



Richard Mundinger, CFA
 Portfolio Manager
 richard@rmhinvestment.com
 520-314-2300

Ashlyn Tucker
 Analyst
 ashlyntucker@email.arizona.edu

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Commerce Bank of Arizona Update (CBOA)

Ticker: CBOF-OTCMKTS
Rating: Outperform, Target \$4.00

Market Data		Financial Data	
Stock Price:	\$3.10	Total Assets (in 000s)	\$344,630
52-Week Range:	\$1.65-\$3.50	NIM	3.83%
Market Capitalization (M)	27	ROA	0.75%
Shares Outstanding (M)	9.356	ROE	7.91%
52-Week Range:	\$2.70-\$3.50	Tier 1 Leverage	9.87%
Dividend (Yield)	N/A	Tier 1 Capital Ratio	12.62%
Insider Ownership	19%	Total Capital Ratio	13.87%
Price/TBV	1.0265	TBV per Share	\$3.02

2017 Capital Raise – exercise your warrants!

In 2017 the CBOA had a capital raise where they sold roughly 5,000,000 shares at \$2.10 with 1/5th of a warrant for each share. They raised in excess of \$10,000,000.00. The warrants expire on 12/31/2022. **We are recommending to all of our clients that they exercise the warrants at \$2.10, as the shares are trading in excess of \$3.00.** The additional capital coming in will allow the CBOA to increase their loans outstanding.

Company Description:

The Commerce Bank of Arizona (CBOA) is a community bank with businesses mostly in Tucson and the Phoenix/Scottsdale areas providing a full range of financial services, including credit and deposit products, cash management, internet banking to businesses, non-profits, and entrepreneurs. CBOA is 1 of 17 banks that are headquartered in Arizona and the only locally owned and operated bank in Tucson.

Arizona Economic Growth:

One of the most important things looking forward is how the state of Arizona is doing. If the state does well, then generally speaking, the bank does well.

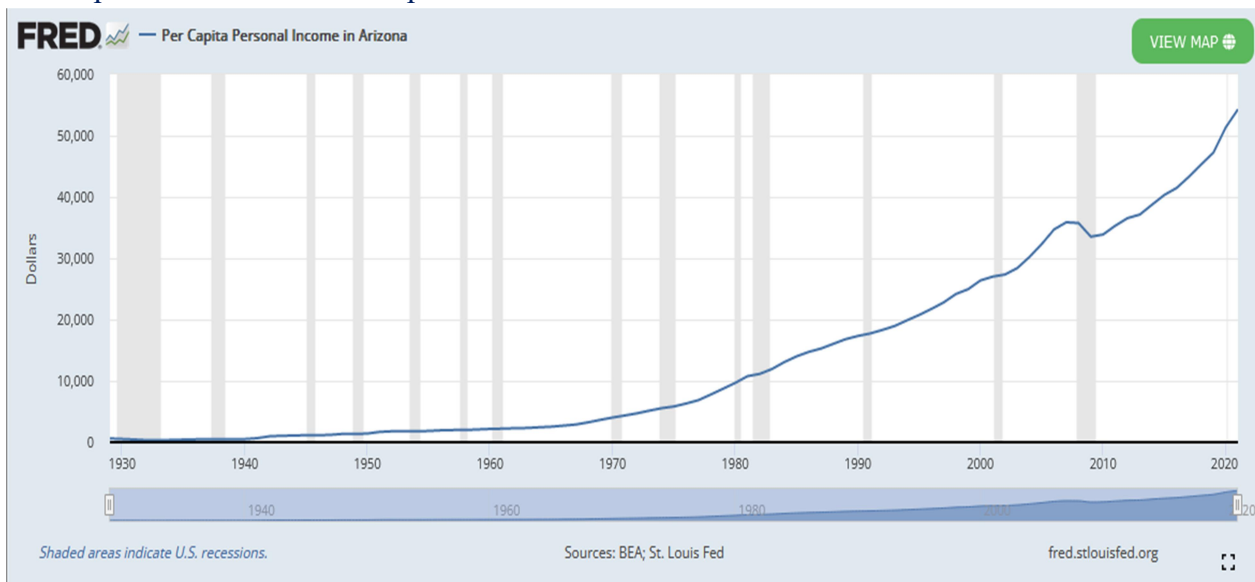
The following is from George W. Hammond, Ph.D., EBRC Director and Research Professor, **“Arizona’s Economy Breaks New Ground Again”**.

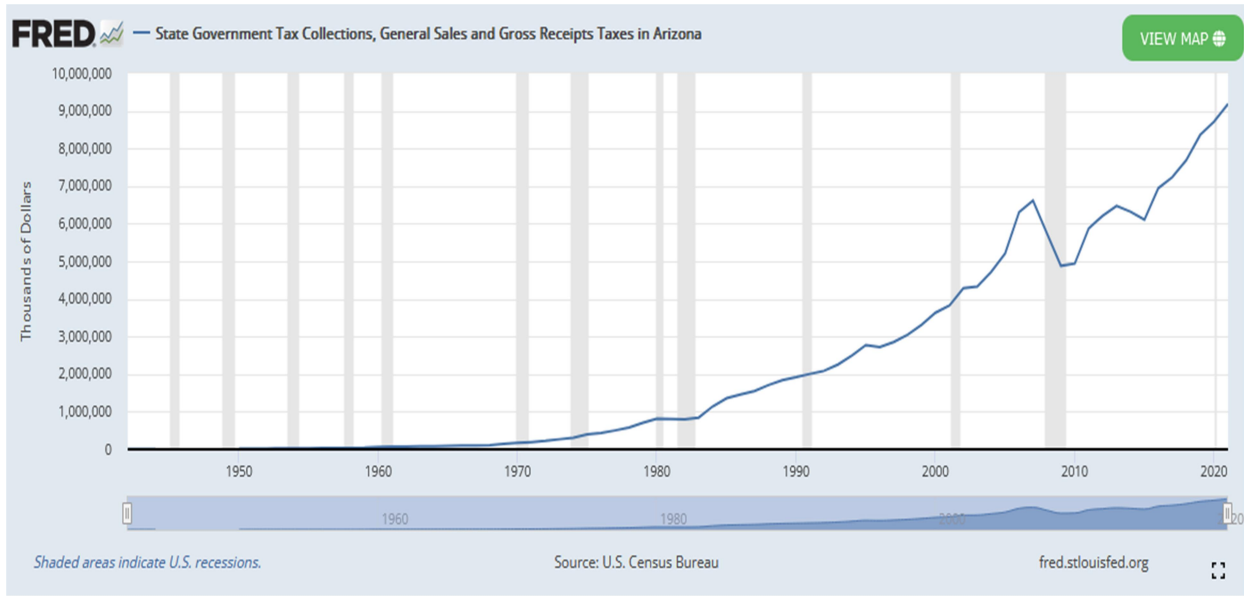
“Arizona’s jobs are once again breaking new ground, after regaining their pre-pandemic peak in November 2021. In addition, the state unemployment plunged during the second half of the year, as the state’s labor market tightened significantly. Nominal retail sales continued to rise rapidly through the end of the year, reflecting past income gains, rising household wealth, and rapid inflation. House prices have soared lately, as household formation increased, dragging down housing affordability. Population gains were solid last year, driven solely by net migration as natural increase dipped into negative territory.”¹

- The state’s unemployment labor rate has fallen from 6.8% in June of 2021 to 4.1% in December, lowest since 2007.
- Personal income rose by 3.7%, driven by earnings from work (9.0%), dividends, interest and rent (3.5%), transfer receipts down (8.0%) over the year.
- Wages up 4.1% up year over year.

“The latest estimates show that Arizona personal income rose by 10.3% in 2020, up from 5.8% in 2019. Disposable income increased by 11.3% in 2020, up from 5.7% in 2019. Per capita personal income rose by 8.4% in 2020, up from 3.9% in 2019.” “Total housing permits in the Phoenix MSA were up 11.9% over the year through October, with single-family permits up 17.7% and multi-family permits up 0.5%. Growth in total permits was even strong in Tucson, with an increase of 30.0%. Single-family permits were up 31.2% and multi-family permits were up 22.2%.” In summary the economic situation of Arizona is a tailwind to the CBOA’s strong financial position.

The next two charts come courtesy of the Federal Reserve Bank of St. Louis, clearly showing the rise in personal income and corporate income taxes.





In summary with the state doing well both on personal income and tax collection, both of these underpin successful businesses that borrow from CBOA.

Current Banking Trends (things we worry about):

The Banking Industry at present is facing disruption as there are several new threats.

The **First** disruption is online banking. This digitalization of loans for consumers takes market share from retail banks (impersonal). Commerce Bank of Arizona’s value proposition is that they have local expertise and can provide personalized service to their business customers. This helps to highlight one of the Commerce Bank’s strengths. The business loan market is at less risk of losing significant market share to online non-bank loans, as they’re less “cookie cutter” and more custom (loans). The CBOA bankers know their customers. Monthly calls to the borrowers mean the bank is on top of potential problems. In addition, the bank can help the borrower with their expertise and experience. In addition, the best thing bankers can do for their client, is to also open doors for them to succeed.

Second, with the big banks pulling out of the small/middle market (<\$10 million) loan space, this has encouraged a lot of other lenders to try and compete on price (interest rate of the loan). This is the second disruption. The problem here is that a lot of the loans that are won on price are still not closed 4 – 6 months later. The borrower’s costs to close the loan rise, in some cases the lending banks wants a “swap” to protect them on interest rate exposure, and the business opportunity for the borrower gets pushed out. All of these are costs to the borrower that are not in the original “teaser” loan rates. Result (time wasted 4 – 6 months for the borrower); CBOA receives a call to see if they can close the loan at similar terms to what they originally offered in

a timely fashion. For example, they just closed a loan on the same terms they offered 4 months ago, as the borrower tried to close the loan with another lending institution.

In looking at Tucson, the majority of the loans are in the \$1 – \$5 million range. Tucson has 3 loan officers (90 years of general banking experience) and one mortgage specialist. In Phoenix/Scottsdale there are 5 loan officers (in excess of 160 years general banking experience) and the majority of the loans are in the \$3 – 5 million range. In the last several years at least 4 of the CBOA lenders (with all of their contacts) have come from traditional banks that are leaving the small/middle market for lending.

Small banks by definition will have above average exposure to real estate. The key to this exposure is to work with the client and stay ahead of potential problems. One of the key metrics to look at is the percentage of bad loans, a good rule of thumb is to be less than 1% of total loans. With Total Loans and Leases of \$240 million, and a current charge off amount of \$129,000.00 this **translates to a 0.06% loan loss percentage, excellent in our opinion.**

CBOA Industry Comparison:

This table shows CBOA’s year over year loan growth and net interest margin compared to industry competitors. CBOA outperforms the field in both categories.

	Loan Growth (Y/Y)	NIM
Group Median	0.60%	3.31
Group Average	3.40%	3.34%
Mid-Atlantic Median	2.70%	3.20%
Midwest Median	-2.60%	3.22%
Northwest Median	-1.30%	3.26%
Southeast Median	1.70%	3.19%
Southwest Median	3.20%	3.67%
CBOA	9.29%	3.83%

Data Source: D.A. Davidson Bison Select Industry Report September 2021

CBOA Summary 2021:

- Record Loan Origination powered revenue
- Efficiency Improvements will benefit future earnings
- Low Cost of Funds preserved earnings
- Team Culture is their competitive advantage

CBOA Earnings

- 2021 Bank Net Income was \$2.6 million
- 45% decrease in Funding Costs preserved interest margin
- 10% increase in Interest Income
- 7% decrease in Overhead (non-interest) expense

Efficient Operations

- Bank's Efficiency Ratio improved 26% to 71%
- Growing revenue without adding costs: Loan Growth
- Bank branch expenses are "right sized" for the bank
- Technology expenses are rising, should add efficiency

Loan Growth

- \$220 million in originations last 5 quarters
- Experienced lenders: 4 in Tucson, 5 in Phoenix area
- 58% originated in the Phoenix Market
- Products funded: 60% real estate, 30% C&I, 8% SFR

Credit Quality

- Focus on maintain credit quality as they grow
- Portfolio Trend oversight by the board
- Stress testing of the CRE portfolio
- Loan Loss Reserve Adequacy analyzed monthly

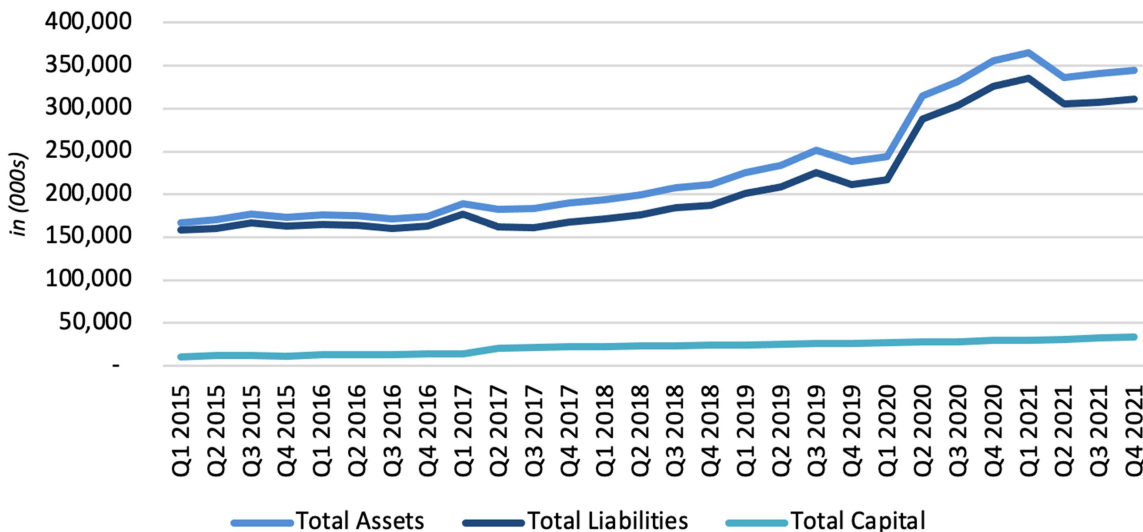
Future Focus

- Targeted Growth and Non-Interest Income
- Small 7a Loan Program with application portal
- Focus on taking advantage of the Phoenix market
- Pursue Digital Opportunities for Efficiency and Funding

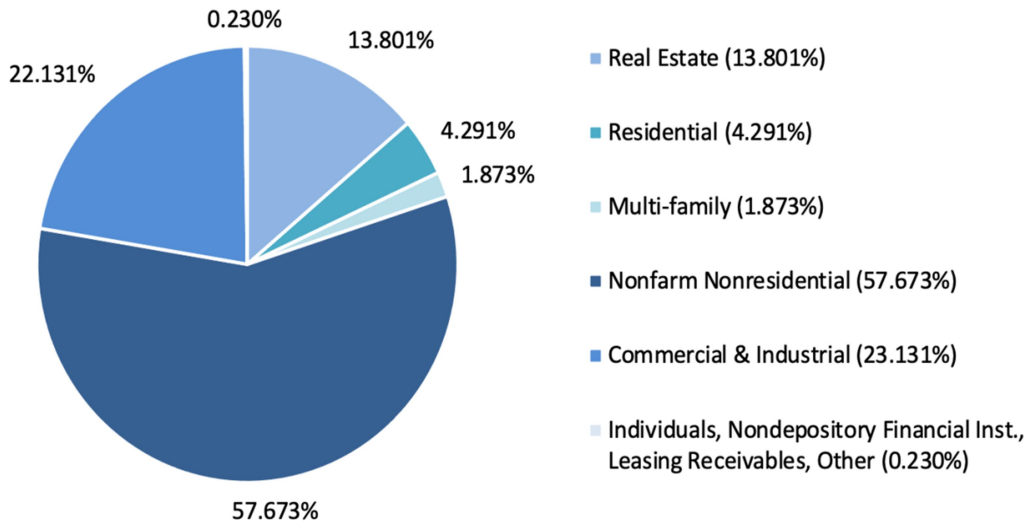
The two charts below show continued strength in the balance sheet with all of the successes they have been having from observations above. Good diversification of loans with an emphasis on growing Commercial & Industrial loans.

In conclusion we feel CBOA is an attractive buy at this level with a target price of \$4.00, a 30% return from these levels.

Balance Sheet Trends



Loans by Category



Full disclosure: some of RMH's clients, Munding Family, along with Richard are invested in Commerce Bank of Arizona.

Sources:

<https://www.azeconomy.org/2022/03/outlook/arizonas-economy-breaks-new-ground-again/>

<https://www.mapazdashboard.arizona.edu/economy/patents>

Data Source: D.A. Davidson Bison Select Industry Report September 2021

