Community Bank System (CBU)

Updated April 30th, 2022, by Josh Arnold

Key Metrics

Current Price:	$64	**5 Year CAGR Estimate:**	2.0%	**Market Cap:**	$3.6 B
Fair Value Price:	$56	**5 Year Growth Estimate:**	2.0%	**Ex-Dividend Date:**	06/14/2022[1]
% Fair Value:	114%	**5 Year Valuation Multiple Estimate:**	-2.6%	**Dividend Payment Date:**	07/08/2022
Dividend Yield:	2.7%	**5 Year Price Target**	$62	**Years Of Dividend Growth:**	29
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Rating:**	Sell

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 $3.6 billion, and it produces over $660 million in annual revenue.

Community Bank reported first quarter earnings on April 25th, 2022, and results were ahead of expectations on both the top and bottom lines. Earnings-per-share came to 91 cents, which was 15 cents ahead of expectations. In addition, revenue was up more than 5% year-over-year, beating estimates by more than $3 million.

The total revenue increase was driven by higher net interest income, deposit and other fees, and an increase in employee benefit services. This was partially offset by a decline in Paycheck Protection Program-related interest income, as that program is winding down.

Net interest income was up fractionally year-over-year, as an increase in interest-earning assets was mostly offset by a decline in net intertest margin. Average interest-earning assets rose by 12%, while net interest margin was down from 3.03% to 2.73%.

Provisions for credit losses were $0.9 million, a sharp deterioration from a benefit of $5.7 million from the year-ago period. Net charge-offs were 0.03% of outstanding loans, which was roughly equivalent to the comparable period a year ago. Management offered a rosy forecast for lending conditions for the balance of the year, indicating that credit quality would remain quite strong.

We now see $3.50 in earnings-per-share for this year following Q1 results.

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	***$3.50***	***$3.86***
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 note that 2022 is off to a great start and that the company has a chance to reach another record for earnings this year.

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

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[1] Estimated date

[2] Share count in millions

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.

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	***18.3***	***16.0***
Avg. Yld.	3.8%	3.4%	3.2%	3.3%	2.9%	2.5%	2.4%	2.5%	2.8%	2.3%	***2.7%***	***2.9%***

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 still quite expensive, trading for 114% of fair value while much of the sector is well below 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%	***49%***	***47%***

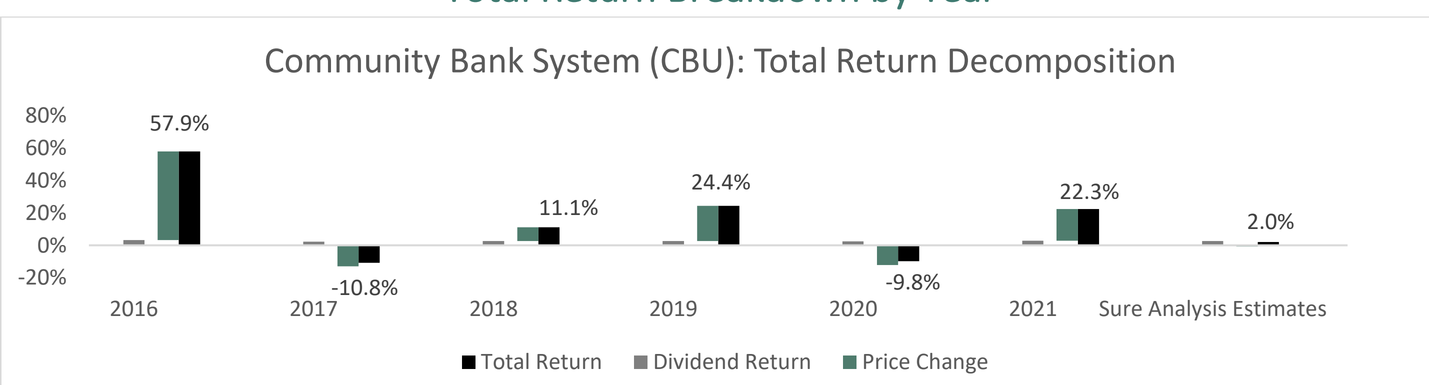
We see the payout ratio remaining around half of earnings for the foreseeable future. The bank's impressive dividend streak appears to be safe at this point we see many more years of increases coming, even if a recession strikes. Growth rates should be low, however, due to low earnings growth.

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 in excess of our estimate of fair value. We forecast total annual returns of 2.0%, 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	30
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	189
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	36
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	3.48

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