



## **Consolidated Annual Report**

### **For the Year Ended June 30, 2019**

California First National Bancorp, (OTCQX: CFNB, “CalFirst” or the “Company”), is a bank holding company headquartered in Orange County, California with two subsidiaries, California First National Bank (“CalFirst Bank” or the “Bank”) and California First Leasing Corporation (“CFLC”). The primary business of the Company is secured financing provided through leasing and financing capital assets, commercial loans acquired through participation in the syndicated commercial loan market, by providing non-recourse loans to third parties secured by leases and equipment, and direct commercial loans. The Bank, responsible for substantially all lease and loan origination, gathers deposits through posting rates on the Internet and conducts all banking and other operations from one central location. CFLC participates in lease transactions with the Bank and also has a growing investment in a portfolio of equity securities.

*This financial report contains forward-looking statements which involve management assumptions, risks and uncertainties. The statements in this report that are not strictly historical in nature constitute “forward-looking statements.” Such statements include, but are not limited to, beliefs regarding investments in equity securities, swings in stock prices and the potential for this to cause significant volatility in reported net earnings, projected changes in lease originations and in the lease and loan portfolios, the credit quality of the lease and loan portfolio, the adequacy of reserves for credit losses, the impact of regulatory limitations on business activities and Bank opportunities, beliefs regarding expected tax rates applicable to future periods, including the benefit of lower tax rates, impact of changes in interest rates and changes in generally accepted accounting principles (“GAAP”). Such forward-looking statements involve known and unknown risks, uncertainties and other factors that could cause actual results to be different from the results expressed or implied by such forward-looking statements. Consequently, if such management assumptions prove to be incorrect or such risks or uncertainties materialize, the Company’s actual results could differ materially from the results forecast in the forward-looking statements. All forward-looking statements are qualified in their entirety by this cautionary statement, and the Company undertakes no obligation to revise or update this information to reflect events or circumstances arising after the date hereof (September 25, 2019).*

## 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,				
	2019	2018	2017	2016	2015
Finance and loan income	\$ 10,189	\$ 17,575	\$ 26,234	\$ 25,471	\$ 21,489
Investment and interest income	4,001	3,067	3,014	2,230	1,516
Total interest income	14,190	20,642	29,248	27,701	23,005
Interest expense on deposits and borrowings	1,599	3,422	7,229	6,210	3,945
Net interest income	12,591	17,220	22,019	21,491	19,060
Provision (release) of reserves for credit losses	(1,100)	(4,225)	250	1,475	1,175
Net interest income after provision for credit losses	13,691	21,445	21,769	20,016	17,885
Operating and sales-type lease income	1,388	1,709	2,716	1,146	305
Gain on sale of leases and leased property	1,839	2,963	4,336	3,497	4,791
Other income	129	299	387	220	3,132
Gain (loss) on equity investments	(607)	-	-	-	-
Realized gain (loss) on sale of AFS securities	-	(1,008)	-	23	481
Total non-interest income	2,749	3,963	7,439	4,886	8,709
Non-interest expenses	7,073	9,374	10,484	10,834	11,779
Earnings before income taxes	9,367	16,034	18,724	14,068	14,815
Income taxes	2,033	3,525	7,601	5,420	5,760
Net earnings	\$ 7,334	\$ 12,509	\$ 11,123	\$ 8,648	\$ 9,055
Basic earnings per common share	\$ 0.71	\$ 1.22	\$ 1.08	\$ 0.83	\$ 0.87
Basic common shares outstanding	10,284	10,284	10,280	10,399	10,460
Cash dividends per share	\$ 0.50	\$ 0.48	\$ 0.46	\$ 0.44	\$ 0.42
Dividend payout ratio	70.1%	39.5%	42.5%	53.2%	48.5%
Net interest margin	3.76%	3.40%	2.71%	2.78%	3.15%
Net interest spread	3.02%	2.99%	2.47%	2.54%	2.88%
Effective tax rate	21.7%	22.0%	40.6%	38.5%	38.9%
Return on average assets	2.09%	2.35%	1.30%	1.06%	1.39%
Return on average equity	3.58%	6.21%	5.78%	4.59%	4.87%

### BALANCE SHEET DATA

(in thousands, except per share amounts)

	AS OF JUNE 30,				
	2019	2018	2017	2016	2015
Cash and cash equivalents	\$ 71,606	\$ 63,307	\$ 96,055	\$ 105,094	\$ 60,240
Fixed income securities available-for-sale (AFS)	23,978	36,725	86,469	94,382	80,003
Equity securities	75,944	38,890	9,040	1,462	1,209
Commercial loans	31,075	104,630	306,009	403,736	243,462
Net investment in leases	90,526	123,467	190,798	237,674	298,324
Total assets	304,944	389,202	715,585	888,176	731,074
Deposits	87,745	169,425	468,634	633,147	471,906
Borrowings	-	-	40,000	40,000	42,000
Non-recourse debt	2,655	3,368	279	4,449	10,193
Stockholders' equity	\$ 207,304	\$ 204,963	\$ 196,134	\$ 191,022	\$ 188,218
Equity to total assets ratio	67.98%	52.66%	27.41%	21.51%	25.75%
Book value per common share	\$ 20.16	\$ 19.93	\$ 19.07	\$ 18.58	\$ 17.99

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

### Overview of Results, Trends and Outlook

For the fiscal year ended June 30, 2019, net earnings of \$7.3 million decreased by 41.4% or \$5.2 million from \$12.5 million in fiscal 2018. The Company's lease and loan portfolio declined by 47% during this period, resulting in a 42% decline in finance and loan income and contributing to a \$4.6 million, or 27%, decline in net interest income. 2019 earnings were also reduced by losses of \$607,000 related to changes in the fair value of our investment in equity securities. The earnings impact of these issues were offset only in part by a \$982,000 or 154% increase in dividends earned from the equity portfolio and 25% reduction in non-interest expense.

For the year ended June 30, 2019, new leases booked of \$56.0 million were 22% below \$71.9 million booked in fiscal 2018. With bookings of new leases down and an increased share sold to third-party participants, the net investment in leases declined 27% to \$90.5 million at June 30, 2019. Loan sales of \$50.0 million during the year reduced the loan portfolio to \$31 million at June 30, 2019 as part of a plan to move resources out of the syndicated loan market. On the positive side, lease originations in fiscal 2019 were up 4% from fiscal 2018, aided by an over 300% increase in the fourth quarter, producing a backlog of lease commitments of \$40 million at June 30, 2019, the highest level in 7 quarters. This was achieved despite a reduction of the sales organization to a small group focused on our core customer base.

During fiscal 2019, the fair value of CFLC's equity securities increased by 95%, or \$37.1 million, to \$75.9 million at June 30, 2019, and exceeded the Company's cost by \$1.6 million. The portfolio includes net new holdings of \$38.8 million. The Company's investment strategy is focused on equity securities of publicly traded corporations that provide attractive cash returns and price appreciation over time. The strategy also aims to buy stocks that are undervalued relative to the rest of the market. Following the adoption of a new accounting standard effective July 1, 2018, during fiscal 2019 all changes in the fair values of equity securities (whether realized or unrealized) have been recognized as gains or losses in our consolidated statement of earnings. These gains and losses are determined based on the stock price on the last day of a fiscal quarter and have varied widely. Prior to July 1, 2018, these gains and losses were recorded in other comprehensive income and therefore comparisons between fiscal 2019 and 2018 net earnings are not meaningful. Notwithstanding the potential volatility in equity markets and impact on earnings, management believes the development of CFLC's equity portfolio is an attractive opportunity and intends to continue to redeploy capital to this endeavor.

### Consolidated Statement of Earnings Analysis

**Net Interest Income** – Net interest income is the difference between interest and dividends earned on the leases, loans, securities and other interest earning assets and interest paid on deposits or borrowings and is affected by changes in the mix of interest 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 income by volume and rate:

2019 compared to 2018			
	Volume	Rate	Total
		(thousands)	
<b>Interest income</b>			
Net investment in leases	\$ (3,633)	\$ 302	\$ (3,331)
Commercial loans	(4,599)	544	(4,055)
Fixed income securities	(821)	62	(759)
Equity securities	963	20	983
Interest-earning deposits with banks	81	629	710
	<u>(8,009)</u>	<u>1,557</u>	<u>(6,452)</u>
<b>Interest expense</b>			
Demand and savings deposits	(208)	13	(195)
Time deposits	(1,570)	208	(1,362)
Borrowings	(266)	-	(266)
	<u>(2,044)</u>	<u>221</u>	<u>(1,823)</u>
<b>Net interest income</b>	<u>\$ (5,965)</u>	<u>\$ 1,336</u>	<u>\$ (4,629)</u>

Total interest income for the year ended June 30, 2019 decreased 31.3% to \$14.2 million from \$20.6 million in fiscal 2018. The decrease includes a \$4.1 million or 53.9% decrease in commercial loan income and \$3.3 million decline in finance income.

- The decrease in commercial loan income resulted from a 61.2% decrease in average loan balances to \$72.3 million that did not offset the increase in average yield of 75 basis points to 4.79%.
- Direct finance income declined 33.1% to \$6.7 million reflecting a 36.1% decrease in average investment in leases to \$103.5 million that offset a 29 basis point increase in average yield to 6.50%. Both fiscal 2019 and 2018 lease yields benefitted from recognition of accelerated finance income, but excluding that benefit from both years, the average lease yield in fiscal 2019 increased by over 78 basis points compared to fiscal 2018.
- Investment interest income declined 2% as a decrease of \$759,000 in income from fixed income securities offset a \$710,000 increase from interest bearing deposits with banks, reflecting a 25% decline in average combined balances offset by a 56 basis point increase in average yield.
- Dividend income increased 154% as the average investment in equity securities increased 150% to \$58.7 million while the yield was relatively unchanged. Interest income on cash and fixed income securities was down 2%.
- Interest expense paid on deposits and borrowings in fiscal 2019 declined 53.3% to \$1.6 million, reflecting a 58.2% decrease in average balances to \$131.5 million offset by a 13 basis point increase in average cost to 1.22%.
- As a result, net interest income decreased 26.9% to \$12.6 million for the fiscal year ended June 30, 2019 from \$17.2 million for fiscal 2018, notwithstanding the 36 basis point improvement in net interest margin in fiscal 2019 to 3.76%.

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

	Year ended June 30, 2019			Year ended June 30, 2018		
	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate
<b>Assets</b>						
Interest-earning assets						
Interest-earning deposits with banks	\$ 64,889	\$ 1,574	2.43%	\$ 59,344	\$ 864	1.46%
Fixed income securities	35,817	804	2.24%	75,405	1,563	2.07%
Equity securities	58,655	1,623	2.77%	23,430	640	2.73%
Commercial loans	72,326	3,462	4.79%	186,296	7,517	4.03%
Net investment in leases (1)	103,543	6,727	6.50%	162,082	10,058	6.21%
Total interest-earning assets	335,230	14,190	4.23%	506,557	20,642	4.07%
Other assets	15,712			24,738		
	<u>\$ 350,942</u>			<u>\$ 531,295</u>		
<b>Liabilities and Shareholders' Equity</b>						
Interest-bearing liabilities						
Demand and savings deposits	\$ 49,701	461	0.93%	\$ 72,754	655	0.90%
Time deposits	81,801	1,138	1.39%	219,883	2,501	1.14%
Other borrowings	-	-	-	21,642	266	1.23%
Total interest bearing liabilities	131,502	1,599	1.22%	314,279	3,422	1.09%
Non-interest bearing demand deposits	1,845			4,528		
Other liabilities	12,552			10,990		
Shareholders' equity	205,043			201,498		
	<u>\$ 350,942</u>			<u>\$ 531,295</u>		
Net interest income		<u>\$ 12,591</u>			<u>\$ 17,220</u>	
Net interest spread (2)			<u>3.02%</u>			<u>2.99%</u>
Net interest margin (3)			<u>3.76%</u>			<u>3.40%</u>
Average interest earning assets over average interest bearing liabilities			<u>254.9%</u>			<u>161.2%</u>

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

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

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

**Provision for Credit Losses** – During fiscal year 2019, the Company released reserves of \$1.1 million from the allowance for credit losses, compared to a release of reserves of \$4.23 million in fiscal year 2018. The fiscal 2019 release of reserves is consistent with the 70% decline in the loan portfolio and 27% decline in leases since June 30, 2018. At June 30, 2019, the allowance for credit losses of \$1.5 million, 1.22% of the investment in leases and loans, is considered to be appropriate for the consolidated portfolio.

**Non-interest Income** – For the year ended June 30, 2019, non-interest income of \$2.7 million fell 30.6% from \$4.0 million in fiscal year 2018. Non-interest income in fiscal 2019 includes a loss of \$607,000 recognized based on the fair value of equity securities at June 30, 2019 while fiscal 2018 included a \$1.0 million loss on sale of fixed-income securities. Excluding unrealized and realized securities losses from both periods, non-interest income for fiscal 2019 of \$3.3 million was down \$1.6 million from fiscal 2018, largely due to a \$1.5 million decrease in income from the sale of leases and loans.

**Non-interest Expenses** – The Company's non-interest expenses recognized for the year ended June 30, 2019 decreased by \$2.3 million, or 24.5%, to \$7.1 million compared to \$9.4 million the year before. The decrease in expenses in fiscal 2019 was due to lower salary, benefits and general overhead expenses as a result of a reduction in headcount and business volumes. Excluding the impact of a \$795,000 decline in deferred expenses, non-interest expenses in fiscal 2019 were down 30%.

**Income Taxes** – The Company's effective tax rate for the year ended June 30, 2019 was 21.7%, compared to 22.0% for the year end June 30, 2018. The Tax Cuts and Jobs Act ("Tax Act") signed into law on December 22, 2017 reduced the U.S. Federal corporate tax rate from 35.0% to 21.0% effective January 1, 2018. As a result, the applicable tax rate for fiscal year ending June 30, 2019 was 27.2%. The reclassification of unrealized equity gains from other comprehensive income to retained earnings on July 1, 2018 and reconciliation adjustments to deferred tax liabilities related to the Tax Act resulted in incremental credits of \$515,000 and reduced the effective rate for fiscal 2019.

The Company's effective tax rate for the year ended June 30, 2018 of 22.0% benefited from revaluing deferred tax assets and liabilities at December 31, 2017 based on the Tax Act and revised federal tax rates to be in effect in future years. This resulted in an estimated net tax benefit of \$2.03 million recognized in results for fiscal 2018.

### **Financial Condition Analysis**

The Company's consolidated balance sheet continues to reflect significant liquidity and a strong capital base. Shareholders' equity at June 30, 2019 was \$207.3 million, or 68% of total assets, with cash and equivalents at \$71.6 million. At June 30, 2019, total assets of \$304.9 million were down 21.6% from \$389.2 million at June 30, 2018, as loans of \$31.1 million declined 70%, leases of \$90.4 million were down 27%, and total deposits of \$87.7 million declined 48%, while the investment in equity securities increased 95% to \$75.9 million.

### **Lease and Loan Portfolio**

	June 30,				
	2019	2018	2017	2016	2015
			(in thousands)		
Net investment in leases	\$ 91,640	\$ 124,867	\$ 192,741	\$ 239,964	\$ 301,733
Commercial loans	27,587	101,984	306,826	401,629	238,978
Commercial real estate loans	3,878	4,134	4,387	6,679	7,531
Total leases and loans	123,105	230,985	503,954	648,272	548,242
Less allowance for credit losses	(1,504)	(2,888)	(7,147)	(6,862)	(6,456)
Net leases and loans	\$ 121,601	\$ 228,097	\$ 496,807	\$ 641,410	\$ 541,786

The lease and loan portfolio remains geographically diverse. The following table shows the geographic distribution at June 30, 2019 and 2018.

(dollars in thousands)

State	Net Investment in Leases & Loans			
	June 30, 2019		June 30, 2018	
	Balance	Percent	Balance	Percent
California	\$ 19,373	15.8%	\$ 30,290	13.2%
New York	15,410	12.6%	17,681	7.7%
Texas	9,154	7.5%	20,137	8.8%
Colorado	8,621	7.1%	13,110	5.7%
Connecticut	7,031	5.7%	7,155	3.1%
Florida, Virginia, North Carolina, Kentucky, Georgia, Tennessee	18,895	15.5%	33,465	14.6%
Indiana, Wisconsin, Minnesota, Illinois, Michigan, Ohio	16,940	13.8%	25,659	11.2%
Maine, Pennsylvania, Rhode Island, Maryland	10,761	8.8%	19,667	8.6%
Washington, Hawaii	5,328	4.4%	11,362	5.0%
Canada & Puerto Rico	1,959	1.6%	15,653	6.8%
All other states (no state greater than 1.0%)	8,779	7.2%	34,735	15.3%
	<u>\$ 122,251</u>	<u>100.0%</u>	<u>\$ 228,914</u>	<u>100.0%</u>

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

<u>Industry</u>	<b>Net Investment in Leases &amp; Loans</b>			
	<b>June 30, 2019</b>		<b>June 30, 2018</b>	
	<u>Balance</u>	<u>Percent</u>	<u>Balance</u>	<u>Percent</u>
Educational services	\$ 22,034	18.0%	\$ 29,344	12.8%
Healthcare and social services	21,358	17.5%	44,560	19.5%
Wholesale distribution	16,312	13.3%	25,138	11.0%
Retail Trade	9,900	8.1%	25,614	11.2%
Manufacturing - chemicals and materials	9,742	8.0%	10,287	4.5%
Arts, entertainment and recreation	9,269	7.6%	14,642	6.4%
Agriculture and food products	9,230	7.6%	11,403	5.0%
Manufacturing – industrial	8,981	7.3%	26,086	11.4%
Public administration	4,961	4.1%	6,631	2.9%
Manufacturing - automotive, truck, aerospace	4,679	3.8%	5,961	2.6%
Transportation	2,991	2.4%	3,678	1.6%
Mining and oil & gas services	1,761	1.4%	5,298	2.3%
Scientific, professional, other business services	938	0.8%	15,021	6.6%
Financial services	86	0.1%	3,725	1.6%
Building and construction	9	0.0%	82	0.0%
Commercial airlines and aviation services	-	0.0%	1,444	0.6%
	<u>\$ 122,251</u>	<u>100%</u>	<u>\$ 228,914</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, 2019, approximately 17.3% of the portfolio is with public and private colleges and universities, up from 11.8% at June 30, 2018, and approximately 7.8% of the portfolio consists of hospitals and medical centers, down from 10.3% at June 30, 2018. The universities and colleges are located throughout the United States and the group includes over 112 leases with 50 different institutions and no university representing more than 3% of the portfolio. The hospital portfolio involves 11 different credits and includes 12 lease schedules.

### **Lease Portfolio**

At June 30, 2019, leases accounted for 74% of the Company's lease and loan portfolio, compared with 54% at June 30, 2018. 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, 2019, 66.8% of the property value of new leases booked by the Company was held in its own portfolio, down from 77.5% during fiscal 2018 and 80% in fiscal 2017. For the fiscal year ended June 30, 2019, the Company's net investment in lease receivables decreased by \$31.4 million and the investment in estimated residual values decreased by \$1.6 million. The decrease in the investment in lease receivables reflects the sale or assignment of \$15.8 million of lease receivables and a lower volume of new lease bookings. The decrease in investment in residual values is due to a lower volume of new leases on which the Company records a residual compared to the volume of residual values recognized during the year.

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 by the lease 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, 2019, the Company's investment in property acquired for transactions-in-process of \$3.7 million was down 59% from \$9.0 million at June 30, 2018, and 79% from \$17.1 million at June 30, 2017.

The Company leases capital assets to businesses and other commercial or non-profit organizations. All leases are secured by the underlying property being leased. The Company's strategy is to develop lease portfolios with risk/reward profiles that meet its objectives and emphasizes diversification on both a geographic and customer level, and spreading the Company's risk across a breadth of leases. The average size of lease transactions booked over the past five years has fluctuated between \$751,000 to \$1.1 million. During the year ended June 30, 2019, three credits accounted for 21.6%, 11.6% and 5.2% of the property cost of leases booked during the fiscal year, respectively, with the five largest transactions aggregating to 46% of leases booked. During the year ended June 30, 2018, three commercial credits accounted for 17.3%, 6.5% and 6.1% of the property cost of leases

booked during the fiscal year, respectively, with the five largest commercial accounts aggregating to 42% of leases booked. At June 30, 2019, one customer accounted for 8.2% of the Company's net investment in leases, compared to one customer accounting for 7.9% of the Company's net investment in leases at June 30, 2018.

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 and networks, property leased includes medical equipment, manufacturing production systems, automated warehouse distribution systems, retail point-of-sale and inventory tracking systems, telecommunications systems such as wireless networks, voice over Internet protocol ("VoIP") systems, and a wide variety of non-electronic property, including office equipment, machine tools, school buses, trucks, exercise equipment and office and dormitory furniture. The mixture of property subject to leases booked 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, 2019 is set forth below (dollars in thousands):

<b>Year End June 30,</b>		<b>2019</b>	<b>%</b>		<b>2018</b>	<b>%</b>
Computer Hardware and Software	\$	15,332	27.4%	\$	20,731	28.8%
Medical Equipment		13,126	23.5%		16,256	22.6%
Manufacturing		10,302	18.4%		6,060	8.4%
Furniture & Fixtures		5,867	10.5%		7,603	10.6%
Point of Sale		3,160	5.6%		6,689	9.3%
Warehouse		2,278	4.1%		1,755	2.4%
Transportation		1,871	3.3%		3,099	4.3%
Office Equipment		1,646	2.9%		2,093	2.9%
Yellow Equipment		912	1.6%		5,089	7.1%
Telecommunications Systems		247	0.4%		1,230	1.7%
Other		1,224	2.2%		1,287	1.8%
Cost of Property on Leases Booked	\$	<u>55,965</u>		\$	<u>71,892</u>	

### **Commercial Loan Portfolio**

The Company's commercial loan portfolio of \$31.5 million at June 30, 2019 was down 70.3% from \$104.6 million at June 30, 2018 and represented 26% of the Company's net investment in leases and loans, down from 46% in fiscal 2018 and 62% in fiscal 2017. The portfolio at June 30, 2019 is comprised of 7 syndicated loan credits with an average balance of \$3.9 million, and 2 real estate loans with two subsidiaries of one corporate guarantor. The syndicated loans have maturity dates between June 2021 and February 2024, however \$6.0 million of the balance at June 30, 2019 was paid-off on July 3, 2019, and the remaining loans are expected to be refinanced or sold prior to maturity.

At June 30, 2019, all syndicated loans were characterized as "Term Loan B" loans with \$14.5 million or 46% characterized as "leveraged loans" under guidance promulgated by federal bank regulators, down from \$50.4 million or 51% at June 30, 2018. Only two credits of \$7.5 million were characterized as higher risk at June 30, 2019, compared to 5 credits for \$22.2 million at June 30, 2018. No loan credits are rated lower than B by Moody's Investors Service or rated less than pass by the Bank.

### **Equity Securities**

The Company's equity securities portfolio consists of common stock holdings of public companies with readily available prices and is carried at fair value. The portfolio is dominated by U.S. large cap equities which made up 86% of the portfolio at June 30, 2019 with 12% in U.S. mid cap equities and 2% in a tax-exempt mutual fund. The equity portfolio at June 30, 2019 consisted of 43 stocks, up from 25 at June 30, 2018. During fiscal 2019, the Company invested \$38 million in 31 different securities, including increasing positions in 13 holdings, and sold one stock that was acquired during the year. The equity portfolio cost basis, unrealized holding gains or losses and fair value by primary industry sector at the end of fiscal years 2019 and 2018 are presented below:

(in thousands)

	Cost Basis	Unrealized		FMV
		Gains	(Losses)	
<b>as of June 30, 2019</b>				
Commercial / Industrial	\$ 33,399	\$ 3,523	\$ (1,172)	\$ 35,750
Consumer	18,901	1,750	(1,554)	19,097
Financial	11,787	726	(723)	11,790
Healthcare	10,290	106	(1,089)	9,307
	<u>\$ 74,377</u>	<u>\$ 6,105</u>	<u>\$ (4,538)</u>	<u>\$ 75,944</u>

(in thousands)

	Cost Basis	Unrealized		FMV
		Gains	(Losses)	
<b>as of June 30, 2018</b>				
Commercial / Industrial	\$ 19,758	\$ 2,610	\$ (606)	\$ 21,762
Consumer	7,558	449	(14)	7,993
Financial	4,148	98	(178)	4,068
Healthcare	5,203	341	(477)	5,067
	<u>\$ 36,667</u>	<u>\$ 3,498</u>	<u>\$ (1,275)</u>	<u>\$ 38,890</u>

The equity portfolio had a cumulative net unrealized gain of \$1.6 million at June 30, 2019. During the twelve months ended June 30, 2019, the Company recognized a net unrealized loss of \$607,000 from the equity securities portfolio that included a net gain of \$2.3 million in the first quarter, a net loss of \$8.4 million in the second quarter, a net gain of \$4.8 million in the third quarter and a net gain of \$742,000 in the fourth quarter. These gains and losses arising from changes in the fair values of equity securities are recorded as part of Non-interest Income. The Company realized a \$49,500 gain on the sale of an equity security in fiscal 2019.

Upon the adoption of ASU 2016-01 on July 1, 2018, the Company reclassified unrealized gains on equity securities of \$2.2 million at June 30, 2018 (\$1.6 million, net after-tax) from accumulated other comprehensive income to retained earnings.

### **Fixed Income Securities Available-for-Sale**

The Company maintains a portfolio of fixed-income securities to generate interest income and to provide liquidity to the Bank. The Company's securities available for sale of \$24.0 million at June 30, 2019 were down \$12.7 million or 34.7% from \$36.7 million at June 30, 2018, due to the maturities of US Treasury securities and a corporate bond.

The carrying cost and fair value of the Company's available-for-sale securities at June 30, 2019 and 2018 is as follows:

(in thousands)	As of June 30, 2019		As of June 30, 2018	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
U.S. Treasury notes	\$ 23,996	\$ 23,978	\$ 31,964	\$ 31,728
Corporate debt securities	-	-	5,002	4,997
Total securities available-for-sale	<u>\$ 23,996</u>	<u>\$ 23,978</u>	<u>\$ 36,966</u>	<u>\$ 36,725</u>

The weighted-average maturity of debt securities at June 30, 2019 was 2.0 months and the corresponding weighted-average yield was 1.73 percent.

### **Asset Quality**

The Company monitors the performance of all leases and loans held in its own portfolio, transactions-in-process and loan commitments 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 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. The following table summarizes the Company's non-performing leases and loans.

<b><u>Non-performing Leases and Loans</u></b>	June 30,				
	2019	2018	2017	2016	2015
	(dollars in thousands)				
Non-accrual leases and loans	\$ -	\$ 3	\$ 3	\$ 12	\$ 41
Restructured leases	-	-	-	-	-
Leases past due 90 days (other than above)	-	-	-	-	-
Total non-performing leases and loans	<u>\$ -</u>	<u>\$ 3</u>	<u>\$ 3</u>	<u>\$ 12</u>	<u>\$ 41</u>
Repossessed equipment	-	-	-	1,300	-
Total non-performing assets	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,312</u>	<u>\$ 41</u>
Non-performing leases as % of net investment in leases and loans before allowances	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.01%</u>
Non-performing assets as % of total assets	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.15%</u>	<u>0.01%</u>



Non-performing assets consist of non-performing leases as well as any repossessed assets. There was no direct finance income actually recorded on non-performing leases during fiscal 2019, 2018 and 2017.

In addition to the non-performing leases identified above, there was investment of \$972,000 in leases at June 30, 2019 classified as substandard, that currently are experiencing financial difficulties or that management believes may experience financial difficulties in the future. This amount compared to \$3.5 million at June 30, 2018. 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 Company's lease and loan portfolios. Lease receivables, loans or residuals 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 lease and loan portfolio. The following table summarizes the activity in the allowance for loan and lease losses for the five years ended June 30, 2019.

	Years Ended June 30,				
	2019	2018	2017	2016	2015
	(dollars in thousands)				
Property acquired for transactions-in-process before allowance	\$ 3,653	\$ 8,955	\$ 17,101	\$ 30,932	\$ 31,340
Net investment in leases before allowance	91,640	124,867	192,741	239,964	301,733
Commercial loans, before allowance	31,465	106,118	311,213	408,308	246,509
Leases and loans, before allowances	<u>\$ 126,758</u>	<u>\$ 239,940</u>	<u>\$ 521,055</u>	<u>\$ 679,204</u>	<u>\$ 579,582</u>
Average leases and loans	<u>\$ 175,869</u>	<u>\$ 348,378</u>	<u>\$ 605,069</u>	<u>\$ 601,237</u>	<u>\$ 493,054</u>
Allowance for credit losses at beginning of year	\$ 2,888	\$ 7,147	\$ 6,862	\$ 6,456	\$ 5,299
Charge-off of lease receivables, loans and transactions-in-process	(17)	(24)	-	(1,120)	(19)
Charge-off on transfer of loans to held-for-sale	(273)	(17)	(168)	-	-
Recovery of lease amounts previously written off	6	7	203	51	1
Provision (release) of reserves for credit losses	(1,100)	(4,225)	250	1,475	1,175
Allowance for credit losses at end of year ("Allowance")	<u>\$ 1,504</u>	<u>\$ 2,888</u>	<u>\$ 7,147</u>	<u>\$ 6,862</u>	<u>\$ 6,456</u>
Components of allowance for credit losses:					
Allowance for lease losses	\$ 1,114	\$ 1,400	\$ 1,943	\$ 2,290	\$ 3,409
Allowance for loan losses	390	1,488	5,204	4,572	3,047
	<u>\$ 1,504</u>	<u>\$ 2,888</u>	<u>\$ 7,147</u>	<u>\$ 6,862</u>	<u>\$ 6,456</u>
Allowance as percent of leases and loans before allowances	1.22%	1.25%	1.42%	1.06%	1.18%
Net (charge-offs) recoveries as percent of average leases and loans	(0.16)%	(0.01)%	0.01%	(0.18)%	(0.00)%

The allowance for credit losses decreased to \$1.5 million at June 30, 2019 from \$2.89 million at June 30, 2018 and consisted of \$37,500 allocated to specific accounts and \$1.47 million that was available to cover losses inherent in the portfolio. The Company considers the allowance for credit losses of \$1.50 million at June 30, 2019 adequate to cover losses specifically identified as well as inherent in the lease and loan portfolios. However, no assurance can be given that the Company will not, in any particular period, sustain lease and loan losses that are sizeable in relation to the amount reserved, or that subsequent evaluations, in light of factors then prevailing, including economic conditions and the on-going credit review process, will not require significant increases in the allowance for credit losses. Among other factors, a renewed economic slowdown may have an adverse impact on the adequacy of the allowance for credit losses by increasing credit risk and the risk of potential loss even further.

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

	2019		2018		2017		2016		2015	
	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	\$1,114	74.4%	\$1,400	54.1%	\$1,943	38.2%	\$2,290	37.0%	\$3,409	55.0%
Commercial Loans	329	22.4%	1,427	44.2%	5,143	60.9%	4,511	62.0%	2,936	43.6%
Commercial Real Estate Loans	61	3.2%	61	1.8%	61	0.9%	61	1.0%	111	1.4%
	<u>\$1,504</u>	<u>100.0%</u>	<u>\$2,888</u>	<u>100.0%</u>	<u>\$7,147</u>	<u>100.0%</u>	<u>\$6,862</u>	<u>100.0%</u>	<u>\$6,456</u>	<u>100.0%</u>

While the allowance is allocated by category above, the allowance is general, in nature and available for the portfolio in its entirety.

### **Liquidity and Capital Resources**

The Company funds its operating activities through internally generated funds, bank deposits, borrowings and non-recourse debt. At June 30, 2019 and 2018, the Company's cash and cash equivalents were \$71.6 million and \$63.3 million, respectively.

Deposits at CalFirst Bank of \$87.7 million at June 30, 2019 were down 48.2% from \$169.4 million at June 30, 2018. The \$81.7 million decrease from June 30, 2018 is consistent with the 46.7% decline in the lease and loan portfolio over that period and the Company's reduced funding needs. The following table presents average balances and average rates paid on deposits for years ended June 30, 2019 and 2018:

	Twelve months ended June 30,					
	2019			2018		
	Ending Balance	Average Balance	Average Rate	Ending Balance	Average Balance	Average Rate
	(dollars in thousands)					
Non-interest bearing demand	\$ 1,686	\$ 1,845	n/a	\$ 2,208	\$ 4,528	n/a
Interest-bearing demand deposits	806	943	0.13%	1,070	1,177	0.20%
Savings & money market deposits	38,696	48,759	0.94%	60,645	71,577	0.91%
Time deposits, less than \$100,000	13,933	20,438	1.29%	25,566	45,720	1.08%
Time deposits, \$100,000 or more	\$ 32,624	\$ 61,363	1.42%	\$ 79,936	\$ 174,163	1.15%

The following table shows the maturities of certificates of deposits at the dates indicated:

	June 30, 2019	
	\$250,000 Or less	More than \$250,000
	(in thousands)	
Under 3 months	\$ 15,684	\$ 4,592
3 – 6 months	7,047	2,321
7 – 12 months	7,693	5,595
13 – 24 months	2,079	540
25 – 36 months	444	562
	<u>\$ 32,947</u>	<u>\$ 13,610</u>

The Bank has a borrowing agreement with the Federal Home Loan Bank of San Francisco ("FHLB") and as such, can take advantage of FHLB programs for overnight and term advances at published daily rates. The Bank had no short-term borrowings outstanding at June 30, 2019 and 2018.

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 2019, the Company sold net lease receivables aggregating to \$15.8 million. This compared to leases sold or assigned of \$31.4 million during fiscal 2018. At June 30, 2019, the Company had outstanding non-recourse debt aggregating \$2.7 million relating to property under 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 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 will be sufficient to meet its foreseeable financing needs.

### **Market and Interest Rate Sensitivity**

Market risk is the risk of loss in a financial asset arising from changes in interest rates and equity prices. The Company's principal market risk exposure is interest rate risk due to differences in the repricing characteristics of interest-earning assets and interest-bearing liabilities. Market risk also arises from the impact that fluctuations in interest rates may have on security prices and the values of available-for-sale securities that are accounted for at fair value. The Company also is exposed to increased market risk related to the investment in equity securities that can be susceptible to significant price volatility.

At June 30, 2019, the Company had assets of \$173.4 million subject to changes in interest rates over the next twelve months, compared to repricing liabilities of \$82.4 million. The mismatch between repricing of maturities within a time band is commonly referred to as the "gap" for that period. A positive gap (asset sensitive), where

interest rate sensitive assets exceed interest rate sensitive liabilities, generally will result in the net interest margin increasing in a rising rate environment and decreasing in a falling rate environment. A negative gap (liability sensitive) will generally have the opposite result on the net interest margin. However, the traditional gap analysis does not assess the relative sensitivity of assets and liabilities to changes in interest rates and other factors that could have an impact on interest rate sensitivity or net interest income. A sudden and substantial increase or decrease in interest rates may adversely impact our income to the extent that the interest rates associated with the assets and liabilities do not change at the same speed, to the same extent, or on the same basis. Non-recourse debt does not represent an interest rate risk to the Company because it is fully amortized through direct payments from lessees to the purchaser of the lease receivable.

### **Consolidated Interest Rate Sensitivity**

(in thousands)	3 Months or Less	Over 3 to 12 Months	Over 1 Through 5 years	Over 5 years	Non- Interest Sensitive	Total
<b><u>Rate Sensitive Assets (RSA):</u></b>						
- \$	71,606	\$ -	\$ -	\$ -	\$ -	\$ 71,606
Investment securities	18,991	4,987	-	2,734	-	26,712
Equity securities	-	-	-	-	75,944	75,944
Net investment in leases	14,768	35,144	50,072	24	(9,482)	90,526
Commercial loans	27,659	204	1,184	2,423	(395)	31,075
Non-interest earning assets	-	-	-	-	9,081	9,081
Totals	133,024	40,335	51,256	5,181	75,148	\$ 304,944
Cumulative total for RSA	\$ 133,024	\$ 173,359	\$ 224,615	\$ 229,796		
<b><u>Rate Sensitive Liabilities (RSL):</u></b>						
- \$	39,502	\$ -	\$ -	\$ -	\$ 1,686	\$ 41,188
Time deposits	20,277	22,656	3,624	-	-	46,557
Non-interest bearing liabilities	-	-	-	-	9,895	9,895
Stockholders' equity	-	-	-	-	207,304	207,304
Totals	59,779	\$ 22,656	\$ 3,624	\$ -	\$ 218,885	\$ 304,944
Cumulative total for RSL	\$ 59,779	\$ 82,435	\$ 86,059	\$ 86,059		
Interest rate sensitivity gap	\$ 73,245	\$ 17,679	\$ 47,632	\$ 5,181		
Cumulative GAP	\$ 73,245	\$ 90,924	\$ 138,556	\$ 143,737		
RSA divided by RSL (cumulative)	222.53%	210.30%	261.00%	267.02%		
Cumulative GAP / total assets	24.02%	29.82%	45.44%	47.14%		

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors  
California First National Bancorp and Subsidiaries  
Irvine, California

**Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of California First National Bancorp and Subsidiaries, which comprise the consolidated balance sheet as of June 30, 2019, and the related statements of earnings, comprehensive income, stockholders' equity, and cash flows for the year 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 audit. We conducted our audit 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 National Bancorp and Subsidiaries as of June 30, 2019, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

**Other Matter**

The financial statements of California First National Bancorp and Subsidiaries as of June 30, 2018 and for the years ended June 30, 2018 and 2017 were audited by Vavrinek, Trine, Day & Co. LLP, who joined Eide Bailly LLP on July 22, 2019, and whose report dated September 11, 2018, expressed an unmodified opinion on those statements.

Eide Bailly

Laguna Hills, California  
September 23, 2019

**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share amounts)

	June 30, 2019	June 30, 2018
<b><u>ASSETS</u></b>		
Cash and due from banks	\$ 68,849	\$ 63,307
Federal funds sold	2,757	-
Fixed income securities available-for-sale	23,978	36,725
Equity investments	75,944	38,890
Investments	2,734	3,555
Receivables	398	798
Property acquired for transactions-in-process	3,653	8,955
Leases and loans:		
Net investment in leases	91,640	124,867
Commercial loans	31,465	106,118
Allowance for credit losses	(1,504)	(2,888)
Net investment in leases and loans	121,601	228,097
Property on operating leases, less accumulated depreciation	1,720	2,054
Income tax receivable	256	2,660
Other assets	399	793
Discounted lease rentals assigned to lenders	2,655	3,368
Total Assets	<u>\$ 304,944</u>	<u>\$ 389,202</u>
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>		
Liabilities:		
Demand and savings deposits	\$ 41,188	\$ 63,923
Time certificates of deposit	46,557	105,502
Accounts payable	1,641	3,190
Accrued liabilities	1,267	1,629
Lease deposits	587	890
Non-recourse debt	2,655	3,368
Deferred income taxes, net	3,745	5,737
	<u>97,640</u>	<u>184,239</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 2019 and June 2018 issued and outstanding	103	103
Additional paid in capital	2,314	2,314
Retained earnings	204,917	201,210
Accumulated other comprehensive (loss) income, net of tax	(30)	1,336
Total Stockholders' Equity	<u>207,304</u>	<u>204,963</u>
Total Liabilities and Stockholders' Equity	<u>\$ 304,944</u>	<u>\$ 389,202</u>

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

**CONSOLIDATED STATEMENTS OF EARNINGS**

(in thousands, except share and per share amounts)

	Years ended June 30,		
	2019	2018	2017
Finance & loan income	\$ 10,189	\$ 17,575	\$ 26,234
Investment interest and dividend income	4,001	3,067	3,014
Total interest and dividend income	14,190	20,642	29,248
Interest expense			
Deposits	1,599	3,156	6,987
Borrowings	-	266	242
Total interest expense	1,599	3,422	7,229
Net interest income	12,591	17,220	22,019
Provision (release) of reserves for credit losses	(1,100)	(4,225)	250
Net interest income after provision for credit losses	13,691	21,445	21,769
<u>Non-interest income</u>			
Operating & sales-type lease income	1,388	1,709	2,716
Gain on sale of leases, loans & leased property	1,839	2,963	4,336
Loss on sale of investment securities	-	(1,008)	-
Loss on equity securities	(607)	-	-
Other fee income	129	299	387
Total non-interest income	2,749	3,963	7,439
<u>Non-interest expenses</u>			
Compensation & employee benefits	4,892	6,442	7,485
Occupancy	508	751	695
Professional and IT services	926	1,224	1,060
FDIC and regulatory fees	146	316	507
Reposessed asset	-	-	(121)
Other general & administrative	601	641	858
Total non-interest expenses	7,073	9,374	10,484
Earnings before income taxes	9,367	16,034	18,724
Income taxes	2,033	3,525	7,601
Net earnings	\$ 7,334	\$ 12,509	\$ 11,123
Basic earnings per common share	\$ 0.71	\$ 1.22	\$ 1.08
Dividends declared per common share	\$ 0.50	\$ 0.48	\$ 0.46
Weighted average common shares outstanding	10,284,139	10,284,137	10,279,818

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

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

	Years ended June 30,		
	2019	2018	2017
Net earnings	\$ 7,334	\$ 12,509	\$ 11,123
Other comprehensive income (loss):			
Unrealized gains/(losses) on securities available-for-sale	206	954	(2,274)
Reclassification adjustment of realized loss/(gain) included in net income on securities available-for-sale	-	1,008	-
Tax effect	(57)	(711)	923
Total other comprehensive income/(loss)	<u>149</u>	<u>1,251</u>	<u>(1,351)</u>
Total comprehensive income	<u>\$ 7,484</u>	<u>\$ 13,760</u>	<u>\$ 9,772</u>

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

	Common Shares	Stock Amount	Additional Paid in Capital	Retained Earnings	Accumulated Comprehensive Income	Total
Balance, June 30, 2016	10,279,807	\$ 103	\$ 2,240	\$ 187,334	\$ 1,345	\$ 191,022
Net earnings	-	-	-	11,123	-	11,123
Other comprehensive loss	-	-	-	-	(1,351)	(1,351)
Shares issued - stock options exercised	4,000	-	64	-	-	64
Stock based compensation expense	-	-	5	-	-	5
Dividends paid	-	-	-	(4,729)	-	(4,729)
Balance, June 30, 2017	<u>10,283,807</u>	<u>103</u>	<u>2,309</u>	<u>193,728</u>	<u>(6)</u>	<u>196,134</u>
Net earnings	-	-	-	12,509	-	12,509
Other comprehensive income	-	-	-	-	1,251	1,251
Stranded tax effects within AOCI	-	-	-	(91)	91	-
Shares issued - stock options exercised	332	-	5	-	-	5
Dividends paid	-	-	-	(4,936)	-	(4,936)
Balance, June 30, 2018	<u>10,284,139</u>	<u>103</u>	<u>2,314</u>	<u>201,210</u>	<u>1,336</u>	<u>204,963</u>
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>

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

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	Years Ended June 30,		
	2019	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net Earnings	\$ 7,334	\$ 12,509	\$ 11,123
Adjustments to reconcile net earnings to cash flows provided by (used for) operating activities:			
Provision (release) of reserves for credit losses	(1,100)	(4,225)	250
Depreciation and net amortization (accretion)	379	(314)	(177)
Gain on sale of loans held-for-sale	(94)	(698)	(189)
Proceeds from sales of loans held -for-sale	50,030	121,710	44,135
Reposessed asset	-	-	(121)
Gain on sale of leased property and sales-type lease income	(364)	(565)	(2,784)
Loss on equity securities, net	607	-	-
Net loss on sale of fixed-income securities	-	1,008	-
Deferred income taxes, including income taxes payable	(2,066)	(572)	(6,246)
Decrease (increase) in income taxes receivable	2,404	(1,572)	(967)
Net decrease in accounts payable and accrued liabilities	(362)	(907)	(1,086)
Other, net	(274)	(660)	390
Net cash provided by operating activities	<u>56,494</u>	<u>125,714</u>	<u>44,328</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Investment in leases, loans and transactions in process	(49,772)	(57,656)	(220,077)
Payments received on lease receivables and loans	93,226	185,687	286,238
Proceeds from sales of leased property and sales-type leases	2,393	3,390	8,149
Proceeds from sales and assignments of leases	16,261	32,332	43,136
Net increase in Fed funds sold	(2,757)	-	-
Purchase of equity investment securities	(38,208)	(31,206)	(8,261)
Pay down on fixed income securities	13,821	11,844	5,817
Proceeds from sale of fixed income securities	-	37,324	-
Proceeds from sale of equity securities	548	3,548	-
Proceeds from sale of reposessed assets	-	-	1,425
Net decrease (increase) in other assets	358	415	(616)
Net cash provided by investing activities	<u>35,870</u>	<u>185,678</u>	<u>115,811</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Net decrease in time certificates of deposit	(58,945)	(272,265)	(173,391)
Net (decrease) increase in demand and savings deposits	(22,735)	(26,944)	8,878
Net decrease in short-term borrowings	-	(40,000)	-
Dividends to stockholders	(5,142)	(4,936)	(4,729)
Proceeds from exercise of stock options	-	5	64
Net cash used for financing activities	<u>(86,822)</u>	<u>(344,140)</u>	<u>(169,178)</u>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<u>5,542</u>	<u>(32,748)</u>	<u>(9,039)</u>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<u>63,307</u>	<u>96,055</u>	<u>105,094</u>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<u>\$ 68,849</u>	<u>\$ 63,307</u>	<u>\$ 96,055</u>
<b><u>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</u></b>			
(Decrease) increase in lease rentals assigned to lenders and related non-recourse debt	\$ (713)	\$ 3,089	\$ (4,170)
Estimated residual values recorded on leases	\$ (216)	\$ (649)	\$ (652)
Interest paid on deposits and borrowed funds	\$ 1,638	\$ 3,577	\$ 7,338
Income taxes paid	\$ 1,696	\$ 5,668	\$ 14,814
Transfers from loans held for investment to loans held-for-sale	\$ 50,220	\$ 121,081	\$ 44,140

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



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

California First National Bancorp, a California corporation (the “Company”) is a bank holding company with two subsidiaries, California First National Bank (“CalFirst Bank” or the “Bank”) and California First Leasing Corp. (“CFLC”). The primary business of the Bank is secured financing provided through leasing and financing capital assets, commercial loans acquired through participation in the syndicated commercial loan market, by providing non-recourse loans to third parties secured by leases and equipment, and direct commercial loans. The lease and loan portfolio is diversified geographically and across industries. CalFirst Bank is an Internet bank that gathers deposits primarily through posting rates on the Internet with all banking and other operations conducted from one central location. CFLC participates in lease transactions with the Bank and has a growing portfolio of equity securities.

The Company is regulated by the Board of Governors of the Federal Reserve System (the “FRB”) while CalFirst Bank is subject to regulation and examination by the Office of the Comptroller of the Currency (“OCC”), its primary regulator. The Federal Deposit Insurance Corporation (“FDIC”) insures the Bank’s deposit accounts up to the maximum allowable amount.

**Basis of Presentation**

The consolidated financial statements include the accounts of California First National Bancorp and its wholly owned subsidiaries, CalFirst Bank and CalFirst Leasing. All intercompany balances and transactions have been eliminated in consolidation.

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 banks, Federal funds sold, cash in demand deposit accounts, and money market accounts, all of which have initial maturities of less than ninety days. The Company had cash in interest-bearing accounts of \$68.4 million and \$62.4 million at June 30, 2019 and 2018, respectively, of which \$11.3 million and \$21.0 million, respectively, represented assets of the Bank. At June 30, 2019, CalFirst Leasing and California First National Bancorp had \$57.1 million held in money market accounts not subject to FDIC insurance.

**Fixed Income Securities Available for Sale**

Securities are designated at the time of acquisition as available for sale or held to maturity. Securities that the Company will hold for indefinite periods of time and that might be sold in the future as part of efforts to manage interest rate risk, or in response to changes in interest rates, changes in prepayment rates, changes in market conditions or changes in economic factors are classified as available for sale and carried at fair values. Net aggregate unrealized gains or losses are reported, net of taxes, as a component of comprehensive income. Securities that the Company has the intent and ability to hold until maturity are classified as investments “held-to-maturity” and are stated at cost adjusted for amortization of premium or accretion of discount. The Company does not have any securities classified as trading.

The Company conducts a regular assessment of its fixed-income securities to determine whether any are other-than-temporarily impaired. In estimating other-than-temporary impairment losses, management considers, among other factors, the length of time and extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer, and the intent and ability of the Company to retain its investment for a period of time sufficient to allow for any anticipated recovery. The term “other-than-temporary” is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value for a debt security is determined to be other-than-temporary, the other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary

impairment related to the credit loss is recognized in other income. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

### 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 Consolidated Statement of Earnings as a component of equity securities gains/losses. Prior to July 1, 2018, the equity security investments were classified as available-for-sale and were also carried at fair value and periodic changes in fair value of these securities were recorded as components of other comprehensive income, and gains and losses were recorded in the Consolidated Statements of Earnings only when equity securities were sold (on a specific identification basis) or were considered other-than-temporarily impaired. In light of the size of the equity securities portfolio, changes in market prices and the related changes in unrealized gains or losses on equity securities will produce significant volatility in interim and annual earnings.

### 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.

A portion of the Company's non-interest expenses directly related to originating lease transactions through June 30, 2019 has been deferred through a reduction to non-interest expenses 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.

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 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, taking into account 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

Accumulated other comprehensive income 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 does not have any stock options outstanding at June 30, 2019.

Recent Accounting Pronouncements

On July 1, 2018, the Company adopted the amendments of ASU 2014-09 “Revenue from Contracts with Customers (Topic 606)” and all subsequent ASUs that modified Topic 606. The Company recognizes revenue when the performance obligations related to the transfer of goods or services under the terms of the contract are satisfied. The majority of the Company’s revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as leases and loans, investment securities, as well as revenue related to gain on sale of leases and loans. The adoption of this ASU did not have a material impact on our results of operations, financial position or disclosure in the notes to the consolidated financial statements.

On July 1, 2018, the Company adopted ASU 2016-01, “Financial Instruments—Overall: Recognition and Measurement of Financial Assets and Financial Liabilities. Adoption of ASU 2016-01 had a material impact on the Company’s financial statements. Changes made to the current measurement model primarily affect the accounting for equity securities with readily determinable fair values, where changes in fair value impact earnings instead of other comprehensive income. Equity securities without readily marketable fair values are to be carried at amortized cost, less impairment (if any) plus or minus changes resulting from observable price changes in orderly transactions for an identical investment or similar investment of the same issuer. The accounting for other financial instruments, such as loans, investments in debt securities, and financial liabilities is largely unchanged. Additionally, as part of adopting this standard, the Company refined the calculation used to determine the disclosed fair value of loans held for investment to be based on an exit price instead of an entrance price. The refined calculation did not have a significant impact on fair value disclosures.

In March 2017, the FASB issued Accounting Standards Update (“ASU”) 2017-08, “Receivable – Nonrefundable Fees and Other Costs (Subtopic 310-20) Premium Amortization on Purchased Callable Debt Securities.” This ASU amends guidance on the amortization period of premiums on certain purchased callable debt securities to shorten the amortization period of premiums on certain purchased callable debt securities to the earliest call date. The amendment is effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, including adoption in an interim period. The Company is currently evaluating the potential impact of ASU 2017-08 on its financial statements and disclosures.

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.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) to increase transparency and comparability among organizations recognizing lease assets and lease liabilities on the balance sheet. The ASU will require

lessees to recognize a right-of-use (ROU) asset for its right to use the underlying asset and a lease liability for the corresponding lease obligation for leases with terms of more than twelve months. Accounting by lessors will remain largely unchanged from current U.S. GAAP. The ASU also requires expanded quantitative and qualitative disclosures for both lessees and lessors. In July 2018, the FASB issued ASU 2018-11, Leases (Topic 842): Targeted Improvements, which provides entities with an additional (and optional) transition method in which the entity applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. In December 2018, the FASB issued ASU 2018-20, Leases (Topic 842): Narrow Scope Improvements for Lessors, which clarifies the treatment of sales taxes and other taxes collected from lessees, lessor costs paid directly by lessees, and recognition of variable payments for contracts with lease and non-lease components. In March 2019, the FASB issued ASU 2019-01, Leases (Topic 842): Codification Improvements, which aligned the new lease guidance with the existing guidance for fair value of the underlying asset by lessors that are not manufacturers or dealers. It also clarified an exemption for lessors and lessees from a certain interim disclosure requirement associated with adopting the board's new lease accounting standard. The Company adopted the guidance in these ASUs on July 1, 2019 and has applied the new transition method upon adoption and recorded a right of use asset and lease liability of \$536,000. ASU 2016-02 limits the types of direct lease origination costs that are able to be deferred. Initial direct costs are incremental costs directly related to origination activity of a lease that would not have been incurred had the lease not been executed and may depend on the facts and circumstances of each transaction. Certain incremental internal costs previously eligible for capitalization will now be expensed.

### Reclassifications

Certain reclassifications have been made to the fiscal 2018 financial statements to conform to the presentation of the fiscal 2019 financial statements.

### Note 2 – Investments

Investments are carried at cost and consist of the following:

	June 30, 2019		June 30, 2018	
	Carrying Cost	Fair Value	Carrying Cost	Fair Value
	(in thousands)			
Federal Reserve Bank Stock	\$ 1,955	\$ 1,955	\$ 1,955	\$ 1,955
Federal Home Loan Bank Stock	672	672	1,490	1,490
Mortgage-backed investment	107	114	110	118
	<u>\$ 2,734</u>	<u>\$ 2,741</u>	<u>\$ 3,555</u>	<u>\$ 3,563</u>

The investment in Federal Home Loan Bank of San Francisco ("FHLB") stock is a required investment related to CalFirst Bank's borrowing relationship with the FHLB. The FHLB obtains its funding primarily through issuance of consolidated obligations of the Federal Home Loan Bank system. The U.S. Government does not guarantee these obligations, and each of the twelve FHLB's are generally jointly and severally liable for repayment of each other's debt. Therefore, the Company's investment could be adversely impacted by the financial operations of the FHLB and actions by the Federal Housing Finance Agency. These investments have no stated maturity. CalFirst Bank is required to hold Federal Reserve Bank stock equal to 6% of its capital surplus, which is defined as additional paid-in capital stock, less any gains (losses) on available for sale securities as of the current period end.

The mortgage-backed investment consists of one U.S. agency issued security. The Company has determined that it has the ability to hold this investment until maturity and, given the Company's intent to do so, anticipates that it will realize the full carrying value of its investment and carries the security at amortized cost.

### Note 3 – Fixed Income Securities Available for Sale:

Securities available-for-sale include U.S. Treasury securities and corporate bonds. The amortized cost, fair value, and carrying value of available-for-sale-securities were as follows:

	at June 30, 2019			
(in thousands)	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
U.S. Treasury notes	\$ 23,996	\$ -	\$ (18)	\$ 23,978

(in thousands)	at June 30, 2018			
	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
U.S. Treasury notes	\$ 31,964	\$ -	\$ (236)	\$ 31,728
Corporate debt securities	5,002	-	(5)	4,997
Total securities available-for-sale	<u>\$ 36,966</u>	<u>\$ -</u>	<u>\$ (241)</u>	<u>\$ 36,725</u>

The following table presents the fair value and associated gross unrealized loss on available-for-sale securities with a gross unrealized loss at June 30, 2019 and 2018.

(in thousands)	Less than 12 Months		12 Months or More		Total	
	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value
At June 30, 2019						
U.S. Treasury notes	<u>\$</u>	<u>\$</u>	<u>\$ (18)</u>	<u>\$ 23,978</u>	<u>\$ (18)</u>	<u>\$ 23,978</u>
At June 30, 2018						
U.S. Treasury notes	\$ (236)	\$ 31,728	\$ -	\$ -	\$ (236)	\$ 31,728
Corporate debt securities	(5)	4,997	-	-	(5)	4,997
Total	<u>\$ (241)</u>	<u>\$ 36,725</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (241)</u>	<u>\$ 36,725</u>

The Company conducts a regular assessment of its investment portfolios to determine whether any securities are other-than-temporarily impaired. In estimating other-than-temporary impairment losses, management considers, among other factors, length of time and extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any recovery. The \$18,000 unrealized loss at June 30, 2019 and \$241,000 unrealized loss at June 30, 2018 relate to fluctuations in interest rates and financial markets and not credit quality. Because the Company has the intent to hold these securities and more likely than not will not need to sell them before recovery, the Company did not consider the investments to be other-than-temporarily impaired at June 30, 2019 and June 30, 2018.

The amortized cost and estimated fair value of available-for-sale securities at June 30, 2019, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(in thousands)	
Due in three months or less	\$ 18,998	\$ 18,991
Due after three months to one year	4,998	4,987
Total securities available-for-sale	<u>\$ 23,996</u>	<u>\$ 23,978</u>

The Company did not sell any available-for-sale securities during fiscal year 2019 but realized losses of \$1.0 million in fiscal year 2018. The losses realized during fiscal 2018 were recognized using the specific identification method and were included in Non-interest income.

At June 30, 2019, U.S. Treasury notes with an amortized cost of \$24.0 million are pledged to secure borrowings from the FHLB. At June 30, 2018, U.S. Treasury notes with an amortized cost of \$26.0 million were pledged to secure borrowings from the FHLB (see Note 10).

#### **Note 4 – Equity Securities:**

Investments in equity securities as of June 30, 2019 and 2018 are summarized based on the primary industry of the investee in the table below.

(in thousands)	Cost Basis	Unrealized		FMV
		Gains	(Losses)	
<b>as of June 30, 2019</b>				
Commercial / Industrial	\$ 33,399	\$ 3,523	\$ (1,172)	\$ 35,750
Consumer	18,901	1,750	(1,554)	19,097
Financial	11,787	726	(723)	11,790
Healthcare	10,290	106	(1,089)	9,307
Total equity securities	<u>\$ 74,377</u>	<u>\$ 6,105</u>	<u>\$ (4,538)</u>	<u>\$ 75,944</u>

(in thousands)

(in thousands)		Unrealized		
	Cost Basis	Gains	(Losses)	FMV
as of June 30, 2018				
Commercial / Industrial	\$ 19,758	\$ 2,610	\$ (606)	\$ 21,762
Consumer	7,558	449	(14)	7,993
Financial	4,148	98	(178)	4,068
Healthcare	5,203	341	(477)	5,067
Total equity securities	\$ 36,667	\$ 3,498	\$ (1,275)	\$ 38,890

Beginning July 1, 2018, gains and losses arising from changes in the fair values of equity securities are recorded as part of Non-interest Income. Prior to July 1, 2018, these gains and losses were recorded in other comprehensive income. Upon the adoption of ASU 2016-01 on July 1, 2018, the Company reclassified unrealized gains on equity securities of \$2.2 million at June 30, 2018 (\$1.6 million, net after-tax) from accumulated other comprehensive income to retained earnings.

**Note 5 – Receivables:**

The Company's receivables consist of the following:

	June 30,	
	2019	2018
	(in thousands)	
Other lessee receivables	\$ 174	\$ 426
Accrued interest and dividends	224	372
Total receivables	<u>\$ 398</u>	<u>\$ 798</u>

**Note 6 – Net Investment in Leases:**

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

	June 30,	
	2019	2018
	(in thousands)	
Minimum lease payments receivable	\$ 97,429	\$ 129,712
Estimated residual value	2,579	4,356
Less unearned income	(8,368)	(9,201)
Net investment in leases before allowances	91,640	124,867
Less allowance for lease losses	(1,089)	(1,363)
Less valuation allowance for estimated residual value	(25)	(37)
Net investment in leases	<u>\$ 90,526</u>	<u>\$ 123,467</u>

The minimum lease payments receivable and estimated residual value are discounted using the internal rate of return method related to each specific lease. Unearned income and discounts include the offset of initial direct costs of \$630,000 and \$1.7 million at June 30, 2019 and 2018, respectively.

At June 30, 2019, 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
2020	\$ 49,453	\$ 460	\$ 49,913
2021	27,986	445	28,431
2022	14,124	884	15,008
2023	5,163	577	5,740
2024	703	213	916
	<u>97,429</u>	<u>2,579</u>	<u>100,008</u>
Less unearned income	(7,962)	(406)	(8,368)
Less allowances	(1,089)	(25)	(1,114)
	<u>\$ 88,378</u>	<u>\$ 2,148</u>	<u>\$ 90,526</u>

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, 2019 are as follows:

Years ending June 30,	Non-recourse Debt (in thousands)
2020	\$ 613
2021	642
2022	673
2023	493
Total non-recourse debt	2,421
Deferred interest expense	234
Discounted lease rentals assigned to lenders	<u>\$ 2,655</u>

Deferred interest expense of \$234,000 at June 30, 2019 will be amortized against direct finance income related to the Company's discounted lease rentals assigned to lenders of \$2.7 million using the effective yield method over the applicable lease term.

### **Note 7 – Commercial Loans:**

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

(in thousands)	June 30,	
	2019	2018
Commercial term loans	\$ 27,592	\$ 102,095
Commercial real estate loans	3,878	4,134
Total commercial loans	31,470	106,229
Less unearned income and discounts	(5)	(111)
Less allowance for loan losses	(390)	(1,488)
Net commercial loans	<u>\$ 31,075</u>	<u>\$ 104,630</u>

### **Note 8 – 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 ("risk assets"). A summary of the allocation of the allowance for credit losses and selected statistics is as follows:

(dollars in thousands)	June 30,	
	2019	2018
Allowance for credit losses at beginning of year	\$ 2,888	\$ 7,147
Charge-off of leases	(17)	(24)
Loans transferred to held-for-sale	(273)	(17)
Recovery of lease amounts previously written off	6	7
Provision (release) of reserves for credit losses	(1,100)	(4,225)
Allowance for credit losses at end of year	<u>\$ 1,504</u>	<u>\$ 2,888</u>
Allowance for credit losses as percent of net investment in leases and loans before allowances	<u>1.22%</u>	<u>1.25%</u>
Net recoveries (charge-offs) as percent of average leases and loans	<u>(0.16)%</u>	<u>(0.01)%</u>

### **Note 9 – Credit Quality of Financing Receivables:**

The following tables provide information on the credit profile of the components of the portfolio and allowance for credit losses related to "financing receivables" as defined under Topic 310, Receivables. This disclosure on "financing receivables" covers the Company's 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 segments and classifications appropriate for assessing and monitoring the portfolios' risk and performance. This disclosure does not encompass all risk assets or the entire allowance for credit losses.

Portfolio segments identified by the Company include leases and loans. These segments have been disaggregated into 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 risk rating



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, 2019:</u>					
Pass	\$ 62,701	\$ 28,170	\$ 27,587	\$ 3,878	\$ 122,336
Special Mention	125	644	-	-	769
Substandard	-	-	-	-	-
Doubtful	-	-	-	-	-
	<u>\$ 62,826</u>	<u>\$ 28,814</u>	<u>\$ 27,587</u>	<u>\$ 3,878</u>	<u>\$ 123,105</u>
Non-accrual	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
<u>As of June 30, 2018:</u>					
Pass	\$ 86,987	\$ 37,772	\$ 88,641	\$ 4,134	\$ 217,534
Special Mention	64	41	9,891	-	9,996
Substandard	-	-	3,452	-	3,452
Doubtful	1	2	-	-	3
	<u>\$ 87,052</u>	<u>\$ 37,815</u>	<u>\$ 101,984</u>	<u>\$ 4,134</u>	<u>\$ 230,985</u>
Non-accrual	<u>\$ 1</u>	<u>\$ 2</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3</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, 2019:</u>						
Commercial Leases	\$ -	\$ -	\$ -	\$ 62,826	\$ 62,826	\$ -
Education, Government, Non-profit Leases	-	-	-	28,814	28,814	-
Commercial and Industrial Loans	-	-	-	27,587	27,587	-
Commercial Real Estate Loans	-	-	-	3,878	3,878	-
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 123,105</u>	<u>\$ 123,105</u>	<u>\$ -</u>
<u>As of June 30, 2018:</u>						
Commercial Leases	\$ -	\$ 1	\$ 1	\$ 87,051	\$ 87,052	\$ -
Education, Government, Non-profit Leases	-	2	2	37,813	37,815	-
Commercial and Industrial Loans	-	-	-	101,984	101,984	-
Commercial Real Estate Loans	-	-	-	4,134	4,134	-
	<u>\$ -</u>	<u>\$ 3</u>	<u>\$ 3</u>	<u>\$ 230,982</u>	<u>\$ 230,985</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, 2019 and 2018:

(in thousands)	Commercial Leases	Education Government Non-profit Leases	Commercial & Industrial Loans	Commercial Real Estate Loans	Total Financing Receivable
<u>As of June 30, 2019:</u>					
Allowance for lease and loan losses					
Balance beginning of period	\$ 1,142	\$ 258	\$ 1,427	\$ 61	\$ 2,888
Charge-offs	(1)	(16)	-	-	(17)
Transfer of loans to held-for-sale	-	-	(273)	-	(273)
Recoveries	6	-	-	-	6
Provision	(275)	-	(825)	-	(1,100)
Balance end of period	<u>\$ 872</u>	<u>\$ 242</u>	<u>\$ 329</u>	<u>\$ 61</u>	<u>\$ 1,504</u>
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	872	242	329	61	1,504
Total ending allowance balance	<u>\$ 872</u>	<u>\$ 242</u>	<u>\$ 329</u>	<u>\$ 61</u>	<u>\$ 1,504</u>
Finance receivables					
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	62,826	28,814	27,587	3,878	123,105
Total ending finance receivable balance	<u>\$ 62,826</u>	<u>\$ 28,814</u>	<u>\$ 27,587</u>	<u>\$ 3,878</u>	<u>\$ 123,105</u>
<u>As of June 30, 2018:</u>					
Allowance for lease and loan losses					
Balance beginning of period	\$ 1,627	\$ 316	\$ 5,143	\$ 61	\$ 7,147
Charge-offs	(10)	(14)	-	-	(24)
Transfer of loans to held-for-sale	-	-	(17)	-	(17)
Recoveries	-	7	-	-	7
Provision	(475)	(50)	(3,700)	-	(4,225)
Balance end of period	<u>\$ 1,142</u>	<u>\$ 259</u>	<u>\$ 1,426</u>	<u>\$ 61</u>	<u>\$ 2,888</u>
Individually evaluated for impairment	\$ 4	\$ 2	\$ -	\$ -	\$ 6
Collectively evaluated for impairment	1,138	257	1,426	61	2,882
Total ending allowance balance	<u>\$ 1,142</u>	<u>\$ 259</u>	<u>\$ 1,426</u>	<u>\$ 61</u>	<u>\$ 2,888</u>
Finance receivables					
Individually evaluated for impairment	\$ 65	\$ 2	\$ -	\$ -	\$ 67
Collectively evaluated for impairment	86,987	37,813	101,984	4,134	230,918
Total ending finance receivable balance	<u>\$ 87,052</u>	<u>\$ 37,815</u>	<u>\$ 101,984</u>	<u>\$ 4,134</u>	<u>\$ 230,985</u>

#### **Note 10 – Borrowings:**

CalFirst Bank is a member of the Federal Home Loan Bank of San Francisco and can take advantage of FHLB programs for overnight and term advances at published daily rates. Under terms of a blanket collateral agreement, advances from the FHLB are collateralized by qualifying real estate loans and investment securities. The Bank also has authority to borrow from the Federal Reserve Bank (“FRB”) discount window amounts secured by certain lease receivables. Borrowing capacity from the FHLB or FRB may fluctuate based upon the acceptability and risk rating of securities, loan and lease collateral and both the FRB and FHLB could adjust advance rates applied to such collateral at their discretion.

The Company had no short-term or long-term borrowings at June 30, 2019 and 2018. At June 30, 2019, there was estimated available borrowing capacity from the FHLB of \$26.0 million related to qualifying real estate loans of \$3.9 million and securities with a carrying value of \$24.0 million. There were no borrowings from the FRB, leaving availability of approximately \$25.0 million secured by \$30.9 million of lease receivables.

**Note 11 – Deposits:**

The composition of deposits is as follows:

	June 30, 2019		June 30, 2018	
	(dollars in thousands)			
Non-interest bearing deposits				
Demand deposits	\$ 1,686	1.9%	\$ 2,208	1.3%
Interest-bearing deposits				
Demand	806	0.9%	1,070	0.6%
Savings and money market	38,696	44.1%	60,645	35.8%
Time certificates of deposits	46,557	53.1%	105,502	62.3%
Total Deposits	<u>\$ 87,745</u>	<u>100.0%</u>	<u>\$ 169,425</u>	<u>100.0%</u>

Time certificates of deposits with balances of more than \$250,000 were \$13.6 million and \$27.8 million at June 30, 2019 and 2018, respectively.

At June 30, 2019, the scheduled maturities of time certificates of deposit are as follows:

<u>Years Ending:</u>	<u>(in thousands)</u>
2020	\$ 42,932
2021	2,619
2022	1,006
Total time certificates of deposit	<u>\$ 46,557</u>

**Note 12 – 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 include primarily equity securities and securities available-for-sale and at June 30, 2019, 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 mutual fund investments, U.S. Treasury securities, and corporate bonds generally are reported at fair value utilizing Level 1 and Level 2 inputs. The fair value of corporate bonds are obtained from independent quotation bureaus that use computerized valuation formulas to calculate current values based on observable transactions, but not a quoted bid (Level 2 input). U.S. Treasury securities, mutual funds and equity securities are valued by reference to the market closing or last trade price (Level 1 inputs). 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 2019 and 2018.

The following table summarizes the Company's assets, which are measured at fair value on a recurring basis as of June 30, 2019 and 2018:

Description of Assets / Liabilities	Total Fair Value	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)				
As of June 30, 2019				
U.S. Treasury notes	\$ 23,978	\$ 23,978	\$ -	\$ -
Equity investments	74,540	74,540	-	-
Mutual fund investments	1,404	1,404	-	-
	<u>\$ 99,922</u>	<u>\$ 99,922</u>	<u>\$ -</u>	<u>\$ -</u>
As of June 30, 2018				
U.S. Treasury notes	\$ 31,728	\$ 31,728	\$ -	\$ -
Corporate debt securities	4,997	-	4,997	-
Equity investments	37,577	37,577	-	-
Mutual fund investments	1,313	1,313	-	-
	<u>\$ 75,615</u>	<u>\$ 70,618</u>	<u>\$ 4,997</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 13 – 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, 2019 and June 30, 2018, and includes financial instruments that are not accounted for or carried at fair value. In accordance with disclosure guidance, certain financial instruments, including all lease related assets and liabilities and all non-financial instruments are excluded from fair value of financial instrument disclosure requirements. Accordingly, the aggregate of the fair values presented does not represent the total underlying value of the Company. These fair value estimates are based on relevant market information and data, however, given there is 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 therefore 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 investments, available-for-sale securities and equity and mutual fund investments are determined as set forth in Note 3 and 12. The fair values of loan participations that trade regularly in the secondary market are based upon current bid prices in such market at the measurement date and are classified as Level 2 in the fair value hierarchy. For other 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 as of June 30, 2019 are based on an exit value pursuant to the adoption of ASU 2016-01. These calculations have been adjusted for credit risk based on the Company's historical credit loss experience. The fair value of certificates of deposit and short-term borrowings are estimated based on discounted cash flows using current offered market rates or interest rates for borrowings 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, 2019		June 30, 2018	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(in thousands)			
Financial Assets:				
Cash and cash equivalents	\$ 71,606	\$ 71,606	\$ 63,307	\$ 63,307
Fixed income securities available-for-sale	23,978	23,978	36,725	36,725
Equity and mutual fund investments	75,944	75,944	38,890	38,890
Investments	2,734	2,741	3,555	3,563
Commercial loan participations	27,258	27,119	96,957	96,646
Other loans	3,817	3,816	7,673	7,420
Financial Liabilities:				
Demand and savings deposits	41,188	41,188	63,923	63,923
Time certificate of deposits	\$ 46,557	\$ 46,615	\$ 105,502	\$ 105,578

#### **Note 14 – 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 jurisdiction, as well as multiple state and local jurisdictions as a result of doing business in most states. The Company's Federal tax returns remain subject to examination from 2016 forward, while state income tax returns are generally open from 2015 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.

The provision for income taxes is summarized as follows:

	June 30,		
	2019	2018	2017
	(in thousands)		
Current tax (benefit) expense:			
Federal	\$ 2,656	\$ 2,670	\$ 10,398
State	1,080	1,260	2,032
	<u>3,736</u>	<u>3,930</u>	<u>12,430</u>
Deferred tax (benefit) expense:			
Federal	(1,190)	(871)	(3,905)
State	(513)	466	(924)
	<u>(1,703)</u>	<u>(405)</u>	<u>(4,829)</u>
Total income tax provision	<u>\$ 2,033</u>	<u>\$ 3,525</u>	<u>\$ 7,601</u>

At June 30, 2019 and 2018, the Company had an income taxes receivable balance of \$256,000 and \$2,660,000 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. Deferred income tax liabilities (assets) are comprised of the following:

	June 30,	
	2019	2018
	(in thousands)	
Deferred income tax liabilities:		
Tax operating leases	\$ 3,800	\$ 5,444
Deferred selling expenses	182	490
Depreciation	219	363
Other investments	342	527
Total liabilities	<u>4,543</u>	<u>6,824</u>
Deferred income tax assets:		
Allowances and reserves	(441)	(827)
State income taxes	(357)	(256)
Stock-based compensation	-	(4)
Total assets	<u>(798)</u>	<u>(1,087)</u>
Net deferred income tax liabilities	<u>\$ 3,745</u>	<u>\$ 5,737</u>

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

	Years Ended June 30,		
	2019	2018	2017
Federal statutory rate	21.00%	28.05%	35.00%
State tax, net of Federal benefit	7.20	6.40	5.92
Incremental adjustments due to Tax Act	(5.49)	-	-
Dividends received deduction	(1.72)	(0.69)	-
Other adjustments and tax exempt leases	0.72	0.91	(0.32)
Reduction in statutory Federal tax rate	-	(12.68)	-
Effective rate	<u>21.71%</u>	<u>21.99%</u>	<u>40.60%</u>

At June 30, 2019, 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, 2019, accrued penalties and interest on unrecognized tax benefits are estimated to be \$57,000.

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

	Years ended June 30,	
	2019	2018
	(in thousands)	
Balance, beginning of period	\$ 338	\$ 188
Increase for tax positions in current year	42	183
Decrease for tax positions taken in prior years	(65)	(59)
Increase for interest and penalties	(4)	26
Balance, end of period	<u>\$ 311</u>	<u>\$ 338</u>

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act ("Tax Act"). The Tax Act makes broad and complex changes to the U.S. tax code, including, but not limited to, reducing the U.S. federal corporate tax rate from 35 percent to 21 percent effective January 1, 2018. The reclassification of unrealized equity gains from other comprehensive income to retained earnings on July 1, 2018 and reconciliation adjustments to deferred tax liabilities related to the Tax Act resulted in incremental credits of \$515,000 recognized during the first six months of fiscal 2019, thereby resulting in a lower rate for fiscal 2019.

#### **Note 15 – Capital Structure and Stock-based Compensation:**

At June 30, 2019, the Company has 20,000,000 authorized shares of common stock and is authorized to issue 2,500,000 shares of preferred stock, from time to time, in one or more series and to fix the voting powers, designations, preferences and the relative participating, 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 upon the exercise of options or SARs, or upon the vesting of restricted stock awards, was initially 1,000,000, but the maximum number of available shares could increase by an amount equal to 1% of the total number of issued and outstanding shares of common stock as of June 30 of the fiscal year immediately preceding such fiscal year.

The Company accounts for equity-based compensation arrangements using the "modified prospective method" under ASC Topic 718, "Compensation – Stock Compensation ("ASC 718"). Stock-based compensation expense is estimated based on the fair-value for all new awards using the Black-Scholes option-pricing model. There have been no new option grants awarded since fiscal 2013. The Company recognized no stock-based compensation expense for the year ended June 30, 2019.

The following table summarizes activity related to stock options for the periods indicated:

	June 30, 2019		June 30, 2018	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options outstanding at beginning of period	-	\$ -	6,000	\$ 16.00
Exercised	-	-	(332)	16.00
Cancelled	-	-	(5,668)	16.00
Granted	-	-	-	-
Options outstanding at end of period	-	\$ 16.00	-	\$ 16.00
Options exercisable at end of period	-	-	-	-
Shares available for issuance	2,533,990		2,431,149	

At June 30, 2019 there were no options outstanding or exercisable. The total intrinsic value of options exercised during the year ended June 30, 2018 was \$6,203.

#### **Note 16 – Regulatory Capital Requirements:**

The Company and CalFirst Bank are subject to regulatory capital requirements administered by federal banking agencies, however, based on changes to federal rules and the Company's decline in total assets, only the Bank is subject currently to minimum capital measurements. Failure to meet minimum capital requirements by the Bank could result in the initiation of certain actions by the federal agencies that, if undertaken, could have a material effect on the Company's financial statements. The Basel III capital standard became effective January 2, 2015 and phases in through 2019. It revised the definition of capital, increased minimum capital ratios, introduced regulatory capital buffers above those minimums, introduced a common equity Tier 1 capital ratio and revised the rules for calculating risk-weighted assets. Under Basel III, the Bank made a one-time election to opt out of the requirement to include components of accumulated other comprehensive income (loss) in common equity Tier 1 capital. The capital standards require the Bank to maintain minimum ratios of core capital to adjusted average assets of 4.0%, common equity tier 1 capital to risk-weighted assets of 4.5%, tier 1 capital to risk-weighted assets of 6.0% and total risk-based capital to risk-weighted assets of 8.0%. The Basel III rules also changed the regulatory capital requirements for purposes of the prompt corrective action regulations. Accordingly, to be categorized as well capitalized, the Bank must have a minimum leverage capital ratio of at least 5.0%, common equity tier 1 capital ratio of at least 6.5%, a tier 1 risk-based capital ratio of at least 8.0%, and a total risk-based capital ratio of at least 10.0%.

In addition to requiring certain capital levels, federal banking regulations may limit the dividends paid by the Bank to the Company. Generally the Bank may not declare or pay a dividend to the Company in excess of 100% of its net retained earnings for the current calendar year combined with its net retained earnings for the preceding two calendar years without prior approval of the OCC. During the fiscal years ended June 30, 2019 and 2018, the Bank paid total dividends of \$54.5 million and \$22.0 million, respectively, to the Company. The Bank submitted a request and obtained an approval from the OCC in fiscal 2019 for payment of \$48.0 million of the dividends that were in excess of net retained earnings for the two preceding calendar years. Future dividends from the Bank to the Company will most likely continue to require approval from the OCC prior to payment.

The following table presents capital and capital ratio information for the Company and CalFirst Bank as of June 30, 2019 and June 30, 2018. The Company and Bank continue to exceed regulatory capital requirements and are considered "well-capitalized" under guidelines established by federal regulators.

(dollars in thousands)	June 30,			
	2019		2018	
	Amount	Ratio	Amount	Ratio
<b>California First National Bancorp</b>				
Common equity Tier 1 capital	\$ 207,333	91.66%	\$ 203,627	65.35%
Tier 1 risk-based capital	\$ 207,333	91.66%	\$ 203,627	65.35%
Total risk-based capital	\$ 208,837	92.32%	\$ 206,515	66.27%
Tier 1 leverage capital	\$ 207,333	67.17%	\$ 203,627	51.30%
<b>California First National Bank</b>				
Common equity Tier 1 capital	\$ 67,317	49.81%	\$ 116,032	44.67%
Tier 1 risk-based capital	\$ 67,317	49.81%	\$ 116,032	44.67%
Total risk-based capital	\$ 68,747	50.87%	\$ 118,835	45.75%
Tier 1 leverage capital	\$ 67,317	38.34%	\$ 116,032	36.14%

**Note 17 – 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, 2019 and 2018, the Company had unfunded lease commitments of \$35.8 million and \$22.2 million, respectively. These lease commitments are approved transactions, but it is likely that some portion of these commitments will not fund or be completed. The Company does not issue standby letters of credit.

**Leases**

The Company leases its corporate offices from an unrelated party, and effective September 1, 2019 moved into a new location under an operating lease that expires in fiscal 2023. Rent expense was \$508,000 (2019) and \$751,000 (2018).

Years ending June 30,	Future Minimum Lease Payments (in thousands)
2020	\$ 232
2021	186
2022	194
2023	32
	<u>\$ 644</u>

**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 \$51,900 (2019) and \$82,400 (2018).

**Note 18 – Segment Reporting:**

The Company's subsidiaries, CalFirst Bank and CFLC, are considered to be two different business segments. The accounting policies of each segment are the same as those described in "Summary of Significant Accounting Policies" (see Note 1). Below is a summary of each segment's financial results for fiscal years 2019 and 2018:

	CalFirst Bank	CFLC	Bancorp and Eliminating Entries (in thousands)	Consolidated
Year end June 30, 2019:				
Total interest and dividend income	\$ 11,256	\$ 2,044	\$ 890	\$ 14,190
Net interest income after provision for credit losses	10,752	2,047	892	13,691
Non-interest income	2,569	180	-	2,749
Net earnings	5,768	1,530	36	7,334
Total assets	\$ 168,150	\$ 81,326	\$ 55,468	\$ 304,944
Year end June 30, 2018:				
Total interest and dividend income	\$ 19,305	\$ 1,240	\$ 97	\$ 20,642
Net interest income after provision for credit losses	19,874	1,442	129	21,445
Non-interest income	2,628	1,335	-	3,963
Net earnings	11,582	2,186	(1,259)	12,509
Total assets	\$ 301,959	\$ 72,799	\$ 14,444	\$ 389,202



**Note 19 – California First National Bancorp (Parent Only) Financial Information:**

The condensed financial statements of California First National Bancorp as of June 30, 2019 and 2018 and for the years ended June 30, 2019 and 2018 as follows:

<b>Condensed Balance Sheets</b> (in thousands, except share amounts)	June 30,	
	2019	2018
<b>ASSETS</b>		
Cash and cash equivalents	\$ 59,551	\$ 17,813
Intercompany receivable	-	585
Investment in banking subsidiary	67,287	115,869
Investment in nonbanking subsidiaries	72,771	71,241
Intercompany note receivable	8,550	-
Other assets	242	739
Premises and other fixed assets	1	13
	<u>\$ 208,402</u>	<u>\$ 206,260</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Accrued liabilities	\$ 299	\$ 355
Intercompany payable	-	271
Income taxes payable- deferred	799	671
	<u>1,098</u>	<u>1,297</u>
<b>Stockholders' equity</b>		
Preferred stock; 2,500,000 shares authorized; none issued	-	-
Common stock, \$.01 par value; 20,000,000 shares authorized: 10,284,139 (June 2019) and 10,284,139 (June 2018)		
issued and outstanding	103	103
Additional paid in capital	2,314	2,314
Retained earnings	204,917	201,210
Other comprehensive (loss) income, net of tax	(30)	1,336
	<u>207,304</u>	<u>204,963</u>
	<u>\$ 208,402</u>	<u>\$ 206,260</u>
<b>Condensed Statements of Earnings</b> (in thousands)	Years Ended June 30,	
	2019	2018
<b>Income:</b>		
Dividends from bank subsidiary	\$ 54,500	\$ 22,000
Dividends from non-bank subsidiary	-	-
Management fee income bank subsidiary	803	968
Management fee income non-bank subsidiaries	223	141
Interest income bank subsidiaries	3	33
Interest income non-bank subsidiaries	50	-
Other interest income	889	97
	<u>56,468</u>	<u>23,239</u>
<b>Non-interest Expenses:</b>		
Salaries & benefits	1,444	1,554
Occupancy	84	211
Professional services	202	417
Other general & administrative	125	172
	<u>1,855</u>	<u>2,354</u>
<b>Income (Loss) before taxes and equity in undistributed earnings of subsidiaries</b>	54,613	20,885
Income tax expense	78	144
Equity in undistributed earnings of subsidiaries	(47,201)	(8,232)
<b>Net Income</b>	<u>\$ 7,334</u>	<u>\$ 12,509</u>

Condensed Statements of Cash Flows (in thousands)	Years Ended June 30,	
	2019	2018
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 7,334	\$ 12,509
Adjustments to reconcile net earnings to cash flows:		
Deferred income taxes	128	(400)
Equity in undistributed earnings of subsidiaries	47,201	8,232
Net change in other liabilities	(56)	(26)
Net change in other assets	497	(306)
Other, net	12	42
Net cash provided by operating activities	<u>55,116</u>	<u>20,051</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Payments for investments in and (advances to) subsidiaries	<u>(8,236)</u>	<u>(292)</u>
Net cash used for investing activities	<u>(8,236)</u>	<u>(292)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Dividends paid	<u>(5,142)</u>	<u>(4,936)</u>
Net cash used for financing activities	<u>(5,142)</u>	<u>(4,936)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	41,738	14,823
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	<u>17,813</u>	<u>2,990</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 59,551</u>	<u>\$ 17,813</u>

**Note 20 – Selected Quarterly Financial Data (Unaudited):**

Summarized quarterly financial data for the fiscal years ended June 30, 2019 and 2018 is as follows:

	Three Months Ended			
	September 30,	December 31,	March 31,	June 30,
	(dollars in thousands, except per share amounts)			
2019				
Total interest and dividend income	\$ 3,647	\$ 3,709	\$ 3,482	\$ 3,352
Net interest income after provision for credit losses	3,172	3,554	3,637	3,328
Non-interest income	3,648	(7,378)	5,001	1,478
Net earnings	\$ 3,897	\$ (3,863)	\$ 4,929	\$ 2,371
Basic earnings per common share	\$ 0.38	\$ (0.38)	\$ 0.48	\$ 0.23
Dividends declared per common share	\$ -	\$ 0.50	\$ -	\$ -
2018				
Total interest and dividend income	\$ 6,231	\$ 5,629	\$ 4,847	\$ 3,935
Net interest income after provision for credit losses	5,485	5,245	5,254	5,461
Non-interest income	950	1,522	1,060	430
Net earnings	\$ 2,295	\$ 5,014	\$ 2,669	\$ 2,530
Basic earnings per common share	\$ 0.22	\$ 0.49	\$ 0.26	\$ 0.25
Dividends declared per common share	\$ -	\$ 0.48	\$ -	\$ -