First Farmers Financial Corporation (FFMR)

Updated February 26th, 2021 by Josh Arnold

Key Metrics

Current Price:	$43	**5 Year CAGR Estimate:**	8.8%	**Market Cap:**	$305 M
Fair Value Price:	$45	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	03/30/21[1]
% Fair Value:	96%	**5 Year Valuation Multiple Estimate:**	0.9%	**Dividend Payment Date:**	04/15/21[1]
Dividend Yield:	3.1%	**5 Year Price Target**	$57	**Years Of Dividend Growth:**	30
Dividend Risk Score:	A	**Retirement Suitability Score:**	A	**Last Dividend Increase:**	3.1%

Overview & Current Events

First Farmers Financial is a holding company for First Farmers Bank & Trust, which provides banking products and services to individuals, families, and commercial customers. It offers core checking and savings accounts, health savings accounts, business accounts, construction loans, auto loans, collateral loans, mortgages, and other services. The bank has 29 offices in Indiana and 6 offices in Illinois, so it is a very small community bank. First Farmers was founded in 1885 and trades with a market capitalization of $305 million. First Farmers also has a dividend streak of 30 years, meaning it qualifies to be a Dividend Champion.

First Farmers reported fourth quarter earnings on January 15th, 2021 and results showed the bank having completed another strong year. Earnings came to another record at $30.4 million, up 3.1% from the prior year. On a per-share basis, earnings rose 3.9% to $4.29.

Revenue was up $10.5 million to $95.6 million during the year, while loan and lease losses more than doubled from the prior year, to $10.4 million due to COVID-related losses. Noninterest expense rose $3.2 million to $48.8 million, while perpetually low yields kept a lid on net interest margin at 3.65% for 2020. That's still very high by any standard but was down from 4.00% in 2019.

Average earning assets were 11.6% higher for the year, but because of lower yields on those assets, net interest income was up just 1.4%. On the plus side, First Farmers was able to generate strong fee income growth from secondary market lending, driving a 62% increase in noninterest income. Noninterest expense was up 7%, due primarily to higher personnel costs. First Farmers finished 2020 with a loan-to-deposit ratio of 86%, which is high among competitors.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$1.50	$1.89	$2.22	$2.27	$2.35	$2.38	$3.03	$3.87	$4.13	$4.29	***$4.50***	***$5.74***
DPS	$0.33	$0.35	$0.40	$0.53	$0.59	$0.65	$0.69	$1.02	$1.22	$1.29	***$1.32***	***$1.85***
Shares	7.1	7.1	7.1	7.1	7.1	7.2	7.2	7.2	7.1	7.1	***7.1***	***7.1***

First Farmers has grown its earnings-per-share at a rate of 11% annually since 2011, which is very impressive to say the least. However, we do not expect that sort of performance to continue given the bank's current balance sheet and profitability metrics. Note that First Farmers executed a 2-for-1 stock split in 2018, which the above numbers reflect.

We estimate 5% annual earnings-per-share growth for the next five years, as we see First Farmers continuing to maintain its elevated loan-to-deposit ratio, but with little room for growth there. At nearly 90%, First Farmers doesn't have meaningful runway to boost the amount of lending it is doing without seeing strong growth in its deposit base, which has slowed in recent quarters. Given that, we see the amount of new lending that can be done as limited at this point, which should slow down revenue and profit growth.

In addition to that, First Farmers has made a significant amount of loans while interest rates have been at or near historical lows. Rates have risen sharply in recent weeks, and if that move sticks, First Farmers may be caught in a

[1] Estimated date

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situation where its deposit costs are rising while its loan yields are fixed. We note this hasn't happened yet, but it is a distinct possibility considering how First Farmers' balance sheet is constructed.

The bank announced another share repurchase program in December, but it is good for just $1 million. First Farmers has done this in the past in order to keep the share count flat; it has typically not bought back enough stock to move the share count lower, and we do not expect this to change anytime soon.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	---	---	---	14.3	14.9	17.5	15.5	10.9	11.3	10.2	***9.6***	***10.0***
Avg. Yld.	---	---	---	1.6%	1.7%	1.6%	1.5%	2.4%	2.6%	3.0%	***3.1%***	***3.2%***

First Farmers has traded with an elevated P/E ratio in past years, generally trading around the mid-teens or higher. However, we see First Farmers as facing a number of growth challenges, as detailed above, and given that sector valuations are still quite low, we assess fair value at 10 times earnings. The stock trades for 9.6 times earnings today, so it is slightly under our estimate of fair value, implying a small tailwind to total annual returns from the valuation.

We note that the low relative valuation and consistent dividend raises have sent the current dividend yield to an impressive 3.1%, much higher than in past years. We expect the dividend to keep pace with earnings growth and the share price, and therefore see the yield remaining around 3% for the foreseeable future.

Safety, Quality, Competitive Advantage, & Recession Resiliency

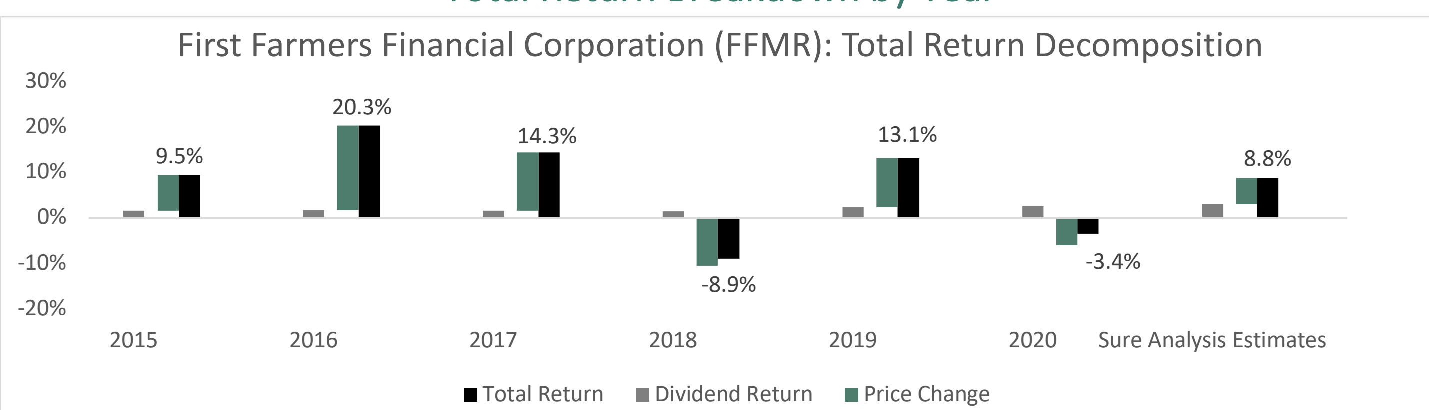
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	22%	19%	18%	23%	25%	27%	23%	26%	30%	30%	***29%***	***32%***

First Farmers, like any other community bank, struggles for competitive advantages given that banking is a highly commoditized business with similar offerings from most players. That said, its performance during periods of low interest rates has been impressive, having grown its earnings consistently through periods of extremely low rates. We're keeping an eye on the bank's long-term debt, which is in excess of $200 million, but we expect First Farmers to hold up relatively well during the next recession. The bank's payout ratio is also quite manageable at well under half of earnings, so we see the dividend as safe.

Final Thoughts & Recommendation

We see First Farmers as a fairly valued, income stock among community banks. We forecast 8.8% total annual shareholder returns in the next five years, and with a 3%+ yield, the security earns a hold rating.

Total Return Breakdown by Year



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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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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	---	---	---	---	56	63	68	74	81	85
SG&A Exp.	---	---	---	---	20	24	26	28	29	31
D&A Exp.	---	---	---	---	3	4	4	3	3	4
Net Profit	---	---	---	---	16	17	17	22	28	30
Net Margin	---	---	---	---	28.8%	26.5%	25.1%	29.4%	34.3%	34.7%
Free Cash Flow	---	---	---	---	18	16	22	27	36	30
Income Tax	---	---	---	---	6	6	6	5	5	5

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	---	---	---	---	1,340	1,480	1,616	1,677	1,749	1,916
Cash & Equivalents	---	---	---	---	80	53	111	88	52	60
Accounts Receivable	---	---	---	---	16	20	20	24	24	26
Goodwill & Int. Ass.	---	---	---	---	12	13	12	11	10	10
Total Liabilities	---	---	---	---	1,228	1,356	1,480	1,523	1,577	1,718
Accounts Payable	---	---	---	---	12	11	19	15	12	21
Long-Term Debt	---	---	---	---	114	120	140	173	158	173
Shareholder's Equity	---	---	---	---	112	125	136	154	172	198
D/E Ratio	---	---	---	---	1.02	0.96	1.03	1.13	0.92	0.87

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	---	---	---	---	---	1.2%	1.1%	1.3%	1.6%	1.6%
Return on Equity	---	---	---	---	---	14.2%	13.1%	15.0%	17.0%	16.0%
ROIC	---	---	---	---	---	7.1%	6.5%	7.2%	8.4%	8.4%
Shares Out.	7.1	7.1	7.1	7.1	7.1	7.2	7.2	7.2	7.1	7.1
Revenue/Share	---	---	---	---	7.89	8.86	9.47	10.30	11.29	11.90
FCF/Share	---	---	---	---	2.48	2.28	3.10	3.75	5.02	4.22

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