

ANNUAL REPORT | 2019



PRIME  
MERIDIAN  
HOLDING COMPANY



**BOARD OF DIRECTORS**

PRIME MERIDIAN  
HOLDING COMPANY

Richard A. Weidner  
*Chairman*

Sammie D. Dixon, Jr.  
*Vice Chairman, President  
and CEO*

Kenneth H. Compton  
*Chairman, Compensation and  
Nominating Committee*

William D. Crona  
*Chairman, Audit and Disclosure  
Committee*

Steven L. Evans

R. Randy Guemple

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

Kathleen C. Jones

Robert H. Kirby

Frank L. Langston

Michael A. Micallef, Jr.

L. Collins Proctor, Sr.

Garrison A. Rolle, M.D.

Steven D. Smith

Marjorie R. Turnbull

Lakeland Office







## Dear Fellow Shareholders,

We are pleased to share some of the accomplishments of Prime Meridian Holding Company (the Company) during the past year. Among the most noteworthy: the Bank surpassed \$500 million in total assets as of December 31, 2019.

We completed our first out-of-market expansion when we opened an office in Lakeland, Florida. The goal: to establish our brand of banking in Central Florida and in Polk County in particular.

Construction and renovation activities at the Timberlane office in Tallahassee, Florida neared completion, transforming the property and expanding our capacity to serve clients. Timberlane is now even better situated to support the demand for banking services in the Market Street area which is, itself, undergoing redevelopment.

The Board of Directors declared an annual cash dividend of \$0.12 per share on the Company's common stock. This dividend was payable March 3, 2020, to shareholders of record on February 13, 2020.

In addition to these milestones, the Bank performed very well operationally and continues to be well-capitalized.

## Other Highlights include:

- Total deposits increased \$89.2 million, or 25.6%, since December 31, 2018, as a result of continued focus on relationship management.
- Net loans increased \$47.6 million, or 16.4%, year over year to \$337.7 million.
- Net income of \$947,000 or \$0.29 per share fully diluted (FD) as of December 31, 2019, compared to \$1,268,000 or \$0.40 per share (FD) at December 31, 2018. Profitability was adversely affected by additional staffing levels and other noninterest expenses primarily associated with the Lakeland, Florida office opening.
- Capital levels remained strong with a consolidated Leverage Ratio of 11.08% and Bank Level Leverage Ratio of 9.31%.
- Book value increased to \$17.51 per share at December 31, 2019, up from \$16.19 per share as of December 31, 2018, with retained earnings as the driver.
- Net interest margin fell to 3.36% at December 31, 2019 compared to 3.75% at December 31, 2018. Margin compression was principally attributed to the Company's increased liquidity position and increase in the overall cost of funds.
- Nonperforming Assets (NPAs) to total loans, excluding TDRs, were 0.52% as of December 31, 2019 compared to 0.09% at December 31, 2018.
- Prime Meridian Bank again ranked third in both mortgage dollar volume and number of mortgage originations in Leon County during 2019 among all financial service providers, according to Metro Market Trends.
- Kenneth H. Compton joined our Boards of Directors as of May 16, 2019.
- As we go to press, the markets are experiencing impacts of the global COVID-19 pandemic. We acknowledge the fluid nature of the circumstances facing our team, clients, shareholders, and communities. With this in mind, please refer to our Form 10-K and periodic Form 8-Ks to stay up-to-date with changes that are the result of the coronavirus response. These can be found at [www.sec.gov](http://www.sec.gov).

We are proud to present the enclosed 2019 Annual Report.

Warm regards,

A handwritten signature in black ink, appearing to read "Sammie D. Dixon, Jr.", written in a cursive style.

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

A handwritten signature in black ink, appearing to read "Richard A. Weidner", written in a cursive style.

Richard A. Weidner, CPA  
Chairman





**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, 2019 and 2018 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 "consolidated 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, 2019 and 2018, 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 consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated 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 consolidated 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 consolidated 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 24, 2020

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Consolidated Balance Sheets**

	<b>December 31,</b>	
	<b>2019</b>	<b>2018</b>
<i>(dollars in thousands, except per share amounts)</i>		
<b>Assets</b>		
Cash and due from banks .....	\$ 9,024	\$ 7,866
Federal funds sold .....	24,613	34,777
Interest-bearing deposits.....	41,445	5,395
Total cash and cash equivalents.....	75,082	48,038
Debt securities available for sale.....	61,333	45,384
Loans held for sale .....	6,193	4,767
Loans, net of allowance for loan losses of \$4,414 and \$3,661 .....	337,710	290,113
Federal Home Loan Bank stock .....	404	355
Premises and equipment, net .....	7,744	4,656
Right of use lease asset.....	3,669	-
Deferred tax asset .....	362	502
Accrued interest receivable .....	1,137	1,034
Bank-owned life insurance.....	6,501	6,323
Other assets .....	726	530
Total assets .....	\$ 500,861	\$ 401,702
<b>Liabilities and Stockholders' Equity</b>		
Liabilities:		
Noninterest-bearing demand deposits.....	\$ 96,807	\$ 80,097
Savings, NOW and money-market deposits .....	272,283	227,674
Time deposits.....	69,174	41,296
Total deposits .....	438,264	349,067
Other borrowings.....	1,254	-
Official checks .....	606	837
Operating lease liability .....	3,758	-
Other liabilities .....	1,111	978
Total liabilities .....	444,993	350,882
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, 3,191,288 and 3,138,945 issued and outstanding .....	32	31
Additional paid-in capital .....	39,456	38,330
Retained earnings.....	16,180	13,015
Accumulated other comprehensive income (loss) .....	200	(556)
Total stockholders' equity .....	55,868	50,820
Total liabilities and stockholders' equity .....	\$ 500,861	\$ 401,702

See Accompanying Notes to Consolidated Financial Statements

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Consolidated Statements of Earnings**

	<b>Year Ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
<i>(in thousands, except per share amounts)</i>		
Interest income:		
Loans .....	\$ 16,188	\$ 14,469
Securities .....	1,309	1,131
Other .....	1,489	634
Total interest income .....	<u>18,986</u>	<u>16,234</u>
Interest expense:		
Deposits .....	3,560	2,307
Other borrowings .....	9	-
Total interest expense .....	<u>3,569</u>	<u>2,307</u>
Net interest income .....	15,417	13,927
Provision for loan losses .....	1,131	591
Net interest income after provision for loan losses .....	<u>14,286</u>	<u>13,336</u>
Noninterest income:		
Service charges and fees on deposit accounts .....	288	333
Debit card/ATM revenue, net .....	252	191
Mortgage banking revenue, net .....	667	447
Income from bank-owned life insurance .....	178	66
Gain on sale of debt securities available for sale .....	7	-
Other income .....	142	118
Total noninterest income .....	<u>1,534</u>	<u>1,155</u>
Noninterest expense:		
Salaries and employee benefits .....	6,095	5,106
Occupancy and equipment .....	1,405	932
Professional fees .....	374	374
Advertising .....	743	677
FDIC assessment .....	119	163
Software maintenance, amortization and other .....	692	634
Other .....	1,758	1,343
Total noninterest expense .....	<u>11,186</u>	<u>9,229</u>
Earnings before income taxes .....	4,634	5,262
Income taxes .....	1,092	1,220
Net earnings .....	<u>\$ 3,542</u>	<u>\$ 4,042</u>
Earnings per common share:		
Basic .....	<u>\$ 1.12</u>	<u>\$ 1.29</u>
Diluted .....	<u>\$ 1.12</u>	<u>\$ 1.29</u>

See Accompanying Notes to Consolidated Financial Statements

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Consolidated Statements of Comprehensive Income**

<i>(in thousands)</i>	<b>Year Ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
Net earnings .....	\$ 3,542	\$ 4,042
Other comprehensive income (loss):		
Change in unrealized loss on debt securities available for sale:		
Unrealized gain (loss) arising during the year .....	1,020	(348)
Reclassification adjustment for realized gain .....	(7)	-
Net change in unrealized gain (loss) .....	1,013	(348)
Deferred income tax expense (benefit) on above change .....	(257)	88
Total other comprehensive income (loss) .....	756	(260)
Comprehensive income .....	\$ 4,298	\$ 3,782

See Accompanying Notes to Consolidated Financial Statements.



**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Consolidated Statements of Stockholders' Equity**

**Years Ended December 31, 2019 and 2018**

	<u>Common Stock</u>		<u>Additional</u>	<u>Retained</u>	<u>Accumulated</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Paid-in</u>	<u>Earnings</u>	<u>Other</u>	<u>Stockholders'</u>
			<u>Capital</u>		<u>Compre-</u>	<u>Equity</u>
					<u>hensive</u>	
					<u>Income</u>	
					<u>(Loss)</u>	
<i>(dollars in thousands)</i>						
Balance at December 31, 2017.....	3,118,977	\$ 31	\$ 37,953	\$ 9,285	\$ (296)	\$ 46,973
Net earnings .....	-	-	-	4,042	-	4,042
Dividends paid.....	-	-	-	(312)	-	(312)
Net change in unrealized loss on debt securities available for sale, net of income tax benefit of \$88.....	-	-	-	-	(260)	(260)
Stock options exercised .....	17,150	-	172	-	-	172
Common stock issued as compensation to directors .....	2,818	-	60	-	-	60
Stock-based compensation .....	-	-	145	-	-	145
Balance at December 31, 2018.....	<u>3,138,945</u>	<u>\$ 31</u>	<u>\$ 38,330</u>	<u>\$ 13,015</u>	<u>\$ (556)</u>	<u>\$ 50,820</u>
Net earnings .....	-	\$ -	\$ -	\$ 3,542	\$ -	\$ 3,542
Dividends paid.....	-	-	-	(377)	-	(377)
Proceeds from sale of common stock, net of offering costs of \$19 .....	44,600	1	872	-	-	873
Net change in unrealized loss on debt securities available for sale, net of income taxes of \$257 .....	-	-	-	-	756	756
Stock options exercised.....	500	-	5	-	-	5
Common stock issued as compensation to directors .....	3,643	-	72	-	-	72
Issuance of restricted stock.....	3,600	-	-	-	-	-
Stock-based compensation .....	-	-	177	-	-	177
Balance at December 31, 2019.....	<u>3,191,288</u>	<u>\$ 32</u>	<u>\$ 39,456</u>	<u>\$ 16,180</u>	<u>\$ 200</u>	<u>\$ 55,868</u>

See Accompanying Notes to Consolidated Financial Statements.

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Consolidated Statements of Cash Flows**

<i>(in thousands)</i>	<b>Year Ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
Cash flows from operating activities:		
Net earnings .....	\$ 3,542	\$ 4,042
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization .....	647	520
Provision for loan losses .....	1,131	591
Net amortization of deferred loan fees .....	(39)	(36)
Deferred income taxes .....	(117)	(75)
Gain on sale of debt securities available for sale .....	(7)	-
Amortization of premiums and discounts on debt securities available for sale .....	301	390
Gain on sale of loans held for sale .....	(667)	(447)
Proceeds from the sale of loans held for sale .....	95,275	77,713
Loans originated as held for sale .....	(96,034)	(76,153)
Stock issued as compensation .....	72	60
Stock-based compensation expense .....	177	145
Income from bank-owned life insurance .....	(178)	(66)
Net increase in accrued interest receivable .....	(103)	(56)
Net change in operating leases .....	89	-
Net (increase) decrease in other assets .....	(196)	43
Net decrease in other liabilities and official checks .....	(98)	(95)
Net cash provided by operating activities .....	3,795	6,576
Cash flows from investing activities:		
Loan originations, net of principal repayments .....	(48,689)	(40,409)
Purchase of debt securities available for sale .....	(33,638)	(2,474)
Principal repayments of debt securities available for sale .....	10,235	5,612
Proceeds from the sale of debt securities available for sale .....	4,245	-
Maturities and calls of debt securities available for sale .....	3,928	549
Purchase of Federal Home Loan Bank stock .....	(49)	(39)
Purchase of bank-owned life insurance .....	-	(4,500)
Purchase of premises and equipment .....	(3,735)	(304)
Net cash used in investing activities .....	(67,703)	(41,565)
Cash flows from financing activities:		
Net increase in deposits .....	89,197	50,770
Net change in other borrowings .....	1,254	-
Proceeds from stock options exercised .....	5	172
Proceeds from sale of common stock, net of offering costs .....	873	-
Common stock dividends paid .....	(377)	(312)
Net cash provided by financing activities .....	90,952	50,630
Net increase in cash and cash equivalents .....	27,044	15,641
Cash and cash equivalents at beginning of year .....	48,038	32,397
Cash and cash equivalents at end of year .....	\$ 75,082	\$ 48,038
Supplemental disclosure of cash flow information .....		
Cash paid during the year for:		
Interest .....	\$ 3,544	\$ 2,276
Income taxes .....	\$ 1,345	\$ 1,217
Noncash transactions:		
Accumulated other comprehensive income (loss), net change in unrealized gain (loss) on debt securities available for sale, net of taxes .....	\$ 756	\$ (260)
Right of use lease assets obtained in exchange for operating lease liabilities .....	\$ 3,818	\$ -

See Accompanying Notes to Consolidated Financial Statements

## PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

### Notes to Consolidated Financial Statements

At December 31, 2019 and 2018 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 four banking offices located in Tallahassee, Crawfordville, and Lakeland, 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 in banks, all of which have original maturities of less than ninety days.

At December 31, 2019 and 2018, 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 \$4,606,000 and \$3,901,000 respectively.

**Debt Securities.** Debt securities may be classified as either trading, held-to-maturity or available-for-sale. Trading debt securities are held principally for resale and recorded at their fair values. Unrealized gains and losses on trading debt securities are included immediately in earnings. Held-to-maturity debt 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 debt securities consist of securities not classified as trading debt securities or as held-to-maturity debt securities. Unrealized holding gains and losses on available-for-sale debt securities are excluded from earnings and reported in accumulated other comprehensive income (loss). Gains and losses on the sale of available-for-sale debt securities are recorded on the trade date determined using the specific-identification method. Premiums and discounts on debt 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 debt 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 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, 2019 and 2018, gains on loans held for sale are reported on the consolidated statements of earnings under noninterest income in mortgage banking revenue. At December 31, 2019, loans held for sale were \$6,193,000 compared to \$4,767,000 at December 31, 2018. At December 31, 2019 and 2018, fair 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, 2019 and 2018.

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.

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## PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY

### Notes to Consolidated Financial Statements, Continued

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

**Allowance for Loan Losses, Continued.** A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for all loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral-dependent.

**Premises and Equipment.** Land is stated at cost. Buildings, leasehold improvements, furniture, fixtures and equipment, 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.

**Bank-Owned Life Insurance (BOLI).** The Company has purchased life insurance policies on certain key officers. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the consolidated balance sheet date, which is the cash surrender value adjusted for other charges or other amount due that are probable at settlement.

**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, 2019, 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:

**Debt 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).

**Debt Securities.** Fair values for debt 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. The market price of the Company's common stock at the date of the grant is used for restricted stock awards. For stock purchase plans, the Black-Scholes model is utilized to estimate the fair value of the award. The impact of forfeitures of share-based awards on compensation expense is recognized as forfeitures occur.

**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 debt 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.

**Debit card/ATM Revenue.** Debit card/ATM revenue primarily includes interchange income from client use of consumer and business debit cards. Interchange income is paid by a merchant bank to the card-issuing bank through the interchange network. Interchange fees are set by the credit card associations and based on cardholder purchase volumes. Also included in Debit card/ATM revenue is ATM foreign fee income and ATM non-client ACH credits. This revenue line is shown net of debit card fees and ATM program expenses.

**Mortgage Banking Revenue.** Mortgage banking revenue includes gains and losses on the sale of mortgage loans originated for sale, net of direct origination costs, 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

**Reclassification.** Certain amounts previously reported have been reclassified to conform to the current year's presentation. Such reclassifications had no effect on earnings and stockholder's equity.

#### **Recent Accounting Standards Update.**

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("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 effect of this ASU was to increase assets and liabilities by approximately \$288,000 on January 1, 2019.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326)*. 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 judgement to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other consolidated 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 amount recorded in the consolidated 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 ASU will take effect for fiscal years, and for interim periods within fiscal years, beginning after December 15, 2022 (as amended). 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 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 to 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. The ASU became effective for public business entities for fiscal years, and interim periods within those fiscal years, 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 the 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 adoption of this guidance had no impact on the Company's consolidated financial statements.

In June 2018, The FASB issued ASU No. 2018-07, *Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*. The ASU is intended to reduce the cost and complexity and to improve financial reporting for nonemployee share-based payments. The ASU expands the scope of Topic 718 (which currently only includes share-based payments to employees) to include share-based payments issued to nonemployees for goods and services. Consequently, the accounting for share-based payments to nonemployees and employees will be substantially aligned. The ASU supersedes Subtopic 505-50, *Equity - Equity-Based payments to Non-Employees*. The ASU is effective for the Company for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the impact of the ASU, if any, on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820) - Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement ("ASU 2018-13")*. ASU 2018-13 removes, modifies, and adds certain disclosure requirements associated with fair value measurements. ASU 2018-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The removed and modified disclosures will be adopted on a prospective basis. Early adoption is permitted upon issuance of this ASU. The Company is currently evaluating the impact of the adoption of this ASU, which only affects the presentation of certain disclosures and is not expected to impact our results of operations, financial position, or liquidity.

**(2) Debt Securities Available for Sale**

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

<i>(in thousands)</i>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<b><i>At December 31, 2019</i></b>				
U.S. Government agency securities .....	\$ 408	\$ -	\$ (1)	\$ 407
Municipal securities .....	9,332	81	(72)	9,341
Mortgage-backed securities .....	45,499	401	(97)	45,803
Asset-backed securities .....	5,825	14	(57)	5,782
Total .....	<u>\$ 61,064</u>	<u>\$ 496</u>	<u>\$ (227)</u>	<u>\$ 61,333</u>
<b><i>At December 31, 2018</i></b>				
U.S. Government agency securities .....	\$ 815	\$ -	\$ (16)	\$ 799
Municipal securities .....	11,580	62	(113)	11,529
Mortgage-backed securities .....	33,733	33	(710)	33,056
Total .....	<u>\$ 46,128</u>	<u>\$ 95</u>	<u>\$ (839)</u>	<u>\$ 45,384</u>

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

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

Debt securities available for sale measured at fair value on a recurring basis are summarized below:

	<u>Fair Value</u>	<u>Fair Value Measurements Using</u>		
		<u>Quoted Prices In Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
<i>(in thousands)</i>				
<b>At December 31, 2019</b>				
U.S. Government agency securities .....	\$ 407	\$ -	\$ 407	\$ -
Municipal securities .....	9,341	-	9,341	-
Mortgage-backed securities .....	45,803	-	45,803	-
Asset-backed securities .....	5,782	-	5,782	-
Total .....	<u>\$ 61,333</u>	<u>\$ -</u>	<u>\$ 61,333</u>	<u>\$ -</u>
<b>At December 31, 2018</b>				
U.S. Government agency securities .....	\$ 799	\$ -	\$ 799	\$ -
Municipal securities .....	11,529	-	11,529	-
Mortgage-backed securities .....	33,056	-	33,056	-
Total .....	<u>\$ 45,384</u>	<u>\$ -</u>	<u>\$ 45,384</u>	<u>\$ -</u>

During the years ended December 31, 2019 and 2018, no debt securities were transferred in or out of Levels 1, 2 or 3.

The scheduled maturities of debt securities are as follows:

	<u>Amortized Cost</u>	<u>Fair Value</u>
<i>(in thousands)</i>		
<b>At December 31, 2019</b>		
Due in less than one year .....	\$ 367	\$ 368
Due in one to five years .....	1,372	1,379
Due in five to ten years .....	2,578	2,570
Due after ten years .....	11,248	11,213
Mortgage-backed securities .....	45,499	45,803
Total .....	<u>\$ 61,064</u>	<u>\$ 61,333</u>

The following summarizes sales of debt securities available for sale:

	<u>Year Ended December 31,</u>	
	<u>2019</u>	<u>2018</u>
<i>(in thousands)</i>		
Proceeds from sale of securities .....	\$ 4,245	\$ -
Gross gains .....	28	-
Gross losses .....	(21)	-
Net gain on sale of securities .....	<u>\$ 7</u>	<u>\$ -</u>

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

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

At December 31, 2019 and 2018, debt securities with a fair value of \$10,983,000 and \$8,311,000 respectively, were pledged as collateral for public deposits and for other borrowings with clients.

Debt 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>				
<b>At December 31, 2019</b>				
<b>Debt Securities Available for Sale</b>				
U.S. Government agency securities .....	\$ (1)	\$ 407	\$ -	\$ -
Municipal securities .....	(72)	3,814	-	-
Mortgage-backed securities.....	(56)	4,629	(41)	4,115
Asset-backed securities .....	(57)	3,901	-	-
Total .....	<u>\$ (186)</u>	<u>\$ 12,751</u>	<u>\$ (41)</u>	<u>\$ 4,115</u>
<b>At December 31, 2018</b>				
<b>Debt Securities Available for Sale</b>				
U.S. Government agency securities .....	\$ (2)	\$ 242	\$ (14)	\$ 557
Municipal securities .....	-	-	(113)	5,760
Mortgage-backed securities.....	(19)	983	(691)	30,061
Total .....	<u>\$ (21)</u>	<u>\$ 1,225</u>	<u>\$ (818)</u>	<u>\$ 36,378</u>

The unrealized losses on thirteen and thirty-nine debt securities at December 31, 2019 and 2018, 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>	<b>At December 31,</b>	
	<b>2019</b>	<b>2018</b>
Real estate mortgage loans:		
Commercial .....	\$ 94,728	\$ 82,494
Residential and home equity .....	135,913	121,454
Construction .....	33,583	31,601
Total real estate mortgage loans.....	264,224	235,549
Commercial loans .....	69,770	51,018
Consumer and other loans.....	7,631	6,747
Total loans.....	341,625	293,314
Add (Less):		
Net deferred loan costs.....	499	460
Allowance for loan losses .....	(4,414)	(3,661)
Loans, net.....	\$ 337,710	\$ 290,113



## 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 Company 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 Company offers both portfolio and secondary market mortgages; portfolio loans generally are based on a 1-year, 3-year, 5-year, 7-year, or 10-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 mid-sized businesses to construct owner-user properties, loans to developers of commercial real estate investment properties, and residential developments. This type of loan is also made to individual clients for construction of single-family homes in our market area. An independent appraisal is used to determine the value of the collateral and confirm that the ratio of the loan principal to the value of the collateral will not exceed policies of the Company. 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 Company 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 Company 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:

<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>			
<b>Year Ended December 31, 2019</b>						
Beginning balance .....	\$ 917	\$ 1,397	\$ 391	\$ 876	\$ 80	\$ 3,661
Provision for loan losses .....	129	176	24	735	67	1,131
Net (charge-offs) recoveries .....	-	-	-	(327)	(51)	(378)
Ending balance.....	<u>\$ 1,046</u>	<u>\$ 1,573</u>	<u>\$ 415</u>	<u>\$ 1,284</u>	<u>\$ 96</u>	<u>\$ 4,414</u>
<b>At December 31, 2019</b>						
Individually evaluated for impairment:						
Recorded investment .....	<u>\$ 611</u>	<u>\$ 965</u>	<u>\$ -</u>	<u>\$ 1,631</u>	<u>\$ 13</u>	<u>\$ 3,220</u>
Balance in allowance for loan losses .....	<u>\$ -</u>	<u>\$ 15</u>	<u>\$ -</u>	<u>\$ 386</u>	<u>\$ 13</u>	<u>\$ 414</u>
Collectively evaluated for impairment:						
Recorded investment .....	<u>\$ 94,117</u>	<u>\$ 134,948</u>	<u>\$ 33,583</u>	<u>\$ 68,139</u>	<u>\$ 7,618</u>	<u>\$ 338,405</u>
Balance in allowance for loan losses .....	<u>\$ 1,046</u>	<u>\$ 1,558</u>	<u>\$ 415</u>	<u>\$ 898</u>	<u>\$ 83</u>	<u>\$ 4,000</u>
<b>Year Ended December 31, 2018</b>						
Beginning balance .....	\$ 894	\$ 1,097	\$ 331	\$ 724	\$ 90	\$ 3,136
Provision for loan losses .....	23	300	63	204	1	591
Net (charge-offs) recoveries .....	-	-	(3)	(52)	(11)	(66)
Ending balance.....	<u>\$ 917</u>	<u>\$ 1,397</u>	<u>\$ 391</u>	<u>\$ 876</u>	<u>\$ 80</u>	<u>\$ 3,661</u>
<b>At December 31, 2018</b>						
Individually evaluated for impairment:						
Recorded investment .....	<u>\$ 611</u>	<u>\$ 409</u>	<u>\$ -</u>	<u>\$ 205</u>	<u>\$ 6</u>	<u>\$ 1,231</u>
Balance in allowance for loan losses .....	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 205</u>	<u>\$ 6</u>	<u>\$ 211</u>
Collectively evaluated for impairment:						
Recorded investment .....	<u>\$ 81,883</u>	<u>\$ 121,045</u>	<u>\$ 31,601</u>	<u>\$ 50,813</u>	<u>\$ 6,741</u>	<u>\$ 292,083</u>
Balance in allowance for loan losses .....	<u>\$ 917</u>	<u>\$ 1,397</u>	<u>\$ 391</u>	<u>\$ 671</u>	<u>\$ 74</u>	<u>\$ 3,450</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>	<b>Real Estate Mortgage Loans</b>			<b>Commercial Loans</b>	<b>Consumer and Other Loans</b>	<b>Total</b>
	<b>Commercial</b>	<b>Residential and Home Equity</b>	<b>Construction</b>			
<b>At December 31, 2019</b>						
Grade:						
Pass .....	\$ 92,586	\$ 133,351	\$ 32,374	\$ 66,649	\$ 7,576	\$ 332,536
Special mention.....	1,531	1,597	1,209	1,197	55	5,589
Substandard.....	611	965	-	1,924	-	3,500
Doubtful.....	-	-	-	-	-	-
Loss.....	-	-	-	-	-	-
Total.....	<u>\$ 94,728</u>	<u>\$ 135,913</u>	<u>\$ 33,583</u>	<u>\$ 69,770</u>	<u>\$ 7,631</u>	<u>\$ 341,625</u>

**At December 31, 2018**

Grade:						
Pass .....	\$ 77,650	\$ 118,368	\$ 31,601	\$ 47,858	\$ 6,657	\$ 282,134
Special mention.....	4,233	2,875	-	2,184	84	9,376
Substandard.....	611	211	-	976	6	1,804
Doubtful.....	-	-	-	-	-	-
Loss.....	-	-	-	-	-	-
Total.....	<u>\$ 82,494</u>	<u>\$ 121,454</u>	<u>\$ 31,601</u>	<u>\$ 51,018</u>	<u>\$ 6,747</u>	<u>\$ 293,314</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, 2019, there were ten loans over thirty days past due and accruing, no loans past due ninety days or more but still accruing and 12 loans on nonaccrual. Age analysis of past-due loans at December 31, 2019 and 2018 is as follows:

	<u>Accruing Loans</u>				<u>Current</u>	<u>Nonaccrual Loans</u>	<u>Total Loans</u>
	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>Greater Than 90 Days Past Due</u>	<u>Total Past Due</u>			
<i>(in thousands)</i>							
<b>At December 31, 2019:</b>							
Real estate mortgage loans:							
Commercial .....	\$ -	\$ -	\$ -	\$ -	\$ 94,728	\$ -	\$ 94,728
Residential and home equity .....	569	-	-	569	134,379	965	135,913
Construction.....	82	-	-	82	33,501	-	33,583
Commercial loans.....	87	-	-	87	68,057	1,626	69,770
Consumer and other loans .....	-	5	-	5	7,626	-	7,631
Total.....	<u>\$ 738</u>	<u>\$ 5</u>	<u>\$ -</u>	<u>\$ 743</u>	<u>\$ 338,291</u>	<u>\$ 2,591</u>	<u>\$ 341,625</u>
<b>At December 31, 2018:</b>							
Real estate mortgage loans:							
Commercial .....	\$ -	\$ -	\$ -	\$ -	\$ 82,494	\$ -	\$ 82,494
Residential and home equity .....	134	30	-	164	121,129	161	121,454
Construction.....	-	-	-	-	31,601	-	31,601
Commercial loans.....	98	-	-	98	50,745	175	51,018
Consumer and other loans .....	-	-	-	-	6,741	6	6,747
Total.....	<u>\$ 232</u>	<u>\$ 30</u>	<u>\$ -</u>	<u>\$ 262</u>	<u>\$ 292,710</u>	<u>\$ 342</u>	<u>\$ 293,314</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:

<i>(in thousands)</i>	<b>With No Related Allowance Recorded</b>		<b>With an Allowance Recorded</b>			<b>Total</b>		
	<b>Recorded Investment</b>	<b>Unpaid Contractual Principal Balance</b>	<b>Recorded Investment</b>	<b>Unpaid Contractual Principal Balance</b>	<b>Related Allowance</b>	<b>Recorded Investment</b>	<b>Unpaid Contractual Principal Balance</b>	<b>Related Allowance</b>
<b>At December 31, 2019:</b>								
Commercial real estate .....	\$ 611	\$ 611	\$ -	\$ -	\$ -	\$ 611	\$ 611	\$ -
Residential and home equity ...	716	716	249	249	15	965	965	15
Commercial loans.....	508	508	1,123	1,123	386	1,631	1,631	386
Consumer and other loans.....	-	-	13	13	13	13	13	13
<b>Total .....</b>	<b>\$ 1,835</b>	<b>\$ 1,835</b>	<b>\$ 1,385</b>	<b>\$ 1,385</b>	<b>\$ 414</b>	<b>\$ 3,220</b>	<b>\$ 3,220</b>	<b>\$ 414</b>

**At December 31, 2018:**

Commercial real estate .....	\$ 611	\$ 611	\$ -	\$ -	\$ -	\$ 611	\$ 611	\$ -
Residential and home equity ...	409	409	-	-	-	409	409	-
Commercial loans.....	-	-	205	205	205	205	205	205
Consumer and other loans.....	-	-	6	6	6	6	6	6
<b>Total .....</b>	<b>\$ 1,020</b>	<b>\$ 1,020</b>	<b>\$ 211</b>	<b>\$ 211</b>	<b>\$ 211</b>	<b>\$ 1,231</b>	<b>\$ 1,231</b>	<b>\$ 211</b>

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

<i>(in thousands)</i>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>	<b>Interest Income Received</b>
<b>Year Ended December 31, 2019</b>			
Commercial real estate .....	\$ 611	\$ 32	\$ 32
Residential and home equity .....	753	5	7
Commercial .....	806	9	12
Consumer and other loans .....	3	-	-
<b>Total .....</b>	<b>\$ 2,173</b>	<b>\$ 46</b>	<b>\$ 51</b>

*(in thousands)*

**Year Ended December 31, 2018**

Commercial real estate .....	\$ 471	\$ 16	\$ 16
Residential and home equity .....	234	7	6
Commercial .....	172	2	7
Consumer and other loans .....	2	-	-
<b>Total .....</b>	<b>\$ 879</b>	<b>\$ 25</b>	<b>\$ 29</b>

(continued)



**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(3) Loans, Continued**

There were no collateral dependent impaired loans measured at fair value on a nonrecurring basis at December 31, 2019 or 2018.

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.

As shown in the table below, the Company entered into three new TDRs during the year ended December 31, 2019 and one TDR during the year ended December 31, 2018.

	Year Ended December 31, 2019			Year Ended December 31, 2018		
	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Current Modification Outstanding Recorded Investment	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Current Modification Outstanding Recorded Investment
<i>(in thousands)</i>						
<b>Troubled Debt</b>						
<b>Restructurings:</b>						
Modified principal						
Residential and home equity:.....	-	-	-	1	\$ 619	\$ 611
Modified interest rate						
Residential and home equity:.....	1	\$ 65	\$ 65	-	-	-
Commercial .....	2	\$ 260	\$ 260	-	-	-
<b>Total.....</b>	<b>3</b>	<b>\$ 325</b>	<b>\$ 325</b>	<b>1</b>	<b>\$ 619</b>	<b>\$ 611</b>

All three of the TDRs entered into during the year ended December 31, 2019 did subsequently default while the one TDR entered into during the year ended December 31, 2018 did not subsequently default. At December 31, 2019, the Company had \$942,000 in loans identified as TDRs.

The Company grants the majority of its loans to borrowers throughout Leon County and Polk 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.

A summary of premises and equipment follows:

	At December 31,	
	2019	2018
<i>(in thousands)</i>		
Land .....	\$ 1,704	\$ 690
Buildings.....	4,960	3,736
Leasehold improvements .....	421	421
Furniture, fixtures and equipment.....	1,505	1,168
Computer and software.....	2,669	2,372
Construction in progress .....	833	40
Total, at cost .....	12,092	8,427
Less accumulated depreciation and amortization .....	(4,348)	(3,771)
Premises and equipment, net.....	\$ 7,744	\$ 4,656

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(4) Premises and Equipment**

The Company adopted ASU 2016-02, Leases on January 1, 2019 which resulted in the recognition of operating leases on the consolidated balance sheets in 2019 and forward. Right of use assets and lease liabilities are disclosed as separate line items in the consolidated balance sheets and are valued based on the present value of the future minimum lease payments at the commencement date. As our lease does not provide an implicit rate, we used our incremental borrowing rate based on the information available at the adoption date in determining the present value of future payments. Lease expense is recognized on a straight-line basis over the lease term.

The Company's operating lease obligations are for the Company's office facilities located at its Timberlane Road, Tallahassee, Florida location. The term of the Lease is 15 years, with four options to renew for five years each. The Lease is a fully net lease, with the Company separately paying real and personal property taxes, all special and third-party assessments, common area maintenance charges, maintenance costs and insurance expenses. As of December 31, 2019, the Company estimates that its portion of expenditures for tenant improvements and furniture, fixtures, and equipment will not exceed \$1,300,000.

The components of lease expense and other lease information as of and during the year ended December 31, 2019 are as follows:

	<b>Year Ended</b>	
	<b>December 31, 2019</b>	
(in thousands)		
Operating lease cost.....	\$	239
Cash paid for amount included in the measurement of lease liabilities operating cash flows from operating leases .....	\$	151
	<b>At December 31,</b>	
		<b>2019</b>
(in thousands)		
Operating lease right of use assets .....	\$	3,669
Operating lease liabilities.....	\$	3,758
Weighted average remaining lease term - operating lease (in years) .....		14.6
Weighted average discount rate .....		3.17%

Future minimum lease payments under non-cancellable leases as of December 31, 2019, reconciled to our operating lease liability presented on the consolidated balance sheet are as follows:

	<b>At December 31</b>	
<b>(in thousands)</b>		<b>2019</b>
2020 .....	\$	294
2021 .....		294
2022 .....		294
2023 .....		294
2024 .....		294
Next five years and thereafter .....		3,273
Total future minimum lease payments.....		4,743
Less interest .....		(985)
Total .....	\$	3,758

The rent expense for the year ended December 31, 2019 was \$312,000.

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(4) Premises and Equipment, continued.**

On February 15, 2019, the Company purchased a new branch office location, located at 3340 South Florida Avenue, Lakeland, Florida. The purchase price of the property was \$2.1 million.

**(5) Deposits**

The aggregate amount of time deposits with a minimum denomination greater than \$250,000 was approximately \$33.4 million and \$20.7 million at December 31, 2019 and 2018, respectively.

A schedule of maturities for all time deposits at December 31, 2019 is as follows:

<i>(in thousands)</i>		
<u>Year Ending December 31,</u>		<u>Amount</u>
2020 .....	\$	47,464
2021 .....		18,280
2022 .....		559
2023 .....		2,168
2024 .....		300
2039 .....		403
Total .....	\$	<u>69,174</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 \$64.9 million as of December 31, 2019 from the FHLB. There were no advances outstanding at December 31, 2019 or 2018. The Company also has available credit of \$18.8 million in lines of credit with correspondent banks. All draws under these lines are subject to approval by the correspondent bank. Other borrowings at December 31, 2019 totaled \$1,254,000 and consist of securities sold under agreements to repurchase. Securities totaling \$2.2 million were pledged as collateral in connection with this agreement.

**(7) Income Taxes**

The components of the income taxes are as follows:

<i>(in thousands)</i>	<u>Year Ended December 31,</u>	
	<u>2019</u>	<u>2018</u>
Current:		
Federal .....	\$ 987	\$ 1,003
State .....	222	292
Total current .....	<u>1,209</u>	<u>1,295</u>
Deferred:		
Federal .....	(94)	(65)
State .....	(23)	(10)
Total deferred .....	<u>(117)</u>	<u>(75)</u>
Total income taxes .....	<u>\$ 1,092</u>	<u>\$ 1,220</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 and the effective tax rates are summarized as follows:

	<b>Year Ended December 31,</b>			
	<b>2019</b>		<b>2018</b>	
	<b>Amount</b>	<b>% of Pretax Earnings</b>	<b>Amount</b>	<b>% of Pretax Earnings</b>
<i>(dollars in thousands)</i>				
Income taxes at statutory rate .....	\$ 973	21.0%	\$ 1,105	21.0%
Increase (decrease) resulting from:				
State taxes, net of federal tax benefit .....	157	3.4	223	4.2
Tax-exempt income .....	(69)	(1.5)	(62)	(1.2)
Stock-based compensation .....	-	-	(29)	(0.6)
Other nondeductible expenses .....	31	0.7	(17)	(0.2)
Total .....	<u>\$ 1,092</u>	<u>23.6%</u>	<u>\$ 1,220</u>	<u>23.2%</u>

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

	<b>At December 31,</b>	
	<b>2019</b>	<b>2018</b>
<i>(in thousands)</i>		
Deferred tax assets:		
Allowance for loan losses .....	\$ 972	\$ 894
Organizational and start-up costs .....	30	40
Stock-based compensation .....	52	27
Unrealized losses on debt securities available for sale .....	-	188
Other .....	32	12
Deferred tax assets .....	<u>1,086</u>	<u>1,161</u>
Deferred tax liabilities:		
Prepaid Expenses .....	(44)	(59)
Deferred loan costs .....	(426)	(380)
Premises and equipment .....	(185)	(220)
Unrealized gain on debt securities available for sale .....	(69)	-
Deferred tax liabilities .....	<u>(724)</u>	<u>(659)</u>
Net deferred tax asset .....	<u>\$ 362</u>	<u>\$ 502</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 2016.

**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 consolidated 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 \$680,000 at December 31, 2019.

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

Standby letters of credit and commitments to extend credit typically result in loans with a market interest rate when funded.

A summary of the contractual amounts of the Company's financial instruments with off-balance sheet risk at December 31, 2019 is as follows:

	<b>At December 31,</b>
	<b>2019</b>
<i>(in thousands)</i>	
Commitments to extend credit .....	\$ 7,905
Construction loans in process .....	17,964
Unused lines of credit .....	46,042
Standby financial letters of credit .....	2,157
Standby performance letters of credit .....	328
Guaranteed accounts .....	1,378
Total off-balance sheet instruments .....	\$ 75,774

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(9) Stock Compensation Plans**

2015 Stock Incentive Compensation Plan

The 2015 Stock Incentive Compensation Plan (the “2015 Plan”) was approved by Shareholders at the Company’s annual meeting of shareholders on May 20, 2015, and permits the Company to grants its key employees and directors stock options, stock appreciation rights, performance shares, and phantom stock. Under the 2015 Plan, the 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, 2019, 272,267 stock options have been granted under the 2015 plan and 202,826 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, 2017 .....	11,540	\$ 17.03		
Options granted .....	252,917	19.91		
Options forfeited .....	(1,000)	20.09		
Outstanding at December 31, 2018 .....	<u>263,457</u>	\$ <u>19.78</u>		
Options granted .....	22,000	20.21		
Forfeited .....	(13,190)	20.09		
Outstanding at December 31, 2019 .....	<u>272,267</u>	\$ <u>19.80</u>	<u>7.8 years</u>	\$ <u>77,000</u>
Exercisable at December 31, 2019 .....	<u>71,827</u>	\$ <u>18.97</u>	<u>6.2 years</u>	\$ <u>77,000</u>

The fair value of shares vested and recognized as compensation expense was \$158,000 for the year ended December 31, 2019 and \$145,000 for the year ended December 31, 2018. The Company recognized an income tax benefit of \$19,000 and \$20,000 with respect to share-based compensation in 2019 and 2018, respectively. Att December 31, 2019, there was \$539,000 of total unrecognized compensation expense related to non-vested share-based compensation arrangements granted under the 2015 Plan. The cost is expected to be recognized over a weighted-average period of 3.4 years.

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

	<u>Year ended December 31,</u>	
	<u>2019</u>	<u>2018</u>
Weighted average risk-free interest rate .....	1.88%	1.47-2.63%
Expected dividend yield .....	0.59%	0.41-0.50%
Expected stock volatility .....	9.90%	10.07-11.90%
Expected life in years .....	6.5	1.0-6.5
Per share fair value of options issued during year .....	\$2.74	\$1.08-\$3.35

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.

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(9) Stock Compensation Plans, Continued**

2007 Stock Option Plan

As of May 20, 2015, no further grants will be made under the 2007 Stock Option Plan (the “2007 Plan”). Unexercised stock options that were granted under the 2007 Plan will remain outstanding and will expire under the terms of the individual stock grant. A summary of the activity in the Company’s 2007 Plan is as follows:

	<b>Number of Options</b>	<b>Weighted- Average Exercise Price</b>	<b>Weighted- Average Remaining Contractual Term</b>	<b>Aggregate Intrinsic Value</b>
Outstanding at December 31, 2017 .....	22,200	\$ 10.31		
Options exercised .....	(17,150)	10.02		
Options forfeited .....	(350)	10.00		
Outstanding at December 31, 2018 .....	<u>4,700</u>	<u>\$ 11.37</u>		
Options exercised .....	(500)	10.00		
Options forfeited .....	(2,000)	10.72		
Outstanding at December 31, 2019 .....	<u>2,200</u>	<u>\$ 12.27</u>	<u>0.32 years</u>	<u>\$ 17,000</u>
Exercisable at December 31, 2019 .....	<u>2,200</u>	<u>\$ 12.27</u>	<u>0.32 years</u>	<u>\$ 17,000</u>

At December 31, 2019, there was no unrecognized compensation expense related to non-vested, share-based compensation arrangements granted under the 2007 plan.

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 OTCQX 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. In 2019, the Board used the greater of quarter-end book value and quarter-end volume weighted average market price to determine what the fair market value of Prime Meridian common stock was for purposes of the Directors’ Plan. The maximum remaining number of shares to be issued pursuant to the Directors’ Plan is limited to 51,640 shares, which is approximately 1.62% of the total shares outstanding as of the record date. In 2019 and 2018, our directors received 3,643 and 2,818 shares of common stock, respectively, in lieu of cash, under the Directors’ Plan. The Company recognized expense of \$72,000 and \$60,000 during the years ended December 31, 2019 and 2018, with respect to the Director’s Plan.

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(9) Stock Compensation Plans, Continued**

Restricted Stock

The Company issued 3,600 restricted common stock shares to its CEO in the first quarter of 2019 as part of his bonus incentive earned for the Company's performance in 2018. One-third of the balance, or 1,200 shares, vest each year beginning February 21, 2020. Stockholders of unvested restricted stock have the right to vote and the right to receive dividends declared on common stock, if any. A summary of restricted stock transaction follows:

	<b>Number of Shares</b>	<b>Wtd-Avg Grant Date Fair Value per Share</b>	<b>Grant Date Fair Value</b>
Non-vested restricted stock issued in 2019 .....	3,600	\$ 18.52	\$ 67,000
Non-vested restricted stock outstanding at December 31, 2019.....	<u>3,600</u>	<u>\$ 18.52</u>	<u>\$ 67,000</u>

During the year ended December 31, 2019, the Company recognized \$19,000 as expense and had \$48,000 in unrecognized expense to be recognized over a weighted-average period of 2.2 years.

**(10) Employee Benefit Plans**

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, 2019 and 2018 were \$175,000 and \$160,000, respectively.

In November 2018, the Company established non-qualified account balance deferred compensation plans to provide retirement benefits for certain officers of the Company. The Company is recognizing the expense of these plans as services are rendered using a discount rate of four percent and a retirement age of sixty-five. The Company's expense in connection with these plans was \$155,000 and \$18,000 for the years ended December 31, 2019 and 2018, respectively. The accrued liability related to these agreements was \$173,000 and \$18,000 at December 31, 2019 and 2018, respectively. Such amounts are included in other liabilities in the accompanying consolidated balance sheets.

**(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>	<b>Year Ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Loans:</b>		
Beginning balance .....	\$ 7,288	\$ 5,870
Originated during the year.....	1,986	2,048
Remove retired Director.....	-	(400)
Principal repayments .....	<u>(1,548)</u>	<u>(230)</u>
Ending balance .....	<u>\$ 7,726</u>	<u>\$ 7,288</u>
<b>Deposits at year-end .....</b>	<u>\$ 7,079</u>	<u>\$ 9,989</u>

In addition, the Company purchases various insurance policies through a company that employs the spouse of one of our directors and former CFO. The premiums paid totaled \$1.1 million and \$739,000 in 2019 and 2018, respectively, 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, 2019		At December 31, 2018	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:					
Cash and cash equivalents .....	1	\$ 75,082	\$ 75,082	\$ 48,038	\$ 48,038
Debt securities available for sale .....	2	61,333	61,333	45,384	45,384
Loans held for sale .....	3	6,193	6,296	4,767	4,842
Loans, net .....	3	337,710	342,435	290,113	283,068
Federal Home Loan Bank stock .....	3	404	404	355	355
Accrued interest receivable.....	3	1,137	1,137	1,034	1,034
Financial liabilities-					
Deposits .....	3	438,264	439,208	349,067	349,416
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.

In January 2020, the Board of Directors declared an annual dividend of \$0.12 per share of common stock payable on March 3, 2020 to shareholders of record as of February 13, 2020.

**(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 phased 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.

The Bank is 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, 2019, and 2018, the Bank's capital conservation buffer exceeded the minimum requirement of 2.50% and 1.875%, respectively.

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

**(14) Regulatory Matters, Continued**

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and percentage (set forth in the table below) of total and Tier 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, 2019, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2019, 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>						
<b><i>As of December 31, 2019</i></b>						
Tier 1 Leverage ratio to Average Assets.....	\$ 46,752	9.31%	\$ 20,084	4.00%	\$ 25,105	5.00%
Common Equity Tier 1 Capital to Risk- Weighted Assets.....	46,752	13.24	15,885	4.50	22,945	6.50
Tier 1 Capital to Risk-Weighted Assets.....	46,752	13.24	21,180	6.00	28,240	8.00
Total Capital to Risk-Weighted Assets.....	51,165	14.49	28,240	8.00	35,300	10.00
<b><i>As of December 31, 2018:</i></b>						
Tier 1 Leverage ratio to Average Assets.....	\$ 37,805	9.28%	\$ 16,288	4.00%	\$ 20,360	5.00%
Common Equity Tier 1 Capital to Risk- Weighted Assets.....	37,805	12.90	13,190	4.50	19,052	6.50
Tier 1 Capital to Risk-Weighted Assets.....	37,805	12.90	17,587	6.00	23,449	8.00
Total Capital to Risk-Weighted Assets.....	41,466	14.15	23,449	8.00	29,311	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, 2019, there is no pending or threatened litigation of which management is aware.

**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:

	2019			2018		
	<b>Earnings</b>	<b>Weighted-Average Shares</b>	<b>Per Share Amount</b>	<b>Earnings</b>	<b>Weighted-Average Shares</b>	<b>Per Share Amount</b>
<i>(dollars in thousands, except per share amounts)</i>						
<b>Year Ended December 31,</b>						
Basic EPS:						
Net earnings .....	\$ 3,542	3,155,891	\$ 1.12	\$ 4,042	3,125,689	\$ 1.29
Effect of dilutive securities-incremental shares from assumed conversion of options .....		3,744			5,857	
Diluted EPS:						
Net earnings .....	\$ 3,542	3,159,635	\$ 1.12	\$ 4,042	3,131,546	\$ 1.29

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

The Holding Company's unconsolidated financial information follows:

	December 31,	
	2019	2018
<i>(in thousands)</i>		
<b>Assets</b>		
Cash .....	\$ 8,895	\$ 13,551
Investment in subsidiary .....	46,953	37,249
Other assets .....	20	20
Total assets .....	\$ 55,868	\$ 50,820
<b>Stockholders' Equity</b>		
Stockholders' equity .....	\$ 55,868	\$ 50,820
Total liabilities and stockholders' equity .....	\$ 55,868	\$ 50,820
<b>Condensed Statements of Earnings</b>		
	Year Ended December 31,	
	2019	2018
<i>(in thousands)</i>		
Revenues .....	\$ -	\$ -
Expenses .....	(501)	(632)
Income tax benefit .....	122	160
Loss before earnings of subsidiary .....	(379)	(472)
Net earnings of subsidiary .....	3,921	4,514
Net earnings .....	\$ 3,542	\$ 4,042

(continued)

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Notes to Consolidated Financial Statements, Continued**

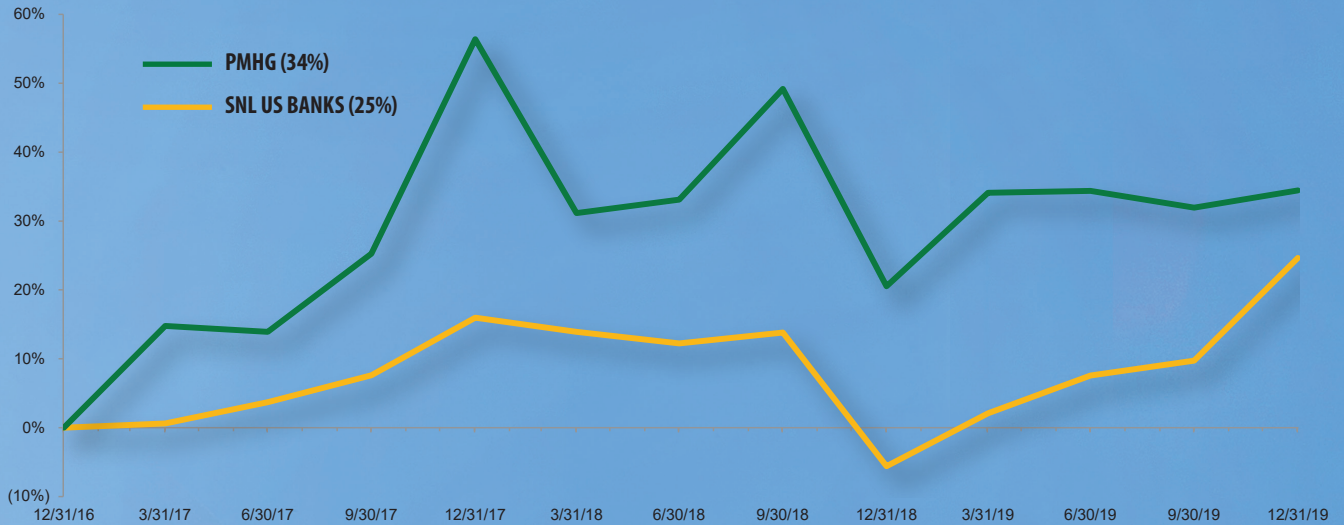
**(17) Parent Company Only Financial Information, Continued**

<i>(in thousands)</i>	<b>Year Ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
Cash flows from operating activities:		
Net Earnings .....	\$ 3,542	\$ 4,042
Adjustments to reconcile net earnings to net cash used in operating activities:		
Equity in earnings of subsidiary .....	(3,921)	(4,514)
Stock issued as compensation .....	72	60
Net cash used in operating activities .....	(307)	(412)
Cash flows from financing activities:		
Proceeds from sale of common stock .....	873	-
Proceeds from stock options exercised .....	5	172
Net cash provided by financing activities .....	878	172
Cash flows from investment activities:		
Cash dividend paid .....	(377)	(312)
Cash infusion to subsidiary .....	(4,850)	-
Net cash used by investing activities .....	(5,227)	(312)
Net decrease in cash .....	(4,656)	(552)
Cash at beginning of the year .....	13,551	14,103
Cash at end of year .....	\$ 8,895	\$ 13,551
Supplemental disclosure of cash flow information-		
Noncash items:		
Net change in accumulated other comprehensive income (loss) of subsidiary, net of change in unrealized loss on debt securities available for sale, net of tax .....	\$ 756	\$ (260)
Stock-based compensation expense of subsidiary .....	\$ 177	\$ 145

**(18) Subsequent Events**

On March 11, 2020, the Company's Board of Directors authorized a plan to repurchase up to \$2,000,000 of the Company's ordinary shares, inclusive of commission and fees. As of March 20, 2020, the Company repurchased and retired a total of 71,814 shares at a weighted average price per share of \$14.80 under this authorized repurchase plan. The total cost of shares repurchased, inclusive of fees and commissions, was \$1,062,868.

Prime Meridian Holding Company (PMHG) vs SNL US BANKS  
**RELATIVE PERFORMANCE (2016-2019)**



Source: S&P Global Market Intelligence

**2019 BY THE NUMBERS**

<b>\$501</b>	TOTAL ASSETS (IN MILLIONS) OF THE COMPANY AS OF DEC. 31, 2019
<b>\$65.4</b>	MARKET CAPITALIZATION (IN MILLIONS) AS OF DEC. 31, 2019
<b>\$438.3</b>	TOTAL DEPOSITS (IN MILLIONS) AS OF DEC. 31, 2019. REFLECTING A YEAR-OVER-YEAR INCREASE OF 25.6%
<b>\$337.7</b>	LOANS, NET OF ALLOWANCE (IN MILLIONS) AS OF DEC. 31, 2019, UP 16.4% YEAR OVER YEAR
<b>#7</b>	DEPOSIT SHARE RANKING IN TALLAHASSEE MSA AS OF JUNE 30, 2019 (AS REPORTED BY FDIC)
<b>#3</b>	2019 RANK AMONG FINANCIAL SERVICE PROVIDERS IN LEON COUNTY, BOTH IN MORTGAGE DOLLAR VOLUME AND NUMBER OF MORTGAGE LOAN ORIGINATIONS
<b>#20</b>	2019 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*



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



**Susan Payne Turner**  
*Executive Vice President  
Chief Risk Officer*



**Monté L. Ward**  
*Executive Vice President  
Chief Information Officer*



**Clint Weber**  
*Executive Vice President  
Chief Financial Officer*

Passion  
*Grace*  
INTEGRITY  
**TENACITY**  
ACCOUNTABILITY

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