



U.S. Bancorp (USB)

Updated May 31st, 2018 by Josh Arnold

Key Metrics

Current Price: \$50	5 Year CAGR Estimate: 11.8%	Quality Percentile: N/A
Fair Value Price: \$57	5 Year Growth Estimate: 6.5%	Momentum Percentile: N/A
% Fair Value: 87%	5 Year Valuation Multiple Estimate: 2.9%	Total Return Percentile: N/A
Dividend Yield: 2.4%	5 Year Price Target: \$79	Valuation Percentile: N/A

Overview & Current Events

U.S. Bancorp traces its lineage back to 1863 when the First National Bank of Cincinnati opened for business. The company has since become one of the largest banks in the US with 73,000 employees, an \$82B market cap, and \$23B in annual revenue.

USB's recently reported Q1 was strong, continuing an impressive streak of operating efficiency and profitability that few banks can rival. Revenue was up 3.4% YoY on strength in net interest income and higher loan balances. USB's efficiency ratio increased slightly but the company's industry-leading profitability metrics improved further as ROA moved up 15bps to 1.50% and ROTCE was a staggering 19.3%, up from 17.2% a year ago. USB's Q1 was a continuation of years of very strong metrics and earnings as EPS was up 17%.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$1.61	\$0.97	\$1.73	\$2.46	\$2.84	\$3.00	\$3.08	\$3.16	\$3.24	\$3.51	\$4.05	\$5.55
DPS	\$1.70	\$0.20	\$0.20	\$0.50	\$0.78	\$0.89	\$0.97	\$1.01	\$1.07	\$1.16	\$1.22	\$1.65

USB's EPS history has been strong since the crisis ended as it is one of very few banks to actually grow earnings every year since 2009. USB's strength has always been in its prudent balance sheet management and focus on operating like a regional bank despite its massive size, focusing on core lending activities in lieu of trading and other money center bank lines of business. Average earnings growth hasn't been overly impressive; we expect 5.2% each year going forward.

USB will achieve this by accruing the benefits of several tailwinds. First, it is seeing a much lower tax rate from recent legislation, boosting its share of operating income that makes its way to shareholders. Second, it continues to grow its loan book at low single digit rates, providing a small but meaningful tailwind to revenue. Third, net interest income continues to rise as rates move higher but USB is slow to pass that benefit on to its depositors. USB's rate on interest-bearing liabilities is rising with short-term rates but it is rising more slowly than USB is increasing its average loan rate, boosting margins. Fourth, USB buys back a small amount of shares and while this won't be a primary source of EPS growth, we can expect perhaps 1% annually in EPS growth from the buyback as well. Overall, USB's earnings outlook appears to be much like it has in the past several years; this is a very well run bank with moderate growth prospects.

USB's payout ratio is in line with its peers and we expect growth in the payout to keep pace with EPS, growing to \$1.65 in five years. That would keep the payout ratio around 30% of earnings and in line with USB's capital return strategy.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	19.2	19.8	14.0	10.3	11.1	12.0	13.7	13.7	13.2	15.0	12.3	14.2
Avg. Yld.	5.5%	1.0%	0.8%	2.0%	2.5%	2.5%	2.3%	2.3%	2.5%	2.2%	2.4%	2.1%

USB's P/E multiple has moved up in recent years as the bank has become more highly valued by investors than its competitors due to its outstanding profitability metrics. The valuation has dipped more recently to 12.3 and we expect that number will move up to its historical average at 14.2, providing a nice 2.9% tailwind to total returns in the process. The combination of rising earnings and a higher valuation should send the yield back down slightly to 2.1% over time, but keep USB roughly in line with its large bank peers on that metric.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
ROA	1.11%	0.80%	1.08%	1.43%	1.60%	1.60%	1.45%	1.41%	1.32%	1.35%	1.45%	1.45%
Debt/A	90%	91%	90%	90%	89%	89%	89%	89%	89%	89%	89%	89%
Int. Cov.	2.5	3.7	4.3	4.6	5.5	6.4	7.3	7.5	6.8	5.2	4.9	4.2
Payout	106%	34%	14%	22%	30%	32%	34%	34%	36%	36%	30%	30%
Std. Dev.	35.9%	72.6%	25.5%	24.2%	16.2%	10.2%	14.5%	14.5%	18.3%	12.8%	17.0%	20.0%

USB's quality metrics have been largely stagnant for a long time but given how strong these numbers are, that's a good thing. We expect USB's ROA number to stay right where it is as well as its balance sheet leverage, which hasn't budged for a decade. Interest coverage may decline slightly depending upon what happens with short and long term rates but as of now, there is no danger of USB seeing any sort of meaningful impact from that. We expect the payout ratio to remain where it is around 30% of earnings, although if EPS growth exceeds our expectations, we may see a bit more growth.

USB's competitive advantage is in its stellar operating history and world-class management team. It operates as a regional bank but on a massive scale and as a result, it is stronger through recessions than its larger peers. Indeed, earnings weren't even cut in half in 2009 when many banks were struggling just to stay in business, and USB came out of the recession in better shape in relation to its competitors than it was before the crisis.

Final Thoughts & Recommendation

USB looks like a well-priced way to own some exposure to large banks. We are expecting robust 11.8% annual total returns moving forward, consisting of the current 2.4% yield, 5.2% EPS growth and a 2.9% tailwind from a rising valuation. USB posted disappointing returns in 2017 but if history is a guide, the stock is at a nice entry point for longer term investors. The company's focus on efficiency and industry-leading operating metrics makes it a buy for those seeking safe, moderate levels of growth as well as value. In addition, the current yield is better than the broader market and will reward shareholders while they wait for the valuation to return to normalized levels.

Total Return Breakdown by Year

