The Bank of New York Mellon Corp. (BK)

Updated July 19th, 2023, by Josh Arnold

Key Metrics

Current Price:	$45	**5 Year CAGR Estimate:**	14.1%	**Market Cap:**	$35 B
Fair Value Price:	$53	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	07/27/23
% Fair Value:	86%	**5 Year Valuation Multiple Estimate:**	3.1%	**Dividend Payment Date:**	08/10/23
Dividend Yield:	3.7%	**5 Year Price Target**	$77	**Years Of Dividend Growth:**	13
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**Rating:**	Buy

Overview & Current Events

Bank of New York Mellon opened its doors in 1784 in the wake of the American Revolution, founded in part by Alexander Hamilton. The bank was the first ever to make a loan to the U.S. government and in the nearly 240 years since, has grown to more than $17 billion in annual revenue and a market capitalization of $35 billion. The bank is present in 35 countries around the world and acts as more of an investment manager than a traditional bank. Indeed, BNY Mellon's stated goal is to help its customers manage their assets throughout the investment lifecycle. As such, BNY Mellon's revenue is mostly derived from fees, not traditional interest income.

BNY Mellon posted second quarter earnings on July 18th, 2023, and results were better than expected on both revenue and profits. Adjusted earnings-per-share came to $1.38, which was an impressive 16 cents ahead of estimates. In addition, it was up from $1.15 in the year-ago period. Revenue was up almost 5% year-over-year to $4.45 billion, ahead of expectations by $90 million.

Net interest revenue increased 33%, while fee revenue was down 2%. Net interest revenue was $1.1 billion, up from $824 million a year ago. BNY Mellon derives the overwhelming majority of its revenue from fees, rather than interest on loans, unlike traditional banks.

Assets under custody and administration rose 9% to $46.9 trillion, driven by higher equity market values globally. Assets under management fell 2% to $1.9 trillion.

Provisions for credit losses were $270 million, up from $231 million in the year-ago period. Noninterest expense was $3.11 billion, flat year-over-year.

The bank boosted its dividend to 42 cents per share quarterly, up 13.5% from the prior payment, and the 13th consecutive year of increases. We boosted our estimate of earnings sharply to a new estimate of $5.00 per share.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$1.74	$2.41	$2.85	$3.17	$3.31	$4.21	$4.02	$4.01	$4.18	$4.59	***$5.00***	***$7.35***
DPS	$0.58	$0.66	$0.68	$0.72	$0.86	$1.04	$1.18	$1.24	$1.33	$1.42	***$1.68***	***$2.14***
Shares[1]	1,142	1,118	1,085	1,048	1,013	1,007	901	879	826	808	***795***	***725***

BNY Mellon's earnings-per-share were a bit underwhelming coming out of the financial crisis as they were roughly flat for six years. However, since 2013 BNY Mellon has fixed its efficiency issues, leading to better margins as it is now more prepared to take advantage of revenue increases. To that end, we are forecasting 8% earnings-per-share growth annually moving forward.

BNY Mellon can achieve this growth in a variety of ways. First, revenue continues to grow over time, something we expect to continue under normalized conditions. Its assets under custody and administration continue to grow as well, particularly during strong equity markets, which is a key driver of fee income. Its lending business is small but growing and continues to add to top line growth as well, although we caution against weakening economic prospects in this unit

[1] Share count in millions

for 2023. We note that issues with AUM and lending margins tend to move in cycles, so BNY Mellon should see some respite from its headwinds over time. We also see the bank continuing its share repurchases over time, resulting in a meaningful tailwind for earnings-per-share outside of revenue and earnings growth. Finally, we expect margins to continue to improve slightly over time as the bank realizes additional operating leverage from higher revenue outpacing expense growth. Investors would do well to continue to monitor expense growth against revenue growth for signs of margin deterioration. We also note that if equity markets begin to recover, the bank will be a beneficiary through its custodial and asset under management fee structure.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	17.2	15.1	14.5	12.7	15.1	12.6	11.9	9.6	12.2	9.9	***9.0***	***10.5***
Avg. Yld.	1.9%	1.8%	1.6%	1.8%	1.7%	2.0%	2.5%	3.2%	2.6%	3.1%	***3.7%***	***2.8%***

The stock's earnings multiple is now just 9, under our estimate of fair value at 10.5 times earnings. Given this, we see a modest tailwind to total returns in the coming years from the valuation. We expect the dividend yield to return to about 3% in the coming years. The stock is now cheaper than it has been at any point in the past decade, which we find very attractive given the strength of its fundamentals.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	34%	28%	27%	25%	29%	25%	29%	31%	32%	31%	***34%***	***29%***

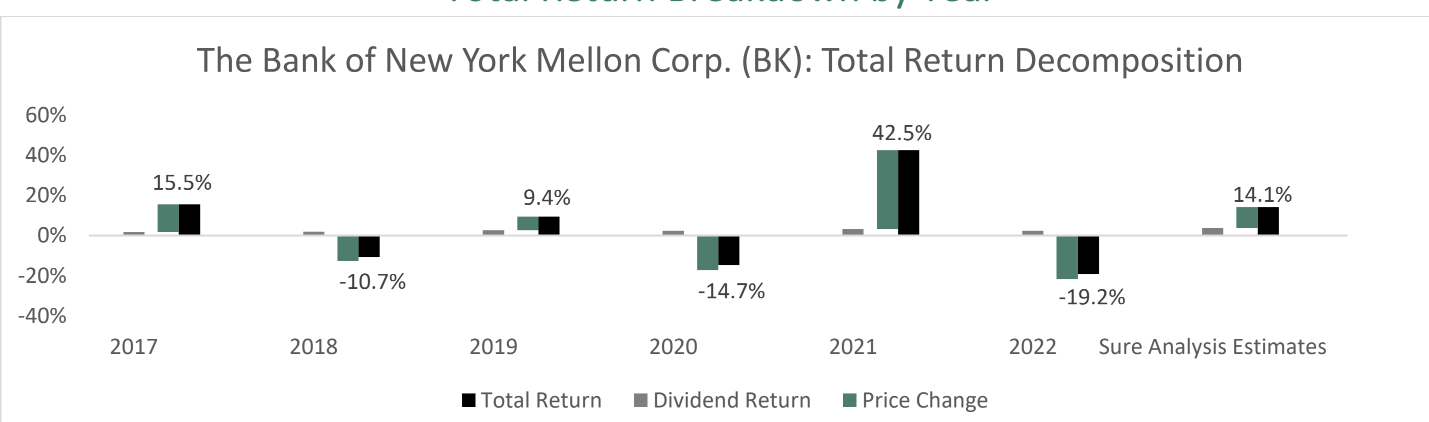
BNY Mellon's dividend is only about a third of its earnings, consistent with other large bank peers. That means the payout is very safe and we expect it to continue growing in the mid-single digits annually in the years to come.

BNY Mellon's competitive advantage is in its lack of reliance upon lending for revenue. This allows it to perform relatively well during recessions when other banks are struggling. While the company is not immune to downturns, its fee model is more resilient to such conditions than a bank that makes the majority of its revenue from interest income. Indeed, when many banks suffered in 2020, BNY Mellon saw essentially flat earnings year-over-year.

Final Thoughts & Recommendation

Overall, BNY Mellon looks like an undervalued stock with strong growth potential. We are forecasting total annual returns of 14.1% going forward, given the valuation tailwind of 3.1%, 3.7% yield, and 8% earnings growth. We are therefore boosting the stock from hold to buy on much stronger return potential.

Total Return Breakdown by Year



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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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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	14,613	15,264	14,656	14,213	14,426	15,295	15,434	15,472	15,633	16,034
SG&A Exp.	6,336	6,113	6,104	6,054	6,262	6,373	6,276	5,966	6,337	6,800
D&A Exp.	1,389	1,292	1,457	1,502	1,474	1,339	1,315	1,630	1,867	1,636
Net Profit	2,104	2,567	3,158	3,547	4,090	4,266	4,441	3,617	3,759	2,573
Net Margin	14.4%	16.8%	21.5%	25.0%	28.4%	27.9%	28.8%	23.4%	24.0%	16.0%
Free Cash Flow	-1,251	3,693	3,526	5,442	3,470	4,888	-1,114	3,816	1,623	13,722
Income Tax	1,592	912	1,013	1,177	496	938	1,120	842	877	768

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets ($B)	374.5	385.3	393.8	333.5	371.8	362.9	381.5	469.6	444.4	405.8
Cash & Eq. ($B)	146.1	123.1	134.9	77.9	108.8	88.0	114.7	162.1	121.3	113.9
Acc. Receivable	4,100	4,773	4,097	4,628	5,200	4,363	4,426	4,129	4,635	858
Goodwill & Int.	23,776	23,328	22,815	22,365	22,474	22,222	22,083	22,392	22,599	19,051
Total Liab. ($B)	336.2	346.8	355.0	294.0	330.1	322.1	339.9	423.5	401.0	346.9
Long-Term Debt	20,623	21,050	22,070	25,217	34,082	34,329	32,059	26,334	26,680	30,855
Total Equity	35,935	35,879	35,485	35,269	37,709	37,096	37,941	41,260	38,196	35,896
LTD/E Ratio	0.55	0.56	0.58	0.65	0.83	0.84	0.77	0.58	0.62	0.76

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	0.6%	0.7%	0.8%	1.0%	1.2%	1.2%	1.2%	0.8%	0.8%	0.6%
Return on Equity	5.9%	7.1%	8.9%	10.0%	11.2%	11.4%	11.8%	9.1%	9.5%	6.9%
ROIC	3.6%	4.3%	5.2%	5.7%	5.8%	5.7%	6.0%	4.9%	5.3%	3.6%
Shares Out.	1,142	1,118	1,085	1,048	1,013	1,007	901	892	856	815
Revenue/Share	12.66	13.42	13.17	13.26	13.87	15.19	16.37	17.34	18.26	19.68
FCF/Share	(1.08)	3.25	3.17	5.08	3.34	4.85	-1.18	4.28	1.90	16.84

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