Should Income Investors Consider Canadian Imperial Bank of Commerce?

Description

Canadian Imperial Bank of Commerce (TSX:CM)(NYSE:CM) often gets the cold shoulder from bank investors, but the blow-off might not be justified.

Let's take a look at CIBC to see if it merits a spot in your income portfolio.

Bad reputation

Investors don't like to get burned, and once a company stumbles in a big way, it takes a long time to regain the market's trust.

CIBC had to swallow $10 billion in write-downs during the financial crisis because management made bad bets on the U.S. subprime mortgage market. As a result, shareholders took a 60% haircut in less than 18 months, which isn't supposed to happen with the rock-solid Canadian banks.

The company learned a valuable lesson and refocused its efforts on building a strong Canadian retail business. The strategy shift has proven to be very successful, and investors who stayed with the company have been rewarded for their loyalty.

Earnings strength

CIBC's latest results suggest the Canadian economy might not be as bad as pundits think.

For its third quarter, which ended July 31, CIBC earned adjusted net income of $990 million, up from $908 million in Q3 2014.

The Canadian retail division continues to see strength and delivered an 8% year-over-year gain in earnings.

Innovation

CIBC has been a leader in the move to mobile banking. The company was the first to offer an e-deposit application for depositing cheques, and clients now have the option to make credit card purchases using their smartphones. This might not have a big impact on earnings right now, but it sends a strong message to investors that management understands how fast the market is evolving.

Dividend growth

Income investors are primarily focused on dividend growth. CIBC just raised its quarterly payout by three cents per share to $1.12. The distribution now yields about 4.7%. The company has increased the payout nine times in the past five years, and investors should see the trend continue.

Risks

CIBC's big bet on Canada has been extremely successful, but it is also the reason some analysts are concerned about the stock.

The company finished Q3 with $159 billion in Canadian residential mortgages on its books. That's a tidy sum considering the bank only has a market cap of $37 billion.

When you drill down into the numbers, the situation doesn't look that scary. Uninsured mortgages only account for 35% of the portfolio, and the loan-to-value ratio on that potion is 60%.

This means the housing market would have to crash pretty hard before CIBC sees any material losses.

Another concern is the company's energy portfolio. CIBC has more than $17 billion of direct exposure to the oil and gas sector, but 79% of the loans are considered to be investment grade.

Loss provisions will probably creep up if oil prices don't start to recover, but the majority of the energy loan book is low risk.

Should you buy CIBC?

The company has a CET1 ratio of 10.8%, which means it is very well capitalized and more than capable of weathering a slowdown in the economy. Most analysts expect a gradual pullback in the housing market, so CIBC shouldn't run into much trouble.

The stock isn't as cheap as it was in August, but you can still buy it for a reasonable 10 times forward earnings. The dividend is safe and the recent hike suggests management is comfortable with the risk profile on the loan book as well as the earnings outlook.

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