



# Farmers & Merchants Bancorp (FMCB)

Updated January 30<sup>th</sup>, 2023 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b>	\$1,005	<b>5 Year CAGR Estimate:</b>	11.1%	<b>Market Cap:</b>	\$769 M
<b>Fair Value Price:</b>	\$1,260	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	6/8/2023 <sup>1</sup>
<b>% Fair Value:</b>	80%	<b>5 Year Valuation Multiple Estimate:</b>	4.6%	<b>Dividend Payment Date:</b>	6/30/2023
<b>Dividend Yield:</b>	1.7%	<b>5 Year Price Target</b>	\$1,608	<b>Years Of Dividend Growth:</b>	58
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Rating:</b>	Buy

## 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 (\$769 million) and its low liquidity, it passes under the radar of most investors. Nevertheless, F&M Bank has paid uninterrupted dividends for 87 consecutive years and has raised its dividend for 58 consecutive years. As a result, it is a Dividend King.

The company is conservatively managed and, until seven years ago, had not made an acquisition since 1985. However, in the last seven years, it has begun to pursue growth more aggressively. It acquired Delta National Bancorp in 2016 and increased its locations by 4. Moreover, in late 2018, it acquired Bank of Rio Vista, which has helped F&M Bank to further expand in the San Francisco East Bay Area.

In late January, F&M Bank reported (1/27/23) financial results for the full fiscal 2022. The bank grew its earnings-per-share 15% over the prior year, from \$84.03 to a new all-time high of \$96.55. It posted 11% growth of loans and 2% growth of deposits. Net interest income grew 20% thanks to an expansion of net interest margin from 3.37% to 4.45% and growth of loans. Management remains optimistic for the foreseeable future, as the aggressive interest rate hikes implemented by the Fed are likely to continue to enhance the net interest margin of the bank significantly. We reiterate that F&M Bank is one of the most resilient banks during downturns, such as the pandemic or a potential recession. Given the strong positive effect of high interest rates on the results of F&M Bank, we expect record earnings-per-share of \$105.00 this year.

## Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>EPS</b>	\$30.93	\$32.64	\$34.82	\$37.44	\$35.03	\$56.82	\$71.18	\$74.03	\$84.03	\$96.55	<b>105.00</b>	<b>\$134.01</b>
<b>DPS</b>	\$12.50	\$12.70	\$12.90	\$13.10	\$13.55	\$13.70	\$14.20	\$14.75	\$15.30	\$16.15	<b>\$16.60</b>	<b>\$21.20</b>
<b>Shares<sup>2</sup></b>	777.9	778.4	786.6	794.0	809.8	801.2	787.0	793.6	789.2	767.9	<b>760.0</b>	<b>740.0</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 10-year average annual rate of 2.2%. As the Fed has raised interest rates aggressively since last year and the bank has only recently begun to pursue growth more aggressively, we expect 9% growth of earnings-per-share in 2023 and 5.0% annual earnings-per-share growth beyond 2023. A contributor to growth will be the new branch in Oakland, which opened in the fourth quarter of 2021.

## Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
<b>Avg. P/E</b>	13.6	14.6	15.8	17.3	16.9	12.2	10.8	9.9	10.2	9.8	<b>9.6</b>	<b>12.0</b>
<b>Avg. Yld.</b>	3.0%	2.9%	2.5%	2.3%	2.2%	2.0%	1.9%	2.0%	1.8%	1.7%	<b>1.7%</b>	<b>1.3%</b>

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

<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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F&M Bank is trading at a price-to-earnings ratio of 9.6, which is lower than the 10-year average price-to-earnings ratio of 13.1 of the stock. 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 4.6% annualized gain thanks to the expansion of its valuation level.

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

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	40.5%	39.7%	37.5%	35.3%	33.2%	24.1%	19.9%	19.9%	18.2%	16.7%	<b>15.8%</b>	<b>15.8%</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 13.1%, 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.

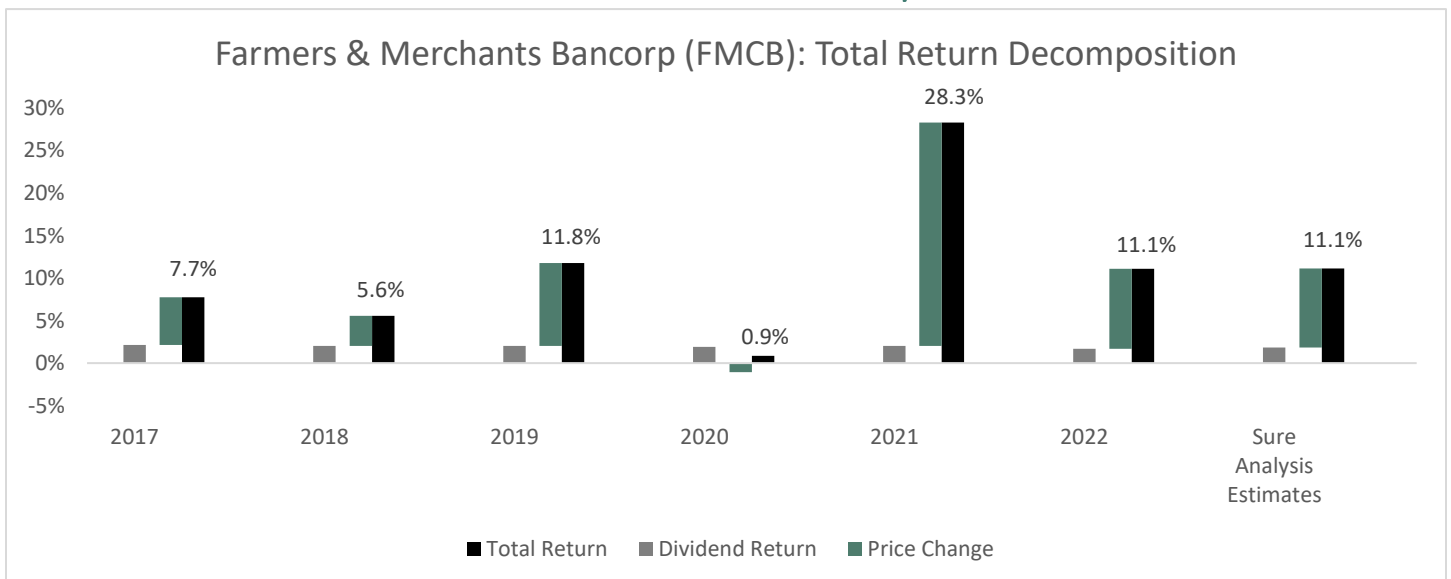
The merits of this strategy were on display during the Great Recession. While most banks saw their earnings collapse, F&M Bank incurred a modest -9% decrease in its earnings-per-share, from \$28.69 in 2008 to \$25.57 in 2009, and kept raising its dividend. That was certainly outstanding performance in 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 2.9% 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 amid fears of an upcoming recession. This is clearly reflected in the outperformance of the stock over the last 12 months (+8% vs. -6% of the S&P 500). Given also the aggressive hikes in interest rates by the Fed, we expect the stock to offer an 11.1% average annual return over the next five years thanks to 5.0% growth of earnings-per-share, a 1.7% dividend and a 4.6% valuation tailwind. The stock 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	86	86	91	100	112	123	140	155	163	179
SG&A Exp.	33	35	38	42	44	48	52	57	58	66
D&A Exp.	2	2	1	2	2	2	3	3	3	3
Net Profit	23	24	25	27	30	28	46	56	59	66
Net Margin	27.2%	27.9%	27.9%	27.3%	26.4%	23.1%	32.6%	36.1%	36.0%	37.0%
Free Cash Flow	31	26	22	35	33	36	53	65	50	58
Income Tax	14	14	15	17	16	26	14	19	19	22

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	1975	2076	2361	2615	2922	3075	3434	3722	4550	5178
Cash & Equivalents	129	84	77	59	99	187	146	295	384	715
Accounts Receivable	73	90	96	88	100	99	126	129	130	18
Total Liabilities	1770	1866	2127	2364	2642	2776	3123	3353	4127	4715
Accounts Payable	37	48	53	76	50	42	50	64	56	---
Long-Term Debt	10	10	10	10	10	10	10	10	10	10
Shareholder's Equity	205	210	233	252	280	300	311	369	424	463
LTD/E Ratio	0.05	0.05	0.04	0.04	0.04	0.03	0.03	0.03	0.02	0.02

## Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	1.2%	1.2%	1.1%	1.1%	1.1%	0.9%	1.4%	1.6%	1.4%	1.4%
Return on Equity	11.8%	11.6%	11.5%	11.3%	11.2%	9.8%	14.9%	16.5%	14.8%	15.0%
ROIC	11.2%	11.0%	11.0%	10.8%	10.8%	9.5%	14.4%	16.0%	14.4%	14.6%
Shares Out.	778.6	777.9	778.4	786.6	794.0	809.8	801.2	787.0	793.6	789.2
Revenue/Share	110.16	110.83	116.79	127.45	141.61	151.80	174.27	197.06	205.56	227.16
FCF/Share	40.04	32.89	28.45	43.99	41.95	44.07	66.39	82.98	63.54	73.32

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

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