



# 04/17/2021: How To Analyze US Regional Banks + Our Favorite In The Space (CAC)

Operators,

Alex and I spend most of our time scouring the markets for great, highly asymmetric investment ideas. This week we found ourselves buried in the regional banking rabbit hole. There are a **ton** of great-looking charts setting up in this industry.

This weekend we're outlining how we analyze banking stocks. What you want to see, what you don't want to see ... What makes a regional bank great?

Then, we'll pitch our favorite US-based regional bank, one with the strongest technicals and fundamentals out there.

Finally, we'll end with a few trade set-ups/portfolio adjustments we might make next week.

Let's get after it.

## Why Analyze Regional Banks

Banks are just another way to go long-rising interest rates. When interest rates rise, banks make more money on their deposit balance and loan book. Plus, rising interest rates incentivize bank customers to store more cash in the bank, further increasing deposit balances.

Interest rates are starting to climb higher, yet regional bank stock prices don't reflect the change. Many banks sit around 10x current earnings with healthy balance sheets and a decent return on equity.

Plus, Americans are saving at some of the highest rates in history. For example, the consumer savings rate in December 2020 was 13.7%. Compare that to the 7.6% at the start of 2020, and it's easy to see the **immense** dry powder available to regional banks to create loans.

But before we dive into our specific regional bank play, it's essential to understand **what** to look for when analyzing a regional bank.

## How To Analyze Regional Banks

Banks are backward businesses. Assets are liabilities. Liabilities are assets. It's all upside-down. There are a few key metrics that matter when valuing banks:

- Return on Assets
- Return on Equity
- Efficiency Ratio
- Deposits Per Share
- Price to Earnings
- Price To Book

The most important metric to analyze a bank is its **deposit growth** (and subsequent deposit per share). This makes intuitive sense. It answers the fundamental question: *“Do you keep your money here? If so, do you increase how much money you keep here every year?”* We want to answer “yes” to this question before looking any deeper.

Despite their complex financial statements, banks *are* simple businesses. They buy and sell money. Banks accept cash via deposits with the cost of goods sold as the interest paid to deposits. The bank then sells that money (i.e., deposits) to customers through loans and investments and collects income via interest payments on the loans.

We don't need to make banks any more complicated than that.

## What Are “Good” Banking Metrics?

The next step is to determine what constitutes a “good” or “bad” banking metric. There are specific numbers we want to see before investing in a bank. Adam Brown wrote a great piece on Seeking Alpha about such metrics (you can read it here).

First, we want a growing deposit balance, preferably with a 10% or higher CAGR. Then, we want a ROA > 1% and ROE between 10% - 15%. I know. The ROA number looks tiny. But banks are highly leveraged institutions (many dollars supported by few dollars of equity). This means that even a micro change in ROA, say from 1.0% to 1.2%, can result in a massive increase in profits.

Next, we'll look at the Efficiency Ratio (or ER), which is non-interest expenses divided by revenue. ER gauges how well the bank's managers control their overhead expenses. Anything above 70% is a red flag and a signal that a bank can't control costs. Look instead at banks with 50%-60% or lower ERs.

Finally, we want to pay a reasonable (or excellent) price for a bank. Regional banks aren't good businesses for the sole reason that they often don't return their cost of capital (~10%). As such, the two critical drivers for capital return are stock appreciation and dividends.

We're looking for ~15x or fewer P/E and <1x-1.5x P/B.

Before moving on to our favorite regional bank, let's review what we've learned. Remember, banks are simple businesses, and we don't need to make them more complicated.

**We want to buy banks that generate at least 1% ROA and 10-15% ROE while controlling overhead costs and increasing deposits per share.**

That's it.

## **How To Find Regional Bank Investment Ideas**

Finding regional bank investments is easy when you know what you want. You take the above criteria and slot them into any stock screening service. Out of the 374 regional bank stocks in the US, we narrowed our list down to 59 names. We chose to keep our list of banks above the \$300M market cap, yet we encourage you to find smaller-cap banks that offer a potentially more significant intrinsic value discount.

You can examine the complete list at the end of this report on **Exhibit A**.

## **Further Resources For Studying Bank Stocks**

Here is a list of resources if you want to go down the regional banking rabbit hole this week:

- [Investing In Bank Stocks: Going Through CFR's 10-K](#) (Focused Compounding)
- [Valuing Community Bank Stocks](#)
- [ANALYZING AND INVESTING IN COMMUNITY BANK STOCKS](#)
- [Frost Stock Valuation](#) (Geoff Gannon)
- [How To Narrow Your Search For A Quality Regional Bank](#) (Seeking Alpha)

Alright, now to our favorite regional bank.

## **Camden National Corporation (CAC): Maine's Leading Regional Banking Provider**

CAC is the largest publicly traded bank headquartered in Northern New England. Established in 1875, CAC has a long history of serving Maine customers.

The stock checks nearly every box for what we want to see in a regional bank:

- Local dominating market share
- A long history of serving niche/local customers
- Excellent customer service
- Above-average ROE and ROA
- Low Efficiency Ratio
- Conservative balance sheet
- History of dividend payments

- Good price

CAC ranks second in overall deposit share in Maine and first for Maine community banks. They also rank third in mortgage originations behind Bangor Savings (private) and Quicken Loans (RKT).

The company's strong balance sheet, diversified revenue streams, and history of deposit growth should allow it to continue paying its dividend while opportunistically buying shares on the open market. As evidence of management's confidence in the business, the company increased its dividend payment by 9% at the end of March 2020.

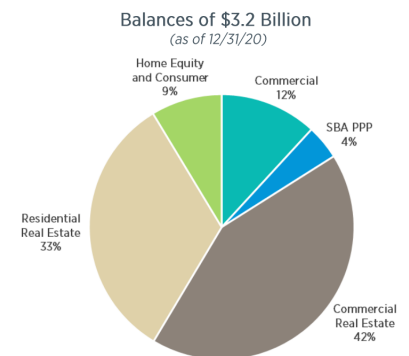
The stock trades for ~12x normalized earnings and is set to break out into new all-time highs.

## Business Overview

CAC generates revenue from personal banking services, wealth management, business banking strategies, and sophisticated products and services.

The company generates ~27% of its income from fee-based products like mortgage banking (36% of fee income), debit cards (21%), wealth management brokerage (18%), and other service charges (12%)

Along with its fee-based income, CAC has two investment portfolios: Loans and Securities. The \$3.2B Loan portfolio has 75% weighting in commercial and residential real estate. 70% of its residential and 67% of its commercial real estate reside in Maine.



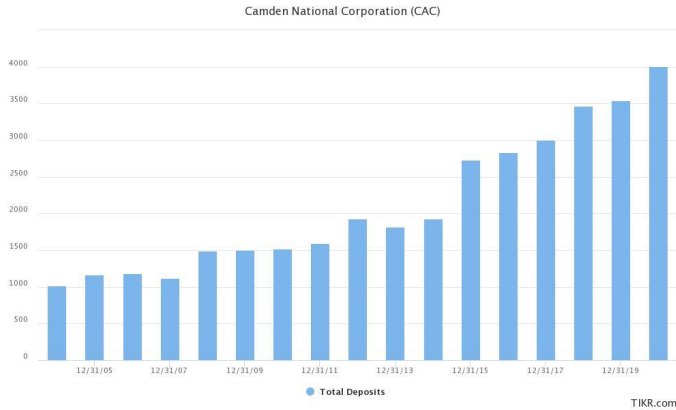
CAC continues its conservative investment practice inside its loan book. For example, 98% of the company's residential mortgages are at an 80% LTV (loan-to-value) or lower, and its top 50 commercial mortgages have an average LTV of 67%.

Moreover, the company has ~\$1B in loan repricings over the next year. Currently, the average yield on those loans is ~2.97%. Repricing those loans to higher interest rates would result in more significant net interest income.

Let's shift to the Securities Portfolio. CAC sports a \$1.1B security book with an average yield of 2.05%. 47% of the Securities portfolio is in mortgage-backed securities (MBS) and collateralized mortgage obligations (CMOs).

## Deposits and Borrowings Metrics

The company has ~\$3.7B in average deposits. 47% of the bank's funding comes from checking accounts, 29% from savings accounts, 13% from borrowings, and 11% from CDs. This explains the company's low cost of deposit (0.38%).



CAC also shows a long history of increased deposits. The chart on the left shows a smooth upward trend since 2004 (as far back as TIKR goes).

The company has ~\$566M in borrowings at an average borrow cost rate of 1.20%.

### Local Dominating Market Share

One of the benefits of investing in regional banks is local market share domination. CAC understands the Maine market and its customers better than any other bank. That deep client understanding explains why 8 out of 10 CAC customers would *gladly* recommend the bank to their friends (~80 NPS rating).

For example, in 2008, Maine was hit with a double-whammy of local economy downturns: low lobster prices and higher energy prices. In response, the company formed a Lobster Industry Loan Program to help local lobster fishers. Here’s an excerpt from CAC’s 2008 annual report (emphasis mine):

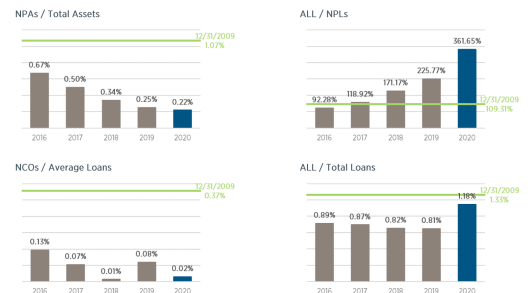
*“Tim worked directly with representatives of FAME and other bankers to develop guidelines for their “Lobster Industry Loan Program,” which was introduced within 30 days of their initial discussion. Since the launch of this collaborative program, Camden National Bank has helped to provide much-needed assistance to one of Maine’s most important industries.”*

It’s impossible to picture a larger bank doing something like this because they can’t. Let alone start and implement a new program in 30 days.

Smaller, regional banks can do things that don’t scale to create satisfied life-long customers.

### Above-Average Metrics

The company sports above-average credit quality and asset/equity return metrics. For example, Non-Performing Assets as a percentage of Total Assets is 0.22% and has declined every year since 2016. Second, CAC generated 1.23% ROA and 12% ROE in 2020 (both above our baseline criteria).



CAC also maintains an iron-clad capital structure. They have ~2x the required Tier 1 Leverage Ratio (9.13%) and roughly \$1.44B in unused liquidity sources. Finally, the company knows how to manage costs with a 52% Efficiency Ratio.

## Valuation: P/E & Deposits Per Share Peer Comparison

I know I'm usually the one shouting about the negatives of using P/E ratios. But for "old school" businesses like banks, the shorthand works well.

CAC trades for ~12x normalized earnings. This isn't wildly cheap compared to its peer group of ~15x. That said, the company does pay a 3% dividend that's increased each of the last five years (in 2016, they paid \$0.83/share in dividends and last year paid \$1.32/share).

Another way we can think about valuation is via deposits per share. The company has 15M shares outstanding and \$4B in deposits as of LTM 2020. That gets us ~\$266 in deposits per share. In other words, we're paying ~12x earnings for \$266 in deposits per share. Let's see how that compares to industry peers (from TIKR):

- First Financial Bankshares (FFIN): \$61.5
- Bank United (BKU): \$294
- Ameris Bancorp (ABCB): \$244
- First Merchants Corporation (FRME): \$209

At first glance, CAC doesn't blow its peers away. Specifically, BKU and ABCB are roughly the same. Yet, there are a few key differences. BKU generates 0.6% ROA and 6% ROE with a 2.1% dividend yield. All three metrics are lower than CAC.

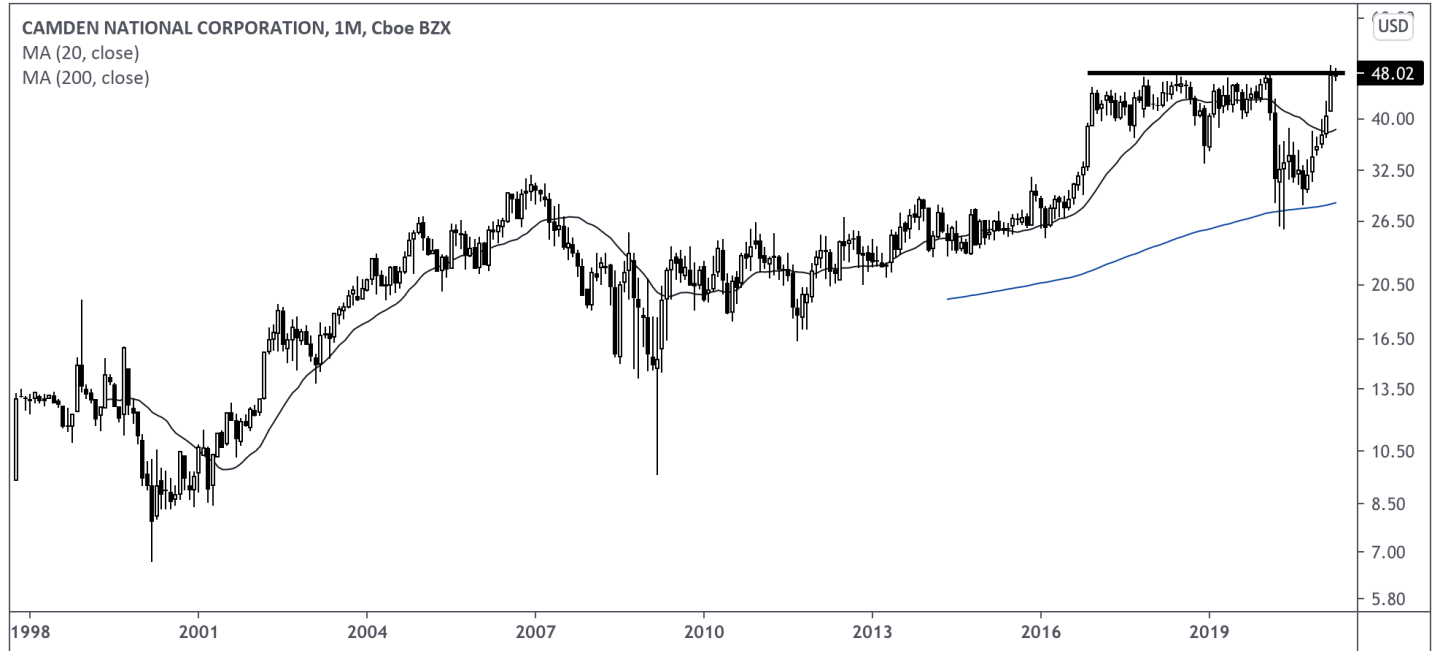
ABCB has nearly 3x the amount of non-performing loans on its books than CAC and sports a 1.2% dividend yield.

Camden National has compounded its book value roughly 8.4% per year for the last five years. Add to that a 3% dividend, and you're looking at ~12% total return per year in a shallow interest rate environment. Should rates head higher at any point in time, CAC would generate much higher returns for shareholders and likely pay out a higher percentage of their net income in dividends (currently, they pay 30-36% of income).

## Chart Analysis: Potential Breakout Into New All-Time Highs

One of the reasons we chose CAC as our favorite stock in the regional banking sector was its chart pattern. The stock is knocking on the door of new all-time highs. Check out the monthly chart below:

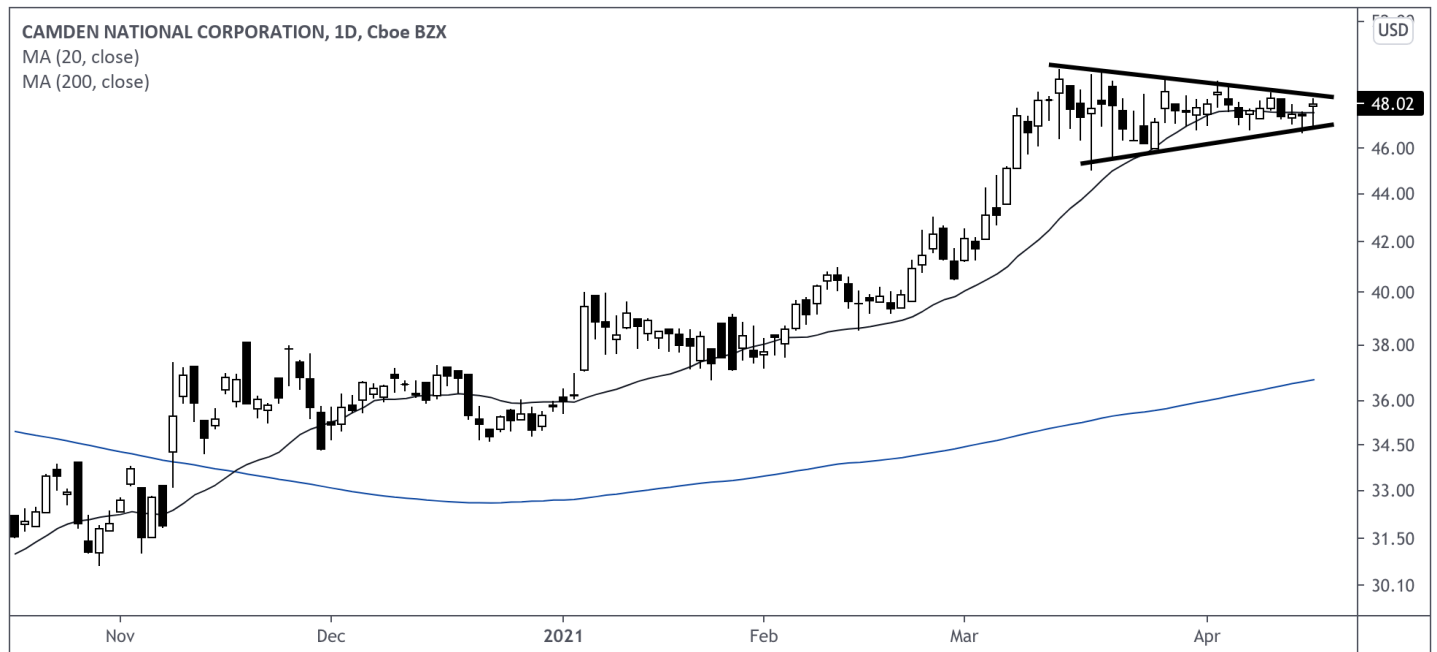
rockvuecap published on TradingView.com, April 17, 2021 17:53:15 EDT  
 BATS:CAC, 1M 48.02 ▲ +0.57 (+1.2%) O:47.52 H:49.10 L:46.70 C:48.02



TradingView

The stock has tested the \$48-\$49/share price five times in the past. If we zoom in on the daily chart, we see even further volatility compression (i.e., something's bound to break soon).

rockvuecap published on TradingView.com, April 17, 2021 17:57:57 EDT  
 BATS:CAC, 1D 48.02 ▲ +0.57 (+1.2%) O:47.88 H:48.27 L:46.96 C:48.02



TradingView

Again there's a lot to like from this chart. The stock is above its 200MA and resting on the 20MA with tight consolidation. A breakout from the launching pattern should propel the stock towards \$50/share.

## Exhibit A: List of 59 Regional Bank Stocks

No.	Ticker	Company
1	USB	U.S. Bancorp
2	ITUB	Itau Unibanco Holding S.A.
3	BSBR	Banco Santander (Brasil) S.A.
4	BCH	Banco de Chile
5	BSAC	Banco Santander-Chile
6	WAL	Western Alliance Bancorporation
7	FHN	First Horizon Corporation
8	FCNCA	First Citizens BancShares, Inc.
9	UMBF	UMB Financial Corporation
10	ABCB	Ameris Bancorp
11	HTH	Hilltop Holdings Inc.
12	AX	Axos Financial, Inc.
13	FBC	Flagstar Bancorp, Inc.
14	PRK	Park National Corporation
15	EGBN	Eagle Bancorp, Inc.
16	CASH	Meta Financial Group, Inc.
17	GGAL	Grupo Financiero Galicia S.A.
18	BMA	Banco Macro S.A.
19	TBBK	The Bancorp, Inc.
20	CHCO	City Holding Company

No.	Ticker	Company
21	NBHC	National Bank Holdings Corporation
22	GABC	German American Bancorp, Inc.
23	TMP	Tompkins Financial Corporation
24	MBIN	Merchants Bancorp
25	FFWM	First Foundation Inc.
26	PFBC	Preferred Bank
27	CUBI	Customers Bancorp, Inc.
28	RBCAA	Republic Bancorp, Inc.
29	HMST	HomeStreet, Inc.
30	WASH	Washington Trust Bancorp, Inc.
31	BBAR	Banco BBVA Argentina S.A.
32	HBNC	Horizon Bancorp, Inc.
33	ALTA	Altabancorp
34	NCBS	Nicolet Bankshares, Inc.
35	QCRH	QCR Holdings, Inc.
36	CAC	Camden National Corporation
37	HIFS	Hingham Institution for Savings
38	AROW	Arrow Financial Corporation
39	MBWM	Mercantile Bank Corporation
40	ALRS	Alerus Financial Corporation



No.	Ticker	Company
41	<a href="#">WSBF</a>	Waterstone Financial, Inc.
42	<a href="#">IBCP</a>	Independent Bank Corporation
43	<a href="#">FLIC</a>	The First of Long Island Corporation
44	<a href="#">HBT</a>	HBT Financial, Inc.
45	<a href="#">FMNB</a>	Farmers National Banc Corp.
46	<a href="#">BWB</a>	Bridgewater Bancshares, Inc.
47	<a href="#">GNTY</a>	Guaranty Bancshares, Inc.
48	<a href="#">RBNC</a>	Reliant Bancorp, Inc.
49	<a href="#">MCB</a>	Metropolitan Bank Holding Corp.
50	<a href="#">MVBF</a>	MVB Financial Corp.
51	<a href="#">WTBA</a>	West Bancorporation, Inc.
52	<a href="#">BSRR</a>	Sierra Bancorp
53	<a href="#">RRBI</a>	Red River Bancshares, Inc.
54	<a href="#">SPFI</a>	South Plains Financial, Inc.
55	<a href="#">MCBS</a>	MetroCity Bankshares, Inc.
56	<a href="#">SMBC</a>	Southern Missouri Bancorp, Inc.
57	<a href="#">MCBC</a>	Macatawa Bank Corporation
58	<a href="#">SMMF</a>	Summit Financial Group, Inc.
59	<a href="#">FNLC</a>	The First Bancorp, Inc.

## Weekly Round-Up: News & Notes About Portfolio Companies

Many of our portfolio companies are surfing their 20MAs higher. Two companies release earnings in the next two weeks:

- Qualitas (Q): April 20th
- Cleveland Cliffs (CLF): April 22nd

There are a few charts that have our short-term attention. We'd like Micron (MU) to fall towards \$84 and bounce on its lower support level. We'd also like to see continued sideways consolidation in Nintendo (NTDOY) and hopeful for an upside breakout in XP before adding another leg to our long position.

We remain active, searching for great Mexican businesses trading at steep discounts (like HCITY). A few more of those, and we'd craft a beautiful long-Mexico basket.