

# Bank of America

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## **Brian Moynihan**

I don't like banks. They are hard to analyze, they require leverage to make a return and they have a long history of getting in trouble. Yet, I am an investor in Bank of America (NYSE: BAC). The reason is quite simple. It's because of Brian Moynihan.

Before Moynihan, BAC was run by two empire builders – Hugh McColl and Ken Lewis. In the 80s and 90s McColl's North Carolina National Bank consolidated banks in the Southeast. Then in 1998 it merged with West Coast giant BankAmerica in what was then the largest bank merger. The merged company was renamed Bank of America.

In 2001, McColl stepped down and his understudy Ken Lewis took over as CEO. Lewis upped the acquisition game by buying FleetBoston Financial, MBNA, LaSalle Bank, Countrywide Financial and finally Merrill Lynch. In 2010, Lewis was replaced by Brian Moynihan.

By this time, BAC was a mess.

The lawsuits and defaults from the financial crisis kept pouring in. Its capital levels were inadequate. Its cost structure was bloated. The acquisitions were never properly integrated. And Countrywide was perhaps the worst deal in the history of financial services.

What happened next is one of the greatest corporate turnarounds.

*I think Brian is a different kind of chief executive. His sport is rugby. Have you ever seen rugby? You can't tell one player from another, and they're in a scrum, but somebody is running the show. That's kind of Brian. He doesn't need to be in the spotlight.*

- Anne Finucane, Vice Chairman, interview with Forbes (2014)

Moynihan wasted little time in getting to work.

To help fix the mortgage business, he recruited Terry Laughlin, a trusted colleague from his days at FleetBoston Financial. Laughlin was the CEO on IndyMac and was credited with turning the troubled subprime mortgage company around. Moynihan needed him to repeat his performance at Countrywide. Laughlin got to work by setting up a 'bad bank' known as Legacy Asset Servicing.

While Laughlin handled Countrywide, Moynihan focused on downsizing. In 2011 he unveiled Project New BAC – his ambitious turnaround plan. He tackled the problems one by one. He settled lawsuits. Paid fines. Sold non-core assets. Slashed expenses. Closed underperforming branches. Got rid of business units. Many of these problems were very expensive and time consuming. Here are some of the non-core assets they sold:

- Exited international credit card business
- Sold Canada credit card business to TD Bank
- Sold stake in China Construction Bank
- Sold mutual fund business Columbia Management to Ameriprise
- Sold Merrill Lynch's overseas wealth management business to Julius Baer
- Sold money-market fund business to BlackRock

*We had \$70 billion of funded private equity investments when I took over. We probably have less than a billion now.*

- Brian Moynihan, interview with David Rubenstein (2019)

Moynihan also fixed the asset side of the balance sheet. Currently BAC has about a \$100 billion credit card portfolio. Notice the big improvement in credit quality.

|                         | 2010     | 2019    |
|-------------------------|----------|---------|
| Credit card outstanding | \$114 bn | \$98 bn |
| % of FICO Scores        |          |         |
| Less than 620           | 12%      | 5%      |
| Greater than 620        | 88%      | 95%     |

At the end of 2010, 12% of their credit card customers had FICO scores under 620, while today it's about 5%. This is important because lower FICO scores is directly correlated with higher delinquency rates.

Unsecured consumer lending (e.g. credit card) is a scary business because banks can't force people to settle their balance. Credit worthiness matters. Leading up to the financial crisis, BAC pushed its credit card engine too far by giving cards to people who couldn't afford them. This mistake cost them dearly.

*Going into the crisis we were way overweight consumer and unsecured consumer credit. We charged off \$50 billion in credit card debt.*

- Brian Moynihan, interview with Bloomberg (2020)

Next, residential mortgage. This is BAC's biggest loan bucket on the consumer side.

|   | 2010     | 2019     |
|---|----------|----------|
| Residential mortgage outstanding                            | \$258 bn | \$236 bn |
| % of portfolio  |          |          |
| Refreshed LTV greater than 90 but less than or equal to 100 | 15%      | 2%       |
| Refreshed LTV greater than 100                              | 32%      | 1%       |

In 2010, 32% of their residential mortgages had loan-to-values greater than 100%, meaning that one third of homeowners were upside down on their homes. Today, only 1% are underwater.

*We were 20% of the mortgage market of which about 15% of it was done through other people. We don't do that anymore. The only way a person gets a mortgage with us is by sitting in front of a Bank of America teammate or digitally with us. We don't buy mortgages from other people. That's left us with 5% of the market.*

- Brian Moynihan, interview with David Rubenstein (2019)

Similar improvements can be seen in their home equity portfolio. Notice the huge decrease in loan outstanding in this category and the percentage of the portfolio that are underwater.

|  | 2010     | 2019    |
|--|----------|---------|
| Home equity outstanding                                      | \$138 bn | \$40 bn |
| % of portfolio   |          |         |
| Refreshed CLTV greater than 90 but less than or equal to 100 | 11%      | 1%      |
| Refreshed CLTV greater than 100                              | 34%      | 2%      |

Moynihan has said that one of his biggest learnings from the financial crisis is ‘all things in moderation.’ His actions have certainly followed those words. Going into the crisis, their loan portfolio leaned heavily toward the consumer side. Now, the loan portfolio is balanced with about an even split between commercial and consumer.

|                              | 2010     | 2019     |
|------------------------------|----------|----------|
| Outstanding loans and leases | \$940 bn | \$983 bn |
| % Consumer                   | 64%      | 47%      |
| % Commercial                 | 36%      | 53%      |

I believe these data points show that Moynihan has succeeded in instilling a conservative banking culture throughout the company.

#### Moynihan's incredible 10-year run at BAC

|                     | 2010    | 2019    |
|---------------------|---------|---------|
| Total deposits      | \$1 T   | \$1.4 T |
| Branches            | 5,900   | 4,300   |
| Deposits per branch | \$171 M | \$334 M |
| Deposits per share  | \$103   | \$152   |
| Employees           | 288,000 | 208,000 |
| Long term debt      | \$448 B | \$241 B |
| Noninterest expense | \$83 B  | \$55 B  |

## Technology tailwind

Technology is more likely to benefit banks rather than hurt them. The adoption of ATMs made it cheaper for banks to service their customers because they didn't need as many tellers. Then mobile banking came along. Now we have AI-powered digital assistants. It has never been easier for banks to service their customers because the phone can act as a 24/7 branch.

Furthermore, I believe that technology will disproportionately benefit the big banks. Banks such as JPM and BAC with immense earning power can invest heavily in technology. BAC is spending about \$700 million per year on cyber security and \$3 billion per year on new technology. A small community bank simply can't match those investments. This allows the big banks to further distance themselves from their smaller competitors.

The silver lining from the Covid-19 crisis is that more people will be accustomed to mobile banking. The number of BAC's mobile banking, Zelle and Erica users should increase substantially in the coming quarters.

*We want a cashless society. It costs BofA \$5 billion a year to move checks and cash around our company. We have more to gain than anybody.*

- Brian Moynihan (2019)

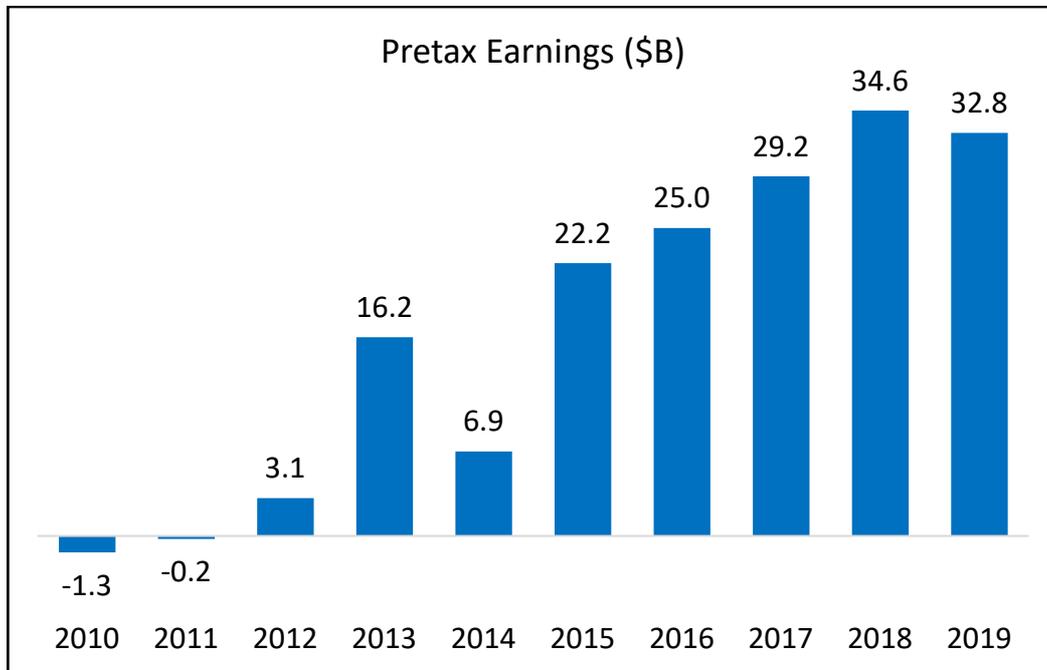
## A compelling investment

I believe BAC is a compelling investment for several reasons. First, BAC is in a much stronger position than it was heading into 2008. The asset side of the balance sheet has healed. The lessons from the crisis have been learnt. A conservative culture has been instilled. And the funding mix has trended towards stable, low-cost consumer deposits.

Second, BAC is a good business with tremendous earning power. They have a valuable deposit franchise in their consumer banking business and their Merrill Lynch wealth management business is a gem. Now that the bank's earnings are no longer disguised by charge offs, a powerful earnings stream is starting to hit the bottom line with consistency (see graph below).

Third, at a \$196 billion market cap or \$22 per share, BAC is cheap across several metrics. It is trading at 0.13x deposits per share, 1x tangible book and 8x last year's earnings. A well run bank should trade at much higher multiples. The company also pays \$0.72 per share in annual dividends. This is a simple case of an above average business trading at a below average price.

Fourth, BAC is an organic growth company. Banks that hold more than 10% of the nation's deposits are banned from making acquisitions. Management's actions and words indicate that they plan to return all the excess capital mostly via share repurchases. This eliminates reinvestment risk and should add nicely to the stock's return.



### Nice Start

BAC is a historic banking franchise whose origin can be traced back to 1904. Today, it has the largest market share in consumer deposits. It serves one out of every two households in the U.S. Everyday 800,000 people walk into their branches. It is deeply interwoven with the U.S. economy.

Over the past decade, Moynihan has orchestrated one of the greatest corporate turnarounds. He has made BAC a simpler, leaner and stronger business. The bank has finally returned to its main street banking roots.

Lastly, Moynihan and team are not resting on their laurels. In a recent interview with Fortune, he disclosed his epic goal of doubling the bank's consumer deposits. It's currently at an industry leading \$736 billion.

*We're out in competition to knock the crap out of everybody else and that's what teammates help you do...The words I use with my team about the turnaround is 'Nice Start'.*

- Brian Moynihan, interview with David Rubenstein (2019)