Investing in providers of capital

Executive Summary
October 2024

Market Capture

Fintech M&A metrics

US Banks

In March 2023, the US banking sector turmoil sent shockwaves through the global financial system. Rapidly-rising interest rates and a sluggish economy caused several high-profile banks to fail. Triggered by sizeable deposit outflows, this event raised concerns about the US banking sector, in particular small banks with large amounts of uninsured deposits, unrealized losses, and commercial real estate exposures. Small banks reacted by building liquidity levels and stabilizing deposit outflows, all while boosting capital levels in anticipation of Basel III, which increases regulatory capital requirements. But to protect against deposit outflows, banks must turn to higher-cost funding sources, which compress their margins and increases market volatility as they try to stabilize liabilities and propel asset growth in the midst of weakening demand. This dynamic will increase M&A appetite in the coming years, particularly among banks struggling to secure deposits, meet changing regulatory requirements, and stabilize balance sheets. Another M&A driver is the need for all banks to electronically digitize their operations and install more sophisticated technology.

Fintech M&A

2023 was a challenging year for fintech. Many companies struggled to raise the same amount of funding as they had in previous years. Most fintechs that are susceptible to consumer spend (such as business-to-consumer payments, buy-now-pay-later apps and mobile wallets) took a dramatic hit in their valuations. At the same time, buyers were keen to acquire companies with consistent revenue growth and a quick ramp to profitability. But surprisingly, private equity buyers stayed quiet for much of 2023, presumably due in large part to higher interest rates and declining revenue projections for sellers.

Expectations for 2024

A Target-rich Environment for Strategics:

There is considerable demand by medium and large companies to acquire small fintech and financial service companies. Strategic growth plans, technology needs, and cash burns are dictating who is selling in this market and who is waiting out the storm. The recent downturn in private equity activity has made 2024 a strategic buyer's market thus far, but that may soon change. While acquirors can benefit currently from low valuations, there are only so many great targets. That will push prices higher at some point. In the meantime, strategic buyers will continue making small, bolt-on acquisitions to complement their existing portfolios.

Cyclical Factors Favor Acquirors Right Now:

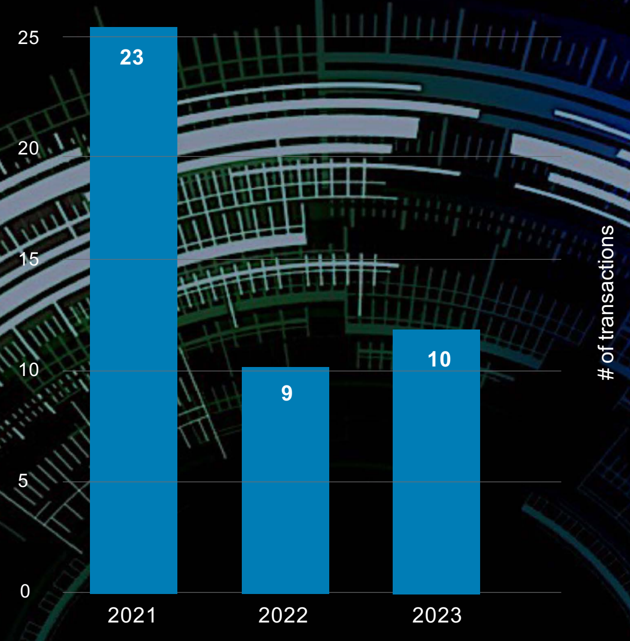
Since 1986, M&A in financial services has tended to follow a 3-year cycle. Generally speaking, merger flows have cycled every 36 months. In year one there is a flurry of activity as acquirors compete to enter new markets, grow a denser footprint in existing markets, or to buy a company for defensively strategic reasons (i.e. to prevent a competitor from acquiring that company).

In year two the acquiror must integrate the company(s) it acquired in year one. If done correctly, the integration preserves most of the loan and deposit accounts and limits poaching by competitors. In year three acquirors are pre-occupied with updating their business strategies, normalizing capital levels and planning for the next round of acquisitions. In M&A, a busy peak year is frequently followed by a 2-year digestive period. While M&A continues in years two and three, it is at half the pace of the peak year.

Sizeable Valuation Disparities Favor Buyers:

The larger acquiror banks are currently valued at about 155% of book value. The small takeover targets are valued at 95% of book value. This means that acquirors can use their stock as currency to make acquisitions and obtain significant book value and earnings addition. In the process they can pay a premium to the target company to incentivize a transaction, making the acquiree feel as if they got a good price for their company.

Merger Activity in 1st & Main's portfolio



The Fund's Focus

Our strategy seeks recurring investments in undervalued firms with potential for growth and a strategic exit. Portfolio holdings may be concentrated in difficult–to- access U.S.-based, sub-regional financial service firms. The Manager will use hedging methods to mitigate macroeconomic and other risks.

Investment Strategy

1st & Main's investment strategy is designed to deliver returns by selectively investing in undervalued, small financial services companies, accelerating growth and facilitating acquisition by strategic buyers who will pay a control premium. This is a strategy that 1st & Main has perfected over 37 years operating eleven previous funds and investing in thousands of financial services companies.

Our strategy capitalizes on inefficient pricing. There is little competition for deals in this corner of the market because smaller companies do not interest large investors. Small financial services companies to not have the scale to pay the big fees that large investors demand, and as a result investor competition for these deals is limited. Pricing inefficiencies allow investors to accrete value almost from inception, and with limited capital infusion. As a result, our portfolio companies grow consistently, generating earnings growth of between 5-15% in all but five of the last 37 years.

Our strategy also relies on our vast experience and expertise. Over the years, we have built sizable databases, information libraries and contact networks, and we have amassed unrivalled industry expertise. We use all of this to create franchise value for our portfolio companies. We also opportunistically rotate and recycle capital within our portfolio, investing in the best and most modestly valued companies while exiting those whose value has peaked. Finally, our strategy is timed to capitalize on the wave of consolidation currently underway, which will make the small financial services companies in our portfolio very attractive to strategic buyers, who will pay a control premium.

Our first ten funds (then called Banc Funds) earned 13% Net IRR, and 1.8X Net MOIC on average. All of our underlying companies operated profitably and performed well at exit. The only period where our investment returns declined was following the 2008 Global Financial Crisis, when financial services companies were perceived as a risky investment. However, this sentiment gave rise to the current pricing inefficiencies that our Fund XII will capitalize upon. At the moment, small financial services companies are valued at 8X after-tax expected earnings and 95% of tangible book value in Q2 of 2024, which is extremely low compared to valuations for companies in almost any other sector. 1st & Main uses a hedge overlay strategy by investing at low valuations in quality companies while hedging the uncertainties around geopolitical events, economic volatility, and investor sentiment.

Market Inefficiency
Exploitable Market Efficiency. Unique access to hard-to-reach, often undervalued small financial service firms.

Experienced Team
17-person team, averages 25 years experience

Proprietary Database
One of the most valuable information libraries, investment models, and contact networks in the sector

Industry Reputation
A meaningful percentage of our investments have attracted strategic buyers, often paying control premiums.

Our Advantages

About the Firm

1st & Main is one of the leading investors in U.S.-based, sub-regional, financial service companies. In 2023, the Banc Funds Company, L.L.C. ("TBFC") was re-branded as 1st & Main. All our previous private equity funds operated under the name of Banc Fund. Our rebranding reflects the expansion of our management company and our fund offerings, in particular our first foray into a fintech fund in 2022. 1st & Main is currently raising a financial services fund, with a hedge overlay.

Historical Measures

$6.0 billion[1]

Capital deployed across 11 funds over 37 years

32%[2]

Historic portfolio holdings acquired by strategic buyers

13.0%[2]

Net IRR for Banc Funds I through X

200+

U.S. Communities in which we have invested

Experienced Leadership Team

Charles J. Moore, Founder and President, manages the Funds and strategically empowers portfolio companies, driving portfolio performance.

John M. Baker, Director of Research, leads the team of investment managers, conducts investment research, analyzes portfolio operations and performance, and leads due diligence on new deals.

Richard Hein, Chief Sourcing Officer, leads research and analysis to unearth investment opportunities, manages exits, and oversees hedging operations and fund liquidation.

(1) Select active Banc Funds IX and X and TBFC Financial Technologies Fund investments
(2) Select former Banc Funds I through X investments (1986-2023)

Key Fund Terms

Fund raising Period	1 year
Investment Period	3 years
Fund Term	8 years, No Extensions
Management Fee	1.80% on called and contributed capital
Waterfall Style	Return of Capital and hurdle to investors, thereafter 80:20 in favor of investor after catch-up
Carried Interest	20%
Catch Up	Yes
Fund Size	$250 million US
Co-Investments	Possible
Investment Committee	4 members