



February 27, 2015

Dear Shareholders:

On May 1, 2015 we will celebrate our 125<sup>th</sup> anniversary of service to our community. When Exchange Bank opened its doors for business in 1890, the City of Santa Rosa was a prosperous community, serving as the marketing and service center of the Redwood Empire. The Bank opened in a modest structure on Fourth Street and served as one of only five banks operating in Santa Rosa. There were three deposits made on that first day of operation; two of which were made by Manville and Frank Doyle.

Today we have over 400 dedicated employees and total assets in excess of \$1.8 billion. As we look ahead to 2015 and beyond, we celebrate our legacy, but today we must focus on our future.

During 2014, there was a significant change within the leadership of Exchange Bank. C. William Reinking retired as Chairman of the Board after fifty years of dedicated service to the Bank. Bill Reinking and his father Charles Reinking, the Bank's third president, gave 92 years of combined service to the Bank, its employees, and the community. We recognize with sincere appreciation that our success today is built on the foundation of their vision and leadership. In this year of celebration we would like to thank Bill, his wife Mary-Louise (M-L), and the Reinking family.

We are very proud to report that our company delivered exceptional financial results while significantly improving the credit quality of our loan portfolio. The Bank achieved growth and profitability through another year of record low interest rates and intense competition. We finished 2014 with strong deposit and loan growth. We grew deposits by 6% and loans by 8%, while maintaining our high standards of credit quality.

During this milestone year, there were many accomplishments achieved in 2014:

- Increased profitability
- Strong growth in core deposits and loans
- Solid improvement in credit quality
- Redemption of all residual, outstanding preferred shares
- Increase in the common shareholder cash dividend
- The introduction of a new era in retail delivery, our Branch of the Future design

Given the continued headwind of an extraordinarily low interest rate environment, we are proud of the financial performance achieved by the Bank in 2014. Net income increased from \$15.7 million in 2013, to \$17.7 million in 2014, an increase of approximately 13%. This level of earnings allowed the Bank to achieve a return on average assets of 0.99%, and a return on average equity for the year of 11.05%. The improvement in earnings was attributable to strong

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loan growth of 8%, or \$91 million, core deposit growth of \$91 million, and reduced loan loss provisioning of \$2.5 million.

There are three distinct areas we can point to that contributed to the Bank's solid financial performance during 2014:

First, the Bank's improved earnings are the direct result of strong loan growth funded by low yielding core deposits, which in turn led to an increase in net interest income of \$4.0 million, resulting in an increased net interest margin. This is the first increase in the Bank's margin since 2010. Contributing to this expansion in margin has been the redeployment of very liquid and low yielding investments into higher yielding loans. It is significant to note that this loan growth was achieved without compromising the Bank's credit quality or taking on extended interest rate risk during this period of historically low interest rates.

Second, control over operating expenses led to an increase of less than 1% in operating expenses during 2014. Discipline in controlling expenses was driven by our improved credit quality. A significant improvement in the credit quality of the Bank's loan portfolio led to a substantial reduction in provision for loan loss reserves and other credit and OREO related expenses. Asset quality continues to improve as many of our customers have seen an upgrade in their performance, ultimately resulting in a net recovery of prior charged-off loans.

Third, after years of gradual improvement, the Bank has, for the most part, completed the repair of the credit quality of its loan portfolio during 2014. Non-accrual loans decreased to \$12.0 million, or 1.0% of total loans at December 31, 2014, from \$29.7 million, or 2.63% of total loans at December 31, 2013. Contributing to the Bank's increase in net interest income was a pickup of approximately \$750 thousand in increased interest income recognized in 2014 as a result of a significant reduction in delinquent loans classified as non-accrual. The impact of dramatically improved credit quality surfaced in almost every area of the Bank's operations. The most visible example is in the Bank's provision for loan loss, which declined from \$2.5 million in 2013 to \$0 in 2014. As a result of the significant improvement in asset quality, and zero net loan losses, the Bank did not make any provision for loan loss in 2014; however, we continue to maintain a prudent ratio of loan loss reserves to total loans of 3.08%.

As a result of the robust level of core earnings and strength of liquidity generated by growth in core deposits of \$91 million, the Bank successfully retired the final \$9.15 million of preferred shares formerly known as TARP capital in the first quarter of 2014. What began as a \$45 million obligation from the government as part of the Capital Purchase Program, we are pleased to report that as of February 14, 2014, we retired the remaining balance of the preferred shares, completing our obligation to pay back the capital we received to help us weather the economic recession. Even with the reduction in preferred shares, our capital levels remain strong and above all current regulatory requirements, including those proposed in the phase-in of the BASEL III capital standards.

With regard to our dividend, due to continued improvement in earnings, capital, and asset quality, the Bank's Board of Directors approved three increases in the level of dividends being paid to common shareholders, and as a result, the quarterly dividend rose from \$.30 per share by the end of 2013, to \$.45 per share by the fourth quarter of 2014.

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During 2014, we opened a new era in our retail delivery channel by upgrading our Windsor and Cotati branches to our new Branch of the Future design. Most of our branches were built many years ago around a design to facilitate accepting deposits and cashing checks; these types of routine transactions are declining. To address this change, we have begun a branch transformation with a design that facilitates a more personalized one-on-one interaction with our customers. The traditional teller line barrier between the customer and banker has been removed to enable a superior customer experience. This allows our employees to engage with our customers and provide a seamless, full-service experience.

There is still an overwhelming focus on finding ways to enhance the branch experience rather than eliminate it. Even as mobile and other self-service channels are leveraged for simple transactions, there will always be a need for the face-to-face interaction afforded in the branch. Branches still account for the majority of all new banking relationships, as customers still want a personal relationship with their financial institution.

Mobile banking is becoming one of the fastest growing delivery channels in the banking industry. However, the reality is that mobile channels will be a key component of the Branch of the Future. We will continue our investment in mobile banking technologies such as remote deposit capture and money transfers, but we will not lose sight that knowledgeable and competent bankers is what makes the difference today and in the future.

We remain fully committed to adapting our service model to meet the changing needs of our customers. Exchange Bank is committed to using new technologies to deliver our banking services. Innovations from image enabled ATMs, online banking, electronic bill pay, remote deposit capture, and mobile banking have made money management more convenient and provided customers with twenty-four hour access to their accounts. We have adopted new advancements in mobile phone technology. Customers can now use a smartphone bank “app” to take a picture of a check and make a deposit anytime, anywhere. We have leveraged this emerging technology to better serve our customers.

Regardless of the method used by Bank customers to access their accounts, we expend considerable resources protecting customer accounts from unauthorized access and fraud. We have robust security programs in place to prevent unauthorized or covert use of customer information and intrusion detection systems to monitor our network inquiries and activity. Our main objective is protecting customer account information and ensuring the security and confidentiality of this information against unauthorized access to, or use of, customer information.

Exchange Bank plays a critical role in the health and prosperity of our local economies. We have helped our communities grow and prosper, directly contributing to the economic vitality by providing capital for business expansion, job creation, and helping individuals create wealth. Exchange Bank’s success depends on that of our customers and the communities we serve.

For 2015, we see business investment spending being a catalyst of growth. This may fuel strong loan demand as companies take advantage of low interest rates to invest in plant and equipment. Additionally, a return of wealth and low levels of consumer debt will result in stronger consumer spending. Steady job creation, lower unemployment rates, and higher equity and home values will also improve consumer confidence in California.

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In recognition of our employees' exceptional work and dedication, and the commitment of our customers, we are proud to report that once again we have been recognized as one of Sonoma County's "Best Places to Work" and "Best Business Bank." In 2014 we were also the recipient of a "Corporate Philanthropy Award" and "Best Architectural Award" for our Branch of the Future design in Windsor.

The Bank's founders, Manville and Frank Doyle, were true visionaries who believed deeply in this community. Today, we carry-on their mission by being a community partner with our time, talent, and treasury. In 2014, we contributed to over 300 charitable organizations throughout Sonoma and Placer counties. Our dedicated employees continue to give back to our community with a commitment to thousands of volunteer hours annually to make this community a better place to live and work.

On behalf of our employees and Board of Directors, we sincerely thank you for your commitment and confidence you have placed in Exchange Bank.

We would like to invite you to our Annual Shareholders' meeting on Friday, March 20, 2015 at 2:00 p.m. If you are unable to attend, we would request your proxy vote be given to management. In the interim, if you have any specific questions you would like answered, please direct them in writing to:

Marlene Soiland  
Corporate Secretary  
Exchange Bank  
P.O. Box 403  
Santa Rosa, CA 95402

You may also contact the chairman directly via email at [schraderb@exchangebank.com](mailto:schraderb@exchangebank.com).



William R. Schrader  
Chairman of the Board

Sincerely,



Gary Hartwick  
President and Chief Executive Officer