BANK PERFORMANCE NEWSLETTER – Q2 2021
RPCA OPPORTUNISTIC FINANCIAL VENTURES LP ("FUND 2")

Important Note: We once again invite you to Save the Date for our *10th Anniversary Annual Investor Meeting and Banking Industry Update*. It will be held at 8:00 a.m. on Monday October 25, 2021 in the Dahnke Family Ballroom at Notre Dame Stadium. If you are unable to attend, the meeting will be live-streamed via Zoom. Formal invitations will be forthcoming.

Prologue: Again this quarter, our banks earnings and overall financial performance were stellar – even surpassing our bullish expectations. Generally speaking, "reserve releases" i.e. zero or negative provision for loan loss expenses, continued to be more favorable than anticipated; net interest income *at our banks* bettered analyst's forecasts; fee income remained stronger than expected; and operating expenses remained under control. Those combination of factors all contributed to great financial results from our banks – which, over time, translates into higher stock prices.

2nd Quarter 2021 Headlines – Operating and Earnings Performance

- **FVCB Bought Out; M&A Activity Continues; YTD Total of 8 Banks Acquired Within Our Funds**
- **Year-Over-Year "Pre-Provision" EPS for Banks in Fund 2 Increased 9% while "Bottom line" EPS Skyrocket 120% YOY Reflecting Continued Massive EPS Recovery from Onset of Pandemic in Q1 '20.**
- **Loan Growth and Net Interest Margin Pressures Remain Key Concerns – But Banks in *Our Portfolio* Grew Loans More than Banking Industry as a Whole**
- **Key Operating Takeaways from Q2:**
  - **Provision Expenses Decrease Further Due to Continued Strong Asset Quality Metrics**
  - **Mortgage Loan Fees & Accretion of SBA PPP Loan Origination Fees into Income Contribute to Ongoing Strength of Non-Interest Income**
  - **Lower Rates and Flatter Yield Curve Affect Margins; Negative "Mix Variance" Remains due to Excess Liquidity in the System**
  - **Dividend Yield(1) for Fund 2 is 3.01%**

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

FVCB Bought Out; M&A Activity Continues; YTD Total of 8 Banks Acquired Within Our Funds: As we wrote in our Q1 Bank Performance Newsletter, M&A in the banking sector was on pace to surpass pre-pandemic levels. The global rollout of multiple COVID-19 vaccines and increasing consumer confidence, seems to have caused companies to behave more bullishly. This trend has continued in the second quarter of 2021 as M&A in the banking sector increased 71% quarter-on-quarter according to a Raymond James Industry Brief from July 2, 2021.

To wit, Fund 2 has had three bank holdings acquired so far this year. Two of which were announced early in the second quarter (which we reviewed in our 1st Quarter Bank Performance Newsletter i.e. Century Bancorp & Flagstar Bancorp) and the third acquisition was announced early in the 3rd quarter (FVCBankcorp). As detailed in the Q1 Newsletter, both Century and Flagstar positions were sold at premiums following the merger announcements. And while the FVCB was announced as a merger of equals we determined that the future growth of the combined company would be muted by the pending transaction, prompting our sale of the Fund's entire position and realizing a ~15% gain.

We reiterate 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. 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 2 Increased 9% while "Bottom line" EPS Skyrocket 120% YOY Reflecting Continued Massive EPS Recovery from Onset of Pandemic in Q1 '20: 83% of all banks reporting so far have beat analyst's estimates – according to the Raymond James Bank Weekly report on August 2, 2021! Declining provision expenses and good operating efficiencies are major contributors to banks within the Raymond James coverage universe reporting increased median year-over-year Return on Assets of 1.25% up from 0.86%; and median improved year-over-year Return on Equity increasing to 15.1% from 10.3%. The increases in both metrics are quite significant! Industry-wide, median total revenue *growth* slowed from the torrid pace of the past 4 quarters – but the ratio of total revenue to total operating expenses i.e. the efficiency ratio, has remained relatively constant increasing only slightly this quarter to 58% vs. 57% last quarter. These impressive results have generally caused continued 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 2nd 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 outstanding. More details regarding the factors leading to these results are provided in the sections below.

Loan Growth and Net Interest Margin Pressures Remain Key Concerns – But Banks in *Our Portfolio* Grew Loans More than Banking Industry as a Whole: The overall environment for our community banks remains very positive. However, as highlighted previously, there are 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. Moderate 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.)

We wish to re-emphasize these challenges are not permanent. As the economy continues to reopen, 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 Further Due to Strong Asset Quality Metrics: As of this writing, 83% of banks that have reported have beaten consensus estimates driven largely by provision expenses as outlook on credit risk continues to improve (according to an August 2, Raymond James Banking Industry Brief). Credit metrics remain in check and reserve levels continue to decline (median down 3 bp's) as many banks report negative provision expense. While government stimulus and Federal Reserve policy has essentially kept credit risk off the table, the continued reopening of the economy causes us to believe that "clouds will continue to part" and even greater clarity will appear as we perpetually review credit.

The overall percentage of Allowance for Loan Losses/Loan is shrinking which 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 improve during Q2 – dropping from 0.61% in Q4 '20 to 0.56% this quarter: (remember, anything below 1% is considered good). Due to this improvement, the Allowance for Loan Losses/Total Loans, i.e. reserves, have declined somewhat and are at 1.39% this quarter vs. 1.50% at year-end '20. 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.

Mortgage Loan Fees & Accretion of SBA PPP Loan Origination Fees into Income Contribute to Ongoing Strength of Non-Interest Income: In other newsletters, we have reviewed how lenders have earned millions in fees in the past five quarters for processing PPP loans and mortgage/refinancing activities. In some ways, the pandemic actually opened up opportunities for banks as many community banks provided PPP loans for *prospects* as well as existing clients.

First, a review of the second quarter: fee income as % of total revenue held steady at 28% compared to Q4 '20. Fee income has been bolstered as banks realize fees for originating PPP loans and generated excellent mortgage loan origination income in '20 and so far in '21.

Second, we've stated in the past that refinancing and purchased mortgage financing will continue to "normalize" in the coming months – impacting fees generated from those activities. So where will fee income growth stem from in the future? We believe that one area of focus will be on increased business lending. Business owners need debt financing – both to rebound and grow. And since many businesses were forced to develop lending relationships with community banks to gain access to the much-needed PPP loan program, those borrowers have expanded their thinking beyond the big-name banks to secure funding from community and regional lenders. Although demand of credit is not currently as strong as it was before the COVID-19 pandemic, approval percentages continue to move higher. Evidence of this can be seen when reviewing small business loan approval percentages. According to the Biz2Credit Small Business Lending Index, small business loan approvals at big banks ($10 billion+ in assets) rose slightly from 13.5% in May to 13.6% in June while smaller banks' approvals climbed from 18.7% to 18.9% during that same time. In short, we believe that as the economy continues to reopen, our banks will be well positioned to use their strong balance sheets to help finance business growth.

Lower Rates and Flatter Yield Curve Affect Margins; Negative "Mix Variance" Remains due to Excess Liquidity in the System: Q2 saw a surprising drop in interest rates. The yield curve flattened further as well. However, as of this writing, the yield on the 10-year UST has rebounded to 1.31% vs. a low of 1.19% on August 3rd. The 10-2 UST spread has also bounced off recent lows and is currently 1.10% – above its historic norm. Importantly, our forecast is for higher rates between now and year-end. Our belief is based on our understanding of increasing Federal budget deficits to fund infrastructure programs and potential "social programs" sponsored by the Biden Administration – along with an overall increased demand for credit as the economy reopens. As mentioned above, the "mix variance" generally had a negative impact on margins, but our banks actually saw the Wtd. Avg. net interest margins expand from 3.02% last quarter to 3.10% this quarter.

Let's expound a bit more on the concept of "mix variance": (please forgive the "accounting 101" for banks). When banks have more deposits (liabilities) than they can deploy into loans (assets), 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 very likely* rebound. As margins expand later this year and into 2022, bottom line earnings will also increase. This is a key reason for our continued bullishness for bank stocks.

Conclusion: The nature of business always presents certain challenges to management teams (in the banking sector and every other industry as well). But in our view, the tailwinds pushing bank returns higher will prevail over the next several quarters. Not to oversimplify things, but there are two strong potential benefits, which on their own should keep bank stock prices moving higher. First, the inevitable rise in interest rates. Second, the underlying fundamentals that should continue to improve. This means that revenue should increase as lending heats up and net interest margin expands. These high-level industry factors, along with the bank specific metrics highlighted above, are why we renew our positive outlook and 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,

John Adam

Fund 2 Q2 2021 Recap

Ticker	Quarterly Record Pre-Prov. EPS?	Total Assets ($bils)	Pre-Provision EPS (1) 2Q '21	% Change from 1Q '21	% Change from 2Q '20	Earnings Per Share 2Q '21	% Change from 1Q '21	% Change from 2Q '20	Tangible CE / Tangible 2Q '21	4Q '20	Net Interest Margin 2Q '21	4Q '20	Non Int. Inc. / Revenue 2Q '21	4Q '20	NPAs+90 PD/ Assets 2Q '21	4Q '20	Reserves / Total Loans 2Q '21	4Q '20	Beta vs. Index S&P 500
A		$7.7	$1.16	-4%	10%	$1.19	8%	65%	10.7%	11.1%	3.14%	3.57%	31%	29%	0.77%	0.89%	2.48%	2.56%	1.09
B	Yes	$6.6	$0.48	1%	25%	$0.50	14%	43%	9.4%	9.2%	3.19%	3.59%	32%	31%	0.80%	1.07%	0.33%	0.36%	1.40
C	Yes	$6.5	$0.98	5%	13%	$1.12	26%	133%	8.8%	8.9%	4.01%	4.16%	4%	4%	0.78%	0.84%	1.11%	1.18%	1.16
D		$3.2	$0.62	-25%	-20%	$0.66	-23%	2%	9.4%	9.3%	2.88%	3.25%	63%	63%	0.27%	0.28%	1.78%	1.63%	0.53
E		$3.2	$0.43	1%	25%	$0.38	3%	46%	9.1%	9.0%	3.51%	3.63%	3%	4%	0.03%	0.04%	1.46%	1.50%	0.88
F		$1.2	$0.89	-14%	7%	$0.81	-18%	189%	6.0%	5.1%	2.38%	3.51%	16%	33%	0.00%	0.00%	1.41%	1.58%	0.14
G	Yes	$7.7	$0.81	10%	4%	$0.81	-1%	119%	10.0%	9.5%	3.59%	3.52%	6%	5%	1.41%	1.30%	1.23%	1.27%	1.22
H		$2.9	$0.89	-9%	28%	$0.95	-15%	150%	7.3%	7.6%	3.49%	3.69%	23%	23%	0.41%	1.04%	1.19%	1.32%	1.09
I		$7.9	$0.66	18%	41%	$0.58	16%	45%	8.2%	8.8%	3.20%	3.19%	20%	18%	0.25%	0.35%	0.37%	0.46%	1.21
J		$87.9	$0.42	-5%	-18%	$0.53	33%	212%	6.9%	6.9%	2.46%	2.73%	37%	36%	0.64%	0.73%	1.41%	1.63%	1.43
K	Yes	$5.8	$0.97	8%	7%	$0.68	183%	13%	8.4%	9.6%	3.22%	3.21%	30%	31%	0.65%	0.65%	1.44%	1.34%	1.07
L		$2.0	$0.37	-2%	5%	$0.36	-5%	71%	9.8%	10.0%	3.06%	3.30%	5%	5%	0.41%	0.53%	0.97%	1.02%	1.18
M		$35.1	$0.98	-8%	-7%	$1.00	-17%	NM	7.7%	7.6%	2.95%	3.23%	28%	25%	0.30%	0.47%	1.88%	2.05%	1.48
N		$6.1	$0.44	5%	5%	$0.50	9%	52%	9.1%	9.1%	3.01%	3.25%	26%	28%	0.39%	0.49%	1.58%	1.47%	1.24
O		$4.8	$0.89	0%	-1%	$1.12	29%	107%	8.5%	8.9%	2.77%	3.04%	30%	31%	0.50%	0.61%	1.10%	1.18%	1.11
P		$7.1	$1.18	-47%	67%	$1.21	-34%	128%	7.9%	6.7%	3.74%	4.68%	48%	41%	0.80%	0.87%	2.54%	2.02%	1.23
Q		$7.3	$0.94	-10%	3%	$1.17	8%	457%	9.1%	8.1%	3.11%	3.09%	18%	22%	0.55%	0.42%	1.40%	1.46%	0.87
R		$20.5	$0.73	-1%	7%	$1.01	40%	NM	9.4%	9.4%	3.43%	3.63%	12%	10%	0.17%	0.15%	1.71%	2.02%	1.33
S		$34.9	$1.02	-3%	-3%	$1.52	20%	443%	7.8%	8.8%	3.39%	3.85%	13%	13%	0.25%	0.36%	1.16%	1.82%	1.39
T		$155.6	$0.50	-5%	-6%	$0.77	22%	NM	7.5%	7.8%	2.80%	3.14%	38%	39%	0.89%	0.93%	1.87%	2.49%	1.41
U	Yes	$12.9	$1.17	9%	3%	$1.19	-25%	NM	9.3%	8.6%	3.62%	3.40%	20%	24%	0.74%	0.91%	1.22%	1.58%	1.08
V		$163.4	$5.59	-33%	4%	$9.09	-9%	106%	5.8%	6.7%	2.05%	2.41%	39%	44%	0.05%	0.10%	0.78%	0.99%	1.50
W		$15.8	$0.64	-26%	-10%	$0.77	-19%	60%	8.9%	9.0%	2.93%	3.00%	39%	41%	0.17%	0.21%	1.08%	1.18%	1.11
X		$0.7	$1.96	-6%	13%	$1.41	-6%	-6%	NA	9.1%	2.24%	2.49%	92%	93%	2.42%	0.21%	1.02%	1.30%	0.14
Y		$9.3	$0.61	-5%	-17%	$0.59	-8%	23%	9.5%	9.2%	3.10%	3.31%	16%	12%	1.10%	1.06%	1.40%	1.54%	1.34
Z		$46.7	$1.55	-27%	-32%	$1.70	-33%	400%	7.1%	6.8%	2.62%	2.55%	31%	38%	0.32%	0.42%	0.77%	0.96%	1.33
Z		$15.1	$0.95	-16%	-8%	$2.01	48%	NM	9.1%	9.0%	3.21%	3.94%	29%	26%	0.32%	0.54%	1.58%	2.48%	1.24
AA		$87.2	$1.26	4%	-3%	$2.08	9%	512%	7.6%	7.8%	2.78%	2.96%	20%	22%	0.74%	0.71%	1.04%	1.45%	1.04
Wtg. Avg.		$27.1		-9%	9%		2%	120%	8.2%	8.3%	3.10%	3.43%	28%	28%	0.56%	0.61%	1.39%	1.50%	1.13

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

Legend: 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.