ValueInvestor INSIGHT
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Nothing Ventured, Nothing Gained

People rarely think about banks as growth companies, but Gator Capital's Derek Pilecki says a number of banks in the U.S. fit that bill and some appear quite undervalued. One representative example: Silicon Valley's SVB Financial.

As a value investor in financial-services stocks, Derek Pilecki of Gator Capital Management [VII, August 31, 2017] has often looked from afar at a subset of his universe he calls growth banks. These unique beasts, often as a result of a specialized focus and a willingness to pay up for talent, have over long periods generated strong and profitable organic growth funded by low-cost deposits. "These are companies I admire and wanted to own," he says, "but the multiples were too high.

Pilecki saw that dynamic start to change in late 2018, as the stocks of such banks started to be hit by fears of lower interest rates and credit-risk woes, as well as neglect as investors chased momentum in sectors deemed more interesting. Average earnings multiples for 14 growth banks he tracks fell from 15x to below 11x.

While the worst fears have subsided, he still sees mispriced value in banks such as SVB Financial, the parent of Silicon Valley Bank. The company specializes in serving the commercial and private banking needs of the U.S. venture-capital community, including VC firms, venture-backed companies and the executives at each. Fueled by its long target-market focus and the nurturing of a self-reinforcing network its customers highly value, the company has grown deposits and loans at a 14%-plus annual rate since Pilecki started following it 20 years ago. Growth has been even faster over the past five years, and returns on equity are consistently 20% or better.

At a time when consumer-packaged-goods companies with low-single-digit annual growth earn mid-20s P/Es, SVB's stock at a recent $250 trades at 12.7x consensus 2020 EPS estimates of $19.50. Pilecki attributes the lack of market enthusiasm to concerns over "peak venture capital," which could signal risks to lending volume, credit quality and even income from equity warrants awarded from client companies. With a preponderance of floating-rate loans and already rock-bottom deposit costs, investors also seem worried the company will be incrementally hurt if interest rates stay so low or go lower.

He counters that while prospective venture-capital returns may not match those of the recent past, he believes the volume of VC activity – which is what is most important to SVB – will remain high. He's

INVESTMENT SNAPSHOT

SVB Financial
(Nasdaq: SIVB)

Business: Parent of Silicon Valley Bank with primary franchise in serving venture-capital firms and venture-backed companies.

Share Information (@12/30/19):

Price	**249.82**
52-Week Range	183.04 – 259.95
Dividend Yield	0.0%
Market Cap	$12.88 billion

Financials (TTM):

Revenue	$3.07 billion
Operating Profit Margin	53.7%
Net Profit Margin	37.1%

Valuation Metrics
(@12/30/19):

	SIVB	S&P 500
P/E (TTM)	11.6	25.5
Forward P/E (Est.)	12.7	19.8

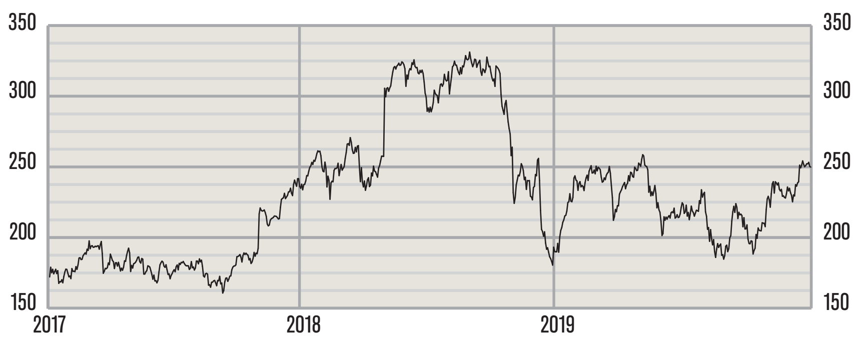
Largest Institutional Owners
(@9/30/19 or latest filing):

Company	% Owned
Vanguard Group	10.8%
Capital Research & Mgmt	5.5%
State Street	5.2%

Short Interest (as of 12/15/19):

Shares Short/Float	1.8%

SIVB PRICE HISTORY



THE BOTTOM LINE

Its specialty serving the venture-capital community is giving the market pause, but Derek Pilecki expects the company to continue its long record of strong and profitable growth. At 15x his 2023 earnings estimate, the stock within three years would trade at over $400.

Sources: Company reports, other publicly available information confident the company's credit underwriting is as conservative as ever. As for risks to net interest margins, he says that's less important when banks grow. "For a bank growing 15% a year over five years, the value of the stock in year five is driven by the growth, not whether the net interest margin is plus or minus 10%," he says.

Assuming loan and deposit growth of 12% per year, he believes the company can earn $27 in EPS by 2023. Applying a 15x forward P/E – the lower end of the ten-year historical range of 11x to 25x – would result in a stock price in three years of over $400, 60% above today's level. "You hear this mentioned as a short because of the 'peak-venture' angle," he says. "While that's maybe thought provoking, I also think it will turn out to be wrong." VII

Disclosure

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