Community Bank System (CBU)

Updated January 24th, 2024, by Josh Arnold

Key Metrics

Current Price:	$49	**5 Year CAGR Estimate:**	1.1%	**Market Cap:**	$2.6 B
Fair Value Price:	$45	**5 Year Growth Estimate:**	-1.0%	**Ex-Dividend Date:**	03/14/2024[1]
% Fair Value:	109%	**5 Year Valuation Multiple Estimate:**	-1.8%	**Dividend Payment Date:**	04/10/2024
Dividend Yield:	3.7%	**5 Year Price Target**	$43	**Years Of Dividend Growth:**	31
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 $2.6 billion, and it produces about $720 million in annual revenue.

Community Bank posted fourth quarter and full-year earnings on January 23rd, 2024, and results were worse than expected. Adjusted earnings-per-share came to 76 cents, which missed estimates widely by eight cents. Revenue was $177 million, flat year-over-year, and about a million dollars better than expectations.

Financial services revenue was $49.5 million in the fourth quarter, up $4.8 million or 11% year-over-year. For the year, total financial services revenue was $197 million, up $10 million, or 5% from 2022.

Total ending loans were $9.7 billion, up $255 million, or 2.7% from the prior quarter. For the year, total ending loans rose $895 million, or 10% from 2022.

Total ending deposits were $12.93 billion, down $103 million from the prior quarter. For the year, deposits were down $84 million, or 0.6%. Credit quality remains very strong, with annualized loan net charge-offs of 0.10% for the fourth quarter, and 0.06% for the year.

We start 2024 with an earnings estimate of $3.20.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$2.22	$2.19	$2.32	$2.55	$3.23	$3.28	$3.24	$3.49	$3.58	$3.35	***$3.20***	***$3.04***
DPS	$1.16	$1.22	$1.26	$1.34	$1.44	$1.58	$1.66	$1.70	$1.76	$1.78	***$1.80***	***$1.89***
Shares[2]	41	41	44	49	51	52	54	54	54	53	***53***	***52***

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 -1% 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.

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 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.

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[1] Estimated date

[2] Share count in millions

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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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	16.5	17.0	18.9	17.8	18.3	19.5	18.5	21.1	17.6	15.6	***15.3***	***14.0***
Avg. Yld.	3.2%	3.3%	2.9%	2.5%	2.4%	2.5%	2.8%	2.3%	2.8%	3.4%	***3.7%***	***4.4%***

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 4.4% in five years, much higher than today as we see the stock's valuation as declining over time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	51%	54%	53%	53%	45%	48%	51%	49%	49%	53%	***56%***	***62%***

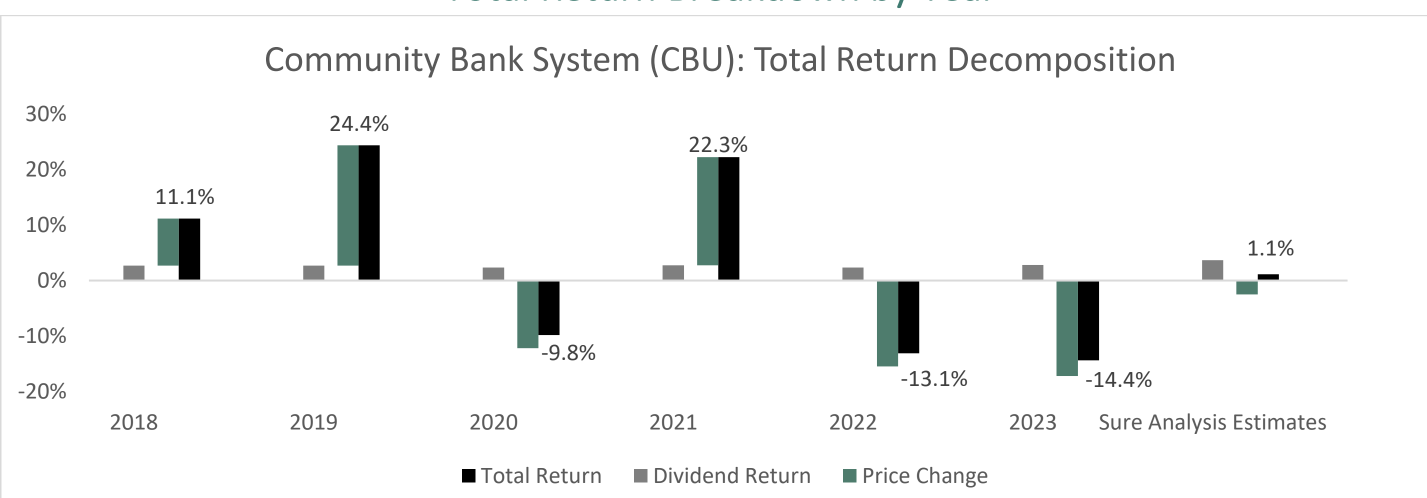
We see the payout ratio remaining just over half of earnings for the foreseeable future. The bank's impressive dividend streak appears to be safe at this point, and we see many more years of increases coming, even if a recession strikes. Growth rates should be low, however, due to low earnings growth 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 1.1%, and we're moving the stock from hold to sell. The 3.7% yield is nice, but the valuation offers a 1.8% potential headwind, with a -1% 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	363	372	430	518	569	590	596	621	679	652
SG&A Exp.	170	174	198	234	256	273	274	302	257	298
D&A Exp.	18	17	20	33	34	32	31	30	38	---
Net Profit	91	91	104	151	169	169	165	190	188	137
Net Margin	25.1%	24.5%	24.2%	29.1%	29.6%	28.7%	27.6%	30.6%	27.7%	20.9%
Free Cash Flow	109	107	123	179	209	197	165	189	202	---
Income Tax	38	41	51	9	44	40	41	52	52	38

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	7489	8553	8666	10746	10607	11410	13931	15553	15836	15555
Cash & Equivalents	138	153	174	221	212	205	1646	1875	210	191
Accounts Receivable	25	26	31	36	31	32	39	36	53	---
Goodwill & Int. Ass.	387	484	481	825	807	837	847	864	903	898
Total Liabilities	6502	7412	7468	9111	8894	9555	11827	13452	14284	13852
Accounts Payable	126	135	144	181	157	215	231	211	134	159
Long-Term Debt	440	403	248	149	154	103	87	330	791	461
Shareholder's Equity	988	1141	1198	1635	1714	1855	2104	2101	1552	1703
LTD/E Ratio	0.45	0.35	0.21	0.09	0.09	0.06	0.04	0.16	0.51	0.27

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	1.3%	1.1%	1.2%	1.6%	1.6%	1.5%	1.3%	1.3%	1.2%	0.9%
Return on Equity	9.8%	8.6%	8.9%	10.6%	10.1%	9.5%	8.3%	9.0%	10.3%	8.4%
ROIC	7.2%	6.1%	6.9%	9.3%	9.2%	8.8%	7.4%	8.2%	8.5%	6.1%
Shares Out.	41	41	44	49	51	52	54	54	54	54
Revenue/Share	8.86	8.98	9.66	10.47	11.00	11.29	11.15	11.39	12.53	12.08
FCF/Share	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.