HERITAGE SOUTHEAST BANCORPORATION, INC

July 30, 2020

Dear Shareholder:

When the excitement of the New Year's Day celebration ended just six months ago, those of us at Heritage Southeast Bancorporation, Inc. (HSBI) and Heritage Southeast Bank (HSB) readied ourselves for what we thought would be an exciting year of transition and growth opportunities. Like everyone, we had read and heard of the disruption in China that was associated with a virus, but little did we know the disruption was headed to the United States. If you looked in our Business Continuity Plan (BCP) you would have seen a section on Pandemics and plans on how to address the challenge if it ever occurred. The odds of this occurring were considered remote at best, but necessary enough to cover in our plan. The truth is as we entered the pandemic, we took the plan as outlined in the BCP, but had to adjust on the fly as this was like no other natural disaster we have experienced. Having offices along the coast in Georgia and Florida, we understand disruption and destruction, but not to the depth and extent of having to design workarounds for practically every human contact point in the organization. I commend the HSB team as they worked diligently to lessen the impact on each other and our clients.

Here we are at the mid-point of the year and about four months into the pandemic. It is easy to see how COVID 19 will define the 2020 year, but we are determined to respond, adapt and persevere. The impact on HSB has been significant and we felt it appropriate to provide an update on how the company and bank are progressing. The financial results have been published, but the story cannot be adequately told with numbers or a press release.

It is difficult to quantify the impact of COVID 19 on the HSB loan portfolio. Many of our customers were able to qualify for the Paycheck Protection Program (PPP) and receive federal dollars to provide for employee compensation and other operating expenses. HSB provided more than a 1,000 PPP loans for more than $105 million. In addition, HSB has offered loan modifications to approximately 17% of our borrowers to assist them. Many of our more than 60,000 consumer clients also received federal stimulus payments and enhanced unemployment benefits. All of these programs have allowed our customers to keep their obligations current and push their financial challenges off to a day when hopefully economic activity and optimism will have been restored. To put it bluntly, the government has flooded the system with liquidity and stimulus that makes it very hard to measure the effects of the pandemic.

When we completed our merger, September 1, 2019, the loan loss reserve and credit mark adjustments totaled 1.21% of all loans outstanding. We provided $560,000 in the fourth quarter of 2019 and ended the year at a level of 1.19% of all loans outstanding. It was our intention to build reserves in 2020 as the credit marks would burn off through accretion to income and losses within the acquired portfolios. It was our intention to provide $350,000 per month in 2020 for total provisions of $4.2 million. In March, when COVID 19 took the spotlight, we decided to start special COVID allocations to our loan loss reserves and provided an additional $1.5 million in both the first and second quarters 2020. As a result, we now have reserves and credit mark adjustments of 1.56% of all loans outstanding as of June 30, 2020. Is that enough? The question will be answered over time as a part of the discussion on whether there will be more federal stimulus, how effectively our economy responds to reopening and ultimately, the threat of

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another round of COVID resurgence. So far, we have been able to fund these provisions through earnings. It has greatly depleted our earnings and with the added pressure of the Federal Reserve Bank actions to stimulate the economy and the rapid decline in interest rates to near zero percent, it is a difficult operating model.

To compound the challenges of declining interest rates and excess cash balances in client accounts reducing the need for borrowing and other fee-based bank services, we have been unable to extract the merger related efficiencies we had expected to accrue to our benefit in the second half of 2020. The pandemic staffing challenges brought to HSB and our primary data processing partner delayed the conversion of our backroom systems to late 1Q2021. Many of our merger related efficiencies are driven by this consolidation. They will be achieved, but the timeline has been extended. On the positive side, we have leveraged talent and services offered in one of our bank divisions to all of the divisions in an effort to generate additional income to HSB. These shared services will continue to build and develop resulting in increased opportunities the remainder of this year and beyond.

While it is never our desire to predict the future, we do feel it is our responsibility to help set the expectations for HSBI and HSB. We entered the merger with great optimism with three banks firmly entrenched in great growth markets like Atlanta and Savannah, Georgia as well as Jacksonville, Florida. We had seasoned teams of bankers with great contacts that were able to generate consistent 8-10% annual growth rates. We coupled this with long histories of superior service in stable markets to provide core funding at extremely low costs and fee rich opportunities. It was our plan to leverage these attributes with a larger balance sheet and more efficient backroom to produce superior results. However, we are still faced with near term impact to operations. As an example, you can see in the financial results the net interest margin in the first quarter of 2020 was 4.21% and declined 50 bps to 3.71% in the second quarter; the balance sheet of HSB was liquid in the first quarter and became even more liquid in the second quarter; the Fed rate cuts to near 0% has caused a significant reduction in earnings as floating rate loans have adjusted downward; and liquid assets have become noncontributors to earnings. As seen on the balance sheet, we continue to be able to grow loans even outside of PPP, but the growth rate is much less as many businesses and individuals needs and plans have changed either due to PPP funding or uncertainty brought on by the pandemic. Much of the significant drop in non-interest income is due to the reduction in deposit services fees. These fees have been reduced as clients have had fewer needs for our services as their personal and small business cash positions have strengthened through the stimulus payments and PPP loans. We expect the fees to return once the stimulus payments and PPP proceeds have been absorbed.

Continuing to look forward, loan growth will be challenged in the COVID environment, loan portfolio delinquencies and losses, while not apparent today, are assumed to be greater than if no pandemic had occurred, and merger cost savings have been pushed into 2021. It is not our nature to accept the negative without a plan and strategy to find success, and we are working diligently in several areas. First, we are identifying ways to leverage the balance sheet and our capital in low risk short duration earning assets to improve the yield on our liquid assets. We are allowing higher cost funding sources to exit without sacrificing long term client relationships. PPP lending was largely successful for our clients and produced more than $4 million in fees that will be recognized over the next twenty-four months. We have accelerated recognition and execution of noncore data processing related cost savings across our three banking divisions. Finally, we are identifying sectors and individual clients within the loan portfolio that are stressed by the COVID 19 impact and designing remediation plans to help lessen the impact on bank earnings and capital.

It is true that banks struggle during periods of zero to low interest rates. Not only do banks make the majority of their earnings on interest spreads, these periods of low interest rates are usually indicative of a struggling economy and therefore struggling borrowers. We feel good about our asset quality. While it appears that nonperforming assets (NPAs) are elevated at $29 million, there is a story to each of these relationships. All of the NPAs are legacy assets to the three banks prior to our merger. During the merger process we were able to mark all of these relationships to current values fully supported by current cash flows. While technically in an NPA status, most every relationship is paying and fully supporting their debt. This is not to say that COVID 19 won't have an adverse effect on these or any other relationship in the bank, but these legacy relationships have been heavily scrutinized and adjusted to right size their debt load to their payment abilities.

To touch on the final area that deserves some explanation, the capital accounts of the bank have been greatly enhanced. The company and bank both are recognized as well capitalized by regulatory standards and were at the time of the merger. Shortly after the merger we spent a great deal of time stress testing the capital of the bank. It was our desire to rapidly cleanse the legacy problem assets and grow aggressively and to support these with limited dilution to shareholders. We expanded our senior debt facility and completed a sub-debt offering providing additional capital resources to the bank without increasing our share count. These facilities will be retired over time and primarily through earnings allowing our shareholders the greatest benefit. The leverage capital level of the bank now exceeds 9.5% and HSBI has additional resources to push this number well above 10.5%. This takes into account a slightly inflated balance sheet due to PPP funding. While capital is the ultimate safety net, it should be noted we have also increased our loan loss reserves by approximately 50 bps during this same time period.

Our goal is to build a strong and vibrant HSBI and HSB. A company that provides opportunity and reward to our employees, unequaled service to our clients and an above average return to our shareholders. It is our belief if we deliver in these areas, we will create the "sustainable community bank" that those on the outside looking in will yearn to be a part of and sacrifice to do so. Thank you for taking this journey with us and we look forward to great days ahead.

Sincerely,

Leonard A. Moreland
Chief Executive Officer

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