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Popular, Inc. (BPOP - NASDAQ - Recent Price: $39.90)

BPOP: 2Q20 Results Beat Estimates, But NIM Compression Leads to Reduced EPS Expectations.

2Q20 Results: Popular reported a 2Q20 net income to common stockholders of $127.3 million, up 278.4% compared to the $33.6 million posted in 1Q20. On a per share basis, BPOP reported earnings of $1.49 compared to $0.37 in 1Q20. The 2Q20 results exceeded our $1.06 estimate and the median $0.93 Street consensus estimate. The primary driver of the outperformance versus our projections were a lower-than-expected provision for loan losses and lower operating expenses, offset partially by lower interest income and lower noninterest income. Highlights of the quarter include:

- Gross loans held-for-investment showed strong growth, advancing $1.4 billion or 5.1% compared to 1Q20, while rising to 29.1 billion. The primary driver was the $1.4 billion in PPP loans originated during the quarter. Mortgage loans also rose, contributing $427 million to loan growth during the quarter. Offsetting these gains were reductions of $237 million in consumer loans and $50 million in auto loans. The BPPR segment showed loan growth of roughly $1.2 billion while the Popular US segment grew approximately $208 million. Government restrictions related to COVID-19 that prevented banks from closing mortgage loans and extending auto loans have been relaxed to some extent, allowing growth of $395 million in Puerto Rico mortgage loans,
- Total deposits rose $9.0 billion or 20.2% linked-quarter to $53.8 billion. Noninterest bearing deposits experienced a $3.1 billion increase, while interest bearing deposits, led by savings, NOW and money market accounts, grew $5.9 billion. Public sector deposits advanced by $4.2 billion sequentially to roughly $14.0 billion. Meanwhile, brokered deposits increased $152 million. The bulk of the deposit increase occurred in the BPPR segment. The growth in deposits was far in excess of the $1.4 billion in loan growth, with the excess going into the securities portfolio (up $4.95 billion) and money market investments (up $3.7 billion sequentially).
- Net interest income fell $22.2 million or 4.7% from the prior quarter, as a 15.5% rise in average earning assets was unable to overcome 69 bps of NIM compression to 3.25%. Average loan yields fell 55 bps sequentially, with the biggest drop occurring in average commercial loan yields, which slumped 88 bps due in part to the low yields on PPP loans. In addition, lower-yielding securities became a greater portion of earning assets. Meanwhile, the average cost of interest bearing deposits fell 29 bps sequentially, leading to a 30 bps decrease in the average cost of interest bearing liabilities. The big increase in

Market Data		Earnings Per Share Data					
				Our Forecast		Consensus	
			2019A	2020E	2021E	2020	2021
Market Value (M)	$3,214	1Q (Mar.)	$ 1.69	$ 0.37	$ 0.88	$1.45	$1.29
ADTV (Shs)	741,963	2Q (Jun.)	$ 1.76	$ 1.49	$ 0.88	$0.93	$1.42
ADTV (000')	$29,604.3	3Q (Sep.)	$ 1.70	$ 1.37	$ 0.80	$1.23	$1.41
52 Week Range	$23.69-$61.46	4Q (Dec.)	$ 1.72	$ 1.34	$ 0.91	$1.21	$1.43
Dividend Yield	4.27%	Year	$ 6.88	$ 4.50	$ 3.46	$3.72	$5.15
		P / E	5.8	8.9	11.5	10.7	7.8

Fundamental Metrics (MRQ)

Balance Sheet	
Total Assets (M)	$62,845
Gross Loans HFI (M)	$29,071
Total Deposits (M)	$53,844
Loans / Deposits	54%
Securities / Assets	33%
Debt / Assets	2%
Profitability	
FTE NIM	3.56%
Nonint. Income / Revenue	19%
Efficiency Ratio	58%
Core ROAA	0.87%
Core ROAE	9.73%
Credit Quality	
NPAs / Assets	1.40%
NPLs / Loans	2.70%
NCO Ratio	0.92%
Reserves / Loans	3.16%
Provision / Avg Loans	0.88%
Capital Adequacy	
TCE / TA Ratio	8.1%
Total Capital Ratio	18.3%
Tier 1 Ratio	15.8%
Tier 1 CE Ratio	15.8%
Leverage Ratio	8.1%
Performance	
Core Value	$12.67
3 Yr. Success Ratio	-33%
Failure Ratio	5.8%

Source: SNL Financial, Company data

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deposits during the quarter without a corresponding rise in loan demand resulted in a sharp rise in low-yielding assets that hurt the NIM.

- Noninterest income declined $14.6 million or 11.5% sequentially in 2Q20. The disruptions caused by the stay-at-home orders and business closures were again apparent in several areas, as credit & debit card fees fell $8.6 million due to lower transaction volumes, deposit service charges declined $11.5 million due partly to waivers of fees during the pandemic, and mortgage banking revenues fell $2.6 million due lower service fees and an unfavorable fair value adjustment on mortgage servicing rights. Partially offsetting these decreases, BPOP posted a favorable $3.6 million adjustment to indemnity reserves on previously sold loans, and a $5.2 million unrealized gain equity securities related to deferred compensation, though this item has an offsetting expense included in personnel expenses.
- Noninterest expenses fell $24.4 million or 6.5% linked-quarter to $348.2 million. Compensation fell $7.7 million due to lower commissions, annual incentives, and other bonuses. Professional fees dipped $8.5 million due to lower processing & technology services and lower advisory expenses. Also contributing to the expense reduction was a $1.9 million decline in marketing fees and a $2.8 million drop in OREO expenses due to a suspension of foreclosure activity. Many of these declines are the result of plans management announced last quarter to reduce operating expenses in light of the reduced economic activity. The guidance at that point was for quarterly operating expenses, excluding profit sharing expenses, to average approximately $369 million for the year, though results for 2Q20 came in considerably below that figure.
- BPOP posted an income tax expense of $24.6 million in 2Q20, which translates to an effective tax rate of 16.2%, which is within management' expectation of an effective tax rate of 14%-18% for 2020.
- The 2Q20 provision for credit losses was $62.4 million, down $127.3 million or 67.1% compared to the $189.7 million recorded in 1Q20. The prior quarter included significant provision expense related to changes to the economic outlook as a result of the COVID-19 pandemic, as well as a Day 1 impact of adopting the CECL accounting standard of $315.1 million. The allowance for loan and lease losses dipped $1.3 million to $918.4 million. The allowance for credit losses now stands at 3.16% of loans held-for-investment and 120.81% of NPLs, compared to 3.32% and 119.65%, respectively, at March 31, 2020.
- NPLs held-in-portfolio decreased $8.5 million or 1.1% sequentially. As a result, NPLs decreased to 2.62% of total loans from 2.78% at March 31, 2020 but were up from 2.09% a year ago. NPL inflows rose $21.0 million in 2Q20 to $106.2 million compared to $85.1 million in 1Q20. Meanwhile, OREO decreased $10.0 million or 8.1%. Total NPAs declined to 1.40% of total assets compared to 1.71% at March 31, 2020. Net charge-offs increased 3.9% sequentially, rising to 0.92% of average loans held-in-portfolio versus 0.91% in 1Q20.
- Regulatory capital ratios decreased modestly compared to 1Q20. The leverage ratio fell to 8.13% from 8.94% in the prior period, the total risk-based capital ratio declined to 18.27% from 18.36%. All of BPOP's regulatory ratios remain far in excess of the minimums required to be considered "well-capitalized".
- Tangible book value per share rose to $60.13 from $56.17 at March 31, 2020. Meanwhile, the TCE ratio slipped to 8.15% at June 30, 2020, down from 9.50% as of March 31, 2020.
- The previously announced accelerated stock repurchase (ASR) plan was pushed forward by the pandemic and the subsequent sharp decline in stock market valuations. BPOP completed the ASR in May, receiving 4.7 million shares at that time, bringing the total repurchase to 11.8 million shares at an average price of $42.3043 per share. The final

transaction under the ASR accounted for $2.20 of the $3.96 increase in tangible book value during the quarter.

Earnings Estimates: Despite the weak economic environment, government relief programs have created a surge in liquidity for many banks. Popular experienced a significant boost to its loan portfolio as a result of the PPP program, but an even greater spike in deposits, as PPP funds found their way into Popular deposit accounts while other government relief efforts caused a boost in public deposits. The jump in liquidity went into low yielding PPP loans and low yielding securities, causing a significant drag on the bank's NIM.

The course of the COVID-19 pandemic is unclear. Given the current deterioration in metrics nationwide, however, it appears that the reduced economic activity associated with the pandemic could be with us for the remainder of 2020. Still, the liquidity being pumped into the economy should have an impact. We expect loans to decline modestly over the next few quarters as PPP loans are forgiven. Healthier originations of mortgage and auto loans will offset some of the lost PPP loans, but not all of it. We expect modest loan growth of roughly 2.0% in 2021. On the deposit side, we expect the excess public funds and the customer deposits associated with the PPP loans to show significant drawdowns over the next several quarters. This should drive reductions in short-term investments. While the interest rate environment is still unfavorable, an improved mix of earning assets coupled with accelerated fee recognition from PPP loan forgiveness should help the NIM regain some of the ground lost in 2Q20. We are projecting 7 bps of NIM expansion in 3Q20. Our full year NIM projection for 2020 is now 3.48%, much lower than our previous estimate of 3.85%. The jump in liquidity accounts for most of the change.

Credit costs, which have trended favorably for the last several years, will be a more significant variable in results going forward. Payment moratoriums make it difficult to glean what we can expect in terms of charge-offs, but there is little doubt that a number of business and consumer an increase in charge-offs leading to loan loss provisions of $95 million to $110 million per quarter over the next year. This is considerably higher than the $62 million recorded in 2Q20, but still well below the $190 million posted in 1Q20.

With the changes outlined above, we are raising our 2020 EPS estimate from $4.06 to $4.53, while reducing our 2021 estimate from $5.13 to $3.52, primarily reflecting a lower NIM expectation. We are setting our initial 2022 estimate at $3.76.

Outlook: Puerto Rico is suffering from the same business disruptions from the COVID-19 pandemic as the reat of the U.S. However, Puerto Rico is still dealing with the aftereffects of Hurricane Maria in late 2017, a government debt crisis, and earthquakes in early 2020. Contrary to what many believe, Puerto Rico is not entirely dependent on tourism. This sector accounts for approximately 7% of GDP. Still, this sector has been deeply harmed by the pandemic. Other sectors, however, such as the pharmaceutical and medical device manufacturing segments could see long-term benefits from the pandemic, as moves to reduce reliance on China and other foreign countries prompts calls for increased incentive to bring manufacturing of critical items back to the U.S. Of more immediate impact, the disaster relief programs related to the hurricanes and earthquakes could provide some support to Puerto Rico's economy that other jurisdictions lack. There is little doubt that many small businesses will close for good before this crisis is over. Still, we believe that Puerto Rico has the resiliency and means to recover at a similar pace with other parts of the U.S.

As the dominant financial institution in Puerto Rico, Popular has a number of advantages, including it's ubiquitous branch network and its pricing power. Popular has long maintained exceptional profitability in Puerto Rico. This profitability may be reduced for a time, but we expect Popular's advantage over peer mainland banks to continue. Of course, the bank also maintains very strong capital levels, and we believe the company is still well positioned to provide increasing levels of capital returns to shareholders when the current crisis passes.

Due to changes in our coprorate structure and a desire to avoid conflicts of interest, we are discontinuing the practice of providing target prices and stock ratings in our reports. However, we still believe we have insights to offer and value to add for the small number of securities that we continue to provide research coverage for.

Exhibit 1:

Popular, Inc.: 2Q20 Highlights

	Actual Results			Change	
	2Q19	**1Q20**	**2Q20**	**LQ[1]**	**YOY**
Loans Held for Investment ($Millions)2	27,006	27,662	29,071	20.4%	7.6%
Total Deposits ($Millions)2	42,060	44,797	53,844	80.8%	28.0%
Average Earning Assets ($Millions)	46,397	48,149	55,636	62.2%	19.9%
Total Revenue ($Millions)	615	600	563	-24.5%	-8.4%
Net Interest Income ($Millions)	476	473	451	-18.8%	-5.3%
NIM (FTE)	4.11%	3.94%	0.00%	-3.94%	-4.11%
Average Securities Yield	3.13%	2.63%	1.64%	-0.99%	-1.49%
Average Loan HFI Yield	6.94%	6.79%	6.24%	-0.55%	-0.70%
Average Cost of Int.-bearing Deposits	0.96%	0.72%	0.43%	-0.29%	-0.53%
Efficiency Ratio	59.2%	61.7%	62.0%	0.24%	2.7%
NCO Ratio	0.71%	0.92%	0.92%	0.01%	0.22%

1. Linked quarter changes for the balances are annualized.

2. Loans Held for Investment and Total Deposits balances are end of period balances.

Source: company filings

Exhibit 2:

Popular, Inc.

(Figures in $Millions except for per share data)

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2018A	2019A	2020E	2021E	2022E		1Q 2020A	2Q 2020A	3Q 2020E	4Q 2020E	1Q 2021E	2Q 2021E	3Q 2021E	4Q 2021E
1,735	1,892	1,881	1,828	1,916	Net interest income	473	451	481	475	456	456	456	461
228	166	444	444	469	Provision for loan losses	190	62	95	96	106	110	116	113
1,507	1,726	1,437	1,384	1,447	**Net Interest Income after Provision**	283	388	386	379	350	346	340	348
151	161	129	105	102	Deposit Service Charges	42	30	29	29	27	26	26	26
53	32	18	19	23	Mortgage Banking revenue	6	4	4	4	4	5	5	5
136	146	111	118	137	Credit & Debit Card Fees	33	25	26	27	27	29	30	31
96	106	98	97	100	Other Operating Fees	24	22	23	29	22	22	24	29
(13)	(0)	(1)	2	0	Gains (losses) on sales of loans	(4)	1	1	1	1	(0)	0	0
95	-	-	-	-	Gains (losses) on FDIC indemnification asset (former	-	-	-	-	-	-	-	-
(2)	4	0	-	-	Other Gains (Losses)	(2)	3	-	-	-	-	-	-
138	122	111	120	128	Other non interest income	27	28	28	28	30	30	30	30
652	570	467	460	491	**Total non-interest income**	127	112	110	118	111	112	115	123
					Total Non-interest expense								
563	591	571	603	639	Compensation and Benefit	147	139	142	143	152	149	150	152
72	84	85	88	92	Equipment expenses	22	21	21	21	22	22	22	22
88	96	102	106	110	Occupancy	25	25	25	26	26	26	27	27
66	75	52	54	60	Marketing expense	14	12	13	13	12	14	14	14
350	384	383	396	426	Professional Fees	101	93	94	95	97	97	100	103
23	4	7	10	11	OREO expenses	2	(0)	2	2	3	3	3	3
247	242	237	245	257	Other Expenses	61	58	59	59	60	61	62	62
1,409	1,477	1,437	1,502	1,596	**Total non-interest expense**	373	348	357	360	371	371	377	382
618	671	393	285	284	**Net Income**	34	128	117	114	74	72	65	73
					Per Share Data:								
6.06	6.88	4.53	3.52	3.76	Earnings Per Share	0.37	1.49	1.38	1.35	0.89	0.90	0.82	0.93
1.00	1.20	1.50	1.75	1.95	Dividend	0.30	0.40	0.40	0.40	0.40	0.45	0.45	0.45
19.56%	17.48%	33.34%	49.73%	51.82%	Dividend Payout Ratio	83.62%	27.06%	28.90%	29.60%	44.78%	50.14%	55.16%	48.60%
53.88	62.42	70.34	77.17	84.96	Book Value	64.08	68.40	69.38	70.34	73.44	75.75	76.40	77.17
46.90	55.10	62.07	68.32	75.43	Tangible Book Value	56.17	60.13	61.12	62.07	64.87	66.96	67.58	68.32
101	97	86	80	75	Average Shares Outstanding (MM)	91	85	84	84	83	80	79	79
					Profitability Measures:								
59.22%	60.01%	61.21%	65.67%	66.32%	Efficiency Ratio	61.73%	61.98%	60.36%	60.79%	65.70%	65.33%	66.05%	65.60%
1.33%	1.33%	0.69%	0.50%	0.49%	Return on average assets	0.27%	0.87%	0.78%	0.78%	0.52%	0.51%	0.45%	0.51%
11.36%	11.75%	7.12%	4.78%	4.63%	Return on average equity	2.52%	9.73%	8.36%	7.90%	5.13%	4.89%	4.29%	4.82%
4.01%	4.03%	3.48%	3.43%	3.51%	Net Interest Margin	3.95%	3.26%	3.33%	3.43%	3.44%	3.44%	3.42%	3.44%
24.40%	23.04%	19.87%	20.11%	20.40%	Fee Income % Revenues	21.41%	19.54%	18.66%	19.83%	19.51%	19.72%	20.17%	21.02%
					Average Balances:								
25,063	26,807	28,167	28,140	28,951	Loans	27,405	28,280	28,780	28,204	27,919	27,989	28,213	28,439
29,697	33,345	38,223	37,394	38,058	Interest Bearing Deposits	34,644	39,978	39,618	38,653	37,981	37,366	37,077	37,153
8,790	8,873	10,618	10,804	10,918	Non-interest Bearing Deposits	9,005	11,006	11,325	11,135	10,986	10,802	10,711	10,718
43,275	46,945	54,120	53,237	54,582	Earning Assets	48,149	55,636	57,575	55,120	53,731	53,201	52,870	53,148
31,576	34,770	39,675	38,424	39,510	Interest Bearing Liabilities	35,971	41,314	41,621	39,794	38,838	38,400	38,134	38,325
					Asset Quality Ratios:								
1.12%	0.96%	1.16%	1.56%	1.59%	Net Charge-offs / Avg Loans	0.92%	0.92%	1.37%	1.41%	1.54%	1.55%	1.58%	1.55%
2.81%	2.36%	3.69%	4.31%	4.31%	Nonperforming Assets / Loans	3.25%	3.02%	3.38%	3.69%	3.96%	4.21%	4.30%	4.31%
2.15%	1.74%	3.44%	3.39%	3.32%	Reserves / Loans	3.32%	3.16%	3.39%	3.44%	3.80%	3.79%	3.93%	3.92%
1.05%	0.94%	1.16%	1.53%	1.55%	Provision /Loans	0.91%	0.90%	1.38%	1.42%	1.53%	1.54%	1.57%	1.54%
					Capital & Leverage Ratios:								
11.42%	11.55%	10.29%	10.61%	10.41%	Equity / Assets	10.74%	9.20%	9.78%	10.29%	10.43%	10.62%	10.67%	10.63%
9.95%	10.20%	9.08%	9.39%	9.25%	Tangible Equity / Assets	9.42%	8.09%	8.62%	9.08%	9.22%	9.39%	9.44%	9.42%

Disclosure Appendix

Analyst Certification:

I, Joseph Gladue, the primary analyst covering this issuer, certify that: 1) all of the views expressed in this report accurately reflect my personal views about the subject security or issuer, and 2) no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Risk Factors:

The realization of any or all of the following risk factors, among others, may adversely affect the company's stock price and prevent it from reaching our target price, if one is established:

- a weakening of the United States economy and the regional and local economies in which the company conducts operations
- unanticipated loan losses or securities-related losses
- a weakening of local real estate markets or the soundness and liquidity of the securities market for real-estate backed assets
- failure to maintain sufficient excess capital or liquidity to conduct operations
- the effects of trade, monetary, and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System
- the effects of increased inflation, a flatter yield curve, or increased volatility in financial markets
- inability to attract core deposits or continue to obtain third party financing on favorable terms
- adverse legal action against the company or litigation initiated by the company
- inability to successfully integrate acquired operations or to maintain sufficient excess capital post the close of a transaction

Investment Rating Definitions:

Investment ratings reflect the analyst's assessment of the subject stock's return potential relative to the NASDAQ Bank Index. There are three investment rating tiers:

- **Outperform/Buy:** The subject stock's total return is expected to exceed the return of the NASDAQ Bank Index by 10% or more over the next 12-month period.
- **Neutral/Hold:** The subject stock's total return is expected to be comparable with the return of the NASDAQ Bank Index over the next 12-month period.
- **Underperform/Sell:** The subject stock's total return is expected to be less than the return of the NASDAQ Bank Index by 10% or more over the next 12-month period.

Investment Rating Distributions (as of June 30, 2020)

	All Covered Companies		Investment Banking Services Provided in the Last 12 Months	
Rating Categories	**Count**	**% of Total**	**Count**	**% of Category**
Outperform/Buy	6	100%	0	0%
Neutral/Hold	NA	0%	0	0%
Underperform/Sell	NA	0%	0	0%
Total	6	100%		

Other Important Disclosures:

J. Alden Associates, Inc. (DBA Alden Securities) is a FINRA-registered broker-dealer.

Alden Securities expects to receive compensation for investment banking services from the subject company in the next three months and/or seeks to receive such compensation.

Analyst compensation is based, in part, on Alden Securities' profitability, which includes revenues from investment banking.

Target prices, if applicable, are derived from our 12 Month Valuation Assessment. Our 12 Month Valuation Assessment is based on a blend of several relative value methodologies.

Alden Securities shares in the commissions for trades that are executed through Tourmaline Partners, LLC.