Mercantile Bank Corporation (MBWM)

Published July 22nd, 2024, by Kody Kester

Key Metrics

Current Price:	$49	**5 Year CAGR Estimate:**	9.8%	**Market Cap:**	$783M
Fair Value Price:	$53	**5 Year Growth Estimate:**	5.5%	**Ex-Dividend Date:**	09/06/24
% Fair Value:	92%	**5 Year Valuation Multiple Estimate:**	1.7%	**Dividend Payment Date:**	09/18/24
Dividend Yield:	2.9%	**5 Year Price Target**	$70	**Years Of Dividend Growth:**	12
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**Rating:**	Hold

Overview & Current Events

Formed in 1997, Mercantile Bank Corporation has established itself as one of the largest banks strictly located in Michigan. As of June 30, MBWM had $5.6 billion in assets. The company operates more than 40 office locations, mostly in West and Central Michigan. The company also has banking offices in the metro Detroit area, Traverse City area, Saginaw area, and Midland area.

Unsurprisingly, MBWM offers a variety of banking services to an array of customers. That includes personal checking, savings, and term certificate accounts for retail/individual customers. Other products provided to these customers include residential real estate loans, home equity loans, and consumer loans like new and used automobile loans, and credit cards. MBWM also serves commercial and industrial customers with a variety of loans, such as vacant land loans, land development loans, and residential construction loans. The company also offers courier services to some commercial customers and safe deposit facilities at most of its office locations.

Of note, MBWM did acquire an existing shelf insurance agency in 2002. Should it choose to do so, the company could enter the business of selling insurance products like homeowners' insurance, umbrella insurance, small business and life insurance, and private passenger automobile insurance. To this point, though, the company has opted to focus all its efforts on being a community bank.

On July 16, MBWM shared its financial results for the second quarter ended June 30. The company's net interest income decreased by 1% year-over-year to $47.1 million in the quarter. A higher mix of higher-cost deposit products offset respectable growth in total deposits (10.4% growth to $4.1 billion) during the quarter. This led to a 42-basis point year-over-year contraction (and an 11-point reduction sequentially) in net interest margin to 3.63% for the quarter. MBWM's non-interest income grew by 26.6% over the year-ago period to $9.7 million in the quarter. This was attributed to higher levels of mortgage banking income and account service charges.

MBWM's diluted EPS declined by 7.9% year-over-year to $1.17 during the second quarter. The headwind to net interest margin offset the company's higher net revenue base. Still, MBWM's diluted EPS came in $0.01 better than anticipated because of its strong growth in deposits.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$1.28	$1.62	$1.96	$1.90	$2.53	$3.01	$2.71	$3.69	$3.85	$5.13	***$4.85***	***$6.34***
DPS	$0.48	$0.58	$0.66	$0.74	$0.92	$1.06	$1.12	$1.18	$1.26	$1.34	***$1.44***	***$1.88***
Shares[1]	17.0	16.4	16.4	16.6	16.5	16.4	16.3	15.8	16.0	16.1	***16.1***	***16.1***

MBWM's growth in recent years has stalled. But as alluded to above, this is more because of external factors than it is internal. In recent years, MBWM has had to deal with the temporary impact of the COVID-19 pandemic. It also is contending with a greater proportion of high-cost deposit products. As this headwind eventually subsides, the

[1] Share count is in millions.

company's net interest margin should improve. That should return MBWM's diluted EPS base to mid- to upper-single-digit annual growth beyond next year.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Avg. P/E	16.0	15.1	19.2	18.6	11.4	12.2	10.0	9.5	8.7	7.9	***10.1***	***11.0***
Avg. Yld.	2.3%	2.4%	1.8%	2.1%	3.2%	2.9%	4.1%	3.4%	3.8%	3.3%	***2.9%***	***2.7%***

Over the past 10 years, MBWM's P/E ratio has varied from as low as the high-single-digits in recent years to the high teens. The average P/E ratio in that time has been just shy of 13. Conservatively, we believe that the company's fair value multiple is around 11. That implies the current P/E ratio of 10.1 is modestly below MBWM's fair value multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	38%	36%	34%	39%	36%	35%	41%	32%	33%	26%	***30%***	***30%***

MBWM's differentiating factor lies in its status as one of the bigger community banks in Michigan. The company faces competition from regional banks and national banks. But few know the communities they serve as well as MBWM. Simply put, the company is big enough to serve the needs of its customers. Yet, it still provides that hometown feeling that many customers prefer.

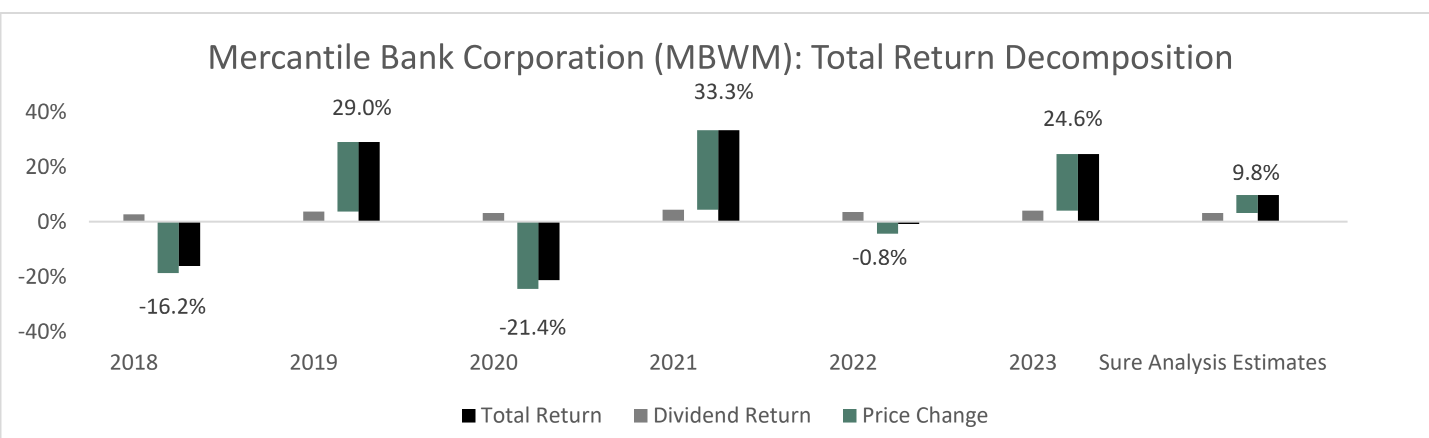
MBWM's loan-to-deposit ratio of 107% is above the peer median of 88%. This does leave its balance sheet somewhat vulnerable relative to its peers. However, MBWM counters this elevated risk with solid execution. The company's efficiency ratio of 51.3% is better than the peer median of 55.4% (the lower the better).

As could be imagined for a community bank, MBWM's dividend isn't perfectly safe. It's worth noting that about half of the company's total loans are related to commercial real estate. MBWM's payout ratio is positioned to be just 29% in 2024. That high dividend coverage ratio builds breathing room for the payout to be modestly grown through the current downturn in profitability. This could even provide some insurance against some further deterioration in the commercial real estate market.

Final Thoughts & Recommendation

MBWM's 2.9% dividend yield, 5.5% annual diluted EPS growth prospects, and potential for 1.7% annual valuation multiple expansion could deliver 9.8% annual total returns for the next five years. These returns are somewhat appealing, but not quite enough to justify an entry currently. Therefore, we're initiating coverage with a hold rating.

Total Return Breakdown by Year



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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	88	117	127	129	139	151	167	179	190	226
SG&A Exp.	42	53	54	56	62	65	62	69	68	73
D&A Exp.	8	12	10	10	10	10	9	14	13	11
Net Profit	17	27	32	31	42	49	44	59	61	82
Net Margin	19.7%	23.1%	25.1%	24.3%	30.2%	32.6%	26.4%	32.9%	32.1%	36.4%
Free Cash Flow	12	35	33	33	55	31	29	59	117	60
Income Tax	8	12	15	15	10	11	11	15	15	20

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	2,893	2,904	3,083	3,287	3,364	3,633	4,437	5,258	4,873	5,353
Cash & Equivalents	162	89	184	200	75	234	626	975	97	131
Goodwill & Int. Ass.	65	62	59	57	55	53	52	51	49	49
Total Liabilities	2,565	2,570	2,742	2,921	2,989	3,216	3,996	4,801	4,431	4,831
Long-Term Debt	108	123	220	266	396	401	442	496	446	607
Shareholder's Equity	328	334	341	366	375	417	442	457	441	522
LTD/E Ratio	0.33	0.37	0.65	0.73	1.06	0.96	1.00	1.09	1.01	1.16

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	0.8%	0.9%	1.1%	1.0%	1.3%	1.4%	1.1%	1.2%	1.2%	1.6%
Return on Equity	7.2%	8.2%	9.5%	8.9%	11.3%	12.5%	10.3%	13.1%	13.6%	17.1%
ROIC	5.2%	6.0%	6.3%	5.2%	6.0%	6.2%	5.2%	6.4%	6.6%	8.2%
Shares Out.	17.0	16.4	16.4	16.6	16.5	16.4	16.3	15.8	16.0	16.1
Revenue/Share	6.48	7.04	7.78	7.81	8.38	9.23	10.29	11.21	12.00	14.09
FCF/Share	0.91	2.10	2.00	2.02	3.34	1.91	1.78	3.69	7.37	3.74

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