PSB Holdings Inc. (PSBQ)

Updated November 30th, 2019 by Josh Arnold

Key Metrics

Current Price:	$28	**5 Year CAGR Estimate:**	4.8%	**Volatility Percentile:**	9.1%
Fair Value Price:	$24	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	58.3%
% Fair Value:	115%	**5 Year Valuation Multiple Estimate:**	-2.7%	**Growth Percentile:**	57.0%
Dividend Yield:	1.5%	**5 Year Price Target**	$32	**Valuation Percentile:**	47.0%
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Total Return Percentile:**	35.3%

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 $950 million. The stock trades with a $123 million market capitalization, making it one of the smallest companies in our coverage universe.

PSB reported Q3 earnings on 10/28/19 and results showed strong revenue growth. The top line gained 10% year-over-year thanks to very strong asset growth. Indeed, total assets rose from $883 million to $950 million year-over-year as both loan and deposit growth were strong. Total loans rose 8.5% year-over-year to $691 million as deposits added 2.6% to $736 million. That puts the bank's loan-to-deposit ratio at 94%, which is very high, but not unsustainably so. PSB still maintains outstanding credit quality metrics, so it can get away with lending out nearly all of its deposits.

Net interest margin declined from 3.72% in Q2 to 3.60% in Q3. However, that was still up from 3.48% in the comparable period last year as short-term rates have continued to decline, improving funding costs.

PSB's efficiency ratio improved dramatically over prior periods, coming in at 55.1%. That's a very low efficiency ratio and, combined with the bank's high loan-to-deposit leverage, means profitability is strong. Earnings-per-share came in at $0.70 in Q3, a record for the company. After the Q3 report, we're reiterating our estimate of $2.40 in earnings-per-share for this year.

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[1]	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 were not 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 in excess of 3.5%, and that its loan-to-deposit ratio is closing in on 100%, we see limited catalysts for outsized growth.

[1] 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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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	***11.5***	***10.0***
Avg. Yld.	3.7%	3.6%	3.1%	2.9%	2.7%	2.5%	2.0%	1.9%	1.5%	1.5%	***1.5%***	***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 11.5 times earnings today, the stock is slightly overvalued in our view.

The yield stands at 1.5%, 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

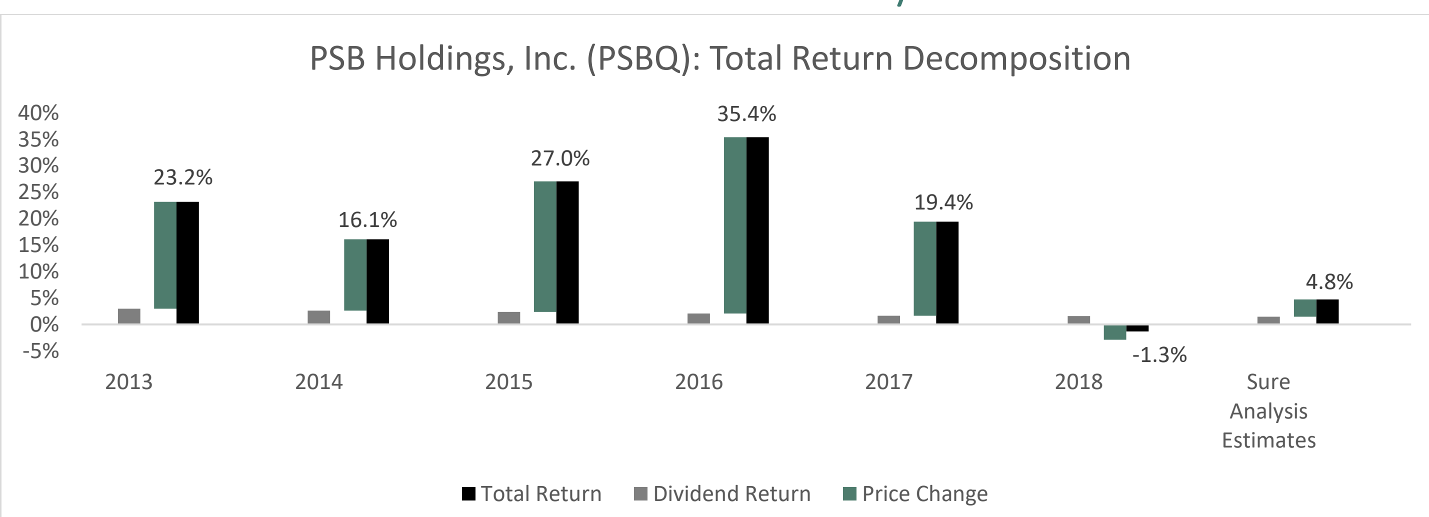
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	34%	23%	22%	21%	27%	21%	17%	16%	20%	16%	***17%***	***19%***

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 an average investment at current levels given that it trades just over fair value, and that its growth could 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. We rate shares as a hold.

Total Return Breakdown by Year



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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.