

Watchlist Investing Newsletter

Patently finding and following great public companies to own at the right price.

Issue #4 | June 2021

“One person said to me, 'I have a list of 300 potentially attractive stocks, and I constantly watch them, waiting for just one of them to become cheap enough to buy.' Well, that's a reasonable thing to do. But how many people have that kind of discipline? Not one in 100.”

– Charlie Munger

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Editorial Notes:

- **Layout:** This month’s issue is laid out in one column. Thank you, Carter, for the suggestion to make reading the newsletter easier. Please let me know your thoughts on the layout or any other feedback you think would improve the reader experience.
 - **Watchlist:** An updated Watchlist (but not the Suspect List) is included at the end of this issue for convenience, in addition to the link to the full Google Sheet.
 - **“Guest” writeup:** The Plumas Bancorp Quick Look on p. 13 was completed by Christophe Nour, an intern helping me in the background. He took his findings to the next level and wrote up a quick piece for this issue. Aside from small editorial revisions the work is his. Thank you, Christophe!
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Deep Dive

Bank7 Corp.

(NASDAQ: BSVN; Disclosure: N/A)

Price (5/24/21):	\$17.64
Shares out (diluted):	9,058,685
Market cap:	\$160m
Total assets (12/31/20):	\$1.02bn
Return on Assets:	2.03%
Return on Equity:	19%
Insider ownership:	56%



Overview/History:

Bank7 came on my radar as part of the Russell 3000 project. The bank made the cut for its ROA greater than 1%, high insider ownership, and market cap in the range likely to fall out of the index.

While the bank is technically a new public company (2018 IPO), its history under current control dates to 2004. In 2004, William B. “Brad” Haines founded BSVN to acquire the \$24 million (assets) First National Bank of Medford, located in Medford, OK. In 2014, BSVN acquired Montezuma State Bank with \$107 million in assets. BSVN then brought on Thomas Travis, an executive with experience leading larger banks, to serve as President and CEO. In 2015, the bank expanded to the Dallas/Fort Worth, Texas area, a market with which Travis was familiar.

BSVN is based in Oklahoma City, Oklahoma and does business in Kansas, Oklahoma, and Texas through a network of nine full-service branches. BSVN employs what it calls a branch-lite model that seeks to gather low-cost deposits from a larger geographic area.

A quick glance at its balance sheet reveals the lending focus of the bank. It has no investment portfolio like a traditional bank. Instead, it keeps excess liquidity in cash/equivalents. The loan portfolio is comprised almost entirely of commercial loans. Within the loan portfolio BSVN maintains higher concentrations in energy-related loans (unsurprising given its location) and hospitality. As of FYE 2020 energy loans comprised 12% of the portfolio while hospitality amounted to 23%.

BSVN maintains a strategy of selectively looking for acquisition candidates but has remained disciplined. Unable to use its stock as a currency and with bank prices trading at higher multiples, BSVN hasn't acquired another bank. On the contrary it repurchased stock when shares dipped below 0.8x book value. Shares currently trade below the 2018 IPO price of \$19/share.

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BSVN - Balance Sheet FYE 12/31/xx (\$ millions, rounded)		2020
Cash & equiv.		\$170
Investment portfolio		0
Loans, net		827
PP&E		9
Other		<u>10</u>
Total assets		1,017
Deposits (non interest-bearing)		247
Deposits (interest-bearing)		659
Other liabilities		4
Equity		<u>107</u>
Total liab. + equity		\$1,017
Shares outstanding		9,045

BSVN - Income Statement FYE 12/31/xx (\$ millions, rounded)		2020
Interest income		\$53
Interest expense		<u>6</u>
Net interest income		47
Loan loss provision		5
Non-interest income		2
Salaries & benefits		10
Other non-interest expense		7
Total non-interest expense		<u>18</u>
Pre-tax income		<u>26</u>
Net income		19

Balance Sheet/Loan Analysis:

Loans:

BSVN maintains a typical bank structure of 80% of total assets in loans. That's where the similarities end, however. Unlike most other banks, BSVN doesn't have a traditional investment portfolio of stocks/bonds. Instead, it keeps that balance in cash/equivalents. This has been the case for many years and appears to indicate management's focus on what they know best.

A similar focus can be seen in the loan book. BSVN focuses on commercial lending and has a negligible amount in consumer or single-family residential loans. At the end of 2020 the bank had about a quarter of the loan book in Commercial & Industrial loans, 23% in hospitality, 12% in energy, and 6% in agricultural. It also maintains a similar concentration by relationship. See detail below:

Loan Portfolio Trends - Selected Categories					Top 20 Relationships			
	2019	% of Total Loans	2020	% of Total Loans	Industry	12/31/2018	12/31/2019	12/31/2020
Commercial & industrial	\$158.60	22.38%	\$204.32	24.36%	C&I	\$73.87 32%	\$60.58 21%	\$103.67 31%
Hospitality	166.96	23.56%	194.32	23.17%	Hospitality	72.16 31%	98.63 35%	127.29 37%
Energy	102.14	14.41%	101.91	12.15%	CRE - Owner Occupied	9.65 4%	47.96 17%	53.04 16%
Agricultural	57.89	8.17%	50.46	6.02%	Energy	64.22 28%	49.72 17%	43.10 13%
					Other	12.38 5%	28.98 10%	11.42 3%
						\$232.28	\$285.86	\$338.52

Source: Company Presentation

In a phone call with management (CEO Tom Travis) I learned the bank feels pressure from Wall Street to diversify out of energy loans, or at least substantially reduce the concentration. There's a tension between ESG trends and what management sees as one of the best times to lend to the industry because it's out of favor. Of the \$93mm energy portfolio (as of 2021-Q1), management considers \$56mm to have a low/minimal risk of loss (because of asset or guarantor protection), \$24mm to have moderate/elevated

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risk of loss, and \$13mm to have an elevated risk of loss. The energy portfolio is fairly diversified between E&P, midstream, mineral/royalty, and service-related loans.

In the bank's earnings reports ([See the 2021-Q1 presentation here](#)) management provides additional detail on its hospitality exposure by class of hotel, flag, and geography. It also provides portfolio-level metrics on average loan size (\$4.2mm), average loan-to-value (61%), average debt service coverage ratio (1.31x), and average remaining amortization (15.1 years). The latter two are important as a seemingly satisfactory DSCR is often the result of a long amortization schedule. Management also estimates average loan per room at about \$45k vs. replacement cost of \$115k.

The elevated NPL ratio at year-end stems from one energy-related loan with a face value of about \$13mm. As of 2021-Q1 the bank had taken a \$3mm charge to that one loan.

Another item of note: in 2020 the bank sold two loans to an entity controlled by the Haines family. The \$20.4mm sale price was at par value and included accrued interest. I asked Travis about this transaction and learned that the loans were part of a capital stack that included the Haines family as a sub debt lender. Several transactions like this had occurred over the years where the bank took the senior debt and Brad Haines personally (or through his companies) lent behind the bank. In instances where the bank was uncomfortable either lending more money or altering terms, Haines had taken them off the bank's books at par. I was told the loan was a performing credit and that there was one remaining loan on the books like those two.

Deposits:

BSVN funds its loan book with a combination of deposits (typically around a 90% loan-to-deposits ratio) and cash/equivalents. Non-interest-bearing deposits have averaged about a quarter of total deposits over the past seven years. Total cost of funds (which doesn't include any borrowed money) has averaged about 38bps over peers over the last five years, according to the FDIC. This seems to confirm BSVN as a market-taker for deposits (i.e., no competitive advantage).

Income Statement Analysis:

BSVN generates most of its revenue via interest income, primarily from the loan book. The company presents net interest margin before and after fee income related to loans. Over the past seven years the headline NIM (including fees) averaged about 5.25%, while excluding fees NIM averaged 4.60%. It should be noted that loan fees are included in interest income on the income statement.

BSVN improved its efficiency ratio from 52% in 2014 to 36% in 2020. This is even more impressive considering its capital ratio (tangible equity/tangible assets) increased from 7.6% in 2014 to 10.4% in 2021. The strong efficiency ratio appears to be more a function of higher loans to employees than strictly low overhead. Occupancy expense has averaged in-line with peers over the past five years while personnel expense has been lower, driven by assets/employee about double its peers.

A note on 2019: The large jump in the efficiency ratio in 2019 to 65% was the result of a non-cash transfer of shares from the Haines family trust to bank management. The transfer of shares, valued at \$11.8mm, was the result of an agreement between Brad Haines and several top executives to provide ownership in the bank from the Haines majority ownership stake. The original intent was to have the

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transfer take place at the time of the 2018 IPO such that it would be counted as a capital gain, however, an error by the bank's counsel caused a delay which resulted in it occurring in 2019 and at ordinary income rates. The effect of the transfer of shares was non-cash to the company and caused no impact to shareholders' equity. The accounting of the transfer was as follows: 1) 656,925 shares were transferred from the Haines trust to the company, which retired 149,425 shares to satisfy income and payroll taxes. The remainder of the shares went to CEO, Tom Travis (245,000); EVP/COO, JT Phillips (220,000); and EVP/Chief Lender, Jason Estes (42,500).

It should be noted that BSVN was organized as an S-Corp. prior to going public in 2018, therefore, the figures presented in the financials for net income are artificially high for prior years. Still, on a pre-tax basis the bank has generated a strong ROE in the mid/high 20's / low 30% range in its intermediate history.

Capital Allocation:

Because the bank was taxed as an S-Corp. prior to going public in 2018 the full capital allocation history is not as meaningful. However, from FDIC data we can see the bank paid out at least enough in dividends to cover personal tax obligations. Since going public it's paid out about half of earnings in dividends and, in 2020, repurchased shares.

Management appears to be disciplined with its capital allocation. The bank stated its intention to acquire other banks over time as early as the 2018 S-1 filing but has not done so because of the lack of properly priced candidates. When shares fell below book value in 2020, the bank authorized a share repurchase program and repurchased just over 1mm shares at \$8.73/share.

Stated future capital allocation outside of organic loan growth includes a well-priced acquisition of a bank or branches, opening one or more branches farther South in Texas, continuing to pay dividends, and repurchasing shares if they become attractive (a P/B ratio of 1.4-1.5x is outside of the range of repurchases based on comments by management).

Ownership/Management:

Key executives include:

William "Brad" Haines: Chairman/Founder: His background is in various general business/founding roles, including construction and energy.

John T. "J.T." Phillips: Director and COO: Phillips served as CFO of the bank from 2004 until 2015. He's intimately involved with Haines's various companies, including serving as CFO of Haines Capital Group since 2003.

Thomas L. "Tom" Travis: Director, President, and CEO since his hire in 2018. He has over 35 years of banking experience in Texas and Oklahoma, including president of IBC Bank San Antonio and IBC Bank Oklahoma.

Other key individuals include Jason Estes, Chief Credit Officer, and Kelly Harris, CFO. It should also be noted that Douglas Haines (Brad's brother) serves as regional president for Western Oklahoma and

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Kansas, Lisa Haines (Brad's daughter) serves as director of the bank (but not the holding company) as well as EVP/Chief Marketing Officer. Brad's nephew, Drew Haines, was listed in the S-1 as being a commercial loan officer but he is no longer disclosed in the most recent proxy statement.

Ownership:

Prior to the 2018 IPO the bank was owned by the Haines family, with 3,662,500 shares (50.26%) owned by Brad Haines and 1,812,500 shares (24.87%) each owned by his two daughters (JT Phillips served as a co-trustee of the trusts that owned the daughters' shares). The 2018 IPO included the sale of 2.9mm shares, the proceeds from which were paid out as a dividend to the existing shareholders. The 2019 transfer of shares noted above came from Brad's stake.

Share Count	2020	2019	2018	2017 & prior
Beginning count	10,057,506	10,187,500	7,287,500	7,287,500
2018 IPO			2,900,000	
Shares issued - RSO	19,437	19,431		
Share repurchases	(1,032,178)	(149,425)		
Ending count	9,044,765	10,057,506	10,187,500	7,287,500

Current ownership and major shareholders break down as follows:

Ownership (2021 Proxy)	# Shares	%
William B. Haines	2,896,512	32.0%
Lisa Haines Trust	1,435,126	15.9%
Julee Lawrence Trust	1,430,864	15.8%
Thomas Travis	389,963	4.3%
John T. Phillips	246,772	2.7%
Insiders subtotal	6,399,237	70.8%
FJ Capital Management	490,015	5.4%
Public float	2,155,513	23.8%
Total	9,044,765	100.0%

The high level of insider ownership means that just a small number of shares are available as public float. Excluding shares held by FJ Capital Management, the 2.2mm shares amount to just \$37mm based on current share prices.

Other important ownership information:

The bank discloses that it leased office and retail space from a Haines-owned entity, and that certain payroll and office sharing arrangements were in place between the company and Haines affiliates.

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Competition:

BSVN currently ranks as the 13th largest insured commercial bank in Oklahoma (2020 FDIC assets of \$948mm). It would rank 69th by the same comparison in Texas. In either case it ranks among the largest banks in each state. The vast majority of banks in each state fall in the < \$250mm category.

We see a typical power-law scaling of banks in each state, although Texas is home to several larger banks. The largest bank in Oklahoma is Bank of Oklahoma (\$48bn assets) which is also a big player in the energy field (controlled by George Kaiser, it has 15% of loans in energy). The next largest OK bank is First United Bank & Trust with \$9bn assets. In Texas, the largest bank is Charles Schwab at \$278bn assets, then Comerica Bank (\$81bn), and Texas Capital Bank (\$37bn).

Considering the number of banks in BSVN's markets it's easy to conclude the bank competes with "the market" for loans and deposits. The chart below highlights BSVN's higher-than-average interest expense compared to peers and its lower than average non-interest expense (except for 2019 which included the non-cash equity transfer). While BSVN reports higher interest income than peers that is likely a function of its loan book (i.e., higher risk energy/hospitality) and not an apple-to-apples comparison. Where BSVN stands out is its efficiency ratio which is largely a function of lower personnel expense driven by higher than average loans/employee and the slight edge it has in occupancy expense.

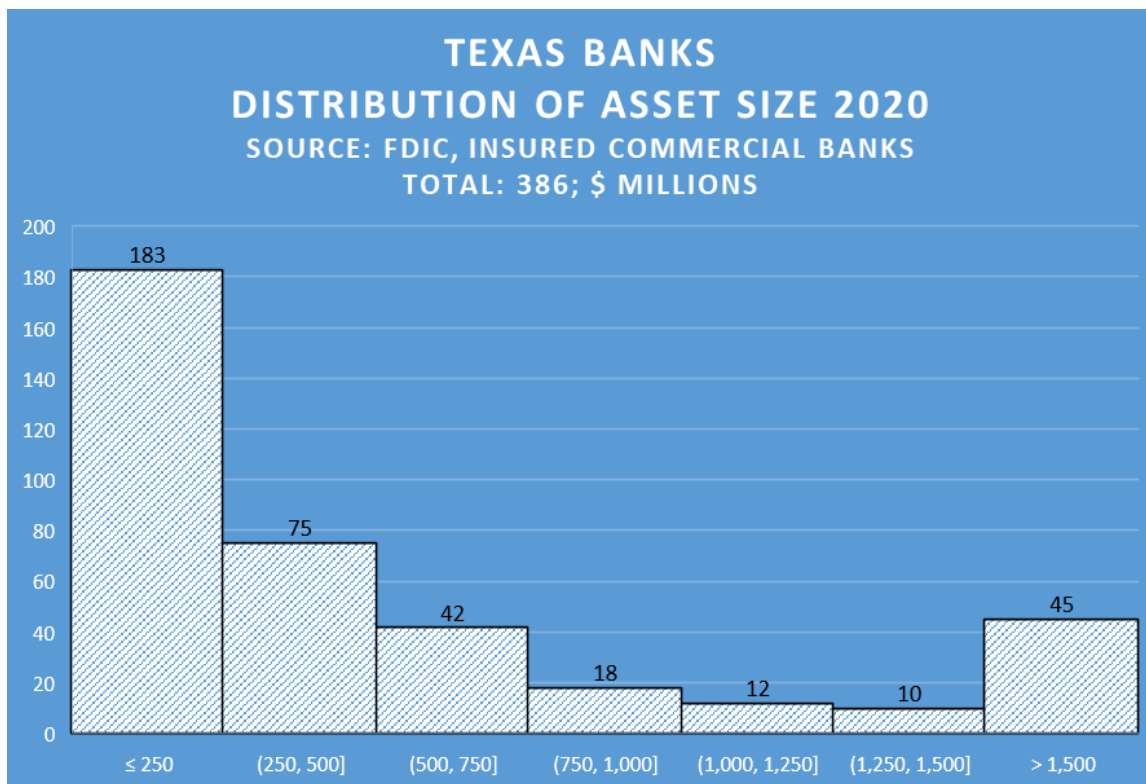
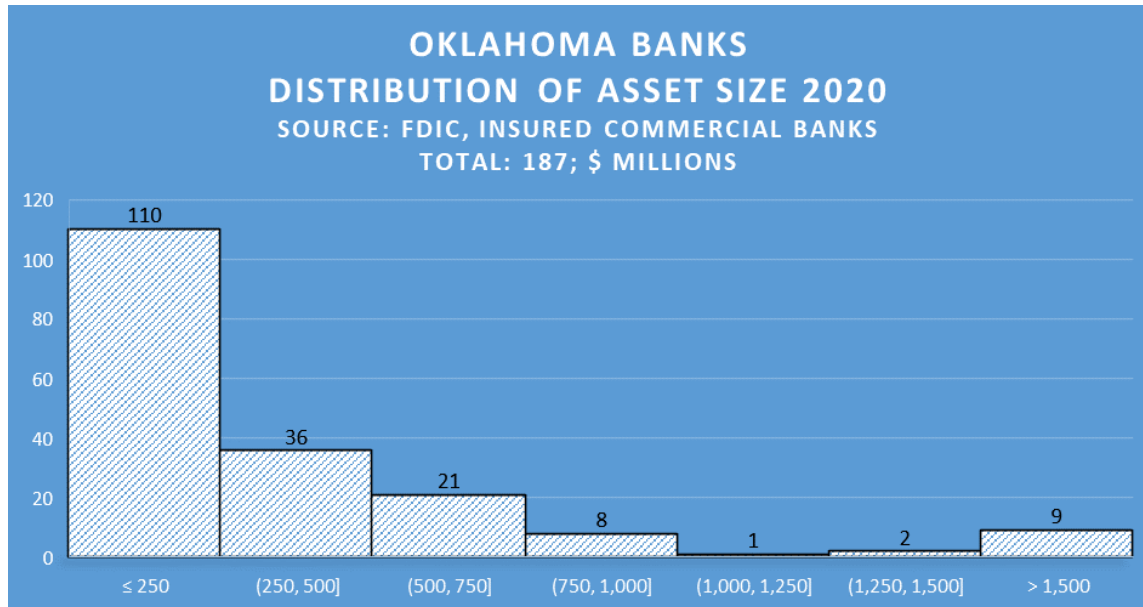
	2020			2019			2018		
<i>Percent of Average Assets:</i>	BSVN	OK	TX	BSVN	OK	TX	BSVN	OK	TX
Interest Income (TE)	5.63%	4.17%	3.77%	6.50%	4.71%	4.36%	6.45%	4.51%	4.16%
- Interest Expense	0.65%	0.55%	0.43%	1.19%	0.80%	0.64%	0.96%	0.57%	0.47%
Net Interest Income (TE)	4.98%	3.60%	3.32%	5.31%	3.90%	3.70%	5.50%	3.92%	3.67%
+ Noninterest Income	0.18%	0.64%	0.61%	0.17%	0.69%	0.67%	0.16%	0.68%	0.66%
- Noninterest Expense	1.86%	2.90%	2.61%	3.61%	3.15%	2.88%	2.03%	3.11%	2.85%
- Provision: Loan & Lease Losses	0.56%	0.22%	0.18%	0.00%	0.19%	0.11%	0.03%	0.15%	0.11%
Pretax Operating Income (TE)	2.73%	1.21%	1.19%	1.87%	1.34%	1.42%	3.60%	1.41%	1.42%
+ Realized Gains/Losses Sec	0.00%	0.03%	0.03%	0.00%	0.01%	0.01%	0.00%	0.00%	0.00%
Pretax Net Operating Income (TE)	2.73%	1.27%	1.25%	1.87%	1.35%	1.45%	3.60%	1.39%	1.41%
Net Operating Income	2.03%	1.13%	1.10%	1.01%	1.19%	1.27%	3.49%	1.26%	1.25%
Adjusted Net Operating Income	2.22%	1.25%	1.23%	1.01%	1.23%	1.32%	3.51%	1.30%	1.29%
Net Income Adjusted Sub S	2.03%	0.99%	0.99%	1.01%	1.04%	1.14%	3.49%	1.09%	1.12%
Net Income	2.03%	1.13%	1.10%	1.01%	1.19%	1.27%	3.49%	1.26%	1.25%
Efficiency Ratio	36.15%	67.36%	65.18%	65.89%	67.43%	64.71%	35.83%	66.93%	64.51%
Assets / Employee	\$12.7mm	\$5.1mm	\$6.5mm	\$11.1mm	\$4.5mm	\$5.5mm	\$10.7mm	\$4.4mm	\$5.3mm
Personnel expense	1.07%	1.68%	1.48%	2.69%	1.79%	1.62%	1.09%	1.77%	1.59%
Occupancy expense	0.28%	0.32%	0.31%	0.31%	0.36%	0.34%	0.33%	0.36%	0.34%

Source: FDIC and author's calculations.

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Moat:

BSVN has no moat. It's a market-taker for deposits and loans. It's advantage stems from a management team that recognizes it must operate with low overhead and control credit losses over time.

Key Variables/Metrics:

With banks there are really two primary drivers that feed into return on assets:

Loan losses: The quality of the loan book is the most important metric to pay attention to. Actual write-offs tell the best story. Reserving is important but subject to management estimates.

Efficiency ratio: Controlling costs is the second major variable management can control and which has an outsize impact on future returns.

Risks:

1. **Total insider control:** With such high insider ownership a minority owner has no hope of driving policy but must sit back for the ride. Not only does the Haines family own a controlling interest, but the history of the bank brings with it additional risks such as the fact that several family members work for the bank and the bank pays rent to the Haines family for certain locations.
2. **Merchant-banking type transactions:** The bank's history includes instances where the bank took a senior position as part of a deal that included sub debt or other involvement by Haines outside of the bank. My sense is that these types of transactions are being worked down. But there's no assurance that they won't continue to pop up again.
3. **Energy/hospitality concentrations:** While management appears attuned to the risks of such concentrations and understands its credits well, there's no way for an outsider to have a true glimpse into the portfolio. By the time any major blowup occurred it would be too late.
4. **Relationship concentrations:** Likewise, the concentration in borrowers poses risks that individual projects or sponsors could face difficulty.
5. **Geographic concentrations:** BSVN faces literal hurricane risks that could impose large and sudden pain on its entire region. Any nominal diversification of its loan book could be overcome by a major event that hits the region. There's also a risk that a systemic shift in energy assets, a major part of the economy in BSVN's region, could have a negative effect on the region as a whole and persist for a long time.

Valuation:

BSVN IPO'd at a P/B ratio of about 2.25x which quickly settled into a range of around 2.0x. It then fell to as low as 0.65x in March 2020 and averaged about 1.0x throughout the remainder of the year. It's since climbed from about 1.25x to 1.40x currently (mid-May 2021).

The bank currently trades at a slight premium to the KBW index of regional banks on a P/B metric but appears attractively priced at just 8x earnings compared to 13x for the KBW index. The differential between the two metrics can be explained by BSVN's highly satisfactory ROA and ROE.

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	<u>BSVN</u>	<u>KBWR</u>
Price/book	1.38x	1.30x
Price/earnings	7.99x	13.41x

I'm hesitant to put a precise value on BSVN because I don't feel I really know the bank as well as others. That said, I'll reason my way through it, and you can adjust my assumptions accordingly.

Base case = reasonable launching point: The current financials appear a good “steady state” for BSVN. Interest income is higher than market but very likely a result of the energy/hospitality focus (i.e., higher risk). Interest expense is unlikely to come down from market. Non-interest income isn't a focus of BSVN (which I like) because it's an area likely to be subject to strong competition from fintech. Non-interest expense is a function primarily of higher-dollar loans. The loss provision was higher-than-typical in 2020 and probably high.

All of that translates into a sustainable ROA of about 2%, and with a 10% leverage ratio that would put sustainable ROE at 20%. Paying 2.0x book gives you a 10% going-in return; 1.3x book provides a 15% return.

Bearish case: Here I've knocked a full percentage point off the topline to account for possible downward market pressure on rates compared to peers (4.17% in OK; 3.77% in TX). Likewise with non-interest expense I've arbitrarily increased it to 2.25% assuming BSVN loses some efficiency compared to peers (2.90% in OK; 2.61% in TX). Finally, I've adjusted the tax rate to 30%. All of this translates into a 9.5% ROE with 10% leverage. To get a 10% return would require buying in at book value.

Bullish case: For the bullish case I've only reduced the loan loss provision to 0.20%. Note that even this is higher than the 0.15% average over the past seven years. This one change increases ROE to about 23%.

	<u>Current</u>	<u>Bearish</u>		<u>Bullish</u>	
Interest income	5.63%	4.63%	-1.00%	5.63%	0.00%
Interest expense	0.65%	0.65%	0.00%	0.65%	0.00%
NIM	4.98%	3.98%	-1.00%	4.98%	0.00%
Non-int. income	0.18%	0.18%	0.00%	0.18%	0.00%
Non-int. expense	1.86%	2.25%	0.39%	1.86%	0.00%
Loss provision	0.56%	0.56%	0.00%	0.20%	-0.36%
Pre-tax income	2.74%	1.35%	-1.39%	3.10%	0.36%
Tax rate	25.91%	30.00%		26.00%	0.09%
Net income (ROA)	2.03%	0.95%	-1.09%	2.29%	0.26%
Capital ratio	10.42%	10%		10%	
ROE - after-tax	19.48%	9.45%		22.94%	
Efficiency ratio	36%	54%		36%	

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Summary: BSVN is a unique small bank stock that offers a quasi-private partnership with heavy insider control/ownership. The bank's focus provides opportunities as well as risks. Focus on energy/hospitality means knowledge of a market segment but increased risk of default/loss if those industries experience difficulties. The strategies of employing a branch-lite model and larger loan relationships compared to peers keeps costs lower than peers but could come at the expense of higher costs down the road if the bank is forced to pay wholesale prices for funding.

As of 5/24/21, BSVN is currently selling for \$17.64, an implied market cap of \$160 million or 1.5x book value. Such a valuation appears to provide little margin of safety for a bearish or base case valuation but could be an appropriate price in an upside scenario.

Bank7 Financials:

BSVN - Balance Sheet							
FYE 12/31/xx							
(\$ millions, rounded)	2020	2019	2018	2017	2016	2015	2014
Cash & equiv.	\$170	\$147	\$160	\$130	\$104	\$95	\$85
Investment portfolio	0	0	0	0	0	0	0
Loans, net	827	699	592	555	607	455	380
PP&E	9	10	8	10	n/a	n/a	n/a
Other	<u>10</u>	<u>10</u>	<u>11</u>	<u>8</u>	n/a	n/a	n/a
Total assets	1,017	866	771	704	614	564	480
Deposits (non interest-bearing)	247	219	201	166	127	113	133
Deposits (interest-bearing)	659	538	475	460	422	396	295
Other liabilities	4	9	6	9	9	9	12
Equity	<u>107</u>	<u>100</u>	<u>88</u>	<u>69</u>	<u>55</u>	<u>45</u>	<u>39</u>
Total liab. + equity	\$1,017	\$866	\$771	\$704	\$614	\$564	\$480
Shares outstanding	9,045	10,058	10,188	7,288	7,288	7,288	7,288

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BSVN - Income Statement							
FYE 12/31/xx							
(\$ millions, rounded)	2020	2019	2018	2017	2016	2015	2014
Interest income	\$53	\$52	\$47	\$43	\$33	\$28	\$24
Interest expense	6	10	7	5	3	3	2
Net interest income	47	42	40	38	30	26	22
Loan loss provision	5	0	0	1	2	3	1
Non-interest income	2	1	1	1	2	2	2
Salaries & benefits	10	21	8	8	7	n/a	n/a
Other non-interest expense	7	7	7	7	7	n/a	n/a
Total non-interest expense	18	28	15	15	13	11	12
Pre-tax income	26	15	26	24	17	14	10
Net income*	19	8	20	14	10	8	6

Note: S-Corp. prior to 2018. As a result, no income tax was booked. 2018-2014 include company estimate as if a C-Corp.

BSVN - Loan Book Detail					
FYE 12/31/xx					
(\$ millions, rounded)	2020	2019	2018	2017	2016
Construction & development	108	71	87	104	115
1-4 family real estate	29	34	33	32	21
Commercial real estate	290	273	156	138	87
Subtotal - real estate	427	378	277	273	223
Commercial & industrial	351	261	248	205	185
Agricultural	51	58	63	75	79
Consumer	10	12	14	12	17
Gross loans	839	709	602	565	504
Deferred loan fees	-2	-1	-2	-2	-1
Allowance	-10	-8	-8	-8	-7
Net loans	827	699	592	555	496
Additional detail:					
Energy loans	102	102	110		
Energy loans - % gross loans	12.1%	14.4%	18.3%		
Hospitality loans	194	167	123		
Hospitality loans - % gross loans	23.2%	23.6%	20.4%		

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BSVN - Key Ratios	2020	2019	2018	2017	2016	2015	2014
Non-performing assets / total assets	1.63%	0.38%	0.35%	0.28%	0.37%	0.90%	0.44%
Charge-offs, net % average loans	0.43%	0.00%	0.00%	0.09%	0.07%	0.43%	0.03%
Cost of funds	0.73%	1.37%	1.11%	0.80%	0.62%	0.55%	0.53%
Efficiency ratio	36.0%	65.4%	37.0%	37.2%	42.3%	41.9%	51.7%
Net interest margin	5.01%	5.35%	5.49%	5.87%	5.13%	5.25%	5.14%
Net interest margin - excl. fees	4.48%	4.78%	4.78%	4.59%	4.37%	4.63%	4.70%
Tangible equity / tangible assets	10.42%	11.37%	11.25%	9.55%	8.62%	7.61%	7.61%
Return on average assets*	2.03%	1.03%	2.75%	2.17%	1.78%	1.65%	1.45%
Pre-tax return on avg. equity	25%	16%	33%	38%	33%	33%	
After-tax return on avg. equity	19%	9%	25%				
Loans / total assets	81%	81%	77%	79%	99%	81%	79%
Loans / deposits	91%	92%	88%	89%	110%	89%	89%
Non-interest bearing deposits %	27%	29%	30%	27%	23%	22%	31%
*ROAA prior to 2018 include assumed C.Corp. tax rate.							

BSVN - Capital Allocation	2020	2019	2018	2017	2016
Net income	19	8	25	24	17
Dividends	-8	-1	-56	-10	-7
Share repurchases/issuance	-9	-3	50	0	0
Note: 2018 income tax expense \$0.8m; 2016/17 no income tax as it was an S-Corp.					

Quick Look

Plumas Bancorp

(NASDAQ: PLBC; Disclosure: N/A)

Price (5/24/21):	\$29.73
Shares out (diluted):	5.2m
Market cap:	\$154m
Total assets (12/31/20):	\$1.1bn
Return on Assets:	1.46%
Return on Equity:	17%
Insider ownership:	18%

Editorial note: This writeup was completed by Christophe Nour, a student at Edhec Business School in France, who is working with me as a part-time intern. Aside from small editorial changes the work is his.

Overview:

PLBC was found as part of the Russell 3000 project, which included a simple screen of small <\$300m market cap US banks with more than 1% of ROA and with more than 10% insider ownership. It's a small typical bank, operating in Northeastern California and Northwestern Nevada, cash-flow generative, with

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consistent earnings, a balance sheet with excess cash and a PE of around 10. Nothing spectacular but worth digging into.

Overview/Industry:

Plumas is an attractive community bank with satisfactory returns on assets and equity driven by the company's concentrated market position in northwestern California. The little competition (usually only one or two other insured institutions) allows the bank to maintain strong net interest margins, a decent efficiency ratio and a good return on equity for an extended period of time.

In the past few years, the asset quality of Plumas has been very good (so has the industry) and broadly consistent with the company's experience prior to the last financial crisis with nonperforming assets as a percentage of total assets of less than 0.3%.

What is intriguing is its relatively high ROE compared to its peers (over 15% compared to a peer average of 9%). Performance increased notably starting in 2014, which, at first glance, appears to be the result of a management change.

The loan book mainly consists of commercial real estate loans and this has been the case for the past 10 years. The bank has a very healthy balance sheet (especially in 2020, with almost no debt) and steady growth in free cash flow over the past several years. With a dividend yield of 2%, it has a low payout ratio of 17%. The company has issued some shares over the past 10 years but nothing alarming.

Other:

In the beginning of 2021, the company planned to acquire Feather River Bancorp in a transaction valued at \$21 million. The CEO is confident that this acquisition will grow Plumas' market share in Northeastern California and grow their earnings. Of note, the acquisition is adjacent to its existing market.

Valuation:

With a 1.3x book value and a PE ratio of 9, the valuation does not appear excessive, and if Plumas gets kicked out of the Russell 2000 with the reconstitution of the index this Summer, it may drop to an interesting price.

Conclusion/Final Thoughts:

Plumas appears to be a good bank in a strong position and with decent long-term prospects. I'm adding to the Watchlist to follow and study.

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RUSSELL 3000 PROJECT:

With the help of two interns, I've been working through the Russell 3000 list specifically looking for banks that might get removed during the reconstitution event in June (when those not making the cut due to size get removed and others are added).

Below is the list of banks that made the cut updated with current pricing data. Highlighted are ones that I'm keeping a close eye on. Plumas and Bank7 are featured in this issue. Next month will have more on Timberland and Northrim. We'll also find out which banks (and non-banks) are being cut, as the list will be announced on June 4. The actual reconstitution date is June 25.

Bank Name	Market Cap (5/11/21)	Assets (\$mil)	5 Yr Avg ROA	Price/Book (4/26/21)	Price (4/26/21)	Current Price (5/25/21)	% Change	52 Wk Low	52 Wk High	Insider Ownership
SB FINANCIAL GROUP, INC. (XNAS:SBFG)	\$ 142,305,200	\$1,260	1.15%	0.90x	\$ 17.65	\$ 19.76	12%	\$ 12.02	\$19.98	9%
PLUMAS BANCORP (XNAS:PLBC)	\$ 153,771,240	\$1,110	1.49%	1.41x	\$ 27.72	\$ 29.59	7%	\$ 18.10	\$31.02	19%
FIRST CAPITAL, INC. (XNAS:FCAP)	\$ 151,439,900	\$1,020	1.10%	1.39x	\$ 45.52	\$ 45.65	0%	\$ 42.57	\$81.71	4%
Bank7 Corp. (XNAS:BSVN)	\$ 167,883,681	\$1,020	2.28%	1.45x	\$ 17.24	\$ 18.55	8%	\$ 8.11	\$19.00	21%
OP BANCORP (XNAS:OPBK)	\$ 158,719,897	\$1,370	1.20%	1.07x	\$ 10.42	\$ 10.55	1%	\$ 5.59	\$12.39	21%
FIRST SAVINGS FINANCIAL GROUP, INC. (XNAS:FSFG)	\$ 172,094,500	\$1,220	1.38%	0.98x	\$ 68.50	\$ 71.95	5%	\$ 36.78	\$74.00	20%
ESQUIRE FINANCIAL HOLDINGS, INC. (XNAS:ESQ)	\$ 191,908,800	\$881	1.26%	1.44x	\$ 23.11	\$ 24.20	5%	\$ 14.00	\$26.79	14%
LEVEL ONE BANCORP, INC. (XNAS:LEVL)	\$ 210,492,100	\$2,450	0.98%	1.05x	\$ 26.40	\$ 27.43	4%	\$ 14.72	\$28.77	23%
NORWOOD FINANCIAL CORP. (XNAS:NWFL)	\$ 207,857,623	\$1,840	0.96%	1.08x	\$ 25.56	\$ 25.29	-1%	\$ 21.87	\$30.47	9%
GREENE COUNTY BANCORP, INC. (XNAS:GCBC)	\$ 228,074,253	\$1,860	1.28%	1.56x	\$ 25.49	\$ 26.79	5%	\$ 20.12	\$29.39	7%
NATIONAL BANKSHARES, INC. (XNAS:NKSH)	\$ 216,008,500	\$1,520	1.23%	1.21x	\$ 35.86	\$ 34.54	-4%	\$ 23.37	\$39.99	4%
TIMBERLAND BANCORP, INC. (XNAS:TSBK)	\$ 243,611,568	\$1,570	1.66%	1.18x	\$ 27.45	\$ 29.13	6%	\$ 15.95	\$30.75	13%
PCB BANCORP (XNAS:PCB)	\$ 250,751,977	\$1,920	1.26%	0.95x	\$ 14.80	\$ 16.18	9%	\$ 8.20	\$16.71	16%
LCNB CORP. (XNAS:LCNB)	\$ 236,752,928	\$1,750	1.06%	0.96x	\$ 17.97	\$ 18.26	2%	\$ 12.43	\$19.99	7%
AMES NATIONAL CORPORATION (XNAS:ATLO)	\$ 233,542,300	\$1,910	1.09%	1.13x	\$ 25.34	\$ 25.79	2%	\$ 16.53	\$27.90	1%
NORTHEAST BANK (XNAS:NBK)	\$ 238,466,352	\$1,260	1.31%	1.36x	\$ 29.76	\$ 29.10	-2%	\$ 14.32	\$30.92	8%
NORTHRIM BANCORP, INC. (XNAS:NRIM)	\$ 274,904,200	\$2,100	1.24%	1.19x	\$ 42.41	\$ 44.92	6%	\$ 20.90	\$48.19	4%
FIDELITY D & D BANCORP, INC. (XNAS:FDBC)	\$ 280,248,900	\$1,710	1.07%	1.70x	\$ 56.20	\$ 55.83	-1%	\$ 34.96	\$70.97	23%

WHAT'S COMING NEXT MONTH:

Queued up for next month are quick looks into Timberland Bancorp and Northrim Bancorp, two banks in the list above that seem likely to be cut from the Russell index.

NOTES (and Ideas!) FROM READERS:

I'm grateful for the feedback from several of you this month. That includes two suggestions for companies to look into. If you have any scuttlebutt on either of these, or would like to suggest companies to look into and/or share with readers, please let me know.

As noted at the top of the newsletter, Carter suggested a one-column format. He also suggested looking at microcap **Bowl America (BWL.A; Disclosure: n/a)**. As he put it, Bowl America could be an interesting asset play with potentially undervalued real estate on the books.

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Another idea comes from Jeff who suggested **Checkpoint Software (CHKP; Disclosure: n/a)**. As he put it to me, CHKP doesn't garner much press but has been a very good business over time and trades at an Oracle-like multiple. The company is based in Israel and is a pure-play cybersecurity vendor.

Watchlist

As of May 25, 2021

WATCHLIST					Count: 8	
Company Name	Industry	Ticker	Current Price	Market Cap	See Issue #	
Berkshire Hathaway	Conglomerate	BRK.B	\$289.44	\$661,678,277,106	1	
Hingham Institution for Savings	Banking	HIFS	\$291.13	\$623,716,631	1	
AAON, Inc.	Building Products	AAON	\$66.66	\$3,490,084,787	1	
Monarch Cement	Building Products	MCEM	\$97.00	\$253,083,100	2	
McCormick	Foods/Seasonings	MKC	\$89.80	\$24,023,386,439	3	
International Flavors and Fragrances	Foods/Seasonings	IFF	\$141.81	\$35,319,230,270	3	
Bank7	Banking	BSVN	\$17.99	\$162,796,149	4	
Plumas Bancorp	Banking	PLBC	\$29.59	#N/A	4	

Note: Plumas market cap was approximately \$155mm. Unsure why it would not pull the data.

To see the latest Watchlist and Suspect List on Google Sheets, head to www.watchlistinvesting.com or click [here](#).

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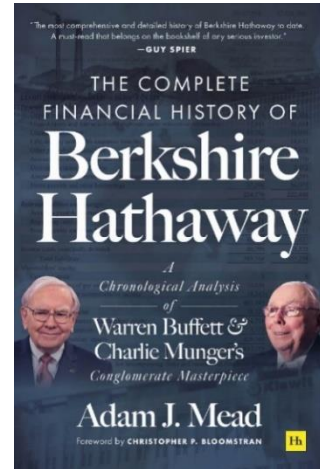
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About

After nearly two decades as an individual investor, a decade in commercial credit at various banks, and a few years managing money for friends/family in the background, I decided to go full-time managing money for clients in 2020. Watchlist Investing is an extension—albeit separate and distinct—of what I do day-to-day as a practicing capital allocator. Inverting the margin of safety principle, I hope to add value to readers above and beyond the nominal cost of the newsletter.

My investing style is influenced by my background growing up in a family of business owners. I followed suit selling firewood through high school and founding a welding business in college. Looking at stocks as businesses is natural to me. My investing approach rests on fundamental value investing tenets, but it's adapted to suit my style. I'm 100% certain I'm not the best investor or analyst, but I hope to improve over time.

Between 2016 and 2021, I wrote a book on Berkshire Hathaway. *The Complete Financial History of Berkshire Hathaway* was and is my passion project. I hope it brings new shareholders up to speed on the company and provide a fresh look to longtime shareholders, in addition to serving as a resource/reference book. It can be purchased [here](#). I also created www.theoraclesclassroom.com as an extension of the book, which includes an archive of a lot of BRK material.



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