The Bank of New York Mellon Corp. (BK)

Updated July 20th, 2019 by Josh Arnold

Key Metrics

Current Price:	$45	**5 Year CAGR Estimate:**	11.0%	**Volatility Percentile:**	40.6%
Fair Value Price:	$51	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	23.6%
% Fair Value:	89%	**5 Year Valuation Multiple Estimate:**	2.3%	**Growth Percentile:**	52.6%
Dividend Yield:	2.7%	**5 Year Price Target**	$68	**Valuation Percentile:**	73.6%
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Total Return Percentile:**	66.0%

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 $46 billion. The bank is present in 35 countries around the world and acts as more of an investment manager than a traditional bank. Indeed, BNY Mellon's stated goal is help its customers manage their assets throughout the investment lifecycle. As such, BNY Mellon's revenue is mostly derived from fees, not traditional interest income.

BNY Mellon reported Q2 earnings on 7/17/19 and results were somewhat weaker than expected. In the context of the even weaker Q1 report, we're lowering our earnings-per-share estimate for this year from $4.10 to $3.90.

Total revenue was down 5% in Q2 to $3.9 billion, which was in line with consensus estimates prior to the release. Fee revenue was down 3% year-over-year as the bank continued to experience outflows in assets under management, which is a large source of fee revenue. In addition, BNY Mellon suffered from currency translation thanks to the stronger US dollar, and lower forex and securities lending revenue. Further, net interest income was down a staggering 12% year-over-year, reflecting further yield curve issues for BNY Mellon. Net interest margin was just 1.12% in Q2, a sizable decline against the 1.26% achieved in last year's Q2.

The bank's CEO said once again in the Q2 release that the shape of the yield curve remains a problem, and that low volatility in global stock and bond markets are negatively impacting results. These are similar to comments made after the Q1 report that sent the stock plummeting, and we see it is as further confirmation that our original earnings-per-share estimate will be missed this year.

On the bright side, expenses declined 4% against the year-ago period, helping to offset the weakness in revenue. This helped operating margin come in at 33% of revenue against 34% in last year's Q2 despite weak revenue.

In total, earnings-per-share came to $1.01, a 2% decline from the year-ago period.

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	***$3.90***	***$5.22***
DPS	$0.51	$0.36	$0.48	$0.52	$0.58	$0.66	$0.68	$0.72	$0.86	$1.04	***$1.24***	***$1.80***
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, since 2013 BNY Mellon has fixed 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 6% earnings-per-share growth annually moving forward, in a continuation of the trend we've seen in the past five years. Importantly, we see materially lower earnings-per-share this year due to the issues discussed above.

BNY Mellon can 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 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, Q2 results notwithstanding. Its lending business is small but growing and continues to add to top line growth as well, although this was not the case in Q2. We note that issues with AUM and lending margins tend to move in cycles, so BNY Mellon should see some respite from its headwinds over time. 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 above the broad market average at 2.7% today, which is high for this stock. We see the dividend rising from $1.24 to $1.80 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	***11.6***	***13.0***
Avg. Yld.	1.9%	1.3%	1.9%	2.3%	1.9%	1.8%	1.6%	1.8%	1.7%	2.0%	***2.7%***	***2.7%***

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 11.6, below what we assess as fair value at 13. Having previously lowered our fair value estimate, we don't see reason to cut it again off of the Q2 report. Given this, we foresee a small 2.3% tailwind to total returns due to a rising valuation, which could also send the yield slightly 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%	***32%***	***35%***

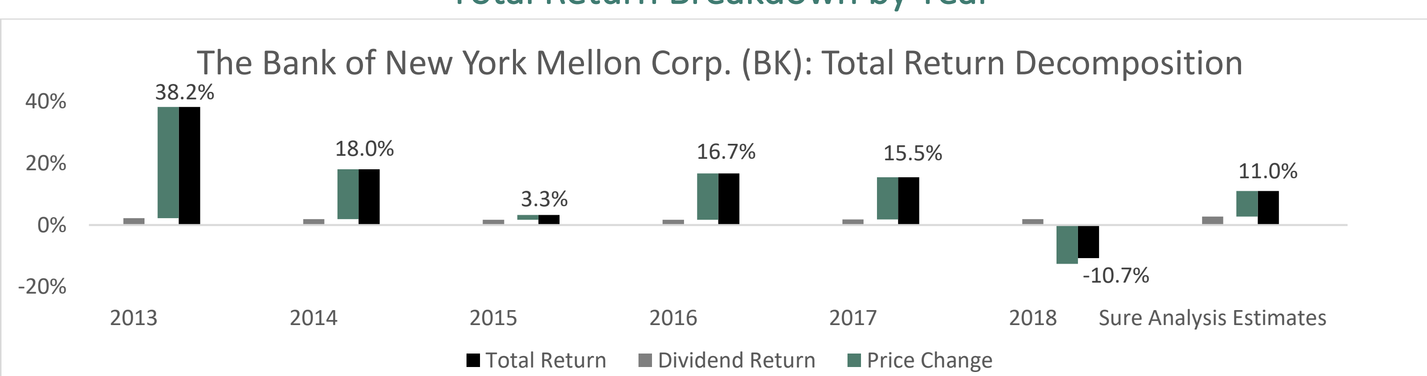
BNY Mellon's dividend is only about a third of its earnings, consistent with other large bank peers. That means the payout is very safe and we expect it to continue growing in the mid-single digits annually in the years to come.

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. While the company 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 11% going forward, consisting of the current 2.7% yield, 6% earnings growth and a 2.3% tailwind from the valuation. BNY Mellon's recent selloff has made the stock more attractive, despite its Q2 issues. We are reiterating BNY Mellon at a hold rating, however, due to its lending margins and AUM outflows.

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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	7654	13875	14314	14189	14613	15264	14813	14832	15124	15986
SG&A Exp.	5460	6002	5987	6036	6336	6113	6104	6054	6262	6373
D&A Exp.	711	629	776	1246	1389	1292	1457	1502	1474	1339
Net Profit	-1084	2518	2516	2437	2104	2567	3158	3547	4090	4266
Net Margin	-14.2%	18.1%	17.6%	17.2%	14.4%	16.8%	21.3%	23.9%	27.0%	26.7%
Free Cash Flow	3463	3820	1569	977	-1251	3693	3526	5442	3470	4888
Income Tax	-1395	1047	1048	842	1592	912	1013	1177	496	938

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
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	88.48
Acc. Receivable	639	508	4868	4848	4100	4773	4097	4628	5200	4363
Goodwill & Int.	21837	23738	24042	24001	23776	23328	22815	22365	22474	22222
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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	-0.5%	1.1%	0.9%	0.7%	0.6%	0.7%	0.8%	1.0%	1.2%	1.2%
Return on Equity	-4.0%	8.2%	7.7%	7.1%	5.9%	7.1%	8.9%	10.0%	11.2%	11.4%
ROIC	-2.2%	5.1%	4.7%	4.4%	3.7%	4.4%	5.3%	5.7%	6.0%	5.9%
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	15.87
FCF/Share	2.94	3.14	1.28	0.83	-1.08	3.25	3.17	5.08	3.34	4.85

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