PSB HOLDINGS INC /WI/
Form 10-Q
November 12, 2003

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2003

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number: 0-26480

PSB HOLDINGS, INC.
(Exact name of registrant as specified in charter)

WISCONSIN 39-1804877
(State of incorporation)(I.R.S. Employer Identification Number)

1905 West Stewart Avenue
Wausau, Wisconsin 54401
(Address of principal executive office)

Registrant's telephone number, including area code: 715-842-2191

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such report), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).
Yes ___ No X

The number of common shares outstanding at October 23, 2003 was 1,651,069.

PSB HOLDINGS, INC.

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PART I. FINANCIAL INFORMATION

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PSB HOLDINGS, INC.

CONSOLIDATED BALANCE SHEETS
September 30, 2003 unaudited, December 31, 2002 derived from audited financial statements)

(dollars in thousands, except per share data)	Sept. 30, 2003	December 31, 2002
ASSETS		
Cash and due from banks	$ 12,377	$ 15,890
Interest-bearing deposits and money market funds	4,669	5,490
Federal funds sold	-	172
Cash and cash equivalents	17,046	21,552
Securities available for sale (at fair value)	69,988	81,056
Federal Home Loan Bank stock (at cost)	2,402	2,264
Loans held for sale	179	949
Loans receivable, net of allowance for loan losses of $3,692 and $3,158, respectively	297,655	256,015
Accrued interest receivable	1,700	1,732
Foreclosed assets, net	183	573
Premises and equipment	6,481	6,158
Mortgage servicing rights, net	749	697
Other assets	635	472
TOTAL ASSETS	$ 397,018	$ 371,468

LIABILITIES		
Non-interest-bearing deposits	$ 46,700	$ 45,458
Interest-bearing deposits	263,405	252,373
Total deposits	310,105	297,831
Federal Home Loan Bank advances	43,000	38,000
Other borrowings	10,483	3,302
Accrued expenses and other liabilities	2,030	3,033
Total liabilities	365,618	342,166
STOCKHOLDERS' EQUITY		
Common stock - no par value with a stated value of $1 per share:		
Authorized - 3,000,000 shares		
Issued - 1,804,850 shares	1,805	1,805
Additional paid-in capital	7,150	7,150
Retained earnings	24,627	21,607
Unrealized gain on securities available for sale, net of tax	891	1,306
Treasury stock, at cost - 153,781 and 138,748 shares, respectively	(3,073)	(2,566)
Total stockholders' equity	31,400	29,302
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 397,018	$ 371,468

PSB HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share data - unaudited)	Three Months Ended September 30, 2003	2002	Nine Months Ende September 30, 2003	2002
Interest income:				
Interest and fees on loans	$ 4,594	$ 4,627	$ 13,466	$ 13,
Interest on securities:				
Taxable	359	665	1,475	2,
Tax-exempt	232	223	676	
Other interest and dividends	56	86	175	
Total interest income	5,241	5,601	15,792	16,
Interest expense:				
Deposits	1,368	1,733	4,312	5,
FHLB advances	506	577	1,520	1,
Other borrowings	61	35	154	
Total interest expense	1,935	2,345	5,986	7,
Net interest income	3,306	3,256	9,806	9,
Provision for loan losses	240	450	705	
Net interest income after provision for loan losses	3,066	2,806	9,101	8,
Noninterest income:				
Service fees	323	334	951	
Gain on sale of mortgage loans	718	310	1,871	
Mortgage loan servicing, net	(63)	17	(372)	
Investment and insurance sales commissions	115	93	303	
Net loss on sale of securities	(19)	-	(19)	
Other noninterest income	69	87	257	
Total noninterest income	1,143	841	2,991	2,
Noninterest expense:				
Salaries and employee benefits	1,508	1,320	4,343	3,
Occupancy	286	267	859	
Data processing and other office operations	131	153	418	
Advertising and promotion	45	63	133	
Other noninterest expenses	365	294	1,119	
Total noninterest expense	2,335	2,097	6,872	6,
Income before provision for income taxes	1,874	1,550	5,220	4,

Provision for income taxes	639	499	1,704	1,
Net income	$ 1,235	$ 1,051	$ 3,516	$ 3,
Basic earnings per share	$ 0.75	$ 0.63	$ 2.12	$ 1
Diluted earnings per share	$ 0.74	$ 0.63	$ 2.10	$ 1

PSB HOLDINGS, INC.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
Nine months ended September 30, 2003 - unaudited

(dollars in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Unrealized Gain (Loss) on Securities Available For Sale	Tr
Balance January 1, 2003	$ 1,805	$ 7,150	$ 21,607	$ 1,306	$ (2
Comprehensive income:					
Net income			3,516		
Unrealized loss on securities available for sale, net of tax				(427)	
Reclassification adjustment for security loss included in net income, net of tax				12	
Total comprehensive income					
Purchase of treasury stock					
Distribution of treasury stock in settlement of liability to Company directors					
Cash dividends declared $.30 per share			(496)		
Balance September 30, 2003	$ 1,805	$ 7,150	$ 24,627	$ 891	$ (3

PSB HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
Nine months ended September 30, 2003 and 2002 - unaudited

	2003	2002
Cash flows from operating activities:		
Net income	$ 3,516	$ 3,033
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for depreciation and net amortization	1,495	500
Provision for loan losses	705	810
Gain on sale of mortgage loans	(1,871)	(642)
Provision for servicing right valuation allowance	28	-
Loss on sale of premises and equipment	-	30
(Gain) loss on sale of foreclosed assets	37	(27)

Loss on sale of securities	19	-
FHLB stock dividends	(138)	(85)
Changes in operating assets and liabilities:		
Accrued interest receivable	32	(33)
Other assets	95	(129)
Other liabilities	(957)	(815)
Net cash provided by operating activities	2,961	2,642
Cash flows from investing activities:		
Proceeds from sale and maturities of:		
Securities held to maturity	-	682
Securities available for sale	40,016	8,848
Payment for purchase of:		
Securities held to maturity	-	(1,537)
Securities available for sale	(30,122)	(12,857)
Net increase in loans	(40,345)	(14,919)
Capital expenditures	(702)	(1,638)
Proceeds from sale of premises and equipment	-	29
Proceeds from sale of foreclosed assets	280	278
Net cash used in investing activities	(30,873)	(21,114)

CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED

Cash flows from financing activities:		
Net increase in non-interest-bearing deposits	1,242	1,809
Net increase in interest-bearing deposits	11,032	13,148
Proceeds from long-term FHLB advances	15,000	-
Repayments of long-term FHLB advances	(10,000)	
Net increase (decrease) in other borrowings	7,181	(813)
Dividends paid	(496)	(320)
Proceeds from issuance of stock options	-	52
Purchase of treasury stock	(553)	(329)
Net cash provided by financing activities	23,406	13,547
Net decrease in cash and cash equivalents	(4,506)	(4,925)
Cash and cash equivalents at beginning	21,552	25,550
Cash and cash equivalents at end	$ 17,046	$ 20,625
Supplemental cash flow information:		
Cash paid during the period for:		
Interest	$ 6,205	$ 7,330
Income taxes	1,650	1,300
Noncash investing and financing activities:		
Loans charged off	$ 206	$ 321
Loans transferred to foreclosed assets	178	397
Loans originated on sale of foreclosed assets	251	331
Distribution of treasury stock in settlement of liability to Company directors	46	60

PSB Holdings, Inc.
Notes to Consolidated Financial Statements

NOTE 1 - GENERAL

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary to present fairly PSB Holdings, Inc.'s ("Company") financial position, results of its operations, and cash flows for the periods presented, and all such adjustments are of a normal recurring nature. The consolidated financial statements include the accounts of all subsidiaries. All material intercompany transactions and balances are eliminated. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year.

These interim consolidated financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission and,

therefore, certain information and footnote disclosures normally presented in accordance with generally accepted accounting principles have been omitted or abbreviated. The information contained in the consolidated financial statements and footnotes in the Company's 2002 annual report on Form 10-K, should be referred to in connection with the reading of these unaudited interim financial statements.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates. Estimates that are susceptible to significant change include the determination of the allowance for loan losses, mortgage servicing right asset, and the valuation of investment securities.

NOTE 2 - CHANGES IN ACCOUNTING PRINCIPLE

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires the use of the purchase method of accounting for business combinations initiated after June 30, 2001. SFAS No. 142 addresses how intangible assets acquired outside of a business combination should be accounted for upon acquisition and how goodwill and other intangible assets should be accounted for after they have been initially recognized. SFAS No. 142 eliminates the amortization for goodwill and other intangible assets with indefinite lives. Other intangible assets with a finite life will be amortized over their useful life. Goodwill and other intangible assets with indefinite useful lives shall be tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset may be impaired. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001. The Corporation's adoption of SFAS No. 142 on January 1, 2002 had no impact on the consolidated financial statements as of the date of adoption.

NOTE 3 - STOCK-BASED COMPENSATION

The Company records expense relative to stock-based compensation using the "intrinsic value method". Since the exercise price is equal to the fair value of the Company's common stock on the date of the award, the intrinsic value of the Company's stock options is "zero" at the time of the award and no expense is recorded.

As permitted by generally accepted accounting principles, the Company has not adopted the "fair value method" of expense recognition for stock-based compensation awards. Rather, the effects of the fair value method on the Company's earnings are presented on a pro forma basis. Because no grants of stock options were made during the three months and nine months ended September 30, 2003, there was no pro forma impact to net income or earnings per share during these periods. However, there were grants of 4,614 stock options (with an exercise price of $17.65 per share) during the quarter ended June 30, 2002. Had compensation cost for the option grants been determined in accordance with the "fair value method", net income would have decreased approximately $9,228 during the nine months ended September 30, 2002, and reduced earnings per share by less than $.01 per share.

Under the terms of an incentive stock option plan adopted during 2001, shares of unissued common stock are reserved for options to officers and key employees at prices not less than the fair market value of the shares at the date of the grant. These options expire 10 years after the grant date. As of September 30, 2003, 26,892 options outstanding were eligible to be exercised at a weighted average exercise price of $16.80 per share. No additional shares of common stock remain reserved for future grants under the option plan approved by the shareholders.

NOTE 4 - EARNINGS PER SHARE

Basic earnings per share of common stock are based on the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income by the weighted average number of shares adjusted for the dilutive effect of outstanding stock options. Presented below are the calculations for basic and diluted earnings per share:

(dollars in thousands, except per share data) (unaudited)	Three months ended September 30, 2003	2002	Nine mon Septem 2003	
Net income	$ 1,235	$ 1,051	$ 3,516	$
Weighted average shares outstanding	1,651,265	1,672,836	1,659,326	
Effect of dilutive stock options outstanding	13,353	4,712	11,892	
Diluted weighted average shares outstanding	1,664,618	1,677,548	1,671,218	
Basic earnings per share	$ 0.75	$ 0.63	$ 2.12	$
Diluted earnings per share	$ 0.74	$ 0.63	$ 2.10	$

NOTE 5 - COMPREHENSIVE INCOME

Generally accepted accounting principles require comprehensive income and its components, as recognized under the accounting standards, to be displayed in a financial statement with the same prominence as other financial statements. The disclosure requirements with respect to the Form 10-Q have been included in the Company's consolidated statement of changes in stockholders' equity. Comprehensive income totaled the following for the periods indicated:

(dollars in thousands - unaudited)	Three months ended September 30, 2003	2002	Nine months September 2003	
Net income	$ 1,235	$ 1,051	$ 3,516	$
Unrealized loss on securities available for sale, net of tax	(602)	(187)	(427)	

Reclassification adjustment for security loss included in net income, net of tax	12			12
Comprehensive income	$ 645	$ 864	$ 3,101	$

NOTE 6 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans receivable are stated at unpaid principal balances plus net deferred loan origination costs less loans in process and the allowance for loan losses.

Interest on loans is credited to income as earned. Interest income is not accrued on loans where management has determined collection of such interest is doubtful or those loans which are past due 90 days or more as to principal or interest payments. When a loan is placed on nonaccrual status, previously accrued but unpaid interest deemed uncollectible is reversed and charged against current income. After being placed on nonaccrual status, additional income is recorded only to the extent that payments are received or the collection of principal becomes reasonably assured. Interest income recognition on loans considered to be impaired under current accounting standards is consistent with the recognition on all other loans.

Loan origination fees and certain direct loan origination costs are deferred and amortized to income over the contractual life of the underlying loan.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. Management believes the allowance for loan losses is adequate to cover probable credit losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio. In accordance with current accounting standards, the allowance is provided for losses that have been incurred as of the balance sheet date. The allowance is based on past events and current economic conditions, and does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions. While management uses

the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions.

The allowance for loan losses includes specific allowances related to commercial loans which have been judged to be impaired as defined by current accounting standards. A loan is impaired when, based on current information, it is probable that the Company will not collect all amounts due in accordance with the contractual terms of the loan agreement. Management has determined that commercial, financial, agricultural, and commercial real estate loans that have a nonaccrual status or have had their terms restructured meet this definition. Large groups of homogenous loans, such as residential mortgage and consumer loans, are collectively evaluated for impairment. Specific allowances are based on discounted cash flows of expected future payments using the loans' initial effective interest rate or the fair value of collateral if the loan is collateral dependent.

In addition, various regulatory agencies periodically review the allowance for loan losses. These agencies may require the subsidiary Bank to make additions to the allowance for loan losses based on their judgments of collectibility based on information available to them at the time of their examination.

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate and are carried as "Loans held for sale" on the balance sheet. Net unrealized losses are recognized through a valuation allowance by charges to income. Gains and

losses on the sale of loans held for sale are determined using the specific identification method using quoted market prices.

NOTE 7 - FORECLOSED REAL ESTATE

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value (after deducting estimated costs to sell) at the date of foreclosure, establishing a new cost basis. Costs related to development and improvement of property are capitalized, whereas costs related to holding property are expensed. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less estimated costs to sell. Revenue and expenses from operations and changes in any valuation allowance are included in loss on foreclosed real estate.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis is presented to assist in the understanding and evaluation of the Company's financial condition and results of operations. It is intended to complement the unaudited financial statements, footnotes, and supplemental financial data appearing elsewhere in this Form 10-Q and should be read in conjunction therewith. Dollar amounts are in thousands, except per share amounts.

Forward-looking statements have been made in this document that are subject to risks and uncertainties. While the Company believes these forward-looking statements are based on reasonable assumptions, all such statements involve risk and uncertainties that could cause actual results to differ materially from those contemplated in this report. The assumptions, risks, and uncertainties relating to the forward-looking statements in this report include those described under the caption "Cautionary Statements Regarding Forward-Looking Information" in Part I of the Company's Form 10-K for the year ended December 31, 2002 and, from time to time, in the Company's other filings with the Securities and Exchange Commission.

BALANCE SHEET

At September 30, 2003, total assets were $397,018, an increase of $36,713, or 10.2%, over September 30, 2002. Gross loans (including loans held for sale and unamortized direct loan origination costs) were $301,526 at September 30, 2003, growing $45,846 over September 30, 2002 for an increase of 17.9%. Book value of investment securities was $69,988 at September 30, 2003, a decrease of $5,685 or 7.5% from September 30, 2002. The decline in securities was due primarily to prepayments of principal on mortgage-backed securities prompted by historically low long-term mortgage rates seen during the second quarter of 2003. Asset growth since September 30, 2002 was funded by an increase in deposits of $21,513, or 7.5%, an increase in other short-term borrowings of $6,969, or 298.3%, and an additional FHLB advance of $5 million, or 13.2%.

Table 1: Period-End Loan Composition

	September 30,		September 30,		De
	Dollars	Dollars	Percentage of total		
(dollars in thousands)	2003	2002	2003	2002	Doll
Commercial, industrial and agricultural	$ 70,928	$ 66,463	23.5%	26.0%	$ 64
Commercial real estate mortgage	140,266	106,902	46.5%	41.7%	114
Residential real estate mortgage	73,291	64,823	24.3%	25.4%	61

Residential real estate loans held for sale	179	-	0.1%	0.0%	
Consumer home equity	8,637	6,601	2.9%	2.6%	7
Consumer and installment	8,225	10,891	2.7%	4.3%	10
Totals	$ 301,526	$ 255,680	100.0%	100.0%	$ 260

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The amount of residential real estate mortgages held increased from the year earlier period and prior quarter by a substantial amount, but continues to reflect a lower percentage of the total loan portfolio. The increase in residential mortgages during 2003 is from the Company retaining some 15 year fixed rate mortgages rather than selling the principal to the secondary market. These mortgages were retained as part of an asset-liability management strategy to maximize net interest margin without a significant increase in interest rate risk due to the current cash and projected liquidity position in light of interest sensitivity of the entire balance sheet and opportunities for re-investment of investment security cash flows into loans or other new securities. The amount of 15 year fixed rate mortgages originated by the program during 2003 was approximately $12.0 million with an average yield of 4.95%. Approximately one-half of this production was funded by maturing and prepaid mortgage backed investment securities during this period. This program was discontinued during August 2003 and all 15 year fixed rate mortgage loans originated by the Company are currently sold to other investors on the secondary market to eliminate the associated interest rate risk.

As the Company reallocated resources to handle demand for residential real estate loans prompted by historically low interest rates, it experienced substantial repayments of consumer retail installment loans that were not replaced. In its markets, the Company faces substantial competition from credit unions and other financial institutions for retail installment lending such as auto loans. The Company renewed efforts during 2003 to retain some market share in consumer lending by educating a wider range of bank staff eligible to originate consumer loans and changing the primary delivery channel from traditional loan officers to personal bankers and other retail customer contact staff. Home equity loans are actively promoted to high quality individual borrowers with low interest rates as compared to local competitors.

During 2003, commercial real estate mortgages increased primarily from new commercial construction and financing owner occupied commercial retail buildings, factories, and warehouses. Non-real estate commercial and industrial loans have experienced a shift in which personal property and equipment secured loans have declined while cash flow business lines of credit have increased.

The loan portfolio is the Company's primary asset subject to credit risk. The Company's process for monitoring credit risks includes weekly analysis of loan quality, delinquencies, non-performing assets, and potential problem loans. Loans are placed on a nonaccrual status when they become contractually past due 90 days or more as to interest or principal payments. All interest accrued but not collected for loans (including applicable impaired loans) that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash basis until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due have been collected and there is reasonable assurance that repayment according to the contractual terms will continue.

The aggregate amount of nonperforming assets decreased $1,280 to $3,455 at September 30, 2003 from $4,735 at September 30, 2002, primarily because of fewer loans on nonaccrual status. However, nonperforming assets have increased $449 from $3,006 at December 31, 2002. Total

nonperforming assets as a percentage of total assets continues to be favorable with .87% and .81% at September 30, 2003 and December 31, 2002, respectively.

The Company ceases to accrue interest on loans which are 90 days past due and considers them nonperforming loans until the borrower has made up any late payments and is able to continue required payments in the future. Nonperforming loans also include restructured loans until 6 consecutive monthly payments are received under the new loan terms. The Company continues to aggressively manage past due customers and lowered the level of nonperforming loans to gross loans from 1.74% at September 2002 to 1.09% at September 2003. The Company also tracks delinquencies on a contractual basis quarter to quarter. Loans contractually delinquent 30 days or more as a percentage of gross loans were 1.02% at September 2003 compared to .87% at December 2002 and 1.24% at September 2002. The allowance for loan losses was 1.23% of gross loans at September 2003 compared to 1.33% at September 2002. Management reviews the activity in individual identified problem loans weekly and adjusts for the adequacy of loan loss reserves quarterly.

At September 30, 2002 nonaccrual loans included $587 of loan principal to a borrower secured by non real-estate commercial collateral. During September 2002, the Company was notified of the borrower's bankruptcy. The Bank was not the lead lender in the commercial relationship, and due to inadequate collateral protection, an additional $270 of loan loss provisions were recorded during the quarter ended September 30, 2002 to cover estimated principal losses not specifically identified and reserved previously. During October 2002, a charge-off of $376 was authorized and recorded. The remaining principal balance on this relationship was fully reserved in the allowance for loan losses from provisions made prior to September 30, 2002.

Table 2: Allowance for Loan Losses

	Three months ended September 30,		Nine months ended September 30,	
(dollars in thousands)	2003	2002	2003	2002
Allowance for loan losses at beginning	$ 3,517	$ 3,254	$ 3,158	$ 2,969
Provision for loan losses	240	450	705	810
Recoveries on loans previously charged-off	13	11	35	59
Loans charged off	(78)	(321)	(206)	(444)
Allowance for loan losses at end	$ 3,692	$ 3,394	$ 3,692	$ 3,394

Nonperforming assets include: 1) loans that are either contractually past due 90 days or more as to interest or principal payments, on a nonaccrual status, or the terms of which have been

renegotiated to provide a reduction or deferral of interest or principal (restructured loans) and 2) foreclosed assets.

Table 3: Nonperforming Assets

	Sept. 30,		Dec. 31,
(dollars in thousands)	2003	2002	2002
Nonaccrual loans	$ 2,775	$ 3,784	$ 1,786
Accruing loans past due 90 days or more	7	-	-

Restructured loans not on nonaccrual	490	655	647
Total nonperforming loans	3,272	4,439	2,433
Foreclosed assets	183	296	573
Total nonperforming assets	$ 3,455	$ 4,735	$ 3,006
Nonperforming loans as a % of gross loans receivable	1.09%	1.74%	0.94%
Total nonperforming assets as a % of total Assets	0.87%	1.31%	0.81%

LIQUIDITY

Liquidity refers to the ability of the Company to generate adequate amounts of cash to meet the Company's need for cash at a reasonable cost. The Company manages its liquidity to provide adequate funds to support borrowing needs and deposit flow of its customers. Management views liquidity as the ability to raise cash at a reasonable cost or with a minimum of loss and as a measure of balance sheet flexibility to react to marketplace, regulatory, and competitive changes. Deposit growth is the primary source of funding. Retail core and time deposits as a percentage of total funding sources were 72.0% at September 30, 2003, and 75.2% at September 30, 2002. Wholesale funding and broker and

national certificates of deposit represent the balance of the Company's total funding needs. Company use of brokered jumbo deposits has increased since September 2002 and accounted for 2.2% of the decline in retail deposits as a percentage of total funding sources.

Table 4: Period-end Deposit Composition

	September 30,			
	2003		2002	
(dollars in thousands)	$	%	$	%
Non-interest bearing demand	$ 46,700	15.1%	$ 43,316	15.0%
Interest-bearing demand and savings	45,257	14.6%	32,848	11.4%
Money market deposits	70,747	22.8%	74,119	25.6%
Retail time deposits less than $100	59,180	19.0%	60,656	21.0%
Retail time deposits $100 and over	39,968	12.9%	37,424	13.0%
Broker & national time deposits less than $100	11,011	3.6%	12,946	4.5%
Broker & national time deposits $100 and over	37,242	12.0%	27,283	9.5%
Totals	$ 310,105	100.0%	$ 288,592	100.0%

The interest rate paid on money market deposits is adjustable based on the Company's discretion but generally tracks the movements of national money market funds. As short-term interest rates have decreased during 2002 and 2003, the yield on this account has declined substantially. Deposits due to investors as part of the Company's secondary market loan servicing activities included in total non-interest bearing deposits was approximately $2.4 million at September 30, 2003 compared to $4.5 million at September 30, 2002. As a source of low cost long-term deposits and in connection with a new full service retail location in Rhinelander, Wisconsin, the Company is aggressively seeking commercial non-interest bearing deposits as well as consumer core deposits.

Table 5: Summary of Changes by Significant Deposit Source

(dollars in thousands)	September 30, 2003	September 30, 2002	Change from prior year $	Change from prior year %
Total time deposits $100 and over	$ 77,210	$ 64,707	$ 12,503	19.3%
Total broker and national time deposits	48,253	40,229	8,024	19.9%
Total retail time deposits	99,148	98,080	1,068	1.1%
Core deposits, including money market Deposits	162,704	150,283	12,421	8.3%

The Company's retail deposit offices are in locations that demand consumer retail deposit rates generally greater than national rates for equivalent certificate of deposit terms. To fund larger commercial loan originations or acquire other large blocks of funding, the Company actively

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purchases broker and other national time deposits. The Company actively manages such deposits to control the potential volatility of such funds while

lowering overall deposit borrowing costs. Consequently, broker and national deposits increased substantially over the prior year, while local retail deposits have shown modest growth in comparison. Company policy is to limit broker and national time deposits to 20% of total assets. As of September 30, 2003 broker and national time deposits were 12.2% of total assets.

Unused credit advances from the Federal Home Loan Bank of Chicago available to the Company at September 30, 2003 totaled approximately $34 million based on an open line of credit and securities available for pledging for advances. In addition, the Company had unused commitments from other correspondent banks for federal funds purchased up to $19.9 million. The primary alternative funding sources utilized are Federal Home Loan Bank advances, federal funds purchased, repurchase agreements from a base of individuals, businesses and public entities, and brokered time deposits. The Company believes its current liquidity position and sources of funds for liquidity management is adequate.

Table 6 below presents maturity repricing information as of September 30, 2003. The following repricing methodologies should be noted:

1. Money market deposit accounts are considered fully repriced within 90 days. NOW and savings accounts are considered "core" deposits as they are generally insensitive to interest rate changes. These deposits are considered to reprice beyond 5 years.

2. Nonaccrual loans are considered to reprice beyond 5 years.

3. Assets and liabilities with contractual calls or prepayment options are repriced according to the likelihood of the call or prepayment being exercised in the current interest rate environment.

4. Impact of rising or falling interest rates is based on a parallel yield curve change that is fully implemented within a 12 month time horizon.

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Table 6: Interest Rate Sensitivity Gap Analysis

	September 30, 2003				
(dollars in thousands)	0-90 Days	91-180 days	181-365 days	1-2 yrs.	Bynd 2-5 yrs. Bey
Earning assets:					

Loans	$ 110,354	$ 21,297	$ 42,432	$ 51,038	$ 61,331	$ 15
Securities	3,780	4,658	9,004	18,126	18,067	16
FHLB stock	2,402	-	-	-	-	
Other earning assets	4,669	-	-	-	-	
Total	$ 121,205	$ 25,955	$ 51,436	$ 69,164	$ 79,398	$ 31
Cumulative rate sensitive assets	$ 121,205	$ 147,160	$ 198,596	$ 267,760	$ 347,158	$ 378
Interest-bearing liabilities						
Interest-bearing deposits	$ 91,698	$ 17,351	$ 48,178	$ 22,974	$ 33,691	$ 49
FHLB advances	16,000	-	-	19,000	8,000	
Other borrowings	2,907	1,644	3,728	-	2,204	
Total	$ 110,605	$ 18,995	$ 51,906	$ 41,974	$ 43,895	$ 49
Cumulative interest sensitive liabilities	$ 110,605	$ 129,600	$ 181,506	$ 223,480	$ 267,375	$ 316
Interest sensitivity gap for the individual period	$ 10,600	$ 6,960	$ (470)	$ 27,190	$ 35,503	$ (18
Ratio of rate sensitive assets to rate sensitive liabilities for the individual period	109.6%	136.6%	99.1%	164.8%	180.9%	
Cumulative interest sensitivity gap	$ 10,600	$ 17,560	$ 17,090	$ 44,280	$ 79,783	$ 61
Cumulative ratio of rate sensitive assets to rate sensitive liabilities	109.6	113.5%	109.4%	119.8%	129.8%	1

If interest rates rose 200 basis points or fell 100 basis points, the 365 day cumulative ratio of rate sensitive assets to rate sensitive liabilities would change from 109.4% to 103.7% (if up 200 basis points) and 113.3% (if down 100 basis points), respectively. The Asset/Liability Committee uses financial modeling techniques that measure the interest rate risk. Policies established by the Bank's Asset/Liability Committee are intended to limit exposure of earnings at risk. A formal liquidity contingency plan exists that directs management to the least expensive liquidity sources to fund sudden and unanticipated liquidity needs. The Company also uses various policy measures to assess adequacy of the Company's liquidity and interest rate risk as described below.

Basic Surplus

The Company measures basic surplus as the amount of existing net liquid assets (after deducting short-term liabilities and coverage for anticipated deposit funding outflows during the next 30 days) divided by total assets. The basic surplus calculation does not consider unused but available correspondent bank federal funds purchased, as those funds are subject to availability based on the correspondent bank's own liquidity needs and therefore are not guaranteed contractual funds. The Company's basic surplus, including available open line of credit FHLB advances not yet utilized at September 30, 2003 and 2002 was 7.4% and 14.0%, respectively and above the 5% minimum required by policy.

Interest Rate Risk Limits

The Company balances the need for liquidity with the opportunity for increased net interest income available from longer term loans held for investment and securities. To measure the impact on net interest income from interest rate changes, the Company models interest rate simulations on a quarterly basis. Company policy is that projected net interest income over the next 12 months will not be reduced by more than 15% given a change in interest rates of up to 200 basis points. At September 30, 2003, net interest income for the next 12 months was projected to increase 1.64% if rates increased 200 basis points, and was projected to decrease 1.55% if rates decreased 100 basis points, which is less than the 15% required by policy and was considered acceptable by management. At September 30, 2002, net interest income for the next 12 months was projected to decrease 1.88% if rates increased 200 basis points, and was projected to decrease 1.75% if rates decreased 100 basis points.

Core Funding Utilization

To assess whether interest rate sensitivity beyond one year helps mitigate or exacerbate the short-term rate sensitive position, a quarterly measure of core funding utilization is made. Core funding is defined as liabilities with a maturity in excess of 60 months and capital. "Core" deposits including DDA, NOW and non-maturity savings accounts (except money market accounts) are also considered core long-term funding sources. The core funding utilization ratio is defined as assets with a maturity in excess of 60 months divided by core funding. The Company's target for the core funding utilization ratio is to remain at 80% or below given the same 200 basis point changes in rates that apply to the guidelines for interest rate risk limits exposure described previously. At September 30, 2003, the Company's core funding utilization ratio was projected to be 44.6% if rates increased 200 basis points and was therefore within policy requirements. At September 30, 2002, the Company's core funding utilization ratio was projected to be 42.0% if rates increased 200 basis points.

CAPITAL RESOURCES

Stockholders' equity at September 30, 2003 increased $3,310 to $31,400, or 11.8% from $28,090 at September 30, 2002. Stockholders' equity included unrealized gains on securities available for sale, net of their tax effect, of $891 at September 30, 2003 compared to unrealized gains of $735 at September 30, 2002.

The adequacy of the Company's capital is regularly reviewed to ensure sufficient capital is available for current and future needs and is in

compliance with regulatory guidelines. As of September 30, 2003, and 2002, the Subsidiary Bank's Tier 1 risk-based capital ratio, total risk-based capital, and Tier 1 leverage ratio were well in excess of regulatory minimums and were classified as "well-capitalized". Management expects the Company to remain well-capitalized during the remainder of 2003 based on planned asset growth.

The Company maintains an annual, ongoing share repurchase program of up to 1% of outstanding shares per year. During the quarter ended September 30, 2003, the Company completed the annual repurchase program and repurchased 400 shares at an average price of $34.00 per share. For all of 2003, 16,700 shares were repurchased at an average price of $33.10 per share. For the remainder of 2003, management anticipates retaining capital to support asset growth while continuing a cash dividend to shareholders.

Effective with the $.30 dividend declared June 17, 2003, the Company intends to equalize the amounts of the semi-annual cash dividends. Accordingly, under the dividend policy, the Company expects that the dividend to be paid in January, 2004 may be less than the January 2003 dividend, but that the total dividends to be paid in July 2003 and January 2004 will exceed the $.565 per share total

dividends paid in July 2002 and January 2003. The Company also reaffirmed its goal of increasing its shareholder dividend on an annual basis subject to operating results and financial condition of the Company.

Table 7: Capital Ratios - Consolidated Holding Company

	September 30, 2003	September 30, 2002	Dec 31. 2002
Tier 1 capital to period end tangible assets (leverage ratio)	7.68%	7.59%	7.55%
Tier 1 capital to adjusted risk-weighted assets	9.79%	10.33%	10.25%
Total capital to adjusted risk-weighted assets	10.97%	11.58%	11.41%

On November 19, 2002, the Company's shareholders approved an increase in authorized shares from 1,000,000 to 3,000,000, allowing the Board of Directors to effect a 2 for 1 stock split paid on December 2, 2002. All references in the accompanying financial statements and statistical analysis to the number of common shares and per share amounts for 2002 have been restated to reflect the split.

PREMISES AND EQUIPMENT

The Company announced during July 2003 the construction of a new bank and financial services office and administrative headquarters located on property adjacent to the existing Wausau, Wisconsin, main office location. Construction of the 32,000 square foot office and drive-through canopy began during August with completion anticipated by the end of the second quarter 2004. The existing Wausau main office which has been used since the Bank opened in 1962 and as most recently expanded during 1992 will be razed. Building project costs including necessary

furniture, fixtures, and equipment are estimated to be $4.4 million. Annual depreciation expense after this investment in fixed assets and equipment is estimated to increase $165 ($100 after income tax benefits). As of November 6, 2003, approximately $749 had been spent on the project ($451 was spent by September 30, 2003). The amount of interest capitalized as project costs by September 30, 2003 was insignificant.

RESULTS OF OPERATIONS

Net income for the quarter ended September 30, 2003 totaled $1,235, or $.75 for basic earnings per share, and $.74 for diluted earnings per share. Comparatively, net income for the quarter ended September 30, 2002 was $1,051, or $.63 per share for basic and diluted earnings per share. Operating results for the third quarter 2003 generated an annualized return on average assets of 1.26% and an annualized return on average equity of 15.76%, compared to 1.17% and 15.00% for the comparable period in 2002.

The following Table 8 presents consolidated quarterly summary financial data of PSB Holdings, Inc. and Subsidiary.

Table 8: Financial Summary

(dollars in thousands, except per share data)	Quarter ended			
EARNINGS AND DIVIDENDS:	Sept. 30, 2003	June 30, 2003	March 31, 2003	Dec. 3 2002
Net interest income	$ 3,306	$ 3,268	$ 3,232	$ 3,288

Provision for loan losses	$ 240	$ 240	$ 225	$ 300
Other noninterest income	$ 1,143	$ 726	$ 1,122	$ 1,040
Other noninterest expense	$ 2,335	$ 2,220	$ 2,317	$ 2,072
Net income	$ 1,235	$ 1,057	$ 1,224	$ 1,332
Basic earnings per share	$ 0.75	$ 0.64	$ 0.73	$ 0.80
Diluted earnings per share	$ 0.74	$ 0.63	$ 0.73	$ 0.80
Dividends declared per share	$ -	$ 0.300	$ -	$ 0.375
Net book value per share	$ 19.02	$ 18.63	$ 18.24	$ 17.59
Dividend payout ratio	0.00%	46.88%	0.00%	46.88
Average common shares outstanding	1,651,265	1,661,142	1,665,729	1,667,34
BALANCE SHEET - AVERAGE BALANCES:				
Loans receivable, net of allowances for loss	$ 288,448	$ 265,863	$ 256,715	$ 255,59
Assets	$ 389,267	$ 371,537	$ 365,906	$ 363,50
Deposits	$ 307,752	$ 292,698	$ 289,635	$ 291,04
Stockholders' equity	$ 31,085	$ 30,670	$ 29,848	$ 28,67
PERFORMANCE RATIOS:				
Return on average assets (1)	1.26%	1.14%	1.36%	1.4
Return on average stockholders' equity (1)	15.76%	13.82%	16.63%	18.4
Average tangible stockholders' equity to average assets	7.70%	7.92%	7.84%	7.7
Net loan charge-offs to average loans	0.02%	0.01%	0.03%	0.2
Nonperorming loans to gross loans	1.09%	1.06%	1.13%	0.9
Allowance for loan losses to gross loans	1.23%	1.26%	1.28%	1.2
Net interest rate margin (1)(2)	3.67%	3.83%	3.89%	3.8
Net interest rate spread (1)(2)	3.21%	3.34%	3.42%	3.3
Service fee revenue as a percent of average demand deposits (1)	2.48%	2.83%	2.99%	2.9
Noninterest income as a percent of gross revenue	17.90%	12.13%	17.49%	15.8
Efficiency ratio (2)	50.94%	53.86%	51.67%	46.4
Noninterest expenses to average assets (1)	2.38%	2.40%	2.57%	2.2
STOCK PRICE INFORMATION:				
High	$ 34.24	$ 34.00	$ 27.25	$ 25.0
Low	$ 33.00	$ 30.00	$ 23.75	$ 20.5
Market value at quarter-end	$ 33.50	$ 33.25	$ 27.25	$ 25.0