Annual Report

Fiscal Year of 2019

M&M MERCHANTS & MARINE BANCORP, INC.

mandmbank.com

Our Promise

The important things haven't changed… and they never will.

TABLE OF CONTENTS

(This page intentionally left blank)

PHONE 228 • 762 • 3311
3118 PASCAGOULA STREET
PASCAGOULA, MS 39567

M&M
MERCHANTS & MARINE
BANCORP, INC.

Fax 228 • 934 • 1346
P.O. BOX 729
PASCAGOULA, MS 39568 • 0729

March 3, 2020

Dear Shareholder:

It is our great pleasure to share an overview of your Bank's 2019 performance. As you know, our team has been working diligently over the last several years to help Merchants & Marine Bank both grow and improve in almost every way. These efforts not only continued during 2019; they accelerated.

One of our most ambitious initiatives to date was the launch of a comprehensive growth transformation project during 2019. This initiative was designed to not only yield a comprehensive assessment of our Bank, but to jumpstart immediate action to help us improve our Bank and prepare for additional growth. This project was led by a team of our best and brightest employees and was supported by a team of highly skilled bank and process consultants. The process yielded an aggressive slate of almost 300 unique recommendations for improvement throughout our Bank.

The focus of these efforts was to improve our customer service, enhance our operational efficiency, improve our profitability and position the Bank for further growth. We are incredibly proud to report that, as of December 31, 2019, over 95% of the recommendations were either Complete or In-process. While the initial list of recommendations may be fully complete at some point, the mindset of continual improvement that has taken root in our Bank will continue to pay dividends for years to come.

As you will see in the attached financial report, your Bank posted another strong performance during 2019. Net income totaled $4,150M, or $3.12 per share, for 2019. This is impressive given the significant financial investment made into the growth transformation project during 2019. These results were supported by improved loan yields, growth in the loan portfolio and controlling other noninterest expense levels. In fact, the Bank's earnings showed steady improvement during each quarter of 2019, including a return on average assets of 1.05% for the fourth quarter of 2019. We are encouraged by the progress we have seen, and plan to continue leveraging opportunities to improve the bank's performance even further.

Lastly, we are pleased to share with you that Merchants & Marine Bancorp, Inc. was recently recognized by the OTC Markets Group as a member of the "2019 50 Best List." This award recognizes MNMB as being one of the Top 50 performing stocks on the OTC Markets, based on growth in average daily volume and total return during 2019. With over 10,000 companies being traded on the OTC Markets, we are honored to have been named to such a prestigious list.

We remain committed to being best-in-class, in every respect. We are very encouraged by the positive momentum that our team has built and by the steady progress being made. We are optimistic that 2020 will be yet another strong year for your Bank.

We cordially invite you to attend our 2020 Annual Shareholder's Meeting on April 2, 2020, at 10:00 a.m. in our Pascagoula Office at 3118 Pascagoula Street, Pascagoula, Mississippi.

Thank you for your continued support and encouragement!

Sincerely,

Clayton Legear
President and
Chief Executive Officer

Royce Cumbest
Chairman of the Board

MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY

FINANCIAL HIGHLIGHTS

(In Thousands, Except Per Share Data)

	As of December 31,				
	2019	2018	2017	2016	2015
PERIOD END BALANCE SHEET					
Total assets	$ 576,106	$558,043	$ 556,705	$ 563,734	$ 562,414
Loans, net	309,648	301,801	265,113	264,002	252,931
Securities	171,420	188,245	205,678	201,614	224,832
Deposits	484,047	474,043	471,762	470,139	463,165
Stockholders' equity	77,492	71,304	70,386	67,917	66,099
AVERAGE BALANCE SHEET					
Total assets	587,797	573,293	582,183	578,947	583,719
Loans, net	312,633	286,100	263,998	258,022	236,607
Securities	172,867	197,615	204,623	210,454	245,027
Deposits	496,355	489,502	489,921	481,697	479,565
Stockholders' equity	74,865	70,844	69,152	67,121	64,781
INCOME STATEMENT					
Interest income	21,313	19,269	17,982	17,666	17,797
Interest expense	3,374	2,384	1,854	1,554	1,529
Net interest income	17,939	16,885	16,128	16,112	16,268
Provision for loan losses	905	882	818	568	336
Net interest income after provision for loan losses	17,035	16,003	15,310	15,545	15,932
Non-interest income	6,095	5,851	6,454	7,038	5,978
Non-interest expense	18,235	16,969	16,133	16,190	16,146
Net income, after tax	4,150	4,272	3,522	5,012	4,360
Cash dividends declared	1,929	1,929	1,862	1,796	1,796
PER SHARE DATA					
Net income	3.12	3.21	2.65	3.77	3.28
Cash dividends	1.45	1.45	1.40	1.35	1.35
Book value	58.25	53.60	52.91	51.05	49.69
RATIOS					
Return on average equity	5.54	6.03	5.09	7.47	6.73
Return on average assets	0.71	0.75	0.61	0.87	0.75
Capital to assets	13.45	12.78	12.64	12.05	11.75
Dividends declared as percentage of income	46.48	45.15	52.88	35.83	41.19

T. E. LOTT & COMPANY
CPAs and Business Advisors since 1926
93 YEARS
QUALITY • INTEGRITY • SERVICE • PROFESSIONALISM

T. E. Lott, CPA (1889-1971)
T. E. Lott, Jr., CPA (1936-2018)
Thomas J. Buckley, CPA
Charles M. Hawkins, CPA, CBA
Jeffry H. Read, CPA
Vivian L. Yeatman, CPA
Bobby G. Shaw, CPA, CBA
Debby H. Gray, CPA, CPC
Clayton H. Richardson, III, CPA, CVA
J. Michael Prince, CPA, CSEP
Mark A. Vickers, CPA, CVA
Stewart R. Greene, CPA
Leslie W. Wood, CPA
J. Aubrey Adair, CPA, CGMA
Robert M. Whitaker, CPA
J. H. Kennedy, Jr., CPA
Lawrence E. Wilson, CPA
S. Dale Brown, CPA, CGMA
Joshua B. Shaw, CPA, CGMA
Katherine W. Little, CPA, CSEP
Lacie B. Junkin, CPA
Michael D. Watkins, CPA
Trent F. Yeatman, CPA
Camille G. Watkins, CPA
Nataliya Winters, CPA
Joseph Iupe, CPA
Wesley Hulett, CPA

COLUMBUS
221 North Seventh St.
P. O. Box 471
Columbus, MS 39703-0471
Tel: 662.328.5387
Fax: 662.329.4993

STARKVILLE
106 B South Washington St.
P. O. Box 80282
Starkville, MS 39759-0282
Tel: 662.323.1234
Fax: 662.323.1284

TUSCALOOSA
6834 Hwy. 69 South
Tuscaloosa, AL 35405
Tel: 205.759.4195
Fax: 205.759.1018

www.telott.com
info@telott.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Merchants & Marine Bancorp, Inc.

We have audited the accompanying consolidated financial statements of Merchants & Marine Bancorp, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the Corporation's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

To the Board of Directors
Merchants & Marine Bancorp, Inc.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Merchants & Marine Bancorp, Inc. and Subsidiary as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

T.E. Lott & Company

Columbus, Mississippi
February 18, 2020

MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2019 AND 2018

ASSETS	2019	2018
Cash and due from banks	$ 49,371,493	$ 23,178,415
Time deposits due from banks	1,750,136	1,250,136
Debt securities:		
Available-for-sale, at fair value	129,264,666	130,024,163
Held-to-maturity, at amortized cost	40,959,238	57,143,083
Equity securities	1,196,190	1,077,315
Loans	312,998,515	304,848,853
Less allowance for loan losses	(3,351,015)	(3,048,219)
Loans, net	309,647,500	301,800,634
Property and equipment, net	18,232,320	16,933,811
Other real estate owned	573,313	1,095,300
Accrued income	1,956,384	2,116,875
Goodwill	2,823,554	2,823,554
Cash surrender value	16,201,146	15,679,947
Operating lease right-of-use asset	507,930	-
Other assets	3,622,057	4,919,838
Total Assets	$ 576,105,927	$ 558,043,071
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Non-interest bearing demand	$ 103,497,250	$ 102,112,668
Interest bearing	380,550,215	371,930,797
Total deposits	484,047,465	474,043,465
Securities sold under agreements to repurchase	5,619,877	3,816,634
Operating lease liability	507,930	-
Accrued expenses and other liabilities	8,438,473	8,879,368
Total liabilities	498,613,745	486,739,467
STOCKHOLDERS' EQUITY		
Common stock- $2.50 par value per share, 5,000,000 shares authorized, 1,330,338 shares issued and outstanding	3,325,845	3,325,845
Surplus	14,500,000	14,500,000
Retained earnings	63,752,454	61,531,628
Accumulated other comprehensive loss	(4,086,117)	(8,053,869)
Total stockholders' equity	77,492,182	71,303,604
Total Liabilities and Stockholders' Equity	$ 576,105,927	$ 558,043,071

The accompanying notes are an integral part of these balance sheets.

MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	2019	2018
INTEREST INCOME		
Interest and fees on loans	$ 16,598,772	$ 14,372,919
Interest on investment securities:		
Taxable	2,263,483	2,577,282
Exempt	1,441,900	1,742,610
Interest on federal funds sold	816,656	527,641
Other interest income	192,274	48,570
Total interest income	21,313,085	19,269,022
INTEREST EXPENSE		
Interest on deposits	3,368,208	2,366,890
Interest on federal funds purchased and securities sold under agreements to repurchase	5,598	17,175
Total interest expense	3,373,806	2,384,065
Net interest income	17,939,279	16,884,957
Provision for loan losses	904,776	882,276
Net interest income after provision for loan losses	17,034,503	16,002,681
NON-INTEREST INCOME		
Service charges on deposit accounts	3,044,751	3,317,192
Other service charges, commissions and fees	1,854,171	1,835,986
Gain (loss) on sale of securities, net	(215,147)	1,333
Gain on sale of other real estate owned	230,049	37,904
Income from bank owned life insurance, net of premiums	467,552	452,938
Bank Enterprise Award	478,791	55,969
Other	234,624	149,461
Total non-interest income	6,094,791	5,850,783

(Continued)

The accompanying notes are an integral part of these statements.

MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	2019	2018
NON-INTEREST EXPENSE		
Salaries and employee benefits	$ 9,206,750	$ 8,703,416
Occupancy expense	3,768,238	3,270,190
Regulatory assessments	120,863	208,689
Professional fees	1,142,975	617,069
Director and committee expenses	623,551	714,897
Other	3,372,339	3,454,488
Total non-interest expense	18,234,716	16,968,749
Income before income taxes	4,894,578	4,884,715
Income taxes	744,762	612,699
Net income	$ 4,149,816	$ 4,272,016
Net income per common share	$ 3.12	$ 3.21

The accompanying notes are an integral part of these statements.

MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	2019	2018
Net income	$ 4,149,816	$ 4,272,016
Other comprehensive income (loss):		
Unrealized gains (losses) on securities:		
Unrealized holding gains (losses) arising during the period	4,310,631	(1,415,599)
Less reclassification adjustment for (gains) losses included in net income	215,147	(1,333)
	4,525,778	(1,416,932)
Defined benefit pension plans:		
Net gain (loss) arising during the period	761,034	(519,313)
Income tax benefit (expense)	(1,319,060)	511,194
Other comprehensive income (loss)	3,967,752	(1,425,051)
Comprehensive income	$ 8,117,568	$ 2,846,965

The accompanying notes are an integral part of these statements.

MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	Common Stock				Accumulated Other Comprehensive Loss	
	Shares Issued	Amount	Surplus	Retained Earnings		Total
Balance, January 1, 2018	1,330,338	$3,325,845	$14,500,000	$59,075,970	$ (6,516,186)	$70,385,629
Net income	-	-	-	4,272,016	-	4,272,016
Cash dividends, $1.45 per share	-	-	-	(1,928,990)	-	(1,928,990)
Other comprehensive loss	-	-	-	-	(1,425,051)	(1,425,051)
Reclassification for implementation of ASU 2016-01	-	-	-	112,632	(112,632)	-
Balance, December 31, 2018	1,330,338	3,325,845	14,500,000	61,531,628	(8,053,869)	71,303,604
Net income	-	-	-	4,149,816	-	4,149,816
Cash dividends, $1.45 per share	-	-	-	(1,928,990)	-	(1,928,990)
Other comprehensive income	-	-	-	-	3,967,752	3,967,752
Balance, December 31, 2019	1,330,338	$3,325,845	$14,500,000	$63,752,454	$ (4,086,117)	$77,492,182

The accompanying notes are an integral part of these statements.

MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 4,149,816	$ 4,272,016
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,224,039	1,059,535
Provision for loan losses	904,776	882,276
FHLB stock dividend	(20,100)	(13,700)
Deferred income tax (benefit) expense	(49,000)	93,000
Increase in cash value of life insurance	(521,199)	(529,879)
Write-downs of real estate owned	13,167	85,003
Amortization of securities premium/discount	998,932	1,068,780
Amortization of operating lease right-of-use asset	48,523	-
Loss on sale of bank property	16,338	-
Gain on sale of other real estate	(230,049)	(37,904)
Loss on sale of securities available-for-sale	222,794	-
Gain on sale of securities held-to-maturity	(7,647)	(1,333)
(Increase) decrease in fair value of equity securities	(98,775)	-
(Increase) decrease in accrued income	160,491	(117,837)
Increase (decrease) in accrued expenses and other liabilities	29,767	(164,827)
(Increase) decrease in other assets	27,721	61,347
Net decrease in accrued pension liability	(470,662)	(185,343)
Net change in operating lease liability	(48,523)	-
Other, net	761,034	(519,313)
Net cash provided by operating activities	7,111,443	5,951,821
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of securities available-for-sale	49,530,721	10,751,604
Purchases of securities available-for-sale	(45,121,144)	(3,768,091)
Proceeds from sale and maturities of securities held-to-maturity	15,845,464	7,152,187
Proceeds from sales and maturities of other securities	-	100,800
Purchases of other securities	-	(319,255)
Net increase in loans	(9,026,239)	(37,589,217)
(Increase) decrease in time deposits due from banks	(500,000)	248,874
Proceeds from sale of bank property	54,955	-
Purchases of property and equipment	(2,593,841)	(3,221,666)
Proceeds from sale of other real estate	1,013,466	910,324
Net cash provided by (used in) investing activities	9,203,382	(25,734,440)

(Continued)

The accompanying notes are an integral part of these statements.

MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	2019	2018
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	$ 10,004,000	$ 2,281,617
Net increase (decrease) in securities sold under agreements to repurchase	1,803,243	(1,399,212)
Dividends paid	(1,928,990)	(1,928,990)
Net cash provided by (used in) financing activities	9,878,253	(1,046,585)
Net increase (decrease) in cash and cash equivalents	26,193,078	(20,829,204)
Cash and cash equivalents, beginning of year	23,178,415	44,007,619
Cash and cash equivalents, end of year	$ 49,371,493	$ 23,178,415

Supplemental Disclosures of Cash Flow Information

	2019	2018
Cash paid during the year for:		
Interest	$ 3,265,346	$ 2,348,847
Income taxes	499,622	621,374
Non-cash activities:		
Transfer of loans to other real estate	274,597	19,320
Initial recognition of operating lease right-of-use asset	556,453	-
Initial recognition of operating lease liability	556,453	-

The accompanying notes are an integral part of these statements.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Merchants & Marine Bancorp, Inc. (the "Bancorp") and its wholly-owned subsidiary, Merchants & Marine Bank (the "Bank") follow accounting principles generally accepted in the United States of America and, where applicable, general practices within the banking industry.

1. Nature of Operations

The Bancorp is a bank holding company and its principal activity is the ownership and management of the Bank. The Bancorp is subject to regulation by the Federal Reserve Bank. The Bank generates commercial, mortgage and consumer loans and receives deposits from customers located in Jackson and George Counties in Mississippi and Baldwin County in Alabama. The Bank operates under a state bank charter and provides full banking services. The Bank is subject to regulation by federal and state banking regulators.

The Bank's goal is to offer all the products and services of the larger banks and multi-bank holding corporations, while maintaining the personalized, local service of a community bank.

2. Basis of Consolidation

The consolidated financial statements include the accounts of the Bancorp, the Bank, and M & M Real Estate Bank Securities Corporation, a wholly-owned subsidiary of the Bank, after elimination of all material intercompany transactions and balances.

3. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The determination of the allowance for loan losses is a material estimate that is particularly subject to significant change in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3. Use of Estimates (Continued)

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bank to recognize additional losses based on their judgments about information available to them at the time of their examination. Due to these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

4. Cash and Cash Equivalents

For the purpose of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-earning balances with banks with an original maturity less than ninety days and federal funds sold.

5. Securities

Securities have been classified into one of three categories: trading, held-to-maturity or available-for-sale. Management determines the appropriate classification of debt and equity securities at the time of purchase and re-evaluates this classification periodically. Trading account securities are held for resale in anticipation of short-term market movements. Debt securities are classified as held-to-maturity when management has the positive intent and ability to hold the securities to maturity. Securities not classified as held-to-maturity or trading are classified as available-for-sale. The Bank had no trading securities during the periods ended December 31, 2019 and 2018. Held-to-maturity securities are stated at amortized cost. Debt securities available-for-sale are stated at fair value, with unrealized gains and losses, net of income taxes, reported in accumulated other comprehensive income (loss) as a separate component of stockholders' equity, until realized. Marketable equity securities are recorded at fair value, with unrealized gain and losses reported in net income.

The amortized cost of each debt security classified as held-to-maturity or available-for-sale is adjusted for amortization of premiums and accretion of discounts to maturity over the estimated life of the security. Amortization, accretion and accrued interest are included in interest on investment securities. Realized gains and losses and declines in fair value judged to be other-than-temporary are included in net security gains (losses). Gains and losses on the sale of securities available-for-sale are determined using the specific identification method.

The Bank also holds non-marketable securities. These securities are restricted and do not have readily determinable fair values. These securities are carried at their acquisition cost and are accounted for by the cost method.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

6. Loans

Loans are stated at the amount of unpaid principal. Interest on commercial and real estate mortgage loans is accrued and credited to income based on the principal amount outstanding. Income on installment loans is credited to income based on a method that approximates the interest method. Generally, the accrual of interest on loans is discontinued once the loan reaches 90 days past due unless the credit is well secured and in the process of collection. Upon such discontinuance, all unpaid accrued interest is reversed, and payments subsequently received are applied first to principal. Interest income is recorded after principal has been satisfied and as payments are received. Loans are returned to accrual status when all principal and interest contractually due are brought current and future amounts are reasonably assured.

Direct loan costs and related loan origination fees are recognized currently as period costs and income, respectively, and do not vary materially from the results that would be recorded using the deferral method prescribed by ASC Topic 310, *Receivables.*

7. Allowance for Loan Losses

The allowance for loan losses is maintained at a level which, in management’s judgment, is adequate to absorb credit losses inherent in the loan portfolio. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to expense. Loan losses are charged against the allowance when management believes the remaining loan balance will go uncollected. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility 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 two components, which are discussed in further detail at Note D.

8. Property and Equipment, Net

Property and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed by the straight-line method over the estimated useful lives of the related assets. Leasehold improvements are amortized over the shorter of the term of the lease or the asset's useful life.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

8. Property and Equipment, Net (continued)

We lease a branch facility in Fairhope, Alabama under an operating lease. We also own certain properties which we lease to outside parties under operating lessor leases; however, such leases are not significant In 2019, we adopted certain accounting standard updates related to accounting for leases as further discussed below. Under the new standards, for operating leases other than those considered to be short-term, we recognize lease right-of-use assets and related lease liabilities. We do not recognize short-term operating leases on our balance sheet. A short-term operating lease has an original term of 12 months or less and does not have a purchase option that is likely to be exercised.

In recognizing lease right-of-use assets and related lease liabilities, we account for lease and non-lease components (such as taxes, insurance, and common area maintenance costs) separately, as such amounts are generally readily determinable under our lease contracts. Lease payments over the expected term are discounted using our incremental borrowing rate referenced to the Federal Home Loan Bank Secure Connect advance rates for borrowings of similar term. We also consider renewal and termination options in the determination of the term of the lease. If it is reasonably certain that a renewal or termination option will be exercised, the effects of such options are included in the determination of the expected lease term. Generally, we cannot be reasonably certain about whether or not we will renew a lease until such time the lease is within the last two years of the existing lease term. However, renewal options are evaluated on a case-by-case basis, typically in advance of such time frame. When we are reasonably certain that a renewal option will be exercised, we measure/remeasure the right-of-use asset and related lease liability using the lease payments specified for the renewal period or, if such amounts are unspecified, we generally assume an increase (evaluated on a case-by-case basis in light of prevailing market conditions) in the lease payment over the final period of the existing lease term.

9. Other Real Estate Owned

Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at the lower of cost or fair value, less estimated selling costs, at the date of foreclosure. Fair value is based primarily on independent appraisals and other relevant factors. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost or fair value, less cost to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed and included in non-interest expense. The portion of interest costs relating to development of real estate is capitalized.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

10. Goodwill

Goodwill represents costs in excess of the fair value of net assets acquired in connection with business combinations accounted for under the acquisition method. In accordance with ASC Topic 350, *Intangibles – Goodwill & Other,* the goodwill impairment test consists of a two-step process, if necessary. However, the Bank first assesses qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in ASC Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. If, after assessing the totality of events or circumstances, the Bank determines that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary and goodwill is considered to be unimpaired. However, if based on the qualitative assessment it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the two-step process is performed. Based on the qualitative assessment as described above, no impairment charges were recognized.

11. Advertising Expense

The Bank expenses advertising costs as they are incurred. Advertising expenses amounted to $220,947 and $223,689 in 2019 and 2018, respectively.

12. Income Taxes

Provisions for income taxes are based on taxes payable or refundable for the current year (after exclusion of non-taxable income such as interest on state and municipal securities) and deferred taxes on temporary differences between the amount of taxable and pretax financial income and between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred taxes on temporary differences are calculated at the currently enacted tax rates applicable to the period in which the deferred tax assets, liabilities, income or expense are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

13. Comprehensive Income

Comprehensive income includes net income and other comprehensive income (loss) items which include unrealized gains and losses on debt securities available-for-sale and the gains or losses and prior service cost or credits that arise during the period related to the defined benefit pension plan but are not recognized as components of net periodic benefit cost. All items of comprehensive income (loss) are stated net of tax.

14. Fair Value Measurements

The Bank records fair value measurements using a specified hierarchy of valuation techniques based upon whether the inputs to those valuation techniques reflect assumptions other market participants would use based upon market data obtained from independent sources (observable inputs). The following summarizes the fair value hierarchy:

Level 1: Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2: Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Bank uses observable market data, when available, in making fair value measurements. When inputs used to measure fair value fall within different levels of the hierarchy, the level within the fair value measurement is categorized based on the lowest level input that is significant to the fair value measurements. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

15. Bank Owned Life Insurance

The Bank invests in bank owned life insurance (BOLI). BOLI involves the purchasing of life insurance on a chosen number of directors and officers. The Bank is the owner of the policies, and the cash surrender value of the policies is included as an asset in the consolidated balance sheets.

16. Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Bank enters into off-balance sheet financial instruments consisting of commitments to extend credit, credit card lines, commercial letters of credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they are exercised.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

17. Revenue from Contracts with Customers

The Bank records revenue from contracts with customers in accordance with ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. Under Topic 606, the Bank must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when, or as, the Bank satisfies a performance obligation. Significant revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous periods.

The Bank's primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of Topic 606. The Bank has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. The Bank generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are fixed, the Bank has made no significant judgments in applying the revenue guidance prescribed in ASC 606 that affect the determination of the amount and timing of revenue from contracts with customers.

18. Recent Accounting Pronouncements

In December 2019, the FASB issued ASU 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*, which simplifies the accounting for income taxes by removing certain exceptions to the general principles in Topic 740. The amendments also improve consistent application of and simplifies GAAP for other areas of Topic 740 by clarifying and amending existing guidance. The amendments in this Update are effective for fiscal years, and interim periods with those fiscal years, beginning after December 15, 2020, with early adopting permitted. The Bancorp is currently assessing the impact of the adoption of this standard on the Bancorp's consolidated financial position.

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*, which removes certain disclosures required by Topic 820 related to transfers between Level 1 and Level 2 of the fair value hierarchy; the policy for timing of transfers between levels; the valuation processes for Level 3 fair value measurements; and, for nonpublic entities, the changes in unrealized gains and losses for the period included in earnings for recurring Level 3 fair value measurements held at the end of the reporting period. The ASU modifies certain disclosures required by Topic 820 related to disclosure of transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities for nonpublic entities; the requirement to disclose the timing of liquidation of an investee's assets and the date when restrictions from redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly for investments in certain entities that calculate net asset

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

18. Recent Accounting Pronouncements (Continued)

value; and clarification that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date. The ASU adds certain disclosure requirements related to changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of insignificant unobservable inputs used to develop Level 3 fair value measurements. For certain unobservable inputs, an entity may disclose other quantitative information in lieu of the weighted average if the entity determines that other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements. The amendments in this update become effective for fiscal years, and interim periods within those fiscal years beginning after December 15, 2019, with early adoption permitted. The adoption of this update is not expected to have a material impact on the Bancorp's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04*, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.* This update is intended to amend existing guidance to simplify subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. The amendments require an entity to perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognizing an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, not to exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. For public business entities, which are not SEC filers, the amendments in this update are effective for fiscal years beginning after December 15, 2020. The adoption of this standard is not expected to have a material impact on the Bancorp's consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* This update was intended to provide financial statement users with more decision - useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this update replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments affect entities holding financial assets and net investments in leases that are not accounted for at fair value through net income. The amendments affect loans, debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. The amendments in this update are effective for fiscal years beginning after December 15, 2022. The Bancorp is currently assessing the impact of the adoption of this standard on the Bancorp's consolidated financial position.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

19. Adoption of New Accounting Standards

ASU 2016-02 "*Leases (Topic 842)*" ("ASU 2016-02") requires lessees and lessors recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements. ASU 2016-02 was effective for the Bancorp on January 1, 2019. ASU 2016-02 provides for a modified retrospective transition approach requiring lessees to recognize and measure leases on the balance sheet at the beginning of either the earliest period presented or as of the beginning of the period of adoption with the option to elect certain practical expedients. The Bancorp has elected to apply ASU 2016-02 as of the beginning of the period of adoption (January I, 2019) and has not restated comparative periods. Of the optional practical expedients available under ASU 2016-02, all that apply have been adopted.

The Bancorp's operating leases relate primarily to branch properties and related equipment. As a result of implementing ASU 2016-02, the Bancorp recognized an operating lease right-of-use ("ROU") asset and an operating lease liability of $556,453 on January 1, 2019, with no impact on our consolidated statements of income or consolidated statements of cash flows compared to the prior lease accounting model. See Note P – Operating Leases for additional information.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606).* This update requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU replaces most existing revenue recognition guidance in GAAP. The new standard was effective for the Bank on January 1, 2019. Adoption of ASU 2014-09 did not have a material impact on the Bank's consolidated financial statements and related disclosures as the Bank's primary sources of revenues are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of ASU 2014-09. The Bank's revenue recognition pattern for revenue streams within the scope of ASU 2014-09, including but not limited to service charges on deposit accounts and gains/losses on the sale of OREO, did not change significantly from current practice. The standard permits the use of either the full retrospective or modified retrospective transition method. The Bank elected to use the modified retrospective transition method which requires application of ASU 2014-09 to uncompleted contracts at the date of adoption however, periods prior to the date of adoption will not be retrospectively revised as the impact of the ASU on uncompleted contracts at the date of adoption was not material.

NOTE B - SECURITIES

The amortized cost, gross unrealized gains, gross unrealized losses and estimated fair value of available-for-sale and held-to-maturity securities are as follows (In thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2019				
Available-for-sale:				
U. S. Government agency funds	$ 38,799	$ -	$ 208	$ 38,591
Mortgage-backed securities	81,055	414	251	81,218
State, county and municipal securities	9,286	185	15	9,456
Total	$ 129,140	$ 599	$ 474	$ 129,265
Held-to-maturity:				
State, county and municipal securities	$ 40,959	$ 675	$ 132	$ 41,502
Total	$ 40,959	$ 675	$ 132	$ 41,502
December 31, 2018				
Available-for-sale:				
U. S. Government agency funds	$ 55,944	$ -	$ 2,085	$ 53,859
Mortgage-backed securities	68,035	-	1,970	66,065
State, county and municipal securities	10,448	5	353	10,100
Total	$ 134,427	$ 5	$ 4,408	$ 130,024
Held-to-maturity:				
State, county and municipal securities	$ 57,143	$ 190	$ 794	$ 56,539
Total	$ 57,143	$ 190	$ 794	$ 56,539

NOTE B - SECURITIES (Continued)

The amortized cost and estimated fair value of securities held-to-maturity and available-for-sale at December 31, 2019, by contractual maturity are as follows (In thousands):

	Available-For-Sale		Held-To-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Amounts maturing in:				
One year or less	$ -	$ -	$ 4,971	$ 4,982
After one year through five years	39,813	39,614	6,065	6,133
After five years through ten years	3,386	3,430	16,179	16,337
Greater than ten years	4,886	5,003	13,744	14,050
Mortgage-backed securities	81,055	81,218	-	-
Total	$ 129,140	$ 129,265	$ 40,959	$ 41,502

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds from sales of available-for-sale securities were $49,530,721 in 2019, including a realized loss of $222,794. Proceeds from sales of available-for-sale securities were $10,751,604 in 2018, with no realized gain or loss. The amortized cost of held-to-maturity securities that were sold in 2019 was $1,483,230. There was a realized gain in the amount $7,647 from the sale of held-to-maturity securities in 2019. The amortized cost of held-to-maturity securities that were sold in 2018 was $1,357,872. There was a realized gain in the amount $1,333 from the sale of held-to-maturity securities in 2018. The held-to-maturity securities were sold based on proximity of call date for 2019 and an evaluation of each security's credit rating for 2019.

Securities with a carrying value of $128,809,417 and $135,756,132 were pledged at December 31, 2019 and 2018, respectively, to secure certain deposits. Information pertaining to securities with gross unrealized losses at December 31, 2019 and 2018, aggregated by investment category and length of time that individual securities have been in a continuous loss position follows (In thousands):

	Less Than 12 Months		12 Months Or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2019:						
U.S. Government Agency Funds	$ 22,170	$ 133	$ 13,421	$ 75	$ 35,591	$ 208
Mortgage-backed securities	29,297	210	2,876	41	32,173	251
State, county and municipal securities	1,419	6	1,346	141	2,765	147
Total	$ 52,886	$ 349	$ 17,643	$ 257	$ 70,529	$ 606

NOTE B - SECURITIES (Continued)

	Less Than 12 Months		12 Months Or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2018:						
U.S. Government Agency Funds	$ -	$ -	$ 53,859	$ 2,085	$ 53,859	$ 2,085
Mortgage-backed securities	-	-	66,065	1,970	66,065	1,970
State, county and municipal securities	7,019	281	30,776	866	37,795	1,147
Total	$ 7,019	$ 281	$ 150,700	$ 4,921	$157,719	$ 5,202

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and to 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 Bank to retain its investments in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

As of December 31, 2019, approximately 15.90% of the number of securities in the investment portfolio reflected an unrealized loss. Management is of the opinion the Bank has the ability to hold these securities until such time as the value recovers or the securities mature. Management also believes the deterioration in value is attributable to changes in market interest rates and not to the credit quality of the Issuer.

At December 31, 2019, the thirty-one debt securities with unrealized losses have declined .85% from the amortized cost basis. These unrealized losses relate principally to current interest rates for similar types of securities and not credit quality. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer's financial condition. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other-than-temporary.

The Bank holds equity securities, which include Federal Home Loan Bank stock, recorded at cost of $875,360 and $855,260 as of December 31, 2019 and 2018, respectively. Equity securities also include VISA Class B stock recorded at fair market value of $320,830 and $222,055 at December 31, 2019 and 2018, respectively, in accordance with ASU 2016-01. The change in accounting principle resulted in a reclassification in 2018, net after-tax unrealized gains from accumulated other comprehensive income to retained earnings.

NOTE B - SECURITIES (Continued)

The Bank also holds non-marketable equity securities. These securities are restricted and do not have readily determinable market values. These securities are carried at their acquisition cost and are accounted for by the cost method. Additionally, FNBB, Inc. equity investment of $932,400, was reclassified from Equity securities to Other assets in 2018 in accordance with ASU 2016-01, which was adopted prospectively as allowed by the standard.

NOTE C - LOANS

The following table shows the composition of the loan portfolio by category:

	December 31, 2019		December 31, 2018	
	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)		(Dollars in thousands)	
Loans secured by real estate:				
Construction	$ 29,286	9.36%	$ 19,336	6.34%
Farmland	852	.27%	916	.30%
Revolving, open and secured 1-4	5,814	1.86%	3,564	1.17%
1-4 Family residential property	78,962	25.23%	84,426	27.69%
Multifamily (5 or more) residential properties	2,117	.68%	2,089	.69%
Nonfarm non-residential properties	126,341	40.36%	127,299	41.76%
Commercial and industrial loans	35,837	11.45%	32,887	10.79%
Loans to individuals for personal expenditures	28,748	9.18%	29,099	9.55%
Municipal and government	4,559	1.46%	4,694	1.54%
Other	483	.15%	539	.17%
	312,999	100.00%	304,849	100.00%
Allowance for loan losses	(3,351)		(3,048)	
Net loans	$ 309,648		$ 301,801	

The Bank primarily grants commercial, residential and consumer loans to customers within its market area and immediate surrounding areas, all of which are affected by the general economic conditions of the area. Although the Bank regularly reviews the diversification of the loan portfolio to avoid concentrations of credit risk, the overall quality of the portfolio and the borrowers' ability to repay the loans are to an extent affected by the local economy.

NOTE D - ALLOWANCE FOR LOAN LOSSES

The Bank has developed policies and procedures for evaluating the overall quality of its credit portfolio and the timely identification of potential problem loans. Management's judgment as to the adequacy of the allowance is based upon a number of assumptions which it believes to be reasonable, but which may not prove to be accurate. Thus, there can be no assurance that charge-offs in future periods will not exceed the allowance for loan losses or that additional increases in the loan loss allowance will not be required.

The Bank's allowance consists of two components. The first component is determined in accordance with authoritative guidance regarding contingencies. The Bank's determination of this component of the allowance is based upon quantitative and qualitative factors. A loan loss history based upon the five year quarterly moving average is utilized in determining the appropriate allowance. These historical loss factors are applied to the loans by loan type to determine an indicated allowance. The historical loss factors may also be modified based upon other qualitative factors including, but not limited to, local and national economic conditions, trends of delinquent loans and management's knowledge of the loan portfolio. These factors require judgment upon the part of management and are based upon state and national economic reports received from various institutions and agencies including the Federal Reserve Bank, United States Bureau of Economic Analysis, Bureau of Labor Statistics, meetings with the Bank's loan officers and loan committee, and data and guidance received or obtained from the Bank's regulatory authorities.

The second component of the allowance is determined in accordance with authoritative guidance regarding loan impairment. Impaired loans are determined based upon a review by internal loan review and senior loan officers.

A loan is considered impaired 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. 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, and a specific allowance is assigned to each loan determined to be impaired. Impaired loans not deemed collateral dependent are analyzed according to the ultimate repayment source, whether that is cash flow from the borrower, guarantor or some other source of repayment. Impaired loans are deemed collateral dependent if, in the Bank's opinion, the ultimate source of repayment will be generated from the liquidation of collateral.

NOTE D - ALLOWANCE FOR LOAN LOSSES (Continued)

Risk characteristics applicable to each segment of the loan portfolio are described as follows:

Residential Real Estate: The residential real estate loan portfolio consists of residential loans for single and multifamily properties. Residential loans are generally secured by owner occupied 1-4 family residences. Repayment of these loans is primarily dependent on the personal income and credit rating of the borrowers. Credit risk in these loans can be impacted by economic conditions within the Bank's market areas that might impact either property values or a borrower's personal income. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

Nonresidential Real Estate: Nonresidential real estate loans typically involve larger principal amounts, and repayment of these loans is generally dependent on the successful operations of the property securing the loan or the business conducted on the property securing the loan. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Credit risk in these loans may be impacted by the creditworthiness of a borrower, property values and the local economies in the Bank's market areas.

Consumer: The consumer loan portfolio consists of various term and line-of-credit loans such as automobile loans and loans for other personal purposes. Repayment for these types of loans will come from a borrower's income sources that are typically independent of the loan purpose. Credit risk is driven by consumer economic factors (such as unemployment and general economic conditions in the Bank's market area) and the creditworthiness of a borrower.

Commercial and other: The commercial portfolio includes loans to commercial customers for use in financing working capital needs, equipment purchases and expansions. The loans in this category are repaid primarily from the cash flow of a borrower's principal business operation. Credit risk in these loans is driven by creditworthiness of a borrower and the economic conditions that impact the cash flow stability from business operations.

The sum of the two parts constitutes management's best estimate of an appropriate allowance for loan losses. When the estimated allowance is determined, it is presented to the Bank's board of directors for review and approval on a quarterly basis.

MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2019 AND 2018

NOTE D - ALLOWANCE FOR LOAN LOSSES (Continued)

Activity in the allowance for loan losses for the years was as follows:

(In thousands)

	Beginning Balance	Charge offs	Recoveries	Provisions for Loan Losses	Ending Balance
Year Ended December 31, 2019					
Residential	$ 1,171	$ (247)	$ 37	$ 226	$ 1,187
Non-Residential	1,016	-	-	142	1,158
Consumer	407	(555)	242	217	311
Commercial	158	(94)	15	342	421
Other	296	-	-	(22)	274
	$ 3,048	$ (896)	$ 294	$ 905	$ 3,351
Year Ended December 31, 2018					
Residential	$ 997	$ (76)	$ 26	$ 224	$ 1,171
Non-Residential	829	-	-	187	1,016
Consumer	373	(488)	226	296	407
Commercial	153	(13)	13	5	158
Other	126	-	-	170	296
	$ 2,478	$ (577)	$ 265	$ 882	$ 3,048

NOTE D - ALLOWANCE FOR LOAN LOSSES (Continued)

The following table represents the Bank's impaired loans at December 31, 2019 and 2018. This table excludes performing troubled debt restructurings.

	December 31, 2019	December 31, 2018
	(In thousands)	
Impaired loans:		
Impaired loans without a valuation allowance	$ 7,824	$ 4,587
Impaired loans with a valuation allowance	1,040	1,198
Total impaired loans	8,864	5,785
Allowance for loan losses on impaired loans at period end	496	396
Total nonaccrual loans	6,351	5,477
Average investment in impaired loans	7,327	5,564

The gross interest income that would have been recorded in the year, if the nonaccrual loans at December 31, 2019 and 2018, had been current in accordance with their original terms and had been outstanding throughout the year or since origination, if held for part of the years ended for December 31, 2019 and 2018, was $236,781 and $186,798, respectively. The Bank had no loan commitments to borrowers in non-accrual status at December 31, 2019.

NOTE D - ALLOWANCE FOR LOAN LOSSES (Continued)

The following table provides the ending balances in the Bank's recorded investment in loans and allowance for loan losses, broken down by portfolio segment as of December 31, 2019 and 2018. The table also provides additional detail as to the amount of the Bank's loans and allowance that correspond to individual versus collective impairment evaluation. The impairment evaluation corresponds to the Bank's systematic methodology for estimating its allowance for loan losses.

	Residential	Non-Residential	Consumer	Commercial	Other	Total
			(In thousands)			
December 31, 2019						
Loans:						
Individually evaluated	$ 5,398	$ 3,066	$ -	$ 400	$ -	$ 8,864
Collectively evaluated	110,781	124,127	28,748	39,996	483	304,135
Total	$ 116,179	$ 127,193	$ 28,748	$ 40,396	$ 483	$ 312,999
% of Total	37.12%	40.64%	9.18%	12.91%	.15%	100.00%
Allowance for Loan Losses:						
Individually evaluated	$ 110	$ 176	$ -	$ 210	$ -	$ 496
Collectively evaluated	1,077	982	311	211	274	2,855
Total	$ 1,187	$ 1,158	$ 311	$ 421	$ 274	$ 3,351
% of Total	35.42%	34.56%	9.28%	12.56%	8.18%	100.00%

NOTE D - ALLOWANCE FOR LOAN LOSSES (Continued)

	Residential	Non-Residential	Consumer	Commercial	Other	Total
			(In thousands)			
December 31, 2018						
Loans:						
Individually evaluated	$ 4,532	$ 1,157	$ 96	$ -	$ -	$ 5,785
Collectively evaluated	104,883	127,058	29,003	37,581	539	299,064
Total	$ 109,415	$ 128,215	$ 29,099	$ 37,581	$ 539	$ 304,849
% of Total	35.9%	42.1%	9.5%	12.3%	.2%	100.0%
Allowance for Loan Losses:						
Individually evaluated	$ 200	$ 146	$ 50	$ -	$ -	$ 396
Collectively evaluated	971	870	357	158	296	2,652
Total	$ 1,171	$ 1,016	$ 407	$ 158	$ 296	$ 3,048
% of Total	38.4%	33.3%	13.4%	5.2%	9.7%	100.0%

NOTE D - ALLOWANCE FOR LOAN LOSSES (Continued)

The following table provides additional detail of impaired loans broken out according to class as of December 31, 2019 and 2018. The recorded investment included in the following tables represents customer balances, plus accrued interest, net of any partial charge-offs recognized on the loans, and net of any deferred fees and costs. The unpaid balance represents the recorded balance prior to any partial charge-offs.

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment YTD	Interest Income Recognized YTD
			(In thousands)		
December 31, 2019:					
Impaired loans with no related allowance:					
Residential real estate	$ 4,958	$ 5,892	$ -	$ 4,431	$ 235
Non-residential real estate	2,679	2,675	-	1,659	98
Consumer	-	-	-	23	-
Commercial	187	187	-	94	11
Total	7,824	8,754	-	6,207	344
Impaired loans with a related allowance:					
Residential real estate	440	439	110	566	24
Non-residential real estate	387	387	176	349	13
Consumer	-	-	-	26	-
Commercial	213	210	210	179	12
Total	1,040	1,036	496	1,120	49
Total impaired loans:					
Residential real estate	5,398	6,331	110	4,997	259
Non-residential real estate	3,066	3,062	176	2,008	111
Consumer	-	-	-	49	-
Commercial	400	397	210	273	23
Total impaired loans	$ 8,864	$ 9,790	$ 496	$ 7,327	$ 393

NOTE D - ALLOWANCE FOR LOAN LOSSES (Continued)

	Recorded Investment	Unpaid Balance	Related Allowance (In thousands)	Average Recorded Investment YTD	Interest Income Recognized YTD
December 31, 2018:					
Impaired loans with no related allowance:					
Residential real estate	$ 3,904	$ 4,828	$ -	$ 3,176	$ 211
Non-residential real estate	638	635	-	1,463	39
Consumer	45	45	-	23	1
Commercial	-	-	-	82	-
Total	4,587	5,508	-	4,744	251
Impaired loans with a related allowance:					
Residential real estate	691	687	182	490	42
Non-residential real estate	311	311	146	232	-
Consumer	51	50	50	26	1
Commercial	145	145	18	72	10
Total	1,198	1,193	396	820	53
Total impaired loans:					
Residential real estate	4,595	5,515	182	3,666	253
Non-residential real estate	949	946	146	1,695	39
Consumer	96	95	50	49	2
Commercial	145	145	18	154	10
Total impaired loans	$ 5,785	$ 6,701	$ 396	$ 5,564	$ 304

NOTE D - ALLOWANCE FOR LOAN LOSSES (Continued)

The following tables set forth the amounts and past due status for the Bank's troubled debt restructurings (TDRs) at December 31, 2019 and 2018 (In thousands):

	Current Loans	Past Due 30 - 89	Past Due 90 Days and Still Accruing	Non-Accrual	Total
December 31, 2019					
Residential real estate loans	$ 222	$ 40	$ -	$ 596	$ 858
Non-residential	-	-	-	11	11
Commercial	-	-	-	99	99
Consumer loans	15	27	-	-	42
Total	$ 237	$ 67	$ -	$ 706	$ 1,010
Allowance for loan losses	$ 14	$ -	$ -	$ -	$ 14
December 31, 2018					
Residential real estate loans	$ 420	$ 9	$ -	$ 711	$ 1,140
Consumer loans	54	1	-	-	55
Total	$ 474	$ 10	$ -	$ 711	$ 1,195
Allowance for loan losses	$ 22	$ -	$ -	$ 18	$ 40

The Bank has not committed to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructurings.

NOTE D - ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents loans by segment modified as TDRs that occurred during the twelve months ended December 31, 2019 and 2018 (Dollars in thousands):

		Outstanding Recorded Investment	
	Number	Pre-modification	Post-modification
December 31, 2019			
Residential real estate loans	-	$ -	$ -
Consumer loans	-	-	-
Total restructured loans	-	$ -	$ -
December 31, 2018			
Residential real estate loans	1	$ 51	$ 41
Consumer loans	1	2	-
Total restructured loans	2	$ 53	$ 41

The TDRs presented above did not increase the allowance for loan losses and resulted in no charge-offs for the years ended December 31, 2019 and 2018, respectively.

There were no TDRs that were modified during the last twelve months that have subsequently violated the terms of the modification.

The following table summarizes by class the Bank's loans classified as past due in excess of 30 days or more in addition to those loans classified as non-accrual:

	30 - 89 Days Past Due	90 or More Days Past Due - Still Accruing	90 or More Days Past Due - Non-Accrual	Total Past Due	Current	Total Loans
			(In thousands)			
December 31, 2019:						
Residential real estate	$ 2,957	$ -	$ 3,988	$ 6,945	$109,234	$ 116,179
Non-residential real estate	1,454	-	1,681	3,135	124,058	127,193
Commercial	503	-	341	844	39,552	40,396
Consumer	856	-	341	1,197	27,551	28,748
Other	-	-	-	-	483	483
Total	$ 5,770	$ -	$ 6,351	$ 12,121	$300,878	$ 312,999

NOTE D - ALLOWANCE FOR LOAN LOSSES (Continued)

	30 - 89 Days Past Due	90 or More Days Past Due - Still Accruing	90 or More Days Past Due - Non-Accrual	Total Past Due	Current	Total Loans
			(In thousands)			
December 31, 2018:						
Residential real estate	$ 2,742	$ 45	$ 3,637	$ 6,424	$102,991	$ 109,415
Non-residential real estate	2,646	-	1,298	3,944	124,271	128,215
Commercial	253	-	125	378	37,203	37,581
Consumer	665	-	417	1,082	28,017	29,099
Other	-	-	-	-	539	539
Total	$ 6,306	$ 45	$ 5,477	$ 11,828	$293,021	$ 304,849

The Bank 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 Bank uses the following definitions for risk ratings, which are consistent with the definitions used in supervisory guidance:

Special Supervision. Loans classified as special supervision are credits that show a sign of weakness in either sources of repayment or collateral but have mitigating factors that minimize the risk of loss.

Special Mention. Loans classified as special mention are credits that show a defined weakness in the primary repayment and/ or collateral but are not to the point of substandard classification.

Substandard. Loans classified as substandard are credits that are inadequately protected by the worth and repayment capacity of the borrower or the collateral. The Bank has a distinct possibility of loss if weaknesses are not corrected.

Doubtful. Loans classified as doubtful are credits that meet characteristics of substandard with further weaknesses that make a collection of the full debt highly questionable and improbable.

Loss. Loans classified as loss are credits that are considered uncollectible and it is not practical to defer writing off. This classification does not mean that there is absolutely no possibility of recovery but that recovery is not practical enough to defer writing off as a worthless asset.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

NOTE D - ALLOWANCE FOR LOAN LOSSES (Continued)

As of December 31, 2019 and 2018, and based on the most recent analysis performed, the risk category of loans was as follows (In thousands):

	Pass	Special Supervision	Special Mention	Sub-standard	Doubtful	Loss	Total
December 31, 2019							
Residential real estate	$ 104,896	$ 1,953	$ 1,431	$ 4,266	$ 3,475	$ 158	$ 116,179
Non-residential real estate	116,407	5,739	2,424	1,373	1,250	-	127,193
Commercial	38,030	98	1,524	383	351	10	40,396
Consumer	27,759	316	218	134	288	33	28,748
Other	483	-	-	-	-	-	483
Total	$ 287,575	$ 8,106	$ 5,597	$ 6,156	$ 5,364	$ 201	$ 312,999
December 31, 2018							
Residential real estate	$ 96,877	$ 3,686	$ 2,505	$ 4,816	$ 1,531	$ -	$ 109,415
Non-residential real estate	119,814	5,749	1,435	859	358	-	128,215
Commercial	36,006	1,116	54	389	16	-	37,581
Consumer	27,916	516	206	331	130	-	29,099
Other	539	-	-	-	-	-	539
Total	$ 281,152	$ 11,067	$ 4,200	$ 6,395	$ 2,035	$ -	$ 304,849

NOTE E - PROPERTY AND EQUIPMENT, NET

Property and equipment as of December 31, 2019 and 2018, are stated at cost less accumulated depreciation as follows (In thousands):

	2019	2018
Land and buildings	$ 26,777	$ 24,284
Furniture and equipment	8,612	7,854
Leasehold improvements	509	509
	35,898	32,647
Accumulated depreciation	(17,666)	(17,003)
	18,232	15,644
Construction in process	-	1,290
Net property and equipment	$ 18,232	$ 16,934

Depreciation expense for the years ended December 31, 2019 and 2018 amounted to $1,224,039 and $1,059,535.

NOTE F - INCOME TAXES

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the deferred tax assets and liabilities included in other assets as of December 31, 2019 and 2018, were as follows (In thousands):

	2019	2018
Deferred tax assets:		
Allowance for loan losses	$ 863	$ 725
Deferred compensation	1,150	1,172
Loan origination costs	248	187
Loan impairment	10	69
Interest on nonaccrual loans	212	138
Other	62	8
Losses on defined benefit plan assets	1,389	1,579
Unrealized losses on securities available-for-sale	-	1,098
Gross deferred tax asset	3,934	4,976
Deferred tax liabilities:		
Property and equipment	(1,217)	(1,062)
Core deposit intangible	(50)	(53)
Prepaid pension obligation	(1,054)	(1,040)
Prepaid expenses	(89)	(91)
Unrealized gain on equity securities	(62)	(35)
Unrealized gain on securities available-for-sale	(31)	-
Other	(19)	(13)
Gross deferred tax liability	(2,522)	(2,294)
Net deferred tax asset	$ 1,412	$ 2,682

The Bank has evaluated the need for a valuation allowance and, based on the weight of the available evidence, has determined that it is more likely than not that all deferred tax assets will be realized.

Income taxes consisted of the following components for the years ended December 31, 2019 and 2018 (In thousands):

	2019	2018
Currently payable	$ 794	$ 520
Deferred	(49)	152
DTA write-down due to the Tax Cuts and Jobs Act - net future deductions	-	(59)
Total income taxes	$ 745	$ 613

NOTE F - INCOME TAXES (Continued)

Income taxes were computed by applying the U.S. Federal income tax rate 21% to income before taxes for the years ended December 21, 2019 and 2018. The reasons for the differences for the years ended December 31, 2019 and 2018, are as follows (Dollars in thousands):

	2019		2018	
	Amount	Percent	Amount	Percent
Taxes computed at statutory rate	$ 1,028	21.0	$ 1,026	21.0
Decrease in taxes resulting from:				
Tax-exempt life insurance income (net of expense)	(92)	(1.9)	(87)	(1.7)
Tax-exempt interest income	(305)	(6.2)	(354)	(7.3)
DTA write-down due to the Tax Cuts and Jobs Act	-	-	(59)	(1.2)
State income tax expense	150	3.1	125	2.6
Other, net	(36)	(.8)	(38)	(.9)
Total	$ 745	15.2	$ 613	12.5

ASC Topic 740, *Income Taxes*, provides guidance on financial statement recognition and measurement of tax positions taken, or expected to be taken, in tax returns. ASC Topic 740 requires an evaluation of tax positions to determine if the tax positions will more likely than not be sustainable upon examination by the appropriate tax authorities. The Bancorp, at December 31, 2019 and 2018, had no uncertain tax positions that qualify for either recognition or disclosure in the financial statements.

The Bancorp files income tax returns in the U.S. Federal jurisdiction and various states. The Bancorp's consolidated federal and state income tax returns for the years prior to 2016 are no longer subject to examination by tax authorities.

NOTE G - DEPOSITS

Deposit account balances at December 31, 2019 and 2018, are summarized as follows (In thousands):

	2019	2018
Non-interest bearing demand	$ 103,497	$ 102,113
Interest bearing demand	206,003	224,273
Savings	62,770	63,303
Certificates of deposit	111,777	84,354
Total deposits	$ 484,047	$ 474,043

NOTE G - DEPOSITS (Continued)

Certificates of deposit by contractual maturity as of December 31, 2019, were as follows (In thousands):

2020	$ 81,321
2021	22,809
2022	2,007
2023	1,806
2024	3,536
Thereafter	298
Total	$111,777

Certificates of deposit in excess of $250,000 aggregated approximately $35,314,000 and $21,365,000 at December 31, 2019 and 2018, respectively.

Overdrawn demand deposits, reclassified as loans, totaled approximately $483,000 and $539,000 at December 31, 2019 and 2018, respectively.

NOTE H - BORROWINGS

The Bank has established various lines of credit with financial institutions, allowing for maximum borrowings of approximately $183,730,983 at rates determined by the lender when borrowed. At December 31, 2019 and 2018, there were no federal funds purchased, which would consist of short-term borrowings from other financial institutions.

Repurchase agreements are treated as collateralized financing obligations and are reflected as a liability in the consolidated financial statements. Securities underlying the repurchase agreements remain under the control of the Bank.

NOTE I - EMPLOYEE BENEFIT PLANS

The Bank has a non-contributory defined benefit pension plan covering all employees who qualify under length of service and other requirements. The plan calls for benefits to be paid to eligible employees at retirement based primarily upon years of service and average earnings for the five consecutive plan years which produce the highest average. The pension plan was frozen effective January 1, 2013. Data relative to the pension plan as of December 31, 2019 and 2018, follows (In thousands):

	2019	2018
Reconciliation of benefit obligation:		
Projected benefit obligation at beginning of period	$ 16,709	$ 17,838
Interest cost	681	623
Actuarial (gain) loss	1,747	(861)
Distributions	(890)	(882)
Curtailments, settlement acquisition	(31)	(9)
Projected benefit obligation at end of period	18,216	16,709
Reconciliation of plan assets:		
Fair value of plan assets at beginning of period	14,885	15,829
Actual return on plan assets	2,899	(803)
Employer contributions	-	750
Benefit payments	(890)	(882)
Settlements	(31)	(9)
Fair value of plan assets at end of period	16,863	14,885
Funded status, included in other liabilities	$ (1,353)	$ (1,824)
Net periodic pension expense:		
Interest cost	$ 681	$ 623
Return on plan assets	(1,002)	(1,071)
Amortization of loss	611	493
Net periodic pension cost	$ 290	$ 45

NOTE I - EMPLOYEE BENEFIT PLANS (Continued)

The accumulated benefit obligation for the defined benefit plan was $18,216,464 and $16,708,830 at December 31, 2019 and 2018, respectively.

	2019	2018
Rate assumptions:		
Discount rate	3.22%	4.22%
Long-term rate of investment return	7.00%	7.00%
Rate of compensation increase	N/A	N/A
Amortization period	7.62	8.17

The investment portfolio objective is to seek a balance of investment risk and return by investing in fixed income and equities using tactical asset allocation. In addition, the portfolio seeks to meet current beneficiary liabilities while at the same time grow the principal of the portfolio through price appreciation, dividend income and interest income. The Pension Plan Investment Committee, in establishing these objectives, acknowledges that any investment, other than cash, entails a risk of loss of principal value, but expects the evaluation of the risk to the potential return to be a significant factor in the selection of the investment assets. The Pension Plan's asset allocation targets are 35% fixed income and 65% equity, with no more than 10% of the total equity investment concentrated in international investments.

The fair values of the pension plan assets at December 31, 2019 and 2018, by asset category were as follows (In thousands):

	Total	Level 1	Level 2	Level 3
December 31, 2019:				
Asset category:				
Cash and cash equivalents	$ 246	$ 246	$ -	$ -
Mutual funds:				
Collective fund – U.S. equity	1,263	-	1,263	-
Other equity	9,485	9,485	-	-
Fixed income	5,869	5,869	-	-
Total pension plan assets	$ 16,863	$ 15,600	$ 1,263	$ -

NOTE I - EMPLOYEE BENEFIT PLANS (Continued)

	Total	Level 1	Level 2	Level 3
December 31, 2018:				
Asset category:				
Cash and cash equivalents	$ 170	$ 170	$ -	$ -
Mutual funds:				
Collective fund – U.S. equity	1,060	-	1,060	-
Other equity	7,849	7,849	-	-
Fixed income	5,806	5,806	-	-
Total pension plan assets	$ 14,885	$ 13,825	$ 1,060	$ -

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

2020	$ 1,179,675
2021	1,180,406
2022	1,182,484
2023	1,183,330
2024	1,154,842
2025 - 2029	5,592,411

The Bank also has a 401(k) retirement plan, which covers all employees who have completed one year of service of 1,000 hours or more and have attained the age of 21. The employees may voluntarily contribute up to one hundred percent (100%) of their wages to the plan on a tax-deferred basis subject to IRS limitations. The Bank's contributions to the plan were $194,108 and $175,359, for the years ended December 31, 2019 and 2018, respectively. The plan was amended in January 2014, to provide a 3% safe harbor contribution by the Bank for the benefit of eligible employees. Also, the plan was amended to allow for separate classifications of participants in the event of discretionary contributions to the plan by the Bank.

The Bank has entered into certain deferred compensation agreements with certain directors. Expenses related to these deferred compensation plans amounted to approximately $208,000 and $305,000 for the years ended December 31, 2019 and 2018, respectively.

NOTE J - REGULATORY CAPITAL

The Bancorp and the Bank are subject to various regulatory capital requirements administered by the federal 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 Bancorp's financial statements. Under the regulatory capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines involving quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Bancorp's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

The prompt corrective action regulations define specific capital categories based on an institution's capital ratios. The capital categories, in declining order, are "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "criticality undercapitalized."

As of December 31, 2019 and 2018, the most recent notification from the Bancorp's and the Bank's regulator categorized the Bancorp and the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," the Bancorp and the Bank must maintain minimum Common Equity Tier 1 risk-based, total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the institution's regulatory designation as "well-capitalized" under the regulatory framework for prompt corrective action.

Quantitative measures established by regulation to ensure capital adequacy require the Bancorp and the Bank to maintain minimum amounts and ratios as set forth in the table below. At December 31, 2019 and 2018, the Bancorp's and the Bank's ratios exceeded the regulatory requirements. Management believes that the Bancorp and the Bank met all capital adequacy requirements to which they were subject as of December 31, 2019 and 2018. The Bancorp's and the Bank's regulatory capital ratios are set forth below.

NOTE J - REGULATORY CAPITAL (Continued)

The Bank's actual and required capital amounts and ratios as of December 31, 2019 and 2018, are as follows (Dollars in thousands):

	Actual		Minimum Capital Requirement		Minimum To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2019						
Common Equity Tier 1 Capital to						
Consolidated	$ 78,755	20.81%	$ 17,029	4.50%	N/A	N/A
Merchants & Marine Bank	75,871	20.05%	17,029	4.50%	$ 24,597	6.50%
Total Capital to Risk Weighted Assets:						
Consolidated	82,208	21.72%	30,273	8.00%	N/A	N/A
Merchants & Marine Bank	79,324	20.96%	30,273	8.00%	37,841	10.00%
Tier 1 Capital to Risk Weighted Assets:						
Consolidated	78,755	20.81%	22,705	6.00%	N/A	N/A
Merchants & Marine Bank	75,871	20.05%	22,705	6.00%	30,273	8.00%
Tier 1 Capital to Average Assets:						
Consolidated	78,755	13.82%	22,796	4.00%	N/A	N/A
Merchants & Marine Bank	75,871	13.31%	22,796	4.00%	28,495	5.00%
December 31, 2018						
Common Equity Tier 1 Capital to						
Consolidated	$ 76,534	20.96%	$ 16,433	4.50%	N/A	N/A
Merchants & Marine Bank	74,263	20.34%	16,433	4.50%	$ 23,737	6.50%
Total Capital to Risk Weighted Assets:						
Consolidated	79,820	21.86%	29,215	8.00%	N/A	N/A
Merchants & Marine Bank	77,549	21.24%	29,215	8.00%	36,518	10.00%
Tier 1 Capital to Risk Weighted Assets:						
Consolidated	76,534	20.96%	21,911	6.00%	N/A	N/A
Merchants & Marine Bank	74,263	20.34%	21,911	6.00%	29,215	8.00%
Tier 1 Capital to Average Assets:						
Consolidated	76,534	13.94%	21,957	4.00%	N/A	N/A
Merchants & Marine Bank	74,263	13.53%	21,957	4.00%	27,447	5.00%

NOTE K - RELATED PARTIES

The Bank has entered into transactions with its officers, Bancorp's directors and significant stockholders and their affiliates. Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features. Such loans amounted to approximately $1,219,000 and $974,000 at December 31, 2019 and 2018, respectively. In addition to these loans, the Bank has commitments to extend credit to these related parties, which amounted to approximately $3,110,000 and $2,648,000 at December 31, 2019 and 2018, respectively. The following is a summary of activity in related party loans:

	2019	2018
Balance, beginning of year	$ 973,714	$290,521
Advances	420,781	896,069
Repayments	(175,894)	(212,876)
Ending balance	$1,218,601	$973,714

Deposits from related parties held by the Bank at December 31, 2019 and 2018, totaled approximately $10,423,000 and $10,402,000, respectively.

During the ordinary course of business, the Bank may purchase goods and services from companies that have a relationship with individuals who are considered related parties to the Bank. Significant transactions of this type include the purchase of legal services, consulting services and outsourced internal auditing services.

During the years ended December 31, 2019 and 2018, the Bank paid $231,333 and $262,260, respectively, in fees to a law firm of which one of the partners is a member of the Bank's Board of Directors.

NOTE L - DISCLOSURES ABOUT FAIR VALUE OF ASSETS AND LIABILITIES

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

NOTE L - DISCLOSURES ABOUT FAIR VALUE OF ASSETS AND LIABILITIES (Continued)

Level 3 Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities.

Recurring Measurements

The following table presents the fair value measurement of assets recognized in the accompanying consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2019 and 2018 (In thousands):

	Total	Level 1	Level 2	Level 3
Assets at December 31, 2019:				
Securities available-for-sale:				
U.S. Government Agency funds	$ 38,591	$ -	$ 38,591	$ -
Mortgage-backed securities	81,218	-	81,218	-
State, county and municipal securities	9,456	-	9,456	-
	$ 129,265	$ -	$ 129,265	$ -

	Total	Level 1	Level 2	Level 3
Assets at December 31, 2018:				
Securities available-for-sale:				
U.S. Government Agency funds	$ 53,859	$ -	$ 53,859	$ -
Mortgage-backed securities	66,065	-	66,065	-
State, county and municipal securities	10,100	-	10,100	-
	$ 130,024	$ -	$ 130,024	$ -

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during 2019 or 2018.

Available-for-sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. 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. Level 2 securities include the entirety of the Bank's available-for-sale securities. For these securities the Bank obtains fair value measurements from an independent pricing service that considers observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, valuation matrices, credit information and the bond's terms and conditions. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. There were no Level 3 securities.

NOTE L - DISCLOSURES ABOUT FAIR VALUE OF ASSETS AND LIABILITIES (Continued)

Nonrecurring Measurements

The following table presents the fair value measurements of assets recognized in the accompanying consolidated balance sheets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2019 and 2018 (In thousands):

	Total	Level 1	Level 2	Level 3
Assets at December 31, 2019:				
Impaired loans	$ 8,864	$ -	$ 8,864	$ -
Other real estate owned	573	-	573	-
Assets at December 31, 2018:				
Impaired loans	$ 5,785	$ -	$ 5,785	$ -
Other real estate owned	1,095	-	1,095	-

Following is a description of valuation methodologies and inputs used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during 2019 or 2018.

Impaired Loans

The estimated fair value of impaired loans is based on the appraised fair value of the collateral, less estimated cost to sell. Impaired loans are classified within Level 2 of the fair value hierarchy.

Other Real Estate Owned

Other real estate owned is carried at the lower of fair value at acquisition date or current estimated fair value, less estimated cost to sell when the real estate is acquired. Estimated fair value is determined on the basis of appraisals and evaluations. The Bank’s other real estate owned are classified within Level 2 of the fair value hierarchy. The Bank considers the appraisal or evaluation as the starting point for determining fair value and then considers other factors and events in the environment that may affect the fair value. Appraisals are obtained when the real estate is acquired and subsequently as deemed necessary by management. Appraisers are selected from the list of approved appraisers maintained by management. Another unobservable input used in the fair value measurement of collateral for impaired loans and other real estate owned relates to the discounting criteria used to consider lack of marketability and estimated costs to sell. These discounts and estimates are developed by management by comparison to historical results.

NOTE L - DISCLOSURES ABOUT FAIR VALUE OF ASSETS AND LIABILITIES (Continued)

Fair Value of Financial Instruments

The following table presents carrying amounts and estimated fair values of financial instruments not carried at fair value at December 31, 2019 and 2018 (In thousands):

	December 31, 2019	
	Carrying Amount	Fair Value
Financial assets		
Level 2 Inputs:		
Cash and due from banks	$ 49,371	$ 49,371
Time deposits due from banks	1,750	1,750
Accrued income	1,956	1,956
FHLB stock	875	875
Loans, net	309,648	315,007
Financial liabilities		
Level 2 Inputs:		
Deposits	484,047	477,706
Interest payable	299	299

FASB ASC Topic 825 requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on either a recurring basis or non-recurring basis. In cases where quoted market prices are not available, fair values are generally based on estimates using present value techniques. The Bank's premise in present value techniques is to represent the fair values on a basis of replacement value of the existing instrument given observed market rates on the measurement date. These techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates for those assets or liabilities cannot be necessarily substantiated by comparison to independent markets and, in many cases, may not be realizable in immediate settlement of the instruments. The estimated fair value of financial instruments with immediate and shorter-term maturities (generally 90 days or less) is assumed to be the same as the recorded book value. All nonfinancial instruments, by definition, have been excluded from these disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Bank. The methodology and significant assumptions used in estimating the fair values presented above are as follows:

NOTE L - DISCLOSURES ABOUT FAIR VALUE OF ASSETS AND LIABILITIES (Continued)

Cash and due from banks, time deposits due from banks, accrued income, FHLB stock, and interest payable

The carrying amount approximates fair value.

Loans

The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The market rates used are based on current rates the Bank would impose for similar loans and reflect a market participant assumption about risks associated with nonperformance, illiquidity and the structure and term of the loans along with local economic and market conditions. Loans with similar characteristics were aggregated for purposes of the calculations.

Deposits

Deposits include demand deposits, money market, NOW and savings accounts. The carrying amount of these deposits approximates fair value. The fair value of fixed-maturity certificates of deposit is estimated using a discounted cash flow calculation that applies the rates currently offered for deposits of similar remaining maturities.

NOTE M - CONCENTRATIONS OF CREDIT

All of the Bank’s loans, commitments, commercial and standby letters of credit have been granted to customers in the Bank’s market area. The concentrations of credit by type of loan are set forth in Note C. Commercial and standby letters of credit were granted primarily to commercial borrowers. Regulations limit the amount of credit that can be extended to any single borrower or group of related borrowers.

The Bank had due from bank balances in excess of the $250,000 federal insurance limit as of December 31, 2019, of approximately $1,015,000.

NOTE N - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit, which are not reflected in the accompanying financial statements until they are funded or related fees, are incurred or received.

NOTE N - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK (Continued)

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments and may require collateral or other credit support for financial instruments with credit risk. These obligations are summarized below as of December 31, 2019 and 2018 (In thousands):

	2019	2018
Commitments to extend credit	$ 52,480	$ 49,441
Standby letters of credit	2,578	2,504

Commitments to extend credit are agreements to lend to a customer as long as conditions established in the agreement have been satisfied. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since commitments often expire without being fully drawn, the total commitment amounts do not necessarily represent future cash requirements. The Bank continually evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending a loan.

NOTE O - COMMITMENTS AND CONTINGENCIES

The Bank is a defendant in legal actions arising from its normal business activities. Management, on advice from counsel, believes that those actions are without merit or that the ultimate liability resulting from them, if any, will not materially affect the Bank's financial position.

NOTE P – OPERATING LEASES

On January 1, 2019, The Bank adopted Accounting Standards Update ("ASU") 2016-02 *Leases* which required the recognition of certain operating leases on the balance sheet as lease right-of-use assets and related lease liabilities. See Note 1 - Summary of Significant Accounting Policies. Rent expense totaled $82,913 and $89,099 in 2019 and 2018, respectively. Rent expense includes amounts related to items that are not included in the determination of lease right-of-use assets including expenses related to short-term leases totaling $21,113.

NOTE P – OPERATING LEASES (Continued)

The Bank leases a branch facility in Fairhope, Alabama under an operating lease. The lease expires in 2022 and contains three options to extend the lease for five years, per option. It is reasonably certain that the first option will be exercised. Lease payments per the agreement are $5,000 per month, and beginning in January 2019, the annual rent increases by 3% per year.

Lease payments under operating leases that were applied to our operating lease liability totaled $48,523 during 2019. The following table reconciles future undiscounted lease payments due under non-cancelable operating leases (those amounts subject to recognition) to the aggregate operating lessee lease liability as of December 31, 2019.

A maturity analysis of the operating lease liability and reconciliation of the undiscounted cash flows to the total operating lease liability is as follows:

2020	$ 62,654
2021	65,564
2022	67,531
2023	69,556
2024	71,643
Thereafter	228,085
Total undiscounted cash flows	566,033
Discount on cash flows	(58,103)
Total operating lease liability included in the accompanying balance sheet	$ 507,930
Weighted-average remaining lease term in years	8
Weighted-average discount rate	2.58%

NOTE Q - SUBSEQUENT EVENTS

Management of the Bancorp and the Bank has evaluated subsequent events through February 18, 2020, the date the financial statements were available to be issued. No material subsequent events have occurred since December 31, 2019, that required recognition or disclosure in the financial statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (In Thousands)

The Company is reporting Net Income of $4,150, or $3.12 per share, for the 12 months ended December 31, 2019 compared to $4,272, or $3.21 per share, for the 12 months ended December 31, 2018. Return on average assets totaled 0.71% and 0.75% for the years ended December 31, 2019, and December 31, 2018, respectively. Return on average equity for the 12 months ended December 31, 2019 and December 31, 2018, totaled 5.54% and 6.03%, respectively.

The Company's net interest margin is a prime indicator of its profitability. The net interest margin (tax equivalent basis) reflects the spread between interest earning asset yields and interest-bearing liability costs, and the percentage of interest earning assets funded by interest bearing liabilities. The Company's net interest margin improved to 3.49% at December 31, 2019, from 3.34% in the same period in 2018. Improvement in the net interest margin is due both to increased loan volumes and improved loan yields.

Average loan yield was 5.25% during 2019, an increase of 27 basis points from 2018. This increase was primarily the result of the application of a new loan pricing methodology by Bank management. Average yield on securities remained relatively stable in 2019 at 2.16%. Heightened competition for interest bearing deposits resulted in an increase in the Company's overall cost of funds from 0.63% in 2018 to 0.87% in 2019.

Average assets totaled $587,797 at December 31, 2019, an increase of $14,504, or 2.52%, from $573,293 at December 31, 2018. Average net loans totaled $312,633 during 2019, an increase of $26,533, or 9.27%, from 2018. This growth was supported, in part, through a reduction in average securities, which totaled $172,867 in 2019 compared to $197,615 in 2018. Average total deposits also grew by $6,853, or 1.40%, totaling $496,355 during 2019.

Total non-performing assets, including non-accrual loans, accruing loans past-due over 90 days, and other real estate owned, totaled $6,924 and $6.617 in 2019 and 2018, respectively. Non-performing assets, as a percentage of total loans, were 2.21% in 2019 and 2.17% in 2018.

The Company places a great emphasis on maintaining its strong capital base. The Company's management and Board of Directors continually evaluate business decisions that may have an impact on the level of stockholders' equity. It is their goal that the Company maintains a "well-capitalized" equity position. The Company's regulator defines a "well-capitalized" institution as one that has at least a 10% total risk-based capital ratio, a 6.5% common equity Tier 1 capital ratio, an 8% Tier 1 risk-based capital ratio, and a 5% leverage ratio. The Company's capital ratios for 2019 were 21.72%, 20.81%, 20.81% and 13.82% compared to 21.86%, 20.96%, 20.96% and 13.94% for 2018. The Company's solid capital base is reflected in the margin by which its regulatory capital ratios exceed the "well-capitalized" standards.

Stockholders' equity to total assets for 2019 and 2018 was 13.45% and 12.78%, respectively.

OTHER INFORMATION

Information Relating to Common Stock

At December 31, 2019, the Company's authorized capital stock consisted of 5,000,000 shares of common stock, par value $2.50 per share, of which 1,330,338 were issued and outstanding. The Company joined the OTCQX Market Place on January 19, 2018 trading under the new ticker symbol MNMB. The common stock was not traded on an exchange prior to this date, nor was there a known active trading market. As of December 31, 2019, the common stock of the Company was held of record by 938 stockholders. Based solely on information made available to the Company from limited numbers of buyers and sellers, the Company believes that the following table sets forth the quarterly range of sales prices for the Company's stock during the years 2019 and 2018.

Stock Prices

2019	High	Low
1st Quarter	$39.00	$37.15
2nd Quarter	39.50	37.20
3rd Quarter	40.25	39.00
4th Quarter	40.30	39.55

2018	High	Low
1st Quarter	$43.00	$40.00
2nd Quarter	41.50	40.15
3rd Quarter	40.50	39.30
4th Quarter	39.80	38.00

During each quarter of 2019 and 2018, cash dividends on common stock were paid as follows:

	2019	2018
1st Quarter	$0.55	$0.55
2nd Quarter	0.30	0.30
3rd Quarter	0.30	0.30
4th Quarter	0.30	0.30
Total	$1.45	$1.45

Although no assurances can be given, the Company anticipates that cash dividends on shares of the Company's common stock will continue to be paid during 2020, subject to the discretion of the Board of Directors.

MERCHANTS & MARINE BANCORP, INC.
AND
MERCHANTS & MARINE BANK

BOARD OF DIRECTORS

William Russell Buster, IV
Owner
C-Sharpe Co, LLC

Royce Cumbest
Chairman of the Board
Merchants & Marine Bancorp, Inc. and
Merchants & Marine Bank

Frank J. Hammond, III
Attorney
Watkins & Eager, PLLC

Scott B. Lemon
Co-Owner
Lemon-Mohler Insurance Agency

Paul H. (Hal) Moore, Jr., M.D.
Retired Radiologist
Singing River Radiology Group

Diann M. Payne
Executive Director
Jackson County Civic Action Committee

Amy L. St. Pé
Attorney
Amy Lassitter St. Pé, P.A.

Alan K. Sudduth
Public & Government Affairs Manager
Chevron Pascagoula Refinery

Henry G. (Hank) Torjusen, Jr.
Co-owner
Fletcher Construction Company

Thomas B. Van Antwerp
Trustee
The Hearin-Chandler Foundation

Julius A. (Jay) Willis, Jr., DMD
Owner
Willis & Associates, LLC

SENIOR ADVISORY DIRECTOR

Jerry St. Pé
President
St. Pé & Associates

ADVISORY DIRECTORS

Abe L. Harper, Jr.
President
Harper Technologies, LLC

T. Bragg Van Antwerp, Jr.
Managing Director
Mitchell McLeod Pugh & Williams Investment Advisors

DIRECTORS EMERITUS

Lynda J. Gautier
Retired Certified Public Accountant

John F. Grafe
Retired Businessman

Jerry L. Lee
Retired President and Chief Executive Officer
Jerry Lee's Grocery, Inc.

Paul H. Moore, Sr., M.D.
Retired Radiologist
Singing River Radiology Group

MERCHANTS & MARINE BANCORP, INC.
Officers as of December 31, 2019

Royce Cumbest*
Chairman of the Board

Clayton Legear*
President and Chief Executive Officer

Herman E. Smith*
Executive Vice President

Jackie Skelton
Secretary to the Board

MERCHANTS & MARINE BANK
Officers as of December 31, 2019

Royce Cumbest*
Chairman of the Board

Clayton Legear*
President and Chief Executive Officer

Herman E. Smith*
Executive Vice President

Kristi Maxwell*
Executive Vice President/Chief Administrative Officer

Jimmy Conyers*
Executive Vice President/Alabama Market President

Mack Rushing*
Executive Vice President/Mississippi Market President

Jeffrey Trammell*
Senior Vice President/Chief Risk Officer

Rita Bailey
Assistant Cashier

Michelle Baldwin
Assistant Vice President/Credit Analyst Manager

Bradley Bell
Vice President/Technology & Integration

Nick Bosco
Associate Business Banker

Shelly Brockway
Community Banker/Loan Officer

Amanda Brown
Assistant Vice President/Community Banker

Barry Brueck
Vice President/Loan Administration

Lauren Carpenter
Retail Solutions Specialist

Richard Cauley
Facilities and Contracts Officer

Luke Chapman
Assistant Vice President/Business Banker

Sherrill Edwards
Assistant Vice President/Community Banker

Riece Fleming
Security Officer/Bank Secrecy Act Compliance Analyst

Sara Gammill
Audit Manager/Information Security Officer

Mary Graham
Loan Officer/Associate Lender

Kelly Green
Assistant Vice President/Retail Administration

Mike Grimme
Vice President/Information Technology Manager

Jonathan Jones
Vice President/Business Banker

Brooke Jordan
Loan Assistant Manager/Bank Officer

Jodi Keating
Vice President/Community Banker

Officers as of December 31, 2019(continued)

Landon McCarty
Assistant Vice President/Business Banker

Debbie Novak
Bank Operations Officer/Bookkeeping

Tom Peresich
Assistant Vice President/Bank Secrecy Act Officer

S.T. Phillips
Assistant Vice President/Community Banker

Jackie Skelton
Secretary to the Board

Stephanie Spring
Vice President/Compliance Manager

Monica Stork
Bank Operations Officer/Electronic Banking Department Manager

David Thomas
Vice President/Retail Banking

Brenda Tingle
Vice President/Community Banker

Glenda Walker
Assistant Vice President/Collections

Sheryl Wolfe
Vice President/Human Resources Director

**Executive Officers*

(This page intentionally left blank)

Locations of Bank Offices

DAPHNE
27765 Highway 98
Daphne, AL 36526

ESCATAWPA
7616 Highway 613
Moss Point, MS 39563

FAIRHOPE
325 Fairhope Avenue
Fairhope, AL 36532

GAUTIER
1200 Highway 90
Gautier, MS 39553

GULF SHORES
1820 Gulf Shores Parkway
Gulf Shores, AL 39547

HURLEY
21536 Highway 613
Moss Point, MS 39562

LUCEDALE
11283 Highway 63 South
Lucedale, MS 39452

MARKET STREET
1807 Market Street
Pascagoula, MS 39567

MOSS POINT
4619 Main Street
Moss Point, MS 39563

OCEAN SPRINGS
2802 Bienville Boulevard
Ocean Springs, MS 39564

PASCAGOULA
3118 Pascagoula Street
Pascagoula, MS 39567

ST. MARTIN
6416 Washington Avenue
Ocean Springs, MS 39564

WADE
16831 Hwy 63
Moss Point, MS 39563

M&M
MERCHANTS & MARINE
BANK

MandMBank.com

MISSISSIPPI

Escatawpa | Gautier | Hurley | Lucedale
Market Street | Moss Point | Ocean Springs
Pascagoula | St. Martin | Wade

ALABAMA

Daphne | Fairhope | Gulf Shores

CONTACT US

Customer Service: 1-866-223-9512
24-Hour Access: 1-866-229-9415