Community Bank System (CBU)

Updated November 1st, 2021, by Josh Arnold

Key Metrics

Current Price:	$74	**5 Year CAGR Estimate:**	-4.5%	**Market Cap:**	$3.9 B
Fair Value Price:	$55	**5 Year Growth Estimate:**	-2.0%	**Ex-Dividend Date:**	12/14/2021[1]
% Fair Value:	134%	**5 Year Valuation Multiple Estimate:**	-5.7%	**Dividend Payment Date:**	01/08/2022
Dividend Yield:	2.4%	**5 Year Price Target**	$50	**Years Of Dividend Growth:**	29
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 U.S. 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 $3.9 billion, and it produces over $600 million in annual revenue.

Community Bank reported third quarter earnings on October 25th, 2021, with results coming in better than expectations on both the top and bottom line. The company reported total revenue of $157 million, an increase of $4 million, or 3%, from the year-ago period. This was due to a $5 million increase in employee benefit services revenue, and a $2 million gain in wealth management revenue. There was a slight decline in net interest income and banking-related fee revenue. Net interest income was $93 million, down fractionally from the year-ago period. Net interest margin was 2.79%, up five basis points year-over-year. Net provisions for credit losses came to a benefit of $0.9 million, up sharply from a $1.9 million in losses in the year-ago period. Earnings-per-share came to 83 cents, up four cents, or 5%, year-over-year. We've updated our estimate for this year to $3.45 in earnings-per-share for 2021.

Community Bank purchased the assets of Thomas Gregory Associates Insurance Brokers, a specialty insurance broker based in Boston. Terms were undisclosed but the assets are expected to produce about $35 million in annual revenue for Community Bank System. The bank also said it is acquiring Elmira Savings Bank in an all-cash transaction of $83 million. The acquired institution has total assets of $650 million, deposits of $550 million, and loans of $465 million. Community Bank System expects accretion of 8 cents per share in 2022 and 15 cents per share in 2023.

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	***$3.45***	***$3.12***
DPS	$1.00	$1.06	$1.10	$1.16	$1.22	$1.26	$1.34	$1.44	$1.58	$1.66	***$1.72***	***$1.81***
Shares[2]	36	40	41	41	41	44	49	51	52	54	***54***	***52***

Earnings-per-share have been 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 -2% 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 very high base of earnings. We see 2021's earnings as the top for the years to come, as the boost in earnings from loan loss provision releases won't reoccur.

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

[1] Estimated date

[2] Share count in millions

strong, so we think the very flat yield curve will see it struggle to continue to boost those margins. However, credit quality remains favorable. 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 see modest dividend growth ahead given the lack of 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	***21.4***	***16.0***
Avg. Yld.	4.0%	3.8%	3.4%	3.2%	3.3%	2.9%	2.5%	2.4%	2.5%	2.8%	***2.3%***	***3.6%***

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 an 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 134% 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%	***50%***	***58%***

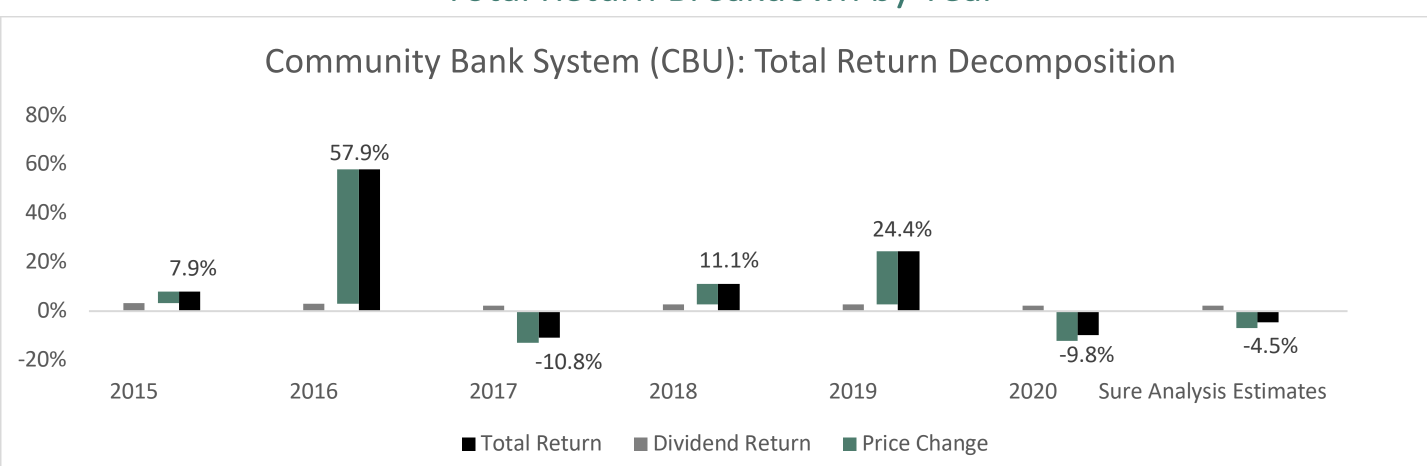
We see the payout ratio rising but remaining below 60%. The bank's impressive dividend streak appears to be safe at this point and we see many more years of increases coming, even if a recession strikes. Growth rates should be low.

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 faces a tough road ahead, and the stock is trading well in excess of our estimate of fair value. We forecast total annual returns of -4.5%, 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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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	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.