



Will Canadian Imperial Bank of Commerce Be Forced to Cut its Dividend?

Description

On Monday, **Moody's** issued a report that is of little surprise for the thousands of investors who are bearish about Canadian banks.

The ratings agency sees at least the possibility of a “severe stress” situation. This would be in the form of excessive losses from consumer-lending portfolios doing serious damage to the bottom line of Canada’s largest banks. This, combined with persistently low oil prices leading to waves of defaults in the energy space, could be enough to force at least some of Canada’s banks to cut dividends.

Of course, there’s always the possibility we avoid such a terrible outcome. Moody’s also tested what it called a “moderate stress” scenario, which would hurt bank profits but wouldn’t force them to raise capital.

Essentially, the banks have to maintain certain capital ratios in order to have the confidence of the market. The CET1 ratio is the most important. If it falls below 9.5%, the banks could be forced to raise money, cut dividends, or take other capital-conservation efforts. In short, it wouldn’t be good.

Moody’s identified **Canadian Imperial Bank of Commerce** ([TSX:CM](#))([NYSE:CM](#)) as a particular risk. The company has operations that are almost exclusively in Canada, plenty of loans outstanding to oil and gas producers, and a big chunk of its earnings that come from its capital markets division.

This is not a good combination to have, especially if persistently low oil prices lead to more losses. Just how likely is a dividend cut from CIBC sometime in the next couple of years?

Are the shorts right?

It’s obvious capital markets revenue will be hurt in 2016. Many of the companies raising money over the past few years have been oil producers. With crude hovering around \$30 per barrel, investors are going to have a pretty tepid response if asked to buy new equity from anyone in the sector. It’s not smart for energy companies to sell shares at today’s bargain prices either.

And many bears think Canada’s housing market is in a massive bubble. It’s hard to look at markets like

Toronto and Vancouver and argue they're fairly valued. Both markets have been bid up to stratospheric levels, which could end very badly.

But at the same time, CIBC is well capitalized with a demonstrated history of paying dividends since 1868, never missing a payment. The company made it through the Great Recession without cutting its dividend either, only pausing the payment at \$3.48 per share annually. These days, that dividend is \$4.60 per share. That's nice growth.

The housing market issue is also overblown, at least in my opinion. Most of the risky mortgages are covered by mortgage default insurance from CMHC, a crown corporation. Moving the burden of risk from a bank's balance sheet onto the government's might not be great for taxpayers, but it's good news for shareholders.

And finally, a couple of things could really help out the energy-loan portfolio. The easy one is crude recovering, even if it's just a bit. The difference between \$30 and \$40 per barrel crude could be the difference between bankruptcy and survival for many producers. And even if crude remains low, lenders could relax debt covenants to help these companies bide more time.

Besides, Moody's even said the chance of a dividend cut was pretty unlikely. According to the report's author, senior vice president David Beattie, the chance of the severe stress case coming true is "very remote" and dividend cuts wouldn't be considered by the big banks "except under extreme duress."

In short, I'd say the chance of CIBC slashing its dividend is pretty small. It could happen, especially if this downturn gets really nasty. But the more likely scenario is this downturn will lead to a couple of poor quarters as the company tries to clear out any iffy loans, similar to just about every other downturn.

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2. Dividend Stocks
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