PSB Holdings Inc. (PSBQ)

Updated August 1st, 2021, by Josh Arnold

Key Metrics

Current Price:	$26	**5 Year CAGR Estimate:**	2.7%	**Market Cap:**	$114 M
Fair Value Price:	$27	**5 Year Growth Estimate:**	0.0%	**Ex-Dividend Date:**	10/07/21[1]
% Fair Value:	96%	**5 Year Valuation Multiple Estimate:**	0.8%	**Dividend Payment Date:**	10/30/21
Dividend Yield:	1.8%	**5 Year Price Target**	$27	**Years Of Dividend Growth:**	28
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	9.5%

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 28 consecutive years. The bank has ten branches, and assets totaling $1.25 billion. The stock trades with a $114 million market cap, making it one of the smallest companies we cover.

PSB reported second quarter earnings on July 26th, 2021. Net interest income was $10.2 million, with net interest margin coming to 3.48%. The first quarter of this year saw $9.6 million and net interest margin of 3.62%. The year-ago period saw $7.8 million and 3.09%, respectively.

Earning asset yields declined 17bps from 3.95% to 3.78%, while deposit and borrowing costs declined four basis points to 0.42%. The decline in earning asset yields was due to lower net accretion of loan fees, as well as lower loan yields, which declined 15bps to 4.42%. This decline was due nearly entirely to Paycheck Protection Program loans, which generally carry very low yields. The company said its recent acquisition of Waukesha Bankshares was accretive to net interest margin given the favorable loans on the bank's balance sheet.

Earnings came to 48 cents per share in Q2, or $2.1 million. This was down from 87 cents per share and $3.9 million, respectively, in the first quarter of this year. The year-ago period saw 72 cents and $3.2 million in earnings. However, this year's Q2 included $2.7 million in merger expenses, and excluding those, earnings for Q2 would have been 93 cents per share, or $4.2 million.

Our estimate is now for $2.70 in earnings-per-share for this year, a fractional decline since our last update.

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	***$2.70***	***$2.70***
DPS	$0.24	$0.25	$0.26	$0.27	$0.28	$0.30	$0.32	$0.34	$0.38	$0.41	***$0.46***	***$0.59***
Shares[2]	5.0	5.0	5.0	5.0	4.8	4.6	4.6	4.5	4.5	4.4	***4.5***	***4.7***

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 little asset growth in the past few quarters outside of acquisitions.

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 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%, we see

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

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limited catalysts for outsized growth. 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, although acquisitions paid for with stock may derail this. 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	***9.6***	***10.0***
Avg. Yld.	3.1%	2.9%	2.7%	2.5%	2.0%	1.9%	1.5%	1.5%	1.5%	1.1%	***1.8%***	***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 9.6 times earnings today, the stock remains slightly undervalued in our view.

The yield stands at 1.8%, which is more in line with historical standards. We see the yield drifting higher over time, potentially hitting 2.2% by 2026.

Safety, Quality, Competitive Advantage, & Recession Resiliency

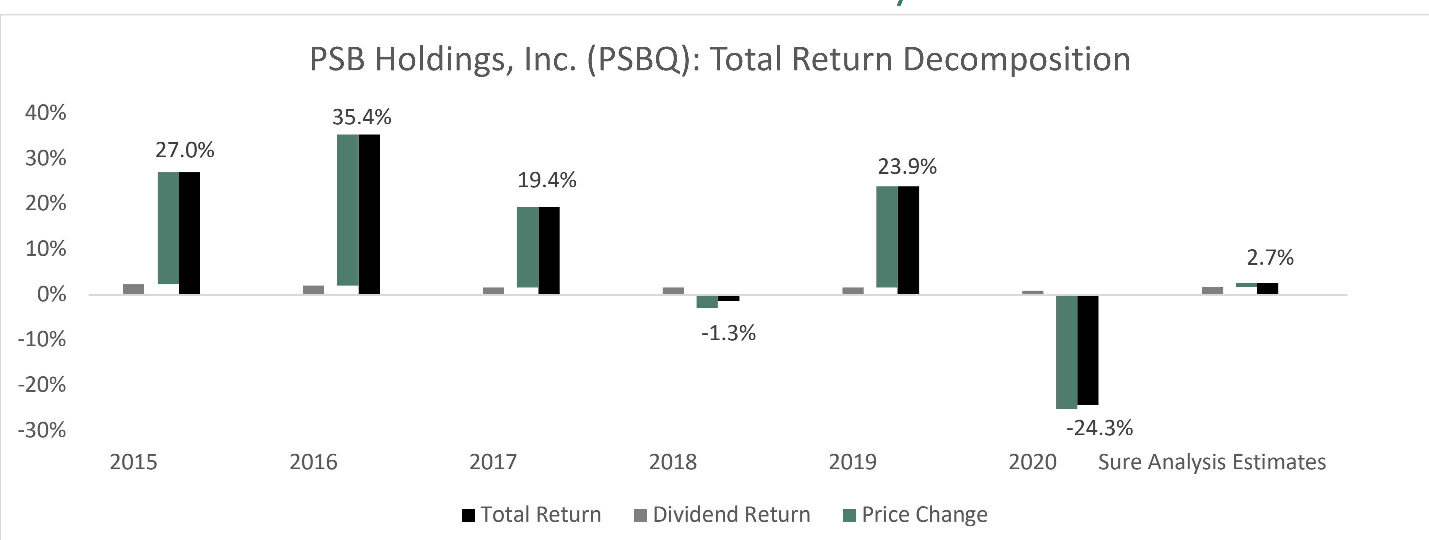
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	22%	21%	27%	21%	17%	16%	20%	16%	15%	10%	*17%*	*22%*

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 17% 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 2.7%. Due to low projected returns, we're reiterating the stock at 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.