



# Bank of America (BAC)

Updated October 15<sup>th</sup>, 2018 by Jonathan Weber

## Key Metrics

<b>Current Price:</b>	\$28	<b>5 Year CAGR Estimate:</b>	14.1%	<b>Volatility Percentile:</b>	79.7%
<b>Fair Value Price:</b>	\$34	<b>5 Year Growth Estimate:</b>	8.2%	<b>Momentum Percentile:</b>	72.5%
<b>% Fair Value:</b>	82%	<b>5 Year Valuation Multiple Estimate:</b>	3.8%	<b>Growth Percentile:</b>	79.0%
<b>Dividend Yield:</b>	2.1%	<b>5 Year Price Target</b>	\$50	<b>Valuation Percentile:</b>	81.9%
<b>Dividend Risk Score:</b>	D	<b>Retirement Suitability Score:</b>	D	<b>Total Return Percentile:</b>	83.1%

## Overview & Current Events

Bank of America provides all the traditional banking services as well as non-banking financial services. Its operations include Consumer Banking, Wealth & Investment Management and Global Banking & Markets. Bank of America was founded in 1904, is headquartered in Charlotte, NC, and is currently valued at \$290 billion, making it one of the biggest financial companies in the world.

Bank of America reported its third quarter earnings results on October 15. The company recorded revenues of \$22.8 billion during the quarter, an increase of 4.3% year over year. The higher revenue was based on higher net interest income and growth in the bank's other business units. The bank earned \$0.66 per share during Q3, an increase of 43% year over year. Profits were driven by lower taxes, higher revenues, and by lower operating expenses.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$0.55	-	-	\$0.01	\$0.25	\$0.90	\$0.36	\$1.31	\$1.50	\$1.83	<b>\$2.50</b>	<b>\$3.71</b>
<b>DPS</b>	\$2.24	\$0.04	\$0.04	\$0.04	\$0.04	\$0.04	\$0.12	\$0.20	\$0.25	\$0.39	<b>\$0.54</b>	<b>\$1.25</b>
<b>Shares</b>	5.02B	8.65B	10.1B	10.5B	10.8B	10.6B	10.5B	10.4B	10.1B	10.3B	<b>9.80B</b>	<b>8.70B</b>

Bank of America's earnings and dividend history over the last decade do not look compelling at first sight. Both earnings and dividends were decimated during the last financial crisis, which made the share price drop substantially, whilst at the same time income investors' dividend stream all but stopped flowing. The last financial crisis was not a regular recession, though, thus a hit to Bank of America's profitability of that dimension is something very unusual.

Bank of America's profits have recovered nicely over the last couple of years, although the impact of the last financial crisis was clearly visible up to 2014. Going forward Bank of America should be able to remain on growth track, although the 43% earnings per share growth rate we have seen during the third quarter will not be the new standard.

In the coming years a couple of factors should provide earnings growth for Bank of America. The first one is that the bank's loan portfolio keeps growing. During Q3 the bank was able to grow its average loan balances across its businesses by 3%. The average loan balance during the quarter was \$871 billion. Loan balances were up in the consumer segment as well as in Bank of America's commercial business. Despite a decline in the spread between short-and-long-term interest rates that could be observed in treasuries, Bank of America was able to grow its net interest margin slightly, which is why net interest income grew by 6.3% during the third quarter.

Bank of America is also focused on minimizing expenses. The bank has been able to lower its efficiency ratio to 57% during Q3, down from 61% one year earlier. Last but not least, Bank of America has made meaningful progress in reducing its share count during the current year, a trend which is likely to continue going forward.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	---	---	---	---	---	15.0	---	12.6	10.3	13.5	<b>11.2</b>	<b>13.5</b>
<b>Avg. Yld.</b>	7.3%	0.3%	0.3%	0.4%	0.5%	0.3%	0.7%	1.2%	1.6%	1.6%	<b>2.1%</b>	<b>2.5%</b>

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During the last financial crisis Bank of America operated at a loss. This makes it difficult to put Bank of America's current valuation in a historic context, as its median PE ratio is 37. With a solid growth outlook and a healthy balance sheet it seems likely that Bank of America's valuation will expand to a low-teens earnings multiple.

Bank of America's dividend yield isn't very high right now, but the dividend growth rate has been quite high over the last couple of years, which is why the dividend yield will likely continue to rise going forward.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
Debt/A	90.1%	89.7%	90.3%	89.2%	89.1%	89.0%	88.6%	88.3%	87.7%	88.2%	<b>87.9%</b>	<b>87.5%</b>
Payout	---	---	---	---	16.0%	4.4%	33.3%	15.3%	16.7%	21.3%	<b>20.8%</b>	<b>33.7%</b>
Std. Dev.	70.4%	127%	31.6%	36.5%	45.5%	19.9%	18.8%	22.4%	21.7%	19.3%	<b>21.0%</b>	<b>23.0%</b>

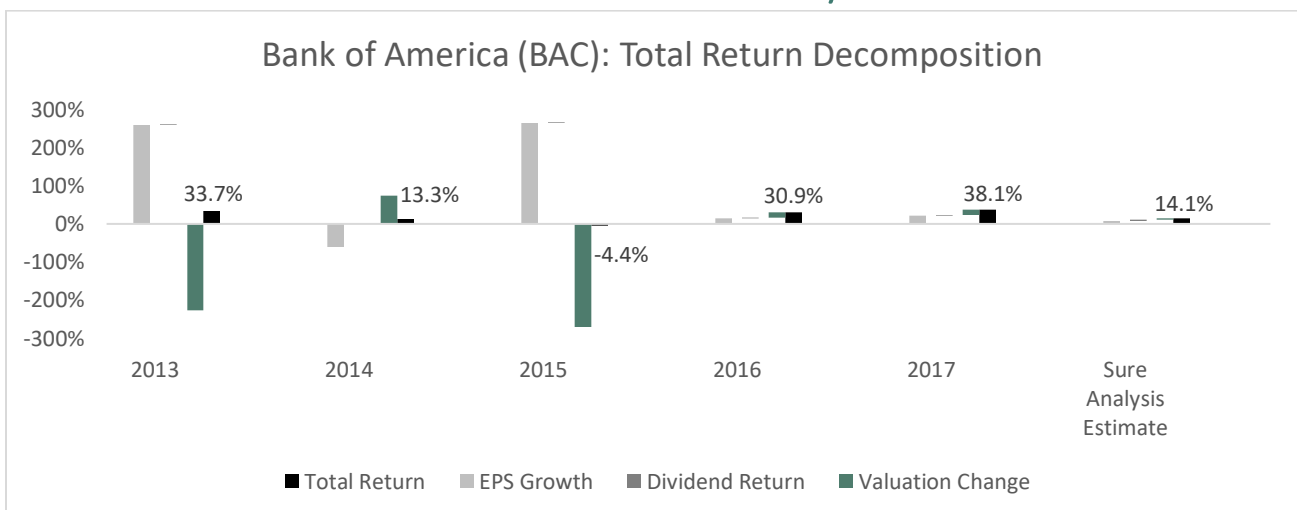
In the above table we see that Bank of America's assets are financed via debt primarily, which is no surprise. Borrowing money and lending it to someone else at a higher rate is a financial institution's primary function. Bank of America's equity ratio has grown somewhat over the last decade, from 10% to 12%, which is a solid number for a bank. The risk for another financial crisis is low, and credit quality at Bank of America is strong as well, as the net charge-off ratio declined further to 0.40% during Q3 of 2018. The ratio of non-performing assets, now 0.59%, declined further during Q3 as well.

Bank of America competes with the biggest banks of the United States. Wells Fargo's (WFC) scandals that were uncovered over the last couple of years are a tailwind for Bank of America, as some customers are moving their accounts to Bank of America because of these scandals, which explains why Bank of America's loan and deposits growth is faster than that of Wells Fargo. Bank of America also is the leader in online banking with more than 35 million active digital banking users and strong growth rates across its digital payments solutions.

## Final Thoughts & Recommendation

Bank of America was hit hard during the last financial crisis. Bank of America is in a solid position right now, though, as its earnings are growing, its dividend experiences a strong growth rate, and its balance sheet looks healthy. Shares trade below fair value right now, and due to the strong expected total returns we rate shares of Bank of America a buy for those seeking exposure to the banking industry. For retirees, Bank of America earns a D rating for both Dividend Safety and Retirement Suitability due to its short dividend history and significant historical stock price drawdowns.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	75.7	112.5	105.0	86.1	81.3	86.0	85.9	83.0	83.7	87.4
SG&A Expense	31.9	52.4	57.3	64.5	60.4	58.6	65.9	49.2	47.3	47.2
D&A Expense	3.3	4.3	3.9	3.5	3.0	2.7	2.5	2.4	2.2	2.1
Net Profit	4.0	6.3	-2.2	1.4	4.2	11.4	5.5	15.9	17.8	18.2
Net Margin	5.3%	5.6%	-2.1%	1.7%	5.2%	13.3%	6.4%	19.2%	21.3%	20.9%
Free Cash Flow	1.9	127.5	81.6	63.1	-16.1	92.8	30.8	28.4	18.4	10.4
Income Taxes	0.4	-1.9	0.9	-1.7	-1.1	4.7	2.4	6.3	7.2	11.0

## Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	1818	2230.2	2264.9	2129.0	2210.0	2102.3	2104.5	2144.3	2188.1	2281.2
Cash & Equivalents	42.4	145.5	134.9	146.1	129.4	142.9	146.1	167.1	157.6	168.6
Accounts Receivable	37.6	82.0	85.7	67.0	71.5	59.4	61.8	58.3	58.8	61.6
Goodwill & Int. Ass.	103.5	118.1	99.0	85.5	82.5	80.5	77.9	76.6	71.7	71.3
Total Liabilities	1641	1998.8	2036.7	1898.9	1973.0	1869.6	1861.1	1888.1	1921.9	2014.1
Long-Term Debt	426.3	508.0	508.4	408.0	306.3	295.7	274.3	264.9	240.8	260.1
Shareholders' Equity	139.4	194.2	211.7	211.7	218.2	219.3	224.2	233.9	241.0	244.8
D/E Ratio	2.4	2.2	2.2	1.8	1.3	1.3	1.1	1.0	0.9	1.0

## Profitability Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	0.2%	0.3%	-0.1%	0.1%	0.2%	0.5%	0.3%	0.7%	0.8%	0.8%
Return on Equity	2.8%	3.8%	-1.1%	0.7%	1.9%	5.2%	2.5%	6.9%	7.5%	7.5%
ROIC	0.7%	0.9%	-0.3%	0.2%	0.7%	2.1%	1.1%	3.1%	3.5%	3.5%

Note: All figures in billions of U.S. Dollars.

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