PSB Holdings Inc. (PSBQ)

Updated March 8th, 2020 by Josh Arnold

Key Metrics

Current Price:	$27	**5 Year CAGR Estimate:**	4.6%	**Market Cap:**	$120M
Fair Value Price:	$26	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	07/10/20[1]
% Fair Value:	105%	**5 Year Valuation Multiple Estimate:**	-1.0%	**Dividend Payment Date:**	07/31/20[2]
Dividend Yield:	1.5%	**5 Year Price Target**	$31	**Years Of Dividend Growth:**	26
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	11.1%

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 $975 million. The stock trades with a $120 million market capitalization, making it one of the smallest companies in our coverage universe.

PSB reported Q4 and full-year earnings on January 27th and results showed record earnings for the bank for the year. Total assets grew 2.7% to $975 million at the end of Q4 from the prior quarter, and up 6.4% year-over-year. Net loan growth was $49 million and core deposit growth equaled $74 million in the past year, respectively.

Net interest margin declined to 3.53% from 3.60% in Q3 as the bank had a larger balance of investments, rather than loans, in its earning asset base. PSB's net interest margin is still very high at 3.53%.

The bank's efficiency ratio was 59.9% in Q4, up from 55.1% in Q3, but down from 62.5% in the year-ago period.

Tangible book value was up 15.2% year-over-year to $20.72, aided by strong earnings in 2019. Earnings increased 9.1% on a dollar basis to $11.2 million, up from $2.29 to $2.51 on a per-share basis.

Our initial estimate is for $2.55 in earnings-per-share for this year as vastly lower interest rates should offset some of the balance sheet growth we expect from PSB this year.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$1.03	$1.07	$1.20	$0.96	$1.30	$1.61	$1.83	$1.58	$2.29	$2.51	***$2.55***	***$3.10***
DPS	$0.24	$0.24	$0.25	$0.26	$0.27	$0.28	$0.30	$0.32	$0.34	$0.37	***$0.40***	***$0.60***
Shares[3]	4.8	5.0	5.0	5.0	5.0	4.8	4.6	4.6	4.5	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 4% annual expansion, down from our prior estimate of 6%, primarily due to the extremely low interest rates persisting in the US.

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

[1] Estimated date
[2] Estimated date
[3] 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.

100%, we see limited catalysts for outsized growth. While the bank's loan-to-deposit ratio has improved of late, it is still very high, and interest rates are a headwind to growth at this point with the very flat and low yield curve.

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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	6.4	7.2	7.1	10.1	8.5	8.7	8.6	13.8	10.7	9.7	***10.5***	***10.0***
Avg. Yld.	3.6%	3.1%	2.9%	2.7%	2.5%	2.0%	1.9%	1.5%	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 10.5 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

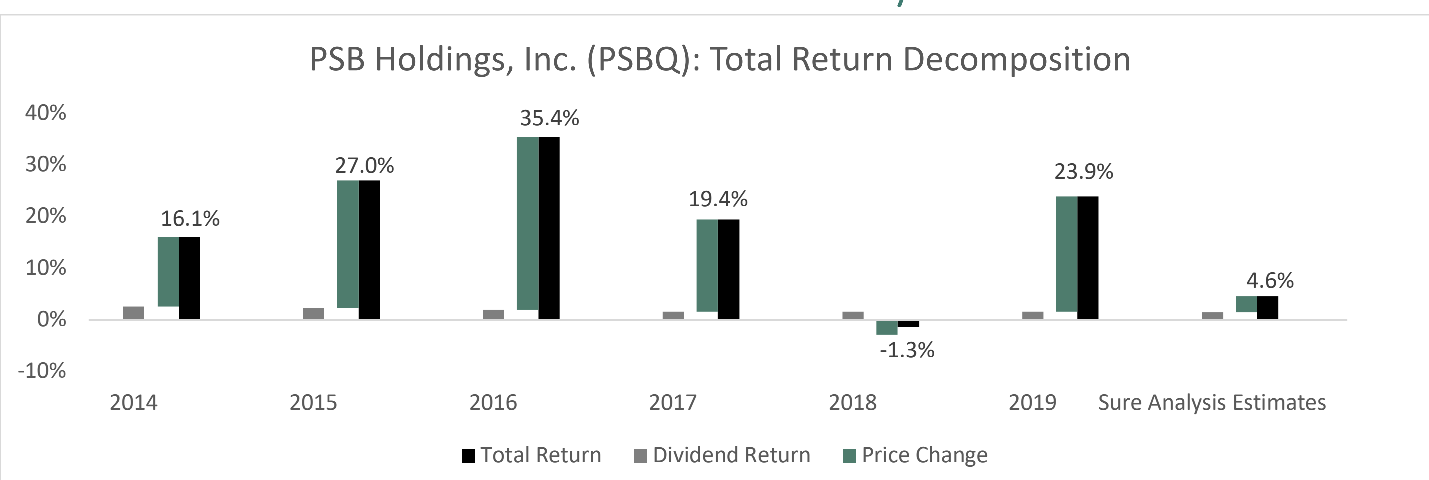
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	23%	22%	21%	27%	21%	17%	16%	20%	16%	15%	***16%***	***19%***

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 our estimate of 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	24	24	25	27	28	30	32	33	35
SG&A Exp.	10	11	11	12	12	13	14	15	15	16
D&A Exp.	2	2	2	3	3	2	2	2	2	2
Net Profit	3	5	5	6	5	6	8	8	7	10
Net Margin	13.8%	20.1%	22.4%	23.8%	17.9%	23.3%	26.2%	26.4%	21.7%	29.2%
Free Cash Flow	3	8	9	7	13	8	8	9	10	11
Income Tax	1	2	2	3	2	3	4	4	5	3

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	607	621	623	712	712	734	784	828	848	916
Cash & Equivalents	16	12	19	26	17	22	24	29	22	22
Accounts Receivable	2	2	2	2	2	2	2	2	2	3
Goodwill & Int. Ass.	1	1	1	1	2	2	2	2	2	2
Total Liabilities	565	574	573	658	655	673	719	758	774	835
Long-Term Debt	101	104	65	65	51	33	33	48	60	91
Shareholder's Equity	42	47	50	54	57	61	65	69	74	81
D/E Ratio	2.40	2.22	1.29	1.19	0.90	0.53	0.51	0.70	0.81	1.13

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%	1.0%	1.0%	0.9%	1.2%
Return on Equity	7.6%	10.7%	10.9%	11.5%	8.5%	10.9%	12.2%	12.6%	10.1%	13.3%
ROIC	2.2%	3.2%	4.0%	5.1%	4.2%	6.4%	8.1%	7.8%	5.7%	6.7%
Shares Out.	4.8	5.0	5.0	5.0	5.0	4.8	4.6	4.6	4.5	4.5
Revenue/Share	4.58	4.79	4.78	5.07	5.34	5.57	6.16	6.91	7.27	7.86
FCF/Share	0.69	1.56	1.91	1.40	2.56	1.70	1.72	1.87	2.30	2.35

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