Community Bank System (CBU)

Updated July 31st, 2023, by Josh Arnold

Key Metrics

Current Price:	$54	**5 Year CAGR Estimate:**	4.5%	**Market Cap:**	$2.8 B
Fair Value Price:	$48	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	09/14/2023
% Fair Value:	113%	**5 Year Valuation Multiple Estimate:**	-2.5%	**Dividend Payment Date:**	10/10/2023
Dividend Yield:	3.3%	**5 Year Price Target**	$58	**Years Of Dividend Growth:**	31
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Rating:**	Hold

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 $2.8 billion, and it produces about $700 million in annual revenue.

Community Bank System posted second quarter earnings on July 31st, 2023, and results were somewhat mixed. Adjusted earnings-per-share were 91 cents, which beat expectations by six cents. Revenue was up 5% year-over-year to $175 million, but was less than $1 million under estimates.

Net interest margin was 3.18%, which was down fractionally from Q1. However, it was up 29 basis points to the comparable period a year ago.

Operating income was $49.1 million, or 91 cents per share, which was up $2.8 million, or six cents, respectively, from a year ago. Net income was $48.3 million, which was up $8.5 million from last year's Q2.

Total loans ended the period at $9.17 billion, which was up $188 million year-over-year. Total financial services revenue was $48.3 million, up $1.4 million.

Annualized net charge-offs were 0.03% of loans, down from 0.07% in the prior quarter. Community Bank continues to have best-in-class credit quality. We see $3.40 in earnings-per-share for this year after largely in line second quarter results, noting outstanding credit quality, but not much in the way of growth.

Finally, the bank boosted its dividend for the 31st consecutive year, adding 2.3% to a new payout of $1.80 per share annually.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$3.38	$2.22	$2.19	$2.32	$2.55	$3.23	$3.28	$3.24	$3.49	$3.58	***$3.40***	***$4.14***
DPS	$1.10	$1.16	$1.22	$1.26	$1.34	$1.44	$1.58	$1.66	$1.70	$1.76	***$1.80***	***$1.89***
Shares[1]	41	41	41	44	49	51	52	54	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 4% 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 growing from 2022 earnings. We note the bank has already offered up a slightly cautious economic forecast in its provisions for credit losses in 2023, but Q2 results were quite good on the credit quality front.

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] 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 upside from there is somewhat limited. However, credit quality remains favorable. Even so, headwinds are still present 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 pace of earnings growth.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	9.6	16.5	17.0	18.9	17.8	18.3	19.5	18.5	21.1	17.6	***15.9***	***14.0***
Avg. Yld.	3.4%	3.2%	3.3%	2.9%	2.5%	2.4%	2.5%	2.8%	2.3%	2.8%	***3.3%***	***3.3%***

Community Bank System's price-to-earnings multiple has moved around significantly in the past decade as its fortunes have improved and deteriorated. We have revised our target valuation to 14 times earnings given the sector is seeing much lower valuations applied by investors. We are forecasting an annual headwind to total returns in the coming years from the valuation. We see the dividend yield at 3.3% in five years, right where it is today.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	32%	51%	54%	53%	53%	45%	48%	51%	49%	49%	***53%***	***46%***

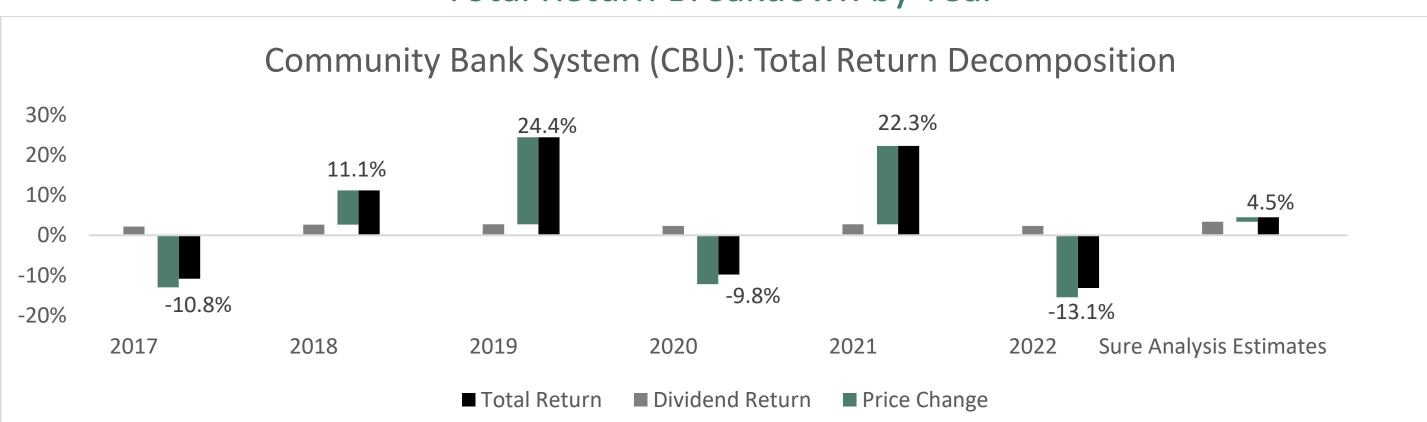
We see the payout ratio remaining around half of earnings for the foreseeable future. The bank's impressive dividend streak appears to be safe at this point, and we see many more years of increases coming, even if a recession strikes. Growth rates should be low, however, due to low earnings growth and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

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's total returns face an uphill battle given lower sector valuations and modest growth outlook. We forecast total annual returns of 4.5%, and we are reiterating Community Bank at a hold rating. The 3.3% yield is nice, but the valuation offers a 2.5% potential headwind, with a 4% projected growth rate.

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	428	363	372	430	518	569	590	596	621	679
SG&A Exp.	166	170	174	198	234	256	273	274	302	257
D&A Exp.	17	18	17	20	33	34	32	31	30	38
Net Profit	79	91	91	104	151	169	169	165	190	188
Net Margin	18.4%	25.1%	24.5%	24.2%	29.1%	29.6%	28.7%	27.6%	30.6%	27.7%
Free Cash Flow	89	109	107	123	179	209	197	165	189	202
Income Tax	32	38	41	51	9	44	40	41	52	52

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	7096	7489	8553	8666	10746	10607	11410	13931	15553	15836
Cash & Equivalents	150	138	153	174	221	212	205	1646	1875	210
Accounts Receivable	25	25	26	31	36	31	32	39	36	53
Goodwill & Int. Ass.	390	387	484	481	825	807	837	847	864	903
Total Liabilities	6220	6502	7412	7468	9111	8894	9555	11827	13452	14284
Accounts Payable	80	126	135	144	181	157	215	231	211	134
Long-Term Debt	244	440	403	248	149	154	103	87	330	1138
Shareholder's Equity	876	988	1141	1198	1635	1714	1855	2104	2101	1552
LTD/E Ratio	0.28	0.45	0.35	0.21	0.09	0.09	0.06	0.04	0.16	0.73

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	1.1%	1.3%	1.1%	1.2%	1.6%	1.6%	1.5%	1.3%	1.3%	1.2%
Return on Equity	8.9%	9.8%	8.6%	8.9%	10.6%	10.1%	9.5%	8.3%	9.0%	10.3%
ROIC	5.5%	7.2%	6.1%	6.9%	9.3%	9.2%	8.8%	7.4%	8.2%	7.8%
Shares Out.	41	41	41	44	49	51	52	54	54	54
Revenue/Share	10.56	8.86	8.98	9.66	10.47	11.00	11.29	11.15	11.39	12.50
FCF/Share	2.21	2.65	2.59	2.77	3.62	4.03	3.77	3.10	3.48	3.72

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