The Bank of New York Mellon Corp. (BK)

Updated April 18th, 2020 by Josh Arnold

Key Metrics

Current Price:	$37	**5 Year CAGR Estimate:**	12.1%	**Market Cap:**	$33.1B
Fair Value Price:	$48	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	04/27/20
% Fair Value:	77%	**5 Year Valuation Multiple Estimate:**	5.3%	**Dividend Payment Date:**	05/11/20
Dividend Yield:	3.3%	**5 Year Price Target**	$59	**Years Of Dividend Growth:**	9
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	10.7%

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 just under $16 billion in annual revenue and a market capitalization of $33 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.

Bank of New York Mellon posted Q1 earnings on April 16th and results beat expectations handily on both the top and bottom lines. Earnings came to $1.05 per share in Q1, easily besting the consensus for $0.91. This was down from $1.52 in Q4 of 2019, but up from $0.94 in the year-ago quarter. The bank's model - which doesn't rely upon borrowing and lending in the way traditional banks do - performs quite well relative to other banks in times of economic stress.

Q1 provisions for credit losses came to $169 million, which was up from just $7 million in the year-ago period. Part of this increase was due to obvious credit-related headwinds from the COVID-19 situation, but part of the increase was also due to new accounting rules surrounding credit loss estimation.

Assets under custody and/or administration, which is Bank of New York Mellon's headline operating metric given its trust business model, was up 2% to $35.2 trillion, reflecting higher client inflows that were partially offset by lower market values, and a small negative impact from a stronger US dollar. Assets under management declined -2% year-over-year to $1.8 trillion on a strengthening of the US dollar against the British pound.

Revenue came to $4.1 billion in Q1, which was up 5% year-over-year. Fee revenue soared 10% year-over-year to $3.2 billion, while net interest revenue was down slightly, falling from $841 million in last year's Q1 to $814 million this year.

We've cut our earnings-per-share estimate from $4.20 to $3.60 for 2020 on COVID-19 impacts, but note this impact should be transitory. We also note Bank of New York Mellon should be better positioned to weather these impacts than banks that rely heavily upon lending revenue and credit quality for earnings.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.14	$2.03	$2.03	$1.74	$2.41	$2.85	$3.17	$3.31	$4.21	$4.02	***$3.60***	***$5.11***
DPS	$0.36	$0.48	$0.52	$0.58	$0.66	$0.68	$0.72	$0.86	$1.04	$1.18	***$1.24***	***$1.66***
Shares[1]	1,245	1,249	1,254	1,142	1,118	1,085	1,048	1,013	1,007	901	***850***	***700***

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 4% earnings-per-share growth annually moving forward, in a continuation of the trend we've seen in the past five years, if on a smaller scale.

[1] Share count in millions

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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 that looks like that will not be the case in 2020 given the impacts of COVID-19. Its assets under custody and administration continue to grow over time, which is a key driver of fee income. Its lending business is small but growing and continues to add to top line growth as well, although this was not the case in Q1. 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 mid-single-digit pace of share repurchases over time, although buybacks have temporarily been suspended, resulting in a meaningful tailwind for earnings-per-share outside of revenue and dollar 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.

We also note that we've used our normalized earnings power estimate of $4.20 for the calculation of the fair value and valuation, rather than the temporarily depressed earnings estimate of $3.60 for this year.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	13.0	12.4	11.2	17.2	15.1	14.5	12.7	15.1	12.6	11.9	***8.9***	***11.5***
Avg. Yld.	1.3%	1.9%	2.3%	1.9%	1.8%	1.6%	1.8%	1.7%	2.0%	2.5%	***3.3%***	***2.8%***

BNY Mellon's price-to-earnings multiple has been fairly steady since the crisis ended but has fallen meaningfully of late. Today, it stands at just 8.9, well below what we assess as fair value at 11.5. Given this, we see a 5% potential tailwind to total annual returns from the valuation in the coming years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	16%	24%	25%	34%	28%	27%	25%	29%	25%	29%	***30%***	***33%***

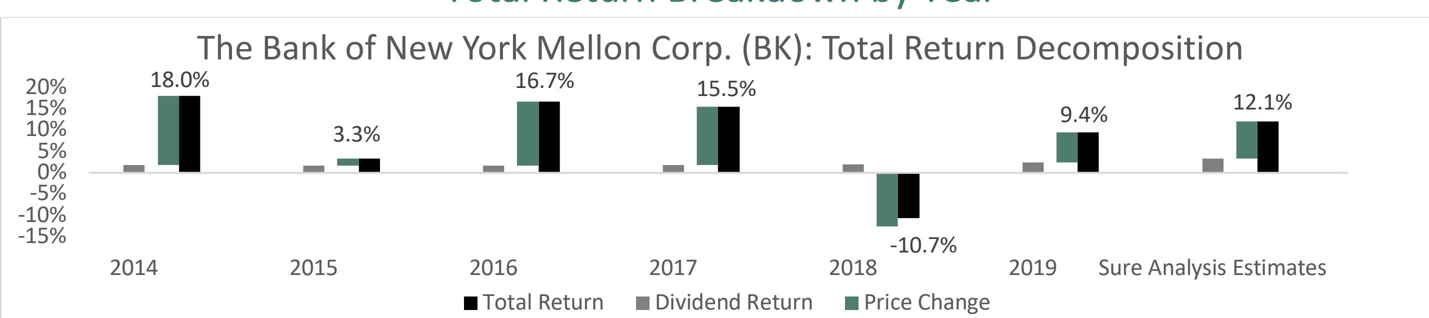
BNY Mellon's dividend is only about a third of its earnings, consistent with other large bank peers. That means the payout is very safe and we expect it to continue growing in the mid-single-digits annually in the years to come.

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 cheaply valued stock with modest growth potential. We are forecasting total annual returns of 12.1% going forward, given the low valuation, 3%+ yield, and moderate earnings growth. BNY Mellon's recent weakness has made the stock more attractive, despite its issues with lending margins. We are upgrading BNY Mellon to a buy rating due primarily to its lower valuation.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	13875	14314	14189	14613	15264	14813	14832	15124	15986	16088
SG&A Exp.	6002	5987	6036	6336	6113	6104	6054	6262	6373	6276
D&A Exp.	629	776	1246	1389	1292	1457	1502	1474	1339	1315
Net Profit	2518	2516	2437	2104	2567	3158	3547	4090	4266	4441
Net Margin	18.1%	17.6%	17.2%	14.4%	16.8%	21.3%	23.9%	27.0%	26.7%	27.6%
Free Cash Flow	3820	1569	977	-1251	3693	3526	5442	3470	4888	-1114
Income Tax	1047	1048	842	1592	912	1013	1177	496	938	1120

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets ($B)	247.26	325.27	358.99	374.52	385.30	393.78	333.47	371.76	362.87	381.51
Cash & Eq. ($B)	72.42	130.74	138.75	146.12	123.15	135.34	78.42	109.35	88.48	114.68
Acc. Receivable	508	4868	4848	4100	4773	4097	4628	5200	4363	624
Goodwill & Int.	23738	24042	24001	23776	23328	22815	22365	22474	22222	20493
Total Liab. ($B)	214.10	291.18	321.73	336.24	346.83	355.01	294.04	330.19	322.13	339.92
Accounts Payable	9962	12671	16095	15707	21181	21900	20987	20184	19731	18758
Long-Term Debt	19385	19943	18868	19960	20264	21547	24463	31054	31102	31460
Total Equity	32354	33417	35363	35935	35879	35485	35269	37709	37096	37941
D/E Ratio	0.60	0.60	0.52	0.53	0.54	0.57	0.63	0.75	0.77	0.76

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	1.1%	0.9%	0.7%	0.6%	0.7%	0.8%	1.0%	1.2%	1.2%	1.2%
Return on Equity	8.2%	7.7%	7.1%	5.9%	7.1%	8.9%	10.0%	11.2%	11.4%	11.8%
ROIC	5.1%	4.7%	4.4%	3.7%	4.4%	5.3%	5.7%	6.0%	5.9%	6.1%
Shares Out.	1,245	1,249	1,254	1,142	1,118	1,085	1,048	1,013	1,007	901
Revenue/Share	11.41	11.70	12.04	12.66	13.42	13.31	13.84	14.54	15.87	17.06
FCF/Share	3.14	1.28	0.83	-1.08	3.25	3.17	5.08	3.34	4.85	-1.18

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