Which Big Canadian Bank May Be Hurt the Most by a Housing Correction?

Description

The housing market in Canada, according to many analysts, is very strong. It may be a tad bubbly, but it's very strong.

With the recent news regarding a potential run on Canadian alternative lending institutions, namely **Home Capital Group Inc.** and, more recently, **Equitable Group Inc.**, it appears that international sentiment on the Canadian housing market may not be as strong as domestic sentiment. After the incredible bull market the Canadian housing market has seen, with prices increasing rapidly and barely stopping during the Great Recession, many Canadians believe the party can't stop.

Canadian Imperial Bank of Commerce (TSX:CM)(NYSE:CM) recently announced expansion plans to grow its presence in the U.S. market and reduce its reliance on the domestic market, following in the footsteps of its peers, who have been building global enterprises for some time now. The acquisition CIBC has in mind is for Chicago-based PrivateBancorp — a deal valued at nearly $5 billion.

The proposed deal is for a part-cash, part-stock transaction that would see CIBC pay 60% of the deal in stock and the remaining 40% in cash. The problem CIBC has had with this transaction is that the number of shares the Canadian bank would have to provide to PrivateBancorp to compensate shareholders for 60% of the transaction has already been increased because shares of CM have slipped of late due to concerns about the health of Canada's financial sector.

U.S.-based shareholder advisory firm Institutional Shareholder Services (ISS) released a report this past week, highlighting some of these concerns relating to CIBC's exposure to the Canadian housing market and the country's broader financial sector, suggesting that shareholders take a hard look at the deal and consider staying independent.

The argument is that PrivateBancorp shareholders may be accepting the lion's share of the transaction value in the stock of a company that has not been trending in the right direction. In including stock compensation as part of the transaction, the deal assumes that the combined CIBC-PrivateBancorp entity will be stronger together than as independent businesses. ISS has essentially made the argument that this acquisition would likely destroy value rather than create value.

CIBC has responded to this report and suggested that the deal will provide both companies with immediate and long-term returns due to synergies related to the combined entity. PrivateBancorp has reiterated the same sentiment, urging its shareholders to follow the unanimous recommendation of the company's board to vote in favour of the transaction. PrivateBancorp shareholders are scheduled to vote on the transaction May 12.

Bottom line

This transaction indicates to me how exposed and potentially vulnerable CIBC is to a Canadian housing market correction. The adverse reaction CIBC's stock has had to recent news signals to investors that the bank's initiative in attempting to increase its exposure to the U.S. market, and thereby reduce its reliance on the domestic market, is something that perhaps should have been done a long time ago; it may be too late.

Stay Foolish, my friends.

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