



Q2' 2024

Dear Partner,

Throughout the second quarter, we continued replacing slower-growth firms with durable, faster-growing firms in temporarily depressed sectors and identified similar opportunities in new industries. These firms align with our longer-term growth themes of consolidation, forced selling of loans, transaction processing, affordable housing finance, and housing construction. Furthermore, we have identified and are analyzing opportunities in the following industries: specialized construction, natural resource royalties, distributors, logistics companies, housing, and specialty finance. New investments have a combined expected growth rate (return on equity ("RoE") * (1-payout ratio)) plus earnings yield of at least 30 to 40%, exemplifying deep value incorporating growth.

As we continue to add faster-growing durable companies to the portfolio, I believe we have the highest-quality businesses in the fund's history, with a discount that continues to persist as the market fails to realize the improvement in our firms' positions. Specific signs of quality that Bonhoeffer pursues include:

- 1) free cash flow growth with highly recurring revenues (such as in subscription businesses),
- 2) high free cash flow conversion, and
- 3) returns on equity that are higher than less-risky alternatives, such as well-underwritten debt which currently has yields in the low-teens.

The Bonhoeffer Fund returned a loss of 4.2% net of fees in the second quarter of 2024. In the same time period, the MSCI World ex-US, a broad-based index, returned 5.7%, and the DFA International Small Cap Value Fund (DISVX), our closest benchmark, returned 1.0%. As of June 30, 2024, our securities have a weighted average earnings/free cash flow yield of 14.4% and an average EV/EBITDA of 3.8.

The current Bonhoeffer portfolio has projected earnings/free cash flow growth of about 12.5%. The DFA International Small Cap Value Fund had an average earnings yield of 10.8% with 8.0% growth. The valuation multiples for the Bonhoeffer Fund, MSCI World ex-US, and DISVX are slightly higher than the previous quarter, primarily due to share price increases.

Bonhoeffer Fund Portfolio Overview

Bonhoeffer's investment portfolio consists of value-oriented special situations, and growth-oriented firms that can compound value over time at a reasonable price. In most cases, we are paying mid-single-digit multiples of five-year forward earning per share (EPS). We are particularly interested in companies in market niches that grow organically and/or through transition or consolidation. We also like to see active capital allocation through opportunistic buybacks, organic growth, and synergistic acquisitions. Finally, we like to see durability, as measured by increasing recurring revenues, high free cash flow conversion, and consistent and growing RoEs in our portfolio companies. There were modest changes

within the portfolio in the second quarter which are in line with our low historical turnover rates. We sold some of our slower-growing investments and invested some of our cash into niche growing banks, like Northeast Bancorp (NBN), United Bancorp of Alabama (UBAB), and this letter's featured case study, FFB Bancorp (FFBB).

As of June 30, 2024, our largest country exposures included: United States, United Kingdom, South Korea, Canada, Latin America, and the Philippines. The largest industry exposures/themes include: distribution, real estate/infrastructure/finance, telecom/media, and consumer products.

Conclusion

As always, if you would like to discuss any of the investment frameworks or specific investments in deeper detail, then please do not hesitate to reach out. As always, I wish you and your family the best and want to thank you for your continued confidence as we invest side by side.

Warm Regards,

Keith D. Smith, CFA

INVESTMENT THEMES

Compound Mispricings (19% of Portfolio; Quarterly Performance 0.7%)

Our Korean preferred stocks, the nonvoting shares of Wilh. Wilhelmsen, and Vistry all feature characteristics of compound mispricings. The thesis for higher returns include: the closing of the voting, nonvoting, holding company and multiple business valuation gap, evidence of better governance and liquidity and/or the decline or sale of the legacy business. We are also looking for corporate actions such as spinoffs, sales, share buybacks, or holding company transactions and overall cash flow growth.

Vistry, one of our largest holdings, is a compound mispricing as it is in the process of exiting its land heavy traditional homebuilding business and becoming a pure play, land light homebuilder, similar to NVR and Dreamfinders in the United States.

Vistry is the largest partnership homebuilder in the UK. It renovates housing and builds new housing in partnership with local housing authorities. The local housing authority provides the land for development or existing buildings for renovation, and the partnership builder executes the planned construction. Some of the completed units are sold at market rates, but most of the units will contribute to the affordable housing stock. Originating the homebuilding agreements requires a network of personnel to develop the relationships and negotiate the deals with local housing authorities. The builder then upgrades and builds the units based upon an agreed scope. The UK recently elected a Labour government committed to expanding the housing stock. Builders like Vistry will be in a good position to provide the services to make this promise a reality.

Since the builder does not purchase the land, the process has historically generated after-tax RoE in the mid-20% in comparison to the mid-teens for the traditional land heavy model. Countryside Properties was the first to develop a partnership only homebuilder. Due to execution issues, Countryside did not meet its goals. After shareholder activism the CEO was ousted and Countryside merged with Vistry. As a part of the merger, Vistry decided to adopt the partnership only model and is now the largest partnership focused homebuilder in the UK. As a part of the transition to a partnership builder, Vistry will generate about £1 billion in excess cash primarily from sale of the land inventory which they expect to use to repurchase shares. Currently, Vistry generates after-tax RoEs of 15% and is expected to increase to the mid-20s in the next five years. Management expects to generate annual net income in the £500m range over the next 3-5 years which would translate into £1.85 per share, assuming the £1 billion in proceeds from asset sales are used for share repurchases. So in five years, Vistry will be a partnerships home builder with returns on invested capital in the mid 20% and a steady source of revenue from local housing authorities, the UK government and private individuals. Based upon Vistry's current stock price, Vistry is selling for 7x 3-5 yr forward EPS.

Vistry is a great business operationally and is in a good position to grow. The largest drawbacks at this point are the timing of the partnership builds (potential home construction slipping beyond management's expectations) and competition. Competition should be nominal as Vistry has much more experience and a larger scale and scope of services versus other competitors in the market. If construction projects are completed and delivered on a slower schedule than planned, holding costs for Vistry will be smaller than traditional home building.

Below is our current valuation of Vistry:

Vistry						
High RoE Home Builders						
		EBIT				5-yr Fwd
	<u>Inv Turns</u>	<u>Margin</u>	<u>RoE</u>	<u>P/E</u>	<u>P/BV</u>	<u>Growth</u>
NVR (USA)	3.47	18.6%	39.5%	17.7	6.41	5.0%
Pulte Homes (USA)	1.00	21.0%	27.0%	9.5	2.26	8.0%
Vistry (UK)*	1.35	11.0%	15.0%	11.8	1.44	10.0%
DreamFinders (USA)	1.90	10.0%	30.0%	9.0	2.57	6.0%
Kaufman & Broad SA (France)	2.78	7.8%	25.0%	13.0	3.02	8.0%
JM (Sweden)	1.40	6.5%	11.5%	15.0	1.63	0.0%
*Based upon buying back 23% of shares w cash from land sales						
Sensitivity Table						
					Price	Upside
Current Adjusted Earnings	£1.15					
7-year Expected EPS Growth Rate	10%			1.8%	£13.85	0.0%
Historical NI Growth Rate	14%			5.0%	£21.28	53.6%
Current AAA Bond Rate	5.0%		Growth Rate	10.0%	£32.78	136.6%
Implied Graham Multiplier **	28.50			15.0%	£44.28	219.7%
Implied Value	£32.78			20.0%	£55.78	302.7%
Current Price	£13.85			22.5%	£61.53	344.2%
** (2*Growth Rate + 8.5)						

Public Leverage Buyouts (LBOs) (44.9% of Portfolio; Quarterly Performance -3.1%)

Public Leverage Buyouts are public companies that use leverage to boost equity returns from historically stable cash flow businesses. Our broadcast TV franchises, leasing, building products distributors and dealerships fall into this category. One trend we find particularly compelling in these firms is growth creation through acquisitions which provides synergies and operational leverage associated with vertical and horizontal consolidation. The increased cash flow from acquisitions and subsequent synergies are used to repay the debt and repurchase stock, and the process is repeated. This strategy's effectiveness is dependent upon the spread between the interest rates of their loans and the cash returns from the core business and acquisitions. Over the past few months, long-term interest rates have been declining and short-term rates are expected to follow so a large and growing spread is available to firms. An example is Builder's First Source ("BFS") which has a high return on capital. One way to measure future expected returns are post-synergy cash flow ratios paid for acquisitions. Another way to measure future growth in expected returns is via incremental return on incremental invested capital ("RoIC").

Many of our holdings used the acquisition/buyback model described above. Some of these firms have also used modest leverage to magnify the returns of equity to 20% and above over the past five to ten years using the acquisition/buyback model. These firms include: Terravest, Asbury Automobile,

Ashtead, Autohellas, BFS, and Millicom. In addition, many of these firms are buying back stock and the modest current valuations make these buybacks accretive.

BFS is an example of an interesting public LBO. Unique among building products distribution firms, BFS not only distributes building products to a fragmented customer base but it provides specialty products in fragmented product markets that are geographically constrained, such as trusses and millwork. Building products distributors primarily sell to small and midsize building contractors, which means the customer base is fragmented. Some of the building product distributors provide products also (such as UFPI). However, many of the building products distributor suppliers are more consolidated. Therefore, they have more pricing power in comparison to the more fragmented supplier base of BFS. Providing these products in addition to distributing them leads to higher gross margins versus other building product distributors. See table below for details.

One way to calculate RoIC, is to divide the changes in FCF by the merger and acquisition investment over a given period of time. For the last 5 years, BFS' free cash flow increased from \$207 million in 2018 to \$1.6 billion in 2023, an increase of \$1.4 billion from investing \$6.2 billion in mergers and acquisitions. The resulting RoIC is 22.5% (\$1.4 billion/\$6.2 billion). Below are the valuation KPIs associated with building product distributors and the potential upside of BFS.

Key building product distributor valuation KPIs are shown below:

Builders First Source													
Building Products Distributors													
	Price	Book Value	2025 Earnings	Inv Turns	EBITA Margin	RoE	2028 RoE	Gross Margin	P/E	P/BV	RoIC	RoWC	Debt/TIC
Beacon Roofing	90.6	28.33	8.32	5.30	8.8%	29.4%	23.0%	26.0%	10.9	3.20	12.5%	38.9%	39%
BlueLinx	104.6	76.28	7.02	6.30	4.3%	9.2%	8.1%	17.0%	14.9	1.37	10.7%	13.2%	14%
Builders FirstSource	182.2	36.97	12.43	8.50	14.7%	33.6%	35.0%	35.0%	14.7	4.93	19.2%	65.0%	17%
GMS	95.37	36.74	8.28	6.40	9.2%	22.5%	22.5%	32.0%	11.5	2.60	14.4%	32.5%	26%
Installed Building Products	232.29	24.41	12.15	11.00	15.0%	49.8%	35.0%	34.0%	19.1	9.52	29.8%	77.6%	8%
TopBuild	410.66	81.18	22.69	9.00	18.6%	28.0%	26.0%	31.0%	18.1	5.06	21.4%	92.9%	8%
UFP Industries	125.1	50.84	8.23	7.00	9.0%	16.2%	15.0%	20.0%	15.2	2.46	20.6%	41.8%	-9%
Sensitivity Table													
					Price	Upside							
Current Earnings	\$12.43												
7-year Expected EPS Growth Rate	13%			3.1%	\$182.20	0.0%							
Historical EPS Growth Rate	25%			5.0%	\$229.96	26.2%							
Current AAA Bond Rate	4.6%		Growth Rate	10.0%	\$354.26	94.4%							
Implied Graham Multiplier *	34.50			15.0%	\$478.56	162.7%							
Implied Value	\$428.84			20.0%	\$602.86	230.9%							
Current Price	\$182.20			22.5%	\$665.01	265.0%							
* (2*Growth Rate + 8.5)													

Distribution (55.9% of Portfolio; Quarterly Performance 6.8%)

Our holdings in car dealerships and branded capital equipment dealerships, building product distributors, automobile transportation logistics, and capital equipment leasing firms all fall into the distribution theme. One of the most important key performance indicators for dealerships is velocity, or inventory turns. We own some of the highest-velocity dealerships in markets around the world.

In our Q1 2024 letter, we described the growth opportunities in the car dealership business. Below are the valuation and operational KPIs for high RoE automobile dealerships around the world, including Asbury Automotive, one of our car dealership holdings:

High RoE Car Dealerships	Price	Book Value	2025		EBITA		2028		P/E	P/BV	Absorption Ratio	NPS Score *
			Earnings	Inv Turns	Margin	RoE	RoE	RoE				
Asbury Auto	240.6	160	29.67	7.30	6.3%	18.5%	16.0%	8.1	1.50	134%	13	
AutoNation	150.4	59.36	19.4	7.10	5.2%	32.7%	20.0%	7.8	2.53	129%	11	
Lithia Motors	294.6	247.4	33.72	6.93	4.8%	13.6%	14.0%	8.7	1.19	121%	-7	
Penske Automotive Group	169.2	77.88	14.22	5.80	4.4%	18.3%	16.0%	11.9	2.17	107%	-8	
GPI	368	231.7	41.54	7.50	5.3%	17.9%	15.0%	8.9	1.59	N/A	N/A	
Bilia	129.1	53.5	12.51	6.80	3.9%	23.4%	20.0%	10.3	2.41	N/A	N/A	
Inchcape	8.36	3.69	0.87	3.70	5.9%	19.5%	18.6%	9.6	2.27	N/A	N/A	
Autohellas	11.2	9.84	1.93	8.40	13.6%	19.6%	20.0%	5.8	1.14	N/A	N/A	
Combined Motor Holdings	33.5	18.28	5.94	5.40	6.0%	32.5%	30.0%	5.6	1.83	N/A	N/A	
Motus Group	113.2	101.64	18.44	3.10	4.2%	18.1%	16.0%	6.1	1.11	N/A	N/A	
* Source: Customer Guru												

We have added the analyst projected 2028 RoE to see how durable the calculated RoE for each automobile dealer is. A steady RoE trend illustrates RoE durability. The US dealers have RoEs from 14% to 33% while those in Europe range from 20% to 23% and those in South Africa range from 18% to 33%. Inventory turns, EBITA margins, and leverage (debt) drive return on equity.

Asbury meets our investment threshold due to a high and consistent RoE and modest P/E which provide an expected growth rate plus earnings yield of 31%, 18.5% RoE plus 12.5% earnings yield.

Telecom/Transaction Processing (18.3% of Portfolio; Quarterly Performance -6.6%)

Increasing use of transaction processing in the markets of our respective firms, as well as the rollout of fiberoptic and 5G networks has offered growth opportunities within the telecom and transaction processing theme. It is important to note, that given that most of our firms are holding companies and have multiple components of value (including real estate), the timeline for realization of value may be longer than for more mono-industry-focused firms.

Millicom (TIGO) is one of the remaining telecom firms in the portfolio. The company retains favorable market conditions including operating in many two-player markets or in markets where the number of participants is getting smaller. With fewer players, telco firms can recover pricing power to offset the increasing cost of network construction and operations. In Columbia, one of its key markets, a large player has entered bankruptcy which will reduce the number of market players. In addition, Millicom is in negotiations to buy the assets of the firm out of bankruptcy.

Some additional promise on the horizon for Millicom includes investor interest in Lati, Millicom's tower spin-off, from US tower firms such as SBA Communications. In addition, Millicom continues to implement cost cuts identified by the new CEO and the team that was put in place by the new large shareholder, Xavier Niel. Mr. Neil has executed tender offers for Millicom shares (the latest of which was at \$25.75 per share) which has increased his stake in Millicom to 40%. TIGO's management has recommended shareholders not to accept Mr. Niel's tender offers because management believes the prices offered were too low. We agree.

Consumer Products (7.4% of Portfolio; Quarterly Performance -11.1%)

Our consumer product retailing, tire, and beverage firms comprise this category. The defensive nature of these firms can lead to better-than-average performance. One theme we have been examining is the development of category-killer retail franchises. These firms have developed local franchises which have higher inventory turns, margins, and sales per square foot than competitors. These factors resulted in great unit economics and high returns on incremental invested capital. They also have some unique characteristics, including specialty niches (such as tire stores or athletic shoes) or offering something the competitors will not (such as selling hunting supplies).

Real Estate/Construction/Finance (42.9% of Portfolio; Quarterly Performance 9.5%)

The current construction holdings, Builders First Source in the US and Vistry in the UK, should do well as governments worldwide incentivize infrastructure programs and new construction continues to replenish the housing deficit in the US and the UK. Financing of low-income real estate development as well as growth in small business lending (via small business administration ("SBA")) and the purchasing of forced sale loans from mergers and acquisition as well as the FDIC are themes driving growth in our bank holdings, FFB Bancorp ("FFB"), United Bancorp of Alabama ("UBAB") and Northeast Bank ("NB"). We are looking for banks with the following characteristics:

- 1) sustainable RoEs and EPS growth rates of 18% or higher;
- 2) good underwriting and reserving practices (loan loss reserves/non-performing of asset great than 80%); and
- 3) selling for single digit or low double earnings multiples.

We continue to find banks that meet these criteria.

NEW PORTFOLIO IDEAS

Platforms and Embedded Optionality

Platforms are firms that can use a common infrastructure to provide products or services to acquired customers where the fixed cost to service the acquired customers can be spread across more units, thus leading to higher margins for the whole platform. Key aspects of platform cash flow growth include geographical and functional service expansion, and operational efficiency optionality.

For firms whose customers and economies of scale are local, such as distributors, restaurants, retailers and banks, geographic expansion is important in cash flow growth. For these firms, geographic expansion can drive cash flow growth for long periods of time. This expansion can produce revenue growth and high margins due to economies of scale. Peter Lynch describes how these firms, restaurants in particular, can generate growth over decades in his book *One Up on Wall Street*. Bonhoeffer has invested in distributors, retailers and banks which benefitted from these positive geographic optionality characteristics.

Functional service or product growth is the second area of platform optionality. A great metric of this growth is described in Philip Fisher's *Common Stock and Common Profits*. Fisher defines product growth as sales of newly introduced products and services as a portion of total sales. This second growth driver in combination with the geographical growth can create an exponential effect of durable high growth. FFB Bancorp (FFBB) is an example of this exponential effect. FFBB is geographically growing into Northern and Southern California as well as in the Fresno, or Central Valley, region. Management estimates their assets can grow by 6x via geographic expansion over the next 7-10 years. FFBB has generated new services such as payment processing, a payment independent sales organization ("ISO"), international payments and small and mid-sized business ("SMB") retail point-of-sale ("POS") services over the past 5 years. These services generate 20% of the current revenue. FFBB has recently hired an information technology ("IT") development team to increase its IT capability to develop new payments and software applications.

Operational efficiency gains are a third area of platform optionality. This includes cost synergies associated with mergers and acquisitions. These can take the form of input cost savings, more efficient operations (higher working capital turns) or selling or discontinuing operations that don't meet return thresholds. Terravest provides an example here with post acquisitions synergies reducing net purchase price to 4.1x (25% return) cash flow from 5.5x (18% return) cash flows. Over the last ten years of these acquisitions, Terravest's return on equity increased from 6% to 23%.

The positive impact of geographic expansion, functional service expansion, and operational efficiency optionality can be further magnified by deposit leverage and share buybacks. An example of these impacts can be seen at FFBB who has, geographic expansion, functional service expansion, a low-cost deposit base (1.0% cost of funds) and has announced a share buyback. Some of the car dealers like Asbury, AutoNation and GPI also exhibit the positive qualities associated with geographic growth, operational efficiency and share buybacks.

Financial Services Unit Economics

The financial services industry is an out-of-favor industry that has some interesting investment opportunities today. Charlie Munger has stated that the first rule of investing is to fish where the fish are. Today banking and related financial services firms fit this description. Although there are specialist financial service investors, the assets under management of specialty finance funds are much smaller than other growth sectors like technology, software and biotechnology. Smaller growth financial services firms have decent growth prospects (upper teen to mid-20s RoE for the next 5-10 years) and can be purchased for less than 10 times current earnings which translates into a valuation of less than 5 times 5 year forward earnings.

One important aspect to examine for financial services firms is unit economics. Return on equity is an important KPI for financial services firms as it illustrates the unit economics of financial services which require capital to operate. Sixth Street Partners has developed a framework that examines the drivers of return on equity, which is useful in this context. Below is an example of how expected returns for business development companies and banks can be compared.

Unit Economics	TSLX	ARCC	OCSL	MAIN	FDUS	NBN	MBSC	FFBB	UBAB	CZBS		
All-in yield	13.5%	11.1%	11.9%	10.7%	14.0%	9.1%	5.7%	6.1%	5.7%	6.1%		
Other fees	1.8%	1.8%	1.8%									3-year average TSLX fees
Cost of Funds	8.3%	5.9%	8.1%	5.3%	4.5%	4.1%	1.1%	0.9%	1.2%	1.0%		Stated cost of funds plus 60bp for fees and swaps
Debt/Equity	1.2	1.06	1.16	0.92	0.73	7.31	9.52	9.42	10.12	12.75		
NII RoE	23.7%	20.3%	20.2%	15.7%	20.9%	45.7%	49.5%	55.1%	51.2%	71.1%		
Additional Fees	0.0%	0.0%	0.0%	0.0%	0.0%	33.3%	7.5%	38.9%	33.3%	10.5%		
Rev RoE	23.7%	20.3%	20.2%	15.7%	20.9%	60.9%	53.2%	76.5%	68.3%	78.6%		
Management Fees	3.3%	3.1%	2.2%	2.5%	3.0%							1.5% for TSLX & ARCC; 1% for OCSL
Operating Exp	0.6%	1.4%	0.3%	0.0%	0.7%	19.3%	21.4%	25.8%	24.5%	34.8%		3-year average other expense (TSLX)
Taxes	0.0%	0.0%	0.0%	0.0%	0.0%	9.0%	7.6%	8.0%	6.2%	8.4%		
RoE Before Inc Fee	19.8%	15.8%	17.7%	13.2%	17.2%	17.4%	20.5%	21.3%	20.5%	27.9%		
Incentive Fee	3.5%	2.8%	3.1%	0.0%	3.4%	0.0%	0.0%	0.0%	0.0%	0.0%		17.5% of RoE
Net Gains/Losses	3.0%	2.0%	1.0%	4.0%	3.0%	-0.5%	-0.3%	-0.3%	-1.5%	-1.0%		Historical Average (3.5% - 5yr; 2.5% - 10yr)
RoE NI	19.3%	15.1%	15.6%	17.2%	16.8%	16.9%	20.3%	21.0%	19.0%	26.9%		
P/BV	1.19	1.01	0.91	1.62	1.07	1.38	1.35	1.88	1.35	1.70		
RoFV NI (Tax free)	18.7%	15.0%	15.9%	15.6%	16.5%	15.8%	19.1%	18.5%	17.9%	24.2%		Premium discount amortized over holding period
AT RoFV (Taxable)	14.6%	11.7%	12.4%	12.2%	12.9%	15.8%	19.1%	18.5%	17.9%	24.2%		
Non-performing	1.1%	1.5%				0.9%	0.0%		1.8%	1.0%		
Port Int Coverage Ratio	2.10	1.50			3.00							
Spread	7.0%	7.0%	5.6%	5.4%	9.5%	5.0%	4.6%	5.2%	4.5%	5.1%		
Amort		5										
Efficiency	31.1%	35.7%	27.5%	15.9%	34.3%	42.3%	43.2%	46.9%	47.9%	48.0%		
Fee Income/Total Revs	0.0%	0.0%	0.0%	0.0%	0.0%	25.0%	7.0%	28.0%	25.0%	9.5%		

Business Development Companies (BDCs) serve as a low-end benchmark for attractive opportunities to deploy Bonhoeffer's capital. Here is a list of notes regarding the comparison above of the funds bank holdings compared to well underwritten BDCs:

1. The return on book equity for the BDCs and the banks is shown in the RoE NI column;
2. The return on equity based upon net income ("RoE NI") values are adjusted to reflect each security's price/book value with the premium to book value being amortized over the expected holding period of five years resulting in the return on equity using market capitalization and net income ("RoFV NI");
3. Taxes are then applied to compare these investment alternatives on an after-tax basis

All of our bank holdings have generated 15-25% unit economics over the past 12 months. These returns are based upon past returns and are expected to continue or possibly improve going forward. NBN's after-tax return on equity using market capitalization and net income ("ATRoFV") may be understated as the ATRoFV varies each year depending upon loan purchases, and the last 12 months was not a large loan purchase period.

CASE STUDY: FFB BANCORP (FFBB)

FFB Bancorp (FFBB) is a regional bank located in California that provides high touch banking services to small and mid-sized businesses (SME). FFBB operates out of one branch in Fresno and provides financial services to California's Central Valley and Southern and Northern California. FFBB also has a loan production office in Torrance, California servicing Southern California. FFBB's geographic expansion strategy includes further development of relationship and business development teams in Southern and Northern California as they have successfully done in the Fresno/Central Valley. FFBB is also increasing the scope of services it provides today. Two of the fastest growing products/services are transaction processing and SBA and real estate loans.

FFBB also has also developed a technology group that has automated banking service functions and created new applications for targeted customer bases such as an integrated point of sale (POS) system for small businesses and restaurants. Management has aspirations to grow its assets in three regions it operates in (Central Valley, Northern California, and Southern California) by six times over the next seven to ten years.

FFBB is truly a growth company and is one of only five firms in the United States whose EPS has grown by 20% or more in each of the last five consecutive years. This growth is driven by transaction processing and increased loan revenue from SMEs (including SBA loans) and Southern California multi-family real estate. FFBB's lending franchise generates an average loan yield of 6.7% and has organically grown loans by 23% per year over the past five years. The incremental loan yield is estimated by management to be 8%. This loan growth was well underwritten yielding only 1.6% of criticized plus watch list loans and 0.5% non-performing loans (NPAs) with a loan loss reserve to NPAs of 145%. FFBB's deposit franchise generates low cost of funds of 1.0% from transaction processing float and non-interest bearing deposits from SME and real estate loan clients. The resulting NIM is 5.2% and is sustainable as incremental loan yield is higher than the current yield and the cost of funds is steady as processing revenue and non-interest bearing deposits are increasing. FFBB's largest shareholder is its Employee Stock Ownership Plan (ESOP), which holds 6% of its common stock.

Fresno First Bank, the predecessor to FFB Bancorp, was founded in 2005 in Fresno, California to provide banking services to the Fresno, California region. In 2015, Steve Miller, FFBB's current CEO and President, joined FFBB. Mr. Miller had experience in transaction processing (working at MBNA for 12 years) and in small business lending (working at and leading small business banks for 9 years in Asia). One result of Steve's experience is that in 2017, FFBB entered the transaction processing business. From 2015 to 2023, FFBB's book value increased by 19% per year and EPS grew by 35% per year materially increasing from the Pre-Steve era when book value growth was 5% annually. FFBB has been recognized in 2023 as the Best Bank in Central California by the *Fresno Bee*, a local paper.

FFBB has recently announced a 5% share buyback and has evolved into a bank that requires little additional capital to grow its loan book. Transaction processing and related services generate a lot of cash flow to provide capital for loan growth. As a result, FFBB has excess capital it has used for technology development and capital returns such as share buybacks. FFBB has an overcapitalized balance sheet with a common equity tier ("CET") ratio of 19.0%, which has been rising over the past few

years. The required regulatory equity CET ratio is 10.5% thus FFBB has excess capital after retaining capital to support historical loan and service growth and technology development.

The platform, as described in the “Platforms and Embedded Optionality section above, that FFBB has built has not only great geographic growth potential, with 6x targeted growth in its three main operating regions (Central Valley, Northern California, and Southern California), but also new service optionality. These new services include cross-border payments, developing its own payment ISO, and developing its own POS system for small businesses. FFBB recently hired a development team that has payments application experience to develop new tailored applications for their customers.

The efficiency ratio is a bank productivity measure, defined as non-interest expense divided by total revenues. A good benchmark for efficiency is a 50% efficiency ratio. The average efficiency ratio for commercial banks for Q1 2024 is 59%. FFBB’s efficiency ratio is 47% for Q2 2024. Given the large number of processing services provided this is an excellent ratio. Many times, a superior efficiency ratio can result from a superior culture. A consistently low efficiency ratio is not common and can signal exceptional management stewardship of the bank’s assets—primarily personnel and money.

FFBB has generated 20% to 30% returns on equity over the past five years. This is an increase from the 10 to 15% range in the previous five years. The ability to generate these returns is the result of increased efficiency, originating real estate and SBA loans and new value-added services such as its own transaction processing ISO.

FFBB has four levers for earnings growth: 1) geographic expansion into Northern and Southern California; 2) new services such as its internal ISO, small business POS system and international payments driven by technology investment; 3) increased efficiency; and 4) distributing excess cash by buying back shares. The firm generates cash flows in excess of what is needed to grow the firm’s loan book.

FFBB has economies of scale in the regions in which it competes (Central Valley, Southern California, and Northern California) as well as economies of scope in providing multiple services to its clients. For example, FFBB provides integrated deposit, line of credit, international payments, SBA loans and POS systems services for small and midsized retailers and restaurants throughout the region.

California Regional Banking Services Market

FFBB competes in the regional banking markets of Fresno (Central Valley), Southern California, and Northern California. Management estimates that the achievable asset size for FFBB’s services over the mid to long term (7 to 10 years) for each of its markets to be about \$3 billion in assets. The current size of FFBB is about \$1.5 billion in assets. This implies a 25% annual growth rate over the next 7 to 10 years driven by new customers and selling new services to both existing and new customers.

Most banks have both a lending franchise and deposit franchise. The lending franchise generates value by originating creditworthy loans at interest rates that more than compensate for loan losses, impairment, and the cost of funds. Banks can have niches (such as SBA loans and mortgages) in which parts of the loans or the whole loans are sold to third parties, and the originator retains the servicing, making the operations capital light. The leading KPI in the lending franchise is the total asset return or

yield (equal to yield plus fees plus principal less any losses). Losses can be estimated based upon the historical write-offs and losses incurred. Banks reserve for expected loan losses via loan loss reserves. Recent financial reporting changes have disclosed the metric of criticized loans to get an idea of which loans are having problems before becoming nonperforming and actual losses. Since banks are levered firms, small amounts of losses can result in large declines in equity.

The deposit franchise will have value when a bank can generate below-market-rate deposits from a sticky customer base whose reason for choosing the bank is not deposit yield. These can be value enhancing when combined with a great lending franchise. FFBB's transaction processing float, ability to provide value-add service for demand deposit accounts, and cater to specific groups (like SMEs) all enhance its deposit franchise. The leading KPI for a deposit franchise is cost of funds. Combining asset yield and cost of funds results in an important KPI: net interest margins.

Specific niches within the banking industry have allowed for compounder-type returns over time despite the relatively mature, slow growing, stable, and fragmented market. Sticking with those niches and not diluting them over time with lower return opportunities is a key skill in finding financial services compounders.

Downside Protection

FFBB's risks include both operational leverage and financial leverage. Operational leverage is based upon the fixed vs. variable costs of the operations. There are economies of scale related to some functions such as transaction and loan processing and cross-selling of banking services.

Financial leverage can be measured by the equity/assets and common equity tier 1 ("CET1") ratios. FFBB has a higher equity/assets of 9.6% and CET1 of 18.7% versus other niche lenders like United Bancorp of Alabama, Merchants Bank of Indiana and Northeast Bancorp. See table in the Comparables and Benchmarking section below. The historical financial performance for FFBB is illustrated below.

KPIs TIKR.com	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018	12/31/2019	12/31/2020	12/31/2021	12/31/2022	12/31/2023	10-yr growth	5-yr growth
Net Interest Income	8.03	9.55	10.62	12.48	14.71	18.24	22.11	27.44	38.84	48.09	63.53	22.98%	28.35%
% Change YoY	12.00%	18.90%	11.20%	17.50%	17.90%	24.00%	21.20%	24.10%	41.50%	23.80%	32.10%		
Non Interest Income Total	1.14	1.07	1.33	1.73	1.93	2.4	4.05	7.07	9.97	13.34	25.05	36.20%	59.85%
Non-Interest/Total Revenues	19.35%	10.45%	11.39%	13.37%	12.21%	12.18%	15.87%	22.65%	21.30%	21.82%	28.85%		
Revenues Before Provision For Loan Losses	9.17	10.62	11.95	14.21	16.64	20.65	26.16	34.52	48.81	61.43	88.58		
Provision For Loan Losses	-3.28	-0.38	-0.27	-1.27	-0.83	-0.95	-0.65	-3.3	-2	-0.3	-1.75		
Total Revenues	5.89	10.24	11.68	12.94	15.81	19.7	25.52	31.22	46.81	61.13	86.83	30.87%	34.54%
% Change YoY	-23.30%	73.80%	14.00%	10.90%	22.20%	24.60%	29.60%	22.30%	50.00%	30.60%	42.00%		
Non Interest Expense	-5.85	-6.93	-7.54	-7.82	-9.17	-11.27	-12.88	-15.51	-18.59	-25.06	-40.61		
Efficiency Ratio	63.79%	65.25%	63.10%	55.03%	55.11%	54.58%	49.24%	44.93%	38.09%	40.79%	45.85%		
Income Tax Expense	-0.02	-1.19	-1.6	-2.05	-2.96	-2.18	-3.43	-4.2	-7.69	-9.55	-12.66		
Earnings From Continuing Operations	0.03	2.12	2.54	3.08	3.68	6.25	9.2	11.51	20.53	26.52	33.56	101.78%	39.95%
Diluted EPS Excl Extra Items	-0.15	0.79	0.93	1.12	1.28	2.14	3.09	3.79	6.62	8.44	10.56		37.61%
% Change YoY	-135.40%	633.30%	17.40%	20.20%	14.30%	67.20%	44.40%	22.70%	74.70%	27.50%	25.10%		
Weighted Average Diluted Shares Outstanding	1.87	2.67	2.72	2.75	2.87	2.92	2.98	3.03	3.1	3.14	3.18		
% Change YoY	-26.30%	42.40%	2.10%	1.00%	4.30%	1.70%	2.10%	1.80%	2.10%	1.40%	1.10%		
Equity	15.74	19.05	26.98	29.93	34.57	40.71	51.96	68.55	89.29	92.36	130.7		
BV/Share	8.42	7.13	9.92	10.88	12.05	13.94	17.44	22.62	28.80	29.41	41.10	17.18%	24.14%
Return on Equity	0.19%	11.13%	9.41%	10.29%	10.65%	15.35%	17.71%	16.79%	22.99%	28.71%	25.68%		
Equity/Assets	7.19%	7.52%	9.11%	8.23%	8.49%	8.71%	9.65%	7.86%	8.27%	7.14%	9.58%		
CET1	17.60%	17.00%	15.40%	14.80%	15.60%	15.30%	14.90%	20.80%	16.10%	15.40%	18.70%		

Management and Incentives

FFBB’s management team has developed a loan origination engine run in an operationally efficient manner along with developing new services being rolled out in new and existing geographies.

The base management compensation for the top three officers ranges from \$1.1 million per year for the President/CEO to \$600,000 per year for the Chief Credit Officer. Over the past year, the total compensation for the top three management officers was about \$2.5 million per year, about 7% of net income per year. The CEO currently holds 77,800 shares (2.5% of shares outstanding) and options worth \$6.8 million, which is more than six times his 2023 salary and bonuses. The CEO’s compensation is structured to include a \$450,000 base pay, \$265,000 in stock compensation, and \$260,000 in performance-based cash compensation. Although specific performance based criteria are not disclosed they can include the following KPIs: return on average common shareholders’ equity; return on average equity; total shareholder return; stock price appreciation; efficiency ratio (other expense as a percentage of other income excluding gains and losses plus net interest income); net operating expense (other income less other expense); earnings per diluted share of Common Stock; per share earnings before transaction-related expense; per share earnings after deducting transaction-related expense; return on average assets; ratio of nonperforming to performing assets; return on an investment in an affiliate; net interest income; net interest margin; ratio of common equity to total assets; regulatory compliance metrics; and customer service metrics.

Board members and ESOP owners have a significant investment in FFBB. The ESOP, board and management owns 722,371 shares, about 22.8% of shares outstanding (\$64 million). Stock grants, provided to management, employees and the ESOP, were equal to 1.7% per year of the shares outstanding over the past three years.

Valuation

FFB Bancorp		Sensitivity Table				
				Price	Upside	
Current Adjusted Earnings	\$10.56					
7-year Expected EPS Growth Rate	25%		0.7%	\$89.00	0.0%	
Historical EPS Growth Rate	38%		10.0%	\$254.66	186.1%	
Current AAA Bond Rate	5.2%	Growth Rate	15.0%	\$344.01	286.5%	
Implied Graham Multiplier **	49.50		20.0%	\$433.37	386.9%	
Implied Value	\$522.72		25.0%	\$522.72	487.3%	
Current Price	\$89.00		30.0%	\$612.07	587.7%	
* (2*Growth Rate + 8.5)						

The key to the valuation of FFBB is the expected growth rate. The current valuation implies an earnings/FCF increase of 0.7% in perpetuity using the Graham formula ((8.5 + 2g)). The historical 5-year earnings per share growth has been 38% per year and the current return on equity is 25%.

A bottoms-up analysis, based upon the market growth rates of FFBB’s markets’ (including transaction processing and banking services provided to SMBs in the Central Valley, Northern California and

Southern California) and management’s goal of increasing assets by 6x over the next 7-10 years (which is equivalent to about 4x over the next 7 years), and about 3% buybacks per year results in a 25% projected EPS growth rate. Historically, FFBB’s EPS growth rate was 38% per year driven by new service offerings and new customer relationships over five years. Using a 25% expected growth rate, the resulting current multiple is 50x of earnings, while FFBB trades at an earnings multiple of about 9x. If we apply 15x earnings to FFBB’s current 2023 earnings of \$10.56, then we arrive at a value of \$160 per share, which is a reasonable short-term target. If we use a 25% seven-year growth rate, then we arrive at a value of \$522 per share. This results in a five-year IRR of 42%.

Growth Framework

FFB Bancorp													
				EPS Growth		31.6%							
	2021	2022	2023	2024	2025	2026	2027	2028	2029	\$ 90.00	2.16 5-yr fwd PE	Growth Bank PE	
										9.4%	8.53 Earnings/FCF Yield	15	
Revs	\$46,810	\$61,130	\$86,830	\$108,538	\$132,416	\$158,899	\$189,090	\$223,126	\$263,288				
		31%	42%	25%	22%	20%	19%	18%	18%		18% organic growth (RoE *retention rate)		
											0% Operation Lev		
NI	\$20,530	\$26,520	\$33,560	\$41,950	\$51,179	\$61,415	\$73,084	\$86,239	\$101,762		5% Repurchase	Future SP	\$624.42
	43.9%	43.4%	38.7%	38.7%	38.7%	38.7%	38.7%	38.7%	38.7%		23% Total EPS growth	IRR	47%
EPS	\$6.62	\$8.45	\$10.55	\$13.89	\$18.62	\$24.55	\$32.10	\$41.63	\$53.98				
		28%	25%	32%	34%	32%	31%	30%	30%	History	EPS GR Rate		
Buyback										5	38%		
5% /year	3100	3140	3180	3021.0	2749.1	2501.7	2276.5	2071.6	1885.2	10	101%		

Another way to look at growth and the valuation of companies is to estimate the EPS five years into the future and see how much of today’s price incorporates this growth. We assume net income will increase by 25% in 2024, declining to 18% by 2028. We are also assuming about 40% of net income (5% of the current market capitalization) will be used for buybacks, consistent with estimated 2024 buyback levels. Using the same revenue described above results in a 2028 EPS of \$41.63, or 2.2x the current price. If we assume a growth bank multiple of 15x, the resulting value is \$624 per share, higher than the seven-year-forward valuation derived above of \$522 per share.

Comparables and Benchmarking

Below is a table of valuation and operational KPIs for high growth specialty bank firms located in the United States. Most of FFBB’s competitors are private banks. I have ranked the banks by expected return as calculated as the sum of the earnings yield plus the long-term earnings growth rate. Compared to the specialty banks, FFBB has the highest 5-year average RoE and TBV plus dividends growth, fee income/total revenue, CET ratios and total addressable market size and lower criticized loan amounts and efficiency ratios. The high total addressable market shows FFBB has a large growth runway. The high CET allows FFBB to return much of its generated cash flow to investors via share buy-backs when the price is right. In addition, FFBB has high management ownership and low management compensation/net income.

Name	5-yr					TAM	Exchange	Efficiency	CoF	NIM	Fee/Tot Rev	Loan Growth	Buybacks	Mgmt		ESOP	CET	Criticized	LRR/NPA	EY	ER	Comments
	TBV + Div Gr	Div Yield	5-yr Avg ROE	Payout	Growth + Div									NI	Ownership							
UBAB*	20.0%	1.3%	13.2%	10.0%	25.1%		OTCPK	47.0%	1.2%	4.5%	26.0%	15.0%	5/10%		4.5%	X	17.2%	5.0%	80.4%	17.0%	40.8%	Low Income & AL/FL Beach Lending, ECIP
MBIN	27.0%	0.0%	23.0%	0.0%	23.0%	5x	NasdaqCM	31.0%	4.6%	2.7%	20.0%	38.0%		5.0%	39.7%		8.0%	3.3%	58.0%	15.9%	38.9%	MF GSE Lending; Risk sharing
CWBK	12.7%	2.9%	19%/24%	15.0%	21.6%		OTCPK	50.0%	1.0%	4.1%	13.2%	11.5%	6.6%				18.6%	1.3%	262.8%	16.9%	38.5%	SoCal RE Lending
FFBB	24.0%	0.0%	25.0%	0.0%	25.0%	6x	OTCPK	42.0%	0.9%	5.2%	28.0%	25.0%	5.0%	7.0%	22.8%	X	19.0%	1.0%	151.3%	11.5%	36.5%	CA & SBA Lending, Processing
CZBS*	10.4%	1.1%	7.1%	15.0%	19.2%		OTCPK	51.0%	1.0%	4.9%	22.0%	8.0%	10.0%		42.5%		23.0%	3.6%	100.6%	16.8%	34.9%	Low Income Lending, ECIP
MSBC	16.6%	0.0%	18.7%/20%	0.0%	19.0%	5x	OTCPK	43.0%	1.1%	4.6%	7.0%	17.0%			53.0%		11.3%	0.7%	5201.0%	14.5%	33.5%	CA Lending, Central/SoCal RE Lending
NBN	20.0%	0.1%	19.0%	1.0%	18.9%	8x	NasdaqGM	42.0%	4.1%	5.1%	25.0%	24.0%	6.0%	14.0%	15.3%		13.2%	1.3%	93.0%	12.3%	31.2%	Forced Selling Loans
AX	16.4%	0.0%	19.6%	0.0%	19.6%		NYSE	47.8%	3.3%	4.7%	13.3%	14.7%	5.0%	4.3%	4.8%		10.2%	3.0%	210.0%	11.1%	30.7%	Brokerage, BaaS
SCZC		1.9%	20.5%	10.0%	20.4%		OTCPK	42.0%	1.3%	5.2%	5.0%	24.0%	2.0%	6.6%	9.5%		12.5%	3.6%	357.0%	12.3%	30.7%	CA Lending
CASH	7.0%	0.4%	17.1%/22.6%	3.0%	19.7%	1.3x	OTCPK	65.8%	0.2%	5.5%	44.7%	8.1%	8.0%	9.5%	0.7%		12.3%	8.1%	235.0%	10.7%	30.0%	Processing, BaaS
TBKB	16.4%	0.0%	17.8%/22.5%	0.0%	20.2%	1.3x	NasdaqGS	41.0%	2.1%	4.8%	24.0%	29.0%	4.0%	6.7%	5.2%		15.8%	4.0%	50.3%	9.6%	29.8%	Processing, BaaS

The exchange a bank trades on can impact current or future price and trading. Stocks that trade on the OTCPK are not included in indices. FFBB trades on the OTCPK and is expected to list on the NASDAQ by the end of the year. Once listed on the NASDAQ, given FFBB's market capitalization (\$282 million) more mutual funds and ETFs will consider FFBB for inclusion in their holdings. If FFBB is listed on the NASDAQ, and included in indices, then the funds which track the indices that FFBB is added to will become forced buyers.

Risks

The primary risks are:

- slower-than-expected market growth due to slower growth of the California economy;
- slower-than-expected acceptance of new product/service offerings; and
- higher than expected losses in the loan portfolio.

Potential Upside/Catalyst

The primary catalysts are:

- faster-than-expected market acceptance of new products and services; and
- mergers and acquisitions and partnerships that could accelerate EPS growth.

Timeline/Investment Horizon

The short-term target is \$160 per share, which is almost 75% above today's stock price. If the continued service growth due to geographic expansion plays out over the next five years (with a resulting 25% earnings per year growth rate), then a value of \$575 (midpoint of the two methods described above) could be realized. This is a 45% IRR over the next five years. Given the quality of the loan portfolio, the predictability of the interest income and non-interest income and the high IRR, FFBB is a nice investment opportunity.

Disclaimer

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