PSB Holdings Inc. (PSBQ)

Updated April 28th, 2020 by Josh Arnold

Key Metrics

Current Price:	$20	**5 Year CAGR Estimate:**	8.0%	**Market Cap:**	$91M
Fair Value Price:	$23	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	07/10/20[1]
% Fair Value:	90%	**5 Year Valuation Multiple Estimate:**	2.0%	**Dividend Payment Date:**	07/31/20[2]
Dividend Yield:	2.0%	**5 Year Price Target**	$27	**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 $970 million. The stock trades with a $91 million market capitalization, making it one of the smallest companies in our coverage universe.

PSB reported Q1 earnings on April 27th, with results being surprisingly strong given the COVID-19 crisis that has shut down large portions of the economy. Earnings came to $1.61 million, or $0.36 per share in Q1, down from $2.81 million and $0.63 per share in last year's Q1. The difference was due to the stay-at-home orders in the bank's home state of Wisconsin in response to the COVID-19 crisis, which caused PSB to take a $1.8 million provision for credit losses in Q1. This is many times the size of the provision the bank is used to taking in a particular quarter, so we believe this may be the only provision that needs to be taken for the crisis this year.

In addition to the provision for losses, PSB saw lower net interest margin due to a higher cash position, higher noninterest expenses, and somewhat higher fees on the sale of mortgage loans.

As a result of the huge provision for credit losses in Q1, we've removed 30 cents from our prior earnings-per-share estimate for 2020. We're now at $2.25, noting that PSB's credit risk is well supported by its industry diversification, and strong credit quality of its borrowers.

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	***$2.25***	***$2.74***
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, primarily due to the extremely low interest rates persisting in the U.S.

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. While the bank's loan-to-deposit ratio has improved of late, it is still

[1] Estimated date
[2] Estimated date
[3] Share count in millions

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very high, and interest rates are a headwind to growth at this point with the very flat and low yield curve. We note some of this unwinding began to occur in Q1, which crimped earnings in excess of the damage caused by new provisions.

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 almost certainly 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	***9.0***	***10.0***
Avg. Yld.	3.6%	3.1%	2.9%	2.7%	2.5%	2.0%	1.9%	1.5%	1.5%	1.5%	***2.0%***	***2.2%***

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 9 times earnings today, the stock is somewhat undervalued in our view.

The yield stands at 2.0%, which is low by historical standards. We see the yield creeping up over time, but it should remain around 2% for the foreseeable future. PSB recently boosted its semi-annual dividend to $0.20 per share.

Safety, Quality, Competitive Advantage, & Recession Resiliency

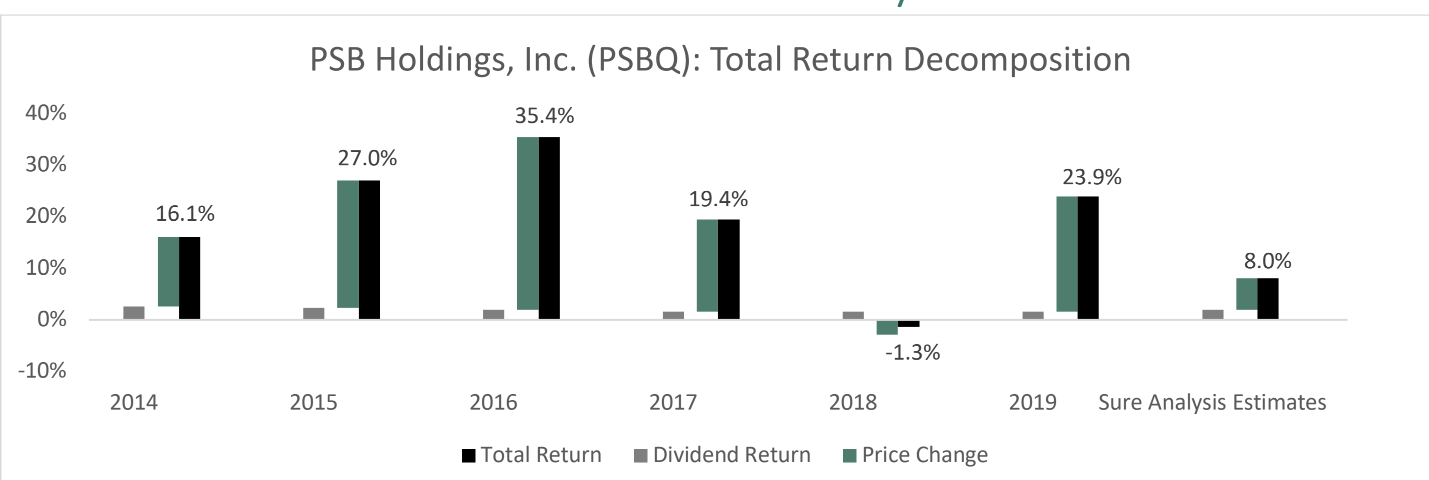
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	23%	22%	21%	27%	21%	17%	16%	20%	16%	15%	***18%***	***22%***

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 producing somewhat slower growth in the near-term, but with a much-improved valuation. 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. With an average dividend yield and an uncertain operating environment, we are reiterating PSB at a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	24	24	25	27	28	30	32	33	35	39
SG&A Exp.	11	11	12	12	13	14	15	15	16	17
D&A Exp.	2	2	3	3	2	2	2	2	2	2
Net Profit	5	5	6	5	6	8	8	7	10	11
Net Margin	20.1%	22.4%	23.8%	17.9%	23.3%	26.2%	26.4%	21.7%	29.2%	28.9%
Free Cash Flow	8	9	7	13	8	8	9	10	11	12
Income Tax	2	2	3	2	3	4	4	5	3	4

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	621	623	712	712	734	784	828	848	916	975
Cash & Equivalents	12	19	26	17	22	24	29	22	22	29
Accounts Receivable	2	2	2	2	2	2	2	2	3	3
Goodwill & Int. Ass.	1	1	1	2	2	2	2	2	2	2
Total Liabilities	574	573	658	655	673	719	758	774	835	882
Long-Term Debt	104	65	65	51	33	33	48	60	91	84
Shareholder's Equity	47	50	54	57	61	65	69	74	81	93
D/E Ratio	2.22	1.29	1.19	0.90	0.53	0.51	0.70	0.81	1.13	0.90

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	0.8%	0.9%	0.9%	0.7%	0.9%	1.0%	1.0%	0.9%	1.2%	1.2%
Return on Equity	10.7%	10.9%	11.5%	8.5%	10.9%	12.2%	12.6%	10.1%	13.3%	13.0%
ROIC	3.2%	4.0%	5.1%	4.2%	6.4%	8.1%	7.8%	5.7%	6.7%	6.5%
Shares Out.	4.8	5.0	5.0	5.0	5.0	4.8	4.6	4.6	4.5	4.5
Revenue/Share	4.79	4.78	5.07	5.34	5.57	6.16	6.91	7.27	7.86	8.67
FCF/Share	1.56	1.91	1.40	2.56	1.70	1.72	1.87	2.30	2.35	2.61

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