U.S. Bancorp (NYSE: USB)

Fall 2022

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I. Investment Overview

Thesis

Buy USB at 1.5% allocation (FVE: $52.23, Implied Upside: 18%)

Wide Moat Due to Business Mix and Cost Advantage

- Incredibly efficient and moaty company, mostly due to its **strong traditional banking** and **competitive advantages in non-traditional banking**
- Attractive **mix of fee-based businesses** including payments, corporate trust, investment management, and mortgage banking
- **High barriers to entry** in the non-traditional segments and **massive cost advantages** due to low-cost deposit base and ability to quickly relocate/downsize

Well Positioned For a Downturn

- USB does great during downturns and has **never reported an unprofitable quarter**
- Conservative debt underwriters, only taking risks in areas that they understand, **resulting in less net charge offs than peers**
- Seeing **robust loan growth** still and segments such as payments and investment management are strongly performing in 2022

Best-in-class Capital Allocation

- Very strong balance sheet with **CET1 ratio is above management's goal** (10%) and **projected stay above the goal in the future**
- Returns more money to shareholders through share repurchases, but still has a **top tier dividend yield at ~4.5%**
- Making strategic investments into **acquisitions and technology**

US Bancorp Company Overview

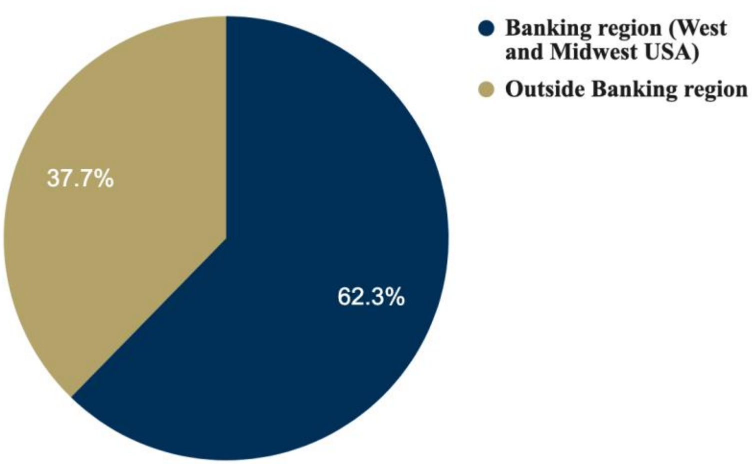
Business Description

- US Bancorp is US's 5th largest bank and is a diversified financial services firm headquartered in Minneapolis, offering an array of financial products and services
- Has four major business divisions: Consumer and Business Banking, Payment Service, Corporate and Commercial Banking, Wealth Management and Investment Services
- US Bancorp runs a network of approximately 2230 branches and 4060 ATMs mainly in West and Midwest USA

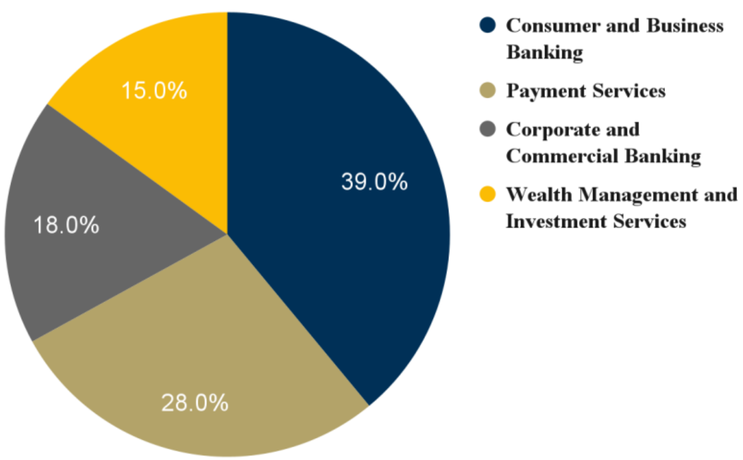
Key Statistics

GICS Sub-Industry	Banking
Market Cap	$66.743B
Revenue	$22.8B
Current Price	$44.92
52-Week Range	$38.39 - $63.57
Beta	0.98
Dividend Yield	4.27%
Credit Rating	A2 (Moody's)

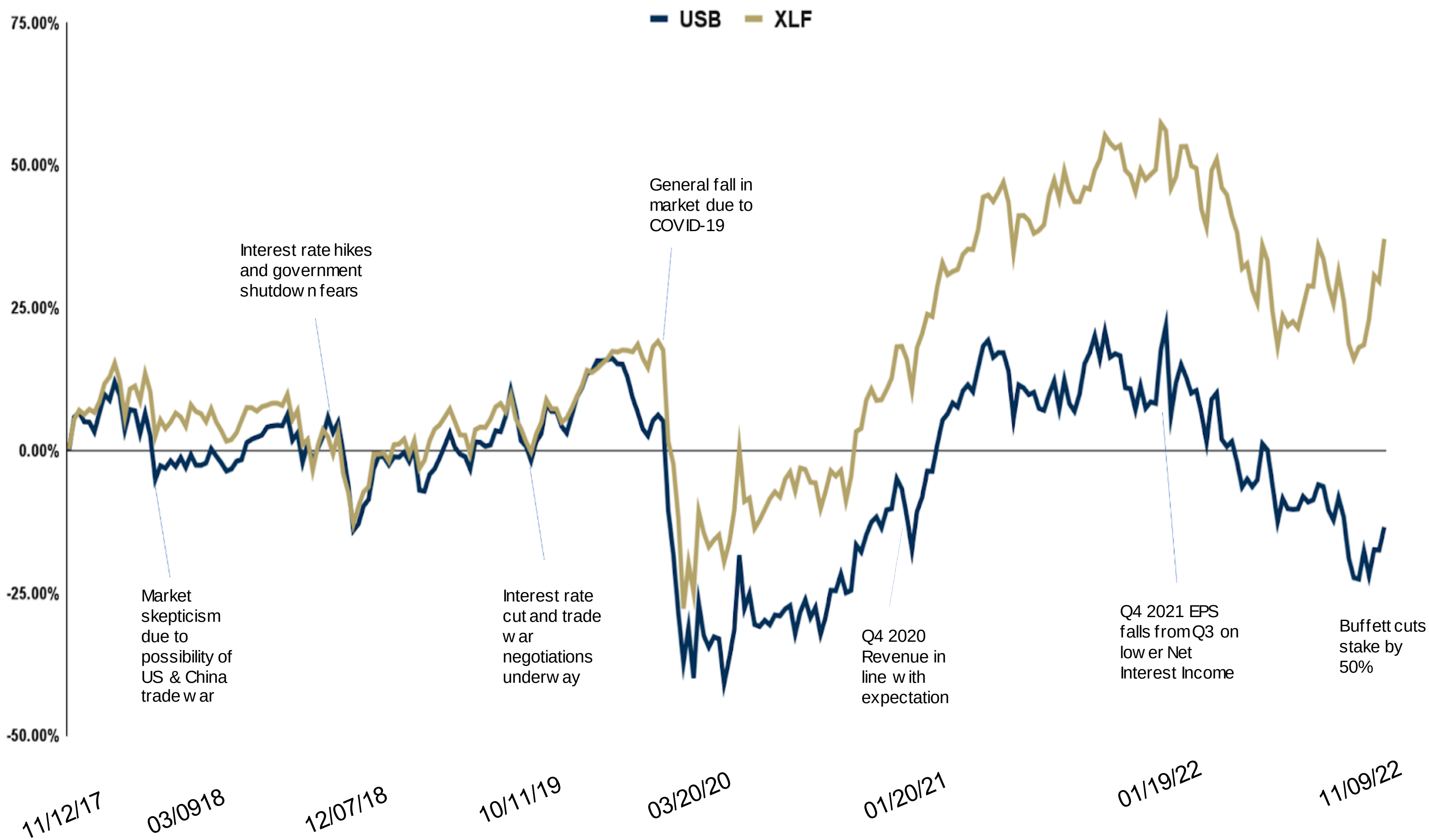
Geographic Breakdown



Segment Breakdown



5 Year Stock Performance



Yahoo Finance

Macro Trends

Inflation

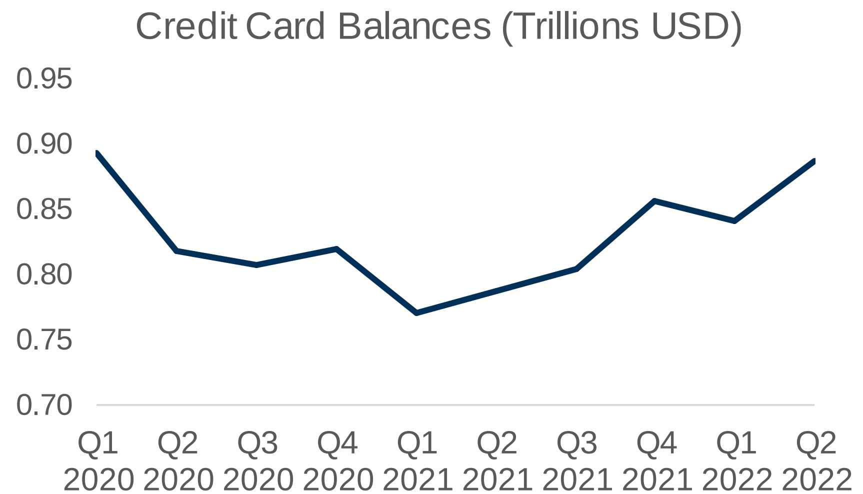
- **Inflation cooled to 7.7% YoY in October,** which could influence the Federal Reserve to slow the pace of interest rate increases
- If inflation resumes its rise, the Federal Reserve could reiterate its intention for large interest rate increases
- Inflation is also squeezing corporate margins with an average **S&P corporate margin of 13% in 2Q2021 and 12.2% in 2Q2022**
- **Discretionary income for consumers continues to decrease** as the cost of staples have taken up a greater share of consumer spending

Rate Hikes

- The federal reserve has raised interest rates 375 basis points since March 2022
- Rising rates have created **downward pressure on bond and equity prices**
- A potential recession in 2023 could increase loan losses and decrease total deposits
- US Bancorp has seen its NIM increase from 2.53% in 3Q2021 to 2.83% in 3Q2022
- **Money market deposits and interest checking deposits have increased ~10% and 11.4%** YoY since 3Q2021

US 10-Year Yield

US Dollar Strength



Yahoo Finance

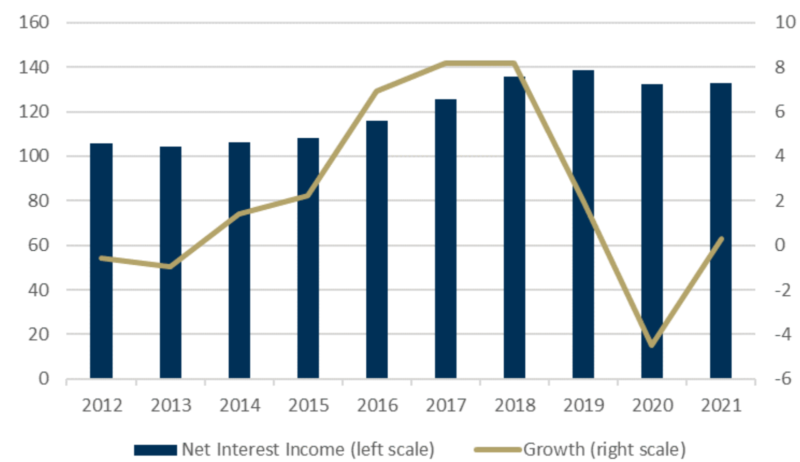
Industry Trends

Regional Banks

- 1H22 regional bank net income fell 10.6% Y/Y despite strong net interest income
- **Fee income** has become a **headwind** as IPO and M&A activity has slowed and is expected to be pressured by a **slowing economy and hawkish monetary policy**, while **mortgage activity as plummeted** as housing affordability has been affected by rising interest rates and high prices
- Overdraft fees are being reduced from regulatory pressure and bad press decreasing revenue, but changes have built loyalty with customers
- Net interest margin (NIM) compressed in 2020 and 2021 but expected to expand through this year
- **Net interest income (NII) has increased** from 2021 and is **expected to continue** driven by increasing rates and commercial and industrial loans (C&I) loans
- **Loan growth expected to be robust** with mid/high single-digit growth, 8.1% Y/Y loan growth as of YTD September 30, 2022
- **Capital, liquidity, and credit quality remain at historically strong levels** – CET1 ratios stayed above Basel II threshold of 6% indicating regional banks have enough capital to absorb significant losses
- When recession fears subside, regional banks are expected to return to M&A to provide scale, diversification, and efficiency benefits
- **Average dividend yield** of large regional banks is **3.4%**

Federal Fund Effective Rate

Net Interest Income (in Billions)



CRFA Equity Research US Regional Banks

II. Business Analysis

Business Divisions

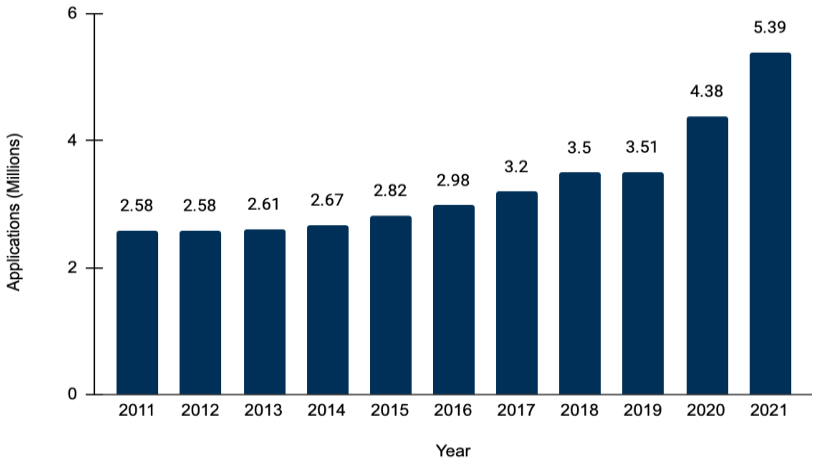
Consumer and Business Banking Overview

- **Services:** Branch banking; 24-hour customer centers; mobile banking; online banking; mortgages; consumer lending; ATM and debit processing; workplace banking; student banking
- **Revenue**: Biggest division by revenue percentage; 39% of annual revenue in 2021
- **Business Essentials:** Collection of smart solutions that provides strategic insights. Combination of digital dashboard and experts helping businesses Pay & Receive, Manage & Run and Plan & Progress better.

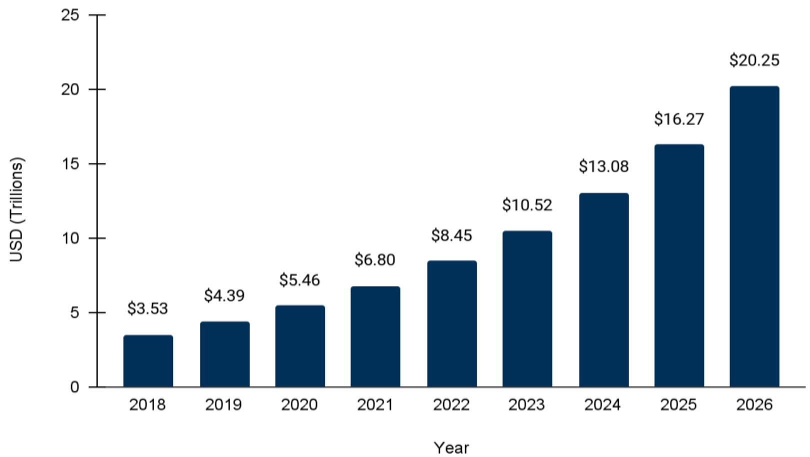
Payment Services

- **Services:** Credit, debit, prepaid, virtual, corporate, purchasing and fleet cards; global payment processing; freight payment services; real time payments; e-commerce
- **Elavon**: Wholly owned subsidiary in 2001. One of largest Payment Processors globally. Offers merchant processing in 36 countries and supports the payment needs of 2 millions customers
- **Technology driven approach**: Innovative division investing in digital payments products like virtual corporate cards, POS systems, RTP, etc.

Number of New Business Applications (USA)



Global Digital Payments Market



Business Divisions

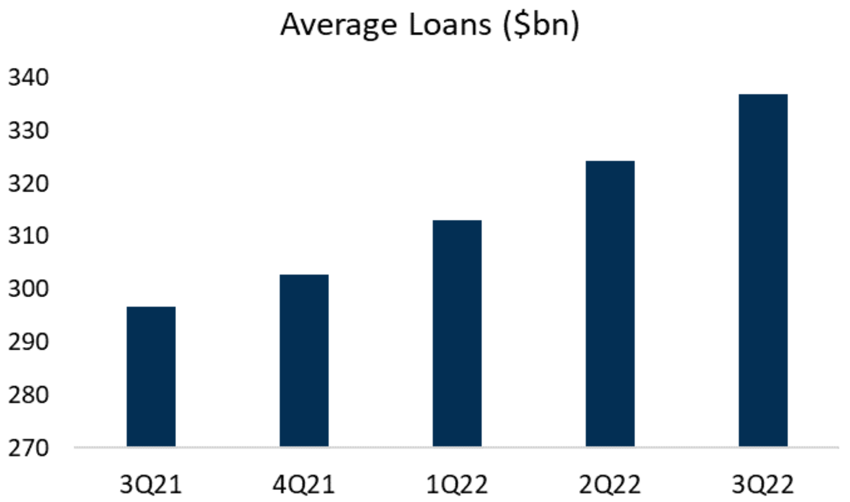
Corporate and Commercial Banking Overview

- **Services:** Lending; asset-based financing; equipment finance and small-ticket leasing; correspondent banking; depository services; capital markets; international trade
- Contributed **~20% of net income** in 2021
- Average deposits within the corporate and commercial bank of $154 billion (3Q 2022) as compared to $132 billion (3Q 2021)
- Average loans of **$131 billion (3Q 2022) as compared to $102 billion (3Q 2021)**

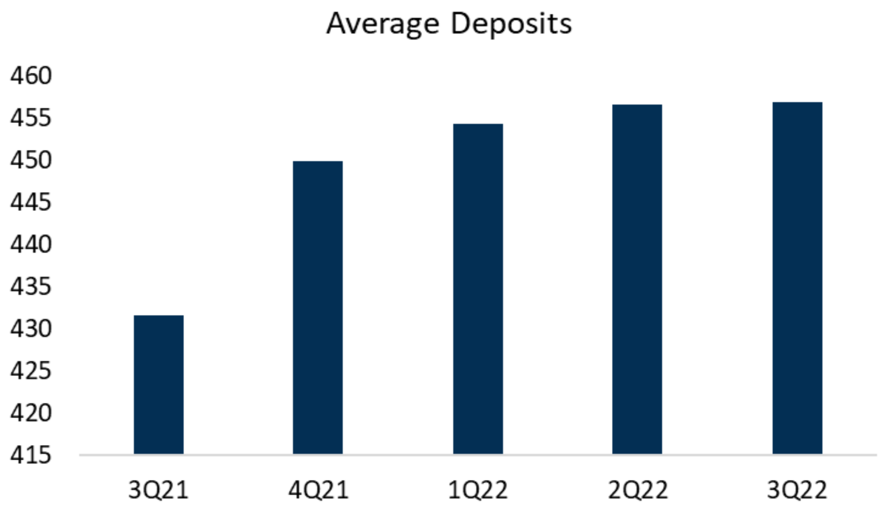
Wealth Management and Investment Services

- **Services:** Wealth planning, investments, trust services; private banking; specialty asset management; global custody solutions; global fund services; corporate and institutional trust services
- Contributed 10.5% of net income in 2021
- **Average deposits have increased slightly** from $96.8 billion (3Q 2021) to $97.1 billion (3Q 2022)
- Loans have increased 23.9% YoY from $18.5 billion to $22.9 billion within the segment

Average Loans ($bn)



Average Deposits ($bn)



Performance in Recession

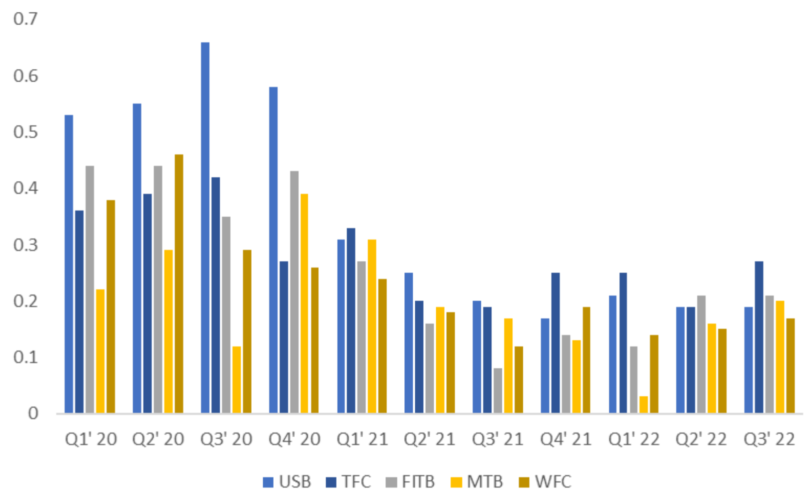
Historical Performance

- Through the 2008-09 Recession, US Bank did not realize a loss in a single quarter
- USB stock fell **~55%** during the crisis while the KBE lost nearly **80%** at the same time
- Low-cost basis allows for the company to keep **margins higher than peers through downturns**
- **Conservative underwriting culture** will put the firm in a good position considering an upcoming downturn
- General macro environment is still a risk because the **bank's profitability is tied to interest rate and debt cycles**

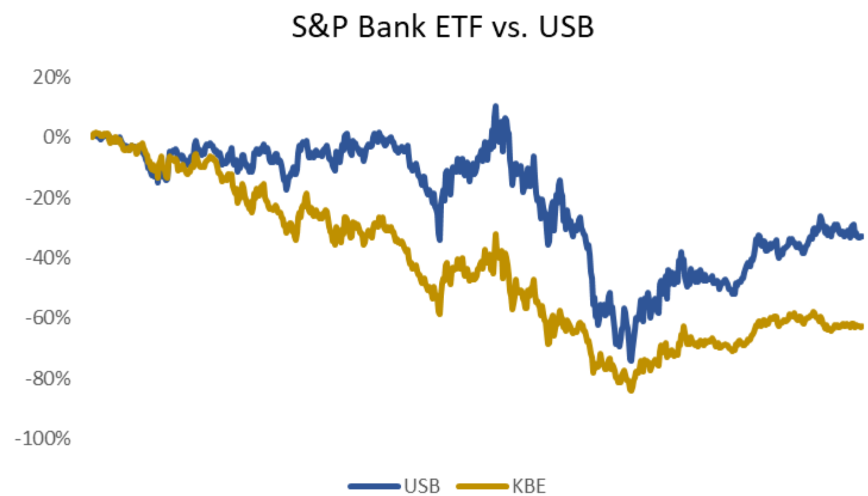
Q3 Earnings Snapshot

- Revenues and EPS beat Wall Street expectations in Q3' 2022
- Revenues were **up 7.4%** from the prior year quarter mostly due to net interest income (up 20%+ from the prior year)
- Earning assets **increased 7.6%** Y/o/Y, supported by growth in investment securities and **loan growth**
- **Credit quality worsened but remained in range with** ACL and net charge-offs up Y/o/Y
- Management reaffirmed their belief that USB is **well prepared for any change in the business cycle**

Net Charge-Offs as % of Loans



USB Performance During Financial Crisis



Key People and Investors

Andrew Cecere, CEO of US Bancorp

- Assumed position of CEO in April 2017; 23-year career at US Bancorp
- Before CEO, he held several leadership roles at US Bank as vice chairman with responsibility for the corporate trust, treasury management, and international banking functions, chief financial officer, chief operating officer
- 980,375 shares ; valued at $44,116,875

Christopher Davis, Portfolio Manager at Davis Advisors

- Davis Advisors has a highly concentrated financials portfolio with USB as the third biggest holding along with WFC and BRK
- The fund believes that USB is a leading franchise earning above average returns on capital in their banking, payments, and investment management segments
- Davis Advisors holds 16,424,077 shares; valued at $662,219,000

Warren Buffett, CEO of Berkshire Hathaway Inc

- Berkshire Hathaway Inc holds 119,805,135 shares; ~%7.5 stake
- Has held a significant stake in USB for over a decade and is the ninth biggest holding in the portfolio (more than Citigroup)
- Stated at the annual meeting that while he still views banking as a great business and their valuations reasonable, he did not feel comfortable with Berkshire's overall exposure to the sector

"The investments we have made and continue to make across our business lines are paying off in terms of improved customer experience, new customer acquisition and deeper relationships. Expense management is a priority, and we continue to target positive operating leverage in 2022 and beyond."

- ***Andrew Cecere, CEO US Bancorp***

III. Valuation

Relative Valuation

Company	ROTCE	Profit Margin 12M	Dividend Yield 12M	Efficiency Ratio	Total Loan/ Total Deposits	Tier 1 Capital Ratio	P/B	P/E
TFC	18.4	27.93%	4.40%	61.39%	76.12%	10.7%	1.16	9.37
MTB	16.8	28.84%	2.89%	56.76%	78.26%	12.13%	1.24	12.82
FRC	12.49	29.22%	0.84%	58.76%	92.1%	11.76%	1.75	15.39
FITB	16.6	30.09%	3.58%	53.68%	75.43%	10.4%	1.73	11.07
USB	20.4	28.78%	4.27%	57.49%	73.51%	11.2%	1.65	10.38
AVG	16.94	28.97%	3.20%	57.62%	79.08%	11.24%	1.506	11.81

Positives

- **ROTCE:** With a return on tangible common equity of 20.4, USB significantly outpaces its peers while also maintaining a similar level of leverage (11.2%)
- **Dividends:** USB has a considerable and stable dividend yield which makes it a good stock to buy and hold

Negatives

- **P/B:** USB has a P/B of 1.65, which is higher than the average P/B for other regional peers. This could suggest overvaluation.
- **Loans/Deposits:** With a loan to deposits ratio of 73.51%, USB is below the Average ratio of 79.08% for its peers. This could suggest a lack of loan underwriting opportunities or higher ownership of securities.

Valuation - DDM

Football Field

Exit Dividend Yield Sensitivity to Payout Sensitivity

	3.3%	3.8%	4.3%	4.8%	5.3%
35%	$50.56	$44.94	$40.62	$37.21	$34.44
40%	$57.78	$51.36	$46.43	$42.53	$39.36
45%	$65.00	$57.78	$52.23	$47.84	$44.28
50%	$72.22	$64.20	$58.03	$53.16	$49.20
55%	$79.45	$70.62	$63.84	$58.47	$54.12

Model Assumptions

- Dividend yield stays constant at 4.3%
- Payout ratio remains at about 45%

Assumptions

Assumptions	
NI or FFO Growth	8.0%
Exit Dividend Yield	4.3%
Payout Ratio	45.0%
Risk Free Rate	3.72%
Beta	0.98
Market Risk Premium	5.5%
Cost of Equity	9.11%
Shares Outstanding	1,485,800,000

IV. Conclusion

Investment Risks

		Explanation	Mitigation
1	**Weak Non-interest Income**	• Non-interest income decreased 7.7% Y/Y and 2.4% Q/Q • Mainly caused by **81% decrease in mortgage banking** due to decreased origination revenues and lower refinancings in the market	• Drop in origination revenues were due to **one-time** hits which should not repeat • These segment decreases were partially offset by others including **strong corporate payments revenue**
2	**Acquisition of MUFG Union Bank**	• Acquisition will result in pro forma assets above $700 billion, the category 2 threshold which will result in **increased regulatory requirements** • **CET1 ratio** expected to drop to **8.3%**, below management's target, **pausing stock buybacks** until the end of next year	• USB has capital and liquidity to deal with increased regulatory requirements • CET1 ratio still above requirements • Deal will help enhance returns as USB **sheds 40% of target's expense base**
3	**Recession**	• A recession in 2023 could result in an **increase in net charge-offs** above long-term averages and cause **loan growth to stall** • Lower confidence levels could lead to reduced spending and business investment	• USB's **net charge-off ratio** remains **near historic lows** • **Consumer spending remains strong**, credit card spend is up 10% Y/Y and 30% above pre-COVID levels
4	**Potential Fed Pivot**	• While not in the near-term future, there is a risk the **Fed** could **pivot** on their promised interest rate hikes • This could cause **NII growth** at USB to **slow** dramatically	• Most economists don't see the fed cutting interest rates until the later parts of 2023 • Interest rates have **increased 4% this year** and that NII growth still needs to flow through the business

Summary

Buy USB at 1.5% allocation (FVE: $52.23, Implied Upside: 18%)

Wide Moat Due to Business Mix and Cost Advantage

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- Attractive **mix of fee-based businesses** including payments, corporate trust, investment management, and mortgage banking
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Best-in-class Capital Allocation

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- Returns more money to shareholders through share repurchases, but still has a **top tier dividend yield at ~4.5%**
- Making strategic investments into **acquisitions and technology**

IV. Appendix

Questions?

Name	Position	Phone Number	Email
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Porter Hill	Analyst	(229) 420 7237	porterhill2001@gmail.com
Christian Wilson	Sector Head	(770) 823 8939	cwilson345@gatech.com

DDM

Dividend Discount Model

Ticker: USB

Multi-Period Discount Model - Exit Dividend Yield

In USD Millions (ex Share Price)	2022A	2023E	2024E	2025E	2026E	Exit Dividend Yield Calculation
NI or FFO	6,800.00	7,344.00	7,931.52	8,566.04	9,251.32	
Dividends	3,060.00	3,304.80	3,569.18	3,854.72	4,163.10	96,816.19
PV of Dividends	3,060.00	3,028.93	2,998.17	2,967.72	2,937.58	
PV of Perpetuity						62,613.07
Total	77,605.47					
Implied Share Price	**$52.23**		**Actual Share Price:**	**$44.23**		

Assumptions	
NI or FFO Growth	8.0%
Exit Dividend Yield	4.3%
Payout Ratio	45.0%
Risk Free Rate	3.72%
Beta	0.98
Market Risk Premium	5.5%
Cost of Equity	9.11%
Shares Outstanding	1,485,800,000

Multi-Period Discount Model - Net Income Growth

In USD Millions (ex Share Price)	2022A	2023E	2024E	2025E	2026E	Perpetuity
NI or FFO	6,800.00	7,344.00	7,931.52	8,566.04	9,251.32	236,462.78
Dividends	3,060.00	3,304.80	3,569.18	3,854.72	4,163.10	
PV of Dividends	3,060.00	3,028.93	2,998.17	2,967.72	2,937.58	
Terminal Value						106,408.25
PV of Perpetuity						68,816.46
Total	83,808.86					
Implied Share Price	**$56.41**		**Actual Share Price:**	**$44.23**		

Assumptions	
NI or FFO Growth	8.0%
NI or FFO Growth Perp.	5.0%
Payout Ratio	45.0%
Risk Free Rate	3.72%
Beta	0.98
Market Risk Premium	5.5%
Cost of Equity	9.1%
Shares Outstanding	1,485,800,000

Multi-Period Discount Model - Dividend Growth

In USD Millions (ex Share Price)	2022A	2023E	2024E	2025E	2026E	Perpetuity
Dividends	3,060.00	3,304.80	3,569.18	3,854.72	4,163.10	
PV of dividends	3,060.00	3,028.93	3,271.24	3,532.94	3,815.57	
Terminal Value						101,341.19
PV of terminal Value						65,539.49
Total	78,432.59					
Implied Share Price	**$52.79**					

Assumptions	
Dividend growth rate (1)	8.0%
Dividend growth rate (2)	5.0%
Risk Free Rate	3.7%
Beta	0.98
Market Risk Premium	5.5%
Cost of Equity	9.1%

Gordon Growth Discount Model

(USD $ dollars)	2022A	2023E	2024E	2025E	2026E	Perpetuity
Dividends	3,060.00	78,213.24				
PV of dividends						
Total	78,213.24					
Implied Share Price in 2023	**$52.64**					

Assumptions	
Dividend growth rate	5.0%
Risk Free Rate	3.7%
Beta	0.98
Market Risk Premium	5.5%
Cost of Equity	9.1%

Exit Dividend Yield Sensitivity to Payout Sensitivity

	2.3%	3.3%	4.3%	5.3%	6.3%
35%	$69.13	$50.56	$40.62	$34.44	$30.22
40%	$59.25	$43.33	$34.82	$29.52	$25.90
45%	$59.25	$43.33	$34.82	$29.52	$25.90
50%	$69.13	$50.56	$40.62	$34.44	$30.22
55%	$88.88	$65.00	$52.23	$44.28	$38.85

NI or FFO Growth to Payout Sensitivity

	3.0%	4.0%	5.0%	6.0%	7.0%
35%	$36.96	$38.27	$39.61	$40.99	$42.41
40%	$42.24	$43.74	$45.27	$46.85	$48.47
45%	$47.52	$49.20	$50.93	$52.71	$54.53
50%	$52.80	$54.67	$56.59	$58.56	$60.59
55%	$58.08	$60.14	$62.25	$64.42	$66.65

COE to Payout Sensitivity

	7.1%	8.1%	9.1%	10.1%	11.1%
35%	$43.87	$43.87	$43.87	$43.87	$43.87
40%	$50.14	$50.14	$50.14	$50.14	$50.14
45%	$56.41	$56.41	$56.41	$56.41	$56.41
50%	$62.67	$62.67	$62.67	$62.67	$62.67
55%	$68.94	$68.94	$68.94	$68.94	$68.94