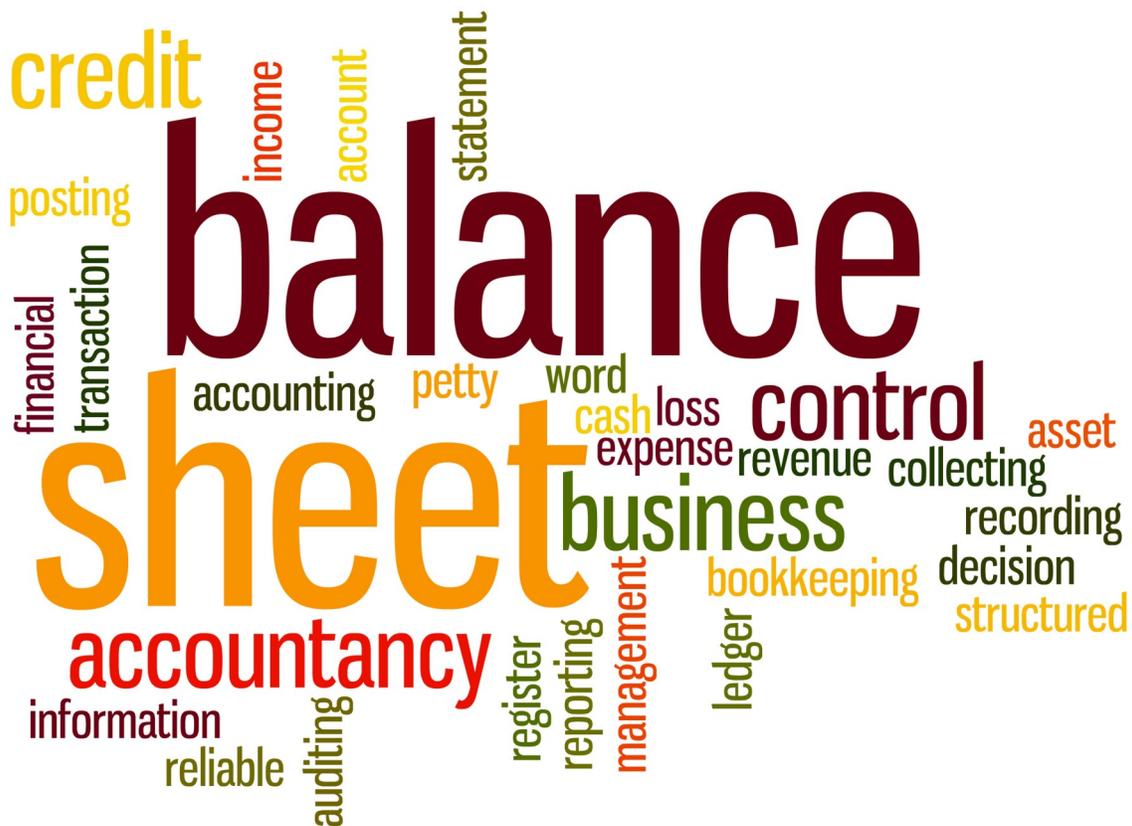




Bank Financial Principles/Emerging Trends



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The Kafafian Group



MARYLAND BANKING SCHOOL BANK FINANCIAL PRINCIPLES

JULY 31, 2023

CONFIDENTIAL

Performance
Measurement



Strategic
Management



Profit & Process
Improvement



Management
Advisory



Financial
Advisory



DISCLOSURE STATEMENT

FORWARD LOOKING STATEMENTS

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REVIEWING THE BASICS

Most Common Bank Ratios

- Return on Avg. Assets: $\frac{\text{Net Income}}{\text{Average Total Assets}}$
- Return on Avg. Equity: $\frac{\text{Net Income}}{\text{Average Total Equity}}$
- Net Interest Margin(NIM): $\frac{\text{Net Interest Income}}{\text{Average Earning Assets}}$
- Yield on Earning Assets: $\frac{\text{Interest \& Dividend Income}}{\text{Average Earning Assets}}$

REVIEWING THE BASICS

Most Common Bank Ratios

- Cost of Funds:
$$\frac{\text{Interest Expense}}{\text{Int. Bearing Liabilities} + \text{Non Int. Bearing Deposits}}$$
- Efficiency Ratio:
$$\frac{\text{Operating Expense}}{\text{Net Int. Income} + \text{Non Interest Income}}$$
- Expense Ratio:
$$\frac{\text{Operating Expense}}{\text{Average Assets}}$$

REVIEWING THE BASICS

Risk / Reward Profile

- Risk and Reward optimization
 - Are you willing to take on greater risk for greater return?
- Risk
 - Credit
 - Liquidity
 - Interest Rate Risk (more to follow)
 - Cyber
 - Operations

Example: Higher Loan-to-value (LTV) home equity loans

- More credit risk should result in more yield

REVIEWING THE BASICS

Balance Sheet

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

- Assets: Loans, investment securities, cash, buildings, intangibles, ALLL
 - Earning: Assets generating revenue
 - Nonearning: Assets not generating revenue
 - ALLL: a contra-asset (negative balance sheet item) “rainy day funds” to ensure part of the balance sheet is prepped for potential loan losses

REVIEWING THE BASICS

Balance Sheet

$$\text{Assets} = \underline{\text{Liabilities}} + \text{Equity}$$

- Liabilities are the debts or borrowings of the bank: Deposits, FHLB borrowings, other debt
 - Interest Bearing: Liabilities with interest-based payments tied to them; all deposits that bear interest, FHLB Borrowings
 - Noninterest Bearing: Liabilities without interest-based payments tied to them. DDA and other liabilities

REVIEWING THE BASICS

Balance Sheet



REVIEWING THE BASICS

Sample Bank Balance Sheet (\$000)

| Assets (\$000) | Current | | Percent Change | Liabilities (\$000) | Current | | Percent Change |
|------------------------------------|-----------|-----------|-------------------|----------------------------------|-----------|-----------|-------------------|
| | CY-1 | Year | | | CY-1 | Year | |
| Cash and Due from Banks | 23,944 | 24,822 | 3.7% | Total Deposits | 1,001,709 | 1,287,448 | 28.5% |
| Fed Funds Sold | 0 | 0 | | FHLB Borrowings | 46,909 | 0 | NM |
| Deposits at Financial Institutions | 10,621 | 130,989 | 1133.3% | Senior Debt | 50,380 | 3,581 | -92.9% |
| Securities Purchased, to Resell | 0 | 0 | | Trust Preferred | 10,310 | 10,310 | |
| Other Cash & Cash Equivalents | 0 | 0 | | Total Subordinated Debt | 10,310 | 10,310 | |
| Cash and Cash Equivalents | 34,565 | 155,811 | 350.8% | Total Debt | 60,690 | 13,891 | -77.1% |
| Trading Account Securities | 0 | 23 | | | | | |
| Available for Sale Securities | 272,839 | 350,035 | 28.3% | Total Other Liabilities | 7,535 | 8,480 | |
| Held to Maturity Securities | 0 | 0 | | Total Liabilities | 1,069,934 | 1,309,819 | |
| Other Securities | 6,382 | 5,271 | -17.4% | | | | |
| Total Cash & Securities | 313,786 | 511,140 | 62.9% | Equity (\$000) | | | |
| | | | | TARP Preferred Equity | 0 | 0 | |
| Gross Loans Held for Investment | 828,479 | 901,102 | 8.8% | Other Preferred Equity | 0 | 0 | |
| Loan Loss Reserve | 8,950 | 11,950 | 33.5% | Total Preferred Equity | 0 | 0 | |
| Loans Held for Sale | 1,061 | 2,107 | 98.6% | Common Equity | 133,607 | 155,860 | 16.7% |
| Total Net Loans | 820,590 | 891,259 | 8.6% | Total Equity | 133,607 | 155,860 | |
| | | | | | | | |
| Real Estate Owned | 289 | 58 | | Total Liabilities + Total Equity | 1,203,541 | 1,465,679 | |
| Goodwill | 0 | 0 | | | | | |
| Other Intangibles | 0 | 0 | | | | | |
| Total Intangible Assets | 0 | 0 | | | | | |
| Loan Servicing Rights | 356 | 324 | | | | | |
| Credit Card Rights | 0 | 0 | | | | | |
| Other Loan Servicing Rights | 0 | 0 | | | | | |
| Total Servicing Rights | 356 | 324 | | | | | |
| Fixed Assets | 20,618 | 20,879 | | | | | |
| Interest Receivable | 3,234 | 4,286 | | | | | |
| Prepaid Expense | 2,658 | 2,496 | | | | | |
| Bank-owned Life Insurance | 31,230 | 31,712 | | | | | |
| Other Assets | 10,780 | 3,525 | | | | | |
| Total Other Assets | 68,520 | 62,898 | | | | | |
| Total Assets | 1,203,541 | 1,465,679 | 21.8% | | | | |

REVIEWING THE BASICS

What to Look for in a Balance Sheet

- Large period over period changes in balances
- Concentration risk
 - Securities
 - Loans
 - Deposits
- Asset quality (past-due loans)
- Capital adequacy

REVIEWING THE BASICS

What to Look for in a Balance Sheet (\$000)

Loan growth lagged deposit growth so cash and securities grew.

| Assets (\$000) | CY-1 | Current Year | Percent Change |
|------------------------------------|-----------|--------------|----------------|
| Cash and Due from Banks | 23,944 | 24,822 | 3.7% |
| Fed Funds Sold | 0 | 0 | |
| Deposits at Financial Institutions | 10,621 | 130,989 | 1133.3% |
| Securities Purchased, to Resell | 0 | 0 | |
| Other Cash & Cash Equivalents | 0 | 0 | |
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| Held to Maturity Securities | 0 | 0 | |
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| Total Net Loans | 820,590 | 891,259 | 8.6% |
| Real Estate Owned | 289 | 58 | |
| Goodwill | 0 | 0 | |
| Other Intangibles | 0 | 0 | |
| Total Intangible Assets | 0 | 0 | |
| Loan Servicing Rights | 356 | 324 | |
| Credit Card Rights | 0 | 0 | |
| Other Loan Servicing Rights | 0 | 0 | |
| Total Servicing Rights | 356 | 324 | |
| Fixed Assets | 20,618 | 20,879 | |
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| Prepaid Expense | 2,658 | 2,496 | |
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| Other Assets | 10,780 | 3,525 | |
| Total Other Assets | 68,520 | 62,898 | |
| Total Assets | 1,203,541 | 1,465,679 | 21.8% |

| Liabilities (\$000) | CY-1 | Current Year | Percent Change |
|----------------------------------|-----------|--------------|----------------|
| Total Deposits | 1,001,709 | 1,287,448 | 28.5% |
| FHLB Borrowings | 46,909 | 0 | NM |
| Senior Debt | 50,380 | 3,581 | -92.9% |
| Trust Preferred | 10,310 | 10,310 | |
| Total Subordinated Debt | 10,310 | 10,310 | |
| Total Debt | 60,690 | 13,891 | -77.1% |
| Total Other Liabilities | 7,535 | 8,480 | |
| Total Liabilities | 1,069,934 | 1,309,819 | |
| Equity (\$000) | | | |
| TARP Preferred Equity | 0 | 0 | |
| Other Preferred Equity | 0 | 0 | |
| Total Preferred Equity | 0 | 0 | |
| Common Equity | 133,607 | 155,860 | 16.7% |
| Total Equity | 133,607 | 155,860 | |
| Total Liabilities + Total Equity | 1,203,541 | 1,465,679 | |

Significant deposit growth

REVIEWING THE BASICS

What to Look for in a Balance Sheet

| Deposit Composition (%) | CY-3 | CY-2 | CY-1 | Current Year |
|--------------------------------|-------|-------|-------|--------------|
| Nonint-bear Dep/ Deposits | 4.99 | 14.30 | 17.92 | 21.10 |
| Transaction Accounts/ Deposits | 9.38 | 8.89 | 11.11 | 56.54 |
| MMDAs+Savings/ Deposits | 71.34 | 64.64 | 69.52 | 28.41 |
| Retail Time Dep/ Deposits | 15.01 | 21.42 | 14.58 | 12.26 |
| Jumbo Time Deposits/ Deposits | 4.27 | 5.06 | 4.78 | 2.79 |

Significant non-interest-bearing deposit growth

Likely a reversal of reclassification of deposits.

| Loan Composition (%) | CY-3 | CY-2 | CY-1 | Current Year |
|---------------------------------------|-------|-------|-------|--------------|
| Construction & Land Dev. Loans/ Loans | 2.72 | 2.48 | 5.72 | 6.62 |
| Tot 1-4 Fam Loans/ Loans | 23.35 | 22.03 | 22.74 | 21.95 |
| Multifamily Loans/ Loans | 2.18 | 2.51 | 1.99 | 3.29 |
| Farm Loans/ Loans | 0.12 | 0.07 | 0.06 | 0.03 |
| CommRE/ Loans | 31.59 | 28.67 | 31.44 | 26.94 |
| Total Real Estate Loans/ Loans | 59.96 | 55.76 | 61.96 | 58.83 |
| Total C&I Loans/ Loans | 19.29 | 17.72 | 17.75 | 26.02 |
| Total Consumer Lns/ Loans | 15.10 | 19.25 | 14.96 | 9.70 |
| Total Agricultural Prod/ Loans | 0.00 | 0.00 | 0.00 | 0.00 |
| Total Other Loans/ Loans | 5.66 | 7.27 | 5.34 | 5.47 |
| Total Leases/ Loans | 0.00 | 0.00 | 0.00 | 0.00 |

Business loans are a larger proportion of portfolio.

Consumer lending a challenge.

REVIEWING THE BASICS

What to Look for in a Balance Sheet

| Capitalization (%) | CY-3 | CY-2 | CY-1 | Current Year | Well Capitalized |
|------------------------------------|-------|-------|-------|--------------|------------------|
| Total Risk Based Capital Ratio (%) | 12.49 | 12.17 | 14.78 | 15.80 | 10.00 |
| Tier 1 Risk-based Ratio (%) | 11.36 | 11.11 | 13.71 | 14.54 | 8.00 |
| Common Equity Tier 1 RBC (CET1) | 11.36 | 11.11 | 13.71 | 14.54 | 6.50 |
| Leverage Ratio (%) | 8.24 | 8.27 | 10.36 | 9.57 | 5.00 |

When total RBC trends up and leverage ratio trends down, what does that tell you?

- $CET\ 1 = \frac{\text{Total Capital} - \text{Preferred Stock} \pm \text{Miscellaneous Adjustments}}{\text{Risk-Weighted Assets}}$
- $\text{Tier 1 Capital Ratio} = \frac{\text{Equity Capital} + \text{Disclosed Reserves}}{\text{Risk-Weighted Assets}}$
- $\text{Total Capital Ratio} = \frac{\text{Tier 1 Capital} + \text{Tier 2 Capital}}{\text{Risk-Weighted Assets}}$

| Asset Quality (%) | CY-3 | CY-2 | CY-1 | Current Year |
|--|--------|--------|-------|--------------|
| NPLs/ Loans | 1.54 | 1.57 | 2.01 | 1.39 |
| NPAs/ Assets | 1.11 | 1.14 | 1.42 | 0.87 |
| NPA Excluding Restructured Loans/ Assets | 0.31 | 0.46 | 0.79 | 0.39 |
| NPAs + 90 Days PD/ Assets | 1.11 | 1.14 | 1.42 | 0.87 |
| Loan Loss Reserves/ Gross Loans | 1.17 | 1.13 | 1.08 | 1.32 |
| Reserves/ NPAs | 70.03 | 67.64 | 52.74 | 94.74 |
| Net Chargeoffs/ Avg Loans | 0.02 | 0.25 | 0.16 | (0.12) |
| Loan Loss Prov/ NCOs | 499.35 | 123.49 | 58.35 | (183.29) |

Asset quality is trending better in all metrics.

When Loan Loss Prov / NCO is negative, what does this indicate?

REVIEWING THE BASICS

Income Statement

$$\text{Net Income} = \text{Revenue} - \text{Expense} - \text{Taxes}$$

- Revenue is the income generated by the bank
 - Interest income
 - Noninterest income
- Expenses represent costs of the bank operation
 - Interest expense
 - Noninterest expense

REVIEWING THE BASICS

Income Statement

| Income Statement (\$000) | CY-3 | CY-2 | CY-1 | Current Year |
|--|--------|--------|--------|-----------------|
| Total Interest Income | 37,847 | 45,082 | 45,979 | 46,262 |
| Total Interest Expense | 4,120 | 7,950 | 9,342 | 5,909 |
| Net Interest Income | 33,727 | 37,132 | 36,637 | 40,353 |
| Provisions for Credit Losses | 769 | 2,550 | 797 | 1,941 |
| Total Noninterest Income | 5,326 | 11,712 | 6,269 | 6,516 |
| Unrealized Holding Gains on Equity Sec not HFT | NA | (27) | 29 | 13 |
| Realized Gain on Securities | 1,597 | (4) | 1,227 | 1,528 |
| Total Noninterest Expense | 27,501 | 28,845 | 29,325 | 28,575 |
| Net Income before Income Taxes | 12,380 | 17,418 | 14,040 | 17,894 |
| Income Taxes | 11,288 | 3,071 | 2,326 | 3,219 |
| Net Income | 1,092 | 14,347 | 11,714 | 14,675 |

Strong net interest income growth was offset in-part by the need to increase the provision.

Expense discipline is helping profitability.

REVIEWING THE BASICS

Ratio Analysis

- With data from the bank we can utilize thresholds or guidance.
 - Regulatory
 - Strategic (policy or SMART goals)
 - Peer groups
- Trend analysis is another key area of ratio analysis.

| Performance Measures (%) | CY-3 | CY-2 | CY-1 | Current Year |
|---------------------------------|-------|-------|-------|--------------|
| ROAA | 0.10 | 1.17 | 0.98 | 1.10 |
| ROAE | 0.96 | 14.12 | 9.01 | 9.97 |
| Noninterest Expense/ Avg Assets | 2.42 | 2.35 | 2.44 | 2.13 |
| Net Interest Margin | 3.22 | 3.24 | 3.27 | 3.26 |
| Efficiency Ratio | 69.18 | 58.48 | 67.66 | 59.95 |
| Yield on Earning Assets | 3.62 | 3.93 | 4.11 | 3.74 |
| Cost of Funds | 0.39 | 0.63 | 0.75 | 0.48 |

Yield on Earning Assets declined 37 bps year over year, while cost of funds decreased 27 bps, causing slight decline in NIM.

EXERCISE

Peer Group Ratio Analysis

Exercise

Identify one financial strength and one weakness from the Peer Group distributed to you. Be prepared to answer why.

MANAGEMENT INFORMATION

Typical Management Information

1. Asset Liability Management
2. Budget and Planning Process
3. Responsibility Reporting

PROFITABILITY ANALYSIS:

4. Organizational Profitability Reporting
5. Product Profitability Reporting
6. Branch Profitability Reporting
7. Customer/Relationship Profitability Reporting
8. Market Segment Profitability Reporting

SUPPORT FUNCTIONS:

9. Funds Transfer Pricing
10. Cost Allocation
11. Capital Assignment

MANAGEMENT INFORMATION

Objectives of Management Information

- Assist in strategic decision making and the budget process
- Provide information to manage GAP, Organizational Units, Products, Branches, Customers, Relationships, Market Segments, Market Areas, Exposures, etc.
- Assist in the measurement of performance (i.e., units/people)
- Assist in the determining of performance rewards, i.e. compensation, bonuses, incentives
- Provide the detail to understand and evaluate complex issues and problems
- Remembering the 80/20 rule Get enough information to be accurate not “all inclusive” information, which can cause needless complexity and sometimes misleading results

MANAGEMENT INFORMATION

Why Do You Need It?

| | <u>Loans</u> | 1Q23 | 1Q21 | 4Q19 | % Change (19 vs. 23) |
|---|-------------------|--------|--------|--------|-------------------------|
| 1 | C&I Loans | 1.08% | 1.53% | 0.27% | 0.81% |
| 2 | CRE Loans | 1.63% | 2.15% | 2.06% | -0.43% |
| 3 | Residential Loans | 0.66% | 1.59% | 1.02% | -0.36% |
| 4 | Consumer Loans | -2.05% | -0.30% | -0.95% | -1.10% |
| 5 | Home Equity Loans | -1.30% | 0.00% | -0.58% | -0.72% |
| 6 | HELOCs | -1.38% | 0.11% | -0.47% | -0.91% |

| | <u>Deposits</u> | 1Q23 | 1Q21 | 4Q19 | % Change (19 vs. 23) |
|----|-------------------------------|--------|--------|--------|-------------------------|
| 7 | Non-Int. Bearing Retail DDA | -1.46% | -3.35% | -4.33% | 2.87% |
| 8 | Non-Int. Bearing Business DDA | 2.11% | -0.42% | 0.05% | 2.06% |
| 9 | Int. Bearing Personal Demand | 1.08% | -0.33% | -0.42% | 1.50% |
| 10 | Int. Bearing Business Demand | 1.77% | 0.47% | 1.10% | 0.67% |
| 11 | Personal Money Market | 0.76% | 0.63% | 0.73% | 0.03% |
| 12 | Business Money Market | 0.75% | -1.56% | -1.32% | 2.07% |
| 13 | Personal Savings | 1.35% | 0.30% | 0.57% | 0.78% |
| 14 | Non-Personal Savings | 0.13% | -0.05% | -0.22% | 0.35% |
| 15 | Regular Time | 1.26% | -0.58% | 0.00% | 1.26% |
| 16 | Jumbo Time | 1.82% | -1.40% | 0.65% | 1.17% |
| 17 | Retirement Accounts | 0.30% | -1.63% | -0.76% | 1.06% |

Percents are medians of the pretax profit as a percent of the product portfolio from Performance Measurement outsourcing clients.

Source: The Kafafian Group, Inc.

MANAGEMENT INFORMATION

Why Do You Need It?

| <i>(all dollars in thousands)</i> | Branch Average Deposits | Pre-tax Profit (fully absorbed) | Pre-tax Profit (direct) |
|-----------------------------------|--|--|--|
| Breakeven - direct costs | \$29,739 | -2.73% | 0.00% |
| Breakeven - fully absorbed costs | \$62,220 | 0.00% | 1.31% |
| Critical mass (>1.0% pre-tax ROA) | \$103,699 | 1.00% | 1.78% |

| Data: | |
|---------------------------------|-------|
| Branch direct Opex (\$000) | \$743 |
| Branch direct Opex (%) | 0.86% |
| Branch total revenue to depts. | 2.50% |
| Branch indirect expense (%) | 0.95% |
| Branch indirect expense (\$000) | \$812 |

Percents are as a percent of the branch's average deposits.

Source: The Kafafian Group, Inc. peer profitability database, fourth quarter 2022.

MANAGEMENT INFORMATION

Case Study: Commercial Lines of Credit

(All % are annualized)

| | Q2 | | Q1 | | Q4 | | Q3 | | Q2 | |
|--------------------------------------|-----------|---------|-----------|---------|----------|---------|----------|---------|----------|---------|
| 1 <u>Gross Funds Provided (Used)</u> | (120,761) | 100.00% | (102,828) | 100.00% | (95,866) | 100.00% | (98,406) | 100.00% | (97,166) | 100.00% |
| 2 | | | | | | | | | | |
| 3 P & L: | | | | | | | | | | |
| 4 Interest Income | 2,063 | 6.85% | 1,541 | 6.08% | 1,491 | 6.19% | 1,322 | 5.34% | 1,257 | 5.20% |
| 5 Cost of Funds | 1,182 | 3.93% | 951 | 3.75% | 825 | 3.42% | 762 | 3.08% | 680 | 2.81% |
| 6 Total Interest Spread | 881 | 2.93% | 590 | 2.33% | 666 | 2.76% | 560 | 2.26% | 577 | 2.39% |

Note: Reads right to left. Q1 Interest Income includes a significant reversal of interest income from a non-performing loan.

Source: The Kafafian Group, Inc.

MANAGEMENT INFORMATION

Profitability Terms

1. Funds Transfer Pricing (FTP) – Determining the spread (Yield minus Cost) of an account, typically by matching the interest income (for an asset account) or interest expense (for a liability account) to a market instrument (such as an FHLB borrowing) of the same duration.
2. Risk Adjusted Return on Capital (RAROC) – Account pre-tax profit divided by assigned capital. Capital is assigned to account based on its balance and risk characteristics.
3. Cost Assignment – For organizational profitability, assigning support center costs to profit centers based on the work being done in the support center. For product and customer profitability, assigning organizational costs to products and/or customers based on the work being done, products supported, or customers served by to support the product.

MANAGEMENT INFORMATION

Funds Transfer Pricing

| | <u>Balance</u> | | <u>Annual Interest</u> | | <u>Rate</u> |
|--|----------------|----------------------|------------------------|---|--------------|
| Home Equity Loan (5 Year Fixed/Amortizing) | \$43,278 | ➔ | \$1,731 | ➔ | 4.00% |
| FTP(4 Year FHLB Borrowing) | NA | | \$714 | | 1.65% |
| Co-terminous Spread | | | <u>\$1,017</u> | | <u>2.35%</u> |
| Business Checking | \$65,840 | ➔ | \$0 | ➔ | 0.00% |
| FTP(Blended Average) | | | <u>\$1,103</u> | | <u>1.68%</u> |
| Co-terminous Spread | | | \$1,103 | | 1.68% |
| <u>Blended Average</u> | | <u>Weight</u> | <u>Result</u> | | |
| 90 Day FHLB Borrowing | 0.40% | 10.00% | 0.04% | | |
| 1-Year FHLB Borrowing | 0.90% | 15.00% | 0.14% | | |
| 5-Year FHLB Borrowing | 2.00% | 75.00% | <u>1.50%</u> | | |
| | | | 1.68% | | |

MANAGEMENT INFORMATION

Capital Assignment / RAROC

RAROC is considered to be a “best practice” tool for measuring risk vs. return in the financial services industry. It provides a framework for measuring risk-adjusted financial performance of organizational units, products, and customers.

FRB Risks

- Credit
- Market (Interest Rate)
- Liquidity
- Reputation
- Legal
- Operational

OCC Risks

- Credit
- Liquidity
- Interest Rate
- Price
- Reputation
- Strategic
- Transaction
- Foreign Exchange
- Compliance

CAMELS Ratings

- Capital
- Asset Quality
- Management
- Earnings
- Liquidity
- Sensitivity (Interest Rate)

MANAGEMENT INFORMATION

Capital Assignment / RAROC – Customer Sample

| | Low | | Medium | | High | |
|--------------------|-----|----|--------|----|------|--|
| Risk Rating Scale | 1 | 2 | 3 | 4 | 5 | |
| Capital Assignment | 0% | 4% | 6% | 8% | 10% | |

| | Credit | Interest Rate | Liquidity | Composite | Assigned Capital | Capital (\$000) |
|-----------------|--------|---------------|-----------|-----------|------------------|-----------------|
| Risk Categories | | | | | | |
| Risk Weights | 55% | 35% | 10% | 100% | | |

| Loans: | Balance | | | | | | |
|----------------------------|---------|---|---|---|------|-------|--------|
| Loan on building(CRE) | 250,000 | 2 | 4 | 4 | 2.90 | 5.80% | 14,500 |
| Home equity loan | 50,000 | 3 | 3 | 3 | 3.00 | 6.00% | 3,000 |
| Deposits/funding: | | | | | | | |
| Business checking | 30,000 | 1 | 2 | 2 | 1.45 | 2.90% | 870 |
| Funding gap | 270,000 | 1 | 2 | 2 | 1.45 | 1.80% | 4,860 |
| Total Capital for Customer | 23,230 | | | | | | |
| Capital Ratio | 7.74% | | | | | | |
| Pre-tax ROE Hurdle Rate | 15.00% | | | | | | |
| Pre-tax Profit Requirement | \$3,485 | | | | | | |

MANAGEMENT INFORMATION

Cost Allocation

- Activity-based-costing
- Full absorption versus standard costing
- Variable/fixed-direct/indirect costs
- Isolating efficiencies/inefficiencies
- Capacity utilization

Allocations methodologies:

- Average balances
- Fixed percentages
- Statistical databases
- Weighted statistics
- Direct Dollar Assignment
- Rate X Volume (ABC)

MANAGEMENT INFORMATION

Cost Allocation

| Name | Activities | Product Group Number | Daily Time (mins) | Salary Data |
|----------|---|----------------------|-------------------|-----------------|
| Jane Doe | Deposit Servicing Rep II | | | \$25,189 |
| | 20% NSF (comml & retail dda) | 10 | 96 | \$5,038 |
| | 30% Processing outgoing returns (all checking) | 10 | 144 | \$7,557 |
| | 30% Verification of new checking acct (all checking) | 10 | 144 | \$7,557 |
| | 10% Processing outgoing mail (bank ovhd) | 98 | 48 | \$2,519 |
| | 5% Posting data input (customer change requests/all deposits) | 1 | 24 | \$1,259 |
| | 5% Phone calls, etc. (dept ovhd) | 99 | 24 | \$1,259 |
| | | | | \$0 |
| | | Totals: | 480 | \$25,189 |

BRINGING IT ALL TOGETHER

Simple Approach to Campaign Profitability

| | |
|--|-----------|
| Number of Prospects | 10,000 |
| x conversion rate | 2% |
| = number of new customers (accounts) | 200 |
| | |
| x average balance per account | \$43,278 |
| x spread per account | 2.46% |
| = revenue per new account | \$1,065 |
| | |
| New Revenue from Campaign | \$212,928 |
| | |
| minus cost of campaign | \$50,000 |
| minus incremental cost to service new accounts | \$36,000 |
| = marginal profitability of campaign | \$126,928 |

BRINGING IT ALL TOGETHER

ROI vs. ROE: Part 1

| | <u>Credit Card</u> | <u>HELOC</u> |
|--------------------------------------|--------------------|--------------|
| <i>(dollars in thousands)</i> | | |
| 1 New Balances | \$10,000 | \$10,000 |
| 2 Interest Income | \$1,000 | \$400 |
| 3 Cost of Funds (FTP) | <u>150</u> | <u>150</u> |
| 4 Spread | 850 | 250 |
| 5 Fee Income | <u>200</u> | <u>50</u> |
| 6 Total Revenue | \$1,050 | \$300 |
| 7 Estimated net charge-offs | 400 | 25 |
| 8 Incremental Operating Expenses | <u>200</u> | <u>15</u> |
| 9 Net Revenue | \$450 | \$260 |
| 10 Campaign Cost | \$50 | \$50 |
| 11 Return on Investment (ROI) | 900% | 520% |

BRINGING IT ALL TOGETHER

ROI vs. ROE: Part 2

| | <u>Credit Card</u> | <u>HELOC</u> |
|--|--------------------|--------------|
| <i>(dollars in thousands)</i> | | |
| 1 New Balances | \$10,000 | \$10,000 |
| 2 Net Revenue | \$450 | \$260 |
| 3 Campaign Cost | \$50 | \$50 |
| 4 Return on Investment (ROI) | 900% | 520% |
| 5 Capital Allocation | \$1,000 | \$500 |
| 6 Risk Adjusted Return on Capital (RAROC) | 45% | 52% |

BRINGING IT ALL TOGETHER

Customer Profitability

| | Percent of Average Balances | | | |
|--------------------------------------|-----------------------------|-----------------------------------|--------------------------------|---------------------------|
| | <u>Business DDA</u> | | <u>Commercial Mortgage</u> | <u>Home Eq. Loans</u> |
| 1 Credit for Funds | 3.45% | Interest Income | 6.27% | 6.32% |
| 2 Interest Expense | 0.00% | Cost of Funds | 3.95% | 4.57% |
| 3 Total Interest Spread | 3.44% | Total Interest Spread | 2.25% | 1.72% |
| 4 Funds Credit Allocated Equity | 0.15% | Funds Credit Allocated Equity | 0.39% | 0.24% |
| 5 Net Interest Spread | 3.58% | Net Interest Spread | 2.62% | 1.93% |
| 6 Non-Interest Income | 0.72% | Provision for Credit Loss | 0.69% | 0.21% |
| 7 Total Income | 4.35% | Marginal Inc (Loss) After Prov. | 2.07% | 1.76% |
| 8 Non-Interest Expense | 3.76% | Non-Interest Income | 0.10% | 0.10% |
| 9 Pretax Profit (Loss) | 0.39% | Total Income | 2.15% | 1.83% |
| 10 | | Non-Interest Expense | 0.66% | 1.29% |
| 11 Number of Accounts | 2,525 | Pretax Profit (Loss) | 1.16% | 0.61% |
| 12 Average Balance per Account | \$18,432 | | | |
| 13 Non-Interest Income per Account | \$36.88 | Number of Accounts | 405 | 1,185 |
| 14 Annualized Cost per Account | \$719.87 | Average Balance per Account | \$505,002 | \$58,427 |
| 15 Annualized Net Income per Account | \$76.28 | Non-Interest Income per Account | \$71.09 | \$9.82 |
| 16 | | Annualized Cost per Account | \$3,535.46 | \$781.60 |
| 17 | | Annualized Net Income per Account | \$6,762.85 | \$670.03 |

| | <u>Customer Balances from RAROC Sample:</u> | <u>Profits</u> | | |
|----|---|----------------|---------|--|
| 18 | Commercial Mortgage | \$250,000 | \$2,900 | Capital Allocation to Customer 7.74% |
| 19 | Home Equity Loan | 50,000 | 305 | |
| 20 | Business DDA | 30,000 | 117 | Profit Hurdle for 15% ROE \$3,485 |
| | Total Profit | \$3,322 | | \$3,322 |
| | | | | Customer profit over (short) of hurdle (\$163) |

BRINGING IT ALL TOGETHER

Where to Go for More Information

Externally

- For FDIC Summary of Deposit (deposit market share data), Institution Directory, Statistics on Banking, and other industry profitability and related data:
www.fdic.gov/quicklinks/analysts.htm
- For Call Reports, Thrift Financial Reports (TFR), and Uniform Bank Performance Reports (peer reports), and other industry related data: www.ffiec.gov

Internally

- Internal profitability reports (Fiserv Vantage, Profitstars, etc.)
- MCIF Systems
- Responsibility reports/general ledger system

INSTRUCTOR

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Mr. Marsico is the President, shareholder, and founding member of TKG. His specialties include: facilitating the development of client strategies; mergers & acquisitions; profit/process improvement consulting engagements; profitability consulting; and regulatory order assistance.

As part of the strategic consulting team, Mr. Marsico has analyzed and facilitated over one hundred strategy development engagements for community financial institutions resulting in documented strategic plans to guide client employees and improve performance. He has negotiated, analyzed, and advised Boards of Directors regarding bank mergers and acquisitions resulting in whole institution and branch sale transactions with values in excess of \$1B, including the first reverse merger-conversion where the converting thrift acquired a commercial bank.

Mr. Marsico began his banking career in 1985 and his experience includes: IT and Trust operations with Northeastern Bank of Pennsylvania (now PNC Financial Services Group, Inc.); retail branch management and strategic planning with First Maryland Bancorp (now M&T Bank Corporation); and financial institution mergers & acquisitions, consulting, and capital formation with Tucker Anthony Sutro Capital Markets (now RBC Capital Markets). He interrupted his banking career and served seven years as a Military Intelligence Analyst in the United States Navy, earning three Navy Achievement Medals, the Kuwait Liberation Medal, the Southwest Asia Service Medal, the Combat Action Ribbon, Sea Service Ribbon, and other various commendations.

Mr. Marsico is the author of [*Squared Away-How Can Bankers Succeed as Economic First Responders*](#) and serves on the faculty of various state banking associations' Executive Development Programs. He is frequently sought out by industry publications regarding the changes occurring in financial services and is a noted industry commentator via his blog.

THE KAFAFIAN GROUP

Helping Banks Perform Better



July 2023

CONFIDENTIAL

Performance
Measurement



Strategic
Management



Profit & Process
Improvement



Management
Advisory



Financial
Advisory



DISCLOSURE STATEMENT

FORWARD LOOKING STATEMENTS

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Source: The Kafafian Group, Inc

1st Year Peer

1ST YEAR PEER FINANCIAL CONDITION

As of March 31, 2023

| Company Name | City | State | Branch Count | Total Assets (\$000s) | Total Loans (\$000s) | Total Deposits (\$000s) | Cash, Int. Bear. Bal. | Loans / Deposits | Borr. / Assets | Tang. Equity / Assets | Tier 1 Leverage | Tier 1 Risk-based Capital | Total Capital | Capital Conservation Buffer | CRE Loans / Total Risk-Based Capital | NPAs / Assets | NPAs ex. TDRs / Assets | NPLs / Loans | Reserves / NPAs | NCOs / Avg. Loans | | | | | | |
|--|-----------------|-------|--------------|-----------------------|----------------------|-------------------------|-----------------------|------------------|----------------|-----------------------|-----------------|---------------------------|---------------|-----------------------------|--------------------------------------|---------------|------------------------|--------------|-----------------|-------------------|--------|--------|--------|--------|--------|------|
| | | | | | | | Assets (%) | (%) | (%) | (%) | (%) | (%) | (%) | (%) | (%) | (%) | (%) | (%) | (%) | (%) | (%) | (%) | (%) | | | |
| 1 Bank of Ocean City | Ocean City | MD | 6 | 585,919 | 375,553 | 517,392 | 2.27 | 72.59 | 1.88 | 9.58 | 9.58 | 9.70 | 14.12 | 14.12 | 14.77 | 6.77 | 292.88 | 0.00 | 0.00 | 0.00 | NA | 0.01 | | | | |
| 2 Community Bank of the Chesapeake | Waldorf | MD | 1 | 2,426,708 | 1,844,374 | 2,156,731 | 1.13 | 85.52 | 0.89 | 8.97 | 9.39 | 10.39 | 13.03 | 13.03 | 14.25 | 6.25 | 378.62 | 0.33 | 0.33 | 0.44 | 289.38 | 0.01 | | | | |
| 3 Eagle Bancorp, Inc. | Bethesda | MD | 14 | 11,088,867 | 7,744,164 | 7,463,241 | 1.56 | 103.68 | 20.28 | 10.36 | 11.20 | 11.42 | 13.75 | 13.75 | 14.74 | 6.73 | 364.35 | 1.05 | 0.08 | 1.49 | 67.00 | 0.05 | | | | |
| 4 First United Corporation | Oakland | MD | 26 | 1,937,442 | 1,289,007 | 1,591,285 | 8.05 | 80.99 | 8.54 | 7.30 | 7.89 | 11.47 | 12.70 | 14.76 | 16.01 | 8.01 | 171.95 | 0.41 | 0.41 | 0.25 | 214.75 | 0.08 | | | | |
| 5 Fulton Financial Corporation | Lancaster | PA | 213 | 27,112,176 | 20,676,695 | 21,316,584 | 2.09 | 96.97 | 9.02 | 7.74 | 9.66 | 9.23 | 9.78 | 10.62 | 13.38 | 4.62 | 178.24 | 0.54 | 0.51 | 0.69 | 190.00 | 0.27 | | | | |
| 6 Hebron Savings Bank | Hebron | MD | 13 | 772,305 | 501,056 | 684,265 | 13.70 | 73.23 | 1.68 | 9.33 | 9.33 | 9.91 | 13.89 | 13.89 | 15.14 | 7.14 | 230.66 | 0.31 | 0.31 | 0.45 | 355.23 | 0.10 | | | | |
| 7 M&T Bank Corporation | Buffalo | NY | 1,051 | 202,956,407 | 132,937,692 | 159,075,240 | 11.89 | 83.27 | 7.12 | 8.59 | 12.50 | 8.98 | 10.16 | 11.48 | 13.28 | 5.04 | 200.41 | 1.40 | 1.26 | 2.10 | 69.56 | 0.21 | | | | |
| 8 Community Heritage Financial, Inc. | Middletown | MD | 8 | 936,620 | 759,315 | 815,833 | 1.37 | 92.86 | 5.09 | 7.10 | 7.26 | 9.57 | 12.30 | 12.30 | 13.47 | 5.47 | 240.41 | 0.30 | 0.22 | 0.37 | 278.19 | (0.00) | | | | |
| 9 Orrstown Financial Services, Inc. | Shippensburg | PA | 21 | 3,011,548 | 2,214,842 | 2,515,626 | 3.26 | 87.75 | 7.24 | 7.31 | 7.97 | 8.52 | 10.37 | 10.37 | 12.85 | 4.37 | 302.31 | 0.71 | 0.71 | 0.96 | 132.97 | (0.01) | | | | |
| 10 Queenstown Bank of Maryland | Queenstown | MD | 9 | 694,183 | 445,948 | 610,483 | 9.92 | 73.05 | 2.88 | 8.53 | 8.53 | 11.39 | 16.43 | 16.43 | 17.69 | 9.69 | 130.82 | 0.74 | 0.01 | 1.16 | 145.71 | (0.02) | | | | |
| 11 Rosedale Federal Savings and Loan Association | Baltimore | MD | 14 | 1,230,779 | 924,227 | 954,839 | 4.24 | 96.79 | 2.44 | 18.40 | 19.51 | 19.75 | NA | NA | NA | NA | 125.63 | 1.62 | 0.67 | 2.07 | 39.44 | 0.00 | | | | |
| 12 Sandy Spring Bancorp, Inc. | Olney | MD | 56 | 14,129,007 | 11,411,503 | 11,075,991 | 3.51 | 102.88 | 10.15 | 8.40 | 10.88 | 9.44 | 10.53 | 10.53 | 14.43 | 4.52 | 346.02 | 0.31 | 0.31 | 0.38 | 269.27 | (0.01) | | | | |
| 13 Shore Bancshares, Inc. | Easton | MD | 42 | 3,553,694 | 2,672,195 | 2,994,562 | 1.06 | 89.12 | 5.19 | 8.41 | 10.18 | 9.26 | 11.17 | 11.85 | 13.85 | 5.85 | 280.17 | 0.06 | 0.06 | 0.07 | 486.65 | 0.00 | | | | |
| 14 Farmers & Merchants Bancorp, Inc. | Archbold | OH | 37 | 3,070,075 | 2,447,603 | 2,513,168 | 2.24 | 97.35 | 7.47 | 7.08 | 9.96 | 8.36 | 10.27 | 10.27 | 12.56 | 4.27 | 264.82 | 0.25 | 0.25 | 0.32 | 319.38 | 0.01 | | | | |
| 15 The Farmers Bank of Willards | Willards | MD | 8 | 529,421 | 345,655 | 451,855 | 1.51 | 76.50 | 4.75 | 9.22 | 9.22 | 9.80 | 15.61 | 15.61 | 16.68 | 8.68 | 123.29 | 0.62 | 0.52 | 0.15 | 105.88 | 0.05 | | | | |
| 16 Woodsboro Bank | Woodsboro | MD | 5 | 406,618 | 262,053 | 385,210 | 6.75 | 68.03 | 0.00 | 4.60 | 4.60 | 7.28 | 10.97 | 10.97 | 12.22 | 4.22 | 257.60 | 0.02 | 0.00 | 0.03 | NM | 0.00 | | | | |
| 17 | 25th Percentile | | | | | | | | | | 7.31 | 8.39 | 9.17 | 10.45 | 10.80 | 13.33 | 4.57 | 176.67 | 0.72 | 0.51 | 1.01 | 112.65 | 0.06 | | | |
| 18 | 75th Percentile | | | | | | | | | | 9.25 | 10.35 | 10.64 | 13.82 | 14.01 | 14.96 | 6.96 | 295.24 | 0.29 | 0.07 | 0.23 | 286.58 | (0.00) | | | |
| 19 | Average | | | | | | 95 | 17,152,611 | 11,678,243 | 13,445,144 | 4.66 | 86.29 | 5.91 | 8.81 | 9.85 | 10.28 | 12.34 | 12.67 | 14.35 | 6.11 | 243.01 | 0.54 | 0.35 | 0.68 | 211.67 | 0.05 |
| 20 | Median | | | | | | 14 | 2,182,075 | 1,566,691 | 1,874,008 | 2.77 | 86.64 | 5.14 | 8.47 | 9.49 | 9.64 | 12.30 | 14.25 | 5.85 | 249.01 | 0.37 | 0.31 | 0.41 | 202.38 | 0.01 | |

Peer Criteria
-Peer consisting of the financial institutions of first year students

NOTE: If GAAP data is not available at the holding company level, bank holding company regulatory data or bank regulatory data is used.

Source: S&P Capital IQ Pro

1ST YEAR PEER

BALANCE SHEET COMPOSITION

| Company Name | As a percent of total loans at March 31, 2023 | | | | | | | As a percent of total deposits at March 31, 2023 | | | | |
|--|---|---------------------------------|---|-------------|--------------|-------------------------------|------------------------------|--|--------------------------|-------------------|-------------------|-------------|
| | 1-4 Family 1st (%) | Const. & Land Dev. (%) | Multi- Family Real Estate (%) | CRE (%) | C&I (%) | Cons. & Home Eq. (%) | All Other Loans (%) | Trans. Accts (%) | MMDA & Savings (%) | Total Time (%) | Jumbo Time (%) | |
| 1 Bank of Ocean City | 20.99 | 14.59 | 2.49 | 54.42 | 4.91 | 1.01 | 1.59 | 38.93 | 46.91 | 14.16 | 4.74 | |
| 2 Community Bank of the Chesapeake | 14.11 | 7.29 | 9.16 | 61.21 | 5.08 | 1.89 | 1.26 | 10.63 | 69.39 | 19.98 | 3.26 | |
| 3 Eagle Bancorp, Inc. | 2.66 | 20.01 | 11.60 | 45.79 | 11.30 | 0.93 | 7.71 | 42.28 | 39.80 | 17.93 | 1.36 | |
| 4 First United Corporation | 30.60 | 5.97 | 3.63 | 31.18 | 18.25 | 9.45 | 0.92 | 20.18 | 68.62 | 11.20 | 2.40 | |
| 5 Fulton Financial Corporation | 25.87 | 6.33 | 4.47 | 30.14 | 13.07 | 8.95 | 11.17 | 55.57 | 32.06 | 12.37 | 1.38 | |
| 6 Hebron Savings Bank | 24.04 | 14.28 | 0.86 | 41.02 | 5.49 | 7.77 | 6.54 | 44.27 | 31.20 | 24.53 | 3.45 | |
| 7 M&T Bank Corporation | 17.95 | 5.92 | 4.77 | 22.36 | 23.44 | 15.25 | 10.31 | 48.75 | 43.15 | 8.07 | 0.95 | |
| 8 Community Heritage Financial, Inc. | 27.67 | 10.08 | 3.02 | 35.75 | 15.65 | 4.45 | 3.38 | 46.35 | 40.98 | 12.68 | 4.73 | |
| 9 Orrstown Financial Services, Inc. | 15.27 | 8.85 | 6.50 | 42.57 | 14.60 | 9.11 | 3.10 | 29.71 | 57.92 | 12.36 | 1.91 | |
| 10 Queenstown Bank of Maryland | 41.55 | 8.13 | 2.41 | 32.78 | 3.50 | 4.74 | 6.89 | 41.76 | 29.92 | 28.32 | 5.51 | |
| 11 Rosedale Federal Savings and Loan Association | 58.00 | 4.71 | 1.98 | 32.88 | 0.91 | 1.49 | 0.03 | 13.79 | 45.00 | 41.21 | 6.52 | |
| 12 Sandy Spring Bancorp, Inc. | 15.79 | 12.14 | 7.05 | 49.10 | 10.49 | 4.24 | 1.19 | 42.44 | 33.66 | 23.90 | 4.54 | |
| 13 Shore Bancshares, Inc. | 27.16 | 9.37 | 2.45 | 39.69 | 5.20 | 14.72 | 1.41 | 51.25 | 32.44 | 16.31 | 3.44 | |
| 14 Farmers & Merchants Bancorp, Inc. | 18.16 | 6.06 | 6.24 | 38.47 | 9.86 | 5.62 | 15.59 | 52.54 | 23.51 | 23.95 | 3.38 | |
| 15 The Farmers Bank of Willards | 45.24 | 11.21 | 2.50 | 21.08 | 9.16 | 6.86 | 3.95 | 41.75 | 34.26 | 23.99 | 3.10 | |
| 16 Woodsboro Bank | 30.53 | 6.83 | 5.69 | 38.43 | 10.87 | 6.96 | 0.69 | 52.16 | 35.61 | 12.23 | 2.92 | |
| 17 | Average | 25.97 | 9.49 | 4.68 | 38.55 | 10.11 | 6.47 | 4.73 | 39.52 | 41.53 | 18.95 | 3.35 |
| 18 | Median | 24.96 | 8.49 | 4.05 | 38.45 | 10.18 | 6.24 | 3.24 | 42.36 | 37.71 | 17.12 | 3.32 |

NOTE: If GAAP data is not available at the holding company level, bank holding company regulatory data or bank regulatory data is used.

Source: S&P Capital IQ Pro

1ST YEAR PEER FINANCIAL HIGHLIGHTS

For the LTM ended March 31, 2023

| Company Name | Net Interest Margin (%) | Yield on Earning Assets (%) | Yield on Loans (%) | Yield on Securities (%) | Cost of Funds (%) | Cost of Deposits (%) | Cost of Bearing Deposits (%) | Cost of Borr. (%) | Non-Int. Income/ Avg. Assets (%) | Non-Int. Income/ Operating Revenue (%) | Non-Int. Expense/ Avg. Assets (%) | Efficiency Ratio (FTE basis) (%) | Return on Average Assets (%) | Return on Average Equity (%) | |
|--|-------------------------|-----------------------------|--------------------|-------------------------|-------------------|----------------------|------------------------------|-------------------|----------------------------------|--|-----------------------------------|----------------------------------|------------------------------|------------------------------|-------|
| 1 Bank of Ocean City | 2.96 | 3.36 | 4.71 | 1.62 | 0.42 | 0.41 | 0.65 | 6.04 | 0.21 | 6.80 | 1.30 | 42.26 | 1.28 | 15.42 | |
| 2 Community Bank of the Chesapeake | 3.40 | 4.04 | 4.62 | 2.21 | 0.59 | 0.54 | 0.91 | 6.14 | 0.27 | 7.59 | 1.55 | 43.82 | 1.41 | 15.57 | |
| 3 Eagle Bancorp, Inc. | 2.99 | 4.34 | 5.45 | 1.72 | 1.48 | 1.31 | 2.14 | 4.47 | 0.17 | 5.71 | 1.31 | 43.06 | 1.04 | 9.50 | |
| 4 First United Corporation | 3.59 | 4.03 | 4.60 | 2.33 | 0.44 | 0.35 | 0.53 | 1.93 | 0.98 | 23.35 | 2.47 | 57.09 | 1.29 | 16.91 | |
| 5 Fulton Financial Corporation | 3.45 | 4.04 | 4.43 | 2.50 | 0.63 | 0.38 | 0.57 | 3.54 | 0.85 | 21.11 | 2.42 | 58.91 | 1.11 | 11.37 | |
| 6 Hebron Savings Bank | 3.83 | 4.21 | 5.14 | 2.51 | 0.39 | 0.36 | 0.57 | 2.20 | 0.35 | 8.63 | 2.04 | 50.74 | 1.41 | 17.67 | |
| 7 M&T Bank Corporation | 3.69 | 4.18 | 4.83 | 2.74 | 0.53 | 0.39 | 0.67 | 4.03 | 1.11 | 25.05 | 2.53 | 55.96 | 1.15 | 9.10 | |
| 8 Community Heritage Financial, Inc. | 3.28 | 4.16 | 4.49 | 2.06 | 0.80 | 0.75 | 1.15 | 3.25 | 0.38 | 10.91 | 2.49 | 71.33 | 0.71 | 11.06 | |
| 9 Orrstown Financial Services, Inc. | 3.92 | 4.51 | 4.84 | 3.52 | 0.61 | 0.48 | 0.61 | 4.20 | 0.89 | 19.82 | 2.81 | 60.98 | 0.80 | 9.68 | |
| 10 Queenstown Bank of Maryland | 3.26 | 3.65 | 4.74 | 1.65 | 0.42 | 0.41 | 0.60 | 1.81 | 0.25 | 7.41 | 1.98 | 58.02 | 1.06 | 12.50 | |
| 11 Rosedale Federal Savings and Loan Association | 2.96 | 3.50 | 4.04 | 1.89 | 0.66 | 0.62 | 0.68 | 3.64 | 0.08 | 2.94 | 2.34 | 80.07 | 0.37 | 1.88 | |
| 12 Sandy Spring Bancorp, Inc. | 3.31 | 4.23 | 4.59 | 2.03 | 0.99 | 0.75 | 1.16 | 3.53 | 0.49 | 13.54 | 1.91 | 51.37 | 1.28 | 11.76 | |
| 13 Shore Bancshares, Inc. | 3.25 | 3.87 | 4.49 | 2.19 | 0.65 | 0.53 | 0.75 | 5.27 | 0.65 | 17.67 | 2.28 | 60.44 | 0.93 | 8.94 | |
| 14 Farmers & Merchants Bancorp, Inc. | 3.28 | 4.10 | 4.72 | 1.40 | 0.78 | 0.71 | 0.91 | 3.27 | 0.57 | 15.50 | 2.01 | 53.92 | 1.07 | 10.67 | |
| 15 The Farmers Bank of Willards | 3.87 | 4.27 | 5.71 | 1.80 | 0.43 | 0.35 | 0.53 | 4.89 | 0.34 | 8.31 | 2.50 | 61.58 | 1.06 | 11.85 | |
| 16 Woodsboro Bank | 3.33 | 3.48 | 4.35 | 2.18 | 0.11 | 0.16 | 0.28 | NA | 0.37 | 10.46 | 2.42 | 68.16 | 0.75 | 18.02 | |
| 17 | 25th Percentile | 3.26 | 3.82 | 4.49 | 1.78 | 0.69 | 0.64 | 0.91 | 4.68 | 0.27 | 7.55 | 2.47 | 61.13 | 0.89 | 9.63 |
| 18 | 75th Percentile | 3.61 | 4.21 | 4.83 | 2.37 | 0.43 | 0.37 | 0.57 | 3.26 | 0.70 | 18.21 | 1.96 | 51.21 | 1.28 | 15.46 |
| 19 | Average | 3.40 | 4.00 | 4.73 | 2.15 | 0.62 | 0.53 | 0.79 | 3.88 | 0.50 | 12.80 | 2.15 | 57.36 | 1.04 | 11.99 |
| 20 | Median | 3.32 | 4.07 | 4.67 | 2.12 | 0.60 | 0.44 | 0.66 | 3.64 | 0.38 | 10.69 | 2.31 | 57.55 | 1.07 | 11.56 |

NOTE: If GAAP data is not available at the holding company level, bank holding company regulatory data or bank regulatory data is used.

Source: S&P Capital IQ Pro

1ST YEAR PEER FINANCIAL HIGHLIGHTS (CONTINUED)

For the quarter ended March 31, 2023 (annualized)

| Company Name | Net Interest Margin (%) | Yield on Earning Assets (%) | Yield on Loans (%) | Yield on Securities (%) | Cost of Funds (%) | Cost of Deposits (%) | Cost of Int. Bearing Deposits (%) | Cost of Borr. (%) | Non-Int. Income/ Avg. Assets (%) | Non-Int. Income/ Operating Revenue (%) | Non-Int. Expense/ Avg. Assets (%) | Efficiency Ratio (FTE basis) (%) | Return on Average Assets (%) | Return on Average Equity (%) |
|--|-------------------------|-----------------------------|--------------------|-------------------------|-------------------|----------------------|-----------------------------------|-------------------|----------------------------------|--|-----------------------------------|----------------------------------|------------------------------|------------------------------|
| 1 Bank of Ocean City | 2.94 | 3.60 | 4.71 | 1.63 | 0.70 | 0.65 | 0.99 | 5.60 | 0.20 | 6.82 | 1.43 | 47.44 | 1.13 | 12.31 |
| 2 Community Bank of the Chesapeake | 3.29 | 4.59 | 5.05 | 2.99 | 1.16 | 1.04 | 1.79 | 8.01 | 0.21 | 6.29 | 1.55 | 45.54 | 1.33 | 14.77 |
| 3 Eagle Bancorp, Inc. | 2.76 | 5.13 | 6.27 | 1.82 | 2.58 | 2.24 | 3.63 | 4.79 | 0.13 | 4.73 | 1.39 | 49.77 | 0.85 | 7.81 |
| 4 First United Corporation | 3.48 | 4.33 | 4.90 | 2.46 | 0.77 | 0.66 | 1.00 | 2.51 | 0.93 | 23.23 | 2.67 | 64.95 | 0.92 | 11.71 |
| 5 Fulton Financial Corporation | 3.49 | 4.73 | 5.10 | 2.60 | 1.26 | 0.81 | 1.21 | 4.32 | 0.77 | 19.35 | 2.37 | 58.49 | 1.02 | 10.46 |
| 6 Hebron Savings Bank | 4.39 | 4.72 | 5.36 | 2.77 | 0.35 | 0.32 | 0.51 | 2.23 | 0.35 | 7.78 | 2.30 | 50.50 | 1.64 | 18.75 |
| 7 M&T Bank Corporation | 3.98 | 5.16 | 5.70 | 2.96 | 1.18 | 0.91 | 1.49 | 4.95 | 1.12 | 23.79 | 2.68 | 55.93 | 1.39 | 11.06 |
| 8 Community Heritage Financial, Inc. | 3.18 | 4.52 | 4.94 | 2.10 | 1.42 | 1.40 | 2.07 | 2.13 | 0.31 | 9.31 | 2.68 | 81.63 | 0.60 | 8.23 |
| 9 Orrstown Financial Services, Inc. | 3.89 | 5.12 | 5.36 | 4.18 | 1.21 | 0.99 | 1.26 | 4.68 | 0.83 | 18.80 | 2.76 | 61.16 | 1.25 | 15.66 |
| 10 Queenstown Bank of Maryland | 3.11 | 3.91 | 4.83 | 1.81 | 0.87 | 0.83 | 1.18 | 2.18 | 0.24 | 7.47 | 1.97 | 60.51 | 0.95 | 11.25 |
| 11 Rosedale Federal Savings and Loan Association | 2.96 | 3.76 | 4.18 | 1.93 | 0.96 | 0.88 | 0.95 | 3.64 | 0.08 | 2.78 | 2.15 | 73.52 | 0.63 | 3.32 |
| 12 Sandy Spring Bancorp, Inc. | 2.95 | 4.63 | 4.93 | 2.20 | 1.76 | 1.48 | 2.19 | 4.35 | 0.46 | 14.08 | 1.90 | 56.87 | 1.47 | 13.74 |
| 13 Shore Bancshares, Inc. | 3.13 | 4.34 | 4.79 | 2.49 | 1.20 | 0.98 | 1.37 | 5.39 | 0.61 | 17.16 | 2.30 | 63.71 | 0.74 | 7.15 |
| 14 Farmers & Merchants Bancorp, Inc. | 3.00 | 4.41 | 4.96 | 1.51 | 1.74 | 1.31 | 1.65 | 3.82 | 0.66 | 18.95 | 2.12 | 59.25 | 0.84 | 8.59 |
| 15 The Farmers Bank of Willards | 3.97 | 4.62 | 5.86 | 2.07 | 0.70 | 0.47 | 0.71 | 5.26 | 0.35 | 8.49 | 2.61 | 62.55 | 1.08 | 11.93 |
| 16 Woodsboro Bank | 3.50 | 3.79 | 4.52 | 2.24 | 0.22 | 0.31 | 0.54 | NA | 0.35 | 9.37 | 2.53 | 68.44 | 0.78 | 18.24 |
| 17 25th Percentile | 2.99 | 4.22 | 4.82 | 1.91 | 1.30 | 1.11 | 1.68 | 5.11 | 0.23 | 7.31 | 2.63 | 64.02 | 0.83 | 8.50 |
| 18 75th Percentile | 3.60 | 4.72 | 5.36 | 2.64 | 0.75 | 0.66 | 0.98 | 3.08 | 0.69 | 18.83 | 1.95 | 54.58 | 1.27 | 14.00 |
| 19 Average | 3.38 | 4.46 | 5.09 | 2.36 | 1.13 | 0.96 | 1.41 | 4.26 | 0.47 | 12.40 | 2.21 | 60.02 | 1.04 | 11.56 |
| 20 Median | 3.23 | 4.56 | 4.95 | 2.22 | 1.17 | 0.90 | 1.24 | 4.35 | 0.35 | 9.34 | 2.30 | 59.88 | 0.98 | 11.48 |

NOTE: If GAAP data is not available at the holding company level, bank holding company regulatory data or bank regulatory data is used.

Source: S&P Capital IQ Pro

1ST YEAR PEER EXPENSE DETAIL

For the LTM ended March 31, 2023

| Company Name | Offices (#) | Number of Emp. (FTE) | Salary & Benefits per Emp. (\$000) | Salary & Benefits (\$000) | Total Nonint. Expense (\$000) | Total Revenue per Emp. (\$000) | |
|--|----------------|----------------------------|---|---------------------------------|--|---|----------------|
| 1 Bank of Ocean City | 6 | 65 | 68.4 | 4,445 | 8,203 | 298 | |
| 2 Community Bank of the Chesapeake | 1 | 199 | 111.5 | 22,189 | 37,027 | 424 | |
| 3 Eagle Bancorp, Inc. | 14 | 486 | 187.7 | 91,207 | 176,676 | 715 | |
| 4 First United Corporation | 26 | 317 | 80.3 | 25,452 | 45,198 | 242 | |
| 5 Fulton Financial Corporation | 213 | 3,329 | 108.7 | 361,703 | 649,355 | 318 | |
| 6 Hebron Savings Bank | 13 | 132 | 78.4 | 10,343 | 16,927 | 252 | |
| 7 M&T Bank Corporation | 1,051 | 23,004 | 131.2 | 3,017,773 | 5,385,422 | 391 | |
| 8 Community Heritage Financial, Inc. | 8 | 174 | 72.0 | 12,536 | 22,595 | 181 | |
| 9 Orrstown Financial Services, Inc. | 21 | 414 | 121.2 | 50,180 | 96,676 | 311 | |
| 10 Queenstown Bank of Maryland | 9 | 96 | 83.8 | 8,045 | 13,464 | 241 | |
| 11 Rosedale Federal Savings and Loan Association | 14 | 155 | 103.6 | 16,060 | 28,430 | 225 | |
| 12 Sandy Spring Bancorp, Inc. | 56 | 1,170 | 135.1 | 158,057 | 261,514 | 418 | |
| 13 Shore Bancshares, Inc. | 42 | 472 | 95.8 | 45,199 | 79,490 | 269 | |
| 14 Farmers & Merchants Bancorp, Inc. | 37 | 417 | 73.5 | 30,651 | 60,727 | 252 | |
| 15 The Farmers Bank of Willards | 8 | 77 | 86.5 | 6,660 | 13,034 | 274 | |
| 16 Woodsboro Bank | 5 | 63 | 87.8 | 5,530 | 10,208 | 238 | |
| 17 | | | 25th Percentile | 113.9 | 60,437 | 116,676 | 242 |
| 18 | | | 75th Percentile | 79.8 | 9,769 | 16,061 | 336 |
| 19 | | Average | 95 | 1,911 | 101.6 | 241,627 | 431,559 |
| 20 | | Median | 14 | 258 | 91.8 | 23,821 | 41,113 |

NOTE: If GAAP data is not available at the holding company level, bank holding company regulatory data or bank regulatory data is used.

Source: S&P Capital IQ Pro



MARYLAND BANKING SCHOOL BANK EMERGING TRENDS

July 31, 2023

CONFIDENTIAL

Performance
Measurement



Strategic
Management



Profit & Process
Improvement



Management
Advisory



Financial
Advisory



DISCLOSURE STATEMENT

FORWARD LOOKING STATEMENTS

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Source: The Kafafian Group, Inc



SECTION I

EMERGING TRENDS

NOTABLE THEMES FOR 2023

WHERE IS THE INDUSTRY HEADED?

01. CHANGING POLITICAL ENVIRONMENT

02. CHALLENGING ECONOMIC ENVIRONMENT

03. BALANCE SHEET MANAGEMENT IN ROUGH WATERS

04. ECONOMIC SLOWDOWN - TIME TO MAKE STRATEGIC INVESTMENTS?

05. DEPOSITS DRIVE VALUE

06. BUILD A BANK THAT MATTERS

07. TECHNOLOGY

08. INDUSTRY CONSOLIDATION

CHANGING POLITICAL ENVIRONMENT

CONSUMER FINANCIAL PROTECTION BUREAU DIRECTOR ROHIT CHOPRA THOUGHTS



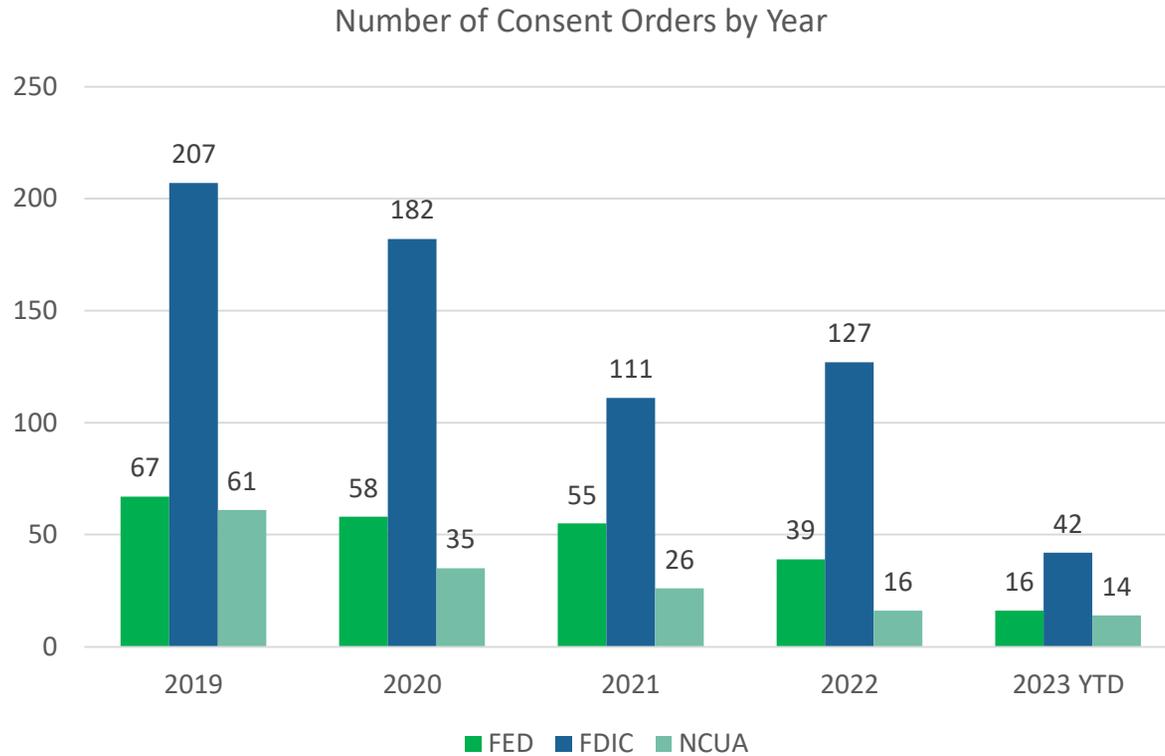
“Regulators should consider creating automatic triggers to slow down some risky activity”

- Chopra said financial regulators can do more than they have done recently to punish bad actors but have allowed certain congressionally-endowed authorities to remain "dormant." Specifically, he said, regulators should do more to "kick the tires" on actions related to executive compensation.

Source: American Banker

CHANGING POLITICAL ENVIRONMENT

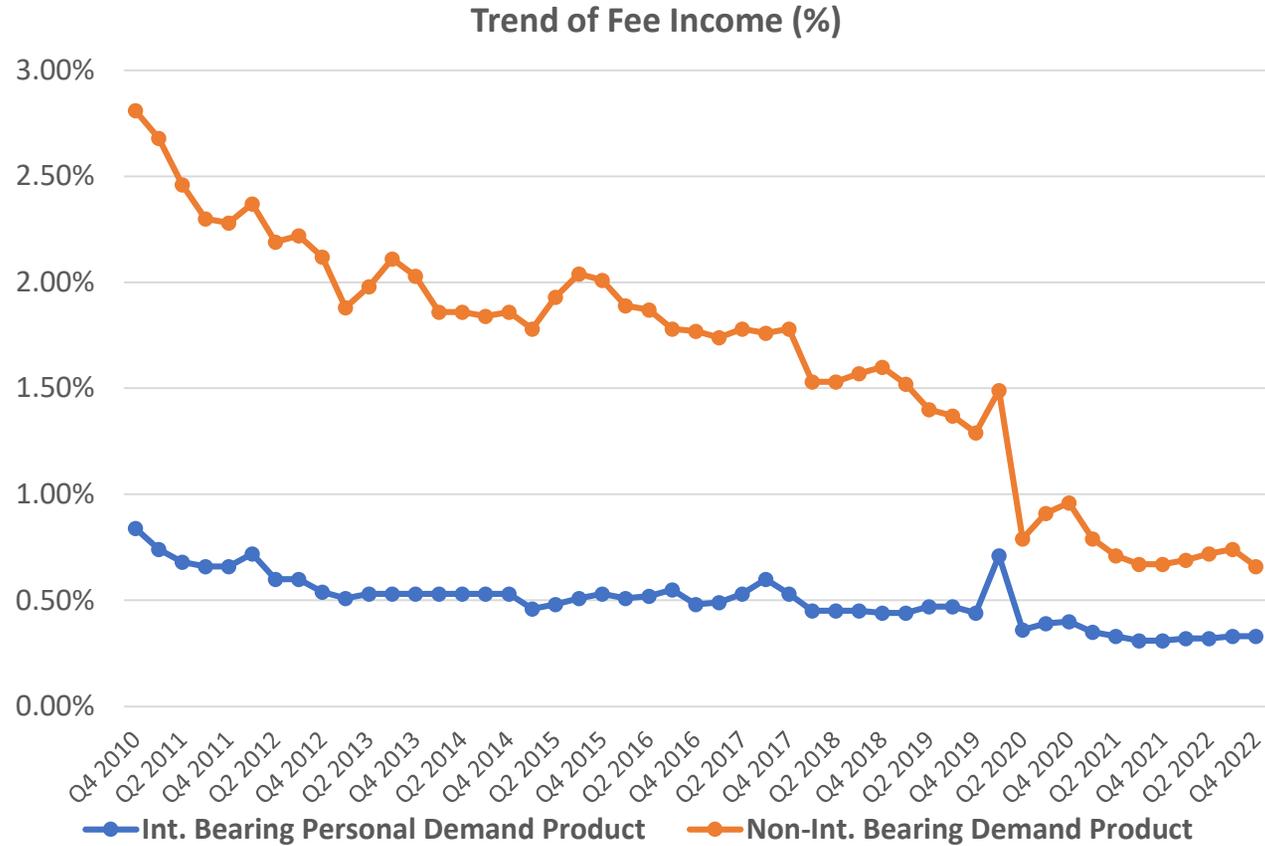
TREND OF ENFORCEMENT ACTIONS



Source: Federal Reserve, FDIC & NCUA as of 7/11/2023

CHANGING POLITICAL ENVIRONMENT

TREND OF FEE INCOME AS A PERCENT OF DEPOSIT BALANCES



Source: Peer Group Comparison Detail Product Profitability Trend, The Kafafian Group, Inc.

CHANGING POLITICAL ENVIRONMENT

SHIFTING REGULATORY PRIORITIES AT THE FEDERAL RESERVE, FDIC AND OCC

Banking regulators are expected to focus on capital requirements and resolvability for regional banks among other key topics in 2023. The Federal Reserve, Federal Deposit Insurance Corp. and Office of the Comptroller of the Currency will also be paying attention to stablecoins and other types of cryptocurrency, climate-related financial risks, new rules related to the Community Reinvestment Act, and a revamp of M&A review procedures.

Bank Regulatory Agenda for 2023



Capital requirements



M&A reviews



Cryptocurrency regulation



Resolvability of regional banks



Community Reinvestment Act



Climate-related financial risks

Sources: Regulators' public comments and bank attorneys.
© 2022 S&P Global.

Source: S&P Capital IQ Pro, Bank regulatory agendas in 2023 include capital requirements, resolvability, Dec. 28, 2022

CHALLENGING ECONOMIC ENVIRONMENT

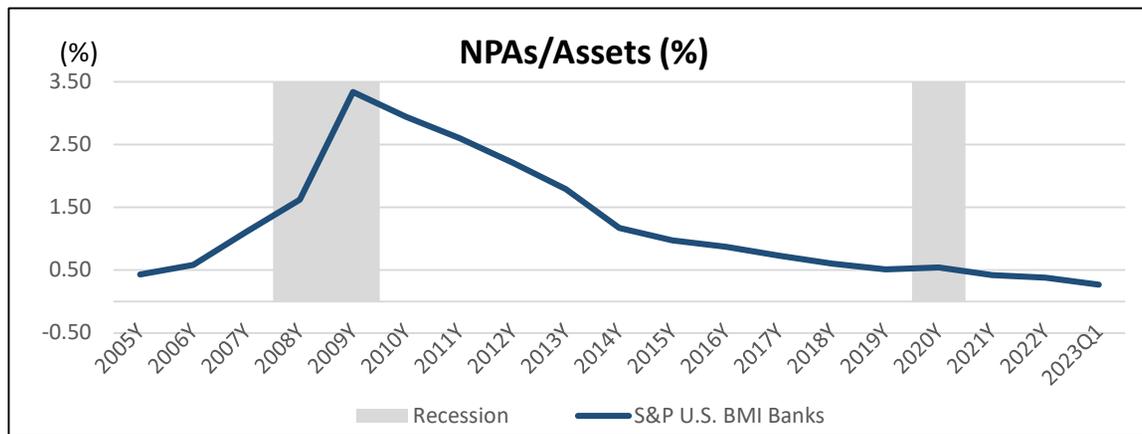
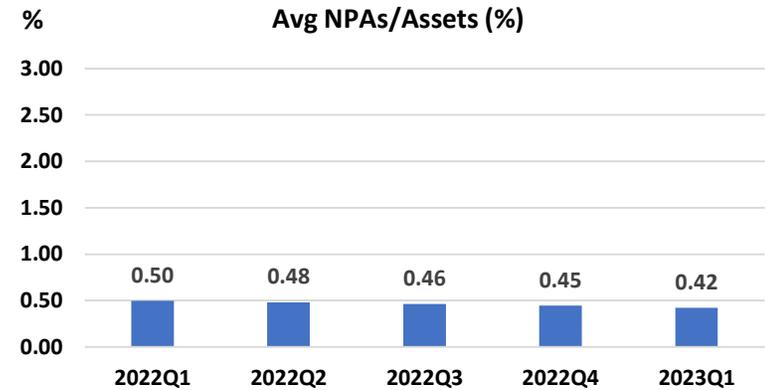
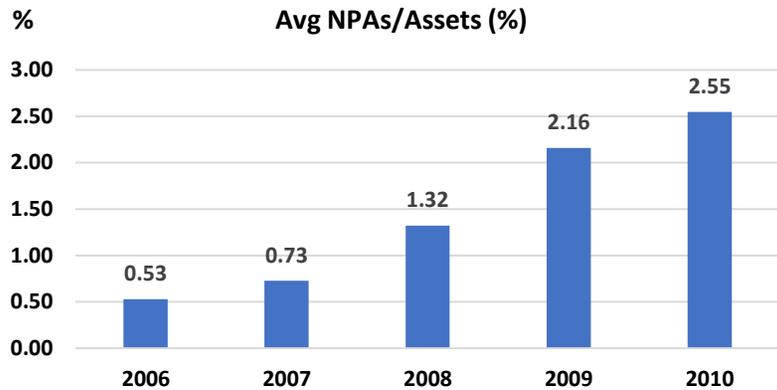
ECONOMIC OUTLOOK



Source: Stifel Investment Strategy Brief, May 2023

CHALLENGING ECONOMIC ENVIRONMENT

CREDIT QUALITY DURING RECESSION PERIOD



Source: S&P Capital IQ Pro, FDIC Insured Commercial and Savings Banks, shaded areas represent recession periods

CHALLENGING ECONOMIC ENVIRONMENT

QUARTERLY COMMERCIAL REAL ESTATE OCCUPANCY RATES FROM Q1 2003 TO Q2 2023

12.9% of office space is vacant, marking the sixth straight quarter the rate has increased and up from a post-financial-crisis low of 9.4% in the second quarter of 2019, CoStar Group reports. "Today's hybrid work arrangements mean that the same office can support more workers," CoStar reported.

U.S. office vacancy rate

Quarterly; Q1 2003 to Q2 2023



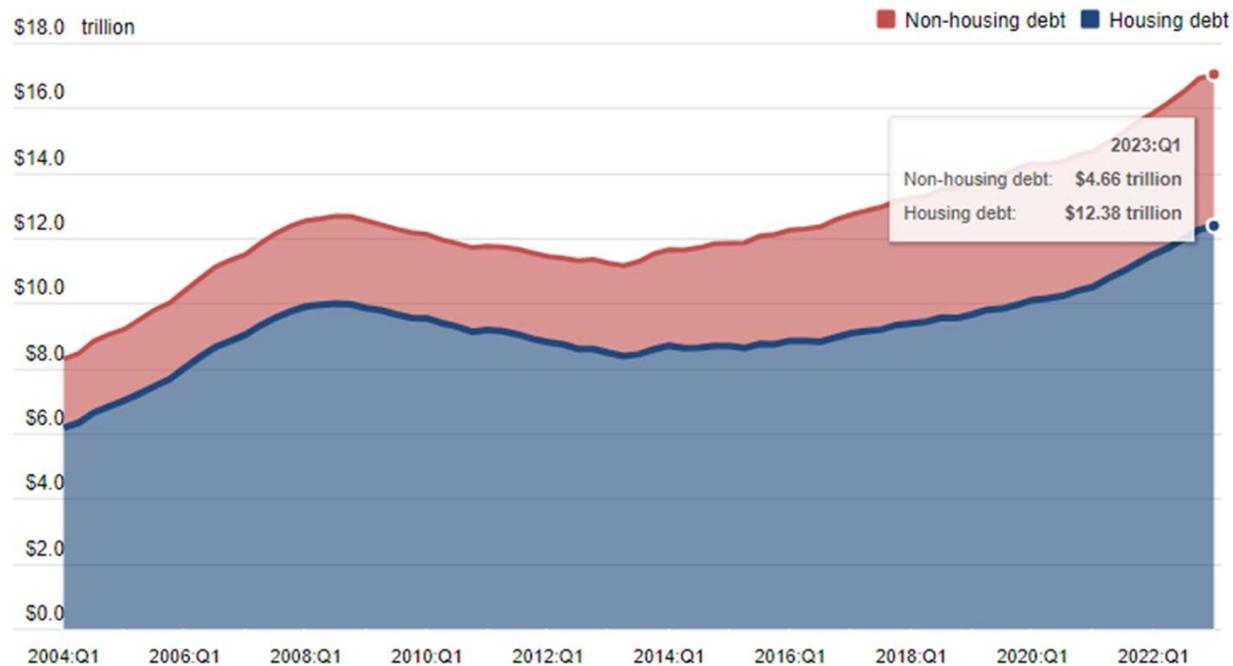
Source: Axios.com

CHALLENGING ECONOMIC ENVIRONMENT

CONSUMER DEBT FROM Q1 2004 TO Q1 2023

Total household debt rose by \$148 billion, or 0.9 percent, to \$17.05 trillion in the first quarter of 2023, according to the latest Quarterly Report on Household Debt and Credit. Mortgage balances climbed by \$121 billion and stood at \$12.04 trillion at the end of March. Auto loan and student loan balances also increased to \$1.56 trillion and \$1.60 trillion, respectively, but credit card balances were flat at \$986 billion.

Total Debt Balance

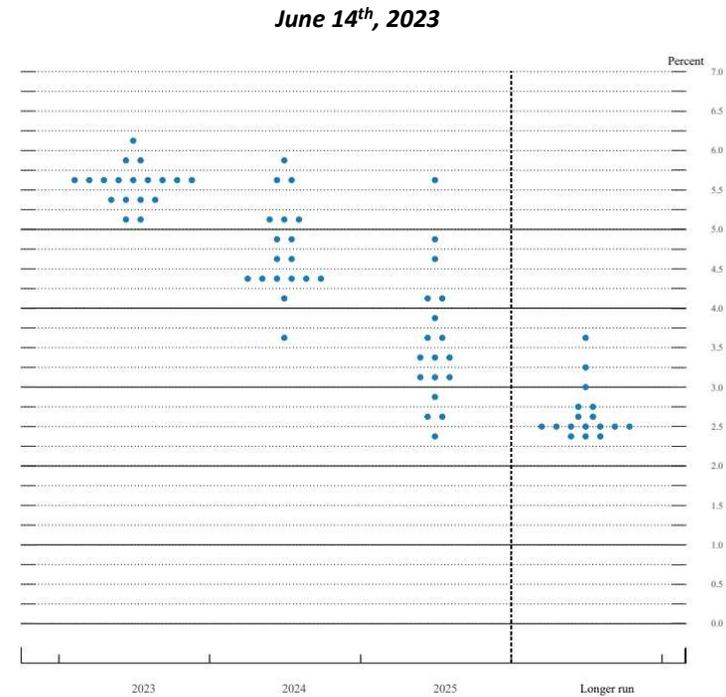
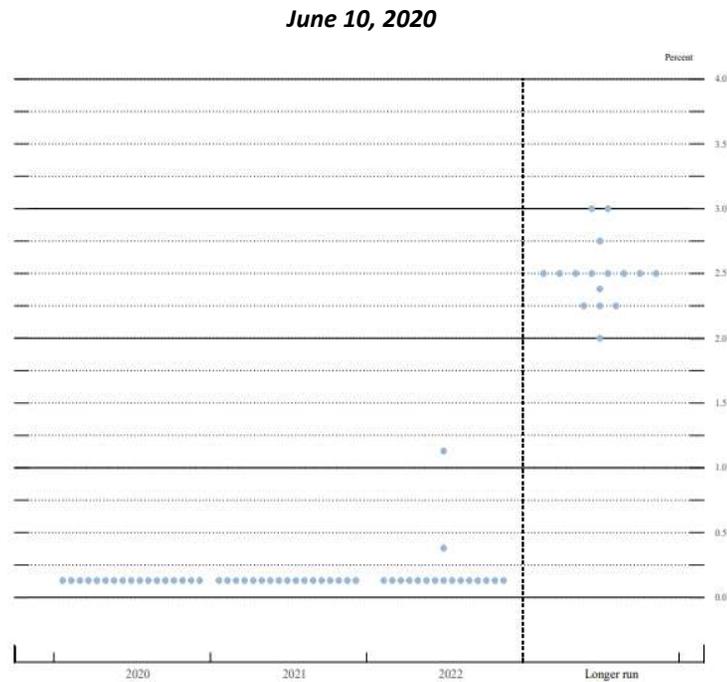


Source: www.newyorkfed.org, FRBNY Consumer Credit Panel/Equifax

CHALLENGING ECONOMIC ENVIRONMENT

THE IMPACT ON BANK PROFITABILITY / BALANCE SHEETS

“The Federal Open Market Committee (FOMC) is firmly committed to fulfilling its statutory mandate from the Congress of promoting maximum employment, stable prices, and moderate long-term interest rates.” FOMC Statement on Monetary Policy adopted January 24, 2012 and reaffirmed on January 31, 2023

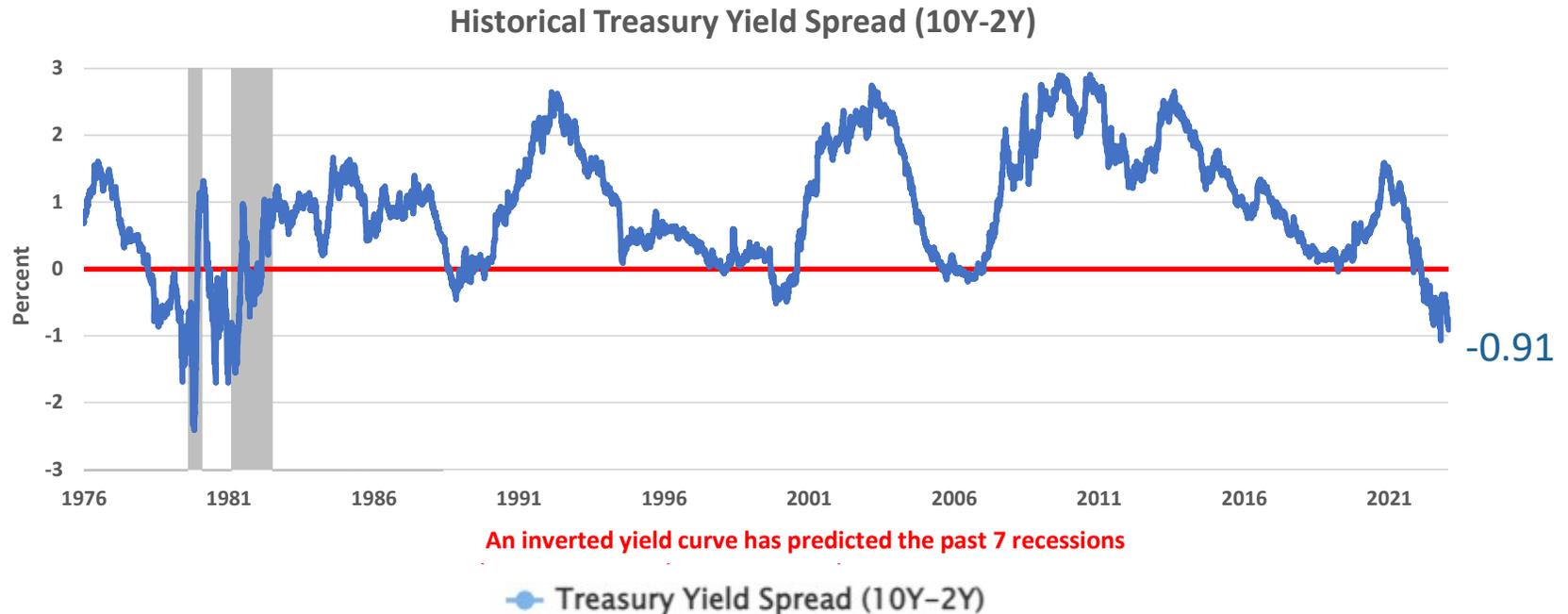


Source: The Kafafian Group, Inc. review of FOMC meeting minutes

CHALLENGING ECONOMIC ENVIRONMENT

U.S. TREASURY CURVE

There is no incentive to extend from 6-months to 30 years, unless the sentiment is long-term rates will drop due to recessionary pressures and investors can lock in for the long haul. Inhibits a bank's ability to make money by taking interest rate risk.



Source: GuruFocus.com and FRED as of 6/15/2023

CHALLENGING ECONOMIC ENVIRONMENT

MATURITY/RATE MISMATCH

| | Q4 2021 | Q1 2022 | Change Prior Qtr | Q2 2022 | Q3 2022 | Q4 2022 | Change Prior Yr |
|-----------------------------------|----------------|----------------|---------------------|----------------|----------------|----------------|--------------------|
| TOTAL FUNDS - MARKET BASIS | | | | | | | |
| TOTAL FUNDS USED | | | | | | | |
| Interest Yield on Assets - FTE | 3.06 % | 3.10 % | 0.04 % | 3.26 % | 3.60 % | 3.97 % | 0.91 % |
| Cost of Funds Used | 1.23 % | 1.27 % | 0.04 % | 1.58 % | 1.98 % | 2.37 % | 1.14 % |
| Funds Used Margin - FTE | 1.84 % | 1.82 % | (0.02)% | 1.68 % | 1.63 % | 1.60 % | (0.24)% |
| TOTAL FUNDS PROVIDED | | | | | | | |
| Credit for Funds Provided | 1.37 % | 1.43 % | | 1.72 % | 2.22 % | 2.76 % | 1.39 % |
| Interest Cost of Liabilities | 0.26 % | 0.24 % | (0.02)% | 0.25 % | 0.36 % | 0.70 % | 0.44 % |
| Funds Provided Margin | 1.08 % | 1.18 % | 0.10 % | 1.46 % | 1.84 % | 2.08 % | 1.00 % |
| Maturity/Rate Mismatch | (0.15)% | (0.17)% | (0.02)% | (0.14)% | (0.24)% | (0.39)% | 1.00 % |
| Total Funds Margin - FTE | 2.78 % | 2.86 % | 0.08 % | 3.02 % | 3.23 % | 3.26 % | 0.48 % |

Source: Peer Group Comparison Detail Product Profitability Trend, The Kafafian Group, Inc.

BALANCE SHEET MANAGEMENT IN ROUGH WATERS

FORTRESSING YOUR BALANCE SHEET

Economists and CEOs entered 2023 bracing for a recession. But a streak of positive economic data has prompted forecasters to push back calls for a downturn. However, strategists expect falling inflation could hurt margins the threat of a recession, while less likely, still remains to a lesser degree. The following are steps banks can take to be better prepared.

TKG article “Build a Moat Around Your Balance Sheet”

- Strengthen liquidity position
- Review lending practices
- Decrease leverage
- Increase capital
- Prepare for a decline in asset values

TKG Podcast “Is Your Loan Portfolio Ready for the Next Recession?”

- Maintain strong underwriting
- Use data analytics
- Incent on risk adjusted returns

Source: <https://kafafiangroup.com/2023/04/30/build-a-moat-around-your-balance-sheet/> and <https://kafafiangroup.com/2019/05/28/is-your-loan-portfolio-ready-for-the-next-recession/>

BALANCE SHEET MANAGEMENT IN ROUGH WATERS

FDIC SENIOR LENDER SURVEY

Over the past three months, how have your bank's credit standards for approving applications for C&I loans or credit lines - other than those to be used to finance mergers and acquisitions - to large and middle-market firms and to small firms changed?

Apart from normal seasonal variation, how has demand for C&I loans changed over the past three months? (Please consider only funds actually disbursed as opposed to requests for new or increased lines of credit.)

Standards for small firms (annual sales of less than \$50 million)

| | All Respondents | | Large Banks | | Other Banks | |
|------------------------------|-----------------|------------|-------------|------------|-------------|------------|
| | Banks | Percent | Banks | Percent | Banks | Percent |
| Tightened considerably | 2 | 3.3 | 0 | 0.0 | 2 | 6.7 |
| Tightened somewhat | 27 | 45.0 | 16 | 53.3 | 11 | 36.7 |
| Remained basically unchanged | 30 | 50.0 | 14 | 46.7 | 16 | 53.3 |
| Eased somewhat | 1 | 1.7 | 0 | 0.0 | 1 | 3.3 |
| Eased considerably | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 |
| Total | 60 | 100 | 30 | 100 | 30 | 100 |

For this question, 3 respondents answered "My bank does not originate C&I loans or credit lines to small firms."

Demand for C&I loans from small firms (annual sales of less than \$50 million)

| | All Respondents | | Large Banks | | Other Banks | |
|------------------------|-----------------|------------|-------------|------------|-------------|------------|
| | Banks | Percent | Banks | Percent | Banks | Percent |
| Substantially stronger | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 |
| Moderately stronger | 5 | 8.3 | 3 | 10.0 | 2 | 6.7 |
| About the same | 18 | 30.0 | 10 | 33.3 | 8 | 26.7 |
| Moderately weaker | 34 | 56.7 | 17 | 56.7 | 17 | 56.7 |
| Substantially weaker | 3 | 5.0 | 0 | 0.0 | 3 | 10.0 |
| Total | 60 | 100 | 30 | 100 | 30 | 100 |

Source: www.federalreserve.gov/data/documents/sloos-202304-table1.pdf, April 2023

BALANCE SHEET MANAGEMENT IN ROUGH WATERS

K BANK (MARYLAND) - FINANCIAL TRENDS FROM 2006 TO 2010 Q3

| | At December 31, | | | | |
|--|-----------------|---------|---------|---------|----------|
| | 2006 | 2007 | 2008 | 2009 | 2010 Q3 |
| Balance Sheet (\$000) | | | | | |
| 1 Total Assets | 656,681 | 659,422 | 672,728 | 612,255 | 538,258 |
| 2 Total Loans & Leases | 504,515 | 527,118 | 555,633 | 472,855 | 417,619 |
| 3 Total Deposits | 569,623 | 566,196 | 563,672 | 528,674 | 500,056 |
| Profitability (%) | | | | | |
| 4 ROAA | 1.38 | 0.06 | (3.67) | (3.48) | (4.55) |
| 5 ROAE | 16.38 | 0.69 | (44.13) | (72.82) | (260.40) |
| 6 Cost of Funds | 3.77 | 4.53 | 3.76 | 3.09 | 2.15 |
| 7 Yield on Loans | 10.04 | 9.33 | 6.73 | 5.34 | 4.82 |
| Balance Sheet Ratios/ Capital (%) | | | | | |
| 8 Loans/ Deposits | 88.57 | 93.10 | 98.57 | 89.44 | 83.51 |
| Asset Quality (%) | | | | | |
| 9 NPAs/ Assets | 3.44 | 5.96 | 12.22 | 20.23 | 24.31 |
| 10 NCOs/ Avg Loans | 0.38 | 1.97 | 2.84 | 3.38 | 2.39 |

Source: S&P Capital IQ Pro

BALANCE SHEET MANAGEMENT IN ROUGH WATERS

SANDY SPRING BANK (MARYLAND) - FINANCIAL TRENDS FROM 2006 TO 2010 Q3

| | At December 31, | | | | 2010 Q3 |
|--|-----------------|-----------|-----------|-----------|-----------|
| | 2006 | 2007 | 2008 | 2009 | |
| Balance Sheet (\$000) | | | | | |
| 1 Total Assets | 2,609,042 | 3,035,925 | 3,308,538 | 3,631,186 | 3,604,867 |
| 2 Total Loans & Leases | 1,816,175 | 2,277,949 | 2,498,676 | 2,310,508 | 2,204,441 |
| 3 Total Deposits | 1,998,200 | 2,281,688 | 2,369,470 | 2,697,853 | 2,639,937 |
| Profitability (%) | | | | | |
| 4 ROAA | 1.32 | 1.14 | 0.51 | (0.40) | 0.96 |
| 5 ROAE | 15.10 | 11.92 | 5.05 | (3.72) | 8.90 |
| 6 Cost of Funds | 2.52 | 2.90 | 2.14 | 1.61 | 0.87 |
| 7 Yield on Loans | 7.05 | 7.24 | 6.13 | 5.25 | 5.25 |
| Balance Sheet Ratios/ Capital (%) | | | | | |
| 8 Loans/ Deposits | 90.89 | 99.84 | 105.45 | 85.64 | 83.50 |
| Asset Quality (%) | | | | | |
| 9 NPAs/ Assets | 0.08 | 0.77 | 2.15 | 3.37 | 2.36 |
| 10 NCOs/ Avg Loans | 0.01 | 0.06 | 0.32 | 2.60 | 1.18 |

Source: S&P Capital IQ Pro

ECONOMIC SLOWDOWN - TIME TO MAKE STRATEGIC INVESTMENTS?

S&P GLOBAL MARKET INTELLIGENCE – US COMMUNITY BANK MARKET REPORT (MAY 2023)

S&P Capital IQ **PRO**

Key Findings:

- US community bank earnings are expected to fall 22.6% in 2023 as deposit outflows and notably higher deposit costs weigh non net interest margins, while credit trends begin to normalize.
- Higher interest rates have boosted loan yields but have also led to growing pressures on bank liquidity. Funding costs will rise at a quicker pace than earning-asset yields in 2023, causing net interest margins to contract by 33 basis points in 2023.
- Deposit betas, or the percentage of rate changes banks pass on to customers, will more than triple the level witnessed in 2022 due to liquidity pressures in the market.

Source: S&P Global Market Intelligence – US Community Bank Market Report, May 2023; CIQ Pro: S&P Global Market Intelligence Inc. (spglobal.com)

ECONOMIC SLOWDOWN - TIME TO MAKE STRATEGIC INVESTMENTS?

S&P GLOBAL MARKET INTELLIGENCE – US COMMUNITY BANK MARKET REPORT (MAY 2023)

S&P Capital IQ ^{PRO}

Community bank aggregate profitability metrics (%)

| | 2022A | 2023P | 2024P | 2025P | 2026P | 2027P |
|---------------------|-------|--------|-------|-------|-------|-------|
| Efficiency ratio | 60.63 | 64.15 | 61.19 | 62.26 | 61.53 | 61.24 |
| Net interest margin | 3.46 | 3.13 | 3.33 | 3.23 | 3.26 | 3.21 |
| ROAA | 1.23 | 0.93 | 1.02 | 1.12 | 1.14 | 1.19 |
| ROAE | 12.82 | 9.57 | 10.22 | 11.00 | 11.10 | 11.34 |
| YOY earnings growth | -4.20 | -22.55 | 11.54 | 11.95 | 4.56 | 5.87 |

Data compiled May 2, 2023.

A = actual; P = projected

Source: S&P Global Market Intelligence – US Community Bank Market Report, May 2023; CIQ Pro: S&P Global Market Intelligence Inc. (spglobal.com)

ECONOMIC SLOWDOWN - TIME TO MAKE STRATEGIC INVESTMENTS? STRATEGIC BETS

BUILD OUR OWN SMALL BUSINESS LOAN PLATFORM



- Could be transformative, yet a company can walk away from them.
- Strategic bet that worked: Think Apple's entry into mobile phones, now 47% of their revenues.
- Strategic bets that didn't work: Think New Coke.

Source: StartEngine, OnDeck, SBA websites.

ECONOMIC SLOWDOWN - TIME TO MAKE STRATEGIC INVESTMENTS?

STRATEGIC BETS

BUILD OUR OWN SMALL BUSINESS LOAN PLATFORM

| | |
|--|-----------|
| Capital Expenditures: | |
| 1. Platform development: | \$50,000 |
| 2. OnDeck white label: | 50,000 |
| 3. SBA/Small Business loan platform: | 100,000 |
| Total: | \$200,000 |
| Holding Co Equity Investment (StartEngine) | \$500,000 |

| | Year 1 (6 mos) | Year 2 | Year 3 | Year 4 |
|---|-------------------|---------|---------|---------|
| Projected Income Statement Impact (000): | | | | |
| Interest Income: SBA Retained Balances | \$35 | \$350 | \$385 | \$424 |
| FTP - Cost of Funds | 18 | 175 | 193 | 212 |
| Net Interest Income | \$18 | \$175 | \$193 | \$212 |
| Provision | \$10 | \$100 | \$110 | \$121 |
| SBA Gain on Sale | \$250 | \$2,000 | \$2,200 | \$2,420 |
| SBA Servicing Fees | 5 | 200 | 220 | 242 |
| OnDeck Origination Fees | 10 | 20 | 24 | 29 |
| Gain on StartEngine Equity Investment | 25 | 50 | 50 | 50 |
| Fee Income | \$290 | \$2,270 | \$2,494 | \$2,741 |
| Salaries and Benefits | \$273 | \$561 | \$578 | \$596 |
| Annual Small Business Lending Solution | 50 | 100 | 103 | 106 |
| Depreciation | 25 | 50 | 50 | 50 |
| Occupancy | 25 | 50 | 52 | 53 |
| Marketing/Business Development | 100 | 90 | 95 | 100 |
| Miscellaneous | 25 | 55 | 57 | 58 |
| Incentive Compensation | 0 | 154 | 175 | 199 |
| Incremental Expenses | \$498 | \$1,060 | \$1,110 | \$1,162 |
| Pre-tax Profit (Loss) | (\$200) | \$1,285 | \$1,467 | \$1,670 |



Source: StartEngine, OnDeck, SBA websites. Financials are by example only

ECONOMIC SLOWDOWN - TIME TO MAKE STRATEGIC INVESTMENTS?

STRATEGIC BETS - MIDDLESEX FEDERAL SAVINGS



| novo | Traditional Business Bank Accounts |
|--|---|
| ✓ No hidden fees | ✗ Hide monthly or usage fees in the fine print |
| ✓ No monthly fees or minimum balance requirements | ✗ Charge up to \$20 per month in fees |
| ✓ Simple, easy-to-use mobile apps | ✗ Difficult and clunky mobile apps |
| ✓ Apply in under 10 minutes | ✗ Can take weeks to open an account |
| ✓ Human-powered customer service | ✗ Chatbots and automated phone support |
| ✓ Free transfers, mailed checks, and incoming wires | ✗ Charge \$3 per transfer and up to \$25 for incoming wires |
| ✓ Integrates with other small business tools | ✗ Upsell you on only their own, out-of-date products |
| ✓ Refunds all ATM fees | ✗ Charge you \$3 to use out-of-network ATMs |
| ✓ Thousands of dollars in exclusive perks | ✗ Charge you to use their products |
| ✓ Backed with FDIC insurance through Middlesex Federal Savings, F.A. | ✓ Backed with FDIC insurance |

Banking as a Service (BaaS)

- Novo started in 2018 and has received \$135 million in funding.
- Middlesex Federal's (MF) deposits have more than doubled since 2018.
- MF's loan/deposit ratio- 2018: 117%, 1Q23: 82%
- MF's non-int. deposits/deps- 2018: 6%, 1Q23: 62%

Source: S&P Global Market Intelligence. Company website

ECONOMIC SLOWDOWN - TIME TO MAKE STRATEGIC INVESTMENTS?

STRATEGIC BETS - 1ST SECURITY BANK OF WASHINGTON

(\$000)

| Balance Sheet Highlights | 2018 | 2019 | 2020 | 2021 | 2022 | 1Q 2023 |
|--|-------------|-------------|-------------|-------------|-------------|----------------|
| Total Assets | 1,621,478 | 1,712,897 | 2,113,056 | 2,286,020 | 2,632,273 | 2,782,772 |
| Total Loans & Leases (Incl HFI & HFS) | 1,376,067 | 1,419,287 | 1,737,618 | 1,880,021 | 2,239,023 | 2,352,976 |
| Total Deposits (Incl Dom & For) | 1,288,291 | 1,405,275 | 1,697,593 | 1,943,638 | 2,145,847 | 2,463,230 |
| GRB: Total Equity Capital | | | | | | |
| Loans/ Deposits (%) | 106.81 | 101.00 | 102.36 | 96.73 | 104.34 | 95.52 |
| Memo: Full-time Employees | 424 | 452 | 514 | 536 | 537 | 586 |
| Performance Measures | | | | | | |
| Net Income | 25,006 | 23,364 | 40,031 | 38,986 | 31,398 | 8,623 |
| ROAA (%) | 2.03 | 1.41 | 2.07 | 1.78 | 1.29 | 1.26 |
| ROAE (%) | 18.06 | 12.05 | 18.83 | 14.90 | 11.69 | 12.37 |
| Noninterest Income/ Average Assets (%) | 2.06 | 1.21 | 2.61 | 1.73 | 0.69 | 0.76 |
| Noninterest Expense/ Avg Assets (%) | 3.75 | 3.55 | 3.23 | 3.45 | 3.14 | 3.42 |
| Net Interest Margin (%) | 4.37 | 4.55 | 4.10 | 4.17 | 4.49 | 4.71 |
| Efficiency Ratio (FTE) (%) | 59.42 | 64.06 | 48.99 | 59.40 | 61.81 | 63.02 |

BENEFITS

Fewer obstacles. More growth.



Convert more customers

Smaller payments make your services more affordable to your customers.



Close bigger projects

Because customers don't have to pay up front, they don't have to compromise on the scope of their project.



Shorten the sales cycle

Reduce the time customers spend "thinking about it" with flexible payment options that make their choice easy.



Get started

Submit a dealer application online in minutes.

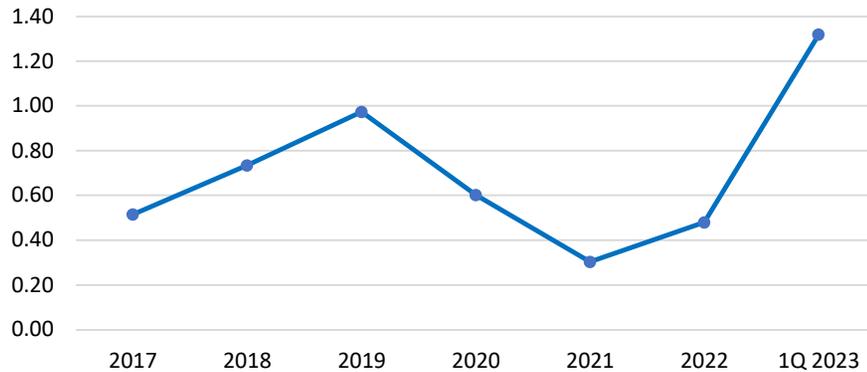
[Apply Now](#)

Source: S&P Global Market Intelligence. Company website

DEPOSITS DRIVE VALUE

COST OF FUNDS

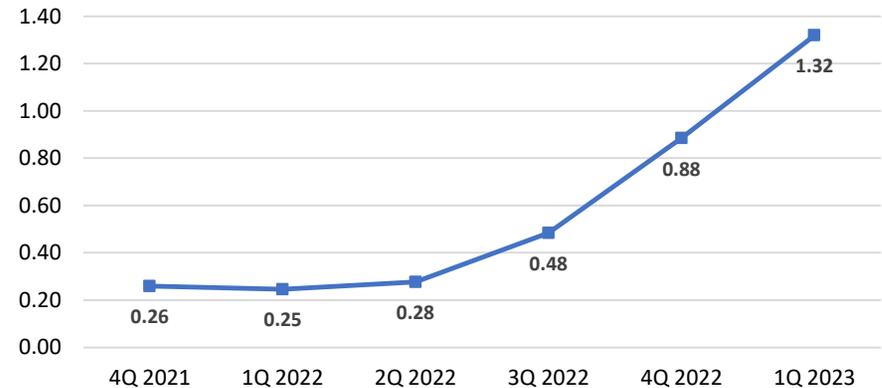
Average Cost of Funds (%)



| FOMC Meeting Date | Rate Change (bps) | Federal Funds Rate |
|-------------------|-------------------|--------------------|
| May 3, 2023 | +25 | 5.00% to 5.25% |
| March 2, 2023 | +25 | 4.75% to 5.00% |
| Feb 1, 2023 | +25 | 4.50% to 4.75% |
| Dec 14, 2022 | +50 | 4.25% to 4.50% |
| Nov 2, 2022 | +75 | 3.75% to 4.00% |
| Sept 21, 2022 | +75 | 3.00% to 3.25% |
| July 27, 2022 | +75 | 2.25% to 2.50% |
| June 16, 2022 | +75 | 1.50% to 1.75% |
| May 5, 2022 | +50 | 0.75% to 1.00% |
| March 17, 2022 | +25 | 0.25% to 0.50% |

Betas grow, sometimes exponentially, at the end of tightening cycles. What are your betas year-to-date?

Average Cost of Funds (%)

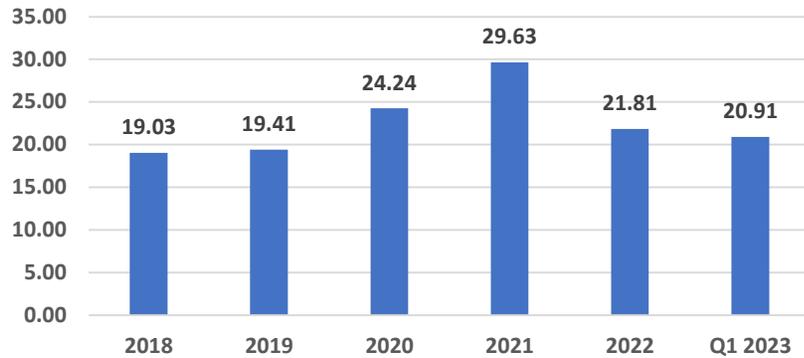


Source: S&P Capital IQ Pro. For Cost of Funds chart, all FDIC-insured banks and savings banks between \$1B-\$10B in total assets. Fed Rate Hikes Table Source: Forbes

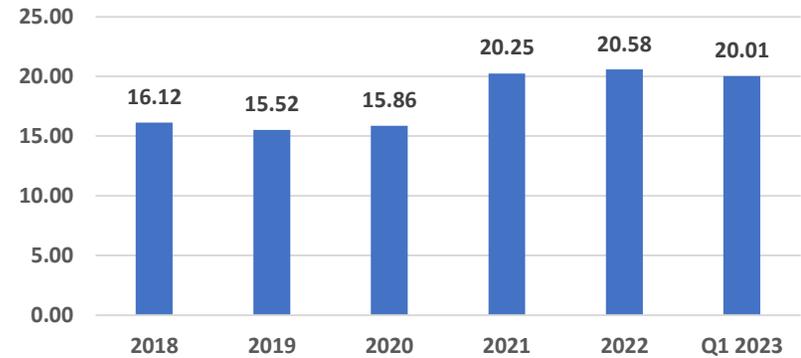
DEPOSITS DRIVE VALUE

LIQUIDITY BY THE NUMBERS

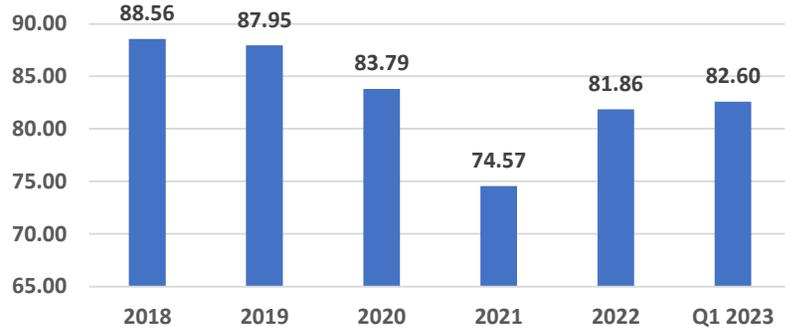
Avg Liquidity Ratio (%)



Avg Securities/Assets (%)



Avg Loans/Deposits (%)



Avg Total Deposits (\$ billions)

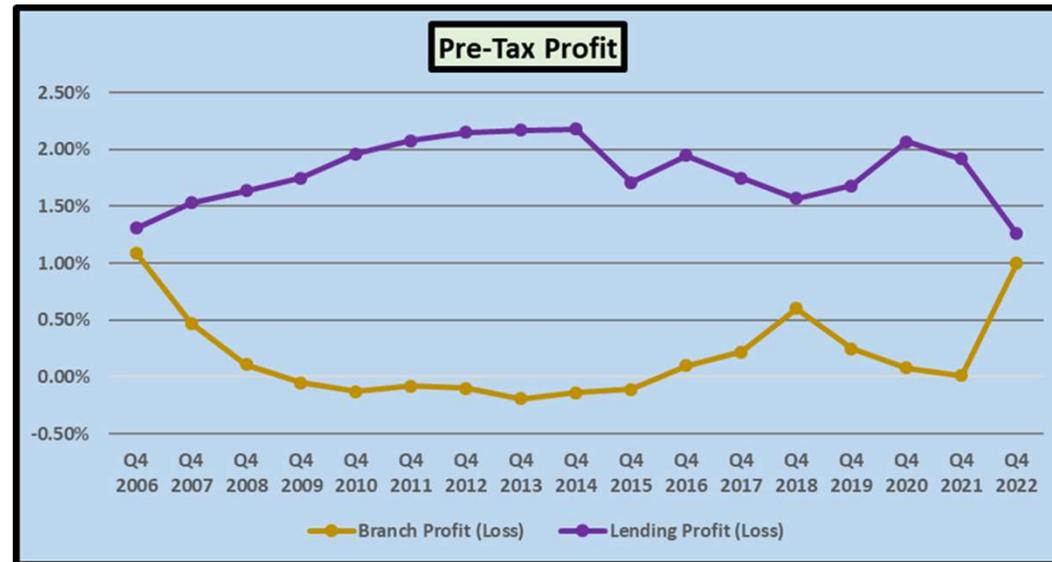


Source: S&P Capital IQ Pro. FDIC-insured banks and savings banks between \$1B-\$10B in total assets.

DEPOSITS DRIVE VALUE

IMPACT OF INTEREST RATES ON ORGANIZATIONAL PROFITABILITY

| Pre-Tax Profit Comparison | | | |
|---------------------------|---------|---------|--------|
| | Q4 2006 | Q4 2022 | Change |
| Branch Organization | 1.09% | 1.00% | -0.09% |
| Lending Organization | 1.31% | 1.26% | -0.05% |



Source: Pre-tax profit as a percent of the product portfolio. Source: The Kafafian Group, Inc.

BUILD A BANK THAT MATTERS

AMERICAN BANKER'S BEST BANKS TO WORK FOR - 8 CORE FOCUS AREAS

The Employee Engagement & Satisfaction Survey consists of approximately 77 statements that employees respond to along with two open-ended and seven demographic questions. This survey makes up the other 75% of the overall score.



Leadership and Planning



Corporate Culture and Communications



Role Satisfaction



Work Environment



Relationship with Supervisor



Training, Development and Resources



Pay and Benefits



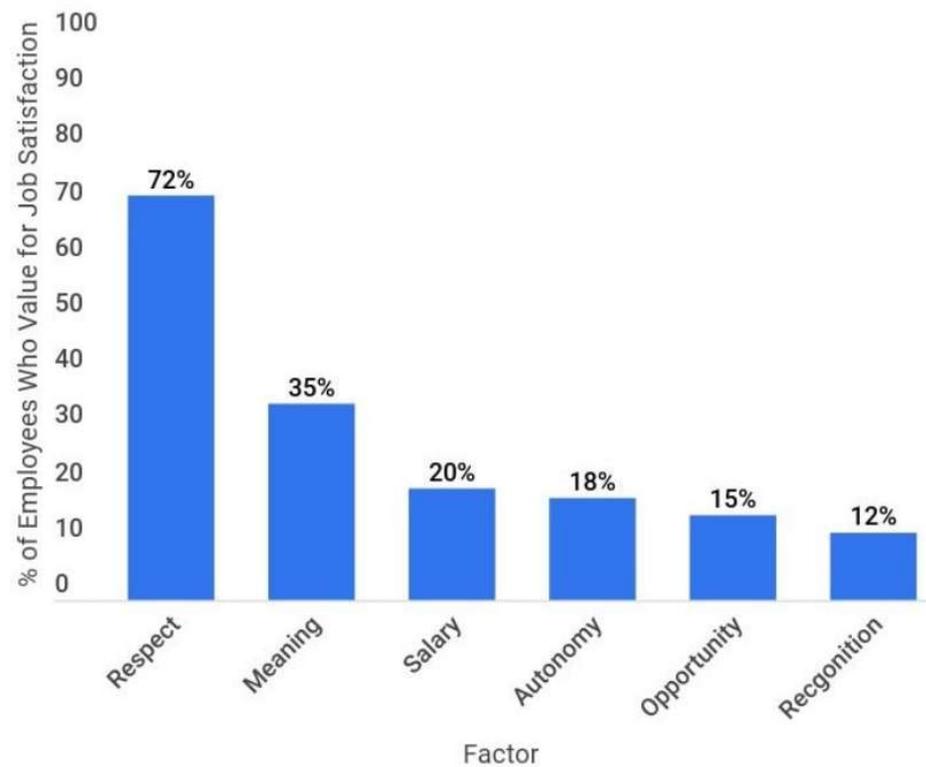
Overall Engagement

Source: American Banker, survey was conducted by bestcompaniesgroup.com

BUILD A BANK THAT MATTERS

IMPORTANT FACTORS FOR JOB SATISFACTION

The U.S. loses an estimated \$550 billion a year due to unhappy employees. For the average company, this equates to 18% lower productivity and 15% lower profitability.



Source: Zippia.com 6/19/2023

BUILD A BANK THAT MATTERS

IMPORTANCE OF SUCCESSION PLANNING

Bank Director's 2023 Compensation Survey, sponsored by Chartwell Partners, surveyed 289 independent directors, CEOs, human resources officers and other executives of U.S. banks below \$100 billion in assets. The survey was conducted in March and April 2023.

- In this year's survey, **41%** of respondents pointed to retaining key people as important compensation-related challenges.
- Concerns about succession planning for the CEO and other key executives ticked up from last year, with **26%** of respondents citing it as a top compensation-related challenge.
- Overall, respondents cited an effective long-term succession plan for the CEO's at **63%** and other key executives at **61%**.
- Looking at their bank's talent pipeline, **65%** feel their organization has a strong bench to prepare for C-suites roles over the next five years.



Source: Bank Director 2023 Compensation Survey

BUILD A BANK THAT MATTERS

SAMPLE OF BANKS THAT SOLD 10 YEARS AGO

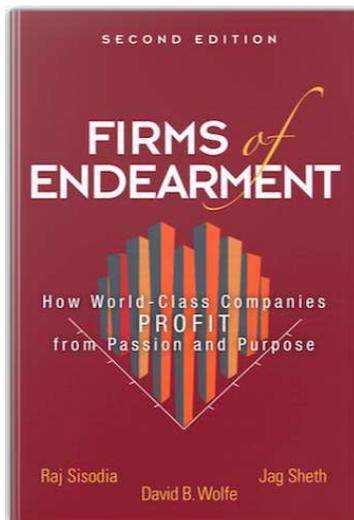


Source: Jeff4banks.com

BUILD A BANK THAT MATTERS

CHARACTERISTICS FROM FIRMS OF ENDEARMENT

“Endearing companies tend to be enduring companies”



- They align the interest of all stakeholder groups.
- Their executive salaries are relatively modest.
- They operate an open door policy to reach top management.
- Their employee compensation and benefits are high for the category; and their employee training is longer; and their employee turnover is lower.
- They hire people who are passionate about customers.
- They view suppliers as true partners who collaborate in improving productivity, quality, and lowering costs.
- They believe that their corporate culture is their greatest asset and primary source of their competitive advantage.
- Their marketing costs are much lower than their peers while customer satisfaction and retention is much higher.

Source: Firmsofendearment.com

BUILD A BANK THAT MATTERS

IT IS NOT A ZERO-SUM GAME



Source: The Kafafian Group, Inc.

BUILD A BANK THAT MATTERS

TOP 10 BANK BRAND VALUE FOR BANKS IN THE U.S.

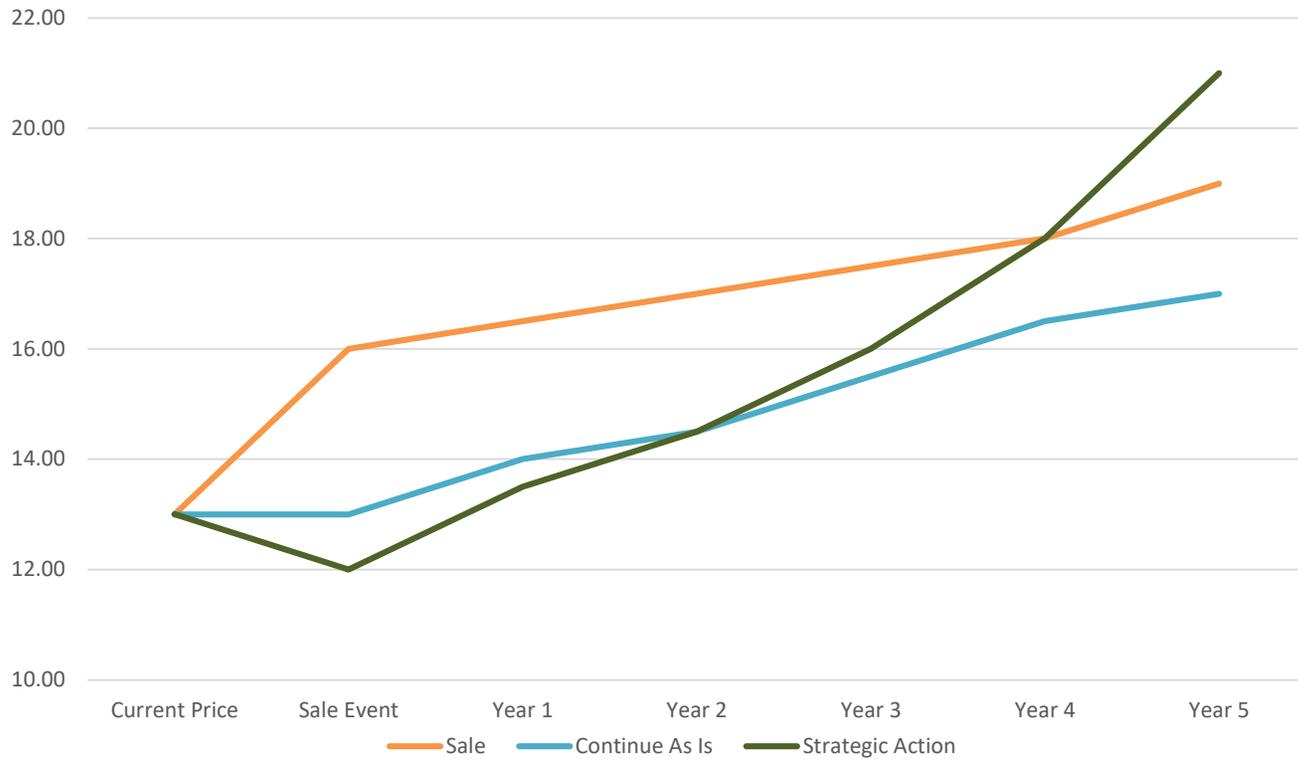
U.S. banks account for nearly a quarter of the total brand value in the Brand Finance Banking 2022 ranking, with a brand value of \$313.7 billion. The Brand Finance Global Brand Equity Monitor conducts research on more than 5,000 brands across 29 sectors and 36 countries. The firm uses a complex methodology that considers multiple contributions to brand value, including what brands pay in royalty agreements and an analysis of how brands impact profitability. It then considers brand strength by reflecting three core pillars of inputs, equity and output before assigning a score based on both brand impact and brand strength.

| U.S. Bank Brand | Brand Value 2022 (in billions) | U.S. Rank 2022 | Global Rank 2022 | Market Cap (in billions) | Brand Value as % of Market Cap |
|-----------------|--------------------------------|----------------|------------------|--------------------------|--------------------------------|
| Bank of America | \$36.70 | 1 | 5 | \$319.93 | 11.50% |
| Citi | \$34.40 | 2 | 6 | \$100.36 | 34.30% |
| Chase | \$30.10 | 3 | 7 | \$392.43 | 7.70% |
| Wells Fargo | \$30.10 | 4 | 8 | \$185.25 | 16.20% |
| JP Morgan | \$28.90 | 5 | 9 | \$392.43 | 7.40% |
| Capital One | \$17.50 | 6 | 15 | \$54.24 | 32.30% |
| Goldman Sachs | \$16.40 | 7 | 16 | \$108.60 | 15.10% |
| Morgan Stanley | \$12.50 | 8 | 22 | \$149.74 | 8.30% |
| U.S. Bank | \$10.10 | 9 | 31 | \$77.59 | 13.00% |
| PNC | \$9.20 | 10 | 37 | \$77.31 | 11.90% |

Source: Thefinancialbrand.com

BUILD A BANK THAT MATTERS

STRATEGY PYRAMID – FINANCIAL PROJECTIONS

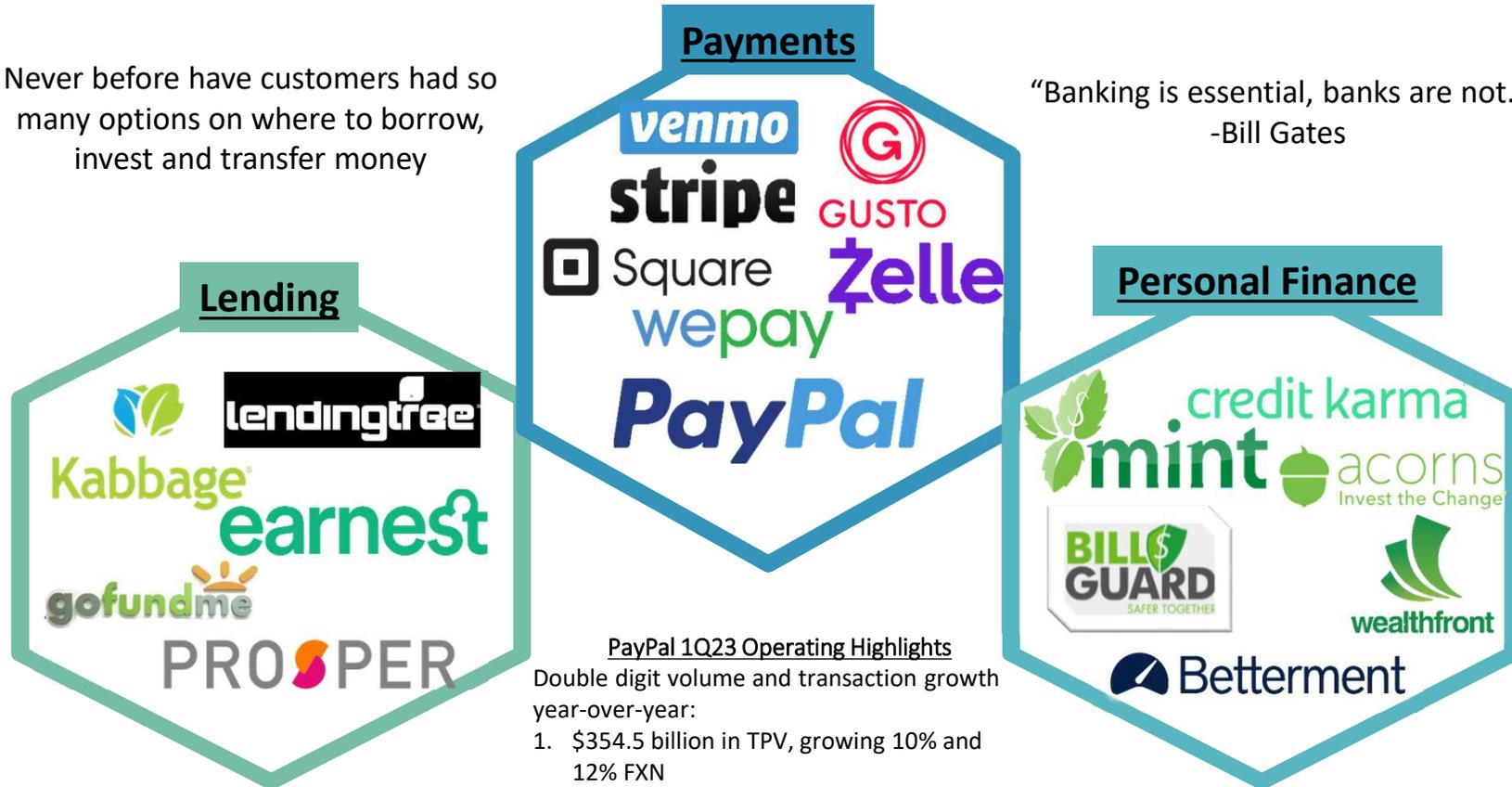


Source: S&P Capital IQ Pro

TECHNOLOGY

COMPETITION WITH TRADITIONAL BANKING

Never before have customers had so many options on where to borrow, invest and transfer money



PayPal 1Q23 Operating Highlights
 Double digit volume and transaction growth year-over-year:

1. \$354.5 billion in TPV, growing 10% and 12% FXN
2. 5.8 billion payment transactions, up 13%
3. 433 million total active accounts, up 1%

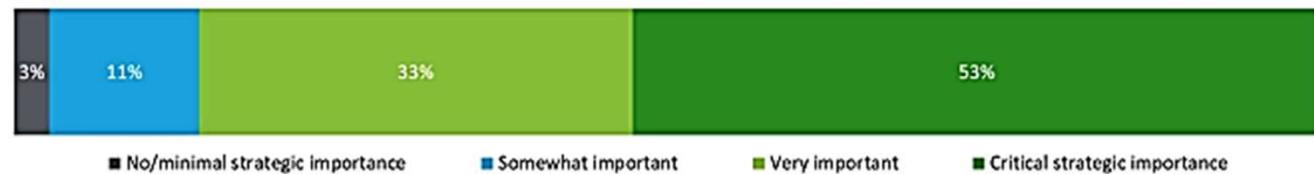
Source: Financial Stability Board, CNBC, PayPal Earnings Release

TECHNOLOGY

THE RAPID EVOLUTION OF ARTIFICIAL INTELLIGENCE

IT'S NOT JUST A THING FROM "TERMINATOR" – IT'S HAPPENING NOW

How artificial intelligence ("AI") is viewed by financial services executives



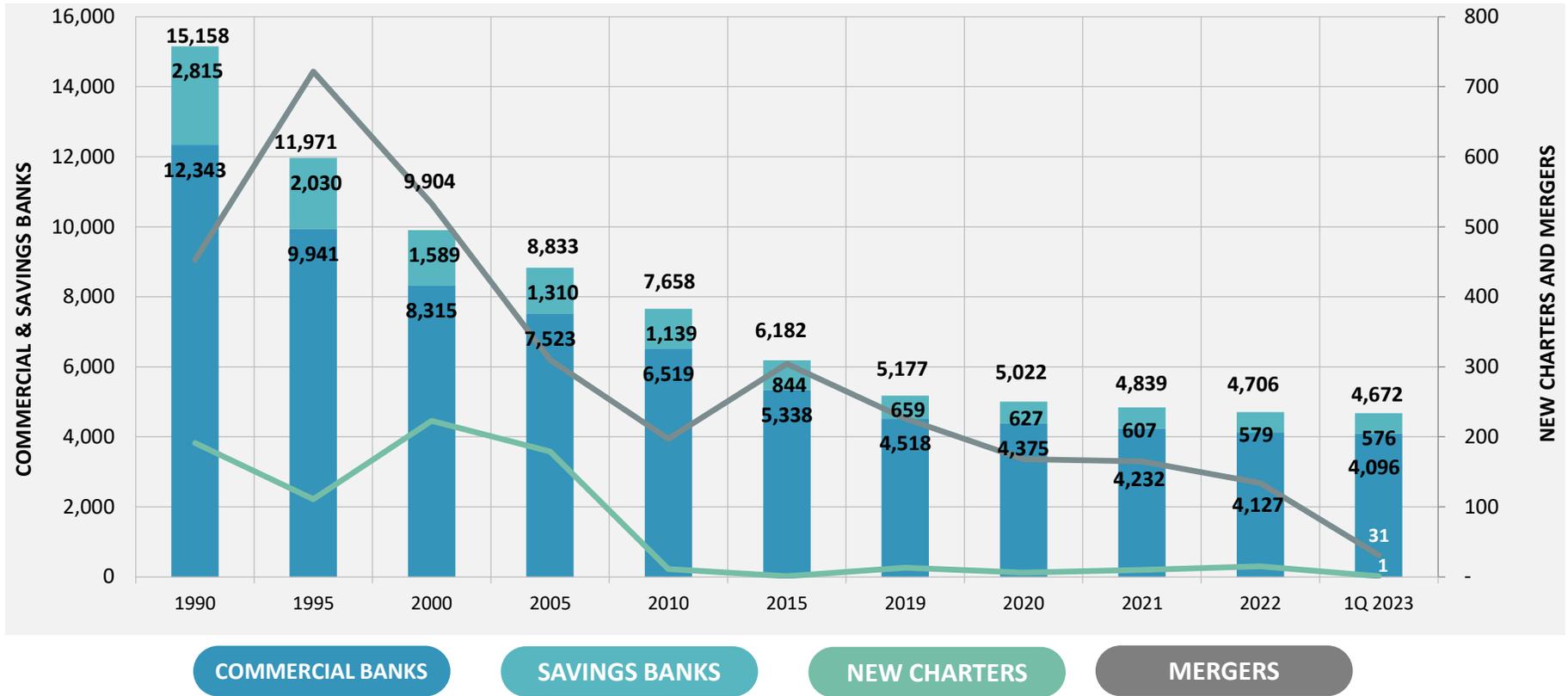
Where and how robotic process automation ("RPA") meets AI and machine learning ("ML")



Source: The Kafafian Group, Inc. review of Deloitte "Artificial Intelligence: Transforming the Future of Banking 2021"

INDUSTRY CONSOLIDATION

NUMBER OF INSTITUTIONS, NEW CHARTERS, AND MERGERS

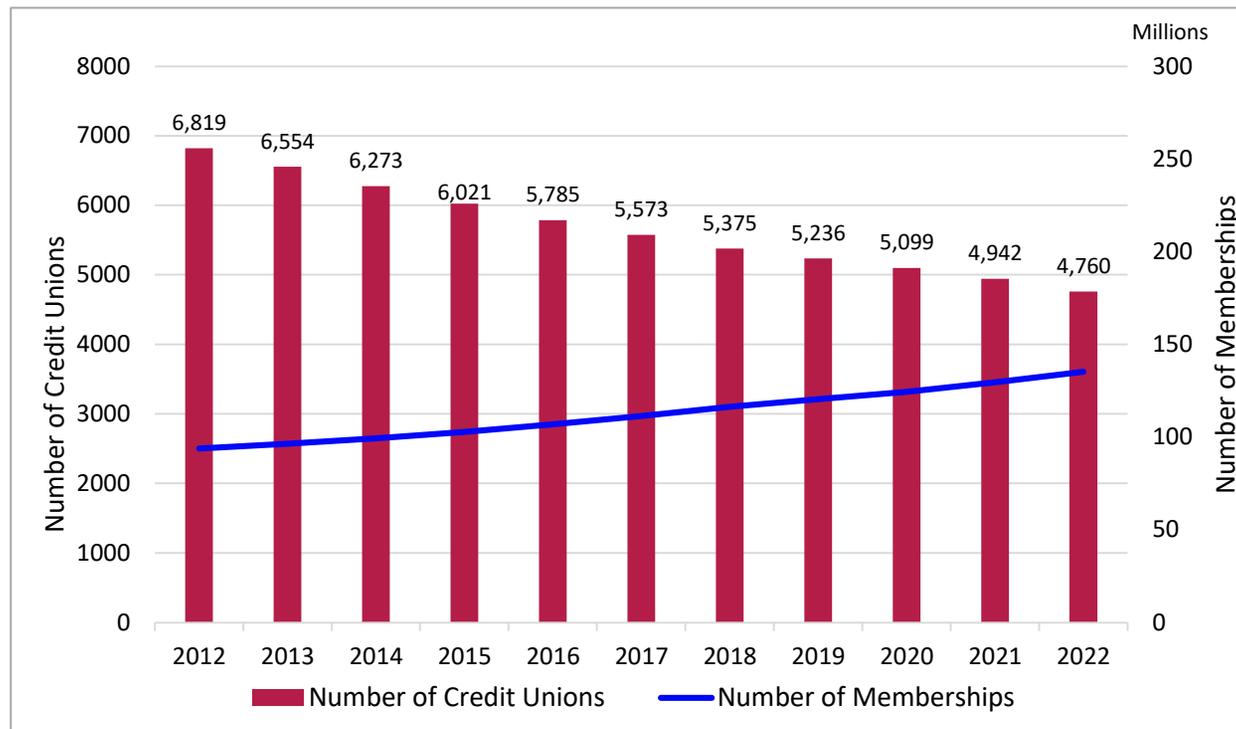


Source: The Kafafian Group, Inc. analysis of FDIC data as of 3/31/2023.

U.S. CREDIT UNIONS

NUMBER OF INSTITUTIONS & MEMBERSHIPS

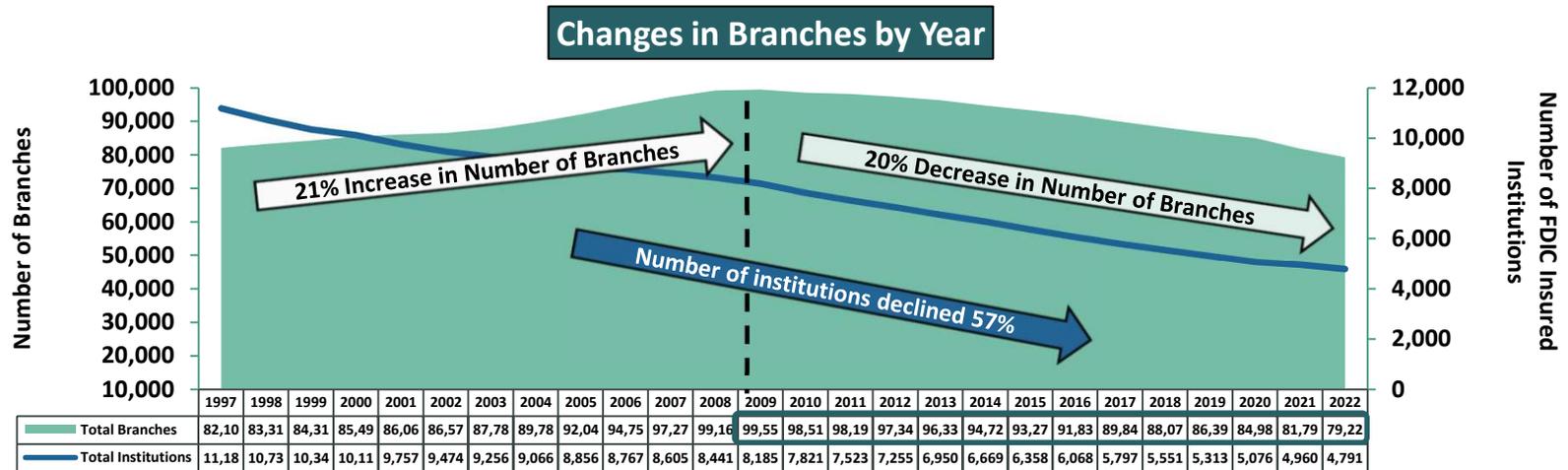
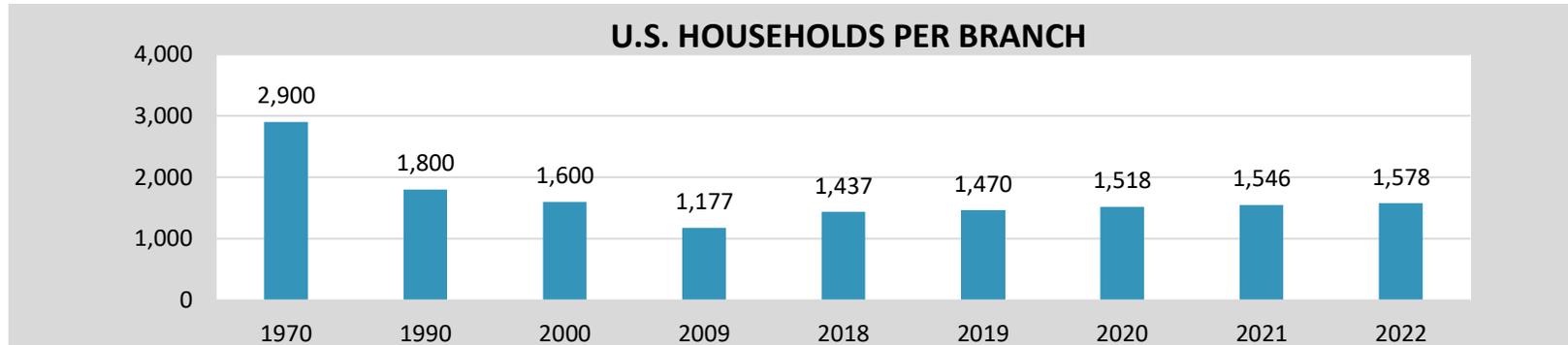
Within the last 10 years the number of U.S. credit unions decreased from 6,819 in 2012 to 4,790 in 2022 while the number of Memberships increased from 93.9 million in 2012 to 135.3 million in 2022.



Source: <https://ncua.gov/files/publications/analysis/quarterly-data-summary-2022-Q4.pdf>

INDUSTRY CONSOLIDATION

BRANCH CONSOLIDATION DASHBOARD – U.S.



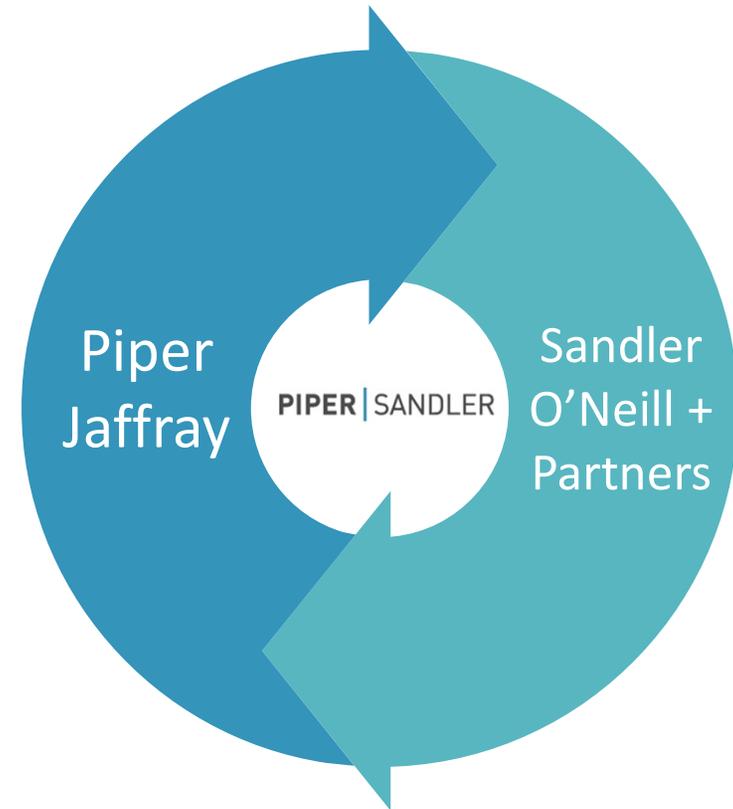
Source: S&P Capital IQ Pro and FDIC data as of 6/30/2022 (Summary of Deposit data is only released annually for June 30)

INDUSTRY CONSOLIDATION

MERGER OF PIPER JAFFRAY & SANDLER O'NEILL + PARTNERS

Piper Jaffray Companies and Sandler O'Neill + Partners, L.P. announced in January 2020, the completion of their merger to become Piper Sandler Companies (NYSE: PIPR).

- The resulting company represents one of the broadest and most capable full-service investment banking platforms on Wall Street complemented by one of the largest securities distribution and trading franchises with market-leading research aligned to serve the middle-market.



Source: Pipersandler.com

INDUSTRY CONSOLIDATION

Q2 HOLDINGS COMPLETES ACQUISITION OF PRECISIONLENDER



- Q2 Holdings, Inc. (NYSE: QTWO), a leading provider of digital transformation solutions for banking and lending, announced in November 2019 it has completed the acquisition of Lender Performance Group LLC (“PrecisionLender”) in a cash transaction valued at approximately \$510 million.
- Based in Charlotte, North Carolina, PrecisionLender is one of the fastest growing enterprise SaaS providers of data-driven sales enablement, pricing and portfolio management solutions for financial institutions (“FIs”) globally. On Oct. 1, 2019, Q2 announced it had entered into an agreement to acquire PrecisionLender.

Source: Businesswire.com

SUMMARY

- Economic headwinds may or may not result in a recession but will put pressure on an institution's financial performance over the next six-to-twelve months.
- The pressure on deposit costs and fees is not likely to abate.
- Has your institution made the necessary strategic investments to fuel your next level of growth, meet member demands, and reduce member friction to distinguish you from the competition?
- Lending typically drives profit while deposits drive value. Does your institution have a funding strategy that is stable, growth oriented, and delivers value to customers?
- Are you building a bank that matters to your constituencies? Firms that matter tend to endure.
- Consolidation in banks, credit unions, and service providers will likely continue as firms strive for scale to absorb increasing regulatory, technology, and personnel costs.