1st Source Corp. (SRCE)

Updated October 29th, 2021, by Josh Arnold

Key Metrics

Current Price:	$48	**5 Year CAGR Estimate:**	2.0%	**Market Cap:**	$1.2 B
Fair Value Price:	$60	**5 Year Growth Estimate:**	-5.0%	**Ex-Dividend Date:**	11/01/21
% Fair Value:	80%	**5 Year Valuation Multiple Estimate:**	4.6%	**Dividend Payment Date:**	11/12/21
Dividend Yield:	2.6%	**5 Year Price Target**	$46	**Years Of Dividend Growth:**	34
Dividend Risk Score:	A	**Retirement Suitability Score:**	A	**Last Dividend Increase:**	10.7%

Overview & Current Events

1st Source was founded in 1863 and since that time has grown into a regional bank with about $8 billion in total assets. The company is headquartered in Indiana and has about 100 locations to service its customers. 1st Source's market capitalization is $1.1 billion, and it is expected to produce in excess of $335 million in revenue this year. 1st Source also has an exceptional dividend increase streak that stands at 34 years, which very few banks can match.

1st Source reported third quarter earnings on October 21st, 2021, and results were much better than expected on both the top and bottom lines. Average loans and leases were $5.4 billion, up 1.5% net of Paycheck Protection Program loans from the year-ago period. Including PPP loans, average loans and leases were up 1.2%. Average deposits were $6.4 billion, up $512 million, or 9%, year-over-year. For the year-to-date period, deposits were up 10% to $6.2 billion.

Net interest income was $62 million, up 13.3% year-over-year, and up 9.3% from this year's second quarter. On a year-to-date basis, NII was up 7.8%. Net interest margin was 3.33%, up 14bps year-over-year. For the first nine months of the year, NIM was 3.27%, a decline of five basis points from the same period of 2020.

Noninterest income was $25.5 million, down -9% year-over-year. For the nine-month period, noninterest income was $76.3 million, down -2% year-over-year. Credit loss provisions were a recovery of $2.6 million in Q3, a decline of nearly $12 million year-over-year, and roughly equal to the second quarter of 2021.

Net income came to $32.5 million, up 7.5% from the second quarter and 62% higher year-over-year, as well as setting a record. On a per-share basis, earnings were $1.29, which was also a record. We're moving our estimate to $4.80 for earnings-per-share for this year after another terrific quarter.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$1.78	$1.84	$2.03	$2.17	$2.17	$2.22	$2.52	$3.16	$3.58	$3.27	***$4.80***	***$3.71***
DPS	$0.58	$0.60	$0.62	$0.65	$0.67	$0.72	$0.76	$0.96	$1.10	$1.13	***$1.24***	***$1.37***
Shares[1]	27	27	27	26	26	26	26	26	26	26	***25***	***23***

Earnings-per-share growth has been robust since the bottom in 2009. Recent growth has been fueled by gains in the company's asset base, averaging 5%+ in the past decade. 1st Source's strong balance sheet growth has been accompanied by expanding margins and prudent operating expenditures, allowing for a rise in returns on its asset base. However, we are forecasting -5% growth, given the lending margin headwinds banks are facing, which are showing no signs of abating, as well as massive credit loss provision recouping that is one-time in nature. 1st Source is trying to build more fee revenue, but its business is still heavily dependent upon lending margins, and we think growth will slow because of the unfavorable interest rate environment, as well as a huge base of earnings for 2021 we think will be very difficult to match.

[1] Share count in millions

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Our expectation for the dividend is now $1.37 in 2026 as we think COVID-19-related economic weakness will force banks to conserve capital. This is particularly true for 1st Source given the earnings growth headwinds it is facing. However, we don't expect the bank to end its very long streak of dividend increases.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	10.9	11.3	11.8	12.8	13.9	15.3	18.4	16.4	13.1	11.2	***10.0***	***12.5***
Avg. Yld.	3.0%	2.9%	2.6%	2.3%	2.2%	2.1%	1.6%	1.9%	2.4%	3.1%	***2.6%***	***2.9%***

1st Source's price-to-earnings multiple has been steady, all things considered, for the past decade. It is trading for 10 times earnings today, which is below our estimate of fair value. Therefore, we see a tailwind to total returns from the valuation in the coming years. This could keep the yield around 3% in the foreseeable future.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	33%	33%	31%	30%	32%	34%	30%	30%	31%	35%	***26%***	***37%***

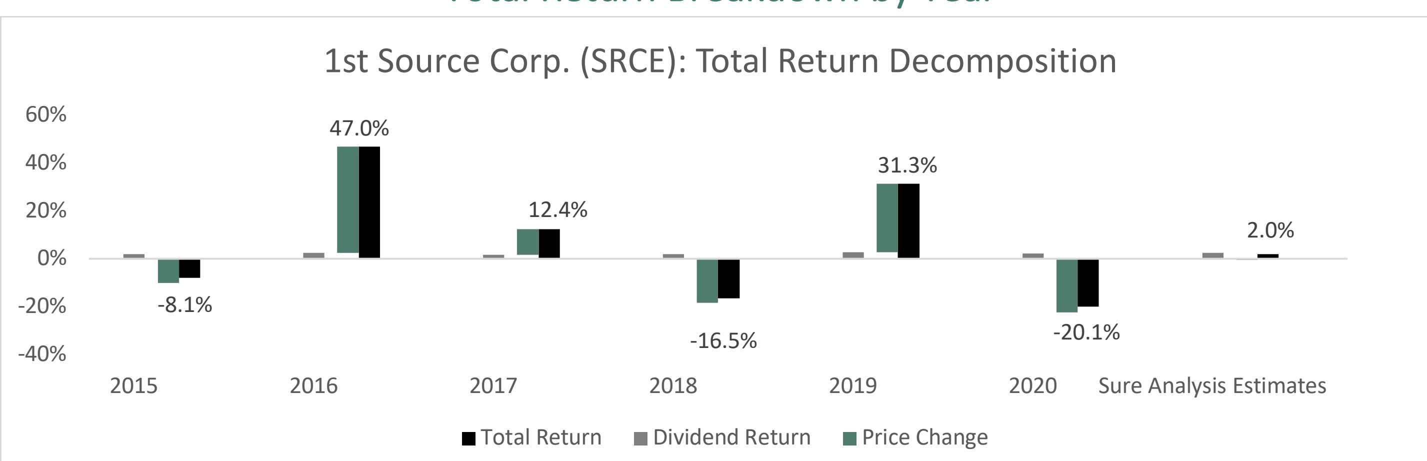
The payout ratio is in the area of one-quarter of earnings and dividend raises will likely be somewhat modest in the coming years. We see the dividend as safe and with a lot of room to grow given 1st Source's commitment to raising the payout, as well as the low payout ratio. We see the payout growing even if 1st Source is not able to produce strong earnings growth, and indeed, that is what we're forecasting.

1st Source's competitive advantage is in its clean balance sheet, strong profitability metrics and robust market position in the areas it serves. The advantage of a community or regional bank is that it can generate sizable market share in lots of small markets, creating a sustainable competitive advantage. It is obviously not immune from recessions but did perform well in 2020 all things considered.

Final Thoughts & Recommendation

We believe total returns for 1st Source investors could be just 2% annually, consisting of the current 2.6% yield, a moderate tailwind from the valuation and -5% earnings-per-share growth. Given that the bank's growth outlook has deteriorated, and the fact that it has struggled to grow loans and leases organically, we think this, combined with perpetually low interest rates, will keep a lid on growth. The one-time earnings bump in 2021 from reversing credit loss provisions will prove to be a sizable headwind as well. Shares earn a sell 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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	229	233	234	238	250	259	284	311	325	330
SG&A Exp.	91	96	94	96	100	100	102	109	112	114
D&A Exp.	25	22	19	20	24	28	32	33	35	---
Net Profit	48	50	55	58	57	58	68	82	92	81
Net Margin	21.0%	21.3%	23.5%	24.4%	23.0%	22.3%	23.9%	26.5%	28.3%	24.7%
Free Cash Flow	103	86	59	37	37	59	88	135	154	---
Income Tax	26	26	29	26	31	31	33	23	28	25

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	4374	4551	4723	4830	5188	5486	5887	6294	6623	7316
Cash & Equivalents	61	83	78	65	65	59	74	95	67	74
Goodwill & Int. Ass.	88	88	86	85	85	84	84	84	84	84
Total Liabilities	3850	3992	4137	4215	4544	4814	5169	5530	5774	6386
Long-Term Debt	145	140	250	222	219	262	119	199	138	148
Shareholder's Equity	524	559	585	614	644	673	719	762	828	887
D/E Ratio	0.28	0.25	0.43	0.36	0.34	0.39	0.17	0.26	0.17	0.17

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	1.1%	1.1%	1.2%	1.2%	1.1%	1.1%	1.2%	1.4%	1.4%	1.2%
Return on Equity	9.5%	9.2%	9.6%	9.7%	9.1%	8.8%	9.8%	11.1%	11.6%	9.5%
ROIC	7.5%	7.3%	7.2%	6.9%	6.8%	6.4%	7.7%	9.2%	9.3%	7.9%
Shares Out.	27	27	27	26	26	26	26	26	26	26
Revenue/Share	9.46	8.72	8.74	9.01	9.55	9.99	10.97	11.99	12.70	12.92
FCF/Share	4.24	3.22	2.19	1.39	1.40	2.28	3.40	5.23	6.02	---

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