Uninvestable?

Another Financial Crisis - How Banks Respond & Proceed

September 2020

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www.yourdictionary.com

uninvestable

Adjective

(*not comparable*)

- That cannot be invested.

Origin

un- + *investable*

Some Investors Might Say …

Banks Are Uninvestable (we cannot own Bank stocks):

- **COVID-19 is an unprecedented curveball. There is *insufficient data to analyze* Banks**
- **The pandemic means *Banks cannot estimate their loan losses*, how can I own Bank stocks?**
- **Interest rates are going to be low for a LONG time. The Fed's "ZIRP" is back.**
- **More dividend cuts are bad for Bank stocks, so are higher taxes (via White House change) and *M&A is on-hold* too.**

Our Experience = Cooler Heads Prevail

Banks are still investable (BUY Bank stocks):

- **Every cycle has a trigger, COVID-19 is a black swan event nobody could see, everyone feared.**
- *Banks are better positioned with more capital and less concentration risk,* **PPNR solid**, **TBV growing**.
- **This is not the first time rates are low for long, start buying discount P-to-TBV discounts**
- **Dividends are intact for 80%+ of the industry!** *We assert the Fed needs Banks to lend, another TARP is not necessary.*

Banks vs S&P 500 *(day vs night!)*

	8-28-20	12-17-19	Low 3/23
S&P 500	3,489.48	9.3%	(29.9%)
		Banks' Performance	
NASDAQ Bank	2,736.65	(31.8%)	(46.7%)
KRE (S&P Reg.Bank ETF)	39.27	(33.7%)	(52.5%)

The S&P 500 fell in the March capital markets' meltdown, quickly recovered and set new Highs.

Banks are far less fortunate.

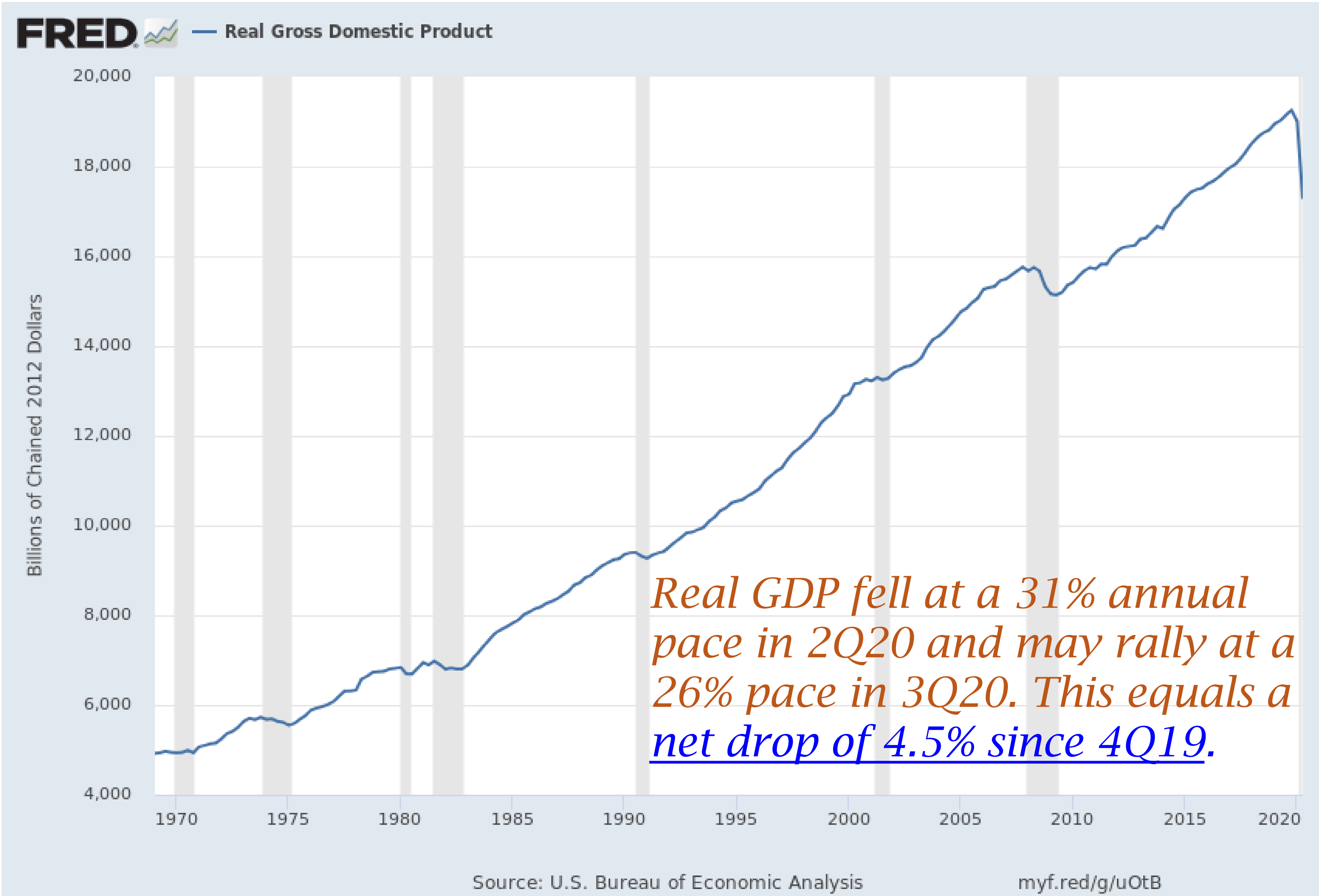
The contrast for $1,000 invested pre-pandemic is quite large!

	Today	Low 3/23
S&P 500	$1,093.02	$700.83
	$1,000 In Banks vs S&P	
NASDAQ Bank	$682.12	$532.59
KRE (S&P Reg.Bank ETF)	$663.12	$475.01

vs. Mid-Dec 2019

Institutions

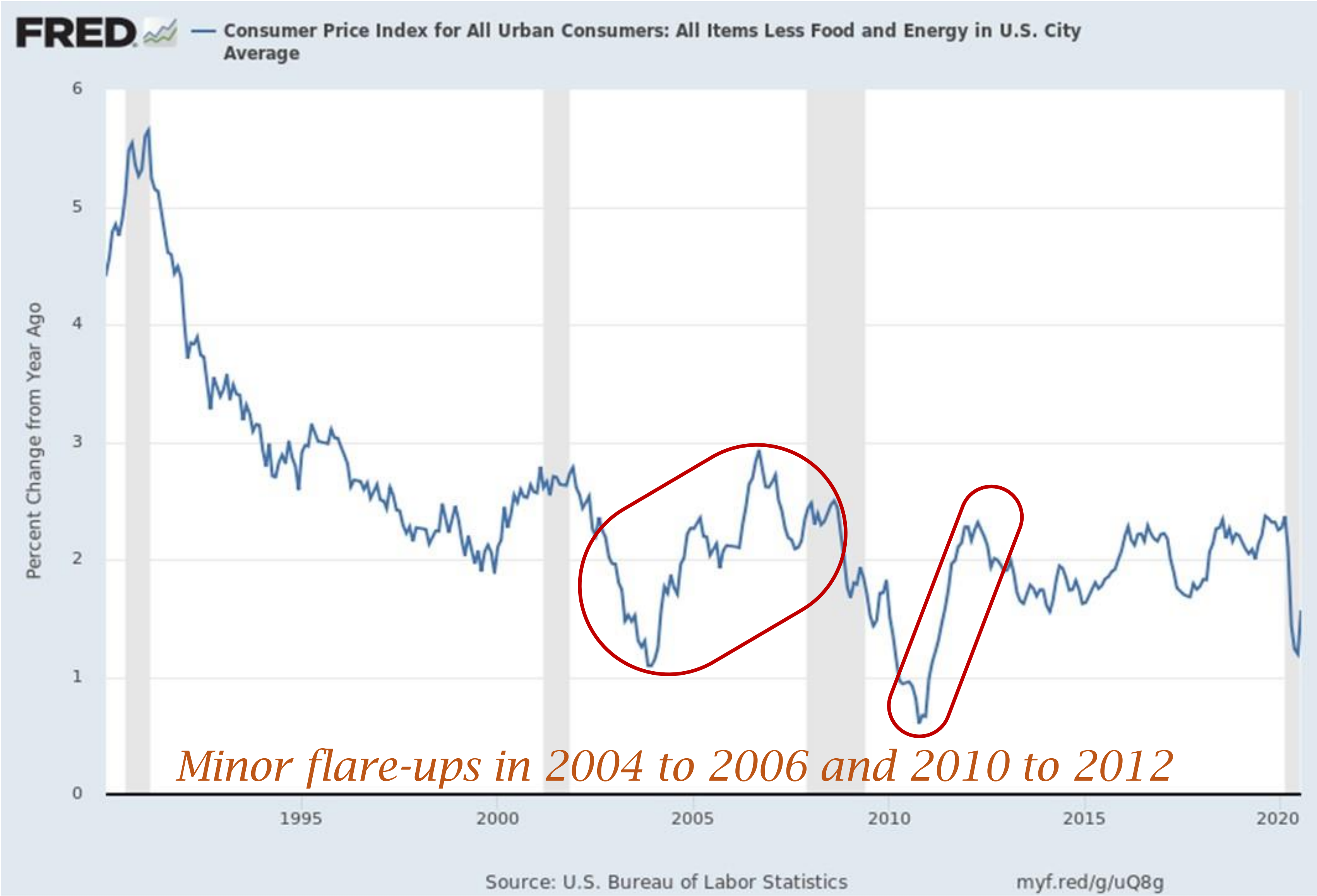
GDP Over The Long Run



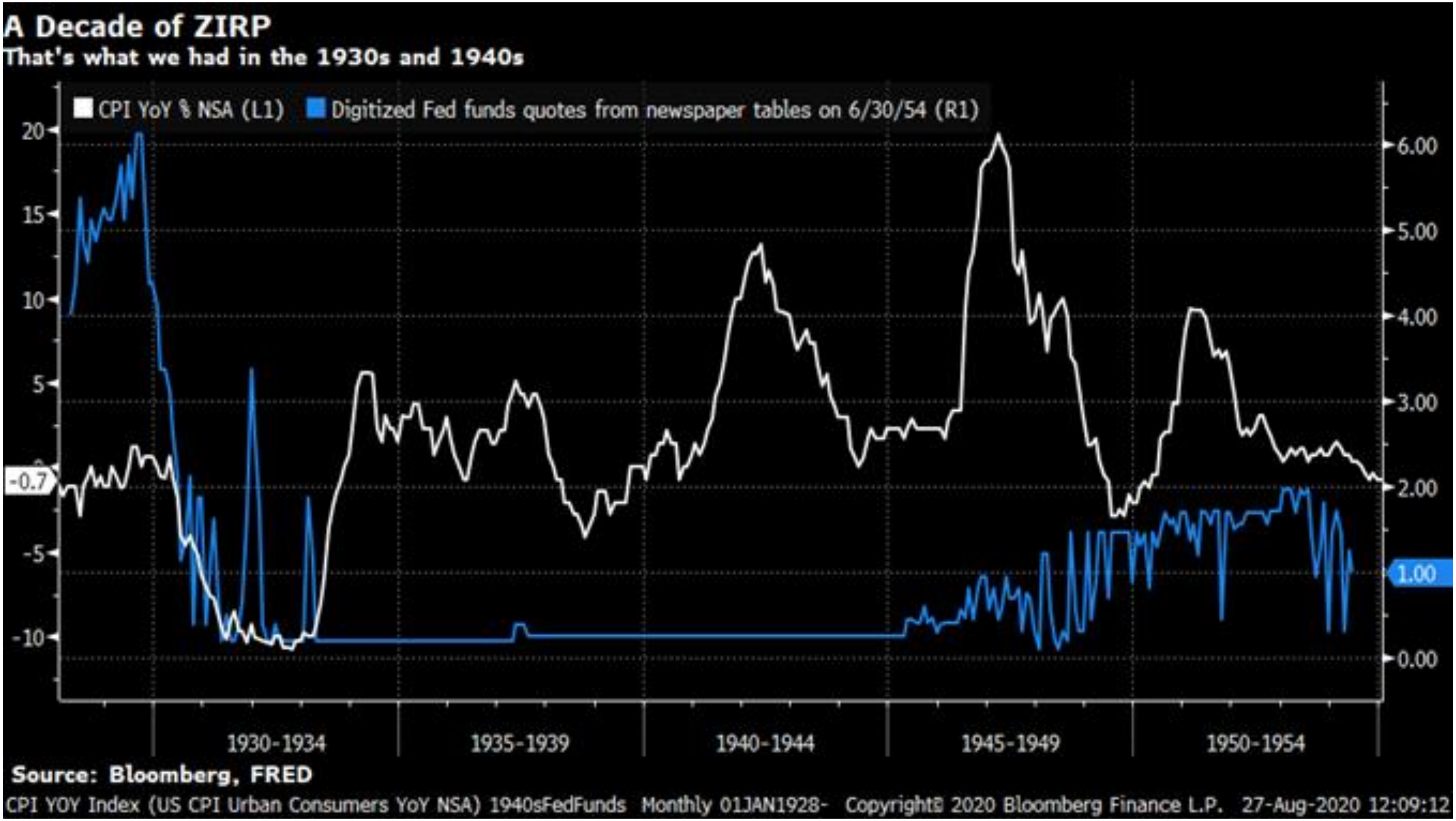
Real GDP fell at a 31% annual pace in 2Q20 and may rally at a 26% pace in 3Q20. This equals a net drop of 4.5% since 4Q19.

Institutions

A 30-Year Look At Inflation

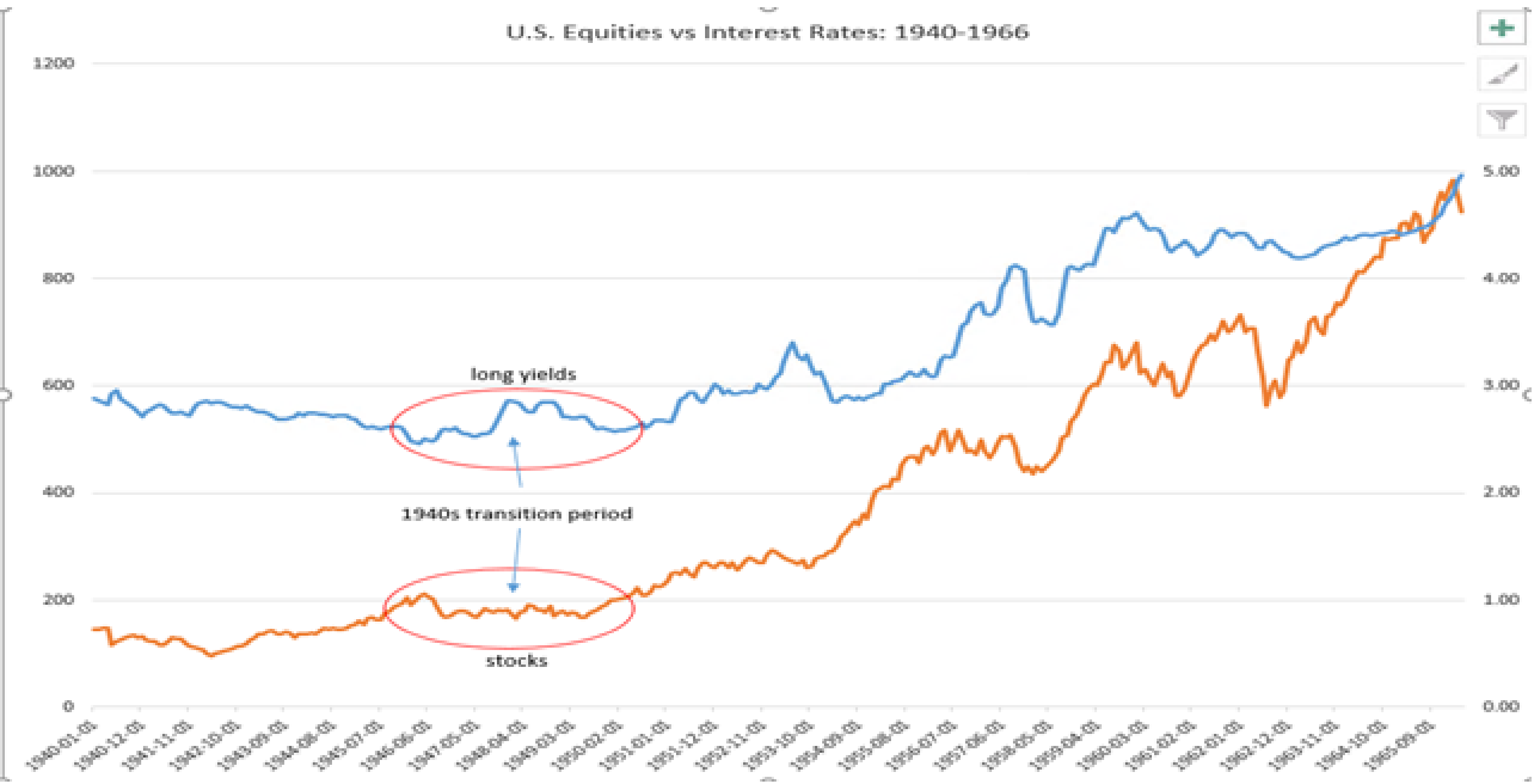


The Fed Had A ZIRP Policy In 1940s



History is repeating itself in 2020 (and beyond) …

Interest Rates & Stocks: 1940 to 1965



Stocks and long-term interest rates when the Fed had ZIRP

Regulatory Solutions Are Different

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Formerly Covered by FIG Partners LLC

March 19, 2020 BANKS & THRIFTS

FDIC Provides Some COVID-19 Credit Guidance. It's Not Enough, Please Send More Clarity And Better Solutions.

- The FDIC posted important details on how Banks should treat Loans that are impacted by the sudden economic dislocation from the COVID-19 virus. Read the FDIC's FAQs on COVID-19.
- In our opinion, some guidance might be better than none. However investors clearly disregard the FDIC's new policy and now expect Banks' credit quality is severely impaired. The daily massive sell-off in Bank stocks reveals a severe mistrust in tangible book value for 3-31-20 - EPS estimates were ignored 3 weeks ago and have taken a back seat to tangible book value (TBV).
- We disagree with the FDIC's lack of clarity and emergency solutions for Banks to specifically address COVID-19. This is an unprecedented credit event for all Banks, therefore it requires an emergency playbook from the FDIC. Bankers require relief or alternatives from current rules on TDRs (Troubled Debt Restructurings).
- In our view, the ability to make a 6-month abatement on payments would be helpful. Specifying time is not mentioned in the FDIC guidance - we understand certain Banks are starting to grant borrowers 90-day relief on both principal and interest payments which may not be long enough for businesses to recover (6 months seems more appropriate). How Banks document these accommodations are critical - today's decisions to help borrowers are tomorrow's regulatory exam file where crisis documentation is paramount. This is precisely why the FDIC guide lacks specific clarity of today's unprecedented credit challenge, in our opinion.

Read Janney's FDIC COVID-19 Report 3-19-2020

Bankers Need To Think On Their Feet

Helping Customers While Supporting Your Credit File:

- **Understand the TDR rules and related triggers auditors use to define a TDR – do the opposite**
- **Accommodate your borrower, defer principal & interest at least 90-days (prefer 180 days), keep your write-up general.**
- **Agency/municipality/city moratoriums on foreclosures are really helpful to document.**
- **Yes, Banks give forbearance and MAC-clause applies – don't use these words. Cite "global economic crisis" (keep it general)**

Pauses On Foreclosure: Help The File

FHFA suspends foreclosures, evictions for enterprise-backed mortgages

Wednesday, March 18, 2020 3:53 PM ET

By Abdullah Khan
Market Intelligence

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The Federal Housing Finance Agency directed Fannie Mae and Freddie Mac to suspend foreclosures and evictions for at least 60 days due to the coronavirus national emergency.

According to the FHFA release, the suspension applies to homeowners with government-sponsored enterprise-backed single-family mortgages.

Earlier in March, the FHFA also announced that Fannie and Freddie would provide payment forbearance to borrowers affected by the virus, allowing for mortgage payments to be suspended for up to 12 months due to hardship caused by the coronavirus.

Bank Performance Post-CECL

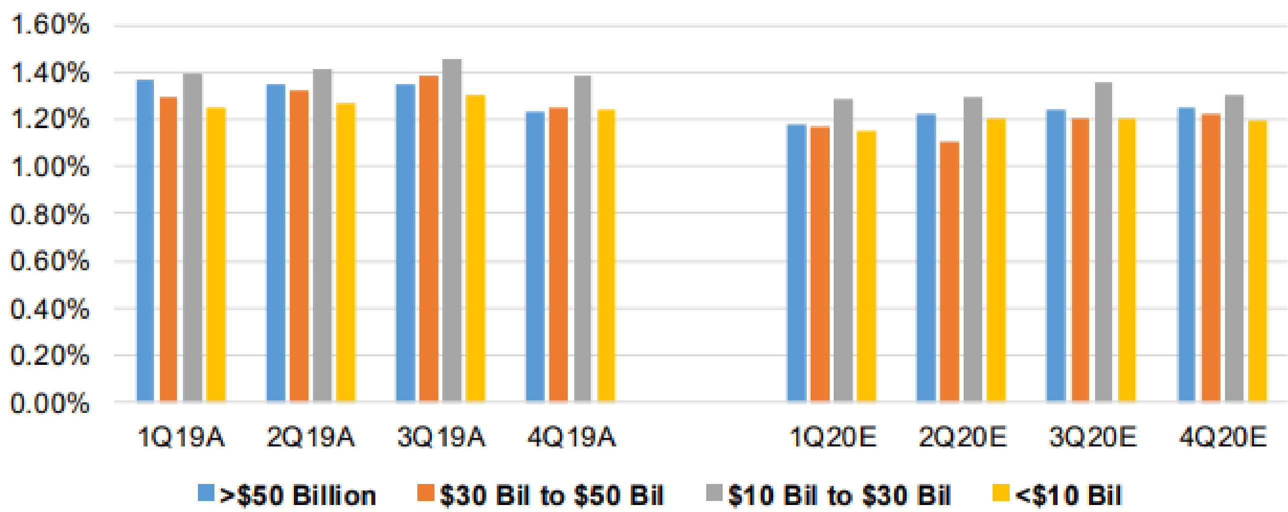
We Propose: Pre-Provision Net Revenue ROAA (Return on Avg. Assets)

(NII + Fee Income - Non-Interest Expense - Net Charge-Offs) * (1-Tax Rate)

Provisions under CECL get muddy.

Instead, focus on PPNR less Charge-Offs

Credit Adjusted Pre-Provision Net Revenue ROAA



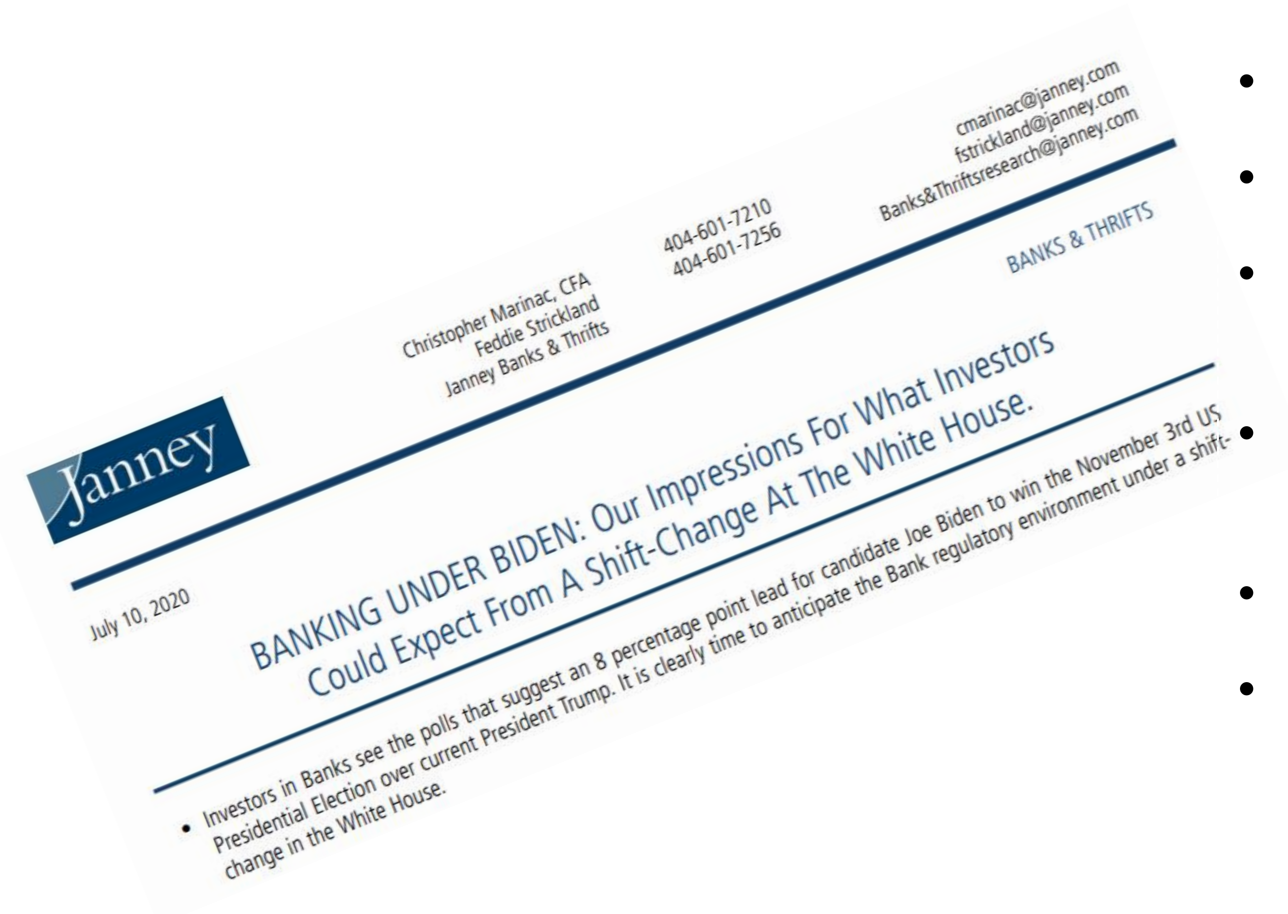
Credit Adjusted Pre-Provision Net Revenue ROAA

Asset Range	Actual Results 1Q19A	2Q19A	3Q19A	4Q19A	Mean Consensus Estimates 1Q20E	2Q20E	3Q20E	4Q20E
>$50 Billion	1.37%	1.35%	1.35%	1.23%	1.18%	1.22%	1.24%	1.25%
$30 Bil to $50 Bil	1.29%	1.32%	1.38%	1.25%	1.17%	1.11%	1.20%	1.22%
$10 Bil to $30 Bil	1.39%	1.41%	1.46%	1.39%	1.29%	1.29%	1.36%	1.31%
<$10 Bil	1.25%	1.27%	1.30%	1.24%	1.15%	1.20%	1.20%	1.19%

Source: Janney Research (FIG Group), S&P Global MI

Read Janney's Weekly Musings 2-18-2020

Banking Under Biden



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July 10, 2020

BANKS & THRIFTS

BANKING UNDER BIDEN: Our Impressions For What Investors Could Expect From A Shift-Change At The White House.

- Investors in Banks see the polls that suggest an 8 percentage point lead for candidate Joe Biden to win the November 3rd US Presidential Election over current President Trump. It is clearly time to anticipate the Bank regulatory environment under a shift-change in the White House.

- Agency heads change
- Key: House vs Senate
- Real regulatory operators are intact
- Expect tax rate hikes (easy to sell 5%)
- Fed governors: 14 yrs
- Modernize/digitize CRA rules

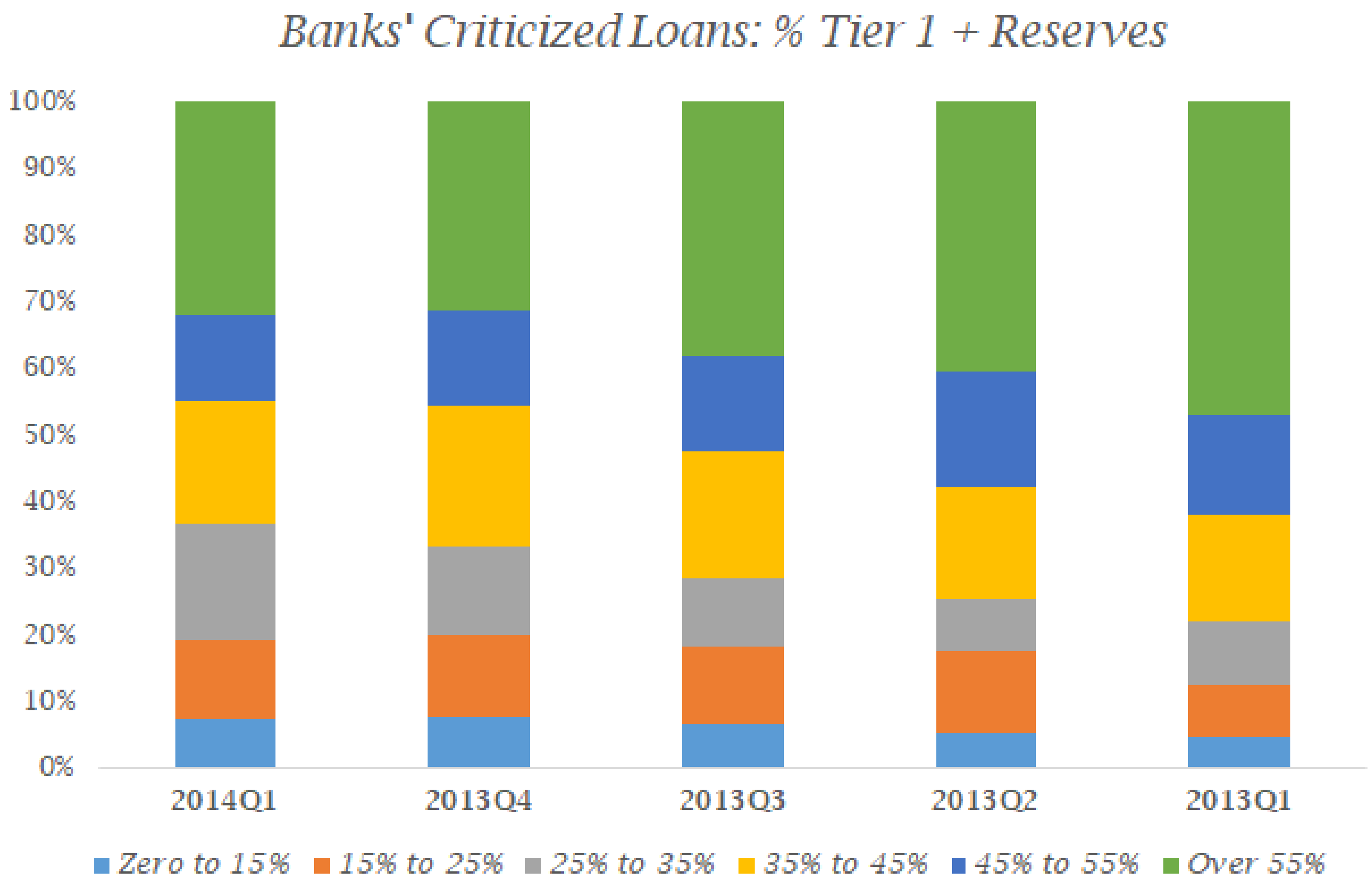
Read the Janney industry report

The Missing Ingredients In Banks

Investors Must Learn & Appreciate The Following:

- **Credit issues are largely solvable, even in a pandemic with no immediate conclusion**
- **Criticized Assets will rise, but given Capital and Reserves, Criticized Ratios are modest**
- **Low interest rates are a headwind (forever) BUT real change is on the cost structure.**
- **COVID-19 already accelerated digital adoption, cost reductions are next (supported by M&A).**

Criticized Asset History



Source: Janney Research (FIG Group), 247 public Bank 10-Q, 10-K filings 2013 to 2014

Studying FDIC Charters: Past Decade

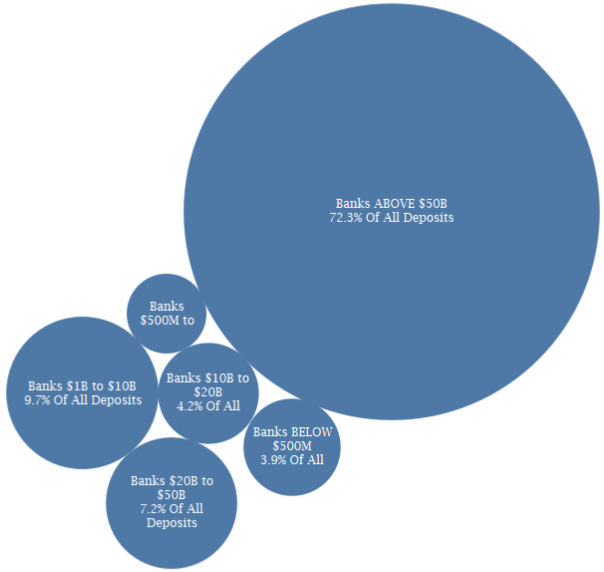
	P-P ROA: 2019 vs 2010	Spread: 2019 vs 2010	Fees: 2019 vs 2010	Costs: 2019 vs 2010	P-T ROA: 2019 vs 2010	LLP: 2019 vs 2010		Assets g%: 2019 vs 2010
Median	0.00%	(0.03%)	(0.04%)	(0.17%)	0.56%	(0.45%)		61%
High Growth (>100%)	0.02%	(0.16%)	(0.18%)	(0.38%)	0.66%	(0.63%)	H	240%
Low Growth (<40%)	0.38%	0.00%	1.11%	0.72%	1.27%	(0.89%)	L	8%

The ROA components for FDIC Banks' Above $500M signals:

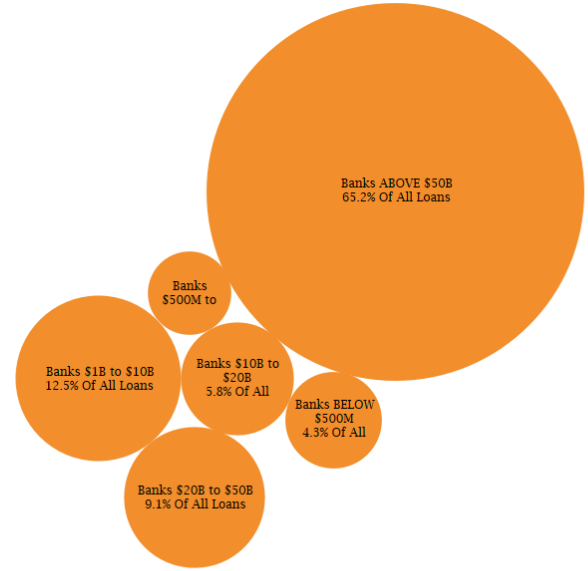
- **Over 60% of FDIC Banks are "high growth" (>100% Assets) or "low growth" (<40%) in the past 10 years.**
- **High growth leads to operating leverage, lower expenses.**
- **Banking is about leading, not just survival.** *The leaders are growers, and the growers are cutting costs and buying Banks.*
- **Stop worrying about low rates/spreads, focus on COSTS**

Large Banks Dominate …

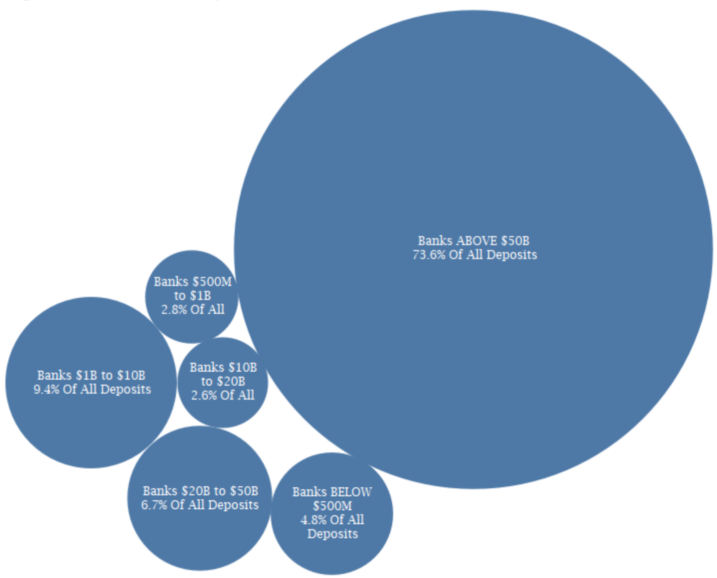
Deposit Distribution By Total Assets In 2019



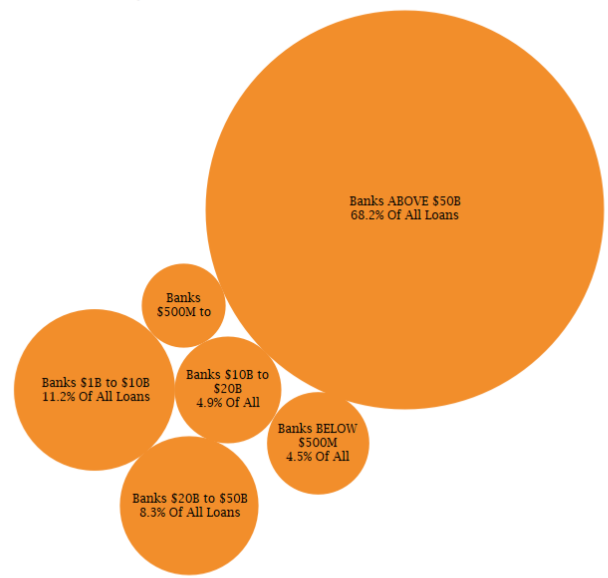
Loan Distribution By Total Assets In 2019



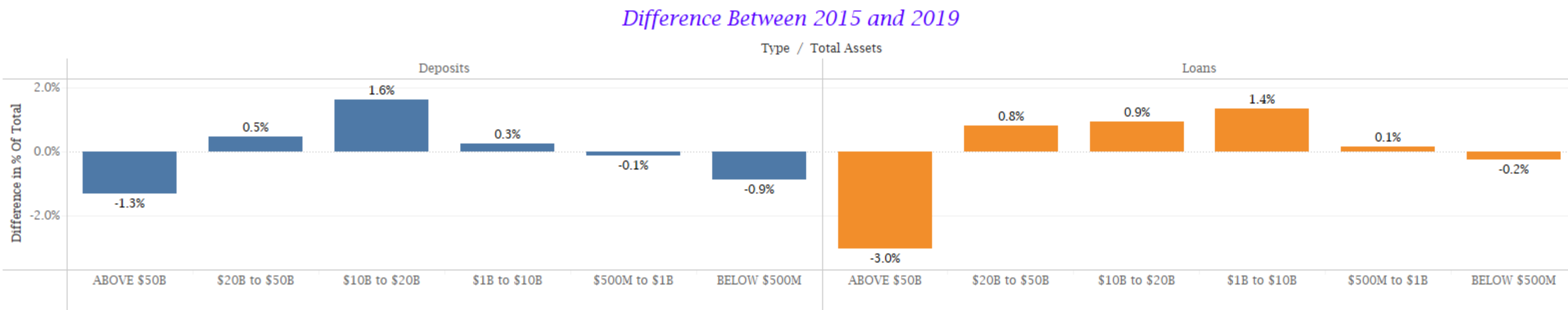
Deposit Distribution By Total Assets In 2015



Loan Distribution By Total Assets In 2015



Watch The Emerging Mid-Sized Banks



Source: Janney Research (FIG Group), S&P Global MI, FDIC Call Report Data

Relative Size - TOTAL Deposits

	12/31/2019	12/31/2015
ABOVE $50B	72.3%	73.6%
$20B to $50B	7.2%	6.7%
$10B to $20B	4.2%	2.6%
$1B to $10B	9.7%	9.4%
$500M to $1B	2.7%	2.8%
BELOW $500M	3.9%	4.8%

Relative Size - Core Deposits

	12/31/2019	12/31/2015
ABOVE $50B	75.4%	77.0%
$20B to $50B	6.8%	6.4%
$10B to $20B	4.0%	2.3%
$1B to $10B	8.5%	8.3%
$500M to $1B	2.2%	2.2%
BELOW $500M	3.1%	3.7%

Relative Size - TOTAL LOANS

	12/31/2019	12/31/2015
ABOVE $50B	65.2%	68.2%
$20B to $50B	9.1%	8.3%
$10B to $20B	5.8%	4.9%
$1B to $10B	12.5%	11.2%
$500M to $1B	3.2%	3.0%
BELOW $500M	4.3%	4.5%

The winners the past 4 years are mid-sized Banks as small as $1B and as large as $50B. Note how the industry's mid-section shifted.

Study Bank Lending: 2019 vs 2015

Relative Size - C&I

	12/31/2019	12/31/2015
ABOVE $50B	72.1%	74.7%
$20B to $50B	9.1%	8.8%
$10B to $20B	3.9%	3.0%
$1B to $10B	10.0%	8.6%
$500M to $1B	2.2%	2.1%
BELOW $500M	2.7%	2.8%

Relative Size - Other CRE

	12/31/2019	12/31/2015
ABOVE $50B	38.5%	46.3%
$20B to $50B	13.8%	12.1%
$10B to $20B	10.4%	7.7%
$1B to $10B	25.0%	21.8%
$500M to $1B	6.2%	5.8%
BELOW $500M	6.1%	6.2%

Relative Size - Own.Occ. CRE

	12/31/2019	12/31/2015
ABOVE $50B	33.7%	41.1%
$20B to $50B	12.8%	11.7%
$10B to $20B	10.0%	7.7%
$1B to $10B	24.8%	21.2%
$500M to $1B	8.1%	7.7%
BELOW $500M	10.6%	10.6%

Relative Size - Multifamily

	12/31/2019	12/31/2015
ABOVE $50B	52.7%	59.3%
$20B to $50B	11.8%	9.9%
$10B to $20B	6.9%	5.6%
$1B to $10B	21.6%	18.4%
$500M to $1B	3.5%	3.3%
BELOW $500M	3.5%	3.5%

Relative Size - Construction

	12/31/2019	12/31/2015
ABOVE $50B	34.7%	43.8%
$20B to $50B	14.3%	11.4%
$10B to $20B	10.2%	7.6%
$1B to $10B	25.2%	22.0%
$500M to $1B	7.4%	7.0%
BELOW $500M	8.1%	8.1%

Relative Size - 1st Lien Mortgage

	12/31/2019	12/31/2015
ABOVE $50B	63.8%	66.3%
$20B to $50B	8.1%	6.8%
$10B to $20B	6.3%	5.3%
$1B to $10B	12.4%	11.8%
$500M to $1B	3.7%	3.7%
BELOW $500M	5.7%	6.1%

Source: Janney Research (FIG Group), S&P Global MI, FDIC call report filings

Aggregate Loan $dollars for each major category are split by Asset bucket in 2015 vs 2019 to illustrate the relative changes.

In many cases, mid-sized Banks have gained influence.

Critical Issues In Banking

Bankers and Investors must remember:

- **"Deposits Rule" in our financial system**
- **Credit is available from many outlets beyond traditional Banks (many sources untested)**
- **Innovation Everywhere: major expense impact (challenge is spending now to save later)**
- **Value still exists in a U.S. Bank charter … expect few de novos, focus on existing players**
- **The "I" word (I-N-E-R-T-I-A)** *a blessing & curse*

Technology + Finance = Fintech

Today's financial and technology ecosystem:

- **INNOVATION via open regulatory sandboxes in Europe, Latin America, India, & Australia**
- **Compliance still matters, U.S. leads with high regulatory standards (not feet-dragging)**
- **Who wins the Deposits?**
- **Bank charters are valuable -** *ask Varo & Radius*
- **Lower costs offset lower spreads** *('19 fee benefit)*

Closet Fintechs = Mortgage Banks

De novos since 2018 include a mortgage bank buying an OK-based community Bank for cheap funds.

[Gateway First Bank] is now $1.5B Assets.

MortgageOrb Articles Industry Insight Required Reading SIGN

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Articles Origination Residential Mortgage

Gateway Mortgage Group to Merge with Farmers Exchange Bank

By **Patrick Barnard** - February 9, 2019 0

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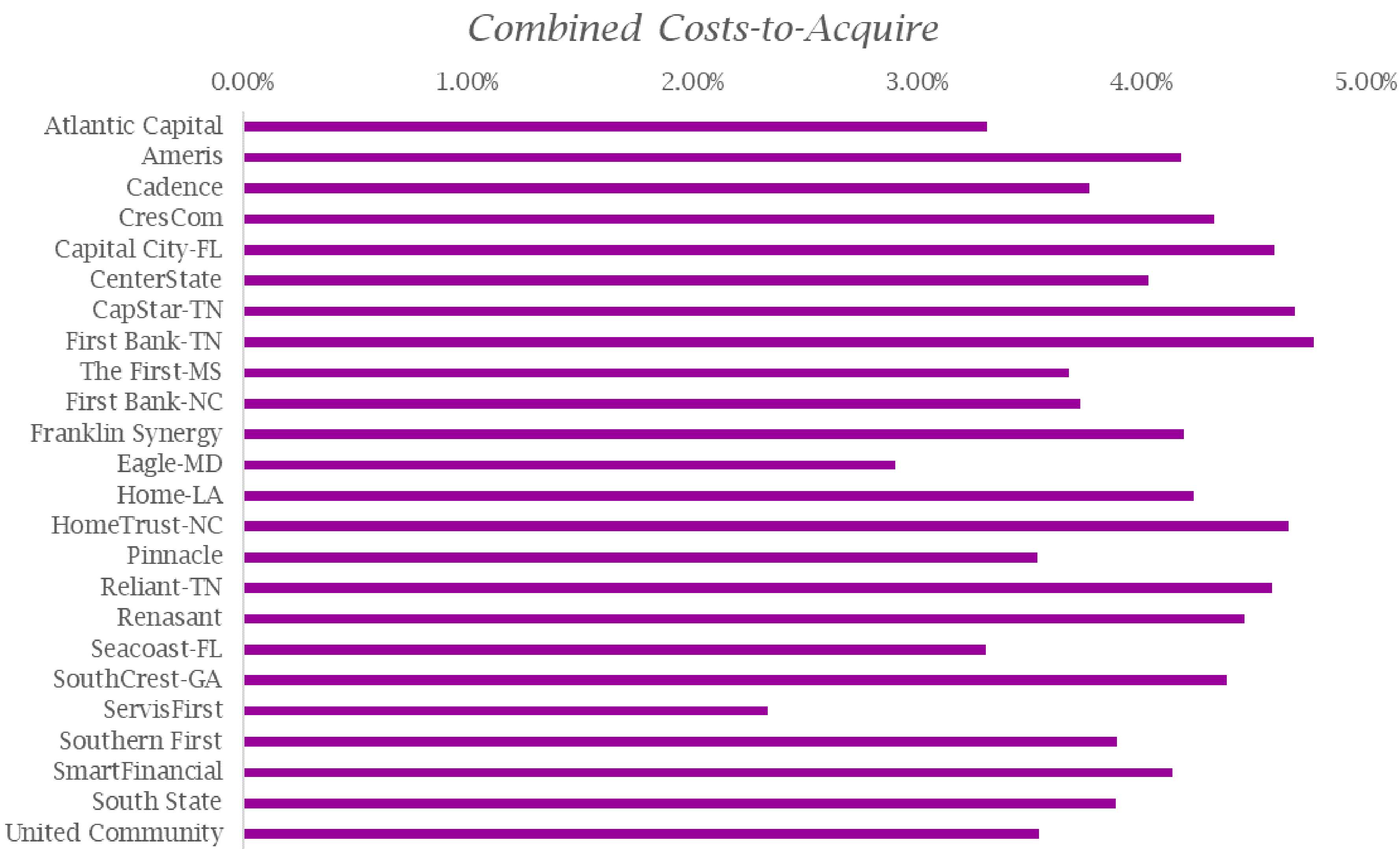
Gateway Mortgage Group, a full-service mortgage company licensed in 40 states and the District of Columbia, recently received approval from the Federal Deposit Insurance Corporation (FDIC) to merge with Farmers Exchange Bank in Cherokee, Okla.

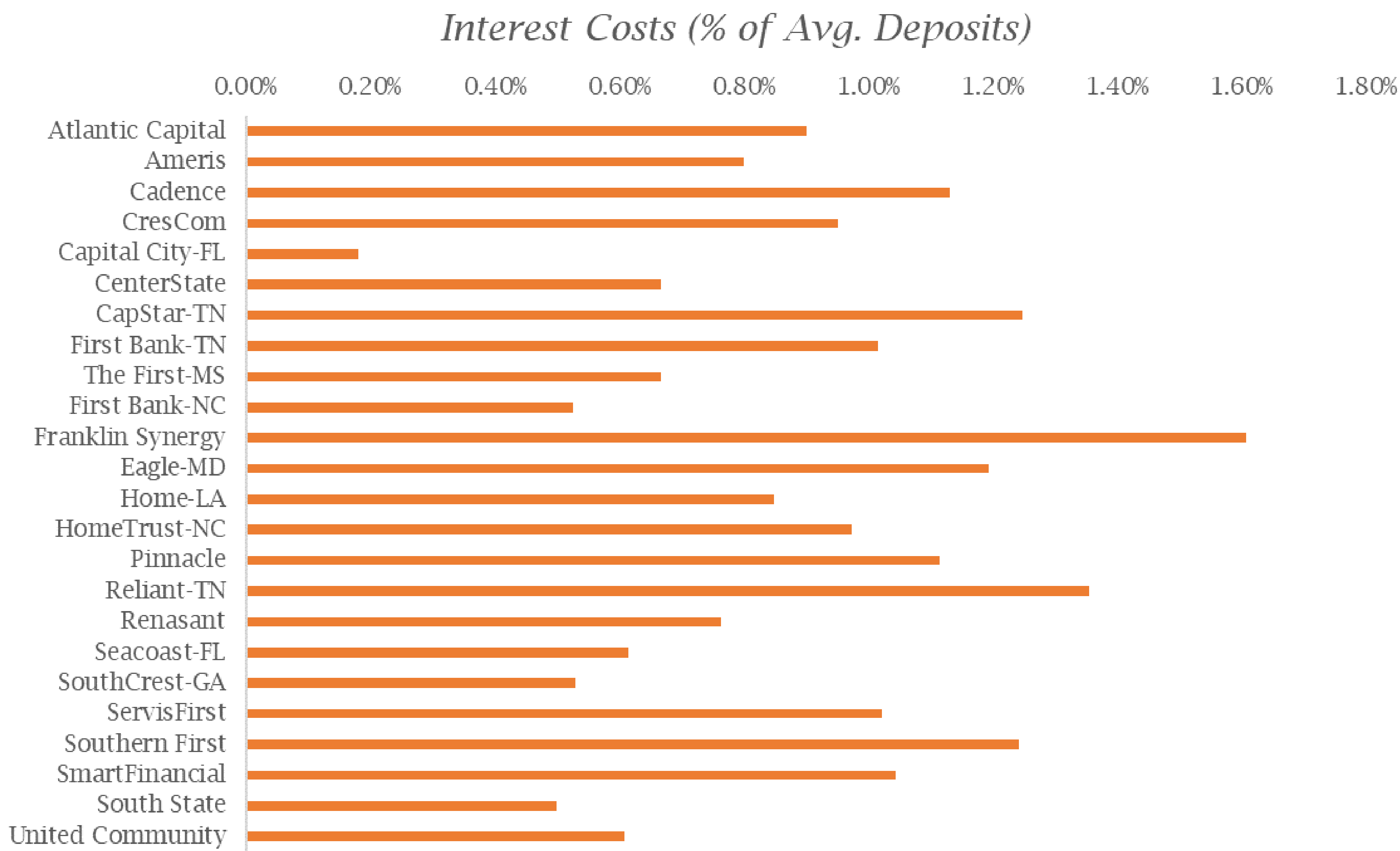
The new entity, Gateway First Bank, will be a diversified financial institution with a strong capital base, size and scale, the lender says in

Key Is Deposit Acquisition Costs



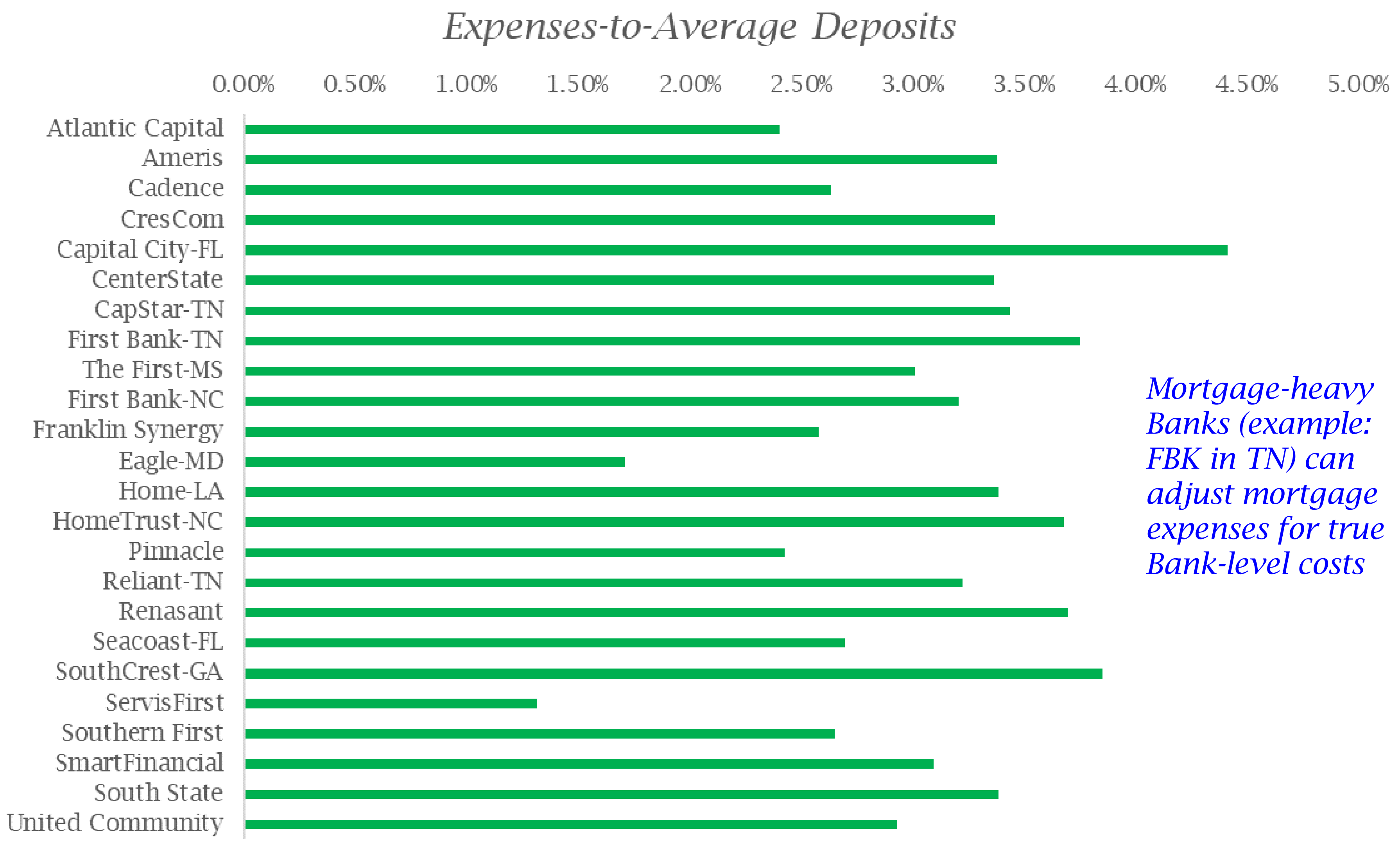
We combine interest and overhead for true cost of Avg. Deposits

Interest Cost Is Not The Only Factor



Most recent FDIC disclosures for Deposit expense-to-Avg. Deposits

Overhead-to-Avg. Deposits Ratio

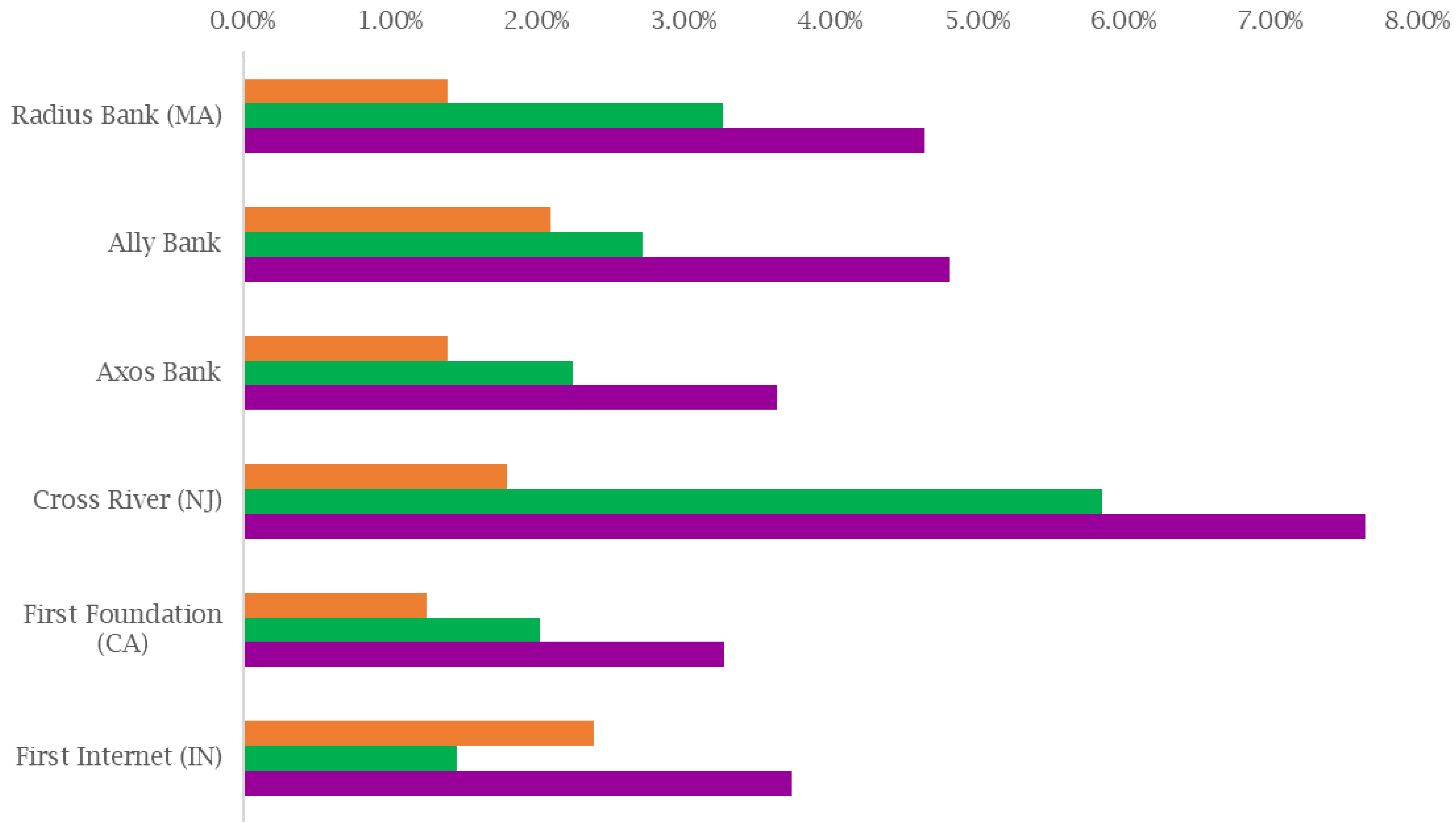


Mortgage-heavy Banks (example: FBK in TN) can adjust mortgage expenses for true Bank-level costs

Non-interest expenses as percentage of Avg. Deposits in 4Q-2019

Branch-Lite/Branch-less Banks

Total Acquisition Costs: **(Interest + Expenses % of Avg. Deposits)**



Fintech examples in the FDIC charter network (private and public)

Disclosures

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NEUTRAL: Janney believes that the subject company is fairly valued and will perform in line with comparable companies within its sector. Investors may add to current positions on short-term weakness and sell on strength as the valuations or fundamentals become more or less attractive.

SELL: Janney expects that the subject company will likely decline in value and will underperform comparable companies within its sector.

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			IB Serv./Past 12 Mos.*	
Rating	**Count**	**Percent**	**Count**	**Percent**
BUY [B]	171	52.78	37	21.64
NEUTRAL [N]	151	46.60	20	13.25
SELL [S]	2	0.62	0	0.00

*Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.

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