

ANNUAL REPORT | 2013



PRIME  
MERIDIAN  
HOLDING COMPANY



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## Dear Friends and Shareholders,

Since our beginning six years ago, we have never been more excited to report the forward strides the Company has made.

- Total assets of the Company were \$206.5 million as of December 31, 2013, up from \$169.7 million as of December 31, 2012.
- Net Income for the year ended December 31, 2013 was \$1.1 million, an increase of 12.9% over the year ended December 31, 2012. The increase was driven by a 25.8% increase in Loan Interest Income and a 12.9% decrease in Total Interest Expense.

The year yielded many extraordinary accomplishments:

- Prime Meridian Holding Company became a public company.
- A \$15 million stock offering was initiated.\*
- Renovations completed, we now occupy the second floor of our 1897 Capital Circle NE location, new home to executive management and bank operations.
- A newly designed website – including a robust investor relations area – was released.
- Mobile Banking and Check Deposit Apps, as well as Instant Issue Debit Cards, became operational.

We submitted our Form S-1 (a formal registration statement filing) and obtained a Securities and Exchange Commission notice of effectiveness on December 11, 2013. This marked a milestone in the life of Prime Meridian Holding Company as a public company and the beginning of our public offering of common stock.

The purpose of the capital raise is to fund organic growth and to position the Company for potential acquisitions or future expansion over the next 18 months.

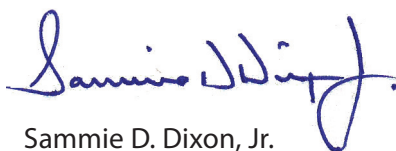
In July, Prime Meridian Bank was the featured cover article in an issue of *Florida Banking Magazine*. The article recognized our growth and our “earned” reputation for asset quality and the strong leadership of our executive management team.

Our reputation as a steady, safe and sound institution are by-products of our ongoing efforts to nurture and imprint our culture as we continue to grow, while adhering to our five core principles of Passion, Grace, Integrity, Tenacity, and Accountability.

Though the impacts of local, regional, and national forces on our region’s economy are still being evaluated, we remain optimistic the Company will maintain momentum and the financial strength to grow and thrive.

We deeply value our original shareholders and appreciate the confidence of our new shareholders as we move forward.

Warm regards,



Sammie D. Dixon, Jr.  
Chief Executive Officer



Richard A. Weidner, CPA  
Chairman of the Board



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\*The offering commenced December 11, 2013, and continues on an ongoing basis until terminated earlier or extended by the Board of Directors to a date no later than June 30, 2014.



## **Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Prime Meridian Holding Company  
Tallahassee, Florida:

We have audited the accompanying consolidated balance sheets of Prime Meridian Holding Company and Subsidiary (the "Company") as of December 31, 2013 and 2012, and the related consolidated statements of earnings, comprehensive income, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company at December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

HACKER, JOHNSON & SMITH PA  
Tampa, Florida  
March 28, 2014

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Consolidated Balance Sheets**  
(\$ in thousands, except per share amounts)

	<u>At December 31,</u>	
	<u>2013</u>	<u>2012</u>
<b>Assets</b>		
Cash and due from banks	\$ 5,033	2,920
Federal funds sold	147	148
Interest-bearing deposits	<u>28,986</u>	<u>23,430</u>
Total cash and cash equivalents	34,166	26,498
Securities available for sale	44,071	43,805
Loans, net of allowance for loan losses of \$1,734 and \$1,243	121,370	93,400
Federal Home Loan Bank stock	204	209
Premises and equipment, net	3,757	3,437
Deferred tax asset	426	-
Accrued interest receivable	516	422
Bank-owned life insurance	1,562	1,507
Capitalized offering costs	218	-
Other assets	<u>183</u>	<u>380</u>
Total assets	\$ <u>206,473</u>	<u>169,658</u>
<b>Liabilities and Stockholders' Equity</b>		
Liabilities:		
Noninterest-bearing demand deposits	59,011	29,328
Savings, NOW and money-market deposits	109,760	100,885
Time deposits	<u>14,594</u>	<u>16,516</u>
Total deposits	183,365	146,729
Other borrowings	5,719	5,760
Official checks	636	712
Deferred tax liability	-	252
Other liabilities	<u>392</u>	<u>166</u>
Total liabilities	<u>190,112</u>	<u>153,619</u>
Commitments and contingencies (Notes 4, 8 and 15)		
Stockholders' equity:		
Preferred stock, undesignated; 1,000,000 shares authorized, none issued or outstanding	-	-
Common stock, \$.01 par value; 9,000,000 shares authorized, 1,498,937 and 1,496,106 issued and outstanding	15	15
Additional paid-in capital	14,929	14,896
Retained earnings	1,732	583
Accumulated other comprehensive (loss) income	<u>(315)</u>	<u>545</u>
Total stockholders' equity	<u>16,361</u>	<u>16,039</u>
Total liabilities and stockholders' equity	\$ <u>206,473</u>	<u>169,658</u>

See Accompanying Notes to Consolidated Financial Statements.

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Consolidated Statements of Earnings**  
(In thousands, except per share amounts)

	<u>Year Ended December 31,</u>	
	<u>2013</u>	<u>2012</u>
Interest income:		
Loans	\$ 6,076	4,831
Securities	838	864
Other	<u>56</u>	<u>45</u>
Total interest income	<u>6,970</u>	<u>5,740</u>
Interest expense:		
Deposits	646	747
Other borrowings	<u>58</u>	<u>61</u>
Total interest expense	<u>704</u>	<u>808</u>
Net interest income	6,266	4,932
Provision for loan losses	<u>513</u>	<u>473</u>
Net interest income after provision for loan losses	<u>5,753</u>	<u>4,459</u>
Noninterest income:		
Service charges and fees on deposit accounts	104	103
Gain on sale of securities available for sale	14	881
Gain on sale of loans	250	-
Income from bank-owned life insurance	55	7
Other income	<u>436</u>	<u>259</u>
Total noninterest income	<u>859</u>	<u>1,250</u>
Noninterest expenses:		
Salaries and employee benefits	2,650	2,082
Occupancy and equipment	897	856
Professional fees	128	137
External data processing	-	47
Advertising	170	160
Other	<u>1,016</u>	<u>820</u>
Total noninterest expenses	<u>4,861</u>	<u>4,102</u>
Earnings before income taxes	1,751	1,607
Income taxes	<u>602</u>	<u>589</u>
Net earnings	<u>\$ 1,149</u>	<u>1,018</u>
Basic earnings per share	<u>\$ 0.77</u>	<u>0.68</u>
Diluted earnings per share	<u>\$ 0.76</u>	<u>0.68</u>
Cash dividends per common share	<u>\$ -</u>	<u>-</u>

See Accompanying Notes to Consolidated Financial Statements.

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Consolidated Statements of Comprehensive Income**  
**(In thousands)**

	<b><u>Year Ended December 31,</u></b>	
	<b><u>2013</u></b>	<b><u>2012</u></b>
Net earnings	\$ <u>1,149</u>	<u>1,018</u>
Other comprehensive loss:		
Change in unrealized gain on securities:		
Unrealized (loss) gain arising during the year	(1,349)	751
Reclassification adjustment for realized gains	<u>(14)</u>	<u>(881)</u>
Net change in unrealized (loss) gain	(1,363)	(130)
Deferred income taxes (benefit) on above change	<u>503</u>	<u>48</u>
Total other comprehensive loss	<u>(860)</u>	<u>(82)</u>
Comprehensive income	\$ <u>289</u>	<u>936</u>

See Accompanying Notes to Consolidated Financial Statements.

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Consolidated Statements of Stockholders' Equity**

**Years Ended December 31, 2013 and 2012**

(\$ in thousands, except share amounts)

	<u>Common Stock</u>		<u>Additional</u>	<u>Accumulated</u>	<u>Accumulated</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Paid-In</u>	<u>(Deficit)</u>	<u>Other</u>	<u>Stockholders'</u>
			<u>Capital</u>	<u>Earnings</u>	<u>Income</u>	<u>Equity</u>
					<u>(Loss)</u>	
Balance at December 31, 2011	1,496,106	\$ 15	14,889	(435)	627	15,096
Net earnings	-	-	-	1,018	-	1,018
Net change in unrealized gain on available for sale securities, net of income tax of \$48	-	-	-	-	(82)	(82)
Stock-based compensation	<u>-</u>	<u>-</u>	<u>7</u>	<u>-</u>	<u>-</u>	<u>7</u>
Balance at December 31, 2012	1,496,106	15	14,896	583	545	16,039
Net earnings	-	-	-	1,149	-	1,149
Net change in unrealized gain on available for sale securities, net of income tax of \$503	-	-	-	-	(860)	(860)
Common stock issued as compensation to directors	2,831	-	30	-	-	30
Stock-based compensation	<u>-</u>	<u>-</u>	<u>3</u>	<u>-</u>	<u>-</u>	<u>3</u>
Balance at December 31, 2013	<u>1,498,937</u>	<u>\$ 15</u>	<u>14,929</u>	<u>1,732</u>	<u>(315)</u>	<u>16,361</u>

See Accompanying Notes to Consolidated Financial Statements.

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Consolidated Statements of Cash Flows**  
(In thousands)

	<b>Year Ended</b>	
	<b>December 31,</b>	
	<b><u>2013</u></b>	<b><u>2012</u></b>
Cash flows from operating activities:		
Net earnings	\$ 1,149	1,018
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	360	388
Provision for loan losses	513	473
Net amortization of deferred loan fees	(91)	(75)
Deferred income taxes (benefit)	(175)	177
Gain on sale of securities available for sale	(14)	(881)
Amortization of premiums, discounts on securities available for sale	455	386
Proceeds from the sale of loans held for sale	2,182	-
Gain on sale of loans held for sale	(250)	-
Loan originated as held for sale	(2,082)	-
Stock issued as compensation to directors	30	-
Stock-based compensation expense	3	7
Income from bank-owned life insurance	(55)	(7)
Net increase in accrued interest receivable	(94)	(64)
Increase in capitalize offering cost	(218)	-
Net decrease (increase) in other assets	197	(230)
Net increase in other liabilities and official checks	<u>150</u>	<u>394</u>
Net cash provided by operating activities	<u>2,060</u>	<u>1,586</u>
Cash flows from investing activities:		
Loan originations, net of principal repayments	(28,242)	(17,120)
Purchase of securities available for sale	(11,650)	(23,966)
Principal repayments of securities available for sale	8,082	6,853
Proceeds from the sales of securities available for sale	1,498	13,594
Redemption of Federal Home Loan Bank stock	5	63
Purchase of premises and equipment	(680)	(832)
Purchase of bank-owned life insurance	<u>-</u>	<u>(1,500)</u>
Net cash used in investing activities	<u>(30,987)</u>	<u>(22,908)</u>
Cash flows from financing activities:		
Net increase in deposits	36,636	31,156
Decrease in Federal Home Loan Bank advances	-	(2,000)
Increase (decrease) in other borrowings	<u>(41)</u>	<u>(367)</u>
Net cash provided by financing activities	<u>36,595</u>	<u>28,789</u>
Net increase in cash and cash equivalents	7,668	7,467
Cash and cash equivalents at beginning of year	<u>26,498</u>	<u>19,031</u>
Cash and cash equivalents at end of year	\$ <u>34,166</u>	<u>26,498</u>

(continued)



**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Consolidated Statements of Cash Flows, Continued**  
**(In thousands)**

	<u>Year Ended</u> <u>December 31,</u>	
	<u>2013</u>	<u>2012</u>
Supplemental disclosure of cash flow information		
Cash paid during the year for:		
Interest	\$ <u>708</u>	<u>832</u>
Income taxes	\$ <u>452</u>	<u>645</u>
Noncash transaction-		
Accumulated other comprehensive (loss) income, net change in unrealized gain on sale of securities available for sale, net of taxes	\$ <u>(860)</u>	<u>(82)</u>

See Accompanying Notes to Consolidated Financial Statements.

# PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

## Notes to Consolidated Financial Statements

At December 31, 2013 and 2012 and for the Years Then Ended

### (1) Summary of Significant Accounting Policies

**Organization.** Prime Meridian Holding Company (the "Holding Company") owns 100% of the outstanding common stock of Prime Meridian Bank (the "Bank") (collectively the "Company"). The Holding Company's primary activity is the operation of the Bank. The Bank is a state (Florida)-chartered commercial bank. The deposit accounts of the Bank are insured up to the applicable limits by the Federal Deposit Insurance Corporation ("FDIC"). The Bank offers a variety of community banking services to individual and corporate customers through two banking offices located in Tallahassee, Florida.

The following is a description of the significant accounting policies and practices followed by the Company, which conform to accounting principles, generally accepted in the United States of America ("GAAP") and prevailing practices within the banking industry.

**Use of Estimates.** In preparing consolidated financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses.

**Principles of Consolidation.** The consolidated financial statements include the accounts of the Holding Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

**Cash and Cash Equivalents.** For purposes of the statement of cash flows, cash and cash equivalents include cash and balances due from banks, federal funds sold and interest-bearing deposits, all of which have original maturities of less than ninety days.

At December 31, 2013 and 2012, the Company was required by law or regulation to maintain cash reserves with the Federal Reserve Bank, in accounts with other banks or in the vault in the amounts of \$986,000 and \$692,000, respectively.

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# PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

## Notes to Consolidated Financial Statements, Continued

### (1) Summary of Significant Accounting Policies, Continued

**Securities.** Securities may be classified as either trading, held to maturity or available for sale. Trading securities are held principally for resale and recorded at their fair values. Unrealized gains and losses on trading securities are included immediately in earnings. Held-to-maturity securities are those which the Company has the positive intent and ability to hold to maturity and are reported at amortized cost. Available-for-sale securities consist of securities not classified as trading securities nor as held-to-maturity securities. Unrealized holding gains and losses on available-for-sale securities are excluded from operations and reported in accumulated other comprehensive income (loss). Gains and losses on the sale of available-for-sale securities are recorded on the trade date determined using the specific-identification method. Premiums and discounts on securities available for sale are recognized in interest income using the interest method over the period to maturity.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

**Loans Held for Sale.** Loans held for sale include mortgage loans and Small Business Administration ("SBA") loans originated which are intended for sale in the secondary market and are carried at the lower of book value or estimated fair value in the aggregate. At December 31, 2013 loans held for sale were \$150,000. There were no loans held for sale on December 31, 2012. Loans held for sale are included in loans at December 31, 2013 and 2012.

**Loans.** Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs.

Commitment and loan origination fees are capitalized and certain direct origination costs are deferred. Both are recognized as an adjustment of the yield of the related loan.

The accrual of interest on all portfolio classes is discontinued at the time the loan is ninety days delinquent unless the loan is well collateralized and in process of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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# PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

## Notes to Consolidated Financial Statements, Continued

### (1) Summary of Significant Accounting Policies, Continued

*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 uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. There were no changes in the Company's accounting policies or methodology during the year ended December 31, 2013.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability 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 specific and general components. The specific component relates to loans that are considered impaired. For such loans, an allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. The general component covers all other loans and is based on the following factors:

The historical loss component of the allowance is determined by losses recognized by portfolio segment over the preceding three years. This is supplemented by the risks for each portfolio segment. Risk factors impacting loans in each of the portfolio segments include any deterioration of property values, reduced consumer and business spending as a result of continued high unemployment and reduced credit availability and lack of confidence in a sustainable recovery. The historical experience is adjusted for the following qualitative factors: (a) changes in lending policies and procedures, risk selection and underwriting standards; (b) changes in national, regional and local economic conditions that affect the collectability of the loan portfolio; (c) changes in the experience, ability and depth of lending management and other relevant staff; (d) changes in the volume and severity of past due loans, nonaccrual loans or loans classified special mention, substandard, doubtful or loss; (e) quality of loan review and Board of Directors oversight; (f) changes in the nature and volume of the loan portfolio and terms of loans; (g) the existence and effect of any concentrations of credit and changes in the level of such concentrations; (h) the effect of other external factors, trends or uncertainties that could affect management's estimate of probable losses, such as competition and industry conditions.

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# PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

## Notes to Consolidated Financial Statements, Continued

### (1) Summary of Significant Accounting Policies, Continued

***Allowance for Loan Losses, Continued.*** A loan is considered impaired when, based on current information and events, it is probable that the Company 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. Impairment is measured on a loan by loan basis for all loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral-dependent.

***Premises and Equipment.*** Land is stated at cost. Buildings, leasehold improvements, furniture, fixtures and equipment, and software are stated at cost less accumulated depreciation and amortization. Depreciation and amortization expense are computed using the straight-line method over the estimated useful life of each type of asset, or the lease term if shorter.

***Transfer of Financial Assets.*** Transfers of financial assets or a participating interest in an entire financial asset are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. A participating interest is a portion of an entire financial asset that (1) conveys proportionate ownership rights with equal priority to each participating interest holder (2) involves no recourse (other than standard representations and warranties) to, or subordination by, any participating interest holder, and (3) does not entitle any participating interest holder to receive cash before any other participating interest holder.

***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, construction loans in process, unused lines of credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded.

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## PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

### Notes to Consolidated Financial Statements, Continued

#### (1) Summary of Significant Accounting Policies, Continued

**Income Taxes.** There are two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred income tax expense results from changes in deferred tax assets and liabilities between periods.

Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. As of December 31, 2013, management is not aware of any uncertain tax positions that would have a material effect on the Company's consolidated financial statements. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Company recognizes interest and penalties on income taxes as a component of income tax expense.

The Company files consolidated income tax returns. Income taxes are allocated to the Holding Company and Bank as if separate income tax returns were filed.

**Derivative Financial Instruments.** Derivative financial instruments are recognized as assets or liabilities in the consolidated balance sheets and measured at fair value. The Company enters into commitments to originate loans whereby the interest-rate on the loan is determined prior to funding (rate lock commitments). Rate-lock commitments on mortgage loans that are intended to be sold are considered to be derivatives. Accordingly, such commitments, along with any related fees received from potential borrowers, are recorded at fair value in derivative assets or liabilities, with changes in fair value recorded in the net gain or loss on sale of mortgage loans. Fair value is based on fees currently charged to enter into similar agreements, and for fixed-rate commitments, the difference between current levels of interest rates and the committed rates is also considered. At December 31, 2013 and 2012, there were no fees received related to rate-lock commitments.

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# PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

## Notes to Consolidated Financial Statements, Continued

### (1) Summary of Significant Accounting Policies, Continued

***Fair Value Measurements.*** GAAP defines fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measurements.

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. GAAP also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The hierarchy describes three levels of inputs that may be used to measure fair value:

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities that are not active; and model-driven valuations whose inputs are observable or whose significant value drivers are observable. Valuations may be obtained from, or corroborated by, third-party pricing services.

Level 3: Unobservable inputs to measure fair value of assets and liabilities for which there is little, if any market activity at the measurement date, using reasonable inputs and assumptions based upon the best information at the time, to the extent that inputs are available without undue cost and effort.

The following describes valuation methodologies used for assets measured at fair value:

***Securities Available for Sale.*** Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government bonds, certain mortgage products and exchange-traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include U.S. Government agency securities, municipal securities and mortgage-backed securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. Securities classified within Level 3 include certain asset-backed securities.

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# PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

## Notes to Consolidated Financial Statements, Continued

### (1) Summary of Significant Accounting Policies, Continued

#### *Fair Value Measurements, Continued.*

*Impaired Loans.* Estimates of fair value for impaired loans is based on the estimated value of the underlying collateral which is determined based on a variety of information, including the use of available appraisals, estimates of market value by licensed appraisers or local real estate brokers and the knowledge and experience of the Company's management related to values of properties in the Company's market areas. Management takes into consideration the type, location and occupancy of the property as well as current economic conditions in the area the property is located in assessing estimates of fair value. Accordingly, fair value estimates for impaired loans are classified as Level 3.

*Fair Values of Financial Instruments.* The following methods and assumptions were used by the Company in estimating fair values of financial instruments:

*Cash and Cash Equivalents.* The carrying amounts of cash and cash equivalents approximate their fair value (Level 1).

*Securities.* Fair values for securities are based on the framework for measuring fair value (Level 2 and 3).

*Loans.* For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for fixed-rate mortgage (e.g. one-to-four family residential), commercial real estate and commercial loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for nonperforming loans are estimated using discounted cash flow analysis or underlying collateral values, where applicable (Level 3).

*Federal Home Loan Bank Stock.* The fair value of the Company's investment in Federal Home Loan Bank stock is based on its redemption value (Level 3).

*Accrued Interest Receivable.* The carrying amounts of accrued interest approximate their fair values (Level 3).

*Deposits.* The fair values disclosed for demand, NOW, money-market and savings deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). Fair values for fixed-rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on time deposits to a schedule of aggregated expected monthly maturities of time deposits (Level 3).

*Other Borrowings.* The carrying amounts of other borrowings approximate their fair value (Level 3).

(continued)



# PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

## Notes to Consolidated Financial Statements, Continued

### (1) Summary of Significant Accounting Policies, Continued

#### *Fair Values of Financial Instruments, Continued.*

**Off-Balance-Sheet Instruments.** Fair values for off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing (Level 3).

**Advertising.** The Company expenses all media advertising as incurred.

**Share-Based Compensation.** The Company expenses the fair value of any stock options granted. The Company recognizes share-based compensation in the statements of earnings as the options vest.

**Comprehensive Income.** GAAP require that recognized revenue, expenses, gains and losses be included in earnings. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the consolidated balance sheets, such items, along with net earnings, are components of comprehensive income.

**Recent Pronouncements.** In July 2012, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment*, which, among other things, gives an entity the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that an indefinite-lived intangible asset is impaired. The adoption of this guidance had no effect on the Company's consolidated financial statements.

In January 2013, the FASB issued ASU No. 2013-01, *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*, which limits the scope of the new balance sheet offsetting disclosures in ASU 2011-11 to derivatives, repurchase agreements, and securities lending transactions to the extent that they are (1) offset in the financial statements or (2) subject to an enforceable master netting arrangement or similar agreement. The adoption of this guidance had no effect on the Company's consolidated financial statements.

In February 2013, the FASB Issued ASU No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, which requires entities to present information about reclassification adjustments from accumulated other comprehensive income in their annual financial statements in a single note or on the face of the financial statements. The adoption of this guidance had no effect on the Company's consolidated financial statements.

(continued)

## PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

### Notes to Consolidated Financial Statements, Continued

#### (1) Summary of Significant Accounting Policies, Continued

**Recent Pronouncements, Continued.** In February 2013, the FASB Issued ASU No. 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date*. ASU 2013-04 provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for obligations within the scope of this ASU, which is effective January 1, 2014. Upon adoption, this guidance is not expected to impact the Company's consolidated financial statements.

In July 2013, the FASB issued ASU 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, which among other things, require an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as denoted within the ASU. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Upon adoption, this guidance is not expected to impact the Company's consolidated financial statements.

#### **Recent Regulatory Developments**

**Basel III Rules.** On July 2, 2013, the Federal Reserve Board ("FRB") approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks. Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by the Bank. The rules include a new common equity Tier 1 capital to risk-weighted assets ratio of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The final rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% and require a minimum leverage ratio of 4.0%. The final rules also implement strict eligibility criteria for regulatory capital instruments. On July 9, 2013, the FDIC also approved, as an interim final rule, the regulatory capital requirements for U.S. banks, following the actions of the FRB. The FDIC's rule is identical in substance to the final rules issued by the FRB.

The phase-in period for the final rules will begin for the Bank on January 1, 2015, with full compliance with all of the final rule's requirements phased in over a multi-year schedule. The Bank is currently evaluating the provisions of the final rules and their expected impact on the Bank.

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(2) Securities Available for Sale**

Securities have been classified according to management's intention. The carrying amount of securities and their fair values are summarized as follows (in thousands):

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<i>At December 31, 2013:</i>				
U.S. Government agency securities	\$ 7,290	8	(329)	6,969
Municipal securities	9,139	14	(269)	8,884
Mortgage-backed securities	26,225	253	(198)	26,280
Asset-backed securities	<u>1,916</u>	<u>22</u>	<u>-</u>	<u>1,938</u>
	\$ <u>44,570</u>	<u>297</u>	<u>(796)</u>	<u>44,071</u>
<i>At December 31, 2012:</i>				
U.S. Government agency securities	7,592	117	(7)	7,702
Municipal securities	5,585	7	(34)	5,558
Mortgage-backed securities	27,865	785	(4)	28,646
Asset-backed securities	<u>1,899</u>	<u>-</u>	<u>-</u>	<u>1,899</u>
	\$ <u>42,941</u>	<u>909</u>	<u>(45)</u>	<u>43,805</u>

Securities available for sale measured at fair value on a recurring basis are summarized below (in thousands):

	<u>Fair Value</u>	<u>Fair Value Measurements Using</u>		
		<u>Quoted Prices In Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
<i>At December 31, 2013:</i>				
U.S. Government agency securities	\$ 6,969	-	6,969	-
Municipal securities	8,884	-	8,884	-
Mortgage-backed securities	26,280	-	26,280	-
Asset-backed securities	<u>1,938</u>	<u>-</u>	<u>1,938</u>	<u>-</u>
	\$ <u>44,071</u>	<u>-</u>	<u>44,071</u>	<u>-</u>
<i>At December 31, 2012:</i>				
U.S. Government agency securities	7,702	-	7,702	-
Municipal securities	5,558	-	5,558	-
Mortgage-backed securities	28,646	-	28,646	-
Asset-backed securities	<u>1,899</u>	<u>-</u>	<u>-</u>	<u>1,899</u>
	\$ <u>43,805</u>	<u>-</u>	<u>41,906</u>	<u>1,899</u>

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(2) Securities Available for Sale, Continued**

During the year ended December 31, 2013, securities of \$1.8 million were transferred from Level 3 to Level 2 due to changes in the inputs used to value the securities. During year ended December 31, 2012, no securities were transferred in or out of Level 1, Level 2 or Level 3.

The table below presents a reconciliation for asset-backed securities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2013 and 2012. These instruments were valued using pricing models and discounted cash flow methodologies incorporating assumptions that, in management's judgment, reflect the assumptions a marketplace participant would use (in thousands):

	<b>Year Ended December 31,</b>	
	<b><u>2013</u></b>	<b><u>2012</u></b>
Balance, beginning of year	\$ 1,899	-
Total gains or (losses) - realized/unrealized-		
Purchases	-	1,899
Transfer in to/out of Level 3	(1,899)	<u>-</u>
Balance, end of year	\$ <u>-</u>	<u>1,899</u>

The scheduled maturities of securities are as follows (in thousands):

	<b><u>Amortized Cost</u></b>	<b><u>Fair Value</u></b>
<i>At December 31, 2013:</i>		
Due in less than one year	\$ 1,005	1,006
Due in one to five years	2,857	2,844
Due five to ten years	5,716	5,402
Due after ten years	6,851	6,601
Mortgage-backed securities	26,225	26,280
Asset-backed securities	<u>1,916</u>	<u>1,938</u>
	\$ <u>44,570</u>	<u>44,071</u>

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(2) Securities Available for Sale, Continued**

The following summarizes sales of securities available for sale (in thousands):

	<u>Year Ended December 31,</u>	
	<u>2013</u>	<u>2012</u>
Proceeds received from sales	\$ <u>1,498</u>	<u>13,594</u>
Gross gains	14	881
Gross losses	<u>-</u>	<u>-</u>
Net gain from sale of securities	\$ <u>14</u>	<u>881</u>

At December 31, 2013 and 2012, securities with a fair value of \$8,352,000 and \$8,451,000, respectively, were pledged as collateral for public deposits and for other borrowings with customers.

Securities with unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (in thousands):

	<u>Less Than Twelve Months</u>	
	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<i>At December 31, 2013:</i>		
U.S. Government agency securities	\$(329)	5,984
Municipal securities	(269)	5,758
Mortgage-backed securities	<u>(198)</u>	<u>12,326</u>
	<u>\$(796)</u>	<u>24,068</u>
<i>At December 31, 2012:</i>		
U.S. Government agency securities	(7)	2,746
Municipal securities	(34)	4,679
Mortgage-backed securities	<u>(4)</u>	<u>2,445</u>
	<u>\$(45)</u>	<u>9,870</u>

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(2) Securities Available for Sale, Continued**

The unrealized losses at December 31, 2013 and 2012 on twenty-five and eight securities were caused by market conditions. It is expected that the securities would not be settled at a price less than the par value of the investments. Because the decline in fair value is attributable to market conditions and not credit quality, and because the Company has the ability and intent to hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

**(3) Loans**

The segments and classes of loans are as follows (in thousands):

	<u>At December 31,</u>	
	<u>2013</u>	<u>2012</u>
Real estate mortgage loans:		
Commercial	\$ 44,796	35,490
Residential and home equity	38,721	30,886
Construction	<u>12,933</u>	<u>6,437</u>
Total real estate mortgage loans	96,450	72,813
Commercial loans	24,651	19,794
Consumer and other loans	<u>2,072</u>	<u>2,105</u>
Total loans	123,173	94,712
Less:		
Net deferred loan fees	(69)	(69)
Allowance for loan losses	<u>(1,734)</u>	<u>(1,243)</u>
Loans, net	\$ <u>121,370</u>	<u>93,400</u>

(continued)

## PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

### Notes to Consolidated Financial Statements, Continued

#### (3) Loans, Continued

The Company has divided the loan portfolio into three portfolio segments and five portfolio classes, each with different risk characteristics and methodologies for assessing risk. All loans are underwritten based upon standards set forth in the policies approved by the Company's Board of Directors. The portfolio segments and class are identified by the Company as follows:

***Real Estate Mortgage Loans.*** Real estate mortgage loans are typically divided into three classes: Commercial, residential and home equity and construction loans. The real estate mortgage loans are as follows:

***Commercial Real Estate Loans.*** Loans of this type are typically our more complex loans. This category of real estate loans is comprised of loans secured by mortgages on commercial property that is typically owner-occupied, but also includes nonowner occupied investment properties. Commercial loans that are secured by owner-occupied commercial real estate are repaid through operating cash flows of the borrower. The maturity for this type of loan is generally limited to three to five years; however, payments may be structured on a longer amortization basis. Typically, interest rates on our commercial real estate loans are fixed for five years or less after which they adjust based upon a predetermined spread over an index. At times, a rate may be fixed for longer than five years. As part of our credit underwriting standards, the Bank typically requires personal guarantees from the principal owners of the business supported by a review of the principal owners' personal financial statements and tax returns. As part of the enterprise risk management process, it is understood that risks associated with commercial real estate loans include fluctuations in real estate values, the overall strength of the borrower, the overall strength of the economy, new job creation trends, tenant vacancy rates, environmental contamination, and the quality of the borrowers' management. In order to mitigate and limit these risks, we analyze the borrowers' cash flow and evaluate collateral value. Currently, the collateral securing our commercial real estate loans include a variety of property types, such as office, warehouse, and retail facilities. Other types include multifamily properties, hotels, mixed-use residential, and commercial properties. Generally, commercial real estate loans present a higher risk profile than our consumer real estate loans portfolio.

***Residential Real Estate Loans.*** We offer first and second one-to-four family mortgage loans and home equity lines of credit; the collateral for these loans is generally on the clients' owner-occupied residences. Although these types of loans present lower levels of risk than commercial real estate loans, risks do still exist because of possible fluctuations in the value of the real estate collateral securing the loan, as well as changes in the borrowers' financial condition. Borrowers may be affected by numerous factors, including divorce, job loss, illness, or other personal hardship. As part of our product mix, the Bank offers both portfolio and secondary market mortgages; portfolio loans generally are based on a 1-year, 3-year or 5-year adjustable rate mortgage; while 15-year or 30-year fixed-rate loans are sold to the secondary market. All portfolio residential loans are underwritten based upon the guidelines of the secondary market, predominantly Freddie Mac and Fannie Mae.

(continued)

## PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

### Notes to Consolidated Financial Statements, Continued

#### (3) Loans, Continued

**Construction Loans.** Typically, these loans have a term of one to two years and the interest is paid monthly. This portion of our loan portfolio includes loans to small and midsized businesses to construct owner-user properties, loans to developers of commercial real estate investment properties, and residential developments. This type of loan is also made to individual clients for construction of single family homes in our market area. An independent appraisal is used to determine the value of the collateral and confirm that the ratio of the loan principal to the value of the collateral will not exceed policies of the Bank. As the construction project progresses, loan proceeds are requested by the borrower to complete phases of construction and funding is only disbursed after the project has been inspected by a third-party inspector or experienced construction lender. Risks associated with construction loans include fluctuations in the value of real estate, project completion risk, and changes in market trends. The ability of the construction loan borrower to finance the loan or sell the property upon completion of the project is another risk factor that also may be affected by changes in market trends since the initial funding of the loan.

**Commercial Loans.** The Bank offers a wide range of commercial loans, including business term loans, equipment financing, and lines of credit to small and midsized businesses. Small-to-medium sized businesses, retail, and professional establishments, make up our target market for commercial loans. Our Relationship Managers primarily underwrite these loans based on the borrower's ability to service the loan from cash flow. Lines of credit and loans secured by accounts receivable and/or inventory are monitored periodically by our staff. Loans secured by "all business assets," or a "blanket lien" are typically only made to highly qualified borrowers due to the nonspecific nature of the collateral. Valuation of business collateral is generally supported by an appraisal, purchase order, or third party physical inspection. Personal guarantees of the principals of business borrowers are usually required.

Equipment loans generally have a term of five years or less and may have a fixed or variable rate; we use conservative margins when pricing these loans. Working capital loans generally do not exceed one year and typically, they are secured by accounts receivable, inventory, and personal guarantees of the principals of the business. Significant factors affecting a commercial borrower's creditworthiness include the quality of management and the ability both to evaluate changes in the supply and demand characteristics affecting the business' markets for products and services and to respond effectively to such changes. These loans may be made unsecured or secured, but most are made on a secured basis. Risks associated with our commercial loan portfolio include local, regional, and national market conditions. Other factors of risk could include changes in the borrower's management and fluctuations in collateral value. Additionally, there may be refinancing risk if a commercial loan includes a balloon payment which must be refinanced or paid off at loan maturity.

In reference to our risk management process, our commercial loan portfolio presents a higher risk profile than our consumer real estate and consumer loan portfolios. Therefore, we require that all loans to businesses must have a clearly stated and reasonable payment plan to allow for timely retirement of debt.

(continued)



**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(3) Loans, Continued**

**Consumer Loans and Other.** These loans are made for various consumer purposes, such as the financing of automobiles, boats, and recreational vehicles. The payment structure of these loans is normally on an installment basis. The risk associated with this category of loans stems from the reduced collateral value for a defaulted loan; it may not provide an adequate source of repayment of the principal. The underwriting on these loans is primarily based on the borrower's financial condition. In many cases, these are unsecured credits that subject us to risk when the borrower's financial condition declines or deteriorates. Based upon our current trend in consumer loans, management does not anticipate consumer loans will become a substantial component of our loan portfolio at any time in the foreseeable future. Consumer loans are made at fixed- and variable-interest rates and are based on the appropriate amortization for the asset and purpose.

An analysis of the change in the allowance for loan losses follows (in thousands):

	<u>Real Estate Mortgage Loans</u>					
	<u>Residential and Home Equity</u>			<u>Consumer and Other</u>		
	<u>Commercial</u>	<u>Construction</u>	<u>Commercial</u>	<u>Other</u>	<u>Total</u>	
<i>Year Ended December 31, 2013:</i>						
Beginning balance	\$ 352	226	237	405	23	1,243
Provision (credit) for loan losses	252	319	(15)	(44)	1	513
Net (charge-offs) recoveries	<u>-</u>	<u>-</u>	<u>(47)</u>	<u>26</u>	<u>(1)</u>	<u>(22)</u>
Ending balance	\$ <u>604</u>	<u>545</u>	<u>175</u>	<u>387</u>	<u>23</u>	<u>1,734</u>
<i>At December 31, 2013:</i>						
Individually evaluated for impairment:						
Recorded investment	\$ <u>-</u>	<u>36</u>	<u>-</u>	<u>346</u>	<u>-</u>	<u>382</u>
Balance in allowance for loan losses	\$ <u>-</u>	<u>23</u>	<u>-</u>	<u>82</u>	<u>-</u>	<u>105</u>
Collectively evaluated for impairment:						
Recorded investment	\$ <u>44,796</u>	<u>38,685</u>	<u>12,933</u>	<u>24,305</u>	<u>2,072</u>	<u>122,791</u>
Balance in allowance for loan losses	\$ <u>604</u>	<u>522</u>	<u>175</u>	<u>305</u>	<u>23</u>	<u>1,629</u>
<i>Year Ended December 31, 2012:</i>						
Beginning balance	311	285	66	225	16	903
Provision for loan losses	41	(59)	336	147	8	473
Net (charge-offs) recoveries	<u>-</u>	<u>-</u>	<u>(165)</u>	<u>33</u>	<u>(1)</u>	<u>(133)</u>
Ending balance	\$ <u>352</u>	<u>226</u>	<u>237</u>	<u>405</u>	<u>23</u>	<u>1,243</u>
<i>At December 31, 2012:</i>						
Individually evaluated for impairment:						
Recorded investment	\$ <u>-</u>	<u>-</u>	<u>101</u>	<u>131</u>	<u>-</u>	<u>232</u>
Balance in allowance for loan losses	\$ <u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Collectively evaluated for impairment:						
Recorded investment	\$ <u>35,490</u>	<u>30,886</u>	<u>6,336</u>	<u>19,663</u>	<u>2,105</u>	<u>94,480</u>
Balance in allowance for loan losses	\$ <u>352</u>	<u>226</u>	<u>237</u>	<u>405</u>	<u>23</u>	<u>1,243</u>

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(3) Loans, Continued**

The following summarizes the loan credit quality (in thousands):

	<u>Real Estate Mortgage Loans</u>			<u>Commercial</u>	<u>Consumer and Other</u>	<u>Total</u>
	<u>Commercial</u>	<u>Residential and Home Equity</u>	<u>Construction</u>			
<i>Credit Risk Profile by Internally Assigned Grade:</i>						
<i>At December 31, 2013:</i>						
Grade:						
Pass	\$ 40,901	36,611	12,528	23,919	1,914	115,873
Special mention	1,804	1,346	396	509	38	4,093
Substandard	2,091	764	9	223	120	3,207
Doubtful	-	-	-	-	-	-
Loss	-	-	-	-	-	-
Total	<u>\$ 44,796</u>	<u>38,721</u>	<u>12,933</u>	<u>24,651</u>	<u>2,072</u>	<u>123,173</u>
<i>At December 31, 2012:</i>						
Grade:						
Pass	35,490	30,333	5,984	19,581	2,105	93,493
Special mention	-	553	352	183	-	1,088
Substandard	-	-	101	30	-	131
Doubtful	-	-	-	-	-	-
Loss	-	-	-	-	-	-
Total	<u>\$ 35,490</u>	<u>30,886</u>	<u>6,437</u>	<u>19,794</u>	<u>2,105</u>	<u>94,712</u>

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors.

The Company analyzes loans individually by classifying the loans as to credit risk. Loans classified as substandard or special mention are reviewed quarterly by the Company for further deterioration or improvement to determine if they are appropriately classified and whether there is any impairment. All loans are graded upon initial issuance. Further construction and nonowner occupied commercial real estate loans are reviewed at least annually and commercial relationships in excess of \$500,000. In addition, during the renewal process of any loan, as well as if a loan becomes past due, the Company will determine the appropriate loan grade.

(continued)

## PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

### Notes to Consolidated Financial Statements, Continued

#### (3) Loans, Continued

Loans excluded from the review process above are generally classified as pass credits until: (a) they become past due; (b) management becomes aware of a deterioration in the credit worthiness of the borrower; or (c) the customer contacts the Company for a modification. In these circumstances, the loan is specifically evaluated for potential classification as to special mention, substandard or even charged-off. The Company uses the following definitions for risk ratings:

**Pass** – A Pass loan's primary source of loan repayment is satisfactory, with secondary sources very likely to be realized if necessary.

**Special Mention** – A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in the deterioration of the repayment prospects for the asset or the Company's credit position at some future date. Special Mention loans are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

**Substandard** – A Substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

**Doubtful** – A loan classified Doubtful has all the weaknesses inherent in one classified Substandard with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

**Loss** – A loan classified Loss is considered uncollectible and of such little value that continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(3) Loans, Continued**

At December 31, 2013, there was one loan over thirty days past due, no loans past due ninety days or more but still accruing and no loans on nonaccrual. Age analysis of past-due loans at December 31, 2012 is as follows (in thousands):

	Accruing Loans				Current	Nonaccrual Loans	Total Loans
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due			
<i>At December 31, 2013:</i>							
Real estate mortgage:							
Commercial	\$ -	-	-	-	44,796	-	44,796
Residential and home equity	-	-	-	-	38,721	-	38,721
Construction	-	-	-	-	12,933	-	12,933
Commercial	38	-	-	-	24,613	-	24,651
Consumer/other	-	-	-	-	<u>2,072</u>	-	<u>2,072</u>
 Total	 \$ <u>38</u>	 <u>-</u>	 <u>-</u>	 <u>-</u>	 <u>123,135</u>	 <u>-</u>	 <u>123,173</u>
 <i>At December 31, 2012:</i>							
Real estate mortgage:							
Commercial	-	-	-	-	35,490	-	35,490
Residential and home equity	-	-	-	-	30,886	-	30,886
Construction	-	-	-	-	6,336	101	6,437
Commercial	-	-	-	-	19,794	-	19,794
Consumer/other	-	-	-	-	<u>2,105</u>	-	<u>2,105</u>
 Total	 \$ <u>-</u>	 <u>-</u>	 <u>-</u>	 <u>-</u>	 <u>94,611</u>	 <u>101</u>	 <u>94,712</u>

The following summarizes the amount of impaired loans (in thousands):

	With No Related Allowance Recorded		With an Allowance Recorded			Total		
	Recorded Investment	Unpaid Contractual Principal Balance	Recorded Investment	Unpaid Contractual Principal Balance	Related Allowance	Recorded Investment	Unpaid Contractual Principal Balance	Related Allowance
<i>At December 31, 2013:</i>								
Residential and home equity	\$ -	-	36	36	23	36	36	23
Commercial loans	<u>27</u>	<u>27</u>	<u>319</u>	<u>319</u>	<u>82</u>	<u>346</u>	<u>346</u>	<u>82</u>
 Total	 \$ <u>27</u>	 <u>27</u>	 <u>355</u>	 <u>355</u>	 <u>105</u>	 <u>382</u>	 <u>382</u>	 <u>105</u>
 <i>At December 31, 2012:</i>								
Construction	101	266	-	-	-	101	266	-
Commercial loans	<u>131</u>	-	-	-	-	<u>131</u>	-	-
	\$ <u>232</u>	<u>266</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>232</u>	<u>266</u>	<u>-</u>

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(3) Loans, Continued**

The average net investment in impaired loans and interest income recognized and received on impaired loans by loan class are as follows (in thousands):

	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Interest Income Received</u>
<i>Year Ended December 31, 2013:</i>			
Real estate mortgage loans-			
Residential and home equity	\$ 36	3	3
Commercial	<u>298</u>	<u>23</u>	<u>23</u>
 Total	 \$ <u>334</u>	 <u>26</u>	 <u>26</u>
 <i>Year Ended December 31, 2012:</i>			
Real estate mortgage loans-			
Commercial	\$ <u>78</u>	<u>-</u>	<u>-</u>

There were no loans measured at fair value on a nonrecurring basis at December 31, 2013. Impaired collateral-dependent loans measured at fair value on a nonrecurring basis by loan class at December 31, 2012 are as follows (in thousands):

	<u>At Year End</u>				<u>Total Losses</u>	<u>Losses Recorded During the Year</u>
	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>		
Commercial real estate loans	\$ <u>101</u>	<u>-</u>	<u>-</u>	<u>101</u>	<u>165</u>	<u>165</u>

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(3) Loans, Continued**

The following is a summary of loans determined to be TDR's entered into during the years ended December 31, 2013 and 2012:

	<u>Number of Contracts</u>	<u>Pre- Modification Outstanding Recorded Investment</u>	<u>Post- Modification Outstanding Recorded Investment</u>
<i>Troubled Debt Restructurings:</i>			
<i>Year Ended December 31, 2013:</i>			
Commercial:			
Modified interest rates	3	\$ 133	133
Modified payment schedule for six months	<u>1</u>	<u>122</u>	<u>122</u>
Total	<u>4</u>	\$ <u>255</u>	<u>255</u>
 <i>Year Ended December 31, 2012:</i>			
Commercial-			
Modified to interest only for three months	<u>1</u>	\$ <u>131</u>	<u>131</u>

The allowance for loan losses on all loans that have been restructured and are considered TDR's is included in the Bank's specific reserve. The specific reserve is determined on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the loan is collateral-dependent. TDR's that have subsequently defaulted are considered collateral-dependent. There were no TDR's that subsequently defaulted during the years ended December 31, 2013 and 2012, which were restructured during the same period.

The Company grants the majority of its loans to borrowers throughout Leon County, Florida. Although the Company has a diversified loan portfolio, a significant portion of its borrowers' ability to honor their contracts is dependent upon the economy of this area. The Company does not have any significant concentrations to any one industry or customer.

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(4) Premises and Equipment**

A summary of premises and equipment follows (in thousands):

	<u>At December 31,</u>	
	<u>2013</u>	<u>2012</u>
Land	\$ 400	400
Building	2,387	2,021
Leasehold improvements	364	362
Furniture, fixtures and equipment	706	512
Computer and software	<u>1,276</u>	<u>1,164</u>
Total, at cost	5,133	4,459
Less accumulated depreciation and amortization	<u>(1,376)</u>	<u>(1,022)</u>
Premises and equipment, net	\$ <u>3,757</u>	<u>3,437</u>

The Company leases certain office facilities under operating leases which expire in 2017. These leases require monthly lease payments and common area maintenance charges and have options to renew. These leases contain escalation clauses during the term of the leases. Rent expense under these operating leases during the years ended December 31, 2013 and 2012 was \$114,000 and \$125,000, respectively. Future minimum rental commitments under these noncancelable leases are as follows (in thousands):

<u>Year Ending December 31,</u>	<u>Amount</u>
2014	\$ 85
2015	85
2016	85
2017	<u>50</u>
	\$ <u>305</u>

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(5) Deposits**

The aggregate amount of time deposits with a minimum denomination of \$100,000 was approximately \$10.9 million and \$13.0 million at December 31, 2013 and 2012, respectively.

A schedule of maturities of time deposits follows (in thousands):

<u>Year Ending December 31,</u>	<u>Amount</u>
2014	\$ 12,377
2015	1,239
2016	494
2017	<u>484</u>
	<u>\$ 14,594</u>

**(6) Other Borrowings**

The Company entered into a repurchase agreement with a customer. This agreement requires the Company to pledge securities as collateral for borrowings under this agreement. A summary of other borrowings follows (\$ in thousands):

	<u>At December 31,</u>	
	<u>2013</u>	<u>2012</u>
Balance outstanding at year-end	\$ 5,719	5,760
Average balance outstanding during the year	5,789	6,397
Average interest rate paid	1.0%	0.95%
Maximum amount outstanding at any month-end during year	5,813	7,148
Pledged securities	5,882	5,864

FHLB advances will be collateralized by a blanket lien on qualifying residential real estate, commercial real estate, home equity lines of credit and multi-family loans. The Company may borrow up to \$23.9 million and \$16.8 million as of December 31, 2013 and 2012, respectively from the Federal Home Loan Bank of Atlanta ("FHLB"), there were no advances outstanding at December 31, 2013 and 2012. The Company also has available credit of \$9.1 million in lines of credit with correspondent banks.

(continued)



**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(7) Income Taxes**

The components of the income taxes are as follows (in thousands):

	<u>Year Ended December 31,</u>	
	<u>2013</u>	<u>2012</u>
Current:		
Federal	\$ 658	341
State	<u>119</u>	<u>71</u>
Total current	<u>777</u>	<u>412</u>
Deferred:		
Federal	(146)	154
State	<u>(29)</u>	<u>23</u>
Total deferred	<u>(175)</u>	<u>177</u>
Total income taxes	<u>\$ 602</u>	<u>589</u>

The reasons for the difference between the statutory Federal income tax rate of 34% and the effective tax rates are summarized as follows (dollars in thousands):

	<u>Year Ended December 31,</u>			
	<u>2013</u>		<u>2012</u>	
	<u>% of</u>		<u>% of</u>	
	<u>Pretax</u>		<u>Pretax</u>	
	<u>Amount</u>	<u>Earnings</u>	<u>Amount</u>	<u>Earnings</u>
Income taxes at statutory rate	\$ 595	34.0%	\$ 546	34.0%
Increase (decrease) resulting from:				
State taxes, net of Federal tax benefit	60	3.4	49	3.0
Stock-based compensation	-	-	1	0.1
Tax-exempt income	(30)	(1.7)	(14)	(0.9)
Other nondeductible expenses	<u>(23)</u>	<u>(1.3)</u>	<u>7</u>	<u>.5</u>
	<u>\$ 602</u>	<u>34.4%</u>	<u>\$ 589</u>	<u>36.7%</u>

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(7) Income Taxes, Continued**

Tax effects of temporary differences that give rise to the deferred tax assets and liabilities are as follows (in thousands):

	<u>At December 31,</u>	
	<u>2013</u>	<u>2012</u>
Deferred tax assets:		
Allowance for loan losses	\$ 517	324
Organizational and start-up costs	130	144
Stock-based compensation	18	17
Unrealized loss on securities available for sale	184	-
Other	<u>63</u>	<u>47</u>
Deferred tax assets	<u>912</u>	<u>532</u>
Deferred tax liabilities:		
Accrual to cash conversion	(145)	(164)
Deferred loan costs	(88)	(76)
Premises and equipment	(253)	(225)
Unrealized gains on securities available for sale	<u>-</u>	<u>(319)</u>
Deferred tax liabilities	<u>(486)</u>	<u>(784)</u>
Net deferred tax asset (liability)	<u>\$ 426</u>	<u>(252)</u>

The Company files consolidated income tax returns in the U.S. federal jurisdiction, and the State of Florida. The Company is no longer subject to U.S. federal, or state and local income tax examinations by taxing authorities for years before 2010.

(continued)

## PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

### Notes to Consolidated Financial Statements, Continued

#### (8) Off-Balance-Sheet Financial Instruments

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments are commitments to extend credit, construction loans in process, unused lines of credit and standby letters of credit and may involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the consolidated balance sheets. The contract amounts of these instruments reflect the extent of involvement the Company has in these financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for available lines of credit, construction loans in process and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for on-balance-sheet instruments.

Commitments to extend credit and unused lines of credit are agreements to lend 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. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Company upon extension of credit is based on management's credit evaluation of the counterparty.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. These letters of credit are primarily issued to support third-party borrowing arrangements and generally have expiration dates within one year of issuance. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The Bank may hold collateral supporting those commitments, and at December 31, 2013 such collateral amounted to \$802,000.

Standby letters of credit and commitments to extend credit typically result in loans with a market interest rate when funded. A summary of the contractual amounts of the Company's financial instruments with off-balance-sheet risk at December 31, 2013 are as follows (in thousands):

Commitments to extend credit	\$ <u>701</u>
Construction loans in process	\$ <u>7,134</u>
Unused lines of credit	\$ <u>21,990</u>
Standby letters of credit	\$ <u>1,039</u>

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(9) Stock Option Plan**

The 2007 Stock Option Plan provides for certain key employees and directors of the Company to have the option to purchase shares of the Company's common stock. Under this Plan, the total number of shares which may be issued is 152,905. All options granted will have four to ten-year terms and vest over periods up to five years. As of December 31, 2013, there were 18,905 shares available for grant.

A summary of the activity in the Company's Stock Option Plan is as follows:

	<u>Number of Options</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Remaining Contractual Term</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at December 31, 2011	136,250	\$ 10.00		
Options granted	2,500	10.00		
Options forfeited	<u>(2,750)</u>	10.00		
Outstanding at December 31, 2012	136,000	10.00		
Options granted	2,500	10.00		
Options forfeited	<u>(4,500)</u>	10.00		
Outstanding at December 31, 2013	<u>134,000</u>	\$ <u>10.01</u>	<u>5.1 years</u>	
Exercisable at December 31, 2013	<u>104,200</u>	\$ <u>10.00</u>	<u>5.0 years</u>	\$ <u>260,500</u>

At December 31, 2013, there was \$5,000 of total unrecognized compensation expense related to nonvested share-based compensation arrangements granted under the plans. The cost is expected to be recognized over a weighted-average period of thirty-two months. The total fair value of shares vesting and recognized as compensation expense was \$3,000 and \$7,000 in the years ended December 31, 2013 and 2012, respectively. The associated income tax benefit recognized was \$1,000 and \$3,000 for the years ended December 31, 2013 and 2012, respectively.

The fair value of each option granted was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	<u>Year Ended December 31,</u>	
	<u>2013</u>	<u>2012</u>
Weighted-average risk-free interest rate	1.13%	1.30%
Expected dividend yield	-	-
Expected stock volatility	11.24%	11.37%
Expected life in years	6.5	6.5
Per share fair value of options issued during the year	\$ <u>1.17</u>	\$ <u>1.55</u>

(continued)

# PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

## Notes to Consolidated Financial Statements, Continued

### (9) Stock Option Plan, Continued

The Company used the guidance in Staff Accounting Bulletin No. 107 to determine the estimated life of options issued. Expected volatility is based on volatility of similar companies' common stock. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The dividend yield is based on the Company's history and expectation of dividend payouts.

### (10) Profit Sharing Plan

The Company sponsors a 401(k) profit sharing plan available to all employees electing to participate after meeting certain length-of-service requirements. The Company's contributions to the profit sharing plan are discretionary and determined annually. Contribution to the plan for the years ended December 31, 2013 and 2012 were \$65,000 and \$0, respectively.

### (11) Related Party Transactions

The Company enters into transactions during the ordinary course of business with officers and directors of the Company and entities in which they hold a significant financial interest. The following summarizes these transactions (in thousands):

	<b>Year Ended</b>	
	<b>December 31,</b>	
	<b><u>2013</u></b>	<b><u>2012</u></b>
Loans:		
Beginning balance	\$ 3,558	3,413
Originated during the year	354	465
Principal repayments	<u>(178)</u>	<u>(320)</u>
Ending balance	<u>\$ 3,734</u>	<u>3,558</u>
Deposits at year end	<u>\$ 13,292</u>	<u>13,066</u>

The Company leases an office facility from a related party. Rent expense under the operating lease during the years ended December 31, 2013 and 2012 were \$114,000 and \$125,000, respectively. In addition, the Bank has contracted with a related party to perform loan reviews of the Bank's loan portfolio. The expenses related to the loan retrieves during the years ended December 31, 2013 and 2012 were \$24,000 and \$15,000, respectively.

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(12) Fair Value of Financial Instruments**

The approximate carrying amounts and estimated fair values of the Company's financial instruments are as follows (in thousands):

		<u>At December 31,</u>			
		<u>2013</u>		<u>2012</u>	
	<u>Level</u>	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets:					
Cash and cash equivalents	1	\$ 34,166	34,166	26,498	26,498
Securities available for sale	2 and 3	44,071	44,071	43,805	43,805
Loans, net	3	121,370	122,097	93,400	93,927
Federal Home Loan Bank stock	3	204	204	209	209
Accrued interest receivable	3	516	516	422	422
Financial liabilities:					
Deposits	3	183,225	183,295	146,729	146,826
Other borrowings	3	5,719	5,719	5,760	5,760
Off-balance-sheet financial instruments	3	-	-	-	-

**(13) Dividend Restrictions**

The Holding Company is limited in the amount of cash dividends it may declare and pay by the amount of dividends it can receive from the Bank. The Bank is limited in the amount of cash dividends that may be paid. The amount of cash dividends that may be paid is based on the Bank's net earnings of the current year combined with the Bank's retained earnings of the preceding two years, as defined by state banking regulations. However, for any dividend declaration, the Bank must consider additional factors such as the amount of current period net earnings, liquidity, asset quality, capital adequacy and economic conditions. It is likely that these factors would further limit the amount of dividend which the Bank could declare. In addition, bank regulators have the authority to prohibit banks from paying dividends if they deem such payment to be an unsafe or unsound practice.

**(14) Regulatory Matters**

The Bank is subject to various regulatory capital requirements administered by the 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 Company's and the Bank's 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 weightings, and other factors.

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(14) Regulatory Matters, Continued**

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and percentage (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2013, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2013, the most recent notification from the regulatory authorities categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as adequately capitalized the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage percents as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category. The Bank's actual capital amounts and percents are also presented in the table (\$ in thousands):

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>For Well Capitalized Purposes</u>	
	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>
<i>As of December 31, 2013:</i>						
Tier I Capital						
to Average Assets	\$ 16,611	8.41%	\$ 7,898	4.00%	\$ 9,872	5.00%
Tier I Capital to Risk-Weighted Assets	16,611	12.41	5,355	4.00	8,033	6.00
Total Capital to Risk-Weighted Assets	18,286	13.66	10,711	8.00	13,388	10.00
<i>As of December 31, 2012:</i>						
Tier I Capital						
to Average Assets	15,437	9.67	6,387	4.00	7,983	5.00
Tier I Capital to Risk-Weighted Assets	15,437	14.78	4,177	4.00	6,265	6.00
Total Capital to Risk-Weighted Assets	16,680	15.97	8,354	8.00	10,442	10.00

**(15) Legal Contingencies**

Various legal claims arise from time to time in the normal course of business which, in the opinion of management, will not have a material effect on the Company's financial statements. As of December 31, 2013, there is no pending or threatened litigation of which management is aware.

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(16) Earnings Per Share**

Earnings per share has been computed on the basis of the weighted-average number of shares of common stock outstanding. Outstanding stock options are considered dilutive securities for purposes of calculating diluted EPS which was computed using the treasury stock method. (dollars in thousands, except per share amounts):

	2013			2012		
	<u>Earnings</u>	<u>Weighted-Average Shares</u>	<u>Per Share Amount</u>	<u>Earnings</u>	<u>Weighted-Average Shares</u>	<u>Per Share Amount</u>
<i>Year Ended December 31:</i>						
Basic EPS:						
Net earnings	\$ 1,149	1,497,737	\$ 0.77	\$ 1,018	1,496,106	\$ 0.68
Effect of dilutive securities-						
Incremental shares from assumed conversion of options (antidilutive in 2012)		<u>20,881</u>			<u>-</u>	
Diluted EPS:						
Net earnings	\$ <u>1,149</u>	<u>1,518,618</u>	\$ <u>0.76</u>	\$ <u>1,018</u>	<u>1,496,106</u>	\$ <u>0.68</u>

**(17) Common Stock Offering**

The Company filed a Registration Statement with the Securities and Exchange Commission which was effective on December 11, 2013. The Company is offering up to 1,200,000 shares of common stock for \$12.50 per share through February 28, 2014. The Registration Statement has been extended to March 31, 2014.

**(18) Subsequent Events**

During March of 2014, the Company determined that a purchased loan participation secured by commercial real estate in the amount of \$1.4 million was impaired. The lead Bank has ordered an appraisal and the Company has not determined if there is a loss related to this loan.

(continued)



**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(19) Parent Company Only Financial Information**

The Holding Company's unconsolidated financial information follows:

**Condensed Balance Sheets  
(In thousands)**

	<u>At December 31,</u>	
	<u>2013</u>	<u>2012</u>
<b>Assets</b>		
Cash	\$ 13	20
Investment in subsidiary	16,296	15,982
Other assets	<u>270</u>	<u>37</u>
Total assets	\$ <u>16,579</u>	<u>16,039</u>
<b>Liabilities-</b>		
Accounts payable	<u>218</u>	<u>-</u>
<b>Stockholders' Equity</b>		
Stockholders' equity	<u>16,361</u>	<u>16,039</u>
Total liabilities and stockholders' equity	\$ <u>16,579</u>	<u>16,039</u>

**Condensed Statements of Operations  
(In thousands)**

	<u>Year Ended December 31,</u>	
	<u>2013</u>	<u>2012</u>
Revenues	\$ -	-
Expenses	(37)	(36)
Income tax benefit	<u>15</u>	<u>13</u>
Loss before earnings of subsidiary	(22)	(23)
Net earnings of subsidiary	<u>1,171</u>	<u>1,041</u>
Net earnings	\$ <u>1,149</u>	<u>1,018</u>

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(19) Parent Company Only Financial Information, Continued**

**Condensed Statements of Cash Flows  
(In thousands)**

	<b>Year Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
Cash flows from operating activities:		
Net earnings	\$ 1,149	1,018
Adjustments to reconcile net earnings to net cash used in operating activities:		
Equity in earnings of subsidiary	(1,171)	(1,041)
Stock issued as compensation	30	-
Increase in other assets	(233)	(13)
Increase in liabilities	218	-
Net cash used in operating activities	(7)	(36)
Net decrease in cash	(7)	(36)
Cash at beginning of the year	20	56
Cash at end of year	\$ 13	20
Supplemental disclosure of cash flow information-		
Noncash items:		
Net change in accumulated other comprehensive (loss) income of subsidiary, net change in unrealized gain on securities available for sale, net of tax	\$ (860)	(82)
Stock-based compensation expense of subsidiary	\$ 3	7

Passion  
*Grace*  
INTEGRITY  
**TENACITY**  
ACCOUNTABILITY



## Team

<b>Caroline Arrant</b>	HR Specialist
<b>Marsha Asbury-Turner</b>	Associate Relationship Manager
<b>John M. Baker</b>	Marketing Director
<b>Edward Blissard</b>	Courier
<b>Ennis Blissard</b>	Assistant Vice President, Branch Manager
<b>Ingrid Burgett</b>	Operations Specialist
<b>Amanda Darvill</b>	Vice President, Associate Relationship Manager
<b>Sammie D. Dixon, Jr.</b>	Chief Executive Officer & President
<b>Chris Edwards</b>	Vice President, Market Leader/Commercial Lender
<b>Georgia Gunn</b>	Loan Operations Specialist
<b>Tyler Harris</b>	Assistant Vice President, Associate Relationship Manager
<b>Laura Jo Hewitt</b>	Vice President, Lending Officer
<b>Candice Hopkins</b>	Vice President, BSA/Compliance Officer
<b>John Hutchison</b>	Compliance
<b>Chris L. Jensen, Jr.</b>	Executive Vice President, Senior Lender
<b>Kathleen C. Jones</b>	Executive Vice President, Chief Financial Officer
<b>Taylor Joyner</b>	Branch Manager
<b>Michele Lawhon</b>	Head Teller
<b>Cody Lewis</b>	Vice President, Commercial Lender
<b>Karen Linville</b>	Branch Manager
<b>Jill Macmillan</b>	Executive Administrator
<b>Christine Manuri</b>	Assistant Vice President, Associate Relationship Manager
<b>Bethany Markley</b>	Teller
<b>Caleb Martin</b>	Teller
<b>Madeline McGrotha</b>	Accounting Assistant
<b>Arden Miller</b>	Assistant Vice President, Treasury Management
<b>Jaina Patel</b>	Personal Banker
<b>Susan Payne Turner</b>	Executive Vice President, Chief Risk Officer
<b>Sandy Perkins</b>	Vice President, Operations
<b>Robert Peterson</b>	Teller
<b>Linda Pettis</b>	Loan Processor
<b>Maurice Platt</b>	Head Teller
<b>Philip Pomeroy</b>	Vice President, Commercial Lender
<b>Katie Proctor</b>	Senior Vice President, Commercial Banker
<b>Tara Sanders</b>	Loan Operations Specialist
<b>Suzanne Sconyers</b>	Personal Banker
<b>Mary Stafford</b>	Vice President, Business Development
<b>Teresa Standland</b>	Vice President, Senior Loan Operations Manager
<b>Monté Ward</b>	Senior Vice President, Bank Operations
<b>Mesha Ware</b>	Operations Specialist
<b>Clint Weber</b>	Vice President, Credit Administration
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