Bank Stocks Are Gearing Up for a Huge 13% Dividend Increase

Description

The Big Six banks in Canada posted profits of $41.13 billion in 2020, despite the unprecedented increases in the provision for credit losses (PCLs). During the same year, the Office of the Superintendent of Financial Institutions (OSFI) lowered the "domestic stability buffer" (DSB) so that banks would have additional capacity to lend to Canadian businesses and households.

The OSFI loosened capital requirements but banned banks from splurging on dividends and performing share buybacks for at least 18 months. After Q2 fiscal 2021 (quarter ended April 30, 2021), the country's top lenders overflowed with cash after reducing their PCLs dramatically.

The anticipated wave of loan defaults didn't happen. With the excess capital, the banks can afford to increase dividends by as much as 13%. However, it's not yet sure whether the banking watchdog would lift the restrictions by October 2021. On June 30, 2021, Peter Routledge, the new OSFI head, said there are no set dates. He added that it's better to do so late than early.

The highest yield in the industry

Bank of Nova Scotia (TSX:BNS)(NYSE:BNS), or Scotiabank, currently pays the highest dividend (4.54%) in the banking sector, followed by the **Canadian Imperial Bank of Commerce** (4.06%). Scotiabank's excess common equity tier one (CET1) capital above the 11% floor is $5.2 billion.

Meny Grauman, an analyst at Scotiabank, 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 … These are unheard-of levels of excess capital ($40 billion combined)."

Meanwhile, Brian Porter, Scotiabank's CEO, said the $95.31 billion bank is ready to swing into action if the OSFI loosens the restrictions. Porter was quoted as saying, "When the regulator gives us the green flag to do that, the next day, we'll be out buying stock back … We think our stock is inexpensive on any historical or current valuation metric."

The bank stock trades at $78.52 per share and is up 18.29% year to date. Market analysts see a potential upside of between 11.88% ($87.55) and 20.99% ($95) in the next 12 months.

Significant dividend hike possible

According to *Bloomberg Intelligence's* analysis, significant dividend hikes will ensue once the OSFI lifts the restrictions. Also, it noted the payout ratios have dropped below the 40-50% range.

Based on consensus earnings estimates for fiscal 2022, **National Bank of Canada** (TSX:NA) and **Bank of Montreal** could afford the most significant dividend increases if you peg the payout ratio at 45%. Currently, Canada's sixth-largest lender pays a decent 2.99%, with the payout ratio at only 38.27%.

National Bank trades at $94.71 (+34.30% year to date). The $31.96 billion bank has $1.1 billion in excess CET1 capital. Based on analysts' forecasts, the share price could rise further by 15.09% to $109 within the next 12 months. Like its larger industry peers, this super-regional bank is an excellent buy-and-hold stock. Its total return over the last 41.41 years is 11,221.11% (12.10% CAGR).

Waiting game

Canadian banks are the envy of the global banking industry. It was only in 2020 that the combined profits of the Big Six were below $46 billion since 2010. Still, investors must wait for dividend increases. OSFI wants to be sure the financial stability risks are gone.

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