Bank of New York Mellon (BK)

Updated May 31st, 2018 by Josh Arnold

Key Metrics

Current Price:	$55	**5 Year CAGR Estimate:**	10.9%	**Quality Percentile:**	N/A
Fair Value Price:	$62	**5 Year Growth Estimate:**	7.0%	**Momentum Percentile:**	N/A
% Fair Value:	90%	**5 Year Valuation Multiple Estimate:**	2.2%	**Total Return Percentile:**	N/A
Dividend Yield:	1.7%	**5 Year Price Target**	$86	**Valuation Percentile:**	N/A

Overview & Current Events

Bank of New York Mellon opened its doors in 1784 in the wake of the American Revolution, founded in part by Alexander Hamilton. The company was the first ever to make a loan to the US government and in the 230+ years since, has grown to $17B in annual revenue and a market cap of $56B.

BK's recently reported Q1 was outstanding as EPS rose 33% YoY. Strength came from a lower tax rate as well as share repurchases, but even excluding those items, operating EPS was up 23%. BK saw its fee revenue increase 10% while net interest revenue was up 16%, far outpacing growth in expenses, which increased 4%. It also saw assets under custody and/or administration up 9% YoY as it continues to grow its fee-heavy revenue over time. Finally, it bought back $644M in stock during the quarter, good for just over 1% of the float.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.20	$1.07	$2.14	$2.03	$2.03	$1.74	$2.41	$2.85	$3.17	$3.31	***$4.25***	***$5.95***
DPS	$0.96	$0.51	$0.36	$0.48	$0.52	$0.58	$0.66	$0.68	$0.72	$0.86	***$0.96***	***$1.35***

BK's EPS were a bit underwhelming coming out of the crisis as earnings were roughly flat for 6 years. However, since 2013 we've seen strong growth from BK as it has worked out its efficiency issues and has been better able to capitalize on its revenue growth. To that end, we are forecasting robust 7% EPS growth annually moving forward in a continuation of the trend we've seen in the past five years.

BK will achieve this growth in a variety of ways. First, revenue continues to grow in the mid-single digits, something which we expect to continue. BK is different from the other large banks in that its revenue is heavily dependent upon fees, not from interest income. Its assets under custody and administration continue to grow, which is a key driver of fee income. Its lending business is small but growing and continues to add to top line growth as well. It is important to remember that BK has very little exposure to interest rate movement because of its reliance upon fees, so that risk isn't present as it is for most other banks. We also see BK continuing its mid-single digit pace of share repurchases, resulting in a meaningful tailwind for EPS outside of revenue and earnings growth. Finally, we expect margins to continue to improve slightly over time as BK realizes additional operating leverage from higher revenue outpacing expense growth.

The dividend isn't a huge draw here as BK has never really been an income stock, but it is roughly at the broad market average at 1.7% today. We see the dividend rising from $0.96 to $1.35 in 5 years, keeping pace with EPS growth.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	31.8	---	13.0	12.4	11.2	17.2	15.1	14.5	12.7	15.1	***13.0***	***14.5***
Avg. Yld.	2.5%	1.9%	1.3%	1.9%	2.3%	1.9%	1.8%	1.6%	1.8%	1.7%	***1.7%***	***1.6%***

BK's PE multiple has been fairly steady since the crisis ended and today, it stands at 13. That is below what we assess as fair value at 14.5 and as such, we foresee a 2.2% tailwind to total returns as the multiple returns to more normalized levels over time. With the large banks selling off of late, BK looks to be a bargain at present. We see the yield as remaining roughly where it is today but the rising valuation may cause it to tick down to 1.6% from today's 1.7%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
ROA	0.60%	---	1.09%	0.77%	0.70%	0.59%	0.76%	0.82%	1.07%	0.99%	***1.08%***	***1.15%***
Debt/A	88%	86%	87%	90%	90%	90%	90%	90%	88%	89%	***89%***	***89%***
Int. Cov.	1.8	---	7.4	5.6	6.8	10.4	10.2	15.4	11.6	5.2	***5.0***	***4.2***
Payout	80%	---	16%	24%	25%	34%	28%	27%	25%	29%	***23%***	***23%***
Std. Dev.	32.6%	43.8%	24.4%	30.1%	21.5%	16.0%	17.8%	20.6%	26.2%	14.3%	***19.0%***	***24.0%***

BK's quality metrics have moved around a bit over the past decade but on the whole, they have improved. Its margins are much higher with ROA in excess of 1% after years of sub-1% results. We see that continuing as BK enjoys its lower tax rate as well as its additional operating leverage moving forward via prudent expense controls. BK's balance sheet is very steady at around 90% of assets financed by liabilities but its interest coverage has declined in recent years. We expect that will continue in the coming years, although the damage will be slight and is not a worry at this point given strength in the fee business and cost controls.

BK's competitive advantage is in its lack of reliance upon lending to make its money. This allows it to perform relatively well during recessions when other banks are struggling and while it isn't immune to downturns, its fee model is much more resilient to such conditions than a bank that makes the majority of its revenue from interest income.

Final Thoughts & Recommendation

Overall, BK looks like an undervalued stock with strong growth potential. We are forecasting total annual returns of 10.9% going forward, consisting of the current 1.7% yield, 7% EPS growth and a 2.2% tailwind from the rising valuation. BK's recent selloff has made the stock attractive once more and we see it as appropriate for those investors seeking value or growth, as well as those that may be seeking diversification from traditional banks. BK's fee model works and with its new focus on cost controls, the future looks bright.

Total Return Breakdown by Year