Farmers & Merchants Bancorp, Inc. (FMAO)

Updated May 16th, 2023, by Yiannis Zourmpanos

Key Metrics

Current Price:	$18.50	**5 Year CAGR Estimate:**	18.0%	**Market Cap:**	$252 M
Fair Value Price:	$23.10	**5 Year Growth Estimate:**	10.0%	**Ex-Dividend Date:**	07/07/2023[1]
% Fair Value:	80%	**5 Year Valuation Multiple Estimate:**	4.6%	**Dividend Payment Date:**	07/20/2023
Dividend Yield:	4.5%	**5 Year Price Target**	$37	**Years Of Dividend Growth:**	15
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Rating:**	Buy

Overview & Current Events

Farmers & Merchants Bancorp, Inc. (FMAO) or F&M is a bank holding company headquartered in Archbold, Ohio, USA. It was founded in 1897 and currently operates in Ohio, Indiana and Michigan. FMAO caters to a diverse set of customers, including individuals, businesses, and farmers, and offers a range of financial services, including deposit accounts, loans, credit cards, and online banking. FMAO faces significant competition from other regional and national banks, but its strong customer relationships and commitment to personalized service help it maintain a competitive position in the market. The company has a competitive position in the community banking market and holds a market share of 10%. FMAO's revenue segments are retail banking, commercial banking, and agricultural lending.

On April 19th, 2023, the company announced results for the first quarter of 2023. F&M reported Q1 Non-GAAP EPS of $0.47, missing market estimates by $0.07. Additionally, the company reported revenues of $25.86 million for the quarter, up 7.2% year-over-year.

Despite fierce competition for deposits, the firm increased its overall deposits by $44.3 million over the last three months. The cost of interest-bearing obligations has dramatically grown due to the competition for deposits. While total deposits climbed by 11.5% during this time, reaching a record $2.51 billion, interest expenditure on deposits jumped from $1.4 million in the first quarter of 2022 to $8.2 million. Despite these patterns, strong loan growth and better loan yields caused net interest income before allowance for credit losses to rise 9.6% to a first quarter record.

In addition, in the first quarter, the company's profitability suffered from several significant one-time costs, including $541,000 in total costs for migrating the credit card platform. Additionally, the company lost $891,000 during the quarter and sold $21.6 million worth of investments, temporarily lowering ROA and ROE by 9 basis points and 93 basis points, respectively.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$0.96	$1.04	$1.12	$1.26	$1.38	$1.61	$1.66	$1.80	$2.01	$2.46	***$2.10***	***$3.38***
DPS	$0.41	$0.42	$0.44	$0.46	$0.50	$0.56	$0.61	$0.66	$0.71	$0.80	***$0.84***	***$1.18***
Shares	9.3	9.2	9.2	9.1	9.2	9.2	11.0	11.1	11.6	13.1	***13.6***	***16.7***

Total loans, net, grew to a record $2.42 billion at the end of March 2023 from $1.95 billion at the end of March 2022 and $2.34 billion at the end of December 2022, a 24.5% rise. The completion of the Peoples acquisition and the ongoing strong organic loan growth were the main drivers of the year over year gain. Without taking into account the Peoples acquisition, total net loans rose organically by 19.1%, or $371.9 million, from the same time last year. Lastly, strong loan growth and higher rates on loans led to a rise in net interest income before credit losses provision of 9.6% to a first quarter record.

Thus, we maintain our EPS forecast of $2.10 in 2023 in-line with analysts' estimates, and amidst the rising interest rate environment, the bank can grow faster in the following years, with a projected annual EPS growth of 10.0%, FMAO's EPS can reach $3.38 by 2028. F&M's DPS had a nine-year and five-year CAGR of 7.7% and 26.5%, respectively. Considering

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[1] [1] The ex-div and dividend payment dates are estimated based on historical data.

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.

the company's 5-year payout ratio of 35.2%, we believe there is room for further DPS growth in light of EPS' expansion due to margin expansion.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Avg. P/E	11.2	12.1	11.8	11.9	21.6	25.8	17.3	12.9	12.1	13.0	***8.8***	***11.0***
Avg. Yld.	1.6%	1.4%	1.3%	1.3%	1.2%	1.3%	1.5%	1.7%	1.8%	2.1%	***4.5%***	***3.2%***

F&M is trading at a forward P/E of 8.8, lower than its nine-year and five-year average P/E of 15.0 and 16.2, respectively. Following the banking turmoil and fears of the contagion effect in the sector, the stock has plunged but has strongly recovered lately. Considering the bank's resiliency, we have assumed a stable P/E of 11.0 to value the company in 2028, slightly lower than its historical averages, which accounts for the higher uncertainty attached to the sector, suggesting a target price of $37, and a 100% upside from current levels.

Safety, Quality, Competitive Advantage, & Recession Resiliency

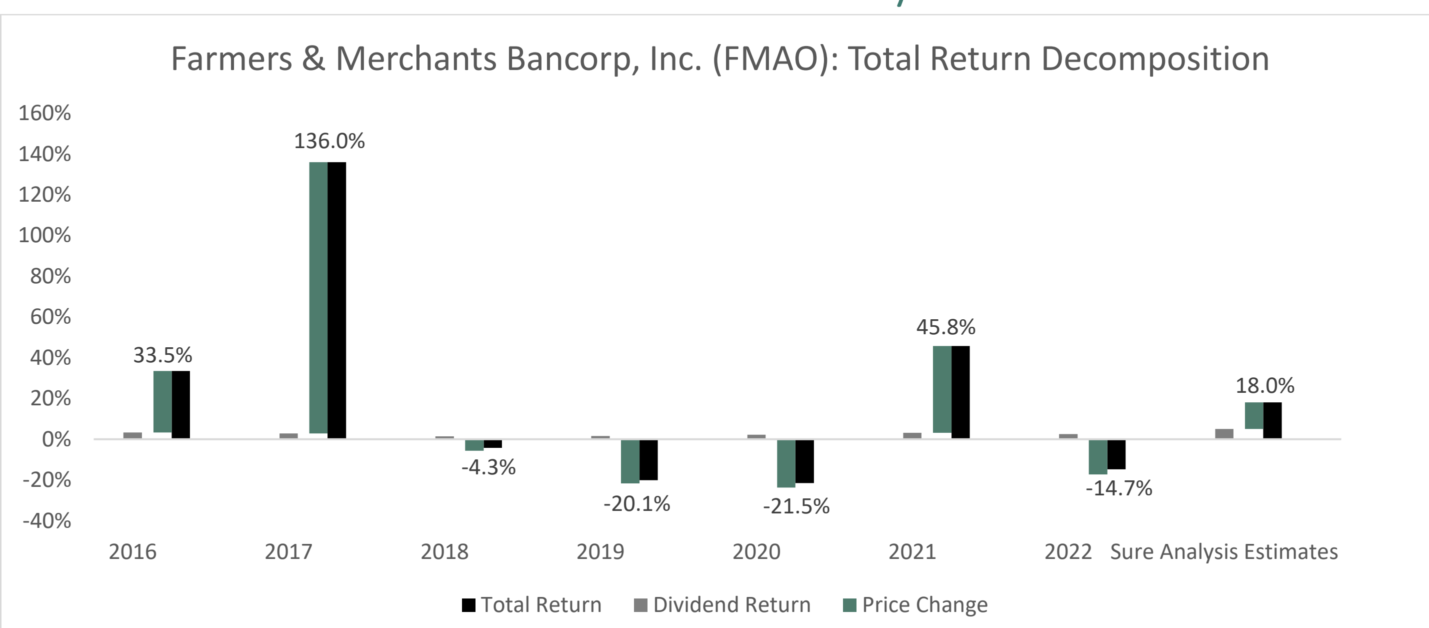
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	43%	40%	39%	37%	36%	35%	37%	37%	35%	33%	***40%***	***36%***

The company's competitive advantage lies in its longstanding reputation for providing quality financial services to its customers, along with its strong presence in the communities it serves. During the recession of 2008, F&M, performed well due to its conservative lending practices and strong capital position.

Final Thoughts & Recommendation

The loan pipeline and the margins are performing better; thus, we anticipate increasing dividend distributions in 2023, especially given that interest rates are currently expected to support profit growth. Following the banking crisis, the sector outlook remains uncertain. However, F&M's strong financial position is robust which leads to our buy rating, premised upon the 18.0% annualized total returns for the medium-term, derived from the forecasted earnings-per-share growth of 10.0%, 4.5% dividend yield, and a valuation tailwind.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	38	40	41	44	46	49	64	75	85	100
SG&A Exp.	19	20	21	20	21	23	30	32	38	42
D&A Exp.	2	2	2	2	2	2	4	4	5	4
Net Profit	9	10	10	12	13	15	18	20	23	33
Net Margin	24.0%	24.3%	25.3%	26.8%	27.9%	30.3%	28.9%	26.8%	27.7%	32.4%
Free Cash Flow	15	16	13	10	16	8	20	24	33	38
Income Tax	4	4	4	5	5	3	4	5	6	8

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	966	941	989	1,056	1,107	1,116	1,607	1,910	2,638	3,015
Cash & Equivalents	18	22	21	29	37	42	54	103	146	88
Goodwill & Int.	6	6	6	6	6	6	50	51	84	90
Total Liabilities	857	827	869	930	973	973	1,377	1,660	2,341	2,717
Long-Term Debt	5	-	10	10	5	-	25	18	99	172
Total Equity	109	114	120	126	134	143	230	249	297	298
LTD/E Ratio	0.04	-	0.08	0.08	0.04	-	0.11	0.07	0.33	0.58

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	0.9%	1.0%	1.1%	1.1%	1.2%	1.3%	1.4%	1.1%	1.0%	1.2%
Return on Equity	8.2%	8.6%	8.8%	9.5%	9.8%	10.8%	9.9%	8.4%	8.6%	10.9%
ROIC	7.7%	8.5%	8.5%	8.8%	9.3%	10.6%	9.2%	7.7%	7.1%	7.5%
Shares Out.	9.3	9.2	9.2	9.1	9.2	9.2	11.0	11.1	11.6	13.1
Revenue/Share	4.04	4.33	4.45	4.77	4.98	5.37	5.72	6.72	7.27	7.60
FCF/Share	1.61	1.77	1.43	1.10	1.72	0.88	1.84	2.17	2.81	2.88

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

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