



# Farmers & Merchants Bancorp (FMCB)

Updated August 16<sup>th</sup>, 2019 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b>	\$766	<b>5 Year CAGR Estimate:</b>	13.4%	<b>Volatility Percentile:</b>	1.5%
<b>Fair Value Price:</b>	\$1,050	<b>5 Year Growth Estimate:</b>	5.0%	<b>Momentum Percentile:</b>	66.3%
<b>% Fair Value:</b>	73%	<b>5 Year Valuation Multiple Estimate:</b>	6.6%	<b>Growth Percentile:</b>	38.1%
<b>Dividend Yield:</b>	1.8%	<b>5 Year Price Target</b>	\$1,340	<b>Valuation Percentile:</b>	88.4%
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Total Return Percentile:</b>	72.3%

## Overview & Current Events

Founded in 1916, Farmers & Merchants Bancorp is a locally owned and operated community bank with 32 locations in California. Due to its small market cap (\$603 million) and its low liquidity, it passes under the radar of most investors. Nevertheless, F&M Bank has *raised its dividend for 53 consecutive years and thus it is a Dividend King*.

The company is conservatively managed and, until three years ago, had not made an acquisition since 1985. However, in the last three years, it has begun to pursue growth more aggressively. It acquired Delta National Bancorp in 2016 and increased its locations by 4. Moreover, in October-2018, it completed its acquisition of Bank of Rio Vista, which has helped F&M Bank to further expand in the San Francisco East Bay Area.

In late July, F&M Bank reported (7/24/19) financial results for the second quarter of fiscal 2019. The bank grew its earnings by 33.7% and its earnings-per-share by 38.9% over last year's quarter. Its net interest income rose 16.0%, assisted by the expansion of net interest margin from 4.29% to 4.50%. Total assets and total loans increased 10.9% over last year. The performance of the bank is remarkable, particularly given the absence of non-recurring income in the quarter. Moreover, despite the shift of Fed to a more dovish stance, management expects the strong momentum to persist in the rest of the year thanks to the strong economic momentum in the service areas of the bank.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$25.57	\$27.05	\$28.49	\$29.99	\$30.93	\$32.64	\$34.82	\$37.44	\$35.03	\$56.82	<b>\$70.00</b>	<b>\$89.34</b>
<b>DPS</b>	\$11.00	\$11.35	\$11.75	\$12.10	\$12.50	\$12.70	\$12.90	\$13.10	\$13.55	\$13.70	<b>\$14.05</b>	<b>\$16.10</b>
<b>Shares<sup>1</sup></b>	782.8	780.6	779.4	778.6	777.9	778.4	786.6	794.0	809.8	801.2	<b>780.0</b>	<b>750.0</b>

In 2018, F&M Bank enjoyed a nice tailwind from its reduced tax rate and posted impressive earnings growth. However, the bank cannot keep growing at this pace. Before last year, F&M Bank grew its earnings-per-share at a 2.2% average annual rate over the last decade. Given the strong economic momentum in the service areas of F&M Bank and the fact that the bank has only recently begun to pursue growth more aggressively; we are expecting approximately 5.0% annual growth going forward.

## Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
<b>Avg. P/E</b>	15.0	15.4	13.1	13.5	13.6	14.6	15.8	17.3	16.9	12.2	<b>10.9</b>	<b>15.0</b>
<b>Avg. Yld.</b>	2.9%	2.8%	3.0%	3.3%	3.0%	2.9%	2.5%	2.3%	2.2%	2.0%	<b>1.8%</b>	<b>1.2%</b>

F&M Bank is trading at a price-to-earnings ratio of 10.9 using expected fiscal 2019 earnings, which is much lower than its 10-year average price-to-earnings ratio of 15.0. The stock could enjoy a 6.6% annualized gain thanks to the expansion of its valuation level if it reverts to our estimate of fair value in five years.

1. In millions.

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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## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	43.0%	42.0%	42.4%	40.4%	40.5%	39.7%	37.5%	35.3%	33.2%	24.1%	<b>20.1%</b>	<b>18.0%</b>

F&M Bank is a prudently managed bank, which has always targeted a conservative capital ratio. The bank currently has a tier 1 capital ratio of 9.9%, which results in the highest regulatory classification of “well capitalized”. Moreover, its credit quality remains exceptionally strong, as there are no non-performing loans and leases in its portfolio. The conservative management results in lower leverage and thus slower growth than leveraged banks during boom times. On the other hand, this strategy protects the company from economic downturns.

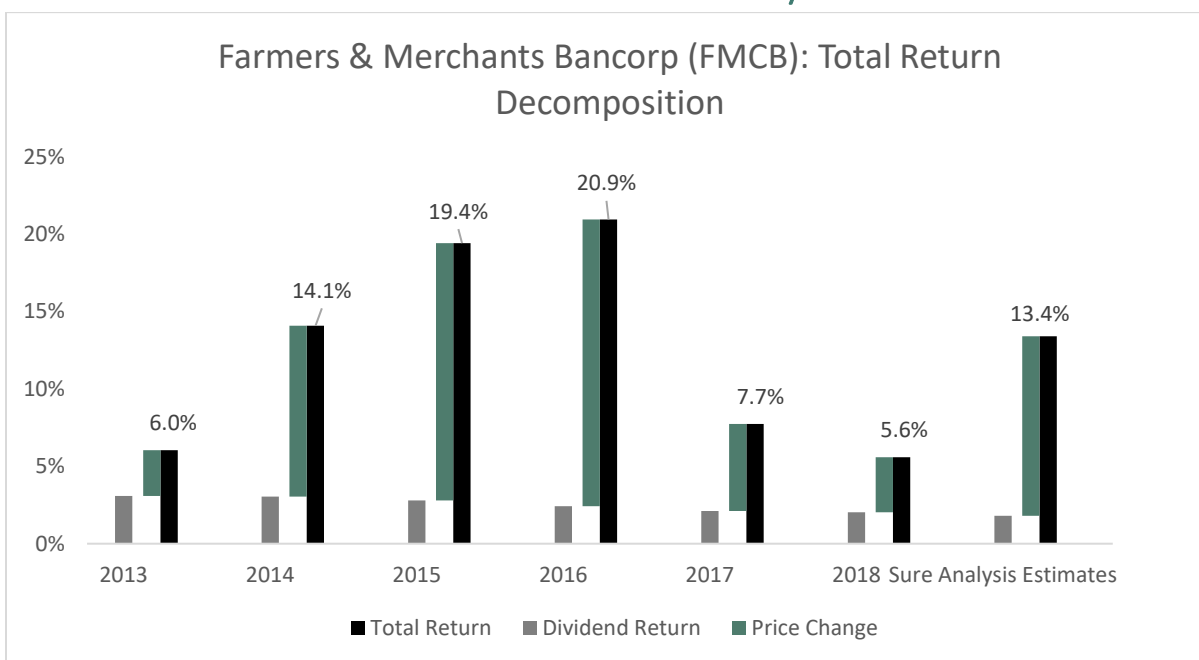
The merits of this strategy were on display during the Great Recession. While most banks saw their earnings collapse, F&M Bank incurred a modest 9% decrease in its earnings-per-share, from \$28.69 in 2008 to \$25.57 in 2009, and kept raising its dividend. That was certainly outstanding performance in the struggling financial sector.

The prudent management of the company is also confirmed by its exceptional dividend growth record. The banks that operate with high leverage cannot achieve such long dividend growth streaks because a recession always shows up after a few years and punishes those that are exposed. On the other hand, F&M Bank has grown its dividend by only 2.7% per year on average during the last decade. This is a slow growth rate, particularly given the lackluster 1.8% dividend yield. Nevertheless, as earnings growth has accelerated lately, the payout ratio has decreased, and the company is likely to be able to enhance its dividend growth rate in the upcoming years.

### Final Thoughts & Recommendation

F&M Bank is a conservatively managed small-cap bank. After years of lackluster growth, the company has begun to pursue growth more aggressively. As a result, F&M Bank can offer a 13.4% average annual return over the next five years. It thus maintains its buy rating, though investors should always keep in mind the risks of stocks with such a small market cap and low trading liquidity before initiating a position.

### Total Return Breakdown by Year



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## Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	93	91	86	86	86	91	100	112	123	140
SG&A Exp.	31	31	31	33	35	38	42	44	48	52
D&A Exp.	2	2	2	2	2	1	2	2	2	3
Net Profit	20	21	22	23	24	25	27	30	28	46
Net Margin	21.5%	23.3%	25.7%	27.2%	27.9%	27.9%	27.3%	26.4%	23.1%	32.6%
Free Cash Flow	8	29	29	31	26	22	35	33	36	53
Income Tax	11	12	13	14	14	15	17	16	26	14

## Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	1781	1841	1920	1975	2076	2361	2615	2922	3075	3434
Cash & Equivalents	33	61	102	129	84	77	59	99	187	146
Accounts Receivable	60	74	74	73	90	96	88	100	99	126
Total Liabilities	1616	1668	1730	1770	1866	2127	2364	2642	2776	3123
Accounts Payable	N/A	N/A	33	37	48	53	76	50	42	50
Long-Term Debt	30	11	11	10	10	10	10	10	10	10
Shareholder's Equity	165	173	189	205	210	233	252	280	300	311
D/E Ratio	0.18	0.06	0.06	0.05	0.05	0.04	0.04	0.04	0.03	0.03

## Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	1.2%	1.2%	1.2%	1.2%	1.2%	1.1%	1.1%	1.1%	0.9%	1.4%
Return on Equity	12.5%	12.5%	12.3%	11.8%	11.6%	11.5%	11.3%	11.2%	9.8%	14.9%
ROIC	11.0%	11.1%	11.6%	11.2%	11.0%	11.0%	10.8%	10.8%	9.5%	14.4%
Shares Out.	782.8	780.6	779.4	778.6	777.9	778.4	786.6	794.0	809.8	801.2
Revenue/Share	119.0	116.04	110.92	110.16	110.83	116.79	127.45	141.61	151.80	174.27
FCF/Share	9.77	36.90	36.82	40.04	32.89	28.45	43.99	41.95	44.07	66.39

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

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