FARMERS AND MERCHANTS BANCSHARES, INC.

2022 Annual Report

FARMERS & MERCHANTS BANK

◆ *THE "COMMUNITY" BANK THAT PUTS PEOPLE FIRST* ◆

Member FDIC

March 10, 2023

Dear Stockholders, Customers, and Friends:

On behalf of Farmers and Merchants Bancshares, Inc. (the "Company"), the parent of Farmers and Merchants Bank (the "Bank"), we are pleased to report that net income for the year ended December 31, 2022 was $8,090,127, or $2.66 per common share, compared to $8,149,606, or $2.70 per common share, for the year ended December 31, 2021. The table below provides a comparison of the Company's results for the years ended December 31, 2022 and 2021.

	Year Ended December 31, 2022	Year Ended December 31, 2021
Income before taxes	$ 10,575,153	$ 10,582,419
Income taxes	2,485,026	2,432,813
Net income	$ 8,090,127	$ 8,149,606
Earnings per share	$ 2.66	$ 2.70
Return on average assets	1.13%	1.16%
Return on average equity	16.03%	14.85%

Cash dividends paid to stockholders in 2022 increased to $0.63 per common share from $0.57 per common share in 2021. The book value of the common stock of Farmers and Merchants Bancshares, Inc. was $15.56 per share at December 31, 2022, compared to $18.64 per share at December 31, 2021.

Total assets increased slightly to $718 million at December 31, 2022 from $717 million at December 31, 2021. Loans increased to $521 million at December 31, 2022 from $482 million at December 31, 2021. Deposits decreased to $624 million at December 31, 2022 from $626 million at December 31, 2021.

As previously announced, long time President James R. Bosley, Jr. retired on December 31, 2022 and was replaced by the Bank's Chief Lending Officer, Gary A. Harris. Mr. Harris became President on July 18, 2022 and CEO on January 1, 2023. We'd like to thank Mr. Bosley for his 39 years of service to the Bank with the last 27 as President and wish him all the best in retirement. Mr. Bosley will continue to serve on the Board of Directors.

Please visit the Company's investor relations section of our website - www.fmb1919.bank. The investor relations section includes press releases, financial information, stock information, peer analysis, and information about the Company's officers and directors.

We sincerely appreciate all of your confidence in and your support of Farmers and Merchants Bancshares, Inc.

Sincerely yours,

Bruce L. Schindler
Chairman

Gary A. Harris
President & CEO

Farmers and Merchants Bancshares, Inc.

About The Company

General

Farmers and Merchants Bancshares, Inc. (the "Company") was incorporated on August 8, 2016. The Company has two wholly-owned subsidiaries, Farmers and Merchants Bank (the "Bank") and Series Protected Cell FCB-4 (the "Insurance Subsidiary"). The Bank was incorporated October 24, 1919 under the laws of Maryland. The Bank is a Federal Deposit Insurance Corporation ("FDIC") insured independent community bank headquartered in Upperco, Maryland. The Bank currently has eight branch locations in Carroll and Baltimore Counties. The Bank's general market area runs along the Route 30, Route 795, Route 140, and Route 26 corridors with branches in Owings Mills, Reisterstown, Upperco, Hampstead, Manchester, Westminster, and Eldersburg. The Insurance Subsidiary is a captive insurance entity that can provide insurance coverage for Farmers and Merchants Bank.

Services of the Bank

The Bank provides comprehensive commercial and retail banking services to small and medium-sized businesses and to individuals. The following types of services are offered by the Bank:

Commercial Services

- Loans, including commercial mortgages, lines of credit, a wide range of demand, term, and time loans, for purposes such as fixed asset purchases, as well as loans guaranteed by the Small Business Administration ("SBA") and U.S. Department of Agriculture ("USDA")
- Commercial checking accounts and Remote Deposit Banking services
- Certificates of Deposit and other interest-bearing accounts
- Direct deposit of payroll
- Merchant credit card services
- Letters of Credit

Consumer Services

- Transaction accounts, including checking and NOW accounts
- Savings accounts
- Certificates of Deposit
- Money Market Accounts
- Individual Retirement Accounts
- Holiday and Vacation Club accounts
- Mortgages (Permanent and Construction)
- Home Equity loans
- Installment and Line of Credit loans
- Land loans
- Car and truck loans
- Agricultural loans
- Educational loans
- VISA Debit cards

The Bank offers 24 hour ATMs, including access to the Allpoint Network, safe deposit boxes, money orders, savings bonds, official checks, night depository, 24 hour Telephone Access System, internet banking, mobile banking, remote deposit, and wire transfers. The Bank does not offer general trust services.

Farmers and Merchants Bancshares, Inc.

MISSION STATEMENT

The mission of Farmers and Merchants Bancshares, Inc. through our wholly-owned subsidiary, Farmers and Merchants Bank, is to improve the quality of life in our community by being a people- oriented, independent, profitable community bank dedicated to providing products and services that fulfill the financial needs of individuals and businesses.

Farmers and Merchants Bank

LOCATIONS

Corporate Office
4510 Lower Beckleysville Road
Suite H
Hampstead, MD 21074
410-374-1510

Main Office
15226 Hanover Pike
Upperco, MD 21155
410-833-6600

Greenmount Office
2320 Hanover Pike
Hampstead, MD 21074
410-374-3436

Hampstead Office
735 Hanover Pike
Hampstead, MD 21074
410-239-4448

Reisterstown Office
P.O. Box 249
25 Westminster Pike
Reisterstown, MD 21136
410-517-3060

Eldersburg Office
1321 Liberty Road
Eldersburg, MD 21784
410-795-1900

Westminster Office
275 Clifton Boulevard
Westminster, MD 21157
410-857-1100

Carroll Lutheran Village
205 Saint Mark Way, Suite 100
Westminster, MD 21158
410-848-1110

Owings Mills Office
9320 Lakeside Boulevard
Owings Mills, MD 21117
410-356-8200

Commercial Loan Center
Westminster Office
275 Clifton Boulevard
Westminster, MD 21157
410-857-1700

Operations Center
P.O Box 249
25 Westminster Pike
Reisterstown, MD 21136
410-517-3065

Commercial Loan Center
Owings Mills Office
9320 Lakeside Boulevard
Owings Mills, MD 21117
410-356-9303

Mortgage Division
Hampstead Office
735 Hanover Pike
Hampstead, MD 21074
410-239-9650

Commercial Loan Center
Eldersburg Office
1321 Liberty Road
Eldersburg, MD 21784
410-795-1900

Farmers and Merchants Bancshares, Inc.
Farmers and Merchants Bank
Directors

Bruce L. Schindler, Chairman
President
Bob Davidson Ford Lincoln

Ronald W. Hux, Vice-Chairman
President
Douron, Inc.

James R. Bosley, Jr.
Retired President and CEO
Farmers and Merchants Bancshares, Inc.
Farmers and Merchants Bank

Roger D. Cassell
President
Communications Electronics, Inc.

Steven W. Eline
President,
Eline Funeral Home

Edward A. Halle, Jr.
Attorney, Fowley & Beckley, P.A.

Gary A. Harris
President and CEO
Farmers and Merchants Bancshares, Inc.
Farmers and Merchants Bank

J. Lawrence Mekulski
Retired Principal KLNB, LLC

Louna S. Primm
Retired Bank Executive

Teresa L. Smack
President
Terry's Tag & Title

Paul F. Wooden, Jr.
Managing Executive
The PFW Foundation & Taylor Properties, LLC

Farmers and Merchants Bancshares, Inc.
Officers

Gary A. Harris, President & CEO
Mark C. Krebs, Treasurer & CFO
Christopher T. Oswald, Sr. Vice President
Lynnette Kitzmiller, Secretary

Farmers and Merchants Bank
Officers

Gary A. Harris
President & CEO

Christopher T. Oswald
EVP/Chief Operations Officer

Mark C. Krebs
EVP/Chief Financial Officer

Senior Vice Presidents

Cheryl Y. Lewis .... Chief Credit Officer
J. Ritchie Solter .... Commercial Banking
Kevin P. Bankert .... Commercial Banking
John Wasowicz...............Commercial Banking
George W. Peck ....Commercial Banking
Barry Luciani ....Retail Banking
Paige Boughan.....................Human Resources

Vice Presidents

Julie A. Harris-Hare .... Computer Operations
Lynnette Kitzmiller .... Corporate Secretary
Michelle L. Miller .... Controller
David L. Hogue .... Commercial Banking
Thomas E. Long .... Commercial Banking
J. Thomas Turner ....Mortgage Officer
Amy L. Collins ....Branch Administration
Susan K. Jaeger .... Business Development

Other Bank Officers

Suzette L. Covalt .... Commercial Banking
Tracey R. Diggs ....BSA

Assistant Vice Presidents

Jennifer R. Caines… ....Operations
Debora A. Smith............................Loan Officer
Betty J. Higgs-Swartz .... Loan Officer
Callie L. Jennings ....Loan Officer

Assistant Vice Presidents
Branch Managers

Kelly P. Johnson ....Eldersburg
T J Sallah.....................................Westminster &
Carroll Lutheran Village
Candice M. Nicholson ....Hampstead &
Greenmount
Catherine E. Davis ....Owings Mills
Shannon M. Panek-Close............. Main Office &
Reisterstown

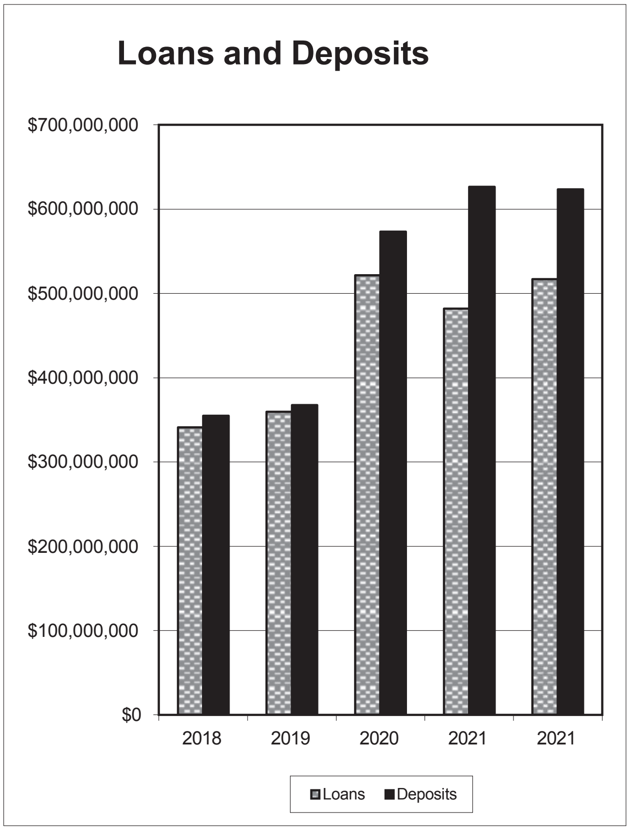
Farmers and Merchants Bancshares, Inc.
Selected Consolidated Financial Data

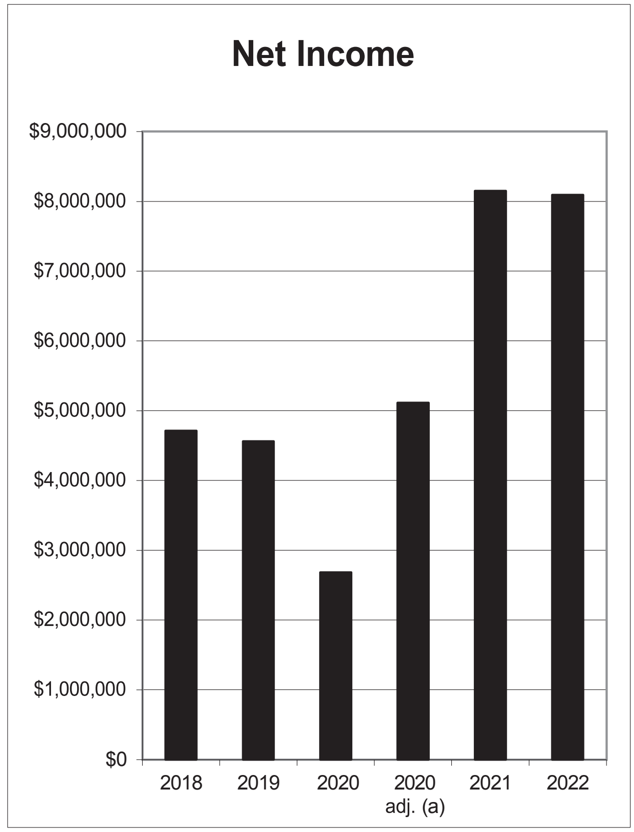
	2022	2021	As Reported 2020	Excluding Acquisition Costs 2020 (a)	2019	2018
OPERATING DATA						
Interest income	$ 26,269,653	$ 25,680,403	$ 20,763,180	$ 20,763,180	$ 18,702,338	$ 17,768,333
Interest expense	2,146,158	2,805,299	3,458,677	3,458,677	3,679,953	2,507,241
Net interest income	24,123,495	22,875,104	17,304,503	17,304,503	15,022,385	15,261,092
Provision for loan losses	475,000	330,000	625,000	625,000	40,000	475,000
Net interest income after provision for loan losses	23,648,495	22,545,104	16,679,503	16,679,503	14,982,385	14,786,092
Noninterest income	2,293,938	1,996,674	2,072,119	2,072,119	1,493,567	1,365,273
Acquisition costs	-	-	3,236,817	-	-	-
Noninterest expense	15,367,280	13,959,359	12,345,591	12,345,591	10,875,814	10,332,480
Income before income taxes	10,575,153	10,582,419	3,169,214	6,406,031	5,600,138	5,818,885
Income taxes	2,485,026	2,432,813	487,211	1,292,806	1,039,334	1,106,209
Net income	$ 8,090,127	$ 8,149,606	$ 2,682,003	$ 5,113,225	$ 4,560,804	$ 4,712,676
PER SHARE DATA						
Net income (Basic)	$2.66	$2.70	$0.90	$1.71	$1.54	$1.61
Dividends	$0.63	$0.57	$0.52		$0.51	$0.47
Book value	$15.56	$18.64	$17.18		$16.63	$15.41
KEY RATIOS						
Return on average assets	1.13%	1.16%	0.51%	0.97%	1.06%	1.14%
Return on average equity	16.03%	14.85%	5.22%	9.96%	9.52%	10.77%
Efficiency ratio	58.17%	56.13%	80.42%	63.71%	65.85%	62.15%
Dividend payout ratio	23.68%	21.11%	57.78%	30.41%	33.12%	29.43%
Net yield on interest-earning assets	3.54%	3.47%	3.50%		3.67%	3.88%
Tier 1 capital leverage ratio	9.83%	9.27%	9.05%		10.94%	10.86%
AT PERIOD END						
Total assets	$ 718,210,672	$ 716,677,255	$ 677,317,082		$ 442,215,098	$ 417,157,877
Gross loans	521,070,738	485,661,602	524,987,052		362,494,703	343,940,842
Cash and cash equivalents	7,263,537	26,462,106	40,975,670		9,121,352	14,618,237
Securities	146,823,446	171,089,891	77,555,805		56,041,792	44,719,058
Deposits	623,611,124	626,414,670	573,401,547		376,613,314	354,713,003
Borrowings	22,270,945	27,392,931	42,227,252		10,958,118	14,012,000
Stockholders' equity	47,774,963	56,621,458	51,729,483		49,453,516	45,394,707
SELECTED AVERAGE BALANCES						
Total assets	$ 714,115,497	$ 704,113,955	$ 526,539,417		$ 431,595,287	$ 412,586,954
Gross loans	49,847,308	515,167,318	421,010,433		344,793,736	343,573,784
Cash and cash equivalents	20,015,477	38,059,811	21,272,187		20,124,328	12,054,442
Securities	174,776,879	119,905,876	65,583,845		53,049,768	44,471,457
Deposits	502,167,291	489,816,460	369,504,859		367,570,825	339,624,630
Borrowings	26,042,874	32,398,746	18,638,621		11,975,017	26,524,352
Stockholders' equity	50,457,994	54,885,256	51,344,333		47,927,778	43,748,434
ASSET QUALITY						
Nonperforming assets	$ 1,897,775	$ 6,454,940	$ 6,048,577		$ -	$ 1,209,468
Nonperforming assets/total assets	0.26%	0.90%	0.89%		0.00%	0.29%
Allowance for loan losses/total loans	0.80%	0.75%	0.63%		0.72%	0.73%

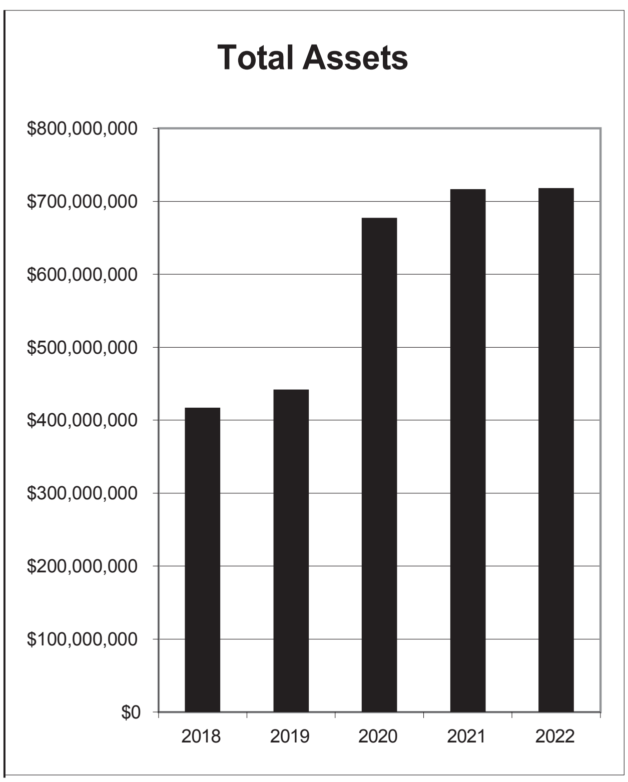
(a) - Operating data and related ratios are presented for 2020 excluding the one-time costs incurred during the acquisition of Carroll Bancorp, Inc.

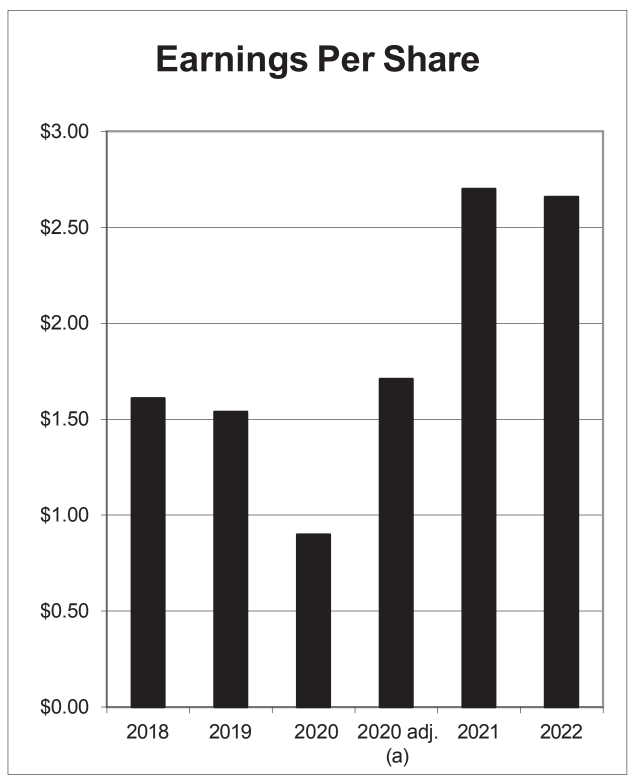
Farmers and Merchants Bancshares, Inc.

Selected Consolidated Financial Data









(a) - Excluding the one-time costs incurred during the acquisition of Carroll Bancorp, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto for the years ended December 31, 2022 and 2021, which are presented elsewhere in this annual report.

The Company was incorporated on August 8, 2016 for the purpose of becoming the bank holding company of the Bank in a share exchange transaction that was intended to constitute a tax-free exchange under Section 351 of the IRC. This reorganization was consummated on November 1, 2016, at which time the Bank became a wholly-owned subsidiary of the Company and all of the Bank's stockholders became stockholders of the Company by virtue of the conversion of their shares of common stock of the Bank into an equal number of shares of common stock of the Company.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

The consolidated financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and follow general practices within the industry in which the Company operates. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the consolidated financial statements; accordingly, as this information changes, the consolidated financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported.

The most significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements presented elsewhere in the annual report. These policies, along with the disclosures presented in the other financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the determination of the allowance for loan losses as the accounting area that requires the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available.

The allowance for loan losses represents management's estimate of probable loan losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the balance sheet. Note 1 to the consolidated financial statements describes the methodology used to determine the allowance for loan losses.

Management applies various valuation methodologies to assets and liabilities which often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets, such as most investment securities. However, for those items for which an observable liquid market does not exist, management utilizes significant estimates and assumptions to value such items. Examples of these items include loans, deposits, borrowings, goodwill, core deposit and other intangible assets, other assets and liabilities obtained or assumed in business combinations. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on our results of operations, financial condition or disclosures of fair value information. In addition to valuation, we must assess whether there are any declines in value below the carrying value of assets that should be considered other than temporary or otherwise require an adjustment in carrying value and recognition of a loss in the consolidated statements of income. Examples include investment securities, goodwill and core deposit intangible, among others.

PAYCHECK PROTECTION PROGRAM

The U.S. Government's Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") established the Small Business Administration ("SBA") Paycheck Protection Program ("PPP"), which provided small businesses in 2020 and 2021 with resources to maintain payroll, hire back employees who may have been laid off, and to cover applicable overhead expenses. During 2021, we made $22 million of PPP loans. All PPP loans are 100% guaranteed by the SBA. At December 31, 2022, $0.7 million of PPP loans are outstanding compared to $9.7 million at December 31, 2021.

FINANCIAL CONDITION

Total assets were $718,210,672 at December 31, 2022, an increase of $1,533,417, or 0.2%, over the $716,677,255 recorded at December 31, 2021. The increase was due primarily to an increase of $34,909,206 in loans, an increase of $6,215,208 in deferred taxes, and an increase of $3,029,179 in bank owned life insurance, offset by a decrease of $24,266,665 in securities available for sale and held to maturity and a decrease of $19,198,569 in cash and cash equivalents.

Total liabilities were $670,435,709 at December 31, 2022, an increase of $10,379,912, or 1.6%, over the $660,055,797 recorded at December 31, 2021. The increase was due primarily to an increase of $15,000,000 in Federal Home Loan Bank of Atlanta ("FHLB") advances, offset by a decrease of $2,803,546 in deposits and a decrease of $1,883,263 in long term debt.

Stockholders' equity was $47,774,963 at December 31, 2022 compared to $56,621,458 at December 31, 2021, a decrease of $8,846,495, or 15.6%. The decrease was due to an after-tax unrealized loss on available for sale securities of $15,710,893 and dividends paid, net of reinvestments, of $1,225,729, offset by net income for 2022 of $8,090,127.

Loans

Major categories of loans at December 31, 2022 and 2021 are as follows:

	2022		2021	
Real estate:				
Commercial	$ 351,794,702	67%	$ 319,185,116	66%
Construction/Land development	23,978,373	5%	28,221,854	6%
Residential	114,683,149	22%	107,436,033	22%
Commercial	31,066,497	6%	31,182,206	6%
Consumer	156,422	0%	355,958	0%
	521,679,143	100%	486,381,167	100%
Less: Allowance for loan losses	4,150,198		3,650,268	
Deferred origination fees net of costs	608,405		719,565	
	$ 516,920,540		$ 482,011,334	

The Company had no foreign loans for any of the years presented.

Loans increased by $34,909,206, or 7.2%, to $516,920,540 at December 31, 2022 from $482,011,334 at December 31, 2021. The increase was due primarily to increases in commercial real estate loans of $32,609,586 and residential real estate loans of $7,247,116, offset by a decrease in construction/land development loans of $4,243,481. With several new loan officers on staff in 2022, total loan production increased by $18 million in 2022 as compared to 2021. In addition, line of credit usage increased by $4 million. Also, loan payoffs decreased by $22 million since rising rates made it more difficult for borrowers to refinance. Finally, $9 million of PPP loans were forgiven. For construction/land development loans the decrease was due primarily to several loans moving to permanent status after the construction completion. The allowance for loan losses increased by $499,930 to $4,150,198 at December 31, 2022 as compared to $3,650,268 at December 31, 2021.

Commercial loans in the table above include $0.7 million and $9.7 million of PPP loans as of December 31, 2022 and December 31, 2021, respectively, which are 100% guaranteed by the SBA. None of these loans were originated during 2022 compared to $22 million originated in 2021.

The Company has adopted policies and procedures that seek to mitigate credit risk and to maintain the quality of the loan portfolio. These policies include underwriting standards for new credits as well as the continuous monitoring including annual external loan reviews and monthly review at loan committee, and reporting of asset quality and the adequacy of the allowance for loan losses. These policies, coupled with continuous training efforts, have provided effective checks and balances for the risk associated with the lending process. Lending authority is based on the level of risk, size of the loan, and the experience of the lending officer. The Company's policy is to make the majority of its loan commitments in the market area it serves. Management believes that this tends to reduce risk because management is familiar with the credit histories of loan applicants and has in-depth knowledge of the risk to which a given credit is subject. Although the loan portfolio is diversified, its performance will be influenced by the economy of the region.

The maturities and interest rate sensitivity of the loan portfolio at December 31, 2022 is as follows:

	Maturing within one year	Maturing after one but within five years	Maturing after five but within fifteen years	Maturing after fifteen years	Total
Real estate:					
Commercial	$ 26,472,724	$ 178,967,907	$ 121,354,539	$ 24,999,532	$ 351,794,702
Construction/Land development	12,965,681	7,499,058	1,809,743	1,703,891	23,978,373
Residential	10,117,341	61,768,382	24,383,092	18,414,334	114,683,149
Commercial	9,405,381	14,984,162	6,581,007	95,947	31,066,497
Consumer	34,202	112,990	9,230	-	156,422
	$ 58,995,329	$ 263,332,499	$ 154,137,611	$ 45,213,704	$ 521,679,143
Rate terms:					
Fixed-interest rate loans	$ 42,703,907	$ 228,449,144	$ 96,821,699	$ 10,518,575	$ 378,493,325
Adjustable-interest rate loans	16,291,422	34,883,355	57,315,912	34,695,129	143,185,818
	$ 58,995,329	$ 263,332,499	$ 154,137,611	$ 45,213,704	$ 521,679,143

It is the Company's policy to place a loan in nonaccrual status when any portion of the principal or interest is 90 days past due unless there are mitigating factors. Management closely monitors nonaccrual loans. The Company returns a nonaccrual loan to accruing status when (i) the loan is brought current with the full payment of all principal and interest arrearages, (ii) all contractual payments are thereafter made on a timely basis for at least six months, and (iii) management determines, based on a credit review, that it is reasonable to expect that future payments will be made as and when required by the contract.

Year-end non-accrual loans, segregated by class of loans, were as follows:

	2022	2021
Non-accrual loans		
Commercial real estate	$ 502,961	$ 4,810,965
Residential real estate	-	31,500
Commercial	152,449	152,449
Total non-accrual loans	$ 655,410	$ 4,994,914

At December 31, 2022, the Company had one non-accrual commercial real estate loan totaling $502,961 and one non-accrual commercial loan totaling $152,449. The commercial loan was secured by business assets and was personally guaranteed. Gross interest income of $45,856 would have been recorded in 2022 if these non-accrual loans had been current and performing in accordance with the original terms. The Company allocated $281,910 of its allowance for loan losses to these non-accrual loans. The decrease of $4.3 million from December 31, 2021 to December 31, 2022 is due to a loan of the same balance that began making full principal and interest payments again in July 2022.

At December 31, 2021, the Company had two non-accrual commercial real estate loan totaling $4,810,965, one non-accrual residential real estate loan totaling $31,500, and one non-accrual commercial loan totaling $152,449. The real estate loan was secured by real estate and business assets and was personally guaranteed. The commercial loan was secured by business assets and was personally guaranteed. Gross interest income of $219,734 would have been recorded in 2021 if these non-accrual loans had been current and performing in accordance with the original terms. The Company allocated $281,910 of its allowance for loan losses to these non-accrual loans. The balance of the nonaccrual loans was net of charge-offs and a nonaccretable discount totaling $27,146 at December 31, 2021.

At December 31, 2022, the Company had no loans that were delinquent 90 days or greater other than the non-accrual loans listed above. At December 31, 2021, the Company had one residential real estate loan with a carrying value of $217,661 and two commercial loans with a carrying value of $263,241 that were delinquent 90 days or greater in addition to the non-accrual loans listed above. The residential loan is a chronic delinquent loan that the borrower brings current at least several times a year. The two commercial loans were PPP loans that were fully guaranteed and were paid in full in January 2022.

Year-end impaired loans are set forth in the following table:

	2022	2021
Impaired loans no valuation allowance	$ 6,772,804	$ 6,357,199
Impaired loans with a valuation allowance	655,410	655,410
Total impaired loans	$ 7,428,214	$ 7,012,609
Valuation allowance related to impaired loans	$ 281,910	$ 281,910

Impaired loans include certain loans that have been modified in troubled debt restructurings ("TDRs") where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months.

At December 31, 2022, the Company had two commercial real estate loans totaling $6,516,454 and two residential loans totaling $256,350 that were classified as TDRs. All four loans are included in impaired loans above. Each loan is paying as agreed. None of the borrowers have defaulted nor have there been charge-offs or allowances associated with the four loans. One of the commercial real estate loans with a principal balance of $4,542,896 and one of the residential loans with a principal balance of $222,767 were restructured as TDRs during 2022.

At December 31, 2021, the Company had one commercial real estate loan totaling $2,009,967 and one residential loan totaling $39,228 classified as TDRs. Both loans are included in impaired loans above. Each loan is paying as agreed. There have been no charge-offs or allowances associated with these two loans.

Year-end TDRs are set forth in the following table:

	2022	2021
Restructured loans (TDRs):		
Total – all performing as agreed	$ 6,772,804	$ 2,049,195

As part of our portfolio risk management, the Company assigns a risk grade to each loan. The factors used to determine the grade are the payment history of the loan and the borrower, the value of the collateral and net worth of any guarantor, and cash flow projections of the borrower. Special mention, Substandard, and Doubtful grades are assigned to loans with a higher frequency of delinquent payments and/or the collateral and/or cash flow are insufficient to support the loan and such loans are included on the Company's watch list. The Special mention grade is intended to be a temporary grade.

Year-end loans graded special mention, substandard and doubtful are set forth in the following table:

	2022	2021
Special mention	$ 5,530,925	$ 5,288,153
Substandard	12,070,750	15,109,965
Doubtful	35,381	20,627
Total	$ 17,637,056	$ 20,418,745

The allowance for loan losses is a reserve established through a provision for loan losses and is charged to expense. The allowance for loan losses represents an amount which, in management's judgment, will be adequate to absorb probable losses on existing loans and other extensions of credit that may become uncollectible. The Company's allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions.

The Company's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, classified and criticized loans and net charge-offs or recoveries, among other factors.

Although management believes, based on currently available information, that the Company's allowance for loan losses is sufficient to cover losses probable and estimable inherent in its loan portfolio at this time, no assurances can be given that the Company's level of allowance for loan losses will be sufficient to cover future loan losses incurred by the Company or that future adjustments to the allowance for loan losses will not be necessary if economic or other conditions differ substantially from the economic and other conditions at the time management determined the current level of the allowance for loan losses.

The following tables detail activity in the allowance for loan losses by portfolio for the years ended December 31, 2022 and 2021. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

							Allowance for loan losses ending balance evaluated for impairment:			Outstanding loan balances evaluated for impairment:		
December 31, 2022	Beginning balance	Provision for loan losses	Charge offs	Recoveries	Ending balance	Loan Segment Percentage	Individually	Purchase Credit Impaired	Collectively	Individually	Purchase Credit Impaired	Collectively
Real estate:												
Commercial	$ 2,482,930	$ 343,424	$ (7,772)	$ -	$ 2,818,582	67%	$ 129,461	$ -	$ 2,689,121	$ 7,019,415	$ -	$ 344,775,287
Construction and land development	214,547	(66,151)	-	16,200	164,596	5%	-	-	164,596	-	369,622	23,608,751
Residential	603,558	173,859	(2,468)	18,970	793,919	22%	-	-	793,919	256,350	209,583	114,217,216
Commercial	255,413	81,890	-	-	337,303	6%	152,449	-	184,854	152,449	-	30,914,048
Consumer	4,370	336	-	-	4,706	0%	-	-	4,706	-	-	156,422
Unallocated	89,450	(58,358)	-	-	31,092	0%	-	-	31,092	-	-	-
	$ 3,650,268	$ 475,000	$ (10,240)	$ 35,170	$ 4,150,198	100%	$ 281,910	$ -	$ 3,868,288	$ 7,428,214	$ 579,205	$ 513,671,724

							Allowance for loan losses ending balance evaluated for impairment:			Outstanding loan balances evaluated for impairment:		
December 31, 2021	Beginning balance	Provision for loan losses	Charge offs	Recoveries	Ending balance	Loan Segment Percentage	Individually	Purchase Credit Impaired	Collectively	Individually	Purchase Credit Impaired	Collectively
Real estate:												
Commercial	$ 2,230,129	$ 241,301	$ -	$ 11,500	$ 2,482,930	66%	$ 129,461	$ -	$ 2,353,469	$ 6,820,932	$ 56,825	$ 312,307,359
Construction and land development	201,692	(3,345)	-	16,200	214,547	6%	-	-	214,547	-	383,666	27,838,188
Residential	644,639	(22,111)	(18,970)	-	603,558	22%	-	-	603,558	39,228	568,151	106,828,654
Commercial	111,390	129,023	-	15,000	255,413	6%	152,449	-	102,964	152,449	-	31,029,757
Consumer	2,138	2,232	-	-	4,370	0%	-	-	4,370	-	-	355,958
Unallocated	106,550	(17,100)	-	-	89,450	0%	-	-	89,450	-	-	-
	$ 3,296,538	$ 330,000	$ (18,970)	$ 42,700	$ 3,650,268	100%	$ 281,910	$ -	$ 3,368,358	$ 7,012,609	$ 1,008,642	$ 478,359,916

	2022	2021
Allowance for loan losses to total loans outstanding	0.80%	0.75%
Ratio of net charge-offs to average loans outstanding during the period	0.00%	0.00%
Nonaccrual loans to total loans outstanding at period end	0.13%	1.03%
Allowance for loan losses to nonaccrual loans at period end	633.22%	73.08%

Net recovery (charge-offs) during the period to average loans outstanding:

	2022
Real estate:	
Commercial	0.00%
Construction and land development	0.06%
Residential	0.02%
Commercial	-0.01%
Consumer	0.00%
Total	0.01%

The Company recorded net recoveries of $24,930 and $23,730 for 2022 and 2021, respectively. The provision for loan losses was $475,000 in 2022 and $330,000 in 2021.

Management believes that the $4.2 million reserve at December 31, 2022 and the $475,000 provision for the year ended December 31, 2022 are appropriate to adequately cover the probable and estimable losses inherent in the loan portfolio. The reserve increased by $499,930 or 14% from December 31, 2021. Excluding PPP loans, the Company's loan portfolio grew by $44 million during the 2022. An increasing portfolio typically requires a commensurate increase in the provision. In addition, several qualitative factors were increased to reflect the potential impact of rising interest rates on loan losses.

Other Real Estate Owned

Other real estate owned ("OREO") at December 31, 2022 included two properties with an aggregate carrying value of $1,242,365. The first property is an apartment building in Baltimore, Maryland with a carrying value of $1,242,365 that was acquired in the Merger. The property is being marketed for sale. The other property is land in Cecil County, Maryland with a carrying value of $0. It was acquired through foreclosure in 2007. The latter property consists of 10.43 acres and is currently under contract for a gross sales price of $295,000 with closing expected in 2023. Due to the length of time that the latter property has been held, Maryland banking law required a write-down of the value to $0 in 2019.

	2022	2021
Other Real Estate Owned	$ 1,242,365	$ 1,242,365

Investment Securities

Investment securities decreased by $24,266,445, or 14.2%, to $146,823,446 at December 31, 2022 from $171,089,891 at December 31, 2021. The decrease was due primarily to a $21,675,430 increase in the unrealized loss of the available for sale securities as a result of the significant increase in interest rates during 2022. At December 31, 2022 and 2021, the Company had classified 86% and 87%, respectively, of the investment portfolio as available for sale. The remaining balance of the portfolio was classified as held to maturity.

Securities classified as available for sale are held for an indefinite period of time and may be sold in response to changing market and interest rate conditions as part of the Company's asset/liability management strategy. Available for sale securities are carried at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity, net of income taxes. Securities classified as held to maturity, which management has both the positive intent and ability to hold to maturity, are reported at amortized cost. The Company does not currently follow a strategy of making security purchases with a view to near-term sales, and, therefore, does not own trading securities. The Company manages the investment portfolio within policies that seek to achieve desired levels of liquidity, manage interest rate sensitivity, meet earnings objectives, and provide required collateral for deposit and borrowing activities.

The following table sets forth the carrying value of investment securities at December 31:

	2022	2021
Available for sale		
State and municipal	$ 552,281	$ 763,498
SBA pools	1,019,797	1,397,762
Corporate bonds	9,389,896	9,234,207
Mortgage-backed securities	115,352,475	137,842,449
	$126,314,449	$149,237,916
Held to maturity		
State and municipal	$ 20,508,997	$ 21,851,975

The following table sets forth the scheduled maturities of investment securities at December 31, 2022:

	Available for Sale			Held to Maturity		
	Amortized Cost	Fair Value	Yield (1)	Amortized Cost	Fair Value	Yield (1)
Within 1 year	$ 580,522	$ 564,841	1.39%	$ 330,000	$ 330,175	4.00%
Over 1 to 5 years	3,079,483	2,937,072	2.12%	474,937	469,235	2.77%
Over 5 to 10 years	7,324,263	6,440,264	4.62%	3,308,340	3,162,389	2.78%
Over 10 years	-	-	-	16,395,720	14,917,996	3.02%
	10,984,268	9,942,177	3.75%	20,508,997	18,879,795	2.99%
SBA Pools	1,033,606	1,019,797	4.12%	-	-	-
Mortgage-backed securities	137,896,519	115,352,475	1.97%	-	-	-
	$ 149,914,393	$ 126,314,449	2.12%	$ 20,508,997	$ 18,879,795	2.99%

(1) – the yields indicated are based upon the amortized cost and have not been tax effected for tax exempt securities.

SBA pools and mortgage-backed securities are due in monthly installments.

Deposits

Total deposits were $623,611,124 at December 31, 2022 compared to $626,414,670 at December 31, 2021, a decrease of $2,803,546, or 0.4%. The decrease was due to a $22,080,938 decrease in certificates of deposit, offset by a $3,348,466 increase in savings accounts, a $5,229,891 increase in interest bearing checking accounts, a $8,179,301 increase in money market accounts and a $2,519,734 increase in noninterest-bearing accounts.

The following table shows the average balances and average costs of deposits for the years ended December 31:

	2022		2021	
	Average Balance	Cost	Average Balance	Cost
Noninterest bearing demand deposits	$ 129,642,652	0.00%	$ 120,935,434	0.00%
Interest bearing demand deposits	134,141,125	0.17%	118,795,136	0.18%
Savings and money market deposits	199,407,223	0.13%	183,453,217	0.15%
Certificates of deposit	168,618,943	0.53%	187,568,107	0.81%
	$ 631,809,943	0.22%	$ 610,751,894	0.33%

As of December 31, 2022, certificates of deposit greater than $250,000 mature as follows:

Period	Balance
3 months or less	$ 13,376,259
Over 3 months to 6 months	6,248,186
Over 6 months to 12 months	8,358,449
Over 12 months	9,993,344
Total	$ 37,976,238

Uninsured deposits totaled $162,415,782 at December 31, 2022.

Off-Balance Sheet Arrangements

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, lines of credit, including home-equity lines and commercial lines, and letters of credit. Loan commitments generally have interest rates at current market values, fixed expiration dates, and may require a fee. Lines of credit generally have variable interest rates and do not necessarily represent future cash flow requirements because it is unlikely that all customers will draw upon their lines in full at any one time. Letters of credit are commitments issued to guarantee the performance of a customer to a third party. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet.

For commitments to extend credit, lines of credit, and letters of credit, the Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument is represented by the contractual notional amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

At December 31, 2022, the Company's off-balance sheet financial instruments were as follows:

Loan commitments	$ 13,975,917
Unused lines of credit	$ 37,550,783
Letters of credit	$ 1,403,956

Management does not believe that any of the foregoing arrangements are reasonably likely to have a material adverse effect on the Company's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

Borrowings and Other Contractual Obligations

The Company's contractual obligations consist primarily of borrowings and operating leases for various facilities.

Securities sold under agreements to repurchase represent overnight borrowings from customers. Securities owned by the Company which are used as collateral for these borrowings are primarily U.S. government agency securities.

On September 30, 2020, Farmers and Merchants Bancshares, Inc. borrowed $17,000,000 from First Horizon Bank ("FHN") to be used, on October 1, 2020, to fund a portion of the merger consideration paid in the Merger. Net of issuance costs of $28,126, the proceeds of the net long-term debt was $16,971,874. The loan matures on September 30, 2025. The interest rate on the loan is fixed at 4.10%. The Company made quarterly interest-only payments through October 1, 2021. During the remaining term of the loan, the Company is required to make quarterly interest and principal payments of approximately $646,472, which is based on a nine-year straight-line amortization schedule. The remaining balance of approximately $9,916,667 will be due at maturity. To secure its obligations under this loan, the Company pledged all of its shares of common stock of the Bank to the lender.

Specific information about the Company's borrowings and contractual obligations is set forth in the following table:

		At December 31,	
		2022	2021
Amount outstanding at year-end:			
Securities sold under repurchase agreements		$ 5,175,303	$ 5,414,026
Federal Home Loan Bank advances		20,000,000	5,000,000
Federal Home Loan Bank advances mature in:			
	2023	$ 15,000,000	$ -
	2025	$ 5,000,000	$ 5,000,000
Long-term debt (net of issuance costs) matures in	2025	15,095,642	16,978,905
Weighted average rate paid at December 31:			
Securities sold under repurchase agreements		0.30%	0.31%
Federal Home Loan Bank advances		3.68%	1.00%
Long-term debt		4.10%	4.10%

	For years ended December 31,	
	2022	2021
Average rate paid for the year:		
Securities sold under repurchase agreements	0.30%	0.43%
Federal Home Loan Bank advances	1.55%	1.01%
Long-term debt	4.10%	4.10%

The terms of the Company's operating leases, including the future minimum payments under those leases, are disclosed in Note 9 to the consolidated financial statements.

RESULTS OF OPERATIONS

Overview

The Company reported net income of $8,090,127 for the year ended December 31, 2022 compared to $8,149,606 for the year ended December 31, 2021. The decrease of $59,479 from 2021 was due to an increase in noninterest expense of $1,238,681, an increase in the provision for loan losses of $145,000, and an increase in income taxes of $52,213, offset by an increase in net interest income of $1,248,391 and an increase in noninterest income of $128,024.

Net Interest Income

The primary source of income for the Company is net interest income, which is the difference between interest income on interest-earning assets, such as investment securities and loans, and interest expense incurred on interest-bearing sources of funds, such as deposits and borrowings.

For the year ended December 31, 2022, the Company recorded net interest income of $24,123,495 compared to $22,875,104 for 2021, an increase of $1,248,391. The increase was attributable to an increase in the average balance of interest-earning assets of $22,011,503 to $686,760,420 in 2022 from $664,748,917 in 2021, and an increase in the net yield on interest-earning assets of 7 basis points to 3.54% in 2022 from 3.47% in 2021.

Total interest income for the year ended December 31, 2022 increased by $589,250 to $26,269,653, from $25,680,403 for 2021. The increase was due primarily to the aforementioned increase in average interest earning assets, offset by a decrease of 4 basis points in the tax equivalent yield on interest earning assets to 3.85% in 2022 from 3.89% in 2021.

Interest income from loans was $22,565,034 in 2022 compared to $23,491,614 in 2021, a decrease of $926,580. This decrease was attributable to a $16,740,010 decrease in the average balance of loans to $498,427,308 in 2022 from $515,167,318 in 2021, and a 3 basis point decrease in the average yield on loans to 4.53% in 2022 from 4.56% in 2021. PPP revenue recognized declined by approximately $659,000 in 2022 compared to 2021 which contributed to a 13 basis point decline in the yield.

For the year ended December 31, 2022, the Company recorded interest income on securities of $3,551,955 compared to $2,123,293 for the same period in 2021. The $1,428,662 increase in 2022 was attributable to a $54,871,003 increase in the average balance of securities to $174,776,879 in 2022 from $119,905,876 in 2021, and a 21 basis point increase in the average tax equivalent yield on securities to 2.13% in 2022 from 1.92% in 2021.

Interest income on federal funds sold and other interest-earning assets (FHLB stock and certificates of deposit) increased $87,168 to $152,664 in 2022 compared to $65,496 in 2021. The increase was due to a 97 basis point decrease in the average tax equivalent yield to 1.20% in 2022 from 0.23% in 2021, offset by a $16,119,490 decrease in the average balance of federal funds sold and other interest-earning assets to $13,556,233 in 2022 from $29,675,723 in 2021.

Total interest expense decreased by $659,141 to $2,146,158 in 2022 compared to $2,805,299 in 2021. The decrease was due to a 13 basis point decrease in the cost of interest-bearing liabilities to 0.41% in 2022 from 0.54% in 2021, offset by an increase of $5,994,959 in the average balance of interest-bearing liabilities to $528,210,165 in 2022 from $522,215,206 in 2021.

Interest paid on NOW, savings, and money market deposit accounts decreased by $9,330 to $476,213 in 2022 compared to $485,543 in 2021. The decrease was due to a 2 basis point decrease in the cost of funds to 0.14% in 2022 from 0.16% in 2021 offset by a $31,299,995 increase in the average balance of these deposits to $333,548,348 in 2022 from $302,248,353 in 2021.

Interest paid on time deposits decreased by $612,852 to $899,478 in 2022 compared to $1,512,330 in 2021. The decrease was due to a decrease of 28 basis points in the average rate paid to 0.53% in 2022 from 0.81% in 2021, and a decrease of $18,949,164 in the average balance to $168,618,943 in 2022 from $187,568,107 in 2021.

Interest paid on securities sold under repurchase agreements decreased by $31,860 to $12,768 in 2022 compared to $44,628 in 2021. The decrease was attributable to a decrease of 13 basis points in the average rate paid to 0.30% in 2022 from 0.43% in 2021, and a $6,167,187 increase in the average balance of securities sold under repurchase agreements to $4,255,436 in 2022 from $10,422,623 in 2021.

Interest paid on long-term debt was $664,620 in 2022 compared to $712,306 in 2021. This debt relates to the $17 million term loan obtained on September 30, 2021 to finance a portion of the cash paid to the former stockholders of Carroll Bancorp, Inc. in the Merger. The average balance, net of issuance costs, decreased $1,059,888 to 15,916,205 in 2022 from $16,976,093 in 2021 due to scheduled principal payments.

Interest paid on FHLB advances and other borrowings increased $42,587 to $93,079 in 2022 from $50,492 in 2021. The increase was attributable to an increase of 58 basis points in the average rate paid to 1.59% in 2022 from 1.01% in 2021, and a $871,203 increase in the average balance of FHLB advances and other borrowings to $5,871,233 in 2022 from $5,000,030 in 2021.

The following table sets forth certain information relating to the Company's average interest-earning assets and interest-bearing liabilities for the periods indicated. The yields and rates are calculated by dividing interest income or expense by the average daily balance of assets or liabilities, respectively. Non-accruing loans are included in the average balance.

	2022			2021		
	Average Balance	Interest	Yield	Average Balance	Interest	Yield
Assets:						
Loans	$ 498,427,308	$22,565,034	4.53%	$ 515,167,318	$23,491,614	4.56%
Securities, taxable (1)	156,008,736	2,986,225	1.91%	99,668,430	1,516,487	1.52%
Securities, tax exempt (1)	18,768,143	736,696	3.93%	20,237,446	787,818	3.89%
Federal funds sold and other interest earning assets (1)	13,556,233	162,410	1.20%	29,675,723	69,098	0.23%
Total interest-earning assets	686,760,420	26,450,365	3.85%	664,748,917	25,865,017	3.89%
Noninterest-earning assets	27,355,077			38,706,505		
Total assets	$ 714,115,497			$ 703,455,422		
Liabilities and Stockholders' Equity:			Rate			Rate
NOW, savings, and money market	$ 333,548,348	476,213	0.14%	$ 302,248,353	485,543	0.16%
Certificates of deposit	168,618,943	899,478	0.53%	187,568,107	1,512,330	0.81%
Securities sold under repurchase agreements	4,255,436	12,768	0.30%	10,422,623	44,628	0.43%
Long-term debt	15,916,205	664,620	4.18%	16,976,093	712,306	4.20%
FHLB advances and other borrowings	5,871,233	93,079	1.59%	5,000,030	50,492	1.01%
Total interest-bearing deposits	528,210,165	2,146,158	0.41%	522,215,206	2,805,299	0.54%
Noninterest-bearing deposits	129,642,652			120,935,434		
Noninterest-bearing liabilities	5,804,686			5,419,526		
Total liabilities	663,657,503			648,570,166		
Stockholders' equity	50,457,994			54,885,256		
Total liabilities and stockholders' equity	$ 714,115,497			$ 703,455,422		
Net interest income		$24,304,207			$23,059,718	
Interest rate spread			3.44%			3.35%
Net yield on interest-earning assets			3.54%			3.47%
Ratio of average interest-earning assets to average interest-bearing liabilities			130.02%			127.29%

(1) - Interest on tax-exempt investments are reported on a fully taxable equivalent basis. The federal, state, and combined tax rates used were 21.00%, 8.25%, and 27.5175% respectively.

The following table sets forth the dollar amount of changes in interest income and interest expense for the major categories of the Company's interest-earning assets and interest-bearing liabilities. The table distinguishes between (i) changes in net interest income attributed to volume (change in volume multiplied by the prior year's interest rate), and (ii) changes in net interest income attributed to rate (change in rate multiplied by the prior year's volume). The change in interest due to the combined rate and volume changes is allocated proportionally to the change in volume and rate.

Rate/Volume Analysis

	Year ended December 31, 2022 compared to 2021			Year ended December 31, 2021 compared to 2020		
	Change due to variance in			Change due to variance in		
	Volume	Rate	Total	Volume	Rate	Total
Interest income:						
Loans	$ (758,854)	$ (167,726)	$ (926,580)	$ 4,293,991	$ (93,539)	$ 4,200,452
Securities, taxable	1,009,107	460,631	1,469,738	856,005	(114,100)	741,905
Securities, tax exempt	(57,625)	6,503	(51,122)	(43,603)	31,580	(12,023)
Federal funds sold and other interest-earning assets	(55,105)	148,417	93,312	56,920	(67,668)	(10,748)
Total interest-earning assets	137,523	447,825	585,348	5,163,313	(243,727)	4,919,586
Interest expense:						
NOW, savings, and money market	47,585	(56,915)	(9,330)	199,146	(232,621)	(33,475)
Certificates of deposit	(140,897)	(471,955)	(612,852)	303,198	(1,400,844)	(1,097,646)
Securities sold under repurchase agreements	(21,159)	(10,701)	(31,860)	11,269	(73,959)	(62,690)
Long-term debt	(44,274)	(3,412)	(47,686)	526,496	4,345	530,841
FHLB advances and other borrowings	9,972	32,615	42,587	1,055	8,537	9,592
Total interest-bearing liabilities	(148,773)	(510,368)	(659,141)	1,041,164	(1,694,542)	(653,378)
Change in net interest income	$ 286,296	$ 958,193	$ 1,244,489	$ 4,122,149	$ 1,450,815	$ 5,572,964

Noninterest Income

Noninterest income was $2,293,938 in 2022 compared to $2,165,914 in 2021, an increase of $128,024. The increase was due primarily to a $673,483 gain on insurance proceeds from the storm damage to the Bank's Upperco, Maryland location and a $151,206 increase in the gain on sale of SBA loans, offset by a $696,470 decrease in mortgage banking revenue as a result of the significant increase in interest rates in 2022 which reduced residential loan activity.

Noninterest Expense

Total noninterest expense increased by $1,238,681 to $15,367,280 in 2022 from $14,128,599 in 2021. The increase was due primarily to increases in salaries and benefits of $730,088 as a result of the addition of several new positions as well as normal salary increases, and an increase in professional fees of $475,872 as a result of third party fees paid in connection with the hiring of new employees.

Other noninterest expenses include the following:

	2022	2021
Directors fees	212,436	221,239
Insurance claims	205,000	145,000
Telephone	202,854	219,418
Correspondent bank services	195,223	185,081
Internet banking fees	177,164	168,424
Stationery, printing, and supplies	176,467	225,266
Liability insurance	137,885	106,938
Other	550,754	516,268
	$ 1,857,783	$ 1,787,634

Income Taxes

Income taxes increased by $52,213 to $2,485,026 in 2022 from $2,432,813 in 2021.

The Company's effective tax rate increased to 23.5% in 2022, from 23.0% in 2021. The increase was due to a lower percentage of tax-exempt revenue. Note 14 to the consolidated financial statements provides additional information about the Company's taxes, including a reconciliation of the Company's effective tax rate to the Federal statutory rate of 21%.

Quarterly Results of Operations

	Three Months Ended Unaudited			
2022	**December 31**	**September 30**	**June 30**	**March 31**
Interest income	$ 6,918,716	$ 6,586,065	$ 6,275,147	$ 6,489,725
Interest expense	623,247	494,313	502,962	525,636
Net interest income	6,295,469	6,091,752	5,772,185	5,964,089
Provision for loan losses	380,000	95,000	-	-
Net income	2,014,282	1,974,310	2,050,733	2,050,802
Earnings per share - basic and diluted	$ 0.66	$ 0.65	$ 0.67	$ 0.68
2021	**December 31**	**September 30**	**June 30**	**March 31**
Interest income	$ 6,374,432	$ 6,654,268	$ 6,281,111	$ 6,370,592
Interest expense	607,293	662,279	738,590	797,137
Net interest income	5,767,139	5,991,989	5,542,521	5,573,455
Provision for loan losses	(100,000)	330,000	(20,000)	120,000
Net income	1,965,265	2,122,547	2,032,219	2,029,575
Earnings per share - basic and diluted	$ 0.65	$ 0.70	$ 0.67	$ 0.67

INTEREST RATE RISK

The Company's principal market risk is exposure to the risk that the interest rates associated with our interest-bearing liabilities and interest-earning assets will fluctuate. This risk arises from the Company's lending, investing and deposit-taking activities, and is affected by many factors, including economic and financial conditions, movements in interest rates and consumer preferences. Interest rate fluctuation has a direct impact on the Company's net interest income. Net interest income is susceptible to interest rate risk when deposits and other short-term liabilities have different repricing intervals than do loans, investments and other interest-earning assets. When interest-earning assets mature or reprice faster than interest-bearing liabilities, a decline in interest rates may cause a decline in net interest income. Conversely, when interest-bearing liabilities mature or reprice faster than interest-earning assets, an increase in interest rates may cause a decline in net interest income.

The Company recognizes that there are many types of interest rate risk. Management believes that the three types that pose the greatest potential threat to current and long-term earnings are:

- Repricing risk – the difference in the timing of the scheduled maturity and re-pricing dates of assets and liabilities within a certain time frame;
- Option risk – interest rate related options embedded in the Company's assets and liabilities which change the cash flow characteristics of the assets and liabilities; and
- Yield curve / basis risk – changes in the relationship between different interest rates with the same maturity or interest rates across a maturity spectrum which create compression or expansion of our net interest margin.

The Company uses earnings at risk and economic value at risk measures to quantify our exposure to these types of interest rate risk. We believe that using simulations that measure all three types of risks in combination is a more efficient tool for measurement, and we therefore do not routinely process models to isolate each risk. Rather, we combine the three types of analyses, which we believe provides a better overall result than a simulation based on a single system and a more economical use of resources than targeted models. Following is a description of the analyses to be utilized:

Earnings at Risk

Earnings at Risk ("EAR") measures exposure to net changes in net interest income ("NII"), and is considered the Company's best source of managing short-term interest rate risk (one-year and two-year time frames). EAR is a dynamic analysis, which can capture all the different forms of interest rate risk under many different interest rate scenarios, and using various assumptions for growth, optionality, and yield curve structure.

Economic Value of Equity

Economic Value of Equity ("EVE") is management's primary analytical tool for measuring long-term interest rate risk, and helps to measure if the long-term safety and soundness of the Company is being compromised for the sake of short-term results. However, the Company also recognizes the inherent difficulties of calculating a definitive value for many sections of the balance sheet as well as the weakness that EVE ignores future events (e.g., growth, etc.). These difficulties, coupled with the nature of our core business, allow the Company to adopt wide limits for this measure.

In order to mitigate the impact of changing interest rates, the Board of Directors has established policies and procedures that include acceptable parameters for the relationship between rate sensitive assets to rate sensitive liabilities as measured by earnings at risk and economic value at risk. The Asset/Liability Committee reviews rate sensitivity measures on a quarterly basis. Material deviations from policy parameters are reported to the Board of Directors and corrective action is initiated and monitored.

Measures of NII at risk produced by simulation analysis are indicators of an institution's short-term performance in alternative rate environments. These measures are typically based upon a relatively brief period, usually one year. They do not necessarily indicate the long-term prospects or economic value of the institution.

Based upon the simulation analysis performed at December 31, 2022 and 2021, management estimated the following changes in NII, assuming the indicated rate changes:

Change in Rate	2022	2021
400 basis point increase	$(2,282,000)	$(1,844,000)
300 basis point increase	(1,610,000)	(1,191,000)
200 basis point increase	(958,000)	(677,000)
100 basis point increase	(424,000)	(278,000)
100 basis point decrease	417,000	(878,000)
200 basis point decrease	375,000	(1,131,000)
300 basis point decrease	216,000	(1,201,000)

LIQUIDITY MANAGEMENT

Liquidity describes our ability to meet financial obligations that arise out of the ordinary course of business. Liquidity is primarily needed to meet depositor withdrawal requirements, to fund loans, and to fund our other debts and obligations as they come due in the normal course of business. We maintain our asset liquidity position internally through short-term investments, the maturity distribution of the investment portfolio, loan repayments, and income from earning assets. On the liability side of the balance sheet, liquidity is affected by the timing of maturing liabilities and the ability to generate new deposits or borrowings as needed. The Bank is approved to borrow 75% of eligible pledged single family residential loans and 50% of eligible pledged commercial loans as well as investment securities, or approximately $60.5 million under a secured line of credit with the FHLB. The Bank also has a facility with the Federal Reserve Bank of Richmond (the "Reserve Bank") under which the Bank could borrow approximately $25.4 million. Finally, the Bank has $23,500,000 ($14,500,000 unsecured and $9,000,000 secured) overnight federal funds lines of credit available from commercial banks. FHLB advances of $20,000,000 and $5,000,000 were outstanding as of December 31, 2022 and 2021, respectively. There were no borrowings from the Reserve Bank or from the commercial banks' lines of credit at December 31, 2022 and 2021. On September 30, 2020, the Company borrowed $17,000,000 from a commercial bank, which was used on October 1, 2020 to fund a portion of the cash consideration paid to the former stockholders of Carroll Bancorp, Inc. in the Merger. The outstanding balance at December 31, 2022, net of unamortized issuance costs, was $15,095,642. Management believes that we have adequate liquidity sources to meet all anticipated liquidity needs over the next 12 months. Management knows of no trend or event which is likely to have a material impact on our ability to maintain liquidity at satisfactory levels.

Cash provided by operating activities decreased by $4,548,768 to $7,155,962 in 2022 from $11,704,730 in 2021. Cash used in investing activities decreased by $23,626,325 to $35,358,568 in 2022 from $58,984,893 in 2021 due primarily to a $110,483,756 decrease in the net cash outflow from the debt securities portfolio, offset by a $75,821,469 increase in the net cash outflow from the loan portfolio. Cash provided by financing activities decreased by $23,762,562 to $9,004,037 in 2022 from $32,766,599 in 2021 due primarily to a $55,905,586 decrease in the net cash inflow from deposits, offset by a $19,101,224 decrease in the net cash outflow from securities sold under repurchase agreements and a $15,000,000 increase in the net cash inflow from FHLB advances.

Information about the various financial obligations, including contractual obligations and commitments that may require future cash payments, to which we are subject is set forth above under the captions "Off-Balance Sheet Transactions" and "Borrowings and Other Contractual Obligations".

CAPITAL RESOURCES AND ADEQUACY

The Company 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 possible additional, discretionary actions by the regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices.

The Basel III Capital Rules became effective for the Bank on January 1, 2015 (subject to a phase-in period for certain provisions). Quantitative measures established by the Basel III Capital Rules to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the table below) of Common Equity Tier 1 capital, Tier 1 capital, and Total capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to adjusted quarterly average assets (as defined).

On September 17, 2019, the FDIC finalized a rule that introduces an optional simplified measure of capital adequacy for qualifying community banking organizations (i.e., the community bank leverage ratio ("CBLR") framework), as required by the Economic Growth, Regulatory Relief and Consumer Protection Act. The CBLR framework is designed to reduce burden by removing the requirements for calculating and reporting risk-based capital ratios for qualifying community banking organizations that opt into the framework.

On April 6, 2020, in a joint statement, the FDIC, Federal Reserve and the Office of Comptroller of the Currency ("OCC"), issued two interim final rules regarding temporary changes to the CBLR framework to implement provisions of the CARES Act. Under the interim final rules, the community bank leverage ratio was reduced to 8% beginning in the second quarter and for the remainder of calendar year 2020, 8.5% for calendar year 2021, and 9% thereafter. In order to qualify for the CBLR framework, a community banking organization must have a tier 1 leverage ratio of greater than 8%, less than $10 billion in total consolidated assets, and limited amounts of off-balance-sheet exposures and trading assets and liabilities. A qualifying community banking organization that opts into the CBLR framework and meets all requirements under the framework will be considered to have met the well-capitalized ratio requirements under the Prompt Corrective Action regulations and will not be required to report or calculate risk-based capital. The Company has not opted-in to the CBLR framework.

Additional information regarding the capital requirements that apply to us can be found in Note 14 of the consolidated financial statements and notes thereto included in the Annual Report.

The following table presents actual and required capital ratios as of December 31, 2022 and 2021, for the Bank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2022 and 2021, based on the phase-in provisions of the Basel III Capital Rules. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

(Dollars in thousands)	Actual		Minimum Capital Adequacy		To Be Well Capitalized	
December 31, 2022	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	$ 75,826	12.96%	$ 61,410	10.50%	$ 58,486	10.00%
Tier 1 capital (to risk-weighted assets)	71,676	12.26%	49,713	8.50%	46,789	8.00%
Common equity tier 1 (to risk-weighted assets)	71,676	12.26%	40,940	7.00%	38,016	6.50%
Tier 1 leverage (to average assets)	71,676	9.83%	29,167	4.00%	36,459	5.00%
December 31, 2021						
Total capital (to risk-weighted assets)	$ 69,957	13.24%	$ 55,471	10.50%	$ 52,830	10.00%
Tier 1 capital (to risk-weighted assets)	66,307	12.55%	44,905	8.50%	42,267	8.00%
Common equity tier 1 (to risk-weighted assets)	66,307	12.55%	36,981	7.00%	34,339	6.50%
Tier 1 leverage (to average assets)	66,307	9.27%	28,614	4.00%	35,797	5.00%

The Company intends to fund future growth primarily with cash, federal funds, maturities of investment securities and deposit growth. Management knows of no other trend or event that will have a material impact on capital.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Farmers and Merchants Bancshares, Inc.
Hampstead, Maryland

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Farmers and Merchants Bancshares, Inc. and its Subsidiaries (the Company) as of December 31, 2022 and 2021, the related consolidated statements of income, comprehensive income (loss), changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2022 and 2021, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

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

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

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

Critical Audit Matters

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing separate opinions on the critical audit matter or on the accounts or disclosures to which it relates.

Allowance for Loan Losses – Loans Collectively Evaluated for Impairment – Qualitative Factors

Description of the Matter

As described in Note 1 (Summary of Significant Accounting Policies) and Note 5 (Loans) to the consolidated financial statements, the Company maintains an allowance representing an amount which, in management's judgement, is appropriate to absorb the probable and estimable losses on existing loans and other extensions of credit that may become uncollectible. The Company's allowance for loan losses consists of three elements: (1) segregating the loan portfolio into pools based upon similar characteristics and risk profiles and applying a loss factor to the pools based on historical losses within those pools; (2) applying qualitative factors to the loan pools that consider economic and other factors, both internal and external, affecting the Company and the pools; and (3) determining specific reserves based on individual evaluation of impaired loans that are not included in the pools discussed above. The qualitative factors are established by applying a loss percentage to the loan pools and made up approximately $3.5 million of the total $4.2 million of allowance for loan losses as of December 31, 2022.

Qualitative factors are determined based on management's continuing evaluation of inputs and assumptions underlying the quality of the loan portfolio. Management evaluates qualitative factors by loan segment, primarily considering current economic conditions, changes in concentrations, delinquency and loan grading trends, movements in interest rates, lending policies and procedures, and may also consider the experience and tenure of the lending team, loan review system, and other legislative and regulatory factors external to the Company. Qualitative factors contribute significantly to the allowance for loan losses. Management exercised significant judgment when assessing the qualitative factors in estimating the allowance for loan losses. We identified the assessment of the qualitative factors as a critical audit matter as auditing the qualitative factors involved especially complex and subjective auditor judgment in evaluating management's assessment of the inherently subjective estimates.

How We Addressed the Matter in Our Audit

The primary audit procedures we performed to address this critical audit matter included:

- Substantively testing management's process, including evaluating their judgments and assumptions for developing the qualitative allocations, which included:
  - Evaluating the completeness and accuracy of data inputs used as a basis for the qualitative allocations.
  - Evaluating the reasonableness of management's judgments related to the determination of qualitative allocations.
  - Evaluating the qualitative allocations for directional consistency in comparison to prior periods and for reasonableness in comparison to supporting documentation.
  - Testing the mathematical accuracy of the allowance calculation, including the application of the qualitative allocations.

Yount, Hyde & Barbour, P.C.

We have served as the Company's auditor since 2021.

Richmond, Virginia
March 10, 2023

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Consolidated Balance Sheets

December 31,	**2022**	2021
Assets		
Cash and due from banks	**$ 6,414,822**	$ 25,258,932
Federal funds sold and other interest-bearing deposits	**848,715**	1,203,174
Cash and cash equivalents	**7,263,537**	26,462,106
Certificates of deposit in other banks	**100,000**	350,000
Securities available for sale, at fair value	**126,314,449**	149,237,916
Securities held to maturity, at cost	**20,508,997**	21,851,975
Equity security, at fair value	**489,145**	543,605
Restricted stock, at cost	**1,332,500**	675,400
Mortgage loans held for sale	**428,355**	126,500
Loans, less allowance for loan losses of **$4,150,198** and $3,650,268	**516,920,540**	482,011,334
Premises and equipment, net	**6,186,594**	6,259,421
Accrued interest receivable	**1,815,784**	1,609,063
Deferred income taxes, net	**8,392,658**	2,177,450
Other real estate owned, net	**1,242,365**	1,242,365
Bank owned life insurance	**14,585,342**	11,556,163
Goodwill and other intangibles, net	**7,042,752**	7,051,080
Other assets	**5,587,654**	5,522,877
	$ 718,210,672	$ 716,677,255
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing	**$ 126,695,349**	$ 124,175,615
Interest-bearing	**496,915,775**	502,239,055
Total deposits	**623,611,124**	626,414,670
Securities sold under repurchase agreements	**5,175,303**	5,414,026
Federal Home Loan Bank of Atlanta advances	**20,000,000**	5,000,000
Long-term debt, net of issuance costs	**15,095,642**	16,978,905
Accrued interest payable	**349,910**	295,910
Other liabilities	**6,203,730**	5,952,286
	670,435,709	660,055,797
Commitments and contingencies		
Stockholders' equity		
Common stock, par value $.01 per share, authorized 5,000,000 shares; issued and outstanding **3,071,214** in 2022 and 3,037,137 shares in 2021	**30,712**	30,372
Additional paid-in capital	**29,549,914**	28,857,422
Retained earnings	**35,300,166**	29,128,600
Accumulated other comprehensive loss	**(17,105,829)**	(1,394,936)
	47,774,963	56,621,458
	$ 718,210,672	$ 716,677,255

The accompanying notes are an integral part of these consolidated financial statements.

Farmers and Merchants Bancshares, Inc. and Subsidiaries
Consolidated Statements of Income

Years Ended December 31,	2022	2021
Interest income		
Loans, including fees	$ 22,565,034	$ 23,491,614
Investment securities - taxable	2,981,300	1,511,970
Investment securities - tax exempt	570,655	611,323
Federal funds sold and other interest earning assets	152,664	65,496
Total interest income	26,269,653	25,680,403
Interest expense		
Deposits	1,375,691	1,997,873
Securities sold under repurchase agreements	12,768	44,628
Federal Home Loan Bank advances and other borrowings	757,699	762,798
Total interest expense	2,146,158	2,805,299
Net interest income	24,123,495	22,875,104
Provision for loan losses	475,000	330,000
Net interest income after provision for loan losses	23,648,495	22,545,104
Noninterest income		
Service charges on deposit accounts	777,901	724,086
Mortgage banking income	214,043	910,513
Bank owned life insurance income	229,179	229,966
Fair value adjustment of equity security	(62,094)	(15,354)
Gain on call of debt security	-	9,190
Gain on insurance proceeds, net	673,483	-
Gain on sale of SBA loans	158,123	6,917
Other	303,303	300,596
Total noninterest income	2,293,938	2,165,914
Noninterest expense		
Salaries	7,865,194	7,214,871
Employee benefits	1,798,150	1,718,465
Occupancy	890,926	948,757
Furniture and equipment	891,250	775,829
Professional services	894,715	415,642
Automated teller machine and debit card expenses	473,917	352,130
Federal Deposit Insurance Corporation premiums	180,196	306,123
Postage, delivery, and armored carrier	235,412	185,542
Advertising	258,032	233,358
Other real estate owned	21,705	190,248
Other	1,857,783	1,787,634
Total noninterest expense	15,367,280	14,128,599
Income before income taxes	10,575,153	10,582,419
Income taxes	2,485,026	2,432,813
Net income	$ 8,090,127	$ 8,149,606
Earnings per share - basic and diluted	$ 2.66	$ 2.70

The accompanying notes are an integral part of these consolidated financial statements.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Consolidated Statements of Comprehensive (Loss) Income

Years Ended December 31,	**2022**	2021
Net income	**$ 8,090,127**	$ 8,149,606
Other comprehensive loss, net of income taxes:		
Securities available for sale		
Net unrealized loss arising during the period	**(21,675,430)**	(2,889,734)
Reclassification adjustment for realized gains included in net income	**-**	(9,190)
Total unrealized loss on investment securities available for sale	**(21,675,430)**	(2,898,924)
Income tax benefit	**5,964,537**	797,711
Total other comprehensive loss	**(15,710,893)**	(2,101,213)
Total comprehensive (loss) income	**$ (7,620,766)**	$ 6,048,393

The accompanying notes are an integral part of these consolidated financial statements.

Farmers and Merchants Bancshares, Inc. and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity

	Common stock		Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total stockholders' equity
	Shares	Par value				
Balance, December 31, 2020	3,011,255	$ 30,113	$ 28,294,139	$ 22,698,954	$ 706,277	$ 51,729,483
Net income	-	-	-	8,149,606	-	8,149,606
Other comprehensive loss	-	-	-	-	(2,101,213)	(2,101,213)
Cash dividends, $0.57 per share	-	-	-	(1,719,960)	-	(1,719,960)
Dividends reinvested	25,882	259	563,283	-	-	563,542
Balance, December 31, 2021	**3,037,137**	**30,372**	**28,857,422**	**29,128,600**	**(1,394,936)**	**56,621,458**
Net income	**-**	**-**	**-**	**8,090,127**	**-**	**8,090,127**
Other comprehensive loss	**-**	**-**	**-**	**-**	**(15,710,893)**	**(15,710,893)**
Cash dividends, **$0.63** per share	**-**	**-**	**-**	**(1,918,561)**	**-**	**(1,918,561)**
Dividends reinvested	**34,077**	**340**	**692,492**	**-**	**-**	**692,832**
Balance, December 31, 2022	**3,071,214**	**$ 30,712**	**$ 29,549,914**	**$ 35,300,166**	**$ (17,105,829)**	**$ 47,774,963**

The accompanying notes are an integral part of these consolidated financial statements

Farmers and Merchants Bancshares, Inc. and Subsidiaries
Consolidated Statements of Cash Flows

Years Ended December 31,	2022	2021
Cash flows from operating activities		
Net income	$ **8,090,127**	$ 8,149,606
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	**482,489**	470,943
Provision for loan losses	**475,000**	330,000
Amortization of right of use asset	**4,355**	17,053
Gain on sale of premises and equipment	**-**	(44,510)
Gain on insurance proceeds	**(673,483)**	-
Write down of other real estate owned	**-**	169,240
Gain on premium call of debt security	**-**	(9,190)
Equity security dividends reinvested	**(7,634)**	(6,393)
Fair value adjustment on equity security	**62,094**	15,354
Gain on sale of SBA loans	**(158,123)**	(6,917)
Deferred income taxes	**(250,672)**	(160,070)
Amortization of debt issuance costs	**5,625**	5,625
Amortization of premiums and accretion of discounts, net	**(224,663)**	(7,602)
Bank owned life insurance cash surrender value	**(229,179)**	(229,966)
Increase (decrease) in		
Deferred loan fees and costs, net	**(111,160)**	(204,430)
Accrued interest payable	**54,000**	(113,712)
Other liabilities	**396,538**	1,035,504
Decrease (increase) in		
Mortgage loans held for sale	**(301,855)**	1,546,850
Accrued interest receivable	**(206,721)**	448,428
Other assets	**(250,776)**	298,917
Cash provided by operating activities	**7,155,962**	11,704,730

The accompanying notes are an integral part of these consolidated financial statements.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
(continued)

Years Ended December 31,	2022	2021
Cash flows from investing activities		
Proceeds from maturity and call of securities		
Available for sale	**19,994,811**	31,327,354
Held to maturity	**1,456,420**	2,171,420
Purchase of securities		
Available for sale	**(19,193,215)**	(129,676,971)
Held to maturity	**-**	(842,062)
Redemption of certificates of deposit	**250,000**	500,000
Loans made to customers, net of principal collected	**(35,960,009)**	39,861,460
Proceeds from sale of SBA loans	**1,250,154**	61,595
(Purchase) redemption of restricted stock	**(657,100)**	225,100
Proceeds from sale of premises and equipment	**-**	1,387,613
Proceeds from insurance	**711,214**	-
Purchase of bank owned life insurance	**(2,800,000)**	(28,855)
Purchase of annuity	**-**	(3,671,145)
Purchases of premises, equipment and software	**(410,843)**	(300,402)
Cash used in investing activities	**(35,358,568)**	(58,984,893)
Cash flows from financing activities		
Net increase (decrease) in		
Noninterest-bearing deposits	**2,519,734**	21,020,502
Interest-bearing deposits	**(5,162,357)**	32,242,461
Securities sold under repurchase agreements	**(238,722)**	(19,339,946)
Federal Home Loan Bank of Atlanta advances	**15,000,000**	-
Long-term debt	**(1,888,889)**	-
Dividends paid, net of reinvestments	**(1,225,729)**	(1,156,418)
Cash provided by financing activities	**9,004,037**	32,766,599
Net decrease in cash and cash equivalents	**(19,198,569)**	(14,513,564)
Cash and cash equivalents at beginning of period	**26,462,106**	40,975,670
Cash and cash equivalents at end of period	**$ 7,263,537**	$ 26,462,106
Supplementary disclosure of cash flow information:		
Cash paid during the period for interest	**$ 2,239,129**	3,154,898
Cash paid during the period for income taxes	**3,365,318**	1,605,500
Net unrealized loss on securities available for sale	**(21,675,430)**	(2,898,924)

The accompanying notes are an integral part of these consolidated financial statements.

1. Summary of Significant Accounting Policies

The accounting and reporting policies reflected in the financial statements conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. Management makes estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosures of commitments and contingent liabilities at the balance sheet date, and revenues and expenses during the year. These estimates and assumptions may affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Principles of consolidation

The consolidated financial statements include the accounts of Farmers and Merchants Bancshares, Inc. and its wholly owned subsidiaries, Farmers and Merchants Bank (the "Bank"), and Series Protected Cell FCB-4 (the "Insurance Subsidiary"), and one subsidiary of the Bank, Reliable Community Financial Services, Inc. (collectively the "Company", "we", "us", or "our"). The Insurance Subsidiary is a series investment, 100% owned by the Company, in First Community Bankers Insurance Co., LLC, a Tennessee "series" limited liability company and licensed property and casualty insurance company. Intercompany balances and transactions, including insurance premiums paid by the Bank that were received by the Insurance Subsidiary through an intermediary, have been eliminated. Effective October 1, 2020, the Company acquired Carroll Bancorp, Inc. and its wholly-owned subsidiary, Carroll Community Bank (collectively, "Carroll"), both of which were based in Eldersburg, Maryland, through a series of merger transactions (the "Merger").

Business

The Bank provides banking services to individuals and businesses located in Baltimore County, Maryland, Carroll County, Maryland and surrounding areas of northern Maryland. The Insurance Subsidiary is a captive insurance entity that provides insurance coverage for the Bank. The Bank chose not to renew coverage effective on November 7, 2022, but may do so in the future, The Insurance Subsidiary is still responsible for claims for events that occurred prior to November 7, 2023. Reliable Community Financial Services, Inc. is licensed to provide a wide range of investment and insurance products to its customers, but is inactive.

Reclassifications

Certain reclassifications have been made to the 2021 financial statements to conform to the current year presentation. These reclassifications had no effect on net income or stockholders' equity.

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, money market funds, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

Comprehensive (loss) income

Comprehensive (loss) income includes net income and the unrealized gains or losses on investment securities available for sale, net of income taxes.

Investment securities

As debt securities are purchased, management determines if the securities should be classified as held to maturity or available for sale. Securities that management has the intent and ability to hold to maturity are recorded at amortized cost, which is cost adjusted for amortization of premiums and accretion of discounts. Discounts are accreted through maturity. Premiums are amortized through the earliest call date. Securities held to meet liquidity needs or that may be sold before maturity are classified as available for sale and carried at fair value with unrealized gains and losses included in stockholders' equity on an after-tax basis. Gains and losses on disposal are determined using the specific-identification method. The Company amortizes premiums and accretes discounts using the interest method.

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

The Company regularly evaluates its securities whose values have declined below their amortized cost to assess whether the decline in fair value is other-than-temporary. The Company considers various factors in determining whether a decline in fair value is other-than-temporary including the issuer's financial condition and/or future prospects, the effects of changes in interest rates or credit spreads, the expected recovery period and other quantitative and qualitative information. The valuation of securities for impairment is a process subject to estimation, judgment and uncertainty and is intended to determine whether declines in the fair value of investments should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions and future changes in assessments of the aforementioned factors. It is expected that such factors will change in the future, which may result in future other-than- temporary impairments. For impairments of debt securities that are deemed to be other-than-temporary, the credit portion of an other-than-temporary impairment loss is recognized in earnings and the non-credit portion is recognized in accumulated other comprehensive income in those situations where the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security prior to recovery.

Equity security at fair value

The Company owns a mutual fund that is measured at fair value with changes in fair value recognized in noninterest income.

Restricted stock, at cost

Restricted stock consists of Federal Home Loan Bank of Atlanta (the “FHLB”) stock, Community Bankers Bank (“CBB”) stock, and Atlantic Community Bankers Bank (“ACBB”) stock. As a member of the FHLB, the Bank is required to purchase FHLB stock in an amount that is based on the Bank’s total assets. Additional stock is purchased and redeemed based on the outstanding FHLB advances to the Bank. CBB and ACBB require its correspondent banking institutions to hold stock as a condition of membership. The restricted investment in bank stocks is carried at cost. On a quarterly basis, management evaluates the bank stocks for impairment based on assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as operating performance, liquidity, funding and capital positions, stock repurchase history, dividend history, and impact of legislative and regulatory changes.

Loans and allowance for loan losses

Loans are stated at the current amount of unpaid principal, adjusted for deferred origination costs, deferred origination fees, premiums and discounts on acquired loans, and the allowance for loan losses. Interest on loans is accrued based on the principal amounts outstanding. Origination fees and costs, along with premiums and accretable discounts, are amortized to income over the terms of loans.

Past due status is based on the contractual terms of the loan. Management may make an exception to reporting a loan as past due, if the past due status is solely due to the loan being past maturity, the Company intends to extend the loan, and the borrower is making principal and interest payments in accordance with the terms of the matured note. The accrual of interest is discontinued when any portion of the principal or interest is 90 days past due and collateral is insufficient to discharge the debt in full. If collection of principal is evaluated as doubtful, all payments are applied to principal. Loans are considered impaired when, based on current information, management considers it unlikely that the collection of principal and interest payments will be made according to contractual terms when due. Generally, loans are not reviewed for impairment until the accrual of interest has been discontinued, the loans are included on the watch list, or the loans are troubled debt restructurings (“TDRs”).

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

The allowance for loan losses represents an amount which, in management's judgment, will be adequate to absorb probable and estimable losses on existing loans and other extensions of credit that may become uncollectible. The Company's allowance for loan losses consists of three elements: (i) segregating the loan portfolio into pools based upon similar characteristics and risk profiles and applying a loss factor to the pools, based on historical losses within those pools; (ii) applying qualitative factors to the loan pools that consider economic and other factors, both internal and external, affecting the Company and the pools; and (iii) determining specific reserves based on individual evaluation of impaired loans that are not included in the pools discussed above.

The allowances established for probable and estimable losses on impaired loans are based on a regular analysis and evaluation of problem loans. Management maintains a watch list of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the borrower's ability to repay; (ii) the underlying collateral, if any; (iii) the economic environment; and (iv) for commercial borrowers, the industry in which the borrower operates. Specific valuation allowances are determined when the collateral value, if the loan is collateral dependent, or the discounted cash flows of the impaired loan is lower than the carrying value.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans. The Company calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool over the prior twenty quarters. The historical loss ratios are updated quarterly based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the annual historical loss ratio and the total dollar amount of the loans in the pool.

Adjustments to the historical valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such adjustments are determined by evaluating, among other things: (i) the impact of economic conditions on the portfolio; (ii) changes in asset quality, including delinquency trends; (iii) the impact of changing interest rates on portfolio risk; (iv) changes in legislative and regulatory policy; (v) the composition and concentrations of credit; and (vi) the effectiveness of the internal loan review function as well as changes to policies and experience of loan personnel. Management evaluates these qualitative factors on a quarterly basis. Each factor could result in an adjustment that is positive, negative, or no impact.

Loan losses are charged to the allowance when management believes that collection is unlikely. Collections of loans previously charged off are added to the allowance at the time of recovery.

Loans acquired in connection with business combinations are recorded at fair value with no carryover of any allowance for loan losses. Fair value of the loans involves estimating the amount and timing of principal and interest cash flows expected to be collected on the loans and discounting those cash flows at a market rate of interest.

Loans acquired through business combinations that are designated as purchase credit impaired loans because they meet the specific criteria of Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality are individually evaluated each period to recast expected cash flows. To the extent that the expected cash flows of a loan have decreased due to credit deterioration, the Company establishes an allowance.

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

The excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loan. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference. These loans are accounted for under ASC 310-30. The nonaccretable difference includes estimated future credit losses expected to be incurred over the life of the loan. Subsequent decreases in expected cash flows will require us to evaluate the need for an addition to the allowance for loan losses. Subsequent improvement in expected cash flows will result in the transfer of a corresponding amount of the nonaccretable difference, which we will then reclassify as accretable discount to be recognized into interest income over the remaining life of the loan.

Loans acquired through business combinations that do not meet the specific criteria of ASC 310-30 are accounted for under ASC 310-20, Receivables - Nonrefundable Fees and Other Costs. These loans are initially recorded at fair value, and include credit and interest rate marks associated with acquisition accounting adjustments. Purchase premiums or discounts are subsequently amortized as an adjustment to yield over the estimated contractual lives of the loans. There is no allowance for loan losses established at the acquisition date for acquired performing loans. Subsequent to acquisition, a quarterly comparison of the remaining fair value discount to the required allowance under appropriate methodology is performed. If the fair value discount remains in excess of the required allowance, then no adjustment is made. If the fair value falls below the required reserve, then a charge to the provision is recorded for the shortfall as part of the allowance for loan losses.

Mortgage loans held for sale and mortgage banking income

Mortgage loans held for sale are carried at the lower of aggregate cost or fair value based on the current fair value of each outstanding loan. Sales of loans are recorded when the proceeds are received, with any gain or loss recorded in mortgage banking income.

The Company sells its mortgage loans to third party investors with servicing released. Upon sale and delivery, loans are legally isolated from the Company and the Company has no ability to restrict or constrain the ability of third party investors to pledge or exchange the mortgage loans. The Company does not have the entitlement or ability to repurchase the mortgage loans or unilaterally cause third party investors to put the mortgage loans back to the Company.

Premises and equipment

Land is carried at cost. Premises and equipment are recorded at cost less accumulated depreciation and amortization. Depreciation on buildings and equipment is computed over the estimated useful lives of the assets using the straight-line method. Leasehold improvements are amortized using the straight-line method over the term of the lease or the estimated useful lives of the asset, whichever is shorter.

Other real estate owned

Real estate acquired through foreclosure or by deed in lieu of foreclosure is recorded at fair value less estimated costs to sell on the date acquired establishing a new cost basis. Losses incurred at the time of acquisition of the property are charged to the allowance for loan losses. Subsequent reductions in the estimated value of the property are included with any gains or losses on sale in noninterest expense.

Bank owned life insurance

The Company has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

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

Goodwill and other intangible assets

Goodwill is calculated as the purchase premium, if any, after adjusting for the fair value of net assets acquired in purchase transactions. Goodwill is not amortized but is reviewed for potential impairment on at least an annual basis, with testing between annual evaluation if an event occurs or circumstances change that could potentially reduce the fair value of a reporting unit. Other intangible assets represent purchased assets that can be distinguished from goodwill because of contractual or other legal rights. The Company's other intangible asset, core deposit intangible ("CDI") has a finite life and is amortized over 10 years on a straight line basis, which is believed to be substantially the same as the interest method.

Revenue recognition

ASC Topic 606 does not apply to revenue associated with the financial instruments, including revenue from loans and securities. The Company's services that fall within the scope of Topic 606 are presented within noninterest income and are recognized as revenue as the Company satisfies its obligation to the customer. A description of the Company's noninterest revenue streams is discussed below:

Service Charges on Deposit Accounts: The Company earns fees from its deposit customers for overdraft, monthly service fees, and other deposit account related fees. Overdraft fees are recognized when the overdraft occurs. The Company's performance obligation for monthly service fees is generally satisfied over the period in which the service is provided. Other deposit account related fees are largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time.

Interchange Income: The Company earns interchange fees from debit cardholder transactions conducted through various payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services. The Company's analysis of its relationship with its interchange debit card provider is agent based. As a result, income from debit cardholder transactions is presented net against expenses paid to the interchange debit card provider in service charges on deposit accounts on the consolidated statements of income.

Other Service Charges and Fees: The Company earns fees from its customers for transaction-based services. Services include, safe deposit box, debit/ATM card income, cashier's check, stop payment and wire transfer fees. In each case, these fees and service charges are recognized in income at the time or within the same period that the services are rendered.

Operating leases

The Company accounts for lease obligations in accordance with FASB Accounting Standards Update ("ASU") 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2016-02, lessees are required to recognize the following for all leases (with the exception of qualifying short-term leases) at the commencement date: (i) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (ii) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. The Company has determined it has no financing or sales type leases as of the balance sheet date.

Advertising costs

Advertising costs are expensed in the period incurred and totaled $**258,032** and $233,358 for the years ended December 31, 2022 and 2021, respectively.

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

Income taxes

The provision for income taxes includes income taxes payable for the current year and deferred income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement basis and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

Per share data

Earnings per share is determined by dividing net income by the weighted average number of shares of common stock outstanding, giving retroactive effect to any stock dividends. Weighted average shares were **3,046,377** and 3,018,112 for 2022 and 2021, respectively. Diluted earnings per share is derived by dividing net income available by the weighted-average number of shares outstanding, adjusted for the dilutive effect of outstanding common stock equivalents. No potentially dilutive stock equivalents were outstanding at December 31, 2022 or December 31, 2021.

Recent accounting pronouncements

Management has the responsibility for the selection and use of appropriate accounting policies. The significant accounting policies used by the Company are described in the notes to the consolidated financial statements.

The following accounting guidance has been approved by the FASB and would apply to the Company if the Company entered into an applicable activity.

During June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” The ASU, as amended, requires an entity to measure expected credit losses for financial assets carried at amortized cost based on historical experience, current conditions, and reasonable and supportable forecasts. Among other things, the ASU also amended the impairment model for available for sale securities and addressed purchased financial assets with deterioration. The Company adopted ASU 2016-13 as of January 1, 2023 in accordance with the required implementation date and recorded the impact of adoption to retained earnings, net of deferred income taxes, as required by the standard. The adjustment recorded at adoption was not significant to the overall allowance for credit losses or shareholders’ equity as compared to December 31, 2022 and consisted of adjustments to the allowance for credit losses on loans and held-to-maturity securities, as well as an adjustment to the Company’s reserve for unfunded loan commitments. Subsequent to adoption, the Company will record adjustments to its allowance for credit losses and reserves for unfunded commitments through the provision for credit losses in the consolidated statements of income.

The Company is utilizing a third-party model to tabulate its estimate of current expected credit losses, using an average charge off or loss rate methodology. In accordance with ASC 326, the Company has segmented its loan portfolio based on similar risk characteristics which included call report categories as well as risk grade. The Company primarily utilizes historical loss rates for the CECL calculation based on Company-specific historical losses and supplemented with peer loss history where applicable. For its reasonable and supportable forecasting of current expected credit losses, the Company analyzes a simple regression using forecasted economic metrics and historical peer loss data. To further adjust the allowance for credit losses for expected losses not already included within the quantitative component of the calculation, the Company may consider the following qualitative adjustment factors: economic conditions, concentrations

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

of credit, interest rates, ability of staff, loan review, trends in loan quality, policy changes, and changes in nature and/or volume of loans. The Company's CECL implementation process was overseen by the Chief Financial Officer and included an assessment of data availability and gap analysis, data collection, consideration and analysis of multiple loss estimation methodologies, an assessment of relevant qualitative factors and correlation analysis of multiple potential loss drivers and their impact on the Company's historical loss experience.

In March 2022, FASB issued ASU 2022-02, "Financial Instruments-Credit Losses (Topic 326), Troubled Debt Restructurings and Vintage Disclosures." ASU 2022-02 addresses areas identified by the FASB as part of its post-implementation review of the credit losses standard (ASU 2016-13) that introduced the CECL model. The amendments eliminate the accounting guidance for troubled debt restructurings by creditors that have adopted the CECL model and enhance the disclosure requirements for loan refinancings and restructurings made with borrowers experiencing financial difficulty. In addition, the amendments require a public business entity to disclose current-period gross write-offs for financing receivables and net investment in leases by year of origination in the vintage disclosures. The amendments in this ASU should be applied prospectively, except for the transition method related to the recognition and measurement of TDRs, an entity has the option to apply a modified retrospective transition method, resulting in a cumulative- effect adjustment to retained earnings in the period of adoption. For entities that have adopted ASU 2016-13, ASU 2022-02 is effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. For entities that have not yet adopted ASU 2016-13, the effective dates for ASU 2022-02 are the same as the effective dates in ASU 2016-13. Early adoption is permitted if an entity has adopted ASU 2016-13. An entity may elect to early adopt the amendments about TDRs and related disclosure enhancements separately from the amendments related to vintage disclosures. The Company is currently assessing the impact that ASU 2022-02 will have on its consolidated financial statements.

In March 2020, FASB issued ASU 2020-04, "Reference Rate Reform (Topic 848)": Facilitation of the Effects of Reference Rate Reform on Financial Reporting. This ASU Provides optional guidance for a limited period of time to ease the potential burden in accounting for (or recognizing the effect of) reference rate reform, on financial reporting. The risk of termination of the London Interbank Offered Rate (LIBOR), has caused regulators to undertake reference rate reform initiatives to identify alternative reference rates that are more observable or transaction based that are less susceptible to manipulation. ASU 2020-04 is effective between March 12, 2020 and December 31, 2022. The Company has identified its products that utilize LIBOR and has begun efforts to transition to an alternative reference rate.

In December 2022, the FASB issued ASU 2022-06, "Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848". ASU 2022-06 extends the period of time preparers can utilize the reference rate reform relief guidance in Topic 848. The objective of the guidance in Topic 848 is to provide relief during the temporary transition period, so the FASB included a sunset provision within Topic 848 based on expectations of when the London Interbank Offered Rate (LIBOR) would cease being published. In 2021, the UK Financial Conduct Authority (FCA) delayed the intended cessation date of certain tenors of USD LIBOR to June 30, 2023. To ensure the relief in Topic 848 covers the period of time during which a significant number of modifications may take place, the ASU defers the sunset date of Topic 848 from December 31, 2022, to December 31, 2024, after which entities will no longer be permitted to apply the relief in Topic 848.

The ASU is effective for all entities upon issuance. The Company is assessing ASU 2022-06 and its impact on the Company's transition away from LIBOR for its loan and other financial instruments. The Company continues to evaluate systems to assist in the transaction to a new rate.

The accounting policies adopted by management are consistent with authoritative GAAP and are consistent with those followed by our peers.

2. **Cash and Cash Equivalents**

The Company normally carries balances with other banks that exceed the federally insured limit. The average balance carried in excess of the limit, including unsecured federal funds sold to the same banks, was $**11,945,635** and $7,549,531 during the years ended December 31, 2022 and 2021, respectively.

Deposits held in noninterest-bearing transaction accounts are aggregated with any interest-bearing deposits the owner may hold in the same category. The combined total is insured up to $250,000.

Banks are required to carry noninterest-bearing cash reserves of specified percentages of deposit balances. The Company's normal balances of cash on hand and on deposit with other banks are sufficient to satisfy the reserve requirements. The FRB reserve requirement was $0 at December 31, 2022 and 2021.

3. **Investment Securities**

Debt securities are summarized as follows:

December 31, 2022	Amortized cost	Unrealized gains	Unrealized losses	Fair value
Available for sale				
State and municipal	**$ 570,122**	**$ -**	**$ 17,841**	**$ 552,281**
SBA pools	**1,033,606**	**1,425**	**15,234**	**1,019,797**
Corporate bonds	**10,414,146**	**-**	**1,024,250**	**9,389,896**
Mortgage-backed securities	**137,896,519**	**-**	**22,544,044**	**115,352,475**
	$149,914,393	**$ 1,425**	**$23,601,369**	**$126,314,449**
Held to maturity				
State and municipal	**$ 20,508,997**	**$ 4,176**	**$ 1,633,378**	**$ 18,879,795**
December 31, 2021				
Available for sale				
State and municipal	$ 753,061	$ 10,437	$ -	$ 763,498
SBA pools	1,418,770	1,656	22,664	1,397,762
Corporate bonds	9,225,153	64,595	55,541	9,234,207
Mortgage-backed securities	139,765,445	336,084	2,259,080	137,842,449
	$ 151,162,429	$ 412,772	$ 2,337,285	$ 149,237,916
Held to maturity				
State and municipal	$ 21,851,975	$ 1,020,877	$ 67,251	$ 22,805,601

3. **Investment Securities** (Continued)

Contractual maturities, shown below, will differ from actual maturities because borrowers and issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale		Held to Maturity	
December 31, 2022	Amortized cost	Fair value	Amortized cost	Fair value
Within one year	**$ 580,522**	**$ 564,841**	**$ 330,000**	**$ 330,175**
Over one to five years	**3,079,483**	**2,937,072**	**474,937**	**469,235**
Over five to ten years	**7,324,263**	**6,440,264**	**3,308,340**	**3,162,389**
Over ten years	**-**	**-**	**16,395,720**	**14,917,996**
	10,984,268	**9,942,177**	**20,508,997**	**18,879,795**
Mortgage-backed securities and SBA pools, due in monthly installments	**138,930,125**	**116,372,272**	**-**	**-**
	$ 149,914,393	**$ 126,314,449**	**$ 20,508,997**	**$ 18,879,795**

Securities with a carrying value of **$24,258,980** and $14,307,989 as of December 31, 2022 and 2021, respectively, were pledged as collateral for securities sold under repurchase agreements and other collateralized deposits.

The following table sets forth the Company's gross unrealized losses on a continuous basis for investment securities, by category and length of time.

December 31, 2022	Less than 12 months		12 months or more		Total	
Description of investments	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
State and municipal	**$ 13,668,676**	**$ 1,057,412**	**$ 1,537,715**	**$ 593,807**	**$ 15,206,391**	**$ 1,651,219**
SBA pools	**-**	**-**	**857,259**	**15,234**	**857,259**	**15,234**
Corporate bonds	**4,184,875**	**356,746**	**4,805,021**	**667,504**	**8,989,896**	**1,024,250**
Mortgage-backed securities	**25,284,430**	**2,293,151**	**90,068,045**	**20,250,893**	**115,352,475**	**22,544,044**
Total	**$ 43,137,981**	**$ 3,707,309**	**$ 97,268,040**	**$21,527,438**	**$ 140,406,021**	**$25,234,747**

3. **Investment Securities** (Continued)

December 31, 2021	Less than 12 months		12 months or more		Total	
Description of investments	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
State and municipal	$ 1,324,648	$ 35,720	$ 715,650	$ 31,531	$ 2,040,298	$ 67,251
SBA pools	-	-	1,133,398	22,664	1,133,398	22,664
Corporate bonds	5,443,886	55,541	-	-	5,443,886	55,541
Mortgage-backed securities	117,840,965	2,034,858	4,781,586	224,222	122,622,551	2,259,080
Total	$ 124,609,499	$ 2,126,119	$ 6,630,634	$ 278,417	$ 131,240,133	$ 2,404,536

Management has the ability and intent to hold securities classified as held to maturity until they mature, at which time the Company should receive full value for the securities. As of December 31, 2022, management did not have the intent to sell any of the securities before a recovery of cost. The unrealized losses are due to increases in market interest rates over the yields available at the time the underlying securities were purchased as well as other market conditions for each particular security based upon the structure and remaining principal balance. The fair values of the investment securities are expected to recover as the securities approach their maturity dates or repricing dates or if market yields for such investments decline. Based on the these factors, as of December 31, 2022, management believes the unrealized losses detailed in the table above are temporary and, accordingly, none of these unrealized losses have been recognized in the Company's consolidated statement of income.

In 2022, there were no security sales.

In 2021, the Company received proceeds of $1,263,845 from the call at a premium of available for sale investment securities. The Company realized a $9,190 gain on the call of the securities.

4. **Related Party Transactions**

Certain executive officers and directors of the Company, including members of their immediate families and companies in which they are significant owners (more than 10%), were indebted to the Company during 2022 and 2021. The loans were made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with borrowers who are not related to the Company. During the years ended December 31, 2022 and 2021, the activity of these loans was as follows:

	2022	2021
Balance, beginning of year	**$ 13,822,556**	$ 14,558,882
Additions	**3,274,719**	2,489,000
Amounts collected	**(4,869,554)**	(3,225,326)
Balance, end of year	**$ 12,227,721**	$ 13,822,556

Unused lines of credit to related parties totaled **$208,100** and $143,000 at December 31, 2022 and 2021, respectively.

4. Related Party Transactions (Continued)

Letters of credit issued to related parties totaled $**15,847** and $0 at December 31, 2022 and 2021, respectively.

Deposits at the Company from related parties totaled **$10,138,362** and $27,187,933 at December 31, 2022 and 2021, respectively.

Payments to companies controlled by directors totaled **$54,624** in 2022 and $40,754 in 2021.

On March 31, 2021, a company of which one of the Company's directors is a co-owner purchased real property from the Company that was acquired in the Merger and on which Carroll previously operated a branch, resulting in net proceeds of $1,359,613. To finance the purchase of this real property, the Company made a loan to the buyer in the principal amount of approximately $1,096,000.

5. Loans

Major categories of loans at December 31, 2022 and 2021 are as follows:

	2022	2021
Real estate:		
Commercial	**$ 351,794,702**	$ 319,185,116
Construction and land development	**23,978,373**	28,221,854
Residential	**114,683,149**	107,436,033
Commercial	**31,066,497**	31,182,206
Consumer	**156,422**	355,958
	521,679,143	486,381,167
Less: Allowance for loan losses	**4,150,198**	3,650,268
Deferred origination fees net of costs	**608,405**	719,565
	$ 516,920,540	$ 482,011,334

Commercial loans in the table above include $0.7 million and $9.7 million of Paycheck Protection Program ("PPP") loans as of December 31, 2022 and December 31, 2021, respectively, which are 100% guaranteed by the Small Business Administration ("SBA"). There were no PPP loans originated in 2022 compared to $22 million originated during 2021.

Year-end nonaccrual loans, segregated by class of loans, were as follows:

	2022	**2021**
Real estate:		
Commercial	**$ 502,961**	$ 4,810,965
Residential	**-**	31,500
Commercial	**152,449**	152,449
Total	**$ 655,410**	$ 4,994,914

5. **Loans (Continued)**

At December 31, 2022, the Company had one non-accrual commercial real estate loan totaling $502,961 and one non-accrual commercial loan totaling $152,449. The commercial loan was secured by business assets and was personally guaranteed. Gross interest income of $45,856 would have been recorded in 2022 if these non-accrual loans had been current and performing in accordance with the original terms. The Company allocated $281,910 of its allowance for loan losses to these non-accrual loans.

At December 31, 2021, the Company had two non-accrual commercial real estate loan totaling $4,810,965, one non-accrual residential real estate loans totaling $31,500, and one non-accrual commercial loan totaling $152,449. The real estate loan was secured by real estate and business assets and was personally guaranteed. The commercial loan was secured by business assets and was personally guaranteed. Gross interest income of $219,734 would have been recorded in 2021 if these non-accrual loans had been current and performing in accordance with the original terms. The Company allocated $281,910 of its allowance for loan losses to these non-accrual loans. The balance of the non-accrual loans was net of charge-offs and a nonaccretable discount totaling $27,146 at December 31, 2021.

An age analysis of past due loans, segregated by class of loans, as of year-end, is as follows:

	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Past Due 90 Days or More and Accruing
December 31, 2022							
Real estate:							
Commercial	**$ -**	**$ -**	**$ 502,961**	**$ 502,961**	**$ 351,291,741**	**$ 351,794,702**	**$ -**
Construction and land development	**-**	**-**	**-**	**-**	**23,978,373**	**23,978,373**	**-**
Residential	**311,409**	**-**	**-**	**311,409**	**114,371,740**	**114,683,149**	**-**
Commercial	**-**	**-**	**152,449**	**152,449**	**30,914,048**	**31,066,497**	**-**
Consumer	**-**	**-**	**-**	**-**	**156,422**	**156,422**	**-**
Total	**$ 311,409**	**$ -**	**$ 655,410**	**$ 966,819**	**$ 520,712,324**	**$ 521,679,143**	**$ -**
December 31, 2021							
Real estate:							
Commercial	$ -	$ -	$ 502,961	$ 502,961	$ 318,682,155	$ 319,185,116	$ -
Construction and land development	-	-	-	-	28,221,854	28,221,854	-
Residential	-	-	249,161	249,161	107,186,872	107,436,033	217,661
Commercial	-	-	415,690	415,690	30,766,516	31,182,206	263,241
Consumer	-	-	-	-	355,958	355,958	-
Total	$ -	$ -	$ 1,167,812	$ 1,167,812	$ 485,213,355	$ 486,381,167	$ 480,902

5. **Loans (Continued)**

Year-end impaired loans, segregated by class of loans, are set forth in the following table:

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Recognized
December 31, 2022							
Commercial real estate	**$ 7,019,415**	**$ 6,516,454**	**$ 502,961**	**$ 7,019,415**	**$ 129,461**	**$ 6,920,174**	**$ 223,476**
Residential real estate	**256,350**	**256,350**	**-**	**256,350**	**-**	**147,789**	**10,594**
Commercial	**152,449**	**-**	**152,449**	**152,449**	**152,449**	**152,449**	**-**
	$ 7,428,214	**$ 6,772,804**	**$ 655,410**	**$ 7,428,214**	**$ 281,910**	**$ 7,220,412**	**$ 234,070**
December 31, 2021							
Commercial real estate	$ 6,820,932	$ 6,317,971	$ 502,961	$ 6,820,932	$ 129,461	$ 6,740,539	$ 125,079
Construction and land development	-	-	-	-	-	-	-
Residential real estate	39,228	39,228	-	39,228	-	41,981	1,672
Commercial	152,449	-	152,449	152,449	152,449	76,225	69,005
	$ 7,012,609	$ 6,357,199	$ 655,410	$ 7,012,609	$ 281,910	$ 6,858,745	$ 195,756

Impaired loans include certain loans, classified as TDRs that have been modified to grant economic concessions to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months.

At December 31, 2022, the Company had **two** commercial real estate loans totaling **$6,516,454** and **two** residential loans totaling **$256,350** that were classified as TDRs. All four loans are included in impaired loans above. Each loan is paying as agreed. None of the borrowers has defaulted nor have there been charge- offs or allowances associated with the four loans. One of the commercial real estate loans with a principal balance of $**4,542,896** and one of the residential loans with a principal balance of $**222,767** were restructured as TDRs during 2022.

At December 31, 2021, the Company had one commercial real estate loan totaling $2,009,967 and one residential loan totaling $39,228 classified as TDRs. Both loans are included in impaired loans above. Each loan is paying as agreed. None of the borrowers has defaulted nor have there been charge-offs or allowances associated with the two loans. There were no new TDRs in 2021.

5. **Loans (Continued)**

As part of our portfolio risk management, the Company assigns a risk grade to each loan. The factors used to determine the grade are the payment history of the loan and the borrower, the value of the collateral and net worth of the guarantor, and cash flow projections of the borrower. Excellent, Above Average, Average and Acceptable grades are assigned to loans with limited or no delinquent payments and more than sufficient collateral and/or cash flow.

A description of the general characteristics of loans characterized as watch list or classified is as follows:

Pass/Watch

Loans graded as Pass/Watch reflect above-average risk. The loans warrant closer scrutiny by management than is routine, due to circumstances affecting the borrower, the borrower's industry, or the overall economic environment. Borrowers may reflect weaknesses such as inconsistent or weak earnings, break even or moderately deficit cash flow, thin liquidity, minimal capacity to increase leverage, or volatile market fundamentals or other industry risks. Such loans are typically secured by acceptable collateral, at or near appropriate margins, with realizable liquidation values.

Special Mention

A special mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. Special mention loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification. This classification is intended to be temporary while the Bank learns more about the condition of the borrower and the collateral.

Borrowers may exhibit poor liquidity and leverage positions resulting from generally negative cash flow or negative trends in earnings. Access to alternative financing may be limited to finance companies for business borrowers and may be unavailable for commercial real estate borrowers.

Substandard

A substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard loans have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Borrowers may exhibit recent or unexpected unprofitable operations, an inadequate debt service coverage ratio, or marginal liquidity and capitalization. These loans require more intense supervision by Bank management.

Doubtful

A doubtful loan has all the weaknesses inherent as a substandard loan with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans by credit grade, segregated by loan type, at year-end, are as follows:

5. **Loans (Continued)**

December 31, 2022	Excellent	Above average	Average	Acceptable	Pass watch	Special mention	Substandard	Doubtful	Total
Real estate:									
Commercial	$ -	$ -	$ 65,908,980	$ 201,854,424	$ 70,826,837	$ 3,558,954	$ 9,645,507	$ -	$ 351,794,702
Construction and land development	-	-	3,845,351	12,087,402	8,045,620	-	-	-	23,978,373
Residential	15,613	573,108	35,774,807	63,833,864	10,815,681	1,397,282	2,272,794	-	114,683,149
Commercial	178,916	-	4,347,337	16,039,145	9,773,961	574,689	152,449	-	31,066,497
Consumer	722	15,715	93,684	4,439	6,481	-	-	35,381	156,422
	$ 195,251	$ 588,823	$ 109,970,159	$ 293,819,274	$ 99,468,580	$ 5,530,925	$ 12,070,750	$ 35,381	$ 521,679,143

December 31, 2021	Excellent	Above average	Average	Acceptable	Pass watch	Special mention	Substandard	Doubtful	Total
Real estate:									
Commercial	$ -	$ 1,225,732	$ 73,924,748	$ 146,174,439	$ 82,018,890	$ 3,345,788	$ 12,495,519	$ -	$ 319,185,116
Construction and land development	-	-	3,853,775	12,452,257	9,973,457	1,942,365	-	-	28,221,854
Residential	41,152	708,162	46,358,477	48,295,430	9,570,815	-	2,461,997	-	107,436,033
Commercial	9,774,570	-	5,292,721	12,585,396	3,377,070	-	152,449	-	31,182,206
Consumer	5,813	168,037	147,903	2,280	11,298	-	-	20,627	355,958
	$ 9,821,535	$ 2,101,931	$ 129,577,624	$ 219,509,802	$ 104,951,530	$ 5,288,153	$ 15,109,965	$ 20,627	$ 486,381,167

The following tables detail activity in the allowance for loan losses by portfolio for the years ended December 31, 2022 and 2021. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

						Allowance for loan losses ending balance evaluated for impairment:			Outstanding loan balances evaluated for impairment:		
December 31, 2022	Beginning balance	Provision for loan losses	Charge offs	Recoveries	Ending balance	Individually	Purchase Credit Impaired	Collectively	Individually	Purchase Credit Impaired	Collectively
Real estate:											
Commercial	$ 2,482,930	$ 343,424	$ (7,772)	$ -	$ 2,818,582	$ 129,461	$ -	$ 2,689,121	$ 7,019,415	$ -	$ 344,775,287
Construction and land development	214,547	(66,151)	-	16,200	164,596	-	-	164,596	-	369,622	23,608,751
Residential	603,558	171,391	-	18,970	793,919	-	-	793,919	256,350	209,583	114,217,216
Commercial	255,413	84,358	(2,468)	-	337,303	152,449	-	184,854	152,449	-	30,914,048
Consumer	4,370	336	-	-	4,706	-	-	4,706	-	-	156,422
Unallocated	89,450	(58,358)	-	-	31,092	-	-	31,092	-	-	-
	$ 3,650,268	$ 475,000	$ (10,240)	$ 35,170	$ 4,150,198	$ 281,910	$ -	$ 3,868,288	$ 7,428,214	$ 579,205	$ 513,671,724

:

December 31, 2021	Beginning balance	Provision for loan losses	Charge offs	Recoveries	Ending balance	Allowance for loan losses ending balance evaluated for impairment: Individually	Purchase Credit Impaired	Collectively	Outstanding loan balances evaluated for impairment: Individually	Purchase Credit Impaired	Collectively
Real estate:											
Commercial	$ 2,230,129	$ 241,301	$ -	$ 11,500	$ 2,482,930	$ 129,461	$ -	$ 2,353,469	$ 6,820,932	$ 56,825	$ 312,307,359
Construction and land development	201,692	(3,345)	-	16,200	214,547	-	-	214,547	-	383,666	27,838,188
Residential	644,639	(22,111)	(18,970)	-	603,558	-	-	603,558	39,228	568,151	106,828,654
Commercial	111,390	129,023	-	15,000	255,413	152,449	-	102,964	152,449	-	31,029,757
Consumer	2,138	2,232	-	-	4,370	-	-	4,370	-	-	355,958
Unallocated	106,550	(17,100)	-	-	89,450	-	-	89,450	-	-	-
	$ 3,296,538	$ 330,000	$ (18,970)	$ 42,700	$ 3,650,268	$ 281,910	$ -	$ 3,368,358	$ 7,012,609	$ 1,008,642	$ 478,359,916

Loans acquired from Carroll were measured at fair value at the acquisition date with no carryover of any allowance for loan losses. The following table provides activity for the accretable credit discount of purchased loans:

Balance at December 31, 2021	**$ 1,629,242**
Transfer to accretable	**-**
Accretion	**(698,269)**
Balance at December 31, 2022	**$ 930,973**

During 2021, accretion of $1,081,403 was recorded.

At December 31, 2022, the nonaccretable difference on purchased credit impaired loans was $233,411, a decrease of $233,176 from December 31, 2021 as a result of a loan pay off. At December 31, 2022, the accretable discount on purchased credit impaired loans was $0 after the accretion of $140,608 as a result of a loan payoff. At December 31, 2022, the remaining yield premium on purchased loans was $878,756. Yield premium amortization was $526,377 and $718,875 in 2022 and 2021, respectively. At December 31, 2022, the principal balance of purchased loans was $86,649,656 and the carrying value was $86,364,028.

Loans having an aggregate balance of approximately **$458.9** million were pledged as collateral to the FHLB as of December 31, 2022. Loans having an aggregate balance of approximately **$62.7** million were pledged as collateral to the Federal Reserve Bank of Richmond (the "FRB") as of December 31, 2022. At December 31, 2022 and 2021, the Company serviced participation loans for others totaling **$13.5** and $22.1 million, respectively.

The Company makes loans to customers located primarily in Baltimore County and Carroll County, Maryland and in surrounding areas of northern Maryland. Although management believes that the loan portfolio is diversified, many loans are secured by real estate and its performance will be influenced by the economy of the region, including local real estate markets.

6. Premises and Equipment

A summary of premises and equipment is as follows:

	Useful lives	2022	2021
Land and improvements	-	$ **2,602,998**	$ 2,602,998
Buildings and improvements	15-39 years	**6,171,003**	6,302,622
Furniture and equipment	3-10 years	**5,162,976**	4,752,133
		13,936,977	13,657,753
Accumulated depreciation and amortization		**7,750,383**	7,398,332
		$ **6,186,594**	$ 6,259,421
Depreciation and amortization expense		$ **445,939**	$ 434,434

In July 2022, the Company's Upperco, Maryland location incurred significant storm damage to the building and its contents. Insurance proceeds of $779,064 were received. $67,850 was used to repair the roof. The remainder of $711,214 less the book value of the damaged portion of the building and contents of $37,732 resulted in a gain of $673,483.

On March 31, 2021, the Company sold real property for net proceeds of $1,359,613. The carrying value of the land, building, and furniture and equipment at the time of the sale was $1,322,000, resulting in a gain of $37,613.

Software with a net book value of **$90,927** and $118,614 as of December 31, 2022 and 2021, respectively, is included in other assets. Amortization expense of **$36,550** and $36,509 was recorded in 2022 and 2021, respectively.

7. Goodwill and Other Intangibles

The Merger in October of 2020 resulted in the recording of goodwill and core deposit intangible ("CDI"). The following table presents the changes in both assets:

	Goodwill	CDI	Total
Balance at December 31, 2020	$ 6,978,208	$ 81,200	$ 7,059,408
Amortization	-	(8,328)	(8,328)
Balance at December 31, 2021	**6,978,208**	**72,872**	**7,051,080**
Amortization	**-**	**(8,328)**	**(8,328)**
Balance at December 31, 2022	**$ 6,978,208**	**$ 64,544**	**$ 7,042,752**

The CDI is being amortized over 10 years on a straight line basis. Annual amortization will be $8,328 per year and $6,246 in year 10. Since the Merger was a tax-free reorganization, goodwill and CDI are not deductible for income tax purposes.

8. Commitments and Contingencies

Lease Commitments

The Company has an operating lease for the land on which the Hampstead branch is located. The initial term of the lease expired on September 30, 2009 and the lease was renewed for three five year terms with an expiration date of September 30, 2024. The lease has options to renew for five additional consecutive five-year terms. Effective in July 2012, the Company entered into an operating lease for certain facilities where the Greenmount branch is located. The initial term of the lease was for five years and, effective January 2018, the lease has been renewed for one five-year term with an option to renew for an additional five-year term. The Company entered into an operating lease for the corporate headquarters in June 2015. In July 2019, the lease was amended to increase the amount of space. The lease was renewed in June 2020 with options to renew for three additional consecutive five year terms. In May 2018, the Company entered into a lease for its Carroll Lutheran Village branch with a term of five years and the option to renew for two additional five year terms.

The following table shows operating lease right of use assets and operating lease liabilities as of December 31, 2022:

	Consolidated Balance Sheet classification	December 31, 2022	December 31, 2021
Operating lease right of use asset	Other assets	**$ 943,933**	$ 1,093,382
Operating lease liabilities	Other liabilities	**1,166,476**	1,311,570

Operating lease cost included in occupancy expense in the statement of income was $**188,909** during 2022 and $191,913 during 2021.

Future undiscounted lease payments for operating leases with initial terms of one year or more as of December 31, 2022 are as follows:

Year	Amount
2023	$ 188,734
2024	194,252
2025	199,944
2026	205,816
2027	211,874
Thereafter	282,496
Total lease payments	1,283,116
Less imputed interest	(116,640)
Present value of operating lease liabilities	$ 1,166,476

For operating leases as of December 31, 2022, the weighted average remaining lease term is 6.54 years and the weighted average discount rate is 3.25%. During the years ended December 31, 2022 and 2021, cash paid for amounts included in the measurement of lease liabilities was $**184,554** and $174,860, respectively.

8. **Commitments and Contingencies** (continued)

Credit Commitments

Outstanding loan commitments, unused lines of credit, and letters of credit as of December 31, were as follows:

	2022	2021
Loan commitments		
Construction and land development	**$ 911,500**	$ 6,810,353
Commercial	**398,046**	630,000
Commercial real estate	**9,264,000**	23,552,400
Residential	**3,402,371**	3,804,617
	$ 13,975,917	$ 34,797,370
Unused lines of credit		
Home-equity lines	**$ 12,086,758**	$ 12,707,519
Commercial lines	**25,464,025**	28,828,911
	$ 37,550,783	$ 41,536,430
Letters of credit	**$ 1,403,956**	$ 1,470,742

Loan commitments and lines of credit are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments generally have interest rates at current market amounts, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Such lines do not necessarily represent future cash requirements because it is unlikely that all customers will draw upon their lines in full at any time. Letters of credit are commitments issued to guarantee the performance of a customer to a third party.

The maximum exposure to credit loss in the event of nonperformance by the customer is the contractual amount of the commitment. Loan commitments, lines of credit and letters of credit are made on the same terms, including collateral, as outstanding loans. Management is not aware of any accounting loss that is likely to be incurred as a result of funding its credit commitments.

Insurance Reserves

Until November 6, 2022, through reinsurance and pooling arrangements, the Insurance Subsidiary insured risks of the Bank (primarily professional liability) that were not available in typical commercially available policies. In addition, the Insurance Subsidiary, as one protected cell of a protected cell captive insurance company, is responsible for a portion of all claims filed by the other captive insurance companies that participate in the pool in which the Insurance Subsidiary participates. The Company records liabilities for claims incurred but not reported based on historical loss information and claim emergence patterns. Total liabilities related to Insurance Subsidiary claims at December 31, 2022 and 2021 were **$530,720** and $390,171, respectively, and are included in other liabilities in the Consolidated Balance Sheet. The Bank did not renew the policy through the Insurance Subsidiary after the previous policy expired on November 6, 2022. The Bank may renew the policy at a later date.

9. Retirement Plans

The Company has a profit sharing plan qualifying under Section 401(k) of the Internal Revenue Code. All employees age 21 or more with six months of service are eligible for participation in the plan. The Company matches employee contributions up to 4% of total compensation and may make additional discretionary contributions. Employee and employer contributions are 100% vested when made. The Company's contributions to this plan were **$256,251** and $259,042 for 2022 and 2021, respectively.

The Company has entered into agreements with **12** employees to provide certain life insurance benefits payable in connection with policies of life insurance on those employees that are owned by the Company. Each of the agreements provides for the amount of death insurance benefits to be paid to beneficiaries of the insured. Some of the policies provide benefits subsequent to the employee's employment with the Company. For this plan, the Company expensed **$6,809** and $6,643 in 2022 and 2021, respectively.

The Company adopted supplemental executive retirement plans for four of its executives. The plans provide cash compensation to the executive officers under certain circumstances, including a separation of service. The benefits vest over the period from adoption to a specified age for each executive. The Company recorded expenses, including interest, of **$154,911** and $168,129 in 2022 and 2021, respectively, for these plans.

Retirement plan expenses are included in employee benefits on the Consolidated Statements of Income.

10. Interest-Bearing Deposits

Major classifications of interest-bearing deposits are as follows:

	2022	2021
NOW	**$ 135,716,736**	$ 130,486,845
Money market	**99,173,640**	90,994,339
Savings	**103,308,454**	99,959,988
Certificates of deposit, greater than $250,000	**37,976,238**	34,697,273
Other time deposits	**120,740,707**	146,100,610
	$ 496,915,775	$ 502,239,055

As of December 31, 2022, certificates of deposit mature as follows:

Year	Amount
2023	**$ 110,590,325**
2024	**39,187,383**
2025	**4,711,082**
2026	**2,570,470**
2027	**1,657,685**
	$ 158,716,945

In connection with the Merger, the Company recognized a certificate of deposit premium of $616,377, which is being accreted using the interest method based upon the maturity of each certificate of deposit. Accretion of $160,923 and $249,840 were recorded in 2022 and 2021, respectively.

11. Borrowed Funds

Borrowed funds consist of securities sold under repurchase agreements, which represent overnight or term borrowings from customers, advances from the FHLB of Atlanta, the FRB, and overnight borrowings from a commercial bank. The government agency securities that are the collateral for these agreements are owned by the Company and maintained in the custody of an unaffiliated agent designated by the Company.

11. **Borrowed Funds (Continued)**

On September 30, 2020, Farmers and Merchants Bancshares, Inc. borrowed $17,000,000 from First Horizon Bank ("FHN") to be used, on October 1, 2020, to fund a portion of the merger consideration paid in the Merger. Net of issuance costs of $28,126, the proceeds of the net long-term debt were $16,971,874. The loan matures on September 30, 2025. The interest rate on the loan is fixed at 4.10%. The Company made quarterly interest-only payments through October 1, 2021. During the remaining term of the loan, the Company is required to make quarterly interest and principal payments of approximately $646,472, which is based on a nine-year straight-line amortization schedule. The remaining balance of approximately $9,916,667 will be due at maturity. To secure its obligations under this loan, the Company pledged all of its shares of common stock of the Bank to the lender.

Additional information is as follows:

			2022		2021
Amounts outstanding at year-end:					
Securities sold under repurchase agreements		**$**	**5,175,303**	$	5,414,026
Federal Home Loan Bank advances:					
Maturity date	Interest Rate		Amount		
3/30/2025 - fixed rate	1.00%		**5,000,000**		5,000,000
11/20/2023 - daily rate	4.57%		**15,000,000**		-
	Total	**$**	**20,000,000**	$	5,000,000
Long-term debt (net of issuance costs):					
Maturity date	Interest Rate		Amount		
9/30/2025	4.10%		**15,095,642**		16,978,905
Weighted average rate paid at December 31:					
Securities sold under repurchase agreements			**0.30%**		0.31%
Federal Home Loan Bank advances			**3.68%**		1.00%
Long-term debt			**4.10%**		4.10%
Average rate paid during the year ended December 31:					
Securities sold under repurchase agreements			**0.30%**		0.43%
Federal Home Loan Bank advances			**1.55%**		1.01%
Long-term debt			**4.10%**		4.10%
Investment securities underlying the repurchase agreements at December 31:					
Carrying value		**$**	**11,389,983**	$	7,062,928
Loans pledged to the Federal Home Loan Bank at December 31:					
Carrying value - loans		**$**	**458,863,387**	$	111,547,027
Loans pledged to the Federal Reserve Bank at December 31:					
Carrying value		**$**	**62,720,368**	$	55,399,031

The Company is approved to borrow approximately $60.5 million against eligible pledged single family residential loans, eligible pledged multi-family loans, eligible pledged commercial loans, and eligible pledged securities under a secured line of credit with the FHLB. In addition, the Company has a facility with the FRB whereby the Company can borrow up to $25.4 million. The Company also has available an unsecured federal funds line of credit of $14.5 million and a secured federal funds line of credit of $9 million from commercial banks.

12. **Income Taxes** (continued)

The components of income tax expense are as follows:

	2022	2021
Current		
Federal	$ 1,852,205	$ 1,798,535
State	883,493	794,348
	2,735,698	2,592,883
Deferred	(250,672)	(160,070)
	$ 2,485,026	$ 2,432,813

The components of the deferred tax expense are as follows:

	2022	2021
Depreciation	$ 15,108	$ 8,291
Insurance proceeds for storm damage	185,326	$ -
Provision for loan losses	(160,332)	(141,488)
Other real estate owned allowance for loss	-	(46,561)
Nonaccrual interest	(29,429)	(83,961)
Prepaid captive insurance premium	(357,518)	(14,375)
Write-down of equity securities	(11,583)	(4,227)
Lease liability, net of right of use asset	(1,198)	(4,693)
Purchase accounting adjustments	153,455	175,037
Post-retirement benefits	(44,501)	(48,093)
	$ (250,672)	$ (160,070)

The components of the net deferred tax asset are as follows:

	2022	2021
Deferred tax assets		
Allowance for loan losses	$ 1,111,679	$ 951,348
Other real estate owned allowance for loss	434,628	434,628
Capital loss carryover	-	5,300
Nonaccrual interest	118,010	88,581
Post-retirement benefits	695,983	651,482
Purchase accounting adjustments	81,687	235,142
Unrealized loss on securities available for sale	6,433,263	468,726
Lease liability, net of right of use asset	61,238	60,040
Other	21,079	-
	8,957,567	2,895,247
Deferred tax liabilities		
Prepaid captive insurance premium	-	357,518
Depreciation	364,008	348,900
Insurance proceeds from storm damage	185,326	-
Other	15,575	11,379
	564,909	717,797
Net deferred tax asset	$ 8,392,658	$ 2,177,450

12. **Income Taxes** (continued)

The differences between the federal income tax rate in effect each year and the effective tax rate for the Company are reconciled as follows:

	2022	2021
Statutory federal income tax rate	**21.0 %**	21.0 %
Increase (decrease) resulting from:		
Federal tax-exempt income	**(3.6)**	(4.4)
State income taxes, net of federal income tax benefit	**5.8**	5.8
Other	**0.3**	0.6
	23.5 %	23.0 %

Included in Federal tax-exempt income is the insurance premium revenue of the Insurance Subsidiary.

The IRS recently audited our fiscal year 2016, 2017, and 2018 U.S. consolidated federal tax returns. As part of its audits, the IRS reviewed the deductions related to, and the income generated by, the Insurance Subsidiary. Following the completion of these audits, the IRS notified the Company that it disagrees with our tax treatment of the Insurance Subsidiary. The Company has appealed the determination, and management believes that it is more than likely that the Company will prevail in that appeal. If we do not prevail in our appeal to this decision, then we could be required to pay taxes, interest, and penalties totaling approximately $3.0 million as of December 31, 2022 for the tax years under appeal. In addition, the IRS is also auditing our fiscal year 2019, 2020, and 2021 U.S. consolidated federal tax returns. Management cannot predict whether any of the tax positions taken in our 2019, 2020 or 2021 tax returns will be challenged by the IRS or, if challenged, whether we will be successful in defending those tax positions. If we are not successful in defending a challenge, then we may be required to amend the applicable tax return and pay additional taxes, interest, fines and/or penalties and our taxable earnings and/or the effective tax rate on our future earnings could increase substantial. In light of the foregoing, a reserve for uncertain tax positions has not been recorded.

The Company does not have other material uncertain tax positions and did not recognize any adjustments for unrecognized tax benefits. The Company remains subject to examination of income tax returns for the years ending after December 31, 2018.

13. **Capital Standards**

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possible additional, discretionary actions by the regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Our capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The Basel III Capital Rules became effective for the Bank on January 1, 2015 (subject to a phase-in period for certain provisions). Quantitative measures established by the Basel III Capital Rules to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the table below) of Common Equity Tier 1 capital, Tier 1 capital, and Total capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to adjusted quarterly average assets (as defined).

13. **Capital Standards (continued)**

In connection with the adoption of the Basel III Capital Rules, the Bank elected to opt-out of the requirement to include accumulated other comprehensive income in Common Equity Tier 1 capital. Common Equity Tier 1 capital for the Bank is reduced by goodwill and other intangible assets, net of associated deferred tax liabilities and subject to transition provisions.

Under the revised prompt corrective action requirements, insured depository institutions are required to meet the following in order to qualify as "well capitalized:" (i) a Common Equity Tier 1 risk-based capital ratio of 6.5%; (ii) a Tier 1 risk-based capital ratio of 8%; (iii) a total risk-based capital ratio of 10%; and (iv) a Tier 1 leverage ratio of 5%.

The implementation of the capital conservation buffer began on January 1, 2015, at the 0.625% level and was phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reached 2.5% on January 1, 2019). The Basel III Capital Rules also provide for a "countercyclical capital buffer" that is applicable to only certain covered institutions and does not have current applicability to the Bank.

The aforementioned capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of Common Equity Tier 1 capital to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) will face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall.

On September 17, 2019, the FDIC finalized a rule that introduces an optional simplified measure of capital adequacy for qualifying community banking organizations (i.e., the community bank leverage ratio (“CBLR”) framework), as required by the Economic Growth, Regulatory Relief and Consumer Protection Act. The CBLR framework is designed to reduce burden by removing the requirements for calculating and reporting risk-based capital ratios for qualifying community banking organizations that opt into the framework.

On April 6, 2020, in a joint statement, the FDIC, Federal Reserve and the Office of Comptroller of the Currency (“OCC”), issued two interim final rules regarding temporary changes to the CBLR framework to implement provisions of the CARES Act. Under the interim final rules, the community bank leverage ratio was reduced to 8% beginning in the second quarter and for the remainder of calendar year 2020, 8.5% for calendar year 2021, and 9% thereafter. In order to qualify for the CBLR framework, a community banking organization must have a tier 1 leverage ratio of greater than 8%, less than $10 billion in total consolidated assets, and limited amounts of off-balance-sheet exposures and trading assets and liabilities. A qualifying community banking organization that opts into the CBLR framework and meets all requirements under the framework will be considered to have met the well-capitalized ratio requirements under the Prompt Corrective Action regulations and will not be required to report or calculate risk-based capital. The Company has not opted-in to the CBLR framework.

The following table presents actual and required capital ratios as of December 31, 2022 and 2021, for the Bank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2022 and 2021, based on the provisions of the Basel III Capital Rules. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

13. Capital Standards (continued)

As of December 31, 2022 the most recent notification from the FDIC has categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain ratios as set forth in the table. There have been no conditions or events since that notification that management believes have changed the Bank's category. Capital ratios of the Company are substantially the same as the Bank's.

The FDIC, through formal or informal agreement, has the authority to require an institution to maintain higher capital ratios than those provided by statute, to be categorized as well capitalized under the regulatory framework for prompt corrective action. The following table presents actual and required capital ratios as of December 31, 2022 and 2021, for the Bank under the Basel III Capital Rules.

(Dollars in thousands)	Actual		Minimum Capital Adequacy		To Be Well Capitalized	
December 31, 2022	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	**$ 75,826**	**12.96%**	**$ 61,410**	**10.50%**	**$ 58,486**	**10.00%**
Tier 1 capital (to risk-weighted assets)	**71,676**	**12.26%**	**49,713**	**8.50%**	**46,789**	**8.00%**
Common equity tier 1 (to risk-weighted assets)	**71,676**	**12.26%**	**40,940**	**7.00%**	**38,016**	**6.50%**
Tier 1 leverage (to average assets)	**71,676**	**9.83%**	**29,167**	**4.00%**	**36,459**	**5.00%**

(Dollars in thousands)	Actual		Minimum Capital Adequacy		To Be Well Capitalized	
December 31, 2021	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	$ 69,957	13.24%	$ 55,471	10.50%	$ 52,830	10.00%
Tier 1 capital (to risk-weighted assets)	66,307	12.55%	44,905	8.50%	42,264	8.00%
Common equity tier 1 (to risk-weighted assets)	66,307	12.55%	36,981	7.00%	34,339	6.50%
Tier 1 leverage (to average assets)	66,307	9.27%	28,614	4.00%	35,767	5.00%

14. Fair Value

Accounting standards define fair value as the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants (an "exit" price). The price in the principal market used to measure the fair value of the asset or liability is not adjusted for transaction costs. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

The standards require the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. The standards establish a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

14. **Fair Value** (Continued)

The fair value hierarchy is as follows:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the Company has the ability to access as of the measurement date.
- Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.
- Level 3: Significant unobservable inputs that reflect the Company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company uses the following methods and significant assumptions to estimate the fair values of the following assets:

- Securities available for sale: The fair values of securities available for sale are determined by obtaining quoted prices from a nationally recognized securities pricing agent. If quoted market prices are not available, fair value is determined using quoted market prices for similar securities. For securities where quoted market prices for similar securities are not available, the book value of the security is used as the fair value.
- Equity security at fair value: The Company's investment in an equity mutual fund is valued based on the net asset value of the fund, which is classified as Level 1.
- Other real estate owned ("OREO"): Nonrecurring fair value adjustments to OREO reflect full or partial write-downs that are based on the OREO's observable market price or current appraised value of the real estate. Since the market for OREO is not active, OREO subjected to nonrecurring fair value adjustments based on the current appraised value of the real estate are classified as Level 3. The appraised value is obtained annually from an independent third party appraiser and is reduced by expected sales costs, which has historically been 10% of the appraised value. State of Maryland regulations require that OREO is written down to $0 after a certain period of time.
- Impaired loans: Nonrecurring fair value adjustments to impaired loans reflect full or partial write-downs and reserves that are based on the impaired loan's observable market price or current appraised value of the collateral. Since the market for impaired loans is not active, such loans subjected to nonrecurring fair value adjustments based on the current appraised value of the collateral are classified as Level 3. The appraised value is obtained annually from an independent third party appraiser and is reduced by expected sales costs, which has historically been 10% of the appraised value.

14. **Fair Value** (Continued)

The following table summarizes financial assets measured at fair value on a recurring and nonrecurring basis as of December 31, 2022 and 2021, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Carrying Value:			
	Level 1	Level 2	Level 3	Total
December 31, 2022				
Recurring:				
Available for sale securities				
State and municipal	$ -	$ 552,281	$ -	$ 552,281
SBA pools	-	1,019,797	-	1,019,797
Corporate bonds	-	8,989,896	400,000	9,389,896
Mortgage-backed securities	-	115,352,475	-	115,352,475
	$ -	$ 125,914,449	$ 400,000	$ 126,314,449
Equity security at fair value	$ 489,145	$ -	$ -	$ 489,145
Nonrecurring:				
Other real estate owned, net	$ -	$ -	$ 1,242,365	$ 1,242,365
Impaired loans	-	-	373,500	373,500
December 31, 2021				
Recurring:				
Available for sale securities				
State and municipal	$ -	$ 763,498	$ -	$ 763,498
SBA pools	-	1,397,762	-	1,397,762
Corporate bonds	-	8,584,207	650,000	9,234,207
Mortgage-backed securities	-	137,842,449	-	137,842,449
	$ -	$ 148,587,916	$ 650,000	$ 149,237,916
Equity security at fair value	$ 543,605	$ -	$ -	$ 543,605
Nonrecurring:				
Other real estate owned, net	$ -	$ -	$ 1,242,365	$ 1,242,365
Impaired loans	-	-	373,500	373,500

The following table provides information describing the unobservable inputs used in level 3 fair value measurements at December 31, 2022 and 2021:

Description of Asset	Fair Value	Valuation technique	Unobservable Inputs	Range (Average)	
Loans with Impairment	$ 373,500	Third party appraisals and in-house real estate valuations of fair value	Marketability/selling costs and current market conditions	0% to 20%	(10%)
Other real estate loans	$ 1,242,365	Third party appraisals and in-house real estate valuations of fair value	Marketability/selling costs and current market conditions	0% to 10%	(5%)

14. **Fair Value (continued)**

Reconciliation of Level 3 Inputs

	Corporate Bonds
December 31, 2021 fair value	**$ 650,000**
Additions	**-**
Principal payments received	**-**
Transfer to level 2	**(250,000)**
December 31, 2022 fair value	**$ 400,000**

The estimated fair value of financial instruments that are reported at amortized cost in the Company's consolidated balance sheets, segregated by the level of the valuation inputs were as follows:

	December 31, 2022		December 31, 2021	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Level 1 inputs				
Cash and cash equivalents	**$ 7,263,537**	**$ 7,263,537**	$ 26,462,106	$ 26,462,106
Level 2 inputs				
Certificates of deposit in other banks	**100,000**	**100,000**	350,000	350,000
Accrued interest receivable	**1,815,784**	**1,815,784**	1,609,063	1,609,063
Securities held to maturity	**17,537,377**	**15,908,175**	18,778,935	19,732,561
Mortgage loans held for sale	**428,355**	**434,271**	126,500	128,829
Restricted stock, at cost	**1,332,500**	**1,332,500**	675,400	675,400
Bank owned life insurance	**14,585,342**	**14,585,342**	11,556,163	11,556,163
Level 3 inputs				
Securities held to maturity (1)	**2,971,620**	**2,971,620**	3,073,040	3,073,040
Loans, net	**516,920,540**	**503,144,771**	482,011,334	487,012,970
Financial liabilities				
Level 1 inputs				
Noninterest-bearing deposits	**$ 126,695,349**	**$ 126,695,349**	$ 124,175,615	$ 124,175,615
Securities sold under repurchase agreements	**5,175,303**	**5,175,303**	5,414,026	5,414,026
Level 2 inputs				
Interest-bearing deposits	**496,915,775**	**492,769,775**	502,239,055	502,396,172
Federal Home Loan Bank advances	**20,000,000**	**19,622,000**	5,000,000	4,967,000
Long-term debt	**15,095,642**	**14,241,237**	16,978,905	17,298,111
Accrued interest payable	**349,910**	**349,910**	295,910	295,910

(1) - Debt securities recorded at book value with unrealized gain/loss estimated to be immaterial.

15. Parent Company Financial Information

The condensed financial statements for the Company (parent only) are presented below:

Balance Sheets

December 31,	2022	2021
Assets		
Cash and cash equivalents	$ 806,384	$ 930,354
Investment in subsidiaries	62,064,533	72,662,265
Other assets	158,127	185,866
	$ 63,029,044	$ 73,778,485
Liabilities and Stockholders' Equity		
Long-term debt	$ 15,095,642	$ 16,978,905
Accrued interest payable	158,439	178,122
	15,254,081	17,157,027
Stockholders' equity		
Common stock, par value $.01 per share, authorized 5,000,000 shares; issued and outstanding 3,071,214 in 2022 and 3,037,137 shares in 2021	30,712	30,372
Additional paid-in capital	29,549,914	28,857,422
Retained earnings	35,300,166	29,128,600
Accumulated other comprehensive income	(17,105,829)	(1,394,936)
	47,774,963	56,621,458
	$ 63,029,044	$ 73,778,485

Statements of Income

Years Ended December 31,	2022	2021
Income		
Cash dividends from subsidiaries	$ 3,574,000	$ 2,595,000
Total income	3,574,000	2,595,000
Interest expense - long-term debt	(664,621)	(712,306)
Noninterest expense	(90,969)	(537)
Income before income taxes and equity in (distributed) undistributed income of subsidiaries	2,818,410	1,882,157
Income taxes (benefit)	(158,556)	(149,486)
Income before equity in (distributed) undistributed income of subsidiaries	2,976,966	2,031,643
Dividends in excess of income of insurance subsidiary	(247,472)	(100,019)
Equity in undistributed income of bank subsidiary	5,360,633	6,217,982
Net Income	$ 8,090,127	$ 8,149,606

15. Parent Company Financial Information (continued)

Statements of Cash Flows

Years Ended December 31,	2022	2021
Cash flows from operating activities		
Net Income	**$ 8,090,127**	$ 8,149,606
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed income of bank subsidiary	**(5,360,633)**	(6,217,982)
Decrease in accrued interest payable	**(19,683)**	(1,935)
Amortization of debt issuance costs	**5,625**	5,625
Change in income tax receivable	**27,739**	(149,486)
Dividend received in excess of income of insurance subsidiary	**247,472**	100,019
Cash provided by operating activities	**2,990,647**	1,885,847
Cash flows from investing activities		
Cash used in investing activities	**-**	-
Cash flows from financing activities		
Long-term debt	**(1,888,888)**	-
Dividends paid, net of reinvestments	**(1,225,729)**	(1,156,418)
Cash used in financing activities	**(3,114,617)**	(1,156,418)
Net (decrease) increase in cash and cash equivalents	**(123,970)**	729,429
Cash and cash equivalents at beginning of period	**930,354**	200,925
Cash and cash equivalents at end of period	**$ 806,384**	$ 930,354

16. Litigation

In the ordinary course of its business, the Company is periodically party to various legal actions normally associated with a financial institution. Management does not believe that any of these normal course proceedings are likely to have a material adverse effect on the financial condition or liquidity of the Company.

MARKET FOR THE COMPANY’S COMMON EQUITY AND OTHER RELATED SHAREHOLDER MATTERS

The Company’s Articles of Incorporation authorize the Company to issue up to 5,000,000 shares of common stock, par value $.01 per share (the “Common Stock”). As of February 28, 2023 there were 3,071,214 shares of Common Stock issued and outstanding held by approximately 467 stockholders of record.

Although many trades occur through privately-negotiated transactions, the shares of the Company’s common stock are traded in the over-the-counter market by certain broker-dealers and price quotations are available through the OTC Markets Group’s OTC Pink Market (the “Pink Market”) under the symbol “FMFG”. The following table sets forth, for the periods indicated, high and low bid information for the common stock as reported through the Pink Market. These prices do not include retail mark-ups, markdowns or commissions, and may not necessarily represent actual transactions. The table also shows the per share cash dividends declared during these periods.

	High	Low	Dividend Per Share
2022			
Quarter ended December 31	$23.50	$19.20	$0.31
Quarter ended September 30	22.50	19.75	0.00
Quarter ended June 30	24.90	21.25	0.30
Quarter ended March 31	24.50	21.25	0.00
2021			
Quarter ended December 31	$25.50	$22.01	$0.29
Quarter ended September 30	25.50	21.45	0.00
Quarter ended June 30	23.50	18.90	0.28
Quarter ended March 31	25.00	13.20	0.00

The Company’s ability to declare and pay dividends is limited by federal banking laws and Maryland corporation laws. Subject to these laws, the payment of dividends is at the discretion of the Company’s board of directors, who considers such factors as operating results, financial condition, capital adequacy, regulatory requirements, and stockholder return. The Company’s ability to pay dividends will be largely dependent on its receipt of dividends from the Bank and/or the Insurance Subsidiary. Like the Company, the Bank’s ability to declare and pay dividends is subject to limitations imposed by federal and Maryland banking and Maryland corporation laws, and the Insurance Subsidiary’s ability to declare and pay dividends is subject to limitations imposed by Tennessee insurance laws. Accordingly, there can be no assurance that dividends will be declared on the shares of the common stock in any future fiscal quarter.

Farmers and Merchants Bancshares, Inc.

Stockholder Information

Corporate Headquarters
4510 Lower Beckleysville Road, Suite H
Hampstead, MD 21074
410-374-1510

Annual Meeting
The annual meeting of stockholders will be held
April 25, 2023 at 3:00 p.m. at the Piney Branch Golf & Country Club,
5301 Trenton Mill Road, Upperco, Maryland 21155.

Securities Markets
Shares of common stock of Farmers and Merchants Bancshares, Inc.
are publicly traded on the NASDAQ Stock Market's Over-the-Counter
Bulletin Board under the trading symbol "FMFG."

Janney Montgomery Scott, LLC. makes a market in Farmers and
Merchants Bancshares Inc. common stock.
For information, please contact Douglas Velnoskey at 443-201-2088

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A copy of the Farmers and Merchants Bancshares, Inc. annual report, including financial statements, may be obtained without charge upon written request to:

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Farmers and Merchants Bank
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