

The Community Financial Corporation (TCFC - NASDAQ - Recent Price: \$33.60)

Rating: Outperform / **Buy Price:** \$33.00 / **Target (Sell) Price:** \$37.00

TCFC: Non-Recurring Items Cause Earnings Miss; Strong Loan & Deposit Growth, Stable Expenses Partly Offset Unfavorable Interest Rate Pressures; Lowering EPS Estimates; Maintaining Price Target, Reiterating Outperform Rating.

3Q19 Results:

TCFC reported 3Q19 net income of \$3.7 million, up 1.8% compared to the \$3.6 million posted in 2Q19. On a per share basis, 3Q19 results were \$0.66 compared to the \$0.65 recorded in the prior quarter. Reported EPS fell \$0.10 short of our \$0.76 estimate, and \$0.07 shy of the \$0.73 median Street estimate. The underperformance was primarily driven by higher-than-anticipated noninterest expenses (mainly employee compensation and OREO expenses) and lower net interest income, offset partially by higher noninterest income. Highlights from the quarter include:

- Gross loans held for investment grew \$28.6 million or 2.1% sequentially, slightly exceeding the 2.0% growth we were projecting. CRE was once again the biggest mover, rising \$14.4 million or 1.6% linked-quarter. Not far behind was the commercial equipment segment, which jumped \$10.6 million or 21.1% linked-quarter. In addition, residential first mortgages grew \$7.1 million or 4.5%, while home equity & second mortgages growth of \$0.3 million or 0.9%. Meanwhile, construction & land loans and residential rental loans declined \$4.9 million or 13.7%, and \$0.8 million or 0.7%, respectively, from the prior quarter. The non-acquired/originated loan portfolio grew \$90.0 million during the quarter while the acquired portfolio declined by \$21.5 million. The company reports a solid loan pipeline, of approximately \$120 million at September 30, 2019, which is up from \$112 million at the previous quarter-end. The company once again increased its cash and liquid investments during 3Q19, as a result of strong deposit growth, while reducing the loans-to-deposits ratio from 92.9% at June 30, 2019 to 90.8% at September 30, 2019.
- Total deposits increased \$65.5 million or 4.4% sequentially in 3Q19. Interest bearing demand accounts claimed almost three-quarters of this growth, rising \$48.8 million or 3.8% in the period. Noninterest bearing demand accounts also rose, climbing \$16.7 million or 7.4% linked-quarter. Time deposits were reduced by \$25.8 million or 5.6% in 3Q19. As a result, core (non-CD) accounts rose to 72.1% of total deposits from 69.2% at June 30, 2019.
- Net interest income rose \$266k or 2.0% linked-quarter, as a 1.8% increase in average earning assets and one extra day in the quarter combined with a stable 3.33% NIM to boost NII. Purchase accounting accretion boosted the NIM by roughly 6 bps in 3Q19, up 1 bps compared to 2Q19. Average loan yields slipped 3 bps compared to 2Q19 (including 1 bps in higher accretion income), and average securities yields decreased 13 bps sequentially, leading to a 4

Fundamental Metrics (MRQ)	
Balance Sheet	
Total Assets (M)	\$1,856
Gross Loans HFI (M)	\$1,417
Total Deposits (M)	\$1,560
Loans / Deposits	91%
Securities / Assets	12%
Debt / Assets	6%
Profitability	
FTE NIM	3.33%
Nonint. Income / Revenue	8.17%
Efficiency Ratio	59.69%
Core ROAA	0.87%
Core ROACE	8.86%
Credit Quality	
NPAs / Assets	1.42%
NPLs / Loans	1.09%
NCO Ratio	0.03%
Reserves / Loans	0.08%
Provision / Avg Loans	0.13%
Capital Adequacy	
TCE / TA Ratio	8.4%
Total Capital Ratio	13.5%
Tier 1 Ratio	11.2%
Tier 1 CE Ratio	10.4%
Leverage Ratio	9.5%
Performance	
Core Value	\$14.67
3 Yr. Success Ratio	5%
Failure Ratio	1.1%

Source: SNL Financial, Company data

Market Data		Earnings Per Share Data					
		Our Forecast			Consensus		
		2018A	2019E	2020E	2019	2020	
Market Value (M)	\$187	1Q (Mar.)	\$ 0.22	\$ 0.70	\$ 0.75	\$0.65	\$0.73
ADTV (Shs)	7,418	2Q (Jun.)	\$ 0.42	\$ 0.65	\$ 0.76	\$0.69	\$0.75
ADTV (000')	\$248.0	3Q (Sep.)	\$ 0.69	\$ 0.66	\$ 0.80	\$0.72	\$0.79
52 Week Range	\$26.47-\$34.15	4Q (Dec.)	\$ 0.69	\$ 0.78	\$ 0.80	\$0.76	\$0.80
Dividend Yield	1.50%	Year	\$ 2.02	\$ 2.79	\$ 3.10	\$2.80	\$2.98
		P / E	16.5	12.0	10.8	11.9	11.2

Source: SNL Financial, Alden Securities estimates

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bps drop in average earning asset yields. However, the average cost of CDs rose 2 bps, while the average cost of all other funding categories remained flat or fell. The average cost of interest bearing demand and money market accounts, the largest funding category, declined 5 bps sequentially. These changes resulted in a 5 bps decrease in the average cost of interest bearing liabilities.

- Noninterest income declined \$14k or 1.1% sequentially, driven by a \$30k reduction in securities gains. Meanwhile, core noninterest income rose slightly, as service charges on deposit accounts rose \$6k or 0.7% and loan appraisal, credit & miscellaneous fees climbed \$9k or 6.5% sequentially. BOLI income contributed \$1k to the noninterest income increase.
- Noninterest expenses rose \$108k or 1.2% sequentially. The main driver of the increase was a \$472k rise in employee compensation costs. This growth was largely caused by higher health insurance costs. TCFC is self-insured and several claims in the quarter boosted expenses. However, caps have been reached on several accounts and management believes that reinsurance will now kick in, reducing any further upward pressures in this area. Offsetting much of the increase in employee compensation were significant declines in OREO expenses, FDIC insurance, and professional fees. The \$169k OREO expense drop was related to 2Q19 preparations for the sale of a commercial property, now expected to occur 4Q19. An \$83k decline in professional fees was related to a 2Q19 rise in spending on technology projects. The company received a credit from previously paid insurance premiums after the Bank Insurance Fund reached its mandated threshold level.
- TCFC recorded an effective tax rate of 27.4% in 3Q19, down slightly from the 27.8% posted in 2Q19, and slightly above the 27.0% we have been using in our model. We anticipate an effective tax rate of 27.0%-28.0% for 4Q19 and we are using a rate of 27.5% for 2020 and beyond.
- The loan loss provision in 3Q19 was \$450k, up from \$375k in the preceding quarter. The provision exceeded the \$116k in charge-offs during the quarter. Net charge-offs to average loans was 0.03% in 3Q19 compared to 0.09% in 2Q19. The allowance for loan & lease losses grew 3.1% sequentially to \$11.3 million, representing 0.79% reserve coverage of total loans compared to 0.79% at June 30, 2019.
- Asset quality was stable in 3Q19. Classified loans increased \$0.3 million or 0.8% in 3Q19, while nonaccrual loans advanced \$2.1 million or 16.1% LQ. Meanwhile, performing TDRs fell \$1.5 million or 70.2% and OREO dipped \$0.1 million or 1.1%. These changes resulted in a 1.9% rise in NPAs. Coupled with the concurrent 5.7% growth in total assets during the quarter, NPAs/Assets (including performing TDRs) edged down to 1.42% from 1.47% at the prior quarter-end. Early stage delinquencies (loans 30-89 days past due) rose \$0.1 million or 3.0% from the prior quarter-end.
- TCFC's regulatory capital ratios were little changed from the prior quarter, and all remained well above the levels to be considered well capitalized. Meanwhile, the company's TCE ratio fell to 8.37% from 8.63% at June 30, 2019. Tangible book value per share grew to \$27.63 from \$26.93 at June 30, 2019.
- The company has \$23.0 million of 6.25% subordinated notes outstanding that become redeemable on February 15, 2020. We believe management will likely explore opportunities to redeem this debt and replace it with other debt at lower rates or with equity.

Earnings Estimates: TCFC's 3Q19 loan growth was slightly better than our forecast, and we believe the company maintains momentum to record loan growth of 5%-7% annually going forward. Deposit growth was even stronger during the quarter, allowing substantial growth in earning assets. Though expectations of additional Fed rate cuts are causing us to reduce our NIM expectations going forward, the bigger base of earning assets is offsetting some of the NIM impact on net interest income. Still, we are projecting quarterly NIM compression of 1 bps-5 bps over the next year. On the expense side, the

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elevated employee compensation expenses affecting 3Q19 results are expected to decline in 4Q19 and into 2020. On the other hand, the FDIC insurance credit recorded in 3Q19 could be repeated in 4Q19, but probably not after that. We expect operating expenses will be around \$9.0 million in 4Q19 and closer to the \$9.2 million-\$9.4 million quarterly range in 2020. Reflecting the relative stability in asset quality demonstrated in 3Q19, we have left our projections for the loan loss provision essentially unchanged.

After making the preceding adjustments, we are reducing our 2019 EPS estimate from \$2.88 to \$2.79, largely reflecting the \$0.10 shortfall in 3Q19 results. We are reducing our 2020 estimate from \$3.16 to \$3.10, while reducing our 2021 EPS estimate from \$3.27 to \$3.23.

Stock Price Implications: TCFC currently trades at 12.4x trailing twelve-month EPS, a noticeable discount compared to the 16.1x median valuation of similar-size peer banks in the Maryland/Virginia region. The bank also trades at a discount to peers in terms of the price-to-tangible book value metric – 121.0% for TCFC versus 141.2% for the peers – and in terms of price-to-forward EPS. TCFC is trading at just 11.2x the median estimate for 2020 EPS while peers are trading at a median of 14.6x 2020 estimates.

We still believe that TCFC has good prospects for improving profitability and EPS growth. Considerable turmoil in the local banking market, including the pending BB&T-SunTrust Merger and the recently announced acquisitions of Old Line Bancshares by WesBanco, and Revere Bank by Sandy Spring Bank, should provide opportunities for TCFC to gain some market share. The consolidating banking market could also have an impact on TCFC's valuation. Our \$37.00 price target is based on a 12.0x multiple, applied to the \$3.08 EPS we are projecting over the next four quarters (4Q19-3Q20). Our target suggests a potential gain of roughly 10.1% over the next twelve months, or a total return of 11.6% including the stock's 1.49% dividend yield. Consequently, we are reiterating our Outperform rating for shares of TCFC.

Exhibit 1

The Community Financial Corporation: 3Q19 Highlights

	Actual Results			Change	
	3Q18	2Q19	3Q19	LQ ¹	YOY
Loans Held for Investment (\$000) ²	1,308,654	1,388,549	1,417,108	8.2%	8.3%
Total Deposits (\$000) ²	1,452,371	1,494,442	1,559,960	17.5%	7.4%
Average Earning Assets (\$000)	1,487,869	1,594,616	1,623,561	7.3%	9.1%
Total Revenue (\$000)	13,831	14,512	14,764	6.9%	6.7%
Net Interest Income (\$000)	12,761	13,259	13,525	8.0%	6.0%
NIM	3.40%	3.34%	3.31%	-0.03%	-0.10%
Average Securities Yield	2.68%	2.92%	2.79%	-0.13%	0.11%
Average Loan HFI Yield	4.72%	4.83%	4.80%	-0.03%	0.08%
Average Cost of Int.-bearing Deposits	0.89%	1.29%	1.00%	-0.29%	0.11%
Efficiency Ratio	58.7%	58.6%	59.6%	0.92%	0.8%
NCO Ratio	0.01%	0.09%	0.03%	-0.06%	0.03%

1. Linked quarter changes for the balances are annualized.

2. Loans Held for Investment and Total Deposits balances are end of period balances.

Source: company filings

Exhibit 2

Community Financial Corporation

(Figures in thousands except for per share data)

	2015A	2016A	2017A	2018A	2019E	2020E	2021E	Fiscal years ending December 31									
								2019A	2019A	2019A	2019A	2019A	2019A	2019A	2019A	2019A	2019A
								13,037	13,037	13,037	13,037	13,037	13,037	13,037	13,037	13,037	13,037
								500	500	500	500	500	500	500	500	500	500
								12,537	12,537	12,537	12,537	12,537	12,537	12,537	12,537	12,537	12,537
								730	730	730	730	730	730	730	730	730	730
								56	56	56	56	56	56	56	56	56	56
								217	217	217	217	217	217	217	217	217	217
								-	-	-	-	-	-	-	-	-	-
								-	-	-	-	-	-	-	-	-	-
								-	-	-	-	-	-	-	-	-	-
								-	-	-	-	-	-	-	-	-	-
								-	-	-	-	-	-	-	-	-	-
								1,061	1,061	1,061	1,061	1,061	1,061	1,061	1,061	1,061	1,061
								5,609	5,609	5,609	5,609	5,609	5,609	5,609	5,609	5,609	5,609
								197	197	197	197	197	197	197	197	197	197
								720	720	720	720	720	720	720	720	720	720
								418	418	418	418	418	418	418	418	418	418
								-	-	-	-	-	-	-	-	-	-
								189	189	189	189	189	189	189	189	189	189
								52	52	52	52	52	52	52	52	52	52
								56	56	56	56	56	56	56	56	56	56
								393	393	393	393	393	393	393	393	393	393
								771	771	771	771	771	771	771	771	771	771
								8,405	8,405	8,405	8,405	8,405	8,405	8,405	8,405	8,405	8,405
								5,193	5,193	5,193	5,193	5,193	5,193	5,193	5,193	5,193	5,193
								1,316	1,316	1,316	1,316	1,316	1,316	1,316	1,316	1,316	1,316
								3,877	3,877	3,877	3,877	3,877	3,877	3,877	3,877	3,877	3,877
								0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70
								0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13
								17.92%	17.92%	17.92%	17.92%	17.92%	17.92%	17.92%	17.92%	17.92%	17.92%
								28.50	28.50	28.50	28.50	28.50	28.50	28.50	28.50	28.50	28.50
								26.09	26.09	26.09	26.09	26.09	26.09	26.09	26.09	26.09	26.09
								5,558	5,558	5,558	5,558	5,558	5,558	5,558	5,558	5,558	5,558
								57.94%	57.94%	57.94%	57.94%	57.94%	57.94%	57.94%	57.94%	57.94%	57.94%
								0.93%	0.93%	0.93%	0.93%	0.93%	0.93%	0.93%	0.93%	0.93%	0.93%
								9.26%	9.26%	9.26%	9.26%	9.26%	9.26%	9.26%	9.26%	9.26%	9.26%
								3.35%	3.35%	3.35%	3.35%	3.35%	3.35%	3.35%	3.35%	3.35%	3.35%
								0.06%	0.06%	0.06%	0.06%	0.06%	0.06%	0.06%	0.06%	0.06%	0.06%
								1,344,656	1,344,656	1,344,656	1,344,656	1,344,656	1,344,656	1,344,656	1,344,656	1,344,656	1,344,656
								1,200,686	1,200,686	1,200,686	1,200,686	1,200,686	1,200,686	1,200,686	1,200,686	1,200,686	1,200,686
								209,321	209,321	209,321	209,321	209,321	209,321	209,321	209,321	209,321	209,321
								1,577,089	1,577,089	1,577,089	1,577,089	1,577,089	1,577,089	1,577,089	1,577,089	1,577,089	1,577,089
								1,308,533	1,308,533	1,308,533	1,308,533	1,308,533	1,308,533	1,308,533	1,308,533	1,308,533	1,308,533
								0.19%	0.19%	0.19%	0.19%	0.19%	0.19%	0.19%	0.19%	0.19%	0.19%
								2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%
								0.79%	0.79%	0.79%	0.79%	0.79%	0.79%	0.79%	0.79%	0.79%	0.79%
								0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%
								9.29%	9.29%	9.29%	9.29%	9.29%	9.29%	9.29%	9.29%	9.29%	9.29%
								8.66%	8.66%	8.66%	8.66%	8.66%	8.66%	8.66%	8.66%	8.66%	8.66%

Additional information available upon request. This report has been prepared from original sources and data that we believe to be reliable but we make no representation as to its accuracy or completeness. This report is published solely for information.

Disclosure Appendix

Analyst Certification:

I, Joseph Gladue, the primary analyst covering this issuer, certify that: 1) all of the views expressed in this report accurately reflect my personal views about the subject security or issuer, and 2) no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Risk Factors:

The realization of any or all of the following risk factors, among others, may adversely affect the company's stock price and prevent it from reaching our target price, if one is established:

- a weakening of the United States economy and the regional and local economies in which the company conducts operations
- unanticipated loan losses or securities-related losses
- a weakening of local real estate markets or the soundness and liquidity of the securities market for real-estate backed assets
- failure to maintain sufficient excess capital or liquidity to conduct operations
- the effects of trade, monetary, and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System
- the effects of increased inflation, a flatter yield curve, or increased volatility in financial markets
- inability to attract core deposits or continue to obtain third party financing on favorable terms
- adverse legal action against the company or litigation initiated by the company
- inability to successfully integrate acquired operations or to maintain sufficient excess capital post the close of a transaction

Investment Rating Definitions:

Investment ratings reflect the analyst's assessment of the subject stock's return potential relative to the NASDAQ Bank Index. There are three investment rating tiers:

- **Outperform/Buy:** The subject stock's total return is expected to exceed the return of the NASDAQ Bank Index by 10% or more over the next 12-month period.
- **Neutral/Hold:** The subject stock's total return is expected to be comparable with the return of the NASDAQ Bank Index over the next 12-month period.
- **Underperform/Sell:** The subject stock's total return is expected to be less than the return of the NASDAQ Bank Index by 10% or more over the next 12-month period.

Investment Rating Distributions (as of September 30, 2019)

Rating Categories	All Covered Companies		Investment Banking Services Provided in the Last 12 Months	
	Count	% of Total	Count	% of Category
Outperform/Buy	9	60%	0	0%
Neutral/Hold	6	40%	0	0%
Underperform/Sell	NA	0%	0	0%
Total	15	100%		

Other Important Disclosures:

J. Alden Associates, Inc. (DBA Alden Securities) is a FINRA-registered broker-dealer.

Alden Securities expects to receive compensation for investment banking services from the subject company in the next three months and/or seeks to receive such compensation.

Analyst compensation is based, in part, on Alden Securities' profitability, which includes revenues from investment banking.

Target prices, if applicable, are derived from our 12 Month Valuation Assessment. Our 12 Month Valuation Assessment is based on a blend of several relative value methodologies.

Alden Securities shares in the commissions for trades that are executed through Tourmaline Partners, LLC.

