Why Canadian Imperial Bank of Commerce Should Follow in BCE Inc.'s Footsteps

Description

On the surface, **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) and **BCE Inc.** (TSX:BCE)(NYSE:BCE) are very different companies. One is Canada's fifth-largest bank, while the other is our largest telecommunications provider.

Yet when I look at CIBC, I can't help but think it should follow in BCE's footsteps. Below I explain why.

BCE: an expensive dividend stock

To begin, let's take a look at BCE. It is a company with practically no growth (annual revenue increased by 3% last year and 2% the year before), yet it trades for 18 times earnings. One analyst called it "the most expensive telco stock in North America."

BCE is an expensive stock for a very simple reason: its big fat dividend. This year alone, the company will pay out $2.60 per share in dividends, even though earnings per share totaled less than $3 in 2014. As a result, the stock yields an impressive 4.8%—normally for such a high yield, investors must opt for a shakier dividend.

Of course, there's a downside: BCE must accept that it will never be a high-growth company. Fortunately, this is not a hard pill to swallow. After all, any big acquisitions in Canada will run into regulatory headwinds, and international expansions have failed miserably in past years. The company seems to accept its fate, and investors are willing to pay a premium as a result.

Why CIBC should follow in BCE's tracks

By now, we can see that CIBC has some big similarities with BCE. The bank's international efforts have mostly flopped, and now practically all its net income comes from Canada. As a result, growth opportunities are limited.

However, there remains one big difference: the dividend. Last year, CIBC made nearly $9 in adjusted earnings per share, yet the quarterly payout is only $1.06. Thus, the bank is devoting only 47% of earnings to dividends, which is about in line with the other banks.

So, how expensive are CIBC’s shares? Well, as of this writing, its stock price is only 10.4 times last year’s adjusted earnings number. The oil slump is partly responsible, but that doesn’t explain the entire difference.

In my opinion, if CIBC were to crank up its dividend, then its share price would respond very well. For example, let’s say the bank decided to pay out three quarters of last year’s earnings to shareholders. Let’s also say the bank’s dividend would never yield below 5%. In this scenario, the stock would be trading for more than $130.

Does this mean you should buy CIBC?

When looking at the example above, it seems that there’s hidden value in CIBC. Unfortunately, that value won’t be realized any time soon. The bank has shown no indication of bumping up its payout ratio, and instead wants to increase its wealth management footprint.

That said, dividend investors should still strongly consider CIBC. But if you’re looking for some big share price gains, like in the above scenario, you’ll likely be disappointed.

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