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West Town Bancorp, Inc. (WTWB - OTC Pink)

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Price:	\$27.65	EPS *	2016A:	\$ 1.24	P/E	2016A:	22.3 x
52 Wk. Range:	\$23.30 - \$27.90	(FY: DEC)	2017A:	\$ 1.54		2017A:	18.0 x
Div/Div Yld:	\$0.00 / 0.0%		2018E:	\$ 2.00		2018E:	13.8x
Shrs/Mkt Cap:	3.0mm / \$82 mm	Book Value: **		\$ 22.21	Price/Book Value:		1.24 x

* EPS in 2017 includes a nonrecurring tax benefit of \$0.22 per diluted share. ** Tangible book value is \$19.07 per share; price/tangible book value is 1.45x.

Background

With \$544 million in assets, West Town Bancorp, Inc. is the Raleigh, NC based multi-bank holding company for West Town Bank & Trust, a North Riverside, IL based state-chartered bank and Sound Bank, a Morehead City, NC based state-chartered bank. West Town Bank & Trust provides banking services through its offices in Illinois and North Carolina, while Sound Bank provides banking services through its offices in North Carolina. Primary deposit products are checking, savings, and time certificate accounts, and primary lending products are residential mortgage, commercial, and installment loans. Additionally, both banks engage in mortgage banking activities and, as such, originate and sell one-to-four family residential mortgage loans in multiple states. The Company is registered with, and supervised by, the Federal Reserve. West Town Bank & Trust's primary regulators are the Illinois Department of Financial and Professional Regulation and the FDIC. Sound Bank's primary regulators are the North Carolina Commissioner of Banks and the FDIC.

Overall Fourth Quarter Results Were Good But Reflected Deliberate Slowdown in Loan Sales

West Town Bancorp reported what we considered to be a nice quarter, although there were a number of nonrecurring/unusual factors that made the results a little difficult to interpret without some digging. The fourth quarter of 2017 was the first full quarter that included the Sound Banking Company, so all of the balance sheet and income statement comparisons were affected by Sound's inclusion in this year's figures. Additionally, earnings in the fourth quarter and full year of 2017 were affected by a large nonrecurring adjustment to its net deferred tax liability (\$605,000, or \$0.22 per share). While this adjustment, which resulted from the recently enacted Tax Cuts and Jobs Act of 2017, negatively impacted fourth quarter earnings for most of the banks we follow (due to there being an adjustment to the net deferred tax *asset*), in West Town's case, it was an adjustment to West Town's deferred tax liability, resulting in an earnings benefit. But more importantly, this new tax legislation will result in a significant drop (from 35% to 21%) in the Company's effective federal tax rate, benefitting long-term earnings. Given that West Town's effective tax rate has historically been high (it was 44% in 2016 and 43% through the first nine months of 2017), the drop in statutory rates should have a meaningful impact on future reported earnings. The other major nonrecurring item we would mention was a year-ago charge of \$1.4 million on the settlement of some litigation in which the Company was engaged.

In terms of the specific results, net income in the fourth quarter of 2017 was \$552,000, or \$0.20 per diluted share, versus a net loss of \$537,000, or \$0.38 per diluted share, in the year-ago quarter. Excluding the nonrecurring tax adjustment, the Company would have posted a small loss (about \$53,000, or \$0.02 per diluted share). While that might initially look disappointing, we would note that the provision for loan losses was much higher than normal in 2017's fourth quarter, principally as a result of the rapid loan growth. If we add back the provision and nonrecurring items, we see that pretax income

	2016	2017
Quarterly Results (\$000s)	Q4	Q4
Pretax Income	(818)	(246)
Adjustments:		
Provision (Add)	570	1,129
Litigation reserve (Add)	1,400	(57)
Transaction-related costs (Add)	176	60
Pretax Inc. Bef. Nonrec/Credit Charges	1,328	886

ASSETS: \$544 MM

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4TH QUARTER HIGHLIGHTS:

EARNINGS INCLUDING
NONRECURRING ITEMS

ONE OF THOSE
NONRECURRING ITEMS WAS A
TAX ADJUSTMENT RELATING
TO THE NEW TAX ACT

THIS ACT WILL
SIGNIFICANTLY LOWER THE
COMPANY'S FUTURE TAX
RATE

REPORTED EPS (LOSS): \$0.20
VS. (\$0.38)

ALTHOUGH PRETAX
EARNINGS BEFORE
NONRECURRING ITEMS WERE
LOWER, MUCH OF THAT WAS
DUE TO A HIGHER PROVISION
AND THE DECISION TO DEFER
SALES OF GOVERNMENT
GUARANTEED LOANS

before these items was \$886,000 in 2017's fourth quarter, which was still below the year-ago figure of \$1,328,000, but pretty respectable given the holdback on government loan sales in 2017's fourth quarter.

One of the more encouraging aspects of the quarter was that, even with a significant reduction in noninterest income (in 2017's fourth quarter, it was less than 38% of the previous year's level), the Company was still profitable on a pre-provision basis. We attribute that mainly to the strong net interest income. Net interest income more than doubled to \$5,234,000 in 2017's fourth quarter from \$2,654,000 in 2016's fourth quarter. While some of that came from the addition of the Sound operation, it was also from organic growth. One of the more impressive aspects about West Town Bancorp is its ability to generate loan volume. In fact, if we consider key differentiators between successful banks and those that are less so, the ability to generate good quality loans is one of the top factors. Some of that increase in net interest income was offset by a much higher provision for loan losses, which grew to \$1,129,000 in 2017's fourth quarter from \$570,000 in the year-ago quarter.

Noninterest income, largely as a result of the decision to slow down government loan sales, was lower at \$1,546,000 in the fourth quarter of 2017, versus \$4,093,000 in the year-ago quarter. Finally, total noninterest expense (excluding nonrecurring items) was \$5,837,000 in 2017's fourth quarter, versus \$5,419,000 in the year ago, with that increase due to the addition of Sound Banking Company.

For the full year of 2017, net income was \$2,892,000, or \$1.54 per diluted share, versus \$1,800,000, or \$1.24 per diluted share, in 2016. Net interest income increased 46%, noninterest income was down 30% and noninterest expense declined 10% from 2016. Balance sheet growth was excellent, due both to the decision to hold more loans and to the Sound Banking Company acquisition. From December 31, 2016 to December 31, 2017, net loans held for investment increased 124% to \$375 million from \$168 million, while deposits were up 81% to \$393 million from \$217 million, and assets grew 94% to \$544 million from \$280 million. The tangible common equity-to-tangible assets ratio was 10.5% as of December 31, 2017, versus 10.0% at the year-ago date.

Linked Quarter Asset Quality Improved

At December 31, 2017, nonperforming assets (including nonaccruing loans, accruing loans more than 90 days past due and OREO) were \$7.3 million, or 1.35% of assets, versus \$8.2 million, or 1.68% of assets, at September 30, 2017 and \$4.3 million, or 1.54% of total assets, at December 31, 2016. The adjacent table shows the incremental NPAs picked up from Sound. The allowance for loan losses totaled \$3.4 million, or 0.91% of loans held for investment, at December 31, 2017, as compared to \$2.3 million, or 1.36% of loans held for investment, at the year-ago date. (The Sound Banking Company loans were marked to market, so the effective allowance for them was zero, making the allowance look lower than normal.)

Projections

We are tentatively projecting earnings for 2018 at \$6.0 million, or \$2.00 per diluted share. These projections are subject to wide variation given the large amount of income coming from the Bank's specialty lines of business.

ADDITIONAL INFORMATION UPON REQUEST

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NET INTEREST INCOME MORE THAN DOUBLED AND ACCOUNTED FOR 77% OF REVENUES

THE PROVISION MORE THAN DOUBLED

NONINTEREST INCOME DECLINED, ALTHOUGH THAT WAS PARTLY BASED ON THE DECISION TO SLOW DOWN GOVERNMENT LOAN SALES

FULL YEAR HIGHLIGHTS:

EPS: \$1.54 vs. \$1.24

BALANCE SHEET GROWTH WAS EXCELLENT

ASSET QUALITY IMPROVED FROM 2017'S THIRD QUARTER

NPAs/ASSETS: 1.35%

RESERVES/LOANS HFI: 0.91%

**EPS:
2016A: \$1.24
2017A: \$1.54
2018E: \$2.00**

