



# Arrow Financial Corporation (AROW)

Updated May 4<sup>th</sup>, 2024, by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$24	<b>5 Year CAGR Estimate:</b>	13.2%	<b>Market Cap:</b>	\$391 M
<b>Fair Value Price:</b>	\$24	<b>5 Year Growth Estimate:</b>	10.0%	<b>Ex-Dividend Date:</b>	05/10/24
<b>% Fair Value:</b>	99%	<b>5 Year Valuation Multiple Estimate:</b>	0.2%	<b>Dividend Payment Date:</b>	05/24/24
<b>Dividend Yield:</b>	4.5%	<b>5 Year Price Target</b>	\$39	<b>Years Of Dividend Growth:</b>	27
<b>Dividend Risk Score:</b>	C	<b>Retirement Suitability Score:</b>	B	<b>Rating:</b>	Buy

## Overview & Current Events

Arrow Financial Corporation is a multi-bank holding company based in Glen Falls, New York. The company operates through two main subsidiary banks, the Glens Falls National Bank and Trust Company, and the Saratoga National Bank and Trust Company. Arrow Financial Corporation is also the parent company of North Country Investment Advisers and Update Agency, an insurance agency. The company is a small cap with a market capitalization of just \$391 million, and it produces about \$140 million in annual revenue. Arrow Financial has increased its dividend for 27 consecutive years and is a member of the Dividend Champions list, as it is too small to be considered a Dividend Aristocrat.

Arrow posted first quarter earnings on April 30<sup>th</sup>, 2024, and results were worse than expected, as Arrow continued its streak of relatively poor performances. Earnings-per-share came to 45 cents, which was two cents light of estimates. Net interest margin was better, but at 2.60%, still poor relative to the rest of the industry.

Net interest income declined \$1.6 million due to higher deposit costs, while noninterest income rose \$1.2 million, and noninterest expense rose \$1.7 million.

Gross loans were up \$50.5 million, or 6.1% on an annualized basis. Deposit balances were \$3.8 billion, growing 2.5%, or \$92 million.

Net charge-offs to average loans were just 0.04%, which is really outstanding on both an absolute and relative basis. Arrow's credit quality has always been terrific and remains as such. Loan-to-deposits ended the quarter at 86%, quite elevated and limiting potential future growth on that front.

Arrow spent \$6 million to buy 244k shares during the quarter, in addition to the dividend paid.

We reiterate our estimate of \$2.20 in earnings-per-share for this year after Q1 results.

## Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
<b>EPS</b>	\$1.31	\$1.44	\$1.58	\$1.80	\$2.28	\$2.35	\$2.56	\$3.10	\$2.95	\$1.77	<b>\$2.20</b>	<b>\$3.54</b>
<b>DPS</b>	\$0.70	\$0.74	\$0.78	\$0.84	\$0.91	\$0.97	\$0.99	\$1.01	\$1.08	\$1.06	<b>\$1.08</b>	<b>\$1.19</b>
<b>Shares<sup>1</sup></b>	14.1	14.1	14.3	14.4	14.5	15.0	15.5	16.0	16.6	16.9	<b>17.2</b>	<b>18.5</b>

Arrow Financial Corporation has compounded its diluted earnings-per-share at a rate of ~5% per year over the last decade. While we note that the company's per-share financial performance could have been significantly better if it were not for the 3% annual stock dividend, it is important to recognize that management does not seem to have any plans to discontinue this policy. Given this, and the very low earnings level forecast for 2024, we forecast 10% annual earnings growth for the foreseeable future. Already high loan-to-deposit leverage will make it more challenging to grow the loan book and thus, we think Arrow has an uphill battle in front of it for earnings-per-share growth. We note that rapidly improving lending margins as well as loan balance growth should fuel growth. This is dependent upon credit quality also remaining strong, which it certainly was in Q1.

<sup>1</sup> Share count 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.



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## Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	14.5	14.3	15.7	17.2	15.5	13.3	11.5	11.3	11.5	15.6	10.9	11.0
Avg. Yld.	3.8%	3.7%	3.3%	2.9%	2.8%	3.1%	3.4%	2.9%	3.2%	3.8%	4.5%	3.1%

Arrow Financial Corporation has traded at an average price-to-earnings ratio of more than 13 over the last decade. We view this valuation as a bit rich relative to its peers in the financial sector. Instead, we peg fair value for a small-cap regional bank like Arrow Financial around 11 times earnings. Using the company's current stock price and our 2024 earnings-per-share estimate of \$2.20, Arrow Financial Corporation is trading at a current price-to-earnings ratio of 10.9. We therefore see essentially no impact to total returns from the valuation.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

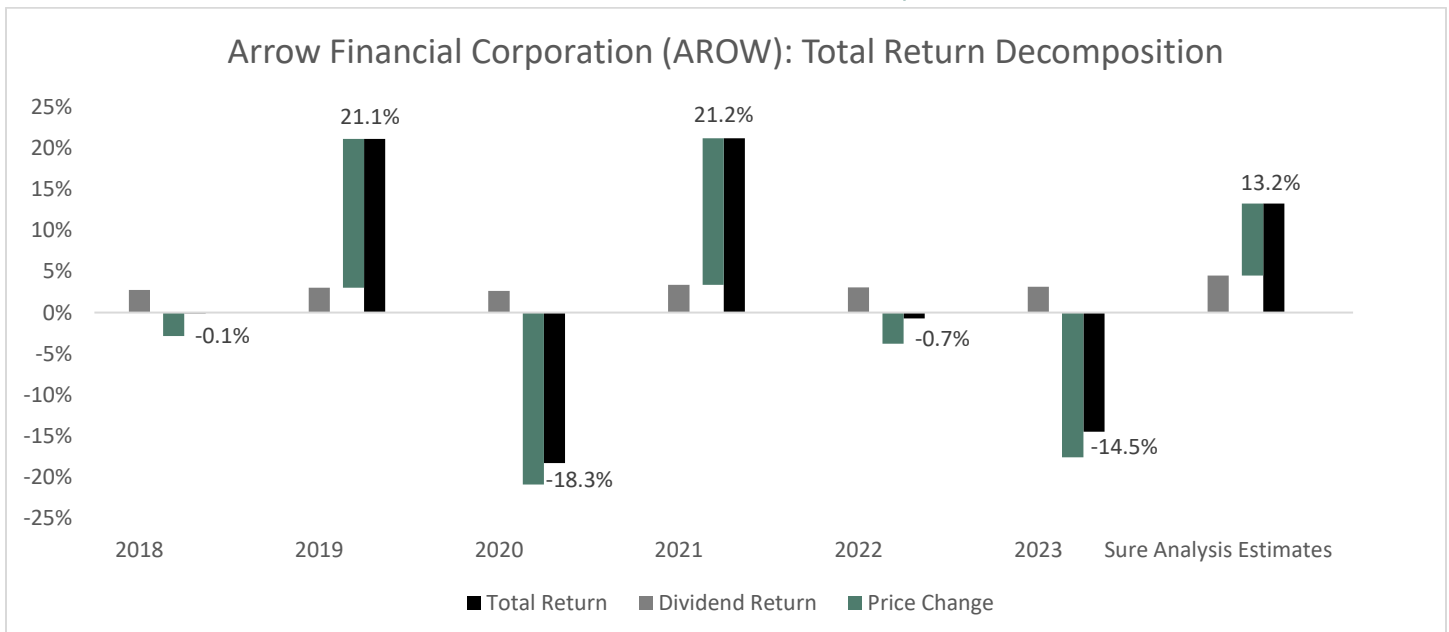
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	53%	51%	50%	47%	40%	41%	39%	33%	37%	60%	49%	34%

As a small-cap regional bank, Arrow Financial Corporation's only potential competitive advantage is the willingness to pursue small markets where its larger competitors (such as Wells Fargo or Bank of America) have no interest in operating. While this advantage may seem slim, it is clearly working – the company is one of few banks to have increased its dividend for 27 consecutive years. Arrow Financial is also very recession resistant. Its earnings-per-share declined by just -5% during the 2007-2009 financial crisis while many other financial institutions were going out of business.

## Final Thoughts & Recommendation

Arrow Financial Corporation could deliver 13.2% total returns to shareholders over the next five years. The 4.5% dividend yield, 10% earnings growth, and a 0.2% valuation tailwind combine to create respectable prospective total returns for potential shareholders. This company is small, illiquid, and offers investors good annual total return potential. With total prospective returns unchanged, we're reiterating the stock at 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
<b>Revenue</b>	89	94	99	105	113	117	132	147	149	134
<b>SG&amp;A Exp.</b>	32	42	44	41	43	42	46	49	48	50
<b>D&amp;A Exp.</b>	7	6	6	5	5	6	7	8	8	7
<b>Net Profit</b>	23	25	27	29	36	37	41	50	49	30
<b>Net Margin</b>	26.1%	26.2%	26.7%	27.9%	32.1%	32.1%	31.0%	34.0%	32.9%	22.4%
<b>Free Cash Flow</b>	29	27	33	35	37	36	37	61	45	13
<b>Income Tax</b>	10	11	11	11	9	10	11	15	14	7

## Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Total Assets</b>	2217	2446	2605	2760	2988	3184	3689	4028	3970	4170
<b>Cash &amp; Equivalents</b>	46	51	57	73	84	70	381	458	65	143
<b>Goodwill &amp; Int. Ass.</b>	26	25	25	24	24	24	24	24	23	23
<b>Total Liabilities</b>	2016	2232	2372	2511	2719	2883	3354	3657	3616	3790
<b>Long-Term Debt</b>	90	157	198	180	299	180	65	65	75	47
<b>Shareholder's Equity</b>	201	214	233	250	270	302	334	371	354	380
<b>LTD/E Ratio</b>	0.45	0.73	0.85	0.72	1.11	0.60	0.19	0.18	0.21	0.12

## Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Return on Assets</b>	1.1%	1.1%	1.1%	1.1%	1.3%	1.2%	1.2%	1.3%	1.2%	0.7%
<b>Return on Equity</b>	11.9%	11.9%	11.9%	12.2%	14.0%	13.1%	12.8%	14.1%	13.5%	8.2%
<b>ROIC</b>	7.9%	7.4%	6.6%	6.8%	7.3%	7.1%	9.3%	11.9%	11.3%	7.0%
<b>Shares Out.</b>	14.1	14.1	14.3	14.4	14.5	15.0	15.5	16.1	16.6	17.0
<b>Revenue/Share</b>	5.99	6.27	6.55	6.89	7.35	7.56	8.52	8.88	9.01	7.86
<b>FCF/Share</b>	1.95	1.82	2.19	2.30	2.40	2.34	2.40	3.8	2.67	0.79

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

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