Community Bank System (CBU)

Updated January 26th, 2022, by Josh Arnold

Key Metrics

Current Price:	$74	**5 Year CAGR Estimate:**	-2.4%	**Market Cap:**	$4.0 B
Fair Value Price:	$51	**5 Year Growth Estimate:**	2.0%	**Ex-Dividend Date:**	03/14/2022[1]
% Fair Value:	145%	**5 Year Valuation Multiple Estimate:**	-7.1%	**Dividend Payment Date:**	04/08/2022
Dividend Yield:	2.3%	**5 Year Price Target**	$57	**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 $4 billion, and it produces over $650 million in annual revenue.

Community Bank System reported fourth quarter and full-year earnings on January 24th, 2022, and results were better than expected on both the top and bottom lines. Earnings-per-share came to 81 cents in Q4 on an adjusted basis, which was down from 85 cents in the year-ago period. For the year, adjusted earnings-per-share came to $3.49, which was an 8% gain over the prior year of $3.24.

Total revenue was $160 million, up 6% year-over-year, and beating estimates by $2.4 million. Noninterest revenue was 40% of revenue in Q4, up from 38% year-over-year. Similar increases were seen for the full year. Net interest income was $2.3 million higher than the prior year period but came in below pre-pandemic levels. Noninterest revenue was 12% year-over-year, gaining nearly $7 million.

Total operating expenses excluding acquisition-related and nonrecurring expenses, rose $5.5 million or 6% year-over-year. The increase in expenses was due to higher salaries and benefits costs, and higher medical plan costs. Total deposit funding costs were 8bps, down from 12bps year-over-year for the quarter. For the year, deposit costs were 9bps, down from 16bps in 2020. Net charge-offs were just 0.09% in Q4, up from 0.07% year-over-year. For the year, it was 0.04%, down from 0.07% in 2020 as credit quality remains outstanding.

We forecast $3.20 in EPS for 2022 following record results in 2021 that will be difficult to replicate.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$1.93	$3.38	$2.22	$2.19	$2.32	$2.55	$3.23	$3.28	$3.24	$3.49	***$3.20***	***$3.53***
DPS	$1.06	$1.10	$1.16	$1.22	$1.26	$1.34	$1.44	$1.58	$1.66	$1.70	***$1.72***	***$1.81***
Shares[2]	40	41	41	41	44	49	51	52	54	54	***54***	***54***

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 replicating 2021 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

[1] Estimated date
[2] Share count in millions

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primary growth driver going forward. Community Bank System is performing well, but its lending margins are already 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	14.3	9.6	16.5	17.0	18.9	17.8	18.3	19.5	18.5	21.1	***23.1***	***16.0***
Avg. Yld.	3.8%	3.4%	3.2%	3.3%	2.9%	2.5%	2.4%	2.5%	2.8%	2.3%	***2.3%***	***3.2%***

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 well 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 145% of our estimate of fair value.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	53%	32%	51%	54%	53%	53%	45%	48%	51%	49%	***54%***	***51%***

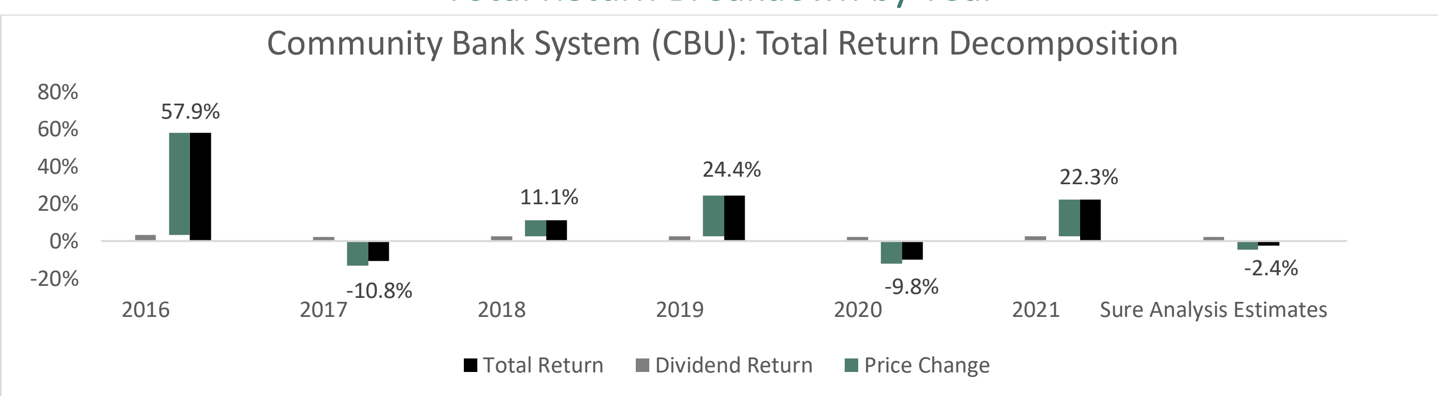
We see the payout ratio remaining around half of earnings for the foreseeable future. The bank's impressive dividend streak appears to be safe at this point and we see many more years of increases coming, even if a recession strikes. Growth rates should be low, however, due to low earnings growth.

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 -2.4%, 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	330	428	363	372	430	518	569	590	596	621
SG&A Exp.	151	166	170	174	198	234	256	273	274	293
D&A Exp.	17	17	18	17	20	33	34	32	31	---
Net Profit	77	79	91	91	104	151	169	169	165	190
Net Margin	23.4%	18.4%	25.1%	24.5%	24.2%	29.1%	29.6%	28.7%	27.6%	30.6%
Free Cash Flow	98	89	109	107	123	179	209	197	165	---
Income Tax	32	32	38	41	51	9	44	40	41	52

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	7497	7096	7489	8553	8666	10746	10607	11410	13931	15553
Cash & Equivalents	229	150	138	153	174	221	212	205	1646	1875
Accounts Receivable	32	25	25	26	31	36	31	32	39	---
Goodwill & Int. Ass.	387	390	387	484	481	825	807	837	847	864
Total Liabilities	6594	6220	6502	7412	7468	9111	8894	9555	11827	13452
Accounts Payable	136	80	126	135	144	181	157	215	231	211
Long-Term Debt	830	244	440	403	248	149	154	103	87	330
Shareholder's Equity	903	876	988	1141	1198	1635	1714	1855	2104	2101
LTD/E Ratio	0.92	0.28	0.45	0.35	0.21	0.09	0.09	0.06	0.04	0.16

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	1.1%	1.1%	1.3%	1.1%	1.2%	1.6%	1.6%	1.5%	1.3%	1.3%
Return on Equity	9.2%	8.9%	9.8%	8.6%	8.9%	10.6%	10.1%	9.5%	8.3%	9.0%
ROIC	4.6%	5.5%	7.2%	6.1%	6.9%	9.3%	9.2%	8.8%	7.4%	8.2%
Shares Out.	40	41	41	41	44	49	51	52	54	54
Revenue/Share	8.31	10.56	8.86	8.98	9.66	10.47	11.00	11.29	11.15	11.39
FCF/Share	2.46	2.21	2.65	2.59	2.77	3.62	4.03	3.77	3.10	---

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