



PERFORMANCE TRUST

CAPITAL PARTNERS

Capital Planning: *More Than Just an Adequacy Exercise*

Gary L. Svec, CPA

Managing Director

Capital Planning: Agenda

1

How do we
diagnose the health of our
capital?

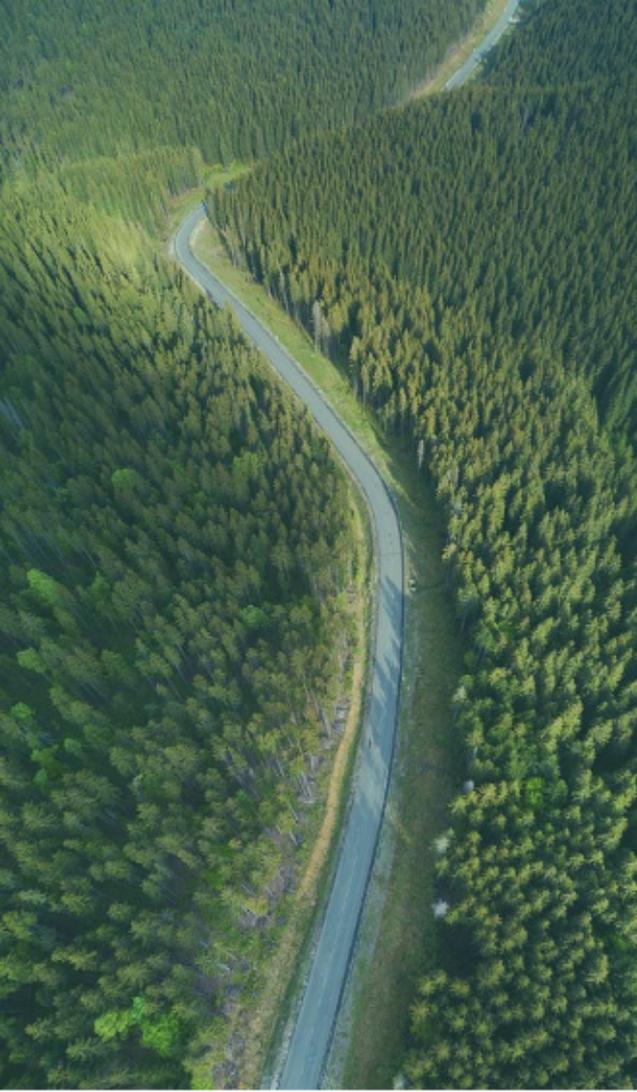
2

How can we put
capital **options** on
a *Level Playing Field*TM

3

Other capital
considerations

Diagnosing the
Health **of our Capital**



Diagnosing the *Health* of Your Capital

Is your capital *healthy enough* for:

- Potential Credit Issues
Will you maintain regulatory good standing?
- The “New Normal” Interest Rate Environment
Will you maintain shareholder good standing?
- Future Opportunities



Diagnostic Tool #1

PT Score™ Credit Analysis stresses your loan portfolio for:

- Your historical loss %'s.
- Regional loss %'s.
- National loss %'s.
- **Customized** loss %'s.



With Each Crisis: Some Fail, Some Emerge Stronger. Why?

with Bart Smith, Partner & Managing Director

PROFILE

- Structural Risk Overview
- Scored KRIG
- Balance Sheet
- Asset Liability Detail

CAPITAL

- Overview
- Charted Ratios

ASSET QUALITY

- Overview
- Charted Ratios
- Credit Performance

Credit Stress Analysis

MANAGEMENT

- Overview
- Peer Comparisons
- PT Score Simulator
- PT Score Em Roll Up
- PT Score Qualitative Risk

EARNINGS

- Overview
- Charted Ratios
- Yield Cost Analysis

LIQUIDITY

- Overview
- Charted Ratios

SENSITIVITY

- Overview
- Charted Ratios
- Sensitivity Stress Analysis

WEBINARS

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REPORTS

Capital Stress Analysis

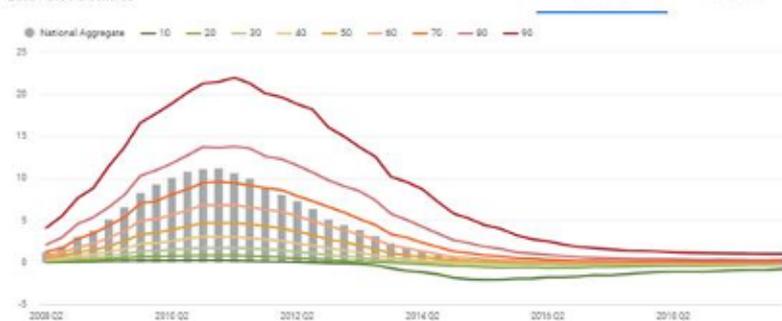
State Stress Analysis

Loss Rates

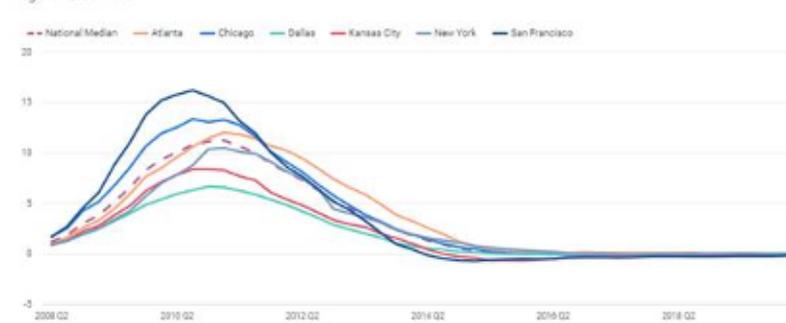
Capital Stress Unfunded

RE: CONSTRUCTION AND DEVELOPMENT

Loss Rate Percentiles

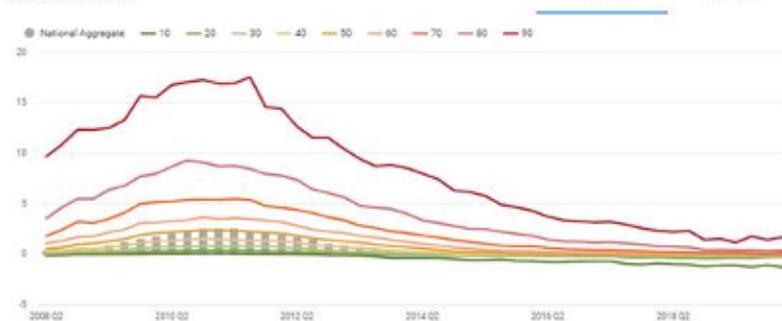


Regional Loss Rates

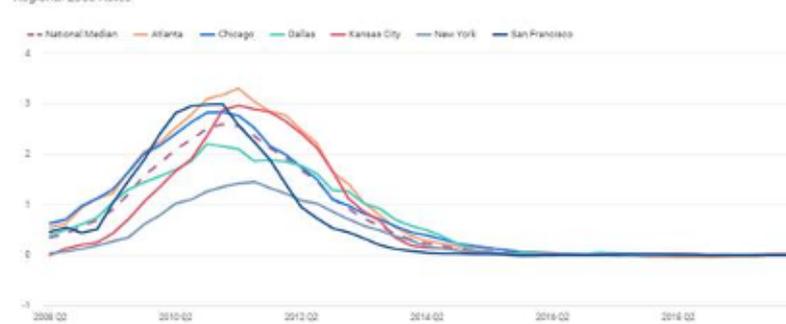


RE: MULTIFAMILY RESIDENTIAL

Loss Rate Percentiles



Regional Loss Rates



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Credit Stress Analysis

Capital Stress Analysis

State Stress Analysis

Loss Rates

Capital Stress Unfunded

PT Score™ Stress: **ADVERSE**

2020 Q1 PT SCORE



ADVERSE STRESS IMPACT ON PT SCORE



COMPARISON OF ADVERSE STRESS IMPACT



Tier 1 Capital Stress: **ADVERSE**

2020 Q1 Tier 1 Leverage Ratio



ADVERSE STRESS IMPACT ON TIER 1 LEVERAGE



COMPARISON OF ADVERSE STRESS IMPACT



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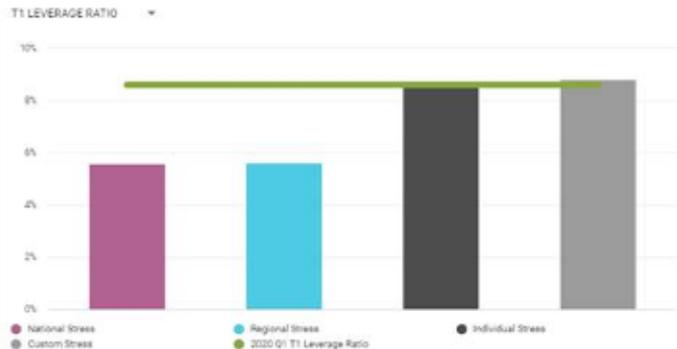
Adverse Stress Scenario with Unfunded Commitments

2020 Q1 Capital Ratios

ADVERSE IMPACT ON CAPITAL RATIOS



COMPARISON OF ADVERSE IMPACT



Adverse Capital Stress Calculations with Unfunded Commitments

Loan Portfolio Stress Losses	NOW		NATIONAL				REGIONAL				INDIVIDUAL			
	Quarter-End Balance	Unfunded	Draw Rate	Loan Bal. + Unfnd Draw	Loss Rate %	Losses	Draw Rate	Loan Bal. + Unfnd Draw	Loss Rate %	Losses	Draw Rate	Loan Bal. + Unfnd Draw	Loss Rate %	Losses
RE Construction and Development	1,402	17,344	30.06%	6,616	11.22%	742	31.27%	6,825	8.50%	572	83.89%	16,299	1.70%	277
RE Farmland	128,024	-	-	128,024	5.96%	6,862	-	128,024	5.96%	6,862	-	128,024	0.43%	576
RE 1-4 Family Residential	31,693	-	-	31,693	3.76%	1,192	-	31,693	5.63%	1,784	-	31,693	0.79%	241
RE Home Equity	5,997	4,477	12.29%	6,147	3.62%	345	12.59%	6,161	7.91%	487	34.77%	7,154	0.90%	64
RE Multifamily Residential	4,678	-	-	4,678	2.59%	121	-	4,678	2.96%	138	-	4,678	0.00%	0
RE Owner Occupied	34,135	-	-	34,135	1.64%	560	-	34,135	1.99%	474	-	34,135	0.24%	82
RE Other Non-Owner Occupied	39,327	-	-	39,327	2.91%	1,144	-	39,327	2.86%	1,125	-	39,327	0.48%	189
Commercial and Industrial	47,817	36,099	11.11%	51,927	3.91%	2,015	8.99%	50,758	4.36%	2,213	22.70%	55,711	3.64%	2,028
Personal Loans	8,854	-	-	8,854	5.31%	470	-	8,854	7.44%	650	-	8,854	4.06%	350
Credit Card Loans	56	568	2.86%	73	21.60%	16	4.34%	82	29.91%	24	7.11%	98	19.11%	19
Other Loans (Includes Ag Loans)	127,587	62,181	25.94%	140,893	7.55%	10,637	12.19%	133,718	7.85%	10,296	34.26%	140,016	1.39%	1,832
Lease Financing	0	-	-	0	2.22%	0	-	0	4.13%	0	-	0	0.00%	0
TOTAL	428,638	110,685		451,965		34,105		444,253		24,435		465,988		5,767

Custom T1 Ratio: 8.80%			
CUSTOM			
Draw Rate	Loan Bal. + Unfnd Draw	Loss Rate %	Losses
0.00 %	1,402	0.00 %	0
	128,024	4.00 %	5,121
	31,693	0.00 %	0
0.00 %	5,997	0.00 %	0
	4,678	0.00 %	0
	34,135	0.00 %	0
	39,327	0.00 %	0
0.00 %	47,817	0.00 %	0
	8,854	0.00 %	0
0.00 %	56	0.00 %	0
19.00 %	132,873	5.00 %	6,629
	0	0.00 %	0
	433,856		11,750

First National Bank Capital Dashboard



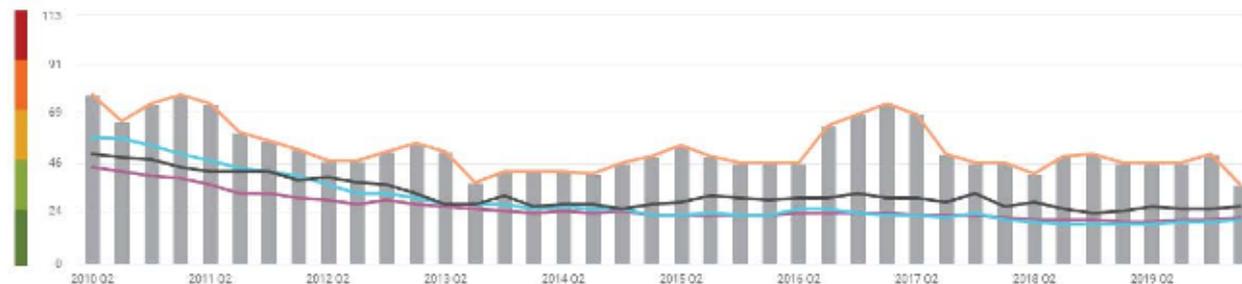
PEER MEDIAN:
27

ASSET SIZE MEDIANS

PEER GROUP	SCORE
0-100M →	13
100M-300M →	17
300M-500M →	21
500M-1B →	27
1B-3B →	36
3B+ →	45

	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q1%
	9.62	9.61	9.67	9.61	76%
	11.53	11.53	11.47	12.37	81%
	11.63	11.66	11.47	12.37	81%
	12.4	12.46	12.38	13.27	82%
	8.14	8.48	3.16	3.13	30%
	37	49	43	43	51%
	4.37	5.64	6.37	3.91	35%
	10	10	10	5	35%
	32	32	44	40	80%
	46	46	30	36	71%

PT Score – Capital Performance Over Time



Source: Performance Trust PT Score

Note: PT Score Capital Score using December 31, 2019 financial data

● Capital Score ● National Median ● Regional(ATL) Median ● State(VA) Median ● Custom Peer Median

Poll Question #1:

In the last 12 months, what has happened to your net interest margin?

A. My NIM has risen

B. My NIM is about the same

C. My NIM has fallen



Diagnostic Tool #2?

The “New Normal” Calculator stresses your NIM for:

- Upcoming impact of loan & deposit repricing, utilizing ALM
- Upcoming impact using a “what if” scenario for “normalized spreads”
- Customized strategies to “change your future”

2020Q1

	<i>Avg. Balance</i>	
Total Assets	\$ 3,453,586	
Earnings Assets	\$ 3,305,282	
Equity	\$ 331,240	
	<i>Avg. Balance</i>	<i>Yield</i>
Cash	\$ 97,504	0.73%
Bonds	\$ 1,114,946	2.43%
Loans	\$ 2,073,735	4.74%
		<i>\$ Annualized</i>
Interest Income	3.65%	\$ 126,046
Interest Expense	0.36%	\$ (12,433)
NIM	3.44%	\$ 113,614
Non Int Income	0.77%	\$ 26,593
Non Int Expense	2.79%	\$ (96,355)
Net Overhead	-2.02%	\$ (69,762)
Pre Tax Pre Provision NI	1.27%	\$ 43,851
Provision Expense	0.12%	\$ (2,400)
Post Tax Net Income		\$ 34,547
ROA - Bank		1.00%
ROE - Bank		10.43%

2023 Projections - Sustained "New Normal"

	<i>Avg. Balance</i>	
Total Assets	\$ 3,584,050	
Earnings Assets	\$ 3,435,746	
Equity	\$ 426,775	
	<i>Avg. Balance</i>	<i>Yield</i>
Cash	\$ 233,734	0.10%
Bonds	\$ 1,119,152	1.25%
Loans	\$ 2,092,500	4.00%
		<i>\$</i>
Interest Income	2.73%	\$ 97,923
Interest Expense	0.25%	\$ (7,893)
NIM	2.62%	\$ 90,030
Non Int Income	0.77%	\$ 27,597
Non Int Expense	2.79%	\$ (99,995)
Net Overhead	-2.02%	\$ (72,398)
Pre Tax Pre Provision NI	0.49%	\$ 17,632
Provision Expense / Loans	0.12%	\$ (2,511)
Post Tax Net Income	21.00%	\$ 11,946
ROA		0.33%
ROE		2.80%

Diagnostic Tool #3?

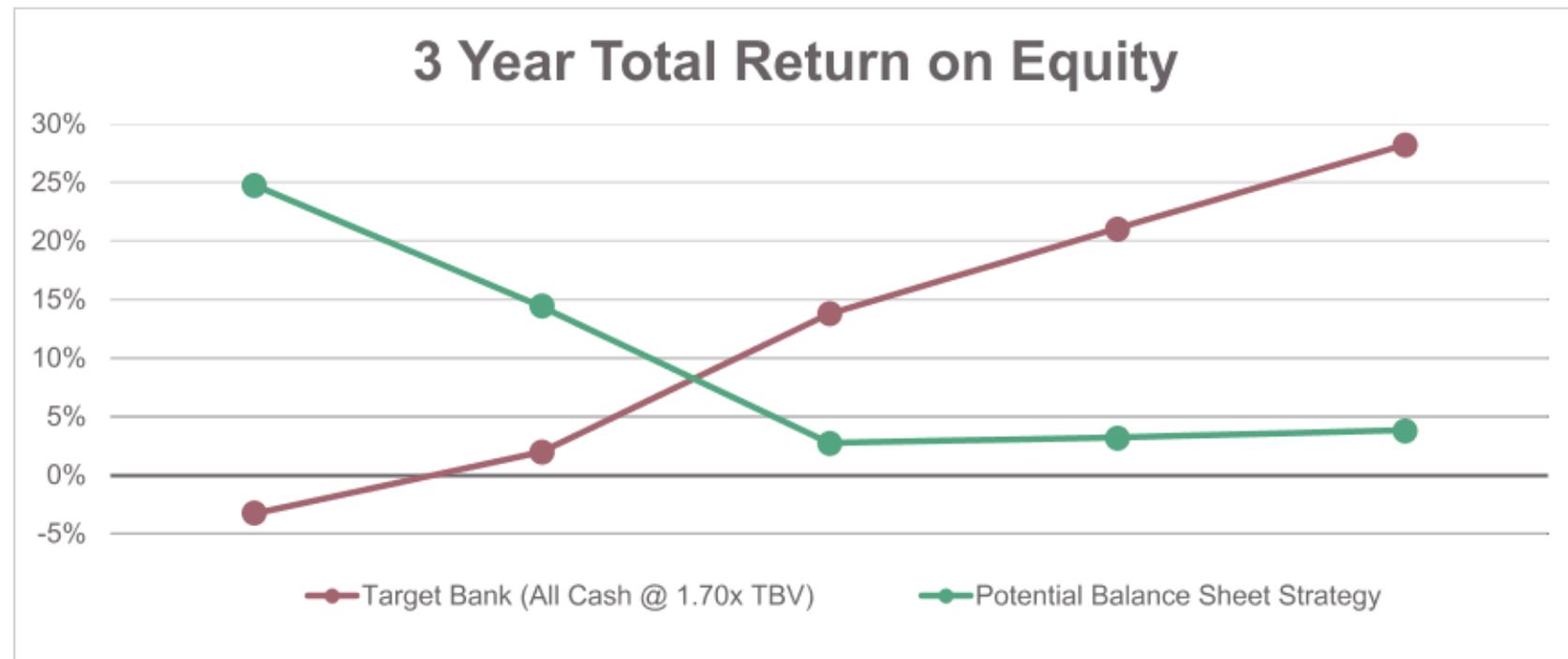
Additional Capital for Future Opportunities

- How to think about M&A
- How to think about leverage
- What about shareholder liquidity?



Shape Management Applied to the Acquisition Process

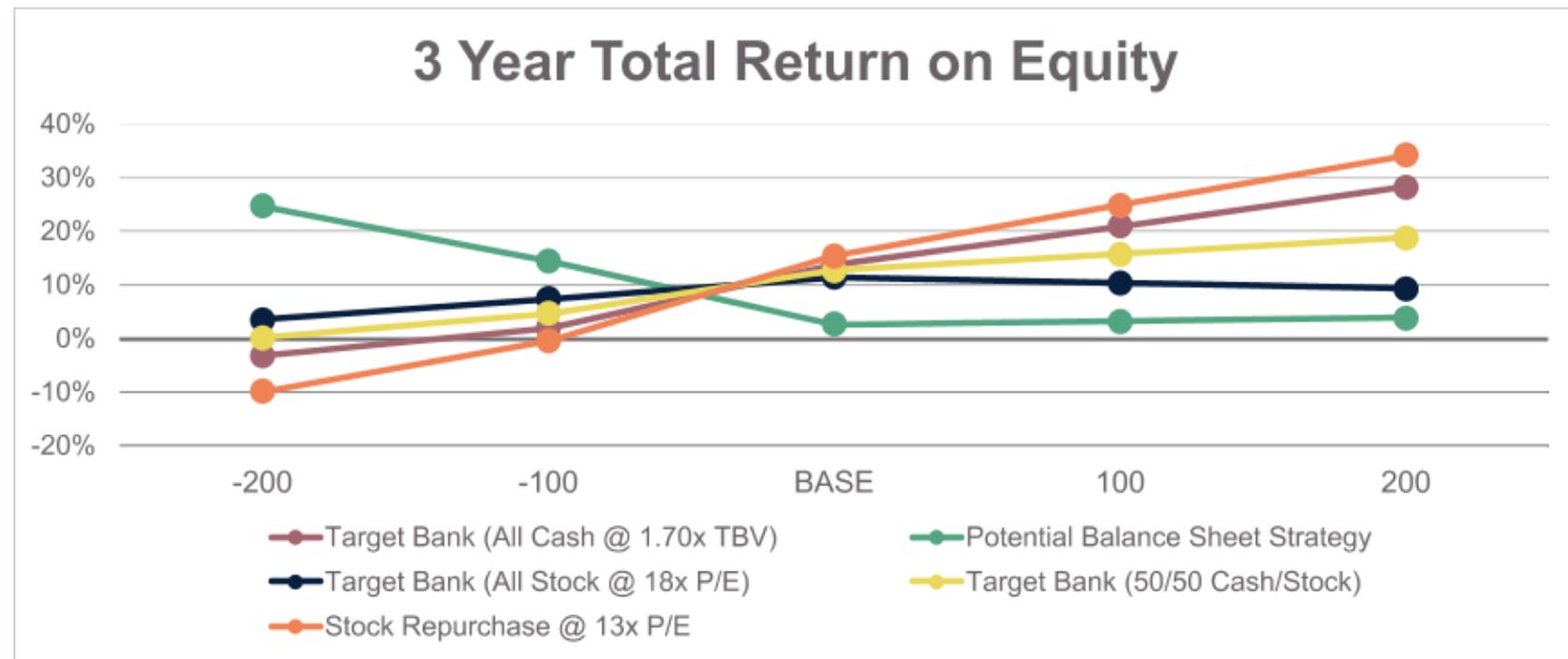
A more complete picture



All Strategic Decisions can be placed on a Level Playing Field

Shape Management Applied to the Acquisition Process

A more complete picture



All Strategic Decisions can be placed on a Level Playing Field

Potential Balance Sheet Strategy

Utilizing specific wholesale assets *AND* liabilities (FHLB Advances) may:

- A. Increase net interest income (you may / will see a decline in NIM)
- B. Proper asset and liability structure could offset further interest rate risk inherent in most bank balance sheets without significant exposure if rates rise
- C. Effectively utilize capital without increasing non-interest expense

Creating a
Level Playing Field™
for capital options



Question:

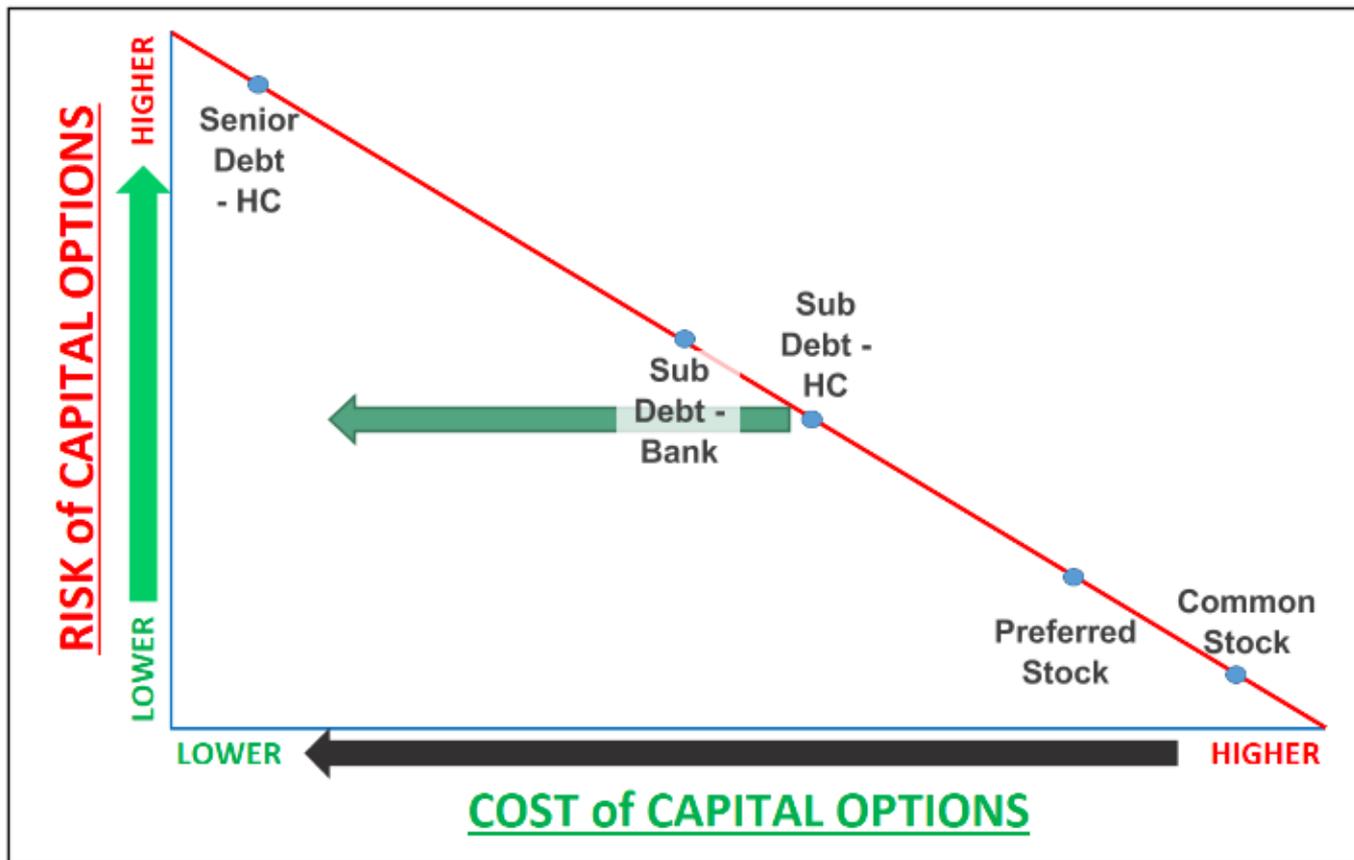
Do *all* forms
of capital have
a “cost”?

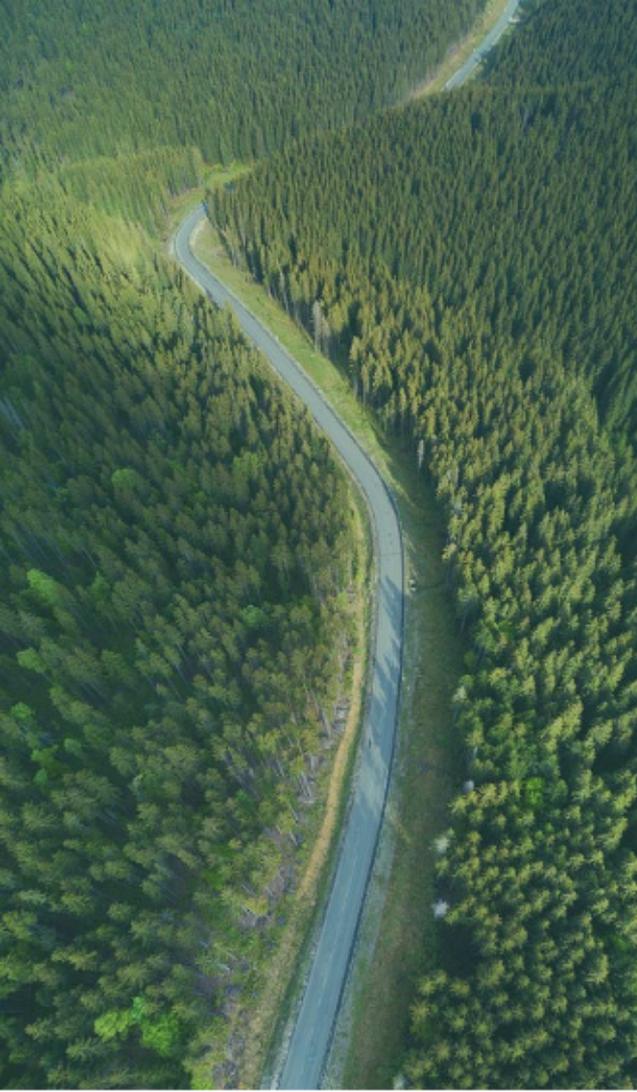
Calculating the Cost of Common Stock

<u>Common Stock</u>			<u>Price to</u>	<u>Cost of</u>
			<u>Earnings</u>	<u>Capital</u>
Earnings per Share	Ex.	\$1.00	=	
<hr/>			10 P/E	=
Price per Share		\$10.00	=	10%

Question: Is this cost fixed or variable?

Analyzing different Types of Capital





Basic Types of Capital

1. Senior Debt

- Typically lowest cost, highest risk and typically shorter maturities
- Typically contains covenants, collateral, and/or guarantees
- **Will feel like debt in times of trouble**

2. Subordinated Debt

- Slightly higher cost, longer maturities, widely available (for how long?)
- **Limited or no covenants, no collateral or guarantees**

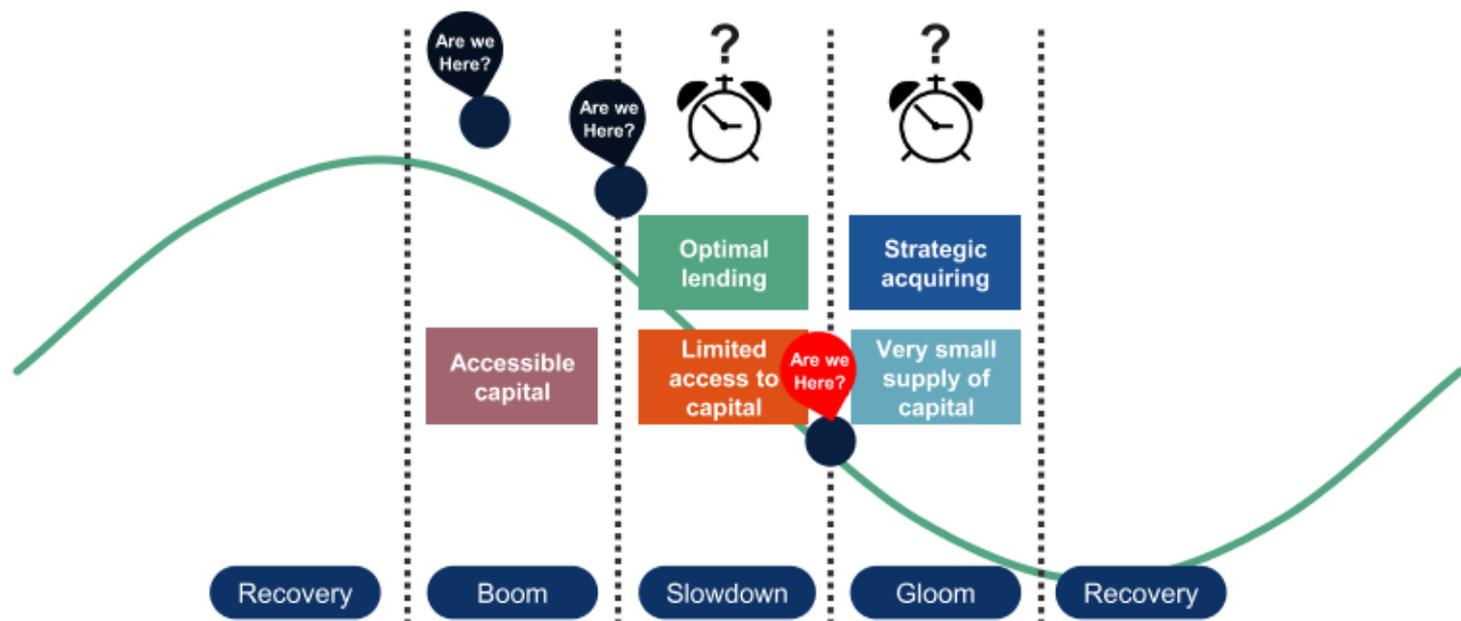
3. Preferred Stock

- May not be publically available for smaller banks
- No stated maturity, higher cost but **very stable form of capital**

4. Common Stock

- Typically highest cost (and gets higher as earnings increase)
- **The lifeblood of banks**, especially in times of crisis

Phases of the Economic Cycle: Cheap vs. Expensive





Few have ever been criticized for having too much capital during times of great uncertainty...or great stress.

- Gary Svec



**Calculating
(and lowering?) the
Cost of Capital**

Poll Question #2:

How do you feel about your current stock price / valuation?

A. It is overvalued

B. It is fairly valued

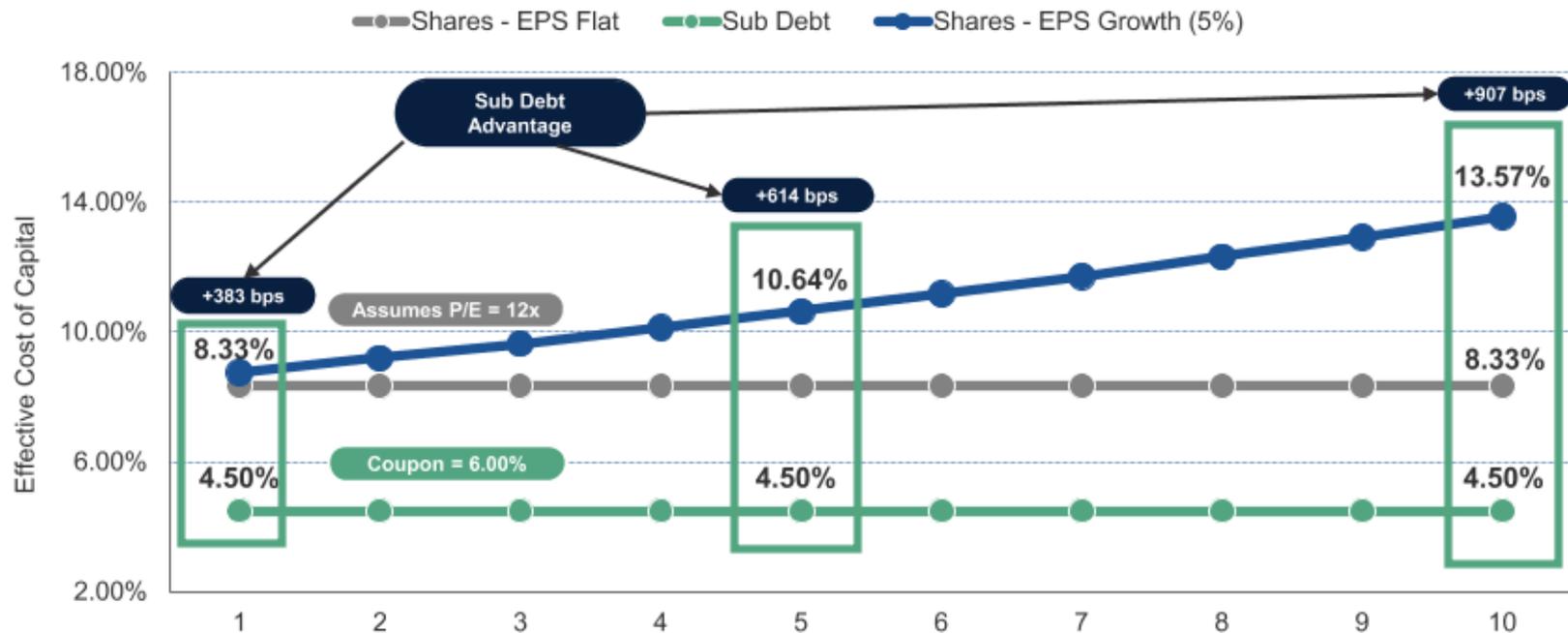
C. It is undervalued

After-Tax Cost Comparison at Issuance

Common Equity			Subordinated Debt		
EPS	Issue Price	After-Tax Cost	Coupon	Tax-Rate	After-Tax Cost
1.00	10.00	10.00%	7.00	21%	5.53
1.00	12.50	8.00%	6.75	21%	5.33
1.00	15.00	6.67%	6.50	21%	5.14
1.00	17.50	5.71%	6.25	21%	4.94
1.00	20.00	5.00%	6.00	21%	4.74

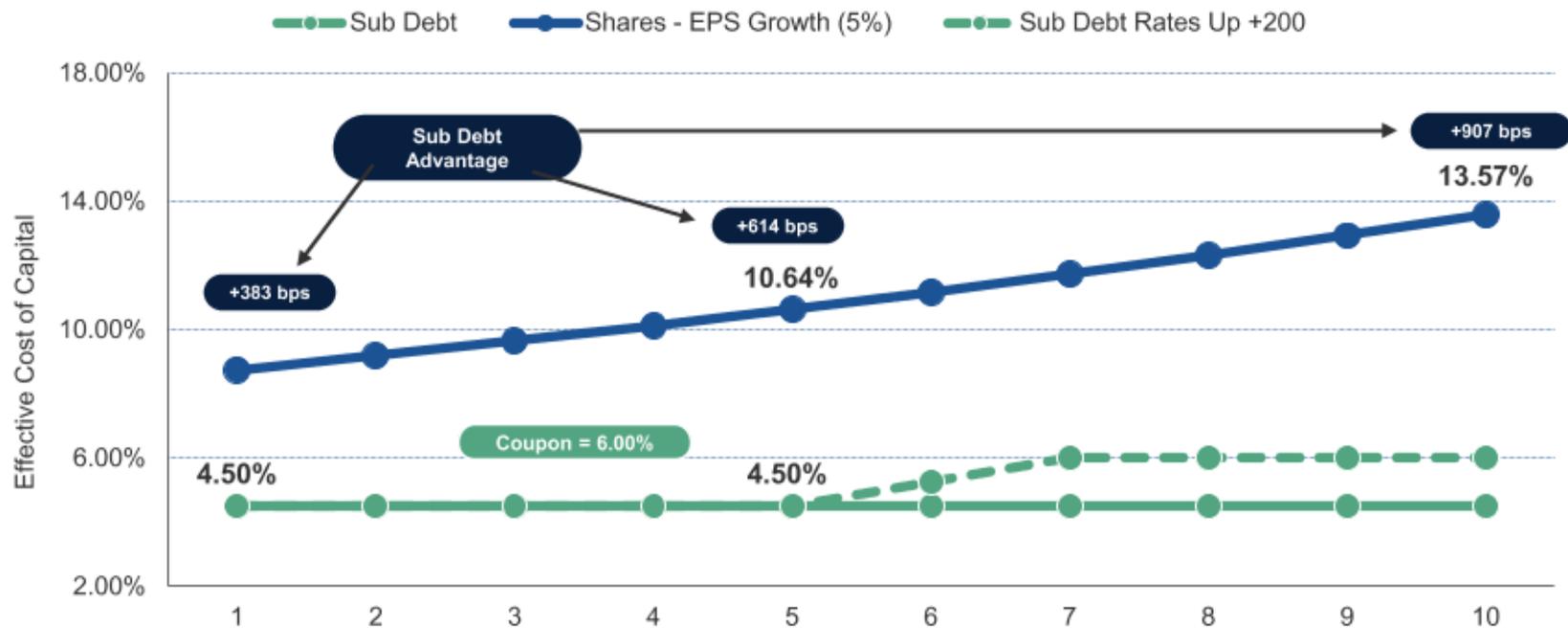


The Ascending Cost of Equity Capital



This illustrates the cost of capital over time for **sub debt (at 6.00% fixed cost)** vs **equity at a 12X assuming flat (0%) EPS growth** vs. **equity at a 12X PE with 5% EPS growth**.

The Ascending Cost of Equity Capital



This illustrates the cost of capital over time for **sub debt (at 6.00% fixed cost)** vs **equity at a 12X assuming flat (0%) EPS growth** vs. **equity at a 12X PE with 5% EPS growth**.

Poll Question #3:

What growth is more valuable?

A. Balance sheet

B. Net income

C. Earnings per share

**...and the proforma impact
of lowering the cost
of capital?**

What Could We Do In This Environment?

Shares Outstanding	624,625			
TBV per Share	\$22.76			Current P/E
Current Share Price	\$17.00	75%	Price to TBV	11/15/19 9.4X
Projected Purchase Price, est	\$17.75	78%	Purchase price to current TBV	
Projected PE Ratio (purch)	9.9X			
Premium to Market	4.41%			
Projected Shares repurchased	124,625	20.0%	% of outstanding	
Existing HC Debt	0			
Buy Back Amount	2,212			
New Sub debt Amount	2,500	21.1%	Pro-forma debt to tangible equity (HC)	
Buy Back from excess capital	-288			

The Impact...

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Net Income, beginning <i>(assume 5% growth)</i>	1,125	1,181	1,240	1,302	1,367
Less sub debt interest expense, net of tax	(117)	(117)	(117)	(117)	(117)
Less cost of cash (rates unch)	4	4	4	4	4
Net income, proforma	1,012	1,068	1,127	1,189	1,254
Shares, beginning	624,625	624,625	624,625	624,625	624,625
Less repurchased	(124,625)	(124,625)	(124,625)	(124,625)	(124,625)
Shares, proforma	500,000	500,000	500,000	500,000	500,000
EPS, beginning	\$1.80	\$1.890	\$1.990	\$2.080	\$2.190
EPS, proforma	\$2.02	\$2.137	\$2.255	\$2.379	\$2.509
Increase	12.4%	13.0%	13.3%	14.4%	14.6%

Year 2	Pro-forma	
ROE	ROE	Increase
8.31%	8.90%	7.10%

....And What About My Book Value Per Share?

Shares Outstanding	624,625				
TBV per Share	\$22.76	\$23.71	Pro Forma		Current P/E
Current Share Price	\$17.00	75%	Price to TBV	11/15/19	9.4X
Projected Purchase Price, est	\$17.75	78%	Purchase price to current TBV		
Projected PE Ratio (purch)	9.9X				
Premium to Market	4.41%				
Projected Shares repurchased	124,625	20.0%	% of outstanding		

...And What About My Capital?

Average assets for Tier 1 calc

Deductions

Assets for Leverage Ratio

Total Equity (GAAP)

Deductions, net

Equity for Leverage Ratio

Tier 1 Leverage Ratio

Double Leverage Ratio

ACTUAL	
<u>Holding Co.</u>	<u>Bank</u>
122,915	123,012
(132)	(132)
122,783	122,880
14,217	13,554
(150)	(150)
14,067	13,404
11.46%	10.91%
95.3%	

PRO-FORMA	
<u>Holding Co.</u>	<u>Bank</u>
123,203	123,300
(132)	(132)
123,071	123,168
12,005	13,842
(150)	(150)
11,855	13,692
9.63%	11.12%
115.3%	

What About Ownership Impact?

Ownership Impact

Scenario #1

	%	
<u>Current</u>	<u>Shares</u>	<u>Ownership</u>
Non-Sellers	500,000	80.05%
Sellers	124,625	19.95%
Total Outstanding	<u>624,625</u>	100.00%

	%		
<u>Proforma</u>	<u>Shares</u>	<u>Ownership</u>	<u>Change</u>
Non-Sellers	500,000	100.00%	24.93%
Sellers	0	0.00%	-100.00%
Total Outstanding	<u>500,000</u>	100.00%	

“

***Sacred
cows make
the best
hamburgers***

Mark Twain

”

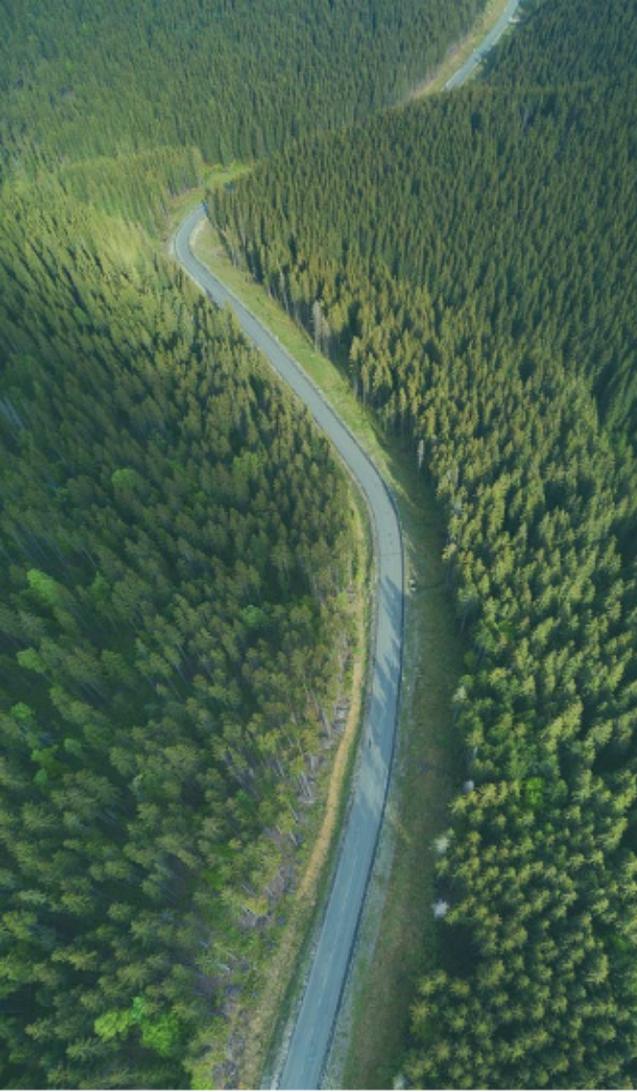
Other Capital Considerations

Zoom Meeting

Audio only

With video



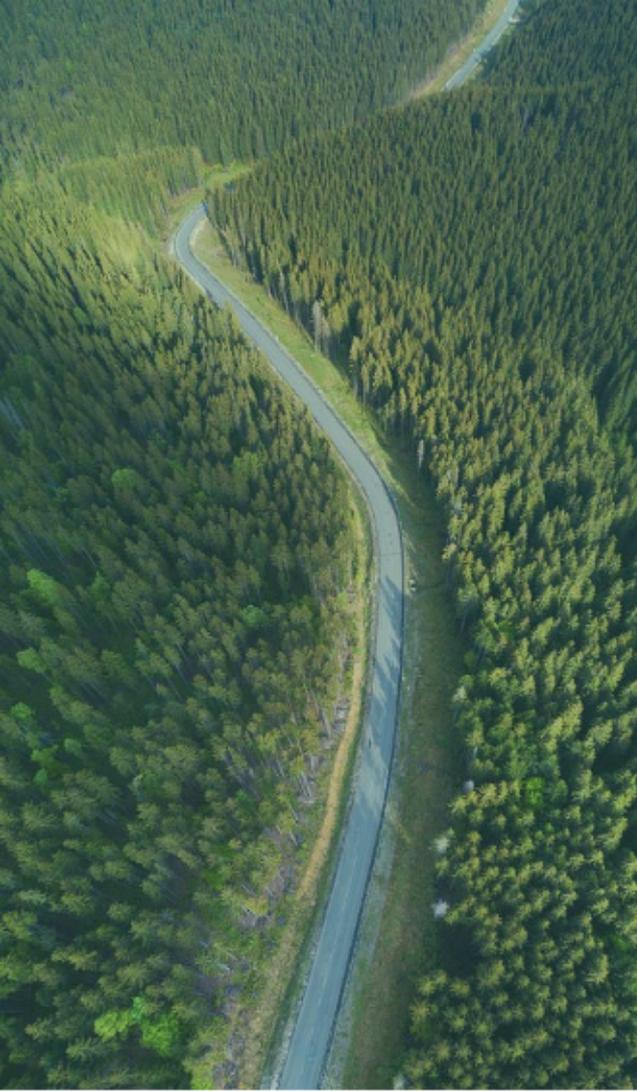


Other Capital Considerations

Items to consider when utilizing capital, other than equity:

- **Need** for an interest reserve
 - *Protect against future net loss*
 - *Protect against regulator decision*
 - *Protect against accounting decision*

- Start building a **sinking fund** at the HC to pay off debt



Bank Dividends Are at Risk. How Regulators Could Force Cuts.

By [Carleton English](#) May 26, 2020 12:32 pm ET

Text size  



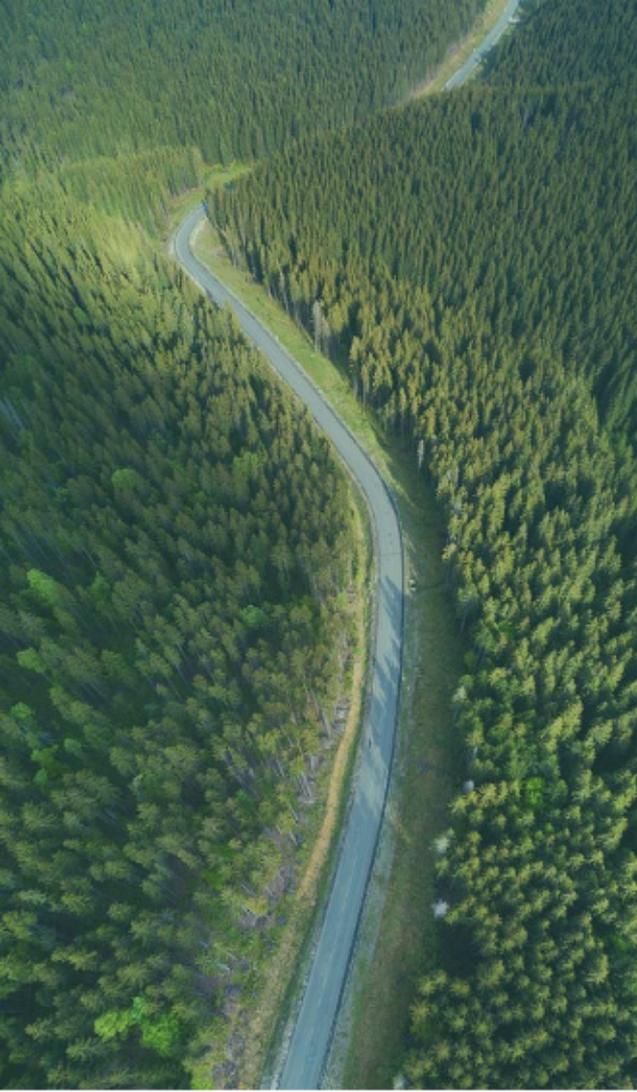
JPMorgan has a history of higher profit levels and should recover quickly when conditions normalize, an analyst says.

Photograph by Bess Adler/Bloomberg

also suspend dividends.

Banks might not be ordered to halt dividends but that doesn't mean investors can rest easy.

Bank dividends have been under pressure over the past two months as profits have been constrained by low interest rates and increasing loan losses. As banks have been working to conserve capital to serve struggling clients—namely by halting buybacks—there have been calls by regulators to



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Goodwill charges emerge amid pandemic

By Jim Dobbs

May 13, 2020, 3:14 p.m. EDT



Bankers face a difficult decision about the goodwill sitting on their balance sheets.



The coronavirus pandemic has punished the economy and the stock market, undermining the value of many banks' intangible assets. That convinced a handful of banks, including PacWest Bancorp, Umpqua Holdings and Cadence Bancorp., to take goodwill impairment charges in the first quarter.



Many more will likely do the same this summer, barring a sudden and unexpected reversal of fortune, sending goodwill impairment to levels that haven't been seen since the financial crisis, industry experts said.

“Excess” Capital - Risk vs. Reward

“I don’t think I need additional capital”

If you’re right,
the cost of the excess capital is minimal.

If you’re wrong,
the cost could be **very very high**.

Takeaways

- **Maintain Positive Attitude**
 - If the market overreacts to unrelated stimuli, be confident to take advantage
 - Predicting 15 of the next 3 recessions can cause analysis paralysis and potentially miss great opportunities to create shareholder value
 - Does NOT mean act recklessly or ignore risks, rather **manage risks**
- **Analyze and ADJUST if necessary**
 - Constantly analyze asset, liability & capital decisions and look for ways to improve your risk versus rewards profile
 - If it's a bad lending environment, may be an interesting liability and/or borrowing environment (like today)
- **Buy LOW, Sell HIGH**
 - Bears make money, bulls make money, PIGS get slaughtered – if there is a great opportunity to enhance shareholder value... ACT. Trying to time the market is very hard and often results in missed opportunities
 - May require contrarian thinking and actions

Speaker Biography



Gary L. Svec, CPA *Managing Director*

Gary combines his financial institution background in accounting, taxes, regulatory compliance, and operations to be a team leader in total balance sheet analysis and a regular contributor on numerous banking issues affecting the clients of Performance Trust. Gary was one of the early employees of Performance Trust, the first CFO of the company, and a regular speaker at Bond Training Camp™. Prior to his current role, Gary was CEO of two small Illinois banks as well as CFO of PrivateBank in Chicago. Gary began his career in public accounting at the firm of Crowe Chizek (now Crowe Horwath LLP). Gary holds a degree in Accounting from DePaul University and is a Certified Public Accountant.

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