

Popular, Inc. (BPOP, Buy, \$66.00 PT)

While 3Q19 EPS Beat Overshadowed by Disclosure of Expected CECL Impact on TBV, Clarity + Pullback in Share Price = Buying Opportunity

WHAT YOU SHOULD KNOW: After Popular, Inc. (BPOP) this morning released a 2Q19 report including a somewhat greater-than-anticipated initial estimate of the impact on BPOP from the adoption of the Current Expected Credit Loss (CECL) accounting standard set to be implemented at the beginning of 2020, overshadowing a solid earnings beat during the quarter and triggering a modest sell-off in the company's shares, management hosted a conference call. Among the topics discussed were management's observations on the state of Puerto Rico's economy, their expectations regarding BPOP's loan growth during the rest of the year, and their thoughts on the impact of consolidation within the banking industry on the island, and the recently announced acquisition of Banco Santander's (SAN SM, Not Rated) Puerto Rico unit by First BanCorp (FBP, Not Rated).

Among our takeaways from the call were the following:

- Management observed that Puerto Rico's economic activity had leveled off somewhat in 2019 relative to the strong post-hurricane recovery seen in 2018, adding that activity nevertheless remained well ahead of levels experienced during 2016 and 2017. They noted that debit and credit card sales – a measure of economic activity about which their business provides particularly good visibility – during 3Q19 had been up 4% versus the prior year period.
- Moreover, the island's employment situation continued to improve with total employment in September up 1% year-over-year. With that said, management said many of BPOP's customers had larger-than-usual available cash balances as a result of the economic upturn, and they had been using a portion of those to pay down loan balances. Consequently, management said they expected the company's loan balances to be flat sequentially during 4Q19.
- Management said Puerto Rico government deposits at BPOP had been \$11.4bn at the end of 3Q19, up from about \$10bn at the end of 2Q19. They added that the Commonwealth government's deposits at the bank had declined by about \$1bn since then. They reiterated that they expected this balance to decline as progress is made in Puerto Rico's debt restructuring but noted that the timing of outflows to fund retirement plans or to begin the payment of debt remained uncertain.
- We are reiterating our Buy recommendation on BPOP and our price target of \$66 based on 1.1x our FY20E tangible book value (TBV) per share of \$58.94 plus \$3.71 representing our estimate of the realizable value of its non-core investments.** We believe the pullback in BPOP shares today has created an attractive entry point for the stock, particularly as clarity around the impact of CECL removes the uncertainty that some investors had cited as their reason for holding off on buying it.
- Valuation:** Our price target of \$66 for BPOP is based on 1.1x our FY20E tangible book value (TBV) per share of \$58.94 plus \$3.71 representing our estimate of the realizable value of its non-core investments.



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COMPANY DATA	
Closing Price:	\$55.07
Price Target:	\$66.00
Market Cap (\$M):	5,326.08
Shares Out (M):	96.7
Avg Daily Vol - 3 Months (M):	0.36
Dividend/Yield:	\$0.00/0.0%

REVISIONS		
	Previous	Current
Rating	Buy	Buy
Price Target	\$66.00	\$66.00
FY19E EPS	\$6.47	\$6.62
FY20E EPS	\$6.48	\$6.38
FY19E Rev. (M)	\$2,807.21	\$2,833.74

Diluted EPS (Adjusted)			
FY Dec	2018A	2019E	2020E
Q1	0.89	1.69	1.46
Q2	1.18	1.76	1.62
Q3	1.38	1.70	1.71
Q4	1.33	1.46	1.60
Calendar EPS	4.77	6.62	6.38
Calendar P/E	11.5x	8.3x	8.6x

REVENUE (\$M)			
FY Dec	2018A	2019E	2020E
Q1	566.58	694.40	711.57
Q2	715.66	709.31	720.75
Q3	679.39	714.69	736.51
Q4	712.72	715.34	730.77
FY	2,674.34	2,833.74	2,899.60

Source: IDC, BTIG Estimates and Company Documents (\$ in millions, except per share amount)

Investment Thesis

Our continued bullishness on BPOP is driven by the continued macroeconomic improvement in Puerto Rico in the aftermath of the September 2017 hurricanes, as demonstrated by multiple indicators, which should continue to provide the company with a tailwind. The company has significant excess capital that should enable it to both buy back an increasing number of its shares and to engage in accretive acquisitions.

Upcoming Catalysts

- 2Q19 earnings report in July demonstrating benefits of economic rebound in Puerto Rico
- Potential for approval by Federal Reserve Bank of New York (FRBNY) for increased amount of share buybacks
- Possible opportunity to buy assets becoming available as result of OFG/Scotiabank and Santander/FBP transactions

Base Case Assumptions

- Our price target of \$66 for BPOP is based on 1.1x our FY20E tangible book value (TBV) per share of \$58.94 plus \$3.71 representing our estimate of the realizable value of its non-core investments.
- We assume that BPOP will continue to receive regulatory approval for an increasing amount of share buybacks.

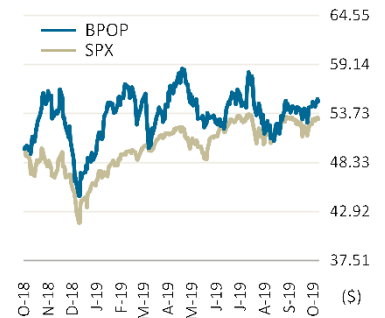
Upside Scenario

- BPOP boosts its ROE by reducing its Common Equity Tier 1 (CET1) ratio from 16.4% as of March 31 through the deployment of capital through asset sales stemming from OFG/Scotiabank and Santander/FBP transactions.
- The pace of increases in the amount of BPOP's share buybacks approved by the FRBNY accelerates, enabling the company to further reduce its CET1 and increase its ROE. The stock trades up to \$71.

Downside Scenario

- BPOP's operating performance suffers from a downturn in Puerto Rico's economy as U.S. aid to the island is curtailed. The company's CET1 remains elevated and its ROE stagnates.
- The amount of BPOP's share buybacks approved by the FRBNY levels out. The stock trades to \$42.

Price Performance



Source: IDC

Company Description

Popular, Inc. (NYSE: BPOP) is the largest bank by both assets and deposits in Puerto Rico and ranks among the top 50 U.S. bank holding companies in terms of assets. BPOP provides retail, mortgage and commercial banking services in Puerto Rico and the U.S. Virgin Islands. In the mainland U.S., the company provides retail, mortgage and commercial banking services through branches in New York and Florida.

- BPOP's 3Q19 report included management's preliminary estimate of the impact on the company from the adoption of CECL. Based on the company's loan balances and macroeconomic assumptions as of June 30, 2019, management estimated that its allowance for loan losses would increase by \$360mm to \$400mm, or 85% to 95%, driven by its Puerto Rico mortgage, auto and credit card loans portfolio. Assuming BPOP's adoption of the new standard at September 30, 2019, CECL would result in a reduction of its TBV per share of approximately \$3, or 5%, they said. They added that the adoption of the new standard also would result on a 30bp reduction in its Common Equity Tier 1 (CET1) ratio.
- Management said they continued to focus on the levers that BPOP could use to deploy more of the company's excess capital, as its CET1 ratio remained high at 17.5% as of September 30, up from 16.8% in the prior quarter, and their target is closer to its U.S. regional bank peers' ratios in the 11-12% context. In addition to purchasing assets and growing organically, BPOP continues to focus on increasing its level of capital return from the \$250mm share buyback that the company was allowed by the Federal Reserve Bank of New York (FRBNY) to execute earlier this year. Management reiterated that discussions with the FRBNY were ongoing and that they hoped to be able to provide the results of those discussions early in 2020.
- While management acknowledged that the flow of U.S. government aid to Puerto Rico had been slower than many had anticipated, and that the pace of disbursement going forward was in question given increased scrutiny of the island's authorities in light of political upheaval during the summer, they said they continued to believe the amount of aid would be "significant" and that it would be sufficient to have an ongoing, positive effect on the local economy.
- Management said consolidation of the Puerto Rico banking industry, including FBP's acquisition of Banco Santander's local unit and Oriental Bank's (OFG, Not Rated) acquisition of Scotiabank's (BNS CN, Not Rated) operations on the island, would create both opportunities and challenges. On the opportunity side, the deals would enable BPOP to pursue clients who may have had particular reasons for banking with Santander or Scotiabank, including the desire to work with an international bank, they said. In terms of the challenge arising from consolidation, management noted that they now faced two enlarged competitors on the island, which meant that they would have to "up our game."



BTIG Covered Companies Mentioned in this Report

POPULAR, INC. (BPOP, Buy, \$66.00 PT; Current Price: \$55.07; Analyst: Mark.Palmer)

Appendix: Analyst Certification and Other Important Disclosures

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I, Mark Palmer, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

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Company Valuation and Risk Disclosures

Popular, Inc. (BPOP, Buy, \$66.00 PT)

Valuation: Our price target of \$66 for BPOP is based on 1.1x our FY20E tangible book value (TBV) per share of \$58.94 plus \$3.71 representing our estimate of the realizable value of its non-core investments.

Risks: Primary risks to our recommendation include weakness in the economy within the company's geographic footprint that could negatively impact its operating results; deterioration in collateral values of properties securing the company's construction, commercial and mortgage loans that could result in credit losses; the potential negative affect on the value of company's loans to the Puerto Rico government and its portfolio of Puerto Rico government securities and increased regulatory scrutiny.

Popular, Inc. (BPOP)



Note: Closing Price and Target Price have been adjusted for corporate actions.

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
17-Mar-14	29.18	42	Mark Palmer	Buy
23-Apr-14	31.68	41	Mark Palmer	Buy
06-Jul-15	29.05	39	Mark Palmer	Buy
24-Jul-15	31.02	41	Mark Palmer	Buy
22-Nov-16	41.12	NA	Mark Palmer	Neutral
31-Oct-17	36.68	46	Mark Palmer	Buy
24-Apr-18	46.08	53	Mark Palmer	Buy
23-Jul-18	50.05	58	Mark Palmer	Buy
22-Apr-19	55.97	66	Mark Palmer	Buy

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Additional Information Available Upon Request

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