PL Capital Advisors, LLC

QUARTERLY REPORT TO THE PARTNERS Q4 2022

QUARTERLY AND YEARLY RESULTS

Even though Q4 was positive for the Partnership and most sectors in the stock market, 2022 was a very tough year for financial assets and markets.

Many investors did worse in their personal portfolios than the S&P 500 index because the mega-cap tech stock darlings owned by almost everyone [Apple (-26%), Microsoft (-28%), Alphabet (formerly Google) (-39%), Meta (Facebook) (-64%), Amazon (-50%), Netflix (-51%), Tesla (-65%), etc.] all meaningfully underperformed the S&P 500 index.

RAPID INCREASES IN INFLATION AND INTEREST RATES DROVE MOST MARKETS LOWER

At the end of 2021 both short- and long-term interest rates were at or near record lows and stock markets were relatively strong. At that time the so-called "Fed Funds" rate, the rate set by the Federal Reserve (the "Fed") and the most widely quoted proxy for short-term interest rates, was close to 0%. 10-year US treasury notes yielded approximately 1.5%. The yield curve was positively sloped, with short-term rates lower than long-term rates.

The economy was improving in late 2021 and early 2022, but Covid was still a lingering concern. At that time, most commentators, including PL Capital, felt that the Fed would not raise rates rapidly in 2022 to avoid jeopardizing the economy's nascent recovery from Covid. In our year-end 2021 letter we predicted the Fed would increase the Fed Funds rate 3x in 2022 and the 10-year US treasury would end 2022 at 2.25%. We and most others simply did not believe the Fed would aggressively raise rates after being so accommodating for the past 14 years.

At year-end 2021 the Fed was still confidently predicting inflation was "transitory" and would subside rapidly. However, the war in Ukraine broke out in February 2022 and supply chains around the world became even more dysfunctional, complicating the inflation picture. At the March 2022 Fed meeting the Fed began increasing short-term interest rates, but only by 0.25%. The stock market was volatile in Q1 2022 but still relatively strong.

Inflation continued to increase in Q2 2022. At the May 2022 Fed meeting, the Fed Funds rate was increased by 0.50%. The March and May increases were not unexpected or unreasonable.

But by the summer of 2022, the Fed was much more concerned about inflation and pledged to reduce it with higher interest rates and a systematic reduction in the size of the Federal Reserve's balance sheet (recall that the Fed bought massive amounts of securities as a monetary stimulant during and after the Financial Crisis and during Covid, using so-called "Quantitative Easing (QE)"—the Fed's new plan to shrink the amount of securities they hold is called "Quantitative Tightening (QT)"—QT began in June 2022 and will continue into 2023 and perhaps beyond).

The Fed increased the Fed Funds rate by 0.75% at both the June and July meetings. Those were large increases. By the end of July, the Fed Funds rate was approximately 2.5%, and 10-year US treasury rates were approximately 2.6%. Those rates were well above year-end 2021 levels and high enough to be a drag on housing, the economy and inflation.

In PL Capital's view, that is when the Fed should have paused. The effect of Fed policy on the economy always lags by at least a few months or longer. The Fed should have waited to allow the early and mid-2022 rate increases to work their way through the economy and to enable supply chains to adjust.

Instead of pausing, by the time the Fed's September 2022 meeting was held, it was clear the Fed was in full-blown panic over inflation. At their September meeting, they increased the Fed Funds rate an additional 0.75%. Then they raised it again by 0.75% at the November 2 meeting and by 0.50% at the December 14, 2022 meeting. The rapid shift by the Fed from "inflation is

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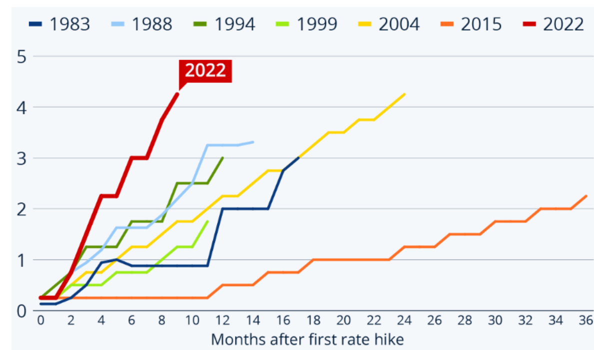
transitory" to "inflation must be contained at all costs" is stunning, bordering on incompetence.

By year-end 2022, the Fed's seven interest rate increases had moved the Fed Funds rate to approximately 4.5%, from almost 0% at the beginning of the year, the largest and fastest increase since former Fed Chairman Paul Volcker dramatically raised rates in the early 1980s.

Exhibit 1: Changes in the Federal Funds Target Rate in Past Tightening Cycles (in percentage points)



Source: Federal Reserve and Statista

At year-end 2022 10-year US treasury yields were also up, to approximately 3.8%, a sharp increase from year-end 2021's 1.5%. Notably, the 10-year US treasury yield at year-end 2022 was below the 4.50% Fed Funds rate, a so-called "inverted" yield curve. The inverted yield curve indicates that financial markets do not share the Fed's concern about inflation lasting into 2023 and beyond. It also signals that short-term rates should begin to decline in 2023 or early 2024, and a recession is possible in 2023, which should push down interest rates. In short, the market thinks the Fed is making a mistake by raising rates so aggressively. We agree.

The impact of these historically large and unexpected increases in interest rates had a significant impact on both bond and stock markets. ***By some measures, it was the worst year ever for investors because both bonds and stocks declined simultaneously.*** This is rare. A study by Bank of America going back to 1920 showed that 2022 was the worst year ***ever*** for a typical investor holding 60% stocks and 40% bonds. This is unusual because bonds typically increase in value when stocks decline because interest rates usually decline when stocks go down materially. However, 2022's stock market decline was driven by interest rate increases, so both bonds and stocks fell simultaneously.

Unlike most other times in the past 15 years, the Fed did not care that financial markets reacted so harshly to the Fed's newfound concern about inflation. In many ways, that is what the Fed wanted. The Fed believes that declining financial markets = slower economy = lower inflation.

The Fed was wrong in so many ways in the past few years. First, they provided too much monetary easing in 2020 and 2021. Second, they ignored inflation in 2021 and waited too long to remove monetary ease. Lastly, now they are overreacting with too much monetary tightening in too fast of a time frame.

WHY DID BANK STOCKS GO DOWN IF HIGHER INTEREST RATES ARE NORMALLY GOOD FOR BANK PROFITS?

It's the right question to ask. For years we have told you that higher interest rates are good for banks. And it's true, as proven by the higher net interest margins and record levels of quarterly net interest income and profits currently enjoyed by most banks.

But investors and the stock market have yet to give bank stocks much credit for that fact. Why? One, it's difficult for any industry as large and economically important as banking to avoid being viewed negatively when the economy is slowing. Two, even though interest rates are higher, the inverted yield curve mitigates some of the benefit (most banks use short-term funding to fund long-term assets—it's better for banks when short-term interest rates are lower than long-term rates). Three, there are fears among investors that banks will incur loan losses due to a slowing economy.

Even with those headwinds, higher interest rates should cause banks to generate EPS growth and high returns on equity in 2023 due to wider net interest margins and higher net interest income, as they did in 2022. Moreover, bank shareholders will share in those profits directly through higher dividends and stock buybacks. This is because only a portion of banks' large profits needs to be fully invested back into the business, unlike many other companies, which constantly need to reinvest earnings and cash flows back into the business.

Banks should grow both earnings and margins in 2023, unlike many other sectors and industries, which should face declining profits and margins. Bank stocks in 2023 should outperform in this environment.

BANK STOCKS ARE UNDERVALUED

Despite the high levels of profitability most banks should enjoy in 2023, bank stocks are undervalued. As of year-end, the median bank in the PL Capital portfolio was trading at 8.3x 2023 estimated EPS compared to 17.1x 2023 estimated EPS for the S&P 500 index [(1)], an approximate 49% relative PE ratio. In addition, the median PL Capital portfolio bank has a 3.12% dividend yield versus 1.70 % for the S&P 500 index.

(1) Yardeni Research, Inc. 2023 S&P 500 EPS estimate of $225.00 as of December 27, 2022

Bank stocks are too cheap.

BANK M&A

The banking industry has been consolidating for over 40 years, as we have discussed in numerous quarterly letters. There are now less than 5,000 banks in the US, down from over 18,000 when we began our careers in the early 1980s. Over the long-term banks will continue to consolidate. That is good for bank stocks.

2022 continued this trend, but at a slower pace. In a typical year, 4% to 5% of the industry consolidates. In 2022, it was 3.5%.

M&A slowed because the well-run, acquisitive banks usually trade at higher multiples than other banks. Those banks then use their higher-valued stock to buy other banks. Conversely, when those normally acquisitive banks trade at lower valuations, they shy away from M&A. This was the case in 2022.

Despite the slowdown in bank M&A, the Partnership benefited from 3 merger announcements in 2022. In February, The Toronto-Dominion Bank announced a deal to buy First Horizon (NYSE: FHN) for an attractive premium in an all-cash deal. In September, Lakeland Bancorp, Inc. (NASDAQ: LBAI) announced a sale to Provident Financial Services, Inc. (NYSE: PFS) in an all-stock transaction we support. Finally, in December, Malvern Bancorp (NASDAQ: MLVF) announced a sale to First Bank (NASDAQ: FRBA) for a large premium to the Partnership's cost basis. The Partnership and PL Capital own 9.9% of Malvern, and we have privately encouraged their management to find a buyer. We are very pleased with the deal and like First Bank's stock, which is undervalued. The terms call for 40% cash and 60% stock. The Partnership will likely hold the 60% FRBA stock portion. The cash portion will be reinvested when received in Q2 2023.

FINTECHS LOST THEIR LUSTER IN 2022

For years many pundits have been predicting the demise of traditional banks, brokers, insurance companies, etc., due to the rise of so-called "fintechs," the term used for financial technology companies. Fintechs use technology and social media to provide financial services and generate assets and liabilities. They eschew traditional banking methods such as branches and long-term relationships. PL Capital's view has long been that most fintechs would either fail or be acquired by more traditional financial institutions, with a few surviving on their own.

Unlike many other investment managers who sold the stocks of banks and other traditional financial services providers to buy fintechs over the past few years, we recognized that most fintechs suffer from a fatal flaw. Namely, fintechs do not have dedicated and stable, low-cost funding sources, unlike the banks, which benefit from FDIC insured, low-cost deposits generated from long-term, local customer relationships. This lack of stable, low-cost funding was not an obvious problem for fintechs when the Fed kept rates at almost 0%, and funds were readily available. However, in 2022 when rates rose and wholesale funding became difficult to source at a reasonable cost, this flaw became a massive problem for most fintechs. A recent article in CNBC covered it well:

https://www.cnbc.com/2022/12/28/fintech-startups-2022-2023-a-reckoning-is-upon-us-heres-what-to-expect.html?qsearchterm=fintech

As noted in the article, fintech valuations once in the stratosphere, collapsed in 2022. Many fintechs failed or will fail. Some will survive and prosper, such as Square and PayPal, but even those two long-term fintech winners saw their stocks decline by over 60% in 2022. Many fintechs will be absorbed into larger banks and financial institutions at a fraction of their peak values.

We are pleased PL Capital never bought into the fintech craze. We examined them numerous times over the years, but there were very few fintech business models that made sense to us, and even those that did rarely made money. Even if we liked a fintech's prospects, the valuations were always divorced from reality.

MBS REITS—A SECTOR WE LIKE FOR 2023

Recently we have been doing a lot of work on MBS REITs. MBS REITs have been around since the 1990s, and at various times over the past 25+ years, PL Capital has invested in both their common and preferred stocks.

You may know that REIT stands for Real Estate Investment Trust. The IRS restricts REITs to only invest directly in real estate or in loans or securities secured by real estate. In return for this restriction, REITs do not pay federal taxes if they pay out in dividends a high percentage of their taxable income each year. Most REITs, therefore, have high dividend yields.

We are focusing on so-called MBS REITs. MBS is an acronym for mortgage-backed securities. MBS can be backed by either residential (1-4 family) or commercial real estate loans. MBS can either be government agency issued or insured (think Ginnie Mae, Freddie Mac, and Fannie Mae) or privately issued.

We particularly like residential agency MBS REITs. These REITs invest primarily in MBS secured by residential mortgage loans pooled together and issued by or guaranteed by a US government agency. ***There is no credit risk on agency MBS due to the government guarantee.***

MBS REIT stocks suffered large losses in 2022 due to rising interest rates because most MBS REITs hold

fixed-rate MBS. As a result, the value of those securities were hit hard when rates rose.

Based on our analysis, MBS REITs are currently attractively valued. They trade at or near book value (which has the potential to rebound if rates stabilize or decline) and have high dividend yields ranging from 10% to 20%. It's complicated, but the MBS REITs have done a decent job of stabilizing their funding costs and net interest income despite higher interest rates, by using various hedges. We believe that the lows for MBS REIT stocks occurred in October 2022 and that most or all will be able to sustain their generous dividends.

We have begun to add some MBS REIT stocks to the Partnership and plan to add more in 2023. We like both the common and preferred stocks of MBS REITs. Both classes of stock have high dividend yields and the potential for capital gains.

If a recession hits in 2023, MBS REIT stocks should outperform other industry sectors because a recession should allow the Fed to reduce interest rates. In addition, lower interest rates should increase the value of both the MBS held by the MBS REITs and the MBS REIT stocks due to their high dividend yields. And because the underlying MBS are 100% government guaranteed, there is no credit risk even if house prices fall and the economy goes into recession.

We will update you further on this opportunity in future quarterly letters.

A REVIEW OF OUR 2022 PREDICTIONS AND OUR 2023 PREDICTIONS

We review our prior year-end predictions in every year-end letter and make new ones for the upcoming year. Since this letter is already long, we have added the 2022 recap and 2023 predictions as appendices.

Our batting average in 2022 was much worse than in prior years. Approximately one-half of our predictions were wrong and one-half right. Suffice it to say that our most important 2022 prediction, that the Fed would not rapidly increase interest rates, was painfully wrong, as discussed earlier.

Our most relevant 2023 prediction is summarized below:

Bank stocks outperform in 2023 because: (1) bank earnings will remain strong due to higher net interest margins and net interest income, while many other industries and companies will suffer from declining EPS and lower margins, and (2) bank stocks are too cheap.

NOTABLE PARTNERSHIP'S ACTIVITY

In Q4 2022 we applied to the Federal Reserve Bank of NY for permission to increase PL Capital's collective ownership of Evans Bancorp (EVBN) up to 19.9% (up from less than 10%). We expect to get this approval in Q1 2023. This will be the second bank for which we have sought permission to own more than 10%. The first, Old Point Financial (OPOF), was approved in early 2022.

2022 INCOME TAXES

We will work closely with KPMG to get the 2022 K-1s issued as soon as possible. As you likely know, all professional services providers are still suffering from staff turnover, so delays are expected.

We wish you and your family a happy, healthy and prosperous New Year!

We are grateful that you have entrusted us with your hard-earned capital.

Please feel free to contact us at any time.

Best regards,

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REVIEW OF 2022 PREDICTIONS

#1. Bank stocks have another strong year, continuing the momentum and strong fundamentals enjoyed at year end 2021. Bank stocks rise by more than 15%. Most of the price increase is driven by improved PE ratios, as 2022 EPS for most banks will be flat vs. 2021. Recall that 2021's profits had one-time gains from the PPP program and unusually low credit costs. These will not be repeated in 2022, so even though "core" EPS will grow, total EPS will be flat. Given that 2021 earnings were at historically record levels, we are okay with a flat EPS year in 2022. **BANK STOCKS DECLINED. THE EPS PREDICTION WAS ACCURATE.**

#2. For the past few years bank stock prices, on at least a short-term basis, have been highly correlated with interest rates and the yield curve, sometimes to nonsensical extremes (e.g., bank stocks go up or down 3% in a day simply because the 10-year treasury yield went down or up by 0.05%). This volatility continues in 2022. Despite this volatility in short-term prices, over the course of the year interest rates rise and the yield curve steepens, driving bank stock prices higher. **WHILE INTEREST RATES ROSE, THE YIELD CURVE DID NOT STEEPEN.**

#3. The aggregate number of bank M&A deals dips in 2022 vs 2021 but is still robust, consistent with the trend started in 2021 and the long-term consolidation of the industry. M&A by large banks (say banks greater than $100 billion in assets) is hampered by the hostility of the Biden administration towards large banks and brokers. Community banks favored by the Partnership still enjoy favored status with the vast majority of national, state, and local politicians and regulators so their M&A ambitions are not impacted. **PARTIALLY ACCURATE BUT OVERALL BANK M&A DROPPED MORE THAN WE PREDICTED.**

#4. Deposit costs remain anchored at very low rates despite increasing open market interest rates. This so-called "low deposit beta" in industry parlance, helps drive net interest margins and net interest income in total $'s higher in 2022 vs. 2021. **ACCURATE.**

#5. The Fed raises the fed funds rate 3 times in 2022, and the 10-year treasury ends the year close to 2.25%. A slowing economy and some financial market volatility in the back half of the year keeps the Fed from being more aggressive. Real (inflation adjusted) interest rates remain very negative due to continued high inflation. The interest rate backdrop is positive for bank stocks. **WRONG, AS DISCUSSED IN THE LETTER.**

#6. Fintech stocks, the darlings of private investors and public markets, struggle to hold their elevated valuations when investors realize that few will be sufficiently profitable to justify current valuations and some will face regulatory challenges. **ACCURATE, AS DISCUSSED IN THE LETTER.**

#7. Despite higher interest rates, real estate markets and pricing remain robust, particularly single-family housing. Aggregate mortgage lending volumes decrease in 2022 vs. the strong levels of 2021 but purchases of homes drives stronger than expected mortgage banking profits. Refinance mortgage volumes decrease materially in 2022 vs. 2021 due to higher interest rates. **PARTIALLY ACCURATE. REAL ESTATE PRICES DID REMAIN ROBUST BUT MOST MORTGAGE BANKERS LOST MONEY IN 2022.**

#8. Inflation remains high but starts to moderate towards the end of 2022. Labor costs go up by the highest % amount since the early 1980s. **ACCURATE, BUT INFLATION REMAINS WELL ABOVE COMFORTABLE LEVELS.**

#9. Republicans win control of the House and the Senate in the mid-term 2022 elections. Gridlock prevails in Congress so President Biden and government agencies use executive orders and regulatory authority to advance their agenda. Banks face headwinds from banking industry regulators appointed by President Biden who are not friendly to the banking industry. Despite the political noise, the banking industry will not fundamentally change in its mission or profitability. **GENERALLY ACCURATE BUT THE SENATE WAS HELD BY THE DEMOCRATS IN A CLOSE ELECTION.**

#10. PL Capital engages in more shareholder activism in 2022. The pandemic did not favor activism. This will change in 2022 and beyond as some banks fall behind their peers despite having attractive franchises, leading to more activism. **PARTIALLY ACCURATE. THE ENVIRONMENT FOR ACTIVISM WAS DIFFICULT IN 2022 DUE TO LOWER M&A ACTIVITY AND LOWER BANK STOCK PRICES.**

2023 PREDICTIONS

#1: Bank stocks outperform most sectors of the stock market. Investors realize that bank earnings are positively impacted by higher interest rates and bank valuations are too cheap.

#2: Most banks enjoy record levels of net interest income due to higher net interest margins and growing balance sheets (although growth is constrained by higher rates and the slowing economy). Many banks will generate record EPS.

#3: While most banks will enjoy growing earnings and margins, many other companies and sectors will suffer from earnings declines and lower margins.

#4: Banks generate excess capital which they use to increase dividends and engage in stock buybacks, which benefits future EPS.

#5: Holding on to low cost or no cost deposits becomes the greatest challenge faced by banks, as higher rates are available elsewhere (e.g., money market funds).

#6: The economy has a moderate recession in 2023 but nominal GDP and strong underwriting standards are strong enough to mitigate credit losses for banks. Unemployment increases, but the shortage of qualified labor causes businesses to avoid mass layoffs.

#7: Inflation recedes but stays above the 2% level desired by the Fed. The Fed stops raising the Fed Funds rate after it rises to 5.00% in early 2023. By year end 2023 or early 2024 they will begin to reduce the Fed Funds rate.

#8: MBS REIT stocks generate high total returns (including dividends). The fact that they have no credit risk (government guarantees on the underlying MBS) gets noticed by investors as the economy slows.

#9: Bank tangible book values (TBVs) improve nicely in 2023, partially from declining interest rates and partially from increased EPS.

#10: Bank M&A continues but at a sub-par pace. Approximately 3% of the industry consolidates.