PSB Holdings Inc. (PSBQ)

Updated November 23rd, 2020 by Josh Arnold

Key Metrics

Current Price:	$22	**5 Year CAGR Estimate:**	7.5%	**Market Cap:**	$98 M
Fair Value Price:	$24	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	01/10/21[1]
% Fair Value:	92%	**5 Year Valuation Multiple Estimate:**	1.8%	**Dividend Payment Date:**	01/31/21[2]
Dividend Yield:	1.9%	**5 Year Price Target**	$29	**Years Of Dividend Growth:**	28
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	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 $1.1 billion. The stock trades with a $98 million market cap, making it one of the smallest companies we cover.

PSB reported third quarter earnings on October 26th, and results were quite strong. Total revenue rose 11% year-over-year to $10.8 million as PSB continued to perform relatively well in a tough environment. Net interest income was $7.9 million and net interest margin was 3.03% in Q3. These compare to last year's Q3 values of $7.8 million and 3.60%, respectively, as PSB is suffering from lower rates, similar to its peers.

Loan investment yields were down 19bps in Q3, falling from 3.69% to 3.50%, while deposit and borrowing costs declined 18bps to 66bps in Q3, which helped offset the decline in loan yields. Like most banks, PSB participated in the Paycheck Protection Program, which offered small businesses very low rate loans. This helped boost the bank's loan book substantially, but at very low average yields. The bank's management team said they expect NIM to be flat or lower in the coming quarters, so it appears this problem will continue for the time being.

Provisions for loan losses came to $1.3 million in Q3, down from $1.8 million in Q2, but still up enormously against historical levels. Indeed, for the first three quarters of the year, provisions stand at $4.9 million, *seven* times the $700k from the same period last year.

Earnings came to $0.59 per share on net income of $2.64 million, down from $0.72 and $3.19 million, respectively, in the second quarter of this year, and $0.70 and $3.13 million, respectively, from the same period last year. We've slightly reduced our estimate for earnings-per-share for this year after Q3 results as PSB continues to see elevated loan loss provisions and lower NIM.

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	***$2.40***	***$2.92***
DPS	$0.24	$0.24	$0.25	$0.26	$0.27	$0.28	$0.30	$0.32	$0.34	$0.37	***$0.41***	***$0.52***
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 an impressive track record of growth. It managed to remain profitable during the Great Recession, which is a testament to its lending standards. 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 had previously 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

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

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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 on 100%, we see limited catalysts for outsized growth. We note some of this unwinding continued to occur in Q3, which crimped earnings in excess of the damage caused by new provisions. With commentary from the management team suggesting more weakness ahead for rate spreads, we are more cautious.

Share buybacks and organic growth should be good enough for a 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 in the current environment.

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	***9.2***	***10.0***
Avg. Yld.	3.6%	3.1%	2.9%	2.7%	2.5%	2.0%	1.9%	1.5%	1.5%	1.5%	***1.9%***	***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, as well as its dividend history. We also believe this multiple accounts for slower growth moving forward. At 9.2 times earnings today, the stock is slightly undervalued in our view.

The yield stands at 1.9%, which is more in line with historical standards. We see the yield drifting lower over time, but it should remain around 2% for the foreseeable future.

Safety, Quality, Competitive Advantage, & Recession Resiliency

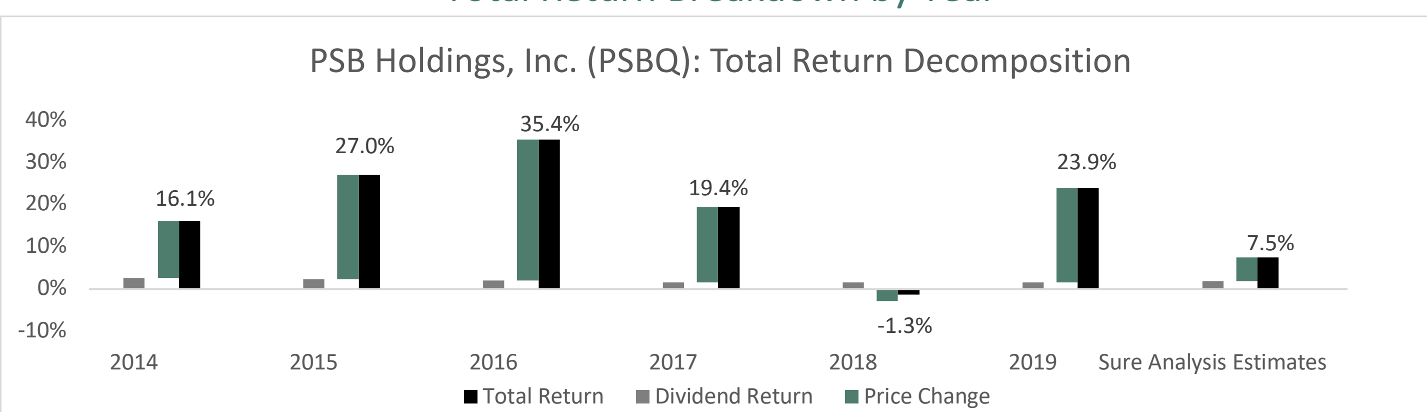
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	23%	22%	21%	27%	21%	17%	16%	20%	16%	15%	***17%***	***18%***

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 are helping in 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

With weakness in NIM coming up, as well as a much higher share price, the total return outlook has deteriorated to our new projection of 7.5%. Therefore, we are moving PSB from buy to hold, and note that investors should closely monitor credit losses and NIM performance in the coming quarters.

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.