PSB Holdings Inc. (PSBQ)

Updated July 7th, 2019 by Josh Arnold

Key Metrics

Current Price:	$24	**5 Year CAGR Estimate:**	7.7%	**Volatility Percentile:**	0.1%
Fair Value Price:	$24	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	30.5%
% Fair Value:	100%	**5 Year Valuation Multiple Estimate:**	0.0%	**Growth Percentile:**	52.3%
Dividend Yield:	1.7%	**5 Year Price Target**	$32	**Valuation Percentile:**	61.2%
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Total Return Percentile:**	46.5%

Overview & Current Events

PSB Holdings is the parent company of Peoples State Bank, or PSB, which opened its doors for the first time in 1962 in Wausau, Wisconsin. The company has paid dividends to shareholders continuously since 1965, and is a Dividend Champion, having raised its payout for at least 25 consecutive years. The bank has ten branches, and assets totaling about $900 million. The stock trades with a $111 million market capitalization, making it one of the smaller companies in our coverage universe.

PSB reported Q1 earnings on 4/29/19 and results improved compared to the year-ago period. Earnings-per-share rose from $0.56 to $0.61, although $0.09 of positive impact to earnings-per-share was realized from a change in equity accounting principle. Without this, earnings-per-share would have fallen modestly.

The bank saw higher loan loss provisions offset better lending spreads in Q1. Indeed, net interest margin rose 14bps year-over-year to a very robust 3.63% in Q1. Loan yields rose 14bps in Q1 to 5.09%, comprising the entirety of the gain in net interest margin; deposit costs were flat. Loan loss provisions rose to $400,000 in Q1 – up significantly from $60,000 in the year-ago period – thanks to accruals against the credit accounts of now-bankrupt retailer ShopKo.

PSB's adjusted efficiency ratio came to 61.9% in Q1, a solid improvement over the 63.1% showing in the year-ago period. This helped boost operating margins, and offset some of the increased provisions for losses.

Non-performing assets rose in Q1 thanks to exposure to ShopKo, rising from 0.79% of total loans to 0.84% year-over-year. In addition, its loan-to-deposit ratio rose from 88% to 92% year-over-year as PSB continues to chase loan growth in excess of the rate of deposit growth. The strategy appears to be working, other than the losses associated with ShopKo.

We're out with an initial estimate of $2.40 in earnings-per-share for this year after a largely in-line quarter. This estimate would represent modest growth over 2018, but investors should keep in mind that last year was a blockbuster year for growth that will be nearly impossible to replicate.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$0.67	$1.03	$1.07	$1.20	$0.96	$1.30	$1.61	$1.83	$1.58	$2.29	***$2.40***	***$3.21***
DPS	$0.23	$0.24	$0.24	$0.25	$0.26	$0.27	$0.28	$0.30	$0.32	$0.36	***$0.40***	***$0.60***
Shares	4.7	4.8	5.0	5.0	5.0	5.0	4.8	4.6	4.6	4.5	***4.5***	***4.2***

PSB has a very impressive track record of growth. It managed to remain quite profitable during the Great Recession, which is a testament to its lending standards. Indeed, many of its competitors weren't so fortunate. Since normalized earnings returned in 2010, PSB has managed to grow earnings-per-share by more than 10% annually, on average. We don't see that sort of growth in the future, however, and instead estimate 6% annual expansion.

This growth is slower than historical rates primarily because the bank's spreads have already expanded widely, and because its loan-to-deposit ratio is stretched at or near the limit. Both of these levers allow banks to boost profitability of the existing asset base by improving margins, and producing leverage, respectively. PSB has done these things well in recent years, but given that its net interest margin is well in excess of 3.5%, and that its loan-to-deposit ratio is closing in on 100%, we see limited catalysts for outsized growth.

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Share buybacks and organic growth should be good enough for a mid-single digit long-term tailwind for earnings-per-share. In addition, the bank's efficiency ratio is drifting lower, which will help operating margins as well. However, PSB won't be able to produce anything like the growth it has for the past decade.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	9.2	6.4	7.2	7.1	10.1	8.5	8.7	8.6	13.8	10.7	***10.0***	***10.0***
Avg. Yld.	3.7%	3.6%	3.1%	2.9%	2.7%	2.5%	2.0%	1.9%	1.5%	1.5%	***1.7%***	***1.9%***

PSB's valuation has remained very low for much of the past decade despite its outstanding profitability and strong growth. The average P/E ratio for the past decade is just 9. However, we see fair value at 10 times earnings given the bank's strong track record of profitability and growth. We also believe this multiple accounts for slower growth moving forward. At 10 times earnings today, the stock is fairly valued against PSB's own historical multiples, as well as its peers.

The yield stands at 1.7%, which is low by historical standards. We see the yield creeping up over time, but it should remain below 2% for the foreseeable future. PSB recently boosted its semi-annual dividend to $0.20 per share.

Safety, Quality, Competitive Advantage, & Recession Resiliency

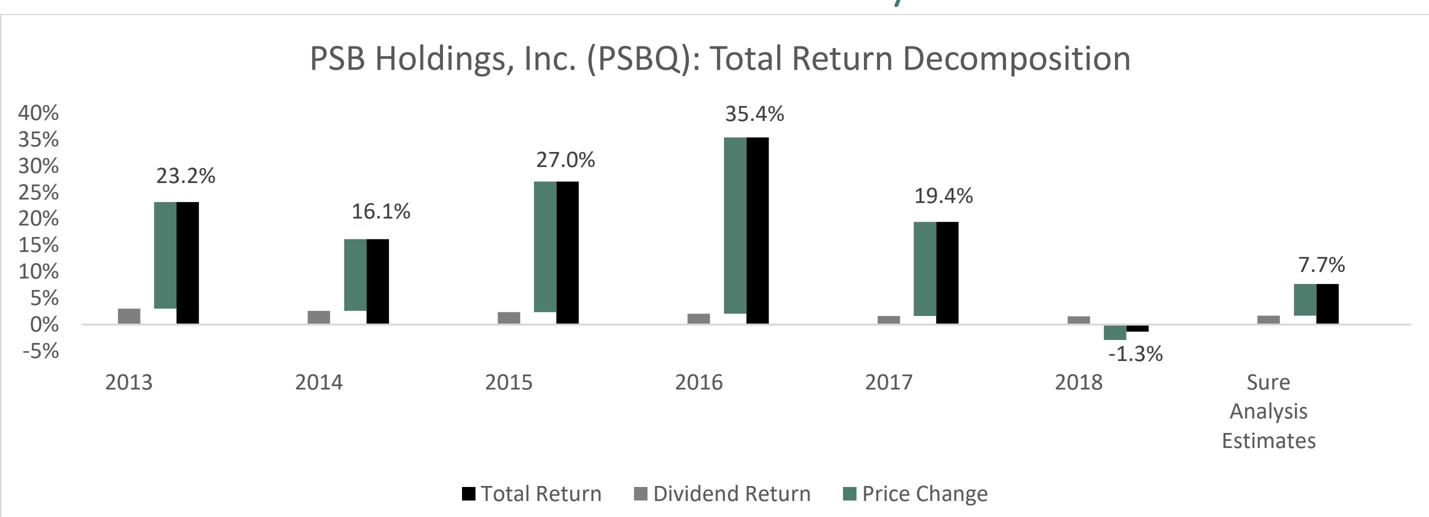
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	34%	23%	22%	21%	27%	21%	17%	16%	20%	16%	***17%***	***19%***

Competitive advantages are tough to come by in banking, but PSB does have a strong brand in the Wausau, WI area. In addition, its lending standards should help it weather the next recession, as it did during the last downturn. The dividend is also very safe at just one-sixth of earnings, and there is plenty of room for future raises.

Final Thoughts & Recommendation

We see PSB as a hold at current levels given that it trades for fair value, and that its growth should be slowing in the coming years. We like PSB's fundamentals, but note that already-high lending spreads and a very high loan-to-deposit ratio will make it much more challenging to grow in the coming years. The dividend yield is also near its lowest point in the past decade despite the recent payout increase. As such, investors would be advised to wait for a better entry price before initiating a position.

Total Return Breakdown by Year



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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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue					23	23	25	26	27	28
SG&A Exp.					10	11	11	12	12	13
D&A Exp.					2	2	2	3	3	2
Net Profit					3	5	5	6	5	6
Net Margin					13.8%	20.3%	21.3%	23.2%	17.6%	23.1%
Free Cash Flow					3	8	9	7	13	8
Income Tax					1	2	2	3	2	3

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets					607	621	623	712	712	734
Cash & Equivalents					16	12	19	26	17	22
Accounts Receivable					2	2	2	2	2	2
Goodwill & Int. Ass.					1	1	1	1	2	2
Total Liabilities					565	574	573	658	655	673
Long-Term Debt					101	104	85	86	51	33
Shareholder's Equity					42	47	50	54	57	61
D/E Ratio					2.40	2.22	1.68	1.57	0.90	0.53

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets					0.5%	0.8%	0.9%	0.9%	0.7%	0.9%
Return on Equity					7.6%	10.7%	10.9%	11.5%	8.5%	10.9%
ROIC					2.2%	3.2%	3.7%	4.4%	3.8%	6.4%
Shares Out.					5.0	5.0	4.8	4.6	4.6	4.5
Revenue/Share					4.58	4.74	5.02	5.18	5.43	5.62
FCF/Share					0.69	1.56	1.91	1.40	2.56	1.70

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