



# Farmers & Merchants Bancorp (FMCB)

Updated February 11<sup>th</sup>, 2020 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b>	\$770	<b>5 Year CAGR Estimate:</b>	13.0%	<b>Market Cap:</b>	\$606 M
<b>Fair Value Price:</b>	\$1043	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	6/11/2020 <sup>1</sup>
<b>% Fair Value:</b>	74%	<b>5 Year Valuation Multiple Estimate:</b>	6.3%	<b>Dividend Payment Date:</b>	6/29/2020
<b>Dividend Yield:</b>	1.9%	<b>5 Year Price Target</b>	\$1331	<b>Years Of Dividend Growth:</b>	55
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	A	<b>Last Dividend Increase:</b>	3.6%

## 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 (\$606 million) and its low liquidity, it passes under the radar of most investors. Nevertheless, F&M Bank has paid uninterrupted dividends for 85 consecutive years and has *raised its dividend for 55 consecutive years. As a result, it is a Dividend King.*

The company is conservatively managed and, until four years ago, had not made an acquisition since 1985. However, in the last four 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 early February, F&M Bank reported (2/5/20) financial results for the fourth quarter of fiscal 2019. In the year, the bank grew its earnings-per-share by 25.3% over prior year. Net interest income grew 12% thanks to 9.8% growth in interest-earning assets and expansion of net interest margin from 4.25% to 4.34%. The performance of the bank is remarkable, particularly given the environment of suppressed interest rates. Despite the dovish stance of the Fed, management expects the strong momentum to persist this year thanks to the strong economic momentum in the service areas of the bank.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$27.05	\$28.49	\$29.99	\$30.93	\$32.64	\$34.82	\$37.44	\$35.03	\$56.82	\$71.18	<b>\$74.50</b>	<b>\$95.08</b>
<b>DPS</b>	\$11.35	\$11.75	\$12.10	\$12.50	\$12.70	\$12.90	\$13.10	\$13.55	\$13.70	\$14.20	<b>\$14.70</b>	<b>\$18.75</b>
<b>Shares<sup>2</sup></b>	780.6	779.4	778.6	777.9	778.4	786.6	794.0	809.8	801.2	787.0	<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. In 2019, the bank posted impressive growth again, mostly thanks to its takeover of Bank of Rio Vista. However, the bank cannot keep growing at this pace. Before 2018, 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
<b>Avg. P/E</b>	15.4	13.1	13.5	13.6	14.6	15.8	17.3	16.9	12.2	10.8	<b>10.3</b>	<b>14.0</b>
<b>Avg. Yld.</b>	2.8%	3.0%	3.3%	3.0%	2.9%	2.5%	2.3%	2.2%	2.0%	1.9%	<b>1.9%</b>	<b>1.4%</b>

F&M Bank is trading at a price-to-earnings ratio of 10.3, which is much lower than its 10-year average price-to-earnings ratio of 14.3. We assume a fair earnings multiple of 14.0 for this small-cap stock. If the stock reaches our fair value estimate over the next five years, it could enjoy a 6.3% annualized gain thanks to the expansion of its valuation level.

<sup>1</sup> Estimated date.

<sup>2</sup> In thousands.

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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	42.0%	42.4%	40.4%	40.5%	39.7%	37.5%	35.3%	33.2%	24.1%	19.9%	<b>19.7%</b>	<b>19.7%</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 10.8%, 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.

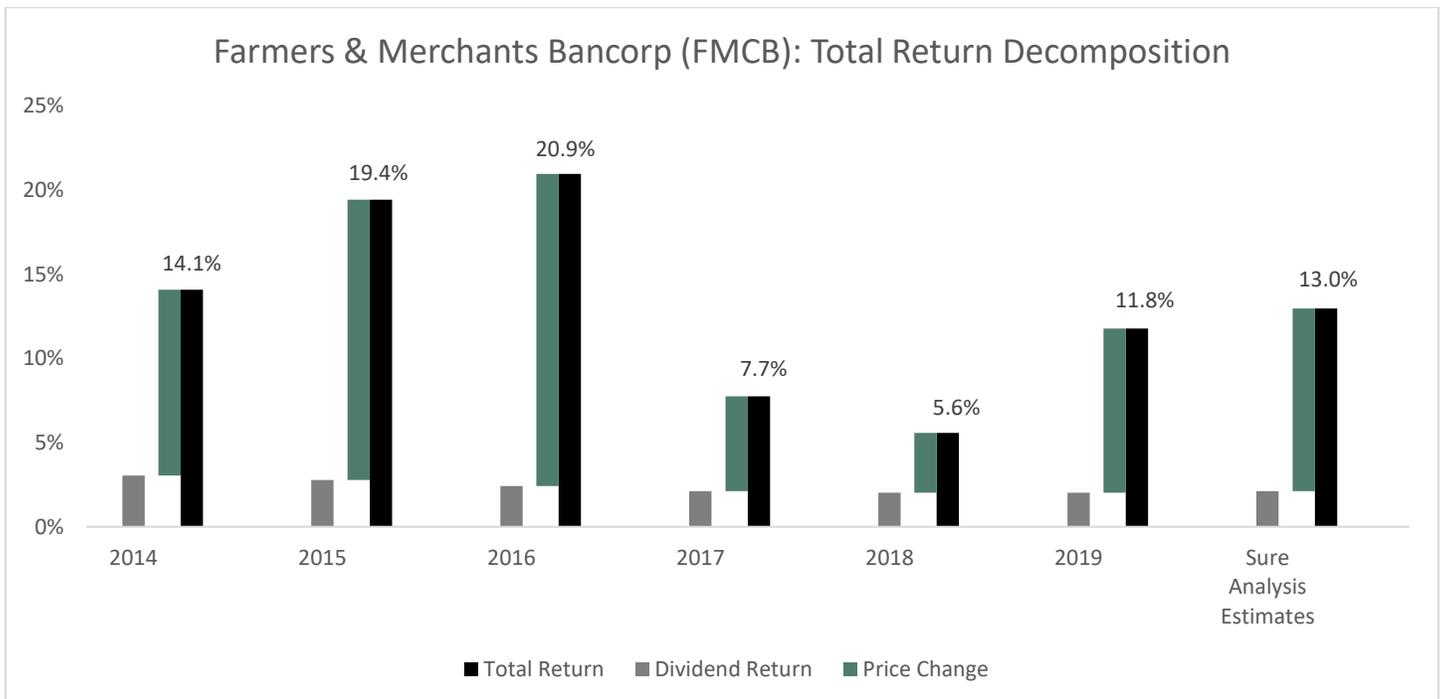
The merits of this strategy were on display during the Great Recession. While most banks saw their earnings collapse, F&M Bank incurred a modest -9% decrease in its earnings-per-share, from \$28.69 in 2008 to \$25.57 in 2009, and kept raising its dividend. That was certainly outstanding performance in 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 2.5% per year on average during the last decade. This is a slow growth rate, particularly given the lackluster 1.9% dividend yield. Nevertheless, as earnings growth has accelerated lately, the payout ratio has decreased and hence 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 could offer a 13.0% 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Revenue</b>	91	86	86	86	91	100	112	123	140	
<b>SG&amp;A Exp.</b>	31	31	33	35	38	42	44	48	52	
<b>D&amp;A Exp.</b>	2	2	2	2	1	2	2	2	3	
<b>Net Profit</b>	21	22	23	24	25	27	30	28	46	
<b>Net Margin</b>	23.3%	25.7%	27.2%	27.9%	27.9%	27.3%	26.4%	23.1%	32.6%	
<b>Free Cash Flow</b>	29	29	31	26	22	35	33	36	53	
<b>Income Tax</b>	12	13	14	14	15	17	16	26	14	

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total Assets</b>	1841	1920	1975	2076	2361	2615	2922	3075	3434	
<b>Cash &amp; Equivalents</b>	61	102	129	84	77	59	99	187	146	
<b>Accounts Receivable</b>	74	74	73	90	96	88	100	99	126	
<b>Total Liabilities</b>	1668	1730	1770	1866	2127	2364	2642	2776	3123	
<b>Accounts Payable</b>	N/A	33	37	48	53	76	50	42	50	
<b>Long-Term Debt</b>	11	11	10	10	10	10	10	10	10	
<b>Shareholder's Equity</b>	173	189	205	210	233	252	280	300	311	
<b>D/E Ratio</b>	0.06	0.06	0.05	0.05	0.04	0.04	0.04	0.03	0.03	

## Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Return on Assets</b>	1.2%	1.2%	1.2%	1.2%	1.1%	1.1%	1.1%	0.9%	1.4%	
<b>Return on Equity</b>	12.5%	12.3%	11.8%	11.6%	11.5%	11.3%	11.2%	9.8%	14.9%	
<b>ROIC</b>	11.1%	11.6%	11.2%	11.0%	11.0%	10.8%	10.8%	9.5%	14.4%	
<b>Shares Out.</b>	780.6	779.4	778.6	777.9	778.4	786.6	794.0	809.8	801.2	
<b>Revenue/Share</b>	116.04	110.92	110.16	110.83	116.79	127.45	141.61	151.80	174.27	
<b>FCF/Share</b>	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.

### Disclaimer

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