First Sound Bank

Experienced. Innovative. Sound.

Dear Shareholders: October 12, 2021

I am pleased to report the third quarter 2021 financial results for First Sound Bank ("the Bank").

For the first nine months ending September 30, 2021 the Bank generated net income of $709 thousand compared to net income of $64 thousand during the same period in 2020. The four primary drivers of this year's good profitability have been a) strong organic growth in our core loan and deposit portfolios, b) strong SBA loan production, c) our success with the second round of Paycheck Protection Program ("PPP") loans, and d) continued diligent expense control. We are continuing to execute our new strategic plan for the Bank, which has involved building out a new lending team, restructuring both the asset and liability sides of our balance sheet, re-engineering our operating costs to improve efficiency, and most importantly, continuing to grow our earning assets.

Regarding the balance sheet at 9/30/2021:

- Loans are up 3.7% from a year ago, but this number is very skewed by two items. First, our PPP loans peaked at this time last year and these are now gradually being forgiven by the SBA and paying off as expected; our net interest margin on the PPP loans is only 0.65%, so having these leave our balance sheet will not materially impact our future earnings. Second, we continue to purposefully exit the equipment finance ("EFA") business; between 9/30/2020 and 9/30/2021 our EFA loan balances dropped from $6.2 million down to only $1.4 million. Offsetting these paydowns is our new core loan production which continues to be very robust; after backing out both our PPP loans and our EFA loans, the Bank's core recurring loan portfiolio grew by an exceptionally strong 30.1% from 9/30/2020 to 9/30/2021 which far exceeded our budget and will position us for improved earnings in the months and quarters to come.

- Deposits are continuing to grow and are up 4.1% from a year ago, which exceeded our budget. We believe this is a reflection of three factors: first, our team's purposeful effort to continue to replace transactional deposits with relationship deposits; second, through our PPP efforts we gained dozens of new customers and many of these have turned into meaningful depositors; finally, the combination of low interest rates, an aggressively priced stock market, and the COVID-induced soft economy have all resulted in an industry-wide increase in bank deposits. This last factor could soon change as the economy rebounds post-pandemic. Our Bank's deposit mix continues to be favorable, with 35% of our deposits being non-interest bearing. Overall, the Bank's liquidity position is very strong.

- The Bank's total assets were relatively flat at $154.2 million as of 9/30/2021 vs. $152.8 million as of 9/30/2020, however both numbers are skewed by the PPP loans and our corresponding Federal Reserve borrowings at both quarter-ends.

Regarding the income statement at 9/30/2021:

- The Bank posted net income of $709 thousand for the nine months ending 9/30/2021 compared to net income of $64 thousand for the same period last year. Comparisons of bottom line net income between this year and last year are not fully meaningful because there were so many nonrecurring items in last year's numbers; but clearly the trends are in a positive direction.

- Looking at net interest income for 2021 compared to 2020 illustrates several key items which have impacted our Bank's profitability. YTD net interest income for the first nine months of 2021 appears to be down by 13% compared to 2020, however these numbers are skewed by two items. First, in 2020 we booked significant fee income from the first round of PPP loans. Second, this year we have taken a small loan loss provision to correspond with our continued strong core loan growth; the Bank continues to have substantial excess loan loss reserves. Backing out these two items, our net interest income actually increased compared to last year despite our EFA loans running off by $4.8 million year over year. We continue to be challenged by the current low interest rate environment, with the Fed funds rate staying near zero and lower yields on both our loans and our investment portfolio. This is an industry-wide issue which is affecting all banks, but small community banks are being impacted to a greater degree because our business model is so heavily reliant on net interest income.

- Non-interest income has shown a strongly positive reversal from last year. Last year at 9/30/2020 the Bank had negative non-interest income due to a one-time charge off of a foreclosed real estate property (OREO). This year, primarily due to our increased focus on SBA lending, the Bank's non-interest income through 9/30/2021 was very strong at $654 thousand. We have several more SBA loans in our pipeline and we anticipate these will generate continued meaningful non-interest income in future quarters this year and next year. SBA lending continues to be one of the most important elements of our new strategic plan.

- Despite the numerous additions we have made to our lending, credit, and operations teams, the Bank's operating expenses remain tightly controlled and in fact are down slightly from last year. Looking at the numbers, the Bank's total non-interest expense dropped 6.1% for the first nine months of 2021 compared to the same period in 2020. However this number is skewed because of the way banks account for fee income as we book new loans, with part of the fee booked as an offset to personnel expense. Because we have booked so many new loans this year, both PPP and core loans, this expense offset was about $200 thousand larger in 2021 compared to last year; backing out this adjustment, our recurring operating expenses in 2021 are roughly flat from last year. Management continues to be very focused on expense control.

Our plan from this point forward is to continue to grow the Bank's core loan portfolio, run off the remaining EFA loans, control operating expenses, focus on SBA origination and sales, and work toward increasing the Bank's core profitability.

Thank you for your continued support of the Bank. Please contact me at any time if you have questions, concerns, business referrals, or ideas.

Sincerely,

Marty Steele
President & CEO

First Sound Bank

Statement of Condition
(In 000's) Unaudited

	As of September 30, 2021	As of September 30, 2020
ASSETS		
Cash and cash equivalents	$ 1,141	$ 1,754
Fed funds and interest-bearing deposits	21,085	29,520
Investment Securities	10,474	5,697
Loans on accrual	118,913	113,488
Loans on nonaccrual	1,616	2,621
Total loans, gross	120,529	116,109
Allowance for Loan Losses	(1,491)	(1,380)
Total loans, net	119,038	114,729
Premises and equipment	110	151
Other real estate owned	0	0
Other assets	2,281	953
Total assets	$ 154,129	$ 152,804
LIABILITIES		
Noninterest-bearing deposits	$ 40,620	$ 38,840
Interest-bearing deposits	75,699	72,872
Other liabilities	23,874	27,431
Total liabilities	140,193	139,143
SHAREHOLDERS' EQUITY		
Common stock and related surplus	61,873	61,391
Accumulated deficit	(47,937)	(47,730)
Total Shareholders' Equity	13,936	13,661
TOTAL LIABILITIES & EQUITY	$ 154,129	$ 152,804

Statement of Operations
(In 000's) Unaudited

	For the Quarter Ended September 30, 2021	For the Quarter Ended September 30, 2020	For the Nine Months Ended September 30, 2021	For the Nine Months Ended September 30, 2020
INTEREST INCOME				
Loans	$ 1,154	$ 974	$ 3,607	$ 3,806
Equipment finance	46	67	161	258
Fed funds & interest-bearing deposits	8	5	18	45
Investment securities	22	30	63	76
Total interest income	1,230	1,076	3,849	4,185
INTEREST EXPENSE				
Deposits/Borrowings	147	152	506	436
Net interest income before provision	1,083	924	3,343	3,749
PROVISION FOR LOAN LOSSES	(29)	-	71	-
Net interest income after provision	1,112	924	3,272	3,749
NONINTERST INCOME	214	104	654	(259)
NONINTERSEST EXPENSE				
Salaries and benefits	580	506	1,716	1,915
Occupancy expenses	132	128	409	473
Other expenses	404	316	1,092	1,038
Total noninterest expense	1,116	950	3,217	3,426
INCOME TAXES	-	-	-	-
NET INCOME	$ 210	$ 78	$ 709	$ 64