Commerce Bank of Arizona Update (CBOA)

Ticker: CBOF- OTCMKTS

Rating: **Out Perform**

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Current and Target Price

Current Price (December 29, 2020)	$2.50
Target Price	$3.50
52-Week Range	$1.76 - $2.85

Market Data

Shares Out. (mil)	8,208,000
Market Cap. (mil)	$21,340,800
Average Daily Vol. (10 day)	4000
Dividend/Yield	$0.00/0.0%
Tang. Book Value	$2.87

Company Description:

CBOA is 1 of 17 banks that are headquartered in Arizona and the only locally owned and operated bank in Tucson. CBOA provides a full range of financial services, including credit and deposit products, cash management, and internet banking, to businesses, non-profits, entrepreneurs,

Earlier in December of this year, we sat down with Chris Webster, President and CEO of the Commerce Bank of Arizona (CBOA). We wanted to get an update on the progress with regards to how they were performing as of calendar year end 2020 came to a close.

Below are the key takeaways from our meeting:

- CBOA has experienced year over year success due to strong management, increased loan activity and great relationships with existing clients. **CBOA (Bank)** has instilled a culture that clients have gravitated towards, which does not force the bank to compete on prices. While many competitors have had to continue to drop loan prices to stay competitive, CBOA has maintained its fees at a similar rate. During the months of the pandemic, CBOA offered 325 PPP loans. Of those 325 PPP loans, 80 new relationships were created. They believe these new relationships can be retained, thus leading to an increase in the banks bottom line.
- Loan demand has been strong and the pricing is under pressure due to the low interest rates. Other banks compete aggressively for these loans, however CBOA sees a number of potential loan quotes **"they lost"** come back, as the other lender changed the terms at closing. I was brought up that your word is your bond. **This is one of the reasons RMH likes CBOA.**
- They do not compete on price; they compete on utilizing their experience, loans that require thinking and understanding their customer's needs.
- CBOA has a robust underwriting process, which is the culmination of many years in the business, resulting in a strong customer base. Frequent contact with the borrower is a plus and in turn leads to fewer loan surprises. **The borrowers know the banks management and staff, as opposed to call centers and decisions being made out of town, out of state.**

- The Bank has saved almost $500,000 in expenses this year, mainly from changing the location of the two branches in Tucson. This will be offset by reduced net interest income, a result of the almost zero interest rate levels.
- A year ago loan rates were in the 5% range, now in the 4% range due to the current zero interest rate policy (ZIRP), as being conducted by the U.S, Federal Reserve. This results in lower interest income for the Bank.
- They hired two senior loan officers for the Phoenix/Scottsdale market as the demand for loans is there. In addition they are looking to add a loan officer for the Tucson area.

This past summer RMH Investment Management made two presentations to the CBOA board with regard to taking certain steps to increase their share price, as we felt investors were not valuing the company properly. The stated book value was $2.83, and the stock was trading in the $2.00 range.

The first request was that insiders show their support and acknowledgment of an underappreciated stock price by the buying of shares in the open market. **This is important to RMH, as we fully believe insiders only buy for one reason, to make money and they did.**

The second request, lead to the following press release:

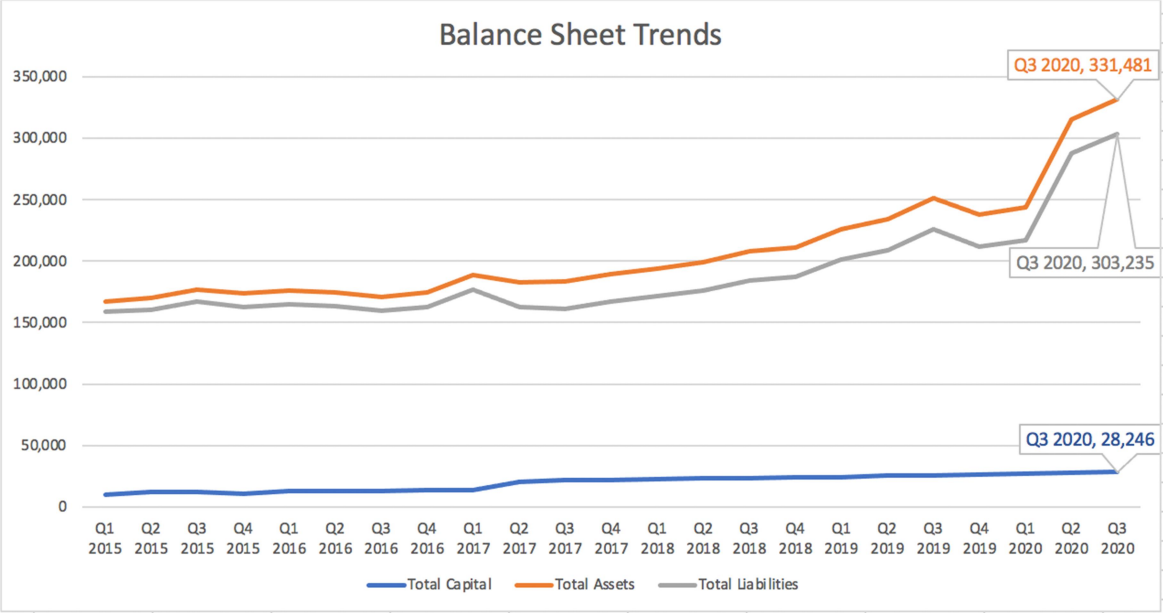
> *TUCSON, Ariz., Dec. 1, 2020 /PRNewswire/ -- CBOA Financial, Inc. (OTCMKTS:CBOF) (the "Company"), parent company of Commerce Bank of Arizona (the "Bank" or "CBAZ"), today announced that its Board of Directors (the "Board") approved a stock repurchase program under which the Company may repurchase up to $250,000 in value of its outstanding shares through open market purchases, privately-negotiated transactions, or otherwise in compliance with Rule 10b-18 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These shares will be purchased from time to time over a six-month period depending upon market conditions.*
>
> *Chris Webster, President and CEO of the Company, indicated that the Board of Directors approved the repurchase program in view of the current price level of the Company's common stock and the strong capital position of the Company's subsidiary, Commerce Bank of Arizona. Mr. Webster stated: "We believe that the repurchase of our shares represents an attractive investment opportunity that will benefit the Company and our stockholders."*

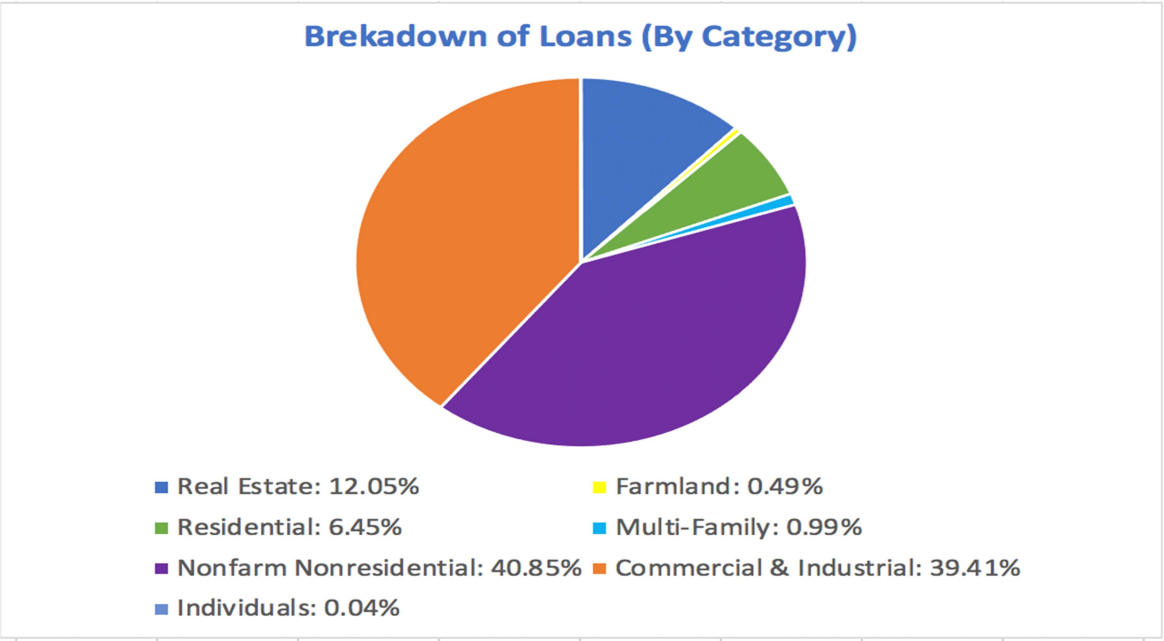
As I started writing this report I looked at the share count outstanding as of the date of our last report dated June 26, 2020, and saw the share count as 7,876,190 shares outstanding. When we got our download of the financial ratios from CBOA, I noticed there were 8,208,000 shares outstanding. Good to see. Looks like the warrants from the 2015 capital raise are being exercised slowly.

I would recommend to the management at CBOA to see if the exercise of the 2015 and 2017 warrants could be accelerated, as this is a tremendous source of funding for the bank, enabling loan growth. Currently we are in a very low interest rate environment, for the foreseeable future as well. In addition competing for "hot deposits" is time consuming, and puts one at the mercy of comparison shoppers, **not long term owners**, as shareholders are known to be.

In conclusion raise more long term capital even if it comes at the expense of forcing the bank to be overcapitalized. At this juncture in time, having too much capital is way more important than not having enough, as one might not be able to get it as needed!

From the charts below the Bank continues its growth for 2020 with good loan diversification.





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What would a research report at this time be without a paragraph or two on Covid and how it is affecting their business? At this time there has been no increase in bad loans as a result of the virus. In the initial stages of Covid, 40 borrowers asked for deferrals on their loans for 90 days, and when they were granted, only 10 firms took the offer up. The loan portfolio has a very small exposure to restaurants, and some are doing quite well as they adapted to the restrictions we have all noticed. With the stimulus being deployed rapidly in the spring and summer, this allowed the bank to be proactive in being over-reserved for loan losses **that have NOT materialized yet.** The situation with respect to Covid and lockdowns could be a different story, depending on how long it lasts.

Main Street Loan Program

From the Federal Reserve website the following:

The Federal Reserve established the Main Street Lending Program (Program) to support lending to small and medium-sized for profit businesses and nonprofit organizations that were in sound financial condition before the onset of the COVID-19 pandemic.

Structure. *To implement the Program, the Federal Reserve Bank of Boston has set up a special purpose vehicle (SPV) to purchase participations in loans originated by eligible lenders. Lenders will retain a percentage of the loans. U.S. businesses and nonprofit organizations may be eligible for loans if they meet the criteria set out in the term sheets.* ***Loans issued under the Program would have a five year maturity, deferral of principal payments for two years, and deferral of interest payments for one year.*** *Eligible lenders may originate new loans (under MSNLF, MSPLF and NONLF) or increase the size of (or "upsize") existing loans (under MSELF and NOELF) made to eligible borrowers.*

In summary well established companies are being given the tools to survive. CBOA splits the risk of the loans with 5% exposure to them, and the Federal Reserve keeps the other 95%. This in turn keeps the loans off the income and balance sheets.

How is Tucson doing?

At the I-10 Interchange of Ajo and Kino (Campbell) a regional hub for development is taking place. Our quiet quaint family trip to Costco will become busy in the years to come. Just South of the Bridges parcel is where the Costco is. **Please look at the aerial photo below.**

The following is a commentary courtesy of Pima County as I had asked a few questions with regard to all of the development we are seeing. and the resulting job and wage multipliers.

1. The steel that just went up is the Boyer project for the UA Tech Park inside The Bridges (shaded yellow and green).
    a. The Boyer company is developing the first building within the UA controlled portion of The Bridges and will be called **The Refinery at The Bridges** and will be 4 stories tall and have approximately 120,000 square feet of class A office space. The UA has leased 50% of the space and the remaining space is being actively marketed by CBRE. The project is scheduled to be complete in Q3 of

2021. Boyer is working closely with the UA tech park team on the development. The overall project budget is around $31 million. The Tucson office of Core Construction is the general contractor and Tucson based Swaim Associates architects is the architectural firm.

2. Bourne has plans for the property north of GEICO but no construction started. They are finalizing agreements with a business style hotel out of Kansas City. Bourne paid to widen 36th street and pave the west half of Martin Luther King Drive
3. There is an Extended Stay hotel under construction next to the Movie Theater and that work is very close to starting to go vertical
4. Additional retail pads are being constructed for small retail and fast food.
5. KB Homes is still planning to build homes on the Park/36th St. corner.
6. The new JTED headquarters is complete and occupied in the SW Corner of The Bridges on the west side of Park. Additional pads are being developed but no specific tenants yet.
7. TEP has completed the new substation at the SE corner of 36th and Kino on land purchased from Pima County as well as the major feeder line from the Irvington Generating Station along Park then East on 36th Street to the Kino Substation.

The Bridges/Kino Redevelopment

Other areas in Pima County:

1. Several Distribution/ Fulfillment Centers are being planned along Alvernon south of Valencia
2. Downtown – 75 E. Broadway if it passes - $100 Million + 19 story mixed use building plus connection to historic buildings on Congress and creation of "the Alley – an outdoor experience" between the new and old buildings. Partnership between Pima County, Rio Nuevo, with City of Tucson incentives.
3. Port of Tucson just completed a 200,000+ sf rail served building and is beginning construction on another building of similar size.

How are Phoenix / Scottsdale doing?

Phoenix / Scottsdale is the economic engine of the state, accounting for almost two-thirds of Arizona residents and nearly three fourths of the state labor economy. The bank is recognizing this as they just hired 2 senior loan officers for the Scottsdale branch. The chart below shows the depth and breadth of the major metropolitan area.

RMH continues to view CBOA as an attractive investment, and the Bank continues to deliver on net profit margins and customer growth through conservative practices. In addition, Scottsdale, Tucson, and the surrounding areas are still displaying strong signs of growth. These various factors have enabled CBOA to grow lending and push earnings higher. In these uncertain times, we conclude that CBOA's stock is currently undervalued. If you have any questions or thoughts, please feel free to reach out to RMH.

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

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