Alerus Financial (ALRS)

Published April 28th, 2023 by Aristofanis Papadatos

Key Metrics

Current Price:	$15	**5 Year CAGR Estimate:**	15.1%	**Market Cap:**	$283 M
Fair Value Price:	$20	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	6/15/23[1]
% Fair Value:	75%	**5 Year Valuation Multiple Estimate:**	6.3%	**Dividend Payment Date:**	7/7/23
Dividend Yield:	4.8%	**5 Year Price Target**	$26	**Years Of Dividend Growth:**	17
Dividend Risk Score:	B	**Retirement Suitability Score:**	A	**Rating:**	Buy

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 $283 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 30% 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 April, Alerus Financial reported (4/26/23) financial results for the first quarter of fiscal 2023. The bank grew its loans 1.7% sequentially but its net interest margin shrank from 3.09% to 2.70% due to higher interest expenses paid on deposits. As a result, earnings-per-share dipped -24%, from $0.53 to $0.40. The decrease in the net interest margin of Alerus Financial was expected, as it was evident in the results of the vast majority of banks. However, Alerus Financial incurred a sharper decrease in earnings than most banks. We have thus lowered our forecast for annual earnings-per-share from $1.90 to $1.70. The stock has plunged -34% this year due to the broad sell-off of regional banks, which has resulted from the collapse of Silicon Valley Bank and Credit Suisse. We are confident that this well-managed bank will endure the ongoing turmoil. It grew its deposits 4% in the first quarter and thus it has a solid tier 1 capital ratio of 13.3%.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$1.46	$1.48	$1.21	$1.00	$1.07	$1.84	$1.91	$2.52	$2.97	$2.10	***$1.70***	***$2.17***
DPS	$0.34	$0.38	$0.42	$0.44	$0.48	$0.53	$0.57	$0.60	$0.63	$0.72	***$0.72***	***$0.96***
Shares[2]	13.8	13.9	13.9	14.0	14.0	14.1	15.1	17.4	17.5	20.2	***20.2***	***25.0***

Alerus Financial has exhibited a decent performance record over the last decade. During this period, the bank, has grown its earnings-per-share at a 4.1% average annual rate. 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 in order to restore inflation to its long-term target. This forms a tailwind for most banks, as it enhances their net interest margin, i.e., the difference between the interest rate they charge on loans minus the interest rate they pay on deposits. Alerus Financial has failed to take advantage of this tailwind so far but it may finally benefit from this favorable environment. Overall, given the low comparison base formed this year, we assume 5.0% average annual growth of earnings-per-share over the next five years, slightly higher than the historic rate of the bank.

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[1] Estimated date.
[2] In millions.

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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	9.0	12.4	16.2	17.7	18.0	13.0	10.6	8.2	10.1	11.7	***8.8***	***12.0***
Avg. Yld.	2.6%	2.1%	2.1%	2.5%	2.5%	2.2%	2.8%	2.9%	2.1%	2.9%	***4.8%***	***3.7%***

Alerus Financial is currently trading at a price-to-earnings ratio of 8.8, which is lower than the 10-year average price-to-earnings ratio of 12.0 of the stock. We expect the stock to trade at its average valuation level in five years. In such a case, the stock will enjoy a 6.3% 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	23%	26%	35%	44%	45%	29%	30%	24%	21%	34%	***42%***	***44%***

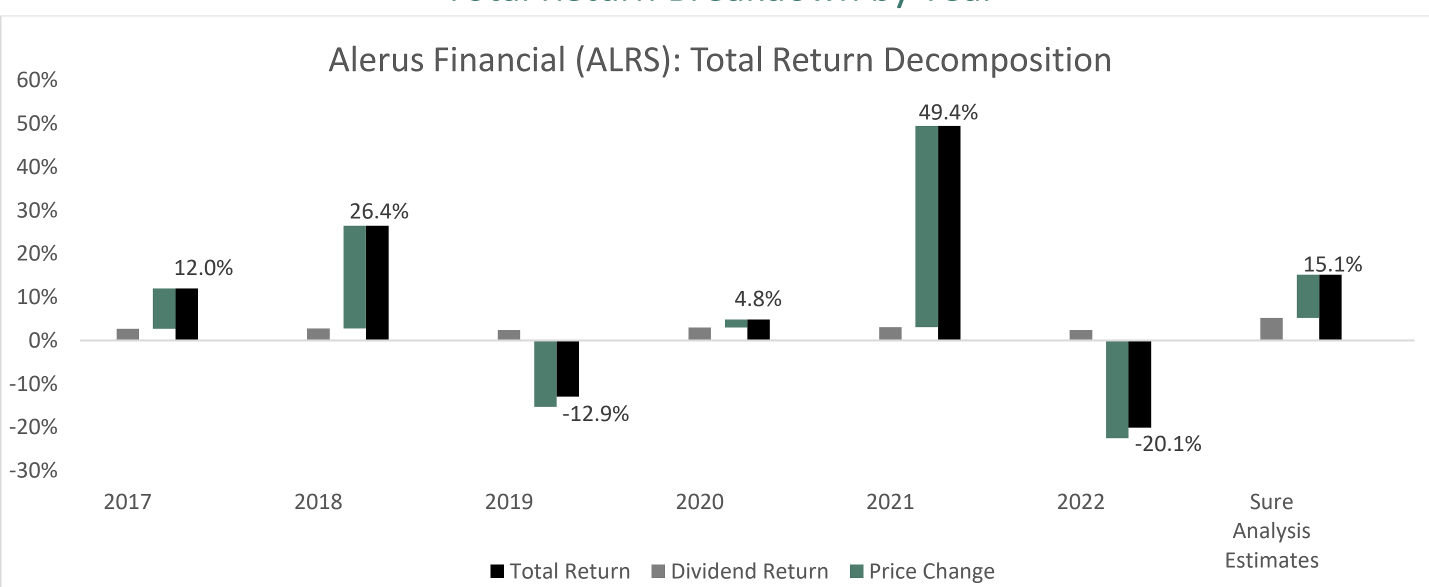
Alerus Financial has fairly prudent management, which is focused on maintaining healthy credit quality metrics. During the last 25 years, the bank has maintained an average net loan charge-off ratio of only 0.27%. Thanks to its cautious strategy, the company has proved resilient to recessions. Most banks 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 have now moderated, 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 10-year high dividend yield of 4.8%. Given its healthy payout ratio of 42% 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 of Metro Phoenix Bank. The stock has plunged this year due to the indiscriminate sell-off of regional banks but we expect the bank to easily endure the ongoing downturn. We expect the stock to offer a 15.1% average annual return over the next five years thanks to 5.0% earnings-per-share growth, its 4.8% dividend and a 6.3% annualized valuation tailwind. We rate the stock as a buy.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	121	123	137	166	168	176	186	228	230	209
SG&A Exp.	66	68	81	89	71	73	77	92	97	84
D&A Exp.	7	8	9	11	10	9	9	9	9	8
Net Profit	20	21	17	14	15	26	30	45	53	40
Net Margin	16.8%	17.0%	12.5%	8.5%	8.9%	14.7%	15.9%	19.6%	22.9%	19.1%
Free Cash Flow	54	19	20	32	45	50	16	(26)	147	101
Income Tax	12	9	7	7	18	7	9	14	16	12

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1,382	1,488	1,745	2,051	2,136	2,179	2,357	3,014	3,393	3,780
Cash & Equivalents	73	46	266	207	122	41	144	173	242	58
Goodwill & Int. Ass.		26	25	65	59	54	50	58	54	72
Total Liabilities	1,228	1,317	1,562	1,882	1,956	1,982	2,071	2,684	3,033	3,423
Long-Term Debt	22	21	69	58	88	58	58	58	59	432
Shareholder's Equity	133	171	183	169	180	197	286	330	359	357
LTD/E Ratio	0.14	0.13	0.38	0.34	0.49	0.29	0.20	0.18	0.16	1.21

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	1.5%	1.4%	1.1%	0.7%	0.7%	1.2%	1.3%	1.7%	1.6%	1.1%
Return on Equity	15.9%	13.6%	9.7%	8.0%	8.6%	13.7%	12.2%	14.5%	15.3%	11.2%
ROIC	12.0%	11.3%	7.7%	5.9%	6.1%	9.9%	9.9%	12.2%	13.1%	6.6%
Shares Out.	13.8	13.9	13.9	14.0	14.0	14.1	15.1	17.4	17.5	18.9
Revenue/Share	8.76	8.80	9.80	11.83	12.03	12.50	12.32	13.05	13.17	11.06
FCF/Share	3.93	1.38	1.47	2.31	3.21	3.54	1.08	(1.50)	8.43	5.36

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