PSB Holdings Inc. (PSBQ)

Updated July 28th, 2020 by Josh Arnold

Key Metrics

Current Price:	$18	**5 Year CAGR Estimate:**	12.2%	**Market Cap:**	$82 M
Fair Value Price:	$25	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	01/10/21[1]
% Fair Value:	74%	**5 Year Valuation Multiple Estimate:**	6.2%	**Dividend Payment Date:**	01/31/21[2]
Dividend Yield:	2.3%	**5 Year Price Target**	$30	**Years Of Dividend Growth:**	27
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 just over $1 billion. The stock trades with an $82 million market capitalization, making it one of the smallest companies in our coverage universe.

PSB reported second quarter earnings on July 27th, with results coming in better than expected. Earnings came to $0.72 per share in Q2, or $3.2 million, compared to $0.36 per share and $1.6 million in the first quarter of this year. In last year's Q2, earnings were $0.57 per share, or $2.6 million, so results were quite strong this quarter.

Strength was seen from record levels of mortgage refinancing income, as well as lower compensation and benefits expense. Lower net interest margin and higher loan loss provisions offset some of this strength. Total assets also grew to more than $1 billion for the first time in the company's history.

Tangible net book value was up to $21.97 by the end of the quarter from $19.41 at the end of last year. This gives PSB a price-to-tangible-book value of just 84%.

The company also announced a 5% increase in its semi-annual dividend, with the July payment coming in at 41 cents per share. We've also boosted our estimate of earnings-per-share to $2.50 for 2020 on the strength of second quarter earnings, which were much better than expected.

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	***$2.50***	***$3.04***
DPS	$0.24	$0.24	$0.25	$0.26	$0.27	$0.28	$0.30	$0.32	$0.34	$0.37	***$0.42***	***$0.54***
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 still in excess of 3%, and that its loan-to-deposit ratio is closing in

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

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on 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. We note some of this unwinding continued to occur in Q2, 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	***7.4***	***10.0***
Avg. Yld.	3.6%	3.1%	2.9%	2.7%	2.5%	2.0%	1.9%	1.5%	1.5%	1.5%	***2.3%***	***1.8%***

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

The yield stands at 2.3%, which is high by recent historical standards. We see the yield drifting lower over time, but it should remain around 2% for the foreseeable future. PSB recently boosted its semi-annual dividend to $0.21 per share.

Safety, Quality, Competitive Advantage, & Recession Resiliency

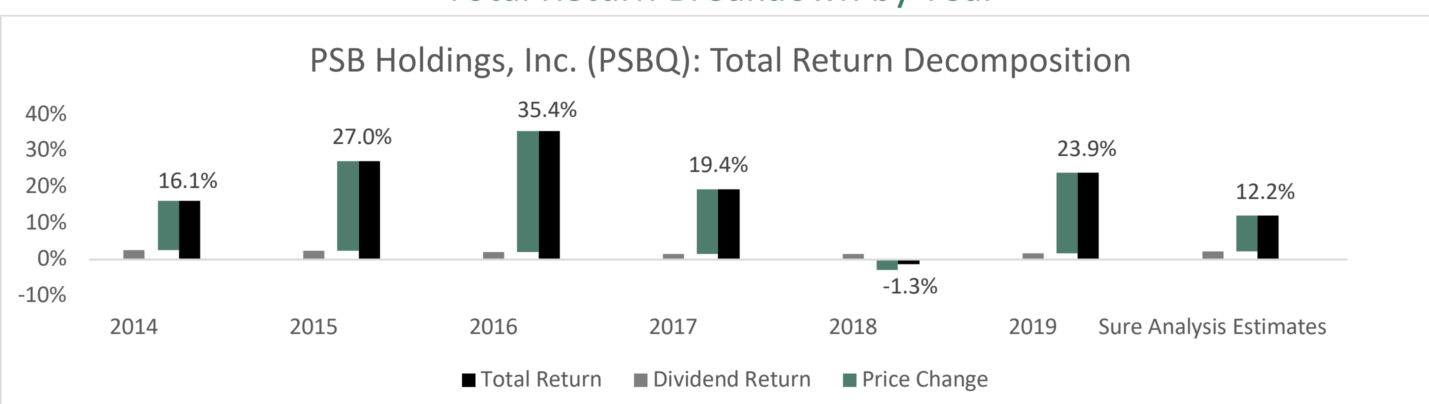
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	23%	22%	21%	27%	21%	17%	16%	20%	16%	15%	***17%***	***18%***

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 this 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 the yield having come up due to a lower valuation, we now rate PSB a buy as we expect 12%+ total annual returns from today's levels.

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.