BANK PERFORMANCE NEWSLETTER – Q1 2021
RPCA FINANCIAL VENTURES QP & LP ("FUND 1")

Prologue: For the reasons we outlined in the *1st Quarter 2021 General Newsletter*, followed by stellar Q1 '21 earnings, we remain very bullish about our Funds and their prospects for this year – and strongly encourage you to consider adding to your investment(s) with us at this time! On the heels of 37% and 22% gains respectively during the last 2 quarters, Fund 1 is up another ~5% in Q2 (as of May 14). Yet, we believe there's still more room for our banks to run.

1st Quarter 2021 Headlines – Operating and Earnings Performance

- **Bryn Mawr Bank Corporation Bought Out; M&A Activity Increasing – Total of 6 Banks Acquired Amongst All Our Funds so far this Year**
- **Year-Over-Year "Pre-Provision" EPS for Banks in Fund 1 Increased a Whopping 30% while Linked-Quarter "Pre-Provision" EPS Pop 11%! "Bottom line" EPS Skyrocket 98% YOY and 22% Linked Quarter, Reflecting Massive EPS Recovery from Onset of Pandemic in Q1 '20. (Industry-Wide Earnings *Crush* Analyst's Estimates; Causing Upward Revisions to EPS Forecasts)**
- **Loan Growth and Net Interest Margin Pressures Persist – Both Should Improve as Economy Reopens**
- **Key Operating Takeaways from Q1:**
  - **Provision Expenses Decline Due to Strong Asset Quality Metrics**
  - **Continued Strong Mortgage Loan Fees & Accretion of SBA Loan Origination Fees into Income Contribute to Non-Interest Income Increases**
  - **Even Though Yield Curve Remains Steep, Margins Slip Due to Negative Mix Variance**
  - **Dividend Yield[1] for Fund 1 is 3.01%**

(1) Using the "cost basis" vs. "current market price"

Bryn Mawr Bank Corporation Bought Out; M&A Activity Increasing – Total of 6 Banks Acquired Amongst All Our Funds so far this Year: After a year of unprecedented upheaval, economic disruption, and political uncertainty, we're beginning to see merger and acquisition activity in the banking industry pick up substantially. Furthermore, with 2021's global rollout of multiple COVID-19 vaccines and consumer confidence increasing, companies appear to be behaving more bullishly. Therefore, we believe overall economic activity should start to resemble or surpass pre-pandemic levels. This is an encouraging mix of events and, so far this year, has translated into good news for M&A activity in our portfolios.

To wit, on March 10, 2021 Bryn Mawr Bank Corporation (a long time holding) announced that it had signed a definitive merger agreement with WSFS Financial Corporation in an all-stock deal valued at approximately $976.4 million. Per the terms of the deal, BMTC stockholders will receive 0.90 of a share of WSFS for each share of BMTC, an implied value of $48.55 (which translated to a 14.2% premium to BMTC shareholders based on the stock price prior to the deals announcement). Given this takeover, we sold our entire position in BMTC and recognized a long-term capital gain of 110% following the sale.

It is our belief that pent-up demand for ongoing consolidation is very high and the primary drivers for deal-making remain intact: i.e. the pursuit of scale efficiencies, the desire to enhance product portfolios, and the need to bolster digital capabilities. We foresee industry players with strong reputations & balance sheets remaining very interested in increased asset accumulation and further diversification and enhancement of fee income business lines. These acquirers appear to be well-prepared to re-engage in strategic buying, investing, or partnering opportunities. Simply put, we expect more acquisitions of banks within our portfolios this year – which should enhance overall returns.

Year-Over-Year "Pre-Provision" EPS for Banks in Fund 1 Increased a Whopping 30% while Linked-Quarter "Pre-Provision" EPS Pop 11%! "Bottom line" EPS Skyrocket 98% YOY and 22% Linked Quarter Reflecting Massive EPS Recovery from Onset of Pandemic in Q1 '20. (Industry-Wide Earnings *Crush* Analyst's Estimates; Causing Upward Revisions to EPS Forecasts.): 91% of all banks reporting so far have beat analyst's estimates! Declining provision expenses and improved operating efficiencies are major contributors to banks within the Raymond James coverage universe reporting increased median quarter-over-quarter Return on Assets of 1.28% up from 1.18%; and median improved quarter-over-quarter Return on Equity increasing to 14.8% from 13.8%. The increases in both metrics are quite significant! Industry-wide, median total revenue *growth* slowed from the torrid pace of the past 3 quarters – but the ratio of total revenue to total operating expenses still produced improved overall operating efficiency outcomes – with median efficiency ratios declining from 61% a year ago to 57% this quarter. These impressive results have generally caused substantial upward revisions in EPS forecasts for the balance of '21 and full-year '22 from bank stock analysts.

In the headline for this section, we *first* highlighted "pre-provision" EPS results for our banks to "normalize" for the extra-ordinary provision for loan losses taken in the 1st Quarter of last year compared to this year. We also presented this data in order to emphasize the **core** earnings growth of our banks. However, *without* adjusting for provision and just looking at raw bottom line EPS results, earnings virtually doubled at our banks this year compared to last! No matter how you look at it, these outcomes are unprecedented in the life of our Funds. More details regarding the factors leading to these results are provided in the sections below.

Loan Growth and Net Interest Margin Pressures Persist – Both Should Improve as Economy Reopens: The overall environment for our community banks is very rosy right now. However, we are not oblivious to certain challenges which exist. Key among them is the lack of strong loan growth caused by the tremendous liquidity which has been pumped into the system by both monetary and fiscal policy. As noted in our recent *General Newsletter*, deposits have exploded at banks and those clients borrowing on working capital lines of credit have paid down their balances with the glut of cash they have. Slowing loan growth (excluding PPP Loans) causes what we refer to as a negative "mix" variance. That phenomenon also negatively impacts net interest margins in the short run. (See more comments in Yield Curve Section below.)

Importantly, we wish to emphasize these challenges are not permanent. As the economy reopens, and excess deposits are drawn down by "spending" of all sorts, loan growth is likely to rebound handsomely, and margins should also pop back up. Remember too, as the low interest rate (1%) PPP Loans are forgiven, the "rate" variance of the margin calculation will also improve. Again, these temporary challenges for banks pale in comparison to the big issue which *might* have caused real problems for banks: namely, loan charge-offs. Speaking of loan quality…

Provision Expenses Decrease Due to Strong Asset Quality Metrics: The key driver to the spectacular earnings results posted by our banks in Q1 '21 were the very significant moderation of provision expenses. At worst, some banks posted greatly reduced provision expense, while many recorded zero or negative provision expenses. The popular press often refers to this phenomenon as "releasing reserves". It means the overall percentage of Allowance for Loan Losses/Loan is shrinking. That, of course, is completely appropriate if loans are performing well – and they are.

As highlighted in the Performance Recap Chart at the end of this letter, Non-Performing Loans/Assets did, in fact, improve during Q1 – dropping from 0.50% last quarter to 0.44% this quarter. (Anything below 1% is considered good.) In spite of this improvement, the Allowance for Loan Losses/Total Loans, i.e. reserves, have actually remained constant at 1.39% in both this quarter and last. This conservative approach is one we very much endorse and appreciate. It also suggests that further reserve releases may be forthcoming during the balance of this year. By every measure, loan quality has held up far better than most every analyst and investor could have dreamed at the beginning of the pandemic. The worry about big loan losses caused by the pandemic has been greatly diminished at this time.

Continued Strong Mortgage Loan Fees & Accretion of SBA Loan Origination Fees into Income Contribute to Non-Interest Income Increases: As anticipated, fee income as a percentage of total revenue at our banks has continued its upward trend – increasing to 29% this quarter compared to 27% last quarter and 26% in Q4 '19! This is very impactful to the "bottom line" for our banks!

The first quarter of 2021 was another strong one for fee income on residential mortgage loans. While many folks have already refinanced existing mortgages, new home buying continues at a very strong pace. Therefore, banks are migrating from a preponderance of "refinancing" activity to more balanced level between refinancing and purchased mortgage financing.
Fee income as a percent of total revenue was also bolstered due to an additional round of PPP funding from the most recent stimulus bill. While the forgiveness process for earlier rounds of PPP lending began during the fourth quarter of 2020 (somewhat reducing the loans held on bank balance sheets), median loans *still* increased 0.7% in the 1st quarter. As the PPP loan forgiveness process is likely to accelerate in Q2 and Q3, we anticipate total loans could decline over the next quarter or two. Yet, we remain convinced the combination of accelerating accretion of PPP loan fees into income, combined with the ultimate redeployment of excess deposits and repaid/forgiven PPP loans into higher yielding assets, (i.e. newly originated loans and draws on working capital lines) should support continued strong pre-tax/pre-provision EPS throughout the balance of the year.

Even Though Yield Curve Remains Steep, Margins Slip Due to Negative Mix Variance: At the time of this writing, the spread between the 10 and 2 year UST's remains near 1.5% – a very steep slope for the yield curve. This is a very positive circumstance for banks as they "borrow" from *depositors* primarily at the short end of the curve, and "lend" to *borrowers* at rates tied to the longer end of the curve. Nonetheless, as mentioned both in our *General Newsletter* and above, the "mix variance" is negatively impacting margins. Specifically, the Wtd. Avg. net interest margins for banks in our portfolio diminished from 3.30% last quarter to 3.07% this quarter. In normal times this level of decline would be cause for concern. But these, as you well know, are not normal times – and we are not unduly concerned about this temporary phenomenon.

Let's expound a bit more on the concept of "mix variance": (please forgive the "accounting 101" for banks). As with any business, banks have assets and liabilities. The confusing part for most is: folks tend to see a deposit for an individual or business as an asset on their own balance sheet. It's the opposite for a bank. Deposits are liabilities which they "owe" their customers. Conversely, people think of a loan as a liability on their own balance sheet, but they are assets for banks. It's flip-flopped for the bank vs. the individual or business.

When banks have more deposits (liabilities) than they can deploy into loans, those deposits are placed into a variety of other assets – mostly investments. The investments banks can make are tightly controlled and highly regulated. Investments at banks are predominantly invested in bonds of various kinds and durations. They almost always yield less than rates on loans. So, as the economy reopens and borrowers start borrowing again, banks will decrease their investments and increase their loans and this should cause the negative mix variance to abate – and margins *will* rebound.

<u>Conclusion:</u> In the Prologue and throughout this letter, we have explained why we remain bullish on community bank stocks. Before closing, we offer one last data point: while community bank stock prices have jumped markedly since September '20, they are still trading somewhere between 5 to 10 basis points below their historic Price/Tangible Book levels, while mid-cap and large cap banks are trading 10-40 bp's *<u>in excess</u>* of their traditional measure of P/TBV. We believe, most fervently, that with the increased M&A activity now underway, the ongoing strength of earnings at our community banks, the superior loan quality imbedded in our bank's loan portfolios, and a recovering economy – our community bank stocks are likely to continue to increase more rapidly than the big banks. This is why we invite you to consider increasing your investment with us at this time.

As always, if you have any questions or comments, we welcome your call to us at 574-243-6501. Or, email us at: john@rosenthalpartners.net or adam@rosenthalpartners.net.

With warmest personal regards,

<u>Fund 1 Q1 2021 Recap</u>

Ticker	Quarterly Record Pre-Prov. EPS?	Total Assets ($bils)	Pre-Provision EPS (1) 1Q '21	% Change from 4Q '20	% Change from 1Q '20	Earnings Per Share 1Q '21	% Change from 4Q '20	% Change from 1Q '20	Tg. CE / Tg. Assets 1Q '21	Tg. CE / Tg. Assets 4Q '20	Net Interest Margin 1Q '21	Net Interest Margin 4Q '20	Non Int. Inc. / Revenue 1Q '21	Non Int. Inc. / Revenue 4Q '20	NPAs+90 PD/ Assets 1Q '21	NPAs+90 PD/ Assets 4Q '20	Reserves / Total Loans 1Q '21	Reserves / Total Loans 4Q '20	Beta vs. S&P 500	Beta vs. SNL Bank
A		$3.5	$0.52	-14%	-16%	$0.50	-14%	-12%	9.2%	10.3%	2.88%	3.20%	18%	21%	0.09%	0.32%	2.27%	2.41%	1.24	0.98
B		$3.2	$0.88	17%	114%	$0.86	37%	187%	8.9%	9.3%	3.08%	3.25%	65%	63%	0.26%	0.28%	1.67%	1.63%	0.52	0.40
C	Yes	$10.5	$1.17	0%	3%	$1.27	20%	87%	8.9%	9.9%	3.32%	3.58%	33%	31%	0.68%	0.79%	1.42%	1.42%	1.18	1.04
D	Yes	$7.7	$0.48	8%	65%	$0.44	7%	100%	7.7%	9.2%	3.35%	3.59%	31%	31%	0.80%	1.06%	0.36%	0.36%	1.37	1.13
E		$3.1	$0.49	-25%	-23%	$0.66	10%	25%	10.5%	11.3%	3.19%	3.48%	8%	7%	0.41%	0.49%	0.94%	1.10%	1.08	0.86
F		$16.1	$1.10	-5%	8%	$1.33	21%	183%	7.8%	8.7%	3.39%	3.66%	17%	16%	0.27%	0.29%	1.55%	1.65%	1.33	1.10
G		$1.2	$2.83	-21%	143%	$2.73	-22%	126%	10.3%	11.0%	3.49%	3.40%	66%	73%	0.21%	0.24%	1.34%	1.26%	0.27	0.20
H		$4.9	$0.73	0%	-13%	$0.85	9%	NM	9.0%	8.1%	3.12%	3.05%	36%	36%	0.25%	0.23%	1.31%	1.48%	1.17	0.97
I		$3.1	$0.42	-3%	32%	$0.37	118%	48%	9.0%	9.0%	3.55%	3.63%	4%	4%	0.03%	0.04%	1.49%	1.50%	0.87	0.74
J		$29.4	$2.98	-1%	210%	$2.80	-1%	250%	7.5%	6.6%	2.78%	2.79%	63%	64%	0.38%	0.35%	0.99%	0.98%	1.12	1.09
K		$5.2	$0.71	-7%	28%	$0.74	-6%	57%	9.6%	10.2%	3.37%	3.72%	27%	23%	0.41%	0.44%	1.44%	1.51%	0.94	0.77
L		$6.0	$0.88	-10%	7%	$0.90	-7%	34%	10.8%	11.2%	3.15%	3.30%	21%	21%	0.29%	0.30%	1.60%	1.32%	0.95	0.77
M		$2.6	$1.09	-4%	82%	$1.10	8%	108%	6.1%	6.4%	3.28%	3.30%	27%	30%	0.64%	0.82%	1.20%	1.26%	1.36	0.92
N		$9.8	$2.23	152%	32%	$1.84	119%	27%	5.2%	6.7%	3.02%	4.68%	61%	41%	0.57%	0.87%	2.65%	2.02%	1.22	1.35
O		$20.2	$0.74	-3%	10%	$0.72	1%	67%	8.9%	9.4%	3.50%	3.63%	11%	10%	0.19%	0.15%	2.03%	2.02%	1.32	1.12
P		$153.3	$0.52	-4%	17%	$0.63	3%	350%	7.4%	7.8%	2.98%	3.14%	40%	39%	0.87%	0.93%	2.29%	2.49%	1.40	1.18
Q		$8.8	$0.55	-2%	42%	$0.60	13%	NM	10.7%	11.0%	3.46%	3.61%	21%	18%	0.63%	0.64%	1.51%	1.60%	1.27	1.07
R		$85.4	$3.69	-5%	13%	$3.24	-1%	72%	6.9%	6.9%	2.07%	2.24%	7%	6%	0.47%	0.55%	1.02%	1.03%	1.12	1.01
S	Yes	$4.8	$0.93	28%	27%	$0.99	27%	71%	9.0%	9.3%	3.35%	3.37%	27%	27%	0.30%	0.29%	1.39%	1.46%	1.06	0.85
T	Yes	$142.3	$8.39	53%	45%	$10.03	36%	293%	6.1%	6.7%	2.25%	2.41%	47%	44%	0.07%	0.10%	0.82%	0.99%	1.49	1.09
U		$8.1	$1.60	1%	15%	$1.72	7%	225%	7.7%	8.2%	2.97%	3.14%	26%	25%	0.59%	0.61%	0.93%	0.98%	1.02	0.84
V	Yes	$3.2	$0.72	2%	33%	$0.70	35%	43%	7.4%	7.0%	3.13%	3.21%	10%	9%	0.78%	0.51%	1.30%	1.29%	1.01	0.81
W		$45.7	$2.14	23%	10%	$2.54	56%	144%	7.0%	6.8%	2.51%	2.55%	41%	38%	0.35%	0.42%	0.81%	0.96%	1.32	1.17
X		$85.1	$1.20	-5%	-2%	$1.90	14%	NM	7.6%	7.8%	2.83%	2.96%	22%	22%	0.72%	0.71%	1.21%	1.45%	1.02	0.99
Wtg. Avg.		**$31.5**		**11%**	**30%**		**22%**	**98%**	**8.3%**	**8.8%**	**3.07%**	**3.30%**	**29%**	**27%**	**0.44%**	**0.50%**	**1.39%**	**1.39%**	**1.15**	**0.97**

Note: For certain performance metrics, if data was not reported, consolidated and/or bank regulatory data for the most recent quarter available may have been used.

(1) Pre-Provision EPS = Pre-provision net revenue per share assuming a 21% federal marginal tax rate and based on average diluted shares outstanding. Pre-Provision Net Revenue = Net Interest Income + Noninterest Income - Noninterest Expense

<u>Legend:</u> Our color coded legend above gives an overview of GREAT, GOOD and BELOW PAR – but oftentimes does not tell the whole story. We do NOT adjust earnings for one-time events such as acquisition costs. So, a "red" in one quarter may end up being a bit misleading. Furthermore, given the lines of business for certain of our banks, there is some seasonality to income; which makes quarterly comparisons difficult. Green is outstanding and represents banks which have posted EPS increases of more than 5%, whose net interest margin is up and whose non-performing loans are down. Yellow is good and represents banks which have posted EPS gains within a range, up or down, of 4.9%. Red represents banks which have posted EPS declines of greater than 5%, had a decrease in their net interest margin or an increase in non-performing loans.

Finally, as always, past performance may not be indicative of future results. Therefore, no current or prospective client should assume that the future performance of any specific investment, investment strategy (including the investments and/or investment strategies recommended by the advisor), will be profitable or equal to past performance levels.