Popular, Inc. (BPOP)

Updated October 25th, 2018 by Josh Arnold

Key Metrics

Current Price:	$49	**5 Year CAGR Estimate:**	9.3%	**Volatility Percentile:**	76.2%
Fair Value Price:	$64	**5 Year Growth Estimate:**	2.0%	**Momentum Percentile:**	96.6%
% Fair Value:	77%	**5 Year Valuation Multiple Estimate:**	5.3%	**Growth Percentile:**	5.0%
Dividend Yield:	2.0%	**5 Year Price Target**	$69	**Valuation Percentile:**	82.4%
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Total Return Percentile:**	45.6%

Overview & Current Events

Popular is a financial services company that traces its lineage back to the 1890's, when it was founded in Puerto Rico. The bank still calls the island home but has grown into several regions, including Central America, the Caribbean and the United States. Popular produces $1.7 billion in annual revenue and has a market capitalization of $5.0 billion.

Popular reported Q3 earnings on 10/24/18 and results were generally strong. Revenue rose 10% excluding an FDIC loss-share gain in last year's Q3. Net interest income gained 9% as yields on the loan portfolio remain strong and loans grew about 7%. Net interest margin was above 4% in Q3, reflecting strong yields, but charge-offs did rise slightly to 1% of loans held. Total operating expenses rose 8% as a result of higher labor costs and investments. Popular has Tier 1 equity capital of 16.2%, which is very high, showcasing the bank's strong balance sheet position. We've reiterated our estimate of $5.80 in earnings-per-share for 2018 after a Q3 report that was largely in-line with expectations.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$25.50	$15.70	$6.60	$1.40	$2.35	$2.55	$2.38	$3.18	$2.04	$2.67	***$5.80***	***$6.25***
DPS	$4.80	$0.20	--	--	--	--	--	$0.15	$0.60	$0.90	***$1.00***	***$1.75***
Shares	28	64	102	103	103	104	104	104	104	102	***102***	***102***

The Great Recession took an obvious toll on earnings and the bank's capital levels, while the weak economic situation in its home country has crimped further earnings growth more recently. In total, we see only 2% growth moving forward.

Popular continues to grab deposit market share and lend it prudently, leading to strong credit metrics. However, it appears credit quality may have plateaued, which removes a source of potential earnings growth, similar to many banks headquartered in the United States. Revenue should continue to climb at a low single digit rate but with net interest margin already near 4%, which is extraordinarily high compared to US banks, we see limited margin upside. Thus, despite Popular's operating metrics and prudent lending strategy, we see earnings growth as an uphill battle. It should be mentioned as well that Popular has nearly quadrupled its pre-Great Recession share count because it needed emergency capital and found it in the form of equity sales. This has kept a lid on earnings-per-share growth in the past decade as the share count mushroomed, and the new normal is going to be ~100 million shares.

The dividend was reinstated in 2015 after a years-long break following the Great Recession. It has since grown to $1.00 per share and we see continued growth in the payout as earnings have improved markedly. We are forecasting a dividend of $1.75 per share by 2023, which amounts to very respectable dividend growth from today's level.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	--	--	--	17.4	7.4	11.2	12.9	9.9	16.0	14.8	***8.5***	***11.0***
Avg. Yld.	5.4%	0.8%	--	--	--	--	--	0.5%	1.8%	2.5%	***2.0%***	***2.5%***

A spotty earnings history makes valuation analysis a bit tricky, but in recent years, the stock has traded with a low double-digit price-to-earnings multiple. Today, it stands at just 8.5, meaning we see the stock as offering good value

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

against our fair value estimate of 11 times earnings. Uncertainty with Puerto Rico's economy may continue to weigh on the stock, but we see a 5.3% tailwind to total annual returns from a higher valuation. We also forecast the dividend yield to rise to 2.5% over time as the payout increases more quickly than the stock price.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
ROA	--	--	--	0.41%	0.67%	0.75%	0.76%	2.50%	0.56%	0.62%	***1.20%***	***1.20%***
Debt/A	92%	93%	90%	90%	89%	87%	87%	86%	87%	88%	***88%***	***88%***
LLP/Loans	4.0%	6.3%	3.8%	2.3%	1.6%	2.5%	1.3%	1.1%	0.7%	1.3%	**1.0%**	**0.9%**
Payout	19%	1%	--	--	--	--	--	5%	29%	34%	***17%***	***28%***
Std. Dev.	71%	125%	66%	44%	43%	38%	25%	21%	32%	24%	***25%***	***30%***

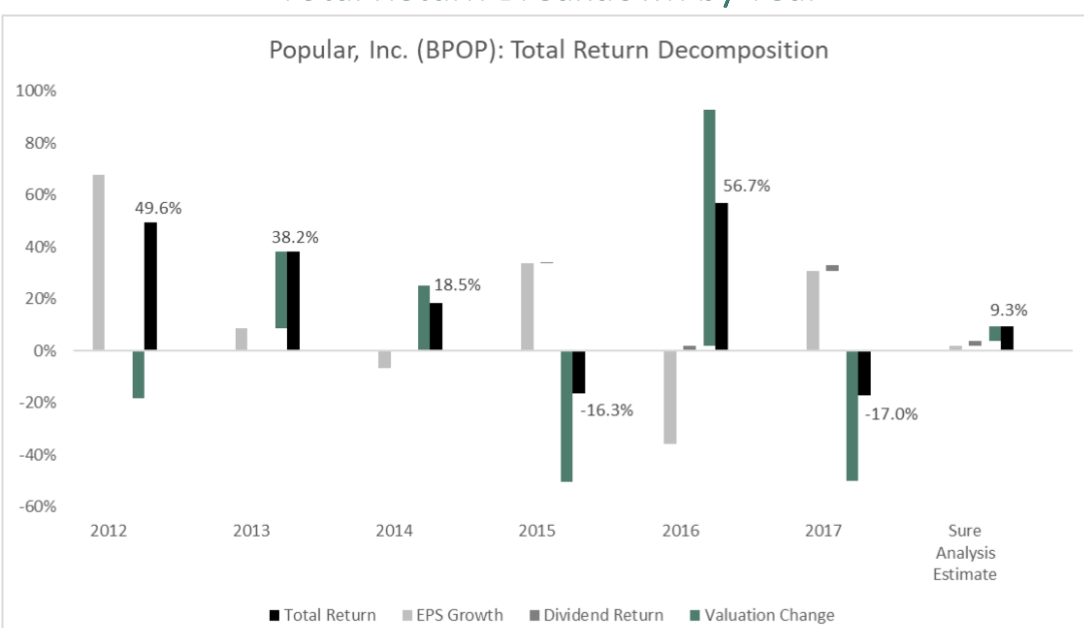
Popular's operating metrics have improved markedly since the depths of the Great Recession. Return on assets is around 1.2%, which is very high for a financial institution, while loan loss provisions have continued to improve and are now around 1% of total loans. We do not expect material deterioration in these key metrics, but the low-hanging fruit has certainly been picked. The payout ratio is still just 17% this year and we forecast it staying below 30% in the coming years, despite strong dividend growth. Popular likely wants to avoid another situation where it needs to cut the payout.

The bank's competitive advantage is in its enormous footprint in Puerto Rico and diversification in other countries in the region. Its balance sheet is also very strong, allowing for acquisitions and organic expansion. Recessions are not kind to Popular and the next one will almost certainly take a significant toll on earnings, which is true of almost any bank.

Final Thoughts & Recommendation

Overall, we see Popular as somewhat attractive given its favorable valuation and dividend growth prospects. We are forecasting total annual returns of 9.3%, consisting of 2% earnings growth, the 2% current yield and a 5.3% tailwind from a higher valuation. Popular would be attractive for dividend growth investors or those seeking value, but earnings growth looks to be limited. We rate Popular as a hold today given all of these factors.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	1921	1720	1929	1332	2136	1774	2052	1900	1998	2109
SG&A Exp.	592	589	582	596	658	685	681	667	706	752
D&A Exp.	58	59	58	57	58	57	56	68	74	85
Net Profit	108	217	895	-313	599	245	151	137	-574	-1244
Net Margin	5.6%	12.6%	46.4%	-23.5%	28.1%	13.8%	7.4%	7.2%	-28.7%	-59.0%
Free Cash Flow	573	489	544	822	781	467	625	95	558	1069
Income Tax	231	79	-495	58	-251	-26	115	108	-8	462

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	44277	38662	35762	33097	35749	36508	37348	38815	34736	38883
Cash & Equivalents	5658	3229	2447	2052	1101	1278	1584	1250	1227	1060
Acc. Receivable	8	47	124	122	72	126				
Goodwill & Int.	831	869	896	652	854	856	864	873	648	659
Total Liabilities	39173	33464	30656	28829	31123	32398	33430	35014	32198	35614
Long-Term Debt	1633	1576	1664	1733	1986	2414	2153	4534	2656	3392
Total Equity	5054	5148	5055	4217	4576	4060	3869	3750	2489	1785
D/E Ratio	0.32	0.30	0.33	0.41	0.43	0.59	0.55	1.19	1.05	1.04

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	0.3%	0.6%	2.6%	-0.9%	1.7%	0.7%	0.4%	0.4%	-1.6%	-3.0%
Return on Equity	2.1%	4.2%	19.3%	-7.1%	13.9%	6.2%	4.0%	4.4%	-26.9%	-48.0%
ROIC	1.6%	3.2%	14.0%	-5.0%	9.1%	3.9%	2.1%	2.0%	-9.7%	-15.2%
Shares Out.	28	64	102	103	103	104	104	104	104	102
Revenue/Share	18.83	16.64	18.70	12.95	20.72	17.28	20.07	21.46	48.94	75.04
FCF/Share	5.61	4.73	5.27	7.99	7.58	4.55	6.11	1.08	13.67	38.03

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

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