First Sound Bank

Experienced. Innovative. Sound.

Dear Shareholders: July 27, 2021

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

For the first six months ending June 30, 2021 the Bank generated net income of $498 thousand compared to a loss of $14 thousand during the same period in 2020. The three primary drivers of this year's good profitability have been a) strong organic growth in our core loan and deposit portfolios, b) our success with the second round of SBA Paycheck Protection Program loans, and c) 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 6/30/2021:

- Loans are up 10% from a year ago, but this number is skewed by two items. First, June 30 of last year was a high water mark for our PPP loan balances 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 65 basis points, 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 6/30/2020 and 6/30/2021 our EFA loan balances dropped from $8.3 million down to $2.2 million. Fortunately our new core loan production continues to be robust, and so after backing out both our PPP loans and our EFA loans the Bank's core recurring loan portfiolio actually grew 22% from 6/30/2020 to 6/30/2021 which 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 10% 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 the PPP program we gained dozens of new customers and many of those 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 exceptionally strong.

- The Bank's total assets grew from $146.7 million at 6/30/2020 to $165.2 million at 6/30/2021, however both numbers are somewhat skewed by the PPP loans and the corresponding Federal Reserve borrowings at both quarter-ends.

Regarding the income statement at 3/31/2021:

- The Bank posted net income of $498 thousand for the six months ending 6/30/2021 compared to a loss of $14 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 impacted our Bank's profitability. YTD net interest income for the first six months of 2021 appears down by 20% 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 prudently increased our loan loss provision by $100 thousand to correspond with our continued strong core loan growth; the Bank continues to be very well reserved. Backing out these two items, our net interest income actually increased 13% compared to last year despite our EFA loans running off by $6.1 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 on our liquid bond and Fed investments. 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 6/30/2020 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 6/30/2021 was very strong at $439 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. 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 15% for the first six months of 2021 compared to the same period in 2020. However these numbers are 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 $300 thousand larger in 2021 than last year; backing out this adjustment, our recurring operating expenses through 6/30/2021 still declined but only by about 3%. 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

Marty Steele
President & CEO

First Sound Bank

Statement of Condition

(In 000's) Unaudited

	As of June 30, 2021	As of June 30, 2020
ASSETS		
Cash and cash equivalents	$ 437	$ 947
Fed funds and interest-bearing deposits	24,986	20,507
Investment Securities	7,986	6,137
Loans on accrual	129,044	116,331
Loans on nonaccrual	1,680	1,990
Total loans, gross	130,724	118,321
Allowance for Loan Losses	(1,491)	(1,423)
Total loans, net	129,233	116,898
Premises and equipment	124	164
Other real estate owned	0	1,139
Other assets	2,477	896
Total assets	$ 165,243	$ 146,688
LIABILITIES		
Noninterest-bearing deposits	$ 40,151	$ 41,330
Interest-bearing deposits	76,023	64,138
Other liabilities	35,353	27,551
Total liabilities	151,527	133,019
SHAREHOLDERS' EQUITY		
Common stock and related surplus	61,653	61,399
Accumulated deficit	(47,937)	(47,730)
Total Shareholders' Equity	13,716	13,669
TOTAL LIABILITIES & EQUITY	$ 165,243	$ 146,688

Statement of Operations

(In 000's) Unaudited

	For the Quarter Ended June 30, 2021	For the Quarter Ended June 30, 2020	For the Six Months Ended 30, 2021	For the Six Months Ended 30, 2020
INTEREST INCOME				
Loans	$ 1,263	$ 1,964	$ 2,453	$ 2,833
Equipment finance	53	85	115	191
Fed funds & interest-bearing deposits	5	2	10	39
Investment securities	26	24	41	46
Total interest income	1,347	2,075	2,619	3,109
INTEREST EXPENSE				
Deposits/Borrowings	189	137	358	285
Net interest income before provision	1,158	1,938	2,261	2,824
PROVISION FOR LOAN LOSSES	100	-	100	-
Net interest income after provision	1,058	1,938	2,161	2,824
NONINTERST INCOME	382	(491)	439	(362)
NONINTERSEST EXPENSE				
Salaries and benefits	728	791	1,136	1,409
Occupancy expenses	186	163	365	307
Other expenses	312	431	601	760
Total noninterest expense	1,226	1,385	2,102	2,476
INCOME TAXES	-	-	-	-
NET INCOME	$ 214	$ 62	$ 498	$ (14)