



U.S. Bancorp (USB)

Updated July 20th, 2019 by Josh Arnold

Key Metrics

Current Price:	\$55	5 Year CAGR Estimate:	9.7%	Volatility Percentile:	24.8%
Fair Value Price:	\$57	5 Year Growth Estimate:	6.5%	Momentum Percentile:	60.1%
% Fair Value:	97%	5 Year Valuation Multiple Estimate:	0.5%	Growth Percentile:	64.8%
Dividend Yield:	2.7%	5 Year Price Target	\$77	Valuation Percentile:	63.0%
Dividend Risk Score:	B	Retirement Suitability Score:	B	Total Return Percentile:	60.0%

Overview & Current Events

U.S. Bancorp traces its lineage back to 1863 when the First National Bank of Cincinnati opened for business. It has since grown to 73,000 employees, an \$88 billion market capitalization, and \$23 billion in annual revenue. The bank has expanded from a regional player to a national powerhouse in recent years, becoming the fifth-largest bank by assets in the US. It competes mostly in traditional banking activities, but also offers wealth management, payment and investment services.

U.S. Bancorp reported Q2 earnings on 7/17/19 and results were in line with expectations. Revenue was up 3.2% year-over-year as net interest income rose 3.3% and noninterest income was up 3.1%. Net interest margin was off 3bps to 3.13%, but that fractional decline in margin was more than offset by loan growth. Indeed, total average loans were up 3.8% during the quarter as the bank saw strong growth in commercial and mortgage lending, respectively. In addition, deposits were up 3.1% to \$345 billion, adding to U.S. Bancorp's cheap funding base.

U.S. Bancorp's efficiency ratio came to 54.3%, down from 54.8% in the year-ago period. This is a very strong value against the bank's peers and shows how efficient U.S. Bancorp is a decade out from the financial crisis. While we expect the bank's efficiency ratio to remain low, Q2's value was so low that we believe U.S. Bancorp may be at or near its plateau in terms of driving operating expenses lower.

U.S. Bancorp's common equity tier 1 ratio, or CET1, is 9.5%, which is much lower than many of its peers that are in the 11%+ range. However, this is due to U.S. Bancorp's robust capital returns, and is still well in excess of regulatory minimums. We aren't concerned by the current value but will continue to monitor it should it fall further.

Earnings-per-share rose from \$1.02 in the year-ago period to \$1.09 this year, and after an in-line Q2, we're reiterating our estimate of \$4.35 for this year's earnings-per-share.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$0.97	\$1.73	\$2.46	\$2.84	\$3.00	\$3.08	\$3.16	\$3.24	\$3.51	\$4.14	\$4.35	\$5.96
DPS	\$0.20	\$0.20	\$0.50	\$0.78	\$0.89	\$0.97	\$1.01	\$1.07	\$1.16	\$1.34	\$1.48	\$2.00
Shares	1,913	1,921	1,910	1,869	1,825	1,786	1,745	1,697	1,656	1,608	1,560	1,350

U.S. Bancorp's earnings-per-share history has been strong since the crisis ended, as it is one of very few banks to grow earnings every year since 2009. We expect U.S. Bancorp to see 6.5% annual earnings growth in the coming years.

It will achieve this by accruing the benefits of several tailwinds. First, it continues to grow its loan book at low single digit rates, as it did again in Q2. Second, net interest income continues to rise as rates move higher, but U.S. Bancorp is slow to pass that benefit on to its depositors. Its rate on interest-bearing liabilities is rising with short-term rates but it is rising more slowly than U.S. Bancorp is increasing its average loan rate, boosting margins over time. Q2 saw a small deviation from this, but we believe long-term margins are intact. Third, it consistently repurchases its own stock, and we expect a low single digit tailwind annually from buybacks.

U.S. Bancorp's payout ratio is in line with its peers and we expect growth in the payout to keep pace with earnings-per-share, growing to \$2.00 in five years. That would keep the payout ratio around 35% of earnings and in line with the

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bank's capital return strategy, affording it the opportunity to continue to buy back shares. With revenue and margin growth becoming tougher this late in the cycle, the buyback will take on increasing importance in the coming years.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	19.8	14.0	10.3	11.1	12.0	13.7	13.7	13.2	15.0	12.7	12.6	13.0
Avg. Yld.	1.0%	0.8%	2.0%	2.5%	2.5%	2.3%	2.3%	2.5%	2.2%	2.6%	2.7%	2.6%

U.S. Bancorp's price-to-earnings ratio has moved up in recent years as the bank has become more highly valued by investors than its competitors due to its outstanding profitability metrics. The valuation is close to fair value at 12.6 earnings after a recent rally, so we see minimal impact from the valuation from here in the coming years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	34%	14%	22%	30%	32%	34%	34%	36%	36%	32%	34%	34%

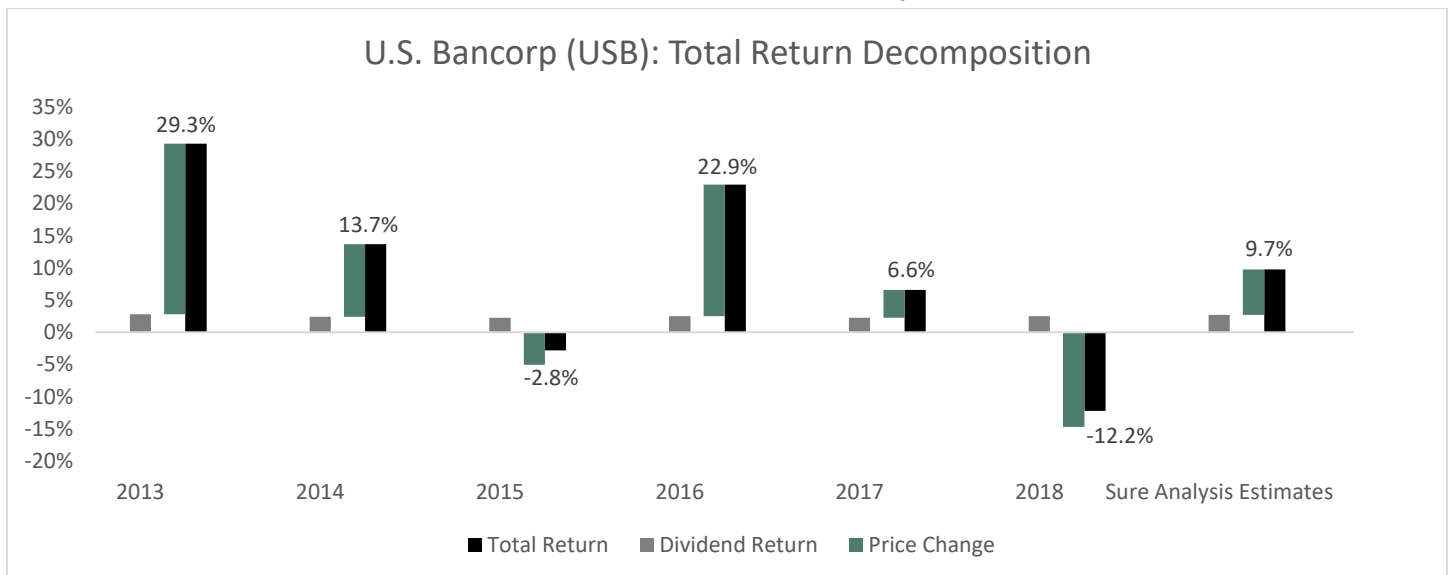
We see the payout remaining around one-third of earnings in the coming years, consistent with past years. U.S. Bancorp's dividend is very safe and we see no risk of a cut at this point. We see future growth in the payout as being roughly congruent with earnings expansion.

U.S. Bancorp's competitive advantage is in its stellar operating history and world-class management team. It operates as a regional bank but on a massive scale and as a result, it has been stronger through recessions than its larger peers. Indeed, earnings were not even cut in half in 2009 when many banks were struggling just to stay in business, and U.S. Bancorp came out of the recession in better shape in relation to its competitors than it was before the crisis.

Final Thoughts & Recommendation

We continue to like U.S. Bancorp's fundamentals but note that total prospective returns have declined thanks to the recent rally. We are expecting 9.7% annual returns moving forward, accruing from 6.5% earnings growth, the 2.7% current yield and a 0.5% tailwind from a rising valuation. U.S. Bancorp continues to look attractive for a variety of investors, and we reiterate our buy rating given that it is still under fair value and offers strong total returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	15186	17939	18883	20064	19378	19939	20093	21105	21852	22521
SG&A Exp.	4375	5878	6316	6778	7026	7137	7524	8032	8774	9124
D&A Exp.	607	596	565	561	520	501	481	470	468	N/A
Net Profit	2205	3317	4872	5647	5836	5851	5879	5888	6218	7096
Net Margin	14.5%	18.5%	25.8%	28.1%	30.1%	29.3%	29.3%	27.9%	28.5%	31.5%
Free Cash Flow	7600	5241	9820	7958	11446	5332	8782	5336	6472	N/A
Income Tax	395	935	1841	2236	2032	2087	2097	2161	1264	1554

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	281.18	307.79	340.12	353.86	364.02	402.53	421.85	445.96	462.04	467.37
Cash & Equivalents	6206	14487	13962	8252	8477	10654	11147	15705	19505	21453
Goodwill & Int.	12417	12167	11663	11849	12734	12551	12711	12647	12662	12761
Total Liab. (\$B)	254.52	277.46	305.15	313.59	322.21	358.36	375.04	398.03	412.37	415.72
Long-Term Debt	63892	64094	50740	42637	44276	59522	58216	46038	47855	55479
Total Equity	24463	27589	31372	34229	36357	38723	40630	41797	43621	45045
D/E Ratio	2.46	2.17	1.49	1.09	1.08	1.37	1.26	0.97	0.98	1.09

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	0.8%	1.1%	1.5%	1.6%	1.6%	1.5%	1.4%	1.4%	1.4%	1.5%
Return on Equity	10.3%	12.7%	16.5%	17.2%	16.5%	15.6%	14.8%	14.3%	14.6%	16.0%
ROIC	2.3%	3.6%	5.4%	6.7%	6.9%	6.2%	5.6%	5.9%	6.5%	6.9%
Shares Out.	1,913	1,921	1,910	1,869	1,825	1,786	1,745	1,697	1,656	1,608
Revenue/Share	8.17	9.34	9.82	10.58	10.48	11.00	11.34	12.24	12.98	13.75
FCF/Share	4.09	2.73	5.11	4.20	6.19	2.94	4.96	3.10	3.85	N/A

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

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