



California First Leasing Corporation

Annual Report

For the Year Ended June 30, 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 its UniversityLease unit focuses on the financing needs of colleges and universities. The Company actively invests available capital in equity securities.

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 periodic 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.

Statements made in this report that are not strictly historical in nature constitute “forward-looking statements.” Forward-looking statements involve management assumptions, risks and uncertainties. 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 portfolio, 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 and equity and fixed income markets. 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 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 (September 21, 2021).



Selected Financial Data

The selected financial data and operating information presented below should be read in conjunction with the financial statements and notes thereto.

INCOME STATEMENT DATA

(in thousands, except per share amounts)

	YEARS ENDED JUNE 30,				
	2021	2020	2019	2018	2017
Finance and loan income	\$ 3,858	\$ 6,162	\$ 10,189	\$ 17,575	\$ 26,234
Investment interest and dividend income	2,845	3,788	4,001	3,067	3,014
Total interest and dividend income	6,703	9,950	14,190	20,642	29,248
Interest expense on deposits and borrowings	39	373	1,599	3,422	7,229
Net interest income	6,664	9,577	12,591	17,220	22,019
Provision (release) of reserves for credit losses	(298)	(582)	(1,100)	(4,225)	250
Net interest income after provision for credit losses	6,962	10,159	13,691	21,445	21,769
Operating and sales-type lease income	533	1,406	1,388	1,709	2,716
Gain on sale of leases and leased property	2,481	3,229	1,839	2,963	4,336
Other income	267	42	129	299	387
Gain (loss) on equity securities (1)	38,770	(9,892)	(607)	-	-
Realized (loss) on sale of AFS securities	-	-	-	(1,008)	-
Gain on sale of bank subsidiary	2,343	-	-	-	-
Total non-interest income (loss)	44,394	(5,215)	2,749	3,963	7,439
Non-interest expenses	4,234	5,234	7,073	9,374	10,484
Earnings (loss) before income taxes	47,122	(290)	9,367	16,034	18,724
Income taxes	10,891	2,073	2,033	3,525	7,601
Net earnings (loss)	\$ 36,231	\$ (2,363)	\$ 7,334	\$ 12,509	\$ 11,123
Basic earnings (loss) per common share	\$ 3.52	\$ (0.23)	\$ 0.71	\$ 1.22	\$ 1.08
Basic common shares outstanding	10,284	10,284	10,284	10,284	10,280
Cash dividends per share	\$ 0.54	\$ 0.52	\$ 0.50	\$ 0.48	\$ 0.46
Dividend payout ratio	15.3%	NM	70.1%	39.5%	42.5%
Net margin	2.69%	3.82%	3.76%	3.40%	2.71%
Net spread	2.58%	3.38%	3.02%	2.99%	2.47%
Effective tax rate	23.1%	NM	21.7%	22.0%	40.6%
Return on average assets	14.28%	-0.85%	2.09%	2.35%	1.30%
Return on average equity	17.03%	-1.16%	3.58%	6.21%	5.78%

(1) Following the adoption of Accounting Standards Update 2016-01 ("ASU 2016-01") on July 1, 2018, results for fiscal 2019 through 2021 include changes in gains and losses (realized and unrealized) on equity securities in earnings. ASU 2016-01 prohibited the restatement of prior year financial statements, so no unrealized gains or losses on equity securities are included in results for fiscal years 2017-2018 and therefore are not comparable.

BALANCE SHEET DATA

(in thousands, except per share amounts)

	AS OF JUNE 30,				
	2021	2020	2019	2018	2017
Cash and cash equivalents	\$ 37,045	\$ 154,123	\$ 71,606	\$ 63,307	\$ 96,055
Fixed income securities available-for-sale	-	-	23,978	36,725	86,469
Equity securities	160,125	51,339	75,944	38,890	9,040
Commercial loans	3,578	3,546	31,075	104,630	306,009
Net investment in leases	35,452	48,416	90,526	123,467	190,798
Total assets	242,917	267,760	304,944	389,202	715,585
Deposits (2)	-	56,807	87,745	169,425	468,634
Non-recourse debt	1,228	1,941	2,655	3,368	279
Stockholders' equity	\$ 230,300	\$ 199,623	\$ 207,304	\$ 204,963	\$ 196,134
Equity to total assets ratio	94.81%	74.55%	67.98%	52.66%	27.41%
Book value per common share	\$ 22.39	\$ 19.41	\$ 20.16	\$ 19.93	\$ 19.07

(2) Following the Bank sale in February 2021, there were no longer any bank deposits and no interest expenses paid on deposits for the fourth quarter of fiscal 2021.



Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview of Results, Trends and Outlook

During fiscal 2021, the Company completed the sale of the stock of the Bank for a purchase price equal to the Bank's equity capital of \$12.6 million on February 26, 2021 plus \$2.5 million, and recognized a gain of \$2.34 million. Prior to the sale, in early January 2021 the Bank distributed 100% of its investment in the leasing business and lease portfolio with a net value of \$47.3 million to the Company in the form of a dividend.

For the fiscal year ended June 30, 2021, CalFirstLease reported net earnings \$36.2 million that included gains of \$38.8 million on equity securities and the \$2.3 million gain realized on the sale of the Bank. This compared to a net loss of \$2.4 million in fiscal 2020 that included a loss of \$9.9 million on equity securities. Excluding the impact of equity gains and losses and the sale of the Bank, the Company's pre-tax earnings for the year ended June 30, 2021 decreased by 37.4% to \$6.0 million from \$9.6 million in fiscal 2020. The Company's lease and loan portfolio declined by 25% during fiscal 2021, contributing to a 37% decline in finance and loan income and a 30% decline in net interest income.

For the year ended June 30, 2021, new leases and loans booked of \$31.8 million were 55% less than the \$71.1 million of leases booked in fiscal 2020. In addition to the decrease in new lease bookings in fiscal 2021, 15% were sold to third-party participants, contributing to the 27% decline in the net investment in leases to \$35.5 million at June 30, 2021. Lease originations also declined in fiscal 2021 leaving a backlog of approved leases of \$5.8 million at June 30, 2021, down from \$21 million at June 30, 2020.

During fiscal 2021, the fair value of CalFirstLease's equity securities portfolio increased by 212%, or \$108.8 million, to \$160.1 million at June 30, 2021. The increase includes purchases of \$115.4 million, sales of \$43.3 million and an increase in net unrealized gains of \$36.7 million.

Throughout fiscal 2021, originations of new leases were down from the year before and management does not expect this to change in the current environment. With interest rates remaining low, the deployment of available resources toward assets with better current yields and growth opportunities will continue as a component of the Company's strategic plan; however, with current market valuation levels and volatility, quarterly reported earnings can be expected to continue to fluctuate widely.

Consolidated Statement of Earnings Analysis

Net Interest and Dividend Income – Net interest and dividend income is the difference between interest and dividends earned on leases, loans, securities and other income-earning assets and interest paid on deposits and is affected by changes in the mix and level of income earning assets and liabilities, the movement of interest rates, and funding and pricing strategies. The following table presents the components of the increases (decreases) in net interest and dividend income by volume and rate:

	2021 compared to 2020		
	Volume	Rate	Total
		(thousands)	
Interest and dividend income			
Net investment in leases	\$ (1,947)	\$ 31	\$ (1,916)
Commercial loans	(367)	(21)	(388)
Investment securities	(185)	34	(151)
Equity securities	594	(370)	224
Interest-earning deposits with banks	166	(1,182)	(1,016)
	<u>(1,739)</u>	<u>(1,508)</u>	<u>(3,247)</u>
Interest expense			
Demand and savings deposits	(93)	(74)	(167)
Time deposits	(119)	(48)	(167)
	<u>(212)</u>	<u>(122)</u>	<u>(334)</u>
Net interest and dividend income	<u>\$ (1,527)</u>	<u>\$ (1,386)</u>	<u>\$ (2,913)</u>

Total interest and dividend income for the year ended June 30, 2021 decreased 32.6% to \$6.70 million from \$9.95 million in fiscal 2020. The decrease includes a \$1.9 million or 34.0% decrease in finance income and \$389,000 decline in commercial loan income.

- Direct finance income declined 34.0% to \$3.72 million reflecting a 34.6% decrease in average investment in leases to \$42.6 million that offset a 7 basis point increase in average yield to 8.73%. Both fiscal 2021



and 2020 lease yields benefitted from recognition of accelerated finance income, but excluding that benefit from both years, the average lease yield in fiscal 2021 decreased by over 13 basis points compared to fiscal 2020.

- Dividend income increased \$225,300 or 9.2% to \$2.68 million reflecting a \$19.7 million or 24.2% increase in average balances offset by a 37-basis point decrease in yield to 2.65%. The decrease in reported yield in part reflects the increase in fair value of equities from June 30, 2020.
- The decrease in commercial loan income resulted from a 69.9% decrease in average loan balances to \$3.6 million and a decrease in average yield of 57 basis points to 3.85%.
- Interest earned on bank deposits and investment securities declined 87.6% or \$1.17 million to \$165,400 reflecting a 128-basis point decrease in rate to 0.17%, offset by a \$7.5 million increase in average balances.
- Interest expense paid on deposits in fiscal 2021 declined 89.5% to \$39,100, reflecting a 56.4% decrease in average balances to \$27.5 million and a 46-basis point decrease in average cost to 0.13%. Effective with the Bank sale, all deposit balances were eliminated on February 26, 2021.
- As a result, net interest and dividend income decreased 30.4% to \$6.66 million for the fiscal year ended June 30, 2021 from \$9.58 million for fiscal 2020.

The following table presents the Company's average balance sheets, dividend, finance and loan income and interest earned or interest paid, the related yields and rates on major categories of the Company's income-earning assets and interest-bearing liabilities:

	Year ended June 30, 2021			Year ended June 30, 2020		
	Average Balance	Income	Yield/Rate	Average Balance	Income	Yield/Rate
Assets						
Income-earning assets						
Interest-earning deposits with banks	\$ 98,971	\$ 95	0.10%	\$ 86,097	\$ 1,111	1.29%
Investment securities	1,052	71	6.75%	6,371	222	3.48%
Equity securities	101,117	2,680	2.65%	81,390	2,455	3.02%
Commercial loans	3,581	137	3.83%	11,884	526	4.43%
Net investment in leases (1)	42,600	3,720	8.73%	65,092	5,636	8.66%
Total income-earning assets	247,321	6,703	2.71%	250,834	9,950	3.97%
Other assets	6,344			28,701		
	<u>\$ 253,665</u>			<u>\$ 279,535</u>		
Liabilities and Shareholders' Equity						
Interest-bearing liabilities						
Demand and savings deposits	\$ 15,419	9	0.05%	\$ 32,468	176	0.54%
Time deposits	12,065	30	0.24%	30,603	197	0.64%
Total interest bearing liabilities	27,484	39	0.13%	63,071	373	0.59%
Non-interest bearing demand deposits	510			1,550		
Other liabilities	12,944			10,572		
Shareholders' equity	212,727			204,342		
	<u>\$ 253,665</u>			<u>\$ 279,535</u>		
Net interest and dividend income		<u>\$ 6,664</u>			<u>\$ 9,577</u>	
Net spread (2)			<u>2.58%</u>			<u>3.38%</u>
Net margin (3)			<u>2.69%</u>			<u>3.82%</u>
Average income earning assets over average interest bearing liabilities			<u>899.9%</u>			<u>397.7%</u>

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

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

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

Provision for Credit Losses – During fiscal year 2021, the Company released reserves of \$297,600 from the allowance for credit losses, compared to a release of \$581,700 of reserves in fiscal year 2020. The fiscal 2021 release of reserves recognizes the 25% decline in the lease and loan portfolio since June 30, 2020 as well as some reversal of reserves established in anticipation of greater losses related to the Covid-19 pandemic than have occurred. The Company saw no increase in non-performing leases during the year, but continues to maintain reserves at a higher than historical level in light of the uncertain pandemic outlook. At June 30, 2021, the allowance for credit losses of \$620,000, 1.56% of the investment in leases and loans, is down from 1.74% at June 30, 2020 and is considered to be appropriate for the consolidated portfolio.



Non-interest Income – For the year ended June 30, 2021, non-interest income was \$44.4 million compared to negative \$5.2 million for fiscal year 2020. Non-interest income in fiscal 2021 includes gains of \$38.8 million recognized based on the fair value of equity securities at June 30, 2021 while fiscal 2020 included a \$9.9 million loss on the fair value of equity securities. Fiscal 2021 non-interest income also included the one-time gain of \$2.3 million from the sale of the Bank. Excluding these gains and losses from both periods, non-interest income for fiscal 2021 of \$3.3 million was down 30% from \$4.7 million in fiscal 2020. This decrease was due to a \$2.9 million reduction in gains on sale of leases, offset by an increase of \$1.27 million in income from end of term transactions.

Non-interest Expenses – The Company's non-interest expenses recognized for the year ended June 30, 2021 decreased by \$1.0 million, or 19.1%, to \$4.2 million compared to \$5.2 million the year before. The decrease in expenses in fiscal 2021 was due to lower compensation costs of \$582,900, or 15.7% and a \$416,800 or 27.5% decline in all other expenses.

Income Taxes – For the year ended June 30, 2021, the total tax provision of \$10.89 million included a provision at an effective tax rate of 25.3% on pretax earnings of \$8.35 million excluding the equity securities gain. A tax provision of \$10.93 million on the equity security gain was 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 in fiscal 2020. Equity gains included net realized taxable gains of \$2.1 million on the sale of equity securities, calculated as the difference between sales proceeds and the original cost, which gains may have been recognized in prior years' earnings.

For the year ended June 30, 2020, the tax provision of \$2.07 million included taxes accrued at 27.2% on pretax earnings of \$9.6 million excluding equity securities losses, less a net tax benefit of \$539,000 attributable to the equity portfolio loss. The net tax benefit included a tax benefit of \$2.69 million at the effective tax rate of 27.2% on the \$9.9 million loss on equity securities for the year ended June 30, 2020, offset by a valuation allowance of \$2.15 million.

Comparisons of income taxes between fiscal years are difficult as the tax provision will vary due to changes in mix of pre-tax earnings, particularly related to gains and losses on securities, and underlying income tax rates applicable in different taxing jurisdictions.

The components of earnings and taxes are summarized as follows:

(dollars in thousands)	Twelve Months Ended June 30,	
	2021	2020
<u>Pretax earnings</u>		
Pretax earnings excluding securities gain (loss)	\$ 8,352	\$ 9,602
Gain (loss) on securities	<u>38,770</u>	<u>(9,892)</u>
Pretax earnings (loss)	<u>47,122</u>	<u>(290)</u>
<u>Income taxes</u>		
Income tax expense excluding securities gain (loss)	2,109	2,612
Income tax expense (benefit) on securities gain (loss)	10,934	(2,691)
Income tax valuation allowance	<u>(2,152)</u>	<u>2,152</u>
Net tax expense	<u>10,891</u>	<u>2,073</u>
<u>Net earnings</u>		
Net earnings excluding equity gain (loss)	6,243	6,990
Net equity portfolio gain (loss)	<u>29,988</u>	<u>(9,353)</u>
Net earnings (loss)	<u>\$ 36,231</u>	<u>\$ (2,363)</u>

Financial Condition Analysis

The Company's balance sheet reflects significant liquidity and a strong capital base. Shareholders' equity at June 30, 2021 was \$230.3 million, or 95% of total assets. At June 30, 2021, total assets of \$242.9 million were down by \$24.8 million or 9.3% from \$267.8 million at June 30, 2020, due primarily to the sale of the Bank that transferred all deposit liabilities and approximately \$61 million of cash to the buyer. This was offset by increased investment in and gains in value of equity securities that more than doubled to \$160.1 million.

**Lease and Loan Portfolio**

	June 30,				
	2021	2020	2019	2018	2017
			(in thousands)		
Net investment in leases	\$ 36,037	\$ 49,273	\$ 91,640	\$ 124,867	\$ 192,741
Commercial loans	281	-	27,587	101,984	306,826
Commercial real estate loans	3,332	3,607	3,878	4,134	4,387
Total leases and loans	39,650	52,880	123,105	230,985	503,954
Less allowance for credit losses	(620)	(918)	(1,504)	(2,888)	(7,147)
Net leases and loans	\$ 39,030	\$ 51,962	\$ 121,601	\$ 228,097	\$ 496,807

The lease and loan portfolio is geographically diverse. The following table shows the geographic distribution at June 30, 2021 and 2020.

(dollars in thousands)

<u>State</u>	Leases and Loans				
	June 30, 2021		June 30, 2020		
	<u>Balance</u>	<u>Percent</u>	<u>Balance</u>	<u>Percent</u>	
Michigan	\$ 7,102	17.9%	\$ 1,002	1.9%	
New York	5,706	14.4%	8,984	17.1%	
California	4,223	10.7%	7,583	14.4%	
Louisiana	2,488	6.3%	246	0.5%	
Rhode Island	2,120	5.3%	2,486	4.7%	
Texas	1,739	4.4%	3,826	7.3%	
Washington DC	1,656	4.2%	479	0.9%	
Florida, Virginia, Maryland, Georgia, Kentucky	4,776	12.1%	8,679	16.5%	
Pennsylvania, New Jersey, Connecticut, Massachusetts	3,405	8.6%	5,237	9.9%	
South Dakota, Wisconsin, Illinois, Minnesota, Indiana	3,152	8.0%	5,079	9.7%	
Hawaii, Colorado	2,224	5.6%	2,380	4.5%	
All other states (no state greater than 1.0%)	1,002	2.5%	6,624	12.6%	
	<u>\$ 39,593</u>	<u>100.0%</u>	<u>\$ 52,605</u>	<u>100.0%</u>	

The lease and loan portfolio is also distributed across a spectrum of industry groups as shown below:

(dollars in thousands)

<u>Industry</u>	Leases and Loans				
	June 30, 2021		June 30, 2020		
	<u>Balance</u>	<u>Percent</u>	<u>Balance</u>	<u>Percent</u>	
Educational services	\$ 11,939	30.1%	\$ 14,278	27.1%	
Manufacturing – automotive	6,670	16.8%	46	0.1%	
Healthcare and social services	5,265	13.3%	10,618	20.2%	
Agriculture and food products	3,507	8.9%	4,494	8.5%	
Public administration	2,722	6.9%	3,807	7.2%	
Retail Trade	2,353	5.9%	3,902	7.4%	
Wholesale distribution	2,152	5.4%	5,287	10.1%	
Arts, entertainment and recreation	1,339	3.4%	3,874	7.4%	
Transportation	1,168	2.9%	2,092	4.0%	
Manufacturing - industrial	838	2.1%	1,064	2.0%	
Manufacturing - chemicals and materials	702	1.8%	1,767	3.4%	
Scientific, professional, other business services	516	1.3%	953	1.8%	
Mining and oil & gas services	422	1.1%	376	0.7%	
Financial services	-	0.0%	47	0.1%	
	<u>\$ 39,593</u>	<u>100%</u>	<u>\$ 52,605</u>	<u>100%</u>	

Most of the industry groups identified above include customers identified by different industry codes that may not be directly comparable or considered a concentration. However, at June 30, 2021 approximately 29.1% of the portfolio is with public and private colleges and universities, up from 25.6% at June 30, 2020, while automotive parts manufacturing increased to 16.8% in fiscal 2021 related to one new lease booked with one lessee. Approximately 9.8% of the portfolio consists of hospitals and medical centers, down from 14.7% at June 30, 2020. The higher share in the education field reflects the reduced size of the portfolio and the continued importance of this market to the Company's objectives. The universities and colleges are located throughout the United States and the group includes over 63 leases with 37 different institutions and no university represents more than 7% of the portfolio.

**Lease Portfolio**

At June 30, 2021, leases accounted for 91% of the Company's lease and loan portfolio compared with 93% at June 30, 2020. Leases generally are for initial terms ranging from two to five years and are structured individually to accommodate a variety of customers' objectives. The Company conducts the leasing business in a manner designed to minimize risk, however, we are subject to risks through the investment in lease receivables held in our own portfolios, lease transactions-in-process, and residual investments. During the fiscal year ended June 30, 2021, 80.9% of the property value of new leases booked by the Company was held in its own portfolio, up from 15.1% during fiscal 2020 and 66.8% in fiscal 2019. For the fiscal year ended June 30, 2021, the Company's net investment in lease receivables decreased by \$13.3 million and the investment in estimated residual values increased by \$370,700.

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 made to facilitate the lessees' property implementation schedule. The lessee generally is contractually obligated to make rental payments directly to the Company during the period that the transaction is in process, and obligated to reimburse the Company for all disbursements under certain circumstances. At June 30, 2021, the Company's investment in property acquired for transactions-in-process of \$1.8 million was down 57% from \$4.0 million at June 30, 2020, and down 52% from \$3.7 million at June 30, 2019.

The Company leases capital assets to businesses and other commercial or non-profit organizations with the leases secured by the underlying property being leased. The average size of lease transactions booked over the past five years has fluctuated between \$826,000 and \$2.2 million. During the year ended June 30, 2021, three credits accounted for 65% (33.5%, 19.1% and 12.6%, respectively) of the property cost of leases booked during the fiscal year. Of the remaining 35%, two credits represented 14.1%, with the balance spread across sixteen other credits. During the year ended June 30, 2020, two credits accounted for 74% (38.3% and 35.2%, respectively) of the property cost of leases booked. Of the remaining 26%, one credit represented 10.3%, with the balance spread across over twenty other credits. At June 30, 2021, one customer accounted for 18.5% of the Company's net investment in leases, compared to one customer accounting for 10.4% of the Company's net investment in leases at June 30, 2020.

The Company leases and finances most capital assets used by businesses and organizations, with a focus on high technology systems and other mission critical assets. In addition to computer systems, software and networks, property leased includes manufacturing production systems, medical equipment, non-electronic property including office equipment, machine tools, school buses, trucks, exercise equipment and office and dormitory furniture. The mixture of property varies year by year. A comparison of the mix of property subject to new leases booked in each of the two years ending June 30, 2021 is set forth below (dollars in thousands):

Year End June 30,	2021	%	2020	%
Manufacturing equipment	\$ 8,984	35.2%	\$ -	0.0%
Computer Hardware and Software	8,954	35.1%	22,969	32.3%
Warehouse systems	4,862	19.1%	27,198	38.3%
Medical Equipment	906	3.6%	8,321	11.7%
Office Equipment	679	2.7%	395	0.6%
Transportation	616	2.4%	1,748	2.5%
Exercise equipment	494	1.9%	872	1.2%
Furniture & Fixtures	-	0.0%	6,735	9.5%
Point of Sale systems	-	0.0%	1,937	2.7%
Other	-	0.0%	909	1.3%
Cost of Property on Leases Booked	<u>\$ 25,495</u>		<u>\$ 71,084</u>	

Commercial Loan Portfolio

The Company's commercial loan portfolio of \$3.58 million at June 30, 2021 was up less than 1.0% from \$3.55 million at June 30, 2020, and represented 9% of the Company's net investment in leases and loans compared to 7% in fiscal 2020 and 26% in fiscal 2019. The portfolio at June 30, 2021 consists of two real estate loans with two subsidiaries of one corporate guarantor and two participations in two Main Street term loans.

**Equity Securities**

The equity securities portfolio at June 30, 2021 consisted of common stock holdings with readily available prices in 33 public companies, compared to 23 companies at June 30, 2020. The fair value of the equity securities portfolio of \$160.1 million at June 30, 2021 increased 212% from \$51.3 million at June 30, 2020 as a result of new purchases of \$115.4 million in 32 companies, sales of \$43.3 million from 20 positions and a net increase in unrealized gains of \$36.7 million. The fair value of the equity portfolio at June 30, 2021 was \$28.7 million above the Company's cost, compared to the fair value at June 30, 2020 being \$7.9 million below the Company's actual cost.

The investment in equity securities as of June 30, 2021 and 2020 is summarized by industry sector below:

(in thousands)		Unrealized		
	Cost Basis	Gains	(Losses)	FMV
as of June 30, 2021				
Commercial / Industrial	\$ 53,950	\$ 15,661	\$ (435)	\$ 69,176
Consumer	39,576	3,038	(16)	42,598
Financial	10,966	4,552	-	15,518
Healthcare	26,888	5,945	-	32,833
	<u>\$ 131,380</u>	<u>\$ 29,196</u>	<u>\$ (451)</u>	<u>\$ 160,125</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>

Asset Quality

The Company monitors the performance of all leases and loans held in its own portfolio, transactions-in-process as well as lease transactions assigned to lenders, if the Company retains a residual investment in the leased property subject to those leases. The accrual of interest income on leases and loans will be discontinued when the customer becomes ninety days or more past due on its lease or loan payments, unless the Company believes the investment is otherwise recoverable. Leases and loans may be placed on non-accrual earlier if the Company has significant doubt about the ability of the customer to meet its lease or loan obligations, as evidenced by consistent delinquency, deterioration in the customer's financial condition or other relevant factors.

There were no non-performing assets at June 30, 2021 or 2020 and no direct finance income recorded on non-performing assets over the last five years.

Non-performing Leases and Loans	June 30,				
	2021	2020	2019	2018	2017
	<i>(dollars in thousands)</i>				
Non-accrual leases and loans	\$ -	\$ -	\$ -	\$ 3	\$ 3
Repossessed equipment	-	-	-	-	-
Total non-performing assets	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3</u>	<u>\$ 3</u>

The Company did have criticized lease investments of \$1.7 million at June 30, 2021 that are not non-performing but are experiencing financial difficulties or that management believes may experience financial difficulties in the future. This amount compared to \$4.6 million at June 30, 2020. The decrease primarily was due to diminished issues related to the Covid-19 pandemic and shut-down. Although these credits have been identified as potential problems, they may never become non-performing. These potential problem leases are considered in the determination of the allowance for credit losses.

Allowance for Credit Losses

The allowance for credit losses and the residual valuation allowance provide coverage for probable and estimable losses in the credit portfolio. Amounts are charged off when they are deemed completely uncollectible. The determination of the appropriate amount of any allowance is based on management's judgment at that time and takes into consideration all known relevant internal and external factors that may affect the portfolio.



The following table summarizes the activity in the allowance for credit losses for the five years ended June 30, 2021.

	Years Ended June 30,				
	2021	2020	2019	2018	2017
	(dollars in thousands)				
Property acquired for transactions-in-process before allowance	\$ 1,751	\$ 4,031	\$ 3,653	\$ 8,955	\$ 17,101
Net investment in leases before allowance	36,037	49,273	91,640	124,867	192,741
Commercial loans, before allowance	3,613	3,607	31,465	106,118	311,213
Leases and loans, before allowances	<u>\$ 41,401</u>	<u>\$ 56,911</u>	<u>\$ 126,758</u>	<u>\$ 239,940</u>	<u>\$ 521,055</u>
Average leases and loans	<u>\$ 46,181</u>	<u>\$ 76,976</u>	<u>\$ 175,869</u>	<u>\$ 348,378</u>	<u>\$ 605,069</u>
Allowance for credit losses at beginning of year	\$ 918	\$ 1,504	\$ 2,888	\$ 7,147	\$ 6,862
Charge-off of lease receivables	-	(3)	(17)	(24)	-
Transfer of loans to held-for-sale	-	(17)	(273)	(17)	(168)
Recovery of lease amounts previously written off	-	16	6	7	203
Provision (release) of reserves for credit losses	(298)	(582)	(1,100)	(4,225)	250
Allowance for credit losses at end of year ("Allowance")	<u>\$ 620</u>	<u>\$ 918</u>	<u>\$ 1,504</u>	<u>\$ 2,888</u>	<u>\$ 7,147</u>
Components of allowance for credit losses:					
Allowance for lease losses	\$ 585	\$ 857	\$ 1,114	\$ 1,400	\$ 1,943
Allowance for loan losses	35	61	390	1,488	5,204
	<u>\$ 620</u>	<u>\$ 918</u>	<u>\$ 1,504</u>	<u>\$ 2,888</u>	<u>\$ 7,147</u>
Allowance as percent of leases and loans before allowances	1.56%	1.74%	1.22%	1.25%	1.42%
Net (charge-offs) recoveries as percent of average leases & loans	0.00%	(0.01)%	(0.16)%	(0.01)%	0.01%

The allowance for credit losses decreased to \$620,000 at June 30, 2021 from \$918,000 at June 30, 2020 and consisted of \$153,000 allocated to specific accounts and \$467,000 that was available to cover losses inherent in the portfolio. The Company considers the allowance for credit losses of \$620,000 at June 30, 2021 adequate, 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, 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.

Based on management's evaluation of the lease and loan portfolio at each period end, management allocated the allowance for loan and lease losses for the past five years as shown in the table below:

(dollars in thousands)	2021		2020		2019		2018		2017	
	Allowance Amount Allocated	% of Leases and Loans	Allowance Amount Allocated	% of Leases and Loans	Allowance Amount Allocated	% of Leases and Loans	Allowance Amount Allocated	% of Leases and Loans	Allowance Amount Allocated	% of Leases and Loans
	(dollars in thousands)									
Net Investment in Leases	\$585	90.9%	\$857	93.2%	\$1,114	74.4%	\$1,400	54.1%	\$1,943	38.2%
Commercial Loans	5	0.7%	-	0.0%	329	22.4%	1,427	44.1%	5,143	60.9%
Commercial Real Estate	30	8.4%	61	6.8%	61	3.2%	61	1.8%	61	0.9%
	<u>\$620</u>	<u>100.0%</u>	<u>\$918</u>	<u>100.0%</u>	<u>\$1,504</u>	<u>100.0%</u>	<u>\$2,888</u>	<u>100.0%</u>	<u>\$7,147</u>	<u>100.0%</u>

While the allowance is allocated by category above, the allowance is available for any part of the portfolio.

Liquidity and Capital Resources

Following the sale of the Bank, the Company no longer has access to bank deposits as a funding source, and will rely on its existing cash and securities balances, internally generated funds and non-recourse debt. At June 30, 2021, the Company's cash and cash equivalents decreased to \$37.0 million from \$154.1 million at June 30, 2020 while equity securities balances increased from \$51.3 million to \$160.1 million at June 30, 2021. The reduction in cash levels during the year reflect the transfer of \$44.0 million of cash upon the Bank sale and the increased investment of \$70 million in equity securities.



All deposit accounts were held at the Bank and transferred upon its sale on February 26, 2021. The following table presents the Bank's ending balances, average balances and average rates paid on deposits for the twelve months ended June 30, 2021 and 2020:

Twelve months ended June 30,						
	2021			2020		
	Ending Balance	Average Balance	Average Rate	Ending Balance	Average Balance	Average Rate
	<i>(dollars in thousands)</i>					
Non-interest bearing demand	\$ -	\$ 510	n/a	\$ 1,188	\$ 1,550	n/a
Interest-bearing demand deposits	-	2,649	0.05%	9,197	2,584	0.05%
Savings & money market deposits	-	12,770	0.06%	24,163	29,884	0.58%
Time deposits, less than \$100,000	-	3,819	0.26%	6,973	9,553	0.61%
Time deposits, \$100,000 or more	\$ -	\$ 8,246	0.22%	\$ 15,286	\$ 21,050	0.66%

An additional source of liquidity for financing and managing the lease portfolio comes from selling, participating or assigning certain lease term payments to banks or other financial institutions. During fiscal 2021, the Company sold net lease receivables aggregating to \$4.6 million. This compared to proceeds of \$56.3 million from leases sold or assigned during fiscal 2020. At June 30, 2021, the Company had outstanding non-recourse debt of \$1.2 million relating to leases assigned to unaffiliated parties. In the past, the Company has been able to obtain adequate non-recourse funding commitments, and the Company believes it will be able to do so in the future.

The Company has the ability to borrow under an investment margin account from the brokerage firm that holds the equity securities owned by the Company. Any such borrowing would provide the firm with a perfected security interest in the equity securities held by the firm as collateral. The Company has not made any borrowings under this facility, and may or may not have the ability to borrow against its equity securities in the future. The amount available for borrowing is based on the market value of the equity security portfolio and fluctuates depending on the value of the underlying securities.

The need for cash for operating activities will fluctuate as the Company expands or contracts. The Company believes that existing cash balances, cash flow from operations, cash flows from its financing and investing activities, and sales or assignments of lease receivables or securities will be sufficient to meet its foreseeable needs.

Market Risk Disclosure

Equity securities of \$160.1 million at June 30, 2021 represent a significant portion, 66%, of the Company's assets at such date. CalFirstLease has been actively investing in public equities to the current extent only since the third quarter of fiscal 2017. Since that time, stock price volatility has been significant and is expected to continue. Equity securities gains and losses, whether realized through sales or unrealized due to changes in market prices, have caused and will continue to cause significant volatility in periodic earnings. At June 30, 2021, no individual stock accounted for more than 10% of the total fair value of equity securities. Management believes the Company's significant levels of stockholders' equity and liquidity help mitigate risks related to market volatility.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors
California First Leasing Corporation
Newport Beach, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of California First Leasing Corporation, which comprise the balance sheets as of June 30, 2021 and 2020, and the related statements of operations, comprehensive income (loss), stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of California First Leasing Corporation as of June 30, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Laguna Hills, California
September 21, 2021

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BALANCE SHEETS
(in thousands, except share amounts)

	June 30, 2021	June 30, 2020 *
<u>ASSETS</u>		
Cash and due from banks	\$ 37,045	\$ 153,083
Federal funds sold	-	1,040
Equity investments	160,125	51,339
Investments	-	2,102
Property acquired for transactions-in-process	1,751	4,031
Leases and loans:		
Net investment in leases	36,037	49,273
Commercial loans	3,613	3,607
Allowance for credit losses	(620)	(918)
Net investment in leases and loans	39,030	51,962
Property on operating leases, less accumulated depreciation of \$0 (2021) and \$2,561 (2020)	28	867
Income tax receivable	2,857	376
Other assets	853	1,019
Discounted lease rentals assigned to lenders	1,228	1,941
Total Assets	<u>\$ 242,917</u>	<u>\$ 267,760</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Liabilities:		
Demand and savings deposits	\$ -	\$ 34,548
Time certificates of deposit	-	22,259
Accounts payable	628	3,266
Accrued liabilities	1,264	2,116
Lease deposits	188	802
Non-recourse debt	1,228	1,941
Deferred income taxes, net	9,309	3,205
	<u>12,617</u>	<u>68,137</u>
Commitments and contingencies	-	-
Stockholders' equity:		
Preferred stock; 2,500,000 shares authorized; none issued	-	-
Common stock; \$.01 par value; 20,000,000 shares authorized; 10,284,139 June 2021 and 2020 issued and outstanding	103	103
Additional paid in capital	2,314	2,314
Retained earnings	227,883	197,206
Total Stockholders' Equity	<u>230,300</u>	<u>199,623</u>
Total Liabilities and Stockholders' Equity	<u>\$ 242,917</u>	<u>\$ 267,760</u>

* For periods prior to February 26, 2021, financial statements represent the consolidation of California First National Bancorp and subsidiaries, California First National Bank and California First Leasing.

The accompanying notes are an integral part of these financial statements.



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

	Years ended June 30,		
	2021	2020	2019
Finance & loan income	\$ 3,858	\$ 6,162	\$ 10,189
Investment interest and dividend income	2,845	3,788	4,001
Total interest and dividend income	6,703	9,950	14,190
Interest expense on deposits	39	373	1,599
Net interest income	6,664	9,577	12,591
Provision (release) of reserves for credit losses	(298)	(582)	(1,100)
Net interest income after provision for credit losses	6,962	10,159	13,691
<u>Non-interest income</u>			
Operating & sales-type lease income	533	1,406	1,388
Gain on sale of leases, loans & leased property	2,481	3,229	1,839
Gain (loss) on equity securities	38,770	(9,892)	(607)
Gain on sale of bank subsidiary	2,343	-	-
Other fee income	267	42	129
Total non-interest income (loss)	44,394	(5,215)	2,749
<u>Non-interest expenses</u>			
Compensation & employee benefits	3,137	3,720	4,892
Occupancy	177	227	508
Professional and IT services	636	784	926
FDIC and regulatory fees	(66)	56	146
Other general & administrative	350	447	601
Total non-interest expenses	4,234	5,234	7,073
Earnings (loss) before income taxes	47,122	(290)	9,367
Income taxes	10,891	2,073	2,033
Net earnings (loss)	\$ 36,231	\$ (2,363)	\$ 7,334
Basic earnings (loss) per common share	\$ 3.52	\$ (0.23)	\$ 0.71
Dividends declared per common share	\$ 0.54	\$ 0.52	\$ 0.50
Weighted average common shares outstanding	10,284,139	10,284,139	10,284,139

* For periods prior to February 26, 2021, financial statements represent the consolidation of California First National Bancorp and subsidiaries, California First National Bank and California First Leasing.

The accompanying notes are an integral part of these financial statements.



STATEMENTS OF COMPREHENSIVE INCOME (LOSS) *
(in thousands)

	Years ended June 30,		
	2021	2020	2019
Net earnings (loss)	\$ 36,231	\$ (2,363)	\$ 7,334
Other comprehensive income (loss):			
Unrealized gains/(losses) on securities available-for-sale	-	35	206
Tax effect	-	(5)	(57)
Total other comprehensive income	-	30	149
Total comprehensive income (loss)	<u>\$ 36,231</u>	<u>\$ (2,333)</u>	<u>\$ 7,483</u>

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

	Common Shares	Stock Amount	Additional Paid in Capital	Retained Earnings	Accumulated Comprehensive Income (Loss)	Total
Balance, June 30, 2018	10,284,139	\$ 103	\$ 2,314	201,210	\$ 1,336	\$ 204,963
Net earnings	-	-	-	7,334		7,334
Other comprehensive income	-	-	-	-	149	149
Adoption of new accounting standard (1)	-	-	-	1,515	(1,515)	-
Dividends paid	-	-	-	(5,142)	-	(5,142)
Balance, June 30, 2019	<u>10,284,139</u>	<u>103</u>	<u>2,314</u>	<u>204,917</u>	<u>(30)</u>	<u>207,304</u>
Net loss	-	-	-	(2,363)	-	(2,363)
Other comprehensive income	-	-	-	-	30	30
Dividends paid	-	-	-	(5,348)	-	(5,348)
Balance, June 30, 2020	<u>10,284,139</u>	<u>103</u>	<u>2,314</u>	<u>197,206</u>	<u>-</u>	<u>199,623</u>
Net earnings	-	-	-	36,231	-	36,231
Dividends paid	-	-	-	(5,554)	-	(5,554)
Balance, June 30, 2021	<u>10,284,139</u>	<u>\$ 103</u>	<u>\$ 2,314</u>	<u>\$ 227,883</u>	<u>\$ -</u>	<u>\$ 230,300</u>

(1) Represents the impact of Accounting Standards Update ("ASU") 2016-01, net of taxes.

* For periods prior to February 26, 2021, financial statements represent the consolidation of California First National Bancorp and subsidiaries, California First National Bank and California First Leasing.

The accompanying notes are an integral part of these financial statements.



STATEMENTS OF CASH FLOWS *
(in thousands)

	Years Ended June 30,		
	2021	2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net earnings (loss)	\$ 36,231	\$ (2,363)	\$ 7,334
Adjustments to reconcile net earnings to cash flows provided by (used for) operating activities:			
Release of reserves for credit losses	(298)	(582)	(1,100)
Depreciation and net amortization	111	489	379
Gain on sale of loans held for sale	-	(19)	(94)
Proceeds from sales of loans held for sale	-	14,605	50,030
Gain on sale of leased property and sales-type lease income	(2,215)	(635)	(364)
(Gain) loss on equity securities, net	(38,770)	9,892	607
Gain on sale of bank subsidiary	(2,343)	-	-
Deferred income taxes, including income taxes payable	6,104	(528)	(2,066)
(Increase) decrease in income taxes receivable	(2,481)	(120)	2,404
Net (decrease) increase in accounts payable and accrued liabilities	(852)	848	(362)
Other, net	69	875	(274)
Net cash (used for) provided by operating activities	<u>(4,444)</u>	<u>22,462</u>	<u>56,494</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Investment in leases, loans and transactions in process	(30,891)	(70,491)	(49,772)
Payments received on lease receivables and loans	38,688	69,777	93,226
Proceeds from sales of leased property and sales-type leases	2,769	1,104	2,393
Proceeds from sales and assignments of leases	4,725	57,298	16,261
Net decrease (increase) in Fed funds sold	660	1,717	(2,757)
Purchase of equity securities	(115,413)	(21,344)	(38,208)
Proceeds from sale of equity securities	45,396	36,057	548
Pay down on or sales of fixed-income securities	-	24,000	13,000
Pay down on investments	452	631	821
Proceeds from sale of bank subsidiary	4,523	-	-
Net (increase) decrease in other assets	(142)	(691)	358
Net cash (used for) provided by investing activities	<u>(49,233)</u>	<u>98,058</u>	<u>35,870</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net decrease in time certificates of deposit	(22,259)	(24,298)	(58,945)
Net decrease in demand and savings deposits	(34,548)	(6,640)	(22,735)
Dividends to stockholders	(5,554)	(5,348)	(5,142)
Net cash used for financing activities	<u>(62,361)</u>	<u>(36,286)</u>	<u>(86,822)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	<u>(116,038)</u>	<u>84,234</u>	<u>5,542</u>
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	<u>153,083</u>	<u>68,849</u>	<u>63,307</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 37,045</u>	<u>\$ 153,083</u>	<u>\$ 68,849</u>

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

(Decrease) increase in lease rentals assigned to lenders and related non-recourse debt	\$ (713)	\$ (714)	\$ (713)
Estimated residual values recorded on leases	\$ (716)	\$ (229)	\$ (216)
Interest paid on deposits and borrowed funds	\$ 43	\$ 395	\$ 1,638
Income taxes paid	\$ 7,267	\$ 2,720	\$ 1,696
Transfers from loans held for investment to loans held-for-sale	\$ -	\$ 14,599	\$ 50,220
Addition to ROU assets from new operating lease liabilities	\$ 336	\$ -	\$ -
Remaining bank equity capital at sale closing	\$ 12,524	\$ -	\$ -

* For periods prior to February 26, 2021, financial statements represent the consolidation of California First National Bancorp and subsidiaries, California First National Bank and California First Leasing.

The accompanying notes are an integral part of these financial statements.

**NOTES TO FINANCIAL STATEMENTS****Note 1 – Summary of Significant Accounting Policies:****Nature of Operations**

Effective February 26, 2021, California First National Bancorp, a California corporation ("Bancorp") completed the sale of the stock in California First National Bank ("Bank") while retaining all leases and loans. Following the sale, a bank holding company structure was no longer required and Bancorp merged its wholly-owned subsidiary, California First Leasing Corporation, into Bancorp and changed its name to California First Leasing Corporation ("CalFirstLease" or the "Company"). For periods prior to February 26, 2021, financial statements represent the consolidation of Bancorp with Bank and California First Leasing.

The Company leases and finances capital assets from one central location to businesses and other commercial or non-profit organizations throughout the United States, while its UniversityLease business focuses on the needs of colleges and universities. The credit portfolio is diversified geographically and across industries. The Company also actively invests retained earnings in equity securities.

Basis of Presentation

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Critical accounting estimates particularly susceptible to change include the allowance for credit losses, residual values and taxes. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash in demand deposit accounts in banks and money market accounts, all of which have initial maturities of less than ninety days. The Company had cash in interest-bearing accounts of \$36.6 million and \$153.2 million at June 30, 2021 and 2020, respectively, with \$36.5 million at June 30, 2021 not subject to FDIC insurance.

Equity Securities

The Company carries all of the investments in equity securities at fair value and records the subsequent changes in fair values in the Statement of Operations as a component of equity securities gains and losses.

Leases-**Capital Leases**

New lease transactions are generally structured as direct financing leases that are non-cancelable "net" leases, contain "hell-or-high-water" provisions under which the lessee must make all lease payments regardless of any defects in the property, and which require the lessee to maintain, service and insure the property against casualty loss and pay all property, sales and other taxes. The re-lease of property that has come off lease may be accounted for as a sales-type lease or as an operating lease, depending on the terms of the re-lease. Leased property that comes off lease and is re-marketed through a sale to the lessee or a third party is accounted for as sale of leased property.

For leases that qualify as direct financing leases, the aggregate lease payments receivable and estimated residual value, if any, are recorded net of unearned income as net investment in leases. The unearned income is recognized as direct finance income on an internal rate of return method calculated to achieve a level yield on the Company's investment over the lease term. There are no costs or expenses related to direct financing leases since lease income is recorded on a net basis.

For leases that qualify as sales-type leases, the Company recognizes profit or loss at lease inception to the extent the fair value of the property leased differs from the Company's carrying value. The difference between the discounted value of the aggregate lease payments receivable and the property cost, less the discounted value of the residual, if any, and any initial direct costs is recorded as sales-type lease income. For balance sheet purposes, the aggregate lease payments receivable and estimated residual value, if any, are recorded net of unearned income as net investment in leases. Unearned income is recognized as direct finance income over the lease term on an internal rate of return method.



The residual value is an estimate for accounting purposes of the fair value of the lease property at lease termination. The estimates are reviewed periodically to ensure reasonableness, however, the amounts the Company may ultimately realize could differ from the estimated amounts.

In some instances, the Company assigns on a nonrecourse basis or participates out the lease payments receivable related to direct financing leases to unaffiliated financial institutions at fixed interest rates. The accounting for the participation or sale of lease receivables is governed by Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 860 Transfer and Servicing, which establishes a framework for determining which transactions should be treated as a sale of the financial asset by the Company or a secured borrowing through retention of the lease as an asset and reporting of non-recourse debt. For lease receivables accounted for as a sale, the Company derecognizes the lease receivable and the unearned income related to the lease is recognized as a gain from the sale of lease receivable in the period in which the lease receivable has been sold. For lease receivables accounted for as a secured borrowing, the minimum lease payments receivable is re-categorized on the balance sheet as discounted lease rentals assigned to lenders. The related obligations resulting from the discounting of the leases are recorded as non-recourse debt. The unearned income related to the lease is reduced by the interest expense from the non-recourse debt. In the event of default by a lessee, the participant or lender has a first lien against the underlying leased property with no further recourse against the Company. If this occurs, the Company may not realize its residual investment in the leased property.

Upon adoption of *ASU 2016-02, Leases* on July 1, 2019, incremental direct costs directly related to lease origination activity, previously eligible for capitalization, are now expensed. Prior to such adoption, a portion of the Company's non-interest expenses that would not have been incurred had the lease not been executed were deferred through a reduction to non-interest expense recognized in the period, with the deferred costs amortized over the lease term as a reduction to direct finance income utilizing the effective interest method. *ASU 2016-02, Leases* has a narrower definition of initial direct costs that may be capitalized and limits the types of direct lease origination costs that are able to be deferred.

Operating Leases

Lease contracts which do not meet the criteria of capital leases are accounted for as operating leases. Property on operating leases is recorded at the lower of cost or fair value and depreciated on a straight-line basis over the lease term to the estimated residual value at the termination of the lease. Most operating leases involve the re-lease of off-lease property for terms of less than 12 months, and the associated cost is the Company's estimated residual. Rental income is recorded on a straight-line basis over the lease term.

Loans

Loans are reported at their principal amount outstanding, net of unearned discounts and unamortized nonrefundable fees and direct costs associated with their origination or acquisition. Interest earned on loans without discounts is credited to income based on loan principal amounts outstanding at appropriate interest rates. Material origination and other nonrefundable fees net of direct costs and discounts on loans are credited to income over the terms of the loans using a method that approximates an effective yield.

Loans held-for-sale are carried at the lower of cost or fair value as determined by quoted prices, and are reported as level 2 inputs. Any amount by which cost exceeds fair value is accounted for as a charge against the allowance for credit losses when transferred to held-for-sale and subsequently reflected in the gain or loss when sold.

Allowance for Credit Losses

The allowance for credit losses is an estimate based on management's judgment applying the principles of ASC Topic 450, "Contingencies," and ASC Topic 310-35, "Loan Impairment." The determination of the adequacy of the allowance is based on an assessment of the inherent loss potential in the lease and loan portfolios given the conditions at the time and are continuously reviewed for adequacy considering levels of past due payments and non-performing assets, customers' financial condition, leased property values as well as general economic conditions and credit quality indicators. The need for reserves is subject to future events, which by their nature are uncertain. Therefore, changes in economic conditions or other events may necessitate additions or deductions to the allowance for credit losses or the residual valuation allowance. The allowance is maintained at a level believed to be adequate to absorb probable losses inherent in the portfolios.

The allowance for credit losses includes specific and general reserves. Specific reserves relate to leases and loans that are individually classified as problems or impaired. Leases are individually evaluated for impairment under ASC Topic 450, while loans are evaluated under ASC 310-35, which does not apply to leases. A lease or loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect amounts due according to the contractual terms. Factors considered in determining impairment include payment status, collateral value and the probability of collecting all amounts when due. The net book value of each non-performing or problem lease is evaluated to determine whether the carrying value is less than or equal to the expected recovery



anticipated to be derived from lease payments, additional collateral or residual realization. Measurement of impairment of a loan is based on expected future cash flows of the impaired loan, which are to be discounted at the loan's effective interest rate, or measured by reference to an observable market value, if one exists, or the fair value of the collateral for a collateral-dependent loan. The Company selects the measurement method on a loan-by-loan basis. The amount estimated as unrecoverable is recognized as a reserve individually identified for the lease or impaired loan.

General reserves are an estimate of probable or inherent losses related to the remaining portfolio. An ongoing review of all leases and loans is conducted, considering recent loss experience, known and inherent risks in the portfolio, levels of delinquencies, adverse situations that may affect customers' ability to repay, trends in volume and other factors, including regulatory guidance and current and anticipated economic conditions. This portfolio analysis includes a stratification of the portfolio by the risk classifications and segments and estimation of potential losses based on risk classification or segment. The composition of the portfolio based on risk ratings is monitored, and changes in the overall risk profile of the portfolio are also factored into the evaluation of inherent risks. Based on the foregoing, an estimated inherent loss not based directly on specific problem assets is recorded as a collective allowance. Lease receivables and loans are charged off when they are deemed completely uncollectible. Subsequent recoveries, if any, are credited to the allowance.

Property Acquired for Transactions-in-process

Property acquired for transactions-in-process represents partial deliveries of property which the lessee has accepted on in-process lease transactions. Such amounts are stated at cost, net of any lessee payments related to the property. Income is not recognized while a transaction is in process and prior to the commencement of the lease. At lease commencement, any pre-commencement payments are included in minimum lease payments receivable and the unearned income is recognized as direct finance income over the lease term.

Income Taxes

Income tax expense is the total of the current year income tax due and the change in deferred tax assets and liabilities. The Company accounts for income taxes using the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. A valuation allowance is established if it is "more likely than not" that all or a portion of the deferred tax asset will not be realized. The tax effects of an uncertain tax position can be recognized in the financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by the taxing authorities.

Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) consists of unrealized gains and losses on available-for-sale securities.

Earnings Per Share

Basic net income per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding. The Company has had no stock options outstanding since December 2017.

Recent Accounting Pronouncements

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. The Company continues to evaluate the extent of the potential impact of ASU 2016-13 on its financial statements.

Subsequent events

The Company has evaluated subsequent events for recognition and disclosure through September 21, 2021, which is the date the financial statements were available to be issued.

Reclassifications

Certain reclassifications have been made to the fiscal 2020 financial statements to conform to the presentation of the fiscal 2021 financial statements.

**Note 2 – Sale of Bank**

On February 26, 2021, Bancorp completed the sale of the stock of California First National Bank to DMG Bancshares, Inc. (“DMG”). Pursuant to the terms of the sale agreement, 1) DMG paid a purchase price equal to the Bank’s equity capital (\$12.6 million on February 26, 2021) plus \$2.5 million, and 2) the leasing business and lease portfolio of Bank were transferred to CalFirstLease. The Company also retained certain assets and liabilities related to the lease business. The Company recognized a gain of \$2.34 million on the sale of the stock of the Bank to DMG.

Prior to completing the sale of the Bank, in January 2021 the Bank distributed its lease portfolio as a dividend recorded as a reduction in the Company’s investment in the Bank based on the net value of the investment in leases of \$47.3 million. In accordance with Internal Revenue Code (IRC) Section 311, the difference in the fair value relative to the tax basis is recognized by the Company as an ordinary gain for tax purposes. On a prospective basis, CalFirstLease receives a step-up in tax-basis that will be amortized as a reduction to future taxable income over five years or the remaining life of each lease. The fair value attributed to the leases transferred was based on assumptions and other information compiled by management that utilized established valuation techniques. The taxable gain was estimated to be **\$15.0 million** and increased taxes due in fiscal 2021 by \$4.2 million.

Management determined that the sale of the Bank did not meet the criteria to be classified as discontinued operations. The following table summarizes the effects of the sale of the Bank on the consolidated Balance Sheet at February 26, 2021:

Assets	Bancorp	Eliminating Entries	CalFirst Leasing
Cash and due from banks	\$ 126,642	\$ (44,310)	\$ 82,332
Investment securities	1,650	(1,650)	-
Equity investments	102,423	-	102,423
Lease transactions in process	643	-	643
Net Investment in Leases	43,673	-	43,673
Commercial loans	3,698	-	3,698
Other assets	2,961	(73)	2,888
Total Assets	\$ 281,690	\$ (46,033)	\$ 235,658
Liabilities			
Demand and time deposits	\$ 48,521	\$ (48,521)	\$ -
Deferred taxes	8,786	715	9,501
Non-recourse debt	1,466	-	1,466
Other liabilities	2,369	(12)	2,358
Total Liabilities	\$ 61,143	\$ (47,818)	\$ 13,325
Total Stockholders' Equity	220,548	1,785	222,333
Total Liabilities & Stockholders	\$ 281,690	\$ (46,033)	\$ 235,658

Note 3 – Investments

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

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

Note 4 – Equity Securities:

Investments in equity securities as of June 30, 2021 and 2020 consist of holdings of public companies with readily available market values and are carried at fair value. Gains and losses arising from changes in the fair values of equity securities based on stock prices on the last day of the fiscal period are recorded as part of non-interest income.



The Company's equity portfolio based on the primary industry sector is summarized in the table below.

(in thousands)

	Cost Basis	Unrealized		FMV
		Gains	(Losses)	
as of June 30, 2021				
Commercial / Industrial	\$ 53,950	\$ 15,661	\$ (435)	\$ 69,176
Consumer	39,576	3,038	(16)	42,598
Financial	10,966	4,552	-	15,518
Healthcare	26,888	5,945	-	32,833
	<u>\$ 131,380</u>	<u>\$ 29,196</u>	<u>\$ (451)</u>	<u>\$ 160,125</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
Total equity securities	<u>\$ 59,255</u>	<u>\$ 2,852</u>	<u>\$ (10,768)</u>	<u>\$ 51,339</u>

Note 5 – Leases:

The Company's lease income consists of the following:

	June 30,	
	2021	2020
	(in thousands)	
Rental income on operating leases	\$ 622	\$ 1,910
Interest income - sales type and direct financing leases	3,737	6,215
Total lease income	<u>\$ 4,359</u>	<u>\$ 8,125</u>

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

	June 30,	
	2021	2020
	(in thousands)	
Minimum lease payments receivable	\$ 36,417	\$ 50,568
Estimated residual value	2,798	2,453
Less unearned income	(3,178)	(3,748)
Net investment in leases before allowances	36,037	49,273
Less allowance for lease losses	(575)	(832)
Less valuation allowance for estimated residual value	(10)	(25)
Net investment in leases	<u>\$ 35,452</u>	<u>\$ 48,416</u>

The minimum lease payments receivable and estimated residual value are discounted using the internal rate of return method related to each specific lease.

At June 30, 2021, a summary of the installments due on minimum lease payments receivable, and the expected maturity of the Company's estimated residual value are as follows:

Years ending June 30,	Lease Receivable	Estimated Residual Value (in thousands)	Total
2022	\$ 20,070	\$ 755	\$ 20,825
2023	10,169	873	11,042
2024	4,049	1,108	5,157
2025	1,663	62	1,725
2026	466	-	466
	<u>36,417</u>	<u>2,798</u>	<u>39,215</u>
Less unearned income	(2,834)	(344)	(3,178)
Less allowances	(575)	(10)	(585)
	<u>\$ 33,008</u>	<u>\$ 2,444</u>	<u>\$ 35,452</u>

Contractual rental obligations on operating leases due after June 30, 2021 extend for only 90 days from such date and aggregate to \$81,000.



Non-recourse debt, which relates to the discounting of lease receivables, bears interest at rates from 4.68% to 4.70%. Maturities of such obligations at June 30, 2021 are as follows:

Years ending June 30,	Non-recourse Debt
	(in thousands)
2022	\$ 673
2023	493
Total non-recourse debt	1,166
Deferred interest expense	62
Discounted lease rentals assigned to lenders	<u>\$ 1,228</u>

Deferred interest expense of \$62,000 at June 30, 2021 will be amortized against direct finance income related to the Company's discounted lease rentals assigned to lenders of \$1.2 million using the effective yield method over the applicable lease term.

Note 6 – Commercial Loans:

The Company's investment in commercial loans consists of the following:

	June 30,	
(in thousands)	2021	2020
Commercial real estate loans	\$ 3,332	\$ 3,607
Commercial term loan participations	323	-
Total commercial loans	3,655	3,607
Less unearned income and discounts	(42)	-
Less allowance for loan losses	(35)	(61)
Net commercial loans	<u>\$ 3,578</u>	<u>\$ 3,546</u>

Note 7 – Allowance for Credit Losses:

The allowance for credit losses includes amounts to cover losses related to the net investment in leases, commercial loans, and transactions-in-process. A summary of the allocation of the allowance for credit losses and selected statistics is as follows:

	June 30,	
(dollars in thousands)	2021	2020
Allowance for credit losses at beginning of year	\$ 918	\$ 1,504
Charge-off of leases	-	(3)
Loans transferred to held-for-sale	-	(17)
Recovery of lease amounts previously written off	-	16
Provision (release) of reserves for credit losses	(298)	(582)
Allowance for credit losses at end of year	<u>\$ 620</u>	<u>\$ 918</u>
Allowance for credit losses as percent of net investment in leases and loans before allowances	<u>1.56%</u>	<u>1.74%</u>
Net recoveries (charge-offs) as percent of average leases and loans	<u>0.00%</u>	<u>(0.01)%</u>

Note 8 – Credit Quality of Financing Receivables:

The following tables provide information related to “financing receivables” as defined under Topic 310, Receivables. “Financing receivables” include direct finance and sales-type leases and all commercial loans, but does not include operating leases and transactions in process.

The portfolio is disaggregated into two segments of leases and loans and four classes: 1) commercial leases, 2) education, government and non-profit leases, 3) commercial and industrial loans and 4) commercial real estate loans. Relevant risk characteristics for establishing these portfolio classes generally include the nature of the borrower, structure of the transaction and collateral type. The Company's credit process includes a policy of classifying all leases and loans in accordance with a classification system consistent with regulatory models under which leases and loans may be rated as “pass”, “special mention”, “substandard”, or “doubtful”. These risk categories reflect an assessment of the ability of the borrowers to service their obligation based on current financial position, historical payment experience, and collateral adequacy, among other factors.



The Company uses the following definitions for risk ratings:

Pass – Includes credits of the highest quality as well as credits with positive primary repayment source but one or more characteristics that are of higher than average risk.

Special Mention – Have a potential weakness that if left uncorrected may result in deterioration of the repayment prospects for the lease or loan or of the Company's credit position at some future date.

Substandard – Are inadequately protected by the paying capacity of the obligor or of the collateral, if any. Substandard credits have a well-defined weakness that jeopardize the liquidation of the debt or indicate the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful – Based on current information and events, collection of all amounts due according to the contractual terms of the lease or loan agreement is considered highly questionable and improbable.

The risk classification of financing receivables by portfolio class is as follows:

(in thousands)	Commercial Leases	Education Government Non-profit Leases	Commercial & Industrial Loans	Commercial Real Estate Loans	Total Financing Receivable
<u>As of June 30, 2021:</u>					
Pass	\$ 19,250	\$ 15,152	\$ 281	\$ 3,332	\$ 38,015
Special Mention	230	-	-	-	230
Substandard	1,223	182	-	-	1,405
Doubtful	-	-	-	-	-
	<u>\$ 20,703</u>	<u>\$ 15,334</u>	<u>\$ 281</u>	<u>\$ 3,332</u>	<u>\$ 39,650</u>
Non-accrual	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
<u>As of June 30, 2020:</u>					
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>

The accrual of interest income on leases and loans will be discontinued when the customer becomes ninety days or more past due on its lease or loan payments with the Company, unless the Company believes the investment is otherwise recoverable. Leases and loans may be placed on non-accrual earlier if the Company has significant doubt about the ability of the customer to meet its lease or loan obligations, as evidenced by consistent delinquency, deterioration in the customer's financial condition or other relevant factors. Payments received while on non-accrual are applied to reduce the Company's recorded value.

The following table presents the aging of the financing receivables by portfolio class:

(in thousands)	31-89 Days	Greater Than 90 Days	Total Past Due	Current	Total Financing Receivable	Over 90 Days & Accruing
<u>As of June 30, 2021:</u>						
Commercial Leases	\$ -	\$ -	\$ -	\$ 20,703	\$ 20,703	\$ -
Education, Government, Non-profit Leases	-	-	-	15,334	15,334	-
Commercial and Industrial Loans	-	-	-	281	281	-
Commercial Real Estate Loans	-	-	-	3,332	3,332	-
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 39,650</u>	<u>\$ 39,650</u>	<u>\$ -</u>
<u>As of June 30, 2020:</u>						
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>



The following table presents the allowance balances and activity in the allowance related to financing receivables, along with the recorded investment and allowance determined based on impairment method as of June 30, 2021 and 2020:

(in thousands)	Commercial Leases	Education Government Non-profit Leases	Commercial & Industrial Loans	Commercial Real Estate Loans	Total Financing Receivable
<u>As of June 30, 2021:</u>					
Allowance for lease and loan losses					
Balance beginning of period	\$ 638	\$ 219	\$ -	\$ 61	\$ 918
Charge-offs	-	-	-	-	-
Transfer of loans to held-for-sale	-	-	-	-	-
Recoveries	-	-	-	-	-
Provision	(190)	(82)	5	(31)	(298)
Balance end of period	<u>\$ 448</u>	<u>\$ 137</u>	<u>\$ 5</u>	<u>\$ 30</u>	<u>\$ 620</u>
Individually evaluated for impairment	\$ 134	\$ 19	\$ -	\$ -	\$ 153
Collectively evaluated for impairment	314	118	5	30	467
Total ending allowance balance	<u>\$ 448</u>	<u>\$ 137</u>	<u>\$ 5</u>	<u>\$ 30</u>	<u>\$ 620</u>
Finance receivables					
Individually evaluated for impairment	\$ 1,453	\$ 182	\$ -	\$ -	\$ 1,635
Collectively evaluated for impairment	19,250	15,152	281	3,332	38,015
Total ending finance receivable balance	<u>\$ 20,703</u>	<u>\$ 15,334</u>	<u>\$ 281</u>	<u>\$ 3,332</u>	<u>\$ 39,650</u>
<u>As of June 30, 2020:</u>					
Allowance for lease and loan losses					
Balance beginning of period	\$ 872	\$ 242	\$ 329	\$ 61	\$ 1,504
Charge-offs	-	(3)	-	-	(3)
Transfer of loans to held-for-sale	-	-	(17)	-	(17)
Recoveries	16	-	-	-	16
Provision	(250)	(20)	(312)	-	(582)
Balance end of period	<u>\$ 638</u>	<u>\$ 219</u>	<u>\$ -</u>	<u>\$ 61</u>	<u>\$ 918</u>
Individually evaluated for impairment	\$ 133	\$ 92	\$ -	\$ -	\$ 225
Collectively evaluated for impairment	505	127	-	61	693
Total ending allowance balance	<u>\$ 638</u>	<u>\$ 219</u>	<u>\$ -</u>	<u>\$ 61</u>	<u>\$ 918</u>
Finance receivables					
Individually evaluated for impairment	\$ 3,331	\$ 2,075	\$ -	\$ -	\$ 5,406
Collectively evaluated for impairment	27,019	16,848	-	3,607	47,474
Total ending finance receivable balance	<u>\$ 30,350</u>	<u>\$ 18,923</u>	<u>\$ -</u>	<u>\$ 3,607</u>	<u>\$ 52,880</u>

Note 9 – Office Lease Obligations

The Company accounts for its leases in accordance with ASC 842 which was implemented on July 1, 2019 and requires the Company to recognize lease arrangements as right-of-use ("ROU") assets and operating lease liabilities based on the present value of lease payments over the lease terms discounted at the Company's incremental borrowing rate. Lease expense is recognized on a straight-line basis over the lease term, with lease and non-lease components as a single lease component.

During fiscal 2021, the Company entered into an operating lease with an unrelated party for its current 4,098 square foot corporate office in Newport Beach that commenced February 1, 2021 for a term of 40 months ending in July 2024. In conjunction with the sale of the Bank in February 2021, the Company sublet its prior office space to DMG who is fully obligated for all remaining lease obligations through August 2022. The new lease for current space was recorded as a ROU asset of \$335,800 and a related lease liability of \$540,800 based on discount rate of 2.82%. The sublet is recorded using the net presentation approach to offset rental expense with the rental income received. As of June 30, 2021, ROU assets of \$509,900 and related lease liabilities of \$701,300 are recorded on the balance sheet as part of other assets and accrued liabilities, respectively.



The future undiscounted lease payments due are as follows:

Year ending June 30,	(in thousands)
2022	\$ 352
2023	195
2024	168
2025	14
	<u>729</u>
Less: Imputed interest	<u>(28)</u>
Present value of future minimum payments	<u>\$ 701</u>

Rent expense was \$177,400 (2021) and \$227,400 (2020) and rental income in 2021 was \$62,300.

Note 10 – Deposits:

All deposit accounts and balances at June 30, 2020 were held at the Bank and were transferred to the buyer of the stock of the Bank as of February 26, 2021. The composition of deposits at June 30, 2020 was as follows:

	June 30, 2020	
	(dollars in thousands)	
Non-interest bearing deposits		
Demand deposits	\$ 1,188	2.1%
Interest-bearing deposits		
Demand	9,197	16.2%
Savings and money market	24,163	42.5%
Time certificates of deposits	22,259	39.2%
Total Deposits	<u>\$ 56,807</u>	<u>100.0%</u>

Note 11 – Fair Value Measurement:

ASC Topic 820: "Fair Value Measurements and Disclosures" defines fair value as the price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. ASC Topic 820 establishes a three-tiered value hierarchy that prioritizes inputs based on the extent to which inputs used are observable in the market and requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs. If a value is based on inputs that fall in different levels of the hierarchy, the instrument will be categorized based upon the lowest level of input that is significant to the fair value calculation. The three levels of inputs are defined as follows:

- Level 1 - Valuation is based upon unadjusted quoted prices for identical instruments traded in active markets;
- Level 2 - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market;
- Level 3 - Valuation is generated from model-based techniques that use inputs not observable in the market and based on the entity's own judgment. Level 3 valuation techniques could include the use of option pricing models, discounted cash flow models and similar techniques, and rely on assumptions that market participants would use in pricing the asset or liability.

ASC 820 applies whenever other accounting pronouncements require presentation of fair value measurements, but does not change existing guidance as to whether or not an instrument is carried at fair value. As such, ASC 820 does not apply to the Company's investment in leases. The Company's financial assets measured at fair value on a recurring basis are primarily equity securities and mutual fund investments and at June 30, 2021 there were no liabilities subject to ASC 820.

The Company classifies financial assets and liabilities within the fair value hierarchy based on the availability of observable market information. Equity and the mutual fund investment generally are reported at fair value utilizing Level 1 inputs by reference to the market closing or last trade price. In the unlikely event that no trade occurred on the applicable date, an indicative bid or the last trade most proximate to the applicable date would be used (Level 2 input). Changes in markets, economic conditions or the Company valuation model may require the transfer of financial instruments from one level to another. Such transfer, if any, would be recorded at the fair value as of the beginning of the period in which the transfer occurred. The Company has had no transfers in fiscal 2021 and 2020.



The following table summarizes the Company's assets, which are measured at fair value on a recurring basis as of June 30, 2021 and 2020:

Description of Assets	Total Fair Value	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)				
As of June 30, 2021				
Equity securities	\$ 155,939	\$ 155,939	\$ -	\$ -
Investment funds	4,186	4,186	-	-
	<u>\$ 160,125</u>	<u>160,125</u>	<u>\$ -</u>	<u>\$ -</u>
As of June 30, 2020				
Equity securities	\$ 50,034	\$ 50,034	\$ -	\$ -
Investment fund	1,305	1,305	-	-
	<u>\$ 51,339</u>	<u>\$ 51,339</u>	<u>\$ -</u>	<u>\$ -</u>

Certain financial assets, such as collateral dependent impaired loans or returned assets are measured at fair value on a nonrecurring basis; that is, the assets are not measured at fair value on an ongoing basis but are subject to fair value adjustments only in certain circumstances.

Note 12 – Fair Value of Financial Instruments:

In accordance with ASC 825-50, the following table summarizes the estimated fair value of financial instruments as of June 30, 2021 and June 30, 2020, and includes financial instruments that are not accounted for or carried at fair value. Certain financial instruments, including all lease related assets and liabilities and all non-financial instruments are excluded from fair value disclosure requirements. These fair value estimates are based on relevant market information and data, however, given there are no active market or observable market transactions for certain financial instruments, the Company has made estimates of fair values which are subjective in nature, involve uncertainties and matters of significant judgment and cannot be determined with precision. Changes in assumptions could significantly affect the estimated values.

For cash and cash equivalents and demand and savings deposits, because of their short-term nature, the carrying amounts approximate the fair value and are classified as Level 1 in the fair value hierarchy. Values for equity and investment funds are determined as set forth in Note 4 and 11. For loans, the estimated fair value is calculated based on discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality and are classified as Level 3 in the fair value hierarchy. Loan fair values are based on an exit value and have been adjusted for credit risk. The fair value of certificates of deposit were estimated based on discounted cash flows using market rates or interest rates for deposits of similar maturity and are classified as Level 3 in the fair value hierarchy.

The estimated fair values of financial instruments were as follows:

	June 30, 2021		June 30, 2020	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
(in thousands)				
Financial Assets:				
Cash and cash equivalents	\$ 37,045	\$ 37,045	\$ 154,123	\$ 154,123
Equity securities and investment funds	160,125	160,125	51,339	51,339
Investments	-	-	2,102	2,113
Commercial loans	3,578	3,675	3,546	3,722
Financial Liabilities:				
Demand and savings deposits	-	-	34,548	34,548
Time certificate of deposits	\$ -	\$ -	\$ 22,259	\$ 22,275

Note 13 – Income Taxes:

The Company accounts for its income taxes under ASC 740, "Income Taxes." Among other provisions, this standard requires deferred tax balances to be determined using the enacted income tax rate for the years in which taxes will be paid or refunds received. The Company is subject to U.S. Federal income tax as well as multiple state and local jurisdictions as a result of doing business in most states.



The provision for income taxes is summarized as follows:

	June 30,		
	2021	2020	2019
	(in thousands)		
Current tax (benefit) expense:			
Federal	\$ 3,805	\$ 2,072	\$ 2,656
State	1,172	968	1,080
	<u>4,977</u>	<u>3,040</u>	<u>3,736</u>
Deferred tax (benefit) expense:			
Federal	5,926	(2,130)	(1,190)
State	2,140	(989)	(513)
Tax valuation allowance	(2,152)	2,152	-
	<u>2,173</u>	<u>(967)</u>	<u>(1,703)</u>
Total income tax provision	<u>\$ 10,891</u>	<u>\$ 2,073</u>	<u>\$ 2,033</u>

At June 30, 2021 and 2020, income taxes receivable balances were \$2,857,000 and \$376,000 respectively.

Deferred taxes result principally from the method of recording lease income on capital leases and depreciation methods for tax reporting, which differ from financial statement reporting, and the inclusion of unrealized gains and losses on securities in operating income that are not currently taxable or deductible. Deferred income tax liabilities (assets) are comprised of the following:

	June 30,	
	2021	2020
	(in thousands)	
Deferred income tax liabilities:		
Tax operating leases	\$ 5,107	\$ 3,721
Deferred selling expenses	-	41
Depreciation	-	180
Equity securities	8,015	-
Total liabilities	<u>13,122</u>	<u>3,942</u>
Deferred income tax assets:		
Depreciation	(3,362)	-
Other investments	-	(2,410)
Allowances and reserves	(230)	(291)
State income taxes	(221)	(188)
Total assets	<u>(3,813)</u>	<u>(2,889)</u>
Tax valuation allowance	-	2,152
Net deferred income tax liabilities	<u>\$ 9,309</u>	<u>\$ 3,205</u>

The tax valuation allowance of \$2.15 million as of June 30, 2020 offset tax benefits estimated on unrealized losses on equity securities as future appreciation of the equity portfolio required to realize future capital gains and the tax benefit could not be assured.

The differences between the federal statutory income tax rate and the Company's effective tax rate are as follows:

	Years Ended June 30,		
	2021	2020	2019
Federal statutory rate	21.00%	21.00%	21.00%
State tax, net of Federal benefit	7.31	7.05	7.20
Incremental adjustments due to Tax Act	-	-	(5.49)
Dividends received deduction	(0.60)	88.88	(1.72)
Other adjustments and tax exempt leases	(0.03)	(89.74)	0.72
Tax valuation allowance	(4.57)	(742.07)	-
Effective rate	<u>23.11%</u>	<u>(714.88)%</u>	<u>21.71%</u>

At June 30, 2021, the liability for uncertain tax positions and unrecognized tax benefits of \$311,000 reflects additional state tax liability relating to apportionment fluctuations, all of which, if recognized would affect the effective tax rate. The amount of unrecognized tax benefits may increase or decrease in the future for various reasons, including additions related to current year provisions, the expiration of the statute of limitation for open tax years, the status of examinations and changes in management judgment. The Company's policy is to include interest and penalties



related to unrecognized tax benefits in income tax expense. As of June 30, 2021, accrued penalties and interest on unrecognized tax benefits are estimated to be \$55,000.

The following table sets forth the change in unrecognized tax benefits:

	Years ended June 30,	
	2021	2020
	(in thousands)	
Balance, beginning of period	\$ 311	\$ 311
Increase for tax positions in current year	38	43
Decrease for tax positions taken in prior years	(36)	(44)
(Decrease) Increase for interest and penalties	(2)	1
Balance, end of period	<u>\$ 311</u>	<u>\$ 311</u>

The Company's Federal tax returns remain subject to examination from 2018 forward, while state income tax returns are generally open from 2017 forward, and vary by individual state statute of limitation. The Company believes that its accrual for income taxes is adequate for adjustments, if any, which may result from these examinations.

At June 30, 2021, there were no material changes to the liability for uncertain tax positions and unrecognized tax benefits. The amount of unrecognized tax benefits may increase or decrease in the future for various reasons; including additions related to current year tax provisions, the expiration of the statute of limitations on open tax years, the status of examinations and changes in management judgment.

Note 14 – Capital Structure and Stock-based Compensation:

At June 30, 2021, the Company has 20,000,000 authorized shares of common stock and is authorized to issue 2,500,000 shares of preferred stock in one or more series, fix the voting powers, designations, preferences and the relative participation, optional or other rights, if any, of any wholly unissued series of preferred stock.

In November 1995, the Company's stockholders approved the 1995 Equity Participation Plan (the "1995 Plan"). The 1995 Plan provides for the granting of options, restricted stock and stock appreciation rights ("SARs") to key employees, directors and consultants of the Company. Under the 1995 Plan, the maximum number of shares of common stock that can be issued increases by an amount equal to 1% of the total number of issued and outstanding shares of common stock as of June 30 of each fiscal year. Shares available for issuance for the years ending June 30, 2021 and 2020 are 2,739,672 and 2,636,831, respectively.

There have been no option grants awarded since fiscal 2013, and at June 30, 2021 there were no options outstanding or exercisable and no stock-based compensation expense was recognized in the year ended June 30, 2021.

Note 15 – Regulatory Capital:

On February 26, 2021, Bancorp sold the stock owned in the Bank to DMG. Bancorp's capital investment in the Bank of \$57.4 million at June 30, 2020 was recovered through 1) a distribution received on January 1, 2021 consisting of 100% of the Bank's lease portfolio valued at \$47.3 million; and 2) a \$15.2 million payment on February 26 from DMG to purchase the capital stock.

During the year ended June 30, 2020, the Bank paid total dividends of \$15.0 million to Bancorp that were in excess of net retained earnings and represented a return of capital. The following table presents capital and capital ratio information for the Bank as of June 30, 2020. The Bank exceeded regulatory capital requirements and was considered "well-capitalized" under guidelines established by federal regulators.

	Actual	
	Amount	Ratio
June 30, 2020	(dollars in thousands)	
<u>California First National Bank</u>		
Common equity Tier 1 capital	\$ 57,388	90.72%
Tier 1 risk-based capital	\$ 57,388	90.72%
Total risk-based capital	\$ 58,180	91.97%
Tier 1 leverage capital	\$ 57,388	48.13%

**Note 16 – Commitments and Contingencies:**

The Company has commitments to extend credit provided there is no violation of any condition in the terms of the approval or agreement. At June 30, 2021 and 2020, the Company had unfunded lease commitments of \$3.6 million and \$16.5 million, respectively.

Litigation

From time to time, the Company is party to legal actions and administrative proceedings and subject to various claims arising out of the Company's normal business activities. Management does not expect the outcome of any of these matters, individually and in the aggregate, to have a material adverse effect on the financial condition and results of operations of the Company.

401(k) Plan

Employees of the Company may participate in a voluntary defined contribution plan (the "401K Plan") qualified under Section 401(k) of the Internal Revenue Code of 1986. Under the 401K Plan, employees who have met certain age and service requirements may contribute up to a certain percentage of their compensation. The Company has made contributions of \$22,800 (2021) and \$38,700 (2020).

Note 17 – Selected Quarterly Financial Data (Unaudited):

Summarized quarterly financial data for the fiscal years ended June 30, 2021 and 2020 is as follows:

	Three Months Ended			
	September 30,	December 31,	March 31,	June 30,
	(dollars in thousands, except per share amounts)			
2021				
Total interest and dividend income	\$ 1,366	\$ 1,729	\$ 1,958	\$ 1,650
Net interest income after provision for credit losses	1,245	1,867	2,075	1,775
Non-interest income	1,906	17,183	17,808	7,497
Net earnings (loss)	\$ 1,438	\$ 15,091	\$ 13,389	\$ 6,313
Basic earnings (loss) per common share	\$ 0.14	\$ 1.47	\$ 1.30	\$ 0.61
Dividends declared per common share	\$ -	\$ 0.54	\$ -	\$ -
2020				
Total interest and dividend income	\$ 2,968	\$ 2,677	\$ 2,596	\$ 1,710
Net interest income after provision for credit losses	2,798	2,968	2,382	2,011
Non-interest income	2,760	9,965	(31,563)	13,624
Net earnings (loss)	\$ 2,981	\$ 8,479	\$ (27,556)	\$ 13,734
Basic earnings (loss) per common share	\$ 0.29	\$ 0.82	\$ (2.68)	\$ 1.34
Dividends declared per common share	\$ -	\$ 0.52	\$ -	\$ -