Bank of New York Mellon (BK)

Updated October 19th, 2018 by Josh Arnold

Key Metrics

Current Price:	$48	**5 Year CAGR Estimate:**	14.6%	**Volatility Percentile:**	49.0%
Fair Value Price:	$62	**5 Year Growth Estimate:**	7.0%	**Momentum Percentile:**	23.2%
% Fair Value:	77%	**5 Year Valuation Multiple Estimate:**	5.3%	**Growth Percentile:**	62.7%
Dividend Yield:	2.3%	**5 Year Price Target**	$86	**Valuation Percentile:**	86.0%
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**Total Return Percentile:**	85.1%

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 bank was the first ever to make a loan to the US government and in the 230+ years since, has grown to $17+ billion in annual revenue and a market capitalization of $48 billion.

BNY Mellon reported Q3 earnings on 10/18/18 and results were strong. Earnings-per-share rose 13% against last year's Q3 as the bank saw revenue rise fractionally. Core fee revenue was essentially flat, but interest revenue increased 6%, aided by higher rates. Total noninterest expenses rose 3% thanks to continued technology investments, partially offset by increases in other areas. Management renewed its commitment to returning to revenue growth, an area where it has struggled in the past, including in Q3. Higher rates should help but the vast majority of BNY Mellon's revenue comes from fees, so that is where efforts are focused. We've reiterated our estimate of $4.25 per share in earnings this year.

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	***$1.12***	***$1.50***
Shares	1149	1209	1245	1249	1254	1142	1118	1085	1048	1013	***980***	***920***

BNY Mellon's earnings-per-share were a bit underwhelming coming out of the crisis as they were roughly flat for six years. However, the years since 2013 have seen BNY Mellon fix its efficiency issues, leading to better margins as it is now more prepared to take advantage of revenue increases. To that end, we are forecasting robust 7% earnings-per-share growth annually moving forward, in a continuation of the trend we've seen in the past five years.

BNY Mellon will achieve this growth in a variety of ways. First, revenue continues to grow in the mid-single digits, something we expect to continue despite Q3's relatively weak performance. BNY Mellon 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, as evidenced in Q3's results. We also see the bank continuing its low single digit pace of share repurchases, resulting in a meaningful tailwind for earnings-per-share outside of revenue and earnings growth. Finally, we expect margins to continue to improve slightly over time as the bank realizes additional operating leverage from higher revenue outpacing expense growth.

The dividend is not a huge draw as BNY Mellon has never really been an income stock, but it is slightly above the broad market average at 2.3% today, which is high for this stock. We see the dividend rising from $1.12 to $1.50 in 5 years.

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	***11.2***	***14.5***
Avg. Yld.	2.5%	1.9%	1.3%	1.9%	2.3%	1.9%	1.8%	1.6%	1.8%	1.7%	***2.3%***	***1.7%***

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BNY Mellon's price-to-earnings multiple has been fairly steady since the crisis ended but has fallen of late. Today, it stands at just 11.2, well below what we assess as fair value at 14.5. Given this, we foresee a 5.3% tailwind to total returns due to a rising valuation, which will also send the yield lower over time.

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***	***4.5***
Payout	80%	---	16%	24%	25%	34%	28%	27%	25%	29%	***26%***	***25%***
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%***

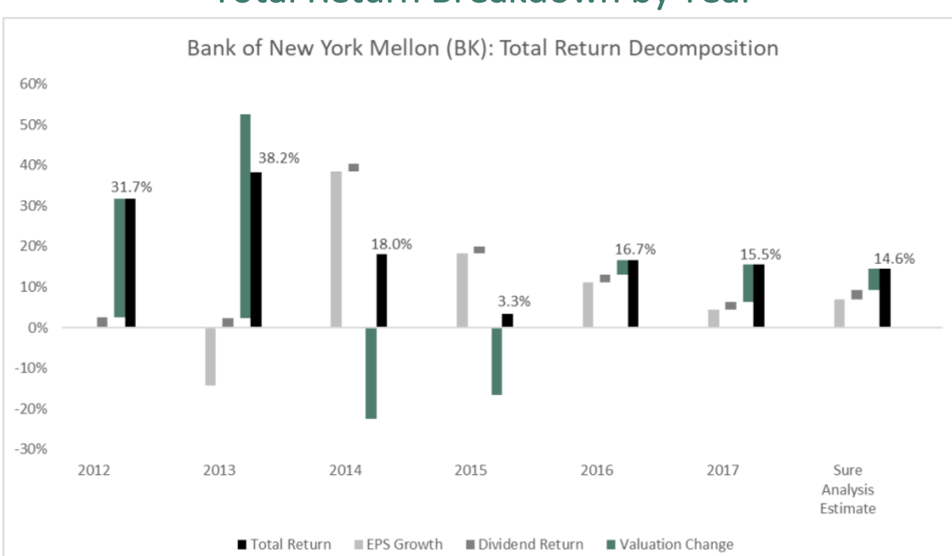
BNY Mellon's quality metrics have moved around a bit over the past decade but overall, they have improved. Its margins are much higher with return on assets in excess of 1% after years of sub-1% results. We see that continuing as it enjoys a lower tax rate as well as additional operating leverage moving forward via prudent expense controls. BNY Mellon'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, although the damage will be slight and is not a worry at this point given strength in the fee business and cost controls.

BNY Mellon's competitive advantage is in its lack of reliance upon lending for revenue. 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 more resilient to such conditions than a bank that makes the majority of its revenue from interest income.

Final Thoughts & Recommendation

Overall, BNY Mellon looks like an undervalued stock with strong growth potential. We are forecasting total annual returns of 14.6% going forward, consisting of the current 2.3% yield, 7% earnings growth and a 5.3% tailwind from the rising valuation. BNY Mellon's recent selloff has made the stock attractive 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. Bank of New York Mellon's model works and with its focus on cost controls, the future looks bright; we rate it a buy.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	13573	7654	13875	14314	14189	14613	15264	14813	14832	15124
SG&A Exp.	6037	5460	6002	5726	5761	6019	5845	5837	5733	5972
D&A Exp.	878	711	629	776	1246	1389	1292	1457	1502	1474
Net Profit	1419	-1084	2518	2516	2437	2104	2567	3158	3547	4090
Net Margin	10.5%	-14.2%	18.1%	17.6%	17.2%	14.4%	16.8%	21.3%	23.9%	27.0%
Free Cash Flow	2611	3463	3820	1569	977	-1251	3693	3526	5421	3444
Income Tax	491	-1395	1047	1048	842	1592	912	1013	1177	496

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets ($B)	237.51	212.22	247.26	325.27	358.99	374.52	385.30	393.78	333.47	371.76
Cash & Eq. ($B)	97.29	67.40	72.42	130.74	138.75	146.12	123.15	134.89	77.95	108.87
Acc. Receivable	619	639	508	4868	4848	4100	4773	4097	4628	5200
Goodwill & Int.	22361	21837	23738	24042	24001	23776	23328	22815	22365	22474
Total Liab. ($B)	209.46	183.22	214.10	291.18	321.73	336.24	346.83	355.01	294.04	330.19
Accounts Payable	9274	10721	9962	12671	16095	15707	21181	21900	20987	20184
Long-Term Debt	22349	17723	19385	19943	18868	19960	20264	21547	24463	31054
Total Equity	25264	28977	32354	33417	35363	35935	35879	35485	35269	37709
D/E Ratio	0.80	0.61	0.60	0.60	0.52	0.53	0.54	0.57	0.63	0.75

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	0.7%	-0.5%	1.1%	0.9%	0.7%	0.6%	0.7%	0.8%	1.0%	1.2%
Return on Equity	5.2%	-4.0%	8.2%	7.7%	7.1%	5.9%	7.1%	8.9%	10.0%	11.2%
ROIC	2.8%	-2.2%	5.1%	4.7%	4.4%	3.7%	4.4%	5.3%	5.7%	6.0%
Shares Out.	1149	1209	1245	1249	1254	1142	1118	1085	1048	1013
Revenue/Share	11.82	6.49	11.41	11.70	12.04	12.66	13.42	13.31	13.84	14.54
FCF/Share	2.27	2.94	3.14	1.28	0.83	-1.08	3.25	3.17	5.06	3.31

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.