Why Canadian Banks Still Make Great Dividend Stocks

Description

If you pay any attention to the newspapers, you would think Canada's banks are incredibly risky stocks. After all, the oil rout is seriously damaging our economy, all while real estate prices and consumer debt are at record levels. As the narrative goes, the banks will be in trouble once the dust has settled.

That said, if you're looking for dividends you can count on, Canada's banks remain one of the first places you should look. Below we look at three reasons why.

1. Loan discipline

The financial crisis taught us what can happen when banks get carried away. No one wants to relive that experience, and this is what turns a lot of people away from Canadian banks.

This is an overreaction; our banks are far more prudent than American banks were 10 years ago. To illustrate, let's use **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) as an example.

CIBC suffered more than any other Canadian bank during the financial crisis, but today the story is very different. Over 40% of its loans are insured residential mortgages, which carry zero credit risk. The rest of its mortgages (which account for ~20% of total loans) are worth only 65% of the borrowers' house values, providing plenty of cushion if these people default.

All in all, CIBC's net impaired loans total only 0.29% of outstanding loans, or about $2 per share—that's not too much for a company with a $90 stock. So, investors should be able to sleep easily.

2. Diversification

Bank investors are very nervous about the oil rout. With that in mind, how much money are these banks loaning to energy companies? The answer is not very much.

Let's take a look at CIBC again. The bank's loans to the energy sector total a little less than $5 billion, less than 2% of its total loan book. In fact, no industry accounts for more than 6% of total loans. So, even as various sectors go through boom-and-bust cycles, CIBC remains well protected. The same could be said for the rest of the banks.

3. A low payout ratio

Let's go back to the financial crisis. At the time, American banks were going bankrupt left and right, yet Canadian banks didn't even cut their dividends. Why was that the case?

Well first of all, the Canadian banks' losses weren't as severe, but there was another reason. Our banks don't pay out too much of their money to shareholders.

Take **Royal Bank of Canada** (TSX:RY)(NYSE:RY) as an example. The bank made $6.00 in earnings per share, and hopes to grow that number by 7%+ per year. Yet its quarterly dividend still only stands at $0.75. So, even if net income were to decline by 50%, the bank could still afford its dividend. Meanwhile, many energy companies pay out more than 100% of free cash flow.

To be fair, the banks have enjoyed a smooth ride, and the road will get bumpier. However, that doesn't mean you should abandon their dividends.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:CM (Canadian Imperial Bank of Commerce)
2. NYSE:RY (Royal Bank of Canada)
3. TSX:CM (Canadian Imperial Bank of Commerce)
4. TSX:RY (Royal Bank of Canada)

Category

1. Bank Stocks
2. Dividend Stocks
3. Investing

Date
2025/09/14
Date Created
2015/03/31
Author
bensinclair