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September 7, 2016

Home Bancorp, Inc. (NASDAQ: HBCP)

Trading Price:	$29.14	**Tangible Book Value**:	$21.90
52-week Range:	$21.29-$29.37	**Price/TBV**:	1.33x
		Dividend/Yield:	$0.40/1.37%
EPS Estimates:	2015A: $1.79	**Market Capitalization**:	$213.4 million
	2016E: $2.15		
	2017E: $2.29		
	3Q16E: $0.56 (vs. $0.41 3Q15)		

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- **There's a lot going on in southern Louisiana banking...**
- **This thrift-turned-bank has a long history...But it continues to grow into a new model...**
- **The most distinctive feature of HBCP is the gutsy way that it does deals...And we think that there are likely more of those to come...**

Who knew that so much transformation was going on in southern Louisiana?...

When we read the headlines about southern Louisiana, the news once again concerns a devastating act of Nature—the massive flooding of Baton Rouge and its environs—and this is an area of the South that has seen its share of natural transformation in the last few years. We've written previously about how southern Louisiana has been reshaped over the past decade by the successive disasters of **Hurricane Katrina** and the **BP Gulf Blowout**—both of which wrought massive damage on the environment, resulted in displacement of people and businesses, and were then followed by a huge inflow of federal, state and corporate funds into the region. **This latest episode of natural trauma—a mid-August deluge of 20-plus inches of rain in roughly 48 hours—has damaged an estimated 60,000 homes and impacted 11% of the state's population, and will likewise result in a long period of rebuilding and recovery.**

But we can argue that the process of coming back this time around will be aided by a regional banking industry that is much more vigorous than it has been for some time. We visited with several banks in the area a few weeks ago (just prior to the flooding), and we were surprised to hear a "story" that was about so much more than the level and direction of energy prices. While it cannot be denied that low oil prices have been destructive to local economies in places like Louisiana, Texas and Oklahoma—and the banks that do business in these places have been preparing for the credit quality fallout that may come as a result—the economies of places like Baton Rouge and Lafayette are also being positively influenced by a lesser-known positive impact of low energy prices.

A whole new industry of chemical and plastics manufacturing (activities that benefit from cheap natural gas as a feedstock) has sprung up along the I-10 corridor, and dozens of new plants are bringing construction spending and new employment to the area. Add to this new reality the ongoing reordering of southern Louisiana's population as Baton Rouge and towns around it continue to benefit from the losses of both people and businesses experienced by New Orleans a decade ago, and it's not all bad news for this oft-afflicted area. Indeed, there seemed to be an expectation of greater growth there than that which has been seen in some time, and perhaps this reflects the new reality that we have seen in other parts of the South—that growth is devolving from the traditional economic centers into new places and industries.

As a result of these growth trends, new banks have sprung up—and some old banks are doing new things…
Home Bancorp (HBCP)—founded as a thrift in 1908—is one of the region's oldest financial institutions, and under the leadership of CEO John Bordelon, the company has effected a remarkable (and still ongoing) transformation from a traditional thrift balance sheet and thrift operating culture into a more aggressive and forward-looking community bank. That transformation has not been either instantaneous or painless—indeed, the conversion from an S&L to a national savings bank in 2008 was not without pushback from some of the company's more traditionally minded constituents, and the bank's ongoing transformation to a national bank in 2015 meant taking on a whole new regulatory regime. But Mr. Bordelon (who has been with the bank since 1981, most remarkably) seems to us to be single-minded in his pursuit of his vision for his company. **That vision is one of more vigorous growth and competition on an interstate basis, and HBCP has started in that direction.**

Indeed, their deal-making history is almost unique, in our experience—and we'd also say that it's also pretty gutsy…
It's not often that we see a company transition from a mutual charter, do a public offering, and then march on to do a deal for a bank that's about 35% of its size—but HBCP did all of those things in the period from 2008-2010 (which we do not recall as being a particularly positive time for financial services industry growth.) That 2-year interim marks the beginning of the "new" Home Bancorp, as the company raised $87 million in its IPO in 2008, and that year also did the first expansion outside of the bank's hometown of Lafayette, opening its first full-service branch in Baton Rouge.

Home Bancorp's first major deal—the FDIC-assisted acquisition of Statewide Bank in March 2010—brought $199 million in assets to HBCP's existing $550 million-in-assets balance sheet and put the company in the growth markets of the Northshore area of Lake Pontchartrain. This deal looks especially significant to us, given that HBCP had its own regulatory issues in 1989-1991 and had operated under a supervisory agreement during that time. The allotment of failed franchises in the wake of the financial crisis, in our view, marked a deliberate regulatory effort to encourage responsible consolidation and growth for the best of the community banking industry—witness the growth in the best North Carolina, South Carolina and Georgia community banks—and this deal seems to us to have put a stamp of approval upon Home's wish to grow through state and regional M&A.

John Bordelon and his management team wasted no time in moving the bank onward and upward from there. They have added about **$900 million in assets**—and **17 branches** in the greater New Orleans area and in two markets in Mississippi—through three additional deals: Guaranty Savings Bank (Orleans and Jefferson parishes), Britton & Koontz Bank (Baton Rouge and Mississippi), and the Bank of New Orleans (Greater New Orleans.) All of these deals have been done for cash, two were done under book value (Bank of New Orleans was done at 1.26x book value), and none required a capital raise on the part of HBCP. **Indeed, the company has emerged from this deal program with a 10.1% tangible equity capital ratio, has instituted a dividend during this time, and is now seeing core earnings begin to climb as deal consolidation is ongoing.**

But no program of rapid deal-making comes without its own costs…

And for HBCP, those costs are the need to now grow into its expense base, as well as the need to begin to think seriously about how to get badly needed fee income. HBCP is hardly unique in this regard—most of the acquiring community banks that we have encountered have had to put aside important earnings goals in order to strike while the acquiring iron is hot—and that may be a circumstance that goes on as the deal-making environment remains favorable.

The expense situation at HBCP is by no means dire. The company seems to be running a normalized overhead ratio in the **62%-63% range**, which is in the middle of the pack of the companies that we follow, and we assume that there are still some residual deal costs in those numbers. (CEO Bordelon and CFO Joe Zanco express their goals for expenses as a **percentage of assets**—they're running at **3.05% of assets** now, and they wish to see costs **come in under 3%.**) In any case, this company seems fully capable of running an **under-60% OH ratio in a more normal interest rate environment, and with a still-contained retail branch network (30 branches total), they may be able to do substantially better than that.**

But the need for fee income looks more pressing, and we wonder if this might not become an imperative for acquisition targets. The reality is that it's easier (although usually more expensive) to buy fee income than to grow it organically, and a number of community banks have chosen the path of buying banks that bring both core deposits and small fee-generating platforms that can then be expanded. In any case, the company is still overly dependent on service charges—which are declining as consumers become more adept at managing overdrafts—and it would seem to us that an **expanded mortgage banking platform** would be a natural addition to their product offerings. In addition, we never miss the opportunity to urge community banks to offer some variety of **wealth management** services—usually delivered as a joint venture or some type of partnership with an existing provider—as we believe that these services, delivered by more familiar and trusted financial institutions, will become increasingly important to American consumers as they retire (Baby Boomers) and raise families (Millennials) in the coming years.

The bank's earnings trends are pretty straightforward…

There's nothing mysterious here—they grow loans, maintain a healthy net interest margin, and try to work expenses down. And HBCP is growing loans at a healthy low-double-digits pace, although that growth has been somewhat obscured by the continued reordering of the loan portfolio in the wake of the Bank of New Orleans deal and deals of past years. The loan portfolio presently is a pretty balanced one—the major categories are commercial real estate (34%) and 1-4 family residential (30%), with C&I loans (another opportunity for growth) coming in at a distant 11%. With this mix and with a large base of market-rate deposits, the company has been able to maintain a **NIM in excess of 4%** over a long period of time, although they concede that there is **likely to be some erosion from the 4.35% level of 2Q16** as the impact of low rates increasingly bites.

And energy lending must be mentioned. Yes, there is an energy portfolio (albeit a small one) which at last disclosure was **$35.7 million** (roughly **3%** of loans) plus another $9.1 million in unfunded commitments. None of these loans is part of a shared national credit and the biggest exposure is to energy-related commercial real estate ($16.0 million.) The bank is maintaining a 3.3% allocated allowance for its energy portfolio, and they referenced in the 2Q16 earnings release an **$11.6 million increase in nonperforming assets** due to the ongoing "struggles" of their energy clients.

The overall credit quality metrics merit an explanation. Due to this large addition to NPAs in the second quarter, the overall credit metrics have worsened somewhat and will likely be a focus for investors in the next few quarters. While actual loan losses remain very low—like **zero** in 2Q16—NPLs have risen to **1.89% of the loan portfolio** while the ratio of the loan loss allowance to loans stands at **0.94%, or roughly 50% coverage of NPLs.** While we do not believe that coverage ratio will merit a large-scale building of the reserve—given the company's historical loss experience—**there may be a bit of lumpiness in loan loss provisions over the next few quarters in order to maintain the allowance at some level acceptable to management and regulators alike.**

Bottom Line: Whether it's the southern Louisiana economy, energy, credit metrics, whatever...This is a very reasonably valued stock…

This is the lowest-valued community bank in our coverage universe—period. This stock presently sells at about **1.33x its tangible book value**—versus a **1.50x** valuation for similarly sized community banks and a whopping **2.29x P/TBV** valuation for the larger community bank consolidators. In addition, the stock's PE ratio of 12.6x our 2017 estimate of $2.29 places this company's valuation more in line with those of the major banks—where growth prospects are much more limited—than with the growth segment of the community banks.

There are likely multiple reasons for this stock's low valuation—most of which are energy, energy, and energy. While there may be other reasons for HBCP's somewhat depressed stock valuation—its history as a thrift, the still-large percentage of 1-4 family residential loans on the books, a low level of analyst coverage of the stock, etc.—it's our bet that the company's presence in the changing southern Louisiana economy and the **still-prevalent concerns about the region's exposure to energy trends** are the dominant issues in investors' minds when it comes to this company.

That's too bad, because it looks to us like their record of well-valued deals and management's long tenure and good operating record merit a second look. After spending some time looking at the sky-high valuations of the $5 billion-$10 billion in assets community bank segment—and all of these banks have been involved in a fairly rapid consolidation trend—we have to ask the question**: How much are investors willing to pay for that kind of growth, and when do they begin to look elsewhere?**

While it may be true that Baton Rouge and Lafayette are not Nashville, it is equally true that these cities are not drawing the cut-throat banking competition that is being experienced in “hot” banking centers like Nashville, Charleston, Charlotte and Atlanta, either. **Sometimes it’s necessary to make a bet on good management and misperceptions about future growth prospects, and better to be early to the party. We’d say that Home Bancorp looks to us like that kind of a bet.**

Table 1
Home Bancorp, Inc.
Earnings Estimates
($ Thousands, Except Per Share Data)

	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016E	2015A	2016E	2017E	Percent Change 16E/15A	17E/16E
Net Interest Income	**$12,765**	**$13,531**	**$15,756**	**$15,722**	**$15,553**	**$15,426**	**$54,544**	**$62,136**	**$64,500**	**14**	**4**
Tax Equivalent Adjustment	0	0	0	0	0	0	0	0	0	(100)	NM
Loan Loss Provision	294	569	670	850	1,050	850	2,071	3,750	3,600	81	(4)
Subtotal	**12,471**	**12,962**	**15,087**	**14,872**	**14,503**	**14,576**	**52,473**	**58,386**	**60,900**	**11**	**4**
Noninterest Income											
Service Charges	955	1,028	1,063	1,036	1,002	1,000	3,938	4,000	4,200	2	5
Bank Card Fees	638	620	590	601	676	700	2,413	2,600	2,800	8	8
Gains on Sale of Loans	268	478	408	301	487	500	1,528	1,800	2,000	18	11
BOLI Income	124	124	123	121	120	120	504	500	500	(1)	0
Gain on Sale of Prop./Eqpt.	(134)	0	0	0	641	0	7	641	0	8,706	(100)
Other Noninterest Income	188	(53)	270	508	522	525	379	2,000	2,100	427	5
Total Noninterest Income	**2,039**	**2,197**	**2,455**	**2,567**	**3,448**	**2,845**	**8,770**	**11,541**	**11,600**	**32**	**1**
Noninterest Expense											
Employment Expenses	6,063	6,268	6,945	7,201	6,921	6,750	25,036	27,600	29,000	10	5
Occupancy Exp.	1,167	1,218	1,320	1,310	1,322	1,300	4,876	5,300	5,500	9	4
Marketing	113	129	134	258	198	200	486	900	900	85	0
DP & Office Expenses	1,048	1,104	1,400	1,721	1,320	1,300	4,641	5,600	5,200	21	(7)
Professional Services	475	648	394	294	259	250	1,755	1,000	1,050	(43)	5
Regulatory fees & franchise tax	444	430	471	542	549	550	1,773	2,300	2,400	30	4
OREO Costs	260	(18)	(35)	118	307	200	443	800	500	80	(38)
Other Expenses	659	742	924	897	978	800	3,012	3,200	3,200	6	0
Total Noninterest Exp.	**10,228**	**10,522**	**11,553**	**12,341**	**11,856**	**11,350**	**42,022**	**46,700**	**47,750**	**11**	**2**
Pretax Income	**4,281**	**4,637**	**5,989**	**5,099**	**6,095**	**6,071**	**19,220**	**23,227**	**24,750**	**21**	**7**
Income Taxes/(Benefit)	1,441	1,738	2,026	1,749	2,078	2,100	6,671	8,000	8,500	20	6
Net Income	**2,840**	**2,899**	**3,963**	**3,350**	**4,016**	**3,971**	**12,550**	**15,227**	**16,250**	**21**	**7**
Average Diluted Shares	6,695	7,022	7,045	7,052	7,088	7,090	7,045	7,075	7,100	0	0
Net Income per Dil. Share	**0.42**	**0.41**	**0.56**	**0.47**	**0.57**	**0.56**	**1.79**	**2.15**	**2.29**	**20**	**6**
Tax Rate	33.67	37.47	33.83	34.30	34.10	34.59	34.71	34.44	34.34	(1)	(0)
Adjusted Tax Rate	33.67	37.47	33.83	34.30	34.10	34.59	34.71	34.44	34.34	(1)	(0)
Net Interest Margin	**4.47%**	**4.55%**	**4.36%**	**4.40%**	**4.35%**	**4.30%**	**4.43%**	**4.33%**	**4.30%**	**(2)**	**(1)**
Average Earning Assets	1,144,444	1,179,946	1,433,133	1,430,075	1,432,190	1,435,000	1,228,768	1,435,000	1,500,000	17	5
Overhead Ratio %	69.1%	66.9%	63.4%	67.5%	62.4%	62.1%	66.4%	63.4%	62.7%	(4)	(1)
Tangible Book Value	**$21.47**	**$20.26**	**$20.68**	**$21.23**	**$21.90**	**$22.47**	**$20.68**	**$22.83**	**$25.12**	**10**	**10**
Revenues	14,804	15,728	18,211	18,290	19,000	18,271	63,314	73,677	76,100		
Fees as % of Total Revenue	**13.8**	**14.0**	**13.5**	**14.0**	**18.1**	**15.6**	**13.9**	**15.7**	**15.2**		

Dated: 9/7/16
NAB Research, LLC

Table 2
Home Bancorp, Inc,
Average Balance Sheet Summary and Analysis
($ Thousands)

	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016	% Change vs. Last Quarter	% Change vs. Last Year
Interest-Earning Assets							
Loans receivable	$916	$969	$1,216	$1,226	$1,225	(0)	34
Taxable Investment Securities	151	NA	NA	153	153	0	1
Non-Taxable Investment Securities	36	NA	NA	35	34	(2)	(6)
Total Investment Securities	**188**	**192**	**195**	**189**	**188**	**(0)**	**0**
Other interest-earning assets	**41**	**19**	**22**	**16**	**19**	19	(54)
Total Earning Assets	**1,144**	**1,180**	**1,433**	**1,430**	**1,432**	**0**	**25**
Non-earning Assets	**105**	**105**	**NA**	**115**	**113**	**(2)**	**8**
Interest-Bearing Liabilities							
Savings, checking & MM	571	575	659	679	670	(1)	17
CD's	213	224	285	274	270	(1)	27
Total Interest-Bearing Liabilities	**784**	**799**	**944**	**952**	**940**	**(1)**	**20**
Short-term FHLB Advances	0	52	138	41	46	12	NM
Long-term FHLB Advances	19	NA	NA	85	84	(2)	NM
Total Interest-Bearing Liabilities	**823**	**856**	**1,082**	**1,078**	**1,070**	**(1)**	**30**
Non-interest bearing liabilities	**267**	**269**	**NA**	**298**	**303**	**2**	**14**
Net Interest Spread	**4.35%**	**3.22%**	**4.24%**	**4.28%**	**4.22%**		
Net Interest Margin	**4.47%**	**3.33%**	**4.36%**	**4.40%**	**4.35%**		

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