



Consolidated Financial Report

(UNAUDITED)

First Quarter and Three Months Ended

September 30, 2020

California First National Bancorp, (OTCQX: CFNB, “CalFirst” or the “Company”), is a bank holding company headquartered in Orange County, California with two subsidiaries, California First National Bank (“CalFirst Bank” or the “Bank”) and California First Leasing Corporation (“CFLC”). The business of the Bank includes leasing and financing capital assets and commercial loans, including non-recourse loans to third parties secured by leases and equipment. The Bank, responsible for substantially all lease and loan origination, gathers deposits through posting rates on the Internet and conducts all banking and other operations from one central location. CFLC participates in transactions with the Bank and also has a portfolio of equity securities. In October 2020, the Company entered into an agreement to sell 100% of the common stock of CalFirst Bank. See *Subsequent Events* (page 13).

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, 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, impact of changes in interest rates, as well as expectations relating to the proposed sale of CalFirst Bank, including the expected timing of the completion of the sale and the ability to obtain regulatory approvals required to complete the proposed transaction. 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, regulatory 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 (October 27, 2020).

Selected Financial Data

	Three Months Ended		
	September 30, 2020	June 30, 2020	September 30, 2019
	<i>(\$ in thousands, except per share data)</i>		
<u>Income Statement</u>			
Net interest income, net of provision	\$ 1,345	\$ 2,010	\$ 2,798
Net interest margin	2.14%	2.85%	4.18%
Gains (losses) on equity securities	\$ (392)	\$ 11,591	\$ 1,115
Net income	\$ 1,438	\$ 13,733	\$ 2,981
Earnings per share	\$ 0.14	\$ 1.34	\$ 0.29
<u>Balance Sheet</u>			
Equity investments	\$ 63,792	\$ 51,339	\$ 86,980
Net investment in leases & loans	\$ 54,227	\$ 51,962	\$ 99,941
Total assets	\$ 260,202	\$ 267,760	\$ 290,644
Total deposits	\$ 50,515	\$ 56,807	\$ 69,360
Stockholders' equity	\$ 201,061	\$ 199,623	\$ 210,312
Book value per share	\$ 19.55	\$ 19.41	\$ 20.45

CalFirst's net earnings of \$1.4 million for the first quarter ended September 30, 2020 were down 52% from net earnings of \$2.98 million for the first quarter of fiscal 2020. The results for both periods include unrealized gains and losses on equity securities determined based on stock prices on the last day of a fiscal quarter. First quarter 2021 net earnings include a net loss of \$391,600 on equity securities compared to a gain of \$1.1 million recognized in the first quarter of fiscal 2020. Excluding any loss or gain on equity securities from both periods, pre-tax earnings for the first quarter of fiscal 2021 would be \$2.5 million, down 16.2% from \$3.0 million in the same period of the year before. This decline includes a 55% or \$1.6 million decrease in net interest income after provision for credit losses, offset by a \$653,000 increase in other non-interest income and \$418,200 reduction in non-interest expense.

During the first quarter of fiscal 2021, lease bookings of \$12.8 million were down 62.3% from the \$33.9 million booked during the first quarter of fiscal 2020. New lease originations were minimal during the quarter and the backlog of approved lease commitments of \$13.6 million at September 30, 2020 was down 60.5% from September 2019 and 35.4% from June 30, 2020. Transactions in process of \$4.35 million at September 30, 2020 are up from \$4.03 million at June 30, 2020 but down from \$24.3 million at September 30, 2019.

The Company has not seen any increase in non-performing assets, but the Covid-19 pandemic is having a disparate impact on certain segments within the lease customer base. The high-impact areas include universities and colleges (24% of the lease portfolio), hospitals and health care (12%) and hotels and restaurants (4%). The total of these categories is \$22.4 million, or 40% of the net investment in leases. Although these customers are adversely impacted by COVID-19, the Bank's commitments are spread over a wide range of clients who we believe possess financial resources and experienced management to work through these economic challenges.

2021 First Quarter Highlights

- Net investment in leases and loans of \$54.2 million at September 30, 2020 was up 4.4% from \$52.0 million at June 30, 2020, but down 45.7% from \$99.9 million at September 30, 2019.
- First quarter net interest income decreased 51.9% due to a 6% decline in interest earning assets that was compounded by a 226 basis point drop in average yield caused by a shift to 54% of earning assets sitting in low yielding Fed Funds and deposit accounts.
- The credit portfolio performed well during the first quarter as all accounts that were provided lease payment deferrals returned to payment status. No new requests for accommodation have been received or new problems identified.
- The \$11.0 million or 24.3% increase in equity securities since June 30, 2020 to \$63.8 million at September 30, 2020 included \$12.8 million of purchases and a \$391,600 unrealized loss.
- Consolidated assets of \$260.2 million at September 30, 2020 were down 2.8% from \$267.8 million at June 30, 2020 and 10.5% from \$290.6 million at September 30, 2019.
- Capital of \$201.1 million at September 30, 2020 affords significant flexibility and strength.

CONSOLIDATED BALANCE SHEETS

(in thousands, except for share amounts)

	September 30, 2020 (Unaudited)	June 30, 2020	Percent Change
ASSETS			
Cash and due from banks	\$ 132,303	\$ 153,083	(13.6) %
Federal funds sold	824	1,040	(20.8) %
Equity investments	63,792	51,339	24.3 %
Investments held-to-maturity (HTM)	1,651	2,102	(21.5) %
Receivables	63	87	(27.6) %
Property acquired for transactions in process	4,351	4,031	7.9 %
Leases and loans:			
Net investment in leases	51,707	49,273	4.9 %
Commercial loans	3,538	3,607	(1.9) %
Allowance for credit losses	(1,018)	(918)	10.9 %
Net investment in leases and loans	<u>54,227</u>	<u>51,962</u>	<u>4.4 %</u>
Net property on operating leases	106	867	(87.8) %
Income taxes receivable	376	376	0.0 %
Other assets	746	932	(20.0) %
Discounted lease rentals assigned to lenders	1,763	1,941	(9.2) %
Total Assets	<u>\$ 260,202</u>	<u>\$ 267,760</u>	<u>(2.8) %</u>
LIABILITIES AND STOCKHOLDERS' EQUITY			
Liabilities:			
Demand and savings deposits	\$ 28,922	\$ 34,548	(16.3) %
Time certificates of deposit	21,593	22,259	(3.0) %
Accounts payable	1,078	3,266	(67.0) %
Accrued liabilities	1,597	2,116	(24.5) %
Lease deposits	377	802	(53.0) %
Non-recourse debt	1,763	1,941	(9.2) %
Deferred income taxes, net	3,811	3,205	18.9 %
Total Liabilities	<u>59,141</u>	<u>68,137</u>	<u>(13.2) %</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	198,644	197,206	0.7 %
Accumulated other comprehensive income, net of tax	-	-	0.0 %
Total Stockholders' Equity	<u>201,061</u>	<u>199,623</u>	<u>0.7 %</u>
Total Liabilities and Stockholders' Equity	<u>\$ 260,202</u>	<u>\$ 267,760</u>	<u>(2.8) %</u>

CONSOLIDATED STATEMENTS OF EARNINGS

(in thousands, except share and per share amounts)
(Unaudited)

	Three Months Ended September 30,		Percent Change
	2020	2019	
Finance & loan income	\$ 865	\$ 1,899	(54.4) %
Investment interest and dividend income	501	1,069	(53.1) %
Total interest and dividend income	1,366	2,968	(54.0) %
Interest expense on deposits	21	170	(87.6) %
Net interest and dividend income	1,345	2,798	(51.9) %
Provision for credit losses	(100)	-	n/m
Net interest income after provision for credit losses	1,245	2,798	(55.5) %
<u>Non-interest income</u>			
Operating & sales-type lease income	204	396	(48.5) %
Gain on sale of leases, loans & leased property	2,081	1,222	70.3 %
Gain on equity securities	(392)	1,115	(135.2) %
Other fee income	13	27	(51.9) %
Total non-interest income	1,906	2,760	(30.9) %
<u>Non-interest expenses</u>			
Compensation & employee benefits	818	1,055	(22.5) %
Occupancy	51	79	(35.4) %
Professional and IT services	194	197	(1.5) %
FDIC and regulatory fees	(93)	15	(720.0) %
Other general & administrative	76	118	(35.6) %
Total non-interest expenses	1,046	1,464	(28.6) %
Earnings before income taxes	2,105	4,094	(48.6) %
Income taxes	667	1,113	(40.1) %
Net earnings	\$ 1,438	\$ 2,981	(51.8) %
Basic earnings per common share	\$ 0.14	\$ 0.29	(51.8) %
Weighted average common shares outstanding	10,284,139	10,284,139	

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited, in thousands)

	Three months ended September 30,	
	2020	2019
Net earnings	\$ 1,438	\$ 2,981
Other comprehensive income:		
Unrealized gains on securities available-for-sale	-	31
Tax effect	-	(4)
Total other comprehensive income	-	27
Total comprehensive income	<u>\$ 1,438</u>	<u>\$ 3,008</u>

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited, in thousands, except for share amounts)

	Common Stock Shares	Common Stock Amount	Additional Paid in Capital	Retained Earnings	Accumulated Comprehensive Income	Total
Balance, June 30, 2019	10,284,139	\$ 103	\$ 2,314	\$ 204,917	\$ (30)	\$ 207,304
Net earnings	-	-	-	2,981	-	2,981
Other comprehensive income	-	-	-	-	27	27
Balance, September 30, 2019	<u>10,284,139</u>	<u>\$ 103</u>	<u>\$ 2,314</u>	<u>\$ 207,898</u>	<u>\$ (3)</u>	<u>\$ 210,312</u>
<hr/>						
Balance, June 30, 2020	10,284,139	\$ 103	\$ 2,314	\$ 197,206	-	\$ 199,623
Net earnings	-	-	-	1,438	-	1,438
Other comprehensive income	-	-	-	-	-	-
Balance, September 30, 2020	<u>10,284,139</u>	<u>\$ 103</u>	<u>\$ 2,314</u>	<u>\$ 198,644</u>	<u>\$ -</u>	<u>\$ 201,061</u>

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Three months ended	
	September 30,	
	2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Earnings	\$ 1,438	\$ 2,981
Adjustments to reconcile net earnings to cash flows provided by (used for) operating activities:		
Provision for credit losses	100	-
Depreciation and net amortization (accretion)	93	83
Gain on sale of leased property and sales-type lease income	(2,105)	(71)
Loss (gain) on equity securities, net	392	(1,115)
Deferred income taxes, including income taxes payable	606	875
Net (decrease) increase in accounts payable and accrued liabilities	(519)	354
Other, net	274	721
Net cash provided by operating activities	<u>279</u>	<u>3,828</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in leases and transactions in process	(14,734)	(55,563)
Payments received on lease receivables and loans	9,731	25,430
Proceeds from sales of leased property and sales-type leases	2,276	359
Proceeds from sales and assignments of leases	-	30,337
Net decrease (increase) in Fed funds sold	216	(581)
Purchase of equity investment securities	(12,845)	(10,814)
Pay down on or sales of fixed-income securities	-	19,000
Pay down on investments held-to-maturity	451	1
Proceeds from sale of equity securities	-	893
Net decrease (increase) in other assets	138	(478)
Net cash (used for) provided by investing activities	<u>(14,767)</u>	<u>8,584</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net decrease in time certificates of deposit	(666)	(12,880)
Net decrease in demand and savings deposits	(5,626)	(5,505)
Net cash used for financing activities	<u>(6,292)</u>	<u>(18,385)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	(20,780)	(5,973)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	153,083	68,849
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 132,303</u>	<u>\$ 62,876</u>
<u>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</u>		
Decrease in lease rentals assigned to lenders and related non-recourse debt	<u>\$ (178)</u>	<u>\$ (179)</u>
Estimated residual values recorded on leases	<u>\$ (716)</u>	<u>\$ (36)</u>
Interest paid on deposits	<u>\$ 22</u>	<u>\$ 182</u>
Income taxes paid	<u>\$ 61</u>	<u>\$ 238</u>

**DISCUSSION OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION
FOR THREE MONTHS ENDED SEPTEMBER 30, 2020**
Consolidated Statement of Earnings Analysis
Net Interest Income

Net interest income is the difference between interest and dividends earned on the investment in leases, loans, securities and other interest earning assets and interest paid on deposits and borrowings. 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 interest income by volume and rate:

	Quarter ended September 30, 2020 vs 2019		
	Volume	Rate	Total
	(in thousands)		
Interest income			
Net investment in leases	\$ (725)	\$ (51)	\$ (776)
Commercial loans	(248)	(10)	(258)
Investment securities HTM	(72)	16	(56)
Equity securities	(100)	(33)	(133)
Interest-earning deposits with banks	408	(787)	(379)
	<u>(737)</u>	<u>(865)</u>	<u>(1,602)</u>
Interest expense			
Demand and savings deposits	(15)	(59)	(74)
Time deposits	(39)	(36)	(75)
	<u>(54)</u>	<u>(95)</u>	<u>(149)</u>
Net interest income	<u>\$ (683)</u>	<u>\$ (770)</u>	<u>\$ (1,453)</u>

Total interest and dividend income for the first quarter ending September 30, 2020 decreased 54.0% to \$1.37 million from \$2.97 million for the first quarter of fiscal 2020. This decrease includes a \$776,000, or 48.2%, decrease in direct finance income, an 89.3% decrease in commercial loan income and a \$568,000 decrease in investment and dividend income.

- The decrease in finance income was due to a 45.0% decrease in average lease balances to \$45.4 million coupled with a 45 basis point decrease in the average yield on leases to 7.35%. The prior year quarter benefitted from accelerated finance income from early terminated leases, and excluding that boost the average lease yield in the 2021 quarter would be up 18 basis points.
- The decline in commercial loan income reflected the 85.8% decrease in average loan balances to \$3.5 million.
- The 53.1% decrease in investment and dividend income for the first quarter of fiscal 2021 included a \$434,100 decrease in interest on deposits with banks due to a 226 basis point decline in average yield, offset only in part by a 68.3% increase in average balances. The decrease in dividend income reflected an 18% decrease in average balances to \$64.3 million and 20 basis point decline in average yield to 2.66%.
- Interest expense paid decreased 87.9% to \$20,600, reflecting a 31.3% decrease in the average deposit balance to \$51.5 million and a 74 basis point decrease in average rate paid from 0.91% to 0.16%.
- With low yielding deposits representing 55% of earning assets, up from 30% the year before, the average yield on all interest-earning assets decreased to 2.17% and the net interest margin decreased to 2.14% in the first quarter of fiscal 2021 from 4.18% in the first quarter of fiscal 2020.

As a result of the foregoing, net interest income for the three months ended September 30, 2020 of \$1.3 million decreased \$1.45 million, or 51.9%, from \$2.8 million for the three months ended September 30, 2019.

The following table presents 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 interest-earning assets and interest-bearing liabilities. Yields/rates are presented on an annualized basis, and the average yield on interest earning assets can fluctuate from quarter to quarter due to transaction activity in both the lease and loan portfolio.

(\$ in thousands)	Three months ended September 30, 2020			Three months ended September 30, 2019		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
Assets						
Interest-earning assets						
Interest-earning deposits with banks	\$ 136,424	\$ 44	0.13%	\$ 69,412	\$ 423	2.44%
Fixed income and HTM securities	2,002	30	5.99%	12,832	86	2.68%
Equity securities	64,311	427	2.66%	78,424	560	2.86%
Commercial loans	3,509	31	3.53%	24,638	289	4.69%
Net investment in leases (1)	45,404	834	7.35%	82,567	1,610	7.80%
Total interest-earning assets	251,650	1,366	2.17%	267,873	2,968	4.43%
Other assets	9,060			27,324		
	<u>\$ 260,710</u>			<u>\$ 295,197</u>		
Liabilities and Shareholders' Equity						
Interest-bearing liabilities						
Demand and savings deposits	\$ 29,572	5	0.07%	\$ 36,426	78	0.86%
Time deposits	21,968	16	0.29%	38,623	92	0.95%
Total interest bearing liabilities	51,540	21	0.16%	75,049	170	0.91%
Non-interest bearing demand deposits	753			2,910		
Other liabilities	7,772			9,311		
Shareholders' equity	200,645			207,927		
	<u>\$ 260,710</u>			<u>\$ 295,197</u>		
Net interest income		<u>\$ 1,345</u>			<u>\$ 2,798</u>	
Net interest spread (2)			<u>2.01%</u>			<u>3.53%</u>
Net interest margin (3)			<u>2.14%</u>			<u>4.18%</u>
Average interest earning assets over average interest bearing liabilities			<u>488.3%</u>			<u>356.9%</u>

(1) Average balance is based on daily balances, includes non-accrual leases, and is presented net of unearned income

(2) Net interest spread is 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 finance and interest income as a percent of average interest earning assets.

Provision for Credit Losses

The Company recorded a \$100,000 provision for the quarter ended September 30, 2020 compared to no provision for the quarter ended September 30, 2019. While there was no increase in non-performing leases during the period, with the magnitude of the Covid-19 pandemic disruption to the education and business environment, it is possible that asset quality measures could worsen if the effects of COVID-19 are prolonged. With the provision taken and 4.4% increase in the lease and loan portfolio, the allowance for credit losses increased to 1.84% of the investment in leases and loans from 1.74% at June 30, 2020.

Non-interest Income

Non-interest income for the first quarter of fiscal 2021 decreased by \$853,600 or 30.9% to \$1.9 million from \$2.8 million in the first quarter of the prior year. Gains and losses on equity securities, including unrealized amounts arising from changes in the fair values during the period, are included in non-interest income. Losses on equity securities of \$391,600 in the first quarter of fiscal 2021 were a \$1.5 million negative swing from a \$1.1 million gain reported the year before. Excluding securities related income, non-interest income increased by 40% as income from end of term transactions increased by \$1.8 million in the quarter, offset by \$1.2 million lower gains on the sale of leases compared to the same prior year quarter.

Non-interest Expenses

The Company's non-interest expenses of \$1.05 million for the first quarter ended September 30, 2020 were reduced by \$418,200 or 28.6% from \$1.46 million in the first quarter of fiscal 2020. The decrease included over \$310,100 reduction in compensation and other direct expenses and a \$109,200 FDIC small bank assessment refund.

Income Taxes

For the quarter ended September 30, 2020, the tax provision of \$667,000 reflected taxes accrued at 26.7% on pretax earnings of \$2.5 million excluding equity securities losses. The tax benefit of \$112,000 attributable to the \$391,600 equity loss in the first quarter of fiscal 2021 was offset by a valuation allowance of the same amount. In accordance with GAAP, the Company's provision for income taxes assumes no tax benefits from net unrealized losses recorded

on the equity securities portfolio as of September 30, 2020 as capital losses can only be applied against capital gains and the Company cannot assume future appreciation of the equity portfolio required to realize future capital gains and the tax benefit. The Company's components of earnings and taxes are summarized as follows:

(dollars in thousands)	Three Months Ended		Percent Change
	September 30, 2020	September 30, 2019	
<u>Pretax earnings</u>			
Pretax earnings excluding equity portfolio	\$ 2,497	\$ 2,979	(16.2) %
Equity portfolio	(392)	1,115	(135.2) %
Pretax (loss) earnings	<u>2,105</u>	<u>4,094</u>	(48.6) %
<u>Income taxes</u>			
Income tax expense excluding equity portfolio	667	810	(17.6) %
Income tax (benefit)/expense on equity portfolio	(112)	303	(137.0) %
Income tax valuation allowance	<u>112</u>	-	n/m %
Net tax (benefit)/expense	<u>667</u>	<u>1,113</u>	(40.1) %
<u>Net earnings</u>			
Net earnings excluding equity portfolio	1,830	2,169	(15.6) %
Net equity portfolio (loss)/gain	<u>(392)</u>	<u>812</u>	(148.3) %
Net (loss)/earnings	<u>\$ 1,438</u>	<u>\$ 2,981</u>	(51.8) %

The Company's has an accumulated tax valuation allowance of \$2.26 million against deferred income taxes related to a cumulative loss on the equity portfolio of \$8.3 million.

Financial Condition Analysis

Consolidated total assets at September 30, 2020 of \$260.2 million were down 2.8% from \$267.8 million at June 30, 2020 and 10.5% from September 30, 2019. The change since June 30, 2020 includes a decline of \$20.8 million in cash and due from banks offset by an increase of \$12.5 million in the equity portfolio and a \$2.3 million increase in the net investment in leases and loans.

Lease Portfolio

During the three months ended September 30, 2020 and 2019, 100% of the new leases booked were originated by the Bank with 100% and 6%, respectively, retained in the Company's portfolio. The Company's net investment in leases consisted of the following:

	September 30, 2020	June 30, 2020
	(in thousands)	
Minimum lease payments receivable	\$ 52,710	\$ 50,568
Estimated residual value	3,185	2,453
Less unearned income	<u>(4,188)</u>	<u>(3,748)</u>
Net investment in leases before allowances	51,707	49,273
Less allowance for lease losses	(932)	(832)
Less valuation allowance for estimated residual value	<u>(25)</u>	<u>(25)</u>
Net investment in leases	<u>\$ 50,750</u>	<u>\$ 48,416</u>

The Company often makes payments to purchase leased property prior to the commencement of the lease. The disbursements for these lease transactions in process are generally made to facilitate the lessees' property implementation schedule. The lessee generally is obligated by the lease to make rental payments directly to the Company during the period that 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 September 30, 2020, the Company's investment in property acquired for transactions in process of \$4.4 million was up from \$4.0 million at June 30, 2020 but down 82.1% from \$24.3 million at September 30, 2019. In addition, the Company had \$11.6 million of unfunded commitments to purchase property for approved leases in process. These commitments are binding and generally have fixed expiration dates or other termination clauses and are estimated to be completed within one year, but it is likely that some of the commitments will expire without being funded.

Commercial Loan Portfolio

The Company's investment in commercial loans consists of two real estate credits and the change in balances during the first quarter relates to loan payments received.

	<u>September 30,</u> <u>2020</u>	<u>June 30,</u> <u>2020</u>
	(in thousands)	
Commercial real estate loans	\$ 3,538	\$ 3,607
Less allowance for loan losses	(61)	(61)
Net commercial loans	<u>\$ 3,477</u>	<u>\$ 3,546</u>

Commercial loans are reported at their outstanding unpaid principal balances reduced by the allowance for loan losses. The Company had no unused commitments on revolving lines of credit at September 30, or June 30, 2020.

Equity Securities

The Company's equity securities portfolio consists of common stock holdings of public companies with readily available prices and is carried at fair value. During the first quarter of fiscal 2021, the Company invested an additional \$12.8 million in 6 existing holdings. Investments in equity securities as of September 30, 2020 and June 30, 2020 are summarized by primary industry sector in the table below.

(in thousands)	Cost Basis	Unrealized		Fair Value
		Gains	(Losses)	
as of September 30, 2020				
Commercial / Industrial	\$ 23,952	\$ 952	\$ (4,764)	\$ 20,140
Consumer	13,468	1,095	(1,769)	12,794
Financial	15,534	75	(4,043)	11,566
Healthcare	19,145	854	(707)	19,292
Total equity securities	<u>\$ 72,099</u>	<u>\$ 2,976</u>	<u>\$ (11,283)</u>	<u>\$ 63,792</u>
as of June 30, 2020				
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>

The aggregate fair market value of the equity securities of \$63.79 million at September 30, 2020 included approximately \$8.3 million of net unrealized losses, up from a net unrealized loss of \$7.9 million at June 30, 2020.

Investments

Investments are carried at cost and consist of the following:

(in thousands)	<u>September 30, 2020</u>		<u>June 30, 2020</u>	
	Carrying Cost	Fair Value	Carrying Cost	Fair Value
Federal Reserve Bank Stock	\$ 1,505	\$ 1,505	\$ 1,955	\$ 1,955
Federal Home Loan Bank Stock	44	44	44	672
Mortgage-backed investment	102	114	103	114
	<u>\$ 1,651</u>	<u>\$ 1,663</u>	<u>\$ 2,102</u>	<u>\$ 2,741</u>

CalFirst Bank is required to hold Federal Reserve Bank (FRB) stock equal to 6% of its capital surplus, which is defined as additional paid-in capital stock, less any gains (losses) on available for sale securities as of the current period end. The FRB redeemed \$450,000 of FRB stock due to the decline in Bank capital during the third quarter of fiscal 2020. The investment in Federal Home Loan Bank of San Francisco ("FHLB") stock is a required investment related to CalFirst Bank's borrowing relationship with the FHLB. These investments have no stated maturity.

Asset Quality

As part of assessing and monitoring the performance of all leases and loans, 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 credit process 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:

(in thousands)	Commercial Leases	Education Government Non-profit Leases	Commercial & Industrial Loans	Commercial Real Estate Loans	Total
As of September 30, 2020:					
Pass	\$ 31,179	\$ 17,155	\$ -	\$ 3,538	\$ 51,872
Special Mention	2,389	853	-	-	3,242
Substandard	-	131	-	-	131
Doubtful	-	-	-	-	-
	<u>\$ 33,568</u>	<u>\$ 18,139</u>	<u>\$ -</u>	<u>\$ 3,538</u>	<u>\$ 55,245</u>
Non-accrual	\$ -	\$ -	\$ -	\$ -	\$ -
As of June 30, 2020:					
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	\$ -	\$ -	\$ -	\$ -	\$ -

There was no change in past due credits during the quarter ended September 30, 2020 or increase in non-performing assets. The following table presents the aging of the leases and loans by portfolio class:

(in thousands)	31-89 Days	Greater Than 90 Days	Total Past Due	Current	Total	Over 90 Days & Accruing
As of September 30, 2020:						
Commercial Leases	\$ -	\$ -	\$ -	\$ 33,568	\$ 33,568	\$ -
Education, Government, Non-profit Leases	-	-	-	18,139	18,139	-
Commercial and Industrial Loans	-	-	-	-	-	-
Commercial Real Estate Loans	-	-	-	3,538	3,538	-
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 55,245</u>	<u>\$ 55,245</u>	<u>\$ -</u>
As of June 30, 2020:						
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 determination of the appropriate amount of any provision is based on management’s judgment at that time and takes into consideration all known relevant internal and external factors that may affect the portfolios.

The allowance for credit losses of \$1.0 million at September 30, 2020 increased \$100,000 when compared to June 30, 2020 but was reduced by \$486,500 from \$1.5 million at September 30, 2019. The Company considers the allowance for credit losses at September 30, 2020 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 credit losses that are sizeable in relation to the amount reserved, or that subsequent evaluations of the lease and loan 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 by increasing credit risk and the risk of potential loss even further.

	Three months ended September 30,	
	2020	2019
	(dollars in thousands)	
Net investment in leases and loans before allowance	\$ 55,245	\$ 101,445
Allowance for credit losses at beginning of period	\$ 918	\$ 1,504
Charge-off of lease receivables	-	-
Recovery of amounts previously written off	-	-
Provision for credit losses	100	-
Allowance for credit losses at end of period	<u>\$ 1,018</u>	<u>\$ 1,504</u>
Components of allowance for credit losses:		
Allowance for lease losses	\$ 932	\$ 1,089
Residual valuation allowance	25	25
Allowance for loan losses	61	390
	<u>\$ 1,018</u>	<u>\$ 1,504</u>
Allowance for credit losses as a percent of net investment in leases and loans before allowances	<u>1.84%</u>	<u>1.48%</u>

The allowance balances and activity in the allowance by portfolio segment for the three months ended September 30, 2020 and September 30, 2019 are presented in the following table

(in thousands)	Commercial Leases	Education Government Non-profit Leases	Commercial & Industrial Loans	Commercial Real Estate Loans	Total
Three months ended September 30, 2020:					
Balance beginning of period	\$ 638	\$ 219	\$ -	\$ 61	\$ 918
Charge-offs	-	-	-	-	-
Recoveries	-	-	-	-	-
Provision	100	-	-	-	100
Balance end of period	<u>\$ 738</u>	<u>\$ 219</u>	<u>\$ -</u>	<u>\$ 61</u>	<u>\$ 1,018</u>
Three months ended September 30, 2019:					
Balance beginning of period	\$ 872	\$ 242	\$ 329	\$ 61	\$ 1,504
Charge-offs	-	-	-	-	-
Recoveries	-	-	-	-	-
Provision	-	-	-	-	-
Balance end of period	<u>\$ 872</u>	<u>\$ 242</u>	<u>\$ 329</u>	<u>\$ 61</u>	<u>\$ 1,504</u>

Liquidity

The Company funds its operating activities through internally generated funds, bank deposits and borrowings, and non-recourse debt. At September 30, 2020 and June 30, 2020, the Company's cash and cash equivalents were \$133.1 million and \$154.1 million, respectively.

Deposits at CalFirst Bank totaled \$50.5 million at September 30, 2020 compared to \$69.4 million at September 30, 2019 and \$56.8 million at June 30, 2020. The \$18.8 million, or 27%, decrease from September 30, 2019 is related to the 45.7% decline in the lease and loan portfolio over that period and the Company's reduced funding needs. The following table presents the ending balances, average balances and average rates paid on deposits for the quarters ended September 30, 2020 and 2019:

	Three months ended September 30,					
	2020			2019		
	Ending Balance	Average Balance	Average Rate Paid	Ending Balance	Average Balance	Average Rate Paid
	(in thousands)					
Non-interest bearing demand deposits	\$ 706	\$ 753	n/a	\$ 1,581	\$ 2,910	n/a
Interest-bearing demand deposits	5,823	6,466	0.05%	1,541	1,405	0.05%
Money market and savings deposits	22,393	23,106	0.07%	32,561	35,021	0.89%
Time deposits, less than \$100,000	6,767	6,869	0.31%	10,852	12,194	0.87%
Time deposits, \$100,000 or more	\$ 14,826	\$ 15,099	0.28%	\$ 22,825	\$ 26,429	0.99%

The following table shows the maturities of certificates of deposits at September 30, 2020:

	\$250,000 or less	More Than \$250,000
	(in thousands)	
Under 3 months	\$ 5,859	\$ 1,039
3 – 6 months	2,989	1,751
7 – 12 months	5,575	1,845
13 – 24 months	1,257	842
25 – 36 months	182	254
	\$ 15,862	\$ 5,731

The Bank has a borrowing agreement with the Federal Home Loan Bank of San Francisco (“FHLB”) and as such can take advantage of FHLB programs for overnight and term advances at published daily rates. The Bank had no short-term borrowings outstanding at September 30, 2020 and 2019. Under terms of the agreement, advances from the FHLB are collateralized by qualifying securities and real estate loans. The Bank also has the authority to borrow from the Federal Reserve Bank (“FRB”) discount window amounts secured by certain lease receivables with unused borrowing availability at September 30, 2020 of approximately \$10.2 million.

Capital Resources

The following table presents capital and capital ratio information for CalFirst Bank as of September 30, 2020 and June 30, 2020. The Bank continues to exceed regulatory capital requirements and is considered “well-capitalized”.

<u>California First National Bank</u>	<u>Actual</u>		<u>To Be Well Capitalized</u>		Minimum Capital Requirement
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	
	(dollars in thousands)				
<u>September 30, 2020</u>					
Common equity Tier 1 capital	\$ 58,631	92.53%	\$ 4,119	6.50%	4.50%
Tier 1 risk-based capital	\$ 58,631	92.53%	\$ 5,069	8.00%	6.00%
Total risk-based capital	\$ 59,426	93.79%	\$ 6,336	10.00%	8.00%
Tier 1 leverage capital	\$ 58,631	50.51%	\$ 5,804	5.00%	4.00%
<u>June 30, 2020</u>					
Common equity Tier 1 capital	\$ 57,388	90.72%	\$ 4,112	6.50%	4.50%
Tier 1 risk-based capital	\$ 57,388	90.72%	\$ 5,061	8.00%	6.00%
Total risk-based capital	\$ 58,180	91.97%	\$ 6,326	10.00%	8.00%
Tier 1 leverage capital	\$ 57,388	48.13%	\$ 5,961	5.00%	4.00%

Market Risk

Market risk is the risk of loss in a financial asset arising from changes in interest rates and equity prices. Equity securities now represent 25% of the Company’s assets and subject it to market risk associated with stock prices that can be susceptible to significant volatility. Investment gains and losses, whether realized from dispositions or unrealized from changes in market prices of equity securities, have caused and will continue to cause significant volatility in periodic earnings.

Interest rate risk results from absolute changes in interest rates as well as differences in the repricing characteristics of interest-earning assets and interest-bearing liabilities. At September 30, 2020, the Company had assets of \$161.7 million subject to changes in interest rates over the next twelve months, compared to repricing liabilities of \$47.3 million. The mismatch between repricing of maturities within a time band is commonly referred to as the “gap” for that period. A positive gap (asset sensitive), where interest rate sensitive assets exceed interest rate sensitive liabilities, generally will result in the net interest margin decreasing in a falling rate environment and increasing in a rising rate environment. A negative gap (liability sensitive) will generally have the opposite result on the net interest margin. However, the traditional gap analysis does not assess the relative sensitivity of assets and liabilities to changes in interest rates and other factors that could have an impact on interest rate sensitivity or net interest income. Sudden and substantial increase or decrease in interest rates may adversely impact our income to the extent that the interest rates associated with the assets and liabilities do not change at the same speed, to the same extent, or on the same basis. Non-recourse debt does not represent an interest rate risk to the Company because it is fully amortized through direct payments from lessees to the purchaser of the lease receivable. The sudden and substantial reduction in interest rates since March 2020 has had a significant negative impact on the Company’s net interest income.

The distribution of assets and liabilities by maturity at September 30, 2020 is as follows:

(in thousands)	3 Months or Less	Over 3 to 12 Months	Over 1- 5 years	Over 5 years	Non-rate Sensitive	Total
<u>Rate Sensitive Assets (RSA):</u>						
Cash due from banks	\$ 133,127	\$ -	\$ -	\$ -	\$ -	\$ 133,127
Investment securities	-	-	-	1,651	-	1,651
Equity securities	-	-	-	-	63,792	63,792
Net investment in leases	7,433	20,854	27,608	-	(5,145)	50,750
Commercial loans	70	213	1,237	2,018	(61)	3,477
Non-interest earning assets	-	-	-	-	7,405	7,405
Totals	140,630	21,067	28,845	3,669	\$ 65,991	\$ 260,202
Cumulative total for RSA	\$ 140,630	\$ 161,697	\$ 190,542	\$ 194,211		
<u>Rate Sensitive Liabilities (RSL):</u>						
Demand and savings deposits	\$ 28,216	\$ -	\$ -	\$ -	\$ 706	\$ 28,922
Time deposits	6,898	12,160	2,535	-	-	21,593
Non-interest-bearing liabilities	-	-	-	-	8,626	8,626
Stockholders' equity	-	-	-	-	201,061	201,061
Totals	35,114	12,160	2,535	-	\$ 210,393	\$ 260,202
Cumulative total for RSL	\$ 35,114	\$ 47,274	\$ 49,809	\$ 49,809		
Interest rate sensitivity gap	\$ 105,516	\$ 8,907	\$ 26,310	\$ 3,669		
Cumulative GAP	\$ 105,516	\$ 114,423	\$ 140,733	\$ 144,402		
RSA divided by RSL (cumulative)	400.50%	342.04%	382.55%	389.91%		
Cumulative GAP / total assets	40.55%	43.97%	54.09%	55.50%		

Subsequent Events

On October 15, 2020 the Company announced that it had entered into a definitive agreement to sell 100% of the common stock of CalFirst Bank to DMG Bancshares, Inc. ("DMG"). The proposed transaction provides for the leasing business and lease portfolio of CalFirst Bank to be transferred to CFLC who will reassume responsibility for all lease origination. Under the terms of the agreement, the Bank will dividend all leases and certain other assets to the Company and DMG will pay a purchase price equal to the remaining equity capital plus \$2.5 million. Subject to customary closing conditions and obtaining the necessary regulatory approvals, the sale is expected to be completed during the last half of fiscal 2021.

On October 27, 2020, the Company's Board of Directors declared an annual dividend in the amount of fifty-four cents (\$0.54) per share. The dividend will be payable on December 15, 2020 to all stockholders of record at the close of business on November 13, 2020.