



Port Wren Capital, LLC

"Finding Value Investments."

PWC Stock Report

TOWN: Regional Bank Acquisition = Investment Opportunity

7/1/15

Thesis:

- Towne Bank (TOWN) (NASDAQ) located in Portsmouth, VA, is a well managed bank with a sound corporate strategy and proven execution in the past and future. Closes \$275Million deal to buy Franklin Federal (FRNK) on 1/2/15. Gets \$1.0Billion in assets to add to existing \$4.97Billion in assets. The regional bank obtains entry into the Richmond, VA market. That offers an opportunity for value investors willing to go long.

Description:

- Mkt Cap: \$838.25M; 52Wk Range: \$12.93 – \$17.03; Close Mkt Price: \$16.30; Common Shares Out: 51.25M; Dividend & Yield: \$0.48 (2.90%); Institutional Owners: 21.40%; Insiders Owners: 18.53%; EPS (ttm): 1.15; P/E (ttm): 14.30.

Opportunities:

- Out of favor regional bank due to new banking regulations. Regulations have increased required capital requirements, and increased overhead costs. Also, current economic environment of low interest rates, slow growth in banking related market segments.

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Strengths:

- Well managed bank with indicators of long term emphasis on the fundamentals. Interest Expense was 48% of Revenue in Dec 2008 has been reduced to 9.7% for (ttm). Credit Losses Provision was 11.70% in December 2008 has been reduced to 0% (ttm). Total cost of deposits for yearend Dec 2012, Dec 2013 and Dec 2014 have been decreasing from 0.51%, 0.39% to 0.36%. Income interest expense as a percentage of average earnings assets for yearend Dec 2012, Dec 2013 and Dec 2014 have been decreasing from 0.77%, 0.64% to 0.60%. Also acquired Beach Properties of Hilton Head, a resort property management company in October 2014, as well as, Southern, an insurance agency in May 2014 reflects an overall corporate strategy and execution.

Weaknesses:

- Slow growth in the economy.

Threats:

- Low interest rate environment currently. However, the fed has indicated a possible increase sometime this year.

Valuation:

- Looking at the Regional Banks US Industry as a whole and three other banks, including the one they are buying (FRNK), within the small to mid size Mkt Cap between \$500M to 1.0M range we see some evidence of an undervalued stock.

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	Industry Statistics	TOWN	FRNK	FCF	SQBK
Mkt Price \$		16.38	21.71	9.69	27.51
Mkt Cap \$M	57.0B	838.25	249.43	853.13	8114.33
EV \$M		1,099	0	2,050	687.10
Rev \$M		242.47	47.26	244.54	128.99
P/E (ttm)	14.30	14.14	16.30	19.20	24.17
P/B (ttm)	1.12	1.10	1.07	1.22	2.56
P/S	2.99	2.49	5.18	3.64	6.18
P/FCF	11.60	n/a	18.72	13.52	13.14
EV/EBIT	14.30	16.52	11.23	31.83	14.10
EV/Rev		4.38	4.09	8.44	5.27
Yield%	1.90	2.75	0	2.88	0
Payout		0.38	0	0.56	0
ROA%	0.80	0.89	1.39	0.37	1.18
ROE%	8.13	7.17	6.26	6.48	11.83
ROIC%		5.97	5.32	2.65	27.52
Operating Margin %	29.54	26.55	36.43	26.53	37.34
Net Profit Margin(ttm)%	21.24	17.74	32.07	18.90	25.60
Cash/Debt (mrq)%	1.48	0.37	1.34	0.05	No debt
Equity/Asset (mrq)%	0.10	0.13	0.22	0.11	0.10
Interest Coverage	1.69	2.36	1.22	3.66	61.74
Debt to		51	69	177	0

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Equity%					
Long Term Debt/Total Assets (mrq)		0.07	0.22	0.11	0.10
10Yr Rev Growth%		8.90	0	-2.70	0
10Yr Erng Growth%		5.80	0	0	0
5Yr Rev Growth%		3.70	0	-0.90	0
5Yr Erng Growth%		15.80	0	0	0
1 Yr Rev Growth%		-3.80	57.50	4.70	-1.80
1 Yr Erng Growth%		-0.90	70.90	11.10	42.50
1 Yr EBITDA Growth (ttm)%		-4.50	43.80	7.90	6.20
1 Yr EBIT Growth (ttm)%		-5.90	45.70	12.90	6.40
1 Yr Free CF Growth (ttm)%		-111.50	-26.60	-19.30	-7.10
1 Yr BV Growth (ttm)%		5.80	3.20	4.50	13.70
Qty Rev Growth (yoy)%		25.10	39.40	5.40	12.10
Qty Erng Growth (yoy)%		30.60	105.00	15.60	3.90

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- Comparison highlights:
 - P/B is low at 1.10, P/E is low at 14.14, Book Value/Share is \$15.41 (mrq), Tangible Book/Share is \$11.73 (mrq), P/S is low at 2.49, Debt over Equity is low at 51%, Equity/Asset is low at 0.13%, Long-term Debt to Total Assets is low at 0.07%, Interest Coverage is very strong at 2.36, looking back to both the 10Yr and 5Yr Rev Growth and Earnings Growth indicate a history for growth, 1 Yr Book Growth is good at 5.90% compared to 5Yr Book Growth was -5.90%, Qty Rev Growth (yoy) up 25.10%, Qty Erng Growth (yoy) up 30.60%. Book Value (2013, 2014, 2015): \$13.47, \$14.39, \$15.22 a good trend; Oper Margin (March 2013, March 2014, March 2015): 25.86%, 28.50%, 29.86% a good trend, ROA (March 2013, March 2014, March 2015): 0.95%, 0.94%, 1.08% a good trend, ROIC (March 2013, March 2014, March 2015): 5.96%, 6.14%, 6.66% a good trend, Long-Term Debt to Total Asset (March 2013, March 2014, March 2015): 0.09%, 0.08%, 0.07% a good trend, Net Profit Margin (March 2013, March 2014, March 2015): 17.58%, 19.22%, 20.09% a good trend. All good indicators on TOWN. FRNK numbers are even more impressive and speak for themselves.
- Fair Value estimates:
 - The current numbers don't reflect the value of the combined operations nor the effects of the future consolations efforts that will in sue. Thus, a different approach is needed for valuation purposes.
 - For FRNK: when selling at \$21.71, using Graham Number the FV was \$24.27 with about a 11.79% MOS, using Tangible Book Value per Share the FV was \$20.34 with about a -6.31% MOS.

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- For TOWN: the Book Value (mrq) is \$15.41, Mkt Price \$16.38, paying \$0.97/sh over Book for a stock in TOWN alone that in itself is a good deal. Then consider prior to the merger FRNK was worth \$20.34 Tangible Book/sh, using the more conservative number of the two, that means you are getting TOWN for only \$0.97/sh with it selling at \$16.38, with a difference of \$3.96/sh. So you are getting \$15.41/sh of TOWN for free at today's Mkt Price.

Catalyst:

- The merger allows reductions in overhead expenses, consolidation of resources, and an expansion into additional market segments for additional revenue streams that include: the past purchase of the insurance company, the resort management company, as well as, the bank.

Recommendation:

Buy @ \$16.38 or <, Long.

Disclosure/Position:

Port Wren Capital, LLC has a position in the common stock: bull, long.

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Key:

Curr Ratio: Current Ratio, **CapEx:** Capital Expenditures, **DCF:** Discounted Cash Flow, **Debt/Eq:** Debt over Equity, **EPS:** Earnings Per Share, **EBITDA:** Earnings Before Interest, Taxes, Depreciation and Amortization, **Erng:** Earnings, **EV/EBIT:** Enterprise Value over Earnings Before Interest and Taxes, **EV:** Enterprise Value, **EV/Rev:** Enterprise Value over Revenue, **FCF:** Free Cash Flow, **FTC:** Federal Trade Commission, **FV:** Fair Value, **IPO:** Initial Public Offering, **Mkt Cap:** Market Capitalation, **MOS:** Margin of Safety, **mqr:** Most Recent Quarter, **P:** Price, **P/B:** Price over Book, **P/CF:** Price over Free Cash Flow, **P/E:** Price over Earnings, **P/S:** Price over Sales, **PWC:** Port Wren Capital, **Qty:** Quarter, **Rev:** Revenue, **R&D:** Research and Development, **ROA:** Return on Assets, **ROC:** Return on Capital, **ROE:** Return on Equity, **ROIC:** Return on Invested Capital, **TP:** Target Price, **ttm:** Trailing Twelve Months, **Yield %:** Dividend annual Interest Rate, **yoY:** Year Over Year.

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