1st Source Corp. (SRCE)

Updated January 20th, 2024, by Josh Arnold

Key Metrics

Current Price:	$53	**5 Year CAGR Estimate:**	-1.1%	**Market Cap:**	$1.3 B
Fair Value Price:	$45	**5 Year Growth Estimate:**	-1.0%	**Ex-Dividend Date:**	02/02/24
% Fair Value:	118%	**5 Year Valuation Multiple Estimate:**	-3.2%	**Dividend Payment Date:**	02/15/24
Dividend Yield:	2.6%	**5 Year Price Target**	$43	**Years Of Dividend Growth:**	36
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 $1.3 billion, and it is expected to produce about $360 million in revenue this year. 1st Source also has an exceptional dividend increase streak that stands at 36 years, which very few banks can match.

1st Source posted fourth quarter and full-year earnings on January 18th, 2024, and results were largely in line with expectations. Earnings-per-share came to $1.15 for the quarter, equal to estimates. Revenue was off 3.3% year-over-year to $91.57 million, which missed expectations fractionally.

Net income was $125 million for the year, a record for 1st Source and up about 4% from 2022. For the fourth quarter, it was $28.4 million, down 14% from Q3, but 8.5% higher from 2022's Q4. The bank said the primary contribution to changes in net income was repositioning of the investment securities portfolio.

Average loans and leases grew $637 million, up 11.5% from 2022. For the quarter, average loans and leases were up on an annualized basis by 9.1% from the third quarter.

Net interest margin was 3.51% in 2023, up six basis points from 2022. For the quarter net interest margin was also 3.51%, up five basis points from Q3, but down 18 basis points from 2022's Q4.

During the fourth quarter, the bank repositioned its investment security portfolio, resulting in losses of about $3 million on the sale of available-for-sale securities. About $40 million of securities with an average yield of 1.1% were sold and used to purchase a similar amount of securities yielding 4.8%.

We start 2024 with an estimate of $4.10 in earnings-per-share, as we think declining interest rates may cause 1st Source's earnings to struggle.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$2.17	$2.17	$2.22	$2.52	$3.16	$3.58	$3.27	$4.70	$4.84	$5.06	***$4.10***	***$3.90***
DPS	$0.65	$0.67	$0.72	$0.76	$0.96	$1.10	$1.13	$1.21	$1.26	$1.30	***$1.36***	***$1.50***
Shares[1]	26	26	26	26	26	26	26	25	25	24	***24***	***24***

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 at times and prudent operating expenditures, allowing for a rise in returns on its asset base. We're improving our estimate of earnings contraction (not growth) to 1% going forward, as the bank continues to struggle in producing earnings expansion in recent quarters. 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 with respect to deposit costs against lending rates. We think 2023's earnings may prove to be the top for some time to come.

[1] Share count in millions

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Our expectation for the dividend is now $1.50 in 2029 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	12.8	13.9	15.3	18.4	16.4	13.1	11.2	9.9	11.0	10.9	***12.9***	***11.0***
Avg. Yld.	2.3%	2.2%	2.1%	1.6%	1.9%	2.4%	3.1%	2.6%	2.4%	2.4%	***2.6%***	***3.5%***

1st Source's price-to-earnings multiple has been steady, all things considered, for the past decade. It is currently trading for 12.9 times earnings, which is well ahead our estimate of fair value. Therefore, we see a 3.2% headwind to total returns from the valuation in the coming years. The yield should remain near 3% to 3.5% for the foreseeable future. The decline in earnings estimates has the valuation much higher than it's been for years, reducing the attractiveness of the stock at the moment.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	30%	32%	34%	30%	30%	31%	35%	26%	26%	26%	***33%***	***39%***

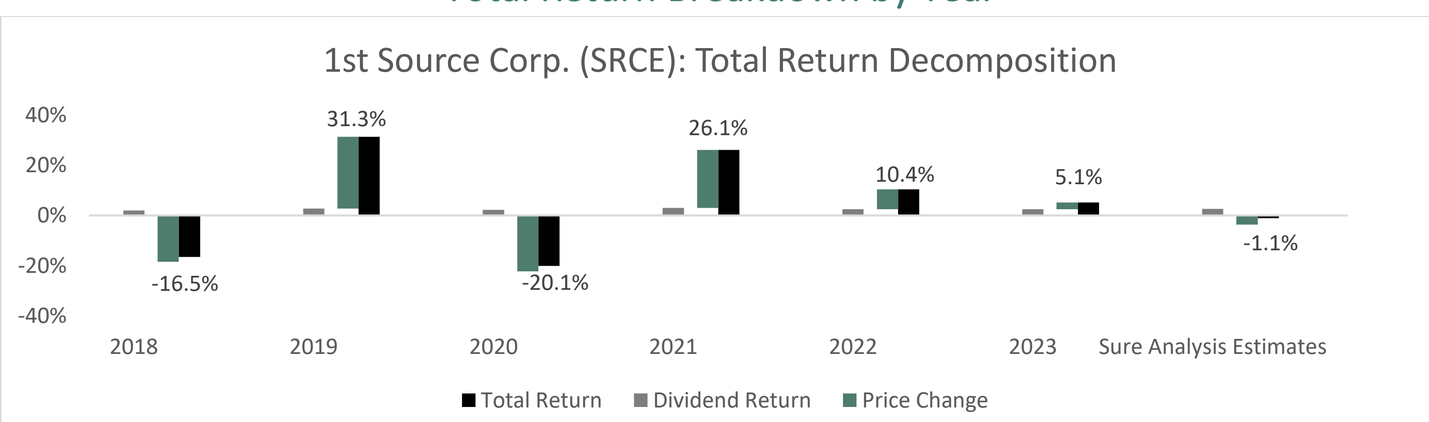
The payout ratio is around one-third of earnings and dividend raises will likely be somewhat modest in the coming years. We see the dividend as safe and with a lot of room to grow given 1st Source's commitment to raising the payout, as well as the low payout ratio. We see the payout growing even if 1st 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 -1.1% annually, consisting of the current 2.6% yield, a meaningful headwind from the valuation and 1% earnings contraction. Given that the bank's growth outlook is poor, and the fact that it has struggled to grow loans and leases organically, we think this will keep a lid on growth. We see worsening total return prospects and have moved the stock from hold to sell after Q4 earnings.

Total Return Breakdown by Year



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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	19
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	173
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	7.01

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