Mercantile Bank Corporation (MBWM)

Updated October 15th, 2024, by Kody Kester

Key Metrics

Current Price:	$44	**5 Year CAGR Estimate:**	12.3%	**Market Cap:**	$703M
Fair Value Price:	$53	**5 Year Growth Estimate:**	5.5%	**Ex-Dividend Date:**	12/06/24
% Fair Value:	82%	**5 Year Valuation Multiple Estimate:**	4.1%	**Dividend Payment Date:**	12/18/24
Dividend Yield:	3.3%	**5 Year Price Target**	$69	**Years Of Dividend Growth:**	12
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**Rating:**	Buy

Overview & Current Events

Formed in 1997, Mercantile Bank Corporation has established itself as one of Michigan's largest community banks. As of Sept. 30th, MBWM had $5.9 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 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 October 15th, MBWM released its financial results for the third quarter ended Sept. 30th. The company's net interest income declined by 1.4% over the year-ago period to $48.3 million during the quarter. Once again, double-digit growth in loans (10.8% to $4.5 billion) was canceled out by a greater mix of higher-cost deposit products. That resulted in a 46-basis point year-over-year decrease in the net interest margin (and 11 basis points sequentially) to 3.52% in the quarter. MBWM's non-interest income grew by 4.6% over the year-ago period to $9.7 million for the quarter. This was due to higher levels of mortgage banking income, treasury management fees, and payroll service fees. MBWM's diluted EPS fell by 6.2% over the year-ago period to $1.22 during the quarter. This came in $0.05 better than the analyst consensus in the quarter. Impressive loan growth was to credit for the diluted EPS beat.

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	***$4.81***	***$6.29***
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 has hit a wall in the last few years. Thankfully, we don't believe this will last for much longer. This is because the Federal Reserve began cutting interest rates last month. Additionally, a slew of further cuts should be on the way in the next 12 to 24 months. That should help the community bank's net interest margins eventually improve and restore it to mid-single-digit annual diluted EPS through 2029 (with more significant growth anticipated in the back half of that period).

[1] Share count is 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	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	***9.0***	***11.0***
Avg. Yld.	2.3%	2.4%	1.8%	2.1%	3.2%	2.9%	4.1%	3.4%	3.8%	3.3%	***3.3%***	***2.7%***

Over the past decade, MBWM's P/E ratio has been as low as the high-single-digits in recent years to the high teens. The average P/E ratio over that time has been just short of 13. Conservatively, we still believe that the company's fair value multiple is around 11. That implies the current P/E ratio of 9.0 is moderately less than 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.

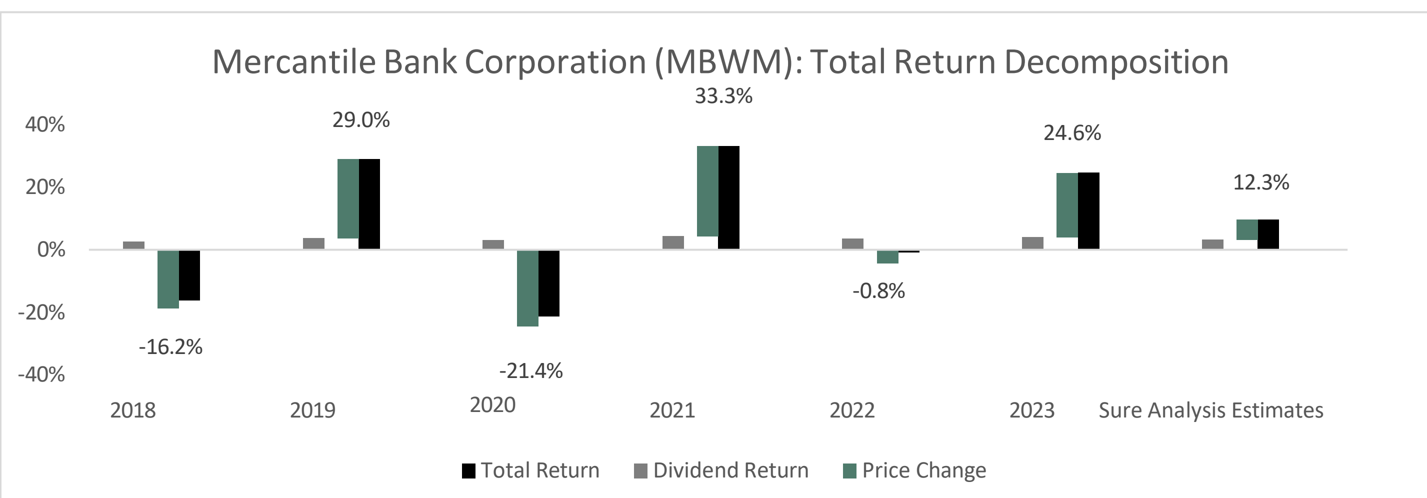
MBWM's loan-to-deposit ratio of 102% as of Sept. 30th is somewhat high for a community bank. However, MBWM offsets this risk with great execution. The company's efficiency ratio was 55.7% in the third quarter. This implies that the community bank knows how to manage its non-interest expenses.

As could be imagined for a community bank, MBWM's dividend isn't perfectly safe. It's worth noting that approximately half of the company's total loans are related to commercial real estate. MBWM's payout ratio is positioned to be just 30% in 2024. This dividend coverage ratio builds breathing room for the payout to be modestly grown through the current downturn in profitability. This could even provide some flexibility against some further deterioration in the commercial real estate market.

Final Thoughts & Recommendation

MBWM's 3.3% dividend yield, 5.5% annual diluted EPS growth prospects, and 4.1% annual valuation multiple upside could produce 12.3% annual total returns for the next five years. These returns are enough to swing the community bank from a hold rating in our initial coverage to a buy rating now.

Total Return Breakdown by Year



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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.