1st Source Corp. (SRCE)

Updated January 23rd, 2023, by Josh Arnold

Key Metrics

Current Price:	$47	**5 Year CAGR Estimate:**	4.8%	**Market Cap:**	$1.2 B
Fair Value Price:	$55	**5 Year Growth Estimate:**	-1.0%	**Ex-Dividend Date:**	02/03/23
% Fair Value:	85%	**5 Year Valuation Multiple Estimate:**	3.3%	**Dividend Payment Date:**	02/16/23
Dividend Yield:	2.7%	**5 Year Price Target**	$52	**Years Of Dividend Growth:**	35
Dividend Risk Score:	A	**Retirement Suitability Score:**	A	**Rating:**	Hold

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 $1.2 billion, and it is expected to produce about $375 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 fourth quarter and full-year earnings on January 19th, 2023, and results were somewhat mixed. Earnings-per-share came to $1.25, which missed expectations by three cents. Revenue, however, was up 13% year-over-year to $94.7 million, which was $0.53 million better than estimates.

Net income was a record of $120.5 million for the full year, up 1.7% year-over-year. For the quarter, it was $31.1 million, up 12.1% year-over-year. On a per-share basis, earnings were $4.84 for the year and $1.25 for the quarter.

Average loans and leases net of Paycheck Protection Program loans grew $402 million for the year, up 7.8% year-over-year. The gain was $216 million in the fourth quarter.

Net interest income was $264 million for the year, up 11.4% year-over-year, and up 19.1% in the fourth quarter. Net interest margin was 3.45% for the year, up 22 basis points from 2021. NIM was 3.69% in the fourth quarter, up 60 basis points from the prior year Q4.

Noninterest income was $91.3 million, down $8.8 million, or 8.8% year-over-year. Fourth quarter noninterest income was $23.3 million, down fractionally from the year-ago period.

We see earnings for this year coming in roughly flat with 2022, as the bank is at risk of higher loan losses against flat revenue and net interest margins.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$2.03	$2.17	$2.17	$2.22	$2.52	$3.16	$3.58	$3.27	$4.70	$4.84	***$4.80***	***$4.56***
DPS	$0.62	$0.65	$0.67	$0.72	$0.76	$0.96	$1.10	$1.13	$1.21	$1.26	***$1.28***	***$1.41***
Shares[1]	27	26	26	26	26	26	26	26	25	25	***25***	***25***

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 normalized conditions in 2022, and the risk of recession in 2023, we're reiterating our earnings growth estimate at -1%. 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 2023 should see roughly flat earnings from 2022.

[1] Share count in millions

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Our expectation for the dividend is now $1.41 in 2028 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.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	11.8	12.8	13.9	15.3	18.4	16.4	13.1	11.2	9.9	11.0	***9.8***	***11.5***
Avg. Yld.	2.6%	2.3%	2.2%	2.1%	1.6%	1.9%	2.4%	3.1%	2.6%	2.4%	***2.7%***	***2.7%***

1st Source's price-to-earnings multiple has been steady, all things considered, for the past decade. It is trading for 9.8 times earnings currently, which is below our estimate of fair value. Therefore, we see a 3.3% tailwind 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	31%	30%	32%	34%	30%	30%	31%	35%	26%	26%	***27%***	***31%***

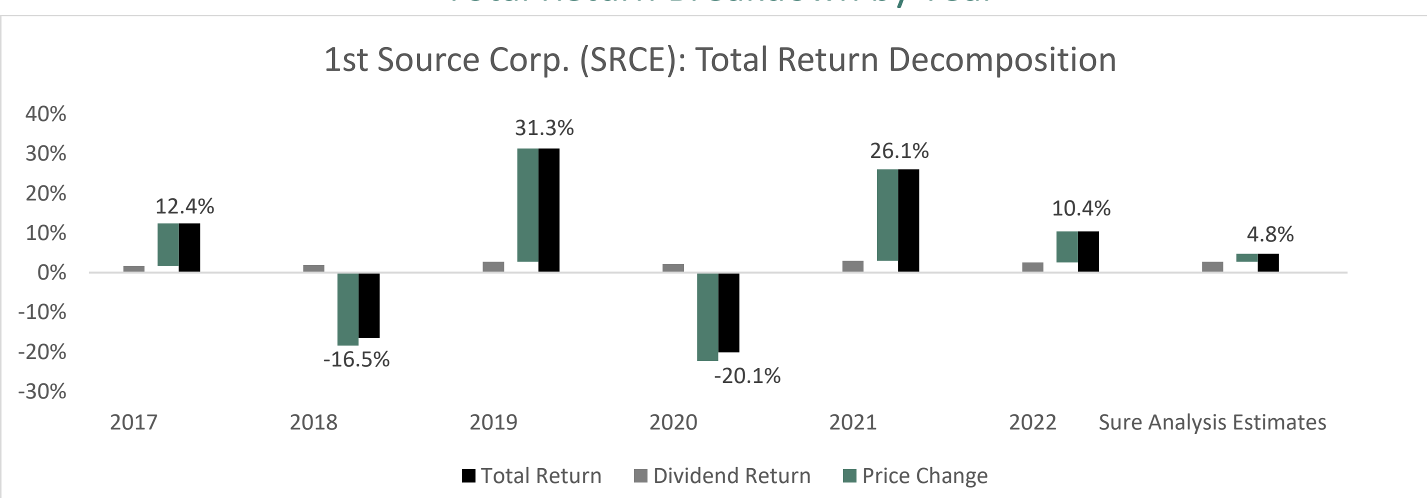
The payout ratio is around one-quarter of earnings and dividend raises will likely be somewhat modest in the coming years. We see the dividend as safe and with a lot of room to grow given 1st Source's commitment to raising the payout, as well as the low payout ratio. We see the payout growing even if 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 4.8% annually, consisting of the current 2.7% yield, a 3.3% tailwind 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. However, given improved total return prospects, we've upgraded the stock from sell to hold.

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	234	238	250	259	284	311	325	330	337	355
SG&A Exp.	94	96	100	100	102	109	112	114	122	137
D&A Exp.	19	20	24	28	32	33	35	31	24	
Net Profit	55	58	57	58	68	82	92	81	119	121
Net Margin	23.5%	24.4%	23.0%	22.3%	23.9%	26.5%	28.3%	24.7%	35.2%	34.1%
Free Cash Flow	59	37	37	59	88	135	154	152	164	
Income Tax	29	26	31	31	33	23	28	25	36	36

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	4723	4830	5188	5486	5887	6294	6623	7316	8096	8339
Cash & Equivalents	78	65	65	59	74	95	67	74	54	85
Goodwill & Int. Ass.	86	85	85	84	84	84	84	84	84	84
Total Liabilities	4137	4215	4544	4814	5169	5530	5774	6386	7127	7416
Long-Term Debt	250	222	219	262	119	199	138	127	115	179
Shareholder’s Equity	585	614	644	673	719	762	828	887	916	864
LTD/E Ratio	0.43	0.36	0.34	0.39	0.17	0.26	0.17	0.14	0.13	0.21

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	1.2%	1.2%	1.1%	1.1%	1.2%	1.4%	1.4%	1.2%	1.5%	1.5%
Return on Equity	9.6%	9.7%	9.1%	8.8%	9.8%	11.1%	11.6%	9.5%	13.1%	13.5%
ROIC	7.2%	6.9%	6.8%	6.4%	7.7%	9.2%	9.3%	7.9%	11.1%	11.0%
Shares Out.	27	26	26	26	26	26	26	26	25	25
Revenue/Share	8.74	9.01	9.55	9.99	10.97	11.99	12.70	12.92	13.45	14.40
FCF/Share	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.