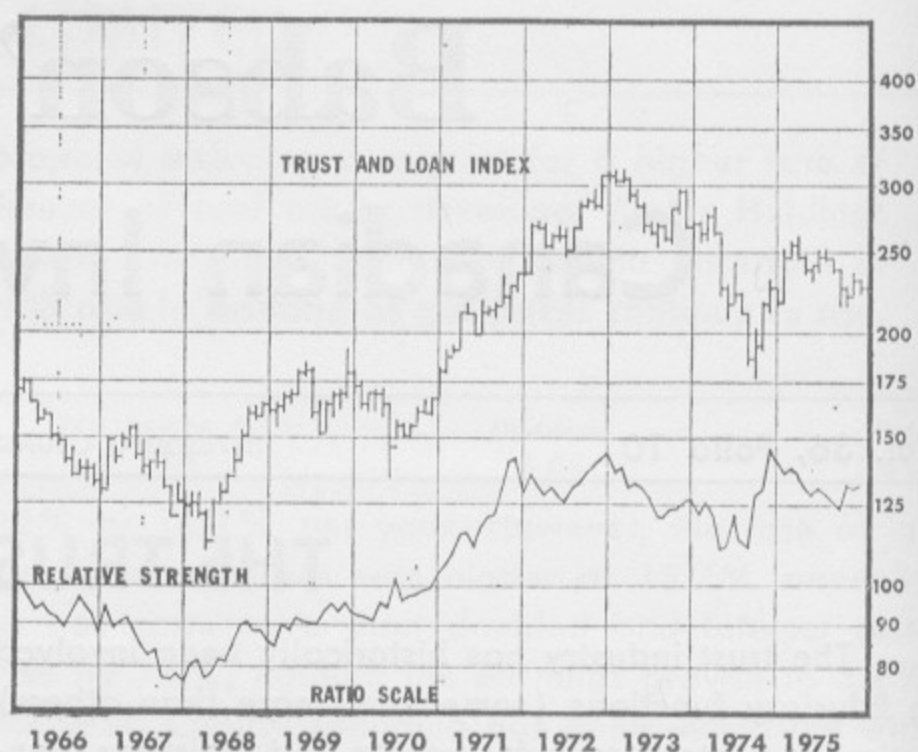
On the immediate horizon we expect a special set of anti-inflation regulations for trust companies similar to those recently issued for banks. Some form of interest spread guidelines will probably be imposed. Also, it appears that trust company activities will be affected by the 1977 revision to the Bank Act. Banks and trust companies are competitive in a number of areas and the new Act may do something to rationalize this trend.

CANADA PERMANENT (\$19½) Profit in 1975 increased by 31% to a record \$14.4 million or \$2.02 per share as revenues rose by 22% to \$254.6 million and assets by 23% to \$2.7 billion. All sectors improved with the exception of real estate, down 15% despite a stronger market toward year-end. Non-interest expenses were sharply higher rising 21%. There has been some investment shift into personal and secured commercial loans to help offset the growth and rate volatility of demand deposits. Diversification moves include leasing. **Hold.**

HURON AND ERIE (\$26¼) Earnings per share advanced by 35% in 1975 to \$2.17 as revenue registered a 21% gain and assets rose by 18% to \$5.8 billion. The interest rate spread improved to 1.77% from 1.47% in 1974 and remains below the average of the past five years. The company has raised \$30 million through issue of a 7¼% convertible debenture and obtained approval to expand deposits by up to 22 times equity and reserves from the year-end multiple of 18 times. A source of concern is the 31% increase in general expenses. Shareholders have approved a change of name to Canada Trustco Mortgage Co. pending government approval. **Hold.**

MONTREAL TRUST (\$13½) Growth in assets remained below industry averages last year at 10.2%. However, lower money costs and improved yield in the mortgage portfolio enabled a 73% earnings increase to \$4.3 million or \$1.65 per share from 96c in 1974. Revenue rose by 17.5% to \$46.3 million. The return on assets is gradually rising as the number of long term, low interest rate mortgages taken out in the 1950s and 1960s declines. The company is extremely sensitive to interest rate changes, currently suffering as rates have risen. **Hold.**

NATIONAL TRUST (\$16½) Operating income was ahead by 16.1% to \$1.91 per share in 1975 aided



by an improved interest spread and a 20% rise in fees and commissions. Mortgage loans increased by 15.4% to \$713.6 million, a gain of close to \$100 million from 1974. Shareholders have approved changes permitting higher deposit levels and the issuance of subordinated debentures, moves which will improve operating flexibility and enable further earnings growth. Trading at 8.0 times estimated 1976 earnings, **the stock offers good value and we recommend purchase.**

ROYAL TRUST (\$23½) After dipping slightly in 1974, profit recovered last year to show a 40% improvement as all operating areas advanced. Interest costs rose by 2% while interest from mortgages and other loans increased by 5.4%. Assets were up by 10% to \$3.4 billion. Computer services acquisition Computel continues in a loss position but Royal hopes to turn operations around and has upped its interest to 94%. Extensive expansion of the Florida banking operation is planned. Royal's broad diversification is helping to offset the impact of higher interest rates and **the stock should be held.**

VICTORIA AND GREY (\$26) Operating income for fiscal 1975 amounted to \$2.91 per share, up by 35% from \$2.15 as total assets increased by 20% to \$1.3 billion. Net interest income advanced by 27%. Mortgages, representing more than 85% of total assets, are the major source of revenue. To upgrade the borrowing base, the company has completed a rights issue and issued \$7 million in subordinated notes. Mortgage lending is now being carried on in Alberta. **We have the shares in a hold position.**

	Recent Price	Revenues Average Growth (5 Years)	Earnings Per Share			P/E Ratio '76 Est.	Indicated Dividend	Indicated Yield	Price Range - 1975
			1974	1975	1976 (Est.)				
Can. Permanent	\$19½	16.4%	\$1.54	\$2.02	\$2.10	9.3	\$1.00	5.1%	\$20 - 14¾
Huron & Erie	26¼	18.1	1.61	2.17	2.25	11.7	1.20	4.6	27 - 22
Montreal T.	13½	10.5	.96	1.65	1.75	7.7	.60	4.4	15½ - 10¾
National T.	16½	19.9	1.64	1.91	2.05	8.0	.68	4.1	18½ - 14
Royal T.	23½	23.5	1.35	1.83	2.05	11.5	.90	3.8	25¾ - 18¾
Vic. & Grey	26	25.0	2.25	2.92	3.20	8.1	1.20	4.6	27⅞ - 21½