President's Message

July 20, 2023

Frank H. Hamlin, III
President & CEO

Dear Shareholders:

Starting in 2022 and into the present, the Federal Reserve has rapidly increased interest rates to reduce inflation while keeping unemployment and Gross Domestic Product (a comprehensive measure of U.S. economic activity) in check. With the rapid increase in interest rates, the banking industry has experienced a rapid increase in its cost of funds, which has put a material pressure on net interest income, the primary source of revenue within true banking entities. Once again, this was the intent of the Federal Reserve. The purpose of raising interest rates was to slow down the economy by making the borrowing of money expensive and thus cooling demand. It is working.

Depositors are seeking higher yields on their deposits, which increases our cost of funds. A higher cost of funds requires banks to charge higher interest rates on lending products. This slows the demand for lending by making it either too expensive or too risky for borrowers to finance the purchase of goods.

Over the course of the year, we have been increasing the rates on our deposit products, while also increasing our lending rates to maintain our net interest income. As lower rate loans amortize on our books, we use those funds to reinvest in current market rate loans which are at materially higher rates. Additionally, we are using the proceeds from those amortizing instruments within our securities portfolio to fund lending at materially higher rates. An important purpose of the securities portfolio is to generate additional liquidity for lending, particularly in cycles where lending demand exceeds deposit growth, and that is exactly how we are using it in the current economic environment.

Lending demand has remained steady within our footprint, despite the higher interest rates. Credit quality remains surprisingly strong. Consistent with the experiences of financial institutions across the country, we have been fighting to retain and grow deposits as the money supply contracts and people seek higher yields through money market funds. Contrary to the media and political hype, deposits have been leaving banks in pursuit of higher yield, not safety, as evidenced by the explosion of growth of money market funds (which are not FDIC insured) over the last year and a half. Through the creative efforts of our consumer groups, we have been able to create attractive products to retain our deposits despite all the headwinds. The included Balance Sheets show deposits decreasing $215 million year-over-year. However, this is entirely attributable to brokered deposits being lower by $221 million. Excluding brokered deposits, our core relationship (direct customer) deposits increased $6 million. We consider this quite an accomplishment and testament to our amazing frontline employees and loyal customers! Brokered deposits are a funding source with characteristics more akin to those included as borrowings. The increase in borrowings of nearly $500 million was used as a replacement for the brokered deposits, and to fund the loan growth of over $300 million (over 9%).

The practical consequence of managing this interest rate environment is our margin getting compressed, and, accordingly, our net interest income is slightly down ($2.3 million) over this time last year, even with the considerable loan growth. We expect this trend to continue through the end of the year and then to materially improve as our assets amortize and are reinvested in instruments at higher rates. Over the decades, this has happened before, and it will happen again in the future. This is nothing new. This is also why we have designed a business with multiple income streams to mitigate against net interest margin compression cycles.

Again, consistent with the experiences of financial institutions across the country, we have seen a decrease in our stock price, which is to be expected considering all the negative news surrounding the economy and the banking industry in general. Additionally, there have been a larger number of shares for sale in the auctions due to the liquidity needs of some decedents' estates for taxation purposes. I also remind all that in the time periods immediately prior to the start of 2023, we had an extraordinary series of stock price increases during a time when the rest of the industry and broader markets were going down. Personally, I focus on the dividend, not the stock price. In the first quarter of 2023, our shareholders received a dividend of $4.50, which was higher than the $4.20 provided in the first half of 2022. This dividend level was able to be sustained, as evidenced through the $4.50 per share that is being provided to shareholders now. The total dividend per share for 2023 of $9.00 is over 3% higher than the $8.70 paid during 2022.

Overall, total operating expenses are down $4.2 million, or 7%. The accounting implications of changes in stock price are seen in salaries and employee benefits expenses, as there is a direct relationship to the value of executive deferred compensation granted over the course of many prior years. An increase in expense associated with this was included within this line item during 2022 when the stock price increased approximately $42, and then an even higher level of expense decrease was included within the line item during 2023 when the stock price decreased approximately $75. We have continued to hire and provide raises to employees and have continued to make investments in technology, marketing and public relations, and other operating expenses needed to sustain our business model and facilitate continued growth.

After all of these and other items are tallied, we were left with net income in the first half of 2023 of $24.8 million, which was approximately 5% higher than the $23.7 million earned in the first half of 2022.

On the legislative front, the failures of a few banks in the beginning of the year have prompted discussion around enhanced regulatory oversight of banks over $100 billion in assets. There is a general recognition that community banks operate under a vastly different business model than large institutions and any resultant regulation should not be applied against community banks. Nothing concrete has come out of these discussions, although we continue to monitor the situation. Additionally, it has been proposed that banks under $5 billion will not be subject to a "special assessment" to replenish the FDIC insurance fund. This will be good news for us assuming this is the final determination. I remind you all that FDIC insurance is paid for by banks, not taxpayers as is often the incorrect assumption.

Overall, we continue to find opportunities within our community to foster its continued growth and success. Despite macroeconomic conditions, our institution is well positioned to continue providing material support for our community and to take advantage of any opportunities which come our way.

Finally, I want to thank my father for his steadfast leadership as Chairman of Canandaigua National Bank & Trust (CNB) and Canandaigua National Corporation (CNC). His decision to step down was not an easy one, but it is in line with a history of transitions in the bank. His father, Frank H. Hamlin II, and his uncle, Arthur S. Hamlin, both stepped down when they were 80. My father will retain a seat on the boards, and Michael C. Goonan, who joined the boards in 2015, will become Chairman. We continue to be well served by our leadership.

I look forward to seeing and talking to many of you at our upcoming Optimum Customer Picnic and various other places in our community over the upcoming months. Thank you, as always, for your continued support.

Sincerely,

Frank H. Hamlin III

Frank H. Hamlin, III
President & CEO

Condensed Balance Sheets

June 30, 2023 and 2022 (Unaudited)
(dollars in thousands)

Assets

		2023	2022
Cash and due from banks	$	64,293	57,804
Interest bearing deposits with others		4,357	7,436
Federal funds sold		242	166
Securities		1,022,750	1,061,455
Loans held for sale		5,193	8,424
Loans - net		3,647,708	3,337,728
Premises and equipment - net		26,447	20,345
Accrued interest receivable		16,532	12,364
Goodwill and intangibles		8,818	8,818
Other assets		121,120	97,330
Total Assets	$	4,917,460	4,611,870

Liabilities and Stockholders' Equity

		2023	2022
Deposits:			
Demand			
Non-interest bearing	$	902,874	970,084
Interest bearing		398,070	461,923
Savings and money market		1,369,466	1,759,118
Time		921,234	615,677
Total deposits		3,591,644	3,806,802
Borrowings		854,800	360,000
Junior subordinated debt		51,547	51,547
All other liabilities		89,909	78,270
Total Liabilities		4,587,900	4,296,619
Stockholders' Equity:			
Preferred stock		-	-
Common stock		9,732	9,732
Additional paid-in-capital		14,133	13,827
Retained earnings		363,333	330,283
Treasury stock, at cost		(17,576)	(11,660)
Accumulated other comprehensive income		(40,369)	(27,242)
Total CNC Stockholders' Equity		329,253	314,940
Non-controlling interests		307	311
Total Equity		329,560	315,251
Total Liabilities and Equity	$	4,917,460	4,611,870

Condensed Statements of Income

For the six months ended June 30, 2023 and 2022 (Unaudited)
(dollars in thousands, except per share data)

		2023	2022
Interest income:			
Loans, including fees	$	91,874	67,860
Securities		12,020	7,830
Other		148	23
Total interest income		104,042	75,713
Interest expense:			
Deposits		21,875	2,108
Borrowings		12,722	2,742
Junior subordinated debt		1,634	721
Total interest expense		36,231	5,571
Net interest income		67,811	70,142
Provision for loan losses		3,634	3,530
Net interest income after provision for loan losses		64,177	66,612
Non-interest income:			
Service charges on deposit accounts		10,186	9,882
Trust and investment services		12,528	12,601
Net gain on sale of mortgage loans		(307)	1,180
All other income		2,535	1,692
Total non-interest income		24,942	25,355
Operating expenses:			
Salaries and employee benefits		28,922	35,629
Technology and data processing		8,648	7,808
Occupancy, net		5,411	5,443
Professional and other services		3,436	3,731
Marketing and public relations		1,881	897
All other operating expenses		7,846	6,831
Total operating expenses		56,144	60,339
Income before income taxes		32,975	31,628
Income taxes		8,149	7,899
Net income, incl. non-controlling interest		24,826	23,729
Noncontrolling interests		-	-
Net income attributable to CNC	$	24,826	23,729
Basic earnings per share	$	13.28	12.65
Diluted earnings per share	$	13.22	12.58

Financial Highlights

As of and for the six months ended June 30, 2023 and 2022
(Unaudited) (dollars in thousands, except per share data)

		2023	2022
Net income attributable to CNC	$	24,826	23,729
Total assets	$	4,917,460	4,611,870
Securities	$	1,022,750	1,061,455
Loans - net	$	3,647,708	3,337,728
Deposits	$	3,591,644	3,806,802
Total equity	$	329,560	315,251
Assets Under Administration			
- Book value	$	3,746,833	3,599,488
- Market value	$	4,463,441	4,153,404
Weighted avg shares outstanding-diluted	$	1,878,480	1,886,353
Diluted earnings per share	$	13.22	12.58
Dividends per share	$	4.50	4.20
Book value per share	$	176.83	167.86
Closing stock price	$	276.64	343.42
Return on average assets, annualized		1.03%	1.07%
Return on average equity, annualized		15.62%	15.05%
Return on beginning equity, annualized		15.95%	14.82%

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STATEMENT OF CONDITION
July 20, 2023