Scott Falagan Presentation Notes

Taken by Keith Miller, all mistakes or omissions are my fault alone.

· Scott has been a banker for over 25 years.

· Farmers State Bank is a local Community Bank.

· He started with an overview of how banks make money, so as investors we can better understand how to work with them.

· At a fundamental level, banks "borrow" money from their depositors and other institutions, and invest it in hopes of a solid return.

· **Interest Income** – This is where the bulk of a bank's income will come from.
<u>3 primary categories:</u>

- First, most of the interest income is generated by the interest generated on loans. Residential, consumer (auto, personal, etc.), and commercial loans.

- Second, interest income received from investments. A CFO and their team will safely and securely invest the excess amounts not needed for loans.

- Third, a bank will have its own deposit accounts. For example, all the money coming and going from checks, wires and ACH run through what is essentially a bank's checking account at Fed. Other accounts facilitate other operations. Some of these accounts also earn interest.

· **Interest Expense** – Our interest expense is a little more basic. This is simply the interest we pay to our customers on their CDs and other interest-bearing accounts (checking and savings) and if/when we borrow funds.
Fun Fact: Did you know, that we can sometimes borrow funds from the Feds and turn right around and invest those funds with a positive return?

· **Net Interest Margin –** This is where the bulk of the bank's actual income is derived. The formula here is simply the interest income we earn minus the interest we pay our customers on deposits equals our net interest margin. Traditionally, our goal is to have an average net interest margin of 4%. In a very competitive market, like today, we are content with a net interest margin of 3.5%.

· A banks liabilities are customer's deposit accounts. Wait… How is having money a liability? For a bank it's a cost, therefore a liability. If we have a loan, that is our asset. Little bit backwards, isn't it? Makes sense once you think about it, but it takes a minute to sink in.

· One thing to know about community bank is that their efficiency ratios regarding their expenses and income are absolutely horrible. This is public information, and anyone can see that all community banks have the worst efficiency ratios in the banking industry. Even talking about regional banks here, not just the big guys. Does anyone want to take a stab at this? It's employee retention. Speaking for ourselves again here, FSB has a 27% higher rate of tenured employees than the industry average. So, when community banks state they specialize in customer service, this is where it is backed. Again, factual data… An example of being committed to customer service is when the mortgage industry saw a significant decline in originations in 2022 and 2023, look to see who laid employees off. Some companies closed the entire division. Raise of hands, does anyone here know there were multiple banks here in Missoula to shut down entire mortgage divisions? FSB laid zero people off. What is hard for a community bank is when originations pick back up, these larger companies will hire new people, offer low price, obtain business, provide sub marginal service and provide a bad name to the industry, such as missing closings and such. Again, these are companies in Missoula, not just online banks.

· From a bank's perspective, creating an environment of which an employee wants to come into everyday, may be the single greatest tool to combat risk. Having seasoned, tenured employees who know what they are doing is absolutely vital. Educating others, such as this/now, our customers and non customers who wish to business with us on a transactional basis. Helping them understand why they have to go through the necessary steps in order to complete x transaction. Examples of check fraud and foreclosures. A friend of ours once said, "Great banks understand how the multiple risks affect one another, and how to identify, monitor and control the various risks." Community banks generally have superior team members working diligently to make sure each step is carefully thought out, evaluated, and executed. This protects your personal money (as a customer), your income (being in this industry) and the local economy (foreclosure prevention).

· Farmers State Bank typically loans to 60% LTV on raw land, higher if there is infrastructure available. 75% LTV for commercial loans on existing properties is typical.