



Quarter 1, 2025

Dear Partner,

Throughout the first quarter of 2025, we continued to sell slower-growth firms and purchased durable, faster-growing firms in temporarily depressed sectors, while identifying similar opportunities in new industries. These firms align with our longer-term growth themes of consolidation, buying from forced sellers, transaction processing, affordable housing finance, distribution, infrastructure spending and housing construction. We identified and continue to analyze opportunities in the following industries: banks, 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%, a metric of 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. I believe high quality is reflected in free cash flow growth with highly recurring revenues (such as in subscription businesses), high free cash flow conversion, and 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 3.4% net of fees in the first quarter of 2025. In the same time period, the MSCI World ex-US, a broad-based index, returned a gain of 5.9%, the S&P 500 returned a loss of 4.3% and the DFA International Small Cap Value Fund, our closest benchmark, returned a gain of 6.5%. A US benchmark was added as the fund has increased exposure to the US to greater than 50%. As of March 31, 2025, our securities have a weighted average earnings/free cash flow yield of 12.8% and an average EV/EBITDA of 3.4 with 14% growth.

The current Bonhoeffer portfolio has projected earnings/free cash flow growth of about 14%. The DFA International Small Cap Value Fund had an average earnings yield of 11% with 9% growth. Bonhoeffer Fund's and the indices' multiples are lower than the previous quarter, primarily due to share price declines.

Bonhoeffer Fund Portfolio Overview

Bonhoeffer's investment portfolio consists of deep value-oriented special situations, as well as growth-oriented firms that can compound value over time and have been purchased at a reasonable price. In most cases, we are paying no more than high single-digit multiples of five years 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. And importantly, 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 fourth quarter, which are in line with our low historical turnover rates. We sold some of our slower-growing investments that are not buying back their stock and invested some of our cash into niche growing banks, like FFB Bancorp, Northeast Bancorp, Citizens Bank, United Bancorp of Alabama and Mission Bank, described in the case study below.

As of March 31, 2025, our largest country exposures included: United States (59%), Canada (11%), United Kingdom (7%), Latin America (6%) and South Korea (4%). The largest industry exposures included: distribution (54%), real estate/infrastructure/finance (51%), telecom/media (5%), and consumer products (7%). Some industries overlap so the total is greater than 100%.

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. I want to thank you for the opportunity to invest by your side and welcome any questions you may have.

Warm Regards,

Keith D. Smith, CFA

INVESTMENT THEMES

There are some overlapping themes thus the total percentage of the portfolio is greater than 100%.

Distribution (54% of Portfolio; Quarterly Performance -7%)

Our holdings in car dealerships and branded capital equipment dealerships, building product distributors and electrical component distributors all fall into the distribution theme. One of the main key performance measures for dealerships is velocity, or inventory turns. We own some of the highest velocity distributors in markets around the world. Distribution firms include: Builders First Source, Asbury Automotive, Arrow Electronics, Ferrycorp (a Caterpillar dealer), Terravest and Autohellas.

Real Estate/Construction/Finance (50% of Portfolio; Quarterly Performance -9%)

The current construction holdings (in US and Europe through Builders First Source and Vistry, respectively) 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 buying of forced loans from forced sellers 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 sustainable RoEs and EPS growth rates higher than about 20% that are selling for single-digit multiples and have decent underwriting. We continue to find banks that meet these criteria. An example is Mission Bancorp, whose investment thesis is laid out in this quarter's case study.

UBAB continues to grow and is deploying excess capital from the ECIP program buybacks, increased low-income housing loans and ongoing examination of acquisition candidates. NB is also growing its SBA loan book as well as buying orphan loans from sellers. NB's had lower than expected loan growth in its FY' Q3 results, driven by the Trump administration's changes in the SBA loan criteria. Management expects that once the SBA criteria are adjusted, its loan levels will return to expected growth. Also in FY'Q3, the delay of bank M&A versus expectations has reduced the pool of orphan loans that NB can review. However, NB has executed its ATM equity offering in FY'Q3, which typically means NB has identified loans to buy with the equity proceeds and associated deposit growth.

FFB received a consent order in January associated with its higher risk third-party ISO transaction processing customers. The consent order allows FFB to repurchase common stock and allow continued on-boarding of low and moderate risk transaction processing customers. The estimated financial impact of the consent order is a loss of about \$10 million (or \$3-\$4 per share) based upon the loss of processing fees and low-cost deposits over the next 12 months and additional compliance costs. Earlier in 2024, FFB hired a former 8-year FDIC lawyer as head of compliance. If FFB can replace the high-risk customer revenue with low or moderate risk customers or other service fees, the financial impact will be more of a one-time event versus a recurring one. The recent compliance hire should facilitate the timely resolution of the consent order. If the consent order turns out to be a one-time event, then the current price is less than eight times current earnings.

Public Leverage Buyouts (LBOs) (43% of Portfolio; Quarterly Performance 2%)

Our broadcast TV franchises, leasing, building products distributors and dealerships and service outsourcing, fall into this category. One trend we find particularly compelling in these firms is growth creation through acquisitions, which provide 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 a spread between borrowing, interest rates 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 like Terravest, who have 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 on expected returns is through incremental return on incremental invested capital ("RoIIC").

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. These firms include: Terravest, Asbury Automobile, Autohellas, Builders First Source and NOA. In addition, many of these firms are buying back stock and the modest current valuations make these buybacks accretive

Terravest is an example of an interesting public leveraged buyout ("LBO") that is also a serial acquirer. Terravest consolidates metal bending industrial firms that make and sell storage tanks, transportation tanks, compressed gas equipment, HVAC and containment equipment and oil and gas processing equipment, while also providing oil and gas field services. The company targets purchasing firms at a price from 4-5x EBIT and after synergies average about 3.5x EBIT (generating RoIIC in the 30%^s). Terravest's latest acquisition of Engineered Transportation International ("ETI") was at 7x EBIT. A higher multiple was paid as ETI is an operational consolidation platform with a young management team similar to Terravest. ETI buys firms in the transportation tanks space that share its philosophy and operate at similar multiples. Thus, Terravest now has two teams rolling up the metal bending industrial firms. Since Terravest purchased ETI, the company has won two military contracts worth \$818 million over 5 years and made two acquisitions.

A useful tool in evaluating returns on capital is return on incremental invested capital analysis. One way to calculate RoIIC, is to divide the changes in cashflow from operations (CFO) by the capital expenditure and merger and acquisition investment over a given period of time. Below is the calculation of the RoIIC over the past 10 years. As can be seen from the RoIIC analysis, Terravest's RoE and RoIIC has increased over the past five to ten years. The ETI acquisition will further increase Terravest's RoE.

Below is the updated Terravest's RoIC analysis:

Terravest		New CEO													
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	5-yr	
Capital Invested	2.8	14.8	22.8	7.2	28.4	28	27	13	57.5	73.5	39	176	28	74.8	
	5.1	5.5	17.6	37.6	30	35.6	56.4	55	40	70.5	131	112.5	215		
			22.7	43.1	47.6	73.2	86.4	90.6	96.4	125.5	171	183	346		
CFO	12	20.6	31.86	17.88	17.29	30.8	35.02	43.3	46.93	67.78	96	139	160	101.942	
	4.1	10.2	19.86	-2.72	-14.57	12.92	17.73	12.5	11.91	24.48	49.07	71.22	64		
			23.96	7.48	5.29	10.2	3.16	25.42	29.64	36.98	60.98	95.7	113.07		
2-yr ROIC		185.5%	112.8%	-7.2%	-48.6%	36.3%	31.4%	22.7%	29.8%	34.7%	37.5%	63.3%	29.8%	39.0%	
4-yr ROIC				17.4%	11.1%	13.9%	3.7%	28.1%	30.7%	29.5%	35.7%	52.3%	32.7%	36.2%	
Net Income	2.53	3.64	8.43	14.96	7.45	9.19	17.27	22.56	26.63	36.41	46.77	49.63	73.24		
Equity	45	80	90	86.52	86.63	88.69	100.93	126.14	132.06	195.9	237.74	399.62	399.62		
RoE	20.4%	7.3%	10.1%	17.3%	8.6%	10.4%	17.1%	24.0%	20.2%	18.6%	24.0%	12.4%	33.0%	21.6%	

Terravest is currently generating RoEs in the 20%^s and RoIC in the 30% range. This should result in Terravest's RoEs increasing to the 30% range over the next few years. Below is a 5-yr Discounted Cash Flow ("DCF") valuation for Terravest:

Terravest					EPS Growth	21.4%									
	2021	2022	2023	2024	2025	2026	2027	2028	2029	\$ 170.00	10.65	5-yr fwd PE	10% growth PE		
										3.8%	26.42	Earnings/FCF Yield	28.5		
Revs	\$308	\$577	\$678	\$912	\$1,504	\$2,041	\$2,347	\$2,699	\$3,104						
		88%	18%	34%	65%	36%	15%	15%	15%			2-4% organic growth			
												1-4% op leverage			
NI	\$34	\$44	\$70	\$123	\$131	\$226	\$234	\$270	\$310			10% M&A	Future SP	\$455.10	
	11.2%	7.5%	10.4%	13.5%	8.7%	11.1%	9.9%	10.0%	10.0%			2% Repurchase	IRR	22%	
												15-20% Total growth			
EPS	\$1.69	\$2.14	\$3.47	\$6.05	\$6.43	\$11.22	\$11.73	\$13.72	\$15.97	\$ -	20.3	\$3,451.00			
		27%	62%	74%	6%	74%	5%	17%	16%						
Buyback										History	Gr Rate	IRR			
	20.3	20.3	20.3	20.3	20.3	20.1	19.9	19.7	19.4	5	26%		9%	19%	
20%	0.00	0.00	0.00	0.00	0.15	0.24	0.23	0.24	0.25	10	17%	Gr Rate	13%	21%	
					170	187	206	226	249				17%	23%	

The key assumptions in this DCF include an increase in operating margin from operating leverage as revenues increase from organic growth as well as merger and acquisition activity and roughly 2% of market cap buyback. The 2% buyback represents 20% of projected income. These assumptions result in a low twenties EPS growth rate over the next five years, a \$455 per share value and a 22% IRR.

Compound Mispricings (9% of Portfolio; Quarterly Performance -11%)

Our Korean preferred stocks, Asian real estate and Vistry all feature characteristics of compound mispricings. The thesis for the closing of the voting, nonvoting, holding company and multiple business valuation gap includes evidence of better governance and liquidity and 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.

Our Lotte Chilsung holding is a compound mispricing as it has both an operating beverage company and a large land plot in downtown Seoul. In addition, the security we hold is the preferred shares of Lotte Chilsung. Korean preferred shares are like equity shares without voting power but have a higher dividend than the common shares. Lotte has gone through two stages of improvement since its corporate

reorganization in 2017. From 2017 to 2022, Lotte Chilsung focused on strengthening its domestic business. From 2023 to the present, Lotte Chilsung has focused on expanding overseas including consolidating foreign subsidiaries. Going forward, Lotte Chilsung will focus on enhancing profitability. Over the past few years, Lotte has increased return on equity (exclusive of real estate) from mid-single digits pre-COVID to mid double-digits from 2020 to 2023. This is in-line with similar sized beverage firms such as Fraser & Neave and Thai Beverage. Going forward, based upon Lotte Chilsung's Value-Up Plan, the company is expected to increase return on equity (exclusive of real estate) to 20%. This will result in earnings of ₩38,500 per share up from the 2023 level of ₩17,000 per share and 2024 level of ₩8,200 per share. Below is the historical RoIC and RoE for Lotte Chilsung.

Lotte Chilsung	2014	2015	2016	Corp Restructure 2017	2018	2019	2020	2021	2022	2023	2024	12.7%
Capital Invested	288.4	236.9	348.6	291.1	229.5	139.4	115	130.6	152.3	204	291	892.9
2-yr sum	502.8	525.3	585.5	639.7	520.6	368.9	254.4	245.6	282.9	356.3	495	
4-yr sum			1088.3	1165	1106.1	1008.6	775	614.5	537.3	601.9	777.9	
CFO	167.7	270.5	260	155.2	219.7	231.6	240	337.7	347.5	344	353	113
2-yr change	-53.2	20.5	92.3	-115.3	-40.3	76.4	20.3	106.1	107.5	6.3	5.5	
4-yr change			39.1	-94.8	52	-38.9	-20	182.5	127.8	112.4	113	
2-yr ROIC	-10.6%	3.9%	15.8%	-18.0%	-7.7%	20.7%	8.0%	43.2%	38.0%	1.8%	1.1%	5-yr avg 22.3%
4-yr ROIC			3.6%	-8.1%	4.7%	-3.9%	-2.6%	29.7%	23.8%	18.7%	14.5%	13.1%
Net Income	27	112	78	251	52	23	60	152	139	170	82	
Equity less RE	1867	1913	2332	863	787	838	1265	995	962	1087	1128	
RoE	1.4%	5.9%	3.3%	29.1%	6.6%	2.7%	4.7%	15.3%	14.4%	15.6%	7.3%	10.6%

This analysis illustrates Lotte Chilsung's improving RoE as management has focused its efforts on product/regional consolidation and cost reductions. Lotte's land parcel, in downtown Seoul (in the Seocho-dong area), is estimated to be worth ₩3.8 trillion. This site is the former bottling location for Lotte Chilsung's beverages. This part of Seoul is a prime real estate location and is the home to many law offices. In early 2025, Lotte Chilsung was in discussions with the Seoul Metropolitan District to develop this site. In the same area, an existing highway will be moved below ground to increase traffic flow. It makes sense from a cost perspective to have Lotte Chilsung's Seocho-dong development and highway project to occur at the same time. In corporate governance news, the Chairman of the Lotte Group, Shin Dong-bin, is expected to step down from the Lotte Chilsung board to focus on turning around Lotte Shopping.

Below is an updated valuation of Lotte Chilsung:

Telecom/Transaction Processing (8% of Portfolio; Quarterly Performance -3%)

The increasing use of transaction processing in the markets of our respective firms, as well as the rollout of fiberoptic and 5G networks, is providing growth opportunities within this theme. Given that most of these firms are holding companies and have multiple components of value (including real estate), the timeline for realization may be longer than for more mono-industry-focused firms.

Millicom (TIGO) is one of the remaining telecom firms in the portfolio as 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 one of its key markets, Columbia, 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 this firm.

The sale of Millicom's tower unit, Lati to SBA Communications has been completed. Millicom continues to implement cost cuts identified by the new CEO and team that was put in place by a large shareholder, Xavier Niel. In addition, Millicom has announced a \$3/yr dividend which is currently yielding over 9% at the current stock price. Based upon the recently released financials, Millicom is selling for a FCF yield of 15%. Earnings have grown by 10%/year over the past five years and are expected to grow by 15%/year over the next five years. Xavier has executed tender offers for Millicom shares (the latest of which was \$25.75 per share), which has increased his stake in Millicom to 40%. Given Mr. Niel's interest in purchasing 100% of TIGO, I feel the upside may be capped. However, based upon Millicom's performance and dividend yield, the share price should appreciate to reflect the good performance and capital allocation.

Consumer Product (7% of Portfolio; Quarterly Performance -13%)

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 turnovers, 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 do (such as selling hunting supplies).

BANKING COMPOUNDERS

The theme of compounders is common amongst funds and individual stockholders today. These firms generate above average rates of return on equity for extended periods of time thus creating attractive firms to hold over time. Charlie Munger used the analogy of surfing a wave to describe these types of firms which provide the holder superior returns even when purchased at above average prices. Most of the firms discussed as compounders are not in the banking business. However, compounder banks (with EPS growth rates above 15%) do exist and today they can be purchased at below average multiples. We have about 20% of our portfolio invested in these bank compounders and a number of these have been described in recent case studies (FFB Bancorp, Northeast Bank and Mission Bank). Each of these compounders have some niche(s) where they specialize and generate above average returns for

extended periods of time. What is interesting today is that these compounders have experienced multiple compressions which can provide various expansion opportunities going forward, assuming the firms can maintain their growth trajectories. An example of a bank compounder is Axos Financial.

Axos buys unwanted assets other banks want to divest in addition to growing its already acquired financial services lines of business. They have also advanced credit to some risky customers (like Donald Trump) but have lent on a secured basis to ensure repayment. These types of loans have attracted the shorts to Axos, but their historical performance has resulted in only temporary declines in value due to short reports. Since current management has controlled Axos (October 2017), the EPS has risen by 30% per year while stock price has increased by 23% per year as illustrated in the chart below:



Since 2007, Axos has purchased loan books from other banks and the FDIC, deposits, leasing assets, brokerage clearing and software assets, stock brokerage deposits and advances. Axos has successfully integrated these assets over the years. As a result, Axos has generated mid-teens RoEs and RoICs over the past 10 years rising over the period as illustrated in Axos' incremental return on equity analysis below:

Axos Financial													3-yr average
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	14.7%
Equity	268.3	370.8	533.5	683.6	834.3	960.5	1073.1	1230.9	1400.9	1643	1917.2	2290.6	
Capital Invested		102.5	162.7	150.1	150.7	126.2	112.6	157.8	170	242.1	274.2	373.40	1217.5
2-yr sum			265.2	312.8	300.8	276.9	238.8	270.4	327.8	412.1	516.3	647.60	
4-yr sum					566	589.7	539.6	547.3	566.6	682.5	844.1	1059.70	
NI	39.5	55.7	82.4	119	134.4	152.1	154.8	183.1	215.5	240.7	307.2	450	179.2
2yr change			42.9	63.3	52	33.1	20.4	31	60.7	57.6	91.7	209.3	
4yr change					94.9	96.4	72.4	64.1	81.1	88.6	152.4	266.9	
2-yr ROIIC			16.2%	20.2%	17.3%	12.0%	8.5%	11.5%	18.5%	14.0%	17.8%	32.3%	18.8%
4-yr ROIIC					16.8%	16.3%	13.4%	11.7%	14.3%	13.0%	18.1%	25.2%	16.4%
Equity	268.3	370.8	533.5	683.6	834.3	960.5	1073.1	1230.9	1400.9	1643	1917.2	2290.6	
RoE	14.7%	15.0%	15.4%	17.4%	16.1%	15.8%	14.4%	14.9%	15.4%	14.7%	16.0%	19.6%	16.1%

Axos is run in an efficient manner with an efficiency (cost/income) ratio of 48% and net interest margins of about 4%. Management, like other bank compounders, buys back stock (if the stock price is modest – which typically is the case) when other assets are not available that meet management’s expected return hurdle of mid-teens. In addition to the quantitative analysis, Axos has many qualitative factors in generating these high returns including:

- Management stock incentives vest based upon achieving a minimum RoE of 6% above the industry average RoE and a stock return premium of 2% versus bank indices;
- Cross selling products and services across segments such as brokerage and consumer banking services;
- Management’s ownership of 5% of Axos’ equity; and
- Modest management compensation of 5% of yearly net income

The question today is whether this performance can be repeated. I think it can, given the amount of assets available for disposal, organic growth of assets owned today and the modest valuation of 9x EPS. With this low valuation, if the growth of greater than 15% can be maintained then a higher multiple is appropriate and should add to appreciation of Axos’ stock price.

Axos would be included in the banks buying unwanted assets category with Northeast Bank (21% EPS growth and 14% stock price growth since current management took over) and BAWAG (11% EPS growth and 17% stock price growth since BAWAG’s IPO), a European bank managed by a US management team. Both of these banks are efficient lenders (with efficiency ratios below 45%) with good net interest margins of greater than 3%. Most of the historical price appreciation of these unwanted asset bank compounders is from EPS growth.

Other categories of compounders include processors, customer service banks, low-income subsidized lending, banking-as-a-service (BaaS) and niche lenders.

Examples of processing bank compounders include FFB Bancorp and Pathward Financial. For these banks, processing provides a low-cost source of funds, regulatory capital as well as recurring fee income. FFB Bancorp generated 31% EPS growth and 20% stock price growth since current management began in 2015. Pathward Financial generated 23% EPS growth and 19% stock price growth over the past 10 years.

Examples of customer service bank compounders include Mission Bancorp and Private Bancorp of America. These banks grow in part by acquiring other banking teams from competing banks. This is a cost-effective strategy as the purchaser is acquiring banking relationships without paying the goodwill associated with purchasing a bank. Mission Bancorp generated 28% EPS growth and 22% stock price growth since current management began in 2013. Private Bancorp of America generated 40% EPS growth and 12% stock price growth since current management began in 2018.

Examples of low-income subsidized bank compounders include United Bancorporation of Alabama and Citizens Bancorp. These banks receive direct (fees and grants) and indirect government support (loan guarantees and support fees). United Bancorporation of America generated 27% EPS growth and 20% stock price growth over the past 10 years. Citizens Bancorp generated 25% EPS growth and 17% stock price growth over the past 10 years.

BaaS bank compounders include Coastal Financial and The Bancorp. For these banks, processing provides a low-cost source of funds, regulatory capital as well as recurring fee income. Coastal Financial generated 28% EPS growth and 28% stock price growth since its IPO. The Bancorp generated 22% EPS growth and 18% stock price growth over the past 10 years.

Niche bank compounders include Esquire Bancorp and Merchant Bancorp of Indiana. Esquire Bancorp focuses on financing lawyers and their clients, including secured litigation finance. Merchant Bancorp of Indiana provides multi-family GSE and bridge financing to multi-family owners. Esquire Bancorp generated 32% EPS growth and 27% stock price since its IPO in 2017. Merchant Bancorp of Indiana generated 26% EPS growth and 14% stock price since its IPO in 2017.

CASE STUDY - MISSION BANCORP (MSBC)

Mission Bancorporation (“MSBC”) is a community bank located in California that provides banking service to small and mid-sized businesses (“SMEs”) in the Central Valley (Bakersfield and Stockton), Central Coast (San Luis Obispo) and Southern California (Ventura and Los Angeles). MSBC also originates and services SBA and FarmerMac loans. MSBC operates out of its headquarters in Bakersfield, California with nine locations in California. MSBC has organically grown in Stockton, Ventura and San Luis Obispo by hiring local banking teams from larger banks similar to ServisFirst in the South. MSBC has a subsidiary, Mission Community Development LLC, who is a designated community development thus is eligible for US Treasury incentive payments including New Market Tax Credits. The current President and CEO, Andrew Antongiovanni, was appointed CEO in 2013. He was trained as a banker at Wells Fargo and joined MSBC in 2011. Mr. Antongiovanni grew up on a farm in the Bakersfield area.

MSBC has grown EPS by almost 19% per year over the past five years and 28% over the past ten years. This growth is driven by providing commercial and commercial real estate loans which have grown by 18% per year over the past ten years and 17% per year over the past five years. MSBC’s lending franchise and loan purchase generates an average loan yield of 6.1% and has organically grown loans by 17% per year over the past five years. The strong loan growth is comprised of criticized plus watch list loans of 0.7%, non-performing loans (“NPAs”) of 0.03% and a loan loss reserve to NPAs of 2,413%. MSBC finances its loans through non-interest bearing and interest-bearing deposits generating a low cost of funds of 1.8%. The resulting net interest margin is 4.3% and is sustainable as funding costs will decline with declining loan yields. MSBC’s largest shareholder is its management, which holds 53% of its common stock. Historically, MSBC has generated on average mid-teens percentage of its revenue from non-interest bearing or spread activities. From 2013 to 2023, MSBC realized operational leverage from its loan growth over a slower growing fixed cost base.

MSBC was founded in 1998 in Bakersfield, California to provide banking services to the Central Valley and Coast and Southern California region. In 2012, MSBC merged with Mojave Desert Bank located in Mojave, California. In 2015, MSBC’s Ag division started working with the FarmerMac program. MSBC’s growth from Bakersfield/Mojave came about from organic growth (opening branches) in Ventura (2017), Stockton (2018) and San Luis Obispo (2020). In each case, MSBC recruited an experienced lending team from a bank in each community. From 2013 to 2023, MSBC’s book value plus dividends increased by 15% per year and EPS grew by 28% per year. From 2022 to 2023, MSBC repurchased shares at a rate of about 0.14% per year. These repurchases partially offset the 5% yearly stock dividend MSBC provides to shareholders.

A bank productivity measure is the efficiency ratio, non-interest expense divided by total revenues. A good benchmark for efficiency is a 50% efficiency ratio. The average efficiency ratio for commercial banks in Q1 2024 was 59%. MSBC’s efficiency ratio is 45% for the trailing three quarters ending Q3 2024.

MSBC has generated on average returns on equity of 17% over the past five years. This has been an increase from an average of 11% in the previous five-year period. The average incremental return on equity over the past five years has been 23%, see the calculation below. The ability to generate these returns is the result of increased efficiency, expansion in existing and new markets and providing new services like 1031 exchanges. Loan growth has been robust with 20% per year growth from 2013 to 2018 to 17% per year growth from 2019 to 2023. Below is a return on incremental equity capital (“RoIEC”) analysis for MSBC:

Mission Bancorp													
	New CEO												3-yr average
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	14.5%
Equity	35.07	38.34	42.13	47.07	53.46	67.05	82.72	102.13	120.28	123.78	156.71	189.49	
Capital Invested		3.27	3.79	4.94	6.39	13.59	15.67	19.41	18.15	3.5	32.93	32.78	106.77
2-yr sum			7.06	8.73	11.33	19.98	29.26	35.08	37.56	21.65	36.43	65.71	
4-yr sum					18.39	28.71	40.59	55.06	66.82	56.73	73.99	87.36	
NI	2.24	3.07	3.73	5.05	6.09	11.85	13.66	15.69	18.72	24.25	30.47	30.14	15.5
2yr change			1.49	1.98	2.36	6.8	7.57	3.84	5.06	8.56	11.75	5.89	
4yr change					3.85	8.78	9.93	10.64	12.63	12.4	16.81	14.45	
													5-yr avg
2-yr ROIIC			21.1%	22.7%	20.8%	34.0%	25.9%	10.9%	13.5%	39.5%	32.3%	9.0%	21.0%
4-yr ROIIC					20.9%	30.6%	24.5%	19.3%	18.9%	21.9%	22.7%	16.5%	19.9%
Equity	35.07	38.34	42.13	47.07	53.46	67.05	82.72	102.13	120.28	123.78	156.71	189.49	
RoE	6.4%	8.0%	8.9%	10.7%	11.4%	17.7%	16.5%	15.4%	15.6%	19.6%	19.4%	15.9%	17.2%

From this analysis, the RoIEC is about 20% with an average RoE of 17%. If this level of incremental rates of return is maintained, the RoE should approach 20%. MSBC has four levers for earnings growth:

- 1) expansion into new markets;
- 2) new services such as 1031 exchanges;
- 3) increased efficiency; and
- 4) distributing excess cash by buying back shares.

MSBC has economies of scale in the service markets it currently or historically competed in (local real estate and business loans). They also have scale based upon the volume of the loans they originate; so as they grow, they should become more efficient.

Fresno/Central Valley/Central Coast/Bakersfield and Loan Market

MSBC competes in California’s Central Valley and Coast and the Los Angeles area banking markets. The table below illustrates the population, income and housing price growth over the past five and ten years in the five MSAs that MSBC competes in:

MSA (annual growth)	Population Growth		Housing Price Growth		Personal Income Growth	
	5 yr	10 yr	5 yr	10 yr	5 yr	10 yr
Bakersfield, CA	0.6%	0.7%	8.1%	10.8%	4.3%	3.3%
Los Angeles-Long Beach-Anaheim, CA	-0.7%	-0.2%	8.9%	6.8%	5.9%	5.2%
Oxnard-Thousand Oaks-Ventura, CA	-0.4%	-0.1%	9.0%	7.4%	5.5%	4.6%
Stockton, CA	1.3%	1.3%	9.0%	9.3%	3.2%	2.6%
San Luis Obispo - Paso Robles, CA	-0.6%	0.2%	8.9%	7.7%	5.6%	5.0%

These are healthy population growth rates for MSBC to provide loans into. MSBC has an \$8 billion asset and an after-tax return on assets goal of 1.6% by 2028. This translates into \$128 million net income and \$49 per share EPS goals by 2028.

Downside Protection

MSBC'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 loan processing and cross-selling of banking services. For banks the amount of non-interest income can provide downside protection especially if this revenue is recurring as is the case for UBAB. Over the past five years, about 15% of MSBC's revenues were from non-interest income.

MSBC's balance sheet, as of September 30, 2024 is comprised of \$305 million of cash, \$234 million of securities and \$1.226 billion of loans. The securities have \$26 million mark to market losses which should decline as the securities mature. The largest part of the loan portfolio is owner occupied commercial real estate loans (42% of loans), followed by non-owner occupied commercial real estate loans (15% of loans), commercial and industrial loans (13% of loans) and farmland loans (11% of loans).

Financial leverage can be measured by the equity/assets and CET1 ratios. MSBC has higher equity/assets of 10.9% and CET1 of 17.2% than other niche lenders (like Northeast Bank, Merchants Bank of Indiana and FFB Bancorp). The historical financial performance for MSBC is illustrated below.

KPIs TIKR.com	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	12/31/2024	10-yr growth	5-yr growth
Net Interest Income	13.26	14.4	15.32	18.15	22.35	28.69	34.29	39.82	43.92	55.27	69.59	18.03%	19.39%
% 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	3.49	4.19	4.09	4.57	4.72	6.31	5.48	6.32	6.63	8.01	5.42	4.50%	-3.00%
Non-Interest/Total Revenues	21.24%	23.43%	21.72%	20.70%	18.15%	18.56%	14.39%	14.43%	13.57%	13.29%	7.37%		
Revenues Before Provision For Loan Losses	16.76	18.6	19.41	22.72	27.07	35	39.77	46.14	50.55	63.28	75.01		
Provision For Loan Losses	-0.33	-0.72	-0.57	-0.65	-1.06	-1.01	-1.69	-2.34	-1.68	-2.99	-1.42		
Total Revenues	16.43	17.88	18.83	22.08	26.01	33.99	38.08	43.81	48.87	60.29	73.59	16.18%	16.71%
% Change YoY	45.60%	8.90%	5.30%	17.20%	17.80%	30.70%	12.00%	15.00%	11.60%	23.40%	22.10%		
Non Interest Expense	-12.32	-12.65	-12.49	-13.55	-14.77	-16.8	-19.48	-22.52	-23.25	-26.67	-31.63		
Efficiency Ratio	73.51%	68.01%	64.35%	59.64%	54.56%	48.00%	48.98%	48.81%	45.99%	42.15%	42.17%		
Income Tax Expense	-1.66	-2.14	-2.58	-3.43	-5.09	-4.43	-4.93	-5.6	-6.9	-9.37	-11.49		
Earnings From Continuing Operations	2.26	3.09	3.77	5.1	6.15	12.76	13.66	15.69	18.72	24.25	30.47	29.71%	19.02%
Diluted EPS Excl Extra Items	0.99	1.34	1.63	2.15	2.53	5.17	5.40	6.18	7.26	9.26	11.54	27.88%	17.44%
% Change YoY	20.90%	35.50%	20.80%	32.90%	17.60%	91.20%	12.50%	14.30%	17.60%	27.30%	24.80%		
Weighted Average Diluted Shares Outstanding	2.29	2.31	2.32	2.37	2.43	2.47	2.53	2.54	2.58	2.62	2.64	1.43%	1.34%
% Change YoY	10.00%	0.70%	0.60%	2.20%	2.40%	1.80%	2.30%	0.50%	1.50%	1.60%	0.60%		
Equity	35.07	38.34	42.13	47.07	53.46	67.05	82.72	102.13	120.28	123.78	156.71		
BV/Share	15.31	16.60	18.16	19.86	22.00	27.15	32.70	40.21	46.62	47.24	59.36	14.51%	16.94%
Return on Equity	6.44%	8.06%	8.95%	10.83%	11.50%	19.03%	16.51%	15.36%	15.56%	19.59%	19.44%		
Equity/Assets	9.27%	9.96%	9.36%	9.64%	9.26%	11.35%	10.91%	8.91%	9.03%	9.24%	10.91%		
CET1	N/A	0.00%	15.50%	14.10%	13.40%	13.10%	13.20%	13.90%	14.10%	16.10%	17.20%		

Management and Incentives

MSBC's management has developed a loan origination pipeline of C&I and real estate loans over time. MSBC has been awarded the Super Premier Bank award by Findley Companies for over twenty years.

Management compensation incentives are not disclosed by MSBC but overall efficiency (including management compensation) is reasonable at 45% during Q3'24. Board members have a significant

investment in MSBC. The board and management own 1.419 million shares, about 53% of shares outstanding (\$134.8 million). Stock options provided to management and employees were equal to 1.4% per year of the shares outstanding over the past three years.

Valuation

Mission Bancorp		Sensitivity Table		
			Price	Upside
Current Adjusted Earnings	\$11.54			
7-year Expected EPS Growth Rate	17%	0.6%	\$95.00	0.0%
Historical EPS Growth Rate	28%	7.5%	\$229.50	141.6%
Current AAA Bond Rate	5.2%	Growth Rate	\$278.33	193.0%
Implied Graham Multiplier **	35.96	15.0%	\$375.99	295.8%
Implied Value	\$415.06	17.5%	\$424.82	347.2%
Current Price	\$95.00	20.0%	\$473.65	398.6%
* (2*Growth Rate + 8.5)				

The key to the valuation of MSBC is the expected growth rate. The current valuation implies an earnings/FCF increase of 0.6% in perpetuity using the Graham formula ((8.5 + 2g)). The historical 5-year earnings per share growth has been 28% per year and the 5-year average return on equity of 17%.

A bottom-up analysis based upon MSBC's market growth rates (California housing and business development loan markets) and historical growth rates results in an estimated 17% projected EPS growth rate driven by expected loan growth rates of 15-20% per year consistent with history. Historically, MSBC's EPS growth rate was 30% per year driven by new service offerings and new customer relationships over ten years. Using a 17% expected growth rate, the resulting current multiple is 36x of earnings, while MSBC trades at an earnings multiple of about 8.2x. If we use a 3% growth rate, the implied multiple is 15x. If we apply 15x earnings to MSBC's current earnings of \$11.54, then we arrive at a value of \$173 per share, which is a reasonable short-term target. If we use a 17% seven-year growth rate, then we arrive at a value of \$415 per share. This results in a five-year IRR of 34%.

Growth Framework

Mission Bancorp	EPS Growth 17.4%												
	2022	2023	2024	2025	2026	2027	2028	2029	2030	\$ 95.00	3.70 5-yr fwd PE	Growth Bank PE	
Revs	\$48.87	\$60.29	\$73.59	\$83.16	\$97.29	\$112.86	\$129.79	\$146.66	\$164.26	9.7%	7.11 Earnings/FCF Yield	15	
		23%	22%	13%	17%	16%	15%	13%	12%		15% organic growth		
											1% Operation Lev		
NI	\$18.72	\$24.25	\$30.47	\$34.93	\$41.35	\$48.53	\$56.46	\$64.53	\$73.10		1% Repurchase	Future SP	
	38.3%	40.2%	40.2%	42.0%	42.5%	43.0%	43.5%	44.0%	44.5%		17% Total EPS growth	IRR	
												\$385.55	
												32%	
EPS	\$7.26	\$9.26	\$11.54	\$13.36	\$15.98	\$18.95	\$22.26	\$25.70	\$29.41		History	EPS GR Rate	
Buyback										5	19%		
1% /year	2.58	2.62	2.64	2.61	2.59	2.56	2.54	2.51	2.49	10	30%		

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 are also assuming about 7% of net income will be used for buy-backs, consistent with the trailing buyback levels. Using the same revenue described above, we arrive at a 2029 EPS of \$25.70, or 3.7x the current price. If we assume a

growth bank multiple of 15x, or \$389 per share, similar to the five-year-forward valuation above of \$415 per share.

Comparables and Benchmarking

Below are the highest growth specialty banks firms located in the United States. Most of MSBC's competitors are private banks. I have ranked the banks by expected return as calculated as the sum of the earnings yield plus the earnings growth rate. Compared to the specialty banks, MSBC has one of the highest 5-year average return on equity and TBV plus dividends growth and the lowest criticized loan amounts.

Name	EPS Growth	TBV + Div Growth	Div Yield	5-yr Avg ROE	Payout	Growth + Div	TAM	Exchange	Efficiency	CoF	NIM	Fee/Tot Rev	Loan Growth	Buybacks	Mgmt Compl/NI	Mgmt Ownership	ESOP	CET	Criticized	LRR/NPA	EY	ER	TR/PE	Comments
MBIN	25%	27.0%	0.0%	23.0%	0.0%	23.0%	5x	NasdaqCM	33.7%	4.6%	3.0%	20.4%	38.0%		5.0%	39.7%		8.0%	3.3%	58.0%	16.2%	39.2%	371.8%	MF GSE Lending; Risk sharing
UBAB*	31%	20.0%	1.3%	13.2%	10.0%	25.1%		OTCPK	47.0%	1.2%	4.5%	26.3%	15.0%	5/10%		4.5%	X	17.2%	5.0%	82.3%	14.2%	37.9%	355.3%	Low Income & AL/FL Beach Lending, ECIIP
CZBS*	27%	10.4%	1.1%	7.1%	15.0%	19.2%		OTCPK	51.0%	1.0%	4.9%	16.2%	8.0%	10.0%		42.5%		23.0%	3.6%	100.6%	15.4%	33.5%	295.5%	Low Income Lending, ECIIP
CWBK		12.7%	2.9%	19%/24%	15.0%	21.6%		OTCPK	50.0%	1.0%	4.1%	16.1%	11.5%	6.6%				18.6%	1.3%	262.8%	13.7%	35.3%	295.3%	SoCal RE Lending
FFBB	35%	24.0%	0.0%	25.0%	0.0%	25.0%	6x	OTCPK	47.0%	0.9%	5.2%	28.0%	25.0%	5.0%	7.0%	22.8%	X	19.0%	1.0%	143.5%	11.3%	36.3%	282.9%	CA & SBA Lending, Processing
NEWT			6.5%	21.0%	45.0%	18.1%		OTCPK	66.3%	6.6%	2.1%	92.7%	15.7%		12.3%	6.3%		16.1%	10.2%	101.5%	15.1%	26.6%	272.5%	
MSBC	22%	16.6%	0.0%	18.7%/20%	0.0%	19.0%	5x	OTCPK	43.0%	1.1%	4.6%	14.0%	17.0%			53.0%		11.3%	0.7%	243.8%	11.9%	30.9%	226.8%	CA Lending, Central/SoCal RE Lending
NBN	36%	20.0%	0.1%	20.0%	1.0%	19.9%	8x	NasdaqGM	42.0%	4.1%	5.1%	25.0%	24.0%	6.0%	14.0%	15.3%		13.2%	1.3%	133.0%	11.0%	30.8%	219.5%	Forced Selling Loans; SBA Loans

Risks

The primary risks are:

- slower-than-expected market growth due to slower than expected loan growth;
- higher-than-expected efficiency ratios; and
- a lack of new investment opportunities (SBA and business development loans) and/or coupled with higher stock prices making buybacks less accretive.

Potential Upside/Catalyst

The primary catalysts are:

- faster-than-expected SBA and business development loan growth; and
- lower than expected efficiency ratios due to economies of scale.

Timeline/Investment Horizon

The short-term target is \$173 per share, which is almost 82% above today's stock price. If the continued service growth due to geographic expansion plays out over the next five years (with a resulting 17% earnings per year growth rate), then a value of \$400, an average of \$389 and \$415 derived above, could be realized. This is a 35% IRR over the next five years.

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