



Alerus Financial (ALRS)

Published January 26th, 2024 by Aristofanis Papadatos

Key Metrics

Current Price:	\$23	5 Year CAGR Estimate:	3.6%	Market Cap:	\$430 M
Fair Value Price:	\$16	5 Year Growth Estimate:	8.0%	Ex-Dividend Date:	3/12/24 ¹
% Fair Value:	147%	5 Year Valuation Multiple Estimate:	-7.5%	Dividend Payment Date:	4/12/24
Dividend Yield:	3.3%	5 Year Price Target	\$23	Years Of Dividend Growth:	18
Dividend Risk Score:	B	Retirement Suitability Score:	B	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 \$430 million and is characterized by prudent management. As a result, it has raised its dividend for 18 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 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 January, Alerus Financial reported (1/24/24) financial results for the fourth quarter of fiscal 2023. It grew its loans 6% sequentially and its net interest margin widened from 2.27% to 2.37%, as loan growth more than offset higher deposit costs amid intense competition among banks. As a result, net interest income grew 6%. On the other hand, the bank sold \$172 million of bonds at a loss of \$24.6 million due to 16-year high interest rates. As a result, it switched from earnings-per-share of \$0.45 to a loss per share of -\$0.73. The stock came under pressure last year due to the broad sell-off of regional banks, which resulted from the collapse of Silicon Valley Bank, Credit Suisse and First Republic. However, Alerus Financial has endured the financial turmoil, which has subsided, and thus its stock has retrieved most of its losses. Deposits grew 8% in the fourth quarter while the bank has a solid tier 1 capital ratio of 11.8%.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$1.48	\$1.21	\$1.00	\$1.07	\$1.84	\$1.91	\$2.52	\$2.97	\$2.10	\$0.58	\$1.30	\$1.91
DPS	\$0.38	\$0.42	\$0.44	\$0.48	\$0.53	\$0.57	\$0.60	\$0.63	\$0.72	\$0.76	\$0.76	\$1.00
Shares²	13.9	13.9	14.0	14.0	14.1	15.1	17.4	17.5	20.2	20.0	20.0	25.0

Alerus Financial has exhibited a decent performance record over the last decade. During this period, the bank grew its earnings-per-share at a 4.1% average annual rate until 2022, though it posted 10-year low earnings-per-share last year due to its losses from the sale of bonds amid high interest rates. 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. Alerus Financial may incur additional losses from the sale of securities this year but it is likely to recover in the upcoming years, assisted by the interest rate reductions expected by the Fed. Overall, given the low comparison base formed this year, we assume 8.0% average annual growth of earnings-per-share over the next five years.

¹ Estimated date.

² In millions.

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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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	12.4	16.2	17.7	18.0	13.0	10.6	8.2	10.1	11.7	31.7	17.7	12.0
Avg. Yld.	2.1%	2.1%	2.5%	2.5%	2.2%	2.8%	2.9%	2.1%	2.9%	4.1%	3.3%	4.4%

Due to its low earnings this year, Alerus Financial is trading at a price-to-earnings ratio of 17.7, which is higher than the 10-year average price-to-earnings ratio of 15.0 of the stock. We assume a fair earnings multiple of 12.0 for the stock, in line with the norm for banks. If the stock trades at this valuation level in five years, it will incur a -7.5% annualized drag.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	26%	35%	44%	45%	29%	30%	24%	21%	34%	131%	58%	52%

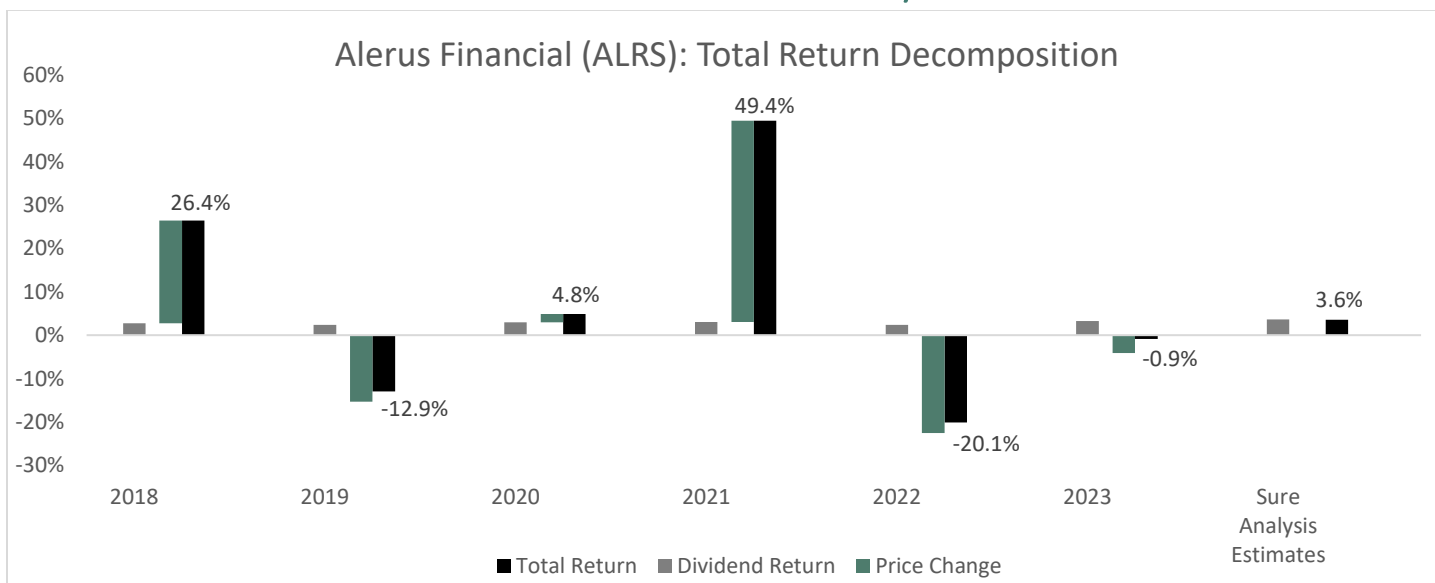
Alerus Financial has fairly prudent management, which is focused on maintaining healthy credit quality metrics. During the last 25 years, the bank has maintained an average net loan charge-off ratio of only 0.3%. Thanks to its cautious strategy, the company has proved resilient to recessions. Most banks 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 dipped due to the decrease in the value of the fixed-income investments of the bank caused by 16-year high interest rates.

Alerus Financial raised its dividend by 5.6% last year. As a result, it has raised its dividend for 18 consecutive years and is currently offering a dividend yield of 3.3%. Given its healthy payout ratio of 58% 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 thanks to its acquisition of Metro Phoenix Bank and has endured the turmoil caused by the collapse of a few banks. The stock has rallied 28% since our last research report, in October, and hence it could offer just a 3.6% average annual return over the next five years thanks to 8.0% earnings-per-share growth and its 3.3% dividend, partly offset by a -7.5% annualized valuation headwind. We lower our rating from “buy” to “hold”.

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.

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