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Earnings Review

October 29, 2020

Popular, Inc. (BPOP - NASDAQ - Recent Price: $40.21)

BPOP: Exceeds Estimates Again, Economic Activity Improves, Raising EPS Estimates. Discontinuing Coverage.

3Q20 Results: Popular reported 3Q20 net income to common stockholders of $168.1 million, up 32.0% compared to the $127.3 million posted in 2Q20. On a per share basis, BPOP reported earnings of $2.00 compared to $1.49 in 2Q20. The 3Q20 results exceeded our $1.38 estimate and the median $1.15 Street consensus estimate. The primary driver of the outperformance versus our projections were a lower-than-expected provision for loan losses and higher noninterest income, offset partially by greater-than-expected NIM compression. Highlights of the quarter include:

- Gross loans held-for-investment showed modest growth, advancing $322 million or 1.1% compared to 2Q20, while rising to 29.4 billion. During the quarter, Popular repurchased $808 million of mortgage loans from loan servicing portfolios with FHLMC, FNMA, and GNMA in order to reduce future exposures to principal and interest advances and to deploy liquidity. As a result, mortgage loans grew $403 million or 5.4% during the quarter. However, commercial loans (including multifamily, CRE and C&I) declined $123.7 million, or 0.9% sequentially, offsetting part of the growth in mortgage loans. The BPPR segment showed loan growth of roughly $241 million while the Popular US segment grew approximately $82 million.
- Total deposits rose $2.2 billion or 4.0% linked-quarter to $56.0 billion. Noninterest bearing deposits experienced a $1.0 billion increase, while interest bearing deposits, led by savings, NOW and money market accounts, grew $1.2 billion. Public sector deposits advanced by $0.5 billion sequentially to roughly $14.5 billion. Meanwhile, brokered deposits decreased $3 million. The growth in deposits was far in excess of the $322 million in loan growth, with the excess going into money market investments (up $2.2 billion sequentially).
- Net interest income rose $10.1 million or 2.2% from the prior quarter, as a 7.6% rise in average earning assets overcame 19 bps of NIM compression to 3.06%. Average loan yields fell 8 bps sequentially, with the biggest drop occurring in average consumer loan yields, which slid 22 bps sequentially. More importantly, lower-yielding securities continued to grow as a portion of earning assets, with money market, trading and investment securities now surpassing loans as a percentage of total earning assets (52.3% to 47.7%). Meanwhile, the average cost of interest bearing deposits fell 8 bps sequentially, leading to an 8 bps decrease in the average cost of interest bearing liabilities. The big increase in deposits during the quarter without a corresponding rise in loan demand resulted in a sharp rise in low-yielding assets that hurt the NIM.

Market Data

Market Value (M)	$3,306
ADTV (Shs)	752,086
ADTV (000')	$29,526.9
52 Week Range	$23.69-$61.46
Dividend Yield	4.08%

Earnings Per Share Data

		Our Forecast		Consensus	
	2019A	2020E	2021E	2020	2021
1Q (Mar.)	$ 1.69	$ 0.37	$ 1.21	$1.45	$1.19
2Q (Jun.)	$ 1.76	$ 1.49	$ 1.18	$0.93	$1.14
3Q (Sep.)	$ 1.70	$ 2.00	$ 1.10	$1.19	$1.10
4Q (Dec.)	$ 1.72	$ 1.61	$ 1.19	$1.22	$1.14
Year	$ 6.88	$ 5.38	$ 4.66	$4.22	$4.70
P / E	5.7	7.3	8.4	9.3	8.4

Fundamental Metrics (MRQ)

Balance Sheet	
Total Assets (M)	$65,910
Gross Loans HFI (M)	$29,393
Total Deposits (M)	$56,022
Loans / Deposits	53%
Securities / Assets	33%
Debt / Assets	2%
Profitability	
FTE NIM	3.37%
Nonint. Income / Revenue	21%
Efficiency Ratio	57%
Core ROAA	1.06%
Core ROAE	12.45%
Credit Quality	
NPAs / Assets	1.27%
NPLs / Loans	2.58%
NCO Ratio	0.24%
Reserves / Loans	3.15%
Provision / Avg Loans	0.27%
Capital Adequacy	
TCE / TA Ratio	8.0%
Total Capital Ratio	18.5%
Tier 1 Ratio	16.0%
Tier 1 CE Ratio	15.9%
Leverage Ratio	7.8%
Performance	
Core Value	$12.67
3 Yr. Success Ratio	-33%
Failure Ratio	5.8%

Source: SNL Financial, Company data

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- Noninterest income advanced $16.7 million or 14.9% sequentially in 3Q20. The easing of stay-at-home orders and business closures showed up in increased credit & debit card fees (up $13.4 million) and deposit service charges (up $6.7 million). However, mortgage banking revenues fell $13.3 million, driven largely by unfavorable fair value adjustments related to the bulk loan repurchase from FNMA and FHLMC. This same transaction had a favorable impact of $5.3 million on adjustments to indemnity reserves. Also contributing to the increased noninterest income was a $2.7 million rise in securities gains and a $4.2 million advance in "other" noninterest income due partly to higher income on equity investments.
- Noninterest expenses climbed $12.8 million or 3.7% linked-quarter to $361.1 million. Compensation fell $3.2 million due to lower salaries and deferred compensation costs. Meanwhile, professional fees rose $3.9 million due to processing costs related to higher customer activity, and equipment costs increased $3.2 million due to higher amortization expenses. Also contributing to the expense rise was a $2.4 million advance in marketing fees and a $7.4 million jump in "other" noninterest expenses due to an operational loss reserves and provision for unused loan commitments. Management lowered its guidance for quarterly operating expenses, excluding profit sharing expenses, from the previous average of approximately $369 million for the year to an average of $365 million. Management expects 4Q20 operating expenses to be approximately $378 million, excluding the $23.1 million in expected expenses related to the branch closures announced along with the earnings release.
- BPOP posted an income tax expense of $41.2 million in 3Q20, which translates to an effective tax rate of 19.6%, which is above the 16.2% recorded in 2Q20, but still positions the company within management' expectation of an effective tax rate of 14%-18% for 2020.
- The 3Q20 provision for credit losses was $19.1 million, down $43.3 million or 69.4% compared to the $62.4 million recorded in 2Q20 due mostly to lower net charge-offs. The allowance for loan and lease losses rose $7.4 million to $925.9 million. The allowance for credit losses now stands at 3.15% of loans held-for-investment and 126.07% of NPLs, compared to 3.16% and 120.81%, respectively, at June 30, 2020.
- NPLs held-in-portfolio decreased $25.8 million or 3.4% sequentially, led by a $33 million drop in Puerto Rico offset by a $7 million rise in the U.S. As a result, NPLs decreased to 2.50% of total loans from 2.62% at June 30, 2020 but increased from 2.07% a year ago. NPL inflows rose $5.9 million in 3Q20 to $112.1 million compared to $106.2 million in 2Q20. Meanwhile, OREO decreased $13.3 million or 11.7%. Total NPAs declined to 1.27% of total assets compared to 1.40% at June 30, 2020. Net charge-offs decreased 74.0% sequentially, falling to 0.24% of average loans held-in-portfolio versus 0.92% in 2Q20.
- Regulatory capital ratios were fairly stable, and most increased modestly compared to 2Q20. The leverage ratio fell to 7.80% from 8.13% in the prior period, but the total risk-based capital ratio advanced to 18.49% from 18.29%. 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 $61.69 from $60.13 at June 30, 2020. Meanwhile, the TCE ratio slipped to 7.97% at June 30, 2020, down from 8.15% as of June 30, 2020.
- Popular announced a branch optimization plan in its New York region, involving closure of 11 underperforming branches in the region while retaining 27 branches. The closures will result in a pre-tax charge of $24.5 million with $23.1 million expected to be incurred in 4Q20. The cost savings from the closures are expected to be roughly $13.0 million annually.

Earnings Estimates: Though still down compared to 2019, economic activity seems to have picked up considerably in 3Q20 compared to 2Q20. The easing of COVID-19 restrictions and an influx of Federal relief funds to address Hurricane Maria, the earthquakes in the south, and the pandemic have helped soften the blow from these crises. Popular is still showing a significant hoard of deposits and liquidity as a result of the relief funds while also holding onto a significant amount of PPP loans in its loan portfolio. Though the extra assets have raised net interest income, the impact on the NIM has been depressive.

Management noted increased cement sales on the island as a sign of expanded economic activity, as well as growing volumes of auto and mortgage loan originations. We expect loans to decline modestly in 4Q20 as PPP loans are forgiven. We expect modest loan growth of roughly 2.1% 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 expand some in 4Q20 before falling back again in subsequent quarters. We are projecting 9 bps of NIM expansion in 4Q20. Our full year NIM projection for 2021 is now 3.16% compared to the 3.33% we are anticipating for full year 2020.

Credit costs, which have trended favorably for the last several years, improved again in 3Q20, but much of the improvement is related to payment moratoriums and government relief efforts extended to combat the pandemic-related downturn. This favorable environment may last through year-end before we start to see significant increases in NPLs and charge-offs resulting from the COVID-19 restrictions. We are still projecting loan loss provisions of $87 million to $100 million per quarter in 2021, a slight decrease from our prior projection, but well above the $19 million recorded in 3Q20.

With the changes outlined above, we are raising our 2020 EPS estimate from $4.53 to $5.38. We are also raising our 2021 estimate from $3.52 to $4.66 and our 2022 estimate from $3.76 to $5.04.

Outlook: Many uncertainties remain related to the COVID-19 pandemic and how quickly economic activity can recover from it. Despite adding this crisis on top of the other crises Puerto Rico continues to deal with (aftereffects from Hurricane Maria, the government debt crisis, an decade-long recession, and earthquakes in the southern part of the island), the outlook for the island seems to have improved in recent months. Activity in the residential real estate market, car sales, and other segments of the economy have rebounded faster than many people expected. Most economic indicators remain well below levels from this time last year, but trends are good. It appears that disaster relief funds are flowing and helping to drive some of the recovery.

Popular seems to be well-positioned to take advantage of the rebound. While excess liquidity will likely remain a drag on margins for some time, expense reductions and rising revenues from increased economic activity should help boost EPS noticeably going forward. In addition, the bank maintains strong capital levels and we anticipate substantial capital returns to shareholders in the form of increased dividends and share buybacks as the impact of the pandemic becomes clearer and the regulators become more comfortable with the economic outlook for the island.

While we have enjoyed covering Popular, Inc. for close to twenty-five years, shifting corporate responsibilities do not allow us time to provide the same level of diligence to our equity research as we would like. Consequently, we are discontinuing coverage of Popular, Inc.

Exhibit 1:

Popular, Inc.: 3Q20 Highlights

	Actual Results			Change	
	3Q19	**2Q20**	**3Q20**	**LQ[1]**	**YOY**
Loans Held for Investment ($Millions)2	27,008	29,071	29,393	4.4%	8.8%
Total Deposits ($Millions)2	44,166	53,844	56,022	16.2%	26.8%
Average Earning Assets ($Millions)	47,509	55,636	59,880	30.5%	26.0%
Total Revenue ($Millions)	620	563	590	19.1%	-4.8%
Net Interest Income ($Millions)	477	451	461	9.0%	-3.3%
NIM (FTE)	4.00%	3.25%	3.06%	-0.19%	-0.94%
Average Securities Yield	3.08%	1.64%	1.49%	-0.15%	-1.59%
Average Loan HFI Yield	6.89%	6.24%	6.16%	-0.08%	-0.73%
Average Cost of Int.-bearing Deposits	0.92%	0.43%	0.35%	-0.08%	-0.57%
Efficiency Ratio	60.4%	62.0%	61.4%	-0.55%	1.0%
NCO Ratio	1.00%	0.92%	0.23%	-0.69%	-0.77%

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 2020A	4Q 2020E	1Q 2021E	2Q 2021E	3Q 2021E	4Q 2021E
1,735	1,892	1,867	1,855	1,938	Net interest income	473	451	461	482	463	464	463	466
228	166	330	379	394	Provision for loan losses	190	62	19	59	87	95	100	97
1,507	1,726	1,537	1,476	1,544	**Net Interest Income after Provision**	283	388	442	423	376	368	362	369
151	161	144	131	128	Deposit Service Charges	42	30	37	35	33	33	33	33
53	32	5	22	26	Mortgage Banking revenue	6	4	(10)	5	5	6	6	6
136	146	131	150	176	Credit & Debit Card Fees	33	25	38	34	35	37	38	40
96	106	99	100	105	Other Operating Fees	24	22	24	29	22	23	25	30
(13)	(0)	1	2	0	Gains (losses) on sales of loans	(4)	1	2	1	2	(0)	0	0
95	-	-	-	-	Gains (losses) on FDIC indemnification asset (former	-	-	-	-	-	-	-	-
(2)	4	6	-	-	Other Gains (Losses)	(2)	3	5	-	-	-	-	-
138	122	114	115	123	Other non interest income	27	28	32	27	28	29	29	29
652	570	499	520	558	**Total non-interest income**	127	112	129	132	125	127	130	138
					Total Non-interest expense								
563	591	574	569	600	Compensation and Benefit	147	139	136	152	146	140	141	142
72	84	91	100	105	Equipment expenses	22	21	24	24	25	25	25	25
88	96	103	107	112	Occupancy	25	25	26	26	26	27	27	27
66	75	56	62	69	Marketing expense	14	12	15	15	14	15	16	16
350	384	388	405	436	Professional Fees	101	93	96	97	99	99	102	105
23	4	2	7	8	OREO expenses	2	(0)	(2)	2	2	2	2	2
247	242	253	248	261	Other Expenses	61	58	66	68	61	62	63	63
1,409	1,477	1,466	1,498	1,589	**Total non-interest expense**	373	348	361	384	372	369	375	381
618	671	466	395	405	**Net Income**	34	128	168	136	102	100	93	100
					Per Share Data:								
6.06	6.88	5.38	4.66	5.04	Earnings Per Share	0.37	1.49	2.00	1.61	1.21	1.18	1.10	1.19
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%	28.23%	37.57%	38.72%	Dividend Payout Ratio	83.62%	27.06%	20.32%	24.88%	33.08%	38.20%	41.01%	37.78%
53.88	62.42	71.14	74.60	82.50	Book Value	64.08	68.40	69.94	71.14	71.95	72.68	73.59	74.60
46.90	55.10	62.90	66.29	73.67	Tangible Book Value	56.17	60.13	61.69	62.90	63.71	64.44	65.32	66.29
101	97	86	84	80	Average Shares Outstanding (MM)	91	85	84	84	84	84	84	84
					Profitability Measures:								
59.22%	60.01%	61.96%	63.09%	63.65%	Efficiency Ratio	61.73%	61.98%	61.43%	62.68%	63.44%	62.57%	63.35%	63.01%
1.33%	1.33%	0.79%	0.63%	0.63%	Return on average assets	0.27%	0.87%	1.06%	0.85%	0.66%	0.64%	0.59%	0.64%
11.36%	11.75%	8.54%	6.53%	6.38%	Return on average equity	2.52%	9.73%	12.45%	9.49%	7.04%	6.65%	6.02%	6.43%
4.01%	4.03%	3.33%	3.16%	3.24%	Net Interest Margin	3.95%	3.26%	3.06%	3.15%	3.16%	3.16%	3.15%	3.17%
24.40%	23.04%	20.92%	21.91%	22.36%	Fee Income % Revenues	21.41%	19.54%	21.14%	21.50%	21.28%	21.48%	21.98%	22.86%
					Average Balances:								
25,063	26,807	28,295	28,736	29,564	Loans	27,405	28,280	28,543	28,952	28,511	28,582	28,811	29,041
29,697	33,345	39,554	40,324	40,976	Interest Bearing Deposits	34,644	39,978	42,138	41,457	40,913	40,338	39,991	40,055
8,790	8,873	11,397	12,487	12,473	Non-interest Bearing Deposits	9,005	11,006	12,806	12,770	12,688	12,521	12,376	12,364
43,275	46,945	56,136	58,706	59,894	Earning Assets	48,149	55,636	59,880	60,880	59,347	58,767	58,269	58,439
31,576	34,770	40,952	41,474	42,493	Interest Bearing Liabilities	35,971	41,314	43,496	43,028	41,984	41,506	41,139	41,268
					Asset Quality Ratios:								
1.12%	0.96%	0.78%	1.33%	1.30%	Net Charge-offs / Avg Loans	0.92%	0.92%	0.23%	1.04%	1.37%	1.31%	1.33%	1.31%
2.81%	2.36%	3.06%	3.64%	3.64%	Nonperforming Assets / Loans	3.25%	3.02%	2.84%	3.06%	3.32%	3.55%	3.63%	3.64%
2.15%	1.74%	3.19%	3.11%	3.05%	Reserves / Loans	3.32%	3.16%	3.15%	3.19%	3.16%	3.15%	3.12%	3.11%
1.05%	0.94%	0.77%	1.31%	1.27%	Provision / Loans	0.91%	0.90%	0.23%	1.05%	1.37%	1.30%	1.32%	1.30%
					Capital & Leverage Ratios:								
11.42%	11.55%	9.47%	9.97%	10.00%	Equity / Assets	10.74%	9.20%	8.97%	9.47%	9.63%	9.85%	9.97%	9.97%
9.95%	10.20%	8.38%	8.87%	8.93%	Tangible Equity / Assets	9.42%	8.09%	7.92%	8.38%	8.53%	8.73%	8.85%	8.87%

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 September 30, 2020)

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

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.