PSB Holdings Inc. (PSBQ)

Updated May 2nd, 2021 by Josh Arnold

Key Metrics

Current Price:	$26	**5 Year CAGR Estimate:**	2.9%	**Market Cap:**	$114 M
Fair Value Price:	$28	**5 Year Growth Estimate:**	0.0%	**Ex-Dividend Date:**	07/07/21[1]
% Fair Value:	95%	**5 Year Valuation Multiple Estimate:**	1.1%	**Dividend Payment Date:**	07/29/21
Dividend Yield:	1.6%	**5 Year Price Target**	$28	**Years Of Dividend Growth:**	27
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	5.0%

Overview & Current Events

PSB Holdings is the parent company of Peoples State Bank, or PSB, which opened its doors in 1962 in Wausau, Wisconsin. The company has paid dividends to shareholders continuously since 1965 and has increased its payment for 27 consecutive years. The bank has ten branches, and assets totaling $1.1 billion. The stock trades with a $114 million market cap, making it one of the smallest companies we cover.

PSB reported first quarter earnings on April 26th, 2021, with results showing record earnings for the first quarter. The company's net interest margin was 3.62% in Q1, which was much higher than the 3.22% in the year-ago period, as PSB bucked the trend of other banks seeing lower NIM due to lower prevailing interest rates. PSB saw strength due to the accretion of $1.3 million in Paycheck Protection Program loans that were repaid in Q1. In addition, its deposit costs fell more quickly than loan yields fell, expanding profitability.

The bank took loan loss reserves of $1 million in Q1, also going against the grain of other banks that were showing loan loss reserve releases for Q1. The $1 million was higher than the $675,000 in Q4 but was down from $1.8 million in last year's Q1. As a percentage of loans, PSB's reserves are still high at 1.4%.

Tangible book value was up 13.4% year-over-year, ending the quarter at $23.69 per share. That includes tangible book value declines from paying the dividend of 42 cents per share.

Earnings came to 87 cents per share on net income of $3.9 million, which were up from 73 cents and $3.3 million, respectively, in last year's Q1. The bank benefited from stronger net interest income supported by the Paycheck Protection Program, elevated mortgage banking income, and lower noninterest expense.

We now see $2.75 in earnings-per-share for this year after a good start to 2021.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$1.07	$1.20	$0.96	$1.30	$1.61	$1.83	$1.58	$2.29	$2.51	$2.40	***$2.75***	***$2.75***
DPS	$0.24	$0.25	$0.26	$0.27	$0.28	$0.30	$0.32	$0.34	$0.38	$0.41	***$0.42***	***$0.54***
Shares[2]	5.0	5.0	5.0	5.0	4.8	4.6	4.6	4.5	4.5	4.4	***4.3***	***4.1***

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 2011, PSB has managed to grow earnings-per-share by more than 8% annually, on average. We don't see that sort of growth in the future, however, and instead estimate 0% annual expansion, primarily due to the extremely low interest rates persisting in the U.S, elevated loan loss reserves, and no asset growth in the past few quarters.

This lack of projected growth is 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 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%,

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[1] Estimated date
[2] 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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we see limited catalysts for outsized growth. With commentary from the management team suggesting more weakness ahead for rate spreads, we are more cautious. In addition, the merger with Sunset will take time and money to complete.

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. The acquisition will see higher expenses in 2021, as is customary. 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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	7.2	7.1	10.1	8.5	8.7	8.6	13.8	10.7	9.7	8.8	***9.5***	***10.0***
Avg. Yld.	3.1%	2.9%	2.7%	2.5%	2.0%	1.9%	1.5%	1.5%	1.5%	1.1%	***1.6%***	***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 9.5 times earnings today, the stock remains slightly undervalued in our view.

The yield stands at 1.6%, which is more in line with historical standards. We see the yield drifting higher over time, but it should remain below 2% for the foreseeable future.

Safety, Quality, Competitive Advantage, & Recession Resiliency

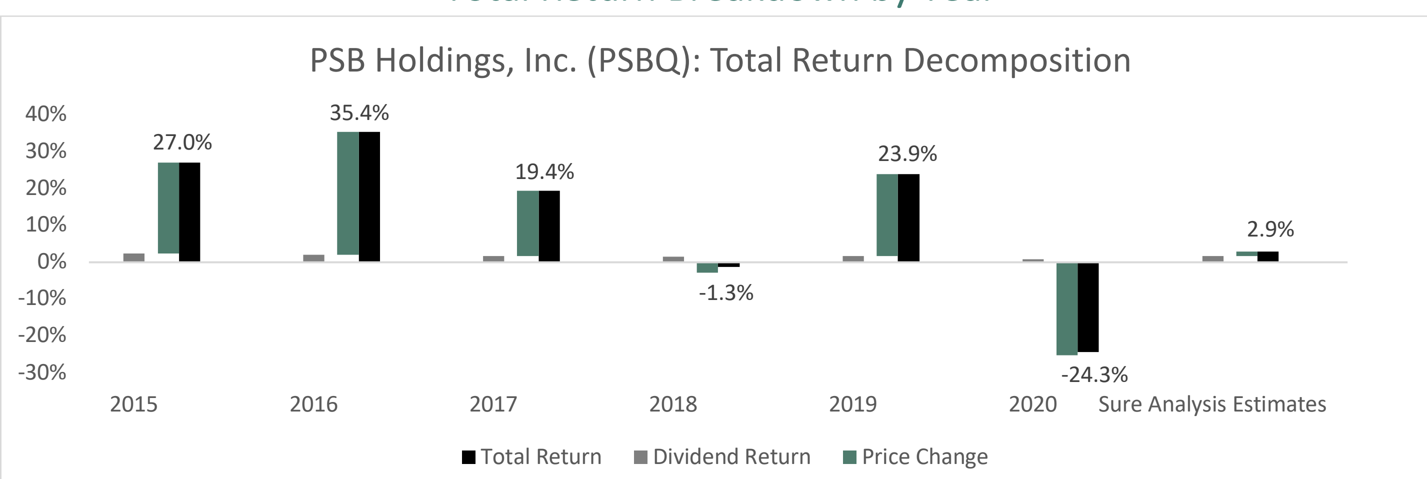
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	22%	21%	27%	21%	17%	16%	20%	16%	15%	10%	***15%***	***20%***

Competitive advantages are tough to come by in banking, but PSB does have a strong brand in parts of Wisconsin. 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 15% of earnings, and there is plenty of room for future raises.

Final Thoughts & Recommendation

With weakness in loan loss reserves, still-low interest rates, as well as the merger, the total return outlook has deteriorated to our new projection of 2.9%. Due to low projected returns, we're moving PSB from a hold to a sell rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	25	27	28	30	32	33	35	39	43
SG&A Exp.	12	12	13	14	15	15	16	17	17
D&A Exp.	3	3	2	2	2	2	2	2	3
Net Profit	6	5	6	8	8	7	10	11	11
Net Margin	23.8%	17.9%	23.3%	26.2%	26.4%	21.7%	29.2%	28.9%	24.7%
Free Cash Flow	7	13	8	8	9	10	11	12	16
Income Tax	3	2	3	4	4	5	3	4	3

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	712	712	734	784	828	848	916	975	1,132
Cash & Equivalents	26	17	22	24	29	22	22	29	8
Accounts Receivable	2	2	2	2	2	2	3	3	4
Goodwill & Int. Ass.	1	2	2	2	2	2	2	2	2
Total Liabilities	658	655	673	719	758	774	835	882	1,028
Long-Term Debt	65	51	33	33	48	60	91	84	72
Shareholder's Equity	54	57	61	65	69	74	81	93	104
D/E Ratio	1.19	0.90	0.53	0.51	0.70	0.81	1.13	0.90	0.69

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	0.9%	0.7%	0.9%	1.0%	1.0%	0.9%	1.2%	1.2%	1.0%
Return on Equity	11.5%	8.5%	10.9%	12.2%	12.6%	10.1%	13.3%	13.0%	10.8%
ROIC	5.1%	4.2%	6.4%	8.1%	7.8%	5.7%	6.7%	6.5%	6.1%
Shares Out.	5.0	5.0	5.0	4.8	4.6	4.6	4.5	4.5	4.4
Revenue/Share	5.07	5.34	5.57	6.16	6.91	7.27	7.86	8.69	9.72
FCF/Share	1.40	2.56	1.70	1.72	1.87	2.30	2.35	2.61	3.61

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