alden

Earnings Review

November 4, 2020

The Community Financial Corporation (TCFC - NASDAQ - Recent Price: $23.15)

TCFC: Expecting Minor Additional NIM Compression, Stable Loan Balances; Reserve Build Should Decline, Allowing EPS Growth. Discontinuing Coverage.

3Q20 Results:

TCFC reported 3Q20 net income of $3.8 million, up 10.1% compared to the $3.5 million posted in 2Q20. On a per share basis, 3Q20 results were $0.64 compared to the $0.59 recorded in the prior quarter. Reported EPS fell $0.17 short of our $0.81 estimate but were in-line with the $0.64 median Street estimate. The underperformance versus our estimate was primarily driven by a higher-than-anticipated loan loss provision, which fell $1.0 million compared to the prior quarter but was still $1.0 million higher than our forecast. The higher provision reduced EPS by approximately $0.12 per share, while lower net interest income accounted for roughly $0.07 of the shortfall versus our estimate. Highlights from the quarter include:

- Gross loans held for investment grew $5.5 million or 0.3% sequentially. In dollar terms, the main drivers of the growth were increases of $25.9 million in CRE loans, $5.4 million in residential rentals, and $2.2 million in PPP loans. Most other segments posted declines for the period, including Residential mortgages, which declined $17.9 million and C&I, which fell $4.4 million. The company reports a solid loan pipeline, of approximately $152 million at September 30, 2020, which is up from $134 million at the previous quarter-end. Deposits continue to flood into the system, boosting the company's liquidity, and a significant portion of the new funds ended up going into fed funds sold (+$52.1M), which is creating a drag on average asset yields.
- Total deposits grew $109.2 million or 6.5% sequentially in 3Q20. Most of the increase was in interest bearing accounts which rose $104.6 million or 8.0% linked-quarter. Meanwhile, noninterest bearing accounts climbed $4.6 million or 1.3%. Core deposit categories all contributed to the growth, as interest bearing demand, money market, and savings accounts rose 16.0%, 4.7%, and 6.2%, respectively from June 30, 2020. CDs, on the other hand, fell 0.8% sequentially. As a result, core (non-CD) accounts rose to 79.6% of total deposits from 78.1% at June 30, 2020. The PPP loans originated in 3Q20 & 2Q20 were largely deposited in TCFC deposit accounts, and this has driven a significant rise in noninterest bearing deposit balances over this period. We expect much of these funds to be utilized over the next few quarters and many of the loans to be forgiven in 4Q20 and 1Q21, resulting in declining deposit balances in over the coming quarters.

Market Data	
Market Value (M)	$130
ADTV (Shs)	7,698
ADTV (000')	$169.3
52 Week Range	$17.50-$36.23
Dividend Yield	2.27%

Earnings Per Share Data		Our Forecast		Consensus	
	2019A	2020E	2021E	2020	2021
1Q (Mar.)	$ 0.70	$ 0.47	$ 0.77	$0.61	$0.55
2Q (Jun.)	$ 0.65	$ 0.59	$ 0.63	$0.61	$0.53
3Q (Sep.)	$ 0.66	$ 0.64	$ 0.56	$0.64	$0.59
4Q (Dec.)	$ 0.73	$ 0.76	$ 0.73	$0.60	$0.60
Year	$ 2.75	$ 2.46	$ 2.69	$2.20	$2.26
P / E	8.0	8.9	8.2	10.0	9.7

Source: SNL Financial, Alden Securities estimates

- Net interest income rose $144k or 0.9% linked-quarter, as a 3.4% increase in average earning assets was partially offset by 7 bps of NIM compression to 3.27%. Purchase accounting

Fundamental Metrics (MRQ)	
Balance Sheet	
Total Assets (M)	$2,137
Gross Loans HFI (M)	$1,626
Total Deposits (M)	$1,780
Loans / Deposits	91%
Securities / Assets	11%
Debt / Assets	7%
Profitability	
FTE NIM	3.27%
Nonint. Income / Revenue	8.55%
Efficiency Ratio	52.88%
Core ROAA	0.72%
Core ROACE	7.86%
Credit Quality	
NPAs / Assets	1.16%
NPLs / Loans	1.24%
NCO Ratio	0.00%
Reserves / Loans	0.12%
Provision / Avg Loans	0.62%
Capital Adequacy	
TCE / TA Ratio	8.5%
Total Capital Ratio	13.1%
Tier 1 Ratio	11.9%
Tier 1 CE Ratio	11.1%
Leverage Ratio	9.7%
Performance	
Core Value	$14.67
3 Yr. Success Ratio	5%
Failure Ratio	1.1%

Source: SNL Financial, Company data

Joe Gladue, CFA, PRM
Director of Research
(484) 588-2887

Institutional Trading
Tourmaline Partners
(203) 302-7300

accretion boosted the NIM by roughly 2 bps in 3Q20, down 2 bps compared to 2Q20. Average loan yields slipped 11 bps compared to 2Q20. Most loan categories saw yield declines from the prior quarter, including drops of 8 bps in CRE loans (the largest category), 28 bps in residential mortgages, and 60 bps in C&I loans. Construction loans managed to buck the trend, posting a 14 bps sequential rise in average yields. Excluding the PPP loans, average loan yields fell roughly 12 bps linked-quarter to 4.14%. Meanwhile, average securities yields decreased 32 bps sequentially, and the proportion of earning assets shifted toward lower-yielding securities and away from loans, leading to a 16 bps drop in average earning asset yields. As the average balance of CDs, the highest cost deposit category, saw a modest decline, the average cost of CDs fell 21 bps. Meanwhile, the average cost of interest bearing demand and money market accounts, the largest funding category, decreased 9 bps sequentially. These changes resulted in an 11 bps decrease in the average cost of interest bearing liabilities.

- Noninterest income retreated $593k or 26.3% sequentially, driven by an $808k drop in loan appraisal, credit & other charges. This drop follows a $662 increase the previous quarter driven by a sharp uptick in customer interest rate hedging fees on a hedging product offered through a third-party provider. We expect this item to add substantially to fee income on an annual basis but be fairly lumpy on a quarterly basis. Despite the sequential decline revenues in this line item were up $223k or 151.7% compared to the year-ago quarter. Partially offsetting the sequential drop in hedging fees was a $77k or 50.7% rise in securities gains and a $130k or 18.3% advance in service charges on deposit accounts.
- Noninterest expenses rose a modest $54k or 0.6% sequentially to $9.5 million, edging just above the range of $9.2 million to $9.4 million anticipated by management as a quarterly expense run rate in 2020. However, management has noted that COVID-19 related expenditures could push expenses above this run rate. The main drivers of the sequential increase were a $385k rise in compensation costs, a $175k advance in professional fees, and a $146k increment in "other" expenses. Offsetting these increases was a $679k drop in OREO and credit-related expenses following a $318 jump in this item in the prior quarter due to increased valuation allowances and the disposal of an office building. Management still expects the bank's quarterly run rate of expenses to range between $9.2 million and $9.4 million in 2020, though OREO and credit expenses could boost this higher depending on the severity of the COVID-19 related economic downturn. The efficiency ratio slipped to 55.48% in 3Q20 from 53.75% in 2Q20.
- TCFC recorded an income tax expense of $1.3 million in 3Q20 compared to $1.1 million in 2Q20. The effective tax rate was 25.3% in 3Q20 and 24.8% in 2Q20. We are still using an effective tax rate of 26.0% for 4Q20 and beyond.
- The loan loss provision in 3Q20 was $2.5 million, down from $3.5 million in the preceding quarter. However, the provision was still higher than the $0.1 million in net recoveries during the quarter. Net charge-offs to average loans was 0.00% in 3Q20 compared to 0.58% in 2Q20. The increased provision recognizes the fact that some loan weaknesses are currently not recognized in adverse loan classification due to loan deferrals and government stimulus programs, and that continued economic weakness stemming from the pandemic will have an impact on some borrowers. As a result, the allowance for loan & lease losses advanced 15.4% sequentially to $18.8 million, representing 1.26% reserve coverage of total loans compared to 1.08% at June 30, 2020 and 0.75% at December 31, 2019.
- Asset quality showed noticeable improvements in 3Q20, though we believe government relief programs and loan deferrals are masking the impact of COVID-19 related stresses on many borrowers. Classified and special mention loans decreased $0.6 million or 2.7% in 3Q20, while nonaccrual loans fell $2.7 million or 12.0% LQ. Meanwhile, performing TDRs edged down by $20k or 3.4% while OREO rose $0.3 million or 8.2%. These changes resulted in an 9.1% decline in NPAs. Combined with the concurrent 0.3% growth in total assets during the quarter, NPAs/Assets (including performing TDRs) slipped to 1.16% from 1.30% at the prior quarter-

end. Early stage delinquencies (loans 30-89 days past due) fell $5.0 million or 85.7% from the prior quarter-end.

- TCFC's regulatory capital ratios were relatively stable during the quarter. Most of the regulatory ratios declined slightly (1 to 3 bps) from the prior quarter, but the total risk-based capital ratio climbed 12 bps from 12.94% at June 30, 2020 to 13.06% at September 30, 2020. All of the capital ratios are well above the minimum levels required to be considered "well capitalized". The company's TCE ratio fell to 8.49% from 8.50/% at June 30, 2020. Tangible book value per share grew to $30.51 from $29.91 at June 30, 2020.

Earnings Estimates: We had expected a reduced reserve build at TCFC in 3Q20, and while this occurred, the reduction in the provision was only half what we projected, leading to an EPS shortfall versus our estimate. We still expect the provision to be smaller going forward, even as the impact of the COVID-19 induced economic recession to work its way through delinquencies and into charge-offs over the next three or four quarters. Still, we have boosted our provision estimates slightly for 4Q20 and 2021, while reducing it for 2022. The company reported a larger loan pipeline at the end of 3Q20 compared to the prior quarter, but some of the growth is just the result of longer times to get loans through the underwriting process due to pandemic-related complications. We are projecting low single digit growth in the core loan portfolio over the next year or so. However, some runoff in the PPP loan segment will offset this growth, particularly over the next few quarters as the PPP loan forgiveness process kicks into gear. On the funding side, we anticipate much of the excess deposits from the PPP program and excess customer liquidity from payment moratoriums and government relief programs will gradually be spent over the next year. We are projecting declining deposit balances for at least the next two quarters. On the other hand, TCFC completed a $20 million sub debt offering in October and some of the proceeds may be used to pay down PPPLF and FHLB Advances. We are expecting gradual reductions in cash and other low-yielding assets over the next few quarters.

We are projecting roughly 6 bps of NIM compression in 4Q20 and a 1-2 bps of additional compression over the subsequent three quarters. We expect swap income to provide a boost to noninterest income, but at levels closer to the 3Q20 amount than the unusually high level in 2Q20. We are maintaining noninterest expense projections within management's guidance range of $9.2 million to $9.4 million per quarter through 2021.

After making the preceding adjustments, we are reducing our 2020 estimate from $2.61 to $2.46, primarily reflecting the lower 3Q20 results. We are also lowering our 2021 EPS estimate from $2.71 to $2.69 while boosting our 2022 estimate from $2.76 to $3.06.

Outlook: TCFC continues to perform well during the COVID-19 pandemic. There are still significant uncertainties regarding how much asset quality deterioration there will be from the reduced economic activity during the pandemic and how much the government stimulus programs aided the survival of companies that otherwise may have failed. Still, TCFC operates in a market that benefits from its proximity to Washington DC, where government spending can offset a significant amount of economic weakness. TCFC's focus on commercial clients in this region could also be beneficial. No area is immune to COVID-related business closures, but the DC area, with its high concentration of government contractors, may have a greater proportion of businesses that make it through the crisis.

TCFC trades at a significant discount to tangible book value and a slight discount to regional peer banks of similar size. While this discount reflects the current economic uncertainty, we still believe TCFC is in a better position than many banks. In our view, TCFC remains an attractive investment.

While we have enjoyed covering The Community Financial Corporation, shifting corporate responsibilities do not allow us time to provide the same level of diligence to our equity research as we would like. Consequently, we are discontinuing coverage of TCFC.

Exhibit 1

The Community Financial Corporation: 3Q20 Highlights

	Actual Results			Change	
	3Q19	**2Q20**	**3Q20**	**LQ[1]**	**YOY**
Loans Held for Investment ($000)[2]	1,417,108	1,620,455	1,625,953	1.4%	14.7%
Total Deposits ($000)[2]	1,559,960	1,670,364	1,779,606	26.2%	14.1%
Average Earning Assets ($000)	1,623,561	1,820,775	1,882,718	13.6%	16.0%
Total Revenue ($000)	14,764	17,483	17,034	-10.3%	15.4%
Net Interest Income ($000)	13,525	15,224	15,368	3.8%	13.6%
NIM	3.31%	3.36%	3.25%	-0.12%	-0.06%
Average Securities Yield	2.76%	2.41%	2.09%	-0.32%	-0.67%
Average Loan HFI Yield	4.80%	4.17%	4.06%	-0.11%	-0.74%
Average Cost of Int.-bearing Deposits	1.26%	0.61%	0.47%	-0.14%	-0.79%
Efficiency Ratio	59.6%	46.6%	52.2%	5.57%	-7.4%
NCO Ratio	0.03%	0.58%	0.00%	-0.58%	-0.04%

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

The Community Financial Corporation (TCFC)

Exhibit 2

Community Financial Corporation

Joe Gladue. CFA (484) 588-2887 -- jgladue@aldensecurities.com

(Figures in thousands except for per share data)

2016A	2017A	2018A	2019A	2020E	2021E	2022E	*Fiscal years ending December 31*	1Q20A	2Q20A	3Q20A	4Q20E	1Q21E	2Q21E	3Q21E	4Q21E
39,905	43,388	50,887	53,534	60,599	60,039	61,599	Net interest income	14,353	15,224	15,368	15,654	14,982	14,817	15,079	15,160
2,359	1,010	1,405	2,130	11,615	7,416	4,505	Provision for loan and lease losses	4,100	3,500	2,500	1,515	1,096	2,059	2,855	1,405
37,546	42,378	49,482	51,404	48,983	52,622	57,094	**Net interest income after provision**	10,253	11,724	12,868	14,138	13,885	12,758	12,224	13,754
							Non-interest income:								
2,675	2,595	3,063	3,308	3,345	3,209	3,314	Service charges on deposit accounts	982	709	839	815	791	799	809	810
289	157	183	1,214	2,423	1,509	1,633	Loan appraisal, credit, & other misc charges	516	1,178	370	359	366	373	381	388
31	175	5	360	785	-	-	Net gain on securities transactions	404	152	229	-	-	-	-	-
789	773	902	885	883	945	1,043	Income from BOLI	219	220	222	222	228	233	239	245
-	294	-	-	-	-	-	Gain on sale of loans held for sale	-	-	-	-	-	-	-	-
12	47	1	-	6	-	-	Gain on sale of assets	-	-	6	-	-	-	-	-
(436)	43	-	-	-	-	-	Gains on sale of OREO	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	Loss on premises and equipment held for sale	-	-	-	-	-	-	-	-
3,360	4,084	4,154	5,767	7,442	5,663	5,990	**Total non-interest income**	2,121	2,259	1,666	1,396	1,385	1,405	1,429	1,444
							Total Non-interest expense								
19,298	19,390	22,664	23,546	23,198	23,228	24,409	Salaries wages & employee benefits	5,922	5,450	5,833	5,993	5,746	5,753	5,811	5,919
-	-	-	-	-	-	-	Furniture and equipment expense	-	-	-	-	-	-	-	-
647	543	671	762	513	571	643	Marketing and advertising	121	130	129	133	136	141	145	150
2,267	2,354	3,020	3,048	3,872	4,307	4,749	Technology & Data processing	928	924	990	1,030	1,050	1,040	1,081	1,135
1,568	1,662	1,513	2,196	2,381	2,605	2,765	Professional services	626	477	652	626	638	645	658	664
-	829	3,625	-	-	-	-	Merger-related expenses	-	-	-	-	-	-	-	-
812	786	810	685	597	616	677	Depreciation of premises and equipment	158	151	142	146	148	152	156	160
174	191	277	203	183	173	166	Communications	43	53	43	44	44	43	43	43
861	746	649	963	2,661	1,453	1,497	OREO and credit-related expenses	782	1,100	421	358	358	361	365	369
875	757	1,622	1,171	1,642	1,586	1,536	Other operating expense	358	441	424	419	402	398	395	391
2,657	2,839	3,290	3,659	2,968	3,053	3,241	Other expense	745	671	817	735	746	758	769	780
29,159	30,097	38,141	36,233	38,015	37,593	39,682	**Total non-interest expense**	9,683	9,397	9,451	9,484	9,269	9,291	9,422	9,610
11,747	16,365	15,409	20,937	18,410	20,692	23,402	**Income before taxes**	2,691	4,586	5,083	6,050	6,001	4,873	4,231	5,588
4,416	9,157	4,173	5,665	3,936	5,401	6,131	**Taxes**	(57)	1,136	1,284	1,573	1,566	1,272	1,104	1,458
7,331	7,208	11,236	15,272	14,474	15,292	17,271	**Net Income**	2,748	3,450	3,799	4,477	4,435	3,601	3,127	4,129
							Per Share Data:								
1.59	1.56	2.02	2.75	2.46	2.69	3.06	Diluted Earnings Per Share	0.47	0.59	0.64	0.76	0.77	0.63	0.56	0.73
0.40	0.40	0.40	0.50	0.51	0.55	0.59	Dividend	0.13	0.13	0.13	0.14	0.14	0.14	0.14	0.15
25.10%	25.69%	19.76%	18.21%	20.74%	20.43%	19.31%	Dividend Payout Ratio	26.78%	21.36%	19.40%	17.68%	17.57%	21.28%	24.32%	19.80%
22.54	23.65	27.70	30.76	33.92	37.71	40.62	Book Value Per Share	31.35	32.05	32.62	33.92	35.26	36.49	37.01	37.71
22.54	23.65	25.25	28.57	31.79	35.56	38.52	Tangible Book Value Per Share	29.18	29.91	30.51	31.79	33.10	34.31	34.85	35.56
4,600	4,629	5,551	5,561	5,885	5,679	5,652	Average Diluted Shares Outstanding (MM)*	5,887	5,894	5,895	5,865	5,771	5,677	5,632	5,638
							Profitability Measures:								
64.75%	60.14%	60.14%	58.32%	51.09%	54.27%	55.91%	Efficiency Ratio	53.08%	46.59%	52.17%	52.72%	53.65%	54.28%	54.16%	54.99%
0.60%	0.52%	0.70%	0.88%	0.74%	0.73%	0.82%	Return on average assets	0.61%	0.70%	0.73%	0.84%	0.86%	0.71%	0.60%	0.79%
7.09%	6.55%	7.53%	9.32%	7.64%	7.46%	7.80%	Return on average equity	6.03%	7.31%	7.82%	9.13%	9.01%	7.09%	5.99%	7.78%
3.48%	3.37%	3.43%	3.31%	3.31%	3.16%	3.18%	Net Interest Margin	3.45%	3.36%	3.25%	3.19%	3.18%	3.16%	3.16%	3.16%
0.27%	0.30%	0.25%	0.33%	0.38%	0.27%	0.28%	Fee Income % Average Assets	0.12%	0.11%	0.08%	0.07%	0.07%	0.07%	0.07%	0.07%
							Average Balances:								
988,289	1,113,822	1,282,292	1,371,637	1,523,759	1,596,444	1,628,755	Net Loans	1,447,533	1,562,995	1,595,506	1,604,767	1,572,204	1,549,502	1,567,288	1,584,025
839,091	916,558	1,110,103	1,229,763	1,351,809	1,447,269	1,488,231	Interest Bearing Deposits	1,246,372	1,270,984	1,301,313	1,425,861	1,425,790	1,427,137	1,444,980	1,457,948
142,116	154,225	217,897	226,964	289,302	318,144	301,678	Non-interest Bearing Deposits	246,304	332,642	358,518	349,135	318,918	300,405	301,907	301,133
1,145,462	1,288,849	1,483,652	1,615,626	1,832,849	1,898,717	1,935,355	Average Earning Assets	1,673,608	1,820,775	1,882,718	1,954,294	1,912,158	1,881,463	1,895,614	1,905,632
974,396	1,102,059	1,223,073	1,328,430	1,464,519	1,528,636	1,557,550	Average Interest Bearing Liabilities	1,344,912	1,450,735	1,501,389	1,561,042	1,539,190	1,518,205	1,524,882	1,532,267
							Asset Quality Ratios:								
0.11%	0.03%	0.07%	0.16%	0.19%	0.41%	0.25%	Net Charge-offs / Loans	-0.01%	0.58%	0.00%	0.18%	0.18%	0.38%	0.74%	0.38%
2.44%	2.09%	2.53%	1.80%	1.54%	1.90%	1.71%	Nonperforming Assets / Loans	1.56%	1.68%	1.52%	1.54%	1.74%	1.95%	1.93%	1.90%
0.91%	0.91%	0.81%	0.75%	1.21%	1.27%	1.24%	Reserves / Loans	1.01%	1.01%	1.16%	1.21%	1.28%	1.31%	1.28%	1.27%
0.22%	0.09%	0.10%	0.15%	0.72%	0.46%	0.27%	Provision /Loans	1.10%	0.86%	0.62%	0.37%	0.28%	0.52%	0.71%	0.35%
							Capital & Leverage Ratios:								
7.83%	7.82%	9.15%	10.10%	9.30%	10.26%	10.73%	Equity / Assets	10.14%	9.05%	9.02%	9.30%	9.88%	10.01%	10.09%	10.26%
7.83%	7.82%	8.50%	9.49%	8.79%	9.74%	10.22%	Tangible Equity / Tangible Assets	9.55%	8.53%	8.52%	8.79%	9.35%	9.48%	9.57%	9.74%

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, 2020)

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

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.