Community Bank System (CBU)

Updated January 28th, 2021 by Josh Arnold

Key Metrics

Current Price:	$66	**5 Year CAGR Estimate:**	-7.1%	**Market Cap:**	$3.6 B
Fair Value Price:	$39	**5 Year Growth Estimate:**	-1.0%	**Ex-Dividend Date:**	03/11/2021[1]
% Fair Value:	169%	**5 Year Valuation Multiple Estimate:**	-10.0%	**Dividend Payment Date:**	04/11/2021[2]
Dividend Yield:	2.5%	**5 Year Price Target**	$37	**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 $3.6 billion, and it produces about $600 million in annual revenue.

Community Bank System reported fourth quarter and full-year earnings on January 25th, 2021 and results for both the top and bottom lines came in ahead of expectations. Total revenue came to $151 million in Q4, up fractionally year-over-year. The increase was driven by slightly higher net interest income, a 7% increase in employee benefit services revenue, a 7% increase in wealth management and insurance services revenue, and a partial offset from lower deposit service and other banking fee revenues.

Net income came to $47 million, or $0.86 per share. These were up from $43 million and $0.82 per share, respectively, in the same period a year ago. The increase in earnings was from higher net interest income, a decline in credit loss provisions, lower operating expenses, and higher noninterest revenues. Community Bank System did see a higher year-over-year share count in 2020, which offset some of the gains seen on a company-wide basis. For the year, the company saw earnings-per-share of $3.24 on an adjusted basis, which was down slightly against 2019.

Our initial estimate for this year is $3.00 in earnings-per-share as we see Community Bank System continuing to struggle to produce growth from a combination of weak banking metrics, such as net interest income, provisions for credit losses, and its new policy of holding mortgage loans rather than selling them. The company continues to be focused on growing its relatively small non-banking revenue streams, which aren't large enough to offset very low interest rates for the core banking business.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$2.01	$1.93	$3.38	$2.22	$2.19	$2.32	$2.55	$3.23	$3.28	$3.24	***$3.00***	***$2.85***
DPS	$1.00	$1.06	$1.10	$1.16	$1.22	$1.26	$1.34	$1.44	$1.58	$1.66	***$1.68***	***$1.77***
Shares[3]	36	40	41	41	41	44	49	51	52	54	***52***	***48***

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 still 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 almost certainly be the lowest they've been since 2017.

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[1] Estimated date

[2] Estimated date

[3] Share count in millions

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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 strong. Even so, headwinds are strong and out of the bank's control to a large extent.

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

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	12.4	14.3	9.6	16.5	17.0	18.9	17.8	18.3	19.5	18.5	***22.0***	***13.0***
Avg. Yld.	4.0%	3.8%	3.4%	3.2%	3.3%	2.9%	2.5%	2.4%	2.5%	2.8%	***2.5%***	***4.8%***

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, now sitting at 169% of our estimate of fair value.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	47%	53%	32%	51%	54%	53%	53%	45%	48%	51%	***56%***	***62%***

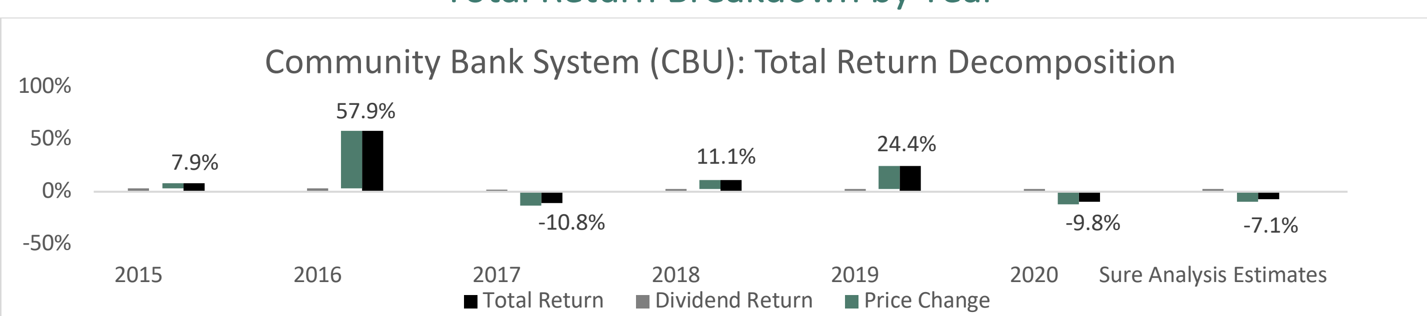
We see the payout ratio rising but remaining around 60%. The bank's impressive dividend streak appears to be safe at this point and we see many more years of increases coming, even if a recession strikes. Growth rates should be low.

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 -7.1%, and we are reiterating Community Bank System at a sell rating principally due to the excessively high valuation.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	299	330	428	363	372	430	518	569	590	596
SG&A Exp.	138	151	166	170	174	198	234	256	273	274
D&A Exp.	17	17	17	18	17	20	33	34	32	---
Net Profit	73	77	79	91	91	104	151	169	169	165
Net Margin	24.5%	23.4%	18.4%	25.1%	24.5%	24.2%	29.1%	29.6%	28.7%	27.6%
Free Cash Flow	85	98	89	109	107	123	179	209	197	---
Income Tax	30	32	32	38	41	51	9	44	40	41

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	6488	7497	7096	7489	8553	8666	10746	10607	11410	13931
Cash & Equivalents	325	229	150	138	153	174	221	212	205	1646
Accounts Receivable	29	32	25	25	26	31	36	31	32	---
Goodwill & Int. Ass.	361	387	390	387	484	481	825	807	837	847
Total Liabilities	5714	6594	6220	6502	7412	7468	9111	8894	9555	11827
Accounts Payable	88	136	80	126	135	144	181	157	215	231
Long-Term Debt	830	830	244	440	403	248	149	154	103	371
Shareholder's Equity	775	903	876	988	1141	1198	1635	1714	1855	2104
D/E Ratio	1.07	0.92	0.28	0.45	0.35	0.21	0.09	0.09	0.06	0.18

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	1.2%	1.1%	1.1%	1.3%	1.1%	1.2%	1.6%	1.6%	1.5%	1.3%
Return on Equity	10.6%	9.2%	8.9%	9.8%	8.6%	8.9%	10.6%	10.1%	9.5%	8.3%
ROIC	4.8%	4.6%	5.5%	7.2%	6.1%	6.9%	9.3%	9.2%	8.8%	7.4%
Shares Out.	36	40	41	41	41	44	49	51	52	54
Revenue/Share	8.26	8.31	10.56	8.86	8.98	9.66	10.47	11.00	11.29	11.15
FCF/Share	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.