



Community Bank System (CBU)

Updated November 23rd, 2020 by Josh Arnold

Key Metrics

Current Price:	\$65	5 Year CAGR Estimate:	-5.9%	Market Cap:	\$3.5 B
Fair Value Price:	\$40	5 Year Growth Estimate:	-1.0%	Ex-Dividend Date:	12/11/2020
% Fair Value:	160%	5 Year Valuation Multiple Estimate:	-9.0%	Dividend Payment Date:	01/11/2021
Dividend Yield:	2.6%	5 Year Price Target	\$38	Years Of Dividend Growth:	28
Dividend Risk Score:	B	Retirement Suitability Score:	B	Last Dividend Increase:	2.4%

Overview & Current Events

Community Bank System was formed in 1983 and since that time, it has expanded to become a diversified financial services company with more than 200 locations in the northeastern US. Its principal business is community banking, but it also owns a large benefits administration business, in addition to offering a variety of insurance products. Its market capitalization is \$3.5 billion, and it produces about \$600 million in annual revenue.

Community Bank System reported third quarter earnings on October 26th, and results for both the top and bottom lines came in better than expected. Total revenue was \$153 million, up 5.3% from the second quarter of 2020; noninterest revenue remains very high for a bank at 39% of the total.

Credit quality looked strong with annualized net charge-offs at just 0.07% of total loans. This is an unusually low charge-off number for a bank in 2020 as credit quality has hit different banks in different ways from COVID-19 impacts.

Net income came to \$43 million, or \$0.79 per fully-diluted share in Q3. This is up from \$39 million and \$0.75 per share, respectively, in the year-ago period. In addition, results were much stronger than Q2 of 2020, rising from \$35 million in net income, and \$0.66 in earnings-per-share.

Gains were made by a significant decrease in acquisition expenses, as well as increases to net interest income and noninterest revenues, which were partially offset by an increase in provisions for credit losses, operating expenses, and litigation reserves. We've boosted our estimate of earnings-per-share for this year to \$3.10 following Q3 results.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$1.89	\$2.01	\$1.93	\$3.38	\$2.22	\$2.19	\$2.32	\$2.55	\$3.23	\$3.28	\$3.10	\$2.95
DPS	\$0.94	\$1.00	\$1.06	\$1.10	\$1.16	\$1.22	\$1.26	\$1.34	\$1.44	\$1.58	\$1.68	\$1.95
Shares¹	33	36	40	41	41	41	44	49	51	52	54	60

Earnings-per-share have been fairly volatile in the past decade but in recent years, growth has been steadier. We see that continuing as the bank is focused on profitable growth, but we forecast -1% earnings-per-share growth annually. We are becoming more cautious given interest rate headwinds present for the entire banking industry, which Community Bank System is suffering from as well. With few levers to pull to boost earnings growth, we think the bank will have a difficult time in the coming years from a high base of earnings. This has already played out to an extent as this year's earnings will be below 2018.

Community Bank System continues to see earnings tailwinds from very low deposit funding costs and organic revenue growth, as well as a constant flow of acquisitions. Growth-by-acquisition is generally tough in the financial services industry, but Community Bank System has proven adept at executing this strategy over time, and this should be the primary growth driver going forward. Community Bank System is performing well, but its lending margins are already best-in-class, so we think the very flat yield curve will see it struggle to continue to boost those margins. However, credit quality remains outstanding. Even so, headwinds are strong and out of the bank's control to a large extent.

¹ Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Dividend growth has been moderate, but management appears to be willing to pay out nearly half of earnings on the dividend. We've reduced our dividend growth target as we see a tougher road for earnings growth ahead.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	12.3	12.4	14.3	9.6	16.5	17.0	18.9	17.8	18.3	19.5	20.8	13.0
Avg. Yld.	4.0%	4.0%	3.8%	3.4%	3.2%	3.3%	2.9%	2.5%	2.4%	2.5%	2.6%	5.1%

Community Bank System's price-to-earnings multiple has moved around significantly in the past decade as its fortunes have improved and deteriorated. However, recent years have seen investors pay much more for the stock, a situation that has left it trading in excess of our estimate of fair value. We are forecasting a massive annual headwind to total returns in the coming years from a valuation reset. Given the outlook for near-term growth, we see the valuation as a key risk to shareholders as shares are as expensive today as they have been at any point in the past decade.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	48%	47%	53%	32%	51%	54%	53%	53%	45%	48%	54%	66%

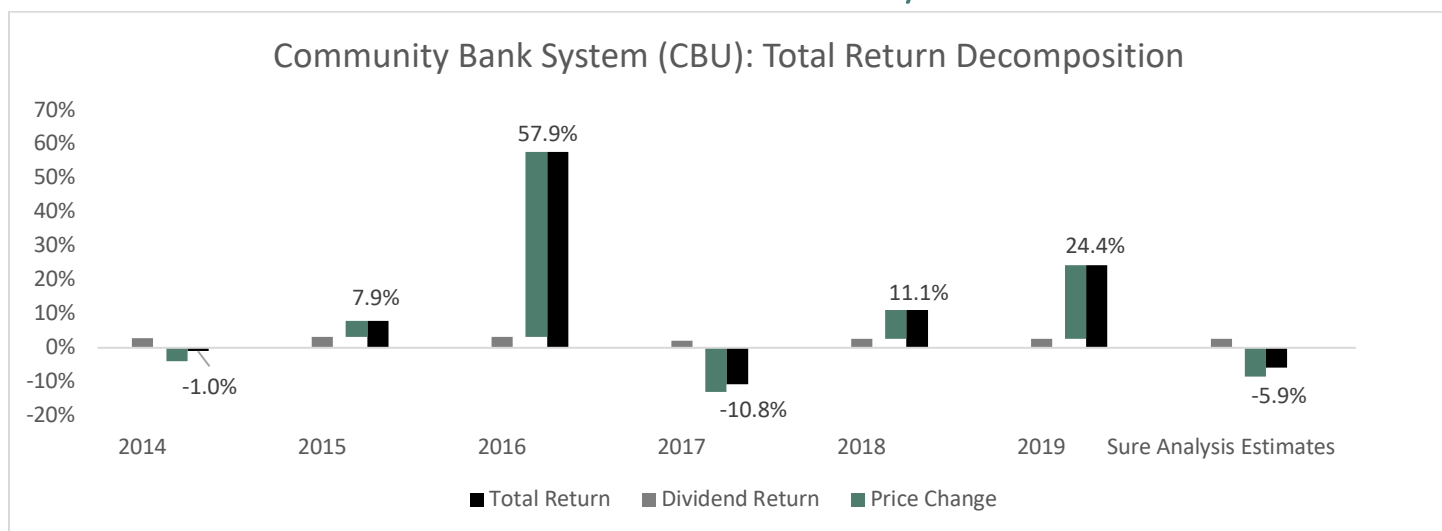
We see the payout ratio rising, but remaining under 70%. The bank's impressive dividend streak appears to be safe at this point and we see many more years of increases coming, even if a recession strikes.

Community Bank System's competitive advantage is in its dominant market position in many of its service areas. It competes in areas that have sparse levels of competition and thus the company is able to hold strong market share in those locations, with many at or above a third of total market deposits. That does not make it immune to recessions, but its strong performance means it can be an acquirer during downturns, softening the blow of economic weakness.

Final Thoughts & Recommendation

Overall, Community Bank System can continue to grow, but the stock is trading well in excess of our estimate of fair value. We see total annual returns of -5.9%, the product of the 2.6% current yield, -1% earnings growth and a large headwind from the valuation. We are reiterating Community Bank System at a sell rating principally due to the excessively high valuation. The stock hasn't been as expensive as it is today in the past decade.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	270	299	330	428	363	372	430	518	569	590
SG&A Exp.	129	138	151	166	170	174	198	234	256	273
D&A Exp.	17	17	17	17	18	17	20	33	34	32
Net Profit	63	73	77	79	91	91	104	151	169	169
Net Margin	23.4%	24.5%	23.4%	18.4%	25.1%	24.5%	24.2%	29.1%	29.6%	28.7%
Free Cash Flow	81	85	98	89	109	107	123	179	209	197
Income Tax	23	30	32	32	38	41	51	9	44	40

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	5445	6488	7497	7096	7489	8553	8666	10746	10607	11410
Cash & Equivalents	212	325	229	150	138	153	174	221	212	205
Accounts Receivable	26	29	32	25	25	26	31	36	31	32
Goodwill & Int. Ass.	312	361	387	390	387	484	481	825	807	837
Total Liabilities	4837	5714	6594	6220	6502	7412	7468	9111	8894	9555
Accounts Payable		88	136	80	126	135	144	181	157	215
Long-Term Debt	830	830	830	244	440	403	248	149	154	103
Shareholder's Equity	607	775	903	876	988	1141	1198	1635	1714	1855
D/E Ratio	1.37	1.07	0.92	0.28	0.45	0.35	0.21	0.09	0.09	0.06

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	1.2%	1.2%	1.1%	1.1%	1.3%	1.1%	1.2%	1.6%	1.6%	1.5%
Return on Equity	10.8%	10.6%	9.2%	8.9%	9.8%	8.6%	8.9%	10.6%	10.1%	9.5%
ROIC	4.4%	4.8%	4.6%	5.5%	7.2%	6.1%	6.9%	9.3%	9.2%	8.8%
Shares Out.	33	36	40	41	41	41	44	49	51	52
Revenue/Share	8.13	8.26	8.31	10.56	8.86	8.98	9.66	10.47	11.00	11.29
FCF/Share	2.45	2.34	2.46	2.21	2.65	2.59	2.77	3.62	4.03	3.77

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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