



February 19, 2020

Dear Fellow Shareholder:

Net income before taxes for 2019 was \$4.3 million, a record for Paragon Bank. As a whole, pre-tax income increased approximately 3% over 2018. During 2019, Paragon's core bank, excluding the SBA related units (Small Business Capital Group and Specialty Lending), had record revenue and record pre-tax income. Pre-tax income for the core bank increased 61% to \$4.4 million in 2019.

During the 3rd and 4th quarters of 2019, Paragon discontinued the Specialty Lending line of business after the loss of key personnel. Excluding Specialty Lending, Paragon would have had record net interest income of \$13.6 million and pre-tax income of \$5.4 million for 2019.

Highlights of 2019 and the fourth quarter of 2019 included:

Balance Sheet

- During the fourth quarter, gross loans decreased \$7.5 million. As a result of that fourth quarter decrease, loans increased only slightly in 2019 to \$333.4 million. Core bank loans, which exclude Paragon's SBA-related businesses, decreased \$4.1 million in the fourth quarter due to bank customers selling businesses and properties and paying off loans. Despite the decrease in core bank loans during the fourth quarter, core bank loans increased by \$12.4 million, or 4.5%, during 2019.
- During 2019 Paragon's SBA related loans (Small Business Capital Group and Specialty Lending) decreased \$10.3 million. The Small Business Capital Group's loans decreased because of a record number of sales of the government-guaranteed portions of loans that were settled in the first quarter of 2019. Specialty lending decreases were a result of the winding down of that business line.
- Demand deposits increased approximately 30% on an annualized basis during the fourth quarter and 15% for the year. This was due to both existing customers increasing their deposits and a strong increase in new bank customers.
- Core deposits increased approximately 19% on an annualized basis during the fourth quarter and increased 15% for the year.
- Propelled by record earnings and an increase in the value of Paragon's investment portfolio, book value per share increased \$.97 to \$10.32.

Income Statement

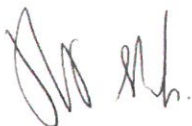
- Paragon's net interest margin dropped from 3.94% for 2018 to 3.62% for 2019 due to a reduction in loan fees and an increase in deposit costs. The largest cause of the drop in the net interest margin was the reduction in loan fees due to the winding down of the Specialty Lending line of business. Increased deposit costs were caused by the late 2018 interest increases instituted by the Federal Reserve Bank. We anticipate those deposit costs to decrease in 2020.
- For 2019, noninterest income increased slightly over 2018, by 1%. Core-bank core-noninterest income increased \$219 thousand or 12% to \$2.0 million, led by increases in mortgage banking income (31%), service charges and fee income (23%), and Solutions income (10%).
- Noninterest expense decreased 4%, or \$587 thousand, from 2018 to 2019. The largest decreases were in salaries and benefits (\$576 thousand) and the FDIC assessment (\$137 thousand).

Asset Quality

- Nonperforming assets, net of government guarantees, decreased from \$1.1 million at September 30, 2019, to \$764 thousand at December 31, 2019. The ratio of nonperforming assets to total assets decreased from .26% to .19%.
- At December 31, 2019, the ratio of the allowance for loan losses to gross loans was 1.15%, which continues to exceed the ratio of Paragon's peer group.

Thank you for your ownership and for your continued confidence in Paragon. 2020 is off to a good start. We look forward to providing further information about 2019 and the first quarter results during our 2020 shareholders' meeting.


Respectfully,



Robert S. Shaw, Jr.
Chief Executive Officer



Michael A. Edwards
President and Chief Operating
Officer



Lewis W. Perkins, III
Chief Financial Officer

Paragon Financial Solutions, Inc.
Consolidated Statements of Financial Condition

| | December 31, 2019 (unaudited) | December 31, 2018 |
|---|--|------------------------------|
| ASSETS | | |
| Cash, cash equivalents & fed funds sold | \$ 10,456,358 | \$ 11,104,628 |
| Securities, available for sale | 50,198,305 | 51,361,638 |
| Loans, net | 329,520,922 | 326,601,811 |
| Restricted equity securities, at cost | 1,262,200 | 1,262,200 |
| Fixed assets | 5,477,611 | 2,174,358 |
| Other real estate owned | 160,087 | 160,087 |
| Other assets | 7,138,971 | 8,888,559 |
| Total assets | \$ 404,214,454 | \$ 401,553,281 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Non-interest-bearing demand deposits | \$ 92,505,182 | \$ 80,115,465 |
| Interest-bearing deposits | | |
| Interest-bearing checking | 70,204,717 | 63,465,480 |
| Savings and money market demand | 90,190,896 | 89,818,742 |
| Certificates of deposit | 93,095,782 | 109,902,084 |
| Total deposits | 345,996,577 | 343,301,771 |
| Repurchase agreements | 2,280,850 | 3,854,212 |
| Short-term borrowings | 2,000,000 | 8,500,000 |
| Accrued interest and other liabilities | 7,011,220 | 4,022,381 |
| Total liabilities | 357,288,647 | 359,678,364 |
| Total shareholders' equity | 46,925,807 | 41,874,917 |
| Total liabilities and shareholders' equity | \$ 404,214,454 | \$ 401,553,281 |
| Tangible Book Value Per Share | \$ 10.32 | \$ 9.35 |

Paragon Financial Solutions, Inc.
Consolidated Statement of Operations (unaudited)

| | Three Months Ended December 31, | | | |
|--|---------------------------------|---------------------|---------------------|----------------|
| | 2019 | 2018 | \$ Change | % Change |
| Interest and dividend income: | | | | |
| Loans, including fees | \$ 4,029,706 | \$ 4,379,854 | \$ (350,148) | -7.99% |
| Securities, available for sale | 341,003 | 397,917 | (56,914) | -14.30% |
| Federal funds sold and other | 49,889 | 40,278 | 9,611 | 23.86% |
| Total interest income | <u>4,420,598</u> | <u>4,818,049</u> | <u>(397,451)</u> | <u>-8.25%</u> |
| Interest expense: | | | | |
| Deposits | 886,689 | 798,986 | 87,703 | 10.98% |
| Securities sold under agreements to repurchase | 4,700 | 9,665 | (4,965) | -51.37% |
| Federal funds purchased and other borrowings | 11,827 | 85,744 | (73,917) | -86.21% |
| Total interest expense | <u>903,216</u> | <u>894,395</u> | <u>8,821</u> | <u>0.99%</u> |
| Net interest income | <u>3,517,382</u> | <u>3,923,654</u> | <u>(406,272)</u> | <u>-10.35%</u> |
| Provision for loan losses | <u>455,000</u> | <u>405,382</u> | <u>49,618</u> | <u>12.24%</u> |
| Net interest income after provision for loan losses | <u>3,062,382</u> | <u>3,518,272</u> | <u>(455,890)</u> | <u>-12.96%</u> |
| Non-interest income | <u>1,326,320</u> | <u>1,308,794</u> | <u>17,526</u> | <u>1.34%</u> |
| Non-interest expense | | | | |
| Salaries and employee benefits | 1,968,889 | 2,155,217 | (186,328) | -8.65% |
| Occupancy and equipment expense | 450,405 | 396,925 | 53,480 | 13.47% |
| Other expenses | 845,992 | 769,093 | 76,899 | 10.00% |
| Total operating expenses | <u>3,265,286</u> | <u>3,321,235</u> | <u>(55,949)</u> | <u>-1.68%</u> |
| Income (loss) before income taxes | <u>1,123,416</u> | <u>1,505,831</u> | <u>(382,415)</u> | <u>-25.40%</u> |
| Income tax expense (benefit) | <u>265,327</u> | <u>313,541</u> | <u>(48,214)</u> | <u>-15.38%</u> |
| Net income (loss) | <u>\$ 858,089</u> | <u>\$ 1,192,290</u> | <u>\$ (334,201)</u> | <u>-28.03%</u> |
| Basic earnings per share | <u>\$ 0.19</u> | <u>\$ 0.27</u> | <u>\$ (0.08)</u> | |

Paragon Financial Solutions, Inc.
Consolidated Statement of Operations (unaudited)

| | Year Ended December 31, | | | |
|--|-------------------------|---------------------|------------------|----------------|
| | 2019 | 2018 | \$ Change | % Change |
| Interest and dividend income: | | | | |
| Loans, including fees | \$ 16,339,343 | \$ 15,941,054 | \$ 398,289 | 2.50% |
| Securities, available for sale | 1,486,638 | 1,493,678 | (7,040) | -0.47% |
| Federal funds sold and other | 195,823 | 119,020 | 76,803 | 64.53% |
| Total interest income | 18,021,804 | 17,553,752 | 468,052 | 2.67% |
| Interest expense: | | | | |
| Deposits | 3,753,722 | 2,475,799 | 1,277,923 | 51.62% |
| Securities sold under agreements to repurchase | 31,813 | 64,389 | (32,576) | -50.59% |
| Federal funds purchased and other borrowings | 118,009 | 288,862 | (170,853) | -59.15% |
| Total interest expense | 3,903,544 | 2,829,050 | 1,074,494 | 37.98% |
| Net interest income | 14,118,260 | 14,724,702 | (606,442) | -4.12% |
| Provision for loan losses | 829,627 | 934,749 | (105,122) | -11.25% |
| Net interest income after provision for loan losses | 13,288,633 | 13,789,953 | (501,320) | -3.64% |
| Non-interest income | 4,543,647 | 4,492,411 | 51,236 | 1.14% |
| Non-interest expense | | | | |
| Salaries and employee benefits | 8,461,065 | 9,037,223 | (576,158) | -6.38% |
| Occupancy and equipment expense | 1,792,122 | 1,810,433 | (18,311) | -1.01% |
| Other expense | 3,303,752 | 3,296,269 | 7,483 | 0.23% |
| Total operating expenses | 13,556,939 | 14,143,925 | (586,986) | -4.15% |
| Income (loss) before income taxes | 4,275,341 | 4,138,439 | 136,902 | 3.31% |
| Income tax expense (benefit) | 1,087,553 | 994,602 | 92,951 | 9.35% |
| Net income (loss) | \$ 3,187,788 | \$ 3,143,837 | \$ 43,951 | 1.40% |
| Basic earnings per share | \$ 0.71 | \$ 0.71 | \$ - | |