



# California First Leasing Corporation

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## Financial Report

(UNAUDITED)

### Third Quarter and Nine Months Ended

**March 31, 2021**

California First Leasing Corporation, (OTCQX: CFNB, “CalFirstLease” or the “Company”), headquartered in Newport Beach, California, leases and finances capital assets to businesses and other commercial or non-profit organizations throughout the United States, while UniversityLease focuses on the financing needs of colleges and universities. The Company also actively invests retained earnings in equity securities with the purpose of improving returns on shareholders’ equity. On February 26, 2021, California First National Bancorp completed the sale of California First National Bank (“Bank”) while retaining the lease portfolio and business. Following the sale, the Company merged its California First Leasing subsidiary into itself and changed the name to “California First Leasing Corporation.”

*The Company’s reported quarterly earnings can fluctuate widely due to including gains and losses on equity securities that are determined based on stock prices on the last day of a fiscal quarter.*

This financial report contains forward-looking statements which involve management assumptions, risks and uncertainties. The statements in this report that are not strictly historical in nature constitute “forward-looking statements.” Such statements include, but are not limited to, beliefs regarding investments in equity securities, swings in stock prices and the potential for this to cause significant volatility in reported net earnings and returns, projected changes in lease originations and in the lease and loan portfolios, the credit quality of the lease and loan portfolio, the adequacy of reserves for credit losses, the impact of external events on business activities and opportunities, estimates of expected tax rates applicable to future periods and impact of changes in interest rates. Such forward-looking statements involve known and unknown risks and uncertainties and factors that could cause actual results to differ materially include political, economic, business, competitive, market, and other risks, including the future impact of the novel coronavirus disease (“COVID-19”) outbreak and measures taken in response to it for which future developments are highly uncertain and difficult to predict. Consequently, if such management assumptions prove to be incorrect or such risks or uncertainties materialize, the Company’s actual results could differ materially from the results forecast in the forward-looking statements. All forward-looking statements are qualified in their entirety by this cautionary statement, and the Company undertakes no obligation to revise or update this information to reflect events or circumstances arising after the date hereof (April 27, 2021).

**SELECTED FINANCIAL DATA**

	<u>Three Months Ended March 31,</u>		<u>Nine Months Ended March 31,</u>	
	<u>2021</u>	<u>2020</u>	<u>2021</u>	<u>2020</u>
<b>Income Statement</b>				
<i>(in thousands, except per share data)</i>				
Net interest income, net of provision	\$ 2,075	\$ 2,382	\$ 5,187	\$ 8,148
Net interest margin	3.17%	4.26%	2.66%	4.12%
Gains (losses) on equity securities	\$ 15,100	\$ (32,167)	\$ 31,665	\$ (21,482)
Total noninterest income (losses)	\$ 17,808	\$ (31,563)	\$ 36,897	\$ (18,838)
Net income (loss)	\$ 13,389	\$ (27,556)	\$ 29,918	\$ (16,096)
Earnings per share	\$ 1.30	\$ (2.68)	\$ 2.91	\$ (1.57)
	<u>March 31,</u>	<u>December 31,</u>	<u>September 30,</u>	<u>June 30,</u>
	<u>2021</u>	<u>2020</u>	<u>2020</u>	<u>2020</u>
<i>(\$ in thousands)</i>				
<b>Balance Sheet</b>				
Equity investments	\$ 106,892	\$ 108,094	\$ 63,792	\$ 51,339
Net investment in leases and loans	\$ 43,666	\$ 51,221	\$ 54,227	\$ 51,962
Total assets	\$ 238,396	\$ 263,878	\$ 260,202	\$ 267,760
Total deposits	\$ -	\$ 42,648	\$ 50,515	\$ 56,807
Stockholders' equity	\$ 223,988	\$ 210,599	\$ 201,061	\$ 199,623

**OVERVIEW**

CalFirstLease's results for the third quarter ended March 31, 2021 include large gains on its equity securities as well as a gain realized on the sale of the Bank. For the third quarter, the Company reported gains of \$15.1 million on the equity portfolio compared a loss of \$32.2 million for the third quarter of the year before. The mostly unrealized gains contributed to the swing in net earnings to \$13.4 million for the third quarter ended March 31, 2021 from a loss of \$27.6 million in the prior year third quarter. The Company recognized a gain of \$2.34 million on the sale of the stock of the Bank to DMG Bancshares, Inc. ("DMG"). Pursuant to the terms of the sale agreement, DMG paid a purchase price equal to the Bank's equity capital of \$12.6 million on February 26, 2021 plus \$2.5 million. Prior to this, in January 2021 the Bank distributed to CFNB 100% of its lease portfolio with a net value of \$47.3 million.

Excluding the impact of the equity securities and the Bank sale, 2021 third quarter pretax earnings of \$1.22 million declined 27.8% from \$1.69 million in the third quarter of fiscal 2020. The decline included a \$307,500 (13%) decrease in net interest income after release of reserves and a decline of \$481,700 (80%) in income from end of term transactions.

Net earnings for the nine months ended March 31, 2021 of \$29.9 million included gains of \$31.7 million on equity securities compared to losses of \$21.5 million on equity securities included for the first nine months of fiscal 2020. Excluding the security gains and the Bank sale, the Company's pre-tax earnings for the first nine months of fiscal 2021 declined \$2.05 million, or 30.3%, to \$4.7 million from \$6.75 million the year before. This decline included a \$2.96 million or 36.4% decrease in net interest income after release of reserves and \$1.1 million decrease in gains from sale of leases and loans, offset by a \$1.3 million increase in income from end-of-term transactions and \$668,400 (16.5%) drop in noninterest expenses.

Total lease bookings during the third quarter of fiscal 2021 of \$4.9 million were up from \$931,000 for the same quarter of the prior year. For the nine months ended March 31, 2021, total bookings of \$30.0 million were down 25% from \$40.2 million during the first nine months of the prior year. Lease originations during the third quarter were minimal, leaving the backlog of approved leases at \$3.3 million at March 31, 2021.

During the first nine months of fiscal 2021, the Company retained 79.5% of new leases booked, and participated 95% of two Main Street Loans to the Federal Reserve in accordance with program guidelines. As a result, the net investment in leases and loans of \$43.7 million at March 31, 2021 was down 16.0% from \$52.0 million at June 30, 2020. The credit portfolio continued to perform well, with no non-performing assets at March 31, 2021. CFNB's equity investment portfolio more than doubled from \$51.3 million at June 30, 2020 to \$106.9 million at March 31, 2021, reflecting \$52.7 million of purchases, \$28.8 million in sales and the \$31.7 million gains noted above.

**BALANCE SHEETS**

(in thousands, except for share amounts)

	March 31, 2021 (Unaudited)	June 30, 2020	Percent Change
<b><u>ASSETS</u></b>			
Cash and due from banks	\$ 83,982	\$ 153,083	(45.1) %
Fed funds sold	-	1,040	(100.0) %
Equity investments	106,892	51,339	108.2 %
Investments held-to-maturity (HTM)	-	2,102	(100.0) %
Receivables	108	87	24.1 %
Property acquired for transactions in process	1,142	4,031	(71.7) %
Leases and loans:			
Net investment in leases	40,734	49,273	(17.3) %
Commercial loans	3,677	3,607	1.9 %
Allowance for credit losses	(745)	(918)	(18.8) %
Net investment in leases and loans	<u>43,666</u>	<u>51,962</u>	<u>(16.0) %</u>
Net property on operating leases	81	867	(90.7) %
Income taxes receivable	376	376	0.0 %
Other assets	743	932	(20.3) %
Discounted lease rentals assigned to lenders	1,406	1,941	(27.6) %
Total Assets	<u>\$ 238,396</u>	<u>\$ 267,760</u>	<u>(11.0) %</u>
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>			
Liabilities:			
Demand and savings deposits	\$ -	\$ 34,548	(100.0) %
Time certificates of deposit	-	22,259	(100.0) %
Accounts payable	386	3,266	(88.2) %
Accrued liabilities	1,295	2,116	(38.8) %
Lease deposits	301	802	(62.5) %
Non-recourse debt	1,406	1,941	(27.6) %
Deferred income taxes, net	11,020	3,205	243.8 %
Total Liabilities	<u>14,408</u>	<u>68,137</u>	<u>(78.9) %</u>
Commitments and contingencies	-	-	n/a
Stockholders' equity:			
Preferred stock; 2,500,000 shares authorized; none issued	-	-	n/a
Common stock; \$.01 par value; 20,000,000 shares authorized; 10,284,139 issued and outstanding both periods	103	103	0.0 %
Additional paid in capital	2,314	2,314	0.0 %
Retained earnings	221,571	197,206	12.4 %
Total Stockholders' Equity	<u>223,988</u>	<u>199,623</u>	<u>12.2 %</u>
Total Liabilities and Stockholders' Equity	<u>\$ 238,396</u>	<u>\$ 267,760</u>	<u>(11.0) %</u>

**STATEMENTS OF EARNINGS**  
 (in thousands, except share and per share amounts)  
 (Unaudited)

	Three Months Ended		Percent Change	Nine months Ended		Percent Change
	March 31,			March 31,		
	2021	2020		2021	2020	
Finance and loan income	\$ 1,101	\$ 1,583	(30.4) %	\$ 3,058	\$ 5,156	(40.7) %
Investment and dividend income	857	1,013	(15.4) %	1,995	3,085	(35.3) %
Total interest and dividend income	1,958	2,596	(24.6) %	5,053	8,241	(38.7) %
Interest expense on deposits	6	64	(90.6) %	39	343	(88.6) %
Net interest income	1,952	2,532	(22.9) %	5,014	7,898	(36.5) %
Provision for credit losses	(123)	150	- %	(173)	(250)	(30.8) %
Net interest income after provision for credit losses	2,075	2,382	(12.9) %	5,187	8,148	(36.3) %
Noninterest income						
Operating and sales-type lease income	114	550	(79.3) %	452	1,155	(60.9) %
Gain on sale of leases, loans and leased property	167	49	240.8 %	2,323	1,449	60.3 %
Gain (loss) on equity securities	15,100	(32,167)	-	31,665	(21,482)	-
Gain on sale of bank subsidiary	2,343	-	-	2,343	-	-
Other fee income	84	5	- %	114	40	185.0 %
Total noninterest income	17,808	(31,563)		36,897	(18,838)	
Noninterest expenses						
Compensation and employee benefits	918	919	(0.1) %	2,533	2,864	(11.6) %
Occupancy	50	49	2.0 %	150	178	(15.7) %
Professional and IT services	129	209	(38.3) %	492	595	(17.3) %
FDIC and regulatory fees	10	13	(23.1) %	(66)	43	-
Other general and administrative	111	104	6.7 %	266	363	(26.7) %
Total noninterest expenses	1,218	1,294	(5.9) %	3,375	4,043	(16.5) %
Earnings before income taxes	18,665	(30,475)		38,709	(14,733)	
Income taxes	5,276	(2,919)		8,791	1,363	545.0 %
Net earnings	\$ 13,389	\$ (27,556)		\$ 29,918	\$ (16,096)	
Basic earnings per share	\$ 1.30	\$ (2.68)		\$ 2.91	\$ (1.57)	
Average common shares outstanding – basic	10,284,139	10,284,139		10,284,139	10,284,139	

**STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited, in thousands)

	Three months ended March 31,		Nine months ended March 31,	
	2021	2020	2021	2020
Net earnings	\$ 13,389	\$ (27,556)	\$ 29,918	\$ (16,096)
Other comprehensive income (loss):				
Unrealized gains on securities available-for-sale	-	-	-	35
Tax effect	-	-	-	(5)
Total other comprehensive income	-	-	-	30
Total comprehensive income	\$ 13,389	\$ (27,556)	\$ 29,918	\$ (16,066)

**STATEMENTS OF STOCKHOLDERS' EQUITY**

(Unaudited, in thousands, except share amounts)

	Shares	Amount	Additional Paid in Capital	Retained Earnings	Accumulated Comprehensive Income	Total
<u>Nine months ended March 31, 2020</u>						
Balance, June 30, 2019	10,284,139	\$ 103	\$ 2,314	\$ 204,917	\$ (30)	\$ 207,304
Net earnings	-	-	-	(16,096)	-	(16,096)
Other comprehensive income	-	-	-	-	30	30
Dividends paid	-	-	-	(5,349)	-	(5,349)
Balance, March 31, 2020	<u>10,284,139</u>	<u>\$ 103</u>	<u>\$ 2,314</u>	<u>\$ 183,472</u>	<u>\$ -</u>	<u>\$ 185,889</u>
<u>Nine months ended March 31, 2021</u>						
Balance, June 30, 2020	10,284,139	\$ 103	\$ 2,314	\$ 197,206	\$ -	\$ 199,623
Net earnings	-	-	-	29,918	-	29,918
Dividends paid	-	-	-	(5,553)	-	(5,553)
Balance, March 31, 2021	<u>10,284,139</u>	<u>\$ 103</u>	<u>\$ 2,314</u>	<u>\$ 221,571</u>	<u>\$ -</u>	<u>\$ 223,988</u>

**STATEMENTS OF CASH FLOWS**

(Unaudited, in thousands)

	Nine months ended March 31,	
	2021	2020
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net Earnings	\$ 29,918	\$ (16,096)
Adjustments to reconcile net earnings to cash flows provided by (used for) operating activities:		
Release of reserves for credit losses	(173)	(250)
Depreciation and net amortization	97	358
Gain on sale of loans held for sale	-	(19)
Proceeds from sales of loans held for sale	-	14,605
Gain on sale of leased property and sales-type lease income	(2,114)	(638)
(Gain) loss on equity securities, net	(31,665)	21,483
Gain on sale of bank subsidiary	(2,343)	-
Deferred income taxes, including income taxes payable	7,815	(946)
Increase in income taxes receivable	-	(100)
Net (decrease) increase in accounts payable and accrued liabilities	(820)	38
Other, net	177	1,270
Net cash provided by operating activities	<u>892</u>	<u>19,705</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Investment in leases, loans and transactions in process	(28,847)	(65,970)
Payments received on lease receivables and loans	32,346	57,187
Proceeds from sales of leased property and sales-type leases	2,518	1,080
Proceeds from sales and assignments of leases	4,725	31,957
Net decrease (increase) in Fed funds sold	1,040	(620)
Purchase of equity securities	(52,664)	(21,079)
Pay down on or sales of fixed-income securities	-	24,000
Pay down on investments held-to-maturity	2,102	3
Proceeds from sale of equity securities	28,776	5,332
Proceeds from sale of bank subsidiary	2,493	-
Net increase in other assets	(122)	(528)
Net cash (used for) provided by investing activities	<u>(7,633)</u>	<u>31,362</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net decrease in time certificates of deposit	(22,259)	(20,330)
Net decrease in demand and savings deposits	(34,548)	(13,534)
Dividends to stockholders	(5,553)	(5,349)
Net cash used for financing activities	<u>(62,360)</u>	<u>(39,213)</u>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	(69,101)	11,854
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	153,083	68,849
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<u>\$ 83,982</u>	<u>\$ 80,703</u>

**SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION**

Decrease in lease rentals assigned to lenders and related non-recourse debt	<u>\$ (535)</u>	<u>\$ (535)</u>
Estimated residual values recorded on leases	<u>\$ (716)</u>	<u>\$ (229)</u>
Interest paid on deposits and borrowed funds	<u>\$ 43</u>	<u>\$ 361</u>
Income taxes paid	<u>\$ 976</u>	<u>\$ 2,409</u>
Transfers from loans held for investment to loans held for sale	<u>\$ -</u>	<u>\$ 14,599</u>
Remaining bank equity capital paid at sale closing	<u>\$ 12,524</u>	<u>\$ -</u>



## DISCUSSION OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION FOR THREE AND NINE MONTHS ENDED MARCH 31, 2021

### Net Interest Income

Net interest income is the difference between interest and dividends earned on the investment in leases, loans, and securities and interest paid on deposits. Net interest income is affected by changes in the volume and mix of interest earning assets and the movement of interest rates. The following table presents the components of the increases (decreases) in net finance, loan and interest income before provision for credit losses by volume and rate. *Comparisons of fiscal 2021 to the third quarter and nine months of fiscal 2020 are limited by the sale of the Bank in February 2021 and the inclusion of deposit expense for only two months and eight months of the respective fiscal 2021 periods.*

(in thousands)	Quarter Ended March 31 2021 vs 2020			Nine Months Ended March 31, 2021 vs 2020		
	Volume	Rate	Total	Volume	Rate	Total
<b>Interest income</b>						
Net investment in leases	\$ (413)	\$ (67)	\$ (480)	\$ (1,687)	\$ (17)	\$ (1,704)
Commercial loans	(4)	2	(2)	(375)	(19)	(394)
Investment securities	(29)	3	(26)	(156)	35	(121)
Equity securities	161	(72)	89	(103)	36	(67)
Interest-earning deposits with banks	21	(240)	(219)	552	(1,454)	(902)
	<u>(264)</u>	<u>(374)</u>	<u>(638)</u>	<u>(1,769)</u>	<u>(1,419)</u>	<u>(3,188)</u>
<b>Interest expense</b>						
Demand and savings deposits	(18)	(10)	(28)	(56)	(103)	(159)
Time deposits	(23)	(7)	(30)	(84)	(61)	(145)
	<u>(41)</u>	<u>(17)</u>	<u>(58)</u>	<u>(140)</u>	<u>(164)</u>	<u>(304)</u>
<b>Net interest income</b>	<u>\$ (223)</u>	<u>\$ (357)</u>	<u>\$ (580)</u>	<u>\$ (1,629)</u>	<u>\$ (1,255)</u>	<u>\$ (2,884)</u>

The following tables present the Company's average balances, finance, loan and dividend income and interest earned or interest paid, the related yields and rates on major categories of the Company's earning assets and interest-bearing liabilities. Yields/rates are presented on an annualized basis.

(dollars in thousands)	Quarter ended March 31, 2021			Quarter ended March 31, 2020		
	Average Balance (1)	Interest	Yield/ Rate	Average Balance (1)	Interest	Yield/ Rate
<b>Assets</b>						
Interest-earning assets						
Interest-earning deposits with banks	\$ 94,771	\$ 24	0.10%	\$ 87,173	\$ 243	1.11%
Investment securities	825	16	7.76%	2,732	42	6.15%
Equity securities	103,805	817	3.15%	84,988	728	3.43%
Commercial loans	3,685	37	4.02%	4,126	39	3.78%
Net investment in leases	43,020	1,064	9.89%	58,748	1,544	10.51%
Total interest-earning assets	<u>246,106</u>	<u>1,958</u>	<u>3.18%</u>	<u>237,767</u>	<u>2,596</u>	<u>4.37%</u>
Other assets	4,418			31,470		
	<u>\$ 250,524</u>			<u>\$ 269,237</u>		
<b>Liabilities and Shareholders' Equity</b>						
Interest-bearing liabilities						
Demand and savings deposits	\$ 11,528	2	0.05%	\$ 28,940	30	0.41%
Time deposits	9,467	4	0.17%	27,829	34	0.49%
Total interest-bearing liabilities	<u>20,995</u>	<u>6</u>	<u>0.11%</u>	<u>56,769</u>	<u>64</u>	<u>0.45%</u>
Noninterest-bearing demand deposits	418			1,144		
Other liabilities	12,046			8,163		
Shareholders' equity	<u>217,065</u>			<u>203,161</u>		
	<u>\$ 250,524</u>			<u>\$ 269,237</u>		
Net interest income		<u>\$ 1,952</u>			<u>\$ 2,532</u>	
Net interest spread (2)			<u>3.07%</u>			<u>3.92%</u>
Net interest margin (3)			<u>3.17%</u>			<u>4.26%</u>

(1) Average balance is based on month-end balances and is presented net of unearned income.

(2) Net interest spread is equal to the difference between the average yield on interest earning assets and the average rate paid on interest-bearing liabilities.

(3) Net interest margin represents net interest income as a percent of average interest earning assets.





Total interest and dividend income for the third quarter ending March 31, 2021 decreased 24.6% to \$1.96 million from \$2.60 million for the third quarter of fiscal 2020. This decrease includes a \$480,400 decrease in direct finance income, and a \$245,500 or 86.1% decrease in investment interest income, offset by a 12% or \$89,000 increase in dividend income.

- The 31.1% decrease in finance income was due to a 26.8% decrease in average lease balances to \$43.0 million and a 62-basis point decrease in the average yield. The 2021 third quarter finance income of \$1.06 million included \$235,880 of accelerated income related to the Bank sale, while the prior year period included a large early lease termination. Excluding these items, the average lease yield for the third quarter of fiscal 2021 would be down 32 basis points to 7.56%.
- Investment interest income decreased by \$245,500 due to a 110-basis point decline in average yield to 0.17% that offset a 6.3% increase in average cash balances to \$95.6 million.
- Dividend income increased \$89,000 despite average balances increasing 22.1% to \$103.8 million as the yield decreased from 3.43% to 3.15%.
- Interest expense paid on deposits decreased 90.6% to \$6,000 reflecting a 63.0% decrease in the average deposit balances to \$21 million and a 34-basis point decrease in average rate paid to 0.11%. Effective with the Bank sale, all deposit balances were eliminated on February 26, 2021.

The average yield on all interest-earning assets for the third quarter of fiscal 2021 decreased by 119 basis points to 3.18% from 4.37% for the third quarter ended March 31, 2020, while the average rate paid on all interest-bearing liabilities decreased by 34 basis points to 0.11%. As a result, the net interest margin decreased to 3.17% in the third quarter of fiscal 2021 from 4.26% in the third quarter of fiscal 2020.

<i>(dollars in thousands)</i>	Nine months ended March 31, 2021			Nine months ended March 31, 2020		
	Average Balance (1)	Interest	Yield/ Rate	Average Balance (1)	Interest	Yield/ Rate
<b>Assets</b>						
Interest-earning assets						
Interest-earning deposits with banks	\$ 118,470	\$ 86	0.10%	\$ 76,018	\$ 988	1.73%
Investment securities	1,472	71	6.43%	7,747	192	3.30%
Equity securities	82,606	1,838	2.97%	87,294	1,905	2.91%
Commercial loans	3,573	101	3.77%	14,653	495	4.50%
Net investment in leases	44,765	2,957	8.81%	70,159	4,661	8.86%
Total interest-earning assets	250,886	5,053	2.68%	255,871	8,241	4.29%
Other assets	7,684			29,356		
	\$ 258,570			\$ 285,227		
<b>Liabilities and Shareholders' Equity</b>						
Interest-bearing liabilities						
Demand and savings deposits	\$ 21,873	9	0.05%	\$ 32,922	168	0.68%
Time deposits	16,842	30	0.24%	32,520	175	0.72%
Total interest-bearing liabilities	38,715	39	0.13%	65,442	343	0.70%
Noninterest-bearing demand deposits	663			1,750		
Other liabilities	12,355			10,573		
Shareholders' equity	206,837			207,462		
	\$ 258,570			\$ 285,227		
Net interest income		\$ 5,014			\$ 7,898	
Net interest spread (2)			2.55%			3.60%
Net interest margin (3)			2.66%			4.12%
Average interest earning assets over average interest-bearing liabilities			648.0%			391.0%

(1) Average balance is based on month-end balances and is presented net of unearned income.

(2) Net interest spread is equal to the difference between the average yield on interest earning assets and the average rate paid on interest-bearing liabilities.

(3) Net interest margin represents net interest income as a percent of average interest earning assets.

For the first nine months of fiscal 2021, total interest income decreased \$3.2 million or 38.7% to \$5.05 million from \$8.24 million for the first nine months of the prior year. This decrease includes a \$1.7 million decline in direct finance income, a \$393,900 fall in commercial loan income, and a decrease of \$1.02 million in investment interest income.

- Finance income decreased by 36.6% to \$2.96 million as the average investment in leases declined 36.2% to \$44.8 million and the average yield earned fell by 5 basis points to 8.81%. In addition to accelerated finance income from early terminated leases in both periods, fiscal 2021 includes a one-time contribution related to the Bank sale; if





excluded, the revised lease yield for the first nine months of fiscal 2021 of 7.30% is 24 basis points below the adjusted prior year rate of 7.54%.

- The 79.5% decrease in commercial loan income reflected a 75.6% decrease in average loan balances to \$3.6 million, while average yields fell 74 basis points to 3.77%.
- A \$1.0 million decrease in investment interest for the first nine months of fiscal 2021 was due primarily to a 164-basis point drop in yields earned that offset a 55.8% increase in average cash balances to \$118.5 million.
- Dividend income for the first nine months of fiscal 2021 fell \$66,700 or 3.5% to \$1.84 million as average equity security balances were 5.4% lower while the average yield increased by 6 basis points to 2.97%.
- For the nine months ended March 31, 2021, interest expense paid on deposits decreased by 88.6% to \$39,100 due to a 40.8% decrease in average deposits to \$38.7 million and a 56-basis point decrease in average rate paid to 0.13%. As of February 26, 2021, there were no deposit balances due to the sale of the Bank.

For the first nine months of fiscal 2021, the average yield on all interest-earning assets decreased by 161 basis points to 2.68% from 4.29%, while the average rate paid on all interest-bearing liabilities decreased by 56 basis points to 0.13%. As a result, the net interest margin decreased to 2.66% for the first nine months of fiscal 2021 from 4.12% for the first nine months of fiscal 2020. The decrease in net interest spread and margin in fiscal 2021 largely reflects the 43% decline in the higher yielding lease and loan portfolio coupled with the 164-basis point drop in yield on average cash balances due to the lower rate environment.

### Provision for Credit Losses

The Company released reserves of \$122,600 from the allowance for credit losses during the third quarter of fiscal 2021, which compared to a \$150,000 reserve added during the quarter ending March 31, 2020. For the first nine months of fiscal 2021, the release of \$172,600 of reserves compared to a \$250,000 release of reserves during the first nine months of fiscal 2020. The resulting 19% reduction in allowance for credit losses is consistent with the 16.0% decline in the lease and loan portfolio since June 30, 2020 and lowered credit risk related to the pandemic. At March 31, 2021, the allowance for credit losses of \$745,000, 1.68% of the investment in leases and loans, is considered reasonable and appropriate.

As a result of the foregoing, third quarter net interest income after provision for credit losses decreased 12.9% to \$2.07 million from \$2.38 million for the third quarter of the prior year, while net interest income after provision for credit losses for the nine months ended March 31, 2021 decreased 36.0% from \$8.2 million to \$5.19 million.

### Noninterest Income

Gains and losses on equity securities, including unrealized amounts arising from the change in the fair value at the end of the period, are included in noninterest income. For the third quarter of fiscal 2021, noninterest income increased to \$17.8 million from a loss of \$31.6 million for the third quarter of the prior year. The increase includes a gain in fair value of equity securities of \$15.1 million for the third quarter of fiscal 2021 compared to a \$32.17 million decline in fair value during the third quarter of fiscal 2020. In addition, third quarter 2021 non-interest income includes a gain of \$2.34 million gain recognized on the sale of the Bank. Excluding income related to equity securities and the Bank sale from both periods, noninterest income for the third quarter of fiscal 2021 of \$367,900 declined 39% primarily due to a \$482,000 decrease in income from end of term transactions offset by a \$164,000 increase in gains on sale of leases and loans.

Noninterest income of \$36.9 million for the first nine months of fiscal 2021 compared to a \$18.84 million net loss reported for the first nine months of fiscal 2020. The change reflects a nine-month 2021 gain on equity securities of \$31.7 million as compared to a \$21.5 million net loss on equity securities for the first nine months of fiscal 2020. Excluding equity gains and losses and the gain on sale of Bank noted above, noninterest income for the first nine months of fiscal 2021 of \$2.9 million was up by \$245,500 as a \$1.3 million increase in income from end of term transactions was offset by a decline of \$1.1 million in gains on sale of leases and loans as compared to the prior year.

### Noninterest Expenses

The Company's noninterest expenses of \$1.22 million for the quarter ended March 31, 2021 declined by \$76,100 or 5.9% from \$1.29 million in the third quarter of fiscal 2020. Third quarter 2021 expenses included severance, moving and other restructure expenses and recoveries related to the Bank sale estimated to have increased costs by about \$71,000 in the period. For the nine months ended March 31, 2021, noninterest expenses of \$3.37 million declined 16.5% from \$4.04 million reported for the same period of the prior year, and included a \$331,000 or 11.6% reduction in compensation costs and \$337,400 or 28.6% decline in all other expenses.

### Income Taxes

The Company's tax provision of \$8.8 million for the nine months ended March 31, 2021 reflects tax of \$10.9 million accrued at 28.3% on pretax earnings of \$38.7 million, offset by a credit of \$2.15 million related to the reversal of the tax valuation allowance previously recorded on the cumulative unrealized losses on the equity portfolio at September 30, and June 30, 2020. The periodic effective income tax rate will vary between periods due to changes in mix of pre-tax

earnings, particularly related to unrealized gains and losses on securities and underlying income tax rates applicable in different taxing jurisdictions.

The Company's components of earnings and taxes are summarized as follows:

(dollars in thousands)	Three Months Ended			Nine Months Ended		
	March 31,		Percent Change	March 31,		Percent Change
	2021	2020		2021	2020	
<b>Pretax earnings</b>						
Pretax earnings excluding equity portfolio	\$ 3,565	\$ 1,692	110.7 %	\$ 7,044	\$ 6,749	4.4 %
Equity portfolio	15,100	(32,167)	n/m	31,665	(21,482)	n/m
Pretax earnings (loss)	18,665	(30,475)	n/m	38,709	(14,733)	n/m
<b>Income taxes</b>						
Income tax expense excluding equity portfolio	957	460	107.9 %	1,886	1,836	2.7 %
Income tax expense/(benefit) on equity portfolio	4,319	(8,749)	n/m	9,056	(5,843)	n/m
Income tax valuation allowance	-	5,370	(100.0) %	(2,151)	5,370	n/m
Net tax expense/(benefit)	5,276	(2,919)	n/m	8,791	1,363	545.2 %
<b>Net earnings</b>						
Net earnings excluding equity portfolio	2,608	1,232	111.7 %	5,158	4,913	5.0 %
Net equity portfolio gain/(loss)	10,781	(28,788)	-	24,760	(21,009)	-
Net earnings/(loss)	\$ 13,389	\$ (27,556)	-	\$ 29,918	\$ (16,096)	-

Prior to completing the sale of the Bank, in January 2021 the Bank distributed its lease portfolio to CFNB as a dividend recorded as a reduction in CFNB's investment in the Bank based on the net value of the investment in leases ("Leases") of \$47.3 million. In accordance with Internal Revenue Code (IRC) Section 311, the difference in the fair value of the Leases relative to the tax basis will be recognized as an ordinary gain for tax purposes. On a prospective basis, CFNB receives a step-up in tax-basis of the Leases that will be amortized as a reduction to future taxable income over five years or the remaining life of each lease. The Company has not completed the assessment of the taxable gain but expects any increased tax liability due in fiscal 2021 will not be material to its operations and will be offset by a corresponding reduction in the deferred tax liability.

## **Financial Condition Analysis**

Total assets at March 31, 2021 of \$238.4 million were down 11.0% from \$267.8 million at June 30, 2020 and 9.7% from \$263.9 million at December 31, 2020. The significant changes since June 30, 2020 include a decline of \$70.1 million in cash and cash equivalents to \$81.0 million at March 31, 2021, and an increase of \$55.6 million in equity investments. The change in cash balances primarily relates to the sale of the Bank which held \$63.0 million in cash at June 30, 2020.

## **Lease Portfolio**

The Company's net investment in leases consisted of the following:

	March 31,	June 30,
	2021	2020
	(in thousands)	
Minimum lease payments receivable	\$ 41,473	\$ 50,568
Estimated residual value	2,952	2,453
Less unearned income	(3,691)	(3,748)
Net investment in leases before allowances	40,734	49,273
Less allowance for lease losses	(700)	(832)
Less valuation allowance for estimated residual value	(10)	(25)
Net investment in leases	\$ 40,024	\$ 48,416

The Company often makes payments to purchase leased property prior to the commencement of the lease. The disbursements are made to facilitate the lessees' property implementation schedule. The lessee generally is obligated to make rental payments while the transaction is in process, and contractually obligated to reimburse the Company for all disbursements under certain circumstances. Income is not recognized while a transaction is in process and prior to the commencement of the lease. At March 31, 2021, property acquired for transactions in process was down to \$2.9 million from \$4.0 million at June 30, 2020 and from \$27.2 million at March 31, 2020. The Company also had \$2.2 million

of unfunded commitments to purchase property for approved leases in process. These commitments are binding, generally have fixed expiration dates or other termination clauses and are estimated to be completed within one year.

### Commercial Loan Portfolio

The Company's net commercial loan portfolio increased less than 2.0% during the first nine months of fiscal 2021 to \$3.6 million and consists of the following:

	March 31, 2021	June 30, 2020
	(in thousands)	
Commercial real estate loans	\$ 3,403	\$ 3,607
Commercial term loans	321	-
Total commercial loans	3,724	3,607
Less unearned income and discounts	(47)	-
Less allowance for loan losses	(35)	(61)
Net commercial loans	<u>\$ 3,642</u>	<u>\$ 3,546</u>

Commercial loans are reported at their outstanding unpaid principal balances reduced by the allowance for loan losses and net of any deferred fees or costs.

### Equity Securities

The Company's equity securities portfolio consists of common stock holdings in public companies with readily available prices and is carried at fair value. At March 31, 2021, the portfolio included investments held in 28 companies, up from 23 at June 30, 2020. During the first nine months of fiscal 2021, the Company invested an additional \$20.8 million in 7 existing holdings and \$31.9 million in 15 new positions. The Company also sold positions in 14 stocks for \$28.8 million and realized a net loss of \$290,200 on these sales. The equity portfolio is distributed among a number of companies and industries, with an average fair value at March 31, 2021 of \$3.8 million; however, one investment accounts for 12.7% of the total fair value of the equity securities at March 31, 2021, three companies account for 32% and the top five investments represent 45% of the current fair value of equity securities.

At March 31, 2021, the aggregate fair market value of the equity securities of \$106.9 million included approximately \$24.04 million of net unrealized gains. Investments in equity securities as of March 31, 2021 and June 30, 2020 are summarized by primary industry sector in the table below:

(in thousands)	Cost Basis	Unrealized		Fair Value
		Gains	(Losses)	
<b>as of March 31, 2021</b>				
Commercial / Industrial	\$ 28,000	\$ 11,901	\$ (386)	\$ 39,515
Consumer	17,519	3,685	(28)	21,176
Financial	15,585	4,614	-	20,199
Healthcare	21,747	4,255	-	26,002
Total equity securities	<u>\$ 82,851</u>	<u>\$ 24,455</u>	<u>\$ (414)</u>	<u>\$ 106,892</u>
<b>as of June 30, 2020</b>				
Commercial / Industrial	\$ 21,238	\$ 1,136	\$ (4,444)	\$ 17,930
Consumer	13,218	235	(1,798)	11,655
Financial	15,534	90	(4,194)	11,430
Healthcare	9,265	1,391	(332)	10,324
	<u>\$ 59,255</u>	<u>\$ 2,852</u>	<u>\$ (10,768)</u>	<u>\$ 51,339</u>

### Investments

The investment portfolio only included holdings of the Bank and has been eliminated with the sale of the Bank. Investments carried at cost at June 30, 2020 were as follows:

(in thousands)	June 30, 2020	
	Carrying Cost	Fair Value
Federal Reserve Bank Stock	\$ 1,955	\$ 1,955
Federal Home Loan Bank Stock	44	44
Mortgage-backed investment	103	114
	<u>\$ 2,102</u>	<u>\$ 2,113</u>

**Asset Quality**

As part of assessing and monitoring the credit portfolio, the Company disaggregates the portfolio into four classes: 1) commercial leases, 2) education, government and non-profit leases, 3) commercial and industrial loans and 4) commercial real estate loans. The Company's also classifies all leases and loans in accordance with a risk rating classification system consistent with regulatory models under which leases and loans may be rated as "pass", "special mention", "substandard", or "doubtful". The classification of the Company's lease and loan portfolios by class is as follows:

(dollars in thousands)	Commercial Leases	Education Government Non-profit Leases	Commercial Loans	Commercial Real Estate Loans	Total
<b>As of March 31, 2021:</b>					
Pass	\$ 23,363	\$ 15,405	\$ 274	\$ 3,403	\$ 42,445
Special Mention	1,674	-	-	-	1,674
Substandard	-	292	-	-	292
Doubtful	-	-	-	-	-
	<u>\$ 25,037</u>	<u>\$ 15,697</u>	<u>\$ 274</u>	<u>\$ 3,403</u>	<u>\$ 44,411</u>
Non-accrual	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

(dollars in thousands)	Commercial Leases	Education Government Non-profit Leases	Commercial & Industrial Loans	Commercial Real Estate Loans	Total
<b>As of June 30, 2020:</b>					
Pass	\$ 27,038	\$ 17,456	\$ -	\$ 3,607	\$ 48,101
Special Mention	3,312	1,298	-	-	4,610
Substandard	-	169	-	-	169
Doubtful	-	-	-	-	-
	<u>\$ 30,350</u>	<u>\$ 18,923</u>	<u>\$ -</u>	<u>\$ 3,607</u>	<u>\$ 52,880</u>
Non-accrual	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

There were no past due credits or increase in non-performing assets during the quarter and nine months ended March 31, 2021. The following table presents the aging of the leases and loans by portfolio class:

(dollars in thousands)	31-89 Days	Greater Than 90 Days	Total Past Due	Current	Total	Over 90 Days & Accruing
<b>As of March 31, 2021:</b>						
Commercial Leases	\$ -	\$ -	\$ -	\$ 25,037	\$ 25,037	\$ -
Education, Government, Non-profit Leases	-	-	-	15,697	15,697	-
Commercial Loans	-	-	-	274	274	-
Commercial Real Estate Loans	-	-	-	3,403	3,403	-
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 44,411</u>	<u>\$ 44,411</u>	<u>\$ -</u>
<b>As of June 30, 2020:</b>						
Commercial Leases	\$ -	\$ -	\$ -	\$ 30,350	\$ 30,350	\$ -
Education, Government, Non-profit Leases	-	-	-	18,923	18,923	-
Commercial and Industrial Loans	-	-	-	-	-	-
Commercial Real Estate Loans	-	-	-	3,607	3,607	-
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 52,880</u>	<u>\$ 52,880</u>	<u>\$ -</u>

**Allowance for Credit Losses**

The allowance for credit losses provides coverage for probable and estimable losses in the Company's lease and loan portfolios. The allowance recorded is based on a quarterly review of all leases and loans outstanding and transactions in process. Lease receivables, loans or residuals are charged off when they are deemed completely uncollectible.

The allowance for credit losses of \$745,000 at March 31, 2021 was reduced by \$173,000 when compared to June 30, 2020 and was reduced by \$492,000 from \$1.24 million at March 31, 2020. The Company considers the allowance for credit losses at March 31, 2021 adequate to cover losses specifically identified as well as inherent in the lease and loan portfolios. However, no assurance can be given that the Company will not, in any particular period, sustain losses that are sizeable in relation to the amount reserved, or that subsequent evaluations of the portfolio, in light of factors then

prevailing, will not require significant increases in the allowance for credit losses. Among other factors, economic, political and regulatory actions may have an adverse impact on the adequacy of the allowance for credit losses.

	Nine months ended March 31,	
	2021	2020
(dollars in thousands)		
Net investment in leases and loans before allowance	\$ 44,411	\$ 60,282
Allowance for credit losses at beginning of period	\$ 918	\$ 1,504
Charge-off of lease receivables	-	-
Transfer of loans to held-for-sale	-	(17)
Recovery of amounts previously written off	-	-
Provision for credit losses	(173)	(250)
Allowance for credit losses at end of period	<u>\$ 745</u>	<u>\$ 1,237</u>
Components of allowance for credit losses:		
Allowance for lease losses	\$ 700	\$ 1,151
Residual valuation allowance	10	25
Allowance for loan losses	35	61
	<u>\$ 745</u>	<u>\$ 1,237</u>
Allowance for credit losses as a percent of net investment in leases and loans before allowances	<u>1.68%</u>	<u>2.05%</u>

The allowance balances and activity in the allowance by portfolio segment for the nine months ended March 31, 2021 and 2020 are presented in the following table:

(dollars in thousands)	Commercial	Education	Commercial	Commercial	Total
	Leases	Government Non-profit Leases	& Industrial Loans	Real Estate Loans	
<b>Nine months ended March 31, 2021:</b>					
Balance beginning of period	\$ 638	\$ 219	\$ -	\$ 61	\$ 918
Charge-offs	-	-	-	-	-
Recoveries	-	-	-	-	-
Provision	(100)	(47)	5	(31)	(173)
Balance end of period	<u>\$ 538</u>	<u>\$ 172</u>	<u>\$ 5</u>	<u>\$ 30</u>	<u>\$ 745</u>
<b>Nine months ended March 31, 2020:</b>					
Balance beginning of period	\$ 872	\$ 242	\$ 329	\$ 61	\$ 1,504
Charge-offs	-	-	-	-	-
Transfer of loans to held-for-sale	-	-	(17)	-	(17)
Recoveries	-	-	-	-	-
Provision	12	50	(312)	-	(250)
Balance end of period	<u>\$ 884</u>	<u>\$ 292</u>	<u>\$ -</u>	<u>\$ 61</u>	<u>\$ 1,237</u>

### Liquidity and Capital Resources

Following the sale of the Bank, the Company's funding sources are its existing cash and securities balances, internally generated funds and non-recourse debt. At March 31, 2021 and June 30, 2020, the Company's cash and cash equivalents were \$84.0 million and \$154.1 million, respectively.

All deposit accounts were held at CalFirst Bank and eliminated with the sale of the Bank. The following table presents the ending balances, average balances and average rates paid on deposits for the nine months ended March 31, 2021 and 2020:

	Nine months ended March 31,					
	2021			2020		
	Ending Balance	Average Balance	Average Rate Paid	Ending Balance	Average Balance	Average Rate Paid
	(dollars in thousands)					
Noninterest-bearing demand deposits	\$ -	\$ 663	n/a	\$ 1,084	\$ 1,750	n/a
Interest-bearing demand deposits	-	3,758	0.05%	1,374	1,409	0.05%
Money market and savings deposits	-	18,115	0.06%	25,195	31,513	0.71%
Time deposits, less than \$100,000	-	5,331	0.26%	7,851	10,226	0.67%
Time deposits, \$100,000 or more	\$ -	\$ 11,511	0.22%	\$ 18,376	\$ 22,294	0.74%