2 Cash-Rich Bank Stocks That Could Raise Dividends

Description

When COVID-19 struck in 2020, Canada's big banks didn't want surprises. All of them had a common goal, and that was to prepare to absorb credit losses. Despite the federal government's dole-outs to households, the collective provision for credit losses (PCLs) reached a staggering $11 billion.

Still, questions arose as to whether the amount was enough to stave off the anticipated increase in loan delinquencies. Fortunately, the economy held up throughout the pandemic and performed better than expected. The result is an unprecedented level of excess capital at the close of Q2 fiscal 2021 (quarter ended April 30, 2021).

As the pandemic unwinds, war chests are so huge that the problem now is where to deploy the cash. The industry standard floor for common equity tier one (CET1) capital is 11%, but the banks had $40.5 billion in excess. If you apply the regulatory floor of 9%, the amount should double to above $80 billion.

The big banks, including **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) and **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), have several options to use the money. However, the banks' dilemma is a pleasant development for investors. Besides share buybacks, the lenders could boost dividend yields to benefit shareholders.

Financial flexibility

TD's chief executive officer Bharat Masrani hinted that Canada's second-largest bank is open to pursuing strategic acquisitions in the southeast U.S. or perhaps another region. Among all banks, TD is the most vocal on possible M&As and is scouting for compelling prospects.

The $128.96 billion bank has the financial flexibility to seal deals and return more capital to shareholders. In the first half of fiscal 2021, TD's adjusted net income rose 53% to $7.15 billion versus the same period in fiscal 2020. Notably, PCL dropped to $64 million from $4.13 billion.

The impressive quarterly results reflect in the bank stock’s performance. Investors enjoy a 28% gain thus far in 2021. As of June 21, 2021, TD trades at $70.91 per share and pays a 3.69% dividend.

Highest dividend payer

Scotiabank analyst Meny Grauman said, “The economy has held up a lot better than what anyone expected. The Canadian banks in some sense are reflecting that picture that’s really true for the economy as a whole.” However, the considerable capital excess could reduce the return on equity, which is not good to see in the balance.

The country’s third-largest bank pays the highest dividend in the banking sector. At $79.85 per share, the dividend offer is 4.51%. Scotiabank’s year-to-date gain on the TSX is 19%, while the payout ratio is less than 60%. Market analysts are bullish and see a potential upside of another 19% to $95 in the next 12 months.

While total revenue fell slightly by 2% in the first half of fiscal 2021, Scotiabank’s net income rose 33% to $4.85 billion versus the same period in fiscal 2020. Its PCL dropped 55% to $1.26 billion. Meanwhile, the $96.92 billion bank has a dividend-reinvestment and share-purchase plan. Eligible shareholders can invest up to $20,000 each fiscal year to purchase additional common shares.

Room for dividend growth

According to **Moody’s** vice-president David Beattie, the robust allowances for PCLs should see the big banks through 2021. TD prefers M&A more, while Scotiabank is likely to allocate capital for organic growth. However, there’s room for dividend increases, which should be a win for investors.

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