Hingham Institution for Savings

HIFS | Disclosure: Long

PRICE 9/13/23	SHARES OUT	MARKET CAP
$202.90	2.150m	$436m

DESCRIPTION: Massachusetts-based bank focused on real estate lending and related deposits. Operations in Boston, Washington, D.C., and San Francisco markets.

PREVIOUS ANALYSIS:
Deep Dive: March 2021
Industry Update: May 2023
LINK TO BACK ISSUES

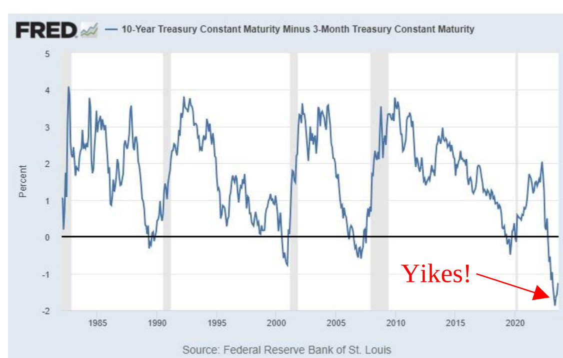
Figures in millions	2Q23	1Q23	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
BALANCE SHEET														
Total assets	$4,311	$4,206	$4,194	$3,431	$2,857	$2,590	$2,409	$2,285	$2,015	$1,769	$1,552	$1,356	$1,206	$1,127
Equity securities	74	67	63	88	66	47	38	34	27	41	71	106	103	97
Total loans, net	3,762	3,672	3,658	2,999	2,495	2,227	2,009	1,834	1,606	1,406	1,239	1,079	950	850
Loan allowance % gross loans	0.69%	0.69%	0.68%	0.68%	0.69%	0.69%	0.68%	0.68%	0.68%	0.70%	0.73%	0.78%	0.84%	0.88%
Total deposits	2,414	2,520	2,505	2,393	2,139	1,821	1,573	1,506	1,366	1,217	1,089	941	870	788
FHLB Advances	1,470	1,265	1,276	665	408	505	607	579	475	402	330	303	234	247
Shareholders' equity	400	393	386	355	293	247	213	186	161	138	122	103	93	82
Average diluted shares (000s)	2,203	2,206	2,202	2,201	2,187	2,183	2,187	2,181	2,152	2,145	2,133	2,130	2,127	2,126
INCOME STATEMENT														
Net interest income	$13	$15	$106	$102	$85	$67	$66	$64	$58	$51	$46	$39	$38	$36
Loan loss provision	0	0	5	3	2	2	1	2	1	1	1	0	1	1
Operating expenses	7	7	27	22	22	21	20	20	19	19	20	17	16	16
Net income	8	9	38	67	51	39	30	26	23	19	22	13	13	12
Core net income*	4	6	55	57	44	33	33	26	23	19	17	13	13	12
*Core net income excludes securities gains/losses.														
CAPITAL ALLOCATION														
Dividends	$1.4	$2.8	$6.6	$5.8	$4.9	$4.7	$4.1	$3.5	$3.3	$3.1	$4.5	$2.9	$2.8	$2.7
Net purchase / (sale) equity securities	1.8	0.7	(3.5)	10.8	10.3	(0.0)	(0.0)	2.8	(17.5)	(30.1)	(0.1)	32.7	7.0	4.7
Growth capex	0.5	0.2	2.0	1.1	0.8	(0.4)	0.5	(0.4)	(0.6)	(0.1)	(0.6)	1.7	3.6	2.6
RATIOS														
Core return on average assets	0.39%	0.56%	1.43%	1.89%	1.65%	1.32%	1.42%	1.21%	1.21%	1.18%	1.52%	n/a	n/a	n/a
Core return on average equity	4.06%	5.85%	14.6%	17.3%	16.7%	14.3%	16.1%	14.7%	15.4%	14.8%	19.3%	n/a	n/a	n/a
Net interest margin	1.28%	1.46%	2.81%	3.48%	3.22%	2.72%	2.90%	3.05%	3.10%	3.17%	3.23%	3.19%	3.38%	3.50%
Weighted average spread	0.66%	0.92%	2.60%	3.40%	3.03%	2.38%	2.66%	2.91%	2.99%	3.06%	3.13%	3.07%	3.25%	3.36%
Operating expense to average assets	0.71%	0.68%	0.70%	0.70%	0.81%	0.82%	0.85%	0.91%	1.02%	1.15%	1.38%	1.36%	1.41%	1.43%
Efficiency ratio	55.0%	46.0%	24.8%	21.3%	25.4%	30.3%	29.9%	30.1%	32.2%	36.3%	37.1%	43.2%	41.4%	42.9%
Average equity to average assets	9.66%	9.51%	9.81%	10.93%	9.93%	9.24%	8.80%	8.22%	7.85%	7.97%	7.87%	7.89%	7.62%	7.44%
Non performing loans / total loans	0.00%	0.01%	0.03%	0.01%	0.16%	0.25%	0.02%	0.09%	0.11%	0.13%	0.18%	0.55%	0.31%	0.79%

*Interim periods are annualized.

SECOND QUARTER 2023 UPDATE

Hingham's liability-sensitive balance sheet continues to be punished by the rapid rise in interest rates and a deeply inverted yield curve. But there are bright spots.

The bad news first: As of June 30, 2023, the weighted average spread stood at just 66 basis points and net interest margin for the quarter came in at 1.28%. Any other bank would be underwater at this point. Hingham's tight expense control with overhead at just 71 basis points saved the day. For comparison, Hingham's FDIC peer group is at 236 basis points.



The spread between the 3-month treasury bill and the 10-year treasury note bottomed out at negative 1.89% on June 1 and as of September 12 stood at negative 1.29%.

Total deposits slipped 3.6% to $2.414 billion from year end. Hingham's efforts with its Specialized Deposit Group and its Massachusetts DIF insurance (providing unlimited coverage to depositors) helped it weather the recent storm. By comparison, Federal Reserve data show small banks (all banks outside the top 25) had deposits shrink 8% over the same period. The bank continues to use FHLB advances to plug the gap between loans and deposits and shift its mix where it makes most sense from a funding perspective.

Total loans grew from $3.658 billion at year end to $3.762 billion as of the end of Q2, an increase of 2.8%. By contrast Federal Reserve data show small banks declined 2.5% over the same period. Loan originations are lumpy by nature, though it's interesting to note that San Francisco originations slowed to just $1 million in Q1 and $4 million in Q2 after $85 million in 2022 and a banner $302 million in 2021. Credit quality remains pristine with zero non-performing loans. On a fair value basis loans are $179.6 million underwater or about 45% of equity; making the adjustment capital is still above 5%.

Hingham continues to pay quarterly dividends. Capex spending has moderated as its Georgetown, Washington, D.C. branch came fully online. It just received permission from the Mass. and D.C. divisions of banks to exercise branch powers and has already started accepting applications for residential loans there.

Additional purchases of equity securities of $0.7 million in Q1 and $1.8 million in Q2 are likely a response to choppy equity markets. The portfolio is managed not for liquidity but as long-term investments.

Management's experience and study of history are a good indication that the bank will weather this storm largely unscathed. A less disciplined bank (or one with a higher cost structure) might seek to grow assets rapidly to increase net interest income, "hit the pause button", or worse choke off today's investments at the expense of tomorrow's growth. Hingham has used the recent turmoil to go on the offensive, adding staff and having conversations with customers previously unwilling to talk to them. It's exactly the type of behavior that a long-term owner looks for.

Without implying a recommendation of any kind, shares look undervalued. At $436 million the bank trades at 1.08x book value (1.95x if you prefer to mark the loan book to fair value*). What counts are future cash flows. I'd expect Hingham to a earn mid-single digit ROE this year as the inversion of the yield curve continues and as the absolute rise in rates causes funding costs to approach the yield on pre-2023 cohort loans. It'll take a few years for Hingham to cycle the loan book and approach the bank's normalized earning power; by my estimate an ROE of somewhere around 15% through the cycle; on top of changes to the value of the equity portfolio. Those holding for 5 years should enjoy highly satisfactory returns from today's prices.

*A note on marking equity to market. If you adjust the equity account for the fair value of loans you must accept the lower equity value as your base. That means core net income of $9.7 million is an ROE of 8.8% not the 4.95% reported figure.