You’re Not Going to Believe Which Canadian Bank Had the Best Year

Description

As good as its earnings were in 2016, **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) wasn’t the biggest success story in the Canadian banking industry this year.

That honour goes to **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM), which managed to grab 12% of the $35.7 billion in annual earnings generated by Canada’s five biggest banks in 2016. More importantly, CIBC increased its 2016 earnings by 19.4% year over year to $4.3 billion; TD was a distant second, upping earnings by 11.3% on the year.

Interestingly, despite CIBC’s winning performance on the income statement, **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) had the last laugh with its stock gaining 41.2% through December 12 compared to 26.8% for CIBC.

In case you’re wondering, BNS increased its 2016 earnings by 2.8% to $7.4 billion. That’s not nearly as impressive, but that’s what makes the markets so interesting. You never know how investors are going to react to information. You just don’t.

By almost every standard, CIBC had a home run this past fiscal year.

“CIBC reported record results for both the fourth quarter and fiscal 2016, wrapping up a year of tremendous progress for our bank,” said CIBC CEO Victor Dodig in its Q4 2016 conference call. “We are transforming CIBC into a strong innovative and relationship-oriented bank, a bank that is very well-positioned to meet the evolving needs of our clients and to deliver future growth for our shareholders.”

The number that stands out for me is the return on equity (ROE).

The bank targets ROE between 18% and 20%; it delivered 2016 ROE of 19.9%, right at the top of its range, and 660 and 560 basis points higher than TD and BNS, respectively. I dare you to find a bank anywhere in North America that does better.

That’s not to say that ROE is the only metric that matters, but the fact that it’s moving into the 20s is a sign Victor Dodig and the rest of his management team are doing a good job running the bank.

Another indication that management has a firm grasp on its business is its common equity tier 1 (CET1) ratio, which measures the bank’s capital against its assets. The higher the CET1 ratio, the more solvent the bank is. CIBC finished the year with a CET1 ratio of 11.3% compared to 10.7% for the average Big Five bank; its ratio is the highest.

That’s a good thing.

Analysts continue to be worried about CIBC’s exposure to the mortgage markets in both Vancouver and Toronto. However, both Dodig and Chief Risk Officer Laura Dottori-Attanasio provided lots of ammunition in its Q4 conference call that its uninsured mortgage business is actually stronger in Toronto and Vancouver than in other parts of the country.

For example, the average loan-to-value ratio across the country for uninsured mortgages is 56%. In Toronto and Vancouver, it is 53% and 46%, respectively. For new uninsured mortgages—it originated $48 billion in fiscal 2016—the national average loan-to-value ratio is 64%. In Toronto and Vancouver, it’s 62% and 57%.

Its loan business appears sound, yet its stock trades at a discount to the other four big banks. Until I feel otherwise, I don’t see a problem at CIBC when it comes to mortgages.

A bigger problem could be the pending $4.9 billion deal to buy Chicago-based PrivateBancorp. When it announced the acquisition in June, the cash and stock offer was worth US$48.94 per share. Today, it’s trading around 10% higher. The bank must now decide if it wants to up its bid, stand firm, or withdraw the offer.

The deal makes too much sense in terms of expanding its U.S. business.

If the bank has to take a hit on its CET1 ratio in order to complete the deal, so be it. In 10 years’ time, this transformational move will be remembered more for putting CIBC on a path to further growth and less about overpaying for the respected Chicago company.

It was a great year for the Canadian Imperial Bank of Commerce; 2017 will be even better, in my opinion.

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