A Top Canadian Dividend Stock With Huge Upside Potential

Description

Income investors looking to add solid dividend stocks to their portfolios find it hard to ignore Canadian banks.

Canada's top lenders have strong balance sheets, good diversification, and a sound regulatory environment. Add these things together and you have lenders that produce hefty cash flows quarter after quarter, thereby providing stability and growth to dividend investors.

On average, Canadian banks distribute between 40% and 50% of their net income in dividends and grow them regularly. In an economy in which interest rates are rising and an improving job market, bank stocks are expected to show strong performance.

Let's look at Canadian Imperial Bank of Commerce (TSX:CM)(NYSE:CM) to see if this lender is a buy after its second-quarter earnings report.

CIBC is the smallest of the Big Five big lenders in Canada. The lender has often been the target of speculators, who blame the bank for its aggressive mortgage lending in a market where home prices have seen massive gains after a decade-long boom.

But CIBC's latest earnings report shows that the lender is in a sound financial position. Its second-quarter profit rose by 26%, which was helped by the lender's acquisition of Chicago-based PrivateBancorp, Inc. last summer. Higher fees and wider spreads also contributed to profit that surpassed analysts' estimates.

For the quarter ended April 30, CIBC reported profits of $1.32-billion, or $2.89 a share, compared with $1.05-billion, or $2.59 a year earlier. When adjusted to exclude certain items, CIBC earned $2.95 a share. Analysts surveyed by Bloomberg L.P. had expected earnings of $2.81. CIBC plans to buy back as many as nine million shares, or about 2% of the outstanding shares, over the next year.

Mortgage lending

One thing that keeps CIBC stock under pressure is its overexposure to the nation's frothy housing market. Short sellers love CIBC stock due to the size of its mortgage lending, which is the largest among the top Canadian lenders. It has more uninsured mortgages in Toronto and Vancouver —

Canada's two hottest real estate markets — than any other bank.

In the second quarter, the lender is seen to cutting that exposure as more stringent mortgage rules forced borrowers out of the market. CIBC's total residential mortgages totaled $208-billion, up 5.5% from a year earlier, but had zero growth when compared with the first quarter of this year.

If home sales fail to pick up in the later part of the year, CIBC expects a 50% decline in its mortgage lending in 2018 compared to 2017.

The bottom line

I see a significant upside for CIBC stock this year, especially when the lender is greatly benefiting from its U.S. operations and the Canadian housing market remains stable despite a considerable slowdown. When compared to analysts' consensus price target of $132.93 for the next 12 months, CIBC looks quite cheap at its current price of $114.89.

With an annual dividend yield of 4.64%, investors can take advantage of the share price weakness this year and lock in this juicy yield, which is the highest among the top lenders.

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