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Earnings Review

July 29, 2020

Howard Bancorp, Inc. (HBMD - NASDAQ - Recent Intraday Price: $9.35)

HBMD: Despite 2Q20 Loss Caused by Goodwill Write-Down, Bank is Well-Positioned for NIM Stability and Market Share Growth.

2Q20 Results: Howard Bancorp reported a 2Q20 net loss of $(29.4) million compared to 1Q20 net income of $3.3 million. This translates to EPS of $(1.57) in 2Q20 compared to $0.18 in 1Q20. There were several significant irregular or non-recurring items affecting 2Q20 results. The biggest was a goodwill impairment charge of $34.5 million or $1.84 per share. In addition, a litigation reserve and FHLB prepayment penalties amounted to $1.2 million pre-tax or a $0.05 cut to EPS. Offsetting these to some extent were securities gains of $3.0 million, which provided a boost of $0.12 to EPS. Included in 1Q20 results was a $788k expense related to the departure of the CFO. Excluding these nonrecurring items and the revenues and expenses from the discontinued mortgage operations from both quarters, "adjusted" EPS was $0.20 in 2Q20 and $0.14 in 1Q20. Adjusted 2Q20 results exceeded our $0.19 estimate by a penny and the median Street estimate by $0.07. The outperformance versus our estimate was due to higher net interest income and lower compensation costs, offset partially by a higher-than-expected loan loss provision.

Highlights from the quarter include:

- Net interest income was $18.1 million in 2Q20, up 3.4% compared to the prior sequential quarter. Average earning assets climbed 7.4% from the prior quarter while the NIM contracted 12 basis points sequentially to 3.22%. Fair value adjustments on acquired loans contributed 9 bps to the NIM this quarter, up from 5 bps in the prior quarter. The main driver of the NIM contraction was a 40 bps decrease in the average yield on loans. Average CRE loan yields fell 54 bps sequentially and construction loan yields declined 58 bps sequentially. In addition, the addition of low-yielding PPP loans reduced average loan portfolio yields by 13 bps. Meanwhile, AFS securities suffered a 47 bps decline in average yields. This drove a 43 bps reduction in average earning asset yields. Meanwhile, the cost of interest bearing liabilities was down 34 bps compared to 1Q20, as a 30 bps drop in the average cost of deposits combined with a 49 bps drop in the cost of FHLB borrowings.
- Noninterest income rose $1.4 million or 41.4% linked-quarter to $4.8 million. The increase was primarily due to $3.1 million in securities gains recognized during the quarter and a $1.0 million decline in mortgage banking activity after HBMD exited this business line. Lower economic activity also affected service charges on deposit accounts, which fell $0.2 million or 32.6% sequentially, and loan-related income, which declined $0.4 million or 69.9%.

Market Data			Earnings Per Share Data					
				Our Forecast			Consensus	
			2019A	2020E	2021E		2020	2021
Market Value (M)	$178	1Q (Mar.)	$ 0.22	$ 0.18	$ 0.22		$0.22	$0.15
ADTV (Shs)	38,625	2Q (Jun.)	$ 0.11	$ (1.57)	$ 0.22		$0.14	$0.15
ADTV (000')	$366.9	3Q (Sep.)	$ 0.24	$ 0.20	$ 0.23		$0.11	$0.16
52 Week Range	$8.44-$19.20	4Q (Dec.)	$ 0.31	$ 0.24	$ 0.24		$0.19	$0.17
Dividend Yield	0.00%	Year	$ 0.89	$ (0.94)	$ 0.91		$0.57	$0.47
		P / E	10.7	(10.1)	10.5		16.7	20.4

Fundamental Metrics (MRQ)	
Balance Sheet	
Total Assets (M)	$2,463
Gross Loans HFI (M)	$1,899
Total Deposits (M)	$1,831
Loans / Deposits	104%
Securities / Assets	12%
Debt / Assets	11%
Profitability	
FTE NIM	3.22%
Nonint. Income / Revenue	9%
Efficiency Ratio	58%
Core ROAA	-4.68%
Core ROACE	-35.87%
Credit Quality	
NPAs / Assets	0.84%
NPLs / Loans	0.97%
NCO Ratio	0.01%
Reserves / Loans	0.86%
Provision / Avg Loans	0.64%
Capital Adequacy	
TCE / TA Ratio	10.1%
Total Capital Ratio	14.1%
Tier 1 Ratio	11.7%
Tier 1 CE Ratio	11.7%
Leverage Ratio	9.2%
Performance	
Core Value	$12.67
3 Yr. Success Ratio	-33%
Failure Ratio	NA

Source: SNL Financial, Company data

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- Noninterest expenses increased $30.1 million or 227.1% sequentially. The main cause was a $34.5 million goodwill impairment charge. Also contributing to the increase was a $1.0 million accrual for legal expenses related to pre-merger First Mariner mortgage loans and $224k in FHLB prepayment penalties. Absent these items, “core” noninterest expenses were down $431k compared to 1Q20. Decreases $555k in compensation and $77k in data processing expenses were partly offset by a $181k increase in OREO expenses.
- The provision for loan losses in 2Q20 was $3.0 million, down 12.9% compared to the $3.4 million recorded in 1Q20. HBMD still operates under the incurred loss model, rather than the CECL model adopted by many larger banks at the beginning of 2020. The bank experienced minor net charge-offs of $28k or 0.01% of average loans during the quarter, compared to $462k or 0.11% of average loans in 1Q20. The loan loss reserve climbed $3.0 million or 22.2% from the prior quarter to $16.4 million. Reserve coverage of total loans (excluding PPP loans) advanced to 0.96% from 0.76% at March 31, 2020, while reserve coverage of NPLs grew to 88.6% from 77.8%.
- NPLs rose $1.3 million or 7.4% sequentially while OREO decreased $0.2 million or 8.0%. Total NPAs (including performing TDRs) advanced 5.5% LQ to 0.84% of total assets from 0.78% at March 31, 2020.
- Gross loans held-for investment climbed $137.2 million or 7.8% from the prior quarter. The growth was driven by the $199.0 million in PPP loans originated during the quarter. Absent PPP loans, “portfolio” loans declined $56.5 million to $1.7 billion. The decrease was concentrated in C&I loans, which fell $36.1 million, and residential mortgages, which were down $23.0 million. This should result in roughly $6.6 million in fee income to the bank over the life of the loan, offset partially by $770k of deferred origination costs.
- Total deposits advanced $41.8 million or 2.3% in 2Q20. This fell well short of the $137.2 million growth in gross loans held-for-investment but exceeded the $56.5 million drop in “portfolio” loans. Much of the deposit growth was in noninterest bearing accounts, which rose $188.1 million. With this strong growth in customer deposits, management allowed $109.8 million of brokered and other non-customer deposits to run-off. At the same time, HBMD reduced cash by $136.9 million sequentially and lowered short-term borrowings by $98.0 million The loans-to-deposits ratio jumped to 103.7% from 98.5% at March 31, 2020, driven largely by the PPP loans.
- Tangible book value per share rose to $13.08 at June 30, 2020 from $12.91 at March 31, 2020. Tangible common equity-to-tangible assets was 10.09% at June 30, 2020 compared to 9.93% at March 31, 2019.
- The total risk-based capital ratio rose 93 bps sequentially to 14.09% while the Tier 1 leverage ratio advanced 8 bps to 9.18%. All of the regulatory ratios remain well above the levels needed to be considered “well capitalized”.

Earnings Estimates:

Howard has excess liquidity on its balance sheet, much like most other banks in this environment. However, Howard made strides in reducing the excess liquidity in 2Q20 while other banks were still growing theirs. With gradual maturities of higher-cost CDs over the next few quarters, coupled with a boost in yields from the forgiveness of PPP loans and the associated acceleration of PPP fee income, we believe that HBMD may see just a few bps of additional NIM deterioration over the remainder of 2020. For 2021, we are modeling a few bps of NIM improvement each quarter as additional high-cost CDs roll off and PPP loans pay off. Of course, the reduction in PPP loans over the next several quarters will have a negative impact on loan and deposit balances. We expect the loan portfolio to shrink over the next three quarters before slowing PPP payoffs and the resumption of more normal economic activity allows the loan portfolio to resume growth. Deposit balances should follow a similar path.

The company has made significant progress on expense reduction initiatives such as branch consolidations and a core systems conversion. We believe the bulk of the savings from these efforts have been realized, but we still expect expenses to remain low, averaging in the $12.0 million to $12.5 million quarterly range through the end of 2021.

Management notes that asset quality measures have remained very good so far, and that government stimulus programs have likely helped a number of businesses that might otherwise have faltered. At the same time, HBMD has continued to build the credit loss reserve, and we believe that reserve build will continue in 3Q20. We have increased our estimate for the credit loss provision in 3Q20 to reflect this, but we have also boosted the provision for subsequent quarters as well, reflecting the greater length and depth of the COVID-19 pandemic compared to our outlook three months ago.

After making these adjustments, we are reducing our 2020 EPS forecast from $(0.94) to $0.73, mainly reflecting the loss incurred in 2Q20. If we exclude the goodwill impairment and other "non-core" items from 1Q20 and 2Q20 results, our estimate for "core" 2020 EPS is $0.78. We are raising our 2021 estimate from $0.82 to $0.91 and introducing a 2022 estimate of $1.07.

Outlook:

HBMD appears to us to be well positioned to make it through the current crisis while coming out on the other side with above average earnings growth and profitability. The bank's position as the largest local bank in Baltimore and its performance with the PPP program should help the bank grow its customer base in the area. Meanwhile, the bank has taken steps to increase its presence in the Washington DC area. The bank's significant portion of fixed-rate loans (roughly $1.0 billion of the portfolio is fixed rate) should dampen any ongoing downward trend in loan yields while higher-cost funding sources continue to mature, helping prevent significant further NIM compression. Expense reduction efforts have been successful and we expect little growth in expenses going forward. With the bank trading well below tangible book value, we believe HBMD remains an attractive investment.

Due to changes in our corporate 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:

Howard Bancorp, Inc.: 2Q20 Highlights

	Actual Results			Change	
	2Q19	**1Q20**	**2Q20**	**LQ**[1]	**YOY**
Loans Held for Investment ($000)[2]	1,701,020	1,761,419	1,898,630	31.2%	11.6%
Total Deposits ($000)[2]	1,717,216	1,788,899	1,830,674	9.3%	6.6%
Average Earning Assets ($000)	1,970,508	2,108,809	2,265,240	29.7%	15.0%
Total Revenue ($000)	22,537	20,891	19,828	-20.4%	-12.0%
Net Interest Income ($000)	17,354	17,525	18,119	13.6%	4.4%
NIM (FTE)	3.53%	3.34%	3.22%	-0.12%	-0.31%
Average AFS Securities Yield	3.05%	2.76%	2.29%	-0.47%	-0.76%
Average Loan HFI Yield	5.00%	4.58%	4.18%	-0.40%	-0.82%
Average Cost of Int.-bearing Deposits	1.27%	1.07%	0.77%	-0.30%	-0.50%
Efficiency Ratio	82.5%	66.0%	235.4%	169.43%	153.0%
NCO Ratio	0.18%	0.11%	0.01%	-0.10%	-0.17%

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:

Howard Bancorp, Inc.

(Figures in thousanSs except for per share data)

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2017A	2018A	2019A	2020E	2021E	2022E	*Fiscal years ending December 31*	1Q20A	2Q20A	3Q20E	4Q20E	1Q21E	2Q21E	3Q21E	4Q21E
37,859	66,618	69,310	71,561	70,438	75,393	Net interest income	17,525	18,119	18,166	17,751	17,100	17,304	17,834	18,200
1,831	6,091	4,193	10,134	5,524	5,611	Provision for loan losses	3,445	3,000	2,556	1,133	1,287	1,272	1,507	1,459
36,028	60,527	65,117	61,427	64,914	69,782	**Net Interest Income after Provision**	14,080	15,119	15,610	16,619	15,813	16,032	16,327	16,742
						Non-interest income:								
923	2,216	2,747	1,958	1,776	1,937	Service charges on deposit accts	642	433	437	445	433	430	454	459
11,035	5,245	7,798	1,036	-	-	Mortgage loan and banking income	1,036	-	-	-	-	-	-	-
5,722	5,624	3,934	791	-	-	Loan related income	581	175	35	-	-	-	-	-
760	1,614	1,858	1,795	1,905	2,032	BOLI Income	445	441	450	459	466	470	480	489
86	-	-	-	-	-	Gains on sale of loans	-	-	-	-	-	-	-	-
998	3,161	4,697	5,752	3,127	3,587	Other fees & non-interest income	662	3,710	673	707	742	779	795	811
19,524	17,860	21,034	11,332	6,809	7,556	**Total non-interest income**	3,366	4,759	1,595	1,611	1,641	1,679	1,729	1,759
						Total Non-interest expense								
23,573	33,674	32,056	27,596	26,459	27,827	Salaries and employee Benefits	8,441	6,259	6,384	6,512	6,372	6,564	6,695	6,829
4,154	10,650	9,077	4,759	5,189	5,507	Occupancy & Equipment	1,033	1,242	1,230	1,254	1,267	1,286	1,305	1,331
3,743	3,523	2,700	1,009	736	788	Loan related expense	468	192	173	176	179	182	185	189
13,730	35,265	20,245	53,190	16,293	15,483	Other Noninterest Expenses	4,618	39,934	4,297	4,341	4,010	4,060	4,101	4,122
45,200	83,112	64,078	86,554	48,676	49,605	**Total non-interest expense**	14,560	47,627	12,084	12,284	11,828	12,092	12,286	12,470
7,200	(3,828)	16,881	(17,765)	17,285	20,800	**Net Income**	3,343	(29,409)	3,841	4,460	4,219	4,215	4,328	4,523
						Per Share Data:								
0.75	(0.22)	0.89	(0.94)	0.91	1.07	Diluted Earnings Per Share	0.18	(1.57)	0.20	0.24	0.22	0.22	0.23	0.24
-	-	-	-	-	-	Dividend	-	-	-	-	-	-	-	-
0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	Dividend Payout Ratio	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
13.47	15.48	16.48	15.51	16.25	17.13	Book Value Per Share	16.85	15.14	15.31	15.51	15.68	15.86	16.05	16.25
13.23	11.16	12.57	13.55	14.48	15.53	Tangible Book Value Per Share	12.91	13.08	13.30	13.55	13.77	14.00	14.24	14.48
9,598	17,557	19,071	18,831	19,093	19,478	Average Diluted Shares OutstanSing (MM)*	18,915	18,791	18,763	18,857	18,951	19,046	19,141	19,237
						Profitability Measures:								
76.78%	94.00%	67.14%	103.84%	57.94%	54.97%	Efficiency Ratio	65.98%	235.41%	56.24%	58.51%	57.95%	58.52%	57.73%	57.59%
0.67%	-0.19%	0.75%	-0.75%	0.72%	0.83%	Return on average assets	0.57%	-4.68%	0.62%	0.74%	0.72%	0.72%	0.72%	0.74%
5.82%	-1.44%	5.54%	-5.85%	5.70%	6.40%	Return on average equity	4.27%	-37.06%	5.35%	6.11%	5.79%	5.63%	5.62%	5.78%
3.74%	3.78%	3.50%	3.24%	3.22%	3.29%	Net Interest Margin	3.34%	3.22%	3.20%	3.19%	3.20%	3.21%	3.23%	3.25%
1.82%	0.89%	0.93%	0.48%	0.28%	0.30%	Fee Income % Average Assets	0.14%	0.19%	0.07%	0.07%	0.07%	0.07%	0.07%	0.07%
						Average Balances:								
930,449	1,639,878	1,735,112	1,784,658	1,826,490	1,938,336	Net Loans	1,748,035	1,882,274	1,849,982	1,784,658	1,758,794	1,776,373	1,808,397	1,826,490
218,139	429,200	468,975	599,603	584,006	598,657	Interest Bearing Deposits	483,499	671,598	644,734	599,603	593,607	581,735	588,715	584,006
645,769	1,256,606	1,245,390	1,122,241	1,146,118	1,217,605	Non-interest Bearing Deposits	1,305,400	1,159,076	1,147,485	1,122,241	1,101,479	1,112,494	1,130,294	1,146,118
1,012,005	1,763,826	1,980,275	2,211,680	2,184,921	2,291,970	Average Earning Assets	2,108,809	2,265,240	2,260,175	2,212,494	2,167,242	2,162,786	2,190,069	2,219,588
730,976	1,322,679	1,490,887	1,508,125	1,440,112	1,513,388	Average Interest Bearing Liabilities	1,565,432	1,551,743	1,466,399	1,448,926	1,424,324	1,422,708	1,445,759	1,467,659
						Asset Quality Ratios:								
0.24%	0.16%	0.22%	0.12%	0.25%	0.23%	Net Charge-offs / Loans	0.11%	0.01%	0.16%	0.19%	0.23%	0.24%	0.27%	0.28%
1.57%	1.76%	1.27%	1.36%	1.44%	1.41%	Nonperforming Assets / Loans	1.11%	1.09%	1.22%	1.36%	1.45%	1.49%	1.50%	1.44%
0.66%	0.60%	0.60%	1.02%	1.05%	1.05%	Reserves / Loans	0.76%	0.86%	0.97%	1.02%	1.05%	1.05%	1.05%	1.05%
0.20%	0.37%	0.24%	0.56%	0.30%	0.29%	Provision /Loans	0.78%	0.63%	0.55%	0.25%	0.29%	0.28%	0.33%	0.32%
						Capital & Leverage Ratios:								
11.50%	13.00%	13.23%	12.36%	12.91%	13.16%	Equity / Assets	12.57%	11.50%	11.83%	12.36%	12.68%	12.80%	12.80%	12.91%
11.30%	9.38%	10.10%	10.80%	11.50%	11.93%	Tangible Equity / Tangible Assets	9.64%	9.93%	10.28%	10.80%	11.13%	11.30%	11.35%	11.50%

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.