Popular, Inc. (BPOP)

Updated July 26th, 2019 by Josh Arnold

Key Metrics

Current Price:	$58	**5 Year CAGR Estimate:**	8.6%	**Volatility Percentile:**	75.5%
Fair Value Price:	$66	**5 Year Growth Estimate:**	2.0%	**Momentum Percentile:**	69.8%
% Fair Value:	80%	**5 Year Valuation Multiple Estimate:**	4.5%	**Growth Percentile:**	7.5%
Dividend Yield:	2.1%	**5 Year Price Target**	$80	**Valuation Percentile:**	78.7%
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Total Return Percentile:**	38.6%

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 $1.9 billion in annual revenue and has a market capitalization of $5.6 billion.

Popular reported Q2 earnings on 7/24/19 and results were terrific, handily beating estimates. Management cited increases in net interest income, or NII, noninterest income, loans, and deposits. Puerto Rico is rebounding from tough economic conditions more quickly than expected, and Popular is benefiting. Popular saw strength in auto and mortgage lending on the island, and its US business is now growing its loan book.

Quantitatively, NII was up slightly year-over-year as an extra day in the quarter helped to offset weakness in lending margins. Net interest margin was 4.11% in Q2 against 4.20% in the previous quarter. Popular saw strong activity from a variety of places, but continued upward pressure on deposit rates is weighing on margins. Higher funding costs offset much of the gains made with a larger loan book. Indeed, total loans held were $27 billion in Q2, up from $26.7 billion a year ago.

Total deposits were $42.1 billion, up more than $1 billion in just the past three months as Popular continues to gather deposits, albeit at slightly higher cost.

Credit quality has improved somewhat as loan loss allowances fell from 2.07% to 2.01%, although we note that banks outside the US tend to have much higher loss rates than US banks. The tradeoff is very high net interest margins.

Earnings-per-share fell from $2.73 to $1.76 year-over-year, but Popular received a very large income tax credit in the year-ago period that makes the comparison less meaningful. Against this year's Q1, earnings-per-share rose about 4% from $1.69. Following the Q2 report, we've boosted our estimate for 2019 earnings-per-share to $6.60 as the bank's recovery in earnings is happening more quickly than previously estimated.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	-$15.70	-$6.60	$1.40	$2.35	$2.55	$2.38	$3.18	$2.04	$2.67	$6.06	***$6.60***	***$7.29***
DPS	$0.20	---	---	---	---	---	$0.15	$0.60	$0.90	$1.00	***$1.20***	***$2.00***
Shares	64	102	103	103	104	104	104	104	102	100	***98***	***92***

The Great Recession took an obvious toll on earnings and the bank's capital levels, while the weak economic situation in its home market has further crimped earnings growth more recently. In total, we see only 2% growth moving forward, although we have bolstered our 2019 estimate after the Q2 report.

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 above 4%, we see limited margin upside. Indeed, Q2 results seem to support this thesis. 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.

The dividend was reinstated in 2015 after a years-long break following the Great Recession. It has since grown to $1.20 per share and we see continued growth in the payout as earnings have improved markedly. We are forecasting a dividend of $2.00 per share by 2024, which amounts to very respectable dividend growth from today's level.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	---	---	17.4	7.4	11.2	12.9	9.9	16.0	14.8	7.8	***8.8***	***11.0***
Avg. Yld.	0.8%	---	---	---	---	---	0.5%	1.8%	2.5%	2.1%	***2.1%***	***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 8.8, meaning we see the stock as offering good value 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 4.5% 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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	1%	---	---	---	---	---	5%	29%	34%	17%	***18%***	***27%***

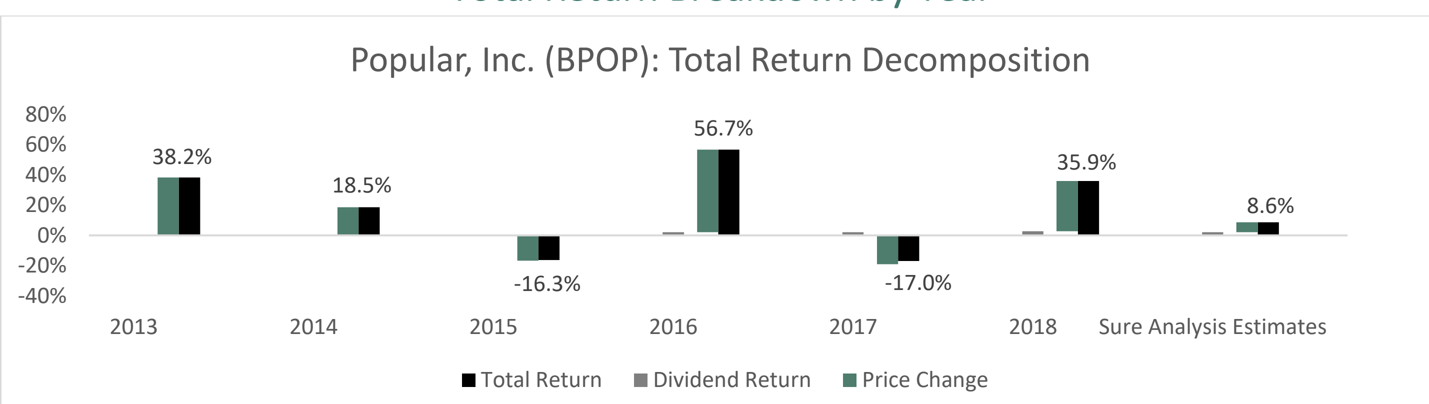
The payout ratio is under 20% this year and we forecast it staying at or below 30% in the coming years, despite strong dividend growth. Popular likely wants to avoid another situation where it needs to cut the payout. Given strong current earnings and a relatively low payout ratio, we see the payout as safe barring a sizable recession.

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 8.6%, consisting of 2% earnings growth, the 2.1% current yield and a 4.5% tailwind from a higher valuation. Popular would be attractive for dividend growth investors or those seeking value, but earnings growth appears to be limited. We continue to rate Popular as a hold today given all of these factors.

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	1998	1900	2043	1774	2116	1310	1929	1699	1895	2359
SG&A Exp.	706	667	699	685	642	612	582	659	683	792
D&A Exp.	74	68	56	57	58	57	58	59	58	63
Net Profit	-574	137	151	245	599	-313	895	217	108	618
Net Margin	-28.7%	7.2%	7.4%	13.8%	28.3%	-23.9%	46.4%	12.8%	5.7%	26.2%
Free Cash Flow	558	95	625	467	781	822	544	496	574	767
Income Tax	-8	108	115	-26	-251	58	-495	79	231	120

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	34736	38815	37348	36508	35749	33097	35762	38662	44277	47605
Cash & Equivalents	1227	1250	1584	1278	1101	2052	2447	3229	5658	4565
Acc. Receivable	N/A	N/A	195	263	203	189	203	185	221	206
Goodwill & Int.	648	873	864	856	854	652	896	869	831	868
Total Liabilities	32198	35014	33430	32398	31123	28829	30656	33464	39173	42170
Long-Term Debt	2656	4534	2153	2414	1986	1733	1664	1576	1614	1236
Total Equity	2489	3750	3869	4060	4576	4217	5055	5148	5054	5385
D/E Ratio	1.05	1.19	0.55	0.59	0.43	0.41	0.33	0.30	0.32	0.23

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	-1.6%	0.4%	0.4%	0.7%	1.7%	-0.9%	2.6%	0.6%	0.3%	1.3%
Return on Equity	-26.9%	4.4%	4.0%	6.2%	13.9%	-7.1%	19.3%	4.2%	2.1%	11.8%
ROIC	-9.7%	2.0%	2.1%	3.9%	9.1%	-5.0%	14.0%	3.2%	1.6%	9.2%
Shares Out.	64	102	103	103	104	104	104	104	102	100
Revenue/Share	48.94	21.46	19.98	17.28	20.53	12.74	18.70	16.44	18.57	23.29
FCF/Share	13.67	1.08	6.11	4.55	7.58	7.99	5.27	4.80	5.62	7.57

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