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Earnings Review

August 3, 2020

Freedom Bank of Virginia (FDVA - OTCQX - Recent Price: $7.25)

FDVA: High Volume of PPP Loans and Attractive Core Market Should Drive Strong Performance Relative to Peer Banks.

2Q20 Results:

Freedom Bank of Virginia reported 2Q20 net income of $1.5 million, up 79.5% compared to the $850k posted in 1Q20 and 199.7% over the $509k recorded in the year-ago period. This translates to 2Q20 earnings per share of $0.21 compared to $0.11 in 1Q20 and $0.07 in 2Q19. The posted results exceeded our $0.16 EPS estimate by $0.05. Higher gains on the sale of mortgage loans and higher net interest income more than offset a higher loan loss provision and higher-than-expected noninterest expenses to generate the outperformance relative to our projection. Highlights from the quarter include:

- Gross loans held-for-investment advanced $11.4 million or 27.7% sequentially to $513.8 million. Loans held-for-sale climbed $2.4 million or 8.0% linked-quarter. The main driver of the growth in loans held-for-investment was the $104.6 million in PPP loans originated during the quarter. However, even if we exclude these loans, the bank achieved sequential loan growth of a healthy 1.7%. The biggest contributor excluding PPP loans was the CRE segment, which rose $16.4 million or 7.6% sequentially. The construction segment also grew during the quarter, rising $1.9 million or 12.7%. The CRE advanced $99.0 million or 11.4%, pushed mainly by the PPP loans. Meanwhile, the residential mortgage and consumer segments declined 2.9% and 8.1%, respectively. Once again, the COVID-19 pandemic has caused us to reduce our expectations for organic loan growth modestly to a mid-single digit pace from our prior mid- to high-single digit pace.
- Despite the big increase in loans, Freedom's asset mix became less favorable in 2Q20, as low-yielding interest bearing deposits with other financial institutions and the bank's AFS investment portfolio grew faster than loans. As a result, loans declined to 78.3% of total assets from 80.6% at the prior quarter-end. Total assets increased to $697.2 million, a $160.9 million or 30.0% sequential increase from 1Q20.
- Total deposits climbed $75.3 million or 18.2% sequentially. Noninterest bearing accounts advanced $68.9 million or 81.1% sequentially, while interest bearing demand deposits rose $4.7 million or 28.5% and money market & savings deposits increased $11.0 million or 9.0% sequentially. Partially offsetting these movements was a $9.4 million or 4.9% decline in time deposits. The growth in deposits was supplemented by $104.7 million in PPP Liquidity Facility funds. The combined increase in deposit and PPPLF funding was more than enough to provide for the growth in PPP and other loans, leading to the increased liquidity and similar to the

Market Data		Earnings Per Share Data					
				Our Forecast		Consensus	
			2019A	2020E	2021E	2020	2021
Market Value (M)	$48	1Q (Mar.)	$ 0.07	$ 0.11	$ 0.11	$0.06	$0.10
ADTV (Shs)	5,692	2Q (Jun.)	$ 0.07	$ 0.21	$ 0.16	$0.16	$0.13
ADTV (000')	$41.3	3Q (Sep.)	$ 0.13	$ 0.19	$ 0.13	$0.21	$0.12
52 Week Range	$5.20-$10.75	4Q (Dec.)	$ 0.10	$ 0.13	$ 0.10	$0.16	$0.11
Dividend Yield	0.00%	Year	$ 0.37	$ 0.65	$ 0.50	$0.65	$0.47
		P / E	19.4	11.2	14.6	11.2	15.4

Source: SNL Financial, AS estimates

Fundamental Metrics (MRQ)	
Balance Sheet	
Total Assets (M)	$698
Gross Loans HFI (M)	$514
Total Deposits (M)	$488
Loans / Deposits	105%
Securities / Assets	13%
Debt / Assets	4%
Profitability	
NIM	2.93%
Nonint. Income / Revenue	41%
Efficiency Ratio	68.30%
Core ROAA	0.92%
Core ROACE	9.19%
Credit Quality	
NPAs / Assets	0.57%
NPLs / Loans	0.77%
NCO Ratio	0.12%
Reserves / Loans	0.10%
Provision / Avg Loans	0.55%
Capital Adequacy	
TCE / TA Ratio	9.7%
Total Capital Ratio	14.99%
Tier 1 Ratio	13.90%
Tier 1 CE Ratio	13.90%
Leverage Ratio	11.23%
Performance	
Core Value	$9.25
3 Yr. Success Ratio	6%
Failure Ratio	1.4%

Source: SNL Financial, Company data

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growth in loans held-for-investment, leading to the growth in lower-yielding securities and other liquid assets.

- Net interest income increased $742k or 18.7% linked-quarter, as a 32.1% advance in average earning assets was more than enough to overcome 33 bps of NIM compression to 2.93% (on a tax equivalent basis). The yield on average earning assets fell by 80 bps sequentially, driven by a 67 bps drop in average loan yields, 11 bps in average securities yields, and the previously noted shift in the earning asset mix away from loans and toward lower yielding cash and securities. The inclusion of low yielding PPP loans (which carry an interest rate of 1.0%) to the mix played a significant part in the reduced loan yields. However, origination and servicing fees on these loans of up to 5.0% are amortized over the life of these loans. If many of these loans are forgiven over the next two to three quarters, as we expect, the accelerated fee accretion will boost the yields recognized on these loans substantially. Meanwhile, the cost of interest bearing liabilities dipped 57 bps on a 46 bps drop in average interest bearing deposit costs and an 82 bps decline in the average cost of borrowings. The reduced borrowing costs were driven by the PPPLF funds, which carry a cost of 0.35%. We still anticipate further reductions in funding costs as CDs and FHLB borrowings mature and get replaced by lower cost deposits.
- Noninterest income increased $0.9 million or 37.7% compared to 1Q20, rising to $3.3 million. The primary driver was a $789k rise in mortgage banking revenues, offset partially by lower securities gains and “other” noninterest income.
- Noninterest expenses increased $580k or 12.0% sequentially. Much of the rise occurred in employee compensation, which climbed $231k or 7.1% sequentially driven by higher mortgage commission compensation. Mortgage fee settlement costs also increased, rising $233k or 105.5% LQ due to higher refinance activity. Professional fees rose $44k sequentially due to PPP related activity, while data processing fees climbed $99k, driven by higher loan and deposit activity.
- Freedom recorded net charge-offs of $150k or 0.12% of average loans, compared to no net charge-offs in 1Q20. As a result of the charge-offs, loan growth, and deteriorating economic conditions related to COVID-19, Freedom recorded a $705k loan loss provision in 2Q20. Freedom reported that it has agreed to payment deferrals of up to six months for 96 borrowers (up from 81 as of March 31, 2020) on loans totaling $89 million in response to the pandemic.
- Nonperforming loans grew roughly $1.8 million or 84.1% in 2Q20. There were no performing TDRs and the company’s balance sheet remained free of OREO at March 31, 2020. Meanwhile, loans 90 days past due and still accruing fell $70k or 46.7% sequentially. At the same time, early stage delinquencies (loans 30-89 days past due) declined $254k or 8.0% sequentially. As a result, NPLS/Loans rose from 0.50% at March 31, 2020 to 0.90% at June 30, 2020 (0.71% if we include PPP loans). NPAs/Assets (including 90-days past due) climbed from 0.43% at March 31, 2020 to 0.58% at June 30, 2020. The loan loss reserve climbed to 1.28% of total loans (excluding PPP loans) at March 31, 2020 from 1.16% at March 31, 2020.
- FDVA’s regulatory capital ratios declined noticeably compared to the prior quarter-end. The Total capital ratio, Tier 1 ratio and CET1 ratio all retreated 39 bps-45 bps, while the Leverage ratio fell 165 bps to 11.23%. All of the regulatory capital ratios remain far above the minimum levels needed to be considered “well capitalized”.
- The tangible common equity ratio dropped to 9.69% at June 30,2020 from 12.17% at March 31, 2020. Meanwhile, tangible book value per share climbed to $9.33 from $9.02.

Earnings Estimates: The COVID-19 pandemic and the related reduction in economic activity has been longer and deeper than we had anticipated three months ago. There are no signs that it is getting better or that we can put it behind us until vaccines become widely available, hopefully early in 2021. Even then, the damage to many households and small businesses is likely to persist for years to come. We believe that FDVA’s geographic location – in the suburbs of Washington DC – and its heavy concentration in commercial clients, particularly government contractors, will mitigate some of the unfavorable effects of the pandemic. Still, we expect loan organic growth to fall short of the reductions in PPP loans over the next three or four quarters and asset quality deterioration to increase as deferral periods end. We have boosted our estimate for loan loss provisioning accordingly and reduced our estimates for loan growth. The bank has substantial liquidity due to strong deposit inflows and the use of the PPP Lending Facility, both of which contributed to a sharp drop in funding costs. We expect both funding sources to decline in coming quarters as PPP loans are forgive or repaid and as borrowers utilize any excess funds sitting in deposit accounts. This will offset any ongoing benefits from reductions in the pricing and volume of time and brokered deposits. While the loss of low-yielding PPP loans due to forgiveness and the accelerated accretion of fees associated with these loans will boost average asset yields over the next several quarters, we still expect ongoing drops in average rates on new loan originations and repricings to continue pressuring the NIM. Mortgage banking revenue has been strong in recent quarters, aided by solid purchase and refinance activity. We don't see any signs of this slowing yet, but we are projecting some reduction in volumes in 4Q20.

After making the preceding adjustments to our model, we are reducing our EPS estimates for 3Q20 and 4Q20, but maintaining our $0.65 estimate for the full year, reflecting the better-than-expected 2Q20 results. We are raising our 2021 EPS estimate to $0.50 from $0.47 and introducing a 2022 estimate of $0.54.

Outlook: WE anticipate a tough interest rate environment over the next year or two and an increase in problem loans, leading to changes to our NIM projections and loan loss provision expectations. Still, we believe Freedom's geographic location and commercial emphasis will serve the bank well and help it perform better than many similar small banks throughout the country.

FDVA currently trades at only 77.7% of tangible book value. This valuation is in-line with similar-size peer banks in the region. However, as we note above, we believe that Freedom has a good chance to outperform these peer institutions due to its location, its business focus, and the recently completed restructuring of the bank that has boosted results in recent quarters, making this an attractive investment.

Due to changes in our corporate structure and a desire to avoid conflicts of interest, we are discontinuing the practice of providing target prices and stock ratings in our reports. However, we still believe we have insights to offer and value to add for the small number of securities that we continue to provide research coverage for.

Exhibit 1

Freedom Bank of Virginia: 2Q20 Highlights

	Actual Results			Change	
	2Q19	**1Q20**	**2Q20**	**LQ[1]**	**YOY**
Loans Held for Investment ($000)[2]	389,070	402,445	409,238	6.8%	5.2%
Total Deposits ($000)[2]	398,408	412,682	487,898	72.9%	22.5%
Average Earning Assets ($000)	465,577	485,982	642,166	128.6%	37.9%
Total Revenue ($000)	5,171	6,347	7,984	103.2%	54.4%
Net Interest Income ($000)	3,771	3,975	4,718	74.7%	25.1%
NIM (FTE)	3.25%	3.29%	2.95%	-0.34%	-0.29%
Average Securities Yield	2.80%	2.62%	2.51%	-0.11%	-0.29%
Average Loan HFI Yield	5.17%	5.07%	4.35%	-0.72%	-0.82%
Average Cost of Int.-bearing Deposits	2.02%	1.76%	1.30%	-0.46%	-0.72%
Efficiency Ratio	82.6%	75.4%	67.5%	-7.93%	-15.06%
NCO Ratio	0.23%	0.00%	0.12%	0.12%	-0.11%

1. Linked quarter changes for the balances are annualized.

2. Loans Held for Investment and Total Deposits balances are end of period balances.

Source: company filings, SNL Financial

Exhibit 2

Freedom Bank of Virginia

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(Figures in thousanSs except for per share data)

Fiscal years ending December 31	2016A	2017A	2018A	2019A	2020E	2021E	2022E	1Q20A	2Q20A	3Q20E	4Q20E	1Q21E	2Q21E	3Q21E	4Q21E
Net interest income	16,770	18,127	17,567	16,122	18,247	17,063	17,266	3,975	4,718	4,906	4,648	4,316	4,267	4,266	4,214
Provision for loan and lease losses	1,091	30	406	195	2,678	1,691	1,563	549	705	701	723	437	413	431	411
Net interest income after provision	15,679	18,097	17,161	15,928	15,569	15,372	15,703	3,426	4,013	4,206	3,925	3,879	3,854	3,836	3,803
Non-interest income:															
Service charges on deposit accounts	224	269	43	24	21	19	20	6	5	5	5	5	5	5	5
Gain on sale of mortgage loans	4,242	4,314	3,168	4,764	8,620	7,356	7,383	1,887	2,805	2,244	1,683	1,515	2,348	1,996	1,497
BOLI Income	60	56	63	382	488	529	545	102	127	129	130	131	131	133	134
Other noninterest income	-	-	236	132	1,275	1,226	1,276	351	329	296	299	302	305	308	311
Total non-interest income	4,525	4,640	2,329	5,408	10,429	9,130	9,224	2,372	3,267	2,674	2,117	1,953	2,789	2,441	1,947
Total Non-interest expense															
Salaries wages & employee benefits	10,726	10,917	11,654	11,347	13,142	13,154	13,302	3,258	3,488	3,314	3,082	3,174	3,428	3,360	3,192
Occupancy expense	983	1,002	1,099	1,143	1,201	1,238	1,269	293	301	302	305	307	308	310	313
Occupancy expense	537	556	664	941	634	614	626	184	148	151	152	152	153	154	155
Data processing	908	931	1,250	886	1,059	987	913	187	286	292	295	280	252	227	229
Professional fees	1,046	1,682	2,108	1,144	1,263	1,207	1,110	281	326	327	329	312	297	298	300
Business Development	204	226	245	336	171	152	154	59	37	37	38	38	38	38	38
Insurance expense	322	364	439	140	206	205	205	52	51	51	51	51	51	51	51
Franchise taxes	386	493	553	571	712	730	744	176	179	179	179	182	182	182	182
OREO writedowns	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Mortgage fees and settlement			498	843	1,313	1,193	1,197	221	455	364	273	246	381	324	243
Other noninterest expenses	689	771	830	809	609	642	655	136	157	158	159	159	160	161	162
Total non-interest expense	15,800	16,940	19,341	18,160	20,310	20,122	20,175	4,847	5,427	5,175	4,862	4,902	5,250	5,104	4,865
Net Income	2,742	2,695	191	2,705	4,742	3,594	3,899	850	1,526	1,399	968	763	1,142	962	726
Per Share Data:															
Diluted Earnings Per Share	0.44	0.39	0.03	0.37	0.65	0.50	0.54	0.11	0.21	0.19	0.13	0.11	0.16	0.13	0.10
Dividend	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Dividend Payout Ratio	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Book Value Per Share	8.36	8.47	8.47	8.87	9.65	10.13	10.64	9.02	9.33	9.52	9.65	9.75	9.90	10.03	10.13
Tangible Book Value Per Share	8.36	8.46	8.47	8.87	9.65	10.13	10.64	9.02	9.33	9.52	9.65	9.75	9.90	10.03	10.13
Average Diluted Shares OutstanSing (MM)*	6,236	6,834	6,949	7,227	7,297	7,253	7,268	7,435	7,268	7,241	7,244	7,248	7,251	7,255	7,259
Profitability Measures:															
Efficiency Ratio	74.41%	76.54%	95.98%	82.78%	70.23%	76.24%	75.58%	75.43%	67.51%	67.77%	71.31%	77.60%	73.88%	75.53%	78.34%
Return on average assets	0.61%	0.52%	0.04%	0.55%	0.85%	0.60%	0.66%	0.68%	0.92%	0.82%	0.60%	0.51%	0.77%	0.65%	0.49%
Return on average equity	5.82%	5.04%	0.33%	4.40%	7.08%	5.01%	5.17%	5.27%	9.24%	8.15%	5.55%	4.40%	6.43%	5.28%	3.94%
Net Interest Margin	3.76%	3.51%	3.50%	3.41%	3.04%	2.98%	3.04%	3.29%	2.95%	2.96%	3.00%	3.00%	2.99%	2.98%	2.97%
Fee Income % Average Assets	1.01%	0.90%	0.46%	1.10%	1.87%	1.52%	1.55%	0.47%	0.49%	0.39%	0.33%	0.32%	0.47%	0.41%	0.33%
Average Balances:															
Net Loans	402,942	402,770	389,508	388,820	455,658	435,102	447,780	397,774	508,598	495,892	455,658	445,623	442,115	437,986	435,102
Interest Bearing Deposits	62,941	69,942	67,013	80,630	110,553	107,579	110,285	84,938	153,835	131,669	110,553	109,775	109,775	107,579	107,579
Non-interest Bearing Deposits	336,451	396,038	333,719	314,581	337,404	357,721	379,654	327,745	334,063	334,063	337,404	339,428	347,235	354,180	357,721
Average Earning Assets	446,053	515,730	502,012	472,321	601,178	571,855	567,685	485,982	642,166	659,342	617,223	583,533	573,074	567,618	563,195
Average Interest Bearing Liabilities	342,645	398,672	382,643	343,661	428,927	407,878	400,424	358,205	448,600	465,460	443,443	419,735	408,625	403,395	399,756
Asset Quality Ratios:															
Net Charge-offs / Average Loans	0.02%	-0.09%	0.09%	0.16%	0.24%	0.36%	0.32%	0.00%	0.12%	0.31%	0.32%	0.34%	0.30%	0.32%	0.32%
Nonperforming Assets / Loans	0.28%	0.19%	0.85%	0.43%	1.10%	1.13%	1.02%	0.54%	0.97%	1.06%	1.10%	1.11%	1.12%	1.12%	1.13%
Reserves / Loans	1.00%	1.10%	1.15%	1.02%	1.34%	1.32%	1.30%	1.08%	1.18%	1.28%	1.34%	1.34%	1.33%	1.32%	1.32%
Provision /Loans	0.27%	0.01%	0.10%	0.05%	0.64%	0.39%	0.34%	0.55%	0.69%	0.68%	0.69%	0.42%	0.39%	0.40%	0.38%
Capital & Leverage Ratios:															
Equity / Assets	10.40%	10.37%	12.35%	12.80%	11.41%	12.57%	12.85%	12.17%	9.69%	10.33%	11.41%	11.78%	12.13%	12.34%	12.57%
Tangible Equity / Tangible Assets	10.40%	10.36%	12.35%	12.80%	11.41%	12.57%	12.85%	12.17%	9.69%	10.33%	11.41%	11.78%	12.13%	12.34%	12.57%

Disclosure Appendix

Analyst Certification:

I, Joseph Gladue, the primary analyst covering this issuer, certify that: 1) all of the views expressed in this report accurately reflect my personal views about the subject security or issuer, and 2) no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Risk Factors:

The realization of any or all of the following risk factors, among others, may adversely affect the company's stock price and prevent it from reaching our target price, if one is established:

- a weakening of the United States economy and the regional and local economies in which the company conducts operations
- unanticipated loan losses or securities-related losses
- a weakening of local real estate markets or the soundness and liquidity of the securities market for real-estate backed assets
- failure to maintain sufficient excess capital or liquidity to conduct operations
- the effects of trade, monetary, and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System
- the effects of increased inflation, a flatter yield curve, or increased volatility in financial markets
- inability to attract core deposits or continue to obtain third party financing on favorable terms
- adverse legal action against the company or litigation initiated by the company
- inability to successfully integrate acquired operations or to maintain sufficient excess capital post the close of a transaction

Investment Rating Definitions:

Investment ratings reflect the analyst's assessment of the subject stock's return potential relative to the NASDAQ Bank Index. There are three investment rating tiers:

- **Outperform/Buy:** The subject stock's total return is expected to exceed the return of the NASDAQ Bank Index by 10% or more over the next 12-month period.
- **Neutral/Hold:** The subject stock's total return is expected to be comparable with the return of the NASDAQ Bank Index over the next 12-month period.
- **Underperform/Sell:** The subject stock's total return is expected to be less than the return of the NASDAQ Bank Index by 10% or more over the next 12-month period.

Investment Rating Distributions (as of June 30, 2020)

	All Covered Companies		Investment Banking Services Provided in the Last 12 Months	
Rating Categories	**Count**	**% of Total**	**Count**	**% of Category**
Outperform/Buy	6	100%	0	0%
Neutral/Hold	NA	0%	0	0%
Underperform/Sell	NA	0%	0	0%
Total	6	100%		

Other Important Disclosures:

J. Alden Associates, Inc. (DBA Alden Securities) is a FINRA-registered broker-dealer.

Alden Securities expects to receive compensation for investment banking services from the subject company in the next three months and/or seeks to receive such compensation.

Analyst compensation is based, in part, on Alden Securities' profitability, which includes revenues from investment banking.

Target prices, if applicable, are derived from our 12 Month Valuation Assessment. Our 12 Month Valuation Assessment is based on a blend of several relative value methodologies.

Alden Securities shares in the commissions for trades that are executed through Tourmaline Partners, LLC.