



Hingham Institution for Savings (NASDAQ:HIFS)

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KRE: The comparative benchmark

- Truly understanding a business is a contextual affair
- The SPDR S&P Regional Banking ETF (NYSEARCA:KRE) is the primary index that measures US regional bank performance
- 138 KRE banks in the dataset, 139 including Hingham
- Data collected spanned 3,600 data points, mostly manually derived
- Research aims:
 - Confirm Hingham's quality
 - Challenge prevailing assumptions
 - Discover other banks of interest

Key considerations for bank analysis

- **When it comes to banks, I like to see:**
 - A loan book that is conservative, and performs well during recessionary periods
 - Management that loves volatility, and optimizes for it
 - A balance sheet that is geared towards worst-case resilience and free from derivative exposure
 - Incentives that encourage operational excellence and long-term managerial orientation

Hingham thesis

- Simple, owner-operated, with a reputation for conservatism that is unparalleled
- Substantial low-cost operational advantage
- Has compounded book value at 12% annually for 20 years, with steadily improving, industry-outperforming ROE
- Is trading at 1.04x book, a valuation only seen during the Great Financial Crisis and the dot-com bust



Hingham Institution for Savings is a US regional bank located in Hingham MA, that was taken over by proxy contest in 1993 by incumbent CEO, Robert H. Gaughen.

“[Our philosophy] is “simple banking, honest value.” A business philosophy that prods us to remain focused on the basics to avoid the cluttered group think of competitors and the panicked “sky is falling” cackling of the consultants.”

- *Robert Gaughen, CEO, 2015 remarks*

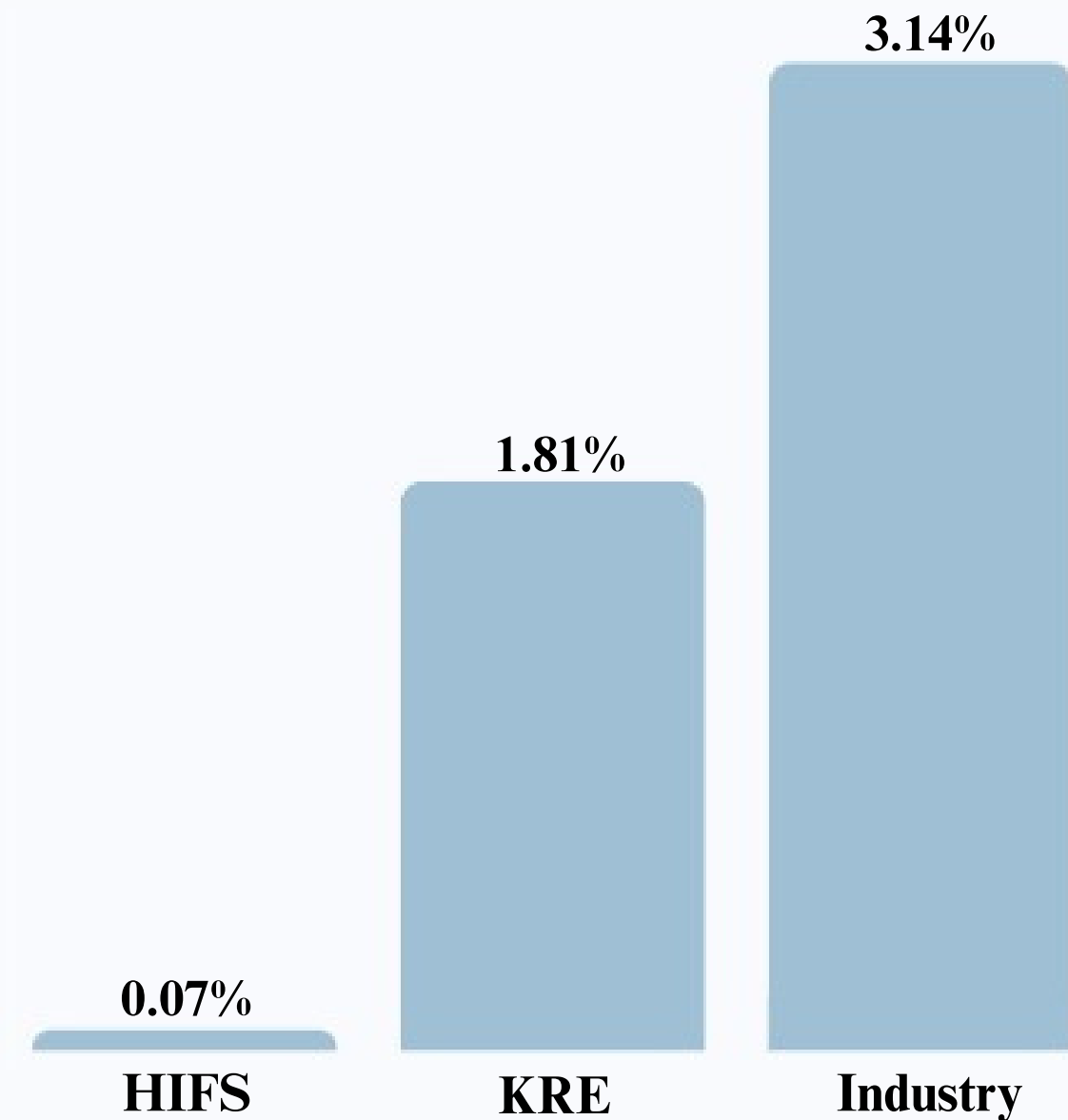
Business summary

- Hingham specializes in CRE lending, with the second highest loan book allocation to CRE versus the KRE, at 81.5% of its \$3.81bn loan book
- Focused on multifamily housing, with the highest multifamily, 1-4 family, and mixed use space loan allocation in the dataset, at 66%
- Primary markets are Massachusetts (66.5%) and Washington D.C. (30.7%), with emergent business in the SF Bay Area (3.1%)

Management are outstanding underwriters

- TTM, Hingham is one of two banks with 0% non-performing loans (NPLs) as a percentage of total loans, with Metropolitan Bank being the other
- During the GFC, net charge-offs peaked at a KRE-wide record of 0.07% as a percentage of loans, versus 3.14% for the industry
- KRE averaged 1.81%, with four incumbents keeping net charge-offs 25< basis points:
 - New York Community Bancorp
 - Veritex Holdings
 - Capitol Federal Financial
 - Washington Trust

GFC Peak Net Charge-Offs



Hingham's loan book is a bunker

- 99% of loans are mortgages with average loan maturity 5-15 years
- 74% of loans are adjustable-rate (5-year legs to an underlying market index)
- 69% of loans are collateralized against MA real estate
- Loan-to-value of the CRE portfolio is 54%, with office sub-50%
- No one borrower exceeds 10% of loans
- 100% of deposits are insured through the Federal Home Loan Bank of Boston (FHLB) and the Massachusetts Depositors Insurance Fund (DIF)
- Strict loan approval process
 - No loan without eight-member executive committee approval
 - No loan >\$2 million without entire fifteen-member board approval
 - Collateral properties require an executive committee member visit prior to underwriting

Management is risk-averse

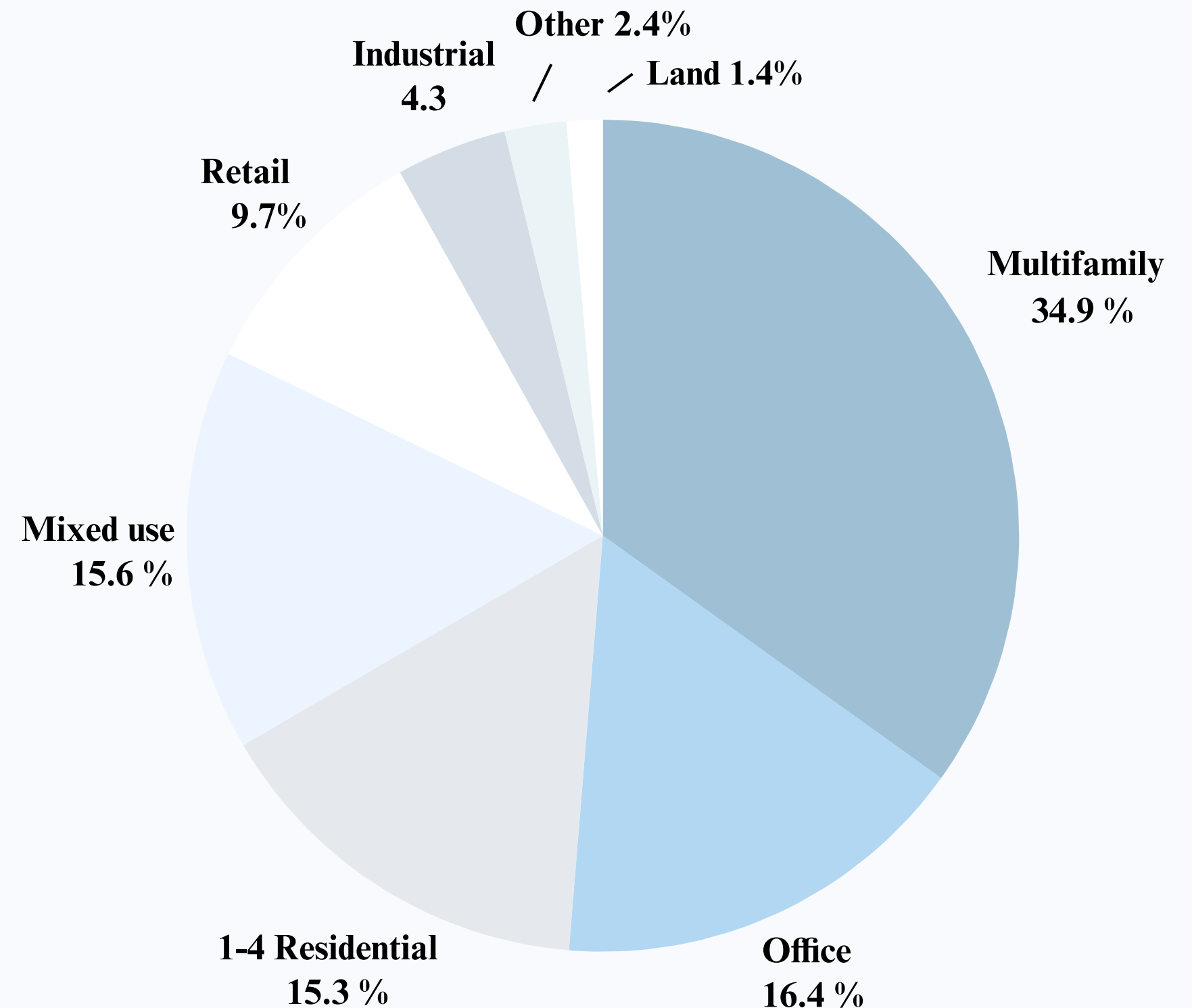
- Equity-to-tangible-assets 9.2% versus 8.2% for the KRE
- Cash as a percentage of tangible assets is 8.6% vs 5.3% for the KRE
- \$354m in cash and federal reserve deposits
- Shift from fixed to adjustable-rate
- 10 day past-due collection process
- No secondary lending (they keep loans they underwrite)
- No material HTM securities exposure
- No derivatives exposure
- No M&A

What We Don't Do

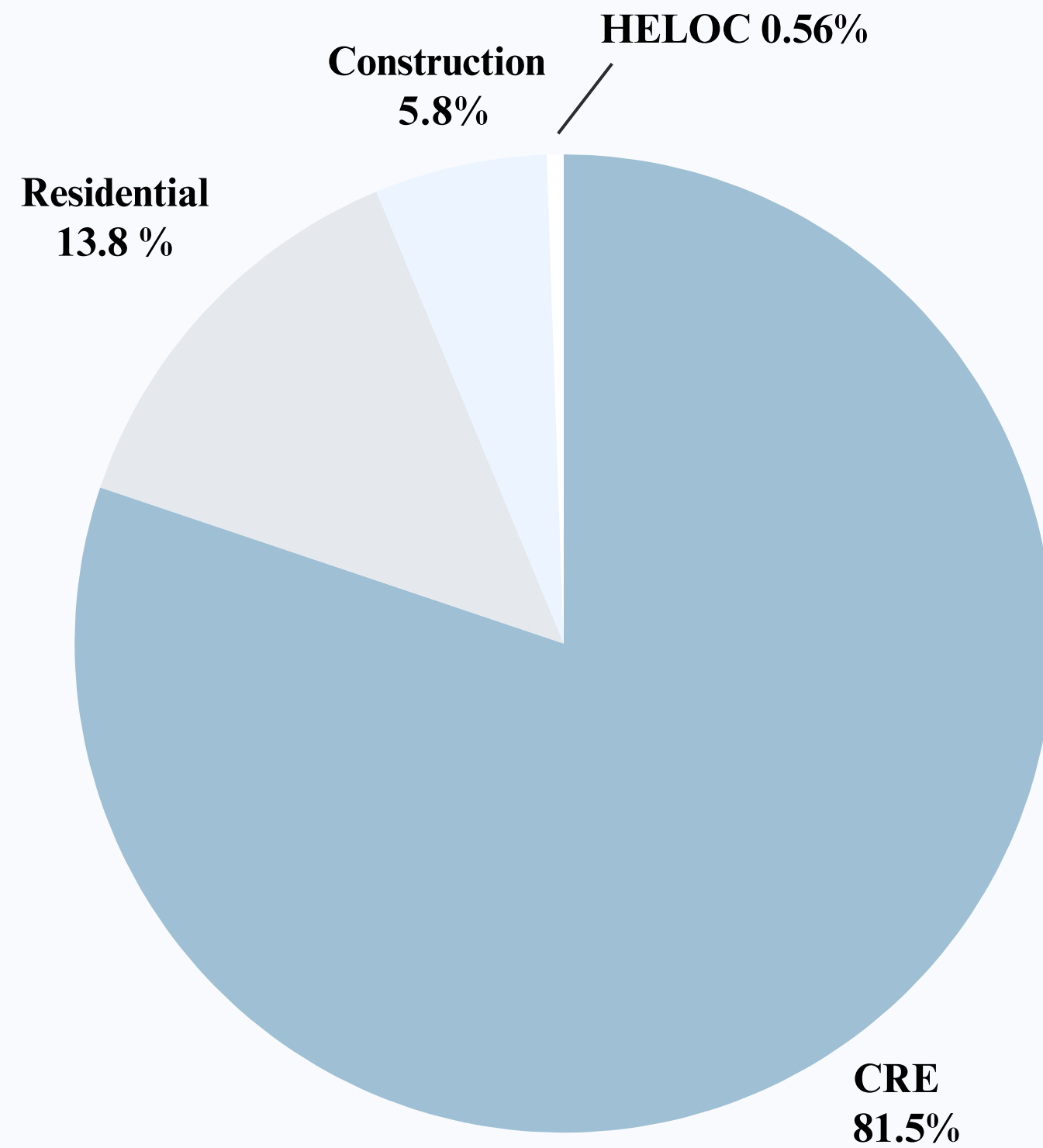
- Commercial and Industrial Lending
 - ABL
 - Leasing
 - Loans and Lines
 - SBA
 - Leveraged Lending
- Consumer Lending
 - Credit Card
 - Marine
 - Auto
 - RV
 - Personal Lines
- Investments
 - Wealth Management
 - Trust
 - Investment Advisory
- Insurance Brokerage or Underwriting
- Secondary Market Residential Mortgage
- Tax Credits
- Solar Lending
- Cannabis Banking
- Cryptocurrency (Deposits, Lending, Ecosystem)
- Commercial Mortgage Participations (*)

- CRE allocations are diversified towards counter-cyclical business lines
- Including residential real estate, the loan book may be considered to be >85% counter-cyclical.
- Office:
 - 15% low-leverage loans to two, large national unions. “[They’re] probably our two safest loans.”
 - 10% residential conversion properties
 - No investor office space

CRE Allocations

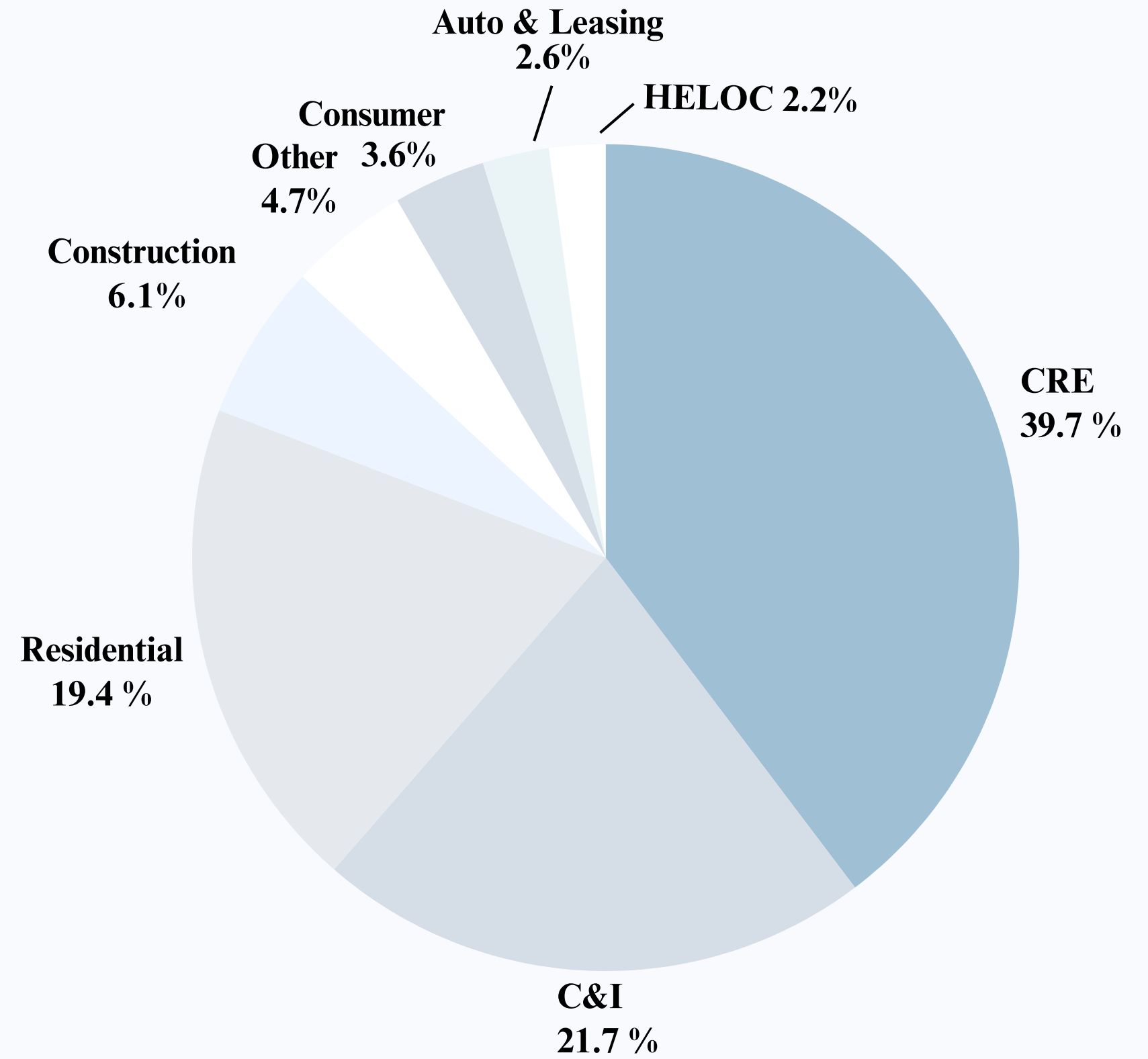


HIFS Loan Book



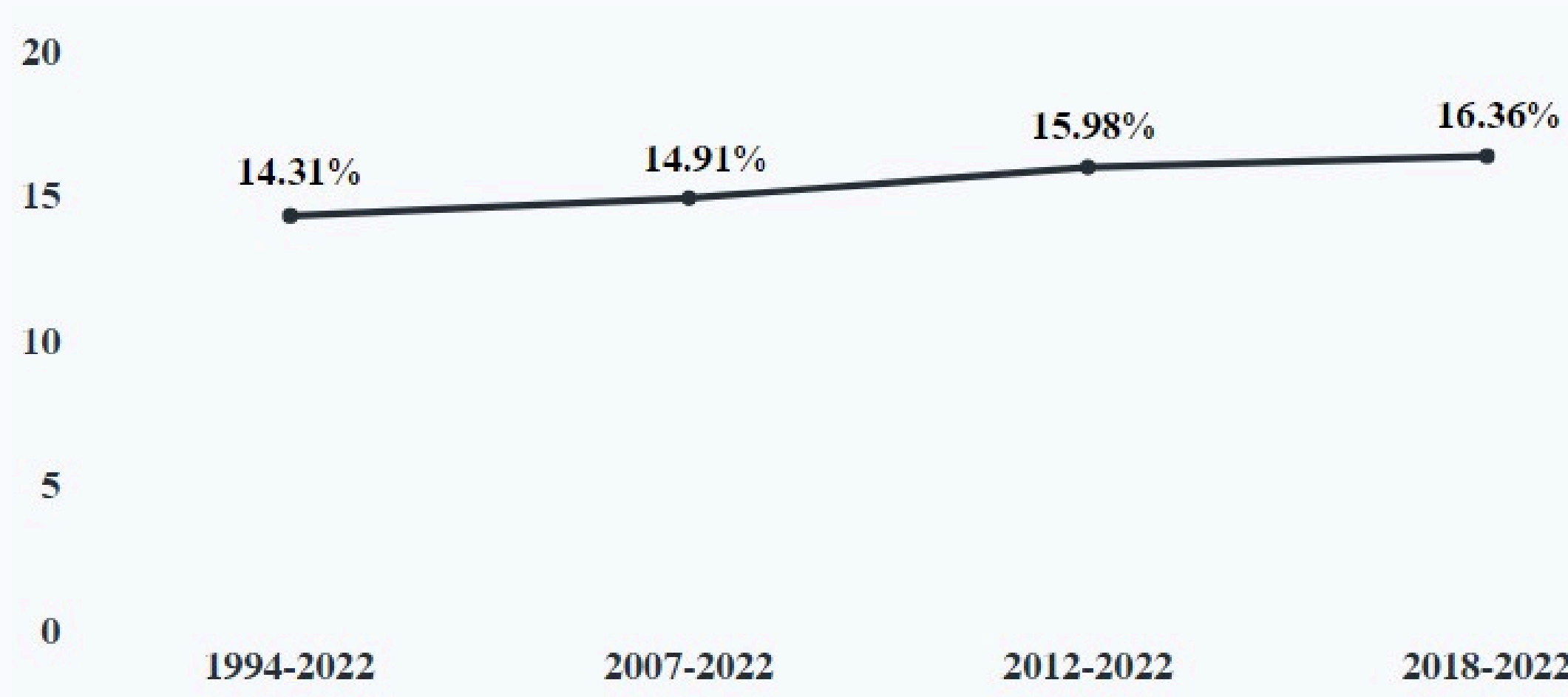
[-71.3% reduction in residential loans since 2009](#)

KRE Loan Book

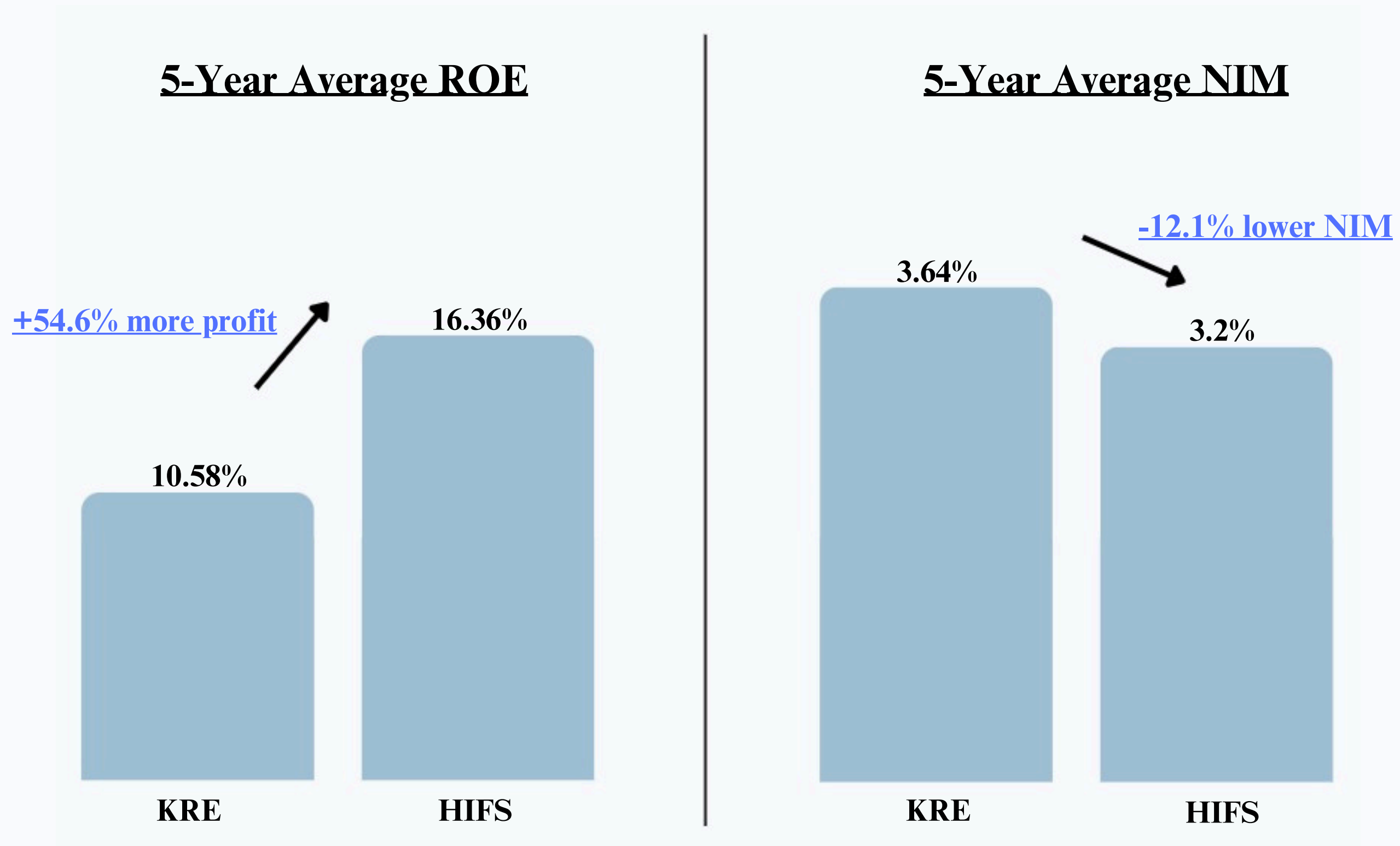


Hingham has a long track record of outstanding business returns

Continuous ROE Improvement since 1994



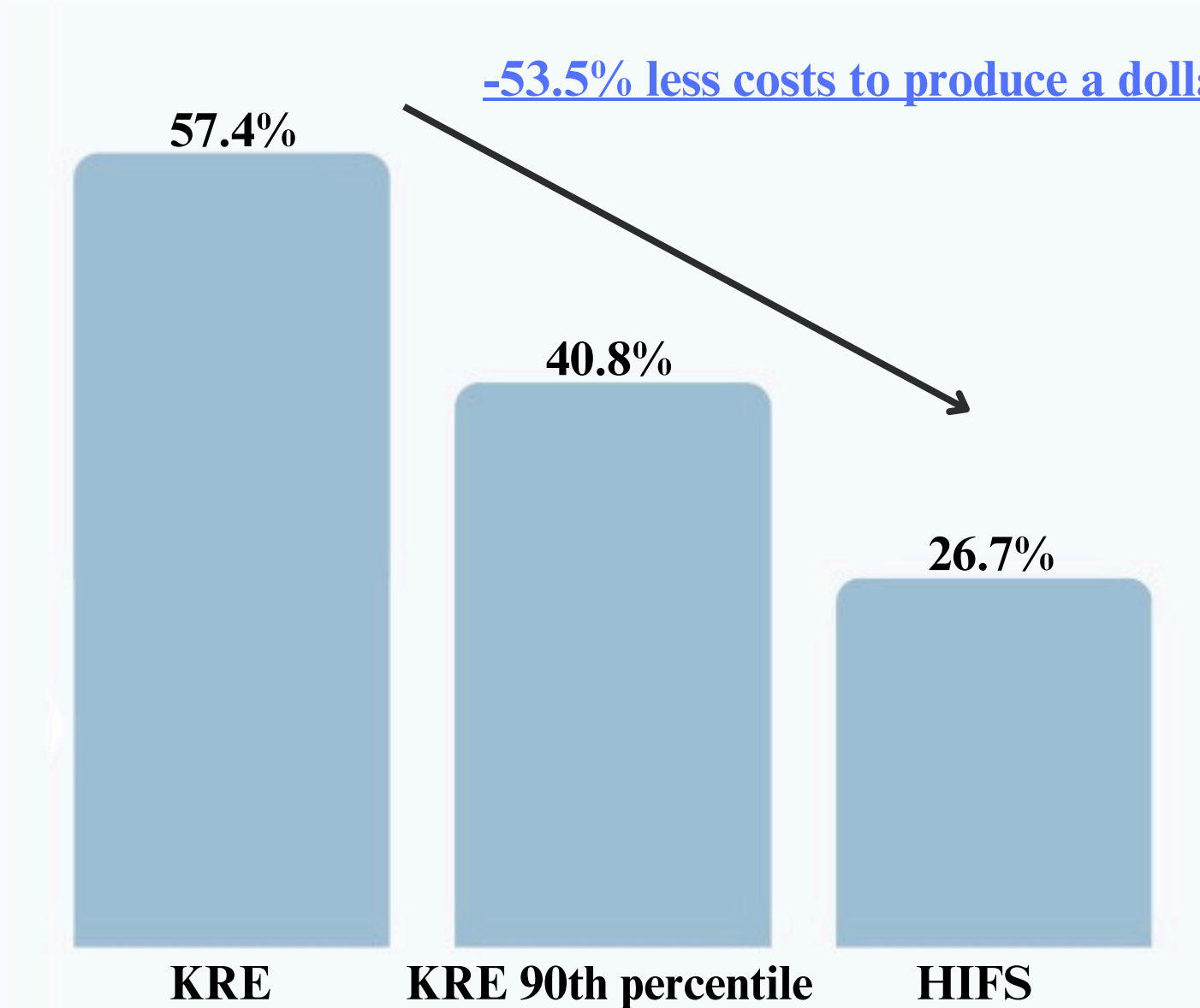
Returns vastly exceed KRE averages, despite lower net-interest margins



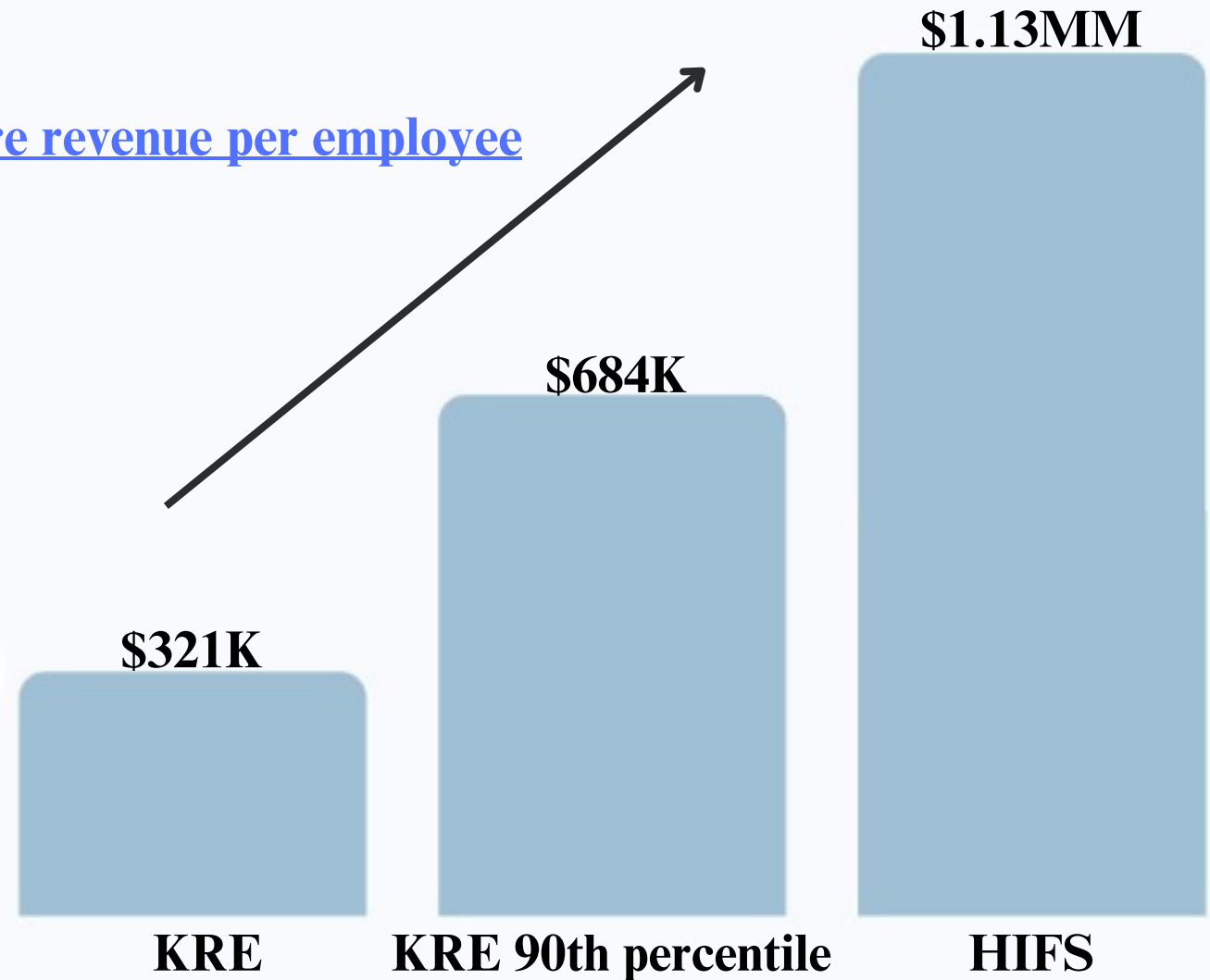
This is due to Hingham being *the* low-cost regional operator

5-Year Average Efficiency Ratio

Revenue per employee



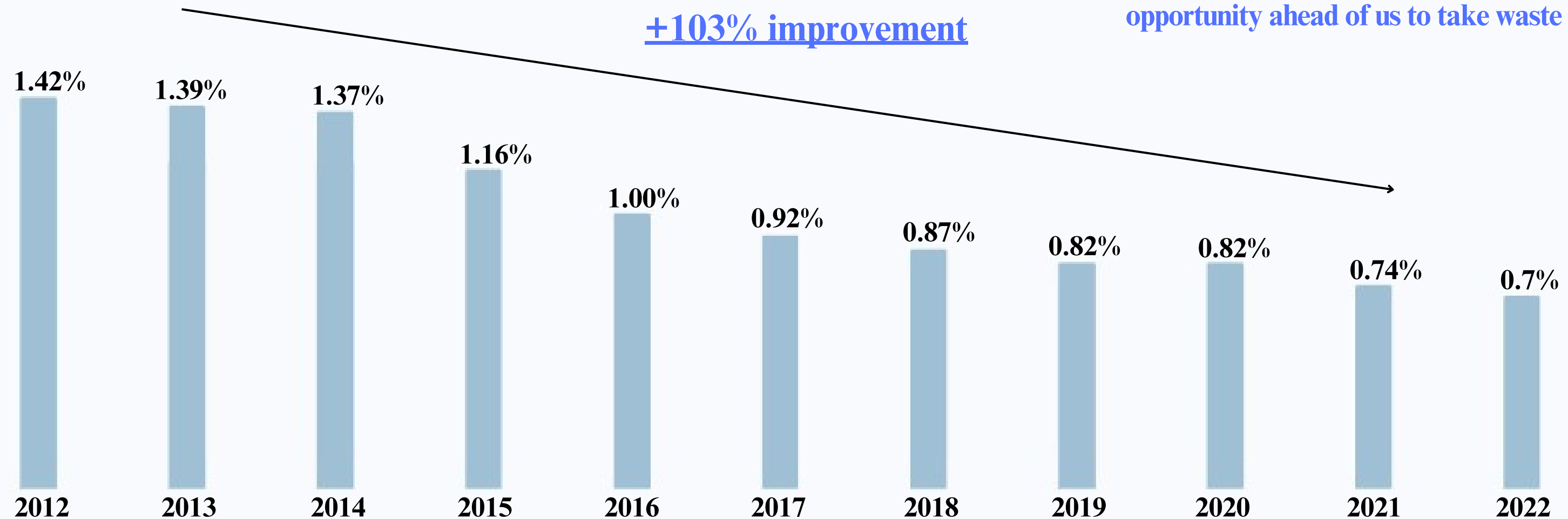
-53.5% less costs to produce a dollar of profit



+253% more revenue per employee

Management has been fighting costs for over a decade

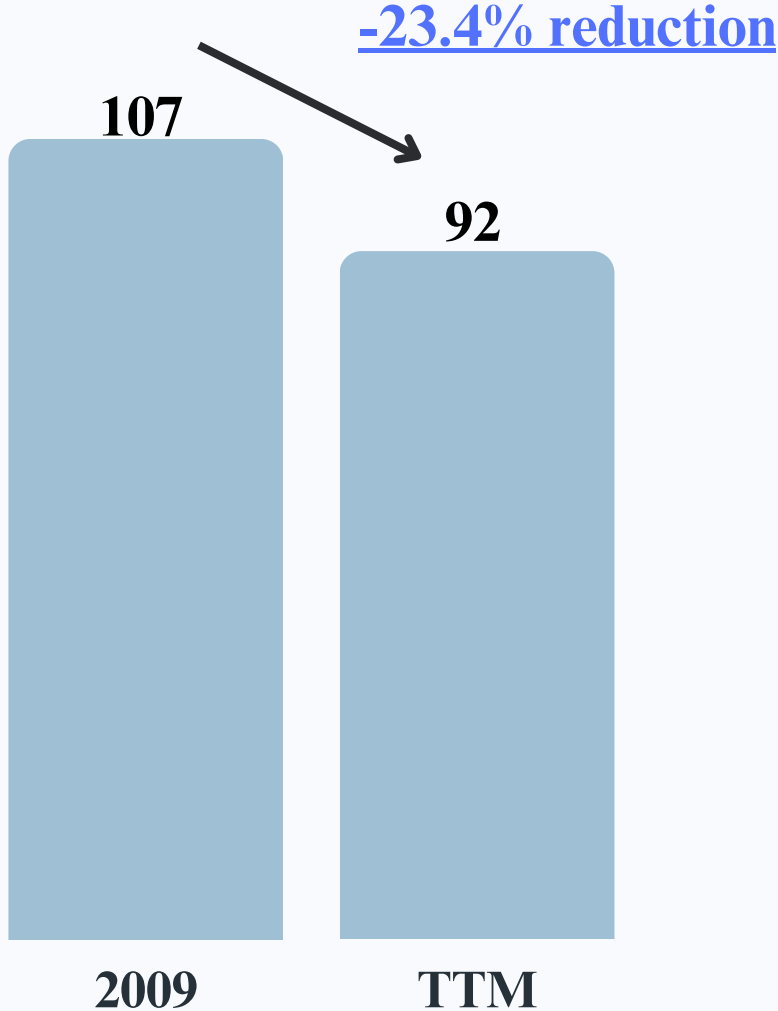
Operating Expenses as a Percentage of Total Assets 2012-2022



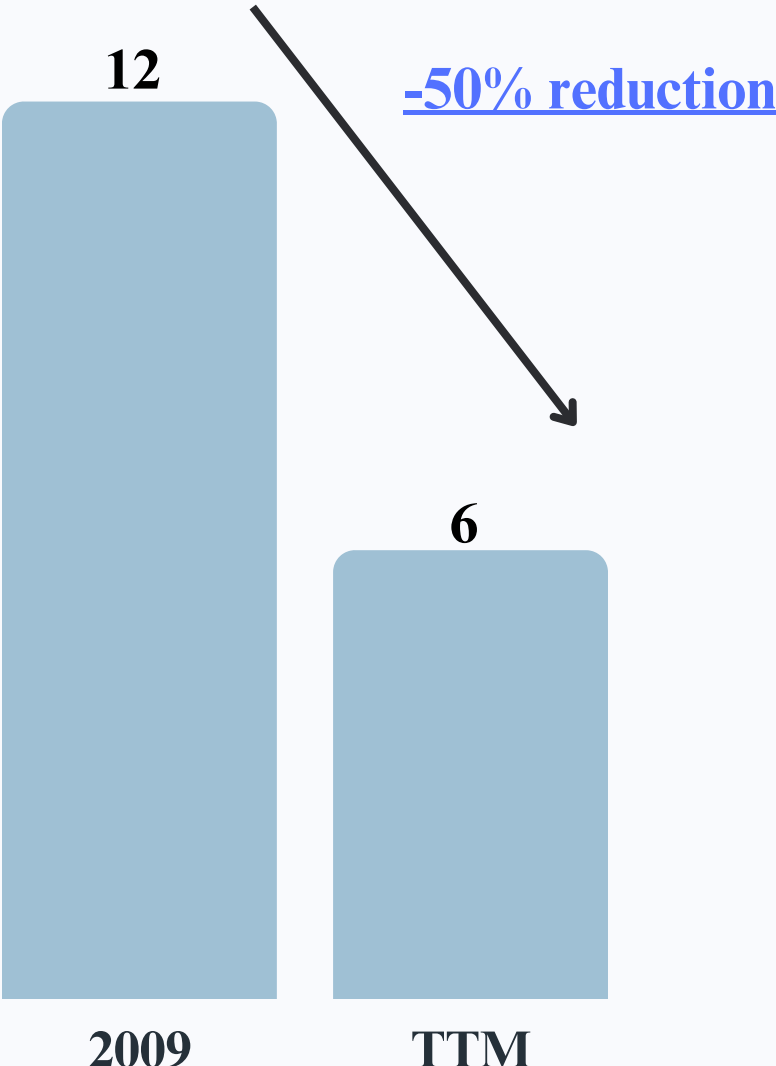
- “70 basis points of expense on total assets and 25% efficiency ratio... I continue to see more opportunity ahead of us to take waste out.”

Reasons for improved efficiency

Headcount Reduction



Branch Closures

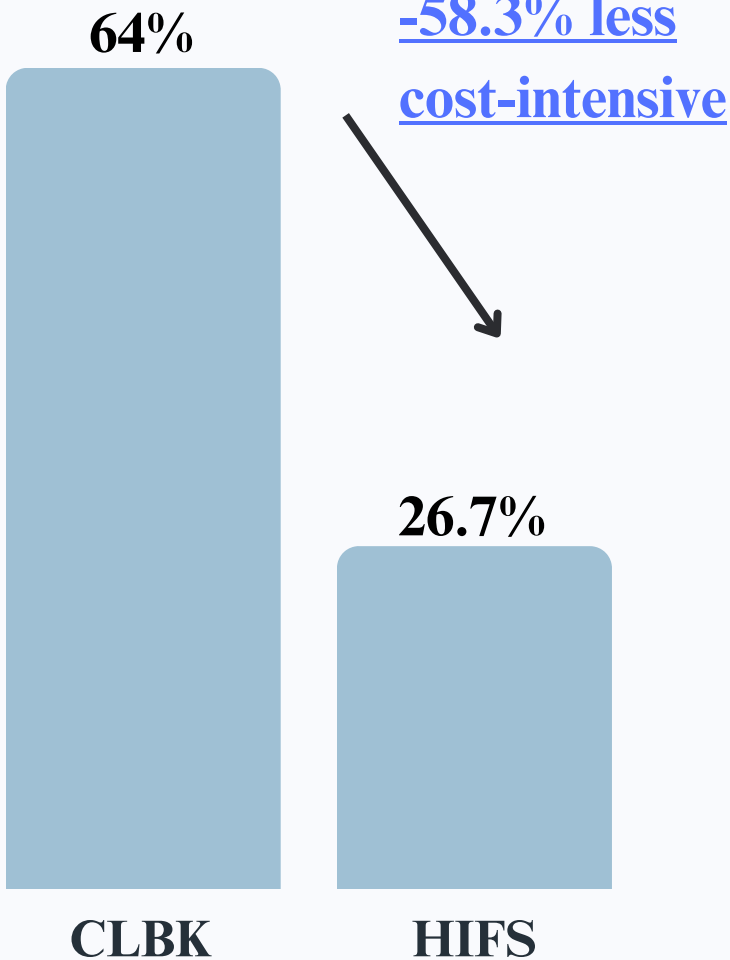


Reasons for improved efficiency

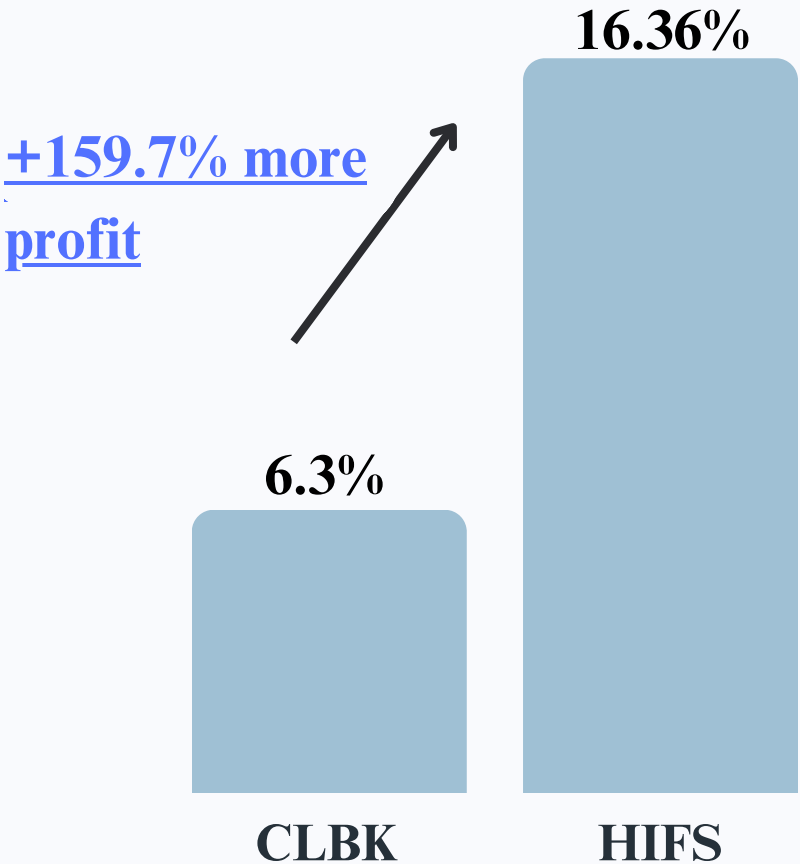
- CEO Robert Gaughen and COO Patrick Gaughen own 31.2% of the company
- Robert's ownership-to-compensation is 31x depressed prices, versus 6x for the KRE, and 2.5x ex 90th percentile.
- No executive share-based compensation or annual bonuses
- Extremely unusual incentives produce low-cost lending advantages over peers: Columbia Financial

Columbia Financial (NASDAQ:CLBK)

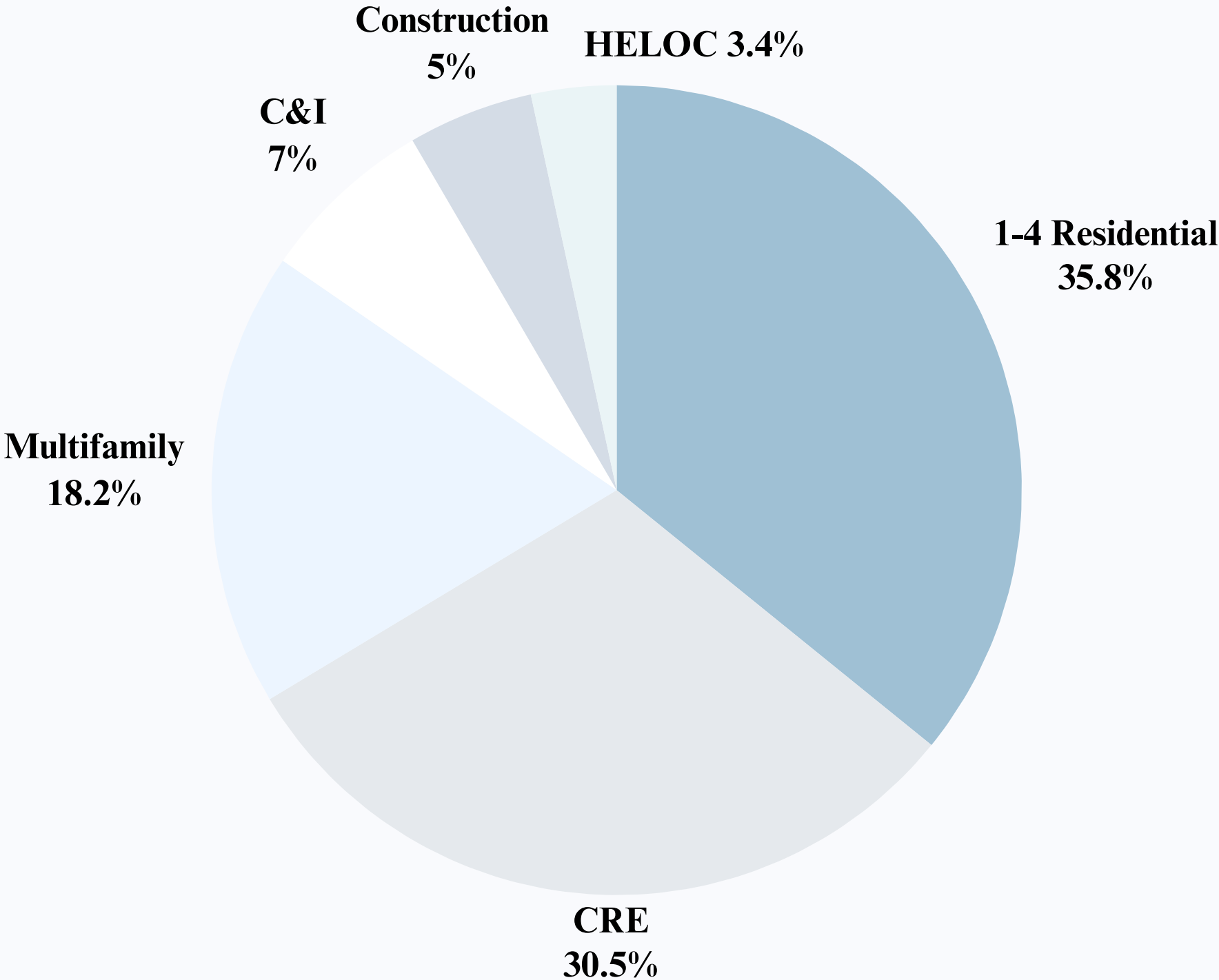
5-Year Average Efficiency Ratio



5-Year Average ROE



CLBK Loan Book

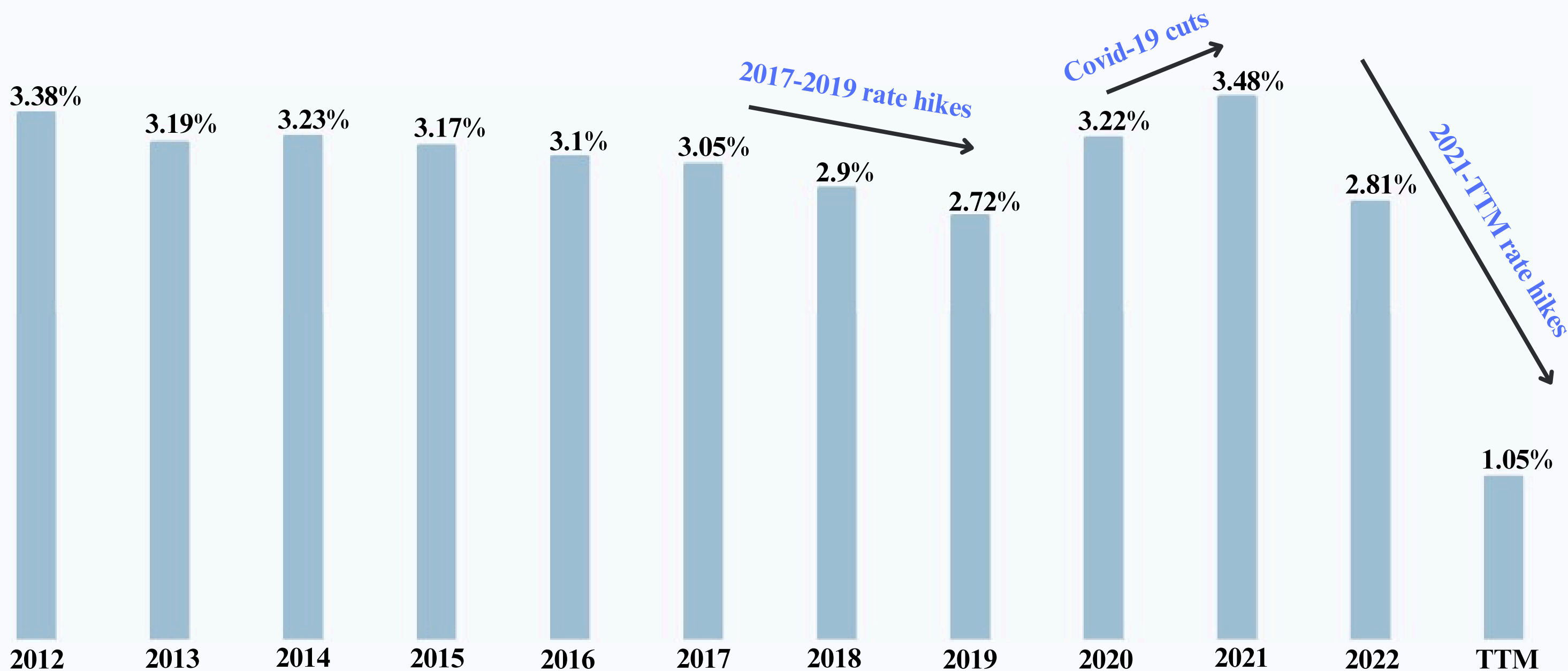


Material impact of interest rate movements

- Between 2012-2019, NIM fell 66 bps, yet ROE improved 175 bps over that period, from 15.18% to 16.93%

Net Interest Margin 2012-TTM

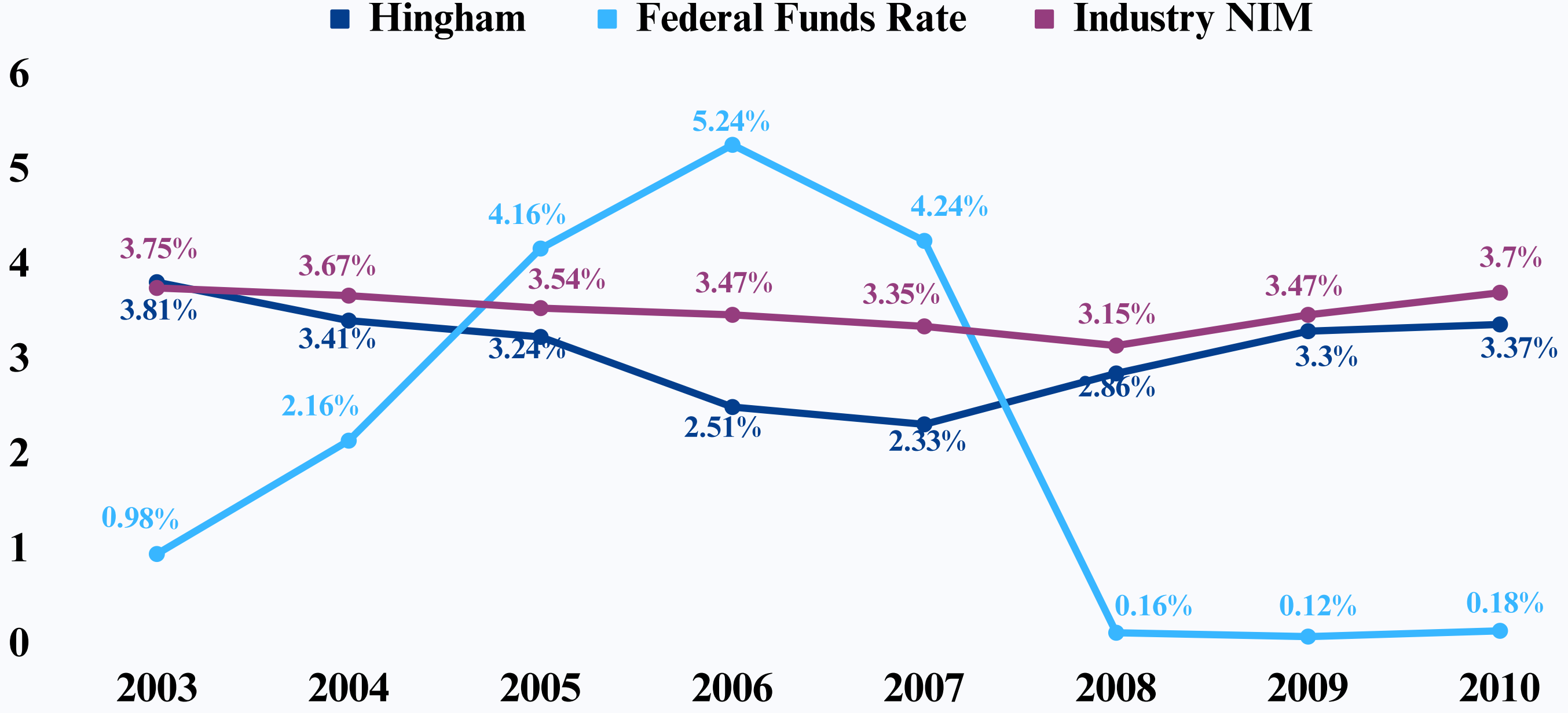
- On a TTM basis, net spread is 0.39%, versus 2.56% for the KRE



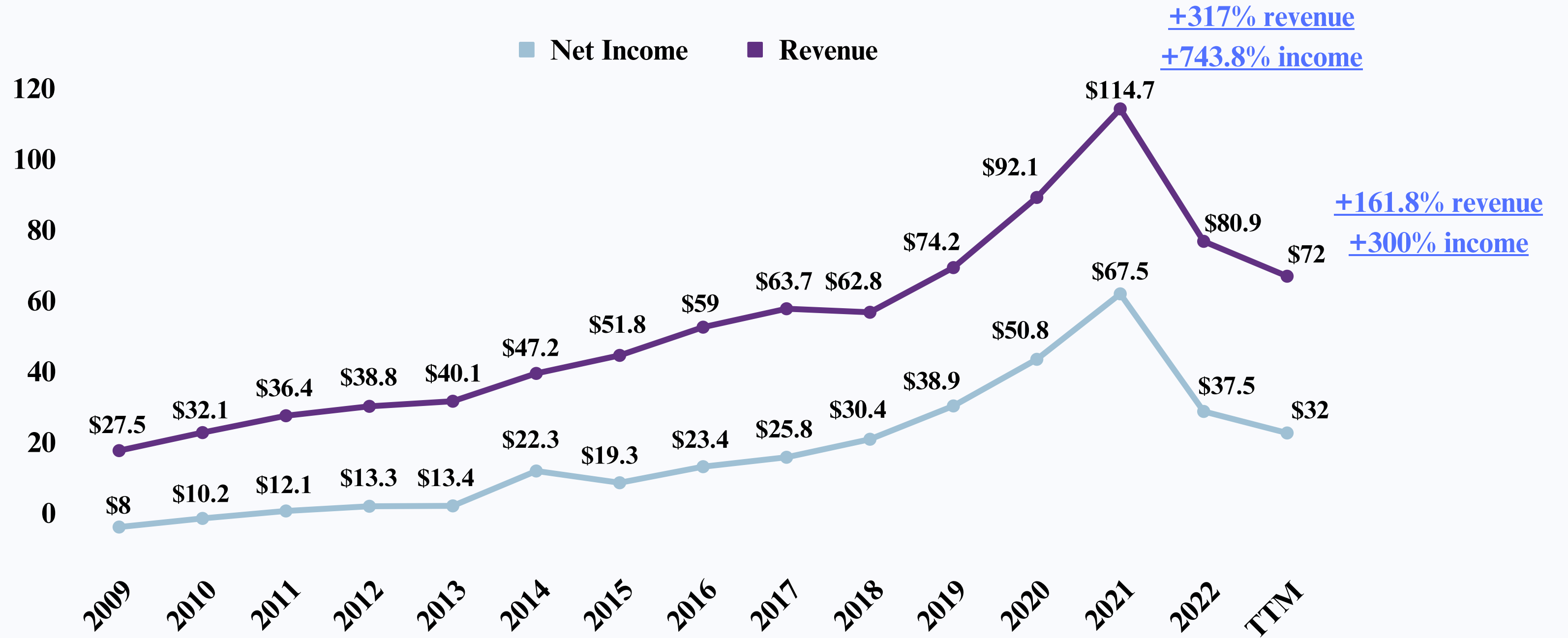
Hingham's NIM 2003-2010

- Hingham suffered a -145 bps decline in NIM, but began recovery in 2008, versus an industry-wide -60 bps decline and 2009 recovery

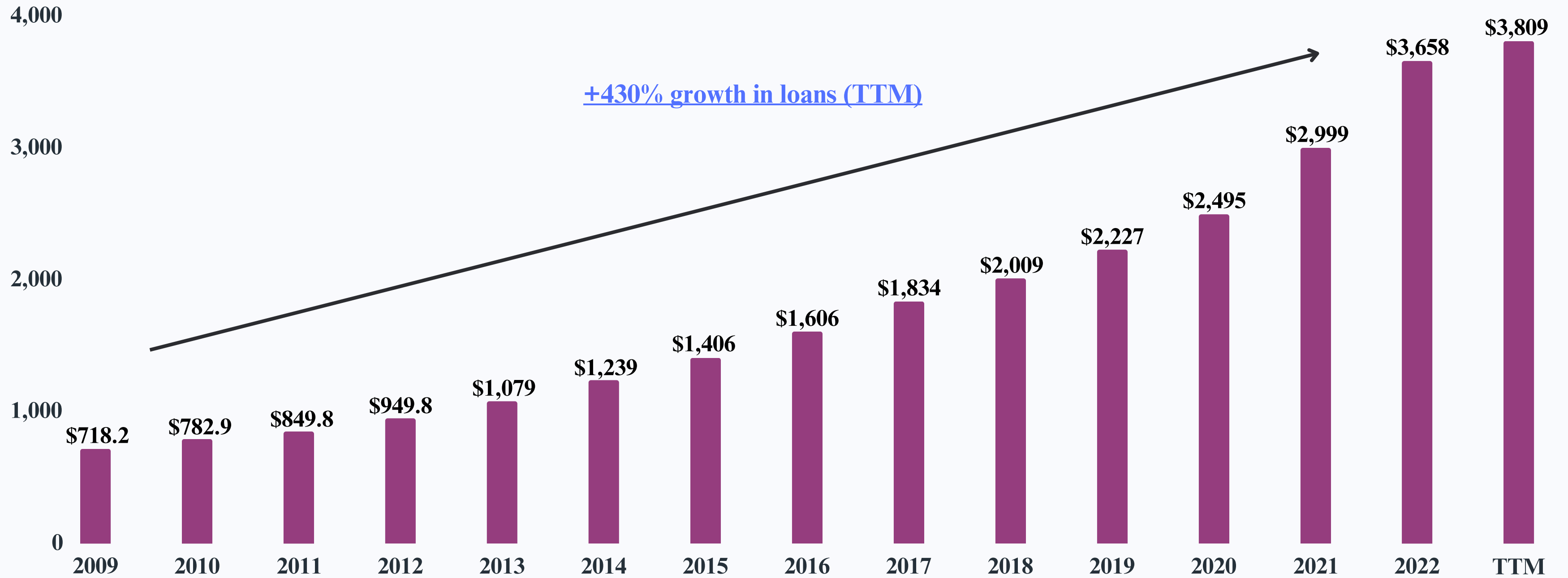
- Industry-wide profit fell from \$124m in Q4 2006 to -\$12.4m in Q4 2009, while Hingham's net profit grew from \$4.64m to \$8.04m over the same period



Revenue and net income growth 2009-TTM (in \$USD millions)

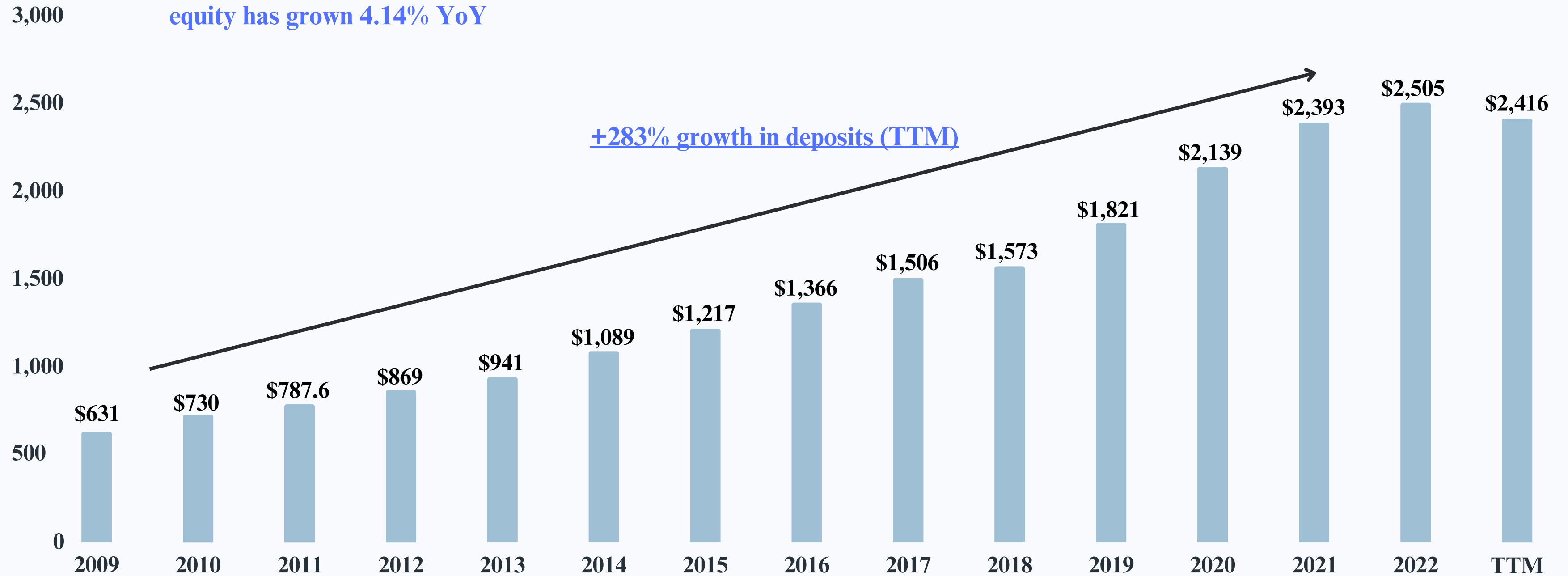


Loan growth 2009-TTM (in \$USD millions)



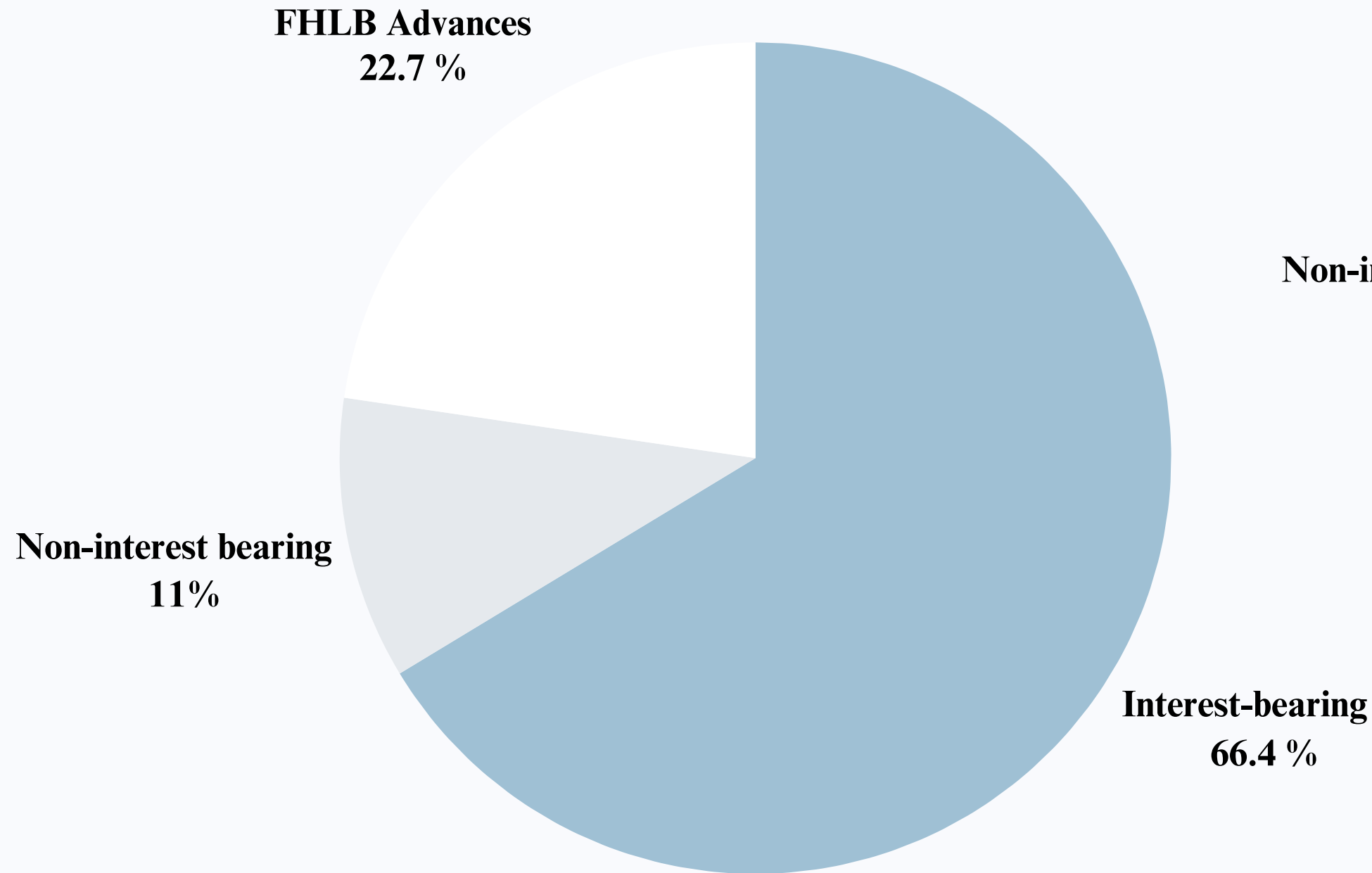
Deposit growth 2009-TTM (in \$USD millions)

- Despite a 3.6% decline in total deposits between Q4 22 - Q3 23, equity has grown 4.14% YoY

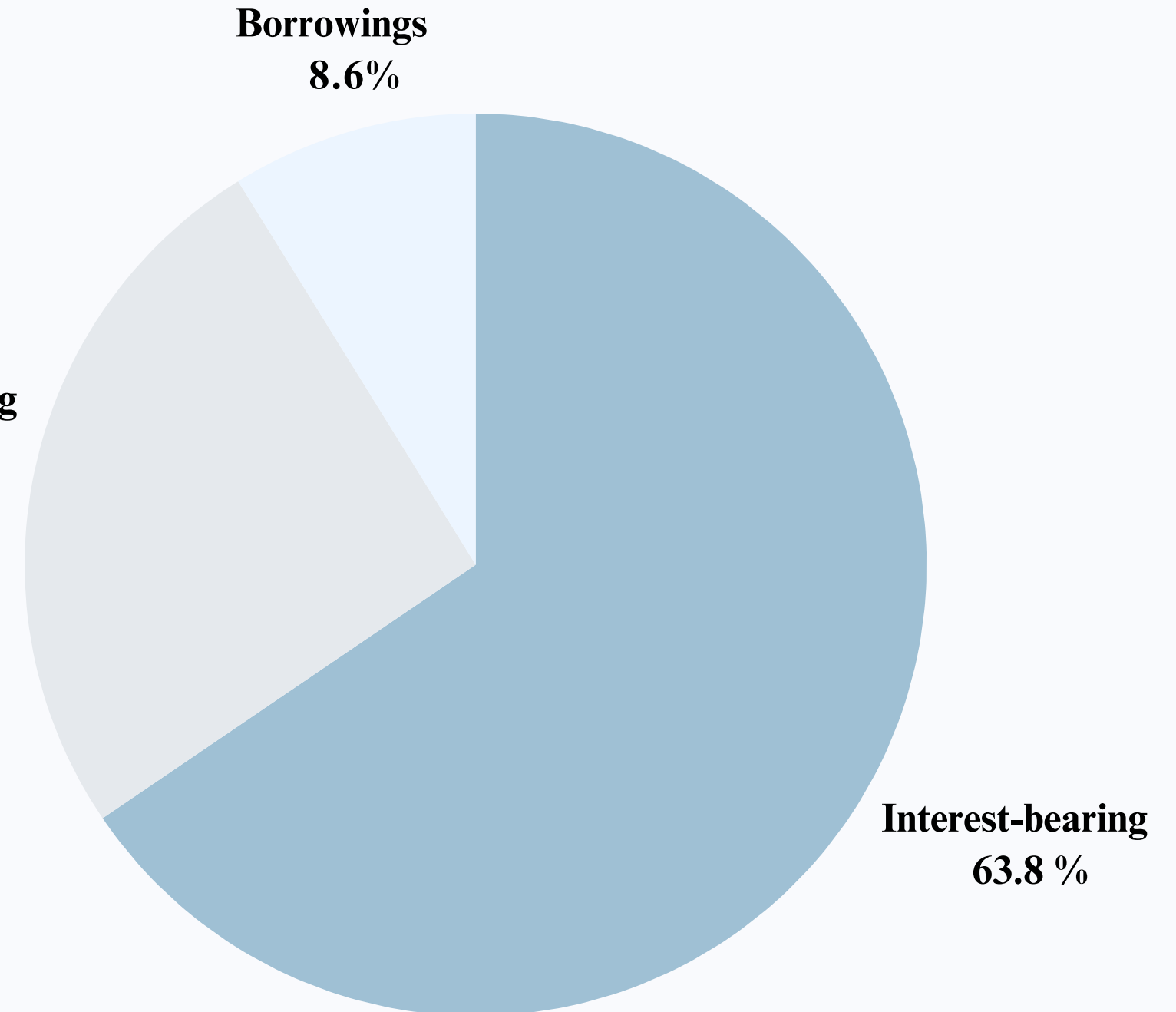


Hingham's unusual deposit-base

5-Year Average Funding Mix

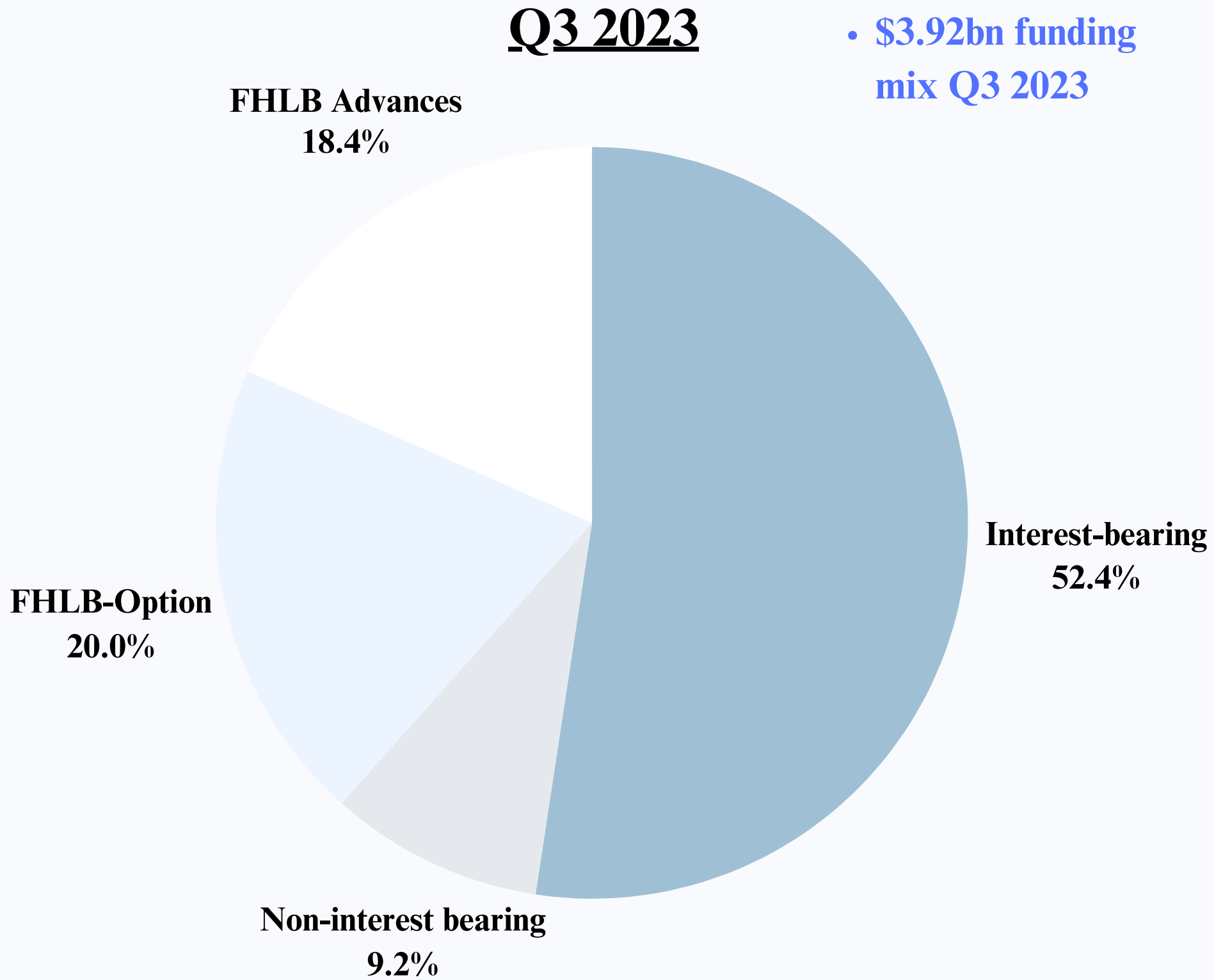


KRE Q3 2023

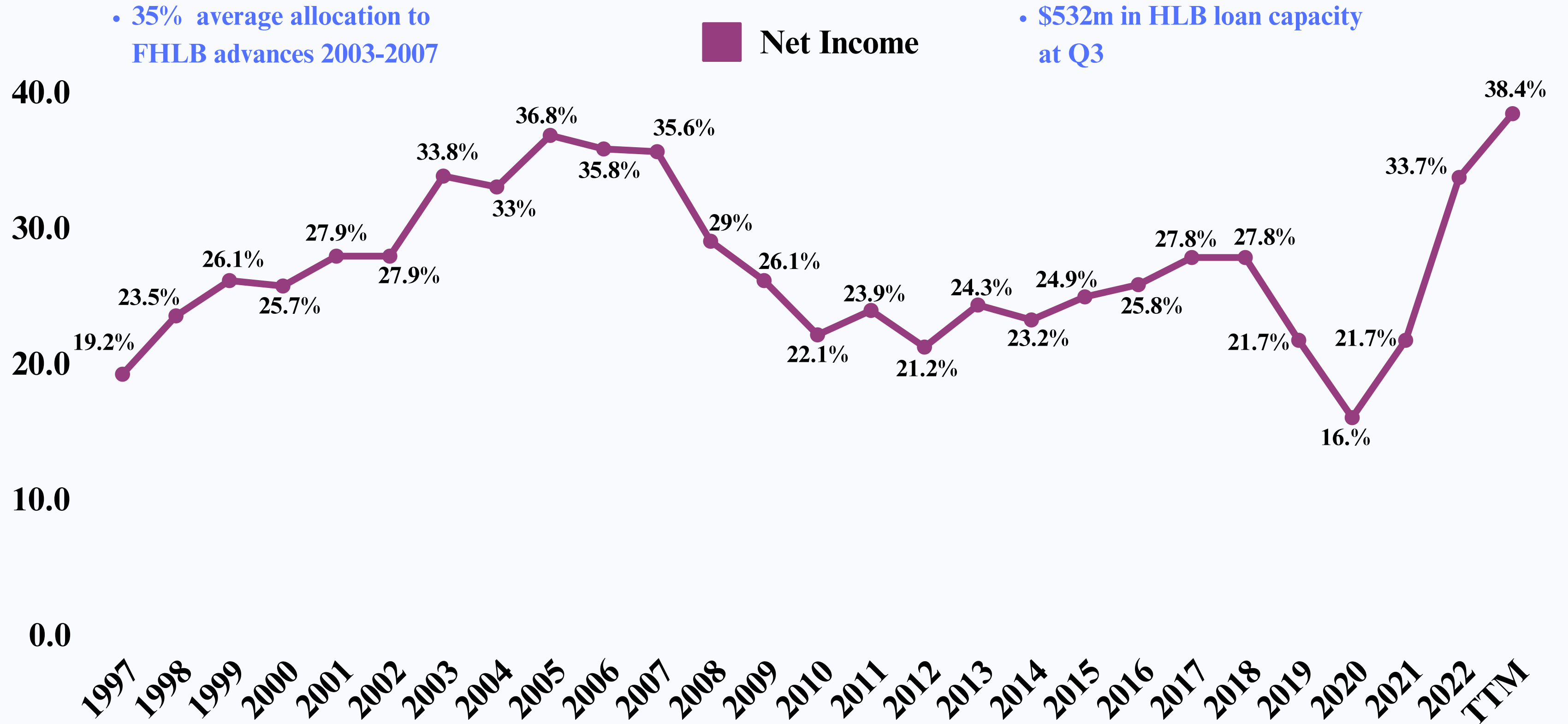


Hingham's unusual deposit-base

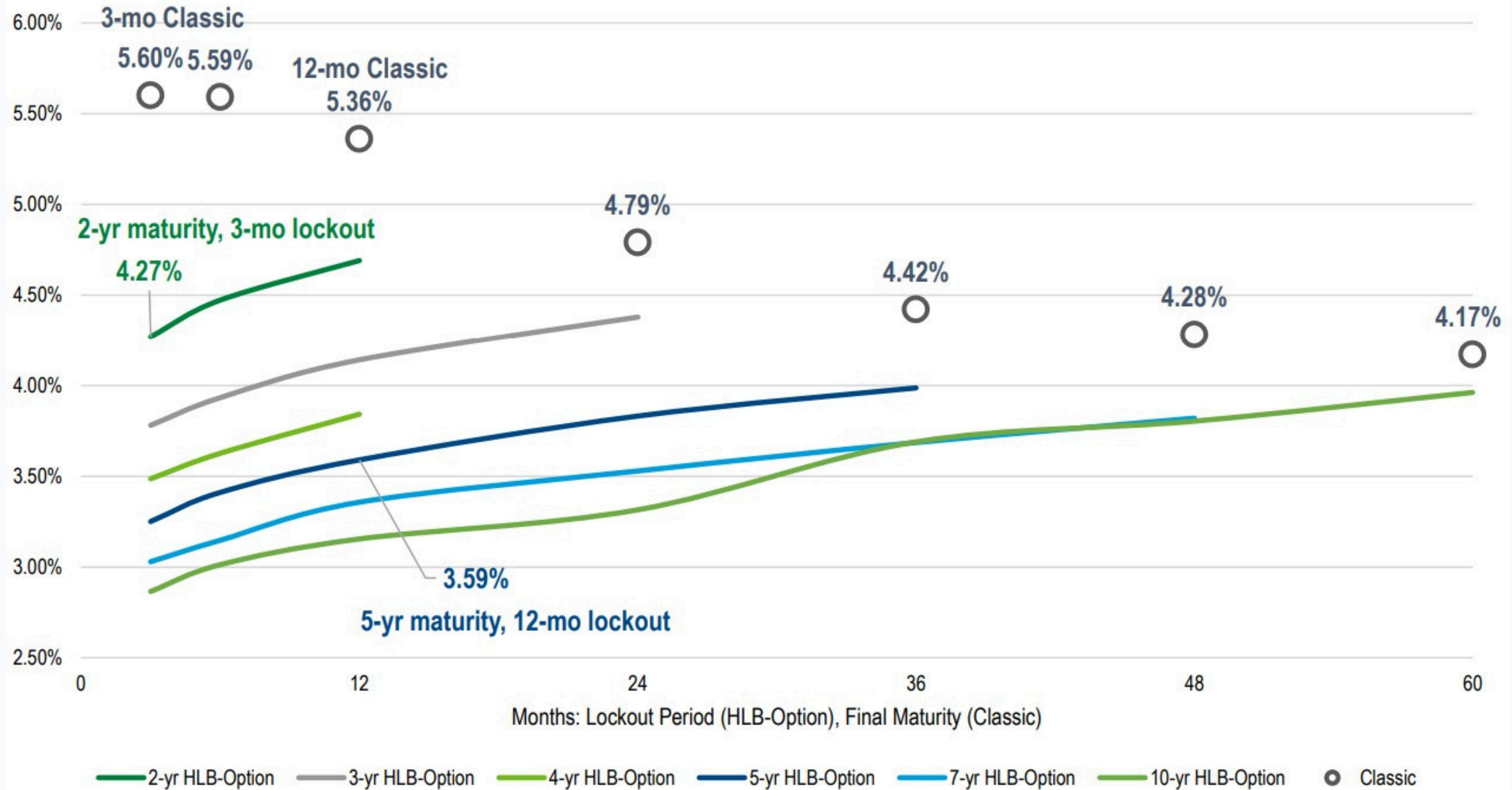
- Historically, funding has mostly comprised of consumer deposits via internet-listings and wholesale brokers
- In lieu of costly brokered deposits, HLB-option advances have been favored
- “We’ve had a model over a long period of time, that we can sustain, which involves a significant component of wholesale funding... [It’s] important that that is a piece of the balance sheet structure.”



FHLB advances: par for the course



HLB-Option Advance and Classic Advance Curves

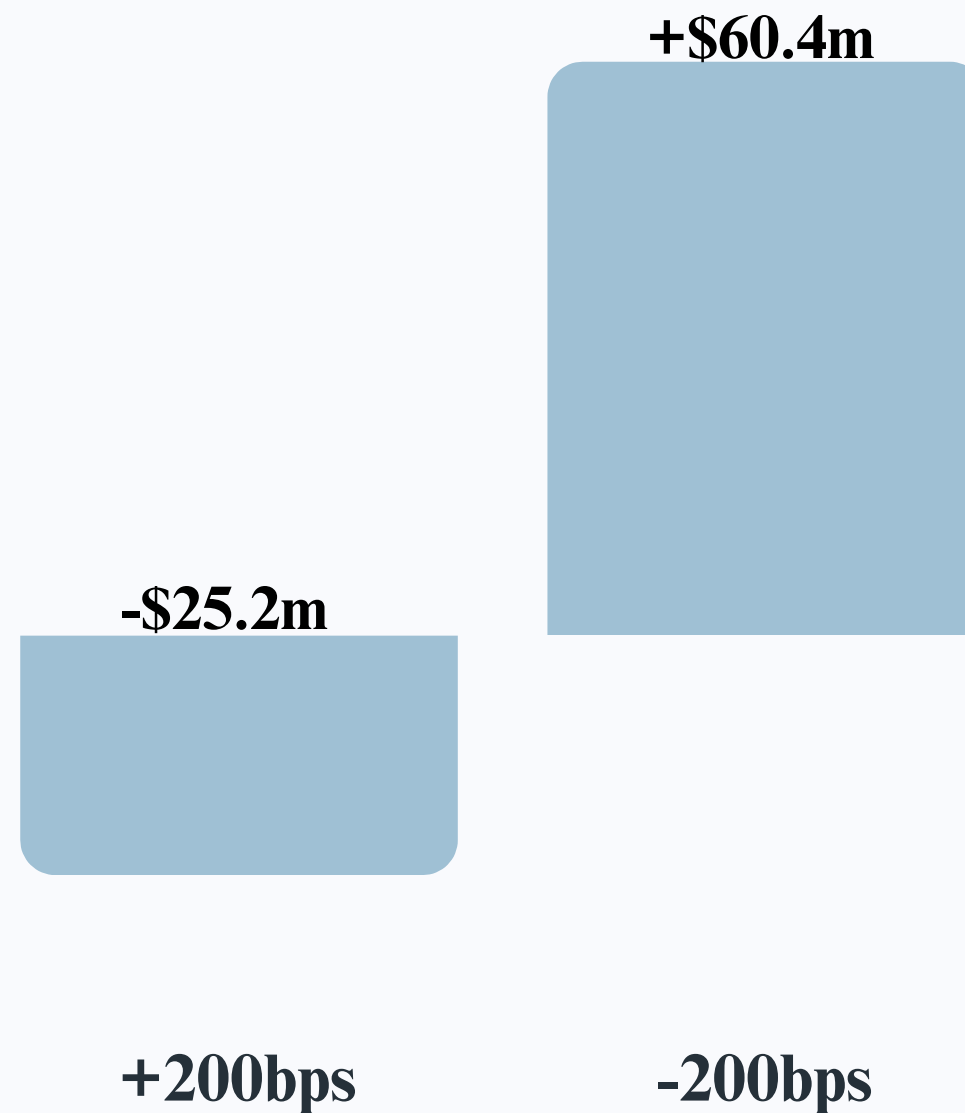


*Rates as of 5/31/23- all pricing is subject to change and rates and spreads are not guaranteed

Source: FHLBank Boston

Interest rate movement impact

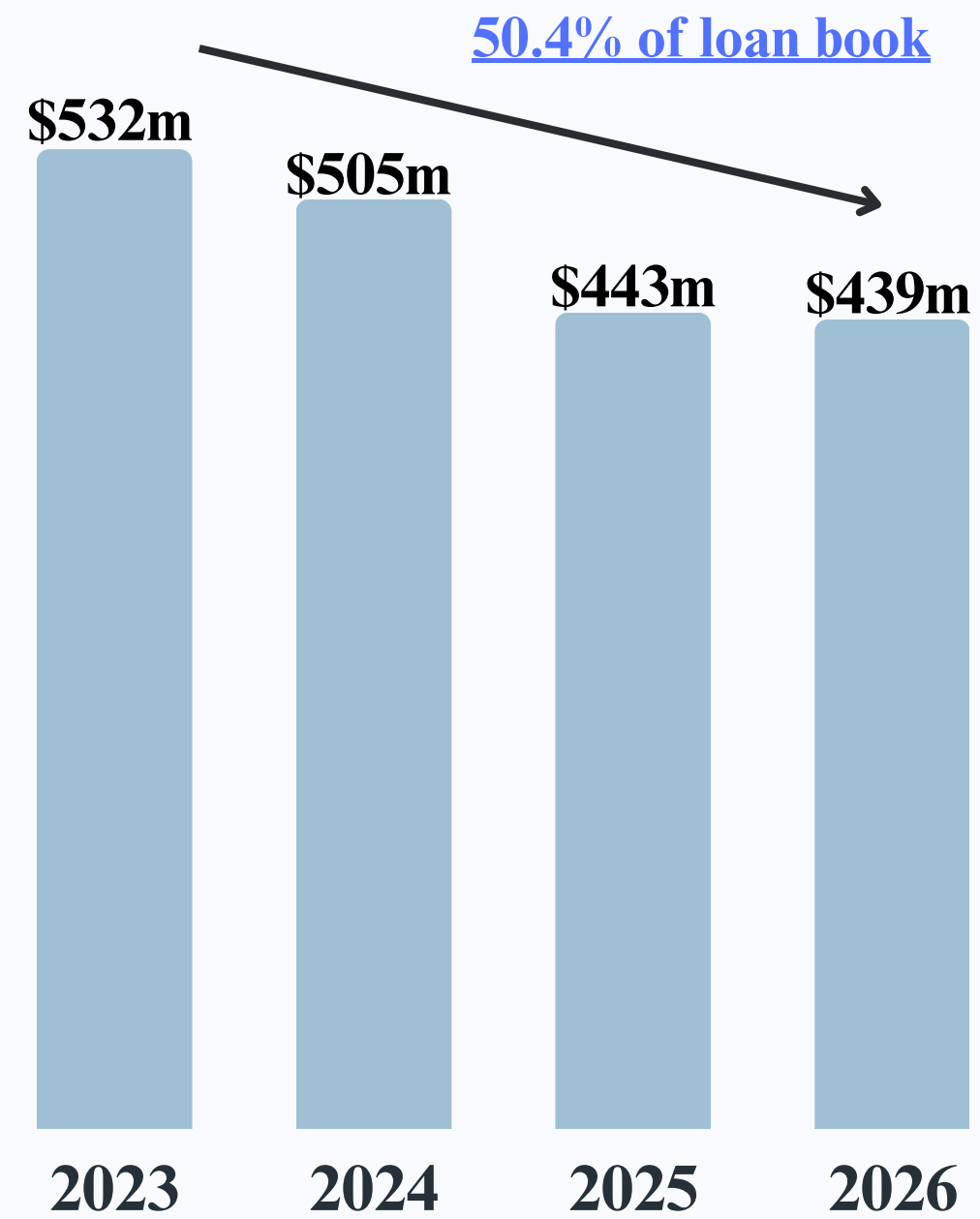
- **200 bps increase in rates:**
 - loss of approximately \$25m against \$354m in cash
- **200 bps decrease in rates:**
 - \$60.4m windfall, bringing net spread back up to roughly 2.5%



Hingham is in an exceptional financial position

- Despite being a bank that is highly liability sensitive, the business has been optimized to endure yield-curve inversions in order to maximize long-term return
- Borrowing capacity at Q3 is approximately \$2.045bn, which is equal to 54% of current loan book value. Non-loan assets comprise \$354m in cash and \$73.2m in equity securities, and an immaterial HTM \$3.5m loan in corporate debt

Hingham's loans adjustment/maturity volume 2023-2026





Robert H. Gaughen: CEO, Age 74

- Robert has been CEO of Hingham since 1993
- Prior to his successful takeover of Hingham, Robert served as President and CEO of East Weymouth Savings Bank from 1981-1988
- Robert has a BA from Georgetown University, and a JD from Suffolk University Law School



Patrick R. Gaughen: President & COO, Age 42

- Patrick has been President and COO of Hingham since 2018, and prior was EVP of Hingham from 2014-2018, and Chief Strategy & Corporate Development Officer from 2012-2014
- Prior to Hingham, Patrick served as a Foreign Service Officer for the U.S. Department of State between 2008-2012
- Patrick holds a B.A. cum laude from Yale University, an M.A. from Georgetown University, and an M.A. from Duke University

- Management takes passion in doing things well, including customer experience
- Hingham's personal savings app has a 4.8/5 star rating on the App Store

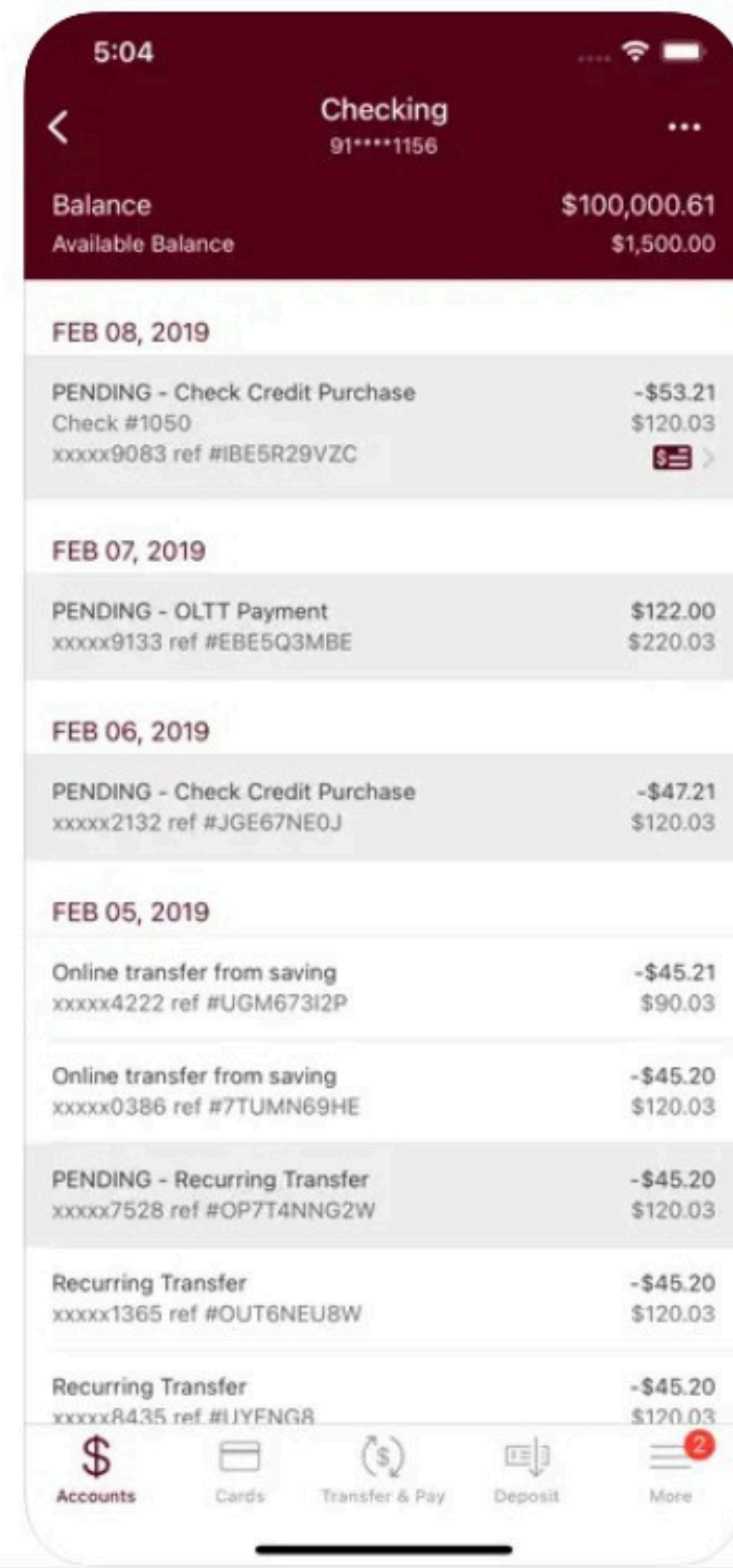
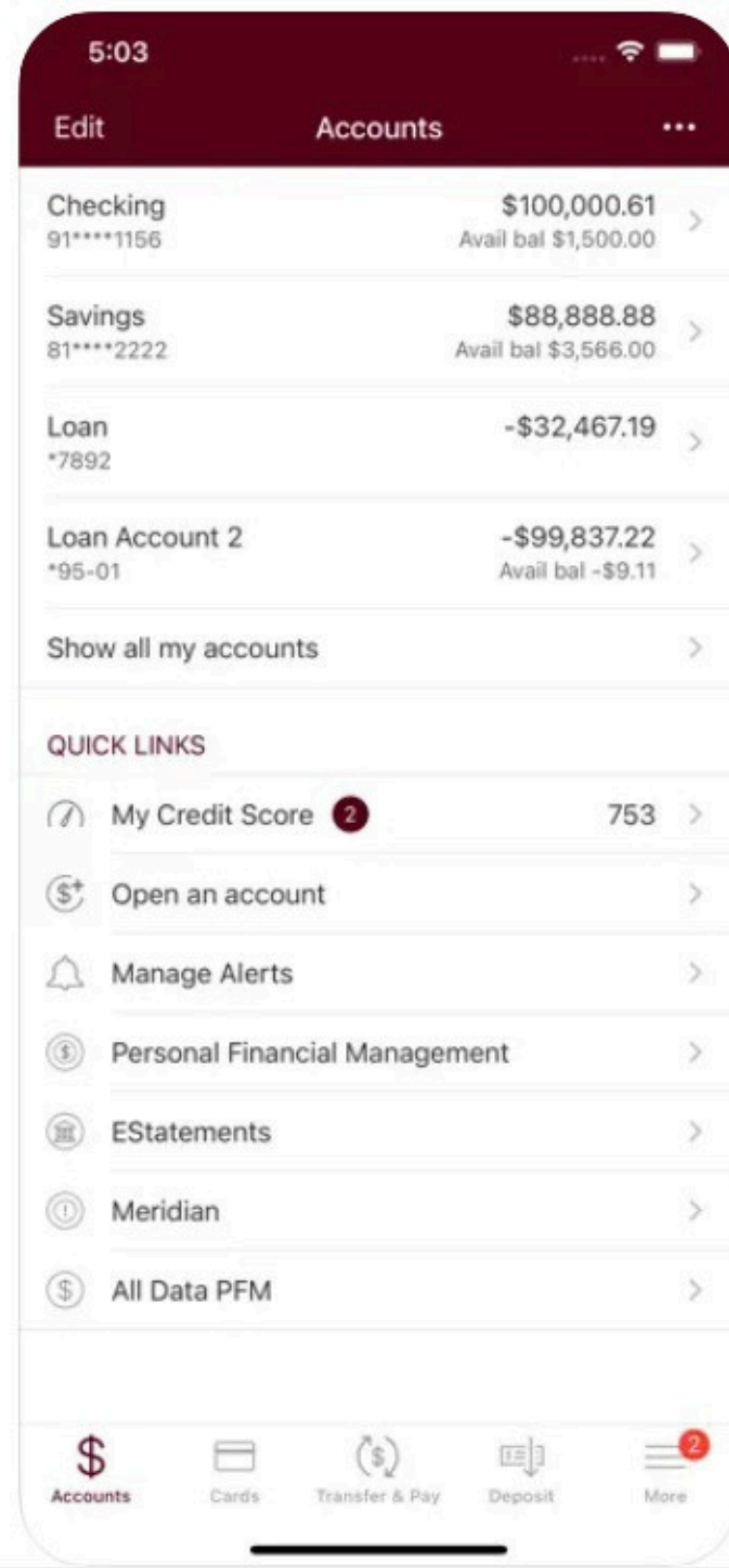
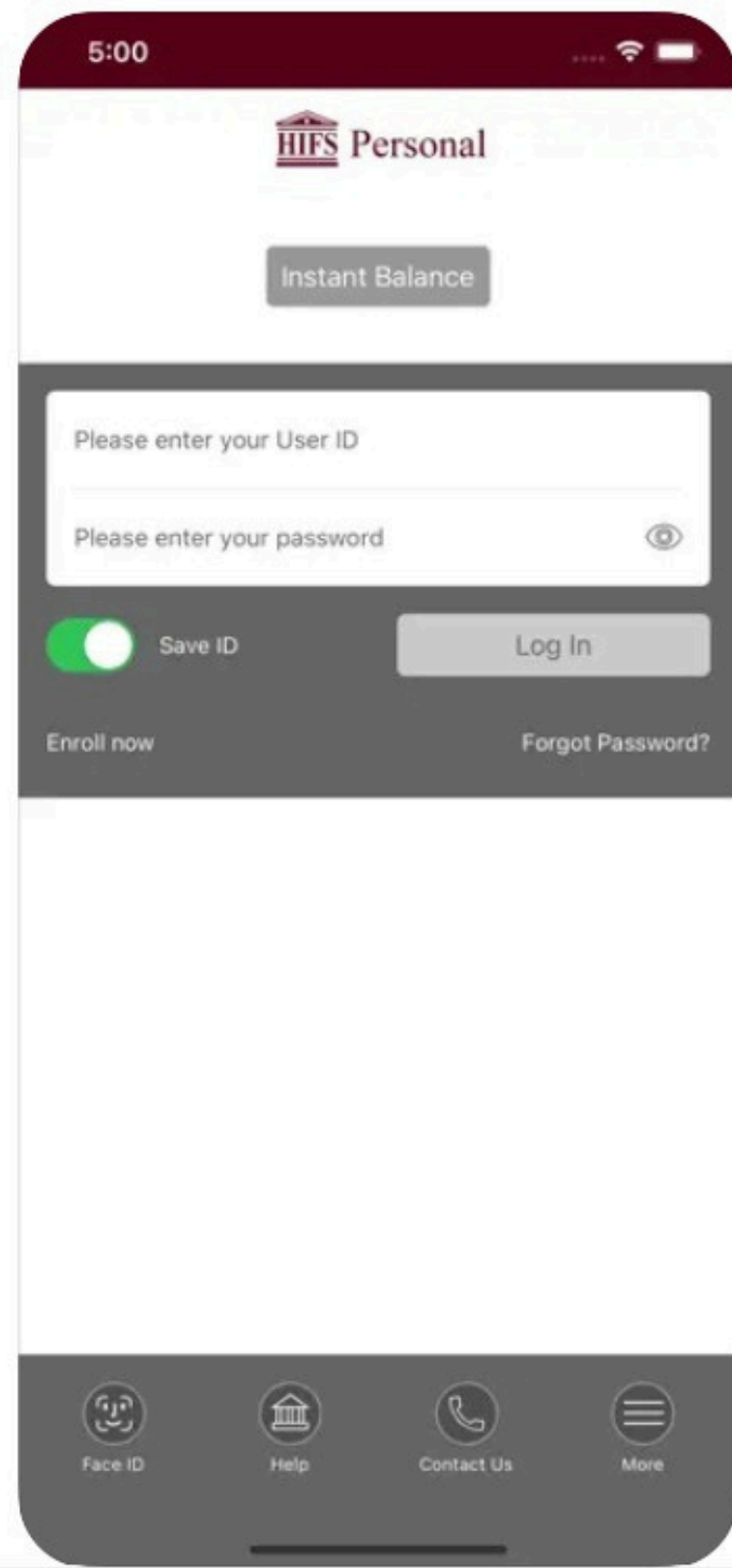


Hingham Savings Personal

Hingham Institution for Savings

★★★★★ 4.8 • 908 Ratings

Free



Management demonstrates unusual behavior

- Patrick Gaughen is the leadership-facing executive of the company, and runs the majority of AGMs
- “We’re probably entering a period where it would be a real mistake to take off some of the liability-sensitivity that we have historically had... If we were going to do swaps or other forms of hedging, the time to do that was probably in the past.”
- “I would rather get into a market when there are a lot of negative headlines, than when there are a lot of positive headlines.”

Hingham is as undervalued as it was in the GFC

- At just 1.04x book, Hingham is as cheap as it was and July 2000 and June 2009. Unsurprisingly, given historical ROE, returns have been about 15.4% since 2009, despite Hingham's stock being presently 54% off its prior highs
- When Hingham was over-earning in 2021, annual returns for 2009 purchasers had been 29.8%, *compounded*

Hingham is as undervalued as it was in the GFC

- Are Hingham's loans worth less in the present environment?
 - The only time a loan should be remarked is if it is highly likely to face future impairment, which isn't the case for Hingham
 - Owning shares in a bank is about having long-term concern for the health of its loan book, and having faith that management won't do existentially stupid things
 - Management isn't stupid, and the loan book is healthy

Hingham is as undervalued as it was in the GFC

- For my analysis, I used the Growth Value Model approach. When buying a bank, you're buying a book of assets. Therefore, the likely growth and return of that book is of paramount in the consideration of gauging forward returns
- In my projections, I assume:
 - Core ROE of 13.53% (ROE ex gains on sales of equities and fixed-assets)
 - Hingham's 12% 20-year average book value growth rate, versus its most recent 10-year, 15.3% growth rate

GVM Projections

- A 12% 10-year book value growth would produce an equity value of \$1.25bn by 2033, and net income of \$168.9m at a 13.53% ROE: a 150% premium to this past cycle's peak earnings
- At its 27-year average P/B of 1.6x, this would fetch a \$1.997bn price tag for the equity, representing a 16.9% compounded rate of return from its present price of \$194.40, excluding dividends

| HIFS GVM 2024-2033 (in \$USDMM) | | | | | | | | | | |
|--|-------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Year | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 |
| Equity | 450.1 | 504.1 | 564.6 | 632.4 | 708.3 | 793.3 | 888.5 | 995.1 | 1114.5 | 1248.2 |
| ROE | 13.53% | 13.53% | 13.53% | 13.53% | 13.53% | 13.53% | 13.53% | 13.53% | 13.53% | 13.53% |
| Net income | \$60.90 | \$68.21 | \$76.40 | \$85.56 | \$95.83 | \$107.33 | \$120.21 | \$134.64 | \$150.79 | \$168.89 |
| P/B 1.6x | \$720.20 | \$806.63 | \$903.42 | \$1,011.84 | \$1,133.26 | \$1,269.25 | \$1,421.56 | \$1,592.14 | \$1,783.20 | \$1,997.18 |
| 2033 value | \$1,997.18 | | | | | | | | | |
| 12.4x P/E | \$2,094.20 | | | | | | | | | |

Risks

- Key personnel risk
 - Board tenure is an average 20.5 years versus 10.2 for the KRE
- Interest rate risk
- Deposit loss
 - First time since 1995 that Hingham is losing deposits
- A significant increase in multifamily supply

Conclusion

- Hingham is the low-cost regional operator, with an outstanding track-record of conservative underwriting
- The business has an incentive structure that is not easily replicated, and is likely to encourage continued upper-tier performance in terms of business return generation, operational efficiency, and growth over the next cycle
- It's run by managers that are focused on optimizing personal and long-term shareholder wealth, not on minimizing short-term discomfort
- It hasn't been this cheap since 2009