



# KEEFE, BRUYETTE & WOODS

Specialists in Financial Services

A Stifel Company

North America Equity Research

## Analysis of Sales/Earnings

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## Banks

### SMIDs

January 30, 2018

## Sussex Bancorp

(SBBX, \$29.10, Outperform, Target: \$32.50)

4Q17 Initial: Delivers Better-Than-Expected NIM, OP

### Summary

**ROCK [\$0.09, \$0.36, \$0.34, \$0.36] R vs. O:** Operating excludes a tax-related \$0.16 DTA revaluation charge, \$0.10 of non-recurring merger charges, and a \$0.01 non-recurring securities loss. **O vs. K:** The in-line quarter to KBW and beat to consensus reflects stronger NII (+\$0.03) and a lower provision expense (+\$0.01), partially offset by weaker core fee income (-\$0.03) and a higher operating tax rate (-\$0.01). **CC:** None.

**Initial Take:** This quarter's bottom line results were in line with our projections; however, the composition to get there varied somewhat. Highlights for the quarter include: 1) better-than-expected NIM, as both asset yields and funding costs came in better than we were expecting; 2) slightly better loan growth than deposit growth, moving the loan to deposit ratio up to 108% from 107%; 3) fees fell, as insurance revenue missed full year growth target of 20%; 4) expenses declined; and 4) NPAs fell, while NCOs rose. Operating ROA improved to 0.89% from 0.85%, while TBV was essentially flat despite the DTA write-down, at \$15.13.

**NIM expansion drives stronger NII.** Net interest income rose +3.9% versus our +0.2% estimate, reflecting a considerably higher NIM. The reported NIM rose +4bps to 3.46%, versus our 3.33% estimate, driven by a +5bp increase in earning asset yields, partially offset by a +2bp increase in IBL costs. Interest-bearing deposit costs increased +3bps q/q, bringing the full year beta to 27% for 2017. Total loans grew +3.2% q/q compared to our +5.0% estimate, while deposit growth came in stronger at +2.8% versus our +2.0% estimate. The loan-to-deposit ratio ticked up to 108% from 107% in 3Q17.

**Operating expenses fall, serving to improve the efficiency ratio.** Core fee income fell -2.0% versus our +12.8% estimate, reflecting lower insurance fees (-7%), partially offset by stronger deposit fees (+13.5%). Insurance fees comprise approximately 58% of SBBX's core fee income, and rose 11% YOY, which fell short of the company's 20% target. Excluding \$705,000 of non-recurring merger charges, operating expenses fell -2.8%, versus our -2.4% estimate. Operating efficiency improved to 61.9% from 65.4% in 3Q17. **CONTINUED ON PAGE 2.**

Flash Note

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**Credit impacted by higher NCOs, trends still hold within a reasonable range.** Nonperforming assets fell \$591,000 or -6.0% to comprise 0.94% of total assets, versus our flat 1.03% projection. NCOs rose to \$626,000, or 0.31% of average loans, versus our 0.12% estimate. The provision expense came in at \$459,000, below our \$512,000 expectation and slightly higher than the 3Q17 level of \$340,000. The provision fell short of NCOs and loan growth for the quarter, causing the reserve-to-loan ratio to fall to 0.89% from 0.94% in 3Q17, and below our 0.93% estimate.



**Sussex Bancorp (SBBX - Outperform - \$32.50 Target)**

**KBW Analyst: Collyn Gilbert**  
Conference Call: None  
Dial-In: Code:

**ROCK: [\$0.09, \$0.36, \$0.34, \$0.36]**

(\$ in millions)	4Q17A	4Q17E	Variance to KBWe/Share	3Q17A	Q/Q %	4Q16A	Y/Y %
<b>Net Interest Income</b>	\$8	\$8	\$0.03	\$8	3.9%	\$7	19.5%
Provision	0	1	\$0.01	0	35.0%	0	93.7%
<b>Net after Provision</b>	\$7	\$7		\$7	2.4%	\$6	16.7%
<b>Non-Interest Income</b>							
Deposit Fees	0	0		0	13.5%	0	24.9%
ATM/Debt Fees	0	0		0	0.5%	0	4.7%
BOLI	0	0		0	0.0%	0	75.6%
Insurance Fees	1	2		1	-7.1%	1	24.0%
Brokerage Fees	0	0		0	33.3%	0	50.0%
Other Income	0	0		0	4.8%	0	19.0%
<b>Operating Fee Income</b>	\$2	\$2	-\$0.03	\$2	-2.0%	\$2	24.2%
Securities Gains (Losses)	0	0		0	103.8%	0	-163.9%
Other Non-Recurring Revenues	0	0		0	NM	0	NM
<b>Total Non-Interest Income</b>	\$2	\$2	-\$0.04	\$2	-3.4%	\$2	15.0%
<b>Expenses</b>							
Compensation Costs	4	4		4	0.7%	3	11.1%
Occupancy & Equipment	1	1		1	0.3%	1	0.9%
Marketing	0	0		0	-23.4%	0	-14.0%
Professional Fees	0	0		0	30.4%	0	81.2%
Director Fees	0	0		0	16.0%	0	51.4%
FDIC Assessment	0	0		0	42.9%	0	-45.7%
Insurance	0	0		0	10.0%	0	14.9%
Stationary	0	0		0	-28.6%	0	-28.6%
Collection Costs	0	0		0	104.3%	0	51.6%
Data Processing	1	1		1	-6.2%	0	10.0%
Other Operating Expenses	1	0		0	153.0%	0	167.9%
<b>Operating Expenses</b>	\$6	\$6	\$0.00	\$6	-2.8%	\$6	6.8%
Non-Recurring Expenses	1	0		0	704	0	NA
<b>Total Non-Interest Expense</b>	\$7	\$6	-\$0.07	\$6	8.4%	\$6	19.1%
Operating Pre-Tax Earnings	3	3		3	10.5%	2	47.4%
Tax Rate	36%	34%	-\$0.01	34%	162bp	35%	89bp
Est. Operating Tax Provision	1	1		1	15.8%	1	51.2%
<b>OPERATING NET INCOME</b>	\$2	\$2		\$2	7.8%	\$1	45.4%
Non-conv Preferred Div.	0	0		0		0	
<b>OPERATING NET INCOME TO COMMON</b>	\$2	\$2		\$2	7.8%	\$1	45.4%
<b>Average (fd) Shares</b>	6	6		6	0.2%	5	27.8%
<b>Reported Earnings per Share (fd)</b>	\$0.09	\$0.36	-\$0.27	\$0.33	-72.7%	\$0.32	-71.9%
<b>Operating Earnings per Share</b>	\$0.36	\$0.36	\$0.00	\$0.33	9.1%	\$0.31	16.1%
<b>Profitability (Operating)</b>							
PTPP ROAA	1.56%	1.55%	1bp	1.42%	14bp	1.20%	37bp
Return on Assets	0.89%	0.88%	0bp	0.85%	4bp	0.71%	18bp
Return on Common Equity	2.2%	9.1%	-690bp	8.4%	-625bp	10.1%	-798bp
Tangible Return on TCE	9.4%	9.3%	2bp	8.8%	58bp	10.4%	-103bp
Net Interest Margin (reported)	3.46%	3.33%	13bp	3.42%	4bp	3.35%	11bp
Efficiency Ratio	61.9%	62.0%	-11bp	65.4%	-349bp	69.8%	-789bp
<b>Balance Sheet</b>							
Average Loans	808	815	-0.9%	784	3.1%	679	18.9%
Average Earning Assets	928	932	-0.5%	903	2.7%	794	16.8%
Average Assets	964	971	-0.8%	937	2.8%	829	16.3%
Average Securities	112	109	2.3%	113	-1.4%	105	6.6%
Average Deposits	752	749	0.4%	726	3.6%	643	17.0%
Average Common Equity	94	95	-0.8%	93	1.0%	59	58.5%
EOP Loans	821	835	-1.7%	795	3.2%	695	18.0%
EOP Assets	979	985	-0.6%	957	2.4%	849	15.4%
EOP Deposits	762	757	0.8%	742	2.8%	661	15.4%
EOP Common Equity	94	96	-1.6%	94	0.3%	60	56.8%
Tangible Common Equity	91	93	-1.7%	91	0.3%	57	59.6%
EOP Loans / Deposits	107.6%	110.3%	-269bp	107.2%	46bp	105.2%	244bp
Average Securities / AEA	12.0%	11.7%	32bp	12.5%	-50bp	13.2%	-115bp
TCE Ratio (TCE/TA)	9.4%	9.5%	-10bp	9.6%	-20bp	6.8%	259bp
<b>CET1/RWA</b>	NA	NA	NA	NA	NA	NA	NA
<b>Tier 1 Leverage Ratio</b>	NA	NA	NA	NA	NA	10.4%	NA
<b>Tangible Book Value per Share</b>	\$15.13	\$15.38	-1.7%	\$15.09	0.3%	\$12.08	25.3%
<b>Asset Quality</b>							
<b>Total NPAs</b>	9	10	-1	10	-6.0%	9	-1.3%
NPA's / Loans & OREO	1.12%	1.21%	-9bp	1.23%	-11bp	1.34%	-22bp
Provision / Avg Loans	0.23%	0.25%	-2bp	0.17%	5bp	0.14%	-22bp
<b>Net Charge-offs</b>	1	0	0	0	20766.7%	0	-589.1%
Net Charge-offs / Avg Loans	0.31%	0.12%	19bp	0.00%	31bp	-0.07%	-22bp
EOP Loan Loss Reserve	7	8	0	8	-2.2%	7	9.5%
Reserve / Loans	0.89%	0.93%	-4bp	0.94%	-5bp	0.96%	-22bp
<b>Reserve / NPLs</b>	1.22x	1.29x	-0.07x	1.14x	0.08x	1.15x	0.07x

Source: Keefe, Bruyette, & Woods, Inc.



**Sussex Bancorp (SBBX)**  
Statement of Operations - \$000s except per share data

	2014	2015	2016	2016	2016	2016	2016	2017	2017	2017	2017	2017	2018	2018	2018	2018	2018	2019
Interest Income	21,300	23,644	6,726	6,999	7,575	7,860	29,160	8,268	8,542	9,255	9,634	35,699	12,711	12,984	13,654	14,087	53,437	62,120
Interest Expense	3,294	3,568	1,080	1,182	1,227	1,273	4,762	1,519	1,647	1,681	1,764	6,611	2,360	2,448	2,538	2,635	9,981	11,623
Net Interest Income	18,006	20,076	5,646	5,817	6,348	6,587	24,398	6,749	6,895	7,574	7,870	29,088	10,351	10,536	11,116	11,452	43,456	50,497
Loan Loss Provision	1,537	636	211	385	458	237	1,291	407	380	340	459	1,586	732	710	755	641	2,838	4,086
Deposit Fees	1,047	906	225	256	245	249	975	253	285	274	311	1,123	313	326	329	335	1,303	1,326
ATM/Debt Fees	726	776	187	200	190	190	767	180	200	198	199	777	191	199	200	201	790	797
BOLI	324	313	77	75	74	82	308	106	128	144	144	522	144	144	144	144	576	576
Insurance Fees	3,139	3,686	1,721	1,039	1,090	946	4,796	1,747	1,143	1,263	1,173	5,326	2,257	1,928	2,120	2,014	8,320	10,246
Brokerage Fees	108	130	27	50	(10)	8	75	3	-	9	12	24	9	9	9	9	36	36
AFS Securities Impairment	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Securities Gains	289	271	167	105	89	83	444	107	(30)	(26)	(53)	(2)	-	-	-	-	-	-
Loan/OREO Gains	(5)	(130)	(13)	(6)	-	-	(19)	-	-	-	-	-	-	-	-	-	-	-
Other Income	333	501	133	107	96	147	483	81	92	167	175	515	196	201	203	205	804	840
Total Non-Interest Income	5,961	6,453	2,524	1,826	1,774	1,705	7,829	2,477	1,818	2,029	1,961	8,285	3,110	2,806	3,005	2,908	11,828	13,821
Other Non-Recurring Income	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Fee-Based Income	5,677	6,312	2,370	1,727	1,685	1,622	7,404	2,370	1,848	2,055	2,014	8,287	3,110	2,806	3,005	2,908	11,828	13,821
Total Revenue	23,967	26,529	8,170	8,122	8,292	8,292	32,227	9,226	8,713	9,603	9,831	37,373	13,461	13,342	14,121	14,361	55,284	64,318
Operating Revenue	23,683	26,388	8,016	7,544	8,033	8,209	31,802	9,119	8,743	9,629	9,884	37,375	13,461	13,342	14,121	14,361	55,284	64,318
Compensation Costs	10,079	11,506	3,353	3,076	3,243	3,406	13,078	3,558	3,677	3,755	3,783	14,773	4,836	4,839	4,984	5,123	19,782	21,753
Occupancy & Equipment	2,353	2,616	657	795	711	689	2,852	740	690	693	695	2,818	895	889	898	924	3,606	3,847
Marketing	281	326	105	86	63	57	311	106	89	64	49	308	65	66	67	67	265	276
Professional Fees	737	654	174	177	219	218	788	277	198	303	395	1,173	184	185	186	187	742	764
Director Fees	475	544	59	160	159	72	450	107	89	94	109	399	103	103	103	103	414	455
FDIC Assessment	607	446	120	121	138	129	508	51	93	49	70	263	51	51	51	51	206	216
Insurance	288	271	73	73	67	67	280	66	66	70	77	279	72	72	72	72	290	300
Stationary	221	197	52	50	47	42	191	32	44	42	30	148	44	44	44	42	173	183
Collection Costs	380	207	32	53	24	31	140	24	28	23	47	122	24	24	24	25	97	103
Data Processing	1,714	1,653	549	548	529	482	2,108	557	521	565	530	2,173	576	582	588	594	2,340	2,435
OREO Costs	432	535	75	144	98	141	458	45	32	221	(15)	283	56	56	57	57	227	236
Other Operating Expenses	1,262	1,598	361	315	353	392	1,421	414	999	415	1,050	2,878	1,268	1,233	1,263	1,295	5,059	5,245
Total Non-Interest Expense	18,829	20,553	5,610	5,598	5,651	5,726	22,585	5,977	6,526	6,294	6,820	25,617	8,175	8,144	8,338	8,543	33,200	35,815
Other Non-Recurring Expense	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Recurring Operating Expense	18,829	20,553	5,610	5,598	5,651	5,726	22,585	5,977	5,970	6,293	6,115	24,355	8,175	8,144	8,338	8,543	33,200	35,815
Pre-Tax Income	3,601	5,340	2,349	1,660	2,013	2,329	8,351	2,842	1,807	2,969	2,552	10,170	4,554	4,488	5,027	5,177	19,246	24,417
Income Taxes	1,001	1,640	775	551	696	806	2,828	831	603	1,006	2,039	4,479	975	960	1,076	1,108	4,119	5,225
Net Income	2,600	3,700	1,574	1,109	1,317	1,523	5,523	2,011	1,204	1,963	513	5,691	3,579	3,528	3,951	4,069	15,127	19,192
Preferred Dividend	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Discontinued Operations / Minority Interests	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Income Available for Common	2,600	3,700	1,574	1,109	1,317	1,523	5,523	2,011	1,204	1,963	513	5,691	3,579	3,528	3,951	4,069	15,127	19,192
Diluted EPS	\$ 0.57	\$ 0.81	\$ 0.34	\$ 0.24	\$ 0.28	\$ 0.32	\$ 1.19	\$ 0.43	\$ 0.25	\$ 0.33	\$ 0.09	\$ 1.06	\$ 0.46	\$ 0.45	\$ 0.50	\$ 0.52	\$ 1.93	\$ 2.44
Operating EPS	\$ 0.52	\$ 0.78	\$ 0.32	\$ 0.23	\$ 0.27	\$ 0.31	\$ 1.13	\$ 0.41	\$ 0.34	\$ 0.33	\$ 0.36	\$ 1.42	\$ 0.46	\$ 0.45	\$ 0.50	\$ 0.52	\$ 1.93	\$ 2.44
% Change	119.7%	50.2%	46%	-29.2%	18.8%	16.2%	43.9%	31%	-17.9%	-1.8%	7.6%	26.4%	29%	-2.5%	12.0%	3.0%	35.2%	26.5%
Avg. Diluted Shares	4,580	4,594	4,606	4,610	4,684	4,705	4,651	4,727	4,741	6,001	6,012	5,370	7,779	7,861	7,861	7,861	7,841	7,861
Effective Tax Rate	27.8%	30.7%	33.0%	33.2%	34.6%	34.6%	33.9%	29.2%	33.4%	33.9%	79.9%	44.0%	21.4%	21.4%	21.4%	21.4%	21.4%	21.4%
Dividends Paid	\$ 0.06	\$ 0.15	\$ 0.04	\$ 0.04	\$ 0.04	\$ 0.04	\$ 0.16	\$ 0.04	\$ 0.06	\$ 0.06	\$ 0.06	\$ 0.22	\$ 0.06	\$ 0.06	\$ 0.06	\$ 0.06	\$ 0.24	\$ 0.24
Dividend Payout (Diluted)	11%	19%	12%	17%	14%	12%	13%	9%	24%	18%	70%	21%	13%	13%	12%	12%	12%	10%
Dividend Payout (Operating)	12%	19%	13%	18%	15%	13%	14%	10%	18%	18%	17%	15%	13%	13%	12%	12%	12%	10%
Book Value	\$ 10.99	\$ 11.61	\$ 11.91	\$ 12.15	\$ 12.37	\$ 12.67	\$ 12.67	\$ 13.04	\$ 15.27	\$ 15.55	\$ 15.59	\$ 15.59	\$ 18.31	\$ 18.70	\$ 19.14	\$ 19.60	\$ 19.60	\$ 21.35
Tangible Book Value	\$ 10.38	\$ 11.00	\$ 11.31	\$ 11.55	\$ 11.77	\$ 12.08	\$ 12.08	\$ 12.46	\$ 14.81	\$ 15.09	\$ 15.13	\$ 15.13	\$ 15.44	\$ 15.83	\$ 16.27	\$ 16.72	\$ 16.72	\$ 18.48
% Change	10.2%	6.0%	2.7%	2.2%	1.9%	2.6%	9.8%	3.1%	18.9%	1.9%	0.3%	25.3%	0.4%	2.5%	2.8%	2.8%	8.7%	10.5%
Growth Rates	2014	2015	2016	2016	2016	2016	2016	2017	2017	2017	2017	2017	2018	2018	2018	2018	2018	2019
Net Income	82.1%	42.3%	72.4%	-29.5%	18.8%	15.6%	49.3%	32.0%	-40.1%	6.8%	-73.9%	3.0%	66.6%	-1.4%	12.0%	3.0%	106.5%	26.9%
Net Interest Income	9.5%	11.5%	6.0%	3.0%	9.1%	3.8%	21.5%	2.5%	2.2%	3.9%	3.9%	19.2%	36.4%	1.8%	5.5%	3.0%	50.8%	16.2%
Net Interest Expense	-2.6%	8.3%	80.8%	-27.7%	-2.8%	-3.9%	21.3%	-45.3%	-26.6%	-11.6%	-3.4%	5.8%	34.1%	-9.8%	7.1%	-3.2%	36.9%	16.8%
Non Interest Expense	3.1%	9.2%	7.9%	-0.2%	0.9%	1.3%	0.9%	4.4%	9.2%	-3.6%	8.4%	13.4%	33.1%	-0.4%	2.4%	2.4%	33.1%	7.9%
Recurring Revenue	7.0%	11.4%	17.5%	-5.9%	6.5%	2.2%	20.5%	11.1%	-4.1%	10.1%	2.6%	17.5%	35.8%	-0.9%	5.8%	1.7%	47.8%	16.3%
Recurring Expense	3.1%	9.2%	7.9%	-0.2%	0.9%	1.3%	0.9%	4.4%	-0.1%	5.4%	-2.8%	7.8%	33.1%	-0.4%	2.4%	2.4%	36.2%	7.9%
Core Pre-Tax Pre-Provision Income	25.0%	20.2%	47.9%	-19.1%	22.4%	4.2%	58.0%	26.5%	-11.7%	20.3%	13.0%	41.3%	40.3%	-1.7%	11.2%	0.6%	69.6%	29.1%
Profitability Ratios	2014	2015	2016	2016	2016	2016	2016	2017	2017	2017	2017	2017	2018	2018	2018	2018	2018	2019
Return on Avg. Assets (ROA)	0.46%	0.59%	0.30%	0.59%	0.66%	0.74%	0.72%	0.94%	0.54%	0.84%	0.21%	0.62%	1.22%	1.02%	1.11%	1.02%	1.11%	1.21%
Operating ROA	0.43%	0.57%	0.34%	0.56%	0.63%	0.71%	0.68%	0.90%	0.71%	0.85%	0.89%	0.84%	1.22%	1.02%	1.11%	1.11%	1.11%	1.21%
Pre Provision Pre Tax ROA	0.87%	0.93%	1.37%	1.04%	1.19%	1.20%	1.20%	1.46%	1.24%	1.42%	1.							



## IMPORTANT DISCLOSURES

**RESEARCH ANALYST CERTIFICATION:** We, Collyn Gilbert and Christopher O'Connell, hereby certify that the views expressed in this research report accurately reflect our personal views about the subject companies and their securities. We also certify that we have not been, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation in this report.

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## COMPANY SPECIFIC DISCLOSURES

KBW or an affiliate expects to receive or intends to seek compensation for investment banking services from Sussex Bancorp in the next three months.

KBW or an affiliate has received compensation for investment banking services from Sussex Bancorp in the past 12 months.

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## Sussex Bancorp (SBBX)

**Target Price:** \$32.50

### Risk Factors:

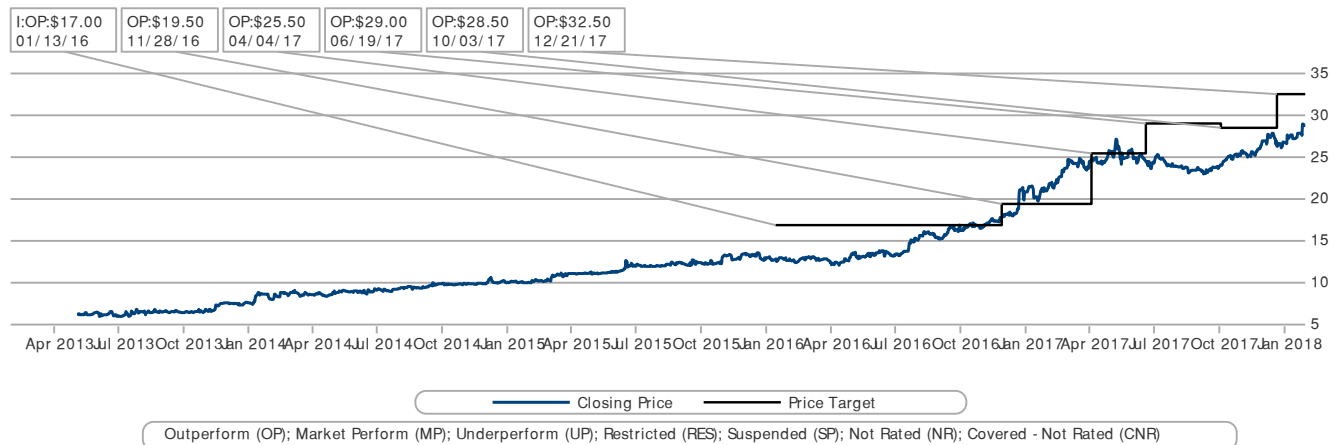
Key risk factors include, but are not limited to: interest rate risk, credit risk, increased competition, and a prolonged recessionary or weak economic environment.

### Valuation:



Our \$32.50 PT represents ~16.2x our 2018E

Rating and Price Target History for: Sussex Bancorp (SBBX) as of 01-29-2018



**Note:** The boxes on the Rating and Price Target History Chart above indicate the date of Report/Note, the rating and price target. Each box represents a date on which an analyst made a change to a rating or price target.

Distribution of Ratings/IB Services  
KBW

Rating	Count	Percent	*IB Serv./Past 12 Mos.	
			Count	Percent
Outperform [BUY]	215	34.79	80	37.21
Market Perform [HOLD]	349	56.47	126	36.10
Underperform [SELL]	38	6.15	10	26.32
Restricted [RES]	0	0.00	0	0.00
Suspended [SP]	16	2.59	1	6.25
Covered -Not Rated [CNR]	2	0.32	0	0.00

\*KBW maintains separate research departments; however, the above chart, "Distribution of Ratings/IB Services," reflects combined information related to the distribution of research ratings and the receipt of investment banking fees globally. \*\*Note: All ratings for Keefe, Bruyette and Woods, Inc. as of January 15, 2015 reflect a relative ratings system.

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