CIBC (TSX:CM) or BMO (TSX:BMO): Which Major Bank Belongs in Your RRSP?

Description

With GDP growth expected to slow over the coming quarters, Canadian banks have been under pressure with major names like **CIBC** (TSX:CM)(NYSE:CM) and **BMO** (TSX:BMO)(NYSE:BMO) falling off their all-time highs. But which of these two presents a buying opportunity, as opposed to a value trap? To help us determine the answer, we will look at their operating metrics, growth drivers, and valuations.

Operating metrics

Last quarter was a lukewarm period across the entire sector, as the housing bubbles in Toronto and Vancouver began to cool along with nationwide consumer spending and as 2018's rate hikes begin to finally catch up to the credit markets. For second quarter 2019, BMO's return on tangible equity ticked upwards to 16.4% from 15.6% in the prior year, though CIBC did not fare as well, returning only 15.9% of adjusted net income to equity compared to 17.4% in 2018.

On the efficiency side of things, both BMO's and CIBC's efficiency ratios (which measure the amount of expenses compared to revenues, with the lower number being better), were stable year over year, remaining within the high 50% range. Finally, with the credit cycle beginning to turn, total provisions for credit losses ticked upwards by $16 million to $176 million for BMO and by $43 million for CIBC to $255 million.

Near-term growth drivers

In the near term, I anticipate that BMO will be able to leverage its smaller exposure to Canadian lending relative to CIBC by essentially sitting out an economic downturn at home. Moreover, BMO's U.S. business earnings totaled $417 million, up 16% versus the prior year, though, of course, with the U.S. Fed set to cut interest rates, it remains to be seen how much longer this strong performance can persist.

Furthermore, BMO also went through a bit of a restructuring in the capital markets division, which is expected to save $40 million in operating expenses, and combined with its large share of the Canadian capital markets as a whole, this segment can possibly deliver strong operating results for the rest of 2019 and 2020. Like BMO, CIBC will be relying on its U.S. division to generate growth, as Canadian Personal & Small Business earnings fell 3% year over year, although losses on Canadian impaired loans might be subdued in the coming quarters, thanks to the Bank of Canada's pause on any further rate increases for 2019.

Valuation

On the valuation front, BMO's consensus 2019 EPS is expected to be $9.5, while CIBC's is anticipated to deliver EPS of $12.14. These numbers translate to 2019 P/E ratios of 10.48 for BMO and 8.52 for CIBC. Therefore, both these names are offering similar discounts to their 2018 P/E of 11.2 for BMO and nine for CIBC, though slightly more so for BMO.

Therefore, due to its lower exposure to Canadian lending, better operating metrics, and superior valuation, I would have to pick BMO over CIBC for a place in my RRSP.

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Author
vmatsepudra