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Earnings Review

November 2, 2020

Freedom Bank of Virginia (FDVA - OTCQX - Recent Price: $7.50)

FDVA: Strong Mortgage Banking, NIM Expansion Drive EPS Beat; Raising EPS Estimates. Discontinuing Coverage.

3Q20 Results:

Freedom Bank of Virginia reported 3Q20 net income of $2.6 million, up 68.9% compared to the $1.5 million posted in 2Q20 and up 176.2% over the $932k recorded in the year-ago period. This translates to 3Q20 earnings per share of $0.35 compared to $0.21 in 2Q20 and $0.13 in 3Q19. The posted results exceeded our $0.19 EPS estimate by $0.16. Higher gains on the sale of mortgage loans, a higher net interest margin, and no provision for loan losses more than offset higher-than-expected noninterest expenses to generate the outperformance relative to our projection. Highlights from the quarter include:

- Gross loans held-for-investment (excluding PPP loans) declined $11.9 million or 2.9% sequentially to $397.2 million. Driven by higher mortgage loan originations, loans held-for-sale climbed $35.7 million or 111.9% linked-quarter. Meanwhile, PPP loans grew $2.8 million or 2.6% sequentially.
- Freedom's asset mix became slightly less favorable in 3Q20, as low-yielding interest bearing deposits with other financial institutions and the bank's AFS investment portfolio continued to grow, but this quarter they were accompanied by investments in held-to-maturity securities. As a result, loans declined to 76.1% of total assets from 78.3% at the prior quarter-end. Total assets increased to $751.6 million, a $53.8 million or 7.7% sequential increase from 2Q20.
- Total deposits climbed $47.0 million or 9.6% sequentially. Noninterest bearing accounts advanced $22.4 million or 14.6% sequentially, while interest bearing demand deposits rose $28.7 million or 19.1%. Partially offsetting these movements was a $0.5 million or 14.4% sequential decrease in savings deposits and a $3.6 million or 2.0% decline in time deposits. The growth in deposits was supplemented by $2.7 million in incremental PPP Liquidity Facility funds. The increases in deposit and PPPLF funding supported the growth in total loans as well as growth in cash and AFS & HTM securities.
- Net interest income increased $243k or 4.8% linked-quarter, driven by a 6.1% advance in average earning assets and 20 bps of NIM expansion to 3.13% (on a tax equivalent basis). The yield on average earning assets rose by 6 bps sequentially, driven by an 81 bps jump in average yields on securities, which offset a 25 bps drop in average loan yields, and a slight increase in the average proportion of loans in the average asset mix. Low yielding PPP loans (which carry an interest rate of 1.0%) remain a drag on average loan yields. Loan forgiveness on a handful of the PPP loans has already been approved, but we still expect the bulk of PPP loan forgiveness, and the accelerated fee income that will accompany forgiveness, to occur in early 2021.

Market Data	
Market Value (M)	$49
ADTV (Shs)	5,551
ADTV (000')	$41.6
52 Week Range	$5.20-$10.75
Dividend Yield	0.00%

Earnings Per Share Data					
		Our Forecast		Consensus	
	2019A	2020E	2021E	2020	2021
1Q (Mar.)	$ 0.07	$ 0.11	$ 0.18	$0.06	$0.11
2Q (Jun.)	$ 0.07	$ 0.21	$ 0.29	$0.16	$0.16
3Q (Sep.)	$ 0.13	$ 0.35	$ 0.23	$0.19	$0.13
4Q (Dec.)	$ 0.10	$ 0.21	$ 0.15	$0.13	$0.10
Year	$ 0.37	$ 0.89	$ 0.84	$0.65	$0.50
P / E	20.0	8.5	8.9	11.5	15.0

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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Meanwhile, other loans are being originated or repriced at lower yields. Still, Freedom was able to deploy excess cash into a mix of corporate bonds municipal bonds and MBS that have helped drive tax-equivalent securities yields up substantially in 3Q20. The cost of interest bearing liabilities dipped 21 bps on a 23 bps drop in average interest bearing deposit costs and a 9 bps decline in the average cost of borrowings. We still anticipate further reductions in funding costs as CDs mature and get replaced by lower cost deposits.

- Noninterest income increased $2.2 million or 76.9% compared to 2Q20, rising to $5.1 million. The primary driver was a $2.3 million rise in mortgage banking revenues due to higher mortgage origination volumes.
- Noninterest expenses increased $1.8 million or 33.6% sequentially. Much of the rise occurred in employee compensation, which climbed $1.6 million or 47.6% sequentially driven by higher mortgage commission compensation. Mortgage fee settlement costs also increased, rising $146k or 32.0% LQ due to higher refinance activity.
- Freedom recorded negligible net charge-offs of 0.00% of average loans, compared to net charge-offs of 0.02% in 2Q20. As a result of the lack of charge-offs and a slight decline in loans held-for-investment, coupled with modest declines in NPAs, Freedom did not record a loan loss provision in 3Q20. Loans on deferral declined to 90 borrowers totaling $73 million, down from 96 borrowers on loans totaling $89 million in response to the pandemic. All of the deferrals are scheduled to end in 4Q20.
- Nonperforming loans fell roughly $284k or 7.1% in 3Q20. There were no performing TDRs and the company's balance sheet remained free of OREO at September 30, 2020. Meanwhile, loans 90 days past due and still accruing fell $80k or 100.0% sequentially to $0. As a result, NPLS/Loans fell from 0.90% at June 30, 2020 to 0.79% at September 30, 2020 (excluding PPP loans). NPAs/Assets (including 90-days past due) declined from 0.58% at June 30, 2020 to 0.49% at September 30, 2020. The loan loss reserve climbed to 1.32% of total loans (excluding PPP loans) at September 30, 2020 from 1.28% at June 30, 2020.
- FDVA's regulatory capital ratios advanced modestly compared to the prior quarter-end. The Total capital ratio, Tier 1 ratio and CET1 ratio all rose 18 bps-20 bps, while the Leverage ratio climbed 34 bps to 11.57%. 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 9.38% at September 30, 2020 from 9.68% at June 30, 2020. Meanwhile, tangible book value per share climbed to $9.75 from $9.33.

Earnings Estimates: The most obvious driver of Freedom Bank's better-than-expected 3Q20 results was the strong performance of the mortgage banking segment. However, the bank also posted NIM expansion, improved asset quality, and strong capital levels. We continue to 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. We expect low single-digit growth in loans held-for-investment as PPP loans start to decline due to forgiveness and gradual paydowns. We expect mortgage originations to remain robust due to the low interest rate environment, but we are projecting that originations over the next few quarters will not reach as high as 3Q20 production, and that loans held-for-sale and mortgage banking revenues decline from 3Q20 levels while still remaining high relative to historical trends at FDVA. We still expect to see noticeable asset quality deterioration in coming quarters, but there are no signs of it yet, and the bank has built up considerable reserves already that should cover much of the expected deterioration. We have reduced our provision expectations slightly as a result.

We are projecting modest NIM compression going forward as maturing wholesale funding is replaced at lower cost while reduced yields on newly originated and repriced loans are offset partially by declines in the low-yielding PPP portfolio that is accompanied by accelerated origination fee income. Given the higher-than-expected expenses and increased mortgage banking expectations, we have boosted our estimates for noninterest expenses going forward.

After making the preceding adjustments to our model, we are raising our EPS estimates for 2020 from $0.65 to $0.89. We are raising our 2021 EPS estimate from $0.50 to $0.84 and our 2022 estimate from $0.54 to $0.85.

Outlook: Despite a difficult economic environment, Freedom Bank has continued to show improvements in a number of areas. The bank has gained a significant number of new customers through the PPP program, the funding mix and funding costs have improved and should continue to do so. Asset quality remains good and reserve levels are strong. Efficiency and profitability have risen steadily. Capital levels are also strong, and should the bank continue to generate significant earnings, we believe management will consider returning capital to shareholders through either a dividend or a buyback program. We still 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 80.4% 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.

While we have enjoyed covering Freedom Bank of Virginia, shifting corporate responsibilities do not allow us time to provide the same level of diligence to our equity research as we would like. Consequently, we are discontinuing coverage of Freedom Bank of Virginia.

Exhibit 1

Freedom Bank of Virginia: 3Q20 Highlights

	Actual Results			Change	
	3Q19	**2Q20**	**3Q20**	**LQ**[1]	**YOY**
Loans Held for Investment ($000)[2]	400,818	409,088	397,224	-11.6%	-0.9%
Total Deposits ($000)[2]	396,652	487,898	534,867	38.5%	34.8%
Average Earning Assets ($000)	477,404	642,166	681,448	24.5%	42.7%
Total Revenue ($000)	6,044	7,928	10,367	123.1%	71.5%
Net Interest Income ($000)	4,208	5,072	5,315	19.1%	26.3%
NIM (FTE)	3.50%	3.18%	3.10%	-0.07%	-0.39%
Average Securities Yield	2.79%	2.51%	3.32%	0.81%	0.53%
Average Loan HFI Yield	5.36%	4.35%	4.10%	-0.25%	-1.26%
Average Cost of Int.-bearing Deposits	2.03%	1.30%	1.07%	-0.23%	-0.96%
Efficiency Ratio	80.3%	67.3%	68.3%	0.99%	-12.08%
NCO Ratio	-0.02%	0.12%	0.00%	-0.12%	0.02%

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)

2016A	2017A	2018A	2019A	2020E	2021E	2022E	*Fiscal years ending December 31*	1Q20A	2Q20A	3Q20A	4Q20E	1Q21E	2Q21E	3Q21E	4Q21E
16,770	18,127	17,567	16,122	19,987	19,020	18,990	Net interest income	4,206	5,072	5,315	5,394	4,897	4,766	4,718	4,639
1,091	30	406	195	1,908	1,581	1,438	Provision for loan and lease losses	549	705	-	654	424	379	398	379
15,679	18,097	17,161	15,928	18,079	17,439	17,551	**Net interest income after provision**	3,657	4,367	5,315	4,740	4,473	4,387	4,319	4,259
							Non-interest income:								
224	269	43	24	7	4	4	Service charges on deposit accounts	6	(1)	1	1	1	1	1	1
4,242	4,314	3,168	4,764	12,348	14,508	14,562	Gain on sale of mortgage loans	1,887	2,399	4,743	3,320	2,988	4,631	3,936	2,952
60	56	63	382	783	1,128	1,162	BOLI Income	102	127	277	277	280	280	283	286
-	-	236	132	492	112	117	Other noninterest income	121	330	14	27	28	28	28	29
4,525	4,640	2,329	5,408	13,674	15,753	15,846	**Total non-interest income**	2,142	2,855	5,052	3,625	3,296	4,940	4,249	3,267
							Total Non-interest expense								
10,726	10,917	11,654	11,347	16,313	17,945	18,146	Salaries wages & employee benefits	3,258	3,431	5,065	4,559	4,331	4,677	4,583	4,354
983	1,002	1,099	1,143	1,209	1,255	1,286	Occupancy expense	293	301	306	309	311	312	314	317
537	556	664	941	684	715	730	Occupancy expense	184	148	176	177	177	178	179	180
908	931	1,250	886	945	810	749	Data processing	187	286	230	242	230	207	186	188
1,046	1,682	2,108	1,144	1,170	1,058	973	Professional fees	281	326	275	288	274	260	261	263
204	226	245	336	265	281	285	Business Development	59	37	100	70	70	70	70	71
322	364	439	140	192	179	179	Insurance expense	52	51	44	45	45	45	45	45
386	493	553	571	725	756	772	Franchise taxes	176	179	185	185	189	189	189	189
-	-	-	-	-	-	-	OREO writedowns	-	-	-	-	-	-	-	-
		498	843	1,697	1,837	1,844	Mortgage fees and settlement	221	455	601	420	378	586	499	374
689	771	830	809	678	770	786	Other noninterest expenses	136	157	195	191	191	192	193	195
15,800	16,940	19,341	18,160	23,878	25,607	25,749	**Total non-interest expense**	4,847	5,370	7,176	6,485	6,195	6,717	6,520	6,175
2,742	2,695	191	2,705	6,468	6,121	6,172	**Net Income**	850	1,525	2,575	1,517	1,270	2,107	1,653	1,091
							Per Share Data:								
0.44	0.39	0.03	0.37	0.89	0.84	0.85	Diluted Earnings Per Share	0.11	0.21	0.35	0.21	0.18	0.29	0.23	0.15
-	-	-	-	-	-	-	Dividend	-	-	-	-	-	-	-	-
0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	Dividend Payout Ratio	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
8.36	8.47	8.47	8.87	9.95	10.78	11.61	Book Value Per Share	9.02	9.33	9.75	9.95	10.13	10.41	10.63	10.78
8.36	8.46	8.47	8.87	9.95	10.78	11.61	Tangible Book Value Per Share	9.02	9.33	9.75	9.95	10.13	10.41	10.63	10.78
6,236	6,834	6,949	7,227	7,304	7,245	7,259	Average Diluted Shares OutstanSing (MM)*	7,435	7,268	7,277	7,236	7,239	7,243	7,246	7,250
							Profitability Measures:								
74.41%	76.54%	95.98%	82.78%	70.15%	72.83%	73.10%	Efficiency Ratio	75.44%	67.27%	68.26%	71.13%	74.76%	68.48%	71.93%	77.21%
0.61%	0.52%	0.04%	0.55%	1.08%	0.92%	0.94%	Return on average assets	0.68%	0.92%	1.45%	0.84%	0.76%	1.28%	1.00%	0.67%
5.82%	5.04%	0.33%	4.40%	9.51%	8.15%	7.60%	Return on average equity	5.27%	9.24%	14.89%	8.47%	7.09%	11.36%	8.60%	5.58%
3.76%	3.51%	3.50%	3.41%	3.19%	3.02%	3.06%	Net Interest Margin	3.48%	3.18%	3.10%	3.09%	3.05%	3.02%	3.01%	2.99%
1.01%	0.90%	0.46%	1.10%	2.29%	2.36%	2.42%	Fee Income % Average Assets	0.42%	0.43%	0.72%	0.50%	0.49%	0.75%	0.65%	0.50%
							Average Balances:								
402,942	402,770	389,508	388,820	460,159	420,224	430,263	Net Loans	397,774	508,448	499,347	460,159	437,538	431,548	424,525	420,224
62,941	69,942	67,013	80,630	154,659	141,140	141,839	Interest Bearing Deposits	84,938	153,835	176,222	154,659	149,959	146,959	144,020	141,140
336,451	396,038	333,719	314,581	362,232	381,419	403,218	Non-interest Bearing Deposits	327,745	334,063	358,646	362,232	364,406	370,965	377,642	381,419
446,053	515,730	502,012	472,321	626,134	630,721	620,649	Average Earning Assets	485,982	642,166	681,448	694,940	651,560	633,940	622,553	614,832
342,645	398,672	382,643	343,661	440,756	430,353	423,450	Average Interest Bearing Liabilities	358,205	448,600	478,344	477,876	445,938	431,159	424,916	419,401
							Asset Quality Ratios:								
0.02%	-0.09%	0.09%	0.16%	0.15%	0.34%	0.31%	Net Charge-offs / Average Loans	0.00%	0.12%	0.00%	0.32%	0.29%	0.26%	0.28%	0.29%
0.28%	0.19%	0.85%	0.43%	0.98%	1.08%	0.98%	Nonperforming Assets / Loans	0.54%	0.97%	0.93%	0.98%	1.05%	1.07%	1.08%	1.08%
1.00%	1.10%	1.15%	1.02%	1.20%	1.24%	1.22%	Reserves / Loans	1.08%	1.19%	1.12%	1.20%	1.22%	1.21%	1.23%	1.24%
0.27%	0.01%	0.10%	0.05%	0.48%	0.38%	0.33%	Provision /Loans	0.55%	0.69%	0.00%	0.65%	0.42%	0.37%	0.38%	0.36%
							Capital & Leverage Ratios:								
10.40%	10.37%	12.35%	12.80%	10.41%	12.12%	12.69%	Equity / Assets	12.17%	9.68%	9.38%	10.41%	11.03%	11.45%	11.86%	12.12%
10.40%	10.36%	12.35%	12.80%	10.41%	12.12%	12.69%	Tangible Equity / Tangible Assets	12.17%	9.68%	9.38%	10.41%	11.03%	11.45%	11.86%	12.12%

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 September 30, 2020)

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

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.