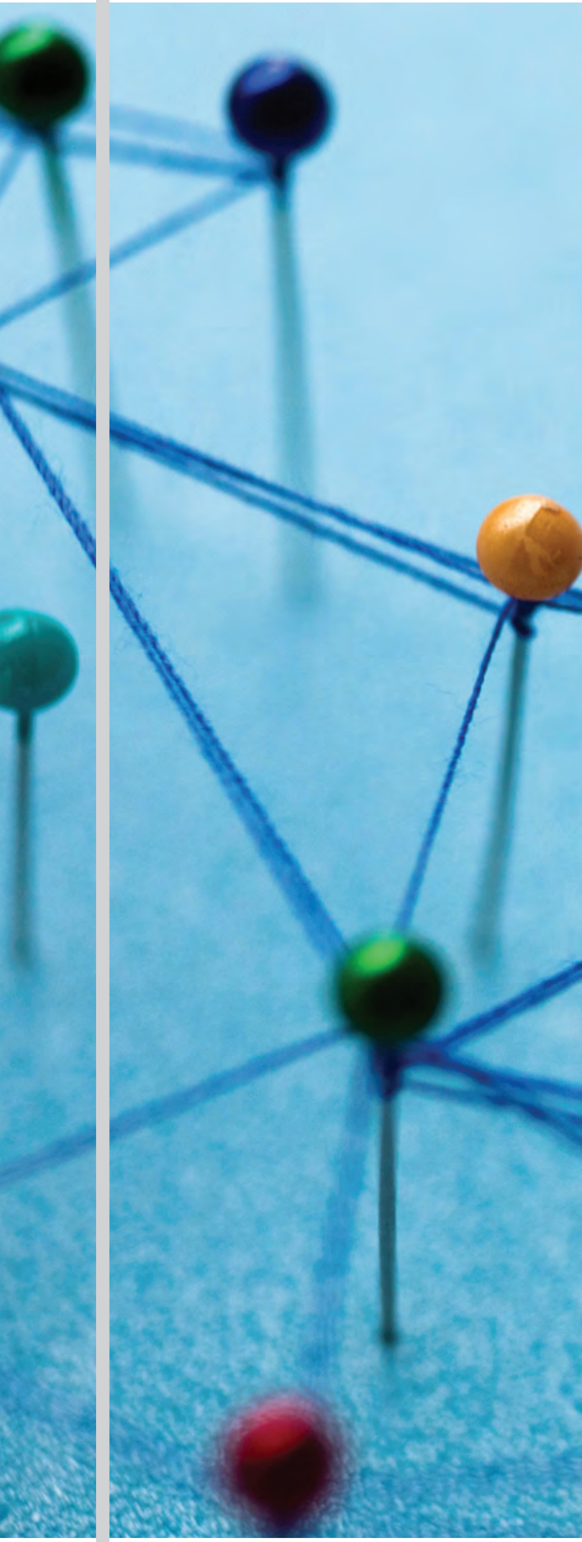
Friendly Hills Bancorp | First Pacific Bank



ANNUAL REPORT 2022

Delivering Responsible Growth

HIGHLIGHTS

$367 million
Total Assets

45%
of total deposits are noninterest-bearing an indication of our focus on small business relationships

“Well-capitalized”
the highest regulatory capital category

$205 million
Total Loans

Strong
infrastructure in place highlighted by a new board, executive team and ownership

Well-diversified
deposit and loan portfolio with no concentration in any one industry or sector

$82 million
of outstanding loans generated by the San Diego Office, opened in 2022

Aligned
our brand debuting a new name to reflect our expanded footprint

Client-centric
culture with a commitment to our clients needs–not ours

$14.1 million
capital offering completed in 2022

Excellent
asset quality with zero loan losses and minimal nonperforming loans

16
years in business

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SHAREHOLDER LETTER

To our Shareholders, Customers, and Communities,

Friendly Hills Bancorp and its wholly owned subsidiary, First Pacific Bank, delivered a solid year of financial performance in 2022. We maintained excellent asset quality and a strong capital and liquidity position while making ongoing investments in key business initiatives to drive growth responsibly.

Continuing on our momentum from 2021, we took a disciplined and thoughtful approach to advancing the Bank—strengthening our infrastructure, aligning our brand and business vision, investing in specialty businesses, and more—setting the stage for long-term profitable growth and enhanced shareholder value.

As we move into this new chapter of our history, we remain focused on building on our foundation and furthering our goal of becoming the bank of choice for Southern California businesses.

2022 Financial Performance

We delivered strong financial performance and successfully repositioned the Bank in 2022, despite the challenging interest rate and economic environment. Highlighted by record loan growth and improved operating results—we are well-positioned to continue our momentum and achieve solid earnings performance in 2023.

- **Total loans** ended the year at **$205 million, increasing $116 million or 131%** since year end 2021.
- The **San Diego Office** opened in 2022, contributed significantly to this loan growth with **$82 million** of outstanding loans at year end 2022 generated by the team, further demonstrating the business community's desire for a local, community bank that offers true relationship banking.
- The Company completed **a private placement of common stock raising gross proceeds of $14.1 million,** before issuance costs.
- **Total assets** ended the year at **$367 million,** up from $293 million at year end 2021.
- **Noninterest-bearing deposits represent 45% of total deposits,** an indication of our focus on small business relationships in the market we serve.
- The Bank ended the fourth quarter with a **leverage capital ratio of 9.49% and total risk-based capital ratio was 13.3%,** considered "well-capitalized" – the highest regulatory capital category.

Delivering Responsible Growth

In addition to achieving strong financial and operational performance, we made meaningful progress in executing our strategy to drive long-term sustainable growth. More specifically, we established the framework for the company, expanded into the San Diego market, formed a specialty lending group, and invested in our team—signifying a new direction for the Bank.

- We strengthened our infrastructure, restructuring our board, executive team, and Bank ownership to include respected and experienced community leaders.
- To achieve faster growth in the loan portfolio, the Bank opened a regional office and full-service branch in San Diego.
- We made investments in our team, hired key talent, and aligned our business vision to reflect our focus on small business banking in our five target markets.
- A specialty lending group was formed dedicated to providing financing solutions for commercial trucks and vehicles to better serve California's underserved market and make a lasting impact on the community.
- Our brand was aligned to better serve our expanded footprint and greater lending capacity and the Bank's name was officially changed from Friendly Hills Bank to First Pacific Bank.

Strong Foundation

As we look ahead, we remain confident in our ability to continue our momentum and build on the solid foundation that First Pacific Bank has established for 16 years. In times like these, we want

Strong Bank Metrics

Top quartile performer in loan growth, deposit growth, non-performing assets, and non-interest bearing deposits

Noninterest-Bearing Deposits are in the **Top 5%** at 45.14% compared to peers

Asset Growth is in the **Top 10%** at 25.16% compared to banks of similar size to reassure you that we are well-diversified and well-positioned to continue to serve our clients and communities for decades to come.

- First Pacific Bank has a history of excellent asset quality, with zero loan losses and minimal nonperforming loans.
- Our loan and deposit portfolio is diversified amongst various industries and geographic markets and does not have a concentration of deposits or loans in any one industry or sector.
- The Bank maintains a strong liquidity position with liquid assets and borrowing capacity of over $155 million as of April 15, 2023—that's over half of our total deposits.
- Our balance sheet continues to be well positioned, with noninterest-bearing deposits representing 45% of total deposits, providing a core, stable funding source.
- We are committed to building and maintaining trusted relationships with our clients and providing solutions that meet their needs–not ours.

In Closing

As we look back on 2022, First Pacific Bank performed well navigating through a highly dynamic environment while demonstrating strength and stability. As we enter 2023, we remain focused on the future and executing our strategy of delivering responsible growth.

In closing, we would like to express our gratitude to all of our stakeholders—employees, customers, communities, and shareholders—for their continued trust, support, and investment in First Pacific Bank.

Nathan Rogge
President and CEO
of First Pacific Bank and
Friendly Hills Bancorp

Joe Matranga
Chairman of the Board
of First Pacific Bank and
Friendly Hills Bancorp

"As we move into this new chapter of our history, we remain focused on building on our foundation and furthering our goal of becoming the bank of choice for Southern California businesses."

Independent Auditor's Report

The Board of Directors and Shareholders
Friendly Hills Bancorp and Subsidiary
Whittier, California

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the consolidated financial statements of Friendly Hills Bancorp and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2022 and 2021, and the related consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Friendly Hills Bancorp and Subsidiary as of December 31, 2022 and 2021, and the results of their operations and their cash flows for years then ended, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of Friendly Hills Bancorp and Subsidiary, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Consolidated Financial Statements

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

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Friendly Hills Bancorp and Subsidiary's ability to continue as a going concern for one year after the date that the consolidated financial statements are available to be issued.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Friendly Hills Bancorp and Subsidiary's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Friendly Hills Bancorp and Subsidiary's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

Eide Bailly LLP

Laguna Hills, California
April 12, 2023

	2022	2021
Assets		
Cash and due from banks	$ 3,861,880	$ 6,498,403
Federal funds sold	27,870,000	-
Interest bearing deposits with other financial institutions	341,550	58,529,324
Cash and cash equivalents	32,073,430	65,027,727
Debt securities available for sale	6,143,732	118,313,949
Debt securities held to maturity	110,678,882	8,544,323
Loans, net of unearned income	205,001,925	88,923,169
Allowance for loan losses	(2,000,021)	(1,800,021)
Loans, net	203,001,904	87,123,148
Restricted stock	2,587,300	1,471,850
Equity securities	1,160,000	1,160,000
Premises and equipment, net	714,703	542,484
Right of use asset	1,178,546	1,771,071
Bank owned life insurance	5,059,435	4,951,387
Goodwill	977,938	1,361,938
Core Deposit Intangible	359,022	425,847
Accrued interest receivable and other assets	2,771,800	2,325,619
Total assets	$ 366,706,692	$ 293,019,343
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing deposits	$ 118,827,118	$ 134,624,786
Interest-bearing deposits	146,025,005	122,935,055
Total deposits	264,852,123	257,559,841
FHLB advances	65,000,000	12,000,000
Accrued interest payable and other liabilities	3,703,515	3,729,753
Total liabilities	333,555,638	273,289,594
Shareholders' Equity		
Common stock, no par value, 10,000,000 shares authorized; 3,776,622 and 2,006,393 shares issued and outstanding in 2022 and 2021, respectively	30,511,315	15,957,620
Additional paid-in-capital	1,770,901	1,637,821
Retained earnings	1,881,483	2,870,258
Accumulated other comprehensive loss, net of tax	(1,012,645)	(735,950)
Total shareholders' equity	33,151,054	19,729,749
Total liabilities and shareholders' equity	$ 366,706,692	$ 293,019,343

	2022	2021
Interest Income		
Interest and fees on loans	$ 7,129,832	$ 4,959,916
Interest on debt securities	2,298,833	727,735
Interest on deposits with other financial institutions	273,861	114,841
Dividends on restricted stock and equity securites	133,768	141,782
Total interest income	9,836,294	5,944,274
Interest Expense		
Interest expense on deposits	473,357	225,359
Interest expense on borrowings	491,060	333,832
Total interest expense	964,417	559,191
Net Interest Income	8,871,877	5,385,083
Provision for Loan Losses	200,000	-
Net Interest Income After Provision for Loan Losses	8,671,877	5,385,083
Noninterest Income		
Service charges on deposit accounts	118,457	75,484
Employee retention tax credit	-	491,307
Increase in cash surrender value of life insurance	108,048	108,787
Payroll service	230,003	240,090
Loss on sale of debt securities available for sale	(18,750)	-
Gain on early extinguishment of debt	469,992	-
Other fees and miscellaneous income	292,260	219,682
Total noninterest income	1,200,010	1,135,350
Noninterest Expense		
Salaries and other employee benefits	7,611,135	3,696,282
Occupancy	1,535,513	585,360
Advertising and marketing	37,094	43,228
Professional services	419,226	537,221
Data processing	609,317	488,783
Stationary and supplies	78,519	38,393
Corporate insurance	105,220	73,136
Supervisory charges	227,866	117,192
Other	725,470	721,286
Total noninterest expense	11,349,360	6,300,881
Income (loss) before provision for income taxes	(1,477,473)	219,552
Provision for income tax expense (benefit)	(488,698)	31,023
Net income (loss)	$ (988,775)	$ 188,529
Earnings (loss) per share basic	$ (0.40)	$ 0.09
Earnings (loss) per share diluted	$ (0.40)	$ 0.09

	2022	2021
Net Income (Loss)	$ (988,775)	$ 188,529
Other Comprehensive Income (Loss)		
Unrealized gains (losses) on securities available for sale		
Change in unrealized gain (loss)	(411,977)	(1,484,162)
Reclassification of loss recognized in income	18,750	-
	(393,227)	(1,484,162)
Related income tax effect		
Change in unrealized gain (loss)	124,568	443,344
Reclassification of loss recognized in income	(8,036)	-
	116,532	443,344
Total other comprehensive income (loss)	(276,695)	(1,040,818)
Total comprehensive income (loss)	$ (1,265,470)	$ (852,289)

	Common Stock		Additional		Accumulated Other	Total
	Shares Outstanding	Amount	Paid-In Capital	Retained Earnings	Comprehensive Income (Loss)	Shareholders' Equity
Balance, December 31, 2020	2,006,393	$ 15,957,620	$ 1,570,413	$ 2,681,729	$ 304,868	$ 20,514,630
Net income	-	-	-	188,529	-	188,529
Stock-based compensation expense	-	-	67,408	-	-	67,408
Other comprehensive loss, net of tax	-	-	-	-	(1,040,818)	(1,040,818)
Balance, December 31, 2021	2,006,393	15,957,620	1,637,821	2,870,258	(735,950)	19,729,749
Issuance of common stock	1,704,229	13,966,295	-	-	-	13,966,295
Exercise of stock options	66,000	587,400	(138,600)	-	-	448,800
Net loss	-	-	-	(988,775)	-	(988,775)
Stock-based compensation expense	-	-	271,680	-	-	271,680
Other comprehensive loss, net of tax	-	-	-	-	(276,695)	(276,695)
Balance, December 31, 2022	3,776,622	$ 30,511,315	$ 1,770,901	$ 1,881,483	$ (1,012,645)	$ 33,151,054

	2022	2021
Operating Activities		
Net income (loss)	$ (988,775)	$ 188,529
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities		
Net amortizations of premiums and discounts on securities	760,318	205,046
Depreciation and amortization	317,277	130,572
Provision for loan losses	200,000	-
Stock-based compensation expense	271,680	67,408
Loss on sale of debt securities available for sale	18,750	-
Loss on sale of fixed assets	37,783	-
Gain on sale of payroll business	(42,000)	-
Gain on early extinguishment of debt	(469,992)	-
Change in deferred income taxes	(513,000)	3,000
Increase in cash surrender value of life insurance	(108,048)	(108,787)
Change in other assets and liabilities	720,592	(593,797)
Net Cash Provided by (Used in) Operating Activities	204,585	(108,029)
Investing Activities		
Purchase of debt securities available for sale	-	(108,360,427)
Purchase of debt securities held to maturity	-	(6,577,680)
Principal paydowns on debt securities available for sale	7,330,060	8,461,037
Proceeds on sale of debt securities available for sale	1,531,250	-
Change in FHLB and FRB stock	(1,115,450)	-
Net decrease (increase) in loans	(116,078,756)	34,642,717
Cash acquired in branch acquisition, net of consideration paid	-	81,068,323
Proceeds from sale of payroll business	450,000	-
Purchase of premises and equipment	(453,254)	(156,473)
Net Cash (Used in) Provided by Investing Activities	(108,336,150)	9,077,497
Financing Activities		
Increase in deposits	7,292,282	13,646,485
Net increase in overnight FHLB advances	65,000,000	-
Payments on FHLB term advances	-	(8,500,000)
Early retirement of term FHLB advances	(11,530,008)	-
Exercise of stock options	448,800	-
Issuance of common stock	13,966,194	-
Net Cash Provided by Financing Activities	75,177,268	5,146,485
Net (Decrease) Increase in Cash and Cash Equivalents	(32,954,297)	14,115,953
Cash and Cash Equivalents, Beginning of Year	65,027,727	50,911,774
Cash and Cash Equivalents, End of Year	$ 32,073,430	$ 65,027,727

	2022	2021
Supplemental Disclosure of Cash Flow Information		
Interest paid	$ 927,799	$ 567,728
Taxes paid	-	409,079
Assets acquired in acquisition plus goodwill recognized, net	-	3,215,140
Liabilities assumed in acquisition	-	84,283,463
Lease liabilities arising from obtaining right-of-use assets	268,190	1,899,339
Transfer of debt securities from available for sale to held to maturity	107,934,098	-

Note 1 - Significant Accounting Policies

Nature of Operations

The Company consists of Friendly Hills Bancorp ("Bancorp") and its wholly-owned subsidiary First Pacific Bank (the "Bank"). Friendly Hills Bancorp was formed in 2021 as a one-bank holding company. Bancorp and the Bank are collectively referred to herein as the Company. First Pacific Bank (formerly Friendly Hills Bank) was incorporated in the State of California, commenced operations on September 18, 2006, and is organized as a single operating segment. The Bank operates full-service branches in Whittier, Santa Fe Springs, Orange, Redlands and San Diego, California. Its principal source of revenue is providing loans to customers, who are predominately small and middle-market businesses and individuals located primarily in the Los Angeles, Orange, San Bernardino and San Diego County areas of California.

Basis of Presentation and Consolidation

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and general practices within the banking industry. The consolidated financial statements of the Company include the accounts of Friendly Hills Bancorp and its wholly-owned subsidiary First Pacific Bank. All significant intercompany balances and transactions have been eliminated in consolidation.

Subsequent Events

The Company has evaluated subsequent events for recognition and disclosure through April 12, 2023 which is the date the financial statements were available to be issued.

Use of Estimates

In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses.

Acquisition Activities

The Company accounts for business combinations under the acquisition method of accounting. Assets acquired and liabilities assumed are measured and recorded at fair value at the date of acquisition, including identifiable intangible assets. Fair values are subject to refinement after the closing date of an acquisition as information relative to closing date fair values becomes available, but not beyond one year from the acquisition. All identifiable intangible assets that are acquired in a business combination are recognized at fair value on the acquisition date. Identifiable intangible assets are recognized separately if they arise from contractual or other legal rights or if they are separable (i.e., capable of being sold, transferred, licensed, rented, or exchanged separately from the entity).

Deposit liabilities and the related depositor relationship intangible assets may be exchanged in observable exchange transactions. As a result, the depositor relationship intangible asset (the core deposit intangible) is considered identifiable, because the separability criterion has been met.

Cash and Cash Equivalents

For the purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks and federal funds sold, all of which have original maturities of 90 days or less.

Balances in transaction accounts at other financial institutions may exceed amounts covered by federal deposit insurance. Management regularly evaluates the credit risk associated with other financial institutions and believes that the Company is not exposed to any significant credit risks on cash and cash equivalents.

Cash and Due from Banks

Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank (FRB). The Company was in compliance with its reserve requirements as of December 31, 2022 and 2021.

Debt Securities

The Company classifies its debt securities as available for sale or held to maturity. Securities classified as available for sale are recorded at fair value, with unrealized gains and losses excluded from earnings and reported in comprehensive income. Securities, which the Company has the positive intent and ability to hold to maturity, are classified as held to maturity and are carried at amortized cost. Equity securities are carried at fair value, with changes in fair value reported in net income. Equity securities without readily determinable fair values are carried at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method. Purchases are accounted for on the trade date.

The Company follows the accounting guidance related to recognition and presentation of other-than-temporary impairment. This guidance specifies that (a) if a bank does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security, and it is more likely than not, the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income.

Equity Securities

Equity securities include investments in bankers bank and other stock without readily determinable fair values. These securities are carried at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment.

Loans

The Company grants real estate, commercial and industrial and consumer loans to borrowing customers. A substantial portion of the loan portfolio is represented by real estate loans in the Southern California region. The ability of the Company's borrowers to honor their contracts is dependent upon many factors, including the real estate market and general economic conditions in the Company's area.

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding unpaid principal balances reduced by any charge-offs or specific valuation allowances and net of deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan. Amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. The accrual of interest on loans is discontinued when principal or interest is past due 90 days based on the contractual terms of the loan or when, in the opinion of management, there is reasonable doubt as to collectability. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to all principal and interest.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Amounts are charged-off when available information confirms that specific loans or portions thereof, are uncollectible. This methodology for determining charge-offs is consistently applied to each segment.

The allowance consists of specific and general reserves. Specific reserves relate to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered in determining impairment include payment status, collateral value and the probability of collecting all amounts when due. Measurement of impairment is based on the expected future cash flows of an 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 except that collateral-dependent loans for which foreclosure is probable are measured at the fair value of the collateral.

The Company recognizes interest income on impaired loans based on its existing methods of recognizing interest income on nonaccrual loans. Loans, for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired with measurement of impairment based on expected future cash flows discounted using the loan's effective rate immediately prior to the restructuring.

If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Smaller balance, homogeneous loans are collectively evaluated for impairment.

General reserves cover non-impaired loans and are based on historical loss rates for each portfolio segment, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's historical loss experience. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in economic conditions, changes in the nature and volume of the portfolio; changes in the experience, ability and depth of lending management and other relevant staff; changes in the volume and severity of past due, nonaccrual and other adversely graded loans; changes in the loan review system; changes in the value of the underlying collateral for collateral-dependent loans; concentrations of credit and the effect of other external factors such as competition and legal and regulatory requirements.

Portfolio segments identified by the Company include real estate, commercial and industrial, and consumer loans. Relevant risk characteristics for these portfolio segments generally include debt service coverage, loan-to-value ratios and financial performance on non-consumer loans and credit scores, debt-to income, collateral type, and loan-to-value ratios for consumer loans.

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which ranges from three to seven years for furniture and equipment. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the improvements or the remaining lease term, whichever is shorter. Expenditures for betterments or major repairs are capitalized and those for ordinary repairs and maintenance are charged to operations as incurred.

Leases

The Company determines if an arrangement contains a lease at contract inception and recognize right-of-use ("ROU") assets and operating lease liabilities based on the present value of lease payments over the lease term. While operating leases may include options to extend the term, the Company does not take into account the options in calculating the ROU asset and lease liability unless it is reasonably certain such options will be reasonably exercised. The present value of lease payments is determined based on the Company's incremental borrowing rate and other information available at lease commencement. Leases with an initial term of 12 months or less are not recorded in the statement of financial condition. Lease expense is recognized on a straight-line basis over the lease term. The Company has elected to account for lease agreements with lease and non-lease components as a single lease component.

Restricted Stock

The Bank is a member of the Federal Home Loan Bank ("FHLB") system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. In addition, the Bank is a member of its regional Federal Reserve Bank ("FRB"). FHLB and FRB stock are carried at cost, classified as a restricted security, and periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and stock dividends are reported as income.

Bank Owned Life Insurance

The Company has purchased life insurance on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contracts at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Allowance for Credit Losses on Off-Balance Sheet Credit Exposures

The Company also maintains a separate allowance for off-balance sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The Allowance for off-balance sheet commitments totaled $44,398 at December 31, 2022 and 2021, and is included in other liabilities in the consolidated balance sheet.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable, and the amount or range of loss can be reasonable estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Advertising Costs

The Company expenses the costs of advertising in the period incurred.

Goodwill and Other Intangible Assets

Goodwill is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill resulting from acquisitions is not amortized, but tested for impairment at least annually. Goodwill amounted to $977,938 and $1,361,938 as of December 31, 2022 and 2021, respectively. No impairment was recognized on goodwill during 2022 or 2021. In 2022, the Company sold its payroll processing business, recognizing a gain of $42,000 on proceeds of $450,000 and after consideration of goodwill and a customer list intangible with a carrying value of $408,000 on the sale date of October 1, 2022.

Other intangible assets consist of core deposit intangible ("CDI") assets arising from the acquisition of deposits. CDI assets are amortized on an accelerated method over their estimated useful life of approximately 10 years. CDI of $443,000 was recognized in the 2021 acquisition disclosed in Note 16. The unamortized balance as of December 31, 2022 and 2021 was $359,022 and $425,848, respectively. CDI amortization expense was $66,826 and $17,152 in 2022 and 2021, respectively. Estimated CDI amortization expense for the next 5 years and thereafter, is as follows:

Year Ending December 31,	Amount
2023	$ 59,885
2024	53,714
2025	48,226
2026	43,339
2027	38,983
Thereafter	114,875
Total	$ 359,022

Income Taxes

Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of property and equipment, intangible assets, and accrued expenses for financial and income tax reporting. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The Company evaluates its tax positions that have been taken or are expected to be taken on income tax returns to determine if an accrual is necessary for uncertain tax positions. As of December 31, 2022, and 2021, the unrecognized tax benefit accrual was zero. The Company will recognize future accrued interest and penalties related to unrecognized tax benefits in income tax expense if incurred.

Financial Instruments

In the ordinary course of business, the Company has entered into off balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit as described in Note 12. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Earnings Per Share (EPS)

The basic earnings per share ratio excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. For the years ended December 31, 2022 and 2021 weighted average shares outstanding used in the computation of basic EPS were 2,448,011 and 2,006,393 in 2022 and 2021, respectively. Weighted-average dilutive shares in 2021 were 2,052,901. The Company reported an operating loss in 2022 and therefore only reported basic EPS.

Stock-Based Compensation

Stock-based compensation expense reflects the fair value of stock-based awards measured at the grant date and recognized over the relevant vesting period. A Black-Scholes option valuation model is utilized to estimate the fair value of stock options granted, while the market price of the Company’s common stock at the date of grant is used for restricted stock unit awards.

Compensation cost is recognized over the requisite service period and adjusted to reflect forfeitures as they occur and for awards with performance conditions changes in the probability that the performance condition will be met. If the grantee of performance condition award does not earn the award, the Company reverses any compensation cost previously recognized during the requisite service period.

Comprehensive Income (Loss)

Comprehensive income (loss) is reported in addition to net income for all periods presented. Comprehensive income (loss) is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income or loss that historically has not been recognized in the calculation of net income. Unrealized gains and losses on the Company's debt securities available for sale are included in other comprehensive income, adjusted for realized gains or losses included in net income. Total comprehensive income or loss and the components of accumulated other comprehensive income or loss is presented in the statement of changes in shareholders' equity and comprehensive income (loss).

Revenue Recognition – Noninterest Income

In accordance with Topic 606, revenues are recognized when control of promised goods or services is transferred to customers in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Company performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligation in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligation in the contract; and (v) recognize revenue when (or as) the Company satisfies a performance obligation. The Company only applies the five-step model to contracts when it is probable that the entity will collect the consideration it is entitled to in exchange for the goods or services it transfers to the customer. At contract inception, once the contract is determined to be within the scope of Topic 606, the Company assesses the goods or services that are promised within each contract and identifies those that contain performance obligation, and assesses whether each promised good or service is distinct.

The Company then recognizes as revenue the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied.

The following is a discussion of key revenues within the scope of the new revenue guidance.

Service Charges and Fees on Deposit Accounts
The Company earns fees from its deposit customers for account maintenance, transaction-based and overdraft services. Account maintenance fees consist primarily of account fees and analyzed account fees charged on deposit accounts on a monthly basis. The performance obligation is satisfied and the fees are recognized on a monthly basis as the service period is completed. Transaction-based fees on deposits accounts are charged to deposit customers for specific services provided to the customer, such as non sufficient funds fees, overdraft fees, and wire fees. The performance obligation is completed as the transaction occurs and the fees are recognized at the time each specific service is provided to the customer.

Interchange Fees
Interchange fees represents fees earned when a debit card issued by the Company is used. The Company earns interchange fees from debit cardholder transactions through a payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. The performance obligation is satisfied and the fees are earned when the cost of the transaction is charged to the card. Certain expenses directly associated with the debit card are recorded on a net basis with the fee income.

Payroll Processing Fees
Payroll processing fees are earned primarily by processing payroll and related transactions for third party employers. The Company earns fees from the processing of payroll, direct deposit and check origination, payroll related reporting services, the processing of related payroll tax payments to regulatory agencies, the filing of payroll tax returns and employee time management solutions. The performance obligation is satisfied and the fees recognized when the transactions occur and when each specific service is provided to the customer.

Fair Value Measurements

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Current accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

The following provides a summary of the hierarchical levels used to measure fair value:

Level 1 - Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 - Significant other observable inputs (other than Level 1 prices) such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 - Significant unobservable inputs that reflect an entity's own assumptions about the factors that market participants would use in pricing an asset or liability.

See Note 10 for more information and disclosures relating to the Company's fair value measurements.

Note 2 - Debt Securities

Debt securities have been classified in the consolidated balance sheets according to management's intent. The amortized cost and fair value of securities, with gross unrealized gains and losses, at December 31, 2022, follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale (AFS)				
CMO securities	$ 3,427,546	$ -	$ (277,845)	$ 3,149,701
Corporate securities	3,000,000	-	(32,507)	2,967,493
Mortgage-backed securities	28,590	-	(2,052)	26,538
Total	$ 6,456,136	$ -	$ (312,404)	$ 6,143,732
Securities Held to Maturity (HTM)				
CMO securities	$ 50,457,681	$ -	$ (8,730,568)	$ 41,727,113
Corporate securities	12,410,012	-	(1,950,697)	10,459,315
Mortgage-backed securities	35,373,076	-	(6,223,786)	29,149,290
Municipal securities	8,402,437	-	(1,613,677)	6,788,760
SBA securities	4,035,676	-	(648,479)	3,387,197
	$ 110,678,882	$ -	$ (19,167,207)	$ 91,511,675

The amortized cost and fair value of securities, with gross unrealized gains and losses, at December 31, 2021, follows:

	Cost	Gains	Losses	Value
Securities Available for Sale				
CMO securities	$ 58,486,290	$ 96,419	$ (693,322)	$ 57,889,387
Corporate securities	8,798,716	12,941	(116,582)	8,695,075
Mortgage-backed securities	39,188,726	1,009	(451,727)	38,738,008
Municipal securities	8,481,032	39,234	(44,484)	8,475,782
SBA securities	4,410,541	105,156	-	4,515,697
Total	$ 119,365,305	$ 254,759	$ (1,306,115)	$ 118,313,949
Securities Held to Maturity				
Corporate securities	$ 8,544,323	$ -	$ (553,261)	$ 7,991,062

In the first quarter of 2022, the Company transferred $107,934,098 of AFS securities to HTM as the Company continues to execute upon its asset-liability management strategies. Management determined that it has both the positive intent and ability to hold these securities to maturity. On the date of transfer, the difference between the amortized cost and the fair value of these securities, which was recorded as a loss in accumulated other comprehensive income (AOCI), resulted in a net discount of $1,124,980. The discount will be accreted and unrealized loss in AOCI will be amortized, offsetting within interest income over the remaining life of the securities using the interest method. There were no gains or losses recognized as a result of this transfer.

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2022, follows:

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ -	$ -	$ -	$ -
Due from one to five years	3,028,591	2,994,032	3,991,534	3,656,656
Due from five to ten years	89,504	85,914	34,002,926	28,192,285
Due after ten years	1,644,432	1,558,399	9,316,534	7,679,412
Due after twenty years	1,693,609	1,505,387	63,367,888	51,983,322
	$ 6,456,136	$ 6,143,732	$ 110,678,882	$ 91,511,675

The Company pledged investment securities with a carrying value of approximately $57.9 million as of December 31, 2022 to secure borrowing arrangements with the FHLB and FRB.

At December 31, 2022, the Company had 55 debt securities with an unrealized loss of $19,479,611, which have depreciated approximately 16.6% from the amortized cost basis. Substantially all debt securities have been in a continuous loss position for greater than 12 months. Unrealized losses on debt securities have not been recognized into income because the bonds are of high credit quality, management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to change in interest rates and other market conditions. The fair value is expected to recover as the bonds approach maturity.

Note 3 - Loans and Allowance for Loan Losses

Loans consist of the following at December 31:

	2022	2021
Real estate	$ 169,361,469	$ 76,580,117
Commercial and industrial	35,587,324	12,388,806
Consumer	57,409	68,339
	205,006,202	89,037,262
Allowance for loan losses	(2,000,021)	(1,800,021)
Deferred loan fees, net	(4,277)	(114,093)
Net Loans	$ 203,001,904	$ 87,123,148

Changes in the allowance for loan losses are as follows:

	2022	2021
Balance, beginning of year	$ 1,800,021	$ 1,464,131
Provision for loan losses	200,000	-
Loan charge-offs	-	(5,131)
Loan recoveries	-	341,021
Balance, end of year	$ 2,000,021	$ 1,800,021

The following tables presents the recorded investment in loans and impairment method as of December 31, 2022 and 2021, and the activity in the allowance for loan losses for the year then ended, by portfolio segment:

December 31, 2022	Real Estate	Commercial and Industrial	Consumer	Total
Allowance for Loan Losses				
Beginning of Year	$ 1,510,610	$ 285,673	$ 3,738	$ 1,800,021
Provisions	50,728	150,623	(1,351)	200,000
Charge-offs	-	-	-	-
Recoveries	-	-	-	-
End of Year	$ 1,561,338	$ 436,296	$ 2,387	$ 2,000,021
Reserves				
Specific	$ -	$ -	$ -	$ -
General	1,561,338	436,296	2,387	2,000,021
	$ 1,561,338	$ 436,296	$ 2,387	$ 2,000,021
Evaluated for impairment				
Individually	$ -	$ -	$ -	$ -
Collectively	169,361,469	35,587,324	57,409	205,006,202
	$ 169,361,469	$ 35,587,324	$ 57,409	$ 205,006,202
December 31, 2021				
Allowance for Loan Losses				
Beginning of Year	$ 1,265,549	$ 198,035	$ 547	$ 1,464,131
Provisions	245,061	(248,252)	3,191	-
Charge-offs	-	(5,131)	-	(5,131)
Recoveries	-	341,021	-	341,021
End of Year	$ 1,510,610	$ 285,673	$ 3,738	$ 1,800,021
Reserves				
Specific	$ -	$ -	$ -	$ -
General	1,510,610	285,673	3,738	1,800,021
	$ 1,510,610	$ 285,673	$ 3,738	$ 1,800,021
Evaluated for impairment				
Individually	$ -	$ -	$ -	$ -
Collectively	76,580,117	12,388,806	68,339	89,037,262
	$ 76,580,117	$ 12,388,806	$ 68,339	$ 89,037,262

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, collateral adequacy, credit documentation, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis typically includes larger, non-homogeneous loans such as commercial real estate and commercial and industrial loans. This analysis is performed on an ongoing basis as new information is obtained.

The Company uses the following definitions for risk ratings:

Pass - Loans considered as pass meet all of the Company's underwriting criteria and are categorized into four different risk categories based on the level of protection provided to the Company by the paying capacity of the borrower and the value and marketability of the collateral.

Special Mention - Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledge, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Impaired - A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement.

Based on the most recent analysis performed, the risk category of loans by class of loans is as follows as of December 31, 2022 and 2021:

December 31, 2022	Pass	Special Mention	Substandard	Impaired	Total
Real estate					
Construction	$ 20,932,454	$ -	$ -	$ -	$ 20,932,454
1-4 family	38,165,424	-	-	-	38,165,424
Commercial real estate	110,263,591	-	-	-	110,263,591
Commercial and industrial	34,210,916	-	1,376,408	-	35,587,324
Consumer	57,409	-	-	-	57,409
	$ 203,629,794	$ -	$ 1,376,408	$ -	$ 205,006,202

December 31, 2021	Pass	Special Mention	Substandard	Impaired	Total
Real estate					
Construction	$ 85,275	$ -	$ -	$ -	$ 85,275
1-4 family	22,324,073	-	-	-	22,324,073
Commercial real estate	53,799,375	-	371,394	-	54,170,769
Commercial and industrial	11,701,167	687,639	-	-	12,388,806
Consumer	68,339	-	-	-	68,339
	$ 87,978,229	$ 687,639	$ 371,394	$ -	$ 89,037,262

The following table summarizes the payment status of the loan portfolio as of December 31:

December 31, 2022	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Not Past Due	Total	Nonaccrual
Real estate						
Construction	$ -	$ -	$ -	$ 20,932,454	$ 20,932,454	$ -
1-4 family	-	-	-	38,165,424	38,165,424	-
Commercial real estate	-	-	-	110,263,591	110,263,591	-
Commercial and industrial	110,444	-	-	35,476,880	35,587,324	-
Consumer	-	-	-	57,409	57,409	-
	$ 110,444	$ -	$ -	$ 204,895,758	$ 205,006,202	$ -

December 31, 2021	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Not Past Due	Total	Nonaccrual
Real estate						
Construction	$ -	$ -	$ -	$ 85,275	$ 85,275	$ -
1-4 family	-	-	-	22,324,073	22,324,073	-
Commercial real estate	-	-	-	54,170,769	54,170,769	-
Commercial and industrial	-	-	-	12,388,806	12,388,806	-
Consumer	-	-	-	68,339	68,339	-
	$ -	$ -	$ -	$ 89,037,262	$ 89,037,262	$ -

The Company had no impaired loans or loans classified as Troubled Debt Restructurings (TDR's) as of December 31, 2022 and 2021.

Note 4 - Premises and Equipment

Premises and equipment are as follows:

	2022	2021
Leasehold improvements	$ 918,685	$ 890,212
Furniture, fixtures, and equipment	629,538	446,871
Computers	1,621,383	1,432,291
	3,169,606	2,769,374
Accumulated depreciation and amortization	(2,454,903)	(2,226,890)
	$ 714,703	$ 542,484

Total depreciation and amortization expense for the years ended December 31, 2022 and 2021, was $225,154 and $113,419, respectively.

Note 5 - Leases

The Company has entered into leases for all of its branch locations. The leases expire at various dates through August of 2025. These leases also include provisions for periodic rent increases as well as payment by the lessee of certain operating expenses. The amount of the lease liability and ROU asset is impacted by the lease term and the discount rate applied to determine the present value of future lease payments.

Balance sheet and other information relating to leases at December 31, 2022 and 2021 is shown below.

	2022	2021
Operating Lease Right-of-Use Assets	$ 1,178,546	$ 1,771,071
Operating Lease Liabilities (included in other liabilities)	$ 1,622,410	$ 2,207,435
Weighted-Average Remaining Lease Term, in Years	2.07	2.95
Weighted-Average Discount Rate	5.00%	5.00%

The Company elected, for all classes of underlying assets, not to separate lease and non-lease components and instead to account for them as a single lease component. Variable lease cost primarily represents variable payments such as common area maintenance and utilities.

The following table represents lease costs and other lease information for the year ended December 31, 2022 and 2021:

	2022	2021
Operating lease cost	$ 751,637	$ 270,953
Impairment loss	135,406	-
Common area maintenance and other lease costs	74,852	58,919
Total lease costs	$ 961,895	$ 329,872

The Company subleases space in one branch location and recognized rental income of $192,303 and $47,061 in 2022 and 2021, respectively.

	2022	2021
Other Information		
Cash Paid for Amounts Included in the Measurement of Lease Liabilities	$ 948,601	$ 352,332
Right-of-Use Assets Obtained in Exchange for Lease Obligations	$ 268,190	$ 1,454,346

Maturities of lease liabilities for periods indicated:

Year Ending	
2023	$ 910,280
2024	648,900
2025	155,136
Total lease payments	1,714,316
Less imputed interest	(91,906)
Present value of net future minimum lease payments	$ 1,622,410

Note 6 - Deposits

Interest-bearing and noninterest-bearing deposits consist of the following:

	2022	2021
NOW accounts	$ 32,527,960	$ 29,261,783
Savings and money market	108,052,290	85,385,412
Time certificate of deposit accounts under $250,000	2,000,715	5,343,350
Time certificate of deposit accounts $250,000 and over	3,444,040	2,944,510
Total interest-bearing deposits	146,025,005	122,935,055
Total noninterest-bearing deposits	118,827,118	134,624,786
Total deposits	$ 264,852,123	$ 257,559,841

As of December 31, 2022, all noninterest-bearing deposits are demand deposits. The maturity of time certificates of deposit is as follows:

	2022	2021
Within one year	$ 4,391,662	$ 5,110,633
One year to three years	902,437	3,173,806
Over three years	150,656	3,421
	$ 5,444,755	$ 8,287,860

Note 7 - Income Taxes

Income tax expense included in the statements of income consist of the following:

	2022	2021
Current		
Federal	$ 14,450	$ 24,593
State	9,852	3,430
	24,302	28,023
Deferred taxes	(513,000)	3,000
Total income tax expense	$ (488,698)	$ 31,023

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition. The following is a summary of the components of the net deferred tax asset accounts recognized in the accompanying consolidated balance sheets at December 31:

	2022	2021
Deferred Tax Assets		
Accrual to cash	$ 164,000	$ 111,000
Allowance for loan losses due to tax limitations	161,000	101,000
Depreciation differences	32,000	65,000
Deferred compensation	85,000	57,000
Net operating loss carryforward	295,000	-
Unrealized loss on debt securities available for sale	434,000	315,000
Other, net	311,000	212,000
	1,482,000	861,000
Deferred Tax Liabilities		
Deferred loan costs	109,000	59,000
Goodwill	145,000	185,000
Other, net	191,000	212,000
	445,000	456,000
Net deferred tax assets (liabilities)	$ 1,037,000	$ 405,000

The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

The Company is subject to federal income tax and franchise tax of the state of California. Income tax returns for the years ending after December 31, 2018 are open to audit by the federal authorities and for the years ending after December 31, 2017 are open to audit by California state authorities.

A comparison of the federal statutory income tax rates to the Company's effective income tax rates at December 31 follows:

	2022		2021	
	Amount	Rate	Amount	Rate
Statutory Federal tax	$ (310,000)	-21.0%	$ 46,000	21.0%
State franchise tax, net of Federal benefit	(133,000)	-9.0%	(30,000)	-13.7%
Other items, net	(45,698)	-3.1%	15,023	6.8%
Actual tax expense	$ (488,698)	-33.1%	$ 31,023	14.1%

The Company has determined that a valuation allowance is not required as it appears that it is more likely than not that the deferred tax asset will be realized, based upon an estimate of future taxable income.

Note 8 - Stock-Based Compensation

Under the Bank's 2017 Equity Incentive Plan (the "2017 Plan"), stock options were granted to eligible employees and directors, providing for up to 200,000 shares of common stock that could be issued pursuant to awards of option and restricted stock.

In July 2022, the Company's shareholders approved and the Company adopted the 2022 Equity Incentive Plan (the "2022 Plan"), providing for up to 420,000 shares of common stock that could be issued pursuant to awards of options and restricted stock. Upon adoption of the 2022 Plan, the 2017 Plan was terminated, however, options previously granted under the 2017 Plan remained valid in accordance with their terms.

The 2022 Plan provides for the granting to eligible participants such incentive awards as the Board of Directors or a committee established by the Board, in its sole discretion, to administer the Plan may from time to time approve. The Board has the power to determine the terms of the awards, including the exercise price, the number of shares subject to each award, the vesting and exercisability of the awards and the form of consideration payable upon exercise. Stock options expire no later than 10 years from the date of grant. The 2022 Plan provides for accelerated vesting if there is a change in control.

Total stock-based compensation cost was $271,680 and $67,408 in 2022 and 2021, respectively, and related tax benefits were approximately $75,900 in 2022 and $15,900 in 2021. As of December 31, 2022, there was $1,553,598 of total unrecognized compensation cost related to the outstanding stock options and restricted share awards, to be recognized over a weighted-average period of 2.5 years.

A summary of the status of the Company's stock option plan as of December 31, 2022, and changes during the year then ended, is presented below:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance, beginning of year	153,350	$ 6.80	2.0 years	
Options granted	-	-		
Options exercised	(66,000)	6.80		
Options forfeited	(7,600)	6.80		
Options expired	-	-		
Balance, end of year	79,750	$ 6.80	1.0 year	$ 97,295
Options exercisable, end of year	63,800	$ 6.80	1.0 year	$ 77,836

The intrinsic value of stock options exercised in 2022 was $148,426.

A summary of the status of unvested restricted stock units awarded under the Plan as of December 31, 2022 and changes during the year then ended is presented below:

	2022	
	Unvested Shares	Weighted-Average Grant Date Fair Value
Balance, beginning of year	200,000	$ 9.50
Granted	-	-
Vested	-	-
Forfeited or expired	-	-
Balance, end of year	200,000	$ 9.50

One half of the outstanding unvested restricted stock units at December 31, 2022 are subject to various performance conditions which the Company has assumed will be achieved for purposes of recognizing compensation cost and is being recognized ratably over the 5 year requisite service period. If the performance conditions are not achieved by the end of the vesting period (December 31, 2026) the previously recognized compensation cost will be fully reversed. There was no intrinsic value associated with the unvested restricted stock units as of December 31, 2022.

Note 9 - Other Borrowings

At year-end, advances from the FHLB were as follows:

	2022	2021
Balance at end of year	$ 65,000,000	$ 12,000,000
Weighted average interest rate at end of year	4.60%	2.12%
Weighted average interest rate for the year	2.90%	1.65%

FHLB advances are secured with eligible collateral consisting of loans and securities valued at $181.2 million as of December 31, 2022. Advances from the FHLB are subject to the FHLB's collateral and underwriting requirements. Unused borrowing capacity based on pledged collateral was $51.9 million and $43.5 million as of December 31, 2022 and 2021, respectively.

FHLB advances at December 31, 2022 were overnight advances. FHLB advances at December 31, 2021 were term advances that were early retired on March 30, 2022, with the Company recognizing a gain of $469,992 on the early retirement.

At December 31, 2022 and 2021, the Company had unsecured revolving lines of credit with Pacific Coast Bankers Bank and Zions Bank, providing for Federal fund purchases up to a total of $14,000,000. Borrowings are payable on demand and interest on outstanding borrowings accrues at rates negotiated at the time of the borrowing. In addition, the Company has a borrowing relationship with the Federal Reserve Bank and has borrowing capacity of approximately $2.3 million based on securities pledged with a carrying value of approximately $2.8 million. As of December 31, 2022 and 2021, the Company did not have any outstanding borrowings on these lines of credit.

Note 10 - Fair Value Measurements

The Company used the following methods and significant assumptions to estimate fair value:

Debt Securities: The fair value of debt securities available for sale are determined by obtaining quoted prices on nationally recognized exchanges (Level 1) or matrix pricing which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather relying on the security's relationship to other benchmark quoted securities resulting in a Level 2 classification.

The following table provides a summary of the financial instruments the Company measures at fair value on a recurring basis as of December 31, 2022:

As of December 31, 2022	Fair Value Measurements Using (Level 1)	(Level 2)	(Level 3)	Total
Assets and liabilities measured on a recurring basis				
Debt securities available for sale	$ -	$ 6,143,732	$ -	$ 6,143,732

The following table provides a summary of the financial instruments the Company measures at fair value on a recurring basis as of December 31, 2021:

As of December 31, 2021	Fair Value Measurements Using (Level 1)	(Level 2)	(Level 3)	Total
Assets and liabilities measured on a recurring basis				
Debt securities available for sale	$ -	$ 118,313,949	$ -	$ 118,313,949

Note 11 - Fair Value of Financial Statements

The fair value of financial instruments is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding the current interest rate environment and future expected loss experience, economic conditions, cash flows, and risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment, and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business, and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

The fair value hierarchy level and estimated fair value of significant financial instruments at December 31, 2022 and 2021, are summarized as follows (dollars in thousands):

		2022		2021	
	Fair Value Hierarchy	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets					
Cash and cash equivalents	Level 1	$ 32,073	$ 32,073	$ 65,028	$ 65,028
Debt securities available for sale	Level 2	6,144	6,144	118,314	118,314
Debt securities held to maturity	Level 2	110,679	91,512	8,544	7,991
Loans, net	Level 3	203,002	201,922	87,123	87,256
Restricted stock and equity securities	Level 2	3,747	3,747	2,632	2,632
Liabilities					
Deposits	Level 2	$ 264,852	$ 261,118	$ 257,560	$ 258,354
FHLB borrowings	Level 2	65,000	65,000	12,000	12,320

Note 12 - Financial Instruments with Off Balance Sheet Risk

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the accompanying balance sheet.

The Company's exposure to credit losses in the event of nonperformance by the other parties for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

The following is a summary of contractual or notional amounts of off-balance sheet financial instruments that represent credit risk:

	2022	2021
Financial instruments whose contract amounts represent credit risks:		
Commitments to extend credit	$ 46,744,000	$ 22,931,000

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Except for home equity lines of credit, commitments generally have fixed expiration dates of not more than 12 months and may require payment of a fee. Since many of the commitments are not expected to be drawn upon, the total commitment amounts may not represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include marketable investment securities, accounts receivable, inventory, property, plant and equipment, and real properties.

Note 13 - Related Party Transactions

In the ordinary course of business, the Company may grant loans to certain officers and directors and the companies with which they are associated. In the Company's opinion, all loans and loan commitments to such parties will be made on substantially the same terms including interest rates and collateral, as those prevailing at the time of comparable transactions with other persons. The Company had no related party loans outstanding as of December 31, 2022 and 2021.

Deposits from certain directors, executives, and shareholders and their related interest with which they are associated held by the Company at December 31, 2022 and 2021, amounted to $3,197,579 and $3,180,824, respectively.

The Bank’s former Chief Executive Officer and current Board member is a member of the Board of Directors for the company that provides core data processing services to the Bank.

Note 14 - Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities and certain off balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes, as of December 31, 2022 and 2021, that the Bank met all capital adequacy requirements to which it was subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and capital restoration plans are required. As of December 31, 2022 and 2021, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank’s category.

The following table presents actual and required capital ratios as of December 31, 2022 and 2021 (dollars in thousands):

	Actual		For Capital Adequacy Purposes		To be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2022						
Total capital (to risk-weighted assets)	$ 33,657	13.29%	$ 20,265	8.0%	$ 25,331	10.0%
Tier 1 capital (to risk-weighted assets)	31,613	12.48%	15,198	6.0%	20,265	8.0%
Common Equity Tier 1 Capital (to Risk-Weighted Assets)	31,613	12.48%	14,994	4.5%	21,658	6.5%
Tier 1 capital (to average assets)	31,613	9.49%	10,132	4.0%	12,665	5.0%
As of December 31, 2021						
Total capital (to risk-weighted assets)	$ 19,796	15.79%	$ 10,032	8.0%	$ 12,541	10.0%
Tier 1 capital (to risk-weighted assets)	18,226	14.53%	7,524	6.0%	10,032	8.0%
Common Equity Tier 1 Capital (to Risk-Weighted Assets)	18,226	14.53%	13,939	4.5%	20,134	6.5%
Tier 1 capital (to average assets)	18,226	5.88%	5,016	4.0%	6,270	5.0%

The California Financial Code provides that a bank may not make a cash distribution to its stockholders in excess of the lesser of the Bank's undivided profits or the bank's net income for its last three fiscal years, less the amount of any distribution made to the bank's stockholders during the same period.

Note 15 - Employee Retention Tax Credit

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) provided an employee retention credit (the Credit) which is a refundable tax credit against certain employment taxes of up to $5,000 per employee for eligible employers. The Credit is equal to 50% of qualified wages paid to employees, capped at $10,000 of qualified wages through December 31, 2020. The Consolidated Appropriations Act of 2021 and the American Rescue Plan Act of 2021 (collectively the Acts) expanded the availability of the Credit and extended the Credit through December 31, 2021. The Infrastructure Investment and Jobs Act subsequently terminated the Credit program effective October 1, 2021. The Acts increased the credit to 70% of qualified wages, capped at $10,000 per quarter. As a result of the changes to the Credit, the maximum credit per employee increased from $5,000 in 2020 to $21,000 in 2021.

The Company was eligible for the credit in various quarters in 2020 and 2021 and during the year ended December 31, 2021 recorded a benefit of $491,307, which is included in noninterest income in the consolidated statement of income. The Company filed for refunds of the Credit in the 4th quarter 2021 and received the claimed refunds in 2022. Refunds claimed are included in accrued interest receivable and other assets in the December 31, 2021 consolidated balance sheet. Laws and regulations concerning government programs, including the Credit are complex and subject to varying interpretations. Claims made under the Acts may also be subject to retroactive audit and review. There can be no assurance that regulatory authorities will not challenge the Company's claim to the Credit, and it is not possible to determine the impact (if any) this would have upon the Company. The Company's Credit filings remain open for potential examination by the Internal Revenue Service through the statute of limitations, which has varying expiration dates extending through 2026. Any disallowed claims resulting from such examination could be subject to repayment to the federal government.

Note 16 - Acquisitions

On September 24, 2021, the Company acquired three branch locations from the Bank of Southern California, N.A, in Orange, Redlands and Santa Fe Springs, California. The acquisition included customer deposits totaling $82,384,124, assignment of the lease agreements for the three locations and several employees. The cash purchase price was $975,945.

The items acquired were deemed to constitute a business under Generally Accepted Accounting Principles and therefore the acquisition was accounted for as a business combination.

The Company acquired the branches to strategically increase its existing presence in the Los Angeles and surrounding area. Goodwill in the amount of $977,938 was recognized in this acquisition. Goodwill represents the future economic benefits arising from net assets acquired that are not individually identified and separately recognized and is attributable to synergies expected to be derived from the acquisition. Goodwill recorded on this transaction is deductible for income tax purposes.

The following table represents the assets acquired and liabilities assumed as of September 24, 2021 and the fair value adjustments and amounts recorded by the Company in 2021 under the acquisition method of accounting.

	Book Value	Fair Value Adjustments	Fair Value
Assets Acquired			
Cash and cash equivalents	$ 82,044,268	$ -	$ 82,044,268
Right of use asset	1,899,339	(444,993)	1,454,346
Core deposit intangible	-	443,000	443,000
Fixed and other assets	339,856	-	339,856
Total assets acquired	$ 84,283,463	$ (1,993)	$ 84,281,470
Liabilities Assumed			
Deposits	$ 82,384,124	$ -	$ 82,384,124
Lease liabilities	1,899,339	-	1,899,339
Total liabilities assumed	84,283,463	-	84,283,463
Excess	-	1,993	1,993
	$ 84,283,463	$ 1,993	
Cash consideration			975,945
Goodwill recognized			$ 977,938

The Company accounted for this transaction under the acquisition method of accounting which requires purchased assets and liabilities assumed to be recorded at their respective fair values at the date of acquisition. The Company determined the fair value of the core deposit intangible with the assistance of a third-party appraisal. The fair value of other assets acquired and liabilities assumed was determined by various methods including estimation of cash flows expected to result from those assets and liabilities.

Note 17 - Formation of Friendly Hills Bancorp

During 2021, Friendly Hills Bank became a wholly-owned subsidiary of Friendly Hills Bancorp in an exchange of stock between entities under common control. Friendly Hills Bancorp issued 2,006,393 shares of common stock in exchange for the surrender of all outstanding shares of the Bank's common stock. There was no cash involved in this transaction. The transaction was accounted for like a pooling of interest and the consolidated financial statements contained herein have been restated to give full retroactive effect to the transaction.

COMPANY PROFILE

Board of Directors

Nathan Rogge
President and
Chief Executive Officer

Joe Matranga
Chairman of the Board

Jeffrey K. Ball
Vice Chairman of the Board

Jason Baker
Director

Kim Buttemer
Director

W.C. ("Chris") Greenbeck
Director

David P. Harris
Director

Alex Sun
Director

Executive Officers

Nathan Rogge
President and
Chief Executive Officer

Elizabeth M. Buckingham
Executive Vice President,
Chief Operating Officer

James Burgess
Executive Vice President,
Chief Financial Officer

Robert A. Marshall
Executive Vice President,
Chief Credit Officer

Paulette Silva
Executive Vice President,
Chief Administration Officer

Locations

Orange Office
625 The City Drive South,
Suite 140
Orange, CA 92868

Redlands Office
408 E State St.
Redlands, CA 92373

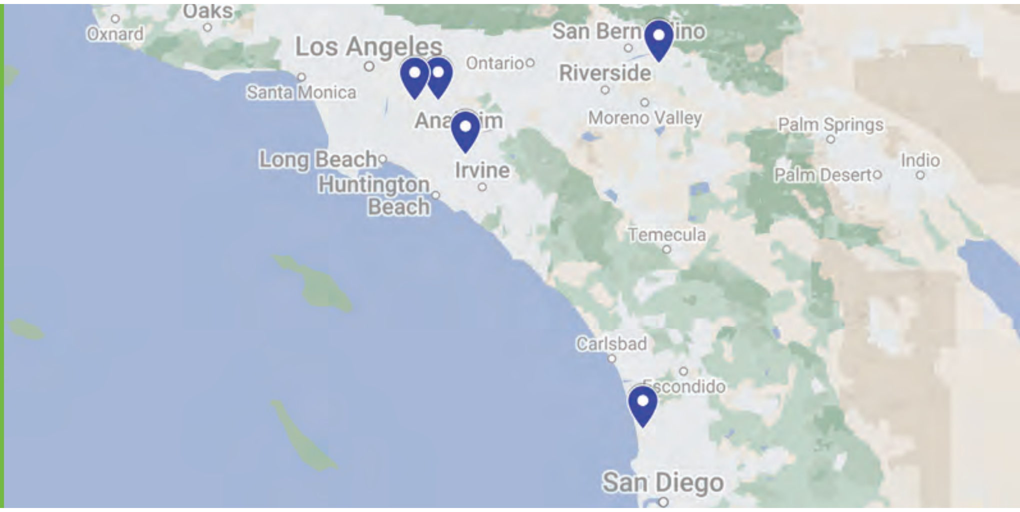
San Diego Office
3579 Valley Centre Drive,
Suite 175
San Diego, CA 92130

Santa Fe Springs Office
12070 Telegraph Road,
Suite 100
Santa Fe Springs, CA 90670

Whittier Office
16011 Whittier Blvd.
Whittier, CA 90603

Common Stock

The common stock trades
on OTC Markets (OTC Pink)
under the symbol FHLB.



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