F&M TRUST

Franklin Financial Services Corporation

# SHAREHOLDER LETTER 2022

## DEAR SHAREHOLDERS,

**It is an honor and a pleasure to once again be writing to share with you what your company accomplished in the past year. Franklin Financial Services Corporation (FFSC) successfully completed the third-most profitable year in its history during a time of dynamic changes that had both positive and negative effects on the local economy and the company.**

Nationally and regionally, 2022 will be remembered as a financially tumultuous year, as the country continued to react to its response to the pandemic. 2022 saw interest rates spike from December 31, 2021, to December 31, 2022, as the Federal Reserve's funds rate went from 0.08% to 4.33%, the prime rate rose from 3.25% to 7.50%, and the 10-year treasury rate climbed from 0.94% to 3.88%. As interest rates climbed, there were equally dramatic effects on loan and deposit pricing and the stock and bond markets. Just as challenging for the country and the region were international and employment issues, as well as financial issues, that created an economy subject to historic inflation levels that affected everyone.

FFSC was affected by the same economic factors that affected the nation and our region. While addressing the current short-term issues, it was also important that your company not overreact and lose sight of our long-term plans and goals. By maintaining a long-term view, your company was able to continue to position itself for future growth and profitability by adding key employees to our team; growing into new markets; adding digital infrastructure, including new ATMs; and adding to our physical footprint with a new headquarters building and two newly renovated community offices.

In 2022, your company posted a net income of $14,938,000. While rising interest rates helped us to recognize higher net interest income, when compared to 2021, that advantage was offset by lower non-interest income and higher expenses. Some of the differences between 2021 and 2022 were due to one-time benefits recognized in 2021, including a $2.1 million loan loss reversal and the sale of the company's headquarters in downtown Chambersburg. In 2022, your company had higher salary and benefit costs, as inflation and wage and salary pressures required the company to raise wages to meet market demand. With the end of federal government support payments related to the pandemic, spending habits changed, reducing some of the bank's non-interest income. Increased interest rates affected your company in several other ways. The Investment & Trust Services team generated higher income levels than the previous year, but the negative effect the movement in interest rates had on both the stock and bond markets slowed the potential growth in fee income generated by the team. Higher rates also significantly slowed residential mortgage originations for both refinancing and acquisition, which reduced related fee income compared to the previous year.

Your company's balance sheet continues to be strong and meets all regulatory benchmarks for being a well-capitalized company. In 2022, book capital (non-regulatory) decreased primarily due to a $51 million decrease in accumulated other comprehensive income (AOCI) and as unrealized losses in the bank's investment portfolio increased with climbing interest rates. Ultimately, most of these unrealized losses will be recaptured as the investment portfolio amortizes and matures, but the short-term effect is significant to the balance sheet. It is important to remember that the AOCI is not considered in the calculation of regulatory capital ratios. Beyond AOCI, the bank began to see a drawdown from record levels of deposits as customers began using the funds for projects and ordinary spending or sought higher deposit rates. As a result, FFSC began to reduce its cash to support the growth of the bank and to avoid having to liquidate longer-term investments. Despite these challenges, your company maintains a strong liquidity position that supports future growth plans.

The bank's loan quality continued to improve in 2022 as non-performing loans to gross loans dropped to 0.01% as of year-end 2022 compared to 0.74% for the same period in 2021. The allowance for loan losses to gross loans at year's end was 1.35%, down from 1.51% a year earlier, and a reflection of the improved loan quality. During 2022, the bank prepared to adopt the Current Expected Credit Loss (CECL) standard for implementation at the beginning of 2023. The company does not anticipate a significant impact from adopting CECL.

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**TIMOTHY G. HENRY**
President & CEO

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Over the course of the year, our stock price moved from $33.10 per share on December 31, 2021, to $36.10 per share on December 31, 2022. The stock traded in a range from $28.05 per share to $36.55 per share, as many factors play a role in the price of our stock on a given day. For the year, the annual dividend was $1.28 per share, up from $1.25 per share in the previous year. We believe that if we run the company effectively, our shareholders will see appreciation of their stock over time while benefiting from a reliable dividend payment.

While the inflationary economy and the dramatically shifting interest rates created short-term challenges, your company stayed focused on investing and building for the future as an independent community bank. In July 2022, the bank moved into Maryland, establishing a community office in Hagerstown that is home to retail, commercial lending, treasury, and investment and trust teams. It is an exciting first step as the bank spreads its community banking, relationship-driven model to new markets. In December, your company announced the addition of Gregory I. Snook to the Board of Directors. Mr. Snook was born and raised in Washington County, Maryland, and has spent his adult life serving the area in many capacities.

**AS WE MAKE DECISIONS REGARDING STRATEGY, PEOPLE, NEW MARKETS, TOOLS, AND INFRASTRUCTURE, WE DO SO WITH AN EYE TO THE FUTURE.**

**TIMOTHY G. HENRY**
President & CEO

2022 also saw the adoption of Salesforce, a Customer Relationship Management (CRM) tool that will support the bank's efforts to digitally connect its teams with our customers and efficiently offer solutions to meet their needs. While engaging the Salesforce tool has been a major undertaking by nearly everyone in the bank, we believe it will become our "digital backbone" and support the ongoing digital transformation that is required for us to be successful.

Your company also improved existing physical infrastructure with renovations to our Mechanicsburg and West Side (Chambersburg) community offices. Both locations were redesigned to meet the needs of our customers more effectively. We created spaces where customers can comfortably meet bank staff, discuss solutions to banking and financial issues, and conduct transactions. We also completed the first phase of a three-phase plan to replace our aging ATMs with new machines that offer improved security and customer-friendly features.

2022 also saw the completion of the new company headquarters and operations center at 1500 Nitterhouse Drive in Chambersburg. The project, which started with selling our two buildings downtown and repurposing a vacant industrial building, was completed on time and on budget, and teams began moving in at the end of June. The project brought employees formerly working on six floors in two buildings into a single-story building designed to promote collaboration. While a new headquarters became a necessity due to the growth of the bank, I am convinced that the result of the collaboration between departments in our new location will be a more customer-focused, efficient, and profitable company.

Amidst all this activity, your company has not lost its focus on community. During 2022, we donated more than $526,000 to 263 community organizations and more than $122,000 in scholarships through the Pennsylvania Educational Improvement Tax Credit (EITC) program. And your company did not just give of its "treasure" but also gave of "time" and "talent" by investing more than 1,300 volunteer hours in 62 different organizations.

Last year, I wrote of the pending retirements of Ron Cekovich, Trish Hanks, and Joe Lieb, which occurred as planned. We thank them for their significant contributions to the company. We are a better organization for them having


**NEW COMPANY HEADQUARTERS AND OPERATIONS CENTER**
Chambersburg PA

been part of the team. In 2022, we introduced two new senior management team members: Chief Retail Services Officer Lou Giustini and Chief Technology Officer Dave Long. On January 2, 2023, we welcomed Chief Operating Officer Chad Carroll. All three have made significant contributions to your company and I am very pleased to have them as part of the team.

The past three years have demonstrated how quickly and dramatically the world around us can change. Those changes require us, in response or proactively, to make changes too. As we make decisions regarding strategy, people, new markets, tools, and infrastructure, we do so with an eye to the future. We are positioning ourselves to be able to continue to grow, both organically and through merger and acquisition, so we can continue to provide the great service and products our customers have come to expect and continue to meet the needs of the communities we serve.

What doesn't change is our focus on being a great, independent, community bank that brings a fair return to our shareholders based on a business model that provides capital and outstanding service to our customers, supports the communities in which we operate, and provides rewarding careers to our employees. If we can do all this effectively, I believe there is a bright future for you, our shareholder, your company, and those it serves.

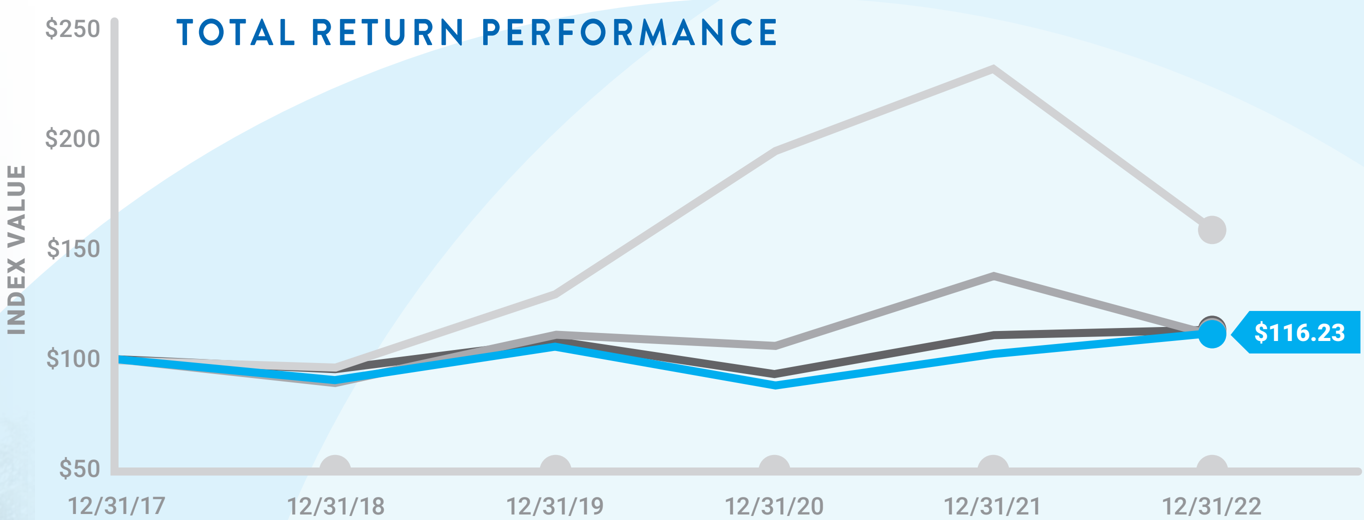
We operate with the guidance of your Board of Directors, who work to set the direction for the company, oversee its management, and ensure that shareholder needs are addressed. Collectively, board members spend many hours in learning opportunities outside the board room so they can be more effective in their roles and bring value to the organization. Their conversations in the board room are straightforward, inquisitive, challenging, respectful of each other and management, and focused on how we can become a better company. I am grateful for their guidance and input.

2023 will be another challenging year. There is no reason why it shouldn't be. The management team and I look forward to embracing the challenges and opportunities the year presents with the goal of continuing to build for a better future for all, including you, our shareholder. Thank you for your continued support.

Sincerely yours,

**Timothy G. Henry**
President & CEO
Franklin Financial Services Corporation and F&M Trust

## TOTAL RETURN PERFORMANCE




**LEGEND**

Frankin Financial Services Corp. · NASDAQ Composite Index · S&P US BMI Banks - Mid-Atlantic Region · Peer Group

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Franklin Financial Services Corporation

# CONSOLIDATED FINANCIAL HIGHLIGHTS 2022

| *(Dollars in thousands, except per share)* | **2022** | 2021 |
|---|---|---|
| **PERFORMANCE MEASUREMENTS** | | |
| Net income | **$ 14,938** | $ 19,616 |
| Return on average assets | **0.83%** | 1.17% |
| Return on average equity | **11.64%** | 13.20% |
| Net interest margin, fully tax equivalent | **3.11%** | 2.88% |
| **SHAREHOLDERS' VALUE** (Per common share) | | |
| Diluted earnings per share | **$ 3.36** | $ 4.42 |
| Basic earnings per share | **3.38** | 4.44 |
| Regular cash dividends paid | **1.28** | 1.25 |
| Book value | **26.01** | 35.36 |
| Market value* | **36.10** | 33.10 |
| Market value/book value ratio | **138.79%** | 93.61% |
| Price/earnings multiple year-to-date | **10.74** | 7.49 |
| Dividend yield | **3.55%** | 3.87% |
| Dividend payout ratio | **37.88%** | 28.16% |
| **BALANCE SHEET HIGHLIGHTS** | | |
| Total assets | **$ 1,699,579** | $ 1,773,806 |
| Investment and equity securities | **487,247** | 530,292 |
| Loans, net | **1,036,866** | 983,746 |
| Deposits | **1,551,448** | 1,584,359 |
| Shareholders' equity | **114,197** | 157,065 |
| **SAFETY AND SOUNDNESS** | | |
| Risk-based capital ratio (Total) | **17.21%** | 18.41% |
| Leverage ratio (Tier 1) | **8.95%** | 8.52% |
| Common equity ratio (Tier 1) | **14.22%** | 15.20% |
| Nonperforming loans/gross loans | **0.01%** | 0.74% |
| Nonperforming assets/total assets | **0.01%** | 0.42% |
| Allowance for loan loss/loans | **1.35%** | 1.51% |
| Net loan (charge-offs) recoveries/average loans | **(0.15)%** | 0.04% |
| **ASSETS UNDER MANAGEMENT** | | |
| Trust and Investment Services (Fair value) | **$ 904,317** | $ 946,964 |
| Held at third-party brokers (Fair value) | **116,398** | 118, 046 |

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