



# JPMorgan & Chase Co. (JPM)

Updated April 18<sup>th</sup>, 2020 by Josh Arnold

## Key Metrics

|                             |       |  |       |                                  |                       |
|-----------------------------|-------|--|-------|----------------------------------|-----------------------|
| <b>Current Price:</b>       | \$95  | <b>5 Year CAGR Estimate:</b>               | 13.8% | <b>Market Cap:</b>               | \$290B                |
| <b>Fair Value Price:</b>    | \$120 | <b>5 Year Growth Estimate:</b>             | 6.0%  | <b>Ex-Dividend Date:</b>         | 07/03/20 <sup>1</sup> |
| <b>% Fair Value:</b>        | 79%   | <b>5 Year Valuation Multiple Estimate:</b> | 4.7%  | <b>Dividend Payment Date:</b>    | 07/31/20 <sup>2</sup> |
| <b>Dividend Yield:</b>      | 3.8%  | <b>5 Year Price Target</b>                 | \$160 | <b>Years Of Dividend Growth:</b> | 10                    |
| <b>Dividend Risk Score:</b> | D     | <b>Retirement Suitability Score:</b>       | D     | <b>Last Dividend Increase:</b>   | 12.5%                 |

## Overview & Current Events

JPMorgan was founded in 1799 as one of the first commercial banks in the US. Since then it has merged or acquired more than 1,200 different institutions, creating a global banking behemoth with a \$290 billion market capitalization and \$110 billion in annual revenue. JPMorgan competes in every major segment of financial services, including consumer banking, commercial banking, home lending, credit cards, asset management and investment banking.

JPMorgan reported Q1 earnings on April 14<sup>th</sup> and results missed expectations on the top and bottom lines. The bank posted earnings-per-share of just \$0.78 in Q1, down by about two-thirds from the prior year Q1 value of \$2.20. JPMorgan, unsurprisingly, took a huge reserve build against future credit losses, adding \$6.8 billion in Q1. That puts its total reserve at \$8.3 billion as of the end of Q1, which is more than five times the size it was at the same time last year. Further, JPMorgan said it expects even more reserve builds in Q2.

The bank guided for net interest income to fall \$3.5 billion this year due to extremely low lending rates, and thus, total revenue should decline year-over-year.

Q1 net interest income was \$14.5 billion, flat year-over-year, while net interest margin came in at 2.37%.

The Consumer and Community Banking segment posted a revenue increase of 2% year-over-year to \$13.2 billion. Corporate & Investment Bank revenue was down fractionally year-over-year to \$10 billion. Investment Banking revenue plummeted -49% to \$866 million, Fixed Income revenue soared 34% to \$5 billion, Equity Markets revenue was up 28% to \$2.2 billion, Commercial Banking revenue rose 10% to \$2.2 billion, and Wealth Management revenue was up 3%.

After the Q1 report, we've cut our estimate for earnings-per-share nearly in half for this year, which now sits at \$5.50.

## Growth on a Per-Share Basis

| Year                      | 2010   | 2011   | 2012   | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019    | 2020          | 2025           |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|---------------|----------------|
| <b>EPS</b>                | \$3.96 | \$4.48 | \$5.20 | \$4.35 | \$5.29 | \$6.00 | \$6.19 | \$6.87 | \$9.00 | \$10.72 | <b>\$5.50</b> | <b>\$14.59</b> |
| <b>DPS</b>                | \$0.20 | \$1.00 | \$1.20 | \$1.44 | \$1.58 | \$1.72 | \$1.88 | \$2.12 | \$2.48 | \$3.30  | <b>\$3.60</b> | <b>\$4.82</b>  |
| <b>Shares<sup>3</sup></b> | 3,910  | 3,772  | 3,804  | 3,756  | 3,714  | 3,664  | 3,561  | 3,425  | 3,340  | 3,084   | <b>3,096</b>  | <b>2,300</b>   |

We see JPMorgan achieving 6% average annual growth on a normalized basis in the years to come after an outstanding 2019. The bank can achieve this with low single-digit revenue growth, leveraging down of noninterest expenses, as well as a meaningful tailwind from the ongoing share buyback program (although this has been temporarily suspended). JPMorgan's balance sheet and earnings potential are more than sufficient to produce a nice tailwind from repurchases indefinitely, but its leverage to the credit card market – which is seeing loss rates continue to rise from historical lows – as well as the flattened and lowered yield curve may keep a lid on profitability going forward. JPMorgan has been able to skillfully navigate a tricky rate environment and produce strong returns, and we expect that will continue indefinitely. However, we also caution that the huge gains produced from the fixed income business, for instance, are transitory as the investment banking business tends to be very volatile.

<sup>1</sup> Estimated date

<sup>2</sup> Estimated date

<sup>3</sup> Share count in millions

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Recent years have seen double-digit payout growth and we see that continuing, given that JPMorgan's payout ratio is still very low. We forecast the dividend being \$4.82 per share in five years as the bank continues to expand the payout with earnings growth. This projected payout growth is a strong reason to consider the stock for income investors. In addition, the most recent dividend increase was sizable and the payout is now \$3.60 per share.

We're using our normalized earnings power estimate of \$10.90 for fair value and valuation calculations, as we see the estimate for this year as artificially depressed thanks to the impact of COVID-19.

## Valuation Analysis

| Year      | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Now  | 2025 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E  | 10.2 | 8.8  | 7.5  | 11.9 | 11.0 | 10.6 | 10.6 | 13.4 | 12.3 | 10.6 | 8.7  | 11.0 |
| Avg. Yld. | 0.5% | 2.5% | 3.1% | 2.8% | 2.7% | 2.7% | 2.9% | 2.3% | 2.2% | 2.9% | 3.8% | 3.0% |

JPMorgan's price-to-earnings ratio is down from our last report at just 8.7 times normalized earnings power. That is well below our fair value estimate of 11 times earnings, implying a sizable tailwind to total returns. The yield could decline back to around 3% in the coming years if the valuation improves from today's trough levels.

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

| Year   | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 9%   | 25%  | 25%  | 36%  | 33%  | 33%  | 34%  | 35%  | 28%  | 31%  | 33%  | 33%  |

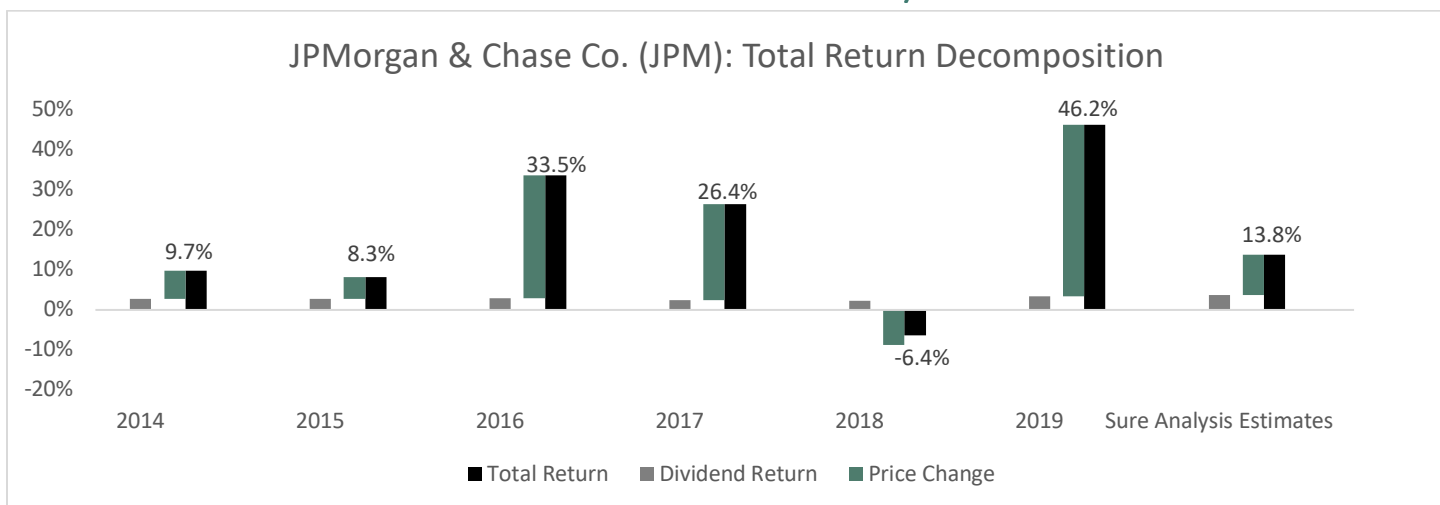
We see the payout ratio remaining in the mid-30% range following the recent dividend increase. JPMorgan had been spending heavily on buybacks but is still able to increase the dividend meaningfully. We see the payout as very safe and a good choice for income investors given strong earnings growth and a willingness to return that capital to shareholders.

JPMorgan's competitive advantages include its enormous scale, diversified revenue streams and world class reputation. However, it is susceptible to recessions, just like any other bank, and earnings will suffer during the downturn.

## Final Thoughts & Recommendation

Overall, we see JPMorgan as a strong franchise with reasonable growth ahead of it, and a much better valuation. The total return outlook has improved significantly given the recent decline in the stock, and we now expect 13.8% total annual returns to shareholders. We like JPMorgan for its continued strong performance and enormous capital return program. In addition, the lower valuation has us moving the stock from hold to buy.

## Total Return Breakdown by Year



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## Income Statement Metrics

| Year                | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017   | 2018  | 2019   |
|---------------------|-------|-------|-------|-------|-------|-------|-------|--------|-------|--------|
| Revenue (\$B)       | 102.7 | 97.2  | 97.0  | 97.4  | 95.1  | 93.5  | 96.6  | 100.7  | 109.0 | 115.6  |
| SG&A Exp.           | 35254 | 37127 | 38386 | 38735 | 38514 | 38651 | 39953 | 41823  | 45209 | 47,555 |
| D&A Exp.            | 4965  | 5105  | 5147  | 5306  | 4759  | 4940  | 5478  | 6179   | 7791  | 8368   |
| Net Profit          | 17370 | 18976 | 21284 | 17886 | 21745 | 24442 | 24733 | 24441  | 32474 | 36,431 |
| Net Margin          | 16.9% | 19.5% | 21.9% | 18.4% | 22.9% | 26.1% | 25.6% | 24.3%  | 29.8% | 31.5%  |
| Free Cash Fl. (\$B) | -3752 | 95932 | 25079 | 108B  | 36593 | 73466 | 21884 | -10.8B | 14187 | 6046   |
| Income Tax          | 7489  | 7773  | 7633  | 8789  | 8954  | 6260  | 9803  | 11459  | 8290  | 8,114  |

## Balance Sheet Metrics

| Year               | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  |
|--------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Assets (\$B) | 2118  | 2266  | 2359  | 2416  | 2572  | 2352  | 2491  | 2534  | 2623  | 2687  |
| Cash & Eq. (\$B)   | 49    | 145   | 176   | 356   | 512   | 361   | 390   | 431   | 279   | 264   |
| Acc. Receivable    | N/A   | 61478 | 60933 | 65160 | 70079 | 46605 | 52330 | 67729 | 73200 | 72861 |
| Goodwill           | 66542 | 58618 | 58024 | 59313 | 56275 | 54948 | 54246 | 54392 | 54349 | 53341 |
| Total Liab. (\$B)  | 1941  | 2082  | 2155  | 2205  | 2341  | 2104  | 2237  | 2278  | 2366  | 2426  |
| Acc. Payable (\$B) | 170   | 203   | 195   | 194   | 207   | 178   | 110   | 103   | 115   | 210   |
| LT Debt (\$B)      | 340   | 308   | 304   | 326   | 343   | 304   | 307   | 336   | 351   | 332   |
| Total Equity (\$B) | 168   | 176   | 195   | 200   | 212   | 222   | 228   | 230   | 230   | 234   |
| D/E Ratio          | 1.93  | 1.68  | 1.49  | 1.54  | 1.48  | 1.23  | 1.21  | 1.31  | 1.37  | 1.27  |

## Profitability & Per Share Metrics

| Year             | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 0.8%  | 0.9%  | 0.9%  | 0.7%  | 0.9%  | 1.0%  | 1.0%  | 1.0%  | 1.3%  | 1.4%  |
| Return on Equity | 10.7% | 11.0% | 11.5% | 9.1%  | 10.6% | 11.3% | 11.0% | 10.7% | 14.1% | 15.7% |
| ROIC             | 3.3%  | 3.8%  | 4.3%  | 3.4%  | 3.9%  | 4.3%  | 4.4%  | 4.2%  | 5.4%  | 6.1%  |
| Shares Out.      | 3,910 | 3,772 | 3,804 | 3,756 | 3,714 | 3,664 | 3,561 | 3,425 | 3,340 | 3,084 |
| Revenue/Share    | 25.82 | 24.80 | 25.39 | 25.52 | 25.05 | 24.79 | 26.17 | 28.16 | 31.94 | 35.79 |
| FCF/Share        | -0.94 | 24.47 | 6.56  | 28.30 | 9.64  | 19.47 | 5.93  | -3.03 | 4.16  | 1.87  |

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

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