How to Benchmark Canada's Big Banks

Description

After some of Canada's big banks reported earnings this past week, investors need to take a step back and understand how to benchmark these names in comparison to the rest of the industry and the rest of the market. For those who currently own shares, the good news is that the industry as a whole has performed extremely well since the Great Recession of 2008, while still allowing for a lot of potential moving forward.

Although the financial industry was previously considered cyclical, the industry has shifted to the defensive side, as the banks that were involved in the traditional banking business expanded into the insurance and wealth management sectors over the past generation. What was industry that traded as a function of tangible book value has become an industry driven by earnings and dividend yield.

Blue-chip stocks are those which are characterized as having high and sustainable dividend yields. In the case of Canada's banks, the standard payout ratio is close to 45% of earnings. As these banks are viewed as defensive, the term "blue chip" should be applied to this industry. To make things better, many of these banks have undertaken large share-buyback plans, which have directly contributed to higher earnings per share, as there are fewer shares outstanding.

Canadian Imperial Bank of Commerce (TSX:CM)(NYSE:CM) recently reported earnings for the quarter ending January 31, 2018, which topped expectations. Bottom-line earnings were no less than $3.15 per share after the company completed a U.S. wealth management acquisition, which undoubtedly saw an increase in the bottom line. As long as equity markets continues to rise, it will be very difficult for the company to disappoint investors. After delivering on the bottom line, the bank increased the dividend to no less than $1.33 per share, per quarter.

On the to-do list of company management (after increasing the dividend, which now stands at 41% of earnings) is to renew the previous share buyback and begin reducing the total number of shares available to investors. Although the number has increased for three consecutive quarters (since undertaking a major acquisition), the truth is that the dividend increase will to a very good job at dissolving shareholders on an ongoing basis.

The moral of the story is that dividends can be invaluable to investors if the payments and share buybacks are executed properly.

With so many good things happening for the industry, investors may need to remain cautious. Just as 2006 and 2007 saw a number of dividend increases and expectations being blown out of the water, this time may be no different. Although Canadian Imperial Bank of Commerce has traditionally done a better job at buying back shares and maintaining an optimal capital structure than most in the industry, investors still need to remain cautious across the board.

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