This Canadian Bank Looks Good, by the Numbers

Description

With interest rates higher than they were last year and the possibility of further increases looming, it’s a good time to compare and contrast the big Canadian banks, as they typically fare well in a rising interest rate environment.

Tabled below are several key variables that investors should be looking at when they are evaluating the banks as an investment opportunity. We’ll use these as the basis of our discussion.

	CIBC (TSX: CM)	**TD** (TSX: TD)	**Scotia**(TSX: BNS)	**Royal Bank** (TSX:RY)	**BMO** (TSX: BMO)
Dividend Yield	5.0%	3.7%	4.1%	4.0%	4.7%
Tier 1 capital ratio	13.8%	10.8%	13.6%	13.6%	11.1%
Op margin	31.6%	32.5%	40.5%	34.0%	31.0%
P/B	1.8	1.7	1.7	2.1	1.4
ROE	22.3%	15.8%	19.7%	19.1%	15.5%

What Looks Interesting

Years ago, CIBC was known for its aggressive business decisions that resulted in not just big financial losses but a big loss of investor confidence as well. There was the claim that CIBC helped Enron to hide losses, which the bank paid $3 billion to settle in 2005. This calamity was then followed up with the bank's participation in the US subprime mortgage market. A foray that resulted in a staggering $10 billion in write downs in 2008 and 2009.

The past is the past though. Let's fast forward back to the present day. Since the subprime debacle, CIBC has become a well-capitalized bank that is focused on its Canadian operations. The bank has shed its risk taking past, and seems determined to grow in a prudent and risk averse manner.

We can see evidence of this new culture at CIBC in its Tier 1 Capital Ratio, which is a measure of financial strength. It leads the pack, at 13.8%. So CIBC's capital ratio has been improving and is now ahead of its peer group. Its ROE of 22.3% is also ahead of the group but the stock's P/B is 1.8 times, just slightly above TD and Scotia's P/B of 1.7 times. And its dividend yield is the best of the bunch at 5%.

TD Bank, by comparison has a Tier 1 Capital Ratio of 10.8%, and even more noteworthy, the ratio has deteriorated from 12% at the end of 2012. In addition to this trend, TD's ROE of 15.8% and dividend yield of 3.7% are not overly appealing, and so we move on to the other banks.

Scotiabank posted a Tier 1 capital ratio of 13.6% in the last quarter, and stands out from the pack with a very impressive operating margin of 40.5% and a respectable ROE of 19.7%. On top of all this, Scotia has an attractive dividend yield of 4.1%.

While Royal Bank has a strong capital ratio of 13.6%, it is highly valued, at a P/B ratio of 2.1 times.

And given its subpar capital ratio and returns, Bank of Montreal appears to be trading at an appropriate P/B multiple.

Rising Interest Rates

While Bank of Canada governor Stephen Poloz kept the overnight interest rate at 1 per cent at the latest meeting, the market has been pricing in interest rate increases. The average yield on 5 to 10 year Government of Canada bonds has risen from 1.62% at the end of 2012, to 2.22% on August 7, 2013.

bond yield

Image not found or type unknown

Source: Bank of Canada website

Rates that the banks charge borrowers are rising more quickly than their cost of funding, and therefore margins and profitability are rising. This is known as a steepening of the yield curve – that is, firm low rates at the short end and rising rates as you go further out the maturity ladder. A steepening yield curve is good for bank profitability.

The Bottom Line

Distinguishing between the big banks is not always an easy thing. However, looking at the important metrics that were discussed in this article is a very good starting point. Based on these figures, CIBC and Scotiabank stand out. CIBC is continuing to transform itself into a reputable, prudent bank, and although investors need to see more of this before they reward the company with a higher multiple, the company pays an attractive 5% yield while we wait. Not bad.

The Canadian banks are no doubt a collection of the best businesses in this country. However, that wasn't enough to warrant inclusion in our special **FREE** report "**5 Stocks That Should Replace Your Canadian Index Fund**". One of the 5 just got taken out at a huge premium. **Click here now** to learn more about this collection of Canadian super-companies.

The Motley Fool's purpose is to help the world invest, better. ***Click here now*** *for your free subscription to* ***Take Stock****, The Motley Fool Canada's free investing newsletter. Packed with stock ideas and investing advice, it is essential reading for anyone looking to build and grow their wealth in the years ahead.*

Follow us on Twitter and Facebook for the latest in Foolish investing.

Fool contributor Karen Thomas does not own shares in any of the companies mentioned. The Motley Fool does not own shares in any companies mentioned at this time.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:BMO (Bank Of Montreal)
2. TSX:BNS (Bank Of Nova Scotia)
3. TSX:CM (Canadian Imperial Bank of Commerce)
4. TSX:RY (Royal Bank of Canada)
5. TSX:TD (The Toronto-Dominion Bank)

Category

1. Investing

Date
2025/08/04
Date Created
2013/08/12
Author
karenjennifer