PL Capital Advisors, LLC

QUARTERLY REPORT TO THE PARTNERS Q2 2020

Q2 2020 REFLECTS BOTH A REBOUND AND CONTINUING CHALLENGES FROM COVID-19

We hope this letter finds you and your family in good health.

Despite severe economic and public health challenges caused by COVID-19, financial markets rebounded in Q2 2020. We attribute this to: (1) massive, record amounts of monetary and fiscal stimulus pumped into the markets and economy by the Fed and the U.S. Treasury; (2) removal or relaxation of COVID-19 restrictions by state and local governments; and (3) the tendency of markets to rebound after large declines such as the ones experienced in Q1. Constraints on the rebound include recent increases in positive COVID-19 cases, high unemployment, reluctance to travel or engage in normal personal and economic activities, and supply chain disruptions. Life is less challenging than 90 days ago but is far from normal.

Bank stocks had a strong quarter by any historical metric, but still trailed behind most major stock market averages.

While we don't want to be downbeat at a time when recoveries in any area are to be celebrated, certain areas of the stock market appear to be in or near a financial "bubble." In many ways, 2020 is similar to the Internet/tech stock bubble of 1999-2000, when fundamentals did not seem to matter and the day-trading hordes pushed certain crowd favorite stocks higher and higher in valuation.

Volatility has also been unprecedented. We have never seen bank stocks (or other stocks) go up and down so much from day to day. Up 5% one day then down 5% the next, for no fundamental reason.

In some ways the volatility and valuation extremes seen in certain stocks in 2020 is worse than 1999-2000. We now have both retail day traders, sitting at home in the pandemic, and institutional algorithmic traders, pushing stocks around regardless of fundamentals. And the use of ETFs exacerbates the problem because the sale (or purchase) of one ETF share results in the sale (or purchase) of all the underlying stocks the ETF is designed to track.

So far, bank stocks and bank ETFs have not been favored by retail day traders or institutional "algo" traders. Their hot money has instead flowed mostly to tech companies or "cult" stocks like Tesla. Some speculative stocks are trading almost their entire outstanding share count in a few days. That is ridiculous and will eventually end badly.

Long term investors may remember that bank stocks and the Partnership had some of their best years ***after*** the internet/tech stock day trading bubble of 1999-2000 burst. While the pandemic certainly challenges a comparison of then and now, it is our view that bank stocks will eventually have their *revenge of the nerds* period of outperformance. It may take some time to reach that inflection point, but fundamentals and valuations matter over the long term. Bank stocks are simply too cheap compared to their long term fundamentals and other stock market sectors.

THE PAST 90 DAYS VALIDATED MOST OF OUR Q1 2020 VIEWS ON BANKS AND THE ECONOMY

Our views contained in the Q1 2020 letter have proven accurate for the most part; so far at least. Q1 2020's letter was very long and you can go back and see the details, but the general themes we foresaw then included:

(1) Most banks will survive the crisis intact. Unlike the Financial Crisis, very few will fail.

(2) Most banks will not only not fail, they won't even have to raise common equity, thereby avoiding permanent dilution to existing shareholders.

(3) Banks will grow their balance sheets despite the economic shutdowns and pandemic.

(4) The bank regulators, Fed, U.S. Treasury and politicians will support the banking industry, unlike the Financial Crisis when banks were under constant political and regulatory attack.

(5) Most banks have sufficient "PTPP" (Pre-Tax, Pre-loan loss Provision earnings) to offset most, if not all, increases in loan losses.

(6) Most banks have excess capital, helping to avoid capital raises and even dividend cuts if PTPP comes up short.

(7) Most banks will emerge post-pandemic with their earnings power and franchise value intact. This will allow bank stocks to recover.

(8) Regulators will not force banks to cut or suspend their dividend as a matter of policy for all banks. Regulators will work with individual banks to assess their ability to pay dividends.

(9) Bank stocks are undervalued. The loan losses implied by recent bank stock prices will not happen.

(10) Bank M&A is on hold.

(11) Interest rates will remain low for an extended period. Bank net interest margins will drop but net interest income (in total $s) will be steady or grow, as banks use balance sheet growth to offset some or all of the net interest margin (%) decline.

(12) The duration of the pandemic will dictate the timing of a full economic recovery, but markets and bank stocks will recover in advance, as markets always anticipate actual events.

While some of these may be proven untrue over longer periods, the events of Q2 2020 give us more confidence in our views. Specific Q1 and Q2 2020 events which buttress our view include:

(1) 93% of all banks made money in Q1 2020 despite large pandemic driven increases in loan loss provisions (normal quarters see 96%-97% of banks making money). Most analysts, including PL Capital, are predicting similar levels of profitability in Q2 and the full year 2020. ***This means the banking industry should handle the pandemic without losing money.***

(2) No banks that we are aware of raised common equity. A few raised preferred equity, and many raised subordinated debt.

(3) Very few banks cut their dividends. Most that did were already paying too much in dividends and would have inevitably reached that decision regardless of the pandemic. Regulators are requiring the largest banks in the U.S. to pay out no more in dividends than their trailing 4 quarter average earnings will support (i.e. 100% payout ratio). This is reasonable and not a blanket prohibition that some misguided commentators were calling for.

(4) The Fed and Treasury injected massive amounts of stimulus into the banking system and economy. For example, the Paycheck Protection Program ("PPP") provided banks with over $600 billion in funds to allocate to businesses and organizations. The loans are forgivable so long as at least 60% of it is used for payroll (taxpayers eat the loan forgiveness---how the country will pay for all of this stimulus is a topic for another letter and time, post-pandemic). The PPP is a huge boon for the banks as well as the economy, businesses and their employees. PPP loans have allowed businesses to maintain millions of jobs.

(5) Net interest margins (in % terms) did drop in Q1 and will likely drop in Q2, as predicted. Net interest income (in $s) increased in Q1, as predicted.

(6) Bank M&A was sparse in Q2. This will likely continue into 2021.

(7) Regulatory "stress" test results on the largest banks in the U.S. were released in late Q2. They confirmed the banking industry is strong and should be able to absorb large amounts of stress from recession, falling markets, high unemployment, etc., without raising additional capital.

The next 90 days and the balance of 2020 should be a continuation of the themes we laid out in the Q1 letter and as summarized above.

Most importantly, despite all the real and ongoing challenges banks face due to the pandemic, the banking industry will not only survive, it will make money during the pandemic. The industry made money in Q1 and is projected to make money in Q2, the balance of 2020 and the full year 2021.

While normalcy is not yet in sight and significant challenges remain, the simple statement above should give you comfort that the Partnership and bank stocks in general will enjoy a healthy rebound in time. The pandemic should <u>not</u> cause permanent damage to the banking industry. If anything, banks may gain favor with investors if they prove their resilience and sustainability. We will take it one step at a time.

We wish everyone the best and hope you and your family remain healthy. Thank you for your support.

Please feel free to contact us at any time with questions or comments.

Best regards,

Rich, John, Curt and Martin

Richard Lashley
(908) 347-7874
RLashley@plcapitalllc.com

John Wm. Palmer
(239) 777-0187
JPalmer@plcapitalllc.com

Curtis J. Thompson
(312) 560-2675
CThompson@plcapitalllc.com

Martin Alwin
(630) 742-7060
MAlwin@plcapitalllc.com

July 8, 2020