

## Commerce Bancshares Inc.

# High quality franchise with minimal rate risk but sky-high premium; Initiate Neutral

Initiating Coverage: NEUTRAL | PO: 55.00 USD | Price: 53.76 USD

## Plenty of “Commerce” to navigate rough waters

We are initiating coverage of Commerce Bancshares Inc (CBSH) with a Neutral rating and a \$55 price objective. We believe with its minimal interest rate exposure, revenue diversity, and historically lower through-the-cycle (TTC) losses, CBSH is well positioned to navigate risks. That said, we think the valuation is quite rich at 1.5X regional peers we see better risk/reward elsewhere.

## Declining revenue trends offset by balance sheet, fees

Lower rates will likely have little impact on CBSH, due to its neutral-positioned balance sheet. Further, the bank generates 40% of its revenue from fee income, more than 2x peer avg), which should help minimize earnings volatility. In 2H24, however, revenue will be negatively impacted by proposed interchange fee rule changes (which resets transaction fees lower) as well as underwater swaps. We estimate these headwinds represent just ~1% of revenue. Meanwhile, stabilizing/improving sentiment should remain a tailwind for fee growth, which we estimate will grow 3.5% in 2024.

## Optically reserves appear low but should prove adequate

CBSH has typically incurred lower TTC loan losses vs. peers, despite greater exposure to credit card loans. We attribute that to 1) minimal exposure to low-FICO borrowers (659 or lower) and 2) actions to reduce risk from the balance sheet (consumer & card loans declined 2% since 2018). While CBSH's lower reserve ratio (95bp of loans vs. 120bp mid-cap average) may concern investors given the bank has less credit leverage (relative to peers), we see downside risk to consensus as being limited. In fact, our sensitivity analysis (see page 9) suggests CBSH's reserves appear sufficient.

## Hefty premium reflects franchise, yet expansion limited

Shares of CBSH are trading at a 50%+ premium to mid-cap bank peers and 17x 2024e EPS, above the high-end of its typical trading range and (Note: CBSH has historically traded at a 10% premium). We believe this valuation reflects: 1) above-average return profile; 2) lower TTC loan losses; 3) revenue diversity; and 4) higher capital levels. That said, we think further multiple expansion is limited. Moreover, CBSH's premium to high-quality peers narrows during periods of slowing economic growth.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	4.29	3.87	3.85	3.15	3.30
GAAP EPS	4.27	3.85	3.76	3.15	3.30
EPS Change (YoY)	49.0%	-9.8%	-0.5%	-18.2%	4.8%
DPS	0.99	1.03	1.08	1.13	1.19
<b>Valuation (Dec)</b>					
P/E	12.5x	13.9x	14.0x	17.1x	16.3x
GAAP P/E	12.6x	14.0x	14.3x	17.1x	16.3x
Dividend Yield	1.8%	1.9%	2.0%	2.1%	2.2%

11 January 2024

### Equity

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### Stock Data

Price	53.76 USD
Price Objective	55.00 USD
Date Established	11-Jan-2024
Investment Opinion	B-2-7
52-Week Range	40.91 USD -66.86 USD
Mrkt Val / Shares Out (mn)	6,005 USD / 111.7
Free Float	91.2%
Average Daily Value	25.86 USD
BofA Ticker / Exchange	CBSH / NAS
Bloomberg / Reuters	CBSH US / CBSH.OQ
ROE (2023E)	18.3%
ESGMeter™	Medium

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Timestamp: 11 January 2024 06:00AM EST

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## Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Interest Income	847	952	1,005	983	1,025
% change	0.5%	12.4%	5.6%	-2.2%	4.2%
Net Fee Income	547	522	515	531	555
Securities Gains / (Losses)	NA	NA	NA	NA	NA
Total Operating Income	1,433	1,517	1,577	1,567	1,633
Operating Expenses	(798)	(843)	(909)	(957)	(995)
% change	4.1%	5.7%	7.8%	5.2%	4.1%
Provisions Expense	66	(28)	(44)	(67)	(74)
% change	-148.3%	NA	55.4%	52.6%	11.5%
Operating Pre-Tax Income	702	645	624	544	563
Operating Net Income to Comm S/Hold.	534	491	475	410	425
GAAP Net Income	534	491	475	410	425

## Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Total Assets	36,689	31,876	31,070	30,862	31,923
Average Interest Earning Assets	32,865	33,394	31,906	31,176	32,068
Total Gross Customer Loans	15,185	16,308	17,274	17,795	18,632
% change	-7.3%	7.4%	5.9%	3.0%	4.7%
Total Customer Deposits	NA	NA	NA	NA	NA
% change	NA	NA	NA	NA	NA
Tangible Equity	3,294	2,327	2,590	3,080	3,569
Common Shareholders' Equity	3,448	2,482	2,751	3,239	3,727

## Key Metrics (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Interest Margin	2.58%	2.85%	3.15%	3.15%	3.20%
Effective Tax Rate	22.6%	22.1%	22.6%	23.1%	23.0%
Loan / Deposit Ratio	NA	NA	NA	NA	NA
Tangible Common Equity / Assets	9.0%	7.3%	8.3%	10.0%	11.2%
ROA	1.6%	1.4%	1.5%	1.3%	1.4%
ROE	15.5%	17.8%	18.3%	13.7%	12.2%
RoTE	16.2%	17.3%	19.6%	14.5%	12.8%
Dividend Payout Ratio	22.8%	26.5%	28.5%	36.0%	36.1%
Efficiency Ratio (Cost / Income Ratio)	55.6%	55.6%	57.7%	61.0%	61.0%

## Quality of Earnings (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Total Non-Interest Inc / Operating Inc	40.9%	37.2%	36.2%	37.3%	37.2%
NPLs plus Foreclosed Real Estate / Loans	0.1%	0.1%	0.1%	0.1%	0.1%
Loan Loss Reserves / NPLs	1,638.57%	1,807.56%	1,766.14%	1,237.66%	1,213.43%
Loan Loss Reserves / Total Loans	0.99%	0.92%	0.96%	0.98%	0.98%

## Company Sector

Banks-US Regionals

## Company Description

Commerce Bancshares Inc is a bank holding company headquartered in Kansas City, MO with \$31bn+ in total assets. CBSH operates a network of approx 275 locations across several US states, including MO, KS, IL, OK, and CO. The bank operates three main segments: Commercial, Consumer, and Wealth.

## Investment Rationale

We view CBSH as a high quality operator with a differentiated business model (fees contribute 40% of total revenues). Meanwhile, with its minimal interest rate exposure, revenue diversity, and historically lower TTC losses, CBSH is well positioned to navigate risks. That said, we think the valuation is quite rich vs regional peers and we see better risk/reward elsewhere

## Stock Data

Average Daily Volume 480,972

## Quarterly Earnings Estimates

	2022	2023
Q1	0.93A	0.95A
Q2	0.94A	1.03A
Q3	0.97A	0.96A
Q4	1.03A	0.92E

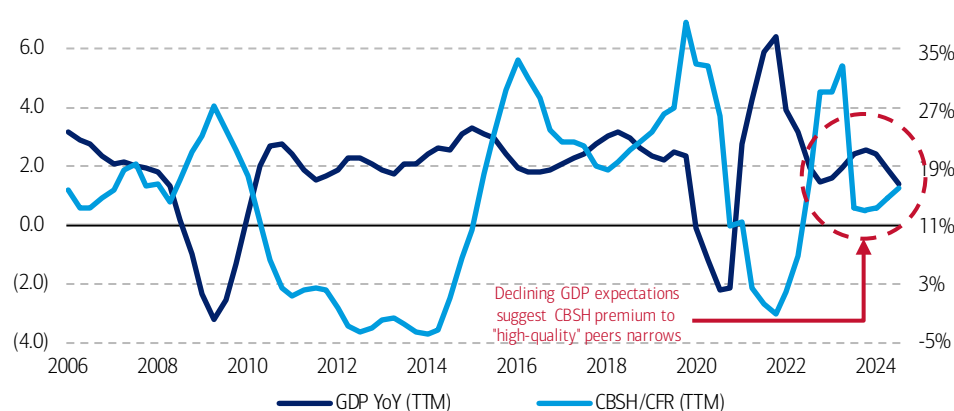
## Initiate at Neutral, PO implies 4% return

We are initiating coverage of Commerce Bancshares Inc (CBSH) with a Neutral rating and a \$55 price objective (+4% total potential return).

Investors are likely entering 2024 focused on interest rate and credit risks. We believe with its minimal interest rate risk, revenue diversity, and historically lower through-the-cycle (TTC) losses, CBSH is well positioned to navigate both. That said, because valuation appears extended, in our opinion, we see better risk/reward elsewhere. We found CBSH's valuation premium to high-quality peers, such as Buy-rated Cullen/Frost Bankers (CFR), narrows during periods of slowing economic growth. (We note premium vs. broader group maintained but relationship less evident). BofA economists forecast US real GDP growth to slow to 0.6% by 4Q24 (vs. 2.7% at 4Q23). This suggests CBSH's premium to CFR would be cut in half, all else equal.

### Exhibit 1: CBSH's premium narrows vs. high-quality peers when GDP growth slows

US real GDP growth vs. CBSH/CFR relative valuation



Source: Bloomberg

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## Declining revenue trends but manageable

We believe CBSH's declining revenue trends are manageable, despite facing several revenue headwinds in addition to lower interest rates. Near-term, lower Treasury Inflation-Protected Securities (TIPS) income will negatively impact net interest income (NII). In 2H24, revenue will be negatively impacted by proposed changes to interchange fee rule (which resets transaction fees lower) as well as underwater swaps. In total, we estimate these headwinds represent ~1% of revenue.

### Fee income: Organic protection against interest rate risk

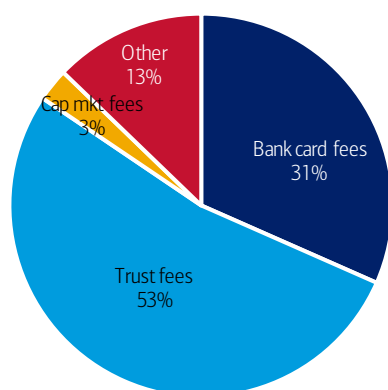
On the other hand, improving sentiment surrounding US economic growth could act as a tailwind for continued fee income growth. Unique among mid-cap banks, CBSH generates ~40% of its revenue from fee income sources – more than 2x peer average. This, we believe, should provide some downside support for total revenue when Fed cuts rates in 2024.

CBSH's two largest contributors to fee income are (1) bank card transaction fees and (2) trust fees (fees generated for trust and asset management services to both private client and institutional trust customers). Together, these contribute more than two-thirds to fee income.



**Exhibit 2: Nearly 85% of core fee growth generated by transaction fees and trust fees**

Contributors of core fee growth (2023 vs. 2017)



Source: company filings

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**Bank card transaction fees (12% of revenue) at risk from upcoming regulation**

For 2024, we forecast bank card fee growth of 4%, below the typical +5-7% growth target. Gross revenue has grown at 3% CAGR over the last five years, driven by volume and penetration. This has been partially offset by increasing network charges and rewards. That said, the bank's expansion markets, coupled with its developing product set, represent an opportunity for growth. Unfortunately, the proposed change to the interchange fee cap could impede revenue growth.

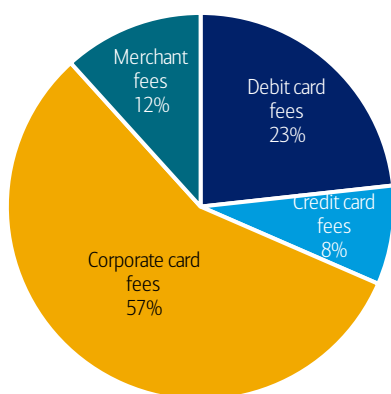
We found a 75%+ inverse correlation between bank card transaction fees and CEO confidence – albeit on a lag

Bank card transaction fees, in which CSH earns fees (including interchange income) for processing the cardholder's purchase transaction or fees for merchant processing services, is comprised of: card fees (88%) and merchant fees (12%). As of 3Q23, bank card transaction fees were up ~25% vs. pandemic-era lows. Recent growth in corporate card fees has been driven by:

- 40% of volume tied to large hospital systems (part of Commerce Healthcare)
- As rates increased, revenue share back to clients decreased (contractual)
- Renegotiated partnership with Visa (frequency ~5 years)

**Exhibit 3: Corp. card fees comprise majority of transaction fees**

Composition of bank card transaction fees (2022)

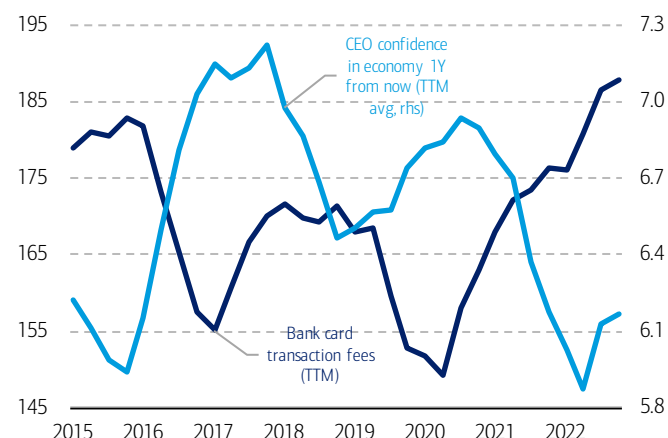


Source: company filings

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**Exhibit 4: CEO sentiment reasonable proxy for transaction fee growth**

Bank card transaction fees vs. CEO Confidence Index; correlation: 76%



Source: company filings, Bloomberg

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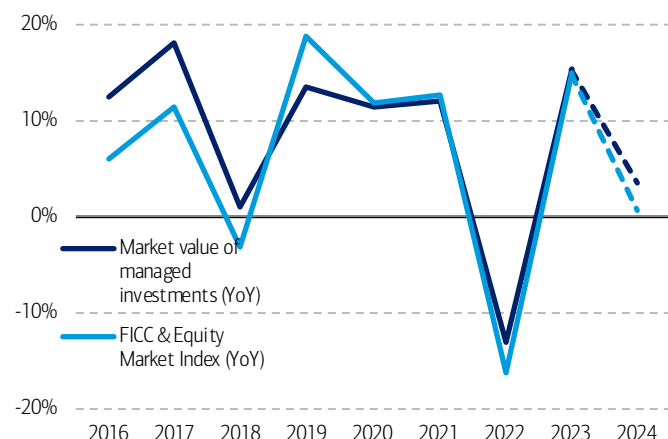
In Oct., the Fed proposed a rule change that would lower the interchange fee a debit card issuer may receive or charge on an electronic debit transaction. If adopted (likely in 4Q24), CBSH estimates the cap would reduce annual debit fees by 25%. Currently, interchange fees for certain electronic debit transactions are capped at 21c plus 5bp of the transaction value for issuers with over \$10bn in total assets. With the proposed change, the base component would fall to 14.4c per transaction (from 21c), while the ad valorem element would be multiplied by 4bp (instead of 5bp.)

**Improving economic sentiment tailwind for Trust fees (12% of revenue)**

Trust fees should benefit from an improvement in the US economic outlook, corresponding with expected market appreciation. (BofA strategists expect YE24 S&P 500 at 5000, implying 5% YoY increase). Fees at CBSH have increased 6% per annum since 2017. Over the same period, customer trust assets have increased 4% per year. Given the 90%+ correlation between trust fees and market values (evenly split between equity and fixed income markets), we expect trust fee increase 8% YoY in 2024.

**Exhibit 5: Value of managed investments to increase 3.5% in '24**

Correlation with FICC and Equity market indices: 90%+



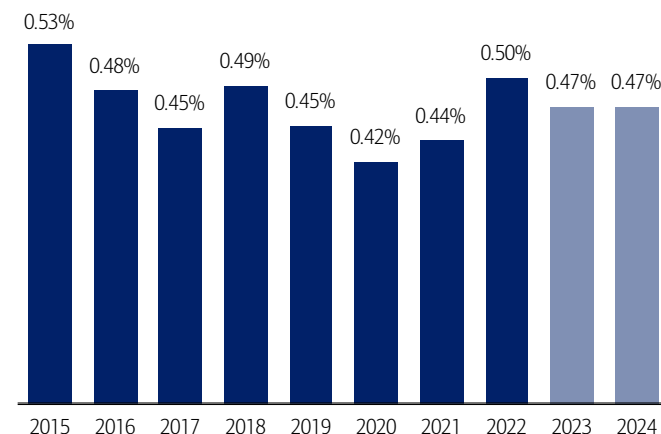
Source: company filings, Bloomberg

Note: Equity market represented by S&amp;P 500; FICC market represented by Barclays Agg Bond Index

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**Exhibit 6: We assume trust fee rate consistent with historic average**

Trust fees as % of managed investments



Source: company filings

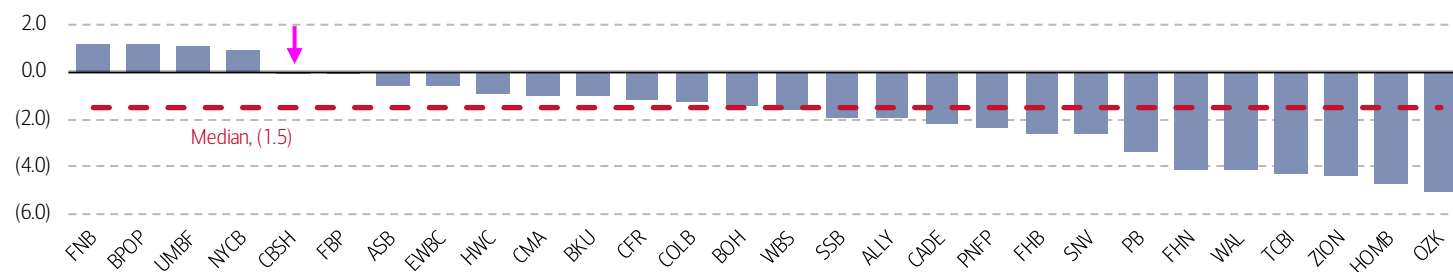
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**Limited downside from lower rates > modest NII headwinds**

We expect CBSH's NIM to remain relatively stable YoY in 2024. This despite lower TIPS income and dilutive hedges (beginning 2H24). Although CBSH has seen a slightly more volatile NIM vs. similar-sized peers historically, we believe its balance sheet as of 3Q23 should limit NIM volatility in the face of rate cuts. This is supported by management's own rate sensitivity disclosure, in which NII remains stable over NTM even if rates were cut by 100bp. (Note: our base case assumes rates remain higher for longer).

**Exhibit 7: CBSH balance sheet neutrally positioned for changes in interest rates**

Interest rate sensitivity disclosure for 100bp rate cut scenario



Source: company filings, S&amp;P Capital IQ

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Given the inconsistency in the underlying assumptions (including disclosure), we compared the composition of mid-cap bank balance sheets to identify the headwinds/tailwinds to lower rates. We found CBSH's balance sheet to be well balanced to navigate NIM headwinds/tailwinds in 2024. For example, expected annual securities cash flows (8% of average earning assets) should provide an offset to higher cash balances (6%) while short-term debt maturities offer an offset to less deposit beta leverage.



**Exhibit 8: CBSH's balance sheet construction suggests minimal NIM volatility in a down rate environment**

Net interest margin decomposition heatmap

(as % of avg. earning assets)	ASB	BOH	BPOP	CBSH	CFR	CMA	EWBC	FBP	FHB	FHN	FNB	NYCB	PB	SNV	TCBI	WAL	WBS	ZION
Cash \$	2%	2%	9%	6%	16%	9%	7%	5%	4%	4%	3%	6%	1%	1%	14%	5%	3%	4%
Annual securities \$ cash flows	5%	3%	6%	8%	2%	2%	2%	4%	3%	1%	2%		6%	2%	1%	3%	2%	4%
Duration (years)	6.1	3.9	2.2	3.9	5.7	5.6	5.1	3.6	5.5	5.3	4.4	7.1	4.5	5.4	4.4	5.5	4.5	3.5
Yield on securities (3Q23)	3.03%	2.46%	2.33%	2.33%	3.24%	2.10%	3.11%	1.59%	2.14%	3.01%	2.61%	4.30%	2.05%	2.29%	2.33%	4.91%	3.39%	2.73%
Fixed rate \$ loans	39%	38%	26%	23%	17%	33%	17%	42%	35%	27%	31%	37%	25%	29%	4%	33%	30%	15%
Consensus loan growth forecast	3%	3%	7%	4%	2%	2%	5%	6%	3%	2%	5%	2%	2%	2%	9%	6%	4%	1%
Loan beta (CTD)	60%	22%	19%	46%	57%	59%	56%	26%	37%	52%	44%	46%	25%	48%	68%	55%	53%	40%
Loan/deposit ratio	94%	67%	54%	68%	45%	80%	92%	73%	67%	92%	93%	102%	78%	87%	86%	91%	83%	75%
Noninterest bearing deposits \$	17%	25%	22%	25%	32%	37%	25%	28%	36%	23%	27%	23%	29%	23%	32%	28%	17%	33%
Brokered \$ CDs + index-linked deposits	9%	10%	1%	4%	0%	6%	3%	2%	11%	5%	2%	8%	0%	11%	5%	10%	12%	10%
CD \$ maturity schedule	1%	3%	4%	1%	1%	0%	0%	5%	6%	0%	2%	16%		3%	4%	13%	6%	0%
Short term \$ borrowings	8%	1%	0%	9%	0%	6%	7%	0%	2%	3%	5%	0%	12%	0%	5%	12%	3%	5%
Long term debt to mature in 2024	0%	0%	0%	0%	0%	1%	0%	0%	0%	2%	0%	1%	0%	5%	0%	1%	0%	0%

Source: BofA Global Research, company filings, S&amp;P Capital IQ

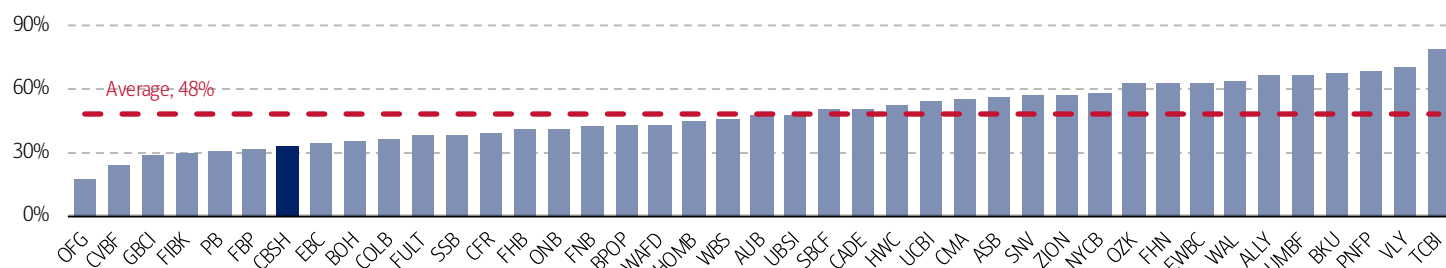
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Higher cash levels will drive more immediate NIM compression relative to peers when the Fed cuts rates, all else equal. However, expected securities cash flows (\$2.4bn over NTM with a roll-off yield of low-2%) could help minimize the earnings impact (depending on how low rates are reduced). After all, securities yield of 2.33% at 3Q23 were ~70bp lower than average. We'd be remiss not to mention that with 65% of securities portfolio (munis + MBS) having an average duration of 5+ years, reinvestment opportunity will likely be limited.

Meanwhile, increases in deposit costs have lagged that of the broader industry. Reason being, management focuses more on building fuller relationships with clients (generates more fee income vs. peers) rather than acquiring or maintaining customers with attractive (i.e., high) deposit rate offers. All else equal, this will limit CBSH's opportunity to offset NIM headwinds relative to peers. That said, CBSH had ~\$900mn of FHLB advances and brokered CDs mature at YE2023.

**Exhibit 9: CBSH has exhibited a below average deposit beta... could limit downside NIM support relative to peers**

Deposit beta CTD by bank



Source: company filings, S&amp;P Capital IQ

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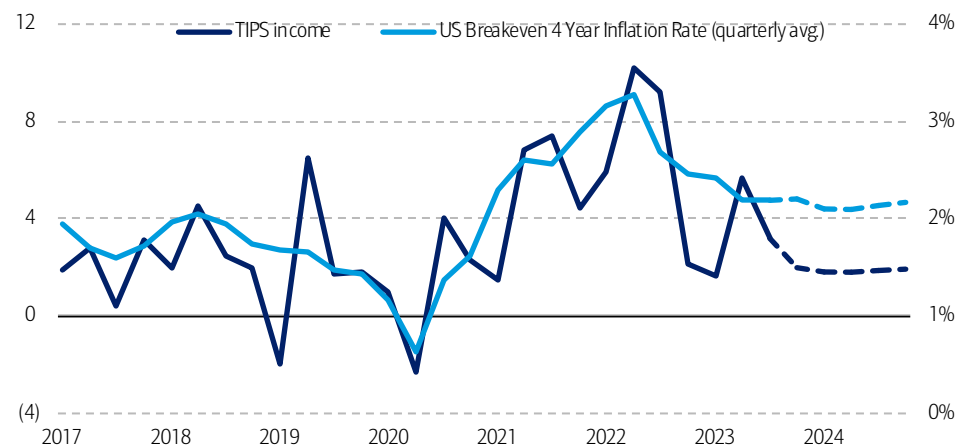
**TIPS income down YoY (with lower CPI) but <1% of revenue**

We expect TIPS income to decline 41% YoY to \$7.4mn in 2024 (+2bp to NIM). This compares to +8bp/4bp in 2022/23. The forward curve implies US breakeven 4Y inflation rate contracts ~12bp YoY, on average, in 2024 to 2.13%.



**Exhibit 10: Current rate forecasts implies a 41% decline in TIPS income in 2024**

US Breakeven 4Y Inflation Rate vs. TIPS income



Source: company filings, Bloomberg

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**Delayed-starting hedges will be underwater until Fed cuts rates by 2%+**

Assuming no change in rates, hedges will become dilutive in 2H24. As of 3Q23, CBSH had \$2bn notional swaps (four \$500mn floor contracts) on the balance sheet. We estimate the Fed funds rate would need to be cut by 2.125% before the entire swaps portfolio breaks even.

**Exhibit 11: CBSH's hedges will be NIM headwind if Fed doesn't cut rates**

Commercial loan hedges

	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25	Notes
Fed funds forecast	4.75%	5.00%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%	
Notional	500	500	500	500	500	500	500	500	500	500	500	500	Matures on Jul 1, 2030
Pay	4.80%	5.14%	5.32%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	
Receive	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	
<b>Total</b>							(2)	(2)	(2)	(2)	(2)	(2)	
Increment							0	0	0	0	0	0	
Notional	500	500	500	500	500	500	500	500	500	500	500	500	Matures on Nov 1, 2030
Pay	4.80%	5.14%	5.32%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	
Receive	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	
<b>Total</b>							(2)	(3)	(3)	(3)	(3)	(3)	
Increment							(1)	0	0	0	0	0	
Notional	500	500	500	500	500	500	500	500	500	500	500	500	Matures on Mar 1, 2031
Pay	4.80%	5.14%	5.32%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	
Receive	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	
<b>Total</b>							(1)	(3)	(3)	(3)	(3)	(3)	
Increment							(2)	0	0	0	0	0	
Notional	500	500	500	500	500	500	500	500	500	500	500	500	Matures on Jul 1, 2031
Pay	4.80%	5.14%	5.32%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	5.35%	
Receive	2.75%	2.75%	2.75%	2.75%	2.75%	2.75%	2.75%	2.75%	2.75%	2.75%	2.75%	2.75%	
<b>Total</b>										(3)	(3)	(3)	
Increment										0	0	0	

Source: BofA Global Research, company filings

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**Reserves: Fail eye test but should prove sufficient**

We could see shares of CBSH come under indiscriminate pressure should investors believe the bank's reserve ratio is inadequate. We don't believe the latter to be the case, but CBSH's reserve ratio on an absolute and relative (vs. consensus' 2024/25 NCO



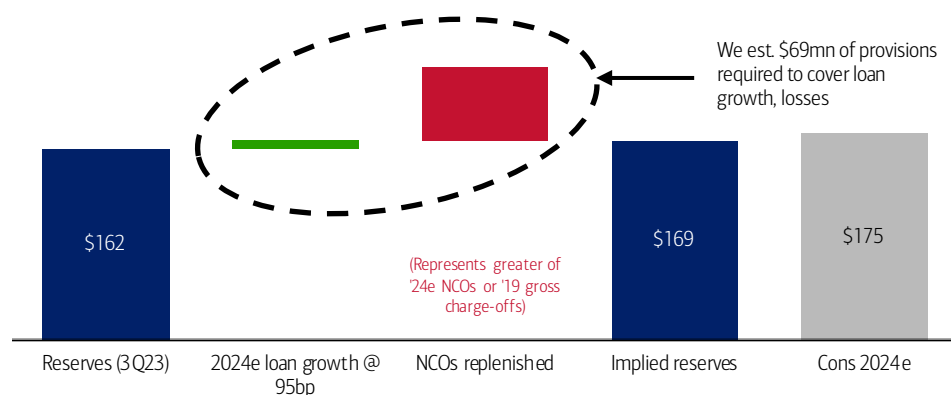


forecasts) basis are both in the bottom quintile among mid-cap banks.

Our sensitivity analysis suggests CBSH's reserves appear sufficient – albeit the bank has limited/no credit leverage relative to peers. Meanwhile, necessary reserve build is captured in consensus' 2024 forecasts. Assuming a 75%/25% blend of Moody's unemployment forecasts within its base case and stagflation scenarios, we forecast NCOs of \$58mn or 33bp (vs. normalized TTC 30-40bp range). This implies provisions of \$66.5mn in 2024.

#### Exhibit 12: Consensus est. captures potential reserve build needs

Reserve walk (\$mn)



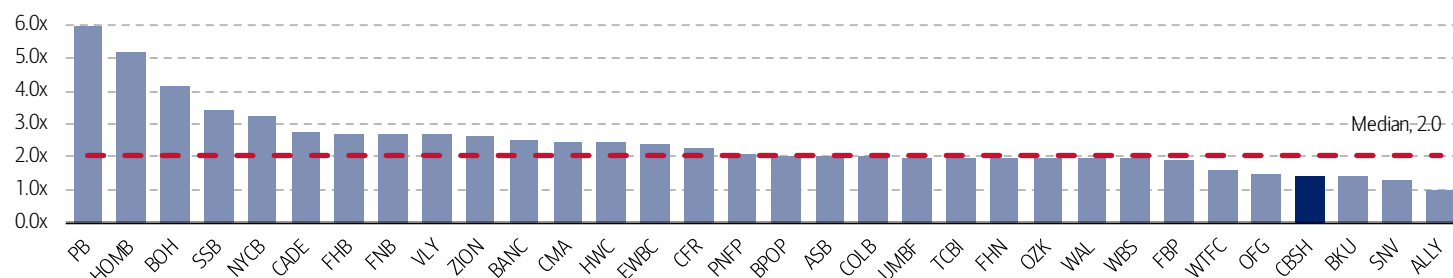
Source: BofA Global Research estimates, company filings, Visible Alpha

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As of 3Q23, CBSH reported an allowance of \$162mn, or 0.95% of loans. (This compares to a mid-cap peer median of 1.2%). Embedded within the reserve, management assumes the unemployment rate increases to 5% during the supportable forecast period of one year. (Economists forecast the unemployment rate to increase to 4.2% in 2024). Relative to consensus' loan loss expectations for the next two years (2024/25e: 0.67%), CBSH's allowance represents 1.4x coverage ratio.

#### Exhibit 13: CBSH's reserves represent 1.4x two years' worth of loan loss estimates

Reserves vs. consensus 2024/25 NCO forecasts



Source: company filings, S&P Capital IQ

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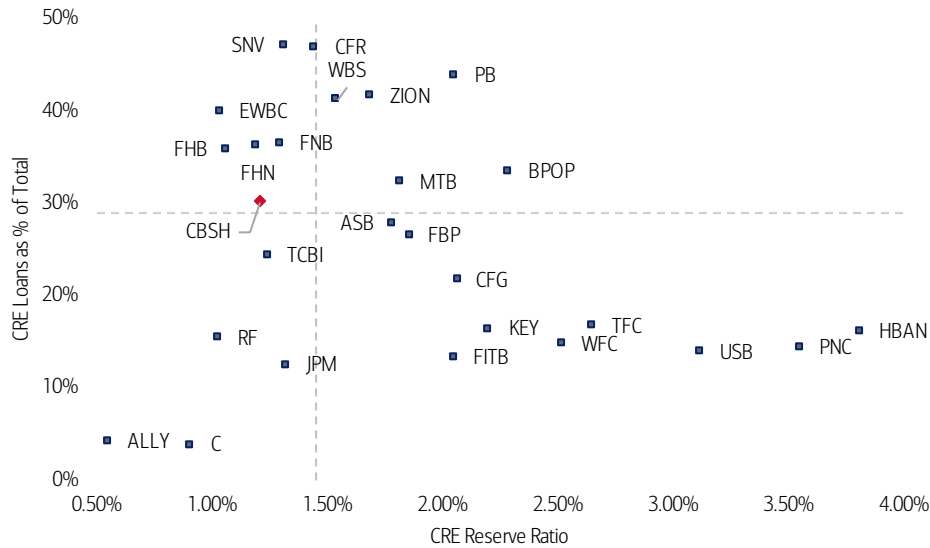
#### CRE reserves may receive undue attention

CRE credit concerns likely remain primary area of focus entering 2024. Although CBSH's exposure to the asset class (30% of loans) is in line with that of banks under coverage, including office-CRE (3%), We note allocated reserves (1.2% of CRE loans) may also appear insufficient relative to peers.



**Exhibit 14: CBSH CRE reserves appear insufficient relative to exposure**

CRE exposure vs. allocated reserves



Source: company filings, S&amp;P Capital IQ

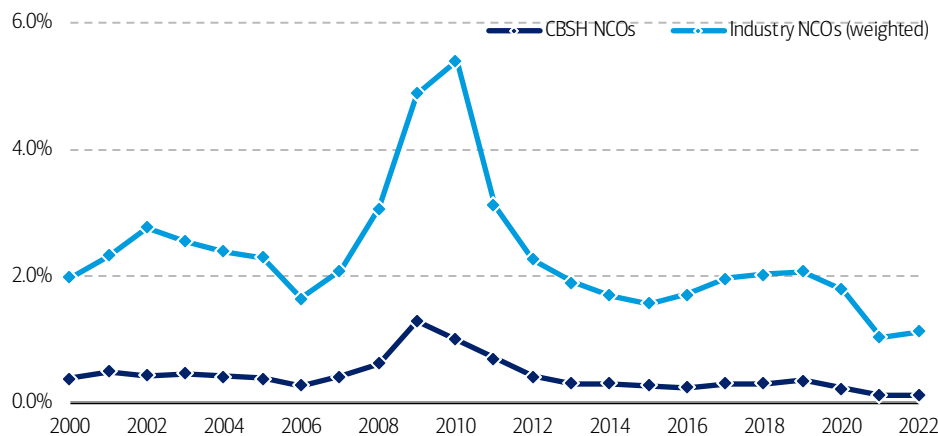
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**Loan losses considerably lower than that of industry**

CBSH has typically experienced lower loan losses vs. the industry. Since 2000, the bank has reported average annual NCOs of 34bp (ex. recessions) vs. a composition-like weighted industry average of ~200bp. We attribute lower loan losses to: 1) minimal exposure to low-FICO borrowers (659 or lower) and 2) actions to reduce risk from the balance sheet (consumer & card loans declined 2% since 2018). Meanwhile, management has identified \$219mn in potential problem loans (1.3% of loans). These are loans for which management has repayment concerns about. The debt is generally secured by either real estate or other borrower assets, reducing the potential for loss should they become non-performing.

**Exhibit 15: CBSH's NCOs 200bp+ lower than composition-like industry average**

Net charge-offs as % of avg. loans



Source: company filings, S&amp;P Capital IQ

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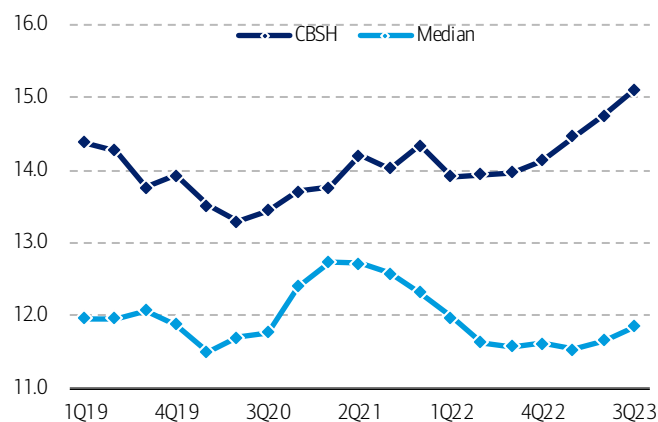


## Maintaining above-average capital levels

CBSH has typically held higher levels of capital vs. mid-cap bank peers, even as others looked to optimize the balance sheet to improve returns. The latter has not been an issue for CBSH, which has generated 150bp of higher returns than peers since 2015. As of 3Q23, CBSH reported a CET1 ratio of 15.1% vs. 11.9% mid-cap peer median. Despite the bank's excess capital position on a regulatory capital basis, management has slowed the pace of buybacks primarily due to its "middle of the pack" TCE ratio – which has been negatively impacted by ~\$1.2bn AOCI. (Note: Adjusting CET1 for AOCI, we est. CBSH's CET1 ratio would be 10.1% vs. 9.6% peer median. The TCE ratio is expected to increase over the next 12-18mo, driven by the combination of a shrinking balance sheet and lower rates (AOCI accretes back to capital at \$300mn per year). This should allow management to buyback stock at a more normal pace over time. (At 3Q23, 2.2mn shares remained available for purchase under the current authorization).

**Exhibit 16: CBSH has 300bp more CET1 capital than peers...**

CET1 ratio timeseries

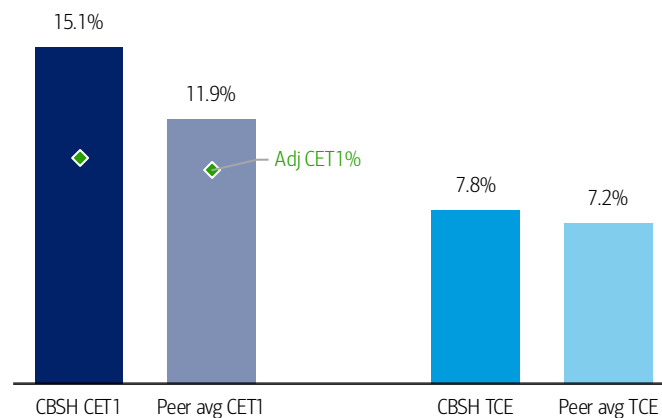


Source: company filings, S&P Capital IQ

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**Exhibit 17: ... but TCE ratio = binding constraint**

Capital ratio comparison



Source: company filings, S&P Capital IQ

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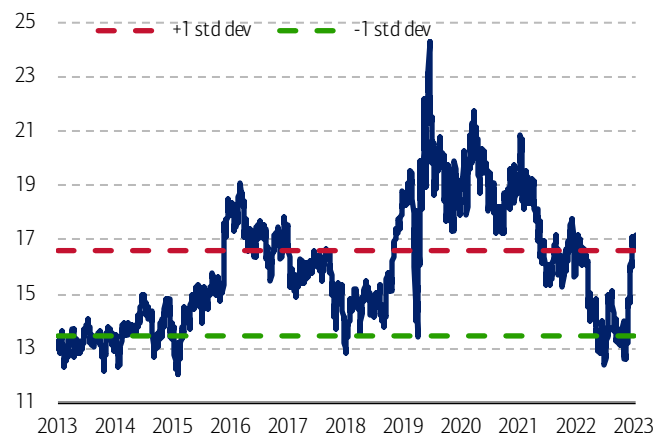
## Valuation

Shares of CBSH are trading at 17x 2024E EPS, 11% above its pre-pandemic average and has broken out above the high-end of its typical trading range (defined as +/-1 standard deviation). This represents a 50%+ premium to peers. (Note: CBSH historically traded at a 10% premium). We believe this premium valuation reflects: 1) above-average return profile; 2) lower TTC loan losses; 3) revenue diversity; and 4) higher capital levels.



**Exhibit 18: CBSH broke above high-end of trading range**

1-year forward P/E (x)



Source: Bloomberg

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**Exhibit 19: Shares trading at 50% premium to peers**

CBSH 1Y fwd P./E vs. KRX



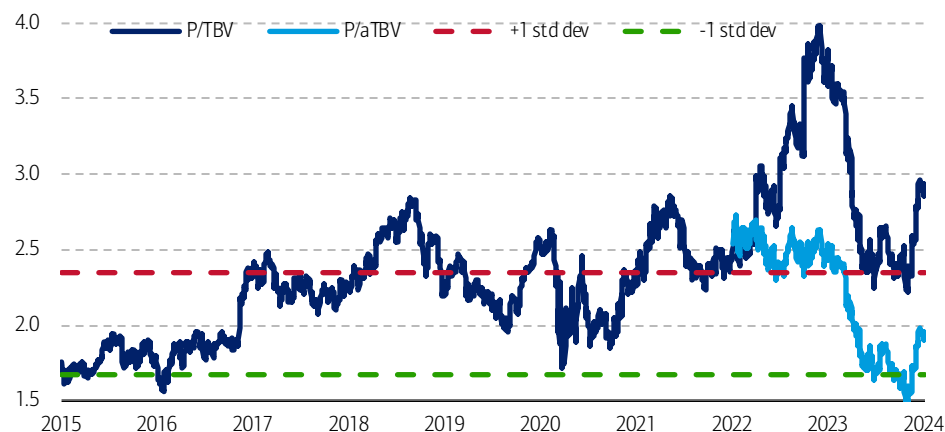
Source: Bloomberg

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CBSH is trading at 2.9x TBV and has broken out above its historical trading range (defined as  $\pm 1$  standard deviation vs. historical average). However, adjusting TBV for AOCI, shares are trading at 1.9x TBV – in line with its historical average. On an adjusted basis, CBSH is trading at a ~42% premium to mid-cap banks (vs. +24% historically).

**Exhibit 20: CBSH trading in line with historical average (on adj. P/TBV basis)**

Price to tangible book value (x)



Source: Bloomberg

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**Price objective**

We value CBSH's shares using a 50/50 blend of forward price-to-earnings (P/E) and price-to-tangible book value (P/TBV) multiples. We arrive at our \$55 price objective based on the following:

Given expectations for CBSH to generate 14.5% (15.3% under stress), we ascribe a 15x multiple on our 2025E EPS. This implies a fair value of \$49.50. The multiple is in-line with its 5-year pre-pandemic history. We believe 2025E more appropriately captures the full effect of revenue headwinds (vs. 2024E), while also recognizing CBSH is positioned well to navigate interest rate and credit risks.

During times of uncertainty, principally driven by the trajectory of credit costs – and therefore earnings – investors will utilize a price-to-tangible book valuation (P/TBV)

methodology. We ascribe a 2.5x P/TBV multiple on our 2024E ROTCE. This implies a fair value of \$60. The discount to history (2.7x) reflects the near-term revenue headwinds.

Upside risk: stronger than expected balance sheet growth; quicker return to profitability; and greater NIM expansion relative to peers. Downside risk: higher than expected expense growth; accelerated credit migration; and greater impact on fee income from regulatory changes.



## Price objective basis & risk

### Commerce Bancshares Inc. (CBSH)

Our \$55 PO is based on a 50%/50% weighting between our 2025e EPS and 2024e tangible book value (TBV). We assigned 15x/2.5x multiples, respectively, to correspond with its near 15% ROTCE profile. We believe our 2025e better captures the full impact of revenue headwinds (vs. 2024e). Our P/TBV multiple is below its pre-pandemic average (2.7x) due to near-term EPS headwinds.

Upside risk: stronger than expected balance sheet growth, quicker return to profitability, and greater NIM expansion relative to peers. Downside risk: higher than expected expense growth, accelerated credit migration, and greater impact on fee income from regulatory changes.

## Analyst Certification

I, Brandon Berman, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
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	Ares Commercial Real Estate Corporation	ACRE	ACRE US	Derek Hewett
	Bank of Montreal	BMO	BMO US	Ebrahim H. Poonawala
	Bank of Montreal	YBMO	BMO CN	Ebrahim H. Poonawala
	Barings BDC Inc	BBDC	BBDC US	Derek Hewett
	Blackstone Mortgage Trust Inc	BXMT	BXMT US	Derek Hewett
	Blue Owl Capital Corporation	OBDC	OBDC US	Derek Hewett
	Carlyle Secured Lending Inc	CGBD	CGBD US	Derek Hewett
	Citigroup Inc.	C	C US	Ebrahim H. Poonawala
	Compass Diversified Holdings	CODI	CODI US	Derek Hewett
	Crescent Capital BDC	CCAP	CCAP US	Derek Hewett
	Cullen/Frost Bankers Inc	CFR	CFR US	Ebrahim H. Poonawala
	East West Bancorp, Incorporated	EWBC	EWBC US	Ebrahim H. Poonawala
	Fifth Third Bank	FITB	FITB US	Ebrahim H. Poonawala
	First Bancorp Puerto Rico	FBP	FBP US	Brandon Berman
	First Horizon Corporation	FHN	FHN US	Ebrahim H. Poonawala
	FNB Corporation of Pennsylvania	FNB	FNB US	Brandon Berman
	Goldman Sachs	GS	GS US	Ebrahim H. Poonawala
	JPMorgan Chase & Co.	JPM	JPM US	Ebrahim H. Poonawala
	KeyCorp	KEY	KEY US	Ebrahim H. Poonawala
	M&T Bank	MTB	MTB US	Ebrahim H. Poonawala
	Morgan Stanley	MS	MS US	Ebrahim H. Poonawala
	New Mountain Finance Corporation	NMFC	NMFC US	Derek Hewett
	New York Community Bancorp	NYCB	NYCB US	Ebrahim H. Poonawala
	Northern Trust Corporation	NTRS	NTRS US	Ebrahim H. Poonawala
	Royal Bank of Canada	RY	RY US	Ebrahim H. Poonawala
	Royal Bank of Canada	YRY	RY CN	Ebrahim H. Poonawala
	Safehold, Inc	SAFE	SAFE US	Derek Hewett
	Sixth Street Specialty Lending, Inc	TSIX	TSIX US	Derek Hewett
	Starwood Property Trust	STWD	STWD US	Derek Hewett
	Synovus Financial Corp.	SNV	SNV US	Ebrahim H. Poonawala
	The Bank of New York Mellon Corporation	BK	BK US	Ebrahim H. Poonawala
	Truist Financial	TFC	TFC US	Ebrahim H. Poonawala
	U.S. Bancorp	USB	USB US	Ebrahim H. Poonawala
	Webster Financial Corp.	WBS	WBS US	Brandon Berman
	Wells Fargo & Company	WFC	WFC US	Ebrahim H. Poonawala
	Western Alliance Bancorp	WAL	WAL US	Ebrahim H. Poonawala

## North America - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>NEUTRAL</b>				
	AGNC Investment Corp	AGNC	AGNC US	Derek Hewett
	Ally Financial	ALLY	ALLY US	Brandon Berman
	Annaly Capital Management	NLY	NLY US	Derek Hewett
	Apollo Commercial Real Estate Finance	ARI	ARI US	Derek Hewett
	Associated Banc-Corp	ASB	ASB US	Brandon Berman
	Bain Capital Specialty Finance, Inc.	BCSF	BCSF US	Derek Hewett
	Bank of Nova Scotia	YBNS	BNS CN	Ebrahim H. Poonawala
	Bank of Nova Scotia	BNS	BNS US	Ebrahim H. Poonawala
	Blackstone Secured Lending Fund	BXSL	BXSL US	Derek Hewett
	BrightSpire Capital Inc.	BRSP	BRSP US	Derek Hewett
	Canadian Imperial Bank of Commerce	CM	CM US	Ebrahim H. Poonawala
	Canadian Imperial Bank of Commerce	YCM	CM CN	Ebrahim H. Poonawala
	Citizens Financial Group	CFG	CFG US	Ebrahim H. Poonawala
	Comerica Incorporated	CMA	CMA US	Brandon Berman
	Commerce Bancshares Inc.	CBSH	CBSH US	Brandon Berman
	Goldman Sachs BDC, Inc.	GSBD	GSBD US	Derek Hewett
	Golub Capital BDC, Inc.	GBDC	GBDC US	Derek Hewett
	Huntington Bancshares Inc.	HBAN	HBAN US	Ebrahim H. Poonawala
	Ladder Capital Corp	LADR	LADR US	Derek Hewett
	PennyMac Mortgage Investment Trust	PMT	PMT US	Derek Hewett
	Popular Inc	BPOP	BPOP US	Brandon Berman
	Regions Financial	RF	RF US	Ebrahim H. Poonawala
	The PNC Financial Services Group, Inc.	PNC	PNC US	Ebrahim H. Poonawala
	Toronto-Dominion Bank	TD	TD US	Ebrahim H. Poonawala
	Toronto-Dominion Bank	YTD	TD CN	Ebrahim H. Poonawala
	TPG RE Finance Trust, Inc.	TRTX	TRTX US	Derek Hewett
<b>UNDERPERFORM</b>				
	Bank of Hawaii Corp.	BOH	BOH US	Brandon Berman
	First Hawaiian Inc.	FHB	FHB US	Brandon Berman
	Guild Holdings Company	GHLD	GHLD US	Derek Hewett
	Invesco Mortgage Capital, Inc.	IVR	IVR US	Derek Hewett
	loanDepot Inc	LDI	LDI US	Derek Hewett
	MidCap Financial Investment Co	MFIC	MFIC US	Derek Hewett
	Prosperity Bancshares Inc	PB	PB US	Ebrahim H. Poonawala
	State Street Corporation	STT	STT US	Ebrahim H. Poonawala
	Texas Capital Bancshares Inc.	TCBI	TCBI US	Brandon Berman
	Zions Bancorp	ZION	ZION US	Brandon Berman

## **iQmethod<sup>SM</sup> Measures Definitions**

### **Business Performance**

Return On Capital Employed

Return On Equity  
Operating Margin  
Earnings Growth  
Free Cash Flow

### **Quality of Earnings**

Cash Realization Ratio  
Asset Replacement Ratio  
Tax Rate  
Net Debt-To-Equity Ratio  
Interest Cover

### **Valuation Toolkit**

Price / Earnings Ratio  
Price / Book Value  
Dividend Yield  
Free Cash Flow Yield  
Enterprise Value / Sales

EV / EBITDA

### **Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income  
Operating Profit  
Expected 5 Year CAGR From Latest Actual  
Cash Flow From Operations – Total Capex

### **Numerator**

Cash Flow From Operations  
Capex  
Tax Charge  
Net Debt = Total Debt – Cash & Equivalents  
EBIT

### **Numerator**

Current Share Price  
Current Share Price  
Annualised Declared Cash Dividend  
Cash Flow From Operations – Total Capex  
EV = Current Share Price × Current Shares + Minority Equity + Net Debt +  
Other LT Liabilities  
Enterprise Value

### **Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill  
Amortization  
Shareholders' Equity  
Sales  
N/A  
N/A

### **Denominator**

Net Income  
Depreciation  
Pre-Tax Income  
Total Equity  
Interest Expense

### **Denominator**

Diluted Earnings Per Share (Basis As Specified)  
Shareholders' Equity / Current Basic Shares  
Current Share Price  
Market Cap = Current Share Price × Current Basic Shares  
Sales

Basic EBIT + Depreciation + Amortization

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Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	100	49.75%	Buy	84	84.00%
Hold	54	26.87%	Hold	41	75.93%
Sell	47	23.38%	Sell	35	74.47%

### Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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