Is Canadian Imperial Bank of Commerce About to Make a Huge Acquisition?

Description

There's one big issue many investors have with **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM): it's too Canadian-centric.

Depending on where we are in the economic cycle, this can either be a good or a bad thing. Right now, folks are still relatively bearish on Canada. The prices of certain commodities have recovered somewhat from recent lows, but things like oil, natural gas, and coal are still too depressed to ensure producers can make a healthy profit. Many producers are, at best, only breaking even in today's current price environment.

Another factor affecting Canada's banks is our housing bubble. It seems like there's a new story every week in the media about real estate prices in Toronto and Vancouver–two markets many people think are extremely overvalued. Since a big part of a bank's business is lending against houses, a big decline in home values is not good news.

Because investors are bearish on Canada, they're naturally bearish about banks without any U.S. exposure. **National Bank of Canada** is also feeling the pressure from investors for that very reason. Both National Bank and CIBC trade at lower P/E ratios than their peers, despite putting up comparable-growth and return-on-equity rates.

Both of these banks' management teams are well aware of this, and there's growing evidence that CIBC is ready to come up with a solution to its problem by acquiring a bank in the United States. Here's why that could be very good news for shareholders.

Closing the valuation gap

As I type this, CIBC shares currently trade at just 10.7 times trailing earnings. The valuation is even cheaper if we look at forward earnings; shares trade at 10.2 times expected 2016 earnings of $9.44 per share.

Let's compare that to **Royal Bank of Canada** (TSX:RY)(NYSE:RY) and **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), two financial institutions with significant U.S. operations. Royal Bank trades at

11.3 times earnings and TD Bank shares trade hands at 12.8 times trailing earnings. Assuming CIBC commands a valuation close to the average of those two banks, shares would trade at approximately 12 times earnings.

That would put CIBC shares at $108.36 today with a one-year target price of $113.28. That represents a potential upside of close to 12% today with the potential to increase that upside to 17% over the course of the next year, assuming everything else stays the same. Add on the 4.9% dividend, and investors are looking at a potential total upside of more than 20%.

Not bad for a stodgy, old bank stock.

The important part is this: CIBC would be moving resources away from Canada at a time when investors are a little worried about our domestic economy. This shift in thinking alone should be enough to give the stock a short-term boost.

Not just speculation

Even though there are dozens of potential acquisition targets in the United States and a deal makes all sorts of sense, it’s silly to invest in CIBC solely because of takeover speculation. Betting on something like that to happen turns investing into a more civilized form of gambling.

Fortunately, there are plenty of other reasons to buy CIBC shares. The first, of course, is valuation. If you believe that CIBC owns a truly great banking franchise in Canada, then you should be thrilled to pay just 10.7 times earnings for such a business.

Secondly, the company has all sorts of history on its side. The company has paid dividends since becoming a company back in 1868–it’s never missed a payment. That’s a payout you can truly count on.

And finally, I like the company’s capital markets exposure. Sure, that business is struggling a bit right now, but I think it’ll rebound nicely when Canadian stock markets recover. This should be a nice boost to earnings, partially offsetting any housing market risk.

Nobody knows for sure if CIBC’s management is about to make a huge U.S. acquisition. Fortunately for investors, there are plenty of other reasons to buy shares in this financial powerhouse.

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1. Bank Stocks
2. Investing

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1. Editor's Choice

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1. NYSE:CM (Canadian Imperial Bank of Commerce)
2. NYSE:RY (Royal Bank of Canada)
3. NYSE:TD (The Toronto-Dominion Bank)

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Date
2025/07/08
Date Created
2016/04/11
Author
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