Better Buy Ahead of Earnings: Royal Bank of Canada (TSX:RY) or CIBC (TSX:CM) Stock

Description

Next week, two of Canada's Big Five banks kick off earnings season. **Royal Bank of Canada** (TSX:RY)(NYSE:RY) is first out of the gate when it releases third quarter results on Wednesday. **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) reports third quarter results the day after.

Recent market volatility has hit the banking sector harder than most. The TSX Index has lost approximately 2% over the past month, while the Big Five have averaged a 5% loss. Royal Bank of Canada and CIBC have both performed in line with the average.

Looking ahead, which is a better buy before earnings? Let's take a look.

Third quarter estimates

As of writing, analysts estimate that Royal Bank of Canada will post earnings of $2.31 per share, a healthy 7.9% increase over the third quarter of 2018. This is tied with **Toronto-Dominion Bank** for the highest expected growth rate among the Big Five.

Another positive to be aware of – earnings estimates have remained consistent over the past quarter. In other words, expect no surprises from Royal Bank of Canada.

How does CIBC compare? Not so great, unfortunately. Earnings estimates of $3.08 per share is flat year over year. In fact, it is the only one of Canada's large banks that is not expected to post quarterly earnings growth.

Unlike Royal Bank of Canada, earnings estimates have trended downwards from $3.17 per share previously. This is a sign that analysts are becoming increasingly bearish on the company's prospects.

What about that dividend?

You can't talk about Canada's Big Five banks without discussing the dividend. The steady and reliable income they provide investors is one of the most important features of the banks. Royal Bank of Canada currently yields 4.13%, while CIBC's 5.65% yield tops the group.

Both companies have a history of raising their dividends twice yearly. They are also Canadian Dividend Aristocrats with eight-year dividend growth streaks.

The good news is that both are also expected to raise dividends along with third quarter earnings. In the first quarter, Royal Bank of Canada raised dividends by 4.04% while CIBC raised dividends by 2.94%. Considering historical growth rates, another raise similar in size is expected.

Which bank should I buy?

Which bank should you buy before earnings? Royal Bank is the clear winner. Although CIBC may look cheaper, it is important to note that the bank has traded at a significant discount to its peers for years. This is in large part thanks to low growth prospects and underperformance.

When compared against historical averages, Royal Bank is also cheap. It is more diversified, has better growth prospects and its dividend is growing at a faster rate.

The only advantage CIBC has over its peer is a higher yield. However, what Royal Bank of Canada lacks in yield, it more than makes up in capital appreciation. It has been the second best performing bank over the past five-years (mid-single digits), whereas CIBC has trailed the pack and posted negative returns.

The answer is clear to me, based on all of the above – Royal Bank is the better buy ahead of its earnings.

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