



November 12, 2018

To our Stockholders:

Please find attached the unaudited financial results for the quarter ended September 30, 2018 for CoastalSouth Bancshares, Inc. (the “Company” or “COSO”), the parent company of CoastalStates Bank (“CSB”).

We continue to make progress executing the strategy highlighted in our pro forma financial plans as part of the 2017 recapitalization. The Company completed the acquisition of First Citizens Financial Corporation, Inc. (FCFC), the parent company of Foothills Community Bank (“Foothills”), on July 17, 2018 and successfully completed the system conversion of Foothills on September 9, 2018. The acquisition of FCFC and Foothills represents the Company’s initial expansion into North Georgia and markets surrounding Atlanta. Our management team has great familiarity with the Dawsonville and Cumming markets, as well as years of experience working with the Foothills management team.

While we continue to evaluate additional acquisition opportunities, we have continued to focus a significant amount of resources on hiring outstanding commercial bankers to support our entry into the Atlanta and Savannah markets, where we see potential fewer entry points from an M&A perspective, but where we find many great bankers looking for a growing, dynamic community bank to partner with. Recent consolidation in the large community bank space has afforded us the opportunity to tell our story to community bankers with deep roots in their respective communities and we expect that our teams in each region will continue to grow over the remainder of the year and into 2019.

The Company also successfully completed a bulk sale of the Lending Club consumer unsecured portfolio to a third-party buyer on September 24, 2018. While a net loss of \$562 thousand (including transaction costs) was recognized on the sale, the Company has significantly reduced its charge-off activity and improved its credit profile and now has additional liquidity to deploy into new and more profitable opportunities.

### **Operating Highlights for the Quarter Ended September 30, 2018**

The Company reported a net loss of \$33 thousand for the third quarter of 2018, compared to net income of \$340 thousand in the second quarter of 2018 and a net loss of \$3.27 million in the third quarter of 2017. The Company reported a net loss from continuing operations of \$33 thousand in the third quarter of 2018, compared to net income from continuing operations of \$340 thousand in the second quarter of 2018 and net income from continuing operations of \$2.582 million in the third quarter of 2017.



The loss in the third quarter was primarily attributable to a one-time \$562 thousand charge related to the sale of the Lending Club portfolio and \$322 thousand of one-time merger related charges related to the acquisition of Foothills. With the sale of the Lending Club portfolio and the conversion of Foothills complete we expect to build on profitability achieved in 2Q18 for 4Q18 and throughout 2019.

Net interest income before provision for credit losses was \$5.47 million in the third quarter 2018, compared to \$4.46 million in the second quarter of 2018 and \$4.24 million in the third quarter of 2017. Net interest margin for the third quarter of 2018 was 4.31% as compared to 4.26% for the second quarter of 2018 and 4.02% for the third quarter of 2017. The expansion in net interest margin is primarily attributable to the Company's asset sensitive interest rate profile and benefited from rate movements throughout 2018. The cost of funds for the third quarter of 2018 was 55 basis points compared to 43 basis points for the second quarter of 2018 and 41 basis points for the third quarter of 2017. The increase in cost of funds is primarily driven by a higher cost of deposits associated with the acquisition of Foothills.

Provision for credit losses was \$518 thousand in the third quarter of 2018, compared to \$103 thousand in the second quarter of 2018 and \$1.92 million in the third quarter of 2017. The provision in the third quarter of 2018 was impacted by the following significant items:

- \$250 thousand attributed to net charge-offs of non-performing loans from the Lending Club portfolio;
- \$306 thousand attributed to a lower of cost or market adjustment for transferring the Lending Club portfolio from loans held for investment to loans held for sale which occurred prior to the sale of the portfolio.

Noninterest income was \$1.29 million in the third quarter of 2018, compared to \$1.62 million in the second quarter of 2018 and \$1.36 million in the third quarter of 2017. The decrease in noninterest income in the third quarter was attributable to a \$324 thousand gain on sale of \$3.9 million of government guaranteed loans sold in the third quarter of 2018 as compared to \$745 million gain on sale of \$8.40 million in government guaranteed loans sold in the second quarter of 2018. Additionally, there was \$64 thousand in gain on sale of the Lending Club portfolio recognized in the third quarter of 2018.

Noninterest expense was \$6.29 million in the third quarter of 2018, as compared to \$5.53 million in the second quarter of 2018 and \$7.57 million in the third quarter of 2017. The increase in non-interest expense is primarily attributable to \$322 thousand of one-time merger related charges recognized in the third quarter of 2018 as the Company prepared for the acquisition of Foothills as well as \$320 thousand in transaction costs related to the sale of the Lending Club portfolio. The material portion of deal related expenses associated with the acquisition of Foothills have been recognized as of the end of the third quarter of 2018.



### **Balance Sheet Highlights for the Quarter Ended September 30, 2018**

Total assets at September 30, 2018 were \$560 million, up from \$478 million at June 30, 2018 and \$536 million at September 30, 2017. The increase in total assets as compared to the prior quarter is attributable to an increase in loans of \$73 million, fixed assets of \$6 million, and goodwill and intangibles of \$6 million associated with the acquisition of Foothills.

Total deposits at September 30, 2018 were \$489 million, up from \$419 million at June 30, 2018 and up from \$362 million at September 30, 2017. The increase in total deposits is attributed to \$94 million in deposits acquired from Foothills, offset by a decrease of \$27 million in legacy CSB deposits. The decrease in legacy CSB deposits relates to the seasonality of certain deposit accounts that build through the summer and decrease at the end of the high season in the Hilton Head Island market. Noninterest bearing deposits make up 24.6% of total deposits at September 30, 2018.

Tangible book value per share at September 30, 2018 was \$9.52. CSB is currently well capitalized with a common equity tier 1 capital ratio of 11.58%, a tier 1 leverage ratio of 9.30%, and a total risk-based capital ratio of 12.11%.



## Detailed Results

Supplementary unaudited financial statements are included for the third quarter of 2018 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.

## APPENDIX

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

	3Q18	2Q18	1Q18	4Q17	3Q17	3Q18 change vs	
						2Q18	3Q17
<b>Assets</b>							
Cash and cash equivalents	\$ 70,224	\$ 61,600	\$ 37,952	\$ 145,801	\$ 148,516	\$ 8,624	\$ (78,292)
Investment securities	61,527	63,706	65,671	58,470	62,495	(2,179)	(968)
Loans held for sale	32,713	32,581	26,372	36,334	47,220	132	(14,507)
Loans held for investment	347,551	289,506	282,650	265,819	249,650	58,045	97,901
Allowance for loan losses	(2,299)	(3,494)	(4,081)	(3,915)	(3,515)	1,195	1,216
Loans held for investment, net	345,252	286,012	278,569	261,904	246,135	59,240	99,117
Premises, furniture and equipment, net	12,141	6,574	6,633	1,176	3,061	5,567	9,080
Other real estate owned	2,619	2,912	3,078	4,172	6,328	(293)	(3,709)
Deferred tax asset	12,414	10,517	10,321	10,021	13,920	1,897	(1,506)
Goodwill & intangible assets	6,469	146	12	-	-	6,323	6,469
Bank-owned life insurance	13,087	11,388	11,307	11,227	6,170	1,699	6,917
Other assets	3,114	2,367	2,517	2,865	3,040	747	74
<b>Total assets</b>	<b>\$ 559,560</b>	<b>\$ 477,803</b>	<b>\$ 442,432</b>	<b>\$ 531,970</b>	<b>\$ 536,885</b>	<b>\$ 81,757</b>	<b>\$ 22,675</b>
<b>Liabilities and stockholders' equity</b>							
<b>Liabilities</b>							
Deposits							
Noninterest bearing DDA	\$ 114,774	\$ 104,628	\$ 98,362	\$ 90,374	\$ 93,546	\$ 10,146	\$ 21,228
Interest bearing DDA	93,436	97,967	87,408	87,829	88,141	(4,531)	5,295
Savings and money market	156,617	136,485	115,952	111,980	111,886	20,132	44,731
Certificates of deposit	124,835	80,315	83,034	77,016	68,127	44,520	56,708
Total Deposits	489,662	419,395	384,756	367,199	361,700	70,267	127,962
Other borrowings	500	500	500	105,682	107,764	-	(107,264)
Other liabilities	2,445	1,613	1,271	1,951	2,596	832	(151)
<b>Total liabilities</b>	<b>492,607</b>	<b>421,508</b>	<b>386,527</b>	<b>474,832</b>	<b>472,060</b>	<b>71,099</b>	<b>20,547</b>
<b>Stockholders' equity</b>							
Voting Common Stock	4,951	4,255	4,255	4,255	4,255	696	696
Nonvoting Common Stock	1,449	1,449	1,449	1,449	1,449	-	-
Preferred stock	-	-	-	-	-	-	-
Capital surplus	101,432	91,017	90,875	90,743	90,518	10,415	10,914
Accumulated deficit	(39,736)	(39,709)	(40,047)	(39,479)	(31,696)	(27)	(8,040)
Accumulated other comprehensive income	(1,143)	(717)	(627)	170	299	(426)	(1,442)
<b>Total stockholders' equity</b>	<b>66,953</b>	<b>56,295</b>	<b>55,905</b>	<b>57,138</b>	<b>64,825</b>	<b>10,658</b>	<b>2,128</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 559,560</b>	<b>\$ 477,803</b>	<b>\$ 442,432</b>	<b>\$ 531,970</b>	<b>\$ 536,885</b>	<b>\$ 81,757</b>	<b>\$ 22,675</b>
<b>Capital ratios (1)</b>							
Leverage ratio	9.30%	9.66%	9.90%	10.38%	9.72%	-0.36%	-0.42%
CET1 risk-based capital ratio	11.58	12.29	12.64	13.38	14.19	-0.7123	-2.6123
Tier 1 risk-based capital ratio	11.58	12.29	12.64	13.38	14.19	-0.7123	-2.6123
Total risk-based capital ratio	12.11	13.28	13.85	14.58	15.35	-1.1749	-3.2449

(1) Ratios are for CoastalStates Bank, a wholly-owned subsidiary of CoastalSouth Bancshares, Inc.

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

						3Q18 change vs	
	3Q18	2Q18	1Q18	4Q17	3Q17	2Q18	3Q17
<b>Interest income</b>							
Interest on cash and cash equivalents	\$ 316	\$ 166	\$ 152	\$ 132	\$ 188	\$ 150	\$ 128
Interest and dividends on investment securities	448	406	333	193	328	42	120
Interest and fees on loans	5,368	4,308	4,133	4,038	4,127	1,060	1,241
<b>Total interest income</b>	<b>6,132</b>	<b>4,880</b>	<b>4,618</b>	<b>4,363</b>	<b>4,643</b>	<b>1,252</b>	<b>1,489</b>
<b>Interest expense</b>							
Deposits	649	406	365	227	243	243	406
Other borrowings	12	13	42	44	160	(1)	(148)
<b>Total interest expense</b>	<b>661</b>	<b>419</b>	<b>407</b>	<b>271</b>	<b>403</b>	<b>242</b>	<b>258</b>
<b>Net interest income</b>	<b>5,471</b>	<b>4,461</b>	<b>4,211</b>	<b>4,092</b>	<b>4,240</b>	<b>1,010</b>	<b>1,231</b>
Provision for credit losses	518	103	490	1,787	1,915	415	(1,397)
<b>Net interest income after provision for credit losses</b>	<b>4,953</b>	<b>4,358</b>	<b>3,721</b>	<b>2,305</b>	<b>2,325</b>	<b>595</b>	<b>2,628</b>
<b>Noninterest income</b>							
Service charges on deposit accounts	167	154	196	164	175	13	(8)
Interchange and card fee Income	170	172	150	155	151	(2)	19
Securities gains/(losses)	-	-	14	-	-	-	-
Mortgage banking related income	292	387	338	497	920	(95)	(628)
Gain/(loss) on BOLI	91	82	80	57	39	9	52
Other noninterest income	574	822	72	116	76	(248)	498
<b>Total noninterest income</b>	<b>1,294</b>	<b>1,617</b>	<b>850</b>	<b>989</b>	<b>1,361</b>	<b>(323)</b>	<b>(67)</b>
<b>Noninterest expense</b>							
Salaries and employee benefits	3,722	3,235	3,515	2,917	4,204	487	(482)
Occupancy	359	273	290	359	343	86	16
Data processing	214	210	211	194	176	4	38
Marketing and advertising	114	81	34	44	48	33	66
Regulatory assessment	109	89	99	(50)	194	20	(85)
Professional services	622	370	259	299	318	252	304
Loss on OREO, net	87	89	(31)	945	382	(2)	(295)
Net cost of operation of OREO	-	84	79	130	25	(84)	(25)
Impairment on investment securities	-	-	-	290	54	-	(54)
Other noninterest expense	1,063	1,098	881	1,111	1,830	(35)	(767)
<b>Total noninterest expense</b>	<b>6,290</b>	<b>5,529</b>	<b>5,337</b>	<b>6,239</b>	<b>7,574</b>	<b>761</b>	<b>(1,284)</b>
<b>Net income (loss) before taxes</b>	<b>(43)</b>	<b>446</b>	<b>(766)</b>	<b>(2,945)</b>	<b>(3,888)</b>	<b>(489)</b>	<b>3,845</b>
Income tax expense (benefit)	(10)	106	(197)	4,268	(1,306)	(116)	1,296
<b>Net income (loss) from continuing operations</b>	<b>\$ (33)</b>	<b>\$ 340</b>	<b>\$ (569)</b>	<b>\$ (7,213)</b>	<b>\$ (2,582)</b>	<b>\$ (373)</b>	<b>\$ 2,549</b>
Loss from discontinued operations, net of tax	-	-	-	(544)	(686)	-	686
<b>Net income (loss)</b>	<b>\$ (33)</b>	<b>\$ 340</b>	<b>\$ (569)</b>	<b>\$ (7,757)</b>	<b>\$ (3,268)</b>	<b>\$ (373)</b>	<b>\$ 3,235</b>
Earnings per share - basic	\$ (0.01)	\$ 0.06	\$ (0.10)	\$ (1.36)	\$ (0.87)	\$ (0.06)	\$ 0.86
Tangible book value	\$ 60,960	\$ 56,295	\$ 55,905	\$ 57,138	\$ 64,825	\$ 4,665	\$ (3,865)
Tangible book value per share	\$ 9.52	\$ 9.87	\$ 9.80	\$ 10.02	\$ 11.36	\$ (0.34)	\$ (1.84)
Total shares outstanding	6,400,084	5,704,196	5,704,196	5,704,196	5,704,196	695,888	695,888
Weighted average shares outstanding	6,328,831	5,704,196	5,704,196	5,704,196	3,776,707	624,635	2,552,124

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

	Nine Months Ended September 30		Change
	2018	2017	
<b>Interest income</b>			
Interest on cash and cash equivalents	\$ 634	\$ 443	\$ 191
Interest and dividends on investment securities	1,187	856	331
Interest and fees on loans	13,809	11,847	1,962
<b>Total interest income</b>	<b>15,630</b>	<b>13,146</b>	<b>2,484</b>
<b>Interest expense</b>			
Deposits	1,420	659	761
Other borrowings	67	786	(719)
<b>Total interest expense</b>	<b>1,487</b>	<b>1,445</b>	<b>42</b>
<b>Net interest income</b>	<b>14,143</b>	<b>11,701</b>	<b>2,442</b>
Provision for credit losses	1,111	2,665	(1,554)
<b>Net interest income after provision for credit losses</b>	<b>13,032</b>	<b>9,036</b>	<b>3,996</b>
<b>Noninterest income</b>			
Service charges on deposit accounts	517	486	31
Interchange and card fee Income	492	444	48
Securities gains/(losses)	14	-	14
Mortgage banking related income	1,017	2,673	(1,656)
Gain/(loss) on BOLI	253	115	138
Other noninterest income	1,468	289	1,179
<b>Total noninterest income</b>	<b>3,761</b>	<b>4,007</b>	<b>(246)</b>
<b>Noninterest expense</b>			
Salaries and employee benefits	10,472	8,360	2,112
Occupancy	922	1,018	(96)
Data processing	635	529	106
Marketing and advertising	229	142	87
Regulatory assessment	297	514	(217)
Professional services	1,251	708	543
Loss on OREO, net	145	500	(355)
Net cost of operation of OREO	163	568	(405)
Impairment on investment securities	-	54	(54)
Other noninterest expense	3,042	3,327	(285)
<b>Total noninterest expense</b>	<b>17,156</b>	<b>15,720</b>	<b>1,436</b>
<b>Net income (loss) before taxes</b>	<b>(363)</b>	<b>(2,677)</b>	<b>2,314</b>
Income tax expense (benefit)	(101)	(758)	657
<b>Net income (loss) from continuing operations</b>	<b>\$ (262)</b>	<b>\$ (1,919)</b>	<b>\$ 1,657</b>
Loss from discontinued operations, net of tax	-	(2,137)	2,137
<b>Net income (loss)</b>	<b>\$ (262)</b>	<b>\$ (4,056)</b>	<b>\$ 3,794</b>
Earnings per share - basic	\$ (0.04)	\$ (2.11)	\$ 2.07

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

	3Q18	2Q18	1Q18	4Q17	3Q17	3Q18 change vs	
						2Q18	3Q17
<b>Average balances</b>							
Cash and cash equivalents	\$ 68,018	\$ 42,529	\$ 45,797	\$ 49,043	\$ 68,876	\$ 25,489	\$ (858)
Investment securities	62,715	64,843	60,484	57,475	59,691	(2,128)	3,023
Loans held for sale	33,530	24,496	22,896	31,615	39,539	9,034	(6,009)
Loans held for investment	342,993	287,244	283,539	260,174	253,441	55,749	89,552
Total earning assets	507,255	419,111	412,716	398,307	421,547	88,144	85,708
Total nonearning assets	43,507	30,105	29,210	30,607	30,667	13,402	12,840
Total assets	<b>550,762</b>	<b>449,216</b>	<b>441,927</b>	<b>428,915</b>	<b>452,213</b>	<b>101,546</b>	<b>98,548</b>
Interest bearing deposits	361,724	290,989	283,624	259,384	283,909	70,735	77,815
Other borrowings	500	500	7,496	8,025	21,232	-	(20,732)
Total interest bearing liabilities	362,224	291,489	291,120	267,409	305,141	70,735	57,083
Noninterest bearing deposits	120,000	100,458	92,646	95,517	87,240	19,543	32,760
Other liabilities	3,187	1,402	1,615	2,055	3,551	1,785	(364)
Stockholders' equity	65,351	55,867	56,546	63,933	56,281	9,483	9,069
Total liabilities and stockholders' equity	<b>550,762</b>	<b>449,216</b>	<b>441,927</b>	<b>428,915</b>	<b>452,213</b>	<b>101,546</b>	<b>98,548</b>
<b>Interest margins</b>							
Cash and cash equivalents	1.86%	1.56%	1.33%	1.08%	1.09%	0.30%	0.77%
Investment securities	2.86%	2.50%	2.20%	1.34%	2.20%	0.35%	0.66%
Loans	5.70%	5.53%	5.39%	5.54%	5.63%	0.18%	0.07%
Total earning assets	4.84%	4.66%	4.48%	4.38%	4.41%	0.18%	0.43%
Interest bearing deposits	0.72%	0.56%	0.51%	0.35%	0.34%	0.16%	0.38%
Other borrowings	9.60%	10.40%	2.24%	2.19%	3.01%	-0.80%	6.59%
Total interest bearing liabilities	0.73%	0.57%	0.56%	0.41%	0.53%	1.37%	1.81%
Cost of total deposits (1)	0.54%	0.41%	0.39%	0.26%	0.26%	0.12%	0.28%
Cost of total funding (1)	0.55%	0.43%	0.42%	0.30%	0.41%	0.12%	0.14%
Net interest spread	4.11%	4.08%	3.92%	3.98%	3.88%	0.02%	0.23%
Net interest margin	4.31%	4.26%	4.08%	4.11%	4.02%	0.06%	0.29%
Efficiency ratio	92.98%	90.97%	105.45%	122.79%	135.23%	2.01%	-42.25%

(1) Includes noninterest bearing deposits