

ANNUAL LETTER TO CLIENTS

“I look forward to leading this historic company and continuing to support the bank’s objective to remain an independent, increasingly profitable, controlled growth company.”

~Mark Kajita

As I enter my first year as President of Baker Boyer I continue to think about the changing environment we see in the global, national and local economies, as well as change in our own Bank. As I mentioned in my recent Wealth Management newsletter, one of the maxims that we as Americans doggedly adhere to is the idea that change is a natural event. Change shouldn’t be avoided, but change should be embraced as an opportunity for growth and evolution. I point to Dr. Baker who moved to the Walla Walla Valley from his birthplace in Illinois. He first opened a mercantile in Walla Walla catering to the miners who were on their way to the gold mines of Idaho. When they came back with their gold, he held it for safekeeping in his mercantile. After many years, he realized that the Northwest economy was changing and what the community really needed was a very stable and safe financial institution. Dr. Baker enlisted the assistance of his brother-in-law, John Boyer, and together they started Baker Boyer Bank in 1869. Dr. Baker recognized the changing times and instead of resisting the change, he altered his outlook to prosper in the new economy of the Northwest.

The Baker Family has proudly carried on the tradition of being the stable banker and advisor to the communities the Bank serves. In addition, the Baker Family has worked to keep the bank independently owned and dedicated to the principles of “Guiding you to a brighter financial future.” They have done so through a partnership of family members and non-family member employees who show passion and a competency for running the business. Over the last 145 years, this coalition of family and non-family leaders has been instrumental in leading the Bank through ever-evolving environments. This small group of leaders, of which I am proud to include myself, shares the traditional values and sense of stewardship that characterizes every generation of Bank leaders. As such, we continue to have open communication with the next generation of Baker Family to prepare them for future leadership at Baker Boyer.

In addition to our strong leadership, I truly believe that what has made Baker Boyer so successful over the years is a meeting of minds between the employees of the Bank and our loyal clients. As I talk more and more to our clients and business partners I am keenly aware that we all share similar values: entrepre-

neurship, energized leadership and excitement for the future. There is an understanding that in a complex world, the need for trusted experts who can guide you through any phase of your life is not only desirable but vital, and Baker Boyer is here to serve our clients to the best of our ability.

One of the most positive outcomes of 2013 was the strong vote of confidence our clients made, as evidenced by an increase in deposits. Average deposits rose to \$476.7 million from \$454.7 million for the year ending December 31, 2013 and 2012 respectively. That amounted to a 4.8% increase in deposits held at Baker Boyer.

This increase in deposits also coincided with the unprecedented intervention by the Federal Reserve to drive down interest rates throughout the country. Because of this, the Bank's net interest margin has continually fallen as the interest charged on the bank's loans has declined faster than the cost of our deposits. At the end of 2013, the Federal Reserve made the long awaited decision to stop its intervention aimed at lowering rates and allow interest rates to rise to a more normalized rate. This was dubbed "tapering" and is expected to raise interest rates in the near future which will have a positive impact on the Bank's net interest margin.

At Baker Boyer we continue to manage our loan portfolio by minimizing the risk to our portfolio from this sudden interest rate increase. As of December 31, 2013, the Bank's average loan balance fell to \$284.5 million from the average loan balance of \$293.4 million the year earlier. Commercial loans in contrast increased \$4.9 million or 2.6% in 2013, signaling a strengthening economy and the Bank's commitment to support small area businesses. Most of the decline is attributable to an \$8.4 million reduction in residential real estate loans, or 12.8%. This occurred due to many clients taking advantage of low 30-year mortgage rates and refinancing their home mortgages with Fannie Mae or Freddie Mac.

In contrast to the challenges we face in lending, the Wealth Management Division has continued to grow. The dual nature of Baker Boyer's business proved to be very beneficial for our shareholders as we rely on both the net income of the Banking and the Wealth Management Divisions. Total assets under management have grown to \$1.1B as of December 31, 2013

from \$962M as of December 31, 2012, an increase of 14.7%. This has translated to Wealth Management revenue of \$8.4 million and \$7.0 million for the years ending December 31, 2013 and 2012 respectively, accounting for a 19.0% increase.

In conclusion, the management of Baker Boyer has worked hard in 2013 to navigate through these challenging times. Total net income for 2013 was \$6.2 million, down a mere 1.5% from our record earnings year hitting \$6.3 million in 2012. This small difference has been through careful planning as well as hard work from all employees of Baker Boyer. As I start my first year as President of Baker Boyer, I am proud of our accomplishments. I look forward to leading this historic company and continuing to support the bank's objective to remain an independent, increasingly profitable, controlled growth company.

