The Bank of New York Mellon Corp. (BK)

Updated January 18th, 2019 by Josh Arnold

Key Metrics

Current Price:	$52	**5 Year CAGR Estimate:**	10.6%	**Volatility Percentile:**	37.7%
Fair Value Price:	$55	**5 Year Growth Estimate:**	7.0%	**Momentum Percentile:**	42.9%
% Fair Value:	93%	**5 Year Valuation Multiple Estimate:**	1.4%	**Growth Percentile:**	64.3%
Dividend Yield:	2.2%	**5 Year Price Target**	$77	**Valuation Percentile:**	57.2%
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Total Return Percentile:**	55.3%

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 $16+ billion in annual revenue and a market capitalization of $51 billion.

BNY Mellon reported Q4 earnings on 1/16/19 and results were quite good. Adjusted revenue was up just 1%, but the bank made up for it with profitability improvements. Fee revenue, which makes up about 80% of the bank's total revenue, was down 1% during Q4. However, net interest revenue rose 4%, helping to offset some of the weakness in the core business. BNY Mellon's multi-year journey to reduce expenses continues and in Q4, noninterest expense fell 1% despite continued technology investments, slightly improving its efficiency ratio.

Assets under custody or management fell 1% as new business wasn't quite enough to offset losses from a stronger US dollar and lower market values. Those same factors helped send assets under management down 9% during the quarter.

BNY Mellon spent $1.4 billion in buybacks in Q4 and a further $278 million in dividends to shareholders. In addition, its capital position remains very strong with its Common Equity Tier 1 ratio at 10.6%, and its Supplementary Leverage Ratio at 6%. We see capital returns as a significant driver of total returns in the coming years as BNY Mellon reduces the float and pays cash dividends, which it can do thanks to its strong capital buffer.

We're out with an initial estimate for 2019 earnings-per-share of $4.25, which is only fractionally higher than 2018. We see recent divestitures as well as market volatility as playing a role in temporarily decelerating earnings growth. The long-term outlook for earnings growth has not materially changed, but near-term challenges exist.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$1.07	$2.14	$2.03	$2.03	$1.74	$2.41	$2.85	$3.17	$3.31	$4.21	***$4.25***	***$5.96***
DPS	$0.51	$0.36	$0.48	$0.52	$0.58	$0.66	$0.68	$0.72	$0.86	$1.04	***$1.12***	***$1.50***
Shares	1,209	1,245	1,249	1,254	1,142	1,118	1,085	1,048	1,013	1,007	***980***	***900***

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, although not necessarily in 2019. 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 over time, 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 Q4's rising net interest income. 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.

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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 2.2% today, which is high for this stock. We see the dividend rising from $1.12 to $1.50 in 5 years.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	---	13.0	12.4	11.2	17.2	15.1	14.5	12.7	15.1	12.6	***12.1***	***13.0***
Avg. Yld.	1.9%	1.3%	1.9%	2.3%	1.9%	1.8%	1.6%	1.8%	1.7%	2.0%	***2.2%***	***1.9%***

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 12.1, below what we assess as fair value at 13. We've moved our estimate of fair value lower from 14.5 given the near-term challenges of revenue growth, as well as generally lower peer valuations in the sector. Given this, we foresee a small 1.4% 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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	16%	24%	25%	34%	28%	27%	25%	29%	25%	***26%***	***25%***

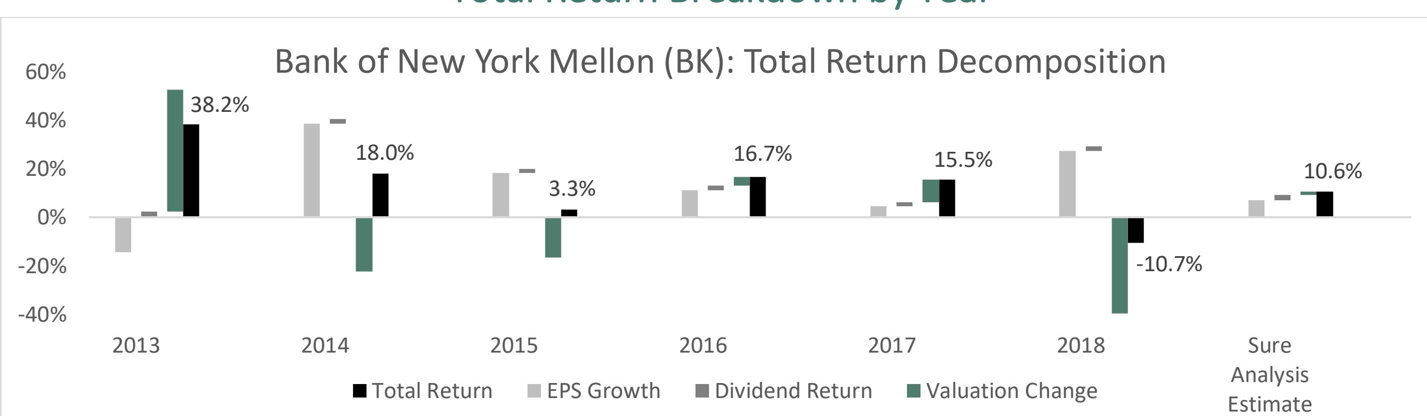
BNY Mellon's quality metrics have moved around a bit over the past decade but overall, they have improved. Its margins are much higher with return on assets in excess of 1% after years of sub-1% results. We see that continuing as it enjoys additional operating leverage moving forward via prudent expense 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 is not 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 a fairly valued stock with meaningful growth potential. We are forecasting total annual returns of 10.6% going forward, consisting of the current 2.2% yield, 7% earnings growth and a 1.4% tailwind from the valuation. BNY Mellon's recent selloff has made the stock attractive and we see it as appropriate for those investors seeking 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 at current prices.

Total Return Breakdown by Year



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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.

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	7654	13875	14314	14189	14613	15264	14813	14832	15124	15124
SG&A Exp.	5460	6002	5987	6036	6336	6113	6104	5978	6201	6262
D&A Exp.	711	629	776	1246	1389	1292	1457	1502	1474	N/A
Net Profit	-1084	2518	2516	2437	2104	2567	3158	3547	4090	4090
Net Margin	-14.2%	18.1%	17.6%	17.2%	14.4%	16.8%	21.3%	23.9%	27.0%	27.0%
Free Cash Flow	3463	3820	1569	977	-1251	3693	3526	5421	3444	N/A
Income Tax	-1395	1047	1048	842	1592	912	1013	1177	496	496

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets ($B)	212.22	247.26	325.27	358.99	374.52	385.30	393.78	333.47	371.76	362.87
Cash & Eq. ($B)	67.40	72.42	130.74	138.75	146.12	123.15	135.34	78.42	109.35	88.00
Acc. Receivable	639	508	4868	4848	4100	4773	4097	4628	5200	671
Goodwill & Int.	21837	23738	24042	24001	23776	23328	22815	22365	22474	20570
Total Liab. ($B)	183.22	214.10	291.18	321.73	336.24	346.83	355.01	294.04	330.19	322.13
Accounts Payable	10721	9962	12671	16095	15707	21181	21900	20987	20184	19731
Long-Term Debt	17723	19385	19943	18868	19960	20264	21547	24463	31054	31102
Total Equity	28977	32354	33417	35363	35935	35879	35485	35269	37709	37096
D/E Ratio	0.61	0.60	0.60	0.52	0.53	0.54	0.57	0.63	0.75	0.77

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	-0.5%	1.1%	0.9%	0.7%	0.6%	0.7%	0.8%	1.0%	1.2%	1.1%
Return on Equity	-4.0%	8.2%	7.7%	7.1%	5.9%	7.1%	8.9%	10.0%	11.2%	10.9%
ROIC	-2.2%	5.1%	4.7%	4.4%	3.7%	4.4%	5.3%	5.7%	6.0%	5.7%
Shares Out.	1,209	1,245	1,249	1,254	1,142	1,118	1,085	1,048	1,013	1,007
Revenue/Share	6.49	11.41	11.70	12.04	12.66	13.42	13.31	13.84	14.54	14.54
FCF/Share	2.94	3.14	1.28	0.83	-1.08	3.25	3.17	5.06	3.31	N/A

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