CONSOLIDATED FINANCIAL HIGHLIGHTS

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE)	2020	2019
PERFORMANCE MEASUREMENTS		
Net income	$ 12,800	$ 16,115
Return on average assets	0.91%	1.29%
Return on average equity	9.56%	13.17%
Net interest margin, fully tax-equivalent	3.21%	3.68%
SHAREHOLDERS' VALUE (PER COMMON SHARE)		
Diluted earnings per share	$ 2.93	$ 3.67
Basic earnings per share	2.94	3.68
Regular cash dividends paid	1.20	1.17
Book value	33.07	29.30
Market value*	27.03	38.69
Market value/book value ratio	81.74%	132.05%
Price/earnings multiple year-to-date	9.23	10.54
Current quarter dividend yield**	4.44%	3.10%
Dividend payout ratio	40.83%	31.74%
BALANCE SHEET HIGHLIGHTS		
Total assets	$ 1,535,038	$ 1,269,157
Investment and equity securities	397,331	187,873
Loans, net	992,915	922,609
Deposits	1,354,573	1,125,392
Shareholders' equity	145,176	127,528
SAFETY AND SOUNDNESS		
Risk-based capital ratio (total)	17.69%	16.08%
Leverage ratio (tier one)	8.69%	9.72%
Common equity ratio (tier one)	14.32%	14.82%
Nonperforming loans/gross loans	0.87%	0.42%
Nonperforming assets/total assets	0.57%	0.31%
Allowance for loan loss/loans	1.66%	1.28%
Net loans (recovered) charged-off/average loans	-0.02%	0.07%
ASSETS UNDER MANAGEMENT		
Trust and investment services (fair value)	$ 836,381	$ 790,949
Held at third-party brokers (fair value)	112,624	127,976

**Based on the closing price of FRAF as quoted on the Nasdaq Capital Market*
***Annualized*

SHAREHOLDER LETTER

Dear Shareholders,

2020 will be remembered by many for the national, local, and personal challenges of dealing with the coronavirus. While I wish, for you our shareholders, that our stock had performed better I will remember 2020 as a year when your company demonstrated tremendous resolve, adaptability, and resilience to the benefit of our customers and laid the groundwork for the bank to continue its growth into the future.

We started 2020 with great promise coming off a record year for your company. However, in mid-March we needed to make the abrupt technological and process changes necessary for the bank's employees to be able to work from home and still keep the bank running and serving our customers. Shortly thereafter we needed to establish a new internal lending team to handle Paycheck Protection Program (PPP) loan requests for the benefit of our existing and new customers whose businesses were being threatened by the pandemic related lock down. Again, our PPP team had to work from home and rely on our technological capabilities. And perhaps most challenging, while we thought in March the conditions brought on by the pandemic would only last for 90 to 120 days, we operated through the remainder of 2020 working under these pandemic driven conditions.

Despite these conditions, from a net income perspective, 2020 was the second-best year in the company's history. Net income was $12.8 million and total assets climbed 21% to $1.54 billion. Net interest income remained relatively flat compared to the previous year despite the margin squeeze from the dramatic downward shift in interest rates. The unusually large provision for loan losses, taken as a conservative step to protect the company in the event of adverse loan performance due to the pandemic, was partially offset by a one-time reversal to our income tax expense of $1.1 million due to a benefit included in the Coronavirus Aid, Relief and Security Act and $840 thousand in gains on bank-owned life insurance policies. On the whole non-interest expenses remained controlled with only a 2.7% net increase year over year.


Timothy G. Henry
President and CEO

Earnings from Investment & Trust Services also supported the income statement as total assets under management grew and the company saw a shift from assets held at third party brokers to assets held and managed by the department.

Through the year the company took prudent steps to strengthen its balance sheet. As noted, the company added significantly to its loan loss reserves in both the first and second quarters as the deteriorating economic conditions of the time warranted. In August, your company issued $20 million in subordinated debt on favorable terms that further strengthened the company's balance sheet.

While commercial loan activity slowed in 2020 overall net loans grew 7.6% due primarily to new PPP loan outstandings. Commercial relationship managers worked tirelessly throughout the year to support their customers' needs which became ever more pressing because of the economic uncertainty.

Deposits grew over 20% year-over-year in 2020. There are several factors for this growth, many of them tied to the response to the pandemic, as some of the stimulus funding and PPP loan proceeds stayed in bank deposit accounts and the customer base became more conservative with their spending in response to the shutdowns.

Loan growth at the company could not match the growth in deposits but the company was successful putting the excess funds to work as investments grew from $188 million to $397 million. I expect that this growth in investments will be temporary as the company would prefer to put these funds to work in good quality loans that benefit our customers and community.

Overall, the balance sheet maintained strong liquidity and improved its already strong capital ratios. Notably, we continue to be a well-capitalized bank. Shareholder equity climbed $17.6 million (13.8%) to $145 million due primarily to retained earnings of $7.6 million and a $9.2 million increase in other comprehensive income from unrealized gains in investments.

Due to the bank's operating performance and strong balance sheet, your company was able to maintain its dividend throughout 2020. This was an important offset to the significant decline in market value of the company's per share stock value as the stocks of financial industry companies across the country fell out of favor due to concerns related to the pandemic. It has been good to see the stock price rally from a 52-week low of $19.60 and we remain confident that as concerns of credit deterioration for the industry decrease and margins stabilize or improve, we will see improvement in our stock's value.

Through the course of the year, I saw the employees of your company repeatedly rise to the challenges of providing excellent customer service during a pandemic. Our community offices, despite having to close the lobbies for most of the year, developed creative ways to provide great service to our customers as evidenced by the growth of deposits and the large number of home equity lines of credit that we established. Despite often not being able to meet face to face with customers, Commercial and Investment & Trust relationship managers worked in unconventional ways to bring the needed services, be it Paycheck Protection Program loans or investment management, to our customers. These extraordinary efforts were made by both internal and customer facing departments throughout the bank.

Important steps for the future of the company were also taken during 2020. In order to respond to the conditions the pandemic imposed on us we accelerated our turn to technology. Initially our technology services department had to focus on setting up our employees to be able to work securely and efficiently from home which they were successfully able to do. Then we turned to technology to improve our interface with our customers and increase the services our mobile customers have available to them. In 2021 we will be rolling out a suite of new products and services that our customers can access either through mobile or online connections. We were already headed in this direction but because of the pandemic the timetable was sped up.

In 2020 we saw a 166% increase in residential mortgage originations, from $47 million originated in 2019 to a record $125 million, which lead to a year-over-year increase of $1.1 million in gains on the sale of mortgages. While the economic environment proved to be good for residential mortgages in 2020 the seeds of our success were actually sown in 2019 as we revamped the systems and procedures of our residential mortgage department and added to our team of residential mortgage originators. These moves positioned us to be able to take advantage of, and build upon, the market opportunities that presented themselves in 2020 and that we think will continue in 2021.

Also, in 2020, we set the plans in action to develop a new Capital Region headquarters located north of Harrisburg along I-81. The new regional headquarters opened in February 2021 and brings together, in one location, members of our Capital Region Commercial, Investment & Trust and Retail teams who can work together to the benefit of our customers. This is an important step in the growth of our presence in a growing and vibrant market for the bank and will benefit us well into the future.

We take our responsibilities of being a leader in the communities we serve seriously. We always have. We always will. Typically, this leadership shows in the financial contributions to community organizations and in our employees' voluntary commitment of their time and talent back into the community. During 2020 we saw the needs of the communities we serve growing and we felt obligated to assist. On top of our normal giving, we added a $100,000 donation that went to local social service and first responder organizations to help them help the community at large. During 2020 we welcomed Kevin W. Craig to your company's Board of Directors. Kevin brings a CPA and business owner background to the Board and he is already making valuable contributions to the Board.

In December Donald A. Fry announced his intentions to retire form the Board effective with the annual shareholders meeting in 2021. Don has been a member of the Board since 1998 and the Board appreciates the contributions he has made to the company over these many years.

Regarding your Board of Directors, they too adjusted quickly, and not a Board or Committee meeting was cancelled or missed. Operating and conducting business in the virtual world became mainstay, and their efforts on behalf of the shareholders, customers and employees was noteworthy.

2020 proved to be a good year for your company as we strengthened the balance sheet, recorded the second-best net income in company's history and positioned the company for future growth. As we move into 2021, we will continue to work under the conditions created by the pandemic. But, as we did in 2020, we will build upon our systems, procedures and, most importantly, our people, to be able to profitably grow our company to meet the future needs of our customers and bring value to you our shareholders.

After this extraordinary year I also want to take a moment to thank our customers. It was not an easy year for us but it was not an easy year for our customers either. During the past year, our customers responded well, with understanding and at times humor, to the changes we needed to make in order to protect them and our employees. Never before in my career have I ever asked a customer to wear a mask into a bank building! But that is the kind of year it was, and our customers stayed with us and rolled with the changes.

We appreciate our customers and thank them for giving us the opportunity to serve them throughout the year.

We have been tested in 2020 and I feel we passed the test. I have great confidence in the team we have at Franklin Financial Services Corporation and F&M Trust. Undoubtably there will be more tests in 2021 brought on by the pandemic and the changing needs of our customers but I believe we will pass those tests too and continue to build the value of your company into the future.

Thank you for your investment and continued support of your company.

Sincerely,

Timothy G. Henry
President and CEO

TOTAL RETURN PERFORMANCE (AS DOLLARS)