

2020



FARMERS BANK

SERVING THE COMMUNITY SINCE 1919

A N N U A L   R E P O R T

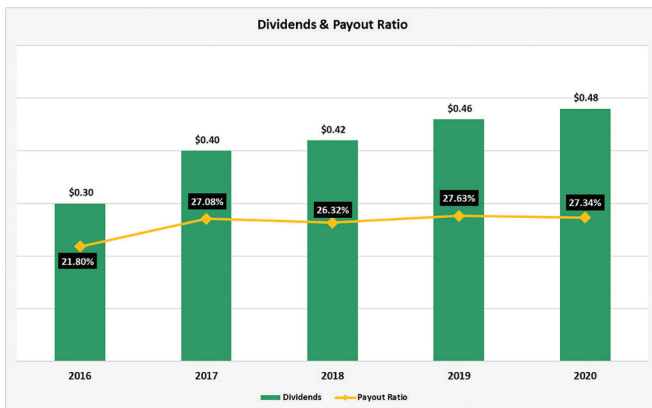


*We were honored to serve  
our small business customers  
through participating in the  
Small Business Administration's  
Paycheck Protection Program.*



## Dear Shareholder,

As we prepare this year's annual report we can not help but reflect on the year that will forever be remembered for many reasons; 2020. While the past year has been challenging for the banking industry we are very pleased to still report record earnings for the sixth consecutive year. Net income for 2020 amounted to \$5,405,629 or \$1.74 per share, a 6.07% increase from the \$5,096,105 or \$1.65 per share, reported for 2019. Return on average assets of 1.05% for 2020 compared to the 2019 results of 1.10%. Return on average equity as of December 31, 2020 was 8.70% as compared to 9.49% for the same period of the prior year. Return on average tangible common equity was 10.45% as of December 31, 2020 and compared to 11.27% as of December 31, 2019.



While net income was increased Management and the Board of Directors felt it was prudent, given the economic and industry uncertainty through the year, to focus on capital preservation. Market rates on subordinated debt were attractive enough that we repaid the remaining \$6 million outstanding on our 2017 capital notes and conducted a locally-based raise of \$8.5 million, with a weighted average yield of 3.17% and weighted average life of just over six years. We believe this relatively affordable capital will position us for future expansions into new markets and new lines of business. Dividends increased slightly from \$0.46 per share in 2019 to \$0.48 per share in 2020, contributing to a very consistent payout ratio.

Our balance sheet was affected throughout the year by many of the COVID-19 related relief programs. We were honored to serve our small business customers through participating in the Small Business Administration's Paycheck Protection Program.

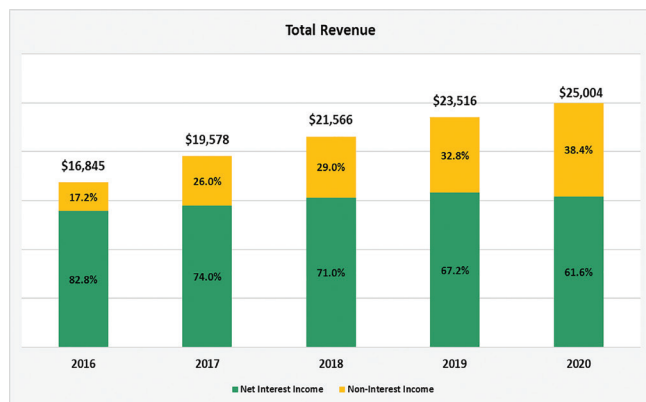
We provided over \$25 million in PPP loans to 259 customers during 2020. Due to this program's success, our balance sheet took on a high level of liquidity as commercial customers were cautious with expansion and spending. We also saw an influx of consumer deposits from stimulus funds and an overall higher national savings rate.

During 2020, we added \$921 thousand to bolster the provision for loan losses. The uncertainty in the economic and regulatory environment drove the additional provision expense during the year. We were able to provide \$37.6 million in 90 day COVID-19 related payment deferrals to assist our customers, all have returned to normal payments after the deferral period. Our credit metrics continue to be favorable and align with our culture of being disciplined and purposeful with lending. While some of our customers have struggled during the pandemic, many have been able to successfully navigate the storm with the help of PPP funds, payment deferrals and hard work. The bank continues to assist customers in the most recent round of PPP loans providing 95 loans totaling \$11.4 million through March 15, 2021.

Net interest income was negatively impacted by the abrupt decline in interest rates during the first quarter of 2020 and decreased 2.47% when compared to annualized results of 2019. While we had productive loan growth in some of our newer markets, several large loans to municipalities repaid during the year which affected net loan growth. Our inflated liquidity allowed us to have success lowering deposit costs from 0.63% as of December 31, 2019 to 0.38% as of December 31, 2020. However, given the already low cost of funds, we will likely not experience this same reduction going into 2021 and margins will continue to be compressed.

Given the expectation that net interest margin compression will continue, we have remained focused on diversifying our revenue streams through other lines of business. Our expansion into the insurance industry by investing in Manry Rawls Insurance and subsequent acquisitions has afforded an attractive return on our investment and provides additional services to offer our customers. The growth in the crop

insurance segment of this agency has increased scale and profitability. The investment in Manry Rawls LLC provided the bank approximately \$1.2 million in pretax income in 2020. Due to the strong homes sales market and mortgage refinances prompted by lower rates, our investment in Tidewater Home Funding contributed to improving earnings. That partnership contributed approximately \$1.1 million in pretax income during 2020. Since 2016, non-interest income as a percent of total revenue has grown from 17.2% to 38.4% in 2020. We have been very intentional about the types of ancillary business lines we explore and even more selective on those organizations with which we decide to partner. This view allows these investments to be financially beneficial to the Company but also valuable to our customers and their long term relationships. We continue to explore investments in businesses that will provide non-interest income to the bank and useful services to our customers.



Non-interest expenses remained relatively flat when comparing 2020 to 2019. We continue to remain prudent with expenses in this low interest rate environment but are also committed to offering our customers technology and services that are convenient and useful. The pandemic has accelerated changes in the way customers conduct business with the bank. Use of online services by both consumer and commercial customers has increased. In order to protect customers and employees, we closed our branches to walk in traffic last March; servicing customers via drive-thru and appointment. While this decision caused minor inconveniences to some customers, many found more efficient ways to conduct business with us resulting in fewer branch visits than in the past. This is a trend we have seen over the past several years as more business of all types is conducted electronically. While customer behavior

is changing, our staff and customers appreciate the in person interactions they have in our offices. As we move into the warmer months, encouraging news on the vaccine effort has us looking forward to opening branches when health conditions permit.

Work has begun renovating our permanent location in the Pungo area of Virginia Beach. Our staff members in Pungo are currently operating out of a temporary location and have been successful in growing relationships in that area. We believe the move to a full service branch will further accelerate growth in that market and we are optimistic about the contribution this area can have to Farmers Bank.

As we look forward into 2021 and beyond we believe there is a bright future for Farmers Bank. The economy is projected to continue to improve throughout the year. Decisions made over the last several years have positioned the bank to take advantage of opportunities to grow loans, continue to invest in non-interest income sources and opportunistically grow our footprint. The bank is well capitalized, has ample liquidity and has the benefit of diverse income streams. The organization is staffed by a team of energetic, talented and caring individuals who are passionate about serving our customers and are committed to seeing the organization not simply survive but to thrive.

While challenges remain, Farmers Bank remains committed to the customers and communities we serve. We remain committed to ensuring your investment in Farmers Bank is a rewarding one. Thank you for your continued confidence and support.

Sincerely,

Richard J. Holland, Jr.  
*Chairman*

Vernon M. Towler  
*President and Chief Executive Officer*



*As we look forward into  
2021 and beyond we believe  
there is a bright future for  
Farmers Bank.*



## BOARD OF DIRECTORS

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*\* Denotes Farmers Bankshares, Inc. Board Member*



## OFFICERS

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OFAC & Security Officer*

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Compliance*

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Market Executive*

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Glynda F. Williams  
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*President, C.W. Brinkley, Inc.  
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*President, Chesapeake Controls*

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*Attorney at Law, Kaufman &  
Canoles*

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*Virginia Dermatology*

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*Certified Public Accountant,  
Charles S. Lowder & Co., LLC*

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*Wealth Advisor, Beacon Harbor  
Wealth Advisors*

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*Certified Public Accountant,  
Robb, Scott, Bradshaw & Rawls*

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## EASTERN TIDEWATER COMMUNITY BOARD

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Rhonda Bridgeman  
*President, Comfort System of  
Virginia, Inc.*

William E. Crawley  
*President, East Coast  
Surety Solutions*

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*Owner, Cullipher Farms*

William B. Higgins  
*Owner, Jack's Towing*

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*General Counsel,  
The Hourigan Group*

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*Attorney at Law,  
Basnight, Kinser, Leftwich &  
Nuckols, P.C.*

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*Retired, Verizon*

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*Owner, Minton Interests, LLC*

Marvin M. Rollins, III  
*Vice President, M.M. Rollins &  
Company*

## WESTERN TIDEWATER COMMUNITY BOARD

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Chairman  
*Owner, Anna's Ristorante &  
JVC Holdings, LLC*

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*Commonwealth Gin*

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*Retired Banker*

P. Milton Cook, Jr. D.D.S.  
*P. Milton Cook, Jr., P.C.*

James H. Lee, IV  
*Owner, Flaggy Run Farms*

Randolph H. Pack  
*President, Smithfield Station*

John T. Randall  
*Attorney at Law,  
Randall Page, P.C.*

Sharon C. Stallings  
*CEO, Hampton Roads  
Contracting, Inc.*

T. Craig Stallings  
*Certified Public Accountant,  
Craig Stallings and Associates*



# Financial Highlights

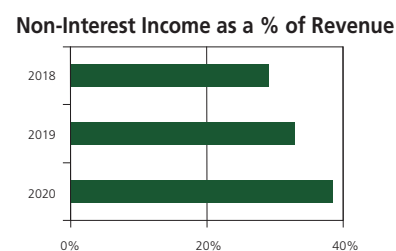
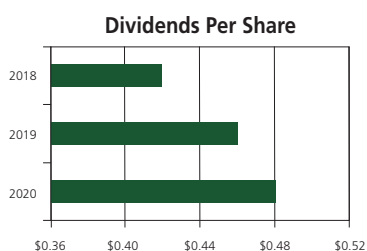
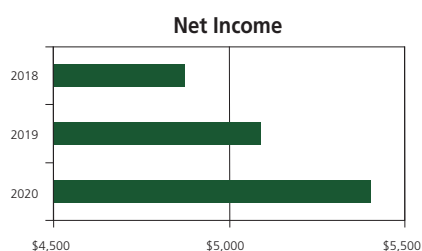
At or for the Years Ended December 31,	2020	2019	2018
(Dollars in thousands, except per share data)			
<b>Summary of Operations</b>			
Interest income	\$17,597	\$18,931	\$18,114
Interest expense	2,184	3,129	2,811
Net interest income	15,413	15,802	15,303
Provision for loan losses	921	-	-
Net interest income after provision for loan losses	14,492	15,802	15,303
Non-interest income	9,591	7,713	6,263
Non-interest expense	17,396	17,419	15,851
Income before income taxes	6,687	6,096	5,715
Income taxes	815	738	619
Net income attributable to noncontrolling interest	466	262	221
Net income	5,406	\$5,096	\$4,875
<b>Per Share and Shares Outstanding (1)</b>			
Basic net income	\$1.74	\$1.65	\$1.59
Book value at end of period, excluding minority interest	\$20.65	\$18.17	\$15.57
Basic weighted average shares outstanding	3,104,776	3,087,868	3,071,643
Dividends per share	\$0.48	\$0.46	\$0.42
Shares outstanding at period end	3,108,462	3,092,133	3,075,860
<b>Balance Sheet Data</b>			
Total assets	\$551,918	\$476,571	\$478,211
Total loans, net (excluding SBA PPP loans receivable)	261,659	261,064	269,520
Total deposits	453,222	385,517	386,682
Borrowings	10,000	15,000	25,000
<b>Selected Performance Ratios (Bank Only)</b>			
Return on average assets	1.08%	1.14%	1.10%
Return on average stockholders' equity	8.51%	9.29%	10.05%
Net interest margin, tax equivalent (2)	3.53%	3.83%	3.70%
Non-interest income as a percentage of total revenue (3)	38.36%	32.80%	29.05%
Efficiency ratio (4)	69.09%	72.79%	71.49%
<b>Asset Quality Ratios</b>			
Nonperforming loans to period-end loans	0.13%	0.28%	0.25%
Allowance for loan losses to period-end loans	2.23%	2.13%	2.15%
Net charge-offs to average loans outstanding	0.09%	0.08%	0.00%
<b>Capital (Bank Only)</b>			
Tier 1 leverage ratio	10.09%	10.35%	9.68%
Total risk-based capital ratio	15.99%	15.09%	13.89%
Stockholder's equity	\$70,488	\$60,395	\$52,139

(1) Computed based on the weighted average number of shares outstanding during each period.

(2) Net interest margin is net interest income divided by average interest earning assets.

(3) Total revenue consists of net interest income and non-interest income.

(4) Efficiency ratio is non-interest expense divided by the sum of net interest income and non-interest income.



# Farmers Bankshares, Inc.

## Consolidated Financial Statements for Years Ended December 31, 2020 and 2019

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## Independent Auditor's Report

To the Board of Directors and Shareholders  
Farmers Bankshares, Inc.  
Windsor, Virginia

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Farmers Bankshares, Inc. and Subsidiary (the Company), which comprise the consolidated balance sheets as of December 31, 2020 and 2019, the related consolidated statements of operations, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Farmers Bankshares, Inc. and Subsidiary as of December 31, 2020 and 2019, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in cursive script that reads 'Elliott Davis' with 'PLLC' written in a smaller font below it.

Raleigh, North Carolina  
March 9, 2021

# Farmers Bankshares, Inc.

## Consolidated Balance Sheets

Assets	December 31,	
	2020	2019
Cash and cash equivalents		
Cash and due from banks	\$ 24,284,709	\$ 28,232,969
Federal funds sold	4,271,919	1,776,842
<b>Total cash and cash equivalents</b>	<b>28,556,628</b>	<b>30,009,811</b>
Available-for-sale securities (Note 3)	203,766,264	145,299,630
Non-marketable equity securities (Note 10)	6,278,781	5,264,989
Small Business Administration Paycheck Protection Program loans receivable, net of fees (Note 5)	17,003,711	-
Loans held for investment, net of allowance for loan losses of \$6,346,592 and \$5,676,680, respectively (Note 6)	261,658,559	261,064,409
Premises and equipment, net (Note 7)	6,276,519	5,795,900
Goodwill (Note 9)	6,027,286	6,027,286
Other intangible assets, net (Note 9)	4,222,657	4,582,184
Other real estate owned	672,404	672,404
Accrued interest receivable	1,942,222	1,806,986
Prepaid expenses	545,975	508,766
Net deferred tax asset (Note 15)	-	16,460
Income taxes receivable	-	54,235
Bank-owned annuity contract	2,862,424	2,913,142
Bank-owned life insurance	11,378,398	11,156,635
Derivative asset (Note 4)	56,295	-
Other assets	669,810	1,397,742
	<b>523,361,305</b>	<b>446,560,768</b>
<b>Total assets</b>	<b>\$ 551,917,933</b>	<b>\$ 476,570,579</b>
<b>Liabilities and Stockholders' Equity</b>		
Deposits		
Noninterest-bearing deposits	\$ 149,636,591	\$ 116,234,905
Interest-bearing deposits (Note 11)	303,585,736	269,282,155
<b>Total deposits</b>	<b>453,222,327</b>	<b>385,517,060</b>
Federal Home Loan Bank borrowings (Note 13)	10,000,000	15,000,000
Capital notes (Note 12)	8,500,000	6,000,000
Securities sold under agreements to repurchase (Note 13)	6,637,320	5,141,855
Deferred compensation plans (Note 14)	1,721,538	1,623,228
Accrued interest payable	169,172	298,985
Income taxes payable	600,372	-
Net deferred tax liability (Note 15)	217,264	-
Other liabilities	4,204,192	4,703,525
<b>Total liabilities</b>	<b>485,272,185</b>	<b>418,284,653</b>
<b>Stockholders' equity</b>		
Common stock, \$0.125 par value; 50,000,000 shares authorized; 3,108,462 and 3,092,133 shares issued and outstanding at December 31, 2020 and 2019, including nonvested shares of 24,236 and 27,853 shares, respectively	388,559	386,518
Capital surplus	3,357,318	3,000,031
Retained earnings	54,102,943	50,175,584
Accumulated other comprehensive income	6,341,023	2,621,878
<b>Total Farmers Bankshares, Inc. stockholders' equity</b>	<b>64,189,843</b>	<b>56,184,011</b>
Noncontrolling interest	2,455,905	2,101,915
<b>Total stockholders' equity</b>	<b>66,645,748</b>	<b>58,285,926</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 551,917,933</b>	<b>\$ 476,570,579</b>

**Farmers Bankshare, Inc.**  
**Consolidated Statements of Operations**

	Years Ended December 31,	
	2020	2019
<b>Interest income</b>		
Interest and fees on loans held for investment	\$ 13,510,590	\$ 14,508,086
Interest on taxable available-for-sale securities	2,012,583	2,450,927
Interest on tax-exempt available-for-sale securities	1,965,344	1,854,664
Interest on federal funds sold	84,859	83,310
Other interest income	23,698	34,656
<b>Total interest and dividend income</b>	<u>17,597,074</u>	<u>18,931,643</u>
<b>Interest expense</b>		
Interest on deposits	1,786,394	2,509,219
Interest on Federal Home Loan Bank advances	137,700	360,806
Interest on capital notes	223,700	195,000
Interest on repurchase agreements	36,011	27,366
Interest on federal funds purchased	271	36,549
<b>Total interest expense</b>	<u>2,184,076</u>	<u>3,128,940</u>
<b>Net interest income</b>	15,412,998	15,802,703
<b>Provision of loan losses</b>	921,000	-
<b>Net interest income after provision for loan losses</b>	<u>14,491,998</u>	<u>15,802,703</u>
<b>Noninterest income</b>		
Service charges	456,989	577,856
Income from automated teller machines and bank card interchange	578,673	576,109
Insurance commissions	6,348,498	5,554,730
Net gain on disposition of available-for-sale securities	607,090	336,269
Income on bank owned life insurance	299,617	305,307
Other income	1,300,472	363,080
<b>Total noninterest income</b>	<u>9,591,339</u>	<u>7,713,351</u>
<b>Noninterest expense</b>		
Salaries and employee benefits	10,338,768	10,281,452
Equipment expense	1,192,120	1,117,945
Occupancy expense	943,872	1,080,292
Bank franchise tax	524,048	383,393
Advertising and marketing	399,127	629,307
Data processing	1,500,773	1,503,977
Loan related legal and other expenses	131,865	119,542
Federal Deposit Insurance Corporation assessment	120,493	49,183
Net loss on sale of premises and equipment	26,932	14,577
Other	2,218,487	2,239,762
<b>Total noninterest expense</b>	<u>17,396,485</u>	<u>17,419,430</u>
<b>Income before income taxes &amp; noncontrolling interest</b>	6,686,852	6,096,624
<b>Income tax expense (Note 15)</b>	814,662	738,359
<b>Net income</b>	<u>\$ 5,872,190</u>	<u>\$ 5,358,265</u>
<b>Net income attributable to noncontrolling interest</b>	466,561	262,160
<b>Net income attributable to Farmers Bankshares, Inc.</b>	<u>\$ 5,405,629</u>	<u>\$ 5,096,105</u>
<b>Basic earnings per common share (Note 21)</b>	<u>\$ 1.74</u>	<u>\$ 1.65</u>
<b>Diluted earnings per common share (Note 21)</b>	<u>\$ 1.74</u>	<u>\$ 1.65</u>

The accompanying notes are an integral part of these consolidated financial statements.

**Farmers Bankshares, Inc.**  
**Consolidated Statements of Comprehensive Income**

	<u>Years Ended December 31,</u>	
	<u>2020</u>	<u>2019</u>
Net income	\$ 5,872,190	\$ 5,358,265
<b>Other comprehensive income:</b>		
Net unrealized holding gains on available-for-sale securities	5,243,609	4,140,813
Tax effect	<u>(1,101,158)</u>	<u>(869,571)</u>
Unrealized holding gains on available-for-sale securities, net of tax	4,142,451	3,271,242
Reclassification adjustment for net realized gains	(607,090)	(336,269)
Tax effect	<u>127,489</u>	<u>70,616</u>
Reclassification adjustment for net realized gains, net of tax	(479,601)	(265,653)
Unrealized gain on interest rate swap designated as cash flow hedge	68,117	-
Tax effect	<u>(11,822)</u>	<u>-</u>
Unrealized gain on interest rate swap designated as cash flow hedge, net of tax	56,295	-
Other comprehensive gain, net of tax	<u>3,719,145</u>	<u>3,005,589</u>
<b>Comprehensive income</b>	<u><u>\$ 9,591,335</u></u>	<u><u>\$ 8,363,854</u></u>

# Farmers Bankshares, Inc.

## Consolidated Statements of Changes in Stockholders' Equity

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Non- controlling Interest	Total
<b>Balances, December 31, 2018</b>	\$ 384,484	\$ 2,895,515	\$ 44,991,893	\$ (383,711)	\$ 2,023,364	\$ 49,911,545
Adoption of ASU 2016-02	-	-	39,600	-	-	39,600
Adoption of ASC 606	-	-	1,456,160	-	-	1,456,160
Net income	-	-	5,096,105	-	262,160	5,358,265
Other comprehensive income	-	-	-	3,005,589	-	3,005,589
Distribution of interest in Manry Rawls, LLC	-	-	-	-	(107,664)	(107,664)
Issuance of common stock - director stock plan	519	70,456	-	-	-	70,975
Stock based compensation	1,515	34,060	-	-	-	35,575
Purchase of additional interest in Manry Rawls, LLC	-	-	-	-	(75,945)	(75,945)
Cash dividends declared on common shares, \$0.46 per share	-	-	(1,408,174)	-	-	(1,408,174)
<b>Balances, December 31, 2019</b>	<u>\$ 386,518</u>	<u>\$ 3,000,031</u>	<u>\$ 50,175,584</u>	<u>\$ 2,621,878</u>	<u>\$ 2,101,915</u>	<u>\$ 58,285,926</u>
Net income	-	-	5,405,629	-	466,561	5,872,190
Other comprehensive income	-	-	-	3,719,145	-	3,719,145
Distribution of interest in Manry Rawls, LLC	-	-	-	-	(112,571)	(112,571)
Issuance of common stock - director stock plan	533	65,992	-	-	-	66,525
Stock based compensation	1,508	291,295	-	-	-	292,803
Cash dividends declared on common shares, \$0.48 per share	-	-	(1,478,270)	-	-	(1,478,270)
<b>Balances, December 31, 2020</b>	<u>\$ 388,559</u>	<u>\$ 3,357,318</u>	<u>\$ 54,102,943</u>	<u>\$ 6,341,023</u>	<u>\$ 2,455,905</u>	<u>\$ 66,645,748</u>

**Farmers Bankshares, Inc.**  
**Consolidated Statements of Cash Flows**

	Years Ended December 31,	
	2020	2019
<b>Cash flows from operating activities</b>		
Net income	\$ 5,872,190	\$ 5,358,265
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	921,000	-
Distribution of interest in Manry Rawls, LLC	(112,571)	(107,664)
Depreciation	530,173	560,701
Amortization of intangible assets	359,527	360,002
Deferred income tax benefit	(739,945)	(55,428)
Amortization of investment securities premiums	944,560	616,618
Net gain on disposition of available-for-sale securities	(607,090)	(336,269)
Increase in cash value of bank owned life insurance and annuity	(221,763)	(305,307)
Decrease in cash value of annuity	50,718	48,379
Stock based compensation	292,803	35,575
Issuance of stock to directors	66,525	70,975
Change in operating assets and liabilities:		
Interest receivable	(135,236)	171,415
Interest payable	(129,813)	(37,623)
Prepaid expenses	(37,209)	51,394
Income taxes receivable	54,235	(51,213)
Other assets	727,932	(88,238)
Deferred compensation	98,310	102,248
Income taxes payable	600,372	-
Other liabilities	(472,401)	885,634
<b>Net cash provided by operating activities</b>	<b>8,062,317</b>	<b>7,279,464</b>
<b>Cash flows from investing activities</b>		
Proceeds from sales, prepayments and maturities of available-for-sale securities	55,052,624	39,370,295
Purchase of available-for-sale securities	(109,220,208)	(24,130,223)
Proceeds from sale of non-marketable equity securities	641,000	425,100
Purchase of non-marketable equity securities	(1,203,000)	(1,431,350)
Purchase of other equity investments, net	(451,792)	(128,040)
SBA PPP loan originations, net of fees	(17,003,711)	-
Loan originations, net of repayments	(1,515,150)	8,455,897
Purchases of premises and equipment	(1,037,725)	(2,978,639)
Acquisition of business, net of cash acquired	-	(2,093,385)
<b>Net cash (used) provided in investing activities</b>	<b>(74,737,962)</b>	<b>17,489,655</b>
<b>Cash flows from financing activities</b>		
Cash dividends paid on common shares	(1,478,270)	(1,377,166)
Proceeds from issuance of capital notes	8,500,000	-
Repayment of capital notes	(6,000,000)	-
Repayment of FHLB borrowings	(5,000,000)	(10,000,000)
Net increase in noninterest-bearing deposits	33,401,686	363,796
Net increase (decrease) in interest-bearing deposits	34,303,581	(1,529,191)
Net increase in securities sold under agreements to repurchase	1,495,465	1,292,951
<b>Net cash provided (used) by financing activities</b>	<b>65,222,462</b>	<b>(11,249,610)</b>
<b>Net increase in cash and cash equivalents</b>	<b>(1,453,183)</b>	<b>13,519,509</b>
<b>Cash and cash equivalents</b>		
Beginning of the year	30,009,811	16,490,302
End of year	<b>\$ 28,556,628</b>	<b>\$ 30,009,811</b>



**Farmers Bankshares, Inc.**  
**Consolidated Statements of Cash Flow (concluded)**

	Years Ended December 31,	
	2020	2019
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for		
Income taxes	\$ 750,000	\$ 845,000
Interest	2,313,889	3,166,563
<b>Supplemental schedule of non-cash investing activities</b>		
Right of use asset	\$ -	\$ 657,157
Right of use liability	-	618,887
<b>Supplemental schedule of non-cash investing activities</b>		
Change in unrealized gains on available-for-sale securities, net of income tax	\$ 3,719,145	\$ 3,005,589
<b>Acquisitions</b>		
Assets acquired	\$ -	\$ 165,597
Liabilities assumed	-	-
Net assets	\$ -	\$ 165,597
Goodwill and fair value acquisition adjustments, net	\$ -	\$ 1,219,429

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 1 - Organization and nature of business

Farmers Bankshares, Inc. (the "Company") was organized and incorporated under the laws of the Commonwealth of Virginia on July 26, 2013. On December 31, 2013, the Company was consummated as the Bank Holding Company of Farmers Bank, Windsor, Virginia (the "Bank") through a reorganization plan, under the laws of the Commonwealth of Virginia. As of this date, the Bank became a wholly-owned subsidiary of Farmers Bankshares, Inc. Through its banking subsidiary, formed on November 12, 1919, the Company provides a wide variety of banking services primarily in southeastern Virginia.

The Bank provides small and mid-sized businesses, professionals, corporate executives and entrepreneurs with banking services comparable to those of the large national and regional institutions. These services include loans that are priced on a deposit-based relationship, direct access to the Bank's decision makers, and quick, innovative response to customers' financial needs. If customers have credit requirements that exceed the Bank's credit limits, the Bank seeks to accommodate those customers by arranging loans on a participation basis with other financial institutions.

The Bank purchased a 66% ownership interest in Manry Rawls, LLC ("Manry Rawls") in May 2017. Manry Rawls is a local and independent regional insurance agency offering a wide array of insurance products. In January 2019, the Bank purchased an additional five percent interest in Manry Rawls. This additional interest made the Bank's total ownership approximately 72%. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 805, *Business Combinations*. As such, the assets acquired and liabilities assumed in the transactions were recorded at their respective fair values as of the acquisition date.

During 2018, the Company acquired The Lankford Agency, an independent insurance agency, which was merged with the operations of Manry Rawls. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and, as such, the assets acquired were recorded at their respective fair values as of the acquisition date. There were no liabilities assumed with this purchase. The results of operations of the acquired business are included in the Company's Consolidated Statements of Operations commencing October 1, 2018. The total purchase price for the transaction was \$200,000 in cash and contingent future payments with a net present value of \$332,989. The allocation of the purchase price resulted in goodwill of \$296,111 and other intangible assets including customer lists of \$236,879.

During 2019, the Company acquired Carolina East Insurance, an independent insurance agency, which was merged with the operations of Manry Rawls. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and as such, the assets acquired were recorded at their respective fair values as of the acquisition date. There was no liabilities assumed with this purchase. The results of operations of the acquired business are included in the Company's Consolidated Statements of Operations commencing January 2, 2019. The total purchase price for the transaction was \$1,150,000 in cash and contingent future payments with a net present value of \$1,200,429 million. The allocation of the purchase price resulted in goodwill of \$1,219,429 and other intangible assets including customer lists of \$1,131,000.

### Note 2 - Summary of significant accounting policies

*Basis of presentation and consolidation* - The consolidated financial statements of the Company are prepared in conformity with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary, the Bank and Manry Rawls. All significant intercompany balances and transactions have been eliminated in consolidation.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 2 - Summary of significant accounting policies (continued)

*Reclassification* – Certain amounts in the 2019 consolidated financial statements have been reclassified to conform to the 2020 presentation. The reclassifications had no effect on net income or stockholders' equity as previously reported.

*Cash and cash equivalents* - For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits with banks and federal funds sold, all of which mature within 90 days or less. The Company is required by the Federal Reserve to maintain average reserve balances. For the final quarterly reporting period in 2020 and 2019, the aggregate amount of daily-required balances was \$0- and \$82,000, respectively.

*Investment securities* - Investments in debt securities classified as held-to-maturity, if any, are stated at cost, and adjusted for amortization of premiums and accretion of discounts using the interest method. The Company held no such securities during the periods reported in the financial statements. Investments in debt securities classified as trading, if any, are stated at fair value. Such securities are purchased and held principally for the purpose of selling them in the near term. Unrealized holding gains and losses for trading securities are included in the Consolidated Statements of Operations. The Company held no such securities during the periods reported on in the financial statements.

Debt securities not classified as either held-to-maturity or trading are classified as available-for-sale. Debt securities classified as available-for-sale are stated at fair value with unrealized holding gains and losses excluded from earnings and reported as a component of accumulated other comprehensive income until realized.

The income statement line items impacted by the reclassification of realized gains (losses) on the sale of securities are the gains (losses) on disposition of securities and income tax expense line items in the Consolidated Statement of Operations. Gains and losses on the sale of securities are determined using the specific identification method and are recognized on a trade date basis. Other than temporary declines in the fair value of individual held-to-maturity and available-for-sale debt securities below their cost, if any, are included in earnings as realized losses. Other than temporarily impaired ("OTTI") guidance for investments states that an impairment is OTTI if any of the following conditions exist: the entity intends to sell the security; it is more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis; or, the entity does not expect to recover the security's entire amortized cost basis (even if the entity does not intend to sell).

*Derivative financial instruments* – Derivatives are recognized as either assets or liabilities and are recorded at fair value on the Company's consolidated balance sheets. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and resulting designation. The Company's hedging policies permit the use of various derivative financial instruments to manage interest rate risk or to hedge specified assets and liabilities.

To qualify for hedge accounting, derivatives must be highly effective at reducing the risk associated with the exposure being hedged and must be designated as a hedge at the inception of the derivative contract. If derivative instruments are designated as fair value hedges, and such hedges are highly effective, both the change in the fair value of the hedge and the hedged item are included in current earnings. If derivative instruments are designated as cash flow hedges, fair value adjustments related to the effective portion are recorded in other comprehensive income and are reclassified to earnings when the hedged transaction is reflected in earnings. Ineffective portions of cash flow hedges are reflected in earnings as they occur. Actual cash receipts and/or payments and related accruals on derivatives related to hedges are recorded as adjustments to the interest income or interest expense associated with the hedged item. During the life of the hedge, the Company formally assesses whether derivatives designated as hedging instruments continue to be highly effective in offsetting changes in the fair value or cash flows of hedged items. If it is determined that a hedge has ceased to be highly effective, the Company will discontinue hedge accounting prospectively. At such time, previous adjustments to the carrying value of the hedged item are reversed into current earnings and the derivative instrument is reclassified to a trading position recorded at fair value.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 2 - Summary of significant accounting policies (continued)

*Derivative financial instruments (concluded)* – For derivatives not designated as hedges, changes in fair value are recognized in earnings, in noninterest income. For additional discussion related to the determination of fair value related to derivative instruments, see Note 4.

*Loans* - The Bank grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by commercial and consumer mortgage loans throughout Southeastern Virginia. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans held for investment that management has the intent and ability to hold for the foreseeable future or until maturity generally are stated at their outstanding unpaid principal balances. Loans held for sale are originated and intended for sale in the secondary market. These loans are carried at the lower of cost or market in the aggregate. Net unrealized losses, if any, are recognized through charges to income. Interest income is accrued on the unpaid principal balance for all loan classes. Discounts and premiums are amortized to income using the interest method. Net deferred fees and costs are amortized over the lives of the applicable loans using the effective interest rate method.

*Allowance for loan losses* - The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of a specific, a historic and a qualitative component. The specific component relates to loans that are considered impaired. For such loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price less selling costs) of an impaired loan are lower than the carrying value of that loan. The historic component covers non-classified and criticized loans and is based on historical loss experience adjusted for qualitative factors. The qualitative reserve of the allowance reflects adjustments to historical experience to account for current conditions impacting the loan portfolio.

The CARES Act also established the Paycheck Protection Program ("PPP"), which allocated funding for loans guaranteed by the Small Business Administration ("SBA"). The program approves the SBA to forgive loans made by approved lenders to eligible borrowers for payroll, mortgage interest, rent and utilities. Due to the unique nature of these provisions, PPP loans have been disclosed as a separate balance sheet item. PPP loans were evaluated separately for the allowance for loan losses given the explicit government guarantee. This analysis, which incorporated historical industry experience with similar SBA guarantees and our personal experience with the beginning of the forgiveness process, concluded a remote likelihood of loss and therefore no allowance for loan losses has been assigned to these loans.

For all classes, a loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 2 - Summary of significant accounting policies (continued)

*Allowance for loan losses (concluded)* - Impairment is measured on a loan-by-loan basis for loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral less selling costs if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. The allowance model is applied to determine the specific allowance balance for impaired loans and the general allowance balance for unimpaired loans grouped by loan type.

The Bank's loan charge-off policy for all loan classes is to charge down loans to net realizable value once a portion of the loan is determined to be uncollectible, and the underlying collateral shortfall is assessed. Loans are moved to nonaccrual status when the loan becomes 90 days delinquent or a portion of the loan is determined to be uncollectible and supporting collateral is not considered to be sufficient to cover potential losses.

Nonaccrual loans are reviewed monthly to determine if all or a portion of the loan is uncollectible. Nonaccrual loans that are determined to be solely collateral dependent are monitored for possible charge downs to net realizable value upon determination that they are impaired.

*Income recognition on impaired and non-accrual loans* - All classes of loans are generally classified as non-accrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-secured and in the process of collection. All classes of loans that are on a current payment status or past due less than 90 days may also be classified as non-accrual, if repayment in full of principal and/or interest is in doubt.

All classes of loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance by the borrower, in accordance with the contractual terms of interest and principal.

When all classes of loans are classified as non-accrual and the future collectibility of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding. When the future collectibility of the recorded loan balance is expected, interest income may be recognized on a cash basis. In the case where a non-accrual loan had been partially charged off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Cash interest receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

*Other real estate owned* - Real estate acquired through, or in lieu of, foreclosure is held for sale and is initially recorded at fair value less estimated cost to sell at the date of foreclosure, establishing a new cost basis. Principal and interest losses existing at the time of acquisition of such assets are charged against the allowance for loan losses and interest income, respectively. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less estimated cost to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Revenue and expenses from operations associated with other real estate owned and the impact of any subsequent changes in the carrying value are included in other expenses.

*Premises and equipment* - Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. For financial reporting purposes, assets are depreciated over their estimated useful lives using the straight-line method. Useful lives for these assets are within the following ranges: buildings from 10-39 years; equipment, furniture and fixtures 3-15 years; computer equipment 3-7 years and software 3-5 years. For income tax purposes, the accelerated cost recovery system and the modified accelerated cost recovery system are used.

*Leases* - On January 1, 2019, the Company adopted ASU No. 2016-02 "Leases (Topic 842)" and all subsequent ASUs that modified Topic 842. The Company elected the optional transition method provided by ASU 2018-11 and did not adjust prior periods for ASC 842.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 2 - Summary of significant accounting policies (continued)

*Leases (concluded)* – The Company also elected certain practical expedients within the standard and consistent with such elections did not reassess whether any expired or existing contracts are or contain leases, did not reassess the lease classification for any expired or existing leases, and did not reassess any initial direct costs for existing leases. The implementation of the new standard in 2019 resulted in recognition of a right-of-use asset of \$657,157 and lease liability of \$618,887 at the date of adoption, which is related to the Company's lease of premises used in operations. The right-of-use asset and lease liability are included in other assets and other liabilities, respectively, in the consolidated balance sheets.

Lease liabilities represent the Company's obligation to make lease payments and are presented at each reporting date as the net present value of the remaining contractual cash flows. Cash flows are discounted at the Company's incremental borrowing rate in effect at the commencement date of the lease. Right-of-use assets represent the Company's right to use the underlying asset for the lease term and are calculated as the sum of the lease liability and if applicable, prepaid rent, initial direct costs and any incentives received from the lessor.

The Company's long-term lease agreements are classified as operating leases. Certain of these leases offer the option to extend the lease term and the Company has included such extensions in its calculation of the lease liabilities to the extent the options are reasonably assured of being exercised. The lease agreements do not provide for residual value guarantees and have no restrictions or covenants that would impact dividends or require incurring additional financial obligations. Note 8 provides additional information related to leases.

*Goodwill and other intangibles* - Goodwill is not subject to amortization, but is subject to an annual assessment for impairment by applying a fair-value-based test as required by ASC 350, *Goodwill and Other Intangible Assets*. Additionally, under ASC 350, acquired intangible assets are separately recognized if the benefit of the assets can be sold, transferred, licensed, rented, or exchanged, and amortized over their useful life.

Goodwill is tested for impairment at the reporting unit level on an annual basis as of September 30, or more often if events or circumstances indicate there may be impairment. Testing is conducted in two steps: identifying the potential impairment and then, if necessary, identifying the amount of impairment. The first step (step 1) compares the fair value of the reporting unit to its carrying amount. If the fair value is less than the carrying amount, a second test is conducted by comparing the implied fair value of goodwill with the carrying amount of that goodwill. If the carrying amount exceeds the implied fair value, an impairment loss is recognized in an amount equal to that excess. For our annual impairment testing conducted during 2020, we identified one reporting unit with goodwill: Manry Rawls. For purposes of the goodwill impairment test, the Company primarily uses the qualitative approach to value the reporting unit. An initial qualitative evaluation is made to assess the likelihood of impairment and determine whether further quantitative testing to calculate the fair value is necessary. When the qualitative evaluation indicates that impairment is more likely than not, quantitative testing is required whereby the fair value of each reporting unit is calculated and compared to the recorded book value. Based on our analysis, we determined there is no goodwill impairment, since the fair value for the reporting unit was in excess of the respective reporting unit's carrying value as of September 30, 2020.

The second step (step 2) of impairment testing is necessary only if the reporting unit does not pass step 1. Step 2 compares the implied fair value of the reporting unit goodwill with the carrying amount of the goodwill for the reporting unit. The implied fair value of goodwill is determined in the same manner as goodwill that is recognized in a business combination. Significant judgment and estimates are involved in estimating the fair value of the assets and liabilities of the reporting unit. Since the reporting unit did not fail step 1, step 2 was not applicable during 2020 testing. The Company monitored events and circumstances during the fourth quarter of 2020, and it determined that there were no triggering events requiring an updated impairment test as of December 31, 2020.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 2 - Summary of significant accounting policies (continued)

*Goodwill and other intangibles (concluded)* - Significant judgment is applied when goodwill is assessed for impairment. This judgment includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, incorporating general economic and market conditions, and selecting an appropriate control premium. Selection and weighting of the various fair value techniques may result in a higher or lower fair value. Judgment is applied in determining the weightings most representative of fair value.

Intangible assets are amortized or tested for impairment based on whether they have finite or indefinite lives. Intangibles that have finite lives are amortized on a straight-line basis over their useful life and tested for impairment whenever events or circumstances indicate the carrying amount of the assets may not be recoverable. The useful life applied to amortize the customer list intangible, which was created from the acquisition of Manry Rawls, is 15 years. Note 9 provides additional information related to goodwill and other intangibles.

*Non-marketable equity securities* - Equity securities are carried at fair value, with changes in fair value reported in net income. Equity securities without readily determinable fair values are carried at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment. On January 1, 2018, the Company adopted a new accounting standard for Financial Instruments (ASU 2016-01), which requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. Upon adoption, equity securities previously classified as available for sale are presented separately on the balance sheet as Equity securities. The amount of unrealized gain (loss), net of tax, related to these securities was reclassified from accumulated other comprehensive to retained earnings as of January 1, 2018. Upon adoption, the amendments related to equity securities without readily determinable fair values (including disclosure requirements) are being applied prospectively to equity investments that existed at January 1, 2018. Because of the redemption provisions of the Federal Reserve Bank (FRB) and Federal Home Loan Bank (FHLB) stock, the Bank estimated that the fair value equaled or exceeded the cost of these investments and the investments were not impaired. Equity method investments are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the investment might not be recoverable. No such impairment was identified in 2020 or 2019.

*Mergers and acquisitions* - Mergers and acquisitions are accounted for using the acquisition method, as required by ASC 805, *Business Combinations*. Under this method, the cost of the acquired entity will be allocated to the assets acquired and liabilities assumed based on their fair values at the date of acquisition. The excess of the cost over the fair value of the acquired net assets is recognized as goodwill.

*Income taxes* - Income taxes are provided for the tax effects of transactions reported in the financial statements, and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of investment securities, deferred loan fees, allowance for loan losses, deferred compensation, interest on non-performing loans and accumulated depreciation for financial and income tax reporting.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered in income. Deferred tax assets are reduced if it is more likely than not that the tax benefits will not be realized. Management has evaluated all other tax positions that could have a significant effect on the financial statements and determined the Company had no uncertain income tax positions at December 31, 2020 and 2019. The years ending on or after December 31, 2017 remain subject to examination by federal and state tax authorities. The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 2 - Summary of significant accounting policies (continued)

*Deferred compensation plans* - The Company maintains deferred compensation and retirement arrangements with certain officers. The Company's policy is to accrue the estimated amounts to be paid under the contracts over the expected period of active employment. The Company purchased life insurance and annuity contracts to fund the expected liabilities under the contracts.

*Revenue recognition on insurance contracts* - Insurance commission income is recorded as of the effective date of insurance coverage or the billing date, whichever is later. Contingent commissions are recognized when determinable, which is generally when such commissions are received or when the Company receives data from the insurance companies that allows the reasonable estimation of these amounts. The income effects of subsequent premium and fee adjustments are recorded when the adjustments become known.

*Earnings per common share* - Basic earnings per share (EPS) is computed by dividing income available to common shareholders by the weighted-average number of shares outstanding for the period. Diluted earnings per share reflects the potential dilution if restricted stock, or other common stock equivalents, would result in the issuance of additional shares of common stock that share in earnings. Potential common shares that may be issued by the Company relate solely to outstanding non-vested restricted stock.

*Off-balance sheet financial instruments* - In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commitments under credit card arrangements, commercial letters of credit, standby letters of credit, and financial guarantees written. Such financial instruments are generally recorded in the financial statements when they become payable. A reserve for these off-balance sheet financial instruments is considered immaterial as is the fair value of the financial guarantees.

*Use of estimates* - The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

□

*Estimation of fair values* - The following notes summarize the major methods and assumptions used in estimating the fair value of financial instruments:

Short-term financial instruments are valued at their carrying amounts included in the Company's balance sheet, which are reasonable estimates of fair value due to the relatively short period to maturity of the instruments. This approach applies to cash and cash equivalents, deposits in other banks, federal funds sold, and short-term borrowings.

Investment securities are valued at quoted market prices, if available. The fair value of equity investments in the restricted stock of the FRB and FHLB approximates the carrying value due to the redemptive provisions of these securities.

For unquoted securities, the fair value is estimated by the Company on the basis of financial and other information.

The carrying amounts of accrued interest approximate fair value.

The fair value of demand deposits and deposits with no defined maturity is taken to be the amount payable on demand at the reporting date. The fair value of fixed-maturity deposits is estimated using discounted cash flow analyses and rates currently offered for deposits of similar remaining maturities. The intangible value of long-term relationships with depositors is not taken into account in estimating the fair values disclosed.



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 2 - Summary of significant accounting policies (continued)

*Estimation of fair values (concluded)* - Fair values of capital notes are based on market prices for debt securities having similar maturity and interest rate characteristics. The impact of the Company's assessment of its own credit risk is not factored into the fair value of the notes.

The carrying amounts of federal funds purchased and borrowings under repurchase agreements approximate their fair values.

The fair values of the Company's FHLB advances are estimated using discounted cash flow analyses based on current rates offered on similar debt instruments.

It is not practicable to separately estimate the fair values for off-balance-sheet credit commitments, including standby letters of credit and guarantees written, due to the lack of cost-effective, reliable measurement methods for these instruments.

*Certain significant estimates* - Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans and the valuation of other real estate owned. Management uses available information to recognize losses on loans and other real estate owned. Future additions to the allowance may be necessary based on changes in local economic conditions and other factors. Management believes the allowance recorded at December 31, 2020 and 2019 is sufficient to cover inherent losses in the portfolio.

*Impact of COVID-19* - On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") was signed into law. The CARES Act was designed to provide financial relief to the American people and businesses in response to the economic consequences from the COVID-19 pandemic. The provisions of the CARES Act included an election to not apply the guidance on accounting for troubled debt restructurings to loan modifications related to the adverse effects of COVID-19 granted to borrowers that were current as of December 31, 2019. The relief applies to modifications made from March 1, 2020, until the earlier of December 31, 2020, or 60 days following the termination of the national emergency declared by the President of the United States. The Company elected to adopt these provisions of the CARES Act. The Company made 66 loan modifications that totaled \$37.6 million pursuant to the terms of the CARES Act Section 4013 and as of December 31, 2020 all loans had returned to their contractual payment structure.

The CARES Act also established PPP loans, which allocated funding for loans guaranteed by the SBA. The program approves the SBA to forgive loans made by approved lenders to eligible borrowers for payroll, mortgage interest, rent and utilities. Due to the unique nature of these provisions, PPP loans have been disclosed as a separate balance sheet item.

*Recent accounting pronouncements* - In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. At the FASB's October 16, 2019 meeting, the Board affirmed its decision to amend the effective date of this ASU for many companies. As a result of this meeting FASB issued ASU 2019-10 in November 2019. This ASU provides guidance to defer the effective dates for private companies, non-for-profit organizations, and certain smaller reporting companies applying standards on current expected credit losses, leases, and hedging. Based on the ASU, the Company expects this ASU will be effective for the Company beginning on January 1, 2023. The Company has engaged a third party to assist with implementation and is continuing to evaluate the impact that ASU 2016-13 will have on its consolidated financial statements.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 2 - Summary of significant accounting policies (continued)

*Recent accounting pronouncements* (concluded) - In January 2017, the FASB issued ASU No. 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the test for Goodwill Impairment. This ASU is intended to simplify goodwill impairment testing by eliminating the second step of the analysis under which the implied fair value of goodwill is determined as if the reporting unit were being acquired in a business combination. The update instead requires entities to compare the fair value of a reporting unit with its carrying amount and recognize an impairment charge for any amount by which the carrying amount exceeds the reporting unit's fair value, to the extent that the loss recognized does not exceed the amount of goodwill allocated to that reporting unit. The amendments are effective for fiscal years beginning after December 15, 2021. Early adoption is permitted. The Company does not expect the amendments to the standard to have a material effect on its consolidated financial statements.

In May 2019, the FASB issued ASU 2019-05, "Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief." The amendments in this ASU provide entities that have certain instruments within the scope of Subtopic 326-20 with an option to irrevocably elect the fair value option in Subtopic 825-10, applied on an instrument-by-instrument basis for eligible instruments, upon the adoption of Topic 326. The fair value option election does not apply to held-to-maturity debt securities. An entity that elects the fair value option should subsequently measure those instruments at fair value with changes in fair value flowing through earnings. The amendments are effective for fiscal years beginning after December 15, 2021, and interim periods within those fiscal years. The amendments should be applied on a modified-retrospective basis by means of a cumulative-effect adjustment to the opening balance of retained earnings balance in the consolidated balance sheet. Early adoption is permitted. The Company does not expect the amendments to the standard to have a material effect on its consolidated financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

### Accounting Standards Adopted in 2020

In April 2019, the FASB issued ASU 2019-04, "Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments." This ASU clarifies and improves areas of guidance related to the recently issued standards on credit losses, hedging, and recognition and measurement including improvements resulting from various Transition Resource Group (or TRG) Meetings. The amendments related to credit losses will be effective for the Company for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. The amendments related to recognition and measurement of financial instruments become effective for the Company on January 1, 2020. These amendments did not have a material effect on the Company's financial statements.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 3 - Available-for-sale securities

At December 31, 2020 and 2019, securities are as follows:

December 31, 2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
State and municipal securities	\$ 78,341,249	\$ 5,323,913	\$ -	\$ 83,665,162
Residential mortgage-backed securities	60,449,227	1,843,843	1,663	62,291,407
Collateralized mortgage obligations	28,816,000	363,163	15,180	29,163,983
Small Business Administration loan securities	28,204,435	468,555	27,278	28,645,712
Total	<u>\$ 195,810,911</u>	<u>\$ 7,999,474</u>	<u>\$ 44,121</u>	<u>\$ 203,766,264</u>

December 31, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
State and municipal securities	\$ 51,650,646	\$ 2,494,430	\$ 8,196	\$ 54,136,880
Residential mortgage-backed securities	38,469,234	315,947	27,075	38,758,106
Collateralized mortgage obligations	41,039,760	248,957	87,863	41,200,854
Small Business Administration loan securities	10,821,156	384,566	1,932	11,203,790
Total	<u>\$ 141,980,796</u>	<u>\$ 3,443,900</u>	<u>\$ 125,066</u>	<u>\$ 145,299,630</u>

At December 31, 2020 and 2019, gross unrealized losses and fair value by length of time that the individual securities have been in a continuous unrealized loss position, are as follows:

December 31, 2020	Fair Value	Less than 12 Months	More than 12 Months	Total Losses
Available-for-sale securities:				
Residential mortgage-backed securities	\$ 2,960,384	\$ 1,663	\$ -	\$ 1,663
Collateralized mortgage obligations	3,485,457	15,180	-	15,180
Small Business Administration loan securities	9,751,073	26,966	312	27,278
Total temporarily impaired investment securities	<u>\$ 16,196,914</u>	<u>\$ 43,809</u>	<u>\$ 312</u>	<u>\$ 44,121</u>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 3 - Available-for-sale securities (continued)

December 31, 2019	Fair Value	Continuous Unrealized Losses Existing for:		Total Losses
		Less than 12 Months	More than 12 Months	
Available-for-sale securities:				
State and municipal securities	\$ 977,050	\$ 8,196	\$ -	\$ 8,196
Residential mortgage-backed securities	4,881,392	78	26,997	27,075
Collateralized mortgage obligations	13,858,900	35,454	52,409	87,863
Small Business Administration loan securities	222,119	307	1,625	1,932
Total temporarily impaired investment securities	\$ 19,939,461	\$ 44,035	\$ 81,031	\$ 125,066

*State and municipal securities* - The Company's unrealized losses on state and municipal securities were caused by the interest rate fluctuations. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on the credit quality of the issuers, and because of the Company's intent to hold the securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell these securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

*Residential mortgage-backed securities and collateralized mortgage obligations* - The Company's unrealized losses on residential mortgage-backed securities and collateralized mortgage obligations were caused by the interest rate fluctuations. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. The Company's mortgage-related securities are backed by the Federal National Mortgage Association ("FNMA") and the Federal Home Loan Mortgage Corporation ("FHLMC"), which are Government Sponsored Entities ("GSE") or are collateralized by securities backed by these agencies. The Company intends to hold the securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell these securities before their anticipated recovery. Because of the preceding factors the Company does not consider these investments other than temporarily impaired.

*Small Business Administration loan securities* - The Company's unrealized losses on small business administration loans were caused by the interest rate fluctuations. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on the credit quality of the issuers, and because of the Company's intent to hold the securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell these securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

At December 31, 2020 and 2019, securities with a carrying value of approximately \$54,898,106 and \$55,908,435, respectively, were pledged to the Commonwealth of Virginia to secure public deposits. In addition, at December 31, 2020 and 2019, securities with a carrying value of \$3,312,240 and \$3,754,145, respectively, were pledged to the FHLB to secure advances. Investment securities with carrying values of \$8,011,482 and \$6,340,534 were pledged to secure repurchase agreements at December 31, 2020 and 2019, respectively.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 3 - Available-for-sale securities (concluded)

At December 31, 2020, the amortized cost and fair value of debt securities by maturity date are as follows:

	Amortized Cost	Fair Value
Due in one year or less	\$ 1,763,444	\$ 1,769,254
Due from one to five years	1,348,868	1,387,105
Due from five to ten years	13,306,315	14,303,502
Due after ten years	179,392,284	186,306,403
Total debt securities	<u>\$ 195,810,911</u>	<u>\$ 203,766,264</u>

Gross realized gains on available-for-sale securities were:

	2020	2019
State and municipal securities	\$ 518,692	\$ 296,468
Residential mortgage-backed securities	88,398	65,954
Total gross realized gains	<u>\$ 607,090</u>	<u>\$ 362,422</u>

Gross realized losses on available-for-sale securities were:

	2020	2019
State and municipal securities	\$ -	\$ 7,367
Residential mortgage-backed securities	-	18,786
Total gross realized losses	<u>\$ -</u>	<u>\$ 26,153</u>

Proceeds from the sale of available-for-sale securities totaled \$11,245,823 and \$21,598,655 for the years ended December 31, 2020 and 2019, respectively.

### Note 4 - Derivatives

*Cash Flow Hedges of Interest Rate Risk* – The Company’s objective in using certain interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company may use interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involved the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The Company entered into an interest rate swap during 2020 to reduce the exposure to variability in interest-related cash outflows attributable to changes in forecasted rates on short-term FHLB borrowings. These derivative instruments are designed as cash flow hedges. The hedged item is the LIBOR portion of the series of future adjustable rate borrowings over the term of the interest rate swap. Accordingly, changes to the amount of interest payment cash flows for the hedged transaction attributable to a change in credit risk are excluded from our assessment of hedge effectiveness. The Company tests for hedging effectiveness on a quarterly basis. The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 4 – Derivatives (concluded)

reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. The Company has not recorded any hedge ineffectiveness since inception. The notional amount and fair value of the swap as of December 31, 2020 was \$10,000,000 and \$56,295, respectively.

*Risk Management Objective of Using Derivatives* – When using derivatives to hedge cash flow risks, the Company exposes itself to potential credit risk from the counterparty to the hedging instrument. This credit risk is normally a small percentage of the notional amount and fluctuates as interest rates change. The Company analyzes and approves credit risk for all potential derivative counterparties prior to execution of any derivative transaction. The Company seeks to minimize credit risk by dealing with highly rate counterparties and by obtaining collateralization for exposures above certain predetermined limits. If significant counterparty risk is determined, the Company would adjust the fair value of the derivative recorded asset balance to consider such risk.

### Note 5 – Small Business Administration Paycheck Protection Program Loans Receivable

Pursuant to the CARES Act, the SBA provided forgivable loans to small businesses through the Paycheck Protection Program. These loans have 2 and 5 year terms, an interest rate of 1.00% and carry a 100% guarantee of the SBA. Due to the guarantee of the SBA, these loans require no provision of loan loss. The Bank processed 259 Paycheck Protection Program loans, which totaled \$24.9 million in approvals from the SBA. During the third quarter of 2020 the SBA began accepting applications from borrowers for forgiveness of PPP loans. As of December 31, 2020 the Bank had received \$7.6 million in payments on 45 loans being fully forgiven. There were 214 PPP loans remaining with a recorded investment of \$17.0 million as of December 31, 2020. The Bank received \$1.04 million in loan fees from the SBA associated with the processing of PPP loans. Any loan fees received and associated costs incurred were accounted for in the same manner as other loans and were deferred with income recognized over the original two year term. As loans are forgiven and repaid by the SBA, the Bank recognizes any remaining loan fees and costs at the time of forgiveness. As of December 31, 2020 the Bank had recognized \$556 thousand in loan fees and had \$483 thousand in deferred loans fees remaining that were associated with PPP loans.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 6 - Loans and Allowance for Loan Losses

*General* - The Bank provides to its customers a full range of short- to medium-term commercial, agricultural, Small Business Administration guaranteed, mortgage, home equity, and personal loans, both secured and unsecured. The Bank also makes real estate mortgage and construction loans. At December 31, 2020 and 2019, loans held for investment consisted of the following:

	2020	2019
Mortgage loans on real estate:		
Construction	\$ 29,278,446	\$ 41,154,005
Commercial Real Estate:		
Non-owner occupied	30,546,095	24,562,446
Owner occupied	78,343,817	59,310,900
Residential 1-4 family	31,145,143	34,757,775
Multifamily	5,725,109	4,435,830
Equity lines of credit	9,183,690	11,128,525
Total mortgage loans on real estate	<u>184,222,300</u>	<u>175,349,481</u>
Commercial and industrial	52,751,952	57,988,750
Agricultural	24,501,916	24,642,239
Individuals	6,276,997	8,563,898
Total loans	<u>267,753,165</u>	<u>266,544,368</u>
Less: Allowance for loan losses	(6,346,592)	(5,676,680)
Net deferred loan fees and costs	251,986	196,721
Loans, net	<u>\$ 261,658,559</u>	<u>\$ 261,064,409</u>

*Real Estate Loans* - Real estate loans include construction and land development loans, commercial real estate loans, home equity lines of credit, multi-family and residential mortgages.

Construction/development lending totaled \$29.3 million and \$41.1 million at December 31, 2020 and 2019, respectively. The Bank originates one-to-four family residential construction loans for the construction of custom homes (where the home buyer is the borrower) and provides financing to builders and consumers for the construction of homes. The Bank generally receives a pre-arranged permanent financing commitment from an outside banking entity prior to financing the construction of pre-sold homes. The Bank also makes commercial real estate construction loans, primarily for owner-occupied properties. The Bank limits its construction lending risk through adherence to established underwriting procedures. Residential one-to-four family loans amounted to \$31.1 million and \$34.8 million at December 31, 2020 and 2019, respectively.

Commercial real estate loans totaled \$108.9 million and \$83.9 million at December 31, 2020 and 2019, respectively. This lending has involved loans secured by owner-occupied commercial buildings for office, storage and warehouse space, as well as non-owner occupied commercial buildings. The Bank generally requires the personal guaranty of borrowers and a demonstrated cash flow capability sufficient to service the debt. Loans secured by commercial real estate may be larger in size and may involve a greater degree of risk than one-to-four family residential mortgage loans. Payments on such loans are often dependent on successful operation or management of the properties.

Multifamily loans totaled \$5.7 million and \$4.4 million at December 31, 2020 and 2019, respectively. These loans are residential housing projects containing five or more rental units. Traditional multifamily projects charge market rents and are located in both city and suburban markets. Equity lines of credit are open-ended revolving lines of credit secured by the

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 6 – Loans and Allowance for Loan Losses (continued)

equity in a borrower's residence. Equity lines of credit totaled \$9.2 million and \$11.1 million at December 31, 2020 and 2019, respectively.

*Commercial and Industrial Loans* - At December 31, 2020 and 2019, the Bank's commercial loan portfolio totaled \$52.8 million and \$58.0 million, respectively. Commercial loans include both secured and unsecured loans for working capital, expansion, and other business purposes. Short-term working capital loans are secured by accounts receivable, inventory and/or equipment. The Bank also makes term commercial loans secured by equipment and real estate. Lending decisions are based on an evaluation of the financial strength, cash flow, management and credit history of the borrower, and the quality of the collateral securing the loan. With few exceptions, the Bank requires personal guarantees and secondary sources of repayment. Commercial loans generally provide greater yields and re-price more frequently than other types of loans, such as real estate loans.

*Agricultural Loans* - Agricultural loans totaled \$24.5 million and \$24.6 million at December 31, 2020 and 2019, respectively and include loans secured by farm equipment, inventory and farm land. Lending decisions are based on an evaluation of the financial strength, cash flow, management and credit history of the borrower, and the quality of the collateral securing the loan. Payments on such loans are often dependent on successful operation or management of the farming operation.

*Loans to Individuals* - Loans to individuals (consumer loans) include automobile loans, boat and recreational vehicle financing, and miscellaneous secured and unsecured personal loans and totaled \$6.3 million and \$8.6 million at December 31, 2020 and 2019, respectively. Overdrafts totaling \$12 thousand and \$37 thousand at December 31, 2020 and 2019, respectively, were reclassified from deposits to loans and are also classified in loans to individuals. Consumer loans generally can carry significantly greater risks than other loans, even if secured, if the collateral consists of rapidly depreciating assets such as automobiles and equipment. Repossessed collateral securing a defaulted consumer loan may not provide an adequate source of repayment of the loan. Consumer loan collections are sensitive to job loss, illness and other personal factors. The Bank manages the risks inherent in consumer lending by following established credit guidelines and underwriting practices designed to minimize risk of loss.

*Loan Approvals* - The Bank's loan policies and procedures establish the basic guidelines governing its lending operations. The guidelines address the type of loans that the Bank seeks, target markets, underwriting and collateral requirements, terms, interest rate and yield considerations and compliance with laws and regulations. All loans or credit lines are subject to approval procedures and amount limitations. These limitations apply to the borrower's total outstanding indebtedness to the Bank, including any indebtedness as a guarantor. The policies are reviewed and approved at least annually by the Board of Directors of the Bank. The Bank supplements its own supervision of the loan underwriting and approval process with periodic loan reviews by independent, outside professionals experienced in loan review. Responsibility for loan review and loan underwriting resides with the Chief Credit Officer position. This position is responsible for loan underwriting and approval. On an annual basis, the Board of Directors of the Bank determines officers' lending authority. Authorities may include loans, letters of credit, overdrafts, uncollected funds and such other authorities as determined by the Board of Directors.

Substantially all of the Bank's loans have been granted to customers in the Hampton Roads area of Virginia.

*Credit Review and Evaluation* - The Bank outsources the credit risk review function which reports to the Board of Directors. The focus of the engagement is on policy compliance and proper grading of higher credit risk loans as well as new and existing loans on a sample basis. Additional reporting for problem/criticized assets has been developed along with an after-the-fact loan review.

The Bank uses a risk grading program to facilitate the evaluation of probable inherent loan losses and the adequacy of the allowance for loan losses. In this program, risk grades are initially assigned by loan officers, reviewed by the Chief Credit



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 6 - Loans and Allowance for Loan Losses (continued)

Officer and reviewed by credit review analysts on a test basis. The Bank strives to maintain the loan portfolio in accordance with conservative loan underwriting policies that result in loans specifically tailored to the needs of the Bank's market area. Every effort is made to identify and minimize the credit risks associated with such lending strategies.

All loans are risk graded on a scale from 1 (highest quality) to 9 (loss). Acceptable loans at inception are grades 1 through 5. These grades have underwriting requirements that at least meet the minimum requirements of a secondary market source. If borrowers do not meet credit history requirements, other mitigating criteria such as substantial liquidity and low loan-to-value ratios could be considered and would generally have to be met in order to make the loan. The Bank's loan policy states that a guarantor may be necessary if reasonable doubt exists as to the borrower's ability to repay.

The Board of Directors has authorized the loan officers to have individual approval authority for risk grade 1 through 5 loans up to maximum exposure limits for each customer. New or renewed loans that are graded 6 (special mention) or lower must have approval from the Chief Credit Officer and Chief Lending Officer. Any changes in risk assessments as determined by loan officers, credit administrators, regulatory examiners and management are also considered.

The risk grades, normally assigned by the loan officers when the loan is originated and reviewed by the Chief Credit Officer, are based on several factors including historical data, current economic factors, composition of the portfolio, and evaluations of the total loan portfolio and assessments of credit quality within specific loan types. In some cases the risk grades are assigned by the Chief Credit Officer or the Chief Lending Officer, depending upon dollar exposure. Because these factors are dynamic, the provision for loan losses can fluctuate. Credit quality reviews are based primarily on analyses of borrowers' cash flows, with asset values considered only as a second source of payment. Credit analysts work with lenders in underwriting, structuring and risk grading the Bank's credits. The Chief Lending Officer and the Chief Credit Officer focus on lending policy compliance, credit risk grading, and credit risk reviews on larger dollar exposures. Management uses the information developed from the procedures above in evaluating and grading the loan portfolio. This continual grading process is used to monitor the credit quality of the loan portfolio and to assist management in determining the appropriate levels of the allowance for loan losses. The following is a summary of the credit risk grade definitions for all loan types:

"1" – Prime – Credits in this category are virtually risk-free and are well-collateralized by cash or cash-equivalent instruments held by the Bank. The repayment program is well-defined and achievable, and repayment sources are numerous. No material documentation deficiencies or exceptions exist.

"2" – Good – This grade is reserved for loans secured by readily marketable collateral, or loans within guidelines to borrowers with liquid financial statements. A liquid financial statement is generally a financial statement with substantial liquid assets, particularly relative to the debts. These loans have excellent sources of repayment, with no significant identifiable risk of collection, and conform in all respects to Bank policy, guidelines, underwriting standards, and Federal and State regulations (no exceptions of any kind).

"3" – Acceptable 1 – This grade is reserved for the Bank's high-quality loans. These loans have excellent sources of repayment, with no significant identifiable risk of collection. Generally, loans assigned this risk grade will demonstrate the following characteristics:

- Conformity in all respects with Bank policy, guidelines, underwriting standards, and Federal and State regulations (no exceptions of any kind).
- Documented historical cash flow that meets or exceeds required minimum Bank guidelines, or that can be supplemented with verifiable cash flow from other sources.
- Adequate secondary sources to liquidate the debt, including combinations of liquidity, liquidation of collateral, or liquidation value to the net worth of the borrower or guarantor.

"4" – Acceptable 2 – This grade is given to acceptable loans. These loans have adequate sources of repayment, with little identifiable risk of collection. Loans assigned this risk grade will demonstrate the following characteristics:

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 6 - Loans and Allowance for Loan Losses (continued)

- General conformity to the Bank's underwriting requirements, with limited exceptions to the Bank's policy, product or underwriting guidelines. All exceptions noted have documented mitigating factors that offset any additional risk associated with the exceptions noted.
- Documented historical cash flow that meets or exceeds required minimum Bank guidelines, or that can be supplemented with verifiable cash flow from other sources.
- Adequate secondary sources to liquidate the debt, including combinations of liquidity, liquidation of collateral, or liquidation value to the net worth of the borrower or guarantor.

"5" – Weak Pass – This grade is given to acceptable loans that show signs of weakness in either adequate sources of repayment or collateral, but have demonstrated mitigating factors that minimize the risk of delinquency or loss. Loans assigned this grade may demonstrate some or all of the following characteristics:

- Additional exceptions to the Bank's policy requirements, product guidelines or underwriting standards that present a higher degree of risk to the Bank. Although the combination and/or severity of identified exceptions is greater for this risk grade, the exceptions may be properly mitigated by other documented factors that offset any additional risks.
- Unproved, insufficient or marginal primary sources of repayment that appear sufficient to service the debt at this time. Repayment weaknesses may be due to minor operational issues, financial trends, or reliance on projected (not historic) performance.
- Marginal or unproven secondary sources to liquidate the debt, including combinations of liquidation of collateral and liquidation value to the net worth of the borrower or guarantor.

"6" – Special Mention – Special Mention loans include the following characteristics:

- Loans with underwriting guideline tolerances and/or exceptions and with no mitigating factors;
- Extending loans that are currently performing satisfactorily but with potential weaknesses that may, if not corrected, weaken the asset or inadequately protect the Bank's position at some future date. Potential weaknesses are the result of deviations from prudent lending practices; or
- Loans where adverse economic conditions have developed subsequent to the loan origination that do not jeopardize liquidation of the debt, but do substantially increase the level of risk, may also warrant this rating.

"7" – Substandard – A substandard loan is inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as substandard must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt; they are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Loans consistently not meeting the repayment schedule should be downgraded to substandard. Loans in this category are characterized by deterioration in quality exhibited by any number of well-defined weaknesses requiring corrective action. The weaknesses may include, but are not limited to:

- High debt to worth ratios
- Declining or negative earnings trends
- Declining or inadequate liquidity
- Questionable repayment sources
- Lack of well-defined secondary repayment source, and
- Unfavorable competitive comparisons.

Such loans are no longer considered to be adequately protected due to the borrower's declining net worth, lack of earnings capacity, declining collateral margins and/or unperfected collateral positions. A possibility of loss of a portion of the loan balance cannot be ruled out. The repayment ability of the borrower is marginal or weak and the loan may have exhibited excessive overdue status or extensions and/or renewals.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 6 - Loans and Allowance for Loan Losses (continued)

“8” – Doubtful – Loans classified Doubtful have all the weaknesses inherent in loans classified Substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable. However, these loans are not yet rated as loss because certain events may occur which would salvage the debt. Among these events are:

- Injection of capital
- Alternative financing
- Liquidation of assets or the pledging of additional collateral.

The ability of the borrower to service the debt is extremely weak, overdue status is constant, the debt has been placed on non-accrual status, and no definite repayment schedule exists. Doubtful is a temporary grade where a loss is expected but is presently not quantified with any degree of accuracy. Once the loss position is determined, the amount is charged off.

“9” – Loss – Loans classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off the loan even though partial recovery may be effected in the future. Probable Loss portions of problem assets should be charged against the Allowance for Loan Losses. Loans may reside in this classification for administrative purposes for a period not to exceed the earlier of thirty (30) days or calendar quarter-end.



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 6 - Loans and Allowance for Loan Losses (continued)

#### Real Estate Credit Exposure as of December 31, 2019

	Commercial Real Estate					Equity lines of credit
	Construction	Non-owner occupied	Owner occupied	Residential 1-4 Family	Multifamily	
	(in thousands)					
Prime	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Good	-	-	-	15	-	-
Acceptable 1	2,875	1,490	2,593	3,236	-	4,670
Acceptable 2	28,082	11,844	33,934	20,473	1,647	5,276
Weak Pass	9,526	11,228	21,482	9,518	2,789	799
Special Mention	305	-	119	290	-	25
Substandard	366	-	1,183	1,226	-	358
	<u>\$ 41,154</u>	<u>\$ 24,562</u>	<u>\$ 59,311</u>	<u>\$ 34,758</u>	<u>\$ 4,436</u>	<u>\$ 11,128</u>

#### Other Credit Exposures as of December 31, 2019

	Commerical			Total
	and industrial	Agricultural	Individuals	
	(in thousands)			
Prime	\$ 301	\$ -	\$ 16	\$ 317
Good	-	-	-	15
Acceptable 1	6,161	1,732	207	22,964
Acceptable 2	30,533	11,718	523	144,030
Weak Pass	19,286	11,192	7,558	93,378
Special Mention	1,699	-	260	2,698
Substandard	9	-	-	3,142
	<u>\$ 57,989</u>	<u>\$ 24,642</u>	<u>\$ 8,564</u>	<u>\$ 266,544</u>

*Nonaccrual loans and past due loans* - Nonperforming assets include loans classified as nonaccrual, foreclosed bank-owned property and loans past due 90 days or more on which interest is still being accrued. There was one loan with a balance of \$196,256 that was past due over 90 days accruing interest as of December 31, 2020. There were no financing receivables past due over 90 days accruing interest as of December 31, 2019. Nonaccrual loans as of December 31, 2020 totaled \$171,515, or 0.06% of total loans, compared with \$753,206, or 0.28% of total loans, as of December 31, 2019. The Bank aggressively pursues the collection and repayment of all loans. Other nonperforming assets, such as repossessed and foreclosed collateral are aggressively liquidated by the Bank's management. The total number of loans on nonaccrual status as of December 31, 2020 and 2019 was 4 and 7, respectively.

For the years ended December 31, 2020 and 2019, the Bank recognized \$0- in interest income on nonaccrual loans. If interest on those loans had been accrued in accordance with the original terms, interest income would have increased by approximately \$14,310 and \$16,967 for the years ended December 31, 2020 and 2019, respectively.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 6 - Loans and Allowance for Loan Losses (continued)

The following is a breakdown of nonaccrual loans as of December 31, 2020 and 2019:

	December 31,	
	2020	2019
Mortgage loans on real estate:		
Construction	\$ -	\$ 366,239
Commercial real estate:		
Residential 1-4 family	169,927	209,716
Equity lines of credit	-	168,786
Commerical and industrial	1,588	8,465
Total	<u>\$ 171,515</u>	<u>\$ 753,206</u>

All classes of loans are considered past due if the required principal and interest income have not been received as of the date such payments were due. The following tables present the Bank's aged analysis of past due loans as of December 31, 2020 and 2019:

	30-59 Days	60-89 Days	Greater Than	Greater Than	Total Past	Current	Total Loans
	Past Due	Past Due	90 Days	90 Days Still Accruing	Due		
<b>December 31, 2020</b>	(in thousands)						
Mortgage loans on real estate:							
Construction	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 29,278	\$ 29,278
Commercial real estate:							
Non-owner occupied	-	-	-	-	-	30,546	30,546
Owner occupied	-	-	-	-	-	78,344	78,344
Residential 1-4 family	165	-	106	196	467	30,678	31,145
Multifamily	-	-	-	-	-	5,725	5,725
Equity lines of credit	-	-	-	-	-	9,184	9,184
Commercial and industrial	-	-	-	-	-	52,752	52,752
Agricultural	-	-	-	-	-	24,502	24,502
Individuals	-	-	-	-	-	6,277	6,277
Total	<u>\$ 165</u>	<u>\$ -</u>	<u>\$ 106</u>	<u>\$ 196</u>	<u>\$ 467</u>	<u>\$ 267,286</u>	<u>\$ 267,753</u>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 6 - Loans and Allowance for Loan Losses (continued)

	30-59 Days	60-89 Days	Greater Than	Greater Than	Total Past	Current	Total Loans
	Past Due	Past Due	90 Days	90 Days Still	Due		
<b>December 31, 2019</b>	(in thousands)						
Mortgage loans on real estate:							
Construction	\$ -	\$ -	\$ 366	\$ -	\$ 366	\$ 40,788	\$ 41,154
Commercial real estate:							
Non-owner occupied	84	-	-	-	84	24,478	24,562
Owner occupied	-	-	-	-	-	59,311	59,311
Residential 1-4 family	10	94	113	-	217	34,541	34,758
Multifamily	53	-	-	-	53	4,383	4,436
Equity lines of credit	54	-	145	-	199	10,929	11,128
Commercial and industrial	-	-	-	-	-	57,989	57,989
Agricultural	-	-	-	-	-	24,642	24,642
Individuals	8	-	-	-	8	8,556	8,564
<b>Total</b>	<b>\$ 209</b>	<b>\$ 94</b>	<b>\$ 624</b>	<b>\$ -</b>	<b>\$ 927</b>	<b>\$ 265,617</b>	<b>\$ 266,544</b>

*Troubled Debt Restructurings* - In order to maximize the collection of loan balances, the Bank evaluates troubled loan accounts on a case-by-case basis to determine if a loan modification would be appropriate. Loan modifications may be utilized where there is a reasonable chance that an appropriate modification would allow the Bank's customers to continue servicing debt. A loan is a troubled debt restructuring ("TDR") if both of the following exist: 1) a creditor has granted a concession to the debtor, and, 2) the debtor is experiencing financial difficulties. Non-accruing loans that are modified can be placed back on accrual status when both principal and interest are current and it is probable that the Bank will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement and a sustained period of payment performance is demonstrated. Interest on troubled debt restructured loans is accrued at the restructured rates when it is anticipated that no loss of original principal will occur and a sustained payment performance period is obtained.

For the years ended December 31, 2020 and 2019, the following table presents a breakdown of the types of concession made by loan class:

	Year ended December 31, 2020			Year ended December 31, 2019		
	Pre-Modification		Post-	Pre-Modification		Post-
	Number	Recorded	Modification	Number	Recorded	Modification
	of loans	Investment	Outstanding	of loans	Investment	Outstanding
Extended payment terms						
Mortgage loans on real estate:						
Commercial real estate:						
Non-owner occupied	-	\$ -	\$ -	-	\$ -	\$ -
Residential 1-4 family	-	-	-	-	-	-
Equity lines of credit	-	-	-	1	165,245	165,245
<b>Total</b>	<b>-</b>	<b>\$ -</b>	<b>\$ -</b>	<b>1</b>	<b>\$ 165,245</b>	<b>\$ 165,245</b>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 6 - Loans and Allowance for Loan Losses (continued)

The restructured loans generally include terms to reduce the interest rate and extend payment terms. The Bank did not forgive any principal associated with any of the above loans during 2020 or 2019. Within the last 12 months, no loans that were restructured in 2020 or 2019, subsequently defaulted and were foreclosed upon. These modifications resulted in specific reserves in the Bank's allowance for loan losses of \$0- and \$0- thousand as of December 31, 2020 and 2019, respectively.

There are no TDRs that are on non-accrual status as of December 31, 2020. There was one TDR that was on non-accrual status and had an unpaid principal balance of \$146,952 as of December 31, 2019. Five TDRs with a current principal balance of \$634,088 and eight TDRs with current principal balance of \$1,000,082 were considered performing loans and are accruing interest based on their sustained payment performance as of December 31, 2020 and 2019, respectively.

The specific reserve portion of the allowance for loan losses on TDRs is determined by discounting the restructured cash flows at the original effective rate of the loan before modification or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent. If the resulting amount is less than the recorded book value, the Bank either establishes a valuation allowance as a component of the allowance for loan losses or charges off the impaired balance if it determines that such amount is a confirmed loss. This method is used consistently for all segments of the portfolio.

Section 403 of the CARES Act provides that a qualified loan modification is exempt by law from classification as a TDR as defined by GAPP, from the period beginning March 1, 2020 until the earlier of December 31, 2020 or the date that is 60 days after the date on which the national emergency concerning the COVID-19 outbreak declared by the President of the United States under the National Emergencies Act terminates. Accordingly, we offered short-term modifications made in response to COVID-19 to borrowers who were current and otherwise not past due during 2020. All modified loans have returned to their contractual payment schedule. Management will continue to review risk grades and update credit risk if additional modifications are needed.

*Impaired Loans* - Management considers certain loans graded "doubtful" (loans graded 8) or "loss" (loans graded 9) to be individually impaired and may consider "substandard" loans (loans graded 7) individually impaired depending on the borrower's payment history. Any loans classified as troubled debt restructurings regardless of loan grade are also classified as impaired loans. The Bank measures impairment based upon discounted expected cash flows or the value of the collateral. Collateral value is assessed based on collateral value trends, liquidation value trends, and other liquidation expenses to determine logical and credible discounts that may be needed. Updated appraisals are required for all impaired loans and typically at renewal or modification of larger loans if the appraisal is more than 12 months old.

Impaired loans for all classes of loans typically include nonaccrual loans, loans over 90 days past due still accruing, troubled debt restructured loans and other problem loans considered impaired based on other underlying factors. Potential problem loans totaled \$2,135,524 and \$3,285,534 as of December 31, 2020 and 2019, respectively. These totals include loans which are currently performing and are not included in nonaccrual or restructured loans above, but about which we have serious doubts as to the borrower's ability to comply with present repayment terms. These loans are likely to be included later in nonaccrual, past due or troubled debt restructured loans, so they are considered by management in assessing the adequacy of the allowance for loan losses. No additional funds are committed to be advanced in connection with impaired loans.



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 6 - Loans and Allowance for Loan Losses (continued)

The following tables present the Bank's investment in loans considered to be impaired and related information on those impaired loans as of December 31, 2020 and 2019:

	Recorded Investment	Unpaid Principal Balance	Related Allowance (in thousands)	Year to Date	
				Average Recorded Investment	Interest Income Recognized
<b>December 31, 2020</b>					
<b>Impaired loans without a related allowance for loan losses</b>					
Mortgage loans on real estate:					
Commercial real estate:					
Non-owner occupied	\$ 122	\$ 122	\$ -	\$ 122	\$ 8
Owner occupied	1,101	1,101	-	1,114	52
Residential 1-4 family	193	193	-	263	8
Equity lines of credit	24	24	-	24	1
<b>Impaired loans with a related allowance for loan losses</b>					
Mortgage loans on real estate:					
Residential 1-4 family	694	694	78	701	36
Commercial and industrial	2	2	2	83	-
<b>Total impaired loans</b>					
Mortgage loans on real estate:					
Commercial real estate:					
Non-owner occupied	122	122	-	122	8
Owner occupied	1,101	1,101	-	1,114	52
Residential 1-4 family	887	887	78	964	44
Equity lines of credit	24	24	-	24	1
Commercial and industrial	2	2	2	83	-
<b>Total impaired loans</b>	<b>\$ 2,136</b>	<b>\$ 2,136</b>	<b>\$ 80</b>	<b>\$ 2,307</b>	<b>\$ 105</b>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 6 - Loans and Allowance for Loan Losses (continued)

	Recorded Investment	Unpaid Principal Balance	Related Allowance (in thousands)	Year to Date	
				Average Recorded Investment	Interest Income Recognized
<b>December 31, 2019</b>					
<b>Impaired loans without a related allowance for loan losses</b>					
Mortgage loans on real estate:					
Construction	\$ 366	\$ 366	\$ -	\$ 366	\$ -
Commercial real estate:					
Non-owner occupied	132	132	-	132	8
Owner occupied	1,137	1,137	-	1,143	55
Residential 1-4 family	247	247	-	226	10
Equity lines of credit	190	190	-	190	10
<b>Impaired loans with a related allowance for loan losses</b>					
Mortgage loans on real estate:					
Residential 1-4 family	1,037	1,037	155	1,048	55
Equity lines of credit	169	169	169	170	-
Commercial and industrial	8	8	8	83	-
<b>Total impaired loans</b>					
Mortgage loans on real estate:					
Construction	\$ 366	\$ 366	\$ -	\$ 366	\$ -
Commercial real estate:					
Non-owner occupied	132	132	-	132	8
Owner occupied	1,137	1,137	-	1,143	55
Residential 1-4 family	1,284	1,284	155	1,274	65
Equity lines of credit	359	359	169	360	10
Commercial and industrial	8	8	8	83	-
<b>Total impaired loans</b>	<b>\$ 3,286</b>	<b>\$ 3,286</b>	<b>\$ 332</b>	<b>\$ 3,358</b>	<b>\$ 138</b>

*Allowance for Loan Losses* - The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate for probable losses that have been incurred within the existing portfolio of loans. The primary risks inherent in the Bank's loan portfolio, including the adequacy of the allowance or reserve for loan losses, are based on management's assumptions regarding, among other factors, general and local economic conditions, which are difficult to predict and are beyond the Bank's control. In estimating these risks, and the related loss reserve levels, management also considers the financial conditions of specific borrowers and credit concentrations with specific borrowers, groups of borrowers, and industries.

The allowance for loan losses is adjusted by direct charges to provision expense. Losses on loans are charged against the allowance for loan losses in the accounting period in which they are determined by management to be uncollectible. Recoveries during the period are credited to the allowance for loan losses. The Bank realized provisions of \$921,000 and \$-0- for the years ended December 31, 2020 and 2019, respectively. The provision expense is determined by the Bank's allowance for loan losses model. The components of the model are specific reserves for impaired loans and a general allocation for unimpaired loans. The general allocation has three components, an estimate based on historical loss experience, an additional estimate based on internal and external environmental factors due to the uncertainty of historical loss experience in predicting current embedded losses in the portfolio that will be realized in the future and an unallocated portion to cover uncertainties that could affect management's estimate of probable losses.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 6 - Loans and Allowance for Loan Losses (continued)

In determining the general allowance allocation, the ratios from the actual loss history for the various categories are applied to the homogeneous pools of loans in each category.

The portion of the general allocation on environmental factors includes estimates of losses related to the following:

- Current national and local economic conditions
- Composition of the nature and volume of the portfolio
- Changes in the trend or volume of past due, watch list and classified loans
- The existence and effect of concentrations or changes in concentrations upon the portfolio
- The existence and effect of granularity in the size of credits in the portfolio
- The existence and effect of loan to values in excess of regulatory guidance – percentage of loans in each category with regulatory exceptions
- Cumulative effect of other factors such as loan portfolio quality, underwriting strength and general determinations about the portfolio held by executive management

Markets served by the Bank continue to experience some uncertainty from the general economy, a slow real estate market and many businesses impacted by the COVID-19 pandemic. Other factors impacting the allowance at December 31, 2020 were watch list trends, unemployment rate trends, government spending expectations and underwriting and servicing assessments.

The following table's present changes in the allowance for loan losses for the years ended December 31, 2020 and 2019:

	December 31, 2019	Charge-offs	Recoveries	Provision	December 31, 2020
	(in thousands)				
Mortgage loans on real estate:					
Construction	\$ 693	\$ -	\$ -	\$ (110)	\$ 583
Commercial real estate:					
Non-owner occupied	540	52	-	246	734
Owner occupied	1,132	-	-	678	1,810
Residential 1-4 family	760	-	41	(92)	709
Multifamily	51	-	21	33	105
Equity lines of credit	340	-	74	(252)	162
Commercial and industrial	1,219	-	4	16	1,239
Agricultural	413	-	-	59	472
Individuals	529	401	62	343	533
	<u>\$ 5,677</u>	<u>\$ 453</u>	<u>\$ 202</u>	<u>\$ 921</u>	<u>\$ 6,347</u>

## Farmers Bankshares, Inc.

### Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

#### Note 6 - Loans and Allowance for Loan Losses (continued)

	December 31, 2018	Charge-offs	Recoveries	Provision	December 31, 2019
			(in thousands)		
Mortgage loans on real estate:					
Construction	\$ 612	\$ -	\$ -	\$ 81	\$ 693
Commercial real estate:					
Non-owner occupied	494	-	-	46	540
Owner occupied	1,372	-	-	(240)	1,132
Residential 1-4 family	881	15	37	(143)	760
Multifamily	52	-	20	(21)	51
Equity lines of credit	431	-	12	(103)	340
Commercial and industrial	1,248	8	6	(27)	1,219
Agricultural	392	-	-	21	413
Individuals	434	313	22	386	529
	<u>\$ 5,916</u>	<u>\$ 336</u>	<u>\$ 97</u>	<u>\$ -</u>	<u>\$ 5,677</u>

The activity in the allowance for loan loss for 2020 and 2019 are summarized by loan class as follows:

	Reserves for loans individually evaluated for impairment	Loans individually evaluated for impairment	Reserves for loans collectively evaluated for impairment	Loans collectively evaluated for impairment
		(in thousands)		
<b>As of December 31, 2020</b>				
Mortgage loans on real estate:				
Construction	\$ -	\$ -	\$ 583	\$ 29,278
Commercial real estate:				
Non owner occupied	-	122	734	30,424
Owner occupied	-	1,101	1,810	77,243
Residential 1-4 family	78	887	631	30,258
Multifamily	-	-	105	5,725
Equity lines of credit	-	24	162	9,160
Commercial and industrial	2	2	1,237	52,750
Agricultural	-	-	472	24,502
Individuals	-	-	533	6,277
	<u>\$ 80</u>	<u>\$ 2,136</u>	<u>\$ 6,267</u>	<u>\$ 265,617</u>

## Farmers Bankshares, Inc.

### Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

#### Note 6 - Loans and Allowance for Loan Losses (concluded)

As of December 31, 2019	Reserves for loans individually evaluated for impairment	Loans individually evaluated for impairment	Reserves for loans collectively evaluated for impairment	Loans collectively evaluated for impairment
	(in thousands)			
Mortgage loans on real estate:				
Construction	\$ -	\$ 366	\$ 693	\$ 40,788
Commercial real estate:				
Non owner occupied	-	132	540	24,430
Owner occupied	-	1,137	1,132	58,174
Residential 1-4 family	155	1,284	605	33,474
Multifamily	-	-	51	4,436
Equity lines of credit	169	359	171	10,769
Commercial and industrial	8	8	1,211	57,981
Agricultural	-	-	413	24,642
Individuals	-	-	529	8,564
	\$ 332	\$ 3,286	\$ 5,345	\$ 263,258

#### Note 7 - Premises and equipment

At December 31, 2020 and 2019, premises and equipment consist of the following:

	2020	2019
Land	\$ 1,433,787	\$ 1,433,786
Buildings	8,432,870	8,038,388
Equipment, furniture and fixtures	3,106,662	3,147,967
Computer equipment	876,526	1,360,096
	13,849,845	13,980,237
Less accumulated depreciation	(7,573,326)	(8,184,337)
Total premises and equipment, net	\$ 6,276,519	\$ 5,795,900

For 2020 and 2019, depreciation charged to operating expense was \$530,173 and \$560,701, respectively.

#### Note 8 - Leases

The Company's long-term lease agreements are classified as operating leases. Certain of these leases offer the option to extend the lease term and the Company has included such extensions in its calculation of the lease liabilities to the extent the options are reasonably assured of being exercised. The lease agreements do not provide for residual value guarantees and have no restrictions or covenants that would impact dividends or require incurring additional financial obligations.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 8 – Leases (concluded)

The following tables present information about the Company's leases:

	December 31,	
	2020	2019
Lease liabilities	\$ 473,714	\$ 618,887
Right-of-use assets	497,152	657,157
Weighted average remaining lease term (in years)	4.38	3.36
Weighted average discount rate	5.50%	5.50%

### Lease Cost

	December 31,	
	2020	2019
Operating lease cost (1) included in occupancy and equipment expense	\$ 365,433	\$ 463,767
Total lease cost	\$ 365,433	\$ 463,767

(1) Includes short-term leases, which are immaterial.

A maturity analysis of operating lease liabilities and reconciliation of the undiscounted cash flows to the total of operating lease liabilities as of December 31, 2020 is as follow:

2020	\$ 179,471
2021	103,916
2022	94,833
2023	65,051
After 2023	86,430
Total lease payments	\$ 529,701
Less interest	(55,987)
Present value of lease liabilities	\$ 473,714

### Note 9 – Goodwill and intangible assets

The gross carrying amount and accumulated amortization for the Company's intangible assets as of December 31,

	2020		2019	
	Gross Carrying	Accumulated Amortization	Gross Carrying	Accumulated Amortization
<b>Intangible assets subject to amortization</b>				
Customer lists	\$ 5,392,879	\$ 1,170,222	\$ 5,392,879	\$ 810,695
Total intangible assets subject to amortization	5,392,879	1,170,222	5,392,879	810,695
Goodwill	6,027,286	-	6,027,286	-
<b>Total intangible assets</b>	\$ 11,420,165	\$ 1,170,222	\$ 11,420,165	\$ 810,695

Aggregate amortization expense for intangible assets with finite lives for the year ended December 31, 2020 was \$359,527, compared to \$360,002 for 2019. The estimated aggregate annual amortization expense for each of the five years subsequent to December 31, 2020, is \$359,525.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 9 – Goodwill and intangible assets (concluded)

Manry Rawls recorded \$0- in increases to goodwill and \$0- in intangible assets during 2020. During 2019, Manry Rawls recorded \$1,219,429 in increases to goodwill and \$1,131,000 in intangible assets from the acquisition of Carolina East Insurance Agency. The intangible assets acquired are finite-lived, consisting primarily of book-of-business purchases. No impairment charges were recorded in any year reported. Impairment testing indicated that goodwill was not impaired in 2020 or 2019.

Balance, December 31, 2019	<u>\$ 6,027,286</u>
Additions to goodwill	-
Other adjustments	-
<b>Balance, December 31, 2020</b>	<b><u>\$ 6,027,286</u></b>

### Note 10 - Non-marketable equity securities

Non-marketable equity securities consist of the following at December 31, 2020 and 2019:

	<u>2020</u>	<u>2019</u>
FHLB stock	\$ 853,900	\$ 1,068,100
FRB stock	414,750	403,550
Community Bankers' Bank stock	61,300	61,300
Plexus Captial, LLC	2,448,792	1,880,856
Tidewater Home Funding, LLC	1,456,609	828,611
Senior Housing Crime Prevention Foundation stock	500,000	500,000
Community Capital Funds	543,430	522,572
Total non-marketable equity securities	<u>\$ 6,278,781</u>	<u>\$ 5,264,989</u>

### Note 11 - Interest-bearing deposits

Interest-bearing deposits consist of the following at December 31, 2020 and 2019:

	<u>2020</u>	<u>2019</u>
NOW accounts	\$ 29,652,019	\$ 23,331,690
Money market accounts	114,308,682	90,327,858
Personal relationship checking	1,130,907	1,456,698
Business interest checking	25,654,809	23,017,893
Savings accounts	36,144,086	29,205,822
Certificates of deposits and IRAs \$250,000 and over	47,839,299	47,881,312
Certificates of deposit and IRAs under \$250,000	48,855,934	54,060,882
Total interest-bearing deposits	<u>\$ 303,585,736</u>	<u>\$ 269,282,155</u>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 11 - Interest-bearing deposits (concluded)

At December 31, 2020, the scheduled maturities of time deposits are as follows:

2021	\$ 55,641,323
2022	15,899,716
2023	13,664,687
2024	5,622,882
2025	5,166,550
Thereafter	700,075
Total time deposits	<u>\$ 96,695,233</u>

### Note 12 - Capital notes

During the second quarter of 2017, the Company closed the private placement of unregistered debt securities (the “2017 Offering”) pursuant to which the Company issued \$6.0 million in principal of notes (the “2017 Notes”). The 2017 Notes were not registered under the Securities Act of 1933 and could not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. The 2017 Notes bore interest at the rate of 3.25% per year with interest payable quarterly in arrears. The 2017 Notes had a maturity date of March 31, 2022, but were subject to prepayment in whole or in part on or after March 31, 2018 at the Company’s sole discretion on 30 days written notice to the holders. There were no assets pledged as collateral for the 2017 Notes.

In the third quarter of 2020, the Company closed the private placement of unregistered debt securities (the “2020 Offering”) pursuant to which the Company issued \$8.5 million in principal of notes comprised of two different maturity and rate terms (the “2020 Notes A” and “2020 Notes B”). The 2020 Notes A and B have not been and will not be registered under the Securities Act of 1933 and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. The 2020 Notes A and 2020 Notes B bear interest at the rate of 3.00% and 3.25%, respectively, per year with interest payable quarterly in arrears. The 2020 Notes A and 2020 Notes B mature on August 14, 2025 and August 14, 2027, respectively. Both notes permit prepayment in whole or in part on or after August 16, 2021 at the Company’s sole discretion on 30 days written notice to the holders. There are no assets pledged as collateral for the 2020 Notes A or 2020 Notes B. Of these capital notes, \$160 thousand and \$0- is due to executive officers and board members of the Company as of December 31, 2020 and 2019, respectively.

During 2020, the Company fully repaid the outstanding balance of the 2017 Notes totaling, \$6.0 million at the original investment price to extend the term of the capital structure.

There was \$1,200 and \$0- interest expense paid to these related parties on the capital notes for the years ended December 31, 2020 and 2019, respectively.

### Note 13 - Securities sold under agreements to repurchase and other borrowings

The Bank utilizes securities sold under agreement to repurchase to facilitate the needs of customers. Securities sold under agreements to repurchase, are classified as secured borrowings, generally mature within one day from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The average interest rate was 0.64% and 0.63% during the years ended December 31, 2020 and 2019, respectively.



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 13 - Securities sold under agreements to repurchase and other borrowings (continued)

The Bank monitors collateral levels on a continuous basis and maintains records of each transaction specifically describing the applicable security and the customer's fractional interest in that security, and the Bank segregates the security from its general assets in accordance with regulations governing custodial holding of securities. The primary risk with the Bank's repurchase agreements is market risk associated with the investments securing the transactions, as the Bank may be required to provide additional collateral based on air value changes of the underlying investments. Securities pledged as collateral under repurchase agreements are maintained with the Bank's safekeeping agent. The carrying value of available for sale investment securities pledged as collateral under repurchase agreement was \$8,011,482 and \$6,340,534 at December 31, 2020 and 2019, respectively.

The remaining contractual maturity of the securities sold under agreements to repurchase by class of collateral pledged included in short-term borrowings in the Consolidated Balance Sheets as of December 31, 2020 and December 31, 2019 is presented in the following tables.

December 31, 2020	Overnight and continuous	Up to 30 Days	30-90 Days	Greater than 90	Total
			(in thousands)		
Repurchase agreements:					
Small Business Administration Pools	\$ 6,637	\$ -	\$ -	\$ -	\$ 6,637
Total borrowings	\$ 6,637	\$ -	\$ -	\$ -	\$ 6,637
Gross amount of recognized liabilities for repurchase agreements					\$ 6,637

December 31, 2019	Overnight and continuous	Up to 30 Days	30-90 Days	Greater than 90	Total
			(in thousands)		
Repurchase agreements:					
Small Business Administration Pools	\$ 5,142	\$ -	\$ -	\$ -	\$ 5,142
Total borrowings	\$ 5,142	\$ -	\$ -	\$ -	\$ 5,142
Gross amount of recognized liabilities for repurchase agreements					\$ 5,142

The Bank has arrangements with various banks which enables the Bank to borrow up to \$30,000,000 in federal funds on an unsecured basis, at a variable rate. At December 31, 2020 and 2019, the Bank had no outstanding federal funds purchased.

The Bank also has arrangements with the FHLB which enables the Bank to borrow up to 25% of total assets.

At December 31, 2020 and 2019, FHLB advances were as follows:

#### December 31, 2020

Maturity date	Call Feature	Amount	Rate
March 29, 2021	-	\$ 10,000,000	0.230%
Total FHLB borrowings/weighted average rate		\$ 10,000,000	0.230%

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 13 - Securities sold under agreements to repurchase and other borrowings (concluded)

December 31, 2019

Maturity date	Call Feature	Amount	Rate
April 15, 2020	-	2,500,000	2.040%
July 29, 2020	-	5,000,000	1.944%
October 13, 2020	-	2,500,000	2.176%
May 17, 2021	-	5,000,000	1.953%
Total FHLB borrowings/weighted average rate		\$ 15,000,000	2.000%

The carrying value of loans pledged as collateral to the FHLB were \$20.7 million and \$24.6 million at December 31, 2020 and 2019, respectively.

During 2020, the Company prepaid \$15.0 million in FHLB advances with a weighted average rate of 2.00%. These advances were paid prior to their maturity date in order to enhance future earnings by way of reduction in interest expense. These repayments resulted in a prepayment penalty on borrowings equaling \$78,313. During 2019, the Company repaid \$10.0 million in FHLB advances at the maturity date with no penalties incurred.

### Note 14 - Employee benefit plans

*Profit sharing plan* - The Company has a profit sharing plan covering substantially all employees. Contributions to the plan are determined annually by the Compensation Committee and are the lesser of 10% of the participants' base compensation or 10% of the net income of the Company. Employee benefits expense included \$545,000 and \$534,705 for the plan for 2020 and 2019, respectively.

*Post-retirement benefits* - The Company has entered into deferred compensation arrangements with certain key personnel which call for the payment of benefits upon the retirement or death of the individuals. In 2016, the Company amended one of these plans and froze the other plan while creating a new plan for this executive, such that upon the executives' retirement, the Company will provide for a monthly retirement payment for their lifetime. The agreements provide that a retirement benefit is payable upon a defined normal retirement age while in service to the Company and a lesser benefit is payable upon early retirement. Other benefits are payable upon disability, death or change in control.

The agreements are unfunded arrangements maintained primarily to provide supplemental retirement benefits and comply with Section 409A of the Internal Revenue Code.

However, the Company has elected to finance the retirement benefits by purchasing annuities that have been designed to provide a future source of funds for the lifetime retirement benefits of the agreements. The primary impetus for utilizing these annuities is a substantial savings in compensation expense for the Company as opposed to a typically designed supplemental retirement plan.

The liabilities associated with these deferred compensation arrangements were \$1,721,538 and \$1,623,228 as of December 31, 2020 and 2019, respectively. The annuity had a balance of \$2,862,424 and \$2,913,142 as of December 31, 2020 and 2019, respectively, and is recorded at amortized cost. Salaries and employee benefits expense included \$123,310 and \$127,248 of expense related to these arrangements for 2020 and 2019, respectively.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 15 - Income taxes

The principal components of the income tax expense as of December 31, 2020 and 2019 are as follows:

	2020	2019
Federal - current tax expense	\$ 1,554,607	\$ 793,787
Federal - deferred tax benefit	(739,945)	(55,428)
	<u>\$ 814,662</u>	<u>\$ 738,359</u>

The differences between expected federal income taxes at statutory rates and actual income tax expense are summarized as follows:

	2020	2019
Income tax expense computed at federal statutory rate (21%)	\$ 1,404,239	\$ 1,280,291
Tax effects of:		
Tax-exempt interest	(444,552)	(448,840)
Non-taxable bank owned life insurance	(62,903)	(59,184)
Non-deductible expenses	13,501	19,808
Minority investment interest	(97,978)	(55,053)
Other	2,355	1,337
	<u>\$ 814,662</u>	<u>\$ 738,359</u>

The Company's deferred tax assets and liabilities and their components are included on the Consolidated Balance Sheets. The components of these deferred tax assets and liabilities are as follows:

	2020	2019
Deferred tax assets:		
Available-for-sale investment securities	\$ -	\$ -
Allowance for loan losses	1,332,785	663,634
Deferred compensation	361,523	340,878
Interest on non-performing loans	31,492	14,138
Other real estate owned	2,599	2,599
Other	77,020	68,827
Total deferred tax asset	<u>1,805,419</u>	<u>1,090,076</u>
Deferred tax liabilities:		
Available-for-sale investment securities	(1,670,624)	(696,955.00)
Accumulated depreciation	(223,515)	(159,624)
Accumulated accretion	(72,801)	(75,719)
Net unamortized deferred fees and expenses	(55,743)	(141,318)
Total deferred tax liability	<u>(2,022,683)</u>	<u>(1,073,616)</u>
Net deferred tax (liability) asset	<u>\$ (217,264)</u>	<u>\$ 16,460</u>

The Company measures deferred tax assets and liabilities using enacted tax rates that will apply in the years in which the temporary differences are expected to be recovered or paid.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 15 - Income taxes (concluded)

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax asset will not be realized. Management considers recoverable taxes paid in prior years, projected future taxable income, and tax planning strategies in making this assessment. It is management's belief that the realization of the net deferred tax assets is more likely than not.

The Company has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions.

The Company and its subsidiaries file income tax returns with the federal government. With few exceptions, the Company is no longer subject to federal income tax examinations by tax authorities for years before 2017.

### Note 16 - Related party transactions

In the ordinary course of business, the Company has loan and deposit transactions with its executive officers and directors, and with companies in which the officers and directors have a significant financial interest. These transactions are at substantially the same rates as similarly situated customers. A summary of related party loan activity during 2020 and 2019 is as follows:

	2020	2019
Beginning balance	\$ 7,165,329	\$ 5,424,545
Originations	4,743,576	2,930,229
Repayments	(2,716,878)	(1,189,445)
Ending balance	<u>\$ 9,192,027</u>	<u>\$ 7,165,329</u>

Commitments to extend credit to related parties amounted to \$7,219,970 and \$4,159,585 at December 31, 2020 and 2019, respectively.

Deposits from related parties held by the Bank amounted to \$12,287,475 and \$11,372,117 at December 31, 2020 and 2019, respectively.

The Bank currently has loans outstanding to Manry Rawls, LLC with a current principal balance of \$72,109 and \$845,567 as of December 31, 2020 and 2019, respectively. These loans are eliminated in consolidation. These loans are at substantially the same terms as similarly situated customers.

### Note 17 - Credit commitments and concentrations of credit risk

Commitments to extend credit are agreements to lend funds to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer. Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized, usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 17 - Credit commitments and concentrations of credit risk (concluded)

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year.

The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments if deemed necessary.

The Bank also has commitments, as detailed below, to invest in a private investment fund that focuses on investments and partnerships with middle market businesses that need capital for growth.

The amounts of loan commitments, guarantees and standby letters of credit are set out in the following table as of December 31, 2020 and 2019. Because many commitments and almost all standby letters of credit and guarantees expire without being funded in whole or in part, the contract amounts are not estimates of future cash flows. A summary of loan commitments and standby letters of credit, as well as capital commitments to investment funds in which the Company invests are as follows:

	2020	2019
Loan commitments	\$ 77,576,165	\$ 75,870,889
Standby letters of credit and guarantees written	6,628,859	6,802,069
Capital commitment to private investment funds	3,500,000	4,100,000

Standby letters of credit outstanding at December 31, 2020 expire between 2021 and 2023.

Loan commitments, standby letters of credit and written guarantees have off-balance sheet credit risk because only origination fees and accruals for probable losses, if any, are recognized in the statements of financial position until the commitments are fulfilled or the standby letters of credit or guarantees expire. Credit risk represents the accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted. The credit risk amounts are equal to the contractual amounts, assuming that the amounts are fully advanced and collateral or other security is of no value. The Bank's policy is to require customers to provide collateral prior to the disbursement of approved loans. For retail loans, the Bank usually retains a security interest in the property or products financed, which provides repossession rights in the event of default by the customer. For business loans and financial guarantees, collateral is usually in the form of inventory or marketable securities (held in trust) or property (notations on title).

Concentrations of credit risk (whether on or off-balance sheet) arising from financial instruments exist in relation to certain groups of customers. A group concentration arises when a number of counterparties have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. A group concentration exists as most of the Bank's customers are located within southeastern Virginia.

The credit risk amounts represent the maximum accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted and any collateral or security proved to be of no value. The Bank has experienced little difficulty in accessing collateral when required.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 18 - Regulatory matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weighting, and other factors.

In July 2013, the FDIC and other federal banking agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (commonly known as Basel III).

On January 1, 2015, the Bank became subject to the Basel III Capital Rules which revises definitions of regulatory capital, the new minimum regulatory capital ratios, and various regulatory capital adjustments and deductions according to transition provision and timelines. The revised rules now require the Bank to maintain (i) a minimum ratio of Common Tier 1 capital to risk-weighted assets of at least 4.5%, plus 2.5% "capital conservation buffer" (conservation buffer will be phased in), (ii) minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, (iii) a minimum ratio of total capital to risk-weighted assets of at 8.0%, and (iv) a minimum leverage ratio of 4.0%. A transition period for the capital conservation buffer under Basel III for all banking organizations began on January 1, 2016 and ended on January 1, 2019. The conservation buffer began at the 0.625% level and was phased in over a four-year period (increasing on each subsequent January 1, reaching 2.5% on January 1, 2019).

Management believes, as of December 31, 2020 and 2019, the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2020, the most recent notification from the Board of Governors of the Federal Reserve Board categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier I risk-based, Common Equity risk-based, and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Bank's actual capital amounts (dollars in thousands) and ratios are presented in the table below:

	Actual		For Capital Adequacy Purposes		Under Prompt Corrective Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2020:	<i>(Dollars in thousands)</i>					
Total Capital						
(to Risk-Weighted Assets)	\$ 58,491	16.0%	\$ 29,265	8.0%	\$ 36,581	10.0%
Tier I Risk-Based Capital						
(to Risk-Weighted Assets)	53,897	14.7%	21,948	6.0%	29,265	8.0%
Common Equity Risk-Based Capital						
(to Risk-Weighted Assets)	53,897	14.7%	16,461	4.5%	23,777	6.5%
Tier I Leverage Ratio						
(to Average Assets)	53,897	10.1%	21,375	4.0%	26,718	5.0%

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 18 - Regulatory matters (concluded)

	Actual		Adequacy Purposes		Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2019:			<i>(Dollars in thousands)</i>			
Total Capital						
(to Risk-Weighted Assets)	\$ 51,441	15.1%	\$ 27,265	8.0%	\$ 34,082	10.0%
Tier I Risk-Based Capital						
(to Risk-Weighted Assets)	47,164	13.8%	20,449	6.0%	27,265	8.0%
Common Equity Risk-Based Capital						
(to Risk-Weighted Assets)	47,164	13.8%	15,337	4.5%	22,153	6.5%
Tier I Leverage Ratio						
(to Average Assets)	47,164	10.3%	18,232	4.0%	22,790	5.0%

The above tables set forth the capital position and analysis for the Bank only. Because total assets on a consolidated basis are less than \$1 billion, the Company is not subject to the consolidated capital requirements imposed by the Bank Holding Company Act. Consequently, the Company does not calculate its financial ratios on a consolidated basis. If calculated, the capital ratios for the Company on a consolidated basis would no longer be comparable to the capital ratios of the Bank because the proceeds of the capital notes do not qualify as equity capital on a consolidated basis.

### Note 18 - Fair value measurements

The Company refers to the *Fair Value Measurements and Disclosures* Topic of the FASB Accounting Standards Codification (ASC 820) to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. This guidance clarifies that fair value of certain assets and liabilities is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

The fair market value measurement specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions.

The three levels of the fair value hierarchy are based on these two types of inputs are as follows:

Level 1 - Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 - Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 - Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 19 - Fair value measurements (continued)

The following describes the valuation techniques used by the Company to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the consolidated financial statements:

*Securities available for sale* - Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that considers observable market data (Level 2).

The following table presents the balances of available-for-sale securities measured at fair value on a recurring basis as of December 31, 2020 and 2019:

Description	Balance as of December 31, 2020	Level 1	Level 2	Level 3
State and municipal	\$ 83,665,162	\$ -	\$ 83,665,162	\$ -
Residential mortgage-backed securities	62,291,407	-	62,291,407	-
Collateralized mortgage obligations	29,163,983	-	29,163,983	-
Small Business Administration loan securities	28,645,712	-	28,645,712	-
	<u>\$ 203,766,264</u>	<u>\$ -</u>	<u>\$ 203,766,264</u>	<u>\$ -</u>

Description	Balance as of December 31, 2019	Level 1	Level 2	Level 3
State and municipal	\$ 54,136,880	\$ -	\$ 54,136,880	\$ -
Residential mortgage-backed securities	38,758,106	-	38,758,106	-
Collateralized mortgage obligations	41,200,854	-	41,200,854	-
Small Business Administration loan securities	11,203,790	-	11,203,790	-
	<u>\$ 145,299,630</u>	<u>\$ -</u>	<u>\$ 145,299,630</u>	<u>\$ -</u>

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets. The following describes the valuation techniques used by the Company to measure certain financial assets recorded at fair value on a nonrecurring basis in the consolidated financial statements:



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 19 - Fair value measurements (continued)

*Derivatives* – Derivative instruments include interest rate swap agreements. Fair values for these instruments are based on quoted market prices, when available. As such, the fair value adjustments for derivatives with fair values based on quoted market prices in an active market are recurring Level 1.

Description	Balance as of December 31, 2020	Level 1	Level 2	Level 3
Cash Flow Hedges				
Interest rate swaps	\$ 56,295	\$ -	\$ 56,295	\$ -
	\$ 56,295	\$ -	\$ 56,295	\$ -

*Impaired Loans* - Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on the observable market price of the loan, the fair value of the collateral or by using the discounted cash flow method. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate.

The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company. The Company records impaired loans secured by real estate as Level 3 assets. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports are recorded as Level 3 assets. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Statements of Operations.

*Other real estate owned* - Other real estate owned is considered held for sale and is adjusted to fair value less estimated selling costs upon transfer of the loan to foreclosed assets. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. The Company considers the other real estate owned as nonrecurring Level 3.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 19 - Fair value measurements (continued)

The following table summarizes the Company's financial assets that were measured at fair value on a nonrecurring basis during the periods.

Description	Balance as of December 31, 2020	Level 1	Level 2	Level 3
Assets				
Other real estate owned	\$ 672,404	\$ -	\$ -	\$ 672,404
Impaired loans	2,055,237	-	-	2,055,237
Total assets	<u>\$ 2,727,641</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,727,641</u>

Description	Balance as of December 31, 2019	Level 1	Level 2	Level 3
Assets				
Other real estate owned	\$ 672,404	\$ -	\$ -	\$ 672,404
Impaired loans	2,953,660	-	-	2,953,660
Total assets	<u>\$ 3,626,064</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,626,064</u>

The following table summarized quantitative information about Level 3 fair value measurements:

Description	Fair Value at December 31, 2020	Valuation Technique	Unobservable Input	Range (Weighted Average)
Assets				
Other real estate owned	\$ 672,404	Discounted appraisals	Collateral discounts	10-20%
Impaired loans	2,055,237	Discounted appraisals	Collateral discounts	10-30%
Total assets	<u>\$ 2,727,641</u>			

Description	Fair Value at December 31, 2019	Valuation Technique	Unobservable Input	Range (Weighted Average)
Assets				
Other real estate owned	\$ 672,404	Discounted appraisals	Collateral discounts	10-20%
Impaired loans	2,953,660	Discounted appraisals	Collateral discounts	10-30%
Total Assets	<u>\$ 3,626,064</u>			

The following table presents the carrying amounts and fair value of the Company's financial instruments as of December 31, 2020 and 2019. FASB Accounting Standards Codification's *Financial Instruments* (ASC 825), defines the fair value of financial instruments as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The carrying amounts in the table are included in the balance sheets under the indicated captions. The capital notes are valued at amortized cost based on the lack of marketability due to transfer restrictions.

## Farmers Bankshares, Inc.

### Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

#### Note 19 - Fair value measurements (concluded)

	2020		2019	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
	<i>(Dollars in thousands)</i>			
Financial assets:				
Cash and cash equivalents	\$ 28,557	\$ 28,557	\$ 31,120	\$ 31,120
Investment securities, available-for-sale	203,766	203,766	145,300	145,300
Loans held for investment & SBA PPP loans receivable, net	278,662	290,205	261,064	267,523
Accrued interest receivable	1,942	1,942	1,807	1,807
Bank-owned annuity contract	2,862	2,862	2,913	2,913
Financial liabilities:				
Demand deposits, NOW, savings and money market accounts	356,527	356,043	284,685	283,263
Time deposits	96,695	97,627	101,942	102,132
Accrued interest payable	169	169	299	299
FHLB Advances	10,000	10,296	15,000	14,977
Capital notes	8,500	7,018	6,000	5,809
Derivative liabilities	56	56	-	-
Securities sold under agreement to repurchase	6,637	6,637	5,142	5,142

#### Note 20 - Stock incentive plan

The Company's shareholders approved a stock incentive plans effective January 1, 2018 and previously January 1, 2007. The plans authorize the grant of awards for a period of ten years, which expires on December 31, 2028 and previously December 31, 2017. The number of shares authorized for issuance under both of the plans is limited to 2.25% of the total authorized and unissued shares of common stock. Three types of awards may be granted under the plans: Incentive Stock Options, Nonqualified Stock Options and Restricted Stock. The Company granted restricted stock awards during 2020 and 2019. The Company accounts for this plan in accordance with the *Stock Compensation* Topic of the FASB Accounting Standards Codification (ASC 718). The non-vested equity share or non-vested equity share unit awarded to an employee is measured at its fair value on the grant date. The compensation expense is recognized over the requisite service period.

The vesting requirements range from three to four years. The compensation expense recognized for the years ended December 31, 2020 and 2019 was \$231,749 and \$220,155, respectively. Members of the Board of Directors of the Company can elect to receive a portion or all of their director's fees in the form of common stock. During the year ended December 31, 2020 and 2019, the expense related to these issuances was \$66,525 and \$82,525, respectively.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 20 - Stock incentive plan (concluded)

A summary of the status of the non-vested shares in relation to our restricted stock awards as of December 31, 2020 and 2019, and changes during the years ended December 31, 2020 and 2019, is presented below; the weighted average price is the weighted average fair value at the date of grant:

Restricted Share Awards	2020		2019	
	Shares	Weighted Average Price	Shares	Weighted Average Price
Nonvested - Beginning of the year	27,853	\$ 16.33	17,806	\$ 15.54
Granted	12,944	16.87	12,316	17.32
Vested	16,276	18.60	2,072	17.09
Forfeited	285	17.57	197	17.30
Nonvested - End of year	24,236	\$ 17.10	27,853	\$ 16.33

### Note 21 - Earnings per share

The following shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of diluted potential common stock. Potential dilutive common stock had no effect on income attributable to common shareholders.

	2020	2019
<b>Basic</b>		
Net income attributable to common shareholders	\$ 5,405,629	\$ 5,096,105
Average common shares outstanding	3,104,776	3,087,868
Basic earnings per share amount	\$ 1.74	\$ 1.65
<b>Diluted</b>		
Net income attributable to common shareholders	\$ 5,405,629	\$ 5,096,105
Average common shares outstanding	3,104,776	3,087,868
Effect of dilutive unvested restricted stock awards	-	2,741
Average diluted shares outstanding	3,104,776	3,090,609
Diluted earnings per share	\$ 1.74	\$ 1.65

### Note 22 - Condensed financial statements of parent company

On July 26, 2013, the Board of Directors of the Bank approved an Agreement and Plan of Reorganization and Share Exchange (the "Agreement") whereby the Bank would become a subsidiary of Farmers Bankshares, Inc., a company incorporated in Virginia on July 26, 2013 for the purpose of becoming a holding company for the Bank. The Agreement provided for the statutory share exchange of all of the Bank's common stock held by stockholders for the common stock of Farmers Bankshares, Inc., on a one-for-one basis.

The Agreement was approved by the Bank's stockholders at a special meeting of the Bank's stockholders held on September 26, 2013 (the "Special Stockholders' Meeting"). The holding company reorganization was consummated on December 31, 2013 (see Note 1). Prior to the holding company reorganization, Farmers Bankshares, Inc. conducted no operations other than obtaining regulatory approval for the holding company reorganization. As this event is considered reorganization under common control, the consolidated financial statements, discussion of the statements and all other information presented herein for the years ended December 31, 2020 and 2019 are presented for the Company as a consolidated entity.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 22 – Condensed financial statements of parent company (concluded)

Financial information pertaining only to Farmers Bankshares, Inc. is as follows:

#### Balance Sheets

	December 31,	
	2020	2019
<b>Assets</b>		
Cash	\$ 1,466,093	\$ 1,066,093
Taxes receivable	770,292	723,316
Investment in Farmers Bank	70,487,898	60,394,602
Other assets	369,740	367,394
<b>Total assets</b>	<b>\$ 73,094,023</b>	<b>\$ 62,551,405</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
Capital notes	\$ 8,500,000	\$ 6,000,000
Other liabilities	404,180	367,394
<b>Total liabilities</b>	<b>8,904,180</b>	<b>6,367,394</b>
<b>Stockholders' equity</b>		
Common stock	388,559	386,518
Capital surplus	3,357,318	3,000,031
Retained earnings	54,102,943	50,175,584
Accumulated other comprehensive income	6,341,023	2,621,878
<b>Total stockholders' equity</b>	<b>64,189,843</b>	<b>56,184,011</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 73,094,023</b>	<b>\$ 62,551,405</b>

#### Statements of Operations

	December 31,	
	2020	2019
<b>Assets</b>		
<b>Income</b>	\$ 2,067,529	\$ 1,603,174
<b>Operating expenses</b>		
Interest expense	223,699	195,000
<b>Total expenses</b>	<b>223,699</b>	<b>195,000</b>
<b>Allocated income tax benefits</b>	<b>(46,977)</b>	<b>(40,951)</b>
<b>Income before equity in undistributed income of subsidiary</b>	<b>1,890,807</b>	<b>1,449,125</b>
<b>Equity in undistributed income - Farmers Bank</b>	<b>3,514,822</b>	<b>3,646,980</b>
<b>Net income</b>	<b>\$ 5,405,629</b>	<b>\$ 5,096,105</b>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 22 – Condensed financial statements of parent company (concluded)

#### Statements of Cash Flows

	Years Ended December 31,	
	2020	2019
<b>Cash flows from operating activities</b>		
Net income	\$ 5,405,629	\$ 5,096,105
Adjustments to reconcile net income to net cash provided by operating activities		
Taxes receivable	(46,976)	(40,952)
Other assets	(2,346)	(31,007)
Other liabilities	36,785	-
Equity in undistributed net income of Farmers Bank	(3,514,822)	(3,646,980)
<b>Net cash provided by operating activities</b>	<u>1,878,270</u>	<u>1,377,166</u>
<b>Cash flows from investing activities</b>		
Investment in Farmers Bank	(2,500,000)	-
<b>Net cash used by investing activities</b>	<u>(2,500,000)</u>	<u>-</u>
<b>Cash flows from financing activities</b>		
Cash dividends paid on common shares	(1,478,270)	(1,377,166)
Proceeds from capital notes issued	8,500,000	-
Redemption of capital notes	(6,000,000)	-
<b>Net cash provided (used) in financing activities</b>	<u>1,021,730</u>	<u>(1,377,166)</u>
<b>Increase in cash and cash equivalents</b>	400,000	-
<b>Cash and cash equivalents</b>		
Beginning of the year	<u>1,066,093</u>	<u>1,066,093</u>
End of year	<u>\$ 1,466,093</u>	<u>\$ 1,066,093</u>

### Note 23 – Revenue from Contracts with Customers

All of the Company's revenue from contracts with customers in the scope of ASC 606 is recognized within Non-Interest Income. A description of the Company's revenue streams accounted for under ASC 606 is as follows:

*Service Charges on Deposit Accounts* - Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, and other deposit account related fees. The Company's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Other deposit account related fees are largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

*Other Service Charges, Commissions and Fees* - Other service charges, commissions and fees are primarily comprised of debit card income, ATM fees, merchant services income, and other service charges. Debit card income is primarily comprised of interchange fees earned whenever the Company's debit and credit cards are processed through card payment networks. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2020 and 2019

### Note 23 – Revenue from Contracts with Customers (concluded)

Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. Other service charges include revenue from processing wire transfers, safe deposit box rentals, cashier's checks, and other services. The Company's performance obligation for other service charges, commission and fees are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

*Insurance Commissions* - Insurance income primarily consists of commissions received on insurance product sales. The Company acts as an intermediary between the Company's customer and the insurance carrier. The Company's performance obligation is generally satisfied upon the issuance of the insurance policy. Shortly after the insurance policy is issued, the carrier remits the commission payment to the Company, and the Company recognizes the revenue.

*Gain on Sales of OREO* - The Company records a gain or loss from the sale of other real estate owned when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of other real estate owned to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the other real estate owned asset is derecognized and the gain on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain on the sale, the Company adjusts the transaction price and related gain on sale if a significant financing component is present.

The following table presents the Company's sources of Non-Interest Income for the twelve months ended December 31, 2020 and 2019. Items outside the scope of ASC 606 are noted as such.

	2020	2019
<b>Non-interest income</b>		
Service charges on deposits		
Overdraft fees	\$ 261,607	\$ 367,172
Other	195,382	210,684
Income from automated teller machines and bank card interchange	578,673	576,109
Insurance commissions	6,348,498	5,554,730
Net gain on disposition of securities (outside of scope)	607,090	336,269
Income on bank owned life insurance (outside of scope)	299,617	305,307
Other income (outside of scope)	1,300,472	363,080
Total non-interest income	<u>\$ 9,591,339</u>	<u>\$ 7,713,351</u>

On January 1, 2019, the Company recorded a net increase to beginning retained earnings of \$1,456,160 due to the cumulative impact of adopting the standard. The adoption did not have a significant impact on the Company's Consolidated Financial Statements for the year ended December 31, 2019 and, as a result, comparisons of revenues and operating profit performance between periods are not materially affected by the adoption of this ASU.

### Note 24 – Subsequent events

The Company has evaluated subsequent events through March 9, 2021, in connection with the preparation of these financial statements which is the date the financial statements were available to be issued. On February 26, 2021, The Company elected to terminate its interest rate swap agreement and unwind the derivative held. As a result of the termination, the Company received a termination payment of \$427,850. This gain will be recognized into income immediately following the termination. The event did not have a material impact on the fair presentation of the financial statements as of December 31, 2020.

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## BRANCH LOCATIONS

### **Chesapeake**

821 North Battlefield Boulevard

### **Courtland**

28319 Southampton Parkway, Suite D

### **Smithfield**

1119 South Church Street, PO Box 888

### **Suffolk – Harbour View**

6255 College Drive, Suite L

### **Suffolk – Hillpoint**

3100 Godwin Boulevard

### **Suffolk – Lakeside**

1008 West Washington Street

### **Windsor**

50 East Windsor Boulevard, PO Box 285

### **Virginia Beach – Pungo**

1776 Princess Anne Road, Unit S

**[www.farmersbankva.com](http://www.farmersbankva.com)**

**757-242-6111**



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