U.S. Bancorp (USB)

Updated July 19th, 2018 by Josh Arnold

Key Metrics

Current Price:	$51	**5 Year CAGR Estimate:**	11.5%	**Volatility Percentile:**	16.4%
Fair Value Price:	$57	**5 Year Growth Estimate:**	6.5%	**Momentum Percentile:**	33.2%
% Fair Value:	88%	**5 Year Valuation Multiple Estimate:**	2.6%	**Valuation Percentile:**	76.9%
Dividend Yield:	2.4%	**5 Year Price Target**	$79	**Total Return Percentile:**	72.4%

Overview & Current Events

U.S. Bancorp traces its lineage back to 1863 when the First National Bank of Cincinnati opened for business. It has since grown to 73,000 employees, an $83 billion market capitalization, and $23 billion in annual revenue.

U.S. Bancorp reported Q2 earnings on 7/18/18 and results were terrific. Earnings-per-share rose 20% over last year's Q2, mostly due to operating leverage. Revenue was up 3.5% as higher net interest margins led to better net interest income, along with slightly higher loan balances. Total noninterest income rose on strength in payment services, as well as investment management fees, which offset marked weakness in the mortgage business. Credit quality continues to improve as well as U.S. Bancorp continues to produce stellar results.

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***

U.S. Bancorp's earnings-per-share history has been strong since the crisis ended as it is one of very few banks to grow earnings every year since 2009. Its strength has always been in its prudent balance sheet management and focus on operating like a regional bank despite its massive size. The bank also focuses on core lending activities rather than trading and other lines of business. We expect U.S. Bancorp to see 6.5% earnings growth in the coming years.

It 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 U.S. Bancorp is slow to pass that benefit on to its depositors. Its rate on interest-bearing liabilities is rising with short-term rates but it is rising more slowly than U.S. Bancorp is increasing its average loan rate, boosting margins, as we saw again in Q2. Fourth, it buys back a small number of shares and while this won't be a primary source of earnings-per-share growth, we can expect perhaps 1% annually in additional growth from the buyback. Overall, U.S. Bancorp'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.

U.S. Bancorp's payout ratio is in line with its peers and we expect growth in the payout to keep pace with earnings-per-share, 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, affording it the opportunity to continue to buy back shares.

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	***12.5***	***14.2***
Avg. Yd.	5.5%	1.0%	0.8%	2.0%	2.5%	2.5%	2.3%	2.3%	2.5%	2.2%	***2.4%***	***2.1%***

U.S. Bancorp's price-to-earnings ratio 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 recently to 12.5, however, and we expect it will move up to its historical average at 14.2, providing a nice 2.6% 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%***

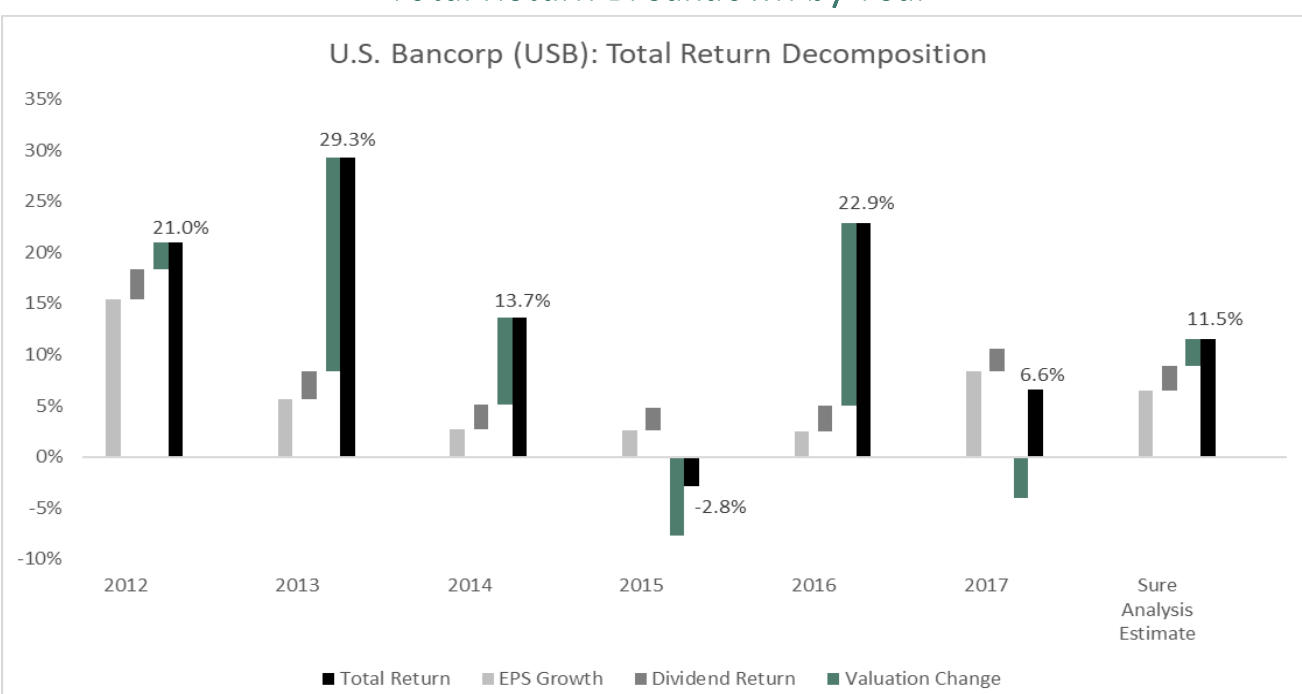
U.S. Bancorp's quality metrics have been largely stagnant for a long time but given how strong these numbers are, that's a good thing. We expect return on assets to stay right where it is as well as its balance sheet leverage, which hasn't budged for a decade. Interest coverage may decline slightly depending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

U.S. Bancorp'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 has been 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 U.S. Bancorp came out of the recession in better shape in relation to its competitors than it was before the crisis.

Final Thoughts & Recommendation

U.S. Bancorp looks like a well-priced way to accumulate some exposure to large banks. We are expecting robust 11.5% annual total returns moving forward, consisting of the current 2.4% yield, 6.5% earnings-per-share growth and a 2.6% tailwind from a rising valuation. U.S. Bancorp 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



Disclosure: This analyst has no position in the security discussed in this article, and no plans to initiate one in the next 72 hours.