



# Farmers & Merchants Bancorp (FMCB)

Updated August 16<sup>th</sup>, 2021 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b>	\$890	<b>5 Year CAGR Estimate:</b>	9.1%	<b>Market Cap:</b>	\$703 M
<b>Fair Value Price:</b>	\$1,008	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	12/7/2021 <sup>1</sup>
<b>% Fair Value:</b>	88%	<b>5 Year Valuation Multiple Estimate:</b>	2.5%	<b>Dividend Payment Date:</b>	12/31/2021
<b>Dividend Yield:</b>	1.7%	<b>5 Year Price Target</b>	\$1,286	<b>Years Of Dividend Growth:</b>	56
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Last Dividend Increase:</b>	3.9%

## 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 (\$703 million) and its low liquidity, it passes under the radar of most investors. Nevertheless, F&M Bank has paid uninterrupted dividends for 86 consecutive years and has *raised its dividend for 56 consecutive years*. As a result, it is a Dividend King.

The company is conservatively managed and, until five years ago, had not made an acquisition since 1985. However, in the last five 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 (7/26/21) financial results for the second quarter of fiscal 2021. Despite the pandemic and the suppressed prevailing interest rates, the bank grew its earnings-per-share 13.4% over last year's quarter, from \$18.03 to \$20.45. It has thus achieved record earnings-per-share of \$79.83 in the last 12 months. Net interest income grew 12.5% thanks to 5.5% growth in loans and higher yields in new loans while deposits grew 17%. F&M Bank has booked provisions for loan losses equal to only 2.0% of its total portfolio thanks to its conservative portfolio. Despite the risk from the variants of the coronavirus, management remains optimistic for this year thanks to the sustained business momentum. We reiterate that F&M Bank is one of the most resilient banks to the pandemic.

## Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
<b>EPS</b>	\$28.49	\$29.99	\$30.93	\$32.64	\$34.82	\$37.44	\$35.03	\$56.82	\$71.18	\$74.03	<b>\$84.00</b>	<b>\$107.21</b>
<b>DPS</b>	\$11.75	\$12.10	\$12.50	\$12.70	\$12.90	\$13.10	\$13.55	\$13.70	\$14.20	\$14.75	<b>\$15.30</b>	<b>\$19.53</b>
<b>Shares<sup>2</sup></b>	779.4	778.6	777.9	778.4	786.6	794.0	809.8	801.2	787.0	793.6	<b>790.0</b>	<b>780.0</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. As the pandemic has begun to subside thanks to the massive vaccination program and the bank has only recently begun to pursue growth more aggressively, we expect approximately 5.0% annual earnings-per-share growth going forward.

## Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
<b>Avg. P/E</b>	13.1	13.5	13.6	14.6	15.8	17.3	16.9	12.2	10.8	9.9	<b>10.6</b>	<b>12.0</b>
<b>Avg. Yld.</b>	3.0%	3.3%	3.0%	2.9%	2.5%	2.3%	2.2%	2.0%	1.9%	2.0%	<b>1.7%</b>	<b>1.5%</b>

<sup>1</sup> Estimated date for the semiannual dividend.

<sup>2</sup> In thousands.

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F&M Bank is trading at a price-to-earnings ratio of 10.6, which is lower than its 10-year average price-to-earnings ratio of 13.8. We assume a fair earnings multiple of 12.0 for this small-cap stock. If the stock reaches our fair value estimate over the next five years, it will enjoy a 2.5% annualized gain thanks to the expansion of its valuation level.

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

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	42.4%	40.4%	40.5%	39.7%	37.5%	35.3%	33.2%	24.1%	19.9%	19.9%	<b>18.2%</b>	<b>18.2%</b>

F&M Bank is a prudently managed bank, which has always targeted a conservative capital ratio. The bank currently has a total capital ratio of 13.25%, which results in the highest regulatory classification of “well capitalized.” Moreover, its credit quality remains exceptionally strong, as there are extremely few 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 but protects the company from recessions, such as the fierce recession that resulted from the pandemic.

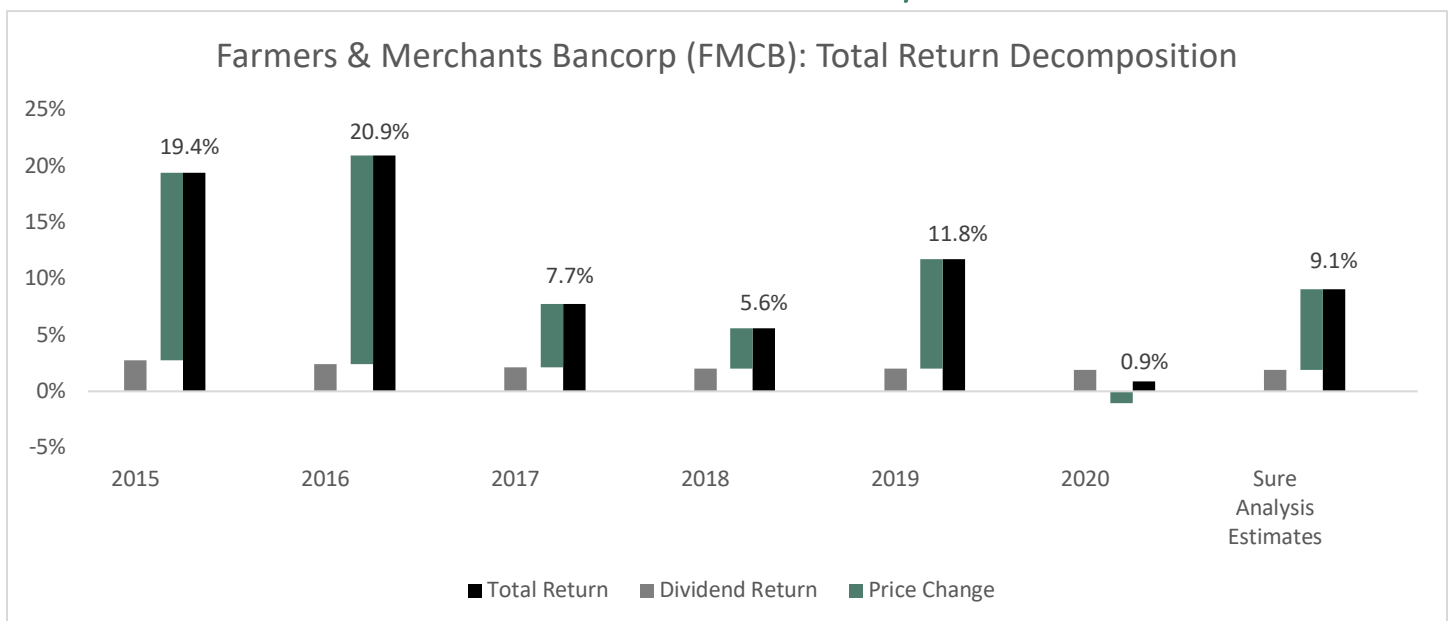
The merits of this strategy were on display during the Great Recession. While most banks saw their earnings collapse, F&M Bank incurred a modest -9% decrease in its earnings-per-share, from \$28.69 in 2008 to \$25.57 in 2009, and kept raising its dividend. That was certainly outstanding performance in 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 2.6% per year on average during the last decade. This is a slow growth rate, particularly given the lackluster 1.7% dividend yield.

## Final Thoughts & Recommendation

F&M Bank is a conservatively managed small-cap bank. The disciplined business execution is a key feature in the ongoing downturn. Moreover, after years of lackluster growth, the company has begun to pursue growth more aggressively. The stock has rallied 7% since our last research report, in May, but we still expect it to offer a 9.1% 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.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Revenue</b>	86	86	86	91	100	112	123	140	155	163
<b>SG&amp;A Exp.</b>	31	33	35	38	42	44	48	52	57	58
<b>D&amp;A Exp.</b>	2	2	2	1	2	2	2	3	3	3
<b>Net Profit</b>	22	23	24	25	27	30	28	46	56	59
<b>Net Margin</b>	25.7%	27.2%	27.9%	27.9%	27.3%	26.4%	23.1%	32.6%	36.1%	36.0%
<b>Free Cash Flow</b>	29	31	26	22	35	33	36	53	65	50
<b>Income Tax</b>	13	14	14	15	17	16	26	14	19	19

## Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Total Assets</b>	1920	1975	2076	2361	2615	2922	3075	3434	3722	4550
<b>Cash &amp; Equivalents</b>	102	129	84	77	59	99	187	146	295	384
<b>Accounts Receivable</b>	74	73	90	96	88	100	99	126	129	130
<b>Total Liabilities</b>	1730	1770	1866	2127	2364	2642	2776	3123	3353	4127
<b>Accounts Payable</b>	33	37	48	53	76	50	42	50	64	56
<b>Long-Term Debt</b>	11	10	10	10	10	10	10	10	10	10
<b>Shareholder's Equity</b>	189	205	210	233	252	280	300	311	369	424
<b>D/E Ratio</b>	0.06	0.05	0.05	0.04	0.04	0.04	0.03	0.03	0.03	0.02

## Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Return on Assets</b>	1.2%	1.2%	1.2%	1.1%	1.1%	1.1%	0.9%	1.4%	1.6%	1.4%
<b>Return on Equity</b>	12.3%	11.8%	11.6%	11.5%	11.3%	11.2%	9.8%	14.9%	16.5%	14.8%
<b>ROIC</b>	11.6%	11.2%	11.0%	11.0%	10.8%	10.8%	9.5%	14.4%	16.0%	14.4%
<b>Shares Out.</b>	779.4	778.6	777.9	778.4	786.6	794.0	809.8	801.2	787.0	793.6
<b>Revenue/Share</b>	110.92	110.16	110.83	116.79	127.45	141.61	151.80	174.27	197.06	205.56
<b>FCF/Share</b>	36.82	40.04	32.89	28.45	43.99	41.95	44.07	66.39	82.98	63.54

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

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