First Sound Bank

Experienced. Innovative. Sound.

Dear Shareholders: August 14, 2020

I am pleased to report the second quarter 2020 financial results for First Sound Bank ("the Bank").

While 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, and re-engineering our operating costs to improve efficiency, two large non-recurring events impacted our income statement and balance sheet in Q2 of 2020:

The first event was our successfully reaching a definitive agreement to sell the Bank's one remaining OREO asset, the foreclosed Mastro property. The sale was actually consummated in July, after the close of Q2, but in compliance with GAAP we accounted for the anticipated costs and revenues of the sale in June. The negative impact was that we incurred expenses of almost $600 thousand in the form of an asset write-down, transaction costs, and associated legal fees. The much more positive impact is that this problem asset is finally off our books, 16 years after the Bank originally made the problem loan which was secured by the property. The Bank's non-performing asset ratio is now down to 1.26%.

The second event was our Bank's participation in the highly publicized Paycheck Protection Program ("PPP" loans). Due to the hard work of our employees, and our Management and Board adopting the program very early on, we were extremely successful in our execution; based on recent data published by the SBA, relative to the size of our Bank we processed PPP loans at a rate more than double that of the average US community bank. This success resulted in bottom line income, net of related personnel costs and other expenses, in excess of $900 thousand. We also gained many new customers who were turned away for PPP loans by the larger national and regional banks.

Regarding the balance sheet at 6/30/2020:

- Loans are up 35% from a year ago, but this is a temporary aberration due to the PPP loans. Looking at our two underlying core loan categories, our equipment finance loans ("EFA" loans) continue to run off as planned; from 6/30/2019 to 6/30/2020, EFA's declined by $11.5 million or 58%, which is substantial but in line with our strategic plan to exit this business line. The good news is that our new commercial lending team was able to produce net new non-EFA loan growth of $12 million during the same period, a growth rate of 18% which is exceptional. As was the case last quarter, this represents our Bank's highest rate of core loan growth since 2007.
- Deposits are up 7% from a year ago, reflecting our team's purposeful effort to continue to replace transactional deposits with relationship deposits. Our deposit mix is more favorable, with non-interest bearing deposits growing 32% and interest bearing deposits declining 6%. We continue to have no brokered deposits and minimal internet deposits.

Regarding the income statement:

- The Bank generated net income for the second quarter 2020 of $62 thousand, and year to date the Bank is still showing a small loss of $14 thousand. However the income statements for both quarter-end and year to date 6/30/2020 are skewed by several one-time events including the $600 thousand Mastro expense, the PPP income over $900 thousand, and about $200 thousand of accruals for regulatory costs and other operating expenses based the Bank's new operating structure.

- Interest income from our core loan portfolio is relatively flat from last year, as income from our increased non-EFA loans has been offset by decreases in the EFA loans plus the general decrease in market interest rates this year. Income from our overnight liquid balances has also declined due to the current interest rate environment. The interest rates on our various earning assets are down about 1.75%, on average, across the yield curve from one year ago.
- Non-interest income year to date in 2020 has more than doubled compared to last year due to the Bank's increased focus on originating and selling SBA loans. This will continue to be a key priority for us in 2020.
- Operating expenses continue to be tightly controlled and in fact declined 8% year to date 6/30/2020 compared to the same period in 2019. However personnel expense increased by over 50%, which was significant and intentional. At the end of second quarter 2019 the Bank had virtually no commercial lending capacity and insufficient support in both credit underwriting and loan processing. As part of our new strategic plan, we have built a completely new lending team including support personnel.

The plan from this point forward is to continue to grow the core non-EFA loan portfolio, run off the remaining EFA loans, control operating expenses, focus on SBA origination and sales, and work toward getting the Bank back to meaningful 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 June 30, 2020	As of June 30, 2019
ASSETS		
Cash and cash equivalents	$ 947	$ 1,069
Fed funds and interest-bearing deposits	20,507	19,246
Investment Securities	6,137	3,912
Loans on accrual	116,331	85,444
Loans on nonaccrual	1,990	1,990
Total loans, gross	118,321	87,434
Allowance for Loan Losses	(1,423)	(1,454)
Total loans, net	116,898	85,980
Premises and equipment	164	190
Other real estate owned	1,139	1,769
Other assets	896	873
Total assets	$ 146,688	$ 113,039
LIABILITIES		
Noninterest-bearing deposits	$ 41,330	$ 31,022
Interest-bearing deposits	64,138	68,048
Other liabilities	27,551	340
Total liabilities	133,019	99,410
SHAREHOLDERS' EQUITY		
Common stock and related surplus	61,399	61,399
Accumulated deficit	(47,730)	(47,770)
Total Shareholders' Equity	13,669	13,629
TOTAL LIABILITIES & EQUITY	$ 146,688	$ 113,039

Statement of Operations

(In 000's) Unaudited

	For the Quarter Ended June 30, 2020	For the Quarter Ended June 30, 2019	For the Six Months Ended 30, 2020	For the Six Months Ended 30, 2019
INTEREST INCOME				
Loans	$ 1,964	$ 950	$ 2,833	$ 1,721
Equipment finance	85	111	191	415
Fed funds & interest-bearing deposits	2	73	39	187
Investment securities	24	22	46	34
Total interest income	2,075	1,156	3,109	2,357
INTEREST EXPENSE				
Deposits/Borrowings	137	133	285	308
Net interest income before provision	1,938	1,023	2,824	2,049
PROVISION FOR LOAN LOSSES	-	-	-	-
Net interest income after provision	1,938	1,023	2,824	2,049
NONINTERST INCOME	(491)	66	(362)	123
NONINTERSEST EXPENSE				
Salaries and benefits	791	502	1,409	980
Occupancy expenses	163	120	307	372
Other expenses	431	514	760	787
Total noninterest expense	1,385	1,136	2,476	2,139
INCOME TAXES	-	-	-	-
NET INCOME	$ 62	$ (47)	$ (14)	$ 33