Alerus Financial (ALRS)

Published November 29th, 2022 by Aristofanis Papadatos

Key Metrics

Current Price:	$24	**5 Year CAGR Estimate:**	8.3%	**Market Cap:**	$469 M
Fair Value Price:	$26	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	12/22/22
% Fair Value:	93%	**5 Year Valuation Multiple Estimate:**	1.5%	**Dividend Payment Date:**	1/13/23
Dividend Yield:	3.0%	**5 Year Price Target**	$31	**Years Of Dividend Growth:**	17
Dividend Risk Score:	B	**Retirement Suitability Score:**	A	**Rating:**	Hold

Overview & Current Events

Alerus Financial is a financial services company headquartered in North Dakota. Its operations date back to 1879, when it was originally founded as the Bank of Grand Forks, one of the first banks in Dakota. In 2000, it changed its name to Alerus Financial to reflect its evolution from a traditional community bank to a financial services company. Alerus Financial provides financial solutions to businesses and consumers through four distinct business segments—banking, retirement and benefit services, wealth management and mortgage. Instead of focusing on the broader population, it targets specific business and consumer segments, which offer significant growth potential. The bank has a market cap of $469 million and is characterized by prudent management. As a result, it has raised its dividend for 17 consecutive years.

On July 1st, 2022, Alerus Financial acquired Metro Phoenix Bank for $85.3 million in an effort to grow its presence in Arizona. As the transaction value is nearly 20% of the current market cap of Alerus Financial, it is evident that the acquisition is major for the growth prospects of the bank.

In late October, Alerus Financial reported (10/26/22) financial results for the third quarter of fiscal 2022. The bank enjoyed strong growth of loans and deposits, primarily thanks to the acquisition of Metro Phoenix Bank. It also expanded its net interest margin from 2.98% in the previous quarter to 3.21% thanks to higher interest rates. Nevertheless, due to high costs related to the acquisition, earnings-per-share dipped -10% sequentially, from $0.52 to $0.47 and missed the analysts' estimates by $0.10. We expect earnings-per-share of $2.15 this year.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$1.17	$1.46	$1.48	$1.21	$1.00	$1.07	$1.84	$1.91	$2.52	$2.97	***$2.15***	***$2.62***
DPS	$0.31	$0.34	$0.38	$0.42	$0.44	$0.48	$0.53	$0.57	$0.60	$0.63	***$0.72***	***$0.96***
Shares[1]	13.6	13.8	13.9	13.9	14.0	14.0	14.1	15.1	17.4	17.5	***20.2***	***25.0***

Alerus Financial has exhibited a decent performance record over the last decade. If it meets our expectations this year, it will have grown its earnings-per-share at a 4.0% average annual rate over the last four years. The bank is trying to grow primarily via the acquisition of smaller peers. The recent acquisition of Metro Phoenix Bank, which marked the 25th acquisition in the history of the bank, is likely to prove a material growth driver in the upcoming years. In addition, the Fed is in the process of raising interest rates aggressively in order to restore inflation to its long-term target. This forms a tailwind for Alerus Financial, as it enhances its net interest margin, i.e., the difference between the interest rate it charges on its loans minus the interest rate it pays on its deposits. Overall, in order to be on the safe side, we assume 4.0% average annual growth of earnings-per-share over the next five years, in line with the historic rate of the bank.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	8.1	9.0	12.4	16.2	17.7	18.0	13.0	10.6	8.2	10.1	***11.2***	***12.0***
Avg. Yld.	3.3%	2.6%	2.1%	2.1%	2.5%	2.5%	2.2%	2.8%	2.9%	2.1%	***3.0%***	***3.1%***

[1] In millions.

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Alerus Financial is currently trading at a price-to-earnings ratio of 11.2, which is somewhat lower than its 5-year average and 10-year average price-to-earnings ratio of 12.0. We expect the stock to trade at its average valuation level in five years. In such a case, the stock will enjoy a 1.5% annualized gain thanks to the expansion of its valuation level.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	26%	23%	26%	35%	44%	45%	29%	30%	24%	21%	***33%***	***37%***

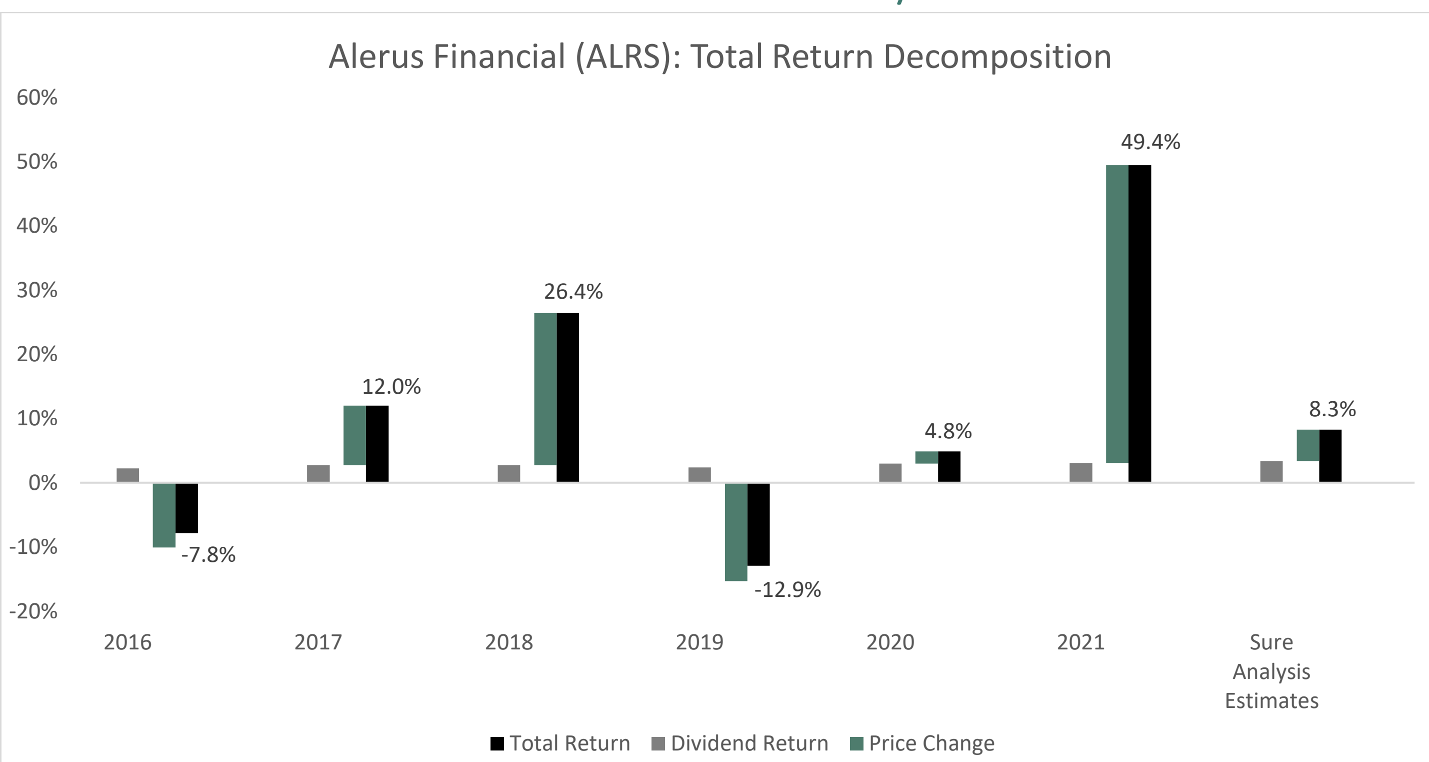
Alerus Financial has fairly prudent management, which is focused on maintaining healthy credit quality metrics. During the last 25 years, the bank has maintained an average net loan charge-off ratio of only 0.27%. Thanks to its cautious strategy, the company has proved resilient to recessions. Most banks faced material loan losses due to the pandemic in 2020, but Alerus Financial proved resilient to this crisis thanks to its defensive business model. The bank grew its earnings-per-share in both 2020 and 2021, though its earnings will moderate this year, mostly due to the non-recurring tailwind from the strong economic recovery in 2021.

Alerus Financial has raised its dividend for 17 consecutive years and is currently offering a nearly 10-year high dividend yield of 3.0%. Given its healthy payout ratio of 33% and its reliable business performance, the bank can continue raising its dividend for many more years.

Final Thoughts & Recommendation

Alerus Financial has promising growth prospects ahead thanks to its recent acquisition and the favorable environment of rising interest rates. We expect the stock to offer an 8.3% average annual return over the next five years thanks to 4.0% earnings-per-share growth, its 3.0% dividend and a 1.5% annualized valuation tailwind. We rate the stock as a hold. The stock is quite attractive right now, though investors should be aware of the low trading volume of this small-cap stock.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	127	121	123	137	166	168	176	186	228	230
SG&A Exp.	59	66	68	81	89	71	73	77	92	97
D&A Exp.		7	8	9	11	10	9	9	9	9
Net Profit	16	20	21	17	14	15	26	30	45	53
Net Margin	12.8%	16.8%	17.0%	12.5%	8.5%	8.9%	14.7%	15.9%	19.6%	22.9%
Free Cash Flow		54	19	20	32	45	50	16	(26)	147
Income Tax	9	12	9	7	7	18	7	9	14	16

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	1,323	1,382	1,488	1,745	2,051	2,136	2,179	2,357	3,014	3,393
Cash & Equivalents	124	73	46	266	207	122	41	144	173	242
Goodwill & Int. Ass.			26	25	65	59	54	50	58	54
Total Liabilities	1,182	1,228	1,317	1,562	1,882	1,956	1,982	2,071	2,684	3,033
Long-Term Debt	22	22	21	69	58	88	58	58	58	59
Shareholder's Equity	121	133	171	183	169	180	197	286	330	359
LTD/E Ratio	0.15	0.14	0.13	0.38	0.34	0.49	0.29	0.20	0.18	0.16

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	1.3%	1.5%	1.4%	1.1%	0.7%	0.7%	1.2%	1.3%	1.7%	1.6%
Return on Equity	14.2%	15.9%	13.6%	9.7%	8.0%	8.6%	13.7%	12.2%	14.5%	15.3%
ROIC	10.4%	12.0%	11.3%	7.7%	5.9%	6.1%	9.9%	9.9%	12.2%	13.1%
Shares Out.	13.6	13.8	13.9	13.9	14.0	14.0	14.1	15.1	17.4	17.5
Revenue/Share	9.37	8.76	8.80	9.80	11.83	12.03	12.50	12.32	13.05	13.17
FCF/Share		3.93	1.38	1.47	2.31	3.21	3.54	1.08	(1.50)	8.43

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