# Community Financial System (CBU)

*Updated October 25th, 2024, by Josh Arnold*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $58 | **5 Year CAGR Estimate:** | 7.4% | **Market Cap:** | $3.1 B |
| **Fair Value Price:** | $48 | **5 Year Growth Estimate:** | 9.0% | **Ex-Dividend Date:** | 12/13/2024 |
| **% Fair Value:** | 122% | **5 Year Valuation Multiple Estimate:** | -3.9% | **Dividend Payment Date:** | 01/10/2025 |
| **Dividend Yield:** | 3.2% | **5 Year Price Target** | $73 | **Years Of Dividend Growth:** | 32 |
| **Dividend Risk Score:** | B | **Retirement Suitability Score:** | B | **Rating:** | Hold |

## Overview & Current Events

Community Financial 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 traditional community banking, but it also owns a large benefits administration business, in addition to offering a variety of insurance products. Its market capitalization is $3.1 billion, and it produces about $735 million in annual revenue.

Community Financial System posted third quarter earnings on October 22nd, 2024, and results were mixed. The company's earnings-per-share came to 83 cents, which was a nickel light of estimates. Earnings were off eight cents from the year-ago period. Revenue was up nicely, adding almost 8% year-over-year to $189 million, but that missed estimates by $3 million.

Net interest income was $113 million, a new quarterly record for the company, up $5 million or 4.6% year-over-year. Total financial services revenue was $56 million, a third consecutive quarterly record. It was $5.7 million, or 11.4% higher from the prior year.

Loans ended the quarter at $10.25 billion, up $228 million or 2.3% from Q2. It was up $802 million or 8.5% from a year ago. Ending deposits were $13.48 billion, up $338 million or 2.6% from Q2. Deposits were up $445 million or 3.4% from a year ago. The bank ended with a loan-to-deposit ratio of 76%, higher than a year ago, but at a comfortable level.

We see $3.40 in adjusted earnings-per-share for this year with a single quarter to go.

## 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 | ***$3.40*** | ***$5.23*** |
| **DPS** | $1.16 | $1.22 | $1.26 | $1.34 | $1.44 | $1.58 | $1.66 | $1.70 | $1.76 | $1.78 | ***$1.84*** | ***$1.93*** |
| **Shares[1]** | 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 9% earnings-per-share growth annually. We are less cautious given interest rate headwinds are beginning to abate, and CBU stands to benefit greatly should that continue. We see interest rates, as well as higher loan balances as drivers for earnings growth.

Community Financial 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 Financial System has proven adept at executing this strategy over time, and this should be the primary growth driver going forward. Community Financial 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.

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[1] Share count in millions

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## 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 | ***17.1*** | ***14.0*** |
| **Avg. Yld.** | 3.2% | 3.3% | 2.9% | 2.5% | 2.4% | 2.5% | 2.8% | 2.3% | 2.8% | 3.4% | ***3.2%*** | ***2.6%*** |

Community Financial System's price-to-earnings multiple has moved around significantly in the past decade as its fortunes have improved and deteriorated. We maintain our target valuation of 14 times earnings given the sector is seeing better valuations applied by investors. We are forecasting a sizable annual headwind to total returns in the coming years from the valuation. We see the dividend yield at 2.6% in five years, lower than today's levels as we think the share price will markedly outpace growth in the dividend.

## 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% | ***54%*** | ***37%*** |

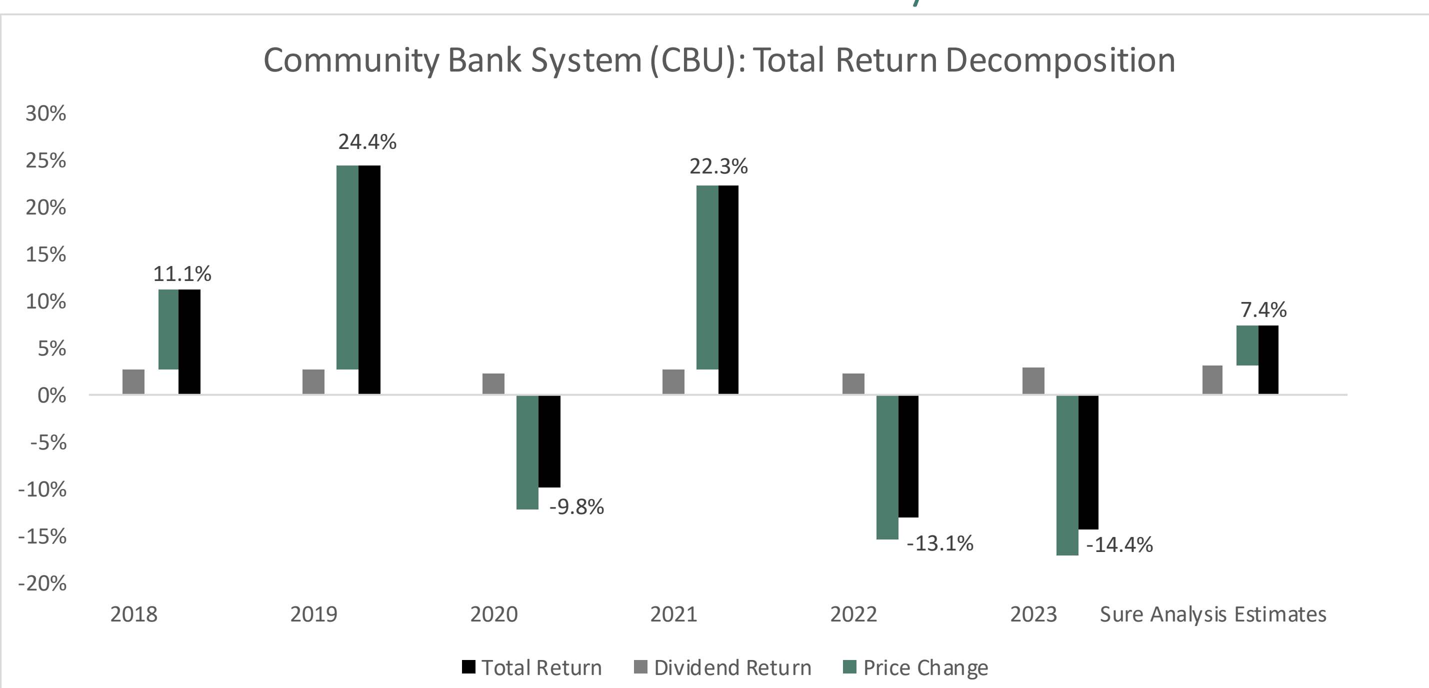
We see the payout ratio remaining around half of earnings for the foreseeable future. The bank's impressive dividend streak appears to be safe at this point, and we see many more years of increases coming, even if a recession strikes. Growth rates should be low, however, given management's past tendencies.

Community Financial System's competitive advantage is 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 Financial's total returns look much improved since our last report. We forecast total annual returns of 7.4%, and as that's much higher than last time, we're upgrading the stock from sell to hold. The 3.2% yield is attractive at roughly double the S&P 500, and the growth outlook for the bank is much better.

## Total Return Breakdown by Year




*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 | 28 |
| 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 | 210 |
| 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 | 55 |
| 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 | 3.91 |

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