# Section 1: 10-K (FORM 10-K)

**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

**FORM 10-K**

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2019.

**OR**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ________________ to ________________.

Commission file number: **333-191801**

## PRIME MERIDIAN HOLDING COMPANY

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Florida** | **27-2980805** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |
| **1471 Timberlane Road, Tallahassee, Florida** | **32312** |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code: **(850) 907-2300**

Securities registered pursuant to Section 12(b) of the Act:

| | |
|---|---|
| **None** | **None** |
| (Title of each class to be registered) | (Name of each exchange on which each class is to be registered) |

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES ☐ NO ☒

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES ☒ NO ☐

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES ☐ NO ☒

Indicate by check mark whether the Registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit such files). YES ☒ NO ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer: | ☐ | Accelerated filer: | ☐ |
| Nonaccelerated filer: | ☐ | Smaller reporting company: | ☒ |
| | | Emerging growth company: | ☐ |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). YES ☐ NO ☒

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the Registrant, computed by reference to the $20.26 per share selling price of the common stock on June 30, 2019 was $50,378,212. As of March 18, 2020, there were 3,126,304 issued and outstanding shares of the Registrant’s common stock.

## Prime Meridian Holding Company

**2019 Form 10-K Annual Report**
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## Part I

### Item 1. Business

#### General Description of Business

Prime Meridian Holding Company ("PMHG") was incorporated as a Florida corporation on May 25, 2010, and is the one-bank holding company for and sole shareholder of Prime Meridian Bank (the "Bank"). The Bank opened for business on February 4, 2008, and was acquired by PMHG on September 16, 2010. PMHG has no significant operations other than owning the stock of the Bank. In this report, the terms "Company," "we," "us," or "our" mean PMHG and its subsidiary. Since opening in 2008, the Bank has conducted a general banking business and has grown to 88 full-time equivalent ("FTE") employees as of December 31, 2019. We operate under the supervision and regulations of the FDIC, the Board of Governors of the Federal Reserve System ("Federal Reserve"), and the State of Florida Office of Financial Regulation ("OFR").

#### History

Prime Meridian Bank, a Florida commercial bank, was chartered on February 4, 2008, with a commitment to providing a high level of client service while maintaining sound and prudent banking practices. In 2010, our holding company, PMHG, was formed and the Bank's shareholders exchanged their shares of common stock for shares of common stock of PMHG, with the Bank becoming a wholly-owned subsidiary of PMHG. This occurred through a statutory share exchange on September 16, 2010. The Company commenced a public offering registered with the United States Securities and Exchange Commission (the "SEC") on December 11, 2013, has continued to file periodic reports with the SEC since that date, and became listed and publicly traded on the OTCQX marketplace on August 24, 2015.

In an effort to provide a superior level of service, we are building a culture and brand that fosters client relationships and creates an inviting atmosphere rather than simply processing customers' transactions. We want a culture that supports relationship banking. This culture has served us well, with many of our clients referring others to us. In our view, there is no greater compliment than to have our existing clients share their positive banking experiences with their family and friends.

Our team developed and adopted the following five core principles to support our actions and guide our decisions:

- ***Passion*** – A level of intense excellence and commitment that goes over and above merely meeting the commercial considerations and legal requirements - **Never** give up. **Never** settle for mediocrity. **Never** let fear hamper us from taking calculated risks. Above all, **Never** let a cynic stand in our way.
- ***Grace*** - Providing a high level of service, with courtesy and compassion. Having an awareness of how our actions, body language, and words affect others. Learning to master a mindful, calm response to any situation.
- ***Integrity*** – Doing the right thing, simply because it is the right thing to do, based on a firm adherence to the Bank's three-way test: (1) Is it right by the client? (2) Is it right by the Bank? (3) Is it legally, morally, and ethically correct?
- ***Tenacity*** – A culture of looking at new ideas, tackling challenges, and overcoming obstacles in order to meet our clients' needs.
- ***Accountability*** – Accepting full and ultimate responsibility for the situation or action at hand.

These core principles and the Bank's three-way test (Is it right by the client? Is it right by the Bank? Is it legally, morally, and ethically correct?) also serve as the foundation for our motto, "Let's think of a few good reasons why it CAN be done!" which is an overarching concept for our Company and team. We stress the question "Why?" because, while we clearly recognize that "how" is imperative, without understanding "why" something should be done, "how it can be done" does not necessarily matter. Our mission statement is also supported by our core principles: "Building bankers to serve our clients and community in order to optimize shareholder value." As a result of our efforts and culture, we have been able to increase our asset and deposit base exclusively through organic growth thus far.

#### Location and Service Area

Prime Meridian Bank is headquartered in Tallahassee, Florida and offers a broad range of banking services to the Tallahassee Metropolitan Statistical Area ("MSA") and the surrounding North and Central Florida and South Georgia areas. The Company is headquartered at 1471 Timberlane Road, Tallahassee, Florida 32312, its original office, which opened on February 4, 2008. The Bank also serves clients from a branch office located 1897 Capital Circle, NE, Tallahassee, Florida 32308 and from its branch office located at 2201 Crawfordville Highway, Crawfordville, Florida 32327, which opened in September, 2015. In April, 2019, the Company opened its fourth full-service branch office at 3340 South Florida Avenue, Lakeland, Florida 33830.

A substantial portion of the Company’s market is located in the larger Tallahassee MSA. Claritas, using primarily United States Census Bureau data, estimates that the 2019 population of the Tallahassee MSA, which includes Leon, Gadsden, Jefferson, and Wakulla counties, is 393,126 and is expected to grow to 410,816, or 4.50%, by 2025. Tallahassee is the state capital and is characterized by mostly small businesses in many different service industries in addition to significant governmental and educational employment. The Tallahassee MSA is furthermore home to over 70,000 college students with two state universities (Florida State University and Florida A&M University) and Tallahassee Community College, one of the largest community colleges in Florida. The region is thought to be attractive for many types of economic development. The Economic Development Council of Tallahassee/Leon County previously identified seven targeted industry sectors that match the region’s strengths, goals, and assets: (1) renewable energy and environment; (2) aviation and aerospace; (3) health sciences, medical education, training and research, and sports medicine; (4) information technology; (5) research and engineering; (6) transportation and logistics; and (7) advanced manufacturing.

According to the U.S. Department of Labor, the national unemployment rate and Florida’s unemployment rate were 3.4% and 2.5%, respectively, at December 31, 2019, while Leon County and Polk County's unemployment rate were reported at 2.5% and 3.0%, respectively. Any increases in unemployment rates could result in nonperforming loans and reduced asset quality.

In 2019, the Company began serving Polk County, Florida (the 8th largest county in the state) with the opening of its office in Lakeland, Florida during the second quarter. Lakeland, home to just over 100,000 residents, is located along the I-4 corridor between Orlando and Tampa. According to the Lakeland Chamber of Commerce, there are over 9 million people within a 100-mile radius of the city of Lakeland. In 2018, the U.S. Census Bureau ranked the Lakeland MSA as the 4th fastest growing metro area in the U.S. for 2017-2018.

**Banking Services**

Our business strategy focuses on traditional, relationship-based banking. The Bank provides a range of consumer and commercial banking services to individuals and businesses. In addition to electronic banking services such as mobile banking, remote deposit, mobile deposit, Apple Pay, Bank-to-Bank transfers and online banking, we offer basic services which include demand interest-bearing and non-interest bearing accounts, savings accounts, money-market deposit accounts, health savings accounts (HSA), NOW accounts, time deposits, safe deposit services, wire transfers, foreign exchange services, escrow accounts, enrollment in ICS and CDARS programs, debit cards, direct deposits, notary services, night depository, official checks, domestic collections, bank drafts, automated teller services, drive-in tellers, banking by mail, credit cards through a third party, and merchant card services with a third party. In addition, the Bank issues standby letters of credit and offers commercial real estate loans, residential real estate loans, construction loans, commercial loans, equipment loans, Small Business Administration (“SBA”) loans, and consumer loans. The Bank provides debit and automated teller machine (“ATM”) cards and is a member of the MoneyPASS and Pulse networks, thereby permitting clients to utilize the convenience of a large ATM network system including more than 400,000 member machines nationwide. As of December 31, 2019, the Bank did not have trust powers.

Our organizational structure focuses on a strong risk management culture. We stay abreast of our market by having our Board and management team highly involved in our communities. We believe our team's banking experience and high-quality client service distinguishes us from other banks. We believe this foundation will enable us to expand our products and services to new and existing clients, resulting in steady, long-term growth. Our culture focuses on servicing our clients and proactively exceeding their expectations, which in turn supports client retention and loyalty, increased referrals, and enhanced profitability.

Our loan target market includes owner-occupied and nonowner-occupied commercial real estate, small businesses, real estate developers, consumers, and professionals. Small business clients are typically commercial entities with sales of $25 million or less; these clients have the opportunity to generate significant revenue for banks.

Our revenues are primarily derived from interest income and fees on loans, interest and dividends from investment securities, and service charge income generated from demand accounts, ATM fees, and other services. The principal sources of funds for the Bank’s lending activities are its deposits, loan repayments, and proceeds from investment securities. The principal expenses of the Bank are the interest paid on deposits, salaries, and general operating expenses.

We are committed to being a successful community bank and being a good business partner within our community. We believe our active community involvement and business development strategies, in conjunction with our client relationship culture, have formed a successful foundation for developing new relationships and enhancing existing ones.

**Lending Activities**

The Bank offers a wide range of lending services to the community, providing loans to small to medium sized companies and their owners and not-for-profit organizations. Included in our array of commercial loan products are commercial real estate loans, equipment loans, small business loans, and business lines of credit. We also are actively engaged in Small Business Administration guaranteed financing to support local borrowers who might not otherwise qualify for conventional financing, which helps mitigate our credit risk and results in fee income if we sell the guaranteed portion. Consumer loans include residential first and second mortgage loans, home equity lines of credit, and consumer installment loans for cars, trucks, boats, and other recreational vehicles. Most of our retail lending connections are driven by our commercial and mortgage client relationships. The Bank maintains strong and disciplined credit policies and procedures and makes loans on a nondiscriminatory basis throughout its lending area. The net loan portfolio, excluding loans held for sale, constituted 67.4% of the Company's total assets at December 31, 2019.

Our lenders have the authority to extend credit under guidelines established and approved by the Board of Directors. With the exception of secured consumer loans, joint approval signatures are required for all loans. Officers may not combine their lending authority to approve a loan in an amount in excess of the lending authority of the officer with the greater authority, unless otherwise provided through the approved lending authority table. However, a loan officer may obtain the approval of another officer with a higher lending authority to grant a loan. The Loan Committee approves all loans with an aggregate indebtedness that exceeds an officer's or co-approving officer's lending authority, staying within the Company's in-house and legal lending limits. The voting members of the Bank's Loan Committee consist of at least five directors, with at least two of those five being nonemployee Board members. Alternates or designates may be appointed by the Board of Directors when needed. Loan Committee generally meets at least bi-weekly to consider any loan requests which are in excess of the lending limits of individual lending officers and require approval before the disbursement of proceeds and to review all other loans for compliance with our loan policy. Liquidity and stability in the Bank's portfolio are given the highest priority; therefore, the Board of Directors reviews the portfolio mix of loans at its monthly meetings. Actions of the Loan Committee are also reported to the Board of Directors at these monthly meetings.

We categorize our loans as follows: commercial real estate, residential real estate (first and second mortgages and home equity loans), construction loans, commercial loans, and consumer loans. Residential real estate and home equity loans, accounting for 39.8% of the loan portfolio, and commercial real estate loans, comprising 27.7% of the loan portfolio, were the two largest categories of loans at December 31, 2019.

*Commercial Real Estate Loans*. Secured by mortgages on commercial property, these loans are typically more complex and present a higher risk profile than our consumer real estate loans. Commercial loans that are secured by owner-occupied commercial real estate are repaid through operating cash flows of the borrower whereas nonowner-occupied commercial real estate loans are generally dependent on rental income. The typical amortization period is twenty years or less. Interest rates on our commercial real estate loans are generally 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, we normally require personal guarantees from the principal owners of the business supported by a review of the principal owners' personal financial statements, personal tax returns, and where applicable, business tax returns. As part of our enterprise risk management process, we understand 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 evaluate collateral value and analyze the borrower's, and if applicable the guarantor's, global cash flow position. Currently, the collateral securing our commercial real estate loans includes a variety of property types, such as office, warehouse, and retail facilities, multifamily properties, hotels, mixed-use residential and commercial properties.

*Residential Real Estate and Home Equity Loans.* 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 includes both owner-occupied residences and nonowner-occupied investment properties. The owner-occupied primary residence loans generally present lower levels of risk than commercial real estate loans; however, 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 3-year, 5-year, 7-year, or 10-year adjustable rate mortgages; while 15-year or 30-year fixed-rate loans are generally sold to the secondary market. The longer-term, fixed-rate loans are sometimes retained in the Company's loan portfolio and are evaluated on a case by case basis.

*Construction Loans.* Typically, these loans have a term of one to two years and the interest is paid monthly. Once the construction period terminates, some of these loans will convert to a term loan carried in the Bank's loan portfolio with an amortization period of twenty years or less, in general. This portion of our loan portfolio includes loans to small-to-medium sized businesses to construct owner-user properties, loans to developers of commercial real estate investment properties, and loans to residential developers. This type of loan is also made to individual clients for construction of single-family homes in our market area. An independent appraisal is generally 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 the Bank's policies. 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 an experienced construction lender. Risks associated with construction loans include fluctuations in the value of real estate, project completion risk, changes in market trends, and the interest rate environment. The ability of the construction loan borrower to move to permanent financing of 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 after the initial funding of the loan.

*Commercial Loans.* The Company offers a wide range of commercial loans, including small business loans, equipment financing, business lines of credit, and SBA loans. Small-to-medium sized businesses, retail, and professional establishments, make up our target market for commercial loans. Our lenders 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. Business lines of credit generally do not exceed two years and typically, are secured by accounts receivable and inventory. Significant factors affecting a commercial borrower's credit-worthiness include the quality of management and the ability to evaluate changes in the supply and demand characteristics affecting the business' markets for products and services and 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 risk factors 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 residential 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.

*Consumer and Other Loans.* Our consumer portfolio is the smallest portion of our loan portfolio, representing 2.3% of our total loan portfolio at December 31, 2019. 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, we do not anticipate that consumer loans will become a substantial component of our loan portfolio at any time in the immediate future. Consumer loans are made at fixed-interest and variable-interest rates and are based on the appropriate amortization for the asset and purpose.

**Investments**

Our investments are managed in relation to loan demand and deposit growth. Available funds are placed in low risk investments and provide liquidity to fund increases in loan demand or to offset fluctuations in deposits. With respect to our investment portfolio, the total portfolio may be invested in U.S. Treasuries, general obligations of government agencies, and bank-qualified municipal securities because such securities generally represent a minimal investment risk. Occasionally, we may invest in certificates of deposit from national and state banks. We also invest in mortgage-backed securities which generally have a shorter life than the stated maturity.

We monitor changes in financial markets. In addition to portfolio investments, our daily cash position is monitored to ensure that all available funds earn interest at the earliest possible date. A portion of the investment account is designated as secondary reserves and invested in liquid securities that can be readily converted to cash with minimum risk of market loss. These investments usually consist of U.S. Treasury obligations, U.S. Government agencies and federal funds. The remainder of the investment account may be placed in investment securities of a different type and longer maturity. Whenever possible, our strategy is to stagger the maturities of our securities to produce a steady cash-flow in the event the Bank needs cash, or economic conditions change to a more favorable rate environment.

**Deposit Activities**

Deposits are the major source of the Bank's funds for lending and other investment purposes. Deposits are gathered principally from within our primary market area through the offering of a broad variety of deposit products, including checking accounts, money-market accounts, regular savings accounts, term certificate of deposit accounts (including "jumbo" certificates in denominations of $250,000 or more), and retirement savings plans. We consider the majority of our regular savings, demand, NOW, and money-market deposit accounts to be core deposits. The majority of our deposits are generated within the Leon County, Florida area. Our deposits are insured up to the maximum amount allowed by law by the FDIC. The Economic Growth, Regulatory Relief, and Consumer Protection Act enacted on May 24, 2018 amended Section 29 of the Federal Deposit Insurance Act to except a capped amount of reciprocal deposits from treatment as brokered deposits for certain insured depository institutions. With this change in regulation, the Company now offers Certificate of Deposit Account Registry Service Insured Cash Sweep accounts.2019. The Bank had no brokered deposits at December 31, 2019 or 2018.

Maturity terms, service fees, and withdrawal penalties are established by the Bank on a periodic basis. The determination of rates and terms is predicated on funds acquisition and liquidity requirements, market rate competition, growth goals, and federal regulations.

We offer certificates of deposit, including time deposits of $250,000 or more, public fund deposits and other large deposit accounts. More than half our time deposits are short-term in nature and are more sensitive to changes in interest rates than other types of deposits; therefore, they may be a less stable source of funds. In the event that existing short-term deposits are not renewed, the resulting loss of the deposited funds could adversely affect our liquidity. In a rising interest rate market, short-term deposits may prove to be a costly source of funds because their short-term nature requires renewal at increasingly higher interest rates, which may adversely affect the Bank's earnings. The opposite is true in a falling interest rate market where such short-term deposits are more favorable to the Bank.

**Company Website and U.S. Securities Exchange Commission Filings**

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports can be found free of charge on our website at www.primemeridianbank.com as soon as reasonably practical after such material is electronically filed with or furnished to the SEC. The SEC maintains a website, www.sec.gov, which contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. Our charters of the Audit Committee and the Compensation and Nominating Committee, along with our Code of Ethics and Insider Trading Policy are available on our website at www.primemeridianbank.com. Printed copies of this information may also be obtained, without charge, by written request to the Corporate Secretary at P.O. Box 13629, Tallahassee, FL 32317.

**Employees**

At December 31, 2019, PMHG had 88 full-time equivalent employees (including executive officers), none of whom are represented by a union or covered by a collective bargaining agreement. Management considers employee relations to be good.

**Competition**

The market for banking is highly competitive. Our competition is made up of a wide range of financial institutions, including credit unions, local, regional, and national commercial banks, mortgage companies, insurance companies, and other non-traditional providers of financial services. According to the annual Summary of Deposits report produced by the FDIC, total deposits (excluding non-retail) in Leon, Polk, and Wakulla counties, Florida, grew to approximately $15.9 billion as of June 30, 2019. As of June 30, 2019, there were fourteen FDIC-insured financial institutions serving Leon County; only two of them, including PMHG, are headquartered in Leon County. As of June 30, 2019, according to the Summary of Deposits, the Company had a 4.59% share of the FDIC-insured deposits in Leon County. As of June 30, 2019, the Summary of Deposits reported that there were sixteen FDIC-insured institutions serving Polk County and that PMHG ranked number sixteen, with .08% share of the FDIC-insured deposits in Polk County. As of June 30, 2019, the Summary of Deposits reported that there were four FDIC-insured financial institutions serving Wakulla County and that PMHG ranked number three, with a 13.55 % share of the FDIC-insured deposits in Wakulla County.

Some of our competitors are not subject to the same level of regulation and oversight that is required of banks and bank holding companies, resulting in lower cost structures. By emphasizing our exceptional client service, knowledge of local trends and conditions, and local decision-making process, we believe the Bank has developed an effective competitive advantage in its market, thus maintaining a strong level of growth.

Some of our competitors are much larger financial institutions with greater financial resources. It is not our goal to compete on all products and services, but rather to remain client-service focused and to adhere to our core principles. This strategy has yielded solid growth for the Bank thus far.

Other important competitive factors that have contributed to our success in our market area include convenient office hours, electronic banking products, community reputation, quality of our banking team, capacity and willingness to extend credit, and our ability to offer cash management and other commercial banking services. Although offering competitive rates is important, we believe that our greatest competitive advantages are our experienced management team, client relationship culture, and personal service.

**Government Supervision and Regulation**

General

As a one-bank holding company, we are subject to an extensive collection of state and federal banking laws and regulations, which impose specific requirements and restrictions on virtually all aspects of our operations. We are affected by government monetary policy and by regulatory measures affecting the banking industry in general. These regulations are primarily intended to protect depositors, borrowers, the public, the FDIC, and the integrity of the U.S. banking system and capital markets. Future legislative enactments, changes in governmental policy, or changes in the way such laws or regulations are interpreted by regulatory agencies or courts could have a material impact on our business, operations, and earnings. Federal economic and monetary policy may also affect our ability to attract deposits, make loans, and achieve our planned operating results.

The following is a brief summary of some of the statutes, rules, and regulations that currently affect PMHG's and the Bank's operations. This summary is qualified in its entirety by reference to the particular statutory and regulatory provision referred to below and is not intended to be an exhaustive description of the statutes or regulations applicable to our business. Any change in applicable laws or regulations may have a material adverse effect on our business.

Prime Meridian Holding Company

As a bank holding company, PMHG is subject to regulation under the Bank Holding Company Act of 1956, as amended (the "BHCA"), and the examination and reporting requirements of the Federal Reserve. As such, the Company is required to file semi-annual reports and other information with the Federal Reserve regarding its business operations and those of its subsidiary. Under the BHCA, a bank holding company may not directly or indirectly acquire ownership or control of more than 5% of the voting shares or substantially all of the assets of any additional bank without prior approval of the Federal Reserve. The Company is further prohibited from merging or consolidating with another bank holding company without prior approval.

Prior to any person or company, excluding a bank holding company, acquiring control of a bank holding company, subject to certain exemptions, the BHCA and the Change in Bank Control Act, together with regulations promulgated by the Federal Reserve, require either the Federal Reserve's stated approval or a notice be furnished to the Federal Reserve and not disapproved. Control is conclusively presumed to exist when an individual or company acquires 25% or more of any class of voting securities of a bank holding company. Control may be presumed to exist if a person acquires 10% or more, but less than 25%, of any class of voting securities and either the bank holding company has registered securities under Section 12 of the Securities Exchange Act of 1934 or no other person owns a greater percentage of that class of voting securities immediately after the transaction. Additionally, the BHCA provides that the Federal Reserve may not approve any of these transactions if it would result in a monopoly, substantially lessen competition, or otherwise function as a restraint of trade, unless the anti-competitive effects of the proposed transaction are clearly outweighed by the public interest in meeting the convenience and needs of the community to be served. The Federal Reserve is also required to consider the financial and managerial resources and future prospects of the bank holding companies and banks concerned and the convenience and needs of the community to be served. The Federal Reserve's consideration of financial resources generally focuses on capital adequacy, which is discussed below. As a result of the USA PATRIOT Act, the Federal Reserve is also required to consider the record of a bank holding company and its subsidiary bank(s) in combating money laundering activities in its evaluation of bank holding company merger or acquisition transactions.

Except as authorized by the BHCA and Federal Reserve regulations or orders, a bank holding company is generally prohibited from acquiring direct or indirect control of 5% or more of the voting shares of any company engaged in any business other than the business of banking or managing and controlling banks. The primary exception allows a bank holding company to own shares in any company whose activities have been determined by the Federal Reserve to be so closely related to banking or to managing or controlling banks that ownership of shares of that company is appropriate. Activities the Federal Reserve has determined by regulation to be permissible for bank holding companies include the following:

- making or servicing loans and certain types of leases;
- engaging in certain insurance activities;
- performing certain data processing services;
- acting in certain circumstances as a fiduciary or investment or financial advisor;
- providing management consulting services;
- owning savings associations;
- and making investments in corporations or projects designed primarily to promote community welfare.

In accordance with Federal Reserve Policy, a bank holding company is expected to act as a source of financial strength to its subsidiary banks. In adhering to the Federal Reserve's policy, we may be required to provide financial support to the Bank at a time when, absent such Federal Reserve Policy, it might not be deemed advisable to provide such assistance. Under the BHCA, the Federal Reserve may also require a bank holding company to terminate any activity or relinquish control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) upon the Federal Reserve's determination that the activity or control constitutes a serious risk to the financial soundness or stability of any subsidiary depository institution of the bank holding company. Further, federal bank regulatory authorities have additional discretion to require a bank holding company to divest itself of any bank or nonbank subsidiary if the agency determines that divestiture may aid the depository institution's financial condition. The Dodd-Frank Act Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") codified the Federal Reserve's policy on serving as a source of financial strength. Such support may be required at times when, absent this Federal Reserve policy, a holding company may not be inclined to provide it. A bank holding company, in certain circumstances, could be required to guarantee the capital plan of an undercapitalized banking subsidiary.

The Federal Reserve's authority was expanded through the Financial Institutions Reform Recovery and Enforcement Act of 1989 ("FIRREA") to prohibit activities of bank holding companies and their nonbanking subsidiaries which represent unsafe and unsound banking practices, or which constitute violations of laws or regulations. FIRREA increased the amount of civil money penalties which the Federal Reserve can assess for activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution. The penalties can be as high as $1.0 million for each day the activity continues. FIRREA also expanded the scope of the individuals and entities against which such penalties may be assessed.

Prime Meridian Bank

As a state-chartered commercial bank, the Bank is subject to the supervision and regulation of the OFR and the FDIC. Our deposits are insured by the FDIC for a maximum of $250,000 per account ownership category. For this protection, we must pay a quarterly statutory assessment and comply with the rules and regulations of the FDIC. The assessment levied on a bank for deposit insurance varies, depending on the capital position of each bank, and other supervisory factors. Currently, we are subject to the statutory assessment.

The Federal Deposit Insurance Act provides that, in the event of the "liquidation or other resolution" of a bank, the claims of depositors of the bank, including the claims of the FDIC as subrogee of insured depositors and certain claims for administrative expenses of the FDIC as a receiver, will have priority over other general unsecured claims against a bank. If a bank fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, non-deposit creditors and shareholders.

Areas regulated and monitored by the bank regulatory authorities include:

- security devices and procedures;
- adequacy of capitalization and loss reserves;
- loans;
- investments;
- borrowings;
- deposits;
- mergers;
- issuances of securities;
- payment of dividends;
- establishment of branches;
- corporate reorganizations;
- transactions with affiliates;
- maintenance of books and records
- and adequacy of staff training to carry out safe lending and deposit gathering practices.

Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Act provides for significant regulation and oversight of the financial services industry. The Dodd-Frank Act addresses, among other things, systemic risk, capital adequacy, deposit insurance assessments, consumer financial protection, interchange fees, derivatives, lending limits, thrift charters, and changes among the banking regulatory agencies. There are many provisions in the Dodd-Frank Act mandating regulators to adopt new regulations and conduct studies upon which future regulation may be based. While many have been issued, some remain to be issued and may have unintended effects on smaller banks.

The changes resulting from the Dodd-Frank Act impact and may further impact the profitability of our business activities, require changes to some of our business practices, or otherwise adversely affect our business. These impacts also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. It may further necessitate higher levels of regulatory capital and/or liquidity and lead to a change in our business strategy. We cannot predict the effects of this legislation and the corresponding regulations on us, our competitors, or on the financial markets and economy, although it may significantly increase costs and impede efficiency of internal business processes.

Restrictions on Transactions with Affiliates and Loans to Insiders

Under Sections 23A and 23B of the Federal Reserve Act, the Bank is subject to restrictions that limit the transfer of funds or other items of value to the parent holding company, and any other non-bank affiliates in so-called "covered transactions." The term "covered transaction" includes loans, leases, other extensions of credit, investments and asset purchases, issuance of a guarantee, as well as other transactions involving the transfer of value from the Bank to an affiliate or for the benefit of an affiliate. An affiliate of a bank is any company or entity which controls, is controlled by, or is under common control with the bank. Unless an exemption applies, covered transactions by the Bank with a single affiliate are limited to 10% of the Bank's capital stock and surplus (tangible capital) and all such transactions are required to be on terms substantially the same, or at least as favorable to the Bank or subsidiary, as those provided to a nonaffiliate. With respect to all covered transactions with affiliates in the aggregate, they are limited to 20% of the Bank's capital and surplus.

The Dodd-Frank Act expanded the scope of Section 23A and includes investment funds managed by an affiliate institution as well as other hurdles. In addition, the Dodd-Frank Act expanded coverage of transactions with insiders by including credit exposure arising from derivative transactions. The Dodd-Frank Act furthermore prohibits an insured depository institution from purchasing or selling an asset to an executive officer, director, or principal shareholder (or any related interest of such a person) unless the transaction is on market terms. If the transaction exceeds 10% of the institution's capital, it must be approved in advance by a majority of the disinterested directors.

A bank’s authority to extend credit to executive officers, directors and shareholders with greater than 10% ownership, as well as entities controlled by such persons, is subject to Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O promulgated thereunder by the Federal Reserve. Among other things, these loans must be made on terms substantially the same as those offered to unaffiliated individuals. The amount of loans a bank may make to these persons is based, in part, on the bank’s capital position, and certain approval procedures must be followed in making loans which exceed specified amounts.

Basel III and Sarbanes-Oxley Act

The Bank is also subject to capital adequacy guidelines and prompt corrective action rules that implement the revised standards of the Basel Committee on Banking Supervision, commonly called Basel III, and address relevant provisions of the Dodd-Frank Act. Basel III and the regulations of the federal banking agencies require bank holding companies and banks to undertake significant activities to demonstrate compliance with certain capital standards. Compliance with these rules impose additional costs on the Company and the Bank.

The Sarbanes-Oxley Act of 2002 comprehensively revised the laws affecting corporate governance, accounting obligations, and corporate reporting requirements for companies with debt or equity securities registered under the Securities Exchange Act of 1934. Compliance with this complex legislation and subsequent Securities and Exchange Commission rules is a major focus of all public corporations and will be so for the Company going forward. One of the more applicable provisions of this act is corporate responsibility for financial reports. Sarbanes-Oxley requires a public company’s principal executive officer and principal financial officer to sign quarterly and annual reports stating that they have reviewed the reports and that the reports are true.

Capital

An international body known as the Basel Committee on Banking Supervision developed regulatory capital rules to implement capital standards (referred to as Basel III) and impose higher minimum capital requirements for bank holding companies and banks. The rules apply to all national and state banks and savings associations, regardless of size, and bank holding companies and savings and loan holding companies with more than $3 billion in total consolidated assets. More stringent requirements are imposed on “advanced approaches” banking organizations which are organizations with $250 billion or more in total consolidated assets, $10 billion or more in total foreign exposures, or that have opted into the Basel III capital regime.

Banks are subject to regulatory capital requirements imposed by the Federal Reserve and the FDIC. Until a bank holding company’s assets reach $3 billion, the risk-based capital and leverage guidelines issued by the Federal Reserve are applied to bank holding companies on a nonconsolidated basis, unless the bank holding company is engaged in nonbank activities involving significant leverage, or it has a significant amount of outstanding debt held by the general public. Instead a bank holding company with less than $3 billion generally applies the risk-based capital and leverage capital guidelines on a bank only basis and must only meet a debt-to-equity ratio at the holding company level. The FDIC risk-based capital guidelines apply directly to insured state banks, regardless of whether they are subsidiaries of a bank holding company. Both agencies’ requirements, which are substantially similar, establish minimum capital ratios in relation to assets, both on an aggregate basis as adjusted for credit risks and off-balance sheet exposures. The risk weights assigned to assets are based primarily on credit risks. Depending upon the riskiness of a particular asset, it is assigned to a risk category. Under the guidelines, capital is compared to the relative risk related to the balance sheet. To derive the risk included in the balance sheet, risk weights (from 0% to 150%) are applied to different balance sheet and off-balance sheet assets, primarily based on the relative credit risk of the counterparty. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Capital is then classified into three categories, Common Equity Tier 1, Additional Tier 1, and Tier 2. Common Equity Tier 1 Capital (“CET1”) is the sum of common stock instruments and related surplus net of treasury stock, retained earnings, Accumulated Other Comprehensive Income (“AOCI”), and qualifying minority interests, less applicable regulatory adjustments and deductions that include AOCI (if an irrevocable option to neutralize AOCI is exercised). Mortgage-servicing assets, deferred tax assets, and investments in financial institutions are limited to an aggregate of 15% of CET1 and 10% of CET1 individually. Additional Tier 1 Capital includes noncumulative perpetual preferred stock, Tier 1 minority interests, grandfathered trust preferred securities, and Troubled Asset Relief Program instruments, less applicable regulatory adjustments and deductions. Tier 2 Capital includes subordinated debt and preferred stock, total capital minority interests not included in Tier 1, and ALLL not exceeding 1.25% percent of risk-weighted assets, less applicable regulatory adjustments and deductions.

Smaller banks, such as the Bank, are also subject to the following new capital level threshold requirements under the FDIC's Prompt Corrective Action regulations.

| Capital Category | Threshold Ratios: Total Risk-Based Capital Ratio | Tier 1 Risk-Based Capital Ratio | Common Equity Tier 1 Risk-Based Capital Ratio | Tier 1 Leverage Capital Ratio |
|---|---|---|---|---|
| Well capitalized | 10.00% | 8.00% | 6.50% | 5.00% |
| Adequately Capitalized | 8.00% | 6.00% | 4.50% | 4.00% |
| Undercapitalized | <8.00% | <6.00% | <4.50% | <4.00% |
| Significantly Undercapitalized | <6.00% | <4.00% | <3.00% | <3.00% |
| Critically Undercapitalized | Tangible Equity/Total Assets ≤ 2% | | | |

Community banks are also subject to the following minimum capital requirements:

| | |
|---|---|
| Minimum CET1 ratio | 4.50% |
| Capital conversion buffer | 2.50% |
| Minimum tier 1 capital | 6.00% |
| Minimum total capital | 8.00% |

Federal banking regulators' risk-based capital guidelines also take account of interest rate risk. Interest rate risk is the adverse effect that changes in market interest rates may have on a bank's financial condition and is inherent to the business of banking. Under the regulations, when evaluating a bank's capital adequacy, the capital standards explicitly include a bank's exposure to declines in the economic value of its capital due to changes in interest rates. The exposure of a bank's economic value generally represents the change in the present value of its assets, less the change in the value of its liabilities, plus the change in the value of its interest rate off-balance sheet contracts.

Federal bank regulatory agencies possess broad powers to take prompt corrective action as deemed appropriate for an insured depository institution and its holding company, based on the institution's capital levels. The extent of these powers depends upon whether the institution in question is considered "well-capitalized," "adequately capitalized," "undercapitalized," "significantly under-capitalized," or "critically undercapitalized." Generally, as an institution is deemed to be less well-capitalized, the scope and severity of the agencies' powers increase, ultimately permitting the agency to appoint a receiver for the institution. Business activities may also be influenced by an institution's capital classification. For instance, only a "well-capitalized" depository institution may accept brokered deposits without prior regulatory approval and can engage in various expansion activities with prior notice, rather than prior regulatory approval. However, rapid growth, poor loan portfolio performance, poor earnings performance, or a combination of these factors, could change the capital position of the Bank in a relatively short period of time. Failure to meet these capital requirements could subject the Bank to prompt corrective action provisions of the FDIC, which may include filing with the appropriate bank regulatory authorities a plan describing the means and a schedule for achieving the minimum capital requirements. In addition, we would not be able to receive regulatory approval of any application that required consideration of capital adequacy, such as a branch or merger application, unless we could demonstrate a reasonable plan to meet the capital requirement within an acceptable period of time.

As of December 31, 2019, the Bank was considered to be "well capitalized" with a 9.31% Tier 1 Leverage ratio; a 13.24% Common Equity Tier 1 Risk-based Capital ratio, a 13.24% Tier 1 Risk-based Capital ratio, and a 14.49% Total Risk-based Capital ratio.

The Federal banking regulatory agencies have adopted a rule to simplify the methodology for measuring capital adequacy for smaller, uncomplicated banks. This community bank leverage ratio ("CBLR") is calculated as the ratio of tangible equity capital divided by average total consolidated assets. CBLR tangible equity is defined as total equity capital, prior to including minority interests, and excluding accumulated other comprehensive income, deferred tax assets arising from net operating loss and tax credit carryforwards, goodwill, and other intangible assets (other than mortgage servicing assets. Under the proposal, beginning in 2020, a qualifying organization may elect to use the CBLR framework if its CBLR is greater than 9%. The Bank has/has not elected to use the CBLR framework because it would not receive any material benefit with respect to compliance or reporting.

Other Safety and Soundness Regulations

The federal banking agencies also have adopted guidelines prescribing safety and soundness standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation and benefits. The federal regulatory agencies may take action against a financial institution that does not meet such standards.

Payment of Dividends

PMHG is a legal entity separate and distinct from the Bank. The Company's principal sources of funds to pay dividends on its common stock are capital retained from stock offerings and dividends from the Bank. Various federal and state laws and regulations limit the amount of dividends the Bank may pay to the Company without regulatory approval. The Federal Reserve Board is authorized to determine the circumstances when the payment of dividends would be an unsafe or unsound practice and to prohibit such payments. The rights of the Company, its shareholders, and creditors, to participate in any distribution of the assets or earnings of the Bank are also subject to the prior claims of creditors of the Bank. Additionally, the Florida Business Corporation Act provides that the Bank may only pay dividends if the dividend payment would not render the company insolvent, or unable to meet its obligations as they come due.

As a Florida state-chartered bank, the Bank is also subject to regulatory restrictions on the payment of dividends, including a prohibition of dividend payments from the Bank's capital under certain circumstances without the prior approval of the OFR and the FDIC. Except with the prior approval of the OFR, all dividends of any Florida bank must be paid out of retained net profits from the current period and the previous two years, after deducting expenses, including losses and bad debts.

Banks are also required to hold a capital conservation buffer of CET1 in excess of their minimum risk-based capital ratios to avoid limits on dividend payments and certain other bonus payments. Those requirements are reflected in the table below:

| **Capital Conservation Buffer (as a percentage of risk weighted assets)** | **Maximum Payout Ratio (as a % of the Previous Four Quarters of Net Income)** |
|---|---|
| Greater than 2.5% | No payout limitation |
| Less than or equal to 2.5% and greater than 1.875% | 60% |
| Less than or equal to 1.875% and greater than 1.25% | 40% |
| Less than or equal to 1.25% and greater than 0.625% | 20% |
| Less than or equal to 0.625% | 0% |

The Federal Reserve expects bank holding companies to serve as a source of strength to their subsidiary bank(s), which may require them to retain capital for investment in their subsidiary bank(s), rather than pay dividends to shareholders. As stated previously, the Bank may not pay dividends to PMHG, if after paying those dividends, the Bank would fail to meet the required minimum levels under the risk-based capital guidelines and the minimum leverage ratio requirements. Payment of dividends by the Bank may be restricted at any time at the discretion of its applicable regulatory authorities, based upon the Bank's capital position and asset quality.

Community Reinvestment

In connection with its lending activities, the Bank is subject to a number of federal laws designed to protect borrowers and promote lending to various sectors of the economy and population. These include the Equal Credit Opportunity Act, the Truth-in-Lending Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, and the Community Reinvestment Act (the "CRA"). The CRA requires the appropriate federal banking agency to assess the Bank's record in meeting the credit needs of the communities served by the Bank, including low and moderate-income neighborhoods. Under the CRA, institutions are assigned a rating of "outstanding," "satisfactory," "needs to improve," or "substantial noncompliance." The Bank received a "satisfactory" rating in its most recent CRA evaluation. In addition, pursuant to the Gramm-Leach-Bliley Act, federal banking regulators have enacted regulations limiting the ability of banks and other financial institutions to disclose nonpublic consumer information to non-affiliated third parties. The regulations require disclosure of privacy policies and allow consumers to prevent certain personal information from being shared with non-affiliated third parties.

The Dodd-Frank Act created the Consumer Financial Protection Bureau (the "CFPB") as an agency to centralize responsibility for consumer financial protection, including implementing, examining and enforcing compliance with federal consumer financial laws. The CFPB has focused its rulemaking in several areas, particularly in the areas of mortgage reform involving the Real Estate Settlement Procedures Act, the Truth in Lending Act, the Equal Credit Opportunity Act, and the Fair Debt Collection Practices Act. The CFPB requires lenders to verify borrowers' income and ability to repay loans and simplify the disclosures borrowers receive when taking out a loan.

Additional rulemakings to come under the Dodd-Frank Act will dictate compliance changes for financial institutions. Any such changes in regulations or regulatory policies applicable to the Bank make it difficult to predict the ultimate effect on our financial condition or results of operations.

Bank Secrecy Act / Anti-Money Laundering Laws

Banking regulators intensely focus on Anti-Money Laundering and Bank Secrecy Act compliance requirements, particularly the Anti-Money Laundering provisions of the USA PATRIOT Act. The USA PATRIOT Act substantially broadened the scope of U.S. anti-money laundering laws and regulations by creating new laws, regulations, and penalties, imposing significant new compliance and due diligence obligations, and expanding the extra-territorial jurisdiction of the U.S. These laws and regulations require the Bank to implement policies, procedures, and controls to detect, prevent, and report potential money laundering and terrorist financing and to verify the identity of its customers. Violations of these requirements can result in substantial civil and criminal sanctions. In addition, provisions of the USA PATRIOT Act require the federal financial institution regulatory agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing bank mergers and BHC acquisitions.

Interstate Banking and Branching

Current federal law authorizes interstate acquisitions of banks and bank holding companies without geographic limitation. Furthermore, national banks and state banks are able to establish branches in any state if that state would permit the establishment of the branch by a state bank chartered in that state. Florida law permits a state bank to establish a branch of the bank anywhere in the state. Accordingly, with the elimination of interstate branching under the Dodd-Frank Act, a bank with its headquarters outside the State of Florida may establish branches anywhere within Florida.

Economic and Monetary Policies

The Bank's earnings are affected by the policies of various banking regulatory authorities of the United States, especially the Federal Reserve and FDIC. The Federal Reserve, among other things, regulates the supply of money, credit and interest rates as a means of influencing general economic conditions within the United States. The instruments of monetary policy employed by the Federal Reserve for these purposes influence the overall level of investments, loans, other extensions of credit and deposits, and the interest rates paid on liabilities and received on assets.

As is generally true with all banking institutions, the Bank's operations are materially and significantly influenced by these general economic conditions and by related monetary and fiscal policies of financial institution regulatory agencies, including the Federal Reserve and the FDIC. Deposit flows and the cost of funds are influenced by interest rates on competing investments and general market rates of interest. Lending activities are affected by the demand for real estate financing and other types of loans, which in turn, is affected by interest rates and other factors affecting local demand and availability of funds.

**Enterprise Risk Management**

As evidenced by many of the challenges that the financial industry has faced, we understand and place significant emphasis on risk management. We have invested resources in comprehensive software which monitors every component of the Bank. We believe that taking a global view of the Bank's processes, down to the details of each procedure, will keep us properly focused. We recognize that enterprise risk management is an ongoing process.

Our solid asset quality statistics support our emphasis on risk management. With respect to lending, our risk management philosophy focuses on structuring credits to provide for multiple sources of repayment; this philosophy, coupled with strong underwriting policies and processes administered by experienced lenders, assists us with managing and mitigating our lending risks. As loans are reviewed, any borrowers who display deteriorating financial conditions are moved to an increased level of monitoring and a plan for implementing corrective actions is developed to minimize losses. We also have an annual independent, third-party loan review performed. In addition, our risk management software has the capability to stress test our portfolio utilizing mild and severe environments.

Our program also focuses on other specific areas of risk management including asset liability management, regulatory compliance, vendor management, policy review tracking, audit functions, and internal controls. Our asset liability management process is extensive; we use independent models by reputable third parties to run our interest rate risk model. We may utilize hedging techniques whenever our models indicate short term (net interest income) or long term (economic value of equity) risk to interest rate movements.

Our enterprise risk management program assists with monitoring operational controls and compliance control functions. We have also engaged an experienced independent public accounting firm to assist us with testing controls for operations and compliance. In addition, another experienced independent firm has been engaged to review and assess our controls with respect to technology and to perform penetration testing to assist us in managing the risks associated with information security.

**Correspondent Banking**

Correspondent banking gives the Bank access to services that we have determined are not economical or practical to perform ourselves. We purchase correspondent services offered by larger banks, including check collections, purchase of federal funds, security safekeeping, investment services, coin and currency supplies. We may also use correspondent banks for overline and liquidity loan participations and sales of loan participations.

**Interest and Usury**

The Bank is subject to numerous state and federal statutes that affect the interest rates that may be charged on loans. These laws do not, under present market conditions, deter the Bank from continuing to originate loans.

## Item 1A Risk Factors

***RISKS RELATED TO OUR BUSINESS OPERATIONS***

**Some of our borrowers will not repay their loans, and losses from loan defaults may exceed the allowance we establish for that purpose, which may have an adverse effect on our business.**

Consistent with the financial institution industry, some of our borrowers inevitably will not repay loans that we make to them. This risk is inherent in the banking business. The risk of credit losses on loans varies with, among other things, general economic conditions, the type of loan being made, the creditworthiness of the borrower over the term of the loan and, in the case of a collateralized loan, the value and marketability of the collateral for the loan. If a significant number of loans are not repaid, it will have an adverse effect on our earnings and overall financial condition.

Like all financial institutions, we maintain an allowance for loan losses to account for possible loan defaults and nonperformance. The allowance for loan losses reflects our best estimate of probable losses in the loan portfolio at the relevant time. This evaluation is based primarily upon the following: a review of our historical loan loss experience as adjusted for certain qualitative factors; known risks contained in the loan portfolio; known risks for each segment of our loan portfolio; composition and growth of the loan portfolio; and certain economic factors. Despite our best efforts, and particularly due to the fact that we have a limited loan loss history, the determination of an appropriate level of loan loss allowance is an inherently difficult process and is based on numerous assumptions and estimations. As a result, our allowance for loan losses may not be adequate to cover our actual losses, and future provisions for loan losses may adversely affect our earnings.

**Our recent results may not be indicative of our future results.**

We may not be able to sustain our historical rate of growth. In addition, our recent growth may distort some of our historical financial ratios and statistics. Various factors, such as economic conditions, regulatory and legislative considerations and limitations, and competition, may also impede or prohibit our efforts to expand our market presence. If we experience a significant decrease in our historical rate of growth, our results from operations and financial condition may be adversely affected due to a high percentage of our operating costs being fixed expenses.

**Changes in business and economic conditions, in particular those of the Florida markets in which we operate, could lead to lower asset quality and lower earnings.**

Unlike larger national or regional banks that are more geographically diversified, our business and earnings are closely tied to general business and economic conditions, particularly the economy of the Tallahassee MSA. The local economy is heavily influenced by government, education, real estate, and other service-based industries. Factors that could affect the local economy include declines in government spending, higher energy costs, reduced consumer or corporate spending, natural disasters or adverse weather, health epidemics, and a significant decline in real estate values. A sustained economic downturn could adversely affect the quality of our assets, credit losses, and the demand for our products and services, which could lead to lower revenue and lower earnings.

**Changes in interest rates affect our profitability and assets.**

Our profitability depends to a large extent on the Bank’s net interest income, which is the difference between income on interest-earning assets such as loans and investment securities, and expenses on interest-bearing liabilities such as deposits and borrowings. We are unable to predict changes in market interest rates, which are affected by many factors beyond our control including inflation, economic recession, unemployment, money supply, domestic and international events, and changes in the United States and other financial markets.

At December 31, 2019, our one-year interest rate sensitivity position was slightly asset sensitive, such that a gradual increase in interest rates during the next twelve months would have a positive impact on our net interest income. Our results of operations are affected by changes in interest rates and our ability to manage this risk. The difference between interest rates charged on interest-earning assets and interest rates paid on interest-bearing liabilities may be affected by changes in market interest rates, changes in relationships between interest rate indices, and changes in the relationships between long-term and short-term market interest rates. Our net interest income may be reduced if: (i) more interest-earning assets than interest-bearing liabilities reprice or mature during a time when interest rates are declining; or (ii) more interest-bearing liabilities than interest-earning assets reprice or mature during a time when interest rates are rising. In addition, the mix of assets and liabilities could change as varying levels of market interest rates might present our client base with more attractive options.

**Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.**

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, and other sources, could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities on terms that are acceptable to us could be impaired by factors that affect us specifically, the financial services industry, or the economy in general. Factors that could negatively impact our access to liquidity sources include a decrease of our business activity as a result of a downturn in the markets in which our loans are concentrated, adverse regulatory action against us, or our inability to attract and retain deposits. Our ability to borrow could be impaired by factors that are not specific to us, such as a disruption in the financial markets and diminished expectations or growth in the financial services industry.

**We may not be able to retain or grow our core deposit base, which could adversely impact our funding costs.**

Like many financial institutions, we rely on client deposits as our primary source of funding for our lending activities. Our future growth will largely depend on our ability to retain and grow our deposit base. Although we have historically maintained a high deposit client retention rate, these deposits are subject to potentially dramatic fluctuations in availability or price due to certain factors outside of our control, such as increasing competitive pressures for deposits, changes in interest rates and returns on other investment classes, client perceptions of our financial health and general reputation, or a loss of confidence by clients in us or the banking sector generally. Such factors could result in significant outflows of deposits within short periods of time or significant changes in pricing necessary to maintain current client deposits or attract additional deposits. Additionally, any such loss of funds could result in lower loan originations, which could have a material adverse effect on our business, financial condition and results of operations.

**Our loan portfolio includes commercial, real estate, and consumer and other loans that may have higher risks.**

Our commercial real estate, residential real estate and home equity, construction, commercial, and consumer and other loans at December 31, 2019, were $ 94.7 million, $135.9 million, $33.6 million, $69.8 million, and $7.6 million, respectively, or 27.7%, 39.8%, 9.8%, 20.4%, and 2.3% of total loans. Commercial loans and commercial real estate loans generally carry larger balances and can involve a greater degree of financial and credit risk than other loans. As a result, banking regulators continue to give greater scrutiny to lenders with a high concentration of commercial real estate loans in their portfolios, and such lenders are expected to implement stricter underwriting standards, internal controls, risk management policies, and portfolio stress testing, as well as higher capital levels and loss allowances. The increased financial and credit risk associated with these types of loans are a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the size of loan balances, the effects of general economic conditions on income-producing properties, and the increased difficulty of evaluating and monitoring these types of loans.

**Our continued pace of growth may require us to raise additional capital in the future, but that capital may not be available when it is needed.**

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. Our ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside our control, and depend on our financial performance. Accordingly, there is no assurance as to our ability to raise additional capital if needed on terms acceptable to us. If we cannot raise additional capital to support our growth, our ability to further expand our operations through internal growth and acquisitions could be materially impaired.

**We may be subject to losses due to fraudulent and negligent acts on the part of loan applicants, mortgage brokers, other vendors and our employees.**

When we originate loans, we rely heavily upon information supplied by loan applicants and third parties, including the information contained in the loan application, property appraisal, title information, and employment and income documentation provided by third parties. If any of this information is misrepresented and such misrepresentation is not detected prior to loan funding, we generally bear the risk of loss associated with the misrepresentation.

**Both our industry and our primary service area are highly competitive.**

There are a number of national and regional financial institutions that compete with us in our primary service areas. By virtue of their larger capital resources, such institutions have significantly greater lending limits than we have, and these financial institutions have the ability to offer a greater mix of financial products and services than we are able to provide. In addition, we are also competing with other financial institutions, such as savings and loan associations and credit unions, for deposits and loans. Most of our competitors benefit from a more established market presence, greater capital, and a larger asset and lending base. As a result, we cannot anticipate the extent to which such competition may negatively affect our ability to operate profitably.

**Our lending limit per borrower will continue to be lower than many of our competitors which may discourage potential clients and limit our loan growth.**

The Bank's legally mandated lending limit is lower than that of many of our larger competitors because we have less capital. At December 31, 2019, our legal lending limit for loans was approximately $11.7 million to any one borrower on a secured basis and $ 7.0 million on an unsecured basis. Furthermore, management has an established in-house lending limit of $5.0 million for any single secured loan or loan relationship and an in-house limit of $1.0 million for any single unsecured loan or loan relationship as of December 31, 2019. Although we have not experienced this to date, our lower lending limit may discourage potential borrowers with loan needs that exceed our limit from doing business with us. This may restrict our ability to grow. We attempt to serve the needs of these borrowers by selling loan participations to other institutions, but this strategy may not always succeed.

**A significant portion of our loan portfolio is secured by real estate in our geographic markets and events that negatively impact the real estate market in our primary market could hurt our business.**

Our interest-earning assets are heavily concentrated in mortgage loans secured by real estate, particularly real estate located in Leon County, Florida. As of December 31, 2019, approximately 77.3% of our gross loan portfolio (excluding loans held for sale) had real estate as a primary or secondary component of collateral. The real estate collateral, in each case, provides an alternate source of repayment in the event of default by the borrower; however, the value of the collateral may decline during the time the credit is extended. Real estate values and real estate markets are generally affected by a variety of factors including changes in economic conditions; fluctuations in interest rates; the availability of credit; changes in tax laws and other governmental statutes, regulations, and policies; and acts of nature. If we are required to liquidate the collateral securing a loan during a period of reduced real estate values to satisfy the debt, our earnings and capital could be adversely affected.

This concentration of loans subjects us to risks if there is a downturn in the economy or a recession similar to the one our country most recently experienced. A downturn could result in decreased loan originations and increased delinquencies and foreclosures, which could more greatly affect us than if our lending were more geographically diversified. In addition, since a large portion of our portfolio is secured by properties located in Leon County, Florida, the occurrence of a natural disaster, such as a hurricane, or a man-made disaster could result in a decline in loan originations, a decline in the value or destruction of mortgaged properties, and an increase in the risk of delinquencies, foreclosures or loss on loans originated by us.

**We face additional risks due to our increased mortgage banking activities that could negatively impact net income and profitability.**

We sell the majority of the mortgage loans that we originate. The sale of these loans generates noninterest income and can be a source of liquidity for the Bank. Disruption in the secondary market for residential mortgage loans could result in our inability to sell mortgage loans, which could negatively impact our liquidity position and earnings. In addition, declines in real estate values or increases in interest rates could reduce the potential for robust mortgage originations, which could negatively impact our earnings. As we do sell mortgage loans, we also face the risk that such loans may have been made in breach of our representations and warranties to the buyers and we could be forced to repurchase such loans or pay other damages.

**The development of our mortgage lending business will depend on our ability to attract and retain effective loan origination officers and other sources of mortgage loan referrals.**

The mortgage lending business is highly dependent on being able to successfully originate a consistent volume of loans. The primary ways we intend to do this is through the personal sales efforts of our mortgage lending officers and our development of loan referral sources, such as real estate brokers. If we are unable to attract and retain a productive team of such officers or develop an effective network of referral sources, we will likely be unable to generate a volume of mortgage loans to produce sufficient revenue for this line of business to be profitable. If we cannot operate this line of business in a profitable manner, we will likely incur losses due to expenses associated with attempting to establish the line of business.

**Future economic growth in our market area may be slower compared to previous years.**

The State of Florida’s population growth historically has exceeded national averages. Consequently, the state has experienced substantial growth in new business formation and public works spending. Although recently home prices have increased due to a moderate economic growth and migration into our market area, growth in our market area may still be restrained in the near term. Any decrease in existing and new home sales limits lending opportunities and negatively affects our income. Additionally, a decline in property values could lead to valuation adjustments on our loan portfolio.

**Our business strategy depends on continued growth; therefore, our financial condition and results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.**

We intend to continue pursuing a growth strategy for our business. Our business prospects must be considered in light of the risks, expenses, and difficulties that are frequently encountered by companies in significant growth stages of development. In light of the prevailing economic conditions, we cannot assure you we will be able to expand our market presence in our existing market, successfully enter new markets, or that any such expansion will not adversely affect our results of operations. Failure to manage our growth effectively could have a material adverse effect on our business, future prospects, financial condition, or results of operations and could negatively affect successful implementation of our business strategy.

**Reputational risk and social factors may impact our results.**

Our ability to originate and maintain deposit accounts and loans is highly dependent upon client and community perceptions of our business practices and our financial health. Adverse perceptions regarding those factors could damage our reputation in our markets, leading to difficulties in generating and maintaining deposit and loan client relationships. Adverse developments with respect to the consumer or other external perceptions regarding the practices of our competitors, or our industry as a whole, may also adversely impact our reputation. Adverse impacts on our reputation, or the reputation of our industry, may also result in greater regulatory or legislative scrutiny, which may lead to laws, regulations or regulatory actions that may change or constrain the manner in which we engage with our clients and the products we offer. Adverse reputational impacts or events may also increase our litigation risk. We carefully monitor internal and external developments for areas of potential reputational risk and have established governance structures to assist in evaluating such risks in our business practices and decisions.

**We may face risks with respect to future expansion.**

We may engage in additional *de novo* branch expansion, expansion through acquisitions of existing branches of other financial institutions, or the acquisition of existing financial institutions in North and Central Florida, South Georgia, or South Alabama. We may consider and enter into new lines of business or offer new products or services. Branch expansion, acquisitions, and mergers involve a number of risks, including, but not limited to: (i) the time and costs associated with identifying and evaluating potential acquisitions and merger partners; (ii) inaccurate estimates and judgments regarding credit, operations, management, and market risks of the target institutions; (iii) the time and costs of evaluating new markets, hiring experienced local management, opening new offices, and the time lags between these activities and the generation of sufficient assets and deposits to support the costs of the expansion; (iv) our ability to finance an acquisition and possible dilution to our existing shareholders; (v) the diversion of our management's attention to the negotiation of a transaction, and the integration of the operations and personnel of the combining businesses; (vi) our ability to penetrate new markets when we lack experience in those markets; (vii) the strain of growth on our infrastructure, staff, internal controls and managements, which may require additional personnel, time, and expenditures; (viii) exposure to potential asset quality issues with acquired institutions; (ix) the introduction of new products and services into our business that could prove costly; and (x) the possibility of unknown or contingent liabilities.

We may incur substantial costs to expand and we can give no assurance such expansion will result in the levels of profits we seek. There can be no guarantee that integration efforts of any future mergers or acquisitions will be successful. Also, we may issue equity securities, including common stock and securities convertible into shares of our common stock in connection with a future acquisition, which could cause ownership and economic dilution to our current shareholders.

**Our business is exposed to the possibility of technology failure and a disruption in our operations may adversely affect our business.**

The Bank relies on its computer systems and the technology of outside service providers for its daily operations. We rely on these systems to accurately track and record our assets and liabilities. If our computer systems or outside technology sources become unreliable, fail, or experience a breach of security, our ability to maintain accurate financial records may be impaired, which could materially affect our business operations and financial condition. In addition, a disruption in our operations resulting from failure of transportation and telecommunication systems, loss of power, interruption of other utilities, natural disaster, fire, global climate changes, computer hacking or viruses, failure of technology, terrorist activity, or the domestic and foreign response to such activity or other events outside of our control could have an adverse impact on the financial services industry as a whole and/or on our business. Our business continuity plan and disaster recovery plan may not be adequate and may not prevent significant interruptions of our operations or substantial losses. The increased number of cyber-attacks during the past few years has further heightened our awareness of this risk. As the environment for such attacks continues to evolve, we will continue to implement additional security controls.

**A failure in or breach of our operational or security systems or infrastructure, or those of our third-party vendors and other service providers, including as a result of cyber-attacks, could disrupt our business, result in the disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs and cause financial losses.**

We rely heavily on communications and information systems to conduct our business. Information security risks for financial institutions such as ours have generally increased in recent years in part because of the proliferation of new technologies, the use of the internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, terrorists, activists, and other external parties. As client, public, and regulatory expectations regarding operational and information security have increased, our operational systems and infrastructure must continue to be safeguarded and monitored for potential failures, disruptions, and breaches. Our business, financial, accounting and data processing systems, or other operating systems and facilities may stop operating properly or become disabled or damaged as a result of a number of factors, including events that are wholly or partially beyond our control. For example, there could be electrical or telecommunications outages; natural disasters such as earthquakes, tornadoes, and hurricanes; disease pandemics; events arising from local or larger scale political or social matters, including terrorist acts; and, as described below, cyber-attacks.

As noted above, our business relies on our digital technologies, computer and email systems, software, and networks to conduct its operations. Although we have information security procedures and controls in place, our technologies, systems, networks, and our clients' devices may become the target of cyber-attacks or information security breaches that could result in the unauthorized release, gathering, monitoring, misuse, loss or destruction of our or our clients' confidential, proprietary and other information, or otherwise disrupt our or our clients' or other third parties' business operations. Third parties with whom we do business or that facilitate our business activities, including financial intermediaries, or vendors that provide services or security solutions for our operations, and other third parties, could also be sources of operational and information security risk to us, including from breakdowns or failures of their own systems or capacity constraints.

While we have disaster recovery and other policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. Our risk and exposure to these matters remains heightened because of the evolving nature of these threats. As a result, cybersecurity and the continued development and enhancement of our controls, processes and practices designed to protect our systems, computers, software, data and networks from attack, damage or unauthorized access remain a focus for us. As threats continue to evolve, we may be required to expend additional resources to continue to modify or enhance our protective measures or to investigate and remediate information security vulnerabilities. Disruptions or failures in the physical infrastructure or operating systems that support our businesses and clients, or cyber-attacks or security breaches of the networks, systems or devices that our clients use to access our products and services could result in client attrition, regulatory fines, penalties or intervention, reputational damage, reimbursement or other compensation costs, and/or additional compliance costs, any of which could materially adversely affect our results of operations or financial condition.

**Technological changes, including online and mobile banking, have the potential of disrupting our business model, and we may have fewer resources than many competitors to invest in technological improvements.**

The financial services industry is experiencing significant and rapid technological changes. Many of our bank and non-bank competitors frequently introduce new technology-driven products and services. Changes in client expectations and behaviors have increased the need to offer these options to our clients. Our future success will depend, in part, upon our ability to invest in and use technology to provide products and services that provide convenience to clients and to create additional efficiencies in operations. We will need to make significant additional capital investments in technology, and we may not be able to effectively implement new technology-driven products and services in a timely manner in response to changes in client behaviors, thus adversely affecting our operations. Many competitors have substantially greater resources to invest in technological improvements than we do.

**We may not be able to attract and retain skilled people.**

Our success depends, in large part, on our ability to attract and retain key people. Competition for the best people in most activities we engage in can be intense and we may not be able to hire people or to retain them. An inability to develop and maintain a skilled and well qualified team of employees could have a material adverse impact on our business, because they are integral to the implementation of our business strategies and the provision of service to our clients. Finding qualified replacement personnel can be time consuming and expensive and distract us from our business activities.

**We are dependent on key executive officers, the loss of which may be detrimental to our operations.**

We are dependent on certain executive officers of the Company and the Bank, for their leadership and oversight in all aspects of our operations and the unexpected loss of any of these personnel could adversely affect our operations. Such adverse effects may be magnified if such officers were to become employed with a competitor of ours.

**If our enterprise risk management framework is not effective, we could suffer unexpected losses and our results of operations could be materially adversely affected.**

Our enterprise risk management framework seeks to achieve an appropriate balance between risk and return, which is critical to optimizing financial performance and stockholder value. We have established processes and procedures intended to identify, measure, monitor, report and analyze the types of risk to which we are subject, including credit, liquidity, operational, regulatory compliance and reputational. However, as with any risk management framework, there are inherent limitations to our risk management strategies as there may exist, or develop in the future, risks that we have not appropriately anticipated or identified. If our risk management framework proves ineffective, we could suffer unexpected losses and our business and results of operations could be materially adversely affected.

**We operate in a geographic location that is vulnerable to hurricanes; a direct hit could be detrimental to our operations.**

In October 2018, Hurricane Michael had a devastating effect on the areas just west of Tallahassee, rendering them virtually inhabitable for long periods of time. We have a disaster recovery plan in place for such events that includes among other things plans to move a team of key employees to an offsite remote location. While management believes it has a viable plan in place to keep the Bank operational, it has never been fully tested in a major natural disaster.

**The effects of widespread public health emergencies may negatively affect our local economies or disrupt our operations, which would have an adverse effect on our business or results of operations.**

Widespread health emergencies, such as the recent global COVID-19 pandemic, can disrupt our operations through their impact on our employees, clients and their businesses, and the communities in which we operate. Disruptions to our clients could result in increased risk of delinquencies, defaults, foreclosures and losses on our loans, negatively impact regional economic conditions, result in a decline in local loan demand, loan originations and deposit availability and negatively impact the implementation of our growth strategy. Any one or more of these developments could have a material adverse effect on our business, financial condition and results of operations.

***LEGAL AND REGULATORY RISKS***

**We are subject to government regulation and monetary policy that could constrain our growth and profitability.**

We are subject to extensive federal government supervision and regulations that impose substantial limitations with respect to lending activities, purchases of investment securities, the payment of dividends, and many other aspects of the banking business. Many of these regulations are intended to protect depositors, the public, and the FDIC but not our shareholders. The banking industry is heavily regulated. We are subject to examinations, supervision, and comprehensive regulation by various federal and state agencies. Our compliance with these regulations is costly and restricts certain activities of the Bank. Banking regulations are primarily intended to protect the Bank Insurance Fund and depositors, not shareholders. The burden imposed by federal and state regulations puts banks at a competitive disadvantage compared to less regulated competitors such as finance companies, mortgage banking companies, and leasing companies. Federal economic and monetary policy may also affect our ability to attract deposits, make loans, and achieve our planned operating results.

**Legislation and regulatory proposals enacted in response to market and economic conditions may materially adversely affect our business and results of operations.**

Changes in the laws, regulations, and regulatory practices affecting the banking industry may increase our costs of doing business or otherwise adversely affect us and create competitive advantages for others. The Dodd-Frank Act in particular represents a significant overhaul of many aspects of the regulation of the financial services industry. These changes may impact the profitability of our business activities, require changes to some of our business practices, or otherwise adversely affect our business, as would other regulatory initiatives that may become effective. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. It may also require us to hold higher levels of regulatory capital and/or liquidity and it may cause us to adjust our business strategy and limit our future business opportunities. We cannot predict the effects of this legislation and the corresponding regulations on us, our competitors, or on the financial markets and economy, although it may significantly increase costs and impede efficiency of internal business processes.

**Our information systems may experience an interruption or security breach.**

We rely heavily on communications and information systems to conduct our business. We also provide our clients the ability to bank electronically through online banking, remote capture, mobile capture, and mobile banking. The secure transmission of confidential information over the internet is a critical element of banking online. Our network could be vulnerable to unauthorized access, computer viruses, phishing schemes, and other security problems. Any failure, interruption, or breach in the security of these systems could result in disruptions in our client relationship management, general ledger, deposit, loan, and other systems. While we have policies and procedures designed to prevent or limit the effects of possible failure, interruption, or security breach of our information systems, there can be no assurance that any such failure, interruption or security breach will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failure, interruption, or security breach of our information systems could damage our reputation, result in a loss of client business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability. While we do carry insurance to protect against losses resulting from such technology issues or breaches, we could be exposed to claims, litigation, and other possible liabilities that could exceed the maximum policy limits.

**Florida financial institutions face a higher risk of noncompliance and enforcement actions with the Bank Secrecy Act and other Anti-Money Laundering statutes and regulations.**

Banking regulators focus intensely on Anti-Money Laundering and Bank Secrecy Act compliance requirements, particularly the Anti-Money Laundering provisions of the USA PATRIOT Act. They also intensely scrutinize compliance with the rules enforced by the Office of Foreign Assets Control. Both federal and state banking regulators and examiners have been extremely aggressive in their supervision and examination of financial institutions located in the State of Florida with respect to institutions' Bank Secrecy Act and Anti-Money Laundering compliance. Consequently, a number of formal enforcement actions have been issued against Florida financial institutions.

In order to comply with regulations, guidelines, and examination procedures in this area, the Bank has been required to adopt policies and procedures and to install expensive systems. If our policies, procedures, and systems are deemed deficient, then we may be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan including acquisition plans.

**Higher FDIC deposit insurance premiums and assessments could adversely affect our financial condition.**

The deposits of the Bank are insured by the FDIC up to legal limits and, accordingly, subject the Bank to the payment of FDIC deposit insurance assessments. The Bank's regular assessments are determined by its risk classification, which is based on its regulatory capital levels and the level of supervisory concern that it poses. Any increases in assessment rates or special assessments which may occur in the future could reduce our profitability or limit our ability to pursue certain business opportunities, which could materially and adversely affect our business, financial condition, results of operations, and prospects.

**The FASB has issued an accounting standard update that may result in a significant change in how we recognize credit losses and may have a material impact on our financial condition or results of operations.**

The Financial Accounting Standards Board ("FASB") has issued an accounting standard update, "Financial Instruments-Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments," which replaces the current "incurred loss" model for recognizing credit losses with an "expected loss" model. This model is commonly referred to as the Current Expected Credit Loss ("CECL"). Under CECL, we will be required to present certain financial assets carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events (including historical experience), current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs from the "incurred loss" model required under current generally accepted accounting principles ("GAAP"), which delays recognition until it is probable a loss has been incurred. Accordingly, the adoption of the CECL model may affect how we determine our allowance for loan losses and could require us to significantly increase our allowance. Moreover, the CECL model may create more volatility in the level of our allowance for loan losses. If we are required to materially increase our level of allowance for loan losses for any reason, such increase could adversely affect our business, financial condition and results of operations.

CECL was originally set to become effective for the Company for fiscal years beginning after December 15, 2019. However, on October 16, 2019, FASB approved an Accounting Standards Update that grants private companies, non-for-profit organizations and certain small public companies until January, 2023 to implement this ASU. The Company is classified as a small reporting company who would qualify for this additional time to implement this ASU. The Company is still in the process of determining the effect of the ASU on its consolidated financial statements.

***RISKS RELATED TO OWNERSHIP OF SHARES OF OUR COMMON STOCK***

**The limited trading market may make it difficult for you to sell your shares in the future.**

Shares of our common stock trade on the OTCQX market under the symbol, "PMHG." However, there is limited trading activity in our common stock which may make it difficult for you to sell your shares and may depress the prices at which you would be able to sell your shares. A public market having depth and liquidity depends on having enough buyers and sellers at any given time. Without an active trading market, shareholders may find it difficult to find buyers for their shares. The price at which you may be able to sell your shares may also be subject to volatility due to the size of, and activity in, the market for them. Investors should be aware that they may be required to bear the financial risks of this investment for an indefinite period of time.

**Our Board of Directors owns a significant percentage of our shares and will be able to make decisions to which you may be opposed.**

As of March 18, 2020, the Company's directors and executive officers as a group owned 665,758 shares of common stock, or 21.3% of our outstanding common stock. In addition, the directors and executive officers have stock options to acquire 96,107 shares of common stock, which, if fully exercised, would result in them owning 23.64% of our outstanding common stock. Our directors and executive officers are expected to exert a significant influence on the election of Board members and on the direction of the Company. This influence could negatively affect the price of our shares or be inconsistent with other shareholders' desires.

**We may face statutory restrictions on our ability to pay dividends in the immediate future.**

In January 2020, the Board of Directors declared an annual dividend of $0.12 per share on our common stock, payable on March 3, 2020 to shareholders of record on February 13, 2020. PMHG's ability to pay dividends to our shareholders depends on our retention of capital from our stock offerings and our possible receipt of dividends from the Bank. The Bank is also subject to restrictions on dividends as a result of banking laws, regulations, and policies. If PMHG has not retained sufficient capital and the Bank elects not to, or is unable to, pay dividends to PMHG, it is unlikely that PMHG will be able to pay dividends to its shareholders.

**Item 1B Unresolved Staff Comments**

None.

**Item 2 Properties**

We operated out of four facilities during the year ended December 31, 2019 .

| Location | Use | Own or Lease | Year First Occupied |
|---|---|---|---|
| 1897 Capital Circle NE<br>Tallahassee, Florida 32308 | Executive office and headquarters of the Company and main office and operations center of the Bank(1) | Own | 2012 |
| 1471 Timberlane Road<br>Tallahassee, Florida 32312 | Branch office of the Bank | Lease | 2007 |
| 2201 Crawfordville Highway<br>Crawfordville, Florida 32327 | Branch office of the Bank | Own | 2016 |
| 3340 South Florida Avenue<br>Lakeland, Florida 33803 | Branch office of the Bank | Own | 2019(2) |

(1) The Company moved its executive office and headquarters to its Timberlane Road office on March 20, 2020.
(2) The Bank purchased this facility on February 15, 2019 and opened this branch office in April, 2019.

**Item 3 Legal Proceedings**

From time to time, we are a party to various matters incidental to the conduct of a banking business. Presently, we believe that we are not a party to any legal proceedings in which resolution would have a material adverse effect on our business, prospects, financial condition, liquidity, results of operation, cash flows, or capital levels.

**Item 4 Mine Safety Disclosure**

Not applicable.

**Item 5 Market for Registrant's Common Equity, Related Stockholder's Matters and Issuer Purchases of Equity Securities**

The Company's stock is traded on the OTCQX, an interdealer quotation system, under the symbol "PMHG." As of March 18, 2020, there were 340 record holders of common stock. Quoations on the OTCQX reflect interdealer prices, without retail mark-up or commission and may not necessarily represent actual transactions. During the fourth quarter of 2019, the Company issued 1,073 shares to its Directors and 200 options were exercised by employees. These sales were made in accordance with SEC Rule 701, as they were part of the compensation paid to employees and directors.

**Share Repurchase**

We did not repurchase any shares of our common stock in 2019. 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.

**Stock Plans**

The equity compensation plan information presented in Part III, Item 12 of this Form 10-K is incorporated herein by reference.

**Item 6: Selected Financial Data**

The following table is a presentation of summary financial data for PMHG as of December 31, 2019, 2018, and 2017 and for the years ended December 31, 2019, 2018, and 2017. The following Selected Financial Data should be read in conjunction with the other financial disclosures and discussions contained elsewhere in this report. Our historical results are not necessarily indicative of results to be expected in future periods.

| | At or For the Years Ended December 31, | | |
|---|---|---|---|
| *(Dollars in thousands, except per share amounts)* | **2019** | **2018** | **2017** |
| **Balance Sheet Data:** | | | |
| Total assets | $ 500,861 | $ 401,702 | $ 347,180 |
| Total loans, net | 337,710 | 290,113 | 250,259 |
| Total deposits | 438,264 | 349,067 | 298,297 |
| Total stockholders' equity | 55,868 | 50,820 | 46,973 |
| | | | |
| **Income Statement Data:** | | | |
| Net interest income | $ 15,417 | $ 13,927 | $ 11,770 |
| Provision for loan losses | 1,131 | 591 | 256 |
| Noninterest income | 1,534 | 1,155 | 1,153 |
| Noninterest expense | 11,186 | 9,229 | 8,115 |
| Income taxes | 1,092 | 1,220 | 1,735 |
| Net earnings | 3,542 | 4,042 | 2,817 |
| | | | |
| **Per Common Share Outstanding Data:** | | | |
| Basic net earnings per common share | $ 1.12 | $ 1.29 | $ 1.04 |
| Diluted net earnings per common share | 1.12 | 1.29 | 1.04 |
| Book value per common share | 17.51 | 16.19 | 15.06 |
| Common shares outstanding | 3,191,288 | 3,138,945 | 3,118,977 |
| Average common shares outstanding: | | | |
| Per basic: | 3,155,891 | 3,125,689 | 2,704,382 |
| Per diluted: | 3,159,635 | 3,131,546 | 2,711,699 |
| **Performance Ratios:** | | | |
| Return on average assets | 0.78% | 1.07% | 0.85% |
| Return on average equity | 6.66 | 8.43 | 7.17 |
| Net interest margin | 3.57 | 3.81 | 3.68 |
| | | | |
| **Asset Quality Ratios:** | | | |
| Allowance to loans | 1.29% | 1.25% | 1.24% |
| Allowance for loan losses to nonperforming loans | 170.36 | 1,070.47 | 2,340.30 |
| Nonperforming loans to total loans | 0.76 | 0.12 | 0.05 |
| Nonperforming assets to total assets | 0.52 | 0.09 | 0.04 |
| Net (charge-offs) recoveries to average loans | (0.12) | (0.02) | 0.00 |
| Troubled debt restructurings to total loans | 0.28 | 0.22 | 0.09 |
| | | | |
| **Capital Ratios:** | | | |
| Total risk-based capital ratio (Bank) | 14.49% | 14.15% | 14.01% |
| Tier 1 risk-based capital ratio (Bank) | 13.24 | 12.90 | 12.80 |
| Common equity Tier 1 risked-based capital ratio (Bank) | 13.24 | 12.90 | 12.80 |
| Tier 1 leverage capital ratio (Bank) | 9.31 | 9.28 | 9.48 |
| Total equity to total assets (Bank) | 11.15 | 12.65 | 13.53 |
| | | | |
| **Other Data:** | | | |
| Number of full-time employees | 88 | 79 | 71 |
| Number of full-service branch offices | 4 | 3 | 3 |

**Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations**

Certain information in this report may include "forward-looking statements" as defined by federal securities law. Words such as "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan," "project," "is confident that," and similar expressions are intended to identify these forward-looking statements. These forward-looking statements involve risk and uncertainty and a variety of factors could cause our actual results and experience to differ materially from the anticipated results or other expectations expressed in these forward-looking statements. We do not have a policy of updating or revising forward-looking statements except as otherwise required by law, and silence by management over time should not be construed to mean that actual events are occurring as estimated in such forward-looking statements.

Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors that could have a material adverse effect on our operations and the operations of our subsidiary, Prime Meridian Bank, include, but are not limited to, changes in the following:

- local, regional, and national economic and business conditions;
- banking laws, compliance, and the regulatory environment;
- unanticipated changes in the U.S. and global securities markets, public debt markets, and other capital markets;
- monetary and fiscal policies of the U.S. Government;
- litigation, tax, and other regulatory matters;
- demand for banking services, both loan and deposit products in our market area;
- quality and composition of our loan or investment portfolios;
- risks inherent in making loans such as repayment risk and fluctuating collateral values;
- competition;
- attraction and retention of key personnel, including our management team and directors;
- technology, product delivery channels, and end user demands and acceptance of new products;
- fraud committed by our clients or persons doing business with our clients;
- consumer spending, borrowing and savings habits;
- any failure or breach of our operational systems, information systems or infrastructure, or those of our third-party vendors and other service providers, including cyber-attacks;
- application and interpretation of accounting principles and guidelines;
- natural disasters, public unrest, adverse weather, public health and other conditions impacting our or our clients' operations;
- and other economic, competitive, governmental, regulatory, or technological factors affecting us.

**General**

The following discussion and analysis present our financial condition and results of operations on a consolidated basis. However, because we conduct all of our material business operations through the Bank, the discussion and analysis relate to activities primarily conducted at the subsidiary level. The following discussion should be read in conjunction with the Company's consolidated financial statements.

As a one-bank holding company, we generate most of our revenue from interest on loans and investments. Our primary source of funding for our loans is deposits. Our largest expenses are interest on those deposits, salaries plus related employee benefits, and occupancy and equipment. We measure our performance through our net interest margin, return on average assets, and return on average equity, while maintaining appropriate regulatory leverage and risk-based capital ratios.

**Application of Critical Accounting Policies and Estimates**

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP") and with prevailing practices within the banking industry. Application of these principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes; therefore, our financial condition and results of operations are sensitive to accounting measurements and estimates of matters that are inherently uncertain. When applying accounting policies in areas that are subjective in nature, the Bank must use its best judgment to arrive at the carrying value of certain assets. The most critical accounting policy applied is the valuation of our subsidiary bank's loan portfolio. A variety of estimates impact the carrying value of the loan portfolio including the calculation of the allowance for loan losses, the valuation of underlying collateral, the timing of loan charge-offs, and the amount and amortization of loan fees and deferred origination costs.

We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under current circumstances. These assumptions form the basis for our judgments about the carrying values of assets and liabilities that are not readily available from independent, objective sources. We evaluate our estimates on an ongoing basis. Use of alternative assumptions may have resulted in significantly different estimates and actual results may differ from these estimates.

We have identified the following accounting policy and estimate as critical. In order to understand our financial condition and results of operations, it is important to comprehend how these assumptions apply to our financial statements.

*Allowance for Loan Losses.* Our allowance for loan losses ("ALLL") is established through a provision for loan losses charged to earnings as specific loan losses are identified by management and as inherent loan losses are determined to exist. Loan losses are charged against the ALLL when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the ALLL.

Our ALLL is evaluated for adequacy by management on a monthly basis and is based upon management's periodic review of the collectability of the loan portfolio in light of historical experience in the industry, 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, prevailing economic conditions and industry standards. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

Specific loan losses are identified and evaluated in accordance with ASC 310-10 – "Receivables." A loan is considered impaired when, based on current information and events, it is probable that we 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 status include payment status and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not considered as impaired. We look at 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.

When a loan is considered impaired, the amount of the impairment is measured on a loan-by-loan basis by comparing the recorded investment in the loan to any of the following measurements: the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. If the recorded investment in the loan is higher than the calculated impairment basis, the difference is maintained as a specific loan loss allocation, or it is charged off if the amount is determined to be uncollectible. As the Bank grows, management may elect to collectively evaluate large groups of smaller balance homogeneous loans for impairment, instead of on a loan-by-loan basis.

Inherent loan losses are evaluated in accordance with ASC 450-20 – "Contingencies." Management currently uses three years of historical loan loss data; however, because of limited loss experience we also take into account the following qualitative factors: (i) changes in lending policies and procedures, risk selection and underwriting standards; (ii) changes in national, regional and local economic conditions that affect the collectability of the loan portfolio; (iii) changes in the experience, ability, and depth of lending management and other relevant staff; (iv) changes in the volume and severity of past due loans, nonaccrual loans or loans classified "Special Mention," "Substandard," "Doubtful" or "Loss;" (v) the quality of loan review and Board of Directors oversight; (vi) changes in the nature and volume of the loan portfolio and terms of loans; (vii) the existence and effect of any concentrations of credit and changes in the level of such concentrations; and (viii) the effect of other external factors, trends or uncertainties that could affect management's estimate of probable losses, such as competition and industry conditions. As evidence of inherent loan loss increases, the appropriate qualitative risk factors may be increased to support any additional risk in the portfolio.

**Recent Interest-Rate Trends**

Like many other financial institutions, our results of operations are dependent on net interest income, which is the difference between interest received on interest-earning assets, such as loans and securities, and interest paid on interest-bearing liabilities, namely deposits and borrowings. We are unable to predict changes in market interest rates, which are affected by many factors beyond our control including inflation, economic conditions, unemployment, money supply, domestic and international events, and changes in the United States and other financial markets. Our net interest income may be reduced if (i) more interest-earning assets than interest-earning liabilities reprice or mature during a time when interest rates are declining, or (ii) more interest-bearing liabilities than interest-earning assets reprice or mature during a time when interest rates are rising. We measure the potential adverse impacts of changing interest rates by shocking average interest rates up or down 100 to 400 basis points and calculating the potential impacts on our net interest income, liquidity, and economic value of equity. We utilize the results of these simulations to determine whether to increase or decrease our fixed rate loan portfolio, to adjust our investment in assets such as bonds, or to take other action in order to maintain or improve our net interest margin given the trending or expected interest rate changes.

As of December 31, 2019, 60.5% of our loan portfolio consisted of adjustable-rate loans, meaning these loans will adjust with changes in interest rates and pose less interest rate risk in a rising interest rate environment. Of these loans, $60.4 million, or 17.7% have interest rate ceilings in place which protects the borrower from rising interest rates. The majority of our loans with ceilings in place are residential mortgage loans. Also, as of December 31, 2019, 41.3% of the total loan portfolio was scheduled to mature in five years or less, which helps mitigate the risks of a fixed-rate loan portfolio in a rising interest rate environment. If interest rates increase, however, borrowers may be less inclined to seek new loans. In addition, higher interest rates could adversely affect an adjustable rate borrower's ability to continue servicing debt. On the other hand, loans totaling $191.9 million, or approximately 56.2% of our total loan portfolio, have interest rate floors which will help protect our net interest margin in a decreasing rate environment.

Our ability to originate new loans may be further impeded by increased competition for high quality borrowers which leads to downward pricing pressure on loans, a general consumer and business bias towards reducing debt levels, and the lingering effects of the economic recession on the financial condition of both consumers and businesses, making the underwriting of new loans more challenging.

**Interest Rate Sensitivity**

A principal objective of the Bank's asset liability management strategy is to manage its exposure to changes in interest rates within Board approved policy limits by matching the maturity and re-pricing characteristics of interest-earning assets and interest-bearing liabilities. This strategy is overseen through the direction of the Bank's Asset and Liability Committee ("ALCO"), which establishes policies and monitors results to control interest rate sensitivity.

We model our current interest rate exposure in various rate scenarios, review our model assumptions, and then stress test those assumptions. Based on the results, we then formulate strategies regarding asset generation, funding sources and their pricing parameters, as well as evaluate off-balance sheet commitments in order to maintain interest rate risk within Board approved target limits. We utilize industry recognized Asset Liability models driven by third-party providers to analyze the Bank's interest rate sensitivity. From these externally generated reports, ALCO can estimate both the effect on Net Interest Income and the effect on Economic Value of Equity ("EVE") in various interest rate scenarios.

As a part of the Bank's Interest Rate Risk Management Policy, our ALCO examines the extent to which the Bank's assets and liabilities are "interest rate sensitive" and monitors its interest rate sensitivity. An asset or liability is considered to be interest rate sensitive, for income purposes, if its projected income/expense amount will change if interest rates change. Likewise, it is considered interest rate sensitive for EVE if its economic value will change if interest rates change.

In an asset sensitive portfolio, the Bank's net income and EVE will increase in a rising rate environment as assets will re-price faster than liabilities. Conversely, if the Bank is liability sensitive and the liabilities re-price faster than the assets, net income and EVE will fall in a rising rate environment.

In modeling the Bank's interest rate exposure, the Bank makes a number of important assumptions about the behavior of assets and liabilities. The critical assumptions fall into three main categories, Nonmaturity Deposit Assumptions, Loan Prepayment Assumptions, and Options. Currently, the most significant assumptions which affect the Bank's interest rate sensitivity are the Nonmaturity Deposit Assumptions, followed by the Loan Prepayment Assumptions.

*Nonmaturity Deposit Assumptions*

*Nonmaturity Deposit Betas* – The Beta of a nonmaturity deposit is a measure of the repricing behavior of the deposit. Based on the Bank's own historical experience, the Bank determines how much the price of a deposit will change as a percentage of the change in the market rates. For example, a 50% Beta means that the deposit price will change by 50% of the market rate change.

*Nonmaturity Decay* – We determine how "sticky" deposits are by assigning a "maturity" to the deposits, e.g. 120 months. These assumptions are based on our own experience by looking at both the age of the current deposit base and the historic monthly account closings experience. The lower the Beta (more fixed rate nature) and the higher the Decay (longer duration), the less sensitive a bank becomes.

*Loan Prepayment Assumptions*

We also determine how likely each asset or liability is to prepay or be withdrawn prior to its contracted maturity date. As refinancing rates become increasingly attractive, prepayment speeds increase as clients are able to prepay loans and refinance at lower rates. Conversely, prepayments decrease in a rising rate environment; however, time deposits will display the opposite behavior if clients are able to withdraw their CDs without significant penalty and reinvest at a higher rate. In a decreasing rate environment, clients generally hold their time deposits to maturity.

Loan prepayment speed changes are not linear; they will continue to increase as rates fall but will plateau as rates rise. Therefore, the Bank's asset prices will not change linearly with market rate changes. The higher the prepayment speed of assets or withdrawal speed of term liabilities, the more liability sensitive the Bank becomes. The Bank monitors its prepayments and withdrawals and updates the assumptions used in the risk models on a monthly basis.

In addition, certain balance sheet instruments such as interest-rate floors or caps on loans, be they periodic or lifetime, and other optionality on investments, limit or increase income and create value changes of the instrument as interest rates change.

*Option Risk*

We monitor our exposure to option-type effects and manage our option risk. The amount of option risk, aside from prepayment risk, is minimal.

We monitor our exposure on a monthly basis under thirteen different rate scenarios, including rates rising or declining by up to 4% and the current yield curve flattening or steepening. We compare these results to the Board's established limits to determine if a limit has been compromised. If a limit is exceeded, we have policies and strategies in place to reduce the exposure back to acceptable levels. In addition, we also stress test all of our assumptions under these rate scenarios to determine at what point the Board approved target limits would be compromised, even if they are not currently compromised using the historically determined assumptions. If the limits are in danger of being compromised with relatively small assumption changes, we would adjust our strategy to reduce exposure. All of these assumptions, reports, stress tests, and strategies are reviewed by ALCO at least quarterly and all limit exceptions are reported to the Board.

Currently, we have not entered into any interest-rate swaps or similar off-balance sheet hedging instruments in connection with our asset liability management. Further discussion on off-balance sheet arrangements can be found in Note 8 of the Notes to Consolidated Financial Statements.

Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, unused lines of credit, guaranteed accounts, and standby letters of credit is represented by the contractual amount of those instruments.

Our strategy is to maintain an interest rate risk position within the tolerance limits set by the Board of Directors in order to protect our net interest margin under extreme market fluctuations. Principal among our asset liability management strategies has been the emphasis on reducing exposure during periods of fluctuating interest rates. We believe that the type and amount of our interest rate sensitive liabilities should reduce the potential impact that a rise in interest rates might have on our net interest income.

We look to maintain a core deposit base by providing quality services to our clients, without significantly increasing our cost of funds or operating expenses. We anticipate that these accounts will continue to comprise a significant portion of the Bank's total deposit base. We also maintain a portfolio of liquid assets in order to reduce overall exposure to changes in market interest rates. Likewise, we maintain a "floor," or minimum rate, on certain of our floating or published base rate loans. These floors allow us to continue to earn a higher rate when the floating rate falls below the established floor rate. All interest rate ceilings and floors are clearly and closely related to the loan agreement; therefore, they are not bifurcated and valued separately.

**RESULTS OF OPERATIONS**

Net interest income constitutes the principal source of income for the Bank and results from the excess of interest income on interest-earning assets over interest expense on interest-bearing liabilities. The principal interest-earning assets are investment securities and loans. Interest-bearing liabilities primarily consist of time deposits, interest-bearing checking accounts, savings deposits, money-market accounts, and other borrowings. Funds attracted by these interest-bearing liabilities are invested in interest-earning assets. Accordingly, net interest income depends upon the volume of average interest-earning assets and average interest-bearing liabilities and the interest rates earned or paid on these assets and liabilities.

The table below sets forth information regarding: (i) the total dollar amount of interest and dividend income of the Bank from interest-earning assets and the resultant average yields; (ii) the total dollar amount of interest expense on interest-bearing liabilities and the resultant average costs; (iii) net interest income; (iv) interest rate spread; (v) net interest margin; and (vi) weighted-average yields and rates. Yields and costs were derived by dividing annualized income or expense by the average balance of assets or liabilities. The yields and costs depicted in the table include the amortization of fees, which are considered to constitute adjustments to yields (dollars in thousands). As shown in the table below, year over year, the yield on the average balance of interest-earning assets decreased five basis points, while the average balance of interest-earning assets increased $66.2 million, or 18.1%. This in combination with the 22.4%, or $56.3 million, increase in the average balance of total interest-bearing liabilities and the 24 basis-point increase in the average cost of interest-bearing liabilities, resulted in a 24 point decrease in the net interest margin.

| | For the Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2019 | | | 2018 | | |
| *(dollars in thousands)* | Average Balance | Interest and Dividends | Yield/ Rate | Average Balance | Interest and Dividends | Yield/ Rate |
| Interest-earning assets: | | | | | | |
| Loans(1) | $ 309,350 | $ 15,884 | 5.13% | $ 283,967 | $ 14,215 | 5.01% |
| Loans held for sale | 6,677 | 304 | 4.55 | 5,385 | 254 | 4.72 |
| Securities | 51,951 | 1,309 | 2.52 | 46,866 | 1,131 | 2.41 |
| Other(2) | 64,058 | 1,489 | 2.32 | 29,625 | 634 | 2.14 |
| Total interest-earning assets | 432,036 | $ 18,986 | 4.39% | 365,843 | $ 16,234 | 4.44 |
| Noninterest-earning assets | 24,761 | | | 13,445 | | |
| Total assets | $ 456,797 | | | $ 379,288 | | |
| | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Savings, NOW and money-market deposits | $ 254,287 | $ 2,445 | 0.96% | $ 218,921 | $ 1,824 | 0.83% |
| Time deposits | 52,962 | 1,115 | 2.11 | 32,665 | 483 | 1.48 |
| Total interest-bearing deposits | 307,249 | 3,560 | 1.16 | 251,586 | 2,307 | 0.92 |
| Other borrowings | 653 | 9 | 1.38 | - | - | |
| Total interest-bearing liabilities | 307,902 | $ 3,569 | 1.16% | 251,586 | $ 2,307 | 0.92 |
| Noninterest-bearing deposits | 91,016 | | | 78,061 | | |
| Noninterest-bearing liabilities | 4,707 | | | 1,709 | | |
| Stockholders' equity | 53,172 | | | 47,932 | | |
| Total liabilities and stockholders' equity | $ 456,797 | | | $ 379,288 | | |
| | | | | | | |
| Net earning assets | $ 124,134 | | | $ 114,257 | | |
| Net interest income | | $ 15,417 | | | $ 13,927 | |
| Interest rate spread | | | 3.23% | | | 3.52% |
| Net interest margin(3) | | | 3.57% | | | 3.81% |
| | | | | | | |
| Ratio of average interest-earning assets to average interest-bearing liabilities | 1.40 | | | 1.45 | | |

(1) Includes nonaccrual loans

(2) Other interest-earning assets include federal funds sold, interest-bearing deposits and FHLB stock.

(3) Net interest margin is net interest income divided by total average interest-earning assets.

**Comparison of the years ended December 31, 2019 and 2018**

| **Year ended December 31,** | | | **Change 2019 vs. 2018** | |
|---|---|---|---|---|
| *(dollars in thousands)* | **2019** | **2018** | **Amount** | **Percent** |
| Net Interest Income | $ 15,417 | $ 13,927 | $ 1,490 | 10.7% |
| Provision for Loan Losses | 1,131 | 591 | 540 | 91.4 |
| Noninterest income | 1,534 | 1,155 | 379 | 32.8 |
| Noninterest expense | 11,186 | 9,229 | 1,957 | 21.2 |
| Income Taxes | 1,092 | 1,220 | (128) | (10.5) |
| Net Income | $ 3,542 | $ 4,042 | $ (500) | -12.4% |

Net earnings for the year ended December 31, 2019, were $3.5 million or $1.12 per basic and diluted share compared to net earnings of $4.0 million, or $1.29 per basic and diluted share in 2018.
The $500,000, or 12.4%, decrease in net earnings is primarily attributed to increases in the provision for loan losses and noninterest expense. Increases in net interest income and noninterest income and a decrease in income tax expense helped offset the impact of the aforementioned factors.

**Net Interest Income**

Our operating results depend primarily on our net interest income, which is the difference between interest and dividend income on interest-earning assets such as loans and investments, and interest expense on interest-bearing liabilities such as deposits and borrowings. Net interest income was $15.4 million for the year ended December 31, 2019, compared to $13.9 million for the year ended December 31, 2018.

*Interest Income.*

| **Year ended December 31,** | | | **Change 2019 vs. 2018** | |
|---|---|---|---|---|
| *(dollars in thousands)* | **2019** | **2018** | **Amount** | **Percent** |
| Interest income: | | | | |
| Loans | $ 16,188 | $ 14,469 | $ 1,719 | 11.9% |
| Securities | 1,309 | 1,131 | 178 | 15.7 |
| Other | 1,489 | 634 | 855 | 134.9 |
| Total interest income | $ 18,986 | $ 16,234 | $ 2,752 | 17.0% |

Year over year, a higher volume of loans and other interest-earning assets was the key driver of the increase in total interest income.

*Interest Expense.*

| **Year ended December 31,** | | | **Change 2019 vs. 2018** | |
|---|---|---|---|---|
| *(dollars in thousands)* | **2019** | **2018** | **Amount** | **Percent** |
| Total interest expense | $ 3,569 | $ 2,307 | $ 1,262 | 54.7% |

The increase in the Company’s cost of funds year over year was driven by growing balances of time deposits and money market accounts and higher rates paid on those deposits. For the year ended December 31, 2019, the average balance of interest-bearing deposits increased $55.7 million, or 22.1%, while the average rates paid on deposits increased 24 basis points. Management strategically began reducing rates in the fourth quarter of 2019 in tandem with the three rate cuts by the Federal Reserve in the latter part of 2019.

*Provision for Loan Losses.* For the year ended December 31, 2019, the provision for loan losses increased $540,000, or 91.4% in comparison to the year ended December 31, 2018. Approximately 48.6%, or $550,000, of the total provision is attributed to the Company’s 16.4% increase in net loans and 51.4%, or $581,000, is attributed to higher reserves taken on impaired and charged-off loans and overdrafts.

**Noninterest Income**

| **Year ended December 31,** | | | | **Change 2019 vs. 2018** | |
|---|---|---|---|---|---|
| *(dollars in thousands)* | **2019** | **2018** | **Amount** | **Percent** |
| Service charges and fees on deposit accounts | $ 288 | $ 333 | $ (45) | -13.5% |
| Debit card/ATM revenue, net | 252 | 191 | 61 | 31.9 |
| Mortgage banking revenue, net | 667 | 447 | 220 | 49.2 |
| Income from bank-owned life insurance | 178 | 66 | 112 | 169.7 |
| Gain on sale of debt securities available for sale | 7 | - | 7 | N/A |
| Other income | 142 | 118 | 24 | 20.3 |
| Total noninterest income | $ 1,534 | $ 1,155 | $ 379 | 32.8% |

Year over year, there were increases in all categories of noninterest income, with the exception of service charges and fees on deposit accounts. The decrease in service charges and fees is primarily explained by lower overdraft activity in 2019. Income from bank-owned life insurance more than doubled from 2018 after the Bank purchased additional life insurance during the fourth quarter of 2018 to expand coverage on additional key personnel. Net revenue from debit card/ATM increased 31.9% in 2019 and now accounts for roughly 16.4% of total noninterest income.

The Bank also experienced significant growth in mortgage banking revenue due to an increased number of loans originated as well as an increase in average balances and average profitability per loan originated. In addition, wholesale brokerage fees from FHA loans experienced a year over year increase of $60,000, or 93.3%.

**Noninterest Expense**

| **Year ended December 31,** | | | **Change 2019 vs. 2018** | |
|---|---|---|---|---|
| *(dollars in thousands)* | **2019** | **2018** | **Amount** | **Percent** |
| Salaries and employee benefits | $ 6,095 | $ 5,106 | $ 989 | 19.4% |
| Occupancy and equipment | 1,405 | 932 | $ 473 | 50.8 |
| Professional fees | 374 | 374 | $ - | - |
| Marketing | 743 | 677 | $ 66 | 9.7 |
| FDIC Assessment | 119 | 163 | $ (44) | (27.0) |
| Software maintenance, amortization and other | 692 | 634 | $ 58 | 9.1 |
| Other | 1,758 | 1,343 | $ 415 | 30.9 |
| Total noninterest expense | $ 11,186 | $ 9,229 | $ 1,957 | 21.2% |

The opening of the Company's new office in Lakeland, Florida in April 2019 was a driving factor of the increase in noninterest expense, accounting for over half of the total increase. The Bank's full-time equivalent employees increased from 79 at December 31, 2018 to 88 at December 31, 2019, eight of which were located in Lakeland at December 31, 2019.

Approximately 49.5%, or $234,000, of the increase in occupancy and equipment expense is attributed to higher depreciation and lease expenses associated with the new lease to expand our Timberlane office while approximately 45.7%, or $216,000, of the increase can be attributed to the new Lakeland office. The increases in other noninterest expense can be attributed to a variety of reasons, but most notably are due to higher printing and supplies expense, travel and entertainment expense, and software expense.

These increases we partially offset by credit towards the Company's FDIC assessment which resulted from the Deposit Insurance Fund Reserve Ratio exceeding it 1.38% threshold on June 30, 2019. This credit ultimately decreased the year-over-year assessment cost by $44,000.

The Company's operating efficiency ratio was negatively impacted by the 21.2%, or $2.0 million, increase in noninterest expense in 2019, increasing our efficiency ratio from 61.2% for the year ended December 31, 2018 to 66.0% for the year ended December 31, 2019.

**Income Taxes**

The provision for income taxes decreased $128,000 for the year ended December 31, 2019, compared to the year ended December 31, 2018. The lower provision resulted from lower earnings before taxes for the year 2019, when compared to 2018.

**Rate/Volume Analysis**

The following table sets forth certain information regarding changes in interest income and interest expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to: (i) changes in rate (change in rate multiplied by prior volume); (ii) changes in volume (changes in volume multiplied by prior rate); and (iii) changes in rate-volume (change in rate multiplied by change in volume). As disclosed in the table below, the higher volume of loans was the primary driver of the increase in net interest income in 2019.

| | Year Ended December 31, 2019 versus 2018 | | | |
|---|---|---|---|---|
| | Rate | Volume | Rate/Volume | Total |
| *(in thousands)* | | | | |
| Interest-earning assets: | | | | |
| Loans | $ 352 | $ 1,334 | $ 33 | $ 1,719 |
| Securities | 50 | 123 | 5 | 178 |
| Other interest-earning assets | 55 | 737 | 63 | 855 |
| Total | $ 457 | $ 2,194 | $ 101 | $ 2,752 |
| Interest-bearing liabilities: | | | | |
| Savings, NOW and money-market deposits | $ 281 | $ 295 | $ 45 | $ 621 |
| Time deposits | 205 | 300 | 127 | 632 |
| Total Deposits | 486 | 595 | 172 | 1,253 |
| Other borrowings | - | - | 9 | 9 |
| Total | 486 | 595 | 181 | 1,262 |
| Total change in net interest income | $ (29) | $ 1,599 | $ (80) | $ 1,490 |

**FINANCIAL CONDITION**

Average interest-earning assets increased $66.2 million from $365.8 million at December 31, 2018 to $432.0 million at December 31, 2019, primarily reflecting growth in both our loan portfolio as well as other interest-earning assets. Year over year, the average balance of portfolio loans grew 8.9% to $309.4 million at December 31, 2019, due solely to organic growth.

**Investment Securities**

Our investment securities portfolio is a significant part of our operations and a key component of our asset/liability management. Our primary objective in managing our investment portfolio is to maintain a portfolio of high quality, highly liquid investments yielding competitive returns. We use the investment securities portfolio for several purposes. It serves as a vehicle to manage interest rate and prepayment risk, to generate interest and dividend income, to provide liquidity to meet funding requirements, and to provide collateral for pledging of public funds. We manage our investment portfolio according to a written investment policy approved by our Board of Directors in order to accomplish these goals. Currently, two types of classifications are approved for investment securities in our portfolio - Available-for-Sale and Held-to-Maturity. Adjustments are sometimes necessary in the portfolio to provide liquidity for funding loan demand and deposit fluctuations and to control interest rate risk. Therefore, from time to time, management may sell certain securities prior to their maturity.

At December 31, 2019, our available-for-sale investment portfolio included U.S. Treasury notes, municipal securities, mortgage-backed securities, and asset-backed securities and had a fair market value of $61.3 million. At December 31, 2019 and 2018, our investment securities portfolio represented approximately 12.2% and 11.3% of our total assets, respectively. The average balance of investment securities increased 10.9%, or $5.1 million year over year, while the average yield on investment securities increased from 2.41% for the year ended December 31, 2018 to 2.52% for the year ended December 31, 2019. At December 31, 2019, we had no securities classified as held-to-maturity.

The following table sets forth the carrying amount of the investment portfolio as of the dates indicated:

| | At December 31, | |
|---|---|---|
| | 2019 | 2018 |
| *(in thousands)* | | |
| ***Available for Sale:*** | | |
| U.S. Government agency securities | $ 407 | $ 799 |
| Municipal securities | 9,341 | 11,529 |
| Mortgage-backed securities | 45,803 | - |
| Asset backed securities | 5,782 | 33,056 |
| Total debt securities available for sale | $ 61,333 | $ 45,384 |

The carrying amount and weighted average yields for investments as of December 31, 2019 are shown below:

| *(dollars in thousands)* | U.S. Government Agency | Municipal | Mortgage-Backed | Asset-Backed | Total | Weighted-Average Yields |
|---|---|---|---|---|---|---|
| Due within one year | $ - | $ 368 | $ - | $ - | $ 368 | 2.25% |
| Due in one to five years | 407 | 972 | - | - | 1,379 | 2.13 |
| Due in five to ten years | - | 2,570 | - | - | 2,570 | 2.92 |
| Due after ten years | - | 5,431 | - | 5,782 | 11,213 | 2.91 |
| No defined maturity | - | - | 45,803 | - | 45,803 | 2.39 |
| Total | $ 407 | $ 9,341 | $ 45,803 | $ 5,782 | $ 61,333 | 2.50% |

* All securities are listed at actual yield and not on a tax-equivalent basis.

**Cash Surrender Value of Bank-Owned Life Insurance**

We maintained investments of $6.5 million and $6.3 million in bank-owned life insurance policies at December 31, 2019 and 2018, respectively, due to attractive risk-adjusted returns and for protection against the loss of key executives, including our Chief Executive Officer Sammie D. Dixon and Senior Lender and Executive Vice President Chris L. Jensen, Jr. The Company increased its investment in bank-owned life insurance in 2018 in order to expand coverage to additional key personnel.

**Loans**

Our primary earning asset is our loan portfolio and our primary source of income is the interest earned on the loan portfolio. Our loan portfolio is divided into three portfolio segments - real estate mortgage loans, commercial loans and consumer and other loans - and five portfolio classes - commercial real estate loans, residential and home equity loans, construction loans, commercial loans, and consumer and other loans.

We work diligently to attract new lending clients through direct solicitation by our loan officers, utilizing relationship networks from existing clients and community involvement, competitive pricing, and innovative structure. Evidence of this effort is seen in the organic growth in our loan portfolio where we saw growth across all portfolio classes in 2019. As of December 31, 2019, the Bank's net loans were $337.7 million, representing 67.4% of total assets, compared to net loans of $290.1 million as of December 31, 2018, representing 72.2% of total assets. These loans were priced based upon the degree of risk, collateral, loan amount, and maturity. We have no loans to foreign borrowers.

The composition of our loan portfolio as of the dates indicated was as follows:

| | As of December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2019 | | 2018 | | 2017 | |
| (dollars in thousands) | Amount | % of Total | Amount | % of Total | Amount | % of Total |
| Real estate mortgage loans: | | | | | | |
| Commercial | $ 94,728 | 27.7% | $ 82,494 | 28.1% | $ 79,565 | 31.5% |
| Residential and home equity | 135,913 | 39.8 | 121,454 | 41.4 | 94,824 | 37.4 |
| Construction | 33,583 | 9.8 | 31,601 | 10.8 | 26,813 | 10.6 |
| Total real estate mortgage loans | 264,224 | 77.3 | 235,549 | 80.3 | 201,202 | 79.5 |
| Commercial | 69,770 | 20.4 | 51,018 | 17.4 | 44,027 | 17.4 |
| Consumer and other loans | 7,631 | 2.3 | 6,747 | 2.3 | 7,742 | 3.1 |
| Total loans | 341,625 | 100.0% | 293,314 | 100.0% | 252,971 | 100.0% |
| Less: | | | | | | |
| Net deferred loan fees | 499 | | 460 | | 424 | |
| Allowance for loan losses | (4,414) | | (3,661) | | (3,136) | |
| Loans, net | $ 337,710 | | $ 290,113 | | $ 250,259 | |

***Maturities of Loans***

The following tables show the contractual maturities of the Bank's loan portfolio at December 31, 2019. Loans with scheduled maturities are reported in the maturity category in which the payment is due. Demand loans with no stated maturity and overdrafts are reported in the "due one year or less" category. Loans that have adjustable rates are shown as amortizing to final maturity rather than when the interest rates are next subject to change. The tables do not include prepayment or scheduled principal repayments.

| (in thousands) | Due in One Year or Less | Due in One to Five Years | Due After Five Years | Total |
|---|---|---|---|---|
| **Type of loans** | | | | |
| Real estate mortgage loans: | | | | |
| Commercial | $ 5,138 | $ 21,667 | $ 67,923 | $ 94,728 |
| Residential and home equity | 9,677 | 20,799 | 105,437 | 135,913 |
| Construction | 14,569 | 9,085 | 9,929 | 33,583 |
| Total real estate mortgage loans | 29,384 | 51,551 | 183,289 | 264,224 |
| Commercial | 27,379 | 25,674 | 16,717 | 69,770 |
| Consumer and other loans | 2,456 | 4,752 | 423 | 7,631 |
| Total loans | $ 59,219 | $ 81,977 | $ 200,429 | $ 341,625 |

*Sensitivity.* For loans due after one year or more, the following table presents the sensitivities to changes in interest rates at December 31, 2019:

| *(in thousands)* | Fixed Interest Rate | Floating Interest Rate | Total |
|---|---|---|---|
| **Type of loans** | | | |
| Real estate mortgage loans: | | | |
| Commercial | $ 23,754 | $ 65,836 | $ 89,590 |
| Residential and home equity | 24,984 | 101,252 | 126,236 |
| Construction | 6,767 | 12,247 | 19,014 |
| Total real estate mortgage loans | 55,505 | 179,335 | 234,840 |
| Commercial | 17,701 | 24,690 | 42,391 |
| Consumer and other loans | 2,429 | 2,746 | 5,175 |
| Total loans | $ 75,635 | $ 206,771 | $ 282,406 |

***Nonperforming Assets***

Nonperforming assets consist of nonperforming loans and other real estate owned, ("OREO"). Nonperforming loans include loans that are on nonaccrual status which includes nonperforming loans restructured as troubled debt restructurings, where we have granted a concession on the interest rate or original repayment terms due to financial difficulties of the borrower, and loans past due greater than 90 days and still accruing interest. OREO consists of real property acquired through foreclosure. We account for troubled debt restructurings in accordance with ASC 310, "Receivables."

We generally place loans on nonaccrual status when they become 90 days or more past due, unless they are well secured and in the process of collection. We also place loans on nonaccrual status if they are less than 90 days past due if the collection of principal or interest is in doubt. When a loan is placed on nonaccrual status, any interest previously accrued, but not collected, is reversed from income.

Accounting standards require the Bank to identify loans as impaired loans when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. These standards require that impaired loans be valued at the present value of expected future cash flows, discounted at the loan's effective interest rate, using one of the following methods: the observable market price of the loan or the fair value of the underlying collateral if the loan is collateral dependent. We implement these standards in our monthly review of the adequacy of the allowance for loan losses and identify and value impaired loans in accordance with guidance on these standards. Fourteen loans and one overdraft account totaling $3.2 million were deemed to be impaired under the Bank's policy at December 31, 2019, while nine loans totaling $1.2 million and two loans totaling $134,000 were deemed to be impaired under the Bank's policy at December 31, 2018, and 2017, respectively.

Our goal is to maintain a high quality of loans through sound underwriting and lending practices. As of December 31, 2019, 2018, and, 2017, approximately 77.3%, 80.3%, and 79.5%, respectively, of the total loan portfolio were collateralized by commercial and residential real estate mortgages. The level of nonperforming loans and OREO also is relevant to the credit quality of a loan portfolio. As of December 31, 2019, 2018, and 2017, there were $2.6 million, $342,000, and $134,000, respectively, in nonperforming loans. We had no OREO at December 31, 2019, 2018, or 2017.

The goal of the loan review process is to identify and address classified and nonperforming loans as early as possible. The following table sets forth certain information on nonaccrual loans and OREO, the ratio of such loans and foreclosed assets to total assets as of the dates indicated, and certain other related information.

| | At December 31, | | |
|---|---|---|---|
| | 2019 | 2018 | 2017 |
| *(dollars in thousands)* | | | |
| Total nonperforming loans | $ 2,591 | $ 342 | $ 134 |
| OREO | - | - | - |
| Total nonperforming loans and foreclosed assets | $ 2,591 | $ 342 | $ 134 |
| Total nonperforming loans as a percentage of total loans | 0.76% | 0.12% | 0.05% |
| Total nonperforming assets as a percentage of total assets | 0.52% | 0.09% | 0.04% |
| | | | |
| Loans restructured as troubled debt restructurings | $ 942 | $ 641 | $ 221 |
| Troubled debt restructurings to loans | 0.28% | 0.22% | 0.09% |

***Allowance for Loan Losses***

As of December 31, 2019, our ALLL was allocated mostly to inherent loan losses using historical loss experience and qualitiative risk factors, but we also had a $414,000 allocation for specific loan losses. Our ALLL was allocated as follows, as of the indicated dates.

| | As of December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2019 | | 2018 | | 2017 | |
| | Amount | % of Loans to Total Loans | Amount | % of Loans to Total Loans | Amount | % of Loans to Total Loans |
| *(dollars in thousands)* | | | | | | |
| Commercial real estate | $ 1,046 | 27.7% | $ 917 | 28.1% | $ 894 | 31.5% |
| Residential real estate and home equity | 1,573 | 39.8 | 1,397 | 41.4 | 1,097 | 37.4 |
| Construction | 415 | 9.8 | 391 | 10.8 | 331 | 10.6 |
| Commercial | 1,284 | 20.4 | 876 | 17.4 | 724 | 17.4 |
| Consumer | 96 | 2.3 | 80 | 2.3 | 90 | 3.1 |
| Total loans | $ 4,414 | 100.0% | $ 3,661 | 100.0% | $ 3,136 | 100.0% |

The following table sets forth certain information with respect to activity in our ALLL during the years indicated:

| | Year Ended December 31, | | |
|---|---|---|---|
| *(dollars in thousands)* | 2019 | 2018 | 2017 |
| **ALLL at beginning of year** | $ 3,661 | $ 3,136 | $ 2,876 |
| Charge-offs: | | | |
| Construction | - | (3) | - |
| Commercial | (360) | (58) | - |
| Consumer | (66) | (20) | (35) |
| Total charge-offs | (426) | (81) | (35) |
| Recoveries: | | | |
| Commercial | 33 | 6 | 16 |
| Consumer | 15 | 9 | 23 |
| Total recoveries | 48 | 15 | 39 |
| Provision for loan losses charged to earnings | 1,131 | 591 | 256 |
| ALLL at end of year | $ 4,414 | $ 3,661 | $ 3,136 |
| | | | |
| Ratio of net (charge-offs) recoveries during the year to average loans outstanding during the year | (0.12)% | (0.02)% | -% |
| ALLL as a percentage of total loans at end of year | 1.29% | 1.25% | 1.24% |
| ALLL as a percentage of nonperforming loans | 170.4% | 1,070.5% | 2,340.3% |

We believe that our ALLL at December 31, 2019, appropriately reflected the risk inherent in the portfolio as of that date. The methodologies used in the calculation are in compliance with regulatory policy and GAAP.

***Deposits***

The major source of the Bank's funds for lending and other investment purposes are deposits, in particular core deposits and non-maturity deposits. Management believes that substantially all of our depositors are residents in our primary market area. Total deposits were $438.3 million at December 31, 2019, compared to $349.1 million at December 31, 2018, a $89.2 million, or 25.6%, increase. Noninterest-bearing deposits increased by $16.7 million, while interest-bearing deposits increased by $72.5 million.

The following table sets forth the distribution by type of our deposit accounts at the dates indicated:

| | As of December 31, | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| *(dollars in thousands)* | Amount | % of Deposits | Amount | % of Deposits |
| **Deposit Types** | | | | |
| Noninterest-bearing deposits | $ 96,807 | 22.1% | $ 80,097 | 23.0% |
| Money-market accounts | 188,100 | 42.9 | 171,219 | 49.1 |
| NOW | 72,529 | 16.5 | 47,229 | 13.5 |
| Savings | 11,654 | 2.7 | 9,226 | 2.6 |
| Subtotal | 369,090 | 84.2 | 307,771 | 88.2 |
| | | | | |
| Time deposits: | | | | |
| 0.00 - 0.50 % | 544 | 0.2 | 1,265 | 0.4 |
| 0.51 - 1.00 % | 8,032 | 1.8 | 5,747 | 1.6 |
| 1.01 - 1.50 % | 3,605 | 0.8 | 3,734 | 1.1 |
| 1.51 - 2.00 % | 5,813 | 1.3 | 7,365 | 2.1 |
| 2.01 - 2.50 % | 43,581 | 10.0 | 18,909 | 5.4 |
| 2.51 - 3.00 % | 7,599 | 1.7 | 4,276 | 1.2 |
| Total time deposits | 69,174 | 15.8 | 41,296 | 11.8 |
| | | | | |
| Total deposits | $ 438,264 | 100.0% | $ 349,067 | 100.0% |

The following table presents the maturities of our time deposits of $250,000 or more as of December 31, 2019:

| *(in thousands)* | |
|---|---|
| **Time Deposits >$250,000** | |
| Due in three months or less | $ 2,856 |
| Due from three months to six months | 4,044 |
| Due from six months to one year | 13,330 |
| Due over one year | 13,138 |
| Total | $ 33,368 |

***Borrowings***

Deposits are the primary source of funds for our lending and investment activities and general business purposes. However, as an alternate source of liquidity, the Bank may obtain advances from the Federal Home Loan Bank of Atlanta, ("FHLB") sell investment securities subject to our obligation to repurchase them, purchase federal funds from designated correspondent banks, and engage in overnight borrowings from the Federal Reserve, correspondent banks, or client repurchase agreements. The level of short-term borrowings can fluctuate on a daily basis depending on funding needs and the source of the funds to satisfy the needs.

The Bank has an agreement with the FHLB and pledges its qualified loans as collateral which would allow the Bank, as of December 31, 2019, to borrow up to $64.9 million. There were no advances outstanding at December 31, 2019 or 2018.

***Capital Adequacy***

Stockholders' equity was $55.9 million as of December 31, 2019, compared to $50.8 million as of December 31, 2018. The Company announced on January 30, 2020, an annual dividend of $0.12 per share of common stock payable on March 3, 2020, to shareholders of record on February 13, 2020.

As of December 31, 2019, the Bank was considered to be "well capitalized" with a 9.31% Tier 1 Leverage ratio; a 13.24% Common Equity Tier 1 Risk-based Capital ratio and Tier 1 Risk-based Capital ratio, and a 14.49% Total Risk-based Capital ratio.

| | Actual | | For Capital Adequacy Purposes | | For Well Capitalized Purposes | |
|---|---|---|---|---|---|---|
| *(dollars in thousands)* | **Amount** | **Percentage** | **Amount** | **Percentage** | **Amount** | **Percentage** |
| ***As of December 31, 2019*** | | | | | | |
| 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 |
| ***As of December 31, 2018:*** | | | | | | |
| 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 |

| | Threshold Ratios | | | |
|---|---|---|---|---|
| **Capital Category** | **Total Risk-Based Capital Ratio** | **Tier 1 Risk-Based Capital Ratio** | **Common Equity Tier 1 Risk-Based Capital Ratio** | **Tier 1 Leverage Capital Ratio** |
| Well capitalized | 10.00% | 8.00% | 6.50% | 5.00% |
| Adequately Capitalized | 8.00% | 6.00% | 4.50% | 4.00% |
| Undercapitalized | <8.00% | <6.00% | <4.50% | <4.00% |
| Significantly Undercapitalized | <6.00% | <4.00% | <3.00% | <3.00% |
| Critically Undercapitalized | Tangible Equity/Total Assets ≤ 2% | | | |

The Federal banking regulatory agencies adopted a rule to simplify the methodology for measuring capital adequacy for smaller, uncomplicated banks. The CBLR is calculated as the ratio of tangible equity capital divided by average total consolidated assets. CBLR tangible equity is defined as total equity capital, prior to including minority interests, and excluding accumulated other comprehensive income, deferred tax assets arising from net operating loss and tax credit carryforwards, goodwill, and other intangible assets (other than mortgage servicing assets. Under the proposal, beginning in 2020, a qualifying organization may elect to use the CBLR framework if its CBLR is greater than 9%. The Bank has not elected to use the CBLR framework because it would not receive any material benefit with respect to compliance or reporting.

***Liquidity***

Liquidity describes our ability to meet financial obligations, including lending commitments and contingencies, which arise during the normal course of business. Liquidity is primarily needed to meet the borrowing and deposit withdrawal requirements of the Company's clients, as well as meet the Company's current and planned expenditures. Management monitors the liquidity position daily.

The Bank's liquidity is derived primarily from our deposit base, scheduled amortization and prepayments of loans and investment securities, funds provided by operations, and capital. Additionally, as a commercial bank, we are expected to maintain an adequate liquidity reserve. The liquidity reserve may consist of cash on hand, cash on demand deposit with correspondent banks, federal funds sold, and marketable securities such as United States government agency securities, municipal securities, and mortgage-backed securities. Our primary liquid assets, excluding pledged securities, accounted for 25.0% and 21.2% of total assets at December 31, 2019 and 2018, respectively.

The Bank also has external sources of funds through the FHLB, unsecured lines of credit with correspondent banks, and the State of Florida's Qualified Public Deposit Program ("QPD"). At December 31, 2019, the Bank had access to approximately $64.9 million of available lines of credit secured by qualifying collateral with the FHLB, in addition to $18.8 million in unsecured lines of credit maintained with correspondent banks. As of December 31, 2019, we had no borrowings under any of these lines. Some of our securities are pledged to collateralize certain deposits through our participation in the State of Florida's QPD program. The market value of securities pledged to the QPD program was $8.8 million at December 31, 2019. Securities valued at $2.2 million were also pledged towards one repurchase agreement at December 31, 2019.

Our core deposits consist of noninterest-bearing accounts, NOW accounts, money-market accounts, time deposits and savings accounts. We closely monitor our level of certificates of deposit $250,000 and greater and other large deposits. At December 31, 2019, total deposits were $438.3 million, of which $33.4 million was in certificates of deposits greater than $250,000. We maintain a Contingency Funding Plan ("CFP") that identifies liquidity needs and weighs alternate courses of action designed to address those needs in emergency situations. We perform a quarterly cash flow analysis and stress test the CFP to evaluate the expected funding needs and funding capacity during a liquidity stress event. We believe that the sources of available liquidity are adequate to meet all reasonably immediate short-term and intermediate-term demands and do not know of any trends, events, or uncertainties that may result in a significant adverse effect on our liquidity position.

***Off-Balance Sheet Arrangements***

In the normal course of business, we enter into various transactions that are not included in our consolidated balance sheets in accordance with GAAP. These transactions include commitments to extend credit in the ordinary course of business to approved clients, construction loans in process, unused lines of credit, guaranteed accounts, and standby performance and financial letters of credit. These instruments may involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

Generally, loan commitments have been granted on a temporary basis for working capital or commercial real estate financing requirements or may be reflective of loans in various stages of funding. These commitments are recorded on our financial statements as they are funded. Commitments typically have fixed expiration dates or other termination clauses and may require payment of a fee. Loan commitments include unused commitments for open-end lines secured by one-to-four family residential properties and commercial properties, commitments to fund loans secured by commercial real estate, construction loans, business lines of credit and other unused commitments.

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 the particular account 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 are written conditional commitments issued by us to guarantee the client will fulfill his or her contractual financial obligations to a third party. 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 repayment from the client.

We minimize our exposure to loss under loan commitments, guaranteed accounts, and standby letters of credit by subjecting them to credit approval and monitoring procedures. The effect on our revenues, expenses, cash flows, and liquidity of the unused portions of these commitments cannot be reasonably predicted because there is no guarantee that the lines of credit will be used.

The following is a summary of the total contractual amount of commitments outstanding at December 31, 2019 and 2018.

| | At December 31, | |
|---|---|---|
| | **2019** | **2018** |
| *(in thousands)* | | |
| Commitments to extend credit | $ 7,905 | $ 6,365 |
| Construction loans in process | 17,964 | 15,023 |
| Unused lines of credit | 46,042 | 43,719 |
| Standby financial letters of credit | 2,157 | 1,934 |
| Standby performance letters of credit | 328 | 378 |
| Guaranteed accounts | 1,378 | 1,330 |
| Total off-balance sheet instruments | $ 75,774 | $ 68,749 |

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Not required.

**Item 8. Financial Statements and Supplementary Data**

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

**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 these 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 consolidated 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 consolidated 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.

/s/ 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**

| *(dollars in thousands, except per share amounts)* | December 31, 2019 | December 31, 2018 |
|---|---|---|
| **Assets** | | |
| 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 |
| | | |
| **Liabilities and Stockholders' Equity** | | |
| 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**

| *(in thousands, except per share amounts)* | Year Ended December 31, 2019 | 2018 |
|---|---|---|
| Interest income: | | |
| Loans | $ 16,188 | $ 14,469 |
| Securities | 1,309 | 1,131 |
| Other | 1,489 | 634 |
| Total interest income | 18,986 | 16,234 |
| Interest expense: | | |
| Deposits | 3,560 | 2,307 |
| Other borrowings | 9 | - |
| Total interest expense | 3,569 | 2,307 |
| Net interest income | 15,417 | 13,927 |
| Provision for loan losses | 1,131 | 591 |
| Net interest income after provision for loan losses | 14,286 | 13,336 |
| 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 | 1,534 | 1,155 |
| 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 | 11,186 | 9,229 |
| Earnings before income taxes | 4,634 | 5,262 |
| Income taxes | 1,092 | 1,220 |
| Net earnings | $ 3,542 | $ 4,042 |
| | | |
| Earnings per common share: | | |
| Basic | $ 1.12 | $ 1.29 |
| Diluted | $ 1.12 | $ 1.29 |

See Accompanying Notes to Consolidated Financial Statements

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Consolidated Statements of Comprehensive Income**

| | Year Ended December 31, | |
|---|---|---|
| *(in thousands)* | **2019** | **2018** |
| 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**

| *(dollars in thousands)* | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital | Retained Earnings | Accumulated Other Compre-hensive Income (Loss) | Total Stockholders' Equity |
|---|---|---|---|---|---|---|
| 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 | 3,138,945 | $ 31 | $ 38,330 | $ 13,015 | $ (556) | $ 50,820 |
| 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 | 3,191,288 | $ 32 | $ 39,456 | $ 16,180 | $ 200 | $ 55,868 |

See Accompanying Notes to Consolidated Financial Statements.

**PRIME MERIDIAN HOLDING COMPANY AND SUBSIDIARY**

**Consolidated Statements of Cash Flows**

| *(in thousands)* | Year Ended December 31, 2019 | 2018 |
|---|---|---|
| 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

## (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)

**(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.

(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)

**(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)

**(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.

***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.

(continued)

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

***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 quanitative 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.

## (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 poeriod. 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 consolidted financials statements.

In June 2018, The FASB issued ASU No. 2018-07, *Stock Compensation (Topic 718)*: *Improvmetns to Nonempmployee 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 finsal years. Early adoption is permitted. The Company is currently evaluating the impact of the ASU, if any, on its consolidated financial statments.

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 reqirements associated with fair value measurements. ASU 2018-13 is effective for fiscal years, and interim periods within those fiscal years, beginnning 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:

| *(in thousands)* | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| ***At December 31, 2019*** | | | | |
| 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 | $ 61,064 | $ 496 | $ (227) | $ 61,333 |
| ***At December 31, 2018*** | | | | |
| 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 | $ 46,128 | $ 95 | $ (839) | $ 45,384 |

(continued)

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

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

| | | Fair Value Measurements Using | | |
|---|---|---|---|---|
| *(in thousands)* | Fair Value | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| ***At December 31, 2019*** | | | | |
| 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 | $ 61,333 | $ - | $ 61,333 | $ - |
| ***At December 31, 2018*** | | | | |
| U.S. Government agency securities | $ 799 | $ - | $ 799 | $ - |
| Municipal securities | 11,529 | - | 11,529 | - |
| Mortgage-backed securities | 33,056 | - | 33,056 | - |
| Total | $ 45,384 | $ - | $ 45,384 | $ - |

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:

| *(in thousands)* | Amortized Cost | Fair Value |
|---|---|---|
| ***At December 31, 2019*** | | |
| 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 | $ 61,064 | $ 61,333 |

The following summarizes sales of debt securities available for sale:

| | Year Ended December 31, | |
|---|---|---|
| *(in thousands)* | 2019 | 2018 |
| Proceeds from sale of securities | $ 4,245 | $ - |
| Gross gains | 28 | - |
| Gross losses | (21) | - |
| Net gain on sale of securities | $ 7 | $ - |

(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:

| | Less Than Twelve Months | | More Than Twelve Months | |
|---|---|---|---|---|
| *(in thousands)* | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value |
| ***At December 31, 2019*** | | | | |
| **Debt Securities Available for Sale** | | | | |
| 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 | $ (186) | $ 12,751 | $ (41) | $ 4,115 |
| ***At December 31, 2018*** | | | | |
| **Debt Securities Available for Sale** | | | | |
| U.S. Government agency securities | $ (2) | $ 242 | $ (14) | $ 557 |
| Municipal securities | - | - | (113) | 5,760 |
| Mortgage-backed securities | (19) | 983 | (691) | 30,061 |
| Total | $ (21) | $ 1,225 | $ (818) | $ 36,378 |

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)

### (3) Loans

The segments and classes of loans are as follows:

| | At December 31, | |
|---|---|---|
| *(in thousands)* | 2019 | 2018 |
| 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 |

(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 midsized businesses to construct owner-user properties, loans to developers of commercial real estate investment properties, and residential developments. This type of loan is also made to individual clients for construction of single-family homes in our market area. An independent appraisal is used to determine the value of the collateral and confirm that the ratio of the loan principal to the value of the collateral will not exceed policies of the 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)

**(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 midsized businesses. Small-to-medium sized businesses, retail, and professional establishments, make up our target market for commercial loans. Our Relationship Managers primarily underwrite these loans based on the borrower's ability to service the loan from cash flow. Lines of credit and loans secured by accounts receivable and/or inventory are monitored periodically by our staff. Loans secured by "all business assets," or a "blanket lien" are typically only made to highly qualified borrowers due to the nonspecific nature of the collateral 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)

**(3) Loans, Continued**

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

| | Real Estate Mortgage Loans | | | | | |
|---|---|---|---|---|---|---|
| *(in thousands)* | Commercial | Residential and Home Equity | Construction | Commercial Loans | Consumer and Other Loans | Total |
| ***Year Ended December 31, 2019*** | | | | | | |
| 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 | $ 1,046 | $ 1,573 | $ 415 | $ 1,284 | $ 96 | $ 4,414 |
| ***At December 31, 2019*** | | | | | | |
| Individually evaluated for impairment: | | | | | | |
| Recorded investment | $ 611 | $ 965 | $ - | $ 1,631 | $ 13 | $ 3,220 |
| Balance in allowance for loan losses | $ - | $ 15 | $ - | $ 386 | $ 13 | $ 414 |
| Collectively evaluated for impairment: | | | | | | |
| Recorded investment | $ 94,117 | $ 134,948 | $ 33,583 | $ 68,139 | $ 7,618 | $ 338,405 |
| Balance in allowance for loan losses | $ 1,046 | $ 1,558 | $ 415 | $ 898 | $ 83 | $ 4,000 |
| ***Year Ended December 31, 2018*** | | | | | | |
| 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 | $ 917 | $ 1,397 | $ 391 | $ 876 | $ 80 | $ 3,661 |
| ***At December 31, 2018*** | | | | | | |
| Individually evaluated for impairment: | | | | | | |
| Recorded investment | $ 611 | $ 409 | $ - | $ 205 | $ 6 | $ 1,231 |
| Balance in allowance for loan losses | $ - | $ - | $ - | $ 205 | $ 6 | $ 211 |
| Collectively evaluated for impairment: | | | | | | |
| Recorded investment | $ 81,883 | $ 121,045 | $ 31,601 | $ 50,813 | $ 6,741 | $ 292,083 |
| Balance in allowance for loan losses | $ 917 | $ 1,397 | $ 391 | $ 671 | $ 74 | $ 3,450 |

(continued)

**(3) Loans, Continued**

The following summarizes the loan credit quality:

| | Real Estate Mortgage Loans | | | | | |
|---|---|---|---|---|---|---|
| *(in thousands)* | **Commercial** | **Residential and Home Equity** | **Construction** | **Commercial Loans** | **Consumer and Other Loans** | **Total** |
| ***At December 31, 2019*** | | | | | | |
| 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 | $ 94,728 | $ 135,913 | $ 33,583 | $ 69,770 | $ 7,631 | $ 341,625 |
| ***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 | $ 82,494 | $ 121,454 | $ 31,601 | $ 51,018 | $ 6,747 | $ 293,314 |

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)

**(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:

| | Accruing Loans | | | | | | |
|---|---|---|---|---|---|---|---|
| *(in thousands)* | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than 90 Days Past Due | Total Past Due | Current | Nonaccrual Loans | Total Loans |
| ***At December 31, 2019:*** | | | | | | | |
| 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 | $ 738 | $ 5 | $ - | $ 743 | $ 338,291 | $ 2,591 | $ 341,625 |
| | | | | | | | |
| ***At December 31, 2018:*** | | | | | | | |
| Real estate mortgage loans: | | | | | | | |
| Commercial | | | | | | | |
| Residential and home equity | $ - | $ - | $ - | $ - | $ 82,494 | $ - | $ 82,494 |
| Construction | 134 | 30 | - | 164 | 121,129 | 161 | 121,454 |
| Commercial loans | - | - | - | - | 31,601 | - | 31,601 |
| Consumer and other loans | 98 | - | - | 98 | 50,745 | 175 | 51,018 |
| Total | - | - | - | - | 6,741 | 6 | 6,747 |
| | $ 232 | $ 30 | $ - | $ 262 | $ 292,710 | $ 342 | $ 293,314 |

(continued)

**(3) Loans, Continued**

The following summarizes the amount of impaired loans:

| | With No Related Allowance Recorded | | With an Allowance Recorded | | | Total | | |
|---|---|---|---|---|---|---|---|---|
| *(in thousands)* | Recorded Investment | Unpaid Contractual Principal Balance | Recorded Investment | Unpaid Contractual Principal Balance | Related Allowance | Recorded Investment | Unpaid Contractual Principal Balance | Related Allowance |
| ***At December 31, 2019:*** | | | | | | | | |
| 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 |
| Total | $ 1,835 | $ 1,835 | $ 1,385 | $ 1,385 | $ 414 | $ 3,220 | $ 3,220 | $ 414 |
| ***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 |
| Total | $ 1,020 | $ 1,020 | $ 211 | $ 211 | $ 211 | $ 1,231 | $ 1,231 | $ 211 |

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

| *(in thousands)* | Average Recorded Investment | Interest Income Recognized | Interest Income Received |
|---|---|---|---|
| ***Year Ended December 31, 2019*** | | | |
| Commercial real estate | $ 611 | $ 32 | $ 32 |
| Residential and home equity | 753 | 5 | 7 |
| Commercial | 806 | 9 | 12 |
| Consumer and other loans | 3 | - | - |
| Total | $ 2,173 | $ 46 | $ 51 |
| *(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 | - | - |
| Total | $ 879 | $ 25 | $ 29 |

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

(continued)

**(3) Loans, Continued**

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

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 | | | |
|---|---|---|---|---|---|---|---|---|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Current Modification Outstanding Recorded Investment | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Current Modification Outstanding Recorded Investment |
| *(in thousands)* | | | | | | | | |
| ***Troubled Debt Restructurings:*** | | | | | | | | |
| Modified principal | | | | | | | | |
| Residential and home equity: | - | - | - | - | 1 | $ 619 | $ 611 | $ 611 |
| Modified interest rate | | | | | | | | |
| Residential and home equity: | 1 | $ 65 | $ 65 | $ 65 | - | - | - | - |
| Commercial | 2 | 260 | 260 | 260 | - | - | - | - |
| Total | 3 | $ 325 | $ 325 | $ 325 | 1 | $ 619 | $ 611 | $ 611 |

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.

(continued)

## (4) Premises and Equipment

A summary of premises and equipment follows:

| | At December 31, 2019 | At December 31, 2018 |
|---|---|---|
| *(in thousands)* | | |
| 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 |

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:

| | Year Ended December 31, 2019 |
|---|---|
| (in thousands) | |
| Operating lease cost | $ 239 |
| Cash paid for amount included in the measurement of lease liabilities operating cash flows from operating leases | $ 151 |

| (in thousands) | At December 31, 2019 |
|---|---|
| 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:

| **(in thousands)** | At December 31 2019 |
|---|---|
| 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.

(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:

| *(in thousands)*<br>**Year Ending December 31,** | | **Amount** |
|---|---|---|
| 2020 | $ | 47,464 |
| 2021 | | 18,280 |
| 2022 | | 559 |
| 2023 | | 2,168 |
| 2024 | | 300 |
| 2039 | | 403 |
| Total | $ | 69,174 |

## (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:

| | **Year Ended December 31,** | | | |
|---|---|---|---|---|
| *(in thousands)* | | **2019** | | **2018** |
| Current: | | | | |
| Federal | $ | 987 | $ | 1,003 |
| State | | 222 | | 292 |
| Total current | | 1,209 | | 1,295 |
| | | | | |
| Deferred: | | | | |
| Federal | | (94) | | (65) |
| State | | (23) | | (10) |
| Total deferred | | (117) | | (75) |
| Total income taxes | $ | 1,092 | $ | 1,220 |

(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:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| *(dollars in thousands)* | Amount | % of Pretax Earnings | Amount | % of Pretax Earnings |
| 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 | $ 1,092 | 23.6% | $ 1,220 | 23.2% |

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

| | At December 31, | |
|---|---|---|
| *(in thousands)* | 2019 | 2018 |
| 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 | 1,086 | 1,161 |
| | | |
| 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 | (724) | (659) |
| Net deferred tax asset | $ 362 | $ 502 |

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.

(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:

| *(in thousands)* | At December 31, 2019 |
|---|---|
| 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 |

(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:

| | Number of Options | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|---|---|---|---|
| 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 | 263,457 | $ 19.78 | | |
| Options granted | 22,000 | 20.21 | | |
| Forfeited | (13,190) | 20.09 | | |
| Outstanding at December 31, 2019 | 272,267 | $ 19.80 | 7.8 years | $ 77,000 |
| Exercisable at December 31, 2019 | 71,827 | $ 18.97 | 6.2 years | $ 77,000 |

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:

| | Year ended December 31, 2019 | 2018 |
|---|---|---|
| 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)

**(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:

| | Number of Options | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|---|---|---|---|
| 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 | 4,700 | $ 11.37 | | |
| Options exercised | (500) | 10.00 | | |
| Options forfeited | (2,000) | 10.72 | | |
| Outstanding at December 31, 2019 | 2,200 | $ 12.27 | 0.32 years | $ 17,000 |
| Exercisable at December 31, 2019 | 2,200 | $ 12.27 | 0.32 years | $ 17,000 |

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.

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:

| | Number of Shares | Wtd-Avg Grant Date Fair Value per Share | Grant Date Fair Value |
|---|---|---|---|
| Non-vested restricted stock issued in 2019 | 3,600 | $ 18.52 | $ 67,000 |
| Non-vested restricted stock outstanding at December 31, 2019 | 3,600 | $ 18.52 | 67,000 |

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.

(continued)

## (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:

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

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.

## (12) Fair Value of Financial Instruments

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

| | | At December 31, 2019 | | At December 31, 2018 | |
|---|---|---|---|---|---|
| *(in thousands)* | **Level** | **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 is 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.

(continued)

## (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.

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:

| | Actual | | For Capital Adequacy Purposes | | For Well Capitalized Purposes | |
|---|---|---|---|---|---|---|
| *(dollars in thousands)* | **Amount** | **Percentage** | **Amount** | **Percentage** | **Amount** | **Percentage** |
| ***As of December 31, 2019*** | | | | | | |
| 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 |
| ***As of December 31, 2018:*** | | | | | | |
| 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.

(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 | | |
|---|---|---|---|---|---|---|
| *(dollars in thousands, except per share amounts)* | **Earnings** | **Weighted-Average Shares** | **Per Share Amount** | **Earnings** | **Weighted-Average Shares** | **Per Share Amount** |
| ***Year Ended December 31,*** | | | | | | |
| 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 |

(continued)

## (17) Parent Company Only Financial Information

The Holding Company's unconsolidated financial information follows:

| *(in thousands)* | December 31, 2019 | December 31, 2018 |
|---|---|---|
| **Assets** | | |
| Cash | $ 8,895 | $ 13,551 |
| Investment in subsidiary | 46,953 | 37,249 |
| Other assets | 20 | 20 |
| Total assets | $ 55,868 | $ 50,820 |
| **Stockholders' Equity** | | |
| Stockholders' equity | $ 55,868 | $ 50,820 |
| Total liabilities and stockholders' equity | $ 55,868 | $ 50,820 |

**Condensed Statements of Earnings**

| *(in thousands)* | Year Ended December 31, 2019 | Year Ended December 31, 2018 |
|---|---|---|
| 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 |

| *(in thousands)* | Year Ended December 31, 2019 | Year Ended December 31, 2018 |
|---|---|---|
| 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.

## Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

## Item 9A. Controls and Procedures

***(a) Evaluation of Disclosure Controls and Procedures***

We maintain controls and procedures designed to ensure that information required to be disclosed in the reports that PMHG files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based upon management's evaluation of those controls and procedures performed within the 90 days preceding the filing of this Report, our Principal Executive Officer and Chief Financial Officer concluded that, subject to the limitations noted below, the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) are effective to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms.

We intend to continually review and evaluate the design and effectiveness of PMHG's disclosure controls and procedures and to improve the Company's controls and procedures over time and to correct any deficiencies that we may discover in the future. The goal is to ensure that senior management has timely access to all material financial and non-financial information concerning the Company's business. While we believe the present design of the disclosure controls and procedures is effective to achieve its goal, future events affecting its business may cause the Company to modify its disclosure controls and procedures.

***(b) Management's Report on Internal Control Over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Such internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2019. In making this assessment, the Company consulted with an external consulting firm to assist in management's evaluation of the adequacy of the Bank's policies and procedures in the areas of internal operational controls and safeguarding of assets, and when applicable, compliance with regulatory guidelines. The Company and the consultant used the 2013 criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in "Internal Control-Integrated Framework" to perform the assessment. Based on this evaluation, management concluded that our internal control over financial reporting was effective as of December 31, 2019.

This annual report does not include an attestation report of PMHG's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to Securities and Exchange Commission Rule 210.2-02(f), which permits the Company to provide only management's report in this annual report.

***(c) Changes in Internal Controls***

We have made no significant changes in our internal controls over financial reporting during the year ended December 31, 2019, that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

***(d) Limitations on the Effectiveness of Controls***

Our management, including our Principal Executive Officer and Principal Financial Officer, does not expect that our disclosure controls and internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

**Item 9B. Other Information**

None.

**Item 10. Directors, Executive Officers and Corporate Governance**

The Boards of Directors of the Company and the Bank are each composed of the same fifteen members. The members of both Boards of Directors are elected each year for one-year terms. Our shareholders elect the Company's Board of Directors, while the Company (as the sole shareholder), elects the Board of Directors of the Bank. Executive officers of the Company and of the Bank are elected annually by the respective Boards of Directors.

Each member of the Board of Directors is an "independent director" using the standards set forth under Section 5600 of the NASDAQ Stock Market Rules, except for Sammie D. Dixon, Jr., R. Randy Guemple, Chris L. Jensen, Jr., Kathleen C. Jones, and Michael A. Micallef, Jr.

The following table lists the names and ages of all directors and executive officers of the Company and the Bank and indicates all positions and offices with the Company and the Bank held by each person, as of March 8, 2020. Also included in the table is the year in which each person commenced service with the Company and a brief description of the current occupation of each director or executive officer. There are no arrangements or understandings between such persons and any other person pursuant to which any person was elected as a director or executive officer.

| Name | Age | Position with the Company | Position with the Bank | Year Joined Prime Meridian | Principal Occupation |
|---|---|---|---|---|---|
| Kenneth H. Compton | 51 | Director | Director | 2019 | CEO, Founder, Compton & Associates, Private Wealth Advisors |
| William D. Crona | 71 | Director | Director | 2010 | Financial Consultant, Investor & CPA |
| Sammie D. Dixon, Jr. | 50 | Vice Chairman, CEO, President | Vice Chairman, CEO, President, Director | 2010 | Chief Executive Officer & President |
| Steven L. Evans | 72 | Director | Director | 2010 | Retired IBM Executive |
| R. Randy Guemple | 68 | Director | Director | 2010 | Retired Executive Vice President, Chief Financial Officer(1) |
| Chris L. Jensen, Jr. | 63 | EVP, Director | SLO, EVP, Director | 2010 | Executive Vice President, Senior Lender |
| Kathleen C. Jones | 66 | Director | Director | 2010 | Retired Executive Vice President, Chief Financial Officer |
| Robert H. Kirby | 53 | Director | Director | 2010 | Businessman, Partner in Rehab Technologies |
| Frank L. Langston | 62 | Director | Director | 2010 | Principal of NAI TALCOR |
| Michael A. Micallef, Jr. | 70 | Director | Director | 2018 | Retired SVP, Market President Lakeland office(2) |
| L. Collins Proctor, Sr. | 50 | Director | Director | 2010 | Principal / Director of FSM (Facility Solutions Management) |
| Garrison A. Rolle, M.D. | 58 | Director | Director | 2010 | Orthopedic Surgeon |
| Steven D. Smith | 67 | Director | Director | 2010 | Businessman, Krispy Kreme Doughnut Franchisee |
| Marjorie R. Turnbull | 79 | Director | Director | 2010 | Consultant |
| Susan Payne Turner | 53 | EVP, CRO | EVP, CRO | 2016 | Executive Vice President, Chief Risk Officer |
| Monte L. Ward | 38 | EVP, CIO | EVP, CIO | 2011 | Senior Vice President, Information Security Officer(3) |
| Clint F. Weber | 38 | EVP, CFO | EVP, CFO | 2013 | Senior Vice President, Chief Credit Officer(4) |
| Richard A. Weidner | 75 | Chairman | Chairman | 2010 | CPA, Partner with Carr, Riggs & Ingram, LLC |

(1) Director Guemple retired as Executive Vice President and Chief Financial Officer of the Company and of the Bank on March 31, 2019. He remains on the Boards of Directors of the Company and the Bank.

(2) Director Micallef retired as Senior Vice President and Market President on February 29, 2020.

(3) Monte Ward assumed the position of Executive Vice President and Chief Information Officer of the Company and the Bank on April 1, 2019.
(4) Clint Weber assumed the position of Executive Vice President and Chief Financial Officer of the Company and the Bank on April 1, 2019.

The following sets forth a brief description of each director and executive officer's principal occupation and business experience, and certain other information. There are no family relationships between any directors or executive officers.

**Executive Officers**

***Sammie D. Dixon, Jr.,*** age 50, was part of the management team that formed both the Bank and Prime Meridian. He is the Vice Chairman, Chief Executive Officer and President of Prime Meridian and the Bank. Prior to joining the Bank, from June 2005 to December 2006, he was the Senior Vice President and Commercial Sales Manager for Regions Bank in Tallahassee, Florida. Before that, he served as Chief Executive Officer and President for Bank of Thomas County from August 2003 to June 2005. From April 1999 to 2003, Mr. Dixon held various positions with Bank of Florida – Southwest in Naples, Florida. He began his banking career with NationsBank in 1997. Mr. Dixon served as an Administrative Committee Member of the American Bankers Association's Community Bankers Council. He is active in the community as a member of the Rotary Club of Tallahassee and member of the Tallahassee Memorial HealthCare Foundation Board of Trustees. He serves on the Boards of the Boys & Girls Clubs of the Big Bend and the Greater Tallahassee Chamber of Commerce. He is a former Campaign Co-Chair of the United Way of the Big Bend where he also served as a director. Mr. Dixon attends Saint Peter's Anglican Church.

***Clint F. Weber,*** age 38, has been with the Bank since 2013. He is presently Prime Meridian's and the Bank's Chief Financial Officer and Executive Vice President. Prior to joining the Bank, he was Vice President and held various credit positions at Premier Bank and its successor financial institution Centennial Bank from 2008 to 2013. From 2003 to 2008, he was a Financial Institution Examiner at the Florida Office of Financial Regulation. Mr. Weber's work experience includes Credit Risk Management, Regulatory Compliance, Accounting and Asset/Liability Management. Mr. Weber is a graduate of Florida State University where he received a Bachelor of Science in Finance and Real Estate. He is also a graduate from the Florida School of Banking at the University of Florida.

***Chris L. Jensen, Jr.,*** age 63, was part of the management team that formed both the Bank and the Company. He is an Executive Vice President of the Company and the Bank's Executive Vice President and Senior Lender. Prior to joining the Bank, from February 2005 to 2007, he served as Tallahassee Market President for Regions Bank. Before that, Mr. Jensen held various management positions with SouthTrust Bank from 1997 to 2005, culminating with the position of Tallahassee's Market President. He also served as Senior Lender for First Bank of Tallahassee in its *de novo* stage in 1990. Mr. Jensen has over forty years of lending experience in Tallahassee and the surrounding markets. He is active in the community and currently serves on the Boards of several local groups, including the Suwannee River Area Council for the Boy Scouts of America, and the Young Actors Theatre.

***Susan Payne Turner,*** age 53, has been with the Bank since 2013. She is presently Executive Vice President and Chief Risk Officer (CRO) of the Company and the Bank. Mrs. Turner began her banking career in 1983. From 2010 to 2013, she was a Regional Retail Leader for Centennial Bank, where she managed ten branches located in Leon, Wakulla, Calhoun and Liberty Counties. Mrs. Turner is a graduate of Florida State University and received a Master of Business Administration from Troy University in 2005. She is also a graduate from the Graduate School of Banking at Louisiana State University. Mrs. Turner is a Past Chair for the Tallahassee Community College Foundation and currently serves on the Foundation's Board. She also serves as Past Chair for the Tallahassee Community College Alumni and Friends Association, as a director on the Board for the Wakulla Senior Center, Florida Bankers Education Foundation and Director Emeritus on the Board for the Wakulla County Chamber of Commerce. Mrs. Turner is a member of the Coastal Optimist Club, is the Associate Director of the Wakulla County Historical Society and serves on the board for the Community Foundation of North Florida.

***Monté L. Ward,*** age 38, has been with the Bank since 2011. He is presently Prime Meridian's and the Bank's Chief Information Officer and Executive Vice President. Prior to joining the Bank, he was Assistant Vice President and held various operational, compliance and information technology positions at Premier Bank from 2002 to 2011. Mr. Ward has a background in software programming and hacking/intrusion. He holds various Microsoft certifications and designations such as Certified Regulatory Compliance Manager, Accredited ACH Professional, Certified Information Security Manager, and others in technology, security, and compliance. Mr. Ward holds a Master of Cybersecurity and Information Assurance. He is a graduate of Florida Agricultural & Mechanical University where he received a Bachelor of Science in Electrical Engineering. Mr. Ward is also a graduate from the Stonier Graduate School of Banking at the University of Pennsylvania

**Company and Bank Directors**

***Kenneth H. Compton,*** age 51, was elected to Prime Meridian's and the Bank's Board in May, 2019. He is the Founder, President and CEO of Compton & Associates, Private Wealth Advisors, which focuses on asset management, retirement planning, estate planning, and business transition planning. Mr. Compton became a director of Community Southern Holdings, Inc. and Community Southern Bank in 2013, where he served as Chairman of both the Loan and Compensation committees, and served on both the Audit and Asset Liability committees. He remained on the Boards until their sale to Sunshine Bancorp, Inc. in 2015. He then joined the Board of Sunshine Bancorp, Inc. and served, as the Sarbanes Oxley Financial Expert on the Audit Committee, until its sale to CenterState Bank Corporation in 2018. His background includes a Juris Doctor degree from the Cumberland School of Law at Samford University, a Master of Law degree from the University of Denver, Sturm College of Law and Daniels College of Business, and a Bachelor of Arts Degree in International Studies and Foreign Policy from Rhodes College. He has served as an adjunct professor of finance and insurance, as a vesting agent under the Florida Comprehensive Land Use Plan, and as a past Executive Vice President of the Highlands County Board of Realtors. Mr. Compton serves on the Board of Baycare's Bartow Regional Medical Center. He also has served on the Board of the Southeastern University Foundation. The Board has concluded that Mr. Compton's business experience and significant involvement in the community qualify him to serve on the Company's Board of Directors

***William D. Crona,*** age 71, is a founding member of the Boards of the Bank and the Company. He is a certified public accountant. In 2005, he retired from a twenty-threeyear career with the accounting firm of Law, Redd, Crona and Munroe, P.A., Tallahassee, Florida, where he served as a partner. He currently is a financial consultant and investor in the Tallahassee area. Mr. Crona serves on the boards of the Apalachee Land Conservancy, Manchebo Beach Resort Hotel, TEC Incorporated, SAVA, and the City of Tallahassee Citizen Advisory Board. The Board of Directors has determined that Mr. Crona's financial and accounting experience, as well as his familiarity with the Tallahassee market area, qualify him to serve on the Company's Board of Directors.

***Steven L. Evans,*** age 72, is a founding member of the Boards of the Bank and Prime Meridian. He retired from a thirty year career with IBM in 2003 where he served as Vice President of its North American education business and IBM's Senior State Executive for its Florida operations. After graduating from the University of Michigan, Mr. Evans played in the St. Louis Cardinal Baseball organization for six years before joining IBM. Mr. Evans currently serves on the Boards of the Florida Taxwatch Research Institute, Tallahassee Memorial Hospital, Ghost Controls, Inc., Vineyard Capital, Fringe Benefits Management Corporation, Applied Fiber Holdings, Inc., Kyra Infotech Group, United Way of the Big Bend, and is the Chairman of the Economic Vitality Leadership Council. He is an Advisor for Elder Care Services and the Florida State University (FSU) Marine Research Lab and is a member of the FSU Research GAP Committee. The Board has concluded that Mr. Evans' business experience and significant involvement in the community qualify him to serve on the Company's Board of Directors.

***R. Randy Guemple*** age 68, is a founding member of the Boards of the Bank and Prime Meridian. He retired as Prime Meridian's and the Bank's Executive Vice President and Chief Financial Officer on March 31, 2019. He is also a certified public accountant. Prior to assuming these offices on January 1, 2016, he was a retired bank Executive Vice President, Chief Operating Officer, and Chief Financial Officer of First Bank of Florida in West Palm Beach, Florida. He is a Past Chairman of the Financial Managers Society, Inc., headquartered in Chicago, Illinois. Mr. Guemple is a Past Chairman and current member of the Board of Trustees for the Tallahassee Memorial HealthCare Foundation, Inc. and Southern Scholarship Foundation, Inc. in Tallahassee, Florida. He is also Director Emeritus of Elder Care Services, Inc. and an active member of the Tallahassee Kiwanis Club. Mr. Guemple is a graduate of Florida State University where he received a Bachelor of Science in Accounting and his Master of Business Administration. He played baseball while at FSU and is a member of Good Shepherd Catholic Church. The Board of Directors believes that Mr. Guemple's extensive banking experience and intimate knowledge of the Company's financial operations qualify him to serve on the Company's Board of Directors

***Kathleen C. Jones,*** age 66, was part of the management team which formed both the Bank and the Company and has been a member of both Boards since 2011. She retired as the Company's and the Bank's Executive Vice President and Chief Financial Officer on December 31, 2015. Prior to joining the Bank, she spent thirty-six years with SunTrust Bank and its Tallahassee predecessor institutions. Mrs. Jones retired from SunTrust Bank in 2007, at the position of North Florida Regional Senior Vice President, Senior Banking Operations Manager. She is a 1978 graduate of Florida State University where she received a Bachelor of Science in Finance. She also is a 1988 graduate of the Graduate School of Banking of the South in Baton Rouge, Louisiana. Mrs. Jones is a member of Thomasville Road Baptist Church. The Board of Directors believes that Mrs. Jones' extensive banking experience and intimate knowledge of the Company's financial operations qualify her to serve on the Company's Board of Directors.

***Robert H. Kirby,*** age 53, was elected to the Company's and the Bank's Board in May 2010. He is a partner in Rehab Technologies, LLC, a medical equipment sales and leasing business, and Huxford Land Company, LLC, a land and timber company. Mr. Kirby currently serves as President and Chief Executive Officer of Cedar Creek Land and Timber Company, Inc. and T.R. Miller Woodlands, Inc., and as a member of the management executive committees of T.R. Miller Mill Company, Inc. and Neal Land Alabama, Inc., all located in Brewton, Alabama. Mr. Kirby received a bachelor's degree from the University of the South, Sewanee, Tennessee and a Master of Business Administration from the University of Alabama, Tuscaloosa, Alabama. He serves on the Boards of a number of private companies and non-profit organizations, including Tall Timbers Research, Inc. The Board of Directors has determined that Mr. Kirby's business experience and knowledge of the Tallahassee market qualify him to serve on the Company's Board of Directors.

***Frank L. Langston,*** age 62, is a founding member of the Boards of the Bank and the Company. He has been a principal/owner, since 2000, with the real estate services company NAI TALCOR, located in Tallahassee, Florida. From 1990 to 2000, Mr. Langston was affiliated with NAI TALCOR as an independent contractor. After attending Auburn University, Mr. Langston entered the management training program of First Florida Banks in Tampa. While assigned to the Marketing Department, Mr. Langston gained valuable first-hand real estate experience in locating bank branch locations around the state. In addition, he participated in strategic planning, new product development, and market analysis. From 1981 to 1984, Mr. Langston served as Marketing Director with the responsibility of business development for the Tallahassee office. In May 1989, he entered the commercial real estate business specializing in retail and office sales and leasing, and bank-owned real estate. Mr. Langston is a Certified Commercial Investment Member, a Florida licensed broker-salesman, and an Alabama licensed broker. He is also a member of the National Association of Realtors, the Florida Association of Realtors, and the Tallahassee Association of Realtors. He currently serves on the Board of Anna's Foundation, Advisory Board of the Master of Real Estate Development Program at Auburn University and the Community Board of the Tallahassee Campus of the Florida State University, College of Medicine. The Board believes that his business experience and knowledge of the real estate market qualify him to serve on the Company's Board of Directors.

***Michael A. Micallef, Jr.,*** age 70, was elected to Prime Meridian's and the Bank's Board in March 2019. On February 29, 2020, he retired as the Bank's Senior Vice President and Market President for the Bank's Polk County market. Prior to joining the Bank, Mr. Micallef served as Regional President for Sunshine Bank from 2015 to 2017. From its founding in 2006 until its sale to Sunshine Bancorp, Inc. in 2015, Mr. Micallef served as the Chief Executive Officer and President of Community Southern Holdings, Inc. and Community Southern Bank, in Lakeland, Florida. Mr. Micallef has more than thirty years of experience as a Chief Executive Officer of financial institutions, including serving as: President of Marco Community Bancorp, Inc. and Chief Executive Officer and President of Marco Community Bank in Marco Island, Florida from 2003 to 2005; and Chief Executive Officer, President, and Vice Chairman of Sterling Bank, FSB, in Lantana, Florida from 1999 to 2003. Mr. Micallef received his Bachelor of Science degree from St. Peters College, his Master of Business Administration from Fordham University and graduate banking degree from Brown University. The Bank has concluded that Mr. Micallef's business and banking experience, as well as his knowledge of the Bank's Polk County, Florida market qualify him to serve on Company's Board of Directors.

***L. Collins Proctor, Sr.,*** age 50, is a founding member of the Boards of the Bank and the Company. He is a co-founding partner of Facility Solutions Management, LLC ("FSM") which serves corporate, government, medical, and education, clients throughout the United States. FSM optimizes facility performance and operating costs through three core services: Engineering Design, Building Controls, and Energy Services and Upgrades. Mr. Proctor focuses primarily within FSM's "Energy Services" division overseeing the strategy, financing, and evaluation of client requirements. Mr. Proctor is also an investment partner of Red Brick Partners, LLC, a real estate and private equity investment entity started in 2006. Prior to 2006, Mr. Proctor owned and managed a North Florida real estate acquisition and construction advisory firm, an affiliate of a national firm with which he was associated for ten years. Mr. Proctor received his Bachelor of Arts from Vanderbilt University and his Master of Business Administration from Emory University, between which times he served five years with NationsBank (now Bank of America) in its leveraged leasing division managing over $3.5 billion in equipment financing for large corporate clients. Mr. Proctor also serves as a commissioner on the Tallahassee-Leon County Planning Commission. The Board has concluded that Mr. Proctor's business and banking experience, as well as his knowledge of the regional market qualify him to serve on the Company's Board of Directors.

***Garrison A. Rolle, M.D.,*** age 58, is a founding member of the Boards of the Bank and the Company. He is an orthopedic surgeon who joined the Tallahassee Orthopedic Clinic in 1997. He served on AmSouth Bank's Advisory Board of Directors in Tallahassee, Florida and was formerly a director of Regions Bank in Tallahassee, Florida. Dr. Rolle played football for the University of Florida while pursuing his Bachelor of Science degree. He received his medical degree from the University of Florida, College of Medicine. The Board of Directors has concluded that Dr. Rolle's business and banking experience and his knowledge of the Tallahassee community qualify him to serve on the Company's Board of Directors.

***Steven D. Smith,*** age 67, is a founding member of the Boards of the Bank and the Company. He is an owner and operator of a number of Krispy Kreme Doughnut franchises throughout the Florida Panhandle, including Tallahassee, Florida. Mr. Smith currently serves as Chairman of the Board for Pursuit Channel, an outdoor network delivered to approximately thirty-eight million U.S. households. He also serves as a member of the Florida Highway Patrol Advisory Council. Mr. Smith is also the owner of a number of other local businesses and is a 1974 graduate of Livingston University in Livingston, Alabama. The Board of Directors believes Mr. Smith's business and banking experience, as well as his knowledge of the Tallahassee community, qualify him to serve on the Company's Board of Directors.

***Marjorie R. Turnbull,*** age 79, is a founding member of the Boards of the Bank and the Company. She currently is a consultant for non-profit organizations. Previously, she served as the Vice President for Institutional Advancement and the Executive Director of the Tallahassee Community College Foundation from 1995 until her retirement in 2006. From 1994 to 2000, Mrs. Turnbull represented Leon County, District 9, in the Florida House of Representatives. Prior to her service in the Florida House of Representatives, she was a member of the Leon County Commission from 1988 to 1994, Deputy Assistant Secretary for Health Planning for the State of Florida, and a member of the staff of the Florida House of Representatives. Mrs. Turnbull serves as the Past Chair of the Economic Club of Florida, and as a member of the Institutional Review Board of Tallahassee Memorial HealthCare, Tallahassee Symphony Orchestra Board and the Big Bend Hospice Foundation Board. The Board has determined that Mrs. Turnbull's extensive knowledge and presence in the community and her prior government activities makes her well-qualified to serve on the Company's Board of Directors.

***Richard A. Weidner, CPA,*** age 75, is a founding member and Chairman of the Boards of the Bank and the Company. Mr. Weidner is a certified public accountant, partner and the Partner Oversight Director of Carr, Riggs & Ingram, LLC, an accounting firm with more than 300 partners and 2,000 professionals. In 2002 this firm acquired Williams, Cox, Weidner & Cox, P.A., Tallahassee, Florida, which Mr. Weidner helped establish in 1972. From approximately 1998 to 2001, Mr. Weidner served as an Advisory Board member for SunTrust Bank. Mr. Weidner is a past member of the Tallahassee Community College Foundation Board. He is a Past Treasurer of the Tallahassee Chamber of Commerce, Past President of the Tallahassee YMCA, and Past Treasurer of the Maclay School Board of Directors. He has also served on the Leon County Library Advisory Board and was a United Way Campaign Captain. The Board of Directors believes that Mr. Weidner's business and accounting experience and his knowledge of the Tallahassee market area makes him qualified to serve on the Company's Board of Directors.

**Audit Committee Matters**

The Board of Directors of the Company has a standing Audit Committee, which has been established in accordance with Section 3(a) (58) (A) of the Exchange Act and which operates under a formal written charter adopted by the Board of Directors. The members of that committee are William D. Crona (Chairman), Steven L. Evans, Robert H. Kirby, Steven D. Smith, and Marjorie R. Turnbull, each of whom is considered independent under NASDAQ listing standards. The Board of Directors has determined that Mr. Crona is an audit committee financial expert, based on his experience as a Certified Public Accountant, as described above.

**Section 16(a) Beneficial Ownership Reporting Compliance**

The Company is not subject to the beneficial ownership reporting requirements of Section 16(a).

**Code of Ethics**

The Company adopted a written Code of Ethics designed to promote ethical conduct by all of the Company's directors, officer, and employees based upon the standards set forth under Item 406 of Regulation S-K of the Exchange Act. The Code of Ethics applies to all Company employees, including our Principal Executive Officer, Principal Financial Officer, and Controller. A copy of the Company's Code of Ethics is filed as an exhibit with this Form 10-K, is available on our website at www.primemeridianbank.com or free of charge from the Company by writing to our Corporate Secretary at Prime Meridian Holding Company, 1897 Capital Circle NE, Second Floor, Tallahassee, Florida 32308 or by calling (850) 907-2301.

**Nomination Procedures**

In 2019, there were no material changes to the procedures by which shareholders may recommend nominees to the Company's Board of Directors.

**Item 11. Executive Compensation**

**General**

The objective of the Company's compensation program is to offer a compensation package that will attract, motivate, reward, and retain high-performing and dedicated employees. We seek to provide financial security for employees and the plan is designed to reward performance, longevity, professional growth, initiative, and increased responsibility. The Company's Compensation and Nominating Committee, working in consultation with the Vice Chairman, Chief Executive Officer and President ("Vice Chair/CEO/President"), reviews different compensation alternatives to attract and retain qualified management, to meet short-term financial goals, and to enhance long-term shareholder value. The objective is to pay each executive officer the base salary that would be paid on the open market for a similarly qualified officer of that position. The Compensation and Nominating Committee determines the level of base salary and any incentive bonus for the Chief Executive Officer position based upon competitive norms, derived from surveys published by independent banking institutes and private companies specializing in the analysis of financial institutions. Such surveys provide information regarding compensation of financial institution officers and employees based on the size and geographic location of the financial institution and serve as a benchmark for determining executive salaries.

At December 31, 2019, the members of the Compensation and Nominating Committee were Kenneth H. Compton (Chairman); Steven L. Evans; Kathleen C. Jones; Robert H. Kirby; Frank L. Langston; Steven D. Smith and Richard A. Weidner. The opinion of the Board of Directors is that in 2019 each member of the Compensation and Nominating Committee was independent under NASDAQ listing standards, except for Director Jones, who received consulting fees in 2017, 2018, and 2019 and whose spouse is employed by the agency which sells insurance to the Company and the Bank.

In 2019, the Compensation and Nominating Committee established a bonus plan for Vice Chair/CEO/President Dixon that included a performance matrix based on a budgeted increase in net income and total asset size growth. To receive any bonus under this program, the Vice Chair/CEO/President must have at least met or exceeded the performance objectives. Pursuant to this program, in early 2020, the Compensation and Nominating Committee approved the grant of 3,835 restricted shares under the 2015 Stock Option Plan, valued at $20.40 per share, the fair market value as of the date of the grant and a $26,532 cash bonus to Mr. Dixon.

Effective January 1, 2019, the Bank's executive management team adopted an Incentive Plan for officers and employees to be used in determining cash bonuses based upon two components: overall Bank performance and individual performance. Pursuant to the Incentive Plan, in early 2020, CRO/EVP Susan Payne Turner earned and received a cash bonus of $22,079 and Senior Lender/EVP Chris L. Jensen, Jr. earned and received a cash bonus of $18,336.

The cash compensation of the Vice Chairman, Chief Executive Officer and President ("Vice Chair/CEO/President") of Prime Meridian and the Bank is paid pursuant to a Master Service Agreement, currently with 30% attributable to the Company and 70% attributable to the Bank. The cash compensation of the The cash compensation of both the CRO and Senior Lender were 100% attributable to the Bank in 2019.

**Compensation Committee Interlocks**

The opinion of the Board of Directors is that in 2019, each member of the Compensation and Nominating Committee was an "independent director" using the standards set forth under Section 5600 of the NASDAQ Stock Market Rules, except for Director Jones, who was employed by the Company until December 31, 2015, who received consulting fees in 2017, 2018, and 2019, and whose spouse is employed by the agency which sells insurance to Prime Meridian and the Bank.

There are no Compensation and Nominating Committee interlocks between the Company and any other entities associated with our executive officers and directors who serve as an executive officer or director of such other entities.

**Summary Compensation Table**

The following table provides information regarding the compensation earned by the Company's named executive officers for our fiscal years ended December 31, 2019, 2018, and 2017.

| Name and Principal Position | Year | Salary | Bonus | Stock Awards | Option Awards | All Other Compensation | | Total |
|---|---|---|---|---|---|---|---|---|
| **Sammie D. Dixon, Jr.** | 2019 | $ 326,550 | $ 26,532 | $ 78,234 | $ - | $ 85,849 | (1) | $ 517,165 |
| **CEO, President and Vice Chairman** | 2018 | 311,000 | 46,650 | 66,672 | 83,750 | 6,600 | (2) | 514,672 |
| | 2017 | 296,100 | 39,480 | - | 23,407 | 6,600 | (2) | 365,587 |
| **R. Randy Guemple (3)** | 2019 | 37,500 | - | - | - | 52,755 | (4) | 90,255 |
| **CFO and EVP** | 2018 | 182,112 | 27,317 | - | 33,500 | - | | 242,929 |
| | 2017 | 185,400 | 24,719 | - | - | - | | 210,119 |
| **Chris L. Jensen, Jr.** | 2019 | 190,618 | 18,336 | - | - | 84,858 | (1) | 293,812 |
| **EVP and Bank Senior Lender** | 2018 | 181,541 | 31,514 | - | 34,338 | 6,600 | (2) | 253,993 |
| | 2017 | 172,896 | 25,000 | - | - | 6,600 | (2) | 204,496 |
| **Susan Payner Turner** | 2019 | 175,963 | 22,079 | - | - | 8,000 | (2) | 206,042 |
| **Chief Risk Officer and EVP** | 2018 | 167,584 | 30,061 | - | 26,800 | 6,600 | (2) | 231,045 |
| | 2017 | 159,604 | 18,990 | - | - | 4,400 | (2) | 182,994 |

(1) Includes car allowance and Supplemental Executive Retirement Plan (SERP) award.
(2) Includes car allowance.
(3) Mr. Guemple retired as EVP and CFO on March 31, 2019. He remains on the Boards of both the Company and the Bank.
(4) Includes $45,000 consulting fee in addition to fees for services on the Boards of Directors and their committees.

**Employment Agreements**

On July 19, 2018, the Company and the Bank entered into an Amended and Restated Employment Agreement with Vice Chair/CEO/President Dixon. The agreement amended and restated in its entirety the Employment Agreement by and between Mr. Dixon and the Company, dated July 25, 2016.

Pursuant to the terms and conditions of the agreement, Mr. Dixon is retained as Chief Executive Officer and President of PMHG and the Bank for a period of three years, subject to an automatic extension for an additional year on each anniversary of the original expiration date of the agreement. In addition, the term of the agreement will be extended for an additional three years upon a Change in Control of the Company (as defined in the agreement). Following an extension of the term of the agreement incident to a Change in Control of the Company, the term of the agreement will be automatically extended for an additional year on each anniversary of the date of the Change in Control. Notwithstanding the foregoing, either the Company or Mr. Dixon may cause the term of the agreement to cease at the end of the then current term by giving the other written notice of not less than 60 days prior to the expiration of the then current term of the agreement. Termination of Mr. Dixon's employment for any reason shall constitute his resignation of his positions on the Boards of Directors of PMHG, the Bank, and either of their subsidiaries.

The agreement provides for Mr. Dixon to receive a base salary and automobile allowance, to be eligible to receive an annual bonus of not less than 25% of his base salary, and to participate in the Company's benefit plans. Mr. Dixon is also eligible to receive an annual equity incentive award of at least 25% of his base salary. The form of the equity award will be at the discretion of PMHG. The Bank will also establish a nonqualified account balance deferred compensation plan for the benefit of Mr. Dixon and purchase bank owned life insurance for the benefit of Mr. Dixon's designated beneficiaries.

If his employment is terminated because of death, Mr. Dixon's estate is entitled to receive accrued and earned payments or benefits due and a prorated portion of the bonus he received in his final year of employment. If Mr. Dixon's employment is terminated as a result of disability, then he is entitled to receive accrued and earned payments or benefits due and health and other insurance benefits for a period of six months following the date of termination.

If employment is terminated by the Company for reasons other than Cause (as defined in the agreement) or disability, or if Mr. Dixon terminates the agreement for Good Reason (as defined in the agreement), Mr. Dixon is entitled to receive his base salary through the date of termination, a prorated portion of the bonus he received in his final year of employment, 18 months of health and other insurance coverage, all other accrued and earned payments or benefits due, and a cash payment equal to two times the average of his base salary over the previous three years. However, if such a termination occurs during the period beginning three months prior to and ending 18 months after a Change in Control, such payment shall equal 2.99 times the sum of Mr. Dixon's then current base salary and the average bonus earned by Mr. Dixon during each of the three calendar years preceding the date of termination.

The agreement includes confidentiality provisions to protect the Company's proprietary and confidential information. The agreement also prohibits Mr. Dixon from competing with the Company during the term of the agreement and during the two-year period following termination by the Company for reasons other than Cause or disability, or termination by Mr. Dixon for Good Reason. During such period, Mr. Dixon will be prohibited from engaging in the business of banking in Gadsden, Jefferson, Leon, and Wakulla Counties, Florida and anywhere within 20 miles of a Bank branch office that is operational on the date of termination of the agreement. The agreement also restricts Mr. Dixon from soliciting certain existing and prospective customers of the Bank for a period of two years following termination of employment. In addition, during the two-year period following termination of employment, the agreement restricts Mr. Dixon from inducing any Bank employee to terminate his or her employment with the Bank or to accept employment with any other employer. The foregoing non-competition, non-solicitation, and non-recruitment provisions do not apply if Mr. Dixon's employment is terminated as a result of the expiration of the agreement or the nonrenewal of the term of the agreement.

On November 19, 2018, the Company and the Bank entered into an Employment Agreement with Executive Vice President and Senior Lender Jensen. Pursuant to the terms and conditions of the agreement, Mr. Jensen was retained as Executive Vice President and Senior Lender of the Bank for a period of three years, subject to an automatic extension for an additional year on each anniversary of the original expiration date of the agreement. In addition, the term of the agreement will be extended for an additional three years upon a Change in Control of the Company (as defined in the agreement). Following an extension of the term of the agreement incident to a Change in Control of the Company, the term of the agreement will be automatically extended for an additional year on each anniversary of the date of the Change in Control. Notwithstanding the foregoing, either the Company or Mr. Jensen may cause the term of the agreement to cease at the end of the then current term by giving the other written notice of not less than 60 days prior to the expiration of the then current term of the agreement. Termination of Mr. Jensen's employment for any reason shall constitute his resignation of his positions on the Boards of Directors of PMHG, the Bank, and either of their subsidiaries.

The agreement provides for Mr. Jensen to receive a base salary and automobile allowance, to be eligible to receive an annual bonus, and to participate in the Company's benefit plans. The Bank will also establish a nonqualified account balance deferred compensation plan for the benefit of Mr. Jensen.

If his employment is terminated because of death, Mr. Jensen's estate is entitled to receive accrued and earned payments or benefits due and a prorated portion of the bonus he received in his final year of employment. If Mr. Jensen's employment is terminated as a result of disability, then he is entitled to receive accrued and earned payments or benefits due and health and other insurance benefits for a period of twelve months following the date of termination.

If employment is terminated by the Company for reasons other than Cause (as defined in the agreement) or disability, or if Mr. Jensen terminates the agreement for Good Reason (as defined in the agreement), Mr. Jensen is entitled to receive his base salary through the date of termination, a prorated portion of the bonus he received in his final year of employment, 12 months of health and other insurance coverage, all other accrued and earned payments or benefits due, and a cash payment equal to two times the average of his base salary over the previous three years. However, if such a termination occurs during the period beginning three months prior to and ending 12 months after a Change in Control, such payment shall equal two times the sum of Mr. Jensen's then current base salary and the average bonus earned by Mr. Jensen during each of the three calendar years preceding the date of termination.

The agreement includes confidentiality provisions to protect the Company's proprietary and confidential information. The agreement also prohibits Mr. Jensen from competing with the Company during the term of the agreement and during the two-year period following termination by the Company for reasons other than Cause or disability, or termination by Mr. Jensen for Good Reason. During such period, Mr. Jensen will be prohibited from engaging in the business of banking in Gadsden, Jefferson, Leon, and Wakulla Counties, Florida and anywhere within 20 miles of a Bank branch office that is operational on the date of termination of the agreement. The agreement also restricts Mr. Jensen from soliciting certain existing and prospective customers of the Bank for a period of two years following termination of employment. In addition, during the two-year period following termination of employment, the agreement restricts Mr. Jensen from inducing any Bank employee to terminate his or her employment with the Bank or to accept employment with any other employer. The foregoing non-competition, non-solicitation, and non-recruitment provisions do not apply if Mr. Jensen's employment is terminated as a result of the expiration of the agreement or the nonrenewal of the term of the agreement.

**Defined Contribution Agreements**

On November 19, 2018, the Company and the Bank entered into Defined Contribution Agreements with Vice Chair/CEO/President Dixon and Executive Vice President and Senior Lender Jensen.

Under Mr. Dixon's agreement the Bank will, at the discretion of the Board of Directors of the Company, credit annually to a defined contribution plan an amount then determined to be sufficient to result in an account balance at the date Mr. Dixon would attain age 65 which would be sufficient to pay to Mr. Dixon at least $150,000 of annual retirement benefits for ten (10) years after his qualifying retirement. Payments under the plan shall commence upon the later of (i) Mr. Dixon attaining age 65 and (ii) the date that Mr. Dixon is no longer providing services to the Bank as an employee. All of Mr. Dixon's rights under the plan shall be subject to all other terms and conditions of that plan. If prior to Mr. Dixon reaching the age of 65: (i) the Company discharges Mr. Dixon for reasons other than cause; (ii) Mr. Dixon becomes permanently disabled; (iii) Mr. Dixon dies; or (iv) on or within 12 months following a Change in Control (as defined in the agreement) Mr. Dixon resigns, the Company shall pay to Mr. Dixon the balance of the plan. Mr. Dixon will forfeit his interest in the plan if he is terminated for cause or if grounds exist for his termination for cause.

The terms of the Defined Contribution Agreement applicable to Mr. Jensen are identical to the terms of the plan for Mr. Dixon, except that the Bank will, at the discretion of the Board of Directors of the Company, credit annually an amount then determined to be sufficient to result in an account balance at the date Mr. Jensen would attain age 67 which would be sufficient to pay to Mr. Jensen at least $50,000 of annual retirement benefits for ten (10) years after his qualifying retirement.

**Outstanding Equity Awards**

In 2015, the Board of Directors adopted the Prime Meridian Holding Company 2015 Stock Incentive Compensation Plan ("2015 Plan"), which was then approved by the shareholders at the Annual Meeting of Shareholders. The 2015 Plan replaced the 2007 Stock Option Plan ("2007 Plan"). The 2,200 unexercised stock options granted under the 2007 Plan remain outstanding and will expire under the terms of the individual stock grants.

Pursuant to the 2015 Plan, selected employees and/or directors of the Company and the Bank are eligible to receive awards of various forms of equity-based incentive compensation, including incentive and non-qualified stock options stock appreciation rights, restricted stock awards, performance units, and phantom stock, as well as awards consisting of combinations of such incentives.

During the first quarter of 2019, the Company issued 3,600 shares of restricted stock to its CEO. These shares vest over three years beginning on February 21, 2020.

In 2019, the Company issued 10,000 stock options to Director Kenneth H. Compton and 12,000 stock options to its Market President and Vice President/Business Development Officer in Lakeland, Florida. These options were issued at $20.21 per share, vest over fiver years, and expire in equal increments beginning August 1, 2025 and concluding August 1, 2029.

The 2015 Plan is administered by the Company's Compensation and Nominating Committee, which has the authority to: (i) interpret the Plan, to establish rules as deemed necessary for the implementation or maintenance of the Plan; (ii)determine grants for eligible participants under the Plan; (iii)make all other decisions or determinations required or considered appropriate for the operation of the Plan and the distribution of benefits under the Plan; and (iv) to retain professional assistance in the evaluation of director and senior executive officer compensation. Our Board of Directors has reserved to itself the right to amend or terminate the Plan. However, no amendment may be implemented without approval of the shareholders to the extent such approval is required under applicable law. Furthermore, in no case can options be re-priced either by cancellation and re-grant or by lowering the exercise price of a previously granted award.

The Company has limited the aggregate number of shares of common stock to be awarded under the 2015 Plan to 500,000 shares, but in no instance more than 15% of the issued and outstanding shares of the Company's common stock. However, the maximum number of shares available under the 2015 Plan is subject to appropriate adjustment in the case of any stock dividends, stock splits, recapitalizations, reorganizations, mergers, consolidations, exchanges, or other changes in capitalization affecting the common stock. As of December 31, 2019, there were 272,267 outstanding stock options under the 2015 Plan.

The following table provides information regarding stock options held by each of our named executive officers as of December 31, 2019. The stock options shown in the table were granted under the 2015 and 2007 Plan and have a per share exercise price equal to or greater than the fair market value of our common stock on the grant date. 2019

| | Option Awards | | | | | Stock Awards | |
|---|---|---|---|---|---|---|---|
| **Name and Principal Position** | **Date of Grant** | **# of Securities Underlying Unexercised Option (#) Exercisable** | **# of Securities Underlying Unexercised Option (#) Unexercisable** | **Option Exercise Price** | **Option Expiration Date** | **# of Shares of Stock that have not Vested** | **Market Value of Shares of Stock that have not Vested** |
| Sammie D. Dixon, Jr. | 3/7/2019 | - | - | - | - | 3,600 | $ 73,800 |
| Vice Chairman | 4/1/2018 | 5,000 | 20,000 | $ 20.09 | 4/1/2028 | - | - |
| President and CEO | 2/28/2018 | 15,667 | - | 17.21 | 2/28/2023 | - | - |
| | 2/1/2017 | 11,540 | - | 17.03 | 2/1/2022 | - | - |
| | 3/30/2015 | 2,000 | - | 12.50 | 3/30/2020 | - | - |
| R. Randy Guemple (1) | 4/1/2018 | 2,000 | 8,000 | 20.09 | 4/1/2028 | - | - |
| EVP and CFO | | | | | | | |
| Chris L. Jensen, Jr. | 4/1/2018 | 2,050 | 8,200 | 20.09 | 4/1/2028 | - | - |
| EVP and Bank Senior Lender | | | | | | | |
| Susan Payne Turner | 4/1/2018 | 1,600 | 6,400 | 20.09 | 4/1/2028 | - | - |
| EVP and CRO | | | | | | | |

(1) Mr. Guemple retired as CFO on March 31, 2019. He remains on the Boards for both the Company and the Bank.

**Director Compensation**

In 2019, Prime Meridian issued stock options to Director Kenneth H. Compton and to Market President/Director Michael A. Micallef, Jr. under the 2015 Stock Option Plan. Mr. Compton and Mr. Micallef each received a grant of 10,000 stock options. These options were issued at $20.21 per share, vest over five years, and expire in equal increments beginning August 1, 2025 and concluding August 1, 2029.

In 2019, the Bank paid its directors $825 per Board meeting attended, $165 per Board committee meeting attended, and $247.50 to chair a Board committee meeting, all of which could be paid in cash or shares of the Company's common stock, as described below. In addition, the Chairman of the Board was paid a $6,000 annual retainer in 2019. Additionally, Mrs. Jones was paid a $72,000 consultant fee in 2019 for her role as Senior Advisor, following retirement as Executive Vice President and Chief Financial Officer on December 31, 2015. Excluding compensation to Mr. Dixon, Mr, Guemple, and Mr. Jensen, the Bank paid a total of $409,658 in the aggregate of fees paid in cash and shares of stock to its directors in 2019.

In 2012, The Company's Board of Directors and shareholders adopted the Directors' Compensation Plan (the "Directors' Plan"). Pursuant to the Directors' Plan, each director is permitted to make an election to receive shares of stock instead of cash for Board or committee fees. 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 Compensation and Nominating Committee and approved by the Board. The stock to be awarded pursuant to the Directors' Plan will be valued at the closing price of a share of common stock as traded on any national market or exchange, or a price set by the Compensation and Nominating Committee and approved by the Board, 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 or quarter-end volume weighted-average market price to determine what the fair market value of the Company's common stock was for purposes of the Directors' Plan. The maximum number of remaining 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, our directors received 3,643 shares of common stock, in lieu of cash, under the Directors' Plan.

The following table sets forth the cash compensation or stock compensation paid, earned, or awarded during 2019 to each of our directors other than executive officers Mr. Dixonand Mr. Jensen, and retired executive officer Mr. Guemple whose compensation is described in the "Summary Compensation Table" on page 80.

| | Total Fees Awarded in Stock | | Stock Option Award | | Total Fees Earned | Total Value of |
|---|---|---|---|---|---|---|
| **Director** | **Cash Value** | **# of Shares** | **Cash Value** | **# of Shares** | **and Paid in Cash** | **Compensation** |
| Kenneth H. Compton | $ 4,719 | 235 | $ 27,400 | 10,000 | $ - | $ 32,119 |
| William D. Crona | - | - | - | - | 15,758 | 15,758 |
| Steven L. Evans | 14,520 | 739 | - | - | 3,630 | 18,150 |
| Kathleen C. Jones(1) | - | - | - | - | 83,880 | 83,880 |
| Robert H. Kirby | 12,161 | 614 | - | - | - | 12,161 |
| Frank L. Langston | - | - | - | - | 14,190 | 14,190 |
| Michael A. Micallef, Jr. | - | - | 27,400 | 10,000 | 132,275 (2) | 159,675 |
| L. Collins Proctor, Sr. | - | - | - | - | 15,263 | 15,263 |
| Garrison A. Rolle, M.D. | 10,346 | 523 | - | - | - | 10,346 |
| Steven D. Smith | 17,787 | 894 | - | - | - | 17,787 |
| Marjorie R. Turnbull | - | - | - | - | 11,715 | 11,715 |
| Richard A. Weidner | 12,614 | 638 | - | - | 6,000 | 18,614 |
| Total | $ 72,147 | 3,643 | $ 54,800 | 20,000 | $ 282,711 | $ 409,658 |

(1) For providing consulting services to the Bank, Kathleen C. Jones was paid a $72,000 consulting fee in addition to fees for service on the Boards of Directors and their committees.

(2) For annual Market President salary and incentive.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

**Principal Shareholders**

As of March 18, 2020 the Company knows of no beneficial owner of five percent or more of its outstanding shares of common stock, the only class of voting securities. We are not aware of any arrangements or any pledge of securities of the Company through which a change in control of the Company may result at some subsequent date. The following table sets forth the number of shares and percentages of common stock that the directors and executive officers of the Company beneficially owned as of March 18, 2020.

| Name | Number of Shares(1) | Right to Acquire(2) | Beneficial Ownership(3) |
|---|---|---|---|
| Kenneth H. Compton | 5,382 | - | 0.17% |
| William D. Crona | 48,600 | 4,000 | 1.68 |
| Sammie D. Dixon, Jr.(4) | 103,078 | 37,207 | 4.43 |
| Steve L. Evans | 30,621 | 4,000 | 1.11 |
| R. Randy Guemple | 33,830 | 4,000 | 1.21 |
| Chris L. Jensen, Jr. | 53,333 | 4,100 | 1.83 |
| Kathleen C. Jones | 17,250 | 4,000 | 0.68 |
| Robert H. Kirby(5) | 78,274 | 4,000 | 2.63 |
| Frank L. Langston | 33,106 | 4,000 | 1.19 |
| Michael A. Micallef, Jr. | 5,000 | - | 0.16 |
| L. Collins Proctor, Sr.(6)(7) | 21,800 | 5,200 | 0.86 |
| Garrison A. Rolle, M.D. | 33,094 | 4,000 | 1.18 |
| Steven D. Smith(8) | 67,517 | 4,000 | 2.28 |
| Marjorie R. Turnbull | 23,700 | 4,000 | 0.88 |
| Susan P. Turner(9) | 8,230 | 3,200 | 0.37 |
| Monte L. Ward | 4,430 | 3,200 | 0.24 |
| Clint F. Weber | 4,512 | 3,200 | 0.25 |
| Richard A. Weidner | 94,001 | 4,000 | 3.13 |
| | 665,758 | 96,107 | 23.64% |

(1) Includes shares for which the named person:

- has sole voting and investment power;
- has shared voting and investment power with a spouse, or
- holds in an IRA or other retirement plan program, unless otherwise indicated in these footnotes.

(2) Shares covered by stock options that are vested or exercisable within sixty (60) days of the Record Date.
(3) Based on 3,126,304 shares outstanding and only the listed individual exercising his or her stock options.
(4) Includes 6,235 shares of restricted stock
(5) Includes 2,500 shares owned by Mr. Kirby’s spouse, and as custodian of UGTMA/FL account.
(6) Includes 9,200 shares beneficially owned by Mr. Proctor’s spouse in her 401(k) and IRA, and as custodian of UGTMA/FL account.
(7) Includes options to acquire 1,200 shares of Company stock owned by Mr. Proctor's spouse.
(8) Includes 24,000 shares owned by Mr. Smith’s spouse.
(9) Includes 350 shares beneficially owned by Mrs. Turner as custodian of UGTMA/FL account.

**Equity Compensation Plan Information**

The following table sets forth information relating to PMHG's equity compensation plans as of December 31, 2019.

| Plan Category | Number of Securities to be issued upon exercise of outstanding Options, Warrants and Rights | Weighted-Average Exercise Price of Options, Warrants and Rights | Number of Securities Remaining Available for Issuance under Equity Compensation Plans |
|---|---|---|---|
| **Equity Compensation Plans Approved by Security Holders** | | | |
| 2007 Stock Option Plan | 2,200 | $ 12.27 | - |
| 2012 Directors' Compensation Plan(1) | - | N/A | 51,640 |
| 2015 Stock Option Plan(2) | 272,267 | 19.80 | 202,826 |
| Equity Compensation Plans Not Approved by Security Holders | N/A | N/A | N/A |
| Total | 274,467 | N/A | 254,466 |

(1) In 2019, pursuant to the Directors' Plan, the Company issued 3,643 shares of its common stock to members of the Board of Directors. The shares issued pursuant to the Directors' Plan were previously authorized but unissued shares of the common stock of the Company and the per share price at which they were awarded was based upon the greater of the book value or the weighted average market price as of the quarter-end preceding the date of grant and was not based upon a previously set exercise price.

(2) In 2019, the Company issued 10,000 stock options to Director Kenneth H. Compton, 10,000 stock options to Director Michael Micallef in Lakeland, Florida., and 2,000 stock options to its Vice President/Business Development Officer in Lakeland, FL. These options were issued at $20.21 per share, vest over five years, and expire in equal increments beginning August 1, 2025 and concluding August 1, 2029.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

**Certain Relationships and Related Transactions**

Both the Company and the Bank encourage its directors, executive officers, and their immediate family members to establish client relationships with the Bank. Loans made to directors, executive officers, and their immediate families, as well as, any principal shareholders, require approval of a majority of the disinterested directors approving the loan. All transactions between the Company or the Bank and their directors, executive officers, the immediate family members of directors and executive officers, employees, and any principal shareholders, were made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with nonaffiliated persons. In these transactions, management's opinion did not involve above average risk of collectability or present any other unfavorable features.

At December 31, 2019 and 2018, loans to directors, executive officers, and their immediate family members and affiliates represented $7.7 million and $7.3 million, respectively, or approximately 2.3% and 2.5%, respectively, of the Bank's total loan portfolio (excluding loans held for sale). All of these loans are current and performing according to their terms.

During 2019, the Company purchased various insurance policies through Earl Bacon Agency, Inc. that employs the spouse of director Kathleen C. Jones. The premiums paid totaled $1.1 million in 2019 and $739,000 in 2018 and included health insurance premiums for employees. Mr. Jones' interest in such premiums was $9,722 in 2019 and approximately $20,000 for the years 2018 and 2019, combined.

**Director Independence**

The opinion of the Board of Directors is that in 2019, each nonemployee member of the Board of Directors was an "independent director" using the standards set forth under Section 5600 of the NASDAQ Stock Market Rules, except for Director Jones, who received consulting fees in 2017, 2018, and 2019, and whose spouse is employed by the agency which sells insurance to the Company and the Bank. Pursuant to the same rules, the directors who served as employees during 2019, Mr. Dixon, Mr. Guemple, Mr. Jensen, and Mr. Micallef were not "independent directors" during the time of their respective employment.

### Item 14. Principal Accounting Fees and Services

During 2019 and 2018, the Company expensed the following fees for professional services to Hacker, Johnson & Smith:

| | 2019 | 2018 |
|---|---|---|
| Audit fees(1) | $ 44,000 | $ 40,000 |
| Tax fees(2) | 8,500 | 8,500 |
| All other fees(3) | 34,000 | 34,000 |
| | $ 86,500 | $ 82,500 |

[1] Expenses exclusively for professional services rendered for the audit of the Company's annual financial statements, including out-of-pocket expenses.
[2] Expenses exclusively for professional services rendered for preparation of state and federal tax returns and assistance with tax questions and research.
[3] Expenses exclusively for professional services rendered in relation to the Company's filing of its Form 10-Qs and Form 10-K.

The above fees were approved in accordance with the Audit Committee's policy. The *de minimus* exception (as defined in Rule 202 of the Sarbanes-Oxley Act) was not applied to any of the 2019 or 2018 total fees.

**AUDIT COMMITTEE REPORT**

The Audit Committee has reviewed and discussed the audited financial statements of the Company for the fiscal year ended December 31, 2019 with Company's management and had a discussion with the Registered Public Accounting Firm of Hacker, Johnson & Smith PA, regarding communications required pursuant to applicable auditing standards. In addition, Hacker, Johnson & Smith PA has provided the Audit Committee with the letters required by applicable requirements of the PCAOB regarding the independent auditor's communications with the Audit Committee and concerning independence. The Audit Committee has also discussed with Hacker, Johnson & Smith PA, the independent auditor's independence.

Based on these reviews and discussions, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2019.

<u>AUDIT COMMITTEE</u>
William D. Crona, Chair　　Steven L. Evans
Robert H. Kirby　　Steven D. Smith　　Marjorie R. Turnbull

## PART IV

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

**(a) 1 and 2 Financial Statements and Financial Statement Schedules**

The following financial statements and financial statement schedules are included under a separate caption "Financial Statements and Supplementary Data" in Part II, Item 8 hereof and are incorporated herein by reference.

Consolidated Balance Sheets — December 31, 2019 and 2018

Consolidated Statements of Earnings — For the Years Ended December 31, 2019 and 2018

Consolidated Statements of Comprehensive Income — For the Years Ended December 31, 2019 and 2018

Consolidated Statements of Stockholders' Equity — For the Years Ended December 31, 2019 and 2018

Consolidated Statements of Cash Flows — For the Years Ended December 31, 2019 and 2018

Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

**(a) 3 Exhibits Required by Item 601 of Regulation S-K**

| Exhibit Number | Description of Exhibit | Incorporated by Reference From or Filed Herewith |
|---|---|---|
| 3.1 | Articles of Incorporation | Exhibit 3.1 to Registration Statement on Form S-1 filed on October 18, 2013 |
| 3.2 | Bylaws | Exhibit 3.2 to Registration Statement on Form S-1 filed on October 18, 2013 |
| 3.3 | First Amendment to Bylaws dated December 17, 2016 | Exhibit 3.3 to Form 10-Q filed on August 11, 2017 |
| 3.4 | Second Amendment to Bylaws dated January 17, 2019 | Exhibit 3.4 to Form 8-K filed on January 18, 2019 |
| 4.1 | Specimen Common Stock Certificate | Exhibit 4.1 to Registration Statement on Form S-1 filed on October 18, 2013 |
| 4.2 | 2010 Articles of Share Exchange | Exhibit 4.2 to Registration Statement on Form S-1 filed on October 18, 2013 |
| 10.1 | 2007 Stock Option Plan ("2007 Plan") | Exhibit 10.1 to Registration Statement on Form S-1 filed on October 18, 2013 |
| 10.2 | Form of Non-Qualified Stock Option Agreement Under 2007 Plan | Exhibit 10.2 to Registration Statement on Form S-1 filed on October 18, 2013 |
| 10.3 | Form of Incentive Stock Option Agreement Under 2007 Plan | Exhibit 10.3 to Registration Statement on Form S-1 filed on October 18, 2013 |
| 10.4 | 2012 Directors' Compensation Plan ("Directors' Plan") | Exhibit 10.4 to Registration Statement on Form S-1 filed on October 18, 2013 |
| 10.5 | Lease for Timberlane office | Exhibit 10.1 to Registration Statement on Form S-1 filed on October 18, 2013 |
| 10.6 | Amended and Restated Employment Agreement by and between Prime Meridian Holding Company, Inc., and Prime Meridian Bank, and Sammie D. Dixon, Jr., dated as of July 19,2018 | Exhibit 10.1 to form 8-K filed on July 19, 2018 |
| 10.7 | 2015 Stock Incentive Compensation Plan | Exhibit 10.7 to Form 8-K filed on May 26, 2016 |

| Exhibit Number | Description of Exhibit | Incorporated by Reference From or Filed Herewith |
|---|---|---|
| 10.8 | First Amendment to 2015 Stock Incentive Compensation Plan | Exhibit 10.8 to Form 10-Q filed on November 10, 2017 |
| 10.9 | Employment Agreement by and between Prime Meridian Holding Company, Inc. and Prime Meridian Bank, and Chris L. Jensen, dated as of November 19, 2018 | Exhibit 10.1 to Form 8-K filed on November 20, 2018 |
| 10.10 | Defined Contribution Agreement by and among Prime Meridian Holding Company, Inc., and Prime Meridian Bank, and Sammie D. Dixon Jr., dated as of November 19, 2018 | Exhibit 10.2 to Form 8-K filed on November 20, 2018 |
| 10.11 | Defined Contribution Agreement by and among Prime Meridian Holding Company, Inc., and Prime Meridian Bank and Chris L. Jensen, Jr., Dated as of November 19, 2018 | Exhibit 10.3 to Form 8-K filed on November 20, 2018 |
| 10.12 | Amendment to Defined Contribution Agreement by and among Prime Meridian Holding Company, Inc. and Prime Meridian Bank, and Sammie D. Dixon, Jr. dated as of December 11, 2018. | Exhibit 10.1 to Form 8-K filed on December 13, 2018 |
| 10.13 | Amendment to Defined Contribution Agreement by and among Prime Meridian Holding Company, Inc. and Prime Meridian Bank, and Chris L. Jensen dated as of December 11, 2018. | Exhibit 10.2 to Form 8-K filed on December 13, 2018 |
| 10.14 | First Amendment to Lease for Timberlane Office | Exhibit 10.14 to Form 10-Q filed on May 9, 2019 |
| 14.1 | Code of Ethics | Exhibit 14.1 to Form 10-K filed on March 28, 2014 |
| 21.1 | Subsidiaries of the Registrant | Exhibit 21.1 to Registration Statement on Form S-1 filed on October 18, 2013 |
| 31.1 | Certification Under Section 302 of Sarbanes-Oxley by Sammie D. Dixon, Jr., Principal Executive Officer | Filed herewith |
| 31.2 | Certification Under Section 302 of Sarbanes-Oxley by R. Randy Guemple, Principal Financial Officer | Filed herewith |
| 32.1 | Certification by the Chief Executive Officer and the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of Sarbanes-Oxley by | Filed herewith |
| 99.1 | Charter of the Audit Committee | Exhibit 99.1 to Form 10-K filed on March 28, 2014 |
| 99.2 | Charter of the Compensation and Nominating Committee | Exhibit 99.2 to Form 10-K filed on March 21, 2017. |
| 101.INS | XBRL Instance Document | Filed herewith |
| 101.SCH | XBRL Taxonomy Extension Schema Document | Filed herewith |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | Filed herewith |
| 101.DEF | XBRL Taxonomy Extension Definitions Linkbase Document | Filed herewith |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document | Filed herewith |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | Filed herewith |

Schedules and exhibits other than those listed are omitted for the reasons that they are not required, are not applicable or that equivalent information has been included in the financial statements, and notes thereto, or elsewhere within.

**Item 16. Form 10-K Summary**

Not applicable

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**PRIME MERIDIAN HOLDING COMPANY**

Date: March 24, 2020

By: /s/ Sammie D. Dixon, Jr.
Sammie D. Dixon, Jr.
*Vice Chairman, Chief Executive Officer, President, and Principal Executive Officer*

Date: March 24, 2020

By: /s/ Clint F. Weber
Clint F. Weber
*Chief Financial Officer, Executive Vice President, Principal Financial Officer and Principal Accounting Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Name and Signature | Title | Date |
|---|---|---|
| /s/ Kenneth H. Compton<br>Kenneth H. Compton | Director | March 24. 2020 |
| /s/ William D. Crona<br>William D. Crona | Director | March 24, 2020 |
| /s/ Sammie D. Dixon<br>Sammie D. Dixon | Vice Chairman, CEO, President & Principal Executive Officer | March 24, 2020 |
| /s/ Steve L. Evans<br>Steven L. Evans | Director | March 24, 2020 |
| /s/ R. Randy Guemple<br>R. Randy Guemple | Director | March 24, 2020 |
| /s/ Chris L. Jensen, Jr.<br>Chris L. Jensen, Jr. | Director | March 24, 2020 |
| /s/ Kathleen C. Jones<br>Kathleen C. Jones | Director | March 24, 2020 |
| /s/ Robert H. Kirby<br>Robert H. Kirby | Director | March 24, 2020 |
| /s/ Frank L. Langston<br>Frank L. Langston | Director | March 24, 2020 |
| /s/ Michael A. Micallef, Jr<br>Michael A. Micallef, Jr. | Director | March 24, 2020 |
| /s/ L. Collins Proctor<br>L. Collins Proctor | Director | March 24, 2020 |
| /s/ Garrison A. Rolle<br>Garrison A. Rolle, M.D. | Director | March 24, 2020 |
| /s/ Steven D. Smith<br>Steven D. Smith | Director | March 24, 2020 |
| /s/ Marjorie R. Turnbull<br>Marjorie R. Turnbull | Director | March 24, 2020 |
| /s/ Richard A. Weidner<br>Richard A. Weidner | Chairman | March 24, 2020 |

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# Section 2: EX-31.1 (EXHIBIT 31.1)

**Exhibit 31.1**

**Certification**
**Pursuant to Section 302 of the**
**Sarbanes-Oxley Act of 2002**

I, Sammie D. Dixon, Jr., certify that:

1. I have reviewed this report on Form 10-K for the year ended December 31, 2019 of Prime Meridian Holding Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 24, 2020

/s/ Sammie D. Dixon, Jr.
Sammie D. Dixon, Jr.
*Vice Chairman, Chief Executive Officer, President, and Principal Executive Officer*

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# Section 3: EX-31.2 (EXHIBIT 31.2)

**Exhibit 31.2**

**Certification**
**Pursuant to Section 302 of the**
**Sarbanes-Oxley Act of 2002**

I, Clint F. Weber, certify that:

1. I have reviewed this report on Form 10-K for the year ended December 31, 2019 of Prime Meridian Holding Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 24, 2020

/s/ Clint F. Weber
Clint F. Weber
*Chief Financial Officer, Executive Vice President and Principal Financial Officer*

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# Section 4: EX-32.1 (EXHIBIT 32.1)

**Exhibit 32.1**

**Certification of Chief Executive Officer**
**and Chief Financial Officer**
**Pursuant to Section 906 of the**
**Sarbanes-Oxley Act of 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), the undersigned officers of Prime Meridian Holding Company (the "Company"), hereby certify that the Company's Annual Report on Form 10-K for the year ended December 31, 2019 (the "Report") fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 24, 2020

/s/ Sammie D. Dixon, Jr.
Name: Sammie D. Dixon, Jr.
Title: *Vice Chairman, Chief Executive Officer, President, and Principal Executive Officer*

Dated: March 24, 2020

/s/ Clint F. Weber
Name: Clint F. Weber
Title: *Chief Financial Officer, Executive Vice President, and Principal Financial Officer*

The foregoing certification is being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350) and is not being filed as part of the Report or as a separate disclosure document.
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