



July 30, 2020

To our Shareholders:

Please find attached the unaudited financial results for the quarter ended June 30, 2020 for CoastalSouth Bancshares, Inc. (the “Company” or “COSO”), the parent company of Coastal States Bank (“CSB” or the “Bank”).

As the world adjusts to a “new normal” during the COVID-19 pandemic, CSB remains a safe and sound institution. During the second quarter, the Company’s momentum continued as deposits grew by \$128.9 million and loans held for investment grew by \$149.8 million, driven largely by the Bank’s participation in the SBA Paycheck Protection Program (“PPP”). Through this program, the Bank was able to support more than 740 different companies, who provide in excess of 16,800 jobs in our communities, by closing a total of approximately \$157 million PPP loans under the program. The Bank will continue to provide PPP loans while the program is open, and funds are available. As a result of participation in the PPP program, the Company has collected \$5.7 million in processing fees, which will help support the Bank in these uncertain times. These fees are earned over the life of the PPP loans, which carry a contractual interest rate of 1.00%.

Commercial loan demand has softened in our markets as business leaders take stock of the state of the pandemic and try to determine how their businesses will move forward. CSB provided \$99 million in COVID-19 related short-term loan modifications to 226 customers during the first and second quarters to customers who requested them. As these deferrals begin to expire this month, our Bankers are closely monitoring loan performance and communicating with their clients to help ensure these businesses stay on track. The Company has also identified certain asset classes that may have a higher risk of default from the economic impact of COVID-19 and has allocated \$1.1 million year-to-date in additional reserves against the portfolio. Management will continue to monitor reserve needs as additional information about our portfolio and the impact of the pandemic continues to be learned.

Despite all of this disruption, our lines of business associated with the residential real estate market have continued to perform very well. With residential mortgage rates at historic lows, demand for mortgage products remains strong. The Mortgage Banker Finance division generated another strong quarter of \$984 million in production volume and the Coastal States Mortgage team produced \$24 million in mortgage originations. Additionally, our Homebuilder line of business continues to experience strong customer demand, and we believe there will be an opportunity to grow this business in the second half of 2020.

The Company is also closely monitoring our deposit costs. As expected, following the rate decreases by the Federal Reserve in March of 2020, certain variable rate loans were repriced, creating a decline in yield on earning assets. In order to help protect the Bank's net interest margin, management worked to re-price deposit accounts to be in line with market rates. Management also is working to thoughtfully manage excess liquidity, including through the expansion of our investment securities portfolio, loan purchases, and core loan growth through our existing lines of business that continue to perform well under current conditions, such as our Mortgage Banker Finance and Homebuilder divisions.

The Company has also continued to support our communities through charitable initiatives. The CSB Community Commitment Fund has earmarked \$100 thousand in contributions to organizations supporting our communities during COVID-19. As of the date of this letter, \$82 thousand has been allocated across more than a dozen different organizations supporting our communities.

Our Bankers remain engaged and ready to serve our customers. While our branches continue to operate with drive-through and appointment-only protocols, we remain enthusiastic about growing our customer relationships and providing excellent customer service through these uncertain times.

Operating Highlights for the Quarter Ended June 30, 2020

Net Income

The Company reported net income of \$1.6 million for the second quarter of 2020 compared to net income of \$954 thousand in the first quarter of 2020 and a net income of \$617 thousand in the second quarter of 2019. Compared to the first quarter of 2020 and second quarter of 2019, the increase in net income was primarily attributable to an increase in net interest income.

Net Interest Income and Net Interest Margin

Net interest income before provision for credit losses was \$7.3 million in the second quarter of 2020, compared to \$6.6 million in the first quarter of 2020 and \$6.1 million in the second quarter of 2019. Net interest income after provision for credit losses was \$6.7 million for the second quarter of 2020 compared to \$6.0 million in the first quarter of 2020 and \$5.5 million in the second quarter of 2019.

Net interest margin for the second quarter of 2020 was 3.36% as compared to 3.74% for the first quarter of 2020 and 4.18% for the second quarter of 2019. Net interest margin compression was attributable to lower market interest rates following the Federal Reserve's rate adjustments at the end of the first quarter of 2020 and excess liquidity resulting from strong deposit gathering activities. In addition, PPP loans have also had an impact on our overall loan yields. While we collected over \$5.7 million in PPP processing fees, our overall loan yield was negatively impacted by 0.66% in the second quarter of 2020.

To combat margin compression, management made changes to lower deposit rates to be in line with market rates. Management also re-deployed excess liquidity into additional earning assets, such as investment securities. We will continue to be opportunistic regarding the deployment of excess liquidity as PPP loans pay down and are forgiven.

The cost of funds for the second quarter of 2020 was 72 basis points compared to 96 basis points for the first quarter of 2020 and 92 basis points for the second quarter of 2019. Beginning in the first quarter of 2020, the Bank began more aggressively lowering deposit costs as the Federal Reserve decreased the federal funds rates twice, bringing index rates down significantly. Management expects the cost of funds to decrease over the next several quarters.

Provision for Credit Losses

Provision for credit losses was \$602 thousand during the second quarter of 2020, compared to \$531 thousand in the first quarter of 2020 and \$624 thousand in the second quarter of 2019. During the second quarter of 2020, an additional \$720 thousand was provided in allowance reserves for the impact of COVID-19, as compared to \$378 in the first quarter of 2020. Charge-off and recovery activity was not significant during the second quarter of 2020.

Noninterest Income

Noninterest income was \$1.3 million in the second quarter of 2020, compared to \$1.4 million in the first quarter of 2020 and \$1.8 million in the second quarter of 2019. The decrease of \$125 thousand in the second quarter of 2020 compared to the first quarter of 2020 was due to an increase in the gain on sale of government guaranteed loans of \$373 thousand, offset by a decrease in securities gains of \$298 thousand and a decrease in other noninterest income of \$106 thousand. Compared to the second quarter of 2019, the decrease of \$486 thousand in noninterest income was primarily due to decreases in securities gains of \$350 thousand and other noninterest income of \$103 thousand. There were no gains on securities during the second quarter of 2020.

Noninterest Expense

Noninterest expense was \$5.9 million in the second quarter of 2020, as compared to \$6.2 million in the first quarter of 2020 and \$6.5 million in the second quarter of 2019. The decrease from the first quarter of 2020 to the second quarter of 2020 of \$278 thousand was primarily attributable to a decrease in salaries and employees' benefits expense of \$300 thousand driven by cost deferrals on the origination of PPP loans. Compared to the second quarter of 2019, the decrease of \$549 thousand in noninterest expense was primarily attributable to a decrease in salaries and employees' benefits as well.

Balance Sheet Highlights for the Quarter Ended June 30, 2020

Assets

Total assets as of June 30, 2020 were \$964 million, compared to \$777 million at March 31, 2020 and \$663 million at June 30, 2019. The increase in total assets as compared to the prior quarter is primarily attributable to additional investment securities and growth in loans from the SBA PPP program.

Investment securities at June 30, 2020 were \$120 million, compared to \$78 million at March 30, 2020, and up from \$59 million at June 30, 2019. As interest rates have declined significantly, Management has continued to look to deploy liquidity into higher interest earning assets through the securities portfolio.

Total gross loans held for investment at June 30, 2020 were \$634 million, compared to \$484 million at March 30, 2020, and up from \$431 million at June 30, 2019. The quarterly increase in loans held for investment of \$150 million is primarily in government guaranteed loans of \$157 million due to the SBA PPP loan program. Total loans held for sale at June 30, 2020 were \$110 million, compared to \$119 million at March 31, 2020 and \$73 million at June 30, 2019. The decrease in loans held for sale is due to the timing of loan balances held by Mortgage Banker Finance at the end of the quarter.

Allowance for loan losses at June 30, 2020 were \$5.0 million, compared to \$4.4 million at March 30, 2020, and from \$3.4 million at June 30, 2019. The increase in provision compared to the first quarter of 2020, is primarily related to the impacts of COVID-19. Compared to the second quarter of 2019, the increase in provision is primarily related to the growth of the loan portfolio and impacts of COVID-19.

Liabilities

Total deposits at June 30, 2020 were \$789 million, an increase from \$660 million at March 31, 2020 and from \$568 million at June 30, 2019. The increase in total deposits is attributable to continued new customer acquisition across the franchise and increases in many of our existing customer's deposit accounts as a result of the PPP program. Noninterest bearing deposits accounts for 27.8% of total deposits as compared to 22.1% of total deposits at March 31, 2020 and 24.2% at June 30, 2019. As the Company wins new loan customers and targets new deposit relationships with competitive rates on interest bearing accounts, our bankers are focused on ensuring that we win the entire relationship, including operating accounts, so that we can preserve our attractive mix of deposits.

Capital

Tangible book value per share at June 30, 2020 was \$11.49. CSB is currently well capitalized with a leverage ratio of 9.15%, a common equity tier 1 capital ratio of 11.70%, and a total risk-based capital ratio of 12.44%.



Detailed Results

Supplementary unaudited financial statements are included for the second quarter of 2020 as an appendix of this letter. As always, I encourage you to contact me with any questions or comments.

Sincerely,

A handwritten signature in black ink that reads "Anthony P. Valduga".

Anthony P. Valduga
CFO / COO

FORWARD-LOOKING STATEMENTS

Certain statements made in this report which are not statements of historical fact are forward-looking statements within the meaning of, and subject to the protections of, the federal securities laws. Forward looking statements include, among others, statements with respect to our beliefs, plans, objectives, goals, targets, expectations, anticipations, assumptions, estimates, intentions and future performance and involve known and unknown risks, many of which are beyond our control and which may our actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by the forward-looking statements made in this report. You can identify forward-looking statements through our use of words such as “believes,” “anticipates,” “expects,” “may,” “will,” “assumes,” “should,” “predicts,” “could,” “should,” “would,” “intends,” “targets,” “estimates,” “projects,” “plans,” “potential” and other similar words and expressions. Forward-looking statements are based on our current beliefs and expectations and are subject to significant risks and uncertainties. Accordingly, we caution you not to place undue reliance on such statements. We undertake no obligation to update or revise any of our forward-looking statements for events or circumstances that arise after the statement is made, except as otherwise may be required by law.

CoastalSouth Bancshares, Inc. and Subsidiary
Consolidated Balance Sheet - Unaudited
(dollars in thousands)

	2Q20	1Q20	4Q19	3Q19	2Q19	2Q20 change vs	
						1Q20	2Q19
Assets							
Cash and cash equivalents	\$ 52,428	\$ 48,250	\$ 49,273	\$ 40,353	\$ 51,900	\$ 4,178	\$ 528
Investment securities	119,519	78,085	62,496	61,408	58,533	41,434	60,986
Loans held for sale	109,749	119,018	81,243	87,255	73,244	(9,269)	36,505
Loans held for investment	634,282	484,468	468,326	453,521	430,598	149,814	203,684
Allowance for loan losses	(4,959)	(4,444)	(3,936)	(3,648)	(3,364)	(515)	(1,595)
Loans held for investment, net	629,323	480,024	464,390	449,873	427,234	149,299	202,089
Premises, furniture and equipment, net	15,354	14,790	14,280	14,137	14,047	564	1,307
Bank-owned life insurance	13,706	13,620	13,533	13,445	13,356	86	350
Deferred tax asset	10,103	10,752	10,779	11,296	11,762	(649)	(1,659)
Goodwill & intangible assets ⁽¹⁾	6,325	6,363	6,426	6,366	6,399	(38)	(74)
Other real estate owned	932	1,464	1,505	1,854	1,854	(532)	(922)
Other assets	6,444	5,080	4,564	4,572	4,327	1,364	2,117
Total assets	\$ 963,883	\$ 777,446	\$ 708,489	\$ 690,559	\$ 662,656	\$ 186,437	\$ 301,227
Liabilities and stockholders' equity							
Liabilities							
Deposits							
Noninterest bearing DDA	\$ 219,477	\$ 145,613	\$ 141,025	\$ 138,639	\$ 137,699	\$ 73,864	\$ 81,778
Interest bearing DDA	117,085	96,394	90,761	94,259	93,465	20,691	23,620
Savings and money market	275,997	236,964	203,402	183,678	183,424	39,033	92,573
Certificates of deposit	176,529	181,238	165,904	157,785	153,811	(4,709)	22,718
Total deposits	789,088	660,209	601,092	574,361	568,399	128,879	220,689
Other borrowings	73,717	20,000	10,000	20,000	-	53,717	73,717
Other liabilities	4,164	3,665	5,103	4,681	3,912	499	252
Total liabilities	866,969	683,874	616,195	599,042	572,311	183,095	294,658
Stockholders' equity							
Voting common stock	5,966	6,203	6,203	6,194	6,194	(237)	(228)
Nonvoting common stock	1,991	1,754	1,754	1,754	1,754	237	237
Capital surplus	121,214	120,979	120,756	120,488	120,568	235	646
Accumulated deficit	(34,405)	(36,012)	(36,966)	(37,646)	(38,935)	1,607	4,530
Accumulated other comprehensive income	2,148	648	547	727	764	1,500	1,384
Total stockholders' equity	96,914	93,572	92,294	91,517	90,345	3,342	6,569
Total liabilities and stockholders' equity	\$ 963,883	\$ 777,446	\$ 708,489	\$ 690,559	\$ 662,656	\$ 186,437	\$ 301,227

Capital ratios ⁽²⁾

Leverage ratio	9.15%	9.93%	10.32%	10.54%	10.98%	-0.78%	-1.83%
CET1 risk-based capital ratio	11.70	10.82	11.72	11.66	12.03	0.88	-0.33
Tier 1 risk-based capital ratio	11.70	10.82	11.72	11.66	12.03	0.88	-0.33
Total risk-based capital ratio	12.44	11.48	12.37	12.27	12.62	0.96	-0.18

⁽¹⁾ Includes commercial mortgage servicing assets of \$805, \$792, \$803, \$689, and \$667 for 2Q20, 1Q20, 4Q19, 3Q19 and 2Q19, respectively.

⁽²⁾ Ratios are for Coastal States Bank, a wholly-owned subsidiary of CoastalSouth Bancshares, Inc.

CoastalSouth Bancshares, Inc. and Subsidiary
Consolidated Statements of Operations - Quarterly - Unaudited
(dollars in thousands)

						2Q20 change vs	
	2Q20	1Q20	4Q19	3Q19	2Q19	1Q20	2Q19
Interest income							
Interest on cash and cash equivalents	\$ 16	\$ 237	\$ 167	\$ 194	\$ 264	\$ (221)	\$ (248)
Interest and dividends on investment securities	616	456	424	398	436	160	180
Interest and fees on loans	8,099	7,425	7,550	7,322	6,718	674	1,381
Total interest income	8,731	8,118	8,141	7,914	7,418	613	1,313
Interest expense							
Deposits	1,360	1,535	1,467	1,404	1,279	(175)	81
Other borrowings	104	31	43	28	10	73	94
Total interest expense	1,464	1,566	1,510	1,432	1,289	(102)	175
Net interest income	7,267	6,552	6,631	6,482	6,129	715	1,138
Provision (recovery) for credit losses	602	531	620	(22)	624	71	(22)
Net interest income after provision for credit losses	6,665	6,021	6,011	6,504	5,505	644	1,160
Noninterest income							
Mortgage banking related income	461	439	322	484	410	22	51
Gain on sale of government guaranteed loans	451	78	843	172	434	373	17
Interchange and card fee income	162	217	193	191	203	(55)	(41)
Securities gains, net	-	298	22	268	350	(298)	(350)
Service charges on deposit accounts	112	174	178	169	170	(62)	(58)
Gain on BOLI	87	86	87	90	89	1	(2)
Other noninterest income	31	137	174	217	134	(106)	(103)
Total noninterest income	1,304	1,429	1,819	1,591	1,790	(125)	(486)
Noninterest expense							
Salaries and employee benefits	3,706	4,006	4,370	4,201	4,355	(300)	(649)
Occupancy and equipment	406	378	435	428	411	28	(5)
Software and other technology expense	365	326	371	373	330	39	35
Data processing	310	315	295	240	241	(5)	69
Other professional services	271	276	410	298	240	(5)	31
Regulatory assessment	165	151	45	92	119	14	46
Loss on other real estate owned, net	51	41	349	-	(3)	10	54
Other noninterest expense	630	689	645	779	760	(59)	(130)
Total noninterest expense	5,904	6,182	6,920	6,411	6,453	(278)	(549)
Net income before taxes	2,065	1,268	910	1,684	842	797	1,223
Income tax expense	457	314	232	392	225	143	232
Net income	\$ 1,608	\$ 954	\$ 678	\$ 1,292	\$ 617	\$ 654	\$ 991
Earnings per share - basic	\$ 0.20	\$ 0.12	\$ 0.09	\$ 0.16	\$ 0.09	\$ 0.08	\$ 0.11
Tangible book value	\$ 91,394	\$ 88,001	\$ 86,671	\$ 85,840	\$ 84,613	\$ 3,393	\$ 6,781
Tangible book value per share	\$ 11.49	\$ 11.06	\$ 10.89	\$ 10.80	\$ 10.65	\$ 0.43	\$ 0.84
Weighted average shares outstanding	7,956,253	7,956,253	7,947,253	7,947,253	6,604,107	-	1,352,147
Shares outstanding	7,956,253	7,956,253	7,956,253	7,947,253	7,947,253	-	9,000

CoastalSouth Bancshares, Inc. and Subsidiary
Consolidated Statements of Operations - Year to Date - Unaudited
(dollars in thousands)

	Six Months Ended June 30		Change
	2020	2019	
Interest income			
Interest on cash and cash equivalents	\$ 253	\$ 592	\$ (339)
Interest and dividends on investment securities	1,072	855	217
Interest and fees on loans	15,524	12,763	2,761
Total interest income	16,849	14,210	2,639
Interest expense			
Deposits	2,895	2,321	574
Other borrowings	135	22	113
Total interest expense	3,030	2,343	687
Net interest income	13,819	11,867	1,952
Provision for credit losses	1,133	1,269	(136)
Net interest income after provision for credit losses	12,686	10,598	2,088
Noninterest income			
Mortgage banking related income	900	696	204
Gain on sale of government guaranteed loans	529	862	(333)
Interchange and card fee Income	379	385	(6)
Securities gains, net	298	350	(52)
Service charges on deposit accounts	286	352	(66)
Gain on BOLI	173	176	(3)
Other noninterest income	168	270	(102)
Total noninterest income	2,733	3,091	(358)
Noninterest expense			
Salaries and employee benefits	7,712	8,405	(693)
Occupancy and equipment	784	846	(62)
Software and other technology expense	691	663	28
Data processing	625	491	134
Professional services	547	588	(41)
Regulatory assessment	316	243	73
Loss on other real estate owned, net	92	50	42
Other noninterest expense	1,319	1,530	(211)
Total noninterest expense	12,086	12,816	(730)
Net income before taxes	3,333	873	2,460
Income tax expense	771	238	533
Net income	\$ 2,562	\$ 635	\$ 1,927
Earnings per share - basic	\$ 0.32	\$ 0.10	\$ 0.22
Weighted average shares outstanding	7,956,253	6,502,659	1,453,594
Shares outstanding	7,956,253	7,947,253	9,000

CoastalSouth Bancshares, Inc. and Subsidiary
Condensed Consolidated Average Balances and Yield Analysis
(dollars in thousands)

	2Q20	1Q20	4Q19	3Q19	2Q19	2Q20 change vs	
						1Q20	2Q19
Average balances							
Cash and cash equivalents	\$ 79,147	\$ 74,870	\$ 42,893	\$ 43,911	\$ 48,315	\$ 4,277	\$ 30,832
Investment securities	96,161	69,469	62,092	58,625	59,914	26,692	36,247
Loans held for sale	93,955	83,301	86,369	85,031	62,759	10,654	31,196
Loans held for investment	601,472	476,274	468,447	445,026	417,334	125,198	184,138
Total earning assets	870,735	703,914	659,801	632,593	588,322	166,821	282,413
Total nonearning assets	48,406	46,867	47,389	48,198	47,886	1,539	520
Total assets	919,141	750,781	707,190	680,791	636,208	168,360	282,933
Interest bearing deposits	535,696	484,497	443,167	430,547	421,331	51,199	114,365
Other borrowings	94,299	16,044	19,672	10,797	429	78,255	93,870
Total interest bearing liabilities	629,995	500,541	462,839	441,344	421,760	129,454	208,235
Noninterest bearing deposits	190,342	152,337	147,450	144,283	137,843	38,005	52,499
Other liabilities	3,818	4,456	4,706	4,135	4,459	(638)	(641)
Stockholders' equity	94,986	93,447	92,195	91,029	72,146	1,539	22,840
Total liabilities and stockholders' equity	919,141	750,781	707,190	680,791	636,208	168,360	282,933
Interest margins							
Cash and cash equivalents	0.08%	1.27%	1.54%	1.75%	2.19%	-1.19%	-2.11%
Investment securities	2.58%	2.64%	2.71%	2.69%	2.92%	-0.06%	-0.34%
Loans	4.68%	5.34%	5.40%	5.48%	5.61%	-0.66%	-0.93%
Total earning assets	4.03%	4.64%	4.90%	4.96%	5.06%	-0.61%	-1.03%
Interest bearing deposits	1.02%	1.27%	1.31%	1.29%	1.22%	-0.25%	-0.20%
Other borrowings	0.44%	0.78%	0.87%	1.03%	9.35%	-0.34%	-8.91%
Total interest bearing liabilities	0.93%	1.26%	1.29%	1.29%	1.23%	-0.32%	0.34%
Cost of total deposits ⁽¹⁾	0.75%	0.97%	0.99%	0.97%	0.92%	-0.22%	-0.17%
Cost of total funding ⁽¹⁾	0.72%	0.96%	0.98%	0.97%	0.92%	-0.24%	-0.20%
Net interest spread	3.10%	3.38%	3.61%	3.67%	3.83%	-0.28%	-0.73%
Net interest margin	3.36%	3.74%	3.99%	4.07%	4.18%	-0.38%	-0.82%
Efficiency ratio	68.88%	77.46%	81.89%	79.41%	81.49%	-8.58%	-12.61%

⁽¹⁾ Includes noninterest bearing deposits