

ANNUAL REPORT | 2015



PRIME  
MERIDIAN  
HOLDING COMPANY

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## Dear Fellow Shareholders,

Prime Meridian's performance last year is a story of steady growth. Our relationship managers created real momentum in both commercial and mortgage lending. A boost in deposits, fueled in part by our venture into Crawfordville, Florida, had a very positive impact. As the numbers demonstrate, our team is getting it done.

As of December 31, 2015, total assets were \$244.0 million, with total deposits measuring \$217.6 million. This compares to \$210.4 million in total assets and \$184.0 million in total deposits at December 31, 2014. The Bank remains "well capitalized" with total capital of \$24.9 million at December 31, 2015.

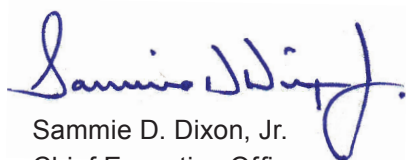
We completed our seventh year in business in February, 2015 and during the late summer, stock in Prime Meridian Holding Company (the "Company") began trading on the open market: OTCQX: PMHG.

The Company declared its first annual cash dividend of \$0.05 per share on its common stock to shareholders. We believe that this is an important step in our mission of optimizing shareholder value. Other highlights include:

- The Bank opened a third full-service office in Crawfordville, Florida. By December 31, 2015 this location had collected nearly \$15 million in new deposits.
- The Company reported net earnings of \$1,704,000 for the year ended December 31, 2015, compared to \$1,006,000 for the same period a year ago.
- Net interest income grew 15.0% for the year ended December 31, 2015, compared to the same period in 2014. The increase was primarily due to increased loan balances.
- Total assets increased 16.0% during 2015 to \$244.0 million.
- In 2015, the Company grew its net loan portfolio 23.2%, or \$35.2 million to \$187.1 million.
- Mortgage banking revenue increased 76.7% to \$546,000 in 2015 and continues to represent a growing and profitable source of income.
- Prime Meridian Bank was ranked No. 12 nationally by American Banker Magazine as one of the "Best Banks to Work For." Only one other Florida bank made the list.

On behalf of the Company's shareholders, we are proud of Prime Meridian's accomplishments over the previous year and it is with great pleasure that we present the enclosed 2015 Annual Report.

Warm regards,



Sammie D. Dixon, Jr.  
Chief Executive Officer

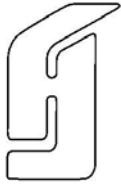


Richard A. Weidner, CPA  
Chairman of the Board

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## **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, 2015 and 2014, 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, 2015 and 2014, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

HACKER, JOHNSON & SMITH PA  
Tampa, Florida  
March 22, 2016

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

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

	<u>December 31,</u>	
	<u>2015</u>	<u>2014</u>
<b>Assets</b>		
Cash and due from banks	\$ 3,528	3,757
Federal funds sold	4,657	3,611
Interest-bearing deposits	<u>244</u>	<u>187</u>
Total cash and cash equivalents	8,429	7,555
Securities available for sale	38,063	42,397
Loans held for sale	2,722	1,871
Loans, net of allowance for loan losses of \$2,473 and \$2,098	187,076	151,869
Federal Home Loan Bank stock	189	186
Premises and equipment, net	4,222	3,563
Deferred tax asset	368	362
Accrued interest receivable	692	624
Bank-owned life insurance	1,662	1,613
Other assets	<u>621</u>	<u>318</u>
Total assets	<u>\$244,044</u>	<u>210,358</u>
<b>Liabilities and Stockholders' Equity</b>		
Liabilities:		
Noninterest-bearing demand deposits	50,158	43,148
Savings, NOW and money-market deposits	144,801	122,166
Time deposits	<u>22,614</u>	<u>18,657</u>
Total deposits	217,573	183,971
Other borrowings	0	2,699
Official checks	744	368
Other liabilities	<u>794</u>	<u>453</u>
Total liabilities	<u>219,111</u>	<u>187,491</u>
Commitments and contingencies (Notes 4, 8 and 15)		
Stockholders' equity:		
Preferred stock, undesignated; 1,000,000 shares authorized, none issued or outstanding	0	0
Common stock, \$.01 par value; 9,000,000 shares authorized, 1,975,329 and 1,941,617 issued and outstanding	20	19
Additional paid-in capital	20,415	20,056
Retained earnings	4,442	2,738
Accumulated other comprehensive income	<u>56</u>	<u>54</u>
Total stockholders' equity	<u>24,933</u>	<u>22,867</u>
Total liabilities and stockholders' equity	<u>\$ 244,044</u>	<u>210,358</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>2015</u>	<u>2014</u>
Interest income:		
Loans	\$ 8,359	7,134
Securities	883	922
Other	<u>47</u>	<u>60</u>
Total interest income	<u>9,289</u>	<u>8,116</u>
Interest expense:		
Deposits	697	625
Other borrowings	<u>20</u>	<u>36</u>
Total interest expense	<u>717</u>	<u>661</u>
Net interest income	8,572	7,455
Provision for loan losses	<u>433</u>	<u>747</u>
Net interest income after provision for loan losses	<u>8,139</u>	<u>6,708</u>
Noninterest income:		
Service charges and fees on deposit accounts	152	138
Mortgage banking revenue	546	309
Income from bank-owned life insurance	49	51
Gain on sale of securities available for sale	95	60
Other income	<u>228</u>	<u>152</u>
Total noninterest income	<u>1,070</u>	<u>710</u>
Noninterest expenses:		
Salaries and employee benefits	3,523	3,210
Occupancy and equipment	1,016	825
Professional fees	375	395
Advertising	425	320
FDIC/State Assessment	114	125
Software maintenance	196	178
Other	<u>1,012</u>	<u>845</u>
Total noninterest expenses	<u>6,661</u>	<u>5,898</u>
Earnings before income taxes	2,548	1,520
Income taxes	<u>844</u>	<u>514</u>
Net earnings	<u>\$ 1,704</u>	<u>1,006</u>
Basic earnings per share	<u>\$ 0.88</u>	<u>0.59</u>
Diluted earnings per share	<u>\$ 0.87</u>	<u>0.58</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>2015</u></b>	<b><u>2014</u></b>
Net earnings	\$ <u>1,704</u>	<u>1,006</u>
Other comprehensive gain (loss):		
Change in unrealized gain on securities:		
Unrealized gain arising during the year	98	646
Reclassification adjustment for realized gains	<u>(95)</u>	<u>(60)</u>
Net change in unrealized gain	3	586
Deferred income taxes on above change	<u>(1)</u>	<u>(217)</u>
Total other comprehensive income	<u>2</u>	<u>369</u>
Comprehensive income	\$ <u>1,706</u>	<u>1,375</u>

See Accompanying Notes to Consolidated Financial Statements.

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Consolidated Statements of Stockholders' Equity**

**Years Ended December 31, 2015 and 2014**

(\$ in thousands, except share amounts)

	<u>Common Stock</u>		<u>Additional</u>	<u>Retained</u>	<u>Accumulated</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Paid-In</u>	<u>Earnings</u>	<u>Other</u>	<u>Stockholders'</u>
			<u>Capital</u>		<u>Income</u>	<u>Equity</u>
					<u>(Loss)</u>	
Balance at December 31, 2013	1,498,937	\$ 15	14,929	1,732	(315)	16,361
Net earnings	0	0	0	1,006	0	1,006
Net change in unrealized gain on available for sale securities, net of income taxes of \$217	0	0	0	0	369	369
Proceeds from sale of common stock, net of \$365 in offering costs	425,619	4	4,951	0	0	4,955
Proceeds from stock options exercised	14,200	0	142	0	0	142
Common stock issued as compensation to directors	2,861	0	32	0	0	32
Stock-based compensation	<u>0</u>	<u>0</u>	<u>2</u>	<u>0</u>	<u>0</u>	<u>2</u>
Balance at December 31, 2014	1,941,617	19	20,056	2,738	54	22,867
Net earnings	0	0	0	1,704	0	1,704
Net change in unrealized gain on available for sale securities, net of income taxes of \$1	0	0	0	0	2	2
Proceeds from stock options exercised	30,540	1	305	0	0	306
Common stock issued as compensation to directors	3,172	0	39	0	0	39
Stock-based compensation	<u>0</u>	<u>0</u>	<u>15</u>	<u>0</u>	<u>0</u>	<u>15</u>
Balance at December 31, 2015	<u>1,975,329</u>	<u>\$ 20</u>	<u>20,415</u>	<u>4,442</u>	<u>56</u>	<u>24,933</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>	
	<u><b>2015</b></u>	<u><b>2014</b></u>
Cash flows from operating activities:		
Net earnings	\$ 1,704	1,006
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	446	400
Provision for loan losses	433	747
Net amortization of deferred loan fees	(346)	(9)
Deferred income taxes	(7)	(153)
Gain on sale of securities available for sale	(95)	(60)
Amortization of premiums, discounts on securities available for sale	425	453
Gain on loans held for sale	(488)	(273)
Proceeds from the sale of loans held for sale	30,319	16,380
Loan originated as held for sale	(30,682)	(17,828)
Stock issued as compensation to directors	39	32
Stock-based compensation expense	15	2
Income from bank-owned life insurance	(49)	(51)
Net increase in accrued interest receivable	(68)	(108)
Increase in capitalized offering cost	0	218
Net increase in other assets	(303)	(135)
Net increase (decrease) in other liabilities and official checks	<u>717</u>	<u>(207)</u>
Net cash provided by operating activities	<u>2,060</u>	<u>414</u>
Cash flows from investing activities:		
Loan originations, net of principal repayments	(35,294)	(32,259)
Purchase of securities available for sale	(12,978)	(12,364)
Principal repayments of securities available for sale	10,252	8,150
Proceeds from the sales of securities available for sale	4,691	4,587
Maturities and calls of securities available for sale	2,042	1,494
(Purchase) Redemption of Federal Home Loan Bank stock	(3)	18
Proceeds from sale of other real estate owned	0	872
Purchase of premises and equipment	<u>(1,105)</u>	<u>(206)</u>
Net cash used in investing activities	<u>(32,395)</u>	<u>(29,708)</u>
Cash flows from financing activities:		
Net increase in deposits	33,602	606
Decrease in other borrowings	(2,699)	(3,020)
Proceeds from stock options exercised	306	142
Proceeds from sale of common stock	<u>0</u>	<u>4,955</u>
Net cash provided by financing activities	<u>31,209</u>	<u>2,683</u>
Net increase (decrease) in cash and cash equivalents	874	(26,611)
Cash and cash equivalents at beginning of year	<u>7,555</u>	<u>34,166</u>
Cash and cash equivalents at end of year	<u>\$ 8,429</u>	<u>7,555</u>

(continued)



**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

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

	<b>Year Ended</b>	
	<b>December 31,</b>	
	<b><u>2015</u></b>	<b><u>2014</u></b>
Supplemental disclosure of cash flow information		
Cash paid during the year for:		
Interest	\$ <u>713</u>	<u>659</u>
Income taxes	\$ <u>989</u>	<u>551</u>
Noncash transactions		
Accumulated other comprehensive income, net change in unrealized gain on sale of securities available for sale, net of taxes	\$ <u>2</u>	<u>369</u>
Loans transferred from Other Real Estate Owned	\$ <u>0</u>	<u>872</u>

See Accompanying Notes to Consolidated Financial Statements.

# PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

## Notes to Consolidated Financial Statements

At December 31, 2015 and 2014 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 clients through its three banking offices located in Tallahassee and Crawfordville, Florida and through its online banking platform.

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 due from banks, all of which have original maturities of less than ninety days.

At December 31, 2015 and 2014, the Company was required by law or regulation to maintain cash reserves with the Federal Reserve Bank, in noninterest-bearing accounts with other banks or in the vault in the amounts of \$1,114,000 and \$1,026,000, respectively.

**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 or 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. 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.

(continued)

# PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

## Notes to Consolidated Financial Statements, Continued

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

**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. Gains on loans held for sale are reported on the Consolidated Statement of Earnings under noninterest income in either gain on sale of SBA loans or mortgage banking revenue. At December 31, 2015 loans held for sale were \$2,722,000 compared to \$1,871,000 at December 31, 2014.

**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 deferred and certain direct origination costs are capitalized. 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 loans that are 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 of the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

**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 confirms that a loan balance cannot be collected. 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, 2015.

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 thirty-six months. 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 unemployment and reduced credit availability, and a lack of confidence in the economy. 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) changes in collateral dependent loans; and (i) 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, standby letters of credit, and guaranteed accounts. Such financial instruments are recorded in the consolidated financial statements when they are funded.

**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

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# PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

## Notes to Consolidated Financial Statements, Continued

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

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, 2015, 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. Rate lock commitments at December 31, 2015 and 2014 were immaterial.

**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 has established 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.

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# PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

## Notes to Consolidated Financial Statements, Continued

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

Securities classified within Level 3 include certain asset-backed securities.

**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 Bank's management related to values of equipment or properties in the Bank's market areas. Management takes into consideration the type, location or occupancy of the equipment or 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).

**Loans Held for Sale.** Fair values of loans held for sale are based on commitments on hand from investors or prevailing market prices. Fair values are estimated using discounted cash flow analyses using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

**Loans.** Fair values for variable rate loans, fixed-rate mortgage loans (e.g. one-to-four family residential), commercial real estate loans 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).

**Bank-owned Life Insurance.** The carrying amounts of the Company's investment in bank-owned life insurance approximate their fair value (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).

**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.

**Stock Option Compensation.** The Company expenses the fair value of any stock options granted. The Company recognizes stock option compensation in the statements of earnings as the options vest.

(continued)

# PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

## Notes to Consolidated Financial Statements, Continued

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

**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.

**Mortgage Banking Revenue.** Mortgage banking revenue includes gains on the sale of mortgage loans originated for sale. The Company recognizes mortgage banking revenue from mortgage loans originated in the consolidated statement of earnings upon sale of the loans.

**Recent Accounting Standards Update.** In January 2016, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") 2016-01, *Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which is intended to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The ASU requires equity investments to be measured at fair value with changes in fair values recognized in net earnings, (public entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes), simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment and eliminates the requirement to disclose fair values, the methods and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost. The ASU also clarifies that the Bank/Company should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale debt securities in combination with the Bank's/Company's other deferred tax assets. These amendments are effective for the Bank/Company beginning January 1, 2018 (January 1, 2017 for public entities). The adoption of this guidance is not expected to have a material impact on the Bank's/Company's consolidated financial statements.

**Recent Regulatory Developments.** 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 Bank's/Company'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 weightings, and other factors.

Effective January 1, 2015, the Bank, became subject to the new Basel III capital level threshold requirements under the Prompt Corrective Action regulations with full compliance with all of the final rule's requirements phased in over a multi-year schedule. These new regulations were designed to ensure that banks maintain strong capital positions even in the event of severe economic downturns or unforeseen losses.

Changes that could affect the Bank going forward include additional constraints on the inclusion of deferred tax assets in capital and increased risk weightings for nonperforming loans and acquisition/development loans in regulatory capital. Under the new regulations in the first quarter of 2015, the Bank elected an irreversible one-time opt-out to exclude accumulated other comprehensive (loss) income from regulatory capital.

As of December 31, 2015, the Bank was well capitalized under the regulatory framework for prompt corrective action. To be categorized as adequately capitalized, the Bank must maintain a minimum Common equity Tier 1 capital ratio, Tier 1 capital ratio, Total capital ratio and Tier 1 leverage ratio as set forth in the table. Management believes, as of December 31, 2015, that the Bank meets all capital adequacy requirements to which it is subject. The Bank's actual capital amounts and percentages are presented in the table:

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

1) Summary of Significant Accounting Policies, Continued

	<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, 2015:</i>						
Tier 1 Leverage Capital Ratio	\$ 23,511	9.48%	\$ 9,918	4.00%	\$ 12,398	5.00%
Common Equity Tier 1 Risk-based Capital Ratio	23,511	12.79	8,269	4.50	11,945	6.50
Tier 1 Risk-based Capital Ratio	23,511	12.79	11,026	6.00	14,701	8.00
Total Risk-based Capital Ratio	25,810	14.05	14,701	8.00	18,377	10.00
<i>As of December 31, 2014:</i>						
Tier 1 Capital to Average Assets	19,589	9.52	8,227	4.00	10,284	5.00
Tier 1 Capital to Risk-Weighted Assets	19,589	12.84	6,102	4.00	9,154	6.00
Total Capital to Risk-Weighted Assets	21,498	14.09	12,206	8.00	15,257	10.00

(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, 2015:</i>				
U.S. Government agency securities	\$ 8,376	61	(9)	8,428
Municipal securities	9,532	130	(54)	9,608
Mortgage-backed securities	<u>20,065</u>	<u>52</u>	<u>(90)</u>	<u>20,027</u>
	<u>\$ 37,973</u>	<u>243</u>	<u>(153)</u>	<u>38,063</u>
<i>At December 31, 2014:</i>				
U.S. Government agency securities	6,943	19	(99)	6,863
Municipal securities	9,497	113	(79)	9,531
Mortgage-backed securities	<u>25,870</u>	<u>228</u>	<u>(95)</u>	<u>26,003</u>
	<u>\$ 42,310</u>	<u>360</u>	<u>(273)</u>	<u>42,397</u>

(continued)



PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(2) Securities Available for Sale, Continued

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

	<u>Fair Value Measurements Using</u>			
	<u>Fair Value</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, 2015:</i>				
U.S. Government agency securities	\$ 8,428	0	8,428	0
Municipal securities	9,608	0	9,608	0
Mortgage-backed securities	<u>20,027</u>	<u>0</u>	<u>20,027</u>	<u>0</u>
	<u>\$ 38,063</u>	<u>0</u>	<u>38,063</u>	<u>0</u>
<i>At December 31, 2014:</i>				
U.S. Government agency securities	6,863	0	6,863	0
Municipal securities	9,531	0	9,531	0
Mortgage-backed securities	<u>26,003</u>	<u>0</u>	<u>26,003</u>	<u>0</u>
	<u>\$ 42,397</u>	<u>0</u>	<u>42,397</u>	<u>0</u>

During the year ended December 31, 2015 and 2014, no securities were transferred in or out of Level 1, Level 2 or Level 3.

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

	<u>Amortized Cost</u>	<u>Fair Value</u>
<i>At December 31, 2015:</i>		
Due in one to five years	\$ 1,707	1,691
Due five to ten years	12,082	12,191
Due after ten years	4,119	4,154
Mortgage-backed securities	<u>20,065</u>	<u>20,027</u>
	<u>\$ 37,973</u>	<u>38,063</u>

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

	<u>Year Ended December, 31</u>	
	<u>2015</u>	<u>2014</u>
Proceeds received from sales	<u>\$ 4,691</u>	<u>4,587</u>
Gross gains	96	60
Gross losses	<u>(1)</u>	<u>0</u>
Net gain from sale of securities	<u>\$ 95</u>	<u>60</u>

At December 31, 2015 and 2014, securities with a fair value of \$9,601,000 and \$7,054,000, respectively, were pledged as collateral for public deposits and for other borrowings with clients.

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(2) Securities Available for Sale, Continued

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>More Than Twelve Months</u>	
	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<i>At December 31, 2015:</i>				
U.S. Government agency securities	\$ (9)	1,616	\$ 0	0
Municipal securities	(14)	1,620	(40)	1,224
Mortgage-backed securities	<u>(40)</u>	<u>10,803</u>	<u>(50)</u>	<u>2,018</u>
	<u>\$ (63)</u>	<u>14,039</u>	<u>\$ (90)</u>	<u>3,242</u>
<i>At December 31, 2014:</i>				
U.S. Government agency securities	0	0	(99)	5,945
Municipal securities	(2)	269	(77)	3,026
Mortgage-backed securities	<u>(47)</u>	<u>8,250</u>	<u>(48)</u>	<u>1,705</u>
	<u>\$ (49)</u>	<u>8,519</u>	<u>\$ (224)</u>	<u>10,676</u>

The unrealized losses on twenty-two securities at December 31, 2015 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.

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(3) Loans**

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

	<b>At December 31,</b>	
	<b>2015</b>	<b>2014</b>
Real estate mortgage loans:		
Commercial	\$ 57,847	52,661
Residential and home equity	69,817	51,858
Construction	17,493	15,876
Total real estate mortgage loans	145,157	120,395
Commercial loans	40,229	30,755
Consumer and other loans	3,877	2,877
Total loans	189,263	154,027
Less:		
Net deferred loan costs (fees)	286	(60)
Allowance for loan losses	(2,473)	(2,098)
Loans, net	<b>\$ 187,076</b>	<b>151,869</b>

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 classes 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. The real estate mortgage loans are as follows:

***Commercial.*** 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 includes 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 loan portfolio.

(continued)

Notes to Consolidated Financial Statements, Continued

(3) Loans, Continued

**Residential and Home Equity.** The Company offers 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. The nonowner-occupied investment properties are more similar in risk to commercial real estate loans, and therefore, are underwritten by assessing the property's income potential and appraised value. In both cases, we underwrite the borrower's financial condition and evaluate his or her global cash flow position. Borrowers may be affected by numerous factors, including 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 generally sold to the secondary market.

**Construction.** Typically, these loans have a construction period of one to two years and the interest is paid monthly. Once the construction period terminates, some of these loans convert to a term loan with a maturity of one to five years. This portion of our loan portfolio includes loans to small and mid-sized 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, lines of credit, and U.S. Small Business Administration (SBA) loans to small and mid-sized 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. The Bank currently offers SBA 504 and SBA 7A loans. SBA 504 loans provide financing for major fixed assets such as real estate and equipment while SBA 7A loans are generally used to establish a new business or assist in the acquisition, operation, or expansion of an existing business. With both SBA loan programs, there are set eligibility requirements and underwriting standards outlined by SBA that can change as the government alters its fiscal policy. 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, unless secured by liquid collateral or as otherwise justified.

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(3) Loans, Continued

**Consumer and Other Loans.** 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>Commercial</u>	<u>Residential and Home Equity</u>	<u>Construction</u>	<u>Commercial</u>	<u>Consumer and Other Loans</u>	<u>Total</u>
<b>Year Ended December 31, 2015:</b>						
Beginning balance	\$ 641	594	263	562	38	2,098
Provision (credit) for loan losses	66	274	(17)	86	24	433
Net (charge-offs) recoveries	<u>0</u>	<u>0</u>	<u>0</u>	<u>(52)</u>	<u>(6)</u>	<u>(58)</u>
Ending balance	<u>\$ 707</u>	<u>868</u>	<u>246</u>	<u>596</u>	<u>56</u>	<u>2,473</u>
<b>At December 31, 2015:</b>						
Individually evaluated for impairment:						
Recorded investment	<u>\$ 0</u>	<u>0</u>	<u>0</u>	<u>137</u>	<u>7</u>	<u>144</u>
Balance in allowance for loan losses	<u>\$ 0</u>	<u>0</u>	<u>0</u>	<u>62</u>	<u>7</u>	<u>69</u>
Collectively evaluated for impairment:						
Recorded investment	<u>\$ 57,847</u>	<u>69,817</u>	<u>17,493</u>	<u>40,092</u>	<u>3,870</u>	<u>189,119</u>
Balance in allowance for loan losses	<u>\$ 707</u>	<u>868</u>	<u>246</u>	<u>534</u>	<u>49</u>	<u>2,404</u>
<b>Year Ended December 31, 2014:</b>						
Beginning balance	604	545	175	387	23	1,734
Provision for loan losses	441	49	88	139	30	747
Net (charge-offs) recoveries	<u>(404)</u>	<u>0</u>	<u>0</u>	<u>36</u>	<u>(15)</u>	<u>(383)</u>
Ending balance	<u>\$ 641</u>	<u>594</u>	<u>263</u>	<u>562</u>	<u>38</u>	<u>2,098</u>
<b>At December 31, 2014:</b>						
Individually evaluated for impairment:						
Recorded investment	<u>\$ 0</u>	<u>0</u>	<u>0</u>	<u>229</u>	<u>8</u>	<u>237</u>
Balance in allowance for loan losses	<u>\$ 0</u>	<u>0</u>	<u>0</u>	<u>92</u>	<u>6</u>	<u>98</u>
Collectively evaluated for impairment:						
Recorded investment	<u>\$ 52,661</u>	<u>51,858</u>	<u>15,876</u>	<u>30,526</u>	<u>2,869</u>	<u>153,790</u>
Balance in allowance for loan losses	<u>\$ 641</u>	<u>594</u>	<u>263</u>	<u>470</u>	<u>32</u>	<u>2,000</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):

	Real Estate Mortgage Loans					Total
	Commercial	Residential and Home Equity	Construction	Commercial Loans	Consumer and Other Loans	
<i>At December 31, 2015:</i>						
Grade:						
Pass	\$ 52,097	65,367	17,204	39,607	3,836	178,111
Special mention	5,750	3,396	163	461	32	9,802
Substandard	0	1,054	126	161	9	1,350
Doubtful	0	0	0	0	0	0
Loss	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total	<u>\$ 57,847</u>	<u>69,817</u>	<u>17,493</u>	<u>40,229</u>	<u>3,877</u>	<u>189,263</u>
<i>At December 31, 2014:</i>						
Grade:						
Pass	50,654	47,357	15,714	30,006	2,801	146,532
Special mention	0	3,065	154	520	68	3,807
Substandard	2,007	1,436	8	229	8	3,688
Doubtful	0	0	0	0	0	0
Loss	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total	<u>\$ 52,661</u>	<u>51,858</u>	<u>15,876</u>	<u>30,755</u>	<u>2,877</u>	<u>154,027</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 and commercial relationships in excess of \$500,000 are reviewed at least annually. The Company determines the appropriate loan grade during the renewal process and reevaluates the loan grade in situations when a loan becomes past due.

Loans excluded from the review process above are generally classified as pass credits until: (a) they become past due; (b) management becomes aware of deterioration in the credit worthiness of the borrower; or (c) the client 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.

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(3) Loans, Continued

**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 necessarily preclude the potential for recovery, but rather signifies it is no longer practical to defer writing off the asset.

At December 31, 2015, there was one loan over thirty days past due, no loans past due ninety days or more but still accruing and two loans on nonaccrual. Age analysis of past-due loans at December 31, 2015 and 2014 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, 2015:</i>							
Real estate mortgage:							
Commercial	\$ 0	0	0	0	57,847	0	57,847
Residential and home equity	0	0	0	0	69,817	0	69,817
Construction	0	0	0	0	17,493	0	17,493
Commercial	0	0	0	0	40,092	137	40,229
Consumer/other	0	0	0	0	3,877	0	3,877
Total	<u>\$ 0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>189,126</u>	<u>137</u>	<u>189,263</u>
<i>At December 31, 2014:</i>							
Real estate mortgage:							
Commercial	0	0	0	0	52,661	0	52,661
Residential and home equity	0	0	0	0	51,858	0	51,858
Construction	0	0	0	0	15,876	0	15,876
Commercial	18	0	0	0	30,566	171	30,755
Consumer/other	0	0	0	0	2,877	0	2,877
Total	<u>\$ 18</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>153,838</u>	<u>0</u>	<u>154,027</u>

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(3) Loans, Continued

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

	<u>With No Related Allowance Recorded</u>		<u>With an Allowance Recorded</u>			<u>Total</u>		
	<u>Recorded Investment</u>	<u>Unpaid Contractual Principal Balance</u>	<u>Recorded Investment</u>	<u>Unpaid Contractual Principal Balance</u>	<u>Related Allowance</u>	<u>Recorded Investment</u>	<u>Unpaid Contractual Principal Balance</u>	<u>Related Allowance</u>
<i>At December 31, 2015:</i>								
Commercial loans	\$ 0	0	137	137	62	137	137	62
Consumer	0	0	7	7	7	7	7	7
Total	<u>\$ 0</u>	<u>0</u>	<u>144</u>	<u>144</u>	<u>69</u>	<u>144</u>	<u>144</u>	<u>69</u>
<i>At December 31, 2014:</i>								
Commercial loans	\$ 0	0	229	229	92	229	229	92
Consumer	0	0	8	8	6	8	8	6
Total	<u>\$ 0</u>	<u>0</u>	<u>237</u>	<u>237</u>	<u>98</u>	<u>237</u>	<u>237</u>	<u>98</u>

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, 2015:</i>			
Commercial	\$ 270	12	12
Consumer	7	1	1
Total	<u>\$ 277</u>	<u>13</u>	<u>13</u>
<i>Year Ended December 31, 2014:</i>			
Commercial	244	14	14
Consumer	8	1	1
Total	<u>\$ 252</u>	<u>15</u>	<u>15</u>

There were no loans measured at fair value on a nonrecurring basis at December 31, 2015. Impaired collateral-dependent loans measured at fair value on a nonrecurring basis by loan class at December 31, 2014 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 loans	\$ 74	0	0	74	52	52
Consumer loans	0	0	0	0	7	7
Total	<u>74</u>	<u>0</u>	<u>0</u>	<u>74</u>	<u>59</u>	<u>59</u>

(continued)



**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(3) Loans, Continued**

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.

**(4) Premises and Equipment**

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

	<u>At December 31,</u>	
	<u>2015</u>	<u>2014</u>
Land	\$ 690	400
Building	2,449	2,399
Leasehold improvements	377	364
Furniture, fixtures and equipment	930	778
Computer and software	1,723	1,399
Construction in progress	<u>275</u>	<u>0</u>
Total, at cost	6,444	5,340
Less accumulated depreciation and amortization	<u>(2,222)</u>	<u>(1,777)</u>
Premises and equipment, net	<u>\$ 4,222</u>	<u>3,563</u>

The Company leases certain office facilities under an operating lease which expires in 2017, but has two 5-year options to extend. This lease requires monthly lease payments and common area maintenance charges and has options to renew. This lease contains escalation clauses during the term of the lease. Rent expense under this operating lease during the years ended December 31, 2015 and 2014 was \$137,000 and \$88,000, respectively. Future minimum rental commitments under this noncancelable lease are as follows (in thousands):

<u>Year Ending December 31,</u>	<u>Amount</u>
2016	\$ 85
2017	91
2018	98
2019	98
2020	98
Thereafter	<u>709</u>
	<u>\$ 1,179</u>

**(5) Deposits**

The aggregate amount of time deposits with a minimum denomination of \$100,000 was approximately \$18.1 million and \$15.2 million at December 31, 2015 and 2014, respectively.

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

<u>Year Ending December 31,</u>	<u>Amount</u>
2016	\$ 16,627
2017	5,303
2018	255
2019	<u>429</u>
	<u>\$ 22,614</u>

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(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>2015</u>	<u>2014</u>
Balance outstanding at year-end	\$ 0	2,699
Average balance outstanding during the year	1,223	3,592
Average interest rate paid	1.0%	1.0%
Maximum amount outstanding at any month-end during year	2,661	5,733
Pledged securities at year-end	0	3,558

The Company has pledged collateral to the Federal Home Loan Bank of Atlanta (“FHLB”) for future advances which 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 \$36.7 million as of December 31, 2015 from the FHLB. There were no advances outstanding at December 31, 2015 or 2014. The Company also has available credit of \$10.2 million in lines of credit with correspondent banks. All draws under these lines are subject to approval by the correspondent bank.

(7) Income Taxes

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

	<u>Year Ended</u> <u>December 31,</u>	
	<u>2015</u>	<u>2014</u>
Current:		
Federal	\$ 828	560
State	<u>23</u>	<u>107</u>
Total current	<u>851</u>	<u>667</u>
Deferred:		
Federal	(25)	(123)
State	<u>18</u>	<u>(30)</u>
Total deferred	<u>(7)</u>	<u>(153)</u>
Total income taxes	<u>\$ 844</u>	<u>514</u>

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(7) Income Taxes, Continued**

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>2015</u>		<u>2014</u>	
	<u>Amount</u>	<u>% of Pretax Earnings</u>	<u>Amount</u>	<u>% of Pretax Earnings</u>
Income taxes at statutory rate	\$ 866	34.0%	\$ 517	34.0%
Increase (decrease) resulting from:				
State taxes, net of Federal tax benefit	27	1.1	51	3.3
Tax-exempt income	(43)	(1.7)	(42)	(2.7)
Other nondeductible expenses	<u>(6)</u>	<u>(0.3)</u>	<u>(12)</u>	<u>(0.8)</u>
	<u>\$ 844</u>	<u>33.1%</u>	<u>\$ 514</u>	<u>33.8%</u>

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

	<u>Year Ended December 31,</u>	
	<u>2015</u>	<u>2014</u>
Deferred tax assets:		
Allowance for loan losses	\$ 848	710
Organizational and start-up costs	101	116
Stock-based compensation	18	18
Other	<u>9</u>	<u>60</u>
Deferred tax assets	<u>976</u>	<u>904</u>
Deferred tax liabilities:		
Accrual to cash conversion	(89)	(139)
Deferred loan costs	(293)	(109)
Premises and equipment	(192)	(261)
Unrealized gains on securities available for sale	<u>(34)</u>	<u>(33)</u>
Deferred tax liabilities	<u>(608)</u>	<u>(542)</u>
Net deferred tax asset (liability)	<u>\$ 368</u>	<u>362</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 2012.

(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, standby letters of credit, and guaranteed accounts 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, construction loans in process and unused lines of credit are agreements to lend to a client 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 client'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 written conditional commitments issued by the Company to guarantee the performance of a client 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. In the event the client does not perform in accordance with the terms of the agreement with the third party, we would be required to fund the commitment. The maximum potential amount of future payments we could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, we would be entitled to seek recovery from the client. Some of the Bank's standby letters of credit are secured by collateral and those secured letters of credit totaled \$623,000 at December 31, 2015.

Guaranteed accounts are irrevocable standby letters of credit issued by us to guarantee a client's credit line with our third party credit card company, First Arkansas Bank & Trust. As a part of this agreement, we are responsible for the established credit limit on certain accounts plus 10%. The maximum potential amount of future payments we could be required to make is represented by the dollar amount disclosed in the table below.

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, 2015 are as follows (in thousands):

Commitments to extend credit	<u>\$ 3,940</u>
Construction loans in process	<u>\$ 4,799</u>
Unused lines of credit	<u>\$ 31,730</u>
Standby letters of credit	<u>\$ 1,097</u>
Guaranteed Accounts	<u>\$ 116</u>

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(9) Stock Option Plan**

The 2015 Stock Incentive Compensation Plan (the “2015 Plan”) was approved by Shareholders at the Company’s annual meeting of shareholders on May 20, 2015 and permits the Company to grants its key employees and directors stock options, stock appreciation rights, performance shares, and phantom stock. Under the 2015 Plan, the amount of shares which may be issued is 500,000, but in no instance more than 15% of the issued and outstanding shares of the Company’s common stock. As of December 31, 2015, no stock options, stock appreciation rights, performance shares, or phantom stock shares had been issued under the 2015 Plan. As of May 20, 2015, no further grants will be made under the 2007 Stock Option Plan (the “2007 Plan”). Unexercised stock options that were granted under the 2007 Plan will remain outstanding and will expire under the terms of the individual stock grant.

A summary of the activity in the Company’s 2007 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, 2013	134,000	10.01		
Options exercised	(14,200)	10.00		
Options forfeited	<u>(11,400)</u>	\$ 10.00		
Outstanding at December 31, 2014	108,400	\$ 10.01		
Options granted	15,000	12.50		
Options exercised	(30,540)	10.00		
Options forfeited	(17,360)	11.44		
Outstanding at December 31, 2015	<u>75,500</u>	<u>\$ 10.19</u>	<u>3.3 years</u>	
Exercisable at December 31, 2015	<u>68,400</u>	<u>10.01</u>	<u>3.1 years</u>	<u>\$159,000</u>

At December 31, 2015, there was \$2,000 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 twenty-two months. The total fair value of shares vesting and recognized as compensation expense was \$15,000 and \$2,000 in the years ended December 31, 2015 and 2014, respectively. The associated income tax benefit recognized was \$5,000 and \$0 for the years ended December 31, 2015 and 2014, respectively.

The fair value of each option granted during the year ended December 31, 2015 was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	<u>Year Ended December 31, 2015</u>
Weighted average risk-free interest rate	0.89%
Expected dividend yield	-
Expected stock volatility	8.13%
Expected life in years	3.0
Per share fair value of options issued during the year	\$ 0.87

(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. Contributions to the plan for the years ended December 31, 2015 and 2014 were \$100,000 and \$102,000, 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 table summarizes these transactions (in thousands):

	<u>Year Ended December 31,</u>	
	<u>2015</u>	<u>2014</u>
Loans:		
Beginning balance	\$ 6,107	4,464
Originated during the year	283	2,727
Principal repayments	<u>(308)</u>	<u>(1,084)</u>
Ending balance	<u>\$ 6,082</u>	<u>6,107</u>
Deposits at year end	<u>\$ 18,166</u>	<u>16,510</u>

The Company leases an office facility from a related party. Rent expense under the operating lease during the years ended December 31, 2015 and 2014 was \$137,000 and \$88,000, respectively. In addition, the Bank has contracted with a related party to perform loan reviews of the Bank's loan portfolio. Loan review expenses totaled \$20,000 in both the year ended December 31, 2015 and the year ended December 31, 2014.

During July, 2015, the Bank purchased three acres of land in Wakulla County, Florida from a related party for \$290,000 for the purpose of building a branch office.

(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>Level</u>	<u>At December 31,</u>			
		<u>2015</u>		<u>2014</u>	
		<u>Carrying</u>	<u>Fair</u>	<u>Carrying</u>	<u>Fair</u>
		<u>Amount</u>	<u>Value</u>	<u>Amount</u>	<u>Value</u>
Financial assets:					
Cash and cash equivalents	1	\$ 8,429	8,429	7,555	7,555
Securities available for sale	2	38,063	38,063	42,397	42,397
Loans held for sale	3	2,722	2,791	1,871	1,923
Loans, net	3	187,076	188,784	151,869	148,588
Federal Home Loan Bank stock	3	189	189	186	186
Accrued interest receivable	3	692	692	624	624
Bank-owned life insurance	3	1,662	1,662	1,613	1,613
Financial liabilities:					
Deposits	3	217,573	217,652	183,971	184,057
Other borrowings	3	0	0	2,699	2,699
Off-balance-sheet financial instruments	3	0	0	0	0

**(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.

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 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2015, that the Bank meets all capital adequacy requirements to which it is subject.

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(14) Regulatory Matters, Continued**

As of December 31, 2015, the Bank is 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 1 risk-based, and Tier 1 leverage percentages 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 percentages are also presented in the table (\$ in thousands):

	<b>Actual</b>		<b>For Capital Adequacy Purposes</b>		<b>For Well Capitalized Purposes</b>	
	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>
<i>As of December 31, 2015</i>						
Tier 1 Leverage Capital	\$ 23,511	9.48%	\$ 9,918	4.00%	\$ 12,398	5.00%
Common Equity Tier 1						
Risk-based Capital	23,511	12.79	8,269	4.50	11,945	6.50
Tier 1 Risk-based Capital	23,511	12.79	11,026	6.00	14,701	8.00
Total Risk-based Capital	25,810	14.05	14,701	8.00	18,377	10.00
<i>As of December 31, 2014</i>						
Tier 1 Capital to Average Assets	19,589	9.52	8,227	4.00	10,284	5.00
Tier 1 Capital to Risk-based						
Assets	19,589	12.84	6,102	4.00	9,154	6.00
Total Capital to Risk-Weighted						
Assets	19,589	14.09	12,206	8.00	15,257	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, 2015, there is no pending or threatened litigation of which management is aware.

**(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):

	<u>2015</u>			<u>2014</u>		
	<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	\$ 1,704	1,945,980	\$ 0.88	\$ 1,006	1,709,746	\$ 0.59
Effect of dilutive securities-						
Incremental shares from						
assumed conversion of						
options		<u>9,593</u>			<u>16,916</u>	
Diluted EPS:						
Net earnings	<u>\$ 1,704</u>	<u>1,955,573</u>	<u>\$ 0.87</u>	<u>\$ 1,006</u>	<u>1,726,662</u>	<u>\$ 0.58</u>

(continued)



**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(17) Common Stock Offering**

The Company filed a Registration Statement with the Securities and Exchange Commission which became effective on December 11, 2013. The Company offered up to 1,200,000 shares of common stock for \$12.50 per share through December 31, 2014, when the Stock Offering was closed. The Company sold 425,619 shares and raised \$4.96 million, net of expenses.

**(18) Reclassification**

Certain noninterest expenses were reclassified from other noninterest expense and occupancy and equipment to advertising and FDIC/State assessment for the year ended December 31, 2014 to conform to 2015 presentation. The reclassification of expenses had no effect on net earnings.

**(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>2015</u>	<u>2014</u>
<b>Assets</b>		
Cash	\$ 1,139	3,132
Investment in subsidiary	23,567	19,643
Other assets	<u>227</u>	<u>92</u>
Total assets	<u>\$ 24,933</u>	<u>22,867</u>
<b>Stockholders' Equity</b>		
Stockholders' equity	<u>24,933</u>	<u>22,867</u>
Total liabilities and stockholders' equity	<u>\$ 24,933</u>	<u>22,867</u>

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

	<u>Year Ended December 31,</u>	
	<u>2015</u>	<u>2014</u>
Revenues	\$ 0	0
Expenses	(322)	(110)
Income tax benefit	<u>119</u>	<u>41</u>
Loss before earnings of subsidiary	(203)	(69)
Net earnings of subsidiary	<u>1,907</u>	<u>1,075</u>
Net earnings	<u>\$ 1,704</u>	<u>1,006</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><u>2015</u></b>	<b><u>2014</u></b>
Cash flows from operating activities:		
Net earnings	\$ 1,704	1,006
Adjustments to reconcile net earnings to net cash used in operating activities:		
Equity in earnings of subsidiary	(1,907)	(1,075)
Stock issued as compensation	39	32
Increase (decrease) in other assets	(135)	177
Decrease in liabilities	<u>0</u>	<u>(218)</u>
Net cash used in operating activities	<u>(299)</u>	<u>(78)</u>
Cash flow from financing activities:		
Proceeds from sale of common stock	0	4,955
Proceeds from stock options exercised	<u>306</u>	<u>142</u>
Net cash provided by financing activities	<u>306</u>	<u>5,097</u>
Cash flow from investment activities:		
Cash dividend received from bank subsidiary	0	300
Capital infusion in subsidiary	<u>(2,000)</u>	<u>(2,200)</u>
Net cash used in investing activities	<u>(2,000)</u>	<u>(1,900)</u>
Net (decrease) increase in cash	(1,993)	3,119
Cash at beginning of the year	<u>3,132</u>	<u>13</u>
Cash at end of year	<u>\$ 1,139</u>	<u>3,132</u>
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	<u>\$ 2</u>	<u>369</u>
Stock-based compensation expense of subsidiary	<u>\$ 15</u>	<u>2</u>

2015 BY THE NUMBERS

**\$244** | TOTAL ASSETS (IN MILLIONS)  
OF THE COMPANY  
AS OF DEC. 31, 2015

**\$1.7** | 2015 NET INCOME  
(IN MILLIONS)

**\$187** | LOANS FUNDED  
(IN MILLIONS)  
AS OF DEC. 31, 2015

**24** | NUMBER OF CONSECUTIVE  
QUARTERS RANKED 5 STARS  
BY BAUER FINANCIAL

**77** | PERCENT INCREASE IN  
MORTGAGE BANKING  
REVENUE OVER 2015

**12** | RANKING (NATIONALLY)  
BEST BANKS TO WORK FOR  
AMERICAN BANKER MAGAZINE



EXECUTIVE  
MANAGEMENT

PRIME MERIDIAN BANK



Sammie D. Dixon, Jr.  
*President  
Chief Executive Officer*



Randy Guemple  
*Executive Vice President  
Chief Financial Officer*



Chris L. Jensen, Jr.  
*Executive Vice President  
Senior Lender*



Susan Payne Turner  
*Executive Vice President  
Chief Risk Officer*

**BOARD OF  
DIRECTORS**

PRIME MERIDIAN BANK

Sammie D. Dixon, Jr.  
*President*  
*Chief Executive Officer*

R. Randy Guemple  
*Executive Vice President*  
*Chief Financial Officer*

Chris L. Jensen, Jr.  
*Executive Vice President*  
*Senior Lender*

Richard A. Weidner  
*Chairman*

William D. Crona

Steven L. Evans

Kathleen C. Jones

Robert H. Kirby

Frank L. Langston

Todd A. Patterson, D.O.

L. Collins Proctor

Garrison A. Rolle, M.D.

Steven D. Smith

Marjorie R. Turnbull

Passion  
*Grace*  
INTEGRITY  
**TENACITY**  
ACCOUNTABILITY

**PRIME MERIDIAN BANK**

MEMBER



**MAIN OFFICE**

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Tallahassee, FL 32308  
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