Orrstown Financial Services, Inc. (ORRF)

Published September 22nd, 2024, by Kody Kester

Key Metrics

Current Price:	$36	**5 Year CAGR Estimate:**	10.0%	**Market Cap:**	$689M
Fair Value Price:	$36	**5 Year Growth Estimate:**	7.5%	**Ex-Dividend Date[1]:**	11/04/24
% Fair Value:	99%	**5 Year Valuation Multiple Estimate:**	0.2%	**Dividend Payment Date:**	11/14/24
Dividend Yield:	2.6%	**5 Year Price Target**	$52	**Years Of Dividend Growth:**	9
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Rating:**	Buy

Overview & Current Events

Founded in 1919, Orrstown Financial Services, Inc. is a community bank. ORRF serves as the holding company for its subsidiary, Orrstown Bank.

The company provides banking and financial advisory services to customers located in the south-central Pennsylvania counties of Berks, Cumberland, Dauphin, Franklin, Lancaster, Perry, and York. ORRF also serves customers in Anne Arundel, Baltimore, Howard, and Washington counties in Maryland.

Savings products include money market accounts, savings accounts, certificates of deposit, and checking accounts. Loan products offered consist of residential mortgages, home equity lines of credit, commercial mortgages, construction loans, and commercial loans. Financial advisory services provided include fiduciary, investment advisory, and brokerage services.

Last December, the company announced a "merger of equals" with Codorus Valley Bancorp, which owns the bank subsidiary, PeoplesBank. This bank also serves customers in Pennsylvania and Maryland. On July 1st, the merger was completed. For each share of Codorus Valley Bancorp that was owned immediately before that date, shareholders received 0.875 shares of ORRF. This accounts for the recent uptick in the share count. Retroactively, the combined assets of the two companies were approximately $5.4 billion as of June 30th ($3.2 billion for ORRF and $2.2 billion for Codorus, respectively).

On July 23rd, ORRF released its financial results for the second quarter ended June 30th. The company's net interest income decreased by 1% over the year-ago period to $26.1 million during the quarter. A greater mix of higher-yielding savings products more than offset the rise in interest income in the quarter. ORRF's non-interest income edged 0.2% higher year-over-year for the quarter. The company's adjusted diluted EPS fell by 11.7% over the year-ago period to $0.83 during the quarter. This was $0.10 above the analyst consensus in the quarter.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$3.59	$0.83	$0.81	$1.30	$1.81	$1.89	$2.21	$2.91	$3.25	$3.51	***$3.60***	***$5.17***
DPS	-	$0.22	$0.35	$0.42	$0.51	$0.60	$0.68	$0.74	$0.76	$0.80	***$0.92***	***$1.23***
Shares[2]	8.3	8.3	8.3	8.3	9.4	11.2	11.2	11.2	10.7	10.6	***19.4***	***19.4***

Of note, ORRF's 2014 adjusted diluted EPS includes a favorable adjustment of $2.00 stemming from a recapture of the deferred tax asset valuation allowance. Factoring this out of the mix, the company's adjusted diluted EPS has compounded by around 9% annually from 2014 through 2023. In the years ahead, we anticipate that growth will be almost as strong.

That's because the Federal Reserve's recent 50 basis point cut to the federal funds rate should be just the start of a two-year rate-cutting cycle. This should help the company's net interest margin turn the corner as more customers take out

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[1] Estimate

[2] Share count is 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.

loans and cash balances are disincentivized by lower interest rates. Additionally, ORRF announced in August that it planned to close six of its branches by the end of 2024. Five were subject to regulatory approval and one was branch consolidation. This should trim costs and improve operating efficiency. Barring any more major acquisitions, we also believe that the share count should be relatively flat in the coming years.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Avg. P/E	4.7	21.5	27.7	19.5	10.1	11.7	7.5	8.7	7.1	8.4	***9.9***	***10.0***
Avg. Yld.	-	1.2%	1.6%	1.7%	2.8%	2.7%	4.1%	2.9%	3.3%	2.7%	***2.6%***	***2.4%***

From a trough valuation multiple of below five to a peak valuation multiple in the high 20s, ORRF's valuation has varied significantly in the past 10 years. The average P/E ratio over this time was 12.7. The five-year average is more modest at 8.7. Almost splitting the difference in the five-year and 10-year multiples, we think that a P/E ratio of 10 represents a reasonable fair value estimate.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	-	27%	43%	32%	28%	32%	31%	25%	23%	23%	***26%***	***24%***

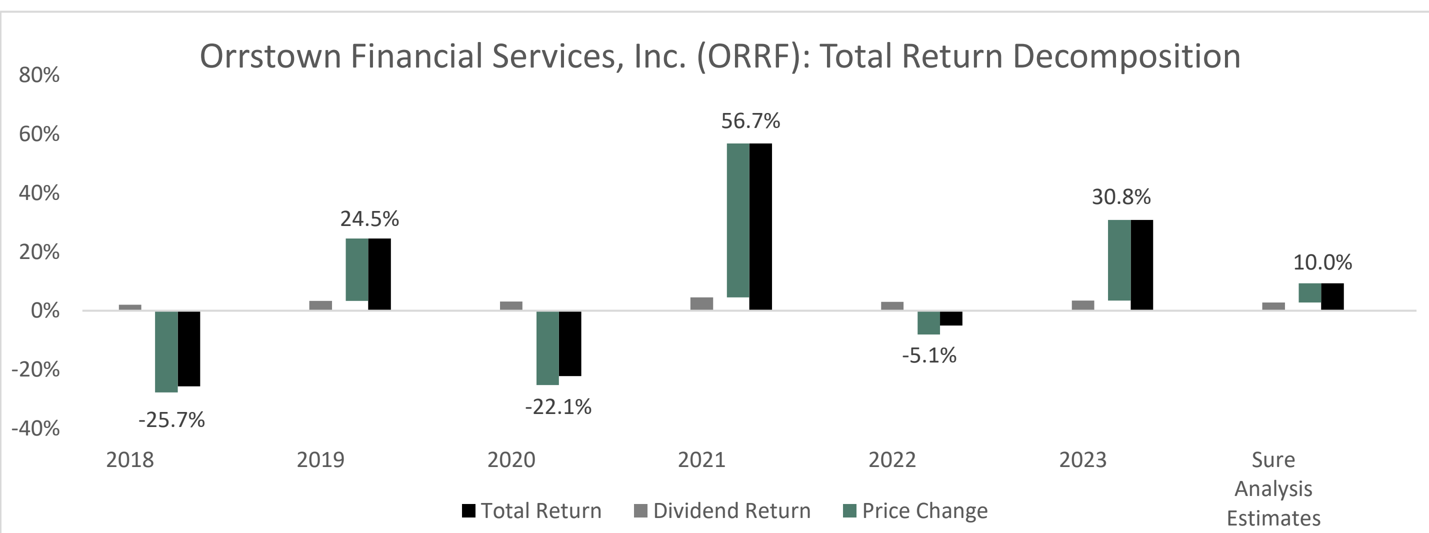
In its 105-year operating history, ORRF has fostered extensive relationships with its customers. This is helping it to retain existing customers and to gain new customers. Along with the improving macroeconomic environment, this should help adjusted diluted EPS to rise over time.

As of June 30th, ORRF's NPAs/assets ratio was 0.26%. This suggests that the bank also takes asset quality seriously. On top of this solid asset quality, ORRF's payout ratio is right around a quarter of its profits. This implies that the bank could withstand a downturn in corporate profits and keep paying dividends to its shareholders. That positions ORRF well to extend its nine-year dividend growth streak in the coming years.

Final Thoughts & Recommendation

ORRF's 2.6% dividend yield, 7.5% annual adjusted diluted EPS growth prospects, and 0.2% annual valuation multiple upside could generate 10.0% annual total returns for shareholders over the next five years. The current valuation leaves a modest margin of safety, so we're initiating coverage with a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	52	53	56	63	72	97	111	115	125	129
SG&A Exp.	30	30	34	36	38	46	47	48	52	56
D&A Exp.	3	3	3	3	4	6	7	5	5	4
Net Profit	29	8	7	8	13	17	26	33	22	36
Net Margin	56.0%	14.9%	11.9%	12.8%	17.7%	17.5%	23.9%	28.6%	17.6%	27.6%
Free Cash Flow	16	11	2	14	18	6	29	40	35	41
Income Tax	(16)	2	1	4	2	3	6	8	5	9

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	1,190	1,293	1,415	1,559	1,934	2,383	2,751	2,835	2,922	3,064
Cash & Equivalents	31	28	30	30	72	56	125	209	61	65
Accounts Receivable	3	4	5	5	6	6	9	8	11	14
Goodwill & Int. Ass.	0			1	17	27	24	23	22	21
Total Liabilities	1,063	1,160	1,280	1,414	1,761	2,160	2,504	2,563	2,694	2,799
Long-Term Debt	80	84	76	134	170	242	90	34	138	170
Shareholder's Equity	127	133	135	145	173	223	246	272	229	265
LTD/E Ratio	0.63	0.64	0.56	0.92	0.98	1.08	0.37	0.12	0.60	0.64

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	2.5%	0.6%	0.5%	0.5%	0.7%	0.8%	1.0%	1.2%	0.8%	1.2%
Return on Equity	26.6%	6.0%	4.9%	5.8%	8.0%	8.5%	11.3%	12.7%	8.8%	14.4%
ROIC	16.0%	3.7%	3.1%	3.3%	4.1%	4.2%	6.6%	10.2%	6.6%	8.9%
Shares Out.	8.3	8.3	8.3	8.3	9.4	11.2	11.2	11.2	10.7	10.6
Revenue/Share	6.41	6.47	6.82	7.66	6.56	9.21	10.05	10.35	11.70	12.39
FCF/Share	2.02	1.31	0.27	1.67	1.60	0.59	2.62	3.56	3.30	3.97

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