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COMPANY INTERVIEW

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Friendly Hills Bank (OTCMKTS:FHLB)



JEFFREY K. BALL is the Founder of Friendly Hills Bank in Whittier, California, where he currently serves as President, Chief Executive Officer and Director. Mr. Ball is a member of the Executive Committee and board of directors of the American Bankers Association where he serves as Vice Chairman of their Government Relations Council Administrative Committee and was a member of their Grassroots Committee. He is a past Chairman of the California Bankers Association where he currently serves on the board of directors and is Chairman of their Federal Government Relations Committee. He was the Lead Petitioner for the establishment of the Kinetic Academy Charter School in Huntington Beach where he currently serves as Board Chair and is also a Founder and current Chairman of the Whittier Union High School District Educational

Foundation. He is a member of the board of directors of Data Center, Inc., a bank technology company based in Hutchinson, Kansas, where he also serves as Chairman of the Audit Committee. Mr. Ball is a past President of the Whittier Host Lions Club and currently serves on the Endowment Committee for the YMCA of Greater Whittier as well as the Economic Forecast Committee for the Orange County Business Council. He served by appointment as Co-Chairman of the Legal Services Trust Fund of the State Bar of California, the Bond Oversight Committee for the Whittier Union High School District, the board of overseers for the Endeavor Academy Charter School in Huntington Beach and the School Site Council for Brywood Elementary School in Irvine. He has also been active in a number of community and civic organizations with board experiences that include the Whittier Area Chamber of Commerce, Orange County Business Council, Junior Achievement, Poet Council Advisory Group at Whittier College, University of Puget Sound Alumni Council and the Whittier High School Alumni Association. Mr. Ball earned a master's degree in business administration from Whittier College in 1989 and a Bachelor of Arts in business administration from the University of Puget Sound in 1986.

SECTOR — BANKING

(BAL600) TWST: Tell us about Friendly Hills' mission and focus, with a view to the community where the bank serves.

Mr. Ball: Friendly Hills Bank is what I like to refer to as a true community bank. Most of our ownership consists of people in our community. We define the communities that we serve to be Southeast Los Angeles County and Northern Orange County. We are one of very few community banks that are focused on that area. And our focus is in providing a quality alternative to the larger banks that dominate that region. We find that there is a certain segment of the economy particularly with small business owners that appreciate having a true community bank relationship where decisions can be made within that community, and they know that they can rely on our high level of service and responsiveness to fulfill their needs. This was the original mission of the bank, and we have been proud to provide that quality alternative for our market for just over 10 years now.

TWST: What are the main business drivers in these communities, and what do you see as the most valuable banking opportunities?

Mr. Ball: The market area that we serve is primarily driven by small businesses. We have a very robust market of small businesses, many of which are family-owned businesses, a lot of those being multigenerational. And so that is why we have that main focus. Our market area is also proud to have a lot of charitable

organizations in our area, and we serve the best of that group. And we have one of the nation's top regional hospitals located within our market area providing a number of business opportunities related to that industry. All of this drives a very strong retail market providing one of the larger deposits-per-capita ratios in LA County. That market, in conjunction with the other industries I mentioned, provides a very strong deposit market opportunity for us.

TWST: Have there been any significant regional trends or secular catalysts impacting your business?

Mr. Ball: Our region has pretty much moved along the same line as the national economy, maybe lagging a little bit. We have not seen as much employment growth as we would have liked to have seen. Overall, it's been an economy that has rather stagnant growth but is showing some promise. Where some other regions of Southern California have started to see more robust growth, our economy has been relatively flat but stable.

We see that changing as we move into 2017 and have already started to see some increased activity. As a relationship bank working very closely with our clients, a lot of our loan growth is driven by their growth. And we are starting to see a lot more expansion opportunities being taken on by our clients, which has had a positive impact on our loan production.

TWST: How do you expect to be impacted by rising interest rates? Do you see any related headwinds on the horizon?

Mr. Ball: Yes, we just had a second interest rate raise this past week, and this is something that we have been managing toward. We have had a prolonged period in which interest rates have been very low, and that has had a lot of impact on the banking sector, and it also has a lot of impact on the market that we serve. The impact on the bank obviously is the concern being that as rates rise, what will that do to the overall net interest margin of the bank. And we have always managed our bank very conservatively. So it has an impact on our earnings when we do that, but we try to keep most of our assets and liabilities on the very short term. And so as a result of that, we believe that a rising rate environment will actually benefit the bank from an earnings perspective because we have managed the bank in such a way.

“I feel very good in terms of how we positioned the bank from a balance sheet standpoint and from an underwriting standpoint so that the overall impact of a rising rate environment should be positive for the bank.”

In terms of how it impacts our local market, I am concerned about the psychological impact of a rising rate environment and what that could mean in terms of economic growth. For the longest time now, we have had interest rates in a historically low, very dramatically low position. And so even with a 50-basis-point rise in rates over the last year, we still have historically very low rates. But when you are comparing, when you have such a low base to work from, that on a percentage basis of growth is a big change from where we are coming from. So I worry about the psychological effect stemming from that.

We always look at all of our borrowers under stress testing to make sure that as rates increase they will be able to handle that increase, but of course now this is going to be put into practice. So I feel very good in terms of how we positioned the bank from a balance sheet standpoint and from an underwriting standpoint so that the overall impact of a rising rate environment should be positive for the bank.

TWST: Congratulations, you were recently elected to the board of directors of the ABA in Washington. What will be your role there? And what will that mean to the bank?

Mr. Ball: Well, first of all, thank you for recognizing that. I am proud to be part of the board of directors and the Executive Committee of the American Bankers Association which represents the entire industry. My primary role there is serving as Vice Chairman of the Government Relations Counsel Administrative Committee. This is the committee which addresses a variety of different issues facing the industry and provides some focus in terms of how we can best benefit all of the members of the banking industry. I have been involved in industry leadership for several years, and I am proud to have this opportunity.

I am also a past Chairman of the California Bankers Association, and just like with that role I think it's extremely helpful for Friendly Hills Bank and the communities that we serve that we have that type of representation, particularly in what is now a

changing political landscape. I am also anticipating potential changes in the regulatory landscape allowing for supervision practices which are more specific to the insured institutions. My involvement provides name recognition for the bank, but my service is to the entire industry. But most of all, I think it also helps us in the markets that we serve in that our clients and members of the community see the bank not only involved in leadership in the local community, but now also in more of the statewide and national scope.

TWST: Looking back, what have been the most burdensome regulatory issues you've had to deal with?

Mr. Ball: Like many of the other community banks across the country, we have suffered a lot of the trickle-down effect in Dodd-Frank. I don't think when Dodd-Frank was originally passed there was an intention to have such a significant impact, predominantly a negative impact, on community banks and their ability to serve their market. But it definitely has done that. It has brought up our regulatory costs significantly; we have much more work and accompanying risk that we have to do in the compliance area, and that means we have to apply resources internally where we would rather have those resources focused on our clients and the community.

But we have a very versatile team; we do a lot of cross-training, and have done our best to try to minimize the impact of that and particularly minimize the impact on our clients. We try to minimize any significant changes in terms of the service levels that they receive. But clearly, having the higher regulatory costs, especially during a period of time in which interest margins were compressing, has had a significant impact on all community banks, and ours is not excluded.

TWST: What are your expectations for upcoming regulatory changes?

Mr. Ball: Well, I think we are going to see this in a couple of different perspectives. First of all, from a legislative standpoint, I had some colleagues call me right after the national election saying, “Oh great! Dodd-Frank is going to go away in January.” No, that's not what's going to happen. Dodd-Frank is not going to go away, but what we now have is an opportunity to look at some of the more negatively impactful parts of Dodd-Frank that have had an impact on the ability of banks to serve their markets. So things like restrictions in the mortgage area, some of the consumer disclosure laws that have become very onerous with and limited consumer choices while driving up costs. Taking a look at regulation to make it more appropriate for the overall risk of the bank as Dodd-Frank brings in certain requirements that are based on size.

And those standards are completely arbitrary; what we really need to look at is what is the overall risk position of that bank and make sure that we tailor our regulatory standards to exactly what those risks are. There are very large banks that have lower risk profiles than some smaller banks. And so we really need to tailor that regulation to what is best for the true risk position of the entity that's being looked at. So from a legislative standpoint, that's some direction that can happen. Also, I think we could potentially see some changes on the regulatory side itself; we will be looking at perhaps new leadership in some of the applicable agencies. While I have great respect and admiration for the leaders we have there now, clearly if there is a change in that leadership, we could see a different tone from within the agencies themselves.

TWST: In 2015, you pointed to the strength of the

bank's deposit base, with over 90% core deposits. How has that evolved? Give us a view to your current deposit base and what's behind that, for better or worse?

Mr. Ball: We continue to enjoy the benefits of a very strong balance sheet, and a big part of that is the fact that we do have much more than 90% core deposits. I attribute that to a couple of different things. First and foremost, I attribute it to the very high service level that we provide in our community and the fact that our relationships have stayed with us, and they have grown. And they have also provided referrals for other relationships that have helped us to grow the bank overall.

"I think the strength and security of the bank gives our depositors confidence in the bank. We are in a very favorable capital position, we have very strong liquidity, and we have maintained very good loan quality."

Second, I think the strength and security of the bank gives our depositors confidence in the bank. We are in a very favorable capital position, we have very strong liquidity, and we have maintained very good loan quality. So we are not taking unusual risks that can cause concern on the part of depositors when they want to know that their bank is sound, and we have benefited from that. I also think we have benefited from the overall raise in the deposit market, which you see across the industry. We have certainly increased our market share over the last several years. But the overall deposit sector is very strong, with a lot of that growth not necessarily in the core area. So we are very proud of the growth that we have had in our core deposits and anticipate that will continue to be a very important part of the bank's profile going forward.

TWST: What do you expect in terms of the loan growth going forward in 2017, and what will be the drivers?

Mr. Ball: Well, again being primarily a relationship bank, our growth is really driven by the activity of our customers, and we are starting to see a lot of increased activity in that regard. We have seen some nice increases in our loan growth. And it's our expectation that as the economy continues to grow that we will continue to see more opportunities for us to be able to grow that loan portfolio while also anticipating continued growth on the deposit side. So I think it creates a nice mix for us to be able to maintain that strong balance sheet.

TWST: Can you share some highlights from your third quarter earnings report that you'd like investors to know about?

Mr. Ball: I think the focus there is that we have continued to see strong growth in our deposits, and that we have been able to maintain a very favorable risk profile on the loan side. And we have achieved that growth with continued diversification of the loan portfolio. The bank is not over-concentrated in certain areas, especially for a bank of our size. I think we have done a very good job in maintaining that diversification. And so it's our goal to continue to do that in growing the bank.

TWST: What have been your best moves insofar as allocating investable capital over the past year or two?

Mr. Ball: Well, I think the big key for us has been maintaining a very conservative position from an asset-liability standpoint. We have managed the bank's balance sheet very effectively, and as we look at a potential rise in interest rates over the coming years, the bank is very well-positioned in that regard. So I think looking back it's certainly had an impact from an earnings standpoint to take that conservative position. But we have the bank very well-positioned for this anticipated period of economic growth in rising interest rates.

TWST: How has the trend to a digitized financial economy affected Friendly Hills? Is your customer base interested in more technology compared to most markets?

Mr. Ball: We are very focused on technology and developing that technology while maintaining our strong levels of customer service. This is an area that I have spent a lot of personal time developing as well. I serve on the board of a bank technology company by the name of Data Center Inc., which is focused on solutions that community banks can employ with advancing technology. We have been able to use that relationship to bring a lot of advanced products to our customers.

People still want to know that they have that customized service, and people want to know who they are talking to when they call in, but that doesn't mean we can't provide some of the more advanced products and features to our customers as well that people find with other larger banks. So I think we provide a very nice mix. We maintain very strong dialogue with our client relationships, understanding what their needs are, and in some cases you see advanced technology that doesn't have a meaningful application.

So we are always looking at those types of products and opportunities and addressing it specifically to how it can best serve our markets. We don't need to always have the newest bells and whistles if it isn't something that's actually going to be useful in our marketplace, but we do have the ability to adapt the changes in technology, and I feel we have a good handle on that. And of course we also have to be mindful of assuring that those advanced products are part of a secure platform, as we are always looking to protect the security of the bank and our clients as these new technologies are brought into play.

TWST: Tell us what is at the top of your strategic agenda heading into 2017. What are the main goals and targets that you would like to reach in the coming year?

Mr. Ball: We are primarily focused on two areas, in recognition of where the economy has been and where we think it's headed, which again is stronger economic growth and higher interest rates. The two areas that we are focused on is, first of all, continuing to grow the bank's balance sheet, but doing it with the same standards of underwriting that we have employed in the past that will allow us to enjoy the benefits of having a very clean balance sheet and very strong regulatory relationships.

The second component is about an investment we made a little over a year ago in a payroll processing company to expand our product base into the business services area. As we have become the reputable leader in serving small business in the markets that we serve, we have found that we can help those businesses by expanding our product base and growing into business service areas. And one area that we were hearing from our clients that they

were really struggling with was in payroll service, which similar to banking — had some very large dominant players that weren't necessarily service-oriented. And so we have established a payroll processing platform, which we have fully integrated into the bank, and we are looking to expand and grow as a way to number one, provide additional quality services for our client base, but number two, also serve to expand our non-interest income. And we think that there is tremendous potential opportunity in that market, and so that, along with continuing to grow the bank with a sound balance sheet, are the primary focuses that we have for the next few years.

TWST: Is there anything else you recommend prospective investors focus on when evaluating Friendly Hills?

Mr. Ball: I think it's important for investors to realize that where there have been so many negative macro trends affecting the community bank sector over the last several years, and it's certainly been reflected in the average multiples for our segment of the industry, now it looks like those things are changing. And what's important to look at is how the banks are adapting to those

changes. I think it's extremely important to maintain a very strong balance sheet, and I think it's also extremely important to be able to diversify revenue sources beyond the traditional banking product. As interest rates rise, there's going to be different challenges facing the banking industry depending upon their balance sheet composition. And so differentiating those entities is extremely important as we look at value opportunities going forward. And Friendly Hills Bank is very well-positioned for the changes that we see coming in the market.

TWST: Thank you. (VSB)

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