1st Source Corp. (SRCE)

Updated October 27th, 2024, by Josh Arnold

Key Metrics

Current Price:	$57	**5 Year CAGR Estimate:**	0.2%	**Market Cap:**	$1.4 B
Fair Value Price:	$58	**5 Year Growth Estimate:**	-3.0%	**Ex-Dividend Date:**	11/05/24
% Fair Value:	98%	**5 Year Valuation Multiple Estimate:**	0.5%	**Dividend Payment Date:**	11/15/24
Dividend Yield:	2.5%	**5 Year Price Target**	$50	**Years Of Dividend Growth:**	37
Dividend Risk Score:	A	**Retirement Suitability Score:**	A	**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 $1.4 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 37 years, which very few banks can match.

1st Source posted third quarter earnings on October 24th, 2024, and results were better than expected on both the top and bottom lines. Earnings-per-share came to $1.41, which was seven cents ahead of estimates. Revenue was up 4.3% year-over-year to $97.93 million, fractionally beating estimates.

Average loans and leases were $6.61 billion, flat to Q2, but up almost 6% year-over-year. Average deposits were $7.13 billion, down fractionally from Q2.

Net interest income was up $1.44 million to $75.63 million, or about 2% from Q2. From the year-ago period, NII was up about 9%, or $6.22 million. Net interest margin was 3.63%, up four basis points from Q2, but up 18 basis points from the same period a year ago. The gain in NII was primarily due to higher rates on loan balances, as well as less reliance upon higher cost short-term borrowings.

Noninterest income was $22.45 million, down 3.33% from Q2, and down 8.21% from the year-ago period. The decline in noninterest income was primarily due to lower trust and wealth advisory income.

We continue to estimate $5.30 in earnings-per-share for this year, which would be a record for 1st Source, if achieved. We note results remain somewhat mixed and don't see a lot of upside risk in our estimate.

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	***$5.30***	***$4.55***
DPS	$0.65	$0.67	$0.72	$0.76	$0.96	$1.10	$1.13	$1.21	$1.26	$1.30	***$1.44***	***$1.59***
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 estimating earnings contraction (not growth) of 3% 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. 1st Source is set to produce what would be record results in 2024, but that may prove to be the top given current estimates.

[1] Share count in millions

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Our expectation for the dividend is now $1.59 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	***10.8***	***11.0***
Avg. Yld.	2.3%	2.2%	2.1%	1.6%	1.9%	2.4%	3.1%	2.6%	2.4%	2.4%	***2.5%***	***3.2%***

1st Source's price-to-earnings multiple has been steady, all things considered, for the past decade. It is currently trading for 10.8 times earnings, which is in line with our estimate of fair value. Therefore, we see very little impact to total returns from the valuation in the coming years. The yield should remain between 2.5% and 3% for the foreseeable future. The increase in earnings estimates has the valuation moderating, boosting the attractiveness of the stock.

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%	***27%***	***35%***

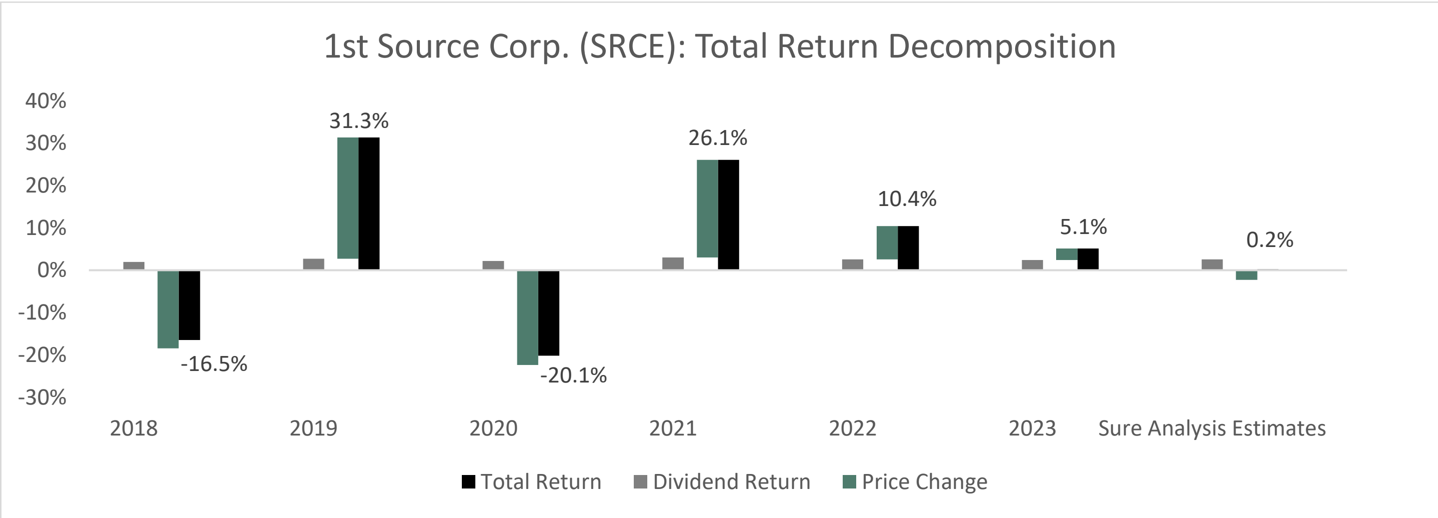
The payout ratio is less than one-third of earnings and dividend raises will likely be somewhat modest in the coming years. We see the dividend as safe and with a lot of room to grow given 1st Source's commitment to raising the payout, as well as the low payout ratio. We see the payout growing even if 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 0.2% annually, consisting of the current 2.5% yield and 3% 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 are reiterating the stock at a sell rating after Q3 results.

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	238	250	259	284	311	325	330	337	355	369
SG&A Exp.	96	100	100	102	109	112	114	122	137	122
D&A Exp.	20	24	28	32	33	35	31	24	19	15
Net Profit	58	57	58	68	82	92	81	119	121	125
Net Margin	24.4%	23.0%	22.3%	23.9%	26.5%	28.3%	24.7%	35.2%	34.1%	33.9%
Free Cash Flow	37	37	59	88	135	154	152	164	173	182
Income Tax	26	31	31	33	23	28	25	36	36	37

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	4830	5188	5486	5887	6294	6623	7316	8096	8339	8728
Cash & Equivalents	65	65	59	74	95	67	74	54	85	77
Goodwill & Int. Ass.	85	85	84	84	84	84	84	84	84	84
Total Liabilities	4215	4544	4814	5169	5530	5774	6386	7127	7416	7660
Long-Term Debt	222	219	262	119	199	138	127	115	179	342
Shareholder’s Equity	614	644	673	719	762	828	887	916	864	990
LTD/E Ratio	0.36	0.34	0.39	0.17	0.26	0.17	0.14	0.13	0.21	0.35

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	1.2%	1.1%	1.1%	1.2%	1.4%	1.4%	1.2%	1.5%	1.5%	1.5%
Return on Equity	9.7%	9.1%	8.8%	9.8%	11.1%	11.6%	9.5%	13.1%	13.5%	12.5%
ROIC	6.9%	6.8%	6.4%	7.7%	9.2%	9.3%	7.9%	11.1%	11.0%	10.0%
Shares Out.	26	26	26	26	26	26	26	25	25	25
Revenue/Share	9.01	9.55	9.99	10.97	11.99	12.70	12.92	13.45	14.40	15.00
FCF/Share	1.39	1.40	2.28	3.40	5.23	6.02	5.94	6.55	7.01	7.39

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