



Pacific Financial Corporation



2016 Annual Report

OTCQB: PFLC



Denise Portmann
President & CEO

Dear Fellow Shareholders:

In 2016, we achieved our seventh consecutive year of profitability and posted the most profitable year in the history of our bank. We generated earnings of \$6.6 million for the full year, or \$0.63 per share, up 18% from 2015. Driving our solid results were strong loan growth, accelerated deposit growth, strong capital and excellent credit quality.

As we streamlined our operations during the year, we expanded our client relationships, deepening our market position in Northwestern Washington and Coastal Washington and Oregon, while expanding our presence in Vancouver, Portland and Salem. In addition, we raised our annual cash dividend for the third consecutive year by 5% to \$0.23 per share, demonstrating our commitment to building shareholder value. The dividend was paid on January 9, 2017, to shareholders of record as of December 31, 2016, providing an annual yield of 2.4%, at recent market levels.

Our total deposit growth rate was 9.1% for the year, outpacing the median deposit growth rate for the state of Washington at 5.6%* and the national median growth rate at 4.6%*. Our core transaction deposits remained high at 84% of total deposits. In addition, we increased our loan portfolio by 5.1% for 2016. We expect loan and deposit growth to continue to be robust in the next few years. In particular, our mortgage lending team is expected to be very active in helping homeowners finance the next home they buy or build in the coming years.

Regarding the effectiveness of our business strategy and continuing the momentum of our strong financial performance, highlights from 2016 are detailed as follows:

- We delivered record earnings of \$6.6 million for 2016.
- Our net interest margin (NIM) improved to 4.11%.
- Our credit quality continued to improve, with nonperforming assets declining 65% to \$1.8 million, or 0.20% of total assets - the lowest level since 2007.
- Although our classified assets increased slightly to \$17.5 million, due primarily to the adverse classification of one commercial property, the ratio of classified assets to gross loans was 2.65% at year-end compared to 3.62% last year.
- We remained well reserved at year end, with our allowance for loan losses at 1.39% of total loans.
- In 2016, we streamlined our operating footprint by closing two underperforming branches and reinvesting in people and technology throughout the franchise.

2016 SHAREHOLDERS' LETTER

- All capital levels exceeded regulatory requirements for a “well-capitalized” financial institution, ending the year with a total risk-based capital ratio of 12.56%, a Tier 1 risk-based ratio of 11.31% and a leverage ratio of 9.25%.

Our objectives for 2017 include expansion of treasury management services in growth markets, enhancing the digital banking experience and increasing branch productivity, resulting in impressive and memorable customer service. We believe these initiatives will result in commercial deposit and fee income growth, broaden access to digital application processing, and increase digital transactions with greater customer adoption of mobile banking and person-to-person payments. We also expect our business banking team to grow as they gain momentum from an integrated calling effort with commercial and branch relationship managers. We continue to build an outstanding franchise. We have a strong team of highly-experienced bankers, and every day they deliver the distinct level of service our customers deserve. We are ideally positioned to serve our communities in 2017 and beyond.

We are also proud of the strong financial and service commitment we have to our local community organizations. It's a commitment that goes beyond offering financial products, services and expertise. In 2016, we invested over \$100,000 back into our communities, and our loyal employees volunteered over 800 hours to local non-profit groups, like local food banks and student food programs, financial literacy programs, medical services and community foundations. As a community bank, we are keenly aware that reinvesting in our communities empowers our neighborhoods, stimulates economic development, helps our small businesses grow, and generates long-lasting customer loyalty.

As we look forward to 2017, we are striving to deliver another strong performance to benefit our shareholders, customers, communities and employees. Please join us for our annual Shareholders' meeting on Wednesday, April 26, 2017, at 4:00 pm at 1216 Skyview Drive, Aberdeen, WA 98520.

Sincerely,



Randy Rognlin
Chairman of the Board
Pacific Financial Corporation

Denise Portmann
President and Chief Executive Officer
Pacific Financial Corporation

* *Source: SNL Financial.*



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