Toronto-Dominion Bank or Canadian Imperial Bank of Commerce: Which Should Investors Bank On?

Description

When looking at the one-year return of these two banks, we see a pretty similar picture. Both have performed extremely well, with **Toronto-Dominion Bank** (TSX: TD)(NYSE: TD) returning 26.8% and **Canadian Imperial Bank of Commerce** (TSX: CM)(NYSE: CM) returning 22.3%. A comparison of the most highly valued bank in terms of P/E (i.e., TD) versus the least expensive bank in terms of P/E (i.e., CIBC) reveals some key reasons why investors should favour CIBC.

EPS growth and ROE

The rate of earnings per share growth over at TD is expected to decline over the next few years. For example, EPS at TD is expected to increase 16.4% this year, but this growth rate will taper off to an EPS growth rate of 8.5% in 2016. Over at CIBC, while EPS is expected to increase a mere 1.9% in 2014, EPS is expected to increase a much better 6.8% in 2016. The key is direction and improvement. CIBC's earnings growth rate is expected to improve and is on the way up, while TD's earnings will be growing at a slower pace. Furthermore, CM handily beat analyst expectations in the last four quarters, with EPS coming in 4% higher than consensus analyst expectations, versus TD, where EPS came in 2% higher than expectations. All of this leaves me inclined to favour CIBC.

Another metric where CIBC has the edge is in its return on equity. The company's ROE of 20.7% in the third quarter was once again higher than TD Bank's 16.8%. This has been the case for many quarters now.

Valuation

CIBC is trading at a forward P/E (based on 2014 consensus EPS estimates) of 11.8 times. This compares to TD, which is trading at a forward P/E of 13.2 times. Some might say that this premium is totally justified, as TD has outperformed CIBC historically. I would say that the future will look different and that this valuation gap will narrow. We have been seeing signs that CIBC is stepping up its game and we continued to see this in the latest quarter.

Dividend yield

With a dividend yield of 3.8%, CIBC ranks above TD, which has a dividend yield of 3.3%.

Wealth management is the key to success

The wealth management business is a very profitable business model with low capital investment required and lower volatility and losses. Furthermore, growth rates in the segment are expected to be strong going forward as the aging population (baby boomers) are driving demand for wealth management services.

Last year, CIBC acquired Atlantic Trust Private Wealth Management, a relatively small acquisition that nonetheless is progress on CIBC's strategy of increasing earnings from the wealth management segment to 15% of net income. In 2013, the wealth management segment represented just over 11% of CIBC's earnings, and in 2012, it represented just over 10%. In the latest quarter, revenue from the wealth management segment increased 24% (or 15% excluding the Atlantic Trust acquisition), and net income increased 18.6%. Assets under management increased 31%, or 16% excluding the acquisition. This highlights the company's success at growing its wealth management business, both organically (16% growth) and through acquisitions. Over at TD, assets under management increased 15%, also showing good growth but below CIBC's growth rate.

Capital

Recently things have changed at CIBC. The company has been hard at work lowering its risk profile and changing its culture in order to generate more sustainable and less volatile returns for shareholders. CIBC has since become a well-capitalized bank that is focused on its Canadian operations. The bank has clearly shed its risk-taking past, and is 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 (a measure of financial strength), which has led the pack in this last year. In the latest quarter, CIBC's Tier 1 capital ratio was 12.1% versus 11% at TD.

Bottom line

All in all, I believe that these are compelling reasons for investors to bank on CIBC for their portfolios rather than TD. CIBC has been emerging from its troubled past, while TD may have difficulty maintaining its premium valuation.

CATEGORY

1. Bank Stocks
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1. NYSE:CM (Canadian Imperial Bank of Commerce)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:CM (Canadian Imperial Bank of Commerce)
4. TSX:TD (The Toronto-Dominion Bank)

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Date
2025/09/14
Date Created
2014/09/10
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