ChoiceOne Financial Services (COFS)

Updated November 7th, 2024 by Aristofanis Papadatos

Key Metrics

Current Price:	$36	**5 Year CAGR Estimate:**	7.4%	**Market Cap:**	$296 M
Fair Value Price:	$37	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date[1]:**	12/12/24
% Fair Value:	97%	**5 Year Valuation Multiple Estimate:**	0.7%	**Dividend Payment Date:**	12/27/24
Dividend Yield:	3.0%	**5 Year Price Target**	$45	**Years Of Dividend Growth:**	12
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**Rating:**	Hold

Overview & Current Events

ChoiceOne Financial Services is the holding company for ChoiceOne Bank, which is headquartered in Sparta, Michigan. Founded in 1898, ChoiceOne Bank has grown to a bank with a full range of financial services. It operates 37 offices and has a market capitalization of $296 million. The bank offers a variety of deposit, payment, credit and other financial services to all types of customers. These services include time, savings, and demand deposits, safe deposit services, and automated transaction machine services. The bank also offers loans to consumers and corporations.

ChoiceOne Bank faces significant competition from much larger financial institutions in its operating area. Due to competition for deposits, the bank cannot achieve a higher-than-typical net interest margin. On the other hand, ChoiceOne Bank performed better than most regional banks in the downturn caused by the surge of interest rates in 2022-2023. While many banks incurred material losses due to the plunge in their fixed-income securities, ChoiceOne Bank posted record earnings-per-share of $3.15 in 2022 and incurred just a -10% decrease last year.

On July 25th, 2024, ChoiceOne Financial Services agreed to acquire Fentura Financial (FETM) in an all-stock deal valued at $180.4 million. Each share of Fentura will be converted to 1.35 shares of ChoiceOne Financial Services. The deal, which is expected to close in Q1-2025, will create the 3rd largest bank in Michigan, with 56 offices in the area. As the deal value is 61% of the market cap of ChoiceOne Financial Services, it is likely to prove a major growth driver for the bank.

In late October, ChoiceOne Financial Services reported (10/23/24) results for the third quarter of 2024. Net interest income grew 25% over the prior year's quarter, as net interest margin expanded from 2.64% to 3.17%, despite higher costs of deposits. In addition, the bank grew its loans and deposits by 18% and 5%, respectively. As a result, earnings-per-share grew 37%, from $0.68 to $0.93, and exceeded the analysts' consensus by $0.19. Given the impressive improvement in net interest margin, we have raised our forecast for annual earnings-per-share from $3.05 to $3.30.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$1.56	$1.58	$1.68	$1.70	$2.02	$1.58	$2.08	$2.87	$3.15	$2.82	***$3.30***	***$4.01***
DPS	$0.54	$0.60	$0.62	$0.64	$0.71	$0.80	$0.82	$0.94	$1.01	$1.05	***$1.08***	***$1.32***
Shares[2]	3.6	3.6	3.6	3.6	3.6	4.5	7.5	7.7	7.5	7.5	***8.6***	***15.0***

In 2020, ChoiceOne Financial Services acquired Community Shores Bank and became the 12th largest bank holding company in Michigan based on asset size. ChoiceOne Financial Services remains a low-market cap company but it has decent growth prospects. It has grown its earnings-per-share by 6.8% per year on average over the last nine years. Moreover, it is on track to expand significantly thanks to the aforementioned pending merger with Fentura Financial. Nevertheless, we prefer to be conservative, given the small size of the bank. Given our expectations for lower interest rates in the upcoming years and material synergies from the pending merger with Fentura Financial, we expect 4% growth of earnings-per-share on average over the next five years.

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[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	9.9	11.7	10.9	11.6	12.1	17.5	13.9	8.9	7.4	8.6	***10.9***	***11.3***
Avg. Yld.	3.5%	3.2%	3.4%	3.2%	2.9%	2.9%	2.8%	3.7%	4.4%	4.3%	***3.0%***	***2.9%***

ChoiceOne Financial Services has traded with an average price-to-earnings ratio of 11.3 over the last decade and over the last five years. We assume this as a fair valuation level for the bank. The stock is currently trading at a price-to-earnings ratio of 10.9. We expect the stock to trade at its average valuation level in five years. In such a case, the stock will enjoy a 0.7% annualized gain thanks to the expansion of its valuation level.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	35%	38%	37%	38%	35%	51%	39%	33%	32%	37%	***33%***	***33%***

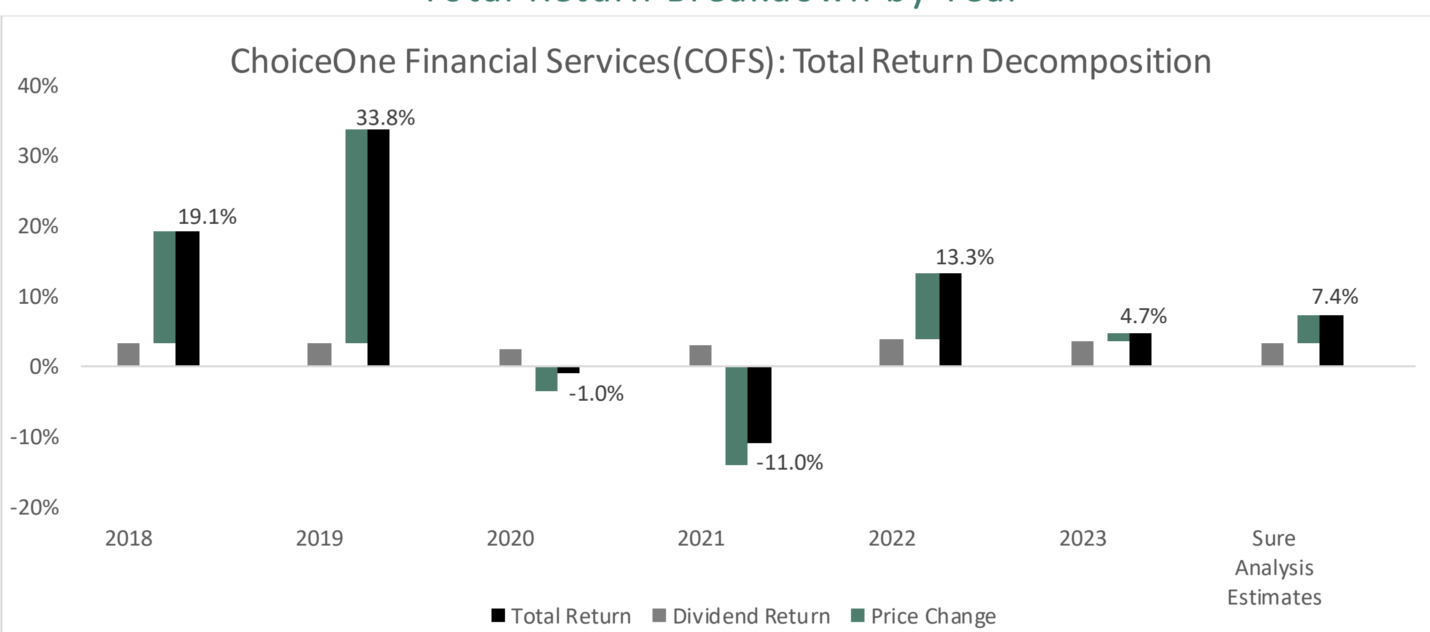
ChoiceOne Financial Services is smaller than many of its competitors while competition has greatly heated among banks for customer deposits. As a result, ChoiceOne Financial Services does not have a meaningful competitive advantage and hence it experiences a typical net interest margin.

The bank has grown its dividend for 12 consecutive years and is offering a 3.0% yield, which is equal to the median yield of the financial sector. In addition, the bank has grown its dividend by 7% per year on average over the last five years and has a healthy payout ratio of 33%, which provides room for meaningful dividend hikes in the upcoming years. Given also the fairly resilient performance of the company in the downturn caused by high interest rates, the stock is suitable for income-oriented investors, though investors should always be aware of the increased risk of small-cap stocks.

Final Thoughts & Recommendation

ChoiceOne Financial Services has rallied 25% since our last research report, in August, but it remains attractive thanks to its expanding net interest margin and its major pending merger. Despite its steep rally, the stock could offer a 7.4% average annual return over the next five years thanks to 4.0% earnings-per-share growth, its 3.0% dividend and a 0.7% annualized valuation tailwind. We lower our rating from “buy” to “hold” but still consider the stock attractive.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	25	26	27	27	29	37	74	80	81	81
SG&A Exp.	9	10	10	11	11	15	28	31	32	34
D&A Exp.	2	2	3	2	2	3	8	12	13	12
Net Profit	6	6	6	6	7	7	16	22	24	21
Net Margin	23.1%	22.0%	22.4%	22.5%	25.3%	19.4%	21.2%	27.6%	29.0%	26.3%
Free Cash Flow	7	3	9	6	6	8	7	35	44	42
Income Tax	2	2	2	2	1	1	3	4	4	4

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	550	568	607	647	671	1,386	1,919	2,367	2,386	2,577
Cash & Equivalents	17	11	15	37	20	60	80	32	44	55
Goodwill & Int. Ass.	15	14	14	14	14	59	66	64	63	62
Total Liabilities	483	498	536	570	590	1,194	1,692	2,145	2,217	2,381
Long-Term Debt	18	11	12	20	5	33	12	85	85	236
Shareholder's Equity	66	70	72	77	80	192	227	222	169	196
LTD/E Ratio	0.28	0.16	0.17	0.26	0.07	0.17	0.05	0.38	0.50	1.20

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	1.1%	1.0%	1.0%	1.0%	1.1%	0.7%	0.9%	1.0%	1.0%	0.9%
Return on Equity	8.9%	8.4%	8.6%	8.3%	9.3%	5.3%	7.4%	9.8%	12.1%	11.7%
ROIC	7.5%	6.9%	7.4%	6.8%	8.0%	4.6%	6.7%	8.1%	8.4%	6.2%
Shares Out.	3.6	3.6	3.6	3.6	3.6	4.5	7.5	7.7	7.5	7.5
Revenue/Share	6.76	7.17	7.50	7.57	7.99	8.14	9.79	10.36	10.81	10.67
FCF/Share	1.83	0.81	2.51	1.77	1.58	1.86	0.88	4.54	5.83	5.58

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