



TowneBank (TOWN)

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Key Metrics

Current Price:	\$27	5 Year CAGR Estimate:	6.1%	Market Cap:	\$2.0 B
Fair Value Price:	\$24	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	6/28/24
% Fair Value:	113%	5 Year Valuation Multiple Estimate:	-2.3%	Dividend Payment Date:	7/12/24
Dividend Yield:	3.7%	5 Year Price Target	\$31	Years Of Dividend Growth:	13
Dividend Risk Score:	D	Retirement Suitability Score:	D	Rating:	Hold

Overview & Current Events

TowneBank is a financial services company that was founded in 1999 and is headquartered in Portsmouth, Virginia. It started with three offices in 1999 and now operates 51 banking offices throughout Hampton Roads and Central Virginia, as well as Northeastern and Central North Carolina. The bank provides retail and commercial banking services to individuals and corporations. It has the #1 market share in deposits in Hampton Roads and has a market capitalization of \$2.0 billion. The bank operates through three segments: Banking, Realty and Insurance.

In late April, TowneBank reported (4/24/24) financial results for the first quarter of fiscal 2024. Loans and deposits grew 2.5% and 4%, respectively, over the prior year's quarter. Net interest margin contracted from 3.36% to 2.74% due to increased deposit costs amid intense competition among banks. As a result, net interest income decreased -16% and earnings-per-share declined -23%, from \$0.62 to \$0.48, in line with the analysts' consensus. The bank has exceeded the analysts' estimates only once in the last six quarters. Net interest margin has contracted for four consecutive quarters due to the impact of 16-year high interest rates on deposit costs. On the bright side, TowneBank expects the headwind from high interest rates to begin to subside in the upcoming quarters. More precisely, the bank expects net interest income to improve from \$103 million in the first quarter to \$106-\$112 million in the second quarter and total \$460-\$475 million in the full year. We expect just a -3% decrease in earnings-per-share this year.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$1.18	\$1.22	\$1.18	\$1.41	\$1.88	\$1.92	\$2.01	\$2.97	\$2.60	\$2.06	\$2.00	\$2.55
DPS	\$0.43	\$0.47	\$0.51	\$0.55	\$0.62	\$0.70	\$0.72	\$0.78	\$0.89	\$0.98	\$1.00	\$1.22
Shares¹	35.2	51.2	57.0	62.4	71.3	72.2	72.3	72.6	72.6	74.8	76.0	90.0

TowneBank has consistently grown its earnings-per-share over the last decade thanks to its disciplined expansion. The bank has grown its earnings-per-share by 6.4% per year on average over the last decade but by only 1.8% per year on average over the last five years due to the impact of 16-year high interest rates on deposit costs. Just like nearly all regional banks, TowneBank has proved vulnerable to the headwind from 16-year high interest rates. Fortunately, the Fed has provided guidance for a material reduction in interest rates, from 5.25%-5.5% now to 2.75%-3.0% after 2026. As a result, TowneBank is likely to experience an improvement in its net interest margin in the upcoming years. Given the somewhat low comparison base formed this year by the 5-year low expected earnings-per-share, we expect 5.0% average annual growth of earnings-per-share over the next five years.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	12.8	14.5	19.4	22.7	16.1	14.1	10.1	10.2	11.5	12.6	13.5	12.0
Avg. Yld.	2.8%	2.7%	2.2%	1.7%	2.1%	2.6%	3.5%	2.6%	3.0%	3.8%	3.7%	4.0%

¹ In millions.

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TowneBank has traded at an average price-to-earnings ratio of 12.0 over the last five years. We assume this valuation level as fair for this stock. TowneBank is currently trading at a price-to-earnings ratio of 13.5. If it trades at its fair valuation level in five years, it will incur a -2.3% annualized valuation drag.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	36%	39%	43%	39%	33%	36%	36%	26%	34%	48%	50%	48%

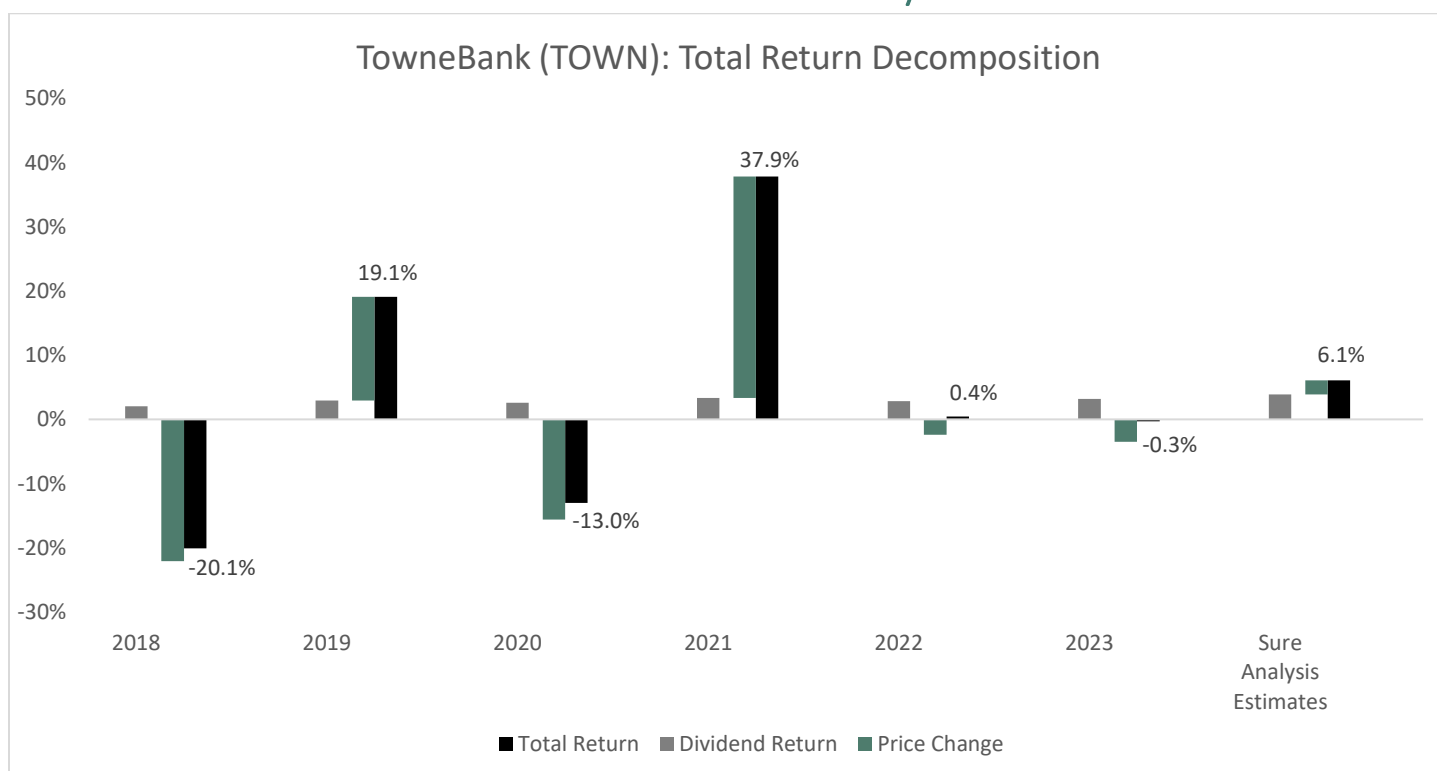
TowneBank has raised its dividend for 13 consecutive years. It is offering a nearly 10-year high dividend yield of 3.7%, which is roughly in line with the median yield of the financial sector. The payout ratio is standing at a 10-year high of 50% but the dividend seems to have a margin of safety, given the recovery in earnings expected in the upcoming years.

TowneBank has a healthy tier 1 capital ratio of 12.3% while its net loan charge-offs have remained below 0.05% and its non-performing loans have remained below 0.12% in each of the last five quarters. In addition, the bank proved resilient to the pandemic, as it posted record earnings-per-share in 2020 and 2021. However, TowneBank proved vulnerable to the downturn caused by the surge of interest rates in 2022-2023, with a -31% decrease in earnings-per-share in 2023 vs. 2021. We also note its pronounced underperformance vs. the S&P 500 over the last five years (-1% vs. +88%) and over the last decade (+64% vs. +175%). Overall, TowneBank is offering a dividend with a wide margin of safety but it is not immune to unexpected downturns.

Final Thoughts & Recommendation

TowneBank is likely to soon begin recovering from the increased deposit costs that have resulted from the 16-year high interest rates prevailing right now. However, the market has already priced a portion of future growth in the stock. We expect the stock to offer a 6.1% average annual return over the next five years thanks to 5.0% growth of earnings-per-share and its 3.7% dividend, partly offset by a -2.3% valuation headwind. The stock receives a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	242	297	373	448	532	563	662	679	686	695
SG&A Exp.	120	141	174	205	244	262	253	267	280	305
D&A Exp.	14	16	21	25	29	29	29	29	29	34
Net Profit	42	62	67	88	134	139	146	215	189	154
Net Margin	17.4%	21.0%	18.0%	19.6%	25.1%	24.6%	22.0%	31.7%	27.5%	22.1%
Free Cash Flow	33	58	166	128	297	(26)	82	488	363	117
Income Tax	18	27	29	55	34	33	32	55	47	31

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	4,982	6,297	7,974	8,522	11,163	11,948	14,626	16,361	15,845	16,835
Cash & Equivalents	214	252	137	521	687	443	1,864	3,297	1,153	1,128
Goodwill & Int. Ass.	136	181	303	309	492	501	498	508	502	521
Total Liabilities	4,364	5,476	6,887	7,380	9,625	10,294	12,843	14,445	13,957	14,779
Long-Term Debt	398	429	688	774	1,047	720	705	405	277	460
Shareholder's Equity	532	811	1,075	1,131	1,526	1,641	1,767	1,899	1,874	2,040
LTD/E Ratio	0.65	0.53	0.64	0.68	0.69	0.44	0.40	0.21	0.15	0.23

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	0.9%	1.1%	0.9%	1.1%	1.4%	1.2%	1.1%	1.4%	1.2%	0.9%
Return on Equity	7.0%	8.7%	7.1%	7.9%	10.0%	8.7%	8.5%	11.6%	9.9%	7.8%
ROIC	4.2%	5.5%	4.4%	4.8%	5.9%	5.6%	6.0%	9.0%	8.4%	6.6%
Shares Out.	35.2	51.2	57.0	62.4	71.3	72.2	72.3	72.6	72.6	74.8
Revenue/Share	6.87	5.81	6.57	7.19	7.46	7.80	9.15	9.36	9.46	9.31
FCF/Share	0.93	1.13	2.93	2.05	4.16	(0.37)	1.13	6.72	5.00	1.57

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

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