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Charter Financial Corp. (CHFN)

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NAB Research, LLC
Distributed by Banks Street Partners, LLC

Price: $20.80
52-week price range: $15.81-$21.94

EPS Estimates: 2017A: $0.95 [fiscal year end = Sept. 30]
2018E: $1.44
2019E: $1.55
Q218E: **$0.35** (versus **$0.22** in 2Q17)

Tangible Book Value: $11.59
Price/TBV: 1.79x
Dividend/Yield: $0.32/1.54%
Market Capitalization: $315 million

This company is a good example of how the surviving thrifts have evolved...

CharterBank management is increasingly venturing forth from their historic west Georgia base…

They have entered the lively Atlanta market and are honing their competitive strategy there… It's a bank that could go in a lot of directions...

Whatever happened to the thrifts, anyway?
We have to start this piece out with a confession—it has been about a million years (plus a couple of decades) since we have thought much about thrifts and savings and loans. That sad confession is based partly upon our historical experience as an analyst looking at the nation's largest banks, and partly upon our experience in the late 1980s, when the meltdown of the S&L industry was the predecessor of more financial services industry troubles to come. In addition, the demise of the thrift regulatory structure—the late and unlamented Office of Thrift Supervision, which was folded into the OCC in 2011 after a regrettable history of lax regulation—has tended to make analysts (like us) think about thrifts in the same way that we do community banks, which is as an integral part of the growth and consolidation trends taking place among smaller Southeastern financial institutions of all types.

And there's still a lot to consolidate. We were surprised to learn in the most recent FDIC Quarterly Banking Profile that there are still 752 savings institutions in the nation (13% of the total number) with about 7% of the nation's deposits ($931 billion, roughly.) **Charter Financial Corp. (CHFN)**—known locally as CharterBank—is one of the 63 thrifts in the FDIC's Atlanta regulatory region, and has a sort of "It's A Wonderful Life" pedigree and history. Founded in the old mill town of West Point, GA, in 1954 by the father of the present CEO Robert Johnson, the company has survived the interest rate debacle of the 1980s, the downturn of its West Point operating area as the textile industry there died, and the Financial Crisis, which hit residential real estate and the fortunes of both big-city and rural Georgia especially hard.

But Charter management hung in there, raised capital and struck out on the path of growth…
We won't pretend that we have ever fully understood the multiple-step conversion process through which a mutual savings institution becomes a fully public stock company—we haven't—but all we need to know here is that Charter completed the conversion process in 2013 and has had plenty of capital to show for its efforts. But they were also confronted with the dilemma that always confronts the leadership of recently converted thrifts—how to earn a decent return on that capital trove and thus satisfy the various retail and institutional investor constituencies that generally participate in thrift conversions.

In order to understand CHFN's rather exceptional growth strategy, you first need to understand Georgia geography and history. West Point is exactly that—a town on the Georgia border with Alabama, that is both the westernmost point of the mighty Chattahoochee River (from there it flows south to Florida) and was also at one time the western terminus of the Atlanta & West Point Railroad. (For Civil War buffs, West Point was also the scene of the Battle of West Point, which took place seven days after Lee's surrender at Appomattox. Better late than never.) West Point's historical prosperity was built upon textiles—with its mills powered by the Chattahoochee River—and upon that position as an important stop on the railway between Atlanta and Montgomery, AL.

The sad fate of the textile industry in the Southeast is well-known—and the West Point area was not an exception. The giant textile manufacturing employer there, West Point Stevens, finally declared bankruptcy in 2003 after years of struggles, leaving an unemployed work force and empty buildings across the Southeast and leading to years of hardship across a vast expanse of central Georgia. But the globalization trends that had caused so much hardship in the textile industry kicked in in a more positive way in 2009, when KIA (the South Korean automaker) established a giant auto manufacturing plant beside Interstate 85 a few miles north of West Point. That plant presently employs 6,700 people on the main campus and contributes to the employment of 15,000 in various ancillary activities throughout central and south Georgia.

From that rejuvenated economic base, CharterBank began to grow. We recently looked at an interesting slide from CHFN's annual meeting in February 2018, and it does not depict the timeline of a company that has decided to cave in to slow growth and decline. After its initial capital raise in the mid-2000s, CharterBank was ready to capitalize (no pun intended) upon the opportunities presented by the chaos of those years. They raised yet more capital in a second offering and were able to do three FDIC-assisted deals in 2009-2012, two of which got them into the coveted Atlanta MSA and marked a new strategic path into the South's premier growth market.

They took the final capital step in April 2013, completing their conversion into a fully public company and raising $143 million in the process. They have taken a multi-pronged approach in using their capital—paying dividends and buying back massive amounts of stock (35.6% of the outstanding shares repurchased from 2013-2015) at the same time they began to put an even bigger stake in the ground in Georgia's largest and fastest-growing market.

They have begun to build a significant Atlanta presence…

While they yet have a way to go in Atlanta, they're off to a good start. The company has added six branches in Atlanta through two deals since 2015—four branches through the **CBS Financial** acquisition in 2015 and another two through the purchase of **Resurgens Bancorp** in mid-2017. (In addition, the company has opened a new branch in a primo location—Buckhead—in the last couple of months.) While this may not yet seem like a massive Atlanta footprint, it is certainly a good foundation in a market which is fiercely competitive; the total number of branches acquired does not tell the full story.

Those six acquired branches represent great geography and large deposit totals. Indeed, thorough those two deals, Charter obtained a presence in Cobb and Dekalb counties, two of the Atlanta MSA's highest growth suburban markets. They acquired roughly $500 million in deposits in both mergers—with an especially large emphasis on core deposits (60% of the deposit base) in the Resurgens deal—and now are positioned both north and west of downtown Atlanta (Cobb County) and east (Dekalb County)—with lots of directions that they can grow from there. **Indeed, Charter now has as much of an Atlanta identity as it does a west Georgia one, with roughly 54% of its loans and deposits and half of its branches (11 of 22 total) in the Atlanta market.**

This is a good time to be growing in Atlanta—because there is a lot of "churn." We would be remiss if we did not mention the latest significant Atlanta deal—the acquisition of **BrandBank**, a $2 billion+ asset Atlanta bank with a well-regarded commercial lending identity—by **Renasant Corp. (RNST)**, of Tupelo, MS, for about 224% of Brand's tangible book value. **Deals such as this add valuation support to Charter's strategy of building out their Atlanta presence and potentially create opportunities for other banks in the marketplace.**

Did we mention that they have a conservative culture?...

Having a foundation as a family company and having been through the S&L wars definitely lend themselves to a conservative financial posture. This attitude is manifested in a couple of notable ways at CharterBank—through the continued maintenance of a strong capital base and through a credit culture that produces few problem loans. The company's CET1 capital ratio was 14.32% at the end of its 2017 fiscal year—plenty of capital to distribute to shareholders and to grow, and **even more capital will be created as the tax rate declines to the 21% statutory level over the next few years.**

As for loan losses—well, there aren't any. While it is possible that CHFN may encounter more credit issues as it grows its market share in Atlanta—which tends to be a market where booms can be quickly followed by busts—any credit issues are likely to be small potatoes compared with their larger competitors. The company does have an emphasis on residential real estate—of the 1-4 family and the multi-family varieties—and CRE, but they have a long underwriting history and a proven track record of not getting over their skis. It's not often that we look at a company that has had no loan loss provision for a number of quarters, has a 0.24% ratio of NPAs to loans (plus ORE) and a 0.96% (of loans) loan loss reserve ratio. That expertise will serve them well as they grow the Atlanta loan book, where multi-family lending is a particularly attractive growth opportunity.

We would mention one other distinctive aspect of this company—they have a good chunk of fee income. Our biggest beef with many community banks is that they neglect the development of their fee income sources, instead depending almost solely on the vicissitudes of the yield curve. CharterBank has a good chunk of fee revenues—roughly 27% of their revenue total in the latest quarter—and it comes from their deposit base and from their success with their signature debit card program, where bank card revenues constitute 40%-plus of deposit fees. (Amazing how customers will use debit cards when they automatically get them in their checking account package.) For a $1.6 billion bank to have more than 50,000 active debit cards in a 62,000 checking account base is no mean feat, and we hope to see more innovative product introductions and packages from Charter as they hone their Atlanta retail strategy.

Bottom Line: Solid historical operating base, good growth prospects in Atlanta, strong capital, steady earnings growth...Which way do they go now?...
We mean that from a double perspective—where do they go geographically, and where do they go strategically? We neglected to mention earlier that CharterBank also has a presence in eastern Alabama and in the Panhandle of Florida, so their growth prospects are by no means confined to Atlanta and central Georgia. While our guess would be that they would choose to go farther afield in the Atlanta metro market—perhaps into the growing Alpharetta/Cumming area and certainly to develop more in the more attractive in-town markets—our guess is that much will be dictated by the availability of smaller merger partners in the area, of which there are still a number left.

From a strategic perspective, this company is in a good spot. As we have just seen with the acquisition of BrandBank, good Atlanta banks do not come cheap. Atlanta is still—along with Charlotte, Greenville, and Nashville—a place that every Southern banker wants to be, and as CharterBank grows its Atlanta presence and hones its strategy in the ATL, it's hard to see how this company would not be a desirable target for a $10 billion+ outsider.

Or on the other hand—maybe not. We do acknowledge that this bank has a few historical quirks—like its founding by the father of the present CEO—but we would also note our conversations with other "family bank" CEOs who have found that their children are not quite as keen to be bankers as they were. The fact that this is also a public company and not closely held would also dictate that any serious bid be considered and that rational and dispassionate decisions be made on the behalf of shareholders—and our belief is that every banker has his price, no matter his (or her) family history.

In the interim, it's looks to us like a good stock for conservative investors. Charter management have produced superior returns over a long period of time, like having an ample capital cushion, are growing their core deposit base (which will come in handy as rates rise), and generally present a profile of predictability and satisfying un-flashiness. **In a world of growing stock market volatility, rising interest rates, and the general craziness of the daily American news cycle—un-flashy and predictable look pretty good to us.**

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Table 1

Second Stage Conversions Since CHFN Company	Ticker	Second Stage Conversion Completion Date	Conversion Price ($)	03/29/18 Closing Price ($)	Investment CAGR Since Conversion[1]	Conversion P/TBV (Pro Forma) (%)[2]	MRQ GAAP P/TBV (%)	Dividend Yield (%)	Stock Increase, First Trading Day (%)
Bancorp 34	BCTF	10/12/16	10.00	15.00	32.0%	76.4	103.2	0.00	27.5
Ottawa Bancorp	OTTW	10/12/16	10.00	13.72	24.2%	68.1	92.9	1.46	15.7
FSB Bancorp	FSBC	07/14/16	10.00	17.17	37.3%	65.1	106.4	0.00	22.3
WCF Bancorp	WCFB	07/14/16	8.00	9.65	11.6%	69.4	NA	2.07	9.9
PB Bancorp	PBBI	01/08/16	8.00	10.55	13.3%	75.3	105.2	1.90	12.5
MSB Financial Corp.	MSBF	07/17/15	10.00	17.95	24.2%	79.9	141.8	0.00	19.8
Equitable Financial Corp.	EQFN	07/09/15	8.00	10.50	10.5%	82.9	102.8	0.00	8.5
Kearny Financial Corp.	KRNY	05/19/15	10.00	13.00	9.6%	82.6	117.4	0.92	7.2
Ben Franklin Financial	BFFI	01/23/15	10.00	9.50	-1.6%	60.4	92.5	0.00	3.0
Beneficial Bancorp	BNCL	01/13/15	10.00	15.55	14.8%	78.6	136.7	1.54	8.2
Pathfinder Bancorp	PBHC	10/17/14	10.00	15.45	13.4%	80.4	115.9	1.49	(2.5)
Meridian Bancorp	EBSB	07/29/14	10.00	20.15	21.0%	101.1	174.6	0.99	6.0
Investors Bancorp	ISBC	05/08/14	10.00	13.64	8.3%	106.6	137.3	2.64	4.2
Sugar Creek Financial Corp.	SUGR	04/09/14	7.00	12.55	15.8%	53.1	87.5	0.00	31.4
Clifton Bancorp	CSBK	04/02/14	10.00	15.65	11.9%	76.9	NA	1.53	16.1
Waterstone Financial	WSBF	01/23/14	10.00	17.30	14.0%	81.3	124.0	2.77	6.6
Delanco Bancorp	DLNO	10/18/13	8.00	15.79	16.5%	51.7	112.7	0.00	4.4
Prudential Bancorp	PBIP	10/10/13	10.00	18.14	14.3%	76.9	128.7	1.10	8.5
AJS Bancorp	AJSB	10/10/13	10.00	14.10	8.0%	67.6	95.7	1.42	19.0
Charter Financial Corp.	CHFN	04/08/13	10.00	20.39	15.4%	84.1	175.9	1.57	0.8
				MEDIAN	**14.1%**	**76.9**	**114.3**	**1.26**	**8.5**
				AVERAGE	**15.7%**	**75.9**	**119.5**	**1.07**	**11.5**

[1] *Annualized investment return since conversion*

[2] *Pro Forma P/TBV on a converted basis as calculated by S&P Global Market Intelligence*

SOURCE: S&P Global Market Intelligence

Table 2
Charter Financial Corp.
Earnings Estimates
($ Thousands, Except Per Share Data)

	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018E	2017A	2018E	2019E	Percent Change 18E/17A	Percent Change 19E/18E
Net Interest Income	**$12,200**	**$11,655**	**$11,987**	**$13,300**	**$14,307**	**$14,438**	**$49,142**	**$59,675**	**$62,400**	**21**	**5**
Loan Loss Provision	(750)	(150)	0	0	0	0	(900)	1,000	1,000	(211)	0
Subtotal	**12,950**	**11,805**	**11,987**	**13,300**	**14,307**	**14,438**	**50,042**	**58,675**	**61,400**	**17**	**5**
Noninterest Income											
Deposit service charges	1,888	1,701	1,972	2,081	2,114	2,050	7,641	8,200	8,800	7	7
Card fees	1,282	1,367	1,443	1,418	1,459	1,500	5,510	6,000	6,600	9	10
Securities gains	0	248	0	0	1	0	248	0	0	(100)	nm
BOLI Income	332	247	306	310	322	275	1,195	1,100	1,100	(8)	0
Loan sale gains	731	543	543	601	619	400	2,418	2,000	1,600	(17)	(20)
Other Noninterest Income	749	441	376	660	876	750	2,226	3,000	3,100	35	3
Total Noninterest Income	**4,983**	**4,546**	**4,639**	**5,070**	**5,391**	**4,975**	**19,239**	**20,300**	**21,200**	**6**	**4**
Noninterest Expense											
Employment Expenses	6,134	6,079	6,530	7,688	7,009	7,100	26,431	27,500	28,500	4	4
Occupancy Exp.	1,323	1,220	1,157	1,503	1,478	1,450	5,203	5,750	6,000	11	4
Data Processing	909	1,004	1,091	1,925	1,153	1,175	4,929	5,500	6,000	12	9
Legal & Professional	284	388	384	808	266	275	1,864	1,500	1,600	(20)	7
Marketing	357	412	384	479	329	400	1,632	1,800	1,900	10	6
Amortization of core deposit intangible	154	149	118	140	191	200	561	800	800	43	0
Regulatory fees	165	197	198	199	188	200	760	850	900	12	6
Furniture, eqpt. & miscellaneous	444	452	426	488	472	475	1,810	2,000	2,100	10	5
Other Expenses	519	849	808	1,156	786	850	3,333	3,500	3,700	5	6
Total Noninterest Exp.	**10,290**	**10,750**	**11,097**	**14,387**	**11,871**	**12,125**	**46,523**	**49,200**	**51,500**	**6**	**5**
Pretax Income	**7,643**	**5,601**	**5,530**	**3,984**	**7,828**	**7,288**	**22,758**	**29,775**	**31,100**	**31**	**4**
Income Taxes/(Benefit)	2,597	2,284	2,016	1,424	3,431	1,900	8,322	8,000	7,716	(4)	(4)
Net Income	**5,046**	**3,316**	**3,514**	**2,560**	**4,397**	**5,388**	**14,436**	**21,775**	**23,384**	**51**	**7**
Average Diluted Shares	15,065	15,340	15,257	15,241	15,233	15,225	15,153	15,125	15,125	(0)	0
Net Income per Dil. Share	**0.33**	**0.22**	**0.23**	**0.17**	**0.29**	**0.35**	**0.95**	**1.44**	**1.55**	**51**	**7**
Tax Rate	33.98	40.79	36.46	35.75	43.83	26.07	36.57	26.87	24.81	(27)	(8)
Net Interest Margin	**3.71%**	**3.61%**	**3.60%**	**3.85%**	**3.87%**	**3.85%**	**3.67%**	**3.85%**	**3.90%**	**5**	**1**
Average Earning Assets	1,316,310	1,320,125	1,330,900	1,382,751	1,479,270	1,500,000	1,338,597	1,550,000	1,600,000	16	3
Overhead Ratio %	59.9%	66.4%	66.7%	78.3%	60.3%	62.5%	68.0%	61.5%	61.6%	(10)	0
Tangible Book Value	**$11.52**	**$11.70**	**$11.92**	**$11.33**	**$11.59**	**$11.88**	**$11.33**	**$12.77**	**$14.32**	**13**	**12**
Revenues	17,182	16,201	16,627	18,370	19,699	19,413	68,381	79,975	83,600		
Fees as % of Total Revenue	**29.0**	**28.1**	**27.9**	**27.6**	**27.4**	**25.6**	**28.1**	**25.4**	**25.4**		

Dated: 4/2/18
NAB Research, LLC

Note: CharterBank's fiscal year ends September 30.

Table 3
Charter Financial Corp.
Average Balance Sheet Summary
($ Thousands)

	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	% Change vs. Last Quarter	% Change vs. Last Year
Interest-Earning Assets							
Loans	**$1,003**	**$1,005**	**$1,025**	**$1,078**	**$1,158**	**7**	**15**
Taxable Investment Securities	195	196	188	186	182	(2)	(7)
Non-Taxable Investment Securities	2	2	2	2	1	(29)	(33)
Total Investment Securities	**197**	**197**	**190**	**188**	**183**	**(2)**	**(7)**
Other interest-earning assets	**116**	**121**	**116**	**118**	**138**	17	19
Total Earning Assets	**1,316**	**1,324**	**1,331**	**1,383**	**1,479**	**7**	**12**
Interest-Bearing Liabilities							
Interest-Bearing Deposits	1,001	1,007	997	1,033	1,098	6	10
Borrowed Funds	50	50	50	53	60	13	20
Floating Rate Debt	7	7	7	7	7	1	2
Total Interest-Bearing Liabilities	**1,058**	**1,064**	**1,054**	**1,093**	**1,165**	**7**	**10**
Non-interest bearing deposits	**172**	**175**	**187**	**205**	**236**	**15**	**37**
Net Interest Spread	**3.58%**	**3.49%**	**3.48%**	**3.72%**	**3.72%**		
Net Interest Margin	**3.71%**	**3.61%**	**3.60%**	**3.85%**	**3.87%**		

Dated: 4/2/18
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