



CalFirst
California First National Bancorp

Consolidated Financial Report

(UNAUDITED)

Second Quarter and Six Months Ended

December 31, 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 “Bank”) and California First Leasing Corporation (“CFLC”). The business includes leasing and financing capital assets, commercial loans, and investing in equity securities of public companies. The Bank gathers deposits through posting rates on the Internet and conducts all banking and other operations from one central location.

In October 2020, the Company entered into an agreement to sell 100% of the common stock of CalFirst Bank while retaining the lease business previously operated within the Bank. In January 2021, final regulatory approvals were received and it is expected that the sale will be completed by the end of February 2021. See Subsequent Events on 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 sale of CalFirst Bank, including the expected timing of the completion of the sale. 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 (January 25, 2021).

SELECTED FINANCIAL DATA

	Three Months Ended December 31,		Six Months Ended December 31,	
	2020	2019	2020	2019
Income Statement				
<i>(in thousands, except per share data)</i>				
Net interest income, net of provision	\$ 1,867	\$ 2,968	\$ 3,112	\$ 5,766
Net interest margin	2.67%	3.92%	2.41%	4.05%
Gains on equity securities	\$ 16,957	\$ 9,569	\$ 16,565	\$ 10,684
Total non-interest income	\$ 17,183	\$ 9,965	\$ 19,089	\$ 12,725
Net income	\$ 15,091	\$ 8,479	\$ 16,529	\$ 11,460
Earnings per share	\$ 1.47	\$ 0.82	\$ 1.61	\$ 1.11
Balance Sheet	December 31,	September 30,	June 30,	December 31,
	2020	2020	2020	2019
<i>(\$ in thousands)</i>				
Equity investments	\$ 108,094	\$ 63,792	\$ 51,339	\$ 102,375
Net investment in leases and loans	\$ 51,221	\$ 54,227	\$ 51,962	\$ 76,162
Total assets	\$ 263,878	\$ 260,202	\$ 267,760	\$ 287,643
Total deposits	\$ 42,648	\$ 50,515	\$ 56,807	\$ 62,166
Stockholders' equity	\$ 210,599	\$ 201,061	\$ 199,623	\$ 213,445

OVERVIEW

CalFirst's results for the second quarter ended December 31, 2020 include large gains on its equity investments related to the robust stock market that sparked an 11.7% increase in the S&P 500 during the period. For the second quarter, the Company reported gains of \$17.0 million on the equity portfolio compared to gains of \$9.6 million for the second quarter of the year before. These, mostly unrealized gains, helped boost net earnings 78% to \$15.1 million for the second quarter ended December 31, 2020 from \$8.5 million in the second quarter of fiscal 2020. This jump demonstrates the volatility to reported earnings resulting from including gains and losses on equity securities that are determined based on stock prices on the last day of a fiscal quarter.

The Company's second quarter pre-tax earnings, excluding the impact of equity securities, were down by 53% to \$982,000 from \$2.1 million for the second quarter of fiscal 2020. The decline included a \$1.1 million decline in net interest income after release of reserves offset by a reduction of \$174,100 in non-interest expenses.

Net earnings for the six months ended December 31, 2020 increased 44% to \$16.53 million and included gains of \$16.6 million on equity securities compared to gains of \$10.7 million on equity securities included for the first six months of fiscal 2020. Excluding the impact of security gains, the Company's pre-tax earnings for the first six months of fiscal 2021 declined by \$1.6 million or 31% to \$3.5 million. This decline included a \$2.7 million or 46% decrease in net interest income after release of reserves and \$1.3 million decrease in gains from sale of leases, offset by a \$1.8 million increase in income from end-of-term transactions and \$592,300 (22%) drop in non-interest expenses.

Total bookings during the second quarter of fiscal 2021 of \$12.4 million were up from \$5.3 million the year before and included \$6.4 million of Main Street Loans funded in the quarter. For the six months ended December 31, 2020, total bookings of \$25.2 million were down 36% from \$39.3 million during the first six months of the prior year. Lease originations did not pick up during the second quarter and as a result, the backlog of approved leases of \$6 million at December 31, 2020 is down significantly from prior periods.

During the first six months of fiscal 2021, the Company retained all new leases booked, but participated 95% of the Main Street Loans to the Federal Reserve in accordance with program guidelines. As a result, the net investment in leases and loans of \$51.2 million at December 31, 2020 was down 1.4% from \$52.0 million at June 30, 2020. The credit portfolio continued to perform well, with no non-performing assets at December 31, 2020. CFLC's equity investment portfolio more than doubled from \$51.3 million at June 30, 2020 to \$108.1 million at December 31, 2020, reflecting \$48.0 million of purchases, \$7.8 million in sales and the \$16.6 million gains noted above.

CONSOLIDATED BALANCE SHEETS

(in thousands, except for share amounts)

	December 31, 2020 (Unaudited)	June 30, 2020	Percent Change
ASSETS			
Cash and due from banks	\$ 98,857	\$ 153,083	(35.4) %
Fed funds sold	494	1,040	(52.5) %
Equity investments	108,094	51,339	110.5 %
Investments held-to-maturity (HTM)	1,650	2,102	(21.5) %
Receivables	207	87	137.9 %
Property acquired for transactions in process	538	4,031	(86.7) %
Leases and loans:			
Net investment in leases	48,362	49,273	(1.8) %
Commercial loans	3,727	3,607	3.3 %
Allowance for credit losses	(868)	(918)	(5.4) %
Net investment in leases and loans	51,221	51,962	(1.4) %
Net property on operating leases	86	867	(90.1) %
Income taxes receivable	376	376	0.0 %
Other assets	770	932	(17.4) %
Discounted lease rentals assigned to lenders	1,585	1,941	(18.3) %
Total Assets	<u>\$ 263,878</u>	<u>\$ 267,760</u>	<u>(1.4) %</u>
LIABILITIES AND STOCKHOLDERS' EQUITY			
Liabilities:			
Demand and savings deposits	\$ 23,728	\$ 34,548	(31.3) %
Time certificates of deposit	18,920	22,259	(15.0) %
Accounts payable	1,301	3,266	(60.2) %
Accrued liabilities	1,390	2,116	(34.3) %
Lease deposits	311	802	(61.2) %
Non-recourse debt	1,585	1,941	(18.3) %
Deferred income taxes, net	6,044	3,205	88.6 %
Total Liabilities	53,279	68,137	(21.8) %
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	208,182	197,206	5.6 %
Accumulated other comprehensive income, net of tax	-	-	-
Total Stockholders' Equity	210,599	199,623	5.5 %
Total Liabilities and Stockholders' Equity	<u>\$ 263,878</u>	<u>\$ 267,760</u>	<u>(1.4) %</u>

CONSOLIDATED STATEMENTS OF EARNINGS

(in thousands, except share and per share amounts)

(Unaudited)

	Three Months Ended		Percent Change	Six Months Ended		Percent Change
	December 31,			December 31,		
	2020	2019		2020	2019	
Finance and loan income	\$ 1,091	\$ 1,674	(34.8) %	\$ 1,957	\$ 3,573	(45.2) %
Investment interest and dividend income	638	1,003	(36.4) %	1,138	2,072	(45.1) %
Total interest and dividend income	1,729	2,677	(35.4) %	3,095	5,645	(45.2) %
Interest expense on deposits	12	109	(88.5) %	33	279	(88.2) %
Net interest income and dividend income	1,717	2,568	(33.1) %	3,062	5,366	(42.9) %
Provision (release) of reserves for credit losses	(150)	(400)	(62.5) %	(50)	(400)	(87.5) %
Net interest income after provision for credit losses	1,867	2,968	(37.1) %	3,112	5,766	(46.0) %
Non-interest income						
Operating and sales-type lease income	135	209	(35.4) %	338	605	(44.1) %
Gain on sale of leases, loans and leased property	74	178	(58.4) %	2,155	1,400	53.9 %
Gain (loss) on equity securities	16,957	9,569	77.2 %	16,565	10,684	55.0 %
Other fee income	17	9	88.9 %	31	36	(13.9) %
Total non-interest income	17,183	9,965	72.4 %	19,089	12,725	50.0 %
Non-interest expenses						
Compensation and employee benefits	797	890	(10.4) %	1,615	1,944	(16.9) %
Occupancy	49	50	(2.0) %	100	129	(22.5) %
Professional and IT services	170	188	(9.6) %	363	386	(6.0) %
FDIC and regulatory fees	16	15	6.7 %	(76)	31	NM %
Other general and administrative	79	142	(44.4) %	155	259	(40.2) %
Total non-interest expenses	1,111	1,285	(13.5) %	2,157	2,749	(21.5) %
Earnings before income taxes	17,939	11,648	54.0 %	20,044	15,742	27.3 %
Income taxes	2,848	3,169	(10.1) %	3,515	4,282	(17.9) %
Net earnings	\$ 15,091	\$ 8,479	78.0 %	\$ 16,529	\$ 11,460	44.2 %
Basic earnings per common share	\$ 1.47	\$ 0.82	78.0 %	\$ 1.61	\$ 1.11	44.2 %
Average common shares outstanding – basic	10,284,139	10,284,139		10,284,139	10,284,139	

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited, in thousands)

	Three months ended December 31,		Six months ended December 31,	
	2020	2019	2020	2019
Net earnings	\$ 15,091	\$ 8,479	\$ 16,529	\$ 11,460
Other comprehensive income (loss):				
Unrealized gains on securities available-for-sale	-	3	-	35
Reclassification adjustment of realized loss included in net income on securities available-for-sale	-	-	-	-
Tax effect	-	(1)	-	(5)
Total other comprehensive income	-	2	-	30
Total comprehensive income	<u>\$ 15,091</u>	<u>\$ 8,481</u>	<u>\$ 16,529</u>	<u>\$ 11,490</u>

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(Unaudited, in thousands, except share amounts)

	Shares	Amount	Additional Paid in Capital	Retained Earnings	Accumulated Comprehensive Income	Total
<u>Six months ended December 31, 2019</u>						
Balance, June 30, 2019	10,284,139	\$ 103	\$ 2,314	\$ 204,917	\$ (30)	\$ 207,304
Net earnings	-	-	-	11,460	-	11,460
Other comprehensive income	-	-	-	-	30	30
Dividends paid	-	-	-	(5,349)	-	(5,349)
Balance, December 31, 2019	<u>10,284,139</u>	<u>\$ 103</u>	<u>\$ 2,314</u>	<u>\$ 211,028</u>	<u>\$ -</u>	<u>\$ 213,445</u>
<u>Six months ended December 31, 2020</u>						
Balance, June 30, 2020	10,284,139	\$ 103	\$ 2,314	\$ 197,206	\$ -	\$ 199,623
Net earnings	-	-	-	16,529	-	16,529
Other comprehensive income	-	-	-	-	-	-
Dividends paid	-	-	-	(5,553)	-	(5,553)
Balance, December 31, 2020	<u>10,284,139</u>	<u>\$ 103</u>	<u>\$ 2,314</u>	<u>\$ 208,182</u>	<u>\$ -</u>	<u>\$ 210,599</u>

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Six months ended December 31,	
	2020	2019
Net Earnings	\$ 16,529	\$ 11,460
Adjustments to reconcile net earnings to cash flows provided by (used for) operating activities:		
Release of reserves for credit losses	(50)	(400)
Depreciation and net amortization	90	234
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	(2,127)	(185)
Gain on equity securities, net	(16,565)	(10,684)
Deferred income taxes, including income taxes payable	2,839	2,277
Net (decrease) increase in accounts payable and accrued liabilities	(726)	128
Other, net	82	779
Net cash provided by operating activities	<u>72</u>	<u>18,195</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in leases, loans and transactions in process	(22,024)	(59,875)
Payments received on lease receivables and loans	24,062	37,925
Proceeds from sales of leased property and sales-type leases	2,504	605
Proceeds from sales and assignments of leases	-	31,957
Net decrease (increase) in Fed funds sold	546	(2,777)
Purchase of equity investment securities	(48,045)	(21,079)
Pay down on or sales of fixed-income securities	-	24,000
Pay down on investments held-to-maturity	452	2
Proceeds from sale of equity securities	7,855	5,332
Net decrease (increase) in other assets	64	(475)
<i>Net cash (used for) provided by investing activities</i>	<u>(34,586)</u>	<u>15,615</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net decrease in time certificates of deposit	(3,339)	(17,691)
Net decrease in demand and savings deposits	(10,820)	(7,888)
Dividends to stockholders	(5,553)	(5,349)
Net cash used for financing activities	<u>(19,712)</u>	<u>(30,928)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	(54,226)	2,882
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	153,083	68,849
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 98,857</u>	<u>\$ 71,731</u>
<u>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</u>		
Decrease in lease rentals assigned to lenders and related non-recourse debt	<u>\$ (357)</u>	<u>\$ (357)</u>
Estimated residual values recorded on leases	<u>\$ (716)</u>	<u>\$ (56)</u>
Interest paid on deposits and borrowed funds	<u>\$ 35</u>	<u>\$ 296</u>
Income taxes paid	<u>\$ 676</u>	<u>\$ 2,005</u>
Transfers from loans held for investment to loans held for sale	<u>\$ -</u>	<u>\$ 14,599</u>

**DISCUSSION OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION
FOR THREE AND SIX MONTHS ENDED DECEMBER 31, 2020**
Net Interest Income

Net interest income is the difference between interest and dividends earned on the investment in leases, loans, securities and other earning assets 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:

<i>(in thousands)</i>	Quarter Ended December 31 2020 vs 2019			Six Months Ended December 31, 2020 vs 2019		
	Volume	Rate⁰	Total	Volume	Rate	Total
Interest income						
Net investment in leases	\$ (535)	\$ 87	\$ (448)	\$ (1,268)	\$ 44	\$ (1,224)
Commercial loans	(129)	(6)	(135)	(375)	(17)	(392)
Investment securities	(50)	11	(39)	(123)	28	(95)
Equity securities	(44)	22	(22)	(140)	(16)	(156)
Interest-earning deposits with banks	202	(506)	(304)	591	(1,274)	(683)
	<u>(556)</u>	<u>(392)</u>	<u>(948)</u>	<u>(1,315)</u>	<u>(1,235)</u>	<u>(2,550)</u>
Interest expense						
Demand and savings deposits	(16)	(41)	(57)	(31)	(99)	(130)
Time deposits	(17)	(23)	(40)	(56)	(60)	(116)
	<u>(33)</u>	<u>(64)</u>	<u>(97)</u>	<u>(87)</u>	<u>(159)</u>	<u>(246)</u>
Net interest income	<u>\$ (523)</u>	<u>\$ (328)</u>	<u>\$ (851)</u>	<u>\$ (1,228)</u>	<u>\$ (1,076)</u>	<u>\$ (2,304)</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.

<i>(dollars in thousands)</i>	Quarter ended December 31, 2020			Quarter ended December 31, 2019		
	Average Balance (1)	Interest	Yield/ Rate	Average Balance (1)	Interest	Yield/ Rate
Assets						
Interest-earning assets						
Interest-earning deposits with banks	\$ 116,154	\$ 19	0.07%	\$ 71,470	\$ 323	1.81%
Investment securities	1,655	25	6.04%	7,678	64	3.33%
Equity securities	91,553	594	2.60%	98,470	616	2.50%
Commercial loans	3,528	32	3.67%	15,194	167	4.40%
Net investment in leases	44,603	1,059	9.50%	69,161	1,507	8.72%
Total interest-earning assets	<u>257,493</u>	<u>1,729</u>	<u>2.69%</u>	<u>261,973</u>	<u>2,677</u>	<u>4.09%</u>
Other assets	7,989			29,273		
	<u>\$ 265,482</u>			<u>\$ 291,246</u>		
Liabilities and Shareholders' Equity						
Interest-bearing liabilities						
Demand and savings deposits	\$ 24,360	3	0.05%	\$ 33,349	60	0.72%
Time deposits	20,014	9	0.19%	31,060	49	0.63%
Total interest-bearing liabilities	<u>44,374</u>	<u>12</u>	<u>0.11%</u>	<u>64,409</u>	<u>109</u>	<u>0.68%</u>
Non-interest bearing demand deposits	850			1,186		
Other liabilities	16,970			14,138		
Shareholders' equity	<u>203,288</u>			<u>211,513</u>		
	<u>\$ 265,482</u>			<u>\$ 291,246</u>		
Net interest income		<u>\$ 1,717</u>			<u>\$ 2,568</u>	
Net interest spread (2)			<u>2.57%</u>			<u>3.41%</u>
Net interest margin (3)			<u>2.67%</u>			<u>3.92%</u>
Average interest earning assets over average interest bearing liabilities			<u>580.3%</u>			<u>406.7%</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 second quarter ending December 31, 2020 decreased 35.4% to \$1.73 million from \$2.68 million for the second quarter of fiscal 2020. This decrease includes a \$447,700, or 29.7%, decrease in direct finance income, a \$134,700 decrease in commercial loan income, and a \$365,600 decrease in investment interest and dividend income.

- The 29.7% decrease in finance income was due to a 35.5% decrease in average lease balances to \$44.6 million, offset by a 78 basis point increase in the average yield. The current year quarter benefitted from accelerated finance income from a large lease that terminated early and boosted the yield by 125 basis points. Without that boost in fiscal 2021, the average lease yield for the second quarter of fiscal 2021 would be down 47 basis points.
- The decline in commercial loan income reflected an 76.8% decrease in average loan balances to \$3.5 million and a 72 basis point decrease in average loan yield.
- Investment interest income decreased by \$304,000 despite a 62.5% increase in average cash balances to \$116 million due to the average yield declining by 174 basis points to .07%.
- Dividend income decreased \$21,700 as average balances declined 7.0% to \$91.6 million while the yield increased from 2.50% to 2.60%.
- Interest expense paid on deposits decreased 88.5% to \$12,600, reflecting a 31.1% decrease in the average balance of deposits to \$44.4 million and a 56 basis point decrease in average rate paid to 0.11%.

The average yield on all interest-earning assets for the second quarter of fiscal 2021 decreased by 140 basis points to 2.69% from 4.09% for the second quarter ended December 31, 2019, while the average rate paid on all interest-bearing liabilities decreased by 56 basis points to 0.11%. As a result, the net interest margin decreased to 2.67% in the second quarter of fiscal 2021 from 3.92% in the second quarter of fiscal 2020.

(dollars in thousands)

	Six months ended December 31, 2020			Six months ended December 31, 2019		
	Average Balance (1)	Interest	Yield/ Rate	Average Balance (1)	Interest	Yield/ Rate
Assets						
Interest-earning assets						
Interest-earning deposits with banks	\$ 126,289	\$ 63	0.10%	\$ 70,441	\$ 746	2.12%
Investment securities	1,828	54	5.91%	10,255	149	2.91%
Equity securities	77,932	1,021	2.62%	88,447	1,177	2.66%
Commercial loans	3,519	64	3.64%	19,916	456	4.58%
Net investment in leases	45,004	1,893	8.41%	75,864	3,117	8.22%
Total interest-earning assets	<u>254,572</u>	<u>3,095</u>	<u>2.43%</u>	<u>264,923</u>	<u>5,645</u>	<u>4.26%</u>
Other assets	8,525			28,298		
	<u>\$ 263,097</u>			<u>\$ 293,221</u>		
Liabilities and Shareholders' Equity						
Interest-bearing liabilities						
Demand and savings deposits	\$ 26,974	\$ 8	0.06%	\$ 34,886	\$ 138	0.79%
Time deposits	20,993	25	0.24%	34,842	141	0.81%
Total interest bearing liabilities	<u>47,967</u>	<u>33</u>	<u>0.14%</u>	<u>69,728</u>	<u>279</u>	<u>0.80%</u>
Non-interest bearing demand deposits	802			2,048		
Other liabilities	12,361			11,725		
Shareholders' equity	<u>201,967</u>			<u>209,720</u>		
	<u>\$ 263,097</u>			<u>\$ 293,221</u>		
Net interest income		<u>\$ 3,062</u>			<u>\$ 5,366</u>	
Net interest spread (2)			<u>2.29%</u>			<u>3.46%</u>
Net interest margin (3)			<u>2.41%</u>			<u>4.05%</u>
Average interest earning assets over average interest bearing liabilities			<u>530.7%</u>			<u>379.9%</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.

For the first six months of fiscal 2021, total interest income decreased 45.2% to \$3.09 million from \$5.64 million for the first six months of the prior year. This decrease includes a \$1.2 million decline in direct finance income, a \$392,900 fall in commercial loan income, and a decrease of \$933,600 in investment and dividend income.

- Finance income decreased by 39.3% to \$1.89 million as the average investment in leases declined 40.7% to \$45.0 million but the average yield earned increased by 20 basis points to 8.41%. Finance income includes accelerated

finance income from early terminated leases in both periods, which if excluded revises the average lease yield for the first six months of fiscal 2021 to 7.28%, down 12 basis points from the adjusted prior year rate of 7.40%.

- The 86.0% decrease in commercial loan income reflected an 82.3% decrease in average loan balances to \$3.5 million, while average yields fell 94 basis points to 3.64%.
- A \$778,000 decrease in investment interest income for the first six months of fiscal 2021 was due primarily to a 202 basis point drop in yields earned that offset a 79% increase in average cash balances to \$126 million.
- Dividend income for the first six months fell \$155,643 or 13% to \$1.0 million as average equity security balances were 12% lower and the average yield declined by 4 basis points to 2.62%.
- For the six months ended December 31, 2020, interest expense paid on deposits decreased by 88.1% to \$33,200, reflecting a 31.2% decrease in average deposits to \$48.0 million and a 66 basis point decrease in average rate paid to 0.14%.

For the first six months of fiscal 2021, the average yield on all interest earning assets decreased by 183 basis points to 2.43% from 4.26%, while the average rate paid on all interest-bearing liabilities decreased by 66 basis points to 0.14%. As a result, the net interest margin decreased to 2.41% in the first six months of fiscal 2021 from 4.05% for the first six months of fiscal 2020. The decrease in net interest spread and margin in fiscal 2021 largely reflects significant growth in excess cash balances that could only be invested at very low rates in Fed Funds and other short-term accounts.

Provision for Credit Losses

The Company released reserves of \$150,000 from the allowance for credit losses during the second quarter of fiscal 2021, which compared to a \$400,000 release of reserves during the quarter ending December 31, 2019. For the first six months of fiscal 2021, the release of \$50,000 of reserves compared to a \$400,000 release of reserves during the first six months of fiscal 2020. The 5.4% reduction in reserves is considered reasonable in light of the 32.7% decline in the lease and loan portfolio since June 30, 2020 and heightened credit risk related to the pandemic. At December 31, 2020, the allowance for credit losses of \$868,000, 1.67% of the investment in leases and loans, is considered appropriate for the consolidated portfolio.

As a result of the foregoing, second quarter net interest income after provision for credit losses decreased 37.1% to \$1.87 million from \$2.97 million for the second quarter of the prior year, while net interest income after provision for credit losses for the six months ended December 31, 2020 decreased 46.0% to \$3.11 million.

Non-interest 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 non-interest income. For the second quarter of fiscal 2021, non-interest income increased 72.4% to \$17.2 million from \$9.97 million for the second quarter of the prior year. The increase reflects the gain in fair value of \$16.96 million for the second quarter of fiscal 2021 as compared to a \$9.57 million gain in the second quarter of fiscal 2020. Excluding equity gains and losses from both periods, non-interest income for the second quarter of fiscal 2021 of \$226,000 declined 42.8% due to a \$116,500 decrease in gains on sale of leases and loans and \$61,600 decrease in income from end of term transactions.

Non-interest income of \$19.09 million for the first six months of fiscal 2021 increased 50.0% from \$12.72 million reported for the first six months of fiscal 2020. The \$6.3 million increase reflects a six-month 2021 gain on equity securities of \$16.57 million as compared to a \$10.68 million gain on equity securities for the first six months of fiscal 2020. Excluding equity gains and losses, non-interest income for the first six months of fiscal 2021 of \$2.52 million was up 23.7% due to a \$1.78 million increase in income from end of term transactions, offset by a \$1.29 million decrease in gains on sale of leases and loans.

Non-interest Expenses

The Company's non-interest expenses of \$1.1 million for the quarter ended December 31, 2020 declined by \$174,100 or 13.5% from \$1.3 million in the second quarter of fiscal 2020. The decrease included reductions of over \$92,000 in compensation and \$62,000 in other general and administrative expenses. For the six months ended December 31, 2020, non-interest expenses of \$2.16 million declined 21.5% from \$2.75 million reported for the same period of the prior year, and included a \$329,500 or 17% reduction in compensation costs and \$262,800 or 32.6% decline in all other expenses.

Income Taxes

The Company's tax expense of \$3.5 million for the six months ended December 31, 2020 reflects a tax provision of \$5.67 million accrued at 26.7% on pretax earnings of \$20.04 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			Six Months Ended		
	December 31,		Percent Change	December 31,		Percent Change
	2020	2019		2020	2019	
<u>Pretax earnings</u>						
Pretax earnings excluding equity portfolio	\$ 982	\$ 2,079	(52.8) %	\$ 3,479	\$ 5,058	(31.2) %
Equity portfolio	16,957	9,569	77.2 %	16,565	10,684	(1,349.0) %
Pretax (loss) earnings	17,939	11,648	54.0 %	20,044	15,742	106.0 %
<u>Income taxes</u>						
Income tax expense excluding equity portfolio	263	565	(53.5) %	929	1,376	(32.5) %
Income tax (benefit)/expense on equity portfolio	4,850	2,603	86.3 %	4,737	2,906	63.0 %
Income tax valuation allowance	(2,265)	-	n/m	(2,151)	-	n/m -
Net tax (benefit)/expense	2,848	3,168	(10.1) %	3,515	4,282	(17.9) %
<u>Net earnings</u>						
Net earnings excluding equity portfolio	719	1,514	(52.5) %	2,550	3,682	(30.7) %
Net equity portfolio (loss)/gain	14,372	6,966	106.3 %	13,979	7,778	79.7 %
Net (loss)/earnings	\$ 15,091	\$ 8,480	78.0 %	\$ 16,529	\$ 11,460	44.2 %

Financial Condition Analysis

Consolidated total assets at December 31, 2020 of \$263.9 million were down 1.4% from \$267.8 million at June 30, 2020 and 8.3% from December 31, 2019. The change since June 30, 2020 includes a decline of \$54.8 million in cash and cash equivalents and \$3.5 million decline in property acquired for transactions in process, offset by a \$56.8 million increase in the equity investments.

Lease Portfolio

During the six months ended December 31, 2020, 100% of new leases booked were retained in the Company's lease portfolio. The Company's net investment in leases consisted of the following:

	December 31, 2020	June 30, 2020
	(in thousands)	
Minimum lease payments receivable	\$ 49,889	\$ 50,568
Estimated residual value	2,979	2,453
Less unearned income	(4,506)	(3,748)
Net investment in leases before allowances	48,362	49,273
Less allowance for lease losses	(782)	(832)
Less valuation allowance for estimated residual value	(25)	(25)
Net investment in leases	\$ 47,555	\$ 48,416

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 December 31, 2020, property acquired for transactions in process was down to \$537,900 from \$4.0 million at June 30, 2020 and \$24.1 million at December 31, 2019. The Company also had \$5.9 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 net commercial loan portfolio increased 3.4% during the first six months of fiscal 2021 to \$3.7 million. The Company's investment in commercial loans consists of the following:

	December 31, 2020	June 30, 2020
	(in thousands)	
Commercial real estate loans	\$ 3,461	\$ 3,607
Commercial term loans	318	-
Total commercial loans	<u>3,779</u>	<u>3,607</u>
Less unearned income and discounts	(52)	-
Less allowance for loan losses	(61)	(61)
Net commercial loans	<u>\$ 3,666</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 on originated loans, or unamortized premiums or discounts on purchased loans. The Company had no unused commitments on revolving lines of credit at December 31 or June 30, 2020.

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 December 31, 2020, the portfolio included 32 companies, up from 23 at June 30, 2020. During the first six months of fiscal 2021, the Company invested an additional \$20.8 million in 7 existing holdings and \$27.2 million in 12 new positions. The Company also realized a net gain of \$82,900 on the sale of two stocks for \$7.8 million. At December 31, 2020, the aggregate fair market value of the equity securities of \$108.1 million included approximately \$8.6 million of net unrealized gains. Investments in equity securities as of December 31, 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 December 31, 2020				
Commercial / Industrial	\$ 33,097	\$ 5,211	\$ (1,448)	\$ 36,860
Consumer	21,317	2,144	(801)	22,660
Financial	21,530	1,719	(1,717)	21,532
Healthcare	23,579	3,463	-	27,042
Total equity securities	<u>\$ 99,523</u>	<u>\$ 12,537</u>	<u>\$ (3,966)</u>	<u>\$ 108,094</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>

Investments

Investments are carried at cost and consist of the following:

(in thousands)	December 31, 2020		June 30, 2020	
	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	44
Mortgage-backed investment	101	114	103	114
	<u>\$ 1,650</u>	<u>\$ 1,663</u>	<u>\$ 2,102</u>	<u>\$ 2,113</u>

CalFirst Bank is required to hold Federal Reserve Bank 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 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:

(dollars in thousands)	Commercial Leases	Education Government Non-profit Leases	Commercial Loans	Commercial Real Estate Loans	Total
As of December 31, 2020:					
Pass	\$ 28,164	\$ 17,493	\$ 266	\$ 3,461	\$ 49,384
Special Mention	1,582	375	-	-	1,957
Substandard	308	440	-	-	748
Doubtful	-	-	-	-	-
	<u>\$ 30,054</u>	<u>\$ 18,308</u>	<u>\$ 266</u>	<u>\$ 3,461</u>	<u>\$ 52,089</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
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	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

There was no change in the past due credits or increase in non-performing assets during the quarter and six months ended December 31, 2020. 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
As of December 31, 2020:						
Commercial Leases	\$ -	\$ -	\$ -	\$ 30,054	\$ 30,054	\$ -
Education, Government, Non-profit Leases	-	-	-	18,308	18,308	-
Commercial Loans	-	-	-	266	266	-
Commercial Real Estate Loans	-	-	-	3,461	3,461	-
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 52,089</u>	<u>\$ 52,089</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 allowance for credit losses of \$868,000 at December 31, 2020 was reduced by \$50,000 when compared to June 30, 2020 and was reduced by \$219,000 from \$1.08 million at December 31, 2019. The Company considers the allowance for credit losses at December 31, 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 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.

	Six months ended December 31,	
	2020	2019
(dollars in thousands)		
Net investment in leases and loans before allowance	\$ 52,089	\$ 77,249
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	(50)	(400)
Allowance for credit losses at end of period	\$ 868	\$ 1,087
Components of allowance for credit losses:		
Allowance for lease losses	\$ 782	\$ 1,001
Residual valuation allowance	25	25
Allowance for loan losses	61	61
	\$ 868	\$ 1,087
Allowance for credit losses as a percent of net investment in leases and loans before allowances	1.67%	1.41%

The allowance balances and activity in the allowance by portfolio segment for the six months ended December 31, 2020 and 2019 are presented in the following table:

(dollars in thousands)	Commercial Leases	Education Government Non-profit Leases	Commercial & Industrial Loans	Commercial Real Estate Loans	Total
Six months ended December 31, 2020:					
Balance beginning of period	\$ 638	\$ 219	\$ -	\$ 61	\$ 918
Charge-offs	-	-	-	-	-
Transfer of loans to held-for-sale	-	-	-	-	-
Recoveries	-	-	-	-	-
Provision	(50)	-	-	-	(50)
Balance end of period	\$ 588	\$ 219	\$ -	\$ 61	\$ 868
Six months ended December 31, 2019:					
Balance beginning of period	\$ 872	\$ 242	\$ 329	\$ 61	\$ 1,504
Charge-offs	-	-	-	-	-
Transfer of loans to held-for-sale	-	-	(17)	-	(17)
Recoveries	-	-	-	-	-
Provision	(88)	-	(312)	-	(400)
Balance end of period	\$ 784	\$ 242	\$ -	\$ 61	\$ 1,087

Liquidity and Capital Resources

The Company funds its operating activities through internally generated funds, bank deposits and borrowings, and non-recourse debt. At December 31, 2020 and June 30, 2020, the Company's cash and cash equivalents were \$99.4 million and \$154.1 million, respectively.

Deposits at CalFirst Bank of \$42.6 million at December 31, 2020 were down 31% from \$62.2 million at December 31, 2019 and 25% from \$56.8 million at June 30, 2020. The \$19.5 million decrease from December 31, 2019 is related to the 32.7% decline in the lease and loan portfolio over that period and the Bank's reduced funding needs. The following table presents the ending balances, average balances and average rates paid on deposits for the six months ended December 31, 2020 and 2019:

	Six months ended December 31,					
	2020			2019		
	Ending Balance	Average Balance	Average Rate Paid	Ending Balance	Average Balance	Average Rate Paid
	(dollars in thousands)					
Non-interest bearing demand deposits	\$ 982	\$ 802	n/a	\$ 1,186	\$ 2,048	n/a
Interest-bearing demand deposits	900	4,458	0.05%	1,398	1,451	0.05%
Money market and savings deposits	21,846	22,516	0.06%	30,716	33,435	0.83%
Time deposits, less than \$100,000	6,155	6,686	0.27%	9,019	11,106	0.75%
Time deposits, \$100,000 or more	\$ 12,765	\$ 14,307	0.23%	\$ 19,847	\$ 23,736	0.83%

The following table shows the maturities of certificates of deposits at December 31, 2020:

	\$250,000 or less	More Than \$250,000
	(in thousands)	
Under 3 months	\$ 5,494	\$ 894
3 – 6 months	3,053	510
7 – 12 months	4,910	1,335
13 – 24 months	1,553	843
25 – 36 months	74	254
	\$ 15,084	\$ 3,836

Capital Resources

The following table presents capital and capital ratio information for CalFirst Bank as of December 31, 2020 and June 30, 2020. The Bank exceeded regulatory capital requirements and was considered “well-capitalized” under guidelines established by the FRB and OCC at both dates.

	Actual		To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio
(dollars in thousands)				
California First National Bank				
December 31, 2020				
Common equity Tier 1 capital	\$ 59,102	109.51%	\$ 3,508	6.50%
Tier 1 risk-based capital	\$ 59,102	109.51%	\$ 4,318	8.00%
Total risk-based capital	\$ 59,779	110.77%	\$ 5,397	10.00%
Tier 1 leverage capital	\$ 59,102	45.76%	\$ 6,458	5.00%
June 30, 2020				
Common equity Tier 1 capital	\$ 57,388	90.72%	\$ 4,112	6.50%
Tier 1 risk-based capital	\$ 57,388	90.72%	\$ 5,061	8.00%
Total risk-based capital	\$ 58,180	91.97%	\$ 6,326	10.00%
Tier 1 leverage capital	\$ 57,388	48.13%	\$ 5,961	5.00%

Subsequent Events

In January 2021, final regulatory approvals were received that permit the Company to proceed with the proposed sale of 100% of the common stock of CalFirst Bank announced in October 2020. It is expected that the sale will be completed at the end of February 2021.

The sale agreement provides for the leasing business and lease portfolio of CalFirst Bank to be transferred to CFLC who will reassume responsibility for all lease origination. In anticipation of regulatory approvals, in early January 2021 the Bank distributed 100% of its investment in the lease portfolio to the Company in the form of a dividend, and the Company then contributed the assets to CFLC as additional paid-in-capital. The net value of the distribution and reduction in Bank’s capital was \$47.3 million. In addition, all Bank employees engaged in the lease business were transferred to California First Leasing as of January 1, 2021.