



November 11, 2020

To our Shareholders:

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

During the third quarter, the Company crossed the \$1 billion threshold in total assets for the first time in its history, ending the quarter with \$1.1 billion in total assets. The Company also successfully raised \$15 million in subordinated debt, which will be used to bolster capital and support the Company's future growth. Management also continued to seek new opportunities to deploy excess liquidity and maintain the Company's earnings momentum. During the third quarter, the Company purchased a \$49 million portfolio of super prime marine and RV loans to deploy excess liquidity, maintain yield on earning assets, and further diversify its loans portfolio. Additionally, the Company established a resell agreement to deploy excess liquidity at rates more attractive than funds held as federal funds sold.

During the third quarter, the Company's momentum continued as deposits grew \$67.9 million. This growth was driven by deepening our relationships with existing customers and continuing to attract new customers that we were able to help through the Paycheck Protection Program in the second quarter. Our commercial lending teams are beginning to see loan pipelines rebound with business leaders resuming projects that had been put on hold during the second and third quarters, given the uncertainty of the COVID-19 pandemic. We expect to see a modest rebound in core loan growth in the fourth quarter which should continue in 2021.

CSB's single-family mortgage related businesses had outstanding quarters. Mortgage Banker Finance had another period of record-breaking production, originating \$1.3 billion of loans during the quarter. Coastal States Mortgage originated \$26.1 million, a 32% increase over the same quarter a year ago. In addition, commitments in our Homebuilder line of business increased during the quarter and we expect funded balances to follow in the fourth quarter. Growth in these lines of business has been fueled by the low interest rate environment and high demand for single family product in our markets.

Throughout the third quarter, the Company's credit metrics remained strong. Of the customers we provided short-term loan modifications to during the second quarter, only five customers were provided additional payment deferrals beyond the initial deferral period. Three additional borrowers were provided payment deferrals who did not request them earlier in the year. The total principal of these eight customers is approximately \$5 million, or 5% of the original modification population. The Bank continues to see a decline in its NPA ratio, which was down to 0.47% at the end of the third quarter.

The Company has identified certain asset classes that may have a higher risk of default from the economic impact of COVID-19 and has allocated \$1.8 million year-to-date in additional reserves against this portfolio. Management will continue to monitor the loan loss reserve and will make adjustments as we learn more about the impact of the pandemic on our markets and our loan customers.

The Company has also continued to support our communities through charitable initiatives. The CSB Community Commitment, our donor advised fund, originally earmarked \$100 thousand in contributions to organizations supporting our communities during COVID-19. As of the date of this letter, the Company exceeded that initial goal and \$155 thousand has been allocated across more than a dozen different organizations supporting our communities.

Operating Highlights for the Quarter Ended September 30, 2020

Net Income

The Company reported net income of \$2.1 million for the third quarter of 2020 compared to net income of \$1.6 million in the second quarter of 2020 and a net income of \$1.3 million in the third quarter of 2019. Compared to the second quarter of 2020, the increase in net income was primarily attributable to increases in net interest income and securities gains, offset with increases in salaries and employee benefits. Compared to the third quarter of 2019, the increase in net income was primarily attributable to an increase in net interest income, offset with an increase in provision for loan losses.

Net Interest Income and Net Interest Margin

Net interest income before provision for credit losses was \$8.3 million in the third quarter of 2020, compared to \$7.3 million in the second quarter of 2020 and \$6.5 million in the third quarter of 2019. Net interest income after provision for credit losses was \$7.6 million for the third quarter of 2020 compared to \$6.7 million in the second quarter of 2020 and \$6.5 million in the third quarter of 2019.

Net interest margin for the third quarter of 2020 was 3.44%, compared to 3.36% for the second quarter of 2020 and 4.07% for the third quarter of 2019. Compared to the second quarter of 2020, net interest margin improved by 8 basis points. Compared to the same quarter last year, net interest margin was compressed by 63 basis points and 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, which have a 1% interest rate, have also had an impact on our overall loan yields. To combat margin compression, management made changes to lower deposit rates to be more in line with market rates. Management also re-deployed excess liquidity into additional earning assets, such as investment securities, loan purchases, and a resell agreement. 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 third quarter of 2020 was 57 basis points compared to 72 basis points for the second quarter of 2020 and 97 basis points for the third quarter of 2019. Beginning in the first quarter of 2020, the Bank began lowering deposit rates as the Federal Reserve decreased the federal funds rates twice, bringing index rates down to zero. Management expects the cost of funds to modestly decline over the next several quarters as pricing changes continue to take effect.

Provision (Recovery) for Credit Losses

Provision for credit losses was \$718 thousand during the third quarter of 2020, compared to \$602 thousand in the second quarter of 2020 and a net recovery of (\$22) thousand in the third quarter of 2019. During the third quarter of 2020, an additional \$733 thousand was provided in allowance reserves for the impact of COVID-19, as compared to \$722 thousand in the second quarter of 2020. Charge-off and recovery activity was not significant during the third quarter of 2020.

Noninterest Income

Noninterest income was \$1.7 million in the third quarter of 2020, compared to \$1.3 million in the second quarter of 2020 and \$1.6 million in the third quarter of 2019. The increase of \$444 thousand in the third quarter of 2020 compared to the second quarter of 2020 was primarily attributable to gains on securities of \$348 thousand in the third quarter of 2020. There were no gains on securities during the second quarter of 2020. Compared to the third quarter of 2019, the increase in noninterest income of \$157 thousand was due to increases in gain on sale of government guaranteed loans and mortgage banking related income; offset by decreases in other categories, primarily other noninterest income.

Noninterest Expense

Noninterest expense was \$6.6 million in the third quarter of 2020, as compared to \$5.9 million in the second quarter of 2020 and \$6.4 million in the third quarter of 2019. The increase of \$662 thousand from in the third quarter of 2020 as compared to the second quarter of 2020 was primarily due to deferred salary costs capitalized in the second quarter related to the origination of PPP loans, which lowered salaries and employee benefits expense in that period. Compared to the third quarter of 2019, the increase of \$155 thousand in noninterest expense was primarily attributable to an increase in salaries and employees' benefits of \$98 thousand.

Balance Sheet Highlights for the Quarter Ended September 30, 2020

Assets

Total assets as of September 30, 2020 were \$1.1 billion, compared to \$964 million at June 30, 2020 and \$691 million at September 30, 2019. The increase in total assets as compared to the prior quarter is primarily attributable to cash and cash equivalents and growth in loans, which was generated by deposit growth.

Cash and cash equivalents at September 30, 2020 was \$123 million, compared to \$52 million at June 30, 2020, and up from \$40 million at September 30, 2019. The increase in cash and cash equivalents as compared to the prior quarter is primarily attributable to an \$82 million resell agreement entered into by the Company; offset by normal fluctuations in due from banks and federal funds sold.

Investment securities at September 30, 2020 remained at the same level as at June 30, 2020 at approximately \$120 million, and up from \$61 million at September 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 September 30, 2020 were \$680 million, compared to \$634 million at June 30, 2020, and up from \$454 million at September 30, 2019. The quarterly increase in loans held for investment of \$46 million is primarily in consumer loans due to a purchase of secured consumer loans. Total loans held for sale at September 30, 2020 were \$127 million, compared to \$110 million at June 30, 2020 and \$87 million at September 30, 2019. The increase in loans held for sale is due growth in Mortgage Banker Finance due to the attractive mortgage interest rate environment and new customer acquisition.

Allowance for loan losses at September 30, 2020 were \$5.7 million, compared to \$5.0 million at June 30, 2020, and from \$3.6 million at September 30, 2019. The increase in provision in the third quarter of 2020 compared to the second quarter of 2020, is primarily related to the impacts of COVID-19. Compared to the third quarter of 2019, the increase in provision is primarily related to and impacts of COVID-19 and growth of the loan portfolio.

Liabilities

Total deposits at September 30, 2020 were \$857 million, an increase from \$789 million at June 30, 2020 and from \$574 million at September 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 30.0% of total deposits as compared to 27.8% of total deposits at June 30, 2020 and 24.1% at September 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.

Other borrowings at September 30, 2020 were \$142 million, a \$68 million increase from \$74 million at June 30, 2020 and a \$122 million increase from \$20 million at September 30, 2019. The increase in other borrowings compared to the second quarter of 2020, is primarily related to increased borrowings from the Paycheck Protection Program Liquidity Facility ("PPPLF") by \$74 million and the newly issued



subordinated debt of \$15 million, offset by a decrease in FHLB advances of \$20 million. Compared to the third quarter of 2019, the increase in other borrowings is primarily related to the new borrowings from the PPPLF and the new subordinated debt as well. Utilizing the PPPLF has allowed the Company to leverage its balance sheet and make additional income with collateralized borrowings that do not have an impact on regulatory capital ratios.

Capital

Tangible book value per share at September 30, 2020 was \$11.79. CSB is currently well capitalized with a leverage ratio of 9.62%, a common equity tier 1 capital ratio of 11.94%, and a total risk-based capital ratio of 12.70%.

Detailed Results

Supplementary unaudited financial statements are included for the third 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)

						3Q20 change vs	
	3Q20	2Q20	1Q20	4Q19	3Q19	2Q20	3Q19
Assets							
Cash and cash equivalents	\$ 123,488	\$ 52,428	\$ 48,250	\$ 49,273	\$ 40,353	\$ 71,060	\$ 83,135
Investment securities	120,304	119,519	78,085	62,496	61,408	785	58,896
Loans held for sale	127,463	109,749	119,018	81,243	87,255	17,714	40,208
Loans held for investment	679,874	634,282	484,468	468,326	453,521	45,592	226,353
Allowance for loan losses	(5,703)	(4,959)	(4,444)	(3,936)	(3,648)	(744)	(2,055)
Loans held for investment, net	674,171	629,323	480,024	464,390	449,873	44,848	224,298
Bank-owned life insurance	18,827	13,706	13,620	13,533	13,445	5,121	5,382
Premises, furniture and equipment, net	16,216	15,354	14,790	14,280	14,137	862	2,079
Deferred tax asset	9,788	10,103	10,752	10,779	11,296	(315)	(1,508)
Goodwill & intangible assets ⁽¹⁾	6,301	6,325	6,363	6,426	6,366	(24)	(65)
Other real estate owned	1,251	932	1,464	1,505	1,854	319	(603)
Other assets	6,076	6,444	5,080	4,564	4,572	(368)	1,504
Total assets	\$ 1,103,885	\$ 963,883	\$ 777,446	\$ 708,489	\$ 690,559	\$ 140,002	\$ 413,326
Liabilities and stockholders' equity							
Liabilities							
Deposits							
Noninterest bearing DDA	\$ 256,820	\$ 219,477	\$ 145,613	\$ 141,025	\$ 138,639	\$ 37,343	\$ 118,181
Interest bearing DDA	137,804	117,085	96,394	90,761	94,259	20,719	43,545
Savings and money market	307,098	275,997	236,964	203,402	183,678	31,101	123,420
Certificates of deposit	155,256	176,529	181,238	165,904	157,785	(21,273)	(2,529)
Total deposits	856,978	789,088	660,209	601,092	574,361	67,890	282,617
Other borrowings	142,162	73,717	20,000	10,000	20,000	68,445	122,162
Other liabilities	5,120	4,164	3,665	5,103	4,681	956	439
Total liabilities	1,004,260	866,969	683,874	616,195	599,042	137,291	405,218
Stockholders' equity							
Voting common stock	5,993	5,966	6,203	6,203	6,194	27	(201)
Nonvoting common stock	1,991	1,991	1,754	1,754	1,754	-	237
Capital surplus	121,442	121,214	120,979	120,756	120,488	228	954
Accumulated deficit	(32,307)	(34,405)	(36,012)	(36,966)	(37,646)	2,098	5,339
Accumulated other comprehensive income	2,506	2,148	648	547	727	358	1,779
Total stockholders' equity	99,625	96,914	93,572	92,294	91,517	2,711	8,108
Total liabilities and stockholders' equity	\$ 1,103,885	\$ 963,883	\$ 777,446	\$ 708,489	\$ 690,559	\$ 140,002	\$ 413,326
Capital ratios ⁽²⁾							
Leverage ratio	9.62%	9.15%	9.93%	10.32%	10.54%	0.46%	-0.92%
CET1 risk-based capital ratio	11.94	11.70	10.82	11.72	11.66	0.24	0.28
Tier 1 risk-based capital ratio	11.94	11.70	10.82	11.72	11.66	0.24	0.28
Total risk-based capital ratio	12.70	12.44	11.48	12.37	12.27	0.27	0.43

⁽¹⁾ Includes commercial mortgage servicing assets of \$830, \$805, \$792, \$803, and \$689 for 3Q20, 2Q20, 1Q20, 4Q19 and 3Q19, 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)

						3Q20 change vs	
	3Q20	2Q20	1Q20	4Q19	3Q19	2Q20	3Q19
Interest income							
Interest on cash and cash equivalents	\$ 72	\$ 16	\$ 237	\$ 167	\$ 194	\$ 56	\$ (122)
Interest and dividends on investment securities	766	616	456	424	398	150	368
Interest and fees on loans	8,776	8,099	7,425	7,550	7,322	677	1,454
Total interest income	9,614	8,731	8,118	8,141	7,914	883	1,700
Interest expense							
Deposits	1,145	1,360	1,535	1,467	1,404	(215)	(259)
Other borrowings	163	104	31	43	28	59	135
Total interest expense	1,308	1,464	1,566	1,510	1,432	(156)	(124)
Net interest income	8,306	7,267	6,552	6,631	6,482	1,039	1,824
Provision (recovery) for credit losses	718	602	531	620	(22)	116	740
Net interest income after provision for credit losses	7,588	6,665	6,021	6,011	6,504	923	1,084
Noninterest income							
Mortgage banking related income	604	461	439	322	484	143	120
Gain on sale of government guaranteed loans	291	451	78	843	172	(160)	119
Securities gains, net	348	-	298	22	268	348	80
Interchange and card fee Income	176	162	217	193	191	14	(15)
Service charges on deposit accounts	118	112	174	178	169	6	(51)
Gain on BOLI	121	87	86	87	90	34	31
Other noninterest income	90	31	137	174	217	59	(127)
Total noninterest income	1,748	1,304	1,429	1,819	1,591	444	157
Noninterest expense							
Salaries and employee benefits	4,299	3,706	4,006	4,370	4,201	593	98
Occupancy and equipment	421	406	378	435	428	15	(7)
Software and other technology expense	329	365	326	371	373	(36)	(44)
Data processing	315	310	315	295	240	5	75
Other professional services	285	271	276	410	298	14	(13)
Regulatory assessment	137	165	151	45	92	(28)	45
Loss on other real estate owned, net	1	51	41	349	-	(50)	1
Other noninterest expense	779	630	689	645	779	149	-
Total noninterest expense	6,566	5,904	6,182	6,920	6,411	662	155
Net income before taxes	2,770	2,065	1,268	910	1,684	705	1,086
Income tax expense	673	457	314	232	392	216	281
Net income	\$ 2,097	\$ 1,608	\$ 954	\$ 678	\$ 1,292	\$ 489	\$ 805
Earnings per share - basic	\$ 0.27	\$ 0.20	\$ 0.12	\$ 0.09	\$ 0.16	\$ 0.07	\$ 0.11
Tangible book value	\$ 94,154	\$ 91,394	\$ 88,001	\$ 86,671	\$ 85,840	\$ 2,760	\$ 8,314
Tangible book value per share	\$ 11.79	\$ 11.49	\$ 11.06	\$ 10.89	\$ 10.80	\$ 0.31	\$ 0.99
Weighted average shares outstanding	7,966,274	7,956,253	7,956,253	7,947,253	7,947,253	10,021	19,021
Shares outstanding	7,983,753	7,956,253	7,956,253	7,956,253	7,947,253	27,500	36,500

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

	Nine Months Ended September 30		Change
	2020	2019	
Interest income			
Interest on cash and cash equivalents	\$ 325	\$ 787	\$ (462)
Interest and dividends on investment securities	1,838	1,253	585
Interest and fees on loans	24,300	20,084	4,216
Total interest income	26,463	22,124	4,339
Interest expense			
Deposits	4,040	3,726	314
Other borrowings	298	51	247
Total interest expense	4,338	3,777	561
Net interest income	22,125	18,347	3,778
Provision for credit losses	1,851	1,247	604
Net interest income after provision for credit losses	20,274	17,100	3,174
Noninterest income			
Mortgage banking related income	1,504	1,181	323
Gain on sale of government guaranteed loans	820	1,034	(214)
Securities gains, net	646	619	27
Interchange and card fee Income	555	575	(20)
Service charges on deposit accounts	404	521	(117)
Gain on BOLI	294	266	28
Other noninterest income	258	486	(228)
Total noninterest income	4,481	4,682	(201)
Noninterest expense			
Salaries and employee benefits	12,011	12,606	(595)
Occupancy and equipment	1,205	1,275	(70)
Software and other technology expense	1,020	1,036	(16)
Data processing	940	731	209
Professional services	832	886	(54)
Regulatory assessment	453	335	118
Loss on other real estate owned, net	93	50	43
Other noninterest expense	2,098	2,308	(210)
Total noninterest expense	18,652	19,227	(575)
Net income before taxes	6,103	2,555	3,548
Income tax expense	1,444	631	813
Net income	\$ 4,659	\$ 1,924	\$ 2,735
Earnings per share - basic	\$ 0.59	\$ 0.28	\$ 0.31
Weighted average shares outstanding	7,957,056	6,989,482	967,574
Shares outstanding	7,983,753	7,947,253	36,500

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

	3Q20	2Q20	1Q20	4Q19	3Q19	3Q20 change vs	
						2Q20	3Q19
Average balances							
Cash and cash equivalents	\$ 62,360	\$ 79,147	\$ 74,870	\$ 42,893	\$ 43,911	\$ (16,787)	\$ 18,449
Investment securities	120,837	96,161	69,469	62,092	58,625	24,676	62,212
Loans held for sale	114,437	93,955	83,301	86,369	85,031	20,482	29,406
Loans held for investment	661,665	601,472	476,274	468,447	445,026	60,193	216,639
Total earning assets	959,299	870,735	703,914	659,801	632,593	88,564	326,706
Total nonearning assets	52,630	48,406	46,867	47,389	48,198	4,224	4,432
Total assets	1,011,929	919,141	750,781	707,190	680,791	92,788	331,138
Interest bearing deposits	577,146	535,696	484,497	443,167	430,547	41,450	146,599
Other borrowings	104,501	94,299	16,044	19,672	10,797	10,202	93,704
Total interest bearing liabilities	681,647	629,995	500,541	462,839	441,344	51,652	240,303
Noninterest bearing deposits	227,902	190,342	152,337	147,450	144,283	37,560	83,619
Other liabilities	4,298	3,818	4,456	4,706	4,135	480	163
Stockholders' equity	98,082	94,986	93,447	92,195	91,029	3,096	7,053
Total liabilities and stockholders' equity	1,011,929	919,141	750,781	707,190	680,791	92,788	331,138
Interest margins							
Cash and cash equivalents	0.46%	0.08%	1.27%	1.54%	1.75%	0.38%	-1.29%
Investment securities	2.52%	2.58%	2.64%	2.71%	2.69%	-0.06%	-0.17%
Loans	4.50%	4.68%	5.34%	5.40%	5.48%	-0.18%	-0.98%
Total earning assets	3.99%	4.03%	4.64%	4.90%	4.96%	-0.04%	-0.97%
Interest bearing deposits	0.79%	1.02%	1.27%	1.31%	1.29%	-0.23%	-0.50%
Other borrowings	0.62%	0.44%	0.78%	0.87%	1.03%	0.18%	-0.41%
Total interest bearing liabilities	0.76%	0.93%	1.26%	1.29%	1.29%	-1.21%	-0.21%
Cost of total deposits ⁽¹⁾	0.57%	0.75%	0.97%	0.99%	0.97%	-0.18%	-0.40%
Cost of total funding ⁽¹⁾	0.57%	0.72%	0.96%	0.98%	0.97%	-0.15%	-0.40%
Net interest spread	3.23%	3.10%	3.38%	3.61%	3.67%	0.13%	-0.44%
Net interest margin	3.44%	3.36%	3.74%	3.99%	4.07%	0.08%	-0.63%
Efficiency ratio	65.31%	68.88%	77.46%	81.89%	79.41%	-3.57%	-14.10%

⁽¹⁾ Includes noninterest bearing deposits