



1st Source Corp. (SRCE)

Updated October 29th, 2022, by Josh Arnold

Key Metrics

Current Price:	\$59	5 Year CAGR Estimate:	0.3%	Market Cap:	\$1.4 B
Fair Value Price:	\$56	5 Year Growth Estimate:	-1.0%	Ex-Dividend Date:	11/01/22 ¹
% Fair Value:	106%	5 Year Valuation Multiple Estimate:	-1.1%	Dividend Payment Date:	11/10/22
Dividend Yield:	2.2%	5 Year Price Target	\$53	Years Of Dividend Growth:	35
Dividend Risk Score:	A	Retirement Suitability Score:	B	Rating:	Sell

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 \$1.4 billion, and it is expected to produce more than \$353 million in revenue this year. 1st Source also has an exceptional dividend increase streak that stands at 35 years, which very few banks can match.

1st Source reported third quarter earnings on October 20th, 2022, and results were better than expected on both the top and bottom lines. Earnings-per-share were \$1.32, which was 16 cents ahead of expectations. Revenue was up 4% to \$91 million, beating estimates by almost \$3 million.

Average loans and leases were \$5.63 billion, up \$452 million, and up almost 9% net of Paycheck Protection Program loans from the year-ago quarter. The company said strong growth was primarily within the specialty finance group portfolio.

Deposits were \$6.67 billion, up \$271 million year-over-year. Deposit growth was from business and consumer clients both moving higher, while brokered deposits fell.

Net interest income was \$69 million, up 11% year-over-year. Net interest margin was 3.59%, up 26 basis points year-over-year as lending rates have risen.

We now see \$4.85 in earnings-per-share for this year following good Q3 results.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$1.84	\$2.03	\$2.17	\$2.17	\$2.22	\$2.52	\$3.16	\$3.58	\$3.27	\$4.70	\$4.85	\$4.61
DPS	\$0.60	\$0.62	\$0.65	\$0.67	\$0.72	\$0.76	\$0.96	\$1.10	\$1.13	\$1.21	\$1.28	\$1.41
Shares²	27	27	26	26	26	26	26	26	26	25	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. With normalizing conditions in 2022, we're reiterating our earnings growth estimate at no growth. 1st Source is trying to build more fee revenue, but its business is still heavily dependent upon lending margins, and we think growth will be tough to come by because of the unfavorable interest rate environment. Normalized conditions for 2022 aren't stopping 1st Source from producing even higher earnings this year.

Our expectation for the dividend is now \$1.41 in 2027 as we see 1st Source facing headwinds in its ability to grow earnings. However, we don't expect the bank to end its very long streak of dividend increases. We see the bank as being hesitant to boost its payout ratio much higher than it is at the moment.

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.



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Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	11.3	11.8	12.8	13.9	15.3	18.4	16.4	13.1	11.2	9.9	12.2	11.5
Avg. Yld.	2.9%	2.6%	2.3%	2.2%	2.1%	1.6%	1.9%	2.4%	3.1%	2.6%	2.2%	2.7%

1st Source's price-to-earnings multiple has been steady, all things considered, for the past decade. It is trading for 12.2 times earnings today, which is ahead of our estimate of fair value. Therefore, we see a small headwind to total returns from the valuation in the coming years. The yield should remain below 3% for the foreseeable future.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	33%	31%	30%	32%	34%	30%	30%	31%	35%	26%	26%	31%

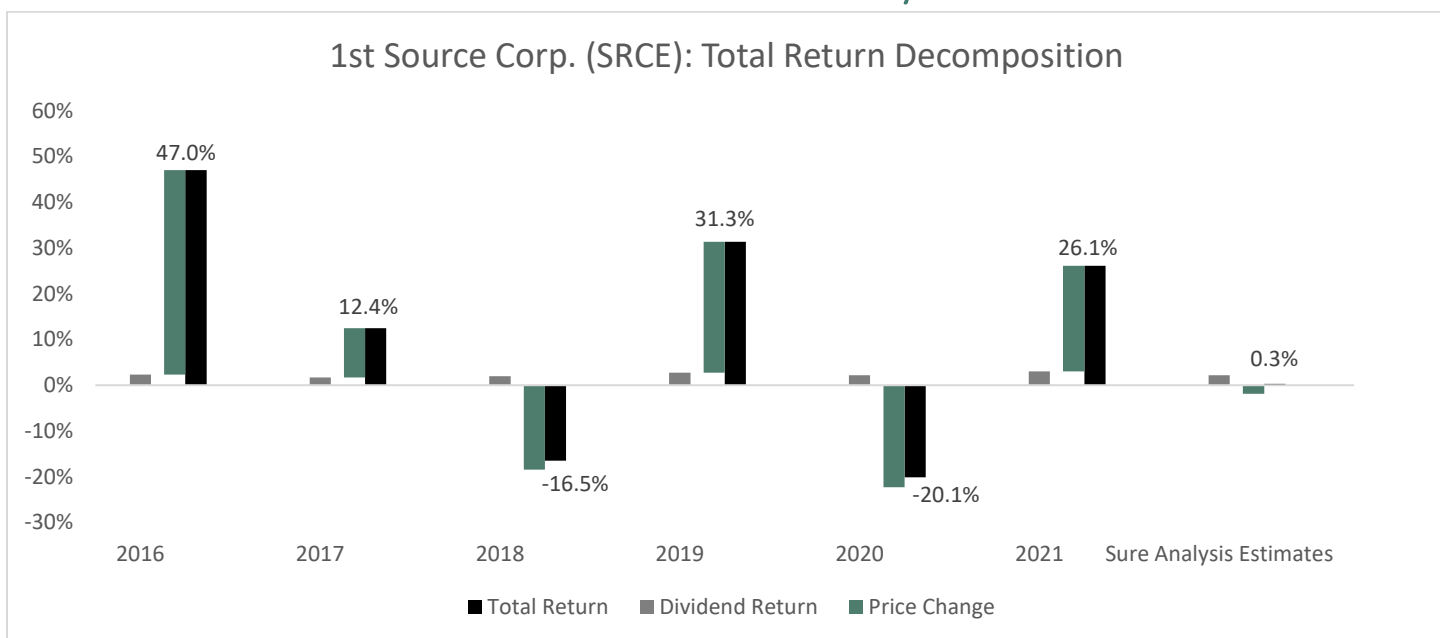
The payout ratio is around one-quarter of earnings and dividend raises will likely be somewhat modest in the coming years. We see the dividend as safe and with a lot of room to grow given 1st Source's commitment to raising the payout, as well as the low payout ratio. We see the payout growing even if 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 0.3% annually, consisting of the current 2.2% yield, a 1.1% headwind from the valuation and 1% earnings contraction. Given that the bank's growth outlook is murky, and the fact that it has struggled to grow loans and leases organically, we think this will keep a lid on growth. Given very low projected returns, we are reiterating the stock at a sell rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	233	234	238	250	259	284	311	325	330	337
SG&A Exp.	96	94	96	100	100	102	109	112	114	122
D&A Exp.	22	19	20	24	28	32	33	35	31	24
Net Profit	50	55	58	57	58	68	82	92	81	119
Net Margin	21.3%	23.5%	24.4%	23.0%	22.3%	23.9%	26.5%	28.3%	24.7%	35.2%
Free Cash Flow	86	59	37	37	59	88	135	154	152	164
Income Tax	26	29	26	31	31	33	23	28	25	36

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	4551	4723	4830	5188	5486	5887	6294	6623	7316	8096
Cash & Equivalents	83	78	65	65	59	74	95	67	74	54
Goodwill & Int. Ass.	88	86	85	85	84	84	84	84	84	84
Total Liabilities	3992	4137	4215	4544	4814	5169	5530	5774	6386	7127
Long-Term Debt	140	250	222	219	262	119	199	138	127	115
Shareholder's Equity	559	585	614	644	673	719	762	828	887	916
LTD/E Ratio	0.25	0.43	0.36	0.34	0.39	0.17	0.26	0.17	0.14	0.13

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	1.1%	1.2%	1.2%	1.1%	1.1%	1.2%	1.4%	1.4%	1.2%	1.5%
Return on Equity	9.2%	9.6%	9.7%	9.1%	8.8%	9.8%	11.1%	11.6%	9.5%	13.1%
ROIC	7.3%	7.2%	6.9%	6.8%	6.4%	7.7%	9.2%	9.3%	7.9%	11.1%
Shares Out.	27	27	26	26	26	26	26	26	26	25
Revenue/Share	8.72	8.74	9.01	9.55	9.99	10.97	11.99	12.70	12.92	13.45
FCF/Share	3.22	2.19	1.39	1.40	2.28	3.40	5.23	6.02	5.94	6.55

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

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