

ANNUAL REPORT | 2017



PRIME
MERIDIAN
HOLDING COMPANY



Dear Fellow Shareholders,

As Prime Meridian Bank rounded the corner toward its ten-year anniversary, several factors made 2017 pivotal for the Bank and the Company.

The Company completed a capital offering in the second quarter of 2017 that netted approximately \$17 million and strategically positioned the Company for future growth and expansion.

Responding to enactment of the Tax Cuts and Job Act on December 22, 2017, the Company revalued its deferred tax asset position to reflect a reduction in its federal corporate income tax rate from 34% to 21%.

This revaluation resulted in a one-time, non-cash charge of \$155,000 recorded in income tax expense during the fourth quarter of 2017. Going forward the reduction in the corporate income tax rate is expected to benefit the Company.

The Company also declared an annual cash dividend of \$0.10 per share on the Company's common stock. This dividend was payable March 6, 2018, to shareholders of record on February 15, 2018.

Prime Meridian Bank maintains its commitment to asset quality and margins in a highly competitive market. We will not compromise the way we structure loans. Building relationships and maintaining our credit standards are as important now as they have ever been.

As we build our Bank we filter everything through the lens of what is right. Decisions about possible expansion, the people we hire, and how we operate must be a good fit for our culture as we move forward.

The continued strength of the Bank's team plays a significant role in our growth. At 71 full-time equivalent employees as of December 31, 2017, the team maintains its ability to operate efficiently with a 65.01% Efficiency Ratio for the year. In September, the team was, again, recognized as one of the nation's Best Banks to Work For (#22) by American Banker magazine.

The Bank maintained an important role in the community by providing financial and volunteer support to dozens of non-profits, schools and programs. We hosted a cybersecurity workshop for clients in the accounting profession to educate them on best practices to protect their business and clients from emerging threats.

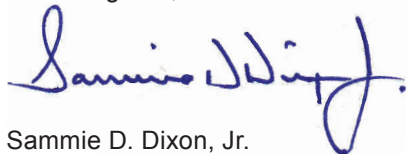
The Mortgage Department continues to build its sales and loan operations team. According to Metro Market Trends reporting service, Prime Meridian Bank ranked third in the Leon County market in mortgage dollar volume for 2017.

Other highlights include:

- Net income increased 26.9% to \$2.8 million from 2016 to 2017, boosted by solid growth in both net interest income and noninterest income.
- Year over year, the Company reported steady growth in its net loan portfolio. Net loans grew 12.3%, or \$27.5 million, to \$250.3 million, with approximately half of that growth coming from the commercial real estate sector.
- Mortgage banking revenue continues to be a growing contributor to net earnings, accounting for 63.6% of noninterest income in 2017, compared to 57.4% in 2016.

On behalf of the Company's shareholders, we are proud of Prime Meridian's accomplishments over the previous year. It is with great pleasure that we present the enclosed 2017 Annual Report.

Warm regards,



Sammie D. Dixon, Jr.
Vice Chairman, President and Chief Executive Officer

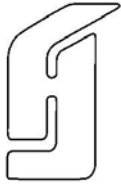


Richard A. Weidner, CPA
Chairman

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Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors
Prime Meridian Holding Company
Tallahassee, Florida:

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Prime Meridian Holding Company and Subsidiary (the "Company"), as of December 31, 2017 and 2016 and the related consolidated statements of earnings, comprehensive income, stockholders' equity and cash flows for the years then ended and the related notes (collectively referred to as the "financial statements"). In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2017 and 2016, and the consolidated 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.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, the Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Hacker, Johnson & Smith PA

HACKER, JOHNSON & SMITH PA
We have served as the Company's auditor since 2008.
Tampa, Florida
March 20, 2018

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Consolidated Balance Sheets

	December 31,	
	2017	2016
<i>(dollars in thousands, except per share amounts)</i>		
Assets		
Cash and due from banks	\$ 6,971	\$ 4,817
Federal funds sold	20,148	25,963
Interest-bearing deposits	5,278	5,385
Total cash and cash equivalents	<u>32,397</u>	<u>36,165</u>
Securities available for sale	49,809	33,103
Loans held for sale	5,880	3,291
Loans, net of allowance for loan losses of \$3,136 and \$2,876	250,259	222,768
Federal Home Loan Bank stock	316	220
Premises and equipment, net	4,872	4,929
Deferred tax asset	339	533
Accrued interest receivable	978	798
Bank-owned life insurance	1,757	1,711
Other assets	573	423
Total assets	<u>\$ 347,180</u>	<u>\$ 303,941</u>
Liabilities and Stockholders' Equity		
Liabilities:		
Noninterest-bearing demand deposits	\$ 76,216	\$ 61,856
Savings, NOW and money-market deposits	200,027	192,768
Time deposits	22,054	20,723
Total deposits	<u>298,297</u>	<u>275,347</u>
Official checks	1,146	632
Other liabilities	764	880
Total liabilities	<u>300,207</u>	<u>276,859</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, 3,118,977 and 2,004,707 issued and outstanding	31	20
Additional paid-in capital	37,953	20,732
Retained earnings	9,285	6,563
Accumulated other comprehensive loss	(296)	(233)
Total stockholders' equity	<u>46,973</u>	<u>27,082</u>
Total liabilities and stockholders' equity	<u>\$ 347,180</u>	<u>\$ 303,941</u>

See Accompanying Notes to Consolidated Financial Statements

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Consolidated Statements of Earnings

	Year Ended December 31,	
	2017	2016
<i>(in thousands, except per share amounts)</i>		
Interest income:		
Loans	\$ 11,589	\$ 9,956
Securities	983	700
Other	379	117
Total interest income	<u>12,951</u>	<u>10,773</u>
Interest expense:		
Deposits	1,181	829
Other borrowings	-	1
Total interest expense	<u>1,181</u>	<u>830</u>
Net interest income	11,770	9,943
Provision for loan losses	<u>256</u>	<u>424</u>
Net interest income after provision for loan losses	<u>11,514</u>	<u>9,519</u>
Noninterest income:		
Service charges and fees on deposit accounts	322	250
Mortgage banking revenue	1,255	935
Income from bank-owned life insurance	46	49
(Loss) gain on sale of securities available for sale	(1)	102
Other income	351	294
Total noninterest income	<u>1,973</u>	<u>1,630</u>
Noninterest expense:		
Salaries and employee benefits	5,056	4,131
Occupancy and equipment	947	907
Professional fees	320	346
Advertising	574	487
FDIC assessment	158	152
Software maintenance, amortization and other	535	501
Other	1,345	1,188
Total noninterest expense	<u>8,935</u>	<u>7,712</u>
Earnings before income taxes	4,552	3,437
Income taxes	<u>1,735</u>	<u>1,217</u>
Net earnings	<u>\$ 2,817</u>	<u>\$ 2,220</u>
Earnings per common share:		
Basic	<u>\$ 1.04</u>	<u>\$ 1.12</u>
Diluted	<u>\$ 1.04</u>	<u>\$ 1.11</u>

See Accompanying Notes to Consolidated Financial Statements

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Consolidated Statements of Comprehensive Income

	Year Ended December 31,	
	2017	2016
<i>(in thousands)</i>		
Net earnings	\$ 2,817	\$ 2,220
Other comprehensive loss:		
Change in unrealized loss on securities:		
Unrealized loss arising during the year	(27)	(358)
Reclassification adjustment for realized loss (gain)	1	(102)
Net change in unrealized loss	(26)	(460)
Deferred income tax benefit on above change	8	171
One-time reclassification for newly enacted corporate tax rate	(45)	-
Total other comprehensive loss	(63)	(289)
Comprehensive income	<u>\$ 2,754</u>	<u>\$ 1,931</u>

See Accompanying Notes to Consolidated Financial Statements.

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Consolidated Statements of Stockholders' Equity

Years Ended December 31, 2017 and 2016

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Compre- hensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount				
<i>(dollars in thousands)</i>						
Balance at December 31, 2015	1,975,329	\$ 20	\$ 20,415	\$ 4,442	\$ 56	\$ 24,933
Net earnings	-	-	-	2,220	-	2,220
Dividends paid	-	-	-	(99)	-	(99)
Net change in unrealized loss on securities available for sale, net of income tax benefit of \$171	-	-	-	-	(289)	(289)
Stock options exercised	25,450	-	261	-	-	261
Common stock issued as compensation to directors	3,928	-	55	-	-	55
Stock-based compensation	-	-	1	-	-	1
Balance at December 31, 2016	<u>2,004,707</u>	<u>\$ 20</u>	<u>\$ 20,732</u>	<u>\$ 6,563</u>	<u>\$ (233)</u>	<u>\$ 27,082</u>
Net earnings	-	\$ -	\$ -	\$ 2,817	\$ -	\$ 2,817
Dividends paid	-	-	-	(140)	-	(140)
Net change in unrealized loss on securities available for sale, net of income tax benefit of \$8 and one-time reclassification for newly enacted corporate tax rate	-	-	-	45	(63)	(18)
Stock options exercised	19,450	-	195	-	-	195
Common stock issued as compensation to directors	3,912	-	65	-	-	65
Sale of common stock, net of stock offering costs of \$1,043	1,090,908	11	16,946	-	-	16,957
Stock-based compensation	-	-	15	-	-	15
Balance at December 31, 2017	<u>3,118,977</u>	<u>\$ 31</u>	<u>\$ 37,953</u>	<u>\$ 9,285</u>	<u>\$ (296)</u>	<u>\$ 46,973</u>

See Accompanying Notes to Consolidated Financial Statements.

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Consolidated Statements of Cash Flows

	Year Ended December 31,	
	2017	2016
<i>(in thousands)</i>		
Cash flows from operating activities:		
Net earnings	\$ 2,817	\$ 2,220
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	519	528
Provision for loan losses	256	424
Net amortization of deferred loan fees	(74)	(64)
Deferred income taxes	202	6
Loss (gain) on sale of securities available for sale	1	(102)
Amortization of premiums and discounts on securities available for sale	425	430
Gain on sale of loans held for sale	(1,101)	(813)
Proceeds from the sale of loans held for sale	65,905	49,739
Loans originated as held for sale	(67,393)	(49,495)
Stock issued as compensation	65	55
Stock-based compensation expense	15	1
Income from bank-owned life insurance	(46)	(49)
Net increase in accrued interest receivable	(180)	(106)
Net (increase) decrease in other assets	(150)	198
Net increase (decrease) in other liabilities and official checks	398	(26)
Net cash provided by operating activities	<u>1,659</u>	<u>2,946</u>
Cash flows from investing activities:		
Loan originations, net of principal repayments	(27,673)	(36,052)
Purchase of securities available for sale	(23,524)	(13,425)
Principal repayments of securities available for sale	5,553	7,892
Proceeds from the sale of securities available for sale	750	8,248
Maturities and calls of securities available for sale	63	1,457
Purchase of Federal Home Loan Bank stock	(96)	(31)
Purchase of premises and equipment	(462)	(1,235)
Net cash used in investing activities	<u>(45,389)</u>	<u>(33,146)</u>
Cash flows from financing activities:		
Net increase in deposits	22,950	57,774
Proceeds from stock options exercised	195	261
Proceeds from sale of common stock, net	16,957	-
Dividends paid	(140)	(99)
Net cash provided by financing activities	<u>39,962</u>	<u>57,936</u>
Net (decrease) increase in cash and cash equivalents	(3,768)	27,736
Cash and cash equivalents at beginning of year	36,165	8,429
Cash and cash equivalents at end of year	<u>\$ 32,397</u>	<u>\$ 36,165</u>
Supplemental disclosure of cash flow information		
Cash paid during the year for:		
Interest	<u>\$ 1,179</u>	<u>\$ 830</u>
Income taxes	<u>\$ 1,698</u>	<u>\$ 1,030</u>
Noncash transactions:		
Accumulated other comprehensive loss, net change in unrealized loss on securities available for sale, net of tax benefit	<u>\$ (18)</u>	<u>\$ (289)</u>
One-time reclassification for newly enacted corporate tax rate	<u>\$ (45)</u>	<u>\$ -</u>

See Accompanying Notes to Consolidated Financial Statements

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements

At December 31, 2017 and 2016 and for the Years Then Ended

(1) Summary of Significant Accounting Policies

Organization. Prime Meridian Holding Company (“PMHG”) owns 100% of the outstanding common stock of Prime Meridian Bank (the “Bank”) (collectively the “Company”). PMHG’s primary activity is the operation of the Bank. The Bank is a Florida state-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 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 PMHG and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

Cash and Cash Equivalents. For purposes of the consolidated statements 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, 2017 and 2016, 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 \$2,618,000 and \$1,799,000 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 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 or call date, if applicable.

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 includes mortgage loans and Small Business Administration (“SBA”) loans 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. For the years ended December 31, 2017 and 2016, gains on loans held for sale are reported on the Consolidated Statements of Earnings under noninterest income in mortgage banking revenue, as there were no SBA loans sold during 2017 or 2016. At December 31, 2017 loans held for sale were \$5,880,000 compared to \$3,291,000 at December 31, 2016. At December 31, 2017 and 2016, market values exceeded book values in the aggregate.

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 the 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 years ended December 31, 2017 and 2016.

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: (1) changes in lending policies and procedures, risk selection and underwriting standards; (2) changes in national, regional and local economic conditions that affect the collectability of the loan portfolio; (3) changes in the experience, ability and depth of lending management and other relevant staff; (4) changes in the volume and severity of past due loans, nonaccrual loans or loans classified special mention, substandard, doubtful or loss; (5) quality of loan review and Board of Directors oversight; (6) changes in the nature and volume of the loan portfolio and terms of loans; (7) the existence and effect of any concentrations of credit and changes in the level of such concentrations; (8) changes in collateral dependent loans; and (9) the effect of other external factors, trends or uncertainties that could affect management’s estimate of probable losses, such as competition and industry conditions.

(continued)

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, computer 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 financial and performance 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.

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(1) Summary of Significant Accounting Policies, Continued

Income Taxes, Continued. 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, 2017, 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.

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.

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.

(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. 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 (Level 3).

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).

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).

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-Based Compensation. The Company expenses the fair value of any stock options granted. The Company recognizes stock option compensation in the consolidated statements of earnings as the options vest.

Comprehensive Income. GAAP requires 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 and losses on the sale of mortgage loans originated for sale and wholesale brokerage fees. The Company recognizes mortgage banking revenue from mortgage loans originated in the consolidated statements of earnings upon sale of the loans.

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(1) Summary of Significant Accounting Policies, Continued

Recent Accounting Standards Update. In January 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 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 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 Company’s other deferred tax assets. For public business entities, the ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The adoption of this guidance did not have any impact on the Company’s consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-2, *Leases (Topic 842)* which will require lessees to recognize on the consolidated balance sheet the assets and liabilities for the rights and obligations created by those leases with term of more than twelve months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. The new ASU will require both types of leases to be recognized on the balance sheet. The ASU also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the consolidated financial statements. For public companies, the ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is in the process of determining the effect of the ASU on its consolidated financial statements. Early adoption is permitted.

In March 2016, the FASB issued ASU No. 2016-09, *Compensation-Stock Compensation (Topic 718)* intended to improve the accounting for employee share-based payments. The ASU affects all organizations that issue share-based payment awards to their employees. The ASU simplifies several aspects of the accounting for share-based payment award transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the consolidated statement of cash flows. For public companies, the amendments in this ASU are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The adoption of this guidance did not have any impact on the Company’s consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments-Credit Losses (Topic 326)*. The ASU improves financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by the Company. The ASU requires the Company to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. The Company will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The new guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted. The Company is in the process of determining the effect of the ASU on its consolidated financial statements.

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(1) Summary of Significant Accounting Policies, Continued

Recent Accounting Standards Update, Continued. In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments in this update provide a more robust framework to use in determining when a set of assets and activities is a business. Because the current definition of a business is interpreted broadly and can be difficult to apply, stakeholders indicated that analyzing transactions is inefficient and costly and that the definition does not permit the use of reasonable judgment. The amendments provide more consistency in applying the guidance, reduce the costs of application, and make the definition of a business more operable. The amendments in this update become effective for annual periods and interim periods within those annual periods beginning after December 15, 2017. The Company is currently evaluating the impact of adopting the new guidance on the consolidated financial statements, but it is not expected to have a material impact.

In March 2017, the FASB issued ASU No. 2017-08, “Premium Amortization on Purchased Callable Debt Securities”, to amend the amortization period for certain purchased callable debt securities held at a premium. Under current GAAP, entities generally amortize the premium as an adjustment of yield over the contractual life of the instrument. The amendments in this update require the premium to be amortized to the earliest call date. No accounting change is required for securities held at a discount. For public business entities, the amendments in this update become effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity should apply the amendments in this update on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company has adhered to this practice since its inception.

In February 2018, the FASB issued ASU No. 2018-02, *Income Statement Reporting Comprehensive Income (Topic 220)*. The ASU requires a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate. The amount of the reclassification would be the difference between the historical corporate income tax rate and the newly enacted 21% corporate income tax rate. The Company early adopted the ASU. The impact of the ASU was to increase retained earnings and other comprehensive loss by \$45,000.

(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:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<i>(in thousands)</i>				
At December 31, 2017				
U.S. Government agency securities	\$ 1,251	\$ 6	\$ (8)	\$ 1,249
Municipal securities	12,340	128	(95)	12,373
Mortgage-backed securities	36,614	23	(450)	36,187
Total	<u>\$ 50,205</u>	<u>\$ 157</u>	<u>\$ (553)</u>	<u>\$ 49,809</u>
At December 31, 2016				
U.S. Government agency securities	\$ 2,186	\$ 2	\$ (17)	\$ 2,171
Municipal securities	12,614	91	(282)	12,423
Mortgage-backed securities	18,673	36	(200)	18,509
Total	<u>\$ 33,473</u>	<u>\$ 129</u>	<u>\$ (499)</u>	<u>\$ 33,103</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:

	Fair Value	Fair Value Measurements Using		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<i>(in thousands)</i>				
At December 31, 2017				
U.S. Government agency securities	\$ 1,249	\$ -	\$ 1,249	\$ -
Municipal securities	12,373	-	12,373	-
Mortgage-backed securities	36,187	-	36,187	-
Total	<u>\$ 49,809</u>	<u>\$ -</u>	<u>\$ 49,809</u>	<u>\$ -</u>
At December 31, 2016				
U.S. Government agency securities	\$ 2,171	\$ -	\$ 2,171	\$ -
Municipal securities	12,423	-	12,423	-
Mortgage-backed securities	18,509	-	18,509	-
Total	<u>\$ 33,103</u>	<u>\$ -</u>	<u>\$ 33,103</u>	<u>\$ -</u>

During the years ended December 31, 2017 and 2016, no securities were transferred in or out of Level 1, Level 2 or Level 3.

The scheduled maturities of securities are as follows:

	Amortized Cost	Fair Value
<i>(in thousands)</i>		
At December 31, 2017		
Due in less than one year	\$ 511	\$ 511
Due in one to five years	2,452	2,417
Due in five to ten years	7,863	7,951
Due after ten years	2,765	2,743
Mortgage-backed securities	36,614	36,187
Total	<u>\$ 50,205</u>	<u>\$ 49,809</u>

The following summarizes sales of securities available for sale:

	Year Ended December 31,	
	2017	2016
<i>(in thousands)</i>		
Proceeds from sale of securities	\$ 750	\$ 8,248
Gross gains	-	102
Gross losses	(1)	-
Net (loss) gain on sale of securities	<u>\$ (1)</u>	<u>\$ 102</u>

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(2) Securities Available for Sale, Continued

At December 31, 2017 and 2016, securities with a fair value of \$9,090,302 and \$9,279,000, respectively, were pledged as collateral for public deposits and for other borrowings with clients.

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:

	<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>(in thousands)</i>				
At December 31, 2017				
Securities Available for Sale				
U.S. Government agency securities	\$ (8)	\$ 694	\$ -	\$ -
Municipal securities	(36)	1,831	(59)	1,203
Mortgage-backed securities	(308)	29,742	(142)	5,667
Total	<u>\$ (352)</u>	<u>\$ 32,267</u>	<u>\$ (201)</u>	<u>\$ 6,870</u>
At December 31, 2016				
Securities Available for Sale				
U.S. Government agency securities	\$ (17)	\$ 1,529	\$ -	\$ -
Municipal securities	(282)	6,111	-	-
Mortgage-backed securities	(191)	12,709	(9)	501
Total	<u>\$ (490)</u>	<u>\$ 20,349</u>	<u>\$ (9)</u>	<u>\$ 501</u>

The unrealized losses on thirty-four and twenty-four securities at December 31, 2017 and 2016, respectively, 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:

<i>(in thousands)</i>	At December 31,	
	2017	2016
Real estate mortgage loans:		
Commercial	\$ 79,565	\$ 65,805
Residential and home equity	94,824	88,883
Construction	26,813	19,991
Total real estate mortgage loans	201,202	174,679
Commercial loans	44,027	46,340
Consumer and other loans	7,742	4,275
Total loans	252,971	225,294
Add (Less):		
Net deferred loan costs	424	350
Allowance for loan losses	(3,136)	(2,876)
Loans, net	\$ 250,259	\$ 222,768

(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 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 are 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 flow 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.

Residential and Home Equity. The Company offers first and second one-to-four family mortgage loans, multifamily residential 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, 5-year, or 7-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, generally with a maturity of one to ten years. 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.

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(3) Loans, Continued

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 and do not require a formal valuation of the business collateral. When commercial loans are secured by specifically identified collateral, then the valuation of the 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.

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. Therefore, both secured and unsecured consumer loans subject the Company 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.

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(3) Loans, Continued

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

	Real Estate Mortgage Loans			Commercial Loans	Consumer and Other Loans	Total
	Commercial	Residential and Home Equity	Construction			
<i>(in thousands)</i>						
Year Ended December 31, 2017						
Beginning balance	\$ 775	\$ 1,074	\$ 258	\$ 714	\$ 55	\$ 2,876
Provision (credit) for loan losses	119	23	73	(6)	47	256
Net (charge-offs) recoveries	-	-	-	16	(12)	4
Ending balance	<u>\$ 894</u>	<u>\$ 1,097</u>	<u>\$ 331</u>	<u>\$ 724</u>	<u>\$ 90</u>	<u>\$ 3,136</u>
At December 31, 2017						
Individually evaluated for impairment:						
Recorded investment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 134</u>	<u>\$ -</u>	<u>\$ 134</u>
Balance in allowance for loan losses	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 134</u>	<u>\$ -</u>	<u>\$ 134</u>
Collectively evaluated for impairment:						
Recorded investment	<u>\$ 79,565</u>	<u>\$ 94,824</u>	<u>\$ 26,813</u>	<u>\$ 43,893</u>	<u>\$ 7,742</u>	<u>\$ 252,837</u>
Balance in allowance for loan losses	<u>\$ 894</u>	<u>\$ 1,097</u>	<u>\$ 331</u>	<u>\$ 590</u>	<u>\$ 90</u>	<u>\$ 3,002</u>
Year Ended December 31, 2016						
Beginning balance	\$ 707	\$ 868	\$ 246	\$ 596	\$ 56	\$ 2,473
Provision (credit) for loan losses	68	206	12	135	3	424
Net (charge-offs) recoveries	-	-	-	(17)	(4)	(21)
Ending balance	<u>\$ 775</u>	<u>\$ 1,074</u>	<u>\$ 258</u>	<u>\$ 714</u>	<u>\$ 55</u>	<u>\$ 2,876</u>
At December 31, 2016						
Individually evaluated for impairment:						
Recorded investment	<u>\$ -</u>	<u>\$ 662</u>	<u>\$ 73</u>	<u>\$ 76</u>	<u>\$ -</u>	<u>\$ 811</u>
Balance in allowance for loan losses	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 76</u>	<u>\$ -</u>	<u>\$ 76</u>
Collectively evaluated for impairment:						
Recorded investment	<u>\$ 65,805</u>	<u>\$ 88,221</u>	<u>\$ 19,918</u>	<u>\$ 46,264</u>	<u>\$ 4,275</u>	<u>\$ 224,483</u>
Balance in allowance for loan losses	<u>\$ 775</u>	<u>\$ 1,074</u>	<u>\$ 258</u>	<u>\$ 638</u>	<u>\$ 55</u>	<u>\$ 2,800</u>

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(3) Loans, Continued

The following summarizes the loan credit quality:

<i>(in thousands)</i>	<u>Real Estate Mortgage Loans</u>			<u>Commercial Loans</u>	<u>Consumer and Other Loans</u>	<u>Total</u>
	<u>Commercial</u>	<u>Residential and Home Equity</u>	<u>Construction</u>			
At December 31, 2017						
Grade:						
Pass	\$ 74,560	\$ 92,282	\$ 26,356	\$ 42,874	\$ 7,715	\$ 243,787
Special mention	4,382	2,122	298	591	27	7,420
Substandard	623	420	159	562	-	1,764
Doubtful	-	-	-	-	-	-
Loss	-	-	-	-	-	-
Total	<u>\$ 79,565</u>	<u>\$ 94,824</u>	<u>\$ 26,813</u>	<u>\$ 44,027</u>	<u>\$ 7,742</u>	<u>\$ 252,971</u>
At December 31, 2016						
Grade:						
Pass	\$ 61,734	\$ 84,695	\$ 19,485	\$ 45,623	\$ 4,227	\$ 215,764
Special mention	4,071	3,152	333	250	46	7,852
Substandard	-	1,036	173	467	2	1,678
Doubtful	-	-	-	-	-	-
Loss	-	-	-	-	-	-
Total	<u>\$ 65,805</u>	<u>\$ 88,883</u>	<u>\$ 19,991</u>	<u>\$ 46,340</u>	<u>\$ 4,275</u>	<u>\$ 225,294</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, 2017, there were two loans over sixty days past due and accruing, 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, 2017 and 2016 is as follows:

	Accruing Loans				Current	Nonaccrual Loans	Total Loans
	30-59 Days Past Due	60-89 Days Past Due	90 Days Past Due	Greater Than Total Past Due			
<i>(in thousands)</i>							
At December 31, 2017:							
Real estate mortgage loans:							
Commercial	\$ -	\$ 623	\$ -	\$ 623	\$ 78,942	\$ -	\$ 79,565
Residential and home equity	-	255	-	255	94,569	-	94,824
Construction	-	-	-	-	26,813	-	26,813
Commercial loans	-	-	-	-	43,893	134	44,027
Consumer and other loans	-	-	-	-	7,742	-	7,742
Total	<u>\$ -</u>	<u>\$ 878</u>	<u>\$ -</u>	<u>\$ 878</u>	<u>\$ 251,959</u>	<u>\$ 134</u>	<u>\$ 252,971</u>
At December 31, 2016:							
Real estate mortgage loans:							
Commercial	\$ -	\$ -	\$ -	\$ -	\$ 65,805	\$ -	\$ 65,805
Residential and home equity	371	-	-	371	87,850	662	88,883
Construction	-	-	-	-	19,918	73	19,991
Commercial loans	-	-	-	-	46,264	76	46,340
Consumer and other loans	-	-	-	-	4,275	-	4,275
Total	<u>\$ 371</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 371</u>	<u>\$ 224,112</u>	<u>\$ 811</u>	<u>\$ 225,294</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:

	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>(in thousands)</i>								
At December 31, 2017:								
Commercial loans	\$ -	\$ -	\$ 134	\$ 134	\$ 134	\$ 134	\$ 134	\$ 134
Total	\$ -	\$ -	\$ 134	\$ 134	\$ 134	\$ 134	\$ 134	\$ 134
At December 31, 2016:								
Real estate mortgage loans:								
Residential and home equity	\$ 662	\$ 662	\$ -	\$ -	\$ -	\$ 662	\$ 662	\$ -
Construction loans	73	73	-	-	-	73	73	-
Commercial loans	-	-	76	76	76	76	76	76
Total	\$ 735	\$ 735	\$ 76	\$ 76	\$ 76	\$ 811	\$ 811	\$ 76

The average net investment in impaired loans and interest income recognized and received on impaired loans by loan class is as follows:

	Average Recorded Investment	Interest Income Recognized	Interest Income Received
<i>(in thousands)</i>			
Year Ended December 31, 2017			
Residential & Home Equity	\$ 277	\$ 28	\$ 28
Construction	42	1	4
Commercial	64	-	-
Total	\$ 383	\$ 29	\$ 32
Year Ended December 31, 2016			
Residential & Home Equity	\$ 354	\$ -	\$ 14
Construction	19	-	-
Commercial	107	7	6
Total	\$ 480	\$ 7	\$ 20

There were no collateral dependent impaired loans measured at fair value on a nonrecurring basis at December 31, 2017 or 2016.

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(3) Loans, Continued

The restructuring of a loan constitutes a troubled debt restructuring (“TDR”) if the creditor grants a concession to the debtor that it would not otherwise consider in the normal course of business. A concession may include an extension of repayment terms which would not normally be granted, a reduction in interest rate or the forgiveness of principal and/or accrued interest. All TDRs are evaluated individually for impairment on a quarterly basis as part of the allowance for loan losses calculation.

The Company entered into a new troubled debt restructured loan during the year ended December 31, 2017. The troubled debt restructuring entered into in 2017 did not subsequently default during that year. The Company did not enter into any new troubled debt restructurings during the year ended December 31, 2016.

	Year Ended December 31,			
	2017			
	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment	Current Modification Outstanding Recorded Investment	
<i>(in thousands)</i>				
Troubled Debt Restructurings -				
Residential and home equity:				
Modified principal	<u>1</u>	<u>\$ 153</u>	<u>\$ 169</u>	<u>\$ 164</u>
Total	<u><u>1</u></u>	<u><u>\$ 153</u></u>	<u><u>\$ 169</u></u>	<u><u>\$ 164</u></u>

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 client.

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(4) Premises and Equipment

A summary of premises and equipment follows:

	At December 31,	
	2017	2016
<i>(in thousands)</i>		
Land	\$ 690	\$ 690
Buildings	3,736	2,461
Leasehold improvements	416	411
Furniture, fixtures and equipment	1,160	993
Computer and software	2,140	1,943
Construction in progress	-	1,181
Total, at cost	8,142	7,679
Less accumulated depreciation and amortization	(3,270)	(2,750)
Premises and equipment, net	\$ 4,872	\$ 4,929

Construction in progress relates to the construction of the Company's branch office in Crawfordville, FL, which was substantially complete at December 31, 2016.

The Company leases an office facility under an operating lease which expires in 2022, but has one 5-year option to extend. This lease requires monthly lease payments and common area maintenance charges and contains escalation clauses during the term of the lease. The Company also had an operating lease that expired in November, 2017, with no options to renew. Rent expense under these operating leases during the years ended December 31, 2017 and 2016 was \$155,000 and \$147,000, respectively. Future minimum rental commitments, including renewal options, under the current operating lease are indicated in the following table.

<i>(in thousands)</i>	Amount
<u>Year Ending December 31,</u>	<u>Amount</u>
2018	\$ 90
2019	90
2020	90
2021	90
2022	90
Total	\$ 450

(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 \$250,000 was approximately \$10.7 million and \$9.0 million at December 31, 2017 and 2016, respectively.

A schedule of maturities of time deposits at December 31, 2017 follows:

<i>(in thousands)</i>	
<u>Year Ending December 31,</u>	<u>Amount</u>
2018	\$ 16,942
2019	2,457
2020	538
2021	21
2022	2,096
Total	<u>\$ 22,054</u>

(6) Other Borrowings

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 \$41.7 million as of December 31, 2017 from the FHLB. There were no advances outstanding at December 31, 2017 or 2016. The Company also has available credit of \$16.3 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:

<i>(in thousands)</i>	<u>Year Ended December 31,</u>	
	<u>2017</u>	<u>2016</u>
Current:		
Federal	\$ 1,309	\$ 1,031
State	224	180
Total current	<u>1,533</u>	<u>1,211</u>
Deferred:		
Federal	193	1
State	9	5
Total deferred	<u>202</u>	<u>6</u>
Total income taxes	<u>\$ 1,735</u>	<u>\$ 1,217</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:

	Year Ended December 31,			
	2017		2016	
	Amount	% of Pretax Earnings	Amount	% of Pretax Earnings
<i>(dollars in thousands)</i>				
Income taxes at statutory rate	\$ 1,548	34.0 %	\$ 1,169	34.0 %
Increase (decrease) resulting from:				
State taxes, net of federal tax benefit	154	3.4	122	3.5
Tax-exempt income	(97)	(2.1)	(82)	(2.4)
Stock-based compensation	(60)	(1.3)	-	-
Change in federal rate	155	3.4	-	-
Other nondeductible expenses	35	0.7	8	0.3
Total	<u>\$ 1,735</u>	<u>38.1 %</u>	<u>\$ 1,217</u>	<u>35.4 %</u>

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

	At December 31,	
	2017	2016
<i>(in thousands)</i>		
Deferred tax assets:		
Allowance for loan losses	\$ 744	\$ 1,008
Organizational and start-up costs	49	87
Stock-based compensation	12	18
Unrealized losses on securities available for sale	100	137
Other	23	16
Deferred tax assets	<u>928</u>	<u>1,266</u>
Deferred tax liabilities:		
Prepaid Expenses	(70)	(69)
Deferred loan costs	(317)	(392)
Premises and equipment	(202)	(272)
Deferred tax liabilities	<u>(589)</u>	<u>(733)</u>
Net deferred tax asset	<u>\$ 339</u>	<u>\$ 533</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 2014.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Act") was enacted. The Act, among other provisions, reduced the corporate tax rate from 35% to 21%. As a result, the Company recorded additional tax expense of \$155,000 to measure the net Deferred Tax Asset at the new enacted tax rate. An election was also made to reclassify the income tax effects of the Tax Cuts and Jobs Act from accumulated other comprehensive loss to retained earnings.

(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 clients. 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 clients. 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 \$413,000 at December 31, 2017.

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.

In 2016, the Company entered into an agreement with another bank. This agreement references an interest rate swap that was transacted between the other bank and its loan client (the "Counterparty"). Should the Counterparty default on its obligations under the interest rate swap agreement with the other bank, then the Company would be liable for 13.208% of all swap liabilities. The maximum potential credit exposure under this contract at December 31, 2017 is \$45,000.

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(8) Off-Balance Sheet Financial Instruments, Continued

A summary of the contractual amounts of the Company's financial instruments with off-balance sheet risk at December 31, 2017 is as follows:

	<u>At December 31, 2017</u>
<i>(in thousands)</i>	
Commitments to extend credit	\$ 1,108
Construction loans in process	\$ 15,681
Unused lines of credit	\$ 37,959
Standby financial letters of credit	\$ 1,812
Standby performance letters of credit	\$ 104
Guaranteed accounts	\$ 1,220

(9) Stock Compensation Plans

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 number 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, 2017, 11,540 stock options have been granted under the 2015 plan. At December 31, 2017, 456,307 options are available for grant.

A summary of the activity in the Company's 2015 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, 2016	-	-		
Options granted	11,540	\$ 17.03		
Outstanding at December 31, 2017	11,540	\$ 17.03	4.1 years	\$ 16,000
Exercisable at December 31, 2017	11,540	\$ 17.03	4.1 years	\$ 16,000

The fair value of shares vested and recognized as compensation expense was \$15,000 for the year ended December 31, 2017. There was no share-based compensation expense during the year ended December 31, 2016. At December 31, 2017, there was no unrecognized compensation expense related to non-vested share-based compensation arrangements granted under the 2015 Plan.

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(9) Stock Compensation Plans, Continued

The fair value of each option granted during the year ended December 31, 2017 was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

Weighted average risk-free interest rate	1.48 %
Expected dividend yield	0.40 %
Expected stock volatility	8.54 %
Expected life in years	3.00
Per share fair value of options issued during period	\$ 1.26

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.

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 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, 2015	75,500	\$ 10.19		
Options exercised	(25,450)	10.29		
Options forfeited	<u>(7,850)</u>	10.00		
Outstanding at December 31, 2016	<u>42,200</u>	<u>\$ 10.16</u>		
Options exercised	(19,450)	10.00		
Options forfeited	(550)	10.00		
Outstanding at December 31, 2017	<u>22,200</u>	<u>\$ 10.31</u>	<u>1.7 years</u>	<u>\$ 180,000</u>
Exercisable at December 31, 2017	<u>21,700</u>	<u>\$ 10.30</u>	<u>1.7 years</u>	<u>\$ 176,000</u>

At December 31, 2017, there was no unrecognized compensation expense related to non-vested, share-based compensation arrangements granted under the 2007 plan.

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(9) Stock Compensation Plans, Continued

In 2012, the Company's Board of Directors and shareholders adopted the Directors' Plan. The Directors' Plan permits the Company's and the Bank's directors to elect to receive any compensation to be paid to them in shares of the Company's common stock. Pursuant to the Directors' Plan, each director is permitted to make an election to receive shares of stock instead of cash. To encourage directors to elect to receive stock, the Directors' Plan provides that if a director elects to receive stock, he or she will receive in common stock 110% of the amount of cash fees set by the Board or the Compensation and Nominating Committee. The value of stock to be awarded pursuant to the Directors' Plan will be the closing price of a share of common stock as traded on the Over-the-Counter Bulletin Board, or a price set by the Board or its Compensation and Nominating Committee, acting in good faith, but in no case less than fair market value. The maximum number of shares to be issued pursuant to the Directors' Plan is limited to 74,805 shares. In 2017 and 2016, our directors received 3,912 and 3,928 shares of common stock, respectively, in lieu of cash, under the Directors' Plan. At December 31, 2017, 58,102 shares remained available for grant.

(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, 2017 and 2016 were \$142,000 and \$128,000, 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:

<i>(in thousands)</i>	Year Ended December 31,	
	2017	2016
Loans:		
Beginning balance	\$ 5,942	\$ 6,082
Originated during the year	634	1,216
Principal repayments	(706)	(1,356)
Ending balance	\$ 5,870	\$ 5,942
 Deposits at year-end	 \$ 10,008	 \$ 13,947

From the Bank's formation until February, 2016, the Company leased an office facility from a related party. In February, 2016, the building was purchased by a non-related party. Rent expense under this operating lease from the related party during the years ended December 31, 2017 and 2016 was \$0 and \$10,000 respectively. In addition, the Bank purchases various insurance policies through a company that employs the spouse of one of our directors and former CFO. The premiums paid totaled \$740,000 in 2017 and \$523,000 in 2016 and included health insurance premiums for employees.

(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:

<i>(in thousands)</i>	Level	At December 31, 2017		At December 31, 2016	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:					
Cash and cash equivalents	1	\$ 32,397	\$ 32,397	\$ 36,165	\$ 36,165
Securities available for sale	2	49,809	49,809	33,103	33,103
Loans held for sale	3	5,880	6,039	3,291	3,500
Loans, net	3	250,259	249,628	222,768	221,320
Federal Home Loan Bank stock	3	316	316	220	220
Accrued interest receivable	3	978	978	798	798
Financial liabilities-					
Deposits	3	298,297	298,403	275,347	275,433
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 capital it has retained and 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 dividends 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.

The Bank is subject to the Basel III capital level threshold requirements under the Prompt Corrective Action regulations which phase in full compliance over a multi-year schedule. These regulations were designed to ensure that banks maintain strong capital positions even in the event of severe economic downturns or unforeseen losses.

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(14) Regulatory Matters, Continued

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. In the first quarter of 2015, the Bank elected an irreversible one-time opt-out to exclude accumulated other comprehensive income (loss) from regulatory capital. Beginning January 1, 2016, the Bank became subject to the capital conservation buffer rules which place limitations on distributions, including dividend payments, and certain discretionary bonus payments to executive officers. In order to avoid these limitations, a bank must hold a capital conservation buffer above its minimum risk-based capital requirements. As of December 31, 2017 and 2016, the Bank's capital conservation buffer exceeds the minimum requirement of 1.25% and 0.625%, respectively. The required conservation buffer of 2.5% is to be phased in over two years. Each January 1st, the buffer will increase by 0.625%.

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, 2017, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2017, 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:

	<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>(dollars in thousands)</i>						
<i>As of December 31, 2017</i>						
Tier 1 Leverage ratio to Average Assets	\$ 33,146	9.48 %	\$ 13,983	4.00 %	\$ 17,479	5.00 %
Common Equity Tier 1 Capital to Risk-Weighted Assets	33,146	12.80	11,654	4.50	16,834	6.50
Tier 1 Capital to Risk-Weighted Assets	33,146	12.80	15,539	6.00	20,718	8.00
Total Capital to Risk-Weighted Assets	36,282	14.01	20,718	8.00	25,898	10.00
<i>As of December 31, 2016:</i>						
Tier 1 Leverage ratio to Average Assets	\$ 25,994	8.73 %	\$ 11,906	4.00 %	\$ 14,883	5.00 %
Common Equity Tier 1 Capital to Risk-Weighted Assets	25,994	11.70	9,995	4.50	14,437	6.50
Tier 1 Capital to Risk-Weighted Assets	25,994	11.70	13,326	6.00	17,769	8.00
Total Capital to Risk-Weighted Assets	28,772	12.95	17,769	8.00	22,211	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, 2017, 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 (“EPS”) 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:

	2017			2016		
	Earnings	Weighted-Average Shares	Per Share Amount	Earnings	Weighted-Average Shares	Per Share Amount
<i>(dollars in thousands, except per share amounts)</i>						
Year Ended December 31,						
Basic EPS:						
Net earnings	\$ 2,817	2,704,382	\$ 1.04	\$ 2,220	1,982,334	\$ 1.12
Effect of dilutive securities-incremental shares from assumed conversion of options		7,317			8,827	
Diluted EPS:						
Net earnings	\$ 2,817	2,711,699	\$ 1.04	\$ 2,220	1,991,161	\$ 1.11

(17) Parent Company Only Financial Information

The Holding Company’s unconsolidated financial information follows:

	At December 31,	
	2017	2016
<i>(in thousands)</i>		
Assets		
Cash	\$ 14,103	\$ 1,301
Investment in subsidiary	32,850	25,761
Other assets	20	20
Total assets	\$ 46,973	\$ 27,082
Stockholders’ Equity		
Stockholders’ equity	\$ 46,973	\$ 27,082
Total liabilities and stockholders’ equity	\$ 46,973	\$ 27,082

(continued)

PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(17) Parent Company Only Financial Information, Continued

Condensed Statements of Earnings

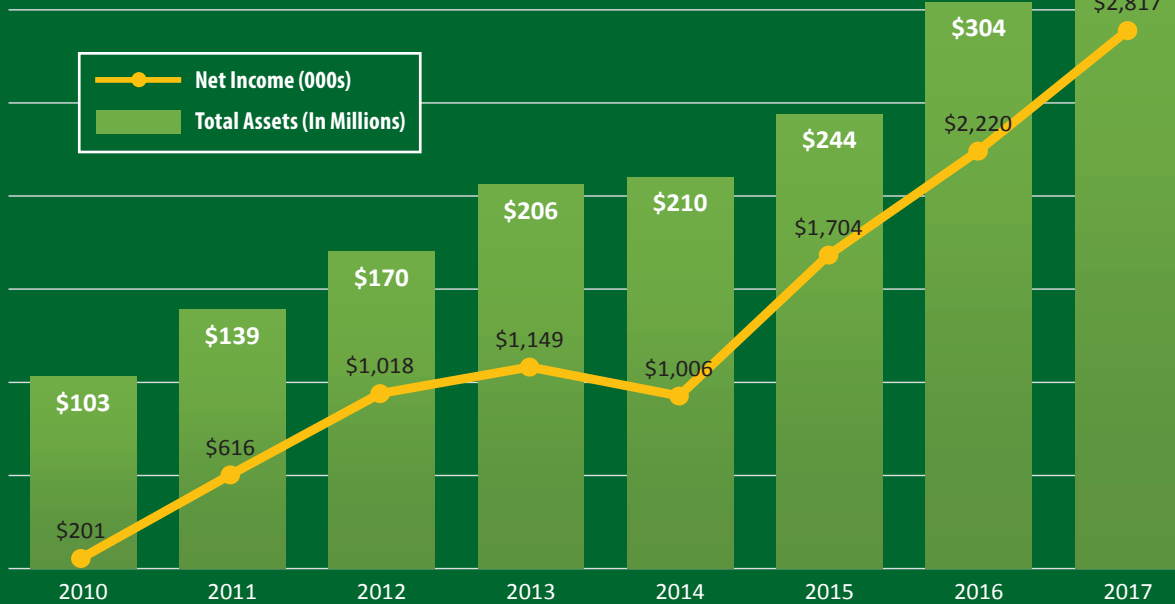
	<u>Year Ended December 31,</u>	
	<u>2017</u>	<u>2016</u>
<i>(in thousands)</i>		
Revenues	\$ -	\$ -
Expenses	(440)	(421)
Income tax benefit	165	159
Loss before earnings of subsidiary	<u>(275)</u>	<u>(262)</u>
Net earnings of subsidiary	3,092	2,482
Net earnings	<u>\$ 2,817</u>	<u>\$ 2,220</u>

Condensed Statements of Cash Flows

	<u>Year Ended December 31,</u>	
	<u>2017</u>	<u>2016</u>
<i>(in thousands)</i>		
Cash flows from operating activities:		
Net Earnings	\$ 2,817	\$ 2,220
Adjustments to reconcile net earnings to net cash used in operating activities:		
Equity in earnings of subsidiary	(3,092)	(2,482)
Stock issued as compensation	65	55
Net decrease in other assets	-	207
Net cash used in operating activities	<u>(210)</u>	<u>-</u>
Cash flows from financing activities:		
Proceeds from sale of common stock	16,957	-
Proceeds from stock options exercised	195	261
Net cash provided by financing activities	<u>17,152</u>	<u>261</u>
Cash flows from investment activities:		
Cash dividend paid	(140)	(99)
Cash infusion to subsidiary	(4,000)	-
Net cash used by investing activities	<u>(4,140)</u>	<u>(99)</u>
Net increase in cash	12,802	162
Cash at beginning of the year	1,301	1,139
Cash at end of year	<u>\$ 14,103</u>	<u>\$ 1,301</u>
Supplemental disclosure of cash flow information-		
Noncash items:		
Net change in accumulated other comprehensive loss of subsidiary, net of change in unrealized loss on securities available for sale, net of tax	<u>\$ (18)</u>	<u>\$ (289)</u>
Stock-based compensation expense of subsidiary	<u>\$ 15</u>	<u>\$ 1</u>

Prime Meridian Holding Company (PMHG)

NET INCOME & TOTAL ASSETS (2010-2017)



2017 BY THE NUMBERS

\$347.2

TOTAL ASSETS (IN MILLIONS) OF THE COMPANY AS OF DEC. 31, 2017

\$74.4

MARKET CAPITALIZATION (IN MILLIONS) AS OF DEC. 31, 2017

26.9%

INCREASE IN NET INCOME FROM 2016 TO 2017

\$250.3

LOANS, NET OF ALLOWANCE (IN MILLIONS) AS OF DEC. 31, 2017

63.6%

2017 MORTGAGE BANKING REVENUE AS A PERCENT OF NON-INTEREST INCOME

**BEST 50
OTCQX
2018 19**

OTCQX RANK AS A TOP PERFORMER BASED ON 2017 TOTAL RETURN & GROWTH IN AVERAGE DAILY DOLLAR VOLUME

22

NATIONAL RANKING BY AMERICAN BANKER MAGAZINE OF BEST BANKS TO WORK FOR

EXECUTIVE MANAGEMENT

PRIME MERIDIAN BANK



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



R. 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
HOLDING COMPANY

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

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

Chris L. Jensen, Jr.
Executive Vice President

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



**Celebrating
10 Years of
Service to
Our Clients
and
Community**



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