

FARMERS AND MERCHANTS BANCSHARES, INC.

2023 Annual Report



The “Community” Bank that Puts People First
since 1919



◆ *THE “COMMUNITY” BANK THAT PUTS PEOPLE FIRST* ◆
Member FDIC

March 11, 2024

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, 2023 was \$6,418,337, or \$2.08 per common share, compared to \$8,090,127, or \$2.66 per common share, for the year ended December 31, 2022. The table below provides a comparison of the Company’s results for the years ended December 31, 2023 and 2022.

	Year Ended December 31,	
	2023	2022
Income before taxes	\$ 8,435,587	\$ 10,575,153
Income taxes	2,017,250	2,485,026
Net income	<u>\$ 6,418,337</u>	<u>\$ 8,090,127</u>
Earnings per share	\$ 2.08	\$ 2.66
Return on average assets	0.86%	1.13%
Return on average equity	13.08%	16.03%

Higher cost of funds for deposits and borrowings due to the Federal Reserve rate increases is the primary reason for the decline in net income year over year. It appears that the higher interest rate environment will continue well into 2024.

Cash dividends paid to stockholders increased to \$0.66 per common share in 2023 from \$0.63 per common share in 2022. The book value of the common stock of Farmers and Merchants Bancshares, Inc. was \$16.74 per share at December 31, 2023, compared to \$15.56 per share at December 31, 2022.

Total assets increased to \$800 million at December 31, 2023 from \$718 million at December 31, 2022. Loans increased to \$528 million at December 31, 2023 from \$521 million at December 31, 2022. Investments in debt securities increased to \$184 million at December 31, 2023 from \$147 million at December 31, 2022. Deposits increased to \$681 million at December 31, 2023 from \$624 million at December 31, 2022.

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. and

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 | • Mortgages (Permanent and Construction) |
| • Savings accounts | • Home Equity loans |
| • Certificates of Deposit | • Installment and Line of Credit loans |
| • Money Market Accounts | • Land loans |
| • Individual Retirement Accounts | • Car and truck loans |
| • Holiday and Vacation Club accounts | • 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-focused, independent, profitable Community Bank dedicated to providing products and services that fulfill the evolving financial needs of individuals and businesses.

Farmers and Merchants Bank

LOCATIONS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Towson Loan Center
22 W. Pennsylvania Avenue
Towson, MD 21204

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

Bruce L. Schindler, Chairman
President
Bob Davidson Ford Lincoln

J. Lawrence Mekulski
Retired Principal
KLNb, LLC

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

Emily Bollinger Miller
Owner/Partner
Barnes-Bollinger Insurance Services, Inc.

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

Robert G. Pollokoff
President and CEO
The Fedder Company

Roger D. Cassell
President
Communications Electronics, Inc.

Teresa L. Smack
President
Terry's Tag & Title

Steven W. Eline
President
Eline Funeral Home

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

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

Louna S. Primm
Director Emeritus
Retired Bank Executive

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

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
Gregory Caroots.....IT and Operations
Kevin P. Bankert.....Commercial Banking
John Wasowicz.....Commercial Banking
George W. Peck.....Commercial Banking
Bart D. Boland.....Commercial Banking
Barry Luciani.....Retail Banking
Paige Boughan.....Human Resources

Vice Presidents

Jennifer R. Caines.....Computer Operations
Michelle L. Miller.....Controller
David L. Hogue.....Commercial Banking
Thomas E. Long.....Commercial Banking
Joshua W. Allen.....Commercial Banking
J. Thomas Turner.....Mortgage Officer
Amy L. Collins.....Branch Administration
Susan K. Jaeger.....Business Development
Tracey R. Diggs.....BSA

Other Bank Officers

Suzette L. Covalt.....Treasury Management

Assistant Vice Presidents

Debora A. Smith.....Loan Officer
Betty J. Higgs-Swartz.....Loan Officer
Callie L. Jennings.....Loan Officer
Danielle Rhodes.....Loan Administrator
Cherie R. Barrett.....Corporate Secretary

Assistant Vice Presidents

Branch Managers

Kelly P. Johnson.....Eldersburg
TJ Sallah.....Westminster &
Carroll Lutheran Village
Shannon M. Panek-Close.....Main Office &
Hampstead
Catherine E. Davis.....Owings Mills
Megan T. Rudolph.....Reisterstown
Stephanie Morris.....Towson

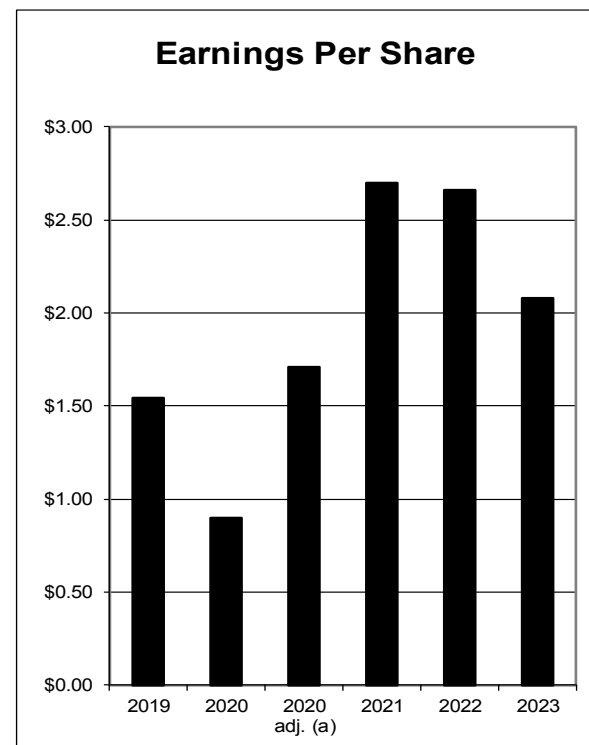
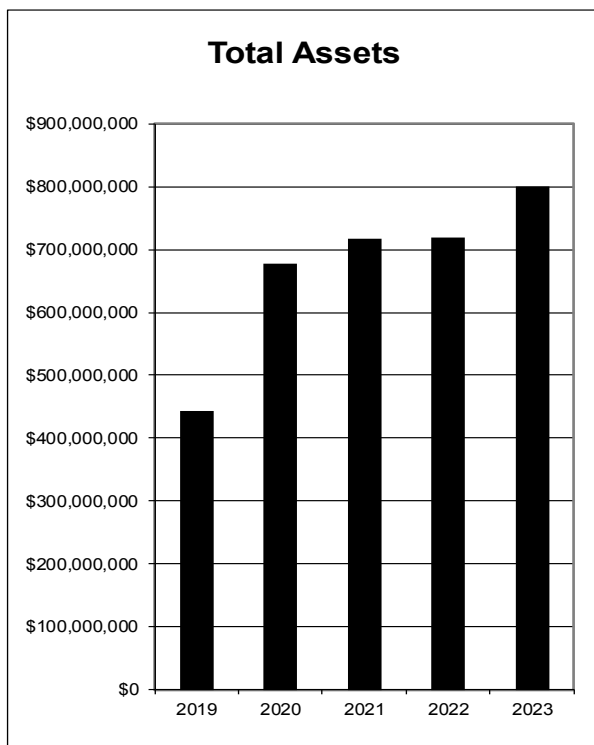
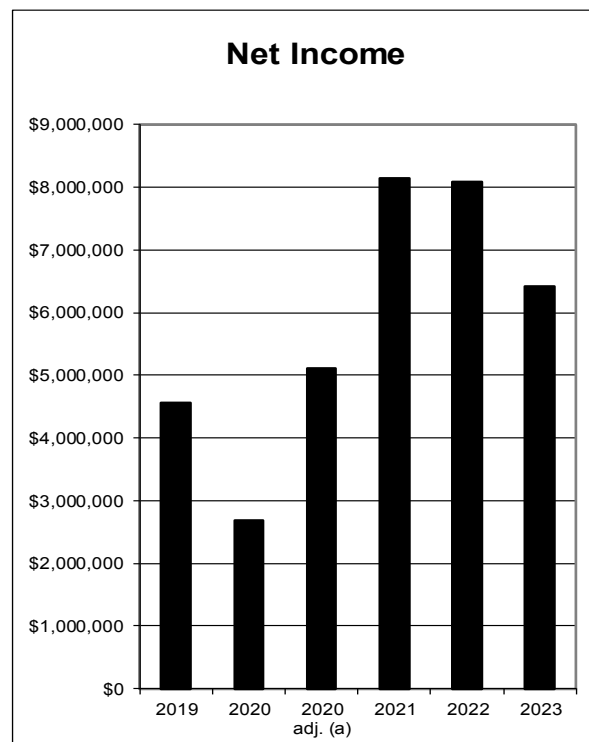
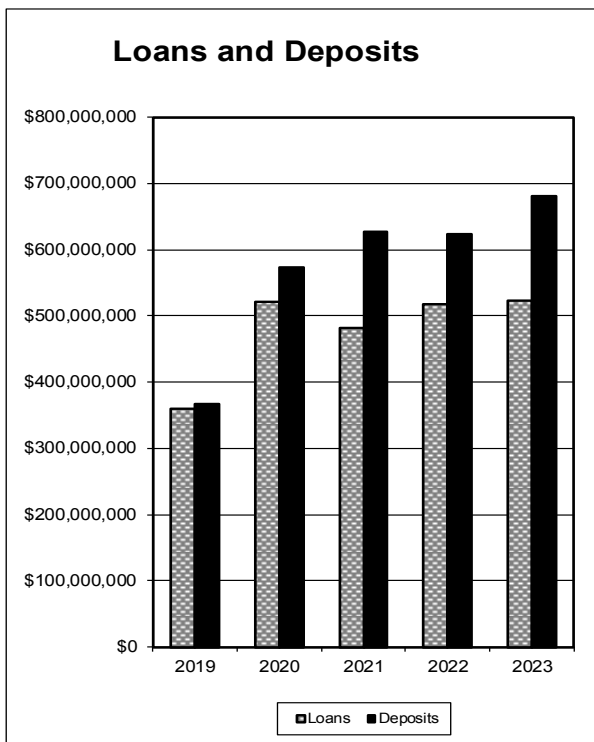
Farmers and Merchants Bancshares, Inc.
Selected Consolidated Financial Data

	<u>2023</u>	<u>2022</u>	<u>2021</u>	As Reported <u>2020</u>	Excluding Acquisition Costs <u>2020 (a)</u>	<u>2019</u>
OPERATING DATA						
Interest income	\$ 31,323,138	\$ 26,269,653	\$ 25,680,403	\$ 20,763,180	\$ 20,763,180	\$ 18,702,338
Interest expense	<u>9,907,125</u>	<u>2,146,158</u>	<u>2,805,299</u>	<u>3,458,677</u>	<u>3,458,677</u>	<u>3,679,953</u>
Net interest income	21,416,013	24,123,495	22,875,104	17,304,503	17,304,503	15,022,385
(Recovery of) provision for credit losses	<u>(570,000)</u>	<u>475,000</u>	<u>330,000</u>	<u>625,000</u>	<u>625,000</u>	<u>40,000</u>
Net interest income after (recovery of) provision for credit losses	21,986,013	23,648,495	22,545,104	16,679,503	16,679,503	14,982,385
Noninterest income	1,840,717	2,293,938	1,996,674	2,072,119	2,072,119	1,493,567
Acquisition costs	-	-	-	3,236,817	-	-
Noninterest expense	<u>15,391,143</u>	<u>15,367,280</u>	<u>13,959,359</u>	<u>12,345,591</u>	<u>12,345,591</u>	<u>10,875,814</u>
Income before income taxes	8,435,587	10,575,153	10,582,419	3,169,214	6,406,031	5,600,138
Income taxes	<u>2,017,250</u>	<u>2,485,026</u>	<u>2,432,813</u>	<u>487,211</u>	<u>1,292,806</u>	<u>1,039,334</u>
Net income	<u>\$ 6,418,337</u>	<u>\$ 8,090,127</u>	<u>\$ 8,149,606</u>	<u>\$ 2,682,003</u>	<u>\$ 5,113,225</u>	<u>\$ 4,560,804</u>
PER SHARE DATA						
Net income (Basic)	\$2.08	\$2.66	\$2.70	\$0.90	\$1.71	\$1.54
Dividends	\$0.66	\$0.63	\$0.57	\$0.52		\$0.51
Book value	\$16.74	\$15.56	\$18.64	\$17.18		\$16.63
KEY RATIOS						
Return on average assets	0.86%	1.13%	1.16%	0.51%	0.97%	1.06%
Return on average equity	13.08%	16.03%	14.85%	5.22%	9.96%	9.52%
Efficiency ratio	66.18%	58.17%	56.13%	80.42%	63.71%	65.85%
Dividend payout ratio	31.73%	23.68%	21.11%	57.78%	30.41%	33.12%
Net yield on interest-earning assets	2.97%	3.54%	3.47%	3.50%		3.67%
Tier 1 capital leverage ratio	9.42%	9.83%	9.27%	9.05%		10.94%
AT PERIOD END						
Total assets	\$ 799,782,317	\$ 718,210,672	\$ 716,677,255	\$ 677,317,082		\$ 442,215,098
Gross loans	528,166,501	521,679,143	485,661,602	524,987,052		362,494,703
Cash and cash equivalents	44,690,337	7,263,537	26,462,106	40,975,670		9,121,352
Securities	184,191,877	146,823,446	171,089,891	77,555,805		56,041,792
Deposits	680,962,851	623,611,124	626,414,670	573,401,547		376,613,314
Borrowings	57,972,871	40,270,945	27,392,931	42,227,252		10,958,118
Stockholders' equity	52,178,291	47,774,963	56,621,458	51,729,483		49,453,516
SELECTED AVERAGE BALANCES						
Total assets	\$ 745,478,612	\$ 714,115,497	\$ 704,113,955	\$ 526,539,417		\$ 431,595,287
Gross loans	528,910,091	498,427,308	515,167,318	421,010,433		344,793,736
Cash and cash equivalents	18,497,261	20,015,477	38,059,811	21,272,187		20,124,328
Securities	182,159,701	174,776,879	119,905,876	65,583,845		53,049,768
Deposits	642,039,185	631,809,943	489,816,460	369,504,859		367,570,825
Borrowings	48,040,853	26,042,874	32,398,746	18,638,621		11,975,017
Stockholders' equity	49,063,426	50,457,994	54,885,256	51,344,333		47,927,778
ASSET QUALITY						
Nonperforming assets	\$ 1,897,775	\$ 1,897,775	\$ 6,454,940	\$ 6,048,577		\$ -
Nonperforming assets/total assets	0.24%	0.26%	0.90%	0.89%		0.00%
Allowance for loan losses/total loans	0.81%	0.80%	0.75%	0.63%		0.72%

(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.

Farmers and Merchants Bancshares, 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, 2023 and 2022, 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 for federal income tax purposes. 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.

On October 1, 2020, Farmers and Merchants Bancshares, Inc. acquired Carroll Bancorp, Inc. ("Carroll") and Farmers and Merchants Bank acquired Carroll's wholly-owned subsidiary, Carroll Community Bank, in a series of merger transactions (collectively, the "Merger"). As a result of the Merger, Carroll was merged with an into Farmers and Merchants Bancshares, Inc., with Farmers and Merchants Bancshares, Inc. as the surviving corporation, and Carroll Community Bank merged with an into Farmers and Merchants Bank, with Farmers and Merchants Bank as the surviving bank. The Merger was intended to constitute a tax-free reorganization for federal income tax purposes.

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 credit 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 credit losses on loans represents management's estimate of expected credit losses in the loan portfolio. Determining the amount of the allowance for credit 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 collateral dependent 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 credit losses.

Management applies various valuation methodologies to assets and liabilities that often involve a

Farmers and Merchants Bancshares, Inc.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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 credit losses 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.

FINANCIAL CONDITION

Total assets were \$799,940,826 at December 31, 2023, an increase of \$81,730,154, or 11.4%, over the \$718,210,672 recorded at December 31, 2022. The increase was due primarily to an increase of \$37,426,800 in cash and cash equivalents, an increase of \$37,424,849 in securities available for sale and held to maturity and an increase of \$6,387,504 in loans.

Total liabilities were \$747,762,535 at December 31, 2023, an increase of \$77,326,826, or 11.5%, over the \$670,435,709 recorded at December 31, 2022. The increase was due primarily to an increase of \$57,351,727 in deposits, an increase of \$33,000,000 in Federal Reserve Bank ("FRB") advances, an increase of \$1,585,190 in securities sold under repurchase agreements and an increase of \$1,132,863 in accrued interest payable, offset by a decrease of \$15,000,000 in Federal Home Loan Bank of Atlanta ("FHLB") advances and a decrease of \$1,883,264 in long term debt.

Stockholders' equity was \$52,178,291 at December 31, 2023 compared to \$47,774,963 at December 31, 2022, an increase of \$4,403,328, or 9.2%. The increase was due primarily to net income for 2023 of \$6,418,337, offset by dividends paid, net of reinvestments, of \$1,235,988 and a decrease in after-tax unrealized loss on available for sale securities of \$578,315.

Farmers and Merchants Bancshares, Inc.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Loans

Major categories of loans at December 31, 2023 and 2022 are as follows:

	2023		2022	
Real estate:				
Commercial	\$	361,942,511	69%	\$ 351,794,702 67%
Construction/Land development		20,446,150	4%	23,978,373 5%
Residential		112,789,631	21%	114,683,149 22%
Commercial		32,823,072	6%	31,066,497 6%
Consumer		165,136	0%	156,422 0%
		<u>528,166,500</u>	<u>100%</u>	<u>521,679,143</u> <u>100%</u>
Less: Allowance for credit losses		4,285,247		4,150,198
Deferred origination fees net of costs		573,209		608,405
	\$	<u>523,308,044</u>		<u>\$ 516,920,540</u>

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

Loans increased by \$6,387,504, or 1.2%, to \$523,308,044 at December 31, 2023 from \$516,920,540 at December 31, 2022. The increase was due primarily to an increase of \$10,147,808 in commercial real estate loans and an increase of \$1,756,575 in commercial loans, offset by a decrease in construction/land development loans of \$3,532,223 and a decrease in residential real estate loans of \$1,893,517. Due primarily to rising interest rates, total loan production decreased by \$65 million in 2023 when compared to 2022 and loan payoffs decreased by \$24 million as rising rates made it more difficult for borrowers to refinance. In addition, line of credit usage was flat year over year. For construction/land development loans the decrease was due primarily to several loans moving to permanent status after the construction completion. The allowance for credit losses increased by \$135,049 to \$4,285,247 at December 31, 2023 compared to \$4,150,198 at December 31, 2022.

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 credit 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.

Farmers and Merchants Bancshares, Inc.

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

The maturities and interest rate sensitivity of the loan portfolio at December 31, 2023 were 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	\$ 34,306,839	\$ 198,774,170	\$ 91,508,386	\$ 37,353,116	\$ 361,942,511
Construction/Land development	6,557,617	11,387,669	562,225	1,938,639	20,446,150
Residential	13,848,111	57,565,626	21,701,657	19,674,237	112,789,631
Commercial	15,158,385	9,995,569	7,624,429	44,689	32,823,072
Consumer	17,404	142,837	4,895	-	165,136
	<u>\$ 69,888,356</u>	<u>\$ 277,865,871</u>	<u>\$ 121,401,592</u>	<u>\$ 59,010,681</u>	<u>\$ 528,166,500</u>
Rate terms:					
Fixed-interest rate loans	\$ 41,975,675	\$ 257,446,892	\$ 62,325,338	\$ 9,777,568	\$ 371,525,473
Adjustable-interest rate loans	27,912,681	20,418,979	59,076,254	49,233,113	156,641,027
	<u>\$ 69,888,356</u>	<u>\$ 277,865,871</u>	<u>\$ 121,401,592</u>	<u>\$ 59,010,681</u>	<u>\$ 528,166,500</u>

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:

	2023	2022
Non-accrual loans		
Commercial real estate	\$ 502,961	\$ 502,961
Residential real estate	-	-
Commercial	152,449	152,449
Total non-accrual loans	<u>\$ 655,410</u>	<u>\$ 655,410</u>

At December 31, 2023, 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 a personal guaranty. Gross interest income of \$45,856 would have been recorded in 2023 if these non-accrual loans had been current and performing in accordance with the original terms. The Company allocated \$450,000 of its allowance for credit losses to these non-accrual loans.

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 a personal guaranty. 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 credit losses to these non-accrual loans.

At December 31, 2023 and 2022, the Company had no loans that were delinquent 90 days or greater other than the non-accrual loans listed above.

Farmers and Merchants Bancshares, Inc.

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

The following table presents the amortized cost basis of collateral-dependent loans by class of loans as of December 31, 2023:

Real estate:	
Commercial	\$ 2,515,103
Construction and land development	-
Residential	275,622
Commercial	152,449
Consumer	-
	<u>\$ 2,943,174</u>

Impaired loans at December 31, 2022 are set forth in the following table:

	<u>2022</u>
Impaired loans no valuation allowance	\$ 6,772,804
Impaired loans with a valuation allowance	<u>655,410</u>
Total impaired loans	<u>\$ 7,428,214</u>
Valuation allowance related to impaired loans	<u>\$ 281,910</u>

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:

	<u>2023</u>	<u>2022</u>
Special mention	\$ -	\$ 5,530,925
Substandard	11,267,782	12,070,750
Doubtful	<u>16,138</u>	<u>35,381</u>
Total	<u>\$ 11,283,920</u>	<u>\$ 17,637,056</u>

The allowance for credit losses is a reserve established through a provision for credit losses and is charged to expense. The allowance for credit losses represents an amount which, in management's judgment, will be adequate to absorb expected losses on existing loans and other extensions of credit that may become uncollectible. The Company's allowance for credit loss methodology is calculated in accordance with Financial Accounting Standards Board Accounting Standards Update ("ASU") 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." The amount of the allowance represents management's best estimate of current expected credit losses on loans considering available information, from internal and external sources, relevant to assessing collectability over the loans' contractual terms, adjusted for expected prepayments when appropriate.

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Relevant available information includes historical credit loss experience, current conditions and reasonable and supportable forecasts. While historical credit loss experience provides the basis for the estimation of expected credit losses, adjustments to historical loss information may be made for differences in current portfolio-specific risk characteristics, environmental conditions or other relevant factors. The allowance for credit losses is measured on a collective basis for portfolios of loans when similar risk characteristics exist. Loans that do not share risk characteristics are evaluated for expected credit losses on an individual basis and excluded from the collective evaluation. Expected credit losses for collateral dependent loans, including loans where the borrower is experiencing financial difficulty but foreclosure is not probable, are based on the fair value of the collateral at the reporting date, adjusted for selling costs as appropriate.

Although management believes, based on currently available information, that the Company's allowance for credit losses is sufficient to cover losses expected in its loan portfolio at this time, no assurances can be given that the Company's level of allowance for credit losses will be sufficient to cover future credit losses incurred by the Company or that future adjustments to the allowance for credit 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 credit losses.

The following tables detail activity in the allowance for credit losses by portfolio for the years ended December 31, 2023 and 2022. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Beginning balance	Impact of ASC 326 Adoption	Provision for (recovery of) credit losses	Charge offs	Recoveries	Ending balance	Allowance for credit losses ending balance evaluated for impairment:		Outstanding loan balances evaluated:	
							Individually	Collectively	Individually	Collectively
December 31, 2023										
Real estate:										
Commercial	\$ 2,818,582	\$ (448,483)	\$ 79,889	\$ -	\$ -	\$ 2,449,988	\$ 297,551	\$ 2,152,437	\$ 2,515,103	\$ 359,427,408
Construction and land development	164,596	277,317	(200,665)	-	11,925	253,173	-	253,173	-	20,446,150
Residential	793,919	508,579	(676,608)	-	387,048	1,012,938	-	1,012,938	275,622	112,514,009
Commercial	337,303	133,838	22,361	-	-	493,502	152,449	341,053	152,449	32,670,623
Consumer	4,706	(4,526)	1,900	-	-	2,080	-	2,080	-	165,136
Unallocated	31,092	(31,092)	73,566	-	-	73,566	-	73,566	-	-
	<u>\$ 4,150,198</u>	<u>\$ 435,633</u>	<u>\$ (699,557)</u>	<u>\$ -</u>	<u>\$ 398,973</u>	<u>\$ 4,285,247</u>	<u>\$ 450,000</u>	<u>\$ 3,835,247</u>	<u>\$ 2,943,174</u>	<u>\$ 525,223,326</u>

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December 31, 2022	Provision					Loan Segment Percentage	Allowance for loan losses ending balance evaluated for impairment:			Outstanding loan balances evaluated for impairment:		
	Beginning balance	for loan losses	Charge offs	Recoveries	Ending balance		Purchase Credit			Purchase Credit		
							Individually	Impaired	Collectively	Individually	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	-	-	-
	<u>\$ 3,650,268</u>	<u>\$ 475,000</u>	<u>\$ (10,240)</u>	<u>\$ 35,170</u>	<u>\$ 4,150,198</u>	<u>100%</u>	<u>\$ 281,910</u>	<u>\$ -</u>	<u>\$ 3,868,288</u>	<u>\$ 7,428,214</u>	<u>\$ 579,205</u>	<u>\$ 513,671,724</u>

	<u>2023</u>	<u>2022</u>
Allowance for credit losses to total loans outstanding	<u>0.81%</u>	<u>0.80%</u>
Ratio of net charge-offs to average loans outstanding during the period	<u>0.00%</u>	<u>0.00%</u>
Nonaccrual loans to total loans outstanding at period end	<u>0.12%</u>	<u>0.13%</u>

Net recovery during the period to average loans outstanding:

	<u>2023</u>
Real estate:	
Commercial	0.00%
Construction and land development	0.05%
Residential	0.34%
Commercial	0.00%
Consumer	0.00%
Total	<u>0.08%</u>

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The Company received net recoveries of loans previously charged-off of \$398,973 and \$24,930 during 2023 and 2022, respectively. The impact on the income statement was a \$570,000 recovery of credit losses in 2023 compared to a \$475,000 provision for loan losses in 2022.

Management believes that the \$4.3 million reserve at December 31, 2023, when coupled with the \$570,000 recovery of credit losses for the year ended December 31, 2023, is appropriate to adequately cover the expected losses inherent in the loan portfolio. The reserve increased by \$135,049, or 3.3%, from December 31, 2022. The Company's loan portfolio grew by \$6 million during the 2023.

Other Real Estate Owned

Other real estate owned ("OREO") at December 31, 2023 included one property with a carrying value of \$1,242,365. The property is an apartment building in Baltimore, Maryland that was acquired in the Merger. The property is being marketed for sale.

	2023	2022
Other Real Estate Owned	<u>\$ 1,242,365</u>	<u>\$ 1,242,365</u>

During 2023, the Company sold property located in Cecil County, Maryland with a carrying value of \$0 for a gain of \$249,217. Due to the length of time that the property had been held, Maryland banking law required a write-down of the value to \$0 in 2019.

Investment Securities

Investment securities increased by \$37,424,849, or 25.5%, to \$184,248,295 at December 31, 2023 from \$146,823,446 at December 31, 2022. The increase was due primarily to security purchases of \$49,742,119, offset by principal paydowns and calls of \$13,341,714. At December 31, 2023 and 2022, the Company had classified 89% and 86%, respectively, of the investment portfolio as available for sale. The remaining balance of the portfolio was classified as held to maturity.

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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:

	<u>2023</u>	<u>2022</u>
<u>Available for sale</u>		
State and municipal	\$ 484,808	\$ 552,281
SBA pools	766,710	1,019,797
Corporate bonds	8,570,429	9,389,896
Mortgage-backed securities	<u>154,262,726</u>	<u>115,352,475</u>
	<u>\$164,084,673</u>	<u>\$126,314,449</u>
<u>Held to maturity</u>		
State and municipal	<u>\$ 20,163,622</u>	<u>\$ 20,508,997</u>

The following table sets forth the scheduled maturities of investment securities at December 31, 2023:

	<u>Available for Sale</u>			<u>Held to Maturity</u>		
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Yield (1)</u>	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Yield (1)</u>
Within 1 year	\$ 1,259,692	\$ 1,220,382	2.70%	\$ 230,000	\$ 230,064	3.25%
Over 1 to 5 years	1,779,830	1,708,398	2.24%	666,321	652,278	2.97%
Over 5 to 10 years	7,314,466	6,126,457	3.25%	5,864,476	5,654,095	2.94%
Over 10 years	<u>-</u>	<u>-</u>	<u>-</u>	<u>13,402,825</u>	<u>12,491,156</u>	<u>2.99%</u>
	10,353,988	9,055,237	3.01%	20,163,622	19,027,593	2.98%
SBA Pools	776,686	766,710	6.47%	-	-	-
Mortgage-backed securities	<u>175,742,562</u>	<u>154,262,726</u>	<u>2.97%</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$ 186,873,236</u>	<u>\$ 164,084,673</u>	<u>3.00%</u>	<u>\$ 20,163,622</u>	<u>\$ 19,027,593</u>	<u>2.98%</u>

(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 \$680,962,851 at December 31, 2023 compared to \$623,611,124 at December 31, 2022, an increase of \$57,351,727, or 9.2%. The increase was due to an \$111,695,140 increase in certificates of deposit and a \$2,016,597 increase in interest bearing checking accounts, offset by a \$17,293,071 decrease in savings accounts, a \$27,656,296 decrease in money market accounts and an \$11,410,643 decrease in noninterest-bearing accounts.

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

	2023		2022	
	Average Balance	Cost	Average Balance	Cost
Noninterest bearing demand deposits	\$ 119,653,595	0.00%	\$ 129,642,652	0.00%
Interest bearing demand deposits	132,407,353	0.50%	134,141,125	0.17%
Savings and money market deposits	171,253,490	0.43%	199,407,223	0.13%
Certificates of deposit	<u>218,724,746</u>	<u>3.01%</u>	<u>168,618,943</u>	<u>0.53%</u>
	<u>\$ 642,039,184</u>	<u>1.24%</u>	<u>\$ 631,809,943</u>	<u>0.22%</u>

As of December 31, 2023, certificates of deposit greater than \$250,000 mature as follows:

Period	Balance
3 months or less	\$ 39,197,000
Over 3 months to 6 months	10,719,593
Over 6 months to 12 months	9,683,539
Over 12 months	<u>3,800,130</u>
Total	<u>\$ 63,400,262</u>

Uninsured deposits totaled \$150,955,541 at December 31, 2023.

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, 2023, the Company's off-balance sheet financial instruments were as follows:

Loan commitments	\$ 35,925,212
Unused lines of credit	\$ 58,006,480
Letters of credit	\$ 1,339,391

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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:

	<u>At December 31,</u>	
	<u>2023</u>	<u>2022</u>
Amount outstanding at year-end:		
Securities sold under repurchase agreements	\$ 6,760,493	\$ 5,175,303
Federal Home Loan Bank advances	5,000,000	20,000,000
Federal Home Loan Bank advances mature in:		
	2023 \$ -	\$ 15,000,000
	2025 \$ 5,000,000	\$ 5,000,000
Federal Reserve Bank advances mature in:		
	2024 \$ 33,000,000	\$ -
Long-term debt (net of issuance costs) matures in	2025 \$ 13,212,378	\$ 15,095,642
Weighted average rate paid at December 31:		
Securities sold under repurchase agreements	1.25%	0.30%
Federal Home Loan Bank advances	1.00%	3.68%
Federal Reserve Bank advances	4.83%	-
Long-term debt	4.10%	4.10%

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The terms of the Company's operating leases, including the future minimum payments under those leases, are disclosed in Note 11 to the consolidated financial statements.

RESULTS OF OPERATIONS

Overview

The Company reported net income of \$6,418,337 for the year ended December 31, 2023 compared to \$8,090,127 for the year ended December 31, 2022. The decrease of \$1,671,790 from 2022 was due to a decrease in net interest income of \$2,707,482 and a decrease in noninterest income of \$702,438, offset by a decrease in the provision for credit losses of \$1,045,000, a decrease in noninterest expense of \$225,354 and a decrease in income taxes of \$467,776.

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, 2023, the Company recorded net interest income of \$21,416,013 compared to \$24,123,495 for 2022, a decrease of \$2,707,482. The decrease was attributable to a decrease in the net yield on interest-earning assets of 57 basis points to 2.97% in 2023 from 3.54% in 2022. Higher interest expense on deposits and borrowings due to the Federal Reserve rate increases was the driving factor in the lower net interest income.

Total interest income for the year ended December 31, 2023 increased by \$5,053,485 to \$31,323,138 from \$26,269,653 for 2022. The increase was due primarily to an increase in average interest earning assets of \$41,199,331 to \$727,959,751 in 2023 from \$686,760,420 in 2022 and by an increase of 48 basis points in the tax equivalent yield on interest earning assets to 4.33% in 2023 from 3.85% in 2022.

Interest income from loans was \$25,730,722 in 2023 compared to \$22,565,034 in 2022, an increase of \$3,165,688. This increase was attributable to a \$30,482,783 increase in the average balance of loans to \$528,910,091 in 2023 from \$498,427,308 in 2022 and a 33 basis point increase in the average yield on loans to 4.86% in 2023 from 4.53% in 2022.

For the year ended December 31, 2023, the Company recorded interest income on securities of \$4,853,602 compared to \$3,551,955 for the same period in 2022. The \$1,301,647 increase in 2023 was attributable to a \$7,382,822 increase in the average balance of securities to \$182,159,701 in 2023 from \$174,776,879 in 2022 and a 62 basis point increase in the average tax equivalent yield on securities to 2.75% in 2023 from 2.13% in 2022.

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Interest income on federal funds sold and other interest-earning assets (FHLB stock and certificates of deposit) increased by \$586,150 to \$738,814 in 2023 compared to \$152,664 in 2022. The increase was due to a 346 basis point increase in the average tax equivalent yield to 4.66% in 2023 from 1.20% in 2022 and a \$3,333,726 increase in the average balance of federal funds sold and other interest-earning assets to \$16,889,959 in 2023 from \$13,556,233 in 2022.

Total interest expense increased by \$7,760,967 to \$9,907,125 in 2023 compared to \$2,146,158 in 2022. The increase was due to a 133 basis point increase in the cost of interest-bearing liabilities to 1.74% in 2023 from 0.41% in 2022 and an increase of \$42,216,277 in the average balance of interest-bearing liabilities to \$570,426,442 in 2023 from \$528,210,165 in 2022. The Federal Reserve rate increases were the primary cause of the significant increase in the cost of funds.

Interest paid on NOW, savings, and money market deposit accounts increased by \$922,032 to \$1,398,245 in 2023 compared to \$476,213 in 2022. The increase was due to a 32 basis point increase in the cost of funds to 0.46% in 2023 from 0.14% in 2022 offset by a \$29,887,505 decrease in the average balance of these deposits to \$303,660,843 in 2023 from \$333,548,348 in 2022.

Interest paid on time deposits increased by \$5,673,371 to \$6,572,849 in 2023 compared to \$899,478 in 2022. The increase was due to an increase of 248 basis points in the average rate paid to 3.01% in 2023 from 0.53% in 2022 and an increase of \$50,105,803 in the average balance to \$218,724,746 in 2023 from \$168,618,943 in 2022.

Interest paid on securities sold under repurchase agreements increased by \$29,105 to \$41,873 in 2023 compared to \$12,768 in 2022. The increase was attributable to an increase of 60 basis points in the average rate paid to 0.90% in 2023 from 0.30% in 2022 and a \$399,570 increase in the average balance of securities sold under repurchase agreements to \$4,655,006 in 2023 from \$4,255,436 in 2022.

Interest paid on long-term debt was \$584,953 in 2023 compared to \$664,620 in 2022. This debt relates to the \$17 million term loan obtained on September 30, 2020 to finance a portion of the cash paid to the former stockholders of Carroll in the Merger. The average balance, net of issuance costs, decreased \$1,656,386 to \$14,259,819 in 2023 from \$15,916,205 in 2022 due to scheduled principal payments.

The FRB's Bank Term Funding Program ("BTFP") was initiated in March 2023. The Company utilized the BTFP with an average balance of \$15,515,069 during 2023 at a cost of 5.31%. We recorded an associated interest expense of \$823,319 in 2023.

Interest paid on FHLB advances increased \$392,807 to \$485,886 in 2023 from \$93,079 in 2022. The increase was attributable to an increase of 198 basis points in the average rate paid to 3.57% in 2023 from 1.59% in 2022 and a \$7,739,726 increase in the average balance of FHLB advances and other borrowings to \$13,610,959 in 2023 from \$5,871,233 in 2022.

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.

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	2023			2022		
	Average Balance	Interest	Yield	Average Balance	Interest	Yield
<u>Assets:</u>						
Loans	\$528,910,091	\$25,730,722	4.86%	\$498,427,308	\$22,565,034	4.53%
Securities, taxable	163,933,787	4,304,728	2.63%	156,008,736	2,986,225	1.91%
Securities, tax exempt	18,225,914	700,330	3.84%	18,768,143	736,696	3.93%
Federal funds sold and other interest-earning assets	<u>16,889,959</u>	<u>786,812</u>	<u>4.66%</u>	<u>13,556,233</u>	<u>162,410</u>	<u>1.20%</u>
Total interest-earning assets	<u>727,959,751</u>	<u>31,522,592</u>	<u>4.33%</u>	<u>686,760,420</u>	<u>26,450,365</u>	<u>3.85%</u>
Noninterest-earning assets	<u>17,518,861</u>			<u>27,355,077</u>		
Total assets	<u>\$745,478,612</u>			<u>\$714,115,497</u>		
<u>Liabilities and Stockholders' Equity:</u>						
NOW, savings, and money market	\$303,660,843	1,398,245	0.46%	\$333,548,348	476,213	0.14%
Certificates of deposit	218,724,746	6,572,849	3.01%	168,618,943	899,478	0.53%
Securities sold under repurchase agreements	4,655,006	41,873	0.90%	4,255,436	12,768	0.30%
Long-term debt	14,259,819	584,953	4.10%	15,916,205	664,620	4.18%
FRB advances and other borrowings	15,515,069	823,319	5.31%	-	-	-
FHLB advances	<u>13,610,959</u>	<u>485,886</u>	<u>3.57%</u>	<u>5,871,233</u>	<u>93,079</u>	<u>1.59%</u>
Total interest-bearing liabilities	<u>570,426,442</u>	<u>9,907,125</u>	<u>1.74%</u>	<u>528,210,165</u>	<u>2,146,158</u>	<u>0.41%</u>
Noninterest-bearing deposits	119,653,596			129,642,652		
Noninterest-bearing liabilities	<u>6,335,148</u>			<u>5,804,686</u>		
Total liabilities	696,415,186			663,657,503		
Stockholders' equity	<u>49,063,426</u>			<u>50,457,994</u>		
Total liabilities and stockholders' equity	<u>\$745,478,612</u>			<u>\$714,115,497</u>		
Net interest income		<u>\$21,615,467</u>			<u>\$24,304,207</u>	
Interest rate spread			<u>2.59%</u>			<u>3.44%</u>
Net yield on interest-earning assets			<u>2.97%</u>			<u>3.54%</u>
Ratio of average interest-earning assets to Average interest-bearing liabilities			<u>128.60%</u>			<u>130.02%</u>

(1) - Interest on tax-exempt securities and other 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.

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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, 2023 compared to 2022			Year ended December 31, 2022 compared to 2021		
	Change due to variance in			Change due to variance in		
	<u>Volume</u>	<u>Rate</u>	<u>Total</u>	<u>Volume</u>	<u>Rate</u>	<u>Total</u>
Interest income:						
Loans	\$ 1,426,401	\$ 1,739,286	\$ 3,165,687	\$ (758,854)	\$ (167,726)	\$ (926,580)
Securities, taxable	158,476	1,160,027	1,318,503	1,009,107	460,631	1,469,738
Securities, tax exempt	(21,024)	(15,341)	(36,365)	(57,625)	6,503	(51,122)
Federal funds sold and other interest-earning assets	<u>48,991</u>	<u>575,411</u>	<u>624,402</u>	<u>(55,105)</u>	<u>148,417</u>	<u>93,312</u>
Total interest-earning assets	<u>1,612,844</u>	<u>3,459,383</u>	<u>5,072,227</u>	<u>137,523</u>	<u>447,825</u>	<u>585,348</u>
Interest expense:						
NOW, savings, and money market	(46,346)	968,378	922,032	47,585	(56,915)	(9,330)
Certificates of deposit	341,921	5,331,450	5,673,371	(140,897)	(471,955)	(612,852)
Securities sold under repurchase agreements	1,306	27,799	29,105	(21,159)	(10,701)	(31,860)
Long-term debt	(68,123)	(11,544)	(79,667)	(44,274)	(3,412)	(47,686)
FRB advances and other borrowings	823,319	-	823,319	-	-	-
FHLB advances	<u>201,484</u>	<u>191,323</u>	<u>392,807</u>	<u>9,972</u>	<u>32,615</u>	<u>42,587</u>
Total interest-bearing liabilities	<u>1,253,561</u>	<u>6,507,406</u>	<u>7,760,967</u>	<u>(148,773)</u>	<u>(510,368)</u>	<u>(659,141)</u>
Change in net interest income	<u>\$ 359,283</u>	<u>\$(3,048,023)</u>	<u>\$(2,688,740)</u>	<u>\$ 286,296</u>	<u>\$ 958,193</u>	<u>\$ 1,244,489</u>

Farmers and Merchants Bancshares, Inc.

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

Noninterest Income

Noninterest income was \$1,591,500 in 2023 compared to \$2,293,938 in 2022, a decrease of \$702,438. The decrease was due primarily to a decrease of \$669,077 on insurance proceeds from the storm damage to the Bank's Upperco, Maryland location, a \$138,731 decrease in the gain on sale of SBA loans, and a \$117,046 decrease in mortgage banking revenue as a result of the significant increase in interest rates in 2023 that reduced residential loan activity, offset by an increase of \$116,233 in bank owned life insurance income.

Noninterest Expense

Total noninterest expense decreased by \$225,354 to \$15,141,926 in 2023 from \$15,367,280 in 2022. The decrease was due primarily to a decrease in salaries of \$320,421 as a result of lower bonuses paid in 2023 of \$495,875, offset by higher salary costs of \$175,454 due to normal salary increases, a decrease of \$257,243 in other real estate owned costs as a result of the gain on the sale of other real estate owned of \$249,217, a decrease in professional fees of \$114,263 as a result of lower headhunting costs of \$129,902, offset by an increase of \$202,782 in employee benefit costs as a result of higher insurance expenses, an increase of \$158,820 in FDIC premiums and an increase of \$91,875 in furniture and equipment expense as a result of higher software maintenance and maintenance contract costs.

Other noninterest expenses include the following:

	2023	2022
Directors fees	\$ 249,845	\$ 212,436
Correspondent bank services	222,634	195,223
Telephone	218,204	202,854
Internet banking fees	201,164	177,164
Stationery, printing and supplies	160,420	176,467
Liability insurance	147,128	137,885
Insurance claims (1)	(110,000)	205,000
Other	857,007	550,754
	<u>\$ 1,946,402</u>	<u>\$ 1,857,783</u>

(1) - Insurance claims decreased by \$315,000 from 2022 to 2023 as a result of the Company not renewing its captive insurance policy effective November 7, 2022. No new claims were added after that date while older claims were either paid, rejected, or withdrawn.

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Income Taxes

Income taxes decreased by \$467,776 to \$2,017,250 in 2023 from \$2,485,026 in 2022.

The Company's effective tax rate increased to 23.9% in 2023, from 23.5% in 2022. 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			
2023	December 31	September 30	June 30	March 31
Interest income	\$ 8,884,690	\$ 8,001,697	\$ 7,384,222	\$ 7,052,529
Interest expense	3,583,564	2,814,708	2,113,392	1,395,461
Net interest income	5,301,126	5,186,989	5,270,830	5,657,068
Provision for loan losses	-	(75,000)	(225,000)	(270,000)
Net income	1,415,230	1,432,139	1,670,117	1,900,851
Earnings per share - basic and diluted	\$ 0.46	\$ 0.46	\$ 0.54	\$ 0.62
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

Farmers and Merchants Bancshares, Inc.

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

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

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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, 2023 and 2022, management estimated the following changes in NII, assuming the indicated rate changes:

<u>Change in Rate</u>	<u>2023</u>	<u>2022</u>
400 basis point increase	\$ (3,323,000)	\$ (2,282,000)
300 basis point increase	(2,119,000)	(1,610,000)
200 basis point increase	(1,192,000)	(958,000)
100 basis point increase	(474,000)	(424,000)
100 basis point decrease	640,000	417,000
200 basis point decrease	373,000	375,000
300 basis point decrease	(237,000)	216,000

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 \$67.0 million under a secured line of credit with the FHLB. The Bank also has two facilities with the Reserve Bank. Under the first facility, which has been in place for over 10 years and is collateralized by loans, the Bank can borrow approximately \$23.4 million. The second facility is the Bank Term Funding Program ("BTFP") that the Reserve Bank created in 2023. The BTFP facility allows securities to be pledged at par, provides fixed rates for up to one-year terms, and allows prepayments in whole or in part at any time. Finally, the Bank has \$23,500,000 (\$14,500,000 unsecured and \$9,000,000 secured) of overnight federal funds lines of credit available from commercial banks.

FHLB advances of \$5,000,000 and \$20,000,000 were outstanding as of December 31, 2023 and 2022, respectively. BTFP advances of \$33,000,000 and \$0 were outstanding as of December 31, 2023 and 2022, respectively. The Company borrowed \$17,000,000 to facilitate the Merger in 2020. There were no borrowings from the Reserve Bank other than the BTFP advances noted above or our commercial bank lenders at December 31, 2023 and 2022. 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. Uninsured deposits were approximately \$150,956,000,000 or 22% of total deposits at December 31, 2023.

Cash provided by operating activities decreased by \$992,216 to \$6,163,746 in 2023 from \$7,155,962 in 2022. Cash used in investing activities decreased by \$7,260,261 to \$42,618,829 in 2023 from \$35,358,568 in 2022 due primarily to a \$38,658,421 decrease in the net cash outflow from the debt securities portfolio, offset by a

Farmers and Merchants Bancshares, Inc.

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

\$30,127,002 increase in the net cash outflow from the loan portfolio. Cash provided by financing activities increased by \$64,877,846 to \$73,881,883 in 2023 from \$9,004,037 in 2022 due primarily to a \$60,064,193 increase in the net cash inflow from deposits and a \$33,000,000 increase in the net cash inflow from Federal Reserve Bank advances and a \$1,823,912 increase in the net cash outflow from securities sold under repurchase agreements, offset by a \$30,000,000 decrease in the net cash outflow from Federal Home Loan Bank of Atlanta 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, 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 13 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, 2023 and 2022, 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, 2023 and 2022, 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.

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(Dollars in thousands)	Actual		Minimum Capital Adequacy		To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2023						
Total capital (to risk-weighted assets)	\$ 79,988	13.45%	\$ 62,437	10.50%	\$ 59,464	10.00%
Tier 1 capital (to risk-weighted assets)	75,440	12.69%	50,544	8.50%	47,571	8.00%
Common equity tier 1 (to risk-weighted assets)	75,440	12.69%	41,625	7.00%	38,651	6.50%
Tier 1 leverage (to average assets)	75,440	9.42%	32,051	4.00%	40,063	5.00%
December 31, 2022						
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%

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, 2023 and 2022, 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, 2023 and 2022, 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.

Adoption of New Accounting Standard

As discussed in Notes 1 and 5 to the financial statements, the Company has changed its method of accounting for the allowance for credit losses in 2023 due to the adoption of ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments*, including all related amendments.

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 Credit Losses – Loans Collectively Evaluated for Losses

As described in Note 1 – Summary of Significant Accounting Policies and Note 5 – Loans and Allowance for Credit Losses to the consolidated financial statements, the Company changed its method of accounting for credit losses on January 1, 2023, due to the adoption of Accounting Standards Update 2016-13, Financial Instruments – Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, as amended. The allowance for credit losses on loans (ACL) is a valuation allowance that represents management’s best estimate of expected credit losses on loans measured at amortized cost considering available information, from internal and external sources, relevant to assessing collectability over the loans’ contractual terms. Loans which share common risk characteristics are pooled and collectively evaluated by the Company using historical data, as well as assessments of current conditions and reasonable and supportable forecasts of future conditions. The Company’s ACL related to collectively evaluated loans made up \$3.9 million of the total recorded ACL of \$4.3 million as of December 31, 2023. The collectively evaluated ACL consists of quantitative and qualitative components.

The quantitative component consists of loss estimates derived from an average charge off or loss rate methodology using primarily internal observations of historical loan losses adjusted for estimated prepayment and forecasts of future conditions over a reasonable and supportable period. These estimates consider large amounts of data in tabulating loss and prepayment rates and require complex calculations as well as management judgment in the selection of appropriate inputs.

In addition to the quantitative component, the collectively evaluated ACL also includes a qualitative component which aggregates management’s assessment of available information relevant to assessing collectability that is not captured in the quantitative loss estimation process. Factors considered by management in developing its qualitative estimates include: economic conditions, concentrations of credit, interest rates, ability of staff, loan review, trends in loan quality, policy changes and changes in the nature and/or volume of loans.

Management exercised significant judgment when estimating the ACL on collectively evaluated loans. We identified the estimation of the collectively evaluated ACL as a critical audit matter as auditing the collectively evaluated ACL involved especially complex and subjective auditor judgment in evaluating management’s assessment of the inherently subjective estimates.

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

- Substantively testing management’s process for measuring the collectively evaluated ACL, including:
 - Evaluating conceptual soundness, assumptions, and key data inputs of the Company’s loss rate methodology, including the identification of loan segments, the calculation of loss rate inputs, and the calculation of prepayment rate inputs for each segment.
 - Evaluating the methodology and testing the reasonableness of incorporating reasonable and supportable forecasts in the collectively evaluated ACL estimate.
 - Evaluating the completeness and accuracy of data inputs used as a basis for the qualitative factors.
 - Evaluating the qualitative factors for directional consistency in comparison to prior periods and for reasonableness in comparison to underlying supporting data.
 - Testing the mathematical accuracy of the ACL for collectively evaluated loans including both the quantitative and qualitative components of the calculation.

/s/ YOUNT, HYDE & BARBOUR, P.C.

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

Richmond, Virginia
March 11, 2024

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Consolidated Balance Sheets

December 31,	2023	2022
Assets		
Cash and due from banks	\$ 44,404,473	\$ 6,414,822
Federal funds sold and other interest-bearing deposits	<u>285,864</u>	<u>848,715</u>
Cash and cash equivalents	44,690,337	7,263,537
Certificates of deposit in other banks	100,000	100,000
Securities available for sale, at fair value	164,084,673	126,314,449
Securities held to maturity, at amortized cost less allowance for credit losses of \$35,627 and \$0	20,163,622	20,508,997
Equity security, at fair value	507,130	489,145
Restricted stock, at cost	863,500	1,332,500
Mortgage loans held for sale	-	428,355
Loans, less allowance for credit losses of \$4,285,247 and \$4,150,198	523,308,044	516,920,540
Premises and equipment, net	6,583,452	6,186,594
Accrued interest receivable	2,180,734	1,815,784
Deferred income taxes, net	8,312,482	8,392,658
Other real estate owned, net	1,242,365	1,242,365
Bank owned life insurance	14,930,754	14,585,342
Goodwill and other intangibles, net	7,034,424	7,042,752
Other assets	<u>5,939,309</u>	<u>5,587,654</u>
	<u><u>\$ 799,940,826</u></u>	<u><u>\$ 718,210,672</u></u>
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing	\$ 115,284,706	\$ 126,695,349
Interest-bearing	<u>565,678,145</u>	<u>496,915,775</u>
Total deposits	680,962,851	623,611,124
Securities sold under repurchase agreements	6,760,493	5,175,303
Federal Home Loan Bank of Atlanta advances	5,000,000	20,000,000
Federal Reserve Bank advances	33,000,000	-
Long-term debt, net of issuance costs	13,212,378	15,095,642
Accrued interest payable	1,482,773	349,910
Other liabilities	<u>7,344,040</u>	<u>6,203,730</u>
	<u><u>747,762,535</u></u>	<u><u>670,435,709</u></u>
Stockholders' equity		
Common stock, par value \$.01 per share, authorized 5,000,000 shares; issued and outstanding 3,116,966 shares in 2023 and 3,071,214 shares in 2022	31,170	30,712
Additional paid-in capital	30,398,080	29,549,914
Retained earnings	39,433,185	35,300,166
Accumulated other comprehensive loss	<u>(17,684,144)</u>	<u>(17,105,829)</u>
	<u><u>52,178,291</u></u>	<u><u>47,774,963</u></u>
	<u><u>\$ 799,940,826</u></u>	<u><u>\$ 718,210,672</u></u>

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,	2023	2022
Interest income		
Loans, including fees	\$ 25,730,722	\$ 22,565,034
Investment securities - taxable	4,299,206	2,981,300
Investment securities - tax exempt	554,396	570,655
Federal funds sold and other interest earning assets	738,814	152,664
Total interest income	<u>31,323,138</u>	<u>26,269,653</u>
Interest expense		
Deposits	7,971,094	1,375,691
Securities sold under repurchase agreements	41,873	12,768
Federal Home Loan Bank advances	485,886	93,079
Federal Reserve Bank advances	823,319	-
Long-term debt	584,953	664,620
Total interest expense	<u>9,907,125</u>	<u>2,146,158</u>
Net interest income	21,416,013	24,123,495
(Recovery of) provision for credit losses	<u>(570,000)</u>	<u>475,000</u>
Net interest income after (recovery of) provision for credit losses	<u>21,986,013</u>	<u>23,648,495</u>
Noninterest income		
Service charges on deposit accounts	792,941	777,901
Mortgage banking income	96,997	214,043
Bank owned life insurance income	345,412	229,179
Fair value adjustment of equity security	5,445	(62,094)
Gain on sale of SBA loans	19,392	158,123
Gain on insurance proceeds, net	4,406	673,483
Other fees and commissions	326,907	303,303
Total noninterest income	<u>1,591,500</u>	<u>2,293,938</u>
Noninterest expense		
Salaries	7,544,773	7,865,194
Employee benefits	2,000,932	1,798,150
Occupancy	874,775	890,926
Furniture and equipment	983,126	891,250
Professional services	642,365	894,715
Automated teller machine and debit card expenses	509,120	473,917
Federal Deposit Insurance Corporation premiums	339,016	180,196
Postage, delivery, and armored carrier	266,647	235,412
Advertising	270,308	258,032
Other real estate owned, net	(235,538)	21,705
Other	1,946,402	1,857,783
Total noninterest expense	<u>15,141,926</u>	<u>15,367,280</u>
Income before income taxes	8,435,587	10,575,153
Income taxes	<u>2,017,250</u>	<u>2,485,026</u>
Net income	<u>\$ 6,418,337</u>	<u>\$ 8,090,127</u>
Earnings per common share - basic	<u>\$ 2.08</u>	<u>\$ 2.66</u>
Earnings per common share - diluted	<u>\$ 2.08</u>	<u>\$ 2.66</u>

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

Farmers and Merchants Bancshares, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income (Loss)

Years Ended December 31,	2023	2022
Net income	\$ 6,418,337	\$ 8,090,127
Other comprehensive loss, net of income taxes:		
Total unrealized gain (loss) on investment securities available for sale	811,381	(21,675,430)
Income tax (expense) benefit	<u>(223,273)</u>	<u>5,964,537</u>
Net unrealized gain (loss) on investment securities available for sale	<u>588,108</u>	<u>(15,710,893)</u>
Total unrealized loss on derivatives	(1,563,527)	-
Income tax benefit	<u>397,104</u>	<u>-</u>
Net unrealized loss on derivatives	<u>(1,166,423)</u>	<u>-</u>
Total other comprehensive loss	<u>(578,315)</u>	<u>(15,710,893)</u>
Total comprehensive income (loss)	<u>\$ 5,840,022</u>	<u>\$ (7,620,766)</u>

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	Retained	Accumulated other	Total
	Shares	Par value	paid-in capital	earnings	comprehensive income (loss)	stockholders' equity
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	<u>34,077</u>	<u>340</u>	<u>692,492</u>	<u>-</u>	<u>-</u>	<u>692,832</u>
Balance, December 31, 2022	3,071,214	30,712	29,549,914	35,300,166	(17,105,829)	47,774,963
Net income	-	-	-	6,418,337	-	6,418,337
Other comprehensive loss	-	-	-	-	(578,315)	(578,315)
Stock-based compensation	2,000	20	42,768	-	-	42,788
Cash dividends, \$0.66 per share	-	-	-	(2,033,981)	-	(2,033,981)
Reclassification due to the adoption of ASU 2016-13	-	-	-	(243,494)	-	(243,494)
Dividends reinvested	<u>43,752</u>	<u>438</u>	<u>805,398</u>	<u>(7,843)</u>	<u>-</u>	<u>797,993</u>
Balance, December 31, 2023	<u>3,116,966</u>	<u>\$ 31,170</u>	<u>\$ 30,398,080</u>	<u>\$ 39,433,185</u>	<u>\$ (17,684,144)</u>	<u>\$ 52,178,291</u>

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,	2023	2022
Reconciliation of net income to net cash provided by operating activities		
Net income	\$ 6,418,337	\$ 8,090,127
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	510,087	482,489
(Recovery of) provision for credit losses	(570,000)	475,000
(Accretion) amortization of right of use asset	(6,566)	4,355
Equity security dividends reinvested	(12,540)	(7,634)
Unrealized (gain) loss on equity security	(5,445)	62,094
Gain on sale of SBA loans	(19,392)	(158,123)
Deferred tax expense (benefit)	392,170	(250,672)
Gain on sale of other real estate owned	(235,538)	-
Gain on sale of premises and equipment	(9,000)	-
Gain on insurance proceeds	(4,406)	(673,483)
Gain on fair value hedge	(45,721)	-
Stock based compensation	42,788	-
Amortization of debt issuance costs	5,625	5,625
Amortization of premiums and (accretion of discounts), net	(332,172)	(224,663)
Bank owned life insurance cash surrender value	(345,412)	(229,179)
Increase (decrease) in		
Deferred loan fees and costs, net	(35,196)	(111,160)
Accrued interest payable	1,132,863	54,000
Other liabilities	(494,845)	396,538
Decrease (increase) in		
Mortgage loans held for sale	428,355	(301,855)
Accrued interest receivable	(364,950)	(206,721)
Other assets	(544,632)	(250,776)
Net cash provided by operating activities	<u>5,904,410</u>	<u>7,155,962</u>

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Years Ended December 31,	2023	2022
Cash flows from investing activities		
Proceeds from maturity and call of securities		
Available for sale	12,910,294	19,994,811
Held to maturity	431,420	1,456,420
Purchase of securities		
Available for sale	(49,742,119)	(19,193,215)
Redemption of certificates of deposit	-	250,000
Loans made to customers, net of principal collected	(5,813,615)	(35,960,009)
Proceeds from sale of loans	-	1,250,154
Redemption (purchase) of stock in FHLB of Atlanta	469,000	(657,100)
Purchase of bank owned life insurance	-	(2,800,000)
Proceeds from sale of other real estate owned	235,538	-
Proceeds from sale of premises and equipment	9,000	-
Proceeds from insurance	4,406	711,214
Purchases of premises, equipment and software	(863,417)	(410,843)
Net cash used in investing activities	<u>(42,359,493)</u>	<u>(35,358,568)</u>
Cash flows from financing activities		
Net increase (decrease) in		
Noninterest-bearing deposits	(11,410,643)	2,519,734
Interest-bearing deposits	68,832,213	(5,162,357)
Securities sold under repurchase agreements	1,585,190	(238,722)
Federal Home Loan Bank of Atlanta advances	(15,000,000)	15,000,000
Federal Reserve Bank advances	33,000,000	-
Long-term debt principal payments	(1,888,889)	(1,888,889)
Dividends paid, net of reinvestments	(1,235,988)	(1,225,729)
Net cash provided by financing activities	<u>73,881,883</u>	<u>9,004,037</u>
Net increase (decrease) in cash and cash equivalents	37,426,800	(19,198,569)
Cash and cash equivalents at beginning of period	<u>7,263,537</u>	<u>26,462,106</u>
Cash and cash equivalents at end of period	<u><u>\$ 44,690,337</u></u>	<u><u>\$ 7,263,537</u></u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	\$ 8,830,152	\$ 2,239,129
Cash paid during the period for income taxes	2,390,848	3,365,318
Supplemental disclosure of non-cash transactions:		
Net unrealized gain (loss) on securities available for sale	811,381	(21,675,430)

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to 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.

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 to not 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, 2022. Reliable Community Financial Services, Inc. is licensed to provide a wide range of investment and insurance products to its customers but is inactive.

On October 1, 2020, Farmers and Merchants Bancshares, Inc. acquired Carroll Bancorp, Inc. (“Carroll”) and the Bank acquired Carroll’s wholly-owned subsidiary, Carroll Community Bank, in a series of merger transactions (collectively, the “Merger”). As a result of the Merger, Carroll was merged with and into Farmers and Merchants Bancshares, Inc., with Farmers and Merchants Bancshares, Inc. as the surviving corporation, and Carroll Community Bank merged with and into the Bank, with the Bank as the surviving bank. The Merger was intended to constitute a tax-free reorganization for federal income tax purposes.

Reclassifications

Certain reclassifications have been made to the 2022 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 and derivative financial instruments, 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

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

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. Declines in the fair value of individual available-for-sale securities below their amortized cost due to credit-related factors are recognized as an allowance for credit losses. Credit-related factors affecting the determination of whether impairment has occurred include a downgrading of the security below investment grade by a rating agency or due to potential default, a significant deterioration in the financial condition of the issuer, increase in entity-specific credit spreads. Additionally, on any available-for-sale securities with unrealized losses, the Company evaluates its intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

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 credit 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 credit 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 individually evaluated 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 experiencing financial difficulties.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

As further discussed below, we adopted Financial Accounting Standards Board (“FASB”) Accounting Standards Update (“ASU”) 2016-13, “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,” on January 1, 2023. FASB Accounting Standards Codification (“ASC”) Topic 326 replaced the previous “incurred loss” model for measuring credit losses, which encompassed allowances for current known and inherent losses within the portfolio, with an “expected loss” model, which encompasses allowances for losses expected to be incurred over the life of the portfolio. The new CECL model requires the measurement of all expected credit losses for financial assets measured at amortized cost and certain off-balance sheet credit exposures based on historical experience, current conditions, and reasonable and supportable forecasts. In connection with the adoption of ASC Topic 326, we revised certain accounting policies and implemented certain accounting policy elections. Results for reporting periods beginning after January 1, 2023 will be presented under ASC Topic 326, while periods prior to January 1, 2023 will be reported in accordance with generally accepted accounting practices in the United States (“GAAP”) applicable for the time period. The revised accounting policies are described below.

Allowance for Credit Losses - Held-to-Maturity Securities: The allowance for credit losses on held-to-maturity securities is a contra-asset valuation account, calculated in accordance with ASC Topic 326, which is deducted from the amortized cost basis of held-to-maturity securities to present management’s best estimate of the net amount expected to be collected. Held-to-maturity securities are charged-off against the allowance when deemed uncollectible by management. Adjustments to the allowance are reported in our income statement as a component of credit loss expense. Management measures expected credit losses on held-to-maturity securities on a collective basis by major security type with each type sharing similar risk characteristics and considers historical credit loss information that is adjusted for current conditions and reasonable and supportable forecasts. Management has made the accounting policy election to exclude accrued interest receivable on held-to-maturity securities from the estimate of credit losses. Further information regarding our policies and methodology used to estimate the allowance for credit losses on held-to-maturity securities is presented in Note 3 – Investment Securities.

Allowance For Credit Losses - Available-for-Sale Securities: For available-for-sale securities in an unrealized loss position, we first assess whether (i) we intend to sell the security or (ii) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis. If either case is affirmative, any previously recognized allowances are charged-off and the security’s amortized cost is written down to fair value through income. If neither case is affirmative, the security is evaluated to determine whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency and any adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an allowance for credit losses is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive (loss) income. Adjustments to the allowance are reported in our income statement as a component of credit loss expense. Management has made the accounting policy election to exclude accrued interest receivable on available-for-sale securities from the estimate of credit losses. Available-for-sale securities are charged-off against the allowance or, in the absence of any allowance, written down through income when deemed uncollectible by management or when either of the aforementioned criteria regarding intent or requirement to sell is met. Prior to the adoption of ASU 2016-13, declines in the fair value of held-to-maturity and available-for-sale securities below their cost that were deemed to be other than temporary were reflected in earnings as realized losses. In estimating other-than-temporary impairment losses prior to January 1, 2023, management considered, among other things, (i) the

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

length of time and the extent to which the fair value had been less than cost, (ii) the financial condition and near-term prospects of the issuer and (iii) the intent and our ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Allowance for Credit Losses - Loans: The allowance for credit losses on loans is a contra-asset valuation account, calculated in accordance with ASC Topic 326, which is deducted from the amortized cost basis of loans to present management's best estimate of the net amount expected to be collected. Loans are charged-off against the allowance when deemed uncollectible by management. Expected recoveries do not exceed the aggregate of amounts previously charged-off and expected to be charged-off. Adjustments to the allowance are reported in our income statement as a component of credit loss expense. Management has made the accounting policy election to exclude accrued interest receivable on loans from the estimate of credit losses.

The amount of the allowance represents management's best estimate of current expected credit losses on loans considering available information, from internal and external sources, relevant to assessing collectability over the loans' contractual terms, adjusted for expected prepayments when appropriate. The contractual term excludes expected extensions, renewals and modifications unless (i) management has a reasonable expectation that a loan to an individual borrower that is experiencing financial difficulty will be modified or (ii) such extension or renewal options are not unconditionally cancellable by us and, in such cases, the borrower is likely to meet applicable conditions and likely to request extension or renewal. Relevant available information includes historical credit loss experience, current conditions and reasonable and supportable forecasts. While historical credit loss experience provides the basis for the estimation of expected credit losses, adjustments to historical loss information may be made for differences in current portfolio-specific risk characteristics, environmental conditions or other relevant factors. The allowance for credit losses is measured on a collective basis for portfolios of loans when similar risk characteristics exist. Loans that do not share risk characteristics are evaluated for expected credit losses on an individual basis and excluded from the collective evaluation. Expected credit losses for collateral dependent loans, including loans where the borrower is experiencing financial difficulty but foreclosure is not probable, are based on the fair value of the collateral at the reporting date, adjusted for selling costs as appropriate.

Credit loss expense related to loans reflects the totality of actions taken on all loans for a particular period including any necessary increases or decreases in the allowance related to changes in credit loss expectations associated with specific loans or pools of loans. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate appropriateness of the allowance is dependent upon a variety of factors beyond our control, including the performance of our loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

In calculating the allowance for credit losses, most loans are segmented into pools based upon similar characteristics and risk profiles. Common characteristics and risk profiles include the type/purpose of loan, underlying collateral, and historical/expected credit loss patterns. For modeling purposes, our loan pools include (i) commercial real estate - owner occupied, (ii) commercial real estate - non-owner occupied, (iii) construction/land development, (iv) residential - multifamily, (v) residential - single family (vi) residential - single family home equity, (vii) commercial and industrial (viii) consumer and other. We periodically reassess each pool to ensure that the loans within the pool continue to share similar characteristics and risk profiles and to determine whether further segmentation is necessary.

The average charge-off method calculates an estimate of losses based upon past experience, which is applied prospectively across the life of each loan. This method allows for analysis and calculation on a note-

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

by-note basis due to the CECL model calculating future cash flows at the individual note level based upon note characteristics. A forward balance is calculated from each note's prior period balance, less monthly principal paydown and prepayment amount.

The Company utilizes its own loss data as the source for its historical loss calculations within the CECL model, where appropriate. This information is sourced from call report data and spans back to an effective start date of March 31, 2000. Loss data will continuously be uploaded into the model across subsequent periods, with results always one quarter in arrears. Utilization of loss rates across this length of time helps to incorporate results recognized across the full economic cycle and smooth periods of economic recession and recovery. The Company may deviate from utilization of its own loss rates on an as-needed basis when said loss rates have historically been non-existent. The Company may also deviate from its existing loss rates when said rates are no longer indicative of the current portfolio composition/quality, such as historical rates impacted by losses resulting from purchased loan portfolios which have since matured or been divested. In these events, the Company will utilize aggregate loss rates recognized from banks of comparable asset size throughout the state of Maryland, incurred across the same period, March 31, 2000 to present.

The measurement of expected credit losses is impacted by loan/borrower attributes and certain macroeconomic variables. Significant loan/borrower attributes utilized in our modeling processes include, among other things, (i) origination date, (ii) maturity date, (iii) payment type, (iv) collateral type and amount, (v) current risk grade, (vi) current unpaid balance, (vii) payment status/delinquency history and (viii) expected recoveries of previously charged-off amounts.

Management qualitatively adjusts model results for risk factors that are not considered within our modeling processes but are nonetheless relevant in assessing the expected credit losses within our loan pools. These qualitative factor ("Q-Factor") and other qualitative adjustments may increase or decrease management's estimate of expected credit losses by a calculated percentage or amount based upon the estimated level of risk. The various risks that may be considered in making Q-Factor and other qualitative adjustments include, among other things, the impact of (i) any concentrations of credit, (ii) local and national economic and business conditions, (iii) changes in the nature and volume of the underlying loans, (iv) changes in the experience, ability, and depth of our lending management and staff, (v) changes in volume and severity of past due loans, the volume of non-accrual loans, and the volume and severity of adversely classified loans, (vi) our credit review function, (vii) changes in lending policies and procedures and, (viii) other factors such as rising interest rates. Management also adjusts model results using a forecast of unemployment and Gross Domestic Product ("GDP") compared to the actual unemployment and GDP during the historical loan loss period used in the model. This adjustment is referred to the forward look adjustment. It reverts back to historical losses after three months.

In some cases, management may determine that an individual loan exhibits unique risk characteristics which differentiate the loan from other loans within our loan pools. In such cases, the loans are evaluated for expected credit losses on an individual basis and excluded from the collective evaluation. Specific allocations of the allowance for credit losses are determined by analyzing the borrower's ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things. A loan is considered to be collateral dependent when, based upon management's assessment, the borrower is experiencing financial difficulty and repayment is expected to be provided substantially through the operation or sale of the collateral. In such cases, expected credit losses are based on the fair value of the collateral at the measurement date, adjusted for estimated selling costs if satisfaction of the loan depends on the sale of the collateral.

Allowance for Credit Losses - Off-Balance-Sheet Credit Exposures: The allowance for credit losses on off-balance-sheet credit exposures is a liability account, calculated in accordance with ASC Topic 326, representing expected credit losses over the contractual period for which we are exposed to credit risk resulting from a contractual obligation to extend credit. No allowance is recognized if we have the unconditional right to cancel the obligation. The measurement of expected credit losses is impacted by

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

loan/borrower attributes and certain macroeconomic variables. Significant loan/borrower attributes utilized in our modeling processes include, among other things, (i) commitment utilization rate, and (ii) collateral type and amount. The allowance is reported as a component of other liabilities in our consolidated balance sheets. Adjustments to the allowance are reported in our income statement as a component of credit loss expense.

	December 31, 2022		January 1, 2023	
	Pre-ASC 326 Adoption	Impact of ASC 326 Adoption	As Reported Under ASC 326	
Assets:				
Loans, gross	\$ 521,679,143	\$ 233,411	\$ 521,912,554	
Allowance for credit losses:				
Loans:				
Real estate:				
Commercial	2,818,582	(448,483)	2,370,099	
Construction and land development	164,596	277,317	441,913	
Residential	793,919	508,579	1,302,498	
Commercial	337,303	133,838	471,141	
Consumer	4,706	(4,526)	180	
Unallocated	31,092	(31,092)	-	
Allowance for credit losses on loans	4,150,198	435,633	4,585,831	
Loans, net	517,528,945	(202,222)	517,326,723	
Allowance for credit losses on debt securities held to maturity	-	51,990	51,990	
Net deferred tax asset	-	92,441	92,441	
Liabilities:				
Allowance for credit losses on off balance sheet credit exposures	-	81,723	81,723	
Total equity	\$ 49,834,244	\$ (243,494)	\$ 49,590,750	

Derivative Financial Instruments: At the inception of a derivative contract, the Company designates the derivative as one of three types based on the Company's intentions and belief as to likely effectiveness as a hedge. These three types are (i) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"), (ii) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"), and (iii) an instrument with no hedging designation ("stand-alone derivative"). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income (loss) and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. Changes in the fair value of derivatives not designated or that do not qualify for hedge accounting are reported currently in earnings, as non-interest income.

Accrued settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Accrued settlements on derivatives not designated or that do not qualify for hedge accounting are reported in non-interest income. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

risk-management objective and the strategy for undertaking hedge transactions at the inception of the hedging relationship. This documentation includes linking fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in fair values or cash flows of the hedged items. The Company discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as non-interest income. When a fair value hedge is discontinued, the hedged asset or liability is no longer adjusted for changes in fair value and the existing basis adjustment is amortized or accreted over the remaining life of the asset or liability. When a cash flow hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income are amortized into earnings over the same periods which the hedged transactions will affect earnings.

The Company is exposed to losses if a counterparty fails to make its payments under a contract in which the Company is in the net receiving position. The Company anticipates that the counterparties will be able to fully satisfy their obligations under the agreements. All the contracts to which the Company is a party settle monthly or quarterly. In addition, the Company obtains collateral above certain thresholds of the fair value of its derivatives for each counterparty based upon their credit standing and the Company has netting agreements with the dealers with which it does business.

The Company's derivative financial instruments are described more fully in Note 14.

Stock-based Compensation: The Company recognizes in the income statement the grant date fair value of stock awards, restricted stock and restricted stock units. The fair value related to forfeitures of stock awards, restricted stock and restricted stock units are recorded to the income statement as they occur, reducing stock-based compensation expense in that period. The Company classifies stock-based compensation as either an equity award or a liability award. Equity classified awards are valued as of the grant date using either an observable market price or a valuation methodology. Liability classified awards are valued at fair value at each reporting date. For the periods presented, all of the Company's stock awards, restricted stock, and restricted stock units are classified as equity awards.

During the third quarter of 2023, the Company granted stock awards under the Farmers and Merchants Bancshares, Inc. 2023 Equity Compensation Plan (the "Plan"). Each share of common stock subject to such awards is valued at the fair market value of such share (as defined in the Plan) as of the grant date. Outstanding restricted stock units vest in one-third increments on the anniversary date of the grant. Compensation expense is recognized on a straight-line basis over the requisite vesting period for the entire award.

The Company's stock-based compensation is described more fully in Note 16.

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.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

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 credit 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.

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.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

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 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 \$270,308 and \$258,032 for the years ended December 31, 2023 and 2022, respectively.

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.

Earnings per share

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. The following table shows the weighted average number of shares used in computing earnings per share and the effect of weighted average number of shares of dilutive potential common stock. Dilutive potential common stock has no effect on income available to common shareholders. There were 3,000 restricted stock units included in weighted average dilutive shares for the year ended December 31, 2023 as the shares were dilutive. There were no common stock equivalents outstanding at December 31, 2022.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

	Year Ended December 31,	
	2023	2022
Net income	<u>\$ 6,418,337</u>	<u>\$ 8,090,127</u>
Weighted average shares outstanding	<u>3,083,021</u>	<u>3,046,377</u>
Effect of dilutive restricted stock units	<u>3,000</u>	<u>-</u>
Weighted average shares outstanding	<u>3,086,021</u>	<u>3,046,377</u>
Earnings per share - basic	<u>\$2.08</u>	<u>\$2.66</u>
Earnings per share - diluted	<u>\$2.08</u>	<u>\$2.66</u>

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.

In November 2023, the FASB issued ASU 2023-07, “Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures.” The amendments in this ASU are intended to improve reportable segment disclosure requirements primarily through enhanced disclosures about significant segment expenses. This ASU requires disclosure of significant segment expenses that are regularly provided to the chief operating decision maker (CODM), an amount for other segments items by reportable segment and a description of its composition, all annual disclosures required by FASB ASU Topic 280 in interim periods as well, and the title and position of the CODM and how the CODM uses the reported measures. Additionally, this ASU requires that at least one of the reported segment profit and loss measures should be the measure that is most consistent with the measurement principles used in an entity’s consolidated financial statements. Lastly, this ASU requires public business entities with a single reportable segment to provide all disclosures required by these amendments in this ASU and all existing segment disclosures in Topic 280. This ASU is effective for fiscal years beginning after December 15, 2023, and interim periods within fiscal years beginning after December 15, 2024. Early adoption is permitted. The amendments should be applied retrospectively. The Company does not expect the adoption of ASU 2023-07 to have a material impact on its consolidated financial statements.

In December 2023, the FASB issued ASU 2023-09, “Income Taxes (Topic 740): Improvements to Income Tax Disclosures.” The amendments in this ASU require an entity to disclose specific categories in the rate reconciliation and provide additional information for reconciling items that meet a quantitative threshold, which is greater than five percent of the amount computed by multiplying pretax income by the entity’s applicable statutory rate, on an annual basis. Additionally, the amendments in this ASU require an entity to disclose the amount of income taxes paid (net of refunds received) disaggregated by federal, state, and foreign taxes and the amount of income taxes paid (net of refunds received) disaggregated by individual jurisdictions that are equal to or greater than five percent of total income taxes paid (net of refunds received). Lastly, the amendments in this ASU require an entity to disclose income (or loss) from continuing operations before income tax expense (or benefit) disaggregated between domestic and foreign and income tax expense (or benefit) from continuing operations disaggregated by federal, state, and foreign. This ASU is effective for

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

annual periods beginning after December 15, 2024. Early adoption is permitted. The amendments should be applied on a prospective basis; however, retrospective application is permitted. The Company does not expect the adoption of ASU 2023-09 to have a material impact on its consolidated financial statements.

Recently Adopted Accounting Developments

During June 2016, FASB issued 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. The adjustment recorded at adoption to the overall allowance for credit losses, which 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, was \$569,346. The adjustment net of tax recorded to stockholders’ equity totaled \$243,494.

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 were applied prospectively, except for the transition method related to the recognition and measurement of troubled debt restructurings an entity had the option to apply a modified retrospective transition method, resulting in a cumulative-effect adjustment to retained earnings in the period of adoption. ASU 2022-02 was effective for the Company on January 1, 2023, and it did not have a material impact on the Company’s consolidated financial statements.

In March 2022, FASB issued ASU 2022-01, “Derivatives and Hedging (Topic 815), Fair Value Hedging - Portfolio Layer Method.” ASU 2022-01 clarifies the guidance in ASC Topic 815 on fair value hedge accounting of interest rate risk for portfolios of financial assets and is intended to better align hedge accounting with an organization’s risk management strategies. In 2017, FASB issued ASU 2017-12 to better align the economic results of risk management activities with hedge accounting. One of the major provisions of that standard was the addition of the last-of-layer hedging method. For a closed portfolio of fixed-rate prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, such as mortgages or mortgage-backed securities, the last-of-layer method allows an entity to hedge its exposure to fair value changes due to changes in interest rates for a portion of the portfolio that is not expected to be affected by prepayments, defaults, and other events affecting the timing and amount of cash flows. ASU 2022-01 renames that method as the “portfolio layer method”. ASU 2022-01 was effective for the Company on January 1, 2023.

Management believes that the accounting policies adopted by management are consistent with authoritative GAAP and are consistent with those followed by our peers.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

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 \$1,050,354 and \$11,945,635 during the years ended December 31, 2023 and 2022, 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, 2023 and 2022.

3. Investment Securities

Debt securities are summarized as follows:

December 31, 2023	Amortized cost	Unrealized gains	Unrealized losses	Fair value	Allowance for Credit Losses	Net Carrying Amount
<i>Available for sale</i>						
State and municipal	\$ 500,000	\$ -	\$ 15,192	\$ 484,808	\$ -	\$ 484,808
SBA pools	776,686	1,160	11,136	766,710	-	766,710
Corporate bonds	9,853,988	-	1,283,559	8,570,429	-	8,570,429
Mortgage-backed securities	175,742,562	1,025,623	22,505,459	154,262,726	-	154,262,726
	<u>\$ 186,873,236</u>	<u>\$ 1,026,783</u>	<u>\$ 23,815,346</u>	<u>\$ 164,084,673</u>	<u>\$ -</u>	<u>\$ 164,084,673</u>

Held to maturity

State and municipal	<u>\$ 20,199,249</u>	<u>\$ 39,537</u>	<u>\$ 1,175,565</u>	<u>\$ 19,063,221</u>	<u>\$ 35,627</u>	<u>\$ 20,163,622</u>
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December 31, 2022	Amortized cost	Unrealized gains	Unrealized losses	Fair value
<i>Available for sale</i>				
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
	<u>\$ 149,914,393</u>	<u>\$ 1,425</u>	<u>\$ 23,601,369</u>	<u>\$ 126,314,449</u>

Held to maturity

State and municipal	<u>\$ 20,508,997</u>	<u>\$ 4,176</u>	<u>\$ 1,633,378</u>	<u>\$ 18,879,795</u>
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The allowance for credit losses on held-to-maturity securities is a contra-asset valuation account that is deducted from the amortized cost basis of held-to-maturity securities to present the net amount expected to be collected. Management measures expected credit losses on held-to-maturity securities on a collective basis by major security type with each type sharing similar risk characteristics, and considers historical credit loss

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

3. Investment Securities (continued)

information that is adjusted for current conditions and reasonable and supportable forecasts. With regard to securities issued by states and political subdivisions, management considers (i) issuer bond ratings, (ii) historical loss rates for given bond ratings, (iii) whether issuers continue to make timely principal and interest payments under the contractual terms of the securities, and (iv) internal forecasts. Unrated bonds were underwritten similar to commercial loans and the financial condition of the issuer is monitored periodically. Expected credit losses on commercial loans are applied to unrated bonds.

The following table summarizes Moody's and/or Standard & Poor's bond ratings (Company's primary credit quality indicator) for our portfolio of held-to-maturity securities issued by states and political subdivisions as of December 31, 2023 at amortized cost:

	<u>December 31, 2023</u>
AAA	2,785,955
AA	10,434,388
A	3,808,365
BAA	250,661
Not rated	<u>2,919,880</u>
Total	<u><u>20,199,249</u></u>

Historical loss rates associated with securities having similar grades as those in our portfolio have generally not been significant. Furthermore, as of December 31, 2023, there were no past due principal or interest payments associated with these securities and none are on nonaccrual.

The following table details activity in the allowance for credit losses on held-to-maturity securities for the year ended December 31, 2023:

	<u>Year Ended</u> <u>December 31, 2023</u>
Beginning balance	\$ -
Impact of adopting ASC 326	51,990
Recovery of credit loss	<u>(16,363)</u>
Ending balance	<u><u>\$ 35,627</u></u>

Available for sale securities accrued interest receivable totaled \$418,549 and \$310,324 and held to maturity securities accrued interest receivable totaled \$121,670 and \$122,874 as of December 31, 2023 and 2022, respectively. Both are grouped in accrued interest receivable on the balance sheet.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

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.

December 31, 2023	Available for Sale		Held to Maturity	
	Amortized cost	Fair value	Amortized cost	Fair value
Within one year	\$ 1,259,692	\$ 1,220,382	\$ 230,000	\$ 230,065
Over one to five years	1,779,830	1,708,398	666,321	652,278
Over five to ten years	7,314,466	6,126,457	5,864,476	5,654,095
Over ten years	-	-	13,438,452	12,526,783
	10,353,988	9,055,237	20,199,249	19,063,221
Mortgage-backed securities and SBA pools, due in monthly installments	176,519,248	155,029,436	-	-
	<u>\$ 186,873,236</u>	<u>\$ 164,084,673</u>	<u>\$ 20,199,249</u>	<u>\$ 19,063,221</u>

Securities with a carrying value of **\$50,371,861** and \$24,258,980 as of December 31, 2023 and 2022, 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, 2023	Less than 12 months		12 months or more		Total	
	Unrealized					
Description of investments	Fair Value	Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
State and municipal	\$ 2,210,426	\$ 19,997	\$ 11,834,320	\$ 1,170,760	\$ 14,044,746	\$ 1,190,757
SBA pools	-	-	659,869	11,136	659,869	11,136
Corporate bonds	341,264	58,736	8,229,165	1,224,823	8,570,429	1,283,559
Mortgage-backed securities	23,840,242	378,379	104,657,869	22,127,080	128,498,111	22,505,459
Total	<u>\$ 26,391,932</u>	<u>\$ 457,112</u>	<u>\$ 125,381,223</u>	<u>\$ 24,533,799</u>	<u>\$ 151,773,155</u>	<u>\$ 24,990,911</u>

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

3. Investment Securities (continued)

<u>December 31, 2022</u>	<u>Less than 12 months</u>		<u>12 months or more</u>		<u>Total</u>	
		Unrealized		Unrealized		Unrealized
Description of investments	Fair value	losses	Fair value	losses	Fair value	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	<u>25,284,430</u>	<u>2,293,151</u>	<u>90,068,045</u>	<u>20,250,893</u>	<u>115,352,475</u>	<u>22,544,044</u>
Total	<u>\$ 43,137,981</u>	<u>\$ 3,707,309</u>	<u>\$ 97,268,040</u>	<u>\$ 21,527,438</u>	<u>\$ 140,406,021</u>	<u>\$ 25,234,747</u>

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, 2023, 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 these factors, as of December 31, 2023, 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.

There were no security sales in 2023 or 2022.

4. Related Party Transactions

Certain executive officers and directors of the Company, including members of their immediate families and related companies were indebted to the Company during 2023 and 2022. 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, 2023 and 2022, the activity of these loans was as follows:

	<u>2023</u>	<u>2022</u>
Balance, beginning of year	\$ 12,227,721	\$ 13,822,556
Additions	177,968	3,274,719
Amounts collected	<u>(927,052)</u>	<u>(4,869,554)</u>
Balance, end of year	<u>\$ 11,478,637</u>	<u>\$ 12,227,721</u>

Unused lines of credit to related parties totaled **\$58,000** and \$208,100 at December 31, 2023 and 2022, respectively.

Letters of credit issued to related parties totaled \$15,847 at December 31, 2023 and 2022.

Deposits at the Company from related parties totaled **\$8,314,359** and \$10,138,362 at December 31, 2023 and 2022, respectively.

Payments to companies controlled by directors totaled **\$6,545** in 2023 and \$54,624 in 2022.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

5. Loans and allowance for credit losses

Major categories of loans at December 31, 2023 and 2022 are as follows:

	2023	2022
Real estate:		
Commercial	\$ 361,942,511	\$ 351,794,702
Construction and land development	20,446,150	23,978,373
Residential	112,789,631	114,683,149
Commercial	32,823,072	31,066,497
Consumer	165,136	156,422
	<u>528,166,500</u>	521,679,143
Less: Allowance for credit losses	4,285,247	4,150,198
Deferred origination fees, net of costs	573,209	608,405
	<u>\$ 523,308,044</u>	<u>\$ 516,920,540</u>

For purposes of monitoring the performance of the loan portfolio and estimating the allowance for credit losses, the Company's loans receivable portfolio is segmented as follows: commercial real estate, construction and land development, residential, commercial and industrial, and consumer.

Commercial real estate loans carry risks of the client's ability to repay the loan from the cash flow derived from the underlying real estate. Risks inherent in managing a commercial real estate portfolio relate to sudden or gradual drops in property values as well as changes in the economic climate. Real estate security diminishes risks only to the extent that a market exists for the subject collateral. These risks are attempted to be mitigated by carefully underwriting loans of this type and by following appropriate loan-to-value standards. The Company generally requires personal guarantees or endorsements with respect to these loans and loan-to-value ratios for real estate-commercial loans generally do not exceed 80%.

Construction and land development real estate loans carry risks that the project will not be finished according to schedule, the project will not be finished according to budget and the value of the collateral may, at any point in time, be less than the principal amount of the loan. Construction loans also bear the risk that the general contractor, who may or may not be a loan customer, may be unable to finish the construction project as planned because of financial pressure unrelated to the project. The Company generally requires personal guarantees or endorsements with respect to these loans and loan-to-value ratios for real estate-commercial loans generally do not exceed 80%.

Residential real estate mortgage loans, including equity lines of credit, carry risks associated with the continued credit-worthiness of the borrower and the changes in the value of the collateral.

Commercial and industrial loans carry risks associated with the successful operation of a business or a real estate project, in addition to other risks associated with the ownership of real estate, because the repayment of these loans may be dependent upon the profitability and cash flows of the business or project. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time and cannot be appraised with as much precision.

Consumer loans carry risks associated with the continued credit-worthiness of the borrower and the value of the collateral. The Company's consumer loans consist primarily of installment loans made to individuals for personal, family and household purposes. These risks are attempted to be mitigated by following appropriate loan-to-value standards and an experienced management team for this type of portfolio.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

5. Loans (continued)

The following tables present the amortized cost basis of loans on nonaccrual status and loans past 90 days or more still accruing as of December 31, 2023 and 2022:

	Nonaccrual With No Allowance for Credit Loss	Nonaccrual With Allowance for Credit Loss
<u>December 31, 2023</u>		
Real estate:		
Commercial	\$ -	\$ 502,961
Construction and land development	-	-
Residential	-	-
Commercial	-	152,449
Consumer	-	-
	<u>\$ -</u>	<u>\$ 655,410</u>
<u>December 31, 2022</u>		
Real estate:		
Commercial	\$ -	\$ 502,961
Construction and land development	-	-
Residential	-	-
Commercial	-	152,449
Consumer	-	-
	<u>\$ -</u>	<u>\$ 655,410</u>

The Company did not recognize any interest income on nonaccrual loans during the year ended December 31, 2023 or the year ended December 31, 2022.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

5. Loans (continued)

At December 31, 2023, 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 a personal guaranty. Gross interest income of \$45,856 would have been recorded in 2023 if these non-accrual loans had been current and performing in accordance with the original terms. The Company allocated \$450,000 of its allowance for credit losses to these non-accrual loans.

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 a personal guaranty. 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 credit losses to these non-accrual loans.

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, 2023							
Real estate:							
Commercial	\$ -	\$ -	\$ 502,961	\$ 502,961	\$ 361,439,550	\$ 361,942,511	\$ -
Construction and land development	-	-	-	-	20,446,150	20,446,150	-
Residential	161,431	-	-	161,431	112,628,200	112,789,631	-
Commercial	-	-	152,449	152,449	32,670,623	32,823,072	-
Consumer	<u>1,163</u>	<u>-</u>	<u>-</u>	<u>1,163</u>	<u>163,973</u>	<u>165,136</u>	<u>-</u>
Total	<u>\$ 162,594</u>	<u>\$ -</u>	<u>\$ 655,410</u>	<u>\$ 818,004</u>	<u>\$ 527,348,496</u>	<u>\$ 528,166,500</u>	<u>\$ -</u>
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	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>156,422</u>	<u>156,422</u>	<u>-</u>
Total	<u>\$ 311,409</u>	<u>\$ -</u>	<u>\$ 655,410</u>	<u>\$ 966,819</u>	<u>\$ 520,712,324</u>	<u>\$ 521,679,143</u>	<u>\$ -</u>

The following table presents the amortized cost basis of collateral-dependent loans by class of loans as of December 31, 2023:

Real estate:	
Commercial	\$ 2,515,103
Construction and land development	-
Residential	275,622
Commercial	152,449
Consumer	<u>-</u>
	<u>\$ 2,943,174</u>

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

5. Loans (continued)

Impaired loans, segregated by class of loans with average recorded investment and interest recognized for the year ended December 31, 2022 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	\$ 3,509,708	\$ 223,476
Residential real estate	256,350	256,350	-	256,350	-	128,175	10,594
Commercial	152,449	-	152,449	152,449	152,449	76,224	-
	<u>\$ 7,428,214</u>	<u>\$ 6,772,804</u>	<u>\$ 655,410</u>	<u>\$ 7,428,214</u>	<u>\$ 281,910</u>	<u>\$ 3,714,107</u>	<u>\$ 234,070</u>

From time to time, loans to borrowers experiencing financial difficulty may be modified. Generally, the modifications we grant are extensions of terms, deferrals of payments for an extended period or interest rate reductions. Occasionally, we may modify a loan by providing principal forgiveness. In some cases, we will modify a loan by providing multiple types, or combinations, of concessions.

The following table presents the amortized cost basis of loans at December 31, 2023 that were both experiencing financial difficulty and modified during the year ended December 31, 2023, by class and type of modification. The percentage of the amortized cost basis of loans that were modified to borrowers in financial distress as compared to the amortized cost basis of each class of loans is also presented below. There was one modification to a borrower experiencing financial difficulty during the year ended December 31, 2023. The term of the loan was extended by three months. The loans was not delinquent at December 31, 2023 and was not in default.

	Term Extension	Total Class of Financing Receivable
Commercial real estate	\$ 1,973,558	0.55%
Total	<u>\$ 1,973,558</u>	<u>0.37%</u>

Accrued interest receivable on loans totaled \$1,539,332 and \$1,373,078 at December 31, 2023 and 2022, respectively, and is included accrued interest receivable on the balance sheet.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

5. Loans (continued)

Credit Quality Indicators

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:

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:

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

5. Loans (continued)

Term Loans Amortized Cost Basis by Origination

	2023	2022	2021	2020	2019	Prior	Revolving Loans	Total
<u>Commercial Real Estate</u>								
Pass	\$ 27,500,909	\$ 73,944,442	\$ 54,973,818	\$ 20,540,492	\$ 25,102,276	\$ 147,755,491	\$ 2,694,268	\$ 352,511,696
Special Mention	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	9,430,815	-	9,430,815
Doubtful	-	-	-	-	-	-	-	-
Total	<u>\$ 27,500,909</u>	<u>\$ 73,944,442</u>	<u>\$ 54,973,818</u>	<u>\$ 20,540,492</u>	<u>\$ 25,102,276</u>	<u>\$ 157,186,306</u>	<u>\$ 2,694,268</u>	<u>\$ 361,942,511</u>
<u>Construction and Land Development</u>								
Pass	\$ 3,359,456	\$ 6,519,085	\$ 4,623,119	\$ 642,571	\$ 309,038	\$ 4,992,881	\$ -	\$ 20,446,150
Special Mention	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-
Total	<u>\$ 3,359,456</u>	<u>\$ 6,519,085</u>	<u>\$ 4,623,119</u>	<u>\$ 642,571</u>	<u>\$ 309,038</u>	<u>\$ 4,992,881</u>	<u>\$ -</u>	<u>\$ 20,446,150</u>
<u>Residential Real Estate</u>								
Pass	\$ 10,109,347	\$ 18,603,074	\$ 9,870,791	\$ 6,793,326	\$ 16,218,714	\$ 40,015,758	\$ 9,501,733	\$ 111,112,743
Special Mention	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	1,676,888	-	1,676,888
Doubtful	-	-	-	-	-	-	-	-
Total	<u>\$ 10,109,347</u>	<u>\$ 18,603,074</u>	<u>\$ 9,870,791</u>	<u>\$ 6,793,326</u>	<u>\$ 16,218,714</u>	<u>\$ 41,692,646</u>	<u>\$ 9,501,733</u>	<u>\$ 112,789,631</u>
<u>Commercial</u>								
Pass	\$ 7,016,763	\$ 8,074,370	\$ 3,264,342	\$ 1,225,297	\$ 884,537	\$ 910,042	\$ 11,295,272	\$ 32,670,623
Special Mention	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	152,449	-	-	152,449
Doubtful	-	-	-	-	-	-	-	-
Total	<u>\$ 7,016,763</u>	<u>\$ 8,074,370</u>	<u>\$ 3,264,342</u>	<u>\$ 1,225,297</u>	<u>\$ 1,036,986</u>	<u>\$ 910,042</u>	<u>\$ 11,295,272</u>	<u>\$ 32,823,072</u>
<u>Consumer</u>								
Pass	\$ 92,295	\$ 32,771	\$ 4,179	\$ 4,895	\$ 7,226	\$ 2	\$ -	\$ 141,368
Special Mention	-	-	-	-	-	-	-	-
Substandard	6,106	-	1,524	-	-	-	-	7,630
Doubtful	-	-	-	-	-	-	16,138	16,138
Total	<u>\$ 98,401</u>	<u>\$ 32,771</u>	<u>\$ 5,703</u>	<u>\$ 4,895</u>	<u>\$ 7,226</u>	<u>\$ 2</u>	<u>\$ 16,138</u>	<u>\$ 165,136</u>
<u>Aggregate total</u>								
Pass	\$ 48,078,770	\$ 107,173,742	\$ 72,736,249	\$ 29,206,581	\$ 42,521,791	\$ 193,674,174	\$ 23,491,273	\$ 516,882,580
Special Mention	-	-	-	-	-	-	-	-
Substandard	6,106	-	1,524	-	152,449	11,107,703	-	11,267,782
Doubtful	-	-	-	-	-	-	16,138	16,138
Total	<u>\$ 48,084,876</u>	<u>\$ 107,173,742</u>	<u>\$ 72,737,773</u>	<u>\$ 29,206,581</u>	<u>\$ 42,674,240</u>	<u>\$ 204,781,877</u>	<u>\$ 23,507,411</u>	<u>\$ 528,166,500</u>

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

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	<u>722</u>	<u>15,715</u>	<u>93,684</u>	<u>4,439</u>	<u>6,481</u>	<u>-</u>	<u>-</u>	<u>35,381</u>	<u>156,422</u>
	<u>\$ 195,251</u>	<u>\$ 588,823</u>	<u>\$ 109,970,159</u>	<u>\$ 293,819,274</u>	<u>\$ 99,468,580</u>	<u>\$ 5,530,925</u>	<u>\$ 12,070,750</u>	<u>\$ 35,381</u>	<u>\$ 521,679,143</u>

The following tables detail activity in the allowance for credit losses by portfolio for the years ended December 31, 2023 and 2022. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

December 31, 2023	Beginning balance	Impact of ASC 326 Adoption	Provision for (recovery of) credit losses	Charge offs	Recoveries	Ending balance	Allowance for credit losses ending balance evaluated for impairment:		Outstanding loan balances evaluated:	
							Individually	Collectively	Individually	Collectively
Real estate:										
Commercial	\$ 2,818,582	\$ (448,483)	\$ 79,889	\$ -	\$ -	\$ 2,449,988	\$ 297,551	\$ 2,152,437	\$ 2,515,103	\$ 359,427,408
Construction and land development	164,596	277,317	(200,665)	-	11,925	253,173	-	253,173	-	20,446,150
Residential	793,919	508,579	(676,608)	-	387,048	1,012,938	-	1,012,938	275,622	112,514,009
Commercial	337,303	133,838	22,361	-	-	493,502	152,449	341,053	152,449	32,670,623
Consumer	4,706	(4,526)	1,900	-	-	2,080	-	2,080	-	165,136
Unallocated	<u>31,092</u>	<u>(31,092)</u>	<u>73,566</u>	<u>-</u>	<u>-</u>	<u>73,566</u>	<u>-</u>	<u>73,566</u>	<u>-</u>	<u>-</u>
	<u>\$ 4,150,198</u>	<u>\$ 435,633</u>	<u>\$ (699,557)</u>	<u>\$ -</u>	<u>\$ 398,973</u>	<u>\$ 4,285,247</u>	<u>\$ 450,000</u>	<u>\$ 3,835,247</u>	<u>\$ 2,943,174</u>	<u>\$ 525,223,326</u>

December 31, 2022	Beginning balance	Provision for loan losses	Charge offs	Recoveries	Ending balance	Allowance for loan losses ending balance evaluated for impairment:			Outstanding loan balances evaluated for impairment:		
						Individually	Impaired	Collectively	Individually	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	<u>89,450</u>	<u>(58,358)</u>	<u>-</u>	<u>-</u>	<u>31,092</u>	<u>-</u>	<u>-</u>	<u>31,092</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$ 3,650,268</u>	<u>\$ 475,000</u>	<u>\$ (10,240)</u>	<u>\$ 35,170</u>	<u>\$ 4,150,198</u>	<u>\$ 281,910</u>	<u>\$ -</u>	<u>\$ 3,868,288</u>	<u>\$ 7,428,214</u>	<u>\$ 579,205</u>	<u>\$ 513,671,724</u>

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

5. Loans (continued)

Loans acquired from Carroll Community Bank in 2020 were measured at fair value at the acquisition date with no carryover of any allowance for credit losses. The following table provides activity for the accretable credit discount of purchased loans:

Balance at December 31, 2022	\$ 930,973
Transfer to accretable	-
Accretion	(391,635)
Balance at December 31, 2023	<u>\$ 539,338</u>

During 2022, accretion of \$698,269 was recorded.

At December 31, 2023, the nonaccretable difference on purchased credit impaired loans was \$0, a decrease of \$233,411 from December 31, 2022 as a result of the adoption of ASU 2016-13 for credit losses. At December 31, 2023, the remaining yield premium on purchased loans was \$509,087. Yield premium amortization was \$369,669 and \$526,377 in 2023 and 2022, respectively. At December 31, 2023, the principal balance of purchased loans was \$74,146,002 and the carrying value was \$74,115,751.

The following table details activity in the allowance for credit losses on unfunded loan commitments:

	2023
Balance at December 31, 2022	\$ -
Impact of adopting ASC 326	81,723
Credit loss expense	145,920
Balance at December 31, 2023	<u>\$ 227,643</u>

The following table provides a summary of all of the components of the allowance for credit losses:

	Year Ended December 31, 2023			
	Held to maturity securities	Loans	Unfunded loan commitments	Total
Beginning balance	\$ -	\$ 4,150,198	\$ -	\$ 4,150,198
Impact of adopting ASC 326	51,990	435,633	81,723	569,346
Provision for (recovery of) credit losses	(16,363)	(699,557)	145,920	(570,000)
Charge-offs	-	-	-	-
Recoveries	-	398,973	-	398,973
Ending balance	<u>\$ 35,627</u>	<u>\$ 4,285,247</u>	<u>\$ 227,643</u>	<u>\$ 4,548,517</u>

Loans having an aggregate balance of approximately **\$468.3** million were pledged as collateral to the FHLB as of December 31, 2023. Loans having an aggregate balance of approximately **\$59.7** million were pledged as collateral to the Federal Reserve Bank of Richmond (the "FRB") as of December 31, 2023. At December 31, 2023 and 2022, the Company serviced participation loans for others totaling **\$15.5** and \$13.5 million, respectively.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

5. Loans (continued)

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	2023	2022
Land and improvements	-	\$ 2,602,998	\$ 2,602,998
Buildings and improvements	15-39 years	6,718,452	6,171,003
Furniture and equipment	3-10 years	5,442,669	5,162,976
		14,764,119	13,936,977
Accumulated depreciation and amortization		8,180,667	7,750,383
		<u>\$ 6,583,452</u>	<u>\$ 6,186,594</u>
Depreciation and amortization expense		<u>\$ 466,559</u>	<u>\$ 445,939</u>

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. Of that amount, \$67,850 was used to repair the roof. The remainder, less the book value of the damaged portion of the building and contents of \$37,732, resulted in a gain of \$673,483.

Software with a net book value of **\$66,375** and \$90,927 as of December 31, 2023 and 2022, respectively, is included in other assets. Amortization expense of **\$43,528** and \$36,550 was recorded in 2023 and 2022, respectively.

7. Goodwill and Other Intangibles

The Merger resulted in the recording of goodwill and CDI. The following table presents the changes in both assets:

	<u>Goodwill</u>	<u>CDI</u>	<u>Total</u>
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
Amortization	-	(8,328)	(8,328)
Balance at December 31, 2023	\$ 6,978,208	\$ 56,216	\$ 7,034,424

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, neither the goodwill nor CDI is deductible for income tax purposes. A goodwill impairment analysis is performed annually as of September 30, 2023.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

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, 2023:

	Consolidated Balance		
	Sheet classification	December 31, 2023	December 31, 2022
Operating lease right of use asset	Other assets	\$ 794,484	\$ 943,933
Operating lease liabilities	Other liabilities	1,010,461	1,166,476

Operating lease cost included in occupancy expense in the statement of income was \$184,300 during 2023 and \$188,909 during 2022.

Future undiscounted lease payments for operating leases with initial terms of one year or more as of December 31, 2023 are as follows:

Year	Amount
2024	\$ 193,232
2025	198,886
2026	204,718
2027	210,735
2028	134,782
Thereafter	147,198
Total lease payments	1,089,551
Less imputed interest	(79,090)
Present value of operating lease liabilities	\$ 1,010,461

For operating leases as of December 31, 2023, the weighted average remaining lease term is 5.57 years and the weighted average discount rate is 3.25%. During the years ended December 31, 2023 and 2022, cash paid for amounts included in the measurement of lease liabilities was \$190,866 and \$184,554, respectively.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

8. Commitments and Contingencies (continued)

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

	2023	2022
Loan commitments		
Construction and land development	\$ 8,575,337	\$ 911,500
Commercial	17,877,375	398,046
Commercial real estate	7,277,500	9,264,000
Residential	2,195,000	3,402,371
	<u>\$ 35,925,212</u>	<u>\$ 13,975,917</u>
Unused lines of credit		
Home-equity lines	\$ 11,395,790	\$ 12,086,758
Commercial lines	46,610,690	25,464,025
	<u>\$ 58,006,480</u>	<u>\$ 37,550,783</u>
Letters of credit	<u>\$ 1,339,391</u>	<u>\$ 1,403,956</u>

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, 2023 and 2022 were **\$332,364** and \$530,720, 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.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

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 **\$261,337** and \$256,251 for 2023 and 2022, 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 **\$7,337** and \$6,809 in 2023 and 2022, 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 **\$165,751** and \$154,911 in 2023 and 2022, 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:

	2023	2022
NOW	\$ 137,733,333	\$ 135,716,736
Money market	71,517,344	99,173,640
Savings	86,015,383	103,308,454
Certificates of deposit, greater than \$250,000	63,400,261	37,976,238
Other time deposits	<u>207,011,824</u>	<u>120,740,707</u>
	<u>\$ 565,678,145</u>	<u>\$ 496,915,775</u>

As of December 31, 2023, certificates of deposit mature as follows:

Year	Amount
2024	\$ 213,140,147
2025	19,413,317
2026	9,266,847
2027	1,348,698
2028	<u>27,243,076</u>
	<u>\$ 270,412,085</u>

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 \$69,843 and \$160,923 were recorded in 2023 and 2022, respectively.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

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.

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 FHN.

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.

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

		<u>2023</u>	<u>2022</u>
Amount outstanding at year-end:			
Securities sold under repurchase agreements	\$	6,760,493	\$ 5,175,303
Federal Home Loan Bank advances		5,000,000	20,000,000
Federal Home Loan Bank advances mature in:	2023	-	15,000,000
	2025	5,000,000	5,000,000
Federal Reserve Bank advances mature in:	2024	33,000,000	-
Long-term debt (net of issuance costs)		13,212,378	15,095,642
Weighted average rate paid at year-end:			
Securities sold under repurchase agreements		1.25%	0.30%
Federal Home Loan Bank advances		1.00%	3.68%
Federal Reserve Bank advances		4.83%	-
Long-term debt		4.10%	4.10%
Average rate paid during the year ended December 31:			
Securities sold under repurchase agreements		0.90%	0.30%
Federal Home Loan Bank advances		3.57%	1.55%
Federal Reserve Bank advances		5.31%	0.00%
Long-term debt		4.10%	4.10%

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

11. Borrowed Funds (continued)

	2023	2022
Investment securities underlying the repurchase agreements at December 31:	\$ 10,931,040	\$ 11,389,983
Carrying value		
Loans pledged to the Federal Home Loan Bank at December 31:	\$ 468,200,244	\$ 458,863,387
Carrying value		
Loans pledged to the Federal Reserve Bank at December 31:	\$ 59,830,354	\$ 62,720,368
Carrying value		

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

The components of income tax expense are as follows:

	2023	2022
Current		
Federal	\$ 1,172,513	\$ 1,852,205
State	452,567	883,493
	1,625,080	2,735,698
Deferred tax expense (benefit)	392,170	(250,672)
	\$ 2,017,250	\$ 2,485,026

The components of the deferred tax expense are as follows:

	2023	2022
Depreciation	\$ (14,401)	\$ 15,108
Insurance proceeds for storm damage	1,212	185,326
Provision for credit losses on loans	52,362	(160,332)
Provision for credit losses on held to maturity securities	4,503	-
Provision for credit losses on unfunded commitments	(40,154)	-
Other real estate owned allowance for loss	388,057	-
Nonaccrual interest	(3,590)	(29,429)
Prepaid captive insurance premium	-	(357,518)
Write-down of equity securities	1,498	(11,583)
Lease liability, net of right of use asset	1,807	(1,198)
Purchase accounting adjustments	22,972	153,455
Stock compensation	(1,249)	-
Post-retirement benefits	(20,847)	(44,501)
	\$ 392,170	\$ (250,672)

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

12. Income Taxes (continued)

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

	<u>2023</u>	<u>2022</u>
Deferred tax assets		
Allowance for credit losses on loans	\$ 1,179,193	\$ 1,111,679
Allowance for credit losses on held to maturity securities	9,803	-
Allowance for credit losses on unfunded commitments	62,642	-
Other real estate owned allowance for loss	46,571	434,628
Derivatives	442,825	-
Nonaccrual interest	121,600	118,010
Post-retirement benefits	716,831	695,983
Purchase accounting adjustments	-	81,687
Unrealized loss on securities available for sale	6,209,991	6,433,263
Lease liability, net of right of use asset	59,431	61,238
Other	20,830	21,079
	<u>8,869,717</u>	<u>8,957,567</u>
Deferred tax liabilities		
Purchase accounting adjustments	5,514	-
Depreciation	349,607	364,008
Insurance proceeds from storm damage	186,539	185,326
Other	15,575	15,575
	<u>557,235</u>	<u>564,909</u>
Net deferred tax asset	<u>\$ 8,312,482</u>	<u>\$ 8,392,658</u>

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

	<u>2023</u>		<u>2022</u>
Statutory federal income tax rate	21.0 %		21.0 %
Increase (decrease) resulting from:			
Federal tax-exempt income	(2.3)		(3.6)
State income taxes, net of federal income tax benefit	5.8		5.8
Other	(0.6)		0.3
	<u>23.9 %</u>		<u>23.5 %</u>

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

The Internal Revenue Service (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 \$1.9 million as of December 31, 2023 for the tax years under appeal. In addition, the IRS is auditing our fiscal year 2019, 2020 and 2021 U.S. consolidated federal tax returns. Although the IRS has not completed these audits, the IRS has notified the Company that it disagrees with our tax treatment of the Insurance Subsidiary. The Company plans to appeal 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 of this decision, then we may be required to amend the applicable tax return and pay additional taxes, interest, fines and/or penalties totaling approximately \$1.5 million as of December 31, 2023 for the tax years under audit. For all six years under audit, if we do not prevail, the total additional taxes, interest, fines and/or penalties would be approximately \$3.4 million. In light of the foregoing, a reserve for uncertain tax positions has not been recorded.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

12. Income Taxes (continued)

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, 2020.

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).

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.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

13. Capital Standards (continued)

On April 6, 2020, in a joint statement, the FDIC, Federal Reserve and the Office of Comptroller of the Currency 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, 2023 and 2022, 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, 2023 and 2022, 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.

As of December 31, 2023 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, 2023 and 2022, for the Bank under the Basel III Capital Rules.

(Dollars in thousands)	Actual		Minimum Capital Adequacy		To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2023						
Total capital (to risk-weighted assets)	\$ 79,988	13.45%	\$ 62,437	10.50%	\$ 59,464	10.00%
Tier 1 capital (to risk-weighted assets)	75,440	12.69%	50,544	8.50%	47,571	8.00%
Common equity tier 1 (to risk-weighted assets)	75,440	12.69%	41,625	7.00%	38,651	6.50%
Tier 1 leverage (to average assets)	75,440	9.42%	32,051	4.00%	40,063	5.00%
December 31, 2022						
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%

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

14. Derivative Financial Instruments

The Company utilizes interest rate swap agreements as part of its asset liability management strategy to help manage its interest rate risk position. The notional amount of the interest rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and other terms of the individual interest rate swap agreements.

Fair Value Hedges: Interest rate swaps with notional amounts totaling \$59.8 million as of December 31, 2023 were designated as fair value last of layer hedges of certain government agency mortgage backed securities. There were no interest rate swaps prior to 2023. The hedges were determined to be effective during all periods presented. The Company expects the hedges to remain effective during the remaining terms of the swaps.

The following table presents the amounts recorded on the balance sheet related to cumulative basis adjustments for fair value hedges as of December 31, 2023:

Line Item in the Balance Sheet in Which the Hedged Item is Included	Carrying Amount of the Hedged Assets December 31, 2023	Cumulative Amount of Fair Value Hedging Adjustment December 31, 2023
Securities available for sale	\$ 69,920,575	\$ (1,609,248)

The Company presents derivative positions gross on the balance sheet. The following table reflects the derivatives recorded on the balance sheet as of December 31, 2023:

	December 31, 2023
	Fair Value
<u>Included in other liabilities:</u>	
Derivatives designated as hedges:	
Interest rate swaps related to securities available for sale	\$ 1,563,527
Total included in other liabilities	\$ 1,563,527

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

14. Derivative Financial Instruments (continued)

The effect of fair value hedge accounting on the statement of income for the year ended December 31, 2023 is as follows:

Fair Value Hedging Relationships	
Total amounts of income and expense line items presented in the statements of income in which the effects of the fair value hedge is recorded are as follows:	
	Year Ended December 31, 2023
	Interest Income
The effects of fair value hedging:	
Gain on fair value hedging relationships:	
Hedged items	\$ 45,721
Interest rate contracts designated as hedging instruments	326,203
Net gain on fair value hedging relationships included in interest income from investment securities - taxable	\$ 371,924

15. Fair Value

In accordance with ASC Topic 820, “Fair Value Measurements and Disclosure”, the Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability (“an exit price”) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company’s various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in the principal or most advantageous market for the asset or liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is the most representative of fair value under current market conditions.

In accordance with the guidance, a hierarchy of valuation techniques is based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

15. Fair Value (continued)

from independent sources, while unobservable inputs reflect the Company's market assumptions. The three levels of the fair value hierarchy under ASC Topic 820 based on these two types of inputs are as follows:

The fair value hierarchy is as follows:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity 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.
- 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.
- Collateral-dependent loans: Nonrecurring fair value adjustments to collateral-dependent loans reflect full or partial write-downs and reserves that are based on the collateral-dependent loan's observable market price or current appraised value of the collateral. Because the market for collateral-dependent 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.
- Fair value hedges: The market value based on independent third party valuation sources that uses observable and traded prices of interest rate swaps from leading banks and brokers.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

15. Fair Value (continued)

The following table summarizes financial assets measured at fair value on a recurring and nonrecurring basis as of December 31, 2023 and 2022, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

<u>December 31, 2023</u>	Carrying Value:			
	Level 1	Level 2	Level 3	Total
Recurring:				
Available for sale securities				
State and municipal	\$ -	\$ 484,808	\$ -	\$ 484,808
SBA pools	-	766,710	-	766,710
Corporate bonds	-	8,570,429	-	8,570,429
Mortgage-backed securities	-	154,262,726	-	154,262,726
	<u>\$ -</u>	<u>\$ 164,084,673</u>	<u>\$ -</u>	<u>\$ 164,084,673</u>
Fair value hedge	<u>\$ -</u>	<u>\$ (1,563,527)</u>	<u>\$ -</u>	<u>\$ (1,563,527)</u>
Equity security at fair value				
Mutual fund	<u>\$ 507,130</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 507,130</u>
Nonrecurring:				
Other real estate owned, net	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,242,365</u>	<u>\$ 1,242,365</u>
Collateral-dependent loans, net	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 205,410</u>	<u>\$ 205,410</u>

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

15. Fair Value (continued)

	Carrying Value:			
	Level 1	Level 2	Level 3	Total
<u>December 31, 2022</u>				
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
	<u>\$ -</u>	<u>\$ 125,914,449</u>	<u>\$ 400,000</u>	<u>\$ 126,314,449</u>
Equity security at fair value				
Mutual fund	<u>\$ 489,145</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 489,145</u>
Nonrecurring:				
Other real estate owned, net	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,242,365</u>	<u>\$ 1,242,365</u>
Impaired loans, net	<u>-</u>	<u>-</u>	<u>373,500</u>	<u>373,500</u>

The following table provides information describing the unobservable inputs used in level 3 fair value measurements at December 31, 2023 and 2022:

Description of Asset	Fair Value	Valuation technique	Unobservable Inputs	Range (Average)
Collateral-dependent loans	\$ 205,410	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 owned	\$ 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%)

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

15. Fair Value (continued)

Reconciliation of Level 3 Inputs

	Corporate Bonds
December 31, 2022 fair value	\$ 400,000
Transfer to level 2	<u>(400,000)</u>
December 31, 2023 fair value	<u>\$ -</u>

The transfer to level 2 occurred because quoted prices for similar assets or quoted prices in markets that are not active was available for this bond at December 31, 2023.

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

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

15. Fair Value (continued)

	December 31, 2023		December 31, 2022	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Level 1 inputs				
Cash and cash equivalents	\$ 44,690,337	\$ 44,690,337	\$ 7,263,537	\$ 7,263,537
Level 2 inputs				
Certificates of deposit in other banks	100,000	100,000	100,000	100,000
Accrued interest receivable	2,180,734	2,180,734	1,815,784	1,815,784
Securities available for sale	164,084,673	164,084,673	126,314,449	126,314,449
Securities held to maturity	17,293,422	16,193,020	17,537,377	15,908,175
Equity security	507,130	507,130	489,145	489,145
Mortgage loans held for sale	-	-	428,355	434,271
Restricted stock, at cost	863,500	863,500	1,332,500	1,332,500
Bank owned life insurance	14,930,754	14,930,754	14,585,342	14,585,342
Level 3 inputs				
Securities held to maturity	2,870,200	2,870,200	2,971,620	2,971,620
Loans, net	523,308,044	507,138,253	516,920,540	503,144,771
Financial liabilities				
Level 1 inputs				
Noninterest-bearing deposits	\$ 115,284,706	\$ 115,284,706	\$ 126,695,349	\$ 126,695,349
Securities sold under repurchase agreements	6,760,493	6,760,493	5,175,303	5,175,303
Level 2 inputs				
Interest-bearing deposits	565,678,145	566,925,060	496,915,775	492,769,775
Federal Home Loan Bank advances	5,000,000	4,754,000	20,000,000	19,622,000
Federal Reserve Bank advances	33,000,000	32,996,852	-	-
Long-term debt	13,212,378	12,428,000	15,095,642	14,241,237
Accrued interest payable	1,482,773	1,482,773	349,910	349,910
Fair value hedge	1,563,527	1,563,527	-	-

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

16. Stock-Based Compensation

On August 22, 2023, the Board of Directors approved the Farmers and Merchants Bancshares, Inc. 2023 Equity Compensation Plan (the “Equity Plan”). The Equity Plan allows the Board of Directors or its Compensation Committee to grant awards that may be payable in shares of common stock or the cash equivalent thereof.

The Company complies with the provisions of ASC Topic 718, Compensation-Stock Compensation, in measuring and disclosing stock compensation cost. The measurement objective in ASC Paragraph 718-10-30-6 requires public companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. The cost is recognized in expense over the period in which an employee is required to provide service in exchange for the award (the vesting period).

During the year ended December 31, 2023, 2,000 fully vested shares of common stock and 3,000 restricted stock units (the “RSUs”) were granted to one executive officer. One-third of the RSUs will vest on September 22, 2024, one-third will vest on September 22, 2025, and one-third will vest on September 22, 2026, provided that, in each case, the grantee is employed and in good standing with the Company on the applicable vesting date.

A summary of the Company’s restricted stock unit grant activity as of December 31, 2023 is shown below:

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Nonvested at January 1, 2023	-	-
Granted	5,000	18.54
Vested	2,000	19.13
Forfeited	-	-
Balance at December 31, 2023	3,000	18.15

The compensation cost charged to income in respect of awards granted under the Equity Plan was \$42,788 for the year ended December 31, 2023. As of December 31, 2023, there was \$49,912 of unrecognized compensation cost related to the unvested RSUs, which is expected to be recognized over a period of 33 months.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

17. Parent Company Financial Information

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

Balance Sheets

December 31,	2023	2022
Assets		
Cash and cash equivalents	\$ 69,905	\$ 806,384
Investment in subsidiaries	65,314,174	62,064,533
Other assets	<u>145,183</u>	<u>158,127</u>
	<u>\$ 65,529,262</u>	<u>\$ 63,029,044</u>
Liabilities and Stockholders' Equity		
Long-term debt	\$ 13,212,378	\$ 15,095,642
Accrued interest payable	<u>138,593</u>	<u>158,439</u>
	<u>13,350,971</u>	<u>15,254,081</u>
Stockholders' equity		
Common stock, par value \$.01 per share, authorized 5,000,000 shares; issued and outstanding 3,116,966 in 2023 and 3,071,214 in 2022	31,170	30,712
Additional paid-in capital	30,398,080	29,549,914
Retained earnings	39,433,185	35,300,166
Accumulated other comprehensive loss	<u>(17,684,144)</u>	<u>(17,105,829)</u>
	<u>52,178,291</u>	<u>47,774,963</u>
	<u>\$ 65,529,262</u>	<u>\$ 63,029,044</u>

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

17. Parent Company Financial Information (continued)

Statements of Income

Years Ended December 31,	2023	2022
Income		
Cash dividends from subsidiaries	<u>\$ 2,880,000</u>	<u>\$ 3,574,000</u>
Total income	2,880,000	3,574,000
Interest expense - long-term debt	(584,953)	(664,621)
Noninterest expense	<u>(89,669)</u>	<u>(90,969)</u>
Income before income taxes and equity in undistributed income of subsidiaries	2,205,378	2,818,410
Income tax (benefit)	<u>(141,509)</u>	<u>(158,556)</u>
Income before equity in undistributed income of subsidiaries	2,346,887	2,976,966
Dividends in excess of income of insurance subsidiary	-	(247,472)
Equity in undistributed income of insurance subsidiary	72,258	-
Equity in undistributed income of bank subsidiary	<u>3,999,192</u>	<u>5,360,633</u>
Net Income	<u>\$ 6,418,337</u>	<u>\$ 8,090,127</u>

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

17. Parent Company Financial Information (continued)

Years Ended December 31,	2023	2022
Cash flows from operating activities		
Net Income	\$ 6,418,337	\$ 8,090,127
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed income of subsidiaries	(4,071,450)	(5,360,633)
Decrease in accrued interest payable	(19,846)	(19,683)
Amortization of debt issuance costs	5,625	5,625
Stock based compensation	42,788	-
Change in income tax receivable	12,944	27,739
Dividend received in excess of income of insurance subsidiary	-	247,472
Cash provided by operating activities	<u>2,388,398</u>	<u>2,990,647</u>
Cash flows from investing activities		
Cash used in investing activities	<u>-</u>	<u>-</u>
Cash flows from financing activities		
Long-term debt	(1,888,889)	(1,888,888)
Dividends paid, net of reinvestments	<u>(1,235,988)</u>	<u>(1,225,729)</u>
Cash used in financing activities	<u>(3,124,877)</u>	<u>(3,114,617)</u>
Net decrease in cash and cash equivalents	(736,479)	(123,970)
Cash and cash equivalents at beginning of period	<u>806,384</u>	<u>930,354</u>
Cash and cash equivalents at end of period	<u>\$ 69,905</u>	<u>\$ 806,384</u>

18. 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.

Farmers and Merchants Bancshares, Inc.

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, 2024 there were 3,116,966 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.

	<u>High</u>	<u>Low</u>	<u>Dividend Per Share</u>
<u>2023</u>			
Quarter ended December 31	\$ 18.70	\$ 15.00	\$ 0.33
Quarter ended September 30	24.50	18.30	-
Quarter ended June 30	27.00	19.31	0.33
Quarter ended March 31	22.00	20.80	-
<u>2022</u>			
Quarter ended December 31	\$ 23.50	\$ 19.20	\$ 0.31
Quarter ended September 30	22.50	19.75	-
Quarter ended June 30	24.90	21.25	0.30
Quarter ended March 31	24.50	21.25	-

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 23, 2024 at 3:00 p.m. at the Piney Branch Golf 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

Transfer Agent

American Stock Transfer & Trust Company
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Brooklyn, NY 12219
(800) 937-5449

General Counsel

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Hoffberger & Hollander, LLC
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Baltimore, Maryland 21202

Independent Accountants

Yount, Hyde & Barbour, PC
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Richmond, Virginia 23233

Website

www.fmb1919.bank

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

Mark C. Krebs, Executive Vice President, Chief Financial Officer
Farmers and Merchants Bank
P. O. Box 249
25 Westminster Pike
Reisterstown, Maryland 21136

