First Sound Bank

Experienced. Innovative. Sound.

Dear Shareholders: April 21, 2021

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

For the first quarter ending March 31, 2021 the Bank generated net income of $284 thousand compared to a loss of $77 thousand during the same period in 2020. The three primary drivers of this year's profitability have been a) our success with the latest round of SBA Paycheck Protection Program loans, b) strong organic growth in our core loan and deposit portfolios, and c) continued diligent expense control. We are continuing to execute our 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 3/31/2021:

- Loans are up 59% from a year ago, but this number is skewed by two items. First, our PPP loan balances of $43.9 million are temporary and we anticipate most of them will gradually pay off over the next 12 months as they are forgiven by the SBA; our net income margin on the PPP loans is only 65 basis points, so having those leave our balance sheet will not materially impact our future earnings. Second, we have been purposefully exiting the equipment finance ("EFA") business; between 3/31/2020 and 3/31/2021, our EFA loan balances dropped from $10.5 million down to $3.1 million. Fortunately, our new core loan production continues to be robust which has more than offset the EFA payoffs. From 3/31/2020 to 3/31/2021 our core portfolio of commercial and residential loans grew 21%; this loan growth exceeded our budget and will position us for improved earnings in the months and quarters to come.

- Deposits are up 27% from a year ago, which far exceeded both our budget and our most optimistic expectations. 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. Our Bank's deposit mix continues to be favorable, with 32% of our deposits being non-interest bearing. Overall, the Bank's liquidity position is exceptionally strong.

- The Bank's total assets have grown 62% during the past year, however that number is skewed by the PPP loans and the corresponding Federal Reserve borrowings we are using to fund them. Backing out the PPP loans and the Fed borrowings, the Bank's total assets grew 21% from 3/31/2020 to 3/31/2021.

Regarding the income statement at 3/31/2021:

- The Bank posted net income of $284 thousand for the quarter ending 3/31/2021 compared to a loss of $77 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; also the Bank's business model continues to evolve as we execute our strategic plan. But clearly the trends are in a positive direction.

- Looking at total interest income for Q1 2021 compared to Q1 2020 illustrates several key items which impacted our Bank's profitability, both positively and negatively. YTD loan interest in 2021 was up by 29% compared to 2020 despite the significantly lower interest rate environment year over year. This income improvement was due to our strong core loan growth and our strong success with the PPP loan program. Offsetting this were two negative items, one of which we budgeted and the other we did not. As budgeted, our EFA loans are running off and the corresponding interest income from them is down 56% this year compared to 2020. What we did not budget was the unexpectedly aggressive response of the Federal Reserve to the COVID pandemic, with the Fed funds rate dropping to near zero in April of last year; as a result, our 2021 YTD interest income from the Bank's overnight deposits at the Fed and our bond portfolio was down 66% compared to last year. This is an industry-wide issue which is affecting all banks, with small community banks being impacted to a greater degree because our business model is so heavily reliant on interest income.

- Non-interest income, much of which is derived from SBA lending, is down compared to last year because of the timing of our SBA transactions. We have several new SBA loans in our pipeline and we anticipate these will generate meaningful non-interest income in future quarters this year. SBA lending continues to be one of the most important elements of our 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 20% between Q1 2020 and Q1 2021. However these numbers are skewed because of the way that banks account for fee income as we book new loans, with part of the fee being booked up front 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 $190 thousand larger in Q1 2021 than it was for the same period in 2020; backing out this adjustment, our recurring operating expenses in Q1 2021 still declined but only by about 2%. 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 March 31, 2021		As of March 31, 2020	
ASSETS				
Cash & Due From Banks	$	716	$	727
Fed Funds & Int Bearing Dep		21,349		11,972
Investment Securities		7,366		3,161
Loans on Accrual		141,430		88,521
Loans on Non Accrual		2,506		1,850
Total Loans		143,936		90,371
Less Allowance for Loan Losses		(1,400)		(1,408)
Net Loans		142,536		88,963
Bank Premises & Equipment		124		166
Other Real Estate Owned		0		1,769
Other Assets		2,547		828
TOTAL ASSETS	$	174,638	$	107,586
LIABILITIES & SHAREHOLDERS' EQUITY				
Liabilities				
Non IB Demand Deposits	$	37,343	$	30,240
Interest Bearing Deposits		77,972		60,574
Other Liabilities		45,865		3,250
Total Liabilities		161,180		94,064
Shareholders' Equity				
Common Stock & Related Surplus		13,174		13,599
Accumulated Surplus (Deficit)		284		(77)
Total Shareholders' Equity		13,458		13,522
TOTAL LIABILITIES & EQUITY	$	174,638	$	107,586

STATEMENT OF OPERATIONS (IN 000'S)
Unaudited

	For the Quarter Ended March 31, 2021		March 31, 2020	
INTEREST INCOME				
Loans	$	1,192	$	876
Equipment Financing		61		99
Fed Funds & Int Bearing Dep		5		38
Investment Securities		15		21
Total Interest Income		1,273		1,034
INTEREST EXPENSE				
Deposits/Borrowings		170		148
NET INTEREST INCOME		1,103		886
Less Provision for Loan Losses		0		0
Net Interest Income After Provision for Loan Losses		1,103		886
NON INTEREST INCOME		57		129
NON INTEREST EXPENSE				
Salaries & Benefits		407		619
Occupancy & Equipment		259		239
Other Expenses		210		234
Total Noninterest Expense		876		1,092
Income taxes		0		0
NET INCOME (LOSS)	$	284	$	(77)

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